ASIA PERSPECTIVE

Investment Outlook

China // 2023

China's investment landscape

China continued to increase foreign direct investment (FDI) in 2022, although at a slower pace than in 2021. The country's severe COVID lockdowns in 2022 dampened its attractiveness as an investment destination. However, with the relaxation of COVID restrictions and a host of new incentives for foreign investors, 2023 may see be a much more successful FDI year for China.

Economic growth

In 2022, China recorded a year-on-year (YoY) GDP growth rate of 3%, the country's worst performance since the 1970s and far below the government's target of 5.5%. The less-than-stellar growth was mainly caused by China's many COVID lockdowns, especially in the commercial centre of Shanghai, and the consequential disruptions to economic activities.

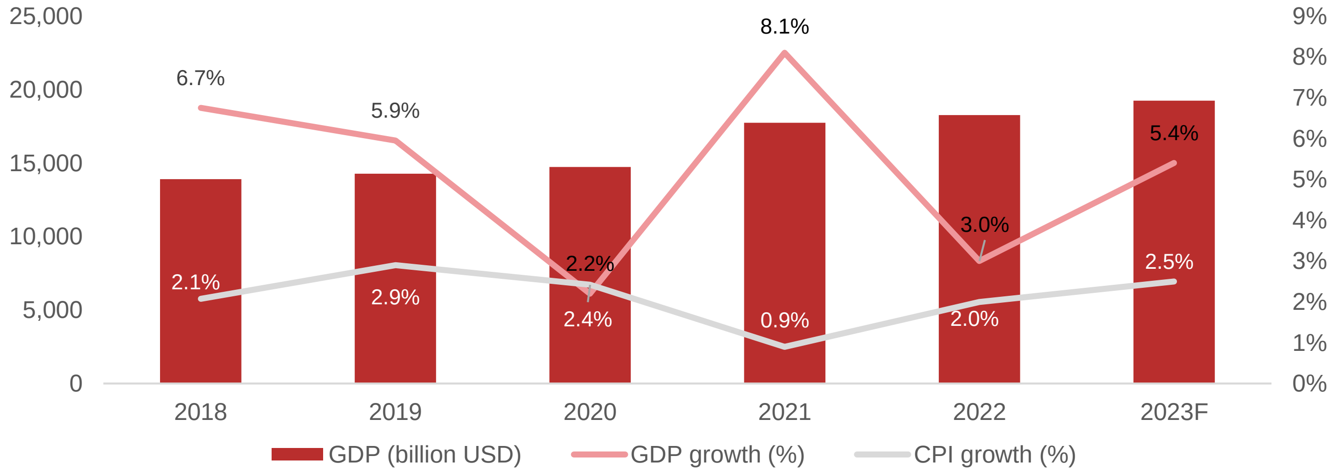
However, the economic landscape of China is expected to brighten significantly in 2023 as the government started to abandon its zero-COVID policy and reopen China to international travel by the end of 2022. Nikkei Asia predicts the economy to grow by 4.7% in 2023, while Morgan Stanley is more optimistic with a forecast of 5.4% growth.

Inflation

A highlight in China's economy 2022 was the country's relatively stable inflation rate at a time when many countries were suffering from rapidly increasing prices. China's 2022 Consumer Price Index (CPI) was only 2.5% higher than in 2021, well below the government's target of 3%.

COVID lockdowns could be a factor that kept demand and, as a result, inflation low. Nevertheless, China's 2023 reopening could cause a surge in demand and a corresponding rise in inflation. According to CNN, the start of 2023 has seen a rise in price for copper, aluminium, and tin to the highest in a decade.

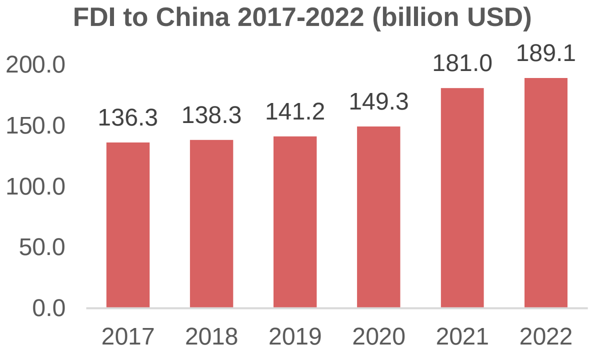
GDP, GDP Growth, and Inflation (2018-2023F)



Source: World Bank, Trading Economics, Capital.com

FDI

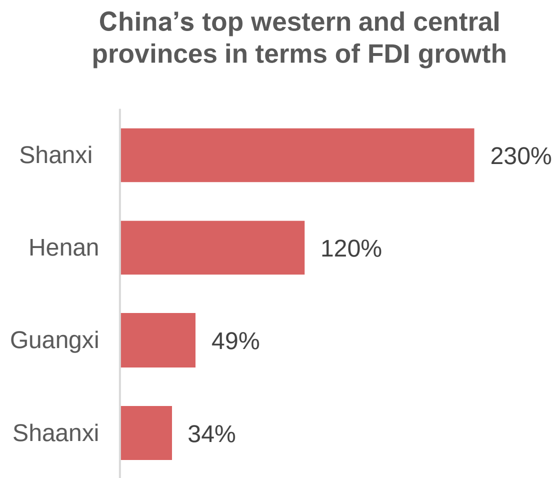
China's inbound FDI in 2022 reached a value of US$ 189.13 billion, a YoY growth of 4.5%. Although much slower than the impressive 20.2% YoY growth in 2021, this year's figure was closer to pre-pandemic levels which averaged at a YoY growth of 3.1% between 2018 and 2020. The sudden rise of FDI in 2021, compared to before and after, can be attributed to the complete and sudden halt in many economic activities 2020. As a result, the 2021 jump in FDI can largely be explained by the repressed activities from the previous years. In addition, China also liberalized the negative list of sectors and activities that were previously limited to foreign investments in 2021. The move was to lift all restrictions in the manufacturing industry for foreign investors in free trade zones, creating a less restrictive business environment and further encouraging investments.



Source: United Nations Conference on Trade and Development (UNCTAD), China Briefing

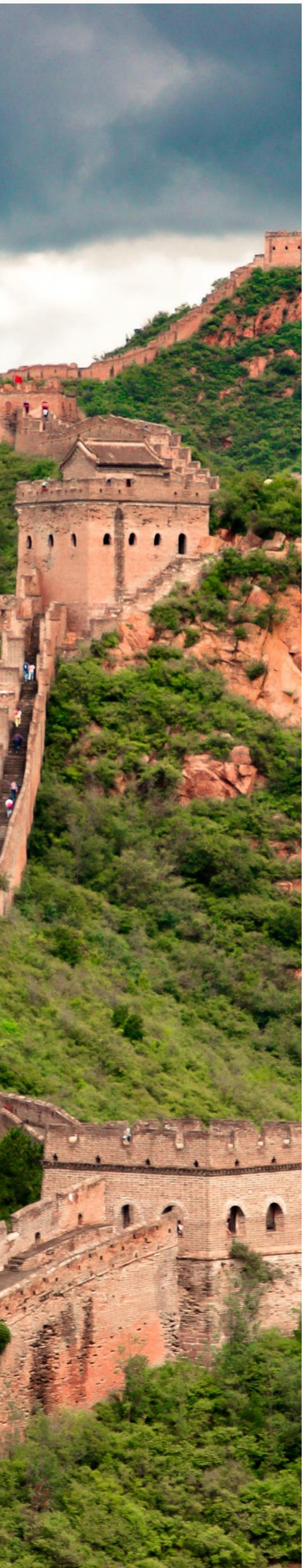
For 2022, the manufacturing and high-tech sectors were the main drivers of FDI in China. Manufacturing accounted for 26.3% of China's total 2022 foreign capital used and grew a remarkable 46.1% YoY. The technology sector, meanwhile, grew by 28.3% YoY and comprised about 36% of all utilized foreign capital.

2022 also continued the trend of moving China's inbound FDI from coastal provinces in the east, to the inland central and western regions. Specifically, FDI in the central region of China grew by 21.9% YoY while that in the western region increased by 14.1% YoY, much higher than the national average of 8%.



Source: China Briefing

The Chinese government is confident that FDI can grow by double-digits in 2023, thus helping China in its goal to pass the United States as the world's top FDI destination. However, the ongoing global economic downturn will present some challenges to their target. It is possible that the 2023 FDI will grow more rapidly than in 2022, but may it not be as impressive as the Chinese government forecasts.



China eases restrictions on foreign enterprises

In 2023, a new host of policies will come into effect. These measures are parts of China's efforts to revitalize the country's economy and FDI landscape after three years of COVID lockdowns and a weak economic performance in 2022.

To boost foreign investments and the overall economy, the Chinese Government has issued a host of new regulations to help ease the regulatory burden on foreign enterprises. These measures include:

- Cancelling the registration requirement for foreign trade operators to import and export goods or technology.
- Expanding the FDI catalogue to boost manufacturing and production-oriented service sectors.
- Extending the preferential individual tax income policies for expats.

In December 2022, the Standing Committee of the National People's Congress, China's legislature, adopted an amendment to the 1994 Foreign Trade Law. The amendment is a simple removal of Article 9. This measure removes the requirement that foreign enterprises have to seek permits from the relevant Departments of Foreign Economic Relations in order to start importing or exporting goods and technology. Despite the removal of Article 9, existing requirements on quality control, customs procedures, and import-export licenses still remain.

In addition, China also issued a new 2023 FDI catalogue that lists the economic sectors, regions, and activities that the Chinese government wants to attract more foreign investments to. The new catalogue includes 1,474 items, expanding the existing 2020 catalogue by 19%. The increase mainly focuses on components manufacturing, advanced manufacturing, energy conservation, and environmental protection. In addition, the new catalogue also encourages foreign investments in the central, western, and northeastern regions of China in order to foster parity with the more prosperous coastal region. The government can benefit from these regions' cheaper labour and existing industrial capabilities in electronics, steel, and automobile to attract investments. The new catalogue also includes incentives such as tariff exemption for imports and a reduced corporate tax rate of 15% for eligible companies investing in the targeted industries and regions.

Furthermore, the State Taxation Administration (STA) and the Ministry of Finance (MOF) announced that they will also extend the preferential individual income tax policy. Under this provision, expats' annual one-time bonuses during 2023 will be calculated separately and not as part of the total annual income.

Positive outlook for the M&A market as China reopens, although challenges remain

Key trends in 2023:

- **The Chinese M&A market grew significantly in Q4/2022.**
- **Cross-border M&A activities are likely to remain stable in the first half of 2023.**
- **High-tech manufacturing and production-oriented services are expected to witness increased M&A activities.**
- **Growth will be driven mainly by the domestic M&A market.**

2022 was a challenging year for China's M&A market with a continued decline in both domestic and cross-border M&A deals. According to the Institute for Mergers, Acquisitions, and Alliances (IMAA), China recorded 2,502 deals with a total value of US$ 214 billion, a moderate decline of 3.4% from 2021. This yearly aggregate value of M&A deals is the lowest recorded value during the period 2010-2022.

On a positive note, the Chinese M&A market's performance improved significantly in Q4 in an otherwise weak 2022. Between Q3 and Q4/2022, the number of deals rose by 126% while aggregate value soared by 66.9%, partially due to the pending deals delayed by the Shanghai lockdown between February and August 2022.

China's reopening after three years of strict COVID restrictions will facilitate travelling, making cross-border M&A less challenging than it has been in the past few years. The Chinese Government also eased the crackdown on the country's booming technology field, thus relieving some of the regulatory burdens on capital expansion in this important sector.

However, these positive developments do not necessarily mean that cross-border M&A activities will rapidly return to pre-pandemic conditions within the year. The ongoing global economic outlook is likely to temper any positive effects that China's reopening and regulatory easing can bring to the M&A market. Moreover, the precipitous decline in global stock market valuations in 2022 will also prevent a possible boom in cross-border M&A deals. This trend is expected to last for the duration of the first half of 2023, and possibly beyond if global economic conditions do not improve.

With the issuance of the new and expanded 2023 FDI catalogue that seeks to encourage foreign investments in manufacturing and production-oriented services, it is predicted that M&A deals will experience healthy growth in these two sectors.

Overall, 2022 was a relatively gloomy year for M&A in China. Nevertheless, as the M&A market improved in Q4/2022 and China reopened, the 2023 market may become more active than in 2022. The increase in activities, however, will more likely be driven by the domestic market rather than the cross-border one as the global economic outlook remains pessimistic.

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