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MANULIFE ASSET MANAGEMENT –WEEK IN PERSPECTIVE

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Philip Petursson

Managing Director, Portfolio Advisory Group
Manulife Asset Management

China's "Great Expectations"

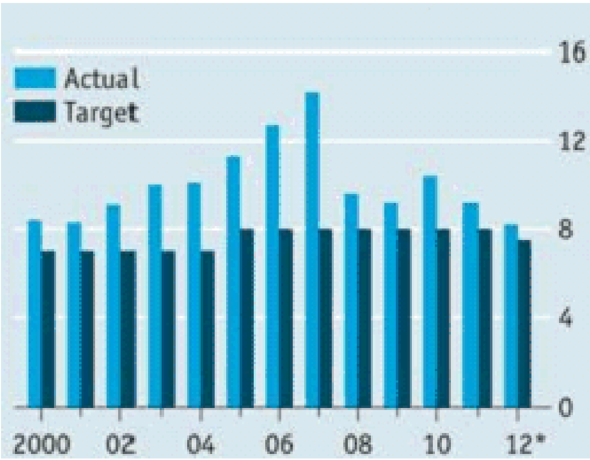
U.S. equity markets eked out another positive return last week, while most other major markets ended the week in the red. Uneasiness surrounding the Greek debt swap deal and China's announcement that they are targeting slower growth this year were the major overhangs. The S&P 500 began the week down nearly 2 per cent by end of day Tuesday, but was able to recover by the end of the week as nonfarm payrolls surprised to the upside by adding 227,000 new jobs in February. That number beat the consensus estimates of 206,000. In addition, the January figures were revised higher to 284,000 from an initial 243,000.

China's Premier Wen Jiabao said in a speech that the government's target for economic growth this year is 7.5 per cent, after aiming for 8 per cent for each of the last eight years. The global markets' negative reaction to the announcement was not all that surprising as China is a major contributor to the global economy, accounting for approximately 14 per cent of GDP on Purchasing Power Parity (PPP) basis.

But a lower Gross Domestic Product (GDP) target does not necessarily mean lower GDP, as last year's target was 8 per cent and the actual figure came in at 9.2 per cent. Is this another case of setting the bar artificially low or is China starting to see a material slowdown? The Chinese government's GDP target has been 8 per cent for the past 7 years and each year they have surpassed that goal, including 2009 during the Great Recession.

False modesty

China's GDP, % increase on previous year

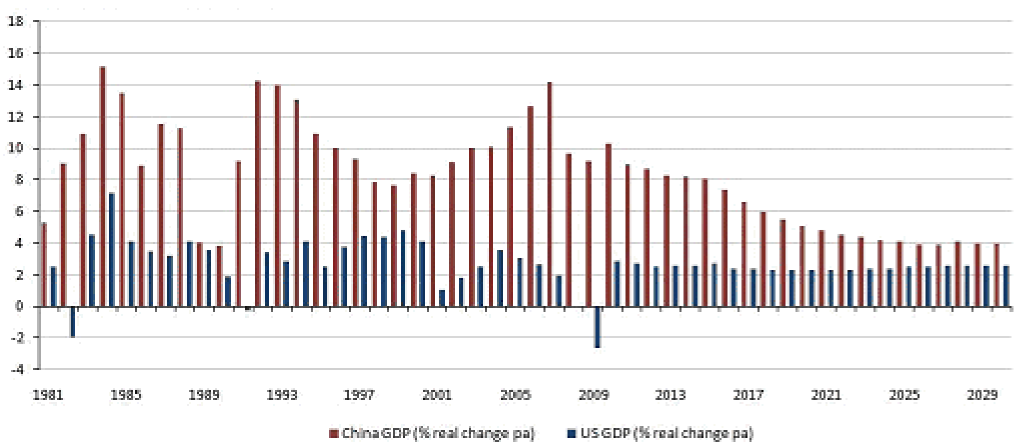


*Forecast. Sources: CEIC Data Company Ltd (CEIC); national statistics; Economist Intelligence Unit, as at March 9, 2012. For illustration purposes only.

Slower economic growth was expected by those that have been tracking the Chinese economy. A double-digit annual expansion is simply not sustainable, especially with the slower growth experienced by its major trading partners to the west. In addition, as part of the natural transition from an emerging market to a developed one, China is looking to transition from an export led economy to one focused more on domestic consumption. Last year, Wen set a 7 per cent target for average annual growth over the period 2011 to 2015, a sign that the government intends to engineer a very gradual slowdown. While this level seems to be quite low relative to what we have experienced over the last 12 years, it is by no means a “hard landing”.

Real GDP growth in China and the U.S., 1981-2030

Percentage change in real GDP, over previous year



Source: China National Bureau of Statistics and U.S. Bureau of Economic Analysis. 2011-2012 forecasts by the Economic Intelligence Unit. As at March 9, 2012. For illustration purposes only.

Despite their expectations of a slower economy, China is still looking to stimulate growth as evidenced by The People's Bank of China recently reducing the Reserve Ratio, the amount of cash that banks must set aside for reserves, by 0.50 percentage point. This is essentially akin to the U.S. Federal Reserve (the "Fed") lowering their short term interest rates.

Terrace Chum, Managing Director, Greater China Equities Team comments, "The slower GDP forecast should come as no surprise to people who've been tracking the Chinese economy. However, the fact that it was made official formalized the government's acknowledgement of the need to rebalance the economy from one dependent on exports to more domestic consumption driven. Having said that, it is easier said than done. In the past few years, despite government rhetoric about increasing consumption demand, consumption as a per cent of GDP continues to trend down. Thus, in the near term, China does need a reviving global economy to support its growth and to buy time for this long transition."

As an export-led economy, trade is the dominant contributor to economic growth. The General Administration of Custom of China published the latest set of trade figures, which showed that China recorded a trade deficit in February of US$31.483 billion, the highest since 1989. Exports amounted to US$114.471 billion, an increase of 18.4 per cent compared to last year, well below market expectation of 31.1 per cent, while Imports grew strongly by 39.6 per cent from last year to US$145.954 billion, above market expectation of 31.8 per cent year-over-year (yoy) growth. However, on a seasonally adjusted basis, exports increased by 4 per cent yoy, while imports increased by 9.4 per cent yoy. On a month-on-month basis, exports decreased by 23.6 per cent, while imports increased by 19.0 per cent. The trade balance for the first quarter of the year has typically been distorted to the downside partly due to the Chinese New Year, as industrial activity slows down for the festivities.

The weaker-than-expected exports could reflect the underlying weakness of the global economy, particularly in Europe. The expanding imports could be simply a restocking of inventory or a sign of higher future demand. The good news from this report, however, is that imports have grown rather strongly, which could be a signal of future demand or simply a restocking of inventory.

The issue remains that if China is positioned for slower growth, their import demand will decrease, which would be drag on Canada's commodities.

Terrace continues, "certainly, a lower growth trajectory should not be taken too positively for commodity markets. In addition, over the years, there has already been surplus capacity built up in industries like steel. Energy continues to be the brightest spot within the commodity space, specifically oil and gas and thermal coal."

Slower growth out of China over the coming years makes it even more important that portfolios remain diversified from a business and country risk perspective.

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