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HD **Firm demand turns China bear into bull - EXCLUSIVE -**

BY DAMON KITNEY, INVESTMENT

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ONE of the nation's most powerful investment managers has changed its previous bearish view on the outlook for the Chinese economy, declaring that underlying levels of demand are very strong in sectors that are the biggest consumers of Australian resource commodities.

Dion Hershan, who is head of Australian equities at Goldman Sachs Asset Management, said the group's recent analysis of ``granular'' data coming out of China made it more optimistic about the economic outlook compared to its position 12 months ago.

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``The country isn't without its concerns and its issues, but the underlying levels of demand remain very strong for a lot of commodity intensive industries,'' Mr Hershan told The Australian.

``For those industries, we are more optimistic than we were 12 months ago. It is not uniformly strong but it appears to us that inventory levels are at more manageable holding levels and underlying demand for things is strong.''

His comments come ahead of a critical week for Chinese economic data and the much anticipated fourth-quarter and full-year GDP numbers, due next week. The HSBC China composite PMI data for December released yesterday, which covers both manufacturing and services, signalled an increased amount of output for the fifth successive month.

Analysts said the release of a strong trade balance tomorrow would be a good lead indicator for the GDP figure, while the quarterly CPI is released the following day. But a weaker-than-expected GDP and CPI numbers well below the official threshold level of 3.5 per cent could see the government consider further monetary stimulus.

``The debate about how China is tracking will define its 2014. Talk will be about whether the `hard landing' talk of the last four years continues, if the central government is moderating growth and whether the small steps it has taken towards a more liberalised, freer trading economy continue in 2014,'' IG market strategist Evan Lucas said yesterday.

KPMG's global chairman, the Hong Kong-based Australian Michael Andrew, told The Australian late last month that the government's new five-year strategic plan had been ``very well received in China''.

``It is regarded as being a very sensible balance tackling issues like income equality, the environment, corruption. The things that have been worrying the normal Chinese guy. Here is now a set of solutions of how things will be done.

``I go into ICBC (the Industrial and Commercial Bank of China) and they say they now have a duty and responsibility to put more prudential controls over the shadow banking system, there will be more lending to growth sectors of the economy, and we've got to wind back lending to manufacturing. You get the plan recited in a very practical way on how we are going to do this.''

Market expectations for the lastest Chinese GDP number are 7.6 per cent, just above the official estimates of 7.5 per cent.

Continued on Page 17

Continued from Page 13

But growth is widely expected to slow to closer to 7 per cent this year. For example, JPMorgan is predicting growth of little more than 7 per cent, as a direct result of government policy. But Mr Hershan said his team was less focused on **Chinese** GDP numbers. ``In a weird sense the more granular the data becomes, the more reliable it becomes. If you are looking at inflation in utility prices or auto sales or housing sales in specific provinces, the more reliable it is,'' he said.

``Let's not focus on GDP, let's focus on those industries that, for example, consume steel and try to form a view on where they sit.''

He said while the car and machinery industries had received a massive boost from the stimulus package following the GFC, which had dramatically pulled forward growth and led to an apparent collapse in demand in the past two years, their average underlying growth rates were still strong. ``I think we are back to looking at more normal levels of underlying activity. Floor space under construction in 2013 was up 15 per cent. Infrastructure spend was up 14 per cent. Car sales were up 13 per cent. They are back to the levels of 2006-08 pre the GFC stimulus,'' he said.

Goldman Sach's team of 10 Melbourne-based analysts manages about $2 **billion** on behalf of clients across all Australian **equity** classes, including three who focus solely on resources and who between them travel to more than 20 **Chinese** cities each year. It also has six analysts in **China**.

The **firm** has been underweight the resources sector in the Goldman Sachs Australian Equities fund for two years.

``The resources sector was our greatest concern 12-18 months ago about the Australian economy,'' Mr Hershan said. ``We are now more relaxed . . . That is not to say we are overweight resources stocks or doing cartwheels about the outlook but I think one of the biggest risks . . . is starting to neutralise.''

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NS ccat : Corporate/Industrial News

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