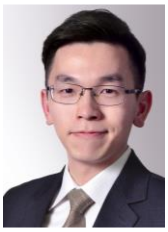
APRIL 2024

Unlocking the power of AI – the China way



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A new buzzword in China

When China's government laid out its top priorities for 2024 at the National People's Congress (NPC) in early March, promoting economic growth did not get the top position. Instead, top spot went to a call to develop "**new productive forces**", a relatively new slogan that symbolizes China's high technology drive.

As China looks to move away from an economic growth model based on property and infrastructure, the importance of technological progress and innovation has for some time been a consistent theme in China's official rhetoric.

Indeed, attempts by the US to contain China's technological development by imposing tariffs and sanctions has only intensified the urgency for China to rely less on imported technologies.

What makes the term "new productive forces" more eye-catching, however, is that it goes beyond the pursuit of technological self-sufficiency. The new emphasis is to make China an outright leader in technologies of the future.

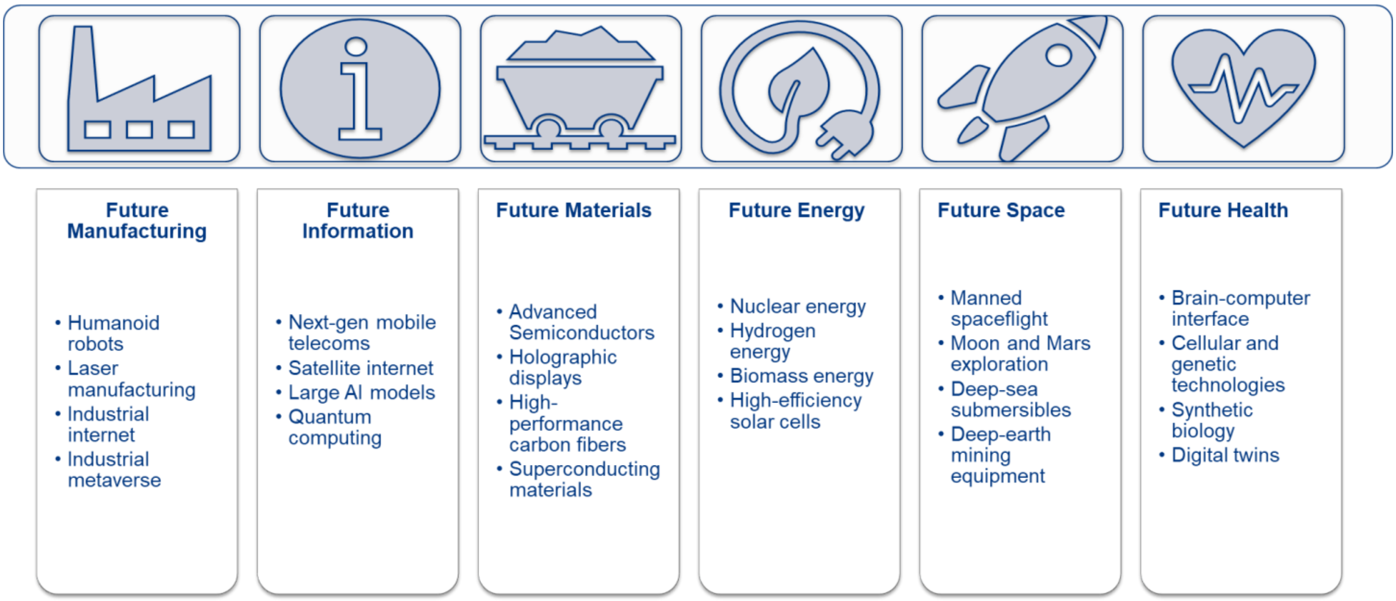
Key Takeaways

- The recently concluded National People's Congress focused on China's high technology drive as a top priority.

- China's AI focus is less on becoming a global leader in large scale generative AI models and more on practical AI applications.

- We see a diverse range of opportunities where companies can benefit both directly and indirectly from China's sustained investments into digital technologies and AI.

Figure 1: Industries of the Future



Source: Gavekal, China Ministry of Industry and Information Technology, 6 March 2024

As the official communique from the Central Economic Work Conference held in December put it, "We will promote industrial innovation through technological innovation, especially by using ground-breaking and cutting-edge technologies to foster new industries, new models and growth drivers, and develop new productive forces."

This is therefore likely to lead to a greater focus on futuristic technologies, including areas such as humanoid robots, nuclear and hydrogen energy, industrial internet and next-generation mobile telecoms.

China's AI ambitions

Over the last year the artificial intelligence boom has appeared to be passing China by, at least when looking at share price performance. Chinese AI-related stocks have lagged well behind the so-called Magnificent 7, for example. This is mainly because there is no Chinese equivalent of Nvidia (a company selling high-performance computing hardware), nor a peer of Microsoft on the software side.

However, this subdued share price performance masks a **high level of investment and a significant commitment of resources in AI**. Chinese companies have, for example, been active participants in the global race to develop larger-scale generative AI models.

In our view, the Chinese models have improved quickly in a relatively short period of time. Established large companies like Baidu and Alibaba have been leading the way. However, there is still a gap to the quality of global leading models. And while this gap may well continue to close, it will be challenging for China to take the lead any time soon, given the US sanctions which are limiting access to high-performance semiconductors, and thus to the computing power that is required to develop such models.

Figure 2: Bloomberg Magnificent 7 vs CSI Artificial Intelligence (Index total return, USD)

Source: Bloomberg as at 27 March 2024

Looking ahead

China's technological advantage will probably come more from practical AI applications, which are able to use 'sufficiently good' generative AI models. Just as Chinese companies have a track record of developing hugely popular super-apps such as WeChat (Tencent's social media platform), so a potentially big growth driver is the application of AI expertise in developing new consumer-focused products that can leverage China's huge domestic market.

And at this early stage of AI development, there is also a range of interesting opportunities in Chinese companies that are providing much needed infrastructure including diverse areas such as AI servers, thermal control systems and data transmission technology.

AI applications in China – case studies

Baidu

China's equivalent of Google, focused on the search industry and AI initiatives. An established and widely used search engine in China. Baidu generates most of its revenue from advertising services. These are on the path of recovery as the economic situation stabilises. As a pioneer in the AI industry, Baidu has rolled out a product comparable to ChatGPT called Ernie Bot and is exploring ways to improve monetization.

Midea

China's largest home appliance company, regularly ranked among the Fortune Global 500, Midea is transforming from a conventional producer of air-conditioners and fridges to a full-scale intelligent manufacturer. Driven by digital technologies and AI, the company is improving products, boosting sales and promoting after-sales services with the support of big data technology.

Trip.com

China's largest online travel agency has released an advanced AI travel assistant, integrated into the company's mobile app. Users can craft bespoke itineraries, make instant bookings and deliver rapid and personalized responses. AI looks set to play a pivotal role in reshaping the travel industry.

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