



FOR PROFESSIONAL INVESTORS – 24 October 2022

Chi Flash

CHINA'S NEW GOVERNMENT, WHAT'S NEW?

When it is obvious that the goals cannot be reached, don't adjust the goals, adjust the action steps.

Confucius

I do not want to repeat the mundane details that are already available in the public domain, but instead aim at providing a quick and focused analysis on the new government and the implications.

The 20th Party Congress concluded yesterday (Sunday, 23 October), and the new Politburo and Standing Committee members will be confirmed today (24 October), and procedurally approved by the National People's Congress in March 2023.

Policy & reform continuity

As expected, President Xi Jinping remains as President and as Party Secretary and Army Chief (the two most powerful positions in the government). This means policy and reform continuity, as I highlighted in my note last Tuesday¹, to focus on 1) economic development to put China on a sustainable path, 2) making China a "moderately affluent" society by 2035 and 3) the roles of both SOEs and private companies in structural reforms.

Policy continuity reflects a stable government and should be seen as good news in the face of economic headwinds, policy uncertainty and rising geopolitical risks. However, the Congress' emphasis on macroeconomic policy prudence and the housing policy stance (that housing is for living, not for speculation) implies that housing market weakness will continue to drag on the economy in the near-term and there is not going to be massive policy easing after the Congress.

The Zero-Covid policy will also continue, though there may be some minor adjustments to increase policy flexibility to lessen its impact on the economy.

¹ "Chi Flash: The 20th Party Congress – the Surprise of No Surprise", 18 October 2022.



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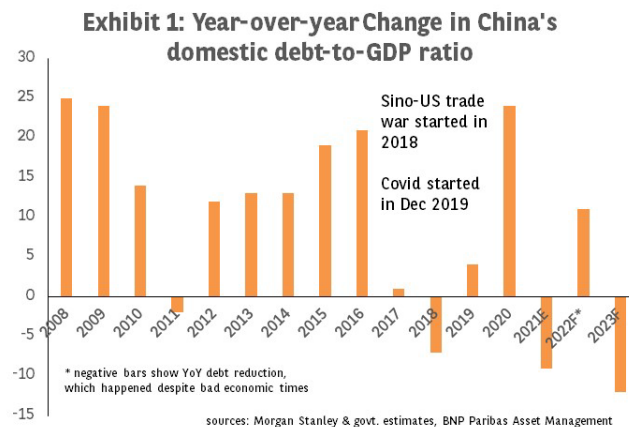
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President Xi's position strengthened

The Party Congress showed that Mr. Xi's core leadership power had been strengthened:

- He broke the two-term president limit of the Party constitution, and broke the implicit retirement age rule of 68 by appointing members in the Politburo and the Standing Committee who will pass the age limit within the next year or two.
- The “Xi Jinping Thoughts on Socialist with Chinese Characteristics in a New Era” were enshrined in the Party Constitution.
- He also broke the Party conventional practice of appointing the premier with someone who served as vice premier before. The new Premier Li Qiang (replacing Li Keqiang) is not a vice premier, surpassing the two Standing Committee members Zhao Leiji and Wang Huning who served as vice premiers before.

Overall, Mr. Xi has surrounded himself by strong supporters, who are also reformers, in the nucleus of the power structure. This guarantees policy and reform continuity, which has delivered some positive results under Mr. Xi's leadership, notably progress in deleveraging and corruption reduction (Exhibits 1 and 2).



While there is a strong justification for Mr. Xi to re-centralise power to push through painful reforms (despite how the West looks at his move)², as I have long argued, China and the world face a “key man risk” under Mr. Xi's regime as he is the one who calls the shots. Given Mr. Xi's track record of delivering reforms, China deserves the

² “Chi on China: Mega Trends of China (6): Evolution of China's Growth Model”, 6 April 2018, and “Chi on China: Changing China's Incentive Scheme in the New Growth Model”, 3 September 2018.

benefit of the doubt that it may be able to sustain long-term growth with higher quality by finding new growth drivers in a creative destruction process.

What's new?

An important change is that the economic and finance team will see a complete reshuffle, with Premier Li Keqiang, first vice Premier Han Zheng, vice Premier Liu He, PBoC governor Yi Gang, CBIRC chairman Guo Shuqing and finance minister Liu Kun, to be replaced by next March. The new team, to be announced later, is expected to contain supporters of Mr. Xi's economic and financial liberalisation policies.

The most important change is the Party's explicit toughening of the policy stance on securing national sovereignty on Taiwan unification, Hong Kong's One-Country-Two-Systems and military upgrading through technology enhancement³. At the Congress, the Party's warned about dramatic changes (read rising geopolitical risks) in the world. This is in sharp contrast to the assessment in the 19th Party Congress five years ago that saw peace and development remain the major themes of world development.

Innovation and security have now become development priorities. They echo Beijing's "dual circulation" policy⁴ (installed since 2020) which emphasises on education, technology and innovation to boost China's long-term sustainable growth by enhancing productivity and preparing for intensifying Sino-US technology competition. Indeed, the US government has recently expanded the scope of export controls and restrictions on technology products to China; the restrictions have extended to talent flows and will probably involve investment flows later.

Intensified competition in the technology sector will pose headwinds to China's supply chain and industry upgrading. It will also hurt the outlook for China's tech sector in the short- to medium term, and slowdown (but not derail) its progress. The increase in geopolitical tensions will make China more determined to improve self-sufficiency and supply chains in technology and advanced manufacturing. But it will continue to opening up its financial sector to leverage on the benefits of international capital flows, as per dual circulation strategy.

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³ See reference in footnote 1.

⁴ "Chi on China: China's Dual Circulation Strategic Pivot to Counter External Exigencies and Global Demand Shift", 16 September 2020.

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