

Harbour Navigator

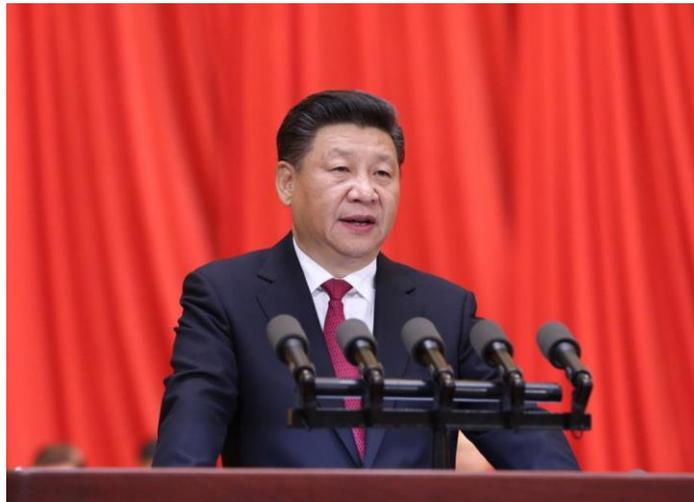
Xi's China: more of the same or big changes ahead?

Harbour Navigator 26/10/17

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In what is undoubtedly the most significant change of global leadership in 2017, President Xi Jinping of China has consolidated his powers further into the next five-year term.



Source: Xinhuanet (official press agency of the People's Republic of China)

Xi is now ranked as one of the most influential Chinese leaders since the Cultural Revolution and has staffed the Politburo Standing Committee with five close allies. The Standing Committee is the top decision-making body in China, and is made up of seven members, including Xi. There are five new members, with only Xi and Premier Li Keqiang continuing.

Whilst there has been no policy release yet, there are certain themes and reforms that President Xi has consistently expressed as priorities, which he now has more political firepower to implement.

Interestingly, though not necessarily broadly acknowledged in the news media, Xi does not have a desire to pursue economic (GDP) growth at all costs (unlike some of his counterparts). According to Chinese media and China experts, such as former Australian Prime Minister Kevin Rudd, it is understood that Xi prioritises an integrated approach to development, where *livelihoods* are more important than GDP growth.¹

Whilst Xi wants economic prosperity for his people, he is believed to view economic growth at the cost of the environment, culture, the rule of law, and social welfare as a failure. Hence, with his extended powers, we believe that all aspects of development will be addressed, which could

¹ Discovery Channel Series: The Time of Xi (October 2017) episodes 1, 2 and 3.

mean a deceleration of headline GDP growth as the economy gradually transitions away from a debt-fuelled investment-led approach to a consumer-oriented economy. The target is to be fully transitioned into a developed and sustainable nation by 2049.

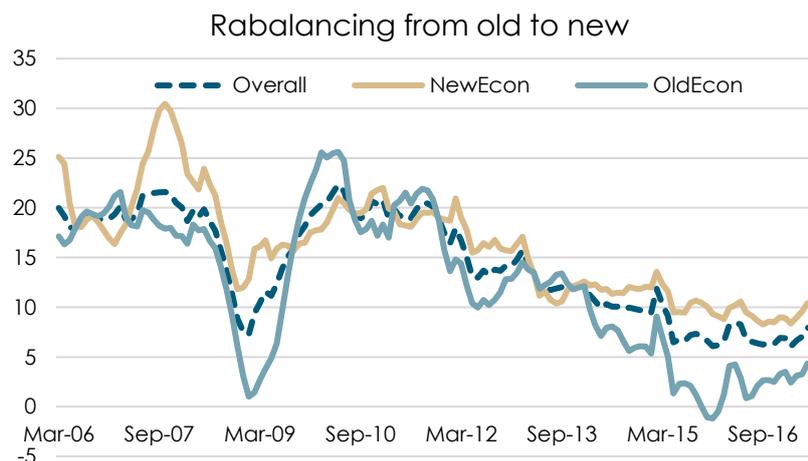
As mentioned, no specific new policies have been announced from the latest Government and we do not expect any until mid-December when officials meet at the Economic Working Conference. However, we can reasonably anticipate implementation and fast-tracking of current **State owned enterprise (SOE) reforms**, including further consolidation of SOEs and deleveraging of the SOE sector. **Financial stability** through general deleveraging is also expected, with a key focus of reigning in debt in poorly performing industrial sectors.

Environmental reforms are also widely believed to be pursued as a central policy of President Xi, which we have seen through a boost of renewable energy projects and a move towards an electrification of the automobile fleet.

It is, however, the **social welfare programmes** that are more likely to impact economic activity in the medium to long-term.

With China targeting a long-term transition to a consumer led economy, the social welfare reforms will be key to lifting the lowest income households up the income ladder and improving overall consumer confidence. This is also perhaps where communist China stands out from other nations. Whilst China has lifted hundreds of millions of residents out of poverty over the last couple of decades, those still living in poverty are not being politically neglected. In fact, they are central to most policy agendas that are designed to narrow the wealth gap.²

At Harbour, we like to track the activity levels of the *new* versus the *old* economy in China. This gives us an indication about the speed of the transition towards services and consumption and we have seen the new economy outperform significantly in recent years.³



Source: Bloomberg Intelligence

² Discovery Channel Series: The Time of Xi (October 2017) episodes 1, 2 and 3.

³ The Bloomberg New Economy Real Activity Index tracks monthly data that measure variables such as medicine consumption, vehicles exports, clean energy production and private enterprise output. The Old Economy Index tracks monthly data such as property investments, coal fired electricity production, textiles production and SOE output.

In terms of short-term implications for New Zealand investors, there is little change expected, although we could potentially see a loosening of capital controls that could see Chinese outbound investments start up again and find their way to New Zealand and Australian assets. The environmental push is also likely to accelerate electric vehicles uptake and lithium-ion battery manufacturing, assisting certain Australian-listed battery materials companies.

We do not expect a big short-term change to bulk commodities, other than the potential for a gradual slow-down in demand as the urbanisation, infrastructure and property development super-cycle is maturing. It seems unlikely that the One Belt One Road programme will be big enough to offset this trend. In terms of the consumer, we expect the opposite, and believe the balance of economic activity will continue to swing in the consumer's favour and, over time, continue to grow at above GDP-growth.

Harbour Asset Management

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