Global Perspective from the Investment Advisory Group

Quick take on the National People's Congress of China

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Eylem Senyuz
Director, Global
Macro Strategist

What happened?

The National People's Congress (NPC), the most critical policy meeting in China, was a virtual event because of the COVID-19 outbreak for the second straight year. China's political and military leadership finalized goals for economic variables and announced key foreign policy directives.

Highlights

Economic agenda – the growth rate target is back but with a conservative touch

Last year during the heights of the pandemic-related uncertainty, China dropped the official economic growth rate target for the first time. Many applauded the move, suggesting that the country is moving in the right direction by allowing market forces to determine the economic growth rate. Unfortunately, that only lasted for a year. Li Keqiang, Premier of the State Council, announced that the country aims for "at least" 6% growth in 2021, a much more conservative rate of growth than the consensus estimates of 8.4%. Nevertheless, that rate is still in line with the original target of doubling the Chinese economy by 2035. The country's fiscal deficit target will be 3.2% of GDP, indicating lower deficit spending versus last year's 3.6% deficit target, but higher than the anticipated figure of 3%. Urban job creation is expected to accelerate with at least 11 million new jobs targeted, well over the previously announced target of 9 million.

Ambitions in high-tech sectors

The previously-announced grandiose plans "Made in China 2025" and "China Standards 2035" that were reiterated in the 14th 5-year plan were also referenced during the NPC as well. China's ultimate goal of not relying on the external markets for technology is expected to be achieved by increasing R&D spending faster than the average GDP growth rates.

Only "patriots" to rule Hong Kong

Deng Xiaoping, China's transformative policymaker in the 1980s, coined the term "patriots governing Hong Kong." According to Deng, a majority of the city's administrators should fully endorse China's exercise of sovereignty over Hong Kong and should not intend to destabilize China and its economic development. President Xi Jinping reiterated this concept last month before the NPC and the NPC highlighted proposals in the works to implement the principle of "patriots governing Hong Kong".

Our take

China is diverting its energy to achieve innovation and high-quality development. This is the right step to promote reforms, sustainable economic growth, and eliminate wasteful spending just to generate growth. It's still unclear what the "at least 6% growth" rate means, as the consensus growth rate is already well above 6%. In theory, the consensus growth rate is still attainable, especially if the rest of the world's external demand for Chinese products accelerates with the help of the global economic recovery. Countries dependent on the Chinese economy, especially commodity and energy exporters, could be negatively affected if China concentrates more on self-sufficiency and sustainability. Over the last two decades, world trade volumes declined when there was a slowdown in Chinese economic growth, or if global trade was constrained due to trade wars or tariffs, like during the previous U.S. administration. World trade volume is on target to grow above 10% this year, recovering lost ground that occurred during the pandemic-induced recession period.

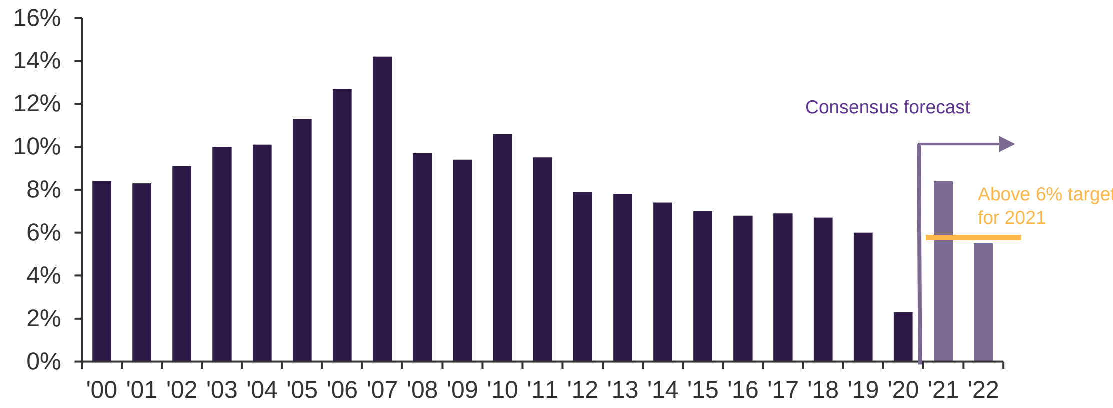
China GDP (%) and world trade volume 12-months change (%)

Data Source: Truist IAG, Bloomberg.

China is a long way from its ultimate goal of not relying on the external market for crucial technology, but bit by bit, they have been working on this goal diligently. The recent reining in of local tech behemoths like Tencent or Alibaba by increasing oversight on monopolistic activities could hinder innovation at a larger scale. Still, it opens the door for smaller firms to take the lead in innovation. R&D spending in strategic sectors like semiconductors, electric & autonomous vehicles, artificial intelligence, robotics, and biotechnology are expected to rise under state sponsorship. China is an expert at generating growth via infrastructure spending, but a recent government-backed high-tech investment push may not achieve similar success. Last year, companies registered as semiconductor enterprises doubled, with many to receive financial support from the government. In the semiconductor space, the current approach is promoting quantity to achieve quality at a later stage.

China announcing an official economic growth target was a surprise to many. Not only that, but the growth rate target was well below consensus estimates as well. The only silver lining with the target is that the country draws a line for a minimum growth rate instead of a hard target. With the help of the latest U.S. stimulus package and China growing slower this year, it's opening the door for the U.S. to grow faster than China for the first time since 1976. Slower Chinese growth rates usually cause a headache for commodity and energy-exporting emerging market (EM) economies. This year, it could be less worrisome for EM if the U.S. and Europe replace that slack.

China's annual GDP growth rate (%)



Data Source: Truist IAG, Bloomberg

The pro-democracy movement in Hong Kong is expected to have a strong reaction against the proposed changes regarding the “patriots ruling Hong Kong” initiatives announced at the NPC. The city’s already dire economic situation due to the COVID-19 pandemic is expected to get worse. Geopolitical tensions between the U.S. and China could escalate further if the “one country, two system” promises made by China in 1997 get diluted before the handover date in 2047.

Bottom line

We recommend neutral positioning in emerging market equities where direct exposure to China is around 40% of the index. The rest of the index heavily relies on Chinese economic growth rates for exports. We expect a 5.7% growth rate from the U.S. with the potential to surprise higher if reopening efforts continue to be successful. We could have a historic year in global economic activity where the U.S. economy delivers a higher growth rate than China for the first time in 45 years.

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