GLOBAL
Insight

Monthly focus

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China pursues a balance of economic pragmatism, reforms

The annual gathering of China's political leadership saw policymakers formalize their economic goals, and introduce new measures aimed at reforming financial institutions and boosting the tech sector.

Jasmine Duan

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MONTHLY
Focus

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China pursues a balance of economic pragmatism, reforms

The annual gathering of China's political leadership saw policymakers formalize their economic goals, and introduce new measures aimed at reforming financial institutions and boosting the tech sector. We unpack the investment implications, as well as our views on commodity markets and the country's real estate sector.

- **To the surprise of many market participants, the highest economic officials were retained. This, combined with the strong track record of the new premier, signals a pro-growth, stable, and market-friendly policy stance.**
- **The 2023 GDP growth target of about five percent seems achievable, and therefore China's economy should support global growth.**
- **The government is seeking to enhance financial stability, boost scientific and technological self-reliance, strengthen data security, and develop the digital economy.**
- **The toughest regulation of the real estate sector is likely behind us, although we think the government will avoid broad-based stimulus.**
- **China's reopening is bullish for commodities overall, but the impacts across individual commodities will likely differ.**
- **We think China equities are in a sweet spot given the policy agenda is business-friendly and the economy is improving, and earnings improvement should soon follow. Meanwhile, equity valuations are still below average.**

The Two Sessions: China's most important annual government meetings

"Two Sessions" refers to the annual meetings of China's two major political bodies: the National People's Congress (NPC), which is the national legislature and the highest organ of state power; and the Chinese People's Political Consultative Conference (CPPCC), the top political advisory body. The meetings include elected representatives of every region, ethnic group, and sector of society.

The Two Sessions this year were of great importance because they laid out the implementation plan for China's long-term development over the next 25 years based on the blueprint set forth during the all-important 20th National Congress of the Communist Party of China (CPC) in October 2022. This year is a milestone in China's intended march to achieve the Second Centennial Goal of building China into a modern socialist country in all respects by 2049.

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The main surprise: Key economic officials retained

The appointments of China's president and premier were widely expected. Xi Jinping was reelected to a third term as president. Li Qiang, former party secretary of Shanghai, was appointed as premier.

To the surprise of many market participants, the highest officials in the economic team were retained. Yi Gang, Liu Kun, and Wang Wentao were reappointed as People's Bank of China (PBoC) governor, finance minister, and commerce minister, respectively. The heads of most ministries are keeping their positions, including the ministers of transportation, education, and industry and information technology. We think this arrangement reflects the government's focus on stability and policy continuity.

Chinese policymakers focusing on institutional reform

The NPC approved a plan for the reform of government institutions which focuses on optimizing and adjusting their responsibilities with the aim of improving governance efficiency and coordination. We think the reform plan shows the intensifying efforts of the Chinese government to enhance financial and economic stability, boost scientific and technological self-reliance, enhance data security, and promote the development of the digital economy. The retention of key officials should help ensure reform implementation during the transition period.

On the financial regulatory front, there were noteworthy changes. China will establish a national financial regulatory administration directly under the State Council (the Central People's Government), to regulate institutions outside the securities sector. The proposed administration will replace the current China Banking and Insurance Regulatory Commission. Importantly, certain functions of the PBoC and the China Securities Regulatory Commission (CSRC), such as investor protection, will be transferred to the new administration. The CSRC will become a government agency directly under the State Council, a higher status than it currently holds.

We think the proposed changes aim to promote integrated regulation in the financial industry and avoid regulatory arbitrage. They will concentrate regulatory functions under the new administration. The decision to retain

Major areas of institutional reform

Finance			Tech	Data
Establish National Financial Regulatory Administration	CSRC reform	Local financial regulatory reform	Restructure the Ministry of Science & Technology	Establish a national data bureau
• Regulate the financial industry for institutions outside the securities sector • Take over responsibilities for protecting consumers of financial products and investors from PBoC and CSRC	• Become a government agency directly under the State Council • Take over responsibility for reviewing corporate bond issuance from NDRC	• Streamline financial regulation at the local level	• Focus on driving major technological breakthroughs and facilitating the application of new technologies	• Coordinate data regulation • Facilitate the development of the digital sector

Source - Xinhua News Agency, RBC Wealth Management

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the CSRC and upgrade its status may demonstrate China's objective of developing the equity market and boosting equity financing, in our view.

The Ministry of Science and Technology will be restructured to promote the development of core technologies and move the country towards greater self-reliance in science and technology. The restructured ministry will focus on driving major technological breakthroughs and innovations, and facilitating the application of new technologies. We believe this will promote the integration of sci-tech with economic and social development needs, helping enhance the contribution of science and technology to industry.

To better coordinate data regulation, and to facilitate the development of the digital sector, a national data bureau will be established under and administered by the National Development and Reform Commission (NDRC), the country's top economic planner. The bureau will be responsible for advancing the development of data-related fundamental institutions, and for coordinating the integration, sharing, development, and application of data resources, while also pushing forward the planning and building of the digital economy and a digital society.

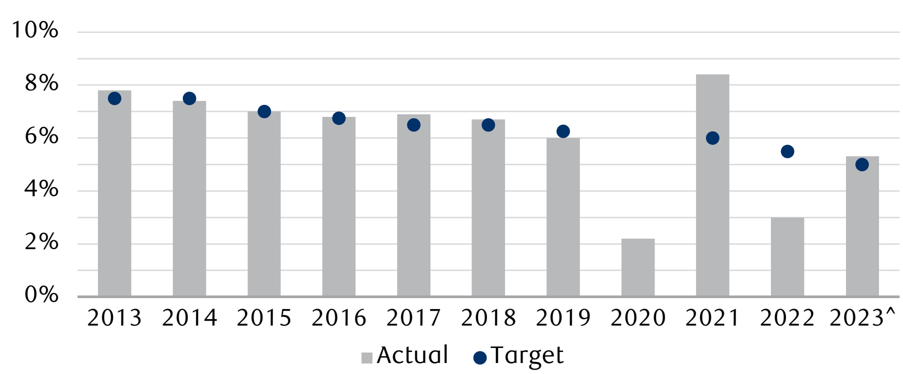
Economic growth: A pragmatic target

The Chinese government set a 2023 GDP growth target of around five percent. In contrast to many market participants who viewed this target as being below expectations, we believe this is a pragmatic and achievable target. Given the economic uncertainties China is facing, such as global economic vulnerabilities, we believe the government wants to leave some room to deal with unexpected risks.

The five percent growth target was part of a government report that also indicated managing major economic and financial risks would be a key focus for 2023. We think China will seek to lay a solid foundation for quality economic growth in the medium to long term, instead of pushing up growth in the short term through aggressive stimulus.

New Premier Li Qiang sent strong pro-growth messages during his first press conference. His remarks appeared pragmatic and market-friendly, in our

China's GDP growth targets vs. actual growth in the past 10 years



GDP growth targets: 2013–14, around 7.5%; 2015, around 7%; 2016, 6.5%–7%; 2017–18, around 6.5%; 2019: 6%–6.5%; 2020, no target due to COVID-19; 2021, above 6%; 2022, around 5.5%; 2023, around 5%. ^2023 growth data is Bloomberg consensus forecast.

Source - Chinese Government Work Reports, Bloomberg, RBC Wealth Management view. Li mentioned that "macro policy combinations" would be introduced to expand domestic demand, push forward reforms and innovation, and limit risks. He also cited his work experience at the local government level in the economically developed regions of Zhejiang, Jiangsu, and Shanghai, and encouraged policymakers to "visit local communities to solicit public opinions" as part of their work. He stated that "government officials should not just slam on the brakes but also hit the accelerator," which to us is a sign of a more pro-growth policy direction going forward.

Property market: Less drag on growth this year

In the government's report, the policy stance that "housing is for living in and not for speculation" was only mentioned in the "past achievements" and was not included in the 2023 policy suggestions. We think this indicates the toughest regulation of the real estate sector is behind us.

But the report stuck to the theme of ensuring risk limitation while promoting stable development of the real estate sector. We think the government will avoid broad-based stimulus, but will continue to support "high-quality, leading real estate enterprises."

We expect the real estate market to gradually recover and to impose a milder drag on GDP growth this year. The National Bureau of Statistics' 70-city house price data suggest the weighted average property price in the primary market edged up sequentially in February after seasonal adjustments. The increase in house prices was broad-based among all city tiers, with the proportion of cities that experienced sequentially higher property prices rising sharply in both the primary and secondary markets.

Commodities: Reopening beneficial, but divergent performance expected

RBC Capital Markets, LLC Global Energy Strategist Michael Tran believes that while China's reopening is bullish for commodities overall, the impacts across individual commodities will likely differ. Sentiment on metals like copper and iron ore shifted upwards swiftly after China's reopening, as investors expect industrial economic activity will pick up. However, WTI and Brent crude oil have drifted lower recently amid global financial sector stress and concerns about the potential knock-on effects for economic growth in the U.S. and Europe.

In Tran's view, the divergent performance of different commodities makes sense with regard to Chinese demand. He recently wrote that "Commodity investors see the metals trade as the first derivative of the reopening, while individual consumer-linked commodities tied to societal behavior (like the oil complex) have lagged the space, for now, but will play catch up once societal behavior shows a steadfast degree of strength." China's latest data confirmed positive dynamics for the economy during the reopening, thanks to consumption and infrastructure investment.

A surge in air travel and a recovery in demand from China could drive global oil demand to record highs in 2023, according to the International Energy Agency (IEA). Global oil demand should accelerate over the year, rising to 2.6 million barrels/day in the fourth quarter from just 710,000

China apparent oil demand is gradually picking up after the reopening

Millions of barrels per day

Note: According to the IEA, apparent demand is an estimate of domestic demand. Calculation varies by country; in China, apparent demand is defined as refinery output plus net product imports (adjusted for fuel oil and direct crude burning, smuggling, and stock changes).

Source - Bloomberg, National Bureau of Statistics, China Customs General Administration, RBC Wealth Management; monthly data through January 2023

barrels/day in the first quarter, the IEA estimates. While China's reopening should provide some support for crude oil output and prices, economic headwinds in the U.S. and Europe could detract from global oil demand if the two regions fall into recession.

Equity investment implications

The "Two Sessions" should allay investors' concerns about China's growth outlook and the policy direction of the new leadership team, in our view. We think China equities are in a sweet spot right now as the policy agenda is business-friendly, the economy is improving, and earnings improvement should soon follow. Meanwhile, low inflation leaves room for accommodative policies. Furthermore, equity valuations are still below their five-year historical average. The recent heightened U.S.-China tensions and global equity market turmoil surrounding the U.S. regional banking and European banking segments have led to a pullback in China equity indexes that, in our view, provides investors with opportunities to gradually build positions.

We prefer companies that are positioned to benefit from China's economic reopening. We also see the reform of state-owned enterprises (SOE) as a theme that should play out positively over the medium to long term. Deepening SOE reforms and enhancing SOEs' competitiveness are among the key tasks of the government this year. Several officials have stated recently that the SOEs are undervalued in the financial market. During the NPC, Shanghai Stock Exchange General Manager Cai Jianchun called for boosting central SOE valuations to a "reasonable level." As reform continues, we believe SOEs can deliver profitability improvements. With good corporate governance and decent dividend payouts, they could outperform. Companies in defensive sectors can also provide investors with attractive spots to park funds during periods of market volatility, in our view.

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