China: Looking beyond the party congress

BlackRock

The key outcome of the 20th party congress in China – a significant power consolidation under President Xi Jinping - paves the way for greater state control of the economy and markets. We see a continued shift in policy emphasis away from GDP growth targets and toward goals such as national security, tighter regulatory oversight of the private sector and income equality. The congress brought little evidence to change our view of a sluggish near-term growth backdrop.

We could see measures to open up the economy though we expect China to be more assertive on self-reliance in technology amid U.S-China competition. This entails greater state scrutiny of corporates, particularly companies that produce intangible output. Coupled with ongoing geopolitical concerns, it underscores why we think Chinese assets warrant a higher risk premium. This reinforces our view that China is entering a lower growth phase - and that a given growth outlook will likely translate into lower market returns than in the past.

China's strong bias not to over-stimulate activity, due to concerns about debt levels and asset bubbles, will likely persist under the new leadership. We think policy will be loosened just enough to stave off a major downturn, yet not enough to offset fully the drag from net demand for its exports likely turning negative: both from a normalization of overseas spending post-pandemic and from major developed economies likely falling into recession from central bank overtightening.

We had expected a bounce in Q3 as the economy restarts and have pencilled in some boost next year from an adjustment of Covid policies. Markets are dismissing the probability of any relaxation of Covid-19 controls this year. We think the end of the congress opens the window for the government to incrementally adjust policy. And the choice of Shanghai party governor Li Qiang as potential premier may mean a more business-friendly economic policies than expected.

The bottom line: We think China is entering a stage of lower growth. Near term, its growth challenges go beyond Covid – and cyclical policy is unlikely to come to the rescue. Longer term, a shrinking workforce – effectively a structural production constraint that limits how much the Chinese economy can produce without generating inflation – leaves authorities less room to stimulate aggressively. With a further focus on self-sufficiency, we see risks to long-term growth trajectory tilted to the downside. Tighter state control of the Chinese economy warrants a higher risk premium than in the past, partly reflected in the 9% drop in Hong-Kong listed Chinese shares since the Congress began. We stay neutral Chinese equities and bonds on a tactical horizon.

Key views

China's party congress saw a significant power consolidation. We see a further shift in priorities in favor of strategic goals over GDP targets.

We think China is entering a lower growth phase – and that Chinese assets warrant a higher risk premium vs. the past.

China's strong bias not to over-stimulate activity will likely persist under the new leadership.

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