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China's National People's Congress: Focused on stability

Seema Shah
Chief Global Strategist

Han Peng, CFA
Director, Quantitative Strategist

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The National People's Congress (NPC) and the Chinese People's Political Consultative Conference (CPPCC) will meet in March. From these two meetings, investors will look for policy directions which could shape the economic landscape of 2022—a crucial year when the Chinese Communist Party will convene its 20th Congress.

Following last year's introduction of the Common Prosperity goals and the subsequent economic slowdown in China, the March meetings will be closely watched for any hints of policy or regulatory changes that may encourage stronger growth. Additionally, with the global approach to COVID-19 becoming more relaxed, investors will be eager to see any softening in China's zero-COVID stance, as well as further discussion on its green energy plans, in light of last year's energy crisis.

"Stability" has been repeatedly highlighted by China's leaders as a top priority for this year. This focus will lay the foundations for the discussions at the Two Sessions event, ensuring a continued commitment to the long-term goals, but executed with greater care and flexibility to avoid further disruption of China's economic, financial, or social stability.

It is through the "stability" lens that we will address five key policy questions facing China in 2022:

1. How will China advance its Common Prosperity goals?

2. How much further will policymakers go to fight the economic slowdown?

3. Will China's zero-COVID policy be relaxed?

4. Should investors expect a change in the regulatory framework?

5. How will China navigate its green initiative goals?

1. How will China advance its Common Prosperity goals?

Last year, President Xi's government introduced the Common Prosperity goals, executing bold reforms aimed at distributing wealth more equitably and promoting a more sustainable growth model. However, these measures were initially destabilizing, impacting economic growth and leading to a significant underperformance of Chinese investment markets.

In December 2021, the Central Economic Work Conference noted that the Common Prosperity goals should be considered as more of a long-term strategy and that the first step is to make the "cake" bigger, before dividing it. As regulatory crackdowns begin to ease, it is likely that the worst of the economic reverberations have passed.

For example, the directive to "strengthen antimonopoly and prevent disorderly expansion of capital," which had specifically hit technology firms, is being softened. This could potentially represent a boost for China's tech sector.

In another example, policymakers have been shifting to a more supportive stance on the housing market. A property tax hike, aimed at regulating the property market and controlling soaring prices, will now be postponed—with the NPC meeting potentially revealing when the tax will be introduced. However, with the government likely to stick to its "house is for living, not speculation" stance, a sharp rebound in property investment is unlikely.

Given the economic headwinds, the Common Prosperity campaign is likely to be executed in a way that avoids further pain to business confidence while reassuring wealthier households that they are not the subject of a witch hunt. In 2022, the government may choose stimulative policies with a common prosperity tilt, such as measures aimed at boosting agriculture and rural consumption, and greater investment into state housing. Policies that are pro-private sector, pro-entrepreneurship and pro-small and medium-sized enterprises will likely continue to be a core focus.

2. How much further will policymakers go to fight the economic slowdown?

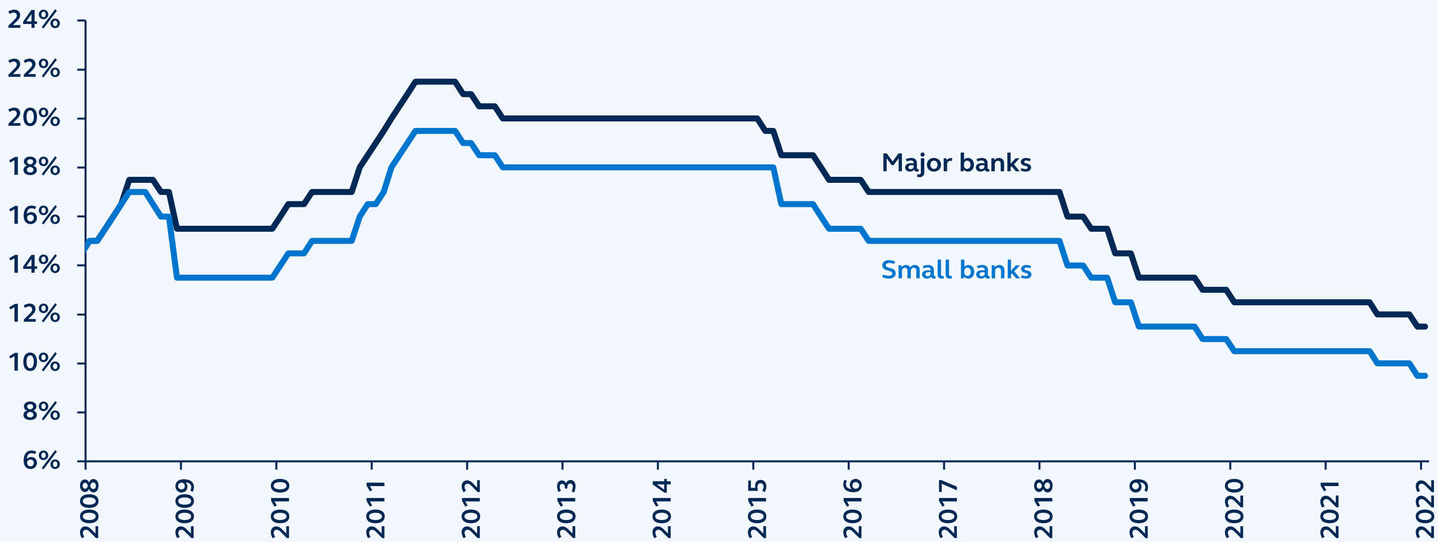
In contrast to much of the global economy, China's growth struggled in 2021 as it introduced a wave of new regulations, with greater focus on social stability. During China's annual economic meeting in December, it was acknowledged that the "economy faces the triple pressures of contracting demand, supply shocks, and weakening expectations," and coordinated fiscal and monetary policies were suggested to offset the slowdown. Since December, there have been a series of monetary easing actions, including cuts in the reserve requirement ratio (RRR), loan prime rates (LPR), the reverse repo rate, and Medium-term Lending Facilities (MLF).

The 2022 GDP growth target will likely be announced in March and will be a very important signal for investors. Last year's growth target was low enough to give policymakers sufficient space to introduce structural reforms. This year, if another low target (sub 5%) is set, markets would likely interpret it as a weaker focus on macroeconomic strength and greater focus on regulatory reform. By contrast, a growth target above 5.5% would imply an intention to stabilize economic growth, paving the way for further monetary stimulus—but with care not to over-inflate the economy.

Despite a challenging macro backdrop, this is not the time to write off Chinese equities. Policy stimulus will be targeted at a modest strengthening of growth, and in turn, boosting corporate profitability.

Reserve requirement ratio in China

January 2008 - present



Source: Bloomberg, Principal Global Asset Allocation. Major banks are state-owned commercial banks, joint-stock commercial banks and postal savings banks. Small banks are rural banks and small-sized city commercial banks. Data as of January 31, 2022.

3. Will China's zero-COVID policy be relaxed?

As most countries have continued to reopen despite the spread of the Omicron variant, China has stuck to its zero-COVID policy (known as "dynamic clearing"). While case numbers are just a fraction of the infections in other economies, Chinese epidemiologists suggest that the dynamic clearing remains the country's best option—China is unlikely to abandon its zero-COVID policy through most of 2022.

However, given the negative impact on domestic consumption, as well as the practical difficulty of sustaining such an approach in China's dense population, the National People's Congress may reveal a modest loosening to rules.

A more targeted and flexible approach, which minimizes disruptions to daily life, appears to be increasingly favored by the central government. Indeed, in late January, China's National Health Commission urged for targeted travel policies, suggesting that local authorities apply tailored measures to people traveling from areas of different risk levels and not adopt a "one-size-fits-all" approach to COVID-19 containment.

4. Should investors expect a change in the regulatory framework?

Even though China's regulatory framework has caused significant disruptions across the economy, the framework is consistent with the government's growth strategy, which prioritizes quality of growth over quantity of growth. Recently, investors have seen this materialize, as intensified regulations on large platform companies have begun to shift the allocation of resources from business model innovation to technological advancement. As a key pillar of China's development plan, regulations are unlikely to be reversed and, if anything, could become more institutionalized in 2022.

A focal point for the NPC may be to emphasize the constructive aspect to the regulations. In late January, the Cyberspace Administration of China (CAC) held a symposium with tech companies, giving regulators an opportunity to express their appreciation for the important role that internet companies play in the economy and to voice their support for the healthy development of the platform companies. While this sent positive signals to entrepreneurs and investors, many remain skeptical. The NPC could provide more reassuring signals, lifting investor sentiment.

5. How will China navigate its green initiative goals?

Since last year's energy shortage, China's government has redirected effort toward ensuring energy security. However, those priorities will need to be balanced against the country's green initiative goals.

China has pledged to control coal consumption and increase renewable energy capacity significantly in order to cap carbon emissions by 2030, if not earlier, and become carbon neutral by 2060. However, just last year, its endeavors to meet those green goals resulted in an electricity supply shortfall, triggering a multi-month energy crisis which was particularly stressful for China's manufacturing sector.

Considering the energy crisis in 2021, China will need to ensure that its energy sources can adequately anchor the power system as they continue with their energy transition. Given its progress to date, if China is to meet its green initiative goals, government policies will need to lean further toward facilitating more investments to green transformation.

Ultimately, China's policy pivot to more accommodative monetary actions should help stabilize economic growth in 2022, boosting investor sentiment and supporting valuations.

While this year's macro environment will be more supportive for risk assets, China's long-term goals, such as Common Prosperity and decarbonization, remain firmly in place, so volatility and uncertainty will likely extend throughout the year. The regime shift undertaken, however, will fundamentally strengthen China's economy and over time, Chinese companies will find ways to reposition their strategies and improve earnings. Investors should stay invested in the Chinese market, but with increased selectivity and focus on areas with long-term growth potential as they navigate this challenging backdrop.

Risk considerations

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