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UOB Investment Insights

Thinking Ahead

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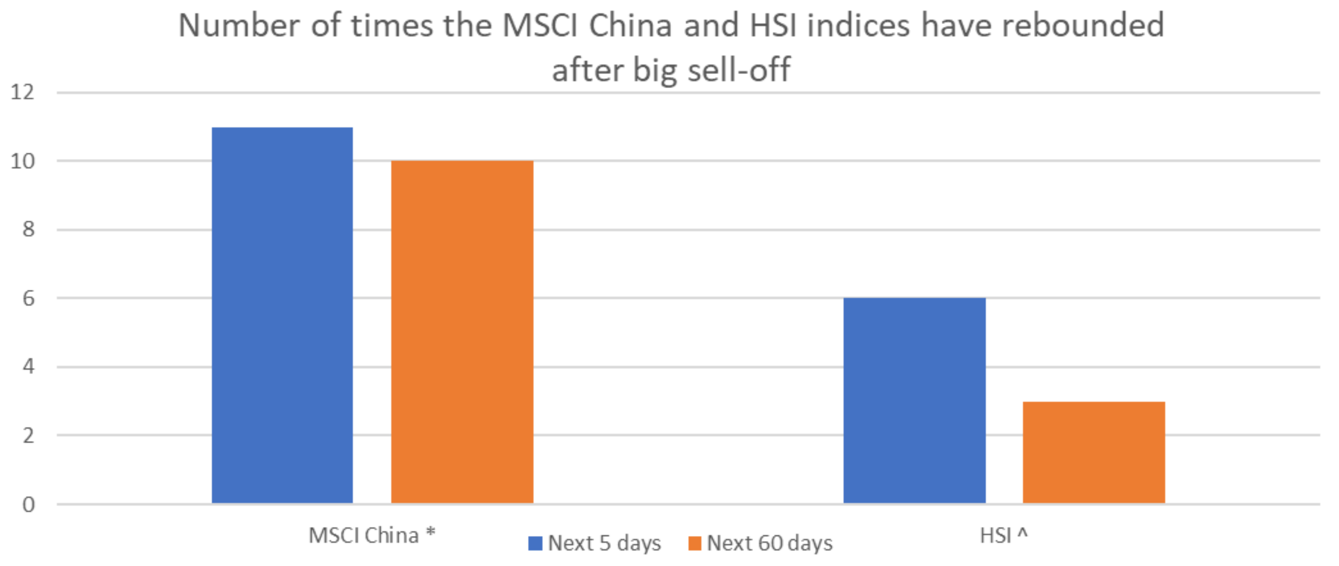
Key Takeaways from China's 20th National Congress

- No big surprises emerged from the Chinese Communist Party's (CCP) 20th National Congress. The highly watched political meeting, which takes place every five years, did not produce major policy changes that were widely hoped for. Notably, President Xi Jinping signalled no imminent change to the nation's zero-COVID approach. He also played up the importance of national security.
- Markets reacted negatively at the conclusion of the meeting, stemming from concerns about the economy and how market-friendly the new leadership will be.
- One silver lining came in the form of President Xi's assertion that economic development remains the CCP's "top priority". This eased concerns that Beijing may tolerate slower economic growth in order to meet national security goals. How big of a priority the economy is will only become apparent in the lead-up to the National People's Congress (NPC) in March 2023.

A knee-jerk reaction? Or a sign of more trouble ahead?

- The market's immediate reaction at the conclusion of the CCP Congress was negative, stemming from concerns that the Politburo Standing Committee – or China's top leadership – does not include any leaders known for steering the economy or any discernible market reformists.
- The leadership shake-up and President Xi's consolidation of power also mean he is less likely to be challenged. This raised concerns that the zero-COVID approach will remain unchanged and that potential policy missteps could go unchecked.
- Others are concerned about how to position for Xi's policy priorities of "common prosperity" and "dual circulation".
  - For the former, the worry is that big-tech and property companies will see no relief from regulatory crackdowns.
  - For the latter, the dual circulation strategy (focusing on both export-oriented development and domestic demand) will keep facing headwinds, as lacklustre retail sales data and weakening external demand indicate. This will not change unless China unwinds its zero-COVID strategy and resuscitates its property sector.
- **Chinese offshore stocks and the Hang Seng Index tumbled sharply in the direct aftermath. The Hang Seng China Enterprises Index fell 7.3%, the MSCI China Index slumped 8.19% and the Hang Seng Index fell 6.45% on the first day of trading after the Congress.**
- **But history suggests markets tend to stabilise soon after such sell-offs.**



* Out of 13 times the MSCI China Index has fallen -8% or more in a day, since 1990s
^ Out of 9 times the HSI has fallen -3.5% or more in a day, since 2015
Source: Bloomberg

What to look out for ahead

- There are still a lot of questions to be answered, including whether President Xi will focus more on the economy now that he has tightened his grip on power.
- We expect to see only a trickle of policy directives heading into the Mar 2023 National People's Congress (NPC), where greater clarity may be found.

What is China's growth target?

- While China has not departed from its priority of economic development, it remains to be seen whether it will announce a lower 2023 GDP target (than the initial 5.5% target for this year), or if it will avoid indicating a definitive target altogether. This question will likely only be answered in Mar 2023, at the earliest.
- This is a double-edged sword, as an upbeat GDP forecast may initially be cheered before investors start to question how achievable it is. A weak GDP projection may look bleak on the surface but may prove to be a low bar for outperformance.

Will there be a tweak to the zero-COVID strategy?

- The world should not underestimate China's resolve in going it alone with its zero-COVID approach, but the balance of risk would suggest that a policy shift will eventually be on the cards. The Chinese public is growing tired of restrictions and lockdowns, while the economic ramifications are plain to see (especially the surge in unemployment for the younger demographic).
- Some are touting 2Q 2023 or slightly after that as the window for any pivot in the COVID policy, but this now seems solely at the discretion of President Xi. What is more likely is that any easing of the zero-COVID approach will be very gradual at best.
- The economic implications are clear. Until Beijing reverses its COVID approach, it is hard to envisage a sustainable recovery in domestic consumption and business sentiment.

Will the housing sector receive more support?

- Additional support for the housing sector seems far more likely, with Beijing ultra-sensitive to social stability, although support measures will likely remain targeted to avoid re-fueling financial risks.

Will we see an easing of geopolitical tensions?

- While President Xi and United States President Joe Biden will likely meet at the G20 summit in November, there is little hope of an improvement in US-Sino relations for now.
- With the US having veered slightly away from its "strategic ambiguity" on Taiwan and the "One China" policy, the risk of a foreign policy miscalculation and increased geopolitical tensions cannot be dismissed.

What should investors do?

- In the short-run, Chinese equities may face headwinds in the form of weak macroeconomic fundamentals, China's zero-COVID strategy and the lack of fresh policy inputs.
- We maintain our cautiously optimistic view on Chinese stocks, but we advise clients to stay defensive for now. Over a multi-year horizon, we remain positive on Chinese risk assets given Beijing's long-term goals and the potential fulfilment of the domestic plank of its "dual circulation" strategy eventually.
    - Clients who are already invested should adopt a long-term approach by staying in the market.
    - For investors looking to establish or increase their exposure to China, we advise a dip-buying approach by investing in tranches to take advantage of attractive valuations. However, investors should be mindful of potential short-term volatility.
- Speak to a UOB advisor on how best to position your portfolio according to your risk appetite.

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