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GLOBAL PERSPECTIVE *from the Investment Advisory Group*

China's Ambitious New Five-Year Plan

The Fifth Plenum, the meeting of the Communist Party's leadership, laid out a vision for the next five years. In the long run, the new plan is supportive of Chinese equities with an already heavy tilt towards preferred high-growth sectors, but in the near term, the US election outcome is critical for the direction of Chinese equities.

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What Happened

China's leadership had a critical policy meeting to draft the 14th five-year plan, covering 2021-2025. The plenum also discussed a comprehensive plan for the next 15 years, with goals that are likely to endure for at least the rest of President Xi Jinping's rule. The final plan is likely to be approved and released during the National People's Congress, which is usually scheduled for the first week of March.

The two key goals of the previous five-year plan: (1) to achieve medium-to-high economic growth rates, and (2) to build a moderately prosperous society, have been accomplished for the most part. China's economic growth rates have averaged 6.6% over the last five years, and incomes have improved significantly, lifting millions out of poverty. This time, the focus has shifted to domestic demand and the quality of economic growth rather than the quantity.

Our Take on Key Initiatives of the Five-Year Plan

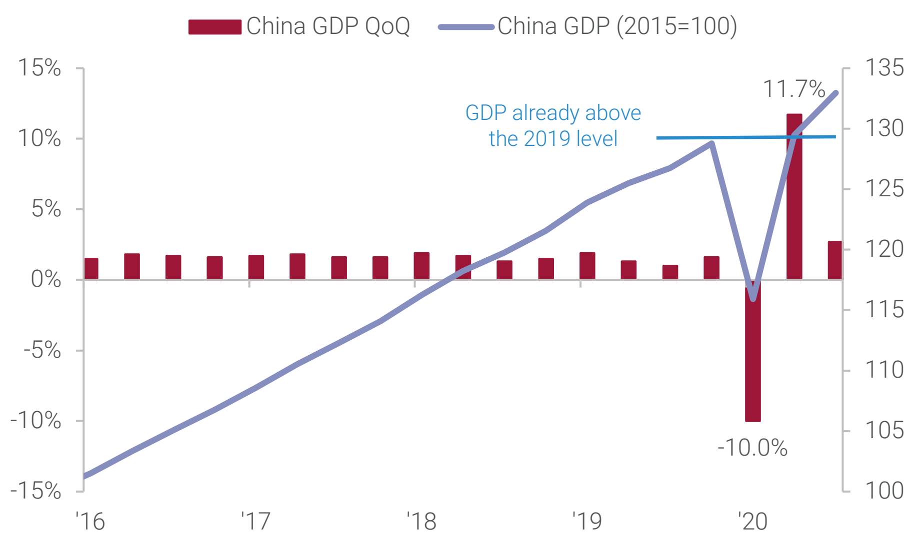
Dual Circulation

The public communique released after the meetings highlighted the importance of an efficient "dual circulation" policy, a balancing act between the importance of the domestic economy and external trade. China has been working on transforming its economy from an export-led to a domestic consumption-based economy. This time the emphasis shifted to "smooth domestic circulation of goods and services" with room for investment and innovation. Due to COVID-19 related disruptions, and more importantly, the trade war with the US, China realized that it also relies on the smooth functioning of global supply chains to operate efficiently. With this new direction, the country aims to become less reliant on overseas markets, specifically on technology. This strategy also re-enforces the "Made in China-2025" program that is already in progress. Therefore, the "dual circulation" concept is not a new economic model; it is mostly reshuffling the importance of and labeling the economic changes that have already happened or are currently happening.

No More GDP Targeting

As many expected, the new five-year plan did not mention a specific economic growth target. With its current trajectory, the Chinese economy is still a candidate to become the world's largest economy within this decade. In Q2 of this year, China's GDP already exceeded its 2019 level, the first major economy to achieve that milestone (Figure 1). Pre-defined growth targets put policymakers in a box to achieve those figures. Shifting importance to the quality or sustainability of growth allows for greater policy flexibility going forward.

Figure 1: China's Real GDP (2015=100) & Quarterly GDP Growth Rate



Data Source: SunTrust IAG, Bloomberg

Carbon Emissions

China has been the world's largest source of carbon emissions since 2004. Last month, President Xi Jinping announced an ambitious plan to make China carbon neutral by 2060. The new plan aims to make significant ecological progress with significant green transformation of production as well as lifestyles in China. To achieve this ambitious plan, China needs to invest substantial amounts to de-carbonize its electricity production and upgrade its electricity grid to transfer its clean energy efficiently. De-carbonization requires more copper, aluminum, iron ore, and other industrial metals for efficient electricity production and distribution. With its strong currency and a favorable economic backdrop, China's imports are on the rise (Figure 2), helping export-oriented economies like Russia, Chile, and Brazil.

Figure 2: Chinese Imports in USD (Year-over-Year % Change)

Data Source: SunTrust IAG, Bloomberg

Geopolitics

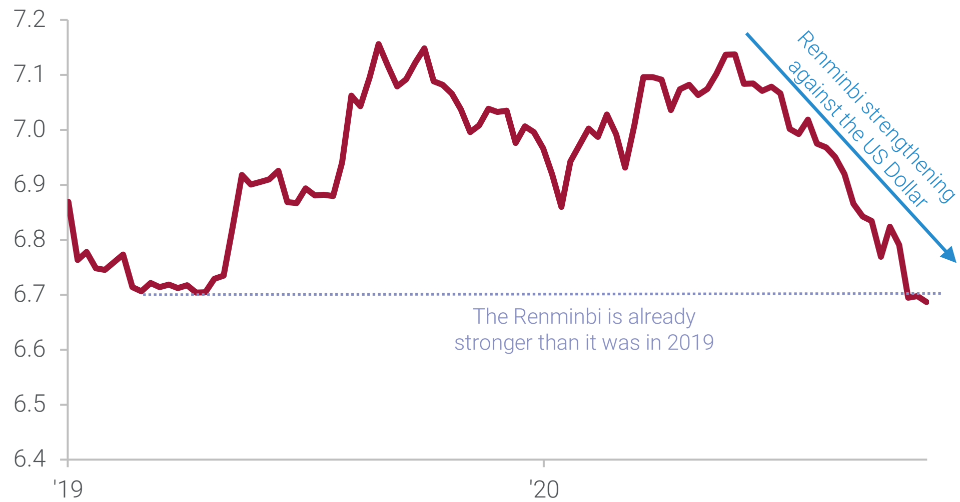
Compared to the previous five-year plan, the authorities decided to de-escalate geopolitical issues related to Hong Kong, Macau, and especially Taiwan. There is still a mention of "reunification of the motherland" related to Taiwan, but it was less pronounced this time. The trade-related tension with the US was mentioned but with no counter recommendations other than the aforementioned "dual circulation" initiatives.

Continued Liberalization

The liberalization of financial markets, relaxing the currency, and capital flows are part of the new plan. It is in China's best interest for the Renminbi to become a global reserve currency or a preferred currency for financial transactions outside of China. To achieve this goal, new steps are needed to improve accessibility to the Renminbi for international investors inside and outside of China's borders, and the new five-year plan aims to address those.

In 2020, the strong economy delivered a stronger Chinese currency (Figure 3). The strength of the currency could continue as China's fight with the coronavirus seems to be much more effective than the rest of the world. With the economy less affected by the virus, significantly less monetary and fiscal stimulus was necessary. Therefore, interest rates in China have stayed relatively elevated. The Renminbi's relative strength is partly driven by much higher interest rates offered in China than the rest of the world, which is expected to continue in 2021.

Figure 3: Chinese Renminbi Exchange Rate (per US Dollar)



Data Source: SunTrust IAG, Bloomberg

Bottom Line

De-carbonization and the ultimate goal of making China self-sufficient, especially in key high growth sectors like artificial intelligence, supercomputing, autonomous vehicles, and fifth-generation (5G) telecommunication technology are expected to become the backbones of China's economic future. In the long run, Chinese equities with an already heavy tilt towards those growth sectors are expected to benefit significantly from the new economic plan's path. Still, the US election outcome is critical for investor sentiment to be favorable for Chinese equities in the near term.

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