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CIO Viewpoint

Pivot to growth focus after China's Communist Party Congress?

Investment Solutions

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The Chinese Communist Party (CCP)'s 20th Congress, which starts on 16 October, is expected to confirm President Xi Jinping for an unprecedented third term in office. In theory, the event just formalises long-planned political retirements and promotions. Yet once confirmed, the appointments should unlock more pragmatic health and industrial policies, improving China's economic and financial market outlook for 2023.

The Congress, which takes place every five years, selects its 200-strong Central Committee that, in turn, chooses leaders in the CCP's Politburo, the top of China's political power. In this process, the CCP will very likely re-elect President Xi as the party's leader, and confirm other key posts at the party that will eventually be echoed at the State Council (cabinet), government ministries, and provincial government level. These proceedings change a swathe of the CCP's Central Committee through promotions, retirements and appointments. While President Xi's third term will set a precedent, the CCP maintains informal nomination and retirement ages and will apply these to renew three-fifths of its Central Committee. Economic policy chief Liu He will retire, and Premier Li Keqiang may do so as he cannot rise further.

These changes create an opening for President Xi and the Politburo to set a new economic narrative after 2022's unexpected challenges. Once the Congress is over, we expect the CCP to signal a pivot back to growth in its economic and public health policies for 2023.

'Second centenary goal'

The CCP, which celebrated its hundredth year in 2021, has a 'second centenary goal' of building China into a 'great modern socialist country' by 2050. The party has also committed itself to the 'doubling' of the size of China's economy by 2035 as an intermediate goal, and that ambition means China will have to maintain growth rates of low-to-mid 4% per year for the decade ahead.

A push may start by relaxing the immediate hurdle of zero-Covid policies. The country of 1.4 billion people has officially recorded little more than 2.8 million Covid infections and 15,400 deaths, a fraction of the toll in the rest of the world. Under the policy, China's authorities tried to stamp out every Covid outbreak with lockdowns, forced isolations and strict travel restrictions. The health policy has also isolated China from the rest of the world. Just 150 international flights landed or took off from China on 3 October, compared with 2,700 the same day three years ago, Bloomberg reported last week.

Stéphane Monier
Chief Investment Officer, Lombard Odier Private Bank

Key takeaways

- The CCP Congress will renew three-fifth of senior posts, while re-electing President Xi Jinping to an unprecedented third term
- Authorities may then shift economic focus to growth, loosen Covid policies, further stabilise the property market, and support domestic industries and demand
- GDP may expand by 3.3% in 2022, and by 5.5% in 2023, depending on the pace of re-opening and further policy support
- The USDRMB exchange rate may continue to weaken, reaching 7.15 over 12 months. We keep our overweight positions in Chinese equities, relative to other emerging markets, and in China's sovereign debt, hedged into USD.

While the restrictions have started to meet resistance among citizens, in some ways, the country had little choice. It has an aging population relatively poorly protected by domestically-developed vaccines. There are limited re-opening steps. The 'special administrative regions' of Hong Kong and Macao have both lifted some restrictions, acting as test-cases for the wider country while some senior CCP officials have travelled or appeared at public events without face masks. If the CCP can relax Covid policy in 2023, one drag on growth and productivity should lift.

Domestic growth drivers, housing

The need for policy shift is not limited to health. With global demand from trading partners for Chinese goods cooling, the country needs domestic growth drivers to offset likely export weakness, and meet economic goals. In areas affected by regulatory crackdowns and macroeconomic austerity, the obvious choice is to ease or even reverse some measures.

Clearly, the government must stabilise the property market, which accounts for more than one-fifth of gross domestic product (GDP). It is also politically sensitive. A large share of Chinese private wealth is locked into home ownership, and new property prices have fallen for the past year. The government has eased mortgage rates, loan access and other home-buying restrictions to shore-up housing demand, and started to allow access to onshore bond markets. There are also reports of the government asking large banks to lend to developers for unfinished projects. We expect such efforts to continue.

The next hurdle is China's trade and industrial policy. China is the world's largest manufacturer, and the globe remains reliant on its machinery exports. For years, China has tried to transition the economy towards more domestic-driven demand. The pandemic has persuaded Western countries of the value in 'onshoring' more raw materials, components and finished goods. Challenging geopolitics, including the Ukraine war, are accelerating the diversification trend away from China while intensifying efforts to become self-sufficient in strategically sensitive technologies. Logically, China will respond with support for industrial activities and investments, and remove the public health policy roadblock.

2023 growth

The Chinese economy expanded 0.4% in the second quarter of 2022, and likely grew in September as the country's purchasing managers' index increased from 49.4 to 50.1 - the first rise in two months - indicating economic expansion. We expect China to record GDP growth of 3.3% in 2022, short of its 5.5% target, and expand by 5.5% in 2023. These forecasts depend on a gradual re-opening starting in early 2023 and further fiscal and monetary policy support.

1. Party Congress marks the start of a new five-year political cycle in China

Source: Lombard Odier

After fiscal austerity equivalent to 4.7% of GDP in 2021, Beijing has added stimulus amounting to 2.9% of GDP, the second-largest level of the past decade after 2020's pandemic support. If growth headwinds intensify over the rest of 2022, the government may spend even more to safeguard a rebound.

In an effort to boost growth, the People's Bank of China (PBoC) has cut lending and interbank lending rates and increased liquidity in the economy even as other central banks tackle high inflation with higher rates. Monetary policy is likely to remain accommodative as China continues to re-structure its property industry and manage declining trade.

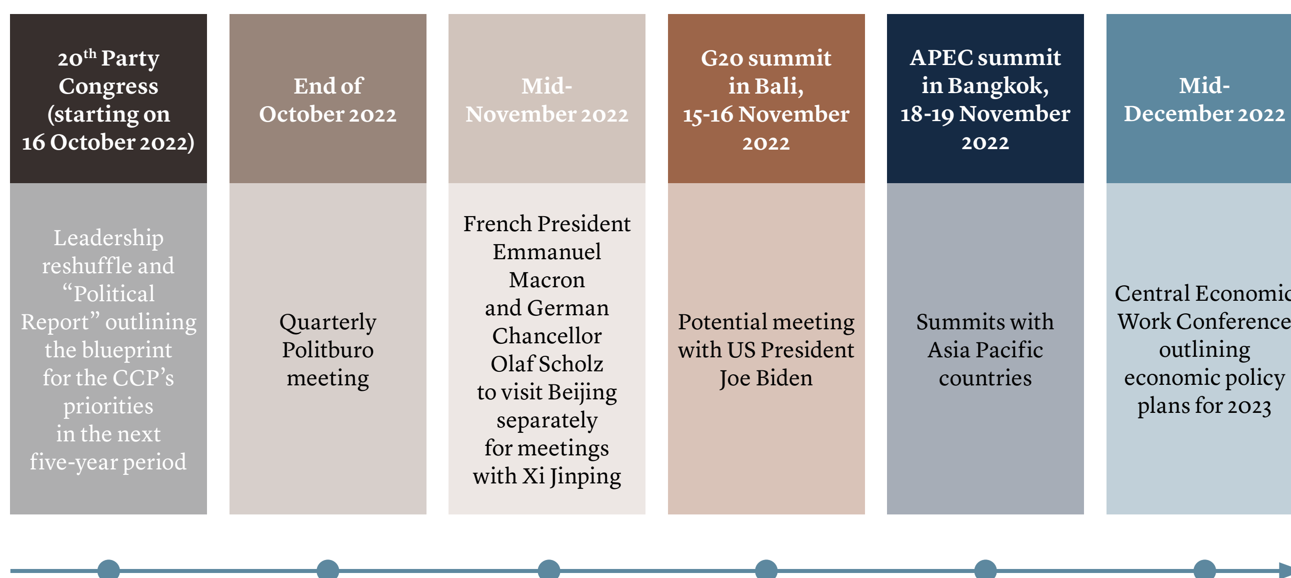
Positioned for re-opening, policy support

For much of the first half of 2022, China enjoyed a current account surplus that reduced the renminbi's sensitivity to the stronger US dollar. However, China has experienced large portfolio outflows as investors sought higher dollar-denominated yields, and more recent weakness in goods exports has undone some of the currency's relative resilience. As a result, the renminbi is now depreciating, in line with many other currencies against the dollar. While we expect more relaxed public health policies to help growth in 2023, Chinese foreign tourism may weaken the renminbi by generating some capital outflows. Recent measures to defend the currency, including the PBoC's setting of exchange rates, all aim to limit the speed of depreciation.

We see the USDRMB exchange rate reaching 7.15 over the next 12 months.

Our portfolios remain positioned to benefit from China's re-opening economy. We have held an overweight position in Chinese equities, relative to other emerging markets, since May 2022. Chinese stocks continue to look attractively priced and the correlation with other global equity markets remains low. We see growth accelerating into next year, thanks to additional fiscal support, and gradually-easing health restrictions. In addition, our renminbi-denominated debt position is currency-hedged, and consistent with the PBoC's position as the only major central bank still managing an accommodative monetary policy.

2. New CCP leadership will have multiple windows to signal its growth focus after the Congress



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SWITZERLAND

GENEVA
Bank Lombard Odier & Co Ltd[1]
Rue de la Corraterie 11 · 1204 Genève · Suisse
geneva@lombardodier.com
Lombard Odier Asset Management (Switzerland) SA
Avenue des Morgines 6 · 1213 Petit-Lancy · Suisse
Support-Client-LOIM@lombardodier.com
Management Company regulated by the FINMA.

FRIBOURG
Banque Lombard Odier & Cie SA · Bureau de Fribourg[1]
Rue de la Banque 3 · 1700 Fribourg · Suisse
fribourg@lombardodier.com

LAUSANNE
Bank Lombard Odier & Co Ltd[1]
Place St-François 11 · 1003 Lausanne · Suisse
lausanne@lombardodier.com

VEVEY
Banque Lombard Odier & Cie SA · Agence de Vevey[1]
Rue Jean-Jacques Rousseau 5 · 1800 Vevey · Suisse
vevey@lombardodier.com

ZURICH
Bank Lombard Odier & Co Ltd[1]
Utoschloss · Utoquai 29-31 · 8008 Zürich · Schweiz
zurich@lombardodier.com

EUROPE

BRUSSELS
Lombard Odier (Europe) S.A. Luxembourg · Belgium branch[2]
Avenue Louise 81 · Box 12 · 1050 Brussels · Belgium
brussels@lombardodier.com
Credit institution supervised in Belgium by the National Bank of Belgium (NBB) and the Financial Services and Markets Authority (FSMA).

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Queensberry House · 3 Old Burlington Street · London W1S 3AB · United Kingdom
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Lombard Odier (Europe) S.A.
291, route d'Arlon · 1150 · Luxembourg · Luxembourg
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Lombard Odier Funds (Europe) S.A.
291, route d'Arlon · 1150 · Luxembourg · Luxembourg
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sao.paulo.office@lombardodier.com
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Bank Lombard Odier & Co Ltd · Representative Office Dubai
Conrad Business Tower · 12th Floor · Sheikh Zayed Road · P.O. Box 212240 · Dubai · UAE
dubai@lombardodier.com
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Israel Representative Office · Bank Lombard Odier & Co Ltd
Alrov Tower 11th floor · 46 Rothschild Blvd. · Tel Aviv 6688312 · Israel · telaviv@lombardodier.com
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JOHANNESBURG
South Africa Representative Office · Bank Lombard Odier & Co Ltd
4 Sandown Valley Crescent · Sandton · Johannesburg 2196 · South Africa · johannesburg@lombardodier.com
Authorised financial services provider Registration number 48505.

NASSAU
Lombard Odier & Cie (Bahamas) Limited
Lyford Cay House · Western Road · P.O. Box N-4938 · Nassau · Bahamas · nassau@lombardodier.com
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PANAMA
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Lombard Odier (Singapore) Ltd.
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Lombard Odier Trust (Japan) Limited
Izumi Garden Tower 41F · 1-6-1 Roppongi, Minato-ku · Tokyo 106-6041 · Japan · tokyo@lombardodier.com
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