

China's new leadership rolls out new blueprint for future development

Business review of China's 19th Party Congress



The 19th National Congress of the ruling Communist Party of China (CPC) which just concluded in Beijing is a landmark event. It represents that the Party has fortified itself with a new theory - the “Xi Jinping Thought on Socialism with Chinese Characteristics for a New Era” and will embark on a journey towards building China into a “great modern socialist country” by 2049. It also marks that the world’s second largest economy stands ready to play a bigger role in shaping the world’s future agenda and to share the “China Solution” with other countries. These developments will not only bring profound impacts on China’s economic and social development in the next 30 years, but also generate significant repercussions at a global scale, given the size of the Chinese economy and its rising influence in the world.





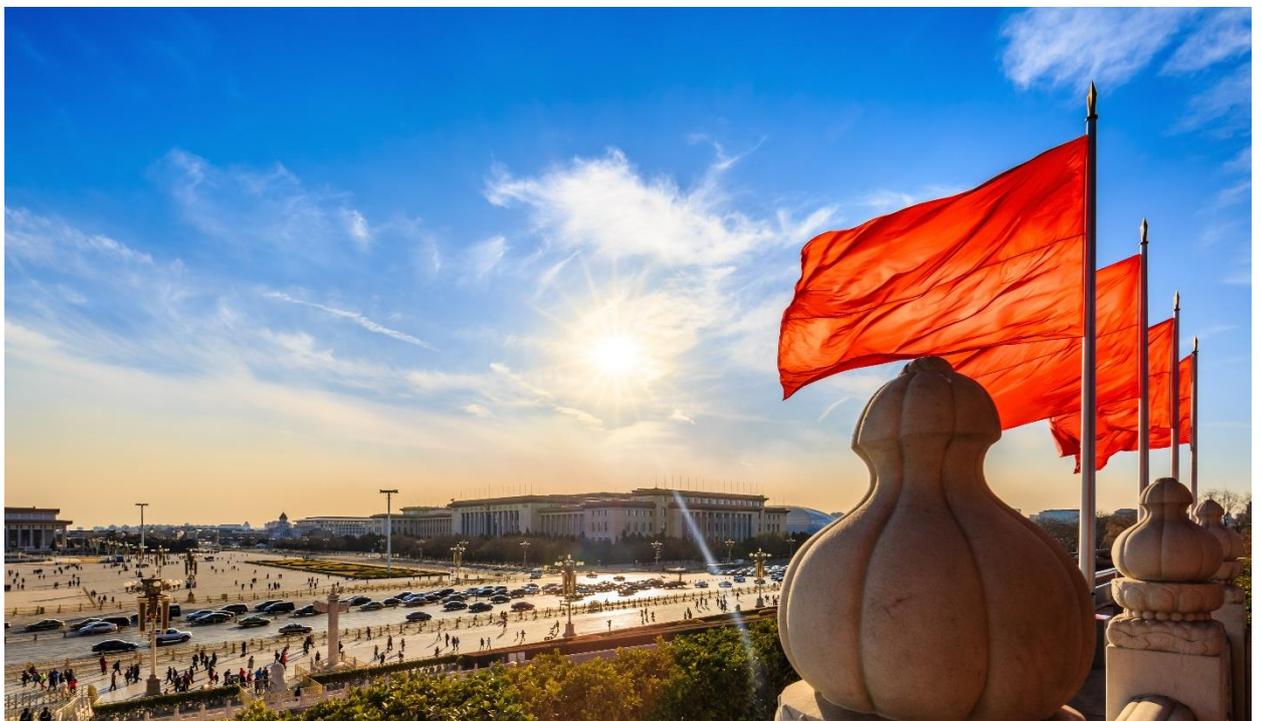
Why is this Party Congress so important?

The 19th CPC National Congress took place at a critical time period in which the timeframes of a few events of historic significance to China will converge:

- By 2020, China is to achieve its target of doubling its real GDP from the 2010 level to turn the country into a “moderately prosperous society” and of eradicating poverty in rural areas,¹ as stipulated in the 13th Five-Year Plan (2016-2020);
- China is on its way to achieving the “two centennial goals” set by the Party two decades ago — building a “moderately prosperous society” by 2021, the centenary of the founding of the CPC, and to become a fully developed nation by 2049, the 100th anniversary of the founding of the People’s Republic;
- The CPC recognises that there is a strong need to amend its constitution to reflect the new governance concepts, thought and strategies developed under General Secretary Xi Jinping over the past five years so to guide the future Party/nation building and fulfilment of the “Chinese dream of national rejuvenation”;

- The Chinese economy, while in transition from one led by exports and investment to an economy that focuses on consumer spending, innovation and services, is facing a series of structural barriers. More rigorous reform measures are needed for the country to reach its potential and avoid falling into the “middle-income trap”;
- Nearly a brand-new top leadership team has emerged as a result of the 19th Party Congress. With the exception of Xi Jinping and Li Keqiang, five out of the seven-member CPC Politburo Standing Committee and around half of the 25 Politburo members have reached their retirement age and been replaced by new faces. This gives Xi a good chance to line up his own team to drive the reform agenda.

The 3.5 hours report delivered by General Secretary Xi Jinping to the Congress is largely regarded as the CPC’s political manifesto under the new era and the mid-and long-term development goals outlined in the report have made clear China’s future direction and focus in the coming 30 years. In this context, the 19th Party Congress carries special weight.



1. According to official figures, China has lifted about 700 million people out of poverty since it began its economic reforms in 1978, but the gap between rich and poor has become quite alarming. By 2016, about 43.3 million rural residents still lived below the nation’s official poverty line of 2,300 yuan (US\$337) a year at 2010 prices, although this is half the level of poverty line by the World Bank’s standard of US\$1.9 per person per day.



What decisions were adopted by the congress?

The 19th Party Congress reviewed the report delivered by Xi Jinping on behalf of the 18th Party Central Committee, discussed the amendments to the Party's Constitution and the report delivered by the CPC's Central Commission for Discipline Inspection. It also elected members of the 19th Party Central Committee and members of the new Central Commission for Discipline Inspection.

Key messages of Xi's report include:

- “Socialism with Chinese characteristics” has entered a new era. The “principal contradiction” in today's Chinese society has evolved to “the contradiction between unbalanced and inadequate development and the people's ever-growing needs for a better life.”² The Party recognises that the needs of the people for a better life range widely from material and cultural growth to demands for democracy, rule of law, fairness and justice, security, and a better environment, and has therefore offered a holistic agenda to address all the issues.
 - To achieve the “two centennial goals”, the Party will adopt a “two-step approach” to build China into a “great modern socialist country” after completing the building of a moderately prosperous society by 2020. The first step is to basically realise socialist modernisation from 2020 to 2035, and the second step is to work for another 15 years to build China into a great modern socialist country that is “prosperous, strong, democratic, culturally advanced, harmonious, and beautiful” by the middle of the 21st century.
 - The overall plan for building socialism with Chinese characteristics is the “five-sphere integrated plan”, i.e. to promote balanced economic, political, cultural, social, and ecological progress; and the overall strategy is the “four-pronged comprehensive strategy”, which refers to building a moderately prosperous society, deepening reform, advancing law-based governance and strengthening Party self-governance. The Party calls for fostering stronger confidence in the path, theory, system, and culture of socialism with Chinese characteristics when advancing the Party agenda.
- As a guide to achieve the goals, the Party lays out “14 fundamental principles”, which are:
 1. ensuring Party leadership over work in all areas of endeavour;
 2. committing to a people-centred approach;
 3. continuing to comprehensively deepen reform;
 4. adopting a new vision for development;
 5. seeing that the people run the country;
 6. ensuring every dimension of governance is law-based;
 7. upholding core socialist values;
 8. ensuring and improving living standards through development;
 9. ensuring harmony between human and nature;
 10. pursuing a holistic approach to national security;
 11. upholding absolute Party leadership over the people's armed forces;
 12. upholding the principle of “one country, two systems” and promoting national reunification;
 13. promoting the building of a community with a shared future for mankind; and
 14. exercising full and rigorous governance over the Party.

These fundamental principles will form the foundation of developing China's roadmap and action plans for future reform and progress.

2. Over the past 30 years, the principal contradiction as defined in China's political jargon has been “the contradiction between the increasing material and cultural needs of the people and the backward social production”. It was first introduced at the 13th CPC National Congress in 1987 and remained intact till now.

- The five guiding principles — innovation, coordination, greenness, openness and inclusiveness — as enshrined in the 13th Five-Year Plan will be adhered to in the whole process.
- In the next three years, priorities will be given to forestall and defuse major risks, especially financial risks; carry out targeted poverty reduction; and prevent and control pollution so to ensure that the goal of building a “moderately prosperous society” will be achieved by 2020, and the people are happy with the results.
- The Party calls for resolve in implementing seven key strategies, i.e. the strategy for invigorating China through science and education; the strategy on developing a quality workforce; the innovation-driven development strategy; the rural vitalisation strategy; the coordinated regional development strategy; the sustainable development strategy; and the military-civilian integration strategy. These strategies are important components of ensuring the realisation of a moderately prosperous society.
- The Party will promote an economy with more effective market mechanisms, dynamic micro-entities, and sound macro-regulation. It will also accelerate the building of an industrial system that promotes coordinated development of the real economy with technological innovation, modern finance and human resources, so to strengthen China’s overall innovation capacity and competitiveness in the world.





On 24th October, the congress approved the addition of “Xi Jinping Thought on Socialism with Chinese Characteristics for a New Era” to the CPC’s constitution, putting it on par with Marxism-Leninism, Mao Zedong Thought, Deng Xiaoping Theory, the Theory of Three Represents, and the Scientific Outlook on Development which already existed in the constitution. Relative to his predecessors, however it represents a unique status as Xi’s name was specifically stated in the title as for Mao and Deng, and more importantly the amendment took place when Xi is still in office, whereas the other theories, except for Mao, were only incorporated into the Party constitution after the relevant leaders had retired.

A wide range of new ideas, thinking and strategies, including the change in the “principal contradiction” facing Chinese society, the “two-step approach” to achieve the “two centennial goals”, the culture of socialism with Chinese characteristics, giving play to the decisive role of market forces in resource allocation, advancing supply-side structural reform, have also been added to the constitution. It clearly spells out that the Xi Jinping Thought will be adhered to and upheld, serving as the guideline of actions on a long-term basis.

On 25th October, the first plenary session of the 19th CPC Central Committee elected a new central leadership. Xi Jinping was re-elected General Secretary of the CPC Central Committee and Chairman of the CPC Central Military Commission.

Zhao Leji, former Minister of the Party’s Organisation Department, was elected head of the CPC’s Central Commission for Discipline Inspection to replace Wang Qishan. This suggests the Party’s rigorous anti-corruption campaign is likely to continue, with new supervision commissions to be set up at national and local levels.

Wang Huning, former secretary of the Secretariat of the CPC Central Committee and head of the Policy Research Office of the CPC Central Committee, was elected the first ranked secretary of the new Secretariat of the CPC Central Committee.

Members of the Standing Committee of the Political Bureau of the CPC Central Committee



Xi Jinping

General Secretary of the Central Committee of the Communist Party of China
Chairman of the CPC Central Military Commission



Li Keqiang

Premier of the State Council



Li Zhanshu



Wang Yang



Wang Huning

The first ranked Secretary of the Secretariat of the CPC Central Committee



Zhao Leji

Secretary of the Communist Party of China Central Commission for Discipline Inspection



Han Zheng

Previous ranking and titles

Li Keqiang

Zhang Dejiang

Chairman of the National People's Congress (NPC) Standing Committee

Yu Zhengsheng

Chairman of the National Committee of the Chinese People's Political Consultative Conference

Liu Yunshan

Wang Qishan

Zhang Gaoli

Executive Vice-Premier

Note: Prior to the election, Li Zhanshu was head of the General Office of the CPC Central Committee; Wang Yang was Vice-Premier of the State Council; Han Zheng was the Party Secretary of Shanghai.



What are the implications for your business?

The economy — The Chinese economy, having gone through “deep and fundamental changes”, in Xi’s words, stands at a crossroad. On the one hand, it achieved an average GDP growth rate of 7.2% - the highest in the world - and contributed around 30% to the world’s GDP growth between 2013 and 2016. In the first three quarters of this year, services accounted for 52.9% of the total GDP and domestic consumption contributed 64.5% to China’s GDP growth, according to latest official data. Thanks to stronger-than-expected growth and supportive government policies in the first three quarters, the International Monetary Fund (IMF) in October raised its forecast for China’s GDP growth in 2017 and 2018 to 6.8% and 6.5% respectively.

On the other hand, the Chinese economy faces many challenges and risks. Among them, rising levels of debt, high cost of production, low returns on investment, persistent industrial overcapacity, high levels of pollution, and property bubbles are sources of concern. But none is easy to fix. For example, the much-in-need supply-side structural reform such as capacity cuts are causing price hikes and squeezing out private investment. And government measures on eliminating speculations in the real estate sector have de facto cooled the property market. This will bring a knock-on effect on GDP performance. It entails high skills to balance growth and reform and maintain an average GDP growth of at least 6.5% for the next three years to ensure the realisation of a moderately prosperous society by 2020.

Going forward, the Party decides to pursue supply-side structural reform as the “main task” and work harder for better quality, higher efficiency and more robust drivers of economic growth through reform. It also calls for new industrialisation, IT application, urbanisation, and agricultural modernisation to go hand in hand. Hopefully these will help provide a clearer direction for future growth.

Financial risk and bad debt — Preventing systemic financial risks has been the focus of attention of the Chinese leadership. At the National Financial Work Conference in July 2017, Xi Jinping stressed that China should treat the deleveraging of state-owned enterprises (SOE) – the major beneficiaries of the banks’ easy credit and main source of bad debt - as “the priority of priorities,” adequately deal with the “zombie enterprises”, and hold officials accountable for a lifetime for building up debt at their respective regions.³

By the end of 2016, China’s overall debt level was 257 percent of GDP, and the non-financial corporate leverage ratio stood at 166.3 percent, relative to the 72.3 percent in the United States, according to BIS data.⁴ In August 2017, the IMF warned that further economic growth led by credit growth could lead to more debt, forecasting that the non-financial sector debt in China could rise to over 290 percent of GDP by 2020.

To address the problems, the 19th Party Congress report calls for “deepening institutional reform in the financial sector, making it better serve the real economy, increasing the proportion of direct financing, and promoting the healthy development of a multilevel capital market.” At a press conference during the 19th Party Congress, Guo Shuqing, Chairman of the China Banking Regulatory Commission (CBRC) pledged to step up supervision of the financial markets by curbing off-balance-sheet debts incurred by local governments and restricting funding sources for property developers.⁵

Amid rising concerns, an imminent systemic financial crisis is unlikely, as China’s rate of non-performing loans remains low by international standards and the Chinese government has significant fiscal buffer and a lot of resources to keep things under control. The new super regulator — the Financial Stability and Development Committee — unveiled in July will also help to improve risk management by coordinating the responses of the supervisory bodies for securities, banking and insurance.

3. The National Financial Work Conference was held in Beijing from July 14 to 15 2017. Xi Jinping, General Secretary of the CPC Central Committee, Chairman of the CPC Central Military Commission and President of the People’s Republic of China, attended the meeting and delivered keynote speech, http://www.gov.cn/xinwen/2017-07/26/content_5213421.htm

4. China continues to lower corporate debt levels, September 26, 2017, http://www.china.org.cn/business/2017-09/26/content_41647440.htm

5. Chief banking regulator vows closer oversight, greater market access, <http://finance.caixin.com/2017-10-19/101158708.html>

RMB and monetary policy — The RMB experienced sharp ups and downs recently, depreciating against the US dollar in real terms from August 2015 to December 2016, triggering the authorities to initiate a number of strong measures to curb rising capital outflow. Then it appreciated against the dollar after entering 2017. Now a new round of depreciation seems to have started in September. Meanwhile the RMB was admitted into the Special Drawing Rights basket of currencies of the IMF, effective from October 2016, marking the RMB status as a global reserve currency.

The 19th Party report calls for “improving the framework of regulation” and making the interest rates and exchange rates “more market-based”. Zhou Xiaochuan, governor of the People’s Bank of China, indicated at a press conference during the 19th Party Congress that the government would reform the generation mechanism for exchange rate, reduce market interventions and steadily improve the availability of RMB assets. He also cited stock connects between Shanghai and Shenzhen with Hong Kong and the recent Shanghai/Hong Kong bond connect in July 2017 as examples of China’s commitment to further opening up.⁶

Going forward, we expect the RMB to experience more two-way fluctuations. In the near term, it could depreciate moderately against the dollar due to overhang of money supply, continued monetary easing and interest rate hike by the US Fed.



SOE reform — SOE reform has become the centrepiece of China’s economic policy. China has given priority to enhancing SOE competitiveness and efficiency through market-oriented reforms and reducing excessive production capacity. There are signs that SOE reform has gathered pace, starting in August with a partial privatisation deal at China Unicom. Over 68% of central SOEs are involved in mixed ownership reform; 34 central SOEs and 136 SOEs at provincial levels have undertaken business restructuring; 92% of SOEs at local levels have established their board of directors; and asset supervision system have been further improved since the 18th Party Congress, according to Xiao Yaqing, head of the State-owned Assets Supervision and Administration Commission of the State Council (SASAC).⁷

Meanwhile, the Party’s influence over SOEs has been increasing, as SOEs are regarded as “important political and material basis” of China’s socialism. According to Xi Jinping’s speech at the Party Building Conference for SOEs in October 2016, state firms and their leaders must remain absolutely loyal to the Party’s cause as “a reliable force that the Party and the nation can trust”. The Party should be “embedded” into corporate governance, with Party officials playing a leading role in the policymaking, implementation and monitoring processes.⁸ It can be expected that this trend will continue after the 19th Party Congress.

The 19th Party Congress report states that the Party will support state capital in “becoming stronger, doing better, and growing bigger”, and turn Chinese enterprises into “world-class, globally competitive firms”. It also says that the Party will work to consolidate and develop the public sector while encouraging, supporting, and guiding the development of the non-public sector. It remains to be seen how SOE expansions will not crowd-out private investment, how to improve SOEs’ returns on investment, and through what mechanisms entrepreneurship and innovation in SOEs are encouraged and flourished.

6. PBOC governor: expand RMB volatility not a top priority, http://www.ce.cn/xwzx/gnsz/gdxw/201710/20/t20171020_26588040.shtml

7. People’s Daily: SOE reform faces deep-rooted contradictions, <https://news.qq.com/a/20171009/002858.htm>

8. Xi Jinping stresses CPC leadership of state-owned enterprises, http://news.xinhuanet.com/politics/2016-10/11/c_1119697415.htm

Private entrepreneurship — China’s private sector contributes to 60% of total GDP, 50% of tax revenues and 80% of employment opportunities. Yet the sector’s growth peaked out in 2011 and plunged in 2016 to a low level. According to official statistics, in the first three quarters this year, fixed investment from the state sector rose by 11% year-on-year, while private investment, accounting for 61% of the total investment, grew by only 6%, slightly better than the annual rate of 3.2% in 2016. Deteriorating investment climate might explain this downward trends. The latest Hurun Report suggests that nearly half of China’s most wealthy individuals are contemplating about migrating to foreign countries.⁹

In response to the situation, the Party and the State Council jointly issued a guideline on encouraging entrepreneurship in September 2017 in a move to spur market confidence. The government vowed to “protect the legal rights and interests of entrepreneurs, ensure fair competition and strengthen protection of intellectual property rights (IPR)”, and introduce a negative list for market access nationwide.¹⁰ Similar messages are recorded in the 19th Party Congress report, which calls for “supporting the growth of private businesses”, and doing away with regulations and practices that impede the development of a unified market and fair competition. While all these measures are in the right direction, time will tell how effective they are in stimulating the vitality of various market entities.

Foreign investment in China and China’s outbound investment — After rapid growths for over two decades, foreign direct investment (FDI) into China has stalled recently, standing at US\$126 billion in 2016. In the first nine months this year, FDI fell by 3.16% year-on-year, according the Ministry of Commerce. There are certainly many reasons for the decline, such as labour-intensive manufacturing companies moving to other low-cost neighbouring countries, termination of cheap land rent contracts and tax deductions, and upgrading of industrial structures at local levels. But a key reason is the accumulated “promise fatigue”, where many

government commitments to further open up to the world and level the playing field are not followed through, as the *European Business in China Position Paper 2017-2018*¹¹ has suggested. In addition to those complaints, foreign companies face difficulties in accessing government subsidies or pilot projects and some may even be forced to make technology transfers in exchange for market access.

The 19th Party Congress report reaffirms that China will not close its door to the world and will only “become more and more open”. It commits to adopt policies to promote high-standard liberalisation and facilitation of trade and investment, significantly “ease market access”, and “protect the legitimate rights and interests” of foreign investors. “All businesses registered in China will be treated equally”, the report declares. Since this time the issues have been elevated to such a high political level, hopefully the situation could significantly improve in real term in the coming years.

While FDI into China has declined, China’s outbound investment also suffered a setback after posting a record level in 2016, with non-financial sectors investment dropping 41.9% year-on-year to US\$78 billion in the first nine months this year, according to the Ministry of Commerce. This is largely the result of increased scrutiny by the authorities around the end of 2016 against “suspicious capital outflows” and “irrational” acquisitions. Going forward, other than the restrictive sectors such as real estate, hotels, film studios, entertainment and sports clubs, we can expect that China’s outbound investment will carry on, especially in high technology, modern manufacturing and modern services sectors.

The 19th Party Congress report calls for “developing new ways of making outbound investments”, promoting international cooperation on production capacity, and forming globally-oriented networks of trade, investment, financing, production, and services. It clearly states that the Belt and Road Initiative will be pursued “as a priority”. In this context, investment into the Belt & Road regions is unlikely to be affected and will grow further.

9. Hurun report: half of China’s millionaires are contemplating about migrating to foreign countries, <http://mp.weixin.qq.com/s/MyONraDY9D6Fuga7dnJFIQ>

10. China Focus: China advocates entrepreneurial spirit to boost innovation 2017-09-25 Xinhua, http://news.xinhuanet.com/english/2017-09/25/c_136637576.htm

11. The *European Business in China – Position Paper (Position Paper)* is the European Chamber’s primary annual publication, <http://www.eurochamber.com.cn/en/publications-position-paper>

Bright spots for future investment — Based on the blueprint the Party has painted for building China into a “great modern socialist country” by 2049, there will be enormous investment opportunities along the way. They could be classified into three broad groups:

- A. Innovation and new technology** — basic research in applied sciences; cutting-edge frontier technologies; modern engineering technologies; disruptive technologies; commercialisation of research findings; new material; infrastructure network; advanced manufacturing; integration of the internet, big data, and artificial intelligence with the real economy; upgrading of traditional industries; medium-high end consumption; the sharing economy; modern supply chains; and human capital services.
- B. Improving people’s wellbeing** — education and training; public culture services; healthcare; elderly care; pension; social insurance platform services; Fitness-for-All programme; Healthy China programme; modern hospital management; preventive medication; traditional Chinese medicine (TCM); food safety; housing rental; social security system management; social governance model development and management; and poverty alleviation/reduction schemes.
- C. Green development/environmental protection** — green technology innovation; green financing; energy conservation; clean production; clean energy; low-carbon economy; circular economy; water conservation; green travel; air pollution control and treatment; water contamination and treatment; soil contamination and treatment; solid waste disposal and management; pollution control monitoring; desertification control; wetland protection and rehabilitation; aerial space planning; disaster prevention; and national park development.





Conclusions

The 19th Party Congress has laid out clear visions, principles and roadmap for China's development in the coming 30 years. Throughout the process, China's new leadership has demonstrated ambition and determination in pursuing a new path of growth with unique Chinese features.

A few important takeaways:

1. The Party will assume “absolute leadership” over work in all areas of endeavour in every part of the country, and advocates “centralised and unified leadership” within the Party with General Secretary Xi Jinping as the “core”;
2. The Party has moved to put more emphasis on “quality and efficiency” of future economic development and purposely set no “quantitative” targets for GDP growth;
3. SOEs, with strong Party and state support, will play a more prominent role in China's future economic drive, while SOE reform will gather pace;
4. Foreign companies and the private sector are expected to enjoy improved market access and fairer treatment as the Party vows to provide a favourable business environment for all types of business entities;
5. The Belt and Road Initiative, representing a China-driven new model of international economic cooperation, is poised to gather new growth momentum;
6. Other than economic growth, the Party has devoted more attention to environmental protection and improving people's livelihood. This more balanced and inclusive approach will not only make China's growth more sustainable, but also open up much more business opportunities to foreign and domestic companies.

According to the past practice, the Party will hold next year the second and third plenary sessions of the CPC Central Committee as well as the annual Central Economic Working Conference to make arrangements on a wide range of issues. In the meantime, the government, led by the State Council, will work to translate the Party's guidelines and targets into detailed implementation plans, and raise them for discussion to the National People's Congress and the Chinese People's Political Consultative Conference which normally convene in March each year.

So stay tuned for much more to come.





PwC Contacts



Frank Lyn

PwC China & Hong Kong
Markets Leader
+86 (10) 6533 2388
frank.lyn@cn.pwc.com



Thomas Leung

PwC China & Hong Kong
Deputy Markets Leader
PwC China South Markets Leader
+86 (10) 6533 2838
thomas.w.leung@cn.pwc.com



Elton Huang

PwC China Central Markets Leader
+86 (10) 2323 3029
frank.lyn@cn.pwc.com



Zhou Xing

PwC China North Markets Leader
+86 (10) 6533 7986
xing.zhou@cn.pwc.com



Allan Zhang

PwC China & Hong Kong
Chief Economist
+86 (10) 6533 7280
allan.zhang@cn.pwc.com

www.pwccn.com

This content is for general information purposes only, and should not be used as a substitute for consultation with professional advisors

© 2017 PwC. All rights reserved. PwC refers to the PwC network and/or one or more of its member firms, each of which is a separate legal entity. Please see www.pwc.com/structure for further details.