

## Fidelity Connects

### China's National Party Congress: Impact and Analysis

**Lynette Ong**, Associate Professor of Political Science at the University of Toronto

**Pamela Ritchie**, Host

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**Announcer:** Hello and welcome to Fidelity Connects, a Fidelity Investments Canada podcast, connecting you to the world of investing and helping you stay ahead.

China's 20<sup>th</sup> Communist Party Congress is set to conclude soon and with President Xi Jinping expected to secure a historical third term, we welcome special guest Lynette Ong to the program, who will help us understand the significance of this event and what it means economically and politically for China.

Ms. Ong is a professor of Political Science at the University of Toronto, author, and China subject matter expert.

Ms. Ong and host Pamela Ritchie look further into the President's words and the implications behind this historic congress. The President touched upon several key matters including the country's zero-COVID policy, the state of their economy, and relations between Taiwan and the West.

Ms. Ong says China's President is putting an emphasis on the economy to foster that stronger security both domestically and internationally. She says if we find a trade-off between economic and security policy that is as great as this one, it will entail de-emphasizing the economy with zero-COVID being the potential source of tension in Taiwan.

Today's podcast was recorded on October 19, 2022

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**Pamela Ritchie:** Lynette, I'd like to begin with the most recent. There's a lot within China's economy that we'd love you to comment on. What did you notice most strikingly that show difference in the opening remarks to this Congress over the weekend?

[00:02:25]

**Lynette Ong:** Several things I think to note about Xi's opening of Congress. First is people have done a word count. The number of times that he has mentioned the word security [*indecipherable*] far exceed that of the economy, which is very unusual in Chinese context because the country and the party that traditionally built its legitimacy on economic growth. But he's moving away that emphasis on the economy, on fostering better and stronger security domestically and internationally.

If we see there's a trade-off, to the extent that there's a trade-off between security policies and economic policies, which I think there are many, many trade-off, this means de-emphasizing the economy, zero-COVID being one, potential tension point in Taiwan and keeping his door closed to foreign investment and continued emphasis on social stability maintenance.

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**Pamela Ritchie:** It's very interesting. You've written not too long ago about sort of what you want to look for within this Congress, within the meeting itself. One of the points that you made was really figuring out who the players are. Is it just rearranging the deck chairs, if you will, or are there new people coming in to new positions and what that means. What do you expect?

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**Lynette Ong:** The Chinese Communist Party has many, many members, millions of them but key seven people really constitute the upper echelons of power. These are the seven people who sit in the Politburo Standing Committee in the previous administration. Five out of these seven people are Xi loyalists, two of them are not. One of them is Premier Li Keqiang whose power has really been weakened and eclipsed by Xi. We expect more or less the same made-up. If there's any change, it could signal that Xi has managed to consolidate power further, let's say, if seven out of seven or all Xi loyalists, but generally we would expect at least one or two people from the rival faction just for him to foster the image that Xi is also interested in party unity, not just consolidation of power. There's actually policy implications.

If we get a very liberal person, which we wouldn't expect someone to come in, if we get a liberal person, someone who is Western educated, we might see the rejuvenation, reinvigoration of liberal economic reform which has been almost dead for the last ten years or so but that sort of scenario is quite unlikely.

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**Pamela Ritchie:** In speaking with you about, perhaps, new individuals, the difference in tone on the economy, there's a shift that you've pointed out in your research moving from leaders within China who have sort of been sharing the spoils, I think is the word that you used, or the idea of kind of sharing the money that's been made in the economy to something a bit different. Can you explain that?

[00:05:33]

**Lynette Ong:** Sure. If you think about how the Chinese Communist Party has been able to buy support among the elite politicians, so people have become very wealthy, millionaire within a decade after reform and opening which created enormous economic opportunities and these people with backdoor access to government contracts, for instance.

It's a system that I would like to think is about spoil sharing. Top leaders share spoils and that sort of spoil sharing is the glue that holds the system together for a long time. But when Xi Jinping came to power ten years ago, the first thing he did was to launch a very ambitious anti-corruption campaign which arrested thousands of people, many of them in a rival faction, which makes it really a campaign that is trying to get rid of his enemies. But I think what that campaign did was it actually also dissolved the glue that holds the system together because people can't do mutual reciprocity and engage in projects that would benefit each other anymore.

What has replaced that sort of foundation of unity is really one of rule by fear. People are loyal to Xi not because they can get rich under Xi but people are afraid that they might get punished and lose their position and get their relatives and sons and daughters into trouble if they are disloyal to Xi. You can imagine it has implications on economic policy. Local officials become overzealous. When you implement zero-COVID people will do all sorts of measures, even unsensible measures, in order to get things done because they are overcautious.

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**Pamela Ritchie:** That's a really interesting point. There are lots of questions about the COVID-zero policy, and I don't know if you have the answers to all of them, but just that idea that so much of it has come at the local level because, perhaps, local officials are so worried about having the most number of COVID numbers in their region, for instance. Just explain that a bit more, if you would.

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**Lynette Ong:** As I explained in my most recent book, *Outsourcing of Repression*, very ambitious everyday policies such as COVID really draws on grassroots volunteers. These people are not necessarily affiliated with the state but they believe in what the government does, especially at the beginning of COVID right before the major resistance in Shanghai. People volunteering their labour, taking temperatures of each resident five times a day, administering various tests and so on. People do believe that they are actually contributing to public good but only up to a certain point. When things become non-sensical they think this is just government going crazy over stability rather than protecting peoples' lives, you start to get resistance and people start to question that. That sort of thing has widespread society implications.

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**Pamela Ritchie:** I guess the follow up question to that is have people resisted?

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**Lynette Ong:** There have been some pockets of resistance. Of course, any sort of resistance is challenging and is risky in China so people have taken their resistance, a lot of them, taken it online. Even with pervasive online censorship, we sometimes see posters openly challenge the regime about why is this policy in place. I can't go to hospitals even though my father is terribly sick because he couldn't produce a vaccine certificate or negative test. Some people have been denied medical care. Some people have actually died and that also daily inconveniences because of zero-COVID. There has been pockets of resistance.

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**Pamela Ritchie:** It really affects the economy. One of the areas that you focus on a lot is the property sector. The property sector is also very tied up in the various levels of government in terms of the development of properties. We know that there have been a piling up of debts that are connected to the property sector. Some think it's been ring fenced to an extent. Can you sort of take us through how actually how much of a cliff it is? What do you think?

[00:10:01]

**Lynette Ong:** Property and real estate-related sector accounts for about 40% of China's GDP. You can imagine how important it is. In a way we can think about it as a value chain or musical chairs. A lot of people buy properties pre-construction and unlike those in Toronto or in Canada, they would pay almost 100% even before they get their properties. The developers, once they get the money, can use the money to go and invest in new projects, so in a way they're taking money before they could give them any property rights or any apartments and they use the money to do something else. That sort of game is fine as long as the economy is going and the music is playing but once the music stops because of economic slowdown, changes in external environment, Xi cracking down on property sector, music stops, a lot of developers, some of them very well known, you thought they are very strong financially have really gotten into trouble.

A owes B money, property sector developers owe construction companies money, construction companies owe migrant workers money and local government, in turn, owes developer money. Once someone along the value chain is in trouble, it affects everyone in the economy.

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What is the end game, no one really knows but I don't think we will see actually a crisis, as such, in the next couple years because I think the party has control over a lot of large, state-owned enterprises that are developers, they will be forced, I think, to absorb the debt of private companies. But that has to come at a cost. Once companies have absorbed all the debt they can't grow as vibrantly anymore. We would expect significant economic slowdown over the next decade. Some people have said around 3% would be quite lucky.

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**Pamela Ritchie:** The debt would be absorbed at the local level meaning it would be domestic and not ... Some of the debt is funded in U.S. dollars, a significant amount, as I understand. Can you comment on that?

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**Lynette Ong:** Most of the debt is domestic in orientation because this is money really from the pockets of households, of individuals, from their savings, so it's really from one part of domestic economy to another part, a transfer between households to companies that are not efficient.

[00:12: 38:]

**Pamela Ritchie:** We'll come back to the real estate and property market as well. When you mentioned what a large piece of the GDP, of the growth, that it is, does more importance get looked at within the equity markets, in fact? Are the equity markets a place to look for other forms of growth, of wealth accrual? How do you see that?

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**Lynette Ong:** I'm not an equity analyst but I would imagine it has implications. It has sectoral implications. I think this is the time to shy away from industries and sectors that are reliant to varying degree on construction. So, people who supply raw materials to construction, wooden products, irons, down the value chain. Any sort of industries, real estate management, property management, that is also very much related to property and that sector. I think they are into a lot of trouble because what has happened is there has been, I think, a significant structural shift. There's a significant decline and that decline has been very, very abrupt. It's about how do you adjust your portfolio quickly enough to, I think, minimize losses.

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**Pamela Ritchie:** Do you see signs that China's relationship with Russia has deteriorated? How would you comment on that?

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**Lynette Ong:** China has interesting relationship with Russia. President Xi has said that Russia is a friend, it's a friendship without any condition. This is what they need to say otherwise China seems very isolated. In the current geopolitical climate, I think China has been increasingly isolated with the U.S. Indo-Pacific Strategy and that from Canada, it seems that we want to make friends in Indo-Pacific and trying to isolate China. China has to be aligning itself with someone else and Russia is definitely a natural partner because of ideological values.

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**Pamela Ritchie:** And on the commodities that it can provide for China?

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**Lynette Ong:** Energy, there are implications for energy prices. China borders a lot of countries in that region. If geopolitically that region becomes unstable, people might be flowing in. It has a lot of implications on border security of China. China is not, in a way, unprepared. I think it is involved in a lot of regional architectural, regional arrangements, to really address those issues if really they do arise.

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**Pamela Ritchie:** Let's do, in fact, go ahead and talk about the U.S. relationship, this particular ... and how it relates to the speech that we saw at the opening of the Congress as well. This question is taking a look at U.S. sanctions. Has it had a significant impact or are they a source of concern? Certainly the demonstration of the types of sanctions that can be put on Russia, I think, have worried countries around the world, what that could do. Is it fair to say that China also is concerned about the way that looks and the overall trade tensions with the U.S.?

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**Lynette Ong:** Yes, but I think China has also been prepared for that for at least a decade. China has been trying to build high-tech industries and they are aware that a lot of semiconductors are coming from the United States and from Taiwan, and they are not their friends. They have been trying to build up their own capacities in that sector. There's also been some black market of semiconductors going on, from what I understand.

This is something that requires very talented, very high-skilled labour force and not an industry that you can build over time. I think, in a sense, there are a couple of things to say. China is aware that their relationship with the U.S. is not good and some of these sectors might be in trouble and they are trying their best to diversify the sources of supply. But it also tells you how entwined the East and the West economy is. This is not another Cold War. China is also well aware that despite all the rhetoric, they cannot do economic decoupling 100%.

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**Pamela Ritchie:** I'm sorry, I didn't interrupt you so much. Did you say it's not another Cold War?

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**Lynette Ong:** This is not another Cold War because there's too much entwinement in economic relationship between China and the West. We can't just draw a line on the sand and say that we want to decouple. A lot of businesses have got value chain across the Pacific. It is really not as easy as it could be done.

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**Pamela Ritchie:** That's so interesting. It's not what the headlines say sometimes, but obviously intertwining economies is good for the peace side of things.

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**Lynette Ong:** Unless you want to close down all your high-tech businesses, which I don't think President Xi is that silly enough, so ill-informed enough, to make that decision.

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**Pamela Ritchie:** Do you see China making... You mentioned alliances and maybe there's isolation that's felt, but do you see stronger alliances? Even further afield, do you see other types of alliances that China is making?

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**Lynette Ong:** With this Belt and Road Initiative, I think the undertone of that is really to buy friends and to isolate Taiwan in the process. It hasn't been that successful. It has received a lot of pushback from democracies such as Australia, Canada, but also from non-democracies for one reason or another.

Because of the debt issue, money has been lent to them at very high interest rates but the intrinsic feature of Chinese foreign investment overseas, a lot of that is actually non-transparent, negotiated with the elite politicians and elite politicians in these nondemocracies or semi-democracies. There's a lot of corruption going on and they don't tell people about it. Once there's a change in government, they go dig up the dirt and get local politicians into trouble and bring very bad press to Chinese investors. Various/This/There is pushback, I think this, actually, will be a lasting legacy of Xi's very ambitious BRI project that things hasn't really gone as smoothly as he has imagined.

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**Pamela Ritchie:** Tell us a little bit about the demographic story in China. I think, as I understand, it is more of an ageing population than it was. Where do you see the birth rate? Can you comment on that?

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**Lynette Ong:** Ageing population is a huge problem. I would probably say the number one constraint in terms of economic growth. Regardless of anything else, people are rapidly ageing even though the government has been trying to reverse its one child policy which has become way too successful and the reversal came way too late.

People are starting to have second child but it takes a long time for that policy really to bear fruit. That, on the one hand, I think your clients who are specializing in health care or other sectors that cater for ageing population, that sector is booming. Even tourism of a particular kind that cater to old people is booming. But this younger population, actually, unemployment rate for the youth has been growing to about 20%. Urban unemployment rate is also growing. These young people are getting restless. They are involved in crime increasingly so. It has economic as well as social implications.

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**Pamela Ritchie:** When you say types of tourism that cater to those who, perhaps, are retired, are we talking cruises? What do you mean by that?

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**Lynette Ong:** We are talking cruises. We are talking about Chinese large tour buses that bring aunties and uncles around to places where they can drink tea and climb some hills. That sort of tourism pre-pandemic was booming.

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**Pamela Ritchie:** I don't know about you, but personally, it took a little while when things reopened to sort of completely come out of the bubble that we'd created in COVID. It's been longer for much of the Chinese population. What do you see on that front? I guess, the stock markets will react the way they react to that but what do you personally think about that? Will it take some time?

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**Lynette Ong:** Yes, I think it will take a long time because while the rest of the world is moving on with COVID with vaccinations and trying to live with COVID. I think the Chinese population is still very, very risk averse. I think, by and large, people do believe in zero-COVID despite the resistance. People do believe that it is the State, the Chinese Communist Party, has the capacity to save peoples' lives.

Once you have that mindset, I think people become very risk averse. They do not want to travel. They do not want to interact with the outside world. Retail will go down. Foreign investors coming in, that sort of tourism, international tourism, will slow down. No one really sees any opening in the next 6, 12 and even 18 months. We actually don't know what the next sign is.

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Six months ago, if you asked people they would say, after the 10th Party Congress, I think it will open up because this is a very politically sensitive time. But right now, if you take a StrawPoll among China observers, I am not sure what sign people are looking for. I think President Xi is very fixated on stability and zero-COVID is not a public health issue, it is a stability issue. It's a stability issue for a security-obsessed Chinese Communist Party.

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**Pamela Ritchie:** One of the areas that certainly was getting an awful lot of attention was the electrification of the world. China's electric car industry was an area that looked like it had a very bright future. What of the decarbonization plans, the green targets that China has had?

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**Lynette Ong:** The environment and the energy sector is not something that I specialize in but my general knowledge is China over the last 20 years have made enormous investment in energy saving, in green tech for two reasons because they realize that they are actually industrializing, so they need a lot of energy. Energy self-sufficiency, like green self-sufficiency, is a security policy, something that the regime who cares about its durability is fixated on.

Number two, green technology has been promoted like other industrial policies. This is a sector that they see tremendous growth in, so there has been active state subsidies to invest in this sector. From what I understand, in the last ten years or so there has been too much investment because central government gives incentives to local governments to invest in those industries. Like all policies in China is often over this overzealous implementation. They would hook up solar panel to show that they have done their jobs but those solar panels are not actually put into proper use. So, a lot of investment but there's also a lot of lack of efficiency.

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**Pamela Ritchie:** Very interesting. It's been fascinating to get your thoughts on various sectors. Is there anything that we haven't really talked about on the property front? You must have so much detail that you could share with us. What do you think is sort of the best thing to let investors know about this industry? I guess they have to wait for a little while on this front but what might....

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**Lynette Ong:** If you think about, people still need housing even though that has slowed down significantly. I would think about efficient use of resources that goes into that sector. Something that I would have to think more about because I don't think about the downstream effects of what is happening at the macro level but alternative channels of resources that allow the industry to grow and to meet the citizens' demands without drawing on so much of the existing resources.

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