For Professional Clients and Institutional Investors Only

New World Insights

16 November 2012

New Chinese leadership unveiled: what to expect next?

- China unveiled the new leadership after the conclusion of the 18th CPC Party Congress
- The change in leadership appears unlikely to cause any significant change to economic policies. Gradual economic reform is expected as outlined in the 12th five-year plan...
- … with focus on reforms to support economic rebalancing and restructuring, ie. financial liberalisation, resources pricing and VAT reform. Urbanisation remains a key theme
- Improving economic outlook provides a generally positive backdrop for the financial markets. Structural reforms are generally positive for the markets in the medium term

New leadership unveiled
At the first plenary meeting of the 18th Central Committee on 15 November, the Communist Party of China (CPC) elected the Politburo and the Politburo Standing Committee (PSC), the core of power, ruling not only the CPC but the entire country. Xi Jinping has taken over from Hu Jintao as the CPC General Secretary and Chairman of the Central Military Commission. He will take over the leadership from Hu as the President in the National People’s Congress (NPC) conference next March.

The CPC also unveiled the seven members of the new PSC. In addition to Xi Jinping, the other members include (by ranking): Lee Keqiang, Zhang Dejiang, Yu Zhengsheng, Liu Yunshan, Wang Qishan and Zhang Gaoli. Li Keqiang is expected to replace Wen Jiabao as the Premier next March.

The composition of the PSC suggest the new leaders are likely pro-stability and focus on building consensus. We do not expect the leadership change to have a significant impact on economic policies. The new leadership will need a few years to consolidate power before they are able to initiate major policy changes. The reform will likely be gradual as in the past, focusing on areas that already have consensus (and ongoing) or are easily to reach consensus. We expect the new leaders to continue the economic agenda as outlined in the 12th five-year plan (2011-15).

Given the mandatory retirement age of 68, five of the seven new members of the PSC – except Xi and Li – are expected to retire after serving one term. So in five years time, there will be another small-scale political transition. There is potential for more bold reforms to be taken in the second term of the Xi-Li leadership.

Policy implications over next 12 months
We do not expect any significant policy stimulus. The economy has showed signs of stabilising so the sense of urgency may have disappeared, at least for the time being. Between now and next March when governmental positions are changing hands, major policy initiatives must be signed off by existing the premier and incoming premier, making it more difficult to make key decisions during this transition period. The new government will have more room to take decisive action, if necessary, to boost growth after March 2013. The next major event is the Central Economic Work Conference in December, which will set the tone of the fiscal and monetary policy for 2013. We expect the government to keep an expansionary fiscal policy and stable monetary policy. The existing property policy will likely remain intact.

Key targets for the next decade
The CPC at party congress set a new target to double real GDP between 2010 and 2020, implying a compound annual growth rate of 6.9% in 2012-20. This confirms the official willingness to tolerate a more moderate growth in future as it pushes forward the critical economic rebalancing and restructuring needed to achieve a more balanced and sustainable growth over the long term. This is also consistent with the 7% growth target outlined in the 12th five-year plan.

Members of China’s new Politburo Standing Committee

<table>
<thead>
<tr>
<th>Name</th>
<th>Age</th>
<th>New position (named or expected)</th>
<th>Local experience</th>
</tr>
</thead>
<tbody>
<tr>
<td>Xi Jinping</td>
<td>59</td>
<td>Party Secretary General and upcoming President</td>
<td>Fujian, Zhejiang, Shanghai</td>
</tr>
<tr>
<td>Li Keqiang</td>
<td>57</td>
<td>Upcoming Premier</td>
<td>Liaoning, Heilong</td>
</tr>
<tr>
<td>Zhang Dejiang</td>
<td>66</td>
<td>Chairman of National People's Congress (NPC)</td>
<td>Zhejiang, Guangdong, Jilin</td>
</tr>
<tr>
<td>Yu Zhengsheng</td>
<td>67</td>
<td>President of CPPCC</td>
<td>Shanghai, Hubei</td>
</tr>
<tr>
<td>Liu Yunshan</td>
<td>65</td>
<td></td>
<td>Inner Mongolia</td>
</tr>
<tr>
<td>Wang Qishan</td>
<td>64</td>
<td>Head of Party Disciplinary Commission</td>
<td>Hainan, Beijing</td>
</tr>
<tr>
<td>Zhang Gaoli</td>
<td>66</td>
<td></td>
<td>Shandong, Tianjin</td>
</tr>
</tbody>
</table>

Note: CPPCC = Chinese People’s Political Consultative Conference
Source: Citi and Chinese government website

In the media briefing, Xi Jinping emphasised the importance of improving social welfare for the population, including better education, rising incomes, a more reliable social safety net, and higher quality healthcare service. His speech suggested that the new leaders are likely to focus more on the quality than the speed of growth and economic reforms will focus on tackling the economic imbalances, particularly to boost consumption.
For the first time, China has set out explicit targets on labour income, which is to double per capita income for both urban and rural residents by 2020. This shows the greater emphasis on boosting consumption as the government seeks to reorient its growth model toward more consumption driven from heavy reliance on investment and exports. The CPC also promises to narrow the income gap and focus more on environment protection.

Economic reforms
The Party pledged market-oriented reforms with the market assuming a more important role, indicating a broad-based deregulation could be expected. More specifically, China will allow market forces to have a bigger role in resource allocation. This implies that the post-transition policy priorities will likely be continued financial reforms (financial deregulation including the liberalisation of interest rates and Chinese renminbi internalisation, for example) and pricing reforms (in areas such as gas, oil and power). The depressed (state-controlled) domestic factor prices (including costs for capital, resources prices, etc) were largely behind the excessive investment (in some industries) and inefficiency of resources allocation and utilisation.

The Party also mentioned that private businesses should enjoy equal access to markets, factors of production and the protection of law. This was consistent with the government’s move to invite private investment in their restructuring as well as opening some previously state-controlled sectors to private investment. These sectors include railways, municipal administration, energy, healthcare, education, finance and telecommunications.

Urbanisation will remain a key theme. The 16th party congress in 2002 set out a goal to reach a 50% urbanisation rate by 2020, which was already achieved in 2011 (51.3%). However, the incoming premier Li Keqian recently mentioned that the actual urbanisation rate in China is only 35% due to the lack or residency (‘hukou’ or household registration) of the city migrants. This suggests that the initiatives will likely be more about fair treatment of migrant workers and farmers. Reform of the hukou system will help promote equal access to resources and services across urban and rural areas, different regions of the country and different groups of people and could also help to facilitate objectives such as income equity, a more extensive social safety net, faster urbanisation and improved productivity.

Tax reform is another area where we may see more progress, with the VAT reform one of the initiatives that have a high degree of consensus among policymakers. The reform of replacing the business turnover tax with value-added tax should help to reduce the corporate tax burden for small-and-medium-sized enterprises and benefit the services sector (the manufacturing/exporting sector has been largely paying VAT).

Investment implications
Despite the initial negative reaction, investors will likely refocus on economic and corporate fundamentals after the political uncertainty of leadership transition is removed. An improving economic outlook should provide a generally positive backdrop for the financial markets, although external headwinds could result in volatility. The Central Economic Working Conference in December will be an important economic event to watch for policy initiatives for 2013 from a market perspective. The new leaders’ remarks at the conference could reveal more details on their plans for policy shifts and structural reforms.

Structural reforms are generally positive for the economy and markets in the medium term. For example, capital market liberalisation could make it easier for Chinese companies to buy foreign companies and expand global market shares as well as pave the way for further opening up of China’s equity and debt markets to foreign investors. Initiatives to develop the bond market will increase investment alternatives and broaden the investor base.

From the macro fundamental views, sectors that are related to China’s economic rebalancing and restructuring themes, such as consumption/autos, gas, healthcare, education, insurance, wealth management, insurance, industrial automation, water treatment, innovation and technology, connectivity of inland-coastal provinces (infrastructure), could potentially benefit over the medium-to-long term.

Renee Chen
Investment Strategist, Macro & Investment Strategy
HSBC Global Asset Management
Important Information: For Professional Clients within all countries except USA & Canada and for Professional / Institutional Investors within the USA & Canada. This document should not be distributed to or relied upon by Retail clients/investors.

The contents of this document may not be reproduced or further distributed to any person or entity, whether in whole or in part, for any purpose. All non-authorised reproduction or use of this document will be the responsibility of the user and may lead to legal proceedings. The material contained in this document is for general information purposes only and does not constitute advice or a recommendation to buy or sell investments. Some of the statements contained in this document may be considered forward looking statements which provide current expectations or forecasts of future events. Such forward looking statements are not guarantees of future performance or events and involve risks and uncertainties. Actual results may differ materially from those described in such forward-looking statements as a result of various factors. We do not undertake any obligation to update the forward-looking statements contained herein, or to update the reasons why actual results could differ from those projected in the forward-looking statements. This document has no contractual value and is not by any means intended as a solicitation, nor a recommendation for the purchase or sale of any financial instrument in any jurisdiction in which such an offer is not lawful. The views and opinions expressed herein are those of HSBC Global Asset Management Macro & Investment Strategy Unit at the time of preparation, and are subject to change at any time. These views may not necessarily indicate current portfolios' composition. Individual portfolios managed by HSBC Global Asset Management primarily reflect individual clients' objectives, risk preferences, time horizon, and market liquidity.

The value of investments and the income from them can go down as well as up and investors may not get back the amount originally invested. Past performance contained in this document is not a reliable indicator of future performance whilst any forecasts, projections and simulations contained herein should not be relied upon as an indication of future results. Where overseas investments are held the rate of currency exchange may cause the value of such investments to go down as well as up. Investments in emerging markets are by their nature higher risk and potentially more volatile than those inherent in established markets. Economies in Emerging Markets generally are heavily dependent upon international trade and, accordingly, have been and may continue to be affected adversely by trade barriers, exchange controls, managed adjustments in relative currency values and other protectionist measures imposed or negotiated by the countries with which they trade. These economies also have been and may continue to be affected adversely by economic conditions in the countries in which they trade.

We accept no responsibility for the accuracy and/or completeness of any third party information obtained from sources we believe to be reliable but which have not been independently verified.

HSBC Global Asset Management is the brand name for the asset management business of HSBC Group. The above communication is distributed by the following entities: in the UK by HSBC Global Asset Management (UK) Limited, who are authorised and regulated by the Financial Services Authority; in Jersey by HSBC Global Asset Management (International) Limited which is regulated by the Jersey Financial Services Commission for Fund Services & Investment Business and is licensed by the Guernsey Financial Services Commission for Collective Investments & Investment Business. HSBC Global Asset Management (International) Limited is registered in Jersey under registration number 29656 with its registered office at HSBC House, Esplanade, St Helier, Jersey JE4. HSBC Bank plc acts as settlement agent to HSBC Global Asset Management (International) Limited. Approved for issue in the UK by HSBC Global Asset Management (UK) Limited; in France by HSBC Global Asset Management (France), a Portfolio Management Company authorised by the French regulatory authority AMF (no. GP99026); in Germany by HSBC Global Asset Management (Deutschland) which is regulated by BaFin; in Hong Kong by HSBC Global Asset Management (Hong Kong) Limited, which is regulated by the Securities and Futures Commission; in Canada by HSBC Global Asset Management (Canada) Limited which is registered in all provinces of Canada except Prince Edward Island; in Malta by HSBC Global Asset Management (Malta) Limited, which is licensed to provide investment services in Malta by the Malta Financial Services Authority; in Bermuda by HSBC Global Asset Management (Bermuda) Limited, of 6 Front Street, Hamilton, Bermuda which is licensed to conduct investment business by the Bermuda Monetary Authority; in United States by HSBC Global Asset Management (USA) which is regulated by the Securities and Exchange Commission; in United Arab Emirates, Qatar, Bahrain, Oman, Jordan, Lebanon by HSBC Bank Middle East Limited which is regulated by Jersey Financial Services Commission and in Singapore by HSBC Global Asset Management (Singapore) Limited, which is regulated by the Monetary Authority of Singapore (HSBC Global Asset Management (Singapore) Limited, or its ultimate and intermediate holding companies, subsidiaries, affiliates, clients, directors and/or staff may, at anytime, have a position in the markets referred herein, and may buy or sell securities, currencies, or any other financial instruments in such markets. HSBC Global Asset Management (Singapore) Limited is an Exempt Financial Adviser and has been granted specific exemption under Regulation 36 of the Financial Advisers Regulation from complying with Sections 25 to 29, 32, 34 and 36 of the Financial Advisers Act).

Copyright © HSBC Global Asset Management Limited 2012. All rights reserved. No part of this publication may be reproduced, stored in a retrieval system, or transmitted, on any form or by any means, electronic, mechanical, photocopying, recording, or otherwise, without the prior written permission of HSBC Global Asset Management Limited. PP12-1777