Xi Thought: Our Thoughts on What it Means for Investors in Asia

Chinese President Xi Jinping casting his vote for a constitutional amendment to abolish presidential term limits.
Photo source: Reuters

On March 11, 2018, 3,000 delegates gathered in the Great Hall of the People in Beijing and voted to abolish the two-term limit on the Chinese presidency. The vote passed almost unanimously with only two dissenting votes. This announcement was met swiftly by predominantly negative reports in the Western media prompting claims of "Chairman Mao 2.0" and fears that China would be returning to the dangerous days of strongman rule. In our view, Xi's crystallization of power actually lowers the medium term risk in China. His firm grip on power actually brings stability to the Chinese leadership which we have not seen since 2002 when Jiang Zemin retired as Chinese President and Party Secretary of the Chinese Communist Party. In other words, if you were sold on investing in China before, you should be even more gung-ho on investing in China today.

First, political continuity bodes well for China's overall economy. As former Foreign Minister of Singapore George Yeo put it so succinctly, "Today, [China] is the only major country which can exercise a national will." A streamlined top-down approach allows President Xi to push through tough policies—such as supply side reforms in the steel and coal industry—without having to compromise with formerly powerful factions. The Chinese Communist Party's legitimacy rests on its implicit economic pact with the Chinese people, who give up political freedoms in exchange for a rising standard of living. According to Edelman's 2018 Trust Barometer, China's trust in its government clocks in at 84% (the highest ranking out of the surveyed countries) compared to the US at 33%.[1] Steady and sustainable development remains of utmost importance to the legitimacy of the CCP.

Abolishing the "age norms" which state that leaders cannot serve a new term after age 68, means that Xi is now free to serve a third term as president once his second term ends in 2022 (Xi will be 69 at that point). The same goes for Wang Qishan too, Xi's newly appointed Vice President and former anti-corruption czar, who is already age 69 this year. Harvard-educated Liu He was also recently appointed as one of China's four vice-premiers and is in charge of economic policies and financial issues. Political continuity should provide Liu He with a long runway to pursue reforms, focusing on slower but more sustainable consumption-based growth rather than export-led growth that had fueled China's rise over the previous four decades. Continuity also gives officials and companies confidence to push forth with long-term projects such as the US$1.3 trillion-dollar Belt and Road Initiative.

Wang Qishan (left) and President Xi at the National People's Congress in Beijing in March 2015.
Photo source: Reuters

Second, stable leadership also suggests lower geopolitical risk. No institution has been spared from Xi's massive anti-corruption campaign, least of all the Central Military Commission. Xu Caihou, one of the top generals in the Chinese army, was found guilty of taking massive bribes in exchange for helping others gain promotions. So much so in fact that when prosecutors searched his luxury home in Beijing in 2014, they had to call more than 10 military trucks to confiscate the piles of cash, rare antiques and precious gems that were found. Corruption was also found to be endemic in the procurement department where embezzlement and taking bribes for contracts was rampant. Prior to Xi's crackdown, being a hardliner was good for business as corrupt generals could have instigated an "incident" to push China down a sub-optimal geopolitical path in exchange for personal gain. Xi's consolidation of power within

[1] *2018 Edelman Trust Barometer Global Report.* The Trust Index is an average of a market's trust in the institutions of government, business, media and NGOs. General population, 28 -market global total.

the People's Liberation Army (PLA) signals that the risk of an unintentional or miscalculated war has decreased.

Yet another positive move is the elevation of Foreign Minister Wang Yi to the Central Committee of the Chinese Politburo, the first in 20 years, since Qian Qichen relinquished his role as Foreign Minister in 1998. This is a clear signal that the current Chinese leaders are taking matters of diplomacy and foreign affairs very seriously. This is timely amid talks of potential trade wars with the US and tensions with North Korea. As the tweet from China Xinhua News below shows, China is making efforts to improve ties with its neighbours, especially with Japan whose relationship has been strained over the latter's wartime occupation of the former's territories. The two nations signed a pact in May calling for regular meetings between their defence officials as well as enforcing a mechanism for their naval vessels to communicate at sea, thereby averting maritime incidents.

Japanese Prime Minister Shinzo Abe holds a welcome ceremony for visiting Chinese Premier Li Keqiang before their talks in Tokyo, Japan, on May 9, 2018.
Photo source: Twitter

At a time when world leaders are championing unilateralism and populism, Xi has strongly advocated for greater market access and new measures to expand reform. During his keynote speech at the Boao Forum (also known as Asia's Davos) on April 10, Xi unveiled his vision for the global economy including lowering tariffs on goods such as automobiles as well as improving the investment environment for foreign investors. Though talks of trade wars between the US and China could potentially be destabilizing, we are hopeful that the impact would be limited.

We would be remiss not to mention North Korea. When we visited this topic in last year's newsletter "How Worried Should We Be About North Korea?" tensions were high as China showed its displeasure with THAAD (Terminal High Altitude Area Defense) by banning Chinese travel agencies from selling tour packages to South Korea. At the time many were concerned with the economic fallout Korea would face as a result of the travel ban. Credit Suisse predicted in March 2017 that if the travel ban were left in place, this would have a severely detrimental effect on the Korean economy, shaving 20% off Korea's GDP growth that year[2].

We reported in our newsletter that while short-term volatility was anticipated, over the long-term we expected tensions and markets to normalize. We are now seeing the return of big spending Chinese tourists to South Korea. According to *Aju Business Daily*, major department stores in South Korea saw a sharp spike in revenue from Chinese shoppers during the recent May Day holiday. Hyundai Department Store in particular saw the total amount of Chinese tourists increase by over 80% from the same one-week period last year, while its Trading Centre branch in Seoul saw a huge increase of 174%.[3] Although major Chinese tour groups have not yet resumed selling tour packages to Korea, individual tourists are returning en masse and we are confident that sentiment for tour groups will soon follow.

Shoppers in the Myeongdong area of Seoul, South Korea, on May 18, 2017.
Photo source: Reuters

Of course the big news is the proposed Trump-Kim summit scheduled to be held in our backyard. Although Kim Jong Un has threatened to call off the high-level talks several times over joint military exercises between the US and South Korea, this is not an unexpected move as it follows the same patterns we have come to expect each time military exercises occur. Our South Korean fund managers share our sentiments. They are feeling confident about the relationship between North and South Korea. In their view, they believe Kim Jong Un sees normalizing relationships with South Korea as his best shot of preserving his authority and his family's safety in North Korea. All in all, North Asia geopolitical prospects show more promise today compared to the last decade.

[2] *"*Korea: China's travel ban may impact GDP growth by 0.5pp*" Credit Suisse*, 6 March 2017.
[3] "Big-spending Chinese tourists start returning to South Korea," *South China Morning Post,* 10 May 2018.