China’s gamble on the Xi factor

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Most analysts believe the freshly-anointed new leaders of the Communist party are likely to embark on cautious reform

Michael Sheridan in Hong Kong Published: 18 November 2012

Red letter day: 18th congress hostesses at Beijing’s Great Hall of the People (How Hwee Young)

CHINA has a new board of directors and a new chief executive after the next leaders of the Communist party, a line-up of men in suits and red ties, stepped into the limelight last week.

The group was immediately labelled “conservative” in snap media reactions but the prospects for a fresh round of economic reforms are better than they appear, according to analysts in the Asian markets.

Headed by Xi Jinping, 59, the seven leaders who emerged at the end of the party’s 18th congress make up the standing committee of the politburo.

“In terms of economic policy, the standing committee decides everything, from setting GDP growth targets to establishing investment policy,” according to Fidelity Worldwide Investment.

Although Chinese politics is opaque, by most calculations the committee divides four to three in favour of cautious reformers.

Xi will become the most powerful leader for a decade. He will inherit the post of state president in 2013, adding to his status as head of the party and chief of the military. That will give him clout.

“He will be in a much stronger position to push forward change and may follow a balanced, but still reformist, agenda,” said analysts at North Square Blue Oak, an investment bank that specialises in China.

At his side will be Li Keqiang, a reformer expected to become premier and nominal chief of economic policy.

Both can probably count on the support of Wang Qishan, a well-regarded former banker, and Yu Zhengsheng, who comes to the standing committee from ruling China’s commercial centre, Shanghai.

Two “members of the board” will be staunch defenders of the state sector and socialist orthodoxy. They are the North Korea-trained economist, Zhang Dejiang, and propaganda chief Liu Yunshan.

The seventh man is “floating voter” Zhang Gaoli, whom critics blame for a state-run investment binge that built a financial district from scratch in the city of Tianjin, leaving it heavily in debt.

Yet Chinese analysts say Zhang is a weather vane: he ran the freewheeling city of Shenzhen and forged economic links with South Korea and Japan when in charge of the northeast province of Shandong.

One conundrum is that the standing committee operates by consensus and no outsider knows how much weight Xi will carry in its councils.

The seven face immediate challenges. Growth in China is slowing down and analysts at Standard Chartered say it could fall to 3% or 4% without fresh reforms to roll back the state sector and inject market forces into the economy.

The Shanghai stock market has already rendered the investors’ verdict on the “lost decade” under the outgoing leader, Hu Jintao. The composite index is down 18% this year and China is the worst performer among its Bric rivals, Brazil, Russia and India.

China’s new chief executive may well borrow from Lenin and ask: what is to be done?

An important pointer can be found deep in the turgid text of the main resolution passed by the 18th congress. It called itself “a guiding Marxist document” but also outlined elements of the reformist manifesto. It spoke of the need to speed up change in China’s growth model, and of the party’s aim to “fire all types of market participants with new vigour” through innovation-led development. Tellingly, it referred to “developing the open economy”.

“This will make economic development driven more by domestic demand, especially consumer demand, by a modern service industry,” said the resolution.

It endorsed “sustained and sound development” in a nod to those, such as outgoing premier Wen Jiabao, who have opposed China’s export-driven dash for growth at any cost.

It also paid lip service to making “progress in building a resource-conserving and environmentally friendly society”.

The new leaders confront a growing urban class ready to take to the streets to protest about environmental ruin and to oppose polluting projects.

China’s new leader Xi Jinping (Lintao Zhang)

Recent demonstrations in the port of Ningbo frightened local officials into postponing a petrochemical plant.

There has also been a flourishing policy argument among economists during the congress. An article in the People’s Daily, the party mouthpiece, trumpeted the claim that incomes for city dwellers and farmers increased 1.8 times between 2002 and 2011.

This was challenged in a blog by Shi Hanbing, an editor at Shanghai Securities News, who said: “People’s incomes did increase but their buying power did not. Yet the government’s tax revenue grew twice as fast as GDP and many state investments are a burden on the people because their costs are high and profits are low."

The future of China's gigantic state enterprises, which dominate the economy under managers appointed by the party, will be a crucial test.

"China has six fevers and one of them is the fever of state and centrally controlled enterprises," said Li Zuojun, an economist, in a speech at the China Social Sciences Academy.

"Their annual income is equal to the total income for all middle and small enterprises in the country. These monopoly industrial companies are widening the income gap. Telecoms, electric power, petroleum, chemical and financial industries are gaining abnormal profits thanks to their monopoly privileges."

Li predicted China could face "a social crisis" unless the gap between rich and poor was closed. He said the government would be forced to let the property bubble deflate, plunging banks and local governments into a debt spiral that could result in bankruptcies and defaults as early as next year.

Such pessimism is not universal. Hong Kong investment bank analysts generally give members of the new standing committee good marks for economic management.

China's growth slowed to 7.4% in the third quarter, the lowest for about three years. The authorities cut interest rates but have not opened the money tap the way they did during the 2008 financial crisis.

A slew of recent statistics on industrial production, exports and retail sales suggested the economy was picking up again.

The Chinese currency, the yuan or renminbi, has more or less stayed at 6.2 to the US dollar, giving an overall rise of 33% against the greenback since 2005.

This has defused some of the trade tensions with America, but there will be tough bargaining when Obama's second-term team has to be faced.

Chinese officials will probably plead heavy domestic preoccupations for the next year or two. A debate is in progress over liberalisation of bank interest rates, staunchly resisted by state-owned banks that profit from fixed margins and by state industries that get cheap finance. Entrepreneurs want change, saying the effect is to choke the private sector.

In an example cited by Bloomberg News, a state-owned construction firm in Tianjin was able to raise $481m at 4.36% through a one-year bond recently while private businesses in the city can face an annual loan rate of 26%.

It is an emblematic case in the liberal campaign to roll back the power and privilege of the state behemoths.

More is at stake than macro-economic policy. In the next few months, foreign governments and businesses will watch a changing of the guard across the top bureaucratic echelons of Chinese trade, finance, industry and regulation.

China will probably get a new finance minister to replace Xie Xuren and a new governor of the central bank to take over from Zhou Xiaochuan, who is well regarded in global financial circles.

His likely successors at the People's Bank of China include commercially minded reformers such as the top banking regulator, Shang Fulin, and the chief securities regulator Guo Shuqing.

In a sign the new leadership may be attuned to financial market opinion, Lou Jiwei, chairman of China Investment Corp, the sovereign wealth fund, was appointed to the party's 205-strong central committee.

"We are not complacent and we will never rest on our laurels," said Xi in his first address as leader of the Chinese people, pledging "continued efforts to free up our minds" and to carry out reform and to open up.

The economics of the casino

How accurate are China's growth figures? It's a question that vexes analysts and investors all over the world.

China releases GDP growth and inflation numbers through the National Bureau of Statistics every month. But the man about to take over running the economy, Li Keqiang, once told American officials that the figures were not much more than an indication.

Still, many regions of China have beaten official GDP targets with growth of 15% and more.

This year, the worries are on the downside. China is aiming for 7.6% growth despite fears for the global economy.

So which figures are helpful? Investors watch purchasing managers' indexes, collected by institutions such as HSBC, to get a sense of business confidence. Some track electricity consumption. Commodity analysts look at demand for iron ore, coal or rare earths. This year, all these indicators have pointed to a slowdown.

Less scientific but more fun are sales of luxury goods, and casino revenues in the gambling enclave of Macau. Both are down, but that could mean fewer bribes are being paid out after the crackdown on corruption.

For the moment, he has the benefit of the doubt.