HUTONG RESEARCH

China Politics
What Will Shape China's Policymaking in 2024

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- Premier Li Qiang's greater role in economic policymaking bodes well for China's growth, but other recent appointees with conflicting priorities could limit his efficacy
- The primacy of national security and a lack of policy coordination also obscure China's commitment to economic development
- Beijing will likely set the 2024 GDP growth target at "around 5%", as it views the economy more positively than a year ago
- It will also pursue structural adjustment, with a focus on resolving local debt issues and upgrading the industrial sector
- Though elections in the US and mutual de-risking pose challenges for China's foreign policy, a "strategic pause" will stabilize US-China relations

With 2024 upon us and Xi Jinping's third term underway, it is time to ask big questions about the country's policy trajectory. There, as elsewhere in the world, a new balance between political and economic priorities is increasingly discernible, and this has resulted in a gulf between the expectations and realities of 2023. To predict and comprehend what will happen in 2024, we must examine several key trends and conditions.

Elite power dynamics

Understanding China's leadership dynamics has always been key to interpreting its policies, but this has never been so essential as now. This is due to extensive power restructuring over the past decade, especially Xi's installation of confidantes in the Politburo in 2022 and the State Council in 2023.

The most important question is the role of premier Li Qiang, whom Xi has given more power and autonomy on economic policymaking. This was evident in December 2023 at the Central Economic Work Conference (CEWC), the Party's most important annual economic policy conference, on the second day of which Xi left for an unrelated trip to Vietnam.

Though Xi's attendance in all CEWC sessions was never formally expected, his early departure signaled high trust in Li's ability to execute Xi's vision and convey guidance faithfully in his absence. Leaving Li to preside alone over sessions of the CEWC, attended by all ministerial and provincial leaders, sent a powerful message.

Xi also appointed Li inaugural chair of the Central Financial Commission (CFC)—the most important decision-making body aimed at aligning the financial sector with Xi's overall economic vision, and the first party central commission not chaired by Xi himself since their establishment in 2018. We anticipate that Li will also be selected to chair the new Central Science and Technology Commission, envisioned as a *primus inter pares* in driving innovation and the acquisition of industry knowledge on "stranglehold" technologies.

Li's greater role in economic policymaking could, however, be offset or even confounded by other senior leaders appointed around the same time. These others may interpret Xi's

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economic vision differently and be disincentivized from coordinating with Li's economic policies given their greater accountability on noneconomic priorities.

Most noteworthy is Cai Qi, the first leader in the Party's history to serve simultaneously as a Politburo Standing Committee (PBSC) member, Central Committee Secretariat (CCS) first secretary, and Central Committee General Office (CCGO) director. This makes him central in not only highest-level party decision-making but also the daily operational management of all central party organs such as the Central Financial and Economic Affairs Commission (CFEAC) and CFC.

As CCS first secretary, Cai is responsible for managing the Party's ideological works and ensuring that Xi's orders are accurately disseminated to and through all party echelons. Thus, he will emphasize and give paramount importance to Xi's vision and direct instructions, as well as prioritize matters of ideology and national security over economic ones.

Vice premier Ding Xuexiang may also be less interested in economic growth than Li, especially if requiring any tradeoffs from the more sensitive portfolios—climate change, Hong Kong, and Macau—that Ding covers.

He Lifeng, the vice premier charged with economic and financial matters, could also hinder Li's effectiveness. He Lifeng is a more typical party cadre with a background mostly in local government. He has had little to no direct exposure to national economic policymaking, financial regulation, or US-China relations—all now within his portfolio. His lack of public addresses to date since acceding to his role further impedes attempts by markets and other observers to interpret and anticipate his activities.

All this contrasts with his predecessor, Liu He, who spent his entire career on economic policymaking in the central government, studied at the Harvard Kennedy School, speaks fluent English, and is a known quantity to market observers.

Development vs. security

These leadership dynamics will ultimately influence how Beijing balances "development" against "security". Since Xi first proclaimed that "development must be secure" in the April 2022 Politburo meeting, the phrase has become a sword of Damocles that hangs over all officials' heads and portends serious consequences for neglecting security in the pursuit of growth. Moreover, Xi's "holistic approach to national security" is an expansive one now covering over 20 types of conventional and unconventional security concerns.

We identify two key implications from the phrase. **First, China's strategic economic choices can be viewed as articulations and indicators of its national security concerns.** In practice, the security establishment—including the "conventional" security agencies and the "unconventional" ones like the Cyberspace Administration of China operating in tandem—could have a greater say and take the front row in driving development in sectors like artificial intelligence (AI) and semiconductors.

Second, China lacks a clear overarching framework to coordinate between its economic and security priorities, which are executed by different and segmented officials and bodies. While Li Qiang is tasked with driving development and ensuring consistency between economic and noneconomic policies, he has limited command over matters solely under the dome of security.

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A recent draft rule on online gaming is a case in point: Just days after Xi's promise of more policy coordination and consistency at the CEWC, said rule took a hammer to gaming firms' business model and caused their stock prices to plunge. Regulators, however, likely believed that the costs and market fallout were justified in countering the negative health and societal impacts of online gaming. This demonstrates that security and matters of political or ideological importance may still override and even disrupt Beijing's own attempts to coordinate policies more effectively.

GDP growth target

China's main metric for economic policymaking will be progress towards its annual GDP growth target. Beijing announces these targets every March during sessions of the National People's Congress and Chinese People's Political Consultative Conference (the "Two Sessions"). Many question the relevance of this target, believing that Beijing no longer has sufficient will and / or tools to pursue it.

However, we do not believe that Beijing's toolbox is empty: It could increase fiscal spending by raising the deficit target above 3% or by issuing more bonds. The former could stimulate consumption via cash handouts and / or social benefits, while the latter could support more infrastructure investment. Beijing could also cut interest rates further or offer more decisive assistance to the property market, such as by nationalizing troubled private developers.

The correct question is whether and / or when Beijing will choose to take such actions—and we believe that this depends on its own perceptions about economic performance and not the market's. For 2023, market observers had hoped for nearly 6% annual growth earl in the year and were disappointed by the approximate 5% ultimately achieved—but 5% had been the government's own target for the year and was thus successfully met.

We expect a growth target "around 5%", as Beijing views the economy more positively than a year ago. At the recent CEWC, top leaders cited more "favorable conditions than unfavorable ones" for the economy. Though they acknowledged challenges such as "insufficient demand" and "weak confidence", this wording sounded less concerning than last year's mentions of "shrinking demand" and "weakening confidence".

If a target "around 5%" begins to seem unattainable, Beijing will likely boost policy support, but not necessarily at the Two Sessions. After all, Q1 data will not be available until mid-April, and Beijing will have other opportunities to administer additional assistance, including the quarterly Politburo meetings. China will also have more space to act after the US Federal Reserve starts to cut interest rates, likely in the summer.

"Establishing the new before abolishing the old"

The CEWC also put greater focus on structural adjustments in the Chinese economy by enshrining "establishing the new before abolishing the old" as one of the guiding principles for policymaking in 2024.

This phrase signals a gradualist approach to addressing China's most pressing economic problems: the real-estate market collapse and local debt crises. In 2023, China sold 960mn sqm in residential housing—40% down from the peak figure but still unsustainably high. As

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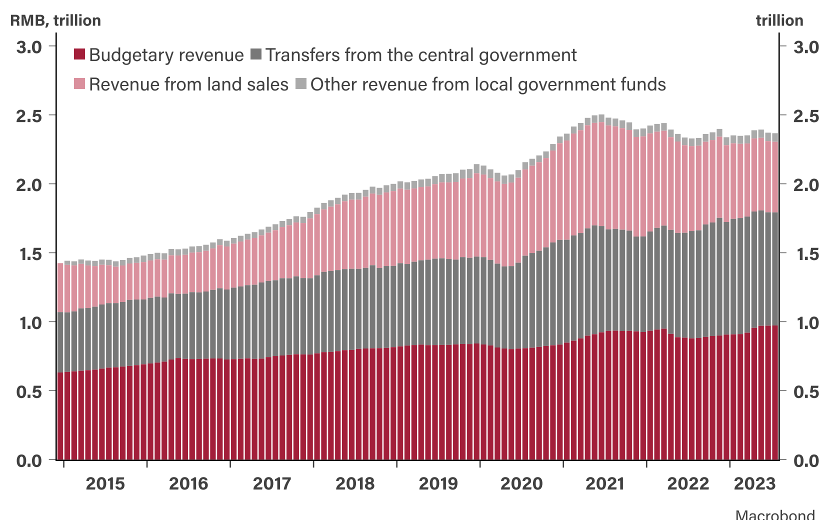
the population shrinks, we expect annual sales under 900mn sqm going forward, or 5-10% below current levels. This decline will starve local governments of revenue from land sales and trigger other significant risks for China's financial system.

In the near term, the phrase will amount to more financial help for local governments to finish ongoing development projects and to restructure their debts. This will allow China's economy to land softly and forestall a crash, as well as align with Xi's ideal of "common prosperity", which is meant to be inclusive of all provinces and local jurisdictions.

In the longer term, we anticipate fiscal reforms to boost local governments' revenue and lessen their spending obligations. Currently, local governments receive only 50% of China's total fiscal revenues but disburse more than 80% of its expenditures; this difference must be covered using transfer payments from the central government or the sale of public land. The imbalance has become increasingly precarious as land sales fall along with the property market and expenditures rise in relation to an aging population.



The CEWC promised to explore new fiscal reforms, and there already seems to be progress: China's National Development and Reform Commission recently disclosed that such reform plans have already been issued to several provincial governments. The Ministry of Finance also pledged to assist local governments in expanding their tax bases.

Beijing's commitment to fiscal reform is also evident in the appointment of its new finance minister, Lan Fo'an. As early as 1997, he recommended clearer boundaries between central and local financial powers, more discipline in fund transfers between the two, and a tax system that enables local governments to break even.

Beyond that, the CEWC has also called for the proactive pursuit of higher-quality growth—particularly policies in support of innovation, industrial upgrades, a green transition, and a digital economy. **In other words, Beijing sees the high-tech industrial sectors as a new engine for growth.**

This is a sensible choice from Beijing's perspective. First, China has had extensive success in industrial development, as evidenced by its becoming the world's manufacturing hub. An industrial upgrade will also be critical in raising China's productivity and competitiveness

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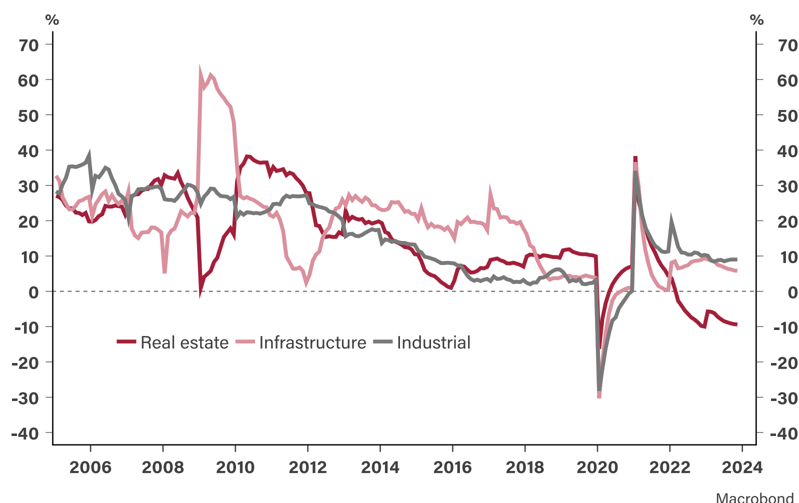
and enabling its long-term growth. Already, China has made great strides in electric vehicles and renewable energy.

The key question for 2024 will thus be whether high-tech industries can grow quickly enough to offset the diminution of real estate. If industrial and infrastructure investment grow at rates in the high single digits, as was the case in 2023, and if the fall in real estate investment slows, China's total investment may accelerate. As well, the likely increase in industrial profits from their 2023 depths may cascade into more growth in employment, wages, and consumption later in the year. If so, growth around 5% is not improbable.



US-China relations and global elections

Geopolitics will also have an outsized impact on Beijing's policymaking, in particular its relations with Taipei and Washington. The latter two will both hold elections this year, adding a layer of uncertainty as to who exactly will be standing on the international stage.

More imminent are Taiwan's elections, scheduled for this very month. Beijing appears to anticipate a victory by the ruling, pro-independence Democratic Progressive Party (DPP). It has already revoked certain favorable tariff policies towards Taiwan as an apparent form of pre-emptive punishment.
The US presidential elections are much later, in November, and no change of power would formally occur until January 2025. Campaigning is already well underway, however, and contingencies will likely dominate China's strategy towards the US just as much as China will pervade US campaign rhetoric.

The outcome of the US elections is uncertain, too. **If Republicans gain majorities in both chambers of Congress and retake the White House, tensions over both trade and Taiwan would resurge, thus raising medium- and longer-term geopolitical challenges for China.** In contrast, a second term for president Biden would likely keep the US-China relationship on its current trajectory.

Beijing will seek to minimize risks by stabilizing relations and sustaining engagement with the US. Namely, we expect president Xi to honor the consensuses reached with Biden during

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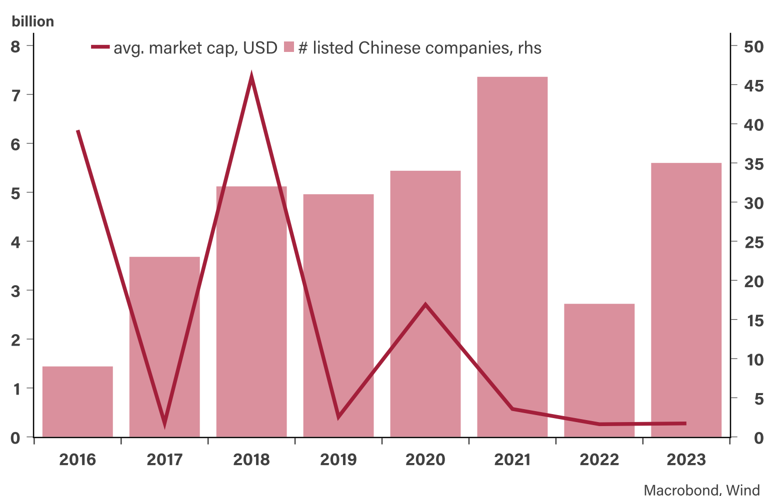
the Asia-Pacific Economic Cooperation (APEC) summit in November 2023. China will also likely refrain from actions that could significantly aggravate bilateral tensions.

In Washington, the Biden administration instituted several competitive and / or restrictive economic policies aimed at China, including the CHIPS and Science Act (CHIPS Act) and high-tech export controls. **Now, we believe that the US will seek to maintain a "strategic pause" and similarly avoid any significant escalation of tensions**, which could in turn impinge on Biden's electoral prospects if China were to retaliate harshly.

Official lines of communication between the two governments will likely remain open, and high-level meetings are expected to continue. For example, US treasury secretary Janet Yellen is scheduled to visit China in the first half of the year, and China's recent appointment of a new defense minister satisfied the necessary condition for top-level military dialogues.

This greater stability will afford companies more bandwidth for business over political risks in 2024. In 2023, only 35 Chinese entities completed initial public offerings (IPOs) on US stock exchanges, with the lowest average IPO valuation in years. We expect both figures to go up this year. Chinese companies under political attack in the US may also see better prospects: TikTok, especially, may find a lifeline in its utility as a campaign channel for the Democrats.



The "strategic pause" will not, however, slow the broader trend of the US "de-risking" from China, and we expect a continuation of export controls and import bans. Corporate subsidies available under the CHIPS Act and Inflation Reduction Act feature sourcing requirements that exclude China-originating components. On- and friend-shoring of critical supply chains by US companies will also continue.

In turn, we likewise expect Chinese companies to continue relocating their own operations and supply chains to Southeast Asia and parts of the Americas outside of the US, especially key juncture markets like Vietnam and Mexico, which could lead to another year of robust outbound direct investment for China.

This is not the only way in which China is mirroring the US, as Beijing is developing its own export-control regime for critical materials. Along with supply-chain migration, such measures will further complicate US-China trade relations.

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Though often overlooked, the outcomes of European elections at both EU and national levels throughout 2024 will also impact China. The EU has expressed increasing intolerance of its trade deficit with China and already launched various trade investigations related to Chinese goods. **It is possible that the EU will initiate more investigations and impose punitive trade measures against China even before elections take place.** This sets the stage for a trade war unless the political landscape substantially changes.

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