



PLMR China Briefing 2021: The Story So Far

Foreword

For those in the UK with investments in China, the past six months have required nerves of steel.

Unprecedented levels of Chinese state intervention in the economy, whether in curbing education related Chinese businesses, or new rejuvenated clarity in the aim to ensure that Chinese economic growth benefits the many and not just the few, and the ongoing taming of Chinese tech tycoons have led to huge falls in many China-related funds and equities. Furthermore as we go to press, the British media remains full of coverage on the woes of Evergrande, the Chinese property giant that is pushing the maxim "too big to fail" to the absolute limit. It looks in desperate trouble.

It's not all bad news. As COP approaches, we hope that a substantial Chinese delegation will attend in Glasgow to continue the spreading of the strong messages on climate change that have of late come out of Beijing. Whatever the latest on global political discussions, it remains the case that China is a hugely valued economic partner to the UK and climate change will not be tackled without the full involvement of and leadership by China.

We have talked in previous reports of the ongoing reality that China and Chinese investment play a significant role in the UK economy. It is in this overall context that we publish our latest update on China and its major economic and political trends as we approach Winter 2021. We hope you find this latest report, drawn up by PLMR Team Members expert in all things Chinese, helpful.

For more details of what we do please see our website [here](#).

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Section 1: China: H1 2021 in review

Section 2: US – China and power dynamics

Section 3: Diplomatic Exchanges

Section 4: Cooperation and Competition

Section 5: National development and policy challenges

Section 5: COVID-19 and the Chinese Economy

Section 6: Economic advantage and trade policy



China: H1 2021 in review

In 2020, China's economy experienced its first quarterly contraction in 20 years and yet, the face of the global COVID-19 pandemic, it recovered and became the only major economy to experience growth that year. President Xi Jinping's handling of the pandemic, with strict lockdowns and widespread testing and extensive border restrictions saw his domestic support rise and the economy bounced back. National spirit grew as pride for China's comparatively deft management was set against policy confusion elsewhere in the world and Xi took a forceful stance in the face of US pressure. Obviously our perceptions in the West were different – but this was the prevailing domestic position on Chinese home soil.

The incoming administration of President Joe Biden presented an opportunity to alleviate some of the tensions in the bilateral relationship and seek areas for cooperation amidst the inevitable competition. In H1 2021, Beijing has sought to navigate its leading role in the international arena and has indicated its support for a rebalance of global power to accommodate China as an equal in addressing global challenges.

Furthermore, Beijing has sought to navigate economic strategy as China's national development moves to a new model. Economic policymakers have faced opportunity, contradictions, and complexity in H1 2021 and they have pursued flexibility in their approach. The COVID-19 pandemic, trade relationships, and geopolitical complexities provide the backdrop for economic policy planning for years to come.



US – China and power dynamics

In the first half of 2021, China grappled with its evolving role in the international arena against the backdrop of an increasingly volatile external environment. Beijing welcomed the incoming Biden administration, not with an expectation that the US would soften in its stance but only that it would be more consistent. Xi and Biden have a shared history that predates Biden's current role as US President. It is said that there is a mutual respect between the two and this was highlighted during their first conversation after Biden's inauguration in early February 2021 when they reminisced about their meetings as vice presidents. In that call and in other high-level talks since there has been a willingness to engage. Beijing views the bilateral relationship as highly nuanced, there are some areas of consensus as well as an undoubted and continued sense of tension.

Diplomatic Exchanges

The first senior level meetings between the Chinese leadership and the Biden administration were held on 18 and 19th March 2021 in Anchorage, Alaska. In their opening remarks, Director of the Office of the Central Commission for Foreign Affairs Yang Jiechi and US Secretary of State Antony Blinken veered into a public spat. The event was widely reported in the global press with headlines such as "The US and China trade angry words at high-level talks in Alaska"¹ and "US and China trade barbs at start of Alaska meeting"². Experts suggest that the meetings on the following day were more civil and even productive, with both sides committing to reduce the tensions, however, the initial exchange did nothing to quell assumptions regarding the intentions of either party.

The following week, Foreign Minister Wang Yi and his Russian counterpart Sergei Lavrov held a meeting in Guilin, China during which they stressed the strong spirit of cooperation between the two countries. The tone of the meeting served as a stark juxtaposition to the public element of the China – US Anchorage talks. The two leaders banded together to eschew international criticism and the US-led international order. Notably they issued a joint statement offering an alternative vision for global governance.

Concerns over the depth of collaboration and coordination between the two countries were fuelled by the timing of military action from both parties as Russian troops assembled along the border with Ukraine and China conducted exercises around Taiwan. Beijing is not naïve to Russia's waning role as a global power, officials believe that the relationship will go some way to bolstering China's own position in the global power dynamic. Furthermore, China's leadership is firm in its intentions to recognise the support that Moscow has extended to it on certain key issues.



1 BBC

2 Financial Times



At the Boao Forum for Asia³ in April 2021, President Xi Jinping made a statement reflecting China's expectation of equal treatment and an equal role in the international arena. He appealed for a revised system of global governance whereby the evolving political and economic landscapes were taken into account and more accurately reflected. He stressed the importance of the UN and the WTO and their critical global roles. He called for extensive consultation and the input of all countries on world affairs. A pointed comment in his speech rejecting the universal imposition of rules set by a single or small handful of countries was clearly aimed at Washington but it also reflected a genuine drive toward a more representative global order. China's leadership wants to convey sincerity in its dismissal of hegemony and in its calls for big countries to act with a sense of responsibility and not purely in their own pursuit for power. Beijing sees no contradiction between this and Xi's position that China should be paid the regard it is due in the evolving global landscape.

While Washington and the global media seem convinced that Beijing is attempting to destabilise the US, key Chinese contacts maintain the reality is more nuanced. It may seem hard for us in the West to understand, but China's leadership considers itself to be acting from a position of defence rather than attack, anticipating increasing US efforts to destabilise China. Beijing will continue to seek ways to bolster against being undermined or isolated by the US but even though China has made no secret of seeking a greater role in the global landscape, it is a misassumption that the intention is to displace the US and take its mantle. That will come as a surprise to many. This more benign view of China was certainly one characterized by UK Government policy in the already distant Cameron/ Osborne era.

Cooperation and Competition

Beijing is taking a dual track approach to the US – China relationship, separating out those areas of anticipated competition and challenge such as the origins of the coronavirus pandemic and the governance of Hong Kong from those topics which present possibilities for cooperation such as trade and climate change.

Climate change: A priority for both leaders, climate change has been identified as an area for positive collaboration between the two powers. In his opening speech at the Boao forum, Xi stated that China and the US have found common ground in this space and had agreed terms for cooperation on matters concerning the global climate crisis. Experts suggest that US Envoy for Climate Change John Kerry's visit to Shanghai in April contributed to this positive strand in the bilateral relationship. His meetings with counterpart Xie Zhenhua along with other senior officials were positive and highly constructive.

Trade: Though there has been tension in the bilateral trade relationship over the past few years, communication in the first half of 2021 between Vice Premier Liu He and US Treasury Secretary Janet Yellen on 26th May and with US Trade Representative Katherine Tai on 1st June had a mollifying effect for both sides. Where China had found Trump's administration to be punitive, Officials assess Biden's team to be approaching the trade relationship in a more collaborative spirit. That said, Beijing had not anticipated significant change in US trade policy measures from the Biden administration or for the conversations to result in any substantive agreements – so in that sense these meetings met expectations – such as they were.

China's exports have not been significantly affected by US tariffs and China's broader trade policy has taken continued trade restrictions into account. The Biden administration offers stability in place of the volatility that existed in the US' prior approach and Beijing values this more highly than the removal of trade tariffs.

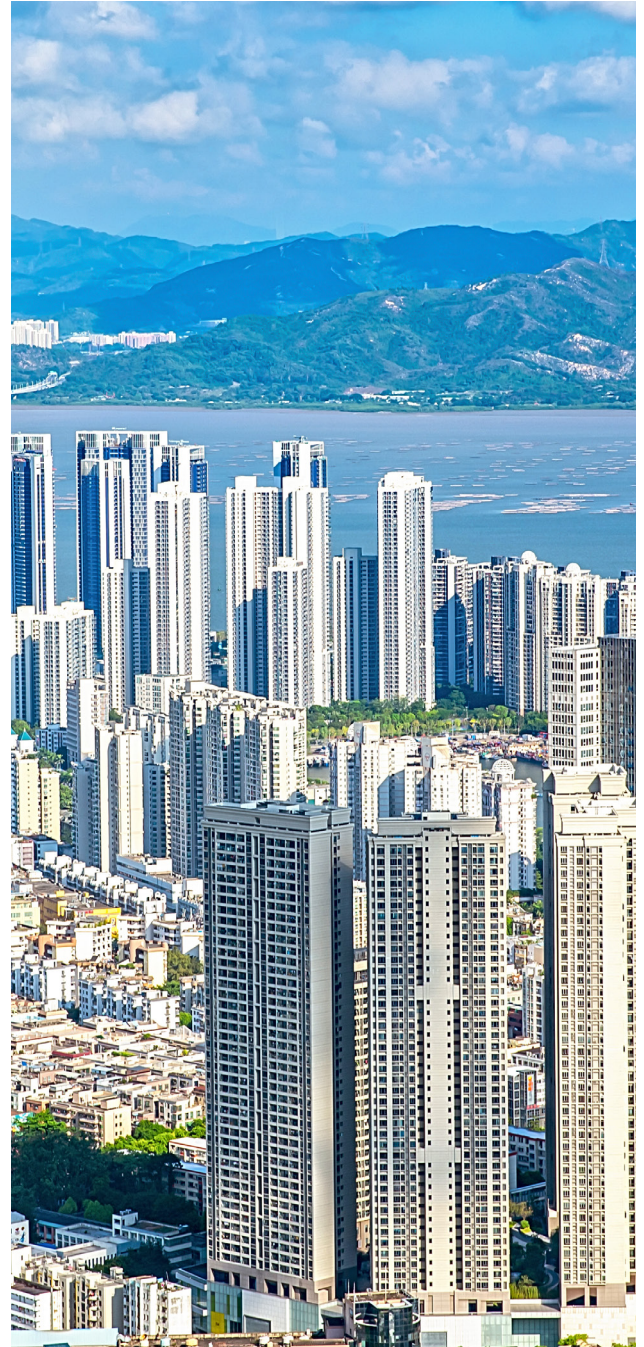
³ The Boao Forum for Asia is a non-profit organisation that hosts governments, business leaders, and academics at high-level conferences on regional and global issues. In 2021, the forum titled "A World in Change: Join Hands to Strengthen Global Governance and Advance Belt and Road Cooperation" was held between 18 and 21 April in Hainan, China.

COVID-19 origins: Potentially problematic areas of the bilateral relationship include Biden's revival of the investigations into the origins of the coronavirus pandemic. Both in public and in private circles, China's officials adamantly deny international claims that the virus originated or came about due to an accidental leak at the Wuhan Institute of Virology. Nevertheless, experts suggest that the investigation has provoked concerns amongst China's leadership that the investigation could be used as a political tool to pressure China by inciting a slew of unsubstantiated lawsuits from countries around the world.

Medical coordination: China's approach throughout the pandemic has been one collaboration and in the first half of 2021, Xi called for improved global coordination, knowledge and resource sharing, and governance in the fight against the pandemic. China's government support the global removal of patents and royalty payments for relevant vaccines, equipment and treatments but this has been met with refusal from the US and Europe, where most of the patents originate, due to a reluctance to disincentivise pharmaceutical companies.

Olympic games: There are concerns amongst policy makers that tensions could see the Beijing 2022 Winter Olympics impacted. Apprehensions are focused on a possible US-led diplomatic boycott which would represent a loss of face for China and its leadership. Cancelling the games entirely would also represent a loss of face thus it is rumoured that Beijing has made it a priority that the games go ahead no matter what and is working with the International Olympic Committee (IOC) to try to mitigate against these possibilities.

Hong Kong: The reform of Hong Kong's governance continues to be a thorn in the bilateral relationship and indeed in China's broader global affairs. In March the National People's Congress (NPC) took the decision to expand Hong Kong's Election Committee and from 1200 to 1500 members, with nominations for a large portion of the new seats by pro-Beijing organisations. A change to Hong Kong's Legislative Council (LegCo) was also agreed, with the new formation of 90 seats rather than the previous 70 and with a greater proportion elected by the Election Committee. It is widely assessed that the NPC's aim was to ensure a pro-Beijing majority on the Election Committee. Since 30 June 2020⁴, Beijing has sought to stamp out any sign of dissent and considers these efforts along with the current and potential future governance reforms to be critical to Hong Kong's stability and, in turn, its future prosperity. In turn, to many in the outside world, the lack of Western-style democracy in Hong Kong continues to grate.



⁴ The National Security Law for Hong Kong was introduced on 30 June 2020 after months of pro-democracy protests.

National development and policy challenges

As mentioned in previous PLMR China Reports - The 14th Five Year Plan (2021 – 2025) was announced at the National People's Congress (NPC) in March 2021. The Five-Year Plan (FYP) outlines the main priorities and themes for China's economic and social development for the period. It highlights changes in policy approach and serves as an indicator, both domestically and to the outside world, of China's ambitions and trajectory.

The 14th FYP focuses on a move from investment-led growth to a model based on innovation and consumption; the dual circulation strategy which is intended to improve interaction between domestic circulation and the external environment, enhance domestic consumption and manage the impact of external forces, and open China's economy to healthy competition. It reflects the leadership's assessment that any truly sustainable long-term development plan must factor in an improved quality of life for the country's citizens. Prosperity and the environment are at the fore.

Beijing is intent that the heavy drive towards innovation should factor in environmental priorities. Officials are faced with the challenge of balancing regulation intended to protect the environment with innovation. Experts advise that even though Beijing accepts that there needs to be a gradual move away from environmentally harmful practices some local and provincial governments have taken the central governments edicts to extremes such as shutting off electricity entirely.

The National Development and Reform Commission (NDRC) is responsible for the transformation of China's economy to a low-carbon green model in line with the countries aims to achieve peak carbon emissions by 2030 and carbon neutrality by 2060⁵. The transition is expected to bring huge investment opportunities, especially for foreign investors, in new technologies as well as in new management methods.

The dual circulation strategy seeks to reduce China's vulnerability to the external economy, technologies, and markets. The trade tensions that erupted with the US in 2018 followed by the economic impact of the COVID-19 pandemic fuelled a sense of urgency in China's domestic innovation and development goals. While international commentators have been quick to assert that this represents a closing of China's economy to the outside world, experts suggest that in the short and mid-term, the opposite is true. Foreign investment and expertise are a core element of the dual circulation strategy. In his speech at the Boao Forum in April 2021, Xi welcomed international participation and highlighted the improved Foreign Investment Law and Negative Investment Lists.

The drive for self-reliance inherent in China's dual circulation strategy and 14th FYP⁶ suggests a longer-term end to ever increasing market share for foreign participation as domestic capabilities improve and enhance on foreign expertise. However, any move away from a reliance on foreign capital and participation at that stage will pose significant challenges.



⁵ Experts suggest that some factions of Chinese government assess that an earlier peak year would be possible however there is broad consensus that the 2060 target for neutrality is extremely ambitious.

⁶ Key industries for home-grown innovation include artificial intelligence, semiconductors, quantum computing, life sciences, neurosciences, biological engineering, aerospace technology and deep sea exploration.

COVID-19 and the Chinese Economy

Chinese economic officials assess that the pandemic will persist for the next five years as new waves hit and the virus continues to mutate. Its economic influence is viewed as significant and long-lasting and has been termed a "centennial pandemic" by the top leadership, with an impact that is expected to be felt over the next 100 years⁷. Though there has been public debate amongst academics and officials in China regarding the country's strict lockdown and quarantine regulations, Beijing perceives that opening up fully will do more economic harm than a continued, targeted, zero-tolerance approach.

In recent years economic leaders have sought to move away from the quantitative economic targets that were once a defining feature of China's economic plans, framing development goals in qualitative terms instead. In 2020, the pandemic and ensuing economic uncertainty did away with an annual growth target, and the 14th FYP does not contain any specific targets either. Nevertheless, Premier Li Keqiang announced a gross domestic product (GDP) growth target for 2021 of more than 6%. Experts consider this to be a moderate target given the low base of 2.3% GDP growth in 2020⁸. H1 YoY GDP growth came in at 12.7%.

Although Li and other economic officials continue to caution against global pandemic-related economic recovery uncertainties, they believe that China's road to recovery is relatively secure. The pandemic stimulus measures rolled out in 2020 have been deemed a success. Policy discussions in H1 2021 focused on plans to normalise economic policy and steadily withdraw pandemic stimulus measures. Experts suggest that attentions have turned to fears over the potential risk of stock market and real estate bubbles.

Since the relaxation of main lending rates in 2020, economic policymakers have been alert to the risk of asset bubbles. At the end of Q1 2021, China's top banking and regulatory official cautioned that the US and European financial markets did not reflect their real economies and expressed concerns over the potential spill-over into China's financial markets. As a result, the People's Bank of China (PBoC) took steps to tighten financial conditions through a combined package of public and more discreet measures. Despite this trajectory, officials aim to retain policy flexibility in the event that the full opening of the economies in the US and Europe have a knock-on or destabilising effect for China's economy.

There has been significant speculation in the western press over signs that China's bond defaults⁹ are cause for major concern. Loan repayment terms for small and medium enterprises (SMEs) saw two extensions, the first to 13 March 2021 and the second to 31 December 2021, and in Q2 2021 the PBoC was considering a range of other refinancing options to address the issue. Experts advise that China's policymakers do not see bond defaults as the major threat to stability that international analysts suggest. Beijing has taken appropriate steps and has a range of tools still available should the problem grow.

The exchange rate has been a matter of internal debate as the renminbi (RMB) has risen to three-year highs against the US dollar. In the face of soaring commodity prices, some officials have suggested that a higher exchange rate is necessary to contend with the higher cost of raw materials. However, universal support for this position has not been found in the central government. Experts suggest that senior leaders support intervention to boost exports by lowering the exchange rate. Meanwhile PBoC officials remain steadfast in their belief that China should pursue reform that results in an exchange rate determined by market forces.

For the time being Beijing has settled on a fluid approach which combines continued reform in the mid to longer term with some influence in the short term. In early June 2021, the PBoC announced an increase in the required reserve rate for financial institutions from 5 to 7% of total foreign exchange deposits. The move was qualified by the rationale that it would strengthen foreign exchange liquidity management¹⁰. Despite this, exchange rate reform, such that two-way fluctuation becomes the norm, is expected to continue over the course of the 14th FYP. Just as the passing of the RMB 7 to the USD threshold in mid-2019 was considered a breakthrough in market-led exchange rate reform, appreciation past the threshold of RMB6.2 to the US at the other end of the scale will be the next key indicator¹¹.

7 The Communist Party of China marked its 100 year anniversary on 1 July 2021.

8 This was China's lowest GDP growth rate since the mid-1970s but as the only major economy to post GDP growth in 2020 it was still considered a positive result.

9 Defaults in 2020 totalled USD 25 billion.

10 The PBoC estimates that it will restrict the domestic supply of foreign currencies and remove approximately USD 20 billion of liquidity from China's foreign exchange market.

11 This would represent genuine two-way fluctuation.

Economic advantage and trade policy

The pandemic brought with it an economic opportunity for China in trade. While the world's production capacity was brought to a halt amidst lockdowns in 2020 and global supply chains saw critical disruptions, China's economy was emerging from its own quarantine. Following the country's success in controlling the pandemic domestically, China found itself exporting to meet the world's demands¹², and in the first half of 2021 exports have surged¹³. In June 2021, China's exports grew by 32.2% while imports rose by 36.7% exceeding all international forecasts.

The economic gap between China and the US has narrowed and China has seen significant benefits from the pandemic in terms of trade. China's trade officials do not believe that any other country is currently able to meet global manufacture demand and they expect China to continue to reap the benefits of its export capabilities while new COVID-19 variants and waves spread across India, Vietnam, and elsewhere in Southeast Asia. This will continue to inform trade policy for the foreseeable future.

Officials were cautiously optimistic that the new US administration might have a refreshed approach to trade policy and the trade relationship. Officials were enthused by the cooperative spirit of telephone calls between Vice Premier Liu He and US Treasury Secretary Janet Yellen and US trade Representative Katherine Tai in May and June 2021 respectively. Experts suggest that Beijing did not anticipate any drastic change in US policy such as the removal of tariffs against China, and was content to continue to uphold the Phase One trade deal in exchange for a less volatile trade partner.

China's officials are approaching trade policy delicately and in the context of ever changing and complex global dynamics. International partners are increasingly wary and Beijing anticipates that the US, Europe and manufacture competitors such as India and Vietnam will take steps to replace China in the global manufacture and supply chain. This has informed policy planning in H1 2021 as leaders seek to retain the competitive advantages that China has harnessed during the pandemic and find ways to ensure that China's domestic market remains attractive to trading partners. Regional trade agreements and partners such as the Regional Comprehensive Economic Partnership (RCEP) and the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP) are of increasing importance.

The highly anticipated EU – China Comprehensive Agreement on Investment (CAI) came to a halt in H1 2021 due to objections from the European Parliament. Nevertheless, China believes that the CAI will ultimately be ratified because China's vast domestic market is too great an opportunity for the individual EU member states to pass up. Beijing is biding its time in this regard, working to ensure that China remains an attractive market and giving the EU countries and large EU multinationals the opportunity to lobby on behalf of the CAI.

Beijing has been planning for the 12th Ministerial Conference of the World Trade Organisation (WTO) in November 2021 where discussions of WTO reform are widely expected. Experts advise that China has gained support from Argentina, Brazil, Mexico, Russia, amongst others to lead in talks on new trade issues such as e-commerce and services and to represent the interests of the developing and less developed economies. China anticipates a move from the developed nations – the US, EU, Japan and others – targeting China's competitiveness through new rules on intellectual property rights (IPR) and industrial subsidy curbs.



¹² ASEAN is China's largest trading partner. Two-way trade with ASEAN rose by 27.8% in H1 2021. Trade with the EU increased by 26.7%. Trade with Australia rose by 24.8%. Trade with Belt and Road Initiative countries rose by 27.5%. Trade with RCEP members rose by 22.7%. Trade with India increased 50.5%.

¹³ Data from the General Administration of Customs shows a 27.9% YoY export growth in May 2021, representing the 11th consecutive month of growth.

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