

## Talking Heads podcast with Chi Lo

**Daniel Morris:** Hello, and welcome to the BNP Paribas Asset Management Talking Heads podcast. Every week, Talking Heads will bring you in-depth insights and analysis on the topics that really matter to investors. In this episode, we'll be discussing China technology and growth policies. I'm Daniel Morris, Chief Market Strategist, and I'm joined today by Chi Lo, Senior Market Strategist. Welcome, Chi, and thanks for joining me.

**Chi Lo:** Pleasure. Thank you for the opportunity.

**DM:** Investor attention [has] perhaps recently been distracted by what's going on in the Middle East. I'm sure at some point we will be turning our attention back to what's happening in China. Clearly relations between the US and China [are] ever a topic of importance and interest. If we think back over what's happened, not only over the last year but over the last three administrations in the US, US policy in both the Trump and Biden administrations has included restrictions on technology exports to and investments in China.

Can you go into what Beijing's response has been to those restrictions in terms of tech policy, and also talk about the implications for the development of China's tech industry?

**Chi Lo:** Beijing does have a game plan for advancing China's technology in the face of rather hawkish US policy. When you look at research and development, China is now spending about 2.8% of GDP each year on R&D. That's almost as much as the US – 3% of GDP each year in terms of research and development spending. In boosting its technology development, China aims at self-sufficiency so that it will not be held hostage by tech good exports from other countries.

To do that, Beijing has been developing what it calls 'new quality productive forces.' These basically refer to the creation of high tech, high efficiency and high quality growth through digitalisation of the production process and technological advancement to create new industrial drivers, like electric vehicles, batteries, artificial intelligence, semiconductors, robotics, aerospace, and a lot more advanced manufacturing.

Now, the goal of doing all this is to enhance total factor productivity and achieve self-reliance in technology development. To make sense of China's tech policy, we need to understand that it is a state-organised – but not state-led – strategic effort that combines top-down industrial planning with bottom-up competition among local players.

What this means is that the government shapes the market structure by setting strategic direction, building supply chains, creating incubation zones, setting and coordinating standards, and providing regulatory support. Direct government intervention and state firms are not involved in the early stage of development.

After all the groundwork is laid, private and state firms alike then enter the market and compete fiercely and freely, driving progress, investment and economy of scale.

**DM:** If we step back and look at the bigger macroeconomic picture, China's been implementing what's called an incremental easing policy since the beginning of the pandemic. Evidence

would suggest, though, that it's not working so effectively to stabilise the economy and public confidence. What would you say is behind Beijing's hesitant policy?

**CL:** Well, indeed, if you look at the economic evidence, the Chinese economy is still weak. Growth momentum is not really picking up, and public confidence is still very weak.

But to understand China's growth policy, we need to first realise that the government is driving a creative destruction process to reform the economy. This approach is totally different from the old reform policy, which was mainly about adding production capacity to the economy. The current new reform and growth policy is about rebalancing and changing the structure of the economy.

So, the macro policy aims at growing new and efficient sectors – hence the creative part – by driving out old and bad sectors – hence the destruction. And of course, macro demand management policy must be easy enough to prevent the economy from being crushed under the inherent contractionary forces of creative destruction.

And here's the point about the perceived policy hesitancy of Beijing's economic easing measures. In this transformation environment, boosting domestic demand is not done by direct stimulus measures as it was in the past, but by creating high value-added jobs to boost household income growth, reduce precautionary saving and upgrade household consumption.

Essentially what this means is that Beijing is trying to coordinate demand management policy with supply side reforms. This approach is new in China's policy and reform management. Only time will tell how successful it will be, but this is also what the new China story is all about. The new policy approach also implies a link between China's technology policy and its growth policy.

Boosting tech development will create high value-added jobs, upgrade income growth and consumption, as I mentioned earlier, realising technological self-reliance for national security and at the same time improving the quality of economic growth. The resulting growth momentum will feed back to create consumer demand, creating a virtuous cycle of technological growth, national security and consumption growth.

This is the inherent plan in China's new reform direction that brings in macro development, national security and technology development all in one big strategic plan.

**DM:** You've laid out the government's response to US measures, the plan that Beijing has. Take it down to the investor level: what does it mean for investors looking at China?

**CL:** Well, the crucial point to note is that market forces do not drive China's structural reforms and economic liberalisation as many investors believe they do. Rather, the government uses the market as a tool to make changes under its strategic objectives.

So, in this model, corporate profitability is not the primary measure of success. It is subordinate to national strategic objectives. Investment value accrues at a system level through integrated supply chains, lower costs, faster production and learning cycles, and the adoption of new technology to strengthen national capabilities.

So, from a macroeconomic perspective, when investment value is created through aligning private incentives with state goals of high-quality growth, technological self-reliance, digitalisation and national security, this environment argues for a top-down policy-driven investment approach to grow with bottom-up portfolio construction, with an investment focus on policy-aligned sectors and industries, and domestic-oriented players.

And also note that state-owned enterprises, SOEs, still play a crucial role in this investment environment because they are crucial to China's economic stability and mandated by the central government to implement structural reform. So do not ignore them – do not just focus on privately-owned companies.

SOEs still have a role in China's investment portfolio. So that's our recommendation to investors, especially for those who are looking into investing in China's new growth story.

**DM:** Thank you, Chi. If I could summarise some of the key points that you shared with us, you highlighted that China's response to the restrictions on technology exports you've seen from the US is to focus on self-sufficiency. The government's increased R&D spending and aims to develop new and innovative technologies that can be managed and developed domestically.

You highlighted, however, that this may be state organised, but not state led, and still depends on significant involvement of the private sector. That said, you did acknowledge the economy is still weak, partly [due to] this dual track policy to develop new industries at the same time as you reduce overproduction in some existing industries.

Finally, when we talk about investment implications, you did acknowledge that corporate profitability is not necessarily the primary measure of success as far as Beijing is concerned, and pointed out that state-owned enterprises will still be very critical to development in the future.

Well, Chi, thank you very much for joining me.

**CL:** Pleasure. Thanks very much, and talk to you again next time.

**DM:** That's it for this week's episode of Talking Heads. If you'd like more information about our capabilities for investing in China, please reach out to your asset management contact or check out Viewpoint, our website for investment insights at [viewpoint.bnpparibas-am.com](https://viewpoint.bnpparibas-am.com).

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Please do join me next week. Until then, take care.