Canada China Business Council
Conseil d'affaires Canada-Chine
加中贸易理事会
trivium

Confidence and Complexity: Initial Findings of the 14th Five-Year Plan for Canadian Companies in China

EXECUTIVE SUMMARY

The 14th Five-Year Plan (FYP) indicates policymakers are embracing the realities of China's medium-term macroeconomic trajectory.

Broadly, this is great news for Canadian companies operating in China.

That said, the political picture for Canadian businesses is growing more complicated.

- The outlook for financial services remains good but will be tempered by tighter oversight.
- China will remain a growth market for agricultural products, but Canadian agribusinesses don't have a guaranteed slice of the pie.
- A transition in China's industrial structure will drive new demand patterns for natural resources companies.
- Efforts to boost energy security while greening China's energy mix will create some opportunities.
- Cleantech has particularly bright prospects.
- China's rapidly evolving data policy is a critical area for all businesses to understand.

The 14th Five-Year Plan indicates policymakers are embracing the realities of China's medium-term macroeconomic trajectory

The fundamentals underpinning China's medium-term economic growth outlook are reasonably straightforward:

- Capital investment rates are declining following years of immoderate investment by local governments.
- Social demographics are shifting – as the aging population depletes the pool of working age adults, creating a drag on growth over a 5- to 15-year time frame.
- Productivity growth is increasingly hampered by institutional challenges and the realities of China's fragmented national market.

The upshot of all of these dynamics is that, over the next decade, China will settle into an overall growth trajectory in the neighborhood of 3-3.5%.

- The good news: This is not uncommon for an economy at China's stage of development.
- Even more positive: China actually needs slower growth to move onto a more sustainable growth path.

Particularly striking from this year's Two Sessions was that senior Chinese policymakers fully embraced these realities:

- The 14th Five-Year Plan (FYP) was clear that the quality of economic growth will increasingly be emphasized over the quantity of growth.
- While this shift has long been signaled, policymakers are undertaking it with a new sense of urgency.
- That is partially underscored by the fact that the 14th FYP did not include a quantitative economic growth target, but instead emphasized targets related to growth, environmental protection, and quality of life issues.

In short, we assess that policymakers are approaching this next five-year period as a key inflection point in the "quality over quantity" growth model. They will move more concertedly toward a qualitative understanding of how economic development should take place, and how the fruits of that economic development should be distributed.

Broadly, this is great news for Canadian companies operating in China.

- Lower but more sustainable growth will limit the extremes of economic growth cycles and make business planning more predictable.

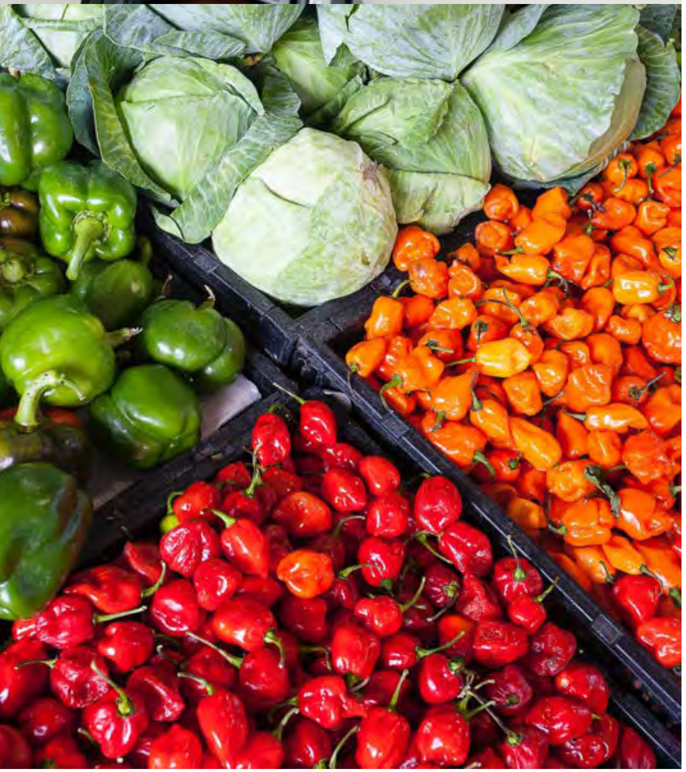
- Over the next five years, government efforts to move up the value chain and boost productivity will necessarily require the involvement of foreign companies.

- While geopolitical pressures will continue to create uncertainties for the China market, and the domestic regulatory environment is still far from consistent or reliable, our view is that the fundamentals of China's ongoing economic transition will continue to create opportunities for Canadian companies.

That said, the political picture for Canadian businesses is growing more complicated.

The position of foreign companies in China has become more complicated. While the 14th FYP calls for greater opening to foreign investment and business activity, increased emphasis on economic security and rising geopolitical tensions mean that foreign firms will need to tread carefully. Companies should look to frame their business operations in China as being in line with Beijing's strategic goals.

- The 14th FYP pledges to open more sectors to foreign participation and improve protections for foreign companies.
- Foreign involvement and investment will be particularly welcome in areas that the 14th FYP has identified as top strategic priorities, including boosting technological innovation, promoting industrial upgrading, and fostering strategic emerging industries.
- However, risks to international businesses are rising, including China's greater emphasis on national security, and closer government and public scrutiny in China and at home. These factors are creating both regulatory and reputational risks.



The outlook for financial services remains good, but will be tempered by tighter oversight.

The 14th FYP largely locks in policymakers' current approach to the reform of China's financial services sector – pledging to continue the process of financial liberalization while strengthening oversight of the financial industry.

- Policymakers committed to "deepening connections between domestic and overseas capital markets" and improving institutional opening. However, the language and tone in the 14th FYP were more conservative than in previous financial opening promises, with modest calls to "steadily and prudently" advance opening in banking, securities, insurance, funds, futures, and other financial sectors.
- Optimizing the efficiency of the financial system – within carefully prescribed regulatory limits – remains the order of the day, including by expanding the registration-based IPO system, improving delisting mechanisms, stepping up development of the bond market, and opening up more financing channels for market entities.
- The 14th FYP also identified new liberalizing priorities, including to promote the development of digital currency, improve the transmission mechanism of market-oriented interest rates, and to improve the market-oriented bond issuance mechanism.
- However, the plan also emphasized that liberalization would be tempered by continued financial de-risking and enhanced regulatory oversight.

A robust, market-oriented financial system is a key plank of China's broader effort to move its economy up the value chain and will likely benefit foreign players bringing international expertise to an increasingly competitive financial services marketplace.

China will remain a growth market for agricultural products, but Canadian agribusinesses don't have a guaranteed slice of the pie.

Policymakers have flagged food security as a top priority under the 14th FYP, but reading between the lines of the 650 million ton annual grain production target, there is a clear acknowledgement that imports of agricultural products will continue to grow for the foreseeable future.

That by no means guarantees Canadian agri-food exporters will see smooth sailing over the next five years. That's because:

- Continued efforts to diversify trade partners – away from traditional major exporters like Canada – remains a top policy priority.
- China is prioritizing homegrown champions – including COFCO's ag commodities trading subsidiary – to lead the sourcing and import of agricultural products.
- Investments in infrastructure and other projects under the Belt and Road Initiative remain a key trade priority under the FYP. Much of this effort is explicitly focused on decreasing China's reliance on western trade partners.

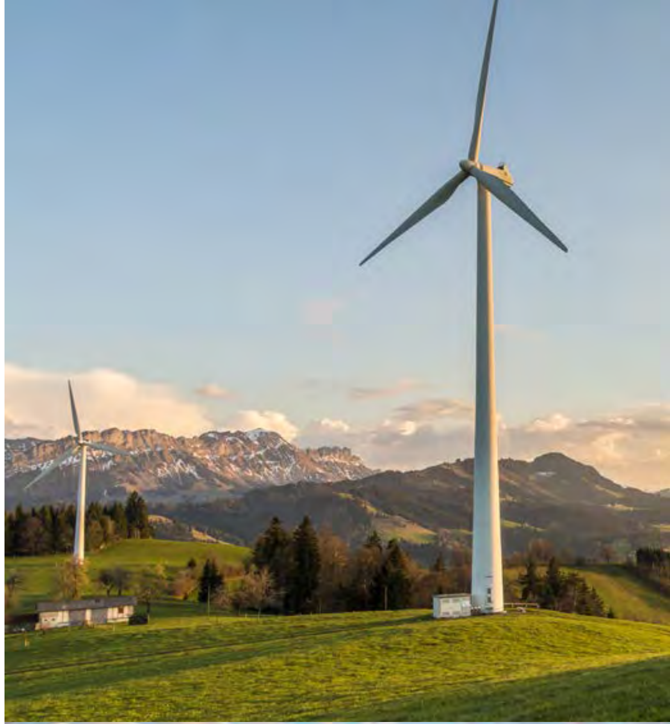
A transition in China's industrial structure will drive new demand patterns for natural resources companies.

Under the 14th FYP, policymakers are looking to continue a transition away from an economic structure dominated by environmentally impactful and energy intensive heavy industries. Instead, the FYP targets a move up the value chain, which includes:

- Building a leaner, greener steel sector through consolidation, pollution control retrofits, and strict capacity controls
- Supporting industrial enterprises to upgrade product offerings and focus on high-quality, specialty, and new materials
- Encouraging innovation and breakthroughs in new materials and technologies
- Doubling down on green technology, renewable energy, and new energy vehicles

All of these agendas will impact demand for Canadian natural resources exports. While demand for the building blocks of heavy industry – like iron ore and coal – will likely begin to fall over the next five years, new drivers of demand for minerals and metals will emerge. These will most likely be driven by:

- The telecommunications and high tech sectors
- Promotion of renewable energy (see next section)
- Growing demand from new energy vehicles (see Cleantech section)



Efforts to boost energy security while greening China's energy mix will create some opportunities.

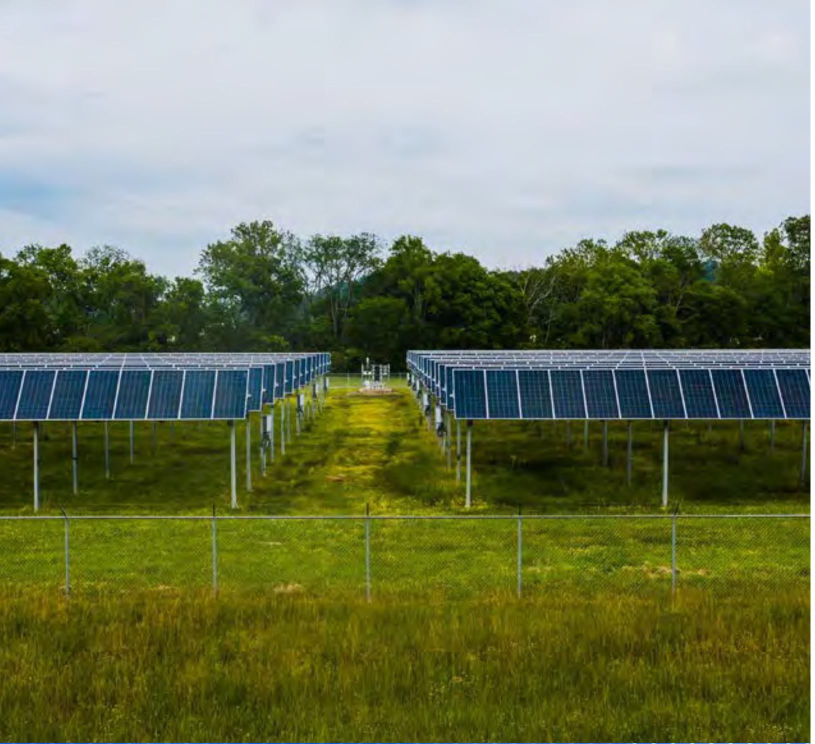
By all accounts, the 14th FYP's emphasis on ensuring energy security while reducing energy consumption per unit of GDP will require China's energy companies to walk and chew gum at the same time. As power generators scramble to lower emissions, we see opportunities for Canadian companies in the energy sector – and a few risks.

The 14th FYP's goal to bring down energy consumption per unit of GDP by 13.5% over the next five years, viewed in the broader context of climate-related ambitions, creates unprecedented opportunities for Canadian renewable energy companies and investors in renewables.

- Where the 13th FYP focused heavily on developing hydropower (which excludes foreign participation), the 14th FYP shifts its development priorities to wind and solar power (which welcomes foreign investment).
- There will be particular opportunities for companies that can introduce advanced technologies to China which help increase uptake or drive down costs of renewable power.

However, the 14th FYP's emphasis on energy security provides some cover and staying power for a number of fossil fuels – likely prioritizing those produced domestically.

- China is coal rich, meaning that coal will continue playing a role in power generation – and competing with renewables projects.
- A pledge to further open up market access for oil and gas exploration could be a lucrative opportunity for Canada's traditional energy companies.
- The 14th FYP aims to boost energy security through increasing self-supply of "core oil and gas demand" – but does not define what constitutes "core" demand, or clarify the role or involvement of foreign companies, if any.



Cleantech has particularly bright prospects.

As expected, the 14th FYP includes a number of strict environmental targets that are likely to drive robust development of the cleantech sector in coming years. These include:

- A pledge to reduce the carbon emissions intensity of the national economy by 18% (in CO_2e volume per unit GDP). This target was also included in the 13th FYP.
- A call to improve energy storage technology and grid absorption capacity for renewable energy. Storing excess energy generated by renewables during off peak hours and efficiently dispatching renewables on the grid are key technical bottlenecks holding back China's efforts to decarbonize. China is also looking to grow its market for new energy vehicles (NEVs). Companies that can contribute technology and resources in this sector have bright prospects.
- Strong language on ecosystem protection and remediation. This includes commitment to several environmental protection and ecological restoration projects, including restoration of contaminated farmland and construction land, and implementing solutions to prevent and control ecological risks to water and soil. The FYP directly solicits more involvement from private companies in ecological protection and restoration, further opening a door to Canadian businesses.
- Plans to upgrade industrial facilities and, more broadly, move industries up the value chain. Production upgrading is a cornerstone of "green and low-carbon development," as Beijing sees it as a driver for better environmental performance and resource utilization. The FYP signals significant investment in cleantech upgrades that reduce pollution and retrofit existing facilities, and commitments to policy support like tax incentives and green financing.

China's rapidly evolving data policy is a critical area for all businesses to understand.

The 14th Five-Year Plan (FYP) signals a fascinating evolutionary shift in China's macro thinking on data policy. The FYP enshrines Beijing's view that data is a critical economic resource, and that the smooth and secure circulation of data between individuals, enterprises, government bodies, and nations is vital to the growth of China's digital economy.

- Under this new high-level rationale, all data policy — including policies related to data privacy, cross-border data transfer, data infrastructure, and cybersecurity — will ultimately be enacted from a macroeconomic perspective.
- Broadly, China is looking to establish a standardized, regulated data market in which the rules and norms governing how data should be classified, valued, bought, sold, traded, stored, and managed are well defined.
- All businesses operating in China should be prepared for shifting paradigms in data regulations.
- Businesses specifically engaged in buying, selling, collecting, and processing data should be alert to new markets and innovative business models emerging in China as these initiatives progress.


Canada China Business Council
Conseil d'affaires Canada-Chine
加中贸易理事会