

November 7, 2022

*(The Bi-Weekly Geopolitical Report will not be published in two weeks due to Thanksgiving. The report will return on December 12.)*

## Reflections on the 20<sup>th</sup> Party Congress

The Communist Party of China's (CPC) 20<sup>th</sup> Party Congress has come to a close. By all accounts, General Secretary Xi has tightened his grip on power. Not only has he secured a third term, breaking the pattern of a two-term limit informally implanted by Deng Xiaoping, but he has also filled his inner circle, the Standing Committee of the Politburo, and the Politburo itself, with loyalists.

In this report, we will offer our take on the meetings, including an examination of key speeches and a rundown of the new Standing Committee of the Politburo along with important figures within the Politburo. From there, we will examine our view of the possible direction of Chinese policy in General Secretary Xi's third term. As always, we will conclude with market ramifications.

### The Speeches: What Stood Out

Capital Economics did a study counting the number of times key phrases were used in speeches and reports during the congress. In terms of characters, the 20<sup>th</sup> Party Congress was the longest in the post-Mao period, at 33,272 characters. Textual analysis should be taken with some degree of caution as there is no real context in such research, but it does tend to show what the authors

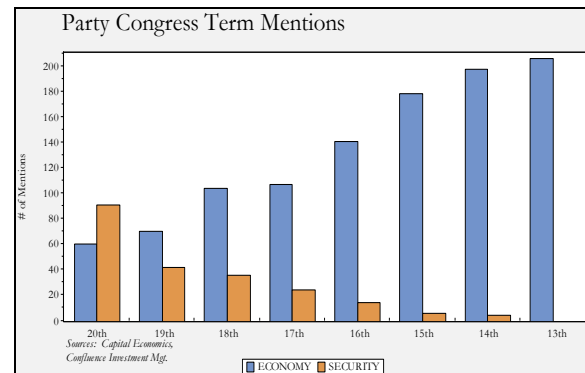
thought was important by how often the term is repeated.

We begin with a table of each General Secretary and their years of presiding over each Party Congress. Note that Jiang presided over three congresses due to the ouster of Zhao Ziyang for his opposition to deploying the military in the Tiananmen Square massacre.

Year	Congress	General Secretary
2022	20th	Xi
2017	19th	Xi
2012	18th	Hu
2007	17th	Hu
2002	16th	Jiang
1997	15th	Jiang
1992	14th	Jiang
1987	13th	Zhao

(Source: Capital Economics)

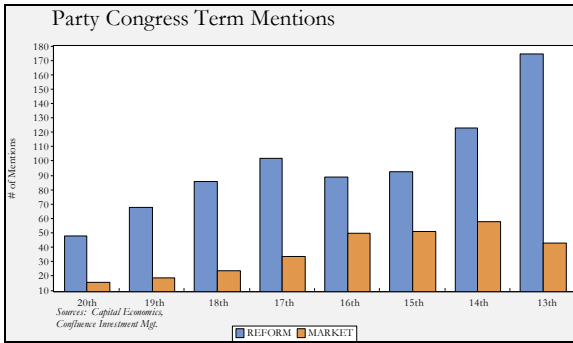
In the below charts, congresses are depicted with the most recent on the left. First, we note the change in trend in the terms "economy" and "security."



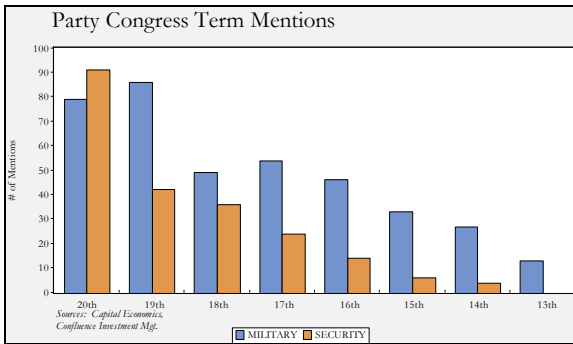
In the 13<sup>th</sup> Party Congress, security wasn't mentioned, while economy was mentioned

206 times. Economy has steadily declined as a matter of concern, while security has increased.

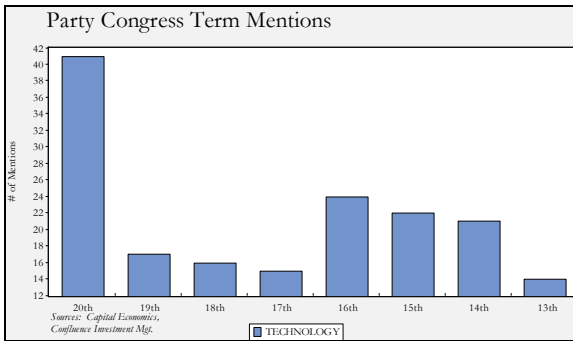
A word often tied to “market” is “reform.” Both of these terms have been steadily mentioned less in recent congresses.



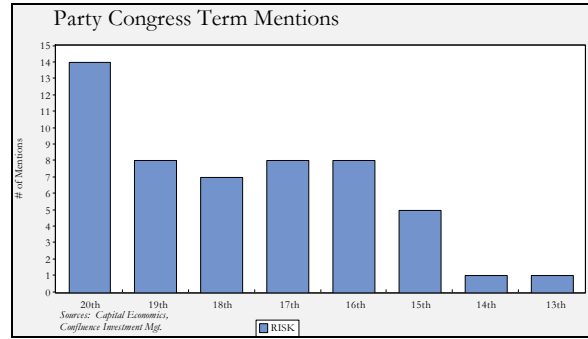
The terms “military” and “security” have been rising, with the former becoming more pronounced under Xi.



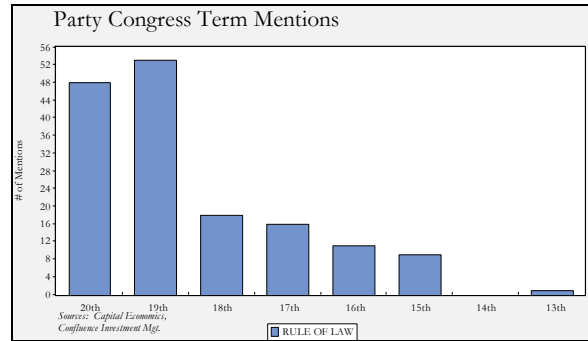
“Technology” mentions saw a significant jump.



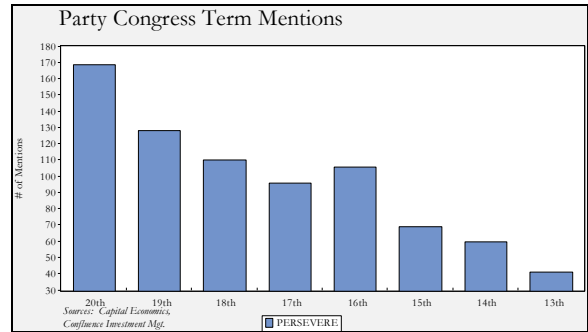
Although the term “risk” doesn’t get many mentions, it is notable that it increased 75% during the 20th Congress.



One of the more curious phrases is “rule of law.” In the West, the term mostly means equal protection; in other words, all citizens are equal before the law and are not subject to the whims of the government. In China, it mostly means institutionalized CPC rule. This idea has clearly become important under Xi.



Finally, use of the term “persevere,” which likely implies holding steadfast in the face of rising difficulties, is growing.



What conclusions can we draw from these paths of mentions? The point of this analysis is to determine changes in national priorities. There has been a definitive shift

in focus from the economy to security, which signals the CPC is less worried about fostering economic growth and more concerned with stability. The increase in military mentions along with security suggests escalating fears of external threats. The major rise in technology mentions likely reflects the current trade and investment conflict with the West. China has been increasing public investment in technology to reduce dependence upon foreign sources. Although there was clearly much discussion of external threats, internal control is also important. The jump in “rule of law” remarks indicates greater party control. The increase in persevere comments could be tied to the Zero-COVID policies but could also be a means of preparing Chinese citizens for harder times ahead.

**The New Standing Committee and the Politburo**

The Standing Committee of the Politburo consists of the most powerful men in the CPC. Perhaps the best parallel would be the president’s cabinet, except that these leaders, who have various portfolios of government, don’t have to deal with a legislature in the Western sense.<sup>1</sup> The table below shows the members of the outgoing and incoming committees.

Standing Committee Members			
2nd Term	Faction	3rd Term	Faction
Xi Jinping	New Zhijiang Army	Xi Jinping	New Zhijiang Army
Li Keqiang	Communist Youth League	Li Qiang	New Zhijiang Army
Zhao Leji	New Zhijiang Army	Zhao Leji	New Zhijiang Army
Wang Huning	New Zhijiang Army	Wang Huning	New Zhijiang Army
Li Zhanshu	New Zhijiang Army	Cai Qi	New Zhijiang Army
Wang Yang	Communist Youth League	Ding Xuexiang	New Zhijiang Army
Han Zheng	Shanghai Clique	Li Xi	New Zhijiang Army

Note that we have listed the members and the “factions” to which they belong. Although the CPC is, by design, the only political party in China, several factions

<sup>1</sup> The National Party Congress does act as a legislature, but it routinely passes whatever is proposed by the Standing Committee.

exist within the CPC. Currently, there are three major factions—the New Zhijiang Army, the Communist Youth League, and the Shanghai Clique. Each generally represents those affiliated with former or current general secretaries. The Shanghai Clique is tied to Jiang Zemin, the Communist Youth League to Hu Jintao, and the New Zhijiang Army to Xi Jinping. In the past, Standing Committee members tended to represent the various factions, but notably, Xi has “run the table” by packing his Standing Committee with only loyalists.<sup>2</sup>

Three of the seven members of the new Standing Committee served in the previous term. The returning members are Xi Jinping, Zhao Leji, and Wang Huning. Xi needs no introduction. Zhao is expected to be the next chair of the National People’s Congress,<sup>3</sup> since in the last government he led the Central Commission for Discipline Inspection which is in charge of anti-corruption efforts. Wang has the informal title of chief ideologue and will likely be the next chair of the Chinese People’s Political Consultative Council (CPPCC).<sup>4</sup> Cai Qi is the head of the Central Secretariat, which is the operational arm of the CPC. Ding Xuexiang is expected to be the next executive vice premier. It should be noted that Ding has never held a provincial level position, suggesting he is also a bit light on experience. Li Xi will be in charge of the Central Commission for Discipline Inspection. One of the surprises was the elevation of Li Qiang as he supervised the

<sup>2</sup> It is worth mentioning that Wang Huning is sometimes slotted as part of the Shanghai Clique, but he has also been a key figure in the Hu and Xi periods of leadership. We consider him, at least for now, to be a member of Xi’s faction, the New Zhijiang Army.

<sup>3</sup> China’s legislature; mostly a ceremonial position.

<sup>4</sup> This body represents a broad swath of the CPC and is as close to representation as the party allows.

massive lockdown of Shanghai that was quite unpopular. The lockdown was not only seen as draconian, but it was also thought to be somewhat inept in its execution. Li was put on the Standing Committee and is also expected to be the next Premier.<sup>5</sup> Most commentators expected Li to be denied a position on the Standing Committee because of his “[botching](#)” of the lockdown. In addition, Li has never held a national position, so his elevation means he was promoted over the heads of many with more experience. The fact that Xi added him to this select group shows the importance of loyalty but also the strength of Xi’s power as he was able to overcome any objections to Li.

In response to the cult of personality years during Mao, Deng had established a number of informal rules to guide leaders and the CPC in selecting its leaders. One of the key ones is called “seven up, eight down.” It means that if a Politburo member is 67 at the time of a Party Congress, he can be appointed to another term, but if he is 68, he must retire. This rule was created to address two problems. First, without turnover, the Politburo would tend to ossify. Second, by turning out leaders based on age, it would undermine the ability of a faction to hold power.

On the 24-member<sup>6</sup> Central Committee of the Politburo, Xi violated the age rule by keeping General Zhang Youxia (72) of the PLA and Wang Yi (69), who has been foreign minister, as part of this body. At the same time, Li Keqiang and Wang Yang, both 67 and on the previous standing committee, were forced out. We also note that Yi Gang, the head of the People’s Bank

<sup>5</sup> This position has two key roles: first, this member is in charge of economic policy, and second, he is usually in line to be the next General Secretary.

<sup>6</sup> It’s usually 25, but Xi didn’t fill one position.

of China, [will likely step down](#) after not being named to the Central Committee even though he is 64. Yi is considered a supporter of market reforms, putting him out of step with the current trend in policy. Thus, the “seven up, eight down” rule really didn’t apply.

Finally, the situation with Hu Jintao was notable. The [video](#) of the former general secretary being [forced to leave the last sessions of the Party Congress](#) has been well covered by the media. The official reason was that Hu had taken ill, but the video looked more like a man who wanted to stay. The Party Congress is heavily choreographed; the CPC leaves nothing to chance. We note that this event occurred only after the foreign media was allowed into the meeting. It strains credibility to believe this was an unexpected event caused by a member who had suddenly taken ill. As we note below, we suspect that Hu’s removal in the fashion it occurred was designed to send a message.

At the same time, it wasn’t a [purge in the classic authoritarian sense](#). Hu wasn’t led away by uniformed security personnel. Instead, two young men in suits moved Hu out of the chamber. The way it was handled does give Xi plausible deniability that this was a purge. However, Hu’s removal, along with the lack of his faction members in positions of power, sends a clear signal that Xi now dominates.

### Key Takeaways

***Loyalty matters most:*** For the first time in the post-Mao era, the Standing Committee is represented by only one faction. Being close to Xi was the key to promotion. From elevating seemingly underqualified Li Qiang to breaking the retirement age rules for members of the Politburo, Xi made it clear that his trust in the individual member was

more important than party rules. Li Qiang, it should be noted, was chief of staff when Xi was party secretary of the Zhejiang province.

***The end of factions:*** The removal of Hu from the meeting likely signals to CPC members that there are no factions in the party but Xi's. As noted above, Hu's extraction was almost a [ceremonial testament that not only is the Hu era over, but so is the Hu faction](#). Although Jiang is old (96), we were surprised that he was not in the audience. His absence could be sending a similar signal to the Shanghai Clique.

***Preparation for war:*** As noted, Zhang Youxia was allowed to stay on the Politburo even though he had reached the informal retirement age. General Zhang is said to have planned the military exercises in response to Speaker Pelosi's visit to Taiwan earlier this year. Zhang's father was a commander that fought against the Nationalists when Xi's father was that group's army political commissar. His appointment reflects the importance of being tied personally to Xi. General He Weidong was named second in command of the Central Military Commission. He is said to have extensive experience in the eastern military districts near Taiwan. Although loyalty still mattered in these promotions, it is also obvious that experience mattered as well.

### **What Does the Party Congress Say About Xi?**

General Secretary Xi is something of an enigma. Not much is written about him within China that isn't a hagiography. From our reading and other research, this is our read on Xi in the aftermath of the congress.

### ***It's all about security and control for Xi:***

The current General Secretary is a princeling as his father was an important figure in the Communist Revolution and the civil war. As a child, Xi lived in the rarefied compounds in Beijing. As a teen, however, Xi's [life was upended by the Cultural Revolution](#). His father fell from grace and was imprisoned. Red Guards threatened and humiliated Xi. In one story, Xi escaped the guards and returned to his home in darkness and rain to ask his mother for food. But his mother refused him as she was worried for her own safety.

He was sent to the countryside for a number of years where he toiled in obscurity. Although current biographies suggest this experience was key in shaping his development, making him a man of the people, we suspect the real lesson was not to [reveal what you are thinking](#) as to avoid a return to such places.

The trauma of the Cultural Revolution affected those who survived it in different ways. Deng concluded that cults of personality and centralization of power was the problem. Thus, he fashioned rules that he thought would prevent exactly what Xi has done. For Xi, it appears the lesson learned was that factionalism and division were the causes of chaos, and thus, preventing them is critical.

***Protecting the Party is paramount:*** As a CPC official, Xi steadily rose through the ranks in unspectacular fashion. It's important to note that Xi came of age when China was growing rapidly. Many CPC officials were becoming extraordinarily rich through corruption. In some respects, it was corruption that fostered development, and so China was able to rapidly build projects because environmental rules were ignored and [poor people who were in the way of](#)

[development](#) could be removed quickly. Party leaders began to fear that [corruption was undermining faith in the CPC](#) and pressed Hu to address it. For the most part, he failed. Although Hu lamented widening income gaps, rooting out corruption would require investigating high-ranking CPC officials. Hu apparently didn't believe he had the power to take that step.

Xi, however, didn't shy away from an [aggressive anticorruption campaign](#). Although it can be argued that the anti-corruption campaign included purges of political rivals, the pervasive corruption in China had to be addressed. The most aggressive action Xi fostered was the [arrest and conviction of Bo Xilai](#), who was a much more flashy rival.

**Nationalism matters too:** Wang Huning is said to have created the concept of the “China Dream,” but Xi has actually built a policy around it. Domestically, the goal is to create a prosperous nation and to overturn the “century of humiliation” that began with the Opium Wars. In terms of foreign policy, the goal is to lift China's position in the world, and that likely includes taking control of Taiwan. The rise of “[Wolf Warrior](#)” diplomacy is an element of this change as well.

It is arguable that Xi moved to this nationalistic stance before China was ready. The West was bound to react to China's harder stance. From Presidents Clinton to Obama, it was generally held that trade and investment would eventually lead China to democratize, but even if that were not the case, there wasn't much concern about China becoming a security threat.<sup>7</sup> Still, there were misgivings beginning to emerge during the Obama administration, although

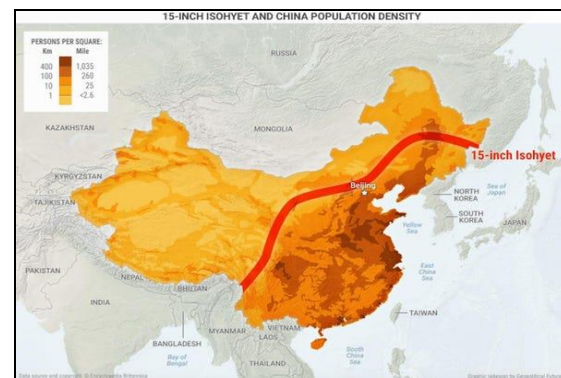
<sup>7</sup> See our [most recent BWGR](#) for an examination of this policy and concept.

these concerns simply didn't materialize into policy.

However, relations turned under President Trump and China was seen as a strategic threat. Tariffs and other trade impediments were implemented. Proving that this change wasn't just driven by party, President Biden has kept most of Trump's tariffs in place and has recently added sweeping restrictions on technology that represent a major threat to China's attempt to build out its technological prowess. As we noted on page 2, mentions of technology rose significantly in the speeches and documents from the Party Congress. Threatening the U.S. and the West is leading to a hardening of positions that may increase the difficulties ahead.

### What Now?

Like all nations, China has geopolitical imperatives. The core imperative for China is to control the regions where the Han live. This area is mostly encapsulated by the 15” isohyet line.



(Source: *Business Insider*)

Everything to the right of that line receives, on average, 15” of rain per year, while the area to the left is drier. This area roughly covers the [Heihe-Tengchong Line](#), and the vast majority of the population (about 94%) live to the right of this line. To protect this region, China must control the paths of invasion. The southwest region to Tibet

must be controlled, and if it is, an invader must traverse the Himalayas, a daunting task. To the southeast, jungles act as barriers. To the west, control of Xingjian is critical. If that area is controlled, an invader must traverse deserts. Xi's [crackdown on Xingjian](#) is consistent with the persistent suppression of Tibet. Finally, to the north, Manchuria and Mongolia must be controlled.

Once these land areas are secured, the only other avenue of invasion is the coast. Chinese rulers have tended to swing between two positions: seal the coast from trade and immigration to protect the Han core but suffer with weak economic growth, or open the coast, which leads to better growth but increases the risk of an outside invasion. In addition, opening up can lead to a divergence in economic outcomes, causing wealth to accumulate on the coast to the detriment of the interior.

Mao resolved this issue by sealing off the coast. Deng, determined to boost economic growth, re-opened the coast. The charts on page 2 show that the emphasis on opening up has been falling in importance, but under Xi, we would expect acceleration of these trends. It doesn't mean an end to trade, but it will almost certainly mean improving coastal security. Xi's idea of "dual circulation," which suggests growing the domestic economy while maintaining exports, [probably isn't possible](#). The policies that boost exports, by design, reduce domestic consumption. However, Xi does seem to be signaling that the era of breakneck growth is over.

There is another potential element of protecting the coast. A strong navy and control of Taiwan would provide security for the coastal regions. China has been increasing its defense spending for some

time and has increased the size of the PLA-Navy. The U.S. Navy could probably still "bottle-up" China, but the task would be more difficult than it would have been a decade ago.

The other threat to the Han core comes from within. There have been periods of Chinese history where strong leadership was lacking and the country, at times, descended into warlordism. Xi is said to be [haunted by the collapse of the Soviet Union](#) and believes that the CPC must have control over the military and must not be afraid to stifle dissent which can lead to division. For Xi, division equals chaos and control is absolutely necessary.

Thus, not only do we expect social control measures to be maintained, but the Zero-COVID policies will probably remain in place for the foreseeable future. The risk of a pandemic emergency appears to bother Xi more so than weaker growth and the suppression of personal freedoms, and Xi intends to use force if necessary to achieve this goal.

### **Ramifications**

In the wake of the Party Congress, Chinese equities tumbled. From the time the meetings opened, the CSI 300 dropped just over 7% and there hasn't been much of a recovery. As it became evident that Xi was going to dominate the next government, financial markets began preparing for increased tensions and more restrictions on trade and investment.

We have written several reports this year on our position that there will be an [evolution of blocs](#) as nations align themselves either with the U.S. or China. Investing will be affected by this development.

As we noted in our last report, the end of globalization, as it was practiced from 1990 to 2020, will tend to increase inflation. We suspect we will see a steady rise in long-term interest rates, which will tend to reward savers but penalize borrowers and those with current bond holdings. Our investment solution has been to deploy laddering techniques in the bond market. Higher inflation tends to contract equity multiples, meaning that growth stocks are less attractive, whereas dividend-payers and value stocks tend to do better. Business cycles will likely be shorter as the era of globalization tended to lower inflation and inflation volatility, which fostered long business expansions. In the future, we expect inflation to rise sooner during recoveries and expansions, leading to faster policy tightening and more frequent downturns. Interestingly enough, this may lead to less credit crises since long expansions tend to encourage risky behavior

by lenders. More frequent recessions will support better lending standards.

For international investing, broad investing through indexes will probably be ineffective. Geopolitical risks will be elevated so selectivity will be paramount. We have overweighted defense equities due to rising geopolitical tensions.

Finally, commodities should benefit. As insecurity grows, nations and consumers will tend to try to hoard key resources, lifting their demand.

This investing message has been a consistent one of ours for some time. The 20<sup>th</sup> Party Congress has simply added additional supporting evidence.

Bill O’Grady  
November 7, 2022

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