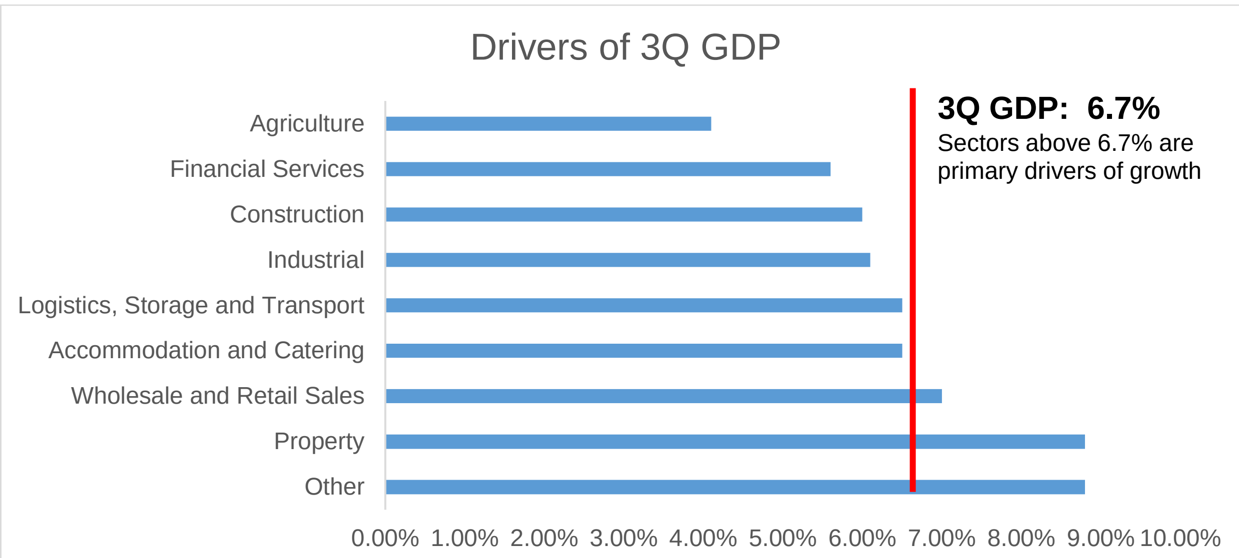
In Case You Missed It: CSOP's Weekly China Wrap-Up

September data sends mixed messages: GDP/PPI up, exports down[1,2]

September's economic data was rife with mixed messages. GDP data outperformed expectations, with 6.7% growth mirroring the country's first and second quarter numbers. However, not all onlookers were pleased with the release; the consistency of the first, second, and third quarter statistics brings suspicions of accounting chicanery. Disagreements about the policy implications are also rampant. While some market players excitedly interpret the GDP figure as reducing the prospect of short-term stimulus because it meets the government target of 6.5%, others fret about the dire need for stimulus. Ongoing measures to cool the property sector are anticipated to shrink fourth quarter GDP figures, as property represented one of the few sectors driving growth in the third quarter.



Source: National Bureau of Statistics of China, 10.21.2016

On the trade side, export data revealed a 10% drop YoY, significantly lower than both expectations and the previous month's figure.[3] The uninspiring export numbers increased the possibility of further RMB depreciation against USD in the near-term, as authorities may lean on the weaker currency as a mechanism for boosting exports.[4,5]

Despite the controversy surrounding GDP and export figures, the most hotly debated data is the PPI, which swung back into positive territory after 5 years of negative readings. While some interpret the positive PPI as a sign of economic stabilization due to rising raw material prices, others are concerned that the data shows hot money as the main driver of commodity prices. This camp blames aggressive monetary policy (M2 growth has been consistently higher than GDP growth) for potential inflation risk.[6]

Demand for QFII and RQFII status skyrockets in September

Twenty-one Qualified Foreign Institutional Investors (QFII) and thirty-four Renminbi Qualified Foreign Institutional Investors (RQFII) opened new accounts at China's stock exchanges in September, representing a 2016 high. Two reasons are cited for the increase.

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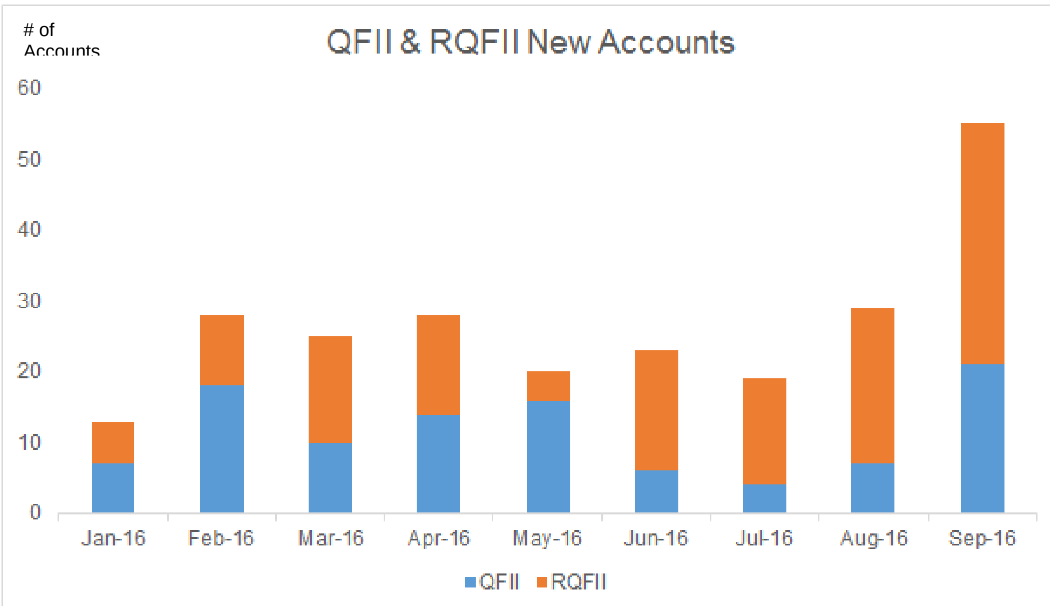
1. The spokesman for China's Securities Regulatory Commission recently announced removal of existing asset allocation ratios for QFII and RQFII investors. Elimination of unpopular rules such as the 50% equity requirement makes the schemes far more attractive to foreign institutional investors accustomed to allocating capital without restriction.
2. By securing QFII and RQFII status, institutional investors are able to access Mainland China's A-Share market. As index provider MSCI is expected to include A-Shares in their popular emerging markets index, the move likely represents institutional investors' attempts to capitalize on the anticipated demand for A-Shares within the coming months.



Source: China Clearing (CSDC), as of October 20, 2016

Signaling commitment to property market reform, property developer bond sales halted

Additional evidence was released today showcasing the central government's seriousness about curbing property prices in key cities. The Shanghai Stock Exchange has temporarily halted approval of property bond sales, rendering it difficult for property developers to raise fund in capital markets. According to data provider Wind, over 70% of new exchange-listed corporate bond issuances stem from the property sector. As such, the suspension of property bond sales will not only reduce the supply of the exchange-listed corporate bonds, but also force property developers rely more heavily on the shadow banking industry.

SOE consortium plans USD 15 billion poverty fund for rural development

A group of Chinese State-Owned-Enterprises announced a new poverty reduction fund that aims to develop the country's poorest regions. The fund will start from USD 1.8 billion and will gradually increase to USD 15 billion, according to the State-Owned Assets Supervision and Administration Commission (SASAC). The fund will invest in industrial parks to develop hydropower and mineral resources in China's most poverty-stricken regions. Urbanization will also be emphasized in the development plans. Currently,

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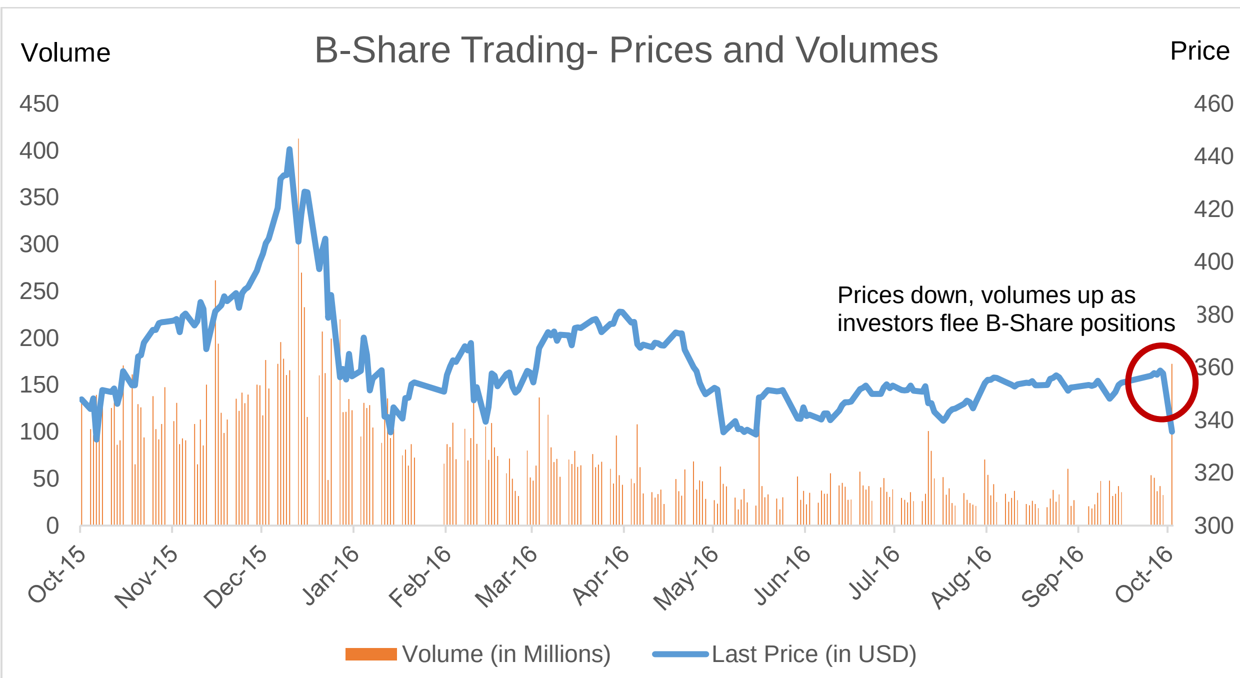
70 million people in China live on less than USD 350 per year, a line which demarcates the official poverty threshold. The country aims to reduce the number of impoverished by 10 million each year.

B-Share prices collapse after announcement of China's FATCA[7]

Shanghai B-Share Stock Price Index (ticker: SHBSHR) closed down 6.15% on Monday, with trading volumes exceeding the previous day's by fivefold. Investors attributed the sudden price collapse to two factors.[8]

1. Domestic B-share investors were spooked by last week's announcement of China's FATCA; implementation of the new rules could result in additional taxes on offshore accounts used for trading B-Shares.
2. Both onshore and offshore RMB have depreciated against the US dollar this month, bottoming at 2010 lows. B-Shares are denominated in USD, while listed companies' underlying assets are denominated in RMB. A weaker RMB lowers the price of B-Shares (in USD) due to FX (Foreign Exchange) conversion.

Although the index has regained the losses since Monday, the precipitous drop represents a warning that investors might want to consider alternative currency hedging strategies. It appears that, for now, B-Shares can no longer be employed as a reliable hedge against the Yuan.



Source: Bloomberg, as of 10.17.2016

Notes:

1. GDP: Gross Domestic Product
2. PPI: Producer Price Index
3. YoY: Year-over-year

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4. RMB: Renminbi, the national currency of China
5. USD: US Dollar, the national currency of the United States
6. M2: M2 money supply includes M1 (currency held by the public, travelers checks, demand deposits and other checkable deposits) plus short-term time deposits in banks and 24-hour money market funds
7. FATCA: Foreign Account Tax Compliance Act
8. Shanghai B-Share Stock Price Index: A cap-weighted index which tracks daily price performance of all B-shares listed on the Shanghai Stock Exchange that are available for investment by foreign investors. *One cannot invest directly in an index.*

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