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

Anti-corruption crackdown and strengthened Presidential authority top agenda at Sixth Plenum

Senior leaders of the Communist Party met on Friday for the Sixth Plenum, a gathering that signifies the kickoff of Beijing's political reshuffle season. Anti-corruption measures and President Xi's succession were the topics most heavily scrutinized.

Despite the widespread public championing of Xi's anti-corruption campaign, the initiative has produced mixed results in practice. On the one hand, the anti-corruption crackdown has suppressed bad behavior by raising enforcement penalties that instill fear in regional leaders. However, this success comes at a price. The anti-corruption measures have severely alienated bureaucratic officials long accustomed to supplementing meagre state incomes through kickbacks and bribes. Unhappy with the new enforcement mechanisms, officials have effectively engaged in work stoppages, halting economic growth at a time when China is desperately attempting to regain its footing.

The second--and more important--agenda item regards Xi's succession plan and potential third term as president. Although Chinese leaders are limited to two five-year terms, rumors abound that the strongman Xi is seeking an extension of his presidency. The election of Xi to "Core" leader status only heightened speculation further, as the designation affords Xi a concentration of power only attained by Mao Zedong and Deng Xiaoping. Compounding the speculation is the logistical issue of succession. At present, only two members of the Central Committee are younger than the maximum age of 55 years, and both were selected by Hu Jintao, Xi's predecessor. Thus, even if Xi were to select a successor for 2022, few can guess who might replace him; he is not actively grooming a candidate.

In summary, although China's election drama manifests more subtly than the boisterous US contest, suffice to say the next five years will be equally as intriguing and addictive for devoted China watchers.

China's white-collar job employment situation improves in 3Q2016, monthly salaries jump 4.1% nationwide

A recent report by recruitment platform operator Zhaopin (Ticker: ZPIN US) shows that China's white-collar job employment situation improved in 3Q2016. The data reveals that 3Q2016 saw an average of 38 candidates applying for one white-collar vacancy across the country, compared with 45 candidates in 2Q and 48 in 1Q, evidencing the creation of new positions. The sectors seeing the fastest growth? Internet, digital, and high-tech.

Also demonstrating an improving labor market, average monthly salaries jumped 4.1% nationwide to RMB 7,531 (USD 1,107) in September.[1, 2] Among the cities offering the highest average salaries, Beijing remained in the top spot at RMB 9,886 (USD 1,453) per month, followed by Shanghai with RMB 9,642 (USD 1,418) and Shenzhen with RMB 8,582 (USD 1,262).

PBOC subtly tightens monetary policy by raising 3-month treasury rates and levying harsher regulations for off-balance sheet assets

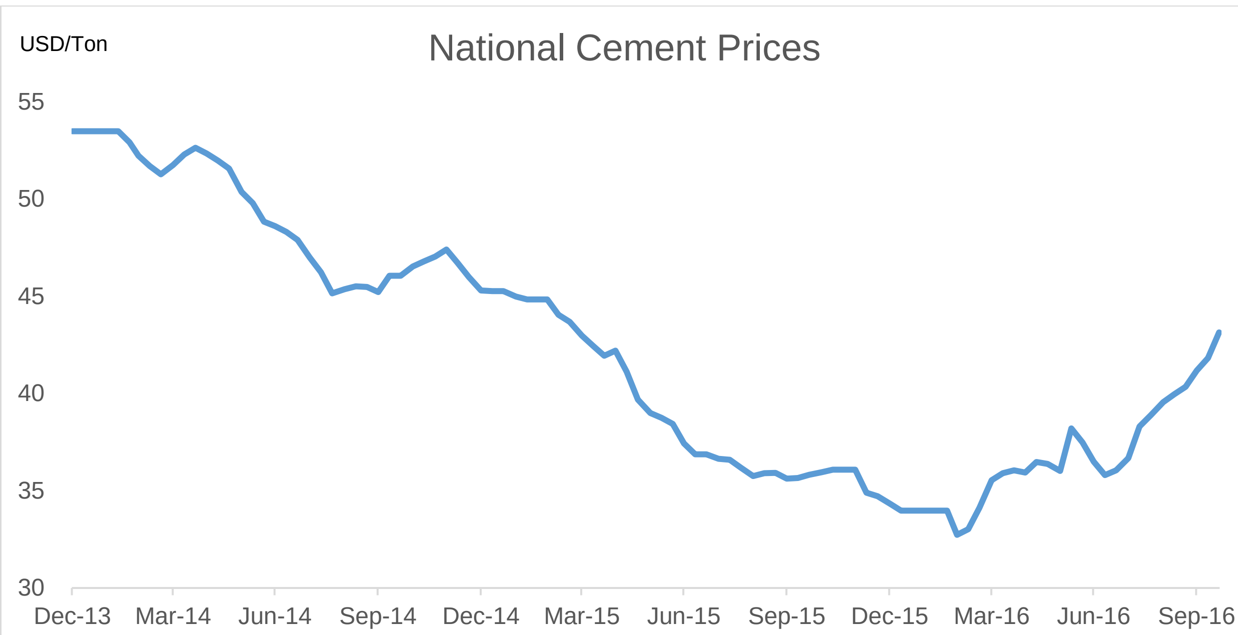
Two recent policy changes indicate that China's Central Bank is subtly tightening monetary policy. First, the PBOC auctioned RMB 80 billion (USD 11.8 billion) of treasury funds to commercial banks as 3-month deposits at 2.95%.[3] The rate is 0.40% higher than the previous deal earlier this year. The auction price delivered a clear message that the PBOC is unwilling to provide cheap funds to banks-- news that sent China's 10-year government bond futures down 0.27%. As a comparison, the prevailing 3-month RMB deposit rate for banks' retail clients is 1.35%.

Second, the PBOC was reported to include off-balance sheet (off B/S) wealth management products into the "broadly defined credit" section of banks' macro-prudential assessments. If implemented, the new policy will negatively impact banks' overall liquidity banks by slowing expansion of off B/S assets, which had grown 75.2% YoY since 2015.[4]

Cement and aluminum record price hikes due to nationwide coal shortage

Industrial commodities such as cement and aluminum saw price hikes in September due to increasing coal prices.

The cement price in Henan Province, near Beijing, has seen the fourth price jump since the end of September, increasing a cumulative 85%. Aluminum prices similarly recorded year-highs. The energy-intensive nature of both production processes render the commodity prices effectively hostage to the fluctuating price of coal inputs.



Source: Wind, as of October 24, 2016

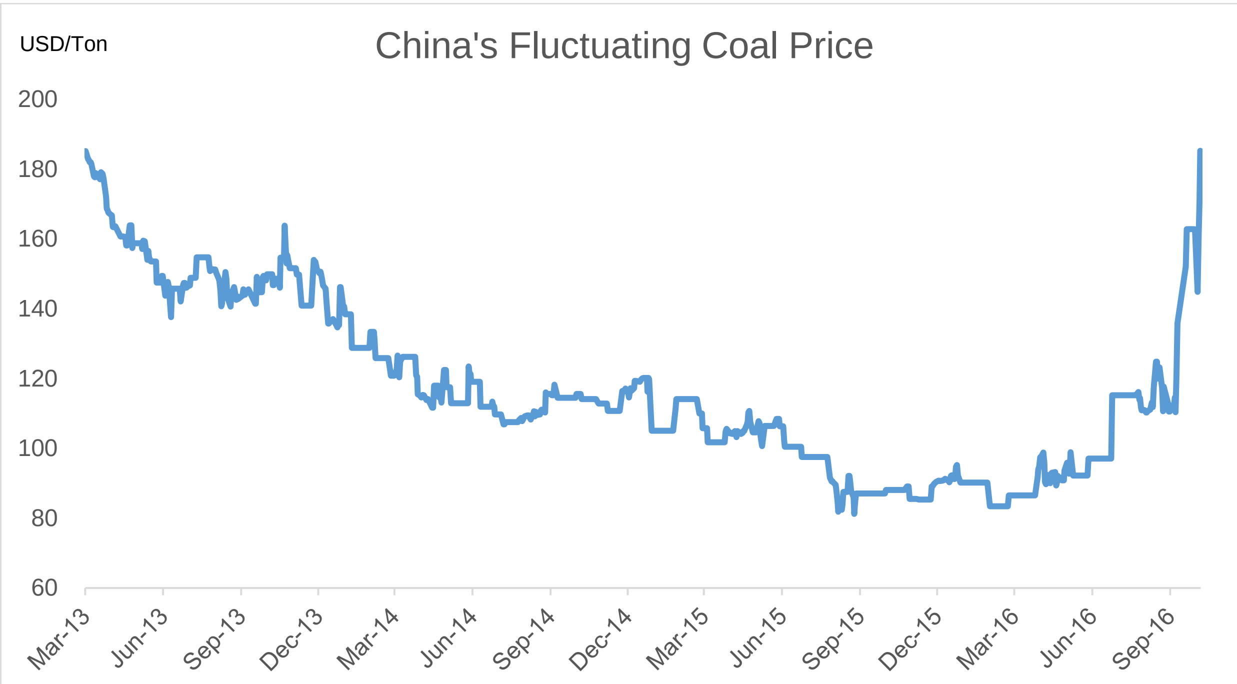
Government experiments with policies balancing short-term coal demand with long- term capacity cuts

A short-term supply shortage has skyrocketed China's coal costs, sending prices up to USD 185/ton from USD 88/ton one year ago. The increase is predicted to last until early 2017 and leave a trail of higher residential and corporate energy bills in its wake, as winter consistently delivers the year's highest demand for the commodity.

The question plaguing policymakers is what to do now. China's vast, extant oversupply of coal has led to a yearlong campaign to cut ineffective production. Prior to the present shortage, the government had planned to cut overcapacity by half a billion tons in the coming decade, with 250 million tons on the chopping block this year alone. And although China's chief economist has temporary allowed increased output to combat the shortage, production still dipped .4% percent in September to 276.96 million tons.

Much of the hesitation comes from coal miners themselves. They remain reluctant to increase production given low visibility about how long the price increase will last. Many do not believe the price rally is supported by fundamentals. Rather, they argue that hot money forced out of the property market is underlying the commodities price rally and will potentially exit the market as quickly as it entered.

Officials thus continue to seek solutions that guarantee a supply of coal for the winter while maintaining their commitment to long-term removal of excess capacity. Thus far, the tinkering has not yielded the desired results, but weekly meetings among the 20 largest coal mining companies are ongoing.



Source: Wind, as of October 24, 2016

Notes:

1. RMB: Renminbi, the national currency of China
2. USD: US Dollar, the national currency of the United States
3. PBOC: People's Bank of China
4. YoY: Year-over-year

The views expressed represent an assessment of market conditions at a specific point in time, are opinions only and should not be relied upon as investment advice regarding a particular investment or markets in general. Such information does not constitute a recommendation to buy or sell specific securities or investment vehicles.