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

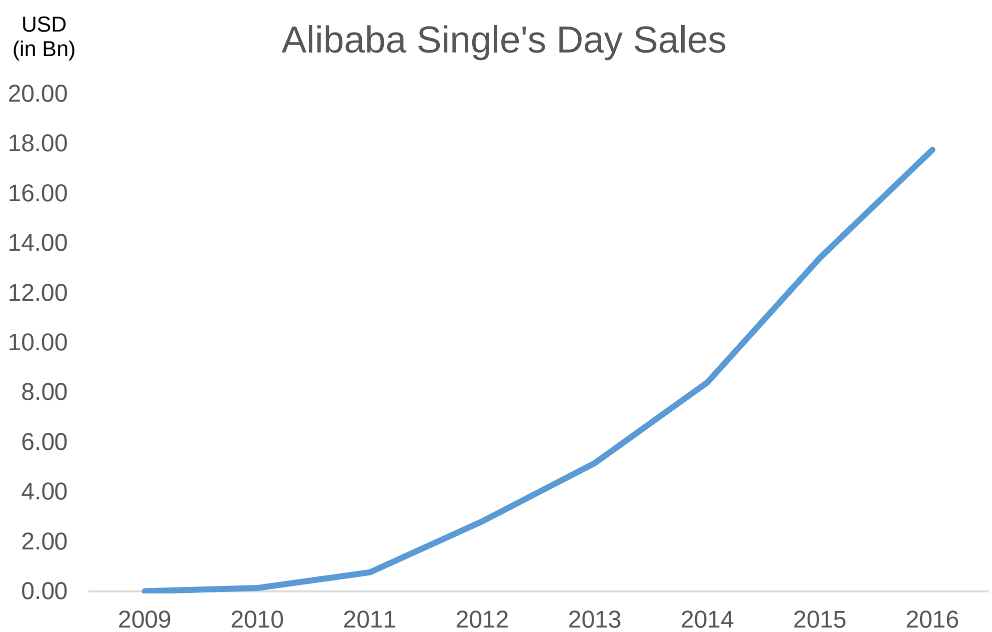
Friday, November 11: Record-breaking Single's Day signals strength in consumer demand

Single's Day in China (11.11) has broken commerce records yet again, heartening investors bullish on China's shift from a manufacturing to a consumption based society. By combining Black Friday sales levels with Cyber Monday's e-commerce platforms, the holiday brings in billions for retailers like Alibaba.

In fact, the total transaction value on Alibaba's Taobao platform reached RMB 10 billion (USD 1.5 billion) in the first 7 minutes of shopping—a phenomena that took more than 12 minutes during the 2015 holiday, signaling a rise in demand.[1, 2]

The ease in consumption enabled by smart phones is one factor behind this year's rise in demand. Whereas 70% of orders in 2015 were placed on smart phones, that figure rose to 85% during Friday's shopping spree.

Fortunately, advances in Alibaba's technology allowed the platform to deal with the onslaught. Alipay processed 120,000 transactions per second at peak, a rate 40% faster than last year.



Source: Alibaba, as of November 14, 2016
Note: *Past performance does not guarantee future results*.

Thursday, November 10: Infrastructure indicators bode well for China

Several developments bode well for President Xi's Asian Infrastructure Investment Bank (AIIB) and One-Belt One Road Initiative.

First, James Woosley, a former Central Intelligence Agency (CIA) head and top advisor to President-elect Donald Trump, expressed his support for the AIIB and OBOR in a South China Morning Post editorial.[3, 4] Although Woosley's view may not represent that of the new US administration, the perspective offers a departure from the Obama administration's hesitation to join the development bank. In light of the already-ballooning US deficits and Trump's proposed tax cuts, the bank could provide much-needed funds to support the expected growth in US infrastructure spending.

Newly released data indicates that China has the capacity to partner on such initiatives. Sales volume of heavy-duty trucks and excavators-- leading indicators for new infrastructure project starts-- grew 49% and 71% YoY respectively in October. Infrastructure investment is expected to pick up further in 4Q2016 and last until late 2017.

Wednesday, November 9: Tariffs and currency volatility: making sense of Trump's China position

Although speculation is rampant and wide-reaching about the President-elect's potential China policy, we believe risk is concentrated on the export side, with hostile trade policy and a volatile RMB the most likely outcomes.

Trump has threatened to impose a 45% tariff on goods imported from China, a move that would harm sectors like steel that face import competition. While we are doubtful such steep measures will be imposed, the consequences are not apocalyptic in the event the threats do manifest. Although China is the United States' largest trade partner, China's export value to the US represents a slim 3% of China's GDP. And because the TPP now appears dead on arrival, it is likely that China will attempt to fill the vacuum left by abandoned US leadership and bolster economic ties with neighbors through measures like One Belt, One Road. Most critically, though, Trump's proposed tariffs will likely impose more damage on the US than China. The trade restrictions would punish US companies who manufacture in China (i.e. Apple), US companies who rely on international supply chains, and—perhaps most critically—middle and working-class US consumers who are accustomed to high-quality, low-cost goods and appliances.

On the currency side, Trump has threatened to label China as a currency manipulator and appreciate the RMB by force. However, judging from the historical inefficacy of the 'currency manipulator' label, it is likely that the rhetoric lacks teeth and is merely employed to placate supporters. The historical examples speak volumes. The US has used the epithet with Japan in 1988, Taiwan in 1988 and 1992, and China from 1992 – 1994. In the China case, the country unified official and market exchange rates at the end of 1993, effectively weakening its currency from RMB 5.8 per USD to RMB 8.7 per USD. Moreover, the US trade deficit with China has increased every year since 1988, showing the futility of the currency manipulator label. Perhaps most critically, US law prohibits the president from unilaterally and immediately imposing punitive tariffs on manipulators, an action further constrained by US commitments to the WTO.[5]

Even if the most hawkish scenario were to play out, China is not without defenses. President Xi is the most powerful leader in recent history and is armed with over USD 1.1 trillion of US Treasury bonds purchased with the proceeds of the country's trade surplus. Liquidating these assets could put downward pressure on the US dollar, strengthening the RMB by comparison.

Tuesday, November 8: Anti-corruption campaign strengthened with consolidated leadership

Wang Qishan, the leader of China's anti-corruption body, is seeing his influence grow as China formalizes plans for a nationwide anti-graft scheme. Although he has already passed the official retirement age of 65, the Xi loyalist will remain in power for another 5-year term to oversee the new plans. The scheme will consolidate a number of established anti-corruption task-forces and offer Mr. Wang consolidated authority over all public servants.

Mr. Wang has already demonstrated willingness to flex his anti-corruption muscle, punishing President Xi's rivals in the government and military. The financial services sector is speculated to be Mr. Wang's next target, with particular attention paid to state-owned banks and insurance companies. Last year, Wang's anti-corruption body reshuffled the whole senior management of Citic Securities, China's influential brokerage house notably tapped to support falling markets in the famed market rout of mid-2015.

Monday, November 7: Local SOE debt declared ineligible for central government bailout

In a pronounced about-face, China replaced its Finance Minister and announced a stark position on local government financing vehicles, declaring local SOE debt ineligible for a central government bailout. Although the ousted minister Lou Jiwei was supposed to hold power until 2018, the loyalist of Premier Li was replaced with Xiao Jie, a noted sympathizer of President Xi. In light of China's neutral monetary policy, it is expected that Mr. Xiao will turn to fiscal policy as his simulative vehicle of choice.

It appears that there will be limits on such stimulus, however. Beijing announced that provincial SOE's (also known as local government financing vehicles) will not be bailed out by local or central governments. The policy announcement contrasts past practices, in which banks were willing to issue credit to LGFVs under the assumption that the LGFVs were implicitly backed by local and central government organs. According to the Ministry of Finance, local governments borrowed RMB 1.1 trillion (USD 160 billion) and LGFV borrowed RMB 2.5 trillion (USD 370 billion) in the first 9 months of 2016, a 67% increase YoY. The move indicates that leaders are clearly worried about the debt burden on local governments and hoping to discharge bad debt from balance sheets.

Notes:

1. RMB: Renminbi, the national currency of China
2. USD: US Dollar, the national currency of the United States
3. AIIB: Asian Infrastructure Investment Bank
4. OBOR: One Belt, One Road
5. WTO: World Trade Organization