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

**Friday, November 18:  China asserts free-trade leadership with Regional Comprehensive Economic Partnership**

The 2016 Asia Pacific Economic Cooperation (APEC) was held over the weekend in Lima, Peru. Twenty-one world leaders gathered to reassess trade relationships and the global economic order in the aftermath of Trump's election. In response to the prospect of increased US isolationism, China has made a concerted effort to assert regional leadership, a posture that manifests in a new free trade agreement with ten Southeast Asian economies including Japan, India, South Korea and Australia. The China-led agreement, known as the Regional Comprehensive Economic Partnership (RCEP), is an opportunistic attempt to replace the faltering US-led Trans-Pacific Partnership (TPP), which was designed to exclude China.

In attending the summit, Chinese President Xi received a warm welcome from his Ecuadorian and Peruvian counterparts, who are seeking a closer trade partnership with China in the anticipated withdrawal of US dominance of the Western hemisphere.

**Thursday, November 17:  China FX regulator announces introduction of MBS and CDS trading**

Playing catch-up with more mature counterparts, China is accelerating development of sophisticated financial products such as mortgage backed securities (MBS) and credit-default swaps (CDS). The China Foreign Exchange Trade System (CFETS), regulator of China's interbank bond market, will allow investors to trade CDS on its platform for the first time, although rules governing the platform remain under discussion.

The demand for CDS as a hedging tool has hastened since authorities gradually began tolerating bond defaults. The need for hedging strategies is especially urgent in bonds issued by struggling state-owned enterprises (SOE), long considered implicitly backed by government credit. Consequences of such fallacious logic reverberate throughout the system, leading to inefficient capital allocation by investors chasing high-yielding junk bonds for "zero default" risk. However, simultaneously allowing CDS, bankruptcy, and bond default will help educate investors about investment risk and lead to more rational and efficient capital allocation.

To be certain, overreliance on CDS can be problematic (the collapse of the US mortgage market and ensuing Global Financial Crisis brings to mind one example), but in the meanwhile introduction of these sophisticated financial products provides a much-needed hedging tool in a bloated economy in desperate need of deleveraging.

**Wednesday, November 16:  Discussion continues of London- Shanghai Stock Connect system**

While investors anxiously await the launch of Shenzhen – Hong Kong Stock Connect, officials in China and the United Kingdom (UK) are quietly studying the feasibility of China's next big innovation:  a London – Shanghai Stock Connect scheme. Like Shanghai – Hong Kong Stock Connect, the proposed scheme will allow investors in the UK to trade SSE-listed stocks and allow investors in China to trade LSE-listed stocks.[1, 2]

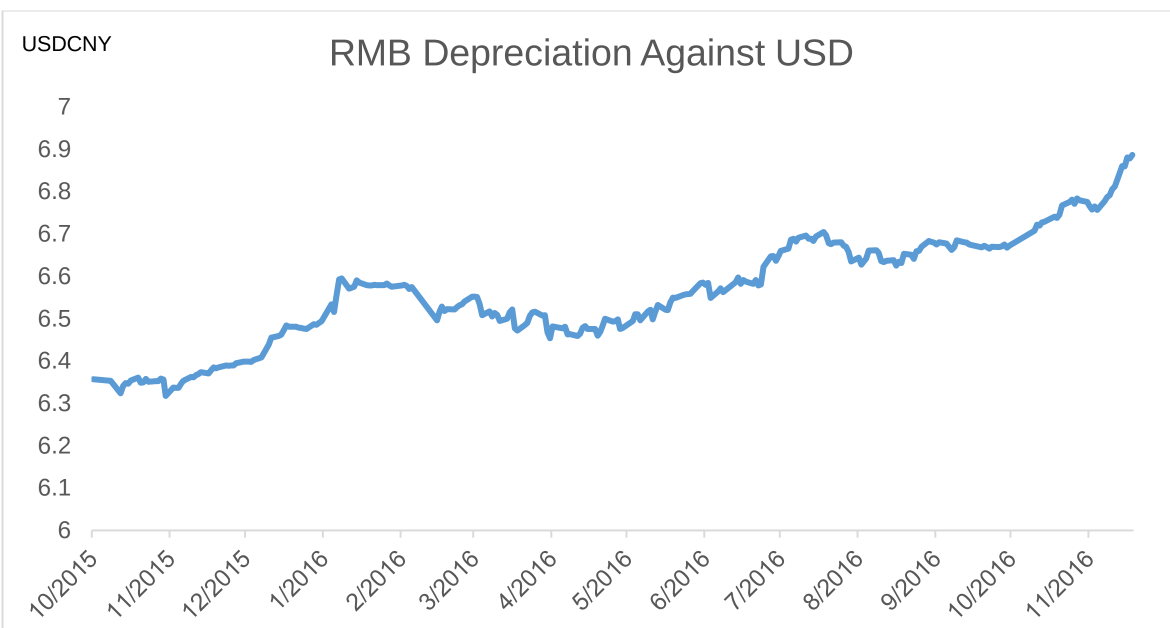
The London link is not as straightforward as its Asian counterparts, however, considering the time zone difference. While Shanghai and Hong Kong sit in the same time zone and trade in overlapping hours, London is eight hours behind Shanghai. In response, officials from both exchanges are brainstorming ways to encourage investors to trade stocks on the other side of the Connect scheme after local markets close. This time difference also brings liquidity concerns, as most orders need to be facilitated outside of normal exchange trading hours.

Admitted difficulties aside, the proposed linkage shows China's determination to further open capital markets to overseas investors, as well as London's ambition to position itself as a major off-shore RMB clearinghouse.[3]

**Tuesday, November 15: RMB continues slide with no intervention in sight**

China's currency has depreciated more than 3% since the RMB's October SDR inclusion.[4] Airline companies and property developers are among the biggest losers of the currency slippage; the sectors are burdened with heavy USD-denominated debts.[5] On the contrary, export-dependent companies expect positive impact on their profitability thanks to the competitive environment brought upon by the weaker currency.

In the past 12 months, China's Central Bank was often seen as actively intervening in the market when the currency depreciated too fast. However, the PBOC has made no such effort since October, a signal that the Bank is tolerating the quick deprecation. Explanations for the decline abound, though concern about ramifications of a potential trade war between China and the US has emerged as the leading theory. However, some investors think that the depreciation is more purposeful, with the Chinese government exploiting the opportunity to deleverage the country's economy.




Source: Bloomberg, 11.18.2016

*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.*

**Monday, November 14: London becomes 2nd largest offshore RMB clearing center in aftermath of Brexit**

While many European and American banks are relocating staff from London to the European continent in the aftermath of Brexit, Chinese banks and financial institutions are busy opening UK branches. In the months following the June decision, China's five largest banks have all established physical locations in the United Kingdom, whose capital city London is vying to be a leading RMB offshore clearing center. As a result of the new cooperation, London has become the second largest offshore RMB trading center, lagging only Hong Kong. However, some market observers believe that London could even overtake Hong Kong if the territory's political strife continues.

Following in the banks' footsteps, China's sovereign fund and largest life insurer, China Life, will also set up shop in London. And as the pièce de résistance of the new financial infrastructure, Shanghai Clearing House and China Foreign Exchange Trade System will also open representative offices there.

Notes:

1. SSE: Shanghai Stock Exchange
2. LSE: London Stock Exchange
3. RMB: Renminbi, the national currency of China
4. SDR: Special Drawing Rights
5. USD: US Dollar, the national currency of the United States