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

November 25, 2016: Shenzhen-Hong Kong Stock Connect to launch December 5th

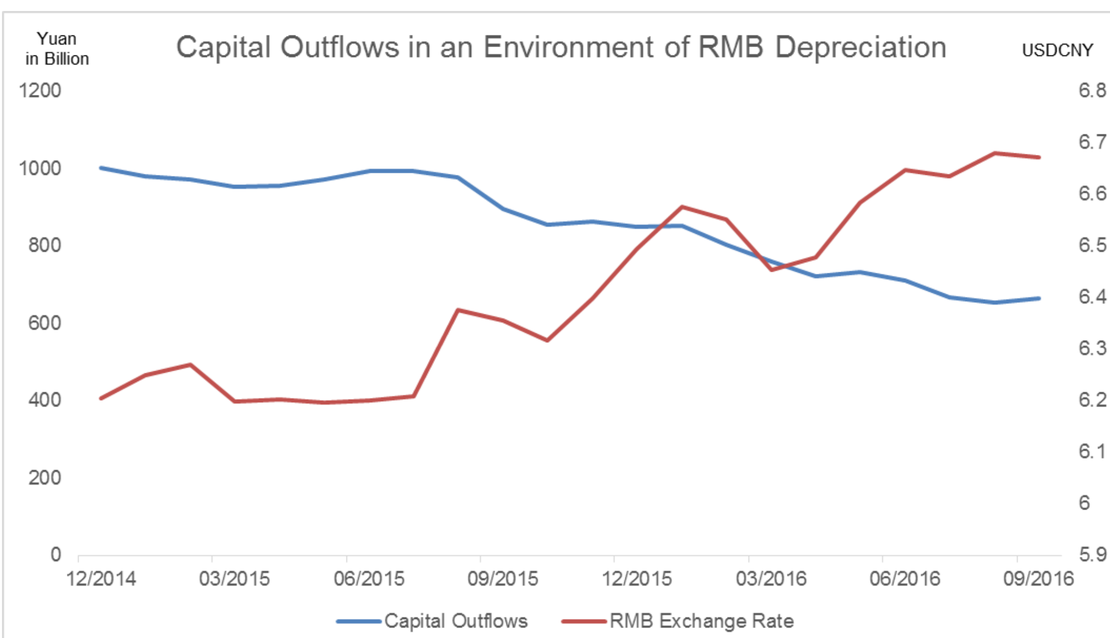
Chinese and Hong Kong regulators announced that the long-anticipated Shenzhen- Hong Kong Stock Connect program will launch on December 5, 2016. The move offers foreign investors the opportunity to directly access shares of "New China"—the country's fast-growing technology and small/mid-cap names. Through the scheme, Southbound investors can access 417 eligible names; Northbound investors can choose from 881. Although this universe includes only single stocks, ETF trading is expected to begin within the next year.[1] To the delight of investors, regulators have abolished the linkage's aggregate quota, though daily quota limits will still exist.

While some market watchers laud the move as an important step in China's capital market liberalization, others question how much mainland investment the scheme will actually inspire. Utilization of the Shanghai- Hong Kong Connect program remains low, leaving investors skeptical whether demand exists for the Shenzhen linkage. Despite the disagreement, one conclusion is universally shared: as the RMB continues depreciating, Southbound trading is anticipated to exceed Northbound investment in the months following the scheme's December launch.[2]

November 24, 2016: Dual-currency credit cards halted in attempt to limit capital outflows

In an attempt to limit currency outflows, the People's Bank of China has instructed Chinese banks to halt issuance of dual-currency credit cards. The popular cards had enabled Chinese consumers to shop overseas using Visa or MasterCard. With the policy change, however, consumers applying for new credit cards will receive cards issued by China UnionPay, the country's main currency clearing corporation.

The announcement is the most recent governmental attempt to prohibit capital flight in an increasingly unfavorable macro environment. Resulting from the RMB's continued depreciation, around US $728 billion of capital has left China since the beginning of this year according to Natixis, US $246 billion of which was in 3Q2016 alone.



Source: Bloomberg, as of 11.28.2016

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.

November 23, 2016: New regulations announced to limit speculative commodity trading

To crack down on rising commodity prices and subsequent inflationary threats, Shanghai Futures Exchange has reportedly increased daily trading limits from 6% to 7%, while raising margin requirements from 8% to 9% on certain contracts. Regulators aim to deter speculative trading by forcing investors to pay higher deposits, rendering trades more expensive. Effective November 24, 2016, the impacted contracts include copper, aluminum, zinc, lead, nickel, tin, steel, and natural rubber.
The move marks the second time in November that the Exchange imposed trading limits. On November 11, 2016, margin requirements for aluminum and lead contracts were increased from 5% to 8% and trading limits from 4% to 6%. Similar changes were imposed for zinc and nickel contracts, with margin requirements increasing from 6% to 8% and trading limits from 5% to 6%.

November 22, 2016: Banks close popular loophole used to avoid property tightening policies

Regulators are closing the most popular loophole used to avoid property tightening policies, as commercial banks begin declining loans to applicants who have divorced within the past 6 months.
The rule change comes in response to a policy implemented in January 2011, which assigned harsher down payment requirements for married couples purchasing a second home (50% to 70%), compared to the 30% down payment required for an unmarried person. Divorce lawyers thrived in this new environment, devising schemes in which couples would divorce to purchase a second home and subsequently remarry. These practices were quietly allowed for several years as regulators sought to reduce China's excessive property inventory. However, in light of the double digit real estate price increases in 2015, officials felt compelled to take action.

Despite the progress, loopholes do remain. Some of the most popular include:

1) Relying on shell companies to hold property, enabling new buyers to purchase the underlying properties through purchasing the shell company
2) Purchasing multiple properties from a property developer as a single transaction (i.e. in one contract) to avoid the home purchase limit policy

November 21, 2016: December conference to determine China's policy goals for 2017

The Central Government Economic Working Conference (CGEWC) is December's primary market focus, an annual forum at which China's top policy leaders establish fiscal goals for the coming year. The goals set at last year's gathering included:

1) Reduce overcapacity;
2) Boost business operational efficiency;
3) Shrink property inventory;
4) Support agriculture and similar sectors;
5) Minimize systematic financial risk

Because of the middling performance in meeting the 2016 goals, market observers expect the upcoming conference to focus more narrowly on the most important monetary and fiscal agenda items. Likely areas of concentration include tax reform (especially China's FATCA rules and property tax), supply-side reform, SOE restructuring and RMB depreciation.[3, 4]

The rules drafted this year will be closely scrutinized due to their consequences for investors. For example, the policies introduced to reduce property inventory in early 2016 are considered to be the major driver for the China's skyrocketing property price rally this year.

Notes:

1. ETF: Exchange-traded fund
2. RMB: Renminbi, the national currency of China
3. FATCA: Foreign Account Tax Compliance Act
4. SOE: State-owned enterprise