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

Friday, December 2- Tax advantages announced for foreigners trading through Shenzhen- HK link

Mainland China's authorities have clarified taxation policies ahead of Monday's Shenzhen- Hong Kong Stock Connect debut, exempting overseas A-Share investors from income tax, value-added tax (VAT) and capital gains taxes (CGT). The primary burden for overseas investors will be a 10% withholding tax, applicable to dividends paid by A-Share companies. The policies are similar to those levied on transactions in the existing Shanghai – Hong Kong Connect linkage.

To be sure, advantages also exist for Mainlanders investing Southbound, though the rewards are not as generous. Chinese individual investors will be granted a three year reprieve from paying CGT when buying Chinese stocks listed in Hong Kong, though will still pay a 20% tax on dividends. In contrast, Chinese institutional investors are required to pay CGT.

Thursday, December 1- Planned 'One Belt, One Road' summit expected to dwarf 2016 G20[1]

China is planning a One Belt, One Road (OBOR) summit in 2017, an event rumored to eclipse the scale and grandeur of this year's G20 summit in Hangzhou. While US President-elect Trump is positioning his regime as anti-globalization, President Xi is taking the opposite approach, exploiting the leadership vacuum to market his Asian Infrastructure Investment Bank (AIIB) and OBOR concepts to a global audience. While 30 heads of state attended the much-ballyhooed G20, it is possible that representatives from the 65 nations represented in the OBOR initiative could gather for the summit.

Thus far, an increasing number of US allies such as Canada and the United Kingdom have joined the AIIB, which has lent USD 829 million to six projects in Pakistan, Tajikistan, Indonesia, and Bangladesh.[2] Despite these successes, critics argue that China still faces an uphill battle in promoting OBOR and the AIIB, especially in an environment of shrinking foreign exchange reserves, a depreciating RMB, and increasingly restrictive capital outflow policies.[3]

Compounding matters, an attitude of mistrust pervades from recipients of Chinese investment in both developing and developed countries alike. For example, a contingent of US senators is actively trying to block a Chinese private company from purchasing the Chicago Stock Exchange. In addition, Chinese infrastructure investments in Africa have triggered resentment in local communities, citing wanton environmental destruction as an unacceptable side effect of the megaprojects.

Wednesday, November 30- One-year interest rate swaps jump, market anticipates no further PBOC easing[4]

China's one-year interest rate swap (IRS, Bloomberg ticker: CCSHO1) jumped to year highs on speculation that rising commodity prices increase inflation risk and the Central Bank's plan to curb excessive lending will cause a year-end liquidity crunch. As investors have expected higher global inflation since Trump's election, the rate surge indicates that the market is pricing out the prospect of further monetary easing.

Meanwhile, the PBOC continued efforts to cool down property and commodity markets by draining excessive liquidity. The Central Bank withdrew RMB 190 billion through open market operations (OMO) at end of November, removing net RMB 10 billion from the system. Like the swap rate, SHIBOR (Shanghai Interbank Offering Rate) also increased for 14 consecutive days, approaching highs not seen since June 2016.

Tuesday, November 29- Chinese consortium moves to purchase Chicago Stock Exchange, faces backlash from US Senate

Chinese companies led by Chongqing Casin Enterprise Group (CCEG) have moved to purchase 49.5% of the Chicago Stock Exchange. Named after its home city in Southwestern China, the private company operates business lines covering property development, environmental protection, financial services, infrastructure, and tourism. The deal allegedly serves as a vehicle for Chinese companies to list on US exchanges and for Chinese investors to access US-listed shares.

Although the Committee on Foreign Investment in the United States (CFIUS) has approved foreign acquisitions of US Stock exchanges in the past—UAE's 2007 purchase of NASDAQ and Deutsche Boerse's approved-though-failed 2011 acquisition of NYSE—political uncertainty surrounds approval of this deal.[5] President-elect Trump's campaign rhetoric cast a negative light on China and US lawmakers have requested that CFIUS reject the purchase.

Monday, November 28- Plans released to curb overseas investment by Chinese companies

Ending a multi-year acquisition spree, China's State Council is planning to restrict overseas investments by Chinese companies. The measures aim to curb capital outflows in light of recent RMB depreciation. Officials fear that the overseas acquisitions are being abused as a fraudulent way to facilitate capital flight. The first ten months of 2016 have seen USD 164 billion of non-financial outbound investments, far surpassing last year's record of USD 121 billion.

While the current rules require only registration--not approval—from companies pursuing foreign deals, the new rules require Chinese regulators to decline all applications from the following categories:

1. Applications from SOEs seeking to invest more than USD 1 billion in property projects
2. Applications from Chinese companies seeking to invest more than USD 10 billion
3. Applications from partnership enterprises
4. Applications from Mainland companies to buy a less than 10% stake in overseas listed companies
5. Applications from Mainland companies to privatize overseas listed Chinese companies

Although this change of course represents a minor retrenchment of China's heretofore liberalizing trends, it allows the PBOC to preserve monetary policy independence without burning through further currency reserves. Most importantly, the move closes the loopholes most frequently employed to take money out of the country. Critics alleged that several recent overseas acquisitions added no economic value, but instead merely served as vehicles to avoid capital controls.

It bears noting that serious acquisitions of strategic technologies will not be impacted by the rule change. For example, private companies purchasing an overseas stake larger than 10% (i.e. Chonqing Casin's acquisition of the Chicago Stock Exchange) will be viewed favorably by Chinese regulators.

Notes:

1. G20: An international forum for the governments and central bank governors from 20 major economies
2. USD: US Dollar, the national currency of the United States
3. RMB: Renminbi, the national currency of China
4. PBOC: People's Bank of China
5. UAE: United Arab Emirates