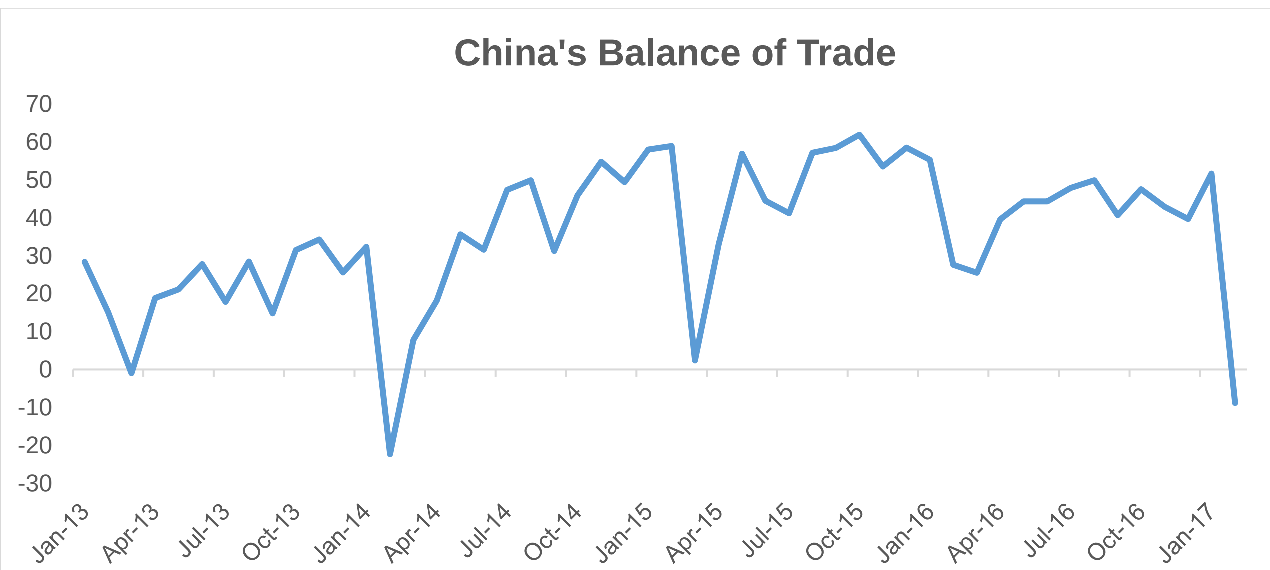
In Case You Missed It: CSOP's Weekly China Wrap Up

China's foreign reserves stabilize in February while exports falter, leading to trade deficit

China reported a mixed bag of economic indicators in February. Heartening investors, foreign reserve levels rebounded above the USD 3 trillion mark, besting market expectations. Economists attributed the net USD 6.9 billion increase to a halt in capital outflows coupled with an acceleration of inflows from exporters converting FX proceeds to RMB. Revaluation of underlying assets also contributed to the stabilization, as did an increase in offshore SOE borrowing. When taken collectively, these factors suggest that China's recent capital controls have been effective, lowering the near-term prospect of additional restrictions.

February's trade data was less inspiring, however, with exports proving weaker than analyst expectations. Exports contracted by 1.3% YoY, a disconcerting result considering the low base from 2016's Chinese New Year holiday. Increased concern about a potential China-US trade war offers one explanation for the weak data. Domestic sentiment offered consolation, though. February import data surged on strong domestic demand, with commodities such as soybeans (30% YoY), iron ore (13% YoY), coal (48% YoY), gas (52% YoY), autos (45% YoY) and crude oil (13% YoY) performing especially well.

Due to the strong import figures and lackluster exports, China recorded a trade deficit of USD 9.15 billion in February, the first deficit recorded since February 2014.



Data: Bloomberg, 3.8.2017

NPC report sets conservative targets for 2017 economic growth

Market onlookers scrutinized reports emerging from the National People's Congress (NPC), seeking clues about China's policy priorities and economic targets for the coming year. Several key metrics were announced in the published report.

The stated GDP and CPI targets mimic those established in 2016, while M2 and Total Social Financing (TSF) are set slightly lower than last year (details below). Although moderately conservative, monetary targets do not indicate a tightening bias. Rather, the double-digit M2 target rate is accommodative and mirrors last year's actual figure.

The Chinese government plans to maintain a 3% budget deficit in 2017 while offering slight fiscal support. Railroad investment will be on par with 2016; road and water transport investment will increase 9% to RMB 1.8 trillion. On the employment side, the government expects to create 11 million jobs to keep the unemployment rate below 4.5%, a figure aligned with last year's goals. Onlookers have noted the absence of detailed discussion of currency and foreign reserve plans. One explanation interprets the RMB exchange rate as largely dependent on extrinsic factors such as a strong USD and potential Trump tariffs, events over which Chinese government exercises little control.

	2017 Target	2016 Actual	2016 Target	2015 Target
GDP growth YoY	**6.5 %**	6.7 %	6.5-7 %	7 %
CPI	**3 %**	2 %	3 %	3 %
M2 growth YoY	**12 %**	11.3 %	13 %	12 %
TSF growth YoY	**12 %**	12.8 %	13 %	
General budget deficit % of GDP	**3 %**	2.9 %	3 %	2.3 %
Unemployment Rate	**4.5 %**		4.5 %	4.5 %
New job creation	**11 million**	13.1 million	10 million	10 million
Railway investment in RMB	**800 billion**		800 billion	800 billion
Road investment in RMB	**1.8 trillion**		1.65 trillion	
Retail growth YoY	**11 %**	13.1 %	10 %	13 %
Military budget increase YoY	**7 %**	7.6 %		10.1 %

Source: Work Reports from National People's Congress in 2015, 2016, and 2017

Preparations made for April summit at Mar-a-Lago between Presidents Xi and Trump

Reports are emerging that a summit for Presidents Xi and Trump will be held in early April at Trump's Mar-a-Lago estate. The gathering will be the first time the leaders of the world's largest economies will meet in person.

Relations between the two leaders have been uncertain since Trump assumed office in January, so the meeting is interpreted as a reassuring sign by global onlookers. As Asian relations are in disarray with impeachment of South Korea's President and North Korea's recent provocations, the meeting is hoped to build deeper alignment between the nations. Despite Trump's China-skeptic campaign rhetoric, signals of cooperation have emerged in recent months. In a February phone call, Trump ensured Xi that the United States would honor its commitment to the One China policy on Taiwan. Moreover, Trump met with a group of top Chinese diplomats at the end of February, a gathering deemed successful by attendees.

Finally, Secretary of State Rex Tillerson is touring Asia this week and will spend two days in Beijing with President Xi and top officials.

Citibank to add China bonds to World Government Bond index

Following the lead of Bloomberg Barclay's indices, Citibank announced it would add China's onshore bonds to the company's World Government Bond Index. The move is significant. Citi analysts estimate that USD 2 trillion of assets track Citibank's World Government Bond Index, meaning that inclusion could trigger an addition USD 100 billion inflow into China's onshore market, assuming a 5% asset weight. Citi's decision will likely trigger other index publishers to mimic the move, resulting in continued growth of China's bond market. Already the world's third largest at USD 9 trillion, the market has expanded eightfold over the past decade, according to ChinaBond.

Although Citi has not reported a specific date of inclusion, the company's choice is shrewd. By including the bonds, the bank scores points with Beijing, who have been eager-- yet struggling-- to attract foreign bond buyers since the IMF included the RMB in its Special Drawing Rights basket in October. The move is also beneficial to overseas investors, who have long expressed frustration with the lack of tools to hedge RMB risk in bond portfolios. Although China has recently approved onshore FX forwards, FX swaps, and currency swaps, available hedging instruments still prove insubstantial. Offshore RMB forwards are liquid, yet volatile, while Hong Kong Stock Exchange-listed RMB futures are less volatile, though illiquid.

Citi cited the availability of these new instruments as motivation for their inclusion. Critics, however, remain wary of China's bond markets, fearing risks related to capital controls, an unreliable credit rating system, and defaults stemming from slower economic growth.

Encouraged by growing profitability, SOE Regulator promotes continued reforms of central government SOEs

Mr. Xiao Yaqing, head of China's State-Owned Asset Supervision and Administration Commission (SASAC), held a press conference to praise SOE profitability and discuss continuing reform efforts.

According to SASAC, revenue and profit for China's 102 central SOEs grew 15.2% YoY and 29.1% YoY, respectively, reaching RMB 3.7 trillion (USD 0.53 trillion) and RMB 168.6 billion (USD 24.4 billion). To ensure continued profitability, Mr. Yaqing urged state-owned steel, coal, machinery, and power generation corporations to expedite mixed-ownership reforms and increase dividends to shareholders. The reforms, if successful, could be especially lucrative to SASAC, which remains the largest shareholder of many SOEs.

To avoid potential social dislocation from the enhanced competitiveness, Mr. Yaqing urged companies to pursue mergers rather than bankruptcy to avoid wide scale unemployment. His message mimics the themes of stability and cautious reform that have emerged ahead of President Xi's second term in November.