

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

Trump administration formally declines to assign ‘currency manipulator’ label to China

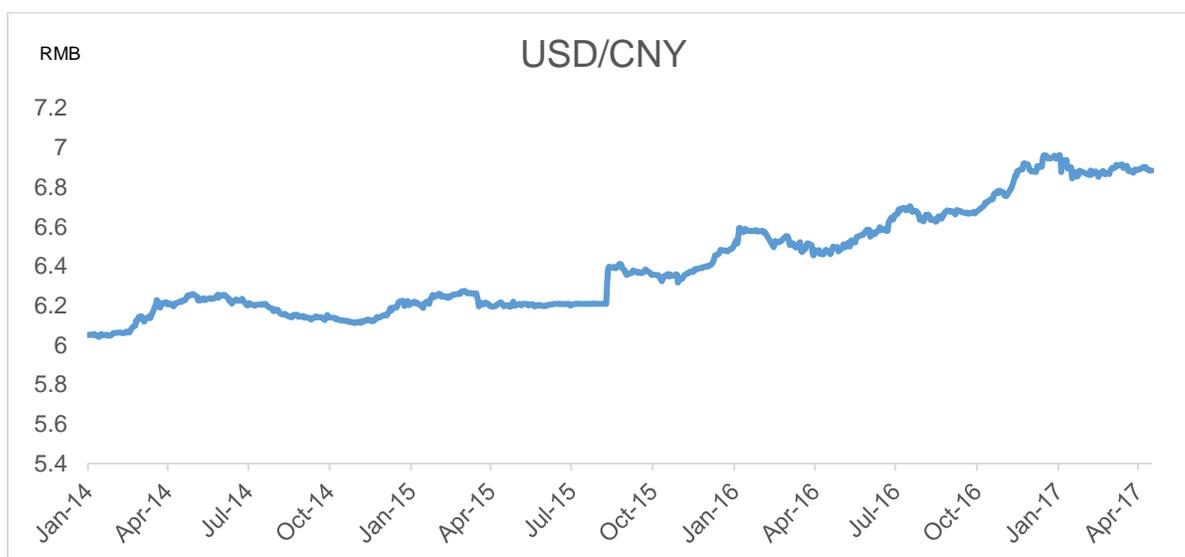
The US Treasury Department declined to label China a currency manipulator in their semi-annual review of trade partners and practices. The judgment indicates a full reversal of one of President Trump’s signature campaign items, as the US leader vociferously promised to assign the designation on “Day One” of his presidency.

China’s currency movements: the facts

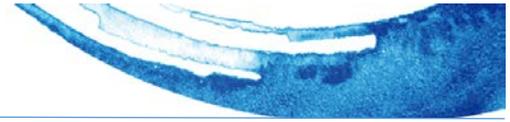
Reasons for the decision appear both political and economic. Speaking to the economic factors, although the RMB has depreciated 6.3% against the USD in the last year, China has undertaken a concerted campaign of capital controls and FX reserve depletion to prop up the flagging currency.^{1,2} The moves seem to have worked, resulting in the RMB’s recent upward climb; it has gained .8% against the dollar since the beginning of the year.³ And although market consensus predicts a mild depreciation of RMB into the end of 2017, the anticipated 3% drop results from a strengthened USD rather than a weakened RMB.

Political motivations

In addition to the economic motivation for avoiding the label, political maneuverings are also afoot. Trump explained that he conceded the currency manipulator label in exchange for China’s help in taming the nuclear threat from North Korea. Whatever the motive, world leaders and corporate heads alike have breathed a sigh of relief that the economic skirmish has been avoided. As such, the Trump administration’s proclamation represents the latest step in normalization of relations between the world’s two largest economies.



Source: Bloomberg, as of 4.17.2017



China calls for peaceful solution to simmering US/North Korea tensions

Beijing is attempting to mediate the sharply escalating tensions engrossing the United States and North Korea. As a group of US aircraft carriers sailed to Asia to deter North Korean nuclear weapons testing, China's leaders urged both sides to stand down before events climax to an "irreversible and unmanageable stage."

Background of the tension

Although President Trump ran on a non-interventionist, "America First" platform, the United States has been emboldened by the generally-positive global response to Trump's action on Syria and deployment of the Mother of all Bombs in Afghanistan. Confirming the trigger happiness, President Trump Tweeted that the US would be willing to pursue unilateral action against North Korea "with or without" China's assistance. In response, North Korea issued a statement that they would "mercilessly ravage all provocative options of the U.S. with Korean-style toughest counteraction" should the US encroach on its sovereignty. To demonstrate the country's sincerity, North Korea paraded an impressive series of intercontinental ballistic missiles through the streets of Pyongyang on Sunday, though a subsequent launch test failed.

China's balancing act

China finds itself in an unenviable position attempting to balance the interests of the warring factions. As North Korea's neighbor, most important ally, and largest trading partner, China has historically been a quiet supporter of North Korea. However, the United States is China's largest export market; alienating the world's largest economy is not a sensible policy move for a slowing China. Any conflict between the two countries would require China to choose sides, an essentially impossible task.

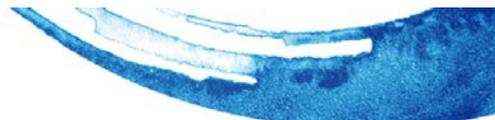
In attempt to forge a middle ground, China has assigned moderate sanctions to North Korea. They've banned all imports of North Korean coal, severing the country's most important export. China has also asked for Russia's assistance in brokering peace. Although Russia's geopolitical status add leverages to North Korea, the country's involvement complicates things, considering Moscow's shaky relationship with Washington.

Two top regulators under investigation, signaling major expansion of anti-corruption campaign

China's anti-corruption taskforce has launched a high-profile investigation into Xiang Junbo, head of the China Insurance Regulatory Commission (CIRC), for "severe violations of discipline." The taskforce has also reportedly turned their sights on Yang Jiakai, the Assistant to Chairman of the China Banking Regulatory Commission (CBRC), who has been 'out of contact' since early last week. The men are under scrutiny for an ambiguous yet growing scandal, and represent two of the highest-profile individuals caught up in President Xi's ongoing anti-corruption dragnet.

Xiang's role in China's insurance industry

Xiang's investigation sent shockwaves through the financial industry due to his Communist Party leadership role and expansive history across the financial services industry. He took the helm at the CIRC in 2011 after a career that included governing PBOC departments and leading the state-owned Agricultural Bank of China. In leading CIRC, Xiang set out to modernize China's underdeveloped insurance industry, though some critics charge that his initiatives were too aggressive. Xiang allowed insurance companies to sell high-yielding products that were regulated as life insurance, but behaved more similarly to junk bonds. Insurers sold these products by the truckload, and under Xiang's guidance, the companies were able to invest the sale proceeds in a



worldwide acquisition spree. Although unconfirmed, Xiang has been linked to fast-growing, unlisted companies like Huaxia Life, whose stakeholder Xiao Jianhua is believed to be in custody after disappearing from the Four Seasons Hong Kong earlier this year. It is thought that Xiao's testimony gave authorities sufficient evidence to implicate Xiang in the emerging scandal.

Yang's potential involvement

Although officials have not formally announced investigation of Yang Jiakai, he too is widely believed to be embroiled in the unfolding brouhaha. After a 15-year career with China's Central Bank, Yang joined CBRC in 2003, rising to become Assistant to the Chairman in 2013.⁵ Yang and Xiang worked together during Yang's tenure at CBRC and Xiang's helming of Agricultural Bank of China (ABC), giving the pair plenty of opportunities for collusion.⁶

What's next?

The events of last week demonstrate the President and Premier's commitment to pursuing high-profile, though corrupt, figures previously assumed invulnerable. Onlookers expect that heads will continue to roll as China's continues cleaning up one of the country's most corrupt sectors. Already, the ex-vice-president of China Securities Regulatory Commission, ex-chairman of property insurer PICC, and ex-head of ABC's New York branch have been announced under investigation for improprieties related to bad assets, bond defaults, and the fast-growing shadow banking sector.⁷ The next target is anyone's guess, and paranoid leaders high and low are scrambling to ensure their bases are covered.

China's March trade data beats expectations on buoyant global economy

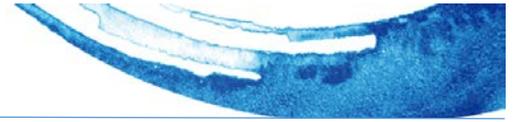
China boasted unexpectedly strong export and trade balance data in March while the country's import figure moderated. Exports number jumped 16.4% in March year-over-year (YoY), forcibly reversing the 1.3% decline in February. Imports growth slowed to 20.3%, a considerable downturn from the 38.1% in February. The combined effect boosted China's trade surplus to USD 23.9 billion, resolutely besting the USD 10 billion market expectation and reversing February's USD 9.15 billion deficit.⁸

Factors contributing to the reversal

China's authorities primarily attributed the improving trade situation to an uptick in global demand. Exporters saw considerably stronger demand in US, Japan, South Korea, and Association of Southeast Asian Nations in March—exports to the US alone grew 20% YoY. On the flipside, falling commodity prices coupled with Beijing's gradual monetary tightening contributed to decelerating import growth. To be sure, some bearish onlookers have accused companies of employing inflated invoice to move capital out of China, potentially resulting in exaggerated export data.

Will the trajectory continue?

Key economic figures across developed nations are looking increasingly attractive, implying a possible cyclical recovery of the global economy. For example, Japan's capital expenses and the United States' durable goods orders both picked up in recent months, a trend expected to continue and spur further demand from China. Moreover, the US refusal to label China a currency manipulator and agreement on cooperative trade terms reduce the prospect of a trade war, increasing the chance that China's export momentum will continue into the second quarter.



Notes:

1. USD: US Dollar, the national currency of the United States
2. FX: Foreign Exchange
3. RMB: Renminbi, the national currency of China
4. PBOC: People's Bank of China
5. CBRC: China Banking Regulatory Commission
6. ABC: Agricultural Bank of China
7. PICC: People's Insurance Company of China
8. USD: US Dollar, the national currency of the United States