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

**Alibaba's Yu'e Bao surpasses JP Morgan product to become world's largest money market fund**

Alibaba's Yu'e Bao became the world's largest money market fund, surpassing JPMorgan's long-dominant U.S. Government Money Market Fund. In only four years, Alibaba's fund has growth to USD 165.5 billion AUM, compared with the USD 150 billion held in JPMorgan's fund, as of May 1, 2017.[1]

*What is Yu'e Bao?*

Yu'e Bao was established in 2013 as a joint venture between online commerce company Alibaba and Tianhong Asset Management. The fund's name means "leftover treasure." With it, Alibaba customers can transfer spare change in their online wallets into a high yielding wealth management product with just one click. Due to the ease of investment, impressive 3.93% yield, and relaxed liquidity provisions—customers can withdraw money the same day without penalty—the fund has grown an average of 112.7% per year since its inception.

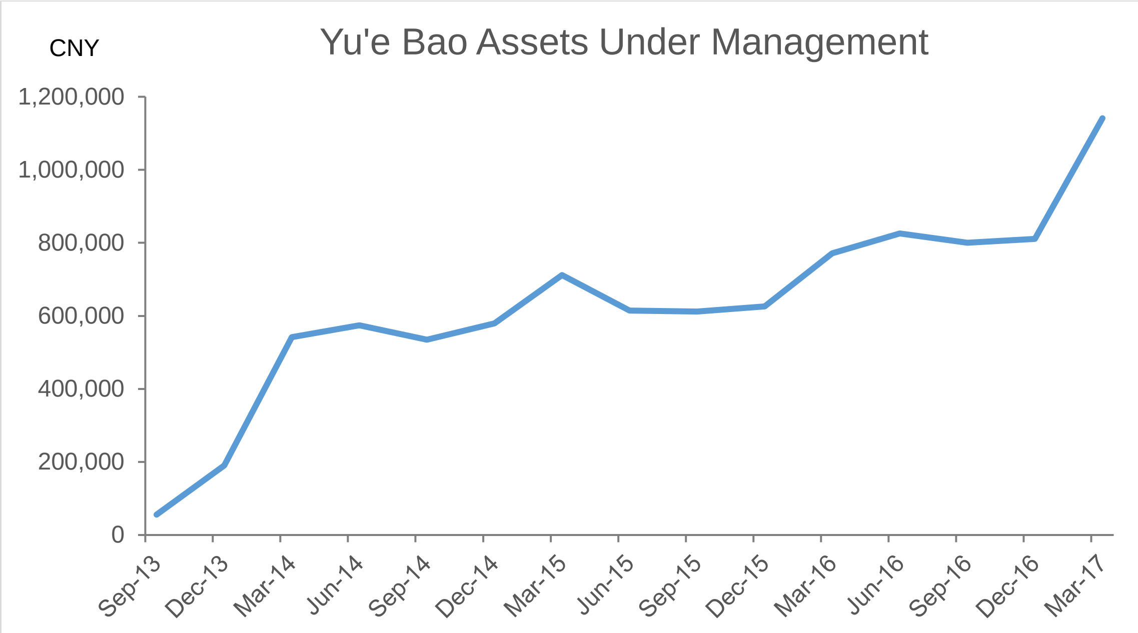
*How Yu'e Bao forces financial liberalization in China*

Yu'e Bao's rapid rise reflects the way in which technology is disrupting China's stodgy state-run apparatus and pushing financial liberalization. China's state-owned banks have historically benefited from centralized control over the financial system. The government established the price at which state-owned banks can borrow and lend, allowing them to capture a healthy spread without much effort. This arrangement benefitted state-owned businesses who received artificially cheap credit, but hurt savers, who were forced to contend with paltry returns ranging from 0.25%-3%.

However, the concurrent rise of China's money market and technology companies like Alibaba are disrupting this dynamic. Because Alibaba's Ant Financial payment platform has hundreds of millions of individual accounts, the company can negotiate with banks to secure higher returns for savers (up to 6%), effectively forcing the banks to fund their rival FinTech competitors.

*A 3.9% yield… what's the catch?*

Some onlookers have begun to wonder about the risks lurking beneath such a high-yielding product. China's money market funds face less stringent rules governing reserve and liquidity requirements, an oversight that could be problematic as China's Central Bank tightens monetary policy to reduce the country's leverage. Although Yu'e Bao keeps around 5% of funds on reserve to meet redemption requirements, a significant majority of Yu'e Bao assets are allocated to negotiable deposits with maturities ranging from one week to one month. Should China's easily-panicked army of retail investors decide to withdraw en masse, the fund could have a hard time meeting its obligations given the maturity mismatch.




Source: Bloomberg, as of May 1, 2017

**Trump's tax plans and aluminum investigation have Chinese government, firms on edge**

President Trump's administration released a preliminary tax plan that, if adopted, would lower the corporate tax rate to 15% from 35%. An article in China's *People's Daily* condemned the plan, alleging that the move would "wreak chaos in the international taxation order" and launch a global tax war.

Compounding tensions, the Trump administration launched an investigation to determine whether the US should restrict aluminum imports on 'National Security' grounds. Any tariffs would disproportionately impact Canada, Russia, the UAE, and China, the latter of whom is the world's largest aluminum supplier, according to Bloomberg.[2]

*Capital flight, loss of manufacturing base, tax cuts: possible effects of Trump's tax plan*

If it gains the approval of Congress, Trump's tax plan could impact China in several ways. First, the proposal includes a provision for one-time, low rate repatriation of US profits held offshore, potentially leading to massive RMB-to-USD conversions and resultant foreign reserve depletion.[3] Second, if the plan works as expected, it will boost US corporate earnings and strengthen the US economy, leading eventually to additional interest rate hikes. Evidencing market views, China's onshore and offshore currencies both saw weakening after the announcement. Third, the diminished rate could reduce China's competitive manufacturing advantage and return factory production to the United States. Although Beijing cut corporate taxes by more than RMB 500 billion in 2016, the country's tax rates remain among the world's highest, rendering the domestic business environment uncompetitive. As a result, China's business community is angling for more aggressive tax cuts, a policy reform that remains a key part of President Xi's economic reform strategy.

*China's views on Aluminum investigation: cooperate or retaliate?*

The US seeks to impose import restrictions to ensure that the country can produce enough high purity aluminum to power military aircraft and produce adequate weaponry, according to Commerce Secretary

Wilbur Ross. Ross maintained that only one US smelter can currently produce the high purity commodity, resulting in the need for corrective policy action. In 2016, the US imported nearly 55% of its aluminum supply, reports Bloomberg. Although Canada, Russia, and the UAE each provided more than China, the country has rapidly become a formidable player in the global aluminum market, increasing production 12-fold since 2000. However, China's use of subsidies to stimulate domestic production has led to a 300,000 ton glut in global market, according to Morgan Stanley. This oversupply has pushed prices down 45% and has left US companies on the verge of bankruptcy, claim Trump administration officials.

China's Commerce Ministry spokesman Sun Jiwen has indicated that China is "seriously concerned" by the investigation and hopes to resolve the dispute through talks. The country's existing efforts to cut production have shown success so far; China's year-on-year production growth is down 16 percent from March 2016, according to Goldman Sachs.

Despite the Trump administration's tough talk, China is not without recourse. Beijing and other national governments are exploring the possibility of retaliating against US exports, a prospect that is helping to moderate the adoption of overly stringent measures.

**Japan Secretary General confirmed to attend One Belt, One Road summit**

Toshihiro Nikai, the secretary general of Japan's ruling party and second in command to Prime Minister Shinzo Abe, will attend China's One Belt, One Road (OBOR) summit in May. With the announcement, Japan becomes the second G7 state to attend the China-initialized summit, following the example of Italy.

*Why Japan decided to attend*

Onlookers are interpreting Nikai's presence as a sign that Tokyo seeks to rebuild trust with Beijing. The Sino-Japanese relationship has been fraught since the mid-1900s, with regional competition and memories of an imperialist Japan tainting interactions.

However, Japan appears poised to build better relationships for a variety of pragmatic reasons. First, in observing the growing regional tension over a militantly nuclear North Korea, Japan joins with South Korea and the US in motivating China to play a bigger role in containing the renegade state.

Second, disquieted by the rapid rise of China's economy--which surpassed Japan to become the world's second largest—Japan also hopes to contain China's regional influence. Although Japan originally declined to join the China-led Asian Infrastructure Investment Bank (AIIB) in favor of the US-led Asian Development Bank, Japan now wishes to hedge its bets and have a greater say in the growing AIIB and OBOR universe.

**PBOC governor: China is "fully confident" that financial risks "well under control"**

While speaking at the International Monetary Fund Committee (IMFC) Conference in Washington, PBOC governor Zhou Xiaochuan ensured the audience that China was fully aware of the potential issues in the financial system and remained fully committed to mitigating the systemic risks.[4]

*Loudly acknowledging the problem: a good sign*

In a statement released on the IMF website, Zhou highlighted China's better-than-expected macro data in the first quarter, asserting the country is on track to achieve the year's 6.5% growth target.[5] He emphasized that supply-side reforms and growing industrial profitability were helping to improve the financial landscape, while promising that the Chinese government was taking action to remedy nonperforming loan problems and the growing shadow banking sector. The PBOC's deputy governor echoed similar refrains at last week's Bloomberg conference, helping to assuage investor worries that key leaders were attempting to gloss over structural problems with flashy new proposals such as the Xiongan Special Economic Zone.

Notes:

1. USD: US Dollar, the national currency of the United States
2. UAE: United Arab Emirates
3. RMB: Renminbi, the national currency of China
4. PBOC: People's Bank of China
5. IMF: International Monetary Fund