

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

President Xi emphasizes importance of “serving real economy,” and “containing financial risk” during Financial Work Conference

In a speech during the Financial Work Conference (FWC), President Xi outlined three priorities for China's financial system: serving the real economy, containing financial risk, and deepening financial reforms. A new Financial Stability and Development Commission (FSDC) has been established to coordinate the supervision of these tasks, though specifics about the proposed body remain undisclosed.

The FSDC: A Primer

As a State Council-level agency, the proposed FSDC will assume a prominent and proactive role in bridging China's regulatory gaps. As it stands presently, China's financial regulatory duties are shared by three agencies: the CSRC, CBRC and CIRC.^{1,2,3} However, this decentralized structure has proven insufficient to govern challenges related to the rise of disruptive technologies and trends like internet finance and financial supermarkets (i.e. banks provide brokerage and asset management services). To remedy the situation, reformists argue that the People's Bank of China (PBOC) should adopt a US Federal Reserve-esque model, managing both monetary policy and financial regulation. Although the new FSDC will sit under the PBOC, it falls short of serving as the superregulatory role that many assumed would emerge from the two-day conference.

Linguistic focus on financial stability

Despite the limitations of the FSDC structure, regulators nonetheless appear committed to designing impactful reform, evidenced by quantitative analysis of conference speeches. The words “risk” and “regulations” were mentioned 31 and 28 times respectively, a frequency that indicates the urgency with which officials are attempting stave off future crises. Representing another linguistic signifier, “stability” precedes “development” in the FSDC title, a symbolic arrangement previously unseen in the 40+ year history of China's growth-obsessed capital markets.

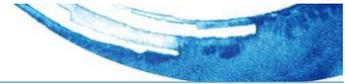
NDRC, bank regulators add another nail to the overseas acquisition spree coffin

China's National Development and Reform Commission (NDRC) issued a statement urging Chinese firms to curb “irrational” overseas investments in the real estate, hospitality, entertainment and sporting industries. Adding teeth to the pronouncement, Chinese banks were reportedly blocked from extending loans to conglomerates like Wanda, HNA, Fosun and Sunac. Standard & Poors assigned the BBB- rated Wanda to their “negative” watch list, while two of the three international agencies downgraded Sunac.⁴ As a result investors sold off bonds and equities of the enterprises *en masse*.

Why the change in tone?

The NDRC's announcement and subsequent regulatory freeze are but the latest efforts in China's year-long crackdown to reduce systemic risk. The recent events represent a marked divergence from the aftermath of the 2012 FWC, whereby Chinese companies in search of outsized returns began reallocating resources from the real economy to leveraged capital and property market speculation. Wanda, HNA, and co. were among the most egregious speculators, directing billions of dollars to highly-leveraged overseas acquisitions. Their strategies have been effectively stymied, however. It seems the coordinated crackdown is yielding results. According to the Ministry of Commerce, outbound direct investment in non-financial sectors has dropped almost 46% YoY thus far in 2017.⁵

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US-China business leaders conduct productive meeting while official summit languishes

Business leaders representing US and Chinese firms gathered in Washington to discuss economic issues of mutual importance during the inaugural US-China Business Leaders Summit. The private meeting preceded the official US–China Comprehensive Economic Dialogue, the latter of which ended abruptly without producing a joint statement.

Summit summary

Fearful that the current political climate was jeopardizing hard-fought business relationships, Alibaba founder Jack Ma organized and co-hosted a daylong summit with Blackstone Group co-founder Stephen Schwarzman. The gathering of 20 included Chinese businessmen and prominent CEOs from Walmart, JP Morgan, General Motors, General Electric, and IBM, among others. Although the day-long event was considered symbolic rather than material—no real outcome was anticipated—onlookers were nonetheless pleased that such a high-level group took the pragmatic initiative to meet and establish relationships on their own accord.

Dialogue disaster

The Commerce and Treasury Secretary-led US–China Comprehensive Economic Dialogue did not have similarly productive outcomes. The idea for the Dialogue was initially established during Trump and President Xi's April summit at Mar-a-Lago. In advance of the meeting, the US delegation argued that the USD 340 billion trade deficit was not “a natural product of free market forces,” and requested that the “fundamental asymmetry” be addressed. However, leaders from the two sides were unable to agree on concrete initiatives and cancelled the joint news conference that was scheduled to bookend the talks.

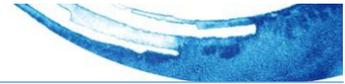
China's government announces effort to establish global AI leadership by 2030

China's State Council issued an ambitious blueprint to build a world-leading, USD 150 billion Artificial Intelligence (AI) industry by 2030. Seeking to establish AI as a major economic driver, the State Council outlined three steps for industry development: 1) keep pace with leading AI technology through 2020; 2) pioneer major breakthroughs and innovations by 2025; 3) establish world leadership by 2030.

Why China is pursuing AI

China's State Council seeks to leverage AI to facilitate China's transition from an investment-driven to consumption-forward economy, increasing the country's competitive advantage in the process. A recent PwC report concluded that China has much to gain from the investment. The country stands to become the world's largest AI beneficiary due to its residual globe-topping status as a manufacturing giant.

China's first steps to AI dominance have been auspicious. According to Wuzhen Institute, the country is already ranked second globally for its number of AI companies and AI funding received. Although China still lags the US by a significant margin-- Silicon Valley's startups enjoy a dominant advantage in AI investment and technology development—the country is catching up due to private and public funding. Private enterprises such as Alibaba, Tencent, JD.com and Lenovo have been investing heavily in AI, while the government plans to launch investment vehicles focused on a range of military, academic, and commercial applications.



Notes:

1. CSRC: China Securities Regulatory Commission
2. CBRC: China Banking Regulatory Commission
3. CIRC: China Insurance Regulatory Commission
4. S&P bond ratings categories: AAA: An obligation rated 'AAA' has the highest rating assigned by S&P Global Ratings. The obligor's capacity to meet its financial commitment on the obligation is extremely strong. AA: An obligation rated 'AA' differs from the highest-rated obligations only to a small degree. The obligor's capacity to meet its financial commitment on the obligation is very strong. A: Obligations rated A are judged to be upper-medium grade and are subject to low credit risk. BBB: An obligation rated 'BBB' exhibits adequate protection parameters. However, adverse economic conditions or changing circumstances are more likely to lead to a weakened capacity of the obligor to meet its financial commitment on the obligation. BB; B; CCC; CC; and C: Obligations rated 'BB', 'B', 'CCC', 'CC', and 'C' are regarded as having significant speculative characteristics. 'BB' indicates the least degree of speculation and 'C' the highest. While such obligations will likely have some quality and protective characteristics, these may be outweighed by large uncertainties or major exposures to adverse conditions. D: An obligation rated 'D' is in default or in breach of an imputed promise. For non-hybrid capital instruments, the 'D' rating category is used when payments on an obligation are not made on the date due, unless S&P Global Ratings believes that such payments will be made within five business days in the absence of a stated grace period or within the earlier of the stated grace period or 30 calendar days. The 'D' rating also will be used upon the filing of a bankruptcy petition or the taking of similar action and where default on an obligation is a virtual certainty, for example due to automatic stay provisions. An obligation's rating is lowered to 'D' if it is subject to a distressed exchange offer. NR: This indicates that no rating has been requested, or that there is insufficient information on which to base a rating, or that S&P Global Ratings does not rate a particular obligation as a matter of policy.
http://www.standardandpoors.com/en_US/web/guest/article/-/view/sourceId/504352
5. YoY: Year-over-year