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

President Xi visits Hong Kong, warns Hong Kong not to challenge Beijing authority

Chinese President Xi visited Hong Kong for a three-day visit to commemorate the 20th anniversary of the city's handover from Britain. The trip brought discussion of the contentious "One Country, Two Systems" principle and a stern speech upholding Beijing's rule.

One country, two systems: a brief history

When Hong Kong was transferred from British to Chinese governance in 1997, it was agreed that the city could retain its capitalist economy and political, legal, and financial systems while remaining under the ultimate rule of China. Known as "one country, two systems" and the "Basic Law," this dual mandate has become increasingly tenuous in recent years as Hong Kong's growth has slowed and political conscious awakened. While Hong Kong was formerly the West's sole window to China—ensuring the city's privileged middleman status—China's liberalizing markets and rising megacities have stripped Hong Kong of its role as the primary hub for Eastern innovation, finance, and logistics.

To restore Hong Kong's economic fortunes, some in the city are angling for autonomy. This sentiment drew hundreds of thousands to Hong Kong's streets in 2013 during the "Occupy Central" protests, and caused two members of Hong Kong's Legislative Council to launch a failed, though heavily publicized, bid for legislative independence. Concerned about the dissident voices, Beijing has moved to usurp perceived threats in recent years, leaving independence-minded Hong Kongers unsettled about the future of the "two systems" principle.

Emphasis on "one country"

Although Xi announced a package of favorable policies and emphasized China's continued support of Hong Kong's growth and the "one country, two systems" model, he also struck an ominous tone in a closely-watched speech. He stated that challenges to China's sovereignty crossed a "red line" and were "absolutely impermissible." Xi departed before the annual July 1st pro-democracy march kicked off.

China's stock exchanges responsible for 30% of global IPO fundraising in 1H2017[1]

China's exchanges in Shanghai, Shenzhen and Hong Kong ranked second, third, and fourth, in the global IPO market in 1H2017, raising USD 11 billion, USD 7.1 billion and USD 6.9 billion, respectively.[2] The three markets were responsible for 30% of global IPO fundraising during the period.

Changing patterns of dominance

This year's results represent a reversal of 2016 trends, which saw Hong Kong assume the top spot globally. In contrast, China's A-Share IPO market showcased its strongest half-year performance in a decade, raising four times the funds it did in 1H2016.

Accounting firm Ernst and Young attributed the surge of inflows to both performance and policy. The firm found that all A-Share listings rose to their debut limit of 44%, while the average IPO return reached a jaw-dropping 153%. Ample liquidity and reasonable valuations were the prime drivers of outperformance, which is expected to continue as IPO reform promises to shorten the IPO process and encourage a higher dividend payout ratio.

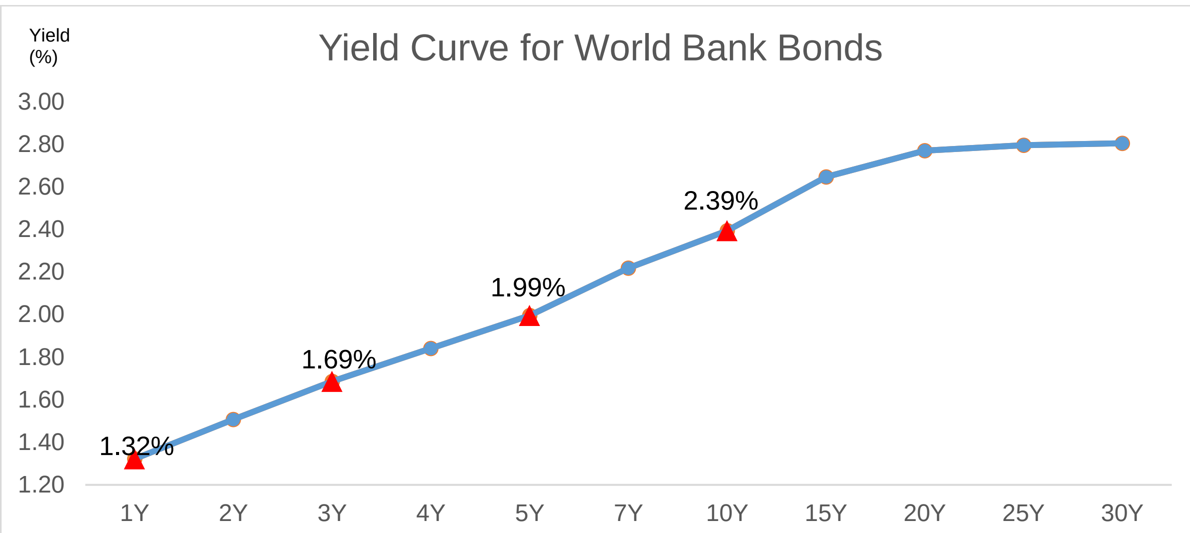
Moody's grants highest rating to China-backed AIIB debt

The China-backed Asian Infrastructure Investment Bank (AIIB) received the top Aaa rating from Moody's, a grade equivalent to that held by the US-based World Bank and Japan-led Asian Development Bank.

'Aaa' big milestone for the AIIB

The triple-A rating is considered a major victory for the AIIB. It will lower fundraising costs as the bank expands its 80-country membership and USD 100 billion capital base. Although Moody's recently downgraded China's sovereign credit rating from Aa3 to A1, the demotion did not tarnish views on the AIIB, which Moody's commended for its strong governance frameworks, robust risk management, capital adequacy, and reassuring liquidity position.

The stamp of approval paves the way for AIIB to sell bonds to international investors. Last April, the bank said it would commence fundraising upon obtaining a favorable credit rating, and confirmed last week that it might issue its first USD-denominated bond as early as this year. Treasurer Soren Elbech indicated that the instrument would be a benchmark bond, but did not specify a maturity. Onlookers have begun investigating the yield curves of similar international agencies for potential clues about the debt's structure.



Source: Bloomberg, as of 6.30.2017

Despite slowing GDP growth, Premier Li assures that China will not face hard landing[3]

China's Premier Li Keqiang assured audiences at the World Economic Forum in Dalian that China was not facing a hard landing. In a widely followed speech, Li promised a continuation of "stable and prudent" monetary policy, confirmed China's commitment to free trade, and encouraged foreign business to retain and reinvest profits in China.

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BOND RATING CATEGORIES: Aaa: Obligations rated Aaa are judged to be of the highest quality, subject to the lowest level of credit risk. Aa: Obligations rated Aa are judged to be of high quality and are subject to very low credit risk. A: Obligations rated A are judged to be upper-medium grade and are subject to low credit risk. Baa: Obligations rated Baa are judged to be medium-grade and subject to moderate credit risk and as such may possess certain speculative characteristics. Ba: Obligations rated Ba are judged to be speculative and are subject to substantial credit risk. B: Obligations rated B are considered speculative and are subject to high credit risk. Caa: Obligations rated Caa are judged to be speculative of poor standing and are subject to very high credit risk. Ca: Obligations rated Ca are highly speculative and are likely in, or very near, default, with some prospect of recovery of principal and interest. C: Obligations rated C are the lowest rated and are typically in default, with little prospect for recovery of principal or interest. While such obligations will likely have some quality and protective characteristics, these may be outweighed by large uncertainties or major exposures to adverse conditions. Non-Rated: These bonds are not rated.

Opinion roundup

Bearish onlookers who predicted a hard landing were surprised by China's 6.7% GDP growth and improving macro data in 1H2017. Despite the near-term uptick, opinions differ about China's prospects moving forward.

- The **Bank of China** is among the most optimistic prognosticators, predicting 6.8% growth for 2017.
- **Former PBOC adviser Li Daokui** went a step further, anticipating 6.7% growth in 2017 and a whopping 7.9% in 2018 barring "unexpected international events." [4]
- The **IMF** has adopted a middle-of-the-road approach with their 6.7% forecast for 2017, a slight improvement up from their previous 6.6% estimate.[5] They surmise the good times won't last, however, anticipating 6.4% growth for 2018-2020.
- Finally, **Fitch** is the least sanguine of the bunch. The ratings agency posits 6.5% growth in 2017 and a dramatic falloff to 5.9% in 2019 and 5.8% in 2020.

China's Mobike expands bike share platform internationally, signaling transition from copycat to innovator

China's Mobike has launched 1000 shared bikes in Manchester, England, the company's first foray outside of Asia. Mobike currently operates 5 million shared bikes in Tier-1 cities like Beijing and Shanghai, but has expressed ambition to expand its service internationally to cover more European cities.[6]

Why the Mobike story matters

Mobike's overseas expansion offers an example of China's transition from a copycat to a global innovation leader. While shared bikes in the United States are typically parked in designated bike docks, China has innovated on the model. For fees as low as USD 15 cents, Chinese users can park the GPS-enabled bikes anywhere, unlocking spare bikes with smartphone apps and QR codes. To avoid bad behavior, Mobike users are provided credits and earn more by documenting and reporting abuses like bad parking jobs. Upon verification of their claims, informant users receive additional credits while perpetrators are docked. Those with less than 80 credits can find it prohibitively expensive to rent bicycles. The "dockless" system has proved wildly popular; 13 out of 15 of the world's largest bicycle share programs are in China.

Speedbumps ahead?

The rapid expansion of China's model of bicycle sharing is not without hiccups. Shared bicycle parking has, at times, overwhelmed public areas, forcing some Chinese cities to regulate parking. The problem of theft and damage also persists; one Chinese company recently filed for bankruptcy after 80% of its cycles were stolen.

Notes:

1. IPO: Initial public offering
2. USD: US Dollar, the national currency of the United States
3. GDP: Gross Domestic Product
4. PBOC: People's Bank of China
5. IMF: International Monetary Fund
6. Tier-1 Cities: Chinese cities that are directly controlled by the central government with populations over 15 million and GDP over USD 300 billion