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

China's Politburo vows to maintain "steady progress" in 2H2017; onlookers expect continued tightening

In a statement summarizing their July meeting, China's 25-member Politburo promised a "proactive" fiscal policy and "prudent" monetary approach, setting a conservative policy tone for the remainder of 2017. The group promised to combat systemic financial risks by continuing supply-side reform, strengthening regulatory coordination, de-risking local governments, liquidating zombie companies, and stabilizing the property market.

Economic priorities

China's 6.9% GDP growth has outpaced expectations in the first half of the year, rendering continued tightening psychologically acceptable.[1] Stability continues to reign as the key theme, though other priorities include:

1. Supply side reform including cutting excess capacity, reducing inventory, and deleveraging, merging, or even liquidating zombie companies
2. Managing local government debt. Leaders seek to cut local government borrowing and curb the growth of hidden debt, crafting a less favorable fiscal policy environment
3. Coordinate financial regulation to develop an innovative, modern system that serves the real economy and combats bubbles
4. Stabilize the real estate market and reduce speculation

What to watch moving forward?

Authorities expressed particular concern over falling foreign direct investment and persistent capital outflows, and vowed to create policies improving the business environment for foreign companies. As a result, policymakers are undertaking a quiet campaign to revise asset protection laws and simplify administration process to encourage inflows of more private capital.

Chinese startup launches cashier-less convenience store in Shanghai, plans to open 5,000 more by end of 2017

Chinese startup BingoBox introduced its first unmanned convenience store in Shanghai, relying on smartphone apps, mobile wallets, and facial recognition technology to process customers and protect against theft. The firm plans to deploy 5,000 stores in China in the coming year.

How it works

In the absence of cashiers, customers scan mobile barcodes to enter the store, process items with a self-service scanner, and pay with their WeChat Wallet or Alipay. Sensors and facial recognition cameras monitor operations to prevent theft or unauthorized customers. BingoBox reports that the stores are 20-30% cheaper to operate than same-sized competitors and can function without security breaches. Indeed, the company boasts 50,000 successfully completed transactions without theft or damage. Adding to the appeal, the franchise-friendly units are built on wheels, allowing owners to switch locations to react to shifts in customer demand.

The past and future of unmanned stores

Amazon pioneered the unmanned convenience concept in December 2016 with launch of their Amazon Go storefront in Seattle. Only available to Amazon employees, the store allows shoppers to check in with mobile Amazon accounts and relies on cameras and wall sensors to automatically charge customers for products removed from shelves. Despite the novelty of the concept, Amazon has delayed plans to open the store to the general public due to “technical difficulties” involved in keeping track of customers and merchandise.

Some spectators believe that the unmanned store concept will proliferate faster in China as startups, existing retailers, and web giants like JD.com pile onto the bandwagon. Research firm IT Juzi indicates that nearly USD 20 million has been invested into the space in less than a month.[2] China’s government innovation funds are also leading the charge as part of the wider effort to transform China’s manufacturing-dominated economy into one driven by consumption and technology.

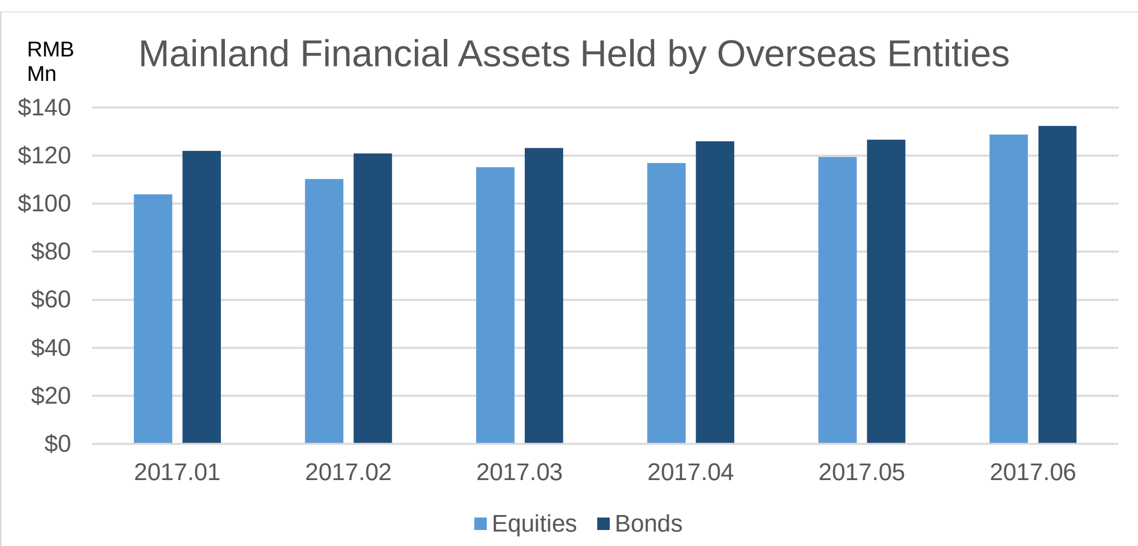
Foreign ownership of mainland securities on the rise, according to PBOC data

Foreign ownership of onshore equities has grown 7.8% since May and 23.9% since January, according to new data released by the People’s Bank of China. Foreign ownership of bonds and depositions have seen a similar jump, respectively reaching a record high of RMB 892.10 billion (USD 132.22 billion) and RMB 1180.97 billion (USD 175.04 billion) as of June 30, 2017.[3]

What's driving the growth of foreign ownership?

Onlookers attributed the inflows to both strong equity market performance and improved market access. For example, the onshore FTSE China A50 Index gained 15.97% in local currency (18.97% in USD terms) in 1H2017, outperforming the S&P 500 Index by 9.62% during the period.[4,5,6] As the valuation of China’s onshore large-cap equities remains attractive-- and continues to benefit from ongoing state-owned enterprise reforms--performance is expected to maintain the upward trajectory. Introduction of the Shenzhen Stock Connect Scheme and MSCI A-Share inclusion provide further support for the foreign inflows, a one-two punch estimated to bring hundreds of billions into China within the decade.

Foreign bond holdings are also expected to increase in 2H2017 following the early July launch of the Mainland-Hong Kong Bond Connect program.[7] The scheme helps investors avoid complicated registration processes while alleviating capital control concerns with offshore trade settling. As the biggest selling point, Chinese government bonds offer yields 100-300 bps greater than debt from the US, UK, Germany and Japan. The stable RMB outlook is yet another motivating factor; the currency’s 2.6% appreciation against the USD in 1H2017 affords an appealing incentive for dollar-denominated investors.



Source: PBOC, as of July 2017

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China assumes world leadership in electric transport industry, beating out Germany, Japan, Korea, and US

China has assumed world leadership in the electric transportation industry, according to German consulting firm Roland Berger. The Made in China 2025 industrial policy initiative and local production of lithium-ion batteries are largely responsible for the rapid ascendance.

How did the industry evolve so quickly?

Eager to both manufacture more sophisticated products and address the growing pollution problem, China's government has pushed hard to encourage development of the electric automobile industry. Policymakers have employed a variety of carrots and sticks, ranging from offering producer subsidies worth 60% of each car's value to mandating 12% of car sales be electric by 2020. Consumers too have reaped benefits, securing an incentive package worth up to 30% of the car's original price. Sales quadrupled in 2015 as a result of the policy measures. And by 2016, China's electric vehicle sales represented 32% of the global total

But is it coming to an end?

Despite the astonishing growth, a growing chorus of onlookers believes that China's market will soon face a slowdown. Displeased with outcomes, China's government cut subsidies by 20% in January 2017 and plans to phase them out completely by 2020. Many companies who had come to rely on the largesse are already feeling the pinch.

Chinese automaker and battery manufacture BYD offers a cautionary tale of the hazards of subsidies. The firm allegedly received USD 435 million in subsidies from 2010-2015, securing incentives equivalent to 14.1% of the firm's whole year net profit in 2016 alone. With the slowdown in handouts, BYD's 1Q2017 profit fell 28.79% YoY, with new energy car sales plunging almost 50% in the same period.[8]

Notes:

1. GDP: Gross Domestic Product
2. USD: US Dollar, the official currency of the United States
3. RMB: Renminbi, the official currency of the People's Republic of China
4. FTSE China A50 Index: An index comprised of the 50 largest A-Share companies on the Shanghai and Shenzhen Stock Exchanges. *One cannot invest directly in an index.*
5. 1H2017: First half of 2017
6. S&P 500 Index: An index comprise of the top 500 large-cap equities on the New York Stock Exchange. *One cannot invest directly in an index.*
7. 2H2017: Second half of 2017
8. YoY: Year-over-year