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

China's state media promotes neutrality if North Korea attacks first, action if US provokes

In response to President Trump promising "fire and fury" on North Korea, China's state media released a controversial article calling for Chinese neutrality if North Korea received retaliation after launching an attack that threatened the US. The author further argued that China should offer aid should external forces attempt to subvert the North Korean regime.

Meanwhile, President Xi urged calm during a phone call with President Trump, encouraging all sides to convene talks.

Would North Korea initiate strikes on South Korea/ the US?

Although North Korea possesses a dominant advantage over neighboring South Korea in military personnel and equipment like fighter jets, tanks and battleships, South Korea boasts superior military tactics, training, logistics, and the trump card of US support.

Aware of the disadvantages and stated China's neutrality, it is unlikely that North Korea would take action to trigger a war with South Korea. Despite threats to Guam, it is similarly unlikely that North Korea would launch strikes on US territory. Geopolitical strategists interpret North Korea's posturing as a bluff to win bargaining power on the negotiating table.

Would South Korea/ US attack North Korea?

Home to a population of 25 million, Seoul sits a mere 35 miles from the North Korean border. Despite the strengths of South Korea's army, any fighting would yield direct collateral damage for Seoul. Moreover, 140,000 American citizens currently live in South Korea. Involvement in a war with North Korea – despite the likelihood of victory– would bring economic catastrophe for South Korea and a major political headache for US leaders. As such, because of the prospect of mass casualties, diplomacy seems the likeliest course of action.

China's mixed monetary data shows slowing M2 growth, growing new loan figures

China reported a mixed bag of monetary data in July. M2 grew 9.2% in the month, falling below June's 9.4% and the 9.5% market consensus.[1] However, July's Total Social Financing reached RMB 1.22 trillion, exceeding the RMB 1 trillion market expectation.[2] Meanwhile, despite New Yuan Loan grows touching November 2016 lows, the RMB 825.5 billion figure exceeded analysts' anticipated RMB 800 billion estimate.

What's the implication?

July was the third continuous month that M2 fell below the 10% level, pointing to authorities' determined attempts to deleverage the financial system. Counterintuitively, the New Loan figures also indicate successful reform; they suggest that banks have responded to regulations by moving risky shadow credit back onto their books. Despite the progress, the excessive Total Social Financing figures demonstrate that authorities are hesitant to tap the brakes too aggressively so as to cause a hard landing.

Taken together, the recent macro data helps inform future financial sector strategy: deleverage the financial sector and squeeze profits back to the real economy-- especially the manufacturing sector. Even if the economy starts to cool and the financial sector sputters—as many onlookers predict it will—China's manufacturing sector is expected to emerge victorious.

The views expressed represent an assessment of market conditions at a specific point in time, are opinions only and should not be relied upon as investment advice regarding a particular investment or markets in general. Such information does not constitute a recommendation to buy or sell specific securities or investment vehicles.

State-Owned China Unicom furthers mixed-ownership reforms with USD 11.7 bn share sale

China Unicom, the world's fourth largest mobile service provider by subscriber base, kicked off its long-anticipated mixed ownership reforms. In a company announcement, management explained that strategic investors like Tencent and Alibaba will subscribe for ~9 billion new shares at RMB 6.83.

Context of the reforms

To combat China's slowing economic growth, many onlookers advocated for reforms to increase SOE productivity.[3] Chinese authorities have recently bowed to the rationale, encouraging private capital to play a more important role in sectors like telecom, oil and military that were previously dominated by the state. In 2016, China Unicom was one of six SOEs hand-selected for a pilot program to funnel capital into the state firms.

Who is involved in the Unicom deal?

Whereas large institutions like insurance companies previously served as the main investors into state-owned companies, China's internet giants like Tencent, Alibaba, Baidu and JD.com are reportedly among the list of Unicom's new owners. Many onlookers are heartened by their participation, as the savvy giants are expected to bring modern corporate governance and potential business cooperation to the aging SOE.

The participation of China's internet behemoths is not without controversy, however. The fast-growing startups have historically had a somewhat adversarial relationship with the state-owned "Gray Rhinos," often accused of stealing business. For example, Tencent's wildly popular WeChat service cannibalized China Unicom by providing users with internet-based messaging and phone services that competed with Unicom's text and telephone platforms. However, aware that the private digital giants will not be stemmed, China's authorities finally relented and allowed the disruptors to take a significant share of the state-owned monopolies.

Wolf Warrior II movie sets worldwide records, becomes country's top grossing film of all time

China-produced Wolf Warrior II earned USD 685 million in four weeks of box office sales, handedly earning the title of China's top-grossing film of all time.[4] It is the first non-Hollywood production ever to break the top-100 list of highest grossing films worldwide.

What's the story?

The film portrays a Chinese Special Forces commander in an unnamed African country who singlehandedly overcomes an army of mercenaries to evacuate Chinese workers to safety. Although Western audiences have long been accustomed to single hero Rambo-esque action flicks, Wolf Warrior II represents the first domestically-produced movie to create a slick superhero geared to the Chinese audience.

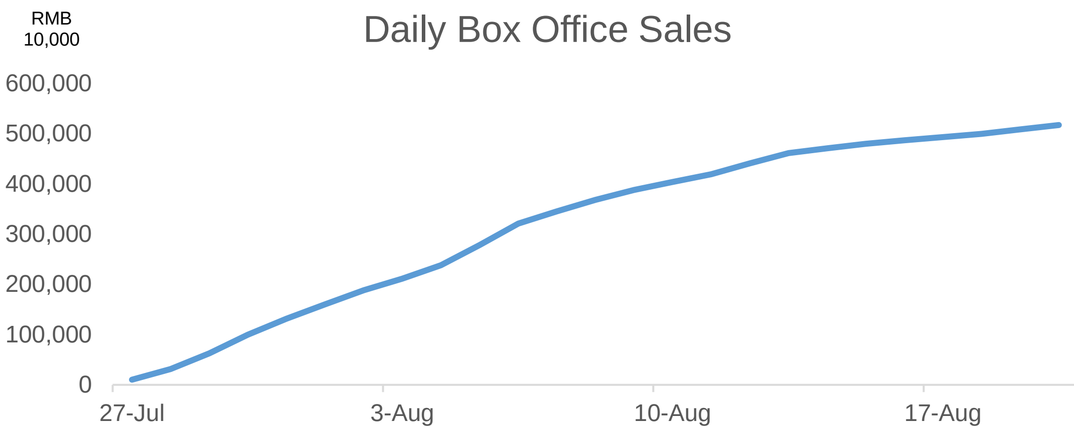
Why the movie so popular?

The film's popularity has largely been attributed to the Chinese public's growing nationalism, driven by President Xi's vows to return the country to its former glory. Under Xi's Belt and Road initiative, Chinese corporations have actively invested in overseas markets, making significant inroads into fragile nations in Africa, Asia, and the Middle East. Some movie reviewers compared the timely plot to the massive evacuation of tens of thousands of Chinese workers from war-torn Libya in 2011.

Skeptics attribute the film's success to the six-week summer blackout of foreign films, during which time Chinese authorities limit the number of imported films by around 50%. Some believe that the Wolf Warrior

The views expressed represent an assessment of market conditions at a specific point in time, are opinions only and should not be relied upon as investment advice regarding a particular investment or markets in general. Such information does not constitute a recommendation to buy or sell specific securities or investment vehicles.

juggernaut capitalized on the lack of competition, and will slow when foreign films begin reentering the market at their regular pace.



Source: pf.maoyan.com, as of 8.21.2017

IMF upgrades China's GDP growth outlook from 6% to 6.4% for 2017-2020, calls rapid credit growth "dangerous"

The International Monetary Fund (IMF) revised its forecast of China's annual GDP growth from 6% to 6.4 per cent from 2017 to 2020.[5] Caveating their findings, the organization predicted that China's debt level would continue to rise faster than GDP, "dangerous" credit growth that adds medium-term risk to financial stability.

What drove the IMF's revised forecast?

China's growth in 1H2017 outperformed both government guidance and analyst consensus, winning authorities time to deleverage the financial system and reform the growth model.[6] IMF analysts were encouraged by both President Xi's commitment to reform and evidence of success such as lower M2 growth and shrinking local government debt burdens.

However, China is not out of the woods yet; more action is needed to defuse the bombs which could trigger a financial meltdown *ala* 1980's Japan. According to IMF research, a sharp rise in private lending typically predicates economic slowdown and financial crisis. Admittedly, at 46%, China's national saving rate is more than double of the global average. However, onlookers say that China has a narrow window of time to reduce overcapacity while encouraging private spending before outstanding debt becomes too onerous.

Notes:

1. M2: Defined as the sum of currency held by the public and transaction deposits at depository institutions in addition to savings deposits, small-denomination time deposits less than $100,000, and retail money market mutual fund shares.
2. RMB: Renminbi, the national currency of China
3. SOE: State-owned enterprise
4. USD: US Dollar, the national currency of the United States
5. GDP: Gross Domestic Product
6. 1H2017: 1st half of 2017

The views expressed represent an assessment of market conditions at a specific point in time, are opinions only and should not be relied upon as investment advice regarding a particular investment or markets in general. Such information does not constitute a recommendation to buy or sell specific securities or investment vehicles.