What You Should Know This Week: CSOP's Weekly China Wrap Up

China's new super financial regulator established, with focus on stability ahead of development

China officially established a new super financial regulator called the Financial Stability and Development Committee (FSDC), placing it directly under the State Council. According to the state media, the committee held its first meeting to define its functions, which include supervision of China's monetary policy and financial regulation. Vice Premier Ma Kai reportedly was appointed to head the super financial regulator. The committee will supervise the existing financial regulators, making it a very powerful agency.

What are the implications?

The agency was created by the Financial Work Conference last July under the order of President Xi to tackle financial risk and safeguard financial stability. For the first time in the history of China, stability was put ahead of development – as in the new agency name. The focus demonstrates the leadership's concern around financial risk, especially after the 2015 stock market turmoil. After a decade of easy credit and wild economic expansion, China saw its financial system put on excessive leverage. China's broad money supply, M2, surged from RMB 18.5 trillion at the end of 2002 to RMB 165.6 trillion by the end of September 2017, at CAGR of 15.7%. Meanwhile, rogue investors looked for arbitrage opportunities between segmented regulation system in recent years, exampled by the famous fight between Foresea Insurance and Vanke.

The establishment of FSDC and the nomination of Ma Kai have significant impact on China's future financial landscape. Firstly, FSDC is headed by a vice premier, making the agency a level higher than other regulators including PBOC, CSRC, CBRC and CIRC. Secondly, the appointment of Ma suggests President Xi will be even more involved in the new regulator. While Ma has extensive political experience as one of the four vice premiers, he has little financial experience. As well, he has already reached the official retirement age at his current 71-years and is likely to be replaced in the next reshuffle. Thirdly, the influence of the People's Bank of China (PBOC) and its governor would be significantly weakened under the FSDC, with the next candidate unlikely to be as independent or as important as before.

Tencent's literature arm goes public in Hong Kong as the hottest tech debut in the city

China Literature, the country's largest publishing and e-book website, went public on the Hong Kong Stock Exchange (HKEx), in the hottest technology initial public offering (IPO) in the history of the city. The listing attracted record demand, oversubscribed 625 times the offering amount, and locked up HKD 520 billion (USD 66.7 billion) of funds. Citing ambitions of "want(ing) to become China's version of Marvel", the company, which is a subsidiary of Tencent and a market leader for both readers and writers of written content in China, intends to use the funds raised to develop films, games and other forms of entertainment based on existing intellectual property. The sale raised USD 1.06 billion, bringing the IPO to the second largest tech deal this year, after Jack Ma-backed Zhong An Insurance's USD 1.5 billion debut just a few months back. Enthusiasm for China Literature dwarfed the insurtech company's however, which was 391 times overbought and locked up HKD 200 billion (USD 25.6 billion) of funds.

What are the implications?

This year has been a dynamic one for HKEx, a market historically focused around financial services rather than technology IPOs. In addition to Zhong An and China Literature, US-based gaming equipment company Razer and leading Chinese car financing platform Yixin Group have also filed for IPOs in the city. The listings are helping HKEx rebrand itself as somewhat of a tech IPO hub. The exchange also announced a new initiative to allow "unicorns" – internet companies with valuations greater than USD 1 billion – to dual-list in Hong Kong, which should support the trend and further increase access of Chinese tech companies offshore.

The enthusiastic reactions were also met with concerns however. Some sees China Literature to be overvalued, lifted by “Tencent glory” rather than fundamentals. The company posted net profits this past half year, swinging from net losses the year previous. Additionally, with HKEx becoming more and more a gateway to China, international listings are being left behind. Two prominent international names announced they will be delisting from HKEx; American luxury brand Coach, and commodities firm Glencore, on the basis of thin trading. While technology is the hottest industry of the moment, investors will always want to invest in high quality, traditional companies, and investors have called HKEx to continue to fight for international business.

China’s top central banker places blame on local government leverage for financial instability

People’s Bank of China (PBOC) governor Zhou Xiaochuan blamed the local government calls for loose monetary policy as the root cause of the country’s financial fragility. According to the governor, the distorted monetary policy caused excessive leverage in the public sector and contributed to systemic risk in the country. The accusation comes a few months ahead of Zhou’s retirement, at the end of a 15-year term as the head of China’s central bank.

What are the implications?

Such a public accusation is rare among government officials in China, even for those who are about to retire. Zhou’s opinion however may be a reflection of what the top leadership thinks. His article was included in the Communist Party’s handbook of official interpretations of policies – indicating his views are officially endorsed by the party. A 15-year serving veteran, Zhou is credited for interest rate liberalization at home, as well as earning the RMB international reserve currency status abroad. At the same time, he was criticized for flooding the economy with excessive money supply.

The governor’s comments may signal a monetary policy shift in China in the coming years. President Xi has been resolute in his drive to curb excessive leverage in the financial system. Xi has also vowed to encourage direct financing in the capital markets rather than continuing to over-rely on bank borrowing. Additionally, Xi has moved the focus from a GDP-driven model to more balanced growth; due to the former model, local governments had tapped easy credit from state-owned banks to fuel economic growth. Furthermore, the top two candidates to be the next PBOC governor, namely Liu He and Guo Shuqing, are both expected to be less dovish on monetary policy.

Index definition:

1. The FTSE China A50 Index is the benchmark for investors to access the China domestic market through A Shares – securities of companies incorporated in mainland China and traded by Chinese and institutional investors under the Qualified Foreign Institutional Investor and Renminbi Qualified Foreign Institutional Investor (QFII & RQFII) regulation. Note that one cannot invest directly in an index

2. The CHINEXT index is China's Nasdaq-like barometer of high-tech stocks. Note that one cannot invest directly in an index

3. The MSCI China Index captures large and mid-cap representation across China H shares, B shares, Red chips, P chips and foreign listings (e.g. ADRs). With 150 constituents, the index covers about 85% of this China equity universe. Note that one cannot invest directly in an index

4. Bloomberg's Global Aggregate + China Index combines the Global Aggregate Index with the treasury and policy bank component of the China Aggregate Index. The EM (Emerging Market) Local Currency Government + China Index combines the EM Local Currency Government Index and treasury component of the China Aggregate Index. Note that one cannot invest directly in an index

5. Citibank's World Government Bond Index (WGBI) measures the performance of fixed-rate, local currency, investment grade sovereign bonds. The JPMorgan Emerging Market Bond Index (EMBI) are a set of three bond indices that track bonds in emerging markets. Note that one cannot invest directly in an index

6. The Hang Seng China Enterprises Index is a free-float capitalization-weighted index comprised of H-Shares listed on the Hong Kong Stock Exchange and included in the Hang Seng Mainland Composite Index. Note that one cannot invest directly in an index

Institutions:

1. PBOC: People's Bank of China
2. SOE: State-owned enterprise
3. IMF: International Monetary Fund
4. CBRC: China Banking Regulatory Commission
5. CIRC: China Insurance Regulatory Commission
6. CSRC: China Securities Regulatory Commission
7. SAFE: State Administration for Foreign Exchange
8. ICBC: Industrial and Commercial Bank of China
9. EU: European Union
10. G20: An international forum for the governments and central bank governors from 20 major economies
11. G7: An international forum for the governments and central bank governors from 7 major economies
12. UAE: United Arab Emirates
13. SSE: Shanghai Stock Exchange
14. LSE: London Stock Exchange
15. AIIB: Asian Infrastructure Investment Bank
16. WTO: World Trade Organization

Currencies:

1. RMB: Renminbi, the national currency of China

2. USD: US Dollar, the national currency of the United States
3. GBP: Pound Sterling/Great British Pound, the national currency of the United Kingdom
4. JPY: Japanese Yen, the national currency of Japan
5. EUR: Euro, the official currency of the Eurozone
6. HKD: Hong Kong Dollar, the national currency of Hong Kong
7. USDCNH: Abbreviation for the US offshore Dollar/RMB currency pair

Others:

1. IPO: Initial public offering
2. SPO: Secondary Public Offering
3. MoM: month over month
4. YoY: Year over year
5. GDP: Gross Domestic Product
6. EM: Emerging Market
7. Bps: Basis points
8. FX: Foreign Exchange
8. OTC: Over-the-counter
9. GDP: Gross domestic product
10. ETF: Exchange-traded fund
11. FATCA: Foreign Account Tax Compliance Act
12. TPP: Trans-Pacific Partnership
13. SDR: Special Drawing Right, an international reserve asset
14. OBOR: One Belt, One Road
15. RCEP: Regional Comprehensive Economic Partnership