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

World's largest emerging markets gather in China for the 2017 BRICS Summit

The 2017 BRICS Summit is kicking off in Xiamen, Fujian from September 3, for an annual gather in which the leaders of Brazil, Russia, India, China and South Africa will get together to discuss economic cooperation. The theme for this year is "BRICS: Stronger Partnership for a Brighter Future", suggesting an effort to improve collaboration among the world's largest emerging markets. The timing of the summit coincided with end of a recent two-month territorial dispute between China and India, during which the two nations conducted military drills to show off their military prowess.

What is BRICS and what importance does it have?

The term "BRIC" – first coined by ex-Goldman Sachs economist Jim O'Neil, then changed to "BRICS" to reflect the addition of South Africa – represents the world's five largest emerging markets which contribute to more than half of the world's population. Together, the group intends to influence global topics such as financial reforms, food safety, energy allocation and climate change. Each member has also benefitted from globalization of the recent decades and is an active member of global trade.

Skeptics argue however, that the five countries have very little in common, in terms of both political and economic systems. Politically, Brazil, India and South Africa employ open democratic systems, while China and Russia do not. Economically, China and India have been growing rapidly, while the others have been negatively impacted by the slump in commodities. Furthermore, there are purported mistrust between members such as China and India – evidenced by the recent border dispute as well as the absence of Indian Prime Minister Modi during the One Belt One Road summit. Given the circumstances, the strength and benefit of such a group remains questionable.

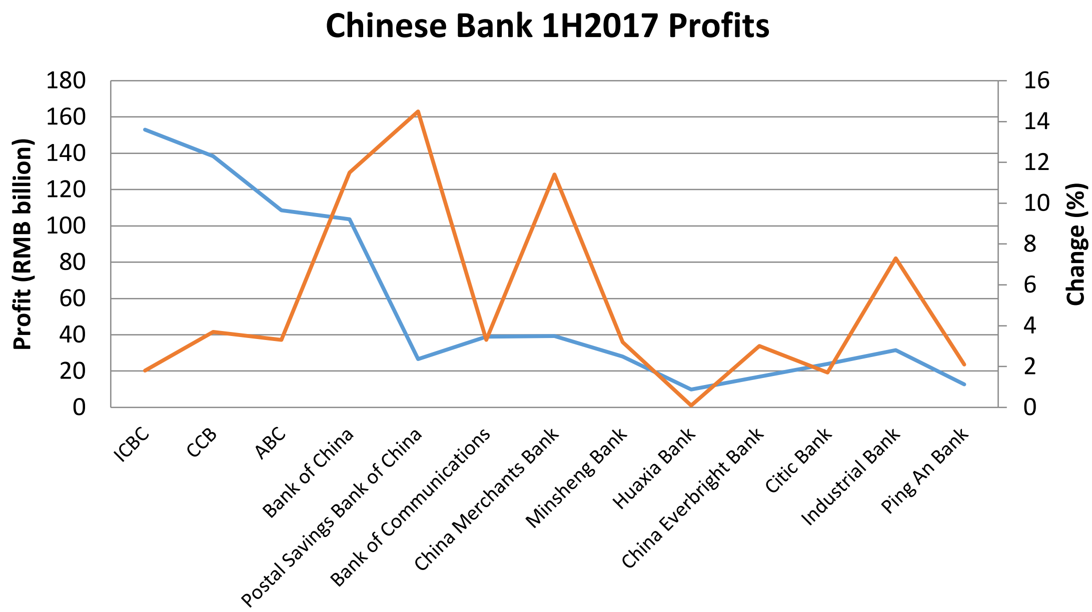
China's banks report solid earnings for 1H2017

China's banking sector reported earnings for 1H2017, with some lenders seeing their net profits jump by double digits. ICBC remained the most profitable with half-year net profits of RMB 153 billion, while Postal Savings Bank of China recorded the highest growth rate of 14.5%.

Who were the winners and why?

Larger banks performed better than smaller players, benefitting from net interest margin (NIM) expansion. NIM is the difference between the interest a bank receives and the interest it pays out. Higher NIM generally indicates improved profitability, especially within Chinese banks, which have much lower non-interest revenue contributions compared to international peers. During the first half of 2017, China's deleveraging initiatives dried up liquidity in the markets, leaving smaller banks struggling to borrow while larger banks survived on larger deposit bases. The difference in access to liquidity allowed larger banks to maintain their NIM levels while smaller players were squeezed.

However, critics have flagged the earning quality of one large bank, Bank of China, questioning the lender's move to slash its non-performing loan (NPL) provision from RMB 50 billion to RMB 27 billion. Generally, a lower NPL provision coverage implies either a more optimistic view on the economy or improved loan quality. In the case of Bank of China however, neither seems to be the reasoning. The large state-owned bank posted the highest profit growth among the big four banks.



China and the US jointly condemns the largest nuclear test performed by North Korea yet

The presidents of China and the US joined forces to condemn North Korea's latest nuclear test over a phone call, according to the White House. The heads of states agreed that Pyongyang's "destabilizing action" is "dangerous to the world", pledging closer cooperation to contain tensions on the Korean peninsula. The latest test performed on September 6 was considered to be the most powerful in the hermit nation's history.

The position of each nation and what that means for the conflict

While the two countries came together to warn North Korea of acting recklessly, they disagree on the path to resolution. President Xi remains determined to resolve the crisis through peaceful talks and disagrees on the effectiveness of further sanctions. Unwilling to let Kim Jong-un's regime collapse in fears of increased political unrest at its border, China is reluctant to stifle its neighbor too much. In addition, China is deeply concerned that a regional war could give Japan, a country with which China and other countries region have deep historical grievances, an excuse to revise its constitution and allow its military to operate outside its own borders.

On the American side however, the Pentagon threatened that any North Korean threats to US allies, including South Korea, would be met with "massive, effective and overwhelming" military response. While the US and its allies are almost certain to be victorious in the case of a full-fledged war, the potential civilian and military casualties would be enormous – which is a worst-case scenario both the American and the newly-elected South Korean presidents would like to avoid. Furthermore, given both China and Russia had consistently opposed increasing sanctions and pressures on North Korea, potential involvement of those nations would further complicate the regional conflict.

Prominent "red princelings" snubbed ahead of a monumental political event

Five senior military personnel linked to revolutionary figures or former state leaders were reportedly left off the invitation list to the 19th National Congress in October, China's most important political event. The rebuff implies that none of the personnel will be included in the president's list of new leadership. Among the uninvited group included the grandson of the late founding father, Mao Zedong.

Who are the "red princelings", and what's the reason for the snub?

The descendants of former leaders, the so-called "red princelings", usually take a significant proportion of seats at China's top ranks, from government to military leadership. Given the president himself is also among this group, the expectation was that more red princelings will be promoted to key positions. However, the absence of so many princelings seems to imply an effort to keep power consolidated.

However, some political observers argue that Xi's decision may be less to suppress other princelings, but rather a calculated personnel decision to place the most qualified candidates into positions. A recent example cited is the newly appointed vice-chairman of the Central Military Commission (CMC), who was a war hero with grassroots background. The CMC directs the armed forces of the country, according to China's constitution.

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 combine 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 combine 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. UAE: United Arab Emirates
12. SSE: Shanghai Stock Exchange
13. LSE: London Stock Exchange
14. AIIB: Asian Infrastructure Investment Bank
15. 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