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

Reserve requirements removed for FX forward transactions

People's Bank of China (PBoC) reduced the required reserve for foreign exchange (FX) transactions from 20% to zero, effective as of September 11, 2017. The new rule reverses the reserve requirement imposed on October 15, 2015, after the RMB exchange reform of August 11, 2015.

Context of the reserve requirements

In order to mitigate FX outflows, the central bank had ordered banks to set aside a 20% reserve when buying dollars through FX forward transactions in October of 2015. This had effectively imposed an implicit tax on FX transactions, in effort to discourage banks from betting on RMB depreciation. Currency intervention through reserve requirement is not an uncommon tactic for central banks in times of significant market movement and speculative trading; Bank of Israel had also imposed a 10% reserve requirement on FX forwards in response to increased FX derivative transactions by non-residents in January of 2012.

What are the implications of the removal?

The reversal of requirement could be interpreted as a sign of PBoC's confidence in RMB outlook, with the currency appreciating 5.9% against the USD in the recent months. With capital controls, China's FX outflow slowed down significantly this year, and foreign reserves stayed above the USD 3 trillion level. In the recent weeks, the appreciation of RMB against the USD actually accelerated, as more and more China bears gave up on their short positions. Some optimistic analysts even suggest that with improving fundamentals in China, RMB may see a boost in demand and bring in FX inflows in the near future.

China imposes travel ban on top financiers during the National Congress meeting

China's securities regulator reportedly is banning the country's top financiers from taking holidays or leaving the country from October 11 till the end of 19th National Congress, the most important political gathering that occurs every five years.

Why is the ban being imposed?

Although China has routinely taken steps to reduce market volatilities during key political events, a travel ban was probably the first in history. Such extreme measures indicate how seriously the top authorities are taking next month's meeting. Apart from the travel ban, the China Securities Regulatory Commission reportedly also ordered financial institutions to check and mitigate liquidity risk and operational risk in their own operations.

Political observers expect the National Congress, which is scheduled to start on October 18, to be an event in which China's top leadership is reshuffled and President Xi's status in the country is secured. Both onshore equity and currency have rallied moderately this year, partially due to the expectation of government support. With the apparent caution exercised by the top office, investors remain generally optimistic at least till the end of October.

Domestic brokerage houses call for a standard minimum commission level

Securities Association of China (SAC), a self-regulatory body, urged for a stop to the price war between brokerage houses, at a meeting attended by representatives of domestic brokerage firms. Through this meeting, an agreement to set an official lowest commission rate and to regulate commission rates was achieved, although a consensus could not be reached on a rate for the commission floor.

What brings about the need for a standard commission floor?

Challenged by the rise of financial technology (fintech) and online brokerage start-ups, traditional brokerage houses have been struggling to make ends meet. The commission rate for the Chinese equity market reaches as low as 3bps, translating into a USD 3 commission for every USD 10,000 trade. Trapped by the high fixed cost, many Chinese broker firms are losing money at these rates, according to a senior brokerage firm manager at the SAC meeting. Among the 28 brokerage firms which reported interim results, only two saw their income from their brokerage business rise year-on-year.

Of course, brokerage firms have diverse channels to derive income from. Some argue that despite offering impossibly low commissions for key clients, the firms can profit from wealth management business in particular. However, in the current context of social and political backdrop, the income from wealth management is likely inadequate to compensate for commission declines in the execution business.

China's PPI and CPI indicators surprise to the upside, suggesting improving fundamentals

China's August PPI and CPI figures surprised the markets to the upside. PPI picked up from 5.5% YoY in July to 6.3% YoY in August, beating economist survey of 5.7%. CPI rebounded from 1.4% YoY in July to 1.8% YoY in August, higher than the consensus of 1.6%.

What are the implications?

Commodity prices recorded double-digit growth, contributing to the higher-than-expected PPI inflation read. Oil, coal and ferrous metal prices increased 16.3%, 32.1% and 14.1% YoY respectively in August. Analysts attributed higher ferrous metal prices to the recently intensified environmental inspections. Non-commodity index also grew 2.5% YoY in August, compared with 2.3% YoY in both July and June 2017. Higher non-commodity index arguably reflects a robust job market and modest price transmission from the industrial sector. Supply-side reform and monetary tightening is likely to support a constructive PPI outlook.

Core CPI (excluding food and energy) rebounded 2.2% YoY in August, reflecting inflationary pressures in service sectors and household appliances. The drivers for the inflation in the service sector may be a robust job market; inflation in household appliances may be a reflection of industry sector inflation (ex. ferrous metals are key materials in household appliances). In contrast, food prices decreased 0.2% YoY, while the price of China's favorite meat – pork – dropped 13.4% YoY in August. The trend is likely to continue, with non-food inflation driving headline CPI.

Ivanka Trump and Jared Kushner cancels trip to China on domestic pressures

Ivanka Trump and Jared Kushner's China visit was reportedly cancelled, as the chief of staff of the White House decided the couple to be unsuitable to make preparation for US President Trump's visit to Beijing. They were planning to visit ahead of the president's Asia tour in November. Instead, it was insisted that President Trump's visit should be made through appropriate channels by responsible and accountable officials.

Why was the couple planning on visiting China?

Ivanka Trump is popular in China thanks to her personal image, as well as her Mandarin-speaking daughter. Meanwhile, President Trump's son-in-law Jared Kushner has been playing an active role in advising the president in dealing with China; Kushner reportedly arranged the meeting between Trump and Chinese President Xi Jinping in Florida last April. The couple could have been leveraged to work with the Chinese for solutions, balancing the harsher rhetoric of the president on China.

Why is their suitability being questioned?

A potential rationale for the cancellation is the controversy over Kushner's engagement with Russian officials and businessmen during Trump's election campaign, and potential legal implications of the investigation. Some political observers in China agree with the decision, noting that Kushner may not be a suitable choice to represent the president in his visit to China, when his credibility is being questioned domestically. Furthermore, his involvement would be against tradition of an Official preparing a formal national visit. Others however, saw the fall through as missed opportunity for a connection between the two countries.

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) is 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