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

Mainland China and Hong Kong could benefit from global equities sell-off

On February 5, the US equity markets tanked, one major index falling 8.5% off its peak a week prior. But for the Chinese economy, the plunge could be good news, according to a Chinese government economist, asserting the view that a devaluation of the yuan could help exports. "If the fall continues, it could reverse the yuan's strengthening against the [USD] and we could see a mild depreciation [RMB]," said Zhang Ming, a senior researcher in international investments at the Chinese Academy of Social Sciences. "That would be a result that Beijing would be glad to see. The strong yuan is of little benefit to the economy", he added. The economist had predicted a large correction looming in the US markets in January, pointing to two major indicators — the 10-year price-to-earnings ratio and the Chicago Board Options Exchange volatility ratio — to demonstrate that there was excessive optimism in the market and that it was time to sell.

What are the implications?

While it is difficult to say whether we are in a short-term correction or the start of a bear market, there are signs that stock markets around the world are vulnerable to a range a factors coming into play this year, including: trade frictions, geopolitical disputes, and central bank tightening. Nevertheless, China's onshore A-share market is protected, to some extent, by the country's closed capital account. Meanwhile, Hong Kong seemed to defy the sentiment, with mainland money continuing to pour in throughout the week. On Monday, February 5, Hong Kong saw record southbound flows of CNY 10.5 billion (USD 1.67 billion) via the Shanghai/Shenzhen StockConnect.

From travels to banking, China's facial-recognition systems are becoming part of daily life

This week, facial recognition glasses for police officers were launched in the emerging megacity of Zhengzhou, where they will be used to scan travelers during the upcoming Lunar New Year. This is just one data point in a growing trend toward large-scale, multi-sector use across China. The smart glasses are expected to significantly improve the efficiency of police during the Lunar New Year holiday, when the biggest annual human migration sees about three billion trips within a six-week period through mid-March.

Using sophisticated artificial intelligence (AI) algorithms, Chinese technology companies have adopted facial recognition systems in retail, travel, and banking environments. In 2015, the Ministry of Public Security partnered with a security company based in Shanghai launched a project to build the world's most powerful facial recognition database. The goal is to identify any one of China's more than 1.3 billion citizens within three seconds and with about 90% accuracy.

Why is this technology important to China's development?

The police force in Zhengzhou is among the first wave of police officers in China equipped with smart glasses allowing them to screen pedestrians. They are also the latest example of how China is moving ahead of the rest of the world in making facial recognition technology a part of people's everyday life. The growing number of public and commercial applications for facial recognition in China may bolster the nation's wider push to lead the world in artificial intelligence. The anticipated commercial roll-out of advanced 5G mobile networks across China starting in 2020 would also mean increased demand to link such a national facial recognition database to various commercial enterprises, which instantaneously push and retrieve biometric information as part of their services. These could include platforms related to autonomous transport, financial services, social media, and healthcare.

China formulates new policies for autonomous cars

In order to catch up to the U.S., where more than twenty-four states have introduced legislation on autonomous driving, China is putting great effort into advancing the technology. The National Development and Reform Commission, China's top economic planning agency, recently disclosed a three-year plan to spur the development of autonomous cars nation-wide. Now a national priority, autonomous vehicle manufacturing in China has thus far included building test fields; working on a system for open-road tests; and increasing efforts in research on self-driving ships, autonomous rail transit, and cars.

What does this mean for the autonomous vehicle market as a whole?

As the world's largest auto market, China has an advantage. Data privacy is much easier to aggregate in China and Southeast Asia than it is in other markets, which makes it easier and less controversial to collect and use data on how people move around in cities. Startups focused on autonomous driving such as Pony.ai and JingChi have moved their global headquarters to Guangzhou from Silicon Valley in the past year, contributing significantly to the development of self-driving cars in China. Jijing became the country's first city to start open road testing for autonomous cars, and Shanghai has already opened the country's first driverless vehicle pilot zone with about two-hundred vehicles being tested in a closed area. Last week, both Pony.ai and JingChi engineered test drives. With the combination of mobility services, driverless technologies, and government support, China could possibly take the lead in this industry as multinational corporations weigh the benefits of moving their operations to China to benefit from a clustering effect.

Rex Tillerson meets China's top envoy amid trade and North Korean tensions

US Secretary of State Rex Tillerson met with Chinese State Councillor Yang Jiechi this week, as concerns of a US-Sino trade war and North Korean nuclear ambitions run high. While the specifics of the closed-door meeting are unknown, both Tillerson and Yang expressed optimistic sentiments toward collaboration. Speaking before the meeting, Tillerson said, "we've had many, many good discussions, and we're going to continue these very important discussions about US-China relations. And I very much warmly, warmly welcome him here". Yang responded by thanking Tillerson and promising to "carry out the agreement between our two heads of state and push forward our very important relationship".

Meanwhile, with elevating trade tensions between the US and China, former acting deputy US trade representative Wendy Cutler confirmed imminent action against China this week, initiating a Section 301 investigation on "Chinese unfair trade practices on intellectual property, including the practice of so-called forced technology transfer, and we are expecting actions to be announced against China imminently".

What are the implications?

Despite concerns about a potential trade war, an outright trade war remains unlikely. China's trade surplus with the US slightly narrowed in January from December by USD 3.7 billion, and the two countries have agreed to resume economic talks suspended last year as tensions started to mount. Raymond Yeung, chief economist for Greater China at ANZ, predicts that while there is more "noise" from the Trump administration on the trade imbalance, the chances of an all-out trade war remains slim. With both Chinese and the US markets seeing weakness in the last month, it would serve no little benefit to either country to engage in a trade war.

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