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# Scroogin' on China Policy Measures and Weekend Links

Investors' stockings were stuffed full of Chinese policy pronouncements this holiday season. From "Hukou reform," to tariff reductions to yet more "support measures" for private companies, the China bulls will have plenty of new toys to play with this January!

Unfortunately, like all of the 'Made in China' crap we pile under our trees every December, most of it will be busted or long forgotten before mid-January. **Bah Humbug!**

Let's run down the slew of new measures, keeping in mind the **primary rule of thumb** for assessing Chinese policy pronouncements: if there's a numerical target attached, failure is not an option; otherwise its most likely bullshit.

Firmly in the latter category are the slew of new measures to "support private enterprises," the affection of Bloomberg News for the policy measures notwithstanding:

BBG: China Vows More Support for Private Sector to Stabilize Growth

> *The steps announced Sunday by the State Council, China's cabinet, aim to help private firms gain better market access and equal regulatory treatment as their state-owned peers. Among actions to be taken are the further opening of key industries to non-state investors, including energy and finance, and also facilitating equity and bond sales by private-sector businesses.*
>
> *With economic growth at the slowest since the early 1990s, private businesses have also seen spreading bankruptcies and defaults. An outpouring about their plight prompted President Xi Jinping in late 2018 to pledge "unwavering" backing for the sector. Since then, Beijing has rolled out a slew of supportive policies, including tax cuts and measures to encourage bank lending to non-state firms.*
>
> *Sunday's announcement was trumpeted by state-owned media as an escalation of that support. Reports emphasized that the newly announced steps were released as a unified central-government document, the first that Beijing has ever published specifically focused on the private sector.*

Whoa – back up. I didn't realize they issued a ***unified Central Government Document***! That's sounds super-important. Let's read on…

*Measures outlined in Sunday's document include:*

- *Giving private-sector investors access to the electricity, telecommunications, railway, oil,*

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*natural gas sectors, including allowing them to become shareholders in telecom carriers and major stakeholders of power generation and distribution businesses*

- *Allowing private companies to enter the exploration, storage and transportation of oil and gas*
- *Supporting qualified private firms to import and export oil*
- *Improving banking services for private firms, including adopting a higher tolerance for the ratio of non-performing loans to small firms*
- *Supporting direct financing by private firms, including encouraging them to be listed on China's NASDAQ-style technology board in Shanghai, supporting bond sales and debt-to-equity swaps*
- *Encouraging private firms to take part in the restructuring of state-owned enterprises and the construction of mega-city clusters*
- *Better promote the achievements and contributions of private-sector businesses*

No shortage of nice-sounding words there: "allowing," "supporting," "improving," "encouraging," "promoting." As for hard targets or specific reform measures that would level the playing field for non-State actors? Well, not so much…

Perhaps the Chinese press might provide some further clarity:

China Daily: Guideline unveiled to boost private enterprises

> *Yin Wenquan, head of the Institute of Economic System and Management National Development and Reform Commission, said private enterprises are playing a significant role in economic and social development, as well as meeting people's growing demand for a better life.*
>
> *"Private companies should further deepen reforms, speed up the construction of a modern enterprise system, innovate technologies and operating models and seize opportunities to move China's development into a high-quality stage," Yin said.*

Got all that?

Wake me up when they actually shut down the Institute of Economic System and Management National Development Reform Commission. Then maybe we can talk about

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improving the environment for private companies…

Reform of the Hukou system - by which access to urban services is limited to most non-professional migrants and transplants – has long been a dream of the China bulls. It's been "in the works" for a decade now. Is it for real this time?

China Vows Freer Movement for Workers by Relaxing 'Hukou' System

> *The steps outlined by the State Council would* ***eliminate the hukou system in cities with less than 3 million residents and relax it in cities with populations of 3-5 million****. For cities home to more than 5 million, such as Beijing and Shanghai, the household registration system will be simplified, it said, without giving details. These steps mirror policies released by the National Development and Reform Commission in April.*
>
> *This policy change would effectively eliminate the hukou hurdle for most of China. Out of almost 300 prefecture-level cities, only 27 have populations exceeding 3 million…*
>
> *Markets reacted positively to the news. An index tracking* ***shares of property developers listed in Shanghai rose by 2.9%****, the most since September 4, while China's benchmark CSI 300 index gained 0.9% on Thursday.*
>
> *"It's the first time the central government has announced clear-cut detailed hukou reform," said Yan Yuejin, lead analyst at E-House China Enterprise Holdings Ltd.'s research institute. "Loosening hukou may spark home-buying demand in some tier-3 and tier-4 cities."*

The central government is motivated to both reduce over-crowding in the main cities and shore up wildly-overbuilt real estate sectors in the smaller cities. So a differentiated policy whereby migrant workers who relocate to smaller cities can access health and educational services not available in the mega-cities appears sensible.

There are two big problems though. The first is that migrant workers are attracted to the mega-cities by employment opportunities that don't exist in the smaller cities. Secondly, small-city compliance with the more liberal provision of urban services will be constrained by budgetary realities.

**Small-city Hukou liberalization is another example of China's habit of treating symptoms, not the disease**. An over-reliance on speculative real estate at the expense of more robust forms of economic development in small cities stems from the distortions inherent in China's system of state finance and central planning. Small cities offering urban services as an inducement of

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absorbing the over-supply of real estate will do little to alter their dire underlying fiscal dynamics.

I'll take a more charitable attitude towards China's recently announced tariff cuts. This is a smart move, with the list of items - aside from foodstuffs - concentrated on intermediate goods, which should have a beneficial effect on the Chinese supply chain which is under heavy pressure.

However, I would resist the spin suggesting this is indicative of a broader embrace of "opening up," or a meaningful gesture in terms of U.S.-China trade relations. It's a marginal tax reduction in support of the supply chain, that's all.

China to Cut Tariffs on Pork, Tech From List Worth $389 Billion

> *China cut import tariffs on a wide range of goods including food and parts for manufacturing smart-phones, continuing Beijing's drive to spur domestic demand and demonstrating its desire to open its economy as it pursues a trade deal with President Donald Trump.*
>
> *The Ministry of Finance on Monday published a list of 859 types of products that will enjoy tariffs lower than the standard rates for this year. It included frozen pork as a key item aimed at alleviating shortages of the meat due to the outbreak of African swine fever.*
>
> *In 2018 imports of the listed items totaled some $389 billion, or about 18% of China's total imports of $2.14 trillion, according to Bloomberg calculations.*

The policy good-tidings came in more mundane forms as well…

More Cuts to Banks' Reserve Requirement Under Consideration, Premier Says

> *Premier Li Keqiang said Monday that the government will study further cutting banks' reserve requirement ratios (RRRs), among other measures, to lower borrowing costs for small businesses.*
>
> *Although growth in consumption and industrial output both rebounded last month, economists from Nomura International (Hong Kong) Ltd. believe that growth headwinds remain strong, especially from "worsening fiscal conditions, a cooling property sector and weakening exports."*

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A RRR cut is likely in early 2020 to accommodate the usual seasonal burst of credit issuance. But remember, **RRR cuts are NOT "easing measures."** The policy target is the rate of credit growth, which is likely to be planned at something around 2019's rate of 11-12%.

Given PBoC's reluctance to continually expand its balance sheet via procurement of domestic assets (i.e QE), the Required Reserve Ratio must continually fall to accommodate the ongoing expansion of M2. **The rate and scope of RRR cuts is simply a mathematical derivation of the policy target for credit growth**.

All that said, the slew of "reform announcements" and a likely RRR cut amidst the usual January torrent of new credit issuance – all against the backdrop of a likely Phase One signing session – sets up for **a New Year's countertrend rally in Chinese assets and the RMB**, all the more so if this week's broad Dollar weakness proves to be the start of the anticipated retracement.

As always though, remember – **Chinese assets are for renting, not owning…**

On the the links…

China Economy & Finance

Bloomberg tells us the rising default rate "is not a crisis. It's a plan." I'd say it's more like a planned crisis.

China's financial system is not immune from mathematics. If cash flow from operations (of which nominal GDP is a macro proxy) slows, and new credit creation is insufficient to make up the resulting debt-servicing shortfall, then defaults must increase.

So long as both nominal GDP growth and new credit creation are constrained by a semi-fixed exchange rate, **choices as to which entities live and die will have to be made with increasing frequency**.

China's Government Is Letting a Wave of Bond Defaults Just Happen

> *"It's incredibly difficult to do true credit analysis for most borrowers in China," says Michel Lowy, chief executive officer at Hong Kong-based banking group SC Lowy. "Ultimately it has a lot less to do with the quality of the businesses that are underneath and a lot more to do with who is supporting them, who owns them, and what is the goal of their setup."*

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Of course, some rules governing this process would be helpful! Unfortunately, this pronouncement seems little more than nonsensical bureacratise:

China central bank publishes draft rules regulating corporate bond default disposal

> *China's central bank on Friday published draft rules on regulating corporate bond default disposal, in an attempt to strengthen risk management.*
>
> *The central bank said it will diversify market-based default disposal methods and strengthen punishment for malicious acts for missed repayments on corporate bonds, according to a statement published on its website.*
>
> *The principle of the draft rules was to fend off systemic financial risks and maintain bond market financing. The rules will also help promote the development of a credit derivative market.*

Loading up local governments with ex-bankers may be helpful in rationalizing the process of picking the default-game winners and losers. But **the math will remain relentless**…

China's Xi turns to financial experts to tame economic risks

> *With pressures mounting, local governments are expecting to take the lead in managing their financial scares and cutting the cost of rescue with local intervention, analysts say.*
>
> *"Appointing financial vice governors to provinces can help better integrate financial policies into local practice, and to prevent financial risks beforehand," said He Haifeng, director of Institute of Financial Policy at Chinese Academy of Social Science, a government think-tank.*

I know the Chinese banking sector is over-covered and heavily-touted, but I've never understood why so many investors feel they must play in this sandbox. Its full of mud, soon to be drying into cement…

China banks: still standing

> *Doomsters say rising credit defaults mean the year ahead will be difficult. It is true that Chinese banks are entering untested times of slowing growth. But inflation concerns will stabilise interest rates and managers are appropriately risk averse. China's big banks are set to prove pessimists wrong yet again next year.*

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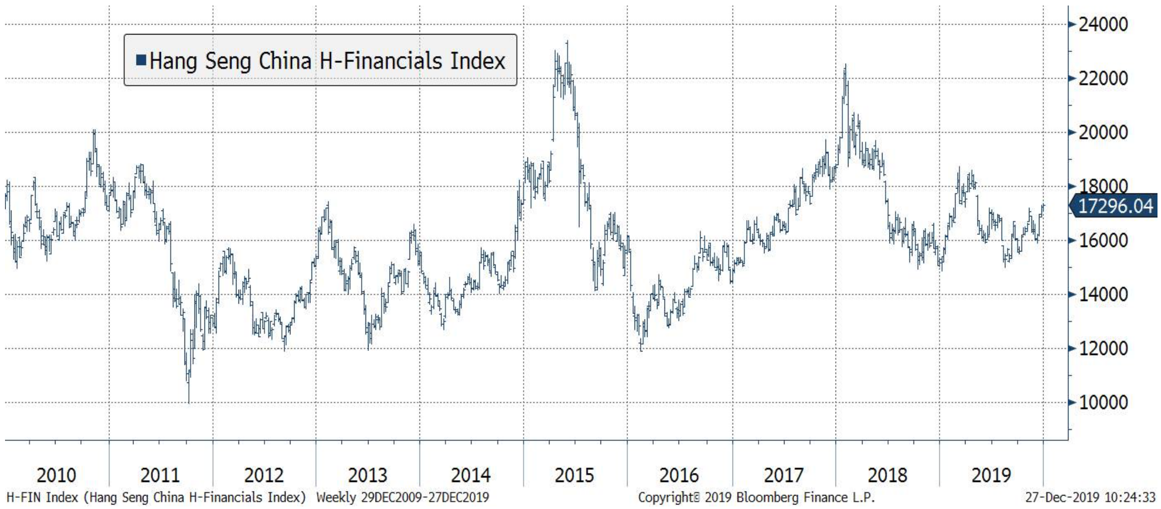
"Prove the pessimists wrong" by what, not descending into crisis? Perhaps, but **pessimism as to share price performance of Chinese banks has been perpetually rewarded**:




800bn in muni bonds in January would be a slug – January 2019 saw 418bn in issuance. That said, topping last January's eye-popping 4.6T in Total Social Financing will be no mean feat. The mere attempt will be construed bullishly in early 2020…

Chinese local governments expected to issue about 800bn yuan bonds in January - YUAN TALKS

> *Chinese local government bond issuance will surge early next year, to exceed 800 billion yuan in January, analysts estimate. The central bank is widely expected to cut banks' reserve requirement ratio (RRR) ahead of the Spring Festival to avoid a cash crunch.*

Foreign funds shun China's commercial property amid slowdown

> *Foreign investors' purchases of mainland Chinese commercial real estate have fallen dramatically over the last year as global economic headwinds and slowing domestic growth have taken a toll on the market.*
>
> *The buying by foreign funds has slowed down as global economic uncertainties and the prospect of lower asset values dampened appetite, Li said in an interview with the South China Morning Post in Shanghai.*

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*In the fourth quarter of last year, foreign capital accounted for about 50% of total investment in China's commercial property, according to a report by Cushman & Wakefield. That had slipped to about 30% in the first quarter of this year and more than 20% in the April to June period, the data showed.*

Another faux-easing measure…

Beijing Closes Out 2019 With New Call to Make Car Buying Easier

*China's cabinet has again prodded local governments to relax restrictions on local car sales in the latest effort to revive a domestic auto market experiencing its worst-ever downturn alongside the nation's slowing economy.*

*A number of cities have already answered the government's call this year. In September, the southwestern city of Guiyang announced it was removing all buying restrictions. The wealthier southern cities of Guangzhou and Shenzhen, as well as Hainan province, have also announced steps to raise the number of new license plates they issue each year. Guangzhou has boosted its current quotas by 100,000 over a year and a half, while Shenzhen is planning to boost its quota by 40,000 next year.*

*But four of China's biggest and most congested cities, Beijing, Shanghai, Hangzhou and Tianjin, have yet to take any action.*

*Wang Qing, a senior market researcher at the State Council, previously told Caixin that relaxing buying restrictions wouldn't necessarily provide a clear stimulus to the market. He pointed out that even if such relaxation resulted in 200,000 more car sales, that would still account for only 1% of all sales. "If only restrictions are relaxed … the assistance honestly wouldn't be that big," he said.*

Interesting op-ed here from the President of the EU Chamber of Commerce in China and head of BASF operations there. Foreign businesses operating China may be unprepared for the scope of challenges stemming from institution of the Orwellian "Corporate Social Credit" system…

Opinion: Crossing the Market by Feeling the Scores

*The corporate social credit system (SCS) that will be introduced in China in the coming years represents a huge challenge for foreign companies operating in China.*

*At its core, the corporate SCS is a novel application of big-data technology that uses tools*

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> *like real-time monitoring to collect information on companies' behavior. This is then processed through opaque algorithms to determine how compliant they are with Chinese regulations.*
> *Based on this analysis, firms will be awarded a rating in each of several dozen categories, all of which then combine to provide a company's overall "score."*
>
> *Higher scores can result in lower tax rates, better credit conditions, easier market access and more public procurement opportunities. Lower scores lead to the opposite, and can even result in blacklisting.*
>
> *The impending paradigm shift in market regulation in China means that competitiveness will soon be determined as much as by complying with the corporate SCS as it will by following market forces.*
>
> *The scores of upstream suppliers will affect a company's own score, making continual monitoring of supply chains critical. Individual ratings of the legal representative and high-ranking management will also impact company ratings, forcing many global companies to consider how to address the personal behavior of employees away from the workplace: a taboo for many.*
>
> *Having done a top-to-bottom audit of my own company, I was initially shocked and overwhelmed by the scale of the corporate SCS and the changes that were needed. But then again, thriving in China has always demanded deftness, flexibility and a pragmatic approach.*

Huawei

The $75bn figure seems a bit inflated - including all manner of tax breaks - but nonetheless, the level of state support is really off the charts in terms of international comparisons…

WSJ News Exclusive | State Support Helped Fuel Huawei's Global Rise

> *Tens of billions of dollars in financial assistance from the Chinese government helped fuel Huawei Technologies Co.'s rise to the top of global telecommunications, a scale of support that in key measures dwarfed what its closest tech rivals got from their governments.*
>
> *A Wall Street Journal review of Huawei's grants, credit facilities, tax breaks and other forms of financial assistance details for the first time how Huawei had access to as much as $75 billion in state support as it grew from a little-known vendor of phone switches to*

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> *the world's largest telecom-equipment company—helping Huawei offer generous financing terms and undercut rivals' prices by some 30%, analysts and customers say.*
>
> *Huawei is vying to build next-generation 5G telecom networks around the world. While financial support for favored firms or industries is common in many countries, China's assistance for Huawei, including tax waivers that began 25 years ago, is among the factors stoking questions about Huawei's relationship with Beijing.*

If the Huawei decisions in early 2020 in the UK and Europe go the wrong way for China the likely result is a **much tougher line from China on Phase One compliance and ongoing trade talks**.

US warns Boris Johnson over Huawei risks to UK citizens' secrets

> *Robert O'Brien, the US national security adviser, told the Financial Times that any UK government decision to allow the Chinese telecoms company to participate in the country's ultrafast 5G networks risked giving the Chinese Communist party access to the "most intimate" details of British citizens and the ability to steal national secrets.*
>
> *"They are just going to steal wholesale state secrets, whether they are the UK's nuclear secrets or secrets from MI6 or MI5," Mr O'Brien said in an interview.* ***"It is somewhat shocking to us that folks in the UK would look at Huawei as some sort of a commercial decision****. 5G is a national security decision."*
>
> *Washington has repeatedly urged the UK to completely ban Huawei, but the warning from Mr O'Brien raises that pressure to a new level. It comes as Prime Minister Boris Johnson prepares to decide whether to ban Huawei from the country's 5G networks.*
>
> *British security officials last year concluded that any risk from Huawei can be mitigated if it is barred from the network "core", but US officials disagree with that assessment. Australia has also urged the UK to exclude Huawei from its 5G networks.*

China - EU Relations

Beijing envoy warns EU against 'disastrous' curbs on China companies

> *Beijing's envoy to the EU has warned the bloc against pursuing policies to curb Chinese companies' access to Europe, saying it would damage its own interests and deter investment.*

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*Zhang Ming said plans to clamp down on foreign corporate ownership, trade opportunities and 5G mobile communications technology threatened to trigger a backlash from "suspicious" Chinese entrepreneurs.*

*The ambassador, a veteran diplomat and previously a senior foreign ministry official in Beijing, said EU countries needed to promote international co-operation and free markets. "Otherwise, it's disastrous for them," he warned in an interview. "What I hope to see is that the EU will keep to the principles of multilateralism and free trade, as well as the principles of openness, fairness, justice and non-discrimination."*

U.S. – China Relations

China vows countermeasures against US defense bill

*The **scathing criticism from the Chinese Ministry of Commerce** (MOFCOM) of the US National Defense Authorization Act (NDAA) for 2020 underscored lingering tensions between Beijing and Washington, despite a looming phase one trade agreement that many view as a step to de-escalate the trade war.*

*"China deplores unfavorable provisions in the NDAA targeting Chinese companies," Gao Feng, a spokesperson for the MOFCOM, told a press briefing in Beijing, noting that restrictions on certain Chinese products and sanctions on Chinese companies are "vile examples" of the US using state power to undermine normal business activities.*

*Gao urged the US to abandon political bias and zero-sum thinking and stop the wrongful actions. **"China will closely monitor how the implementation of the act will affect Chinese companies and will take all necessary measures to protect Chinese firms' legitimate rights and interests**," he said.*

*The NDAA, which was signed into law by US President Donald Trump last week, includes **provisions that authorize sanctions on Chinese drug companies**. It also **bars the US government from taking Chinese telecom giant Huawei off its export control list** and US companies from buying Huawei's equipment, according to media reports.*

Nothing will stand in China's way, foreign minister assures the nation

*China's Foreign Minister Wang Yi has used an end-of-year interview to blast the West's "interference" in Hong Kong, Taiwan and Xinjiang, telling Chinese state media it was*

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> *"doomed to fail".*
>
> ***"Any attempt to interfere in China's domestic affairs and to block its development will be left behind as the wheel of history turns,"*** *he said.*
>
> *Wang, who sits on the Communist Party's policy coordination group on Hong Kong and Macau affairs, said Beijing would remain "consistent, confident and patient" in dealing with what he described as attempts to sabotage China's development.*

Not that we're rooting for OBOR to implode or anything…

China's $1.3tn global spending spree will collapse, says top US official

> *Adam Boehler, the chief executive of the US International Development Finance Corporation, told the Financial Times that China's international investments* ***were "100 per cent" like a house of cards because of "debt overload, poor infrastructure, bribes [and] lack of transparency****".*
>
> *"We have to be there as an alternative because I could see China take down a whole bunch of emerging countries…there will be more and more cracks and then the glass will break," he added.*
>
> *The DFC is also part of the US government's broader effort to stop countries from using technology run by Huawei, the Chinese telecommunications company that is accused by Washington of espionage and being a threat to national security.*
>
> *"The answer to Huawei is not 'don't buy Huawei' and that's it. You need an effective and credible alternative," he said.*
>
> *While many in Washington fear that the US is struggling to persuade countries to reject Huawei as they build out their 5G networks, Mr Boehler was more upbeat, saying* ***he detected "changing winds" as governments were "getting smart" on these issue****s. "More and more you're seeing people say no".*
>
> ***He called Chinese investment a "drug"*** *but said more countries were becoming sceptical of it in terms of the sustainability of the debt. "I think people are pretty circumspect about it," Mr Boehler added.*

Dollars to donuts the Phase One commitments on forced technology transfer are based on

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China's new foreign investment law, which is riddled with more holes than a Swiss cheese…

China's new foreign investment law is a missed opportunity

*China's new approach is largely to establish protocols that* ***vaguely define the limits of the rights foreign investors are entitled to*** *enjoy and the ways in which various government agencies are to conduct themselves to ensure such rights are honoured. It is almost as if Beijing is looking through the wrong end of a telescope.*

*To be sure, there are some important advances. The foundational principle underpinning world-class foreign investment laws of "national treatment" — affording foreign investors rights equivalent to those enjoyed by domestic firms — is well articulated. Intellectual property rights of foreign businesses are deemed to be protected in the same way as those of Chinese firms. Agencies are prohibited from divulging foreign enterprises' trade secrets. Foreign investors are given the freedom for overseas remittance of profits, capital gains and liquidation proceeds (among other sources of income) in renminbi or in foreign currency. Participation in Chinese government procurement tenders by foreign firms is explicitly allowed. Moreover, when expropriation occurs, "fair and reasonable" compensation "shall be given in a timely manner".*

*However,* ***the ways in which many of these provisions are to be exercised in practice are neither rigorously nor fully spelled out*** *(especially in the November 2019 implementing regulations, where one would expect to see them). Some appear to be actually hollow.*

*For example, the text indicates that the adherence to "national treatment" may vary both across different levels of government (local, municipal, provincial and central) and across various regions of the country. Indeed,* ***the lack of an integrated national treatment regime is reflected in the law's text****: it admonishes agencies to "co-operate closely" and "in accordance with their division of responsibilities".*

*Although foreign investors are given the right to appeal to various governmental authorities, an* ***independent adjudicative process is not established****. Nor are there rules defining time-bound decision-making to foster timely resolution of such issues. Foreign firms may request the opportunity to review regulatory documents only when a lawsuit is instituted against administrative actions.*

***Aligning the extent of foreign firms' protection of intellectual property to that which applies to domestic businesses is not a very high standard. Ask any Chinese entrepreneur how effective he or she feels their intellectual property is accorded legal protection****.*

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Hong Kong

The holidays have brought an uptick in protest activity after a bit of a lull…

Christmas in Hong Kong 'ruined' by protesters, says Carrie Lam

> *After several weeks of relative calm, the territory was again rocked by violent clashes between an increasingly aggressive police force and a smaller but radicalising protest movement that spread through shopping malls and crowded streets on Christmas Eve and Christmas Day.*
>
> *Human rights groups accused the Hong Kong police of a disproportionate response as they carried out random searches of shoppers in busy malls, fired numerous rounds of tear gas and rubber bullets and detained scores of people in indiscriminate mass arrests.*