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China opens its doors to private capital

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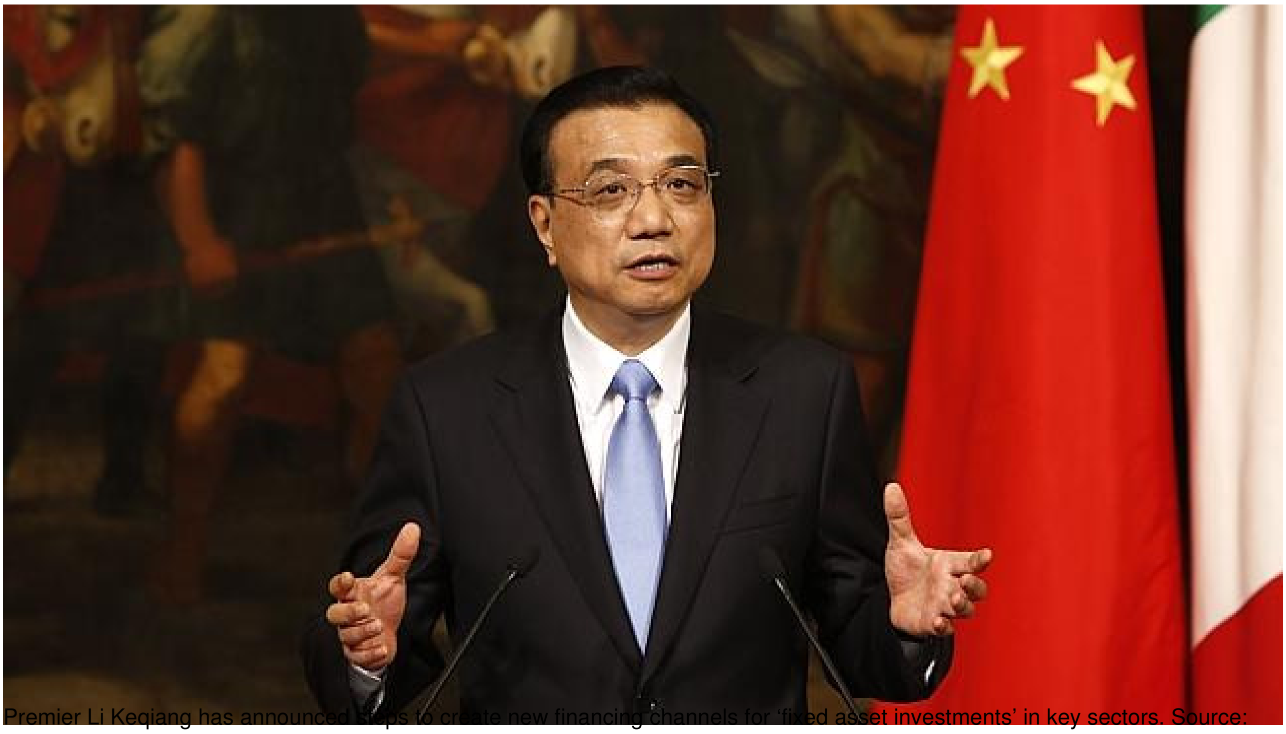

Premier Li Keqiang has announced steps to create new financing channels for 'fixed asset investments' in key sectors. Source: AP

THE past three months in China have been impressive.

Sophisticated investors recognise that they are witnessing the greatest leap forward since Deng Xiaoping's "Gaige Kaifang" reforms of 1978 and therefore remain unfazed by short-term cyclical downturns that have no real bearing on their strategic outlook.

Declining manufacturing and industrial output, a sharp slowdown in domestic property investment and even weak external export demand are all accepted by ultra-high-net-worth (UHNW) investors who understand that these are necessary consequences of a far more important and exciting overall transition under way.

Since the Third Plenum of the 18th Communist Party Congress, President Xi Jinping and Premier Li Keqiang have announced more than 130 sweeping reforms — the most important of which signal China's commitment to the transition towards a "new normal" of stable growth with quicker reforms.

In May, President Xi said "China is still in a significant period of strategic opportunity. We must boost our confidence, adapt to the new normal condition based on the characteristics of China's economic growth in the current phase and stay cool-minded".

This was reiterated in September by Premier Li at the World Economic Forum.

While global commentary remains temporarily transfixed on China's internal dispute with Hong Kong, other announcements have been widely ignored. These included licences being granted for the first time to foreign hospitals and private oil importers and new policies to allow and support greater levels of private capital participation across the economy launched.

In particular, Premier Li last Friday held a State Council meeting announcing steps to create new financing channels for "fixed asset investments" in key sectors, which would involve opening these up to domestic and international private capital.

In a serious attempt to improve inbound investment demand, the global investor is now presented with unique investment opportunities in Chinese healthcare, education and urban utilities, supported by state-subsidised funding and collateralised by Public Private Partnerships.

The council also openly advocated that state-owned enterprises (SOEs) should sell assets or equity to private investors to finance restructuring, thereby deleveraging the economy and simultaneously increasing privately held equity.

These are seen as unprecedented steps and a welcome opportunity for astute global investors, many of whom are already recognised as "renminbi qualified foreign institutional investors", colloquially referred to as "RQFII".

These Australians who sit alongside their North America and EMEA peers currently invest 640 billion yuan, or $119bn, as of this month, through this channel.

However, the announcement this week that the Shanghai-Hong Kong Stock Connect program, which would have allowed global investors direct access to China's A-Sharemarket for the first time, would be indefinitely delayed, came as a shock to market participants. They had hoped that this initiative would be an important additional step towards integrating China's capital markets with the rest of the global financial system.

This highlights the point that China is still confronted with the same puzzle that we in the West face: how to stimulate growth and wealth creation by means of enterprise and innovation and not feign them by measures of inflation, exceedingly loose monetary supply or market manipulations.

Its solution is the "new normal" that emboldens productivity growth, technological advancement and a consumption-led model driven predominantly by the services sector.

The Chinese housing market still sits at the heart of the country's economy and accounts for 15 per cent of GDP. Despite a sharp decline in property sales in recent months, property investment in coastal provinces, along with Beijing, has slowed only slightly this year. These regions account for one-third of total property investment in China. Even though aggregate demand is expected to recover, according to Jing Ulrich, managing director of Asia Pacific for JPMorgan Chase, "We don't expect the market to go back to the heyday a few years ago when (Chinese) home prices were appreciating drastically".

With the knock-on effects that returning volatility is known to have on the hard commodity mix supplied to that market — which include steel, cement and copper — savvy UHNW investors are once more turning to "Comex copper" as a conduit trade to pair US and Australian equity market performance with China "hard landing" tail risks. This was a popular sophisticated strategy seen throughout 2010 and 2011, and today can be replicated via an on-market position in the ASX-quoted

Copper Future MINI shorts (ZHGKOY).

Conversely, for those who believe in global growth prospects, which include China, but hold the view that stockmarkets are misaligned to economic growth, a long position in “Comex copper” could provide a viable alternative. Again, this could be replicated via an on-market position in the ASX-quoted Copper Future MINI longs (ZHGKOH).

Like any hard commodity, copper has its own pricing conditions to be wary of. But sophisticated investors are once more considering how it may complement their comprehensive portfolios.

Xi’s leadership has allowed provinces to issue bonds for the first time, rather than purely relying on bank lending, which has been seen as a significant step forward and another opportunity for global UHNW investors.

Following the recent “Chaori Solar bond” restructuring plan, which has successfully restored investors’ confidence in the high- yield Chinese bond market, the news this week that the British government had successfully issued 3 billion yuan of British government bonds, denominated in renminbi, is still as significant.

This makes Britain the first developed country to have issued sovereign debt in Chinese currency, and according to Chancellor of the Exchequer George Osborne, the proceeds will be used as foreign exchange reserves for Britain. This step places greater pressure on Glenn Stevens and the Reserve Bank to fulfil their declared intention of holding 5 per cent of Australia’s foreign reserves in renminbi by next year.

The self-awareness of investors to know when to step back and watch history in the making can be an invaluable asset in itself.

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