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# China News Alert Issue 333

## Capital Markets

### HK and Guangdong sign cooperative agreement

Donald Tsang, chief executive of Hong Kong, and Huang Huahua, governor of Guangdong province, signed the first framework agreement on Hong Kong-Guangdong cooperation in Beijing on 7th April in the presence of Vice-President Xi Jinping.

At the ceremony, Tsang said the agreement is the first on Hong Kong-Guangdong cooperation ever endorsed by the State Council and signed by the two local governments since the Hong Kong-Guangdong Cooperation Joint Conference was founded in 1998.

He described the agreement as "the key to the door of development" and hoped the measures would be included in the country's 12th Five Year Plan (2011-2015).

Huang said he believes the agreement marks a new stage of cooperation between the two jurisdictions, increasing high-level contacts and making ties warmer.

The landmark agreement translated the macro policies of the plan outline for the reform and development of the Pearl River Delta (PRD) into concrete measures.

It seeks "early and pilot implementation" and sets out major work plans every year.

The 10-year agreement aims to create a new world-class economic zone, with plans to create an advanced global manufacturing and modern services base, an international aviation, shipping and logistics hub, a high quality living area, as well as a world-class metropolitan cluster.

The accord also sets out to enhance Hong Kong's position as an international financial center. Hong Kong's financial assets will be supported by resources and services in PRD cities.

To achieve those objectives, the two governments have put forward a number of policies and measures for this year:

* Officials will advance the Chinese yuan, or RMB, cross-border trade settlement pilot project. Participation will be broadened in a timely manner to include more regions, banks and industries.
* "We welcome financial institutions from Hong Kong to launch banks in rural areas and open small loan companies," Huang said.
* Hong Kong processing enterprises will be assisted in upgrading and restructuring to gain entry into the mainland market.
* To facilitate the flow of people, goods, information and capital, specific policies are set out, including expediting construction of cross-boundary highways, rail links and ancillary works.
* The air transport network in the PRD will improve with the addition of short-haul helicopter services. The two sides will work to enhance Hong Kong's standing as an international maritime center.
* The city's development as an international logistics hub will be considered.
* Both sides will pursue the implementation of the Hong Kong-Zhuhai-Macao bridge project, continue planning the Hong Kong-Shenzhen western express line and strive to complete the construction of the Hong Kong section of the Guangzhou-Shenzhen-Hong Kong express rail link by 2015.

The agreement has set out key areas where the two sides could strengthen cooperation and provide the basis for the implementation of cooperation, said Lau Pui-king, a deputy to the National People's Congress.

[Source: China Daily](http://www.chinadaily.com.cn/china/2010-04/08/content_9700362.htm) ([see archive](HK_and_Guangdong_sign_cooperative_agreement.pdf))

### Early stimulus exit may hamper recovery

It is still premature at this stage for China to withdraw its fiscal stimulus despite the country's sustained economic growth, the World Bank said on 7th April.

Although the country registered an 8.7 percent GDP growth year-on-year in 2009, its private investment is yet to become the engine of growth, which would disrupt the recovery process, the bank said in its latest East Asia and Pacific Economic Update.

China needs to carefully manage the withdrawal of fiscal stimulus measures in the short term while returning to the structural reform agenda to promote growth in the long term "as it faces a very different global economy, which is characterised by slower growth in developed countries, tighter global financial conditions, and a more difficult environment for free trade", said Vikram Nehru, World Bank chief economist in a video conference from Tokyo.

The focus on structural reform for China means rebalancing the economy, including enabling a larger role for the services sector and private consumption, and moving away from investment-heavy, export-led growth as well as encouraging environmental sustainability, the World Bank said in the report.

In addition, with rising inflation and asset prices, and continued strong economic growth, the exchange rate of the yuan "is likely to appreciate" as it would help domestic economic restructuring, the World Bank said, without providing any forecast on the timetable for the yuan revaluation.

"Strengthening the exchange rate can help reduce inflationary pressure and rebalance the economy," said Ardo Hansson, World Bank's lead economist for China.

Meanwhile, China's central bank is set to resume selling three-year bills from 9th April, according to a Bloomberg report. The bills may yield between 2.7 percent and 2.8 percent at the sale, compared with 1.9264 percent for one-year bills, traders at three of the nation's largest banks were cited as saying.

It could be a precursor to the first increase in benchmark lending rates in more than two years or allowing yuan to be more flexible, Jiang Chao, analyst at Guotai Junan Securities Company told Bloomberg.

This is meant to pave the way for the central bank to raise interest rates or resume yuan appreciation," said Jiang. "The central bank can drain liquidity by issuing bills if the interest-rate hike or appreciation attracts more hot money."

"The People's Bank of China needs to use higher-yielding bills to attract banks so that they won't make too many loans," Xu Xiaoqing, a bond analyst at China International Capital Corporation told Bloomberg.

"Three-year bills can lock up banks' cash for longer periods, which will push up money-market rates and bond yields."

The World Bank expects China's GDP to expand by 9.5 percent year-on-year in 2010, with inflation reaching 3.5 percent to 4 percent on average, higher than the pre-set government goal of 3 percent.

It also raised its forecast for economic growth in East Asia to 8.7 percent in 2010, compared with 7.8 percent in its November 2009 forecast.

[Source: China Daily](http://www.chinadaily.com.cn/bizchina/2010-04/08/content_9701234.htm) ([see archive](WB_Early_stimulus_exit_may_hamper_recovery.pdf))

### Agricultural Bank may float IPO in July

Agricultural Bank of China (ABC) is likely to launch its initial public offering (IPO) in June or July after its plan received approval from the State Council, a source familiar with the matter said on 7th April.

The bank has started talks with foreign and domestic lenders to arrange its public issue in Hong Kong and Shanghai.

More than 20 banks have received invitations to participate in the bidding process for the IPO mandate, the source told China Daily on condition of anonymity.

"Top policymakers have approved Agricultural Bank's plans to reform the rural finance unit, something that had slowed its listing plan in the past. The bank is now expected to complete the IPO process in June or July," the source said, without elaborating.

Even though details are still sketchy, the source said the nation's third-largest lender by assets could raise around US$22 billion from the IPO, with the Hong Kong tranche being bigger than that of Shanghai.

The mega IPO is expected to be similar to the one floated by the Industrial and Commercial Bank of China in 2006 to raise around US$21.9 billion. It has already evoked keen interest from domestic and overseas investment banks.

China International Capital Corporation and Citic Securities, the advisers for ABC's preparatory work for the IPO, are likely to get the mandate for the lender's A share offering, the source said.

Western banks licensed to underwrite yuan share offerings, including Credit Suisse, Deutsche Bank AG, Goldman Sachs and UBS, will compete to arrange both the Hong Kong and Shanghai portions, the source said.

Market watchers are also keeping tabs on whether ABC would emulate the other three big State-run lenders, by roping in a foreign strategic investor ahead of the IPO.

Sources, however, maintain that ABC may not be inclined to bring on board a foreign investor despite the obvious advantages of better risk control expertise and corporate governance from a long-term perspective.

The agriculture-focused lender is generally considered to be weaker than the other big State-run lenders, as it has been largely supporting rural development for several years through government-directed lending programs.

The bank has enough strength to sustain future growth due to its strong rural focus. Rural areas are considered to be the new engines for economic growth as the urbanisation drive gathers momentum in China, Xiang Junbo, chairman of the bank, said in a recent interview to this paper.

As part of the plan to keep its books in order ahead of the share float, ABC wrote off some 800 billion yuan (US$117 billion) of bad debts in 2008 and received a US$19 billion capital injection from Central Huijin, the domestic investment arm of the nation's sovereign wealth fund.

With non-performing loan ratio and capital adequacy ratio, the two major indicators for financial health, standing at 2.91 percent and 10.07 percent by the end of 2009, the bank is in a better position that the other three lenders prior to their listing between 2005 and 2007.

[Source: China Daily](http://www.chinadaily.com.cn/bizchina/2010-04/08/content_9701591.htm) ([see archive](Agricultural_Bank_may_float_IPO_in_July.pdf))

### Banks skirt credit control measures

As lending tightens, banks may prefer selling bank-trust asset management products to finance local infrastructure projects instead of giving loans, a tactic that will allow them to bypass stringent regulations associated with lending quotas, such as the capital adequacy ratio, analysts said on 7th April.

Many asset management products are set up by trust companies, a number of which are subsidiaries of mammoth State-owned Enterprises such as PetroChina and Sinopec.

"Many [bank-trust] products were sold in January and February, and a product with a three-month maturity offered a 2.5 percent annualised return rate, which is higher than the current annual interest rate of 2.25 percent, sold out in two hours last week," said Wang Fei, a customer service clerk at a Bank of China in Beijing's Central Business District.

Apart from investing in securities portfolios, the money raised by banks selling asset management trust products is transferred to local financing platforms for infrastructure projects such as building roads, railways, and industrial parks, said Zhao Yang, an analyst at the Trust and Asset Management Institute of Southwest University of Finance and Economics in Chengdu, capital of Sichuan Province.

In the first three months of this year China Construction Bank launched a series of trust products and the capital raised was transferred to provincial government-backed infrastructure companies.

China Merchants Bank, well known for its asset management, also invested trust funds it raised in transportation and water facilities in southeast provinces and regions, the 21Century Business Herald reported on 7th April.

Banks sold 355 bank-trust products in March, almost double the 182 products sold in February, Zhao said, citing data from the institute.

There are two types of trust products; one includes investments in securities and bonds portfolios, while the other centers on credit related to infrastructure projects.

The amount of credit trust products raised on average was 113 million yuan (US$16.54 million) per product in December, an average that increased to 298 million yuan (US$43.63 million) in February.

"It's beneficial for banks to sell trust products, as they can earn commission supposedly without taking responsibility for default risks. Also, they can maintain a good customer relationship by providing new product information," said Wen Chunling, associate director of Fitch Ratings China.

In addition, the trust products sold at banks are not loans, and are thus not subject to the stringent requirements like the capital adequacy ratio rules, she said.

In a document issued to financial institutions by the China Banking Regulatory Commission (CBRC) in December, the regulator asked banks and trust companies to pay close attention to local government projects for their bank-trust products.

The institutions are required to fully understand local fiscal revenues and assess their credibility, and are forbidden from financially supporting problematic projects.

The CBRC raised the capital adequacy ratio to 11.5 percent from 11 percent last year, the Economic Observer confirmed 29th March, citing an executive with China Construction Bank.

The tightened rule means banks have to increase the issuance of shares on the stock market or issue bonds to raise their capital to support their lending expansion.

[Source: People's Daily](http://english.people.com.cn/90001/90778/90859/6943571.html) ([see archive](Banks_skirt_credit_control_measures.pdf))

### China Everbright Bank becomes first domestic bank to go carbon neutral

The China Everbright Bank (CEB) signed an agreement with the Beijing Environment Exchange (BEE) on 8th April, according to which the bank will buy carbon credits to offset its carbon dioxide emissions generated in daily operation.

It was the first domestic bank that had committed to neutralising its carbon discharge, according to the BEE.

Specific purchasing volume was yet to be confirmed, which would be based on the CEB's calculation on its carbon emissions, said Mei Dewen, general manager with the BEE.

The bank leads its counterparts in promoting carbon reduction.

It launched a zero-carbon credit card on 2nd March, which has six functions to help with carbon reduction including a recyclable chip.

The CEB has environmental thresholds for lending, restricting loans going to the energy-intensive and highly polluted industries, said Zhang Huayu, vice president of the bank.

In a bid to create a nationwide emissions trading platform, China established carbon-trading exchanges in Beijing, Shanghai and Tianjin in 2008, where emission rights can be traded.

China vowed in November that it would reduce carbon dioxide emissions per unit of GDP in 2020 by 40 to 45 percent compared with 2005 levels.

[Source: People's Daily](http://english.people.com.cn/90001/90778/90859/6944811.html) ([see archive](China_Everbright_Bank_becomes_first_domestic_bank_to_go_carbon_neutral.pdf))

## Corporate & Commercial

### China and Costa Rica signs free trade agreement

China and Costa Rica signed a Free Trade Agreement (FTA) in Beijing on 8th April to remove trade barriers and enhance bilateral ties, the Ministry of Commerce announced in a statement on its website.

The agreement was the first free-trade pact between China and a Central American country, and would help both sides tap into each other's market, as well as other markets in Asia and Central America, it said.

The agreement was signed between Chinese Commerce Minister Chen Deming and his Costa Rican counterpart Marco Ruiz. The two sides hoped that the FTA could be implemented as early as the second half of this year.

The two countries will gradually lift tariffs from more than 90 percent of products traded between them once the FTA takes effect.

The FTA also would open sectors for investment from the other side: 45 service sectors in Costa Rica, including telecommunications and real estate, and 7 sectors in China.

The tax reduction would benefit the trading of Chinese products such as textile materials, light industrial goods and machineries, as well as coffee, beef and fruit juice from Costa Rica, it said.

Costa Rica is now China's ninth largest trade partner in Latin America while China is Costa Rica's second largest trade partner.

Bilateral trade between China and Costa Rica reached US$3.18 billion in 2009, compared with US$2.89 billion in 2008, according to statistics from Chinese customs.

China and Costa Rica started the FTA talks in November 2008 and concluded the negotiations at their sixth round of talks in February this year.

China also has FTAs with Chile, Pakistan, New Zealand, Singapore, Peru and the Association of Southeast Asian Nations.

[Source: China Daily](http://www.chinadaily.com.cn/bizchina/2010-04/08/content_9704164.htm) ([see archive](China_Costa_Rica_ink_free_trade_agreement.pdf))

### Geithner heads to Beijing for talks

BEIJING - US Treasury Secretary Timothy Geithner will visit Beijing for talks on economic issues with Vice-Premier Wang Qishan on Thursday, Geithner's spokesman said, in a sign that the two sides are moving toward settling a dispute over China's currency.

"The secretary and the vice-premier have been working together to find an opportunity to meet for some time," spokesman Andrew Williams said on Wednesday, as Geithner ended a two-day visit to India.

Williams gave no details of the agenda, but the decision to hold such a high-level encounter suggested Washington and Beijing are moving toward resolving the currency dispute, which has threatened to overshadow cooperation on the global economy, Iran's nuclear program and other issues.

Speaking in India, Geithner said the yuan would take a broader international role, calling it a "healthy, necessary adjustment".

Washington is pressing Beijing to ease exchange rate controls that it says keep the yuan undervalued, allegedly giving China's exporters an unfair price advantage and swelling its trade surplus. Some US lawmakers are calling for punitive tariffs on Chinese imports if Beijing does not act on the issue.

Mei Xinyu, a researcher at the Chinese Academy of International Trade and Economic Cooperation affiliated to the Ministry of Commerce, said the yuan issue could top the agenda of Geithner's meeting with Chinese officials.

"It is normal for the two countries to conduct exchanges given the many frictions between them," Mei said.

But the timing of the visit is very unusual."

"The purpose of the trip is to try to finalize the deal apparently reached over the exchange rate," said Heritage Foundation research fellow Derek Scissors.

"If successful, China can announce and implement changes at its preferred time, rather than being rushed due to political pressure and the schedule of bilateral and multilateral meetings."

"After a time of disturbance and unpleasantness, Chinese-US relations are entering a track of getting closer to one another," said Liu Jiangyong, a professor at the institute of international studies at Beijing's Tsinghua University. "I hope the Geithner visit promotes understanding."

Philip Levy, a scholar at the American Enterprise Institute for Public Policy Research, said the Geithner visit to Beijing is a "very positive development".

"As Secretary Geithner has said, the United States and China have a common interest in seeing China's currency adjust to a more appropriate level. The best way to achieve this is through cooperative dialogue, not ultimatums and threats. The visit will allow just such dialogue," Levy said.

Pieter Bottelier, professor of China Studies of Johns Hopkins University, said the bilateral relationship has indeed been under a lot of stress lately.

But he said he believes that "China's exchange rate policy is mainly China's business".

"I hope that Secretary Geithner and Vice-Premier Wang Qishan will be able to solve the issues in a professional and statesmanlike manner. It is in the interest of both countries and it is also in the interest of other countries".

In another sign of warming bilateral ties, President Hu Jintao is due to hold talks with US President Barack Obama during an 12-13 April visit to Washington for a nuclear security summit.

Obama will raise the currency issue with Hu on the sidelines of the nuclear summit, the White House said on 6th April.

The Obama administration delayed a report to the US Congress due 15th April in which it had the option of citing Beijing as a currency manipulator, a designation that could lead to possible trade sanctions. The White House denied the delay had anything to do with seeking Chinese support for penalties over Iran's nuclear program.

Zhou Shijian, a senior economist at the China-US relations research center of Tsinghua University, said that although the US Treasury delayed the release of its foreign exchange report, it will continue to press China in that respect.

"The delay does not mean the pressure has disappeared," he said. Instead, he said it would continue to pressure China to revalue the yuan in the upcoming China-US Strategic and Economic Dialogue in May and the G20 meeting in June.

The delay is part of US strategy to win China's support in the Iran nuclear issue, Zhou said.

Premier Wen Jiabao has also publicly rejected foreign pressure over the yuan and said in March the currency was not undervalued.

Similarly, Foreign Ministry spokeswoman Jiang Yu said Beijing has never manipulated the yuan's exchange rate for profit.

The National Development and Reform Commission (NDRC), the country's top economic planner, has said China will monitor exchange rate risks facing exporters.

"We should keep the yuan basically stable at a balanced and reasonable level, while strengthening analysis and monitoring and making announcements about risks in a timely manner to reduce exporters' risks and losses," the NDRC said in a policy overview.

On his India trip, Geithner met with Prime Minister Manmohan Singh and his counterpart, Finance Minister Pranab Mukherjee.

Mukherjee and Geithner presided over the first meeting of the US-India Economic and Financial Partnership to promote trade and investment. The initiative is part of Obama's efforts to forge closer ties with India.

[Source: China Daily](http://www.chinadaily.com.cn/china/2010-04/08/content_9699497.htm) ([see archive](Geithner_heads_to_Beijing_for_talks.pdf))

## Others

### Shanghai plans property tax

Shanghai, China's wealthiest city, may impose a property tax to curb price gains, the Shanghai Securities News reported, citing unidentified people.

The city government has already completed a basic plan for the tax, which would affect ownership of investment properties, the Shanghai-based newspaper reported, without saying when the charge may be levied. The tax is likely to be applied to existing homes as well as new properties, the report said.

The Shanghai Housing Support and Building Administration Bureau's press officer didn't answer calls to its office.

China's government unleashed a US$1.4 trillion lending boom last year to stimulate the economy and is now trying to slow the surge in property prices. Shanghai posted the biggest gains in luxury home prices last year among 56 markets worldwide studied by Knight Frank LLP, according to a 23rd March report from the London-based property broker.

Home prices in 70 major Chinese cities jumped the most in almost two years in February, led by the southern cities of Sanya and Guangzhou. More than 70 percent of Chinese households consider home prices "unacceptably high", a proportion that has climbed for four quarters, the People's Bank of China said in its quarterly survey last month.

Shanghai's property prices may fall as much as 10 percent this year as the government prepares to roll out tightening measures to cool the overheated market, the South China Morning Post reported today, citing Colliers International.

Premier Wen Jiabao has pledged to restrain speculation in the housing market and curb land hoarding and excessive price gains in some cities, using tools including tax and credit policies.

China scrapped a tax break on property sales in December and the central bank has asked lenders to set aside more deposits as reserves twice this year to curb liquidity while leaving benchmark interest rates unchanged. Morgan Stanley said last month that another increase in the requirements may be "imminent" and rates may rise in April.

The nation's central bank will sell three-year bills for the first time since June 2008 at a yield of 2.75 percent, according to a survey of traders. Selling higher-yielding bills may be a precursor to the first increase in rates in more than two years and allowing yuan gains, said Jiang Chao, an analyst at Guotai Junan Securities Company, the nation's largest brokerage by revenue.

[Source: People's Daily](http://english.people.com.cn/90001/90778/90860/6944249.html) ([see archive](Shanghai_plans_property_tax_report.pdf))

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