

CHARLTONS  
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# China- Investment Climate

# Introduction to China's economy



785 million

labour force in China  
in 2020



463 million

employed in  
urban areas

500%

The urban labour force  
outsizes Germany's entire  
population by more than 500%

China's economy grew by 8.1% in 2021 and  
a GDP per capita (current prices) of US\$11,700

Hong Kong's economic growth was recorded  
at 6.4% with a GDP per capita of US\$48,000

The United States' economy grew by 6.0% with  
per capita GDP at US\$66,100 in 2021

Russia's economy grew 4.7% with  
per capita GDP at US\$10,800

In 2021 China's GDP  
**16.8 trillion US\$**

In 2021 Hong Kong's GDP  
**369.7 billion US\$**

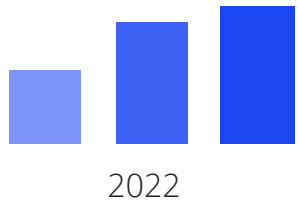
In 2021 US' GDP  
**369.7 billion US\$**

In 2021 Russia's GDP  
**1.7 trillion US\$**

MF's 2022 estimates predict China's per  
GDP capita to increase to US\$12,990  
with 5.6% economic growth

Hong Kong's per GDP capita to reach  
US\$51,900 with 3.5% economic  
growth

# What to expect from the Chinese economy



5.4%

2022's expected growth to slow to 5.4% as economy returns to pre-COVID trends

Impressive recovery from the impact of COVID-19

However → China now faces numerous headwinds, including a property slump, energy crisis, weak consumer sentiment and soaring raw material costs

Investment to remain as an engine of growth → Structure to shift towards private investment

# Continued control on major industries

Common Prosperity policy may be responsible for control on different parts of different industries

For China's property sector:



Current property turmoil was a culmination of many property firms' fast expansion through highly leveraged borrowings over the past decades




Being caught in a "negative credit loop" with limited funding access and therefore reducing liquidity, developers → reduced spending on land and construction to preserve liquidity for debt servicing



Investors' and lenders' risk aversion has increased in response, exacerbating refinancing risk, particularly for small and financially weak developers

# Regarding tech companies

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- Nov 2021 Personal Information Protection Law (Effective Nov 2021)
  - Sept 2021 Data Security Law (Effective Sept 2021)
  - Anti-Monopoly Guidelines of the State Council on the Platform Economy
  - Nov 2020 Regulators unveiled guidelines to root out monopolistic practices in the internet industry
  - Feb 2021 The final antitrust guidelines for internet platforms were released
  - July 2021 New rules regarding overseas listing were released


# Stabilising Growth in 2022

National Development and Reform Commission (NDRC): Security and Stability

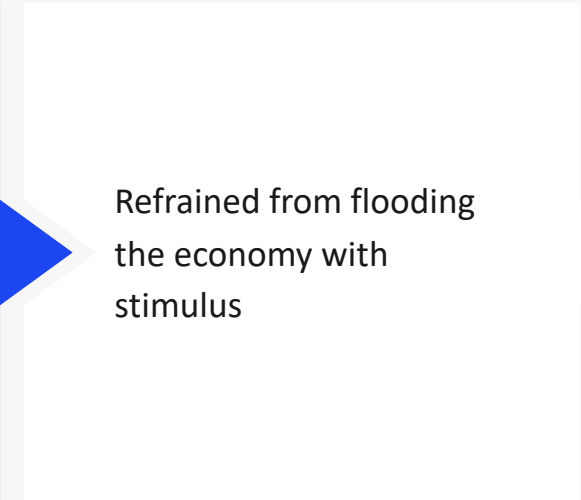
6th December 2021: China Political Bureau

→ warned that China's economy is facing risks from "contracting demand, supply shock and weakening expectations,"

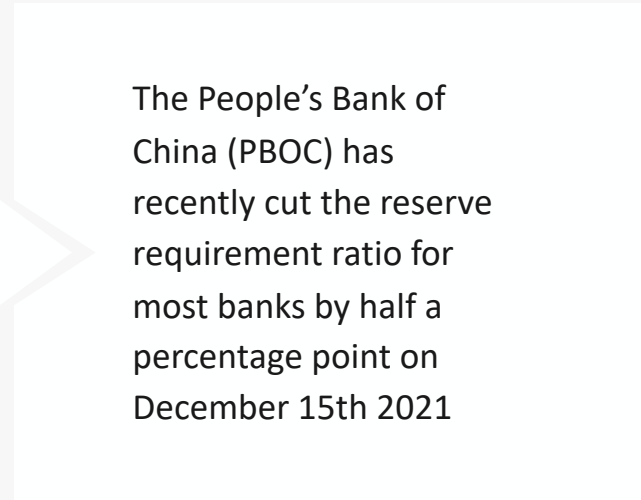
China is managing the economy *cautiously*



Has not cut the country's benchmark lending rate since early 2020



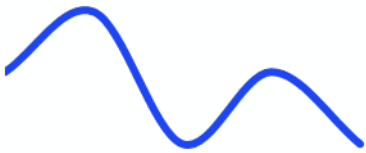
Refrained from flooding the economy with stimulus



The People's Bank of China (PBOC) has recently cut the reserve requirement ratio for most banks by half a percentage point on December 15th 2021

# Post-2022

2022



Growth rate is expected to continue at a downward trend due to an ageing and shrinking labour force → slowdown in labour productivity

However

→ Human capital investment and innovative technological upgrades could counteract this decline

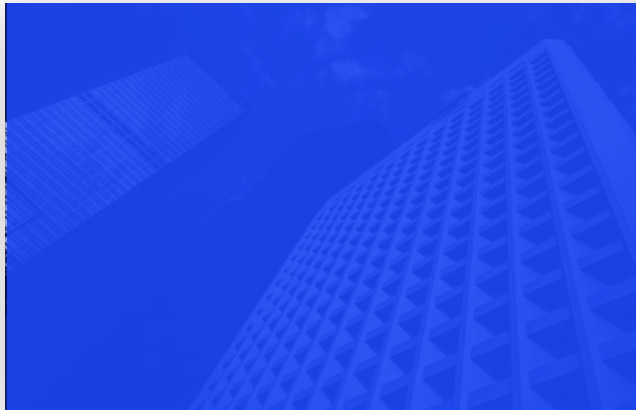
Geopolitics: Tensions with the US

Potential internationalisation of the RMB

Dual Circulation Strategy → Insulate the domestic market → Belt and Road Initiative

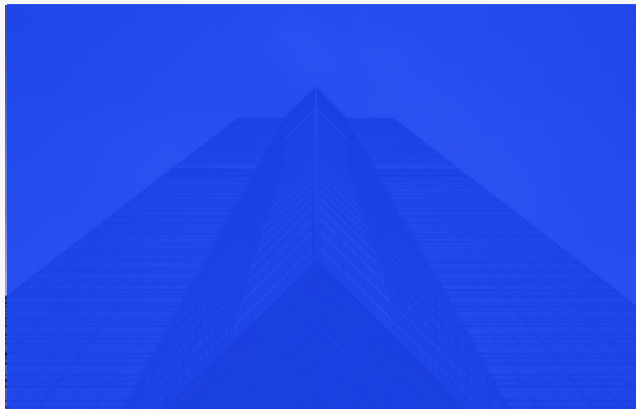
Financial Decoupling

# Current Regulatory Framework for state regulation of investments?



## China's Legal System

Civil law system mixing elements of the old Qing dynasty law code, Russian civil law, and continental civil law



## Establishing business from abroad → New Foreign Investment Law

Investment Promotion, Investment Protection, Investment Administration, Legal Liabilities



# What are the features of the relationship between government and private companies in the PRC?

## National Security Law:

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All enterprises must maintain national security

## Cybersecurity Law:

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Article 28 says network operators must provide technical support and assistance to government offices involved in national security

## National Intelligence Law:

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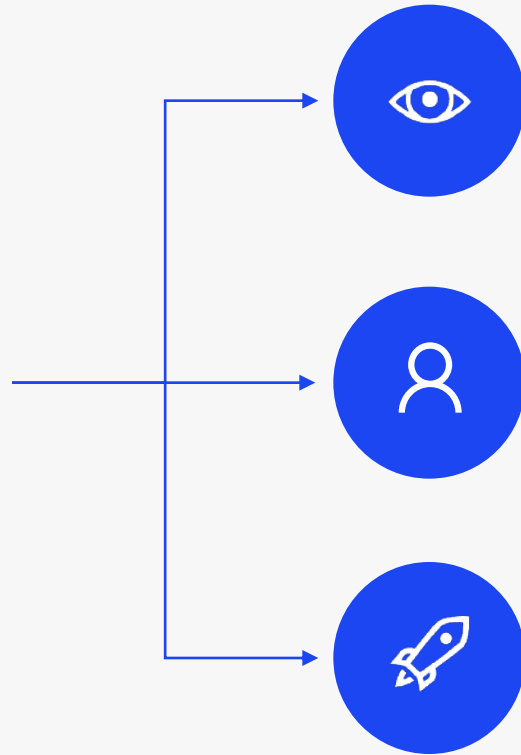
Every organisation must cooperate with national intelligence work

## Company Law:

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Article 19 says companies shall provide necessary conditions to facilitate the activities of the Party

- Party guidelines for companies: “serve the state”
- Party demands and expectations



Have a seat at the table

For companies to not become rival players in the political system

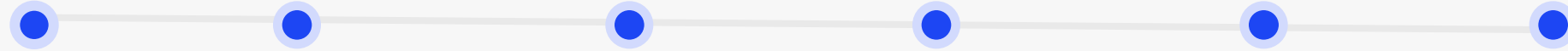
Economic growth objectives

# What are the main directions of GR strategies in the PRC now?

Communication  
is key

Abiding by the law

Building ties, keeping up  
with new regulations



A more effective business  
operating plan compliments  
public policy objectives

The importance of  
a knowledgeable  
government affairs team

Increasing  
government officials'  
awareness of your  
company

Building strong lasting relationships on national  
AND local level

The need to work with all local government  
administrative levels

Provincial, Municipal, District, and County levels

- a) Understand China's vertically integrated and complex power structure & all stakeholders
- b) Develop a government relations strategy or direction
- c) Identify powerful and influential people and organisations at different levels of the party-state system
- d) Create government relations messaging that demonstrates commercial goals that are aligned with the objectives of the Chinese government
- e) Spot and analyse the role of individuals in power relations, hierarchies, networks, and status positions
- f) Determine whether a behind-the-scenes influencer may be driving issues in unexpected ways
- g) Map the complex web of stakeholders needed to address each issue
- h) Engage proactively before any critical needs emerge
- i) Train government relations employees to work together closely
- j) Develop "Guānxi" (relationships)
- k) Build a personal relationship with the party on a day-by-day basis
- l) Track and evaluate government relations performance and adjust strategies accordingly

## Best practice guide for a government -relationship strategy:

# Does the Party have leverage over the business and how often does it use them in its national interests?

Control over a majority of major businesses operating in China

President Xi and Big State Firms

## China's Company law Article 19:

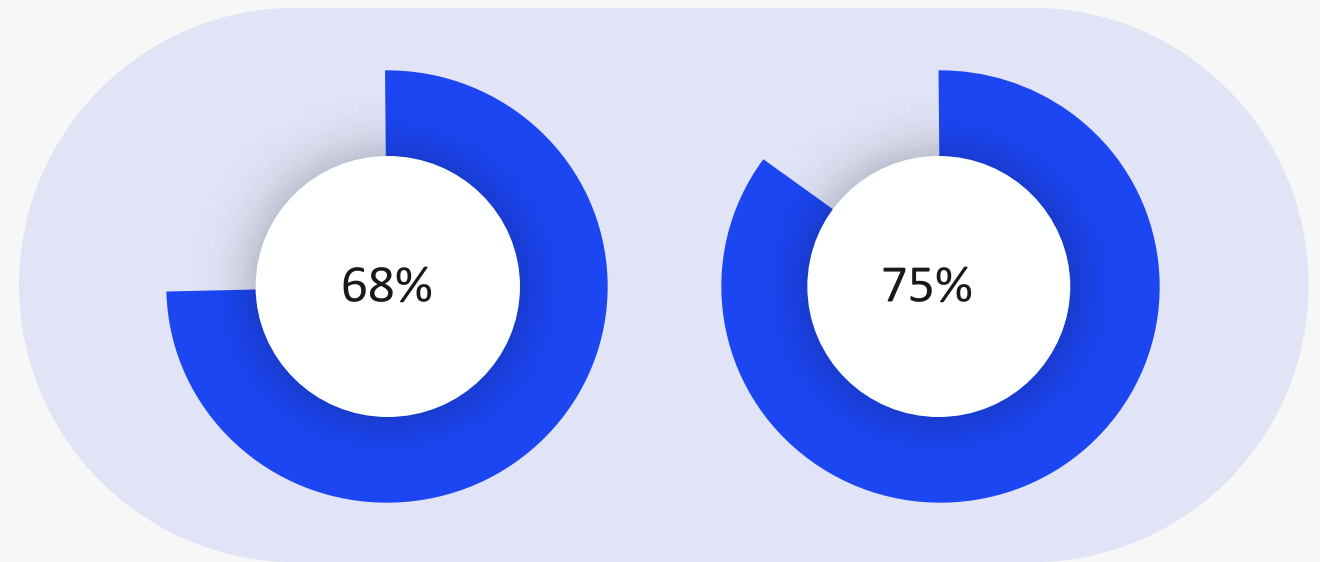
Companies need to provide the “necessary conditions” for the activities of party organisations to operate

Different expectations for the role of party groups in state-owned enterprises (SOEs) and private companies rprises must maintain national security

For foreign-invested enterprises  
→ Company Law requires party organisations to be established, whether JV or 100% foreign-owned, by employing 3 or more party members

However → no management or governance role is required and company best practices suggest these organisations are not required to hold a managerial function

Recent survey by the Central Organisation Department:



68% of China's private companies had party bodies

14th Five-Year Plan for the 2021-25 period

70% of foreign enterprises, accounting for a total of 1.86 million private owned companies

Calling for a transition from a focus on high-speed growth to a high-quality development model



# How does China plan to stimulate the country's economy?

Two Negative Lists:

Free Trade Zones  
Two Negative Lists:

National Negative List →  
applies throughout the country

Jointly released by the National  
Development and Reform  
Commission (the NDRC) and the  
Ministry of Commerce (MOFCOM)

The items on the two lists have been  
gradually decreasing → reducing the  
number of measures limiting access to  
foreign investment

Chinese companies on the negative list  
may receive foreign investment to go  
public overseas



- Lifting SMEs
- Fixing the "roof" on Real Estate
- Market oriented reforms& incentives to boost rural enterprise and small private business productivity
- Strong exports and effective control of the pandemic



## 1. Lifting SMEs

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- People's Bank of China to provide 300 billion Yuan (US\$ 46.4 billion) low-cost funding for SMEs
- "The Notice"

# VIE Structure (Variable Interest Entity Structures)

New draft rules by the Chinese Securities Regulatory Commission (CSRC)

Previously used by China's tech firms to seek listing on overseas stock markets

→ To avoid Chinese restrictions

New rules → framework to guide Chinese companies to raise funds overseas if they choose, rather than tightening controls on overseas share sales

(Provided they comply with requirements and file with regulators)

## Key points from the draft rules:

30%

Foreign ownership in a company is capped at 30%

10%

The urban labour force outside with no single investor holding more than 10%

Companies will be barred from overseas share sales in five circumstances:

1



if they are violating national laws and rules,

2



if overseas listings could threaten national security,

3



if involved in major disputes over assets or core technology,

4



if major shareholders are investigated for corruption or convicted in the last three years,

5



if senior management are investigated or punished for major violations



Companies may be ordered to divest domestic assets  
→ prevent their overseas IPO from harming national security;



Companies seeking overseas share sales should file with the CSRC within three days after they submit listing documents to overseas market regulators;



Companies are defined as domestic and should follow the new rules if they have over 50% of revenue, profit, and assets coming from the China market over the past financial year;



Chinese securities firms sponsoring domestic companies' overseas share sales should file with the CSRC





## 2. Fixing the “roof” on Real Estate

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- Cool down property sector at risk of overheating
- Reduce property developers’ debts
- Easing of strict property policies: Expected to further ease in 2022

**On this point:** Central Bank also plans to ease measures to facilitate economic recovery

- Development of offshore yuan market: Long awaited flexibility of currency?

Lifting SMEs

Fixing the "roof"  
on Real Estate

Market oriented reforms&  
incentives to boost rural  
enterprise and small  
private business  
productivity

Strong exports and  
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### 3. Market oriented reforms & incentives to boost rural enterprise and small private business productivity

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- Capital stock vs capital-output ratio
- Need for higher productivity
- How to recreate the 1978 Productivity Boom?

Lifting SMEs

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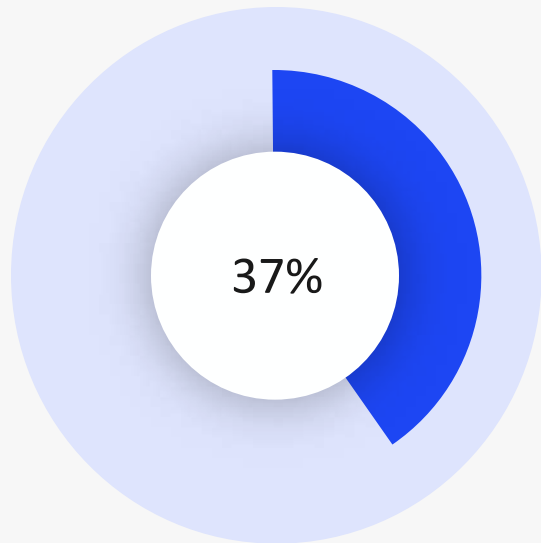
#### 4. Strong exports and effective control of the pandemic

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- Contractionary fiscal policy to align with GDP growth
- Exports as driver of Chinese economy
- Large scale capital investment
- Productivity gains

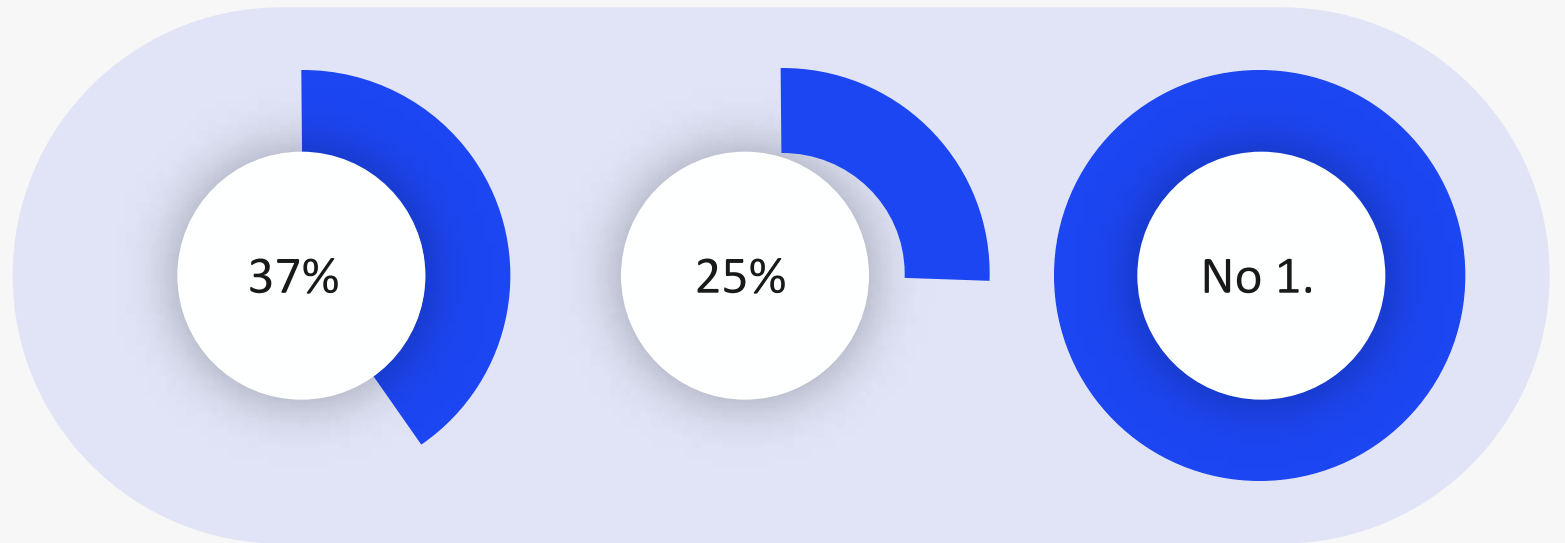
# Why Buy Chinese Stocks?

## Rising Industries



China is a large percentage of the emerging markets indices — roughly 37% of the MSCI EM Index

## Continued Growth



Biggest ecommerce market globally → 37% of the global ecommerce market share

Cafes, bars, drinking establishments up almost 25% from 2020

No. 1 in exports globally



# Risks of investing in China?

2020  
\$2.4 trillion

2020  
\$27 trillion

2020  
60%

2020  
\$5.6 trillion

## Continuing uncertainties

- Is there a pivot in Chinese policy?

## Inflation and Volatility

### Debt

- End of 2020: China's foreign debt at US\$2.4 trillion.
- Corporate debt is US\$27 trillion, total public debt exceeds 300% of the GDP.
- China's public debt 60% higher than the average across other countries, outpacing its GDP growth.
- China creditor of more than US\$5.6 trillion to low-income countries

## Outward pressures

- Facing a shift towards deglobalisation  
→ Decoupling with the US
- Chinese companies delisted from New York Stock Exchange
- Disruption of global supply chains →  
Chinese manufacturing shutdown mid-2020
- Ripple effects → growing debate of reshoring  
and less dependence on outsourcing
- Common Prosperity → Property market drops  
necessary or not?

## Homecoming for listed companies:

The US' Holding Foreign Companies Accountable Act (HFCAA), December 2020

- Delistings quite likely

## Common Prosperity:

- Expand the proportion of middle-income citizens
- Boost incomes of the poor, rationally “adjust excessive incomes,” and ban illegal incomes
- Push to rein in Big Tech monopolies,
- Tackle health-care costs, labour conditions for wage earners, and tax evasion among wealthy individuals

# Difference between investing in China through funds and buying common stock in Chinese companies?

Understanding of how Chinese stocks and funds work

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## Stocks

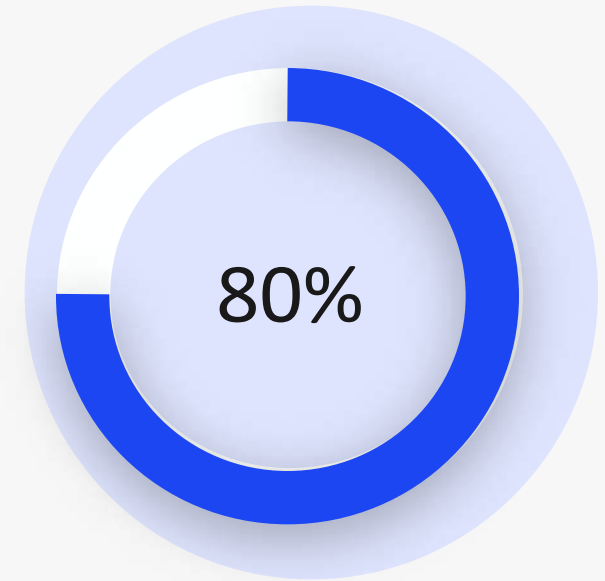
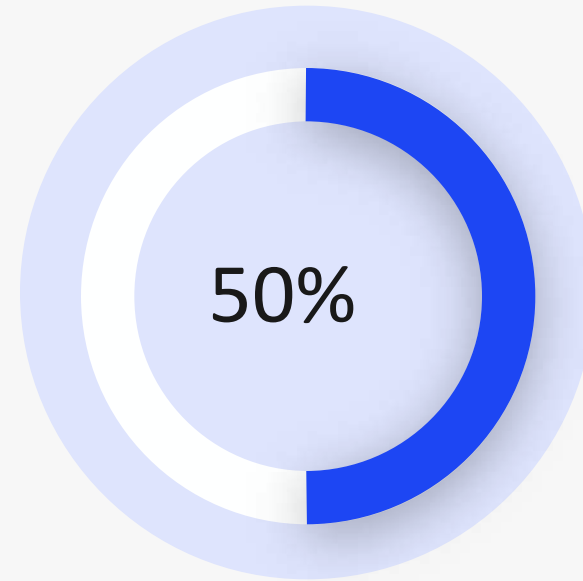
American Depositary Receipts (ADRs) and Variable Interest Entities (VIEs) Secondary listings in Hong Kong → Shanghai-Hong Kong Stock Connect & → Shenzhen-Hong Kong Stock Connect



## Importance of investing in Chinese stocks through Hong Kong

50% of companies listed on HKEx are from the Mainland, they account for over

80% of the market capitalisation



## Mainland stocks listing on the HKEx are increasing

Hong Kong ranked 2nd in total proceeds with 154 new IPOs, raising HK\$397.5 billion (US\$50.1 billion)

**2<sup>nd</sup>**  
Rank

**154**  
New IPOs

**HK\$397.5**  
billion (US\$50.1 billion)

## Different classes of shares:

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# A

**A-shares:** publicly listed Chinese companies that trade on Chinese stock exchanges such as the Shenzhen and Shanghai Stock Exchanges. Trade in RMB.

# B

**B-shares:** Domestically listed foreign investment shares. They list on the Shenzhen and Shanghai exchanges, and are denominated in RMB but settle in USD in Shanghai and HKD in Shenzhen.

# H

**H-shares:** Chinese companies' shares traded on Hong Kong's exchanges.

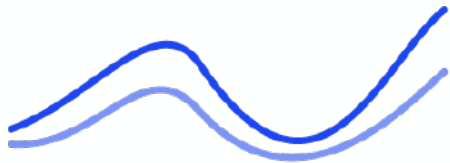
Subject to relevant Chinese laws and regulations, and to Hong Kong applicable laws and non-statutory codes. Freely tradable by anyone and they trade using the Hong Kong dollar (HKD).

# R

**Red Chips:** Companies incorporated outside Mainland China (usually Cayman Islands) but trades in Hong Kong

# Investment Funds

August  
2001 — 2021



● S&P 500  
**9.3%**

● MSCI China Index  
**12.3%**

A broader selection of investment opportunities

Mutual Recognition of Funds (MRF): allows international investors to purchase recognised Mainland funds sold in Hong Kong

Funds available to be sold in HK:

- Regular equity funds, bond funds, mixed funds, unlisted index funds and physical index-tracking exchange traded funds (ETFs)

Private equity funds and venture capital funds:

- China's private equity funds and venture capital funds' market enjoying surge
- China 2<sup>nd</sup> largest private equity market in the world
- PE and VC funds raised nearly USD 200 billion in 2021 Jan - Sept

# Bond Connect

Established  
2017



- Average daily turnover in 2021:  
**RMB 26 billion**
- Annual trading volume  
**RMB 6.5 trillion**

Allows Hong Kong and international investors to buy and sell bonds on markets in Mainland China

Funds available to be sold in HK:

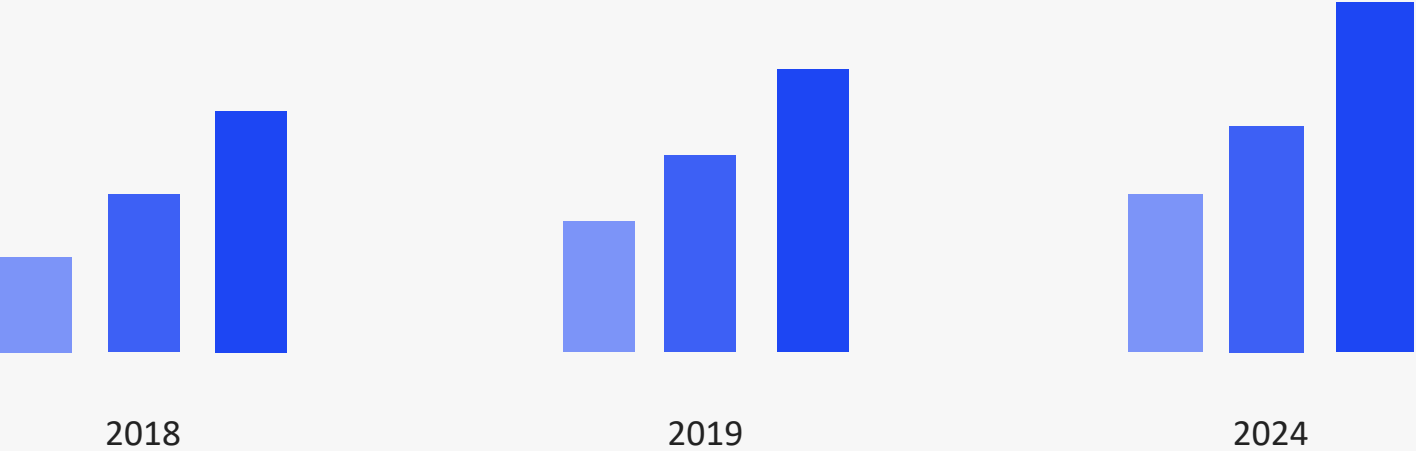
- Over 2400 global institutional investors including major global bond indices

Bond investors:

- China ranked most attractive destination
- Over 95% looking to increase exposure in Asia



# Sino-Russian economic/trade relations?



2018  
100 billion USD

2019  
110 billion USD

2024  
200 billion USD



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