



Number 3/2017 (February 3 - 16, 2017)

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METRIX

77,42
Gigawatt

Installed photovoltaic capacity in China **almost doubled last year** and rose to 77.42 gigawatts at the end of 2016, according to data from the National Energy Agency NEA. China now is the world's biggest producer of solar energy by capacity.

TOPIC OF THE WEEK: CHINA'S MONETARY POLICY

Central bank torn between market needs and economic policy goals



People's Bank of China headquarters in Beijing. Source: victorhenry via 123rf

China's central bank is increasingly struggling to balance monetary policy needs with politically defined economic growth targets. In recent weeks, the People's Bank of China (PBOC) has tightened its monetary policy in an effort to cool lending while continuing to supply the market with the liquidity needed to achieve China's economic growth targets.

Reacting to a sharp rise in lending in 2016, the **PBOC raised a number of key money market rates effective February 3**. Most notably, it increased the interest rate for short-term reverse repurchase agreements (repos), a major rate at which commercial banks can lend from the central bank, from 2.25 to 2.35 percent. Effectively this increases the cost of lending as banks pass the rate rise down to consumers and companies. The moderate increase may be a test balloon for tighter monetary policy in the months to come.

In another policy shift, the central bank halted its cash injections into the money market, citing a "relatively high level of liquidity" on February 4 – only to resume these open market operations less than two weeks later by **injecting CNY 100 billion (USD 14.5 billion) on February 13** and another **CNY 130 billion on February 14**.

China's economic growth is heavily reliant on credit, and the Chinese leadership's ambitious GDP growth targets can only be fulfilled if lending is not curtailed too strongly. At the same time, fears of

inflation, asset bubbles in the stock and real estate markets as well as rising corporate debt levels require a tighter monetary policy, which in turn could dampen the private investment activity necessary to achieve the economic growth targets.

The PBOC's decision-making will continue to be unsteady as long as it has to balance these incompatible goals. China's future economic development will hinge on how successfully its **central bank can manage and communicate the difficult balancing act** between ensuring both credit discipline and growth.

CHINA AND THE WORLD

Beijing hopes for new phase in China-US relations after Trump calls Xi

After Chinese President Xi Jinping and his U.S. counterpart Donald Trump spoke by phone last Friday, **party-state media** in Beijing are hoping for an ease of recent diplomatic frictions between the two countries. Official Chinese **coverage** of the first personal contact between the two heads of state focused on Trump's promise to "uphold" the One China Policy. Some experts warned against overinterpreting the result of the call. Trump's commitment marked "no significant breakthrough but a return to normal," Peking University researcher Niu Jun told "China Daily USA".

Trump had snubbed the Chinese government by distancing himself from the One China Policy, which Washington had supported for decades. He further aggravated tensions in the U.S.-China relationship by accepting a phone call from Taiwan's president Tsai Ing-wen. During the election campaign Trump had caused dismay in Beijing by threatening to impose punitive tariffs on Chinese exports.

The fact that Trump took weeks to personally get in touch with Xi also triggered mocking comments in Chinese media. Trump was described by some as a **"paper tiger"** who was forced to abandon his tough stance on the One China issue in order to establish his first contact with Xi. Such critical views are not echoed by official sources. In the run-up to the 19th party congress the CPC wants to ensure stability, including in the China-U.S. relationship.

Xi Jinping announces reform of foreign aid system

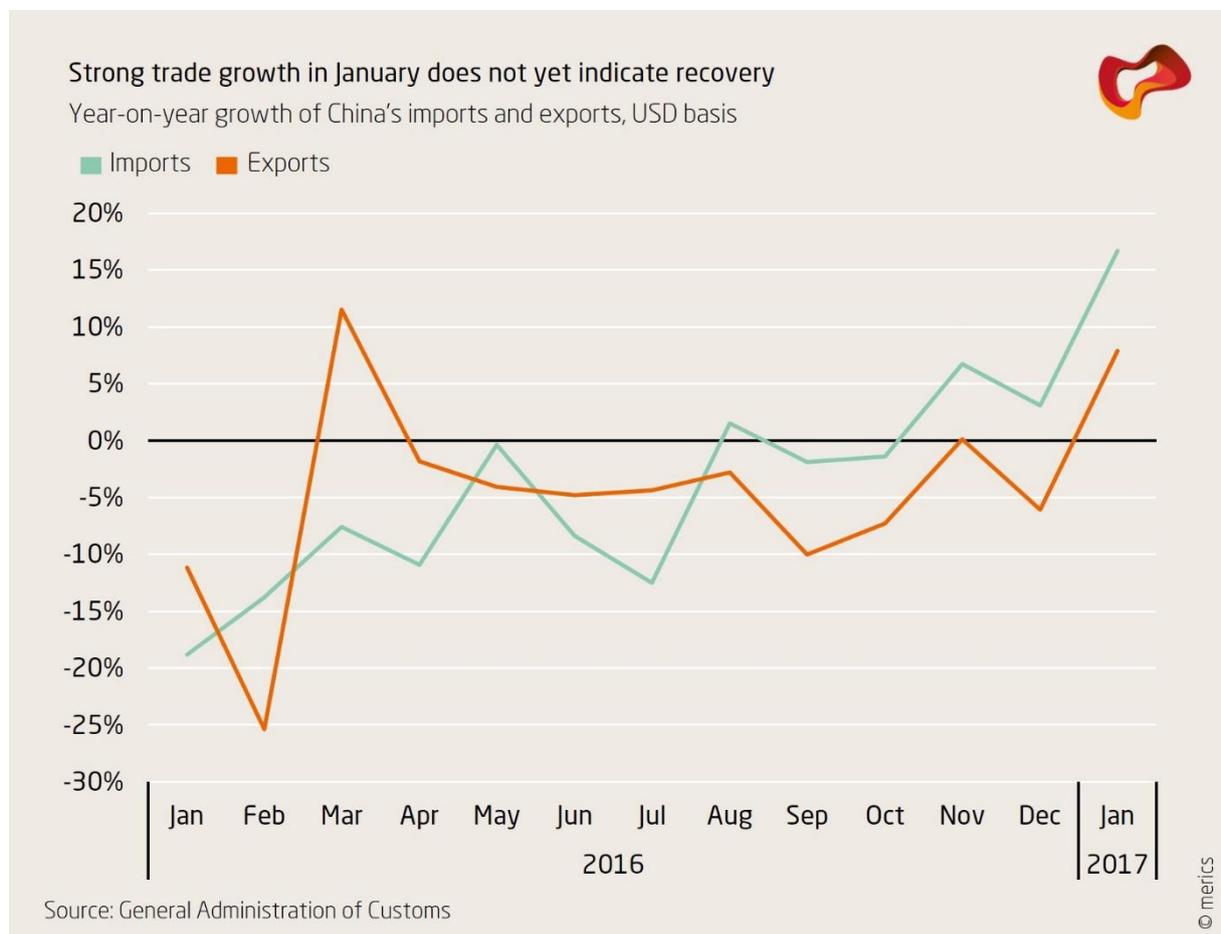
President Xi Jinping has called for a reform of China's foreign aid system. China needs to "improve management of foreign aid funds and projects, reform the foreign aid administration system and enhance the overall results of foreign aid," the party-state **Xinhua news agency quoted Xi** as telling a meeting of the Leading Small Group on Comprehensively Deepening Reform on February 6.

Xi's announcement illustrates that the Chinese government wants to see greater returns on Chinese overseas financing and spending. Its implementation could also have implications for China's infrastructure projects under the Belt and Road Initiative (BRI) in Europe and Central Asia. BRI projects might face stricter assessments of risks and potential return on investment.

China's foreign aid policy **has come under increased pressure** as shrinking foreign exchange reserves reduce the availability of financial resources for overseas spending. Facing slower economic growth at home, many in the Chinese public argue that Chinese money should rather be spent at home.

The necessity of reforms and a more centralized coordination in this field had been discussed for a long time. In international comparison, many Chinese overseas financing projects in developing countries are associated with higher risks.

Strong export growth in January does not yet indicate upward trend



Chinese exports grew stronger than expected in January, seemingly suggesting an upward trend. An overly optimistic interpretation may be premature though, as the data were strongly distorted by seasonal and market factors.

The US dollar value of China's **exports increased by 6.9 percent in January** over the same period last year, exceeding forecasts. Imports also grew faster than predicted, by 16.7 percent over January 2016.

Trade data are an important indicator of the health of an economy, and in particular manufacturing. The uptick in exports and imports may point to an increase in global and domestic demand. But observers are skeptical whether the strong performance early in the year can be interpreted as a turning point.

The surge in the import value was mostly fueled by stronger commodity prices. The Chinese New Year holiday, which was two weeks earlier than last year, was another cause of likely distortions through pre-holiday shipments and purchases. Lastly, the growth rates in January 2017 look so strong as they are compared against a base of relatively low growth in January 2016.

News in brief

- Chinese Foreign Minister **Wang Yi will attend the Munich Security Conference** from February 17-19
- Beijing faces pressure from U.S. and its allies after **new North Korean missile test**
- China's **foreign exchange reserves** drop to a near six year low
- Russian aluminium producer Rusal plans **to issue first "panda bond"** in China

POLITICS, SOCIETY, MEDIA

Carrie Lam is Beijing's candidate for Hong Kong Chief Executive

The candidates for Hong Kong's Chief Executive elections are off to the races, but Beijing has already picked its preferred winner. The **South China Morning Post reported on February 9** that Zhang Dejiang, Chairman of the Standing Committee of the National People's Congress, had recently told a number of Hong Kong elites in Shenzhen that the Standing Committee of the Politburo had decided to back Carrie Lam, the Special Administrative Region's former Chief Secretary for Administration.

There are five major contenders for Hong Kong's top job, but Beijing's backing usually decides the election results in Hong Kong. However, there is **widespread public uncertainty about Lam** who has not yet brought forward concrete policy proposals on crucial issues.

Her main rival, John Tsang, is running an aggressive campaign to win over votes from the pan-democratic coalition, which holds 326 (or a quarter) of the seats on the Election Committee. Although part of the pro-Beijing establishment himself, the former Financial Secretary began to soften his stance on the future of political reforms in Hong Kong. He hopes to convince reform-minded voters in the Election Committee to choose him as the lesser of two evils.

The **nomination process for the candidates began on February 14** and will continue until March 1. To become an official candidate, a contender needs at least 150 nominations from members of the Election Committee. On March 26 the Election Committee will meet to elect Hong Kong's new Chief Executive. A candidate needs 601 votes to win. The Election Committee consists of 1200 members from industry representatives, business elites and religious organizations. The majority of these groups belong to the pro-Beijing coalition.

Incumbent **Chief Executive Leung Chun-ying** announced in December 2016 that he would not seek reelection.

China tightens grip over businesses of missing Hong Kong billionaire

After the alleged abduction of billionaire Xiao Jianhua from Hong Kong to the Chinese mainland, his business operations are reportedly targeted by Chinese authorities. **According to the New York Times**, at least 30 staff members of Xiao's Tomorrow Group were banned from leaving the People's Republic. The financial magazine **Caixin reported** that the head of the newspaper Securities Daily Media, Xie Zhenjiang, was removed from his position and expelled from the Communist Party. Tomorrow Group owns a controlling stake in the stock market publication and reportedly influenced the paper's editorial decisions.

Xiao had vanished from his home at Hong Kong's Four Seasons Hotel on January 27. The "New York Times" and other media quoted eyewitness reports according to which he was whisked away in a wheelchair with his head covered by a sheet. As of late January, he was reportedly in police custody on the mainland where he was **"assisting investigations"** into the stock market turmoil in 2015, among other issues.

The tycoon's disappearance could be related to attempts by Beijing to step up its crackdown on corruption and economic crimes ahead of the 19th Party Congress this fall. Xiao, who has close relations with high-ranking party cadres and their families, has become known as the **de facto banker of the CCP elites**.

Xiao's case, just like the disappearance of five booksellers last year, is another blow to Hong Kong. His kidnapping would amount to yet another violation of the legal autonomy Beijing guaranteed to the Special Administrative Region when it obtained sovereignty over the former British colony in 1997.

Party-state publication invests in gay dating app

Homosexuality remains a taboo subject in China, but that has not kept one party-state media organization from investing into the gay dating market. The newspaper **"Beijing News" is funneling "several million Renminbi"** into the dating app **Blued (pronounced "Blue-duh")**.

With 27 million users, Blued is the biggest dating service for gay men in China. It reports higher daily traffic than its Western counterpart Grindr. The company is valued at USD 300 million.

It is unclear why Beijing News decided to invest into the platform. Homosexual content is regularly censored on Chinese websites, and **television shows about LGBT topics** are discouraged or banned.

Apart from seizing a share of **China's profitable "pink economy"**, the media group might hope to gain influence over Blued's managerial decisions as well as access to its customer database. It is also possible that Beijing wants to demonstrate tolerance vis-à-vis LGBT issues or that it plans to use the platform for HIV-prevention campaigns.

MERICS analysis: “Censorship in China: how sexuality became an ideological battleground.” Please read the [blogpost by Simon Lang](#).

China plans to store foreigners’ fingerprints upon entry

International travellers will have their fingerprints taken on future trips to China. The **Ministry of Public Security announced the new rule** for all foreigners from age 14 to 70, independent of the country of origin. Customs officials started collecting fingerprints at the international airport of the Southern Chinese city of Shenzhen on February 10. The practice will be rolled out to all entry points across the country by the end of 2017.

The rules do not apply to visitors traveling on diplomatic or official passports or visas, among several other exceptions. China appears to model its approach on the immigration practices of the United States and other countries that collect biometric data from foreign visitors. Many governments justify these measures with the intention to deter criminals and terrorists.

News in brief

- **Mayor of Beijing is put in charge of military reform group.** The appointment bolsters expectations that Xi Jinping confidante Cai Qi is candidate for Politburo.
- **China expels 32 South Korean missionaries** amid tension over stationing of US missile defense system.
- Rare phone call from house arrest sparks **fears over mental health of Liu Xia**, wife of jailed Nobel peace laureate Liu Xiaobo.

ECONOMY, FINANCE AND TECHNOLOGY

China’s new smart phone king is called “Oppo”

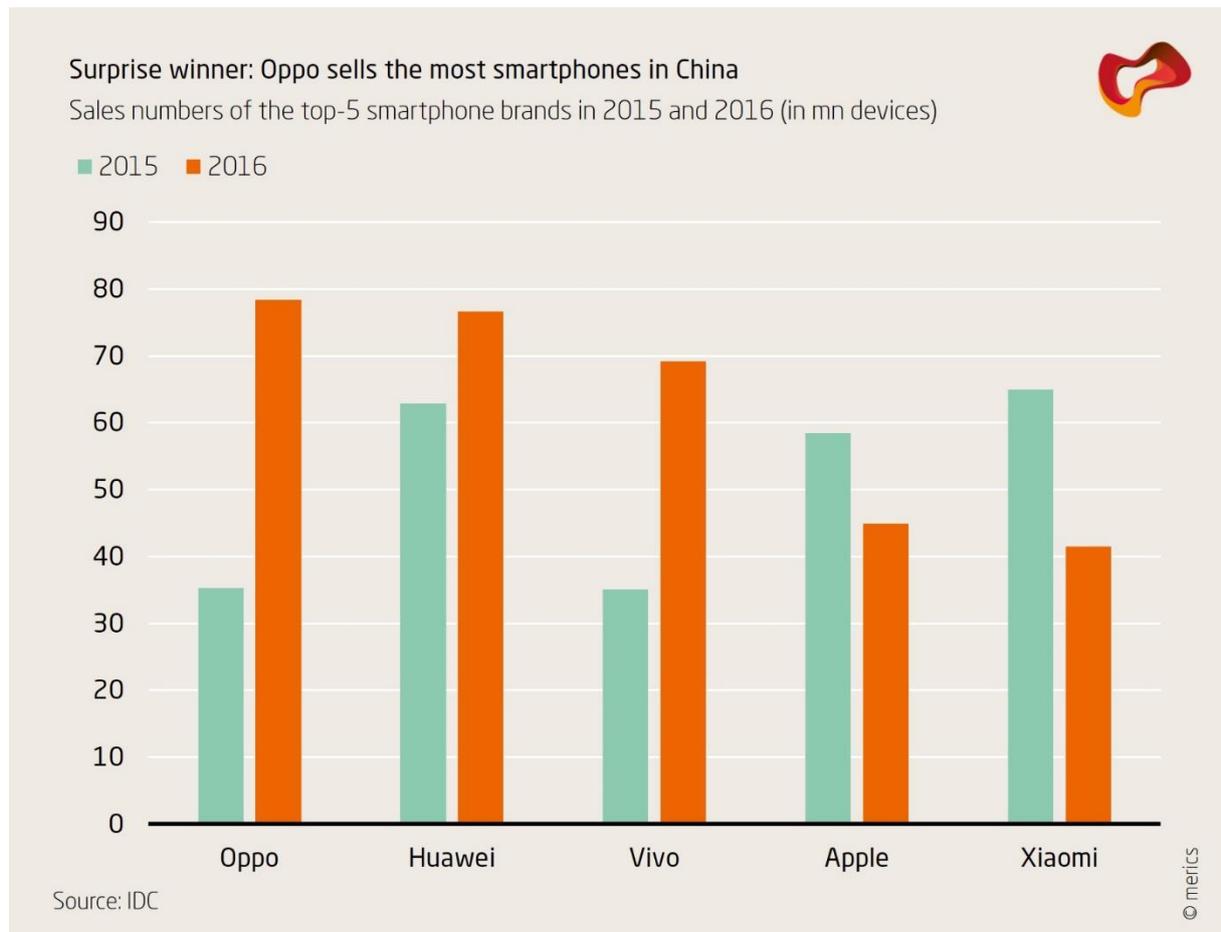
The Chinese manufacturer Oppo has surprisingly surged to the top of China’s smartphone market in 2016. According to the International Data Corporation (IDC), [Oppo’s market share reached 16.8 percent](#), higher than that of telecommunications giant Huawei and that of Oppo’s sister company Vivo. Oppo and Vivo both belong to the Cantonese BKK Electronics (步步高). Xiaomi and Apple remained within the top five, but both companies’ sales declined in 2016. Other established brands like Samsung or Lenovo are falling behind.

Oppo had only risen to the group of top five Chinese smartphone suppliers in 2015. The success of the company, which is little known outside of China, is based on an **aggressive sales strategy** for smartphones in the mid-range price segment in smaller and less wealthy Chinese cities where many customers are now switching from cheap mobile phones to smartphones. Different from Xiaomi, Oppo mainly relies on traditional retail business, in line with preferences of Chinese customers who increasingly bought smartphones in stores in 2016.

Chinese manufacturers are also **rising on the global smartphone market** where Huawei, Oppo and Vivo ranked third, fourth and fifth behind Samsung and Apple in 2016.

“Oppo’s rise illustrates the dynamic development of China’s smartphone market, where no single manufacturer is able to stay in the lead for a long time.”

Jost Wübbeke, Head of Programme Economy and Technology



News in brief

- **Five-year hiring freeze for state-owned coal producers** in Shanxi. Plans to reduce scale of industry meets with popular resistance.
- **China labor unrest spreads to ‘new economy’**: retail and logistics sectors hit by strikes and protests
- **“Red lines”** to save the environment: Central Committee and State Council issue **guidelines** for protecting “natural areas with important ecological functions”
- **Maiden flight** of China’s first domestically-produced large passenger aircraft expected in first half of 2017

THE EUROPEAN VIEW

Germany, France and Italy demand stricter EU rules for strategic foreign investment

Germany, France and Italy have asked the European Commission to tighten rules on strategic foreign investment into technological assets. In a [joint letter to EU Trade Commissioner Cecilia Malmström](#), the economics and industry ministers of the three countries voiced their concern over a lack of instruments to block the sale of sensitive technological knowledge to investors from non-EU countries. At the same time, the ministers also complain about barriers that European companies face when they try to invest in other countries.

China was not mentioned specifically, but the letter has to be seen in the context of recent European debates over oftentimes state-backed Chinese acquisitions of high tech companies in Germany and other EU member states. The demand for more reciprocity, i.e. for mutual openness for outside investors, also seems directly connected to common concerns over market barriers in China.

Chinese investment in Europe reached a record high in 2016. According to a joint [report by MERICS and the Rhodium Group](#), they rose by 77 percent to more than EUR 35 billion. Germany, the most popular destination, attracted investments valued at EUR 11 billion. Chinese investors are mostly interested in advanced German manufacturing and technology assets such as the robot maker Kuka or the lighting specialist Osram.

“It is a promising sign that three of the most important EU member states coordinate their approach in such a difficult field of European China policy. The challenge will now be to bring other member states on board.”

Mikko Huotari, Head of Program International Relations

French presidential candidates warn of unfair trade with China

In the French election campaign, trade with China and inbound Chinese investment raise similar controversies as in the U.S. last fall. Even if a moderate candidate wins, France is likely to adopt a tougher stance vis-à-vis China, writes Bertram Lang in this [new MERICS blogpost](#).

MAD MERIX

You snooze, you lose

Sleeping on the job is usually not frowned upon in China, where many companies encourage their employees to take a noon time nap (午觉). But several officials from central China's Hubei province took this habit a step too far when they [dozed off during two meetings on how to improve their work ethic](#).

The city government of Xiangyang had organized the meetings to discuss issues such as “laziness, mediocrity, the shirking of responsibility, tardiness, and impatience” among civil servants.

The rude awakening followed when the local evening news broadcast images of the cadres slouching in their armchairs, either sleeping or playing with their phones. In addition to the public humiliation, the officials were ordered to write self-criticisms. But as it turned out, old habits die hard. Only a few days later, participants of another meeting against laziness in the rural areas surrounding Xiangyang had to be roused and disciplined for the same offenses as their urban peers.

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