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**METRIX**

**48.8%**  
decrease

China's non-financial outbound direct investment (ODI) dropped 48.8 percent year-on-year in the first quarter of 2017.

## TOPIC OF THE WEEK: SHANGHAI AUTO SHOW

### China cements its leadership position in e-mobility and connectivity



Exhibition area on the Shanghai Auto Show 2017. Source: ImagineChina.

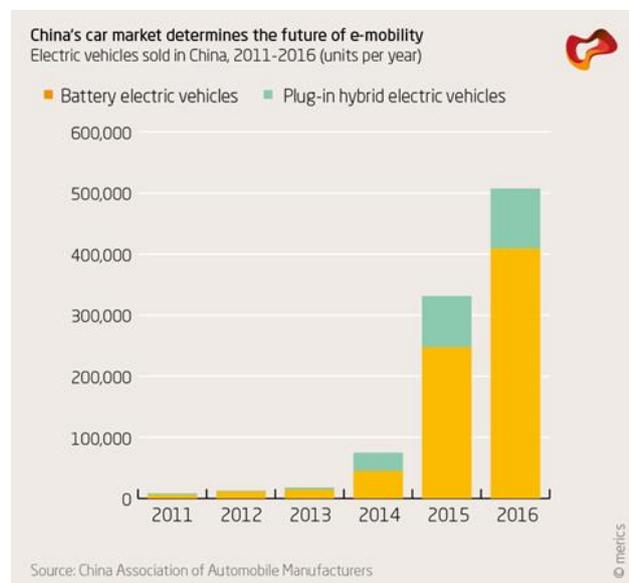
Times are getting harder for foreign manufacturers in the world's largest automobile market, where domestic manufacturers are charging ahead with new energy vehicles and the digitization of the industry. The topics **connectivity and e-mobility dominated this year's Shanghai Auto Show**, which will end on April 28. Chinese manufacturers contributed **two thirds of the presented new energy vehicles**. Companies like Chery, the Geely subsidiary Lynk & Co. as well as Nio moved to the center of the international attention.

The Chinese government actively promotes e-mobility to create opportunities for domestic manufacturers to catch up with and eventually overtake international competitors. It does so by subsidizing purchases of Chinese-made cars, and by setting domestic charging standards that are incompatible with foreign standards. Its plan to introduce a quota for electrical vehicles triggered protests from industry and government, including Germany. Beijing has reportedly offered to delay the quota requirement to 2019, but this has not yet been confirmed.

The sales of electric vehicles in China grow at enormous rates. **507,000 electrical cars were sold** on the Chinese market in 2016, 53 per cent more than a year before.

China's manufacturers and policy-makers are also making great strides in the area of connectivity (autonomous driving and networked traffic systems via internet or satellite navigation). The official goal is to ensure that half of all digital products for cars will be produced by Chinese manufacturers by 2020. This goal appears to be realistic. Chinese carmakers and technology companies cooperate closely on developing and integrating intelligent technology. At the auto show, Volkswagen's Chinese joint venture partner SAIC Motor presented his new Roewe I6 model, an intelligent car that conducts a self-check once the motor starts and provides the driver with weather and traffic information. The car's "brain" was **jointly developed by SAIC and tech giant Alibaba.**

It would be dangerous for international carmakers and governments to underestimate the Chinese competition as Chinese manufacturers are also venturing abroad. The Chinese Beiqi Foton Motor Co plans to **sell electrical vehicles on the German market under the revived Borgward brand** that it purchased from the founder's grandson. **Lynk & Co plans to expand to San Francisco and Berlin** in 2019 and challenge BMW's Mini brand with its smart city cars that are equipped with permanent internet access, enabling owners to rent out their cars through an App-operated car-sharing scheme.



#### MERICS analysis:

**End of the road for international car makers in China?** – China Monitor by Mirjam Meissner and Jost Wübbecke

**“Who will build tomorrow's car? According to Beijing, it will be China”** – a blogpost by Sebastian Heilmann and Mirjam Meissner

## CHINA AND THE WORLD

### China eases capital controls amid growing confidence

In light of a stabilization of the CNY and an easing of capital outflow, the People's Bank of China has taken a **cautious step towards relaxing capital controls** in the first quarter of 2017. According to reports, the central bank lifted a requirement for commercial banks to stop processing cross-border CNY payments once the outbound payment sum exceeded the incoming sum

The relaxation is a sign of monetary authorities' increased confidence in the stability of the CNY. According to the State Administration of Foreign Exchange (SAFE), the **downward pressure on the currency has weakened** significantly in the first three months of this year. This means that capital controls were effective in containing the rapid capital flight of previous months. The decline of China's overseas direct investment by 48.8 percent in the first quarter is a direct consequence of these controls.

China's foreign exchange reserves climbed back over the psychologically important benchmark of 3 trillion USD. They had shortly fallen below that level in January as a result of the PBOC's interventions to stabilize the CNY exchange rate.

The relaxation of capital controls can be expected to proceed at a very slow pace, as the government will remain vigilant about any event that could trigger renewed capital outflows. Chinese regulators combat risky credit growth (see article below "**Chinese regulators combat risky credit growth**"). This could include external events, such as an interest hike by the U.S. Federal Reserve or a slowdown of China's economic growth.

#### Trump orders probe of Chinese steel imports



Red-hot steel billets on their way to be processed. Source: zhaojiankangphoto via 123RF.com.

Following up on his campaign promise to expose China's unfair trade practices, U.S. President Donald Trump has ordered a trade investigation of steel imports into the U.S., most of them from China. Secretary of Commerce Wilbur Ross launched the probe on April 20 to determine whether surging steel imports present a national security threat to the U.S. "Steel is critical to both our economy and our military,"

said Trump, when he announced the step at a **meeting with U.S. steel executives**. "This is not an area where we can afford to become dependent on foreign countries."

A designation of cheap steel imports as a national security threat would give the U.S. President broad authority to block the import of a range of products or to impose new tariffs. Shares of U.S. steel manufacturers rose by up to 8.5 percent after the announcement.

Depending on the outcome, the investigation has the potential to trigger retaliatory measures on the Chinese side and making a trade war more likely. After an initial cautious reaction by China's foreign ministry spokesman Lu Kang, China's party-state media criticized the announcement sharply. **China Daily dismissed the alleged national security concerns as a pretext** for imposing protectionist measures and called on the U.S. to resolve the conflict within the framework of the WTO.

Chinese imports currently make up **more than 26 percent of the U.S. steel market**. However, less than 0.3 percent of the U.S. steel industry's output are used by the Department of Defense.

#### News in brief

- **More U.S. products on Taobao**: Chinese e-commerce giant Alibaba wants to promote its retail platforms at Detroit trade fair
- China launches its first **locally-built aircraft carrier**
- Xi Jinping urges **restraint on North Korea** in phone call with Trump
- **U.S. Treasury Department**: China isn't a currency manipulator

## POLITICS, SOCIETY AND MEDIA

### China turns to Interpol to arrest fugitive tycoon

The Chinese government has asked Interpol to issue a global arrest request for Guo Wengui and started a propaganda campaign against him after the fugitive tycoon had threatened to publicize corruption allegations against family members of Communist Party officials.

China's **foreign ministry claimed on April 19** that a so-called "red notice" had been issued, although the name had not appeared on Interpol's wanted list by then. The United States, where Guo has lived since 2013, does not have a bilateral extradition treaty with China, making it unlikely that the 50-year-old Chinese real estate billionaire will be arrested there. Guo claims to have 11 passports from different countries and is a member of U.S. President Donald Trump's Mar-a-Lago golf resort.

China does seem to have some influence over the U.S. concerning Guo. Voice of America interrupted a **live television interview with Guo** after an hour and 15 minutes, although it was scheduled to last three hours. Representatives of the broadcasting station said that this had happened in response to pressure from Beijing. The interview had started only hours after Beijing had made the arrest request.

Only **months before the important 19<sup>th</sup> Party Congress** this fall, Guo's threat to expose corruption at the highest levels has set off alarm bells in Beijing. Guo has already made corruption allegations against relatives of former leading CCP cadre He Guoqiang. He also criticized the Vice Minister for Public Security, Fu Zhenhua, for sabotaging President Xi Jinping's fight against corruption.

Guo himself is wanted for corruption allegations in China. In his interview with VAO, he rejected recently circulated accusations as politically motivated. Chinese party-state media have launched a propaganda campaign against Guo, citing his alleged corruption activities. In a Youtube video, the disgraced **former Vice Minister of State Security Ma Jian describes how he helped Guo** to resolve business disputes or to suppress police investigations and media reports for a bribe of 60m CNY in cash and real estate.

### **Growing income inequality in China's rural communities**

The wealth gap between China's regions is narrowing, but the countryside has seen a sharp increase in income inequality. According to a new **report by the Chinese Academy of Social Sciences**, annual disposable income in rural areas increased by 6.2 percent on average over the past years. But while high- and middle-income households saw an increase of 9.8 percent, the low-income groups suffered a decrease by 2.6 percent. According to the National Bureau of Statistics, the higher income groups earned more than twice as much (around 12,000 CNY) as households on the low end of the income scale (around 5,200 CNY).

The growing wealth gap in rural areas runs counter to the Communist Party's promise to ensure more equal living conditions. To fulfill the goal of achieving a well-off society by 2020, party and state leader Xi Jinping pledged to wipe out poverty, defined by an annual income of under 2300 CNY. He also promised to narrow the income divide between urban and rural areas.

**MERICS analysis:** "**China's social security system: increasing equality, looming risks**" – blogpost by Matthias Stepan

### **Xi Jinping participates as Guizhou province delegate at the 19th Party Congress**

China's president and chairman of the Communist Party (CCP), Xi Jinping, will participate as a delegate of Guizhou province at the highly anticipated 19th CCP congress this fall. The CCP's provincial branch in Guizhou **unanimously** voted for Xi as a delegate on April 20. This is a shift from the past since Xi took part in two previous party congresses as a delegate of Shanghai, where he was a party chairman shortly before his election to the CCP's Politburo in 2007.

Xi's representing the poor province in China's southwest is unusual: He has no ties with Guizhou and has neither grown up there nor held political office in the province. **Observers** interpret this step as a possible signal of support for Chen Min'er, the Party Secretary of Guizhou.

Chen is considered to be Xi's protégé. In the fall, he could ascend to the top leadership circle of the CCP and get a seat on the Politburo or even on the powerful Politburo Standing Committee. The decision is also seen as a recognition of Chen's success in the fight against poverty and as a sign that Xi could give priority to this issue in the coming years.

By June 2, 300 delegates will be elected for the party congress, where important personnel decisions will be made and a large number of key positions will be filled.

### News in brief

- **Hong Kong:** disqualified law makers arrested for attempting to storm LegCo meeting last November
- **NGO law:** German political foundations can continue their work in China
- **Concession by the Holy See?** Illicit Bishop Zhan Silu concelebrates with Bishop Ma Daqin of Shanghai
- **Academic fraud:** international scientific journal retracts 107 articles by Chinese scientists
- **Beijing's anti-espionage drive:** government teaches students how to identify spies

## ECONOMY, FINANCE AND TECHNOLOGY

### Chinese regulators combat risky credit growth

China's **banking and insurance regulators have moved to combat risky credit growth** and illegal activities that could threaten the stability of the financial system. A number of measures were taken by regulators in recent weeks. Financial institutions were instructed to curb loans for speculative investments in sectors including real estate. In addition, disclosure and accountability requirements for the sale and purchase of asset management products were tightened. Insurance companies will be required to guard against liquidity risks by performing stress tests. Banks are already subject to such tests.

The Chinese Banking Regulatory Commission (CBRC) has told banks to make sure employees involved in the sale of wealth management products are recorded when interacting with customers. To avoid conflicts of interest, CBRC announced that it will ban officials in regulatory positions from entering the private market within three years after resignation. The China Insurance Regulatory Commission (CIRC) has issued two sets of **guidelines against "aggressive investment strategies."**

The tightening occurs as China's credit growth has become a major area of concern for policy makers. A combination of poor accounting standards, an expanding shadow banking sector, and a large off-balance sheet wealth management sector make assessing the risk structure of China's credit difficult.

However, the government's recent promotion of debt-to-equity swaps (which transfer ownership to creditors thus reducing total debt outstanding) indicates that not all of it is repayable. The default of several companies this year, among them Huishan Dairy, set off alarms in Beijing. Recent anti-corruption **inves-**

tigations against at least one, possibly two, high-ranking officials at CRBC, the dismissal of CIRC's former chairman Xiang Junbo, as well as a scandal over the disappearance of more than 3 bn CNY from China Minsheng Bank's wealth management products have highlighted the turmoil in the financial sector.

#### News in brief

- **Drone chaos at Chengdu airport:** dozens of flights diverted, returned, or cancelled
- **Campaign against pollution:** large-scale environment breaches revealed
- **Cargo spacecraft launched:** China takes major step towards a permanently manned space station by 2020
- **Protection against data export?** China draft cyber law mandates security assessment for out-bound data

## THE EUROPEAN VIEW

### Fear of Donald Trump sparks EU-China honeymoon

Their shared fear of Donald Trump has brought the EU and China closer together. At their 7<sup>th</sup> High-Level Strategic Dialogue on April 19<sup>th</sup> in Beijing, both sides showed willingness to ignore their differences and to move ahead on issues of bilateral interest and on defending mutually valued parts of the international order they perceive as being threatened.

On economic issues, both sides renewed their commitment to negotiations over a bilateral investment treaty, while pledging to protect the WTO order against protectionist tendencies. They agreed on close coordination on implementing the Paris Climate Agreement and declared their support for the UN Sustainable Development Goals. US President Donald Trump has criticized Chinese as well as mainly German trade practices and threatened protectionist measures. His administration has also been critical of international institutions and is debating whether to withdraw from the Paris Agreement.

Distancing themselves from Trump's confrontational rhetoric on some of the major global security crises, China and the EU expressed support for a full implementation of the nuclear deal with Iran. They also called for implementing UNSC sanctions against North Korea, but also called for de-escalation and a swift return to dialogue. The joint statement supports the UN-led process to end the war in Syria and the OPCW investigation of chemical weapon usage. Both sides further pledged to explore stronger cooperation on peacekeeping, anti-piracy, and counterterrorism.

The harmony is a clear shift compared to 2016, when EU-China relations were fraught by the EU's hesitation to grant China Market Economy Status under the WTO and by China's refusal to accept an international tribunal's ruling on its territorial claims in the South China Sea. These differences were downplayed at this meeting, which was co-chaired by EU High Representative Mogherini and State

Councillor Yang Jiechi. In contrast to previous summits, Mogherini only mentioned **human rights in a half-sentence** towards the end of her statement.

The meeting was an indication of the EU's attempt to seek greater strategic autonomy. While both Trump and Russian President Vladimir Putin had supported Brexit, China has remained a staunch **supporter of a united EU** and underlined its commitment with a meeting between Mogherini and Prime Minister Li Keqiang on the sidelines of the Strategic Dialogue.

## **MAD MERIX**

### **Drunk driver eats grass to sober up for breath test**

Drunk driving can quickly land you in trouble almost anywhere in the world. China is no exception. Drunk drivers face harsh penalties and can lose their license. Those penalties might have been on the mind of a man in the eastern province of Zhejiang who was stopped by traffic police **on Monday night**.

The police officers noticed that he smelled strongly of alcohol – although the man insisted he was sober. When the officers suggested a breath test, the man ran away but didn't get very far before he was caught. He then began pulling grass from the roadside and stuffing it into his mouth, media reports say. He apparently was trying to lower his blood alcohol level by eating grass, police said. Video footage of the incident show the man dejectedly sitting by the roadside and putting grass in his mouth.

The video went viral and the man's bizarre behavior was mocked on social media. "The man's zodiac sign is probably a cow", one person wrote. Another one deplored the destruction of the precious grass.

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