Even by the roller-coaster standards for which China’s equity markets are renown, the recent price swings have been extraordinary. Between July 15, 2014 and June 12 this year, the Shanghai Composite Index, which is Mainland China’s most closely followed index, rose by a stunning 150 percent to reach a 7-year high of 5,178. That made it one of the top performing stock markets in the world, far exceeding gains in London or New York. Some companies saw their stocks triple in a matter of months.

The mainland A-Share market was not the only one to soar. The bull market extended to Hong Kong listed China shares known as H-shares, which are more easily tradable for foreign investors. Mainland companies listed in New York also saw their shares rise sharply.

Since the middle of June, however, the good times have come to an end. As the Shanghai index plunged by more than 30 percent in a matter of weeks, panicked investors attempted to dump their holdings. The government intervened with unprecedented support measures that included buying by state institutions, restrictions on short selling, the suspension of all IPOs and a ban on major shareholders selling down their stakes for a period of 6 months. A brief period of stability ensued. Then the market tumbled once again.

(Continued on page 5)
Haitong International: a Leading Hong Kong Based Financial Institution Focused on Investment Banking Business

As the key overseas business arm of Haitong Securities, one of China’s largest securities firms, Haitong International Securities Group (665.HK) has set its sights on becoming a leading Hong Kong-based financial institution. Over the past five years, the group has successfully transformed itself from a traditional brokerage house to a full-service financial institution. Now using its experience of the China market and its diversified range of financial products and services, it is rapidly expanding its network across the globe.

In January 2014, Haitong International established a Singapore subsidiary and became a securities and derivatives trading member of the Singapore Exchange. Following the acquisition of Japaninvest in March 2015, the group has since extended its office network to New York, London and Tokyo. Today its cash equity business provides products covering around 900 A-share, H-share, Japan, Korea, Taiwan and US listed companies. It also serves over 1,300 institutional clients around the world.

Unique Business Model
Haitong International has developed a diversified business model that sets it aside from its competitors. Building on Haitong Securities’ financial strength and established client network, it offers six core business segments: corporate finance; brokerage and margin financing; asset management; fixed income, currency and commodities; leveraged and acquisition finance; and equity derivatives.

Senior management prides itself on the group’s international standard products and services and its strong track record. The group boasts a proven execution ability, prudent risk controls as well as a team of top professionals.

Outstanding Financial Performance
Haitong International recorded a sharp increase in net profit of 504% for the six months ended 30 June 2015 as compared with the six months ended 30 June 2014. The increase was mainly attributable to impressive growth across the group’s all business segments. Its average growth rate of revenue and profit for past three years are over 40% and 80% respectively.

Superior Revenue Growth (HK$ mln)

<table>
<thead>
<tr>
<th>Year</th>
<th>2012</th>
<th>2013</th>
<th>2014</th>
<th>1H2015</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net Profit</td>
<td>1,177</td>
<td>1,647</td>
<td>2,713</td>
<td>4,138</td>
</tr>
<tr>
<td>ROE</td>
<td>9.34%</td>
<td>12.57%</td>
<td>15.71%</td>
<td>18.35%</td>
</tr>
</tbody>
</table>

Source: Haitong International

On 14 Sep 2015, Haitong International (665.HK) became one of the new constituents of the Hang Seng Composite Large Cap & Mid Cap Index, the stock is now one of the investable stocks under the Shanghai-Hong Kong Stock Connect scheme, in turn optimizing both the stock liquidity and shareholding structure of Haitong International. Haitong International will strive to reward shareholders and investors with sustainable earnings and a stable dividend policy over the long run.

Contact Information
Investor Relations
Haitong International Securities Group Limited
ir@htisec.com
Tel: +852-2213-8622
With around 4.18 million brokerage clients, 1,900 institutional clients and over 250 regional offices as of Dec 31, 2014, GF Securities ranks as one of the major players in China’s fast growing securities industry. The company provides a comprehensive range of capital market services ranging from investment banking and wealth management to brokerage, trading and institutional client services and investment management.

GF Securities has five wholly-owned subsidiaries: GF Futures Co., Ltd., GF Holdings (Hong Kong) Co., Ltd., GF Xinde Investment Management Co., Ltd., GF Qianhe Investment Co., Ltd. and GF Asset Management (Guangdong) Co., Ltd., and is the controlling shareholder of GF Fund Management Co., Ltd. with equity interests in E Fund Management Co., Ltd., Guangdong Equity Exchange Co., Ltd. In addition, the Company indirectly owns GF Financial Markets (U.K.) Ltd., a Category 1 member of the London Metal Exchange (LME), and GF Securities (Canada) Co., Ltd. Predominantly engaged in the securities industry, GF Securities has developed into a fully integrated financial group, with a growing presence both domestically and internationally.

Behind the group’s remarkable track record is a business culture that places strong emphasis on inquisitiveness, integrity, client focus, and teamwork. Senior management focuses on stable growth, continuous innovation performance-driven culture and business synergies as well as strict risk management.

“We strive to provide our clients with top-tier services whilst upholding strong ethics and always placing clients’ interests before our own,” says Chairman Sun Shuming. “We have a multi-disciplined team with in-depth knowledge covering an extensive range of industries and products. Our credentials speak for themselves.”

Successful IPO

GF Securities passed another key milestone on 10 April 2015 when the company listed its shares on the Hong Kong Stock Exchange. The long-awaited global offering of H-Shares was heavily oversubscribed due to strong demand from institutional investors and retail investors looking to tap into China’s fast growing financial markets. After exercising the greenshoe option, the total amount of H-Shares issued was increased from 1.4 billion shares to 1.7 billion, with a total of HK$32 billion raised. According to Goldman Sachs, one of the lead-underwriters, at the time of the global offering, this was the largest IPO ever for a securities firm. It was also the largest Hong Kong listing in five years as well as being the largest IPO in Asia for 2015, and the second biggest IPO worldwide.

International Strategy

GF Securities’ strategic plan is to expand internationally in order to meet rising demand for its wealth management, investment banking, investment management, trading and institutional client services business.

“There is a clear that Chinese entrepreneurs and businesses seeking to grow further compete increasingly in global markets,” says Sun. “Overseas companies continue to enter and invest in China, aiming at an increased market share, as Chinese domestic consumption and disposable income continue to rise. With a competitive edge in the Chinese capital market, we are well positioned to become a leading global investment bank.”

Growth Prospects

With China’s economy growing at around 7% per annum, a level that is the envy of much of the world, senior executives at GF Securities remain optimistic about the outlook for the domestic capital markets. Indeed, despite the recent volatility, few markets boast
as much long term growth potential. “The Chinese economy has experienced a rapid, unprecedented economic rise during the last few decades,” notes chief executive officer Lin Zhihai “but extensive growth has simultaneously created the need for greater sustainability and efficiency.” That could lead to a period of consolidation as China adjusts to a more challenging environment. Longer term, however with the nation’s prodigious savings rate, ample foreign exchange reserves, a strong local currency, and rising consumer demand, China looks set to play a crucial role in the world economy.

Key Performance Indicators

<table>
<thead>
<tr>
<th>Exceptional Results</th>
<th>GF Securities prides itself on the company's exceptional performance. For the first half of 2015, revenue and other income totalled RMB24 billion, a 324% increase over the corresponding period of 2014. Net profit reached RMB 8.4 billion, a rise of 402% compared with the corresponding period of last year. The impressive results came on the back of strong performances by all core businesses including Investment banking, wealth management, investment management and trading and institutional client services.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Comprehensive Services</td>
<td>GF Securities believes in offering the best and most comprehensive capital markets services to corporations, individuals, institutional investors, financial institutions, and government clients in China and around the world. The company operates its business through Investment Banking, Wealth Management, Trading and Institutional Client Services, and Investment Management segments. As of June 30, 2015, the China Securities Regulatory Commission had rated GF Securities “Class A Grade AA” for five consecutive years, the highest rating awarded to any PRC securities firm.</td>
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<table>
<thead>
<tr>
<th>Market leader in numerous areas among investment banks</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Equity Financing</td>
<td>Ranked #3 and #2 respectively by numbers of equity offerings and IPOs in the 2015H1</td>
</tr>
<tr>
<td>Financial Advisory</td>
<td>Ranked #3 in terms of financial advisory for material asset reorganization with 7 projects in 2015H1</td>
</tr>
<tr>
<td>Financial advisory for NEEQ listing</td>
<td>• Acted as sponsor for 34 companies listing in NEEQ in 2015H1 • Ranked #3 in terms of listings on the National Equities Exchange and Quotations (NEEQ) Board having brokered 107 listings</td>
</tr>
</tbody>
</table>

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<thead>
<tr>
<th>Superior product innovation and leading research capabilities</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Equity sales and trading</td>
<td>• Gained the qualification as market maker for stock option in Jan 2015, and became one of the eight market markers in Shanghai Stock Exchange with SHSE 50 ETF future contract varieties. • Issue new beneficiary certificate for structured gold futures.</td>
</tr>
<tr>
<td>Equity research</td>
<td>• Covers 26 industries and over 580 mainland China listed companies, and over 70 HK listed companies. • Revenue from investment research was RMB224mn in 2015H1, with a yoy increase of 217.52%.</td>
</tr>
<tr>
<td>Prime brokerage</td>
<td>Provides tailored transaction services to meet the demand from trading and institutional clients in investment, financing, risk management and liquidity management.</td>
</tr>
<tr>
<td>Fixed income sales and trading</td>
<td>The company engaged in expanding FICC business, and gained special membership from Shanghai Gold Exchange, commodity contract agent of precious metals (such as gold), and the proprietary trading qualification of gold commodity.</td>
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</tbody>
</table>

<table>
<thead>
<tr>
<th>Total Assets (RMB mm)</th>
<th>2014</th>
<th>2015H</th>
</tr>
</thead>
<tbody>
<tr>
<td>240,100</td>
<td>517,126</td>
<td>+115.4%</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Revenue and other income (RMB mm)</th>
<th>Jan-Jun 2014</th>
<th>Jan-Jun 2015</th>
<th>+324.2%</th>
</tr>
</thead>
<tbody>
<tr>
<td>5,656</td>
<td>23,993</td>
<td></td>
<td></td>
</tr>
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</table>

<table>
<thead>
<tr>
<th>Net Profit (RMB mm)</th>
<th>Jan-Jun 2014</th>
<th>Jan-Jun 2015</th>
<th>+401.9%</th>
</tr>
</thead>
<tbody>
<tr>
<td>1,675</td>
<td>8,406</td>
<td></td>
<td></td>
</tr>
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</table>

Source: Corporate Financial Report
(Continued from page 1)

Now investors have been left wondering what the future holds for the world’s second largest economy.

Not everyone is downbeat about the stock market rout. Some bankers and fund managers believe that plunging equities and a slowing economy could be the necessary catalyst for an acceleration of financial reforms. Faster liberalization could in turn transform China’s heavily over-regulated capital markets much as it did in other countries in the region. “The situation in China is similar to Japan, Taiwan and Korea in the 1980s and 1990s,” says Tan Eng Teck, senior portfolio manager at Nikko Asset Management in Singapore. “These countries were all forced to open up their financial markets as a result of domestic crises.”

In the case of China, Tan does not view the crisis as so severe. But he believes that the authorities will want to push through the reforms to ensure they are ahead of the curve. “The message that the government wants to send to investors is that they are still committed to financial liberalization despite the volatility in the market,” he says.

Erwin Sanft, head of China Strategy at Macquarie Securities is also optimistic about the prospects for reform. And because financial reforms are easier to push through than an overhaul of the country’s bloated and inefficient state-owned enterprises, he expects the authorities to make this the priority area. “The new leadership undoubtedly wants to increase the quotas for foreign money to come into equities and bonds,” he says. “This is an encouraging trend.”

Better still, he predicts that the next mid term party congress in 2017 will usher in younger leaders who are capable of pushing through the more difficult state-owned enterprise reforms. “We have a positive view on China’s reform blueprint,” he says. “That is what keeps us invested despite the obvious risks.”

Other economists remain deeply sceptical about the recent figures released by the Chinese authorities, arguing that the economy is growing at a far slower rate than Beijing is prepared admit. They also point to a worrying loss of confidence in the government’s ability to manage the crisis. “The real condition of China’s economy is dire and growing worse,” notes one economist. “Corporate margin collapse, financial stress ‘Japan-style’ is here.”

**IPO Slowdown**

Initially at least, one of the biggest impacts of the recent sell-off in Chinese stocks is likely to be a slowdown in the frenetic pace of initial public offerings not only in Shanghai and Shenzhen, but also in Hong Kong. According to Dealogic, Hong Kong registered US$12.5 billion of new listings in the first half of 2015, followed closely by Shanghai with US$11.1 billion. That makes China’s IPO market by far the largest in the world during the period.

Burgeoning demand for new offerings in part followed the decision by the Chinese authorities in November 2013 to end a 14 month freeze on IPOs imposed in a bid to clean up the market and boost investor confidence. Investors lucky enough to get their hands on IPOs frequently saw the value of their shares soar in the days following the listing. Typical were shares in Guotai Junan Securities, China’s second largest brokerage. In the first four days of trading on the Shanghai Stock Exchange, they leapt 77 percent thanks to frenzied buying by retail investors who dominate market trading.

But in early July, IPOs were temporarily suspended to halt the downward spiral in stock prices that at one stage had wiped out as much as US$4 trillion from market capitalization.

In some ways, a temporary freeze in IPOs is not necessarily a bad thing. Whilst reforms to the IPO process have made some progress over the past 2 years, the recent market rout is likely to accelerate the process. Amongst new measures under consideration are reforms to streamline the labyrinthine approval process for listing, reduce frenzied market speculation and build a stronger institutional base. Chinese retail investors currently account for around 80 percent-90 percent of daily market turnover leading to huge price swings. Indeed Premier Li Keqiang has made it clear that “stable and healthy development of the capital market and the currency...
market” are critical to China’s future growth.

A more urgent task for the government is how to roll back the support measures that were put in place in a bid to stabilize the equities market. The poorly thought-out intervention was seen as little more than a thinly veiled attempt to manipulate the market. “The government panicked,” says one fund manager. “This was not a pretty move. The Chinese are not used to allowing the market to dictate.” The fear now is that the failure of the authorities to halt the market slide, could hit confidence once again, sending the market plunging to new lows.

A few brave analysts, however, are starting to see value after the latest correction. “If you missed the first bottom, here is a second opportunity,” notes Wendy Liu, head of China Equity Research at Nomura. “We suggest investors take advantage of this likely second bottom to buy stocks with structurally sound portfolios. We maintain our view that the MSCI-China index may finish the year higher than its April peak and the current bull market in the MSCI-China may peak in 2017.”

One reason for her guarded optimism is the government’s blanket support for the local share market. She also believes the economy may begin to pick up in the second half of the year. Like many analysts, Liu expects Chinese regulators to draw lessons from this market correction and learn from the experience of other countries. “We hope that this means that A-shares may be more in sync with global legal and risk management practices sometime down the road,” she says in a report published on July 28.

For investors who have a high risk threshold and a long term investment horizon, China can still offer some interesting opportunities. UBS Securities recommends clients to take another look at Hong Kong-listed H-shares on reduced risks to the financial system, lower interest rates, stabilizing profits, greater capital discipline and attractive valuations. In particular, it believes the sell-off provides attractive entry points for companies such as Bank of China, China Life Insurance, Datang International Power Generation and Daqin Railway.

Tan at Nikko Asset Management is also starting to see value after the sharp falls. “We believe this is a great time for stock picking,” he says. “We like companies in the health care and automation sectors together with some of the technology parts companies and internet companies. These are the ones that we think could be multi-year winners.”

DBS Vickers Securities for its part favours Chinese companies listed on US stock exchanges. Amongst the most promising N-shares are new economy stocks such as Alibaba, Baidu, NetEase and JD.Com. These businesses are expected to benefit from fast expanding network coverage and improving internet speeds.

“I see China as a classic bottom up stock pickers story on a rather larger scale than normal,” says a Hong Kong-based equity salesman with a major international investment bank. For the market to really take off, he believes the government must address 3 fundamental weaknesses. It must sort out the balance sheet, improve margins and address the culture to better compensate all stakeholders. But when these issues are addressed, which is likely to be only a matter of time, he predicts that the upside could be enormous.

Others take a very different view. Despite the recent fall in share prices, many analysts believe that A-shares still command excessive valuations. And corporates earnings growth is decelerating. Kevin Lau, senior economist at Daiwa Securities warns that government intervention may have badly damaged the country’s reputation. Furthermore he argues that never in history has a government been able to successfully prop up a stock market in the face of deteriorating economic fundamentals. As the selling pressure increases, this could spin into a currency and a credit crisis, with a huge knock on effect across the region.

Economic Slowdown
Concerns that China is sliding towards recession
have become widespread. Taimur Baig, chief economist at Deutsche Bank believes that risks remain firmly tilted towards the downside. “Whether or not China achieves 7 percent growth this year, the fact of the matter is the second largest economy in the world is growing substantially below trend, with downside risks galore,” he says in a report published on 16 July. For 2016, Deutsche is predicting growth to fall to 6.7 percent. However Taimur sees the possibility of additional weakness as a result of the recent market sell-off. “The equity market sell-off imposes a risk to the economy,” he says. “If the market sell-off continues in the second half, it may lead to negative wealth effect. The risk is higher in the first half of 2016.”

The latest data on manufacturing will do little to allay those concerns. The National Bureau of Statistics said on August 12 that industrial production growth slowed to 6 percent for the 12 months to July, weighed down by weak external demand and domestic investment demand. Government spending on infrastructure surprised on the downside. Meanwhile retail sales are slackening.

According to Yu Song, senior China economist at Goldman Sachs, there are several reasons for slower growth in July ranging from less aggressive monetary and administrative policy support to weaker export growth. As a result, he expects the government’s relaxed monetary policy to continue. Additional loosening measures could include further cutting the reserve requirement ratio for banks, which currently stands as high as 16 percent, providing greater support for policy banks, increasing government bond issuance, and pressurizing local governments to spend idle fiscal deposits to support fixed asset investment.

One consequence of slower domestic growth may be to weaken the currency, lending support to faltering exports. Another consequence may be a trend for Chinese companies to invest more overseas, boosting future economic growth whilst extending China’s global influence.

To some extent that trend is already well underway. Under the government’s One Belt, One Road development strategy launched in late 2013, China plans to fund and build a vast network of roads, high-speed railways and international ports spanning the Asia Pacific. Hailed as one of Beijing’s grandest flagship projects, the initiative promises to strengthen infrastructure links and connectivity between China and some of the most remote and isolated parts of the region. Better still, it will provide new markets for China’s products and excess capacity.

As a first step, Beijing announced a US$40 billion Silk Road Fund last November to support the ambitious program. Even greater impetus may come from the establishment of the Asian Infrastructure Investment Bank with the support of more than 50 nations from around the world. The AIIB is eventually expected to rival the Asian Development Bank and other US institutions.

Thailand’s third biggest lender. “They have realized that their traditional export markets are slowing and that China’s own economy is slowing. To keep this huge export engine going, they need to create demand. And the biggest need out there is for infrastructure.”

Kamalkant believes that economic weakness at home will only accelerate overseas investment on infrastructure around the region, providing jobs and projects for the country’s giant state-owned enterprises. “China’s plans are for real,” he says. “The bigger the slowdown, the more this is going to happen,” he says.

But will lower stock prices lead to a further slowdown of China’s economy? Not everyone is so sure. Equity investment of household wealth is estimated at 12 percent-13 percent of total wealth compared to around 32 percent in housing. That means the wealth effect may still be manageable. Furthermore, equity performance is still positive over the past 12 months despite the selloff. For his part, Premier Li Keqiang has made it clear that he will do whatever it takes to stabilize the economy. “Our aim is to keep the economic momentum with moderated rate of growth and to raise both the quantity and quality

Tan Eng Teck
Senior portfolio manager
Nikko Asset Management

“The situation in China is similar to Japan, Taiwan and Korea in the 1980s and 1990s. These countries were all forced to open up their financial markets as a result of domestic crises.”

CSI300 Stock Market Index

Source: Deutsche Bank, Bloomberg Finance LP
Headquartered in Beijing, China Construction Bank (CCB) is one of the Big Four banks of China, and has earned a sterling reputation in global markets. Established in 1954, the Bank was listed on the Hong Kong Stock Exchange in 2005, and the Shanghai Stock Exchange in 2007. Today, China Construction Bank is the fourth-largest bank in the world by market capitalization.

Aside from over 15,000 domestic branches, CCB has 26 tier-one capitalized branches and subsidiaries overseas, and 133 entities at all tier levels in 24 countries and regions. CCB’s performance has garnered it over 100 major awards from renowned publications and institutions. It was named "The Best Bank in China" in 2014 by Global Finance magazine in the U.S., and the "Strongest Bank in China for 2014" by The Asian Banker magazine in Singapore, and retaied the second position in the "Global 2000" published by Forbes.
of the Chinese economy," the Premier said in a speech given at the OECD headquarters in early July. “We have both the confidence and the capabilities to meet the target set for this year, and we will strive to sustain medium-high rates of growth and move the Chinese economy toward medium-high levels of development.”

**Bond Stimulus**

One boon to the economy could come from the Chinese government’s plans to issue at least RMB1 trillion of bonds to finance essential local government infrastructure projects, such as social housing, railways and utilities. The bonds, which will be issued through policy banks such as China Development Bank and the Agricultural Development Bank, signal a major departure from recent financing practice. Previously, these infrastructure projects had largely relied on local government financing vehicles (LGVF) introduced in the wake of the 2008 stimulus program, to skirt restrictions on local government fundraising. However with fears mounting over the LGVF’s high levels of debt, bankers claim it makes sense for more of these projects to be financed by the central government.

“We believe this is the beginning of the government’s new fiscal-stimulus package, which we consider crucial to stabilizing China’s economic slowdown,” says Jianguang Shen, managing director and chief economist of Mizuho Securities Asia. “We expect that many of the projects are among those delayed since September 2014 following the tightening of budgetary requirements.”

If the bond issuance program proceeds as planned, it could go a long way towards stimulating much needed spending on infrastructure. For the first six months of the year, according to Mizuho Securities Asia, infrastructure fixed asset management slowed to 19.1 percent year-on-year compared with 25.1 percent in the corresponding period of 2014.

The sharp falls have raised fears in many quarters that the economy could be heading for another hard landing, similar to the one experienced in 2008. For her part, Sophie Jiang, head of Hong Kong and China banks at Nomura, believes the latest fund raising plans could herald a more innovative funding model for the economy. “We continue to expect a big shift from loans to bonds, where bond financing could potentially grow into a pillar for the economy’s funding,” she says in a report published on August 7.

That would be good news for China’s relatively under-developed bond market. Although bond issuance has grown significantly in recent years, bank lending still accounts for a far larger share of debt financing. Indeed China’s bond market capitalization stands at just 57 percent of GDP, according to Macquarie, compared with 223 percent in the US.

Greater liquidity and transparency in the onshore bond markets would help to improve another major structural weakness in China’s economy: the inefficient allocation of capital. Better still, it would attract increased foreign investment and strengthen China’s ambitions to internationalize its currency.

**China’s Reform Agenda**

Surprisingly for a country widely criticised as too slow to open up its markets, China’s financial and securities regulators continue to introduce reforms at an impressive rate. Over the past 18 months, they have boosted cross-border investment through the Hong Kong-Shanghai Connect, given the green light for new offshore Yuan trading centres in countries as diverse as the UK, Singapore, Luxembourg and Australia, unveiled the Asian Infrastructure Investment Bank and removed the limit on daily RMB conversion in HK. That’s on top of moves to expand quotas for Qualified Foreign Institutional Investor (QFII) and Renminbi Qualified Foreign Institutional Investor programs (RQFII). These schemes allow licenced global investors to invest in China’s capital markets subject to strict controls.

Perhaps the most dramatic and unexpected move of all however was the recent decision to change the way the Yuan peg is calculated. Effective of August 11, the official daily parity rate will be based on the closing rate of the interbank foreign exchange market and the price movement of major currencies.

Sanft at Macquarie Securities
welcomes the new exchange mechanism as evidence of the increased flexibility of the authorities. “This is another step in the right direction as it will make the RMB exchange rate more market-determined,” he says. “Whilst we expect some moderate depreciation of the RMB in the second half of the year, a sizeable depreciation is not very likely given concerns on capital outflows.”

Despite some fears that the new exchange rate policy could unleash a spate of competitive devaluations around the region, many observers believe that a more market-determined exchange rate is likely to win favour from the International Monetary Fund (IMF) as well as from foreign bankers who for years have been calling for China to loosen its grip on the Yuan.

“The timing certainly aligns with current efforts to further prop up growth in non-financial sectors,” notes Brian Jackson, China economist for IHS Global Insight. “The government is a long way in a relatively short period of time. Indeed it was only 30 years ago that the first public company was formed in China. And it was only a decade ago that Chinese investments became accessible to international investors, with the first batch of the Qualified Foreign Institutional Investor (QFII) scheme approved in 2003.

“The past five years have seen remarkable progress in the Renminbi internationalisation story,” says one foreign strategist. “The issue is there is still a very long way to go.”

**Stock Connect**

For investors wanting to access China’s mainland A-share market, in many ways the most important liberalization measure is the Shanghai-Hong Kong Stock Connect program. Officially launched in November 2014, the link allows Hong Kong investors to buy into shares listed in Shanghai, whilst also allowing Shanghai investors to buy into shares listed in Hong Kong. The two-way flows are subject to daily and aggregate quotas.

Until early April, the impact of the trading link was relatively small with demand in both directions failing to live up to the high expectations. Following the introduction of measures to facilitate trading for large institutional funds, however, volumes took off with daily trading quotas heavily oversubscribed.

“From a regulatory standpoint, the launch of the Shanghai-Hong Kong Stock Connect was extremely important,” says Ivan Shi, senior manager at Z-Ben Advisors, a Shanghai-based research and strategic consulting firm. “This is one of the key avenues to liberalize the current account in China.”

Although the volume of shares traded on the link may be relatively small compared with the overall size of the A-share market, Shi believes that the move sends out a very strong message to foreign investors that the government’s liberalization program is for real.

“The fundamental driver for increased foreign investment will be further integration of the China economy and financial markets into the global community. There has been an acceleration of financial reforms on many different fronts.”

Ivan Shi  
Senior manager  
Z-Ben Advisors

**Nominal Retail Sales Growth**

![Nominal Retail Sales Growth](image)

Source: CEIC, Macquarie Research, August 2015

keen to highlight steps towards greater marketization and transparency in its exchange rate regime, given its interest in joining the IMF’s Special Drawing Rights basket.

Other economists point out that for all its structural weaknesses, the country has come
RMB: New Choice
Bank of China,
Your Premier
Bank of RMB Services.

RMB Services with Bank of China
Building on the century-long international experience, Bank of China's cross-border Renminbi business reflects the world's economic and financial needs. With its leading position at home and abroad, global clearing network, broad base of financial products and high level of professionalism, Bank of China can provide a comprehensive tailor-made cross-border and offshore Renminbi service solution to support your economic and trade activities around the world.
country in the index. “Global institutional investors are heavily underweight in China because of restricted market access, lack of transparency and capital controls,” observes one analyst. Many asset managers go a step further claiming that China is

an administrative nightmare and simply not worth the effort.

Some fund managers had hoped that the Chinese market would get a lift from inclusion of A-shares in the MSCI global benchmarks. On June 9, however, MSCI confounded those expectations by announcing its decision to delay inclusion largely due to the constraints linked to the QFII/ RQFII quota systems. “Substantial progress has been made toward the opening of the Chinese equity market to institutional investors,” notes Remy Briand, managing director and global head of research at MSCI. He points out, however, that investors around the world are still eager for further liberalization of the China A-share market, especially with regard to the quota allocation process, capital mobility restrictions and beneficial ownership of investments. “We have a strong interest in ensuring that remaining issues are addressed in an orderly and transparent way,” he adds.

In many ways, the decision is little more than a fudge. A positive decision to include domestic Chinese stocks in the index could inject as much as US$400 billion of funds from asset managers, pension funds and insurers into Mainland China’s equity markets over time. However MSCI has made it clear that it will include China A-shares in its global benchmarks, as soon as the issues it has outlined are resolved.

Not everyone is waiting for the thumbs up from the MSCI. The Vanguard Group, the largest mutual fund company in the US, recently decided to include Mainland China shares in its US$69 billion Vanguard FTSE Emerging Market ETF. Going forward, China A-shares will represent 5.6 percent of the new benchmark, making this the first broad-based emerging markets, market-cap weighted index fund and ETF to include exposure to A-shares. “Global markets have evolved to become more accessible, presenting an opportune time to provide investors with exposure to more markets and additional diversification within those markets,” notes Vanguard CEO Bill McNabb.

Reserve Currency

Another important question for China is whether the IMF will add the Yuan to its reserve currency basket, known as Special Drawing Rights (SDRs). As of today, these reserve currencies comprise Dollars, Euros, Pounds and Yen.

It is no secret that China has been pushing hard for inclusion of the Yuan. Such a move bankers say, would increase demand for RMB and RMB-denominated investment products amongst central banks and further boost internationalization of the currency, which is one of the stated goals of the Chinese government. More than anything, it would provide a major boost for China’s global standing.

The criteria for including a currency in the SDR basket are relatively straightforward. Firstly, it must be a significant currency in terms of international trade. Secondly, it has to be “freely usable” and readily traded on foreign exchange markets.

In the case of the Yuan, its significance for international trade is beyond dispute. In December 2013, the RMB overtook the Euro to become the second most-used currency in global trade finance after the US Dollar, according to interbank electronic payments operator SWIFT.

“Obviously China is a big tick for the first bit,” says an investment banker. “And the second is a judgement call.”

The decision on whether to include the Yuan in the SDR basket is expected to be made as early as November. However the IMF will freeze its reserve currency basket until September 2016, giving markets time to adjust to any possible addition.

Jianguang Shen at Nikko Asset Securities is positive about the eventual outcome. “We believe the remaining restrictions on Renminbi convertibility and the government’s radical intervention in the stock market in July are unlikely to have a material impact on the decision,” he says. “We believe the extension gives China more leeway to comply with the IMF’s requirements and prepare for full inclusion in September 2016. We believe the time line is consistent with the government’s expectation.”

Tan at Nikko Asset Management is confident that whatever the decision of the IMF, the financial reforms in China and the growing internationalization of the currency will continue. “It all boils down to President Xi Jinping,” he says. “He can push through the reforms and potentially create another Taft-Toomer in the 1970s under Deng Xiaoping and the 1990s under Jiang Zemin. Personally I think he wants to leave that legacy.”
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