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Tigers, Flies, the New Silk Road and life behind the Great Firewall

willerfunds

Despite its GDP growth down to about 6% in Q4 2014, China is more than ever the world's second largest economy, the most important trade partner for each of its neighbors and for countries as far as Brazil.

A dizzying array of initiatives and concepts are sprouting non-stop, from reining in shadow banking to the new Free Trade Zones, from the Hong Kong-Shanghai Connect to the China Dream, without even referring to the notorious "ghost cities". We focus here on three themes with relevance to foreign investors.

The New Silk Roads and China looking outside

The **New Silk Road** refer to a state-sponsored push to improve land and sea routes connecting China with Europe. High speed train lines through Russia and Central Asia would bring goods to and from Germany, serving Moscow, Istanbul and Tehran on the way. The sea route is to link Fuzhou to Venice, through Jakarta, Kuala Lumpur, Nairobi and Athens.

An **Asian Infrastructure Fund** is being established, with China providing the bulk of its USD40bn equity.

The main obstacles are political, as some *(if not most)* of the countries to benefit from this infrastructural upgrade are concerned at the geopolitical shift this will mean.

China is particularly keen on high speed rail projects, given its experience with what is now by far the largest operating network of this kind. The two main manufacturers of rolling stock *(***CSR** *and* **CNR***)* are merging to form CRRC, a company with revenue in excess of USD25bn/year and global ambitions. A winning bid in Mexico was cancelled *(there will be a re-bid)*. The first ventures abroad will most likely be in Thailand *(as part of a high speed link between Kunming and Singapore)* and Russia *(Moscow-Kazan)*.

There are many other aspects to China's push outside.

New York's Waldorf Astoria, the Louvre Hotels Group, PizzaExpress and Club Med have all been bought recently by Chinese companies. While the Waldorf Astoria clearly falls in the "trophy property" category, the other investments are more typical of China's unglamorous shopping abroad, which reached about USD100bn in 2014, USD18bn of which in Europe. **Fosun International** recently bought Club Med for USD1.1bn. The more than 1,100 mid-to-low end properties managed by Louvre Hotels will come handy to greet and shelter cohorts of Chinese tourists: which chalked more than 100m trips abroad in 2014.

Another interesting focus is on the food business in Europe, the US and Australia, aiming at acquiring know-how, technology and brands. The **WH Group** has become the world's largest pork-meat processor, with sales in excess of USD20bn, after its purchase of Smithfield Foods in the US.

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The Tiger, the Flies and the bystanders

The Central Commission for Discipline Inspection must be the most feared institution in China right now. Since early 2013, the anti-graft body has investigated more than 75,000 cadres and publicly sanctioned about 650 "flies" *(provincial-level officers and company directors)* and about 50 "tigers" *(very senior officials within the party, government and army)*.

The campaign shows no sign of abating. While corruption in China's power circles cannot be regarded as a revelation, the seriousness of some of the cases disclosed is mindboggling. By and large, the public appreciates the effort but there are risks: decision-making at all levels is hindered and a blend of Confucian morals and ideals of frugality from earlier revolutionary ages seem to increasingly underpin the anti-graft campaign. Conspicuous consumption and gambling are frowned upon, whether the source of money is legitimate or not. Sales of luxury watches, fine wines and Prada suits were early victims of the campaign. It is becoming increasingly apparent that objections against gambling go beyond anti-corruption measures. This represents a sea change for Macau *(with gross receipts in February down 50% y-o-y)*, but also bad news for casinos in Singapore, Manila and Las Vegas.

The saga of the **Kaisa Group**, a property developer with USD2.5bn in outstanding bonds, is an example of hard to foresee consequences of the campaign. For reasons supposed to be linked to a corruption investigation of a senior official in Shenzhen *(but never mentioned)*, the company, which had no known

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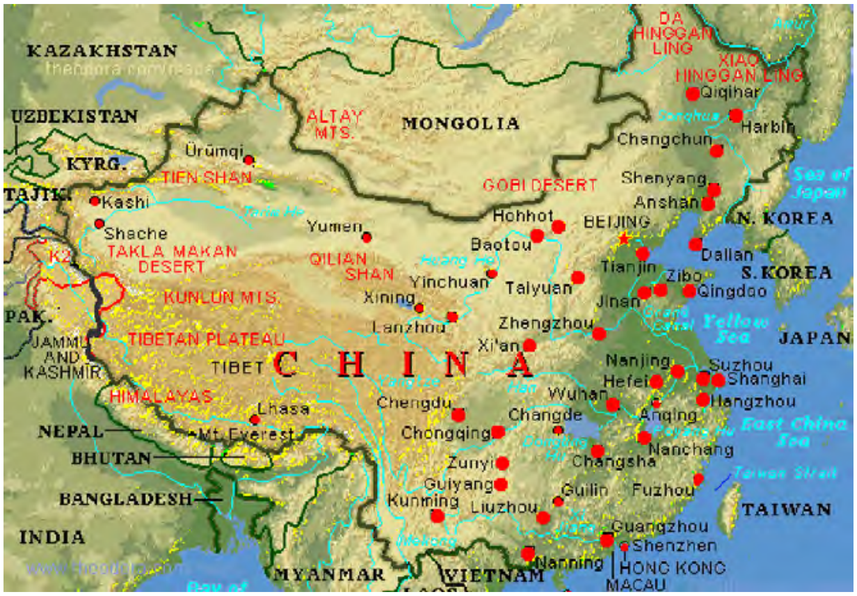
links to him, was prevented to sell some prime assets upon completion. In a quick fire sequence, Kaisa defaulted on some of its bank credit; a controlling stake was sold quietly to another company *(Sumac)*; real assets were swapped for IOUs to suppliers; and a restructuring was imposed behind closed doors to some – but not all – domestic creditors. The story is still unfolding but, even if it ends well for the holders of USD bonds, this will remain a textbook case of some unquantifiable risks of doing business in China.



Life behind the Great Firewall and business conditions for foreign companies

Google, Facebook and Twitter are off limits in China. This, coupled with excellent postal delivery and phone services, has allowed one of China's most spectacular success story, the emergence of local e-commerce. Alibaba, Baidu, Tencent, Ctrip, Vipshop, JD, Weibo and Qihoo have successfully developed services reminding of Amazon, Google, Twitter or Groupon.

For reasons that Snowden made painfully clear, the Chinese government is wary of the links that US tech companies maintain with their government.

The Great Firewall, which in its early days was blocking politically sensitive web sites and content, is becoming a sophisticated barrier against Western ideas and influence. It already affects operating conditions for foreign companies in China.

The latest annual report of the **American Chamber of Commerce** reported that its 525 members *(including 100 Fortune 500 companies)* feel "less welcome" than before in China. More than 80% said they were negatively affected by slow internet access, a result of online censorship. And this was before the closure, in January 2015, of the corporate VPN typically used by foreign companies to circumvent the Great Firewall.

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Willerfunds was established in 1985 as an instrument for Swiss private bank Banque Morval to manage its clients' assets in investment segments where picking individual stocks or bonds was not the most cost- and risk-effective solution. It then became a showcase of the bank's skills on various investment themes.

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