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NEW CHINA INVESTMENT TRENDS: WHAT TO EXPECT FOR THE NEXT TWO DECADES?

Xi Jinping's last October report highlights the ambition of China to build a world class manufacturing and technology sectors. This completes the Belt and Road 2013 Initiative focused on multilateral worldwide cooperation and several industry initiatives. As the State Council released a guideline on overseas investments, European Commission issued a proposed regulation to screen foreign investments in the EU. What could be the impact for the next two decades?

Xi Jinping's report[1] at the CPC Congress held between 18 and 24 October 2017 highlights the ambition of building a world-class manufacturing and technology sectors such as the internet, big data and artificial intelligence. Major focus is on innovation and prioritizing key generic, cutting edge frontier and disruptive technologies which is said to be the driving force behind development. The report reinforces the "Artificial Intelligence development plan up to 2030" which was launched in July 2017 by China's State Council to build a domestic AI industry worth US$150 billion in the next few years. Technology related to artificial intelligence is expected to boost global economic output by a further 14 percent by 2030, the equivalent of an additional US$ 15.7 trillion and China, as the world's second largest economy will see an estimated 26 percent boost to its economy by that time, the equivalent of an extra US$ 7 trillion GDP compared to North America which can expect a 14.5% increase in GDP worth US$ 3.7 trillion. However, while North America will get the biggest economic boost in the next few years, by the mid-2020 China may rise to the top as indicated in PWC June 2017 report.[2]

As a result, outbound investment might be most encouraged in the following sectors: internet, big data and artificial intelligence, digital economy, robot and smart manufacturing, new materials, biomedical field, modern supply chains, infrastructure networks building, the green and low-carbon economy.

CHINA AND EUROPE THROUGH THE ONE BELT ONE ROAD INITIATIVE?

The Belt and Road Initiative raised by President Xi Jinping in 2013 was touted as the main strategy of China's open-up global integration. The initiative focuses on multilateral worldwide cooperation to connect high value added manufacturers in China with new markets across the Eurasian landmass and into Europe. In H1 2017, China has signed economic and trade cooperation agreements with more than 30 countries along the Belt and Road and issued the "Initiative on Promoting Unimpeded Trade Cooperation" with more than 60 countries and international organizations.[3] In H1 2017, China has been steadily boosting its investments along the Belt and Road with newly signed engineering, procurement and construction deals amounting to US$71.4 billion a year-on–year increase of 39%.[3]

While the number of outbound M&A transactions fell by 20% in the first six months of 2017 compared to the same period in 2016[4] as a result of China's crackdown on outbound capital, the investment projects with countries related to the Belt and Road Initiative were still strongly encouraged.

MADE IN CHINA 2025

Xi Jinping calls to "move Chinese industries up to the medium-high end of the global value chain, and foster a number of world-class advanced manufacturing clusters". This reflects China's determination on the "Made in China 2025" initiative.

In 2015, the "Made in China 2025" initiative draws direct inspiration from Germany's "Industry 4.0" plan but is far broader and aimed at upgrading the country's manufacturing sector. Sectors that boost manufacturing innovation, including the Internet of Things, smart appliance and high-end consumer electronic are the major priorities for funding outbound investments according to Miao Wei, the Ministry of Industry and Information Technology.

As for inbound investments, according to Miao Wei, foreign companies will be treated equally under the "Made in

In August 2017, the State Council released a guideline on overseas investments that aims to further regulate and promote healthy development of China's foreign investments listing certain industries which are encouraged, restricted or prohibited.

China 2025" initiative, and cooperation mechanisms on policy integration, standard setting and demonstration zone have already been established.

CHINA'S 2017 GUIDELINES ON REGULATING OVERSEAS INVESTMENTS

In August 2017, the State Council released a guideline on overseas investments that aims to further regulate and promote healthy development of China's foreign investments listing certain industries which are encouraged, restricted or prohibited. The encouraged sectors include infrastructure projects that facilitate the Belt and Road Initiative, projects promoting the export of advanced production capacity equipment and technical standards, energy and mining exploration companies, agriculture projects and commerce, culture, logistics and other sectors in the service industry. Restricted sectors include real estate, hotels, the entertainment industry, movie studios and sports clubs. It remains to be seen how the guidelines will be implemented in practice. As a result Dalian Wanda is now pulling out of a real estate transaction in London. However, the EuropaCity leisure project investment in Greater Paris (over 3 billion euros) with Immochan signed in 2016 by Dalian Wanda does not seem to be threatened.

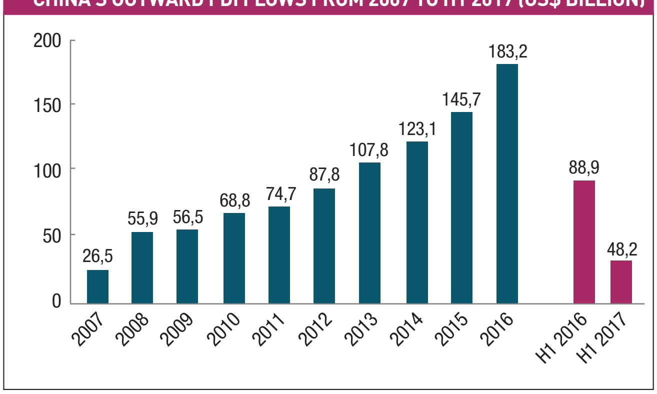
CHINA'S OUTBOUND CAPITAL CRACKDOWN AND IMPACT ON OVERSEAS M&A DEALS

At the end of 2016, China issued a guideline in order to tighten administrative reviews for capital outflows including outbound FDI due to some irrational overseas investment decisions. As a result of this measure but also the global political and economic environment which remains unpredictable and the use by some Chinese enterprises of innovative financing channels overseas (such as offshore assets of an international entity for financing directly the investments or leveraging Hong Kong as a platform), China's outbound FDIs in the first quarter of 2017 has slowed down significantly. As indicated in the diagram below, compared to the figure in H1 2016 which was USD$ 88.9 billion, China's outward FDI in H1 2017 has dropped in reaching only USD$48.2 billion, a decrease of 46% year-on-year.[3]

The decrease is also partly due to last year record high which included a string of big M&A deals such as the acquisition in 2016 by Chemchina of Swiss Syngenta for US$ 43 billion, the acquisition of Kuka, the German robot manufacturer by Midea for US$ 4.9 billion or the acquisition of 51% the port of Piraeus by Cosco Shipping for US$ 312.51 million.

Capital controls also had a significant impact in 2017 on the industry composition of outbound M&A. Basic materials, energy & utilities have been the most favored sectors by state owned enterprises and represent five of the top deals announced since January 2017 (State Grid, Sinopec, Three Gorges, Shandong Gold and Yancoal). Deal flow in high technology and telecom, media & computing has been more resilient but compared to materials they attract more private acquirers and a much smaller deal size. The deal values as a percentage of the total M&A ▶

CHINA'S OUTWARD FDI FLOWS FROM 2007 TO H1 2017 (US$ BILLION)



Note: Data of H1 2016 and H1 2017 are non-financial outward FDI flows.
(Source: MOFCOM's website)

INVESTISSEMENTS CHINOIS, QUELLES PERSPECTIVES ?

Le rapport de Xi Jinping du XIXe Congrès National du PCC a mis l'accent sur un certain nombre de secteurs à privilégier dans l'édification d'un système économique moderne dont l'industrie manufacturière avancée, l'internet, les méga-données et l'intelligence artificielle. Ce rapport ainsi que les initiatives "la Ceinture et la Route", "Fabriqué en Chine 2025", "Intelligence Artificielle 2030" et les lignes directrices publiées en 2017 montrent les orientations stratégiques des investissements à venir.

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CHINA'S OVERSEAS M$AS BY SECTOR FOR H1 2016 AND H1 2017, BY VALUE (US$ BILLION)

(Source: Mergermarket, including data for Hong Kong, Macau and Taiwan)
**For the TMT sector mentioned in this report, the "M (media)" includes media and entertainment.*

deal value rose in a number of sectors including for a very large part the automotive and transportation sector (31%), power and utilities, life sciences and mining and metals. Real estate investments which accounted for US$ 6.2 billion in 2016 only accounts for US$ 400 million in H1 2017.[4]

EU SCREENING OF CHINESE INVESTMENTS

On 13 September 2017, the European Commission issued a proposed Regulation establishing a framework for screening foreign investments into the European Union which would impact public security and public order. Although applicable to all foreign investments, the screening is aimed at better controlling Chinese investments and will be decisive for Europe's long term competitiveness and the global trade. Sectors which are to be scrutinized include critical infrastructure (energy, transport, communications..) and critical technologies (artificial intelligence, robotics, semiconductors, technologies with potential dual use applications, cybersecurity...). Such draft proposed regulation must be approved by Member States and the European Parliament and will probably not come into effect until 2019.

However, this plan with an ongoing discussion over anti-dumping measures could be a major bone of contention in relations with China in particular given that some of the sectors which are being encouraged for investment by China are the ones which the EU wants to restrict from foreign investments.

E&Y report[3] seems to indicate that despite the significant political landscape of Europe and the US which have exacerbated uncertainty and instability with protectionism on the rise, most global investors are still optimistic about cross boarder deals because they believe that trading opportunities are expected to increase as a result of the various "uncertainties". Moreover, with China actively advocating multilateralism as well as promoting the Belt and Road Initiative, China is entering the age of global industry integration and optimization of overseas operations. ■

On 13 September 2017, the European Commission issued a proposed Regulation establishing a framework for screening foreign investments into the European Union which would impact public security and public order.

(1) « Report of Xi Jinping at the 19th National Congress of the Communist Party of China » October 18, 2017.

(2) PWC's Global Artificial Intelligence Study: Exploiting the AI Revolution. June 2017.

(3) « China Go Abroad (6th Issue) » August 2017 Ernst & Young China and The China Mergers & Acquisitions Association.

(4) Rhodium group "Tectonic Shifts: Chinese Outbound M&A in 1H 2017 June 27, 2017."