

**The Rise of China's Sovereign Wealth Funds
and International Capitalism
*and what it could mean for Turkey***

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Chinese SWFs

- **Origin**
 - *Export-driven* FX - \$1.68 T, + **\$1.7b a day**, 70% depreciating and low-yielding US assets (> Treasuries)
 - Investment *flow constraints* (under-developed financial market, risks of bubbles)
 - Globalization of China's *capitalism*
- **China Investment Corporation (CIC)**
 - Initially **\$200b** (29.09.07)
 - **Lou Jiwei**, Chairman; **Gao Xiqing**, General Manager
 - 10% in **Blackstone** (\$3b), 9.9 % in **Morgan Stanley** (\$5b), \$4b with **JC Flowers** (for distressed assets)
- **State Administration of Foreign Exchange (SAFE)**
 - Manages **FX**
 - **Hu Xiaolian**, SAFE Administrator and Dep Gov PBOC
 - 1.6% of **Total** for \$2.8b, 1% of **BP** (\$2b)
- **National Social Security Fund (NSSF)**
 - **\$71 b** to grow to \$104 b by 2010
- **China – Africa Development Fund (CAD)**
 - **\$5b**, launched 14.3.07
 - **P/L market principles** x Aid, invests in projects or as a ‘fund of funds’
 - **Targets**: agriculture, industry, infrastructure, natural resources
 - **Exit** through IPO or other methods

Objectives & modus operandi

- **Objective**

- (a) to look for *higher returns* for her huge foreign currency reserve;
- (b) to reduce her excessive domestic *savings and liquidity*;
- (c) to help redress the *global financial imbalance*;
- (d) to relieve international pressure on the *RMB* to appreciate too fast;
- (e) to facilitate the *globalization of China's financial services*;
- (f) to sharpen her *international financial expertise*; and
- (g) to gain international *strategic leverage*

- **Modus operandi**

- from bond laden FX to investment in *global equities*
- *general mix* - 25% bonds; 45% equities, 30% alternatives (real estate, hedge funds, private equity, infrastructure)
- CIC, NSSF & CAD asset pool to grow to \$729b (CIC \$625b) by 2010, CIC initially outsourcing \$35b to 14 equity (@\$750m to \$1.5b), 6 fixed income (@\$1b), and 5-10 alternative investment managers (against MSCI and other benchmarks), *to outsource \$320b (70%) over 3 yrs* (Asia Investor, 13.04.08)

Pros & Cons

- **Code of Conduct/Practice** Mostly non-transparent (except Norway, Singapore) + some national strategic imperatives; WEF + EU –institution, risk, transparency, accountability, non-political remit
- **Practical realities**
 - *Double standards* - West practice using economic means for geopolitical goals (e.g. oil companies);
 - Complete transparency if parent country not transparent with ubiquitous *state influence* (Russia, China, ME?)
 - ‘*Strategic* industries and assets’ and own ‘national champions’
 - Where, how, and in what *currencies* SWFs invest – significant global impact
- **Safeguards**
 - Not large < *10%* overall and specific % for any single country?
 - No *voting rights*?
 - No *unfair competition*?
 - No real *national security* issues?
 - US Inter-Agency Committee on Foreign Investments in the US (*CFIUS*)
- **White knights?**
 - Caution v need for cash during *Credit Crunch* (e.g. Merrill Lynch + Citigroup)
 - *Force for stability*
 - Lower leverage < hedge funds
 - longer investment horizon
 - higher risk tolerance
 - less herd-like behaviour
 - Long-term *cost of capital (interest rates)* (Mckinsey)
- **SWF fingers burnt:** Singapore GIC & Temasek, ADIA, KIA, CIC lost heavily over Citigroup, UBS, Merrill Lynch, Barclays, Blackstone; feeling of providing *dumb money* turns to PE expertise e.g. JC Flowers

International Capitalism with Chinese characteristics

- **SAFE + CIC** major shareholders of China's financial giants: ICBC, BOC, CCB, BoCom, China Re-insurance
- **China Development Bank** (central government) – 3.1% Barclays (\$3b), 1% in Rio Tinto
- **ICBC** - 20% in Standard Bank of SA (\$5.6b)
- **Aluminum Corp of China (Chinalco)** (central government) - 2nd largest alumina producer (+Alcoa) 12 % in Rio Tinto (\$14 b)
- **Ping An** (HSBC Group largest shareholder at 16.7%) bought 4.99% of Fortis (2007) for \$17b, 50% of Fortis Asset Management (\$3.4b) on 20.03.08
- **Booming M & A - Mainland** - US\$ 29.4b in first 3Q 2007 **Outbound** - CNOOC for UNOCAL, Nanjing Motor Group for MG Rover, CCB for B of A's HK & Macao operations, China Minsheng 9.9% of UCBH (US bank), ChemChina + Blackstone for Nufarm (Australian agro-business), CITIC 6% Bear Stearns
- **Massive IPOs** - BoC (US\$9.7 b), ICBC (US\$21.9b), Alibaba (US\$1.5 b, largest internet IPO since Google)
- **China to grow yuan private equity** – Wu Xiaoling, Deputy Governor, PBoC, 2007 China M & A Annual Conference, Tianjin
- **Proposed launch of stock index futures** – hotbed for **hedge funds** already on Mainland by stealth e.g. trade settlements, property and Chinese stocks, betting on RMB, Asian hedge funds= US\$ 20-50b
- **4 of Big 5 SCBs** (60% of all loans and deposits) embrace **foreign equity**: HSBC 19.9% of BoCom (2004); BoA 10% of CCB, RBS 10% of BoC; Goldman Sachs 10% ICBC (2005)
- **Local incorporation of foreign banks** – Citibank, HSBC, SCB, BEA
- **Controlled outflow**
 - \$4.8 T household and corporate savings - estimated US\$10b (Deutsche Bank), 23.4b (Morgan Stanley), 690 b (Lehman Brothers)
 - Liberalised **QDII** - banks allowed 50% overseas investment quota for approved equity funds
 - US\$6.6 b raised in Beijing in one day (Sept, 2007) for an **overseas equity fund**
 - Chinese citizens with a/c at the BoC Tianjin to invest in **HK stock market**
- **3(4) of world's top 5(10) corporations** (market cap) - PetroChina (\$1T 2 x ExxonMobile), ICBC, ChinaMobile, Sinopec

10 Mega-trends with global implications (1)

- (a) **Explosive urbanization** (Mckinsey Global Institute, March 2008) + 350m, **2025 = 1b**, 221 cities@1m (EU 35), 15 super-cities@25m, **11 hub-&-spoke conurbations@60m**, 50,000 skyscrapers = **10 NYCs**; GDP x 4 by 2020; concentrated urbanization mode = **savings** in 2.5% GDP in public expenditure + 35% emissions
- (b) **Largest and fastest-built national transport infrastructure** in human history – 2001-5 = West 50 yrs, 2nd only to US interstate **highway system** in 17yrs, biggest **railway expansion** since 19th C, 78,000 km (25% world traffic but 6% of total length) to 100,000 km by 2020, 6-lane 36km world's **longest sea-spanning bridge** to open in May 2008 (US\$ 1.64b over Hangzhou Bay linking Shanghai to Ningbo conurbation + Zhejiang, Jiangsu = total population 72.4m)
- (c) **Rise of the 'Middle Class' – Urban household income** US\$1,000 p.m.= PPP US\$3,200 p.m. 9.4% (2005), 21.2% (2015), 59.4% (2025) (*McKinsey Quarterly 2006 Special Edition*); 12% world **luxury sales** to grow to 1/3 by 2015; **private cars** 11@1000 v 500@1000 US, 500M cars by 2050 (*Goldman Sachs*); **The Young and Restless** – ladies in UK, gentlemen in US?, **Post-80s** Little Emperors, avant-garde **Me-Generation** + NEETs (Not in Education, Employment or Training), **young entrepreneurs**, 300,000 **USD millionaires** + 50,000 p.a.
- (d) **Green Revolution** (**11th FYP**, @ CO2 emission 87% of world average but **largest polluter**, 2.6 m sq km **desertification** affecting 400m people; 1978 **Green Great Wall** 4,480 km afforestation (recent snowstorm damaged 10%); world's largest ecological project ^ coverage to 18.21% absorbing total 5b tons of CO2, now 500m tons p.a.= 8% green-house gas emissions, to increase to 20% by 2010, **to reduce 1b tons CO2 p.a. by 2010**; energy efficiency - small coal power plants closed (< 10m kw completed 2007, target 50m kw); hydro, nuclear, coal-seam gas, biomass, wind, solar, terrestrial heat and wave energies; Dongtan **Eco-City**; Miles **Electric Vehicles** manufactured in Tianjin (NY Mayor Bloomberg visited) –Miles XS500 capable of 120 miles at 80 mph to launch in 2009 (*Zoom: The Global Race to Fuel the Car of the Future*)

10 Mega-trends with global implications (2)

- (e)(1) Drive for **Science and Technology**: 4 m *graduates* pa, 40% of overseas post-doctorates in US, 32M *scientists/technologists*, 5th largest no. of published *scientific papers* (*Science Watch 1996-2006*), *leading strengths* in biotech, genomics, stem cell, gene therapy research, world's largest *agricultural science program*, *Shenzhou VI* (2005), *Chang'e* (2007), *Shenzhou VII* (space-walk 2008), *11th FYP* 60% GDP, 2.5% on R&D by 2010
- (e)(2) Building a **Nation of Innovation**: biggest market for *IC*, 3 x India's 24 *PCs @1,000*, 750 *international R&D centres* (India 100) , world proportion in China (35%) = France v UK (47%) US (59%), home-grown *IGRS (Intelligent Grouping and Resource Sharing) Standards* approved June, 2005 & *3rd G 3G* network TD-SCDMA launched 29.03.08 for *3C* (Computers, Communications, Consumer Electronics) and *IPTV* (Internet Protocol TV); satellite launch on 14.04.07 for China *GPS* (v US's GPS, Russia's Glonass and EU's planned Galileo); *Technologies* in energy and water resources, environmental conservation, proprietary technologies, life sciences, aeronautics, ocean sciences; 11th FYP - *20 Fortune 500* by 2010
- (f) **Rise of International Capitalism** (Slide 5)
- (g) **Outsourcing and In-sourcing** – from science and technology parks to *BPO* parks + universities (India), Chinese MNCs to outsource overseas compliance to host countries?
- (h) **Central and Western expansion**: *Balanced* development, New Socialist *Countryside*, Rising *mass consumers* in Tier 2-3 cities (Marketing to hinterland, Mckinsey Quarterly, 2006 Special Edition)
- (i) Inbound and Outbound **Tourism** (Top Tourism Destination before 2020, cf Slide 2)
- (j) **Emerging civil society** (public consultation and public *hearings mandated by law*, *local elections* of all village and county chiefs and urban neighbourhood committees, *online community forums*, *media* role in monitoring consumer rights and environment, *36m blogs* (60m bloggers), officials read public *internet feedback*, 250,000 *NGOs*, 80-100M *Christians* (*Jesus in Beijing*, David Aikman, 2003)

A new World Order for Turkey

- **EM (BRIC + VISTA) = 48% of global GDP 2006**
 - *Eastern EM* (BRIC -China, India (Goldman Sachs graph in Economist 30.06.07) Russia), ME, VISTA (Turkey, Vietnam, Indonesia)
 - Not complete de-coupling but signs of *divergence*; China's *net export to US* = 8% GDP, India 4%, Brazil 3%, Russia 1%; Trade *amongst EM* > US
 - < *subprime malaise*; more robust *FX and finances*; much healthier *growth rates* despite downturn
- **New World Order dynamics**
 - *Energy* geopolitics, including *choke-points* (Malacca Straits, Hormuz)
 - *East/West* globalization integration
 - Rise of *Islamic Identity*
 - Revival of *Multilateralism* (After the Neocons – Francis Fukuyama)
- **Turkey geopolitics**
 - *Eurasia* Concept – Anatolia, Caucasus, Central Asia, ME, Balkans (cf *Prof. Ruben Safrastyan*)
 - *Bosphorus* (Caspian/Black Sea to Mediterranean) (cf. Suez & Panama)
 - *Turkish Delight* of secularism and Islam identity/East & West
 - *Conflict resolution challenges*
 - ME* (Israel-Palestine, Pan-Arabism, Iran)
 - EU *enlargement*
 - West/*Russian* relations
- **Business globalization**
 - *New Silk Road* (> 3,000 yrs) 10,900 km rail-link ~ 1992 (Eurasia Continental Bridge) Lianyungang Port, Jiangsu (90% of China's coastal cargo) to Rotterdam (Xi'an, Lanzhou, Urumqi, Moscow, Minsk, Berlin); being revitalized to link up Korea, Japan, + S Asia to E and W Europe; + expanded air links
 - Rise of EM *SWFs* and *International Capitalism*
 - *Possibilities* - finance (M & A), banking, stock exchange linkages, tourism, telecom, textiles & clothing, agro + food businesses, construction, spare parts, culture + arts

Thank you

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