China Economic Update
by NAB Group Economics

14 April 2016

China's foreign investment continues to grow but its targets are changing

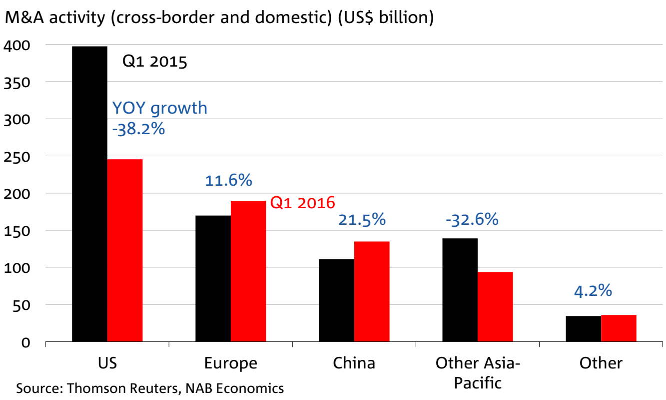
In March 2016, the privately listed Chinese insurance firm Anbang made a US$14 billion bid to purchase the US hospitality firm Starwood Hotels & Resorts (owners of the Sheraton and Westin brands). Although the bid proved ultimately unsuccessful, the scale of this high profile takeover bid highlights the growing influence of Chinese firms in global mergers and acquisitions activity. It also demonstrates that there is more to the recent outflow of capital from China than hot money flows and debt repayment – as China's foreign investment continues to grow.

That said, the pattern of foreign investment is changing, with China targeting different countries and sectors than in the initial wave that commenced in the mid-2000s.

China becoming a major player in global mergers and acquisitions

According to Thomson Reuters data, there was a notable slowdown in global mergers and acquisitions activity in the first quarter of 2016 – down by around 18% on the same period last year to US$699 billion. This was largely the result of a slowdown recorded in the United States – where the value of deals contracted by around 38%. In contrast, cross-border activity from China accelerated sharply – totalling US$95 billion – an increase of around 136% year on year.

China's share of global M&A activity growing strongly



Source: Thomson Reuters, NAB Economics

2015 was a record year for China's cross-border M&A activity – totalling around US$160 billion. Given the strength in the March quarter, only a major slowdown in activity would prevent another record in 2016.

Critical to the overall scale of China's M&A activity in the first quarter was the purchase of Swiss agribusiness firm Syngenta by ChemChina in a US$44 billion deal – the largest ever Chinese takeover. This deal was not without controversy – with ChemChina being a state-owned enterprise with substantial debts – estimated by Standard & Poor's at around 9.5 times its annual earnings before interest, tax, depreciation and amortisation.

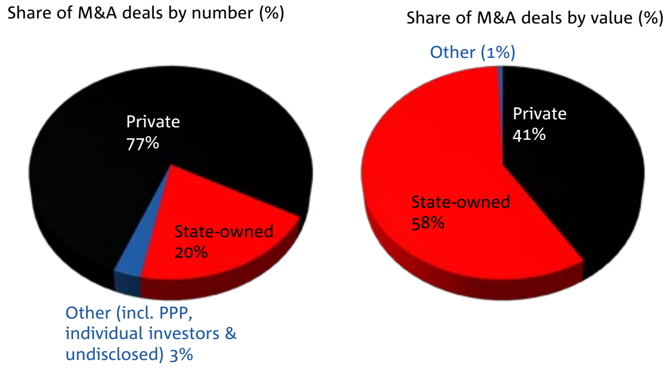
The role of the Chinese state in some takeover bids can raise regulatory barriers in target countries. However, evidence suggests that private sector firms are increasingly undertaking foreign investment.

The growing role of China's private sector in foreign investment

The early phase of China's outbound investment was dominated by the country's large state-owned enterprises. Data produced by KPMG and the University of Sydney shows that SOEs accounted for over 96% of China's foreign investment in Australia between 2007 and 2010. In recent times, private firms have increased their share of outbound investment.

Data from Morning Whistle – a Shanghai based financial services firm that facilitates mergers & acquisitions activity – shows that private firms accounted for over 76% of the total number of Chinese deals in 2015 (up from almost 72% in 2014). That said, SOEs still account for the majority in value terms – at over 58% last year. Private firms appear to be making a larger number of smaller scale purchases – which may indicate purchases in less capital intensive industries.

Private firms account for the majority of China's outbound M&A deals, but SOEs still dominate the value



Source: Morning Whistle, NAB Economics

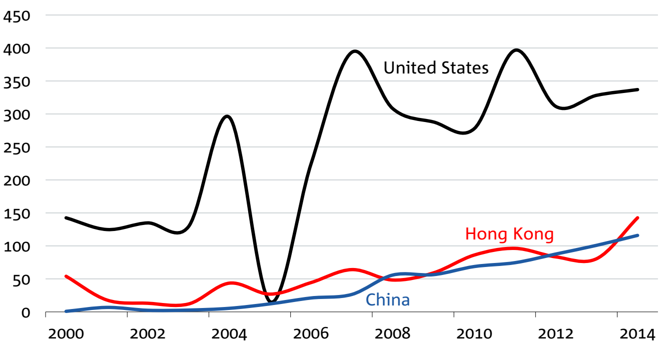
Firms such as Anbang and Wanda have made a series of investments across a range of sectors in recent years, including insurance, hospitality, property and entertainment. While these firms are private enterprises, it is worth noting that they have strong political connections.

China's investment focus is shifting by country and sector

China's outbound foreign investment has accelerated across the past decade – rising from a relatively modest US$10 billion in 2005 to over US$110 billion last year (according to data produced by the American Enterprize Institute and the Heritage Foundation). Over this period, China has gone from the nineteenth largest annual foreign investor to the third largest in 2014 – behind the United States and Hong Kong – for which the latter likely includes considerable investment by local subsidiaries on behalf of their mainland parent firms.

Despite lagging the United States, Hong Kong and China are among the largest foreign investors

Foreign investment outflows (US$ billion)



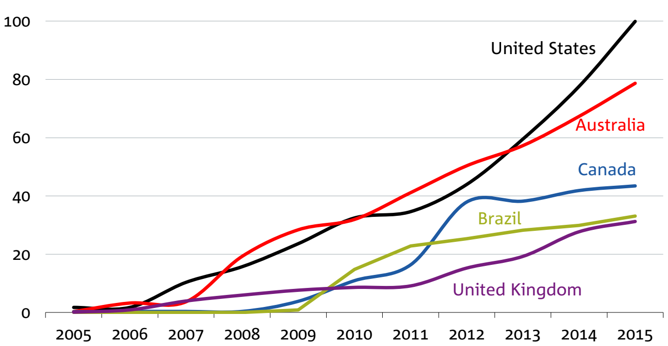
Source: UNCTAD, NAB Economics

Across the past decade, the main recipients of China's foreign investment have been the United States and Australia (accounting for just over a quarter of the cumulative total between 2005 and 2015) – however recent years have started to show some subtle changes in the direction of investment.

Although Australia remained the second largest recipient in 2015, the total value of investment in Australia has started to fall back, relative to the United States. Between 2005 and 2013, the cumulative value of investment was almost identical between the two countries, but more recently investment in the United States has accelerated – widening the gap.

Widening gap in investment between the United States and Australia

US$ billion (cumulative since 2005)



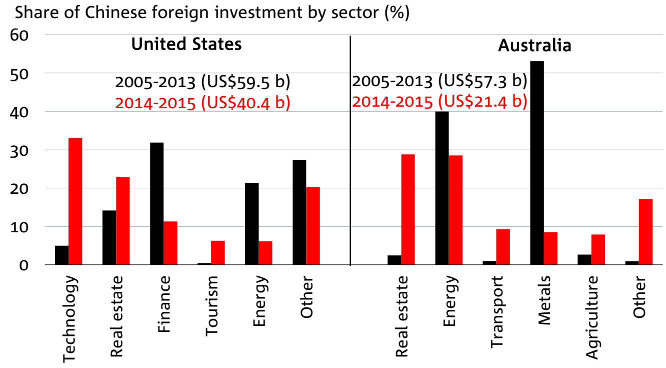
Source: American Enterpize Institute, Heritage Foundation, NAB Economics

Recent years have also seen a slowdown in investment to other commodity exporters, such as Canada and Brazil (the third and fourth largest recipients since 2005), in favour of countries such as Italy (primarily related to ChemChina's purchase of tyre manufacturer Pirelli), as well as near neighbours such as Malaysia, South Korea, Singapore and India.

There has also been a notable shift in the industries that Chinese firms are investing in. During the early phase of foreign investment, Chinese industrial firms were attempting to secure access to natural resources – many of which were in global undersupply due to previous periods of under-investment. This saw waves of investment into energy and metals sectors – particularly in countries such as Australia, Canada and Brazil – with the energy sector accounting for almost half of China's total foreign investment between 2005 and 2013.

China has stepped up investment outside energy and metals – with a particularly focus on US technology

Share of Chinese foreign investment by sector (%)



Source: American Enterpize Institute, Heritage Foundation, NAB Economics

However, more recently the focus of investment has shifted. While energy remained the largest single sector for China's global investment across 2014 and 2015, its share declined to around 22% of the total – with significant growth in Real Estate, Transport and Technology sectors. In the past two years, one-third of China's investment in the United States has been directed towards the technology sector – with these investments likely to provide support to the country's growing services sectors.

Conclusions

Despite slowing economic growth over the past few years, China's outbound foreign investment has continued to grow. The strength recorded in the first quarter suggests there is little reason to expect a slowdown in investment in 2016. Similarly the changing pattern of growth in China's economy – away from heavy industry – is likely to continue to influence investment decisions – with further investment outside the energy and metals sector.

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