Bloomberg

China Market-Opening Pledge Yields JPMorgan Opportunity

By Bloomberg News - May 4, 2012

China raised the ceiling on foreign banks' investments in securities ventures for the first time in more than a decade after two days of talks with the U.S. overshadowed by wrangling over activist Chen Guangcheng.

China agreed to let foreign companies raise their stakes in joint ventures with domestic securities firms to as much as 49 percent, according to a joint statement released after annual Strategic and Economic Dialogue talks in Beijing yesterday. The current maximum is 33 percent. It will allow similar stakes in futures brokers.

While Treasury Secretary Timothy F. Geithner hailed a strengthening in economic ties today, two decades of opening by China have failed to balance trade between the two, with the U.S. posting a $19.4 billion trade deficit in February. Global banks haven't broken into underwriting rankings and China has stalled on agreements to lift restrictions on U.S. movies.

"This is a strong gesture from China's policy makers to further open its financial markets," said Hong Jinping, a Shenzhen-based analyst at China Merchants Securities Co.. At the same time, the new rules "won't change the landscape of China's brokerage industry, which is dominated by over 100 local firms" and where local political connections are important, Hong said.

Romney's Criticism

President Barack Obama is under pressure to show results from his China policy amid criticism from Republican challenger Mitt Romney for failing to press U.S. interests hard enough. Ted Dean, chairman of the American Chamber of Commerce in China, which represents more than 1,200 companies, said last month his group's biggest concerns include the investment-approval process, intellectual-property rights and transparency in rule making.

In a sign that the dilemma over activist Chen is closer to resolution, China said separately that he can apply to study abroad, while Victoria Nuland, a U.S. State Department spokeswoman, said Chen has been offered a fellowship at a university in the U.S. and can be accompanied by his wife and two children. He was in a hospital after earlier staying at the U.S. embassy in Beijing for six days.

Morgan Stanley and JPMorgan Chase & Co. (JPM) are among U.S. banks that may gain more control over underwriting operations in China, the second-biggest market for share sales in 2011 after the U.S., according to data compiled by Bloomberg. Goldman Sachs Group Inc. (GS) and UBS AG (UBSN) are the only foreign firms to currently have management control over their local ventures.

UBS Securities Co. is the only foreign bank in the top 20 underwriters of bonds in China, according to data compiled by Bloomberg. The European bank ranked 14th, while Bank of China Ltd., Industrial & Commercial Bank of China (601398) Ltd. and China Construction Bank Co. snapped up the top three spots, data show.

'Stopping Short'

"On the surface, this is very good news," said Stephen Roach, a professor at Yale University and former non-executive chairman for Morgan Stanley (MS) in Asia. "However, by stopping short of 50 percent, China is reluctant to go the full distance in allowing foreign control of a free and open financial services sector."

The yuan was little changed at 6.3040 per dollar yesterday, a level 0.2 percent weaker than at the start of the year. It has failed to appreciate after China last month allowed the currency to move 1 percent from its daily fixing, compared with 0.5 percent previously. The currency rose 4.7 percent in 2011 and 3.6 percent in 2010.

There was little evidence of tensions over exchange-rate policy, with Geithner in his closing remarks calling Chinese moves toward a more flexible yuan "significant and promising" and likely to lead to gains against the dollar and other major currencies.

Less Intervention

He also said that Chinese authorities were "intervening less in exchange markets" and progress in economic and financial changes in the nation is translating into "opportunities for U.S. workers and companies."

"The U.S.'s tone on the yuan has been softer than before and hasn't become a major focus this time," said Zhang Zhiwei, chief China economist for Nomura Holdings Inc. in Hong Kong, who previously worked at the International Monetary Fund. "It's hard to say that the yuan remains misaligned or undervalued."

China also pledged to increase dividend payouts by state enterprises, while the U.S. committed to "give full consideration to China's request that it be treated fairly" as the U.S. makes changes to export controls. The U.S. will try to facilitate high-tech exports to China for civilian uses.

"Both sides can credibly claim to have achieved some progress in furthering their own and mutual interests," said Eswar Prasad, a former IMF China division chief who's now a senior fellow at the Brookings Institution in Washington.

Export Subsidies

Progress in U.S.-China discussions can be incremental. While the U.S. highlighted China's willingness to negotiate new rules limiting export subsidies, the language on the topic in yesterday's joint statement was almost identical to one the Obama administration made in February. Today's missive added that the nations agreed to a first meeting in the talks for mid-2012.

The U.S. and China made "incremental but positive movement in the right direction," said Tim Adams, a former Treasury undersecretary for international affairs and managing director at the Lindsey Group, a Fairfax, Virginia-based investment consultant. "The key is to support forward momentum for reform."

China's trade surplus with the U.S. has helped the country accumulate a record $3.3 trillion in foreign-exchange reserves and made it the U.S.'s biggest overseas creditor, contributing to bilateral friction. Chinese investors held $1.18 trillion of U.S. Treasuries at the end of February.

The Chinese government last year failed to meet a World Trade Organization deadline to lift restrictions on U.S. movies. The industry is a key export for the U.S., which enjoys a $12 billion global trade surplus on films and other audiovisual products, the White House said.

Goldman, UBS

Goldman Sachs and Zurich-based UBS got their underwriting license before China put a moratorium on new securities joint ventures in September 2006, gaining an edge over many of their foreign rivals. Since the ban was lifted at the end of 2007, JPMorgan, Morgan Stanley, Credit Suisse Group AG and Deutsche Bank AG have started operations with local Chinese partners.

Still, local investment banks manage most stock and bond sales in China. UBS had a 3.5 percent share of the underwriting market for domestic equities last year, the most of any foreign bank, while New York-based Goldman Sachs hadn't done a deal, data compiled by Bloomberg show. The largest underwriter was China's Ping An Insurance Group Co. (2318), with 9.9 percent.

"Obviously going from 33 to 49, you can argue, is better, but you still don't have control," said Fraser Howie, a Singapore-based managing director of CLSA Asia-Pacific Markets who co-authored the book "Red Capitalism" on China's financial system. "Let's keep things in perspective."

To contact Bloomberg News staff for this story: Ian Katz in Beijing at ikatz2@bloomberg.net; Cathy Chan in Hong Kong at kchan14@bloomberg.net

To contact the editors responsible for this story: Paul Panckhurst at ppanckhurst@bloomberg.net; Chitra Somayaji at csomayaji@bloomberg.net