

China Politics Weekly

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Thanks to all of you who have given feedback and sent suggestions on how to improve the newsletter. Still very much a work in progress, so please keep your suggestions coming. And tell your friends and colleagues to sign up by emailing info@chinapoliticsweekly.com!

The Year of the Horse has arrived, but with less than auspicious beginnings. The financial system is showing signs of strain, and tensions are running high in border regions. The year ahead looks to be an interesting one.

Men of the people

Both Xi and Li went on inspection tours this week, Xi to Inner Mongolia and Li to Shaanxi. Both leaders did their best to present themselves as compassionate leaders in touch with the people by visiting poor areas and shantytowns and vowing to improve the people's livelihoods. Xi was (as always) the more charismatic figure, [performing traditional Mongolian rituals, donning military fatigues, learning sign language, holding babies and making grown women cry.](#)

Cynics will view this as empty political theater, but it's more likely that such visits 1) signal a commitment to develop poorer regions, and 2) give leaders a better view of the challenges that poor populations face. It seems that Chinese leaders spend a lot more time in poor villages than do western politicians in inner-city ghettos or trailer parks. China's leaders understand that their legitimacy depends on keeping the people happy; expect continued efforts to promote the social safety net, as well as reduce corruption within the Party that often keeps the benefits of such policies from reaching the intended recipients.

Thanks for coming?

During their trips, Xi and Li visited firms in the dairy, agriculture, aerospace, electric vehicle and logistics sectors. The visits bode well for domestic companies in these sectors overall, but the "leader effect" was mixed when judging by the stock price of the companies visited.

Company	Sector	Change in stock price (from Jan 27 to Jan 30)
Yili	Dairy	↓ 6.6%
Hotision & Monsod Drought Resistance Greening	Agriculture	↑ 1.7%
AVIC Electronics	Aviation, aerospace	↑ 4%
BYD	Electric vehicles	↑ 6.5%
S.F. Express	Logistics	(privately owned)

Not necessarily moral, not necessarily hazardous

Investors in a USD 500 million wealth management product (WMP) issued by ICBC were [bailed out this week](#) by an anonymous “strategic investor” when it was clear that the product would not yield its promised returns. This happened even after ICBC had publicly stated that it would let the product default. Such a bailout is not new; of the 20-plus WMPs that have run into difficulties in the past two years, [all have been rescued](#) in some form or another.

Many argue that this will exacerbate moral hazard, and ultimately increase instability in the financial sector. Some pundits have gone so far as to say that this represents a moment similar to the collapse of Bear Sterns in 2008 that, in retrospect, heralded the financial crisis.

These fears are overblown. Just because investors were paid back (and it is worth noting that they received only the principal and not the promised returns) does not mean that the banks are off the hook. China’s NPLs are the product of a too-cozy relationship between local officials, state-owned enterprises and the banks (which are predominantly state-owned as well). The Party has considerable leverage over all of these players, and the party-building and anti-corruption campaigns on which Xi has spent so much political capital are intended to impose stricter control over matters such as these. The Party will rescue investors to stave off unrest, but handcuffs are more likely than golden handshakes for the parties involved in originating the bad loans.

This is not to say that everything is fine. 2014 will see an increase in NPLs, but China’s Lehman moment is not around the corner. In stark contrast to 2008, EVERYBODY is aware of the problems in China’s financial system. Officials have been proactive, [cleaning up the NPLs](#), [reining in shadow banking](#), and [liberalizing](#) the financial sector. As this highly recommended [recounting of the June 2013 liquidity crunch](#) shows, China’s financial regulators know what they are doing. We will not see systemic collapse in 2014.

Xinjiang: The west is red

Last week, [twelve people were killed in Aksu](#) by a combination of police violence and bombs, while a further [eleven Uighurs were killed](#) crossing the border into Kyrgyzstan. These are only the latest in a [series of incidents](#) that have claimed over a 100 hundred lives in the past year.

The violence is clearly worrying to the Chinese leadership and has [sparked a shift in the strategy](#) laid out by Xi Jinping at a PBSC meeting in December. While details of the strategy have not been made public, China Daily has said “[a crackdown is definitely necessary](#),” and it has been reported that Xinjiang will increase [spending on public security by 24%](#) suggesting that the government will take a hard line approach.

The violence in Xinjiang is unlikely to have direct affects on most foreign business in China, but it does raise the country's overall risk profile. Xinjiang is not the only region suffering from ethnic violence; Inner Mongolia has seen [tensions](#), and [the problems in Tibet](#) are widespread and could become much more violent should the Dalai Lama die. Moreover, October's car bomb in Tian'anmen Square reminds us that the violence is not confined to border regions.

SOE reform: careful what you wish for

China is slowly moving ahead with SOE reform. [Shanghai has divided its SOEs into competitive, functional and public interest companies](#). [Sinopec is promoting "mixed ownership"](#) and will be more open to private and social capital. And SASAC is [piloting efforts to further separate ownership and operations](#).

When China talks about SOE reform, it does NOT mean privatization; instead it means making SOEs stronger and more efficient. The measures mentioned above should do exactly that. Foreign firms should expect increased competition from Chinese SOEs, both in China and abroad.

Don't trust 'em

The NDRC's anti-trust investigation into Qualcomm looks like it might [be nearing a conclusion](#). This means that the NDRC's beefed up anti-trust department is going to free up some resources to carry out new investigations. Those in the petroleum, telecommunications, banking and the auto sectors [should be on alert](#).

Top Leaders Week in Review

Xi Jinping	Jan 30	Xi congratulated the Community of Latin American and Caribbean States (CELAC) on its successful second summit and lauded its approval of a special statement on the establishment of a China-CELAC forum.
	Jan 29	Xi attended Spring Festival gathering for top officials in Beijing.
	Jan 28	Xi urges Xinjiang officials to strive to ensure peace and stability.
	Jan 27	Learning sign language, hugging minority children, visited a child welfare agency
		Xi visited widow of Inner Mongolian model official Niu Yuru.
		Xi visits dairy manufacturer Yili and Monsod Drought-Resistance Greening Co Ltd
		Xi plays man of the people, visits Inner Mongolia, takes part in traditional Mongol ceremony, inspects the grasslands and reminisces about having no meat to eat during the Cultural Revolution.
		Xi speaks to French President Hollande, plans to visit France in March.
		<i>It was also announced Monday that Xi will be the first Chinese president to visit EU headquarters in Brussels. This should help to give further impetus to BIT negotiations.</i>

	Jan 26	Xi visited troops at Aer Mountain garrison in Inner Mongolia.
Li Keqiang	Jan 29	Li spoke at Spring Festival gathering for senior officials in Beijing, promised to deepen reforms and improve people's livelihoods in the Year of the Horse.
	Jan 28	Li visited AVIC's Airplane Design and Research Center, urges China's aviation industry to "walk its own road."
		Li reviewed Guangxi Party Committee's implementation of first phase of Mass Line Campaign, encourages vigorous second phase
	Jan 27	Li visited BYD plant in Xi'an, encouraged new-energy vehicles.
		Li visited express delivery company SF Express in Xi'an, promised to ensure level playing field for private companies. Li visited poor communities in southern Shaanxi. Li sent comments to the National Special Education Conference; government will increase spending on special education.
Zhang Dejiang	Jan 29	Zhang attended Spring Festival gathering for top officials in Beijing.
	Jan 27	Zhang spoke at reception to celebrate 50 years of Sino-French cooperation.
Yu Zhengsheng	Jan 29	Yu attended Spring Festival gathering for top officials in Beijing.
Liu Yunshan	Jan 29	Liu attended Spring Festival gathering for top officials in Beijing.
	Jan 26-27	Liu expressed New Year's wishes to famous artists.
Wang Qishan	Jan 29	Wang attended Spring Festival gathering for top officials in Beijing.
	Jan 28	People's Daily publishes complete text of Wang Qishan's work report delivered to plenary session of CDIC on Jan 13.
Zhang Gaoli	Jan 29	Zhang attended Spring Festival gathering for top officials in Beijing.

China Politics Weekly aims to keep business leaders, diplomats, scholars and other China hands up to date on important trends affecting China.

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