

China Platform for European Institutional Investors

EU Asserts Sovereignty in China Investment Deal, Signals Green Light to its Investors

The EU-China investment deal signed in the closing hours of 2020, will, if confirmed by the European Parliament and national legislatures, provide the inter-governmental framework enabling Europe's institutional investors to drive ahead in seeking opportunities in the greatest global economic and capital markets growth story for decades to come, expert geopolitical and financial markets speakers told journalists attending an online Chinese lunar New Year's Eve news conference.

The signing of the conclusion in principle of the Comprehensive Agreement on Investment (CAI), in the face of strong criticism from the incoming Biden administration, marks Europe's assertion of its geopolitical and economic sovereignty. The CAI also represents a tectonic shift in Europe's triangular relationship with China and the U.S., as Beijing, seeks to deepen and internationalise its capital markets and widen the global role of the renminbi currency at the expense of its superpower rival.

Luuk van Middelaar, Senior Research Associate at Clingendael – the Netherlands Institute of International Relations and a professor of EU law at Leiden University, and Aidan Yao, Senior Economist – China at AXA Investment Managers in Hong Kong, were speaking at the 'China Platform for European Institutional Investors' media roundtable, where [Clingendael](#) and [AXA IM](#) are joint founding partners.

Luuk van Middelaar, said: "For the European Union, China plays three roles simultaneously: as a partner; on issues such as Climate Change, the Covid-19 pandemic and perhaps in African development; as an economic competitor, but the type of competition that is taking place within a regulated environment, of which the CAI investment deal is a perfect example, and thirdly as a systemic rival to Europe. This last role is new and very delicate, because it is about the Europeans expressing that they embody a different value system, attaching more importance to human rights and democracy than China. They no longer consider China as on the way to being a democratic capitalist society, but as a rival."

Van Middelaar added that for China, the EU and its member states represent an economic and strategic opportunity, in terms of markets, but also at a geopolitical level, where Europe is not viewed as an independent actor, rather almost as a vassal of the U.S. China sees the EU as one way to break the U.S.' "monopoly" on international relations and its "weaponisation" of the pivotal role of the dollar in the global financial system.

In the third side of the triangular relationship between the world's tripolar economic blocs, President Biden brings a "continuation" of the hard line tone of his predecessor in dealings with the Chinese, but also a "break" -- in that his administration's policies are far more

ideological, “a battle of liberty versus tyranny,” compared with Trump’s more transactional approach. Biden also understands, however, the U.S. can’t slow China’s rise alone and that it needs to build alliances with the Europeans and others, Van Middelaar concluded.

Europeans Drive Record Capital Flows into Chinese Bond Markets

The further internationalization and deepening of China’s capital markets depends on adjustments on both the demand side and the supply side of the equation, in which the CAI will play an important part, AXA IM’s Aidan Yao said. Beijing needs to continue to open up and provide more channels for foreign investors to come in and they will need to have more confidence in the resilience of China’s economy and its investment policies and regulatory framework, and ultimately in Chinese assets themselves.

China has already reached the status of the world’s second largest bond market after the U.S., without much deepening in its capital markets, which AXA IM calculates by dividing the total outstanding volume of debt securities by GDP. By this measure, China’s debt market is about 100% of GDP, compared with around 200% for the U.S. and around 250% for Japan and the Netherlands. It also has the world’s largest green bond issuance at €55 billion in 2019, or 21% of global supply, even before President Xi Jinping’s pledge to the UN last year that China would achieve carbon-neutrality by 2060. A target that it is estimated would require between 100 to 200 trillion renminbi (\$16 - \$32 trillion) in green-related investments over the next 40 years.

Chinese bond markets can therefore potentially accommodate much higher levels of foreign capital inflows, which hit a record one trillion renminbi (\$160 billion) in 2020, led by European investors, with Italy and the mutual investment fund centres of Luxembourg and Switzerland occupying the top three global rankings.

Yao said compared with the extremely low or negative fixed income yields on offer in Europe, the Chinese bond market is very attractive. Current 10-year CDB (China Development Bank) bonds are yielding 3.2% and Chinese high-yield debt over 8.0%.

He added that the “ground-breaking” CAI deal could tighten economic links between China and the EU and might narrow the wide gap between trade and investment flows between the two markets. Yao also said he did not agree with western perceptions the CAI was strongly in favour of the Chinese and argued that, in fact, China has far more to do in further reducing barriers to foreign investment under the deal than the Europeans, even before the safeguards on labour rights and the environment Brussels insisted were built into the agreement, are considered.

Aidan Yao said: “The CAI is really about levelling the playing field, and in this case, China is the one that will have to open its market more to European businesses, rather than the other way around. Now arguably, we will have to measure the execution of the deal. But at this point, when we haven’t even started implementation, to question the CAI as the Europeans surrendering their economic interests doesn’t really make that much sense to me,” Yao said.

Another channel for China to boost the international role of the renminbi is to leverage its position as the world's largest importer of commodities, for example in oil, to challenge the domination of international trade contracts overwhelmingly denominated in U.S. dollars. But Yao told journalists he believed that attaching the Chinese currency to fossil fuels is going to be less important in the future than it was in the past.

Aidan Yao, concluded: "We're entering a new era where economies are going to be run on renewable energy and China is making huge investments in clean technology. Therefore to me, it would make more strategic sense to connect the renminbi to the global evolution of these markets. Data is the 'new oil' and China is leading the world in the development of digital currency. Finding a way to connect your currency to new technologies, things that everybody has to use day in and day out --- then you have a world reserve currency."