13 March 2015

China’s Financial Footprint in Europe

The EU’s crisis-prone periphery has largely welcomed China’s financial penetration of Europe. That’s not a sentiment shared by the Eurozone’s leading states, observes Nicola Casarini. They’re concerned that Chinese investments will make it difficult for Brussels to adopt critical stances against Beijing in the future.

By Nicola Casarini for ISN

China’s financial footprint is spreading across Europe, providing economic benefits for particular in the crisis-hit countries of Eurozone and anxiety for its more established and stable member states. The latter are concerned that a growing reliance on Chinese investment in Southern and Eastern Europe could make it more difficult for the European Union to adopt critical stances toward Beijing.

China’s financial pivot

Beijing’s investment outflows are growing fast and Europe is one of the main beneficiaries of this trend. By the end of 2014, China had invested $54 billion in the stocks of European companies, becoming the fifth largest investor in the ‘Old Continent’ (— after the United States ($3,23 trillion), Canada ($155 billion), Bermuda ($77 billion) and Japan ($56,5 billion)). China has also stepped up its involvement in project financing, mergers and acquisition (M&A) activities, purchased growing quantities of euro-denominated assets and boosted monetary relations with European central banks through currency-swap agreements and Yuan bank clearing.

This financial rebalancing towards Europe is part of Beijing’s broader strategy to export capital and political influence. In 2014, China became a net exporter of capital for the first time after the country implemented legislation that reduces restrictions on outbound investment and encourages companies to look overseas for mergers and acquisitions. In 2013, Chinese outbound investments were at a high of $108 billion, up 23% from a year earlier, bringing total direct offshore investment to $660 billion.

In November 2014, President Xi Jinping announced that Chinese offshore investment will reach $1.25 trillion over the next decade, nearly tripling current Chinese outbound direct investment. This sum includes a $40 billion contribution to the Chinese-led ‘Silk Road Fund’ for infrastructural developments support his vision of a ‘new silk road and maritime silk road’ that links China with Europe and the Mediterranean. To support this vision, Chinese officials have repeatedly declared that Europe is one of the primary destinations of capital outflows, a trend which became evident in the second half of 2014.

Investment spree

While Germany, France and the United Kingdom have long been the preferred destinations of Chinese investments, Beijing is now showing greater interest for Eastern and Southern Europe, in what has been dubbed as the dawn of a second Marshall Plan for the continent's troubled periphery. Since early 2014, the People's Bank of China (PBOC) — through its investment arm, the State Administration of Foreign Exchange (SAFE) — has invested more than â¬3.2 billion on stakes of about 2% each in eight of Italy's largest companies: these include Fiat Chrysler Automobiles, and the state-controlled Eni (oil and gas operator) This has made the PBOC the 12th largest investor in Italy's stock exchange. Moreover, in May 2014 the Shanghai Electric Group bought a 40% stake in power engineering company Ansaldo Energia for â¬400 million. This was quickly followed by China's State Grid's acquisition of a 35% stake in energy grid holding company CDP Reti for â¬2.1 billion.

By the end of 2014, Beijing had invested more than â¬5.8 billion in Italy, a sum which represents around 7% of China's total investments in Europe. The Italian government has unwaveringly supported Chinese investments, a move mirrored by other austerity-hit peripheral countries of the Eurozone. In June 2014, Greece and China signed a ship-building deal worth â¬2 billion, financed by China Development Bank. And in Portugal, Chinese investors swept up 45% of the total assets - mainly infrastructure — put up for privatisation under the Economic Adjustment Programme inspired by the EU and the IMF.

Project financing has emerged as one of the most promising areas for Chinese involvement in Southern and Eastern Europe. At the Third Meeting of heads of government of China and the 16 Central and Eastern European Countries (CEECs) held in Belgrade in mid-December 2104, Chinese Premier Li Keqiang pledged to inject more investment to boost infrastructure and sea and land connections between China and the region, in addition to the 69 cooperation projects between China and the CEECs implemented after the second meeting in Romania in November 2013.

The Balkans has also become a new frontier for Chinese investment. On 17 December 2014, China, Hungary, Serbia and Macedonia agreed to build a land-sea express route by expanding the Budapest-Belgrade rail line to Skopje, Athens and the port of Piraeus in Greece — one of the largest container ports in Europe — where Chinese shipping giant COSCO has a 35-year concession for two piers. Needless to say the corridor will be built and financed by Chinese companies.

Europe's real estate sector is also attracting Chinese investors. Countries like Portugal, Spain, Greece, Cyprus, Lithuania and Hungary have seduced rich Chinese by offering residence permits to those who spend a certain amount on property. Europe's economic crisis has also opened doors to Chinese investors interested in the banking sector where Haitong Securities agreed to pay â¬379 million for Banco Espirito Santo de Investimento in austerity-hit Portugal, and Anbang Insurance — a Chinese financial services company — reached an agreement to buy Delta Lloyd Bank Belgium for â¬219 million.

The purchases reflect that European governments and companies are eager to attract Chinese investment where it is arguably needed most. In October 2014, for instance, the China-British Business Council organised in Beijing the China Outbound Conference where companies from the United Kingdom showcased more than 40 investment opportunities in such sectors as infrastructure and property, advanced technology and retail. Such events demonstrate that a more friendly investment environment — compared with other developed economies such as the US and Japan— and the slower than expected recovery from the debt crisis has made Europe a valuable destination for China as it looks for global opportunities to preserve and increase the value of its reserves.

Monetary connections

Alongside investment in companies, China has also stepped up purchases of euro-denominated assets

and boosted monetary relations with European central banks through currency-swap agreements and Yuan bank clearing.

Today, the Renminbi is the world's second most used trade finance currency and the seventh-ranked global payments currency. More than 50 central banks have so far added the Chinese currency to their portfolios as growing trade ties and a growing number of reforms by Beijing are leading reserve managers to view it as a viable reserve currency. Most of Europe's major central banks have added — or are considering adding - the Chinese currency to their portfolio, often at the expense of the Dollar. In October 2014, for instance, the United Kingdom raised 3 billion Yuan via a landmark offshore sovereign Yuan bond and kept the proceeds into its foreign exchange reserves rather than converting them into Dollars.

In addition, the PBOC has in the past few years signed bilateral currency swap agreements worth more than 3 trillion Yuan ($480 billion) with 28 central banks and monetary authorities. In October 2013, for example, the PBOC and European Central Bank (ECB) signed a bilateral currency swap agreement for a sum of â¬45billion (RMB350 billion), the largest ever signed by Beijing outside the region. In November 2014, the ECB decided to add the Chinese Yuan to its foreign-currency reserves.

The PBOC has also designated a number of Yuan clearing banks, known as RMB Qualified Foreign Institutional Investor (RQFII). Half of these 'Renminbi hubs' are in Europe, in places like London, Frankfurt, Paris, Luxemburg and Prague. On 21 January 2015, China's and Switzerland's central banks signed a RQFII agreement, making Zurich the newest hub for Renminbi trading.

Political implications

China's ultimate goal is to make the Yuan one of the main currencies for global trade and to place limits on the role of the Dollar in the international monetary system. Since 2008, Chinese officials and scholars have maintained that the US is abusing its position as controller of the main reserve currency by pursuing irresponsible economic policies. In March 2009, Zhou Xiaochuan, the PBOC governor, explicitly called for the creation of a new international reserve currency. An op-ed by Xinhua agency on 22 October 2013 did not hesitate to call for a 'de-Americanized' world.

The Euro is seen in Beijing as a counterbalance to the Dollar and instrumental for creating a multipolar currency order where the Renminbi would also have its place. Consequently, China has divested away from the Dollar in recent years and into the Euro. Today, Euro-denominated assets represent around one-third of China's total foreign currency reserves which, at more than US$4 trillion, are the world's largest. This means that Beijing has bought around â¬1.3 trillion.

Eurozone governments and institutions have actively courted Chinese purchases of Euro-denominated assets. Since its establishment in May 2010, the European Financial Stability Facility (EFSF) — replaced in October 2012 by the European Stability Mechanism (ESM) — has actively sought Beijing's support, obtaining concrete pledges for the purchase of Portuguese, Irish and Greek bailout bonds auctioned by the EFSF/ESM â¬440 billion rescue fund. Chinese investors are expected to further step up their asset purchases in Europe after the ECB started its Quantitative Easing (QE) in March 2015.

As China's financial involvement in Europe grows, it will be harder for European governments — in particular in the smaller and weaker countries of the periphery — to adopt a critical stance toward Beijing. This may be the price to pay for benefiting from a chunk of China's massive foreign reserves.

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International Relations and Security Network (ISN)

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