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China's announced FDI gained as much as 39% in 1H16 y-o-y

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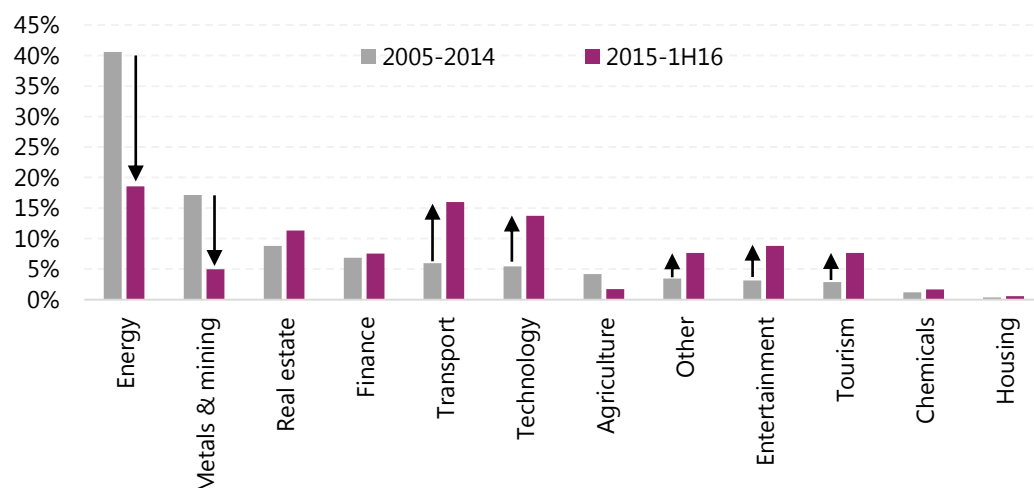
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China no longer invests in raw materials

China's foreign direct investment analysis

The share of new contracts on China's foreign direct investments (FDI)¹ in commodity assets fell to 30% in 1H16 from 53% in 2014 and 80% in 2005-2011. Utilities and metals & mining are quickly phased out by transport, tourism, entertainment and high-tech sectors as preferred investment targets, with the latter four seeing their share growing from 17.4% in 2005-2014 to 46% in 2015-2016. Moreover, Chinese investments are changing their geographical pattern moving away from developing countries towards regions with developed economy and mature postindustrial sector, i.e. to Europe and North America (their share in compound FDI from China climbed over the same period from 38% to 60%).

Figure 1. Chinese investment no longer focus on access to raw materials and product markets, but target technology imports and the services sector instead



Source: MOFCOM, American Enterprise Institute, ACRA estimates

A rapid increase in foreign financial activities has already put China on the second line in the global FDI volume ranking. Despite the observed and expected economic slowdown, the expansion continues. In 1H16, Chinese announced FDI climbed 39% y-o-y, propelled mainly by a) substantial positive current account (#1 on the global scale in dollars and in the top 10 among major economies in relation to GDP) due to trade surplus and b) the effect of the ongoing liberalization of cross-border activities, part of the "Go out" strategy developed in the mid-2000s.

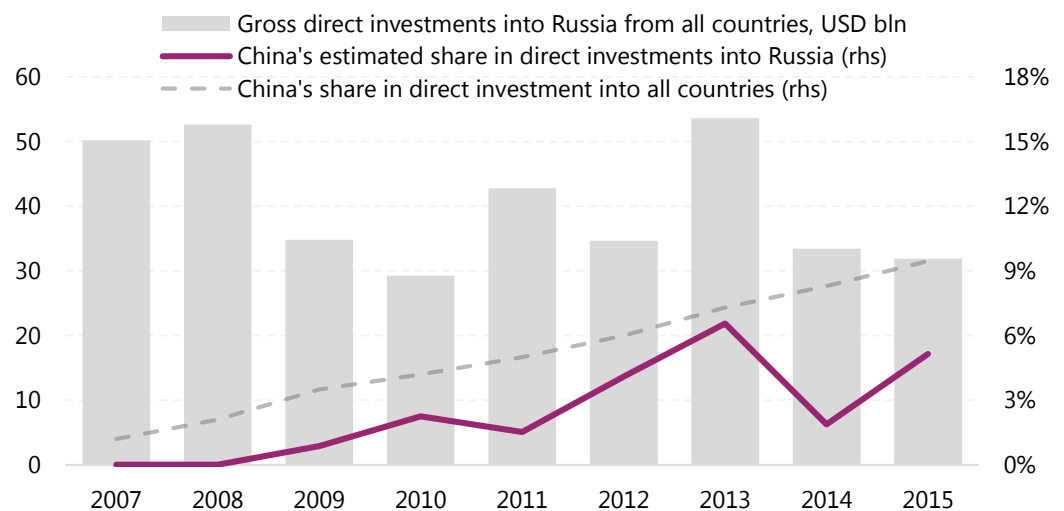
Outbound Chinese investments are likely to continue growing – despite their substantial volume and developed foreign trade, China is not yet sufficiently integrated into the global financial system and its economic authorities seem to pursue that goal. That said, many countries have been facing a slower economic growth starting 2009 and now they have incentives to compete for external funding. They may want to attract investments from China hoping to benefit from its further "globalization".

¹ China Global Investment Tracker data for the 2005-2016 years were used. Unless otherwise stated, further on the text refers to the type of gross direct investments called "participation in capital".

Current trends may reduce Chinese companies' interest to investing in Russia...

At the moment Russia is less open to Chinese investments than other countries on average (Figure 2). Moreover, the above mentioned change in priorities for the Chinese business and state and, accordingly, the shift of the geographical focus for investments may leave Russia aside from the Chinese financial expansion. In fact, despite a record-breaking increase in the volume of new transactions with other countries, China signed no major new deals with Russia in 1H16, while showing only some potential interest to buying into Reftinskaya GRES. About 67% of Chinese investments growth in Russia has been sourced by the primary sector (Table 1), while investments targeting the postindustrial universe will be restrained by a relatively small scale of the services industry in Russia and the closed nature of the country's high technology sector.

Figure 2. China's share in non-financial FDI in Russia stopped growing in 2014²



Source: Bank of Russia, American Enterprise Institute, MOFCOM, UNCTAD, ACRA estimates

In 2016-2020, Chinese FDI to Russia could potentially total USD 9-12 bln on the back of China's continued expansion, provided that the Russian economy maintained the current level of openness. In the new reality, however, this figure may be two to three times lower, which should limit equity financing opportunities in Russia's oil & gas sector capex.

...although the transport sector will retain its strategic attractiveness.

A strategic intersection point for Chinese and Russian economic and political interests may still be large-scale transportation and infrastructure projects linking China with Europe, China's second largest trade partner. Strengthening the role of Russia and Central Asian countries as transit routes requires significant investments in the transport industry and infrastructure.

² China's share in FDI into Russia has been based on the adjusted data on public agreements. The entire amount of a transaction/project has been attributed to the year of the agreement signing.

Table 1. Large announced Chinese FDI projects in Russia, 2006-2015³

Sector	Year	Investor	Partner	Amount, USD mln	Implementation ⁴
Forestry	2006	MCC		120	-
	2013	CIC	Russia Forest Products	100	+
Agriculture and fertilizers	2013	CIC	Uralkali	2,040	+
	2015	ZOJE Resources		440	-
Energy	2006	Sinopec	Rosneft	3,490	+
	2006	CNPC	Rosneft	500	+
	2009	CIC	Nobel Holdings	300	+
	2010	Huadian	JSC Territorial	360	+
	2010	Three Gorges	EuroSibEnerg	170	-
	2011	Three Gorges	EuroSibEnerg	2,290	-
	2013	State Grid	Sintez	1,140	-
	2013	CNPC	Novatek	940	+
	2013	CNPC	Rosneft	620	-
	2013	Shenhua	En+	460	-
	2014	CNPC	Vankorneft	990	-
	2014	Power Construction Corp	RusHydro	1,460	-
	2014	Harbin Electric		450	-
	2015	SAFE	Novatek	1,210	-
	2015	Sinopec	Sibur	1,340	+
Metals & mining	2009	Haicheng Xiyang Group		480	-
	2012	Zijin Mining		100	+
	2012	Norinco	Basic Element	500	-
	2012	CIC	Polyus	420	+
	2013	China Nonferrous	East Siberian Metals	750	+
	2015	Highland Fund	Norilsk Nickel	100	-
Transport and machinery	2011	Fuyao Glass		200	+
	2014	Great Wall Motor		340	+
	2014	Lifan		290	+
Real estate and construction	2006	Group of Shanghai state firms		1,300	+
	2011	China Chengtong		350	-
	2015	Anhui Conch		310	+
Finance	2011	CIC	VTB Group	100	-
	2012	CIC	RCIF	900	+
	2013	CIC	Moscow Stock Exchange	100	+
	2013	China Construction Bank	VTB Bank	100	+
	2015	Cybernaut	Skolkovo Foundation	200	+
High tech	2010	Tencent	Digital Sky Technologies	300	+
	2015	Cybernaut	Skolkovo Foundation	200	+

Source: American Enterprise Institute, ACRA estimates

³ According to the data by China Global Investment Tracker, adjusted by information in the Russian business press.

⁴ “+” – the project is being implemented and funds allocated, or the project has been implemented, “-” – the project has been announced, the agreement has been signed, but no further steps are being taken.

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