Chinese influence in Europe: Enter the dragon?

Recent months have seen China make sizeable investments in European debt securities. Chinese companies, too, see Europe as a major market for foreign investments. However, it would be premature to speak of a 'Chinese invasion'. The investments made by China are a logical consequence of the size of China's economy and the trade relations which it has with Europe. Hence it is in China's own interest to help safeguard stability in the euro zone and to extend sovereign loans there.

In October 2010, the Chinese authorities announced their intention to invest in Greek government paper, followed by similar commitments regarding Portuguese and Spanish paper. Also, the Chinese government has spoken out more than once in favour of stability in the euro area and declared its continued willingness to invest in the peripheral nations. Likewise, the EFSF bonds issued to fund the European support facility were financed largely (30%) by Asian parties, most prominently the Chinese central bank. China sources these investments mainly from its international reserves, while investments by the CIC State fund (China Investment Corporation, China's sovereign wealth fund) and by Chinese private investors have also increased.

China's external reserves

Over the past two decades, China has accumulated huge international reserves. The direct cause of this massive build-up is a combination of a large trade surplus and a more or less fixed exchange rate.

At end-2010, China's international reserves amounted to EUR 2,200 billion. By way of illustration: the country holding the second largest international reserves, Japan, is way behind at EUR 800 billion, whereas the countries of the euro zone, including the ECB, hold almost EUR 600 billion (Table 1).

Table 1: Countries by their international reserves (EUR bn)

1.	China	2.162
2.	Japan	811
-	Euro countries	595
3.	Russia	387
4.	Saudi Arabia	317
5.	Taiwan	294
38.	Netherlands	29

The Chinese external reserves are managed by the State Administration of Foreign Exchange or SAFE, which is part of the Chinese central bank, the People's Bank of China (PBoC). Through its reserves, China has accumulated claims vis-à-vis other countries. In mid-2009, the country held USD 1,350 billion's worth of US government debt. It is generally assumed that the other Chinese investments consist mainly of (government) debt paper denominated in yen, euro and sterling.

Given the currency distribution of other central banks' reserves and also given the US dollar position built by SAFE, from 25% to 30% of China's reserves may be assumed to be held in euros, an amount of EUR 550–650 billion. This sum is held mainly in the form of government bonds, or some 10% of the euro zone's total estimated negotiable sovereign debt. Arguably, the internal distribution of this amount leans towards government debt issued by peripheral countries given the associated higher returns and the (geo)political gains to be made there, especially now that these countries are steeped in worries.

China has several times before come to the economic rescue of peripheral euro countries. In November 2008, for instance, China's State President Hu Jintao undertook to invest EUR 4.3 billion in a container terminal in Greece – a major investment for that country in terms of employment; and for China an opportunity to open up a supply route to Greece's 'hinderland' around the Black Sea. This move was inspired by more than geopolitical motives alone. The EU is China's main trade partner, with the euro area on an equal footing with the United States. Hence the stability of the euro zone is also in China's own interest.

Sovereign wealth funds

Apart from the international reserves managed by the Chinese central bank, the Chinese Ministry of Finance also has its own sovereign wealth fund named CIC. With its estimated USD 332 billion in capital, CIC is in the same order of magnitude as the sovereign wealth funds of other, mainly oil and gas exporting countries (Table 2).

While information on CIC's transactions and investments is still scarce, its foreign investments appear to focus on financial institutions and electric power providers. It holds substantial interests in private equity investors Blackstone and Apax Partners, MorganStanley and several electric power providers. And CIC also seems to hold equity in the largest Chinese banks.

The SWF Institute uses the *Linaburg-Maduell Transparency Index* to compare the transparency and information disclosure of sovereign wealth funds. CIC, at 6 on this 10 point scale, scores above SAFE (2) and several other funds including those of Abu Dhabi (3) and Saudi Arabia (2).

Table 2: Sovereign wealth funds (by managed assets in USD bn)

Abu Dhabi Investment Authority	UAE	627
Norway Government Pension Fund - Global	Norway	512
China Investment Corporation (CIC)	China	332
SAMA Foreign Holdings	Saudi Arabia	289
Government of Singapore Investment Corp (GIC)	Singapore	248
Kuwait Investment Authority	Kuwait	203
Temasek Holdings	Singapore	133
Qatar Investment Authority	Qatar	85
Libyan Investment Authority	Libya	70

Sources: IMF, SWF Institute.

Corporate investment

The Chinese corporate sector also makes large investments in Western Europe. And while many Chinese enterprises continue to be managed (indirectly) by political interests, takeovers in the private sector tend to be nonpolitical in nature and simply a consequence of China's rising star in the global economy. However, China's foreign direct investments have been relatively modest. For instance, it continues to hold less equity in the US than does the Netherlands. This will soon change, however, as Chinese enterprises claim their rightful role on the global economic stage. Table 3 provides an overview of the largest Chinese private takeovers in Europe so far. Ranked by order of magnitude, these took place mainly in the oil and financial services sectors (Figure 1).

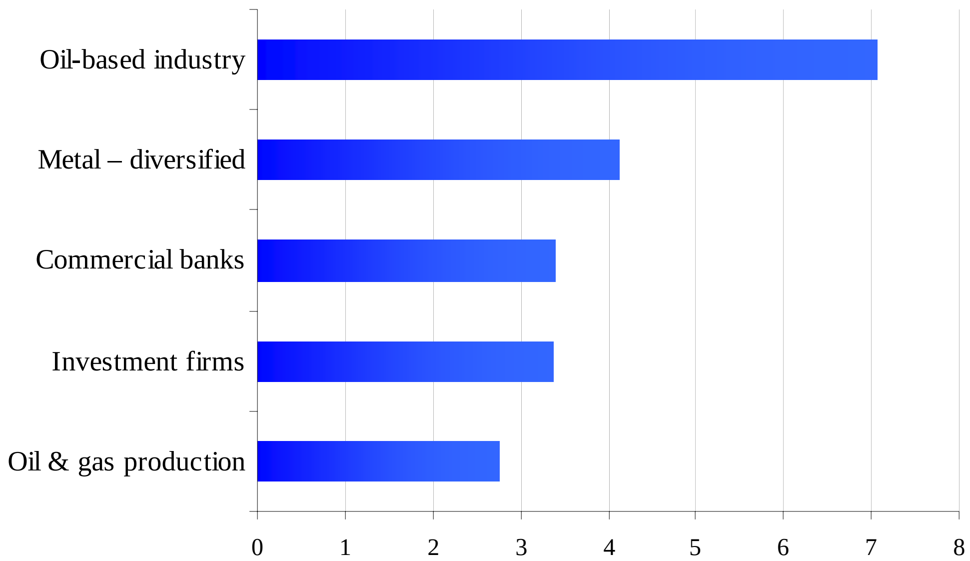
Table 3: largest takeovers by Chinese enterprises in Western Europe

Target	Acquirer	Value (USD m.)
Rio Tinto PLC	China Aluminium Corp & Alcoa (US)	14.135
Barclays PLC	China Development Bank Corp	3.062
COSL Drilling Europe AS	China Oilfield Services Ltd	2.755
Glencore International AG	Multiple acquirers	2.200
Intergen NV	China Huaneng Group Corp	1.232
Telefonica SA	China Unicom Hong Kong Ltd	1.005

Source: Bloomberg

By geographical spread, most direct investments were made in the United Kingdom, followed by Norway, Switzerland and the Netherlands. Where in 2006, a total of 17 such deals were closed, in 2010 the number had doubled. The total value of (announced) takeovers by Chinese enterprises in Western Europe over the 2001–2010 period came to some USD 47 billion, spread across 136 transactions. Whereas the numbers have gone up considerably in recent years, one can hardly speak, given the size of the Chinese economy, of a corporate 'Chinese invasion'. However, the mountain of capital now heaped up by the Chinese government and corporate sectors looks set to make itself increasingly felt in Europe over the next few years – both politically economically.

Figure 1: Total deal size by sector (in USD bn)[1]



Source: Bloomberg.