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Economic Watch

China

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Economic Analysis

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China's outward FDI expands

Summary

In the past several weeks China's Ministry of Commerce has released detailed annual data on 2010 outward foreign direct investment (OFDI). The data reveal a 21.7% increase in OFDI in 2010, to a new historic high of USD 68.8 billion, and resuming an upward trend that was interrupted in 2009 due to the global economic crisis. Net FDI inflows for the year remained positive, but the surplus narrowed due to the pickup in OFDI. By destination, Asia remains the primary recipient of China's OFDI, especially Hong Kong (USD 38.5, equivalent to 56% of total OFDI). Latin America accounted for USD 10.5 billion (15% of the total), Europe USD 6.8 billion (10% of the total), and North America USD 2.6 billion (4%). (Large FDI flows into the tax havens of the British Virgin Islands and the Caymen Islands, of USD 9.6 billion in total, partially obscure the ultimate destination.) OFDI flows to Africa remain strong (USD 2.1 billion). As in previous years, the composition of investment flows is concentrated in services (including trade and finance), mining, transportation, and manufacturing.

The rise in OFDI reflects a continuation of the authorities' "Go-out" policy, whose underlying motivation, as officially stated and emphasized in the most recent 5-year development plan, is to secure energy resources, and to open access for Chinese companies abroad. It may also reflect efforts to ease pressure on China's rising foreign exchange levels and to extend the country's international influence. These factors are likely to continue driving a rise in outward FDI in the years ahead.

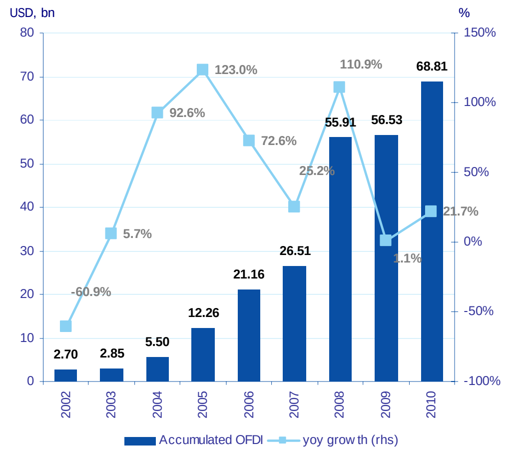
A pickup in China's OFDI

China has aggressively expanded its outward foreign direct investment (OFDI) since joining the WTO in 2001. OFDI has been facilitated by China's massive foreign exchange holdings and the easing of exchange controls under the government's "Go-out" strategy (see Appendix-Table 1.1-1.2 for China's OFDI Policy Framework). The 2008-09 global financial crisis led to a temporary lull in OFDI, but it has since rebounded strongly, as seen in the 2010 annual figures, especially to developed economies. Indeed, the economic crisis may have presented an opportunity to make investments at reduced prices, with a further impetus coming from a steady accumulation of foreign exchange reserves.

- In 2010, China's OFDI amounted to USD 68.8 billion, an increase of 21.7% yoy, after stagnating in 2009. In the first two quarters of 2011, OFDI recorded USD 26.2 billion, a slower, but still substantial 17% gain over the same period in 2010. OFDI in non-financial sectors reached USD 60.2 billion in 2010, up 25.9% YoY, while OFDI in the finance sector remained flat at USD 8.6 billion, after hitting a record high of USD14 billion in 2008 (USD 6.7 billion went into the financial sector in the first half of 2011).
- From 2002 to 2010, the average annual growth of OFDI amounted to 49.9% and by the end of 2010, the total stock of OFDI reached USD 317.2 billion. (Charts 1&2). China surpassed Japan and United Kingdom in FDI outflows and hit a historical high.

- In 2010, FDI outflows were, in order of magnitude, to Hong Kong, the British Virgin Islands (BVI), Cayman Islands, Luxemburg, Australia, Sweden, the United States, Canada and Singapore, amounting to a collective 58.0 billion, or 84.2% of total OFDI outflows.
- In both stock and flow terms the top 5 sectors in 2010 included business services, financial, wholesale and retail, mining, and transportation, accounting for around 82% of total FDI outflows. This compares to a share of over 90% in 2008, implying that China's outward direct investment flows have become more diversified.

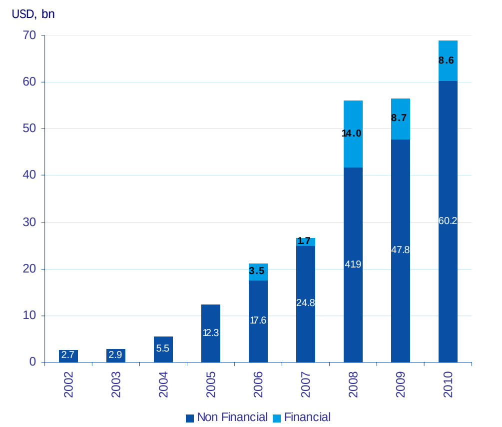
Chart 1
China's OFDI is growing again



Note: Including both financial and non-financial OFDI

Source: Ministry of Commerce and BBVA Research

Chart 2
Growth of OFDI is mainly led by investment in non-financial sectors



Note: Including both financial and non-financial OFDI

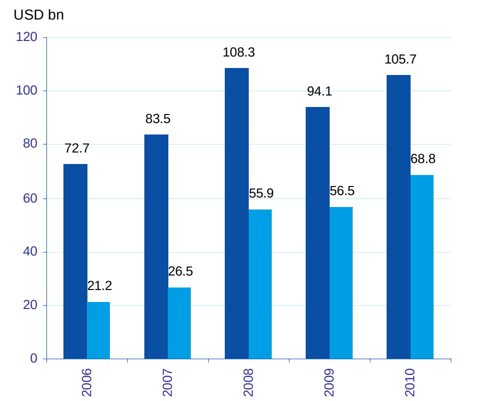
Source: Ministry of Commerce and BBVA Research

Table 1
China's domestic enterprise distribution (2010)

	No.of Enterprises	Share	Main Countries
Asia	8,591	53.3%	Hong Kong, Vietnam, Japan, United Arab Emirates, Laos, Singapore, Korea, Indonesia, Thailand
Europe	2,386	14.8%	Russia, Germany, UK, Italy, Netherlands, France
Africa	1,955	12.1%	Nigeria, South Africa, Zambia, Ethiopia, Egypt, Sudan, Algeria
North America	1,867	11.6%	US, Canada
Latin America	791	4.9%	BVI, Brazil, Cayman Islands, Mexico, Chile, Argentina, Peru
Oceania	517	3.2%	Australia, New Zealand, Pupua New Guinea, Fiji

Source: Ministry of Commerce and BBVA Research

Chart 3
China's inward and outward FDI



Source: CEIC and BBVA Research

Outward FDI is likely to continue to grow

Two factors continue to drive the growth in China's OFDI. First, is the political/strategic factor. For example, Premier Wen Jiabao delivered a report at the Fourth Session of the Eleventh National People's Congress on March 5, 2011, in which he further emphasized the government's "go global" strategy, including to, "improve relevant support policies, simplify examination and approval procedures, and provide assistance for qualified enterprises and individuals to invest overseas."

The second factor is a further accumulation of international reserves (to USD 3.2 trillion at present (Table 2). This has continued to put pressure on the PBoC to sterilize the impact, and has generated further tensions with trading partners over currency appreciation.

Table 2
China Foreign Reserve

(USD billion)	2007	2008	2009	2010
Foreign Exchange Reserves	1,528	1,946	2,399	2,847
Trade Balance	263	298	196	182
FDI	84	108	94	106
Portfolio Flows	116	11	163	160

Source: CEIC and BBVA Research

Geographical destinations

A large share of Chinese OFDI continue to go to tax havens (especially the Cayman Islands and BVI) and through Hong Kong to other destinations (including perhaps to China due to roundtripping), making it very hard to make sense of OFDI figures by destination.

Nevertheless, if we exclude flows directed to tax havens and focus on the official figures, Asia is still the most important region for China's OFDI both in flow and stock terms. The main destinations, in order, are Hong Kong, Singapore and Macao (Table 3&4, Chart 4-5-6-7). China's OFDI in ASEAN countries is not large (the total stock amounted to USD 14.35 billion in 2010) with Singapore still accounting for a major share of the total for ASEAN (around 42%,) and a more diversified second group of FDI receivers, including Burma, Indonesia, Cambodia and Thailand (Chart 8).

In terms of growth rates, Europe and North America have outpaced other regions in attracting FDI from China, with yoy growth of 102% and 72% yoy, respectively, in 2010. FDI to Africa continues to grow fast, at 47% in 2010. China's outward investment in Latin America has rebounded strongly, increasing by 44% in 2010, following a 99% rise in 2009. The growth reflects Latin American's rich commodity endowment and China's warming international relations with the region. In contrast, OFDI in Oceania (including Australia) has stagnated.

Table 3
2010 OFDI Outflow Distribution: USD bn

	OFDI Outflow	YOY Growth	Main Countries
Asia	44.89	11%	Hong Kong, Singapore, Burma, Thailand, Iran, Cambodia
Latin America	10.54	44%	BVI, Cayman Islands, Brazil, Peru
Europe	6.76	102%	Luxemburg, Sweden, Russia, Germany, Hungary, UK, Norway
North America	2.62	72%	United States, Canada
Africa	2.11	47%	South Africa, Congo DR, Niger, Algeria, Nigeria, Kenya
Oceania	1.89	-24%	Canada, US

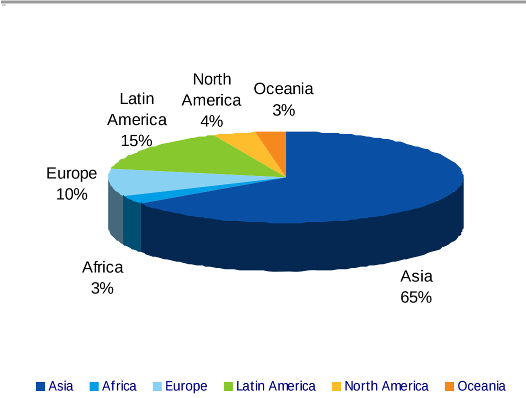
Source: Ministry of Commerce and BBVA Research

Table 4
2010 OFDI Stock Distribution: USD bn

	OFDI Stock	Main Countries
Asia	228.15	Hong Kong, Singapore, Macau, Burma, Pakistan, Kazakstan, Mongolia, Indonesia, Cambodia, Japan, Thailand, Vietnam, Laos, UAE, Saudi Arabia, Korea
Latin America	43.88	BVI, Cayman Islands, Brazil, Peru, Venezuela, Panama, Argentina, Guyana, Mexico
Europe	15.71	Luxemburg, Russia, Germany, Sweden, UK, Netherlands, Hungary
Africa	13.04	South Africa, Nigeria, Zambia, Algeria, Congo DR, Sudan, Niger, Ethiopia, Angola, Egypt, Tanzania, Mauritius, Madagascar
Oceania	8.61	Austrialia, Pupua New Guinea, New Zealand, Western Samoa
North America	7.83	United States, Canada

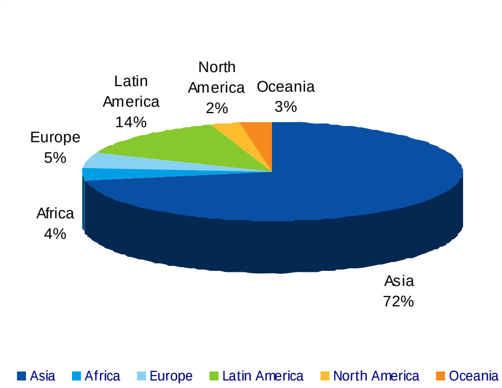
Source: Ministry of Commerce and BBVA Research

Chart 4
2010 OFDI outflow (Total USD 68.81 bn)



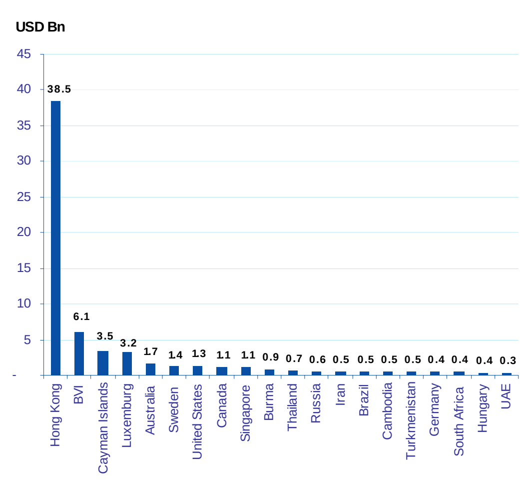
Source: Ministry of Commerce and BBVA Research

Chart 5
OFDI stock as of 2010 (Total USD 317.21 bn)



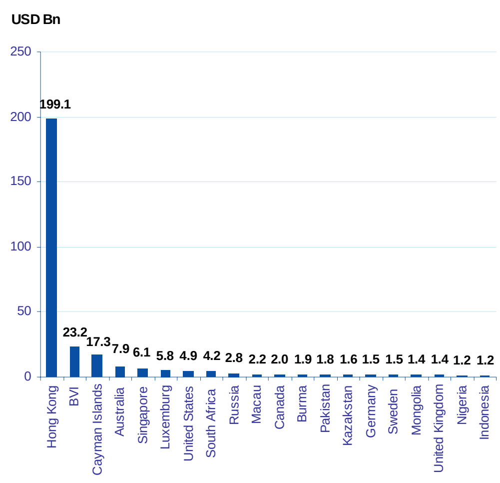
Source: Ministry of Commerce and BBVA Research

Chart 6
OFDI flow in 2010 in top 20 countries/regions



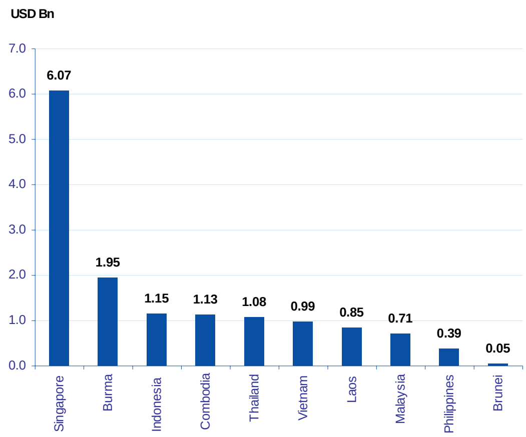
Source: Ministry of Commerce and BBVA Research

Chart 7
OFDI stock as of 2010 in top 20 countries/regions



Source: Ministry of Commerce and BBVA Research

Chart 8
OFDI Stock to Asean10 as of 2010 (Total USD 14.35 bn)



Source: Ministry of Commerce and BBVA Research

OFDI by sector

Among the industries that are attracting most OFDI, is the service sector (including trade and finance), although its share has declined. OFDI in business services, finance, wholesale & retailing, etc., totaled 66 percent of the total OFDI in 2010, down from 76 percent in 2008.

OFDI in the mining sector, after doubling in 2009, has dropped significantly by 57%, while that in transportation, manufacturing, real estate, construction sectors all rebounded strongly, by 173%, 108%, 72%, 352%, respectively, in 2010. (Table 5)

In the countries/regions with the most China's OFDI outflow, Hong Kong, BVI, Cayman Islands, and Luxemburg all have business service industry as the top one to attract it, Singapore has electricity industry, manufacturing in Sweden and the U.S., and mining is in Australia and Canada. (Table 6)

Table 5
China's OFDI by Industries (2004 - 2010) USD mn

	OFDI outflow							Stock as of 2010
Industry	**2004**	**2005**	**2006**	**2007**	**2008**	**2009**	**2010**	
Leasing & business service	749	4942	4522	5607	21717	20474	30281	97246
Finance			3530	1668	14048	8734	8627	55253
Mining	1800	1675	8540	4063	5824	13343	5715	44661
Wholesale and Retail Trade	800	2260	1114	6604	6514	6136	6729	42006
Transport,Storage & Post	829	577	1376	4065	2656	2068	5655	23188
Manufacturing	756	2280	907	2127	1766	2241	4664	17802
Information Transmission, Computer Service	31	15	48	304	299	278	506	8406
Real Estate	9	116	384	909	339	938	1613	7266
Construction	48	82	33	329	733	360	1628	6173
Scientific Research, Technical Service	18	129	282	304	167	776	1019	3967
Production and Supply of Electricity, Gas & Water	78	8	119	151	1313	468	1006	3411
Residential & Other Service	88	63	112	76	165	268	321	3230
Agriculture, Forestry, Husbandry, Fishing	289	105	185	272	172	343	534	2612
Water Conservancy, Enviro & Public Utility Mgt	1	0	8	3	141	4	72	1133
Accommodation & Catering Service	2	8	3	10	30	75	218	450
Culture, Sport & Recreation	1	0	1	5	22	20	186	346
Health Care, Social Security & Welfare	0	0	0	1	0	2	34	36
Education			2	9	2	2	2	24
Public Management & Social Organization	0	2						
Total	**5498**	**12261**	**21,164**	**26,506**	**55,907**	**56,529**	**68,811**	**317211**

Source: Ministry of Commerce and BBVA Research

Table 6

2010 OFDI outflow by top regions: USD bn

	OFDI Outflow	Major Industries
Hong Kong	38.51	Business Service, Finance, Wholesale & Retail Trade, Transport, Real Estate, Manufacturing
BVI	6.12	Business Service
Cayman Islands	3.50	Business Service
Luxemburg	3.21	Business Service
Australia	1.70	Mining, Real estate, Manufacturing
Sweden	1.37	Manufacturing
United States	1.31	Manufacturing, Business service, Construction, Mining, Wholesale & Retail Trade
Canada	1.14	Mining, Wholesale & Retail Trade, Manufacturing, Business Service
Singapore	1.12	Production and Supply of Electricity, Gas & Water, Mining, Business Service

Source: Ministry of Commerce and BBVA Research

Appendix:

1. China's OFDI Policy Framework

Table 1.1: China's OFDI Policy Evolution

Phase 1: Tight Controls 1979—1983	Restrictive attitude toward OFDI due to ideological skepticism, inexperienced, and low foreign exchange reserves. Only specially designated trade corporations could apply for OFDI projects. No regulatory framework was existent; firms had to apply for direct, high-level approval from the State Council on a case-by-case basis.
Phase 2: Cautious encouragement 1984—1991	As global markets gained more importance, the government gradually started to encourage OFDI projects that generated foreign technology, control over resources, access to overseas markets, and foreign currency. The first regulatory framework for OFDI was drafted in 1984-85, allowing companies other than trading firms to apply for OFDI projects. However foreign exchange reserves were still at a low level and only firms that earned foreign exchange from overseas activities could qualify for OFDI projects.
Phase 3: Active encouragement 1992—1996	The post-Tiananmen decision to accelerate economic reforms and global integration led to a policy of more active encouragement of OFDI. The goal was to increase the competitiveness of Chinese businesses, with a special focus on 100 plus state-owned national champions. The foreign exchange regime shifted from an "earn-to-use" to a "buy-to-use" policy and the OFDI approval procedures were gradually eased and localized.
Phase 4: Stepping back 1997-1999	Government tightened regulatory processes for OFDI projects and recentralized foreign exchange acquisition against the backdrop of the Asian financial crisis, which revealed that many firms had used OFDI projects for illegal and speculative transactions, leading to heavy losses of state assets and foreign exchange reserves.
Phase 5: Formulation & implementation of the "Go-out" policy 2000—2006	In anticipation of WTO accession and growing competition in domestic markets, policymakers returned to their previous stance of encouraging OFDI and announced a policy package aiming at supporting Chinese firms from various sectors to "go abroad". In 2004, the regulatory process was reformed and foreign exchange controls were further eased and localized. Central officials and local governments begun to provide broad and active political and practical assistance for firms with overseas expansion plans.
Phase 6: Growing political support for transnational corporations and a new push for liberalization 2007—2009	Policymakers' support for outbound FDI further increased both because of China's massive foreign exchange reserves (surpassing \$2 trillion in 2009) and the need to build up competitive transportation corporations to sustain a change in China's economic growth model. A new regulatory framework implemented in May 2009 further eased and decentralized the approval procedures. New rules proposed by SAFE in the same month will significantly ease the foreign exchange management for overseas projects and broaden the sources of financing available for outbound investment.
Phase 7: Accelerating the "Go-out" strategy during the new "12th Five-year Plan" period (2011-2015) 2010—present	In the latest "12th Five-year Plan", the government emphasised to accelerate the implementation of the "Go Out" strategy. The new outline encourages Chinese enterprises to expand overseas under policy guidance based on the principals of market orientation and corporate autonomy. It implies a shift to a more balanced weighting of both inward and outward FDI. Meanwhile, the "go out" policy is also linked with the ongoing process of RMB internationalization. The PBoC announced new rules for promoting FDI outflows with RMB settlements in early 2011.

Source: Working Paper Number PB09-14, Peterson Institute of International Economics and BBVA Research.

Table 1.2: Changes and updates in the regulatory framework for OFDI

	Approval Process
Ministry of Commerce (MOFCOM) Administrative measures on regulation of outbound investment Effective May 1, 2009 In the late 2010, China's National Development and Reform Commission (NDRC), the Ministry of Commerce (MOFCOM) and the Taiwan Affairs Office of the State Council issued "Measures for the Administration of the Mainland Enterprises' Investment in Taiwan Region", as a specific guideline under the current regulatory framework to promote investment cooperation between both sides of the Straits. Effective November 9, 2010	● All outbound investments need to be submitted to MOFCOM for approval; outbound investment is defined as (a) establishing new overseas firms; (b) merging with, acquiring, or obtaining controlling stakes in an existing firm; or (c) reinvestment in an existing overseas subsidiary. ● An investment needs to be approved by central MOFCOM if the investment volume exceeds $100 million, involves an offshore purpose vehicle for the purpose of listing overseas, if it concerns the interests of multiple countries, or if the investment is to take place in a politically sensitive territory (as defined in a list by MOFCOM and other relevant authorities). ● An investment needs approval by provincial-level MOFCOM authorities if the investment volume is between $10 million and $100 million, or if the investment is made in the areas of energy and natural resources. ● If the investment is below $10 million and does not meet any of the above mentioned criteria, it qualifies for a special approval procedure: The application can be submitted electronically to the responsible MOFCOM bureau (local offices for local firms, central MOFCOM for centrally administered firms); the approval process should not take more than three business days. ● If approved, firms get an outbound investment certificate, which they can use for the following 2 years to proceed with other necessary formalities, for example foreign exchange purchase or bank loans. ● In addition to MOFCOM approval, investors must also consider the interests of other competent government agencies, if applicable; this includes entities such as National Development and Reform Commission (NDRC), the State Administration of Foreign Exchange (SAFE), the State-Owned Assets Supervision and Administration Commission (SASAC), or industry regulators such as the China Banking Regulatory Commission (CBRC) or the China Insurance Regulatory Commission (CIRC).
	Foreign exchange management
State Administration of Foreign Exchange (SAFE) Draft regulations of foreign exchange administration for domestic enterprises' overseas direct investments Draft rules published for comment in May 2009 The People's Bank of China (PBoC) Draft "Administrative Measures for the Pilot RMB Settlement of Outward Direct Investment" to assist in the pilot RMB settlement in cross-border trade and provide conveniences for banking financial institutions and domestic institutions to conduct the RMB settlement of outward direct investment (ODI). Announcement No.1 [2011] Effective January 6, 2011	● Firms will no longer have to submit an application including the source of funding for approval to SAFE; instead, companies must register at the local SAFE bureau and can report the funding source after the investment took place. ● Companies will be allowed to use a broader range of funding sources for overseas investments than in the past: they can use their own foreign exchange, recycle retained profits from overseas, and purchase foreign exchange with renminbi; renminbi-denominated OFDI will also be permitted on a trial basis. ● Domestic institutions will be allowed to provide loans, financing guarantees, and follow-up financing for overseas firms in which they are invested. ● Remittances will only have to be registered ex post instead of being approved in advance, and early-stage expenses of up to 15 percent of the total investment volume will be allowed. ● SAFE will further streamline its administrative procedures with other regulatory authorities; there will be an annual joint examination of outbound FDI projects together with MOFCOM. ● The People's Bank of China (PBOC) and the State Administration of Foreign Exchange (SAFE) shall administer the pilot RMB settlement of outward direct investment pursuant to the "Administrative Measures for the Pilot RMB Settlement of Outward Direct Investment".
State Administration of Foreign Exchange (SAFE) Notice on the administration of cross-border loans by domestic enterprises Effective August 1, 2009	● All firms that meet certain standards will be allowed to make cross-border loans to overseas units. ● Eligible firms can transfer up to 30 percent of the value of their total equity to offshore subsidiaries. ● The permitted sources of loan funds include firms' own foreign exchange holdings, renminbi-purchased foreign exchange, and other funds approved by local SAFE bureaus.

Source: Working Paper Number PB09-14, Peterson Institute of International Economics and BBVA Research.

Table 2: Top 50 Non-Financial Enterprises with OFDI Stock (2010)

Rank	Nameof Enterprise
1	China Petrochemical Corporation
2	China National Petroleum Corporation
3	China National Offshore Oil Corporation
4	China Resources (Holdings) Co.,Ltd.
5	China Ocean Shipping (Group) Company
6	China National Cereals,Oils & Food suffs Corp.
7	Aluminum Corporation of China
8	China Merchants Group
9	Sinochem Corporation
10	China Unicom Corporation
11	China State Construction Engineering Corporation
12	China Minmetals Corporation
13	China National Aviation Holding Corporation
14	SINOTRANS Changjiang National Shipping (Group) Corporation
15	SinoSteel Corporation
16	CITIC Group
17	China Shipping (Group) Company
18	China Huaneng Group
19	China Mobile Communications Corporation
20	China Metallurgical Group Corp.
21	China Power Investment Corporation
22	China National Chemical Corporation
23	ZTE Corporation
24	Hunan Valin Iron & Steel (Group) Co. Ltd
25	Geely Holding Group
26	Legend Holdings Ltd.
27	Shum Yip Holdings Company Limited
28	China Nonferrous Metal Mining&Construction (group) Co.,Ltd.
29	China Communication Construction Company Ltd.
30	GDH Limited
31	China North Industries Group Corporation
32	Wuhan Iron & Steel (Group) Corporation
33	SINOHYDRO Co., Ltd
34	State Grid Corporation of China
35	Shougang Corporation
36	Anshan Iron&Steel Group Corporation
37	Shenhua Group Corporation Ltd.
38	Shanghai Baosteel Group Corporation
39	China Guangdong Nuclear Power Holding Co., Ltd.
40	CRCC-Tongguan Investment Co., Ltd.
41	Beijing Enterprises Group Company Limited
42	China Telecom
43	China Chengtong Holdings Group Ltd.
44	Yanzhou Coal Mining Company Limited
45	Aviation Industry Corporation of China
46	China Datang Corporation
47	Huawei Technologies Co.,Ltd.
48	Shanghai Overseas United Investment Co., LTD
49	Guangzhou Yuexiu Holdings Limited
50	Jinchuan Group Ltd.

Source: Ministry of Commerce

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