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Special Report | Fixed Income | CEE
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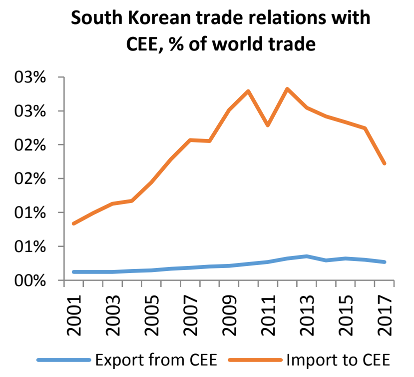
China's presence in CEE

- Despite increasing volume of trade, China remains minor trade partner for CEE
- Chinese investments focused on transport, energy and technology sectors
- Chinese financing still less attractive for CEE than EU funds

Source: Trade Map, Erste Group Research



Source: Trade Map, Erste Group Research

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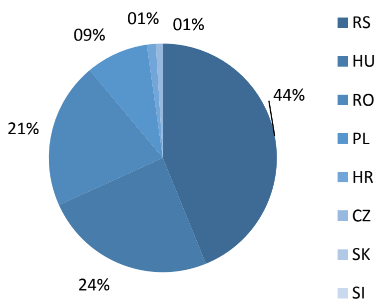
For the past half-decade, China has been attempting to increase its presence in the CEE region, both in terms of trade and political influence, but recently interest has visibly increased. While trade and investment links between China and the CEE region have grown over the last decade, growth has not hit declared values and did not meet the expectations of some of the CEE countries. In our view, the current level of Chinese presence in the region is not threatening and should not have significant influence on those markets.

Trade relations between China and CEE countries intensified in the early 2000s. Before joining the EU, we saw gradual growth in imports from China to the region and that accelerated in 2007. Despite strengthening trade relations, direct links between China and CEE remain rather small. As of 2016, the biggest importer of Chinese goods in CEE was Poland, with import volume equal to EUR 13.6bn, which corresponds to 7.8% of Polish imports, i.e. 3.2% of GDP. On the other hand, exports from the CEE region to China have been rather stable over the last two decades. The biggest exporter to China is Hungary, with export volume of EUR 3.1bn, which corresponds to 3.1% of total Hungarian exports and 2.7% of GDP. Although, the volume of trade has been increasing in recent years, CEE region countries remain a minor import partner to China; total volume of Chinese imports to the region amount to 3.2% of GDP of the region, whereas CEE exports stand at only 1.1% of GDP. The majority of imports to CEE covers such goods as electrical machinery and mechanical appliances. Hence, sensitive sectors for CEE economies such as automobiles or iron and steel production should not be affected by the inflow of Chinese products.

Although attention on links between China and CEE has been growing, there are also other Asian countries with non-negligible exposure to the region. For example, looking at the development of trade relations with South Korea, we can observe a different picture. In the early 2000s, imports to the CEE region grew rapidly and reached 2.8% of the value of global exports from South Korea in 2010; however, since then we have observed a gradual decline in trade volumes from South Korea. As of 2016, import volumes to the CEE region amounted to only 1.2% of total GDP of the region, and exports to only 0.2% of GDP.

Chinese construction projects by country, 2007 - 2017



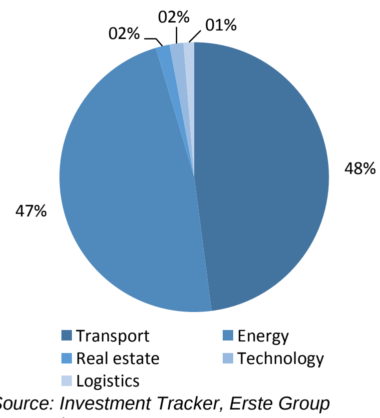
Source: Investment Tracker, Erste Group Research

The Chinese presence in the region is not only focused on trade relations. Recently, China has also been pursuing investment opportunities in the region, as is evidenced by the increasing value of Chinese transactions. In the last ten years, the value of construction projects co-financed with China amounted to EUR 8.2bn (0.7% of GDP of region in 2017), with almost 90% of this conducted in Serbia, Hungary and Romania. These projects focus mostly on the transport, energy and technology sectors. For example, in Hungary, Chinese companies operate in the ICT sector (Huawei, Lenovo, ZTE, Comlink), but are also market players in the solar panel sector or provide lighting technology. In Slovakia, the Chinese presence focuses on the ICT sector (Huawei, Lenovo) as well as automotive industry (SaarGummi, ZVL Auto). Moreover, Slovakia is supposed to be under consideration as a destination for Chinese plants for electro-mobiles (Zhi Dou) or tires (Linglong). Although we have seen investment growth in the region, Chinese companies are not ranked among the top 20 companies in manufacturing. However, we can find among them two South Korean companies with total revenue of EUR 9.6bn in 2017 (Kia Motors in Slovakia, Hyundai Motors in the Czech Republic). Nonetheless, the Chinese investments are mostly acquisitions, not 'greenfield' projects.

Box1: CEFC China biggest Chinese investor in Czech Republic

CEFC was founded in 2002 as a small oil trader and has rapidly increased its market share through acquisitions. Recently, CEFC became a conglomerate with interests not only in the oil industry but also in overseas media. The CEFC China presence in the CEE region has focused mainly on the Czech Republic. However, there has been increasing concern about whether CEFC is a purely commercially-driven company or is operating under the influence of the Chinese government. In recent months, CEFC China has been involved in a series of unclear deals, which, after the arrest of Ye Jianming, the chairman and executive director of CEFC China Energy on suspicion of economic crimes, seem to be highly irregular. The deals that had been in the pipeline, i.e. the acquisition of a majority stake in the J&T bank operating in the Czech Republic, Slovakia and Croatia or participating in media purchases in the Czech Republic and Slovakia, have not taken place. Another concern which arises from CEFC operations in Czech Republic is political influence at the highest levels, as Ye was an honorary advisor on economic cooperation with China to Czech president Milos Zeman.

Chinese construction projects by sectors, 2007 - 2017



Source: Investment Tracker, Erste Group Research

At the end of 2017, the Chinese Prime Minister announced that China plans to invest an additional EUR 2.4bn in the already existing fund of EUR 8.9bn. This announcement again triggered discussion about tensions between the EU, CEE and China. The EU is mostly concerned about the geopolitical leverage which those investments might trigger, especially in a region in which euro-skepticism has recently been growing. Moreover, Chinese financing mechanisms do not have to be the most attractive way of funding for the EU-CEE countries that can benefit from EU Cohesion Funds. The biggest advantage of using EU funds is that they are classified as transfers not liabilities and do not have to be repaid. However, while Chinese financing might not seem as attractive to EU-CEE countries, it is much more significant in the Western Balkans, which have only limited access to EU grants. Moreover, the main drawback of Chinese financing is the requirement to use specific Chinese instead of local contractors.

Box2: **Initiatives aiming at deepening China and CEE integration comes with risk**

China’s Belt and Road Initiative (BRI) was introduced by the Chinese president in 2013 and is a development campaign which provides a framework of integrating the country more deeply into the world economy. The BRI consists of two economic corridors: the Silk Road Economic Belt (the Belt) and the 21st century Maritime Silk Road Initiative (the Road) encompassing around 65 countries in Asia, Europe and Africa. The main aim of the BRI is to boost trade and stimulate economic growth across Asia and beyond.

An essential part of the BRI of special importance to CEE is the ‘16+1’ initiative, which brings together 16 CEE region countries (11 are EU members and 5 Balkan states). China sees the CEE region as a gateway to Europe and would like to increase its political and economic influence in Europe. The initiative focuses mainly on heavy investments in infrastructure such as the planned high-speed railway between Belgrade and Budapest. Despite the fact that the ‘16+1’ initiative is presented only as an investment initiative, it comes together with strong political engagement. That is perceived by the EU as a threat in case Chinese investments drive a wedge between states that stay inside or outside the ‘16+1’. Inside the European Union, Hungary seems to be standing out as being the strongest official backer of China’s intentions.

Source: Bloomberg

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