

UK finance aims to keep China links despite souring relations

As the UK navigates geopolitical ‘crosscurrents,’ London financial center hopes to remain West’s link to China.

by Matei Rosca | Jun 9, 2020, 11:30 AM CET

The British financial sector hopes to ride out the rise in political tensions with China, but even the most sanguine bankers expect there to be some fallout.

Following a pattern seen in other Western countries, Britain is courting a backlash from Beijing as it questions its response to the coronavirus, the reliability of global supply chains, Chinese investment in U.K. industry, human rights and political self-determination in Hong Kong.

Financial services, already bruised by Brexit, now face another instance where much is at stake, yet the sector's interests are not a priority for politicians reconsidering relations with a trading partner.

“We are in the middle of a storm here,” said one executive in the London arm of a large U.S. bank, who's also familiar with its operations in Asia. “It would be naive to think that nothing changes, but we are optimistic. A recalibration of the relationship with China seems inevitable but the financial sector is not high on the list of targets.”

British banks HSBC and Standard Chartered have nonetheless been dragged into the fray in recent days.

Under pressure from a former chief executive of the Chinese administration for Hong Kong, both of the Asian-focused banks have reportedly expressed support for the national security law that has rekindled street demonstrations — and which the British government opposes.

Spokespersons for the banks declined to comment for this article. The case nonetheless illustrates how the financial industry is at the same time a bridge and a pawn in East-West relations.

Growing hostility

This was meant to be a "golden era" for U.K.-China commerce, as promised by then-Prime Minister David Cameron and his Chancellor George Osborne.

The City of London financial center was along for the ride, building up the world-leading market trading hub for renminbi outside China or Hong Kong, clearing some £82 billion worth per day between July and September last year, and rising — until the coronavirus hit.

The novel pathogen, which first came to the world's attention in the Chinese city of Wuhan, has changed the conversation.

Where he lambasted "bizarre autarkic rhetoric" three months before, Prime Minister Boris Johnson began to push for "self-sufficiency" in manufacturing as shipments of medical gear from China were deemed defective. He also signaled a retreat from his previous openness to letting Huawei supply parts of the U.K.'s 5G telecommunications network.

Now China's move to tighten control over Hong Kong puts Johnson under pressure to uphold a guarantee of democracy in the former colony.

In parliament, Conservative critics of Beijing created a China Research Group in April, following the template of Brexiteers' European Research Group.

CRG founder Neil O'Brien said there had been "a shift in thinking across all democratic countries."

"The coronavirus crisis has underlined for people what the problems are with the Chinese government's secrecy, their authoritarianism, their very aggressive response to reasonable questions," he told POLITICO in an interview.

China's ambassador to the U.K., Liu Xiaoming, has hit back at critics, saying they are "addicted to the Cold War mentality" and will "poison" the relationship.

The Chinese embassy in Britain did not respond to emailed questions about the ongoing political disputes.

Financial interests

The City is caught in the middle, and not just from the renminbi trading hub.

Thanks largely to the likes of StanChart and HSBC — originally the Hongkong and Shanghai Banking Corporation, and which has considered moving headquarters to Hong Kong in recent years — the British banking system ranks as the world leader in Chinese business, as measured by \$195 billion in consolidated claims on counterparties in China as of the end of 2019. (The figures include U.K. units of Chinese banks.)

The London and Shanghai stock exchanges also have a link, allowing investors on either side to buy some securities directly on the other market. The connection was

switched on in 2019 after years of haggling, and, while not free of political controversy, remains a potential asset for British finance.

China media have reported Beijing might move the listing of some Chinese firms from New York to London in response to U.S. lawmakers pushing for tougher rules on foreign companies.

“With the London-Shanghai connect already in place, the business here could scale up very quickly,” said Artur Baluszynski, director and head of research at Henderson Rowe, a London asset manager.

“However, this doesn’t mean that the City is in a strong negotiating position ... the City will have to work hard to attract Chinese business,” he said by email. For example, he said Chinese companies will be keen to avoid stringent public disclosures usually imposed on premium listings in the U.K.

A Chinese diplomat in London wrote on Twitter last month, “We hope the U.K. will provide fair, transparent, non-discriminatory policy environment for Chinese investors.”

The British financial industry meanwhile is waiting for Beijing, after allowing more capital to flow out of the country for investment elsewhere, to fully open the taps.

“It is about politics,” Baluszynski said. “London was set to become the hub for Chinese business on this side of the Atlantic, but due to Chinese geopolitical interests, it ended up a bit of a disappointment.”

Letting flowers bloom

The financial sector has worked to ingratiate itself with the Chinese.

The City of London Corporation, a governing body for the financial district and often a semi-official commercial diplomat for the British government, has provided space for Huawei to showcase its latest products at the London Guildhall, and it created a secretariat in London and Beijing to promote sustainable investment as part of China’s “One Belt One Road” initiative. A spokesman for the corporation declined to comment for this article.

British alongside American banks were among the first to take advantage when China began allowing foreign finance companies to own controlling stakes in businesses there.

“We have no reason to think geopolitics will stop the opening up of China’s financial sector in its tracks,” said the London executive of the U.S.-based bank. “There could be some trouble but [Beijing leaders] know it’s a good thing for China.”

Finance links also fit with China's plan to expand its business model beyond cheap manufacturing, into services, research and high-end consumption.

"On financial services, this is what the Chinese leadership is keen [on] to transform its economy," said Yu Jie, a senior fellow researching China at London's Royal Institute of International Affairs.

"The U.K. has been set as an example that China aspires to be," she said, making it unlikely that the Communist Party will seek to punish London firms for government policy, the same way it has Australian farmers and coal miners.

Still, she warned, "The U.K. will continue to be squeezed between China and the U.S., this situation will not ease but worsen as the COVID-19 outbreak passes."

Crosscurrents

Britain's "special relationship" with another former colony — America — also creates complications for the City of London, according to Harry Broadman, a former trade negotiator and economic policy adviser in multiple U.S. administrations.

Besides pressure from President Donald Trump to take a harder line against Beijing, the British government has to juggle Brexit talks and its historical baggage in Hong Kong.

"There are a lot of crosscurrents here and the Chinese see them," Broadman said over the phone from his home on the Chesapeake Bay near Washington.

"Johnson presumably has a China free-trade agreement on the agenda for some time in the future ... but now he is sending a lot of mixed signals."

When the current tensions eventually cool down and the U.K. moves to attend to its trade ambitions with China, experts expect the banks, securities firms and money managers to be at the forefront of some form of future cooperation.

"London's financial center is of interest to China," Broadman said.