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Investment Event

EU and China agree investment deal

Following seven-years of negotiations, the EU and China have tentatively approved an investment deal

Market access for European companies will be improved

Chinese firms will benefit from locking in existing EU market access rights

Our views

For European businesses, the deal could mean improved access and new opportunities as well as fairer competition in China's markets

The deal also sends a strong signal of China's commitment to reforms and opening up

We remain overweight in European and Chinese equities

EU and China agree in principle an investment deal

After seven years of talks, the European Union (EU) and China have reached an agreement in principle, on investment. The Comprehensive Agreement on Investment (CAI) aims to create a better balance in the EU-China trading relationship, as the EU has traditionally been much more open than China to foreign direct investment (FDI).

Better market access and level playing field

How does the EU benefit?

According to the EU, market access for European companies will be improved by "prohibiting forced technology transfers and other distortive practices" (such as state subsidies and perceived favouritism towards state-owned enterprises). The deal also opens a route for EU to resort to a dispute resolution mechanism in case of a breach of commitments.

There are also sector-by-sector market access rights, removing requirements such as entering into joint ventures with local firms, and removing caps on levels of investment. Sectors that are set to benefit include manufacturing, automotive, financial services, telecoms, real estate and transport.

And what does China get out of it?

The EU market is already open to Chinese investment with very few restrictions. Nevertheless, the CAI will lock in existing rights and improve market access in some manufacturing and (renewable) energy sectors, albeit with some restrictions (e.g. renewables access capped at 5% of each EU member state's market, and subject to reciprocal openness from China).

Greater inward FDI into China can also boost domestic competition between firms, helping to raise productivity and innovation.

What happens now?

Both sides are now working towards finalising the text of the agreement, which will need to be legally reviewed and translated before it can be submitted for approval by the EU Council and the European Parliament. The EU is aiming for the deal to take effect in early 2022. Both sides have also set a two-year deadline for the conclusion of negotiations on an additional investment protection agreement.

Investment implications

FDI flows between the EU and China are currently a small fraction of both economies' overall GDP. So although this deal has the scope to significantly boost these flows, from a macroeconomic perspective we do not expect a major *direct* impact on economic growth in either region. However, the *indirect* impacts also need to be considered, for example the effect of greater FDI on competition and innovation in markets.

The deal will have important sector-by-sector impacts. China has made significant commitments on manufacturing, the most important sector for EU investment in China. Within this, European carmakers are already well established in China and account for the largest share of inward FDI. As such, these firms are well positioned to take advantage of better market access rights to gain a greater foothold in the steadily growing Chinese market.

Within the context of **European equity markets**, where we maintain an overall overweight position, this could see some scope for outperformance of those markets more heavily weighted to manufacturing (including autos) such as Germany.

We also **remain positive on China's equities**. China's economic recovery is strong and broadening out across sectors that have lagged such as services. The EU-China CAI sends a clear signal of China's commitment to greater reforms and opening up (as part of the 'dual circulation' strategy).

This deal also follows another mega trade deal, the Regional Comprehensive Economic Partnership (RCEP), that China signed with 14 Asia-Pacific nations on 15 November. Overall, these deals reduce the perceived risk of economic "de-coupling" and concerns about massive supply-chain reallocation out of China. President Xi has also indicated that China will proactively consider joining the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP).

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