Global Counsel

Brexit upside for Chinese investors

Blog post by Chief Economist Gregor Irwin, 07 July 2016

I have spent this week in Shanghai and Beijing explaining the likely consequences of the vote for Brexit to investors and hearing their views.

The referendum result has surprised Chinese investors as much as anyone, but the real shock has been the political mess that has followed. The ups and downs of the Conservative leadership contest, the disarray in the Labour party, and the difficulty a new government will have in defining and implementing a new relationship with the EU are hard enough to explain, let alone justify. Make no mistake – Chinese investors are well informed. I have been particularly surprised by questions on the legal interpretation of Article 50, the means by which Jeremy Corbyn might be deposed, and the prospects for Scottish independence.

From a Chinese perspective the UK system looks unstable right now, and of course they are right. The inevitable consequence is that this will constrain outside investment for some time. There is also concern about what Brexit means politically in the rest of Europe, but this is tempered by an assumption that the British mess will discourage others from following the same course.

Chinese investors are, however, always looking for opportunities. For some – if they are careful – there are tempting opportunities amid the fall-out from the referendum.

This is partly because the decrease in the value of the pound, and the slide in stock prices across Europe, means acquisitions are cheaper. It is hard to gauge whether prices now fully reflect changed fundamentals, given the weaker outlook. But for many Chinese investors this is a second order concern. It is remarkable just how many say they want to acquire technology or expertise that can be exploited in the Chinese market. For these investors now is a good time to buy. The technology is more valuable to them than it is to European companies in sectors that are largely closed to non-Chinese firms. With European asset prices lower, the gap in valuations is proportionately higher.

In some sectors there is also recognition that the European regulatory environment may be more accommodating. One of the biggest barriers to an outward acquisition can be regulatory approval, most obviously in financial services, but also in some other sectors. The precise legal hurdles vary, but in most cases there is some regulatory discretion and this can be an important factor in determining whether an investment is viable. Right now – with several European countries in great need of outside investment – that regulatory discretion is likely to be used to the fullest possible extent.

Chinese investors are constrained by government restrictions and official caution regarding capital outflows, but only partly. If the business case is good, either approval will be forthcoming, or funds can be raised outside of China. The political uncertainty in the UK probably means it is just too hot to handle right now for all but the bravest investors. But don’t be surprised if some look to buy in other parts of the EU, particularly in troubled economies where the need for outside investment is most acute. At some point, when the political dust settles, they may look for opportunities in the UK as well.