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## Domestic Trade

- Retail sales of consumer goods gain 10.7% yoy in 2015.
- Ex-factory prices of industrial products continue to drop.
- Household income posts slower growth in 2015.
- All couples are allowed to have two children.
- Minimum down-payment ratio lowered for first-time home buyers in cities without purchase restrictions.
- Top leaders pledge to focus on 'supply-side reforms'.
- Confidence among entrepreneurs in the secondary industry weakens.

## Foreign Trade

- Both exports and imports continue to record yoy declines in 4Q15.
- Exports to the US, ASEAN and India show positive growth in 2015.
- FDI maintains positive growth in 2015.
- Foreign exchange reserves fall to the lowest level in three years.
- Chinese yuan appreciates against its trading partners by 3.9% in real terms in 2015.
- China lowers import tariff rates on several types of consumer products.
- China to establish cross-border e-commerce comprehensive pilot areas in more cities.

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## Part 1: Domestic Trade



## Part 2: Foreign Trade






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# Executive Summary



## Domestic Trade

Retail sales of consumer goods reached 30,093.1 billion yuan in 2015, up nominally by 10.7% yoy. Online retail sales of goods, which accounted for 10.8% of total retail sales, surged by 31.6% yoy in 2015.

Ex-factory prices of industrial products have continued to drop. The producer price index of industrial products fell by 0.6% mom in December, falling for the twenty-fourth month in a row.

Household income posts slower growth in 2015. The nominal growth rate of the per capita disposable income of households decelerated to 8.9% yoy in 2015 from 10.1% yoy in 2014.

All couples are allowed to have two children. According to the newly amended Population and Family Planning Law, all couples are allowed to have two children effective from 1 January 2016, marking the end of the three-decade-long one-child policy.

The minimum down-payment ratio has been lowered for first-time home buyers in cities without purchase restrictions. This was the second time in four months that China cut the minimum down-payment ratio for first-time home buyers in cities without purchase restrictions. The government has continued its efforts to boost the property sector.

Top leaders pledge to focus on 'supply-side reforms' in the Central Economic Work Conference held on 18-21 December. More emphasis will be put on tackling the overcapacity problem, reducing housing inventories, and cutting taxes and fees on enterprises this year.

Confidence among entrepreneurs in the secondary industry has weakened. China's Entrepreneur Confidence Index (ECI) for the secondary industry came in at 108.9 in 4Q15, falling for the third consecutive quarter.

## Foreign Trade

Both exports and imports continued to show negative yoy growth in 4Q15. Exports contracted by 5.0% yoy in 4Q15, posting negative yoy growth for three consecutive quarters. Imports dropped at a slower pace, by 11.8% yoy, in 4Q15, after falling by 14.4% yoy in 3Q15.

Exports to the US, ASEAN and India grew by 3.4% yoy, 2.1% yoy and 7.4% yoy respectively in 2015. In contrast, exports to the EU and Japan fell by 4.0% yoy and 9.2% yoy respectively last year.

FDI grew by 5.6% yoy to reach US$ 126.3 billion in 2015. The share of the service sector in the total FDI went up to 61.1% in 2015 from 55.4% in 2014, while the share of the manufacturing sector fell to 31.4% in 2015 from 33.4% in 2014.

Foreign exchange reserves fell to the lowest level in three years, amounting to US$ 3.33 trillion as at the end of 2015. Overall, in 2015, China's foreign exchange reserves dropped sharply by US$ 512.7 billion.

Chinese yuan appreciated against its trading partners by 3.9% in real terms in 2015, according to the Bank for International Settlements.

China has lowered import tariff rates on several types of consumer products, effective from 1 January 2016. These consumer products include bags and suitcases, clothes, scarves, blankets, vacuum-insulated mugs, sunglasses, etc.

Cross-border e-commerce comprehensive pilot areas will be established in more cities, including Tianjin, Shanghai, Chongqing, Hefei, Zhengzhou, Guangzhou, Chengdu, Dalian, Ningbo, Qingdao, Shenzhen and Suzhou. According to the government announcement, the 'six major systems and two platforms' adopted in the China (Hangzhou) Cross-Border E-Commerce Comprehensive Pilot Area will be introduced to these new pilot areas.

# A Recent developments

## 1. China's real GDP growth moderates

According to the National Bureau of Statistics, China's real GDP growth edged down to 6.8% year-on-year (yoy) in 4Q15 from 6.9% yoy in 3Q15 *(see exhibit 1)*. On a quarter-on-quarter basis, the real growth of seasonally-adjusted GDP decelerated to 1.6% in 4Q15 from 1.8% in 3Q15. These figures indicate that the Chinese economic growth has been softening. Overall, in 2015, China's nominal GDP amounted to 67.8 trillion yuan, up by 6.9% yoy in real terms.

The tertiary industry has continued to grow faster than the secondary industry. The value-added of the tertiary industry, which contributed 50.5% of China's nominal GDP in 2015, gained 8.3% yoy in real terms in 2015. Meanwhile, the value-added of the secondary industry, which contributed 40.5% of the country's nominal GDP, increased 6.1% yoy in real terms over the same period.

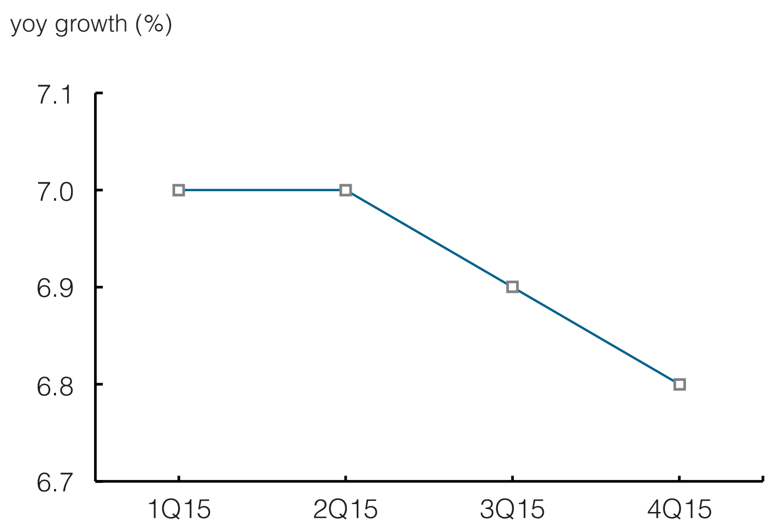
Compared to investment, consumption has played a more important role in boosting the economic growth. In 2015, the contribution by the final consumption expenditure to the GDP growth was 66.4%, 15.4 ppts higher than that in 2014.

As export demand is set to remain weak, the government will continue its efforts to boost domestic demand in coming future. On the monetary front, we expect to see further interest rate reductions this year. On the fiscal front, the government is likely to increase fiscal expenditure and public investment in near future. Meanwhile, the government will push forward structural reforms, especially the 'supply-side reforms'. As part of its efforts to carry out the 'supply-side reforms', the government will focus on tacking problems of overcapacity, reducing housing inventories, and cutting taxes and fees on enterprises this year.

Going forward, we forecast the real GDP growth to stay stable at around 6.8% yoy in 1Q16. We do not expect to see a V-shaped recovery of the economy this year, as the policy focus has shifted to 'supply-side reforms' instead of boosting short term growth.



**Exhibit 1** China's real GDP growth, 1Q15 to 4Q15




| FY15 | 6.9% |
|---|---|
| 1Q15 | 7.0% |
| 2Q15 | 7.0% |
| 3Q15 | 6.9% |
| 4Q15 | 6.8% |

Source: National Bureau of Statistics, PRC

## 2. Growth of retail sales stabilizes

According to the National Bureau of Statistics, the growth of China's total retail sales of consumer goods edged up from 11.0% yoy in October to 11.2% yoy in November, the highest level since January 2015, before dropping slightly to 11.1% yoy in December. The month-on-month (mom) growth of seasonally-adjusted retail sales stayed in the range of 0.82% - 0.85% in October to December. These figures indicate the relatively stable growth of China's retail sales in the past three months.

Overall, in 2015, the total retail sales of consumer goods reached 30,093.1 billion yuan. The nominal growth rate was 10.7% yoy in 2015, compared to the 12.0% yoy growth seen in 2014 *(see exhibits 2 and 3).*

In 2015, China's online retail sales of goods rose strongly by 31.6% yoy to reach 3,242.4 billion yuan, accounting for 10.8% of China's total retail sales of consumer goods.



**Exhibit 2** China's total retail sales, year-on-year nominal growth, January 2014 to December 2015


| FY15 | 10.7 |
|---|---|
| Jan-Feb 15 | 10.7 |
| Mar | 10.2 |
| Apr | 10.0 |
| May | 10.1 |
| Jun | 10.6 |
| Jul | 10.5 |
| Aug | 10.8 |
| Sep | 10.9 |
| Oct | 11.0 |
| Nov | 11.2 |
| Dec | 11.1 |

Source: National Bureau of Statistics, PRC

**Exhibit 3** China's total retail sales, month-on-month nominal growth, July to December 2015

*mom growth (%), seasonally adjusted*

| | Jul 15 | Aug | Sep | Oct | Nov | Dec |
|---|---|---|---|---|---|---|
| Total retail sales | 0.80 | 0.91 | 0.88 | 0.82 | 0.85 | 0.82 |

Source: National Bureau of Statistics, PRC

Rural retail sales have been growing faster than urban retail sales. In 2015, rural retail sales expanded by 11.8% yoy to reach 4,193.2 billion yuan, while urban retail sales rose by 10.5% yoy to 25,899.9 billion yuan.

The pace of retail sales growth diverged for different modes of sales: The nominal growth for catering services sales improved from 9.7% yoy in 2014 to 11.7% yoy in 2015. In contrast, the nominal growth for sales of goods decelerated to 10.6% yoy in 2015 from 12.2% yoy in 2014.

Retail sales of goods by enterprises above a designated size[1] rose 7.9% yoy to reach 13,389.1 billion yuan in 2015. By product category, sales of 'telecommunications equipment' achieved the fastest growth (29.3% yoy), boosted by the strong demand for smartphones. The growth in sales for 'clothing, shoes, hats and textiles' came in at 9.8% yoy over the same period, down from the 10.9% yoy growth seen in 2014. Sales of 'petroleum and related products' dropped by 6.6% yoy, partly attributed to the fall in fuel prices. Exhibit 5 demonstrates the growth of China's retail sales by product among enterprises above a designated size.

**Exhibit 4** China's total retail sales, 2014 to 2015

| *Nominal growth, yoy (%)* | FY14 | 1Q15 | 1H15 | 1-3Q15 | FY15 |
|---|---|---|---|---|---|
| Total retail sales | 12.0 | 10.6 | 10.4 | 10.5 | 10.7 |
| Goods | 12.2 | 10.5 | 10.3 | 10.4 | 10.6 |
| Sales by enterprises above a designated size | 9.8 | 7.8 | 7.4 | 7.5 | 7.9 |
| Online sales | NA | 41.0 | 38.6 | 34.7 | 31.6 |
| Catering services | 9.7 | 11.3 | 11.5 | 11.7 | 11.7 |

Source: National Bureau of Statistics, PRC



## 3. Consumer confidence becomes weaker

The consumer confidence index[2] fell from 104.1 in November to 103.7 in December, the lowest level since November 2014, indicating the relatively weak confidence among consumers *(see exhibit 6).*

## 4. Household income posts slower growth

In 2015, the per capita disposable income of households in China amounted to 21,966 yuan. The growth rate decelerated to 8.9% yoy in nominal terms (or 7.4% yoy real) in 2015 from 10.1% yoy in nominal terms (8.0% yoy real) in 2014.

The growth of rural household income has outpaced the growth of urban household income. In 2015, the per capita disposable income of rural households increased nominally by 8.9% yoy (or 7.5% yoy real) to reach 11,422 yuan; while the per capita disposable income of urban households rose by 8.2% yoy in nominal terms (or 6.6% yoy real) to reach 31,195 yuan.

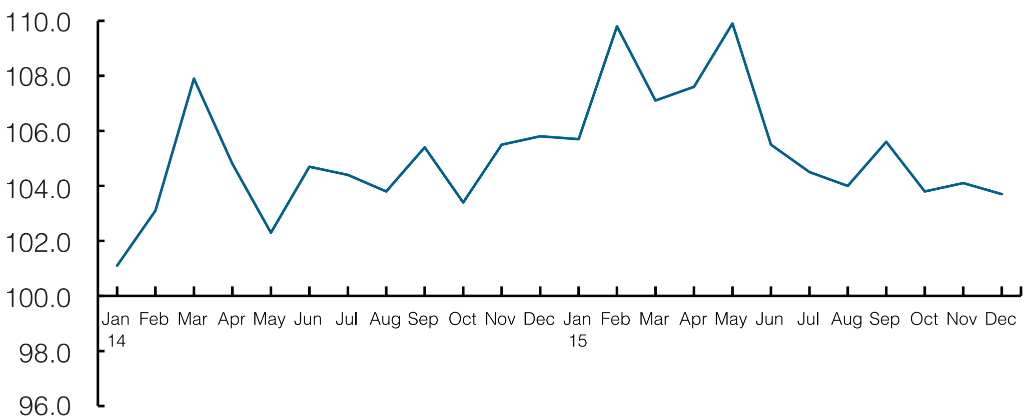
1 'Enterprises above a designated size' refers to enterprises with annual sales of 5 million yuan or more and with an employee strength of 60 or more.
2 A reading above 100 indicates that consumers tend to be optimistic; a reading below 100 indicates that consumers tend to be pessimistic.

**Exhibit 5** China's retail sales by enterprises above a designated size, by product, 2014 to 2015

| *Nominal growth, yoy (%)* | FY14 | 1Q15 | 1H15 | 1-3Q15 | FY15 |
|---|---|---|---|---|---|
| Grain, oil and food | 11.6 | 10.9 | 12.6 | 14.2 | 15.1 |
| Beverages | 11.6 | 12.8 | 13.8 | 15.4 | 15.3 |
| Tobacco and liquor | 9.1 | 9.7 | 10.9 | 12.1 | 12.7 |
| Clothing, shoes, hats and textiles | 10.9 | 10.5 | 10.7 | 10.2 | 9.8 |
| Cosmetics | 10.0 | 10.1 | 9.2 | 9.0 | 8.8 |
| Gold, silver and jewellery | 0.0 | 3.6 | 5.2 | 7.4 | 7.3 |
| Products for daily use | 11.6 | 14.9 | 12.7 | 11.8 | 12.3 |
| Sports and entertainment products | 1.8 | 8.9 | 11.7 | 14.5 | - |
| Home appliances and video equipment | 9.1 | 13.7 | 10.7 | 10.8 | 11.4 |
| Chinese and Western medicines | 15.0 | 15.1 | 14.5 | 14.7 | 14.2 |
| Stationery and office accessories | 11.6 | 14.2 | 14.3 | 15.3 | 15.2 |
| Furniture | 13.9 | 15.4 | 16.5 | 16.7 | 16.1 |
| Telecommunications equipment | 32.7 | 38.0 | 37.0 | 35.8 | 29.3 |
| Petroleum and related products | 6.6 | -7.2 | -6.5 | -6.9 | -6.6 |
| Automobiles | 7.7 | 6.5 | 4.6 | 4.2 | 5.3 |
| Building and decoration materials | 13.9 | 15.8 | 17.4 | 18.6 | 18.7 |

Source: National Bureau of Statistics, PRC

**Exhibit 6** China's consumer confidence index, January 2014 to December 2015




| | |
|---|---|
| Jan 15 | 105.7 |
| Feb | 109.8 |
| Mar | 107.1 |
| Apr | 107.6 |
| May | 109.9 |
| Jun | 105.5 |
| Jul | 104.5 |
| Aug | 104.0 |
| Sep | 105.6 |
| Oct | 103.8 |
| Nov | 104.1 |
| Dec | 103.7 |

Source: National Bureau of Statistics, PRC

## 5. CPI growth rebounds

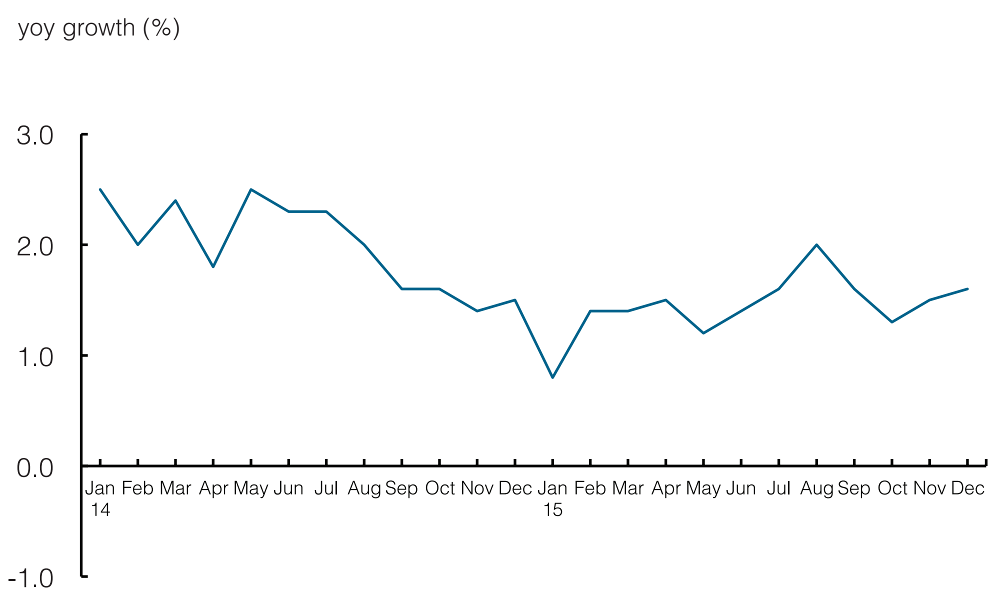
The year-on-year (yoy) growth rate of China's consumer price index (CPI)[3] rebounded from the recent low of 1.3% yoy in October to 1.5% yoy in November and 1.6% yoy in December.

The rebound in the CPI growth was largely due to the rise in the yoy growth of the food component in the CPI, which went up from 1.9% yoy in October to 2.3% in November and 2.7% in December. Meanwhile, the yoy growth of the non-food component in the CPI edged up from 0.9% in October to 1.1% in November and in December *(see exhibits 7 and 8)*.

Looking ahead, we expect that the non-food inflation will stay at around the current level in the near future, amid weak domestic demand and falling crude prices; and food prices may stay high during the wintertime. Overall, in our view, the CPI growth is likely to be mild in the coming months.



**Exhibit 7** China's CPI growth, January 2014 to December 2015




| | |
|---|---|
| Jan 15 | 0.8% |
| Feb | 1.4% |
| Mar | 1.4% |
| Apr | 1.5% |
| May | 1.2% |
| Jun | 1.4% |
| Jul | 1.6% |
| Aug | 2.0% |
| Sep | 1.6% |
| Oct | 1.3% |
| Nov | 1.5% |
| Dec | 1.6% |

Source: National Bureau of Statistics, PRC

3 The CPI, compiled by the National Bureau of Statistics of China, measures the price of a basket of goods and services purchased by a typical household.

**Exhibit 8** China's CPI growth by commodity, July to December 2015

| *yoy growth (%)* | Jul 15 | Aug | Sep | Oct | Nov | Dec |
|---|---|---|---|---|---|---|
| Food | 2.7 | 3.7 | 2.7 | 1.9 | 2.3 | 2.7 |
| Tobacco and liquor | 3.6 | 3.8 | 3.8 | 3.8 | 3.8 | 3.9 |
| Clothing | 2.9 | 2.9 | 2.8 | 2.4 | 2.2 | 2.0 |
| Household goods and maintenance services | 1.0 | 1.0 | 1.0 | 0.8 | 0.8 | 0.8 |
| Medical and healthcare and personal care | 1.9 | 1.9 | 2.1 | 2.2 | 2.6 | 2.5 |
| Transportation and communication | -1.8 | -2.1 | -2.1 | -1.9 | -1.4 | -1.3 |
| Recreational, educational products and services | 1.7 | 1.8 | 1.4 | 1.1 | 1.2 | 1.3 |
| Housing | 0.8 | 0.8 | 0.8 | 0.6 | 0.7 | 0.8 |

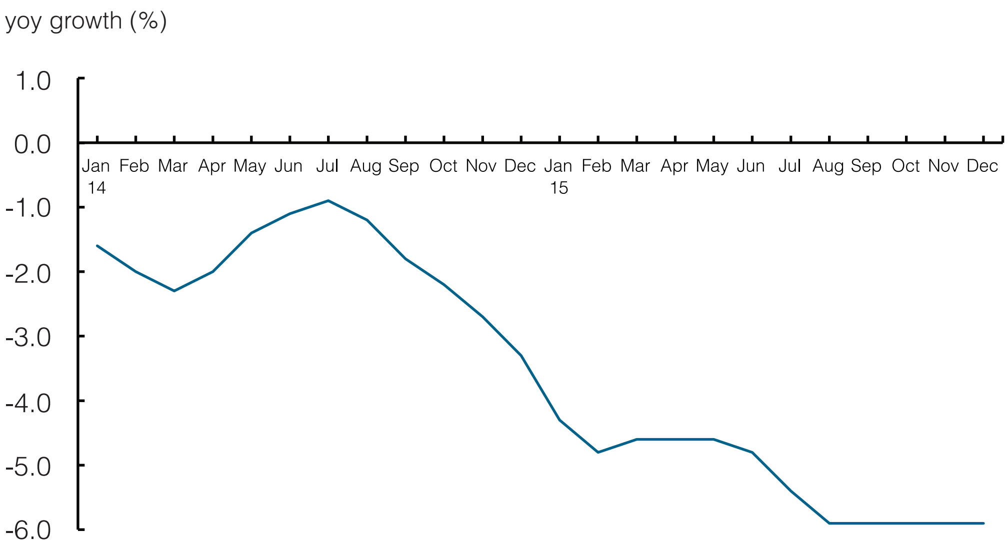
Source: National Bureau of Statistics, PRC

China's producer price index of industrial products (PPI)[4] registered the fifth consecutive minus 5.9% yoy growth in December, starting from August *(see exhibits 9 & 10)*. On a month-on-month (mom) basis, the PPI dropped by 0.6% in December. In fact, the mom growth of the PPI has been in the negative territory since January 2014, indicating the continuous downtrend of the ex-factory prices of industrial products. In our view, this price trend can be associated with the problems of overcapacity in many sectors in China.

In the coming months, we expect that the deflation for industrial products will continue, as both domestic demand and foreign demand are likely to remain weak. The yoy growth of China's PPI is therefore expected to stay at low level.

4 The PPI, compiled by the National Bureau of Statistics of China, measures the prices of industrial products when they are sold for the first time after production.

**Exhibit 9** China's PPI growth, January 2014 to December 2015




| | |
|---|---|
| Jan 15 | -4.3% |
| Feb | -4.8% |
| Mar | -4.6% |
| Apr | -4.6% |
| May | -4.6% |
| Jun | -4.8% |
| Jul | -5.4% |
| Aug | -5.9% |
| Sep | -5.9% |
| Oct | -5.9% |
| Nov | -5.9% |
| Dec | -5.9% |

Source: National Bureau of Statistics, PRC

**Exhibit 10** China's PPI growth by selected industry, July to December 2015

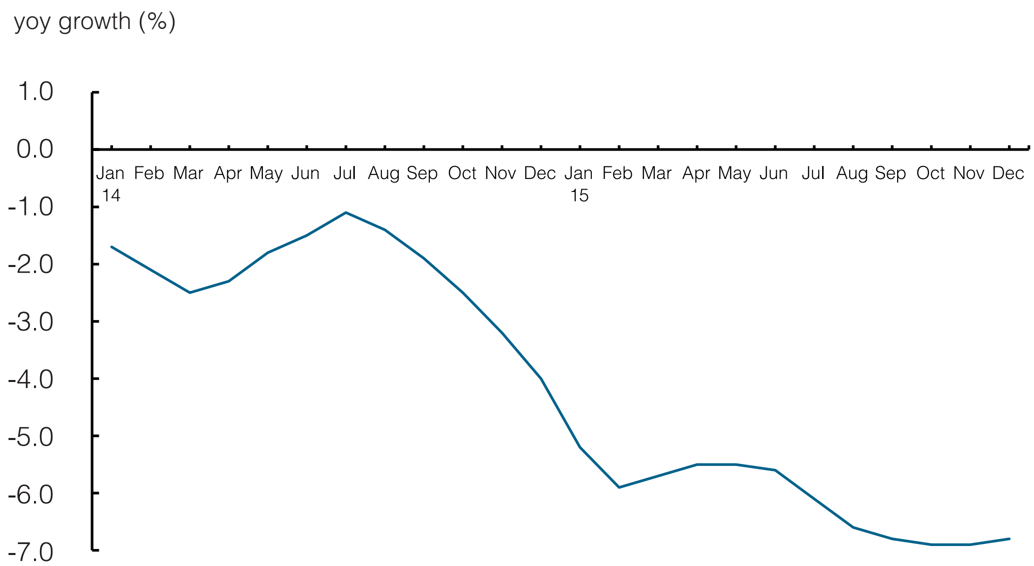
| *yoy growth (%)* | Jul 15 | Aug | Sep | Oct | Nov | Dec |
|---|---|---|---|---|---|---|
| Textile industry | -2.5 | -2.5 | -2.5 | -2.3 | -2.2 | -2.2 |
| Textile and clothing | 0.7 | 0.7 | 0.9 | 0.8 | 0.8 | 0.6 |
| Timber processing & wood, bamboo, cane, palm fiber and straw products | -0.3 | -0.6 | -0.5 | -0.7 | -0.8 | -1.0 |

Source: National Bureau of Statistics, PRC

The yoy growth rate of the purchaser price index of industrial products fell to minus 6.9% in October and November, before rebounding slightly to minus 6.8% in December *(see exhibits 11 & 12)*. On a mom basis, the purchaser price index dropped by 0.6%, 0.7% and 0.7% in October, November and December respectively, indicating that the deflationary pressures on the domestic prices of production inputs persist. Manufacturers have continued to see a drop in their costs of raw materials.

The input prices sub-index of China's manufacturing PMI, a leading indicator of upstream prices, improved from 41.1 in November to 42.4 in December and 45.1 in January. In our view, the latest index reading suggests that the price deflation of production inputs may start to decelerate in the near term.

**Exhibit 11** Growth of China's purchaser price index of industrial products, January 2014 to December 2015




| | |
|---|---|
| Jan 15 | -5.2% |
| Feb | -5.9% |
| Mar | -5.7% |
| Apr | -5.5% |
| May | -5.5% |
| Jun | -5.6% |
| Jul | -6.1% |
| Aug | -6.6% |
| Sep | -6.8% |
| Oct | -6.9% |
| Nov | -6.9% |
| Dec | -6.8% |

Source: National Bureau of Statistics, PRC

**Exhibit 12** China's purchaser price index of industrial products by selected commodity, July to December 2015

| *yoy growth (%)* | Jul 15 | Aug | Sep | Oct | Nov | Dec |
|---|---|---|---|---|---|---|
| Fuel & power | -11.1 | -11.8 | -12.3 | -12.4 | -11.5 | -11.0 |
| Non-ferrous metals | -7.5 | -9.4 | -9.7 | -9.6 | -11.3 | -12.0 |
| Raw materials for the chemical industry | -5.8 | -7.0 | -7.6 | -7.7 | -7.6 | -7.0 |
| Timber and paper pulp | -0.9 | -0.7 | -0.5 | -0.5 | -0.6 | -0.7 |
| Textile raw materials | -2.2 | -2.2 | -2.1 | -2.0 | -1.9 | -1.6 |

Source: National Bureau of Statistics, PRC

## 6. Growth of industrial production stabilizes

The growth rate of China's value-added for industry (industrial production, IP) stayed between 5.6% yoy and 6.2% yoy during 4Q15, after fluctuating between 5.7% yoy and 6.1% yoy during 3Q15. We believe that the recent trend of China's IP growth indicates the stabilization of the manufacturing sector in China *(see exhibit 13)*.[5] Overall, in 2015, China's IP expanded by 6.1% yoy, slower than the 8.3% yoy growth recorded in 2014.

In the coming months, industrial activities will be supported by the positive impact of an accommodative monetary policy and the increase in public investment. That being said, we do not expect to see a V-shaped recovery of the manufacturing sector this year, as the policy focus has shifted to 'supply-side reforms'. Challenges facing Chinese manufacturers, especially those in traditional industries, include wider exchange rate fluctuations, the rising labour and environmental costs, slow growth of the global economy, foreign protectionism and weaker luxury spending. Overall, we expect the industrial production (VAIO) growth to go up slightly to around 6.5% yoy in 1Q16.

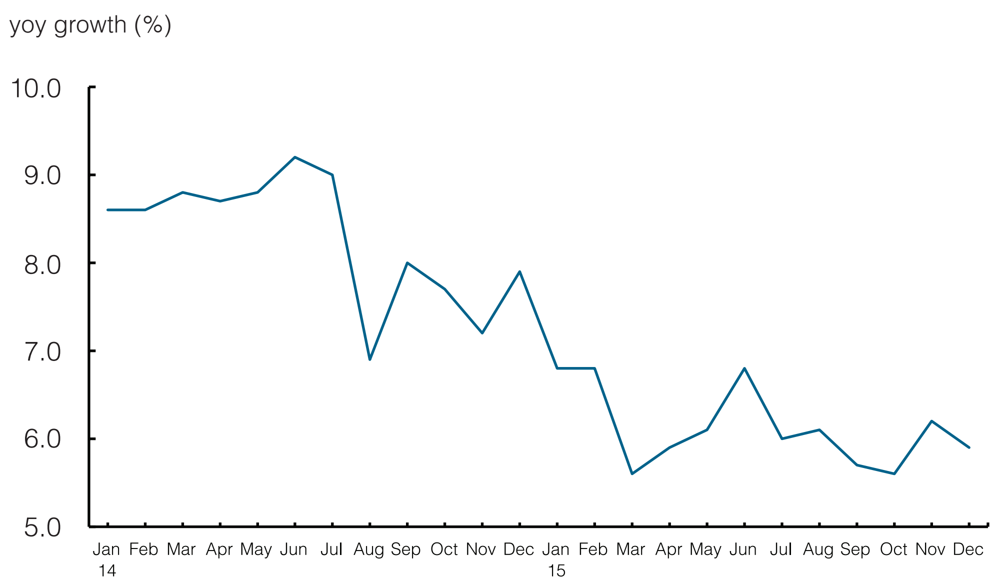


## 7. Industrial profits posts negative yoy growth for sixth consecutive month

The total profits earned by large and medium industrial enterprises above a designated size[6] dropped by 1.4% yoy in November, posting negative yoy growth for six consecutive months. Overall, in January to November 2015, China's industrial profits amounted to 5538.7 billion yuan, down by 1.9% yoy, compared to the positive growth of 3.3% yoy seen in 2014 *(see exhibit 14)*.

Profits of upstream industries such as 'coal mining and washing', 'extraction of petroleum and natural gas' and 'mining of ferrous metals' plunged by 61.2% yoy, 70.4% yoy and 68.0% yoy, respectively, in January to November 2015. In contrast, profits of industries such as 'petroleum refining and coking and processing of nuclear fuels', 'water supplies' and 'chemical fibres' increased strongly by 138.8% yoy, 25.0 % yoy and 24.1% yoy, respectively, over the same period.

**Exhibit 13** China's industrial production growth, January 2014 to December 2015




| | |
|---|---|
| Jan-Feb 15 | 6.8% |
| Mar | 5.6% |
| Apr | 5.9% |
| May | 6.1% |
| Jun | 6.8% |
| Jul | 6.0% |
| Aug | 6.1% |
| Sep | 5.7% |
| Oct | 5.6% |
| Nov | 6.2% |
| Dec | 5.9% |

Source: National Bureau of Statistics, PRC

5 The National Bureau of Statistics has changed the method of compiling the value added for industry (industrial production, IP), effective January 2011. The statistical threshold for industrial enterprises has been raised to cover those with annual revenues of 20 million yuan or above, up from the previous threshold of 5 million yuan or above.

6 'Industrial enterprises above a designated size' refers to industrial enterprises with annual sales of 20 million yuan or more.

**Exhibit 14** China's industrial profits growth, June to November 2015

| *yoy growth (%)* | Jun 15 | Jul | Aug | Sep | Oct | Nov |
|---|---|---|---|---|---|---|
| Total profits made by industrial enterprises above a designated size | -0.3 | -2.9 | -8.8 | -0.1 | -4.6 | -1.4 |

Source: National Bureau of Statistics, PRC

## 8. Growth of fixed asset investment decelerates

The growth of China's nominal fixed asset investment (FAI) (excluding rural households) decelerated to 10.0% yoy in 2015 from 15.7% yoy in 2014.[7] In 2015, China's nominal FAI (excluding rural households) amounted to 55.2 trillion yuan *(see exhibit 15)*.

The growth of FAI (excluding rural households) for real estate development fell sharply to 1.0% yoy in 2015 from 10.5% yoy in 2014. We believe that the high inventories of new homes have discouraged property developers to make investment.

The growth of FAI (excluding rural households) in the secondary industry decelerated to 8.0% yoy in 2015, down from the 13.2% yoy growth recorded in 2014. In our view, the fall in FAI growth can be attributed to the decline in profitability of industrial enterprises, resulted from the overcapacity problem in heavy industries and weakening competitiveness of light industries.

The growth of FAI in infrastructure (excluding power infrastructure) remained high at 17.2% yoy in 2015. Of which, the growth of FAI in the 'public facilities management' sector and the 'water conservancy facilities management' sector registered 20.2% yoy and 21.0% yoy respectively in 2015; and the FAI in the 'road transportation' sector gained 16.7% yoy.

As export demand is set to remain weak, the government will continue its efforts to boost domestic demand in coming future. As parts of its efforts to boost domestic demand, the government is likely to increase investment in infrastructure in the near term. On the other hand, the recent government moves to tackle the problems of overcapacity could constrain the growth of FAI in the manufacturing sector.

**Exhibit 15** China's FAI (excluding rural households) growth, July to December 2015

| | Jul 15 | Aug | Sep | Oct | Nov | Dec |
|---|---|---|---|---|---|---|
| FAI (excluding rural households) *(year-to-date, yoy growth %)* | 11.2 | 10.9 | 10.3 | 10.2 | 10.2 | 10.0 |
| FAI (excluding rural households) *(mom growth %, seasonally adjusted)* | 0.72 | 0.70 | 0.71 | 0.72 | 0.73 | 0.68 |

Source: National Bureau of Statistics, PRC

7 The National Bureau of Statistics has expanded coverage of the monthly statistics for FAI from the urban areas to rural enterprises and institutions, effective from 2011. Thus: 'FAI (excluding rural households)', the new indicator, has been released by the bureau as from March 2011 to replace 'urban FAI', the previous indicator. Also, a new statistical criterion has been adopted. The statistical threshold for the size of investment projects has been adjusted upwards from 500,000 yuan to 5 million yuan.

## B Highlights

### 1. Minimum down-payment ratio lowered for first-time home buyers in cities without purchase restrictions

On 2 February, China's central bank and the China Banking Regulatory Commission jointly announced that the minimum down-payment ratio for first-time home buyers in cities without purchase restrictions 'was allowed to be reduced by 5 ppts' from the previous level of 25%.[8]

This was the second time in four months that China cut the minimum down-payment ratio for first-time home buyers in cities without purchase restrictions. The previous adjustment was made on 29 September last year, when the minimum down-payment ratio for first-time home buyers in those cities was reduced from 30% to 25%. The latest policy shows that the government has continued its efforts to boost the property sector. Indeed, the growth of investment in real estate development has stayed weak and housing inventories have remained high, and the Chinese leaders have identified the reduction of housing inventories as one of their major tasks this year.

Going forward, the government is expected to introduce more supportive measures for the property sector, such as offering subsidies and tax reductions to home buyers, in coming future. We also expect to see more interest rate cuts this year. The recent reduction in the minimum down-payment ratio, together with these possible policy moves, will help boost the sales of new homes, which will in turn support the demand for housing-related items such as furniture, home textile products and home appliances.

### 2. All couples are allowed to have two children

On 27 December 2015, the Standing Committee of the National People's Congress (NPC) passed the amendments to the Population and Family Planning Law.[9] According to the newly amended law, all couples are allowed to have two children effective from 1 January 2016, marking the end of the three-decade-long one-child policy.

Under the new policy, it is widely expected that new births will increase by a few million per year, boding well for sectors such as toys, baby and kids products, maternal and child health care, education, to name just a few.

### 3. Growth rates of broad money supply and RMB loans accelerate in 2015

Growth rates of broad money supply (M2) and outstanding RMB loans accelerated in 2015. The M2 growth came in at 13.3% yoy as at the end of December 2015, up from the growth of 12.2% yoy as at the end of December 2014. Meanwhile, the growth of outstanding RMB loans accelerated to 14.3% yoy as at the end of December 2015, compared to the 13.6% yoy growth as at the end of December 2014. Overall, in 2015, the amount of increase in RMB loans was as high as 11.72 trillion yuan *(see exhibit 16)*. These indicators are in line with the monetary easing actions by China's central bank in the past year.

Looking ahead, in response to the weak domestic demand, the government is likely to continue its efforts to support economic growth, through maintaining abundant liquidity and reducing financing costs. We expect to see further interest rate reductions this year, which will help ease cost burden on enterprises and home buyers. That being said, lowering interest rates may encourage the further outflows of hot money and thus put more depreciation pressure on the Chinese yuan, especially at a time when the US Federal Reserve has just entered a rate hike cycle. This is what the Chinese leaders do not want to see. According to a report by the official media, Premier Li Keqiang told the International Monetary Fund chief Christine Lagarde on 28 January that the Chinese government had no intention to boost exports through currency depreciation and would keep the exchange rate of Chinese yuan 'basically stable at a reasonable and balanced level'.[10] Therefore, the ability of China's central bank to ease the monetary policy has been limited by the government's objective to prevent a sharp depreciation of the Chinese yuan.

8 Currently, the cities with home purchase restrictions include Beijing, Shanghai, Guangzhou, Shenzhen and Sanya.
9 http://www.fmprc.gov.cn/mfa_eng/zxxx_662805/t1336812.shtml
10 http://gss.mof.gov.cn/zhengwuxinxi/zhengcefabu/201512/P020151231629265415525.pdf

**Exhibit 16** Broad money supply (M2) and RMB loans, January to December 2015

| As of | Broad money supply (M2) Amount (trillion yuan) | Broad money supply (M2) yoy growth | Total outstanding RMB loans Amount (trillion yuan) | Total outstanding RMB loans yoy growth |
|---|---|---|---|---|
| End-Jan 15 | 124.3 | 10.8% | 83.7 | 13.9% |
| End-Feb | 125.7 | 12.5% | 84.7 | 14.3% |
| End-Mar | 127.5 | 11.6% | 85.9 | 14.0% |
| End-Apr | 128.1 | 10.1% | 86.6 | 14.1% |
| End-May | 130.7 | 10.8% | 87.5 | 14.0% |
| End-Jun | 133.3 | 11.8% | 88.8 | 13.4% |
| End-Jul | 135.3 | 13.3% | 90.3 | 15.5% |
| End-Aug | 135.7 | 13.3% | 91.1 | 15.4% |
| End-Sep | 136.0 | 13.1% | 92.1 | 15.4% |
| End-Oct | 136.1 | 13.5% | 92.7 | 15.4% |
| End-Nov | 137.4 | 13.7% | 93.4 | 14.9% |
| End-Dec | 139.2 | 13.3% | 94.0 | 14.3% |

| | Increase in RMB loans (trillion yuan) |
|---|---|
| FY14 | 9.78 |
| FY15 | 11.72 |
| Jan 15 | 1.47 |
| Feb | 1.02 |
| Mar | 1.18 |
| Apr | 0.71 |
| May | 0.90 |
| Jun | 1.27 |
| Jul | 1.48 |
| Aug | 0.81 |
| Sep | 1.05 |
| Oct | 0.51 |
| Nov | 0.71 |
| Dec | 0.60 |

Source: People's Bank of China



## 4. 'Total social financing' increases by a smaller amount in 2015

The increase in 'total social financing' (covering sources of financing such as RMB loans to the real sector, foreign currency loans to the real sector, trust loans, entrusted loans, bank acceptance bills, corporate bonds, equity issuance and other instruments) amounted to 15.41 trillion yuan in 2015, smaller than the increase seen in the previous year (i.e. 16.46 trillion yuan) *(see exhibit 17)*. The smaller increase in 'total social financing' was largely due to the reductions in foreign currency loans and bank acceptance bills, and the smaller increases in entrusted loans and trust loans.

In 2015, RMB loans contributed 73.1% to the increase in 'total social financing', much higher than 59.4% in 2014, indicating that the role of RMB loans as a source of financing has strengthened significantly.

**Exhibit 17** Increase in total social financing, 2014 to 2015

| | FY14 Amount (billion yuan) | FY14 Share (%) | FY15 Amount (billion yuan) | FY15 Share (%) |
|---|---|---|---|---|
| Total social financing | 16,457.0 | 100.0 | 15,410.0 | 100.0 |
| RMB loans to the real sector | 9,781.6 | 59.4 | 11,269.3 | 73.1 |
| Foreign currency loans to the real sector | 355.4 | 2.2 | -642.7 | -4.2 |
| Trust loans | 517.4 | 3.1 | 43.4 | 0.3 |
| Entrusted loans | 2,507.0 | 15.2 | 1,591.1 | 10.3 |
| Bank acceptance bills | -128.5 | -0.8 | -1,056.9 | -6.9 |
| Corporate bonds | 2,425.3 | 14.7 | 2,824.9 | 18.3 |
| Equity issuance | 435.0 | 2.6 | 760.4 | 4.9 |

Source: People's Bank of China

# C Outlook

## 1. Top leaders pledge to focus on 'supply-side reforms'

The Central Economic Work Conference, a meeting which set the key economic tasks for this year, was held on 18-21 December last year.[11] During the four-day conference, the Chinese top leaders pledged to focus more on carrying out the 'supply-side reforms'. More emphasis will be put on tackling the overcapacity problem, reducing housing inventories, and cutting taxes and fees on enterprises this year.

Meanwhile, to avoid a hard landing of the economy, the government will continue with its efforts to boost the domestic demand. A more expansionary fiscal policy will be adopted. Fiscal expenditure and government investment will increase, and a rise in the fiscal deficit to GDP ratio is expected. On the monetary front, China will strive to maintain abundant liquidity and reduce financing costs for enterprises.



## 2. Weakening confidence among entrepreneurs in the secondary industry

China's Entrepreneur Confidence Index (ECI) for the secondary industry came in at 108.9 in 4Q15, falling for the third consecutive quarter. The downtrend of the index indicates the weakening confidence among Chinese entrepreneurs in the industry *(see exhibit 18).* [12]

The 'manufacturing', 'mining' and 'electricity, gas & water' sectors all recorded lower index readings in 4Q15, compared to the previous quarter; among which, the 'mining' sector index saw the sharpest quarter-on-quarter fall, by 6.1 pts in 4Q15 *(see exhibit 19).*

**Exhibit 18** China's Entrepreneur Confidence Index (Secondary Industry), 1Q14 to 4Q15

| | 1Q14 | 2Q14 | 3Q14 | 4Q14 | 1Q15 | 2Q15 | 3Q15 | 4Q15 |
|---|---|---|---|---|---|---|---|---|
| Entrepreneur Confidence Index (Secondary Industry) | 124.3 | 121.4 | 119.0 | 115.1 | 120.6 | 114.5 | 112.1 | 108.9 |

Source: National Bureau of Statistics, PRC

11 http://news.xinhuanet.com/politics/2015-12/21/c_1117533201.htm
12 China's Entrepreneur Confidence Index (ECI) ranges from 0 to 200. A reading above 100 indicates that entrepreneurs tend to be optimistic; a reading below 100 indicates that they tend to be pessimistic.

**Exhibit 19** Entrepreneur Confidence Index by sector, 3Q15 and 4Q15

| | 3Q15 | 4Q15 | Compared with the previous quarter |
|---|---|---|---|
| Secondary industry | 112.1 | 108.9 | Lower |
| Mining | 74.8 | 68.7 | Lower |
| Manufacturing | 113.6 | 110.4 | Lower |
| Electricity, gas & water | 125.1 | 124.2 | Lower |

Source: National Bureau of Statistics, PRC

## 3. December PMI suggests stabilization of manufacturing activities

After dropping from 49.8 in September and October to 49.6 in November, China's manufacturing Purchasing Managers' Index (PMI) went up slightly to 49.7 in December. In our view, the rise in the PMI in December suggests that manufacturing activities have stabilized, supported by the earlier easing measures taken by the government *(see exhibit 20).*

The output index rebounded to 52.2 in December, after falling from 52.2 in October to 51.9 in November. This suggests that output growth has reaccelerated recently.

After dropping from 50.3 in October to 49.8 in November, the new orders index rebounded to 50.2 in December, slightly higher than the critical 50-mark.[13] The index returned to the expansionary zone in December, indicating that the month-on-month growth of overall new orders turned positive in the month. We believe this shows the recovery in the domestic demand for industrial products.

Meanwhile, the new export orders index fell from 47.4 in October to the recent low of 46.4 in November, and then rebounded to 47.5 in December, still below the neutral level of 50. The December reading indicates that the new export orders have contracted at a slower pace lately.

For the first time in five months, the purchases of inputs index was above the critical 50-mark in December. The index registered 48.8 in October and 48.3 in November, before rising strongly by 2.0 pts to 50.3 in December. The latest index reading suggests that purchasing activities have started to increase recently.

The stocks of finished goods index stayed below the neutral level of 50 in the past three months. The index dropped all the way from 47.2 in October to 46.1 in December, suggesting that destocking activities have quickened. Meanwhile, the stocks of major inputs index fluctuated in the narrow range of 47.1 and 47.6 throughout October to December, still below the critical 50-mark. Manufacturers have continued to reduce their stocks of production inputs.

After dropping from 44.4 in October to 41.1 in November, the lowest level since May 2013, the input prices index showed a rebound to 42.4 in December. The December reading was still well below the critical 50-mark, indicating that the deflationary pressures on prices of production inputs persist. Manufacturers have continued to see a drop in their costs of raw materials.

The business expectations index dropped all the way from 54.1 in August to 44.6 in December, the lowest on record since the sub-index was introduced in January 2013. In fact, the index has been below the critical 50-mark since November last year, indicating that purchasing managers have become pessimistic about the near term outlook for their respective industries.

13 The 'new orders index' covers both domestic and export orders. That is to say, the manufacturers are not asked to differentiate between domestic and export orders when filling in questionnaires.

**Exhibit 20** China's manufacturing PMI at a glance, December 2015

| Index | Seasonally Adjusted Index | Index Compared with the Previous Month | Direction |
|---|---|---|---|
| PMI | 49.7 | Higher | Contracting |
| Output | 52.2 | Higher | Expanding |
| New orders | 50.2 | Higher | Expanding |
| New export orders | 47.5 | Higher | Contracting |
| Backlogs of orders | 43.6 | Higher | Contracting |
| Stocks of finished goods | 46.1 | Lower | Contracting |
| Purchases of inputs | 50.3 | Higher | Expanding |
| Imports | 47.6 | Higher | Contracting |
| Input prices | 42.4 | Higher | Falling |
| Stocks of major inputs | 47.6 | Higher | Contracting |
| Employment | 47.4 | Lower | Contracting |
| Suppliers' delivery time | 50.7 | Higher | Quickening |
| Business expectations | 44.6 | Lower | Pessimistic |

Source: China Federation of Logistics & Purchasing; National Bureau of Statistics, PRC



## 4. Non-manufacturing sector expands at a fast pace

China's Business Activity Index, which is quoted as the Non-manufacturing Purchasing Managers' Index (NMI), rose from the recent low of 53.1 in October to 53.6 in November, and further to 54.4 in December, the highest level since September 2014. The December NMI indicates that the non-manufacturing sector has been expanding at a fast pace lately *(see exhibit 21).*

New orders have been expanding. The new orders index rose to a 19 month-high of 51.7 in December, after dropping from 51.2 in October to 50.2 in November.

The sales prices index came in at 48.2 in December. In fact, the index has stayed below the critical 50-mark since June 2015, showing that enterprises have continued to reduce their service charges. Meanwhile, the input prices index has dropped below the critical 50-mark since November, indicating that costs of inputs have started falling.

Purchasing managers in the non-manufacturing sector remain optimistic about the near-term outlook for their respective sub-sectors: The business expectation index came in at 58.3 in December, well above the neutral level of 50.

**Exhibit 21** China's non-manufacturing purchasing managers' index (NMI) at a glance, December 2015

| Index | Seasonally Adjusted Index | Index Compared with the Previous Month | Direction |
|---|---|---|---|
| Business activity | 54.4 | Higher | Expanding |
| New orders | 51.7 | Higher | Expanding |
| Input prices | 49.0 | Lower | Falling |
| Sales prices | 48.2 | Higher | Falling |
| Business expectations | 58.3 | Lower | Optimistic |

Source: China Federation of Logistics & Purchasing; National Bureau of Statistics, PRC

# A Recent developments

## 1. Both exports and imports continue to show negative yoy growth

China's exports fell by 5.0% yoy in 4Q15, posting negative yoy growth for three consecutive quarters. The negative export growth in the past three quarters indicates that foreign demand for Chinese products has been sluggish *(see exhibits 22, 23 and 24)*. Overall, in 2015, China's exports amounted to US$ 2,276.6 billion. The growth rate of the exports was minus 2.8% yoy for 2015, compared to 6.1% yoy for 2014.

China's imports fell at a slower pace, by 11.8% yoy, in 4Q15, after dropping by 14.4% yoy in 3Q15. It was the fifth quarter in a row that China's imports recorded negative yoy growth, attributable to the weak domestic demand and the sharp fall in commodity prices. Overall, in 2015, China's imports totalled US$ 1,682.1 billion, down by 14.1% yoy.

With imports dropping faster than exports, China's trade surplus continued to widen, reaching US$ 175.8 billion in 4Q15. Overall, in 2015, China's trade surplus amounted to US$ 594.5 billion, the highest since the records began in 1978.

The demand for Chinese products from the US and major countries in Southeast Asia and South Asia has been relatively strong. In 2015, China's exports to the US, ASEAN and India grew by 3.4% yoy, 2.1% yoy and 7.4% yoy respectively, faster than China's total export growth over the same period (i.e. minus 2.8% yoy). In contrast, China's exports to the EU, its largest trading partner, and Japan fell by 4.0% yoy and 9.2% yoy respectively in 2015, highly associated with the sharp appreciation of the Chinese yuan against the Euro and the Japanese yen in recent years.



**Exhibit 22** China's quarterly foreign trade data, 1Q15 to 4Q15

*USD billion (yoy growth)*

| | Exports | | Imports | | Trade Balance |
|---|---|---|---|---|---|
| FY15 | 2,276.6 | (-2.8%) | 1,682.1 | (-14.1%) | 594.5 |
| 1Q15 | 513.9 | (4.7%) | 390.2 | (-17.6%) | 123.7 |
| 2Q15 | 559.1 | (-2.0%) | 418.9 | (-13.6%) | 140.2 |
| 3Q15 | 597.5 | (-5.9%) | 433.9 | (-14.4%) | 163.6 |
| 4Q15 | 613.8 | (-5.0%) | 438.0 | (-11.8%) | 175.8 |

Source: China Customs

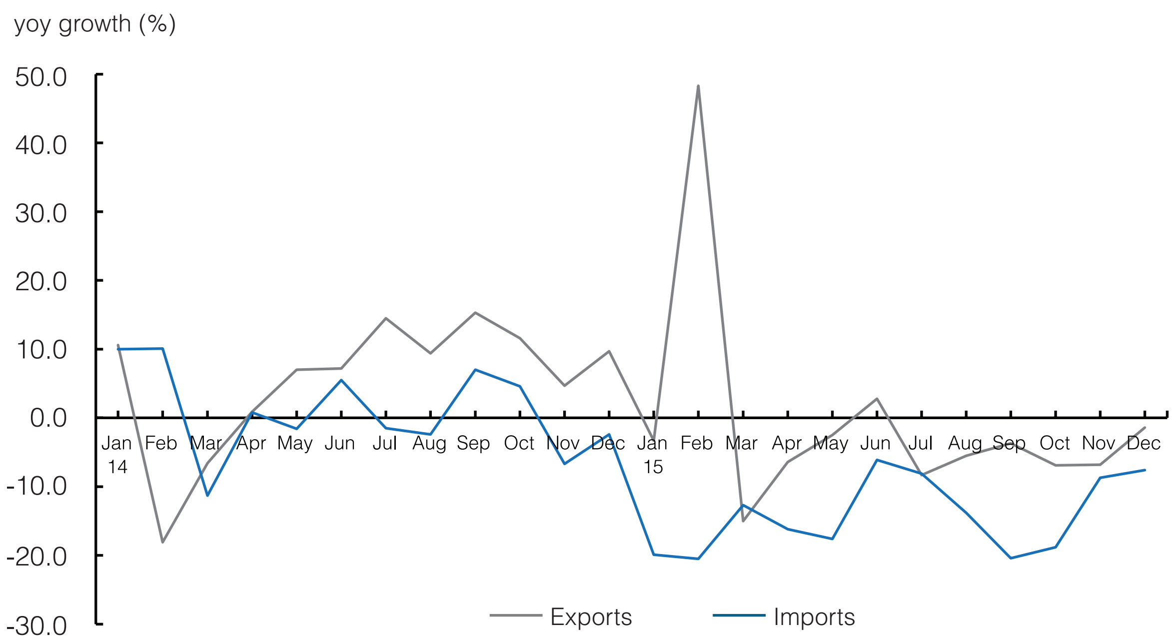
**Exhibit 23** China's monthly foreign trade data, January to December 2015

*USD billion (yoy growth)*

| | Exports | | Imports | | Trade Balance |
|---|---|---|---|---|---|
| January 2015 | 200.3 | (-3.3%) | 140.2 | (-19.9%) | 60.0 |
| February | 169.2 | (48.3%) | 108.6 | (-20.5%) | 60.6 |
| March | 144.6 | (-15.0%) | 141.5 | (-12.7%) | 3.1 |
| April | 176.3 | (-6.4%) | 142.2 | (-16.2%) | 34.1 |
| May | 190.8 | (-2.5%) | 131.3 | (-17.6%) | 59.5 |
| June | 192.0 | (2.8%) | 145.5 | (-6.1%) | 46.5 |
| July | 195.1 | (-8.3%) | 152.1 | (-8.1%) | 43.0 |
| August | 196.9 | (-5.5%) | 136.6 | (-13.8%) | 60.2 |
| September | 205.6 | (-3.7%) | 145.2 | (-20.4%) | 60.3 |
| October | 192.4 | (-6.9%) | 130.8 | (-18.8%) | 61.6 |
| November | 197.2 | (-6.8%) | 143.1 | (-8.7%) | 54.1 |
| December | 224.2 | (-1.4%) | 164.1 | (-7.6%) | 60.1 |

Source: China Customs

**Exhibit 24** Growth rates of exports and imports, January 2014 to December 2015




Source: China Customs

**Exhibit 25** Exports by category, 2014 and 2015

| *yoy growth (%) of export value, calculated in USD* | 2014 | 2015 |
|---|---|---|
| Textile materials and products | 4.9 | -2.3 |
| Garments and clothing accessories | 5.2 | -6.4 |
| Footwear | 10.8 | -4.8 |
| Toys | 14.2 | 10.8 |
| Coal | -34.5 | -28.3 |
| Crude oil | -66.3 | 215.0 |
| Refined oil | 5.2 | -25.9 |
| Steel | 33.1 | -11.3 |
| Mechanical and electrical products | 3.7 | 0.1 |

Source: China Customs

**Exhibit 26** Imports by category, 2014 and 2015

| *yoy growth (%) of import value, calculated in USD* | 2014 | 2015 |
|---|---|---|
| Cereal and cereal flour | 21.9 | 51.1 |
| Soybean | 6.0 | -13.6 |
| Iron ore | -11.8 | -38.3 |
| Crude oil | 3.9 | -41.1 |
| Refined oil | -26.8 | -39.0 |
| Steel | 5.0 | -20.0 |
| Textile yarns, fabric and textile products | -6.0 | -6.4 |
| Vehicles and related parts | 24.4 | -26.1 |

Source: China Customs



## 2. Share of processing trade in China's total trade drops in 2015

The growth rate of processing trade[14] exports turned negative, falling to minus 9.8% yoy in 2015 from 2.7% yoy in 2014. Meanwhile, the growth of general trade[15] exports dropped from 10.7% yoy in 2014 to 1.1% yoy in 2015 *(see exhibit 27).*

Both general trade imports and processing trade imports posted negative growth in 2015. After recording zero growth in 2014, the general trade imports slid 16.8% yoy in 2015. Meanwhile, the growth of processing trade imports deteriorated from 5.5% yoy in 2014 to minus 14.8% yoy in 2015.

The share of processing trade in China's total trade was 31.4% in 2015, down from 32.7% in 2014. That being said, with a large surplus of US$ 350.8 billion in 2015, processing trade still plays a key role in China's overall total foreign trade. Also noteworthy is that the general trade surplus has been catching up – The general trade surplus increased from US$ 94.2 billion in 2014 to US$ 294.1 billion in 2015.

14 'Processing trade' refers to the business of importing all or part of the raw and auxiliary materials, parts and components, accessories and packaging materials from abroad, and re-exporting the finished products after processing or assembly by enterprises within the Chinese Mainland.

15 'General trade' refers to China's import or export of goods by enterprises holding import-export rights. According to China's National Bureau of Statistics, the scope of general trade covers: Imports and exports using loans or aids; the import of materials by foreign invested enterprises (FIEs) for processing of goods for sale in the domestic market; the export of goods purchased by FIEs or manufactured by processing domestically-produced materials; the import of food and beverages by restaurants and hotels; the supply of domestically-produced fuels, materials, parts and components to foreign vessels or aircraft; the import of goods as payment in kind, in lieu of wages in labour service cooperation projects with foreign countries; and the export of equipment and materials by enterprises in China for their investment abroad.

**Exhibit 27** China foreign trade (general and processing trades), 2014 to 4Q15

| Item | yoy growth (%) | | | | Share (%) | | | |
|---|---|---|---|---|---|---|---|---|
| | FY14 | FY15 | 3Q15 | 4Q15 | FY14 | FY15 | 3Q15 | 4Q15 |
| Exports<br>Of which: | 6.1 | -2.8 | -5.9 | -5.0 | 100.0 | 100.0 | 100.0 | 100.0 |
| General Trade | 10.7 | 1.1 | -3.7 | -2.6 | 51.4 | 53.5 | 53.3 | 51.5 |
| Processing Trade | 2.7 | -9.8 | -11.2 | -12.2 | 37.7 | 35.0 | 34.3 | 35.9 |
| Imports<br>Of which: | 0.4 | -14.1 | -14.4 | -11.8 | 100.0 | 100.0 | 100.0 | 100.0 |
| General Trade | 0.0 | -16.8 | -15.3 | -14.4 | 56.6 | 54.9 | 54.7 | 52.3 |
| Processing Trade | 5.5 | -14.8 | -19.6 | -16.6 | 26.8 | 26.6 | 26.2 | 28.0 |
| Total of Imports and Exports<br>Of which: | 3.4 | -8.0 | -9.7 | -8.0 | 100.0 | 100.0 | 100.0 | 100.0 |
| General Trade | 5.3 | -7.5 | -9.0 | -7.9 | 53.8 | 54.1 | 53.9 | 51.8 |
| Processing Trade | 3.8 | -11.6 | -14.4 | -13.8 | 32.7 | 31.4 | 30.9 | 32.6 |

Source: China Customs

## 3. China's exports to the US and ASEAN maintain positive growth in 2015

The EU was China's largest trading partner in 2015. Accounting for 14.3% of China's total foreign trade, Sino-EU trade amounted to US$ 564.9 billion in 2015. Sino-EU trade dropped by 8.2% yoy in 2015, compared to the positive growth of 9.9% yoy in 2014. China's exports to the EU fell by 4.0% yoy in 2015. China's imports from the EU dropped even more, by 14.5% yoy, in 2015 *(see exhibits 28 and 29).*

The US continues to be China's second largest trading partner in 2015, accounting for 14.1% of China's total foreign trade. The total Sino-US trade gained 0.6% yoy in 2015. China's exports to the US maintained positive growth of 3.4% yoy in 2015. Meanwhile, China's import growth from the US turned negative, registering minus 6.5% yoy in 2015.

The Association of South East Asian Nations (ASEAN), China's third largest trading partner, accounted for 11.9% of China's total foreign trade in 2015. China's trade with ASEAN dropped by 1.7% yoy to US$ 472.2 billion in 2015. The growth of China's exports to ASEAN decelerated from 11.5% yoy in 2014 to 2.1% yoy in 2015; and the growth of China's imports from ASEAN fell to minus 6.6% yoy in 2015 from 4.4% yoy in 2014.

Sino-Japan trade contracted by 10.8% yoy to US$ 278.7 billion in 2015. China's exports to Japan fell by 9.2% yoy, while China's imports from Japan went down by 12.2% yoy over the period.

## 4. China's trade with Russia and Brazil falls markedly in 2015

China's exports to India still managed to post positive growth of 7.4% yoy in 2015. However, China's imports from India contracted at a fast pace, by 18.2% yoy, in 2015. Overall, growth of Sino-Indian trade decelerated to 1.5% yoy in 2015 from 7.9% yoy in 2014.

China's foreign trade with Russia fell markedly by 28.6% yoy in 2015, after gaining 6.8% yoy in 2014. In fact, both exports and imports deteriorated for Sino-Russian trade, mainly due to Russia's poor domestic economy and the fall in oil prices. Specifically, China's exports to Russia fell by 35.2% yoy, while imports from Russia slid 20.0% yoy in 2015 *(see exhibits 28 and 29)*.

China's foreign trade with Brazil dropped by 17.3% yoy in 2015. China's imports from Brazil fell by 14.5% yoy last year, attributable to the drop in commodity prices. Meanwhile, China's exports to Brazil declined by 21.4% yoy. A major reason for the decline is that the fall in commodity prices has adversely affected the economy in Brazil, one of the major commodity-exporting countries, which has in turn weakened its demand for Chinese products.

Together, these three BRIC members accounted for 5.3% of China's total exports and 5.4% of China's total imports in 2015, down from 6.1% and 5.6%, respectively, in 2014.



**Exhibit 28** China's trading partners, 2015

| Country/ Region | Trade value (USD billion) | Share of total trade (%) | Export value (USD billion) | Import value (USD billion) | yoy growth (%) | | |
|---|---|---|---|---|---|---|---|
| | | | | | Total trade | Exports | Imports |
| EU | 564.9 | 14.3 | 356.0 | 208.9 | -8.2 | -4.0 | -14.5 |
| US | 558.4 | 14.1 | 409.6 | 148.7 | 0.6 | 3.4 | -6.5 |
| ASEAN | 472.2 | 11.9 | 277.7 | 194.5 | -1.7 | 2.1 | -6.6 |
| Japan | 278.7 | 7.0 | 135.7 | 143.0 | -10.8 | -9.2 | -12.2 |
| Brazil | 71.6 | 1.8 | 27.4 | 44.2 | -17.3 | -21.4 | -14.5 |
| Russia | 68.1 | 1.7 | 34.8 | 33.3 | -28.6 | -35.2 | -20.0 |
| India | 71.6 | 1.8 | 58.3 | 13.4 | 1.5 | 7.4 | -18.2 |

Source: China Customs

**Exhibit 29** China's trading partners, comparing growth rates for 2014 and 2015

*yoy growth (%)*

| Country/Region | Total Trade | | Exports | | Imports | |
|---|---|---|---|---|---|---|
| | 2014 | 2015 | 2014 | 2015 | 2014 | 2015 |
| EU | 9.9 | -8.2 | 9.4 | -4.0 | 10.7 | -14.5 |
| US | 6.6 | 0.6 | 7.5 | 3.4 | 4.2 | -6.5 |
| ASEAN | 8.3 | -1.7 | 11.5 | 2.1 | 4.4 | -6.6 |
| Japan | 0.0 | -10.8 | -0.5 | -9.2 | 0.4 | -12.2 |
| Brazil | -4.0 | -17.3 | -2.8 | -21.4 | -4.8 | -14.5 |
| Russia | 6.8 | -28.6 | 8.2 | -35.2 | 4.9 | -20.0 |
| India | 7.9 | 1.5 | 12.0 | 7.4 | -3.5 | -18.2 |

Source: China Customs

## 5. Share of top seven provinces/ municipalities in terms of foreign trade rises in 2015

China's top seven provinces and municipalities in terms of foreign trade value – Guangdong, Jiangsu, Shanghai, Zhejiang, Beijing, Shandong and Fujian – jointly accounted for 78.4% of China's total foreign trade in 2015, up from 77.4% in 2014 *(see exhibit 30).*

Five of the top seven provinces/ municipalities in terms of foreign trade witnessed drop in exports in 2015. Among these provinces, Beijing saw the sharpest fall in exports, which registered minus 12.2% yoy in 2015. Meanwhile, exports of Zhejiang and Fujian rose slightly by 1.2% yoy and 0.4% yoy respectively over the same period.

It is noteworthy that some provinces in China's central and western regions witnessed relatively fast growth in exports, as a result of industrial upgrade and relocation. For example, exports from Henan, Hubei, Guangxi and Guizhou grew by 9.3% yoy, 9.7% yoy, 15.4% yoy and 11.2% yoy respectively in 2015.

**Exhibit 30** Top seven provinces and municipalities in terms of foreign trade value, 2015

| Provinces/ Municipalities | Foreign trade value (USD billion) | Share of total trade (%) |
|---|---|---|
| Guangdong | 1,023.7 | 25.9 |
| Jiangsu | 546.0 | 13.8 |
| Shanghai | 451.7 | 11.4 |
| Zhejiang | 347.6 | 8.8 |
| Beijing | 320.0 | 8.1 |
| Shandong | 242.3 | 6.1 |
| Fujian | 170.6 | 4.3 |

Source: China Customs



## 6. Growth of China's FDI accelerates in 2015

China's foreign direct investment (FDI) has registered negative yoy growth for two consecutive months, down by 0.4% yoy and 8.0% yoy in November and December respectively. Overall, in 2015, China's FDI grew by 5.6% yoy to reach US$ 126.3 billion *(see exhibit 31).*

Among the sectors, FDI in the service sector rose by 16.6% yoy to US$ 77.2 billion in 2015. The share of the service sector in China's total FDI reached 61.1% in 2015, up from 55.4% in 2014. Meanwhile, FDI in the manufacturing sector amounted to US$ 39.5 billion in 2015, accounting for only 31.4% of China's total FDI. These figures suggest that foreign enterprises are less optimistic about the prospects in the manufacturing sector.

Among the regions, the eastern region was the largest recipient of FDI, accounting for 83.8% of China's total FDI in 2015. Meanwhile, the central and the western regions together accounted for 16.2% of China's total FDI over the same period.

The top ten countries/ regions in terms of FDI value jointly accounted for 94% (US$ 118.6 billion) of China's total FDI in 2015. FDI from ASEAN and the EU showed positive yoy growth in 2015. In contrast, FDI from Japan and the US recorded yoy declines last year.

**Exhibit 31** China's FDI, January to December 2015

| | Amount (USD billion) | yoy growth |
|---|---|---|
| FY14 | 119.6 | 1.7% |
| FY15 | 126.3 | 5.6% |
| January 15 | 13.9 | 29.4% |
| February | 8.6 | 0.2% |
| March | 12.4 | 1.3% |
| April | 9.6 | 10.2% |
| May | 9.3 | 8.0% |
| June | 14.6 | 1.1% |
| July | 8.2 | 5.2% |
| August | 8.7 | 20.9% |
| September | 9.6 | 6.1% |
| October | 8.8 | 3.2% |
| November | 10.4 | -0.4% |
| December | 12.2 | -8.0% |

Source: Ministry of Commerce, PRC

## 7. China's foreign exchange reserves fall to the lowest level in three years

China's foreign exchange reserves fell by US$ 183.8 billion in 4Q15, amounting to US$ 3.33 trillion as at the end of 2015, the lowest level in three years. Overall, in 2015, China's foreign exchange reserves dropped sharply by US$ 512.7 billion *(see exhibit 32)*.

The decrease in foreign exchange reserves in 4Q15 was largely attributable to hot money outflows. We believe that the market expectations on the Chinese yuan depreciation and the US interest rate hike were the major drivers of hot money outflows.

Looking ahead, we expect China's foreign exchange reserves to drop further in 1Q16, as hot money outflows from China may continue due largely to the expectations of yuan depreciation.

**Exhibit 32** Foreign exchange reserves by quarter, 1Q15 to 4Q15

| USD billion | Accumulation | End of the quarter |
|---|---|---|
| FY15 | -512.7 | |
| 1Q15 | -113.0 | 3,730.0 |
| 2Q15 | -36.2 | 3,693.8 |
| 3Q15 | -179.7 | 3,514.1 |
| 4Q15 | -183.8 | 3,330.4 |

Source: State Administration of Foreign Exchange, PRC

# B Highlights

## 1. Chinese yuan depreciates against the US dollar

The exchange rate of the Chinese yuan against the US dollar has depreciated in recent months. The daily fixing rate (also known as the central parity rate) of the Chinese yuan against the US dollar depreciated all the way from on 6.3154 on 2 November 2015 to 6.5646 on 7 January 2016, before appreciating slightly to 6.5516 on 29 January *(see exhibit 33)*.[16] In line with the trend of the daily fixing rate, the USD-CNY spot exchange rate depreciated throughout November 2015 to early January 2016, and has appreciated slightly since early January. On 29 January, the USD-CNY spot exchange rate closed at 6.5789, representing a 5.6% depreciation from 6.2097 on 10 August 2015, the day before the exchange rate reform.

The daily fixing rate of the Chinese yuan against the Euro has also depreciated in recent months. The daily fixing rate of the Chinese yuan against the Euro depreciated from 6.7598 on 1 December 2015 to the recent low of 7.1936 on 11 January 2016, and has shown fluctuations since then *(see exhibit 35)*. On 29 January, the daily fixing rate of the Chinese yuan against the Euro was 7.1700, representing a 6.2% depreciation from 6.7226 on 10 August 2015, the day before the exchange rate reform.

According to the Bank for International Settlements, the real effective exchange rate (REER) of the yuan remained high in 4Q15, staying between 129.03 and 131.00 throughout October to December.[17] Overall, in 2015, the Chinese yuan appreciated in real terms against its trading partners by 3.9% *(see exhibit 34.*

It is noteworthy that, on 30 November 2015, the IMF announced the inclusion of the Chinese yuan in the IMF's special drawing rights (SDR) basket with effect from 1 October this year. The Chinese yuan will be initially assigned a weight of 10.92% in the basket.[18] In the short to medium term, the inclusion of the Chinese yuan in the SDR basket may lead to an increase in foreign demand for the yuan and yuan-denominated assets, mainly by central banks worldwide which are looking to diversify their reserves.

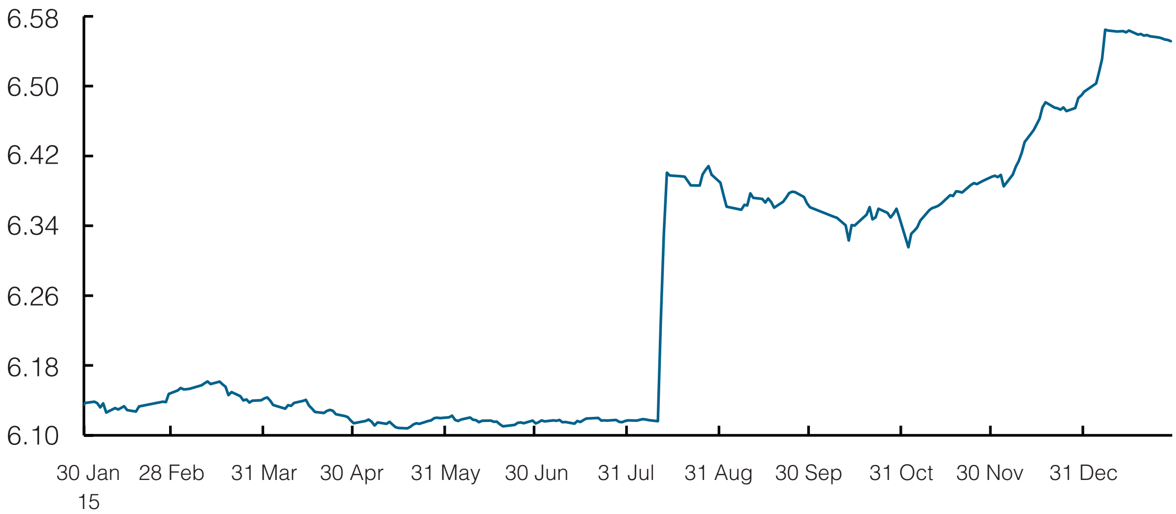
Driven partly by the expectations of further rise in the US interest rate, hot money outflows from China are likely to continue, which will in turn put depreciation pressure on the Chinese yuan. Looking ahead, we expect the Chinese yuan to depreciate slightly against the US dollar in the coming months.

16 According to the PBOC, the daily fixing rate (also known as the central parity rate) of the Chinese yuan against the US dollar is directly formed by market makers based on the closing rate of the previous day, the supply-demand conditions in the market and the movements of major international currencies.

17 The Bank for International Settlements (BIS) calculates effective exchange rate (EER) indices for a total of 61 economies (including individual Eurozone countries and, separately, the Eurozone as an entity). Nominal EERs are calculated as geometric weighted averages of bilateral exchange rates. Real EERs are the same weighted averages of bilateral exchange rates adjusted by relative consumer prices. The weighting pattern is time-varying, and the most recent weights are based on trade in 2008-10.on trade in 2008-10.

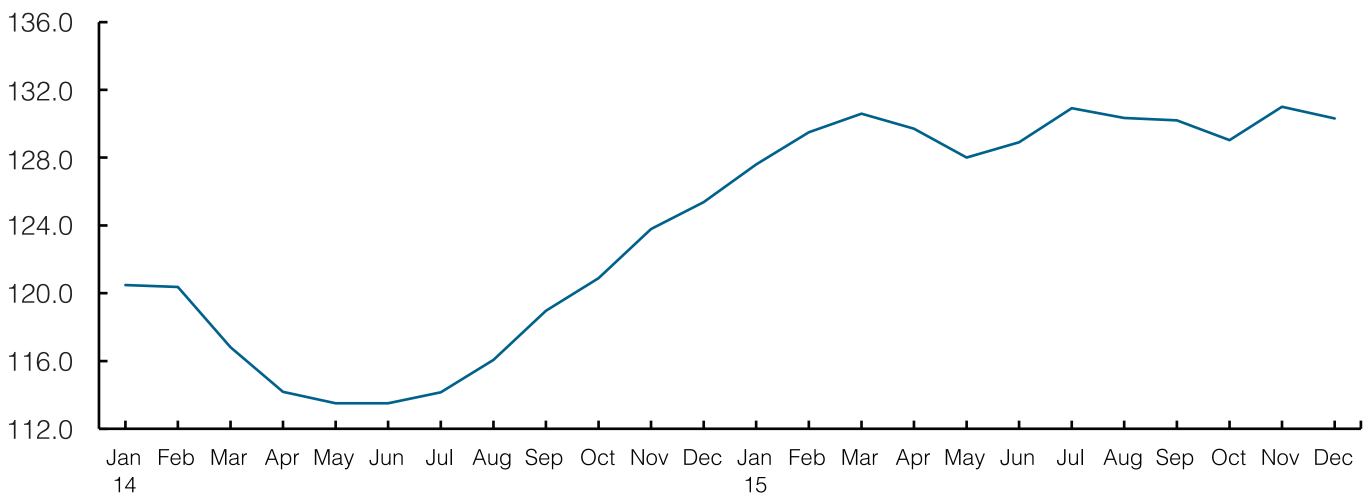
18 The SDR, created in 1969 by the IMF, is a supplementary international reserve asset based on the value of four major currencies, the US dollar, Euro, Japanese yen and Pound sterling. It is not a currency on its own but a claim to reserve currencies owned by member countries of the IMF.

**Exhibit 33** USD-CNY daily fixing rate, January 2015 to January 2016



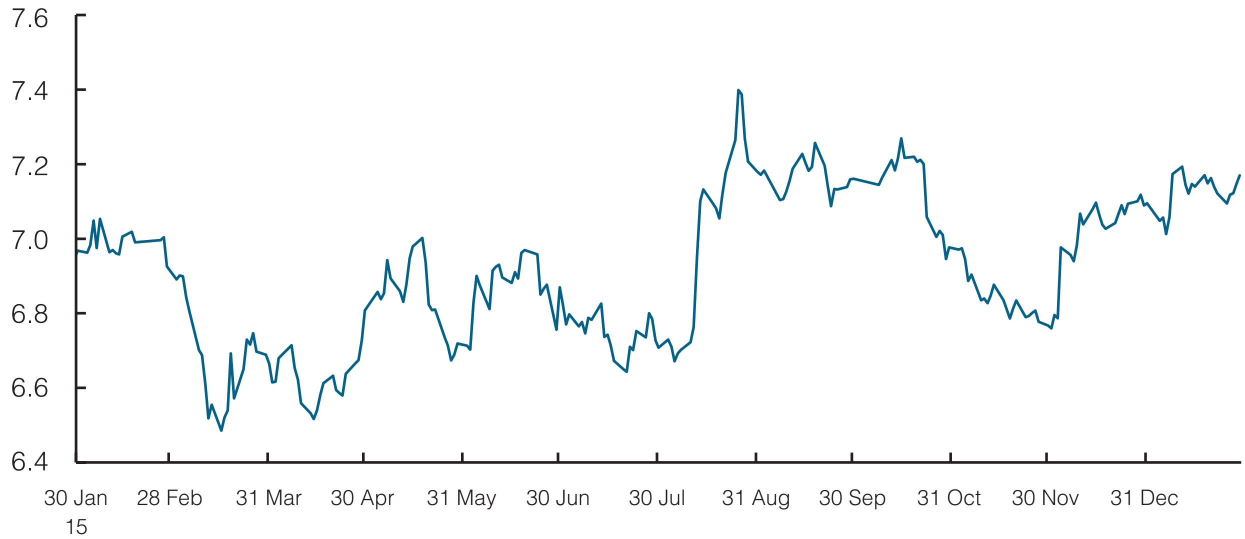

Source: State Administration of Foreign Exchange

**Exhibit 34** Real effective exchange rate of the Chinese yuan, January 2014 to December 2015




Source: Bank for International Settlements

**Exhibit 35** EUR-CNY daily fixing rate, January 2015 to January 2016




Source: State Administration of Foreign Exchange

## 2. China to establish cross-border e-commerce comprehensive pilot areas in more cities

On 15 January, the Chinese government announced to establish cross-border e-commerce comprehensive pilot areas in more cities, including Tianjin, Shanghai, Chongqing, Hefei, Zhengzhou, Guangzhou, Chengdu, Dalian, Ningbo, Qingdao, Shenzhen and Suzhou.[19] According to the announcement, the 'six major systems and two platforms' adopted in the China (Hangzhou) Cross-Border E-Commerce Comprehensive Pilot Area will be introduced to the abovementioned new pilot areas. The 'six major systems' include the information sharing system among enterprises, financial institutions and regulatory departments, the one-stop system for providing online financial service, the smart logistics system, the credit information system for e-commerce, the statistics monitoring system and the system for risk prevention and control. The two 'platforms' are the online 'single window' platform and the offline 'comprehensive zone' ,which can help different government departments in areas such as information exchange, mutual recognition of supervision and mutual aid in law enforcement, and can help pool logistics and financial infrastructure and services.

In our view, the newly established cross-border e-commerce comprehensive pilot areas will help foster the development of cross-border e-commerce, as enterprises in pilot areas can benefit from the improvement in services provided by the government departments and the cluster effect, which would in turn facilitate their operation and development.

As more and more shoppers make cross-border purchases on the internet, China's cross-border e-commerce trade saw a strong growth of over 30% in 2015, according to the Ministry of Commerce. Looking ahead, we expect the government to establish cross-border e-commerce comprehensive pilot areas in more cities in the foreseeable future.

## 3. China lowers import tariff rates on several types of consumer products

On 9 December, the Chinese government announced to reduce the tariff rates for imports of several types of consumer products, effective from 1 January 2016.[20] These consumer products include bags and suitcases, clothes, scarves, blankets, vacuum-insulated mugs, sunglasses, etc. It is expected that the retail prices of related imported products will fall, as the lower import tariffs will give the retailers more room to reduce prices.

19 http://www.gov.cn/zhengce/content/2016-01/15/content_10605.htm

20 http://www.npc.gov.cn/npc/xinwen/lfgz/lfdt/2015-12/28/content_1957481.htm

## C Outlook

### 1. US GDP shows sluggish growth in 4Q15

The US real GDP showed sluggish growth in 4Q15. The real GDP advanced by an annual rate of 0.7% in 4Q15, a deceleration from the real annual growth of 2.0% in 3Q15. Overall, in 2015, the real GDP growth was 2.4%, the same as in 2014.

Indicators point to weakness in the manufacturing sector. For example, industrial production fell by 0.4% mom in December, posting negative mom growth for three consecutive months *(see exhibit 37)*. Meanwhile, according to the Institute for Supply Management, the manufacturing Purchasing Managers' Index (PMI) came in at 48.2 in December, staying below the critical 50-mark for two consecutive months. Also noteworthy is that, compared to the previous month, the new orders for manufactured durable goods dropped sharply by 5.0% in December on a seasonally adjusted basis.



The non-manufacturing sector has been expanding at a slower pace lately. The non-manufacturing index (NMI), compiled by the Institute for Supply Management, registered 55.9 in November and 55.3 in December, below the 12-month average of 57.2.

In December, the US retail sales recorded a growth of 2.2% yoy (or minus 0.1% mom). The Reuters/University of Michigan Index of consumer sentiment rose all the way from 87.2 in September to 92.6 in December, indicating an improvement in confidence among consumers in the US *(see exhibit 38)*.

The pace of job creation has accelerated recently. After rising by 521,000 in 3Q15, the non-farm payroll employment increased at a faster pace by 851,000 in 4Q15. The US unemployment rate also stayed low at 5.0% throughout 4Q15 *(see exhibit 39)*.

Looking ahead, we expect the US economic growth to accelerate this year, due to the strong housing and labour markets. According to the latest projection by the World Bank, the US real GDP growth is forecast to accelerate to 2.7% in 2016.[21] Downside risks, in our view, come mainly from further appreciation of the US dollar and the pace of normalization of the US monetary policy. It is noteworthy that the US central bank announced to raise the target range for the federal funds rate by 0.25% on 16 December last year, and is expected to further increase the rate this year.

**Exhibit 36** US national accounts, 2014 to 4Q15

| *Annual growth (%)* | 2014 | 2015 | 1Q15 | 2Q15 | 3Q15 | 4Q15 |
|---|---|---|---|---|---|---|
| Real GDP | 2.4 | 2.4 | 0.6 | 3.9 | 2.0 | 0.7 |

Source: US Department of Commerce

**Exhibit 37** US industrial sector, July to December 2015

| *mom growth (%), seasonally adjusted* | Jul 15 | Aug | Sep | Oct | Nov | Dec |
|---|---|---|---|---|---|---|
| Industrial production | 0.8 | 0.1 | 0.0 | -0.2 | -0.9 | -0.4 |
| New orders for manufactured durable goods | 1.9 | -2.9 | -0.8 | 2.8 | -0.5 | -5.0 |

Source: US Department of Commerce, Reuters/University of Michigan Surveys of Consumers, US Department of Labor

21 World Bank, *Global Economic Prospects*, January 2016

**Exhibit 38** US consumer market, July to December 2015

| | Jul 15 | Aug | Sep | Oct | Nov | Dec |
|---|---|---|---|---|---|---|
| Retail and food services sales *(mom growth %, seasonally adjusted)* | 0.8 | 0.0 | -0.1 | 0.0 | 0.4 | -0.1 |
| Reuters/University of Michigan index of consumer sentiment | 93.1 | 91.9 | 87.2 | 90.0 | 91.3 | 92.6 |
| CPI *(yoy growth %)* | 0.2 | 0.2 | 0.0 | 0.2 | 0.5 | 0.7 |

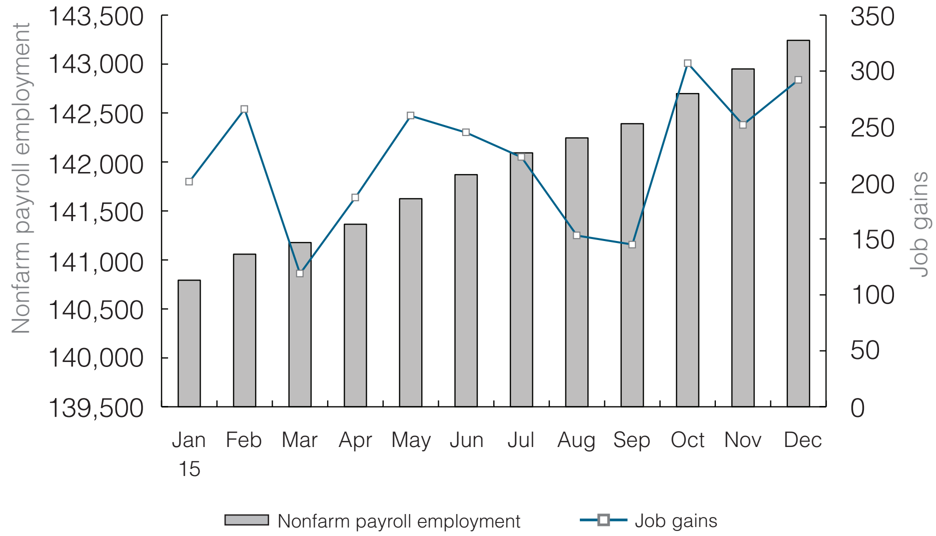
Source: US Department of Commerce, Reuters/University of Michigan Surveys of Consumers, US Department of Labor

**Exhibit 39** US employment

| | Unemployment rate (%) |
|---|---|
| 2014 | 6.2 |
| 2015 | 5.3 |
| Jan 15 | 5.7 |
| Feb | 5.5 |
| Mar | 5.5 |
| Apr | 5.4 |
| May | 5.5 |
| Jun | 5.3 |
| Jul | 5.3 |
| Aug | 5.1 |
| Sep | 5.1 |
| Oct | 5.0 |
| Nov | 5.0 |
| Dec | 5.0 |

Yearly figures: Annual average
Monthly figures: Seasonally adjusted

Nonfarm payroll employment, January to December 2015
In thousands, seasonally adjusted




Source: US Department of Labor

## 2. Eurozone economy is struggling to recover

The Eurozone economy is still struggling to recover.[22] According to the global survey firm Markit Economics, the Eurozone manufacturing PMI rose all the way from 52.0 in September to 53.2 in December, the highest level since May 2014. The index then softened to 52.3 in January. The latest reading indicates that growth of the manufacturing sector in the Eurozone has continued but at a mild pace.

Meanwhile, the Eurozone services PMI climbed to 54.2 in November and in December, before moderating to 53.6 in January. The index indicates that the services

22 Lithuania has become the 19th member of the Eurozone as from 1 January 2015. Other member countries include Austria, Belgium, Cyprus, Estonia, Finland, France, Germany, Greece, Ireland, Italy, Latvia, Luxembourg, Malta, the Netherlands, Portugal, Slovakia, Slovenia and Spain.

sector in the Eurozone has been expanding at a steady pace.

On a seasonally adjusted basis, the retail trade volume in the Eurozone fell by 0.3% mom in November, posting negative mom growth for the third consecutive month, indicating weakening consumption demand in the region *(see exhibit 41)*.

The good news is that the labour market conditions in the region have improved. The seasonally-adjusted unemployment rate fell further to 10.4% in December, the lowest rate recorded since September 2011 *(see exhibit 42)*.

Besides, the Eurozone's economic sentiment indicator (ESI) rose all the way from 103.5 in June to 106.8 in December, indicating a continuous improvement in economic sentiment *(see exhibit 43)*.

Looking ahead, benefiting from the weak Euro, the low oil prices and the improving economic sentiment, the Eurozone economy will continue its recovery, though at a slow pace, in the foreseeable future. According to the projections by the World Bank, the Eurozone's real GDP growth is forecast to edge up from 1.5% in 2015 to 1.7% in 2016.[23]

**Exhibit 40** Eurozone's real GDP growth, 2013 to 3Q15

| | 2013 | 2014 | 4Q14 | 1Q15 | 2Q15 | 3Q15 |
|---|---|---|---|---|---|---|
| Real GDP *(qoq growth %)* | | | 0.4 | 0.5 | 0.4 | 0.3 |
| Real GDP *(yoy growth %)* | -0.2 | 0.9 | 0.9 | 1.3 | 1.6 | 1.6 |

* The figures in 2013 and 2014 do not reflect Lithuania's membership of the Eurozone, which began on 1 January 2015.

Source: Eurostat

**Exhibit 41** Eurozone consumer market, July to December 2015

| | Jul 15 | Aug | Sep | Oct | Nov | Dec |
|---|---|---|---|---|---|---|
| Volume of retail trade *(mom growth %, seasonally adjusted)* | 0.6 | 0.1 | -0.1 | -0.2 | -0.3 | - |
| Annual inflation (%) | 0.2 | 0.1 | -0.1 | 0.1 | 0.1 | 0.2 |

Source: Eurostat

**Exhibit 42** Eurozone labour market, July to December 2015

| *seasonally adjusted* | Jul 15 | Aug | Sep | Oct | Nov | Dec |
|---|---|---|---|---|---|---|
| Unemployment rate (%) | 10.8 | 10.8 | 10.6 | 10.6 | 10.5 | 10.4 |

Source: Eurostat

23 World Bank, *Global Economic Prospects*, January 2016

**Exhibit 43** Eurozone economic sentiment indicator, July to December 2015

| *seasonally adjusted* | Jul 15 | Aug | Sep | Oct | Nov | Dec |
|---|---|---|---|---|---|---|
| Economic sentiment indicator | 104.0 | 104.1 | 105.6 | 106.1 | 106.1 | 106.8 |

Source: Eurostat

## 3. China's exports are expected to show single-digit decline in 1Q16

In its *Global Economic Prospects* released on 6 January this year, the World Bank announces its cuts on 2016 growth forecasts for major economies, including the US, the Eurozone, Japan, the UK, Russia, China, India and Brazil. The World Bank's 2016 growth forecast for the high income countries is adjusted downward 0.2 ppts to 2.1%, compared to its previous prediction made in June last year. Meanwhile, the 2016 growth forecast for the developing countries is revised downward by 0.6 ppts to 4.8% *(see exhibit 44)*. The downward adjustments in growth forecasts suggest that the global economic recovery has been weaker than the World Bank's previous expectations. We remain pessimistic over China's export outlook, and expect to see single-digit decline in China's exports in 1Q16.

**Exhibit 44** Latest GDP growth forecasts by the World Bank

| *yoy growth (%)* | 2015 (Estimates) | 2016 (Forecasts) | 2017 (Forecasts) |
|---|---|---|---|
| World economy | 2.4 | 2.9 | 3.1 |
| High income countries | 1.6 | 2.1 | 2.1 |
| US | 2.5 | 2.7 | 2.4 |
| Eurozone | 1.5 | 1.7 | 1.7 |
| Japan | 0.8 | 1.3 | 0.9 |
| Developing countries | 4.3 | 4.8 | 5.3 |
| China | 6.9 | 6.7 | 6.5 |
| India [24] | 7.3 | 7.8 | 7.9 |
| Brazil | -3.7 | -2.5 | 1.4 |
| Russia | -3.8 | -0.7 | 1.3 |

Source: World Bank, Global Economic Prospects, January 2016

24 Data and forecasts are presented on a fiscal year basis. India's fiscal year runs from 1 April to 31 March.

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Please visit www.funggroup.com for more about the Fung Group.

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