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Domestic Trade

Retail sales of consumer goods grow by 10.4% yoy in 2016.

Ex-factory prices of industrial products continue to go up.

Both rural and urban households see high single-digit income growth in 2016.

Number of new births in China increases by 11% yoy in 2016.

Growth in fixed asset investment falls to 8.1% yoy in 2016.

Top leaders pledge to ensure economic and social stability.

Entrepreneurs in secondary industry become more optimistic.

Foreign Trade

Both exports and imports drop by 7.7% and 5.5% respectively in 2016.

Exports to the US, the EU, Japan, the ASEAN and Brazil register negative growth in 2016.

Only three provinces see positive growth in exports in 2016.

FDI grows by 4.1% in 2016.

Foreign exchange reserves fall below US\$ 3 trillion.

Depreciation of the Chinese yuan against the US dollar quickens slightly in 2016.

Major economies refuse to recognize China as a market economy.

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Executive Summary

Domestic Trade

Retail sales of consumer goods reached 33,231.6 billion yuan in 2016, up nominally by 10.4% yoy. Online retail sales of goods, which accounted for 12.6% of total retail sales, rose strongly by 25.6% yoy in the year.

Ex-factory prices of industrial products have been going up, led by strong rise in prices of industrial products in heavy industries. The producer price index of industrial products went up by 1.6% mom in December, posting month-on-month gain for six consecutive months.

Both rural and urban households saw high single-digit income growth in 2016: the per capita disposable income of rural households increased nominally by 8.2% yoy to reach 12,363 yuan; while that of urban households rose by 7.8% yoy in nominal terms to reach 33,616 yuan.

Number of new births in China increased by 11% yoy to 18.67 million in 2016. Looking forward, the National Health and Family Planning Commission predicts that number of new births will rise further this year and will range from 17 million to 20 million per annum by 2020. The expected high number of new births bodes well for sectors such as toys, baby and kids products, maternal and child health care, and education, to name just a few.

Growth in fixed asset investment dropped to 8.1% yoy in 2016 from 10.0% yoy in 2015, mainly dragged down by the deceleration in growth in FAI in the secondary industry.

Top leaders pledged to ensure economic and social stability in the Central Economic Work Conference held on 14-16 December. The key tasks for year 2017 will include stabilizing growth, promoting reforms, adjusting structure, improving people's livelihood and preventing risks.

Chinese entrepreneurs in the secondary industry have become more optimistic. China's Entrepreneur Confidence Index for the secondary industry rose to a seven-quarter high of 115.4 in 4Q16.

Foreign Trade

Both exports and imports posted year-on-year drop in 2016. Exports fell by 7.7% yoy to US\$ 2,097.4 billion, while imports slid 5.5% yoy to US\$ 1,587.5 billion in the year.

Exports to the US, the EU, Japan, the ASEAN and Brazil dropped by 5.9% yoy, 4.7% yoy, 4.7% yoy, 7.8% yoy and 19.9% yoy respectively in 2016. In contrast, exports to Russia and India managed to record positive growth of 7.3% yoy and 0.2% yoy respectively in the year.

Only three provinces in China saw positive growth in exports in 2016: Shanxi, Shaanxi and Xinjiang, all of which are in the central and the western regions. Exports from Shanxi, Shaanxi and Xinjiang expanded by 9.5% yoy, 8.0% yoy, and 11.1% yoy respectively in 2016.

FDI grew by 4.1% yoy to reach 813.2 billion yuan in 2016. The share of the service sector in China's total FDI reached 70.3% in 2016, up from 61.1% in 2015. Among the industries, FDI in the 'information and consultancy services', the 'computer services', the 'integrated technology services', the 'distribution services' and the 'retail' industries posted rapid growth of 59.8% yoy, 112.8% yoy, 66.4% yoy, 42.9% yoy and 83.1% yoy respectively in 2016.

Foreign exchange reserves went down to US\$ 2,998.2 billion as at the end of January, dipping below the US\$ 3 trillion level for the first time since March 2011.

Depreciation of the Chinese yuan against the US dollar quickened slightly in 2016. The USD-CNY spot exchange rate depreciated by 6.56% in 2016, compared to the 4.46% depreciation in 2015.

11 December 2016 marked the 15th anniversary of China's accession to the World Trade Organization (WTO). The Chinese government expected China to gain the market economy status on the same day. However, the EU, Japan and the US have refused to recognize China as a market economy and to abolish the practice of using prices of goods of a 'surrogate' market economy in anti-dumping investigations against China.

A Recent developments

1. China's real GDP grows by 6.7% yoy in 2016

According to the National Bureau of Statistics, China's real GDP growth came in at 6.8% year-on-year (yoy) in 4Q16, up from 6.7% yoy in 3Q16 (see exhibit 1). Overall, in 2016, China's nominal GDP amounted to 74.4 trillion yuan. The real GDP growth rate in 2016 was 6.7% yoy, a slight deceleration from 6.9% yoy in 2015.

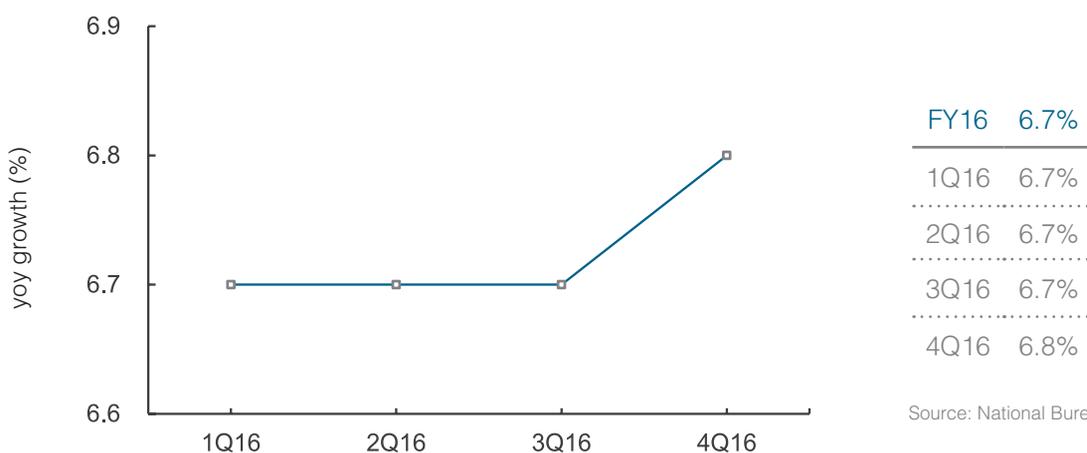
The tertiary industry has continued to grow faster than the secondary industry. The value-added of the tertiary industry, which contributed 51.6% of China's nominal GDP in 2016, gained 7.8% yoy in real terms in 2016. Meanwhile, the value-added of the secondary industry, which contributed 39.8% of the 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 driving economic growth. In 2016, final consumption expenditure contributed 4.3 ppts to the real GDP growth, while gross capital formation contributed 2.8 ppts. Meanwhile, net exports made a negative contribution of 0.5 ppts to real GDP growth in 2016.

Looking ahead, the Chinese government will put more efforts into maintaining stable economic growth and improving the quality of economic development in near term. According to the official media's report on the Central Economic Work Conference held in December 2016, the meeting which sets the key economic tasks for year 2017, China will adopt a prudent and neutral monetary policy to help maintain stable liquidity conditions, and will carry out a more active fiscal policy. Meanwhile, the government will accelerate the 'supply-side reforms', the main tasks of which include tackling the overcapacity problem, reducing housing inventories, de-leveraging, bringing down costs on enterprises and shoring up weak areas.

China's economic growth is set to be relatively stable in coming future. We forecast the real GDP growth to be around 6.7% yoy in 1Q17. Downside risks to the economic growth, in our view, come mainly from the negative impact of the recent introduction of property tightening measures and the less accommodative monetary policy.

Exhibit 1 China's real GDP growth, 1Q16 to 4Q16



2. Growth in retail sales accelerates

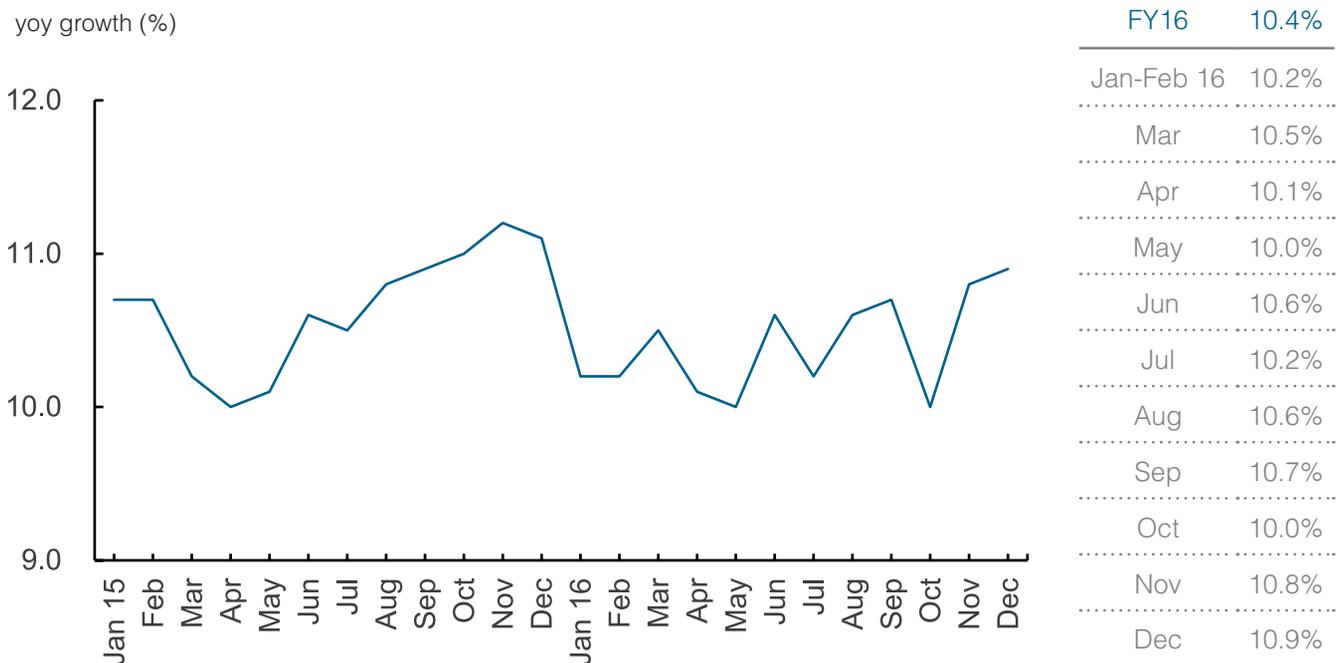
According to the National Bureau of Statistics, the growth in China's total retail sales of consumer goods rose from 10.0% yoy in October to 10.8% yoy in November and 10.9% yoy in December, indicating an improvement in consumption demand.

The month-on-month (mom) growth in seasonally-adjusted retail sales accelerated from 0.75% in October to 0.98% in November, before dropping to 0.89% in December.

Overall, in 2016, the total retail sales of consumer goods reached 33,231.6 billion yuan. The nominal growth rate was 10.4% yoy in 2016, lower than the 10.7% yoy growth seen in 2015 (see exhibits 2 and 3).

China's online retail sales of goods increased by 25.6% yoy to reach 4,194.4 billion yuan in 2016. Consequently, the share of online retail sales in the total retail sales of consumer goods went up to 12.6% in 2016 from 10.8% in 2015, indicating that popularity of online shopping has been growing rapidly.

Exhibit 2 China's total retail sales, year-on-year nominal growth, January 2015 to December 2016



Source: National Bureau of Statistics, PRC

Exhibit 3 China's total retail sales, month-on-month nominal growth, July to December 2016

mom growth (%), seasonally adjusted

	Jul 16	Aug	Sep	Oct	Nov	Dec
Total retail sales	0.79	0.93	0.88	0.75	0.98	0.89

Source: National Bureau of Statistics, PRC

Rural retail sales have been rising slightly faster than urban retail sales. In 2016, rural retail sales expanded by 10.9% yoy to reach 4,650.3 billion yuan, while urban retail sales rose by 10.4% yoy to 28,581.4 billion yuan.

Growth in both sales of goods and catering services sales decelerated: the nominal growth in catering services sales moderated from 11.7% yoy in 2015 to 10.8% yoy in 2016, while the nominal growth in sales of goods softened from 10.6% yoy in 2015 to 10.4% yoy in 2016.

Retail sales of goods by enterprises above a designated size¹ rose 8.3% yoy to reach 14,507.3

billion yuan in 2016. By product category, sales of 'furniture' and 'building and decoration materials' posted rapid growth of 12.7% yoy and 14.0% yoy respectively, attributed to the strong sales of new homes. Besides, boosted by the cut in the purchase tax rate on passenger-vehicles with less than 1.6 litre, the growth in sales of 'automobiles' accelerated to 10.1% yoy in 2016 from 5.3% yoy in 2015. In contrast, sales of 'gold, silver and jewellery' recorded zero yoy growth in 2016, indicating that the demand for jewellery from Chinese consumers has remained sluggish. Exhibit 5 demonstrates the growth in China's retail sales by product among enterprises above a designated size.

Exhibit 4 China's total retail sales, 2015 to 2016

Nominal growth, yoy (%)	FY15	1Q16	1H16	1-3Q16	FY16
Total retail sales	10.7	10.3	10.3	10.4	10.4
- Goods	10.6	10.2	10.2	10.3	10.4
Sales by enterprises above a designated size	7.9	8.0	7.6	7.9	8.3
Online sales	31.6	25.9	26.6	25.1	25.6
- Catering services	11.7	11.3	11.2	11.0	10.8

Source: National Bureau of Statistics, PRC

3. Chinese consumers are quite optimistic

The consumer confidence index² rose all the way from 104.6 in September to its recent peak of 108.6 in November. The index then stayed high at 108.4 in

December, indicating that Chinese consumers have been quite optimistic lately (see exhibit 6).

4. Both rural and urban households enjoy high single-digit growth in income in 2016

Both rural and urban households witnessed high single-digit nominal growth in income in 2016. The per capita disposable income of rural households grew nominally by 8.2% yoy (or 6.2% yoy real) to reach 12,363 yuan; while the per capita disposable income of urban households rose by 7.8% yoy in nominal terms (or 5.6% yoy real) to reach 33,616 yuan in 2016.

Earning more income, both rural and urban households had more room to increase their consumption expenditures in 2016. The per capita consumption expenditure of rural households reached 10,130 yuan, up nominally by 9.8% yoy (or 7.8% yoy real); while the per capita consumption expenditure of urban households grew by 7.9% yoy in nominal terms (or 5.7% yoy real) to reach 23,079 yuan in 2016.

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, 2015 to 2016

Nominal growth, yoy (%)	2015	1Q16	1H16	1-3Q16	FY16
Grain, oil and food	15.1	12.7	12.3	11.7	10.9
Beverages	15.3	9.8	10.7	11.0	10.5
Tobacco and liquor	12.7	7.6	9.2	9.1	9.3
Clothing, shoes, hats and textiles	9.8	7.2	7.0	7.2	7.0
Cosmetics	8.8	10.6	8.9	8.4	8.3
Gold, silver and jewellery	7.3	-3.9	-1.5	-1.3	0.0
Products for daily use	12.3	10.9	11.7	11.4	11.4
Sports and entertainment products	16.6	16.3	16.9	12.9	13.9
Home appliances and video equipment	11.4	7.2	7.3	7.9	8.7
Chinese and Western medicines	14.2	15.1	13.3	12.5	12.0
Stationery and office accessories	15.2	7.4	9.2	9.7	11.2
Furniture	16.1	16.2	15.6	13.9	12.7
Telecommunications equipment	29.3	18.9	14.9	12.7	11.9
Petroleum and related products	-6.6	0.4	-1.3	-0.5	1.2
Automobiles	5.3	7.7	7.7	9.1	10.1
Building and decoration materials	18.7	15.2	15.6	15.4	14.0

Source: National Bureau of Statistics, PRC

Exhibit 6 China's consumer confidence index, January 2015 to December 2016



Source: National Bureau of Statistics, PRC

Jan 16	104.0
Feb	104.4
Mar	100.0
Apr	101.0
May	99.8
Jun	102.9
Jul	106.8
Aug	105.6
Sep	104.6
Oct	107.2
Nov	108.6
Dec	108.4

5. Consumer inflation stays high

The year-on-year growth rate of China's consumer price index (CPI) stayed high, registering 2.1%, 2.3% and 2.1% in October, November and December respectively.³

Food inflation has eased recently. The year-on-year growth in the food component in the CPI dropped from 4.0% in November to a four-month low of 2.4% in December, due largely to a slower increase in vegetable prices, a major driver of food inflation. In contrast, non-food inflation has continued to go up in past few months. The year-on-year growth in the non-food component in the CPI rose all the way from 1.4%

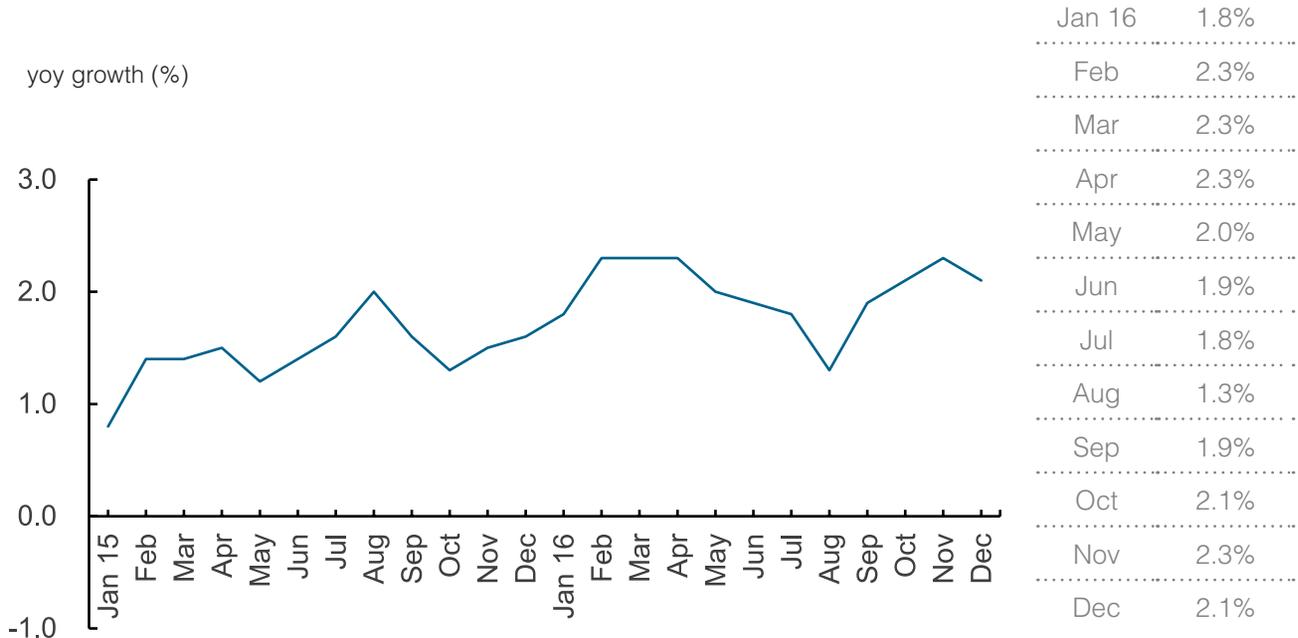
in August to a five-year high of 2.0% in December (see exhibits 7 and 8).

Overall, in 2016, China's CPI growth was 2.0% yoy, up from 1.4% yoy in 2015, but was still below the government's target of 3.0% set for the year.

Going forward, the food inflation is set to stay low in the near term, due to the recent stabilization of pork prices and vegetable prices; and we expect the non-food inflation to stay around the current level in the near future. All in all, we forecast the CPI growth to fluctuate between 2.0% yoy and 2.5% yoy in 1Q17.

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Exhibit 7 China's CPI growth, January 2015 to December 2016



Source: National Bureau of Statistics, PRC

³ The CPI, compiled by the National Bureau of Statistics (NBS) of China, measures the price of a basket of goods and services purchased by a typical household. It is noteworthy that the NBS has changed the weights assigned to the various components in the CPI basket, effective from January 2016. The weight of the food component, for example, has been reduced by 3.2 ppt; the weight of the housing component has been increased by 2.2 ppt; and the weights of other components have been adjusted by around or less than 1 ppt. The impact of the re-weighting on the CPI growth was limited, according to the NBS.

Exhibit 8 China's CPI growth by commodity, July to December 2016⁴

yoy growth (%)	Jul 16	Aug	Sep	Oct	Nov	Dec
Food, tobacco and liquor	2.8	1.5	2.7	3.0	3.2	2.2
Clothing	1.4	1.5	1.2	1.3	1.4	1.1
Housing	1.6	1.5	1.5	1.8	2.0	2.1
Household goods and services	0.6	0.4	0.3	0.4	0.3	0.4
Transportation and communication	-1.6	-1.2	-0.4	-0.4	0.0	0.9
Education, culture and recreational activities	1.6	1.3	2.0	2.1	2.2	2.3
Medical and healthcare	4.3	4.3	4.3	4.8	4.4	4.6
Other goods and services	4.4	4.5	4.4	3.6	4.2	4.0

Source: National Bureau of Statistics, PRC

The year-on-year growth in China's producer price index of industrial products (PPI)⁵ rose to 5.5% in December, the highest level since October 2011 (see exhibits 9 & 10). The acceleration in the PPI growth in December was mainly driven up by the faster growth in prices of industrial products of some heavy industries. For example, the PPI growth rates for 'manufacture and processing of ferrous metals', 'manufacture and processing of non-ferrous metals', 'mining and washing of coal' and 'processing of petroleum, coking and processing of nucleus fuel' went up to 35.0% yoy, 17.1% yoy, 34.0% yoy and 16.6% yoy respectively in December, up strongly from 22.2% yoy, 12.6% yoy, 28.6% yoy and 9.0% yoy respectively in November.

On a month-on-month basis, the PPI gained 1.6% in December, posting month-on-month gain for six straight months. In our view, the continuous rise in the PPI in recent months was due largely to an increase in prices of production inputs and a better supply-demand balance related to the strong government's efforts to cut excess capacities in various sectors.

Looking ahead, the year-on-year growth in the PPI is expected to rise further in the coming months, as prices of production inputs are set to continue to trend upward.

⁴ The NBS has re-categorized the categories in the CPI basket, effective from January 2016. For example, the old category of 'household goods and maintenance services' has been re-categorized into a new category called 'household goods and services' and the category of 'other goods and services'. The old category of 'recreational, educational products and services' has been re-categorized into a new category called 'education, culture and recreational activities' and the category of 'other goods and services'.

⁵ 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.

Part 1 : Domestic Trade

Exhibit 9 China's PPI growth, January 2015 to December 2016



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Source: National Bureau of Statistics, PRC

Exhibit 10 China's PPI growth by selected industry, July to December 2016

yoy growth (%)	Jul 16	Aug	Sep	Oct	Nov	Dec
Textile	-1.4	-0.8	-0.4	0.3	1.0	1.0
Textile wearing apparel and ornament	0.7	0.4	0.3	0.3	0.5	0.5
Processing of timbers, manufacture of wood, bamboo, rattan, palm, and straw products	0.4	-0.2	-0.2	0.0	0.1	0.1

Source: National Bureau of Statistics, PRC

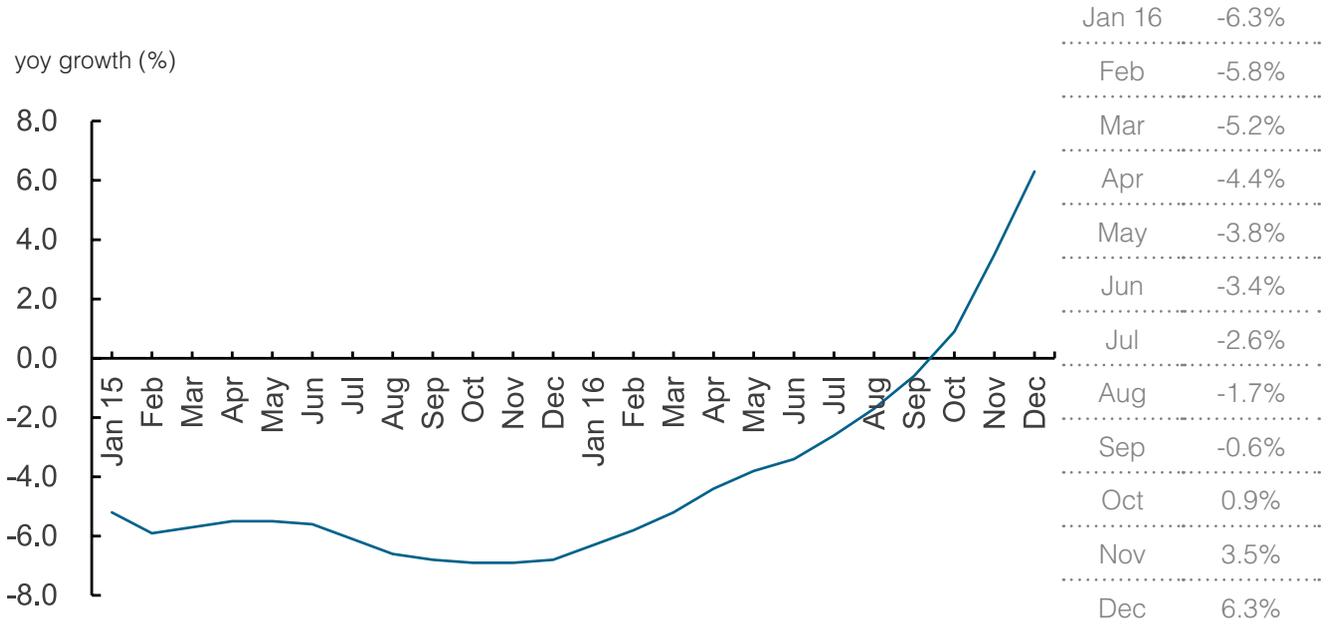
The year-on-year growth rate of the purchaser price index of industrial products, a major indicator of upstream prices, went up from 0.9% in October to 3.5% in November, and further to 6.3% in December, the highest level since October 2011 (see exhibits 11 & 12).

On a month-on-month basis, the purchaser price index of industrial products rose by 1.9% in December, posting month-on-month gain for ten consecutive months. The uptrend of the purchaser price index in

recent months can be attributable to the increase in global commodity prices, in our view.

The input prices sub-index of China's manufacturing PMI, a leading indicator of upstream prices, came in at 64.5 in January, well above the critical 50-mark, indicating the strong rise in prices of production inputs. Thus, we believe that the year-on-year growth rate of the purchaser price index of industrial products will climb further in the near future.

Exhibit 11 Growth in China's purchaser price index of industrial products, January 2015 to December 2016



Source: National Bureau of Statistics, PRC

Exhibit 12 China's purchaser price index of industrial products by selected commodity, July to December 2016

yoy growth (%)	Jul 16	Aug	Sep	Oct	Nov	Dec
Fuel and power	-6.2	-5.0	-1.9	1.8	6.0	10.1
Non-ferrous metal materials and wires	-2.5	-0.3	0.3	2.2	9.5	14.9
Chemical raw materials	-3.6	-2.5	-1.6	-0.1	2.0	5.3
Wood and pulp	-0.8	-0.6	-0.7	-0.3	0.5	2.1
Textile raw materials	-0.4	0.1	0.1	1.0	1.8	2.5

Source: National Bureau of Statistics, PRC

6. Growth in industrial production stays relatively stable

The growth rate for China's industrial production (IP), measured by value-added of industrial output (VAIO), stayed relatively stable at between 6.0% yoy and 6.2% yoy throughout October to December (see exhibit 13).⁶ Overall, in 2016, China's IP expanded by 6.0% yoy, slightly slower than the 6.1% yoy growth recorded in 2015.

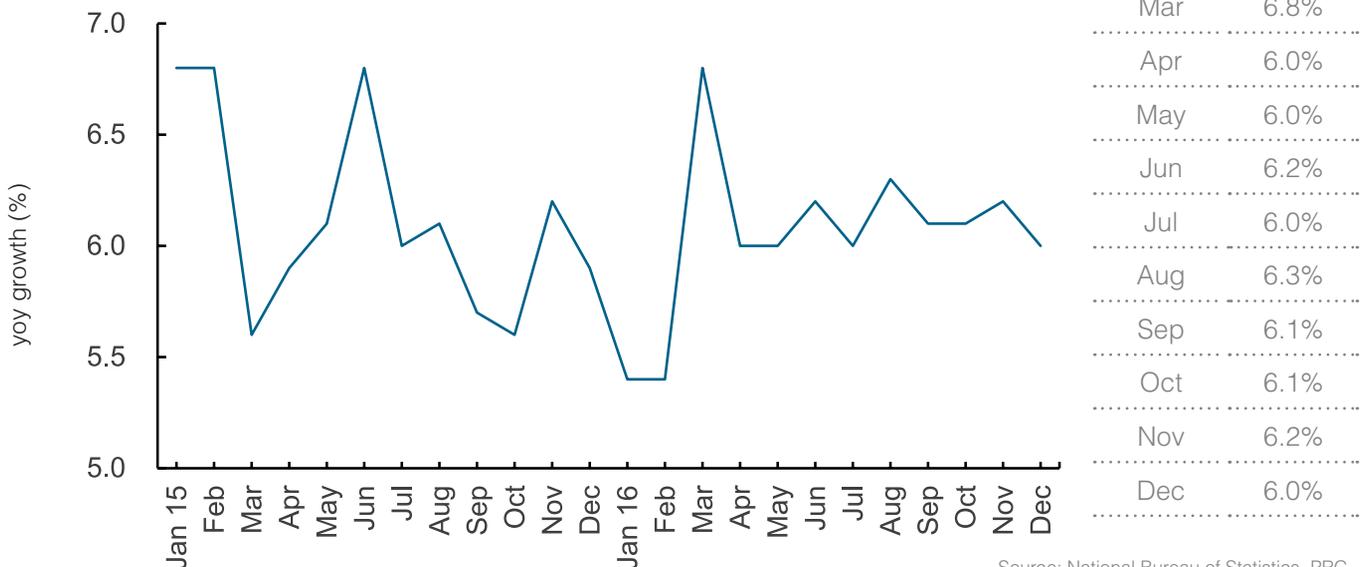
Looking ahead, we expect that the industrial production (VAIO) will show relatively fast growth in near term. The output sub-index of China's manufacturing PMI, a leading indicator of output of manufacturers, came in at 53.1 in January, still the third highest level since November 2014.

7. Growth in industrial profits turns positive in 2016

The growth in the total profits earned by large and medium industrial enterprises above a designated size⁷ fluctuated within the range of 2.3% yoy to 14.5% yoy throughout October to December. Overall, in 2016, China's industrial profits totalled 6,880.3 billion yuan. The growth in China's industrial profits recovered to 8.5% yoy in 2016 from minus 2.3% yoy in 2015, due largely to an acceleration in the growth in sales revenue and an increase in profit margins (see exhibit 14).

Among the sectors, profits of the manufacturing sector recorded double-digit growth of 12.3% yoy in 2016. In contrast, profits of the mining sector plunged by 27.5% yoy, while profits of the electricity, heat, gas and water sector dropped by 14.3% yoy over the year.

Exhibit 13 China's industrial production growth, January 2015 to December 2016



Source: National Bureau of Statistics, PRC

⁶ 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.

⁷ '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, July to December 2016

<i>yoy growth (%)</i>	Jul 16	Aug	Sep	Oct	Nov	Dec
Total profits made by industrial enterprises above a designated size	11.0	19.5	7.7	9.8	14.5	2.3

Source: National Bureau of Statistics, PRC

8. Fixed asset investment growth decelerates in 2016

Mainly dragged down by the deceleration in growth in FAI in the secondary industry, the growth in China's nominal fixed asset investment (FAI) (excluding rural households) came in at 8.1% yoy in 2016, down from 10.0% yoy in 2015.⁸ In 2016, China's nominal FAI (excluding rural households) amounted to 59.7 trillion yuan (see exhibit 15).

The growth in FAI (excluding rural households) in the secondary industry fell to 3.5% yoy in 2016 from 8.0% yoy growth in 2015. This could be due largely to the weak export demand for industrial products and the overcapacity problem in some sectors. In contrast, the growth in FAI (excluding rural households) for real estate development accelerated to 6.9% yoy in 2016 from 1.0% yoy in 2015, boosted by the strong sales of new homes last year. Meanwhile, FAI in infrastructure (excluding power, heat, gas and water infrastructure) still managed to rise rapidly by 17.4% yoy in 2016,

as the government has continued to provide great support to infrastructure investment.

Looking ahead, we expect China's FAI growth to moderate in coming future. The main reasons are that the government's efforts to cut excess capacities in certain industrial sectors and to tighten property markets in various cities are likely to slow down the growth in investments in the secondary and the real estate industries. Nevertheless, China's FAI growth is unlikely to decelerate markedly, supported by the rapid growth in infrastructure investment. In coming future, the government will push forward the construction of the major projects identified in the 13th Five-year Plan, promote Public-Private Partnership (PPP) projects and encourage central state-owned enterprises to make investment in weak areas such as power grids and telecommunication infrastructure in rural areas.

Exhibit 15 China's FAI (excluding rural households) growth, July to December 2016

	Jul 16	Aug	Sep	Oct	Nov	Dec
FAI (excluding rural households) <i>(year-to-date, yoy growth %)</i>	8.1	8.1	8.2	8.3	8.3	8.1
FAI (excluding rural households) <i>(mom growth %, seasonally adjusted)</i>	0.54	0.62	0.68	0.62	0.57	0.53

Source: National Bureau of Statistics, PRC

⁸ 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. High number of new births bodes well for many sectors

According to the National Health and Family Planning Commission, the number of new births in China increased by 11% yoy to 18.67 million and second child accounted for 45% of the new births in 2016. In our view, the year-on-year increase in new births in the year was due largely to the introduction of the policy that all couples are allowed to have two children effective from 1 January 2016.

Looking forward, the Commission predicts that the number of new births will rise further this year and will range from 17 million to 20 million per annum by 2020. The expected high number of new births bodes well for sectors such as toys, baby and kids products, maternal and child health care, and education, to name just a few.

2. Growth in sales of housing-related items decelerates amid slower growth in new home sales

Growth in the sales of new homes has decelerated in recent months: the sale of residential housing in terms of floor space posted a slower growth of 22.4% yoy in 2016, compared to the 27.1% yoy growth in 1-3Q16. We believe that the growth deceleration can be attributed to the introduction of the property tightening measures in various first tier and second tier cities from late September last year onwards.

Against this backdrop, the sales of housing-related items have increased at a slower pace in past few months. For example, the growth rates for retail sales of 'furniture' and 'building and decoration materials' by enterprises above a designated size were 12.7% yoy and 14.0% yoy respectively in 2016, compared to 13.9% yoy and 15.4% yoy respectively in 1-3Q16.

According to the latest media report, the sales of new homes during the Chinese New Year holidays were weak in some first tier and second tier cities such

as Guangzhou, Tianjin and Zhengzhou.⁹ Looking ahead, we expect that the growth in the sales of residential housing will drop further this year, as local governments in many cities are set to continue their property tightening measures. This will have an adverse impact on the sales of housing-related items in the foreseeable future.

3. Growth in RMB loans accelerates

The growth in RMB loans has accelerated in recent months. As at the end of December, the total outstanding RMB loans gained 13.5% yoy, compared to the growth of 13.0% yoy as at the end of September. Overall, in 2016, the increase in the total outstanding RMB loans reached 12.65 trillion yuan, up from 11.72 trillion yuan in 2015. Meanwhile, the broad money supply (M2) grew by 11.3% yoy as at the end of December 2016 (see exhibit 16).

Driven mainly by the demand for housing mortgages, the total outstanding medium- to long term RMB loans to households gained 5.68 trillion yuan, contributing 44.9% of the increase in RMB loans in the year. Meanwhile, the total outstanding medium- to long term RMB loans to non-financial business and other sectors expanded by 4.18 trillion yuan, contributing 33.0% of the increase in RMB loans in the year.

Recently, there have been signs that China's central bank may have started to adopt a less accommodative monetary policy. On 24 January, China's central bank lent 245.5 billion yuan via the medium-term lending facility (MLF) to 22 financial institutions. The one year MLF rate was 3.1%, while the six-month MLF rate was 2.95%. Both rates were 10 bps higher than the rates at which the central bank lent money via the MLF the previous time. Afterwards, on 3 February, the overnight, the seven-day and the one-month interest rates of the standing lending facility (SLF) were raised by 35 bps, 10 bps and 10 bps respectively. The rise in the interest rates of MLF and SLF is believed to increase the financing costs on financial institutions, which would lead to a less accommodative credit conditions in China.

Exhibit 16 Broad money supply (M2) and RMB loans, January to December 2016

As of	Broad money supply (M2)		Total outstanding RMB loans		Increase in RMB loans (trillion yuan)	
	Amount (trillion yuan)	yoy growth	Amount (trillion yuan)	yoy growth	FY15	FY16
End-Jan 16	141.6	14.0%	96.5	15.3%	Jan 16	2.51
End-Feb	142.5	13.3%	97.2	14.7%	Feb	0.73
End-Mar	144.6	13.4%	98.6	14.7%	Mar	1.37
End-Apr	144.5	12.8%	99.1	14.4%	Apr	0.56
End-May	146.2	11.8%	100.1	14.4%	May	0.99
End-Jun	149.1	11.8%	101.5	14.3%	Jun	1.38
End-Jul	149.2	10.2%	102.0	12.9%	Jul	0.46
End-Aug	151.1	11.4%	102.9	13.0%	Aug	0.95
End-Sep	151.6	11.5%	104.1	13.0%	Sep	1.22
End-Oct	152.0	11.6%	104.8	13.1%	Oct	0.65
End-Nov	153.0	11.4%	105.6	13.1%	Nov	0.79
End-Dec	155.0	11.3%	106.6	13.5%	Dec	1.04

Source: People's Bank of China

4. 'Total social financing' increases by 17.8 trillion yuan in 2016

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 17.8 trillion yuan in 2016, larger than the increase seen in the previous year (i.e. 15.41 trillion yuan) (see exhibit 17).

Compared to 2015, trust loans, entrusted loans and equity issuance played a more important role in driving up 'total social financing' in 2016. For example, equity issuance contributed 7.0% of the increase in 'total social financing' in 2016, compared to a 4.9% share in the previous year.

Exhibit 17 Increase in total social financing, 2015 to 2016

	2015		2016	
	Amount (billion yuan)	Share (%)	Amount (billion yuan)	Share (%)
Total social financing	15,410	100.0	17,800	100.0
RMB loans to the real sector	11,269	73.1	12,440	69.9
Foreign currency loans to the real sector	-643	-4.2	-564	-3.2
Trust loans	43	0.3	859	4.8
Entrusted loans	1,591	10.3	2,190	12.3
Bank acceptance bills	-1,057	-6.9	-1,950	-11.0
Corporate bonds	2,825	18.3	3,000	16.9
Equity issuance	760	4.9	1,240	7.0

Source: People's Bank of China

C Outlook

1. Top leaders pledge to ensure economic and social stability

On 14-16 December last year, top leaders in China attended the Central Economic Work Conference, the meeting which sets the key economic tasks for year 2017.¹⁰ The key takeaways are:

China will strive to ensure economic and social stability ahead of the 19th National Party Congress which will be held in late 2017. The key tasks will include stabilizing growth, promoting reforms, adjusting structure, improving people's livelihood and preventing risks.

Fiscal policy will be more proactive and effective, and should be in line with the requirements to push forward supply-side structural reforms, reduce tax burden on enterprises and improve people's livelihood.

China will continue with its prudent and neutral monetary policy, to help maintain stable liquidity conditions.

Greater importance will be attached to the prevention and control of financial system risks.

The Chinese yuan exchange rate will be kept basically stable at an appropriate and equilibrium level, and its flexibility will increase.

China will provide credit support to purchases of homes for self-use, while loans for property speculations will be strictly limited.

China will continue to deepen the supply-side structural reforms.

2. Entrepreneur Confidence Index for the secondary industry reaches a seven-quarter high

China's Entrepreneur Confidence Index (ECI) for the secondary industry rose by 4.0 pts from the previous quarter to a seven-quarter high of 115.4 in 4Q16. The index has posted quarter-on-quarter gain for three consecutive quarters, indicating that Chinese entrepreneurs in the secondary industry have become more optimistic (see exhibit 18).¹¹

The rise in profits of enterprises is believed to be one of the major reasons behind the improvement in confidence among Chinese entrepreneurs in the secondary industry. According to the NBS, the total profits earned by large and medium industrial enterprises above a designated size posted positive growth of 8.5% yoy in 2016, compared to the 2.3% yoy drop in 2015.

¹⁰ http://news.xinhuanet.com/politics/2016-12/16/c_1120133804.htm

¹¹ 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 18 China's Entrepreneur Confidence Index (Secondary Industry), 1Q15 to 4Q16

	1Q15	2Q15	3Q15	4Q15	1Q16	2Q16	3Q16	4Q16
Entrepreneur Confidence Index (Secondary Industry)	120.6	114.5	112.1	108.9	108.7	109.3	111.4	115.4

Source: National Bureau of Statistics, PRC

3. PMI indicates relatively fast expansion of China's manufacturing sector

After reaching its recent peak of 51.7 in November, China's manufacturing Purchasing Managers' Index (PMI) remained high at 51.4 in December and 51.3 in January. The index readings in the past three months indicate the relatively fast expansion of China's manufacturing sector (see exhibit 19).

The new orders index stayed high at 53.2, 53.2 and 52.8 in November, December and January respectively.¹² Meanwhile, the new export orders index rose by 1.1 pts from the previous month to 50.3 in November, returning to the expansionary zone, and then registered 50.1 and 50.3 in December and January respectively. These index readings indicate that both new domestic and export orders have expanded at a relatively quick pace in recent months.

Output growth has continued to be strong. The output index moderated from 53.9 in November to 53.3 in December and 53.1 in January; the January level was still the third highest level since November 2014.

Against this backdrop, manufacturers have been active in purchasing production inputs: the purchases of inputs index stayed high at between 52.1 and 52.9 throughout November to January.

Both the stocks of finished goods index and the stocks of major inputs index have remained below the critical 50-mark in the past few months, indicating that destocking activities have continued.

The input prices index went up from 68.3 in November to 69.6 in December, before moderating to 64.5 in January. The index was well above the critical 50-mark in the past three months, showing that the prices of production inputs have been rising at a fast pace. Accordingly, cost pressure on manufacturers has been intensifying.

The business expectations index edged up from 58.2 in December to 58.5 in January, indicating that purchasing managers have remained optimistic about the near term outlook for their respective industries.

¹² 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.

Part 1 :
**Domestic
 Trade**

Exhibit 19 China's manufacturing PMI at a glance, January 2017

Index	Seasonally Adjusted Index	Index Compared with the Previous Month	Direction
PMI	51.3	Lower	Expanding
Output	53.1	Lower	Expanding
New Orders	52.8	Lower	Expanding
New Export Orders	50.3	Higher	Expanding
Backlogs of Orders	46.3	Higher	Contracting
Stocks of Finished Goods	45.0	Higher	Contracting
Purchases of Inputs	52.6	Higher	Expanding
Imports	50.7	Higher	Expanding
Input Prices	64.5	Lower	Rising
Stocks of Major Inputs	48.0	Unchanged	Contracting
Ex-factory Prices	54.7	Lower	Rising
Employment	49.2	Higher	Contracting
Suppliers' Delivery Time	49.8	Lower	Slowing
Business Expectations	58.5	Higher	Optimistic

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

4. Non-manufacturing sector expands at a rapid pace

China's Business Activity Index, which is quoted as the Non-manufacturing Purchasing Managers' Index (NMI), stayed high at 54.7 in November, the highest level since July 2014, 54.5 in December and 54.6 in January. The index readings in past three months indicate that the non-manufacturing sector has expanded at a rapid pace recently (see exhibit 20).

The fast growth of the non-manufacturing sector was highly associated with the continuous increase in new orders. The new orders index came in at 51.3 in January, staying above the critical 50-mark for five consecutive months.

In response to rising new orders, enterprises have been increasing their service charges. The sales prices index registered 51.4, 51.9 and 51.0 in November, December and January respectively, above the critical 50-mark. Meanwhile, the input prices index went up from 53.5 in November to its recent peak of 56.2 in December, and then stayed high at 55.1 in January, indicating a marked rise in input prices in recent months.

The business expectation index has stayed at high level: 60.7 in November, 59.5 in December and 58.9 in January. Purchasing managers in the non-manufacturing sector have continued to be optimistic.

Exhibit 20 China's non-manufacturing purchasing managers' index (NMI) at a glance, January 2017

Index	Seasonally Adjusted Index	Index Compared with the Previous Month	Direction
Business activity	54.6	Higher	Expanding
New orders	51.3	Lower	Expanding
Input prices	55.1	Lower	Rising
Sales prices	51.0	Lower	Rising
Business expectations	58.9	Lower	Optimistic

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

A Recent developments

1. Both exports and imports post year-on-year drop in 2016

China's exports fell by 4.8% yoy in 4Q16, posting year-on-year drop for seven consecutive quarters (see exhibits 21, 22 and 23). The weak export performance in 4Q16 can be attributable to the slackening external demand, intense competition in the international market as well as rising labour and environmental costs in China. Overall, in 2016, China's exports amounted to US\$ 2,097.4 billion, down by 7.7% yoy.

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China's exports to most of its major trading partners showed negative yoy growth in 2016. Exports to the US, the EU, Japan, the ASEAN and Brazil dropped by 5.9% yoy, 4.7% yoy, 4.7% yoy, 7.8% yoy and 19.9% yoy respectively in 2016. In contrast, China's exports to Russia and India managed to record positive growth of 7.3% yoy and 0.2% yoy respectively in 2016, indicating that the demand for Chinese products from these two emerging countries was relatively strong in the year.

China's imports gained 2.7% yoy in 4Q16, recording positive year-on-year growth for the first time since 4Q14. In our view, the improvement in China's import growth was due largely to the rise in commodity prices and the stronger domestic demand. Overall, in 2016, China's imports totalled US\$ 1,587.5 billion, down by 5.5% yoy.

China's imports of some major commodities managed to show year-on-year gains in 2016. The imports of iron ore, crude, coal, steel and copper increased by 7.5% yoy, 13.6% yoy, 25.2% yoy, 3.4% yoy and 2.9% yoy, respectively, in volume terms during the period.

In January 2017, China's exports and imports gained 7.9% yoy and 16.7% yoy respectively. One of the possible reasons behind the strong year-on-year rise in both exports and imports was the different timing of the Chinese New Year holiday in 2016 and 2017: Chinese enterprises rushed to export and import their goods before the Chinese New Year, which falls in late January this year.

China's trade surplus remained high at US\$ 134.5 billion in 4Q16, after registering US\$ 146.3 billion in 3Q16. Overall, in 2016, China's trade surplus totalled US\$ 510.0 billion. Amid the rising tide of foreign trade protectionism, a country having massive trade surplus with another country is likely to face more trade disputes. As China's trade surplus with the US was as much as US\$ 250.8 billion in 2016, China is likely to face difficult challenge in maintaining good trade relations with the US under the Trump's administration.

Exhibit 21 China's quarterly foreign trade data, 1Q16 to 4Q16

USD billion (yoy growth)

	Exports		Imports		Trade Balance
FY16	2,097.4	(-7.7%)	1,587.5	(-5.5%)	510.0
1Q16	463.9	(-9.6%)	338.2	(-13.5%)	125.7
2Q16	534.2	(-4.4%)	390.6	(-6.8%)	143.7
3Q16	559.8	(-6.3%)	413.5	(-4.7%)	146.3
4Q16	584.4	(-4.8%)	449.9	(2.7%)	134.5

Source: China Customs

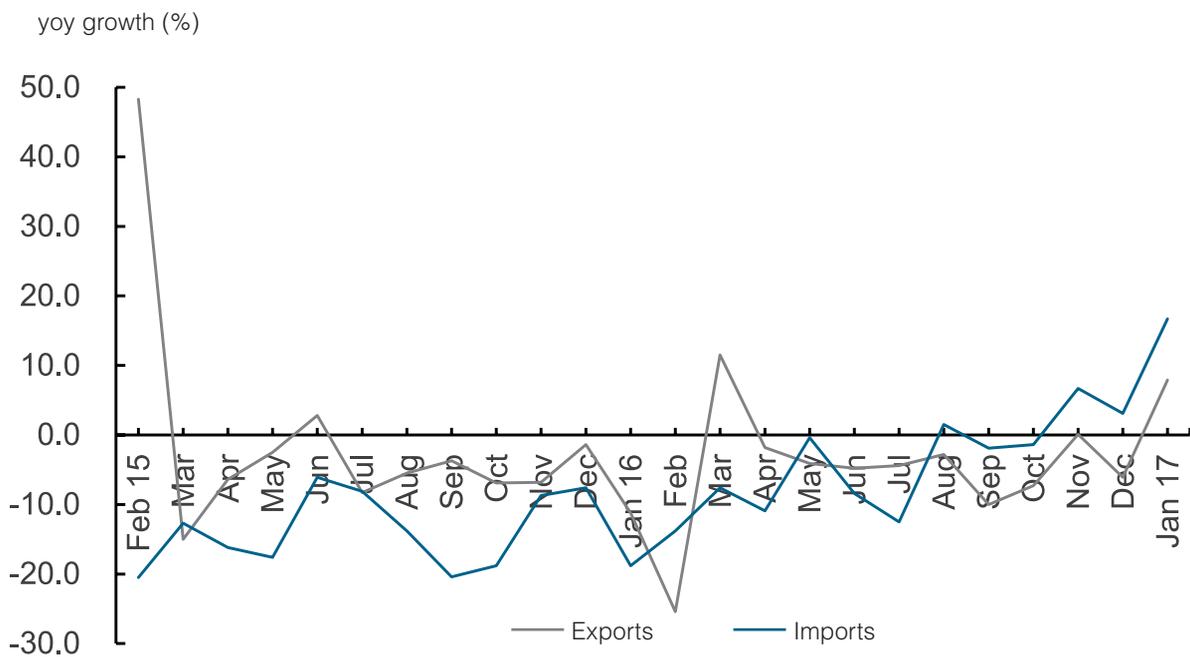
Exhibit 22 China's monthly foreign trade data, February 2016 to January 2017

USD billion (yoy growth)

	Exports		Imports		Trade Balance
February 2016	126.1	(-25.4%)	93.6	(-13.8%)	32.6
March	160.8	(11.5%)	131.0	(-7.6%)	29.9
April	172.8	(-1.8%)	127.2	(-10.9%)	45.6
May	181.1	(-4.1%)	131.1	(-0.4%)	50.0
June	180.4	(-4.8%)	132.3	(-8.4%)	48.1
July	184.7	(-4.4%)	132.4	(-12.5%)	52.3
August	190.6	(-2.8%)	138.5	(1.5%)	52.0
September	184.5	(-10.0%)	142.5	(-1.9%)	42.0
October	178.2	(-7.3%)	129.1	(-1.4%)	49.1
November	196.8	(0.1%)	152.2	(6.7%)	44.6
December	209.4	(-6.1%)	168.6	(3.1%)	40.8
January 2017	182.8	(7.9%)	131.4	(16.7%)	51.3

Source: China Customs

Exhibit 23 Growth rates of exports and imports, February 2015 to January 2017



Source: China Customs

Exhibit 24 Exports by category, 2015 and 2016

<i>yoy growth (%) of export value, calculated in USD</i>	2015	2016
Textile materials and products	-2.3	-4.1
Garments and clothing accessories	-6.4	-9.6
Footwear	-4.8	-12.1
Toys	10.8	17.4
Coal	-28.3	39.8
Crude oil	215.0	-39.0
Refined oil	-25.9	1.5
Steel	-11.3	-13.4
Mechanical and electrical products	0.1	-7.7

Source: China Customs

Exhibit 25 Imports by category, 2015 and 2016

<i>yoy growth (%) of import value, calculated in USD</i>	2015	2016
Cereal and cereal flour	51.1	-39.3
Soybean	-13.6	-2.3
Iron ore	-38.3	0.5
Crude oil	-41.1	-13.3
Refined oil	-39.0	-21.8
Steel	-20.0	-8.2
Textile yarns, fabric and textile products	-6.4	-12.2
Vehicles and vehicle chassis	-26.1	-0.5

Source: China Customs

2. Both general trade exports and processing trade exports continue to post year-on-year declines in 4Q16

Both the general trade¹³ exports and the processing trade¹⁴ exports continued to post year-on-year negative growth in 4Q16. It is noteworthy that the growth of the general trade exports deteriorated to minus 10.3% yoy in 4Q16 from minus 9.9% yoy in 3Q16. Meanwhile, the processing trade exports fell by 5.4% yoy in 4Q16, compared with the 8.7% yoy decline in 3Q16 (see exhibit 26).

On the import side, the year-on-year growth of the general trade imports turned positive in 4Q16, partly attributed to the rise in commodity prices. After falling by 0.3% yoy in 3Q16, the general trade imports gained 7.2% yoy in 4Q16. Meanwhile, the processing trade

imports fell by 5.1% yoy in 4Q16, compared to the 7.9% yoy drop in 3Q16. In our view, the fall in the processing trade imports in 4Q16 suggests that the processing trade exports are likely to continue to show negative growth in the near future, as processing trade imports serve as a leading indicator of processing trade exports performance.

In 4Q16, the share of processing trade in China's total trade was 32.3%, much lower than that of general trade (i.e. 52.5%). Nevertheless, with a large surplus of US\$ 91.8 billion in 4Q16, processing trade still plays an important role in China's foreign trade.

¹³ '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.

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.

Exhibit 26

China foreign trade (general and processing trades), 2015 to 4Q16

Item	yoy growth (%)				Share (%)			
	FY15	FY16	3Q16	4Q16	FY15	FY16	3Q16	4Q16
Exports	-2.8	-7.7	-6.3	-4.8	100.0	100.0	100.0	100.0
Of which:								
General Trade	1.1	-7.0	-9.9	-10.3	53.5	53.8	51.2	50.5
Processing Trade	-9.8	-10.3	-8.7	-5.4	35.0	34.1	33.4	37.2
Imports	-14.1	-5.5	-4.7	2.7	100.0	100.0	100.0	100.0
Of which:								
General Trade	-16.8	-2.5	-0.3	7.2	54.9	56.6	57.2	54.9
Processing Trade	-14.8	-11.3	-7.9	-5.1	26.6	25.0	25.4	26.1
Total of Imports and Exports	-8.0	-6.8	-5.6	-1.7	100.0	100.0	100.0	100.0
Of which:								
General Trade	-7.5	-5.1	-5.8	-2.9	54.1	55.0	53.8	52.5
Processing Trade	-11.6	-10.6	-8.4	-5.3	31.4	30.2	30.0	32.3

Source: China Customs

3. China's exports to the US post the first year-on-year drop in seven years

The EU was still China's largest trading partner, accounting for 14.8% of China's total foreign trade in 2016. Sino-EU trade amounted to US\$ 546.9 billion in 2016, down by 3.1% yoy. Specifically, China's exports to the EU fell by 4.7% yoy in 2016, compared to the 4.0% yoy drop in 2015; and China's imports from the EU fell by 0.4% yoy in 2016, compared to the 14.5% yoy drop in 2015 (see exhibits 27 and 28).

Accounting for 14.1% of China's total foreign trade, the US continued to be China's second largest trading partner in 2016. Sino-US trade fell by 6.7% yoy in 2016. For the first time in seven years, China's exports to the US posted negative year-on-year drop, down by 5.9% yoy in 2016. Meanwhile, China's imports from the US decreased at a faster pace, by 9.1% yoy, in 2016, compared to the 6.5% yoy drop in 2015.

The Association of South East Asian Nations (ASEAN) accounted for 12.3% of China's total foreign trade in 2016. China's trade with ASEAN dropped by 4.2% yoy to US\$ 451.8 billion in 2016. Of which, China's exports to ASEAN shrank by 7.8% yoy, and China's imports from ASEAN gained 0.9% yoy, in 2016.

Sino-Japanese trade contracted by 1.3% yoy to US\$ 274.8 billion in 2016. China's exports to Japan fell by 4.7% yoy, while China's imports from Japan rose by 1.9% yoy in 2016.

4. China's exports to Russia recover quickly in 2016

In 2016, the growth of China's exports to Russia turned positive to 7.3% yoy, up from minus 35.2% yoy in 2015. The recovery could be attributed to the recent improvement in Russia's economy. Meanwhile, China's imports from Russia fell at a slower pace, by 3.1% yoy, in 2016, compared to the 20.0% yoy drop in 2015 (see exhibits 27 and 28).

In 2016, China's exports to India gained 0.2% yoy, while China's imports from India dropped by 12.0% yoy. Overall, the growth of Sino-Indian trade worsened to minus 2.1% yoy in 2016 from 1.5% yoy in 2015.

Sino-Brazilian trade dropped by 5.3% yoy in 2016. China's exports to Brazil fell by 19.9% yoy in 2016. In contrast, China's import from Brazil expanded by 3.7% over the same period.

Together, these three BRIC members accounted for 5.6% of China's total exports and 5.7% of China's total imports in 2016, up from 5.3% and 5.4%, respectively, in 2015.

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Exhibit 27 China's trading partners, 2016

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	546.9	14.8	339.0	207.9	-3.1	-4.7	-0.4
US	519.6	14.1	385.2	134.4	-6.7	-5.9	-9.1
ASEAN	451.8	12.3	255.6	196.2	-4.2	-7.8	0.9
Japan	274.8	7.5	129.2	145.6	-1.3	-4.7	1.9
Brazil	67.7	1.8	22.0	45.7	-5.3	-19.9	3.7
Russia	69.5	1.9	37.3	32.2	2.2	7.3	-3.1
India	70.1	1.9	58.3	11.8	-2.1	0.2	-12.0

Source: China Customs

Exhibit 28 China's trading partners, comparing growth rates for 2015 and 2016

Country/Region	Total Trade		Exports		Imports	
	2015	2016	2015	2016	2015	2016
EU	-8.2	-3.1	-4.0	-4.7	-14.5	-0.4
US	0.6	-6.7	3.4	-5.9	-6.5	-9.1
ASEAN	-1.7	-4.2	2.1	-7.8	-6.6	0.9
Japan	-10.8	-1.3	-9.2	-4.7	-12.2	1.9
Brazil	-17.3	-5.3	-21.4	-19.9	-14.5	3.7
Russia	-28.6	2.2	-35.2	7.3	-20.0	-3.1
India	1.5	-2.1	7.4	0.2	-18.2	-12.0

Source: China Customs

5. Exports from Shanxi, Shaanxi and Xinjiang manage to show positive growth in 2016

All top six provinces and municipalities in terms of value of exports – Guangdong, Jiangsu, Shanghai, Zhejiang, Shandong and Fujian – witnessed negative year-on-year growth in exports in 2016 (see exhibit 29).¹⁵ Among these provinces, Guangdong, which accounted for 31.2% of total China's exports in 2016, saw the sharpest fall in exports in 2016. Exports from Guangdong dropped by 10.4% yoy to US\$ 654.2 billion in 2016.

In fact, only three provinces in China saw positive growth in exports in 2016: Shanxi, Shaanxi and Xinjiang, all of which are in the central and the western regions. Exports from Shanxi, Shaanxi and Xinjiang expanded by 9.5% yoy, 8.0% yoy, and 11.1% yoy respectively in 2016.

¹⁵ China's top six provinces and municipalities in terms of value of exports – Guangdong, Jiangsu, Shanghai, Zhejiang, Shandong and Fujian – jointly accounted for 79.0% of China's total China's exports in 2016.

Exhibit 29 Top six provinces and municipalities in terms of value of exports, 2016

Provinces/ Municipalities	Value of exports (USD billion)	yoy growth (%)	Share of total exports (%)
Guangdong	654.2	-10.4	31.2
Jiangsu	331.2	-5.1	15.8
Zhejiang	273.5	-3.4	13.0
Shanghai	166.5	-6.8	7.9
Shandong	144.4	-2.8	6.9
Fujian	87.3	-6.9	4.2

Source: China Customs

6. Share of service sector in total FDI reaches 70.3% in 2016

China's foreign direct investment (FDI) in Renminbi terms gained 5.7% yoy in December, recording positive year-on-year growth for five consecutive months. Overall, in 2016, China's FDI amounted to 813.2 billion yuan, up by 4.1% yoy (see exhibit 30).

FDI in the service sector increased by 8.3% yoy to 571.6 billion yuan in 2016. The share of the service sector in China's total FDI reached 70.3% in 2016, up from 61.1% in 2015. Among the industries in the service sector, FDI in the industries of 'information and consultancy services', 'computer services', 'integrated technology services', 'distribution services' and 'retail' posted rapid growth of 59.8% yoy, 112.8% yoy, 66.4% yoy, 42.9% yoy and 83.1% yoy respectively in 2016. The figures indicate that foreign enterprises are optimistic about these industries in China.

Among industries in the manufacturing sector, FDI in the 'pharmaceutical industry' and the 'medical equipment, instruments and meters industry' grew strongly by 55.8% yoy and 95.0% yoy respectively over the same period.

Among regions, FDI in the western region rose by 1.6% to reach 62.7 billion yuan in 2016. Meanwhile, FDI in the eastern region increased by 7.6% yoy to 704.7 billion yuan in 2016.

FDI from the US and the EU soared by 52.6% yoy and 41.3% yoy respectively in 2016. Meanwhile, FDI from the Japan gained 1.7% yoy in 2016, after posting year-on-year drop in 2014 and 2015.

Exhibit 30 China's FDI, January to December 2016

	Amount (billion yuan)	yoy growth
FY15	781.4	6.4%
FY16	813.2	4.1%
January 16	88.3	3.2%
February	53.6	1.8%
March	82.3	7.8%
April	62.6	6.0%
May	56.8	-1.0%
June	98.2	9.7%
July	49.8	-1.6%
August	57.3	5.7%
September	60.2	1.2%
October	57.3	4.7%
November	65.5	0.9%
December	81.4	5.7%

Source: Ministry of Commerce, PRC

Exhibit 31 Foreign exchange reserves by quarter, 1Q16 to 4Q16

USD billion	Accumulation	End of the quarter
FY16	-319.8	
1Q16	-117.8	3,212.6
2Q16	-7.4	3,205.2
3Q16	-38.8	3,166.4
4Q16	-155.9	3,010.5

Source: State Administration of Foreign Exchange, PRC

7. China's foreign exchange reserves fall below US\$ 3 trillion

After decreasing by US\$ 38.8 billion in 3Q16, the foreign exchange reserves fell at a faster pace, by US\$ 155.9 billion, in 4Q16. Then, the foreign exchange reserves went down further by US\$ 12.3 billion to US\$ 2,998.2 billion as at the end of January, dipping below the US\$ 3 trillion level for the first time since March 2011 (see exhibit 31). We believe that the drop in the foreign exchange reserves was mainly due to the continuous capital outflows.

It is noteworthy that, since early January, the government has strengthened scrutiny on individual's purchases of foreign currency. According to the Chinese media report, effective from 1 January, individuals who purchase foreign currencies at banks are required to fill in an application forms to declare the purposes of the purchases. Using the foreign currencies to buy flats, securities, life-insurance plans and investment type insurance plans overseas are prohibited – and the penalties for doing so are clearly stated on the application form.

It is expected that the measure will ease the demand for foreign currencies from individuals. Nevertheless, we still predict that China's foreign exchange reserves will fall further in coming future due to increase in overseas investment and hot money outflows driven by the expectation of quicker hike in the US interest rate.

B Highlights

1. Major economies refuse to recognize China as a market economy

11 December 2016 marked the 15th anniversary of China's accession to the World Trade Organization (WTO).

According to a clause of the treaty of China's accession to the WTO, other WTO members can use prices of goods of a 'surrogate' market economy instead of prices of goods sold in China for calculating dumping margins in anti-dumping investigations in the first 15 years of China's membership given that China was not regarded as a market economy under the standards of the WTO. The clause expired on 11 December 2016.¹⁶ Accordingly, the Chinese government expected China to gain the market economy status on the same day. However, according to media reports, the EU, Japan and the US have refused to recognize China as a market economy and to abolish the practice of using prices of goods of a 'surrogate' market economy in anti-dumping investigations against China.¹⁷ This would put China in an unfavourable position in anti-dumping investigations, as importing economies are likely to choose a 'surrogate' market economy where products are sold at high prices, which will result in stronger chances of proving allegations of dumping by Chinese manufacturers and higher anti-dumping duty rates on Chinese products. Amid the rising tide of trade protectionism, China is expected to face more allegations of dumping in coming future.

According to China's Ministry of Commerce spokesman Shen Danyang, if WTO members continue to adopt the methodology of a 'surrogate' market economy in antidumping investigations against Chinese products after 11 December 2016, China would defend its rights through taking necessary actions in accordance with WTO rules.¹⁸

2. China announces a package of tariff adjustments

On 19 December 2016, the Customs Tariff Commission of the State Council announced to introduce a package of tariff adjustments in 2017.¹⁹ The key takeaways are:

- Starting from 1 July 2017, the most-favoured-nation (MFN) tariff rates for a number of information technology products will be lowered.²⁰
- Starting from 1 January 2017, the provisional tariff rates will be imposed on 822 imported items; and starting from 1 July 2017, the number of imported items to which the provisional tariff rates apply will be reduced to 805.²¹ It is noteworthy that, for those items, the provisional tariff rates are lower than the most-favoured-nation tariff rates.

¹⁶ <http://www.reuters.com/article/us-china-trade-wto-idUSKBN14112M>

¹⁷ <http://theory.people.com.cn/BIG5/n1/2017/0209/c40531-29067649.html>

¹⁸ http://www.gov.cn/xinwen/2016-12/09/content_5145896.htm

¹⁹ http://gss.mof.gov.cn/zhengwuxinxi/zhengcefabu/201612/t20161223_2498029.html

²⁰ <http://gss.mof.gov.cn/zhengwuxinxi/zhengcefabu/201612/P020161223553420693120.pdf>

²¹ <http://gss.mof.gov.cn/zhengwuxinxi/zhengcefabu/201612/P020161223553420940646.pdf>

3. Exchange rate of Chinese yuan against the US dollar appreciates in early to late January

The daily fixing rate (also known as the central parity rate) of the Chinese yuan against the US dollar depreciated from the recent peak of 6.6056 on 17 August to 6.9508 on 16 December, the weakest level since late May 2008, before staying relatively stable until the end of year 2016 (see exhibit 32).²² Afterwards, the daily fixing rate appreciated from 6.9498 on 3 January, the first trading day of this year, to 6.8331 on 24 January, and stayed relatively stable in late January to early February, before depreciating slightly to 6.8806 on 14 February.

In line with the trend of the daily fixing rate, the USD-CNY spot exchange rate depreciated throughout mid-August to mid-December last year, appreciated in early to late January this year, and has stayed relatively stable since then (as of 14 February).²³

Overall, in 2016, the USD-CNY spot exchange rate depreciated by 6.56%, compared to the 4.46% depreciation in 2015. In our view, the depreciation of the Chinese yuan against the US dollar in 2016 was mainly driven by hot money outflows from China.

The daily fixing rate of the Chinese yuan against the Euro appreciated from 7.5099 on 7 November to 7.2270 on 21 December, and then depreciated to 7.4010 on 6 February (see exhibit 33). Since then, the daily fixing rate of the Chinese yuan against the Euro has appreciated again, reaching 7.2948 on 14 February. Overall, in 2016, the daily fixing rate of the Chinese yuan against the Euro depreciated by 2.90%.

According to the Bank for International Settlements, the real effective exchange rate (REER) of the yuan has shown a slight rebound in recent months, rising all the way from 120.91 in October to 122.86 in December, the highest level since July 2016.²⁴ Overall, in 2016, the Chinese yuan depreciated in real terms against its trading partners by 5.7% (see exhibit 34).

Looking ahead, we predict that the exchange rate of the Chinese yuan against the US dollar will stay weak in coming months, amidst the expectations of the US interest rate hikes this year.

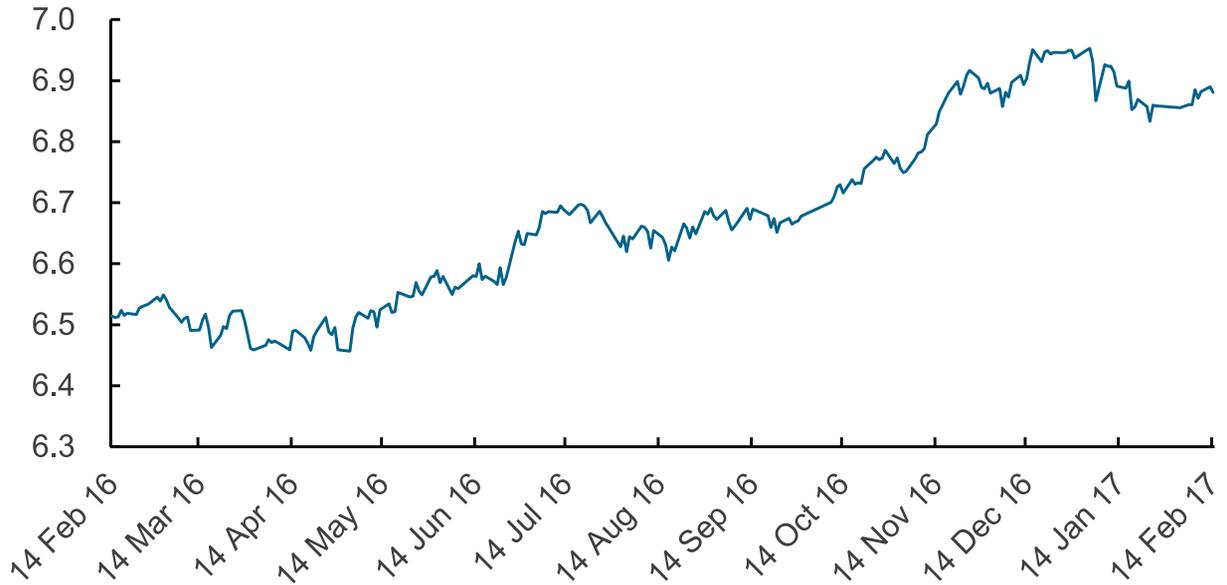
²² According to the PBOC, the daily fixing rate (also known as the central parity rate) of the Chinese yuan against the US dollar is directly formed by market makers based on the closing rate of the previous day, the supply-demand conditions in the market and the movements of major international currencies.

²³ The daily trading band of the Chinese yuan against the US dollar is $\pm 2.0\%$ around the daily fixing rate.

²⁴ 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 2011-13.

Part 2 :
Foreign
Trade

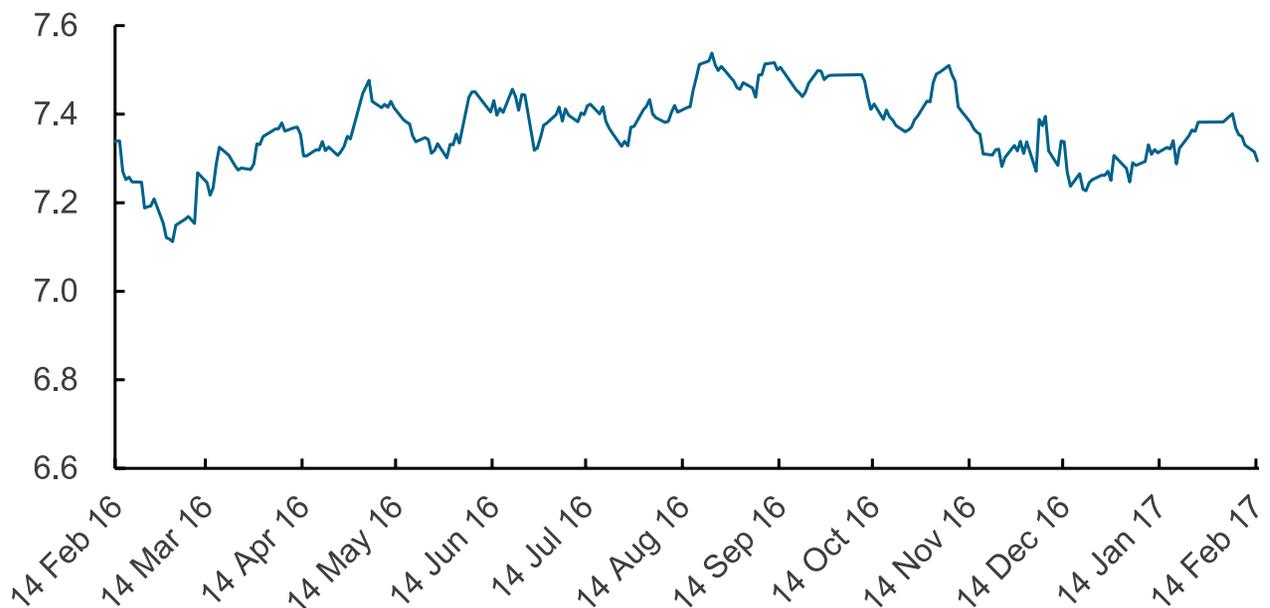
Exhibit 32 USD-CNY daily fixing rate, February 2016 to February 2017



Source: State Administration of Foreign Exchange

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Exhibit 33 EUR-CNY daily fixing rate, February 2016 to February 2017



Source: State Administration of Foreign Exchange

Exhibit 34

Real effective exchange rate of the Chinese yuan, January 2015 to December 2016



Source: Bank for International Settlements

C Outlook

1. US economic growth moderates in 4Q16

The economic growth in the US moderated, but was still strong in 4Q16. After growing by an annual rate of 3.5% in 3Q16, the US real GDP advanced by 1.9% in 4Q16, the second highest level in five quarters. Overall, in 2016, the real GDP growth was 1.6%, weaker than 2.6% in 2015 (see exhibit 35).

Latest indicators show that the US manufacturing sector has gained momentum recently. According to the Institute for Supply Management, the manufacturing Purchasing Managers' Index (PMI) rose all the way from 49.4 in August 2016 to 56.0 in January 2017, indicating that the growth of the manufacturing sector has continued to accelerate in past few months. Besides, industrial production gained 0.8% mom in December, posting the fastest month-on-month growth since November 2014 (see exhibit 36). However, the new orders for manufactured durable goods dropped by 0.5% mom in December, posting negative month-on-month growth for two consecutive months, indicating moderation in the demand for durable goods.

The non-manufacturing index (NMI), compiled by the Institute for Supply Management, went up from 54.8 in October to 57.2 in November and in December, the highest level since November 2015, and then edged down to 56.5 in January. The index readings in recent months indicate that the non-manufacturing sector has expanded at a fast pace lately.

US consumers have continued to increase their purchases in past few months. The US retail sales gained 0.6% mom in December, recording positive month-on-month growth for four consecutive months. Meanwhile, the Reuters/University of Michigan Index of consumer sentiment rose all the way from 87.2 in October to 98.5 in January, the highest level since 2004. The latest reading indicates that US consumers have been quite optimistic recently, attributable to the anticipation of better job prospects under Trump administration (see exhibit 37).

The pace of job creation has been relatively fast lately. The non-farm payroll employment rose by 227,000 in January, higher than its 12-month average of 195,000. In the meantime, the US unemployment rate rose slightly to 4.8% in January from 4.7% in December (see exhibit 38).

Looking ahead, we forecast that the US economic growth will accelerate this year, driven partly by the tax cuts and increase in infrastructure investment under the Trump administration. According to the latest projection by the International Monetary Fund (IMF), the real GDP growth in the US is forecast to rise from 1.6% in 2016 to 2.3% in 2017.²⁵

Exhibit 35 US national accounts, 2015 to 4Q16

Annual growth (%)	2015	2016	1Q16	2Q16	3Q16	4Q16
Real GDP	2.6	1.6	0.8	1.4	3.5	1.9

Source: US Department of Commerce

Exhibit 36 US industrial sector, July to December 2016

<i>mom growth (%), seasonally adjusted</i>	Jul 16	Aug	Sep	Oct	Nov	Dec
Industrial production	0.3	-0.1	-0.2	0.2	-0.7	0.8
New orders for manufactured durable goods	3.6	0.2	0.3	5.0	-4.7	-0.5

Source: US Federal Reserve, US Department of Commerce

Exhibit 37 US consumer market, August 2016 to January 2017

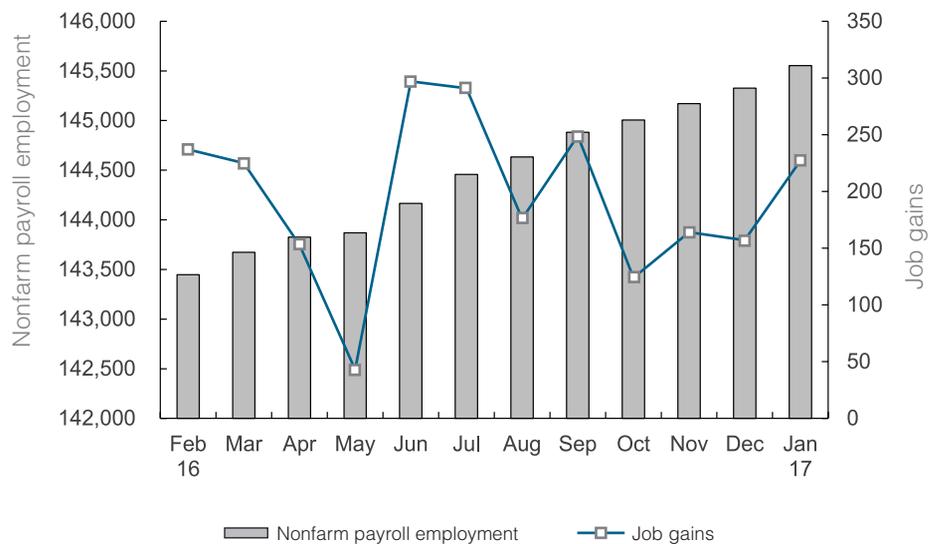
	Aug 16	Sep	Oct	Nov	Dec	Jan 17
Retail and food services sales <i>(mom growth %, seasonally adjusted)</i>	0.0	1.0	0.7	0.2	0.6	-
Reuters/University of Michigan index of consumer sentiment	89.8	91.2	87.2	93.8	98.2	98.5
CPI <i>(yoy growth %)</i>	1.1	1.5	1.6	1.7	2.1	-

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

Exhibit 38 US employment

	Unemployment rate (%)
2015	5.3
2016	4.9
Feb 16	4.9
Mar	5.0
Apr	5.0
May	4.7
Jun	4.9
Jul	4.9
Aug	4.9
Sep	4.9
Oct	4.8
Nov	4.6
Dec	4.7
Jan 17	4.8

Nonfarm payroll employment, February 2016 to January 2017
In thousands, seasonally adjusted



Yearly figures: Annual average
Monthly figures: Seasonally adjusted

Source: US Department of Labor

2. Eurozone economy shows signs of improvement

The real GDP growth in the Eurozone accelerated slightly to 0.5% qoq in 4Q16 from 0.4% qoq in 3Q16.²⁶ Overall, in 2016, the real GDP in the region gained 1.7% yoy (see exhibit 39).

Recent indicators point to relatively strong growth of both the service sector and the manufacturing sector in past few months. According to the global survey firm Markit Economics, the Eurozone services PMI went up all the way from 52.2 in September to 53.8 in November, and then remained high at 53.7 in December and in January, indicating that the services sector in the Eurozone has expanded at fast pace recently. Meanwhile, the Eurozone manufacturing PMI rose all the way from 51.7 in August to 55.2 in January, the highest since May 2011, indicating that the growth momentum of the manufacturing sector in the region has become more robust.

On a seasonally adjusted basis, the retail trade volume in the Eurozone fell by 0.3% mom in December, posting negative month-on-month growth in four of the past five months (see exhibit 40).

The labour market conditions in the region have shown signs of improvement recently. The seasonally-adjusted unemployment rate fell all the way from 10.0% in August to 9.6% in December, the lowest level since May 2009 (see exhibit 41). Meanwhile, confidence on the economy in the region has continued to strengthen in past few months. The Eurozone's economic sentiment indicator (ESI) rose all the way from 103.5 in August to 107.9 in January (see exhibit 42).

Looking ahead, the Eurozone economy is expected to maintain the current pace of growth this year, supported by the accommodative monetary policy. According to the latest projection by the IMF, the Eurozone's real GDP is forecast to grow by 1.6% in 2017, slightly lower than the 1.7% growth in 2016.²⁷

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Exhibit 39 Eurozone's real GDP growth, 2015 to 4Q16

	2015	2016	1Q16	2Q16	3Q16	4Q16
Real GDP (<i>qoq growth %</i>)			0.5	0.3	0.4	0.5
Real GDP (<i>yoy growth %</i>)	2.0	1.7	1.7	1.6	1.8	1.8

Source: Eurostat

Exhibit 40 Eurozone consumer market, July to December 2016

	Jul 16	Aug	Sep	Oct	Nov	Dec
Volume of retail trade (<i>mom growth %, seasonally adjusted</i>)	0.4	-0.1	-0.3	1.5	-0.6	-0.3
Annual inflation (%)	0.2	0.2	0.4	0.5	0.6	1.1

Source: Eurostat

Exhibit 41 Eurozone labour market, July to December 2016

<i>seasonally adjusted</i>	Jul 16	Aug	Sep	Oct	Nov	Dec
Unemployment rate (%)	10.0	10.0	9.8	9.7	9.7	9.6

Source: Eurostat

²⁶ 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.

²⁷ IMF, World Economic Outlook Update, January 2017

Exhibit 42 Eurozone economic sentiment indicator, August 2016 to January 2017

<i>seasonally adjusted</i>	Aug 16	Sep	Oct	Nov	Dec	Jan 17
Economic sentiment indicator	103.4	104.7	106.3	106.5	107.8	107.9

Source: Eurostat

3. China's export growth is expected to improve in 1Q17

In its *World Economic Outlook Update* released on 16 January this year, the IMF predicts that the world economic growth will improve from 3.1% in 2016 to 3.4% in 2017, as the advanced economies, the emerging market economies and the developing economies are all set to grow at a faster pace due partly to the anticipated policy stimulus carried out by the US (see exhibit 43).

Looking ahead, against the backdrop of an improving global economy, we forecast that the year-on-year growth in China's exports will improve to minus 2-3% in 1Q17 from minus 4.8% in 4Q16. Still, challenges facing Chinese manufacturers persist, which include greater uncertainty in the US trade policies under the Trump administration, intense competition in the international market, stronger government's efforts to cut excess capacities in various sectors, increasing labour and environmental costs, as well as tough operating environment.

Exhibit 43 Latest GDP growth forecasts by the IMF

<i>yoy growth (%)</i>	2015	2016 (Estimates)	2017 (Forecasts)
World economy	3.2	3.1	3.4
Advanced economies	2.1	1.6	1.9
US	2.6	1.6	2.3
Eurozone	2.0	1.7	1.6
Japan	1.2	0.9	0.8
UK	2.2	2.0	1.5
Emerging market and developing economies	4.1	4.1	4.5
China	6.9	6.7	6.5
India *	7.6	6.6	7.2
Brazil	-3.8	-3.5	0.2
Russia	-3.7	-0.6	1.1

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

Source: IMF, World Economic Outlook Update, January 2017

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