

# China Trade Quarterly

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## Domestic Trade

Retail sales of consumer goods grow by 10.4% yoy in 1H17.

Ex-factory prices of industrial products trend downward.

Both rural and urban households see high single-digit growth in income in 1H17.

Growth in nominal fixed asset investment accelerates to 8.6% yoy in 1H17.

GMV of internet consumption finance market reaches 436.7 billion yuan in 2016.

Entrepreneurs in the secondary industry remain optimistic in 2Q17.

PMI fluctuates within a narrow range throughout April to July.

Non-manufacturing sector expands at a relatively fast pace lately.

## Foreign Trade

Both exports and imports post strong growth in 2Q17.

Exports to the US, the EU, Japan and the ASEAN gain 12.6% yoy, 9.2% yoy, 6.2% yoy and 9.5% yoy respectively in 1H17.

Exports from some western provinces show robust growth.

FDI drops slightly by 0.1% yoy in 1H17.

Foreign exchange reserves record the first positive quarter-on-quarter gain in twelve quarters.

Chinese yuan appreciates against the US dollar, but depreciates against the Euro.

Belt and Road Forum draws worldwide participation.

China and the US hold the first Comprehensive Economic Dialogue in mid-July.

# In This Issue:

## Part 1: Domestic Trade

<b>A</b>	<b>Recent developments</b>	4
<b>B</b>	<b>Highlights</b>	14
<b>C</b>	<b>Outlook</b>	16

## Part 2: Foreign Trade

<b>A</b>	<b>Recent developments</b>	20
<b>B</b>	<b>Highlights</b>	28
<b>C</b>	<b>Outlook</b>	32

2

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Helen Chin, Timothy Cheung

T: (852) 2300 2471  
helenchin@fung1937.com  
timothycheung@fung1937.com

Global Sourcing  
Fung Business Intelligence

10/F, LiFung Tower,  
888 Cheung Sha Wan Road,  
Kowloon, Hong Kong

T: (852) 2300 2470  
F: (852) 2635 1598  
E: fbicgroup@fung1937.com

<http://www.fbicgroup.com/>



# Executive Summary

## Domestic Trade

Retail sales of consumer goods reached 17,236.9 billion yuan in 1H17, up by 10.4% yoy. Online retail sales of goods, which accounted for 13.8% of total retail sales, rose strongly by 28.6% yoy over the period.

Ex-factory prices of industrial products have trended downward. The producer price index of industrial products slid 0.2% mom, dropping for the third consecutive month in June.

Both rural and urban households saw high single-digit growth in income in 1H17: The per capita disposable income of rural households grew nominally by 8.5% yoy to reach 6,562 yuan; while that of urban households rose by 8.1% yoy in nominal terms to reach 18,322 yuan in 1H17.

Growth in nominal fixed asset investment accelerated to 8.6% yoy in 1H17 from 8.1% yoy in 2016, driven by the investment in infrastructure, the secondary industry and real estate development.

Gross merchandise volume of China's internet consumption finance market reached 436.7 billion yuan in 2016, up markedly from 6 billion yuan in 2013, according to iResearch.

Chinese entrepreneurs in the secondary industry remained optimistic in 2Q17. The Entrepreneur Confidence Index for the secondary industry recorded 127.3 in 2Q17.

PMI fluctuated within a narrow range of 51.2 to 51.7 throughout April to July, showing that the growth in manufacturing and economic activities in China has largely stabilized.

Non-manufacturing sector has expanded at a relatively fast pace lately. After going up from 54.5 in May to 54.9 in June, the second highest level this year, the NMI moderated to 54.5 in July.

## Foreign Trade

Both exports and imports posted strong growth in 2Q17. Exports gained 9.1% yoy, while imports expanded by 14.5% yoy in the quarter.

Exports to the US, the EU, Japan and the ASEAN gained 12.6% yoy, 9.2% yoy, 6.2% yoy and 9.5% yoy respectively in 1H17. Exports to some commodity-exporting emerging countries posted robust growth: Exports to Brazil and Russia increased by 39.4% yoy and 22.2% yoy respectively in 1H17.

Four provinces in the western region witnessed robust year-on-year growth in exports in January to May: Exports from Sichuan, Shaanxi, Qinghai and Xinjiang surged by 30.2% yoy, 36.1% yoy, 124.1% yoy and 30.5% yoy respectively over the period.

FDI dropped slightly by 0.1% yoy to 441.5 billion yuan in 1H17. FDI in the manufacturing sector accounted for 29.1% of the total FDI in 1H17. Among industries, FDI in the 'general equipment' industry, the 'petrochemical engineering, coking and nuclear fuel' industry and the 'chemical raw material and chemical product' industry grew at a relatively fast pace, by 14.4% yoy, 329.4% yoy and 38.4% yoy respectively, over the period.

Foreign exchange reserves increased by US\$ 47.7 billion in 2Q17, recording the first positive quarter-on-quarter gain in twelve quarters. As at the end of June, the foreign exchange reserves amounted to US\$ 3,056.8 billion.

The Chinese yuan has appreciated against the US dollar, but has depreciated against the Euro in recent months. The daily fixing rate of the Chinese yuan against the US dollar strengthened from 6.9066 on 10 May to 6.7283 on 31 July; the daily fixing rate of the Chinese yuan against the Euro depreciated from 7.3025 on 17 April to 7.9059 on 31 July, the weakest level since mid-September 2014.

China's first Belt and Road Forum held on 14-15 May drew worldwide participation. Around 1,500 delegates from more than 130 countries and 70 international organizations, including 29 foreign heads of state and government, attended the forum. During the forum, Chinese President Xi Jinping and 29 other heads of state and government signed a joint communique, reaffirming their commitment to building an open economy, ensuring free and inclusive trade, and promoting a universal, rules-based, open, non-discriminatory and equitable multilateral trading system with WTO at its core.

China and the US held the first Comprehensive Economic Dialogue in Washington on 19 July. During the meeting, both China and the US agreed that, to tackle the problem of trade imbalance, the US has to increase its exports to China, instead of reducing its imports of Chinese products.

## A Recent developments

### 1. China's real GDP growth stays high in 2Q17

Supported by the relatively strong domestic and export demand, China's real GDP growth stayed high at 6.9% year-on-year (yoy) in 2Q17, the same as in 1Q17 (see exhibit 1). The latest figure indicates the resilient growth momentum of the Chinese economy. Overall, in 1H17, China's nominal GDP amounted to 38.1 trillion yuan, up by 6.9% yoy in real terms.

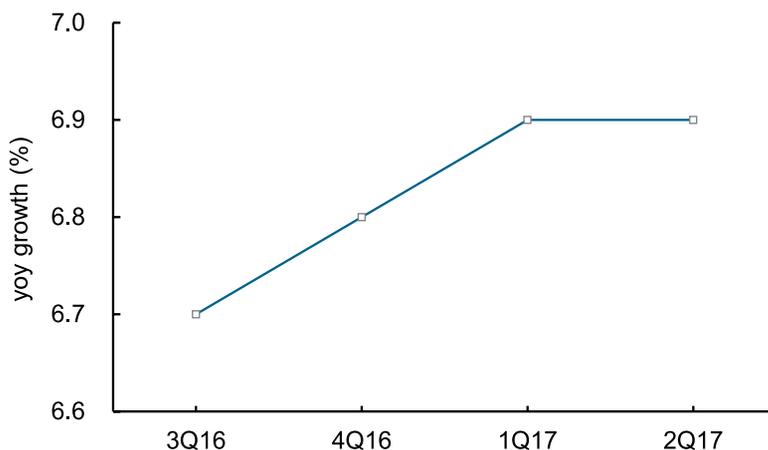
Among the industries, the secondary industry expanded at a faster pace in 1H17, compared to 2016. The real growth rate for the value-added of the secondary industry quickened to 6.4% yoy in 1H17 from 6.1% yoy in 2016. In contrast, the real growth rate for the value-added of the tertiary industry decelerated to 7.7% yoy in 1H17 from 7.8% yoy in 2016.

Among the economic drivers, consumption played the most important role in driving economic growth in 1H17. Final consumption expenditure contributed 4.4 pts to the real GDP growth, while gross capital formation contributed 2.3 pts and net exports contributed 0.3 pts in 1H17.

Looking ahead, the Chinese government will strive to ensure the stability of the economy and the financial system. We predict that China's central bank will continue to maintain stable liquidity conditions. Meanwhile, the fiscal policy will stay expansionary. The government has launched a series of measures to cut taxes. According to the State Council's announcement on 19 April, the number of value-added tax brackets would be reduced from 4 to 3, with the removal of the 13% tax bracket, and the value-added tax rates of agricultural products and natural gas would be cut from 13% to 11%, effective from 1 July. Besides, the coverage of small enterprises that can enjoy tax breaks would be expanded. These measures would reduce tax burden on enterprises, boding well for the development of the real economy.

We predict that China's economy will maintain stable growth in near future. Going forward, we also forecast that the real GDP growth will stay within the range of 6.5% to 7.0% in 3Q17. Downside risks to the economic growth, in our view, come mainly from the negative impact of the ongoing property tightening measures, the prudent and neutral monetary policy and the strengthened regulation of the financial sector.

**Exhibit 1** China's real GDP growth, 3Q16 to 2Q17



FY16	6.7%
3Q16	6.7%
4Q16	6.8%
1Q17	6.9%
2Q17	6.9%

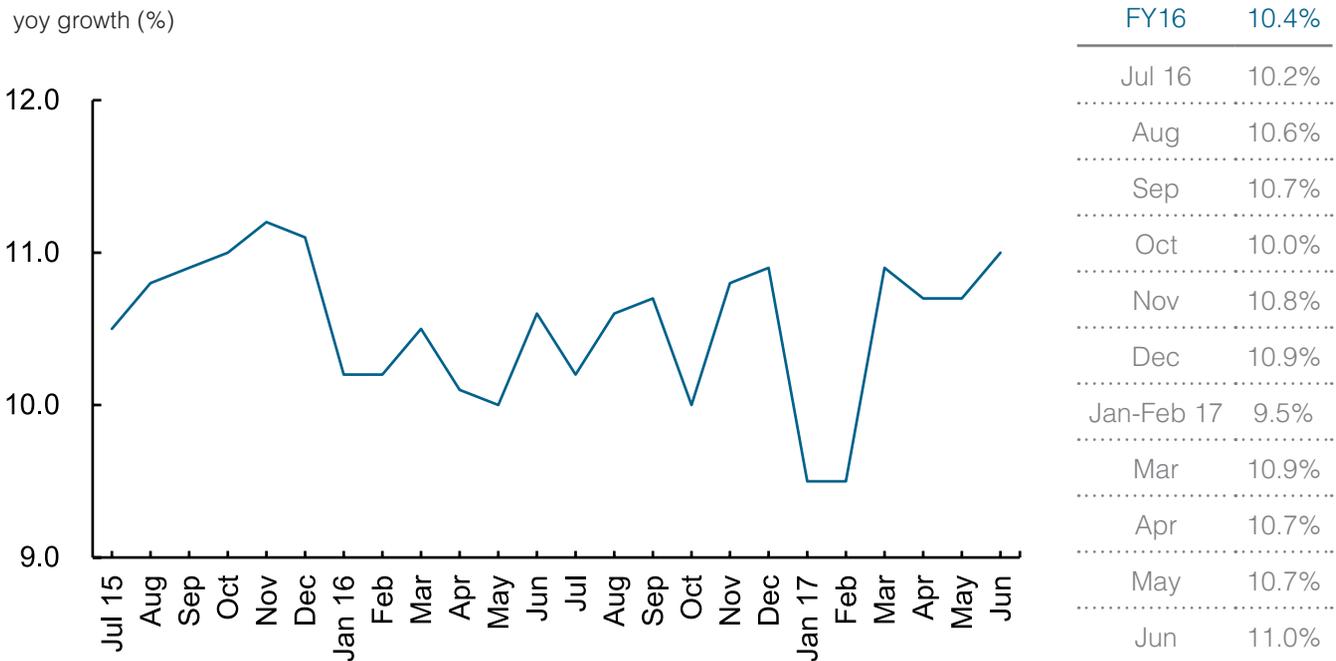
Source: National Bureau of Statistics, PRC

## 2. Growth in retail sales accelerates in June

According to the National Bureau of Statistics, the growth in China's total retail sales of consumer goods improved from 10.7% yoy in April and May to 11.0% yoy in June. The month-on-month (mom) growth in seasonally-adjusted retail sales accelerated from 0.82% in April to 0.87% in May, and further to 0.93% in June. These figures indicate that consumption demand has been strong recently. Overall, in 1H17, the total retail sales of consumer goods reached 17,236.9 billion yuan. The growth rate was 10.4% yoy in 1H17, the same as in 2016 (see exhibits 2 and 3).

China's online retail sales of goods increased by 28.6% yoy to reach 2,374.7 billion yuan. Consequently, the share of online retail sales in the total retail sales of consumer goods went up to 13.8% in 1H17 from 12.6% in 2016, indicating that popularity of online shopping has been growing rapidly.

**Exhibit 2** China's total retail sales, year-on-year nominal growth, July 2015 to June 2017



Source: National Bureau of Statistics, PRC

**Exhibit 3** China's total retail sales, month-on-month nominal growth, January to June 2017

	mom growth (%), seasonally adjusted					
	Jan 17	Feb	Mar	Apr	May	Jun
Total retail sales	0.68	1.05	0.89	0.82	0.87	0.93

Source: National Bureau of Statistics, PRC

# Part 1 : Domestic Trade

Rural retail sales have increased at a faster pace: the growth in rural retail sales accelerated to 12.3% yoy in 1H17 from 10.9% yoy in 2016. In contrast, the growth in urban retail sales moderated to 10.1% yoy in 1H17 from 10.4% yoy in 2016.

The growth in catering services sales came in at 11.2% yoy in 1H17, up from 10.8% yoy in 2016. Meanwhile, the growth in sales of goods decelerated slightly from 10.4% yoy in 2016 to 10.3% yoy in 1H17.

The growth rate for the retail sales of goods by enterprises above a designated size<sup>1</sup>, which

amounted to 7,242.0 billion yuan in 1H17, accelerated to 8.8% yoy in 1H17 from 8.3% yoy in 2016. Among products, 'sports and entertainment products' saw the strongest growth in sales (17.1% yoy) in 1H17, followed by 'building and decoration materials' (13.9% yoy). Meanwhile, 'automobiles' witnessed the weakest growth in sales (5.2% yoy), partly due to the upward adjustment in the purchase tax rate on passenger-vehicles with less than 1.6 litre on 1 January this year. 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, 2016 to 1H17

Nominal growth, yoy (%)	FY16	1Q17	1H17
<b>Total retail sales</b>	<b>10.4</b>	<b>10.0</b>	<b>10.4</b>
Goods	10.4	9.9	10.3
Sales by enterprises above a designated size	8.3	7.9	8.8
Online sales	25.6	25.8	28.6
Catering services	10.8	10.8	11.2

Source: National Bureau of Statistics, PRC

### 3. Chinese consumers are optimistic

The consumer confidence index<sup>2</sup> rose to its recent peak of 113.4 in April, and then stayed high at 112.0 in May, indicating that Chinese consumers have been optimistic recently (*see exhibit 6*).

In our view, the strong consumer confidence was highly associated with the relatively stable growth in household income and a recent improvement in the economic situations in China.

### 4. Both rural and urban households see high single-digit growth in income in 1H17

Both rural and urban households continued to see high single-digit nominal growth in income in 1H17. The per capita disposable income of rural households grew nominally by 8.5% yoy (or 7.4% yoy real) to reach 6,562 yuan; while the per capita disposable income of urban households rose by 8.1% yoy in nominal terms (or 6.5% yoy real) to reach 18,322 yuan in 1H17.

With higher income, both rural and urban households had more room to increase their consumption expenditures in 1H17. The per capita consumption expenditure of rural households reached 5,174 yuan, up nominally by 8.1% yoy (or 7.0% yoy real); while the per capita consumption expenditure of urban households grew by 6.7% yoy in nominal terms (or 5.1% yoy real) to reach 11,931 yuan in 1H17.

<sup>1</sup> '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.

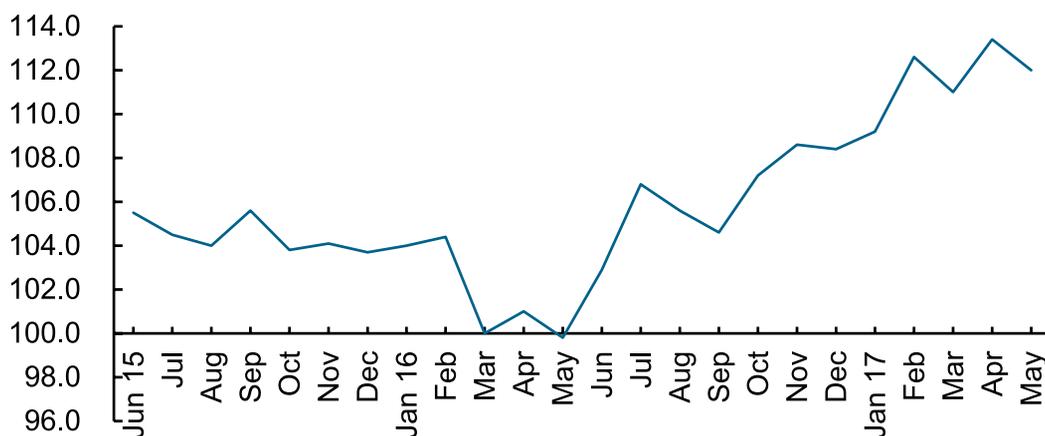
<sup>2</sup> A reading above 100 indicates that consumers tend to be optimistic; a reading below 100 indicates that consumers tend to be pessimistic.

**Exhibit 5** China's retail sales by enterprises above a designated size, by product, 2016 to 1H17

Nominal growth, yoy (%)	FY16	1Q17	1H17
Grain, oil and food	10.9	10.4	11.5
Beverages	10.5	12.7	12.7
Tobacco and liquor	9.3	9.8	9.8
Clothing, shoes, hats and textiles	7.0	6.2	7.3
Cosmetics	8.3	9.9	11.3
Gold, silver and jewellery	0.0	7.9	7.9
Products for daily use	11.4	8.5	9.0
Sports and entertainment products	13.9	17.3	17.1
Home appliances and video equipment	8.7	8.0	10.4
Chinese and Western medicines	12.0	10.7	12.1
Stationery and office accessories	11.2	14.8	11.8
Furniture	12.7	12.6	13.4
Telecommunications equipment	11.9	11.0	10.1
Petroleum and related products	1.2	13.0	10.6
Automobiles	10.1	2.3	5.2
Building and decoration materials	14.0	14.8	13.9

Source: National Bureau of Statistics, PRC

**Exhibit 6** China's consumer confidence index, June 2015 to May 2017



Jun 16	102.9
Jul	106.8
Aug	105.6
Sep	104.6
Oct	107.2
Nov	108.6
Dec	108.4
Jan 17	109.2
Feb	112.6
Mar	111.0
Apr	113.4
May	112.0

Source: National Bureau of Statistics, PRC

## 5. CPI growth trends upward

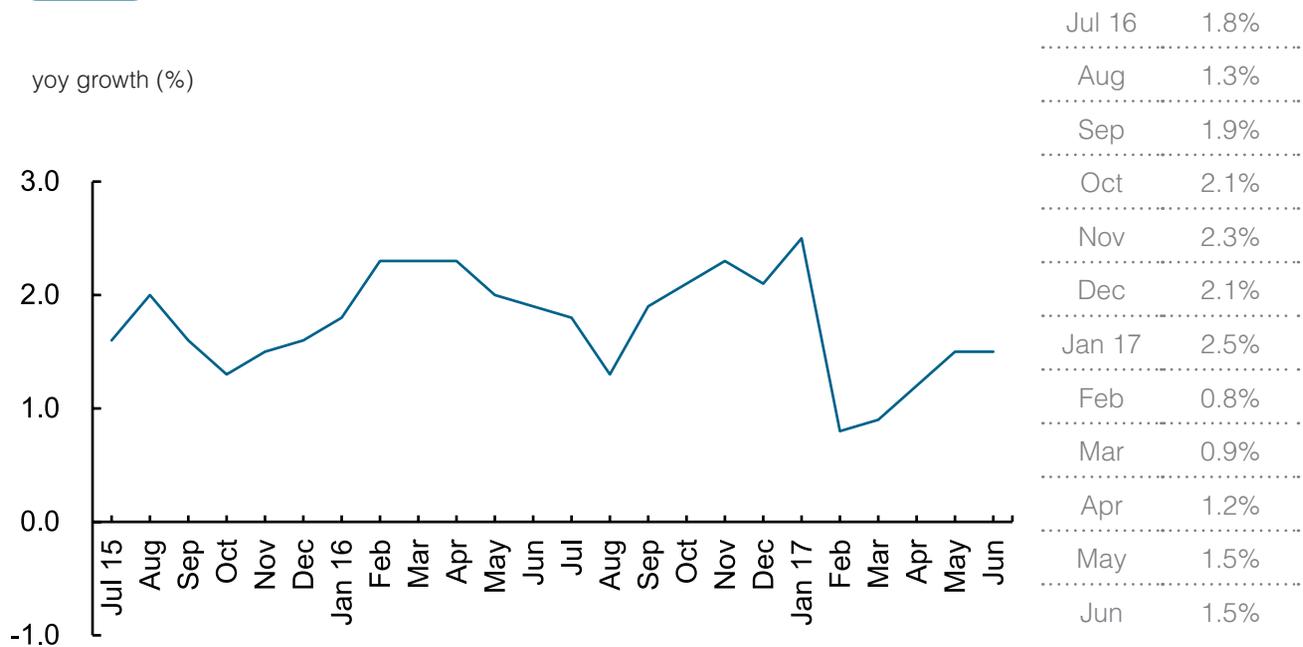
The year-on-year growth rate of China's consumer price index (CPI) went up all the way from 0.8% yoy in February to 1.5% yoy in May and in June.<sup>3</sup>

The rise in the CPI growth was due to a slower decline in the food prices in recent months. The growth rate for the food component in the CPI improved from minus 3.5% yoy in April to minus 1.6% yoy in May, and further to minus 1.2% yoy in June. Meanwhile, the growth rate for the non-food component in the CPI stayed relatively stable, registering 2.4% yoy, 2.3% yoy and 2.2% yoy in April, May and June respectively (see exhibits 7 and 8).

Looking ahead, we predict that the food deflation will slow further and eventually disappear in near future as the recent flooding in southern China is likely to lead to higher food prices; in the meantime, we expect the non-food inflation to stay relatively stable in the near term, supported by the firm consumption demand. Overall, in our view, the CPI growth is likely to rise slightly and stay below 2% in the coming couple of months.

8

**Exhibit 7** China's CPI growth, July 2015 to June 2017



Source: National Bureau of Statistics, PRC

<sup>3</sup> 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, January to June 2017<sup>4</sup>

yoY growth (%)	Jan 17	Feb	Mar	Apr	May	Jun
Food, tobacco and liquor	2.5	-2.4	-2.4	-1.8	-0.5	-0.2
Clothing	1.1	1.2	1.3	1.3	1.3	1.4
Housing	2.3	2.5	2.4	2.4	2.5	2.5
Household goods and services	0.6	0.5	0.7	0.8	1.0	1.1
Transportation and communication	2.3	1.7	2.0	1.8	1.1	0.1
Education, culture and recreational activities	3.3	1.8	2.3	2.6	2.6	2.5
Medical and healthcare	5.0	5.1	5.3	5.7	5.9	5.7
Other goods and services	4.8	3.1	2.9	3.4	2.9	2.8

Source: National Bureau of Statistics, PRC

The year-on-year growth in China's producer price index of industrial products (PPI)<sup>5</sup> fell all the way from 7.8% in February to 5.5% in May, the lowest level since January this year, and then stayed at 5.5% in June (*see exhibits 9 & 10*).

On a month-on-month basis, the PPI slid 0.2% mom, dropping for the third consecutive month in June. This indicates that the ex-factory prices of industrial products have been on a downward trend.

Looking ahead, the year-on-year growth in the PPI is expected to drop slowly in the coming months, driven by the fall in the domestic prices of production inputs.

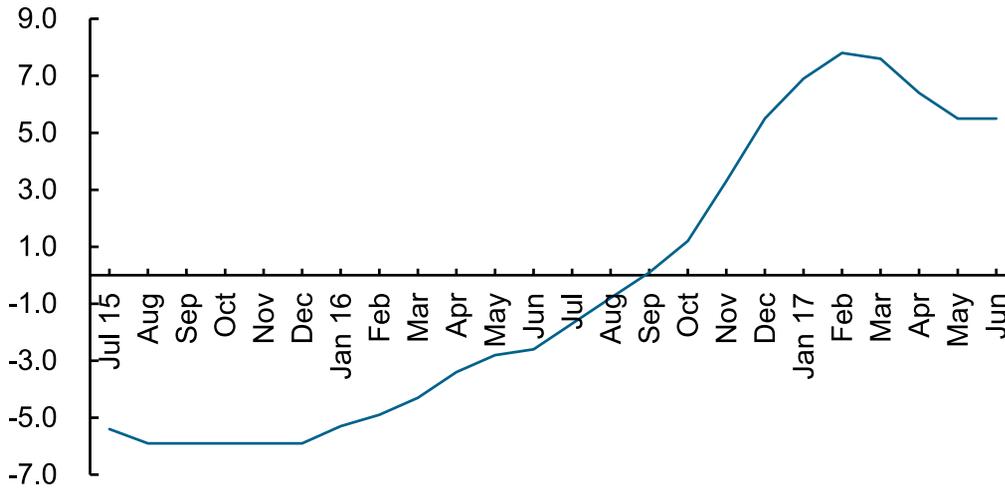
<sup>4</sup> The NBS has re-categorized the categories in the CPI basket, effective from January 2016. For example, the old category of 'household goods and maintenance services' has been re-categorized into a new category called 'household goods and services' and the category of 'other goods and services'. 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'.

<sup>5</sup> 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, July 2015 to June 2017

yoy growth (%)



Jul 16	-1.7%
Aug	-0.8%
Sep	0.1%
Oct	1.2%
Nov	3.3%
Dec	5.5%
Jan 17	6.9%
Feb	7.8%
Mar	7.6%
Apr	6.4%
May	5.5%
Jun	5.5%

10

Source: National Bureau of Statistics, PRC

**Exhibit 10** China's PPI growth by selected industry, January to June 2017

yoy growth (%)

	Jan 17	Feb	Mar	Apr	May	Jun
Textile	2.6	3.2	3.5	3.8	3.8	3.8
Textile wearing apparel and ornament	0.6	0.9	1.0	1.0	1.0	0.9
Processing of timbers, manufacture of wood, bamboo, rattan, palm, and straw products	0.2	0.1	0.6	0.5	0.5	0.4

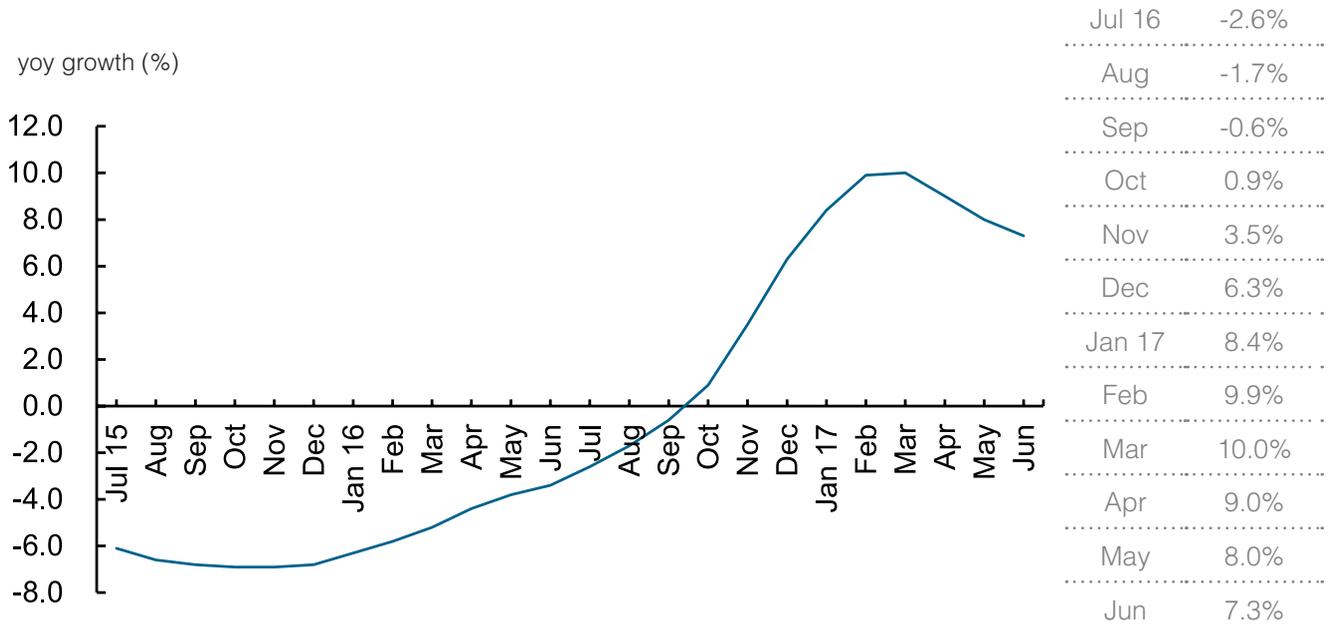
Source: National Bureau of Statistics, PRC

The year-on-year growth rate for the purchaser price index of industrial products, a major indicator of upstream prices, dropped from 9.0% in April to 8.0% in May, and further to a six-month low of 7.3% in June (see exhibits 11 & 12).

On a month-on-month basis, after having risen for thirteen consecutive months, the purchaser price index of industrial products dropped by 0.3%, 0.3% and 0.4% in April, May and June respectively. The price index has trended downward in the past three months amid the drop in global commodity prices.

The input prices sub-index of China's manufacturing PMI, a leading indicator of upstream prices, has stabilized at around the neutral level of 50 in recent months, after trending downward in the first few months of this year. We therefore predict that the purchaser price index will stabilize soon.

**Exhibit 11** Growth in China's purchaser price index of industrial products, July 2015 to June 2017



Source: National Bureau of Statistics, PRC

**Exhibit 12** China's purchaser price index of industrial products by selected commodity, January to June 2017

yoy growth (%)	Jan 17	Feb	Mar	Apr	May	Jun
Fuel and power	14.7	18.7	19.0	17.6	15.8	12.5
Non-ferrous metal materials and wires	15.8	17.1	16.1	15.4	13.9	14.1
Chemical raw materials	8.1	10.3	10.0	8.1	7.1	7.0
Wood and pulp	3.3	4.0	4.5	4.7	4.9	5.3
Textile raw materials	3.3	4.0	4.6	4.7	4.9	4.8

Source: National Bureau of Statistics, PRC

## 6. Growth in industrial production rebounds in June

The growth rate for China's industrial production (IP), measured by value-added of industrial output (VAIO), decelerated from 7.6% yoy in March to 6.5% yoy in April and in May, but then rebounded to 7.6% yoy in June (see exhibit 13).<sup>6</sup> Overall, in 1H17, China's IP expanded by 6.9% yoy, faster than the 6.0% yoy growth recorded in 2016. We believe that the acceleration in IP growth in 1H17 was driven mainly by the relatively strong domestic and export demand.

The output sub-index of China's manufacturing PMI, a leading indicator of output of manufacturers, moderated from 53.8 in April 53.4 in May, and rose further to 54.4 in June, the highest level since December 2013. The index readings in recent months suggest that the industrial production is set to maintain fast growth in coming months. Looking ahead, we expect that the growth in the VAIO will be around 7% yoy in 3Q17.

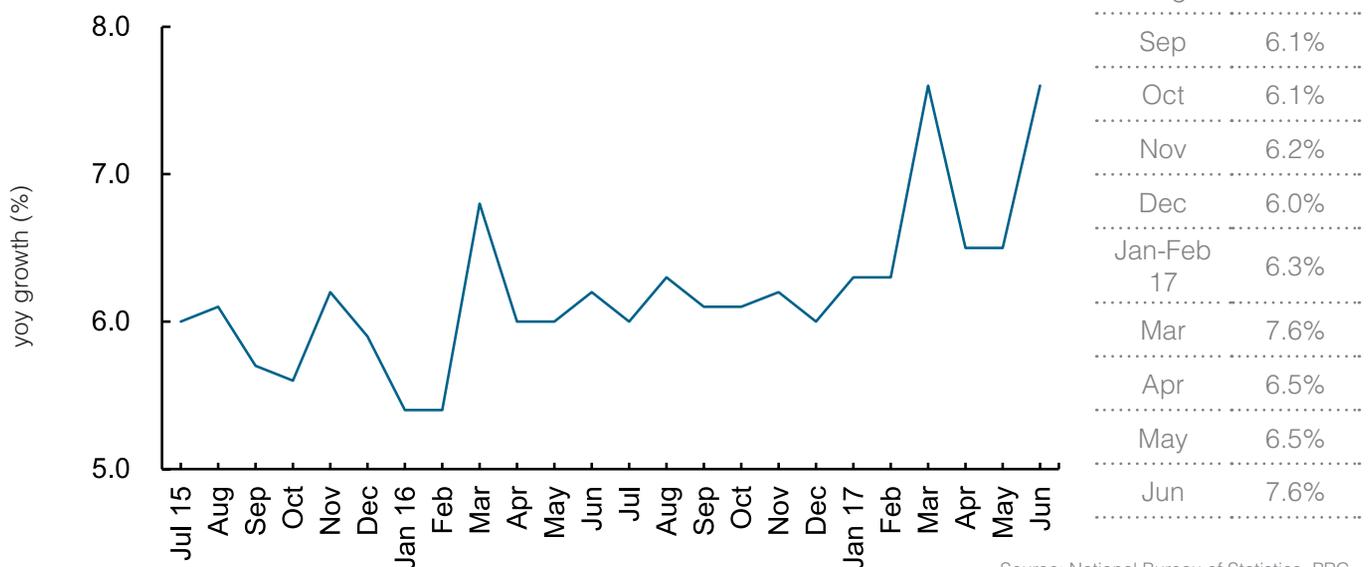
12

## 7. Growth in industrial profits accelerates in May

The growth rate for the total profits earned by large and medium industrial enterprises above a designated size<sup>7</sup> improved from 14.0% yoy in April to 16.7% yoy in May, due largely to the faster growth in product sales and investment income and low comparison base in the same period of the last year. In January to May 2017, China's industrial profits totalled 2,904.8 billion yuan, up by 22.7% yoy (see exhibit 14).

Among sectors, profits of the manufacturing sector rose by 18.6% yoy to 2,552.3 billion yuan in January to May 2017; profits of the mining sector soared by 79.4 times to 203.3 billion yuan. In contrast, profits of the 'electricity, heat, gas and water' sector fell by 29.7% yoy to 149.2 billion yuan over the same period.

**Exhibit 13** China's industrial production growth, July 2015 to June 2017



Source: National Bureau of Statistics, PRC

<sup>6</sup> 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.

<sup>7</sup> '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, November 2016 to May 2017

<i>yoy growth (%)</i>	Nov 16	Dec	Jan-Feb 17	Mar	Apr	May
Total profits made by industrial enterprises above a designated size	14.5	2.3	31.5	23.8	14.0	16.7

Source: National Bureau of Statistics, PRC

## 8. Fixed asset investment growth accelerates in 1H17

The growth in China's nominal fixed asset investment (FAI) (excluding rural households) accelerated to 8.6% yoy in 1H17, compared to 8.1% yoy in 2016.<sup>8</sup> In 1H17, China's nominal FAI (excluding rural households) amounted to 28.1 trillion yuan (*see exhibit 15*).

Infrastructure saw rapid acceleration in the growth in investment in 1H17. The growth in FAI in infrastructure (excluding power, heat, gas and water infrastructure) improved to 21.1% yoy in 1H17 from 17.4% yoy in 2016. Meanwhile, the growth in FAI (excluding rural households) in the secondary industry rose to 4.0% yoy in 1H17 from 3.5% yoy in 2016; the growth in FAI (excluding rural households) for real estate development quickened to 8.5% yoy in 1H17 from 6.9% yoy in 2016.

Looking ahead, we expect that China's FAI will maintain current pace of growth in the near term. The possible fall in growth in property investment triggered by a cooling in the housing markets in first-tier cities is likely to be offset by an acceleration in growth in investment in the manufacturing sector. The relatively strong demand for industrial products amid the improving economic situations may encourage manufacturers to increase investment to strengthen their technological capabilities. Besides, the government will continue to provide strong support to infrastructure investment for the purposes of fostering regional development, preventing flooding, reducing pollution and shoring up other weak areas of the country.

**Exhibit 15** China's FAI (excluding rural households) growth, January to June 2017

	Jan 17	Feb	Mar	Apr	May	Jun
FAI (excluding rural households) <i>(year-to-date, yoy growth %)</i>	-	8.9	9.2	8.9	8.6	8.6
FAI (excluding rural households) <i>(mom growth %, seasonally adjusted)</i>	0.61	0.77	0.78	0.74	0.71	0.73

Source: National Bureau of Statistics, PRC

<sup>8</sup> 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. GMV of China's internet consumption finance market soars

The gross merchandise volume (GMV) of China's internet consumption finance market increased markedly to 436.7 billion yuan in 2016 from 6 billion yuan in 2013, according to a report published by iResearch, a China-based research company, on 5 May.<sup>9</sup>

The rapid development of the internet consumption finance market was highly associated with the growing popularity of online shopping in China. Besides, more and more internet players have entered the consumption finance market in past few years. Consumers can now easily get consumer loans when they make purchases of goods or services on the internet. According to iResearch, players in the internet consumption finance market have successfully unleashed the demand for consumption loans from university students and young blue collar workers who have strong desire to buy goods or services but lack money. These groups of customers have long been ignored by traditional financial institutions.

### 2. Housing market shows signs of cooling

The housing market in China has shown signs of cooling. With the government continuing to carry out property tightening measures such as home purchase restrictions and high down payment requirements, the growth in the sales of new homes in the country has decelerated in past few months: the sale of residential housing in terms of floor space posted a slower growth of 13.5% yoy in 1H17, compared to growth rate of 22.4% yoy in 2016. We therefore predict that the growth in sales of housing-related items such as furniture, home appliances, kitchen products, bathroom products and household textile products to fall in the foreseeable future.

### 3. Growth of broad money supply decelerates

The growth of broad money supply has decelerated in recent months. As at the end of June, the growth of the broad money supply (M2) was 9.4% yoy, lower than the 10.6% yoy growth as at the end of March (*see exhibit 16*). The deceleration in M2 growth was due largely to a reduction in leverage inside the financial system driven by the recent tightening in financial regulations, according to the People's Bank of China (PBoC).<sup>10</sup>

The total outstanding RMB loans gained 12.9% yoy as at the end of June, compared to the growth of 12.4% yoy as at the end of March. Overall, in 2Q17, the increase in the total outstanding RMB loans amounted to 3.75 trillion yuan, larger than the increase seen in the same period of the previous year (i.e. 2.92 trillion yuan). These figures indicate that the impact of regulatory tightening on credit growth has been limited so far. A major reason is that banks in China have provided strong loan support to the real sector in recent months: the rise in RMB loans to the real sector was as large as 3.71 trillion yuan in 2Q17.

Looking ahead, we predict that China's central bank will continue to maintain stable credit conditions in order to ensure the stability of the economy and the financial system ahead of the 19<sup>th</sup> National Party Congress which will be held in autumn this year.

<sup>9</sup> <http://report.iresearch.cn/report/201705/2987.shtml>

<sup>10</sup> <http://www.pbc.gov.cn/goutongjiaoliu/113456/113469/3325739/index.html>

**Exhibit 16** Broad money supply (M2) and RMB loans, July 2016 to June 2017

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	FY16	1H17
End-Jul 16	149.2	10.2%	102.0	12.9%	12.65	0.46
End-Aug	151.1	11.4%	102.9	13.0%	7.97	0.95
End-Sep	151.6	11.5%	104.1	13.0%		1.22
End-Oct	152.0	11.6%	104.8	13.1%		0.65
End-Nov	153.0	11.4%	105.6	13.1%		0.79
End-Dec	155.0	11.3%	106.6	13.5%		1.04
End-Jan 17	157.6	11.3%	108.6	12.6%		2.03
End-Feb	158.3	11.1%	109.8	13.0%		1.17
End-Mar	160.0	10.6%	110.8	12.4%		1.02
End-Apr	159.6	10.5%	111.9	12.9%		1.10
End-May	160.1	9.6%	113.0	12.9%		1.11
End-Jun	163.1	9.4%	114.6	12.9%		1.54

Source: People's Bank of China

#### 4. 'Total social financing' increases by 11.2 trillion yuan in 1H17

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 11.2 trillion yuan in 1H17, larger than the increase seen in the previous year (i.e. 9.8 trillion yuan) (see exhibit 17). The figures indicate that the real economy has got considerable funding support from the financial system so far this year.

Amid a tightening of financial regulations, shadow banking activities have shown signs of cooling in recent months. Bank acceptance bills and entrusted loans played less important roles in driving up 'total social financing' in 2Q17, compared to 1Q17. Bank acceptance bills contributed 5.1% of the increase in 'total social financing' in 1H17, compared to a 9.8% share in 1Q17. Meanwhile, entrusted loans contributed 5.4% of the increase in 'total social financing' in 1H17, compared to the share of 9.2% in 1Q17.

**Exhibit 17** Increase in total social financing, 2016 to 1H17

	2016		1H17	
	Amount (billion yuan)	Share (%)	Amount (billion yuan)	Share (%)
<b>Total social financing</b>	<b>17,800</b>	<b>100.0</b>	<b>11,170</b>	<b>100.0</b>
RMB loans to the real sector	12,440	69.9	8,210	73.5
Foreign currency loans to the real sector	-564	-3.2	47	0.4
Trust loans	859	4.8	1,310	11.7
Entrusted loans	2,190	12.3	599	5.4
Bank acceptance bills	-1,950	-11.0	570	5.1
Corporate bonds	3,000	16.9	-371	-3.3
Equity issuance	1,240	7.0	470	4.2

Source: People's Bank of China

## C Outlook

### 1. Chinese entrepreneurs in the secondary industry remain optimistic

After rising markedly by 13.8 pts in 1Q17, China's Entrepreneur Confidence Index (ECI) for the secondary industry moderated by 1.9 pts from the previous quarter to 127.3 in 2Q17 (*see exhibit 18*).<sup>11</sup> The high index reading in 2Q17 indicated that Chinese entrepreneurs in the secondary industry remained optimistic in the quarter.

By sector, the ECIs for the 'manufacturing' and 'mining' sectors recorded quarter-on-quarter fall, down by 2.0 pts and 4.8 pts respectively in 2Q17. In contrast, the ECI for the 'electricity, gas and water' sector rose slightly by 0.8 pts in the same quarter (*see exhibit 19*).

### 2. PMI points to growth stabilization

16

China's manufacturing PMI stayed at 51.2 in April and May, and then rose to 51.7 in June, the second highest level this year, before dropping to 51.4 in July. The small fluctuation in the index in recent months shows that the growth in manufacturing and economic activities in China has largely stabilized (*see exhibit 20*).

After registering 52.3 in April and May, the new orders index went up to 53.1 in June, and then stayed high at 52.8 in July.<sup>12</sup> Meanwhile, the new export orders index rose all the way from 50.6 in April to 52.0 in June, before dropping to 50.9 in July, still the third highest level this year. Both indices indicate the relatively strong domestic and export demand in recent months.

The output index, a leading indicator of output of manufacturers in China, has fluctuated around high levels in recent months. The index recorded 53.8 in April and 53.4 in May, and then rose to a 43-month high of 54.4 in June, before moderating to 53.5 in July.

The purchases of inputs index rebounded strongly from 51.5 in May to 52.5 in June and 52.7 in July, showing that the growth in purchasing activities has accelerated amid the relatively strong demand.

The stocks of finished goods index fell all the way from 48.2 in April to a six-month low of 46.1 in July, indicating that the stocks of finished goods held by manufacturers have dropped at a faster pace in the past few months. In the meantime, the stocks of major inputs index stayed within the narrow range of 48.5 to 48.6 in May to July, below the critical 50-mark, indicating a continuous fall in the stocks of major inputs.

The input prices index rebounded from its recent low of 49.5 in May to 50.4 in June, and jumped further to 57.9 in July. The latest reading shows a sharp rise in the prices of production inputs in July. Meanwhile, the ex-factory prices index rose above the critical 50-mark for the first time in four months, registering 52.7 in July. The latest reading suggests that China's producer price index may show a rebound soon.

The business expectations index went up all the way from 56.6 in April to 59.1 in July. The recent uptrend indicates a continuous improvement in confidence among purchasing managers in China.

<sup>11</sup> 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.

<sup>12</sup> 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 18** China's Entrepreneur Confidence Index (Secondary Industry), 3Q15 to 2Q17

	3Q15	4Q15	1Q16	2Q16	3Q16	4Q16	1Q17	2Q17
Entrepreneur Confidence Index (Secondary Industry)	112.1	108.9	108.7	109.3	113.4	115.4	129.2	127.3

Source: National Bureau of Statistics, PRC

**Exhibit 19** Entrepreneur Confidence Index by sector, 1Q17 and 2Q17

	1Q17	2Q17	Compared with the previous quarter
Secondary industry	129.2	127.3	Lower
Mining	113.8	109.0	Lower
Manufacturing	130.1	128.1	Lower
Electricity, gas & water	129.4	130.2	Higher

Source: National Bureau of Statistics, PRC

Part 1 :  
**Domestic  
 Trade**

**Exhibit 20** China's manufacturing PMI at a glance, July 2017

Index	Seasonally Adjusted Index	Index Compared with the Previous Month	Direction
PMI	51.4	Lower	Expanding
Output	53.5	Lower	Expanding
New Orders	52.8	Lower	Expanding
New Export Orders	50.9	Lower	Expanding
Backlogs of Orders	46.3	Lower	Contracting
Stocks of Finished Goods	46.1	Lower	Contracting
Purchases of Inputs	52.7	Higher	Expanding
Imports	51.1	Lower	Expanding
Input Prices	57.9	Higher	Rising
Stocks of Major Inputs	52.7	Higher	Rising
Ex-factory Prices	48.5	Lower	Contracting
Employment	49.2	Higher	Contracting
Suppliers' Delivery Time	50.1	Higher	Quickening
Business Expectations	59.1	Higher	Optimistic

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

### 3. Non-manufacturing sector expands at a relatively fast pace

China's Business Activity Index, which is quoted as the Non-manufacturing Purchasing Managers' Index (NMI), has fluctuated around high levels in recent months. After going up from 54.5 in May to 54.9 in June, the second highest level this year, the index moderated to 54.5 in July, indicating that the non-manufacturing sector has expanded at a relatively fast pace lately (*see exhibit 21*).

The demand for services has shown signs of moderation recently. The new orders index dropped to 51.1 in July, after rising all the way from 50.5 in April to 51.4 in June.

The input prices index went up all the way from 51.1 in May to a five-month high of 53.1 in July, showing that the input prices have increased at a faster pace lately. Against this backdrop, the sales prices index rose above 50 in July, indicating a latest increase in service charges.

The business expectation index registered 60.2, 61.1 and 61.1 in May, June and July respectively, well above the critical 50-mark, suggesting that purchasing managers in the non-manufacturing sector have remained optimistic.

**Exhibit 21** China's non-manufacturing purchasing managers' index (NMI) at a glance, July 2017

Index	Seasonally Adjusted Index	Index Compared with the Previous Month	Direction
Business activity	54.5	Lower	Expanding
New orders	51.1	Lower	Expanding
Input prices	53.1	Higher	Rising
Sales prices	50.9	Higher	Rising
Business expectations	61.1	Unchanged	Optimistic

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

## A Recent developments

### 1. Both growth rates for exports and imports stay strong in 2Q17

China's exports gained 9.1% yoy in 2Q17, posting positive year-on-year growth for two consecutive quarters (see exhibits 22, 23 and 24). The latest figure indicates the strong export performance in 2Q17, attributable to an improvement in the foreign demand for Chinese products amid the ongoing recovery in the global economy. Overall, in 1H17, China's exports amounted to US\$ 1,047.3 billion, up by 8.5% yoy.

20

China's exports to its major trading partners recorded positive year-on-year growth in 1H17. For example, China's exports to the US, the EU, Japan and the ASEAN gained 12.6% yoy, 9.2% yoy, 6.2% yoy and 9.5% yoy respectively in 1H17. Meanwhile, China's exports to some commodity-exporting emerging countries posted robust growth in 1H17: the exports to Brazil and Russia increased by 39.4% yoy and 22.2% yoy respectively in 1H17.

The growth rate for China's imports decelerated, but remained strong in 2Q17: the growth rate came in at 14.5% yoy in 2Q17, after registering 24.0% yoy in 1Q17, the highest level since 4Q11. The double-digit import growth in 2Q17 shows the robust domestic demand for imported goods. Overall, in 1H17, China's imports totalled US\$ 862.2 billion, up by 18.9% yoy.

China's trade surplus rebounded markedly to US\$ 120.8 billion in 2Q17 from US\$ 64.3 billion in 1Q17, showing quarter-on-quarter gain for the first time in three quarters.

**Exhibit 22** China's quarterly foreign trade data, 3Q16 to 2Q17

*USD billion (yoy growth)*

	Exports		Imports		Trade Balance
FY16	2,097.4	(-7.7%)	1,587.5	(-5.5%)	510.0
3Q16	552.9	(-7.0%)	414.1	(-4.4%)	138.9
4Q16	579.5	(-5.3%)	448.6	(2.7%)	130.9
1Q17	481.2	(7.8%)	416.9	(24.0%)	64.3
2Q17	566.1	(9.1%)	445.3	(14.5%)	120.8

Source: China Customs

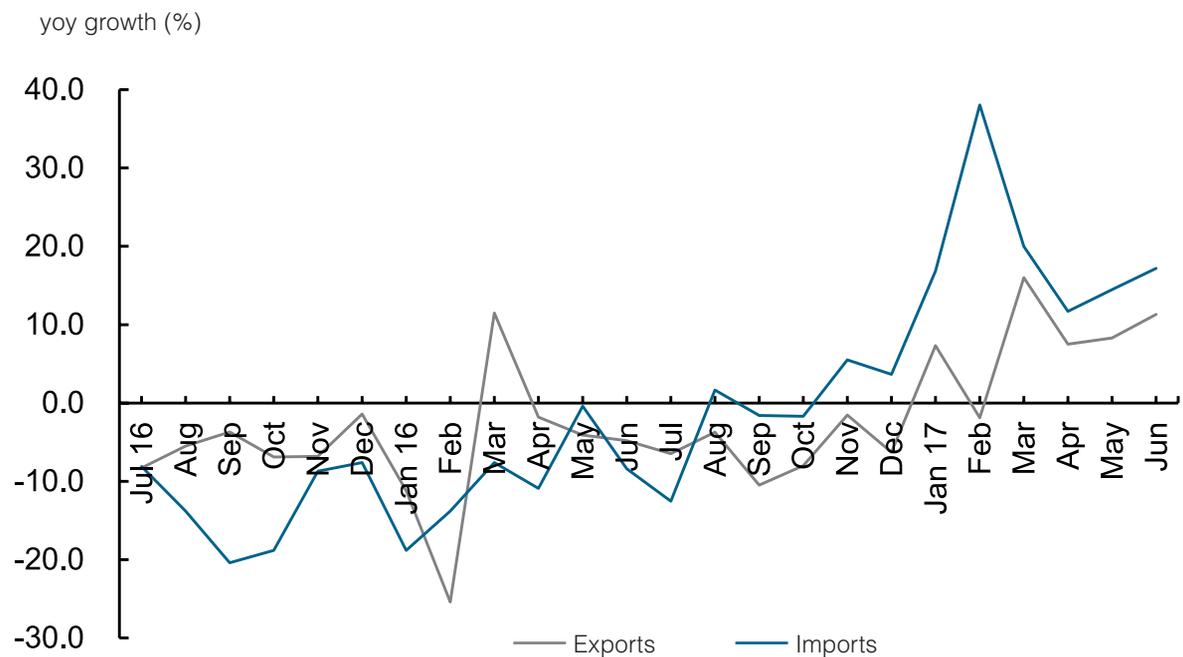
**Exhibit 23** China's monthly foreign trade data, July 2016 to June 2017

*USD billion (yoy growth)*

	Exports		Imports		Trade Balance
July 2016	180.7	(-6.5%)	132.3	(-12.5%)	48.3
August	188.8	(-3.7%)	138.7	(1.7%)	50.1
September	183.4	(-10.5%)	143.0	(-1.6%)	40.4
October	176.8	(-8.0%)	128.7	(-1.7%)	48.2
November	193.6	(-1.5%)	150.5	(5.5%)	43.1
December	209.1	(-6.3%)	169.5	(3.6%)	39.6
January 2017	181.8	(7.3%)	131.5	(16.8%)	50.3
February	119.4	(-1.9%)	129.2	(38.1%)	-9.8
March	179.9	(16.0%)	156.2	(20.0%)	23.7
April	179.2	(7.5%)	141.7	(11.7%)	37.5
May	190.3	(8.3%)	149.8	(14.5%)	40.5
June	196.6	(11.3%)	153.8	(17.2%)	42.8

Source: China Customs

**Exhibit 24** Growth rates of exports and imports, July 2015 to June 2017



Source: China Customs

**Exhibit 25** Exports by category, 2016 and 1H17

<i>yoy growth (%) of export value, calculated in USD</i>	2016	1H17
Textile materials and products	-4.1	3.1
Garments and clothing accessories	-9.6	1.4
Footwear	-12.1	7.1
Toys	17.4	55.3
Coal	39.8	108.9
Crude oil	-39.0	165.6
Refined oil	1.5	44.3
Steel	-13.4	5.9
Mechanical and electrical products	-7.7	8.2

Source: China Customs

**Exhibit 26** Imports by category, 2016 and 1H17

<i>yoy growth (%) of import value, calculated in USD</i>	2016	1H17
Cereal and cereal flour	-39.3	-2.8
Soybean	-2.3	27.3
Iron ore	0.5	60.0
Crude oil	-13.3	59.0
Refined oil	-21.8	24.6
Steel	-8.2	14.1
Textile yarns, fabric and textile products	-12.2	3.3
Vehicles and vehicle chassis	-0.5	16.1

Source: China Customs

## 2. Growth rates for both general trade imports and processing trade imports decelerate in 2Q17

The year-on-year growth rate for the general trade<sup>13</sup> exports accelerated, while that for the processing trade<sup>14</sup> exports moderated in 2Q17. The growth in the general trade exports improved to 3.8% yoy in 2Q17 from minus 0.3% yoy in 1Q17. In contrast, the growth in the processing trade exports fell to 7.1% yoy in 2Q17 from 8.5% yoy in 1Q17 (*see exhibit 27*).

On the import side, the growth in the general trade imports dropped markedly to 17.5% yoy in 2Q17 from

30.8% yoy in 1Q17, partly attributable to the fall in import prices of commodities. In comparison, the growth rate for the processing trade imports showed a smaller drop in 2Q17: the growth rate softened to 11.4% yoy in 2Q17 from 12.3% yoy in 1Q17.

The share of processing trade in China's total trade fell to 27.9% in 2Q17 from 29.0% in 1Q17. That being said, with a large surplus of US\$ 77.7 billion in 2Q17, processing trade still plays an important role in China's foreign trade.

<sup>13</sup> '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.

<sup>14</sup> '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 27**

China foreign trade (general and processing trades), 2016 to 2Q17

Item	yoy growth (%)			Share (%)		
	FY16	1Q17	2Q17	FY16	1Q17	2Q17
<b>Exports</b>	-7.7	7.8	9.1	100.0	100.0	100.0
Of which:						
General Trade	-7.0	-0.3	3.8	53.8	53.3	55.4
Processing Trade	-10.3	8.5	7.1	34.1	34.5	31.8
<b>Imports</b>	-5.5	24.0	14.5	100.0	100.0	100.0
Of which:						
General Trade	-2.5	30.8	17.5	56.6	60.0	59.6
Processing Trade	-11.3	12.3	11.4	25.0	22.7	22.9
<b>Total of Imports and Exports</b>	-6.8	14.8	11.4	100.0	100.0	100.0
Of which:						
General Trade	-5.1	13.0	9.7	55.0	56.4	57.3
Processing Trade	-10.6	9.8	8.6	30.2	29.0	27.9

Source: China Customs

### 3. China's trade with the EU, the US, ASEAN and Japan shows double-digit growth in 1H17

The EU was still China's largest trading partner, accounting for 15.0% of China's total foreign trade in 1H17. Sino-EU trade amounted to US\$ 286.6 billion, up by 11.0% yoy in 1H17. Specifically, China's exports to the EU gained 9.2% yoy in 1H17, compared to the negative growth of 4.7% yoy in 2016; and China's imports from the EU grew by 13.9% yoy in 1H17, compared to the 0.4% yoy drop in 2016 (*see exhibits 28 and 29*).

Accounting for 14.0% of China's total foreign trade, the US continued to be China's second largest trading partner in 1H17. Sino-US trade expanded by 14.5% yoy to US\$ 268.2 billion in 1H17. China's export growth to the US turned positive in 1H17: after dropping by 5.9% yoy in 2016, China's exports to the US grew by 12.6% yoy in 1H17. Meanwhile, China's imports from

the US recorded strong growth of 19.8% yoy in 1H17, compared to the 9.1% yoy decline in 2016.

The Association of South East Asian Nations (ASEAN) accounted for 12.4% of China's total foreign trade in 1H17. Sino-ASEAN trade grew by 15.1% yoy to US\$ 236.3 billion in 1H17. Of which, China's exports to ASEAN rose by 9.5% yoy, while China's imports from ASEAN soared by 22.9% yoy, in 1H17.

Sino-Japanese trade increased by 11.1% yoy to US\$ 142.2 billion in 1H17. China's exports to Japan gained 6.2% yoy, while China's imports from Japan jumped by 15.6% yoy in 1H17.

#### 4. Growth rates for China's exports to Russia, India and Brazil accelerate quickly in 1H17

China's export growth to Russia accelerated to 22.2% yoy in 1H17 from 7.3% yoy in 2016, amid the recovery in Russia's economy. Meanwhile, China's import growth from Russia improved to 29.3% yoy in 1H17 from minus 3.1% yoy in 2016 (see exhibits 28 and 29). Consequently, the growth in China's trade with Russia picked up to 25.7% yoy in 1H17 from 2.2% yoy in 2016.

China's export growth to India rose to 18.9% yoy in 1H17 from 0.2% yoy in 2016. In the meantime, China's import growth from India accelerated rapidly to 42.5% yoy in 1H17 from minus 12.0% yoy in 2016. Overall, the growth of Sino-Indian trade improved to 23.0% yoy in 1H17 from minus 2.1% yoy in 2016.

With Brazil's economy showing strong improvement, the growth in China's exports to Brazil rose to 39.4% yoy in 1H17, compared to the 19.9% yoy drop in 2016. Meanwhile, the growth in China's imports from Brazil quickened to 33.5% yoy in 1H17 from 3.7% yoy in 2016. Consequently, the growth in Sino-Brazilian trade accelerated to 35.3% yoy in 1H17.

Together, these three BRIC members accounted for 6.2% of China's total exports and 6.7% of China's total imports in 1H17, up from 5.6% and 5.7%, respectively, in 2016.

24

**Exhibit 28** China's trading partners, 1H17

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	286.6	15.0	172.7	113.9	11.0	9.2	13.9
US	268.2	14.0	192.9	75.4	14.5	12.6	19.8
ASEAN	236.3	12.4	130.7	105.6	15.1	9.5	22.9
Japan	142.2	7.4	65.3	76.9	11.1	6.2	15.6
Brazil	41.9	2.2	13.0	28.9	35.3	39.4	33.5
Russia	39.8	2.1	19.4	20.3	25.7	22.2	29.3
India	40.6	2.1	32.4	8.2	23.0	18.9	42.5

Source: China Customs

**Exhibit 29** China's trading partners, comparing growth rates for 2016 and 1H17

Country/Region	yoy growth (%)					
	Total Trade		Exports		Imports	
	2016	1H17	2016	1H17	2016	1H17
EU	-3.1	11.0	-4.7	9.2	-0.4	13.9
US	-6.7	14.5	-5.9	12.6	-9.1	19.8
ASEAN	-4.2	15.1	-7.8	9.5	0.9	22.9
Japan	-1.3	11.1	-4.7	6.2	1.9	15.6
Brazil	-5.3	35.3	-19.9	39.4	3.7	33.5
Russia	2.2	25.7	7.3	22.2	-3.1	29.3
India	-2.1	23.0	0.2	18.9	-12.0	42.5

Source: China Customs

## 5. Exports from Sichuan, Shaanxi, Qinghai and Xinjiang record robust year-on-year growth in January to May

China's top six provinces and municipalities in terms of value of exports – Guangdong, Jiangsu, Shanghai, Zhejiang, Shandong and Fujian – jointly accounted for 78.4% of China's total exports in January to May 2017, down from 79.0% in 2016 (see exhibit 30). Among these provinces, Shandong saw the fastest growth in exports over the period. Exports from Shandong grew by 11.6% yoy to US\$ 60.9 billion in January to May this year.

Four provinces in the western region witnessed robust year-on-year growth in exports in January to May. Exports from Sichuan, Shaanxi, Qinghai and Xinjiang surged by 30.2% yoy, 36.1% yoy, 124.1% yoy and 30.5% yoy respectively over the period.

**Exhibit 30** Top six provinces and municipalities in terms of value of exports, January to May 2017

Provinces/ Municipalities	Value of exports (USD billion)	yoy growth (%)	Share of total exports (%)
Guangdong	255.8	8.4	30.0
Jiangsu	139.5	8.5	16.4
Zhejiang	111.3	5.8	13.0
Shanghai	66.4	3.7	7.8
Shandong	60.9	11.6	7.1
Fujian	35.1	0.7	4.1

Source: China Customs

## 6. China's FDI drops slightly by 0.1% yoy in 1H17

The growth rate for China's foreign direct investment (FDI) in Renminbi terms turned negative in April, registering minus 4.3% yoy in the month. Then, in May, the growth rate improved slightly to minus 3.7% yoy, before picking up to a positive 2.3% yoy in June. Overall, in 1H17, China's FDI amounted to 441.5 billion yuan, down slightly by 0.1% yoy (*see exhibit 31*).

FDI in the service sector came in at 310.0 billion yuan in 1H17. The share of the service sector in China's total FDI was 70.2% in 1H17, almost the same level as in 2016 (70.3%). Among the industries in the service sector, FDI in the 'power, gas and water' industry, the 'farming, forestry, animal husbandry and fishery services' industry and the 'construction and related engineer services' industry posted rapid growth of 100.2% yoy, 76.8% yoy and 56.3% yoy respectively in 1H17, indicating the optimism about these industries among foreign enterprises.

FDI in the manufacturing sector increased by 3.0% yoy to 128.6 billion yuan, accounting for 29.1% of the total FDI in 1H17. Among industries in the manufacturing sector, FDI in the 'general equipment' industry, the 'petrochemical engineering, coking and nuclear fuel' industry and the 'chemical raw material and chemical product' industry grew at a relatively fast pace, by 14.4% yoy, 329.4% yoy and 38.4% yoy respectively, over the same period.

**Exhibit 31** China's FDI, July 2016 to June 2017

	Amount (billion yuan)	yoy growth
FY16	813.2	4.1%
1H17	441.5	-0.1%
July 16	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%
January 17	80.1	-9.2%
February	58.6	9.2%
March	87.8	6.7%
April	59.9	-4.3%
May	54.7	-3.7%
June	100.5	2.3%

Source: Ministry of Commerce, PRC

## 7. China's foreign exchange reserves increase in 2Q17

China's foreign exchange reserves increased by US\$ 47.7 billion in 2Q17, recording the first positive quarter-on-quarter gain in twelve quarters. As at the end of June, the foreign exchange reserves amounted to US\$ 3,056.8 billion (*see exhibit 32*).

The rebound in the foreign exchange reserves in 2Q17 was due largely to a higher US-dollar value of non-US-dollar denominated assets in the foreign exchange reserves amid the appreciation of the non-dollar currencies.<sup>15</sup> Also noteworthy is that the cross-border flows of funds stabilized in May and June, according to the State Administration of Foreign Exchange.

In our view, the value of China's foreign exchange reserves in the near term will depend largely on the strength of the US dollar, which affects the US-dollar value of non-US-dollar denominated assets in the reserves. The market expectations of the movement of the Chinese yuan exchange rate could be another factor, determining hot money flows.

**Exhibit 32** Foreign exchange reserves by quarter, 3Q16 to 2Q17

USD billion	Accumulation	End of the quarter
FY16	-319.8	
3Q16	-38.8	3,166.4
4Q16	-155.9	3,010.5
1Q17	-1.4	3,009.1
2Q17	47.7	3,056.8

Source: State Administration of Foreign Exchange, PRC

<sup>15</sup> According to the Bloomberg, the US dollar index was 95.628 on 30 June, compared to 100.350 on 31 March.

## B Highlights

### 1. Chinese yuan appreciates against the US dollar, but depreciates against the Euro

The Chinese yuan has appreciated against the US dollar in recent months. The daily fixing rate (also known as the central parity rate) of the Chinese yuan against the US dollar strengthened from 6.9066 on 10 May to 6.7283 on 31 July (see exhibit 33).<sup>16</sup> In line with the trend of the daily fixing rate, the USD-CNY spot exchange rate has appreciated in the past few months.<sup>17</sup> The USD-CNY spot exchange rate closed at 6.7290 on 31 July, implying that the Chinese yuan appreciated against the US dollar by 3.28% in the first seven months of this year.

The recent appreciation of the Chinese yuan against the US dollar was highly associated with the weakening of the US dollar against most of the major currencies. According to Bloomberg, the US dollar index dropped from its recent peak of 101.180 on 7 April to 92.863 on 31 July, indicating the depreciation of the US dollar against a basket of currencies consisting of the Euro, Japanese yen, British pound, Canadian dollar, Swedish krona and Swiss franc.

The Chinese yuan has weakened against the Euro since mid-April. The daily fixing rate of the Chinese yuan against the Euro depreciated from 7.3025 on

17 April to 7.9059 on 31 July, the weakest level since mid-September 2014 (see exhibit 34). In the first seven months of this year, the daily fixing rate of the Chinese yuan against the Euro depreciated by 7.58%.

According to the Bank for International Settlements, the real effective exchange rate (REER) of the yuan has stayed low in recent months.<sup>18</sup> The index fell to 118.49 in May, the lowest level since September 2014, and then rebounded slightly to 118.76 in June. Overall, in 1H17, the Chinese yuan depreciated in real terms against its trading partners by 3.3% (see exhibit 35).

Looking ahead, we predict that the exchange rate of the Chinese yuan against the US dollar will remain relatively strong in the near term, as the US dollar is expected to stay weak and China's central bank is likely to continue its less accommodative monetary policy amid the strong economic situations of the country. Nevertheless, the depreciation pressure on the exchange rate of the Chinese yuan against the US dollar may return in the medium term, due to the US central bank's likely moves to increase interest rate and reduce the size of its balance sheet in coming future.

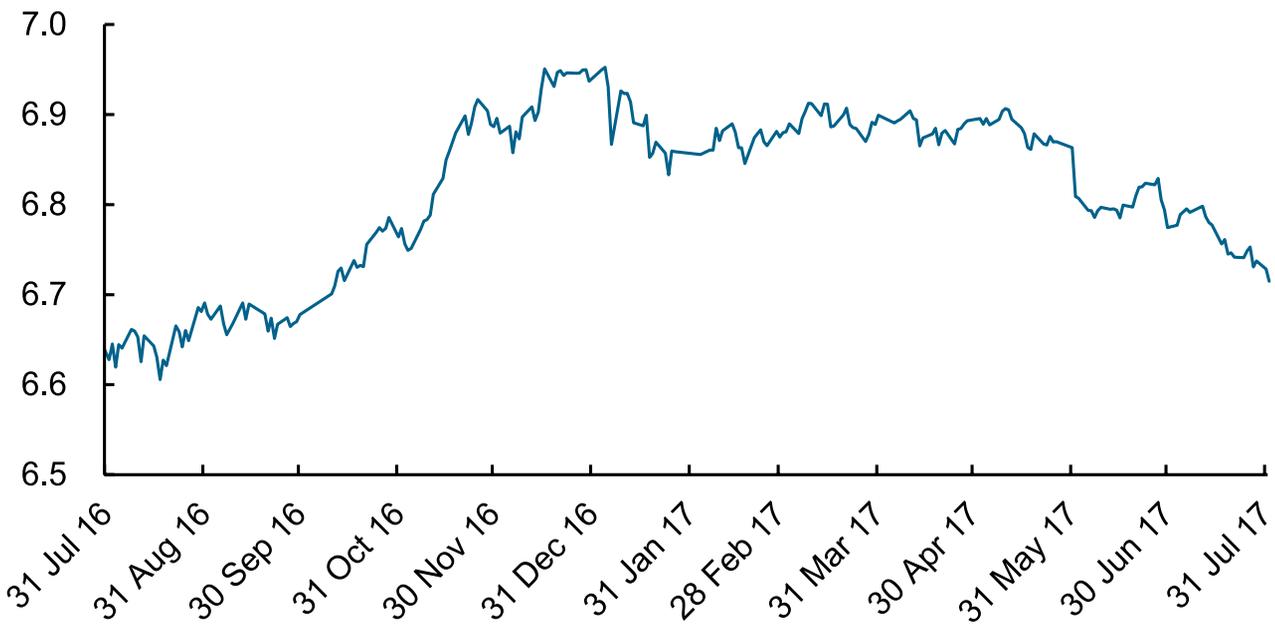
28

<sup>16</sup> 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.

<sup>17</sup> The daily trading band of the Chinese yuan against the US dollar is  $\pm 2.0\%$  around the daily fixing rate.

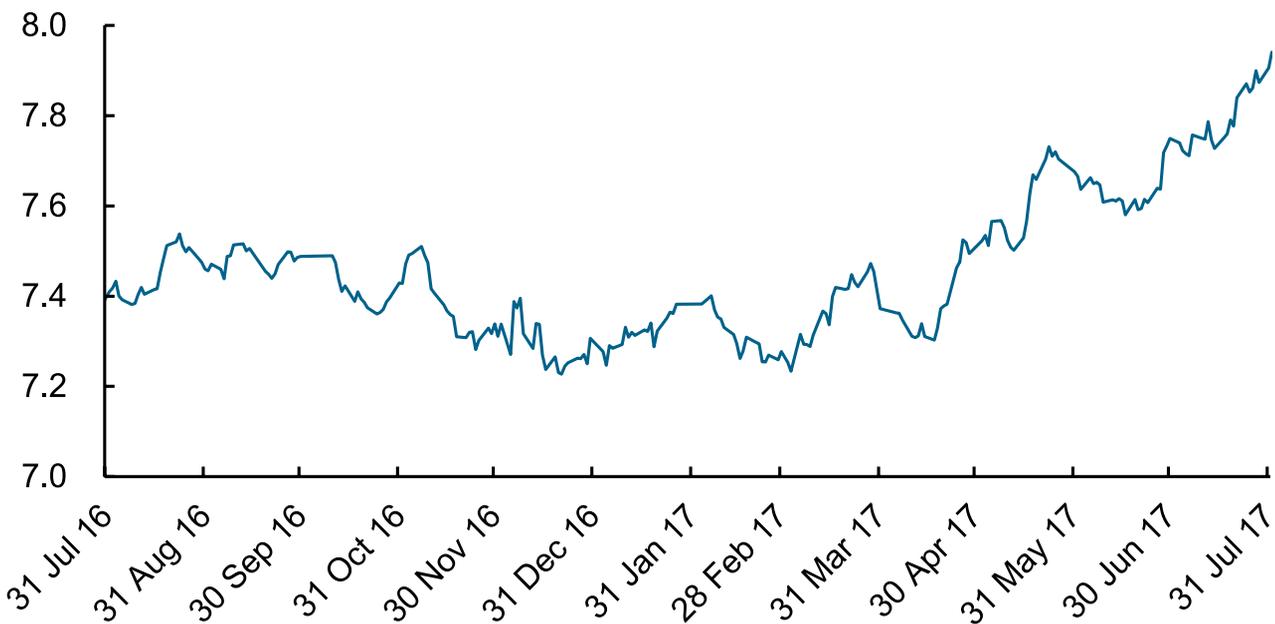
<sup>18</sup> The Bank for International Settlements (BIS) calculates effective exchange rate (EER) indices for a total of 61 economies (including individual Eurozone countries and, separately, the Eurozone as an entity). Nominal EERs are calculated as geometric weighted averages of bilateral exchange 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.

**Exhibit 33** USD-CNY daily fixing rate, July 2016 to July 2017



Source: State Administration of Foreign Exchange

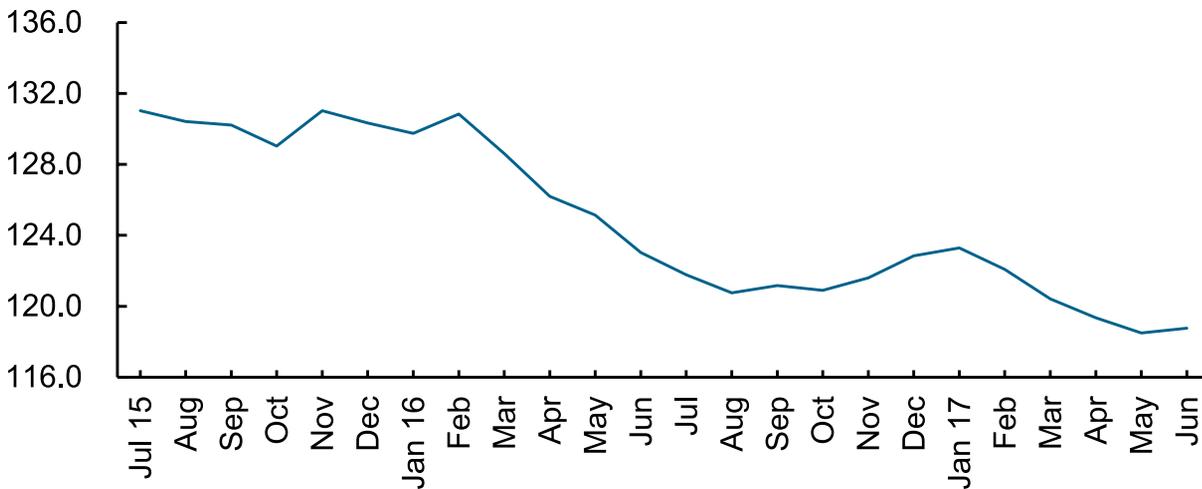
**Exhibit 34** EUR-CNY daily fixing rate, July 2016 to July 2017



Source: State Administration of Foreign Exchange

**Exhibit 35**

Real effective exchange rate of the Chinese yuan, July 2015 to June 2017



Source: Bank for International Settlements

## 2. China's first Belt and Road Forum draws worldwide participation

30

The first Belt and Road Forum was held in Beijing on 14-15 May. The two-day forum drew worldwide participation. Around 1,500 delegates from more than 130 countries and 70 international organizations, including 29 foreign heads of state and government, attended the forum. Particularly noteworthy is that the US and Japan, which were previously indifferent to the forum, also sent delegations to Beijing at the last moment.

During the forum, Chinese President Xi Jinping and 29 other heads of state and government signed a joint communique, reaffirming their commitment to building an open economy, ensuring free and inclusive trade, and promoting a universal, rules-based, open, non-discriminatory and equitable multilateral trading system with WTO at its core. This shows that the China-led Belt and Road Initiative has been transformed into a truly open platform with global recognition.

The two-day forum yielded fruitful results with 270 deliverables in five key areas, namely policy coordination, trade, infrastructure, finance as well as people-to-people exchange.<sup>19</sup> Some of the notable deliverables related to trade and infrastructure include:

- The Chinese government signed economic and trade cooperation agreements with the governments of 30 countries, and signed the *China-Georgia Free Trade Agreement* with the government of Georgia.

- The Chinese Ministry of Commerce and the relevant agencies of more than 60 countries and international organizations jointly issued the *Initiative on Promoting Unimpeded Trade Cooperation along the Belt and Road*.
- Bilateral cooperation agreements in the fields of promoting SME development, agriculture trade, e-commerce, inspection and quarantine, cross-border economic cooperation zone, etc. were signed between China and government departments of relevant countries.
- The railway companies in China, Belarus, Germany, Kazakhstan, Mongolia, Poland and Russia signed an agreement for further cooperation on China-Europe Container Block Trains.
- Bilateral cooperation agreements in various fields such as energy, water, ports, railways and information technology, were reached between relevant government departments.
- The China Development Bank and the Export-Import Bank of China signed financing agreements on various infrastructure projects with parties of relevant countries participating in the Initiative.

(More detailed discussion about the forum can be found in our report titled '*The Belt and Road Initiative: Seeking Deeper and Broader Cooperation*').<sup>20</sup>

<sup>19</sup> [http://www.chinadaily.com.cn/china/2017-05/16/content\\_29359377.htm](http://www.chinadaily.com.cn/china/2017-05/16/content_29359377.htm)

<sup>20</sup> <http://www.fbicgroup.com/?q=publication/belt-and-road-initiative-seeking-deeper-and-broader-cooperation>

### 3. China and the US hold the first Comprehensive Economic Dialogue in mid-July

China and the US held the first Comprehensive Economic Dialogue, a high-level meeting co-chaired by Chinese Vice Premier Wang Yang, the US Treasury Secretary Steven Mnuchin and Secretary of Commerce Wilbur Ross, in Washington on 19 July. During the meeting, both sides discussed a wide range of issues such as trade, investment, finance and agricultural industries, macroeconomic policy, the 100-day plan and the one-year action plan of economic cooperation, global economy and governance, etc.

After the meeting, the US said in a statement that China acknowledged their shared objective to reduce the US trade deficit with China which both sides would work cooperatively to achieve.<sup>21</sup> Meanwhile, according to the Chinese Vice Minister of Finance Zhu Guangyao, both China and the US agreed that, to tackle the problem of trade imbalance, the US has to increase its exports to China, instead of reducing its imports of Chinese products. As part of the effort to increase the US exports, both sides agreed on inspection and quarantine protocols for the US exports of rice to China; the US can begin to export rice to China in near future after the Chinese government's completion of an audit of the US rice facilities, according to China's state-run Xinhua news agency.<sup>22</sup>

There were signs of disagreement between China and the US, as both countries cancelled their post-meeting press conferences. According to Reuters, an unnamed US official disclosed that both countries failed to reach agreement on important issues such as US enterprises' access to the financial service market in China, the cuts in capacity of steel industry, auto tariffs and subsidies on state-owned enterprises in China, and the upper limits on ownership for foreign firms in China, etc.

<sup>21</sup> <https://www.commerce.gov/news/press-releases/2017/07/statement-secretary-ross-and-secretary-mnuchin-following-us-china>

<sup>22</sup> [http://news.xinhuanet.com/english/2017-07/21/c\\_136461124.htm](http://news.xinhuanet.com/english/2017-07/21/c_136461124.htm)

## C Outlook

### 1. US economic growth accelerates in 2Q17

The economic growth in the US accelerated in 2Q17. The US real GDP expanded by an annual rate of 2.6% in 2Q17, compared to the annual growth of 1.2% in 1Q17 (see exhibit 36).

On the production side, industrial production gained 0.4% mom in June, posting month-on-month growth for five consecutive months (see exhibit 37). Besides, the manufacturing PMI rose all the way from 54.8 in April to 57.8 in June, the highest level since August 2014, and remained high at 56.3 in July, showing that the manufacturing sector has expanded at a relatively fast pace recently. Meanwhile, the new orders for manufactured durable goods increased strongly by 6.5% mom in June, boosted by the demand for transportation equipment. Excluding transportation, the new orders rose by 0.2% mom in the month.

The growth in the non-manufacturing sector has decelerated recently, as indicated by reading of the non-manufacturing index (NMI) in July: the index fell from 57.4 in June to 53.9 in July, the lowest level in eleven months.

The consumption demand has shown signs of moderation in recent months. The US retail sales dropped by 0.2% mom in June, recording negative month-on-month growth for the second consecutive month. Moreover, the Reuters/University of Michigan index of consumer sentiment fell

all the way from 97.1 in May to 93.4 in July, indicating that US consumers have become less optimistic lately (see exhibit 38).

The pace of job creation has reaccelerated. After increasing by 152,000 in May, the non-farm payroll employment rose at a faster pace, by 222,000, in June. In the meantime, the US unemployment rate dropped from 4.4% in April to a 16-year low of 4.3% in May, before rising slightly to 4.4% in June (see exhibit 39).

The Federal Reserve has gradually changed its stance in the monetary policy recently. On 14 June, the central bank raised the federal funds rate by 25 bps for the third time in six months, a move that implies a fast pace of interest rate hike. In addition, according to the address by its chair Janet Yellen to the US Congress on 12 July, the central bank is likely to implement the programme of reducing the size of its balance sheet this year and the balance-sheet reduction will be a gradual process.<sup>23</sup>

Looking ahead, the US economy is expected to expand at a moderate pace over the next couple of years, given the slow adjustment in the US monetary policy. According to the latest projection by the International Monetary Fund (IMF), the real GDP growth in the US will rise from 1.5% in 2016 to 2.1% in 2017 and 2018.<sup>24</sup>

**Exhibit 36** US national accounts, 2015 to 2Q17

Annual growth (%)	2015	2016	3Q16	4Q16	1Q17	2Q17
Real GDP	2.9	1.5	2.8	1.8	1.2	2.6

Source: US Department of Commerce

**Exhibit 37** US industrial sector, January to June 2017

mom growth (%), seasonally adjusted	Jan 17	Feb	Mar	Apr	May	Jun
Industrial production	-0.3	0.2	0.1	0.8	0.1	0.4
New orders for manufactured durable goods	0.3	1.4	2.4	-0.8	-0.1	6.5

Source: US Federal Reserve, US Department of Commerce

<sup>23</sup> <https://www.federalreserve.gov/newsevents/testimony/yellen20170712a.htm>

<sup>24</sup> IMF, *World Economic Outlook Update*, July 2017

**Exhibit 38** US consumer market, February to July 2017

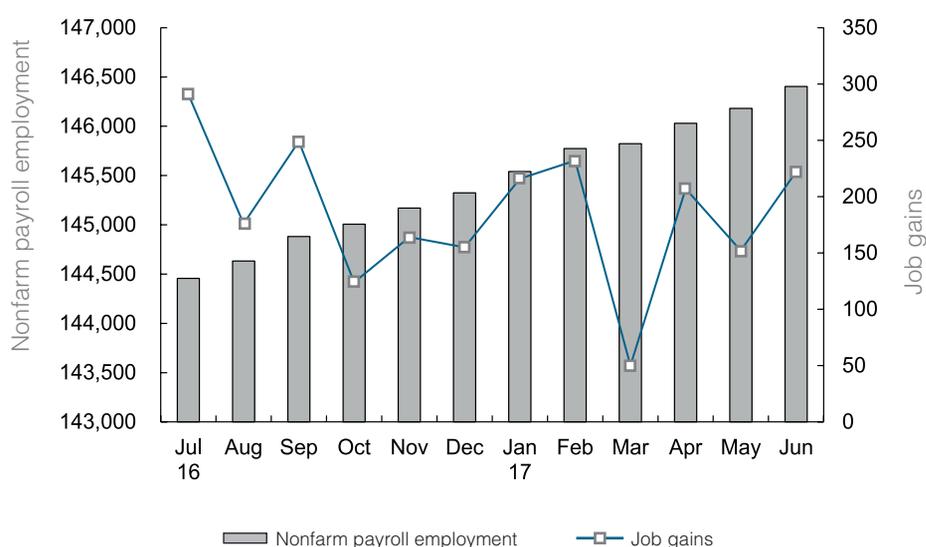
	Feb 17	Mar	Apr	May	Jun	Jul
Retail and food services sales (mom growth %, seasonally adjusted)	-0.2	0.1	0.3	-0.1	-0.2	-
Reuters/University of Michigan index of consumer sentiment	96.3	96.9	97.0	97.1	95.1	93.4
CPI (yoy growth %)	2.7	2.4	2.2	1.9	1.6	-

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

**Exhibit 39** US employment

	Unemployment rate (%)
2015	5.3
2016	4.9
Jul 16	4.9
Aug	4.9
Sep	4.9
Oct	4.8
Nov	4.6
Dec	4.7
Jan 17	4.8
Feb	4.7
Mar	4.5
Apr	4.4
May	4.3
Jun	4.4

Nonfarm payroll employment, July 2016 to June 2017  
In thousands, seasonally adjusted



Yearly figures: Annual average  
Monthly figures: Seasonally adjusted

Source: US Department of Labor

## 2. Eurozone economy grows at a relatively fast pace

Several indicators suggest that the Eurozone economy has grown at a relatively fast pace lately. For example, the quarter-on-quarter growth rate for the real GDP in the Eurozone accelerated to 0.6% in 2Q17 from 0.5% in 1Q17 (see exhibit 40).<sup>25</sup> Besides, according to the global survey firm Markit Economics, the Eurozone

services PMI went up to 56.4 in April, the highest level since April 2011, and then remained high at 56.3, 55.4 and 55.4 in May, June and July respectively, indicating the strong growth momentum of the services sector in the Eurozone. Meanwhile, after rising to a six-year peak of 57.4 in June, the Eurozone manufacturing PMI

<sup>25</sup> 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.

## Part 2 : Foreign Trade

came in at 56.6 in July, well above the critical 50-mark, indicating the rapid expansion of the manufacturing sector in the region.

The retail trade volume in the Eurozone gained 0.5% mom in June on a seasonally adjusted basis, posting positive month-on-month growth in five of the past six months (*see exhibit 41*).

The labour market conditions in the region have continued to improve in past few months. The seasonally-adjusted unemployment rate fell all the way from 9.6% in January to 9.1% in June, the lowest level since February 2009 (*see exhibit 42*). Meanwhile, confidence among consumers and managers in various sectors has been strong. The Eurozone's

economic sentiment indicator (ESI) dropped from its recent peak of 109.6 in April to 109.2 in May, but then rebounded to 111.1 in June and 111.2 in July, the highest level in ten years (*see exhibit 43*).

In its latest *World Economic Outlook Update* published on 24 July, the International Monetary Fund (IMF) revises upward its forecasts on the real GDP growth rate for the Eurozone, as the better-than-expected economic performance in late 2016 to early 2017 indicates the stronger domestic demand in the region. The IMF predicts that the growth rate for the Eurozone's real GDP will be 1.9% in 2017 and 1.7% in 2018, up by 0.2 ppts and 0.1 ppts, respectively, from its previous projections made in April this year.<sup>26</sup>

**Exhibit 40** Eurozone's real GDP growth, 2015 to 2Q17

	2015	2016	3Q16	4Q16	1Q17	2Q17
Real GDP ( <i>qoq growth %</i> )			0.4	0.6	0.5	0.6
Real GDP ( <i>yoy growth %</i> )	2.0	1.8	1.7	1.9	1.9	2.1

Source: Eurostat, World Bank

**Exhibit 41** Eurozone consumer market, January to June 2017

	Jan 17	Feb	Mar	Apr	May	Jun
Volume of retail trade ( <i>mom growth %, seasonally adjusted</i> )	0.1	0.5	0.5	0.0	0.4	0.5
Annual inflation (%)	1.8	2.0	1.5	1.9	1.4	1.3

Source: Eurostat

**Exhibit 42** Eurozone labour market, January to June 2017

<i>seasonally adjusted</i>	Jan 17	Feb	Mar	Apr	May	Jun
Unemployment rate (%)	9.6	9.5	9.4	9.2	9.2	9.1

Source: Eurostat

**Exhibit 43** Eurozone economic sentiment indicator, February to July 2017

<i>seasonally adjusted</i>	Feb 17	Mar	Apr	May	Jun	Jul
Economic sentiment indicator	108.0	108.0	109.7	109.2	111.1	111.2

Source: Eurostat

### 3. China's exports are expected to show high single-digit growth in 3Q17

According to the *World Economic Outlook Update* released on 24 July, the IMF forecasts that the world economic growth will accelerate from 3.2% in 2016 to 3.5% in 2017 and 3.6% in 2018. The growth in the advanced economies is projected to rise from 1.7% in 2016 to 2.0% in 2017, and moderate to 1.9% in 2018. Meanwhile, the growth in the emerging market and developing economies is projected to improve continuously, accelerating from 4.3% in 2016 to 4.6% in 2017 and further to 4.8% in 2018 (*see exhibit 44*).

As the acceleration in the growth in the world economy, in particular the advanced economies, is likely to support the foreign demand for China's products in the near term, we forecast that China's exports will show high single-digit year-on-year growth in 3Q17. However, challenges facing Chinese exporters persist, including the greater uncertainty in the US trade policies under Trump administration, intense competition in the international market, stronger government's efforts to enforce environmental regulations, increasing costs of labour and materials.

**Exhibit 44** Latest GDP growth forecasts by the IMF

<i>yoy growth (%)</i>	2016	2017 (Forecasts)	2018 (Forecasts)
<b>World economy</b>	<b>3.2</b>	<b>3.5</b>	<b>3.6</b>
<b>Advanced economies</b>	<b>1.7</b>	<b>2.0</b>	<b>1.9</b>
US	1.5	2.1	2.1
Eurozone	1.8	1.9	1.7
Japan	1.0	1.3	0.6
UK	1.8	1.7	1.5
<b>Emerging market and developing economies</b>	<b>4.3</b>	<b>4.6</b>	<b>4.8</b>
China	6.7	6.7	6.4
India *	7.1	7.2	7.7
Brazil	-3.6	0.3	1.3
Russia	-0.2	1.4	1.4

\* Data and forecasts are presented on a fiscal year basis.

Source: IMF, US Department of Commerce

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