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Domestic Trade

Retail sales of consumer goods grow by 10.2% yoy in 2017.

Producer price index of industrial products rises by 6.3% yoy in 2017.

Both rural and urban households see high single-digit growth in income in 2017.

Growth in nominal fixed asset investment decelerates to 7.2% yoy in 2017.

Government reduces tariff rates for imports of 187 tariff items on 1 December.

Entrepreneur Confidence Index stays high at 126.0 in 4Q17.

Growth of manufacturing sector moderates.

January NMI indicates growth acceleration in non-manufacturing sector.

Foreign Trade

Growth rates of exports and imports turn positive in 2017.

Exports to the US register double-digit growth of 11.5% yoy in 2017.

Exports from Shaanxi, Guizhou, Sichuan and Ningxia soar by 50.7% yoy, 37.8% yoy, 34.3% yoy and 30.1% yoy respectively in 2017.

FDI increases by 7.9% yoy in 2017.

Foreign exchange reserves rise for twelve consecutive months.

Chinese yuan appreciates against the US dollar in 2017.

Recent US moves may worsen China-US trade relations.

FUNG BUSINESS INTELLIGENCE

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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 36,626.2 billion yuan in 2017, up by 10.2% yoy. Online retail sales of goods, which accounted for 15.0% of total retail sales, increased markedly by 28.0% yoy over the period.

For 2017, producer price index of industrial products (PPI) climbed 6.3% from the previous year, the first rise since 2011.

Both rural and urban households saw high single-digit growth in income in 2017: The per capita disposable income of rural households grew nominally by 8.6% yoy to reach 13,432 yuan; while that of urban households rose by 8.3% yoy in nominal terms to reach 36,396 yuan in 2017.

Growth in nominal fixed asset investment decelerated to 7.2% yoy in 2017 from 8.1% yoy in 2016, attributable to the FAI growth deceleration in the primary industry and the secondary industry, in particular the production and supply of power, heat, gas and water.

Government reduced the tariff rates for imports of 187 tariff items on 1 December. These 187 tariff items include food, health supplements, medicines, chemical products for daily use, clothing, shoes, hats, household equipment, cultural and entertainment products, etc. The move would reduce the average tariff rate for imports of these items from 17.3% to 7.7%.

Entrepreneur Confidence Index came in at 126.0 in 4Q17, still well above the critical level of 100, indicating that Chinese entrepreneurs have remained optimistic about the prospects for their industries.

Growth of manufacturing sector has moderated in recent months. PMI dropped from 51.8 in November to 51.6 in December, and further to 51.3 in January.

January NMI indicates growth acceleration in non-manufacturing sector. NMI has been on an upward trend in past few months, going up to a four-month high of 55.3 in January.

Foreign Trade

Growth rates of exports and imports turned positive in 2017. Export growth improved to 7.9% yoy in 2017 from minus 7.7% yoy in 2016; import growth reached 15.9% yoy in 2017, up from minus 5.5% yoy in 2016.

Exports to the US registered double-digit growth of 11.5% yoy in 2017. Exports to the EU, Japan and the ASEAN expanded by 9.7% yoy, 6.1% yoy and 9.0% yoy respectively over the same period.

Among provinces/ municipalities, Shaanxi witnessed the fastest year-on-year growth in exports in 2017, followed by Guizhou, Sichuan and Ningxia. Exports from Shaanxi, Guizhou, Sichuan and Ningxia soared by 50.7% yoy, 37.8% yoy, 34.3% yoy and 30.1% yoy respectively over the period.

FDI increased by 7.9% yoy to 877.6 billion yuan in 2017. FDI in the Hi-Tech industries grew rapidly by 61.7% yoy to 251.3 billion yuan, accounting for 28.6% of the total FDI in the year.

Foreign exchange reserves increased by US$ 21.5 billion in January, rising for twelve consecutive months. As at the end of January, the foreign exchange reserves amounted to US$ 3,161.5 billion.

The Chinese yuan appreciated against the US dollar in 2017. The USD-CNY spot exchange rate appreciated by 6.72% in 2017, compared to the 6.56% depreciation in 2016.

Recent US moves may worsen China-US trade relations. On 29 November, the US Department of Commerce announced to launch a countervailing duty and anti-dumping probe into the imports of alloy aluminium sheet from China. Then, on 1 December, the Office of the US Trade Representative disclosed that the US had officially informed the WTO about its opposition to granting China market economy status. Almost two months later, the US President Donald Trump approved the imposition of safeguard tariffs on imported solar cells and modules, most of which are imported from China, as well as large residential washing machines.

Part 1 :

Domestic Trade

A Recent developments

1. China's real GDP maintains rapid growth in 4Q17

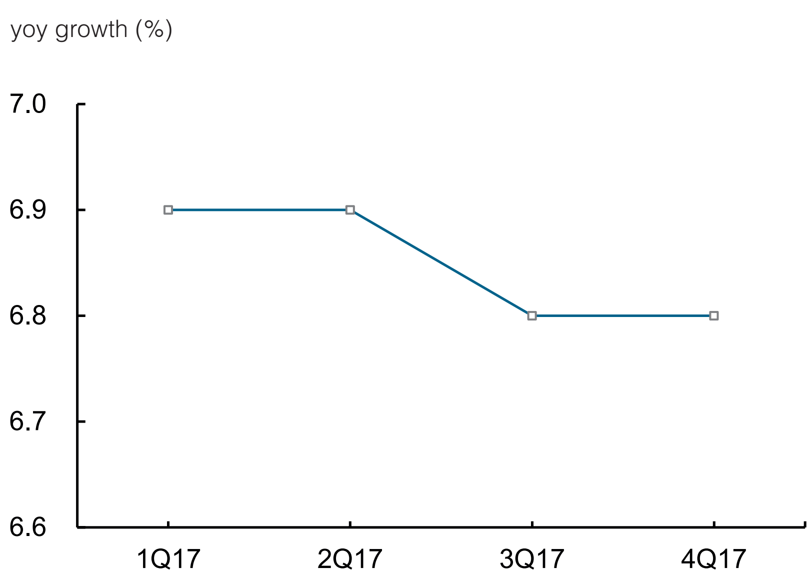
China's real GDP growth stayed high at 6.8% year-on-year (yoy) in 4Q17, the same as in 3Q17 *(see exhibit 1)*. The 4Q17 figure indicates a continued rapid expansion of the Chinese economy. Overall, in 2017, China's nominal GDP amounted to 82.7 trillion yuan, up by 6.9% yoy in real terms.

The real growth rate for the value-added of the tertiary industry accelerated to 8.0% yoy in 2017, up from 7.8% yoy in 2016. In comparison, the real growth rate for the value-added of the secondary industry came in at 6.1% yoy in 2017, the same as in 2016.

In 2017, final consumption expenditure contributed 4.1 ppts to the real GDP growth, while gross capital formation contributed 2.2 ppts and net exports contributed 0.6 ppts. The figures show that China has been shifting towards a consumption-led economy.

Chinese top leaders have shifted their focus from speed of growth to quality of growth. According to the speech made by the Chinese President Xi Jinping at the 19th National Congress of the Communist Party of China (CPC) on 18 October 2017, China will make greater efforts to curb major risks, reduce poverty and contain pollution over the next three years.[1] China will focus on reducing financial risks by tackling illegal financing activities and tightening financial regulations. Besides, to contain pollution, China will take stronger moves to eliminate outdated production capacities. In our view, these moves may have adverse impact on short-term domestic demand and supply, thereby constraining China's economic growth in the near term. Looking ahead, we forecast that China's real GDP growth will stay at 6.8% in 1Q18 and then decelerate in the following quarters.

Exhibit 1 China's real GDP growth, 1Q17 to 4Q17



FY17	6.9%
1Q17	6.9%
2Q17	6.9%
3Q17	6.8%
4Q17	6.8%

Source: National Bureau of Statistics, PRC

1 http://www.xinhuanet.com/english/special/2017-11/03/c_136725942.htm

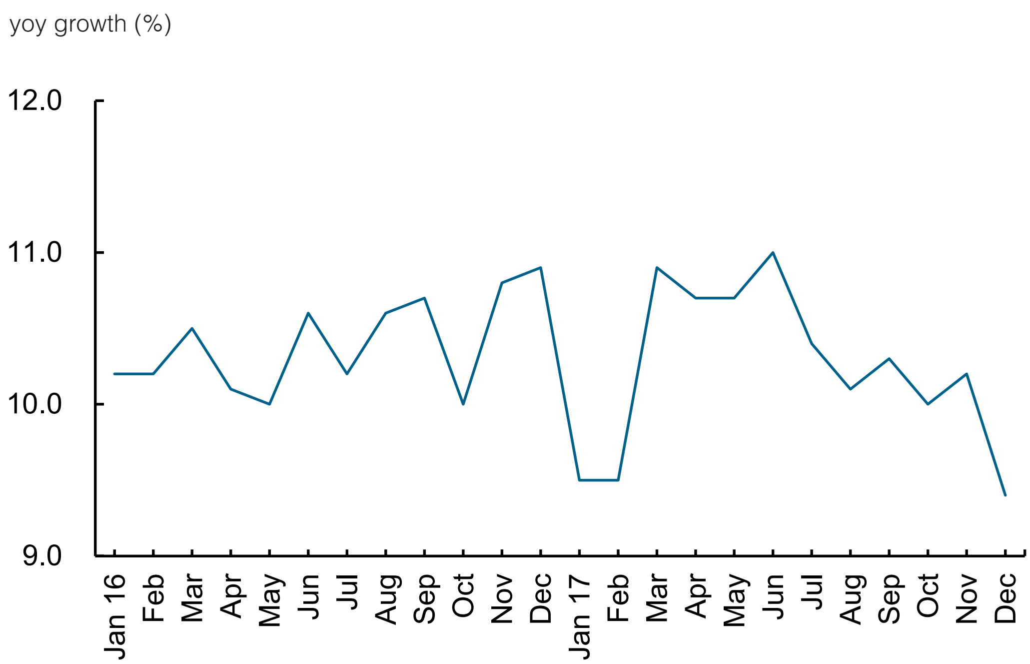
2. Growth in retail sales decelerates in December

According to the National Bureau of Statistics, the growth in China's total retail sales of consumer goods improved from 10.0% yoy in October to 10.2% yoy in November, before falling to 9.4% yoy in December. The month-on-month (mom) growth in seasonally-adjusted retail sales fluctuated within the range of 0.70% to 0.81% throughout October to December.

Overall, in 2017, the total retail sales of consumer goods reached 36,626.2 billion yuan. The growth rate was 10.2% yoy in 2017, down slightly from 10.4% yoy in 2016 (*see exhibits 2 and 3*).

China's online retail sales of goods increased by 28.0% yoy to reach 5,480.6 billion yuan in 2017. Consequently, the share of online retail sales in the total retail sales of consumer goods went up to 15.0% in 2017 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, January 2016 to December 2017



FY17	10.2%
Jan-Feb 17	9.5%
Mar	10.9%
Apr	10.7%
May	10.7%
Jun	11.0%
Jul	10.4%
Aug	10.1%
Sep	10.3%
Oct	10.0%
Nov	10.2%
Dec	9.4%

Source: National Bureau of Statistics, PRC

Exhibit 3 China's total retail sales, month-on-month nominal growth, July to December 2017

mom growth (%), seasonally adjusted

	Jul 17	Aug	Sep	Oct	Nov	Dec
Total retail sales	0.69	0.74	0.85	0.72	0.81	0.70

Source: National Bureau of Statistics, PRC

Rural retail sales have increased at a faster pace: the growth in rural retail sales accelerated to 11.8% yoy in 2017 from 10.9% yoy in 2016. In contrast, the growth in urban retail sales moderated to 10.0% yoy in 2017 from 10.4% yoy in 2016.

The growth in catering services sales came in at 10.7% yoy in 2017, down slightly from 10.8% yoy in 2016. Meanwhile, the growth in sales of goods decelerated slightly from 10.4% yoy in 2016 to 10.2% yoy in 2017.

The growth rate for the retail sales of goods by enterprises above a designated size[2], which amounted to 15,086.1 billion yuan in 2017, decelerated modestly to 8.2% yoy in 2017 from 8.3% yoy in 2016. Among products, 'sports and entertainment products' saw the strongest growth in sales (15.6% yoy) in 2017, followed by 'cosmetics' (13.5% yoy). Meanwhile, 'automobiles' witnessed the weakest growth in sales (5.6% yoy), partly due to the upward adjustment in the purchase tax rate on passenger-vehicles with engines smaller than 1.6 litre on 1 January last 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 2017

Nominal growth, yoy (%)	FY16	1Q17	1H17	1-3Q17	2017
Total retail sales	10.4	10.0	10.4	10.4	10.2
- Goods	10.4	9.9	10.3	10.3	10.2
Sales by enterprises above a designated size	8.3	7.9	8.8	8.5	8.2
Online sales	25.6	25.8	28.6	29.1	28.0
- Catering services	10.8	10.8	11.2	11.0	10.7

Source: National Bureau of Statistics, PRC

3. Chinese consumers are optimistic

The consumer confidence index[3] rose strongly from 114.7 in August to 118.6 in September and 123.9 in October, and stayed high at 121.3 in November. The latest figure indicates that Chinese consumers have been optimistic recently *(see exhibit 6)*.

In our view, the improving consumer confidence was highly associated with the stable growth in household income amid the rapidly growing Chinese economy.

4. Both rural and urban households see high single-digit growth in income in 2017

Both rural and urban households continued to see high single-digit nominal growth in income in 2017. The per capita disposable income of rural households grew nominally by 8.6% yoy (or 7.3% yoy real) to reach 13,432 yuan; while the per capita disposable income of urban households rose by 8.3% yoy in nominal terms (or 6.5% yoy real) to reach 36,396 yuan in 2017.

With higher income, both rural and urban households had more room to increase their consumption expenditures in 2017. The per capita consumption expenditure of rural households reached 10,955 yuan, up nominally by 8.1% yoy (or 6.8% yoy real); while the per capita consumption expenditure of urban households grew by 5.9% yoy in nominal terms (or 4.1% yoy real) to reach 24,445 yuan in 2017.

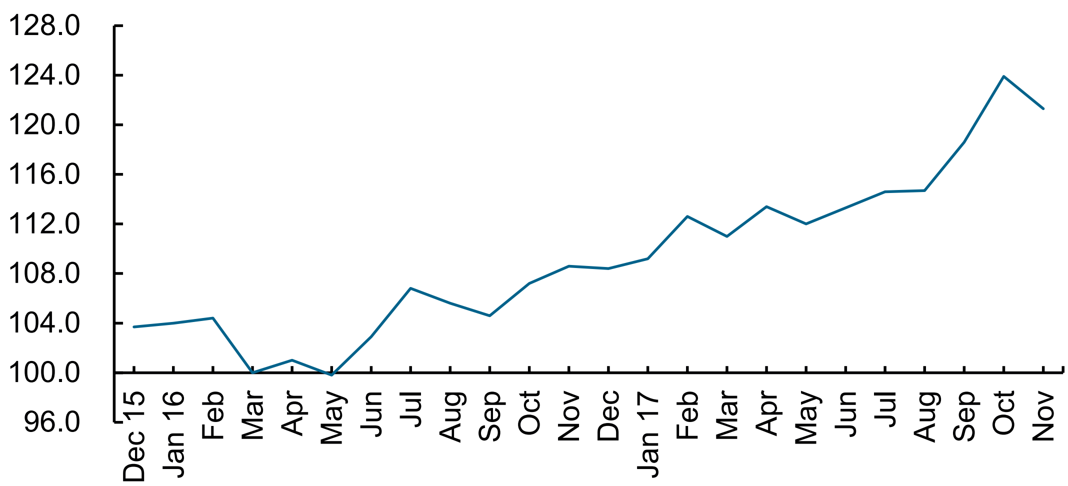
2 'Enterprises above a designated size' refers to enterprises with annual sales of 5 million yuan or more and with an employee strength of 60 or more.
3 A reading above 100 indicates that consumers tend to be optimistic; a reading below 100 indicates that consumers tend to be pessimistic.

Exhibit 5 China's retail sales by enterprises above a designated size, by product, 2016 to 2017

Nominal growth, yoy (%)	FY16	1Q17	1H17	1-3Q17	2017
Grain, oil and food	10.9	10.4	11.5	10.6	10.2
Beverages	10.5	12.7	12.7	11.2	10.3
Tobacco and liquor	9.3	9.8	9.8	8.7	7.9
Clothing, shoes, hats and textiles	7.0	6.2	7.3	7.2	7.8
Cosmetics	8.3	9.9	11.3	12.1	13.5
Gold, silver and jewellery	0.0	7.9	7.9	6.9	5.6
Products for daily use	11.4	8.5	9.0	8.4	8.0
Sports and entertainment products	13.9	17.3	17.1	17.4	15.6
Home appliances and video equipment	8.7	8.0	10.4	10.1	9.3
Chinese and Western medicines	12.0	10.7	12.1	12.4	12.4
Stationery and office accessories	11.2	14.8	11.8	9.9	9.8
Furniture	12.7	12.6	13.4	13.3	12.8
Telecommunications equipment	11.9	11.0	10.1	9.3	11.7
Petroleum and related products	1.2	13.0	10.6	9.0	9.2
Automobiles	10.1	2.3	5.2	6.2	5.6
Building and decoration materials	14.0	14.8	13.9	12.6	10.3

Source: National Bureau of Statistics, PRC

Exhibit 6 China's consumer confidence index, December 2015 to November 2017



Dec 16	108.4
Jan 17	109.2
Feb	112.6
Mar	111.0
Apr	113.4
May	112.0
Jun	113.3
Jul	114.6
Aug	114.7
Sep	118.6
Oct	123.9
Nov	121.3

Source: National Bureau of Statistics, PRC

5. CPI growth falls in January

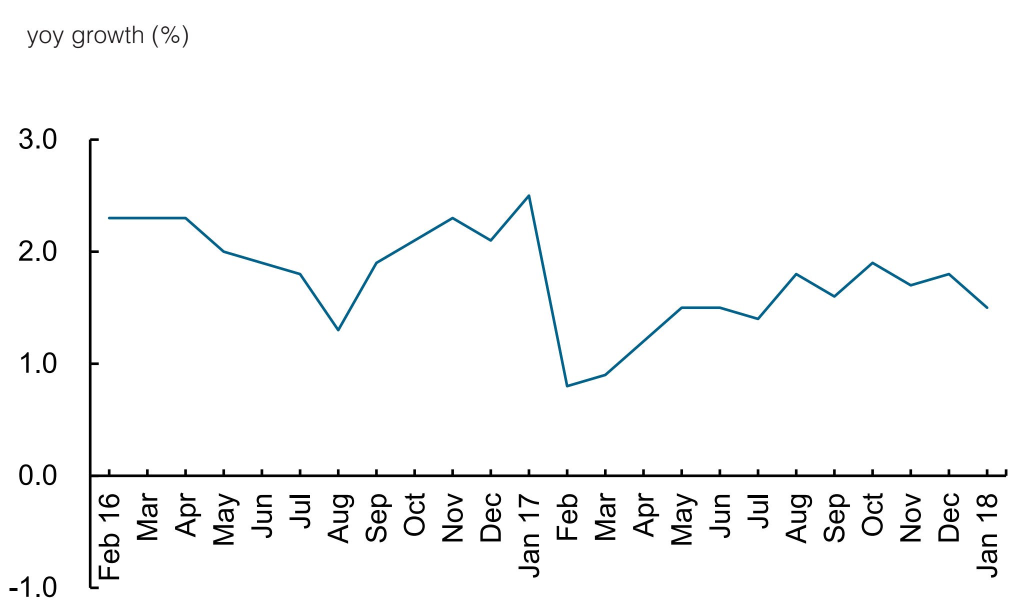
In 2017, the growth rate of China's consumer price index (CPI)[4] was 1.6% yoy, down from 2.0% yoy in FY16, and was well below the government's target of 3.0% set for the year.

The year-on-year growth rate of CPI went down from 1.8% in December 2017 to 1.5% in January 2018, which was in line with market expectations (*see exhibits 7 and 8*).

The slowdown in CPI growth in January was largely attributable to the different timing of the Chinese New Year each year. The Chinese New Year in 2018 began in mid-February, while that in last year was from late January. Due to a higher comparison base in January last year, the year-on-year growth in the non-food component in the CPI dropped to 2.0% in January 2018 from 2.4% in December 2017, while the year-on-year growth in the food component went down to minus 0.5% in January from minus 0.4% in the previous month, despite a month-on-month rise in food prices caused by bad weather.

Looking ahead, we expect that the CPI reading in February will continue to be distorted by the timing of the Chinese New Year. The CPI growth is likely to rise above 2% in the month, thanks to a stronger demand for food and travel before and during the Chinese New Year holidays this year, and a lower comparison base in February last year.

Exhibit 7 China's CPI growth, February 2016 to January 2018



Feb 17	0.8%
Mar	0.9%
Apr	1.2%
May	1.5%
Jun	1.5%
Jul	1.4%
Aug	1.8%
Sep	1.6%
Oct	1.9%
Nov	1.7%
Dec	1.8%
Jan 18	1.5%

Source: National Bureau of Statistics, PRC

4 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, August 2017 to January 2018[5]

yoy growth (%)	Aug 17	Sep	Oct	Nov	Dec	Jan 18
Food, tobacco and liquor	0.4	-0.4	0.3	-0.2	0.3	0.2
Clothing	1.3	1.3	1.2	1.2	1.3	1.4
Housing	2.7	2.8	2.8	2.8	2.8	2.7
Household goods and services	1.3	1.4	1.5	1.5	1.6	1.5
Transportation and communication	0.7	0.5	0.8	1.3	1.2	0.2
Education, culture and recreational activities	2.5	2.3	2.3	2.0	2.1	0.9
Medical and healthcare	5.9	7.6	7.2	7.0	6.6	6.2
Other goods and services	1.4	1.4	1.8	1.7	1.9	1.2

Source: National Bureau of Statistics, PRC

For 2017, China's producer price index of industrial products (PPI) climbed 6.3% from the previous year, the first rise since 2011.

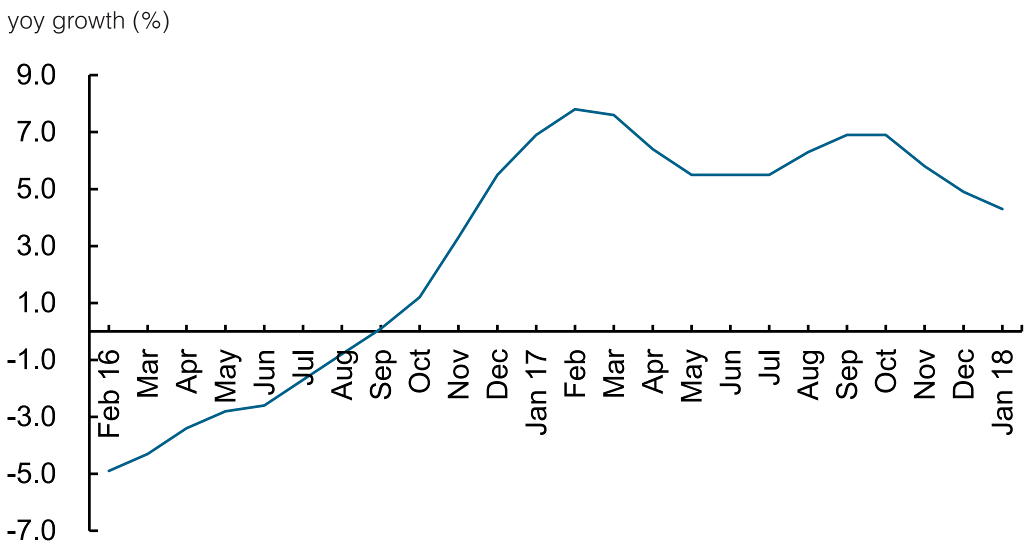
The year-on-year growth in China's PPI dropped from 4.9% in December 2017 to 4.3% in January 2018, the lowest level in more than a year (*see exhibits 9 & 10*).

On a month-on-month basis, the PPI advanced by 0.3% in January, after gaining 0.8% in the previous month. The moderation in PPI growth in the month was due largely to slower increases in ex-factory prices in the 'extraction of petroleum and natural gas', 'processing of petroleum', and 'manufacture of non-metallic mineral products' industries, as well as declines in ex-factory prices in the 'manufacture and processing of ferrous metals' industry.

Going forward, the PPI is expected to go up further on a month-on-month basis in the near term, as the recent rise in the domestic prices of production inputs will put upward pressures on the ex-factory prices of industrial products. Meanwhile, the year-on-year growth in the PPI is likely to fall further in the coming couple of months, given a higher base for comparison in early 2017.

5 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'.

Exhibit 9 China's PPI growth, February 2016 to January 2018



Feb 17	7.8%
Mar	7.6%
Apr	6.4%
May	5.5%
Jun	5.5%
Jul	5.5%
Aug	6.3%
Sep	6.9%
Oct	6.9%
Nov	5.8%
Dec	4.9%
Jan 18	4.3%

Source: National Bureau of Statistics, PRC

Exhibit 10 China's PPI growth by selected industry, August 2017 to January 2018

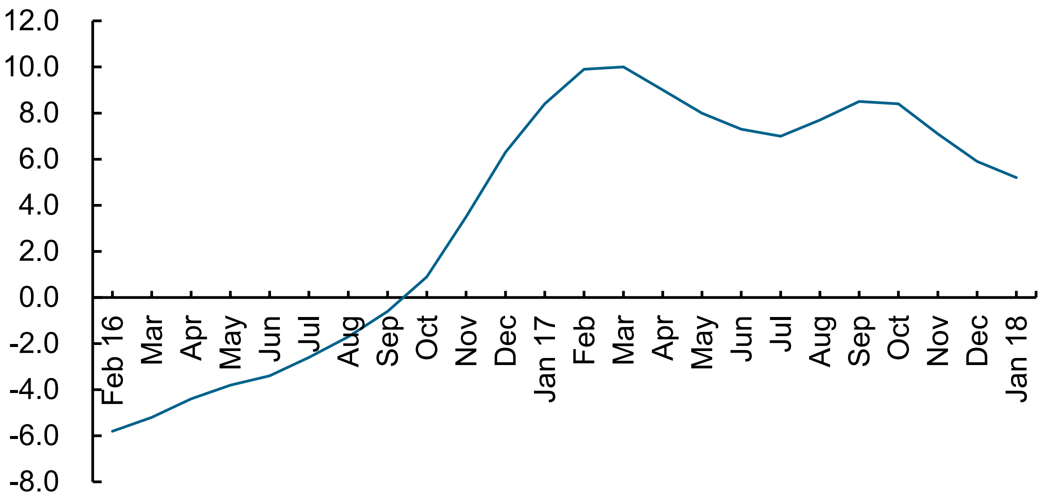
yoy growth (%)	Aug 17	Sep	Oct	Nov	Dec	Jan 18
Textile	2.9	3.0	2.7	2.4	2.4	2.1
Textile wearing apparel and ornament	1.0	0.8	0.7	0.7	0.5	0.8
Processing of timbers, manufacture of wood, bamboo, rattan, palm, and straw products	0.3	0.6	0.8	1.0	1.2	1.2

Source: National Bureau of Statistics, PRC

In 2017, China's purchaser price index of industrial products jumped by 8.1% from the previous year, ending a five-year decline. This was driven by excess capacity reduction and rise in global commodity prices, in our view.

The input prices sub-index of China's manufacturing PMI, a leading indicator of upstream prices, registered 59.7 in January. The index reading is well above the neutral level of 50 but lower than that of last month (62.2), indicating that domestic prices of production inputs have increased at a slower pace recently. Therefore, we believe that the growth rate of the purchaser price index of industrial products is likely to moderate on a month-on-month basis in the near term. Meanwhile, the year-on-year growth rate of the purchaser price index is likely to go down in the coming couple of months, due largely to a higher comparison base in the same period last year.

Exhibit 11 Growth in China's purchaser price index of industrial products, February 2016 to January 2018



Feb 17	9.9%
Mar	10.0%
Apr	9.0%
May	8.0%
Jun	7.3%
Jul	7.0%
Aug	7.7%
Sep	8.5%
Oct	8.4%
Nov	7.1%
Dec	5.9%
Jan 18	5.2%

Source: National Bureau of Statistics, PRC

Exhibit 12 China's purchaser price index of industrial products by selected commodity, August 2017 to January 2018

yoy growth (%)	Aug 17	Sep	Oct	Nov	Dec	Jan 18
Fuel and power	11.8	11.9	10.6	8.0	7.1	6.2
Non-ferrous metal materials and wires	15.3	18.6	19.5	14.7	10.4	10.5
Chemical raw materials	7.7	9.0	9.4	9.2	7.6	5.9
Wood and pulp	6.5	8.5	9.8	9.4	7.6	7.0
Textile raw materials	4.0	4.1	3.8	3.4	2.8	2.3

Source: National Bureau of Statistics, PRC

Part 1 :

Domestic Trade

6. Growth in industrial production moderates in 4Q17

The growth rate for China's industrial production (IP), measured by the value-added of industrial output (VAIO), fell from 6.6% yoy in September to 6.2% yoy in October, and then stayed low at 6.1% yoy and 6.2% yoy in November and December respectively *(see exhibit 13)*.[6] Overall, in 2017, China's IP expanded by 6.6% yoy, slightly lower than the 6.7% yoy growth recorded in 1-3Q17, indicating a moderation in IP growth in 4Q17.

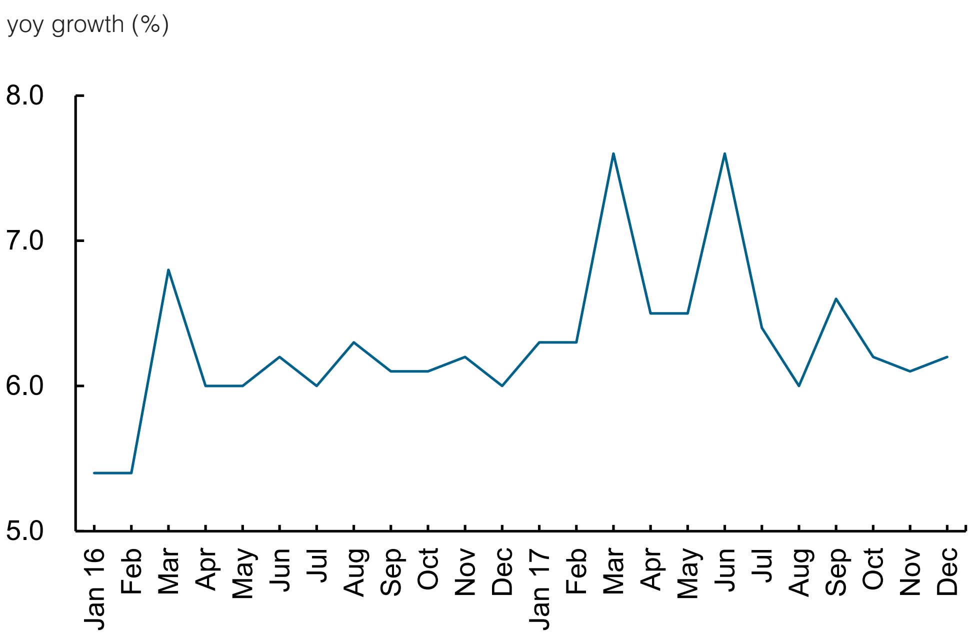
Looking ahead, we expect that the industrial production (VAIO) growth will be around 6.0-6.5% yoy in 1Q18, supported by stable demand. However, challenges facing Chinese manufacturers remain, including strong government's efforts to enforce environmental regulations, a marked increase in prices of materials, the greater uncertainty in the US trade policies under the Trump administration, intense competition in the international market, and the weak demand for luxury products.

7. Growth in industrial profits grows strongly in 2017

The growth rate for the total profits earned by large and medium industrial enterprises above a designated size[7] decelerated from 25.1% yoy in October to 14.9% yoy in November, and further to 10.8% yoy in December. In 2017, China's industrial profits totalled 7,518.7 billion yuan, up strongly by 21.0% yoy, compared to the growth rate of 8.5% yoy in 2016 *(see exhibit 14)*. One of the major reasons behind the strong profit growth in 2017 was that the government's move to tackle overcapacity problems in several sectors had led to a rise in product prices of those sectors.

Among sectors, profits of the mining sector soared by 261.6% yoy to 458.7 billion yuan in 2017; profits of the manufacturing sector increased by 18.2% yoy to 6,651.1 billion yuan. In contrast, profits of the 'electricity, heat, gas and water' sector fell by 10.7% yoy to 408.9 billion yuan over the same period.

Exhibit 13 China's industrial production growth, January 2016 to December 2017



Jan-Feb 17	6.3%
Mar	7.6%
Apr	6.5%
May	6.5%
Jun	7.6%
Jul	6.4%
Aug	6.0%
Sep	6.6%
Oct	6.2%
Nov	6.1%
Dec	6.2%

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 2017

yoy growth (%)	Jul 17	Aug	Sep	Oct	Nov	Dec
Total profits made by industrial enterprises above a designated size	16.5	24.0	27.7	25.1	14.9	10.8

Source: National Bureau of Statistics, PRC

8. Fixed asset investment growth decelerates in 2017

The growth in China's nominal fixed asset investment (FAI) (excluding rural households) decelerated to 7.2% yoy in 2017 from 8.1% yoy in 2016.[8] Overall, in 2017, China's nominal FAI (excluding rural households) amounted to 63.2 trillion yuan *(see exhibit 15).*

The moderation in the overall FAI growth was attributable to the FAI growth deceleration in the primary industry and the secondary industry, in particular the production and supply of power, heat, gas and water: the growth in FAI (excluding rural households) in the primary industry went down to 11.8% yoy in 2017 from 21.1% yoy in 2016; dropped to 3.2% yoy in 2017 from 3.5% yoy in 2016 for the secondary industry; and fell to 0.8% yoy in 2017 from 11.3% yoy in 2016 for the production and supply of power, heat, gas and water industry.

In contrast, the growth in FAI in infrastructure (excluding power, heat, gas and water infrastructure) accelerated to 19.0% yoy in 2017 from 17.4% yoy in 2016. Besides, the growth in FAI (excluding rural households) for real estate development rose slightly to 7.0% yoy in 2017 from 6.9% yoy in 2016.

Going forward, we expect that China's overall FAI growth will further moderate in the near term, as the ongoing property tightening measures is likely to drag down the growth in real estate investment and tighter rules on public private partnership (PPP) projects are set to weaken the growth in infrastructure investment.

Exhibit 15 China's FAI (excluding rural households) growth, July to December 2017

	Jul 17	Aug	Sep	Oct	Nov	Dec
FAI (excluding rural households) *(year-to-date, yoy growth %)*	8.3	7.8	7.5	7.3	7.2	7.2
FAI (excluding rural households) *(mom growth %, seasonally adjusted)*	0.58	0.57	0.55	0.54	0.52	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. China lowers import tariff rates on several types of consumer products

On 24 November, the Chinese government announced to reduce the tariff rates for imports of 187 tariff items effective from 1 December.[9] One of the main purposes of the measure was to encourage Chinese consumers to purchase foreign goods in the Chinese mainland.

These 187 tariff items include food, health supplements, medicines, chemical products for daily use, clothing, shoes, hats, household equipment, cultural and entertainment products, etc. For example, the provisional tax rate for various types of special infant formulas was reduced from 5% to zero; the provisional tax rate for men's jackets made of wool or fine animal hair was revised downward to 5% from 8%; the provisional tax rates for lip make-up preparations and eye make-up preparations were set at 5% on 1 December, lower than their most-favored-nation (MFN) tariff rates (i.e. 10%).[10] According to the notice published by the Chinese government, this move would reduce the average tariff rate for imports of those 187 tariff items from 17.3% to 7.7%.[11]

It is expected that the retail prices of related imported products will fall, as the lower import tariffs will give the retailers more room to reduce prices.

2. Growth rates for broad money supply and total outstanding RMB loans decelerate in 4Q17

The growth rates for the broad money supply (M2) and the total outstanding RMB loans decelerated in 4Q17. As at the end of December, the M2 growth was 8.2% yoy, lower than the 9.2% yoy growth as at the end of September *(see exhibit 16)*. Meanwhile, the growth in the total outstanding RMB loans moderated to 12.7% yoy as at the end of December, compared to the growth of 13.1% yoy as at the end of September. Overall, in 4Q17, the rise in the total outstanding RMB loans amounted to 2.37 trillion yuan, lower than the increase seen in the same period of the previous year (i.e. 2.49 trillion yuan).

However, it is noteworthy that, in FY17, the rise in the total outstanding RMB loans amounted to 13.53 trillion yuan, the highest level on record. In our view, the main reasons behind the massive bank loans in the year were that the loan demand was strong amid the rapidly growing Chinese economy and the tightening in financial regulations drove banks to shift off-balance sheet credit onto their balance sheets.

In January this year, the rise in the total outstanding RMB loans amounted to 2.90 trillion yuan. Consequently, the M2 growth and the growth in total outstanding RMB loans rebounded to 8.6% yoy and 13.2% yoy respectively as at the end of January. In our view, the reacceleration in loan growth in January was due largely to the different timing of the Chinese New Year in 2017 and 2018, and thus does not indicate that China's central bank has switched to a more expansionary monetary policy.[12] China's monetary policy will stay neutral, and loans and 'total social financing' will continue to grow at a reasonable pace this year, according to the press release of the Central Economic Work Conference, which sets the key economic tasks for year 2018, held in mid-December last year.

9 http://gss.mof.gov.cn/zhengwuxinxi/zhengcefabu/201711/t20171123_2755506.html

10 The most-favored-nation (MFN) tariff rate applies to products originated from WTO member countries. If there is provisional tax rate on a product, products originated from WTO member countries can enjoy the provisional tax rate.

11 http://gss.mof.gov.cn/zhengwuxinxi/zhengcejiedu/201711/t20171123_2755930.html

12 The Chinese New Year in 2018 began in mid-February, while that in last year was from late January.

Exhibit 16 Broad money supply (M2) and RMB loans, February 2017 to January 2018

	Broad money supply (M2)		Total outstanding RMB loans	
As of	Amount (trillion yuan)	yoy growth	Amount (trillion yuan)	yoy growth
End-Feb 17	158.3	11.1%	109.8	13.0%
End-Mar	160.0	10.6%	110.8	12.4%
End-Apr	159.6	10.5%	111.9	12.9%
End-May	160.1	9.6%	113.0	12.9%
End-Jun	163.1	9.4%	114.6	12.9%
End-Jul	162.9	9.2%	115.4	13.2%
End-Aug	164.5	8.9%	116.5	13.2%
End-Sep	165.6	9.2%	117.8	13.1%
End-Oct	165.3	8.8%	118.4	13.0%
End-Nov	167.0	9.1%	119.6	13.3%
End-Dec	167.7	8.2%	120.1	12.7%
End-Jan 18	172.1	8.6%	123.0	13.2%

	Increase in RMB loans (trillion yuan)
FY16	12.65
FY17	13.53
Feb 17	1.17
Mar	1.02
Apr	1.10
May	1.11
Jun	1.54
Jul	0.83
Aug	1.09
Sep	1.27
Oct	0.66
Nov	1.12
Dec	0.58
Jan 18	2.90

Source: People's Bank of China

3. 'Total social financing' increases strongly by 19.4 trillion yuan in FY17

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 19.4 trillion yuan in FY17, larger than the increase seen in FY16 (i.e. 17.8 trillion yuan) *(see exhibit 17)*.

RMB loans and foreign currency loans together contributed 71.2% of the increase in 'total social financing' in FY17, compared to a 66.7% share in FY16. The figures indicate that bank loans played a more important role in driving up 'total social financing' in FY17. In January this year, the increase in 'total social financing' totaled 3.06 trillion yuan, much lower than 3.70 trillion yuan in the same period of the previous year. The share of RMB loans and foreign currency loans in the increase in 'total social financing' went up further to 88.8% in the month.

Exhibit 17 Increase in total social financing, 2016 to 2017

	2016		2017	
	Amount (billion yuan)	Share (%)	Amount (billion yuan)	Share (%)
Total social financing	17,800	100.0	19,440.0	100.0
RMB loans to the real sector	12,440	69.9	13,840.0	71.2
Foreign currency loans to the real sector	-564	-3.2	1.8	0.0
Trust loans	859	4.8	2,260.0	11.6
Entrusted loans	2,190	12.3	777.0	4.0
Bank acceptance bills	-1,950	-11.0	536.4	2.8
Corporate bonds	3,000	16.9	449.5	2.3
Equity issuance	1,240	7.0	873.4	4.5

Source: People's Bank of China

C Outlook

1. China's Entrepreneur Confidence Index drops slightly in 4Q17

China's Entrepreneur Confidence Index (ECI) for the secondary industry dropped slightly by 1.3 pts from the previous quarter to 126.0 in 4Q17. That being said, the latest reading was still well above the critical level of 100, indicating that Chinese entrepreneurs have remained optimistic about the prospects for their industries *(see exhibit 18)*.[13]

By sector, the ECIs for the 'mining' and the 'manufacturing' sectors recorded a quarter-on-quarter drop, down by 2.5 pts and 1.4 pts respectively in 4Q17. In contrast, the ECI for the 'electricity, gas and water' sectors gained 1.5 pts in the same quarter *(see exhibit 19)*.

2. Growth of manufacturing sector moderates

China's manufacturing PMI dropped from 51.8 in November to 51.6 in December, and further to 51.3 in January, indicating a growth moderation in the manufacturing sector in China *(see exhibit 20)*.

The new orders index moderated from 53.6 in November to 53.4 in December, and further to 52.6 in January, showing that the growth of overall new orders has decelerated in recent months.[14] Meanwhile, after rising from 50.8 in November to 51.9 in December, the new export orders index went down to 49.5 in January, showing a fluctuation in the growth of new export orders.

In line with the recent trend of the new orders index, the output index, a leading indicator of output of manufacturers in China, fell from 54.3 in November to 54.0 in December, and further to 53.5 in January. The downtrend of the index shows a deceleration in output growth of the manufacturing sector in China.

The purchases of inputs index went down from 53.6 in December to 52.9 in January, showing that manufacturers have slowed their purchasing activities lately.

The stocks of major inputs index fluctuated within the narrow range of 48.0 to 48.8 throughout November to January. The index stayed below the critical 50-mark in the past three months, indicating a continuous fall in the stocks of major inputs. In the meantime, after dropping slightly from 46.1 in November to 45.8 in December, the stocks of finished goods index rebounded to 47.0 in January, the highest level since May last year. The January reading shows that the stocks of finished goods held by manufacturers have dropped at a slower pace recently.

The input prices index came in at 59.8, 62.2 and 59.7 in November, December and January respectively, well above the critical 50-mark, implying intensifying cost pressure on Chinese manufacturers. Meanwhile, the ex-factory prices index fluctuated within the range of 51.8 to 54.4 during November to January, showing that manufacturers passed through the higher costs to customers by raising the ex-factory prices of their products.

The business expectations index fell by 1.9 pts from the previous month to 56.8 in January, the lowest level since June last year, indicating that purchasing managers have become less optimistic about the near term outlook for their respective industries recently.

13 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.

14 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), 1Q16 to 4Q17

	1Q16	2Q16	3Q16	4Q16	1Q17	2Q17	3Q17	4Q17
Entrepreneur Confidence Index (Secondary Industry)	108.7	109.3	113.4	115.4	129.2	127.3	127.3	126.0

Source: National Bureau of Statistics, PRC

Exhibit 19 Entrepreneur Confidence Index by sector, 3Q17 and 4Q17

	3Q17	4Q17	Compared with the previous quarter
Secondary industry	127.3	126.0	Lower
Mining	113.1	110.6	Lower
Manufacturing	128.0	126.6	Lower
Electricity, gas & water	128.6	130.1	Higher

Source: National Bureau of Statistics, PRC

Exhibit 20 China's manufacturing PMI at a glance, January 2018

Index	Seasonally Adjusted Index	Index Compared with the Previous Month	Direction
PMI	51.3	Lower	Expanding
Output	53.5	Lower	Expanding
New Orders	52.6	Lower	Expanding
New Export Orders	49.5	Lower	Contracting
Backlogs of Orders	45.3	Lower	Contracting
Stocks of Finished Goods	47.0	Higher	Contracting
Purchases of Inputs	52.9	Lower	Expanding
Imports	50.4	Lower	Expanding
Input Prices	59.7	Lower	Rising
Stocks of Major Inputs	51.8	Lower	Rising
Ex-factory Prices	48.8	Higher	Contracting
Employment	48.3	Lower	Contracting
Suppliers' Delivery Time	49.2	Lower	Slowing
Business Expectations	56.8	Lower	Optimistic

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

3. January NMI indicates growth acceleration in non-manufacturing sector

China's Business Activity Index, which is quoted as the Non-manufacturing Purchasing Managers' Index (NMI), has been on an upward trend in recent months, going up to a four-month high of 55.3 in January. The continuous rise in the index indicates a growth acceleration in the non-manufacturing sector *(see exhibit 21).*

The new orders index rose from 51.8 in November to 52.0 in December, the second highest level since January last year, and then moderated to 51.9 in January. The index readings in the past three months show that the new orders have expanded at a relatively fast pace recently.

The input prices have increased at a slower pace lately: the input prices index dropped all the way from 56.2 in November to 53.9 in January. In response to the rising input prices, enterprises were trying to pass through the higher costs to their clients by increasing service charges: the sales prices index recorded 52.8, 52.6 and 52.6 in November, December and January respectively, above the critical 50-mark.

The business expectation index came in at 61.7 in January, well above 50, suggesting that purchasing managers in the non-manufacturing sector have stayed optimistic about the near term outlook for their respective industries.

Exhibit 21 China's non-manufacturing purchasing managers' index (NMI) at a glance, January 2018

Index	Seasonally Adjusted Index	Index Compared with the Previous Month	Direction
Business activity	55.3	Higher	Expanding
New orders	51.9	Lower	Expanding
Input prices	53.9	Lower	Rising
Sales prices	52.6	Unchanged	Rising
Business expectations	61.7	Higher	Optimistic

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

A Recent developments

1. Growth rates of exports and imports turn positive in 2017

China's exports growth accelerated from 6.6% yoy in 3Q17 to 9.9% yoy in 4Q17, as China's exports continued to benefit from the global economic recovery *(see exhibits 22, 23 and 24).* Overall, in 2017, China's exports amounted to US$ 2,263.5 billion. The growth rate came in at 7.9% yoy in 2017, improving from minus 7.7% yoy in 2016.

Among China's major trading partners, China's exports to the US registered double-digit growth in 2017: China's exports to the US gained 11.5% yoy in the year. Meanwhile, China's exports to the EU, Japan and the ASEAN expanded by 9.7% yoy, 6.1% yoy and 9.0% yoy respectively over the same period. In comparison, China's exports to some commodity-exporting emerging countries showed relatively strong growth in 2017: the exports to Brazil and Russia increased by 31.8% yoy and 14.8 % yoy respectively in 2017.

After registering 14.5% yoy in 3Q17, the growth rate for China's imports maintained double-digit growth of 12.5% yoy in 4Q17, supported by the rise in global commodities prices and the strong domestic demand. Overall, in 2017, China's imports totalled US$ 1,841.0 billion. The growth rate was 15.9% yoy in 2017, up strongly from the negative growth of minus 5.5% yoy in 2016.

In 4Q17, China's exports increased by US$ 47.6 billion from the previous quarter, while imports rose at a relatively slower pace, by US$ 30.7 billion. Consequently, China's trade surplus rose to US$ 131.9 billion in 4Q17 from US$ 114.9 billion in 3Q17.

In January, China's exports maintained the current pace of growth, up by 11.1% yoy, while the growth of China's imports accelerated markedly to 36.9% yoy.

Exhibit 22 China's quarterly foreign trade data, 1Q17 to 4Q17

USD billion (yoy growth)

	Exports		Imports		Trade Balance
FY17	2,263.5	(7.9%)	1,841.0	(15.9%)	422.5
1Q17	480.0	(7.6%)	417.8	(24.2%)	62.2
2Q17	563.4	(8.6%)	444.8	(14.4%)	118.6
3Q17	589.2	(6.6%)	474.3	(14.5%)	114.9
4Q17	636.7	(9.9%)	504.8	(12.5%)	131.9

Source: China Customs

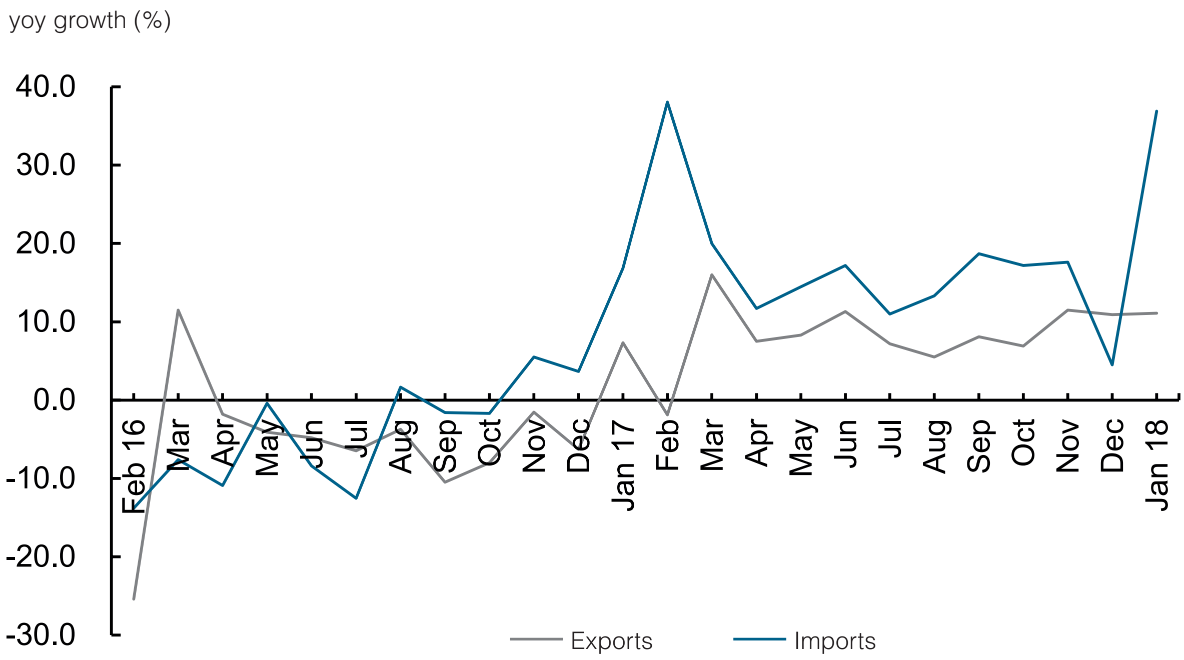
Exhibit 23 China's monthly foreign trade data, February 2017 to January 2018

USD billion (yoy growth)

	Exports		Imports		Trade Balance
February 2017	119.1	(-2.1%)	129.5	(38.4%)	-10.4
March	179.3	(15.6%)	156.4	(20.1%)	22.9
April	178.2	(6.9%)	141.5	(11.6%)	36.7
May	189.6	(7.9%)	149.5	(14.2%)	40.1
June	195.6	(10.8%)	153.8	(17.2%)	41.8
July	192.4	(6.5%)	147.0	(11.1%)	45.4
August	198.6	(5.1%)	157.5	(13.5%)	41.0
September	198.3	(8.1%)	169.8	(18.7%)	28.5
October	189.0	(6.9%)	150.8	(17.2%)	38.2
November	215.9	(11.5%)	176.9	(17.6%)	39.0
December	231.8	(10.9%)	177.1	(4.5%)	54.7
January 2018	200.5	(11.1%)	180.2	(36.9%)	20.3

Source: China Customs

Exhibit 24 Growth rates of exports and imports, February 2016 to January 2018



Source: China Customs

Exhibit 25 Exports by category, 2016 and 2017

yoy growth (%) of export value, calculated in USD	2016	2017
Textile materials and products	-4.1	4.5
Garments and clothing accessories	-9.6	-0.4
Footwear	-12.1	2.0
Toys	17.4	30.4
Coal	39.8	58.1
Crude oil	-39.0	93.2
Refined oil	1.5	30.9
Steel	-13.4	0.0
Mechanical and electrical products	-7.7	9.3

Source: China Customs

Exhibit 26 Imports by category, 2016 and 2017

yoy growth (%) of import value, calculated in USD	2016	2017
Cereal and cereal flour	-39.3	13.7
Soybean	-2.3	16.7
Iron ore	0.5	31.4
Crude oil	-13.3	39.1
Refined oil	-21.8	29.8
Steel	-8.2	15.3
Textile yarns, fabric and textile products	-12.2	3.6
Vehicles and vehicle chassis	-0.5	13.4

Source: China Customs

2. Growth rates for both general trade exports and processing trade exports accelerate in 4Q17

The year-on-year growth rates for both general trade[15] exports and processing trade[16] exports accelerated in 4Q17. The growth in general trade exports improved significantly to 14.5% yoy in 4Q17 from 6.9% yoy in 3Q17. In the meantime, the growth in processing trade exports rose to 5.2% yoy in 4Q17 from 3.5% yoy in 3Q17 *(see exhibit 27)*.

On the import side, the growth in general trade imports accelerated to 18.9% yoy in 4Q17 from 16.7% yoy in 3Q17. In contrast, the growth rate for processing trade imports dropped to 4.0% yoy in 4Q17 from 8.7% yoy in 3Q17.

The share of processing trade in China's total trade stayed low at 30.0% in 4Q17. That being said, with a large surplus of US$ 98.2 billion in 4Q17, processing trade still plays an important role in China's foreign trade.

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

16 '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 4Q17

Item	yoy growth (%)				Share (%)			
	FY16	FY17	3Q17	4Q17	FY16	FY17	3Q17	4Q17
Exports Of which:	-7.7	7.9	6.6	9.9	100.0	100.0	100.0	100.0
General Trade	-7.0	8.7	6.9	14.5	53.8	54.6	55.3	54.2
Processing Trade	-10.3	5.9	3.5	5.2	34.1	33.4	32.9	34.6
Imports Of which:	-5.5	15.9	14.5	12.5	100.0	100.0	100.0	100.0
General Trade	-2.5	20.2	16.7	18.9	56.6	58.7	57.9	57.7
Processing Trade	-11.3	8.7	8.7	4.0	25.0	23.5	24.1	24.2
Total of Imports and Exports Of which:	-6.8	11.4	10.0	11.0	100.0	100.0	100.0	100.0
General Trade	-5.1	13.8	11.2	16.5	55.0	56.4	56.5	55.7
Processing Trade	-10.6	6.9	5.4	4.8	30.2	29.0	29.0	30.0

Source: China Customs

3. China's trade with EU, US, ASEAN and Japan shows double-digit growth in 2017

The EU was still China's largest trading partner, accounting for 15.0% of China's total foreign trade in 2017. Sino-EU trade amounted to US$ 616.9 billion, up by 12.7% yoy in 2017. Specifically, China's exports to the EU gained 9.7% yoy in 2017, compared to the negative growth of minus 4.7% yoy in 2016; and China's imports from the EU grew by 17.6% yoy in 2017, compared to the 0.4% yoy drop in 2016 *(see exhibits 28 and 29).*

Accounting for 14.2% of China's total foreign trade, the US continued to be China's second largest trading partner in 2017. Sino-US trade expanded by 12.3% yoy to US$ 583.7 billion in 2017. China's export growth to the US turned positive in 2017: after dropping by 5.9% yoy in 2016, China's exports to the US grew by 11.5% yoy in 2017. Meanwhile, China's imports from the US recorded strong growth of 14.5% yoy in 2017, compared to the 9.1% yoy decline in 2016.

The Association of South East Asian Nations (ASEAN) accounted for 12.5% of China's total foreign trade in 2017. Sino-ASEAN trade grew by 13.8% yoy to US$ 514.8 billion in 2017. Of which, China's exports to ASEAN rose by 9.0% yoy, while China's imports from ASEAN soared by 20.1% yoy, in 2017.

Sino-Japanese trade increased by 10.1% yoy to US$ 303.0 billion in 2017. China's exports to Japan gained 6.1% yoy, while China's imports from Japan expanded by 13.7% yoy in 2017.

4. Growth rates for China's imports from Russia, India and Brazil improve significantly in 2017

China's export growth to Russia accelerated to 14.8% yoy in 2017 from 7.3% yoy in 2016, driven by the recovery in Russia's economy. Meanwhile, China's import growth from Russia improved to 27.7% yoy in 2017 from minus 3.1% yoy in 2016 *(see exhibits 28 and 29)*. Consequently, the growth in China's trade with Russia picked up to 20.8% yoy in 2017 from 2.2% yoy in 2016.

China's export growth to India rose to 16.5% yoy in 2017 from 0.2% yoy in 2016. In the meantime, China's import growth from India accelerated rapidly to 38.9% yoy in 2017 from minus 12.0% yoy in 2016. Overall, the growth of Sino-Indian trade improved to 20.3% yoy in 2017 from minus 2.1% yoy in 2016.

With Brazil's economy showing strong improvement, the growth in China's exports to Brazil rose to 31.8% yoy in 2017, compared to the 19.9% yoy drop in 2016. Meanwhile, the growth in China's imports from Brazil quickened to 27.8% yoy in 2017 from 3.7% yoy in 2016. Consequently, the growth in Sino-Brazilian trade accelerated to 29.1% yoy in 2017.

Together, these three BRIC members accounted for 6.2% of China's total exports and 6.3% of China's total imports in 2017, up from 5.6% and 5.7%, respectively, in 2016.

Exhibit 28 China's trading partners, 2017

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	616.9	15.2	372.0	244.9	12.7	9.7	17.6
US	583.7	14.2	429.8	153.9	12.3	11.5	14.5
ASEAN	514.8	12.3	279.1	235.7	13.8	9.0	20.1
Japan	303.0	7.4	137.3	165.7	10.1	6.1	13.7
Brazil	87.5	2.2	29.0	58.6	29.1	31.8	27.8
Russia	84.1	2.1	42.9	41.2	20.8	14.8	27.7
India	84.4	2.1	68.1	16.3	20.3	16.5	38.9

Source: China Customs

Exhibit 29 China's trading partners, comparing growth rates for 2016 and 2017

yoy growth (%)

Country/Region	Total Trade		Exports		Imports	
	2016	2017	2016	2017	2016	2017
EU	-3.1	12.7	-4.7	9.7	-0.4	17.6
US	-6.7	12.3	-5.9	11.5	-9.1	14.5
ASEAN	-4.2	13.8	-7.8	9.0	0.9	20.1
Japan	-1.3	10.1	-4.7	6.1	1.9	13.7
Brazil	-5.3	29.1	-19.9	31.8	3.7	27.8
Russia	2.2	20.8	7.3	14.8	-3.1	27.7
India	-2.1	20.3	0.2	16.5	-12.0	38.9

Source: China Customs

5. Guangdong witnesses relatively weak growth in exports in 2017

China's top six provinces and municipalities in terms of value of exports – Guangdong, Jiangsu, Shanghai, Zhejiang, Shandong and Fujian – jointly accounted for 78.1% of China's total exports in 2017, down from 79.0% in 2016 *(see exhibit 30)*. Guangdong, which accounted for the largest share of China's exports in 2017, registered relatively weak growth in exports in 2017. Exports from Guangdong expanded by 3.3% in 2017, lower than the country's total export growth (7.9% yoy).

Among 31 provinces/ municipalities in China, Shaanxi witnessed the fastest year-on-year growth in exports in 2017, followed by Guizhou, Sichuan and Ningxia. Exports from Shaanxi, Guizhou, Sichuan and Ningxia soared by 50.7% yoy, 37.8% yoy, 34.3% yoy and 30.1% yoy respectively over the period.

Exhibit 30 Top six provinces and municipalities in terms of value of exports, 2017

Provinces/ Municipalities	Value of exports (USD billion)	yoy growth (%)	Share of total exports (%)
Guangdong	675.6	3.3	29.8
Jiangsu	375.2	13.4	16.6
Zhejiang	292.5	7.0	12.9
Shanghai	174.2	4.7	7.7
Shandong	157.4	9.0	7.0
Fujian	92.3	5.8	4.1

Source: China Customs

6. China's FDI gains 7.9% yoy in 2017

China's foreign direct investment (FDI) in Renminbi terms fell by 9.2% yoy in December, recording its first year-on-year drop in five months. Overall, in 2017, China's FDI amounted to 877.6 billion yuan, up by 7.9% yoy *(see exhibit 31)*.

In 2017, FDI in the Hi-Tech industries grew rapidly by 61.7% yoy to 251.3 billion yuan, accounting for 28.6% of the total FDI in 2017. The figures indicate the optimism about the Hi-Tech industries among foreign enterprises. Among Hi-Tech industries in the manufacturing sector, FDI in the 'electronics and communications equipment industry', the 'computers and office equipment industry' and the 'medical instruments, equipment and meters industry' increased by 7.9% yoy, 71.1% yoy and 28% yoy respectively during the period. Meanwhile, among Hi-Tech industries in the service sector, FDI in the 'information services industry' and the 'environmental monitoring and management services industry' recorded robust year-on-year growth of 162.0% yoy and 133.3% yoy respectively in the year.

Exhibit 31 China's FDI, January to December 2017

	Amount (billion yuan)	yoy growth
FY16	813.2	4.1%
FY17	877.6	7.9%
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%
July	43.9	-11.8%
August	62.5	9.1%
September	70.6	17.3%
October	60.1	5.0%
November	124.9	90.7%
December	73.9	-9.2%

Source: Ministry of Commerce, PRC

7. China's foreign exchange reserves continue to increase

China's foreign exchange reserves increased by US$ 21.5 billion from the previous month to US$ 3,161.5 billion as at the end of January, posting month-on-month gain for twelve consecutive months *(see exhibit 32).*

The rise in the foreign exchange reserves in the past months 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.[17]

The US dollar index has shown signs of bottoming out recently. We therefore expect the US-dollar value of non-US-dollar denominated assets in the foreign exchange reserves to peak soon, thereby putting downward pressure on the US-dollar value of China's foreign exchange reserves.

Exhibit 32 Foreign exchange reserves by quarter, 1Q17 to 4Q17

USD billion	Accumulation	End of the quarter
FY17	129.4	
1Q17	-1.4	3,009.1
2Q17	47.7	3,056.8
3Q17	51.7	3,108.5
4Q17	31.4	3,139.9

Source: State Administration of Foreign Exchange, PRC

17 According to the Bloomberg, the US dollar index was 89.133 on 31 January this year, compared to 94.552 on 31 October last year.

B Highlights

1. Chinese yuan appreciates against the US dollar

The Chinese yuan has appreciated against the US dollar since mid-December last year. After fluctuating within a narrow range of 6.5808 to 6.6493 throughout early October to mid-December, the daily fixing rate (also known as the central parity rate) of the Chinese yuan against the US dollar appreciated to its recent peak of 6.2822 on 8 February, and then depreciated slightly to 6.3247 on 13 February *(see exhibit 33).*[18]

In line with the trend of the daily fixing rate, the USD-CNY spot exchange rate stayed relatively stable throughout early October to mid-December, and then appreciated until early February, before weakening a bit in the following week.[19] Overall, in 2017, the USD-CNY spot exchange rate appreciated by 6.72%, compared to the 6.56% depreciation in 2016. In our view, the appreciation of the Chinese yuan against the US dollar in 2017 was due largely to the weakness of US dollar and tightened capital outflow restrictions from China.

The daily fixing rate of the Chinese yuan against the Euro fluctuated within the range of 7.6877 to 7.8996 throughout early October to mid-February *(see exhibit 34)*. Overall, in 2017, the daily fixing rate of the Chinese yuan against the Euro depreciated by 6.35%.

According to the Bank for International Settlements, the real effective exchange rate (REER) of the yuan stayed between 121.32 and 121.62 throughout October to December.[20] Overall, in FY17, the Chinese yuan depreciated in real terms against its trading partners by 1.0% *(see exhibit 35)*.

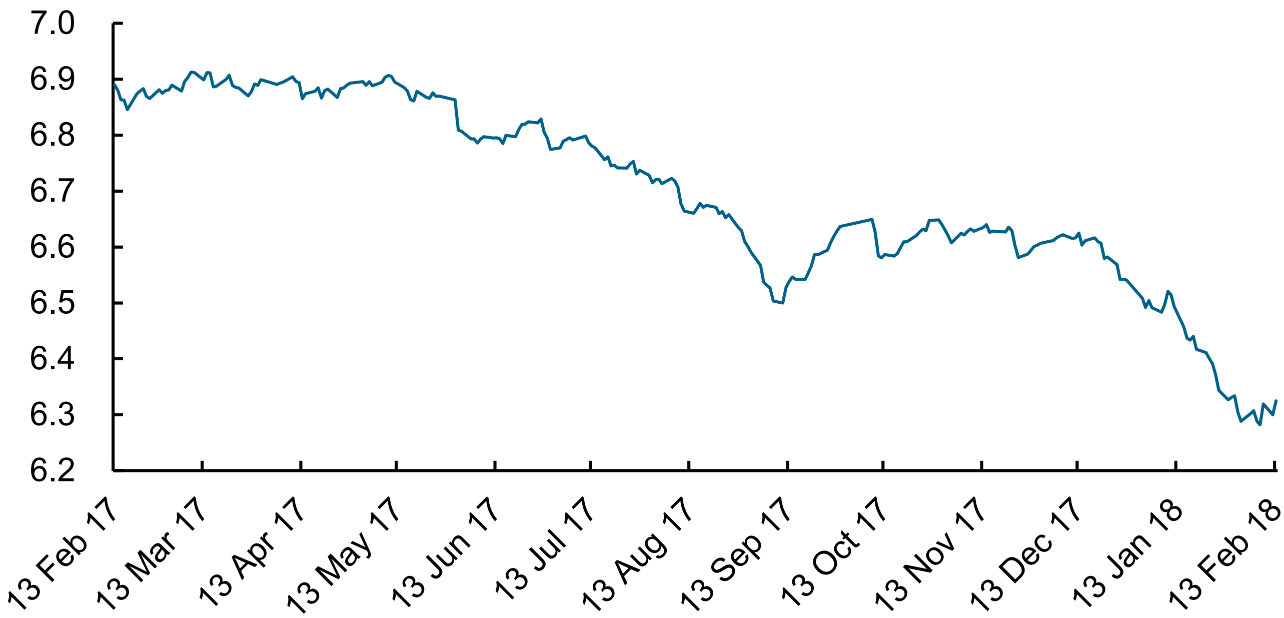
Looking ahead, we predict that the Chinese yuan will stay strong against the US dollar in the near term, as China's trade surplus is set to remain massive and the strong growth of the Chinese economy and tight restrictions are likely to discourage capital outflows.

18 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.

19 The daily trading band of the Chinese yuan against the US dollar is ±2.0% around the daily fixing rate.

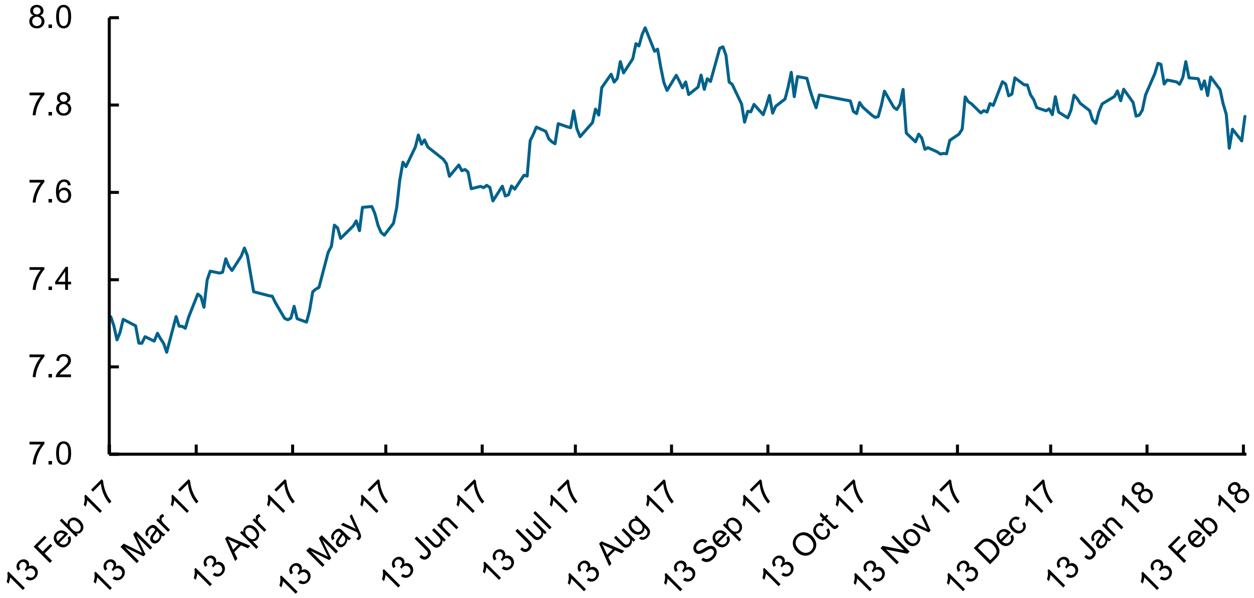
20 The Bank for International Settlements (BIS) calculates effective exchange rate (EER) indices for a total of 61 economies (including individual Eurozone countries and, separately, the Eurozone as an entity). Nominal EERs are calculated as geometric weighted averages of bilateral exchange rates. Real 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, February 2017 to February 2018



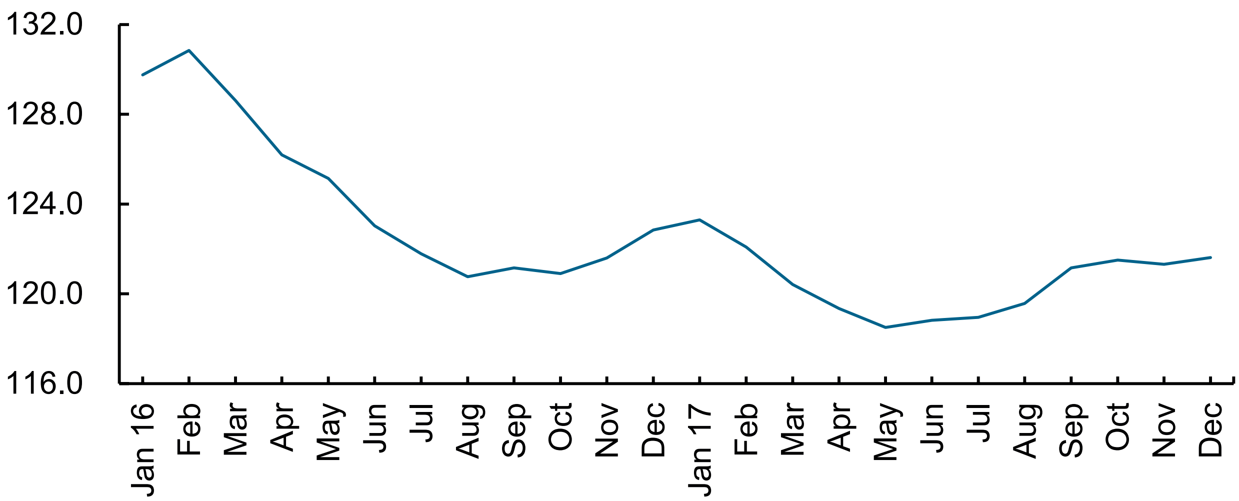
Source: State Administration of Foreign Exchange

Exhibit 34 EUR-CNY daily fixing rate, February 2017 to February 2018



Source: State Administration of Foreign Exchange

Exhibit 35 EUR-CNY daily fixing rate, January 2016 to December 2017



Source: Bank for International Settlements

2. Recent US moves may worsen China-US trade relations

A series of actions recently taken by the US government may worsen China-US trade relations. For example, on 29 November, the US Department of Commerce announced to launch a countervailing duty and anti-dumping probe into the imports of alloy aluminium sheet from China. Soon afterwards, on 1 December, the Office of the US Trade Representative told the media that the US had officially informed the World Trade Organisation (WTO) about its opposition to granting China market economy status.[21] Almost two months later, on 22 January, the US Trade Representative Robert Lighthizer announced that the US President Donald Trump had approved the imposition of safeguard tariffs on imported solar cells and modules, most of which are imported from China, as well as large residential washing machines.[22]

An obvious reason behind the recent US actions is the massive US trade deficit with China. According to the US Census Bureau and the US Bureau of Economic Analysis, the US trade deficit in goods with China amounted to US$ 375.2 billion, accounting for around 46% of the US total goods deficit in 2017.[23] Looking ahead, we expect the US government to launch more protectionist measures against some other Chinese products in coming future. Nevertheless, a full-blown trade war between China and the US is still unlikely given the strong interdependence between the two countries. For instance, China is one of the major holders of the US Treasuries. In 2017, China held US$ 1.18 trillion worth of the US Treasuries, according to the media report.[24] If the US takes more aggressive protectionist measures against Chinese products, China can retaliate by ditching its US Treasuries, which would in turn put upward pressure on the US Treasury yields.

21 http://www.xinhuanet.com/english/2017-12/02/c_136795861.htm
22 https://ustr.gov/about-us/policy-offices/press-office/press-releases/2018/january/president-trump-approves-relief-us#
23 https://www.census.gov/foreign-trade/Press-Release/current_press_release/ft900.pdf
24 http://money.cnn.com/2018/02/20/news/economy/china-us-trade-gap-government-debt/index.html

C Outlook

1. US economic growth remains high in 4Q17

Supported by strong domestic demand, the US economic growth moderated, but was still high in 4Q17. The US real GDP expanded by an annual rate of 2.6% in 4Q17, compared to the annual growth of 3.2% in 3Q17. In FY17, the US real GDP growth was 2.3% yoy, faster than 1.5% yoy in FY16 *(see exhibit 36).*

On the production side, industrial production grew by 0.9% mom in December, recording positive month-on-month growth in three of the past four months *(see exhibit 37).* Besides, the manufacturing PMI rose from 58.2 in November to 59.3 in December, and then stayed high at 59.1 in January, indicating a rapid expansion of the manufacturing sector. Meanwhile, the new orders for manufactured durable goods gained 2.9% mom in December, recording month-on-month growth in four of the past five months.

The growth of the non-manufacturing sector has decelerated lately: the non-manufacturing index (NMI) dropped from its recent peak of 60.1 in October to 57.4 in November, and further to 55.9 in December.

The US retail sales rose by 0.4% mom in December, posting month-on-month growth for four consecutive months. The positive growth in recent months points to an improvement in the consumption demand. Nevertheless, the Reuters/ University of Michigan index of consumer sentiment dropped all the way from 100.7 in October to 94.4 in January, indicating that US consumers have been become less optimistic lately *(see exhibit 38).* The downtrend of the index may suggest a weaker growth of consumer spending in coming months.

The labour market conditions in the US have remained strong lately. After increasing by 160,000 in December, the non-farm payroll employment rose at a faster pace, by 200,000, in January, above the 12-month average of 176,000. Besides, the US unemployment rate stayed low at 4.1% in January *(see exhibit 39).*

Looking ahead, the US economic growth is expected to further accelerate this year. According to the latest projection by the World Bank, the real GDP growth rate for the US is forecast to be 2.5% in 2018, up from 2.3% in 2017. [25]

Exhibit 36 US national accounts, 2016 to 4Q17

Annual growth (%)	2016	2017	1Q17	2Q17	3Q17	4Q17
Real GDP	1.5	2.3	1.2	3.1	3.2	2.6

Source: US Department of Commerce

Exhibit 37 US industrial sector, July to December 2017

mom growth (%), seasonally adjusted	Jul 17	Aug	Sep	Oct	Nov	Dec
Industrial production	-0.2	-0.4	0.2	1.8	-0.1	0.9
New orders for manufactured durable goods	-6.8	2.1	2.4	-0.4	1.7	2.9

Source: US Federal Reserve, US Department of Commerce

25 World Bank, Global Economic Prospects, January 2018

Exhibit 38 US consumer market, August 2017 to January 2018

	Aug 17	Sep	Oct	Nov	Dec	Jan 18
Retail and food services sales *(mom growth %, seasonally adjusted)*	-0.1	2.0	0.7	0.9	0.4	-
Reuters/University of Michigan index of consumer sentiment	96.8	95.1	100.7	98.5	95.9	94.4
CPI *(yoy growth %)*	1.9	2.2	2.0	2.2	2.1	-

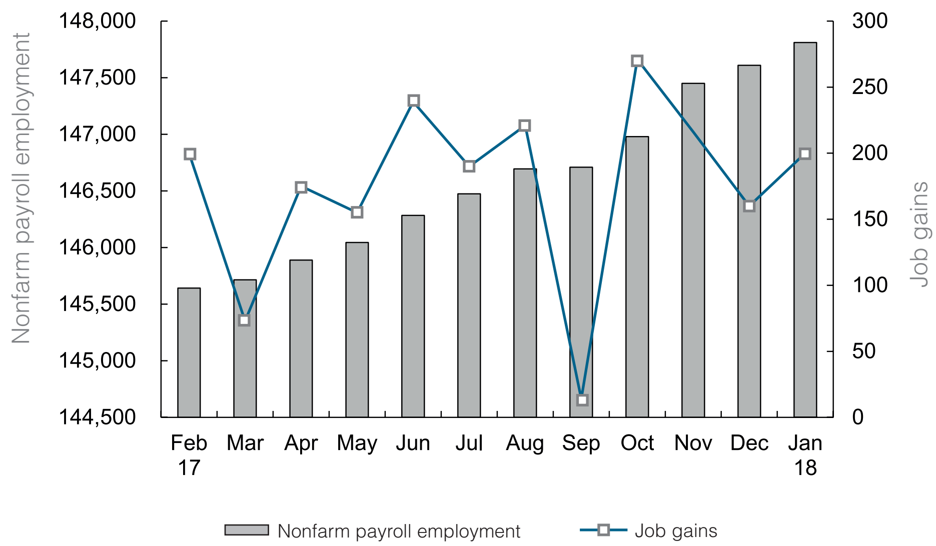
Source: US Department of Commerce, Reuters/University of Michigan Surveys of Consumers, US Department of Labor

Exhibit 39 US employment

	Unemployment rate (%)
2016	4.9
2017	4.4
Feb 17	4.7
Mar	4.5
Apr	4.4
May	4.3
Jun	4.3
Jul	4.3
Aug	4.4
Sep	4.2
Oct	4.1
Nov	4.1
Dec	4.1
Jan 18	4.1

Yearly figures: Annual average
Monthly figures: Seasonally adjusted

Nonfarm payroll employment, February 2017 to January 2018
In thousands, seasonally adjusted



Source: US Department of Labor

2. Real GDP in Eurozone expands at the fastest pace in ten years in 2017

The real GDP growth in the Eurozone came in at 0.6% qoq in 4Q17, down slightly from 0.7% qoq in 3Q17.[26] Overall, in FY17, the real GDP in the region grew by 2.5% yoy, the fastest pace in ten years.

Recent indicators point to the strong growth of both the service sector and the manufacturing sector in recent months. According to the global survey firm Markit Economics, the Eurozone manufacturing PMI rose from 58.5 in October to 60.1 in November, and further

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.

to 60.6 in December, the highest level since June 1997, when the survey was first conducted. Afterwards, the PMI stayed high at 59.6 in January. Besides, the Eurozone services PMI went up all the way from 55.0 in October to 56.6 in December, well above the critical 50-mark.

The retail sales in the region have shown fluctuation in recent months. The retail trade volume in the Eurozone gained 0.8% mom in September on a seasonally adjusted basis, but then dropped by 1.1% mom in October, before rebounding by 1.5% mom in November *(see exhibit 41)*.

The labour market conditions in the region have further improved in past few months. The seasonally-adjusted unemployment rate fell from 8.9% in September to 8.8% in October, and down further to 8.7% in November and December *(see exhibit 42)*.

Meanwhile, consumers and managers in various sectors have been remained optimistic about the economic outlook. The Eurozone's economic sentiment indicator (ESI) reached 115.3 in December, the highest level in seventeen years, and stayed high at 114.7 in January *(see exhibit 43)*.

In its latest Global Economic Prospects published in early January, the World Bank forecasts that the real GDP growth rate for the Eurozone would ease to 2.1% in 2018, in the expectation of the gradual unwinding of policy stimulus and a moderation in the domestic demand.[27]

Exhibit 40 Eurozone's real GDP growth, 2016 to 4Q17

	2016	2017	1Q17	2Q17	3Q17	4Q17
Real GDP *(qoq growth %)*			0.6	0.7	0.7	0.6
Real GDP *(yoy growth %)*	1.8	2.5	2.1	2.4	2.8	2.7

Source: Eurostat, World Bank

Exhibit 41 Eurozone consumer market, July to December 2017

	Jul 17	Aug	Sep	Oct	Nov	Dec
Volume of retail trade *(mom growth %, seasonally adjusted)*	0.0	-0.2	0.8	-1.1	1.5	-
Annual inflation (%)	1.3	1.5	1.5	1.4	1.5	1.4

Source: Eurostat

Exhibit 42 Eurozone labour market, July to December 2017

seasonally adjusted	Jul 17	Aug	Sep	Oct	Nov	Dec
Unemployment rate (%)	9.0	9.0	8.9	8.8	8.7	8.7

Source: Eurostat

27 World Bank, Global Economic Prospects, January 2018

Exhibit 43 Eurozone economic sentiment indicator, August 2017 to January 2018

seasonally adjusted	Aug 17	Sep	Oct	Nov	Dec	Jan 18
Economic sentiment indicator	111.4	112.5	113.5	114.0	115.3	114.7

Source: Eurostat

3. China's exports are expected to show high single-digit growth in 1Q18

According to the Global Economic Prospects released in early January, the World Bank forecasts that the world economic growth will stay high at 3.1% in 2018, up slightly from 3.0% in 2017. The growth in the advanced economies is projected to soften from 2.3% in 2017 to 2.2% in 2018. Meanwhile, the growth in the emerging market and developing economies is projected to accelerate from 4.3% in 2017 to 4.5% in 2018 *(see exhibit 44).*

Looking ahead, the rapid world economic growth is set to support the foreign demand for China's products in the near term. We therefore forecast that China's exports will maintain high single-digit year-on-year growth in 1Q18. Challenges facing Chinese manufacturers, however, include stronger government's efforts to enforce environmental regulations, a marked increase in prices of materials, the appreciation of the Chinese yuan against the US dollar, the greater uncertainty in the US trade policies under the Trump administration, intense competition in the international market, and the weak demand for luxury products.

Exhibit 44 Latest GDP growth forecasts by the World Bank

yoy growth (%)	2017 (Estimates)	2018 (Forecasts)	2019 (Forecasts)
World economy	3.0	3.1	3.0
Advanced economies	2.3	2.2	1.9
US	2.3	2.5	2.2
Eurozone	2.5	2.1	1.7
Japan	1.7	1.3	0.8
Emerging market and developing economies	4.3	4.5	4.7
China	6.9	6.4	6.3
India *	6.7	7.3	7.5
Brazil	1.0	2.0	2.3
Russia	1.7	1.7	1.8

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

Source: World Bank, US Department of Commerce, Eurostat, National Bureau of Statistics, PRC

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