



# China Trade Quarterly

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## Domestic Trade

Retail sales of consumer goods grow by 9.8% yoy in 1Q18.

Ex-factory prices of industrial products trend downward.

Consumption expenditure of rural households posts double-digit growth in 1Q18.

Growth in nominal fixed asset investment accelerates to 7.5% yoy in 1Q18.

China to boost domestic demand amidst intensifying China-US tensions.

Entrepreneur Confidence Index rises strongly to 132.9 in 1Q18.

Manufacturing sector expands at a relatively stable pace.

April NMI indicates gradual acceleration in growth of non-manufacturing sector.

## Foreign Trade

Both exports and imports record double-digit growth in April.

Growth of exports to US accelerates in 1Q18.

Exports from Guizhou, Gansu and Shaanxi show robust growth in 1Q18.

FDI increases slightly by 0.5% yoy in 1Q18.

Foreign exchange reserves trend downward.

Chinese yuan shows depreciation trend against US dollar.

China-US trade tensions ease temporarily after trade talk.

China to cut import tariff rates on automobiles.

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# Executive Summary

## Domestic Trade

Retail sales of consumer goods reached 9,027.5 billion yuan in 1Q18, up by 9.8% yoy. Online retail sales of goods, which accounted for 16.1% of total retail sales, increased markedly by 34.4% yoy over the period.

Ex-factory prices of industrial products have trended downward in recent months. The producer price index of industrial products fell by 0.1%, 0.2% and 0.2% in February, March and April respectively.

Consumption expenditure of rural households posted double-digit growth in 1Q18. The per capita consumption expenditure of rural households grew nominally by 11.0% yoy to 3,241 yuan in the quarter. Meanwhile, the per capita consumption expenditure of urban households increased by 5.7% yoy in nominal terms to reach 6,749 yuan in 1Q18.

Growth in nominal fixed asset investment accelerated to 7.5% yoy in 1Q18 from 7.2% yoy in 2017, attributable to the FAI growth acceleration in the primary industry and real estate development.

China is likely to boost domestic demand amidst intensifying China-US trade tensions. According to the media report on the Communist Party's Politburo meeting on 23 April, China would 'combine the acceleration of structural adjustment with the continuous expansion of domestic demand'. This is the first time since December 2014 that the idea of boosting domestic demand was mentioned in a report on a Politburo meeting, and we believe it signals that the Chinese leaders have recently attached higher importance to domestic demand.

Entrepreneur Confidence Index rose strongly to 132.9 in 1Q18 from 126.0 in 4Q17, indicating that confidence among Chinese entrepreneurs has greatly improved lately.

Manufacturing sector has expanded at a relatively stable pace recently. PMI rose from 50.3 in February to 51.5 in March, before dropping slightly to 51.4 in April.

April NMI indicates gradual acceleration in growth of non-manufacturing sector. NMI rose slightly to 54.8 in April from 54.6 in March.

## Foreign Trade

Both exports and imports recorded double-digit growth in April. Exports gained 12.9% yoy, while imports rose markedly by 21.5% yoy in April.

Growth of exports to the US accelerated in 1Q18 amid intensifying China-US trade tensions: Growth of exports to the US was 14.8% yoy in 1Q18, up from 11.5% yoy in 2017.

Several western provinces in China witnessed robust year-on-year growth in exports in 1Q18. Exports from Guizhou, Gansu and Shaanxi soared by 60.4% yoy, 60.4% yoy and 57.8% yoy respectively over the period.

FDI increased slightly by 0.5% yoy to 227.5 billion yuan in 1Q18. FDI in the Hi-Tech industries grew rapidly by 12.8% yoy to 43.9 billion yuan, accounting for 19.3% of the total FDI in the quarter.

Foreign exchange reserves have trended downward since February, falling to US\$ 3,124.9 billion as at the end of April, the lowest level since December last year.

Chinese yuan has depreciated against the US dollar since mid-April. After fluctuating within a narrow range throughout early February to mid-April, the daily fixing rate of the Chinese yuan against the US dollar depreciated to 6.3852 on 21 May, the weakest level since late January.

On 19 May, China and the US issued a joint statement on economic and trade consultations, after a two-day meeting between the Chinese and the US delegations in Washington. According to the statement, China will significantly increase its purchases of the US goods and services, in particular agricultural and energy products; China will amend its laws and regulations in areas of intellectual property protections, including the Patent Law. Most importantly, both sides agreed to put the trade war and the imposition of tariffs 'on hold', according to the remarks made by the US Treasury Secretary Steven Mnuchin on the day after the release of the joint statement.

On 22 May, the Chinese government announced the details for the reduction of import tariffs on automobiles: The import tariff rates for automobiles would be cut to 15% from 25% and 20%, while the import tariff rates for automobile parts would be adjusted downward to 6% from 8%, 10%, 15%, 20% and 25%, effective from 1 July.

## A Recent developments

### 1. China's real GDP maintains strong growth in 1Q18

China's real GDP growth came in at 6.8% year-on-year (yoy) in 1Q18, staying at the same level for three consecutive quarters (*see exhibit 1*). The latest figure confirms the robust growth momentum of the Chinese economy. Overall, in 1Q18, China's nominal GDP amounted to 19.9 trillion yuan.

Compared to 2017, the growth of the tertiary industry decelerated while that of the secondary industry accelerated in 1Q18. The real growth rate for the value-added of the tertiary industry came in at 7.5% yoy in 1Q18, lower than 8.0% yoy in 2017. In the meantime, the real growth rate for the value-added of the secondary industry was 6.3% yoy in 1Q18, compared to 6.1% yoy in 2017.

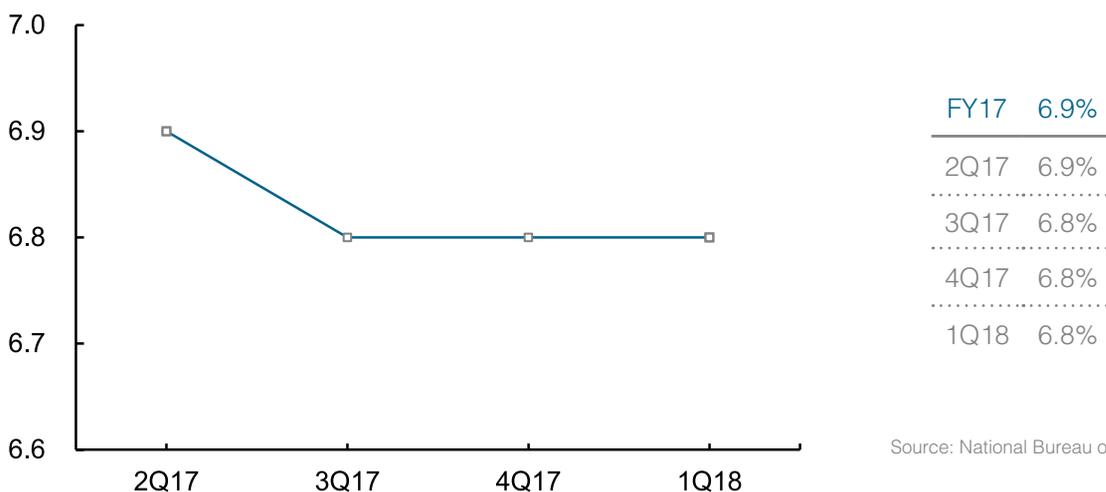
In 1Q18, final consumption expenditure contributed 5.3 ppts to the real GDP growth, while gross capital formation contributed 2.1 ppts. These figures show that China has been shifting towards a consumption-led economy.

Looking ahead, the Chinese policy makers will strive to maintain stable growth of the Chinese economy in near future. We predict that China's monetary policy will stay neutral, and loans and 'total social financing' will continue to grow at a reasonable pace this year. Moreover, the central government will continue with its active fiscal policy. According to the Government Work Report published in March, the government will launch a series of measures to reduce taxes and fees by 800 billion yuan and 300 billion yuan respectively this year. Given these policy directions and the continuous recovery of the global economy, we remain optimistic about China's economic outlook in the near term. We predict that the real GDP growth will stay stable at 6.8% in 2Q18. Downside risks to the economic growth, in our view, come mainly from the escalating trade tensions between China and the US, the negative impact of the ongoing property tightening measures and the strengthened regulation of the financial sector.

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**Exhibit 1** China's real GDP growth, 2Q17 to 1Q18

yoy growth (%)



Source: National Bureau of Statistics, PRC

## 2. Growth in retail sales accelerates

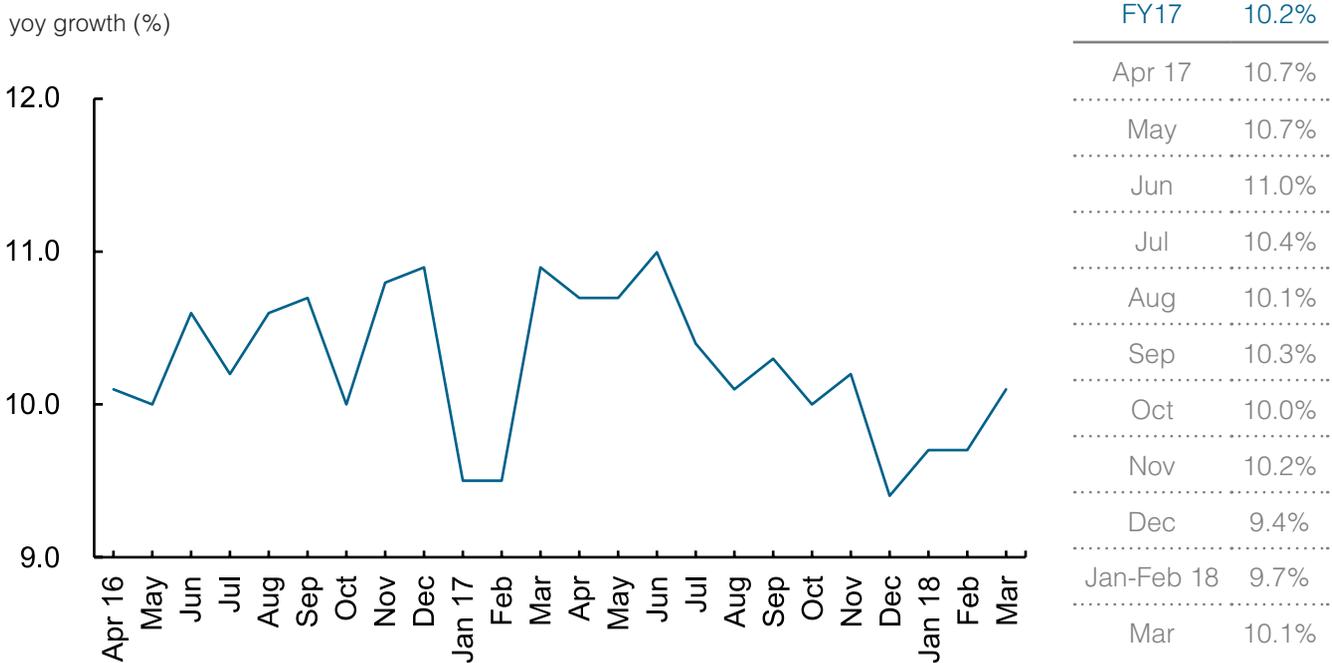
According to the National Bureau of Statistics, the growth in China's total retail sales of consumer goods improved from 9.4% yoy in December to 9.7% yoy in January to February, and further to 10.1% yoy in March. The month-on-month (mom) growth in seasonally-adjusted retail sales accelerated from 0.63% in January to 0.71% in February and 0.73% in March.

Overall, in 1Q18, the total retail sales of consumer goods reached 9,027.5 billion yuan. The growth rate

was 9.8% yoy in 1Q18, lower than 10.2% yoy in 2017 (see exhibits 2 and 3).

China's online retail sales of goods increased by 34.4% yoy to reach 1,456.7 billion yuan in 1Q18. Consequently, the share of online retail sales in the total retail sales of consumer goods went up to 16.1% in 1Q18 from 15.0% in 2017, indicating that popularity of online shopping has been growing rapidly.

**Exhibit 2** China's total retail sales, year-on-year nominal growth, April 2016 to March 2018



Source: National Bureau of Statistics, PRC

**Exhibit 3** China's total retail sales, month-on-month nominal growth, October 2017 to March 2018

	mom growth (%), seasonally adjusted					
	Oct 17	Nov	Dec	Jan 18	Feb	Mar
Total retail sales	0.81	0.89	0.79	0.63	0.71	0.73

Source: National Bureau of Statistics, PRC

# Part 1 : Domestic Trade

Both rural and urban retail sales have increased at a slower pace: the growth in rural retail sales moderated to 10.7% yoy in 1Q18 from 11.8% yoy in 2017. In the meantime, the growth in urban retail sales decelerated to 9.7% yoy in 1Q18 from 10.0% yoy in 2017.

The growth in catering services sales came in at 10.3% yoy in 1Q18, down from 10.7% yoy in 2017. Meanwhile, the growth in sales of goods decelerated to 9.8% yoy in 1Q18 from 10.2% yoy in 2017.

The growth rate for the retail sales of goods by enterprises above a designated size<sup>1</sup>, which amounted to 3,275.5 billion yuan in 1Q18, accelerated to 8.6% yoy in 1Q18 from 8.2% yoy in 2017. Among products, 'cosmetics' saw the strongest growth in sales (16.1% yoy) in 1Q18, followed by 'products for daily use' (12.3% yoy). Meanwhile, 'sports and entertainment products' witnessed the weakest growth in sales (1.3% yoy). 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, 2017 to 1Q18

Nominal growth, yoy (%)	FY17	1Q18
<b>Total retail sales</b>	<b>10.2</b>	<b>9.8</b>
- Goods	10.2	9.8
Sales by enterprises above a designated size	8.2	8.6
Online sales	28.0	34.4
- Catering services	10.7	10.3

Source: National Bureau of Statistics, PRC

### 3. Chinese consumers are optimistic

The consumer confidence index<sup>2</sup> rose from 122.3 in January to its recent peak of 124.0 in February, and then stayed high at 122.3 in March. These figures indicate that Chinese consumers have been optimistic recently (*see exhibit 6*). In our view, the strong consumer confidence was highly associated with the stable growth in household income amid the rapidly growing Chinese economy.

### 4. Consumption expenditure of rural households posts double-digit growth in 1Q18

Both rural and urban households continued to see high single-digit nominal growth in income in 1Q18. The per capita disposable income of rural households grew nominally by 8.9% yoy (or 6.8% yoy real) to reach 4,226 yuan; while the per capita disposable income of urban households rose by 8.0% yoy in nominal terms (or 5.7% yoy real) to reach 10,781 yuan in 1Q18.

With higher income, both rural and urban households had more room to increase their consumption expenditures in 1Q18. In particular, the per capita consumption expenditure of rural households, which reached 3,241 yuan, posted double-digit growth of 11.0% yoy in nominal terms (or 8.8% yoy real). Meanwhile, the per capita consumption expenditure of urban households grew by 5.7% yoy in nominal terms (or 3.4% yoy real) to reach 6,749 yuan in 1Q18.

<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, 2017 to 1Q18

Nominal growth, yoy (%)	FY17	1Q18
Grain, oil and food	10.2	10.1
Beverages	10.3	9.1
Tobacco and liquor	7.9	9.2
Clothing, shoes, hats and textiles	7.8	9.8
Cosmetics	13.5	16.1
Gold, silver and jewellery	5.6	7.9
Products for daily use	8.0	12.3
Sports and entertainment products	15.6	1.3
Home appliances and video equipment	9.3	11.4
Chinese and Western medicines	12.4	10.4
Stationery and office accessories	9.8	4.0
Furniture	12.8	9.3
Telecommunications equipment	11.7	7.7
Petroleum and related products	9.2	9.1
Automobiles	5.6	7.4
Building and decoration materials	10.3	8.0

Source: National Bureau of Statistics, PRC

**Exhibit 6** China's consumer confidence index, April 2016 to March 2018



Source: National Bureau of Statistics, PRC

Apr 17	113.4
May	112.0
Jun	113.3
Jul	114.6
Aug	114.7
Sep	118.6
Oct	123.9
Nov	121.3
Dec	122.6
Jan 18	122.3
Feb	124.0
Mar	122.3

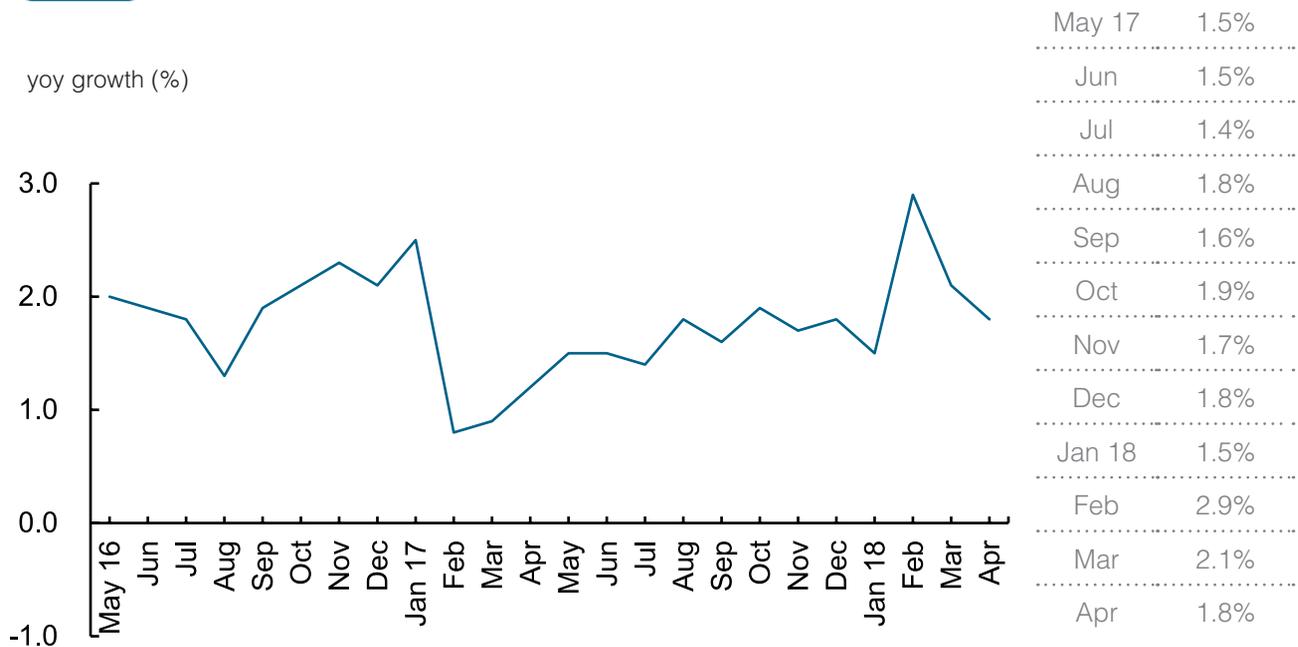
## 5. CPI growth falls in recent months

The year-on-year growth rate of China's consumer price index (CPI)<sup>3</sup> went down from its recent peak of 2.9% in February to 2.1% in March, and further to 1.8% in April (see exhibits 7 and 8). The drop in CPI growth in April was a result of a slower growth in food prices. Due largely to a fall in pork prices, the year-on-year growth in the food component went down to 0.7% in April from 2.1% in March. Meanwhile, the year-on-year growth in the non-food component in the CPI came in at 2.1% in April, the same as in March.

Looking ahead, we expect China's CPI growth to stabilize soon, due largely to the pass-through of higher oil prices to the 'transportation and communication' component in the CPI.

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**Exhibit 7** China's CPI growth, May 2016 to April 2018



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, November 2017 to April 2018<sup>4</sup>

<i>yoy growth (%)</i>	Nov 17	Dec	Jan 18	Feb	Mar	Apr
Food, tobacco and liquor	-0.2	0.3	0.2	3.6	2.0	1.1
Clothing	1.2	1.3	1.4	1.1	1.1	1.1
Housing	2.8	2.8	2.7	2.2	2.2	2.2
Household goods and services	1.5	1.6	1.5	1.8	1.6	1.5
Transportation and communication	1.3	1.2	0.2	1.5	0.3	1.1
Education, culture and recreational activities	2.0	2.1	0.9	3.7	2.2	2.0
Medical and healthcare	7.0	6.6	6.2	6.0	5.7	5.2
Other goods and services	1.7	1.9	1.2	1.7	1.2	0.9

Source: National Bureau of Statistics, PRC

The year-on-year growth in China's producer price index of industrial products (PPI) dropped all the way from 4.3% in January 2018 to 3.1% yoy in March, but then rebounded to 3.4% yoy in April (see exhibits 9 & 10). On a month-on-month basis, the PPI fell by 0.1%, 0.2% and 0.2% in February, March and April respectively. The downtrend of the PPI indicates a continuous fall in ex-factory prices of industrial products in the past three months.

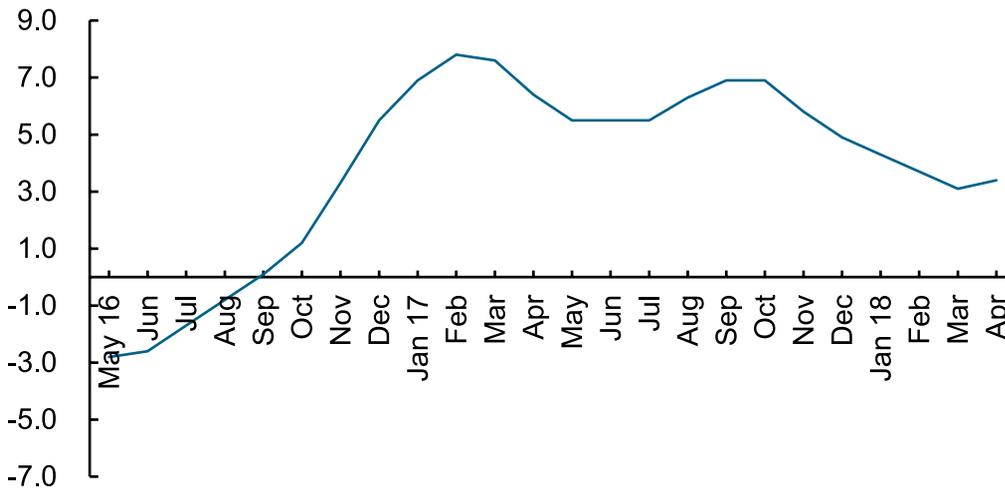
Looking ahead, we expect the PPI to stabilize on a month-on-month basis in the near future, as the April reading of the ex-factory prices sub-index of China's manufacturing PMI went up to 50.2, indicating slight inflationary pressures on ex-factory prices. Meanwhile, the year-on-year growth in the PPI is likely to rise further in the coming months.

<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'.

# Part 1 : Domestic Trade

**Exhibit 9** China's PPI growth, May 2016 to April 2018

yoy growth (%)



May 17	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%
Feb	3.7%
Mar	3.1%
Apr	3.4%

Source: National Bureau of Statistics, PRC

**Exhibit 10** China's PPI growth by selected industry, November 2017 to April 2018

yoy growth (%)

	Nov 17	Dec	Jan 18	Feb	Mar	Apr
Textile	2.4	2.4	2.1	1.7	1.7	1.7
Textile wearing apparel and ornament	0.7	0.5	0.8	0.7	0.4	0.5
Processing of timbers, manufacture of wood, bamboo, rattan, palm, and straw products	1.0	1.2	1.2	1.2	1.2	1.6

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, fell all the way from 5.2% yoy in January to 3.7% in March and April (see exhibits 11 & 12).

On a month-on-month basis, after having risen for seven consecutive months, the purchaser price index of industrial products fell by 0.3% in March, and then dropped by 0.3% in April. The figures indicate a fall in prices of production inputs in the past two months.

The input prices sub-index of China's manufacturing PMI, a leading indicator of upstream prices, fell from 53.4 in February and March to a ten-month low of 53.0 in April. Therefore, we believe that the purchaser price index of industrial products is likely to stay low in the near term.

**Exhibit 11** Growth in China's purchaser price index of industrial products, May 2016 to April 2018



Source: National Bureau of Statistics, PRC

**Exhibit 12** China's purchaser price index of industrial products by selected commodity, November 2017 to April 2018

yoy growth (%)	Nov 17	Dec	Jan 18	Feb	Mar	Apr
Fuel and power	8.0	7.1	6.2	6.0	4.9	4.6
Non-ferrous metal materials and wires	14.7	10.4	10.5	8.3	6.8	6.4
Chemical raw materials	9.2	7.6	5.9	4.3	3.4	4.2
Wood and pulp	9.4	7.6	7.0	6.4	6.5	7.0
Textile raw materials	3.4	2.8	2.3	1.7	1.7	1.7

Source: National Bureau of Statistics, PRC

## 6. Growth in industrial production decelerates in March

The growth rate for China's industrial production (IP), measured by the value-added of industrial output (VAIO), accelerated from 6.2% yoy in December to 7.2% yoy in January to February, before falling to 6.0% yoy in March (see exhibit 13).<sup>5</sup> Overall, in 1Q18, China's IP expanded by 6.8% yoy, slightly higher than the 6.6% yoy growth recorded in 2017.

Looking ahead, we expect that the industrial production (VAIO) growth will be around 6.5-7.0% yoy in 2Q18, as the new orders sub-index of China's PMI has been relatively strong in recent months, registering 53.3 and 52.9 in March and April respectively. However, challenges facing Chinese manufacturers remain, including the escalating trade tensions between China and the US, strong government's efforts to enforce environmental regulations, a marked increase in prices of materials, intense competition in the international market, and the weak demand for luxury products.

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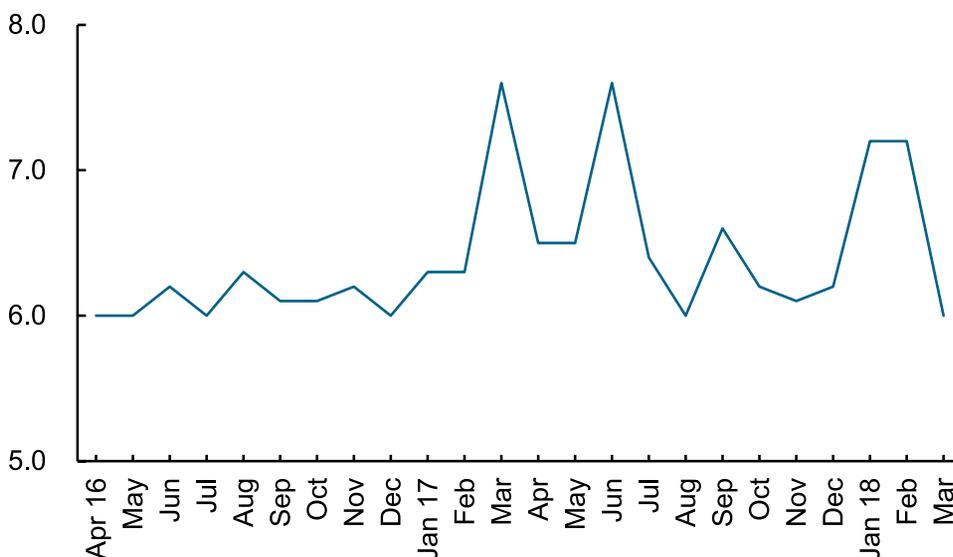
## 7. Industrial profits gain 11.6% yoy in 1Q18

The growth rate for the total profits earned by large and medium industrial enterprises above a designated size<sup>6</sup> accelerated from 10.8% yoy in December to 16.1% yoy in January to February 2018, before falling to 3.1% yoy in March. In 1Q18, China's industrial profits totalled 1,553.3 billion yuan, up by 11.6% yoy, compared to the growth rate of 21.0% yoy in 2017 (see exhibit 14). One of the major reasons behind the moderation in profit growth in 1Q18 was a slower rise in prices of ex-factory products.

Among sectors, profits of the manufacturing sector rose by 8.2% yoy to 1,303.7 billion yuan; profits of the mining sector increased by 36.1% yoy to 137.5 billion yuan; profits of the 'electricity, heat, gas and water' sector grew by 30.4% yoy to 112.1 billion yuan in 1Q18.

**Exhibit 13** China's industrial production growth, April 2016 to March 2018

yoy growth (%)



Apr 17	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%
Jan-Feb 18	7.2%
Mar	6.0%

Source: National Bureau of Statistics, PRC

<sup>5</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>6</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, September 2017 to March 2018

<i>yoy growth (%)</i>	Sep 17	Oct	Nov	Dec	Jan-Feb 18	Mar
Total profits made by industrial enterprises above a designated size	27.7	25.1	14.9	10.8	16.1	3.1

Source: National Bureau of Statistics, PRC

## 8. Fixed asset investment growth accelerates in 1Q18

The growth in China's nominal fixed asset investment (FAI) (excluding rural households) accelerated to 7.5% yoy in 1Q18 from 7.2% yoy in 2017.<sup>7</sup> Overall, in 1Q18, China's nominal FAI (excluding rural households) amounted to 10.1 trillion yuan (*see exhibit 15*).

The rise in the overall FAI growth was attributable to the FAI growth acceleration in the primary industry and the real estate development: the growth in FAI (excluding rural households) in the primary industry rose strongly to 24.2% yoy in 1Q18 from 11.8% yoy in 2017; and the growth in FAI in real estate development went up to 10.4% yoy in 1Q18 from 7.0% yoy in 2017.

In contrast, the growth in FAI in infrastructure (excluding power, heat, gas and water infrastructure) fell to 13.0% yoy in 1Q18 from 19.0% yoy in 2017; and the growth in FAI (excluding rural households) for the manufacturing sector decelerated to 3.8% yoy in 1Q18 from 4.8% yoy in 2017.

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

**Exhibit 15** China's FAI (excluding rural households) growth, October 2017 to March 2018

	Oct 17	Nov	Dec	Jan 18	Feb	Mar
FAI (excluding rural households) <i>(year-to-date, yoy growth %)</i>	7.3	7.2	7.2	-	7.9	7.5
FAI (excluding rural households) <i>(mom growth %, seasonally adjusted)</i>	0.57	0.56	0.56	0.57	0.58	0.57

Source: National Bureau of Statistics, PRC

<sup>7</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. China to boost domestic demand amidst intensifying China-US tensions

On 23 April, Xi Jinping, the General Secretary of the Chinese Communist Party, chaired a meeting of the Politburo, a top decision-making body of the ruling party. According to the report on the meeting published by the state-run Xinhua news agency, China would 'combine the acceleration of structural adjustment with the continuous expansion of domestic demand'.<sup>8</sup> This is the first time since December 2014 that the idea of boosting domestic demand was mentioned in a report on a Politburo meeting, and we believe it signals that the Chinese leaders have recently attached higher importance to domestic demand. We therefore expect China to intensify its efforts to boost domestic demand in the near future. As stimulating investment would increase its already high debt level, China is likely to rely more on consumption, instead of investment, as its driver of domestic demand.

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Amidst the intensifying China-US tensions, boosting domestic demand is crucial to the development of the Chinese economy. Looking ahead, we expect that the government will announce policies aimed at driving consumption soon. Recent comments made by a senior official of the National Development and Reform Commission (NDRC) may give some hints about the future directions of consumption policies. On 30 March, the NDRC published a report on the development of Chinese households' consumption in 2017. At the press conference on the launch of the report, the Secretary-General of the NDRC Li Pumin disclosed the major policy directions for the expansion and upgrade of household consumption. These include:

- To support non-governmental agencies in the society to provide services in areas of healthcare, elderly care, education, culture and sports.
- To continue to push forward the '10 initiatives for boosting consumption'; to nurture hotspots in areas such as information consumption, tourism and green consumption.
- To improve quality and standards of products and services.
- To strengthen the regulations of the markets; to promote the sharing of credit information.
- To improve consumption-related infrastructure and upgrade consumption experience; to strengthen distribution networks; to implement major 'internet plus' projects and to promote a wide application of big-data, cloud computing and Internet of Things.

### 2. Both broad money supply and total outstanding RMB loans show weak growth

Both the broad money supply (M2) and the total outstanding RMB loans have shown weak growth recently. The M2 growth decelerated from 8.8% yoy as at the end of February to 8.2% yoy as at the end of March, and then stayed low at 8.3% yoy as at the end of April (*see exhibit 16*).

Meanwhile, the growth rate of the total outstanding RMB loans came in at 12.7% yoy as at the end of April, the lowest since the end of January this year. Overall, in January to April this year, the rise in the total outstanding RMB loans amounted to 6.04 trillion yuan, higher than the increase seen in the same period of the previous year (i.e. 5.32 trillion yuan). In our view, the main reason behind the larger bank loans in the first four months of this year was that the tightening in financial regulations had driven banks to shift off-balance sheet credit onto their balance sheets.

On 17 April, the People's Bank of China (PBoC), China's central bank, announced to cut the reserve requirement ratios (RRRs) of banks in China by 100 bps effective 25 April, pumping funds of about 1.3 trillion yuan into the banking system. Nevertheless, banks must use the funds to pay back their loans borrowed via the medium-term lending facility (MLF) from the PBoC. After the repayment of MLF loans, banks would have extra funds of 400 billion yuan. At the request of the PBoC, banks must use these extra funds to provide loans to micro- and small enterprises. The PBoC said that the move, which was intended to lower the banks' funding costs of loans to micro- and small enterprises, did not signal a change in the tone of the monetary policy. Indeed, the move is consistent with the directions of the monetary policy announced by the government in March this year. According to the *Government Work Report* published on 5 March, the monetary policy should remain neutral, and the central bank should make better use of differentiated reserve ratios and credit policies to encourage more funds to flow towards small and micro businesses, agriculture, rural areas, rural residents, and poor areas.

**Exhibit 16** Broad money supply (M2) and RMB loans, May 2017 to April 2018

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	FY17	13.53
End-May 17	160.1	9.6%	113.0	12.9%	Jan-Apr 18	6.04
End-Jun	163.1	9.4%	114.6	12.9%	May 17	1.11
End-Jul	162.9	9.2%	115.4	13.2%	Jun	1.54
End-Aug	164.5	8.9%	116.5	13.2%	Jul	0.83
End-Sep	165.6	9.2%	117.8	13.1%	Aug	1.09
End-Oct	165.3	8.8%	118.4	13.0%	Sep	1.27
End-Nov	167.0	9.1%	119.6	13.3%	Oct	0.66
End-Dec	167.7	8.2%	120.1	12.7%	Nov	1.12
End-Jan 18	172.1	8.6%	123.0	13.2%	Dec	0.58
End-Feb	172.9	8.8%	123.9	12.8%	Jan 18	2.90
End-Mar	174.0	8.2%	125.0	12.8%	Feb	0.84
End-Apr	173.8	8.3%	126.2	12.7%	Mar	1.12
					Apr	1.18

Source: People's Bank of China

### 3. 'Total social financing' increases at a slower pace

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 7.1 trillion yuan in January to April this year, smaller than the increase seen in the same period of the previous year (i.e. 8.3 trillion yuan) (see exhibit 17).

The smaller increase in 'total social financing' could be associated with the slowdown in shadow banking activities. Entrusted loans decreased by 479.5 billion yuan in January to April this year, compared to an increase of 629.9 billion yuan in the same period of the previous year. Meanwhile, the increase in trust loans amounted to 66.4 billion yuan in January to April, much smaller than the increase seen in the same period of the previous year (i.e. 882.2 trillion yuan).

**Exhibit 17** Increase in total social financing, 2017 to Jan-Apr 18

	2017		Jan-Apr 18	
	Amount (billion yuan)	Share (%)	Amount (billion yuan)	Share (%)
<b>Total social financing</b>	<b>19,440.0</b>	<b>100.0</b>	<b>7,140.0</b>	<b>100.0</b>
RMB loans to the real sector	13,840.0	71.2	5,950.0	83.3
Foreign currency loans to the real sector	1.8	0.0	46.6	0.7
Trust loans	2,260.0	11.6	66.4	0.9
Entrusted loans	777.0	4.0	-479.5	-6.7
Bank acceptance bills	536.4	2.8	267.5	3.7
Corporate bonds	449.5	2.3	914.7	12.8
Equity issuance	873.4	4.5	181.6	2.5

Source: People's Bank of China

## C Outlook

### 1. China's Entrepreneur Confidence Index rises strongly in 1Q18

China's Entrepreneur Confidence Index (ECI) for the secondary industry rose strongly by 6.9 pts from the previous quarter to 132.9 in 1Q18, indicating that confidence among Chinese entrepreneurs has greatly improved lately (*see exhibit 18*).<sup>9</sup>

By sector, the ECIs for the 'mining', the 'manufacturing' and the 'electricity, gas and water' sectors all recorded a quarter-on-quarter gain, up by 6.3 pts, 6.6 pts and 9.8 pts respectively in 1Q18 (*see exhibit 19*).

### 2. Manufacturing sector expands at a relatively stable pace

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China's manufacturing PMI rose from 50.3 in February to 51.5 in March, before dropping slightly to 51.4 in April.<sup>10</sup> The latest reading indicates that the manufacturing sector in China has expanded at a relatively stable pace recently (*see exhibit 20*).

The new orders index went up from 51.0 in February to a three-month high of 53.3 in March, before moderating to 52.9 in April. The index readings in the past two months show that the growth of overall new orders has stayed relatively strong recently. Meanwhile, the new export orders index came in at 50.7 in April, staying in the expansionary zone for two consecutive months. This indicates that new export orders have continued to increase lately, despite the escalating China-US trade tensions.

Against the backdrop of the relatively strong growth of overall new orders, the output index climbed from 50.7 in February to 53.1 in March and in April, showing a relatively fast expansion of output of the manufacturing sector in China.

The purchases of inputs index went up from 50.8 in February to 53.0 in March, before dropping slightly to 52.6 in April. The latest readings indicate that the growth of purchasing activities has stayed strong in recent months.

The stocks of major inputs index fluctuated within the narrow range of 49.3 to 49.6 throughout February to April. The index stayed slightly below the critical 50-mark in the past three months, indicating a small drop in the stocks of major inputs during the period. In the meantime, the stocks of finished goods index rose from 46.7 in February to 47.3 in March, and then dropped slightly to 47.2 in April, the second highest level since May last year. The index readings in the past two months show that the stocks of finished goods held by manufacturers have dropped at a slower pace recently.

The input prices index fell from 53.4 in February and March to a ten-month low of 53.0 in April, indicating that upstream cost pressure has eased recently. Meanwhile, for the first time in three months, the ex-factory prices index went up above the critical 50-mark, registering 50.2 in April. The latest reading shows a rebound in ex-factory prices of finished goods.

The business expectations index stayed between 58.2 and 58.7 throughout February to April. The index was well above the critical 50-mark in the past three months, indicating that purchasing managers in China have stayed optimistic about the near term outlook for their respective industries recently.

<sup>9</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>10</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), 2Q16 to 1Q18

	2Q16	3Q16	4Q16	1Q17	2Q17	3Q17	4Q17	1Q18
Entrepreneur Confidence Index (Secondary Industry)	109.3	113.4	115.4	129.2	127.3	127.3	126.0	132.9

Source: National Bureau of Statistics, PRC

**Exhibit 19** Entrepreneur Confidence Index by sector, 1Q18

	1Q18	Compared with the previous quarter
Secondary industry	132.9	Higher
Mining	116.9	Higher
Manufacturing	133.2	Higher
Electricity, gas & water	139.9	Higher

Source: National Bureau of Statistics, PRC

Part 1 :  
**Domestic  
 Trade**

**Exhibit 20**

China's manufacturing PMI at a glance, April 2018

Index	Seasonally Adjusted Index	Index Compared with the Previous Month	Direction
PMI	51.4	Lower	Expanding
Output	53.1	Unchanged	Expanding
New Orders	52.9	Lower	Expanding
New Export Orders	50.7	Lower	Expanding
Backlogs of Orders	46.2	Higher	Contracting
Stocks of Finished Goods	47.2	Lower	Contracting
Purchases of Inputs	52.6	Lower	Expanding
Imports	50.2	Lower	Expanding
Input Prices	53.0	Lower	Rising
Stocks of Major Inputs	50.2	Higher	Rising
Ex-factory Prices	49.5	Lower	Contracting
Employment	49.0	Lower	Contracting
Suppliers' Delivery Time	50.2	Higher	Quickening
Business Expectations	58.4	Lower	Optimistic

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

### 3. April NMI indicates gradual acceleration in growth of non-manufacturing sector

China's Business Activity Index, which is quoted as the Non-manufacturing Purchasing Managers' Index (NMI), has trended slightly upward in recent months. The index rose from 54.4 in February to 54.6 in March, and further to 54.8 in April, indicating a gradual acceleration in the growth of the non-manufacturing sector (see exhibit 21).

After dropping from 50.5 in February to 50.1 in March, the new orders index rebounded to 51.1 in April. The latest reading shows a reacceleration in the growth of new orders.

The input prices have increased at a relatively mild pace lately: The input prices index came in at 52.7 in April, the second lowest level since July last year. Meanwhile, the sales prices index went up from 49.3 in March to 50.6 in April, above the critical 50-mark, showing that enterprises have raised their service charges lately.

The business expectation index was 61.5 in April, 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, April 2018

Index	Seasonally Adjusted Index	Index Compared with the Previous Month	Direction
Business activity	54.8	Higher	Expanding
New orders	51.1	Higher	Expanding
Input prices	52.7	Higher	Rising
Sales prices	50.6	Higher	Rising
Business expectations	61.5	Higher	Optimistic

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

## A Recent developments

### 1. Both exports and imports record double-digit growth in April

China's exports growth accelerated from 9.9% yoy in 4Q17 to 14.1% yoy in 1Q18, as China's exports continued to benefit from the global economic recovery (see exhibits 22, 23 and 24). Overall, in 1Q18, China's exports amounted to US\$ 545.3 billion.

Against the backdrop of the escalating China-US trade tensions, China's export growth to the US accelerated in 1Q18: China's export growth to the US was 14.8% yoy in 1Q18, up from 11.5% yoy in 2017. Meanwhile, China's exports to its other major trading partners such as the EU, Japan and the ASEAN also showed improvement in 1Q18. China's export growth to the EU, Japan and the ASEAN accelerated to 13.2% yoy, 7.1% yoy and 18.0% yoy respectively in 1Q18 from 9.7% yoy, 6.1% yoy and 9.0% yoy respectively in 2017. In 1Q18, China's exports to Brazil and Russia, two major commodity-exporting countries in the world, continued to post impressive growth of 33.0% yoy and 23.7% yoy respectively.

The growth rate for China's imports rose from 12.5% yoy in 4Q17 to 19.0% yoy in 1Q18, indicating that domestic demand has remained strong recently. Overall, in 1Q18, China's imports totalled US\$ 497.3 billion.

Compared to 4Q17, China's exports dropped by US\$ 91.4 billion in 1Q18, as most factories suspended their operations during Chinese New Year holidays. Meanwhile, China's imports fell at a relatively slower pace, by US\$ 7.5 billion, over the same quarter. Consequently, China's trade surplus decreased markedly to US\$ 48.0 billion in 1Q18 from US\$ 131.9 billion in 4Q17.

In April, China's exports maintained double-digit growth of 12.9% yoy, while China's imports rose markedly by 21.5% yoy.

**Exhibit 22** China's quarterly foreign trade data, 2Q17 to 1Q18

*USD billion (yoy growth)*

	Exports		Imports		Trade Balance
<b>FY17</b>	<b>2,263.5</b>	<b>(7.9%)</b>	<b>1,841.0</b>	<b>(15.9%)</b>	<b>422.5</b>
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
1Q18	545.3	(14.1%)	497.3	(19.0%)	48.0

Source: China Customs

**Exhibit 23** China's monthly foreign trade data, May 2017 to April 2018

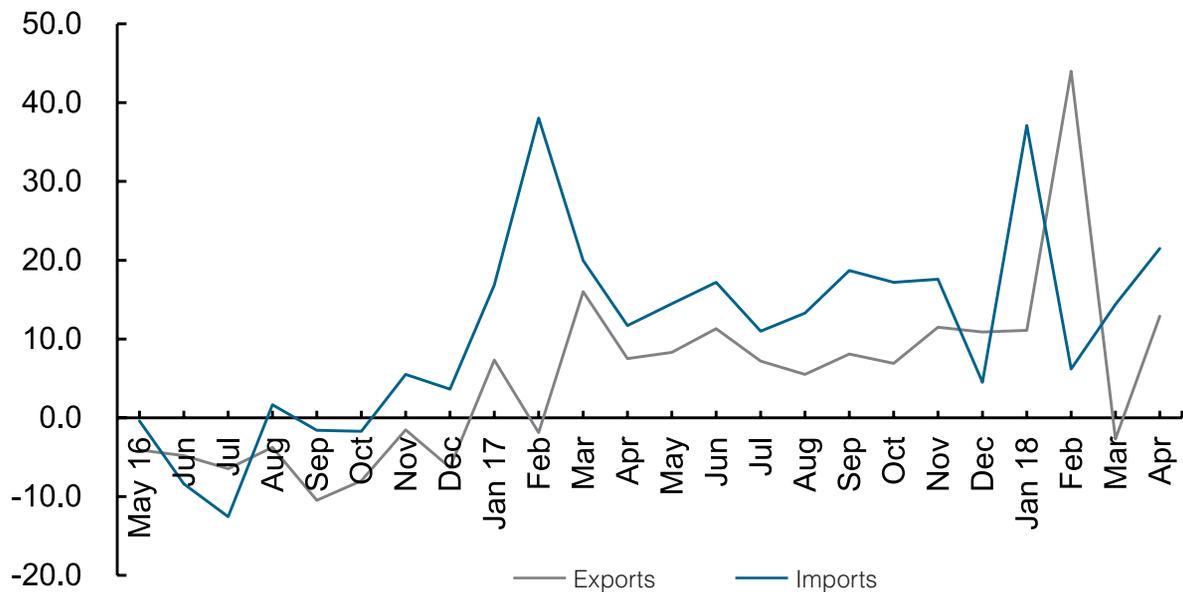
*USD billion (yoy growth)*

	Exports		Imports		Trade Balance
May 2017	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	200.1	(11.0%)	180.4	(37.1%)	19.7
February	171.1	(44.0%)	137.8	(6.2%)	33.3
March	174.1	(-2.7%)	179.1	(14.4%)	-5.0
April	200.4	(12.9%)	171.7	(21.5%)	28.8

Source: China Customs

**Exhibit 24** Growth rates of exports and imports, May 2016 to April 2018

yoy growth (%)



Source: China Customs

## Part 2 : Foreign Trade

**Exhibit 25** Exports by category, 2017 and 1Q18

<i>yoy growth (%) of export value, calculated in USD</i>	2017	1Q18
Textile materials and products	4.5	12.4
Garments and clothing accessories	-0.4	0.7
Footwear	2.0	0.9
Toys	30.4	14.3
Coal	58.1	-33.2
Crude oil	93.2	-38.7
Refined oil	30.9	39.2
Steel	0.0	0.1
Mechanical and electrical products	9.3	16.3

Source: China Customs

**Exhibit 26** Imports by category, 2017 and 1Q18

<i>yoy growth (%) of import value, calculated in USD</i>	2017	1Q18
Cereal and cereal flour	13.7	1.4
Soybean	16.7	-2.7
Iron ore	31.4	-11.5
Crude oil	39.1	28.5
Refined oil	29.8	23.7
Steel	15.3	19.3
Textile yarns, fabric and textile products	3.6	-1.4
Vehicles and vehicle chassis	13.4	15.7

Source: China Customs

## 2. Growth rates for both general trade exports and processing trade exports accelerate in 1Q18

The year-on-year growth rates for both general trade<sup>11</sup> exports and processing trade<sup>12</sup> exports accelerated in 1Q18. The growth in general trade exports improved to 20.3% yoy in 1Q18 from 14.5% yoy in 4Q17. The growth in processing trade exports rose slightly to 6.3% yoy in 1Q18 from 5.2% yoy in 4Q17 (*see exhibit 27*).

On the import side, the growth in general trade imports accelerated to 20.3% yoy in 1Q18 from 18.9% yoy in 4Q17. The growth rate for processing trade imports rose to 10.7% yoy in 1Q18 from 4.0% yoy in 4Q17.

The share of processing trade in China's total trade fell to 27.0% in 1Q18 from 30.0% in 4Q17. That being said, with a large surplus of US\$ 72.0 billion in 1Q18, processing trade still plays an important role in China's foreign trade.

<sup>11</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>12</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), 2017 to 1Q18

Item	yoy growth (%)			Share (%)		
	FY17	4Q17	1Q18	FY17	4Q17	1Q18
<b>Exports</b>	<b>7.9</b>	<b>9.9</b>	<b>14.1</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>
Of which:						
General Trade	8.7	14.5	20.3	54.6	54.2	56.0
Processing Trade	5.9	5.2	6.3	33.4	34.6	32.4
<b>Imports</b>	<b>15.9</b>	<b>12.5</b>	<b>18.9</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>
Of which:						
General Trade	20.2	18.9	20.3	58.7	57.7	60.8
Processing Trade	8.7	4.0	10.7	23.5	24.2	21.1
<b>Total of Imports and Exports</b>	<b>11.4</b>	<b>11.0</b>	<b>16.3</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>
Of which:						
General Trade	13.8	16.5	20.3	56.4	55.7	58.3
Processing Trade	6.9	4.8	7.9	29.0	30.0	27.0

Source: China Customs

### 3. China's trade with EU, US, ASEAN and Japan maintains double-digit growth in 1Q18

The EU was still China's largest trading partner, accounting for 14.7% of China's total foreign trade in 1Q18. Sino-EU trade amounted to US\$ 153.7 billion, up by 14.9% yoy in 1Q18. Specifically, China's exports to the EU gained 13.2% yoy in 1Q18, compared to the growth of 9.7% yoy in 2017; and China's imports from the EU increased by 17.5% yoy in 1Q18, compared to the growth of 17.6% yoy in 2017 (*see exhibits 28 and 29*).

Accounting for 13.6% of China's total foreign trade, the US continued to be China's second largest trading partner in 1Q18. Against the backdrop of the escalating China-US trade tensions, Sino-US trade expanded by 13.0% yoy to US\$ 141.6 billion in 1Q18. China's export growth to the US accelerated further in 1Q18: after expanding by 11.5% yoy in 2017, China's exports to the US grew by 14.8% yoy in 1Q18. In contrast, China's imports from the US recorded weaker growth of 8.9% yoy in 1Q18, compared to 14.5% yoy in 2017.

The Association of South East Asian Nations (ASEAN) accounted for 12.8% of China's total foreign trade in 1Q18. Sino-ASEAN trade grew by 20.9% yoy to US\$ 133.6 billion in 1Q18. Of which, China's exports to ASEAN rose by 18.0% yoy, while China's imports from ASEAN gained 24.3% yoy, in 1Q18.

Sino-Japanese trade increased by 10.1% yoy to US\$ 75.7 billion in 1Q18. China's exports to Japan gained 7.1% yoy, while China's imports from Japan expanded by 12.7% yoy in 1Q18.

#### 4. Growth rates for China's exports to Russia, India and Brazil accelerate in 1Q18

China's export growth to Russia accelerated to 23.7% yoy in 1Q18 from 14.8% yoy in 2017, driven by the continuous recovery in Russia's economy. Meanwhile, China's import growth from Russia improved to 32.0% yoy in 1Q18 from 27.7% yoy in 2017 (see exhibits 28 and 29). Consequently, the growth in China's trade with Russia rose to 28.2% yoy in 1Q18 from 20.8% yoy in 2017.

China's export growth to India accelerated slightly to 17.2% yoy in 1Q18 from 16.5% yoy in 2017. In contrast, China's import growth from India fell to 9.1% yoy in 1Q18 from 38.9% yoy in 2017. Overall, the growth of Sino-Indian trade decelerated to 15.4% yoy in 1Q18 from 20.3% yoy in 2017.

The growth in China's exports to Brazil stayed high at 33.0% yoy in 1Q18, after registering 31.8% yoy in 2017. Meanwhile, the growth in China's imports from Brazil decelerated to 23.1% yoy in 1Q18 from 27.8% yoy in 2017. Consequently, the growth in Sino-Brazilian trade moderated to 26.4% yoy in 1Q18 from 29.1% yoy in 2017.

Together, these three BRIC members accounted for 6.5% of China's total exports and 6.3% of China's total imports in 1Q18, compared to 6.2% and 6.3%, respectively, in 2017.

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**Exhibit 28** China's trading partners, 1Q18

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	153.7	14.7	90.2	63.5	14.9	13.2	17.5
US	141.6	13.6	99.9	41.7	13.0	14.8	8.9
ASEAN	133.6	12.8	70.8	62.9	20.9	18.0	24.3
Japan	75.7	7.3	34.4	41.3	10.1	7.1	12.7
Brazil	21.5	2.1	7.5	14.0	26.4	33.0	23.1
Russia	23.1	2.2	10.3	12.8	28.2	23.7	32.0
India	22.1	2.1	17.6	4.6	15.4	17.2	9.1

Source: China Customs

**Exhibit 29** China's trading partners, comparing growth rates for 2017 and 1Q18

Country/Region	Total Trade		Exports		Imports	
	2017	1Q18	2017	1Q18	2017	1Q18
EU	12.7	14.9	9.7	13.2	17.6	17.5
US	12.3	13.0	11.5	14.8	14.5	8.9
ASEAN	13.8	20.9	9.0	18.0	20.1	24.3
Japan	10.1	10.1	6.1	7.1	13.7	12.7
Brazil	29.1	26.4	31.8	33.0	27.8	23.1
Russia	20.8	28.2	14.8	23.7	27.7	32.0
India	20.3	15.4	16.5	17.2	38.9	9.1

Source: China Customs

## 5. Guizhou, Gansu and Shaanxi witness robust growth in exports in 1Q18

China's top six provinces and municipalities in terms of value of exports – Guangdong, Jiangsu, Shanghai, Zhejiang, Shandong and Fujian – jointly accounted for 77.1% of China's total exports in 1Q18, down from 78.1% in 2017 (*see exhibit 30*). The drop in the share of exports of these six provinces was due to the relatively slow growth of exports from Guangdong, Shanghai and Shandong in 1Q18. Exports from Guangdong, Shanghai and Shandong expanded by 10.8% yoy, 7.4% yoy and 12.1% yoy, respectively, in 1Q18, lower than the country's total export growth (14.1% yoy) during the period.

Several western provinces in China witnessed robust year-on-year growth in exports in 1Q18. Exports from Guizhou, Gansu and Shaanxi soared by 60.4% yoy, 60.4% yoy and 57.8% yoy respectively over the period.

**Exhibit 30** Top six provinces and municipalities in terms of value of exports, 1Q18

Provinces/ Municipalities	Value of exports (USD billion)	yoy growth (%)	Share of total exports (%)
Guangdong	151.7	10.8	27.8
Jiangsu	92.5	15.3	17.0
Zhejiang	71.4	16.1	13.1
Shanghai	42.8	7.4	7.8
Shandong	38.5	12.1	7.1
Fujian	23.7	18.9	4.4

Source: China Customs

## 6. China's FDI grows slightly by 0.5% yoy in 1Q18

China's foreign direct investment (FDI) in Renminbi terms recorded weak growth of 0.3% yoy, 0.8% yoy and 0.4% yoy in January, February and March, respectively. Overall, in 1Q18, China's FDI amounted to 227.5 billion yuan, up by 0.5% yoy (*see exhibit 31*).

In 1Q18, FDI in the Hi-Tech industries grew rapidly by 12.8% yoy to 43.9 billion yuan, accounting for 19.3% of the total FDI in the quarter. The figures indicate the optimism about the Hi-Tech industries among foreign enterprises. Among Hi-Tech industries in the manufacturing sector, FDI in the 'pharmaceutical

industry', the 'electronics and communications equipment industry' and the 'computers and office equipment industry' increased by 54.8% yoy, 39.4% yoy and 35.2% yoy respectively during the period. Among Hi-Tech industries in the service sector, FDI in the 'research and development and design services industry' recorded year-on-year growth of 25.6% yoy in the quarter.

**Exhibit 31** China's FDI, April 2017 to March 2018

	Amount (billion yuan)	yoy growth
FY17	877.6	7.9%
1Q18	227.5	0.5%
April 17	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%
January 18	80.4	0.3%
February	59.0	0.8%
March	88.1	0.4%

Source: Ministry of Commerce, PRC

## 7. China's foreign exchange reserves trend downward

Since February this year, China's foreign exchange reserves have generally been on a downward trend, falling to US\$ 3,124.9 billion as at the end of April, the lowest level since December last year (*see exhibit 32*).

The recent fall in the foreign exchange reserves was due largely to the depreciation of the non-US dollar currencies and the fall in value of assets in the foreign exchange reserves.<sup>13</sup> 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. If the US dollar continues to appreciate, the value of China's foreign exchange reserves is likely to drop further.

**Exhibit 32** Foreign exchange reserves by quarter, 2Q17 to 1Q18

USD billion	Accumulation	End of the quarter
FY17	129.4	
2Q17	47.7	3,056.8
3Q17	51.7	3,108.5
4Q17	31.4	3,139.9
1Q18	2.9	3,142.8

Source: State Administration of Foreign Exchange, PRC

<sup>13</sup> According to the Bloomberg, the US dollar index was 91.841 on 30 April, compared to 89.133 on 31 January.

## B Highlights

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### 1. Chinese yuan shows depreciation trend against US dollar

The Chinese yuan has depreciated against the US dollar since mid-April. After fluctuating within a narrow range throughout early February to mid-April, the daily fixing rate (also known as the central parity rate) of the Chinese yuan against the US dollar depreciated to 6.3852 on 21 May, the weakest level since late January (see exhibit 33).<sup>14</sup>

28

In line with the trend of the daily fixing rate, the USD-CNY spot exchange showed slight fluctuation throughout early February to mid-April, and then depreciated in the following month.<sup>15</sup> So far this year, the USD-CNY spot exchange rate has appreciated by 1.93% (as of 21 May).

The daily fixing rate of the Chinese yuan against the Euro appreciated from 7.7757 on 19 April to 7.5070 on 21 May (see exhibit 34). So far this year, the daily fixing rate of the Chinese yuan against the Euro has appreciated by 3.93%.

According to the Bank for International Settlements, the real effective exchange rate (REER) of the yuan rose to 127.59 in February, the highest level since April 2016, and then stayed high at 125.86 and 126.24 in March and April respectively.<sup>16</sup> Overall, in January to April, the Chinese yuan appreciated in real terms against its trading partners by 3.8% (see exhibit 35).

Looking ahead, we predict that the exchange rate of the Chinese yuan against the US dollar will largely depend on the strength of the US dollar against major currencies in the global market. The recent uptrend of the US dollar index indicates a depreciation of other major currencies against the US dollar. If the trend continues, the Chinese yuan is likely to stay weak against the US dollar in the near future.

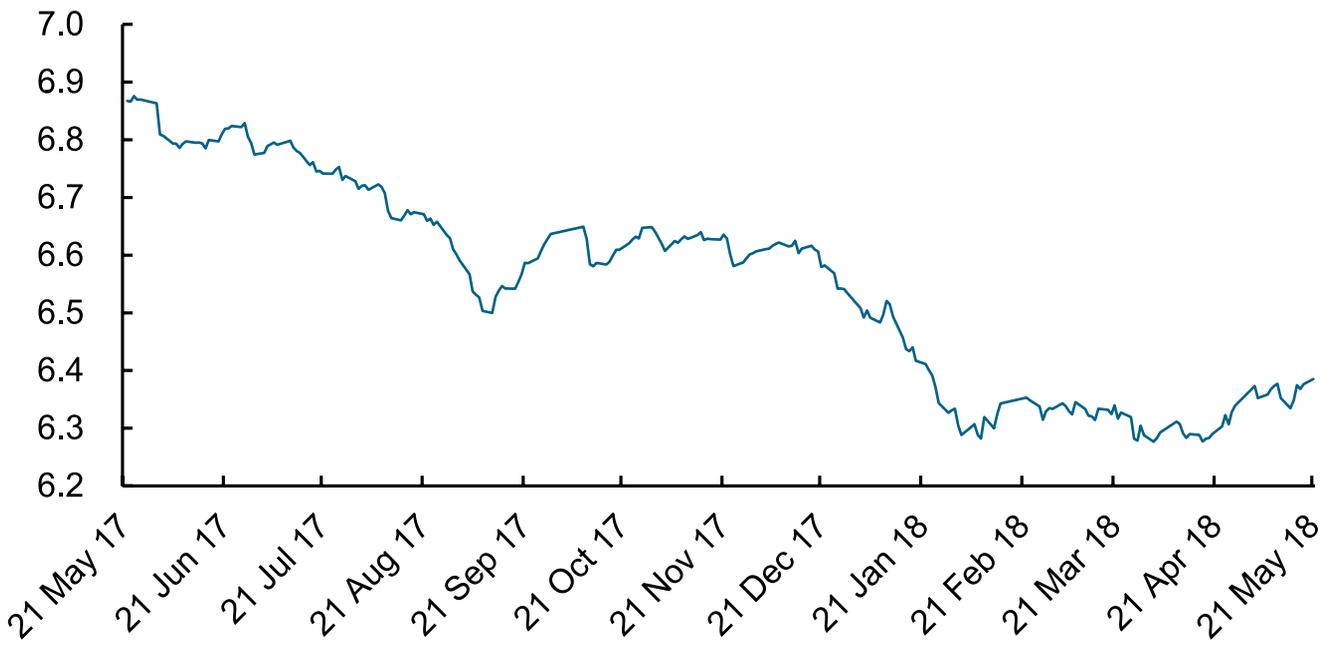
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<sup>14</sup> According to the PBOC, the daily fixing rate (also known as the central parity rate) of the Chinese yuan against the US dollar is directly formed by market makers based on the closing rate of the previous day, the supply-demand conditions in the market and the movements of major international currencies.

<sup>15</sup> The daily trading band of the Chinese yuan against the US dollar is  $\pm 2.0\%$  around the daily fixing rate.

<sup>16</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.

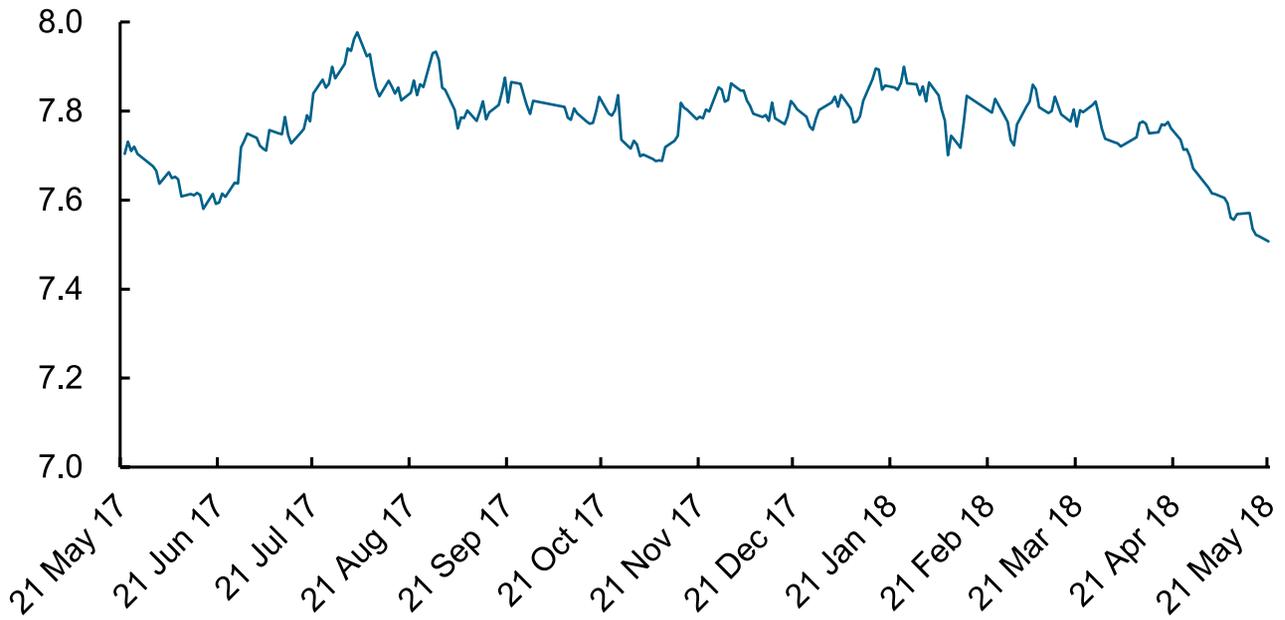
**Exhibit 33** USD-CNY daily fixing rate, May 2017 to May 2018



Source: State Administration of Foreign Exchange

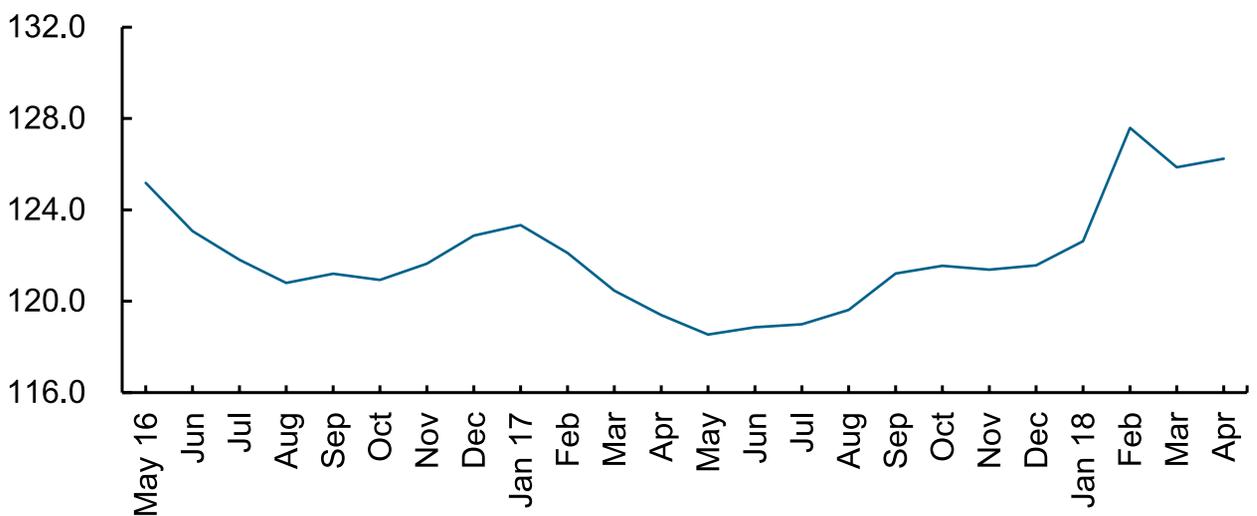
Part 2 :  
Foreign  
Trade

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



Source: State Administration of Foreign Exchange

**Exhibit 35** Real effective exchange rate of the Chinese yuan, May 2016 to April 2018



Source: Bank for International Settlements

## 2. China-US trade tensions ease temporarily after trade talk

The trade tensions between China and the US intensified during early March to mid-April, with both sides slapping each other with tit-for-tat import duties and tariff threats. (Detailed discussion about the China-US trade disputes during the period can be found in our *China-US Trade Disputes Series, Part I to VI*).<sup>17</sup>

On 17-18 May, a Chinese delegation led by China's Vice Premier Liu He, a special envoy of President Xi, travelled to Washington to have discussions about trade issues with the US delegation.

After the talk, China and the US issued a joint statement on economic and trade consultations on 19 May.<sup>18</sup> According to the statement, there is consensus on taking effective measures to substantially reduce the US trade deficit in goods with China; China will significantly increase its purchases of the US goods and services, in particular agricultural and energy products; China will amend its laws and regulations in areas of intellectual property protections, including the Patent Law. Moreover, both sides agree to create favourable conditions to increase trade in manufactured goods and services, encourage two-way investment between China and the US and create fair and level playing field for competition.

Most importantly, on the day after the release of the joint statement, the US Treasury Secretary Steven Mnuchin, one of the members of the US delegation, said that both sides agreed to put the trade war and the imposition of tariffs 'on hold'.<sup>19</sup>

## 3. China to cut import tariff rates on automobiles

Following the Chinese President Xi Jinping's pledge to cut the import tariffs on automobiles on 10 April, the Customs Tariff Commission of the State Council announced the details of the measure on 22 May. According to the announcement, the import tariff rates for automobiles would be reduced to 15% from 25% and 20%, while the import tariff rates for automobile parts would be cut to 6% from 8%, 10%, 15%, 20% and 25%, effective from 1 July this year.<sup>20</sup> According to the Ministry of Finance, the measure would bring down the average import tariff rates for automobiles and automobile parts to 13.8% and 6% respectively.

In our view, the joint statement and Mnuchin's remarks indicate that China and the US reached consensus on some important issues in the trade talk, implying that the tensions between China and the US has eased temporarily. A full-fledged trade war between China and the US can therefore be avoided, at least in near term. This is a good news to businesses, as the uncertainty over trade and investment between two sides has reduced.

However, one has to bear in mind that there is still huge difference between China and the US on some important issues, such as the Chinese government's industrial policies of supporting development of advanced manufacturing technology and the US export controls that prohibit sale of sensitive US technology items to China. To settle their major differences, both sides will still need to conduct difficult and lengthy negotiations in coming future. Any failure of negotiation would again heighten the tension between the two countries. We will continue to keep a close eye on their negotiations in coming months.

The tariff reduction on automobiles will greatly reduce the tax burden on imported automobiles, which will in turn put downward pressure on prices of imported automobiles sold in China. Both Chinese consumers and foreign automobile makers therefore stand to benefit from the move.

The tariff reduction on imported automobiles can also be regarded as another move to alleviate the China-US trade tensions. In his Twitter post on 9 April, the US President Donald Trump criticized the high tariff rate of 25% imposed on US automobiles by China.<sup>21</sup>

17 [http://www.fbicgroup.com/sites/default/files/C-US\\_0.pdf](http://www.fbicgroup.com/sites/default/files/C-US_0.pdf)

18 <https://america.cgtn.com/2018/05/19/joint-statement-of-the-united-states-and-china-regarding-trade-consultations>

19 <https://www.bloomberg.com/news/articles/2018-05-20/u-s-puts-tariffs-against-china-on-hold-mnuchin-says>

20 [http://www.mof.gov.cn/zhengwuxinxi/caizhengxinwen/201805/t20180522\\_2903781.htm](http://www.mof.gov.cn/zhengwuxinxi/caizhengxinwen/201805/t20180522_2903781.htm)

21 <https://twitter.com/realDonaldTrump/status/983284198046826496>

## C Outlook

### 1. US economic growth moderates in 1Q18

Due partly to the slower growth in personal consumption expenditures, the US economic growth moderated in 1Q18. The US real GDP expanded by an annual rate of 2.3% in 1Q18, compared to the annual growth of 2.9% in 4Q17 (*see exhibit 36*).

On the production side, industrial production grew by 0.5% mom in March, recording positive month-on-month growth in five of the past six months (*see exhibit 37*). Besides, the new orders for manufactured durable goods recorded strong month-on-month growth of 3.5% and 2.6% respectively in February and March respectively. Nevertheless, the manufacturing PMI dropped from its recent peak of 60.8 in February to 59.3 in March, and further to 57.3 in April, indicating a moderation in the growth of the manufacturing sector.

The growth of the non-manufacturing sector has also decelerated in recent months: the non-manufacturing index (NMI) fell all the way from 59.9 in January to 56.8 in April.

The US retail sales rose by 0.6% mom in March, posting first month-on-month growth in four months. Meanwhile, the Reuters/ University of Michigan index of consumer sentiment went up from 99.7 in February to 101.4 in March, the highest level since February 2004, and then stayed high at 98.8 in April (*see exhibit 38*). The index readings in the past three months suggest that the US consumers have been optimistic recently.

The non-farm payroll employment rose at a relatively low pace, by 164,000, in April, below the 12-month average of 190,000. That being said, the US unemployment rate fell from 4.1% in March to 3.9% in April, the lowest level since 2000, indicating the strength of the labour market in the US (*see exhibit 39*).

Looking ahead, the US economic growth is likely to further accelerate in near term, especially as the tax reform beginning this year will lead to a reduction in tax burdens. According to the latest projection by the IMF, the real GDP growth rate for the US is forecast to be 2.9% in 2018, up from 2.3% in 2017.<sup>22</sup>

**Exhibit 36** US national accounts, 2016 to 1Q18

Annual growth (%)	2016	2017	2Q17	3Q17	4Q17	1Q18
Real GDP	1.5	2.3	3.1	3.2	2.9	2.3

Source: US Department of Commerce

**Exhibit 37** US industrial sector, October 2017 to March 2018

mom growth (%), seasonally adjusted	Oct 17	Nov	Dec	Jan 18	Feb	Mar
Industrial production	1.5	0.5	0.5	-0.2	1.0	0.5
New orders for manufactured durable goods	-0.4	1.7	2.7	-3.6	3.5	2.6

Source: US Federal Reserve, US Department of Commerce

**Exhibit 38** US consumer market, November 2017 to April 2018

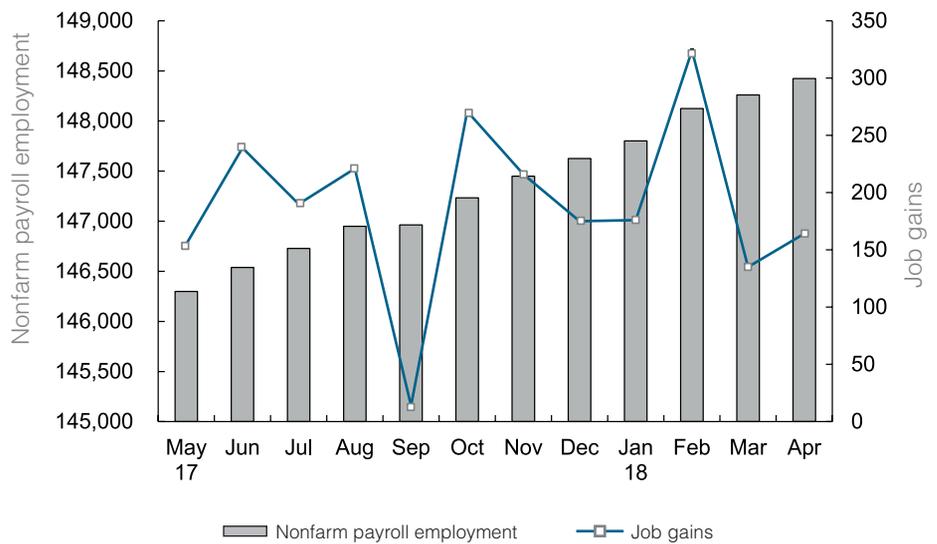
	Nov 17	Dec	Jan 18	Feb	Mar	Apr
Retail and food services sales (mom growth %, seasonally adjusted)	0.8	-0.1	-0.2	-0.1	0.6	-
Reuters/University of Michigan index of consumer sentiment	98.5	95.9	95.7	99.7	101.4	98.8
CPI (yoy growth %)	2.2	2.1	2.1	2.2	2.4	-

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
May 17	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
Feb	4.1
Mar	4.1
Apr	3.9

Nonfarm payroll employment, May 2017 to April 2018  
In thousands, seasonally adjusted



Yearly figures: Annual average  
Monthly figures: Seasonally adjusted

Source: US Department of Labor

## 2. Eurozone economy shows signs of moderation

The Eurozone economy has shown signs of moderation recently. The real GDP growth in the Eurozone came in at 0.4% qoq in 1Q18, down from 0.7% qoq in 4Q17.<sup>23</sup> Besides, according to the global survey firm Markit Economics, the Eurozone manufacturing PMI fell all the way from 60.6 in December to 56.2 in April, indicating

a growth deceleration of the manufacturing sector in the region. Meanwhile, the Eurozone services PMI has generally been on a downward trend since January this year, showing that the service sector in the region has expanded at a slower pace lately.

<sup>23</sup> The member countries of the Eurozone include Austria, Belgium, Cyprus, Estonia, Finland, France, Germany, Greece, Ireland, Italy, Latvia, Lithuania, Luxembourg, Malta, the Netherlands, Portugal, Slovakia, Slovenia and Spain.

## Part 2 : Foreign Trade

The retail trade volume in the Eurozone posted weak growth of 0.3% mom and 0.1% mom in February and March respectively on a seasonally adjusted basis, after falling by 1.1% mom and 0.3% mom in December and January respectively (*see exhibit 41*).

The labour market conditions in the region have further improved recently. The seasonally-adjusted unemployment rate fell from 8.6% in January to 8.5% in February and March (*see exhibit 42*). Nevertheless, consumers and managers in various sectors have been become less optimistic about the economic outlook. The

Eurozone's economic sentiment indicator (ESI) dropped all the way from 115.3 in December, the highest level in seventeen years, to 112.7 in March and April (*see exhibit 43*).

Going forward, supported by an expansionary monetary policy, the Eurozone economy is expected to maintain the current pace of growth in near future. In its latest World Economic Outlook published in April, the IMF forecasts that the real GDP growth rate for the Eurozone will improve slightly to 2.4% in 2018 from 2.3% in 2017.<sup>24</sup>

**Exhibit 40** Eurozone's real GDP growth, 2016 to 1Q18

	2016	2017	2Q17	3Q17	4Q17	1Q18
Real GDP ( <i>qoq growth %</i> )			0.7	0.7	0.7	0.4
Real GDP ( <i>yoy growth %</i> )	1.8	2.3	2.4	2.7	2.8	2.5

Source: Eurostat, World Bank

**Exhibit 41** Eurozone consumer market, October 2017 to March 2018

	Oct 17	Nov	Dec	Jan 18	Feb	Mar
Volume of retail trade ( <i>mom growth %, seasonally ad-justed</i> )	-1.1	2.0	-1.1	-0.3	0.3	0.1
Annual inflation (%)	1.4	1.5	1.4	1.3	1.1	1.3

Source: Eurostat

**Exhibit 42** Eurozone labour market, October 2017 to March 2018

<i>seasonally adjusted</i>	Oct 17	Nov	Dec	Jan 18	Feb	Mar
Unemployment rate (%)	8.8	8.7	8.6	8.6	8.5	8.5

Source: Eurostat

**Exhibit 43** Eurozone economic sentiment indicator, November 2017 to April 2018

<i>seasonally adjusted</i>	Nov 17	Dec	Jan 18	Feb	Mar	Apr
Economic sentiment indicator	114.4	115.3	115.1	114.4	112.7	112.7

Source: Eurostat

### 3. China's exports are expected to show double-digit growth in 2Q18

According to the *World Economic Outlook* released in mid-April, the IMF forecasts that the world economic growth will accelerate modestly from 3.8% in 2017 to 3.9% in 2018 and 2019, partly based on its expectations about the large US fiscal stimulus this year and next. The growth in the advanced economies is projected to rise from 2.3% in 2017 to 2.5% in 2018. Meanwhile, the growth in the emerging market and developing economies is projected to accelerate from 4.8% in 2017 to 4.9% in 2018 (see exhibit 44).

Looking ahead, the strong 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 continue to show double-digit year-on-year growth in 2Q18. Challenges facing Chinese manufacturers, however, include the greater uncertainty in the US trade policies under the Trump administration, stronger government's efforts to enforce environmental regulations, a marked increase in prices of materials, intense competition in the international market, and the weak demand for luxury products.

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

<i>yoy growth (%)</i>	2017 (Estimates)	2018 (Forecasts)	2019 (Forecasts)
World economy	3.8	3.9	3.9
Advanced economies	2.3	2.5	2.2
US	2.3	2.9	2.7
Eurozone	2.3	2.4	2.0
Japan	1.7	1.2	0.9
Emerging market and developing economies	4.8	4.9	5.1
China	6.9	6.6	6.4
India *	6.7	7.4	7.8
Brazil	1.0	2.3	2.5
Russia	1.5	1.7	1.5

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

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

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