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Domestic Trade

Retail sales of consumer goods grow by 9.0% yoy in 2018.

Growth in nominal fixed asset investment falls to 5.9% yoy in 2018.

China announces plan to boost consumption.

Entrepreneur Confidence Index for secondary industry drops in 4Q18.

Manufacturing sector continues to contract.

January NMI indicates an acceleration in growth of non-manufacturing sector.

Foreign Trade

Growth rates of both exports and imports decelerate in 4Q18.

Exports to US, EU and Japan maintain stable growth in 2018.

Exports from Guangdong and Shanghai post relatively slow growth in 2018.

FDI increases by 0.9% yoy in 2018.

Foreign exchange reserves decrease for third quarter in a row.

China and US hold trade talks after reaching trade war truce.

Chinese yuan appreciates against US dollar in recent months.

FUNG BUSINESS INTELLIGENCE

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Executive Summary

Domestic Trade

Retail sales of consumer goods reached 38,098.7 billion yuan in 2018, up by 9.0% yoy. Online retail sales of goods, which accounted for 18.4% of total retail sales, increased markedly by 25.4% yoy over the period.

Growth in nominal fixed asset investment fell to 5.9% yoy in 2018 from 7.2% yoy in 2017, mainly attributable to the FAI growth deceleration in infrastructure (excluding power, heat, gas and water infrastructure).

On 29 January, the National Development and Reform Commission, together with nine government departments, published the *'Implementation plan on improving supply for promoting steady growth of consumption and building a strong domestic market (2019)'*. The plan covers six areas, including auto consumption, urban consumption, rural consumption, sales of new products, supply of products and services with high quality and market environment. Policies include introduction of 'old-for-new' subsidies for car and home appliance purchases and subsidies for purchases of green and smart home appliances, increase in subsidies for purchases of new energy vehicles, etc.

Entrepreneur Confidence Index for the secondary industry dropped from 127.3 in 3Q18 to 123.5 in 4Q18, indicating that Chinese entrepreneurs have become less optimistic recently.

Manufacturing sector has continued to contract. The manufacturing PMI registered 49.4 and 49.5 in December and January respectively, staying below the critical 50-mark for two consecutive months.

January NMI indicates an acceleration in growth of non-manufacturing sector. The NMI rose to 54.7 in January, the highest level in four months.

Foreign Trade

Growth rates of both exports and imports decelerated in 4Q18. Export growth decelerated to 4.6% yoy in 4Q18 from 11.6% yoy in 3Q18, while import growth fell to 4.8% yoy in 4Q18 from 20.7% yoy in 3Q18.

Exports to major trade partners maintained stable growth in 2018. Growth rates of China's exports to the US, the EU and Japan registered 11.3% yoy, 9.8% yoy and 7.2% yoy respectively in 2018, close to the growth rates of 11.5% yoy, 9.7% yoy and 6.1% yoy respectively registered in 2017.

Exports from Guangdong and Shanghai posted relatively slow growth in 2018. Exports from Guangdong and Shanghai expanded by 4.7% yoy and 4.0% yoy, respectively, in 2018, lower than the country's total export growth (9.9% yoy) for the year.

FDI increased by 0.9% yoy to 885.6 billion yuan in 2018. FDI in the manufacturing industries grew by 20.1% yoy to 271.0 billion yuan, accounting for 30.6% of the total FDI in the year.

Foreign exchange reserves amounted to US$ 3,072.7 billion as at the end of 4Q18, down by US$ 14.3 billion compared with end-3Q18. This was the third quarter in a row that the foreign exchange reserves posted a quarter-on-quarter drop.

China and US have held trade talks after reaching trade war truce. Following trade talks held by a Chinese delegation led by Vice-Premier Liu He and a US delegation led by US Trade Representative Robert Lighthizer in Washington on 30-31 January, the US trade delegation visited Beijing on 14-15 February to continue the trade talks. A new round of talks is being held in Washington on 21-22 February. According to media reports, although China and the US remain far apart on structural issues regarding China's economy, a broad outline of a potential trade deal is beginning to emerge, as the two countries push for an agreement by 1 March.

Chinese yuan has appreciated against the US dollar in recent months. The USD-CNY spot exchange rate has appreciated by 2.91% since 28 November last year when the exchange rate closed at its recent low of 6.9560 (*as of 13 February*).

A Recent developments

1. China's real GDP growth moderates further to 6.4% in 4Q18

China's real GDP growth fell from 6.5% year-on-year (yoy) in 3Q18 to 6.4% yoy in 4Q18, indicating that the country's economic growth has further decelerated in recent months. One of the main reasons behind the growth deceleration in 4Q18 was that the ongoing China-US trade war hit export demand and consumer sentiments (*see exhibit 1*). Overall, in 2018, China's nominal GDP amounted to 90.0 trillion yuan. The real growth rate in 2018 was 6.6% yoy, the lowest level since 1991.

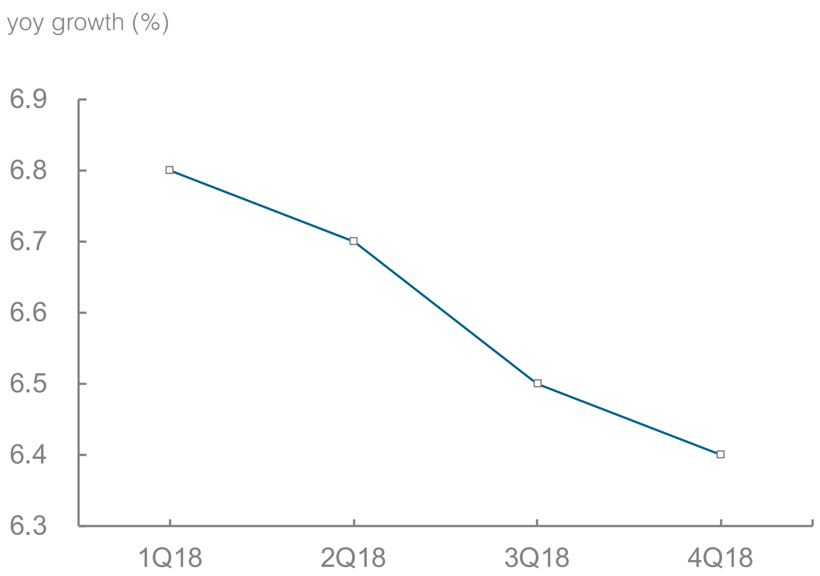
Both the tertiary industry and the secondary industry witnessed growth deceleration in 2018. The real growth rate for the value-added of the tertiary industry came in at 7.6% yoy in 2018, lower than the 8.0% yoy growth in 2017. In the meantime, the real growth rate for the value-added of the secondary industry was 5.8% yoy in 2018, down from the 6.1% yoy growth in 2017.

In 2018, final consumption expenditure contributed 5.0 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, we expect that the central government will increase its efforts to stimulate China's economy. The Central Economic Work Conference, a meeting which sets the tone for the economic tasks this year, was held on 19-21 December last year. According to the statement issued after the conference, China will take stronger and more effective actions to carry out the proactive fiscal policy; more significant tax and fee cuts will be introduced and the issuance of special local government bonds will be increased substantially; the prudent monetary policy should be 'neither too tight nor too loose', and the government will keep liquidity 'reasonably ample', improve monetary policy transmission, increase direct financing, solve financing difficulties and lower financing costs for private enterprises and small businesses. We believe that these policies will help alleviate the downward pressure on the Chinese economy.

Going forward, we predict that the real GDP growth will decelerate from 6.4% yoy in 4Q18 to 6.3% yoy in 1Q19.

Exhibit 1 China's real GDP growth, 1Q18 to 4Q18



FY18	6.6%
1Q18	6.8%
2Q18	6.7%
3Q18	6.5%
4Q18	6.4%

Source: National Bureau of Statistics, PRC

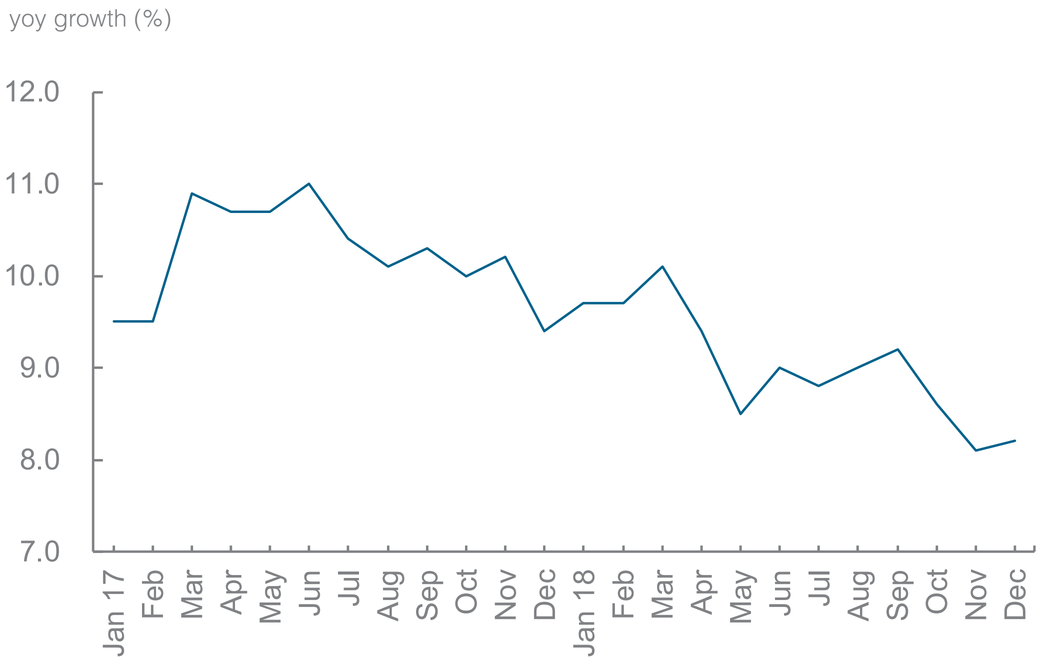
2. Growth in retail sales stays low in December

According to the National Bureau of Statistics, the growth in China's total retail sales of consumer goods decelerated from 9.2% yoy in September to 8.6% yoy in October and 8.1% yoy in November, and then stayed low at 8.2% yoy in December. The month-on-month (mom) growth in seasonally-adjusted retail sales fell from 0.63% in October to 0.50% in November, before rebounding to 0.55% in December.

Overall, in 2018, the total retail sales of consumer goods reached 38,098.7 billion yuan. The growth rate was 9.0% yoy in 2018, lower than the 10.2% yoy growth recorded in 2017 (*see exhibits 2 and 3*).

China's online retail sales of goods increased by 25.4% yoy to reach 7,019.8 billion yuan in 2018. Consequently, the share of online retail sales in the total retail sales of consumer goods went up to 18.4% in 2018 from 15.0% in 2017, indicating the rapidly growing popularity of online shopping.

Exhibit 2 China's total retail sales, year-on-year nominal growth, January 2017 to December 2018



FY18	9.0%
Jan-Feb 18	9.7%
Mar	10.1%
Apr	9.4%
May	8.5%
Jun	9.0%
Jul	8.8%
Aug	9.0%
Sep	9.2%
Oct	8.6%
Nov	8.1%
Dec	8.2%

Source: National Bureau of Statistics, PRC

Exhibit 3 China's total retail sales, month-on-month nominal growth, July to December 2018

mom growth (%), seasonally adjusted

	Jul 18	Aug	Sep	Oct	Nov	Dec
Total retail sales	0.79	0.63	0.53	0.63	0.50	0.55

Source: National Bureau of Statistics, PRC

Both rural and urban retail sales have increased at a slower pace: the growth in rural retail sales moderated to 10.1% yoy in 2018 from 11.8% yoy in 2017. In the meantime, the growth in urban retail sales decelerated to 8.8% yoy in 2018 from 10.0% yoy in 2017.

The growth in catering services sales came in at 9.5% yoy in 2018, down from 10.7% yoy in 2017. Meanwhile, the growth in sales of goods decelerated to 8.9% yoy in 2018 from 10.2% yoy in 2017.

The growth rate for the retail sales of goods by enterprises above a designated size[1], which amounted to 13,607.5 billion yuan in 2018, decelerated to 5.7% yoy in 2018 from 8.2% yoy in 2017. Among products, 'products for daily use' saw the strongest growth in sales (13.7% yoy) in 2018, followed by 'petroleum and related products' (13.3% yoy). In contrast, sales of 'sports and entertainment products' registered a negative growth of minus 2.7% 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 2018

Nominal growth, yoy (%)	FY17	1Q18	1H18	1-3Q18	FY18
Total retail sales	10.2	9.8	9.4	9.3	9.0
- Goods	10.2	9.8	9.3	9.2	8.9
Sales by enterprises above a designated size	8.2	8.6	7.6	6.9	5.7
Online sales	28.0	34.4	29.8	27.7	25.4
- Catering services	10.7	10.3	9.9	9.8	9.5

Source: National Bureau of Statistics, PRC

3. Chinese consumers become more optimistic

The consumer confidence index[2] rose from 118.5 in September to 119.1 in October, and further to 122.1 in December. These figures show that Chinese consumers have become more optimistic recently (*see exhibit 6*).

4. Growth of rural households' income shows slight acceleration in 2018

The growth of rural households' income showed a slight acceleration in 2018. The nominal growth rate of the per capita disposable income of rural households, which amounted to 14,617 yuan in 2018, improved to 8.8% yoy in 2018 from 8.6% yoy in 2017. In contrast, the nominal growth rate of the per capita disposable income of urban households, which totalled 39,251 yuan in 2018, decelerated to 7.8% yoy in 2018 from 8.3% yoy in 2017.

Both rural and urban households' consumption expenditures increased at a faster pace in 2018, compared to 2017. The nominal growth rate of the per capita consumption expenditure of rural households, which reached 12,124 yuan in 2018, accelerated to 10.7% yoy in 2018 from 8.1% yoy in 2017. Meanwhile, the per capita consumption expenditure of urban households, which amounted to 26,112 yuan in 2018, rose to 6.8% yoy in 2018 from 5.9% yoy in 2017.

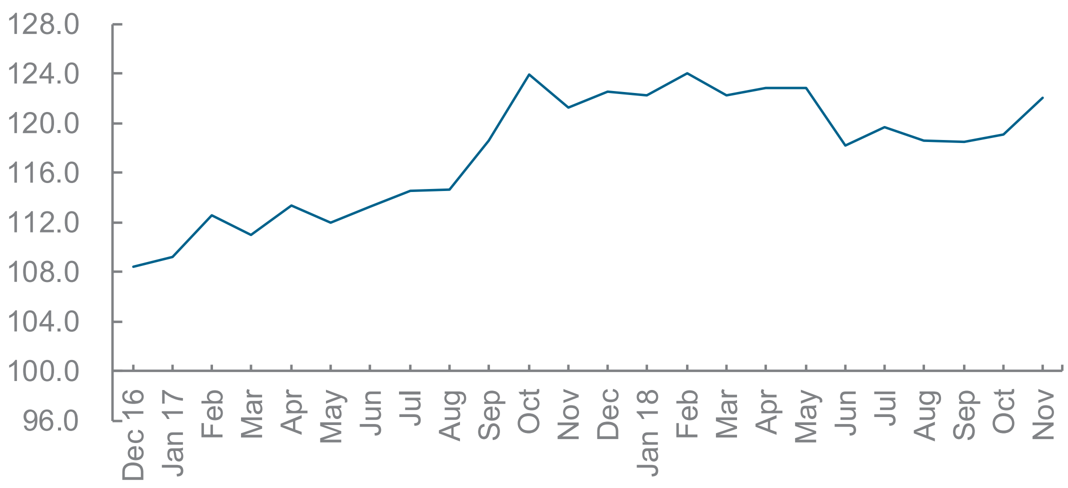
1 'Enterprises above a designated size' refers to enterprises with annual sales of 5 million yuan or more and with an employee strength of 60 or more.
2 A reading above 100 indicates that consumers tend to be optimistic; a reading below 100 indicates that consumers tend to be pessimistic.

Exhibit 5 China's retail sales by enterprises above a designated size, by product, 2017 to 2018

Nominal growth, yoy (%)	FY17	1Q18	1H18	1-3Q18	FY18
Grain, oil and food	10.2	10.1	9.8	10.3	10.2
Beverages	10.3	9.1	9.6	9.2	9.0
Tobacco and liquor	7.9	9.2	8.9	8.6	7.4
Clothing, shoes, hats and textiles	7.8	9.8	9.2	8.9	8.0
Cosmetics	13.5	16.1	14.2	12.0	9.6
Gold, silver and jewellery	5.6	7.9	7.4	8.7	7.4
Products for daily use	8.0	12.3	12.6	13.4	13.7
Sports and entertainment products	15.6	1.3	-0.1	-1.3	-2.7
Home appliances and video equipment	9.3	11.4	10.6	8.2	8.9
Chinese and Western medicines	12.4	10.4	9.3	9.1	9.4
Stationery and office accessories	9.8	4.0	6.6	5.7	3.0
Furniture	12.8	9.3	10.1	10.1	10.1
Telecommunications equipment	11.7	7.7	10.6	10.7	7.1
Petroleum and related products	9.2	9.1	11.9	14.4	13.3
Automobiles	5.6	7.4	2.7	0.2	-2.4
Building and decoration materials	10.3	8.0	8.1	7.8	8.1

Source: National Bureau of Statistics, PRC

Exhibit 6 China's consumer confidence index, December 2016 to November 2018



Dec 17	122.6
Jan 18	122.3
Feb	124.0
Mar	122.3
Apr	122.9
May	122.9
Jun	118.2
Jul	119.7
Aug	118.6
Sep	118.5
Oct	119.1
Nov	122.1

Source: National Bureau of Statistics, PRC

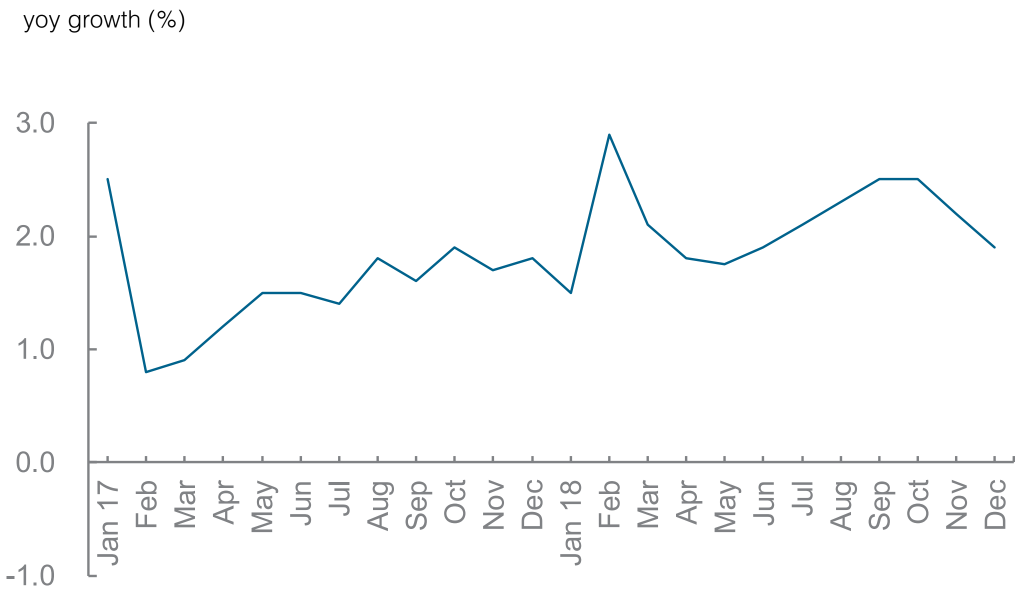
5. CPI growth decelerates in December

The year-on-year growth rate of China's consumer price index (CPI)[3] decelerated to 1.9% in December from 2.2% in November (*see exhibits 7 & 8*).

The fall in the CPI growth in December was the result of a drop in non-food inflation in the month. Due partly to the recent fall in prices of gasoline and diesel, the year-on-year growth in the non-food component went down from 2.1% in November to 1.7% in December. Meanwhile, the year-on-year growth of the food component in the CPI was 2.5% yoy in December, the same as in November.

Looking ahead, we expect that China's CPI growth will fall further in the near term, as the domestic demand is likely to continue to moderate due to weakening confidence among consumers and enterprises amid the China-US trade war.

Exhibit 7 China's CPI growth, January 2017 to December 2018



Jan 18	1.5%
Feb	2.9%
Mar	2.1%
Apr	1.8%
May	1.8%
Jun	1.9%
Jul	2.1%
Aug	2.3%
Sep	2.5%
Oct	2.5%
Nov	2.2%
Dec	1.9%

Source: National Bureau of Statistics, PRC

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

Exhibit 8 China's CPI growth by commodity, July to December 2018[4]

yoy growth (%)	Jul 18	Aug	Sep	Oct	Nov	Dec
Food, tobacco and liquor	1.0	1.9	3.0	2.9	2.5	2.4
Clothing	1.2	1.3	1.2	1.4	1.4	1.5
Housing	2.4	2.5	2.6	2.5	2.4	2.2
Household goods and services	1.6	1.6	1.6	1.5	1.5	1.4
Transportation and communication	3.0	2.7	2.8	3.2	1.6	-0.7
Education, culture and recreational activities	2.3	2.6	2.2	2.5	2.5	2.3
Medical and healthcare	4.6	4.3	2.7	2.6	2.6	2.5
Other goods and services	1.2	1.2	0.7	1.3	1.5	1.6

Source: National Bureau of Statistics, PRC

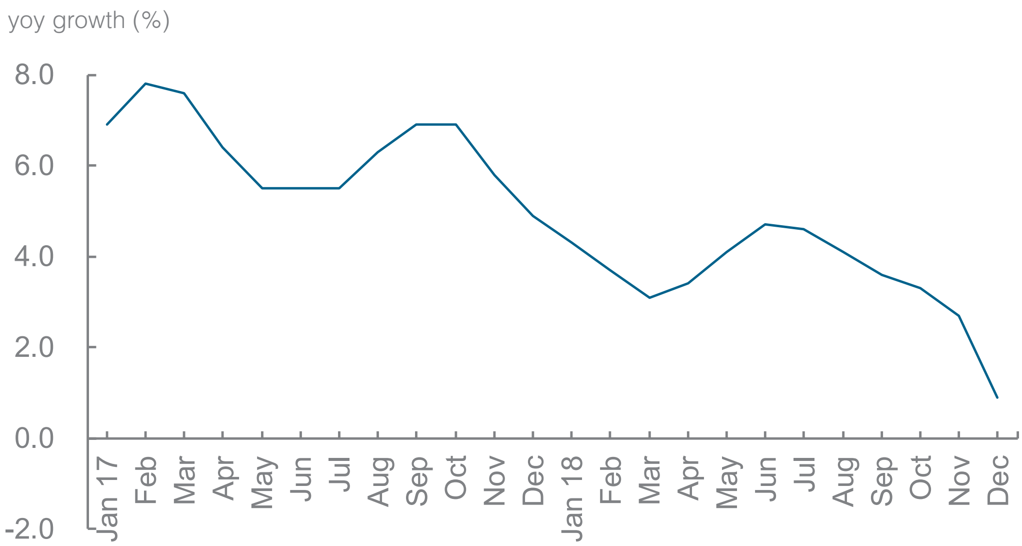
The year-on-year growth in China's producer price index of industrial products (PPI) fell from 2.7% in November to 0.9% in December (*see exhibits 9 & 10*).

On a month-on-month basis, the PPI dropped by 1.0% in December, posting a fall for two consecutive months. The decrease in the PPI in the month was caused mainly by lower ex-factory prices in the 'extraction of petroleum and natural gas', 'processing of petroleum, coking, processing of nucleus fuel', 'manufacture of chemical raw material and chemical products' and 'manufacture and processing of ferrous metals' industries.

Looking forward, we expect that China's ex-factory prices of industrial products will drop further and thus the year-on-year growth in the PPI will continue to decelerate soon, due mainly to the weakening demand and the fall in upstream prices. Moreover, the government has recently relaxed its controls on the production activities of key polluting industries. Such a move would in turn lead to an increase in output and thus lower prices of products in those industries.

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

Exhibit 9 China's PPI growth, January 2017 to December 2018



Jan 18	4.3%
Feb	3.7%
Mar	3.1%
Apr	3.4%
May	4.1%
Jun	4.7%
Jul	4.6%
Aug	4.1%
Sep	3.6%
Oct	3.3%
Nov	2.7%
Dec	0.9%

Source: National Bureau of Statistics, PRC

Exhibit 10 China's PPI growth by selected industry, July to December 2018

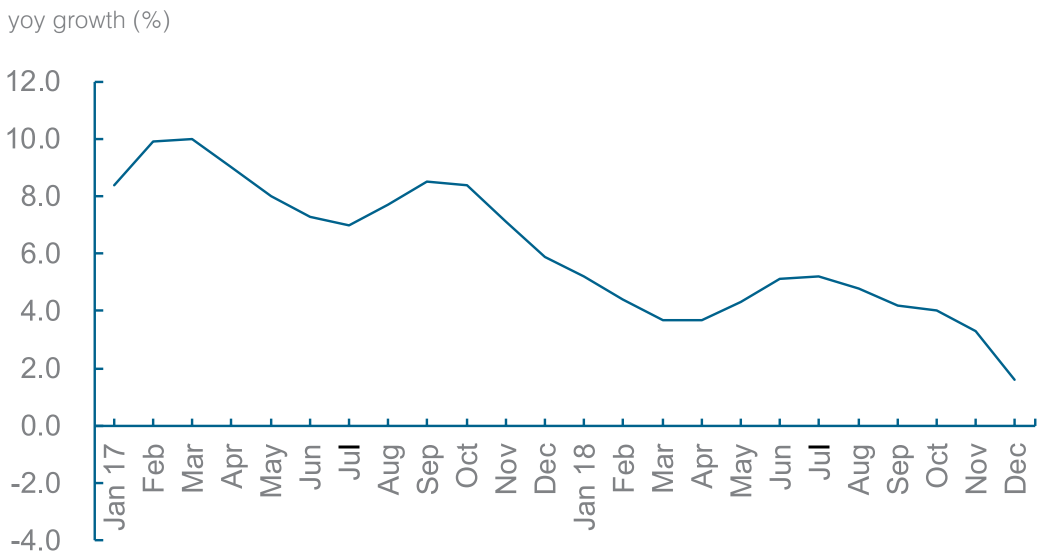
yoy growth (%)	Jul 18	Aug	Sep	Oct	Nov	Dec
Textile	2.3	3.0	3.1	3.1	2.8	1.7
Textile wearing apparel and ornament	1.1	1.3	1.4	1.4	1.6	1.7
Processing of timbers, manufacture of wood, bamboo, rattan, palm, and straw products	2.0	2.2	2.2	1.9	1.6	1.2

Source: National Bureau of Statistics, PRC

The year-on-year growth rate of the purchaser price index of industrial products fell from 3.3% in November to 1.6% in December (*see exhibits 11 & 12*). On a month-on-month basis, the purchaser price index dropped by 0.9% in December, registering its first fall in eight months.

The input prices sub-index of China's manufacturing PMI, a leading indicator of upstream prices, dropped markedly from 50.3 in November to 44.8 in December, and then stayed low at 46.3 in January. As the index has fallen below the critical 50-mark since December, we expect the purchaser price index of industrial products to drop further in the near future.

Exhibit 11 Growth in China's purchaser price index of industrial products, January 2017 to December 2018



Jan 18	5.2%
Feb	4.4%
Mar	3.7%
Apr	3.7%
May	4.3%
Jun	5.1%
Jul	5.2%
Aug	4.8%
Sep	4.2%
Oct	4.0%
Nov	3.3%
Dec	1.6%

Source: National Bureau of Statistics, PRC

Exhibit 12 China's purchaser price index of industrial products by selected commodity, July to December 2018

yoy growth (%)	Jul 18	Aug	Sep	Oct	Nov	Dec
Fuel and power	9.9	9.7	9.2	9.4	7.9	3.8
Non-ferrous metal materials and wires	5.6	2.5	-0.4	-1.7	-2.1	-2.0
Chemical raw materials	5.7	6.1	5.8	5.3	3.2	0.3
Wood and pulp	7.1	6.6	4.5	2.6	1.6	1.4
Textile raw materials	2.4	2.6	2.9	2.7	2.3	1.9

Source: National Bureau of Statistics, PRC

6. Growth in industrial production rebounds to 5.7% in December

The growth rate for China's industrial production (IP), measured by the value-added of industrial output (VAIO), decelerated from 5.9% yoy in October to 5.4% yoy in November, but then rebounded to 5.7% yoy in December (*see exhibit 13*).[5] Overall, in 2018, China's IP expanded by 6.2% yoy, lower than the 6.6% yoy growth recorded in 2017.

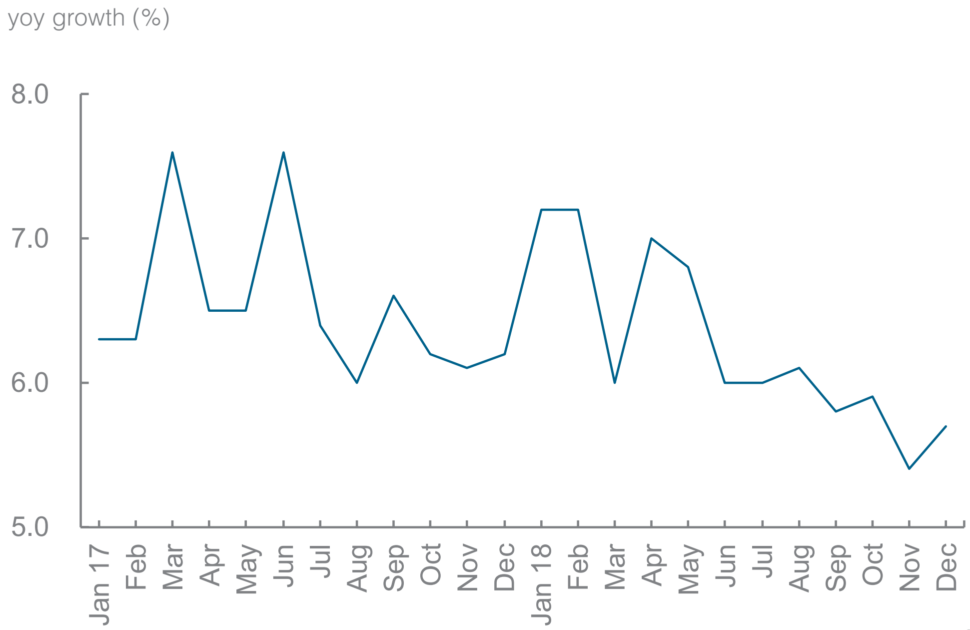
Looking ahead, we expect that the industrial production (VAIO) growth will moderate to around 5.0-5.5% yoy in 1Q19. Challenges facing Chinese manufacturers include ongoing trade frictions between China and the US, strong government's determination to tackle pollution problem, intense competition in the international market, and the weak demand for luxury products.

7. Industrial profits record negative growth in November and December

After increasing by 3.6% yoy in October, the total profits earned by large and medium industrial enterprises above a designated size[6] recorded negative year-on-year growth of minus 1.8% and minus 1.9% in November and December respectively. In 2018, China's industrial profits totalled 6,635.1 billion yuan, up by 10.3% yoy (*see exhibit 14*).

Among sectors, in 2018, profits of the manufacturing sector rose by 8.7% yoy to 5,696.5 billion yuan; profits of the mining sector increased by 40.1% yoy to 524.6 billion yuan; and profits of the 'electricity, heat, gas and water' sector grew by 4.3% yoy to 414.1 billion yuan.

Exhibit 13 China's industrial production growth, January 2017 to December 2018



Jan-Feb 18	7.2%
Mar	6.0%
Apr	7.0%
May	6.8%
Jun	6.0%
Jul	6.0%
Aug	6.1%
Sep	5.8%
Oct	5.9%
Nov	5.4%
Dec	5.7%

Source: National Bureau of Statistics, PRC

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

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

Exhibit 14 China's industrial profits growth, July to December 2018

yoy growth (%)	Jul 18	Aug	Sep	Oct	Nov	Dec
Total profits made by industrial enterprises above a designated size	16.2	9.2	4.1	3.6	-1.8	-1.9

Source: National Bureau of Statistics, PRC

8. Fixed asset investment growth falls in 2018

The growth in China's nominal fixed asset investment (FAI) (excluding rural households) fell to 5.9% yoy in 2018 from 7.2% yoy in 2017.[7] Overall, in 2018, China's nominal FAI (excluding rural households) amounted to 63.6 trillion yuan (*see exhibit 15*).

The drop in the overall FAI growth was mainly attributable to the deceleration of FAI growth for infrastructure (excluding power, heat, gas and water infrastructure), which fell markedly to 3.8% yoy in 2018 from 19.0% yoy in 2017. In contrast, the growth in FAI (excluding rural households) for the manufacturing sector accelerated to 9.5% yoy in 2018 from 4.8% yoy in 2017; the growth in FAI (excluding rural households) in real estate development went up to 9.5% yoy in 2018 from 7.0% yoy in 2017.

Looking ahead, we predict that the growth in China's FAI will rebound this year. To avert economic slowdown, China's government has increased its efforts to stimulate infrastructure investment. For example, according to the statement issued after the Central Economic Work conference held on 19-21 December last year, the central government plans to increase investment in areas of artificial intelligence, the Industrial Internet, the Internet of things, transportation, logistics and public facilities. Besides, local governments can start to issue their bonds as early as January this year versus March in the past, as the Standing Committee of the National People's Congress has recently approved the State Council to allocate the 2019 quotas of local government bonds to local governments, which was set at 1.39 trillion yuan. Such a move will enable local governments to boost their infrastructure investment.

Exhibit 15 China's FAI (excluding rural households) growth, July to December 2018

	Jul 18	Aug	Sep	Oct	Nov	Dec
FAI (excluding rural households) *(year-to-date, yoy growth %)*	5.5	5.3	5.4	5.7	5.9	5.9
FAI (excluding rural households) *(mom growth %, seasonally adjusted)*	0.43	0.43	0.44	0.45	0.43	0.42

Source: National Bureau of Statistics, PRC

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

B Highlights

1. China announces plan to boost consumption

To boost consumption, the National Development and Reform Commission, together with nine government departments, published the *'Implementation plan on improving supply for promoting steady growth of consumption and building a strong domestic market (2019)'* on 29 January.[8]

The plan covers six areas, including auto consumption, urban consumption, rural consumption, sales of new products, supply of products and services with high quality and market environment.[9] Policies include introduction of 'old-for-new' subsidies for car and home appliance purchases and subsidies for purchases of green and smart home appliances, increase in subsidies for purchases of new energy vehicles, cut in value-added tax rate on second hand auto dealers, introduction of subsidies on housing facilities for the elderly in old residential buildings in selected districts, quicker issuance of 5G commercial licenses, etc. Looking ahead, we expect the details of the policies to be released gradually in coming months.

2. Growth of total outstanding RMB loans accelerates

The total outstanding RMB loans have grown at a faster pace recently, attributable to the Chinese central bank's easing measures (*see exhibit 16*). The growth rate of the total outstanding RMB loans was 13.5% yoy as at the end of December, higher than the 13.2% yoy growth as at the end of September. Overall, in 2018, the rise in the total outstanding RMB loans amounted to 16.17 trillion yuan, higher than the increase seen in 2017 (i.e. 13.53 trillion yuan).

Meanwhile, the growth of the broad money supply (M2) has decelerated lately. The M2 growth softened to 8.1% yoy as at the end of December, compared to 8.3% yoy as at the end of September.

The People's Bank of China (PBoC), China's central bank, has continued to take actions to inject liquidity in the banking system recently. For example, on 4 January, it announced to reduce the reserve requirement ratios (RRRs) of financial institutions in China by 50 bps on 15 January and 25 January. As banks' loans borrowed via the medium-term lending facility (MLF) from the PBoC which will mature in 1Q19 would not be renewed, banks have to use parts of the funds to pay back their loans. Taking into account the repayment of MLF loans and other recent central bank's moves to inject liquidity into the banking system, the PBoC estimates that this RRR cut would provide extra funds of 800 billion yuan to banks.[10]

The Central Economic Work Conference, a meeting which sets the tone for the economic tasks this year, was held on 19-21 December last year. According to the summary of the conference published by the state-run Xinhua News Agency on 21 December, the prudent monetary policy should be 'neither too tight nor too loose'. It is noteworthy that the wordings were different from those used before: according to an announcement published by the central bank on 19 December, China would 'maintain a prudent and neutral monetary policy'.[11] In our view, the change in wordings implies that the monetary policy is likely to become more accommodative in the near future.

3. 'Total social financing' increases at a slower pace in 4Q18

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, local government special bonds, equity issuance, asset-backed securities of depository financial institutions, written-off loans and other instruments) amounted to 19.3 trillion yuan in 2018, smaller than the increase seen in 2017 (i.e. 22.4 trillion yuan) (*see exhibit 17*).[12]

On a quarter-on-quarter basis, the 'total social financing' increased at a slower pace by 3.9 trillion yuan in 4Q18, after rising by 5.3 trillion yuan in 3Q18. The slowdown in the increase in the 'total social financing' in 4Q18 was due mainly to a smaller rise in RMB loans and slower issuance of local government special bonds.

8 http://www.ndrc.gov.cn/zcfb/zcfbtz/201901/t20190129_926565.html

9 http://www.ndrc.gov.cn/zcfb/zcfbtz/201901/W020190129289300711236.pdf

10 Other recent central bank's moves to inject liquidity into banking system include an introduction of 'Targeted Medium-Term Lending Facility' (TMLF) and the relaxation of evaluation threshold for inclusive financing for qualifying more financial institutions to enjoy a lower RRRs.

11 http://www.pbc.gov.cn/goutongjiaoliu/113456/113469/3719703/index.html

12 The People's Bank of China has changed the statistical method of the total social financing recently, incorporating 'local government special bonds', 'asset-backed securities of depository financial institutions' and 'written-off loans'. Consequently, the figures of the total social financing have been readjusted.

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

As of	Broad money supply (M2) Amount (trillion yuan)	Broad money supply (M2) yoy growth	Total outstanding RMB loans Amount (trillion yuan)	Total outstanding RMB loans yoy growth	Increase in RMB loans (trillion yuan)	
					FY17	13.53
					FY18	16.17
End-Jan 18	172.1	8.6%	123.0	13.2%	Jan 18	2.90
End-Feb	172.9	8.8%	123.9	12.8%	Feb	0.84
End-Mar	174.0	8.2%	125.0	12.8%	Mar	1.12
End-Apr	173.8	8.3%	126.2	12.7%	Apr	1.18
End-May	174.3	8.3%	127.3	12.6%	May	1.15
End-Jun	177.0	8.0%	129.2	12.7%	Jun	1.84
End-Jul	177.6	8.5%	130.6	13.2%	Jul	1.45
End-Aug	178.9	8.2%	131.9	13.2%	Aug	1.28
End-Sep	180.2	8.3%	133.3	13.2%	Sep	1.38
End-Oct	179.6	8.0%	134.0	13.1%	Oct	0.70
End-Nov	181.3	8.0%	135.2	13.1%	Nov	1.25
End-Dec	182.7	8.1%	136.3	13.5%	Dec	1.08

Source: People's Bank of China

Exhibit 17 Increase in total social financing, 2017 to 2018

	2017		2018		3Q18		4Q18	
	Amount (billion yuan)	Share (%)	Amount (billion yuan)	Share (%)	Amount (billion yuan)	Share (%)	Amount (billion yuan)	Share (%)
Total social financing	22,397.0	100.0	19,260.0	100.0	5,333.6	100.0	3,855.7	100.0
- RMB loans to the real sector	13,843.2	61.8	15,670.0	81.4	4,034.2	75.6	2,872.5	74.5
- Foreign currency loans to the real sector	1.8	0.0	-420.1	-2.2	-178.8	-3.4	-228.8	-5.9
- Trust loans	2,255.5	10.1	-690.1	-3.6	-278.9	-5.2	-224.9	-5.8
- Entrusted loans	777.0	3.5	-1,610.0	-8.4	-358.9	-6.7	-446.9	-11.6
- Bank acceptance bills	536.4	2.4	-634.3	-3.3	-407.0	-7.6	44.3	1.1
- Corporate bonds	442.1	2.0	2,480.0	12.9	597.9	11.2	836.0	21.7
- Local government special bonds	1,996.2	8.9	1,790.0	9.3	1,334.6	25.0	89.8	2.3
- Equity issuance	875.9	3.9	360.6	1.9	58.8	1.1	50.6	1.3
- Asset-backed securities of depository financial institutions	197.7	0.9	594.0	3.1	151.9	2.8	284.8	7.4
- Written-off loans	758.6	3.4	1,015.1	5.3	216.8	4.1	369.3	9.6

Source: People's Bank of China

C Outlook

1. Chinese entrepreneurs become less optimistic

China's Entrepreneur Confidence Index (ECI) for the secondary industry dropped from 127.3 in 3Q18 to 123.5 in 4Q18, indicating that Chinese entrepreneurs have become less optimistic recently (*see exhibit 18*).[13]

By sector, the ECIs for the 'mining' and the 'manufacturing' sectors recorded a quarter-on-quarter fall, down by 3.7 pts and 4.3 pts respectively in 4Q18. In contrast, the ECI for the 'electricity, gas and water' sector rose by 4.0 pts in the same quarter (*see exhibit 19*).

2. Manufacturing sector contracts

China's manufacturing PMI dropped from 50.0 in November to 49.4 in December, and then stayed low at 49.5 in January. The index has stayed below the critical 50-mark for two consecutive months, indicating a continuous contraction of the manufacturing sector (*see exhibit 20*).

Output has expanded at a slower pace in recent month: The output index fell from 51.9 in November to 50.8 in December, the lowest level in ten months, and edged up to 50.9 in January. The relatively slow output growth in the past two months was due mainly to a weakening domestic and export demand: The new orders index went down from 50.4 in November to 49.7 in December and further to 49.6 in January; the new export orders index was 46.9 in January, staying in the contractionary zone for eight consecutive months.

Against the backdrop of falling orders, purchasing activities have started to decrease: Since December last year, the purchases of inputs index has been below the critical 50-mark, registering 49.8 in December and 49.1 in January. Another reason behind the drop in purchasing activities was that the stocks of major inputs have fallen at a slower pace lately: The stocks of major inputs index rose from 47.1 in December to a five-month high of 48.1 in January. In contrast, the stocks of finished goods index fell from its recent peak of 48.6 in November to 48.2 in December, and further to 47.1 in January, showing that stocks of finished goods held by manufacturers have decreased at a faster pace in recent months.

The input prices index plunged from 58.0 in October to 50.3 in November, and then fell sharply to 44.8 in December, well below 50, only to show a slight rebound to 46.3 in January. The index readings in the past two months indicate a sharp fall in prices of production inputs and thus the production costs facing Chinese manufacturers.

The ex-factory prices index went down from 52.0 in October to 46.4 in November and 43.3 in December, and then rebounded to 44.5 in January. The index has been below 50 for three consecutive months, indicating that Chinese manufacturers have been reducing the ex-factory prices of their products.

The business expectations index dropped from 54.2 in November to 52.7 in December, and further to 52.5 in January. The downtrend indicates that confidence among purchasing managers has weakened in recent months.

Exhibit 18 China's Entrepreneur Confidence Index (Secondary Industry), 1Q17 to 4Q18

	1Q17	2Q17	3Q17	4Q17	1Q18	2Q18	3Q18	4Q18
Entrepreneur Confidence Index (Secondary Industry)	129.2	127.3	127.3	126.0	132.9	130.3	127.3	123.5

Source: National Bureau of Statistics, PRC

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.

Exhibit 19 Entrepreneur Confidence Index by sector, 4Q18

	4Q18	Compared with the previous quarter
Secondary industry	123.5	Lower
Mining	113.7	Lower
Manufacturing	123.0	Lower
Electricity, gas & water	140.8	Higher

Source: National Bureau of Statistics, PRC

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

China's Business Activity Index, which is quoted as the Non-manufacturing Purchasing Managers' Index (NMI), rose from 53.4 in November to 53.8 in December, and further to 54.7 in January, the highest level in four months. The index readings in recent months indicate an acceleration in the growth of the non-manufacturing sector.

The rise in the NMI was highly associated with an improvement in demand. The new orders index rose all the way from 50.1 in November to 51.0 in January, showing that new orders have expanded at a faster pace lately (*see exhibit 21*).

The sales prices index has dropped below the critical 50-mark since November, indicating a continuous reduction in service charges of enterprises in the past three months. In contrast, the input prices index went up from 50.1 in December to a three-month high of 52.0 in January, showing that input prices have increased at a faster pace recently.

The business expectation index was 59.6 in January, well above the critical 50-mark, suggesting that purchasing managers in the non-manufacturing sector have stayed optimistic about the near-term outlook for their respective industries.

Exhibit 20 China's manufacturing PMI at a glance, January 2019

Index	Seasonally Adjusted Index	Index Compared with the Previous Month	Direction
PMI	49.5	Higher	Contracting
Output	50.9	Higher	Expanding
New Orders	49.6	Lower	Contracting
New Export Orders	46.9	Higher	Contracting
Backlogs of Orders	43.7	Lower	Contracting
Stocks of Finished Goods	47.1	Lower	Contracting
Purchases of Inputs	49.1	Lower	Contracting
Imports	47.1	Higher	Contracting
Input Prices	46.3	Higher	Falling
Stocks of Major Inputs	44.5	Higher	Falling
Ex-factory Prices	48.1	Higher	Contracting
Employment	47.8	Lower	Contracting
Suppliers' Delivery Time	50.1	Lower	Quickening
Business Expectations	52.5	Lower	Optimistic

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

Exhibit 21 China's non-manufacturing purchasing managers' index (NMI) at a glance, January 2019

Index	Seasonally Adjusted Index	Index Compared with the Previous Month	Direction
Business activity	54.7	Higher	Expanding
New orders	51.0	Higher	Expanding
Input prices	52.0	Higher	Rising
Sales prices	49.8	Higher	Falling
Business expectations	59.6	Lower	Optimistic

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

A Recent developments

1. Growth rates of both exports and imports decelerate in 4Q18

Amid the China-US trade war, the growth of China's exports decelerated to 4.6% yoy in 4Q18 from 11.6% yoy in 3Q18 (*see exhibits 22, 23 and 24*). A possible reason for the sharp growth deceleration was that Chinese exporters front-loaded shipments to the US in 3Q18 for getting ahead of expected tariffs and this type of activities decreased in 4Q18.[14] Overall, in 2018, China's exports amounted to US$ 2,487.4 billion, up by 9.9% yoy.

Compared to 2017, China's exports to its major trade partners maintained relatively stable growth in 2018. The growth rates of China's exports to the US, the EU and Japan registered 11.3% yoy, 9.8% yoy and 7.2% yoy respectively in 2018, close to the growth rates of 11.5% yoy, 9.7% yoy and 6.1% yoy respectively registered in 2017. It is also noteworthy that the growth of China's exports to the ASEAN accelerated to 14.2% yoy in 2018 from 9.0% yoy in 2017.

The growth rate for China's imports fell to 4.8% yoy in 4Q18 from 20.7% yoy in 3Q18, showing that the domestic demand for imported goods has weakened recently. Overall, in 2018, China's imports totalled US$ 2,135.6 billion, up by 15.8% yoy.

China's trade surplus increased markedly from US$ 87.6 billion in 3Q18 to US$ 136.6 billion in 4Q18. The reason for the rise in trade surplus in 4Q18 was that imports decreased while exports increased in the quarter. In 4Q18, China's imports fell by US$ 42.8 billion, while China's exports increased by US$ 6.2 billion.

Exhibit 22 China's quarterly foreign trade data, 1Q18 to 4Q18

USD billion (yoy growth)

	Exports		Imports		Trade Balance
FY18	2,487.4	(9.9%)	2,135.6	(15.8%)	351.8
1Q18	545.3	(14.1%)	497.3	(19.0%)	48.0
2Q18	630.0	(11.8%)	534.7	(20.2%)	95.3
3Q18	659.6	(11.6%)	572.0	(20.7%)	87.6
4Q18	665.8	(4.6%)	529.2	(4.8%)	136.6

Source: China Customs

14 For example, on 10 July, the US government announced to impose extra tariffs on US$200 billion of Chinese goods, which started to take effect on 24 September.

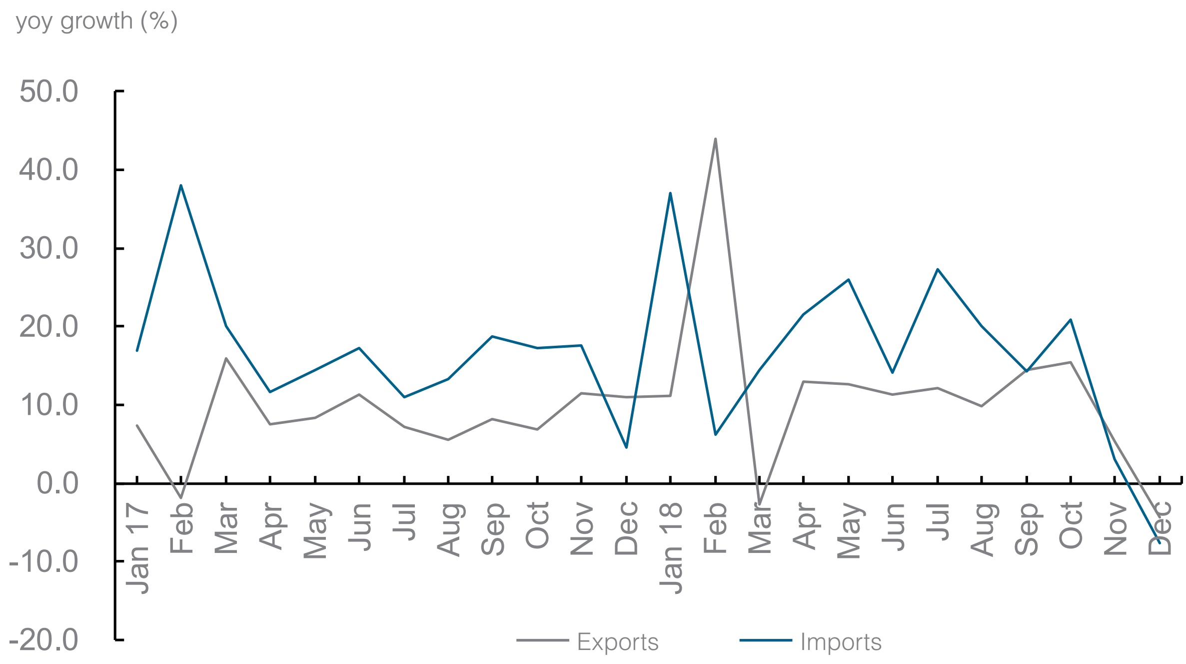
Exhibit 23 China's monthly foreign trade data, January to December 2018

USD billion (yoy growth)

	Exports		Imports		Trade Balance
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
May	212.9	(12.6%)	187.9	(26.0%)	24.9
June	216.7	(11.3%)	175.1	(14.1%)	41.6
July	215.6	(12.2%)	187.5	(27.3%)	28.1
August	217.3	(9.8%)	189.5	(20.0%)	27.9
September	226.7	(14.5%)	195.0	(14.3%)	31.7
October	217.1	(15.6%)	182.3	(21.4%)	34.8
November	227.4	(5.4%)	182.7	(3.0%)	44.8
December	221.3	(-4.4%)	164.2	(-7.6%)	57.1

Source: China Customs

Exhibit 24 Growth rates of exports and imports, January 2017 to December 2018



Source: China Customs

Exhibit 25 Exports by category, 2017 and 2018

yoy growth (%) of export value, calculated in USD	2017	2018
Textile materials and products	4.5	8.1
Garments and clothing accessories	-0.4	0.3
Footwear	2.0	-2.7
Toys	30.4	4.5
Coal	58.1	-27.6
Crude oil	93.2	-30.3
Refined oil	30.9	41.3
Steel	0.0	11.2
Mechanical and electrical products	9.3	10.6

Source: China Customs

Exhibit 26 Imports by category, 2017 and 2018

yoy growth (%) of import value, calculated in USD	2017	2018
Cereal and cereal flour	13.7	-8.8
Soybean	16.7	-4.0
Iron ore	31.4	-1.3
Crude oil	39.1	46.7
Refined oil	29.8	39.1
Steel	15.3	8.3
Textile yarns, fabric and textile products	3.6	3.0
Vehicles and vehicle chassis	13.4	0.0

Source: China Customs

2. Growth rates for general trade exports and processing trade exports decelerate in 4Q18

The year-on-year growth rates for both general trade[15] exports and processing trade[16] exports decelerated in 4Q18. The growth in general trade exports fell to 7.2% yoy in 4Q18 from 13.5% yoy in 3Q18.Meanwhile, the growth in processing trade exports dropped to minus 0.3% yoy in 4Q18 from 8.0% yoy in 3Q18 (see exhibit 27). On the import side, the growth in general trade imports decelerated markedly to 4.1% yoy in 4Q18 from 22.9% yoy in 3Q18. Meanwhile, the growth rate for processing trade imports fell sharply to minus 0.1% yoy in 4Q18 from 16.7% yoy in 3Q18. In our view, the growth deceleration in the processing trade imports in 4Q18 suggests that the processing trade exports are likely to continue to show negative growth in the near future, as processing trade imports serve as a leading indicator of processing trade exports performance.

The share of processing trade in China's total trade rose to 28.6% in 4Q18 from 27.9 % in 3Q18. Also noteworthy is that, with a large surplus of US$ 97.6 billion in 4Q18, processing trade plays a vital 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), 2017 to 2018

Item	yoy growth (%)				Share (%)			
	FY17	FY18	3Q18	4Q18	FY17	FY18	3Q18	4Q18
Exports Of which:	7.9	9.9	11.6	4.6	100.0	100.0	100.0	100.0
General Trade	8.7	13.9	13.5	7.2	54.6	56.3	56.1	55.6
Processing Trade	5.9	4.9	8.0	-0.3	33.4	32.0	31.8	33.0
Imports Of which:	15.9	15.8	20.7	4.8	100.0	100.0	100.0	100.0
General Trade	20.2	17.4	22.9	4.1	58.7	59.7	58.9	57.3
Processing Trade	8.7	8.6	16.7	-0.1	23.5	22.0	23.3	23.0
Total of Imports and Exports Of which:	11.4	12.6	15.8	4.7	100.0	100.0	100.0	100.0
General Trade	13.8	15.5	17.8	5.8	56.4	57.9	57.4	56.3
Processing Trade	6.9	6.2	11.2	-0.2	29.0	27.4	27.9	28.6

Source: China Customs

3. China's imports from US post sharp growth deceleration in 2018

The EU was still China's largest trading partner, accounting for 14.8% of China's total foreign trade in 2018. Sino-EU trade amounted to US$ 682.2 billion, up by 10.6% yoy in 2018. Specifically, China's exports to the EU expanded by 9.8% yoy in 2018, compared to the growth of 9.7% yoy in 2017; and China's imports from the EU increased by 11.7% yoy in 2018, compared to the growth of 17.6% yoy in 2017 (*see exhibits 28 and 29*).

Accounting for 13.7% of China's total foreign trade, the US continued to be China's second largest trading partner in 2018. Against the backdrop of the China-US trade war, Sino-US trade expanded by 8.5% yoy to US$ 633.5 billion in 2018. Compared to 2017, China's export growth to the US maintained relatively stable pace in 2018: after expanding by 11.5% yoy in 2017, China's exports to the US grew by 11.3% yoy in 2018. Meanwhile, the growth of China's imports from the US decelerated sharply from 14.5% yoy in 2017 to 0.7% yoy in 2018.

The Association of South East Asian Nations (ASEAN) accounted for 12.7% of China's total foreign trade in 2018. Sino-ASEAN trade grew by 14.1 % yoy to US$ 587.9 billion in 2018. Of which, China's exports to ASEAN rose by 14.2% yoy, while China's imports from ASEAN gained 13.8% yoy, in 2018.

Sino-Japanese trade increased by 8.1% yoy to US$ 327.7 billion in 2018. China's exports to Japan gained 7.2% yoy, while China's imports from Japan expanded by 8.9% yoy in 2018.

4. Growth rate for China's imports from Russia accelerates significantly in 2018

China's export growth to Russia moderated to 12.0% yoy in 2018 from 14.8% yoy in 2017. Meanwhile, China's import growth from Russia improved significantly to 42.7% yoy in 2018 from 27.7% yoy in 2017 (see exhibits 28 and 29). Consequently, the growth in China's trade with Russia rose to 27.1% yoy in 2018 from 20.8% yoy in 2017.

China's export growth to India dropped to 12.7% yoy in 2018 from 16.5% yoy in 2017, while China's import growth from India fell to 15.2% yoy in 2018 from 38.9% yoy in 2017. Overall, the growth of Sino-Indian trade decelerated to 13.2% yoy in 2018 from 20.3% yoy in 2017.

The growth in China's exports to Brazil fell to 16.3% yoy in 2018 from 31.8% yoy in 2017. In the meantime, the growth in China's imports from Brazil accelerated to 31.7% yoy in 2018 from 27.8% yoy in 2017. Consequently, the growth in Sino-Brazilian trade moderated to 26.6% yoy in 2018 from 29.1% yoy in 2017.

Together, these three BRIC members accounted for 6.4% of China's total exports and 7.3% of China's total imports in 2018, up from 6.2% and 6.3%, respectively, in 2017.

Exhibit 28 China's trading partners, 2018

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	682.2	14.8	408.6	273.5	10.6	9.8	11.7
US	633.5	13.7	478.4	155.1	8.5	11.3	0.7
ASEAN	587.9	12.7	319.2	268.6	14.1	14.2	13.8
Japan	327.7	7.1	147.1	180.6	8.1	7.2	8.9
Brazil	111.2	2.4	33.7	77.5	26.6	16.3	31.7
Russia	107.1	2.3	48.0	59.1	27.1	12.0	42.7
India	95.5	2.1	76.7	18.8	13.2	12.7	15.2

Source: China Customs

Exhibit 29 China's trading partners, comparing growth rates for 2017 and 2018

yoy growth (%)

Country/Region	Total Trade		Exports		Imports	
	2017	2018	2017	2018	2017	2018
EU	12.7	10.6	9.7	9.8	17.6	11.7
US	12.3	8.5	11.5	11.3	14.5	0.7
ASEAN	13.8	14.1	9.0	14.2	20.1	13.8
Japan	10.1	8.1	6.1	7.2	13.7	8.9
Brazil	29.1	26.6	31.8	16.3	27.8	31.7
Russia	20.8	27.1	14.8	12.0	27.7	42.7
India	20.3	13.2	16.5	12.7	38.9	15.2

Source: China Customs

5. Exports from Guangdong and Shanghai post relatively slow growth in 2018

China's top six provinces and municipalities in terms of value of exports – Guangdong, Jiangsu, Shanghai, Zhejiang, Shandong and Fujian – jointly accounted for 76.9% of China's total exports in 2018, 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 and Shanghai in 2018. Exports from Guangdong and Shanghai expanded by 4.7% yoy and 4.0% yoy, respectively, in 2018, lower than the country's total export growth (9.9% yoy) during the period.

Several western provinces in China witnessed robust year-on-year growth in exports in 2018. Exports from Gansu and Sichuan soared by 52.8% yoy and 35.8% yoy respectively over the period.

Exhibit 30 Top six provinces and municipalities in terms of value of exports, 2018

Provinces/ Municipalities	Value of exports (USD billion)	yoy growth (%)	Share of total exports (%)
Guangdong	708.1	4.7	28.5
Jiangsu	417.2	11.3	16.8
Zhejiang	328.0	12.2	13.2
Shanghai	181.0	4.0	7.3
Shandong	173.5	10.3	7.0
Fujian	105.1	13.9	4.2

Source: China Customs

6. China's FDI grows slightly by 0.9% yoy in 2018

China's foreign direct investment (FDI) in Renminbi terms increased by 24.9% yoy in December, after dropping by 26.3% yoy in November. Overall, in 2018, China's FDI amounted to 885.6 billion yuan, up by 0.9% yoy (*see exhibit 31*).

In 2018, FDI in the manufacturing industries grew by 20.1% yoy to 271.0 billion yuan, accounting for 30.6% of the total FDI in the period. Of which, FDI in the Hi-Tech manufacturing industries rose sharply by 35.1% yoy.

Among regions, FDI in the central region rose by 15.4%, while FDI in the western region increased by 18.5% yoy in 2018.

Among major sources, FDI from Singapore, Korea, Japan, the UK, Germany, the US soared by 8.1% yoy, 24.1% yoy, 13.6% yoy, 150.1% yoy, 79.3% yoy and 7.7% yoy respectively in 2018.

7. China's foreign exchange reserves decrease further in 4Q18

As at the end of 4Q18, China's foreign exchange reserves amounted to US$ 3,072.7 billion, down by US$ 14.3 billion compared with end-3Q18 (*see exhibit 32*). This was the third quarter in a row that the foreign exchange reserves posted a quarter-on-quarter drop.

On a month-on-month basis, China's foreign exchange reserves decreased in October, due largely to the depreciation of non-US dollar currencies and a fall in the value of assets held by the Chinese government.[17] Afterwards, the foreign exchange reserves increased in November and December, as the US dollar depreciated against other major currencies and a rise in values of assets held by the Chinese government.[18]

Looking ahead, we expect that China's foreign exchange reserves will rise further in the near future, as the US central bank is widely expected to slow its pace in interest rate hikes, and this has in turn put downward pressure on the US dollar.

17 According to the Bloomberg, the US dollar index was 97.13 on 31 October, up from 95.13 on 28 September.
18 According to the Bloomberg, the US dollar index was 96.17 on 31 December, down from 97.13 on 31 October.

Exhibit 31 China's FDI, January to December 2018

	Amount (billion yuan)	yoy growth
FY17	877.6	7.9%
FY18	885.6	0.9%
January 18	80.4	0.3%
February	59.0	0.8%
March	88.1	0.4%
April	59.2	-1.1%
May	58.8	7.6%
June	100.7	0.3%
July	50.4	14.9%
August	63.7	1.9%
September	76.3	8.0%
October	64.5	7.2%
November	92.1	-26.3%
December	92.3	24.9%

Source: Ministry of Commerce, PRC

Exhibit 32 Foreign exchange reserves by quarter, 1Q18 to 4Q18

USD billion	Accumulation	End of the quarter
FY18	-67.2	
1Q18	2.9	3,142.8
2Q18	-30.7	3,112.1
3Q18	-25.1	3,087.0
4Q18	-14.3	3,072.7

Source: State Administration of Foreign Exchange, PRC

B Highlights

1. China and US hold trade talks after reaching trade war truce

After China and the US reached a 90-day trade war truce on 1 December, the two countries hold a series of trade talks on 'structural changes' in the Chinese economy to resolve China-US trade conflicts.

Following trade talks held by a Chinese delegation led by Vice-Premier Liu He and a US delegation led by US Trade Representative Robert Lighthizer in Washington on 30-31 January, the US trade delegation visited Beijing on 14-15 February to continue the trade talks. Both countries hailed progress at the conclusion of this round of negotiations. Chinese state news agency Xinhua reported that China and the US reached a 'consensus in principle' on major issues. US President Trump said that the trade talks brought the two countries within reach of a breakthrough in their trade relations. 'We're a lot closer than we ever were in this country with having a real trade deal,' Trump said.

At the time of writing a new round of talks is being held in Washington on 21-22 February. According to media reports, although China and the US remain far apart on structural issues regarding China's economy, a broad outline of a potential trade deal is beginning to emerge, as the two countries push for an agreement by 1 March. It was reported that the two negotiation teams were drafting six memorandums of understanding (MOU) on key structural issues, covering forced technology transfer and cyber theft, intellectual property, services, agriculture, currency, and non-tariff barriers. The negotiators are also looking at shorter-term measures to address the US trade deficit with China.

If China and the US fail to reach a deal by 1 March, the US could boost the additional tariff rate on US$200 billion worth of Chinese imports from 10% to 25%. However, Trump indicated that he could extend the deadline if both sides are close to reaching a deal, and that he was looking forward to meeting Chinese President Xi Jinping in the near future to discuss and agree on some of the difficult issues. Although another Xi-Trump meeting was unlikely before the 1 March deadline, the two leaders could meet in mid- or late March, according to media reports.

Only a few days remain until the 1 March deadline for trade talks between China and the US. Given that the trade negotiations focus on the sensitive issue of 'structural changes' in China's economic policies, on which the differences between the two countries are deep, and that the US insists on an enforcement mechanism of the promises by Beijing that could carry the threat of US tariffs, we do not expect a comprehensive trade deal to be finalised by the deadline. That being said, it is likely that an agreement of some sort could be reached to extend the 1 March deadline (possibly for 60 days as rumoured) to allow for further negotiations, and to keep the US tariffs on US$200 billion of Chinese imports at 10% in the meantime, in our view.

2. China announces provisional tariff rates on 706 imported items

On 22 December 2018, the Customs Tariff Commission of the State Council announced to impose the provisional tariff rates on 706 imported items in 2019.[18] These 706 tariff items cover various types of food products, consumer goods, raw materials, industrial equipment and instruments. It is noteworthy that the provisional tariff rates on several types of overcoats, jackets, suits and scarves are set at 5% in 2019, the same as their provisional tariff rates in 2018.

3. Chinese yuan appreciates against US dollar

The Chinese yuan has appreciated against the US dollar since December last year. The daily fixing rate (also known as the central parity rate) of the Chinese yuan against the US dollar appreciated to 6.7675 on 13 February, compared to 6.9357 on 30 November (*see exhibit 33*).[19]

In line with the movement of the daily fixing rate, the USD-CNY spot exchange rate has been on appreciation trend in recent months.[20] The USD-CNY spot exchange rate has appreciated by 2.91% since 28 November last year when the exchange rate closed at its recent low of 6.9560 (as of 13 February).

Meanwhile, the daily fixing rate of the Chinese yuan against the Euro appreciated to 7.6418 on 12 February, the strongest level since late June last year, before depreciating slightly to 7.6711 on 13 February (*see exhibit 34*).

According to the Bank for International Settlements, the real effective exchange rate (REER) of the yuan rose slightly from 121.80 in November to 122.73 in December, the highest level since August last year.[21] Overall, in 2018, the Chinese yuan appreciated in real terms against its trading partners by 0.9% (*see exhibit 35*).

Looking ahead, we predict that the exchange rate of the Chinese yuan against the US dollar will stay strong in the near term. The US central bank has recently signalled that it would slow its pace in interest rate hikes this year, and thus the demand for riskier assets such as yuan-denominated assets is likely to increase in the coming future. Moreover, if China and the US are able to reach a trade deal by 1 March, China's economic prospects will improve and thus China's central bank will be under less pressure to further ease its monetary policy, which would help support the exchange rate of the Chinese yuan against the US dollar.

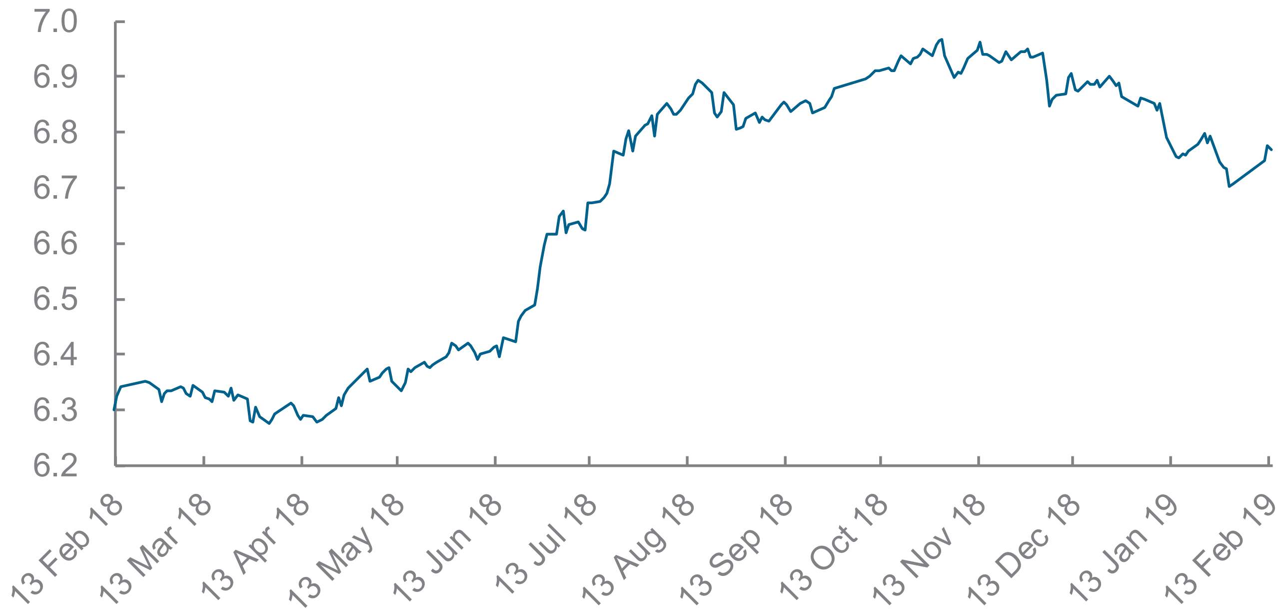
18 http://gss.mof.gov.cn/zhengwuxinxi/zhengcefabu/201812/t20181221_3101662.html

19 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 movements of major international currencies and 'counter cyclical coefficient'.

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

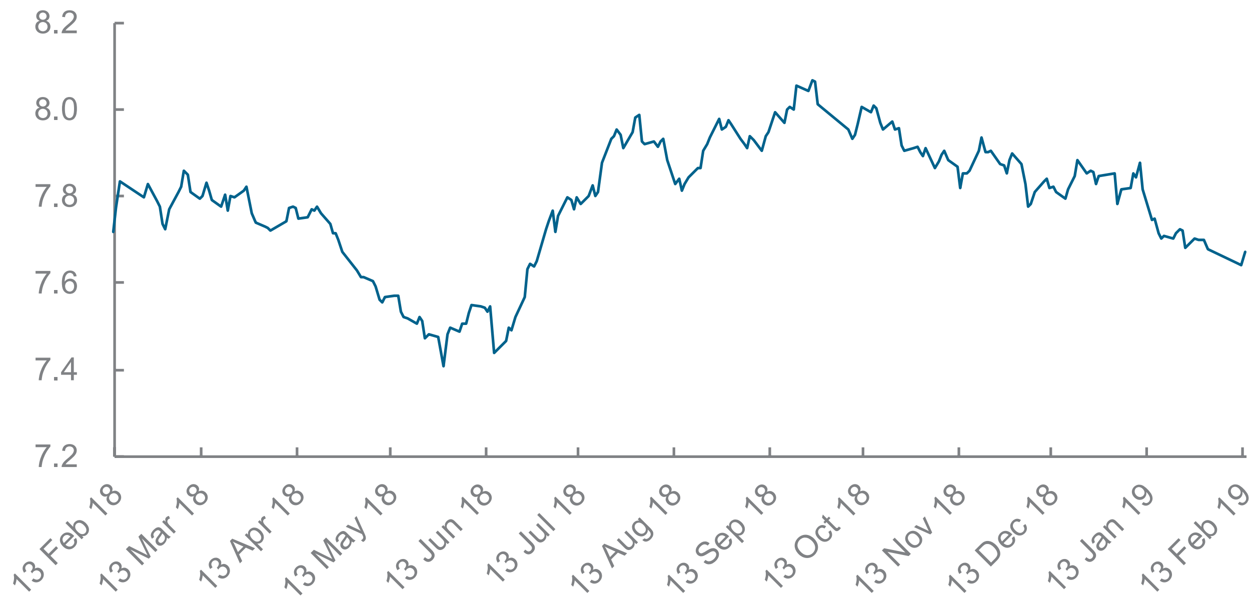
21 The Bank for International Settlements (BIS) calculates effective exchange rate (EER) indices for a total of 61 economies (including individual Eurozone countries and, separately, the Eurozone as an entity). Nominal EERs are calculated as geometric weighted averages of bilateral exchange rates. Real 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 2018 to February 2019



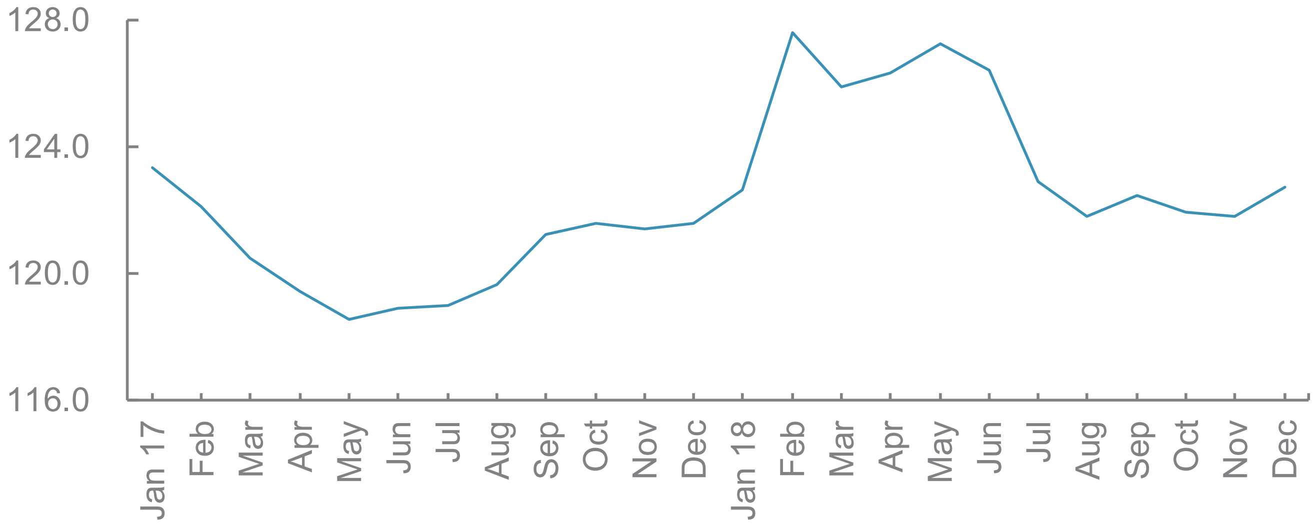
Source: State Administration of Foreign Exchange

Exhibit 34 EUR-CNY daily fixing rate, February 2018 to February 2019



Source: Bank for International Settlements

Exhibit 36 Real effective exchange rate of the Chinese yuan, January 2017 to December 2018



Source: State Administration of Foreign Exchange

C Outlook

1. Recent indicators paint a mixed picture of US economy

Due to the partial shutdown of the federal government in the US during late December 2018 to late January 2019, the 4Q18 US GDP figure has not been released yet.

High-frequency indicators, however, paint a mixed picture of the US economy. On the production side, the new orders for manufactured durable goods rose by 0.7% mom in November. Besides, industrial production grew by 0.3% mom in December, recording positive month-on-month growth for seven consecutive months (see exhibit 37). Nevertheless, the manufacturing PMI dropped markedly from 59.3 in November to 54.1 in December, and then stayed low at 56.6 in January, indicating that the manufacturing sector in the US has expanded at a slower pace lately.

The growth of the non-manufacturing sector has decelerated lately: the non-manufacturing index (NMI) went down from 60.7 in November to 57.6 in December, and further to 56.7 in January.

The US retail sales gained 1.1% mom and 0.2% mom in October and November respectively. However, the Reuters/ University of Michigan index of consumer sentiment fell sharply from 98.3 in December to 91.2 in January, indicating that the confidence among US consumers has weakened lately (see exhibit 38).

The labour market in the US has remained solid: In January, the non-farm payroll employment increased by 304,000, much higher than the 12-month average of 234,000, while the unemployment rate stayed low at 4.0% (see exhibit 39).

Looking ahead, the IMF predicts that the US economic growth will decelerate in the near future. According to the latest projection by the IMF, the real GDP growth rate for the US is forecast to slow to 2.5% in 2019 and 1.8% in 2020.[22]

Exhibit 36 US national accounts, 2016 to 3Q18

Annual growth (%)	2016	2017	4Q17	1Q18	2Q18	3Q18
Real GDP	1.6	2.2	2.3	2.2	4.2	3.4

Source: US Department of Commerce

Exhibit 37 US industrial sector, July to December 2018

mom growth (%), seasonally adjusted	Jul 18	Aug	Sep	Oct	Nov	Dec
Industrial production	0.4	0.8	0.1	0.2	0.4	0.3
New orders for manufactured durable goods	-1.2	4.7	0.0	-4.3	0.7	-

Source: US Federal Reserve, US Department of Commerce

22 IMF, World Economic Outlook Update, January 2019

Exhibit 38 US consumer market, August 2018 to January 2019

	Aug 18	Sep	Oct	Nov	Dec	Jan 19
Retail and food services sales *(mom growth %, seasonally adjusted)*	-0.1	-0.2	1.1	0.2	-	-
Reuters/University of Michigan index of consumer sentiment	96.2	100.1	98.6	97.5	98.3	91.2
CPI *(yoy growth %)*	2.7	2.3	2.5	2.2	1.9	-

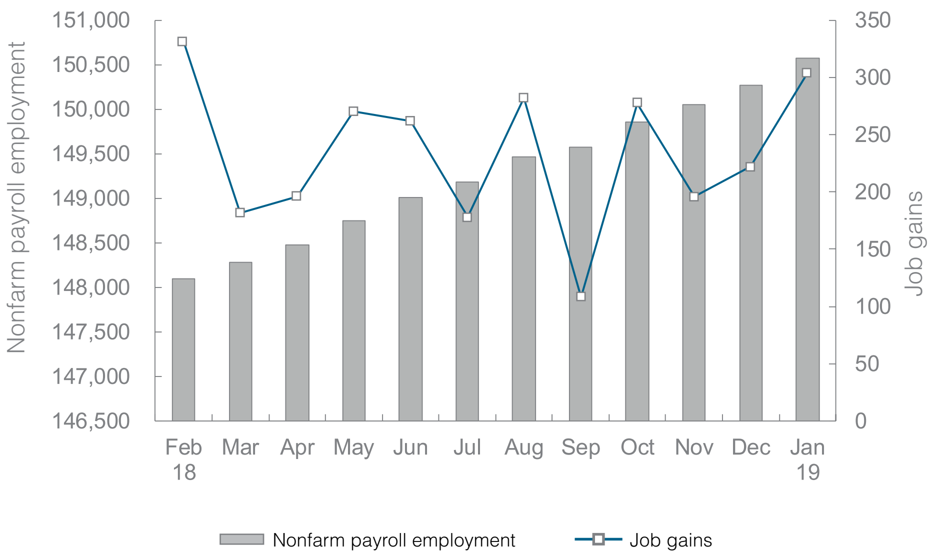
Source: US Department of Commerce, Reuters/University of Michigan Surveys of Consumers, US Department of Labor

Exhibit 39 US employment

	Unemployment rate (%)
2017	4.4
2018	3.9
Feb 18	4.1
Mar	4.0
Apr	3.9
May	3.8
Jun	4.0
Jul	3.9
Aug	3.8
Sep	3.7
Oct	3.8
Nov	3.7
Dec	3.9
Jan 19	4.0

Yearly figures: Annual average
Monthly figures: Seasonally adjusted

Nonfarm payroll employment, February 2018 to January 2019
In thousands, seasonally adjusted



Source: US Department of Labor

2. Manufacturing and service sectors in Eurozone expand at slower pace

Recent indicators indicate a growth deceleration of the Eurozone economy.[23] According to the global survey firm Markit Economics, the Eurozone manufacturing PMI fell from 51.8 in November to 51.4 in December, and further to 50.5 in January, the lowest level since November 2014. The figures indicate that the manufacturing sector in the Eurozone has expanded at a slower pace recently.

Meanwhile, the Eurozone services PMI went down from 53.7 in October to 53.4 in November, and then dropped to 51.2 in December and in January, indicating a growth moderation of the service sector in the region.

The retail trade volume in the Eurozone dropped by 1.6% mom on a seasonally adjusted basis in December, posting the biggest fall since May 2011 (*see exhibit 41*).

The labour market conditions in the region have gradually improved. The seasonally-adjusted unemployment rate fell from 8.0% in October to 7.9% in November and December (*see exhibit 42*).

Nevertheless, confidence among consumers and managers in various sectors has weakened: the Eurozone's economic sentiment indicator (ESI) dropped further to 106.2 in January, the lowest level since November 2016 (*see exhibit 43)*.

Looking ahead, the growth of the Eurozone economy is expected to decelerate this year. In its latest World Economic Outlook Update published in January, the IMF forecasts that the real GDP growth rate for the Eurozone will fall from 1.8% in 2018 to 1.6% in 2019, before rebounding slightly to 1.7% in 2020.[24]

Exhibit 40 Eurozone's real GDP growth, 2016 to 3Q18

	2016	2017	4Q17	1Q18	2Q18	3Q18
Real GDP *(qoq growth %)*			0.7	0.4	0.4	0.2
Real GDP *(yoy growth %)*	1.8	2.4	2.7	2.4	2.2	1.6

Source: Eurostat, IMF

Exhibit 41 Eurozone consumer market, July to December 2018

	Jul 18	Aug	Sep	Oct	Nov	Dec
Volume of retail trade *(mom growth %, seasonally adjusted)*	-0.5	0.5	-0.5	0.8	0.8	-1.6
Annual inflation (%)	2.1	2.0	2.1	2.2	1.9	1.6

Source: Eurostat

Exhibit 42 Eurozone labour market, July to December 2018

seasonally adjusted	Jul 18	Aug	Sep	Oct	Nov	Dec
Unemployment rate (%)	8.1	8.0	8.0	8.0	7.9	7.9

Source: Eurostat

23 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.
24 IMF, World Economic Outlook Update, January 2019

Exhibit 43 Eurozone economic sentiment indicator, August 2018 to January 2019

seasonally adjusted	Aug 18	Sep	Oct	Nov	Dec	Jan 19
Economic sentiment indicator	111.0	110.4	109.7	109.5	107.4	106.2

Source: Eurostat

3. China's exports are expected to show negative growth in 1Q19

According to the World Economic Outlook Update released in January, the IMF cuts its forecasts on world economic growth in 2019 and 2020 by 0.2 ppt. and 0.1 ppt. respectively, compared to its previous projections made in October last year. The primary reasons behind the latest downward revision are that the slower growth momentum of the world economy in 2H18 is likely to carry over to 2019 and that the sentiments in the financial market have weakened. The IMF forecasts that the world economic growth will fall from 3.7% in 2018 to 3.5% in 2019 and will improve slightly to 3.6% in 2020. The growth in the advanced economies is projected to decelerate from 2.3% in 2018 to 2.0% in 2019, and further to 1.7% in 2020. Meanwhile, the growth in the emerging market and developing economies is projected to fall from 4.6% in 2018 to 4.5% in 2019, and to rebound strongly to 4.9% in 2020 (*see exhibit 44*).

Looking ahead, we forecast that China's exports will only show negative year-on-year growth in 1Q19, compared to the positive growth of 4.6% yoy in 4Q18. Challenges facing Chinese manufacturers include ongoing trade frictions between China and the US, intense competition in the international market, and the weak demand for luxury products.

Exhibit 44 Latest GDP growth forecasts by the IMF

yoy growth (%)	2018 (Estimates)	2019 (Forecasts)	2020 (Forecasts)
World economy	3.7	3.5	3.6
Advanced economies	2.3	2.0	1.7
US	2.9	2.5	1.8
Eurozone	1.8	1.6	1.7
Japan	0.9	1.1	0.5
Emerging market and developing economies	4.6	4.5	4.9
China	6.6	6.2	6.2
India *	7.3	7.5	7.7
Brazil	1.3	2.5	2.2
Russia	1.7	1.6	1.7

* 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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