

China Trade Quarterly

Domestic Trade

China leads recovery as economy returns to growth in 2Q20

Retail sales remain in contraction in 2Q20

State Council supports exporters explore domestic market

Foreign Trade

Surprise rebound in exports in June and July signals recovering external demand

ASEAN remains China's largest trading partner but US regains status as China's top export market in 1H20

Fung Business Intelligence

Helen Chin

Vice President

helenchin@fung1937.com

William Kong

Senior Research Manager

Williamkong@fung1937.com



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Helen Chin

Vice President

E: helenchin@fung1937.com

William Kong

Senior Research Manager

E: williamkong@fung1937.com

Fung Business Intelligence

1/F LiFung Tower

888 Cheung Sha Wan Road

Kowloon, Hong Kong

T: (852) 2300 2470

F: (852) 2635 1598

E: fbicgroup@fung1937.com

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



Part One: Domestic Trade

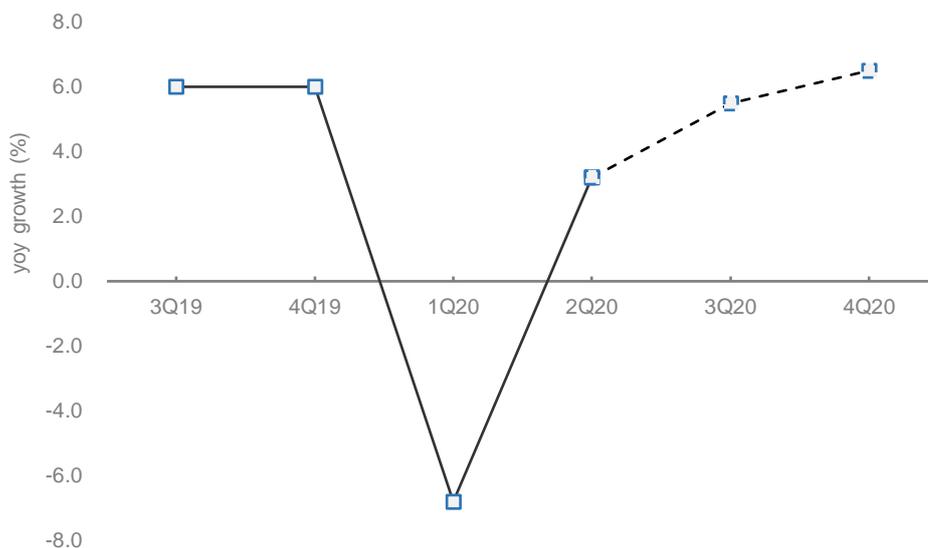
A. Recent developments

1. China leads recovery as economy returns to growth in 2Q20

China's real GDP growth picked up strongly from minus 6.8% year-on-year (yoy) in 1Q20 to 3.2% yoy in 2Q20, becoming the first major economy to return to growth in the wake of the COVID-19 pandemic (see *exhibit 1*). Overall, in 1H20, China's nominal GDP amounted to 45.7 trillion yuan, down by 1.6% yoy in real terms.

Exhibit 1: China's real GDP growth and forecasts, 3Q19 to 4Q20

FY19	3Q19	4Q19	1Q20	2Q20	3Q20	4Q20
6.1%	6.0%	6.0%	-6.8%	3.2%	5.5%	6.5%



Source: National Bureau of Statistics, PRC

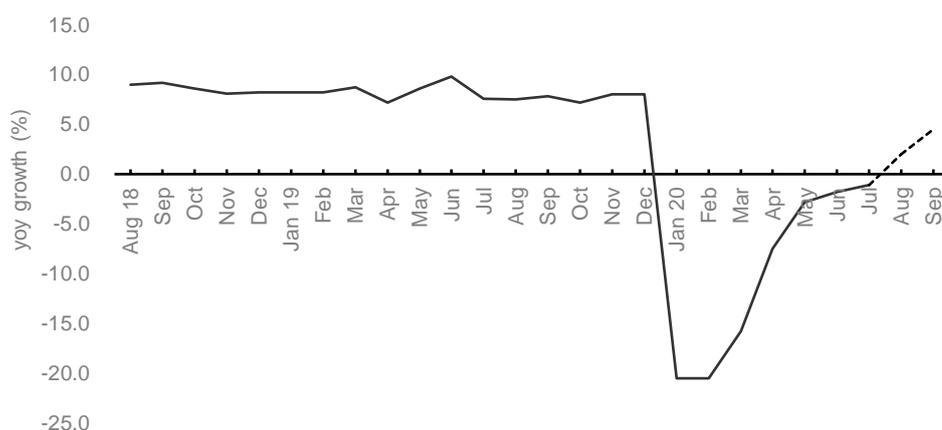
With the positive impact of China's stimulus policies starting to unfold and more measures likely in the pipeline, we predict that China's real GDP growth will rise to around 5.5% in 3Q20. However, the economic recovery is likely to be uneven, driven more by supply (production) than demand (consumption).

2. Retail sales remain in contraction in 2Q20

In 1H20, China's total retail sales of consumer goods reached 17.2 trillion yuan, down by 11.4% yoy (see exhibits 2, 3 and 4).

Exhibit 2: China's total retail sales, year-on-year nominal growth and forecasts, August 2018 to September 2020

FY19	Aug 19	Sep	Oct	Nov	Dec	Jan-Feb 20	Mar	Apr	May	Jun	Jul
8.0%	7.5%	7.8%	7.2%	8.0%	8.0%	-20.5%	-15.8%	-7.5%	-2.8%	-1.8%	-1.1%



Source: National Bureau of Statistics, PRC

Exhibit 3: China's total retail sales, month-on-month nominal growth, February to July 2020

mom growth (%), seasonally adjusted

	Feb 20	Mar	Apr	May	Jun	Jul
Total retail sales	0.82	0.81	0.82	0.82	0.83	0.85

Source: National Bureau of Statistics, PRC

Exhibit 4: China's total retail sales, 2019 to 1H20

Nominal growth, yoy (%)	FY19	1Q20	1H20
Total retail sales	8.0	-19.0	-11.4
- Goods	7.9	-15.8	-8.7
Sales by enterprises above designated size	3.9	-18.9	-9.0
Online sales	19.5	5.9	14.3
- Catering services	9.4	-44.3	-32.8

Source: National Bureau of Statistics, PRC

The recovery in consumer spending lagged behind that of industrial production in 2Q20. Boosting consumption will be key to sustaining China's recovery in 2H20.

Going forward, as the COVID-19 crisis is over in China, consumer spending will basically return to normal levels in the near term. We predict that the growth in retail sales will recover to about 2.0% yoy in 3Q20.

Impact of the COVID-19 outbreak on different types of consumption in 1H20 was not uniform. While catering services sales plunged amid the threat of COVID-19 and social distancing measures, online retail sales of goods bucked the trend to post strong growth as people avoided going out and turned to online shopping.

Exhibit 5: China's retail sales by enterprises above designated size, by product, 2019 to 1H20

Nominal growth, yoy (%)	FY19	1Q20	1H20
Grain, oil and food	10.2	12.6	12.9
Beverages	10.4	4.1	10.5
Tobacco and liquor	7.4	-14.0	-3.1
Garments, footwear, hats and textiles	2.9	-32.2	-19.6
Cosmetics	12.6	-13.2	-0.2
Gold, silver and jewellery	0.4	-37.7	-23.6
Commodities for daily use	13.9	-4.2	5.2
Home appliances and audio/video equipment	5.6	-29.9	-12.2
Traditional Chinese and Western medicines	9.0	2.9	5.8
Cultural and office appliances	3.3	-3.4	1.6
Furniture	5.1	-29.3	-14.1
Communication appliances	8.5	-3.6	5.8
Petroleum and related products	1.2	-23.5	-18.4
Automobiles	-0.8	-30.3	-15.2
Building and decoration materials	2.8	-23.9	-11.0

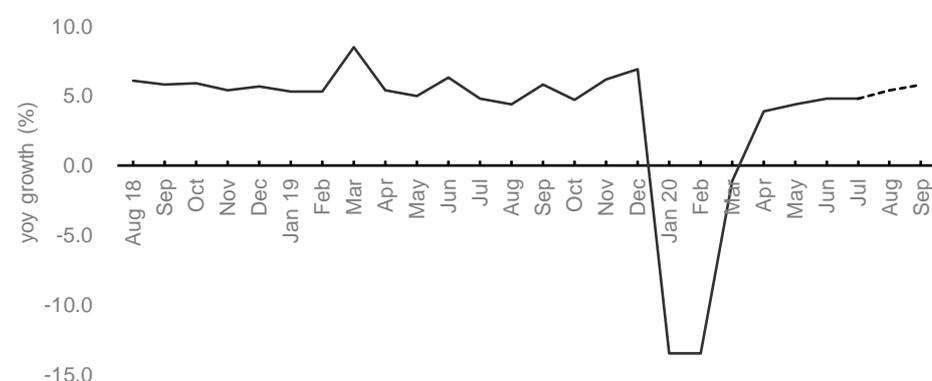
Source: National Bureau of Statistics, PRC

3. Industrial production returns to growth in 2Q20

China's industrial production (IP), measured by the value-added of industrial output (VAIO) of industrial enterprises above designated size¹, rose by 4.8% yoy in June (see exhibit 6). Overall, China's IP contracted by 1.3% yoy in 1H20.

Exhibit 6: China's industrial production growth and forecasts, August 2018 to September 2020

Aug 19	Sep	Oct	Nov	Dec	Jan-Feb 20	Mar	Apr	May	Jun	Jul
4.4%	5.8%	4.7%	6.2%	6.9%	-13.5%	-1.1%	3.9%	4.4%	4.8%	4.8%



Source: National Bureau of Statistics, PRC

In 1H20, basic consumer staples categories such as 'grain, oil, foodstuff', 'beverages' and 'commodities for daily use' still managed to post respectable sales growth. Meanwhile, consumer discretionary categories such as 'gold, silver and jewellery' and 'garments, footwear, hats, knitwear' suffered the worst drop in retail sales.

We expect that China's industrial production growth will average around 5.5% yoy in 3Q20, as manufacturers have resumed normal production. Moreover, the government's stimulus measures are likely to partly offset the negative impact of the global economic slowdown on China's industrial activities.

¹ 'Industrial enterprises above designated size' refer to industrial enterprises with annual revenue of 20 million yuan or more.

4. Fixed asset investment drops year-on-year in 1H20

The nominal growth of China's fixed asset investment (FAI) (excluding rural households) declined to minus 3.1% yoy in 1H20, the lowest half-year figure on record. Overall, China's FAI (excluding rural households) amounted to 28.2 trillion yuan in 1H20 (see exhibit 7).

Exhibit 7: China's FAI (excluding rural households) growth, February to June 2020

Year-to-date, yoy growth %	Feb 20	Mar	Apr	May	Jun
FAI (excluding rural households)	-24.5	-16.1	-10.3	-6.3	-3.1
- Manufacturing sector	-31.5	-25.2	-18.8	-14.8	-11.7
- Infrastructure (excluding power, heat, gas and water infrastructure)	-30.3	-19.7	-11.8	-6.3	-2.7
- Real estate development	-16.3	-7.7	-3.3	-0.3	1.9

Source: National Bureau of Statistics, PRC

We predict that the growth in China's FAI will continue to pick up and return to the positive territory in 3Q20, on the back of massive government efforts to increase infrastructure investment, including fiscal boost, monetary easing and pushes from the central government to expedite project approval and construction.

5. Fast growth in M2 and total outstanding RMB loans indicates credit easing

Both the broad money supply (M2) and the total outstanding RMB loans have grown at a faster pace recently, indicating an ease in credit conditions in China (see exhibit 8 & 9).

Exhibit 8: Broad money supply (M2) and RMB loans, August 2019 to July 2020

As of	Broad money supply (M2)		Total outstanding RMB loans	
	Amount (trillion yuan)	yoy growth	Amount (trillion yuan)	yoy growth
End-Aug 19	193.6	8.2%	148.2	12.4%
End-Sep	195.2	8.4%	149.9	12.5%
End-Oct	194.6	8.4%	150.6	12.4%
End-Nov	196.1	8.2%	152.0	12.4%
End-Dec	198.7	8.7%	153.1	12.3%
End-Jan 20	202.3	8.4%	156.5	12.1%
End-Feb	203.1	8.8%	157.4	12.1%
End-Mar	208.1	10.1%	160.2	12.7%
End-Apr	209.4	11.1%	161.9	13.1%
End-May	210.0	11.1%	163.4	13.2%
End-Jun	213.5	11.1%	165.2	13.2%
End-Jul	212.6	10.7%	166.2	13.0%

Exhibit 9: Increase in RMB loans, 2019 to July 2020

Increase in RMB loans (trillion yuan)	
FY19	16.81
1H20	12.09
Aug 19	1.21
Sep	1.69
Oct	0.66
Nov	1.39
Dec	1.14
Jan 20	3.34
Feb	0.91
Mar	2.85
Apr	1.70
May	1.48
Jun	1.81
Jul	0.99

Source: People's Bank of China

In the past few months, the People's Bank of China (PBoC), China's central bank, has continued to take actions to maintain reasonably sufficient liquidity in the banking system and encourage banks to channel funds into the real economy.

The PBoC lowered interest rates of major lending facilities on 1 July.² The re-lending rates charged by the PBoC to financial institutions for lending to agricultural and small enterprises were reduced by 0.25 percentage point. The rediscount rates also dropped by the same extent.

China's monetary policy is shifting from broad easing to targeted support, which could be more effective in providing the needed financing for enterprises and supporting the real economy. Refraining from flood-like easing is also aimed to prevent asset speculation caused by excessive liquidity.

In 2H20, China's central bank is likely to further lower interest rates of major lending facilities to support the real economy.

² http://www.gov.cn/xinwen/2020-07/01/content_5523056.htm

6. PMI indicates accelerated recovery of industrial production

China's manufacturing PMI fell from 50.8 in April to 50.6 in May, and then rose to 50.9 in June and 51.1 in July. The index readings in recent months show that the recovery of China's manufacturing sector from the COVID-induced slowdown has accelerated (see exhibit 10).

Production activities have recovered at a relatively fast pace in recent months, as indicated by the strong output index throughout April to July. This was supported by the relatively stable growth in overall new orders: The new orders index rose from 50.2 in April to 51.7 in July, indicating an improvement in the overall demand lately.

Prices of industrial products have started to rise: The ex-factory prices index went up above the critical 50-mark in June and July. The rise in product prices was partly attributed to the recent increase in the prices of materials: The input prices index returned to the expansionary zone in May, and further reached 58.1 in July.

The business expectations index rose from 54.0 in April to 57.9 in May and stayed high at 57.5 in June and 57.8 in July. The index has been well above the critical 50-mark in recent months, indicating that purchasing managers in China have been optimistic about the near-term outlook for their respective industries.

Exhibit 10: China's manufacturing PMI at a glance, July 2020

Index	Seasonally Adjusted Index	Index Compared with the Previous Month	Direction
PMI	51.1	Higher ▲	Expanding
Output	54.0	Higher ▲	Expanding
New Orders	51.7	Higher ▲	Expanding
New Export Orders	48.4	Higher ▲	Contracting
Backlogs of Orders	45.6	Higher ▲	Contracting
Stocks of Finished Goods	47.6	Higher ▲	Contracting
Purchases of Inputs	52.4	Higher ▲	Expanding
Imports	49.1	Higher ▲	Contracting
Input Prices	58.1	Higher ▲	Rising
Ex-factory Prices	52.2	Lower ▼	Rising
Stocks of Major Inputs	47.9	Higher ▲	Contracting
Employment	49.3	Higher ▲	Contracting
Suppliers' Delivery Time	50.4	Lower ▼	Quickening
Business Expectations	57.8	Higher ▲	Optimistic

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

The July PMI indicates an accelerating pace of recovery in China's manufacturing. Production activities continued to recover at a fast pace. New orders also grew compared with June, indicating an improvement in the overall demand. Prices of industrial products started to rise, due partly to the recent increase in the prices of materials.

Looking ahead, we predict that the headline PMI will fluctuate within 50.0 to 51.0 in the next few months, pointing to a stable recovery of the manufacturing sector and the economy.

7. NMI indicates continued recovery in non-manufacturing sector

China's Non-manufacturing Business Activity Index, which is quoted as the Non-manufacturing Purchasing Managers' Index (NMI), fluctuated within a narrow range of 53.2 to 54.4 throughout April to July (see *exhibit 11*). The index readings indicate that the non-manufacturing sector has been recovering from the COVID-19 outbreak in China.

After rising from 52.1 in April to 52.7 in June, the new orders index fell to 51.5 in July, indicating a deceleration in the growth of new orders.

The sales prices index rose above the critical 50-mark in July, meaning that enterprises have raised their service charges recently. Meanwhile, the input prices index went up from 49.0 in April to 53.0 in July, indicating that input prices have increased at a faster pace recently.

The business expectation index came in at 62.2 in July, well above the critical 50-mark, suggesting that purchasing managers in the non-manufacturing sector have remained optimistic about the near-term outlook for their respective industries.

We expect that China's non-manufacturing sector will sustain its recovering momentum and that the NMI will fluctuate around 54.0 in the next few months.

Exhibit 11: China's non-manufacturing purchasing managers' index (NMI) at a glance, July 2020

Index	Seasonally Adjusted Index	Index Compared with the Previous Month	Direction
Business activity	54.2	Lower ▼	Expanding
New orders	51.5	Lower ▼	Expanding
Input prices	53.0	Higher ▲	Rising
Sales prices	50.1	Higher ▲	Rising
Business expectations	62.2	Higher ▲	Optimistic

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

B. Policy updates and outlook

1. NDRC takes key measures to boost consumption

The National Development and Reform Commission (NDRC) said on 24 May³ that it will take multiple measures to promote the further rebound in consumption:

- Promoting consumption upgrade, strengthening the supervision of brands, product quality, industry standards and improving the consumption environment.
- Expanding service consumption, especially in service consumption in culture, tourism, sports, elderly care, childcare, housekeeping, and education.
- Accelerating the cultivation of new modes of consumption such as digital consumption, online consumption and information consumption; promoting the integration of online and offline consumption; promoting the transformation and upgrading of traditional offline retail formats.
- Promoting green consumption; promoting the upgrading of motor vehicles, home appliances and electronic products.
- Developing new infrastructure that supports new modes of consumption such as 5G networks, data centres, industrial Internet, and Internet of Things; improving urban and rural logistics networks to facilitate consumption.

2. State Council supports exporters explore domestic market

The State Council issued a circular on 22 June⁴, introducing measures to help exporters sell products domestically and support foreign trade businesses.

Foreign trade enterprises are allowed to sell export products that meet China's standards in the domestic market. These enterprises are encouraged to expand sales channels such as e-commerce platforms.

The government will provide various administrative support for foreign trade companies, such as simplifying product certification procedures and taxation procedures. Moreover, financial institutions are asked to provide support for the transformation, and strengthen supply chain financial services.

To boost consumption, the NDRC will take steps to promote consumption upgrade, expand service consumption, prompt the growth of digital and online consumption, encourage the use of green products, and speed up construction of new infrastructure.

The policy represents China's latest effort to alleviate the woes of foreign trade enterprises and to keep growth on track as the COVID-19 outbreak sees no sign of abating overseas. However, one caveat is that the domestic sales of export goods could exacerbate over-supply in the still-sluggish domestic market.

³ <http://politics.people.com.cn/n1/2020/0524/c1001-31721164.html>

⁴ http://www.gov.cn/zhengce/content/2020-06/22/content_5521078.htm

3. Government Work Report and CPC meeting lay out policy orientation

According to the Government Work Report⁵ released in late May, China will step up macroeconomic policies to keep businesses and employment stable. The proactive fiscal policy must be more effective, with steps to raise the budget deficit to at least 3.6% of the GDP and to issue special sovereign bonds worth 1 trillion yuan. The prudent monetary policy must be more flexible and appropriate. The central bank will use a variety of tools such as required reserve ratio reductions, interest rate cuts, and re-lending to enable M2 money supply and aggregate financing to grow at notably higher rates than last year and guide interest rates to fall.

Moreover, the government aims to reduce corporate burden by more than 2.5 trillion yuan in 2020. It will continue to foster an enabling environment for the development of the private sector. It will also work to improve the consumption willingness and ability of the people and support the recovery and development of consumer service sectors.

A meeting of the Political Bureau of the Communist Party of China (CPC) Central Committee was held on 30 July to make arrangements for the economic work for the second half of the year.⁶ The meeting also called for pursuing a more proactive and effective fiscal policy that meets the funding requirements for the construction of major projects, and a more flexible and appropriate monetary policy.

China's macroeconomic policy stance is likely to remain supportive in 2H20, which will help alleviate the downward pressure on the Chinese economy and promote its continued recovery.

⁵ <http://english.www.gov.cn/2020special/govtworkreport2020>

⁶ <http://cpc.people.com.cn/n1/2020/0730/c64094-31804413.html>

Part Two: Foreign Trade

A. Recent developments

1. Surprise rebound in exports in June and July signals recovering external demand

In 1H20, China's exports declined by 6.2% yoy to US\$1,098.7 billion, while China's imports fell by 7.1% yoy to US\$930.9 billion (see exhibits 12, 13 and 14).

Exhibit 12: China's quarterly foreign trade data, 3Q19 to 2Q20

	Exports		Imports		Trade Balance
	Amount (USD billion)	yoy growth	Amount (USD billion)	yoy growth	Amount (USD billion)
FY19	2,499.5	0.5%	2,078.4	-2.7%	421.1
3Q19	654.9	-0.3%	537.1	-6.2%	117.8
4Q19	673.1	1.8%	546.3	3.2%	126.7
1Q20	477.9	-13.4%	464.8	-3.0%	13.1
2Q20	620.8	0.1%	466.2	-9.7%	154.7

Source: China Customs

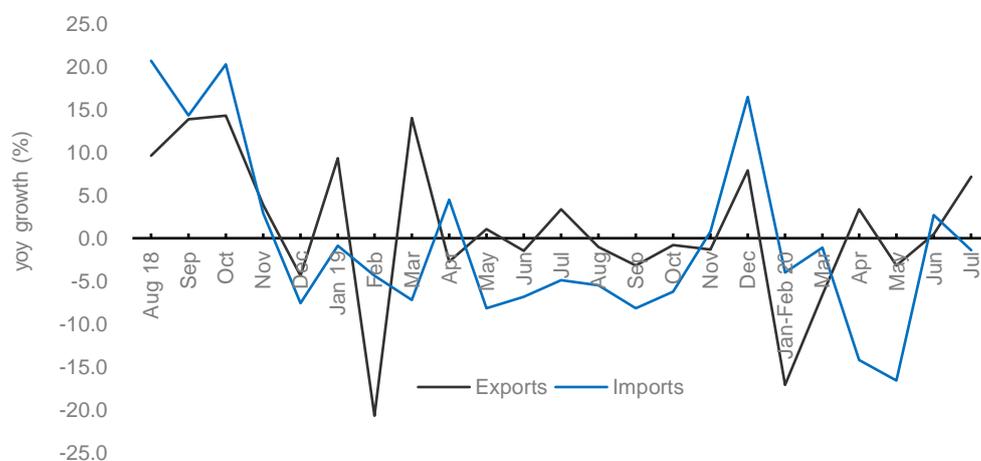
Exhibit 13: China's monthly foreign trade data, August 2019 to July 2020

	Exports		Imports		Trade Balance
	Amount (USD billion)	yoy growth	Amount (USD billion)	yoy growth	Amount (USD billion)
August 19	214.9	-1.0%	180.2	-5.5%	34.7
September	218.2	-3.2%	179.1	-8.2%	39.1
October	213.0	-0.8%	170.7	-6.2%	42.3
November	221.4	-1.3%	184.3	0.8%	37.2
December	238.6	7.9%	191.4	16.5%	47.2
Jan-Feb 2020	292.8	-17.1%	299.7	-4.0%	-6.9
March	185.1	-6.6%	165.1	-1.1%	20.1
April	200.1	3.4%	154.9	-14.2%	45.2
May	207.1	-3.2%	144.1	-16.6%	63.0
June	213.6	0.5%	167.2	2.7%	46.4
July	237.6	7.2%	175.3	-1.4%	62.3

Source: China Customs

The unanticipated year-on-year increase in exports in June and July signals that external demand is recovering, which bodes well for China's economic recovery in the second half of the year.

Exhibit 14: Growth rates of exports and imports, August 2018 to July 2020



Source: China Customs

The strong increase in textile exports in 1H20 was driven by a surge in overseas demand for personal protective equipment such as masks, gloves and isolation suits. With the end of the COVID-19 pandemic no end in sight, overseas demand for these ‘anti-epidemic’ goods will continue to boost China’s exports in the foreseeable future.

Exhibit 15: Exports by category, 2019 and 1H20

<i>yoy growth (%) of export value, calculated in USD</i>	2019	1H20
Textile yarn, fabrics and textile products	0.9	27.8
Garments and clothing accessories	-4.0	-19.4
Footwear	1.7	-30.2
Toys	24.2	-12.1
Furniture and parts	0.8	-11.6
Lighting fittings and parts	9.6	-6.5
Suitcases and handbags	0.5	-30.2
Refined oil	7.0	-15.1
Steel	-11.3	-18.7
Mechanical and electrical products	-0.1	-5.5

Source: China Customs

Exhibit 16: Imports by category, 2019 and 1H20

<i>yoy growth (%) of import value, calculated in USD</i>	2019	1H20
Soybeans	-7.2	12.7
Iron ores	33.6	10.2
Crude oil	0.4	-23.0
Refined oil	-15.2	-24.9
Steel	-14.1	-0.3
Textile yarn, fabrics and textile products	-12.1	-11.4
Vehicles and vehicle chassis	-4.3	-12.1
Integrated circuits	-2.1	12.2
Plastics	-5.5	-9.9

Source: China Customs

The drop in China’s imports in 1H20 was led by the decrease in the import value of crude oil and refined oil. However, it should be noted that the decrease was driven by a fall in crude oil prices rather than import quantities: China’s import of crude oil totalled 244.6 million metric tons in 1H20, up 9.9% yoy.

2. ASEAN remains China's largest trading partner but US regains status as China's top export market in 1H20

The ASEAN was still China's largest trading partner in 1H20. However, the US overtook the ASEAN and the EU to become China's largest export market again in 1H20 (see exhibits 17 and 18).

Exhibit 17: China's trading partners, 1H20

Country/Region	Trade value (USD billion)	Share of total trade (%)	Export value (USD billion)	Import value (USD billion)	yoy growth (%)		
					Total trade	Exports	Imports
ASEAN	297.9	14.7	164.0	133.9	2.2	0.0	5.0
EU	284.2	14.0	172.3	111.9	-4.9	-1.5	-9.6
US	234.0	11.5	177.6	56.4	-9.7	-11.1	-4.8
Japan	147.1	7.2	67.4	79.7	-2.9	-3.1	-2.6
Brazil	51.9	2.6	14.3	37.6	-1.3	-9.1	2.0
Russia	49.2	2.4	20.9	28.2	-5.6	-6.0	-5.3
India	35.4	1.7	26.7	8.7	-20.9	-25.4	-3.1

Source: China Customs

Exhibit 18: China's trading partners, comparing growth rates for 2019 and 1H20

yoy growth (%)

Country/Region	Total trade		Exports		Imports	
	2019	1H20	2019	1H20	2019	1H20
ASEAN	9.2	2.2	12.7	0.0	5.0	5.0
EU	3.4	-4.9	4.9	-1.5	1.1	-9.6
US	-14.6	-9.7	-12.5	-11.1	-20.9	-4.8
Japan	-3.9	-2.9	-2.6	-3.1	-4.9	-2.6
Brazil	3.7	-1.3	5.5	-9.1	2.9	2.0
Russia	3.4	-5.6	3.6	-6.0	3.2	-5.3
India	-2.8	-20.9	-2.4	-25.4	-4.5	-3.1

Source: China Customs

China's exports to certain developing economies such as the ASEAN remained robust in 1H20. We expect that developing economies will continue to be growth spots for China's exports in the near future.

3. Leading export provinces register export drop in 1H20

China's top six provinces and municipalities in terms of value of exports – Guangdong, Jiangsu, Zhejiang, Shandong, Shanghai and Fujian – jointly accounted for 75.3% of China's total exports in January to June 2020, down from 76.5% in 2019 (see exhibit 19).

Exhibit 19: Top six provinces and municipalities in terms of value of exports, January to June 2020

Provinces/ Municipalities	Value of exports (USD billion)	yoy growth (%)	Share of total exports (%)
Guangdong	294.5	-11.2	26.8
Jiangsu	178.5	-8.7	16.2
Zhejiang	150.6	-4.6	13.7
Shandong	78.8	-8.8	7.2
Shanghai	77.7	-4.8	7.1
Fujian	47.0	-10.2	4.3

Source: China Customs

4. China's FDI returns to growth in 2Q20

China's foreign direct investment (FDI) increased by 8.4% yoy in 2Q20, after a 10.8% yoy drop in 1Q20. Overall, in 1H20, China's FDI amounted to 472.2 billion yuan, down by 1.3% yoy (see exhibit 20).

Exhibit 20: China's FDI, July 2019 to June 2020

	Amount (billion yuan)	yoy growth
FY19	941.5	5.8%
January to June 2020	472.2	-1.3%
July 19	54.8	8.7%
August	70.9	3.6%
September	79.2	3.8%
October	69.2	7.4%
November	93.5	1.5%
December	95.5	3.5%
January 20	87.6	4.0%
February	46.8	-25.6%
March	81.8	-14.1%
April	70.4	11.8%
May	68.6	7.5%
June	117.0	7.1%

Source: Ministry of Commerce, PRC

In a somewhat surprising development, exports from Hubei, once hit hard by the COVID-19 outbreak, grew by 3.6% yoy in 1H20.

Several provinces still managed to record double-digit export growth in 1H20. For example, exports from Yunnan, Hunan and Sichuan jumped 34.9% yoy, 25.6% yoy and 17.6% yoy respectively in the period.

The COVID-19 outbreak only had a short-lived and limited impact on China's FDI. With COVID-19 being gradually brought under control in China, FDI flows into the country have begun to recover and record fast growth since April.

China is also witnessing a new trend in foreign investment activities, with FDI in China's high-tech service sector growing rapidly: FDI in the high-tech service sector soared by 19.2% yoy in 1H20.

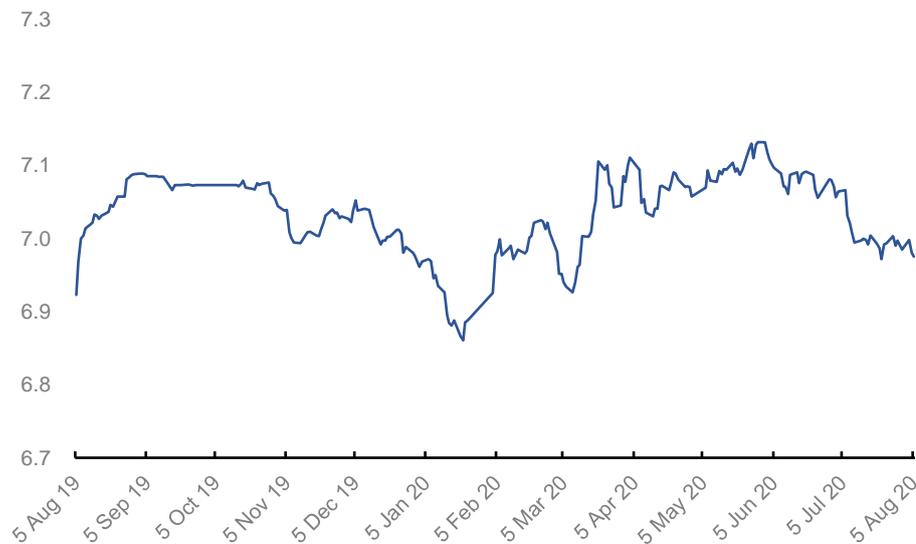
5. Chinese yuan appreciates against US dollar but depreciates against Euro since May

The daily fixing rate (also known as the central parity rate) of the Chinese yuan against the US dollar appreciated from a recent low of 7.1316 on 29 May to 6.9752 on 5 August (see exhibit 21).⁷ So far this year, the daily fixing rate of the Chinese yuan had appreciated by 0.01% (as of 5 August) against the US dollar.

Meanwhile, the daily fixing rate of the Chinese yuan against the Euro depreciated from a recent high of 7.6548 on 7 May to 8.2321 on 5 August. So far this year, the daily fixing rate of the Chinese yuan had depreciated by 5.06% (as of 5 August) against the Euro (see exhibit 22).

According to the Bank for International Settlements, the Chinese yuan depreciated in real terms against its trading partners by 0.43% in 1H20 (see exhibit 23).

Exhibit 21: USD-CNY daily fixing rate, August 2019 to August 2020

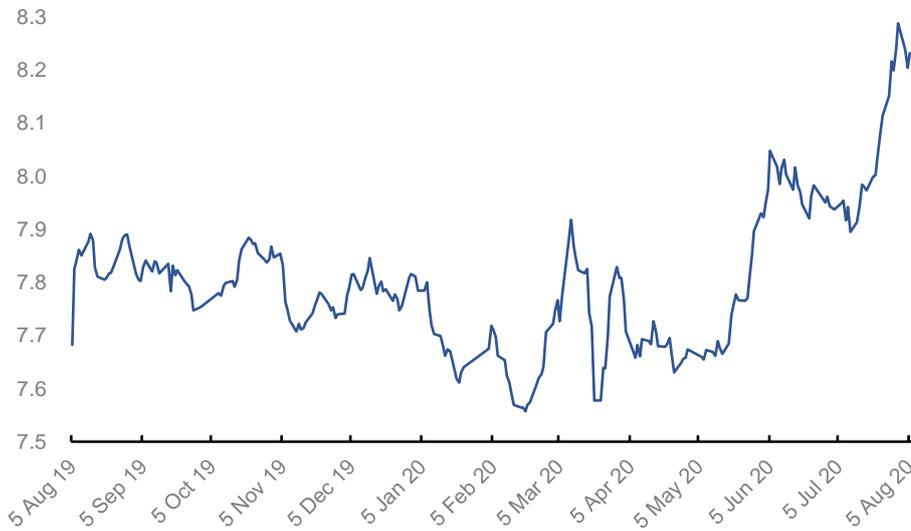


Source: State Administration of Foreign Exchange

Looking ahead, we predict that the exchange rate of the Chinese yuan against the US dollar will fluctuate around the current levels in the near term. While China-US tensions could add volatility and downside risks to Chinese yuan’s exchange rate, China’s strong economic recovery and the large interest-rate differential between China and developed economies will continue to support the Chinese yuan.

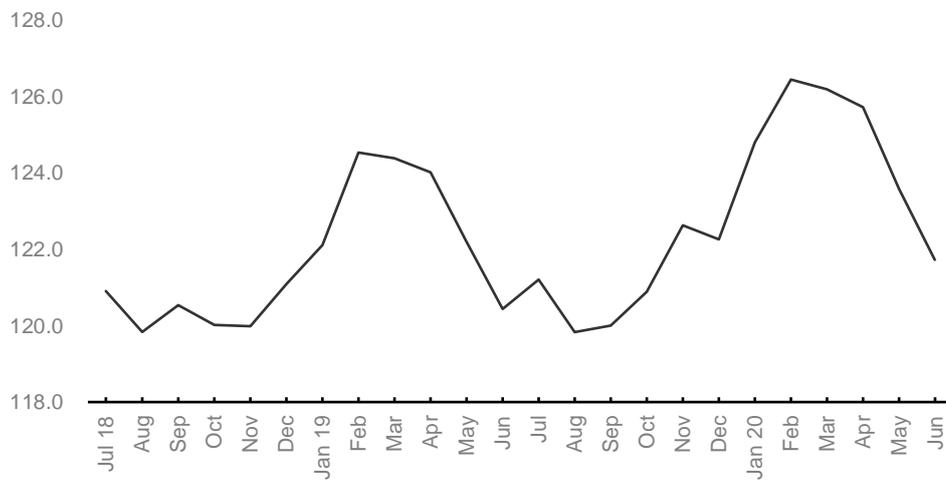
⁷ According to the PBOC, the daily fixing rate of the Chinese yuan against the US dollar is directly formed by market makers based on the closing rate of the previous day, the movements of major international currencies and ‘counter cyclical coefficient’.

Exhibit 22: EUR-CNY daily fixing rate, August 2019 to August 2020



Source: State Administration of Foreign Exchange

Exhibit 23: Real effective exchange rate of the Chinese yuan, July 2018 to June 2020



Source: Bank for International Settlements

B. Highlights

1. China-US tensions heighten over national security legislation for Hong Kong

Responding to China's passage of a new national security law imposed on Hong Kong, the US has announced new punitive measures against China. On 29 May, US President Donald Trump issued a proclamation to ban graduate students and researchers with ties to the Chinese government from using student visas to enter the US, effective from 1 June. Trump also instructed his Presidential Working Group on Financial Markets to study the 'differing practices' of Chinese companies listed on the US financial markets.

The US administration announced on 26 June that it would impose visa restrictions on current and former Chinese officials who the US claimed to be responsible for 'undermining Hong Kong's high degree of autonomy'. Then on 29 June, the US government announced that it would end the exports of US-origin defense equipment to Hong Kong, and take steps towards imposing the same restrictions on exports of US defense and dual-use technologies to Hong Kong as it does for China.

On 14 July, Trump took two actions against China. First, Trump signed an executive order ending Hong Kong's different treatment from the Chinese Mainland. The executive order has revoked several of the provisions under the United States – *Hong Kong Policy Act of 1992*, including eliminating preference for Hong Kong passport holders and revoking license exceptions for certain exports (mainly high-tech and defense-related) to Hong Kong. Second, Trump signed into law the *Hong Kong Autonomy Act* which was earlier passed by the Congress. The Act directs the US government to impose sanctions against any foreign individuals for 'contributing to the violation of China's commitments to Hong Kong', and against any foreign financial institutions that conduct business with those individuals.

Then on 7 August, the US administration imposed economic sanctions on 11 current and former Chinese and Hong Kong officials, including Hong Kong's Chief Executive, Carrie Lam Cheng Yuet-ngor. Responding to the US move, the Chinese government announced on 10 August sanctions on a group of 11 Americans, including lawmakers and top executives of US non-governmental organizations.

According to a notice published on the US Federal Register on 11 August, starting from 25 September, imported goods produced in Hong Kong 'must be marked to indicate that their origin is "China"'. Since the US will treat Hong Kong's domestic exports as exports from the Chinese Mainland, the 'China Section 301 tariffs' will be applied on Hong Kong as well. However, as Hong Kong's domestic exports to the US amounted to only HK\$3.57 billion (0.13% of GDP) in 2018, the impact on Hong Kong's economy and trade is limited.

Over the past few months, the US has announced a flurry of actions against Hong Kong. Although the direct impact on Hong Kong's economy and trade is limited, we see these moves as dangerous signs that China-US tensions have spilled over into a wider range of fronts in addition to the ongoing trade war and tech war, while China-US relations have nosedived to their lowest point in decades.

2. China-US tech war heats up

On 31 July, Trump said that he planned to ban Chinese short-video app TikTok's operations in the US. Trump changed course on 3 August and said he supports the sale of TikTok to Microsoft, but the transaction would have to be completed by 15 September.

On 6 August, citing the threats to US national security, foreign policy, and economy, Trump signed executive orders to ban any transactions with TikTok's parent company ByteDance and Wechat's parent company Tencent. Both orders will take effect in 45 days.

TikTok said the new executive order 'risks undermining global businesses' trust in the United States' commitment to the rule of law', adding it sets 'a dangerous precedent for the concept of free expression and open markets'.

3. China's new, shorter 'negative lists' signal further opening up

On 23 June, the National Development and Reform Commission (NDRC) and the Ministry of Commerce (MOF) jointly issued two 'negative lists' – the 2020 National Negative List and the 2020 Free Trade Zone Negative List, both of which took effect on 23 July. Compared with the 2019 negative lists, the new 2020 National Negative List has cut the number of prohibited industries from 40 to 33, and the new 2020 Free Trade Zone Negative List has cut the number of prohibited industries from 37 to 30. The two new negative lists have not only further relaxed foreign investment's access to the manufacturing and agriculture sectors, but also opened up key areas in service industries.

The US latest moves are part of a broader US crackdown on Chinese technology companies, aiming to thwart China's rise as a global technology power. Such heightening geopolitical rivalries point to an irreversible decoupling trend of the two economies, which is sure to cause huge disruptions to supply chains, production, investment and trade in the years to come.

With the new 2020 National Negative List, all restrictions on the share-holding ratio of foreign capital in the financial sector have been eliminated, which marks the full opening of China's financial sector. This is also in line with China's promise in its Phase One Trade Deal with the US.

C. Outlook

1. US and Eurozone see deep economic slumps

The US real GDP shrank by an annual rate of 32.9% in 2Q20, the steepest pace of contraction in the US GDP ever (see *exhibit 24*). Meanwhile, the Eurozone economy⁸ also contracted by a record 15.0% yoy in 2Q20 (see *exhibit 25*).

Exhibit 24: US real GDP growth, 2018 to 2Q20

Annual growth (%)

	2018	2019	3Q19	4Q19	1Q20	2Q20
Real GDP	3.0	2.2	2.6	2.4	-5.0	-32.9

Source: US Department of Commerce

Exhibit 25: Eurozone's real GDP growth, 2018 to 2Q20

	2018	2019	3Q19	4Q19	1Q20	2Q20
Real GDP (qoq growth %)			0.3	0.0	-3.6	-12.1
Real GDP (yoy growth %)	1.9	1.3	1.4	1.0	-3.1	-15.0

Source: Eurostat, IMF

As the number of new COVID-19 cases continues to stay high in the US and concerns grow over a second wave of infections in Europe, some US states and European countries have scaled back or paused the reopening of their economies. The recovery of the US and Eurozone economies in 3Q20 is likely to be constrained, in our view.

⁸ 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.

2. IMF projects dim global economic outlook for 2020

In the *World Economic Outlook Update* released in June, the IMF slashes its forecasts for world economic growth to minus 4.9% in 2020, from a 3.0% decline predicted in April. As such, the global economy is very likely to experience its worst downturn since the Great Depression amid the COVID-19 global pandemic (see exhibit 26).

	yoy growth (%)		
	2019 (Estimates)	2020 (Forecasts)	2021 (Forecasts)
World economy	2.9	-4.9	5.4
Advanced economies	1.7	-8.0	4.8
- US	2.3	-8.0	4.5
- Eurozone	1.3	-10.2	6.0
- Japan	0.7	-5.8	2.4
Emerging market and developing economies	3.7	-3.0	5.9
- China	6.1	1.0	8.2
- India*	4.2	-4.5	6.0
- Brazil	1.1	-9.1	3.6
- Russia	1.3	-6.6	4.1
- ASEAN-5 ⁹	4.9	-2.0	6.2

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

Source: *World Economic Outlook Update* released in June 2020, the IMF

Despite weak global economic outlook in the near term, we forecast that China's exports will post low single-digit year-on-year growth in 3Q20 due to a number of positive developments lately, including the gradual reopening of developed economies; robust demand from developing economies, especially the ASEAN; a continued huge demand for personal protective equipment and medical devices from China; and production disruptions in alternative production countries.

⁹ ASEAN-5 refers to Indonesia, Malaysia, Philippines, Thailand and Vietnam.

Fung Business Intelligence

Fung Business Intelligence collects, analyses and interprets global market data on sourcing, supply chains, distribution, retail and technology.

Headquartered in Hong Kong, it leverages unique relationships and information networks to monitor, research and report on these global issues with a particular focus on business trends and developments in China. Fung Business Intelligence makes its data, impartial analysis and specialist knowledge available to businesses, scholars and governments through regular research reports and business publications.

As the knowledge bank and think tank for the Fung Group, a Hong Kong-based multinational corporation, Fung Business Intelligence also provides expertise, advice and consulting services to the Group and its business partners on issues related to doing business in China, ranging from market entry and company structure, to tax, licensing and other regulatory matters.

Fung Business Intelligence was established in the year 2000.

Fung Group

Fung Holdings (1937) Limited, a privately-held business entity headquartered in Hong Kong, is the major shareholder of the Fung Group of companies, whose core businesses operate across the entire global supply chain for consumer goods including sourcing, logistics, distribution and retail. The Fung Group comprises over 34,000 people working in more than 40 economies worldwide. We have a rich history and heritage in export trading and global supply chain management that dates back to 1906 and traces the story of how Hong Kong and the Pearl River Delta emerged as one of the world's foremost manufacturing and trading regions. We are focused on both creating the Supply Chain of the Future to help brands and retailers navigate the digital economy as well as creating new opportunities, product categories and market expansion for brands on a global scale.

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