# China Trade Quarterly

ISSUE
39
AUG
2015

## Domestic Trade

Retail sales of consumer goods gain 10.4% yoy in 1H15.

Producer price index continues to fall.

Household income shows high single-digit growth in 1H15.

Stock market in the Chinese mainland plunges.

State Council releases *the guiding opinions on promoting the 'Internet Plus' action plan.*

Entrepreneurs in the secondary industry become less optimistic.

July PMI falls to the lowest level since March this year.

## Foreign Trade

Both exports and imports show negative yoy growth in 2Q15.

Foreign exchange reserves fall for the fourth consecutive quarter.

Chinese yuan depreciates in August as a result of exchange rate reform.

Global merchandise trade registers lower growth in 1Q15.

President Obama signs the trade promotion authority to speed up the Trans-Pacific Partnership negotiations.

Favourable policies are released to support the development of cross-border e-commerce.

馮氏
Fung Business Intelligence Centre

# In This Issue:

## Part 1: Domestic Trade



## Part 2: Foreign Trade





**Helen Chin, Timothy Cheung, Wang Yao**

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

**Global Sourcing**
**Fung Business Intelligence Centre**

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

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

http://www.fbicgroup.com/

# Executive Summary



## Domestic Trade

**Retail sales of consumer goods reached 14,157.7 billion yuan in 1H15,** up nominally by 10.4% yoy. By product category, sales of 'telecommunications equipment' achieved the fastest growth (37.0% yoy), boosted by the strong demand for smartphones.

**Ex-factory prices of industrial products have continued to drop.** The producer price index fell by 0.7% yoy in July, falling for the nineteenth consecutive month.

**Household income showed high single-digit growth in 1H15.** The per capita disposable income of households in China amounted to 10,931 yuan in 1H15, up by 9.0% yoy in nominal terms.

**Impact of the stock market crash on consumption is expected to be limited,** as only a small proportion of Chinese households participate in the stock market. A large part of Chinese households' wealth is not directly affected by the fluctuations in stock prices. We therefore do not expect the stock market crash to trigger a sharp decline in household consumption.

**On 4 July, the State Council released *the guiding opinions on promoting the 'Internet Plus' action plan*,** aiming at integrating the Internet with traditional industries. As for the retail sector, the government will support physical retailers to open online stores, and adopt technologies such as mobile payment and smart fitting rooms.

**Entrepreneurs in the secondary industry become less optimistic.** The Entrepreneur Confidence Index for the secondary industry fell from a three-quarter high of 120.6 in 1Q15 to 114.5 in 2Q15.

**PMI came in at 50.0 in July, the lowest level since March this year.** The index reading suggests stagnant growth in the manufacturing sector.

## Foreign Trade

**Both exports and imports showed negative yoy growth in 2Q15.** Exports fell by 2.0% yoy, while imports dropped by 13.6% yoy in 2Q15.

**Exports to the US and ASEAN gained 9.3% yoy and 9.5% yoy, respectively, in 1H15.** In contrast, exports to the EU and Japan fell by 2.5% yoy and 10.5% yoy respectively over the same period, signalling the sluggish demand for Chinese products from the EU and Japan.

**FDI maintained positive but decelerating yoy growth during 2Q15.** The growth of China's FDI registered 10.2%, 8.0% and 1.0% in April, May and June respectively. By sector, FDI in service sector grew by 23.6% yoy in 1H15. In contrast, FDI in manufacturing sector fell by 8.4% yoy over the same period, suggesting that foreign enterprises were less optimistic about the prospects in China's manufacturing sector.

**Foreign exchange reserves fell for the fourth consecutive quarter.** China's foreign exchange reserves fell by US$ 40.0 billion in 2Q15, amounting to US$ 3.69 trillion as at the end of 2Q15.

**Chinese yuan depreciated in August as a result of exchange rate reform.** The People's Bank of China announced the reform of the USD-CNY fixing rate quote on 11 August, aiming at a more market oriented exchange rate of the Chinese yuan. The reform and the 'one-off' depreciation of the yuan against the US dollar help close the gap between the fixing rate and the market rate, and help relieve the depreciation pressure on Chinese yuan.

**Global merchandise trade registered lower growth in 1Q15, according to the WTO.** Global merchandise exports gained 0.4% yoy in 1Q15, a further 0.3 ppts drop from the growth of 0.7% yoy in 2014. Exports from developing countries and emerging economies grew by 1.5% yoy, while exports from developed economies fell by 0.5% yoy in 1Q15.

**President Obama signed the trade promotion authority to speed up the Trans-Pacific Partnership (TPP) negotiations on 29 June.** The TPP, if realized, will become the largest free trade agreement in history, covering 12 countries in the Asia-Pacific region, excluding China. If the negotiations succeed, the TPP may pose pressures to China's foreign trade growth.

**Favourable policies were released to support the development of cross-border e-commerce.** The total trading value of cross-border e-commerce grew by 33.3% yoy in 2014, accounting for 14.2% of China's total foreign trade in the year. A number of facilitating measures for cross-border e-commerce have been issued since May, focusing on the custom clearance process, inspection and quarantine supervision, tax policy, payment and settlement, and financial support for cross-border e-commerce.

## A Recent developments

### 1. China's economic growth stabilizes

According to the National Bureau of Statistics, China's real GDP growth came in at 7.0% year-on-year (yoy) in 2Q15, the same as in 1Q15 (see exhibit 1). The figures indicate growth stabilization of the Chinese economy, attributable to the positive impact of the pro-growth policies. Overall, in 1H15, China's nominal GDP amounted to 29.7 trillion yuan.

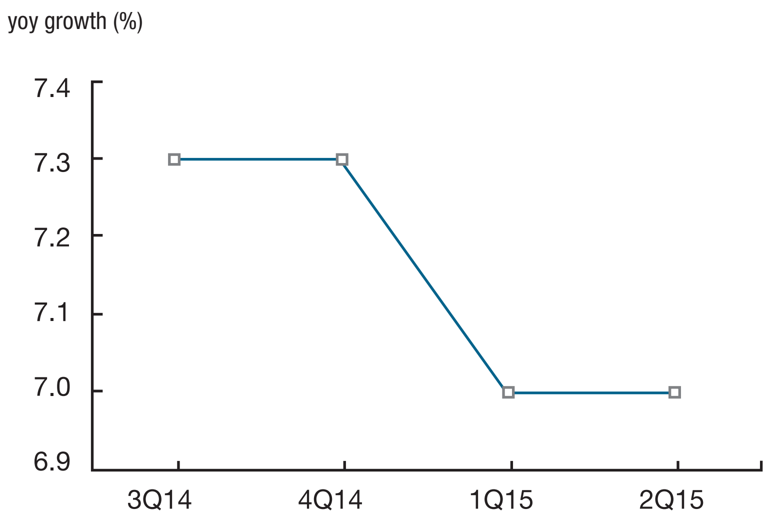
The tertiary industry has continued to grow faster than the secondary industry. The value-added of the tertiary industry, which contributed 49.5% of China's nominal GDP in 1H15, gained 8.4% yoy in real terms in 1H15. Particularly noteworthy is that the value-added of the financial sector witnessed sharp growth in 1H15, which rose by 17.4% yoy in real terms. Meanwhile, the value-added of the secondary industry, which contributed 43.7% of the country's nominal GDP, increased 6.1% yoy in real terms over the same period.

In response to the sluggish domestic and foreign demand, the government has continued to take moves to boost the economy in recent months. For example, China's central bank cut the benchmark interest rates on 11 May, and then reduced the required reserve ratio (RRR) for selected financial institutions and the benchmark interest rates on 28 June. Besides, on 10 June, the state council announced to expand the pilot programme of consumer finance companies from sixteen cities to the whole country. On 17 June, the state council revealed its decision to increase investment in areas such as power grids in rural areas, grain storage facilities, sewage treatment plants in urban areas, and renovations of old industrial areas and mining regions.

Looking ahead, we expect that the government will increase its efforts to boost economic growth in coming future. On the monetary front, we expect to see further interest rate reductions and RRR cuts this year. On the fiscal front, the government is likely to speed up the construction of infrastructure in near future. Regarding the long term policies, the government is expected to quicken the implementation of the *Belt and Road Initiative*, the *'Internet Plus' action plan* and the *'Made in China 2025'* strategy. With the pro-growth policies continuing to take effect, we forecast the real GDP growth to be around 7% yoy in 3Q15.



**Exhibit 1** China's real GDP growth, 3Q14 to 2Q15




| FY14 | 7.4% |
|---|---|
| 3Q14 | 7.3% |
| 4Q14 | 7.3% |
| 1Q15 | 7.0% |
| 2Q15 | 7.0% |

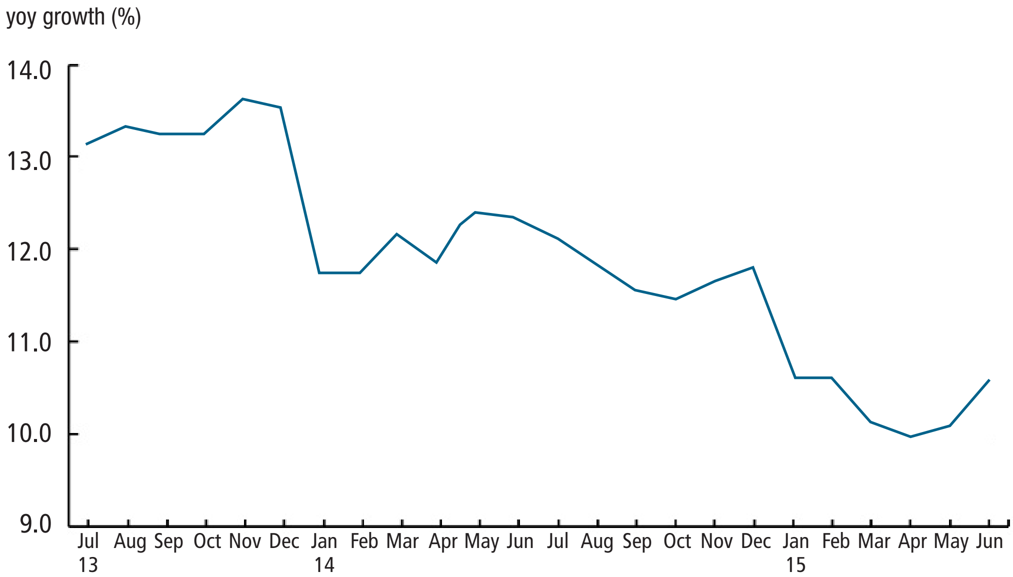
Source: National Bureau of Statistics, PRC

## 2. Growth of retail sales accelerates

According to the National Bureau of Statistics, the growth of China's total retail sales edged up from the recent low of 10.0% yoy in April to 10.1% yoy in May, and further accelerated to 10.6% yoy in June. On a month-on-month (mom) basis, the growth of seasonally-adjusted retail sales rose all the way from 0.62% in March to 0.96% in June. These figures indicate an improvement in consumption demand, despite the recent sharp fall in the A-share market.

Overall, in 1H15, the total retail sales of consumer goods reached 14,157.7 billion yuan. The nominal growth rate was 10.4% yoy in 1H15, compared to the 12.0% yoy growth seen in FY14 (see exhibits 2 and 3).

**Exhibit 2** China's total retail sales, year-on-year nominal growth, July 2013 to June 2015




| FY14 | 12.0 |
|---|---|
| Jul 14 | 12.2 |
| Aug | 11.9 |
| Sep | 11.6 |
| Oct | 11.5 |
| Nov | 11.7 |
| Dec | 11.9 |
| Jan-Feb 15 | 10.7 |
| Mar | 10.2 |
| Apr | 10.0 |
| May | 10.1 |
| Jun | 10.6 |

Source: National Bureau of Statistics, PRC

**Exhibit 3** China's total retail sales, month-on-month nominal growth, January to June 2015

*mom growth (%), seasonally adjusted*

| | Jan 15 | Feb | Mar | Apr | May | Jun |
|---|---|---|---|---|---|---|
| Total retail sales | 0.50 | 1.04 | 0.62 | 0.72 | 0.81 | 0.96 |

Source: National Bureau of Statistics, PRC

Rural retail sales have been growing faster than urban retail sales. In 1H15, rural retail sales expanded by 11.6% yoy to 1,972.7 billion yuan, while urban retail sales rose by 10.2% yoy to 12,185.0 billion yuan.

The pace of retail sales growth diverged for different modes of sales: The nominal growth for catering services sales improved from 9.7% yoy in FY14 to 11.5% yoy in 1H15. In contrast, the nominal growth for sales of goods decelerated to 10.3% yoy in 1H15 from 12.2% yoy in FY14.

Retail sales of goods by enterprises above a designated size[1] rose 7.4% yoy to reach 6,230.6 billion yuan in 1H15. By product category, sales of 'telecommunications equipment' achieved the fastest growth (37.0% yoy), boosted by the strong demand for smartphones. In contrast, sales for 'petroleum and related products' dropped by 6.5% yoy, partly attributed to the fall in fuel prices. The growth in sales for 'clothing, shoes, hats and textiles' came in at 10.7% yoy over the same period, down slightly from the 10.9% yoy growth seen in FY14. Exhibit 5 demonstrates the growth of China's retail sales by product among enterprises above a designated size.

**Exhibit 4** China's total retail sales, 2014 to 1H15

| *Nominal growth, yoy (%)* | FY14 | 1Q15 | 1H15 |
|---|---|---|---|
| Total retail sales | 12.0 | 10.6 | 10.4 |
| Goods | 12.2 | 10.5 | 10.3 |
| Sales by enterprises above a designated size | 9.8 | 7.8 | 7.4 |
| Catering services | 9.7 | 11.3 | 11.5 |

Source: National Bureau of Statistics, PRC



## 3. Chinese consumers become more optimistic

The consumer confidence index[2] rebounded from 107.1 in March to 107.6 in April and 109.9 in May, indicating that Chinese consumers have become more optimistic (see exhibit 6).

## 4. Household income shows high single-digit growth in 1H15

In 1H15, the per capita disposable income of households in China amounted to 10,931 yuan, up by 9.0% yoy in nominal terms (or 7.6% yoy real).

Growth of rural household income has outpaced growth of urban household income. In 1H15, the per capita disposable income of rural households increased nominally by 9.5% yoy (or 8.3% yoy real) to 5,554 yuan; while the per capita disposable income of urban households rose by 8.1% yoy in nominal terms (or 6.7% yoy real) to reach 15,699 yuan.

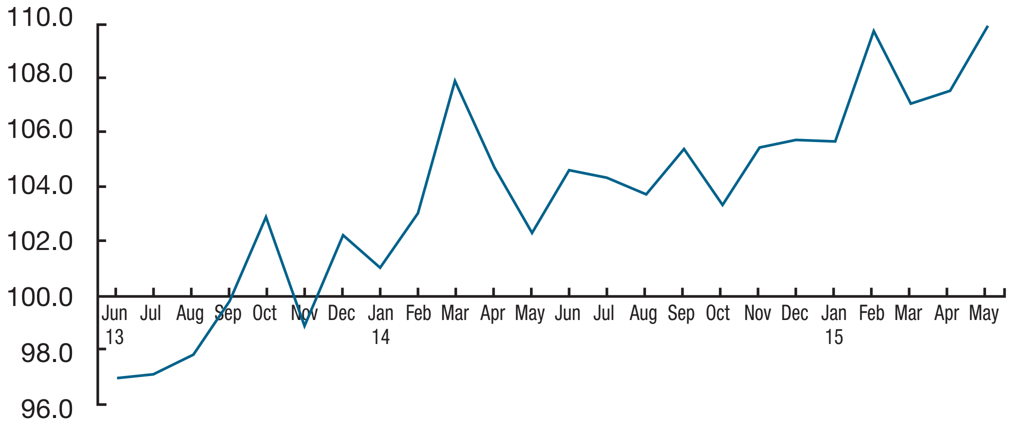
1 'Enterprises above a designated size' refers to enterprises with annual sales of 5 million yuan or more and with an employee strength of 60 or more.
2 A reading above 100 indicates that consumers tend to be optimistic; a reading below 100 indicates that consumers tend to be pessimistic.

**Exhibit 5** China's retail sales by enterprises above a designated size, by product, 2014 to 1H15

| *Nominal growth, yoy (%)* | FY14 | 1Q15 | 1H15 |
|---|---|---|---|
| Grain, oil, food, beverages, tobacco and liquor | 11.1 | 10.8 | 12.8 |
| Clothing, shoes, hats and textiles | 10.9 | 10.5 | 10.7 |
| Cosmetics | 10.0 | 10.1 | 9.2 |
| Gold, silver and jewellery | 0.0 | 3.6 | 5.2 |
| Products for daily use | 11.6 | 14.9 | 12.7 |
| Sports and entertainment products | 1.8 | 8.9 | - |
| Home appliances and video equipment | 9.1 | 13.7 | 10.7 |
| Chinese and Western medicines | 15.0 | 15.1 | 14.5 |
| Stationery and office accessories | 11.6 | 14.2 | 14.3 |
| Furniture | 13.9 | 15.4 | 16.5 |
| Telecommunications equipment | 32.7 | 38.0 | 37.0 |
| Petroleum and related products | 6.6 | -7.2 | -6.5 |
| Automobiles | 7.7 | 6.5 | 4.6 |
| Building and decoration materials | 13.9 | 15.8 | 17.4 |

Source: National Bureau of Statistics, PRC

**Exhibit 6** China's consumer confidence index, June 2013 to May 2015




| | |
|---|---|
| Jun 14 | 104.7 |
| Jul | 104.4 |
| Aug | 103.8 |
| Sep | 105.4 |
| Oct | 103.4 |
| Nov | 105.5 |
| Dec | 105.8 |
| Jan 15 | 105.7 |
| Feb | 109.8 |
| Mar | 107.1 |
| Apr | 107.6 |
| May | 109.9 |

Source: National Bureau of Statistics, PRC

## 5. CPI growth remains low

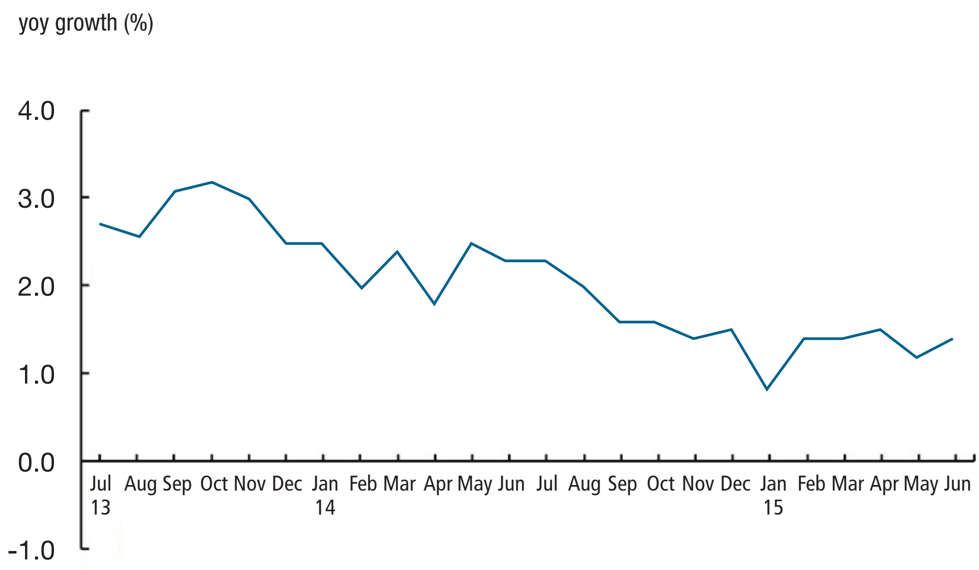
The year-on-year (yoy) growth rate of China's consumer price index (CPI)[3] remained low, staying between 1.2% yoy and 1.5% yoy throughout April to June.

Food prices have risen faster than non-food prices in recent months. The yoy growth of the food component in the CPI fluctuated between 1.6% and 2.7% during April to June. Meanwhile, the yoy growth of the non-food component in the CPI stayed within the range of 0.9% to 1.2% over the same period (see exhibits 7 and 8).

Looking ahead, we expect that the non-food inflation will stay low in near term, as domestic demand is likely to remain weak. We therefore expect the CPI growth to remain subdued, unless there is a strong rise in food prices. It is noteworthy that the recent floods in many provinces in China have limited the supply of vegetables, which could, in turn, put upward pressure on the prices of vegetables.



**Exhibit 7** China's CPI growth, July 2013 to June 2015




| | |
|---|---|
| Jul 14 | 2.3% |
| Aug | 2.0% |
| Sep | 1.6% |
| Oct | 1.4% |
| Nov | 1.4% |
| Dec | 1.5% |
| Jan 15 | 0.8% |
| Feb | 1.4% |
| Mar | 1.4% |
| Apr | 1.5% |
| May | 1.2% |
| Jun | 1.4% |

Source: National Bureau of Statistics, PRC

3 The CPI, compiled by the National Bureau of Statistics of China, measures the price of a basket of goods and services purchased by a typical household.

**Exhibit 8** China's CPI growth by commodity, January to June 2015

| *yoy growth (%)* | Jan 15 | Feb | Mar | Apr | May | Jun |
|---|---|---|---|---|---|---|
| Food | 1.1 | 2.4 | 2.3 | 2.7 | 1.6 | 1.9 |
| Tobacco and liquor | -0.4 | -0.6 | -0.5 | -0.5 | 1.7 | 3.5 |
| Clothing | 2.9 | 2.9 | 3.0 | 2.9 | 2.8 | 2.9 |
| Household services, maintenance and renovation | 0.9 | 1.5 | 1.2 | 1.1 | 1.0 | 1.0 |
| Medical and healthcare and personal care | 1.6 | 1.9 | 1.6 | 1.8 | 1.8 | 1.9 |
| Transportation and communication | -2.2 | -1.7 | -1.5 | -1.6 | -1.3 | -1.5 |
| Recreational, educational products and services | 0.3 | 1.8 | 1.6 | 1.6 | 1.7 | 1.7 |
| Housing | 0.8 | 0.6 | 0.6 | 0.6 | 0.7 | 0.8 |

Source: National Bureau of Statistics, PRC

After staying at minus 4.6% throughout March to May, the yoy growth rate for China's producer price index of industrial products (PPI)[4] edged down to minus 4.8% in June (see exhibits 9 & 10). On a mom basis, the PPI fell by 0.1%, 0.3%, 0.1% and 0.4% in March, April, May and June respectively, indicating that the ex-factory prices of industrial products have continued to drop.

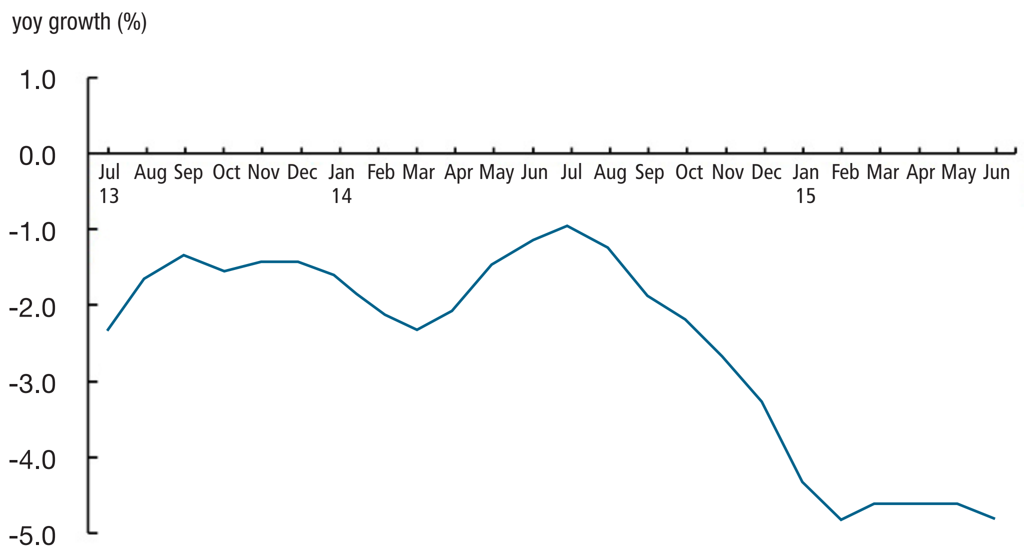
Going forward, we expect China's PPI to drop further in the near term, as domestic demand and foreign demand are likely to remain weak.

The yoy growth rate of the purchaser price index of industrial products registered minus 5.5% yoy in April and May, and then edged down to minus 5.6% yoy in June (see exhibits 11 & 12). On a mom basis, the purchaser price index dropped by 0.2% in April and stayed flat in May. In June, the price index fell again by 0.2%, indicating a drop in the domestic prices of production inputs.

The input prices sub-index of China's manufacturing PMI, a leading indicator of upstream prices, dropped all the way to 44.7 in July from 49.4 in May. In our view, the July index reading suggests that the domestic prices of production inputs are likely to trend downward in near term.

4 The PPI, compiled by the National Bureau of Statistics of China, measures the prices of industrial products when they are sold for the first time after production.

**Exhibit 9** China's PPI growth, July 2013 to June 2015




| | |
|---|---|
| Jul 14 | -0.9% |
| Aug | -1.2% |
| Sep | -1.8% |
| Oct | -2.2% |
| Nov | -2.7% |
| Dec | -3.3% |
| Jan 15 | -4.3% |
| Feb | -4.8% |
| Mar | -4.6% |
| Apr | -4.6% |
| May | -4.6% |
| Jun | -4.8% |

Source: National Bureau of Statistics, PRC

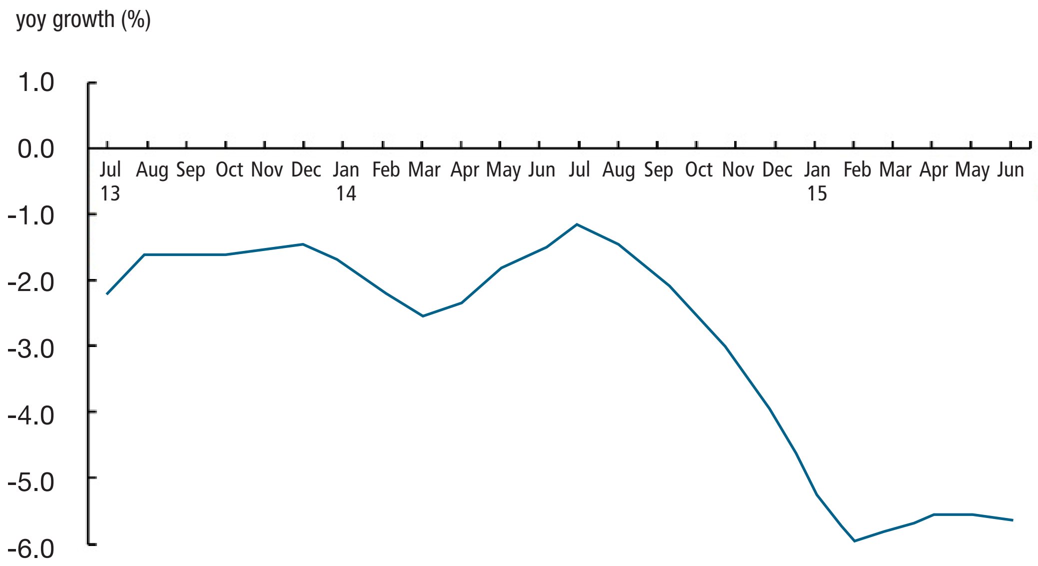


**Exhibit 10** China's PPI growth by selected industry, January to June 2015

| *yoy growth (%)* | Jan 15 | Feb | Mar | Apr | May | Jun |
|---|---|---|---|---|---|---|
| Textile industry | -2.1 | -2.4 | -2.5 | -2.4 | -2.3 | -2.3 |
| Textile and clothing | 0.7 | 0.6 | 0.9 | 0.6 | 0.6 | 0.7 |
| Timber processing & wood, bamboo, cane, palm fiber and straw products | 0.7 | 0.5 | 0.6 | 0.4 | 0.0 | -0.3 |

Source: National Bureau of Statistics, PRC

**Exhibit 11** Growth of China's purchaser price index of industrial products, July 2013 to June 2015




| | |
|---|---|
| Jul 14 | -1.1% |
| Aug | -1.4% |
| Sep | -1.9% |
| Oct | -2.5% |
| Nov | -3.2% |
| Dec | -4.0% |
| Jan 15 | -5.2% |
| Feb | -5.9% |
| Mar | -5.7% |
| Apr | -5.5% |
| May | -5.5% |
| Jun | -5.6% |

Source: National Bureau of Statistics, PRC

**Exhibit 12** China's purchaser price index of industrial products by selected commodity, January to June 2015

| *yoy growth (%)* | Jan 15 | Feb | Mar | Apr | May | Jun |
|---|---|---|---|---|---|---|
| Fuel & power | -9.9 | -12.0 | -11.5 | -11.2 | -10.9 | -10.6 |
| Non-ferrous metals | -4.8 | -5.7 | -4.6 | -3.7 | -3.9 | -5.3 |
| Raw materials for the chemical industry | -5.5 | -6.3 | -6.0 | -5.4 | -4.8 | -5.0 |
| Timber and paper pulp | -0.7 | -0.8 | -0.8 | -0.8 | -0.7 | -0.8 |
| Textile raw materials | -2.4 | -2.5 | -2.5 | -2.4 | -2.3 | -2.0 |

Source: National Bureau of Statistics, PRC

## 6. Growth of industrial production rebounds

The growth of China's value-added for industry (industrial production, IP) has rebounded in recent months. The IP growth accelerated all the way from the recent low of 5.6% yoy in March to 6.8% yoy in June (see exhibit 13).[5] Overall, in 1H15, China's IP expanded by 6.3% yoy, still slower than the 8.3% yoy growth recorded in 2014.

In the coming months, industrial activities will be supported by the positive impact of the accommodative monetary policy and the relaxation of mortgage policies, and the accelerating construction of infrastructure. Negative factors, however, include the rising labour and environmental costs, intense competition in the international market, foreign protectionism, weaker luxury and housing-related spending, and the overcapacity problem. Overall, we expect the industrial production (VAIO) growth to accelerate slightly to around 7% yoy in 3Q15.

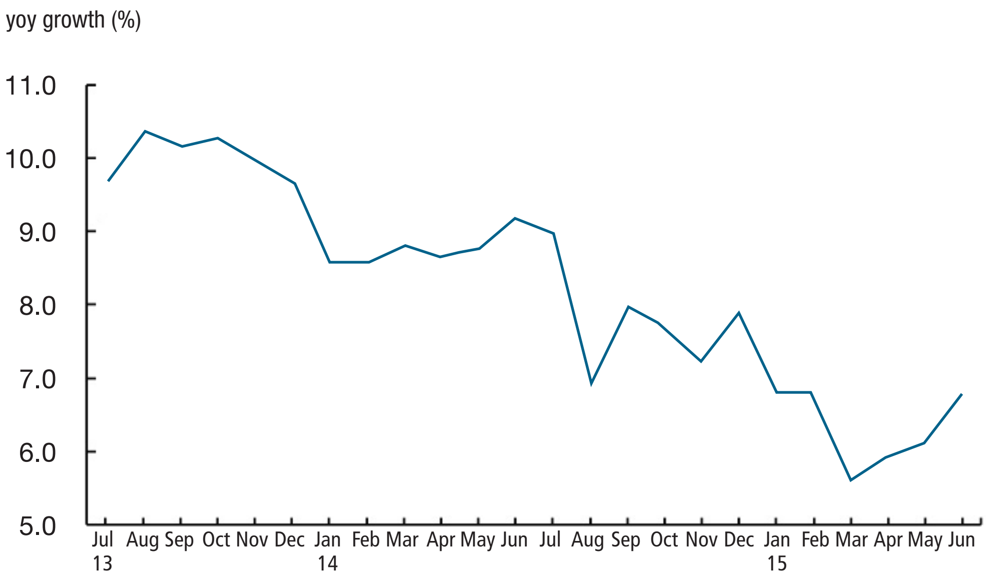
## 7. Industrial profits record positive growth

The total profits earned by large and medium industrial enterprises above a designated size[6] have posted positive growth in recent months. China's industrial profits gained 2.6% yoy and 0.6% yoy in April and May respectively. Overall, over the period January to May, China's industrial profits amounted to 2,254.8 billion yuan, posting negative growth of minus 0.8% yoy, compared to the positive growth of 3.3% yoy seen in 2014 (see exhibit 14).

Profits of upstream industries such as 'coal mining and washing', 'extraction of petroleum and natural gas' and 'mining of ferrous metals' plunged by 66.8% yoy, 69.5% yoy and 46.6% yoy respectively over the period January to May. In contrast, several high-tech industries such as 'railway, ships, aircrafts, aerospace and other transportation equipment' and 'communications, IT and electronic equipment and instruments' recorded positive growth of 9.0% yoy and 24.3% yoy respectively over the same period.



**Exhibit 13** China's industrial production growth, July 2013 to June 2015




| | |
|---|---|
| Jul 14 | 9.0% |
| Aug | 6.9% |
| Sep | 8.0% |
| Oct | 7.7% |
| Nov | 7.2% |
| Dec | 7.9% |
| Jan-Feb 15 | 6.8% |
| Mar | 5.6% |
| Apr | 5.9% |
| May | 6.1% |
| Jun | 6.8% |

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.

Meanwhile, profits of light industries such as 'textile', 'garments and clothing accessories' and 'furniture' gained 6.3% yoy, 7.9% yoy and 16.6% yoy respectively over the period January to May, boding well for these industries.

## 8. Growth of fixed asset investment decelerates

The growth of China's nominal fixed asset investment (FAI) (excluding rural households) decelerated to 11.4% yoy in 1H15 from 15.7% yoy in 2014.[7] Overall, in 1H15, China's nominal FAI (excluding rural households) amounted to 23.7 trillion yuan (see exhibit 15).

The growth of FAI (excluding rural households) for real estate development fell to 4.6% yoy in 1H15 from 10.5% yoy in 2014, despite the recent signs of recovery in the property market in China.

The growth of FAI (excluding rural households) in the secondary industry decelerated to 9.3% yoy in 1H15, down from the 13.2% yoy growth recorded in 2014. In our view, a major reason for the fall in FAI growth is that the weak demand for industrial products has discouraged manufacturers from making investment.

The growth of FAI in infrastructure (excluding power infrastructure) remained high at 19.1% yoy in 1H15. Of which, the growth of FAI in the 'public facilities management' sector rose by 19.1% yoy, and the FAI in the 'road transportation' sector gained 22.2% yoy.



**Exhibit 14** China's industrial profits growth, November 2014 to May 2015

| *yoy growth (%)* | Nov 14 | Dec | Jan-Feb 15 | Mar | Apr | May |
|---|---|---|---|---|---|---|
| Total profits made by industrial enterprises above a designated size | -4.2 | -8.0 | -4.2 | -0.4 | 2.6 | 0.6 |

Source: National Bureau of Statistics, PRC

**Exhibit 15** China's FAI (excluding rural households) growth, January to June 2015

| | Jan 15 | Feb | Mar | Apr | May | Jun |
|---|---|---|---|---|---|---|
| FAI (excluding rural households) *(year-to-date, yoy growth %)* | - | 13.9 | 13.5 | 12.0 | 11.4 | 11.4 |
| FAI (excluding rural households) *(mom growth %, seasonally adjusted)* | 0.88 | 0.80 | 0.90 | 0.75 | 0.84 | 0.88 |

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. Impact of the stock market crash on consumption is expected to be limited

The recent plunge in the stock market in the Chinese mainland has caught the media's attention. The Shanghai Composite Index, China's benchmark index, closed at 3,965 on 14 August, down markedly by around 23% from its recent peak of 5,178 on 12 June.

Undoubtedly, the fall in stock prices has reduced China's total household wealth. Nevertheless, we believe that the impact on the overall consumption demand will be limited, as only a small proportion of Chinese households participate in the stock market. A recent survey conducted by the China Household Finance and Survey Centre of the Chinese Southwestern University of Finance and Economics suggests that only 8.8% of Chinese households held shares in the stock market in 2Q15. The figure implies that a large proportion of Chinese households' wealth is not directly affected by the fluctuations in stock prices. This may explain why the wealth effect from the earlier boom in the stock market in mid-2014 to mid-2015 on China's total retail sales was limited. (Despite the fact that the Shanghai Composite Index went up from its low of 2,024 on 19 June 2014 to 5,166 on 12 June 2015, the growth of China's total retail sales stayed low at between 11.5% yoy and 12.4% yoy throughout June to December 2014, and even slowed from 10.7% yoy in January to February 2015 to 10.1% yoy in May.) We therefore do not expect the stock market crash to trigger a sharp decline in household consumption.



### 2. Pilot programme of consumer finance companies is expanded to the whole country

To unleash the spending power of low- and middle-income consumers, the State Council announced to expand the pilot programme of consumer finance companies from sixteen cities to the whole country on 10 June.[8] Besides, the power to approve the establishment of consumer finance companies was delegated to provincial governments.

The consumer finance company is a type of financial institution that specializes in lending money to consumers. In early 2010, the China Banking Regulatory Commission (CBRC) introduced the pilot programme of consumer finance company and approved the establishments of four consumer finance companies in four selected cities. Afterwards, in September 2013, the CBRC announced to expand the pilot programme to cover sixteen cities in the country.

In our view, the latest policy move will lead to a remarkable increase in the number of consumer finance companies across China, which will greatly enhance the availability of consumer financial services. This bodes well for China's consumption growth in the future.

### 3. China releases the 'Internet Plus' action plan to integrate the Internet with traditional industries

On 4 July, the State Council released *the guiding opinions on promoting the 'Internet Plus' action plan*, aiming at integrating the Internet with traditional industries such as retail, manufacturing, logistics, agriculture, finance and health-care.[9]

The document outlines the related development goals and policy directions. Regarding the policy directions on the retail sector, the government will support physical retailers to open online stores, and adopt technologies such as mobile payment and smart fitting rooms. This will help enhance the shopping experience of consumers and boost sales of retailers. Looking ahead, we expect to see concrete measures to be launched soon.

### 4. Retail prices for gasoline and diesel trend downward

The retail prices for gasoline and diesel have trended downward in recent months. In response to the price movements of the global crude oil prices, the government reduced the maximum retail prices (including taxes) of gasoline and diesel on 9 June, 8 July and 22 July. In aggregate, the maximum retail prices (including taxes) of gasoline and diesel decreased by 5.6-7.2% after these three adjustments.

The fall in fuel prices is set to reduce transportation costs, which would in turn put downward pressure on consumer prices. According to the revised pricing mechanism for refined oil adopted since March 2013, fuel prices are adjusted every 10 working days, based on the changes in a basket of global crude oil prices.

8 http://big5.gov.cn/gate/big5/www.gov.cn/guowuyuan/2015-06/10/content_2877603.htm

9 http://big5.gov.cn/gate/big5/www.gov.cn/zhengce/content/2015-07/04/content_10002.htm

## 5. Growth of broad money supply edges up

Growth of broad money supply (M2) edged up to 11.8% yoy as at the end of June, compared to 11.6% yoy as at the end of March. Meanwhile, the growth of outstanding RMB loans came in at 13.4% yoy as at the end of June, compared to 14.0% yoy at the end of March. The amount of new RMB loans reached 2.88 trillion yuan in 2Q15, higher than the same period of the previous year (i.e. 2.72 trillion yuan) (see exhibit 16).

The People's Bank of China (PBOC) has continued to take moves to ease the credit conditions in China recently. For example, the central bank cut the benchmark interest rates on 11 May, and then reduced the required reserve ratios (RRRs) for selected financial institutions and the benchmark interest rates on 28 June.

Looking ahead, the government is likely to increase its efforts to boost economic growth in coming future. We therefore expect to see further interest rate reductions and RRR cuts this year, which will help lower financing costs on Chinese enterprises.





**Exhibit 16** Broad money supply (M2) and RMB loans, July 2014 to June 2015

| | Broad money supply (M2) | | Total outstanding RMB loans | |
|---|---|---|---|---|
| *As of* | Amount (trillion yuan) | yoy growth | Amount (trillion yuan) | yoy growth |
| End-Jul 14 | 119.4 | 13.5% | 78.0 | 13.4% |
| End-Aug | 119.8 | 12.8% | 78.7 | 13.3% |
| End-Sep | 120.2 | 12.9% | 79.6 | 13.2% |
| End-Oct | 119.9 | 12.6% | 80.1 | 13.2% |
| End-Nov | 120.9 | 12.3% | 81.0 | 13.4% |
| End-Dec | 122.8 | 12.2% | 81.7 | 13.6% |
| End-Jan 15 | 124.3 | 10.8% | 83.7 | 13.9% |
| End-Feb | 125.7 | 12.5% | 84.7 | 14.3% |
| End-Mar | 127.5 | 11.6% | 85.9 | 14.0% |
| End-Apr | 128.1 | 10.1% | 86.6 | 14.1% |
| End-May | 130.7 | 10.8% | 87.5 | 14.0% |
| End-Jun | 133.3 | 11.8% | 88.8 | 13.4% |

| | New RMB loans (trillion yuan) |
|---|---|
| FY14 | 9.78 |
| 1H15 | 6.56 |
| Jul 14 | 0.39 |
| Aug | 0.70 |
| Sep | 0.86 |
| Oct | 0.55 |
| Nov | 0.85 |
| Dec | 0.70 |
| Jan 15 | 1.47 |
| Feb | 1.02 |
| Mar | 1.18 |
| Apr | 0.71 |
| May | 0.90 |
| Jun | 1.27 |

Source: People's Bank of China

## 6. 'Total social financing' falls

'Total social financing' (covering sources of financing such as RMB loans, foreign currency loans, trust loans, entrusted loans, bank acceptance bills, corporate bonds, equity issuance and other instruments) amounted to 8.81 trillion yuan in 1H15, down by 1.46 trillion yuan compared to 1H14 (see exhibit 17). The drop in 'total social financing' was due to the reduction in new foreign currency loans, new entrusted loans, new trust loans, bank acceptance bills and corporate bond financing.

In 1H15, the share of new RMB loans in 'total social financing' was 74.8%, much higher than 59.4% in 2014, indicating that RMB loans have become a more important source of financing recently.



**Exhibit 17** Total social financing, 2014 to 1H15

| | FY14 | | 1H15 | |
|---|---|---|---|---|
| | Amount (billion yuan) | Share (%) | Amount (billion yuan) | Share (%) |
| Total social financing | 16,457.0 | 100.0 | 8,810.0 | 100.0 |
| RMB loans | 9,781.6 | 59.4 | 6,590.0 | 74.8 |
| Foreign currency loans | 355.4 | 2.2 | 43.6 | 0.5 |
| Trust loans | 517.4 | 3.1 | 30.9 | 0.4 |
| Entrusted loans | 2,507.0 | 15.2 | 532.4 | 6.0 |
| Bank acceptance bills | -128.5 | -0.8 | 30.0 | 0.3 |
| Corporate bonds | 2,425.3 | 14.7 | 928.6 | 10.5 |
| Equity issuance | 435.0 | 2.6 | 424.5 | 4.8 |

Source: People's Bank of China

# C Outlook

## 1. Entrepreneurs become less optimistic

China's Entrepreneur Confidence Index (ECI) for the secondary industry fell from a three-quarter high of 120.6 in 1Q15 to 114.5 in 2Q15, indicating that Chinese entrepreneurs in the industry have become less optimistic (see exhibit 18).[10]

The 'manufacturing', 'mining' and 'electricity, gas & water' sectors all recorded lower index readings in 2Q15, compared to 1Q15. Among these sectors, the 'manufacturing' sector posted the biggest fall in ECI – the ECI for the sector dropped by 6.6 pts from the previous quarter to 116.0 in 2Q15. Meanwhile, the ECI for the 'mining' sector was still well below the critical 100-mark in 2Q15, indicating that entrepreneurs in this sector have remained pessimistic amid the sluggish domestic demand for raw materials (see exhibit 19).

**Exhibit 18** China's Entrepreneur Confidence Index (Secondary Industry), 3Q13 to 2Q15

| | 3Q13 | 4Q13 | 1Q14 | 2Q14 | 3Q14 | 4Q14 | 1Q15 | 2Q15 |
|---|---|---|---|---|---|---|---|---|
| Entrepreneur Confidence Index (Secondary Industry) | 122.7 | 121.0 | 124.3 | 121.4 | 119.0 | 115.1 | 120.6 | 114.5 |

Source: National Bureau of Statistics, PRC

**Exhibit 19** Entrepreneur Confidence Index by sector, 1Q15 and 2Q15

| | 1Q15 | 2Q15 | Compared with the previous quarter |
|---|---|---|---|
| Secondary industry | 120.6 | 114.5 | Lower |
| Mining | 78.8 | 77.0 | Lower |
| Manufacturing | 122.6 | 116.0 | Lower |
| Electricity, gas & water | 131.6 | 127.5 | Lower |

Source: National Bureau of Statistics, PRC

10 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.

## 2. July PMI suggests stagnant growth in the manufacturing sector

China's manufacturing Purchasing Managers' Index (PMI) fell slightly from 50.2 in June to 50.0 in July, the lowest level since March this year. The July PMI indicates that China's manufacturing sector lacks growth momentum (see exhibit 20).

10 of the 12 sub-indices were lower than their respective levels in the previous month. For the first time since October 2012, the new orders index dropped below the critical 50-mark, registering 49.9 in July, indicating a slight contraction in new orders.[11] Meanwhile, the output index fell to a four-month low of 52.4 in July, showing that the output growth has decelerated recently. Also noteworthy is that the input prices index went down by 2.6 pts. from the previous month to 44.7 in July, showing that the prices of production inputs have dropped at a faster pace lately.

By size of enterprises, the PMI of 'large enterprises' went down to 50.6 in July from 50.8 in June. The PMI of 'medium enterprises' fell to 50.0 in July from 50.2 in June, while the PMI of 'small enterprises' dropped to 46.9 in July from 47.5 in June.

The business expectations index dropped all the way from 61.3 in March to a five-month low of 52.2 in June, before rebounding to 52.9 in July. The fall in the index suggests that Chinese manufacturers have become less optimistic about the near term outlook for their respective industries.



**Exhibit 20** China's manufacturing PMI at a glance, July 2015

| Index | Seasonally Adjusted Index | Index Compared with the Previous Month | Direction |
|---|---|---|---|
| PMI | 50.0 | Lower | Unchanged |
| Output | 52.4 | Lower | Expanding |
| New orders | 49.9 | Lower | Contracting |
| New export orders | 47.9 | Lower | Contracting |
| Backlogs of orders | 44.0 | Lower | Contracting |
| Stocks of finished goods | 47.4 | Lower | Contracting |
| Purchases of inputs | 50.3 | Lower | Expanding |
| Imports | 47.8 | Lower | Contracting |
| Input prices | 44.7 | Lower | Falling |
| Stocks of major inputs | 48.4 | Lower | Contracting |
| Employment | 48.0 | Lower | Contracting |
| Suppliers' delivery time | 50.4 | Higher | Quickening |
| Business expectations | 52.9 | Higher | Optimistic |

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

11 The 'new orders index' covers both domestic and export orders. That is to say, the manufacturers are not asked to differentiate between domestic and export orders when filling in questionnaires.

## 3. Growth of the non-manufacturing sector accelerates

China's Business Activity Index, which is quoted as the Non-manufacturing Purchasing Managers' Index (NMI), went up from 53.2 in May to 53.8 in June and 53.9 in July, the highest level in five months. The index readings in recent months suggest that the growth of the non-manufacturing sector has accelerated lately (see exhibit 21).

The new orders index rose from 49.5 in May to 51.3 in June. Nevertheless, the index fell to 50.1 in July, indicating that the growth of new orders has slowed.

The sales prices index was below the critical 50-mark in both June and July, showing that enterprises have lowered their service charges recently. Meanwhile, the input prices index dropped below 50 in July, indicating a fall in the costs of inputs.

Despite facing difficult situations, purchasing managers in the non-manufacturing sector remain optimistic about the near-term outlook for their respective sub-sectors: The business expectation index registered 60.1, 59.7 and 60.0 in May, June and July respectively, well above the neutral level of 50.



**Exhibit 21** China's non-manufacturing purchasing managers' index (NMI) at a glance, July 2015

| Index | Seasonally Adjusted Index | Index Compared with the Previous Month | Direction |
|---|---|---|---|
| Business activity | 53.9 | Higher | Expanding |
| New orders | 50.1 | Lower | Expanding |
| Input prices | 48.9 | Lower | Falling |
| Sales prices | 47.4 | Lower | Falling |
| Business expectations | 60.0 | Higher | Optimistic |

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

# A Recent developments

## 1. Both exports and imports show improving yoy growth in June

China's export growth further deteriorated from 4.7% yoy in 1Q15 to minus 2.0% yoy in 2Q15 (see exhibits 22, 23 and 24). This drop indicates that foreign demand remains sluggish for Chinese products, as the global economic recovery is still weak. Competitiveness of Chinese exports is also hurt by high costs, especially labour cost, and the strong Chinese yuan in real effective terms.

However, seen from the monthly data, the export growth showed improving trend during 2Q15, from minus 6.4% yoy in April to 2.8% yoy in June. Overall, China's exports amounted to US$ 1,073.0 billion in 1H15, increasing by 1.0% yoy.

China's import growth improved from minus 17.6% yoy in 1Q15 to minus 13.6% yoy 2Q15. The decrease in imports was mainly due to the downward pressure of domestic economy that had dragged down the domestic demand, and the sharp fall in commodity prices. However, the monthly yoy growth rate has been gradually improving in recent months. After 5 consecutive months of double-digit negative growth since January 2015, the imports dropped at a slower pace, by 6.1% yoy, in June 2015. Overall, in 1H15, China's imports totalled US$ 808.8 billion, decreasing by 15.5% yoy.

In 1H15, China's exports to the US, ASEAN and India gained 9.3% yoy, 9.5% yoy and 10.8% yoy respectively. China's exports to some of the countries covered by the *Belt and Road Initiative* recorded remarkable growth. For example, China's exports to Bangladesh, Pakistan, Saudi Arabia and Egypt showed growth rates of above 17% yoy, respectively, in 1H15, much higher than the total export growth (i.e. 1.0% yoy).[12] In contrast, the growth rates for exports to Japan and Russia have stayed negative, registering minus 10.5% yoy and minus 36.2% yoy respectively, over the same period. The figures signal the continued weak economic conditions and thus the sluggish demand for Chinese products in Japan and Russia.

Meanwhile, the growth rate for exports to the EU dropped significantly from 9.4% yoy in 2014 to minus 2.5% yoy in 1H15, mainly due to the weaker Euro and the sluggish economy.

Although the yoy growth of both exports and imports declined in 2Q15, China's trade surplus increased by US$ 16.5 billion from the previous quarter to US$ 140.2 billion in 2Q15.

**Exhibit 22** China's quarterly foreign trade data, 3Q14 to 2Q15

*USD billion (yoy growth)*

| | Exports | | Imports | | Trade Balance |
|---|---|---|---|---|---|
| FY14 | 2,342.7 | (6.1%) | 1,960.3 | (0.4%) | 382.5 |
| 3Q14 | 635.1 | (13.0%) | 506.9 | (1.2%) | 128.2 |
| 4Q14 | 646.1 | (8.5%) | 496.6 | (-1.6%) | 149.5 |
| 1Q15 | 513.9 | (4.7%) | 390.2 | (-17.6%) | 123.7 |
| 2Q15 | 559.1 | (-2.0%) | 418.9 | (-13.6%) | 140.2 |

Source: China Customs

12 http://fangtan.customs.gov.cn/tabid/350/InterviewID/62/Default.aspx

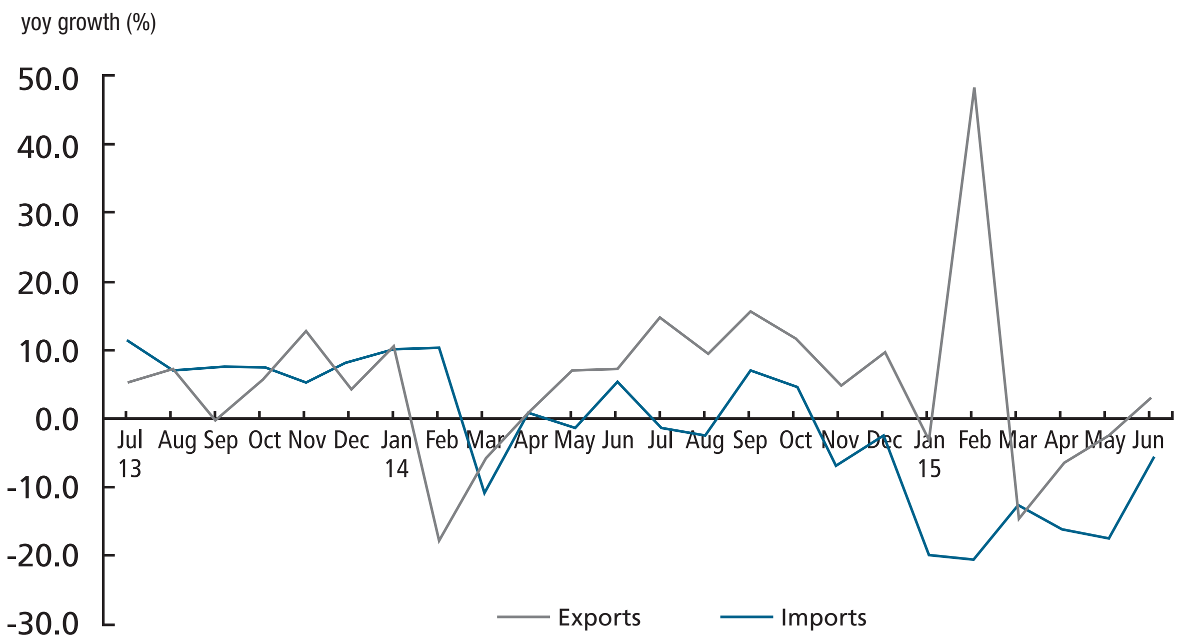
**Exhibit 23** China's monthly foreign trade data, July 2014 to June 2015

*USD billion (yoy growth)*

| | Exports | | Imports | | Trade Balance |
|---|---|---|---|---|---|
| July 14 | 212.9 | (14.5%) | 165.6 | (-1.5%) | 47.3 |
| August | 208.5 | (9.4%) | 158.6 | (-2.4%) | 49.8 |
| September | 213.7 | (15.3%) | 182.7 | (7.0%) | 31.0 |
| October | 206.9 | (11.6%) | 161.5 | (4.6%) | 45.4 |
| November | 211.7 | (4.7%) | 157.2 | (-6.7%) | 54.5 |
| December | 227.5 | (9.7%) | 177.9 | (-2.4%) | 49.6 |
| January 15 | 200.3 | (-3.3%) | 140.2 | (-19.9%) | 60.0 |
| February | 169.2 | (48.3%) | 108.6 | (-20.5%) | 60.6 |
| March | 144.6 | (-15.0%) | 141.5 | (-12.7%) | 3.1 |
| April | 176.3 | (-6.4%) | 142.2 | (-16.2%) | 34.1 |
| May | 190.8 | (-2.5%) | 131.3 | (-17.6%) | 59.5 |
| June | 192.0 | (2.8%) | 145.5 | (-6.1%) | 46.5 |

Source: China Customs

**Exhibit 24** Growth rates of exports and imports, July 2013 to June 2015




Source: China Customs

**Exhibit 25** Exports by category, 2014 and 1H15

| *yoy growth (%) of export value, calculated in USD* | 2014 | 1H15 |
|---|---|---|
| Textile materials and products | 4.9 | -0.7 |
| Garments and clothing accessories | 5.2 | -4.7 |
| Footwear | 10.8 | 1.3 |
| Toys | 14.2 | 13.4 |
| Coal | -34.5 | -38.3 |
| Crude oil | -66.3 | 436.2 |
| Refined oil | 5.2 | -31.6 |
| Steel | 33.1 | 0.1 |
| Mechanical and electrical products | 3.7 | 3.0 |

Source: China Customs

**Exhibit 26** Imports by category, 2014 and 1H15

| *yoy growth (%) of import value, calculated in USD* | 2014 | 1H15 |
|---|---|---|
| Cereal and cereal flour | 21.9 | 52.1 |
| Soybean | 6.0 | -22.0 |
| Iron ore | -11.8 | -45.9 |
| Crude oil | 3.9 | -41.7 |
| Refined oil | -26.8 | -35.4 |
| Steel | 5.0 | -14.6 |
| Textile yarns, fabric and textile products | -6.0 | -5.2 |
| Vehicles and related parts | 24.4 | -24.9 |

Source: China Customs



## 2. Share of processing trade in China's total trade falls slightly in 2Q15

The growth of processing trade[13] exports further dropped from minus 6.1% yoy in 1Q15 to minus 8.7% yoy in 2Q15; while the growth of general trade[14] exports dropped from 11.9% yoy in 1Q15 to 1.6% yoy in 2Q15 (see exhibit 27).

Growth of both general trade imports and processing trade imports remained negative in 2Q15. However, the growth of processing trade imports dropped further from minus 8.4% in 1Q15 to minus 12.8% in 2Q15, while the growth in general trade imports improved from minus 21.8% yoy in 1Q15 to minus 15.5% yoy in 2Q15. The decline in processing trade imports suggests that the processing trade exports is likely to continue its negative growth in the near future, as processing trade imports serves as a leading indicator of processing trade exports performance.

The share of processing trade in China's total trade slightly fell from 31.4% in 1Q15 to 30.6% in 2Q15. Although processing trade continues to play a key role in China's overall total foreign trade, with a large surplus of US$ 82.7 billion in 2Q15, the gap between processing trade surplus and general trade surplus significantly narrowed in 2Q15. General trade surplus increased from US$ 55.1 billion in 1Q15 to US$ 71.0 billion in 2Q15.

**13** '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.

**14** '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.

**Exhibit 27** China foreign trade (general and processing trades), 2014 to 2Q15

| Item | yoy growth (%) | | | Share (%) | | |
|---|---|---|---|---|---|---|
| | FY14 | 1Q15 | 2Q15 | FY14 | 1Q15 | 2Q15 |
| Exports | 6.1 | 4.7 | -2.2 | 100.0 | 100.0 | 100.0 |
| *Of which:* | | | | | | |
| General Trade | 10.7 | 11.9 | 1.6 | 51.4 | 54.0 | 54.7 |
| Processing Trade | 2.7 | -6.1 | -8.7 | 37.7 | 35.4 | 34.2 |
| Imports | 0.4 | -17.6 | -13.7 | 100.0 | 100.0 | 100.0 |
| *Of which:* | | | | | | |
| General Trade | 0.0 | -21.8 | -15.5 | 56.6 | 57.0 | 56.0 |
| Processing Trade | 5.5 | -8.4 | -12.8 | 26.8 | 26.2 | 25.8 |
| Total of Imports and Exports | 3.4 | -6.3 | -7.4 | 100.0 | 100.0 | 100.0 |
| *Of which:* | | | | | | |
| General Trade | 5.3 | -6.1 | -6.6 | 53.8 | 55.3 | 55.3 |
| Processing Trade | 3.8 | -7.0 | -10.3 | 32.7 | 31.4 | 30.6 |

Source: China Customs

## 3. Growth of China's exports to US accelerates in 1H15

China's largest trading partner in 1H15 is still the EU, comprising 14.4% of China's total foreign trade. Sino-EU trade amounted to US$ 271.7 billion in 1H15. Sino-EU trade dropped by 6.7% yoy in 1H15, compared to the positive growth of 9.9% yoy in 2014. The growth of China's exports to the EU also fell to minus 2.5% yoy in 1H15 from 9.4% yoy in 2014. China's imports from the EU dropped even more, by 12.9% yoy in 1H15, compared to the positive growth of 10.7% yoy in 2014 (see exhibits 28 and 29).

The US continues to be China's second largest trading partner in 1H15, accounting for 14.2% of China's total foreign trade. The growth of total Sino-US trade was 4.0% yoy in 1H15, slower than the 6.6% yoy growth seen in 2014. The growth of China's imports from the US declined to minus 7.7% yoy in 1H15 from 4.2% yoy in 2014. In contrast, the growth of China's exports to the US improved to 9.3% yoy in 1H15, as compared to a growth of 7.5% yoy in 2014.

China's third largest trading partner, the Association of South East Asian Nations (ASEAN), comprised 11.9% of China's total foreign trade in 1H15. China's trade with ASEAN gained 1.6% yoy to reach US$ 224.4 billion in 1H15. The growth of China's exports to ASEAN decelerated from 11.5% yoy in 2014 to 9.5% yoy in 1H15, but was still relatively high compared to the growth of China's exports to other major trading partners. In the meantime, the growth of China's imports from ASEAN decelerated to minus 8.3% yoy in 1H15 from 4.4% yoy in 2014.

Sino-Japan trade contracted by 10.6% yoy to US$ 135.6 billion in 1H15. China's exports to Japan fell by 10.5% yoy, while China's imports from Japan were down by 10.6% yoy over the period.

## 4. Growth rates of China's trade with Brazil and Russia drop in 1H15

Growth of China's foreign trade with Brazil and Russia both dropped in 1H15, from minus 4.0% yoy and 6.8% yoy in 2014 to minus 19.1% and minus 30.2% in 1H15 respectively. Particularly noteworthy is that China's imports from Brazil dropped markedly by 26.1% yoy in 1H15.

Both exports and imports dropped significantly for Sino-Russian trade, mainly due to Russia's deteriorating domestic economy and falling oil price.[15] Specifically, growth of China's exports to Russia declined from 8.2% yoy in 2014 to minus 36.2% yoy in 1H15; while growth of China's imports from Russia declined from 4.9% yoy in 2014 to minus 23.9% yoy in 1H15 (see exhibits 28 and 29).

Although growth of Sino-Indian trade also dropped from 7.9% yoy in 2014 to 1.1% yoy in 1H15, China's exports to India maintained high growth of 10.8% yoy in 1H15, only decelerating slightly from 12.0% yoy in 2014. However, China's imports from India significantly dropped by 24.7% yoy in 1H15, compared with the 3.5% yoy drop in 2014.

Together, these three BRIC members accounted for 5.3% of both China's total exports and total imports in 1H15, down from 6.1% of China's total exports and 5.6% of China's total imports in 2014.



**Exhibit 28** China's trading partners, 1H15

| 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 | 271.7 | 14.4 | 168.0 | 103.7 | -6.7 | -2.5 | -12.9 |
| US | 266.7 | 14.2 | 193.3 | 73.4 | 4.0 | 9.3 | -7.7 |
| ASEAN | 224.4 | 11.9 | 134.8 | 89.6 | 1.6 | 9.5 | -8.3 |
| Japan | 135.6 | 7.2 | 65.8 | 69.7 | -10.6 | -10.5 | -10.6 |
| Brazil | 34.2 | 1.8 | 14.9 | 19.3 | -19.1 | -8.0 | -26.1 |
| Russia | 31.1 | 1.7 | 14.6 | 16.4 | -30.2 | -36.2 | -23.9 |
| India | 34.2 | 1.8 | 27.3 | 6.9 | 1.1 | 10.8 | -24.7 |

Source: China Customs

15 http://www.chinatimes.cc/article/49886.html

**Exhibit 29** China's trading partners, comparing growth rates for 2014 and 1H15

*yoy growth (%)*

| Country/Region | Total Trade | | Exports | | Imports | |
|---|---|---|---|---|---|---|
| | 2014 | 1H15 | 2014 | 1H15 | 2014 | 1H15 |
| EU | 9.9 | -6.7 | 9.4 | -2.5 | 10.7 | -12.9 |
| US | 6.6 | 4.0 | 7.5 | 9.3 | 4.2 | -7.7 |
| ASEAN | 8.3 | 1.6 | 11.5 | 9.5 | 4.4 | -8.3 |
| Japan | 0.0 | -10.6 | -0.5 | -10.5 | 0.4 | -10.6 |
| Brazil | -4.0 | -19.1 | -2.8 | -8.0 | -4.8 | -26.1 |
| Russia | 6.8 | -30.2 | 8.2 | -36.2 | 4.9 | -23.9 |
| India | 7.9 | 1.1 | 12.0 | 10.8 | -3.5 | -24.7 |

Source: China Customs

**Exhibit 30** The top seven provinces and municipalities in terms of foreign trade value, 1H15

| Provinces/ Municipalities | Foreign trade value (USD billion) | Share of total trade (%) |
|---|---|---|
| Guangdong | 463.0 | 24.6 |
| Jiangsu | 262.6 | 14.0 |
| Shanghai | 216.2 | 11.5 |
| Zhejiang | 164.7 | 8.8 |
| Beijing | 159.1 | 8.5 |
| Shandong | 114.5 | 6.1 |
| Fujian | 82.6 | 4.4 |

Source: China Customs

## 5. The share of top seven provinces/ municipalities in terms of foreign trade remains stable in 1H15

China's top seven provinces and municipalities in terms of foreign trade value – Guangdong, Jiangsu, Shanghai, Zhejiang, Beijing, Shandong and Fujian – jointly accounted for 77.8% of China's total foreign trade in 1H15, up slightly from 77.4% in 2014 (see exhibit 30).

Although the top seven provinces/ municipalities in terms of foreign trade all showed negative yoy growth of foreign trade in 1H15, most of them performed better than China's overall foreign trade (which dropped 6.9% yoy) over the same period. Also, it is noteworthy that some provinces in China's central and western regions, such as Henan, Shanxi, Hunan, Guizhou and Qinghai, have recorded robust growth in foreign trade, as a result of industrial upgrading and transformation in these provinces. For example, exports from Henan gained as much as 19.4% yoy in 1H15. With exports of mobile phone accounting for 55.8% of the province's total exports in January to May 2015, Henan has been successfully evolving from an agricultural province to a manufacturing and exporting province of mobile phones.[16]



## 6. China's FDI maintains positive year-on-year growth

China's foreign direct investment (FDI) maintained positive but declining growth in the past three months, with the growth rate registering 10.2% yoy, 8.0% yoy and 1.0% yoy in April, May and June respectively. Overall, in 1H15, China's FDI amounted to US$ 68.4 billion, up by 8.0% yoy (see exhibit 31).

Among the sectors, FDI in the service sector rose by 23.6% yoy to US$ 43.4 billion in 1H15. The share of the service sector in China's total FDI reached 63.5% in 1H15, up from 55.4% in 2014. In contrast, FDI in the manufacturing sector fell by 8.4% yoy in 1H15, only comprising 30.5% of China's total FDI, suggesting that foreign enterprises are less optimistic about the prospects in this sector. However, the manufacturing of telecommunication equipment, pharmaceutical preparation, and other hi-tech devices gained high growth in FDI, which increased by 231.6% yoy, 71.9% yoy and 23.6% yoy respectively in 1H15.[17]

FDI in the eastern region increased by 11.5% yoy in 1H15. In comparison, FDI in the central and the western regions dropped by 7.3% yoy and 10.8% yoy respectively over the same period.

The top ten countries/ regions in terms of FDI value jointly accounted for 94.0% (US$ 642.9 billion) of China's total FDI in 1H15. Among these countries/ regions, FDI from the EU, Hong Kong, Macau and France registered robust yoy growth of 13.7%, 15.6%, 56.2% and 46.9% respectively in 1H15, while FDI from Japan and the US dropped by 16.3% yoy and 37.6% yoy during the same period.

16 http://news.xinhuanet.com/fortune/2015-07/14/c_128019636.htm

17 http://www.mofcom.gov.cn/xwfbh/20150721.shtml

**Exhibit 31** China's FDI, July 2014 to June 2015

| | Amount (USD billion) | yoy growth |
|---|---|---|
| FY14 | 119.6 | 1.7% |
| 1H15 | 68.4 | 8.0% |
| | | |
| July 14 | 7.8 | -17.0% |
| August | 7.2 | -14.0% |
| September | 9.0 | 2.0% |
| October | 8.5 | 1.3% |
| November | 10.4 | 22.2% |
| December | 13.3 | 10.3% |
| January 15 | 13.9 | 29.4% |
| February | 8.6 | 0.7% |
| March | 12.4 | 1.6% |
| April | 9.6 | 10.2% |
| May | 9.3 | 8.0% |
| June | 14.6 | 1.0% |

Source: Ministry of Commerce, PRC

## 7. China's foreign exchange reserves fall for the fourth consecutive quarter

China's foreign exchange reserves fell by US$ 40.0 billion in 2Q15, amounting to US$ 3.69 trillion as at the end of 2Q15 (see exhibit 32). It was the fourth quarter in a row that China saw a drop in foreign exchange reserves. The decrease was attributable to capital outflows due partly to the reduction in voluntary settlement and sale of foreign exchanges by residents and the depreciation of non-dollar assets against the US dollar held in the foreign exchange reserves.[18]

Looking ahead, we expect China's foreign exchange reserves to drop further in 3Q15. The US Federal Reserve is widely expected to raise the interest rates later this year, which may lead to further hot money outflows from China and a further appreciation of the US dollar against other currencies.

**Exhibit 32** Foreign exchange reserves by quarter, 3Q14 to 2Q15

| *USD billion* | Accumulation | End of the quarter |
|---|---|---|
| FY14 | 21.7 | |
| | | |
| 3Q14 | -105.5 | 3,887.7 |
| 4Q14 | -44.7 | 3,843.0 |
| 1Q15 | -113.0 | 3,730.0 |
| 2Q15 | -40.0 | 3,690.0 |

Source: State Administration of Foreign Exchange, PRC

18 http://politics.people.com.cn/n/2015/0728/c70731-27369691.html

# B Highlights

## 1. Chinese yuan depreciates in August as a result of exchange rate reform

The People's bank of China (PBOC) announced the reform of the USD-CNY fixing rate quote on 11 August aiming at a more market oriented and more flexible exchange rate of the Chinese yuan. In particular, the daily opening fixing rate (also known as the central parity rate) of the Chinese yuan against the US dollar will be directly formed by market makers based on the closing rate of the previous day, the supply-demand conditions in the market and the movements of major international currencies. After the announcement, the fixing rate of the Chinese yuan depreciated against US dollar by 1.9% from 6.1162 on 10 August to 6.2298 on 11 August. As of 18 August the fixing rate of USD-CNY closed at 6.3966, depreciated by 4.4% since 10 August (see exhibit 33). Accordingly, the USD-CNY spot rate also depreciated by 2.9% from 6.2097 on 10 August to 6.3942 on 18 August.

Before the exchange rate reform, the fixing rate of the Chinese yuan stayed stable or even appreciated slightly against the dollar during 2Q15, which went up from 6.1615 on 16 March to 6.1079 on 18 May and then fluctuated within the range of 6.1098 to 6.1225 till 10 August (see exhibit 33).[19]

The PBOC announced that the adjustment in the fixing rate formation mechanism was aimed at correcting the disparity between the fixing rate (previously set by the PBOC) and the spot rate (market rate) of the Chinese yuan against the US dollar. Since mid-2014, the strong dollar with the expectation of the Fed's raising the interest rate, the expectation of China's capital outflow and China's weak export growth all aggravated the depreciation pressure on the yuan. Since the beginning of 2015, the spot rate has been consistently below the fixing rate, with the disparity between the spot and the fixing rate ranging from 0.8% to 1.9%. According to the PBOC, the disparity between the equilibrium exchange rate estimated by analysts and the fixing rate was around 3%, signalling the depreciation pressure on the yuan.[20] The reform and the 'one-off' depreciation of the yuan help close the gap between the fixing rate and the market rate, and will make the fixing rate more representative of market expectation in the future.

In fact, from mid-2014 to mid-2015, the yuan has been appreciating against many other currencies, including both emerging economies' currencies and the currencies in the SDR basket (Euro, Japanese yen and British pound). For example, from mid-2014 to mid-2015 the yuan appreciated against the Euro by around 30%; appreciated against the Japanese yen and the British pound by around 20%; appreciated against the Mexican peso by more than 20%; and appreciated against the Turkish lira by more than 30% (see exhibit 34). In fact, many of China's trading partners, especially emerging market economies, have experienced currency depreciation since mid to late-2014. Specifically, the Brazilian real, the Indian rupee, the Russian ruble, the Korean won, the Singapore dollar and the Malaysia ringgit have depreciated significantly against the US dollar since mid to late-2014. However, the Chinese yuan remained relatively stable against the US dollar until the depreciation in August 2015. According to the Bank for International Settlements, China's trade weighted effective exchange rate (the nominal effective exchange rate, NEER) has been strong since mid-2014, and climbed from the low of 110.59 in May 2014 to 127.46 in July 2015, a historical high (see exhibit 35).[21]

Looking ahead, we believe that the yuan may not show further substantial depreciation, but more fluctuations or slight depreciation against the US dollar in 2H15, as the Chinese economy still lacks



19 The daily fixing rate (also known as the central parity rate) of the Chinese yuan against the US dollar is released by the China Foreign Exchange Trade System (CFETS), a sub-institution of the People's Bank of China, at 9:15 am on each working day.

20 http://news.xinhuanet.com/finance/2015-08/13/c_128124640.htm

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 2008-10.

22 Yi Gang, administrator of the State Administration of Foreign Exchange (SAFE) said that the Chinese yuan was still under the managed floating system; and the PBOC will step in to manage the exchange rate if the market is overly volatile, to maintain the confidence and stability of the market. http://www.xinhuanet.com/fortune/zhibo/2015yhdw_zb3/index.htm

growth momentum and China's exports are likely to remain weak. Also, we still see that after the reform, the PBOC has a strong will to maintain the stability of the yuan exchange rate and market confidence.[22] Moreover, China is preparing for the vote on inclusion of the Chinese yuan in the Special Drawing Right (SDR) basket in October to November. This fixing rate reform, together with the earlier announcement by the State Council that the floating band of the yuan will be widened, shows China's determination to promote a more liberalized yuan. We might expect to see more exchange rate liberalization measures in coming months.

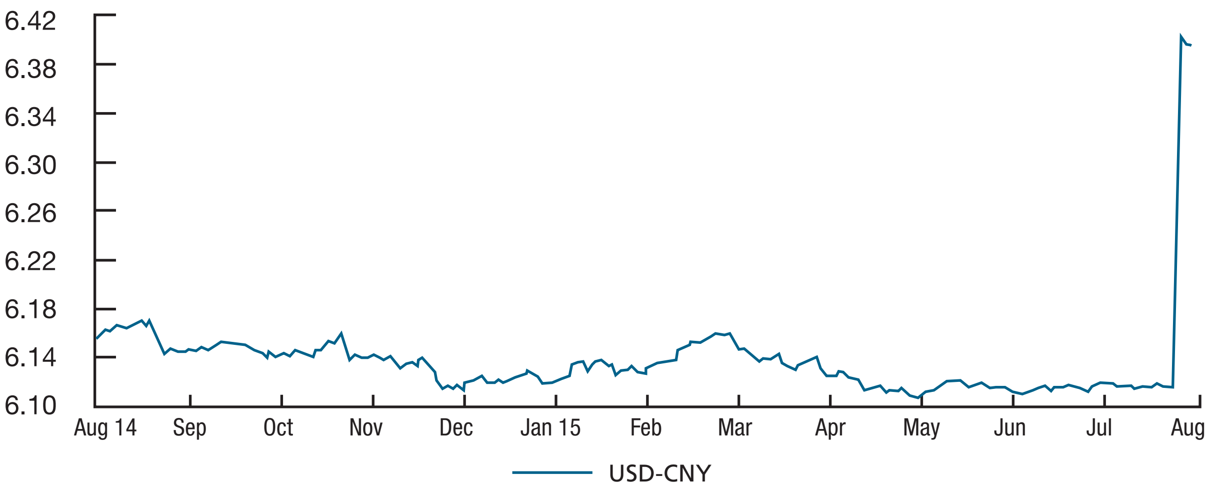
The daily fixing rate of the Chinese yuan against the Euro fluctuated within the range of 6.6 to 7.0 between mid-May and early August. Afterwards, the Chinese yuan depreciated against the Euro from 6.7226 on 10 August to 7.0816 on 18 August (see exhibit 36).







**Exhibit 33** USD-CNY daily fixing rate, August 2014 to August 2015



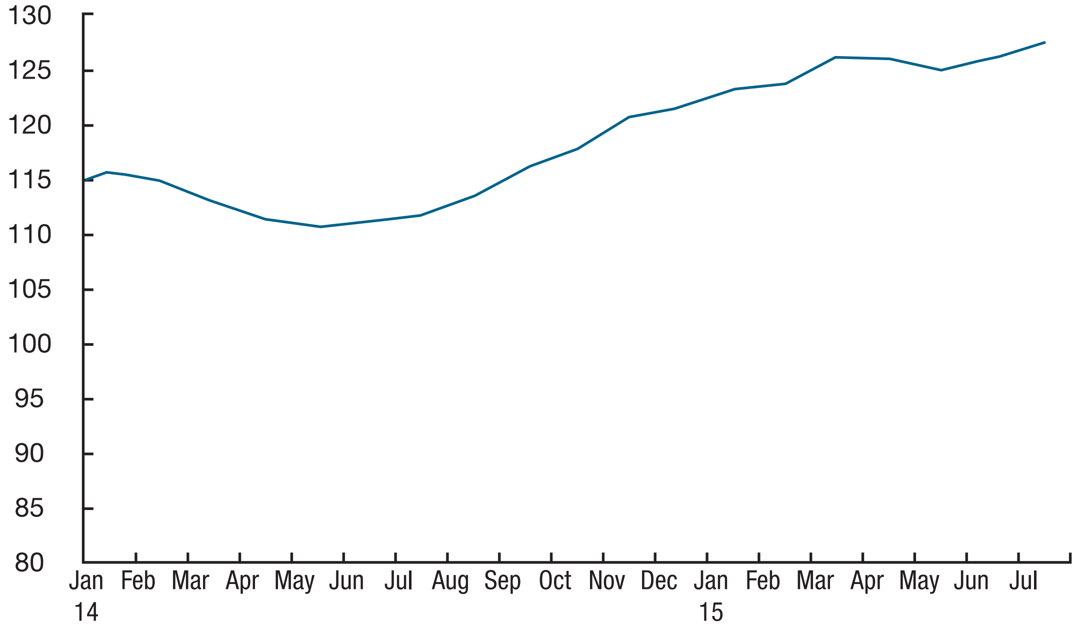

Source: State Administration of Foreign Exchange

**Exhibit 34** Appreciation of Chinese yuan against other currencies, mid-2014 to August 2015

| Currency | Date | Exchange rate | Date | Exchange rate | Percentage of CNY appreciation | Source |
|---|---|---|---|---|---|---|
| *SDR currencies* | | | | | | |
| EUR-CNY | 2-May-14 | 8.6733 | 10-Aug-15 | 6.5967 | 31.5 | Bloomberg |
| CNY-JPY | 30-May-14 | 16.292 | 10-Aug-15 | 20.2491 | 24.3 | Google Finance |
| GBP-CNY | 4-Jul-14 | 10.6569 | 10-Aug-15 | 9.0812 | 17.4 | Google Finance |
| *Non-SDR currencies* | | | | | | |
| BRL-CNY | 30-Jun-14 | 2.8567 | 10-Aug-15 | 1.7558 | 62.7 | Yahoo Finance |
| CNY-INR | 23-May-14 | 1821.74 | 10-Aug-15 | 2180.33 | 19.7 | Yahoo Finance |
| CNY-IDR | 4-Apr-14 | 9.3618 | 10-Aug-15 | 10.3584 | 10.6 | Bloomberg |
| CNY-MXN | 6-Jun-14 | 2.0593 | 10-Aug-15 | 2.6327 | 27.8 | Yahoo Finance |
| CNY-TRY | 9-Jun-14 | 0.3326 | 10-Aug-15 | 0.4492 | 35.1 | Yahoo Finance |
| CNY-KRW | 4-Jul-15 | 162.591 | 10-Aug-15 | 188.4743 | 15.9 | Bloomberg |
| SGD-CNY | 18-Jul-14 | 5.002 | 10-Aug-15 | 4.4844 | 11.5 | Bloomberg |
| CNY-MYR | 18-Jul-15 | 0.51277 | 10-Aug-15 | 0.64245 | 25.3 | Bloomberg |
| CNY-RUB | 27-Jun-14 | 5.4131 | 10-Aug-15 | 10.3307 | 90.8 | Bloomberg |

Source: Bloomberg, Google finance, Yahoo finance

**Exhibit 35** Nominal effective exchange rate of Chinese yuan, January 2014 to July 2015




Source: Bank for International Settlements



**Exhibit 36** EUR-CNY daily fixing rate, August 2014 to August 2015


Source: State Administration of Foreign Exchange

## 2. Global merchandise trade registers lower growth in 1Q15

In late June, the World Trade Organization (WTO) released the world trade statistics for 1Q15.[23] According to preliminary estimates by the WTO and the United Nations Conference on Trade and Development (UNCTAD), the growth of global merchandise trade volume[24] dropped to 0.7% yoy in 1Q15, compared to the growth of 2.8% yoy in 2014, due mainly to the continuing sluggish growth of the world economy.

In 1Q15, the global merchandise exports in US dollar terms gained by a mere 0.4% yoy, a further 0.3 ppts drop from the growth of

23 https://www.wto.org/english/news_e/news15_e/stts_24jun15_e.htm

24 The growth of global merchandise trade volume is measured by the average of imports and exports growth.

0.7% yoy in 2014. Developing countries and emerging economies posted export growth of 1.5% yoy, compared to developed economies' export growth of minus 0.5% yoy in 1Q15. Especially, exports from the US fell by 4.5% yoy in 1Q15.

For imports, developing and emerging economies reported a gain of 0.6% yoy in 1Q15. In particular, South and Central America registered strong growth of imports at 6.8% yoy in 1Q15. Developed economies achieved import growth of 1.3% yoy during the same period, with stronger import growth seen in the EU and the US.

## 3. The challenge of TPP and the opportunity of the Belt and Road Initiative

On 29 June, President Obama signed the trade promotion authority (TPA) to speed up the Trans-Pacific Partnership (TPP) negotiations. The TPP negotiations include 12 countries: Australia, Brunei, Canada, Chile, Japan, Malaysia, Mexico, New Zealand, Peru, Singapore, the US and Vietnam. The TPP, if realized, will become the largest free trade agreement in history, with the total GDP of the 12 countries comprising approximately 40% of global GDP and one-third of global trade.

The TPP treaty, although the draft text has not been released yet, is expected to reduce barriers in high value-added services trade and boost exports of high value-added goods for the US. It goes well beyond further tariff cuts, but seeks to set up higher standards for service trade, labour rules, environmental protection, intellectual property and the liberalization of protected industries, especially for the state-owned companies heavily protected in some economies.[25]

If the negotiations succeed, it may set up new rules for trade and investment in Asia Pacific region to give US traders preferential access to important markets in the region where the US and Chinese companies compete. The success of TPP negotiations will pose challenges to China's foreign trade growth, and may create pressures for China to find new overseas markets for its exports.

During the past few years, China's trade mode is gradually being optimized, with improving trade composition and more diversified trading partners. This can help China to deal with the potential adverse impact of the TPP. As seen from the 1H15 data, the share of private enterprises in China's foreign trade reached 35.9%, up by 2.3 ppts from a year ago; and exports of some high value-added products showed relatively fast growth. For example, exports of wireless telephones grew by 19.8% yoy; and exports of medical equipments grew by 9.3% yoy in 1H15.

On the other hand, China has been taking measures to safeguard its trade position. *The action plan for the 'Silk Road Economic Belt and the 21st Century Maritime Silk Road' (Belt and Road) Initiative* issued in March clearly aims at promoting integration of markets and creating in-depth, inclusive and balanced regional cooperation among the countries along the Belt and Road. The initiative is expected to provide great opportunities for China to develop its trade and investment relations with over 60 countries. Some positive signs are already shown in China's exports, as China's exports to some of the countries along the Belt and Road registered high growth rates in 1H15. Exports to Bangladesh, Pakistan, Israel, Saudi Arabia and Egypt grew by 27.9% yoy, 25.9% yoy, 17.7% yoy, 17.2% yoy and 17.3% yoy, respectively, in 1H15. Different from the traditional way of promoting exports, the Initiative promotes overseas investment and lending to foreign borrowers which may, in turn, enhance utilization of China's industrial capacity and opens up new markets for China.[26]

Alongside the *Belt and Road Initiative*, China also established the Asian Infrastructure Investment Bank (AIIB), the Silk Road Fund, and the New Development Bank BRICS to provide necessary financial support for its global strategic plans. All of these measures will strengthen China's role in the regional and global arena, which will help China relieve the pressures from the TPP.

## 4. Cross-border e-commerce: more favourable policies released

In recent years, China's growth in traditional foreign trade has slowed down; however, cross-border e-commerce has emerged rapidly. In 2014, the total trading value of cross-border e-commerce amounted to 4.2 trillion yuan, posting a growth of 33.3% yoy and accounting for 14.2% of total foreign trade of China. 85.4% of this amount are exports.[27] As stated by China Customs, the cross-border e-commerce trades have gradually become an important driving force for China's foreign trade.[28]

A number of facilitating measures have been issued since May. Specifically, to facilitate the custom clearance process for cross-border e-commerce, starting 15 May, China Customs has implemented the 365 working days (no rest day) for cross-border e-commerce, and has strived to complete the custom clearance process for goods within 24 hours after arrival.[29]

On 20 June, the State Council issued the *'guiding opinions on promoting the healthy and rapid development of cross-border e-commerce'*.[30] This guidance emphasized five issues: (i) to optimize the regulatory measures for custom clearance process for cross-border e-commerce; (ii) to improve the inspection and quarantine supervision measures; (iii) to set up clear and well-regulated tax policies for e-commerce imports and exports, and to continue to implement the existing retail export tax policy for cross-border e-commerce; (iv) to improve the management of cross-border e-commerce payment and settlement; (v) to provide fiscal and financial support for cross-border e-commerce enterprises to 'go abroad'.

25 http://www.brookings.edu/blogs/future-development/posts/2015/05/05-tpp-trade-meltzer

26 http://finance.sina.com.cn/china/20150410/084021925383.shtml

27 http://www.gov.cn/zhengce/2015-06/20/content_2882254.htm

28 http://fangtan.customs.gov.cn/tabid/350/InterviewID/62/Default.aspx

29 http://finance.people.com.cn/n/2015/0713/c1004-27295797.html

30 http://www.gov.cn/xinwen/2015-06/20/content_2882205.htm

# C Outlook

## 1. US economic growth rebounds

After an economic slowdown in 1Q15 (i.e. real annual growth rate of the US GDP dropped from 2.1% in 4Q14 to 0.6% in 1Q15, due partly to the strong US dollar and weakening investment in the oil sector), the US economy however improved in 2Q15, recording an annual real growth rate of 2.3%. Also noteworthy is that the annual real growth rate of personal consumption expenditures, which moderated from 4.3% in 4Q14 to 1.8% in 1Q15, bounced back to 2.9% in 2Q15, indicating a recovery in consumption.

On the production side, industrial production increased by 0.3% mom in June, slightly recovering from the negative growth recorded in April and May (see exhibit 38). According to the Institute for Supply Management, the manufacturing Purchasing Managers' Index (PMI) also rebounded from 51.5 in April to 52.8 in May, and further to 53.5 in June. Nevertheless, the PMI fell to 52.7 in July, indicating the moderating growth of the manufacturing sector.

The growth of the non-manufacturing sector has quickened lately. The non-manufacturing index (NMI), compiled by the Institute for Supply Management, rose all the way from 55.7 in May to 60.3 in July.

The US retail sales maintained positive growth from March to May, registering mom growth of 1.0% in May. However, retail sales dropped in June and registered a mom decline of 0.3%. Meanwhile, the Reuters/University of Michigan Index of consumer sentiment dropped from 96.1 in June to 93.1 in July, much lower than expectation (see exhibit 39).[31]

The pace of job creation has improved recently. After rising by 187,000 in April, the non-farm payroll employment increased at a faster pace by 254,000 and 223,000 in May and June, respectively. In the meantime, the US unemployment rate further dropped to 5.3% in June, the lowest level since June 2008 (see exhibit 40).

Looking ahead, we expect the US economic growth to continue to pick up in 2H15. Positive factors include the improving labour market and the lower crude prices, which gives consumers more room to spend. Negative factors, however, include the recent appreciation of the US dollar and the projected gradual increase in interest rates. According to the latest projection by the International Monetary Fund (IMF), the US real GDP growth will be 2.5% in 2015 and 3.0% in 2016, compared to 2.4% in 2014.[32]

**Exhibit 37** US national accounts, 2013 to 2Q15

| *Annual growth (%)* | 2013 | 2014 | 3Q14 | 4Q14 | 1Q15 | 2Q15 |
|---|---|---|---|---|---|---|
| Real GDP | 1.5 | 2.4 | 4.3 | 2.1 | 0.6 | 2.3 |

Source: US Department of Commerce

**Exhibit 38** US industrial production growth, January to June 2015

| *mom growth (%), seasonally adjusted* | Jan 15 | Feb | Mar | Apr | May | Jun |
|---|---|---|---|---|---|---|
| Industrial production | -0.4 | 0.0 | 0.2 | -0.5 | -0.2 | 0.3 |

Source: US Federal Reserve

31 http://wallstreetcn.com/node/220907
32 IMF, *World Economic Outlook Update*, July 2015

**Exhibit 39** US consumer market, February to July 2015

| | Feb 15 | Mar | Apr | May | Jun | Jul |
|---|---|---|---|---|---|---|
| Retail and food services sales *(mom growth %, seasonally adjusted)* | -0.5 | 1.5 | 0.0 | 1.0 | -0.3 | - |
| Reuters/University of Michigan index of consumer sentiment | 95.4 | 93.0 | 95.9 | 90.7 | 96.1 | 93.1 |
| CPI *(yoy growth %)* | 0.0 | -0.1 | -0.2 | 0.0 | 0.1 | - |

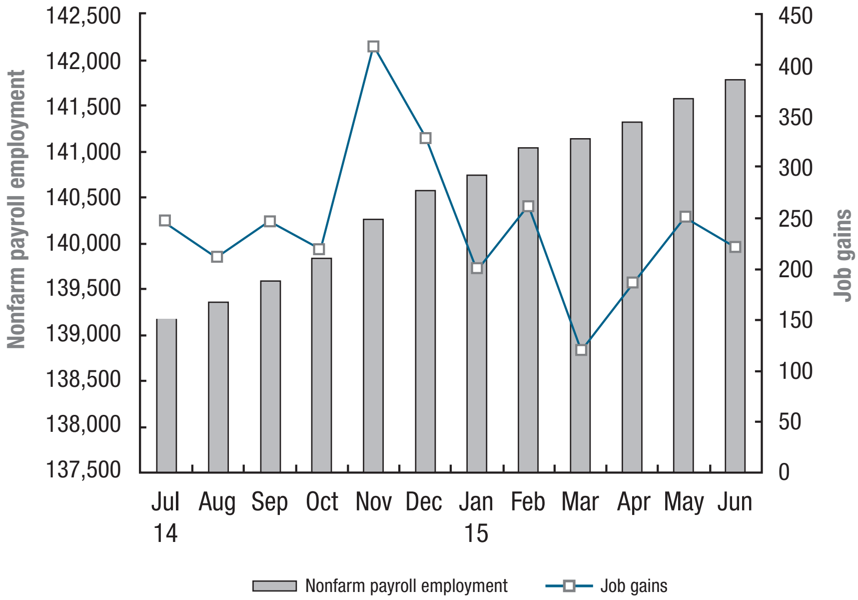
Source: US Department of Commerce, Reuters/University of Michigan Surveys of Consumers, US Department of Labor

**Exhibit 40** US employment

| | Unemployment rate (%) |
|---|---|
| 2013 | 7.4 |
| 2014 | 6.2 |
| | |
| Jul 14 | 6.2 |
| Aug | 6.1 |
| Sep | 5.9 |
| Oct | 5.7 |
| Nov | 5.8 |
| Dec | 5.6 |
| Jan 15 | 5.7 |
| Feb | 5.5 |
| Mar | 5.5 |
| Apr | 5.4 |
| May | 5.5 |
| Jun | 5.3 |

Yearly figures: Annual average
Monthly figures: Seasonally adjusted

**Nonfarm payroll employment, July 2014 to June 2015**
*In thousands, seasonally adjusted*




Source: US Department of Labor

## 2. Eurozone economy continues to improve

The Eurozone economy has continued to improve.[33] According to the global survey firm Markit Economics, the Eurozone manufacturing PMI registered 52.4 in July, slightly down from the 13-month high of 52.5 in June. The relatively high PMI figure indicates that growth of the manufacturing sector in the Eurozone has remained robust.

Similar to the pattern of manufacturing PMI , the Eurozone services PMI went up to 54.4 in June, the highest level since August last year, before edging down to 54.0 in July.

Also, on a seasonally adjusted basis, the retail trade volume in

33 Lithuania has become the 19th member of the Eurozone as from 1 January 2015. Other member countries include Austria, Belgium, Cyprus, Estonia, Finland, France, Germany, Greece, Ireland, Italy, Latvia, Luxembourg, Malta, the Netherlands, Portugal, Slovakia, Slovenia and Spain.

the Eurozone recorded a negative growth rate of 0.6% in June, indicating a moderation in consumption demand (see exhibit 42). The labour market conditions in the region are still poor, but have shown signs of improvement lately. After registering 11.3%, 11.2% and 11.2% in January, February and March respectively, the unemployment rate fell and stayed at 11.1% from April to June (see exhibit 43).

The Eurozone's economic sentiment indicator (ESI) dropped all the way from 103.9 in March to 103.5 in June, indicating a continuous deterioration of economic sentiment (see exhibit 44).

Going forward, the Eurozone economic growth is set to improve further in the near term, due to favourable factors such as lower oil prices, low interest rates and the depreciation of the Euro. According to the projections by the IMF, the Eurozone's real GDP growth will rise from 0.8% in 2014 to 1.5% in 2015 and 1.7% in 2016.[34]

**Exhibit 41** Eurozone's real GDP growth, 2013 to 1Q15

| | 2013 | 2014 | 2Q14 | 3Q14 | 4Q14 | 1Q15 |
|---|---|---|---|---|---|---|
| Real GDP *(qoq growth %)* | | | 0.1 | 0.2 | 0.4 | 0.4 |
| Real GDP *(yoy growth %)* | -0.4 | 0.8 | 0.8 | 0.8 | 0.9 | 1.0 |

*** The figures in 2013 and 2014 do not reflect Lithuania's membership of the Eurozone, which began on 1 January 2015.**

Source: Eurostat



**Exhibit 42** Eurozone consumer market, January to June 2015

| | Jan 15 | Feb | Mar | Apr | May | Jun |
|---|---|---|---|---|---|---|
| Volume of retail trade *(mom growth %, seasonally adjusted)* | 0.6 | 0.0 | -0.4 | 0.7 | 0.1 | -0.6 |
| Annual inflation (%) | -0.6 | -0.3 | -0.1 | 0.0 | 0.3 | 0.2 |

Source: Eurostat

**Exhibit 43** Eurozone labour market, January to June 2015

| *seasonally adjusted* | Jan 15 | Feb | Mar | Apr | May | Jun |
|---|---|---|---|---|---|---|
| Unemployment rate (%) | 11.3 | 11.2 | 11.2 | 11.1 | 11.1 | 11.1 |

Source: Eurostat

34 IMF, *World Economic Outlook Update*, July 2015

**Exhibit 44** Eurozone economic sentiment indicator, January to June 2015

| *seasonally adjusted* | Jan 15 | Feb | Mar | Apr | May | Jun |
|---|---|---|---|---|---|---|
| Economic sentiment indicator | 101.5 | 102.3 | 103.9 | 103.8 | 103.8 | 103.5 |

Source: Eurostat







## 3. China's exports are expected to post negative growth in 3Q15

In its *World Economic Outlook Update* released on 9 July, the IMF predicts that the real GDP growth of the advanced economies will go up from 1.8% in 2014 to 2.1% in 2015. In contrast, the real GDP growth of the emerging markets and the developing economies is projected to decelerate from 4.6% in 2014 to 4.2% in 2015 (see exhibit 45).

The IMF's 2015 growth prediction for advanced economies is adjusted downward by 0.3 ppts to 2.1% from the previous prediction of 2.4% made in April this year. Accordingly, its prediction for the growth of the world economy is revised downward by 0.2 ppts to 3.3%. The downward revisions of growth forecasts suggest that the global economic recovery is still under pressure. Also, the IMF warns that the expected move by the Fed to raise the interest rates can have spillover effects and may increase risks for other economies, especially the emerging markets.[35] All in all, in 3Q15, we expect that China's exports will still be under pressure and may show negative growth, and Chinese manufacturers will continue to face intense competition from manufacturers in other Asian countries, including Vietnam, Indonesia, India and Bangladesh, to name just a few.

**Exhibit 45** Latest GDP growth forecasts by the International Monetary Fund

| *yoy growth (%)* | 2014 | 2015 (Forecasts) | 2016 (Forecasts) |
|---|---|---|---|
| World economy | 3.4 | 3.3 | 3.8 |
| Advanced economies | 1.8 | 2.1 | 2.4 |
| US | 2.4 | 2.5 | 3.0 |
| Eurozone | 0.8 | 1.5 | 1.7 |
| Japan | -0.1 | 0.8 | 1.2 |
| Emerging markets and developing economies | 4.6 | 4.2 | 4.7 |
| China | 7.4 | 6.8 | 6.3 |
| India [36] | 7.3 | 7.5 | 7.5 |
| ASEAN-5 [37] | 4.6 | 4.7 | 5.1 |
| Brazil | 0.1 | -1.5 | 0.7 |
| Russia | 0.6 | -3.4 | 0.2 |

Source: International Monetary Fund, World Economic Outlook Update, July 2015

35 http://www.reuters.com/article/2015/07/23/us-imf-spillovers-idUSKCN0PX26J20150723

36 Data and forecasts are presented on a fiscal year basis. India's fiscal year runs from 1 April to 31 March.

37 Indonesia, Malaysia, the Philippines, Thailand and Vietnam.

**The Fung Group** is a privately held multinational group of companies headquartered in Hong Kong whose core businesses are trading, logistics, distribution and retailing. The Fung Group employs over 46,800 people across 40 economies worldwide, generating total revenue of over US$24.65 billion in 2014. Fung Holdings (1937) Limited, a privately held business entity headquartered in Hong Kong, is the major shareholder of the Fung group of companies.

Please visit www.funggroup.com for more about the Fung Group.

**The Fung Business Intelligence Centre (FBIC)** collects and analyses market data on sourcing, supply chains, distribution and retail. It also provides thought leadership on technology and other key issues shaping their future.

Headquartered in Hong Kong, FBIC leverages unique relationships and information networks to track and report on trends and developments in China and other Asian countries. In addition, its New York-based Global Retail & Technology research team follows broader retail and technology trends, specialising in how they intersect and building collaborative knowledge communities around the revolution occurring worldwide at the retail interface.

Since its establishment in 2000, the FBIC (formerly known as the Li & Fung Research Centre) has served as the knowledge bank and think tank for the Fung Group. Through regular research reports and other publications, it makes its market data, impartial analysis and expertise available to businesses, scholars and governments around the world. It also provides advice and consultancy services to colleagues and business partners of the Fung Group on issues related to doing business in China, ranging from market entry and company structure, to tax, licensing and other regulatory matters.

Find us on WeChat



馮氏

Fung Business Intelligence Centre