China News in Brief
June, 2014

Compiled by Yimin Zhang, University of Shanghai for Science and Technology for the Kiebach Center in International Business Studies, Whitman School of Management
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China Sees More Evidence of Stabilizing Economy in May; PMI Reading Has Remained Below 50 All Year

Two more measures of China's economic health showed improvement in May, adding to signs that the economy is stabilizing after its sluggish start this year and suggesting that government support policies may be starting to show results. Added to a stronger reading in May for the official manufacturing Purchasing Managers' Index, released on Sunday, the overall economic picture appeared somewhat brighter following moves to accelerate spending on railways, offer business tax breaks and make more financing available to smaller companies. The official nonmanufacturing Purchasing Managers' Index rose to 55.5 in May from 54.8 in April, according to the China Federation of Logistics and Purchasing, which releases the data along with the statistics bureau. The nonmanufacturing PMI covers services, including retail, aviation and software, as well as real estate and construction. The upturn was largely a result of the important services sector, a key source of employment, while construction was less robust as a result of weaker property prices.

Meanwhile, the HSBC China Manufacturing Purchasing Managers' Index, a gauge of nationwide factory activity, rose to a final reading of 49.4 in May from 48.1 in April, HSBC Holdings PLC said Tuesday. "The final (manufacturing) PMI reading for May confirmed that the economy is stabilizing, but it is too early to say that it has bottomed out, particularly in light of a weaker property sector," said Qu Hongbin, HSBC's chief economist for China, in a statement accompanying the data. The nation's once buoyant property market has been showing fresh signs of stress. China's housing prices fell in May for the first time in nearly two years, according to a private survey that showed more cities with price declines and weaker sales. Average new home prices on a month-to-month basis fell 0.3% in May from April, the first decline since June 2012, data provider China Real Estate Index System said Friday.

Also on Friday, the government unveiled fresh measures to boost the economy, announcing it would expand an existing program that allows banks to lend more of their deposits if they are financing agricultural areas or small business. The statement didn't give details but most banks must keep 20% of their deposits on reserve. That followed a series of tax and spending measures that have been referred to as "mini-stimulus" policies earlier this year. Beijing has more recently ordered local governments to spend funds that have already been allocated while the central bank has called on commercial banks to make more money available for mortgage loans to help the property sector.

The final HSBC reading was lower than a preliminary or "flash" PMI of 49.7, announced on May 22, and based on 85% to 90% of responses to a PMI survey. HSBC said the downward revision from the flash level reflected a higher level of stocks of finished goods, which suggests still weak demand. On Sunday, the government said its official manufacturing Purchasing Managers' Index rose to 50.8 in May from 50.4 in April, the highest level this year and above market expectations of 50.6, according to a survey by The Wall Street Journal.

Source: Grace Zhu; Kazer, William: China Sees More Evidence of Stabilizing Economy in May; PMI Reading Has Remained Below 50 All Year, Wall Street Journal (Online) [New York, N.Y] 03 June 2014: n/a.

China economy: A slower reality

In the first quarter of 2014, 30 of the country's 31 provinces recorded a weakening in growth from the previous quarter. Dwindling investment will have a larger impact on some economies than others. Western provinces and regions with economies dominated by industrial sectors burdened with overcapacity, such as steel, recorded the sharpest moderations in expansion. The trend is likely to continue as political priorities continue their shift towards building a more sustainable growth model. Steering the economy away from investment-driven growth tops the economic reform agenda for the leadership. Access to credit has been tightened relative to recent historic levels, and the leadership has signalled that slowing economic growth will not prompt a large stimulus package on par with the one issued in 2008. Real GDP growth at the national level slowed to 7.4% year on year in the first quarter of 2014, dipping from 7.7% in the fourth quarter of 2013. Only the central province of Anhui maintained its rate of economic growth over the period. The divergence in provincial performances proved stark. Western provinces have been hit the hardest by this shift, as state-led
investment takes a dominant share of their local economies. A reduction in the investment growth rate has a larger impact on western provincial economies than on their central and eastern counterparts.

The biggest losers: Yunnan, a south-western province, was a star performer in 2013, but in the first quarter of 2014 the economic growth rate fell by 4.4 percentage points from October-December 2013, to 7.7% year on year, as expansion in fixed-asset investment eased sharply. Investment growth in the province’s industrial and property sectors slowed, as fewer new projects entered the pipeline. The local statistical bureau reported that the industrial performances of the non-ferrous metals, chemicals and steel sectors were particularly weak, as domestic demand slumped. Ningxia, Gansu and Guangxi suffered comparable slowdowns. Growth in Hebei, Heilongjiang and Shanxi fell by 3 percentage points or more over the same period, to 4-5.5%. Industrial output in these regions has fallen dramatically, as sluggish domestic demand and a broader drive to close down heavily polluting plants and industrial overcapacity have had a disproportionate impact on these regions too. Steel accounts for nearly one-third of industrial value-added output in Hebei. The province has been shutting down steel mills since a drive to cut air pollution in the national capital, Beijing, began in late 2013. Shanxi, where coal mining is a pillar industry, is being hit particularly hard by slowing demand and falling prices for the dirty fuel. Heilongjiang, which has a large energy sector, is suffering from similar problems. The economy of Daqing, a major oil-producing city in Heilongjiang, grew by just 2.5% year on year in the first quarter. Four of the north-eastern province’s major coal-producing cities saw their economies contract by more than 10%.

Staying afloat: The central and eastern regions proved more resilient. In most of these provinces, the weakening in growth between October-December 2013 and the first quarter of this year was less than 1 percentage point. The moderation in state-led investment has had a milder impact on these regions, which have more diverse economies; a larger proportion of investment in eastern provinces is driven by the private sector and oriented towards services. Central provinces continued to see their manufacturing sectors strengthen, as infrastructure for transporting goods improved rapidly. As these regions have stronger consumption bases, with larger pools of relatively wealthy households, their development trajectories appear to be more closely aligned with those of more developed economies. The policies of the current leadership appear to favour consumption-boosting reforms that will benefit the eastern and central regions, further inspiring investor confidence.

When compared with the national figure, weighted provincial real GDP growth saw a sharper decline of 1.3 percentage points between the fourth quarter of 2013 and the first quarter of 2014, from 9.3% to 8%. The gap between the national rate and the provincial aggregate thus narrowed significantly. Until recently, missing GDP growth targets was often equated with dimmed career prospects, in a system where growth served as the primary indicator upon which the performance of local officials was evaluated. This has encouraged the distortion and exaggeration of economic growth

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Source: CEIC, Economist Intelligence Unit calculations.
data at local-government level. However, with the central government having signalled its comfort with slower rates of economic growth, incentives for local officials may be slowly changing. Amid growing public discontent with worsening pollution and the growing costs of ballooning overcapacity, efforts appear to be under way to reduce the importance of GDP growth targets in cadre assessment altogether. Local officials are instead being encouraged to focus on the "quality" of economic growth, rather than the headline figure itself.

In December 2013 the Organisation Department, which oversees cadre appointments and performance assessments, issued new guidelines on the latter. GDP and its growth will no longer be the primary indicator in assessing local officials' achievement; instead, the department called for a broad-based assessment structure covering social development, environmental protection and particularly the ability to manage local debts. In agricultural areas and ecological protection zones, GDP and industrial indicators will be removed entirely from assessment guidelines. A number of places have started to experiment with new cadre evaluation systems. In Shenyang, the provincial capital of Liaoning, a heavier weight has been assigned to improvement in social welfare. New indicators such as food and drug security have been added and innovation in reform and environmental protection will be rewarded from this year. These new priorities are likely to be implemented with gusto; local officials have proved themselves adept at making things happen when they will be rewarded for doing so. Bolder reforms may have an upside for sustainable expansion, as slower growth is accepted as a prerequisite for it.


**Targeted moves' will help secure yearly goal**

Premier Li Keqiang said China will target "prominent problems" in the economy and precisely and appropriately fine-tune policies in a timely manner to keep it running within a reasonable range. An optimal combination of policy tool will be used in macroeconomic control, and China will focus more on "targeted adjustment" — instead of big stimulus — to achieve the annual growth target of about 7.5 percent, he said on Tuesday. "China's economy, after the high-speed expansion of three decades, still has the conditions and the ability to leap over the middle-income trap and keep the economy moving at an intermediate and high speed for a longer period of time," he said. Li made the remarks when addressing the biennial conference of the country's two top research bodies, the Chinese Academy of Sciences and Chinese Academy of Engineering.

Li said China's economic situation is "generally stable" and major economic indicators are within the reasonable range. "Positive signs are showing in economic restructuring and market expectation is rising." China must have "firm confidence and composure" to maintain the current macroeconomic stance, using a combination of proactive fiscal policy and prudent monetary policy, he stressed. Li said the country still has great potential for development and strong resilience, considering the people's longing for a better life, an ever-growing domestic market and industrialization. China will increase the strength and frequency of policy fine-tuning to lend more support to rural sector and small firms, News Agency reported.

Source: ZHAO YINAN: 'Targeted moves' will help secure yearly goal, China Daily, 2014-06-11

**Positive Indices for China**

China's consumer inflation climbed from an 18-month low in April to usual levels in May, while factory price deflation eased, indicating that the sluggish economy is slowly stabilizing. The consumer price index, the main gauge of inflation, rebounded to a four-month high of 2.5 percent in May from a year earlier, quickening from a worrying 1.8 percent rise in April, the National Bureau of Statistics said on Tuesday. On a month-on-month basis, consumer prices rose 0.1 percent, ending the previous two straight months of decline, but are still lower than the 1 percent month-on-month gain recorded in January, the NBS said. Yu Qiumei, an analyst with the NBS, said the CPI growth was mainly fueled by higher food prices, particularly a 20 percent surge in the cost of fruits. Food prices rose 4.1 percent over a year earlier, pulling the overall CPI up 1.35 percentage points, according to NBS. Unlike developed economies, food prices account for a bulk of the CPI in China. Another key indicator that gauges the
factory gate price, the producer price index, narrowed its decline by falling 1.4 percent in May from a year earlier, versus a 2 percent fall in April. It is the 27th consecutive month of decline for the indicator, a fact that is particularly painful for upstream industrial manufacturers. Prices for housekeeping, processing and maintenance services jumped 7.1 percent and those for tourism surged 8.1 percent year-on-year, much higher than the average growth rate. Kuang deemed these figures a good sign for the whole economy as they reflected the "continuous upgrading of the consumption structure." The latest CPI and PPI data also confirmed a series of positive changes since May. Other encouraging data include faster export growth and rising Purchasing Managers Index readings.

Premier Li Keqiang had in a recent meeting asked local government leaders to take more proactive measures to keep their economies in the pink of health. He said while the government does not put GDP above everything else, "it does not mean that we don't want a reasonable economic growth rate". The central bank responded to that call by announcing a "targeted easing" policy on Monday. It will cut reserve requirements for some lenders by 0.5 percentage point from June 16, especially those that support agriculture and small businesses. The latest inflation data could give proponents of cross-board reserve requirement cut a fresh ground to argue, citing the current moderate inflation would provide sufficient room for the central bank to loosen its monetary policy without risking CPI to rebound above 3.5 percent, the upper limit the government can tolerate.

Source: ZHENG YANGPENG: Indexes augur well for China, China Daily, 2014-06-11

World News: Chinese Premier Urges 'Targeted' Policy Moves

China Premier Li Keqiang said that policy makers will focus more on "targeted measures" to support economic growth, the state radio reported on Tuesday, in a sign that Beijing is unlikely to unveil large stimulus measures soon. The government should target the "most prominent problems" in the economy and identify the most effective tools to address them, Mr. Li was cited as saying. Mr. Li didn't specify any problems but economists have said that high borrowing costs for smaller companies, lingering overcapacity in some industries and an ailing property sector are slowing China's growth.

The government has refrained from rolling out a big stimulus package, instead using modest measures to boost growth. The central bank said on Monday it would reduce bank reserve requirements for city commercial banks and rural banks -- but not the biggest banks -- by half a percentage point. Beijing has also recently stepped up spending on rail, water and energy projects and announced new initiatives to boost exports, cut red tape, route more venture capital to emerging industries and ease lending terms for first-time homeowners. Mr. Li reportedly said the government is determined to keep growth in a reasonable range and to reach this year's economic targets, which Beijing has set as 7.5% growth and 10 million new urban jobs.


China's power consumption rises 5.2% in Jan-May

China's power consumption rose 5.2 percent in the first five months from a year earlier, official data showed on Saturday. The Jan-May growth figure was in line with the rate in the first four months, according to the National Energy Administration. In May alone, power use, an indicator of economic activity, gained 5.3 percent from a year ago, picking up speed from the 4.6 percent growth in April.

Source: Xinhua: China's mixed ownership reform advances against headwinds, 2014-06-14

'Fiscal reforms to ease local govt debt pressure

Repayment pressure for local governments will escalate this year, as more debt matures, a top government official said on Tuesday. Vice-Minister of Finance Wang Bao'an said in a recent meeting with finance ministry officials that nearly 21.89 percent of the outstanding local government debt will mature by the end of this year. An
official survey last year indicated that China's local government debt stood at 17.9 trillion yuan ($2.86 trillion) by the end of June 2013. Though the debt repayment levels are slated to go up this year, the overall numbers are still under control, Wang said adding that at no point would the government lower its guards. "Overcapacity and accumulation of local debt are key issues for the central government, as both could spiral into a financial crisis if left unchecked," he said. Citing aspects like slower growth in fiscal revenue and higher expenditures, Wang said payment pressures for local governments will continue to grow in the long term.

What come with the massive debt are the interest payments. For example, in 2012, the annual interest rate of governments' borrowings via their financing vehicles was 8 percent. The cost was even higher in the shadow banking system. Annual cost of trust financing can be as high as 24 percent, and 42 percent for government-repo financing. Tackling the debt repayment issue is also important due to the irregularities and multiple channels associated with government financing. According to estimates, there are 154,000 borrowers involved at various levels in government organizations and State-owned enterprises, using more than 30 financing tools. To address these issues it is important to press ahead with reforms and set up a modern fiscal system, Wang said.

According to Wang, more transparency in the budget system, a fair tax system and a reciprocal transfer-payment system between the central and local governments should be cornerstones of fiscal reforms. "The central government will take back some of the fiscal expenditure duties from the local governments to ease the burden. Central funding for special programs floated by the local governments will be reduced by a third this year, and even further in the future," he said. China is also allowing more local governments to issue bonds directly, rather than the indirect approach they used earlier, as it will help settle the debt ownership issues once and for all. In May, China selected 10 provinces and cities to pilot the bond project and allowed them to float the issues in their own names and to assume responsibility for the repayment of the associated interest and principal.

Source: We Tian in Shanghai: Fiscal reforms to ease local govt debt pressure, China Daily, 2014-06-11

Debt crisis looms for local governments

Dwindling revenue from land sales and slower fiscal revenue growth may hurt local governments' ability to repay outstanding debt, a leading Chinese credit ratings agency said on Tuesday. China Chengxin International Credit Rating Co Ltd, the Chinese unit of global ratings agency Moody's Investors Service, said in its report that the weakening property market poses the biggest threat for debt repayment, as land sales account for the bulk of the local governments' revenue. Based on 2013 data, the ratings agency said property-related taxes and revenue from land sales accounted for 52 percent of the total revenue of local governments, after excluding the central government's transfer payment component. The ratio will be lower if Beijing's transfer payment is included, it said. China's land transaction market has cooled following the recent downturn in the property market. In May, land sale revenues in 300 cities monitored by the China Index Academy, a Beijing-based real estate research institute, dropped 38 percent from a year ago. What makes the going tough for local governments is their predetermined plan to use the revenue from land sales for debt repayments. Different provinces have vowed different ratios of land sale revenue repayment. The average ratio was 37 percent in 2012 and it could be as high as 66 percent (in Zhejiang province).

Local governments are set to face huge debt repayment pressures, with over 4.24 trillion yuan ($678.8 billion) of outstanding debt, or 38.95 percent of the total debt, set to mature in 2014 and 2015. An official survey last year indicated that direct debt and contingent liabilities of local governments stood at 17.9 trillion yuan by the end of June 2013. The repayment pressure was also amplified by the widening gap between local governments' revenue and expenditure growth. During the first five months of this year, the fiscal revenue of local governments rose just 11.2 percent year-on-year, far lower than the level three years ago, when it expanded at a more than 30 percent rate. Local governments are also under pressure to rev up their spending as a part of the effort to prop up economic growth. Local government expenditure soared 26.9 percent in May, a sharp acceleration from the 9.6 percent rise in the first four months, according to data released by the Ministry of Finance.
But so far, most of the local governments have issued debt indirectly through LGFVs and other government-related entities. With the central government curbing bank loans, most of these entities have shifted to trusts and other innovative products for financing. Such trends complicate the ability of the government to monitor debt and the ability of market participants to judge the real indebtedness of local governments. The China Chengxin report said an increasingly salient problem is that while benefits of debt raising go to lower county-level governments or even township governments, risks aggregate upward to higher authorities such as provincial governments.

Source: ZHENG YANGPENG: Debt crisis looms for local governments, China Daily, 2014-06-18

**Standard Chartered: Nation's total debt surges to $22.7 trillion**

China's overall debt stood at 142 trillion yuan ($22.7 trillion), or 245 percent of GDP, as of March 31, Standard Chartered Plc estimated. That's up from 133 trillion yuan, or 233 percent of GDP, at the end of 2013, the bank said, noting that debt expansion slowed to 18 percent year-on-year during the first quarter, compared with 24 percent in the first three months of 2013.

Many foreign institutions have estimated the scale of China's debts using various calculation methods. Standard Chartered has its own definition of debt, which is based on that of the central bank's "total social financing" concept, with some additional items. It includes yuan bank loans, foreign exchange loans and entrusted loans (which are included in the calculation of 'total social financing'), as well as cross-border bank lending, offshore bond issues and other credits. The slowdown of overall debt growth was particularly attributed to changes in foreign-currency bank loans, trust loans, undiscounted bank accepted drafts and outstanding corporate bonds, which slowed more than 50 percent year-on-year in the first quarter. The bank said that the deceleration partly reflected China's deleveraging efforts, as well as higher interbank yields in the second half of 2013. The buildup of total debt, unprecedented in recent history, is leading to mounting repayment pressures. The bank estimated that interest payments were equivalent to 13 percent of GDP in March, up from an average of 7 to 8 percent in recent years. This high ratio is eating up an increasing share of corporate profit and government revenues and crowding out new investment, which makes a pick-up in growth momentum in 2014 all the more difficult to achieve. The average nominal interest rate on China's debt was about 5.8 percent in the first quarter, down slightly from the average 6 percent rate in 2013, the bank said. "While we do not believe a debt crisis is around the corner, partly because some of this debt is 'evergreenable', it is clearly dragging on investment and will continue to do so for the foreseeable future," the report said. "This trajectory is unsustainable."

Behind the credit expansion and slower growth is a painful fact: China's return on investment is declining, the report noted, which raises questions about the nation's credit-fueled, investment-driven model. Standard Chartered cautioned that the debt burden should be reduced while preventing a collapse in investment. "The key quandary for policymakers today is not how to deleverage per se, but rather how to deleverage 'beautifully'. You cannot deleverage an economy that is not growing," it said.

Source: Zheng Yangpeng: Standard Chartered: Nation's total debt surges to $22.7 trillion, China Daily, 2014-06-19

**Small firms get a break on VAT**

The Ministry of Finance announced on Wednesday that the value-added tax rate will be a flat 3 percent for many small businesses, effective July 1. The 4 percent and 6 percent rates were eliminated to make the system fairer, the ministry said. An executive meeting of the State Council, the cabinet, said last week the move is expected to reduce companies' tax burden by about 24 billion yuan ($3.84 billion) a year. At present, VAT rates range from 2 percent to 17 percent. The rate cut will mainly benefit the water sector, small hydropower facilities, building materials producers and biological products manufacturers, all of which now pay 6 percent VAT. Also benefitting will be consignment stores, pawnshops and auction houses, which now pay a VAT rate of 4 percent. This reform mainly targets small and medium-sized companies involved in the sale of certain commodities, he said, adding that
the new policy won't mean much change for the shift from business tax to VAT, because the companies are already subject to VAT and generally not eligible to claim VAT credits. The shift from business tax to VAT "is likely to be expanded to the consumer service sector, which also created lots of jobs but now faces challenges due to increasing costs, and it is possible that the reform may aim at lowering, or at least maintaining, the tax burden for these companies as well," Li said.

Source: Small firms get a break on VAT, China Daily, 2014-06-19
http://www.chinadaily.com.cn/business/2014-06/19/content_17599543.htm

China backs new global credit rating system

China supports the development of a new international credit rating system that is objective, rational and balanced, Chinese Vice-Premier Zhang Gaoli said here on Monday. During a meeting with international personages attending an Asian credit system forum in Beijing, Zhang said China is ready to work with all other countries to push for the perfecting of the existing credit rating system and the establishment of an Asian credit rating system and standards that suit regional characteristics. Present at the meeting were former French Prime Minister Dominique de Villepin, former Pakistani Prime Minister Shaukat Aziz, former Australian Prime Minister Kevin Rudd and former Russian Foreign Minister Igor Ivanov. The international guests are members of the newly founded International Advisory Council for the Universal Credit Rating Group (UCRG), a Hong Kong-based rating organization co-sponsored by China, Russia and the United States. Zhang said during the meeting that China is accelerating the development of its social credit system, pushing forward sharing of government information and promoting credit in the administrative, business and social sectors. He said China is ready to make positive contributions to reform of regional and international credit systems on the basis of building its own domestic credit system.

The international guests are in Beijing to attend the Summit Forum on UCRG and Construction of Asian Credit System held on Monday. De Villepin said the establishment of UCRG will help change the state of the international credit rating system and promote its improvement. He said the UCRG is ready to play an active role in economic development of China and the whole Asian region. The UCRG was officially founded in Hong Kong in June 2013. It is aimed at constructing a "dual rating" system in parallel with the current one dominated by the Western "Big Three," namely Standard and Poor's, Moody's and Fitch Ratings.

Source: Xinhua: China backs new global credit rating system, 2014-06-24

PBOC Gains New Power Over Policy

China's central bank is turning itself into a policy heavyweight, fending off calls within government circles to cut interest rates and persuading leaders to make only small adjustments to monetary policy as a way to bolster growth without deepening credit and real estate problems. In the latest battle, the country's top banking regulator on Friday said it would ease rules to make it easier for banks to lend to small companies, even though China's gross domestic product growth has fallen to below its target of 7.5% for the year. That followed a decision a week ago by the State Council, the government's top decision-making body, to target additional bank funding for small businesses and farms. These moves are the latest measures in what has been labeled China's "mini-stimulus," and the government has spent time briefing Chinese media on the strategy to make sure the effort is presented as a united front, say officials and journalists familiar with the efforts. Behind the scenes, however, China's biggest economic agencies -- the People's Bank of China, the Ministry of Finance, the state planning commission and other financial regulators -- fought over whether more should be done, including cutting interest rates for the first time in two years, according to officials familiar with the government's deliberations.

The central bank has long been more cautious about economic stimulus than other agencies. It has frequently lost battles to the Ministry of Commerce or the state planning agency, which is called the National Development and Reform Commission, which count big, influential state companies among their constituents. In China, the central bank isn't independent; it is one voice among many in the topmost panels of decision-making. Over the past
two years, Mr. Zhou has accumulated more power, Chinese and Western officials say. Mr. Zhou's allies are rising, too. Yi Gang, the central bank's vice governor, who is in charge of managing China's nearly $4 trillion foreign-exchange reserves, has been named deputy chief of the economic policy group that advises the Politburo Standing Committee, China's seven-member ruling body, according to Chinese and Western officials familiar with Mr. Yi's assignment. Another Zhou partisan, Fang Xinghai is in charge of putting together a financial-reform blueprint for the economic policy group, called the Office of the Central Leading Group on Financial and Economic Affairs. Among its other victories, the PBOC has won approval for the creation of privately owned banks and the widening of the band in which the tightly controlled Chinese yuan can trade daily -- a step toward full convertibility. It is also in the last stages of getting approval of bank deposit insurance, which has been batted around for 20 years and has been opposed by large state-owned banks.

In the days before the State Council's mini-stimulus announcement, Chinese Vice Premier Ma Kai, who is responsible for the financial sector, called a meeting of the major economic agencies to discuss how to make credit more accessible and less expensive for businesses around the country. During the discussions, officials from China's top banking regulator and the state planning agency pushed for an interest-rate cut, saying the easing measures taken by the central bank so far weren't enough to help prop up the economy, the official said. The central bank, which in mid-April approved a cut in the funds rural banks had to keep in reserve at the central bank, was now pushing for a similar cut in reserve requirements at other banks, but only if the funds were targeted to small and medium-size businesses. The opponents at the session argued that cutting the reserve requirements would be ineffective because many banks were already approaching government-imposed lending limits and wouldn't be able to lend more, Chinese officials said. PBOC officials carried the day, the official said, by citing concerns about boosting credit growth. Two other officials said that Mr. Ma was among those convinced by the arguments. In the end, the State Council agreed to limited measures, including reducing business fees, and tightening regulation on so-called shadow-banking institutions, such as trust companies, leasing companies and other informal lenders, as a way to reduce borrowing costs for business. It also approved the reserve-requirement reduction aimed at smaller businesses.


**PBOC to Cut Reserve Ratio for Banks Lending to Rural Sector, Small Firms**

China's central bank on Monday unveiled details of a previously signaled cut in the portion of deposits that some financial institutions need to keep on reserve, making more money available for lending as economic growth slows. The People's Bank of China said it will cut the reserve ratio by 0.5 percentage point for some banks that focus on lending to the rural sector and smaller companies. It said in a statement on its website that the move, which takes effect June 16, also applies to financial leasing and auto financing firms.

In April, the PBOC cut the reserve ratio for county level rural commercial banks by 2 percentage points and trimmed the ratio for rural cooperatives by 0.5 percentage point. That move took effect April 25. The central bank also said on Monday that the measures don't signal a monetary policy change. It added that it is maintaining its prudent monetary policy.


**Global Finance: Citic Seeks to Secure Metal in Chinese Port --- Move Comes Amid Probe into Alleged Fraud on Loans Backed by Copper, Other Commodities; Worries Spread to Second Site**

One of China's most important financial companies moved to secure metals at a warehouse while concerns about fraud in commodities markets spread to a second Chinese port. State-owned Citic Resources Holdings Ltd.
said Tuesday it has applied to courts in the port city of Qingdao to secure metal assets it owns in warehouses, as concerns mount over the use of commodities for financing in China. Citic Resources' parent is Citic Group, one of the country's biggest state-owned enterprises. The operator of Qingdao port, on China's eastern coast, confirmed on Monday that Chinese authorities were conducting a probe into allegations of fraud. Separately, Western banks worry that the potential fraud has flared up at a second Chinese port, Penglai, also located in Shandong province, according to people familiar with the matter.

Banks and trading houses are looking into suspected fraud involving metals stored in China that were as collateral for loans, according to people with knowledge of the matter. At least a half-dozen lenders, including Standard Chartered PLC, provided loans to trading firms that were backed by metals such as copper and aluminum stored at Qingdao, one of China's biggest ports, the people said.

The trading firms hold the deed to the metal, which can be used to secure financing, but the metal stays in a warehouse. Banks fear a private Chinese company may have used the metal as collateral to get multiple loans, potentially defrauding the lenders and trading firms. These banks haven't been able to get access to the collateral, stored at Qingdao Port, which administers the warehouses. A number of Western and Chinese banks have sought similar court orders in an effort to secure their collateral, according to one person familiar with the matter. But the court orders won't alleviate the problem of multiple lenders claiming the same piece of collateral that had been promised to them by the borrower, this person said.


**Banks Fear Collateral Is Missing in China:** [Business/Financial Desk]

Large banks and trading firms are frantically trying to determine whether they have fallen victim to a suspected commodities fraud emanating from the giant Qingdao Port in northeast China. Citigroup and several other big Western banks are concerned that their loans may lack the appropriate collateral of big stockpiles of copper and aluminum at the port. The banks have inspectors on the ground who are trying to assess whether enough of the metals are there. The worry stems from suspicions that a Chinese company pledged the same collateral for multiple loans. Chinese authorities are investigating the matter.

Western banks, including Citigroup, are bracing for any potential fallout. Just months ago, Citigroup fell victim to a multimillion-dollar fraud in Mexico. If the Qingdao developments hurt the bank, regulators and shareholders are likely to press it to explain why its controls failed again. Chinese companies are at risk, too. The potential fraud is linked to an opaque corner of China's financial system that has grown substantially in recent years, bringing huge amounts of capital into the country. Many Chinese companies and investors, struggling to secure traditional loans from the state-dominated banking sector, have instead turned to alternative, unregulated financing methods involving imports of materials like copper, aluminum and iron ore.

Typical commodities financing deals work like this: Copper is imported using letters of credit, warehoused in duty-free zones and pledged as collateral for cheap bank loans. The loan proceeds are used by the importer to speculate in higher-yielding, short-term investments. When the letter of credit comes due, the importer then either sells the commodity or the investment product. One such importer in Qingdao has drawn particular scrutiny. Last Friday, Qingdao Port International, the biggest port operator in the Chinese city, announced that the authorities had begun investigating a suspected fraud related to the aluminum and copper stored in its warehouses. A day earlier, a report in The 21st Century Business Herald, a Chinese-language newspaper, identified the company under investigation as Decheng Mining. The report said Decheng Mining was suspected by the authorities of having pledged the same stocks of the metals -- about 100,000 tons of aluminum and 2,000 to 3,000 tons of copper -- as collateral for multiple loans, amassing bank debt exceeding 1 billion renminbi ($160 million). Phone calls and emails to Decheng's parent company, Dezheng Resources,
went unanswered on Wednesday. The figures in the Decheng case are not huge compared with China’s overall imports of commodities. But the concern is that such schemes may be broader, involving more than just one company at one port.


Into the shadows: risky business, global threat

As chief accountant for Yuncheng City Investment, a financing vehicle for the local government, Mr Qiao has played a crucial role in the development of this gritty steelmaking city in central China. His latest job is to sell his company’s “trust product” – a high-interest, deposit-like investment – with the proceeds going to a big public heating project for Yuncheng. Despite paying a tempting 9.7 per cent annual interest rate, his product, marketed as “Eternal Trust Number 37”, is not catching on with investors. Mr Qiao is worried. The problem could be that Yuncheng’s property market has hit a rough patch or that a local steel plant has closed. But he blames events outside Yuncheng for his predicament. The near-default of other Chinese financial products recently has set off alarms – inside China and in global markets – that the country is in the midst of a dangerous credit bubble.

Trust products, such as the one offered by Yuncheng City Investment, lie at the heart of China’s shadow banking sector, which has provided more than Rmb30tn ($4.8tn) worth of loans to the country’s riskier enterprises since 2007. It has helped create the biggest credit boom in history. But in Yuncheng and scores of similar nondescript cities across the country, China’s enormous and poorly regulated shadow banking sector is starting to run into trouble, with profound implications for the world’s second-largest economy – and potentially the global economy.

Today the Financial Times begins a series on how “shadow banking” – a term that covers a wide range of “non-bank” institutions that perform many of the functions of traditional banks, but do so outside the traditional system of regulated banks – is reshaping finance around the world. The last shadow banking bubble, in the US in the run-up to 2008, compounded the global crisis that followed. Now markets and regulators are concerned that the rapid build-up of risk in China’s shadow banking sector could inflict similar damage. Worries about China’s shadow banking system rattled global stock markets this winter, after a wealth management product called “Credit Equals Gold” was reported to be on the verge of default. It was quickly restructured, only to be followed by concerns about a similar product known as “Opulent Blessing”. Although these were small products in relation to the Chinese economy, the financial markets – and regulators – paid attention. Noting how large the sector has grown, many in China warn that the country could face its own “Lehman moment” if it were to see a serious run on shadow banks. The concern is that financing could disappear for the most leveraged and riskiest parts of the economy, from real estate developers to steel mills. China’s investment-reliant growth could come to an abrupt end.

Yuncheng City Investment is one of more than 10,000 “local government financing vehicles” (LGFVs) set up by Communist party officials as a way to circumvent laws that forbid local governments from running deficits. Their job is to raise money any way they can and spend it on behalf of local authorities, often on public works projects such as roads, public heating or sewage systems. The latest official estimate puts the total amount of debt held by LGFVs at Rmb17.9tn by the middle of last year, equivalent to more than 31 per cent of China’s gross domestic product in 2013. Most LGFVs were created in the wake of the global financial crisis in late 2008, when Chinese exports fell off a cliff and the government launched an enormous stimulus plan to stave off economic disaster. The LGFVs were seen by Beijing as a necessary evil and were initially allowed to borrow directly from the
country’s state-owned banks.

With Beijing exhorting companies and local governments to borrow and spend as much as they could, total debt to GDP in China’s economy rose from 130 per cent in 2008 to more than 220 per cent in 2013. Assets in the formal and shadow banking sector increased from around $10tn to as much as $25tn. That means China created new credit roughly equivalent to the entire US banking system in the space of five years. The massive stimulus quickly led to a rebound in growth rates, but the new credit soon began weighing on lenders’ balance sheets and capital requirements. So, with tacit approval from policy makers in Beijing, alternative forms of credit began to sprout in the shadows. The banks repackaged their riskiest loans to their least creditworthy borrowers, including many LGFVs, and sold them as “wealth management products” to ordinary depositors. Lightly regulated trust companies joined the action, making high-interest loans to risky borrowers, repackaging them and selling them through banks as “trust products”. On paper, trust products are only supposed to be sold to investors with Rmb1m to spend but this rule is often broken. And the trusts were designed to be alluring. Deposit rates in China are capped by the government but these innovative trusts were classified as investment products, allowing banks to tempt depositors with the promise of much higher returns. After the Chinese economy rebounded in 2009 and 2010, policy makers began worrying about wasteful investment and asset inflation. Banks were told to cut back on lending to real estate projects, local government borrowers like Yuncheng City Investment and industries suffering from serious overcapacity, such as steel, glass and cement. That created enormous demand for the high-interest loans on offer through the fledgling shadow banking sector.

Next in the series: how shadow banking is restructuring the financial landscape and Paul McCulley on challenges for the US Federal Reserve. Economists at Barclays estimate the size of China’s shadow banking system at around Rmb38.8tn at the end of last year, or around a quarter of the size of total assets in the banking sector. Analysts say roughly half of all credit extended in 2013 came from outside the formal banking system. Total outstanding trust product assets in China rose 8 per cent in the first quarter from the previous quarter to reach Rmb11.7tn, a fourfold increase from the total at the end of 2010. As much as Rmb5.3tn of those products will come due this year, according to estimates from Haitong Securities, a Chinese brokerage. Even as China’s economy is slowing and revenues from land sales dry up, local governments such as Yuncheng’s are being called on to prop up their financing vehicles and bail out the high-interest trust products they have sold to investors. At best, this could push growth lower, since government revenues will be diverted from new investment into paying off old debts. At worst, collapsing government revenue will lead to financial crises as defaults in the shadow banking sector soar and investment-reliant growth collapses. Yuncheng is not a particularly extreme example, since Mr Qiao and his colleagues have been relatively conservative in their borrowing. Many Chinese cities have dozens of LGFVs that have issued scores of trust products between them. “Yuncheng represents a case of a city in real need of financial restructuring and there are many cities like this across China,” says Li Daokui, of the Center for China in the World Economy at Tsinghua University and a former member of the central bank’s monetary policy committee. “The central government will have to step in to facilitate this restructuring but the holders of these kinds of high-interest trust products across the country will definitely lose money.”
Chinese fund CIC under fire over overseas losses

China Investment Corporation, the world’s fourth-largest sovereign wealth fund, has been accused by the country’s top auditor of mismanagement, dereliction of duty and poor due diligence just seven years after its inception. The National Audit Office said CIC – an investor in big US financial institutions such as Blackstone and Morgan Stanley – had incurred unquantified losses on overseas investments because of this mismanagement. CIC, which has $650bn in assets under management, has made some $200bn in investments around the world since it was set up in 2007 to earn higher returns on the country’s burgeoning foreign exchange reserves. However the report found that between 2008 and 2013, CIC made 12 overseas investments that faced losses or potential losses because of “dereliction of duty, inadequate due diligence, a lack of post-investment management and other problems”. Some other investments suffered from irregularities in the hiring of external managers, the auditor found. The auditor on Wednesday also found that Bank of China and Agricultural Development Bank, a state lender tasked with supporting Beijing’s rural development policies, had issued billions of renminbi worth of “irregular” loans in recent years. The report gave more detail on problems discovered in CIC’s domestic operations. It scolded several Chinese financial institutions owned by the fund for concentrating too much on real estate investments in violation of government directives. It also said CIC’s main domestic subsidiary lost Rmb1.26bn ($202m) in potential investment gains in 2011 by selling its holding in a Chinese securities company for its cost price without conducting an asset appraisal as required. The auditor found CIC’s management of its own internal finances was “relatively weak” and some of its bookkeeping and account management did not comply with regulations. CIC reported an annual return of 10.6 per cent in 2012, following a 4.3 per cent loss in 2011. The fund has said it earned returns of more than 8 per cent last year and its cumulative annualised return since it was set up in 2007 is 5 per cent.

Source: Jamil Anderlini : Chinese fund CIC under fire over overseas losses, Financial Times, June 18, 2014

Central bank chief highlights China's financial risks

Vice-governor of China's central bank on Tuesday highlighted the country's current financial risks, promising to strengthen and improve financial regulation. China’s economy is running in a reasonable range, with controllable financial risks; however, due to various uncertainties, financial risks remain prominent in some sectors or regions, said Liu Shiyu, when delivering a report to the Standing Committee of the National People’s Congress, the top legislature. The debt ratio of enterprises is excessively high due to the rapid expansion of some of them and local financing platforms, resulting in greater payment risks and credit risks, Liu said. The credit default risks of some sectors and regions have increased, as commercial banks' non-performing loan balances have climbed for 10 quarters in a row, and the non-performing loan ratio is also rising, he noted.

In the meantime, liquidity management has become more difficult as some inefficient enterprises account for a large amount of funds while small and mid-sized ones suffer difficulties in financing. Liquidity management is becoming more difficult and complicated due to the United States’ withdrawal of quantitative ease. Hidden dangers in the network and information security of the financial industry also continue to exist, in particular the industry’s increasing reliance on the Internet and other open systems, according to Liu’s report. Risks in the businesses of shadow banking, abnormal fluctuations of cross-border capital flows, and the rise of expiration payment and surrender rates are also dangers in China’s financial sectors, warned Liu.

In a bid to address those risks, he said, the central bank will use integrated monetary policy tools to better service the real economy, and strengthen financial risk monitoring and analysis so as to prevent and defuse risks in a timely manner. According to the senior banker, the central bank will strengthen financial regulation, improve the market system and monitoring of cross-border capital flows, and deepen reform in financial sectors in order to to strengthen defenses against risks.
Global Finance: **Auditor Slaps 8 Banks**

Industrial & Commercial Bank of China Ltd. and seven other banks improperly lent more than $60 billion to property developers and others despite government restrictions, according to a Chinese auditing agency. The disclosure, in a report released Tuesday by China's National Audit Office, follows efforts to curb loans to areas where Beijing worries that mounting debts could lead to problems for the financial system in the world's No. 2 economy. The report said the eight banks had irregularly extended a total of 374.99 billion yuan ($60.5 billion) to property developers and local-government financing vehicles. Local governments are barred from borrowing directly, so they set up the vehicles to obtain capital. The banks used the interbank market, where banks lend to one another to meet their daily cash needs, as well as other methods to skirt lending limits, said the auditor. The auditor didn't disclose the identities of the banks other than ICBC, or the amounts extended by each bank. In May, Chinese regulators enacted rules intended to stop banks from disguising corporate loans as less-risky interbank loans through complex transactions. Such loans often are made to borrowers considered too risky for banks' on-balance-sheet lending arms. Disguising the loans also lets banks set aside less in capital and reserves, making their balance sheets look healthier. Last year, Chinese officials instigated a cash squeeze in the interbank market, driving interest rates higher, in part to send a signal to discourage such practices.


**Report Warns Investors in China Firms**

A U.S. government commission warned that investors face "major risks" if they buy shares in Chinese companies like e-commerce firm Alibaba Group Holding Ltd. A report released this week by a commission that advises Congress on U.S.-China economic issues took aim at the legal structure underpinning Alibaba as well as a host of other Chinese Internet firms, calling it "a complex and highly risky scheme of legal arrangements." It warned that the structure could lead to losses by shareholders in the U.S. "U.S. shareholders face major risks from the complexity and purpose" of the structure, said the report, released on Wednesday by the U.S.-China Economic and Security Review Commission. The group, an independent agency directed by Congress, has in the past issued critical reports about China.

The report focuses on a structure called a variable-interest entity, or VIE. Chinese companies seeking to sell shares on U.S. markets use the structure to circumvent Chinese government restrictions on foreign ownership of businesses in sensitive industries, including Internet-related businesses. The VIE structure solves the problem of foreigners investing in prohibited industries by splitting companies into two entities. One, based in China, controls licenses and other assets required to do business in China. Foreign investors can buy shares in the foreign-listed parent of the second entity, which is based offshore. Under a typical VIE structure, the Chinese entity pays fees and royalties to the foreign entity based on a series of contracts, thus ensuring the economic benefits of the Chinese operations flow to shareholders in the foreign entity. The structure has drawn criticism from some corporate governance specialists. They argue that it gives foreign investors little control over some assets of the company, which generally remain under the control of the Chinese entity and its owners. In a 2011 dispute that highlighted the problems of such corporate structures, the individuals who controlled Alibaba's Chinese entity split off the assets of a payments unit and put them under the control of Alibaba founder Jack Ma, over the objections of Yahoo Inc., a large shareholder in the foreign entity. Investors haven't seemed too concerned about VIEs. Several companies including Baidu and JD.com have so far have been winners for investors.

Tax benefits expected as China pilots ESOP

China has released long-awaited guidance on employee stock ownership plans (ESOP), but analysts expect more policy infrastructure, such as tax benefits, to be in place before the mechanism proves effective. China Securities Regulatory Commission (CSRC) on Friday allowed ESOP to be piloted in listed companies on a voluntary basis, as long as total stocks owned by employees account for no more than 10 percent of the company’s share capital. For each individual employee taking part in plans, such proportion shall be kept at no more than one percent. The document also stipulates how long the stock shall be owned by an employee, as well as requirements on information disclosure and other regulations. The ESOP, in which companies provide employees with stock ownership to allow them to enjoy share entitlement under certain conditions, is a widely-used method to increase efficiency and internal growth of a company in mature securities market. Previously, China introduced plans that encouraged only senior executives to own stakes in listed companies.

In fact, de facto employee-owning-stocks phenomena are not uncommon in China's A-share market. CSRC data showed that by the end of 2012, 74 percent of listed companies had employees holding stocks of their own firm. However, without regulation, the real ESOP, as an incentive plan and a management tool, did not exist in China. In the United States, where the ESOP originated, workers taking part in plans enjoy tax exemptions for their stock dividends. Similar tax rebates can be found in ESOPs for United Kingdom government employees. According to CSRC spokesman Zhang, the commission is now working with relevant government departments on tax policies relating to ESOPs.

Source: Xinhua: Tax benefits expected as China pilots ESOP, 2014-06-23

Asia-Pacific - Hong Kong - Stock Exchange - Hong Kong's mainland connection

The Shanghai-Hong Kong Stock Connect created a strong air of excitement in the Asian markets and beyond when it was announced in April. Once launched, the initiative will connect the Stock Exchange of Hong Kong with the Shanghai Stock Exchange, allowing mutual market access in designated equities, considerably enhancing the financial links between the former UK colony and the Chinese mainland. The connect opens a path to the Shanghai Stock Exchange for all Hong Kong and overseas investors, but only institutional investors and those with an aggregate balance of Rmb500,000 ($81,000) or more in their securities and cash accounts will be allowed to trade from the mainland side of the system into Hong Kong. The potential benefits of the connect are numerous for both sides and many in the markets are looking forward to the implementation of the system with serious enthusiasm.

The economic benefits are clear, but the tie-up also represents a strong political willingness on the part of the Chinese government to open up mainland markets to outside investors. Reluctance from China to do this in the past often frustrated investors who were keen to raise their exposure to Chinese assets through quicker and easier methods such as stock trading. Carrying out trading from Hong Kong will increase investor confidence when considering issues such as dispute resolution that arise as a result of market activity. This further integration of Hong Kong and its world-class financial centre with the mainland sends a strong signal about China's global outlook.

The Shanghai-Hong Kong Stock Connect will provide strong benefits to certain market participants, but there may be slightly less enthusiasm from competitor exchanges elsewhere in the Asia-Pacific region. There are a number of strong regional exchanges that compete with Hong Kong and Shanghai for trading volumes, which boost liquidity in their respective bourses. According to the chief executive of one stock exchange outside the region, exchanges elsewhere in Asia-Pacific would likely be looking at the potential competitive impact rather than the benefits. Whereas rival exchanges are no doubt watching closely how the connect develops and what impact it may have on their businesses when it is up and running, there are those who believe the competitive dangers from the new system could be overestimated and that it is better seen as a local initiative that affects only the two exchanges involved.

According to the website of Hong Kong Exchanges and Clearing (HKEx), the parent company of the Stock Exchange of Hong Kong, the launch of the project can only take place once certain regulatory approvals are in
place, the relevant trading and clearing rules and system have been finalised, and market participants are given enough time to adapt their systems. Therefore, the preparation for the formal launch of the project is expected to take about six months to complete. The Stock Connect has certainly been well received by the investment communities of both the Chinese mainland and Hong Kong. The long-awaited initiative solidifies the ties between the two markets and offers the prospect of more co-operation in future. How it will affect rival exchanges in the Asia-Pacific region remains to be seen, but they will certainly be watching closely as the finer details of the project emerge. China's hunger to connect its capital markets with the outside world through the Shanghai-Hong Kong Stock Connect has been warmly welcomed from those outside who see it as a long overdue innovation. And depending on the success of the project when it comes online, this could be just the start of a wider embrace of the global financial system from the Chinese government, providing the initial stages of the project prove a success.


Global Finance: Citic, Brainchild of 'Red Capitalist,' Makes a Shift

When China's late leader Deng Xiaoping held a meeting with the country's few remaining businesspeople in January 1979, he singled out Rong Yiren, a former textile tycoon, to "do some actual work and play a role" in Beijing's nascent economic-overhaul efforts. Within a month, Mr. Rong, known as the "Red Capitalist" because he chose to stay in China after the Communist takeover in 1949, responded with a proposal to establish China International Trust & Investment Corp. Eight months later, the company, now known as Citic Group, was in place, with Mr. Rong as chairman and chief executive, seeking to attract foreign capital and helping Beijing invest overseas. Mr. Rong laid the groundwork for Citic Group to become China's most influential conglomerate. A Citic Group unit, (Citic Pacific Ltd.), was one of the first "red chip" stocks, the mainland-controlled companies listed in Hong Kong. The conglomerate now boasts a suite of financial services from banking to insurance, iron-ore mines in Australia, one of China's most underachieving soccer clubs and the country's top offshore-helicopter-service operator.

On Tuesday, Citic Group returned to the vanguard of China's efforts to overhaul its state sector. Independent shareholders approved Citic Pacific's $37 billion takeover of Citic Group's assets, effectively listing nearly all of Citic Group in Hong Kong, where it will be subject to tougher rules and disclosure requirements than on the mainland. Advocates say the move could become a blueprint for overhauling China's huge, inefficient state-owned enterprises. "Citic has always been right at the heart of the process of reform and development in China, and this landmark transaction marks the next stage of the group's transformation," Chang Zhenming, chairman of both companies, said when the deal was unveiled in April. To pay for the deal, Citic Pacific, which will be renamed Citic Ltd., will issue around $29 billion in shares that will be bought by its parent company. It will also issue $8 billion in shares that will mostly be bought by state entities. After the transaction, the government's stake will rise to 82%, from 58% now. The scale of the deal is a far cry from Citic Group's more humble beginnings. Mr. Rong founded Citic Group with about US$5 million in 1979. At the end of 2012, the company had assets totaling US$572 billion. In a sign of appreciation for Mr. Rong's accomplishment, Beijing appointed him to the position of vice president in 1993. Mr. Rong died in 2005.

"The conglomerate's upcoming listing in Hong Kong will definitely improve corporate governance and help make operations more market-oriented and transparent," said Jiang Shiqing, an analyst at Industrial Securities.


Down to Brass Tacks - China has identified all the potential roadblocks lying in the path of the country's transformation. But how exactly should it now proceed?

On May 20, the State Council approved and forwarded the Key Tasks for Deepening Economic Structural
Reforms in 2014 released by the National Development and Reform Commission, mapping out the route for the newly initiated cause. The key tasks imply that a priority has been given to stabilizing growth, restructuring the economy and improving people's overall livelihood, said Wang Jun, an expert with China Center for International Economic Exchanges.

The Key Tasks represents an answer to public concerns. According to the document, the transformation of government functions tops the agenda. The government should reduce administrative procedures, and establish a power list system, which requires the government publish a list of areas over which it has oversight and pledge not to intervene in areas which it does not hold power. In addition, the practice of “negative lists” should be widely adopted to manage market access, making sure that market participants can do whatever the law doesn't forbid. "The essence of economic structural reform is to balance the relationship between the government and the market and let the market play a decisive role in allocating resources, or more specifically, reduce administrative intervention," said Wang.

Another main point is the liberalization of all competitive fields. According to the Key Tasks, efforts will be made to correctly position state-owned enterprises, to push forward reforms in sectors like telecommunications, power, petroleum and natural gas, while, at the same time, respecting the law of market economy, and giving larger play to private capital. Although China had, before now, launched policies to encourage non-public capital to enter these monopolized sectors several years ago, little progress has been made so far. The promotion of the mixed ownership model will act as a catalyst for change. The fiscal and taxation system will also stand in the breach of the economic structural reform. The document suggested China will implement a transparent and standardized budget system, and make taxpayers the supervisor. As far as local government debt is concerned, the document showed an intention to establish a debt-financing mechanism for local governments through the issuance of government bonds.

Despite the continued slowing down in the past two years, the Chinese Government hasn't been on tenterhooks, as they know such a slowdown is inevitable in the process of economic restructuring. Since China began to quicken its steps toward economic structural reform in 2010, its economic development has been held back by policies such as energy conservation and emission reduction and the elimination of backward production capacity. Externally, international environment does not give cause for optimism. According to a study by CITIC Securities, owing to its entry into the World Trade Organization, China's trade surplus has been substantially increased, which had fueled high-speed growth. But since 2011, global trade has become sluggish and stagnant, exerting downward pressure on what was once the country's most important growth engine - export.

Source: Xinzhen: Down to Brass Tacks - China has identified all the potential roadblocks lying in the path of the country's transformation. But how exactly should it now proceed?, Beijing Review (Jun 5, 2014)

China approves marine development pilot in Qingdao

China's State Council, the Cabinet, has approved of the establishment of the Qingdao West Coast New Area in East China's Shandong province, a central government statement said on Monday. The area, aiming to pilot marine technology innovation and serve as a strategic base for deep sea and off-shore exploration, is to play a role in seeking new ways for scientific development of the country's marine economy, the statement said. The area, in the west coast of Jiaozhou Bay, covers Huangdao district in Qingdao, a coastal city in Shandong. The area's land size is 2,096 square kilometers and the sea area is about 5,000 square kilometers. According to the document, the area will focus on the development of the marine economy and emerging marine industries.

Source: Xinhua: China approves marine development pilot in Qingdao, 2014-06-10

Shanghai pilot to steer growth of free trade zones

Ongoing experiments at the pilot free trade zone in Shanghai will determine whether China will extend the FTZ experiment to other regions, a top official of the country's top economic planner said on Tuesday. "Many Chinese cities have proposed free trade zones, but whether or not they will get the nod depends on the findings
from the Shanghai project. The FTZ in Shanghai is an experiment ... we need to see and assess its test results," said Fan Hengshan, vice-general secretary of the National Development and Reform Commission.

At least 28 local governments have reportedly submitted proposals or plans for similar zones, after the Shanghai FTZ got the central government nod in September. "Full assessment is needed before establishing new pilots, and it will be done in an orderly fashion," said Fan, in response to questions on whether China has suspended approval for its second free trade zone. The Shanghai FTZ, with specific initiatives in service trade and financial openness, is one of the most significant steps since the reform and opening up. "It's natural that all regions want to join the race and gain a higher starting point in future development," said Wei Houkai, a researcher at the Chinese Academy of Social Sciences. "The Shanghai FTZ can only play a limited role in spurring economic development. Personally, I think more FTZs should be considered and built in an orderly way to rebalance the economy in different regions," he said.

According to media reports, a number of regions such as Tianjin and Chongqing have also lobbied the central government for FTZ approvals. Guangdong is charting plans for a new integrated free trade zone along with Macao and Hong Kong. Fan said the NDRC, the Ministry of Foreign Affairs and the Ministry of Commerce will jointly design the overall plan for the proposed "Silk Road Economic Belt". The belt was proposed by President Xi Jinping in September. It will be a free trade zone that includes China and Eurasian countries, which have a combined population of 3 billion. Experts said it would play a significant role in boosting cooperation between China and Eurasian countries and economic development of the regions along the road. More regional policies are in the pipeline. A detailed plan for the coordinated development of Beijing, Tianjin and Hebei province is in the making, Fan said last month. The Beijing-Tianjin-Hebei area had a combined GDP of over 6 trillion yuan ($980 billion) in 2013 and a total population of more than 100 million. The NDRC is also working on plans for an economic belt along the Yangtze River, which will involve 11 regions: Shanghai, Jiangsu, Zhejiang, Anhui, Jiangxi, Hubei, Hunan, Sichuan, Chongqing, Yunnan and Guizhou. Wei said the belt will be a new pillar for China's economic development in the long run and achieve a balance between the central and western regions, which are expected to drive China's future economic growth. Development across regions is becoming more coordinated, and regional gaps are narrowing. All policies are designed after taking regional individual competitiveness and strengths into account, Fan said.

Source: Lan Lan: Shanghai pilot to steer growth of free trade zones, China Daily, 2014-06-11

China's mixed ownership reform advances against headwinds

As a priority on China's reform agenda, diversifying the ownership of the country's State-owned enterprises (SOEs) is making progress although the road ahead may be bumpy. IT engineers for digital map service provider Navinfo have become much busier these days after the SOE invited in Tencent Holdings in May by selling an 11.28-percent stake to the private IT titan for 1.17 billion yuan ($187.6 million). The two companies are working on a smart in-vehicle navigation system with more accurate navigation and rich location-based services. The tie-up of Navinfo, a subsidiary of the China Aerospace Science and Technology Corporation, and Tencent marked the first step taken by an SOE to open up to private capital in order to forge mixed ownership. Such reform is high on China's to-do list for 2014 as the country aims to invigorate generally torpid SOEs and provide fair chances to different market entities.

"China will loosen grips on all the competitive sectors and set up an arena in which private investors can fairly compete," said the National Development and Reform Commission (NDRC), China's top economic planner, in a statement last month. The commission later released a first batch of 80 programs to solicit private investment. They mainly involve transport infrastructure, new energy projects and telecommunication facilities. As one of the country's three telecom operators, China Telecom has also taken action. The company is working with Amazon and Japanese auto maker Infiniti among others to incubate 68 innovative projects.

"Navinfo and Tencent are highly complementary," said Ren Yuxin, Tencent's chief operating officer,
explaining that Navinfo has strong mapping capacity and Tencent has a sea of consumer data collected from a huge user base. Combining the advantages can enable the two to create new location-based services and enrich Navinfo's in-vehicle navigation system by adding functions like instant messaging and music playing, according to Ren. The deal is also expected to put Tencent in a favorable position in digital map services against BaiduMap and Alibaba's AutoNavi.

The SDIC also benefits from diversified ownership. Its contract with private insurance company Taikang helped the SDIC expand insurance market share. Partnering with the corporation, Taikang is expected to be able to raise investment more easily. "The mixed ownership reform pushes us closer to the market and boosts our vitality and competitiveness," said SDIC board chairman Wang Huisheng.

China has thousands of SOEs and 113 of them are directly administered by the country's central authority. These enterprises are deemed as the backbone of China's economy. But their monopoly in many scopes shuts out smaller market entities and causes low efficiency and poor services.

Despite a number of successful cases, failures have showed that pushing forward mixed ownership is not easy. A photovoltaic project managed by an SOE in Northwest China's Qinghai province refused to invite in private investment. The project is one of the NDRC's 80 programs. A senior executive surnamed Xie said, "We have abundant capital and can easily get credit from banks. If the ownership becomes complicated, management will get difficult." Cai Zebin, general manager of a Nanjing-based private electrical equipment manufacturer, is also hesitant to invest. "Even if we participate, we have no controlling stakes. Who can safeguard our interests against powerful SOEs?" said Cai. "To dismiss these worries, China should lay down rules or even make laws to regulate activities during the reform and make sure private investors are treated fairly," said Gao Minghua, an SOE researcher with Beijing Normal University.

Source: Xinhua: China's mixed ownership reform advances against headwinds, 2014-06-11

World News: Beijing's Overhauls Get Short Shrift --- Long-Term Plans to Revamp Economy Take Back Seat to Immediate Needs; Premier Pushes Spending

Long-term economic overhauls that China's leadership promised are taking a back seat to short-term needs as Beijing wrestles with a slowing economy and a foot-dragging bureaucracy. In the more-than-six months since the Communist Party announced the restructuring package, economic growth has slowed more quickly than leaders anticipated, prompting stimulus measures. In recent weeks, Beijing has laid out plans for stepped-up spending on rail, water, nuclear power and housing, nudged banks to lend more to home buyers, eased export rules and cut reserves that smaller banks must hold in a bid to loosen credit. Premier Li Keqiang recently tried to impress upon local officials the urgent need to accelerate spending to generate growth and to warn them against doing nothing, state media reported. He added that Beijing was sending out inspection teams to "root out laziness" and punish those paralyzed by "fear of making mistakes," the official Xinhua news agency reported.

It isn't that the overhauls have been scrapped. President Xi's team has widened a trading band for the yuan, expanded a municipal-bond trial, clarified some equity rules and allowed more private ownership in the state-dominated banking sector. Rather, in the trade-off between short-term growth and longer-term restructuring, Beijing is tacking decidedly short-term. In doing so, economists and analysts said, the government is exacerbating old problems and working at cross-purposes to reform. Beyond the economy, also vying for the leadership's attention are deadly attacks the government attributes to separatists from western Xinjiang province and friction over territorial disputes with Japan, the Philippines, Vietnam, and the U.S.

Mr. Xi's plan promised to limit the government's hand in the economy, overhaul China's stodgy state companies, liberalize financial markets, let markets play a "decisive" economic role, and tap private-sector initiative. Overall, the program aims to make consumption the main economic driver, rather than investment, which has spurred industrial overcapacity, a property glut, elevated corporate debt and environmental despoliation. But tight credit policies engineered by the central bank over the past year in a bid to rein in debt were quietly reversed.
“Are they saying it’s mission accomplished?” said ING economist Tim Condon. “They’re worried that they need more liquidity.” Where overhauls have advanced, the measures seem incremental. Ultimately, Beijing sees reform more as a tool to maintain its grip than an end in itself, said Zheng Yongnian, director of the National University of Singapore's East Asian Institute. "The point is to consolidate the Party," he said, "not to weaken it.” China has outlined ambitious overhaul plans, but arresting a slide in growth has hindered the program.

Goal: Restructure state-owned companies: Progress: Citic and Sinopec introduced ownership changes, but monetary policies have eased pressure on state-owned firms.
Goal: Liberalize financial system: The yuan trading band was widened, though the central bank keeps fluctuations firmly under government control.
Goal: Give markets a ‘decisive’ role in the economy: Authorities control or heavily influence vast swaths of the economy.
Goal: Develop a Shanghai Free Trade Zone: A lengthy list of off-limits activities has been reduced, but freeing up cross-border capital controls has been slow.


China mulls $321 billion to treat water pollution
China's State Council, the cabinet, is weighing a 2 trillion yuan ($321 billion) action plan to prevent and control water pollution, the China Business News reported on Wednesday citing unnamed sources from the Ministry of Environmental Protection. The plan aims to improve overall water quality, ensure water safety, and maintain the entire water eco-system, the sources said. It will be another major step by the world's second-largest economy to curb environmental pollution after the Air Pollution Prevention and Control Law, which was rolled out in September last year. China has stepped up efforts to improve water quality in recent years, as a significant part of the water system has been polluted and drinking water safety issues keep popping up. "As much as 10 percent of China's surface water system has been severely contaminated, and in some places the pollution level is as high as 39.1 percent," the report quoted Li Ganjie, vice-minister of the environmental protection, as saying at a news conference last Wednesday.

With rapid urbanization and industrialization in the past decade, discharge of waste water in China has increased, reaching 68.5 billion tons in 2012 - an increase of 58.2 percent from that of 2001. Main reason behind the sharp rise is the rapid growth of urban domestic sewage, although it is not as contaminated as industrial waste water, said the report, citing statistics from the environmental protection ministry that showed that annual increase of urban sewage took a lion's share of 92.2 percent of the total surge as of 2012.

Source: He Yini: China mulls $321 billion to treat water pollution, China Daily, 2014-06-11

Energy Companies; Emerging Unconventional Resources Overview 2014: China, Australia, Poland and Argentina - Key Emerging Markets for Shale Developments
China, Australia, Poland and Argentina: Key Emerging Markets for Shale Developments China and Australia are among the most important emerging markets for shale and Coal Bed Methane (CBM) development in the world. China possesses an estimated 643 billion barrels (billion bbl) of risked, prospective shale oil and 4,746 trillion cubic feet (tcf) of risked shale gas in-place, of which around 32.2 billion bbl and 1,115 tcf are estimated to be technically recoverable. China's shale resources are primarily located in the Sichuan, Junggar, Tarim and Songliao basins. The country also possesses around 1,300 tcf of CBM resources, which are primarily located in north, northeast, northwest, and south China.

In China, the commercial production of shale gas has already started and is expected to increase at a considerable pace in future. Until December 2013, China's cumulative commercial shale gas production amounted
to around 5.1 billion cubic feet (bcf). China Petrochemical Corporation (Sinopec) and PetroChina account for almost all of the shale gas production in the country. Sinopec achieved a total production of around 2.6 bcf, equivalent to a daily production rate of 5.3 million cubic feet per day (mmcfd), up until December 2013 from its project in Chongqing. The company plans to achieve an annual shale gas production capacity of 178.7 bcf by 2015 through its Fuling project in Chongqing municipality in southwest China. The capacity at the Fuling site is also expected to enable China to achieve or exceed its national target of 232.3 bcf of shale gas production by 2015.

Source: Energy Companies; Emerging Unconventional Resources Overview 2014: China, Australia, Poland and

### Nation's wealthy ranks fourth globally

The nation stands fourth in the global ranking of US dollar millionaires following the United States, Japan and Germany, which together account for 60 percent of global millionaires, said France-based Capgemini and the Royal Bank of Canada. The annual wealth report is the latest of many surveys, highlighting the growth of the wealthy in the Asia-Pacific region, despite concerns over slowing growth in the world's second-largest economy. The number of people with at least $1 million in liquid assets in China reached about 750,000, compared to 4 million in the US, Japan's 2.3 million and Germany's 1.1 million, according to the survey. China and Japan, the only two Asian countries that made into the top five, contribute the most to Asia's growing wealth pool, which took experts by surprise due to the economic slowdown in both countries.

The report said that the Asia-Pacific region will replace North America to become the world's largest wealth management market thanks to the booming housing market in Asia, Japan. Asia's millionaire population surpassed that in Europe for the first time in 2009, and in 2011 it edged out North America for the top spot, according to previous editions of the report. "Surging stock prices really helped many people change from millionaires to billionaires, especially when many start-up companies were looking for IPOs in China," Lu said. In 2013, the Asia-Pacific region came close in the millionaire race to North America, which still remains the world's wealthiest region, with an increase of 17 percent to reach $14.88 trillion, the report said.

Source: Lyu Chang: Nation's wealthy ranks fourth globally, China Daily, 2014-06-21

### How China can help its rural poor

Since launching reforms in 1978, China has grown faster - and over a longer period - than any other country, ever. This achievement means that China is now the world's biggest market for industries ranging from telecom to automobiles to energy. But how much has this development filtered down to ordinary people, especially those living in rural areas? If China wants to further cement economic and social benefits in every part of the country, then it has to take some tough measures, said Zhang Xiaobo, distinguished professor of economics and associate dean, National School of Development, Peking University, in an interview with China Daily.

Zhang said that China should invest more in rural education, particularly in interior regions, by extending the nine-year compulsory education to 12 years. The country should also recognize farmers' ownership of their residential land – as farmers cannot use their houses for mortgage, and it is extremely difficult to transact their residential houses because of ambiguous property rights. Finally, the authorities should abolish the hukou (residence permit) system, giving rural residents the same opportunities as urbanites. Under the current system, rural migrants cannot access welfare benefits or subsidized housing in the cities in which they work.

Zhang urged the government to implement these steps and also stressed that China has achieved much more compared to other developing countries. "Although the Indian economy has also grown very fast in the past two decades, its trickle-down effect has not been as strong as China's. Indonesia has fallen into a middle income trap and failed to achieve much in poverty reduction in the past decade. Brazil, on the other hand, has made much progress in reducing urban poverty through social safety programs," he said.

Additionally, the illiteracy rate in China was 31.9 percent in 1981, based on the 1982 Population Census. It dropped to 4.08 percent by 2010 (according to the 2010 Population Census). Over the same period, the infant
mortality rate - defined as the number of infant deaths per thousand births - declined from 36.6 to 13.1. Zhang added that another area where China has made impressive progress concerns the increase in its per capita income. Per capita income in China in 1980 reached $190, about 1/54 of the per capita income in the US ($10,300). In 2013, per capita GDP in China and the US were $6,629 and $51,248, respectively, and the gap has shrunk to 7.7:1. In India, on the other hand, 35 percent of adults do not have basic reading and writing skills, its infant mortality rate is 44.6 per thousand births and per capita income stands at $1,504.

Though there are many reasons why China has been able to improve the lives of so many people so fast, Zhang credits the rural reform (the so-called 'household responsibility system') for triggering rapid economic growth. And he also said that the rural household responsibility system adopted in the early 1980s granted farmers land cultivation rights and empowered them to make their own production decisions. "Due to better-aligned incentives, agricultural production and rural incomes witnessed a dramatic increase in the ensuing years. Consequently, the rural poverty rate dropped sharply from 76 percent in 1980 to 24 percent in 1986. In other words, more than 400 million people moved out of poverty in a short, six-year spell," Zhang said.

He also said that the opening up and reform of the economy ensured a three-decade long continuous growth, which allowed hundreds of millions of people from the rural areas to seek job opportunities in the big cities. And, since 2004, China has passed the so-called "Lewis turning point" (real wages start to increase more rapidly) thanks to the increasing opportunities in the non-farm sector, which benefit the poor who mainly rely on labor income. Lastly, Zhang said the abolishment of agricultural taxation was another favorable policy for rural residents.

Source: Faisal Kidwai: How China can help its rural poor, China Daily, 2014-06-4

**NDRC gears up to support Xinjiang development**

China's top economic planning body said Wednesday that it will work to implement a variety of support policies in employment, education and poverty reduction for Northwest China's Xinjiang Uygur autonomous region. In the near term, the National Development and Reform Commission (NDRC) will focus on promoting economic and social development and improving living standards in southern Xinjiang, which has difficult geography and lower living standards, it said. The top economic planning agency will also speed up the building of major transportation, water conservation and agricultural infrastructure.

The NDRC's statement came as part of follow-up moves to major decisions made at the second central work conference on Xinjiang, a two-day meeting which closed last Thursday. The meeting was held in the wake of a series of bloody terrorist attacks in the region, including one in an open air market in Urumqi, the region's capital, which left 39 people dead and 94 injured on May 20. A priority of good governance will improve livelihood so that people from all ethnic groups feel taken care of by the Party and state, President Xi Jinping said at the meeting, vowing that the government will focus on employment, education and poverty alleviation. It will also optimize the allocation of Xinjiang-supporting funds and enhance supervision and inspection over how policies aimed at boosting Xinjiang development are carried out.

Source: Xinhua: NDRC gears up to support Xinjiang development, 2014-06-4

**Liangjiang New Area Becomes Investment Hot Spot**

As an inland opening-up portal, Liangjiang New Area attracts investors at home and abroad with sound infrastructures and numerous industries. A total of 127 Fortune 500 companies have been attracted to settle in Liangjiang New Area (LNA) since it was established four years ago, which account for more than half of the total investment companies in Chongqing. Contracted projects in LNA has reached 1,395, and the total investment has amounted to about 600 billion yuan ($96.06 billion). "Liangjiang New Area will deepen reform, create a top-ranking investment environment and strive to become one of the best investment destinations in the world," said Tang Zongwei, deputy secretary of the Party working committee and deputy director of the Liangjiang administrative committee. As a State-level development and opening-up district, Liangjiang New Area focuses on the development of the emerging
industry, including electronic information, high-end equipment, general aviation and the modern service industry. Funded by the comprehensive experimental region of the nationwide modern manufacture-related service industry, many e-commerce projects and logistics projects of well-known enterprises, such as Cainiao, Vailog from Italy, Goodman Group from Australia, Prologis from America and Minsheng Logistics, have signed contracts and settled down here. Liangjiang New Area has become an important commerce and trade gathering place of Chongqing and China.

"Liangjiang New Area chooses industrial projects based on five aspects, scale, improvement, promotion, influence and dedication," said Tang Zongwei. "Liangjiang will focus on developing State-level industries of new industrialization. Emerging industries, such as cloud computing, new fight sources, robots, aviation, medical apparatus and instruments, and shale gas equipment, and some industries that have never existed before are all development priorities of Liangjiang New Area in the future." From January to May 2014, total industrial output value above a designated scale was 167 billion yuan, with a year-on-year growth of 29 percent. Fixed-asset investment was 55.7 billion yuan, increasing by 23 percent. Foreign investment in actual use was $610 million, increasing by 36 percent.


Chinese firms have high compliance risks: Ernst & Young

Bribery and corruption remain widespread in many countries around the world and Chinese enterprises’ compliance risks are still high amid growing competition and slower economic growth, a new report published by global consultancy firm Ernst & Young said. The report, released on Wednesday, said that 40 percent of the executives polled for the survey consider bribery and corruption widespread in 59 countries. The survey polled 2,719 executives globally in in-depth interviews including 50 from the Chinese mainland and 50 from the Hong Kong Special Administrative Region between November 2013 and February 2014, covering a wide range of industries, according to the report.

In China, the report said, executives show more willingness to act in a manner that often leads them in the wrong direction. About 46 percent of the Chinese respondents said they are willing to pay money to win/retain business, compared with the global average of 13 percent. About 76 percent of the Chinese respondents said they have an anti-bribery or anti-corruption policy and code of conduct in place, which is lower than the global average of 82 percent.

In most of the other aspects Chinese C-suites, or a corporation's most important senior executives, are doing much better than their global peers, including mechanisms for internal checks and reports. While only 51 percent of the C-suites surveyed globally said they have internal reporting channels, 70 percent of China's C-suites indicated that they have such mechanism in place for reporting unethical behavior like corruption, bribery and fraud. Top brass in Chinese companies are more aware and committed about the anti-bribery and anti-corruption policies, the survey said. In China, 86 percent of the executives said they are aware of the policies, while the global average is 83 percent. "C-suites in China are also more aware of the fact that strengthened investigations and penalties over corruption and bribery alike may impact not only enterprises but also individuals, especially senior managers. Ethical growth is significant for both enterprises and individuals," said Dinan Shin, managing director of Ernst & Young's Fraud Investigation & Dispute Services in China. Enterprises in China may optimize their mechanism of reducing compliance risks by promoting training and strengthening checks by using big-data to identify high-risk records of compliance behavior, said Shin.

Unethical behaviors persist, the report said, including offering entertainment to win or retain business, giving personal gifts and giving cash payments and misstating a company's financial performance. About 42 percent of the respondents said they feel at least one of these behaviors can be justified if it helps the business survive an economic downturn.

The difficulties of the C-suite, including chief executive officers, chief financial officers, and chief compliance officers can only be heightened by insufficient awareness of the risks they face, the report said, as findings point out that they are less likely than their teams to attend anti-bribery or anti-corruption policy training or participate in such risk assessment. Only 38 percent of respondents said they have participated in the anti-bribery or anti-corruption policy training, according to the report. CEOs are especially exposed to compliance risks as 21 percent of the CEOs said that they had been approached to pay a bribe in the past, compared with 10 percent of all C-suite interviewees. In certain
markets, companies are facing investigations about recruiting practices after allegations that offspring of influential figures were hired to win or retain business, the report said.

Source: Wu Yiyao in Shanghai: Chinese firms have high compliance risks:Ernst & Young, China Daily, 2014-06-14

Alibaba’s Latest Field Is the Soccer Pitch

With its latest investment, Alibaba Group Holding Ltd. is ranging far afield from its core e-commerce business into an unlikely industry: sports. Alibaba said Thursday it bought a 50% stake in China's Guangzhou Evergrande soccer team for 1.2 billion yuan ($192 million), a deal that Alibaba's founder said was ironed out in a mere 15 minutes. The transaction is the latest in a string of purchases by Alibaba and takes the company into the terrain of sports, where many high-profile companies have stumbled. "I think not understanding soccer doesn't matter," Alibaba Chairman Jack Ma said in a news conference Thursday, while acknowledging he knew little about the sport. "I also didn't understand retail, e-commerce or the Internet, but that didn't stop me from doing it anyway," he said.

Speaking in the southern Chinese city of Guangzhou on Thursday, Mr. Ma said the deal to buy the stake in Guangzhou Evergrande Football Club only came together in recent days after Mr. Ma had drinks in Hong Kong with club owner Xu Jiayin, a property magnate.

In the run-up to its U.S. listing, Alibaba has been making a slew of deals to bolster its core business and to broaden its appeal. As China's hundreds of millions of Internet users have increasingly turned to smartphones to access the Internet, Alibaba has faced challenges attracting users, who are much more accustomed to shopping on Alibaba's PC-based websites. The turn to entertainment could be one way for the company to ensure a steady flow of traffic to its mobile e-commerce sites. In January, for example, Alibaba started offering mobile videogames using its e-commerce mobile apps. In April, Alibaba agreed to buy a 16.5% stake in Youku Tudou Inc., a Chinese online video company that works like a combination of YouTube and Netflix Inc. With the Guangzhou Evergrande deal, Mr. Ma joins an elite circle of club owners, many of whom are property moguls, like Mr. Xu. Sports has proved to be a risky, if fashionable, venture for many companies. In 2009 U.S. media conglomerate Tribune Co. sold the Chicago Cubs baseball team to the Ricketts family after several years of financial difficulties. And the previous owner of Guangzhou Evergrande, Guangzhou Pharmaceutical Group, sold the club to Mr. Xu in 2010 after it was relegated due to a match-fixing scandal.


Internet giant becomes China’s most valuable brand

Tencent Holdings Ltd has been crowned the most valuable Chinese brand in 2014, according Hurun Report, a leading authority on China's wealthy, on Thursday. Shenzhen-based Internet giant has seen its brand value increase by 136 percent year-on-year to reach 208 billion yuan ($33.4 billion), it said. It is the first time that Tencent has taken the first place on the list, overtaking the State-owned giants China Mobile Communications Corporation and Industrial and Commercial Bank of China Limited, as well as the search engine giant Baidu Inc. Rupert Hoogewerf, chairman and chief researcher of the Hurun Report, said privately-owned Chinese brands have demonstrated more creativity than the State-owned ones. The rapid growth of Tencent can be very much attributed to the success of real-time communication application WeChat, he added. In the Hurun Rich List 2013, Ma Huateng, co-founder and chairman of Tencent who owns a 10.25 percent stake of the company, came at third place for the first time with a personal wealth of about $10.1 billion.

ICBC remains the second most valuable Chinese brand this year although its brand value has shrunk 16 percent to reach 206 billion yuan, as it has been actively exploring the overseas market and has been somehow challenged by Internet finance. Last year's leading player CMCC dropped to third place this year as its brand value fell by 19 percent to 203 billion yuan. It is a combined result of the company's setting up of its 4G network and the impact of WeChat of Tencent, said Hurun Report. The most valuable privately-owned brand last year, Baidu, was dislodged by Tencent to the second place this year with a brand value of 190 billion yuan, up 79 percent. Among all surveyed privately-owned
companies, China's largest online marketplace Taobao.com was next to Baidu and Tencent as its brand value surged 320 percent year-on-year to reach 185 billion yuan.

Out of the 200 brands, 105 of them have seen their value increase and 89 have seen it fall. The total brand value of these brands rose 13 percent to reach over 3.17 trillion yuan, half of which is taken up by the top 10 brands. About half of the 200 surveyed companies are privately-owned, whose average brand value has increased about 80 percent year-on-year to reach 12.5 billion yuan. Jack Ma, founder of Alibaba, Robin Li, founder and CEO of Nasdaq-listed Baidu and Ma Huateng of Tencent has held controlling interests or has had stakes in the 12 percent of the top 100 most valuable Chinese brands.

Source: SHI JING in Shanghai: Internet giant becomes China’s most valuable brand, China Daily, 2014-06-26

Microsoft's Windows 8 Catches Flak in China

China's powerful state-run television broadcaster criticized Microsoft Corp.'s Windows 8 operating system in a national news show on Wednesday, adding to the software maker's challenges in a traditionally tough market. Companies like Microsoft could face further backlash in China. The U.S. and China have clashed in recent weeks after the U.S. indicted five officers in the People's Liberation Army on allegations of cyberespionage. In response, China said it would more closely scrutinize imported Internet technology for vulnerabilities it might pose to the nation's security. Widespread piracy of Windows and Office software means that Microsoft earns far less in China than it does in smaller countries, even though it has a massive presence in what is the world's largest personal-computer market. In 2011, then-Chief Executive Steve Ballmer told employees in a meeting that Microsoft's revenue in China was only 5% of what it got in the U.S. even though the PC markets were comparable in size at the time.


IBM to Work on Building Shanghai Airport Software-System; Computer Maker Says Project Would Help Manage Operations at Hongqiao Airport

International Business Machines Corp. agreed to work with the Shanghai Airport Authority to build a software system to help manage operations at the city's Hongqiao International Airport. The computer maker said Thursday that the project would help the airport anticipate flight arrivals by tracking a large amount of data about air traffic coming into and leaving Hongqiao International. It would also help the airport manage other operations, such as the flow of taxis. Financial terms weren't disclosed. The contract follows an IBM project completed in March that it said helped reduce delays.


Small firms get a break on VAT

The Ministry of Finance announced on Wednesday that the value-added tax rate will be a flat 3 percent for many small businesses, effective July 1. The 4 percent and 6 percent rates were eliminated to make the system fairer, the ministry said. An executive meeting of the State Council, the cabinet, said last week the move is expected to reduce companies' tax burden by about 24 billion yuan ($3.84 billion) a year. At present, VAT rates range from 2 percent to 17 percent. The rate cut will mainly benefit the water sector, small hydropower facilities, building materials producers and biological products manufacturers, all of which now pay 6 percent VAT. Also benefitting will be consignment stores, pawnshops and auction houses, which now pay a VAT rate of 4 percent. “This suggests that policy change is still inclined to those sectors that are more related to living standards”, said RobertLi, a tax specialist in China for PricewaterhouseCoopers LLP. This reform mainly targets small and medium-sized companies involved in the sale of
certain commodities, he said, adding that the new policy won't mean much change for the shift from business tax to VAT, because the companies are already subject to VAT and generally not eligible to claim VAT credits.

Tax revenue at the national level rose 6.8 per-cent in May to 1.22 trillion yuan, according to the Finance Ministry. The low rate of growth reflected a weakening economy, slowing property sales and a growing tax base.

Source: Anonymous: Small firms get a break on VAT, China Daily, 2014-06-19
http://www.chinadaily.com.cn/business/2014-06/19/content_17599543.htm

Small businesses to brighten China's economic prospects

The People's Bank of China, the country's central bank, announced this month a 0.5 percentage point cut in the reserve requirement ratio for banks lending to small firms, desperate for capital. Companies of this type account for over 70 percent of market entities. The cut could provide 350 billion yuan ($57 billion) in loanable funds and have a significant effect on the real economy if used properly, Xiang Songzuo, chief economist at the Agricultural Bank of China, estimated. Small firms already enjoy tax breaks, reduced admin fees and relaxed market access. The effects of those policies can be seen in a software park in South China's Hainan province, which, with local government support on finance, land and administrative approval, has attracted over 300 companies, mostly small startups. A 30 percent tax refund is available for companies paying less than 300,000 yuan in annual taxes for three years after they enter the park.

"Small" in Chinese business terms means entities with total assets worth no more than 30 million yuan for industrial players and 10 million yuan for those in other sectors. The number of employees should not exceed 100 and tax due should be less than 300,000 yuan. There are around 11.7 million such firms, almost 77 percent of total companies. If one-man operations are taken into account, the number quintuples and the ratio tops 94 percent, according to the State Administration for Industry and Commerce. Despite limited revenue and volatile profits, those firms contributed 60 percent of GDP and paid half of the nation's tax bill. Over 70 percent of new jobs are provided by them.

As the foundation of China's real economy, these enterprises play irreplaceable role in economic advance, technological innovation and social stability, said Miao Wei, China's Minister of Industry and Information Technology. Small firms in China still face a bumpy ride. Financing costs and taxes can not be eliminated once and for all and labor costs keep rising. Tang wants the central government to be more bold in cutting taxes and in financial support to truly help the small firms that have borne the brunt of the economic downturn. A bank focused on loans to small firms should be established to provide liquidity for small but important market players, he said.

Source: Xinhua: Small businesses to brighten China's economic prospects, 2014-06-20

China's PMI hits 5-month high, pointing to stabilizing economy

The purchasing managers' index (PMI) increased to 50.8 in May from 50.4 in April, according to data released by the China Federation of Logistics and Purchasing (CFLP) and the National Bureau of Statistics (NBS). This is the third consecutive monthly uptick in the widely watched data. The index, seen as one of the key indicators of economic performance, began to climb in March after three months of declines. Eight of the 12 sub-indices in the PMI registered growth, with the sub-index for production edging up 0.3 to 52.8 after dipping 0.2 in the previous month, according to the NBS and the CFLP. The sub-index for new orders, seen by analysts as the most important of all sub-indices, jumped by 1.1 to 52.3 in May after gaining 0.6 in April. The sub-index for export orders, which slumped by 1.1 in April, reversed the declining trend and rose by 0.2 to 49.3. The employment sub-index of the PMI dipped to 48.2 from April's 48.3, pointing to contraction in the job market. The official reading is also broadly in line with the HSBC/Markit PMI figure, released in late May, which rebounded sharply to 49.7 in May, hitting a five-month high.

As one of the first leading indicators showing economic momentum, the PMI reading could bode well for the second quarter, when the economy is expected to regain some lost ground. The think tank expects a series of new
growth-boosting measures soon to produce "accumulative effects" for the whole economy in the next few months. These so-called "targeted" measures include cutting reserve requirement ratios (RRR) for rural banks, speeding up railway and public housing construction, and tax breaks for small businesses.

In spite of the upbeat data, experts have cautioned that it is still too early to say that the economic slowdown has completely reversed and economic momentum is confirmed. While the sub-indices for new orders and export orders both rose in May, the sub-indices for stocking as well as production and business operations both declined, pointing to still cautious attitudes held by companies toward the future market, said Zhang. While attributing the PMI pickup mainly to the "targeted" economy-boosting measures, Cai said the "endogenous power" for economic growth is yet to be confirmed, and small businesses still hold cautious expectations for future business activities. In addition, overseas market demand remains weak and full of uncertainties despite increasing domestic demand, which could be reflected in the tiny recovery in the sub-index for export orders, Cai said.

Source: Xinhua: China's PMI hits 5-month high, pointing to stabilizing economy, 2014-06-1

World News: China Housing Still Clouds Economy

China's economy is struggling to find equilibrium, with data released Friday showing that government stimulus measures gained traction last month while the vital housing market continues its swoon. Improvements in industrial production and retail sales in May, combined with gains in exports and inflation reported earlier, suggested to some analysts that government stimulus measures are boosting the economy. Beijing has ramped up spending on water, energy and rail projects, loosened some credit, urged local officials not to leave their budgets unspent and nudged banks to cut interest rates and ease mortgage terms for first-time home buyers.

Property sales continued to slide, however, and if the problem persists at the current pace, some analysts said Beijing will need to reach for stronger measures. "The only fly in the ointment is the real-estate market," said Credit Agricole CIB economist Dariusz Kowalczyk. He said the weakness is affecting construction, steel and other related industries and if it continues for the year, it could take 0.5 to 0.75 percentage point off the economic-growth rate. Property investment in the first five months of this year rose 14.7% to 3.07 trillion yuan, compared with 16.4% growth in the first four months, while construction starts in the January-May period measured by project size fell 18.6% to 599.1 million square meters. This compared with a decline of 24.5% to 311.8 million square meters in the first four months. "The property market is still the biggest threat to the Chinese economy," said CIMB Securities economist Zhang Fan. "More local governments are expected to ease housing restrictions in the months ahead to boost demand."


Hohhot ends curbs on home purchases

Hohhot, the capital of the Inner Mongolia autonomous region, has ended all restrictions on home purchases, the first city in China to take such a sweeping step. There will be no further limits on how many homes each resident may own, and those who don't have official residence (hukou) in the city may also buy apartments, according to a statement posted on the local housing authority's website. Those currently seeking homes are also covered by the policy change, the statement said. Since 2011, more than 40 cities have imposed restrictions on home ownership by limiting the number of units each household may own and/or by banning purchases by non-local residents. Other cities have relaxed their restrictions, but none have totally eliminated them. Cities that have eased or ended restrictions are those where housing supply has substantially exceeded demand. Hohhot's housing stock is close to 120,000 units, while monthly transactions are running at about 1,000, according to data from Centaline Group.

Source: Hu Yuanyuan: Hohhot ends curbs on home purchases, China Daily, 2014-06-28

China's May retail sales up 12.5%
China's retail sales grew 12.5 percent year on year to 2.13 trillion yuan ($348.36 billion) in May, the National Bureau of Statistics (NBS) said on Friday. In the first five months, China's retail sales grew 12.1 percent year on year to 10.30 trillion yuan. The growth rate was slightly higher than the 12-percent growth rate in the first four months. Sales in rural areas rose 13.9 percent in the first five months from the same period last year. Retail sales in urban areas climbed 12.3 percent year on year in the same period.

The Consumer Price Index (CPI), a main gauge of inflation, increased 2.5 percent year on year in May, up from 1.8 percent in the previous month, the NBS said on Tuesday. 

Source: Xinhua: China's May retail sales up 12.5%, 2014-06-14

CHINA: China will 'rise' as a high-end manufacturer

China is no longer just the world's 'factory'. While retaining strong positions in low value-added mass-manufacturing, Chinese firms are increasing their presence in global markets for high value-added products too, competing directly with US, European and Japanese firms. China's growth into a major innovation centre is also changing the global power balance in science and technology. As labour and other production costs rise, China will intensify efforts to upgrade industries ranging from machinery to consumer goods. Within several years, its high-tech production could exceed that of the United States, becoming the largest in the world.

Chinese makers are likely to play a leading role in areas such as solar panels, electric vehicles and power equipment. China's efforts to improve quality control will create demand for foreign products and expertise. The prestige of Chinese-made products will rise as quality control improves, undermining domestic consumers' preference for foreign brands. Beijing will better protect intellectual property rights as more Chinese firms become victims of piracy. Incentives for commercial cyber espionage will grow, and this will assist industrial upgrading. China's importance as a manufacturing centre for technologically advanced products is growing rapidly; China's share of global high-tech manufacturing output soared from 8% in 2003 to 24% in 2012. The US share was 27%. China's high-tech production volume by 2012 was about 30% greater than the EU's and three times Japan's. Chinese makers are likely to play a leading role in a growing number of high-tech industries: Solar panels, Electric vehicles, Power equipment. A growing number of makers enforce strict quality control, challenging the 'poorly made in China' stereotype: Top manufacturers of lithium-ion batteries BYD, BAK Battery and Tianjin Lishen Battery (now a partner supplier for Samsung and Motorola), have significantly improved safety and reliability. Chinese machine-tools are starting to compete with the world's leading models.

Chinese companies are increasingly aggressive in brand-building. Initially, this was achieved by buying internationally known brands, along with particular product departments or entire companies: Lenovo purchased IBM's PC department in 2004, China's second-largest television maker, TCL, created a joint venture with France's Thomson and became its majority partner. In autos, Geely acquired Volvo, Pearl River Piano, the world's largest producer of pianos, acquired a UK maker which itself owned the German brand Ritmuller. However, more Chinese companies are establishing international brands of their own, notably: telecoms equipment manufacturers ZTE and Huawei; domestic appliance manufacturer Haier; air-conditioner maker Midea; and clean technology company LDK Solar; Sports apparel maker Li Ning is competing with Nike and Adidas on design and product selection. Chinese companies mostly begin by establishing brands in China and then expand to other developing countries. Having acquired brand-building skills and experience, they then enter developed-world economies.

Chinese consumer goods manufacturers are now very active in the high-end niche domestically, where proximity to the marketplace and knowledge of customers' preferences confer advantages. Domestic brands often enjoy popularity equalling or exceeding Western counterparts (for instance, the Kurhn doll sells better than Barbie); Yun Dian Furniture is a popular maker of traditional Chinese-style furniture with a Western flavour; Foshan Jihao is a high-end sofa manufacturer with several brand names well known in China and independently developed brands in South Korea, Spain, Australia and Poland; Fu Yi Furniture owns numerous brands in classic and modern styles.
In 2012, China overtook the EU in research and development (R&D) as a percentage of GDP, with 1.98% versus 1.97%, through it still trails the United States (2.8%) and Japan (3.3%). It targets 2.2% by 2015. China’s Medium and Long-Term Plan for the Development of Science and Technology (2006-20) aims to make China a ‘technological great power’ by developing breakthrough technologies in eight fields: biotechnology; IT; advanced materials; advanced manufacturing; advanced energy technology; marine technology; laser technology; and aerospace technology. Beijing is allocating at least 10 billion renminbi (1.6 billion dollars) to each of 16 ‘megaprojects’ in electronic components, software, machinery and pharmaceuticals. These aim to absorb advanced imported technologies so that China can develop its own key products with proprietary intellectual property rights.

Foreign investment in China increasingly targets high value-added products and R&D. Foreign companies often seek to combine advanced technologies with cost advantages China still provides. Foreign-invested firms produce about 82% of China’s high-tech exports. The majority of the Fortune Global 500 companies already have R&D facilities in China. By 2013, some 1,800 R&D centres had been established by foreign firms, concentrated in electronics, software, telecommunications, biotechnology and pharmaceuticals, chemicals and autos. They increasingly go beyond product development for the Chinese market, engaging in basic research and development of key technologies.

CONCLUSION: Widely recognised Chinese brands will multiply and become major players, first in developing markets and then in developed ones. However, for individual firms, upgrading will require trial and error, and many will lose as they enter fierce competition with developed-market (DM) counterparts. Chinese manufacturers that upgrade will probably retain cost advantage vis-a-vis DM peers for 5-10 years at least, but as production costs rise, those who fail to upgrade will lose competitiveness.

Source: Anonymous: CHINA: China will ‘rise’ as a high-end manufacturer, OxResearch Daily Brief Service. (Jun 18, 2014).

World News: China Survey On Output Is Upbeat

A gauge of China’s factory activity showed fresh signs of strength in June, helped by improved export demand and an economic-support program. The HSBC preliminary manufacturing Purchasing Managers’ Index came in at a seven-month high of 50.8, up from 49.4 in May, according to data released on Monday. “The improvement was broad-based,” said HSBC chief China economist Qu Hongbin in a statement accompanying the release. “This improvement is consistent with data suggesting that the authorities’ mini-stimulus measures are filtering through to the real economy.” And it has granted certain qualifying banks the right to lend more of their deposits -- in what it calls targeted measures. “I think this is further confirmation that the economy may have stabilized,” said Ding Shuang, Citigroup economist.


Costs hit corporate profit growth in May

Profit growth at major Chinese industrial companies decelerated in May because of sluggish business, higher inventories and rapidly increasing costs, said analysts. The year-on-year growth rate of 9.8 percent for the first five months was down slightly from the 10 percent pace for the first four months, the National Bureau of Statistics said on Friday. He Ping, an analyst at the NBS, said slower growth in the electronics, coal and general equipment industries depressed the overall rate.

In May, revenues from industrial companies’ core businesses rose 6.9 percent year-on-year, down 2.8 percentage points from April. Interest expenses increased 10.4 percent and financial costs soared 17.4 percent in the first five months, compared with 9.5 percent and 15.8 percent for the first four months. Major
companies’ finished goods inventory rose 12.5 percent to 3.5 trillion yuan ($564 billion) in May, which ate into their profits. In May, profits of industrial companies rose 8.9 percent year-on-year to 512.7 billion yuan, down from 9.6 percent in April. Profits of State-owned enterprises increased 3.4 percent from January to May, while profits for private companies rose 12.9 percent.

Among the 41 industries surveyed, 32 registered profit growth in the first five months, while eight saw their profits decline. The coal mining and processing industries recorded a 43.9 percent profit decline in the first five months. Five industries - including vehicle manufacturing, electricity and heating power production and supply - accounted for 77 percent of the profit growth. Oil refining, coking and nuclear fuel processing recorded 49.3 percent profit growth in the first five months, the highest among all industries. Vehicle manufacturing recorded 29.6 percent profit growth. To boost economic growth, the government has recently launched modest stimulus measures including tax cuts, accelerating infrastructure spending and targeted reserve requirement ratio cuts to boost funding for smaller companies and agriculture.

Source: LAN LAN and LI JIABAO: Costs hit corporate profit growth in May, China Daily, 2014-06-28

China’s PPI drops 1.4% in May

China's producer price index (PPI) contracted 1.4 percent year on year in May, following a 2-percent decline in April, data from the National Bureau of Statistics (NBS) showed on Tuesday. The index edged down 0.1 percent in May from the previous month. Both the year-on-year and month-on-month decreases narrowed from those in the previous month, signalling rebounding market demand in industrial products, said Yu Qiuei, a senior statistician with the NBS. The index, which measures inflation at the wholesale level, has been in deflationary territory for 27 consecutive months, the longest drop since the 1990s. Among the 30 main industries surveyed, 16 sectors including oil and gas exploration posted month-on-month price increases in May. The remaining sectors, including non-ferrous metal smelting production, posted month-on-month price drops. China's consumer price index, a main gauge of inflation, increased 2.5 percent year on year in May, up from 1.8 percent in the previous month, the NBS said on Tuesday.

Source: Xinhua: China's PPI drops 1.4% in May, 2014-06-10

Eastern Europe/China economy: Quick View - Third spur of Central Asia-China

The third spur of the Central Asia-China pipeline began pumping gas from Turkmenistan on May 31st, the China National Petroleum Corporation (CNPC) announced. The spur, known as Line C, will increase the capacity of the Central Asia-China pipeline—which carries gas from Turkmenistan into China's western Xinjiang province via Uzbekistan and Kazakhstan—to 55bn cu metres of gas annually, said the CNPC. Line C has a design capacity of 25bn cu metres of gas per year, of which 10bn cu metres will be sourced from Turkmenistan, 10bn from Uzbekistan and 5bn from Kazakhstan. Initially some 7bn cu metres of gas will be transported annually via Line C, which is expected to reach capacity by the end of 2015. Construction of the 1,830-km third spur-which runs parallel to the existing Lines A and B-began in 2012 and was completed at the end of last year.

Since the pipeline was opened Turkmenistan has become an increasingly important energy supplier for China. By 2012 it accounted for over half of Chinese gas imports (51.4% of the total, or 21.3bn cu metres), according to BP's Statistical Review of World Energy. Last month, CNPC said that between mid-December 2009 and April 30th 2014 Turkmenistan had supplied 78.3bn cu metres of gas to China through the pipeline. Exports from Turkmenistan are expected to reach some 25bn cu metres this year, rising to 65bn cu metres by 2020. Uzbekistan exported an estimated 10bn cu metres of gas to China in 2013, and hopes to increase sales to 25bn cu metres by 2016. However, slow growth in production means this target is unlikely to be met.

Silk Road Spirit will prevail over zero-sum mentality

The "Silk Road Spirit" could become a guiding principle in solving complex regional and international issues. Peace and cooperation, openness and inclusiveness, mutual learning and mutual benefit, form the core values of the Silk Road Spirit, as proposed by Chinese President Xi Jinping at the sixth Ministerial Conference of the China-Arab States Cooperation Forum (CASCF).

In the ancient time, it was through the Silk Road that the Chinese inventions of paper-making, gun powder, movable type printing and compass were spread to Europe via the Arab region and that the Arab astronomy, calendar and medicine were introduced to China. In the present time, China, located in the East Asia, and the Arab countries, which are mainly located in the West Asia and North Africa, are carrying forward the Silk Road Spirit and deepening cooperation in political and economic fields. China and Arab countries will also jointly build the Silk Road economic belt and 21st century maritime Silk Road. The two concepts were put forward by Xi during two separate visits to Central Asia and Southeast Asia in 2013.

When the Cold War ended, the international security situation remained complex. Both East and West Asia are facing up to traditional and non-traditional challenges and threats. To make matters worse, a certain individual country persistently promotes its own value and political systems and "zero-sum" mentality, complicating the regional situation. To be different, the Silk Road Spirit means peace and win-win cooperation. When addressing the opening ceremony of the sixth Ministerial Conference of the CASCF, Xi said "We want to achieve development for ourselves and we want to enable others to grow as well." Xi also pledged to work with Arab states to encourage dialogue as a way to find the greatest common denominator on issues of concern to all parties, and provide more public goods for the proper settlement of regional hotspot issues. The Chinese president have made many diplomatic proposals with the core spirit of peace and cooperation. Apart from the Spirit of Silk Road, Xi called for a common, comprehensive, cooperative and sustainable security strategy for Asia, when he delivered a keynote speech at the fourth summit of the Conference on Interaction and Confidence Building Measures in Asia (CICA) in Shanghai in May. Perhaps it will take some time for the world to accept and put more trust in China's standpoints and hopefully, the cooperation between China and Arab countries could be a good example and solid evidence for China's win-win cooperation resolve.

Source: Xinhua: Silk Road Spirit will prevail over zero-sum mentality, 2014-06-7

How to Ride the Next Wave of Chinese Growth

China's gross-domestic-product growth has fallen below its target of 7.5% for 2014. With a glut of new construction and a mounting overhang of debt, Beijing's new "mini-stimulus" program is aimed at weaning China from past excesses by pumping up domestic consumption and the services sector. In 2013, China's services sector jumped to 46% of GDP -- up three percentage points in two years and a larger share of GDP than construction and manufacturing combined. Consistent with the structure of other modern economies, China's still nascent services sector could rise to 55%-60% of its GDP by 2025.

With the U.S. having the world's largest and most competitive services sector -- accounting for 14% of global services exports, twice the share of the next largest competitor -- American companies are well positioned to capture a significant share of the coming bonanza in Chinese services. From retail chains (Wal-Mart) and leisure (Disney) to domestic transportation (United Airlines) and an array of insurance and hospital systems, U.S. multinational services companies have what China is lacking in strategy, experience and quality control. The timing is ideal. With the U.S. economy mired in a sluggish postcrisis recovery, America's growth agenda needs to tilt away from overstretched consumer demand toward exports and foreign demand. The continuing boom in China's services sector provides such an opportunity.

Of course, it's one thing to see the opportunity. It's another to seize it. The key in this regard is "market access" -- especially problematic due to caps on minority ownership stakes in joint ventures that nations typically impose on one another in efforts to protect their most sacrosanct industries such as services. Both China and the U.S. have
a long history of putting such limits on each other's cross-border investments. That's especially the case in finance but also true of most nonfinancial services.

The good news is that at the 2013 Strategic and Economic Dialogue both the U.S. and China entered into negotiations over a Bilateral Investment Treaty, or BIT. Such treaties are common in today's global economy. There are some 3,000 BITs currently in effect around the world that, among other things, allow for significant liberalization of heretofore stringent requirements on foreign ownership of domestic companies. Typically, BIT negotiations are framed in terms of a "negative list" -- industries or sectors that one nation views as off-limits to foreign control. China currently has a very long negative list when compared with America's. That should not be discouraging. China started out with an equally long negative list when it began negotiating in the 1990s for entry into the World Trade Organization -- a list that was subsequently pruned down dramatically before formal accession in 2001. The negative list construct is helpful in framing the debate and the agenda for subsequent negotiations. The upside of a breakthrough on a U.S.-China BIT is huge. It would not only open up services investment and trade between the two nations, but it could also set the stage for China's participation in broader multilateral trade arrangements, such as the Trans-Pacific Partnership. That would be a big plus for the global economy. Further progress on a Bilateral Investment Treaty should be a focal point of the coming Strategic and Economic Dialogue between the U.S. and China set for early July in Beijing. But that progress will require a more constructive tone in the broader relationship between the two nations. The recent flare-ups over cyberhacking, territory disputes in the South China Sea, and currency policy all risk sidetracking the agenda. These issues are all important and should not be ignored -- but they need to be set in context.


**China's industrial output accelerates**

China's industrial production expanded at faster pace in May, adding to signs for a stabilizing economy, according to the National Bureau of Statistics (NBS) on Friday. The industrial added-value output rose 8.8 percent in May from a year ago, accelerating 0.1 percentage points from the April figure, the NBS data showed. On a monthly basis, the industrial output in May rose 0.71 percent from April. For the January-May period, the total output in the industrial sector increased 8.7 percent year on year, a growth rate that tied with that in the January-April period. The latest industrial reading was in line with the purchasing managers' index (PMI) in China's manufacturing sector in May, which rose to 50.8 and marked the highest level this year.

The Chinese government has launched a series of "mini-stimulus" measures, including quickening investment approval, tax breaks for small business and targeted cuts for rural lenders, to arrest the current slowdown. The government's policy fine-tuning in April came a bit early this year, as similar measures were launched in June and July last year. Arresting the economic slowdown is important as China needs a sound environment for structural reforms.

Source: Xinhua: China's industrial output accelerates, 2014-06-13

**Europe News: British, China Firms Reach Trade Deals During Li's Visit**

British and Chinese companies signed trade and investment deals valued at some GBP 14 billion ($23.8 billion) on Tuesday as Premier Li Keqiang continued a three-day visit to the U.K. to bolster business ties between the two nations. "I believe there is extensive common interests between our two countries and our cooperation serves the interests of both and has global ramifications," Mr. Li said in a news conference with Mr. Cameron. "And China is ready to work with the U.K. to foster a partnership for growth and inclusive development to ensure that this relationship will grow faster and in a healthier way." The British government has made expanding exports to fast-growing developing economies such as China a priority to offset the impact of the euro-zone crisis on its own economy. Official data show annual British goods exported to China grew to GBP 12.4 billion last year from GBP
7.6 billion in 2010, when Mr. Cameron took office.

In an editorial published in the Times newspaper on Monday, Mr. Li said China had made a quantum leap in its development in recent decades. But, he added, millions of its citizens still lived below the poverty line as measured by the World Bank, and development was uneven between urban and rural areas. He said that China's economy was expected to expand around 7.5% this year and that he was confident the growth target would be met. Mr. Li said his visit was aimed at deepening cooperation to spur the economies of both countries, to present the real China and "change misperceptions and ease misgivings" as well as draw on British perspectives and experience.

The largest of the deals agreed at the bilateral summit on Tuesday was a $20 billion long-term contract for BP PLC to supply liquefied natural gas to China National Offshore Oil Co., or Cnooc. The deal will see BP supply Cnooc with 1.5 million metric tons of gas a year over the next 20 years, starting in 2019. China Minsheng Investment Corp., China's largest private-sector investment group with capital of $8 billion, announced it was opening its European headquarters in London with an investment of around $1.5 billion. And on the financial front, China Merchant Securities, China's third-largest securities firm in terms of net capital, opened its first London office. CMS will increase the volume of commodity trading in London and play a significant part in the internationalization of the Chinese currency, reinforcing London's position as the second-largest offshore-trading center for the yuan, the U.K. government said.


**Chinese, Greek PMs meet to enhance ties, cooperation**

Chinese Premier Li Keqiang and Greek Prime Minister Antonis Samaras agreed on Thursday to further advance bilateral ties and pragmatic cooperation between their two countries. China is fully confident about the prospect of Greece's development, Li said when meeting with Samaras, adding that his country stands ready to further consolidate political mutual trust with the European country and lift the comprehensive strategic partnership to a higher level. The Piraeus Container Terminal (PCT) project has become a model of Sino-Greek and Sino-European cooperation, Li said, calling for more investment from both sides and vowing to jointly build Piraeus a top port in the Mediterranean. The Piraeus port, the largest in Greece, is jointly operated by China's State-owned shipping giant COSCO and the Greek port authority under a 35-year lease signed in 2009. The Chinese premier expressed his hope that Greece will further facilitate bilateral cooperation by improving investment environment, legal protection, visa procedure and project examination. China will also work with Greece to explore new economic growth points, especially in maritime cooperation, where Li said the two countries should make joint efforts in developing maritime economy, technology and tourism, and hold a successful Sino-Greek maritime cooperation year in 2015. Calling on both sides to continuously expand bilateral trade and deepen cultural exchanges, the Chinese premier appreciated Greece's efforts as the rotating EU president in pushing forward the China-Europe ties. Reaffirming China's support for European integration, Li said he hopes Greece will continue to play a unique role in advancing the China-Europe investment agreement talks and jointly opposing protectionism so as to achieve win-win results in China-Europe cooperation.

For his part, Samaras said when Greece was caught in its worst-ever debt crisis, the timely support provided by China brought confidence and strength to the debt-ridden country. While expressing his willingness to further deepen the mutually beneficial cooperation and cultural exchanges with China in various fields, the Greek prime minister said his country will actively take part in the construction of the 21st Century Maritime Silk Road. Greece is also ready to work with China to jointly build the Piraeus port, he said, adding that his country welcomes more investments from Chinese enterprises as well as more Chinese tourists. As the rotating EU president, Greece is willing to push forward the EU-China ties, said Samaras.

Source: Xinhua: Chinese, Greek PMs meet to enhance ties, cooperation, 2014-06-20
China and Europe: time for a second 'honeymoon'?

Chinese Premier Li Keqiang is touring parts of Europe this week, cementing ever-closer economic ties that have made the European Union China's biggest trading partner for ten years in a row. This is Li's third visit to Europe since he took office in 2013. In Britain, where the Chinese Premier met Queen Elizabeth II and Prime Minister David Cameron, the two countries on Tuesday signed deals worth more than 14 billion pounds, with energy and finance dominating the trade agenda. Two days later in Athens, Li oversaw the signing of trade and investment accords worth $4.6 billion with Greece, while expressing support for the bailed-out country's economic revival efforts.

The open show of support, both in words and in deals, has prompted a question to which many are curious about the answer: is a second "honeymoon" around the corner? China and Europe enjoyed years of cozy cooperation at the beginning of the millennium. But relations cooled slightly in the mid-2000s. An upturn in trade ties and frequent high-level official exchanges have kindled hope of a second "honeymoon". Annual trade volume between China and the EU has exceeded $550 billion and there are over 5 million visits between the two sides each year. The EU's direct investment in China jumped to $6.5 billion in 2013, a 21.9 percent increase year on year. China's direct investment in the EU, meanwhile, spiked 6.2 percent to $3.6 billion.

Frequent visits by leaders from both sides are another telling illustration of the close rapport. In 2013, heads of states and governments from Europe, including former French Prime Minister Jean-Marc Ayrault, Dutch Prime Minister Mark Rutte and Britain's Cameron visited China. Chinese President Xi Jinping and Premier Li, meanwhile, also paid visits to countries in Europe in March and this month, signaling growing political trust with the continent.

But there have been signs of a "seven-year itch". A Chinese policy paper issued in April admitted that "the two sides have disagreements and frictions on issues of value such as human rights as well as economic and trade issues." Trade is perhaps the strongest area between the two sides, but it is also home to their main disputes. The EU's year-long anti-dumping case on Chinese photovoltaic power systems threatened to turn into a potential trade war, before the two sides managed to reach agreement.

Perhaps a second "honeymoon" is not round the corner after all. But disagreements do not render relations fruitless. On the contrary, ties are without doubt heading in the right direction, according to Cui Hongjian, director of European studies at the Foreign Ministry think tank, the China Institute of International Relations. Maturity means the two sides are able to deepen points of agreement. On points of non-agreement, they are able to speak constructively and find a way out, Barroso said. Noting that there have been fluctuations in Sino-Europe trade ties, Cui Hongjian said they are likely to last only in the short term.

Source: Xinhua: China and Europe: time for a second 'honeymoon'?, 2014-06-21

Li's UK visit marks commitment to bilateral ties

Premier Li Keqiang's recent trip to the United Kingdom has played a significant role in boosting bilateral relations, top business leaders from the UK said on Tuesday. Li and UK Prime Minister David Cameron signed deals on investment, trade and business collaboration worth $30 billion in London on June 17. China is already the second-largest overseas investor in London and the third-biggest in the UK as a whole, according to UK government data. Mark Boleat, policy chairman at the City of London Corp, said Li's visit provided significant progress on a wide variety of shared issues, including the internationalization of the renminbi and new opportunities to further develop London's offshore yuan market. Li's visit heralded direct trading between the British and Chinese currencies for the first time. China Construction Bank was designated as clearing-service provider for offshore trading of the yuan in London. "We view Premier Li's visit to the UK as a sign of China and the UK's commitment to further develop stronger trade and investment opportunities," Boleat said. Global oil major BP signed an agreement worth $18 billion to provide China National Offshore Oil Corp with liquefied natural gas for 20 years. The State-owned China Development Bank signed an agreement, with TheCityUK, a private financial services association. It will encourage bank lending in the UK as well as trading in the yuan, which will open up trade opportunities for Chinese and UK businesses.
World News: U.S., China Seek Investment Pact

The U.S. ambassador to China said Wednesday that a new investment treaty between the two countries would be among his priorities. Max Baucus, the 72-year-old former senator for Montana, was speaking to an audience of businesspeople in Beijing in his first public engagement since he took up the post in March. The U.S. and China are in the early stages of negotiating the Bilateral Investment Treaty, which would further open up each country to investment from the other. "There's a lot of work to do on the [treaty], but moving forward on that will be a top priority for me," Mr. Baucus said. He played down the role of the Committee on Foreign Investment in the U.S., the congressional body that serves as a gatekeeper for deals with potential national-security implications. In China the committee is often seen as a major barrier to investment in the U.S. The committee's close scrutiny of several proposed Chinese acquisitions, including attempts to buy private-jet manufacturer Hawker Beechcraft Inc. and battery maker A123 Systems Inc., contributed to the collapse of those deals. The committee also studied the purchase of Smithfield Foods Inc., America's biggest pork producer, by a Chinese company last year. The deal was eventually approved.

Mr. Baucus worked with then-Premier Zhu Rongji to promote China's entry into the World Trade Organization, a catalyst for internal reform and the beginning of a decade of breakneck economic expansion. The investment treaty could create consensus for difficult economic changes in China. China's leaders have already pledged to slash red tape, although other changes, such as reducing support for state-owned enterprises, are likely to prove more difficult.

The ambassador nodded toward increasing frustrations in the U.S.-China relationship, noting that he disapproved of China's suppression of political dissidents. The two nations also have "strong disagreements" as to what is acceptable behavior in cyberspace, he said. But he urged discussion, not confrontation, on these issues. "At moments like this we need more dialogue, not less," he said.


Infrastructure biggest challenge for Silk Road

The Silk Road Economic Belt proposed by President Xi Jinping is a platform that will be open to all countries wishing to contribute and benefit from rebuilding the ancient trade routes connecting China, Central Asia and Europe, an official from the Ministry of Commerce said on Thursday. "The economic belt doesn't need a new mechanism. Instead, it will make full use of the existing multilateral economic cooperation agreements among different countries, but inject new content into them," said Zhong Shan, deputy international trade representative for China. Zhong made his remarks at the opening ceremony of the two-day International Seminar on the Silk Road Economic Belt in Urumqi, capital of the Xinjiang Uygur autonomous region. He added that the economic belt could only be built and thrive when all countries and their people can benefit from it. The idea of building an economic belt along the Silk Road, first proposed by Xi in Kazakhstan when he made a speech on China's Central Asia strategy in September, faces many difficulties.

The biggest challenge to reviving the ancient Silk Road, which dates back 2,000 years, is poor transportation infrastructure, said Li Pumin, secretary-general of the National Development and Reform Commission, the top economic planner. Many key roads connecting China and Central Asia desperately need upgrades or reconstruction, Li said, adding that such construction work will require massive financial support from governments due to complex geographical conditions. "Countries along the belt must jointly push forward the infrastructure construction by planning together," Li said.

Additionally, many nations are cautious about China's new proposal out of fear that China's growing presence in their countries might be a threat, so China must let them know that the economic belt
is about sharing and prospering together to win their support, said Alexander Lukin, vice-president of the Diplomatic Academy of the Ministry of Foreign Affairs of Russia. Instability caused by factors such as terrorism and separatism will also slow the progress of the construction of the economic belt, Lukin said. "No economic development could be achieved without a stable social environment," he said. The ancient Silk Road was abandoned for almost a century because of wars in the region. "At the same time, economic development could help to shake off poverty, which may have contributed to breed terrorism," Lukin added.

Plans are shaping up for Xinjiang to develop into the main transportation and trade hub along the economic belt. "Three main corridors passing through southern, central and northern Xinjiang will be built as part of the plan to connect China with Central Asia, which has great marketing potential," Zhang Chunxian, Party chief of the region, said at the opening ceremony. The region will also develop a manufacturing industry so that the products made there could be exported via the economic belt, Zhang said.

Source: CUI JIA: Infrastructure biggest challenge for Silk Road, China Daily, 2014-06-27

**China economy: Back on the up**

China's currency has begun to strengthen again after weakening sharply against the US dollar over the first five months of the year. The reversal is overdue. There were clear signs that the earlier appreciation had been engineered by the People's Bank of China (PBC, the central bank), in a move that went against its long-term goal of exchange-rate liberalisation. The Economist Intelligence Unit had expected that the depreciation would prove to be a temporary phenomenon, and we maintain our forecast that the renminbi's value will rise by 1.4% on average against the US dollar over 2014 as a whole. Looking at the renminbi's exchange rate in recent weeks one can only conclude that the PBC has been keen to exploit the potential for volatility created when it widened the currency's trading band in March 2014. That move doubled the permitted trading range about the mid-point figure set daily by the PBC from 1% to 2%. Although the full movement possible under the band has not yet been exploited, daily exchange rate movements since March have been significantly stronger than previously.

Confirming suspicions, data from the IMF show that China's foreign-exchange reserves rose by US$126.5bn between end-December 2013 and end-March 2014. This provides evidence that the central bank was buying up foreign currency to hold down the renminbi's exchange rate. Indeed, the substantial scale of the increase in reserves suggests that underlying upward pressure on the currency remains strong.

The ultimate goal of the PBC's reform agenda is to allow the market to exert a greater influence over the renminbi's value. This is partly because of the costs that come with reserve accumulation, which significantly complicates monetary policy management, and partly because of a desire to allow the renminbi to become a global currency. In line with this, the central bank has recently appeared to be stepping back from its moves to undermine the exchange rate against the US dollar. The renminbi has consequently strengthened from a recent low of Rmb6.26:US$1 on May 1st to Rmb6.21:US$1 on June 13th. We believe that this appreciating trend will be generally sustained throughout the rest of the year, with the currency ending the year at Rmb6.04:US$1. However, it is also likely that the authorities will try to introduce a degree of volatility within this overall path, including bouts of depreciation.

Although the Chinese currency's upward movement against the US dollar looks set to continue in the short term, the medium-term outlook is growing less certain. The modest scale of the current-account surplus in the first quarter may have been primarily driven by the wind-down of last year's over invoicing problem, but it forms part of a steady picture of declining current-account surpluses. China's massive trade surplus will fall over the next few years, a phenomenon that will be accompanied by ever-larger outflows on the services and income accounts. We expect the current account to move into deficit by 2017. By this stage, capital outflows will also be increasing. The combined impact of this will be to put the renminbi under downward pressure, and we expect that, on average, in 2018 the currency's value is actually likely to fall against the US dollar.
For now, the return to renminbi appreciation may reassure many companies that things are back to normal. However, firms should be aware that the exchange rate is likely to be significantly more volatile in the coming years than it has been in the past. Companies with exposure to exchange-rate movements should ensure that they are properly protected. Foreign companies are already adopting strategies such as hedging or trading directly in renminbi—in April Australia’s Rio Tinto made its first sale of iron ore to a Chinese counterparty in renminbi. The Chinese government will need to allow the development of more innovative solutions in local financial markets to ensure that domestic enterprises can also find ways to adapt to a less predictable exchange rate.


Forex deposit rate caps lifted

Banks in Shanghai can offer deposit rates on their own for corporate foreign-currency accounts with balances below $3 million. Provided to China Daily Expansion of trial program from free trade zone in Shanghai could go nationwide. Interest-rate ceilings on corporate foreign-currency accounts with balances below $3 million will end on Friday throughout Shanghai, part of a key reform expected to be expanded nationwide, it was announced on Thursday. The policy, which has already been tried out in the China (Shanghai) Pilot Free Trade Zone, is a major step in interest rate liberalization, the People's Bank of China's Shanghai Head Office said. The rate ceiling for foreign-currency deposits is now 1.5 percent for current accounts. The balance of foreign-currency deposits in Shanghai is estimated at $76.7 billion, of which 26.4 percent would be covered by the change. Foreign-currency deposits in Shanghai account for about 14.3 percent of the national total. China liberalized lending and deposit rates, from 2000, for accounts holding more than $3 million. Pan Yuehan, head of the Shanghai branch of Bank of China Ltd, said removing the rate cap will enhance banks' management of corporate capital and enhance their market competitiveness. "The move will also prepare banks for renminbi interest rate liberalization," he said.

As the FTZ trial went smoothly and helped corporate customers and lenders, the regulators decided to expand it to other parts of the city, said the PBOC. The policy will be expanded nationwide if it proves successful in Shanghai, the central bank said. Deposit rates offered by lenders didn't fluctuate wildly, and there have been no massive deposit flows between accounts or among lenders.


World News: Asia: China Sees May Exports Rise 7% as Imports Lag

China posted solid export gains in May, pointing to improving global demand for the nation's goods and providing a bright spot in the outlook for the world's second-largest economy. But surprisingly weak imports in the same month raised concerns over domestic demand, suggesting that the economy isn't out of the woods after its sluggish growth early this year. The 1.6% drop in imports in May was worrisome as analysts polled by The Wall Street Journal had been looking for a 6% rise. "Continued subdued import growth seems to reflect slow growth of demand in China's economy," said Louis Kuijs of Royal Bank of Scotland in a note to clients. Beijing has tried to boost domestic demand with measures such as speeding up spending on railways and offering tax breaks for smaller businesses in what has been dubbed a "mini-stimulus" package. Analysts said improved May figures in the official manufacturing-purchasing-managers index suggested the mini-stimulus measures may be working.
improved exports and less-than-robust imports led to a substantially wider trade surplus of $35.9 billion for the month, up from a $18.45 billion surplus in April and topping economists' forecast of a $23.4 billion surplus.


Exports recovery bodes well for economy

China's exports continued to recover in May amid improving demand in developed countries, which analysts believe will ease concerns over a slowdown and help stabilize growth. Exports increased by 7 percent in May from a year earlier, outpacing the 0.9 percent increase in April and 6.6 percent drop in March. However, imports in May declined by 1.6 percent year-on-year, compared with the 0.8 percent growth in April and 11.3 percent slump in March, according to the General Administration of Customs.

Economic growth eased to 7.4 percent in the first quarter, below the government's target of 7.5 percent for 2014. But recent data have suggested a stabilizing trend. The purchasing managers index, a key indicator of economic performance, increased to 50.8 in May from 50.4 in April.

However, Wei Jianguo, vice-chairman of the China Center for International Economic Exchanges, warned of a "very challenging outlook" for China's foreign trade this year. "The recovery in May, mainly backed by supportive measures, may continue in June and July but may not last for the whole year owing to external uncertainties, such as the sluggish economy in the US, the unsteady recovery in Europe and reduced demand in emerging markets." Wei said. "The economic restructuring at home will constrain steep import recovery. Supportive measures for imports, not only for exports, should be in place."

Source: LI JIABAO: Exports recovery bodes well for economy, China Daily, 2014-06-9

PBOC guidelines to boost foreign trade

China's central bank issued guiding opinions on Wednesday to support stable growth of foreign trade. The People's Bank of China said in a statement published on its website that it will encourage financial institutions in the banking sector to broaden funding channels for Chinese enterprises, innovate financial products and services, and further expand financing through export credit insurance. The PBOC will support qualified financial leasing companies to expand funding channels by issuing financial bonds and participating in pilot projects for credit asset securitization. Apart from simplifying cross-border trading and yuan settlement procedure for direct investment, the central bank will also support cooperation among financial institutions and payment service providers on cross-border yuan settlement. Multinational corporations are allowed to carry out centralized cross-border yuan fund operations, including two-way cross-border yuan cash pool business, according to regulations of the PBOC. Financial institutions can provide cross-border yuan settlement service for trade in goods and services developed by individuals based on the institutions' knowledge of the clients and due diligence check.

Source: Jiang Xueqing: PBOC guidelines to boost foreign trade, China Daily, 2014-06-12

China's exports to continue rebound: official

China's export activity may maintain a steady rebound in the coming months as the country is faced with several favorable factors, an official said on Tuesday. Shen Danyang, spokesman for the Ministry of Commerce (MOC), told a press conference that factors bolstering exports include recovering global demand, domestic support policies and rising confidence among Chinese export companies. China's exports rose 7 percent year on year to $195 billion in May, following a 0.9-percent increase in April and sharp declines in March and February, customs data showed. Shen noted that government measures designed to stabilize foreign trade include a 16-point guideline unveiled by the State Council last month.

Source: Xinhua: China's exports to continue rebound: official, 2014-06-17
China eyes to become high-tech exporter

High-speed rail were once again buzzwords in Chinese diplomacy this week as they were included in a joint statement issued in London after a meeting between visiting Chinese Premier Li Keqiang and British Prime Minister David Cameron. This was not the first time that Li has promoted China's high-speed rail technology to other countries during overseas visits, but it was the first to a Western developed country. In the document, the two sides agreed to promote cooperation on design and construction of railways, including high-speed rail, paving the way for Chinese enterprises to participate in one of Britain's largest infrastructure projects HS2 (High Speed 2), a rail project linking London and the north of England. High-speed rail has become a new "image card" for China. A video of a Chinese bullet train made its way to Times Square, New York, this year, showcasing the advanced equipment. Behind the "high-speed rail diplomacy" is China's endeavor to shift from labor-intensive and low-end manufacturing to an innovation hub for high-end technology. Apart from high-speed rail, Britain, the cradle of the Industrial Revolution, also expressed a willingness to welcome investment in energy, particularly nuclear, offshore wind power and photovoltaic projects, the joint statement said. During Li's trip, trade and investment deals worth over $30 billion were signed between Chinese and British firms in areas of finance, technology, education, energy and infrastructure.

After growing to become the world's second largest economy, China is now seeking to shed its image as a "world factory" and inject vitality into the country by grasping opportunities the technological revolution offers. Money has been pouring into innovation. Expenditure on research and development (R&D) topped 1 trillion yuan ($168 billion) in 2012, about 1.97 percent of gross domestic product (GDP). It surpassed 2 percent for the first time to reach 2.05 percent in 2013. China plans to become an innovative country by 2020, when scientific progress is predicted to contribute 60 percent of the nation's economic development, and R&D investment will jump to 2.5 percent of GDP, according to a government sci-tech development document. The contribution to China's economic development from scientific progress has increased from 39 percent in 2011 to nearly 52 percent at present, official statistics showed, with some key technologies ranking among the first in the world.

Source: Xinhua: China eyes to become high-tech exporter, 2014-06-20

Asia-Pacific shifts away from Japan to China

China is now playing a pivotal and increasingly integrated role in the Asia-Pacific, as value-added trade between China and the region surged in the past two decades, while trade between Japan and the region declined, according to a recent IMF report.
All 11 export-led economies in the region, except for Indonesia, have shifted their focus to China, with value added volume far outstripping that to/from Japan, according to the International Monetary Fund that compared data from 1995 to 2012 in a report - Regional Economic Outlook: Asia and Pacific - released on April 14. Malaysia's exports to China, for instance, accounted for 10 percent of its total volume in 2012, doubling that in 1995. However, its exports to Japan fell to 6 percent from about 25 percent during the same period. That reflects the region's growing economic dependence on China - a major change in the past 20 years considering that most of these nations relied mainly on Japan in mid 1990s.

IMF figures not only reveal the rapid growth of China's economy in the Asia-Pacific, it also shows how quickly Japan's economy has declined because of the Plaza Accord of 1985, in which Japan's decision to raise the exchange rate of yen led to its economic stagnation later that decade. The nature of integration with partners, though, differs between China and Japan, with China specializing comparatively more in activities such as assembling, even though the country is now increasingly moving up the value chain, and Japan in upstream activities providing various intermediate goods as inputs, the report said.

Source: He Yini: Asia-Pacific shifts away from Japan to China, China Daily, 2014-06-27

U.S. Grows More Attractive for Foreign Investment; China Comes in Second, Followed by Canada, Britain, Brazil

The U.S. has grown more attractive as a destination for foreign investment, while Russia and some other emerging markets have faded, according to a survey by A.T. Kearney, a Chicago-based management-consulting firm. The U.S. ranked first in the firm's annual survey of senior executives, to be released Monday. China was second, followed by Canada, Britain and Brazil. Russia, which ranked 11th in the year-earlier survey, dropped out of the top 25. India slipped to seventh place from fifth, while Mexico fell to 12th from ninth. "There is this continued flight to safety, or perceived safety," said Paul Laudicina, a partner at Kearney. That trend helped the U.S. and some European countries, including Britain, Germany, Switzerland and France, all of which moved up in the ranking. Senior executives at 300 companies scattered around the world participated in the survey, conducted in January and February. The companies all have revenue of more than $1 billion, Kearney said. The survey asked them about the likelihood of investing in various countries over the next three years. Kearney uses the responses to create an index ranking the top 25 countries on a scale of 0 to 3 in terms of attraction. The U.S. score was 2.16 in the latest survey, while China's was 1.95 and Canada's 1.93. Kearney has conducted the survey since 1998. The U.S. topped the survey for the first four years. China was then No. 1 in the surveys released in 2002 through 2012, before the U.S. regained the top spot in 2013.

The survey covers expectations about future investments, not actual spending. According to recent estimates
from the Organization for Economic Cooperation and Development, China was the top destination for foreign direct investment in 2013. China's estimated inflow was $258.2 billion, up 2% from a year earlier. The U.S. ranked second, attracting $193.4 billion, up 16%. Russia attracted $54.5 billion, up 80%.


As costs rise in China, U.S. companies look closer to home: As costs rise in China, U.S. manufacturers look south for an alternative

"They're all looking for a new model," Mr. [Jason Sauey] said at his offices in Middlefield, Ohio. "It's not just about cost; it's about speed of response and quality." "It's a lot more convenient to fly to Mexico than to China," said Ken Kaiser, the company's owner. "But we just couldn't find a way to get an advantage by moving. It took forever just to get a price quote." As Mr. Sauey notes, today's global economy has increasingly come to resemble the volatile market for yo-yos or any other fad: the ups and downs come and go faster than ever. "It's like shooting to the moon when the spikes happen," he said. "And it's like falling off a cliff when it ends."


China's FDI inflows down 6.7% in May

Foreign direct investment (FDI) into the Chinese mainland fell 6.7 percent year on year to $8.6 billion in May, the Ministry of Commerce said on Tuesday. In the first five months of 2014, the FDI, which excludes investment in the financial sector, came in at $48.9 billion, up 2.8 percent from the same period last year, the ministry said. During the same period, FDI into China's service sector rose 19.5 percent year on year to $27.5 billion, accounting for 56.2 percent of the total, while that to the manufacturing sector dropped 16.5 percent to $17.4 billion.

In January-May, the top five investors in the Chinese mainland were Hong Kong, Taiwan, Singapore, the Republic of Korea (ROK), and Japan. Investment from the ROK and the United Kingdom saw the biggest rises, up 87.9 percent and 62.2 percent year on year, respectively. However, FDI from Japan slumped 42.2 percent from a year ago, while that from the United States fell 9.3 percent year on year. Investment from the European Union shed 22.1 percent in the first five months to $2.58 billion. Investment from the ASEAN dropped 22.3 percent to $2.54 billion, but MOC spokesman Shen Danyang denied it was affected by tensions with neighboring countries.

Shen attributed the drop to a high comparative base last year resulting from big projects and said the decline did not represent any trend. "Our economic and trade cooperation with the ASEAN is not affected by current factors in the neighboring areas," he said, adding that economic cooperation between the two sides will maintain growth momentum.

Source: Xinhua: China's FDI inflows down 6.7% in May, 2014-06-17

China Flexes Its Regulatory Muscle

China is flexing its growing power over global deals, after it put the kibosh on a shipping alliance that officials here said would hold too much sway over trade lanes to Europe. Tuesday's decision by China's Ministry of Commerce came despite approvals for the shipping alliance in Europe and the U.S. It marks only the second time the Chinese regulator has stepped in to block a corporate combination since the country enacted its antitrust law in 2008.

Other Chinese agencies have also stepped in to set conditions on deals, including when no Chinese company was directly involved. They include the merger that formed mining giant Glencore Xstrata PLC as well as separate deals by Microsoft Corp. and Google Inc. to acquire mobile device makers. Major deals for which China imposed conditions included Microsoft's purchase of Nokia Corp.'s phone business earlier this year and Google's 2012 purchase of Motorola Mobility Holdings Inc. China first used its antitrust law in 2009, when it was only a year old,
China still hadn’t approved the planned merger of advertising giants Omnicom Group Inc. and Publicis Groupe SA -- which was announced last July and blessed by the U.S. -- when the deal was called off last month.

In a statement on its website posted late Tuesday local time, the Commerce Ministry said it believed the proposed P3 alliance that would have included AP Moeller-Maersk A/S's Maersk Line, CMA CGM SA and Mediterranean Shipping Co. would control about 47% of the Asia-to-Europe container-shipping market. The parties, it said, "failed to demonstrate that the alliance would bring more benefit than harm or that it is in line with the public interest.”

China's ambition to have greater say in global pricing trends is one factor behind its increasingly expansive use of its antitrust laws. China is the world's largest trading nation in terms of imports and exports, making it a major customer for big shipping lines. It is the world's largest importer of copper, soybeans and iron ore, and it is challenging the U.S. as the world's largest importer of oil.


**FDI into developing economies forecast to stall**

Foreign direct investment into developing economies is poised to plateau as companies raise long-term bets on economies in Europe and the US recovering, UN economists predicted on Tuesday. Moreover, investments out of China are likely to overtake those into the country as soon as this year, they said, pointing to a move overseas by confident Chinese companies that will end more than two decades of net flows into the country. The changes are part of a shift in investment flows, accompanying the recovery in the global economy, anticipated by the UN Conference on Trade and According to Unctad, the value of long-term bets by companies around the world on factories and other projects grew 9 per cent last year to $1.45tn after falling sharply in 2012. The total is forecast to increase 12.5 per cent this year to $1.6tn.

The report points to five issues. 1 After a grim year, optimism was back in 2013 in its annual World Investment Report. According to Unctad, FDI flows rose in all of its groupings: the developed, developing, and transition, or former Soviet bloc, economies. After recording a sharp fall in 2012, largely because of the eurozone crisis, FDI into developed economies rose 9 per cent last year to $566bn. FDI was also up sharply in the transition economies, which saw inflows of $108bn in 2013. However, as a share of total global FDI, the flows into rich economies remained at a historical low of 39 per cent. By comparison, flows into the developing world were at a record $778bn, accounting for 54 per cent of global FDI last year. Moreover, the biggest destination continued to be China and the rest of developing Asia, which as a region attracted $426bn in FDI in 2013. The EU and North America both drew about $250bn in FDI.

2 FDI into developing economies is set to plateau.

FDI flows into developing economies have been the main trend for more than a decade but that is about to change, according to Unctad economists. In 2000, FDI flows into developing and transition economies accounted for just 19 per cent of the global total. By last year, they had grown to almost 60 per cent. But Unctad economists say the recovery under way in developed economies is changing that dynamic. They expect FDI into developed economies to increase 35 per cent this year against a 0.2 per cent fall in those flows into developing countries such as China.

By 2016, they expect the flow of FDI into developed economies to make up 52 per cent of the total.

3 China is about to become a source of FDI rather than a destination

China’s FDI outflows – the amount of money domestic companies invested in overseas assets – topped $100bn for the first time in 2013, according to Unctad. And that is a portent of an emerging trend, according to the UN economists.
China last year still attracted more interest from foreign investors, $124bn in inbound FDI, than it sent overseas but 2013 may well be the last year that will happen. James Zhan, the Chinese Unctad economist in charge of the World Investment Report, said, if present trends hold, outbound FDI from China will overtake inbound FDI this year or next.

The reason is simple. Chinese companies are buying assets in developed economies and moving production to places such as Cambodia, Myanmar and Africa to take advantage of lower costs and preferential trade deals.

4 2013 added to the evidence for 'reshoring'

Investors in developed economies put $857bn into overseas FDI in 2013. But the composition of FDI outflows has changed since the 2007-08 crisis.

In 2007, more than half the FDI outflows from key developed economies, including the US, UK and Germany, were made up of equity outflows while just 30 per cent were reinvested earnings, including cash. Two-thirds of FDI recorded last year as flowing out of those economies was cash and other reinvested earnings parked overseas by multinational companies. Not all of it amounts to FDI, of course. A lot of cash is sitting in short-term investments, as well. But it is a huge pile with an estimated $3.5tn held offshore by the top corporations from developed economies at the end of 2013, according to Unctad. At the very least, the biggest multinationals appear to have stopped sending jobs overseas, according to Unctad. Data gathered by the UN agency’s economists from the 100 biggest multinational companies, most of which are in developed economies, show their domestic production expanding faster than their offshore operations. Unctad said the ratio of foreign to total employment at those companies fell for a second consecutive year in 2013, although a majority of their workers remained offshore.

The 100 largest companies employed 17.3m people in 2013: of those, 9.8m were overseas and 7.5m were domestic staff.

However, jobs appear to be coming home. The number of workers employed offshore by those 100 companies has fallen since 2011 but they are employing almost a million more people at home than they were in 2011.

5 Multinationals’ cash piles are distorting the global picture

Source: Shawn Donnan in London: FDI into developing economies forecast to stall, Financial Times, June 24, 2014

'Red Capitalist's' Firm Makes a Shift

When China's late leader Deng Xiaoping held a meeting with the country's few remaining businesspeople in January 1979, he singled out Rong Yiren, a former textile tycoon, to "do some actual work and play a role" in Beijing's nascent economic-overhaul efforts. The meeting was China's way of drawing the nation's residual industrialists into helping the Communists rebuild a shattered economy and restore social order after the Cultural Revolution ended in 1976. In return for the trust that Deng gave him, Mr. Rong laid the groundwork for Citic Group to become China's most influential conglomerate. A Citic Group unit, Citic Pacific Ltd., was one of the first "red chip" stocks, mainland-controlled companies listed in Hong Kong. The conglomerate now boasts a suite of financial services from banking to insurance, iron-ore mines in Australia, one of China's richest but most underachieving soccer clubs and the country's top offshore-oil helicopter-service operator.

On Tuesday, Citic Group returned to the vanguard of China's efforts to overhaul its state sector. Independent shareholders approved Citic Pacific's $37 billion takeover of Citic Group's assets, effectively listing nearly all of Citic Group in Hong Kong, where it will be subject to tougher rules and disclosure requirements than on the mainland. Advocates say the move could become a blueprint for overhauling China's huge, inefficient state-owned enterprises. Citic Pacific has played a central role in Hong Kong since the early 1990s. Its transactions have often reflected Beijing's interest in reducing Britain's influence over the city's economy. Over the years, the firm has gobbled up investments in Hong Kong shopping malls, power plants, tunnels and the city's de facto flag carrier, Cathay Pacific Airways Ltd.

L.A. economy's Chinese influx; Tourism and investment from China in Southern California are surging, a new report says

Tourism from China into Los Angeles nearly quadrupled last year to 570,000 visitors, up from 158,000 in 2009, according to a new report from the Los Angeles County Economic Development Corp. The LAEDC thinks the county could see as many as 2 million Chinese tourists annually by 2020. The purchase of the Sheraton Gateway hotel was handled in part by California law firm Jeffer Mangels Butler & Mitchell, which in 2011 launched its Chinese Investment Group to orchestrate deals for Chinese clients, who recently acquired the Crowne Plaza Los Angeles Harbor Hotel in San Pedro.


China's non-financial ODI drops Jan-May

The combined outbound investment of Chinese companies declined during the first five months of 2014 due to plunges in major investment destinations, official data showed on Tuesday. Shen Danyang, spokesman for the Ministry of Commerce, said at a press conference that China's outbound direct investment (ODI) in non-financial sectors slumped 10.2 percent year on year to $30.81 billion in the January-May period. The investment went to 2,766 overseas enterprises in 146 countries and regions. Hong Kong, the Association of Southeast Asian Nations, the EU, Australia, the United States, Russia and Japan received 68.7 percent of the ODI, or $21.16 billion, Shen said. During the period, investment to Hong Kong plummeted 32.6 percent year on year, and investment to the EU and Australia dropped 9.2 percent and 3.2 percent, respectively. The United States saw investment from China soar 144 percent to $2.03 billion, while Russia and Japan also saw surges of more than 100 percent due to a relatively low base number in the same period of last year. As of the end of May, China had an accumulated outbound investment of $556.5 billion in non-financial sectors.

Source: Xinhua: China's non-financial ODI drops Jan-May, 2014-06-17

China set to be net investor

Outward flows likely to exceed FDI in nation this year, UN report says. China's outward investment is very likely to exceed foreign direct investment inflows this year, making the country a net investor, according to officials at a United Nations body. This "inevitable trend" will have "great significance in reshaping the economic structure and long-term development" of the world's second-largest economy, they said. In 2013, China's foreign direct investment rose by 2.3 percent year-on-year to $123.9 billion, ranking second in the world after the United States, according to the United Nations Conference on Trade and Development's World Investment Report on Tuesday. "China remained the recipient of the second-largest flows in the world. Meanwhile, the quality of FDI inflows improved, with more into high-end manufacturing and services with high added value," said Zhan Xiaoning, director of the Investment and Enterprise Division at UNCTAD.

In 2013, investment outflows from China increased by 15 percent year-on-year to $101 billion, the third highest in the world after the United States and Japan, the report said. As China continues to deregulate outbound investment, outflows to developed and developing countries are expected to grow further, it said. Zhan said, "China's economic landscape, driven by exports and foreign investment in the past three decades, will change significantly. Outward investment will serve as an important driver for industrial upgrading and economic growth." Liang Guoyong, an economic affairs officer at UNCTAD, said, "It is very hard to predict when China will become a net investor, but the trend is inevitable." The process will accelerate along with the nation's fast economic growth, the increase in Chinese
companies' competitiveness and the amount of resources and market share they gain, Liang said. The change will lead to a more effective allocation of financial resources for the Chinese economy, as the country holds the world's largest foreign exchange reserves, Liang added. "The rapid increase in overseas investment by Chinese enterprises is very likely to transform the trade landscape, because profits from the overseas market will lessen the country's reliance on exports, reducing trade frictions and pressure from swelling foreign exchange reserves," Huo said.

Source: Li Jiabao and Mu Chen: China set to be net investor, China Daily, 2014-06-25