ASIA PERSPECTIVE

China Economic Update Report

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This Issue

Picked up momentum in the second quarter

China ‘s economy was steaming ahead in the second quarter, growing 7.5% after a slowdown earlier in the year. Because the government has been announcing a series of measures since March, which has helped to stabilize growth in Q2.

Beijing also released a swathe of other data: June industrial output rose 9.2 percent year-on-year, while fixed asset investment grew 17.3 percent in the January-June period, a little better than the forecast for 17.2 percent growth. A challenge for the economy is the real-estate market. The sector accounts for more than 20% of the economy when related industries such as steel and construction are included.

With China's growth so far this year below the government's official target of 7.5 percent growth for the full year, second half expansion would have to improve, and analysts say that would mean more aggressive stimulus is coming.

In July, the government posted its biggest-ever monthly trade surplus, which hit USD47.3 billion in July, up from USD31.6 billion in June, even though the economy was slowing down earlier this year.

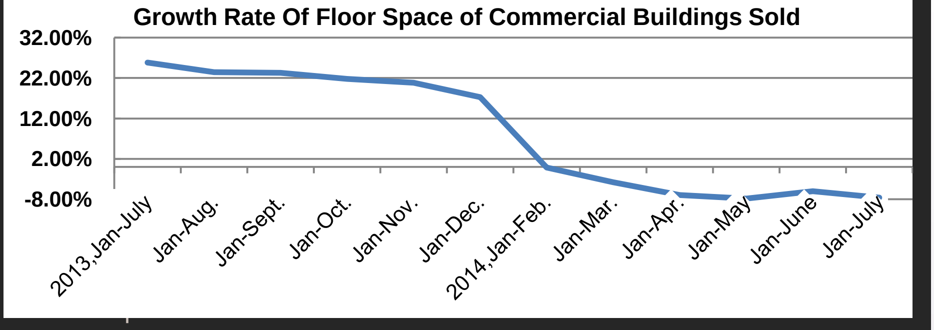
China Jan-July FDI falls for first time in 17 months

During January-July of 2014, China’s total FDIs increased by USD71.1 billion (42 billion pounds) in foreign direct investment (FDI), down 0.4 percent from a year ago and its first decline since February 2013, as investment in the manufacturing industry fell 14.3%, while the service industry jumped 11.4%.

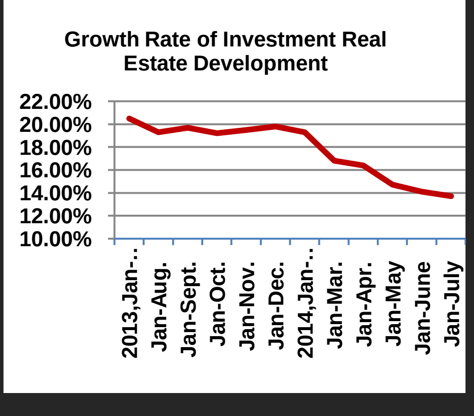
The top 10 foreign investors in the first 7 months were Hong Kong, Taiwan, Singapore, South Korea, Japan, Germany, the UK, France, Netherlands and the United States. Their combined investment hit USD66.8 billion, accounting for 94% of total FDI. Investment from the UK and South Korea grew fastest in the first seven months, rising 61% and 32%. In contrast, investment from Japan slumped 45% to $2.83 billion in the same period, due in part to a series of territorial disputes. FDI from the United States fell 17.4% to $1.8 billion, while investment from Europe dropped 17.5% to $3.8 billion in the first seven months.

China's Real Estate Market: Oversupply Becoming Bigger Problem?

According to the National Bureau of Statistics, in the first seven months of 2014 the floor space of commercial buildings sold stood at 564.80 million square meters, a year-on-year decrease of 7.6%.



the Chinese economy? In the year 2010, real estate accounted for around 15% of China's GDP, according to the IMF's calculations. While a slowing of investment and construction by as much as 10% would definitely reduce growth from 7.5% to 6.5%.



The IMF said in a report released on Friday that oversupply was already a big problem in the industrial northeast and in coastal cities in the north. Residential real estate inventories have increased sharply in third- and fourth-tier cities, including once-hot coastal cities like Hangzhou, Dalian, Fuzhou and Wenzhou. The problem is that Chinese urbanization trends have not accelerated enough to account for the new buildings, many of which are not fully sold. Unsold

turn have less revenue to pay off debt. The sudden decline in housing prices will surely affect not only China, but impact the global economy as a whole such as Japanese construction equipment, Australian iron ore, Chilean copper and European furniture.

As a result, the many Chinese local governments have implemented new measures in an effort to loosen their macro controls of the market. The central government can also take other measures such as financial easing for lenders, as well as removing restrictions on second and third home purchases.

Easing property regulations

China's property market has been booming since 2003, and many local governments have been trying to rein things in by control measures such as home purchase restrictions, focusing on controlling housing prices in their respective locations.

However, the total investment in real estate development in the first seven months of 2014 was RMB5,038.1 billion, a nominal increase of 13.7% year-on-year, 0.4 percentage points lower over the first six months. Oversupply is becoming bigger problem. The cooling property market pressures the incomes of local governments, which depend on the real estate sector for a substantial part of their proceeds.

Nanning, the capital city of Guangxi Province, became the first city to ease home purchase restrictions by allowing more non-residents to buy homes starting in May. So far, more than 40 cities nationwide adjusted property control measures to encourage home purchases, though there is no sign that the central government will relax property controls on a nationwide scale as the economy is slowing. Maybe as president Xi Jinping has said China should adapt to a "new normal" of slower growth as government pushing market reforms to generate more sustainable long-term growth.

New Policies of the Shanghai Pilot Free Trade Zone

On September 27, 2013, the State Council of China issued the Blueprint of the China (Shanghai) Pilot Free Trade Zone ("FTZ"). It would ease certain regulatory restrictions, particularly foreign investment in of some industries. The FTZ is China's national strategy, which is to expand the opening of service sectors, to promote the reform of the foreign investment, and to explore the Chinese currency convertibility for opening up the financial services.

The FTZ uses the negative list, a special measure for market entry of foreign investments. On July 1, 2014, the new negative list was issued. The new negative list is nearly 27% shorter than the 2013 negative list. For those industries which are not on the negative list, foreign investments only need to register through filing with the pertinent government agency. Such filing can be completed on-site which previously needed eight-day's filing time.

On August 1, 2014, Shanghai's Pilot Free Trade Zone confirmed new international finance regulations that is a significant boost to companies in the zone. Effective, cheaper, cross border financing will be available to companies in the free trade zone. The new financial regulations in FTZ allow businesses within the zone to finance offshore after simply filing out one document. "The Regulations allow companies in the zone to borrow RMB overseas and use the money in the Free Trade Zone. Once these companies have registered Free Trade Accounts, the RMB they borrowed from other countries may even be used to supplement other businesses, even if they're not in the Free Trade Zone" Said professor He Xiaoyong, associate Director of Institute of China FTZ Law. For example, they may borrow RMB in Hong Kong, where the interest rate of around 3%, which is about half the rate in the Chinese Mainland. It's a big step for cross-border finance in China.

The companies in the zone also benefit from the newly announced FTZ foreign exchange policy. Now, if a company in the zone wants to invest overseas, for example, it only needs to notify the bank, and its RMB savings in the Free Trade account would then be exchanged into USD and be wired directly to the destination, without the company going through any foreign exchange controls at all.

So far, more than 16,000 corporations have registered in the Shanghai Free Trade Zone, and 24% of them are finance-related corporations. And by the end of June 2014, there are 1,245 foreign-invested enterprises. They all have high expectations.

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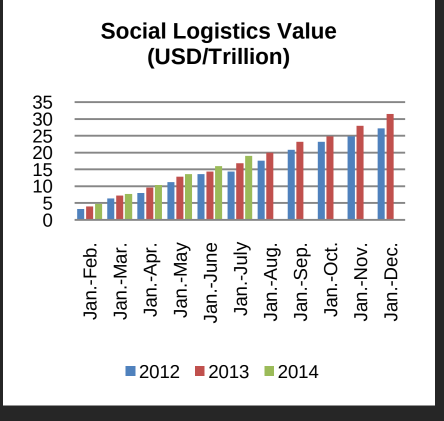
First wholly foreign invested hospital in FTZ

On 22 July 2014, German-based Artemed Group, HK-based Silver Mountain Capital, Shanghai Waigaoqiao Free Trade Zone 3U-Development Co., Ltd. and Shanghai Waigaoqiao Medical Centre get a framework agreement relating to the establishment of the first wholly foreign invested hospital in FTZ. Artemed Group and Silver Mountain Capital will jointly invest in and establish a comprehensive wholly foreign owned hospital with approximately 300 beds, 10 foreign doctors as well as a number of therapists. The new hospital will also share medical resources and patients with the Shanghai Waigaoqiao Medical Centre, which is located nearby.

As a pilot, Shanghai FTZ foreign investors are permitted to establish wholly foreign owned hospitals. Further, the Shanghai Free Trade Zone Negative List 2014 (issued on 30 June 2014) has abolished the total amount of investment requirement (which was previously no less than RMB 20 million) and the maximum 20 years business term of a wholly foreign invested medical institute. However, the Shanghai Free Trade Zone Negative List 2014 still prohibits the establishment of branch offices by a wholly foreign invested medical institute outside Shanghai FTZ.

A Review and Outlook For China's Logistics Industry

China is experiencing huge demand for transportation and logistics services—so much that dedicated service providers are struggling to keep up. Foreign and local players continue to expand into the logistics market, and the government is pushing to improve logistics capacity and efficiency. Accordingly, we believe the logistics sector is set to maintain a steady and rapid growth over the coming years. During Jan-July of 2014, the total logistics value reached USD19.04 trillion, up by 8.7% year-on-year.

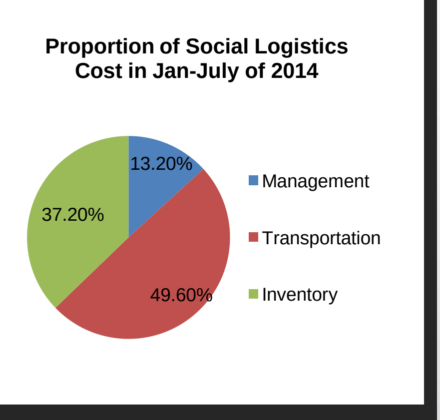


The manufacturing sector is key to China's economic development. As a result, the logistics value of industrial products accounted for 91.8% of the total value last year.

The high demand for logistics and transportation services in China is attributable to some factors. Firstly, rapid growth in domestic consumption has created a need to deliver more goods to a greater number of destinations. Second, improved infrastructure, particularly in the second and third-tier cities， has opened up new markets for retailers. Third, there has been increased interest in industrial property development in China against a declining outlook for commercial and residential properties.

More than any of the above growth factors, demand for logistics and transport services in China is the direct outcome of the unexpectedly strong performance of e-commerce.

However, the total logistics costs stay high. In 2013, China's total logistics costs amounted USD0.88 trillion, up by 8.8% year-on-year. On the other hand, the ratio of total logistics costs to GDP 16.9% in the first half year of 2014.



Logistics costs are likely to continue increasing. Soaring fuel costs and steadily rising labor costs will also push up the overall costs of sourcing in China. Road transport remains the major freight transport mode in China, so logistics burden the high toll fees.

Without doubt, the logistics industry in China is robust in its growth. Although it still faces many challenges, many global private equity firms moving quickly to take advantage of the demand for logistics in China, such that the industry now receives 2.8 percent of all FDI into China.

GLP Buys Into China Logistics Firm

Singapore's Global Logistic Properties is investing USD324 million in China's largest state-owned warehouse logistics provider to capitalize on growing domestic consumption in China. GLP will take a 15.3% stake in Shanghai-listed CMST Development Co., becoming its second-largest shareholder. CMST Development's largest shareholder is China National Materials Storage and Transportation Corp., which is indirectly owned by the Chinese government.

The logistics industry in China has attracted a range of investors in the past two years. Growing e-commerce and consumption make necessary better logistics networks to house and transport goods from factories to businesses and homes.

Haier expands China logistics business as 3PL demand grows

Haier Electronics spent USD60 million in the first half developing its logistics business, which is a bold new strategy to tackle the increasingly outsourced logistics requirements of household electrical appliances and consumer electronics. Haier Electronics' new strategy gained momentum this year with the goal to create industry-leading standards for the logistics of household appliances across the country.

ASIA PERSPECTIVE

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What differentiates us from our competitors is the knowledge and expertise we have gained after several years in the Asian market. We have experience from a variety of industries and clients including leading international companies from Europe, the US and Asia.

With a highly collaborative team of problem solvers and a passion for excellence we will add value to your business. We work closely with our clients to create and deliver insight, advantage and real impact.

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