ASIA PERSPECTIVE

China Economic Update Report

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This Issue

Third quarter growth reflects a slowdown in the Chinese economy

China's GDP grew by 7.3 percent year-on-year in the third quarter, decreasing 0.2 percent compared to the second quarter. This is the weakest growth seen since the first quarter of 2009 when growth fell to 6.6 percent due to the global financial crisis. There is an increasing uncertainty whether or not China will be able to reach its annual growth target of 7.5 percent this year. The decline was mainly caused by a slower manufacturing growth and a cooling real estate market.

Foreign Direct Investment (FDI) declined by 1.4 percent year-on-year in the three first quarters of 2014. The service sector is showing a solid growth, while the manufacturing sector is showing a significant decline. Fixed asset investments grew by 16.1 percent year-on-year, down 0.2 percent from the expected growth of 16.3 percent and 1.2 percent lower then the end of second quarter. Industrial output fell to 8 percent in September, down 1.2 percent from June and retail sales fell to 11.6 percent in September, a 0.8 percent decline from June.

Foreign Direct Investment in service sector increases

The manufacturing sector has been the key to China's economic development for decades, but for the first time in 2013 the service sector accounted for more then 50 percent of total FDI into China.

In 2013 the FDI into the service sector was US$61.5 billion, up 14.2 percent year-on-year. Accounting for 52.3 percent of total FDI. Investment into the manufacturing sector was US$45.6 billion, a decline of 6.8 percent year on year.

In the first nine months of 2014 FDI into China service sector grew by 8.7 percent compared to 2013, reaching US$48.6 billion, while the manufacturing sector dropped by 16.5 percent to a total of US$29.6 billion.

The Chinese economy is changing, but optimism remains high

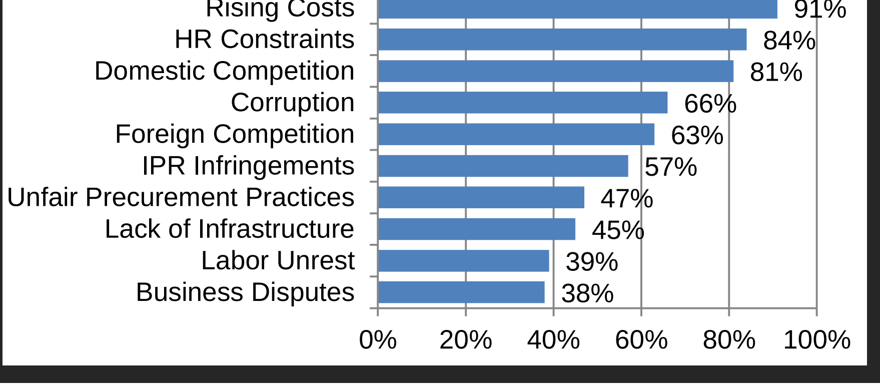
According to the annually conducted China Business Climate Survey, as many as 85 percent of the respondents are reporting an optimistic or slightly optimistic outlook for the next five years. As many as 96 percent of the companies surveyed reported to have maintained or increased their investment in China in 2014, and 67 percent replied they wish to increase their investment levels in 2015, while 28 percent reported they wish to maintain their current investment levels.

But there are also indicators reflecting challenges in the market, where the top three reported business challenges are reported to be the rising costs, HR constraints, and domestic competition.

As many as 91 percent reported that the rising costs was their main business challenge and 53 percent reported that this concern had increased since 2013. As many as 86 percent report increasing labor cost to be their main concern. Of the companies saying they plan to address the problem, 26 percent would consider automation or downsizing, 13 percent would consider moving to a different region within China, 10 percent say they would move to another country in the Asia-Pacific region and 4 percent would consider relocating elsewhere.

Respondents to the survey indicated that the talent environment have become worse in last year in all the categories surveyed; managers and executives up 12 percent, recruit and retain skilled workers up 8 percent and technical staff up 5 percent.

The third biggest business challenge is the increasing domestic competition from both state owned enterprises and private sector. Chinese companies are no longer competing on price alone, but are increasing competitive regarding quality.



The Asian Infrastructure Investment Bank

The AIIB is an international financial institution first proposed by China in October 2013. The purpose of the newly established bank is to provide finance to support infrastructure projects in the Asia-Pacific region. In contrast, the Asian Development Bank (ADB) supports everything from environmental protection, to gender equality, education and infrastructure projects, the AIIB will only focus on the financing of infrastructure projects.

The initial capital is expected to be around $50 billion, while the authorized capital is $100 billion. The ADB has a capital base just over $160 billion and the World Bank has $230 billion.

According to a report published by the ADB in 2010, there is a massive infrastructure funding gap in Asia if the region wish to maintain its economic growth. The ADB estimates that between 2010 and 2020 the total funding gap is about $800 billion, which the ADB and the World Bank cannot hope to fill.

China facing corruption issues in the country's healthcare sector

China has been facing a continuously increasing problem related to systematic bribery in the country's healthcare sector, where several Chinese and multinational pharmaceutical companies made media headlines in 2013. As a part of an effort to govern misconduct within the healthcare sector, the NHFPC (China National Health and Family Planning Commission) announced in December 2013 there would be several new regulations implemented in 2013 and 2014.

Circular No. 49, "Nine prohibitions to strengthen ethical conduct in the healthcare industry" became effective on December 26th 2013 and targets the improper payments made to Chinese hospitals, medical institutions and their employees. The circular also clearly states the consequences of violation any of the nine prohibitions will result in disciplinary action.

Circular No. 50, " Regulations on establishing of commercial bribery records for purchase and sale of medicines" came into effect on March 1st 2014, and introduces a blacklist system targeting all manufacturers, distributors and sales representatives of pharmaceuticals and other medical products. All medical suppliers and their personnel will be required to sign an detailed integrity agreement with the medical institutions with which they do business. Blacklisting companies who behave inappropriately is not news in China, but Circular No. 50 clarifies the terms of which a company will be blacklisted and the consequences of being blacklisted is far more serious. Once a company have been blacklisted it will be prohibited from selling to any public hospital in the province for two years, and should the company be blacklisted more then two times within a five year period, it will be banned from selling to any public hospital in China.

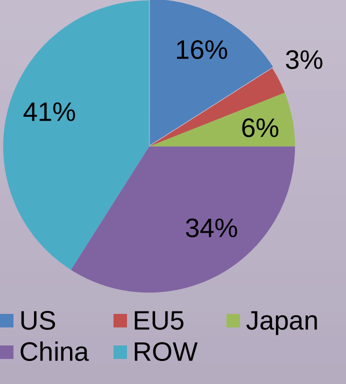
Circular No 163, "Agreement on integrity in the sale and purchase of healthcare products", adds additional guidelines on the blacklist procedures, including an aggressive timeline for reporting and investigate violations and a first draft of the recently introduced integrity agreement.

According to the NHFPC, medical suppliers in China should expect a series of regulations to be implemented within the next few years.

China pharmaceutical market growing rapidly

China is currently the third largest pharmaceutical market in the world behind the US and Japan. According to McKinsey & Co. China pharmaceutical market is growing rapidly, showing a compound annual growth rate of 21% between 2008-2013, reaching $98 billion in retail sales. The market is expected to continue to grow by 17% through 2020, approaching $310 billion in retail sales.

China is expected to account for approximately 34% of global growth in the pharmaceutical industry between 2012-2017, where an aging population, expanded coverage of public health insurance and increased wealth is considered key factors.



Source: IMS Health

Measures taken in third quarter to prevent “hard landing” for the economy

The Chinese government implemented several measures in the third quarter to help ease the landing in a slowing economy. The Chinese economy has seen lower growth this year then expected, and the question remains whether or not China will be able to reach it’s target of 7.5 percent growth. The recent measures taken is not designed to boost the over all economy, but rather focus on a smaller boost in key sectors, such as real estate, small and medium sized enterprises (SME), and infrastructure to prevent a “hard landing”.

In July, the State Council implemented several measures to cut financing costs for companies, focusing on SMEs. The measures taken include cutting bank finance charges, encourage the private sector to establish financial institutions, and expanding direct financial channels. The State Council also released a number of measures aimed to upgrade the manufacturing technology and increase growth in the service sector. The service sector is becoming increasingly important to the Chinese economy as there has been a significant decline in the manufacture sector in recent years.

In September, the Ministry of Finance (MOF) issued a notice to promote Public Private Partnerships (PPP), to encourage more social capital investment in infrastructure. Measures was also taken by the State Council to speed up the approval reviews for infrastructure investment projects.

At the same time, the Chinese Central Bank eased the mortgage loan policies, including reducing minimum down payment, discounting mortgage rates, as well as implementing restrictions when buying a third home. In addition, all local governments except Beijing, Shanghai, Guangzhou, Shenzhen and Sanya, loosened the restrictions on property purchases.

According to China Premier Li Keqiang, the government wish to keep the domestic economic growth at a “medium to high rate” through precise macro-control effects, reforms, structural adjustments and increasing people’s livelihoods. There will also be more small-scale measures implemented by the end of the year.

Weak growth in China automotive market

According to the China Association of Automobile Manufacturers (CAAM), the sales of automobile vehicles in China grew by 7 percent year-on-year in the first nine months of 2014, reaching a total number of 1,700,900 units. This is a 5.7 percent decline from what seen in the first nine months of 2013, where total growth was 12.7 percent.

The expected growth for 2014 was set to 10 percent in the beginning of the year, but this number was adjusted in July to 8.3 percent, after a weak growth in the first two quarters.

The weakest growth so far this year was seen in September, where total sales only grew by 2.5 percent year-on-year. The prime reason for this decline is most likely the implementation of the national fourth-phase standard in 2013.

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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