# Asia Perspective Economic Update Report

Quarter 1 2016

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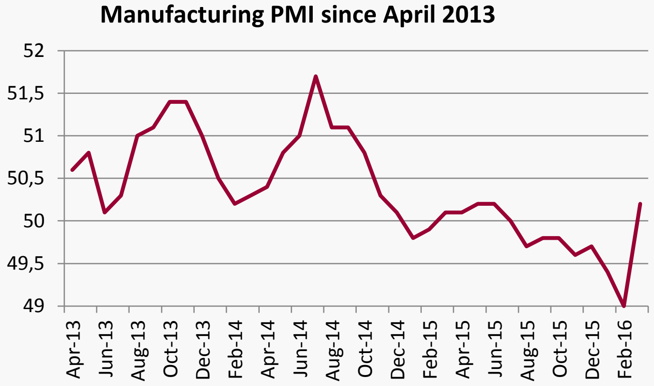
# Optimism in the Chinese Economy

China´s GDP expansion of just 6,9% during 2015 might have been the lowest in over 25 years, but a series of indicators in the first quarter of 2016 are now predicting brighter times.

Exports rose by 11,5% during March this year which is a considerable improvement compared to February´s fall of 25,4%. The import decrease also slowed from 13,8% to 7,6% between the same months. At the same time the manufacturing purchasing index in China rose to 50,2, breaking the 50-barrier for the first time in almost a year. The corresponding index for the service sector; the Caixin Services purchasing managers index rose to 52,2 from 51,2 in February. For both indexes any reading above 50 indicates an expansion of the sector during the given month.

During March 2016 value-added output increased by 6% which is an acceleration from 5,4% in both January and February.

In effect of these positive indications the International Monetary Fund raised the estimate of China's GDP growth for 2016 from 6,3% to 6.5%. Louis Kuijs, head of Asia economics at Oxford Economics, commented that the optimistic news about the Chinese economy have helped to neutralize some of the panic in regards of the Chinese economy that has been seen recently.



# Finally Increasing Trade Again

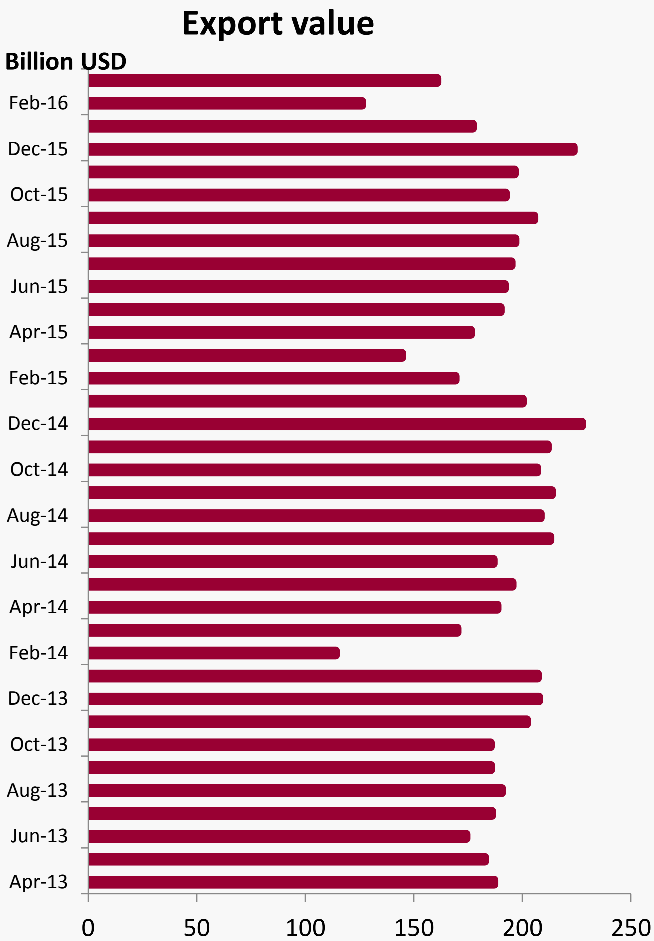
China offered the world economy a well needed surprise when it released its trade data for the first quarter of 2016. In March alone, export grew by an impressive 18,7% year-on-year in terms of Chinese Yuans and 11,5 % in terms of US Dollars. The difference being due to the Yuan´s recent appreciation against the dollar by 1,9%. This marks the first month with increasing exports since June 2015 and the largest monthly expansion in over a year.

An explanation for China´s increasing exports can partly be found in the country´s successful rise up the manufacturing value chain. While low-skill manufacturing such as textiles have been increasingly outsourced to cheaper neighbouring markets, China itself has developed greater production skills in high tech industries such as automotive and cleantech. Increasing quality and efficiency in high end manufacturing industries have made China more competitive and boosted exports. Commodity export have also picked up. Steel exports during March reached almost 10 million tonnes and thus marked a 30% increase compared to the previous year.

In fact, the main cause for China´s earlier slumping exports was week global demand rather than intrinsically issues with the Chinese economy itself.  This was commented in a research not by HSBC: "China's export sector is not losing competitiveness. In fact, China is increasing its share of other countries' imports, even though the global volume of trade has been sadly stagnant in recent years,"

And while exports have been increasing, the decline in imports have slowed. During February 2016 imports fell by 8% while the decline was only 1,7% in March. Especially commodity imports have been increasing and copper imports during the first quarter of 2016 was up by 30% compared  to the previous year.  Altogether the trade balance in March alone reached 194 billion CNY.

The recovery  of Chinese imports is fuelled by a reinvigorated real estate market as well  as  increasing public investments . It also shows that the measures to stimulate domestic demand are having effect. Financial institutions  are now  optimistic about the future development  of Chinese imports and Zhou Hao at Commerzbank commented that “China’s commodity imports should see further improvement soon”.




# Global Enthusiasm

China is inevitably connected to the international economy and every change in the kingdom of the middle is felt across the globe. The IMF has estimated that a decrease of 1% in investment driven GDP growth in China decimates the growth in the entire G 20 group by 0,25%. It is thus not surprising that stock markets across the world has reacted with enthusiasm on the optimistic trade data from China.

The broadest MSCI's index of Asian shares outside Japan rose by 1.7 percent on the news, and the European index FTSEurofirst gained 2,6% - its biggest increase in a month. The Shanghai stock exchange reacted to the same news by rising 2%.

# Stimulate the Economy but Beware of Inflation

Large scale reforms to stimulate the economy are expected. The Chinese economy is starting to show signs of recovery but the authorities are nevertheless rolling out stimulus measures to support up the optimism .

Starting at May 1st this year a value added tax (VAT) will replace current business taxes in construction, real estate, the financial sector and the consumer services sector. This is part of a VAT-reform that started in 2012. The reform was first tested in telecom-, railway transportation-, postal- and some service sectors. The test proved successful and decreased the tax burden on businesses in in those sectors by 600 billion Yuan.

The new sectors that are now going to be covered by the VAT-reform instead of the old business tax are however more complicated according to government sources. Implementation may thus be more difficult. Nevertheless the government plan to decrease the tax burden by 500 billion Yuan in those sectors during 2016 alone. Authorities hope that the reform will help to accelerate ongoing structural changes in the Chinese Economy.

The finance ministry also recently also allowed local governments to issue more bonds in order to boost regional public spending. Local governments have also pledged to increase their spending in order to stimulate economic growth. On a national level the finance ministry proposed to increase the fiscal deficit this year.

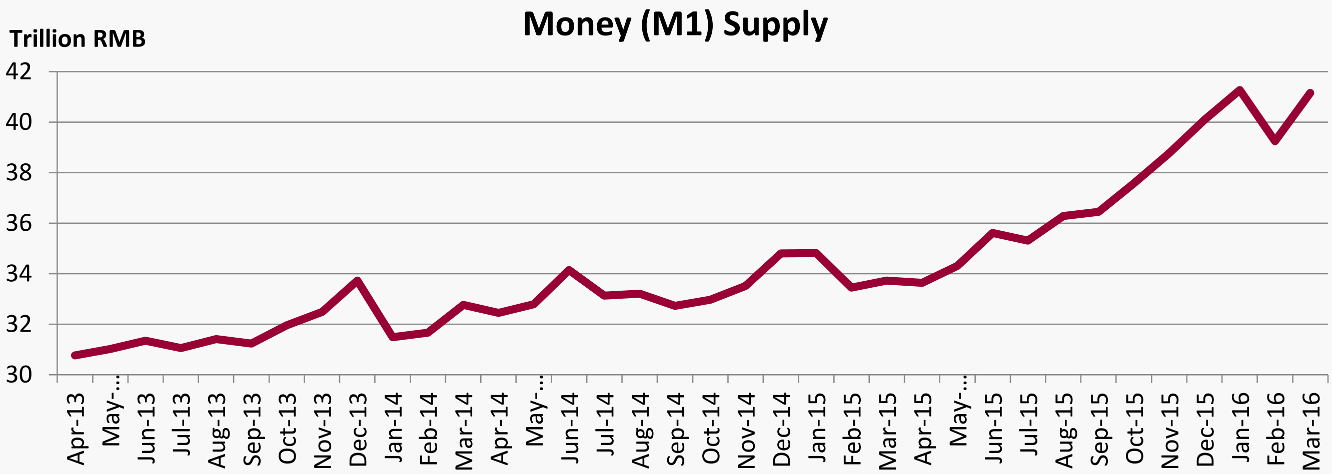
These measures will be the last in a long effort to stimulate the Chinese economy. The central bank has introduced no less than six interest rate cuts since the end of 2014 alone. During the same time it has also reduced the share of deposits that banks are required to hold as reserves several times. Monetary easing is however spurring inflation and fear of rapidly increasing prices may block further similar measures.

During March this year the Consumer price index (CPI) rose by 2,5% year on year compared to an increase of 2,3% in February.

That marks the fifth month of continuous acceleration in consumer inflation. This is a signal for the authorities not to release more capital on the consumer market. In the light of this, UBS recently stated that they no longer believed further interest rate cuts were possible during 2016 and added the following. “Given the upcoming stabilization of real economic activity, ongoing rebound in property sales and prices, and the recent jump in headline CPI, we think policy easing momentum has likely peaked in the near term,”

While consumer prices are on the rise in China, so is not the price level of the country´s manufacturing output. The producer price index, an instrument for measuring prices of factory output, dropped by 4,6% in March and 4,9% in February. There is thus no risk for overheating in the manufacturing sector.

In summary the Chinese authorities will continue stimulating the economy but are now more cautious not to overheat consumer inflation. Fiscal measures such as tax cuts for businesses and targeted public investments are thus more likely than monetary measures that would affect the access to capital not only for businesses but also for consumers.



ASIA PERSPECTIVE

# About Asia Perspective

Asia Perspective is an Independent Management Consultancy with global presence and local knowledge. We assist our clients with business advisory regarding Analysis, Strategy and Implementation. Our mission is to turn our clients' Asia business vision into reality and add significant value to your business.

We offer specialist services covering Supply Chain Management, Purchasing, Market Entry, and Financial Advisory. This includes market entry research and strategy sourcing and pricing strategy, M&A advisory, risk management, operational improvements etc.

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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