

China Trade Quarterly

ISSUE
52
NOV
2018

Domestic Trade

Retail sales of consumer goods grow by 9.3% yoy in 1-3Q18.

Both rural and urban households see high single-digit growth in income in 1-3Q18.

Growth in nominal fixed asset investment falls to 5.4% yoy in 1-3Q18.

China proposes details about tax-deductible items for Individual Income Tax.

Entrepreneur Confidence Index for secondary industry drops further in 3Q18.

Growth of manufacturing sector continues to decelerate.

October NMI indicates a recent moderation in growth of non-manufacturing sector.

Foreign Trade

Both exports and imports maintain strong growth in 3Q18.

Exports to US record double-digit growth in 1-3Q18.

Exports from Guangdong and Shanghai post relatively slow growth in 1-3Q18.

FDI increases by 2.9% yoy in 1-3Q18.

Foreign exchange reserves decrease further in 3Q18.

China-US trade war escalates.

Chinese yuan depreciates further against US dollar.

China lowers import tariff rates on a wide range of industrial products.

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Executive Summary

Domestic Trade

Retail sales of consumer goods reached 27,429.9 billion yuan in 1-3Q18, up by 9.3% yoy. Online retail sales of goods, which accounted for 17.5% of total retail sales, increased markedly by 27.7% yoy over the period.

Both rural and urban households saw high single-digit growth in income in 1-3Q18. The per capita disposable income of rural households grew nominally by 8.9% yoy to reach 10,645 yuan; while the per capita disposable income of urban households rose by 7.9% yoy in nominal terms to reach 29,599 yuan in 1-3Q18.

Growth in nominal fixed asset investment moderated to 5.4% yoy in 1-3Q18 from 7.2% yoy in 2017, attributable to the FAI growth deceleration in infrastructure (excluding power, heat, gas and water infrastructure).

On 20 October, the Ministry of Finance and the State Administration of Taxation jointly published the 'Temporary Measure on Special Additional Deductions for Individual Income Tax (consultation draft)', proposing the details for the newly increased tax-deductible items such as expenses on children's education, continuing education, medical treatments for serious illnesses, housing mortgage interest and housing rent. According to media, the proposed deductible amounts are much more than expectations.

Entrepreneur Confidence Index for the secondary industry dropped from 130.3 in 2Q18 to a three-quarter low of 127.3 in 3Q18, indicating that Chinese entrepreneurs have become less optimistic recently.

Growth of the manufacturing sector has continued to decelerate in recent months. PMI fell from 51.3 in August to 50.8 in September, and further to 50.2 in October, the lowest level since August 2017.

October NMI indicates a recent moderation in the growth of the non-manufacturing sector. NMI dropped to 53.9 in October, the lowest level since September last year.

Foreign Trade

Both exports and imports maintained strong growth in 3Q18. Exports grew by 11.6% yoy, while imports rose by 20.7% yoy in the quarter.

Exports to US recorded double-digit growth in 1-3Q18. Growth of exports to the US was 13.0% yoy in 1-3Q18, compared to 11.5% yoy in 2017.

Exports from Guangdong and Shanghai posted relatively slow growth in 1-3Q18. Exports from Guangdong and Shanghai expanded by 6.4% yoy and 5.9% yoy, respectively, in 1-3Q18, lower than the country's total export growth (12.2% yoy) during the period.

FDI increased by 2.9% yoy to 636.7 billion yuan in 1-3Q18. FDI in the Hi-Tech industries grew by 6.8% yoy to 143.3 billion yuan, accounting for 22.5% of the total FDI during the period.

Foreign exchange reserves decreased by US\$ 25.1 billion in 3Q18. This was the second quarter in a row that the foreign exchange reserves posted a quarter-on-quarter drop.

China-US trade war is rapidly escalating. On 17 September, the US announced to levy additional tariffs, at 10% effective 24 September and 25% effective 1 January 2019, on US\$200 billion of Chinese imports. Together with the first round of US tariffs on US\$50 billion of Chinese goods imposed earlier, approximately US\$250 billion worth of Chinese goods would face extra tariffs. Less than 24 hours later, the Chinese government announced retaliatory tariffs of 5% or 10% on US\$60 billion worth of US imports effective 24 September.

Chinese yuan has depreciated further against US dollar in recent months. So far this year, the USD-CNY spot exchange rate has depreciated by 5.48% (as of 2 November).

On 1 November, the Chinese government reduced the most-favored-nation tariff rates for the imports of 1,585 tariff items. These 1,585 tariff items include a wide range of industrial products and materials such as engineering machinery, instruments, meters, textile products, building materials and paper products.

A Recent developments

1. China's real GDP growth moderates to lowest level since 2Q09

China's real GDP growth fell from 6.7% year-on-year (yoy) in 2Q18 to 6.5% yoy in 3Q18, the lowest level since 2Q09, indicating that the country's economic growth has further decelerated amid the escalating China-US trade war and the Chinese government's deleveraging efforts (see exhibit 1). Overall, in 1-3Q18, China's nominal GDP amounted to 65.1 trillion yuan, up by 6.7% yoy in real terms.

Both the tertiary industry and the secondary industry witnessed growth deceleration in 1-3Q18. The real growth rate for the value-added of the tertiary industry came in at 7.7% yoy in 1-3Q18, lower than the 8.0% yoy growth in 2017. In the meantime, the real growth rate for the value-added of the secondary industry was 5.8% yoy in 1-3Q18, down from the 6.1% yoy growth in 2017.

In 1-3Q18, final consumption expenditure contributed 5.2 ppts to the real GDP growth, while gross capital formation contributed 2.1 ppts. These figures show that China has been shifting towards a consumption-led economy.

In response to the negative impact of the escalating China-US trade war on the Chinese economy, China's central government has taken a series of measures to boost domestic demand. For example, to accelerate construction of infrastructure, the central government has urged local governments to speed up the issuance of 1.35 trillion yuan of special bonds and the use of funding obtained through the bonds. In addition, on 15 October, China's central bank cut the reserve requirement ratios (RRRs) of some financial institutions in China by 100 bps. Besides, the Standing Committee of the National People's Congress passed the 'Amendments to the Individual Income Tax Law' on 31 August. The minimum threshold for individual income tax has been raised and the tax brackets of the three lowest grades have been widened. This would help reduce the tax burden on low- and middle-income earners.

Going forward, we predict that the real GDP growth will decelerate further to 6.4% yoy in 4Q18.

Exhibit 1 China's real GDP growth, 4Q17 to 3Q18

yoy growth (%)



Source: National Bureau of Statistics, PRC

2. Growth in retail sales rebounds

According to the National Bureau of Statistics, the growth in China's total retail sales of consumer goods rebounded from 8.8% yoy in July to 9.0% yoy in August, and further to 9.2% yoy in September. The month-on-month (mom) growth in seasonally-adjusted retail sales stayed relatively high at 0.84%, 0.82% and 0.80% respectively in July, August and September respectively.

Overall, in 1-3Q18, the total retail sales of consumer goods reached 27,429.9 billion yuan. The growth rate

was 9.3% yoy in 1-3Q18, lower than the 10.2% yoy growth recorded in 2017 (see exhibits 2 and 3).

China's online retail sales of goods increased by 27.7% yoy to reach 4,793.8 billion yuan in 1-3Q18. Consequently, the share of online retail sales in the total retail sales of consumer goods went up to 17.5% in 1-3Q18 from 15.0% in 2017, indicating the rapidly growing popularity of online shopping.

Exhibit 2 China's total retail sales, year-on-year nominal growth, October 2016 to September 2018



Source: National Bureau of Statistics, PRC

Exhibit 3 China's total retail sales, month-on-month nominal growth, April to September 2018

mom growth (%), seasonally adjusted

	Apr 18	May	Jun	Jul	Aug	Sep
Total retail sales	0.79	0.41	0.80	0.84	0.82	0.80

Source: National Bureau of Statistics, PRC

Both rural and urban retail sales have increased at a slower pace: the growth in rural retail sales moderated to 10.4% yoy in 1-3Q18 from 11.8% yoy in 2017. In the meantime, the growth in urban retail sales decelerated to 9.1% yoy in 1-3Q18 from 10.0% yoy in 2017.

The growth in catering services sales came in at 9.8% yoy in 1-3Q18, down from 10.7% yoy in 2017. Meanwhile, the growth in sales of goods decelerated to 9.2% yoy in 1-3Q18 from 10.2% yoy in 2017.

The growth rate for the retail sales of goods by enterprises above a designated size¹, which amounted to 9,809.9 billion yuan in 1-3Q18, decelerated to 6.9% yoy in 1-3Q18 from 8.2% yoy in 2017. Among products, 'petroleum and related products' saw the strongest growth in sales (14.4% yoy) in 1-3Q18, followed by 'products for daily use' (13.4% yoy). In contrast, sales of 'sports and entertainment products' registered a negative growth of minus 1.3% yoy. Exhibit 5 demonstrates the growth in China's retail sales by product among enterprises above a designated size.

Exhibit 4 China's total retail sales, 2017 to 1-3Q18

Nominal growth, yoy (%)	FY17	1Q18	1H18	1-3Q18
Total retail sales	10.2	9.8	9.4	9.3
- Goods	10.2	9.8	9.3	9.2
Sales by enterprises above a designated size	8.2	8.6	7.6	6.9
Online sales	28.0	34.4	29.8	27.7
- Catering services	10.7	10.3	9.9	9.8

Source: National Bureau of Statistics, PRC

3. Chinese consumers become less optimistic

The consumer confidence index² fell from 122.9 in May to a ten-month low of 118.2 in June, and then stayed low at 118.6 and 118.5 in August and September respectively. These figures indicate that Chinese consumers have become less optimistic recently (see exhibit 6).

4. Both rural and urban households see high single-digit growth in income in 1-3Q18

Both rural and urban households continued to see high single-digit nominal growth in income in 1-3Q18. The per capita disposable income of rural households grew nominally by 8.9% yoy (or 6.8% yoy real) to reach 10,645 yuan; while the per capita disposable income of urban households rose by 7.9% yoy in nominal terms (or 5.7% yoy real) to reach 29,599 yuan in 1-3Q18.

With higher income, both rural and urban households had more room to increase their consumption expenditures. In particular, the per capita consumption expenditure of rural households, which reached 8,538 yuan in 1-3Q18, posted double-digit growth of 12.0% yoy in nominal terms (or 9.8% yoy real). Meanwhile, the per capita consumption expenditure of urban households grew by 6.5% yoy in nominal terms (or 4.3% yoy real) to reach 19,014 yuan in 1-3Q18.

¹ 'Enterprises above a designated size' refers to enterprises with annual sales of 5 million yuan or more and with an employee strength of 60 or more.

² A reading above 100 indicates that consumers tend to be optimistic; a reading below 100 indicates that consumers tend to be pessimistic.

Exhibit 5

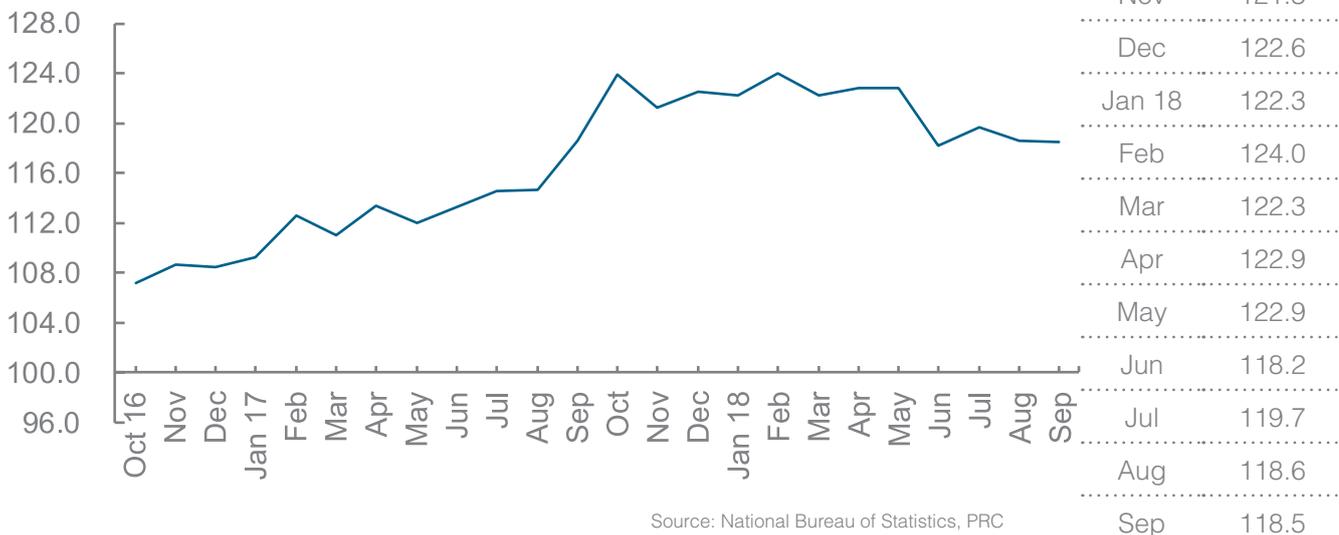
China's retail sales by enterprises above a designated size, by product, 2017 to 1-3Q18

Nominal growth, yoy (%)	FY17	1Q18	1H18	1-3Q18
Grain, oil and food	10.2	10.1	9.8	10.3
Beverages	10.3	9.1	9.6	9.2
Tobacco and liquor	7.9	9.2	8.9	8.6
Clothing, shoes, hats and textiles	7.8	9.8	9.2	8.9
Cosmetics	13.5	16.1	14.2	12.0
Gold, silver and jewellery	5.6	7.9	7.4	8.7
Products for daily use	8.0	12.3	12.6	13.4
Sports and entertainment products	15.6	1.3	-0.1	-1.3
Home appliances and video equipment	9.3	11.4	10.6	8.2
Chinese and Western medicines	12.4	10.4	9.3	9.1
Stationery and office accessories	9.8	4.0	6.6	5.7
Furniture	12.8	9.3	10.1	10.1
Telecommunications equipment	11.7	7.7	10.6	10.7
Petroleum and related products	9.2	9.1	11.9	14.4
Automobiles	5.6	7.4	2.7	0.2
Building and decoration materials	10.3	8.0	8.1	7.8

Source: National Bureau of Statistics, PRC

Exhibit 6

China's consumer confidence index, October 2016 to September 2018



Source: National Bureau of Statistics, PRC

5. CPI growth rises to seven-month high

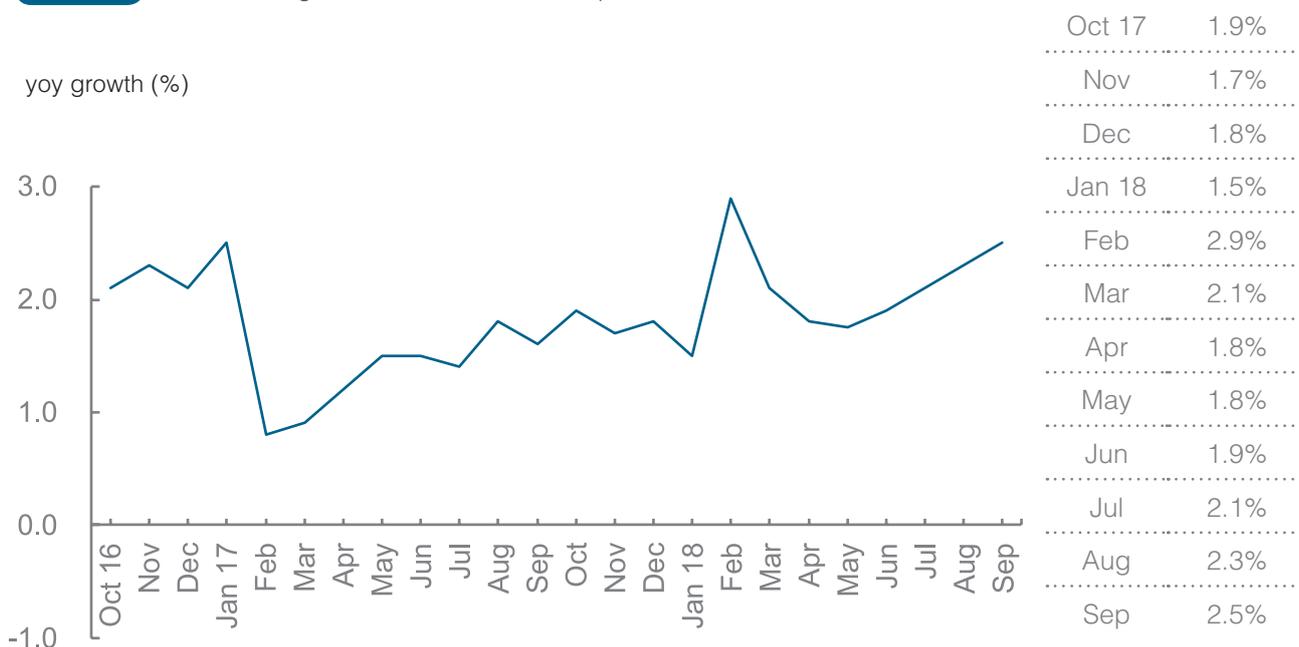
The year-on-year growth rate of China's consumer price index (CPI)³ went up from 2.3% in August to a seven-month high of 2.5% in September, which was in line with market expectations (see exhibits 7 & 8).

The reason for the rise in the CPI growth in September was that a faster increase in food prices outweighed a slower growth in non-food prices in the month. The year-on-year growth in the food component in the CPI climbed from 1.7% in August to 3.6% in September, due largely to a jump in vegetable prices amid bad weather and a slower year-on-year drop in pork

prices affected by the African swine fever outbreaks. Meanwhile, the year-on-year growth in the non-food component fell from 2.5% in August to 2.2% in September.

In our view, China's retaliatory tariffs on US\$110 billion worth of US imports⁴ and the recent depreciation of the Chinese yuan are likely to push up import prices, especially food prices, further. Thus, we expect that China's CPI growth will trend slightly upward in the coming months.

8 **Exhibit 7** China's CPI growth, October 2016 to September 2018



Source: National Bureau of Statistics, PRC

³ The CPI, compiled by the National Bureau of Statistics (NBS) of China, measures the price of a basket of goods and services purchased by a typical household. It is noteworthy that the NBS has changed the weights assigned to the various components in the CPI basket, effective from January 2016. The weight of the food component, for example, has been reduced by 3.2 ppt; the weight of the housing component has been increased by 2.2 ppt; and the weights of other components have been adjusted by around or less than 1 ppt. The impact of the re-weighting on the CPI growth was limited, according to the NBS.

⁴ Of which, tariffs on US\$34 billion of US goods kicked in on 6 July, US\$16 billion took effect on 23 August, and US\$60 billion became effective on 24 September.

Exhibit 8China's CPI growth by commodity, April to September 2018⁵

yoy growth (%)	Apr 18	May	Jun	Jul	Aug	Sep
Food, tobacco and liquor	1.1	0.7	0.8	1.0	1.9	3.0
Clothing	1.1	1.1	1.1	1.2	1.3	1.2
Housing	2.2	2.2	2.3	2.4	2.5	2.6
Household goods and services	1.5	1.5	1.5	1.6	1.6	1.6
Transportation and communication	1.1	1.8	2.4	3.0	2.7	2.8
Education, culture and recreational activities	2.0	1.9	1.8	2.3	2.6	2.2
Medical and healthcare	5.2	5.1	5.0	4.6	4.3	2.7
Other goods and services	0.9	1.0	0.9	1.2	1.2	0.7

Source: National Bureau of Statistics, PRC

The year-on-year growth in China's producer price index of industrial products (PPI) eased from 4.1% in August to 3.6% in September (see exhibits 9 & 10). On a month-on-month basis, the PPI jumped by 0.6% in September, a larger increase than the 0.4% growth recorded in the previous month. The increase in the PPI in the month was caused mainly by higher ex-factory prices in the oil and chemical industries amidst higher global crude prices in recent months.

In our view, the retaliatory tariffs levied on US\$110 billion worth of US goods by China and the recent depreciation of the Chinese yuan would raise the

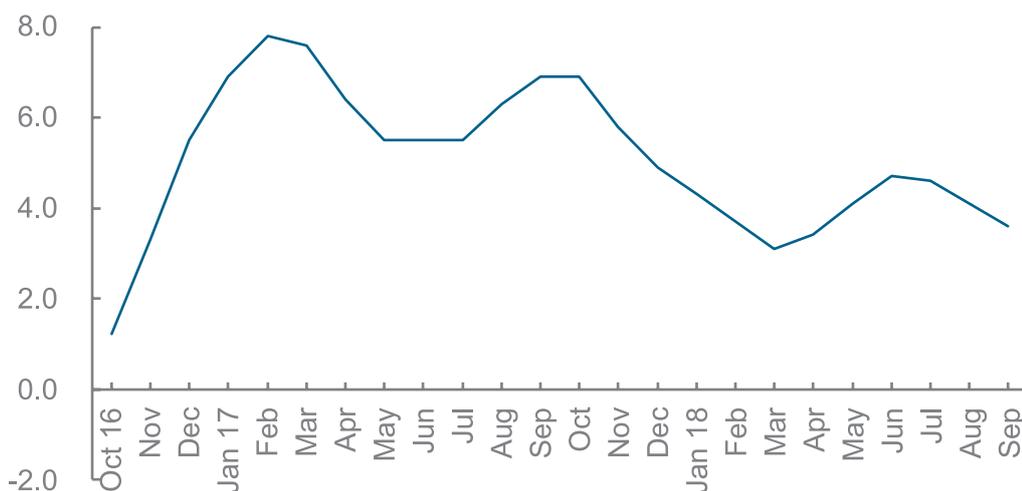
import prices of raw materials and intermediate goods, thereby putting inflationary pressures on ex-factory prices of industrial products. That being said, we expect that the year-on-year growth in the PPI will continue to fall in the fourth quarter, due partly to a higher base for comparison in the same period last year.

⁵ The NBS has re-categorized the categories in the CPI basket, effective from January 2016. For example, the old category of 'household goods and maintenance services' has been re-categorized into a new category called 'household goods and services' and the category of 'other goods and services'. The old category of 'recreational, educational products and services' has been re-categorized into a new category called 'education, culture and recreational activities' and the category of 'other goods and services'.

Part 1 : Domestic Trade

Exhibit 9 China's PPI growth, October 2016 to September 2018

yoy growth (%)



Oct 17	6.9%
Nov	5.8%
Dec	4.9%
Jan 18	4.3%
Feb	3.7%
Mar	3.1%
Apr	3.4%
May	4.1%
Jun	4.7%
Jul	4.6%
Aug	4.1%
Sep	3.6%

Source: National Bureau of Statistics, PRC

Exhibit 10 China's PPI growth by selected industry, April to September 2018

yoy growth (%)

	Apr 18	May	Jun	Jul	Aug	Sep
Textile	1.7	1.9	2.1	2.3	3.0	3.1
Textile wearing apparel and ornament	0.5	0.6	0.6	1.1	1.3	1.4
Processing of timbers, manufacture of wood, bamboo, rattan, palm, and straw products	1.6	1.7	1.9	2.0	2.2	2.2

Source: National Bureau of Statistics, PRC

The year-on-year growth rate of the purchaser price index of industrial products slowed from 4.8% in August to 4.2% in September (see exhibits 11 & 12). On a month-on-month basis, the purchaser price index went up by 0.6% in September, posting month-on-month rise for five consecutive months.

In our view, China's tariffs imposed on US\$110 billion worth of US imports and the Chinese yuan's recent weakness would lead to a rise in the prices of imported production inputs. That being said, the year-on-year growth in the purchaser price index is likely to drop further in the rest of the year, due mainly to a higher comparison base in the same period last year.

Exhibit 11

Growth in China's purchaser price index of industrial products, October 2016 to September 2018

yoy growth (%)



Oct 17	8.4%
Nov	7.1%
Dec	5.9%
Jan 18	5.2%
Feb	4.4%
Mar	3.7%
Apr	3.7%
May	4.3%
Jun	5.1%
Jul	5.2%
Aug	4.8%
Sep	4.2%

Source: National Bureau of Statistics, PRC

Exhibit 12

China's purchaser price index of industrial products by selected commodity, April to September 2018

yoy growth (%)	Apr 18	May	Jun	Jul	Aug	Sep
Fuel and power	4.6	5.5	8.1	9.9	9.7	9.2
Non-ferrous metal materials and wires	6.4	7.6	7.9	5.6	2.5	-0.4
Chemical raw materials	4.2	5.3	5.8	5.7	6.1	5.8
Wood and pulp	7.0	7.8	7.4	7.1	6.6	4.5
Textile raw materials	1.7	1.7	2.1	2.4	2.6	2.9

Source: National Bureau of Statistics, PRC

6. Growth in industrial production decelerates to 5.8% in September

After accelerating slightly from 6.0% yoy in July to 6.1% yoy in August, the growth rate for China's industrial production (IP), measured by the value-added of industrial output (VAIO), decelerated to 5.8% yoy in September, the lowest level since March 2016 (see exhibit 13).⁶ Overall, in 1-3Q18, China's IP expanded by 6.4% yoy, lower than the 6.6% yoy growth recorded in 2017.

Looking ahead, we expect that the industrial production (VAIO) growth will fluctuate within a lower range of 5.5% yoy to 6.0% yoy in 4Q18, as both domestic demand and export demand have moderated recently and the government will limit production by key polluting industries in the winter.

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7. Growth of industrial profits decelerates sharply

The growth rate for the total profits earned by large and medium industrial enterprises above a designated size decelerated from 20.0% yoy in June to 16.2% yoy in July, and then fell to 9.2% yoy in August and 4.1% yoy in September.

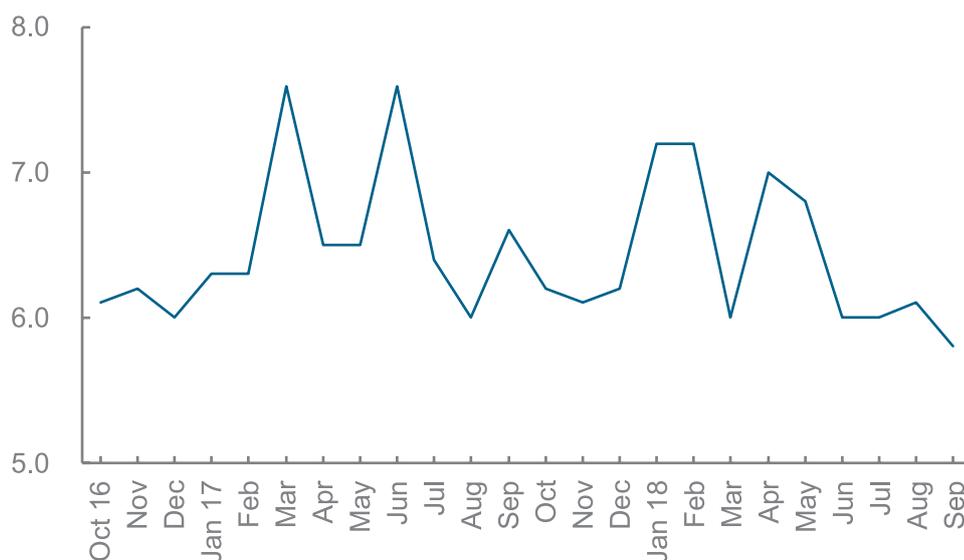
In the first nine months of 2018, China's industrial profits totalled 4,971.3 billion yuan, up by 14.7% yoy, compared to the growth rate of 21.0% yoy in 2017 (see exhibit 14).

The deceleration in profit growth in recent months was due largely to a slower growth in revenue and a faster rise in prices of production inputs.

Among sectors, in the January to September period, profits of the manufacturing sector rose by 12.5% yoy to 4,208.3 billion yuan; profits of the mining sector increased by 50.0% yoy to 429.6 billion yuan; and profits of the 'electricity, heat, gas and water' sector grew by 8.8% yoy to 333.5 billion yuan.

Exhibit 13 China's industrial production growth, October 2016 to September 2018

yoy growth (%)



Oct 17	6.2%
Nov	6.1%
Dec	6.2%
Jan-Feb 18	7.2%
Mar	6.0%
Apr	7.0%
May	6.8%
Jun	6.0%
Jul	6.0%
Aug	6.1%
Sep	5.8%

Source: National Bureau of Statistics, PRC

⁶ The National Bureau of Statistics has changed the method of compiling the value added for industry (industrial production, IP), effective January 2011. The statistical threshold for industrial enterprises has been raised to cover those with annual revenues of 20 million yuan or above, up from the previous threshold of 5 million yuan or above.

⁷ 'Industrial enterprises above a designated size' refers to industrial enterprises with annual sales of 20 million yuan or more.

Exhibit 14 China's industrial profits growth, April to September 2018

<i>yoy growth (%)</i>	Apr 18	May	Jun	Jul	Aug	Sep
Total profits made by industrial enterprises above a designated size	21.9	21.1	20.0	16.2	9.2	4.1

Source: National Bureau of Statistics, PRC

8. Fixed asset investment growth falls in 1-3Q18

The growth in China's nominal fixed asset investment (FAI) (excluding rural households) fell to 5.4% yoy in 1-3Q18 from 7.2% yoy in 2017.⁸ Overall, in 1-3Q18, China's nominal FAI (excluding rural households) amounted to 48.3 trillion yuan (*see exhibit 15*).

The drop in the overall FAI growth was largely attributable to the deceleration of FAI growth for infrastructure (excluding power, heat, gas and water infrastructure), which fell markedly to 3.3% yoy in 1-3Q18 from 19.0% yoy in 2017.

In contrast, the growth in FAI (excluding rural households) for the manufacturing sector accelerated to 8.7% yoy in 1-3Q18 from 4.8% yoy in 2017; the growth in FAI (excluding rural households)

in real estate development went up to 9.9% yoy in 1-3Q18 from 7.0% yoy in 2017.

Looking ahead, we expect that the trend of China's FAI growth will depend largely on infrastructure investment, which has witnessed a sharp growth deceleration since early this year. To boost economic growth, China's central government has recently urged local governments to speed up the issuance of 1.35 trillion yuan of special bonds and the use of funding obtained through the bonds. This move is likely to lend support to the growth of infrastructure investment.

Exhibit 15 China's FAI (excluding rural households) growth, April to September 2018

	Apr 18	May	Jun	Jul	Aug	Sep
FAI (excluding rural households) <i>(year-to-date, yoy growth %)</i>	7.0	6.1	6.0	5.5	5.3	5.4
FAI (excluding rural households) <i>(mom growth %, seasonally adjusted)</i>	0.40	0.40	0.43	0.42	0.41	0.43

Source: National Bureau of Statistics, PRC

⁸ The National Bureau of Statistics has expanded coverage of the monthly statistics for FAI from the urban areas to rural enterprises and institutions, effective from 2011. Thus: 'FAI (excluding rural households)', the new indicator, has been released by the bureau as from March 2011 to replace 'urban FAI', the previous indicator. Also, a new statistical criterion has been adopted. The statistical threshold for the size of investment projects has been adjusted upwards from 500,000 yuan to 5 million yuan.

B Highlights

1. China proposes details about tax-deductible items for Individual Income Tax

On 31 August, the Standing Committee of the National People's Congress passed the '*Amendments to the Individual Income Tax Law*', effective from 1 January 2019. One of the major amendments is to increase tax-deductible items, including expenses on children's education, continuing education, medical treatments for serious illnesses, housing mortgage interest and housing rent.

Afterwards, on 20 October, the Ministry of Finance and the State Administration of Taxation jointly published the '*Temporary Measure on Special Additional Deductions for Individual Income Tax (consultation draft)*', proposing the details for each type of tax-deductible expense (see *exhibit 16*).⁹

According to media, the proposed deductible amounts are much more than expectations. The measure, if carried out on 1 January next year based on the consultation draft, can boost disposable income of low- and middle- income earners next year, which bodes well for consumption in China.

2. Both broad money supply and total outstanding RMB loans grow at a faster pace

Both the broad money supply (M2) and the total outstanding RMB loans have grown at a faster pace recently, attributable to Chinese central bank's easing measures. The M2 growth accelerated to 8.3% yoy as

at the end of September, compared to 8.0% yoy as at the end of June (see *exhibit 17*). The growth rate of the total outstanding RMB loans was 13.2% yoy as at the end of September, higher than the 12.7% yoy growth as at the end of June. Overall, in 1-3Q18, the rise in the total outstanding RMB loans amounted to 13.14 trillion yuan, higher than the increase seen in the same period of the previous year (i.e. 11.16 trillion yuan).

China's central bank has continued to take moves to ensure adequate liquidity in the banking system in the country recently. On 15 October, it reduced the reserve requirement ratios (RRRs) of some financial institutions in China by 100 bps, which was its third RRRs cut in six months. Going forward, China's central bank is likely to increase its efforts to ease the financing problem facing enterprises, especially private enterprises. According to an interview with its Governor Yi Gang published on 19 October, the central bank will use various types of monetary policy instruments to support commercial banks for increasing loans to private enterprises.¹⁰

⁹ http://www.gov.cn/xinwen/2018-10/20/content_5332914.htm

¹⁰ <http://www.pbc.gov.cn/english/130721/3647907/index.html>

Exhibit 16 Details of tax-deductible items

	Deduction from taxable income per year
Expenses on children's education	12,000 yuan per child (fixed amount)
Expenses on continuing education	
- Academic education	4,800 yuan (fixed amount)
- Education for vocational qualification	3,600 yuan (fixed amount)
Expenses on medical treatments for serious illnesses	Maximum: 60,000 yuan (the part of actual expense in excess of 15,000 yuan)
Housing mortgage interest	12,000 yuan (fixed amount)
Housing rent	
- For flat in municipality, or provincial capital city, or city listed in the state plan or other city designated by the State Council	14,400 yuan (fixed amount)
- For flat in city with a registered urban population of over 1 million	12,000 yuan (fixed amount)
- For flat in city with a registered urban population of 1 million and below	9,600 yuan (fixed amount)
Parents' living expenses	24,000 yuan (fixed amount)

Source: State Administration of Taxation

Exhibit 17 Broad money supply (M2) and RMB loans, October 2017 to September 2018

As of	Broad money supply (M2)		Total outstanding RMB loans		Increase in RMB loans (trillion yuan)	
	Amount (trillion yuan)	yoy growth	Amount (trillion yuan)	yoy growth	FY17	13.53
End-Oct 17	165.3	8.8%	118.4	13.0%	Oct 17	0.66
End-Nov	167.0	9.1%	119.6	13.3%	Nov	1.12
End-Dec	167.7	8.2%	120.1	12.7%	Dec	0.58
End-Jan 18	172.1	8.6%	123.0	13.2%	Jan 18	2.90
End-Feb	172.9	8.8%	123.9	12.8%	Feb	0.84
End-Mar	174.0	8.2%	125.0	12.8%	Mar	1.12
End-Apr	173.8	8.3%	126.2	12.7%	Apr	1.18
End-May	174.3	8.3%	127.3	12.6%	May	1.15
End-Jun	177.0	8.0%	129.2	12.7%	Jun	1.84
End-Jul	177.6	8.5%	130.6	13.2%	Jul	1.45
End-Aug	178.9	8.2%	131.9	13.2%	Aug	1.28
End-Sep	180.2	8.3%	133.3	13.2%	Sep	1.38

Source: People's Bank of China

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3. 'Total social financing' increases at a faster pace in August and September

The increase in 'total social financing' (covering sources of financing such as RMB loans to the real sector, foreign currency loans to the real sector, trust loans, entrusted loans, bank acceptance bills, corporate bonds, local government special bonds, equity issuance, asset-backed securities of depository financial institutions, written-off loans and other instruments) amounted to 15.8 trillion yuan in 1-3Q18, smaller than the increase seen in the same period of the previous year (i.e. 17.7 trillion yuan) (see exhibit 18).¹¹

However, taking a closer look at the monthly figures, the 'total social financing' increased at a faster pace in the past few months, up by 1.2 trillion yuan, 1.9 trillion yuan and 2.2 trillion yuan in July, August and September respectively. This could be highly associated with the quicker issuance of local government special bonds, which rose by 185.1 billion yuan, 410.6 billion yuan and 738.9 billion yuan in July, August and September respectively.

¹¹ The People's Bank of China has changed the statistical method of the total social financing recently, incorporating 'local government special bonds', 'asset-backed securities of depository financial institutions' and 'written-off loans'. Consequently, the figures of the total social financing have been readjusted.

Exhibit 18

Increase in total social financing, 2017 to 1-3Q18

	2017		1-3Q18	
	Amount (billion yuan)	Share (%)	Amount (billion yuan)	Share (%)
Total social financing	22,397.0	100.0	15,370.0	100.0
- RMB loans to the real sector	13,843.2	61.8	12,800.0	83.3
- Foreign currency loans to the real sector	1.8	0.0	-191.3	-1.2
- Trust loans	2,255.5	10.1	-465.2	-3.0
- Entrusted loans	777.0	3.5	-1,160.0	-7.5
- Bank acceptance bills	536.4	2.4	-678.6	-4.4
- Corporate bonds	442.1	2.0	1,590.0	10.3
- Local government special bonds	1,996.2	8.9	1,700.0	11.1
- Equity issuance	875.9	3.9	309.1	2.0
- Asset-backed securities of depository financial institutions	197.7	0.9	309.3	2.0
- Written-off loans	758.6	3.4	645.5	4.2

Source: People's Bank of China

C Outlook

1. Chinese entrepreneurs become less optimistic

China's Entrepreneur Confidence Index (ECI) for the secondary industry dropped from 130.3 in 2Q18 to a three-quarter low of 127.3 in 3Q18, indicating that Chinese entrepreneurs have become less optimistic recently (*see exhibit 19*).¹²

By sector, the ECIs for the 'electricity, gas and water' and the 'manufacturing' sectors recorded a quarter-on-quarter fall, down by 1.5 pts and 3.3 pts respectively in 3Q18. Meanwhile, the ECI for the 'mining' sector rose by 0.4 pts in the same quarter (*see exhibit 20*).

2. Growth of manufacturing sector decelerates

China's manufacturing PMI fell from 51.3 in August to 50.8 in September, and further to 50.2 in October, the lowest level since August 2017, indicating that growth of the manufacturing sector in China has continued to decelerate in recent months (*see exhibit 21*).

The new orders index fell slightly from 52.2 in August to 52.0 in September, and further to 50.8 in October, showing that the growth of overall new orders has moderated lately.¹³ Meanwhile, the new export orders index dropped from 49.4 in August to 48.0 in September, and then fell to 46.9 in October, the lowest level since February 2016. The low index reading in October shows that new export orders have decreased at a faster pace recently, apparently due to the escalating China-US trade frictions.

Against the backdrop of moderating growth of overall new orders, the output index dropped from 53.0 in September to 52.0 in October, indicating that the output has also posted weaker growth recently.

The purchases of inputs index fell from 51.8 in August to 51.5 in September, and further to 51.0 in October, indicating that the growth of purchasing activities has moderated lately.

The stocks of finished goods index stayed relatively high, at between 47.1 and 47.4, throughout July to October, showing that the stocks of finished goods held by manufacturers have decreased at a relatively slow pace in recent months. In the meantime, the stocks of major inputs index went down from 48.7 in August to 47.8 in September, and fell further to 47.2 in October, the lowest level since July 2016. The downtrend indicates that stocks of major inputs have decreased at a faster pace in recent months.

The input prices index climbed from 58.7 in August to 59.8 in September, and then stayed high at 58.0 in October, indicating that the prices of materials have gone up at a relatively fast pace in recent months. Meanwhile, the ex-factory prices index came in at 52.0 in October, down from 54.3 in August and in September. Consequently, the difference between the input prices index and the ex-factory prices index widened from 4.4 pts in August to 5.5 pts in September and 6.0 pts in October, indicating that the prices of materials have been rising faster than the prices of industrial products. This would have adverse impact on profitability of Chinese manufacturers.

The business expectations index fell from 57.0 in August to 56.4 in September and in October. The relatively low readings in the past two months indicate that purchasing managers have been less optimistic recently.

Exhibit 19 China's Entrepreneur Confidence Index (Secondary Industry), 4Q16 to 3Q18

	4Q16	1Q17	2Q17	3Q17	4Q17	1Q18	2Q18	3Q18
Entrepreneur Confidence Index (Secondary Industry)	115.4	129.2	127.3	127.3	126.0	132.9	130.3	127.3

Source: National Bureau of Statistics, PRC

¹² China's Entrepreneur Confidence Index (ECI) ranges from 0 to 200. A reading above 100 indicates that entrepreneurs tend to be optimistic; a reading below 100 indicates that they tend to be pessimistic.

¹³ The 'new orders index' covers both domestic and export orders. That is to say, the manufacturers are not asked to differentiate between domestic and export orders when filling in questionnaires.

Exhibit 20 Entrepreneur Confidence Index by sector, 3Q18

	3Q18	Compared with the previous quarter
Secondary industry	127.3	Lower
Mining	117.4	Higher
Manufacturing	127.3	Lower
Electricity, gas & water	136.8	Lower

Source: National Bureau of Statistics, PRC

3. October NMI indicates growth moderation of non-manufacturing sector

China's Business Activity Index, which is quoted as the Non-manufacturing Purchasing Managers' Index (NMI), rose from 54.2 in August to 54.9 in September, but then dropped to 53.9 in October, the lowest level since September last year. The latest figure indicates a recent moderation in the growth of the non-manufacturing sector (see exhibit 22).

The new orders index fell from 51.0 in September to 50.1 in October, showing a growth slowdown of new orders. Nevertheless, the sales prices index registered 51.2 in October, above the critical 50-mark, showing that enterprises have managed to raise their service charges lately. Meanwhile, the input prices index climbed to 55.6 in September, the highest level since December last year, and then stayed high at 54.9 in October, indicating that the input prices have increased at a relatively fast pace recently.

The business expectation index was 60.6 in October, well above the critical 50-mark, suggesting that purchasing managers in the non-manufacturing sector have stayed optimistic about the near-term outlook for their respective industries.

Exhibit 21 China's manufacturing PMI at a glance, October 2018

Index	Seasonally Adjusted Index	Index Compared with the Previous Month	Direction
PMI	50.2	Lower	Expanding
Output	52.0	Lower	Expanding
New Orders	50.8	Lower	Expanding
New Export Orders	46.9	Lower	Contracting
Backlogs of Orders	44.3	Lower	Contracting
Stocks of Finished Goods	47.1	Lower	Contracting
Purchases of Inputs	51.0	Lower	Expanding
Imports	47.6	Lower	Contracting
Input Prices	58.0	Lower	Rising
Stocks of Major Inputs	52.0	Lower	Rising
Ex-factory Prices	47.2	Lower	Contracting
Employment	48.1	Lower	Contracting
Suppliers' Delivery Time	49.5	Lower	Slowing
Business Expectations	56.4	Unchanged	Optimistic

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

Exhibit 22 China's non-manufacturing purchasing managers' index (NMI) at a glance, October 2018

Index	Seasonally Adjusted Index	Index Compared with the Previous Month	Direction
Business activity	53.9	Lower	Expanding
New orders	50.1	Lower	Expanding
Input prices	54.9	Lower	Rising
Sales prices	51.2	Lower	Rising
Business expectations	60.6	Higher	Optimistic

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

A Recent developments

1. Both exports and imports maintain strong growth in 3Q18

Amid the escalating China-US trade war, China's exports maintained strong growth of 11.6% yoy in 3Q18, compared to the 11.8% yoy growth recorded in 2Q18 (see exhibits 23, 24 and 25). A possible reason for the strong export figure was that Chinese exporters were front-loading shipments to the US to get ahead of expected tariffs.¹⁴ Overall, in 1-3Q18, China's exports amounted to US\$ 1,826.7 billion, up by 12.2% yoy.

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Compared to 2017, China's exports to the US managed to grow at a faster pace in 1-3Q18, despite the fact that the US has started to impose extra tariffs on Chinese products since July this year. Growth of China's exports to the US was 13.0% yoy in 1-3Q18, up from 11.5% yoy in 2017. Meanwhile, China's exports to its other major trading partners such as the EU, Japan and the ASEAN also showed improvement in 1-3Q18. Growth of China's exports to the EU, Japan and the ASEAN accelerated to 11.6% yoy, 8.5% yoy and 17.3% yoy respectively in 1-3Q18, up from 9.7% yoy, 6.1% yoy and 9.0% yoy respectively in 2017.

The growth rate for China's imports was 20.7% yoy in 3Q18, slightly higher than the 20.2% yoy growth in 2Q18. Nevertheless, taking a closer look at the monthly figures, the import growth decelerated from 27.3% yoy in July to 20.0% yoy in August and 14.3% yoy in September. The fall in the import growth showed that the domestic demand for imported goods has moderated in recent months. Overall, in 1-3Q18, China's imports totalled US\$ 1,605.3 billion, up by 20.0% yoy.

China's trade surplus dropped slightly from US\$ 95.3 billion in 2Q18 to US\$ 87.6 billion in 3Q18. The reason for the fall in trade surplus in 3Q18 was that imports had increased by more than the increase in exports in the quarter. In 3Q18, China's imports rose by US\$ 37.3 billion, while China's exports increased by US\$ 29.6 billion.

Exhibit 23 China's quarterly foreign trade data, 4Q17 to 3Q18

USD billion (yoy growth)

	Exports		Imports		Trade Balance
FY17	2,263.5	(7.9%)	1,841.0	(15.9%)	422.5
4Q17	636.7	(9.9%)	504.8	(12.5%)	131.9
1Q18	545.3	(14.1%)	497.3	(19.0%)	48.0
2Q18	630.0	(11.8%)	534.7	(20.2%)	95.3
3Q18	659.6	(11.6%)	572.0	(20.7%)	87.6

Source: China Customs

¹⁴ For example, on 10 July, the US government announced to impose extra tariffs on US\$200 billion of Chinese goods, which started to take effect on 24 September.

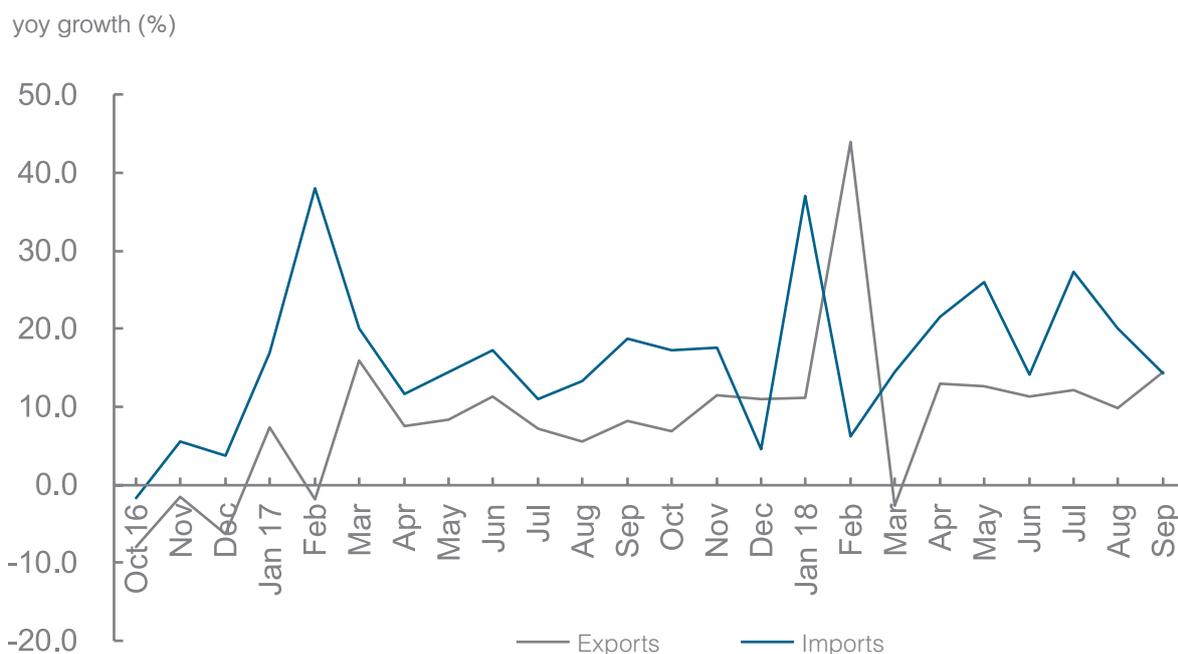
Exhibit 24 China's monthly foreign trade data, October 2017 to September 2018

USD billion (yoy growth)

	Exports		Imports		Trade Balance
October 2017	189.0	(6.9%)	150.8	(17.2%)	38.2
November	215.9	(11.5%)	176.9	(17.6%)	39.0
December	231.8	(10.9%)	177.1	(4.5%)	54.7
January 2018	200.1	(11.0%)	180.4	(37.1%)	19.7
February	171.1	(44.0%)	137.8	(6.2%)	33.3
March	174.1	(-2.7%)	179.1	(14.4%)	-5.0
April	200.4	(12.9%)	171.7	(21.5%)	28.8
May	212.9	(12.6%)	187.9	(26.0%)	24.9
June	216.7	(11.3%)	175.1	(14.1%)	41.6
July	215.6	(12.2%)	187.5	(27.3%)	28.1
August	217.3	(9.8%)	189.5	(20.0%)	27.9
September	226.7	(14.5%)	195.0	(14.3%)	31.7

Source: China Customs

Exhibit 25 Growth rates of exports and imports, October 2016 to September 2018



Source: China Customs

Exhibit 26 Exports by category, 2017 and 1-3Q18

<i>yoy growth (%) of export value, calculated in USD</i>	2017	1-3Q18
Textile materials and products	4.5	10.5
Garments and clothing accessories	-0.4	0.6
Footwear	2.0	-3.1
Toys	30.4	1.6
Coal	58.1	-36.8
Crude oil	93.2	-23.0
Refined oil	30.9	52.2
Steel	0.0	12.2
Mechanical and electrical products	9.3	13.5

Source: China Customs

Exhibit 27 Imports by category, 2017 and 1-3Q18

<i>yoy growth (%) of import value, calculated in USD</i>	2017	1-3Q18
Cereal and cereal flour	13.7	-0.2
Soybean	16.7	1.9
Iron ore	31.4	-5.4
Crude oil	39.1	43.1
Refined oil	29.8	37.7
Steel	15.3	12.3
Textile yarns, fabric and textile products	3.6	7.6
Vehicles and vehicle chassis	13.4	7.3

Source: China Customs

2. Growth rate for general trade exports decelerates in 3Q18

The year-on-year growth rate for general trade¹⁵ exports decelerated in 3Q18. The growth in general trade exports fell to 13.5% yoy in 3Q18 from 16.4% yoy in 2Q18. In contrast, the growth in processing trade¹⁶ exports rose to 8.0% yoy in 3Q18 from 6.2% yoy in 2Q18 (see exhibit 28).

On the import side, the growth in general trade imports moderated to 22.9% yoy in 3Q18 from 23.7% yoy in 2Q18. Meanwhile, the growth rate for processing trade imports accelerated to 16.7% yoy in 3Q18 from 7.7% yoy in 2Q18.

The share of processing trade in China's total trade rose to 27.9 % in 3Q18 from 25.8 % in 2Q18. With a large surplus of US\$ 76.0 billion in 3Q18, processing trade still plays an important role in China's foreign trade.

¹⁵ 'General trade' refers to China's import or export of goods by enterprises holding import-export rights. According to China's National Bureau of Statistics, the scope of general trade covers: Imports and exports using loans or aids; the import of materials by foreign invested enterprises (FIEs) for processing of goods for sale in the domestic market; the export of goods purchased by FIEs or manufactured by processing domestically-produced materials; the import of food and beverages by restaurants and hotels; the supply of domestically-produced fuels, materials, parts and components to foreign vessels or aircraft; the import of goods as payment in kind, in lieu of wages in labour service cooperation projects with foreign countries; and the export of equipment and materials by enterprises in China for their investment abroad.

¹⁶ 'Processing trade' refers to the business of importing all or part of the raw and auxiliary materials, parts and components, accessories and packaging materials from abroad, and re-exporting the finished products after processing or assembly by enterprises within the Chinese Mainland.

Exhibit 28

China foreign trade (general and processing trades), 2017 to 3Q18

Item	yoy growth (%)			Share (%)		
	FY17	2Q18	3Q18	FY17	2Q18	3Q18
Exports	7.9	11.8	11.6	100.0	100.0	100.0
Of which:						
General Trade	8.7	16.4	13.5	54.6	58.0	56.1
Processing Trade	5.9	6.2	8.0	33.4	30.3	31.8
Imports	15.9	20.2	20.7	100.0	100.0	100.0
Of which:						
General Trade	20.2	23.7	22.9	58.7	61.4	58.9
Processing Trade	8.7	7.7	16.7	23.5	20.6	23.3
Total of Imports and Exports	11.4	15.2	15.8	100.0	100.0	100.0
Of which:						
General Trade	13.8	19.7	17.8	56.4	59.5	57.4
Processing Trade	6.9	6.8	11.2	29.0	25.8	27.9

Source: China Customs

3. China's imports from US see growth deceleration in 1-3Q18

The EU was still China's largest trading partner, accounting for 14.8% of China's total foreign trade in 1-3Q18. Sino-EU trade amounted to US\$ 506.7 billion, up by 12.7% yoy in 1-3Q18. Specifically, China's exports to the EU expanded by 11.6% yoy in 1-3Q18, compared to the growth of 9.7% yoy in 2017; and China's imports from the EU increased by 14.4% yoy in 1-3Q18, compared to the growth of 17.6% yoy in 2017 (see exhibits 29 and 30).

Accounting for 13.7% of China's total foreign trade, the US continued to be China's second largest trading partner in 1-3Q18. Against the backdrop of the escalating China-US trade war, Sino-US trade expanded by 12.1% yoy to US\$ 471.8 billion in 1-3Q18. China's export growth to the US accelerated in 1-3Q18: after expanding by 11.5% yoy in 2017, China's exports

to the US grew by 13.0% yoy in 1-3Q18. In contrast, the growth of China's imports from the US decelerated from 14.5% yoy in 2017 to 9.4% yoy in 1-3Q18, due largely to a weakening in the Chinese imports of US agricultural products.

The Association of South East Asian Nations (ASEAN) accounted for 12.6% of China's total foreign trade in 1-3Q18. Sino-ASEAN trade grew by 18.6% yoy to US\$ 434.0 billion in 1-3Q18. Of which, China's exports to ASEAN rose by 17.3% yoy, while China's imports from ASEAN gained 20.1% yoy, in 1-3Q18.

Sino-Japanese trade increased by 10.7% yoy to US\$ 243.7 billion in 1-3Q18. China's exports to Japan gained 8.5% yoy, while China's imports from Japan expanded by 12.5% yoy in 1-3Q18.

4. Growth rate for China's imports from Russia accelerates significantly in 1-3Q18

China's export growth to Russia decelerated to 12.7% yoy in 1-3Q18 from 14.8% yoy in 2017. Meanwhile, China's import growth from Russia improved significantly to 39.2% yoy in 1-3Q18 from 27.7% yoy in 2017 (see exhibits 29 and 30). Consequently, the growth in China's trade with Russia rose to 25.7% yoy in 1-3Q18 from 20.8% yoy in 2017.

China's export growth to India dropped to 15.1% yoy in 1-3Q18 from 16.5% yoy in 2017, while China's import growth from India fell to 16.6% yoy in 1-3Q18 from 38.9% yoy in 2017. Overall, the growth of Sino-Indian trade decelerated to 15.4% yoy in 1-3Q18 from 20.3% yoy in 2017.

The growth in China's exports to Brazil fell to 21.8% yoy in 1-3Q18 from 31.8% yoy in 2017. In the meantime, the growth in China's imports from Brazil decelerated to 23.0% yoy in 1-3Q18 from 27.8% yoy in 2017. Consequently, the growth in Sino-Brazilian trade moderated to 22.6% yoy in 1-3Q18 from 29.1% yoy in 2017.

Together, these three BRIC members accounted for 6.5% of China's total exports and 7.0% of China's total imports in 1-3Q18, up from 6.2% and 6.3%, respectively, in 2017.

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Exhibit 29 China's trading partners, 1-3Q18

Country/ Region	Trade value (USD billion)	Share of total trade (%)	Export value (USD billion)	Import value (USD billion)	yoy growth (%)		
					Total trade	Exports	Imports
EU	506.7	14.8	301.5	205.2	12.7	11.6	14.4
US	471.8	13.7	348.8	123.0	12.1	13.0	9.4
ASEAN	434.0	12.6	233.2	200.8	18.6	17.3	20.1
Japan	243.7	7.1	107.9	135.8	10.7	8.5	12.5
Brazil	81.8	2.4	25.5	56.3	22.6	21.8	23.0
Russia	77.1	2.2	35.2	41.9	25.7	12.7	39.2
India	71.9	2.1	58.0	13.9	15.4	15.1	16.6

Source: China Customs

Exhibit 30 China's trading partners, comparing growth rates for 2017 and 1-3Q18

Country/Region	yoy growth (%)					
	Total Trade		Exports		Imports	
	2017	1-3Q18	2017	1-3Q18	2017	1-3Q18
EU	12.7	12.7	9.7	11.6	17.6	14.4
US	12.3	12.1	11.5	13.0	14.5	9.4
ASEAN	13.8	18.6	9.0	17.3	20.1	20.1
Japan	10.1	10.7	6.1	8.5	13.7	12.5
Brazil	29.1	22.6	31.8	21.8	27.8	23.0
Russia	20.8	25.7	14.8	12.7	27.7	39.2
India	20.3	15.4	16.5	15.1	38.9	16.6

Source: China Customs

5. Exports from Guangdong and Shanghai post relatively slow growth in 1-3Q18

China's top six provinces and municipalities in terms of value of exports – Guangdong, Jiangsu, Shanghai, Zhejiang, Shandong and Fujian – jointly accounted for 77.1% of China's total exports in 1-3Q18, down from 78.1% in 2017 (see exhibit 31). It is noteworthy that exports from Guangdong and Shanghai expanded by 6.4% yoy and 5.9% yoy, respectively, in 1-3Q18, lower than the country's total export growth (12.2% yoy) during the period.

Several western provinces in China witnessed robust year-on-year growth in exports in 1-3Q18. Exports from Gansu, Shaanxi and Sichuan soared by 66.7% yoy, 38.5% yoy and 41.8% yoy respectively over the period.

Exhibit 31 Top six provinces and municipalities in terms of value of exports, 1-3Q18

Provinces/ Municipalities	Value of exports (USD billion)	yoy growth (%)	Share of total exports (%)
Guangdong	514.3	6.4	28.2
Jiangsu	305.8	12.5	16.7
Zhejiang	246.6	15.5	13.5
Shanghai	134.2	5.9	7.3
Shandong	129.1	13.0	7.1
Fujian	78.2	16.3	4.3

Source: China Customs

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6. China's FDI grows by 2.9% yoy in 1-3Q18

China's foreign direct investment (FDI) in Renminbi terms increased by 8.0% yoy in September, registering positive growth for five consecutive months. Overall, in 1-3Q18, China's FDI amounted to 636.7 billion yuan, up by 2.9% yoy (see exhibit 32).

In 1-3Q18, FDI in the Hi-Tech industries grew by 6.8% yoy to 143.3 billion yuan, accounting for 22.5% of the total FDI in the period. FDI in the Hi-Tech manufacturing industries rose strongly by 22.5% yoy to 64.7 billion yuan in 1-3Q18. Of which, FDI in the 'electronics and communications equipment industry', the 'computers and office equipment industry' and the 'medical instruments, meters and equipment industry' grew rapidly by 37.5% yoy, 72.8% yoy and 64.1% yoy, respectively, during the period.

7. China's foreign exchange reserves decrease further in 3Q18

As at the end of 3Q18, China's foreign exchange reserves amounted to US\$ 3,087.0 billion, down by US\$ 25.1 billion in 3Q18 (see exhibit 33). This was the second quarter in a row that the foreign exchange reserves posted a quarter-on-quarter drop. The fall in the foreign exchange reserves in 3Q18 was due largely to mild capital outflows and a slight depreciation of non-US dollar currencies.¹⁷

Looking ahead, we predict that China's foreign exchange reserves will fall further in coming future, due to capital outflows driven by the expectation of a continuous hike in the US interest rate and an ease in China's monetary policy amid growth moderation of the Chinese economy.

¹⁷ According to the Bloomberg, the US dollar index was 95.13 on 28 September, compared to 94.47 on 29 June.

Exhibit 32 China's FDI, October 2017 to September 2018

	Amount (billion yuan)	yoy growth
FY17	877.6	7.9%
1-3Q18	636.7	2.9%
October 17	60.1	5.0%
November	124.9	90.7%
December	73.9	-9.2%
January 18	80.4	0.3%
February	59.0	0.8%
March	88.1	0.4%
April	59.2	-1.1%
May	58.8	7.6%
June	100.7	0.3%
July	50.4	14.9%
August	63.7	1.9%
September	76.3	8.0%

Source: Ministry of Commerce, PRC

Exhibit 33 Foreign exchange reserves by quarter, 4Q17 to 3Q18

USD billion	Accumulation	End of the quarter
FY17	129.4	
4Q17	31.4	3,139.9
1Q18	2.9	3,142.8
2Q18	-30.7	3,112.1
3Q18	-25.1	3,087.0

Source: State Administration of Foreign Exchange, PRC

B Highlights

1. The China-US trade war escalates

The China-US trade war is rapidly escalating. On 17 September, the US announced to levy additional tariffs, at 10% effective 24 September and 25% effective 1 January 2019, on US\$200 billion of Chinese imports. Together with the first round of US tariffs on US\$50 billion of Chinese goods imposed earlier, approximately US\$250 billion worth of Chinese goods would face extra tariffs. Less than 24 hours later, the Chinese government announced retaliatory tariffs of 5% or 10% on US\$60 billion worth of US imports effective 24 September.

The new US\$200 billion-worth product list covers 5,745 tariff items, including consumer goods such as apparel and clothing accessories made of leather, fur, plastic, and rubber, footwear, hats and headgear, handbags, travel goods, and furniture. It also includes machinery, wood products and paper, minerals and metals, chemicals, transport equipment, and agricultural products.

Moreover, US President Donald Trump has threatened to impose tariffs on another US\$267 billion of Chinese goods which, combined with earlier rounds of tariffs, would cover virtually all Chinese imports. However, Trump and Chinese President Xi Jinping both expressed willingness to resolve the trade disputes during their phone conversation on 1 November. A meeting has also been planned for the two leaders at the end of November at the upcoming G20 summit held in Argentina.

Although the Republican Party has lost control of the House of Representatives in the midterm elections held on 6 November, a major shift in Trump's China trade policy is not likely in the near term due to two reasons. First, the trade war is mainly an executive decision, as the US President is given the power to impose restrictions on foreign trade, including levying tariffs. More importantly, there is a bipartisan support from both Republicans and Democrats for a tough stance against China, especially on trade, since China is generally seen as a villain hurting US workers through 'unfair' economic and trade practices.

That being said, Trump could come under pressure to moderate his hardline position on China, as the election results and exit poll results indicate that the trade war with China might have cost support for the Republicans among voters nationwide. If the China-US trade war does escalate into a full-fledged trade war, the public perception of Trump's trade policy is likely to worsen further, which will endanger Trump's chance in his re-election bid in 2020.

Thus, it is still possible that the China-US trade disputes can be resolved through negotiations before further escalating to a full-fledged trade war, in our view. We will continue to keep a close eye on the latest developments of the China-US trade war in the coming months.

2. China raises export VAT rebate rates on a wide range of products

On 15 September 2018, the Chinese government raised the export value-added-tax (VAT) rebate rates on 397 tariff items.¹⁸ These 397 tariff items include various types of products such as multi-component semiconductors, parts of machinery products, chemical materials, stainless steel products, books, newspapers, etc.

Afterwards, on 1 November, the government increased export VAT rebate rates on more than one thousand tariff items, including agricultural products, metal products, plastic products, lamps, lubricants, aircraft tyres, carbon fibers, bricks, and fiberglass.¹⁹

The increase in the export VAT rebate rates on these products will help reduce tax costs on Chinese exporters. Therefore, this is viewed as one of the government's moves to alleviate the negative impact of the China-US trade war on Chinese exporters.

¹⁸ <http://www.chinatax.gov.cn/n810341/n810755/c3722995/content.html>

¹⁹ <http://www.chinatax.gov.cn/n810341/n810755/c3843788/content.html>

3. China lowers import tariff rates on a wide range of industrial products

On 1 November, the Chinese government reduced the most-favored-nation (MFN) tariff rates for the imports of 1,585 tariff items.²⁰ These 1,585 tariff items include a wide range of industrial products and materials such as engineering machinery, instruments, meters, textile products, building materials and paper products. According to China's state-run media Xinhua News Agency, this move would reduce the average import tariff rate on those 1,585 tariff items from 10.5% to 7.8%.²¹ The downward adjustment in the import tariff rates can help ease import tax burden on industrial enterprises and support China's import demand for industrial products and materials.

Earlier in July this year, the Chinese government reduced import tariff rates for automobiles and a number of consumer goods. The latest move confirms Chinese leaders' determination to reduce trade barriers amid the rising tide of protectionism.

4. China pledges to import US\$ 30 trillion dollar worth of goods over next 15 years

In its keynote address to the inaugural China International Import Expo made on 5 November, the Chinese President Xi Jinping pledged that China's total goods imports would amount to US\$ 30 trillion dollar over the next 15 years.²²

According to Xi, China will take a series of measures to increase its imports, including further cutting import tariffs, facilitating the process of customs clearance, reducing the institutional costs for imports and accelerating the development of cross-border e-commerce.

5. Chinese yuan depreciates further against US dollar

The Chinese yuan has depreciated further against the US dollar in recent months. The daily fixing rate (also known as the central parity rate) of the Chinese yuan against the US dollar depreciated to 6.9670 on 1 November, the weakest level since 21 May 2008, before appreciating to 6.9371 on 2 November (see exhibit 34).²³

In line with the movement of the daily fixing rate, the USD-CNY spot exchange rate has been on depreciation trend in past few months. So far this year, the USD-CNY spot exchange rate has depreciated by 5.48% (as of 2 November).

In contrast, the daily fixing rate of the Chinese yuan against the Euro strengthened from 8.0078 on 16 October to 7.8923 on 1 November, before depreciating slightly to 7.9120 on 2 November (see exhibit 35). So far this year, the daily fixing rate of the Chinese yuan against the Euro has depreciated by 1.39% (as of 2 November).

According to the Bank for International Settlements, the real effective exchange rate (REER) of the yuan fell from its recent peak of 127.24 in May to 121.78 in August, before showing a slight rebound to 122.45 in September.²⁴ Overall, in 1-3Q18, the Chinese yuan appreciated in real terms against its trading partners by 0.7% (see exhibit 36).

Looking ahead, we predict that the exchange rate of the Chinese yuan against the US dollar will remain weak, as the US dollar is set to stay strong against major currencies in the global market and China's central bank has taken moves to ease the credit conditions recently. That being said, we do not expect a sharp depreciation of the Chinese yuan against the US dollar in the near term, as a deep depreciation of the Chinese yuan is likely to lead to faster capital outflows and higher imported inflation, which would adversely affect the economic development in China. In fact, the Chinese government has increased its efforts to reduce the market expectations of further depreciation of the Chinese yuan. For example, in order to 'moderately hedge against procyclical market sentiment toward a weaker Chinese yuan', the 'counter cyclical coefficient' used in the formula for calculating the central parity rate has been adjusted since August, according to the announcement made by the China Foreign Exchange Trade System on 24 August.²⁵ The adjustment in the coefficient is likely to enhance the stability of the central parity rate of the Chinese yuan against the US dollar in coming future. As the daily trading band of the Chinese yuan against the US dollar is $\pm 2.0\%$ around the central parity rate, such an action can help narrow the interday fluctuation of the spot exchange rate of the Chinese yuan against the US dollar.

²⁰ http://www.gov.cn/premier/2018-09/26/content_5325538.htm; http://www.gov.cn/xinwen/2018-10/01/content_5327319.htm

²¹ http://www.xinhuanet.com/fortune/2018-10/01/c_129964566.htm

²² http://www.chinadaily.com.cn/a/201811/05/WS5bdfaf3fa310eff3032868fe_1.html

²³ According to the PBOC, the daily fixing rate (also known as the central parity rate) of the Chinese yuan against the US dollar is directly formed by market makers based on the closing rate of the previous day, the movements of major international currencies and 'counter cyclical coefficient'.

²⁴ The Bank for International Settlements (BIS) calculates effective exchange rate (EER) indices for a total of 61 economies (including individual Eurozone countries and, separately, the Eurozone as an entity). Nominal EERs are calculated as geometric weighted averages of bilateral exchange rates. Real EERs are the same weighted averages of bilateral exchange rates adjusted by relative consumer prices. The weighting pattern is time-varying, and the most recent weights are based on trade in 2011-13.

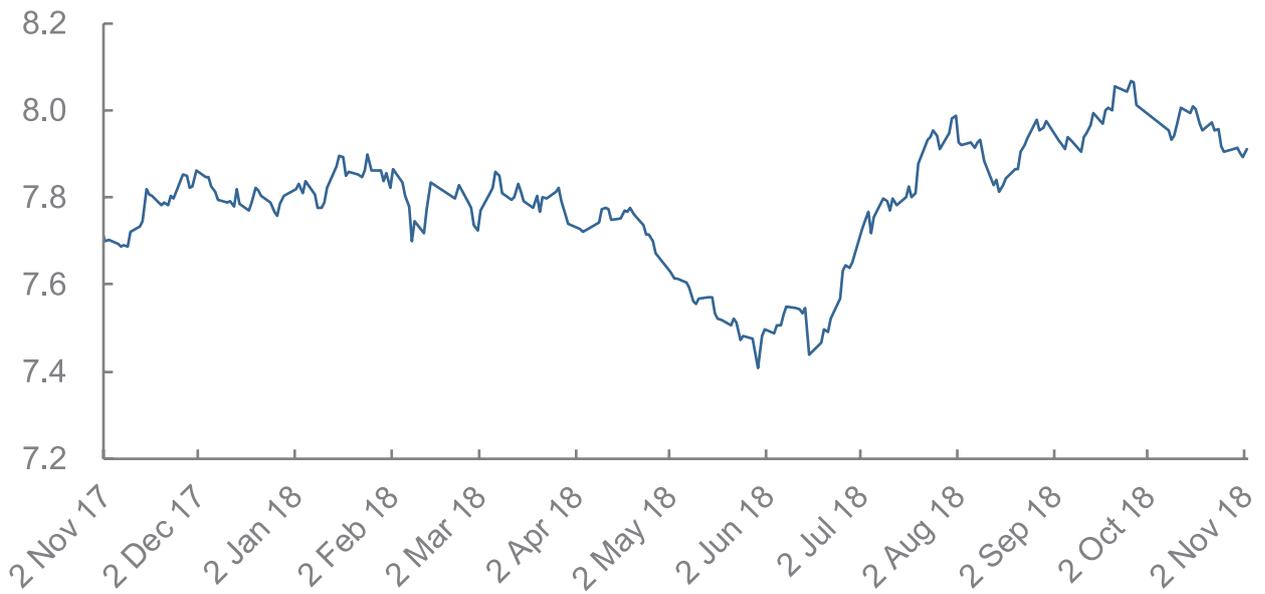
²⁵ <http://new.chinamoney.com.cn/chinese/dynamic/20180824/1154567.html?cp=overview>

Exhibit 34 USD-CNY daily fixing rate, November 2017 to November 2018



Source: State Administration of Foreign Exchange

Exhibit 35 EUR-CNY daily fixing rate, November 2017 to November 2018



Source: Bank for International Settlements

Exhibit 36

Real effective exchange rate of the Chinese yuan, October 2016 to September 2018



Source: State Administration of Foreign Exchange

C Outlook

1. US economy records strong growth in 3Q18

Supported largely by the fast growth in personal consumption expenditures and an upturn in private inventory investment, the US economy recorded strong growth in 3Q18. The US real GDP expanded by an annual rate of 3.5% in 3Q18, compared to the annual growth of 4.2% in 2Q18 (see exhibit 37).

On the production side, industrial production grew by 0.3% mom in September, recording positive month-on-month growth for four consecutive months (see exhibit 38). Besides, the new orders for manufactured durable goods rose by 0.8% mom in September, faster than market expectations. The manufacturing PMI rose from 58.1 in July to 61.3 in August, and then stayed high at 59.8 in September, indicating that the manufacturing sector has expanded at a relatively fast pace recently.

The non-manufacturing sector has also grown at a relatively rapid pace lately: the non-manufacturing index (NMI) went up from 55.7 in July to 58.5 in August, and further to 61.6 in September.

The retail sector in the US has fared well in recent months. The US retail sales gained 0.1% mom in September, posting month-on-month growth for eight consecutive months. Meanwhile, the Reuters/ University of Michigan index of consumer sentiment went up markedly from 96.2 in August to 100.1 in September, and then stayed high at 98.6 in October, indicating that US consumers have been optimistic lately (see exhibit 39).

The labour market in the US has remained solid lately. Despite the fact that the non-farm payroll employment increased at a relatively slow pace, by 134,000, in September, the US unemployment rate dropped to a 49-year low of 3.7% in the month (see exhibit 40).

Looking ahead, the IMF predicts that the US economic growth is likely to peak this year and then decelerate next year, due largely to the trade protectionist measures launched by the US government in recent months. According to the latest projection by the IMF, the real GDP growth rate for the US is forecast to decelerate from 2.9% in 2018 to 2.5% in 2019.²⁶

Exhibit 37 US national accounts, 2016 to 3Q18

Annual growth (%)	2016	2017	4Q17	1Q18	2Q18	3Q18
Real GDP	1.6	2.2	2.3	2.2	4.2	3.5

Source: US Department of Commerce

Exhibit 38 US industrial sector, April to September 2018

mom growth (%), seasonally adjusted	Apr 18	May	Jun	Jul	Aug	Sep
Industrial production	1.1	-0.8	0.6	0.3	0.4	0.3
New orders for manufactured durable goods	-1.0	-0.3	0.9	-1.2	4.6	0.8

Source: US Federal Reserve, US Department of Commerce

Exhibit 39 US consumer market, May to October 2018

	May 18	Jun	Jul	Aug	Sep	Oct
Retail and food services sales <i>(mom growth %, seasonally adjusted)</i>	1.2	0.2	0.6	0.1	0.1	-
Reuters/University of Michigan index of consumer sentiment	98.0	98.2	97.9	96.2	100.1	98.6
CPI <i>(yoy growth %)</i>	2.8	2.9	2.9	2.7	2.3	-

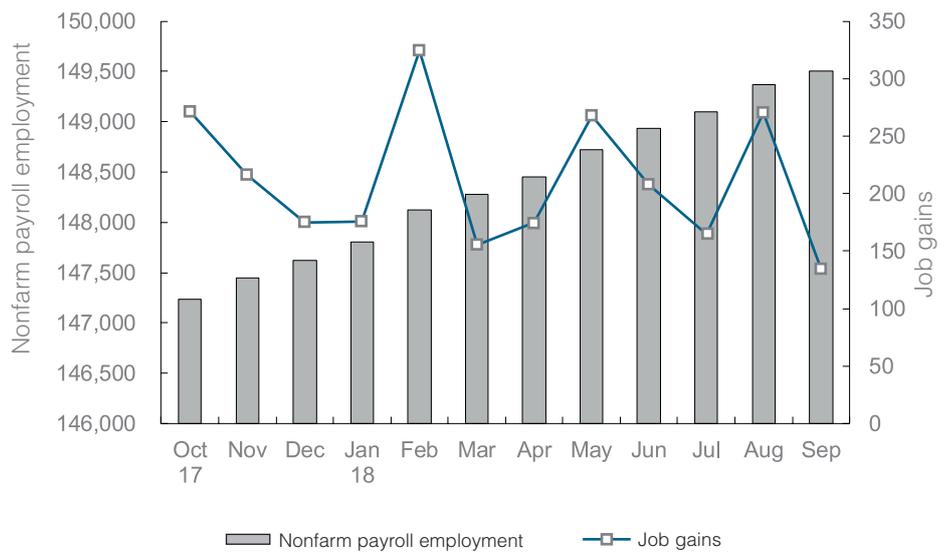
Source: US Department of Commerce, Reuters/University of Michigan Surveys of Consumers, US Department of Labor

Exhibit 40 US employment

	Unemployment rate (%)
2016	4.9
2017	4.4
Oct 17	4.1
Nov	4.1
Dec	4.1
Jan 18	4.1
Feb	4.1
Mar	4.1
Apr	3.9
May	3.8
Jun	4.0
Jul	3.9
Aug	3.9
Sep	3.7

Yearly figures: Annual average
Monthly figures: Seasonally adjusted

*Nonfarm payroll employment, October 2017 to September 2018
In thousands, seasonally adjusted*



Source: US Department of Labor

2. Recent indicators paint a mixed picture of Eurozone economy

Recent indicators paint a mixed picture of Eurozone economy.²⁷ According to the global survey firm Markit Economics, the Eurozone manufacturing PMI fell from 55.1 in July to 54.6 in August, and further to 53.2 in September. The figures indicate that the growth of the

manufacturing sector in the Eurozone has decelerated recently. In contrast, the Eurozone services PMI rose all the way from 54.2 in July to 54.7 in September, indicating a modest acceleration in the growth of the service sector in the region.

²⁷ The member countries of the Eurozone include Austria, Belgium, Cyprus, Estonia, Finland, France, Germany, Greece, Ireland, Italy, Latvia, Lithuania, Luxembourg, Malta, the Netherlands, Portugal, Slovakia, Slovenia and Spain.

Part 2 : Foreign Trade

The retail trade volume in the Eurozone dropped by 0.2% mom on a seasonally adjusted basis in August, recording negative month-on-month growth for two consecutive months (see exhibit 42).

The labour market conditions in the region have gradually improved. The seasonally-adjusted unemployment rate fell from 8.2% in June and July to 8.1% in August (see exhibit 43). Nevertheless, confidence among consumers and managers in various sectors has weakened: the Eurozone's economic sentiment indicator (ESI) has trended further downward, falling to 110.9 in September, the lowest level since June 2017 (see exhibit 44).

Going forward, the growth of the Eurozone economy is expected to decelerate in near future. In its latest *World Economic Outlook* published in October, the IMF forecasts that the real GDP growth rate for the Eurozone will fall from 2.4% in 2017 to 2.0% in 2018 and 1.9% in 2019.²⁸

Exhibit 41 Eurozone's real GDP growth, 2016 to 2Q18

	2016	2017	3Q17	4Q17	1Q18	2Q18
Real GDP (qoq growth %)			0.7	0.7	0.4	0.4
Real GDP (yoy growth %)	1.8	2.4	2.8	2.7	2.4	2.1

Source: Eurostat, IMF

Exhibit 42 Eurozone consumer market, April to September 2018

	Apr 18	May	Jun	Jul	Aug	Sep
Volume of retail trade (mom growth %, seasonally adjusted)	0.0	0.3	0.4	-0.6	-0.2	-
Annual inflation (%)	1.3	1.9	2.0	2.1	2.0	2.1

Source: Eurostat

Exhibit 43 Eurozone labour market, March to August 2018

seasonally adjusted	Mar 18	Apr	May	Jun	Jul	Aug
Unemployment rate (%)	8.4	8.4	8.2	8.2	8.2	8.1

Source: Eurostat

34

Exhibit 44

Eurozone economic sentiment indicator, April to September 2018

<i>seasonally adjusted</i>	Apr 18	May	Jun	Jul	Aug	Sep
Economic sentiment indicator	112.7	112.5	112.3	112.1	111.6	110.9

Source: Eurostat

3. China's exports are expected to show single digit growth in 4Q18

According to the *World Economic Outlook* released in early October, the IMF cuts its forecasts on world economic growth in 2018 and 2019 by 2 ppt., compared to its forecasts made in July this year. Major reasons behind the downward revision include the US government's trade protectionist measures, weaker-than-expected economic activities in the Eurozone and the UK in early 2018, tighter financial conditions in emerging countries and geopolitical tensions.

The IMF forecasts that the world economic growth will be 3.7% in 2018 and 2019, the same as in 2017. The growth in the advanced economies is projected to maintain relatively fast growth of 2.4% in 2018, before moderating to 2.1% in 2019. Meanwhile, the growth

in the emerging market and developing economies is projected to be 4.7% in 2018 and 2019 (*see exhibit 45*).

Looking ahead, we forecast that China's exports will only show a single-digit year-on-year growth in 4Q18, compared to the growth of 11.6% yoy in 3Q18. Challenges facing Chinese manufacturers include the China-US trade war, stronger government's efforts to enforce environmental regulations, a marked increase in prices of raw materials, intense competition in the international market, and the weak demand for luxury products.

Exhibit 45

Latest GDP growth forecasts by the IMF

<i>yoy growth (%)</i>	2017 (Estimates)	2018 (Forecasts)	2019 (Forecasts)
World economy	3.7	3.7	3.7
Advanced economies	2.3	2.4	2.1
US	2.2	2.9	2.5
Eurozone	2.4	2.0	1.9
Japan	1.7	1.1	0.9
Emerging market and developing economies	4.7	4.7	4.7
China	6.9	6.6	6.2
India *	6.7	7.3	7.4
Brazil	1.0	1.4	2.4
Russia	1.5	1.7	1.8

* Data and forecasts are presented on a fiscal year basis.

Source: IMF, US Department of Commerce, Eurostat, National Bureau of Statistics, PRC

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