

SCI China Market Update – August 2014

Dear friends,

In our March newsletter, we talked about the anti-corruption investigation of Mr. Zhou Yongkang, China's feared ex-chief of the Ministry of Public Security. Now this looks like it may go to trial. If it does, it will signal a break with a long-standing taboo against publicly targeting the country's topmost leaders. To be clear, there are three top bodies in China's ruling Communist Party. First is the Communist Party Central Committee, with several hundred members (205 right now). Above that is the Political Bureau (Politbureau) with 25 members right now. And above that is the all-important 7-member Standing Committee of the Politbureau. The Standing Committee is therefore at the very top of the political food chain and its members have long been considered entirely safe from any kind of public scrutiny. Zhou was a member of this very highest Party authority under the previous administration of Hu Jintao. Moreover, as head of the Bureau of Public Security, he ran China's entire legal, security and law enforcement system including police, armed police, national security and anti-terrorism activities, the courts, etc. He had eyes and ears everywhere and was therefore thought to be basically an untouchable "big tiger". You could say he was a bit like the Herbert Hoover of China!

The closest historical analog to this investigation was the 1981 treason trial of Mao Zedong's wife and the rest of the "Gang of Four" for their merciless behavior during the Cultural Revolution. In fact, however, Mao's wife was just a member of the Politbureau, not the Standing Committee. So this puts Zhou in an infamous class by himself. Zhou is alleged to have used his position to illegally gain enormous wealth for himself and his family.

In any case, the net effect is that it is now clear to everyone that Xi Jinping is not kidding around with his anti-corruption campaign and no one is automatically "safe". In the past, anti-corruption initiatives were typically used for symbolic purposes or when there was no choice – as with Bo Xilai and his wife. Only if the nail was sticking up did it get hammered down. But now all Chinese officials – high and low - know they must be really careful and behave properly or the hammer may suddenly come down on them.

Moreover, the investigations are not limited to Chinese officials. They include numerous foreign companies as well. GlaxoSmithKline, for example, has been the subject of on-going investigation following allegations of systematically offering bribes to doctors and hospitals and passing on the costs to consumers. Five foreign baby formula producers and one Chinese producer were fined a total of

\$108 million for price-fixing. German Audi and US Chrysler have been accused of "monopoly behavior". Mercedes-Benz is also under investigation. Twelve Japanese companies were under investigation for monopoly pricing of auto parts. High profile Microsoft is under investigation for anti-trust activities. And so on. In general, foreign companies are being aggressively accused of maintaining a double standard in pricing – one for China and one for “rest of world”.

We are monitoring the impact of this really tough and pervasive anti-corruption campaign and will let you know what unfolds. Now let's turn to the latest China market news, taken from a variety of public sources.

China's July PMI rises to 2-yr peak at 51.7

China's manufacturing activity quickened to the highest level in more than two years in July, reinforcing signs that the economy is firming up on government support policies. The purchasing managers' index rose to 51.7 in July, up from 51 in June, according to data released on Friday by the National Bureau of Statistics (NBS) and the China Federation of Logistics and Purchasing. A reading above 50 indicates expansion, while a reading below 50 reflects contraction.

The stronger-than-expected growth marked the fifth monthly recovery of the PMI, a widely watched indicator for the health of the world's second-largest economy. The data is also in line with the HSBC final PMI reading of 51.7, which better reflects the performance of smaller businesses.

China Jan-June FDI rises 2.2%

Foreign direct investment (FDI) into China rose 2.2 percent to \$63.33 billion during the first six months of this year, the government announced Tuesday.

For the month of June alone, FDI -- which excludes investment in financial sectors -- inched up 0.2 percent year-on-year to \$14.42 billion, the commerce ministry said. But it was a substantial jump on May's \$8.6 billion, according to previous figures.

Foreign investment into China rebounded in 2013 to \$117.59 billion, after declining in 2012 for the first time in three years. Chinese investment to the US rose 12.8 percent to \$2.46 billion during the first half of the year, the ministry said, and to ASEAN countries it climbed 14 percent to \$2.52 billion.

BRICS set up bank to counter Western hold on global finances

Leaders of the BRICS emerging market nations launched a \$100 billion development bank and a currency reserve pool in their first concrete step toward reshaping the Western-dominated international

financial system. The bank aimed at funding infrastructure projects in developing nations will be based in Shanghai and India will preside over its operations for the first five years, followed by Brazil and then Russia, leaders of the five-country group announced at a summit.

They also set up a \$100 billion currency reserves pool to help countries forestall short-term liquidity pressures. The long-awaited bank is the first major achievement of the BRICS countries - Brazil, Russia, India, China and South Africa - since they got together in 2009 to press for a bigger say in the global financial order created by Western powers after World War II and centered on the International Monetary Fund and the World Bank.

China sets solar power target for 2014

China's central energy authority unveiled its photovoltaic (PV) development targets for 2014, vowing to install 13 gigawatts of new PV power capacity this year. Wu Xinxiong, head of the National Energy Administration (NEA), said China will strive to secure the target by supporting the development of distributed PV power generation.

The target is more ambitious than the State Council guideline released in July 2013, which outlined plans to install 10 gigawatts of PV power capacity every year from 2013 to 2015. To boost the sagging solar power industry, China has turned to distributed PV power generation and rolled out a string of preferential policies, including subsidies and tax reduction.

Beijing to ban coal use to curb pollution

Beijing will ban coal use in its six main districts by the end of 2020, state media cited the Beijing Municipal Environmental Protection Bureau as saying, as the Chinese capital steps up efforts to combat air pollution.

Beijing and the surrounding area in China's northeast are often wreathed in noxious smog, which has been cited as a factor in high rates of lung cancer.

China's coal inventories rise, losses widen

China's coal producers faced greater inventories in the first half of the year as an economic slowdown and lingering oversupply continued to weigh down the sector, according to data from the National Development and Reform Commission (NDRC). By the end of June, Chinese coal producers had 99 million tons of unsold coal, while the country's key thermal power plants, the primary consumer of coal, had 79.06 million tons of coal inventories able to meet demand for 23 days, the NDRC said Saturday in a statement. A CNCA investigation across the country showed more than 70 percent of the

country's coal enterprises are operating at a loss and workers at over half of China's coal producers have had wage cuts or defaults.

China's smoggiest province closes 56 mines

Fifty-six mines have been shut down in North China's Hebei province, which holds the country's smoggiest cities. The 56 include 10 illegal mines and 46 others, which are within 300 meters of expressways or railways, said Wei Fenghua, an official with the Hebei Land and Resources Department, on Wednesday. In April, the province launched a campaign to make its mines less polluting and stop them operating near densely populated areas, targeting 632 mines close to railways, expressways and cities. Beijing, Tianjin and Hebei plan to cut PM2.5, a key indicator of air pollution, by 25 percent from 2012 levels by 2017.

1% of Chinese own one-third of national wealth: report

About one percent of Chinese households own 1/3 of the nation's wealth, raising concerns about income inequality in the world's most populous country, according to a study by Peking University. Chinese households on average had a net worth of 439,000 Yuan (about \$71,000) in 2012, up 17 percent from the 2010 level, the university's Institute of Social Science Survey said in its latest report on China's livelihood development.

However, income inequality rose rapidly during the period, the report said, as the top one percent of Chinese households held more than one-third of the nation's wealth, while 25 percent of households at the bottom owned only 10 percent of the country's property value. The report showed about 74.7 percent of Chinese household wealth came from owning real estate.

China to get new dairy hub

US-based Abbott Laboratories, one of the biggest infant formula sellers in China, is getting deeper into milk production for the world's most populous country by building a dairy farm hub with New Zealand company Fonterra. The \$300 million joint investment with Fonterra is expected to begin producing milk by the first half of 2017.

In June, Abbott opened a new manufacturing plant in Jiaxing, Zhejiang province, one of the company's most technologically advanced. The 120,000 square-meter facility manufactures the company's Similac QINTI infant formula and the product was made available in more than 200 cities last month. The US exported \$327.8 million worth of dairy products to China in the January to May period this year, which is up 67 percent from the same period last year, the largest percent increase recorded of any country. China is the US' fifth-largest market for dairy exports

China Internet population reaches 632 million

China is now home to 632 million Internet users, although use of social networks has dropped amid a crackdown. The Asian giant's Internet population -- defined as those who have gone online at least once in the past six months -- has increased by 14 million since January, according to the China Internet Network Information Centre (CNNIC). Mobile phone users represent a large share of the online population, with 527 million people in China accessing the Internet using mobile devices in the six months to June.

Huawei says ships 34 million smartphones in H1 globally, up 62 percent year-on-year

China's Huawei Technologies Co Ltd said smartphone shipments in the first half rose 62 percent year-on-year, as it targets the more expensive smartphone sector dominated by Samsung and Apple. Shenzhen-based Huawei has shipped 34.27 million smartphones globally in the first six months ending June 30 - about 43 percent of its annual shipment target of 80 million. Huawei had a 4.7 percent share of the global smartphone market in the first quarter of this year, a distant third behind Samsung Electronics with 30.8 percent and Apple with 15.2 percent, according to IDC.

Safety questioned as China plant blast deaths rise to 71

The death toll from an explosion at a Taiwan-invested car parts factory in China climbed to 71 on Sunday, state media said, as a labor rights group cast doubt on its safety measures. The blast on Saturday in a wheel hub polishing workshop at the Zhongrong Metal Products Co. in Kunshan, near Shanghai, also left 186 injured, state television said, many with severe burns and respiratory problems. Zhongrong was a contractor for a global supplier of GM, Dicastal, though the US company did not have direct contact with it, GM said in a statement provided to AFP on Sunday.

For more information about today's China market and opportunities please visit our website at www.s-c-i.com or call me at the number below, or Dr. Tim Weckesser at 610-828-8060.

Best regards

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