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SCI China Market Update – August 2018

Dear friends,

Where are we in the US-China trade war? Where are the new China market opportunities for your firm after this round of trade disputes between the world's two largest economies? It may be time for you to rethink the China market and re-do your market research in light of the new economy and development trends. In fact, this is just what we are starting to see. Our clients are already talking with us about new research to better understand customers, market changes, the impact of tariffs, and how the competition is changing. Don't hesitate to call me if you would like to chat about this for your firm.

All wars end sooner or later – even trade wars. In fact, neither President Trump nor President Xi wants a long trade war, but both need a solution that saves face especially President Trump needs votes from US farmers and workers. One thing is very clear, China will eventually have to agree to open its market wider to US products and lower import taxes. Why? Forget the trade deficit argument but take pumps as an example. A Chinese pump company can export quality, low-cost pumps to the U.S. buyer/importer who enjoys almost duty free treatment. In other words, if the CIF Long Beach Port price is $10,000 per pump, the U.S. buyer/importer can budget $10,000 and be reasonably safe.

However, if a Chinese importer buys a "Made in USA" pump at the same CIF Shanghai Port price of $10,000, the importer must budget at least $13,000. Why? Because the Chinese importer must pay 16% (of the contract value) Value Added Tax (VAT), plus around 8% tariff for customs clearance (16% + 8% = 24%). For cars, watches, cosmetics as well as other luxury products, tariffs are higher. The EU, Japan, Korea as well as most of the major exporters face the same barriers in exporting to China.

Because of this imbalanced international trading system, because both Chinese and US companies play critical roles in the global supply chain, and because the trade war will damage both economies as well as the rest of the world, a kind of ceasefire agreement must be reached between the two powers sooner or later. If terms are reasonable, I think China will very likely agree to lower its barriers to help US and other foreign products become more competitive in the China market.

Currently, the U.S. has imposed tariffs on $34 billion worth of shipments from China, and a proposal would raise this to $50 billion. China's argument is that a big percentage of the "Made in China" products are made by Taiwan, US, Japan as well as EU invested manufacturers, not really Chinese companies. And this is true. Almost all major companies worldwide have manufacturing or contractual production operations in China including GM, Ford, GE, P&G, Caterpillar and many more. What's the impact of the trade war? How about the Chinese economy today? Here is some very recent China market news from various public sources.

Trump threatens tariffs on all $500 billion of Chinese imports

U.S. President Donald Trump on Friday said he was ready to impose tariffs on all $500 billion of imported goods from China, threatening to escalate a clash over trade policy that has unnerved financial markets.

"We're down a tremendous amount," Trump said in an interview about trade imbalances with China on CNBC television broadcast on Friday. "I'm ready to go to 500."

US to give farmers $12bn trade war bailout

The US has unveiled a $12 billion plan aimed at helping US farmers hurt by the intensifying trade war. The aid is intended to protect the industry as countries raise taxes on US products such as soybeans in response to new Trump administration tariffs.

The US plans to provide subsidies to farmers and buy unsold crops, among other measures. President Trump had promised the aid after fierce criticism from farmers, an important part of his support base. The US Agriculture Department said it expects losses of about $11 billion as a result of the trade disputes. Much of the $12 billion in emergency relief will go toward direct payments to farmers of commodities such as soybeans, sorghum, and wheat, officials said.

China's GDP growth hits 6.8% year-on-year in H1

China's GDP growth reached 6.8 percent year-on-year in the first half of this year, beating general market expectations, according to Beijing.

Growth in the second quarter was 6.7 percent, compared with 6.8 percent in the first quarter, according to the National Bureau of Statistics (NBS). Retail sales increased by 9.4 percent year-on-year in the first half of this year, 0.4 percentage points lower than the first quarter, the data showed.

The industrial output posted steady growth in the first six months, up by 6.7 percent year-on-year, 0.1 percentage point lower than the first quarter, the data showed. Fixed-asset investment growth was 6 percent in the first half of this year, 1.5 percentage points lower than the first quarter.

Current RMB Depreciation against to USD

A CNBC report on Friday noted that the tit-for-tat Sino-US trade dispute has turned into a "currency war" between the two economies, with both currencies depreciating in recent days.

On Friday, the Yuan's reference rate against the US dollar weakened by 605 basis points to 6.7671, data from the People's Bank of China, China's central bank, showed. On January 2, the first trading day this year, the Yuan stood at 6.5079 against the US dollar. And the US dollar index edged down 0.72 percent to 94.48 on Friday.

Tesla Will Build Its 1st Factory Outside the U.S. in Shanghai

Electric car producer Tesla will build its first factory outside the United States in Shanghai, becoming the first wholly foreign-owned automaker in China. Tesla Inc.'s announcement comes amid mounting U.S.-Chinese tension over technology and follows Beijing's April promise to end restrictions that required foreign automakers to work through local partners.

Tesla said construction would begin in the near future, once official permits are obtained. It said production would begin two to three years after that and eventually increases to 500,000 vehicles annually.

Trump tariffs bite into GM 2018 profit forecast

GM on Wednesday lowered its full-year 2018 earnings forecast, citing higher steel and aluminum costs as a result of tariffs imposed by U.S. President Donald Trump's administration, sending its shares down more than 5 percent in pre-market trading.

The No. 1 U.S. automaker said it would be able to partially offset higher commodity costs and the unfavorable effect of currency fluctuations in Brazil and Argentina, but they would have a net impact of around $1 billion on the company's full-year results. Previously GM had expected those costs would total around $500 million. GM also said the higher costs would reduce its adjusted automotive free cash flow by around $1 billion to $4 billion versus its previous expectation of $5 billion.

Chinese automaker rolls first car off production line from S. Africa plant

Chinese automaker Beijing Automotive Industry Corporation on Tuesday rolled the first car off production line in its South African plant near the car export hub of Port Elizabeth. The plant is a joint venture between BAIC and South Africa's state-owned Industrial Development Corporation, with planned investment of US$800 million and expectation to build 50,000 cars annually.

The plant, located in the Coega Special Economic Zone, was launched in August 2016 and is expected to have the capacity of assembly, painting and welding by the end of 2019. The plant is also regarded a miniature of cooperation between China and South Africa in recent years.

Harley Trudges Through Tariff Costs, Sending Shares Up Sharply

Harley-Davidson Inc. cut its forecast for profit margin this year by an amount that suggests it's finding a way to cope with the damage done by the trade war. Harley sped up shipments to the European Union to blunt the impact of higher tariffs that the bloc enacted last month. As a result of the tariffs, operating margin this year will drop to about 9.5 percent, the midpoint of a range the Milwaukee-based manufacturer gave in a statement Tuesday, compared with a previous projection of about 10 percent.

1.11 billion now use 4G in China

The number of people using China's 4G networks hit 1.11 billion by the end of June, according to statistics released by the country's Ministry of Industry and Information Technology (MIIT). Those using 4G make up 73.5 percent of all mobile phone users in China.

In the first half of 2018, China Telecom, China Mobile and China Unicom, China's three major carriers, made combined revenue of 476.2 billion Yuan ($70.3 billion) from their communication services, up 1.8 percent year on year. Their combined revenue from mobile data and mobile Internet services reached 309.5 billion Yuan, a growth of 12.8 percent from the previous year.

China's new energy power generation sees faster growth

China reported faster growth in new energy power generation in June, official data showed Tuesday. In June, nuclear power generation increased 19.3 percent year-on-year, compared with 15.1 percent in May, according to NDRC data.

Electricity generated by wind and solar rose 11.4 percent and 21.1 percent, respectively, compared with 6.7 percent and 14.8 percent in May.

Thermal and hydropower output climbed 6.3 percent and 3.7 percent, respectively, down by 4 percentage points and 3.2 percentage points from May, Yan told reporters.

China is promoting new energy to cope with pollution and boost growth quality. Overall electricity output rose 6.7 percent year-on-year last month, while consumption went up 8 percent year-on-year, the NDRC data showed. In the first half of the year, power generation increased 8.3 percent year-on-year, slower than the 8.5-percent growth in the first five months.

China sees fast growth in industrial robots production

The industry scale of China's domestically made robots has seen 20 percent annual growth in five years. According to the China Robot Industry Alliance (CRIA), 131,000 industrial robots were domestically made in 2017. By the end of 2017, there were more than 6,500 enterprises engaged in robot production. The market shares of domestically made industrial robots fell for the first time in five years, shrinking to below 27 percent in 2017.

For more information about today's China market and opportunities please visit our website at www.s-c-i.com or call me at (610) 828-8061.

Best regards

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