

## SCI China Market Update – July 2013

Dear friends,

Last week, there was a piece of news about a “liquidity squeeze” in Chinese banks which immediately pushed global stock markets south – as if to confirm that today’s world economy seems really to turn on what happens in China. China’s bank regulator said this liquidity issue would not affect the stability of the banking system, but questions remain...? For three weeks, funds have been in short supply on China’s interbank market, and the interest rates banks charge to lend to each other have surged to record highs. Considering that China’s financial institutions have current excess reserves of 1.5 trillion Yuan (\$244 billion), this issue should be brought under control soon, especially because it has spurred Beijing to expedite banking system reform.

Another piece of news from China also drew the attention of many: “China’s Shenzhou-10 Spacecraft Returns to Earth”. In fact this really means that China’s success in spaceflight has set stage for a major space station. And beyond that, it is symbolic of how fast China is advancing in technology and moving up the value chain. During the 15-day Shenzhou-10 spaceflight, three Chinese astronauts accomplished both automatic and manual dockings to China’s Tiangong 1 space laboratory. The crew also achieved a two-hour-long fly-around of the module, a first for China, which is seen as an effort to sharpen rendezvous expertise useful for future space station construction. The space technology dream is surely an important part of the “Chinese Dream” that we discussed in our June, 2013 newsletter. And China is finding novel ways to foster this dream among youth. For example, female astronaut Wang Yaping, one of the three crew members of Shenzhou-10 spacecraft, provided a live, interactive, video lecture from space to about 330 primary and middle school students in Beijing, as well as about 60 million more students around the country who were tuned in. The impact of China’s space program on investment in R&D, education and technology advancement can be very big.

Below is other recent market information taken from a variety sources:

### **British, Chinese central banks agree currency swap line**

The Bank of England and the People’s Bank of China have signed an agreement to establish a reciprocal, three-year sterling-yuan currency swap line, Britain’s central bank announced. The deal was agreed between BoE governor Mervyn King, who steps down at the end of the month, and his counterpart Zhou Xiaochuan of the central People’s Bank of China. “The maximum value of the swap is 200 billion (Yuan) renminbi (\$32.6 billion, 24.8 billion euros),” the BoE said in a statement. “The swap

line may be used to promote bilateral trade between the two countries and to support domestic financial stability should market conditions warrant."

### **China's June manufacturing PMI falls to 50.1**

China's Purchasing Managers' Index (PMI) for the manufacturing sector fell to 50.1% in June from 50.8% in May, data from the China Federation of Logistics and Purchasing (CFLP) showed Monday. The index tracks manufacturing activity and is a closely watched barometer of the health of the economy. A reading above 50 indicates expansion while anything below points to contraction.

### **Industry to pay 15% more for natural gas**

The price of natural gas will rise by an average of 15% for non-residential users from July 10, in a move an official and analyst say will help end overcapacity in industrial sectors and boost natural gas imports.

The NDRC said that if gas consumption does not exceed last year's level, users will have to pay a maximum of 0.4 Yuan (6.5 cents) more per cubic meter, but fertilizer producers will pay a maximum of 0.25 Yuan more. If gas consumption exceeds last year's level, the price for the excess consumption will be equal to 85% of that for alternative energy sources such as fuel oil and liquefied petroleum gas.

After the adjustment, the average price for natural gas will rise from 1.69 Yuan per cubic meter to 1.95 Yuan. Gas prices for residential users will not change. Non-residential gas consumption totaled 112 billion cubic meters in China last year. It is expected to increase by 10% this year. Natural gas power plants will be hardest-hit by the price increase. According to Sublime, the cost of power generated by natural gas is 0.05 Yuan to 0.11 Yuan higher than for thermal coal for each kWh, indicating that the unit cost for natural gas power plants will be 0.4 Yuan higher when the government charges this much more for each cubic meter of natural gas.

### **China in \$270b oil deal with Russia**

China and Russia are to deepen their existing energy industry cooperation after signing a deal to supply oil to China worth \$270 billion over the next 25 years. The deal will see the supply of 365 million metric tons of oil to China starting from July 2013. The oil is likely to be delivered to China via the existing Eastern Siberia-Pacific Ocean oil pipeline that will pump direct into the Chinese region of Mohe in Heilongjiang province.

### **Top auditor warns of soaring local gov't debts**

China's top auditor on Thursday warned that local governments must improve their debt management with the sharp increases in local debts. The warning by Liu Jiayi, auditor general of the National Audit

Office (NAO), came at the ongoing session of the Standing Committee of the National People's Congress (NPC), China's top legislature. Debts owed by 18 provincial-level governments and municipalities at provincial capital level have risen sharply, hitting 3.85 trillion Yuan (626 billion U.S. dollars) by the end of last year, according to an NAO report submitted to the NPC Standing Committee. The debts rose by 13% over the past two years. About 46% of the accumulated debt was owed after 2011, Liu said. Four provinces and eight provincial capitals have seen their debt rise at rates above 20%, with the highest at 65%, he said. Some governments have relied too much on land revenues and new borrowing to repay old debts, he said. About 45.4 billion Yuan in new debt was created for the purpose of old debt payment in the construction of highways in 2012, he said.

### **China to double fines for trademark infringement**

China is expected to double the compensation ceiling for trademark infringement to 2 million yuan (\$325,400), according to the latest draft amendment to the Trademark Law. Compensation ranging from 20,000 Yuan to 2 million Yuan shall be paid to the holders of trademark rights in the case of infringement, according to the draft tabled for a second reading at the ongoing four-day bimonthly session of the Standing Committee of the National People's Congress (NPC), China's top legislature.

The move aims to better protect exclusive trademark rights and further crack down on infringement, said Xie Jingrong, deputy head of the NPC's law committee. China adopted its Trademark Law in 1982 and made amendments to the law in 1993 and 2001. As of June 2012, China held the world's largest number of registered trademarks and valid trademark registrations, at 7.17 million and 6.09 million, respectively, according to the most recent official statistics available.

### **China considers harsher legislation against polluters**

The draft amendment to the environmental protection law, tabled for the second reading has adopted harsher punishment on polluters and highlighted the public's right to know and participate. According to the bill, companies and other organizations, which intentionally escape supervision and discharge pollutants, will be prosecuted if they violate the law. Those, whose activities are not serious enough for criminal prosecution, will be punished according to the law on penalties for administration of public security, for instance being put under administrative detention.

A new chapter is added to protect the public's right to know concerning environmental information. According to the bill, governments of all levels should publicize environmental information and facilitate the participation of and supervision by citizens and institutions in environmental protection. Polluters are required to publish the information about the pollutants they discharge and how they act to control the pollution.

The law has not been revised since it took effect in 1989. However, over the past two decades, the country has faced worsening pollution problems and the public has become less tolerant about environmental hazards.

Multiple Chinese cities were choked by dense smog earlier this year. Beijing's average PM2.5 density in January was 180 micrograms per cubic meter, about 30% higher than the level recorded during the same period in 2011, according to meteorological data.

### **China steps up checks on milk formula producers**

China will step up checks on infant milk formula producers and eliminate sub-standard ones. The China Food and Drug Administration will consult the Good Manufacturing Practices certification system used by drug producers to improve standards in baby milk formula production, said Teng Jiakai, deputy head of the administration. Companies using sub-standard technology and equipment shall be shut down, the statement said.

In a similar overhaul in 2011, the General Administration of Quality Supervision, Inspection and Quarantine shut down 475 milk enterprises.

China now has 127 infant formula producers and manufactured about 600,000 tons of the product in 2012. Demand for infant formula is booming in China, but confidence in domestic products was badly hit after a milk scandal in 2008, which killed six infants and sickened 300,000 over melamine-tainting.

### **China to ban chemical-laden health food**

China's food and drug watchdog on Friday announced that 13 types of health food will be banned, as they have been found to contain undesirable chemicals. According to a statement issued by the State Food and Drug Administration (SFDA), the 13 products contain sibutramine, phenolphthalein, metformin and other chemicals.

According to Chinese law and regulations, health food and medicines are differentiated, as chemicals are not allowed to be added to health food.

Sibutramine can lead to high blood pressure, abnormal liver function and other serious side effects. The chemical has been banned in China since 2010. The SFDA urged regulatory bodies around the country to fully implement the ban, as well as transfer cases involving criminal activity to the police.

**China probes staff of Britain's GlaxoSmithKline**

Chinese police are investigating senior staff of British drug firm GlaxoSmithKline (GSK) in China for suspected "economic crimes", according to a statement. Police in the central Chinese city of Changsha said they were investigating "top management personnel" of GlaxoSmithKline (China) Investment Co. Hong Kong's South China Morning Post newspaper said police had detained company employees in three cities: Changsha, the commercial hub Shanghai and Beijing.

The exact nature of the allegations was not specified by Changsha police. But authorities typically use the phrase "economic crimes" when referring to corruption. Internet postings, which could not be confirmed, said more than 10 police in plainclothes entered the GSK office in Shanghai last Thursday and seized account books. The allegations involve at least one foreign executive employed by the British company, said the postings on China's Twitter-like microblogs. It is common practice for Chinese pharmaceutical firms to offer doctors and hospitals bribes to have their products used, industry insiders say. GSK is one of the largest multinational pharmaceutical companies in China with total investment of more than \$500 million, according to its website.

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

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