SCI China Market Update – March 2014

Dear Friends

I am near the end of another busy trip to China. Here are a few observations from my travels.

- As soon as my UA flight landed in Beijing on Sunday, February 23rd, I could see the severely polluted air out of the Terminal 3 windows. Taking a taxi out of the airport, you could easily tell that the PM2.5 level was very high that day. However, later in the trip when I arrived in Tianjin from Yantai (Shandong Province) the sky was blue, sunny and clear thanks to strong northwest winds and a drop in temperature. Beijing was reported to be very much the same that day. We know that pollution control and environmental protection are now top priorities for Beijing. We think this also means new business opportunities in China for high-end, proven pollution control companies.

- It seems to me that Xi Jinping's new anti-corruption drive is working. From many of our friends we learned that almost no government officials at any level dare to dine at the most expensive restaurants "for business" without proper permission. If they do, they really risk losing their jobs. Numerous high-ranking government officials, including Mr. Zhou Yongkang, have already been jailed for corruption and "wrong doing". I was born and raised in China and have never before seen the same thing happen in China over the past 20-plus years. Of course, "Guanxi" still plays a big role in China from daily life activities like finding a job to million-dollar business contracts. However, at least for now, China is indeed getting tougher on graft and, I think, the business environment is improving.

- China's high-speed train network is really developing fast and it works well. Today, on the very comfortable new high-speed trains, it takes only 27 minutes to travel from Tianjin to Beijing, compared to a two hour-plus drive on the jammed freeway. It takes just over 4 hours to travel from Tianjin to Suzhou, where before you had to fly from Tianjin to Shanghai and then take a car or bus from Shanghai to Suzhou – a considerably longer and more difficult trip. In terms of convenient and fast rail transportation, it seems that China is now really more advanced than most developed nations.

Below is some of the latest China market news taken from a variety of public sources.

China announces $1.6 billion fund to reward cities, regions making progress on air pollution
China's Cabinet has announced that 10 billion Yuan ($1.6 billion) has been set aside this year to reward cities and regions that make significant progress in controlling air pollution, highlighting how the issue has become a priority for the leadership. The fund will be set up to reward rather than offer subsidies for the prevention and control of air pollution in the key areas. The statement said the consumption of coal should be controlled and also called for increased efforts to promote high-quality gasoline for vehicles, energy saving in construction and the use of environmentally friendly boilers. The government is eager to bring about a visible improvement in China's bad air, which has caused discontent among its citizens and tarnished the country's image abroad.

While heavily polluting industries have emissions standards, they are not necessarily enforced, and local governments often still favor pollution-intensive projects that can generate growth, which is what their performance is judged on. Separately Wednesday, the official Xinhua News Agency reported that Beijing's city government said it would shut down 300 polluting factories this year and eventually phase out some industries to improve the city's air, citing a document detailing the capital's action plan to 2017 to clean up its air. Energy and pollution-intensive projects such as steel and cement are not to be approved on principle, it said.

China smog makes capital 'barely suitable' for life: report
Severe pollution in Beijing has made the Chinese capital "barely suitable" for living, according to an official Chinese report, as the world's second-largest economy tries to reduce often-hazardous levels of smog caused by decades of rapid growth. Pollution is a rising concern for China's stability-obsessed leaders, keen to douse potential unrest as affluent city dwellers turn against a growth-at-all-costs economic model that has tainted much of the country's air, water, and soil.

The report, by the Beijing-based Social Science Academic Press and the Shanghai Academy of Social Sciences, ranked the Chinese capital second worst out of 40 global cities for its environmental conditions, official media reported on Thursday. China's smog has brought some Chinese cities to a near standstill, caused flight delays and forced schools to shut. Beijing was hit by severe levels of pollution at least once every week, according to the 2012 Blue Paper for World Cities report. That was on top of a significant level of air pollution covering the capital for 189 days in 2013, according to city's Environmental Protection Bureau.

China ponders energy strategy
China's leading think tank has outlined a revamped energy strategy, highlighting new energy and calling for industrial transformation.

In an article entitled "Foreseeing and Analyzing China's Future Energy Development" published on the People's Daily. China must transform itself into a country of "security, greenery and efficiency" by 2030, or face with erratic supplies and unsurmountable environmental challenges.

By 2030, as much as 75 percent of China's oil might be imported, and the dependency on overseas natural gas will also rise rapidly, bringing grave energy security concerns. Total coal consumption should peak by 2020 and be capped below 3 billion tons. Oil consumption should be limited below 550 million tons by 2020 and capped at 650 million tons by 2030. The article also set goals for energy efficiency. By 2030, the efficiency rate should reach "international advanced level," and energy consumption per capita GDP must be 30 percent lower than the 2020 level. China's urbanization could reach 65 percent by 2030, another 300 million people in cities. Per capita urban energy consumption is normally about three times higher than rural, and an increase of one percentage point in urbanization rate implies increased energy consumption of 60 million tons of standard coal.

China aims to expand its offshore wind power installed capacity to 5 million kilowatts by 2015 and 30 million kW by 2020, but those targets seem ambitious. In 2012, the world's largest wind power market had installed only 389,600 kW of offshore wind capacity. Even though this put China third after the United Kingdom and Denmark, it was still far short of the targets for 2015 and 2030. But China, the world's biggest energy user, made progress in connecting idle wind farms to the grid last year.

Government aims to get larger fleet of alternative-fuel vehicles on road

A campaign to drive more new-energy vehicles on to the streets of China's cities has set new goals in the hope of revving up a market showing a distinct lack of interest. An announcement from the central authorities included 12 more cities in a program to advance the use of environmentally friendly cars, taking the total number of cities and regions involved to 40.

Given lackluster national sales in 2013, the cities - including Beijing - have been set specific sales targets and are expected to act as icebreakers, getting the sector's frozen situation on the move again. Cities in eastern regions are required to promote not less than 10,000 new-energy vehicles by the end of 2015, while targets for the rest are set at 5,000. Beijing and Shenzhen have set their own targets of 35,000, pushing up the total for the 40 cities to around 320,000, according to a calculation by Hongyuan Securities. That means at least 160,000 new-energy cars should be sold this year, over nine times last year's national sales. In 2013, sales of new-energy vehicles stood at just 17,642, according to the China Association of Automobile Manufacturers.

HSBC confirms China manufacturing index at seven-month low

Chinese manufacturing activity contracted in February at its worst rate in seven months, British banking giant HSBC said Monday, the latest data indicating trouble in the world's number two economy. HSBC said its final purchasing managers' index (PMI) for China, which tracks manufacturing activity in factories and workshops, fell to 48.5 last month. It was a slight increase on the flash PMI of 48.3 the bank released 11 days ago, but it remained the weakest reading since July when the figure stood at 47.7, according to the bank's data.

The index is a closely watched gauge of the health of the Asian economic powerhouse. A reading above 50 indicates growth, while anything below signals contraction. In January, the index showed contraction for the first time in six months to hit 49.5. The HSBC release came after China's National Bureau of Statistics on Saturday announced its official PMI reading fell to an eight-month low in February at 50.2.

China Yuan ends at eight-month low against dollar

China's Yuan currency fell nearly one percent against the US dollar in intraday trade Friday, its biggest drop in years, before recovering some ground but still closing at an eight-month low. The Yuan -- also called the Renminbi (RMB) -- dropped around 0.9 percent from the previous day's close in morning trading to 6.1808 against the dollar, its largest slide since the country ended a fixed peg to the dollar in 2005, according to Dow Jones Newswires. The Yuan ended at 6.1450 on the national foreign exchange market, still down around 0.3 percent from Thursday's close of 6.1284, marking the weakest finish since June last year.

The Yuan steadily appreciated against the US dollar last year, rising more than three percent, official figures showed. The government's State Administration of Foreign Exchange, which advises the central bank on policy, said Wednesday that the unexpected depreciation in the Yuan's value was normal and advised there could be more two-way fluctuations in trading.

China increases holdings of middle- and long-term US bonds

Chinese holdings of middle- and long-term US government bonds increased by $81.1 billion in 2013, the fastest growth pace in five years, despite the rising yields of the benchmark notes, data from the US Treasury Department showed. Since 2009, China, the largest foreign US creditor, has increased its middle- and long-term US debt by $281.9 billion, which has provided a stable financing source for the US government. Last year, the country's total holdings of the US debt rose by 4 percent, the second annual gain after falling in 2011 for the first time on record, according to the US Treasury.

China has 12 million private firms

China has more than 12 million private companies in the country, which are helping boost economy, the All-China Federation of Industry and Commerce (ACFIC) said Friday. By the end of 2013, 12.54 million private firms were registered in the country, an increase of 15.5 percent year on year, the ACFIC said in a statement. Registered capital of the companies reached 39.3 trillion Yuan (6.4 trillion U.S. dollars), marking a year-on-year rise of 26.4 percent, it said. The federation said the number of registered individual businesses reached 44.36 million as of 2013, up 9.3 percent year on year and total registered capital amounted to 2.4 trillion Yuan. Private businesses accounted for over 60 percent of the total gross domestic product (GDP) in China last year, said the statement. China's e-commerce transactions reached 9.9 trillion Yuan and its online retail sales amounted 1.85 trillion Yuan in 2013, up 21.3 percent, 42 percent respectively.

ABB business hits record high amid upgrading

Both orders and revenue of ABB China, the Chinese unit of the Swiss-Swedishgroup, reached $5.6 billion in 2013. Its revenue growth rose 7.7 percent from the previous year. ABB invested $136 million in the country last year. Its cumulative China investment has reached $1.8 billion. Gu Chunyuan, senior vice-president of ABB Group, said China's national development strategy now emphasizes quality economic growth as well as "green", low-carbon and sustainable development. ABB is willing to participate in China's ultra-high voltage power transmission and new energy vehicle projects, as well as providing more industrial robots to optimize the nation's manufacturing structure.

China's surging wealth accumulation and fast ongoing urbanization pace have caused labor-intensive industries to struggle as they face a myriad of difficulties, such as recruitment problems and high employee turnover rates, especially in the country's computer, communication and consumer electronics product manufacturing sectors. The nation's rapid economic growth has driven up labor costs and wages. The average labor cost in China has risen fast in the past five years, to more than 49,000 Yuan ($8,485) a year in 2013 from less than 28,000 Yuan a year in 2008, according to a report by Beijing-based institute of industrial economics under the Chinese Academy of Social Sciences in January.

China vows tougher measures on overcapacity

China's Industry and Information Technology Ministry (MIIT) on Tuesday pledged tougher measures to cut overcapacity in bloated sectors as the problem has become a severe drag on economic growth. China will ban new projects in steel, cement, electrolytic aluminum, flat glass and shipbuilding industries before 2017, while gradually eliminating existing projects that were found to be below standards, MIIT vice minister Mao Weiming revealed at a press conference. While placing stricter standards in environmental protection, energy efficiency and safety, China will also encourage mergers and acquisitions in industries to crowd out outdated capacities, Mao said.

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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