

SCI China Market Update – May 2014

Dear friends,

China really began to open its doors to the outside world around 1980 under Deng Xiaoping. At that time, I was studying in a Tianjin university. It wasn't too long after that when everyone, it seemed, began to learn English, and textbooks like *English Sentence 900* and *New Concept English* became very popular all over the country. Ironically, not long after Mao's 10-year Cultural Revolution which fought violently against all things Western, China began to embrace all things Western. It started modestly – and ideologically - with Hollywood movies like “*Truck Driver*” (to show that the working man is key in America) and “*First Blood*” (to show how lawless and violent Americans are) and French novels like Stendhal's *Red and Black*; and later to IBM computers and the Stock Exchange – a central institution of Capitalism - opening in “red” Shanghai, of all places!

Little by little, it has become fashionable, stylish for almost everyone to speak some US-made English words along with Chinese. Today, whether in Beijing or Shanghai or a small city in Inner Mongolia, you will hear everyone say “OK”, “Alright”, “Pizza” and “Coke” to you in English directly. Further, “iPhone”, “PM2.5”, “GDP”, “WiFi”, “NBA”, “MBA”, VIP and much more are seen daily in major Chinese newspapers and journals. If you don't know these terms, your Chinese friends may say, “you are out” – a Chinese abbreviation of the U.S. slang, “out if it”. And the English word “out” is integrated right into the Chinese expression.

Also from Beijing to that small city in Inner Mongolia, all major road signs, airport signs, train station signs, etc. are in both English and Chinese Pinyin - no matter if the English translation is wrong and often even really funny (e.g. “No Smoking!”). And Chinese subways and airports announce information in fairly clear English.

Today, more and more Chinese middle school students are highly capable at taking TOEFL and SAT exams in English and winning high scores. They like to drink Starbucks coffee and Coke; they like to wear Nike, Adidas and Levi's; they like to eat pizza at Pizza Hut and hamburgers at McDonalds and chicken at KFC; they enjoy watching the NBA and Hollywood's latest releases; they love the “face” gained by driving a made-in-Shanghai Buick; and they dream of coming to the U.S. to study at an Ivy League university.

Well, the point is that English and American values have had a huge influence – much bigger than most people imagine. The world is changing in a very interesting way. “PM 2.5”, which means very

hazardous particulate sizes and levels in the air, has become a buzzword among Chinese who worry about air quality. But now some people want to replace this term with a lengthy, confusing Chinese equivalent to protect the purity of the Chinese language. An expert in Confucianism at Beijing's Capital Normal University says that mixing English words with the Chinese language in fact reflects a lack of cultural confidence. But many others say the use of foreign words has helped to improve communication. Maybe it's time to change my name from Shiqiang Gu to, well, say, James Gu? But I think Shiqiang is pretty good in both English and Chinese. OK, let's get to the latest China market news, taken from a variety of public sources, to track more changes in China:

China manufacturing up in April: government

China's manufacturing activity improved in April, the government said last Thursday, showing increased strength for a second straight month as the country's broader economy slows. The official purchasing managers index (PMI) was 50.4 in April, the National Bureau of Statistics said in a statement, up from 50.3 in March.

China manufacturing shrinks for 4th month

Survey shows China manufacturing shrinks for 4th month but decline slows slightly. China's manufacturing contracted in April for the fourth straight month but the pace of decline was less severe, suggesting the downturn in the world's No. 2 economy is bottoming out. HSBC's purchasing managers' index released Monday ticked up to 48.1 from 48.0 in March on a 100-point scale on which numbers above 50 indicate expansion.

The reading is slightly lower than 48.3 in a preliminary version of the report last month. But it's the first time the index has risen since it started falling from 50.9 in October. The report said new export orders contracted in April although the decrease was slight and outpaced by a faster decline in new orders overall, indicating that weak domestic demand was mainly to blame for weakness in manufacturing. Employment at factories declined for the sixth month in a row.

China to raise natural gas supply

China will raise its natural gas supply to as much as 420 billion cubic meters per year by 2020 amid rising demand due to urbanization. The increased supply will cater to the rising demand for natural gas in people's daily lives, schools, nursing homes, home heating, as well as in buses and taxis, a statement on the central government website said. The supply increase is also driven by the nation's efforts to mitigate air pollution stemming from an over-reliance on coal, the statement said. Data showed that natural gas consumption in China hit nearly 170 billion cubic meters last year.

Toughest quarter in years for steel sector

China's steel industry faces rising costs, shrinking demand and tight loans from banks. Those conditions made the sector's first quarter its toughest this century. Weaker demand slowed growth in China's economy, the world's second-largest. Crude steel output increased in the first three months of this year, up 2.37 percent year-on-year, to 202.7 million metric tons. That translates to daily output of 2.25 million tons and an annualized 822 million tons for 2014.

Severe overcapacity brought a 2.33 billion Yuan (\$377 million) loss for major domestic steel companies in the period, said Zhang Changfu, vice-chairman of CISA. It compares with a 3.3 billion Yuan profit in the year-ago period. Zhang cited high iron ore costs, rising spending on carbon emissions and falling prices for the result and said industry profitability is expected to improve, but still struggle, in the second quarter. The domestic price of unit steel products dropped 10.14 percent, or 368 Yuan a ton in the January-March period. The average price of export steel products was \$794 a ton, down \$63 year-on-year. Weak demand and increased output produced high steel inventories, which by end-March stood at 19.41 million tons, up 43.65 percent from the start of the year. With the contribution from non-steel businesses stripped out, domestic steel companies' losses were 4.1 billion Yuan in the first quarter, she said.

Nuclear plants to get the nod

China is quickening its approvals for nuclear energy and will launch projects in coastal areas to ensure energy security and economic growth, according to the State Energy Commission. The latest approvals of nuclear plants and other energy projects are part of the government's plan to push economic growth with minimal measures. As the fastest-growing atomic energy nation, China will launch another 8.6GW of capacity for nuclear power this year, according to the National Energy Administration. That is in stark contrast to the two reactors with 2.1GW of capacity approved in 2013. Even so, experts argue that the country's reliance on nuclear power is still small. Its 20 reactors in operation contributed only 1.2 percent of the country's energy use in 2013, much lower than the world's average of 9.8 percent.

China to close nearly 2000 small coal mines

China will close 1,725 small-scale mines with a total capacity of 117.48 million tons in 2014 as part of its program to phase out low-quality coal production, according to its energy administration. Smog-hit China has been desperate to reduce coal consumption, a major source of pollutants, including hazardous airborne particulate matter in the country's cities.

While China is determined to reduce the share of coal in its energy mix to less than 65 percent this year, its last five-year plan for the energy sector still allows for the construction of an additional 860 million tons of new coal production capacity over the 2011-2015 period. China aims to cap total coal

production at 4.1 billion tons by 2015, up from 3.7 billion tons in 2013, but some experts predict the actual figure will be much higher, given the number of new mine project approvals.

China remains top destination for clean energy investment

China remains the leading destination for clean energy investment in 2013 as global investment kept declining in 2013. China remains the leading regional and global clean energy market, attracting \$54.2 billion in 2013, 6 percent lower than that in 2012, said a report by the Pew Charitable Trusts. The report said the worldwide investment in clean energy kept declining in 2013 after it reached its peak in 2011, mainly dragged down by the curtailment of incentives in Europe region, including Europe, the Middle East and Africa.

Clean energy finance in the European region slid sharply for the second consecutive year, by 42 percent to \$55 billion. Investment plunged by 55 percent in Germany and 75 percent in Italy, said the report.

The report also found more solar than wind energy was installed globally for the first time in 2013. Solar generating capacity increased by 20 percent while wind capacity addition declined by more than 40 percent due to the uncertainty about US policy in the wind sector. The solar will be the leading clean energy technology in both investment and capacity for the next several years, the report predicted.

Tesla to power up across China, says Musk

Tesla Motors Inc. hopes to launch a nationwide charging and service network in China for its electric vehicles by as early as 2015, CEO Elon Musk said in Beijing on Monday. Tesla will build solar-powered charging stations in Beijing and Shanghai this year and will add more charging stations across the country in the coming years, Musk said during his first public appearance in China. The company's S model, equipped with an 85-kilowatt-hour battery, will be priced at 734,000 Yuan (\$118,000), about \$47,000 more than its sticker price in the United States. Freight, tariffs and value-added tax are behind the difference, said the company.

The 42-year-old billionaire did not reveal who his Chinese partners will be in building the stations. But China Daily reported last week, citing a company insider, that Tesla may join up with State-owned oil giant Sinopec Group for the charging network project in the country. Musk suggested that the charging and service networks will start in big cities where demand for electric cars is greater. Zhou Hongyi, founder of Beijing-based Internet security company Qihoo 360 Technology Co Ltd, said electric cars may have a big market share in China. But he also pointed out Tesla's solar-powered charging station project may not work well in some Chinese cities because days of bad air quality could hinder the process.

Jan-March foreign direct investment in China up 5.5%

Foreign direct investment (FDI) into China increased 5.5 percent in the first three months of the year despite faltering in March, the government said, though outbound investment slumped. FDI, which excludes investment in financial sectors, totalled \$31.55 billion in the March quarter, the commerce ministry said in a statement. However, investment in March declined 1.47 percent to \$12.24 billion, it said. Foreign investment into China rebounded in 2013 to \$117.59 billion as confidence in the country's growth potential picked up, but the forecast this year is for slowing expansion in gross domestic product (GDP).

Fiat-Chrysler to produce iconic Jeep in China from 2015

Automaker Fiat-Chrysler said that it would begin producing the iconic American brand Jeep in China from 2015 to meet demand in the world's largest car market. Fiat-Chrysler -- created by Italy's Fiat acquiring Chrysler of the United States -- will produce three Jeep sport utility vehicle (SUV) models in China, including one specifically designed for the Chinese market, the company said in a statement. Fiat-Chrysler will produce Jeep vehicles through its existing joint venture with Guangzhou Automobile Group Co. (GAC) but at a new manufacturing branch in the southern city of Guangzhou, it said. Last year, China's auto sales surged 13.9 percent to 21.98 million vehicles.

GM to battle VW in China with \$12 billion investment and new plants

GM plans to invest \$12 billion in China from 2014 to 2017 and build more plants next year as it competes with aggressive rivals in the world's largest auto market. GM expects its China sales to expand 8-10 percent this year, in line with the overall growth of the Chinese market. The president of General Motors said that the company and local partners are boosting production capacity for GM-brand vehicles in China to 5 million. GM is neck and neck with Germany's Volkswagen AG to be China's most popular vehicle brand. GM said earlier its 2013 sales rose 11.4 percent to 3.1 million vehicles.

Ford launches luxury Lincoln brand in China

Ford Motor launched its luxury Lincoln car brand in China, just days ahead of Beijing's auto show in the world's largest car market. Ford said the Lincoln was designed specifically for China customers. The company will begin sales in the autumn in seven cities with the Lincoln MKZ, a midsize sedan, and the Lincoln MKC, a small sports utility vehicle.

VW aims for double-digit growth in China

German carmaker Volkswagen is targeting double digit sales growth in China this year and will launch two new hybrid cars in the world's leading auto market, the group's chief said on Saturday. "For 2014 we have once again set our sights on double-digit growth in China and are aiming to deliver more than

3.5 million vehicles to customers for the first time in a calendar year," Martin Winterkorn, said in a statement released in Beijing. Volkswagen sales already jumped 16.2 percent in China in 2013.

Avon to pay \$135 M to settle bribery charges

Avon Products Inc. will pay \$135 million to settle a long-standing U.S. government probe into whether the cosmetics company paid bribes in China and other countries to gain favors. Avon, the world's largest direct seller of cosmetics, said it would fork over \$68 million to the Justice Department and \$67 million to resolve the dispute with the Securities and Exchange Commission. The preliminary resolution still needs SEC authorization and court approval, according to documents filed with the regulatory agency Thursday.

Bosch: Global products, local talent and facilities

German auto components and electrical equipment giant Bosch concluded its 2013 fiscal year with a record sales revenue of 41.2 billion Yuan in China, a significant growth of 18 percent from the previous year. "This outstanding performance demonstrated the lasting strength and success of our innovative technologies and localized solutions," said Peter Tyroller, board member of Bosch responsible for the Asia-Pacific region. "China will have stable growth, which will ensure a healthy business environment with dynamic opportunities. We aim to further strengthen our position in China, and we strive to achieve double-digit growth in the years to come as well," he added. Bosch's automotive sector grew almost twice as fast as the market in China in 2013.

In 2013, Bosch opened a plant for automotive aftermarket products in Nanjing, a chassis plant in Chengdu and an automotive test and technology center in Donghai, Jiangsu province. This year, its joint venture Mahle Turbo Systems opened a plant in Shanghai to produce turbochargers for gasoline engines and a plant for diesel systems in Qingdao. Bosch currently has 17 technical centers in China. The number of Chinese associates working in R&D increased to 3,300, more than 10 percent of Bosch's total headcount in China. Its power tools business reported moderate revenue growth. Bosch attributed continued success in China to ongoing efforts in localization at its various operations.

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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