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SCI China Market Update – October 2013

Dear friends,

China's weeklong National Day Holiday ends October 7th. If you are a history buff you may already know that this important holiday celebrates Mao's declaration to the world of the New China - the People's Republic of China – on October 1, 1949. The New China was born from a period of long and great pain, first the bloody War with Japan from 1937 through 1945, followed by the civil war between the communist forces led by Mao and Kuomintang forces led by Chiang Kai-Shek and backed by the US. The latter lost the mainland to Mao and retreated in defeat to Taiwan, and this was the origin of the "two Chinas". To Beijing, this is a great holiday of remembrance, not unlike the Memorial Day. Interestingly, National Day was traditionally only a single day holiday. But starting in1999, under Premier Zhu Rongji, it was expanded to a weeklong holiday, along with May Day. The reason? To stimulate the economy, to encourage people to spend money. It has worked! This week all the major tourist cities like Beijing, Shanghai, Suzhou, Hangzhou and others are hosting millions and millions visitors. Traffic is a mess, restaurants are packed to overflowing – non-stop. So we've decided its best just to stay home during this "Golden traveling week". But it should be a great week for McDonalds, KFC, Pizza Hut, Starbucks, Hollywood films and California red wines.

The US government closure could also hit China, along with the impact on millions of Americans. It's a new test of Sino-US ties as China still remains the biggest foreign buyer of US government debt. Treasury data show the amount surged to nearly $1.28 trillion in July, ahead of Japan. That's up $1.5 billion over its June US Treasury holdings. Because of the National Day Holidays, any official reaction from Beijing is likely to be delayed. But analysts say it's likely to be mild as Beijing remains more focused on boosting business ties with America, than on Washington politics. Despite this, the recent fall of the US dollar could force the RMB Yuan to rise, inflating the price of Chinese goods. Thus it's likely business leaders in China will be closely watching what happens next on Capitol Hill. Below is some very recent China market news from a variety of sources for your information:

China's manufacturing activity at six-month high: HSBC
China's manufacturing activities rose to a six-month high in September, according to a preliminary survey from HSBC. The HSBC Flash Manufacturing Purchasing Managers' Index for September rose to 51.2, the highest level since April and up from 50.1 in August, according to figures released by HSBC.

The Flash PMI is based on a survey of purchasing executives in Chinese companies. An index figure above 50 signals expansion, while below 50 indicates contraction. Qu Hongbin, chief economist of HSBC China, said the country's manufacturing sectors are being boosted by rising external demand and micro stimulus policies at home. The HSBC report showed that output and new orders including new export orders rose in September. Meanwhile, stocks of raw material purchases and finished goods also increased.

China Yuan advances to 6.1480 against USD Monday

The Chinese currency Renminbi, or the Yuan, gained 15 basis points to 6.1480 against the US dollar on Monday, according to the China Foreign Exchange Trading System. In China's foreign exchange spot market, the Yuan is allowed to rise or fall by 1 percent from the central parity rate each trading day. The central parity rate of the Yuan against the US dollar is based on a weighted average of prices before the opening of the market each business day.

China launches free trade zone in Shanghai

China launched a free trade zone in its commercial hub Shanghai last week, state-media reported, with the project seen as a testing ground for much-needed reforms in the world's second largest economy. Xinhua News said the zone, which covers 29 square kilometers (11 square miles), started operating last week, adding that it was "a test bed for the Chinese leadership's drive of deepening market-oriented reforms and boosting economic vigor".

The government will allow free Yuan convertibility under the capital account on a trial basis, according to a statement released by China's State Council cabinet on Friday. Market-set interest rates, seen by analysts as a key reform for China's economy, will also be trialed, according to the statement. Restrictions on foreign investment will be eased inside the area, which will also loosen controls on 18 service sectors ranging from finance and shipping to culture services. Excitement over the launch has boosted stocks of Shanghai-based firms and spurred a rally in home prices and land costs in areas neighboring the zone in the past few weeks, state media have reported.

Yuan to be fully convertible in the zone

The Yuan will be fully convertible in the Shanghai Free Trade Zone, a development that puts it in a better position to become a global currency. In a set of rules published on Friday, the central government said that it will allow "interest-rate liberalization and the currency's cross-border use on the condition that risks are well controlled". That means institutions and individuals will be able to freely trade the yuan for any foreign currency — and vice versa — whether for trade or investment. Before, government approval was required to convert the Yuan for overseas investments.

Analysts said a free Yuan in the zone will create onshore-offshore interest-rate and exchange-rate disparities, and force the onshore market to hasten deregulation and eventually make the currency fully convertible across the country. This will boost the Yuan's prospects as a global reserve currency, and challenge the US-dollar-dominated global monetary system that many believe is the root cause of many of the global economic problems today. An average of $120 billion worth of Yuan was traded per day in April, almost quadrupling the $34 billion three years ago, making the Yuan the world's ninth most actively traded currency, according to Reuters, citing a survey by the Bank of International Settlements this month.

Facebook, other banned sites to be open in China free trade zone: report

Facebook, Twitter and other websites deemed sensitive and blocked by the Chinese government will be accessible in a planned free-trade zone (FTZ) in Shanghai, the South China Morning Post reported on Tuesday. Citing unidentified government sources, the Hong Kong newspaper also said authorities would welcome bids from foreign telecoms firms for licenses to provide Internet services in the zone.

China's ruling Communist Party aggressively censors the Internet, routinely deleting online postings and blocking access to websites it deems inappropriate or politically sensitive. Facebook and Twitter were blocked by Beijing in mid-2009 following deadly riots in the western province of Xinjiang that authorities say were abetted by the social networking sites. The New York Times has been blocked since reporting last year that the family of then-Premier Wen Jiabao had amassed a huge fortune.

China announces pricing policy for fuel upgrade

Chinese drivers will have to pay more in fuel prices amid the country's drive to reduce air pollution through upgraded fuel quality. In the next two years, the prices of motor gasoline and diesel that meet the national "fourth-phase" standard will be raised by 290 Yuan ($46.8) per ton and 370 Yuan per ton, respectively, the National Reform and Development Commission (NDRC), the country's top economic planner, said recently.

After 2017, the prices of motor gasoline and diesel that meet the national "fifth-phase" standard will be lifted further by 170 Yuan per ton and 160 Yuan per ton, respectively, said the NDRC. China has announced stricter motor fuel standards in a bid to reduce harmful emissions after smog blanketed much of the country at the beginning of 2013. Under the country's timetable of fuel quality upgrades, motor gasoline should meet the "fourth-phase" standard by the start of 2014 and motor diesel by the start of 2015; both gasoline and diesel should meet the "fifth-phase" standard by the start of 2018.

US pork giant Smithfield agrees to Chinese takeover
Shareholders of US pork giant Smithfield Foods approved this week the company's $7.1 billion purchase by China's Shuanghui International, the largest-ever Chinese takeover of a US company. The deal received 96 percent of the votes cast at a special shareholders meeting, despite an earlier challenge by a key investor arguing the deal undervalued Smithfield. Shuanghui, a leading Chinese meat processor, will pay $4.5 billion in cash, $34 a share, for Smithfield, the world's largest combined pig raiser and pork processor and an iconic name in American kitchens. Including Smithfield debt, the deal's value comes to $7.1 billion.

Tesco looks to China as profits dive in Europe
Britain's biggest retailer, Tesco, agreed to a major deal to create a retail giant in China, as it seeks to offset "challenging" trading conditions in Europe which hit profits hard. Tesco will create a joint venture with China Resources Enterprise (CRE). London-listed Tesco -- the world's third-biggest supermarket group after US retailer Wal-Mart and number two Carrefour of France -- added that the Chinese move was part of its international strategy to tap further into fast-growing economies. The new venture will combine Tesco's 134 Chinese branches, as well as the firm's Chinese shopping mall business with the China Resources Vanguard business of 2,986 outlets.

China wins $2 billion oil deal in Uganda
China's state-owned CNOOC has secured a $2-billion deal to develop a petroleum field in Uganda and help propel the east African nation into the club of oil-producing countries, an official said Friday. Uganda has oil reserves estimated at 3.5 billion barrels but the path to production has been a bumpy one since deposits were discovered in 2006 near its border with the Democratic Republic of Congo. Such reserves have the potential to radically alter Uganda's economy and could eventually as much as double the national income. China has invested heavily in Africa's oil sector to feed its energy-hungry economy.

China's Huawei expects $2 billion in 4G revenue this year
Huawei Technologies Co Ltd expects to take in more than $2 billion in revenues selling 4G gears this year as global carriers from China to Europe expand their networks, senior company executives said. Even though 4G LTE (long-term evolution) promises faster video streaming and Internet downloads, the cost of smartphones would need to come down before the technology can enter the global mainstream, they told reporters in a briefing.

There are 100 million 4G LTE users globally now, which makes up a small fraction of total mobile subscribers. That 4G number will grow to 1 billion in 2016, or more than half of total global subscribers. China is the world's largest wireless market with more than 1 billion subscribers, but only a fifth of them use 3G technologies and the rest on 2G.

Danone's Nutricia accused of bribing China doctors: media
French conglomerate Danone faced fresh bribery accusations in China on Wednesday, made by a newspaper against its healthcare subsidiary Nutricia, as authorities investigate corruption among drug and dairy firms. Nutricia "provided improper benefits on a large scale to more than 100 doctors at 14 hospitals in Beijing in order to spur medicine sales", the 21st Century Business Herald said, citing evidence it said was supplied by an unidentified hospital intern.

The bribes included a total of 300,000 Yuan ($49,000) to dozens of doctors at two hospitals, the report said. They also included receipts that could be submitted for reimbursement and group activities like strawberry-picking, it said, citing evidence from 2010 until last year. State media last week accused another Danone subsidiary, the baby formula maker Dumex, of bribing Chinese hospital officials with to 10,000 Yuan each to give its products to newborns. Danone pledged at the time to investigate the matter. Its China office could not immediately be reached for comment about the Nutricia accusations.

Authorities last month launched a three-month probe into a variety of industries for unfair competition, following a series of scandals and arrests. Police have detained at least 20 employees of British drugmaker GlaxoSmithKline since July. Beijing officials are investigating French firm Sanofi over $280,000 in alleged bribes to doctors, state media has reported.

In a price-fixing probe of milk formula manufacturers, authorities in August fined six companies including Dumex more than $100 million altogether. Imported baby formula is popular with Chinese families following a series of food scandals, notably in 2008 when six babies died from drinking milk tainted with the chemical melamine.

China's foreign debt stands at 772 billion U.S. dollars
China's top foreign exchange regulator said that the amount of debt China owes foreign lenders stood at 771.95 billion U.S. dollars as of the end of June in 2013. Of which, 403.31 billion U.S. dollars were international commercial loans and 59.14 billion U.S. dollars were loans extended by foreign governments and international financial organizations, according to data released by the State Administration of Foreign Exchange. Meanwhile, 309.5 billion U.S. dollars were debts stemming from trade loans between companies, the data showed. The majority, or 80.79 percent of the nation's foreign debt was denominated in the U.S. dollar, followed by the Euro, which accounted for 5.96 percent in China's foreign debt structure, and the Japanese yen, which accounted for 5.53 percent, the data showed.

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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