



# China Economic Monitor

Q4 2018

November 2018

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# Executive Summary

Both external and domestic environment remains challenging in Q3. The escalation in US-China trade frictions brought more uncertainty, increasing overseas concerns about growth momentum of the Chinese economy. Although downward pressure has increased, China's economic performance has remained largely stable. GDP grew by 6.5% in Q3 and 6.7% year to date, ahead of the government's annual growth target of 6.5%.

Domestic production and demand weakened in Q3. In terms of production, the added value of industrial production increased by 6.4% year-on-year (YOY) from January to September, down 0.3 percentage points from the pace seen in the first half of the year (H1). The monthly growth rate in September fell below 6%, the first time in recent years excluding the seasonal fluctuations around the Chinese New Year. On the demand side, growth in consumption continued its slow downward trend. From January to September, the nominal and actual growth rates of retail sales stood at 9.3% and 7.4%, respectively, down 0.1 and 0.3 percentage points from H1. Infrastructure investment continued to drag down the growth in fixed asset investment. From January to September, fixed asset investment increased by 5.4% YOY, 0.6 percentage points slower than H1. Growth in exports remained strong. The growth rate of exports to the US stayed at double digits for five consecutive months. However, it is mainly caused by Chinese companies trying to pull forward exports to the US to avoid future tariff increases. This should increase the downward pressure on exports in 2019.

Externally, US-China trade frictions continued to escalate. After the US government imposed additional tariffs on USD34 billion and USD16 billion worth of Chinese exports in July and August, respectively, it announced a further 10% increase in tariffs on Chinese imports of USD200 billion in September, which is scheduled to be raised to 25% on January 1, 2019. In its latest World Economic Outlook, the IMF lowered its expectation for global economic growth for this year and 2019, and pointed out that the current global economic expansion has weakened and the possibility of shocks has increased. Slowed global economic growth would dampen Chinese exports.

Current downward pressures on China's economy are mainly coming from two fronts: the escalation in US-China trade frictions, in conjunction with deleveraging policies on infrastructure investment and financing conditions. During its meeting on July 31, the Political

Bureau of the Central Committee ('Politburo') pointed out that China's economy is still stable but is also experiencing significant changes, especially from the external environment. It calls for fiscal and monetary policies to work together to ensure that economic growth remains within 'a reasonable range'. In addition, the Politburo emphasizes keeping 'employment, finance, foreign trade, foreign investment, domestic investment, and market expectations stable'.

In terms of fiscal policy, tax reductions have gradually shown their impacts. In September, the YOY growth of domestic value-added tax (VAT) revenue turned to negative (-1.2%), which was the first decline since March 2016. The growth rate of corporate income tax has also slowed, and the tax burden of enterprises has lessened. At the same time, there has been a clear acceleration in the issuance of special local government bonds, supporting fiscal expenditure. According to Wind statistics, the issuance of special local government bonds reached RMB121.4 billion in July, RMB444.8 billion in August, and RMB671.3 billion in September. As of the end of September, 95% of the full year's issuances had been reached. In September, national fiscal spending increased by 11.7% YOY, significantly higher than the 3.3% growth rate posted in August. In particular, there was a strong increase in infrastructure spending in agriculture, forestry and water (43.4%), urban and rural communities (30.9%), and transportation (16.9%).

In terms of monetary policy, on October 7, the People's Bank of China (PBOC) announced a 1 percentage point reduction on Reserve Requirement Ratio (RRR), which released an estimated RMB750 billion to boost the real economy and increase support for small, private and innovative enterprises. Compared with the previous liquidity injections through open market operations, this RRR cut will help release long-term funds and ease financing pressure. In addition, on October 22, PBOC issued two policy measures aimed at supporting the financing of small and private enterprises. First, an additional RMB150 billion of re-lending and re-discounting quota will be added to support the credit supply to small and micro enterprises. Second, PBOC will issue guidance to set up tools to support bond financing for private enterprises, especially to those facing temporary difficulties but with promising growth potentials or competitive technologies.

# Executive Summary

During a visit to Liaoning province at the end of September, Chinese President Xi Jinping reiterated the government's 'unabated encouragement, support and guidance to the development of the private economy'. He called on focusing on solving practical problems, and better implementing Central Government's decisions and reform measures in order to create a better environment for the growth of the private sector. On October 19, Vice Premier Liu He said in an interview with the People's Daily that the government would support the development of private enterprises, deepen state owned enterprises (SOEs) reforms and strengthen the financial system to serve the real economy in order to increase the vitality, resilience and innovative prowess of micro entities and to further push forward the supply-side structural reform.

The rebalancing of China's economy over the past several years has increased its resilience for stable growth. First, domestic demand has become the major drive of China's economic growth. The contribution by domestic demand to overall growth in the first three quarters of the year reached 109.8%, while the contribution by net exports remained negative. Second, industrial structure has continued to transform and optimize. Growth of the service industry, high-tech industry, equipment manufacturing industry, and emerging industries of strategic importance continued to exceed the overall industrial growth. Third, the profitability of companies has increased. Manufacturing investment is recovering, up 8.7% in the first three quarters of the year — the highest rate since August 2015. Overall, the fundamentals of the Chinese economy remain solid, and further reform and opening-up should boost its long term growth potential.

## Special topic: CFIUS reform and China's investment in the US

On 13 August 2018, US President Donald Trump signed the Foreign Investment Risk Review

Modernization Act (FIRRMA), significantly expanding the Committee on Foreign Investment in the United States (CFIUS)'s authority to scrutinize foreign investment, and revising the review process.

FIRRMA significantly expanded the scope of CFIUS's jurisdiction by defining four new types of 'covered transactions' — specific non-controlling investments, changes in the rights of foreign investors that have already invested in US companies, real estate transactions and deliberate circumvention of transaction reviews. In addition, the reform adjusted the review process, for example, introducing informal 'pre-notice consultations and draft notices', differentiating between 'selective declaration' and 'mandatory declaration', extending review times, charging review fees and the establishment of an unidentified reporting transaction mechanism. FIRRMA aims to reduce the cost of regular reviews as well as making CFIUS reviews more targeted.

Although the US claims that the new FIRRMA is not targeting investment by specific countries, the number of investigations by CFIUS on Chinese companies' investment in the US has increased significantly. According to CFIUS's latest annual report, 29 Chinese companies' M&A transactions in the US were reviewed in 2015, accounting for 20.3% of the total reviews that year. In 2016, this figure further increased to 67, representing 39% of the total CFIUS reviews that year.

The new review process and covered areas will increase the uncertainties and difficulties of Chinese firms investing in the US; it is worthwhile for Chinese firms to pay close attention to. Chinese investors should be better prepared before investing in the US, limit investment in sensitive fields, be more proactive in communications with relevant parties, and seek help from professional advisors.



# 1

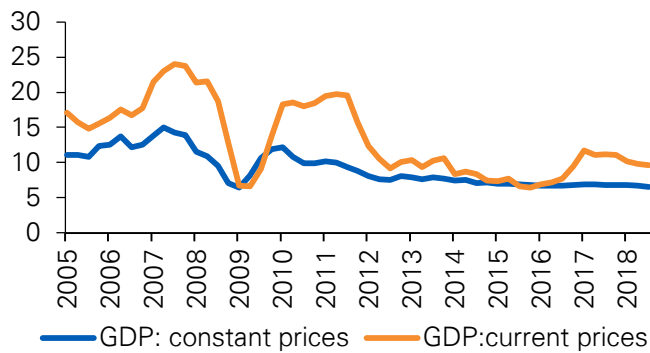
## Economic outlook



# Production growth weakened and economic activities remained largely stable

China's GDP growth in Q3 was 6.5% YOY, a drop of 0.2 percentage points compared to Q2. During the first three quarters, GDP increased by 6.7% YOY, down 0.1 percentage points compared to H1.

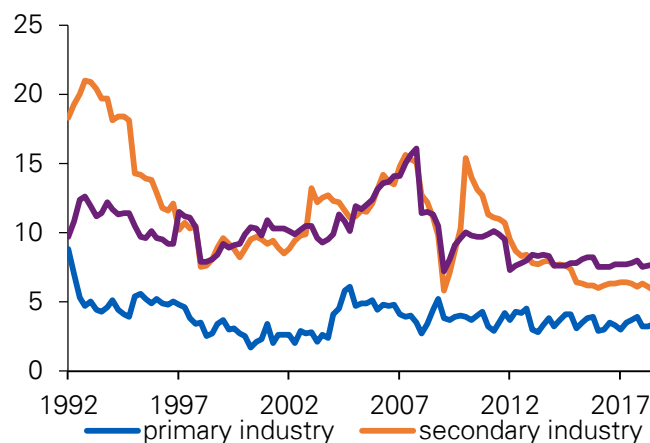
**Figure 1: GDP growth rate, quarterly YOY, %**



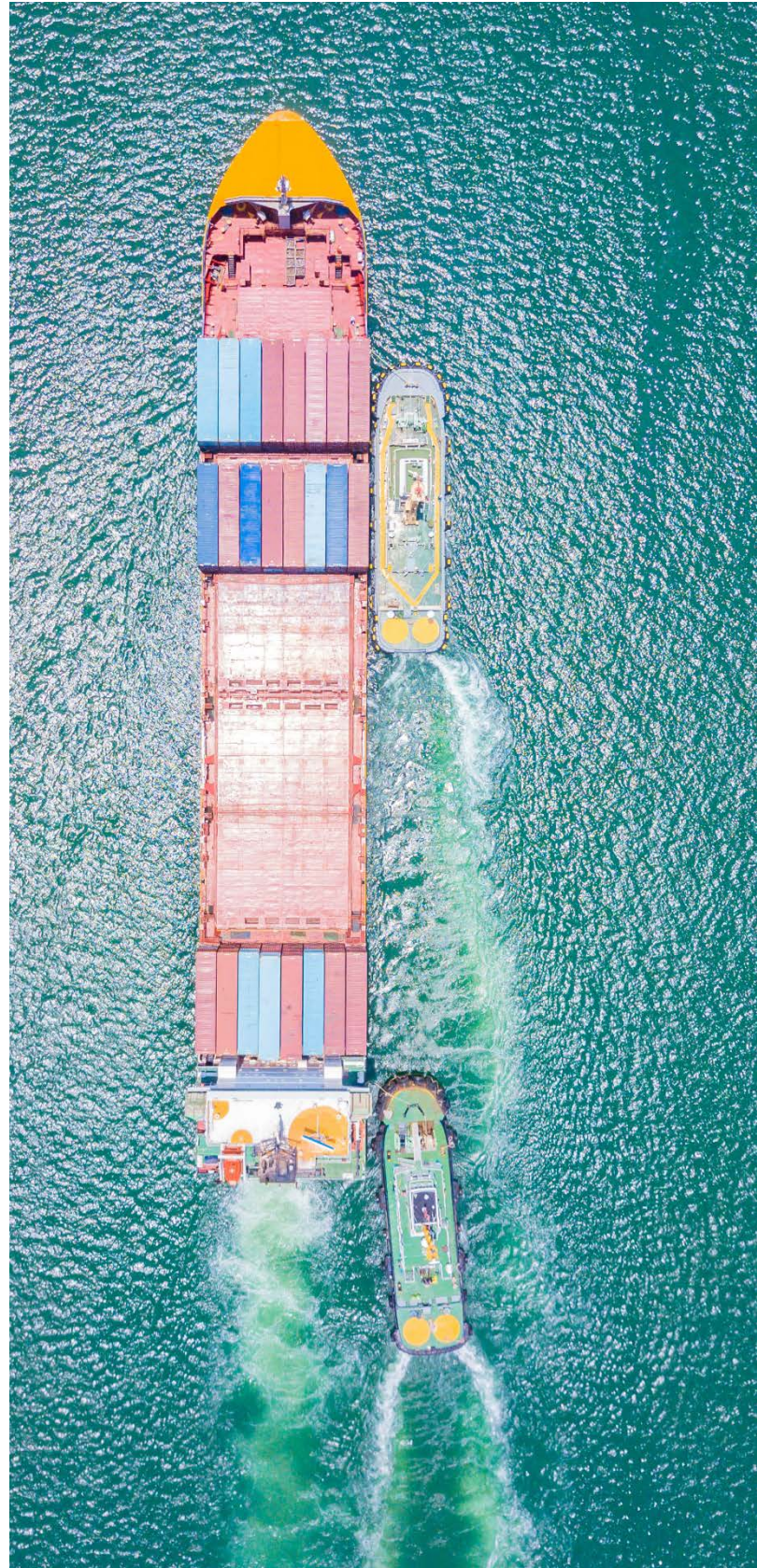
Source: Wind, KPMG analysis

The growth of the service industry continued to extend its lead over other industries, while growth of the secondary industry continued to slow. In the first three quarters, the service industry grew by 7.7% YOY, a 0.1 percentage point increase over H1. Its contribution to GDP growth increased from 60.5% to 61.3%. The growth momentum of the secondary industry continued to weaken, with YOY growth dropping to 5.8% from 6.1% in H1. Its contribution to growth fell to 35.2% from 36.7%. It was the main reason for the slowdown in GDP growth.

**Figure 2: Cumulative YOY growth rate of the three industries, %**

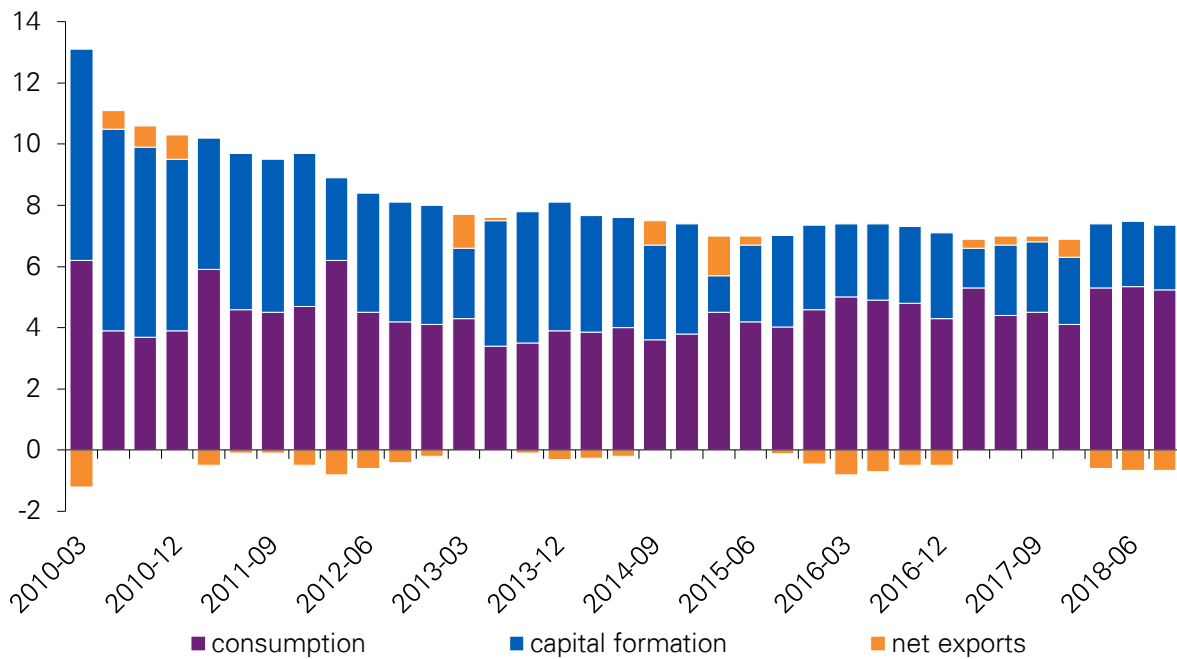


Source: Wind, KPMG analysis



On the demand side, consumption continued to serve as the cornerstone for stable economic growth. In the first three quarters, its contribution to economic growth reached 78.0%. Capital formation's contribution to economic growth rebounded slightly to 31.8% (it was 31.4% in H1), but was still lower than the same period last year. External demand's contribution to economic growth continued to be negative and was a cumulative -9.8% in Q3. Specifically, the growth rate of the total retail sales of consumer goods is still in a slow downward trend, with YOY growth of 9.3% during the first three quarters, a slight decrease of 0.1 percentage points compared to H1; the fixed asset investment remained relatively stable with slow growth, recording a growth rate of 5.4% in the first three quarters, a slight rebound of 0.1 percentage points compared to the previous eight months. Growth in exports remained relatively high, with a YOY increase of 12.2% in the first three quarters, but the trade surplus was significantly narrower than in the past few years.

**Figure 3: Growth of GDP in various sectors, cumulative value, %**



Source: Wind, KPMG analysis

In terms of output, the growth rate of the industrial output has slowed. In the first three quarters, the industrial value added above the designated size increased by 6.4% YOY, a 0.3 percentage point drop compared to H1. In terms of monthly data, the industrial value added dropped below 6% in September to an increase of 5.8% YOY; excluding the 'Chinese New Year factor'<sup>1</sup>, this was the lowest in recent years.

The Purchasing Manager Index (PMI) of manufacturing fell for the fourth consecutive month and was recorded at 50.8 in September, which was a slight drop of 0.5 percentage points compared to the previous month and significantly lower than the same period last year (52.4), indicating that there continues to be a marginal decline in the climate of manufacturing. Most factories usually close for approximately two or three weeks during the Chinese New Year for workers to go home and reunite with their families.

<sup>1</sup> Most factories usually close for approximately two or three weeks during the Chinese New Year for workers to go home and reunite with their families.

**Figure 4: Industrial value added for enterprises above the designated scale, monthly YOY %**



Source: Wind, KPMG analysis

The structural transformation continues apace. In the first three quarters, the growth rates of high-tech, equipment manufacturing and strategic emerging industries increased by 11.8%, 8.6% and 8.8% respectively, higher than the growth rate of all other industries above the designated size.

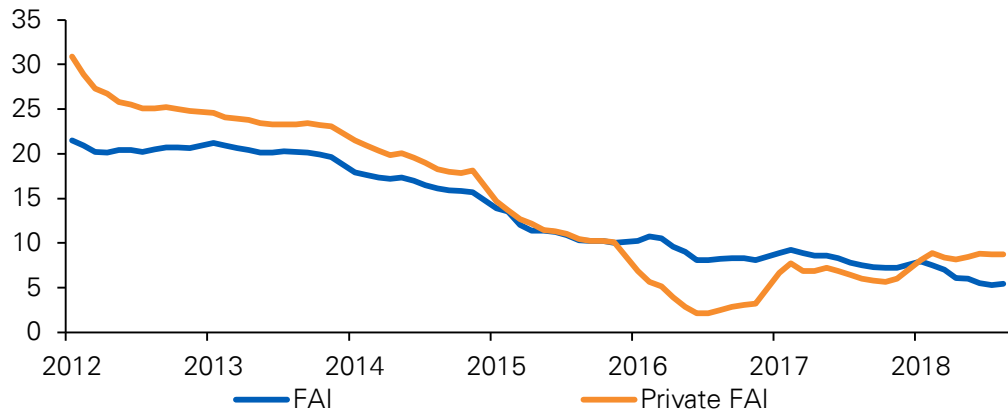




# Growth in manufacturing investment rebounded, and infrastructure investment is expected to stabilise

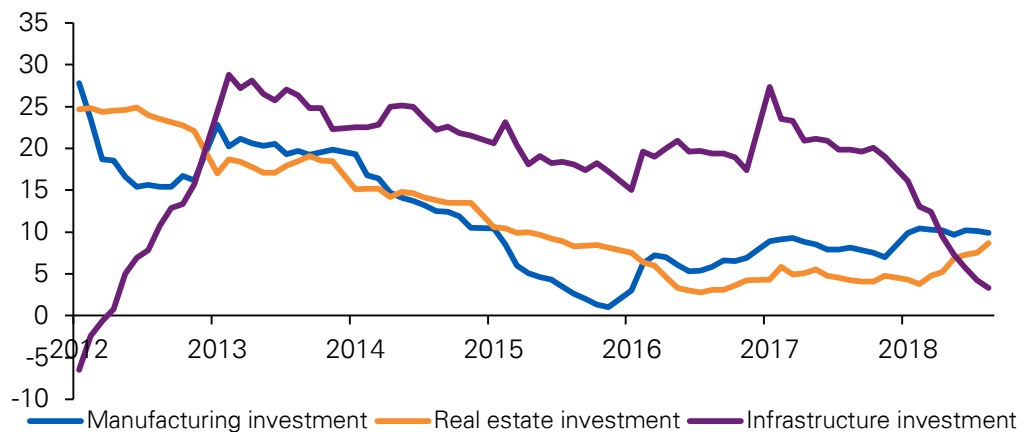
The growth of fixed asset investment remained low, but is expected to stay stable. In the first three quarters, fixed asset investment for the whole of society increased by 5.4% YOY, a drop of 0.6 percentage points compared to the previous year but a small rebound of 0.1 percentage points compared to the period from January to August. Private investment activities remained active, with an increase of 8.7% YOY across the first three quarters of 2018, 0.3 percentage points higher than H1.

**Figure 5: Fixed assets investment, cumulative YOY, %**



Source: Wind, KPMG analysis

**Figure 6: Fixed assets investment in sub-sectors, cumulative YOY, %**



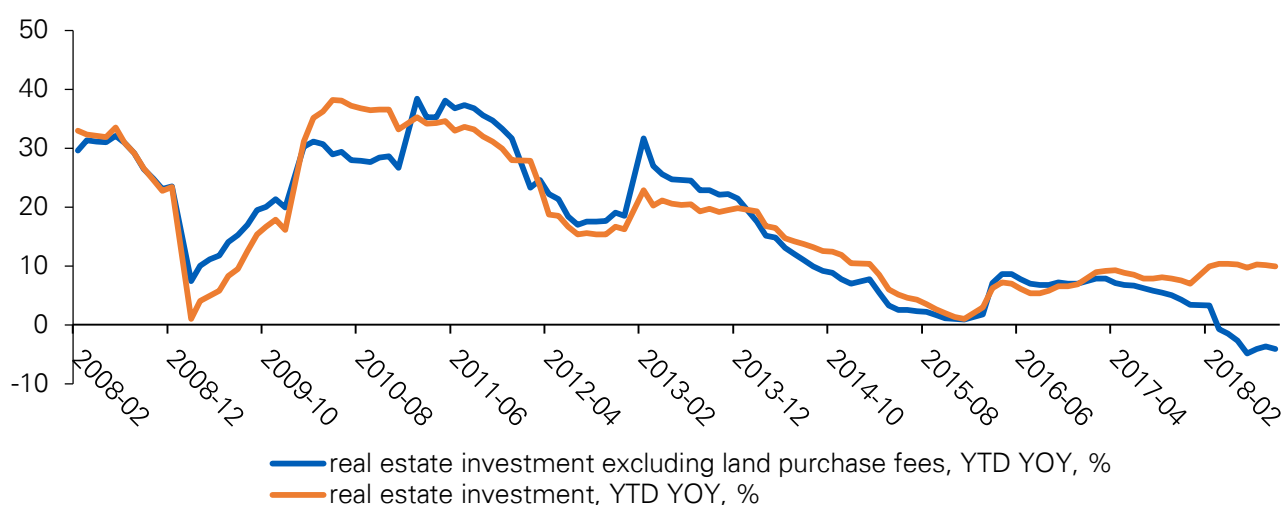
Source: Wind, KPMG analysis

Manufacturing investment activities showed robust growth momentum against the backdrop of overall investments getting weakening. During the first three quarters of 2018, manufacturing investment grew by 8.7% YOY, 1.9 percentage points more than H1 and significantly higher than the overall investment rate. Liu Kun, Minister of Finance (MoF) recently stated that MoF was in the process of researching larger tax cuts and more conspicuous measures to reduce costs. The scale of tax reductions for the whole year is expected to be RMB1.3 trillion (more than the RMB1.1 trillion determined at the beginning of the year). This will benefit private investment in the long term and consolidate the foundation for the recovery of manufacturing investment.

The growth in infrastructure investment (excluding electricity) continued to weaken, with a YOY increase of 3.3% in the first three quarters — down 4 percentage points from H1. As proactive fiscal policies are carried out, the growth of infrastructure investment is expected to stabilise or rebound slightly. Fiscal policy became more proactive in Q3. On one hand, the acceleration of local government special bond issuance has provided financial support for infrastructure investment. According to Wind statistics, the total issuance of local government special debts in H1 was only RMB43.18 billion, but surged to RMB121.45 billion, RMB444.77 billion and RMB671.32 billion in July, August and September, respectively. 95% of the special bond issuance quota (RMB1.35 trillion) was reached at the end of Q3. Its associated impact will gradually show in infrastructure financing. On the other hand, fiscal spending has also been strengthened. Fiscal expenditure increased significantly in September, with public fiscal spending increased by 11.7% YOY — a clear increase compared to August (3.3%). Spending for agriculture, forestry and water; urban and rural communities; and transport was strengthened by 43.4%, 30.9% and 16.9%, respectively. It should be pointed out that a more proactive fiscal policy environment will provide some support to infrastructure investment, but a substantial rebound in the overall infrastructure investment is hard to expect in the near term. According to our calculation, about 60% of infrastructure investment funds (the scale of which was approximately RMB10 trillion in 2017) rely on self-funding. In the climate of limited off-balance sheet financing activities and strict management of local government debt, infrastructure investments will still be under scrutiny.

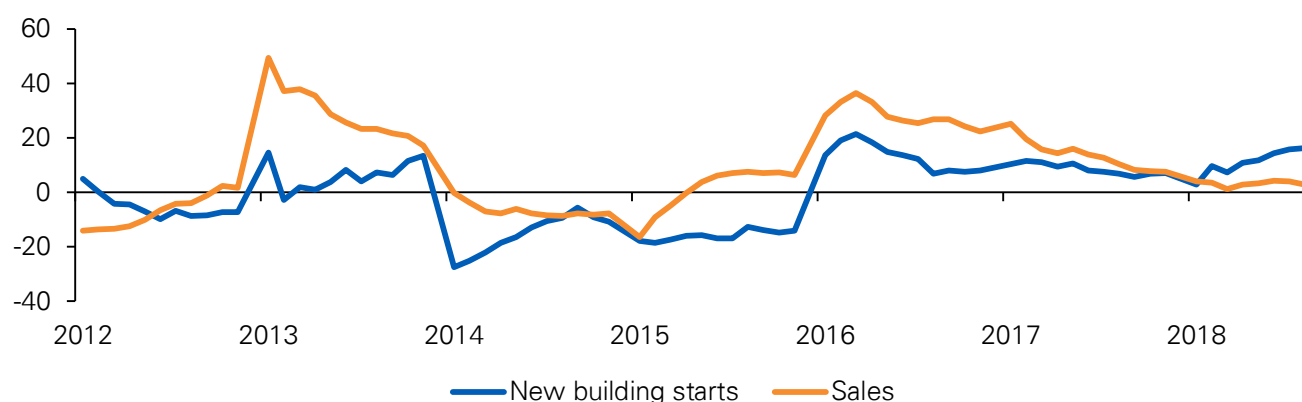
Real estate investment continued to maintain rapid growth of 9.9% YOY during the first three quarters, a slight rebound of 0.2 percentage points compared to H1. The increase in real estate investments was mainly driven by land prices. If land acquisitions are excluded, the scale of real estate investments has been shrinking for seventh consecutive months. Given the lack of effective support from the sales market, the current high growth rate in real estate investment will be difficult to maintain in the long run.

**Figure 7: Real estate development investment growth vs. investment growth, excluding land acquisitions, cumulative YOY, %**



Source: Wind, KPMG analysis

**Figure 8: New construction and sales area of real estate, cumulative YOY, %**

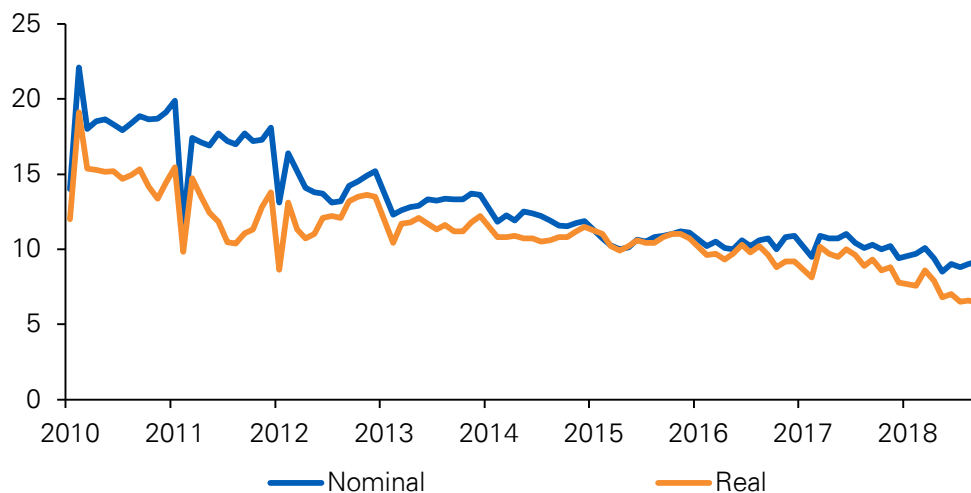


Source: Wind, KPMG analysis

# Consumption growth dragged down by sluggish automobile sales

From October 2015 to December 2017, China lowered the car purchase tax to stimulate the automobile industry, leading to a surge in car sales. However, policy concessions have been lifted this year, resulting in a decline in car sales. Car retail sales dropped by 7.1% in September. Dragged down by sluggish automobile sales, growth in consumption continued to decline. In the first three quarters, the total retail sales of consumer goods increased by 9.3% YOY, 0.1 percentage points lower than H1. The total retail sales rose by 7.4% YOY, a drop of 0.3 percentage points from H1. The monthly data shows that the nominal growth rate of the total retail sales in September (9.2%) was a slight rebound compared to August and July, respectively. The increase was mainly driven by inflation; the actual growth dropped to 6.4%.

**Figure 9: Total retail sales of consumer goods, YOY, %**

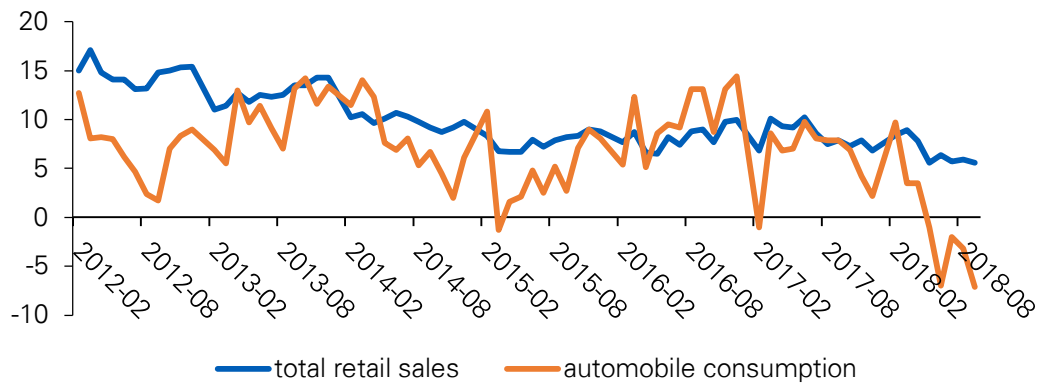


Source: Wind, KPMG analysis





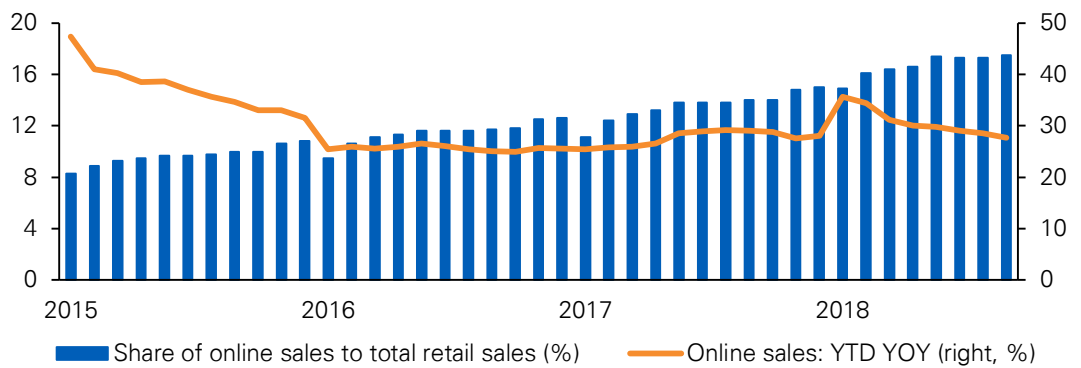
**Figure 10: Retail sales of goods above the designated size vs. sales of automobiles, YOY, %**



Source: Wind, KPMG analysis

Online consumption growth remained strong. In the first three quarters, online retail sales increased by 27.7% YOY. Though the number represented a decline compared to H1 (29.8%), it was significantly higher than the overall growth rate of consumption. The share of online retail sales in total public consumption also climbed to a new high of 17.5%, a 0.1 percentage point increase compared to H1.

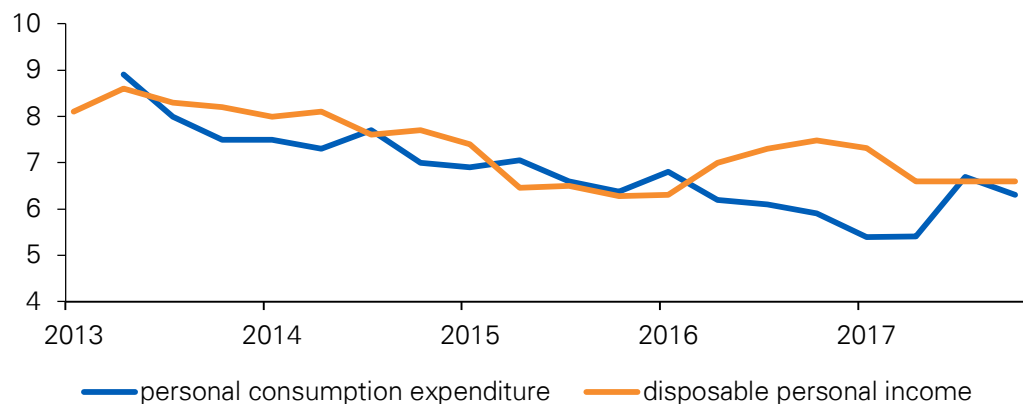
**Figure 11: Online consumption of physical goods and its growth rate**



Source: Wind, KPMG analysis

There was a steady growth in household income. In the first three quarters, the growth of per capita real disposable income was roughly equal to the real GDP growth, up 6.6% YOY and the same as the growth in H1. Relatively stable income growth will continue to support growth in consumption. In the first three quarters, the per capita real consumption expenditure increased by 6.3% YOY, a slight decrease compared to H1.

**Figure 12: Growth rate of per capita household disposable income and per capita household consumption expenditure, cumulative YOY, %**



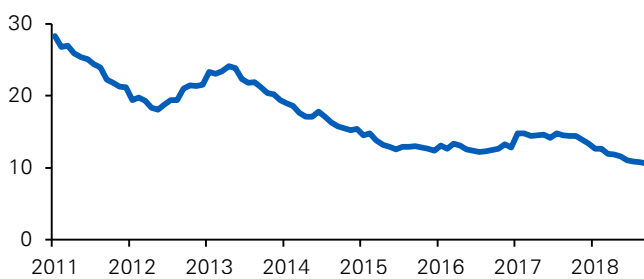
Source: Wind, KPMG analysis

# Corporate financing remained tight and inflation pressure muted

Since September, PBOC has included the issuance of local government special bonds in total social financing (TSF) calculations. Under the new calibre, the growth of TSF stock continued to weaken to 10.6% YOY, down 0.5 percentage points from the first half of 2018.

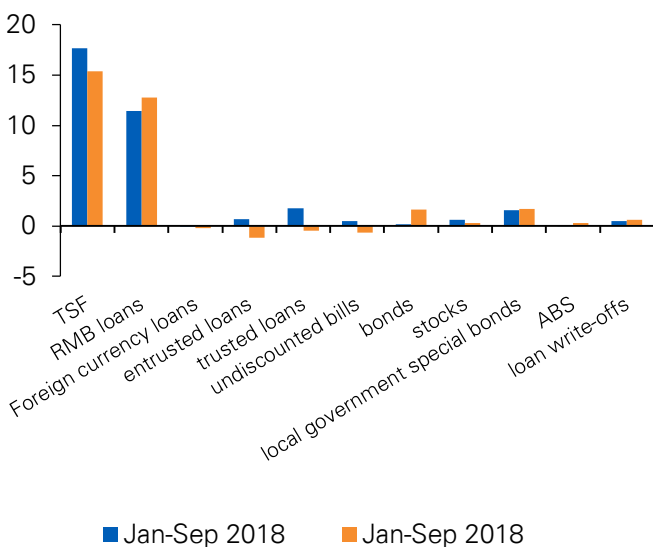
In Q3, newly added social financing stood at RMB5.4 trillion, a YOY decrease of RMB144.68 billion. Of this, non-standard financing continued to shrink — entrusted loans, trust loans and undiscounted bank acceptance bills decreased by RMB1.04 trillion, a drop of about RMB1.5 trillion YOY and the main drag on TSF's growth rate.

**Figure 13: TSF stock, YOY, %**



Source: Wind, KPMG analysis

**Figure 14: The composition of newly added financing (RMB trillion)**

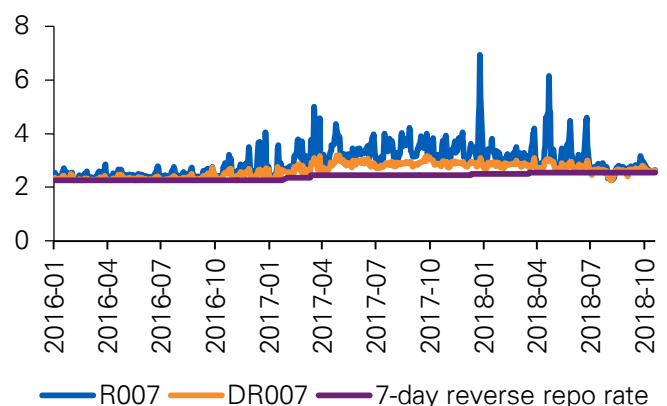


Source: Wind, KPMG analysis

In Q3, financial institutions added RMB4.1 trillion of loans, an increase of RMB924.5 billion over the same period last year. Of these, note financing increased by RMB959.55 billion YOY, accounting for more than 100% of new loans. In contrast, the scale of medium- and long-term loans to enterprises decreased by RMB90 billion, indicating that financing remains tight for corporates.

Since July, the deposit institutions' seven-day pledge-style repo rate (DR007) and the seven-day interbank pledge-style repo rate (R007) have both been relatively low, even dropping below the central bank's seven-day reverse repo rate at certain times — indicating abundant liquidity in the current interbank market. The current difficulties in corporate financing, meanwhile, suggest that issues remain in monetary policy transmission mechanisms.

**Figure 15: Interbank market interest rate, %**



Source: Wind, KPMG analysis

On October 7, PBOC announced the fourth RRR cut of the year, bringing the scale of cuts to 1 percentage point. After repaying the RMB450 billion medium-term loan facility (MLF) due on October 15, it will release approximately RMB750 billion of incremental funds, which is more than the scale of the previous three cuts this year added together. Sticking to the wider direction of not implementing strong stimulus policies, but more focused on targeted regulations', this will help release long-term funds, optimise liquidity structure and reduce bank capital costs, thus making it easier for commercial

banks to support the real economy — particularly when it comes to the growth of small, private and innovative enterprises. On October 22, PBOC issued two policy measures to support the financing of small and private enterprises. The first was an RMB150-billion increase in re-financing and re-discounting quotas to support the credit supply of small and micro enterprises. Second, the bank has set up tools to support bond financing for private enterprises, especially to those facing temporary difficulties but with promising growth potentials or competitive technologies.

In the current economic environment, the introduction of the above two policies is a timely and effective response to difficulties the real economy is facing in financing and monetary policy's poor transmission mechanisms. They will be conducive to improve these transmission mechanisms, better meeting the necessary financing needs of the real economy, and promoting the adjustment and optimisation of the economic structure<sup>2</sup>.

In terms of inflation, the extreme weather conditions such as typhoon and heavy rainfalls, as well as the African swine flu have played roles in pushing up CPI growth in Q3 by 2.5%. After deducting food and energy, the core CPI, however, remains weak, with a YOY increase of 1.7% in September, striking a record low since September 2016. It shows the real CPI is not rising and thus will not be a constraint on monetary policy in the short term. The production price index (PPI)'s YOY growth slowed; in September, it recorded a YOY growth of 3.6%, which was 1 and 0.5 percentage points less than in July and August, respectively. Base effect was the major reason for the slowing down. Month-on-month growth accelerated by 0.6% in September, up by 0.5 and 0.2 percentage points from July and August, respectively, which was mainly due to the effect of recent changes in

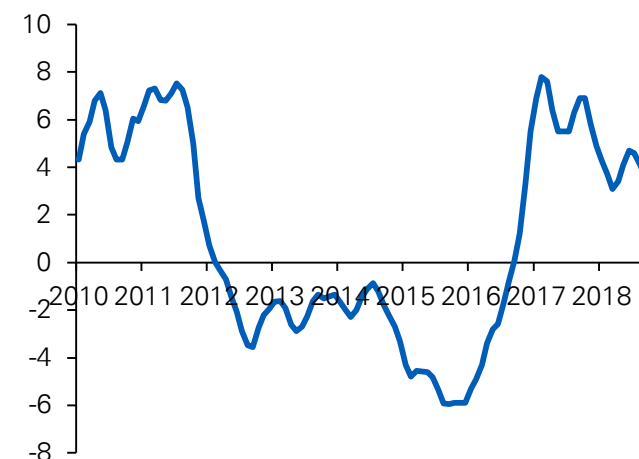
international oil prices. Including the RMB150 billion increase in refinancing and rediscounting quotas in June, this year will see RMB300 billion worth of refinancing and rediscounting.

**Figure 16: CPI, YOY, %**



Source: Wind, KPMG analysis

**Figure 17: PPI, YOY, %**



Source: Wind, KPMG analysis



<sup>2</sup>Including the RMB150 billion increase in refinancing and rediscounting quotas in June, this year will see RMB300 billion worth of refinancing and rediscounting.

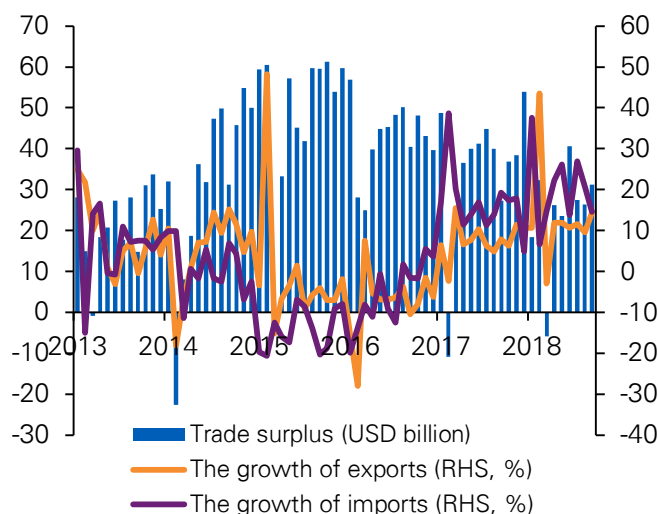
# Export growth expected to slow and RMB depreciation pressure lingering

In the first three quarters, the total imports and exports increased by 15.7% YOY. Exports increased by 12.2% and the trade surplus reached USD221.38 billion, representing a decrease of 23.8% from the same period of the previous year (USD290.37 billion). In Q3, export growth was better than expected. The growth of exports to the US remained at double digits (14.0% in September), largely attributed to enterprises rushing to export to avoid the US tariff increase.

US-China trade frictions continued to escalate. Following the completion of tariffs on the remaining USD16 billion of Chinese exports in August, in September the US government announced that it would impose a 10% tariff on USD200 billion of Chinese exports and plans to increase tariffs to 25% for certain product types from 1 January 2019. As a result, enterprises will continue to export early in Q4, distorting the annual export data.

In its latest World Economic Outlook, the IMF lowered its expectation for global economic growth for this year and 2019 by 0.2 percentage points to 3.7%, and pointed out that the current global economic expansion has weakened and the possibility of shocks has increased. Slowed global economic growth would dampen Chinese exports.

**Figure 18: The growth of China's imports and exports versus China's trade balance (LHS)**

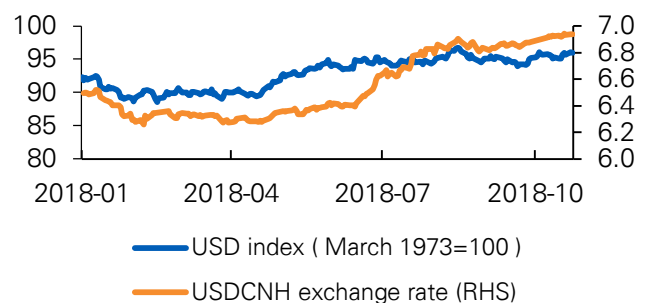


Source: Wind, KPMG analysis

This year, yuan's exchange rate against the US dollar rose first and then depreciated. It rose slightly during January–April then began sustained depreciation against the US dollar in May. The rate increased significantly after mid-June and broke the 6.9 yuan to a dollar mark by August 15. After that, the yuan's exchange rate against the US dollar began to fluctuate; after the Fed announced a hike of 25 basis points on September 26, however, it once again started depreciating, and on October 18 recorded the lowest of the year, at 6.9409 (as of October 24).

US is still in the interest rate hike cycle (another round of interest hike is expected to happen this year), while China must strike a balance between expanding domestic demand and adjusting economic structure; as a result, depreciation pressure on the yuan will linger in the near future.

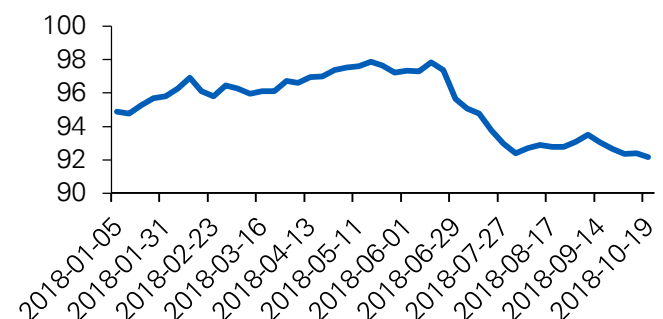
**Figure 19: USD index and RMB exchange rate**



Source: Wind, KPMG analysis

Since late June, the CFETS exchange rate index, which reflects the yuan against a 'basket of currencies', has continued to fall, reaching a low of 92.15 on 19 October — down 5.8% from its mid-June high of 97.85.

**Figure 20: CFETS exchange rate index**



Source: Wind, KPMG analysis

# 2

## Policy review





# Shanghai-London Stock Connect set to open soon

On 12 October, the China Securities Regulatory Commission (CSRC) officially issued the Regulations on the Implementation of the Interconnection Depository Receipts Business of the Shanghai Stock Exchange and the London Stock Exchange (Trial) (referred to as the 'Supervisory Regulations' below). The Shanghai Stock Exchange and the CSDC also publicly solicited opinions on relevant documents guiding its implementation. The progress is significant since the two countries started conducting the feasibility study in 2015. It also echoes the PBOC Head Yi Gang's pledge to open the Shanghai-London Stock Connect within the year.

The Shanghai-London Stock Connect refers to the interconnection of the Shanghai and London Stock Exchanges, allowing eligible listed companies on either Exchange to issue depository receipts (DRs) and use market trading mechanisms in the opposite market. DR-based securities are currently limited to the form of stocks. The Shanghai-London Stock Connect employs the mode of depository receipts and listing in the opposite market. Eligible listed companies in both markets are welcomed to apply to the opposite side's securities regulator and Exchange for listing to actively engage in eastward and westward businesses.

Unlike the Shanghai-Shenzhen-Hong Kong Stock Connect, investors involved in the Shanghai-London Stock Connect will directly invest in the DR, rather than the target company's underlying stocks. That being said, stocks in the respective markets must first be converted into DRs and listed on the opposite market, following which investors can trade through the purchase of DRs. In the Shanghai-Shenzhen-Hong Kong Stock Exchange, meanwhile, investors in each location buy stocks directly in the other market, without the need to go through the process of conversion.

**Table 1: Shanghai-London Stock Connect Chart:**

	Eastward business (CDR)	Westward business (GDR)
<b>Summary</b>	Companies listed on London Stock Exchange issue Chinese depository receipts (CDRs) on the Shanghai Stock Exchange.	Shanghai Stock Exchange-listed A-share companies issue global depository receipts (GDRs) on London Stock Exchange.
<b>Direct financing</b>	Companies listed on London Stock Exchange are not currently permitted to engage in direct financing from China's domestic market via issuing CDRs.	A-share companies listed on the Shanghai Stock Exchange can raise funds on the British market directly via issuing GDRs.
<b>Issuer criteria</b>	The issuer of the overseas underlying security should be a listed company with good reputation on the main board of the London Stock Exchange. The company's listing period and capital must meet certain criteria, the purpose of which is to select issuers with relatively good liquidity and a comparatively large investor pool to participate in eastward business.	The London Stock Exchange welcomes companies that sell on the main board of the Shanghai Stock Exchange and meet certain criteria to issue GDRs.

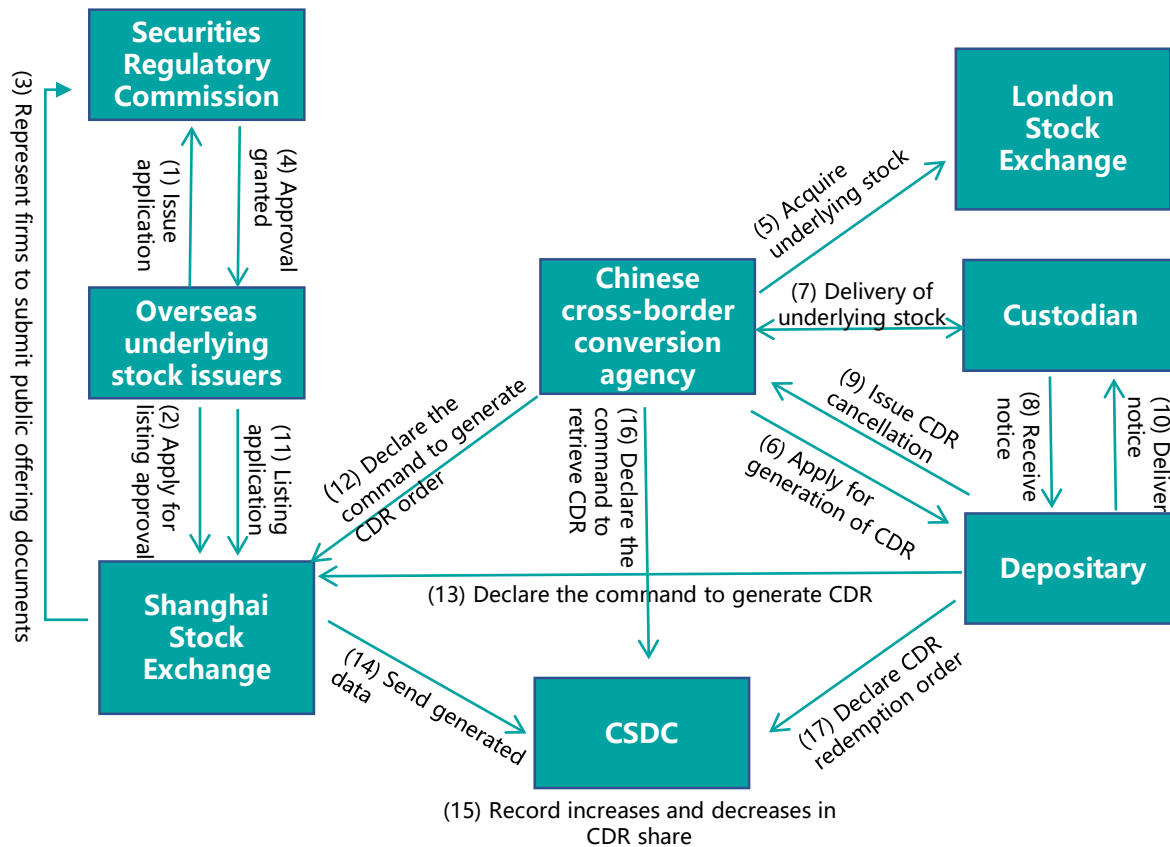
Sources: The Shanghai Stock Exchange's press conference on the Shanghai-London Stock Connect (August 31, 2018), KPMG analysis

In addition, eligible securities trading institutions in both locations can directly open securities and fund accounts in the other market and, in accordance with the associated regulations, engage in the cross-border DR conversions.

### ► Shanghai-London Stock Connect Trading Process

The Shanghai-London Stock Connect must execute trades via a cross-border conversion mechanism between the DR and underlying stocks. Specifically, cross-border conversion is divided into the DR 'generation' process and the DR's 'redemption' (transfer back to underlying stock) process. Cross-border conversion is completed via coordination between investors, depository<sup>3</sup>, custodians<sup>4</sup> and cross-border conversion agencies.

Figure 21: Shanghai-London Stock Connect trading flow chart (using eastbound business as an example)



Source: Wind, KPMG analysis

#### — Issuance application and review stage [steps (1)–(4)]

Where non-additional stock-based securities are used to publicly issue listed DRs in China, the issuer of the overseas underlying securities should apply to the CSRC, which will approve the application of the foreign underlying securities issuer in accordance with the laws. In addition, the issuer of the overseas underlying securities should submit the listing pre-audit application to the Shanghai Stock Exchange, which will submit the public issuance application to the CSRC<sup>5</sup>.

<sup>3</sup>A depository shall be a domestic legal person who holds the overseas underlying securities in accordance with the depository agreement and accordingly signs and issues the depository receipts representing the rights and interests of the overseas underlying securities. A depository mainly plays the role of the "converter" between the overseas underlying stocks and the domestic depository receipts.

<sup>4</sup>The custodian is a financial institution entrusted by the depositor to hold the underlying securities represented by the DRs in custody in accordance with the escrow agreement.

<sup>5</sup> Article 4 of the Regulations on the Shanghai Stock Exchange and the London Stock Exchange's Interconnection Depository Receipts Business (Trial), Article 3 of the Guidelines for the Pre-audit of China Depository Receipts for the Shanghai Stock Exchange and the London Stock Exchange (Draft for Comments)

### — — Cross-border conversion stage (steps (5)–(11))

After receiving approval from the CSRC, the overseas issuer entrusts the Chinese cross-border conversion agency to carry out cross-border conversion and establish initial liquidity<sup>6</sup>. Steps (5) to (10) are the CDR generation and redemption process. Only CDR generation is carried out during initial liquidity generation; CDR redemption is not carried out<sup>7</sup>. Step (11) is when the CDR generation amount reaches the listing threshold, at which point the issuer should promptly submit the listing application to the Shanghai Stock Exchange<sup>8</sup>.

### — — CDR generation and redemption registration phase [steps (12)–(17)]

CDR's generation and redemption requires corresponding registration with CSDC<sup>9</sup>.

## ► CDR issuance conditions and validation process

The conditions and validation procedures for GDR issuance are clearly explained in the 'Supervisory Regulations':

Criteria for issuance: If a domestic listed company issues overseas DRs using its new shares as the underlying security, or lists its overseas DRs using the existing issues as the underlying security, it shall comply with such laws and regulations as the Securities Act and the Special Provisions on the Raising of Shares and Listings Abroad and the relevant provisions of the CSRC on overseas issuance or listing of securities by domestic enterprises. In addition, if any of the following circumstances apply to a domestic listed company, it may not issue overseas DRs using newly issued shares as the underlying security.

1. The issuance application documents contain false records, misleading statements or material omissions.
2. The rights and interests of the listed company are seriously harmed by the controlling shareholder or actual controller, and the said controlling shareholder or actual controller has not been removed.
3. The listed company and its subsidiaries have violated the regulations for the provision of guarantees, and the said issue has yet to be rectified.
4. The current directors and senior executives have received administrative penalties from the CSRC in the past 36 months or have been publicly condemned by the securities exchange in the last 12 months.
5. The listed company or its current directors and senior executives are being investigated by the judicial authorities for suspected crimes or by the CSRC on suspicion of violating laws and regulations.
6. A certified public accountant raised reservations, negative opinions or opinions that could not be expressed regarding the financial statement from the most recent year or quarter. This does not apply if the major effect on the matters pertaining to the said reservations, negative opinions or opinions that could not be expressed has been eliminated, or if the issuing is being performed after a major restructuring.
7. The public interest and the legitimate rights and interests of investors are significantly harmed.

CDR review process: If a CDR is issued on non-newly issued stock-based securities, the issuer of the overseas basic securities should apply to the CSRC. The CSRC accepts the application documents submitted by the issuers of overseas basic securities through the Shanghai Stock Exchange. According to its own regulations, the Shanghai Stock Exchange audits whether the issuer of the overseas basic securities meets the listing requirements of CDR. The CSRC approves the application of the foreign basic securities issuer; there is no need for submission to the Issuance Review Committee for review.

In September 2018, listed companies that met criteria started taking actions. Huatai Securities announced that it intended to issue GDRs and list on the London Stock Exchange to raise funds of no less than USD500 million. Huatai Securities will also become the first company to issue GDR through the Shanghai-London Stock Connect, which is a milestone.

## KPMG observations:

KPMG believes that the launch of the Shanghai-London Stock Connect will promote the healthy development of China's financial markets in the following ways:

<sup>6</sup>Article 10 of the Interim Measures for the Listing and Trading of Depository and Depository Deposits between the Shanghai Stock Exchange and the London Stock Exchange (Draft for Comments)

<sup>7</sup>Article 3 of the Guidelines for the Cross-border Conversion of the Depository and Depository Deposits of the Shanghai Stock Exchange and the London Stock Exchange (Draft for Comments) and Article 12 of the Interim Measures for the Listing of the Depository and Depository Deposits of the Shanghai Stock Exchange and the London Stock Exchange (Draft for Comments)

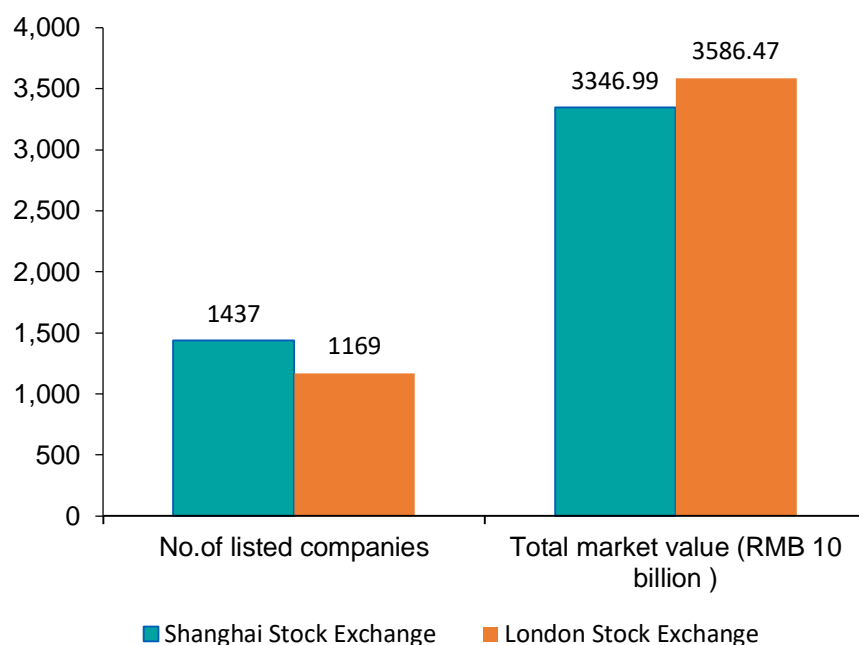
<sup>8</sup>Article 13 of the Interim Measures for the Listing and Trading of Depository and Depository Deposits between the Shanghai Stock Exchange and the London Stock Exchange (Draft for Comments)

<sup>9</sup>Article 6 of the Implementation Rules for the Registration and Settlement of the Depository and Debt Deposits of the Shanghai Stock Exchange and the London Stock Exchange of China Securities Depository and Clearing Co., Ltd. (Draft for Comment)

### — — **Expanded investment and improved quality**

A comparison of the listings of the main boards of the Shanghai Stock Exchange and London Stock Exchange reveals that as of August 2018, the Shanghai Stock Exchange had approximately 270 more listed companies than the London Stock Exchange, but their total market value fell short of the London Stock Exchange by almost RMB2.4 trillion. This indicates that the opening of the Shanghai-London Stock Connect will broaden the range of investments available to Chinese investors, enabling them to invest in the high-quality assets of companies listed on the London Stock Exchange.

**Figure 22: Comparison of the size of the main boards of Shanghai Stock Exchange and London Stock Exchange (August 2018)**



Source: Wind, London Stock Exchange Data, KPMG analysis

### — — **Accelerating foreign investment in the A-share market**

The opening of the Shanghai-London Stock Connect will also help Chinese listed companies raise funds from overseas markets, expanding the scale of foreign shareholdings in China's stock market. According to data released by PBOC<sup>10</sup>, as of June this year, foreign institutions and individuals held approximately RMB1.28 trillion of Chinese stock, accounting for just 2.53%<sup>11</sup> of the total market value of the country's stock market. According to statistics from the UK's statistical department, by the end of 2016, the proportion of foreign shares in the UK stock market was 53.9% — much higher than in China. There is still significant room for improvement when it comes to opening up the Chinese stock market<sup>12</sup>.

### — — **Steady progress expected to take precedence**

Trading will be limited to stocks, eastward stock issuances and investments quotas, which indicates that the emphasis will be on stability during the early stages of the Shanghai-London Stock Connect. There will be no major shocks to the A-share market during this time.

<sup>10</sup> People's Bank of China, overseas institutions and individuals holding domestic RMB financial assets, June 2018

<sup>11</sup> People's Bank of China, Stock Market Statistics, June 2018

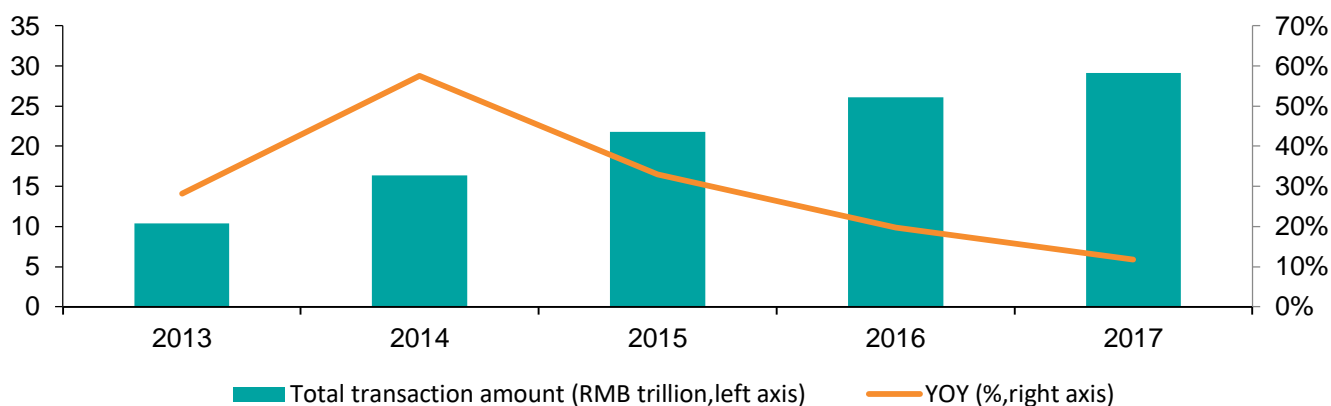
<sup>12</sup> Office for National Statistics, Ownership of UK quoted shares: 2016, November 2017

# E-commerce Law passed

On August 31, the Fifth Session of the Standing Committee of the 13th National People's Congress voted to pass the Electronic Commerce Law of the People's Republic of China (referred to below as the 'E-commerce Law'). The legislative process was initiated at the end of 2013 and has been five years in the making. After being reviewed by the Fourth Session of the Standing Committee of the National People's Congress, it finally passed and will be implemented from January 12019. The law provides comprehensive regulation of e-commerce from the perspective of e-commerce business entities, e-commerce transactions and services, e-commerce transaction guarantees, cross-border e-commerce, supervision and management, and legal responsibilities.

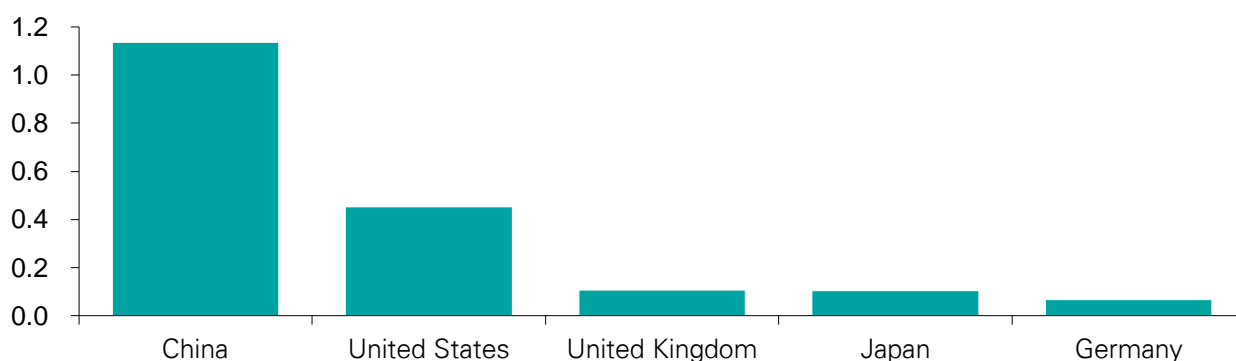
During the five-year legislative process, e-commerce — which is a major part of the digital economy — boomed following the rapid development of network technology and the logistics infrastructure in China. In terms of transaction volume, the total amount of e-commerce transactions nationwide increased from RMB10.4 trillion in 2013, to RMB29.2 trillion in 2017, a compound annual growth rate of nearly 30%. In 2017, e-commerce retail sales in China reached USD1.14 trillion; this figure was the world's highest — 2.5 times that of the US and accounted for half of the world's total.<sup>13</sup> The rapid development of e-commerce also placed higher demands on its supervision. Such a massive market urgently needed comprehensive, authoritative industry legislation to increase regulation and bring more order to the industry.

**Figure 23: Overview of China's e-commerce development from 2013 to 2017 (RMB trillion)**



Source: E-commerce annual reports by Ministry of Commerce (2013-2017), KPMG analysis

**Figure 24: Top five countries in global e-commerce retail sales in 2017 (USD trillion)**



Source: e-Marketer, KPMG analysis

<sup>13</sup> Retail Ecommerce Sales, by Country, e-Marketer, January 2018

According to the E-commerce Law, e-commerce refers to natural persons, legal persons and unincorporated organisations that sell commercial goods or provide services through IT networks. This includes product sales platforms specialising in the provision of physical goods — such as Taobao and Suning — as well as service providers covering areas such as housekeeping, ride-hailing platforms and online education.

E-commerce entities are classified as:

E-commerce platforms: such as Taobao, Alibaba, JD.com and other platform providers

Operators within the platform: e-commerce operators that sell goods or provide services through e-commerce platforms

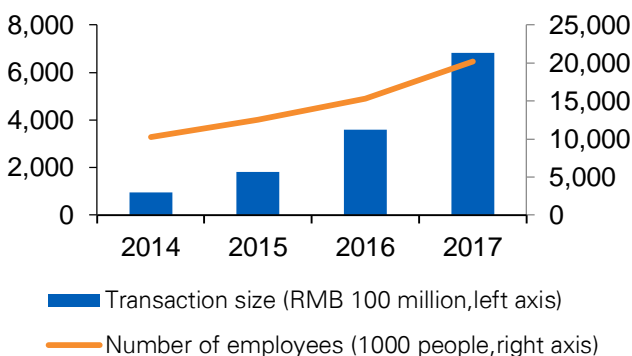
E-commerce operators that sell goods or provide services through self-built websites and other online services: for example online education websites.

Following the continued growth of social networks and the gradual decline in profitability from traditional e-commerce, various new business types have proliferated in the e-commerce field. According to Internet Society statistics, the number of employees in China’s social platform commerce and WeChat commerce reached 20.19 million in 2017, with a transaction volume of RMB683.8 billion. However, the long-term absence of industry laws and regulations has led to a regulatory vacuum for social platform commerce; in response to this, the E-commerce Law, in its third review phase, will introduce WeChat commerce and live video streaming sales into the scope of e-commerce businesses.<sup>14</sup>

It is worth noting that the E-commerce Law stipulates that in addition to personnel selling self-produced agricultural and ‘side-line’ products and homemade handicraft products, as well as individuals who use their own skills to engage in freelance labor and sporadic small-scale trading activities and do not, according to the laws, require a permit; and those who, in accordance with laws and administrative regulations, do not need to be registered, other e-commerce operators shall also register market entities in compliance with the laws. This provision increases the requirements for e-commerce operators but also facilitates the regulation of business activities as well as tax collection and management.

The relevant provisions on intellectual property protection and the legal responsibilities of e-commerce platform operators are also an area of focus. The E-commerce Law stipulates that e-commerce platform operators must establish rules for the protection of intellectual property. Where the holders of intellectual property rights believe that their intellectual property rights have been infringed, they have the right to notify the e-commerce platform to remove, block, disconnect or terminate transactions and services. If required, the platform should promptly take necessary measures; otherwise, it will bear joint liability for the greater part of the damage. At the same time, to protect relatively weak consumer rights in e-commerce transactions, if the goods or services provided by the platform operator do not meet requirements for the protection of people and property, or the operators engage in any other behavior that violates the legitimate rights and interests of consumers and do not taken necessary remedial action, the platform shall bear joint liability.

**Figure 25: Number of employees and transaction scale in China’s social platform commerce and WeChat commerce**



Source: China Internet Society, KPMG analysis

<sup>14</sup>2017 China Social Platform Commerce and WeChat Commerce Development Report, WeChat commerce Working Group of China Internet Association, August 2017

## KPMG observations:

KPMG believes that the implementation of the E-commerce Law will play the following positive roles in the regulated development of the industry:

**Market entity registration will help to improve compliance:** In order to further clarify the scope of e-commerce operators, the E-commerce Law clarifies the requirements for e-commerce merchants to register as market entities. This will be conducive to the legal and compliant operations of merchants within the platform, promoting further healthy development of the e-commerce industry and effectively protecting the legitimate rights and interests of consumers. However, since the E-commerce Law stipulates that it is the responsibility of the platform to supervise and remind merchants within its platform to register, the platform's compliance costs and technical requirements for regulatory audits will be further increased.

**Platform operators are required to jointly protect consumers' legal rights:** The E-commerce Law's regulations for platform operators' joint liability and increase in the penalty limit (it was raised to RMB2 million from RMB500,000 during the second round of reviewing process) further emphasizes platform operators' auxiliary supervision and review obligations. It encourages them to adjust and improve their operating mechanisms, establish a network security contingency plan and enhance competitiveness.

**Personal data protection regulations in line with international standards:** The E-commerce Law proposes relevant provisions on users' information protection in Articles 23 to 25, aiming at solving the problem of personal online shopping data leak in the era of big data. Most importantly, it reflects the integration with international legislation; regulations relating to queries, correction and deletion of user data that were formally implemented in the EU General Data Protection Regulations are also taken into consideration by the E-commerce Law.



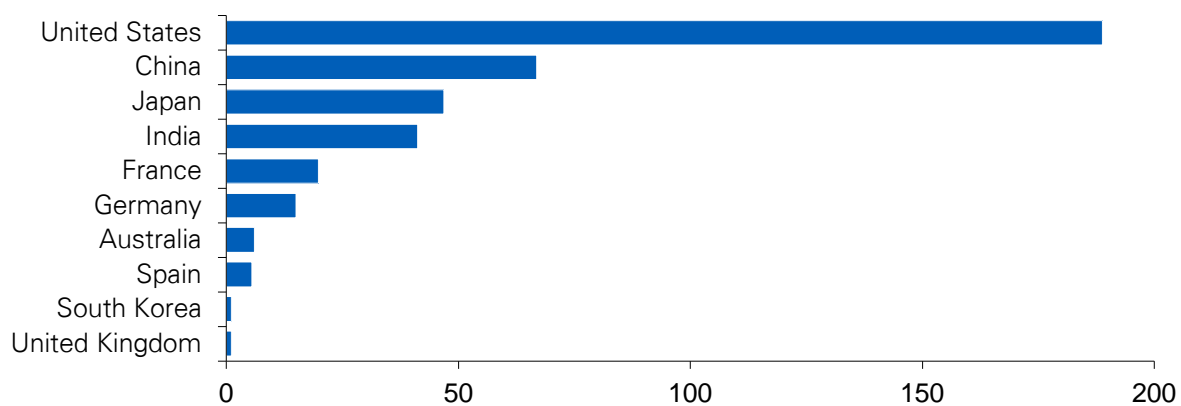
# CRS information exchange initiated in Mainland China

In September 2018, more than 100 countries including China exchanged information on tax-related financial accounts in accordance with CRS regulations. This was the first time that Mainland China has exchanged information with countries and regions that fall under CRS tax jurisdiction.

## ► Review of CRS development

The continued acceleration of economic globalization has seen taxpayers hold and manage assets through overseas financial institutions and conceal their income in overseas financial accounts to avoid tax obligations in their resident countries. A survey by UK-based advocacy group Tax Justice Network estimates that private wealth of approximately USD21 trillion to USD32 trillion is hidden in tax havens around the world.<sup>15</sup> In addition, a survey by the World Institute for Development Economics Research (UNU-WIDER) in 2017 pointed out that in 2013, tax evasion in China resulted in a USD66.8 billion loss in tax income, which was the second-highest figure among surveyed countries.<sup>16</sup>

**Figure 26: Tax losses in major countries in 2013 (USD billion)**



Source: UNU-WIDER, KPMG analysis



<sup>15</sup> Financial Secrecy Index – 2018, Tax Justice Network, January 2018

<sup>16</sup> Global distribution of revenue loss from tax avoidance, UNU-WIDER Working Paper, March 2017





In July 2014, to further strengthen the international exchange of tax data and safeguard countries' tax interests, the Organisation for Economic Co-operation and Development (OECD) was commissioned by the G20 to issue the Standard for Automatic Exchange of Financial Account Information in Tax Matters (AEOI), providing a powerful tool to help countries strengthen international tax cooperation and combat cross-border tax evasion.

CRS is part of the AEOI standard. It requires signatories to regularly disclose the financial account information of their tax residents to each other, thus improving tax transparency and combatting cross-border tax evasion and money laundering. According to OECD data, as of August 2018, a total of 149 countries and territories had pledged to implement CRS, and 103 countries and territories had signed the Multilateral Competent Authority Agreement (MCAA).<sup>17</sup> This covers almost all developed economies, including Bermuda, the British Virgin Islands, the Cayman Islands, Hong Kong, Singapore and Switzerland. In September 2017, the initial batch of 49 countries and territories exchanged financial account data for the first time, followed by the second batch of 53 countries and territories (including mainland China, Hong Kong, Macao, New Zealand and Australia) in September 2018. The successful launch of efforts to automatically exchange financial account data will further boost global tax compliance work. According to the OECD report, since the OECD began its global tax transparency work in 2009, about 500,000 people have disclosed global offshore assets over the past eight years, leading to the recovery of 85 billion euros in total.<sup>18</sup>

In March 2018, the OECD issued a new template for disclosure rules requiring lawyers, accountants, financial advisors, banks and other service providers to inform the tax authorities of any 'tax avoidance' schemes they have developed for their clients (schemes that enable clients to avoid the CRS or prevent disclosure of information about the beneficial owner of a business or trust).

In October 2018, the OECD released a list of high-risk investment immigration plans and measures to circumvent the exchange of CRS data through the abuse of investment immigration programmes.

It is worth noting that the US issued the Foreign Account Tax Compliance Act (FATCA) in 2010 to exchange information with other countries (regions) under intergovernmental agreements, but it is not a CRS-participating country.

### ► CRS development in China

In September 2014, China pledged to implement CRS. In December 2015, it signed the MCAA, promising to exchange tax information on non-resident-held financial accounts with other countries and territories from September 2018. According to the MCAA agreement, as of October this year, tax authorities from a total of 87 countries and territories are required to submit data to China, while China must also submit data to the tax authorities of 61 countries and territories.<sup>19</sup>

<sup>17</sup> List of CRS MCAA signatories, OECD, Status as of 7 August 2018

<sup>18</sup> OECD Secretary-General Report To G20 Leaders, OECD, July 2017

<sup>19</sup> "Activated Exchange Relationships for CRS Information", OECD, October 2018

To ensure the implementation of CRS, the State Administration of Taxation issued the Measures for the Management of Due Diligence of Tax Information on Non-Resident Financial Accounts (Draft for Comments) in October 2016, and in May 2017, together with the Ministry of Finance and China's 'Big Four' financial bodies (PBOC, the China Banking Regulatory Commission, the China Insurance Regulatory Commission and the CSRC), officially promulgated the No. 14 Announcement on the Measures for the Administration of Due Diligence of Tax Information on Non-Resident Financial Accounts (referred to as 'Announcement 14'), which stipulated that financial institutions should collect and report information about non-resident accounts related to domestic branch organisations before May 31 of each year. The promulgation of Announcement 14 ensures that the implementation of CRS takes the special regulatory and operational environment of the Chinese financial industry into full account and marks the official implementation of CRS in China.

**Table 1: China's implementation timetable for AEOI standards**

<b>September 2014</b>	Following approval by the State Council, China announces to implement the AEOI standards at a meeting of G20 finance ministers and central bank governors. The first data exchange is set on September 2018.
<b>July 2015</b>	The Multilateral Tax Administration and Mutual Assistance Convention is approved by the 15th meeting of the 12th National People's Congress Standing Committee and comes into force in China in February 2016, laying a multilateral legal foundation for the implementation of the AEOI standards.
<b>December 2015</b>	Following approval by the State Council, the State Administration of Taxation signs the Agreement on Multilateral Competent Authorities for the Automatic Exchange of Tax Information in Financial Accounts, providing a multilateral legal tool for the exchange of financial accounts tax information between China and other countries and territories at the operational level.
<b>October 2016</b>	The State Administration of Taxation publicly solicits opinions on the Measures for the Management of Due Diligence of Tax Information on Non-Resident Financial Accounts (Draft for Comments).
<b>May 9, 2017</b>	The Measures for the Administration of Due Diligence of Tax Information on Non-Resident Financial Accounts is officially released.
<b>July 1, 2017</b>	Financial institutions begin conducting due diligence on newly opened personal and institutional accounts.
<b>Before December 31, 2017</b>	Financial institutions complete due diligence on the stock of personal high-net-worth accounts (as of 30 June 2017, the total balance of these financial accounts exceeded USD1 million).
<b>Before May 31, 2018</b>	Financial institutions submit data.
<b>September 2018</b>	The State Administration of Taxation exchanges information with the tax authorities of other countries and territories for the first time.
<b>Before December 31, 2018</b>	Financial institutions complete due diligence on personal low-net-worth accounts stock and agency accounts stock with a total balance of more than USD250,000 as of 30 June 2017. <sup>20</sup>

Source: State Administration of Taxation, KPMG analysis

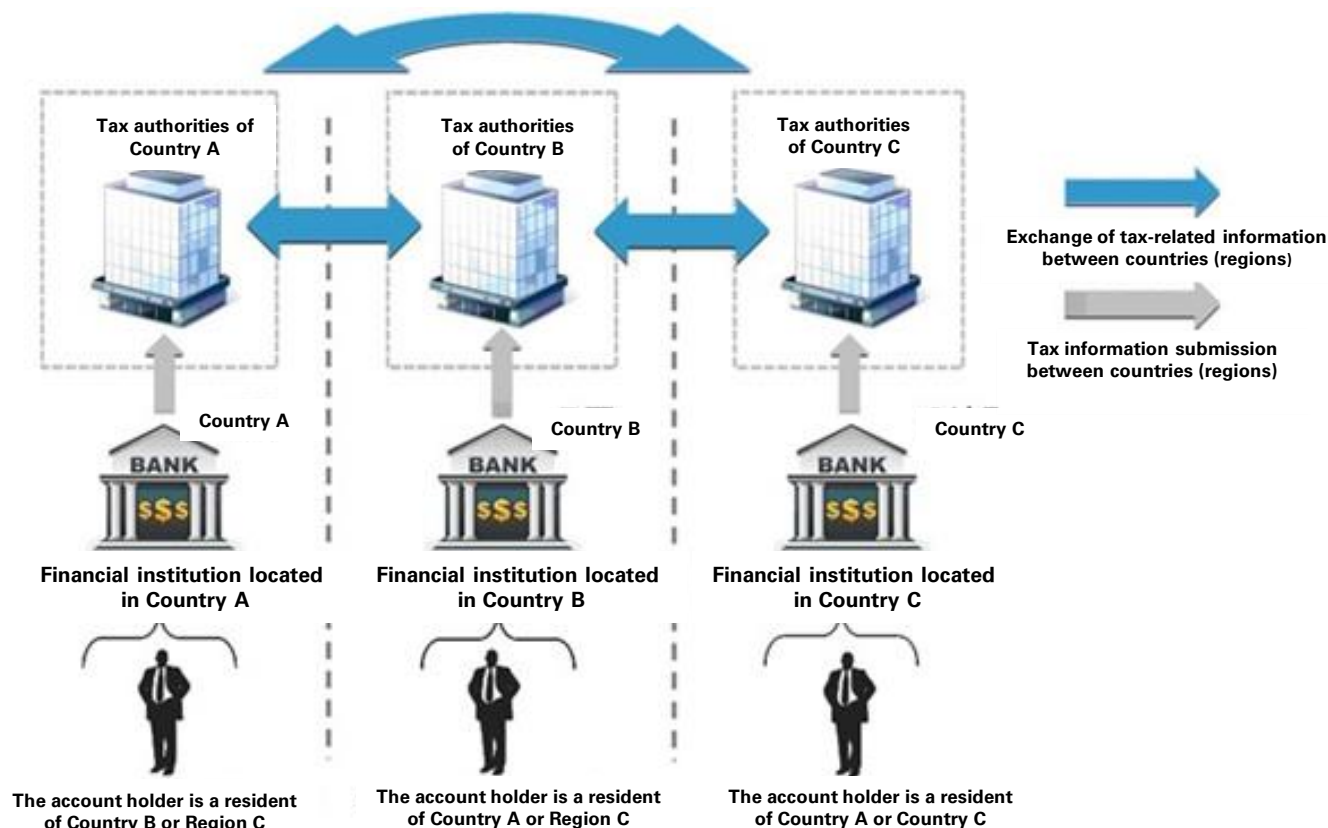
In addition, on 31 August 2018, the Fifth Session of the Standing Committee of the 13th National People's Congress voted to approve the amendment plan for the Personal Income Tax Law of the People's Republic of China. The amendment is scheduled to be fully implemented from January 1 2019 and represents the addition of an 'anti-tax avoidance clause' for the first time, meaning that 'personal tax avoidance behavior' will also be included in the anti-tax avoidance system.

### ► Financial account tax information

According to the AEOI standards, the launch of the automatic exchange of financial account tax information starts with a financial institution in a country or territory identifying the individual or enterprise accounts of tax residents from another country or territory that are held in that institution through due diligence. The competent authority of the country where the institution is located reports the account holder's name, taxpayer identification number, address, account number, balance, interest, dividends and income from the sale of financial assets, and the local tax authority exchanges data with the tax authority of the country in which the account holder is resident, ultimately providing data support for each country and territory to monitor cross-border tax sources.

<sup>20</sup> A low-net-worth account refers to an account with a total balance that does not exceed the equivalent of USD1 million as of June 30, 2017. A high-net-worth account refers to an account with a total balance that exceeds the equivalent USD1 million as of the end of 30 June 2017.

Figure 27: Flow chart of the automatic exchange



Source: State Administration of Taxation

### ► Reporting obligations

According to Announcement 14, financial institutions established in China include deposit institutions, trustee institutions, investment institutions and specific insurance institutions.

Financial institutions that are subject to reporting obligations	Financial institutions that are not subject to reporting obligations
<ol style="list-style-type: none"> <li><b>Financial institutions and policy banks (i.e. commercial banks and rural credit cooperatives etc.) that absorb public deposits</b></li> <li><b>Securities companies</b></li> <li><b>Futures companies</b></li> <li><b>Securities investment fund management companies, private equity fund management companies and partnership enterprises that manage private equity funds</b></li> <li><b>An insurance company or insurance asset management company engaged in insurance or annuities with a cash value</b></li> <li><b>Trust companies</b></li> <li><b>Other eligible institutions.</b></li> </ol>	<ol style="list-style-type: none"> <li>Financial asset management companies</li> <li>Finance companies</li> <li>Financial leasing companies</li> <li>Auto finance companies</li> <li>Consumer finance companies</li> <li>Currency brokerage companies</li> <li>Securities registration and settlement institutions</li> <li>Other ineligible institutions.</li> </ol>

## ► Financial accounts and financial assets

- **Financial accounts** include deposit accounts, escrow accounts and other accounts (accounts that meet one of the following conditions: equity or creditor rights of investment institutions, including partnership interests of private equity funds and beneficiary rights of trusts; an insurance contract with a cash value or annuity contract)
- **Financial assets** include securities, partnership interests, commodities, swaps, insurance contracts, annuity contracts or the interests of the aforementioned assets (the aforementioned interests include futures, forward contracts or options.)

It is worth noting that financial assets do not include physical goods or non-debt, direct interest in real property (for example: non-financial assets such as real estate, cars, jewellery and artworks).

## ► Affected groups

Those affected are mainly Chinese tax residents who open accounts outside China or passive non-financial institutions with Chinese tax resident controllers.

**Passive non-financial institutions:** If more than 50% of the income of a non-financial institution is from non-active business activities such as dividends, interest, rent and royalties, or financial assets that generate income from non-active business activities account for more than 50% of the total assets, then the institution is classified as a passive financial institution. An example would be an intermediate holding company that is established in a tax haven and holds only the equity of the subsidiary.

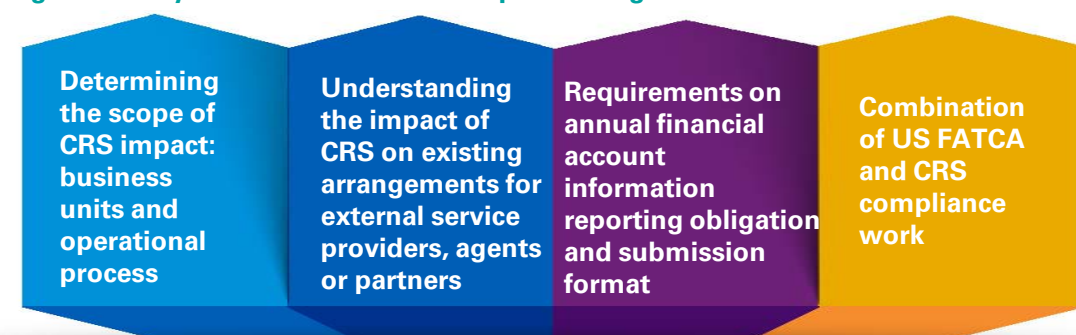
**'Penetration Review':** Since passive non-financial institutions are easily used as a tool to evade tax across borders, financial institutions need to identify these institutions and the actual controllers behind them. If the controller of a passive non-financial institution is a non-resident, the financial institution must collect and report information about the controller. The 'penetration review' function of CRS means it is no longer easy to deliberately use offshore finances to hide assets and avoid taxation.

## KPMG observations

### **Financial institutions<sup>21</sup>:**

Announcement 14 will have a broad impact on the entire financial services industry and will affect almost every business department of financial institutions doing business in China. Based on the practical experiences of KPMG and the content of CRS-based legal regulations, we recommend that financial institutions should analyse how the CRS legal regulations affect business units, operational departments, compliance departments, IT systems and internal controls.

**Figure 28: Key considerations when implementing CRS**



Source: KPMG analysis

<sup>20</sup> China Tax Newsletter - Issue 16, May 2017, KPMG, May 2017, <https://home.kpmg.com/cn/en/home/insights/2017/05/china-Tax-alert-16.html>



## **Individuals<sup>21</sup>:**

With China's active implementation of the 'going out' strategy and the proliferation of international exchanges with multinational corporations, an increasing number of Chinese individuals are being dispatched overseas, just as foreign nationals dispatched to China to participate in business exchanges and long-term employment. If the assets involved in the relevant personal financial account opened outside the country fail to fulfil the relevant national and territorial tax reporting obligations in a timely manner, they will face tax risks. In addition, the Personal Income Tax Law of the People's Republic of China passed in August clearly defines the concept of resident and non-resident individuals: individuals who have a residence in mainland China vs those who have not and have stayed for a total of 183 or more days in Mainland China during a tax year. In addition, the new tax law adds anti-tax avoidance clauses to assist the implementation of CRS. As such, in response to the implementation of the new tax law and launch of the CRS information exchange, taxpayers must have an understanding of the 'tax nature' of their assets, and must carry out a self-assessment of the tax implications for reporting overseas account information to their resident country or territory — or else consult a professional advisor that will carry out the relevant tax assessment — to actively and pre-emptively improve their tax compliance.

<sup>21</sup>China Tax Newsletter – Issue 20, June 2017, KPMG, June 2017, <https://home.kpmg.com/cn/en/home/insights/2017/06/china-Tax-alert-20.html>

# Regulation passed to further reduce debt levels of SOEs

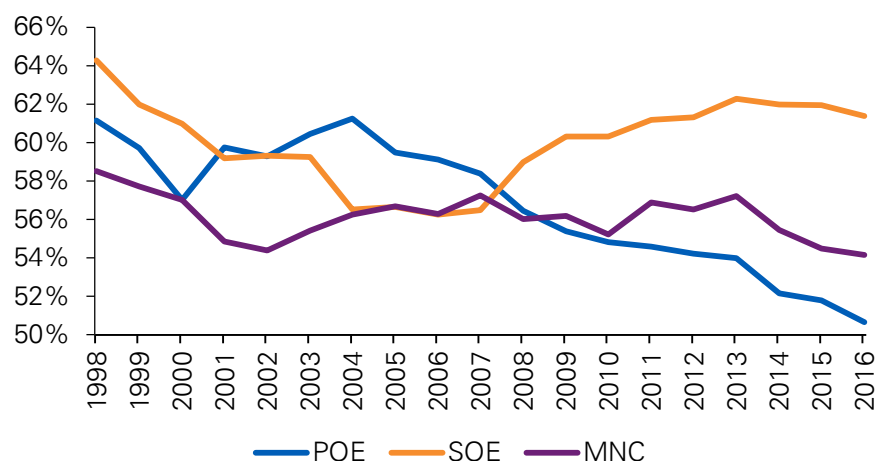
In September, China's Central Committee and State Council issued the Guiding Opinions on Strengthening the Asset and Liability Constraints of State-Owned Enterprises (referred to as 'Guiding Opinions'). The Guiding Opinions require the establishment of a long-term mechanism for further constraining the asset liability ratios of SOEs and reducing the leverage ratio of SOEs. Clear targets were set out in the Guiding Opinions.

## Overall targets:

<b>Short-term target:</b>	By the end of 2020, the average asset-liability ratio of SOEs will be about 2 percentage points lower than the end of 2017.
<b>Long-term target:</b>	After 2020, the asset-liability ratio of state-owned enterprises will basically remain at the average level of enterprises of the same size in the same industry.

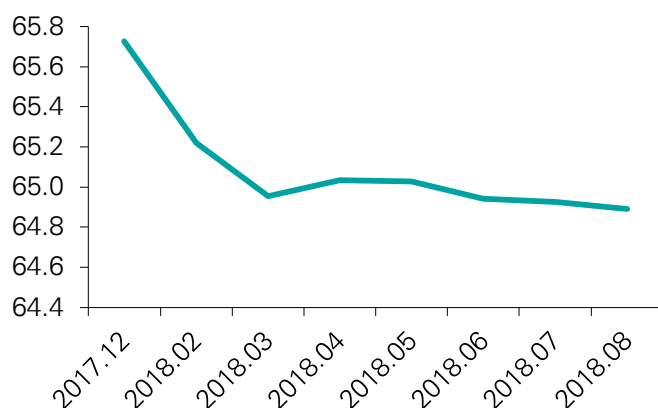
The asset-liability ratios of different types of industrial enterprises show a downward trend of asset-liability ratio in SOEs, private enterprises and foreign enterprises since 1998. Between 2007 and 2013, the leverage ratio of SOEs was similar to that of foreign enterprises and lower than private enterprises on average. Changes took place in that trend from the 2008 financial crisis. Compared with the sustained decline in the asset-liability ratio of private enterprises, the debt ratio of SOEs has been rising, leading to a gradual widening of the gap between SOEs and private and foreign enterprises. Since 2013, as supply-side structural reforms have made steady progress, the asset-liability ratio of various types of industrial enterprises has dropped significantly; the decline in the asset-liability ratio of SOEs, however, remains relatively flat. Against this backdrop, SOEs have become the top priority in efforts to reduce leverage in 2018. Since this year's NPC and CPPCC conferences, the State-owned Assets Supervision and Administration Commission and other relevant departments have carried out a number of major deployments aimed at reducing the leverage of SOEs. According to information disclosed by the Ministry of Finance, as of August 2018, the asset-liability ratio of SOEs was 64.9%. This was 0.8 percentage points lower than that at the end of 2017 and indicated the preliminary effects of deleveraging.

**Figure 29: Asset-liability ratios of various types of industrial enterprises (%)**



Source: Wind, KPMG analysis

**Figure 30: Change in asset-liability ratio of state-owned enterprises (%)**



Source: Bureau of Statistics, Ministry of Finance, KPMG analysis

In addition, the Guiding Opinions use the asset-liability ratio as the basic constraint indicator to introduce classified management and dynamic adjustment for SOEs of different industries and types. This includes strict control of the asset-liability ratio of SOEs in industries facing overcapacity, as well as suitable and flexible control of the asset-liability ratio of SOEs in strategic emerging industries or innovative, entrepreneurial fields.

**Table 3: Asset-liability constraint indicator**

Asset-liability constraint indicator	
<b>Baseline</b>	The average asset-liability ratio of all SOEs above the designated size in the previous year
<b>Alarm line of asset-liability ratio of the current year</b>	Baseline +5 percentage points
<b>Key supervision line of asset-liability ratio of the current year</b>	Baseline +10 percentage points

The Guiding Opinions also specify the asset-liability ratios of the following types of SOEs:

**SOEs: The asset-liability ratio of the consolidated statement** can be determined by the relevant state-owned asset management department based on the composition of the main business, the level of development and classification of supervisory requirements.

**Enterprises in special industries such as postal and railway or for which it is not possible to obtain statistical data:** The asset-liability ratio is determined by relevant state-owned asset management departments according to national policy guidance and industry conditions, with reference to international experience.

**Enterprises whose investment contribution duties are performed by the State-owned Assets Supervision and Administration Commission of the State Council (SASAC):**

Asset-liability ratio management and control work will continue to carry out currently enforced requirements. Adjustments and improvements will be made during practice.

**State-owned financial enterprises:** Asset and liability constraints are implemented in accordance with the existing management systems and standards.

► **Internal governance and external constraints**

The Guiding Opinions put forward specific requirements in the areas of internal governance and external constraints to strengthen the management of state-owned enterprises' asset-liability ratios.

**Internal governance:** Asset and liability constraints should be organically combined with deepened reform of state-owned enterprises, the establishment of a modern enterprise system and the optimisation of the corporate governance structure to establish sound, long-term mechanisms.

1. Establish a sensible asset-liability ratio level and structure for assets and liabilities.
2. Strengthen the day-to-day management of assets and liabilities: The management personnel of SOEs should be faithful and diligent in performing their duties; prudently carry out business activities such as debt financing, investment, expenditure and external guarantees to prevent excessive accumulation of interest-bearing liabilities and contingent liabilities; and ensure that the asset-liability ratio remains at a reasonable level.
3. Urge SOEs to limit the assets and liabilities of their subsidiaries. Determine a reasonable asset-liability ratio for subsidiaries and incorporate the subsidiaries' asset-liability constraints into the group's assessment system to ensure their strict and thorough implementation. State-owned groups should bolster the independence of their subsidiaries' assets, finances and business to mitigate the transmission of risk between parent companies and their subsidiaries, and between subsidiaries.
4. Drive productivity and increase profitability through innovation.

**External constraints:** Strengthen assessment, enhance corporate financial veracity and transparency, and place reasonable limits on debt financing and investment

1. Establish a scientific, standardized enterprise asset-liability monitoring and warning system.
2. Establish a mechanism for enterprises with high debt ratios to reduce the asset-liability ratio within a specified time frame: prohibition of domestic or overseas investment that pushes up the asset-liability ratio; major investments subject to special approval procedures; strict high-risk business management to effectively reduce corporate debt levels via active optimization of debt structure, equity financing, market-oriented debt-to-equity swaps and legal bankruptcy.
3. Improve the assessment and guidance of asset and liability constraints.
4. Strengthen financial institutions' coordinated constraint of highly indebted enterprises. For SOEs that are under major supervision, financial institutions may not, in principle, finance their new debts.
5. Strengthen disciplinary mechanisms for untrustworthy financial behavior by enterprises. Professional intermediaries such as accounting firms must issue audit reports in strict accordance with accounting standards, and objectively and accurately reflect the liabilities of enterprises.





# 3

Special topic:  
CFIUS reform  
and Chinese  
investment in  
the US



On August 13, 2018, US President Donald Trump signed the Foreign Investment Risk Review Modernization Act (FIRRMA), significantly expanding the Committee on Foreign Investment in the United States (CFIUS)'s authority to review foreign investment and altering the process by which these reviews are carried out.

Although the US government has strenuously denied that FIRRMA is aimed at China, many provisions of the act will create restrictions for overall investment activities of Chinese companies. As such, Chinese investors should be aware of these provisions.<sup>22</sup>

#### FIRRMA release process:



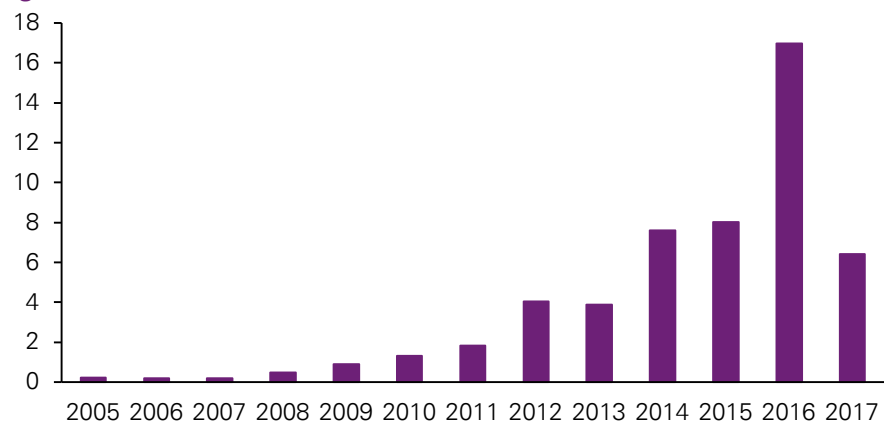
<sup>22</sup> See: FIRRMA FAQs, <https://www.treasury.gov/resource-center/international/Documents/FIRRMA-FAQs.pdf>.

# Review of changes in Chinese direct investment in the US

The US has always been a major destination for Chinese investment. The China Foreign Direct Investment Bulletin shows that in 2010, China’s direct investment in the US crossed the USD1 billion mark (it was recorded as USD1.31 billion) and continued to maintain rapid growth during the subsequent years. In 2016, Chinese direct investment flows to the US<sup>24</sup> reached a record USD16.98 billion, which was almost 12 times the figure for 2010. The compound annual growth rate during this period was 53.3%, which was significantly higher than the 19.1% overseas direct investment (ODI) growth rate.

After peaking in 2016, Chinese direct investment in the US declined significantly in 2017, with investment flows decreasing by 62.2% year-on-year to USD6.43 billion. Investment in the US as a share of the total ODI flows also dropped from 8.7% to 4.0%, making China fourth after Hong Kong, the Association of Southeast Asian Nations and the European Union.

**Figure 31: Direct investment flows to the US (USD billion)**



Source: China Foreign Direct Investment Bulletin, KPMG analysis



<sup>24</sup> Direct investment flows to the United States refer to the total amount of direct investment in the United States in the current period, minus the reverse investment of domestic enterprises by domestic enterprises in the current period.

In terms of industry distribution, the number of industries with Chinese investment flows to the US exceeding USD1 billion in 2017 decreased from six in the previous year to two. Of these, the scale of funds invested in information transmission/software and information technology services dropped from USD4.9 billion in 2016 to less than USD300 million in 2017—a reduction of more than 90%. Although the total amount of funds invested in manufacturing reached USD3.604 billion, compared with the 2016 investment of USD6 billion, this figure had shrunk by nearly 40%. In terms of investment stock, the manufacturing industry topped the list at USD17.28 billion, accounting for 25.6% of the total. These investments were mainly in automotive manufacturing; pharmaceutical manufacturing; special equipment manufacturing; industries involved in the production of goods and footwear made from leather, fur and feathers; computer/communications and other electronic equipment manufacturing; railway/shipping/aerospace and other transportation equipment manufacturing; manufacturing of metal products, non-metallic mineral products chemical raw materials; and chemical manufacturing.

**Table 4: 2017 Main industries for Chinese ODI in the US**

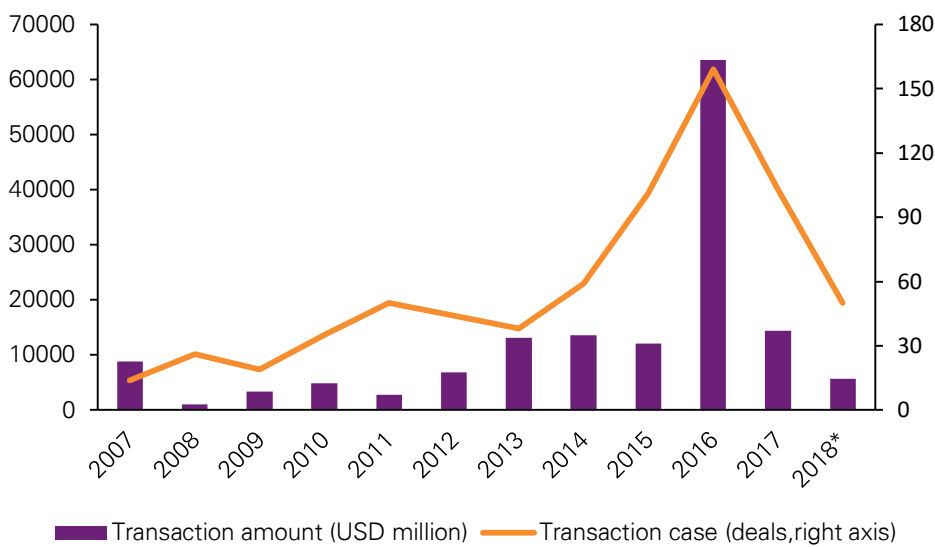
Industry	Flows (USD1,000)	Proportion (%)	Stock (USD1,000)	Proportion (%)
Manufacturing	3604,480	56.1	17,279,530	25.6
Leasing and business services	1275,580	19.9	11,002,440	16.3
Finance	-1165,830	-18.1	9,141,050	13.6
Information transmission/Software and IT services	293,510	4.6	6,591,130	9.8
Wholesale and retail trade	789,030	12.3	5,175,420	7.7
Real estate industry	233,680	3.6	4,469,050	6.6
Mining	310,050	4.8	3,513,300	5.2
Scientific research and technical services	451,970	7.0	3,329,890	4.9
Culture/Sports and entertainment	17,880	0.3	2,341,690	3.5
Construction industry	247,490	3.9	1,529,440	2.3
Accommodation services/Maintenance and other services	33,810	0.5	750,660	1.1
Transportation/Warehousing and postal services	44,250	0.7	5,953,800	0.9
Electricity/Heat/Gas and water production and supply	110,090	1.7	566,420	0.8
Accommodation and catering industry	24,270	0.4	517,670	0.8
Agriculture, forestry, animal husbandry and fisheries	95,060	1.5	326,860	0.5
Education	35,060	0.5	127,610	0.2
Health and social work	13,950	0.2	67,280	0.1
Water conservancy/Environment and public facilities management	11,160	0.2	56,180	0.1
<b>Total</b>	<b>6425,490</b>	<b>100.0</b>	<b>67,381,000</b>	<b>100.0</b>

Source: 2017 China Foreign Direct Investment Statistics Bulletin, KPMG analysis

Corporate merger and acquisition (M&A) data also shows significantly less investment by Chinese companies in the US. According to Dealogic, the number and value of Chinese M&A transactions involving US companies decreased from 159 and USD63.53 billion in 2016, to 103 and USD14.39 billion in 2017. The total value of M&A deals fell by 77.3%. Of these, the value of transactions involving computer and electronic products, finance, catering and accommodation, real estate, consumer products, leisure and entertainment, and insurance fell by more than USD1 billion. During the period January–August 2018, the number and value of M&A transactions by Chinese companies were 50 and USD5.66 billion, respectively, which is 22 transactions and USD3.23 billion less than the same period last year.



**Figure 32: Chinese M&A deals toward US companies in recent years**



Source: Dealogic, KPMG analysis

Note: 2018 figures are for the first eight months of the year

Plummeting Chinese investment in the US since 2017 is connected to restrictions on 'irrational' foreign investment introduced by the Chinese government at the end of 2016. Furthermore, it is related to CFIUS's increasingly stringent reviews of Chinese investment in recent years.

According to publicly available data and statistics on Chinese investments in the US from January 2017 to the end of July 2018 for which CFIUS reviews are ongoing, terminated, pending approval or of unclear status, during the period from when President Trump took office in January 2017 till the end of July 2018, of the 50 Chinese investments in the US being reviewed by CFIUS for which information is available, only 20 were approved; 15 were denied, 6 are still being investigated and 9 were not included due to lack of publicly available information.

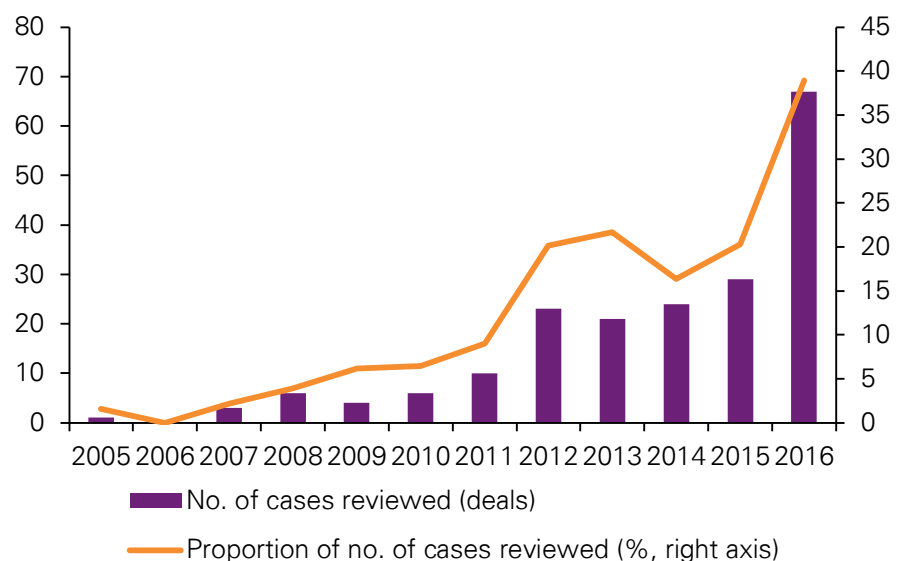
# Breakdown of CFIUS reviews of direct investment by Chinese enterprises

CFIUS is an inter-departmental committee of the US Federal Government. Its members consist of the heads of nine departments: The Department of Treasury (Chairman), the State Department, the Department of Commerce, the Department of Defence, the Department of Justice, the Department of Homeland Security, the Department of Energy, the Office of the US Trade Representative, and the Office of Science and Technology Policy. Five departments — the Office of Management and Budget, the Economic Advisory Board, the National Security Council, the National Economic Council and the Homeland Security Committee — also observe the activities of CFIUS and participate as appropriate. In addition, the Director of the National Intelligence Agency and the Secretary of Labor are non-voting members of CFIUS whose responsibilities are governed by the relevant laws and regulations.

The primary responsibility of CFIUS is to conduct national security reviews of transactions by foreign entities aimed at acquiring and controlling US companies. Depending on the national security assessment needs, CFIUS may also invite other federal government agencies to participate in its review process. These include the Department of Transportation, the Department of Health and Human Services, and the Department of Agriculture.

Over the past decade, there has been a sustained increase in the number of CFIUS reviews of Chinese companies; the pace picked up considerably in 2012. As a result, the proportion of Chinese companies in the total number of CFIUS annual review cases has risen rapidly. According to CFIUS's latest annual report in 2015, 29 Chinese companies' M&A transactions in the US were reviewed, accounting for 20.3% of the total number of reviews that year. In 2016, this figure increased to 67, which accounted for 39% of the total CFIUS reviews that year.

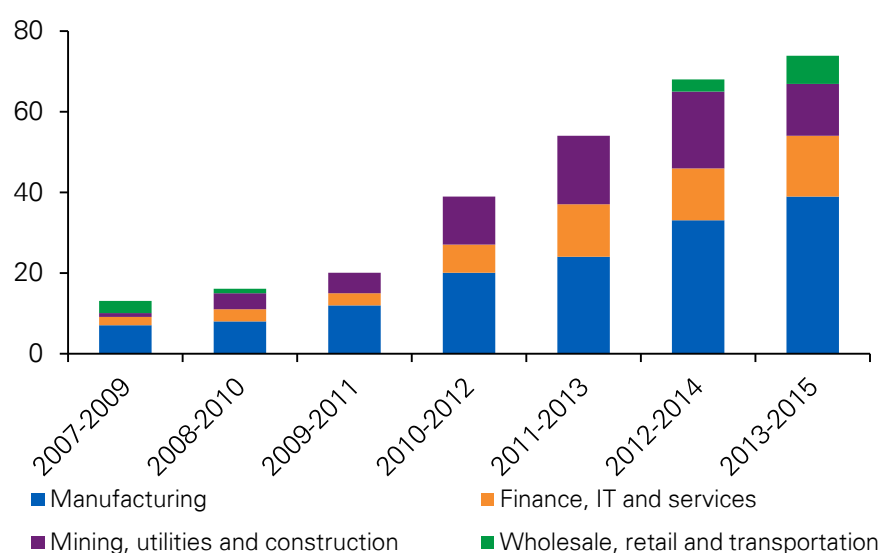
**Figure 33: Number of Chinese direct investment review cases and its proportion in the total number of review cases**



Source: CFIUS Annual Reports (2008-2015), US Government Accountability Office, KPMG analysis

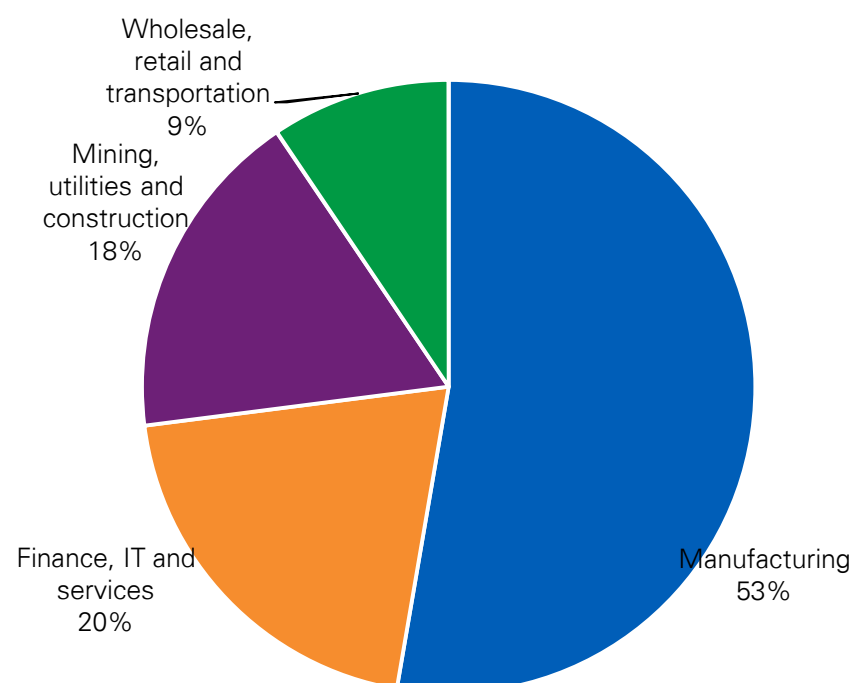
Manufacturing has always been a focus of reviews. The number of manufacturing-related reviews increased from 7 in 2007-09 to 39 in 2013-15; their proportion among total reviews, however, remained stable, in the 40–60% range. The fields of finance, IT and services, mining, utilities and construction are also major areas under CFIUS reviews. Since 2007, the number of transactions under review in these fields has grown rapidly from 3 in 2007-09, to 28 in 2013-15.

**Image 34: Distribution of CFIUS reviews of Chinese enterprises by industry from 2007 to 2015 (deals)**



Source: CFIUS Annual Reports (2008-2015), KPMG analysis

**Figure 35: Distribution of CFIUS reviews of direct investment in China by sector, 2013-15**



Source: CFIUS Annual Report (2015), KPMG analysis

# Overview of key CFIUS reform measures

FIRRMA significantly expanded CFIUS's jurisdiction for reviewing foreign investment and altered the process by which it does so.

## ► Expanded scope of review

FIRRMA significantly expanded CFIUS's jurisdiction for reviewing foreign investment and altered the process by which it does so.

### **1. Specific non-controlling investments**

One of FIRRMA's major revisions to CFIUS's jurisdiction was the inclusion of certain 'other investments' that do not result in US companies being controlled by foreign investors. This was a significant change to CFIUS's jurisdiction, which was previously limited to transactions that would cause foreign investors to control US companies and businesses.

Specifically, as long as a transaction meets one of the following two criteria (specific industry and specific rights), it belongs to the 'other investment' category and is subject to review, even if it is a non-controlling transaction.

#### **Specific industry:**

- Owns, operates, produces, supplies or services 'critical infrastructure'
- Produces, designs, tests, manufactures or develops of one or more 'critical technologies'
- Maintains or collects sensitive personal data of US citizens that has the potential for abuse or could pose a threat to national security.

Specifically, critical infrastructure includes: telecommunications, medical, municipal engineering, transportation, financial services and services for the US government; key technologies include: defense equipment and services, goods subject to export controls, nuclear-related equipment, and investment in materials, specific formulations, toxins and many sensitive industries (such as semiconductors and chips, artificial intelligence, robotics, and biotechnology) that could damage the US's technological leadership.

#### **Specific rights:**

- Access to any major non-public technical information owned by US businesses
- A seat or place as observer in a US company board or similar governing body, or the right to nominate a position on a board or equivalent governing body
- The ability to participate in substantive decisions for US companies involved in key technologies, critical infrastructure or the sensitive personal data of US citizens (except through voting).



## **2. Changes in the rights of foreign investors who/that have already invested in US companies**

FIRRMA also grants CFIUS's jurisdiction over transactions where changes in the rights of foreign investors who/that have already invested in a US company result in their ability to control the said company, or constitute the 'other investment' referred to in the specific non-controlling investment section above.

It should be noted that after the completion of an initial investment, even if the investment has received CFIUS approval or is not subject to CFIUS review, if a change occurs in the investor's rights in the company due to increased investment or other reasons, the investor should pay attention to whether potential investments fall under CFIUS's jurisdiction described above.

## **3. Real estate transactions**

Foreigners who purchase, lease or receive special concession for private or public real estate are subject to CFIUS review if one of the following criteria is met:

- Purchase, leasing or receipt of special concessions for real estate in or near an airport or port, or at a location neighboring US military facilities or other location sensitive to national security
- If the purchase, lease or use of such real estate will facilitate information gathering by foreigners, or risks exposing to foreign monitoring the national security activities carried out in the associated property or facilities.

## **4. Deliberately circumventing the transaction reviews**

It covers any other transactions, transferrals, agreements or arrangements aimed at circumventing CFIUS review.

### **► Reform of the review process**

While expanding the authority of CFIUS reviews, the US government also aims to maintain the country's attractiveness to foreign investment. As a result, FIRRMA made adjustments to the CFIUS review process to reduce the cost of reviews of regular transactions.

### **1. Pre-notice consultations and draft notices**

The transaction party may engage in informal consultations with CFIUS prior to submitting the written CFIUS notice.

CFIUS must provide feedback or accept the formal written notice within 10 days after receiving a draft or formal written notice submitted by the transaction party. If the content of the notice is incomplete, CFIUS will notify the transaction party once during the period mentioned above.

## **2. Application procedure**

FIRRMA introduced procedures for 'declarations' and 'mandatory declarations'.

### **Selective declaration: Fast track**

To strike a balance between strengthening security reviews and continuing to maintain attractiveness to foreign investment, FIRRMA introduced a new 'declaration' process as a fast track to reduce the cost of reviewing regular transactions. This process allows the transaction party to replace the complete 'written notice' with a 'declaration'. The latter makes the length of declarations shorter; only the basic information about the transaction needs to be provided, the declaration must be no more than five pages and the declaration does not automatically trigger a CFIUS review. FIRRMA requires CFIUS to respond to the declaration within 30 days upon receipt. Feedback includes the following:

- Request the transaction party to submit a written notice.
- Notify the transaction party that it is not possible to take action based on the supplied materials, and invite the said party to submit a written notice.
- Launch a unilateral review of the transaction.
- Announce that the transaction has been reviewed.

### **Mandatory declaration: For specific types of transactions**

FIRRMA stipulates that for certain types of transactions, the participating party must submit a 'mandatory declaration' to CFIUS or provide a written notice in its stead. The 'mandatory declaration' system changes the CFIUS national security review system's principle of voluntary declaration, thus strengthening reviews of investment in sensitive areas influenced by foreign governments.

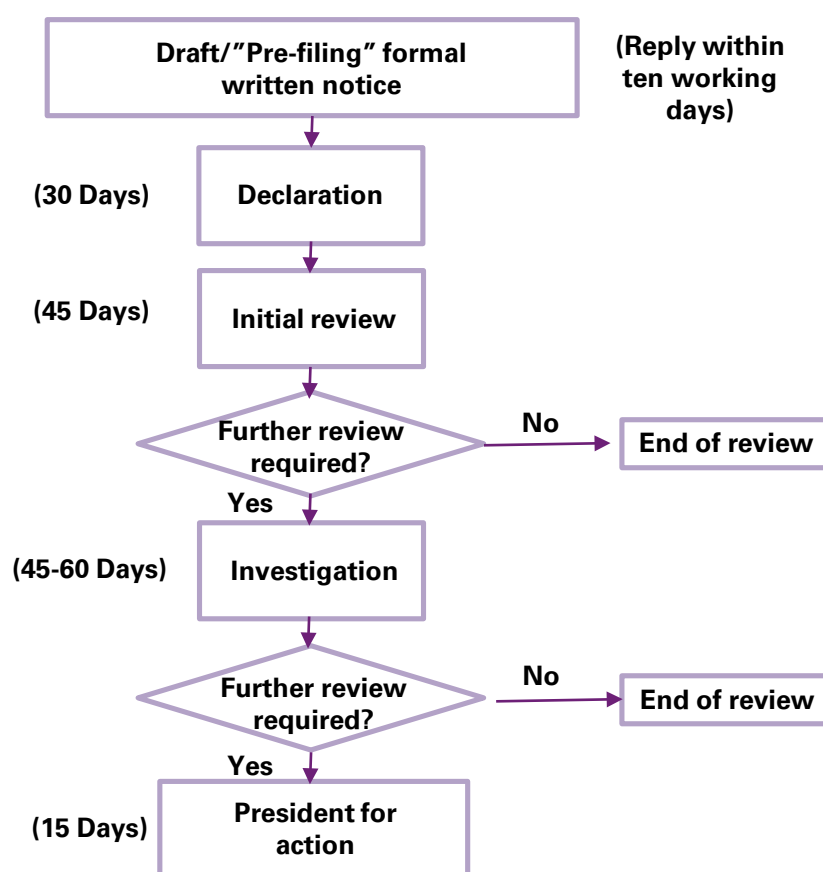
FIRRMA stipulates that transactions requiring 'mandatory declaration' include: acquisitions initiated by individuals associated with foreign governments of 'substantial interest'<sup>25</sup> and transactions of 'substantial interest' in critical infrastructure, key technologies or sensitive personal data that may be used in investments that threaten US national security.

## **3. Review period**

FIRRMA extends CFIUS's initial review period for written notifications from 30 days to 45 days. The extended review period is still 45 days, but under 'extraordinary circumstances', it can be increased by an additional 15 days. As a result, calculated from the receipt date of the written notice, the CFIUS review period will be prolonged from 75 days to 90 days (or, under extraordinary circumstances, to 105 days).

<sup>25</sup> FIRRMA stipulates that investments that are not included under 'other investments' and involve less than 10% voting rights shall not be viewed as of 'substantial interest', and will therefore not require mandatory declaration.

**Table 5: CFIUS review main process**



Source: KPMG analysis

It is worth noting that as there may be multiple withdrawals and resubmissions of declarations, each resubmission could result in the review period being re-started; as such, the time required for CFIUS reviews will often exceed the legally stipulated period. For example, in the transaction of China Oceanwide Holdings Group’s acquisition of the US-listed insurance company Genworth Financial, the CFIUS review lasted approximately 480 days before it was finally approved. Investors, therefore, need to set aside sufficient time for government approval and set reasonable ‘long stop dates’ for transaction documents.

#### **4. Review fees and identification of unreported transactions**

##### **Review fees**

FIRRMA also authorises CFIUS to calculate and charge a review fee that must not exceed 1% of the transaction amount or USD300,000 (adjusted annually based on inflation levels), whichever is lower.

##### **Mechanism for identifying undeclared transactions**

The new bill establishes a mechanism for identifying transactions that fall within the jurisdiction of CFIUS but for which a written notification or statement has not been submitted, significantly reducing the number of ‘fish that slip through the net’.

# Implications for Chinese companies investing in the US

Although the US government claims that the purpose of expanding the authority of CFIUS reviews is to mitigate the threat posed by improper foreign investment behavior to US national security, and has stressed that FIRRMA is not aimed at any single country, the specific provisions of FIRRMA restrict the normal investment activities of many Chinese enterprises and increase the uncertainty of Chinese investors towards investment in the US. Given these circumstances, Chinese investors should be highly vigilant against the revised CFIUS review standards and carry out risk control measures in the following areas.

Firstly, carry out preliminary research and reduce investment in sensitive areas. They should bring the research on the industry of the company to be acquired and the probability of transaction approval forward to the screening stage for the target company, as well as perform prudent assessment of the feasibility of investments involving key infrastructure, key technologies, sensitive personal data and sensitive locations. They should strive to avoid the involvement of investors who may be deemed to have a connection of 'significant interest' with the government, so as to increase the likelihood of the investment being approved.

Secondly, they should properly prepare for the review and be proactive in declaration communication. Since CFIUS review is usually one of the conditions for the conclusion of an investment transaction, CFIUS has the right to request a review of ongoing and completed transactions. Therefore, enterprises intending to invest in the US should consult with CFIUS in advance and be proactive in their declarations to avoid being insufficiently prepared as a result of unanticipated demands by CFIUS.

Thirdly, they should hire specialist organisations to help share the burden of risk. They should hold extensive consultations with financial advisors, obtain professional advice, and legally and effectively plan and advance the transaction under the new framework and environment established by FIRRMA to maximise the investment's chances of success; in addition, investors should carefully evaluate reverse termination fees, long stop dates and contract termination rights associated with CFIUS approval, and the level of effort required to secure CFIUS approval.

Fourthly, they should be rational when considering investing in the US, and should give thought to a broader global array of investments. On the one hand, Chinese enterprises can acquire brands and technology through licensing (technical licences will still be subject to US export control policies), using the establishment of a joint venture in China or elsewhere; on the other hand, Chinese enterprises can array themselves across a broader range of territories through stronger economic collaboration with Europe, Japan and Latin America to avoid the risks associated with investments in the US.



## Appendix: Key indicators

			2016	2017	2018					
	Indicator	Unit	Annual	Annual	April	May	June	July	Aug	Sep
Economic activity	Nominal GDP	Trillion RMB	74.4	82.7	22.0			23.2		
	Real GDP	% YOY	6.7	6.9	6.7			6.5		
	Industrial production	% YOY	6.0	6.6	7.0	6.8	6.0	6.0	6.1	5.8
	Industrial profit	% YOY YTD	8.5	21.0	15.0	16.5	17.2	17.1	16.2	14.7
	Retail sales	% YOY	10.4	10.2	9.4	8.5	9.0	8.8	9.0	9.2
	Fixed asset investment	% YOY YTD	8.1	7.2	7.0	6.1	6.0	5.5	5.3	5.4
	Property starts	% YOY YTD	8.1	7.0	7.3	10.8	11.8	14.4	15.9	16.4
	Property sales	% YOY YTD	22.5	7.7	1.3	2.9	3.3	4.2	4.0	2.9
	Land purchases	% YOY YTD	-3.4	15.8	-2.1	2.1	7.2	11.3	15.6	15.7
	Manufacturing PMI	Index	50.3	51.6	51.4	51.9	51.5	51.2	51.3	50.8
International trade and investments	Exports	% YOY	-7.7	7.9	12.0	12.0	10.5	11.4	9.1	14.5
	Imports	% YOY	-5.5	16.1	21.9	26.1	13.8	26.9	19.9	14.3
	Trade balance	USD billion	509.7	419.6	27.0	23.6	40.4	27.1	26.7	31.7
	Foreign direct investment (FDI)	USD billion	126.0	131.0	9.1	9.1	15.7	7.8	10.4	11.5
	Outbound direct investment (ODI)	USD billion	170.1	120.1	10.1	12.3	9.3	8.1	8.8	7.9
Financial market	RMB exchange rate	USD/RMB	6.64	6.75	6.3	6.4	6.5	6.7	6.8	6.8
	RMB real effective exchange rate	Index	124.4	120.6	126.3	127.3	126.4	122.9	121.8	122.5
	Shanghai Composite Index (Period end)	Index	3104	3307	3082	3095	2847	2876	2725	2821
	Money supply (M2)	% YOY	11.3	8.1	8.3	8.3	8.0	8.5	8.2	8.3
	Stock of Total Social Financing (TSF)	% YOY	12.8	12.0	11.9	11.6	11.1	10.8	10.8	10.6
	New TSF	RMB billion	17802	19440	1773	946	1485	1216	1929	2205
	New bank loans	RMB billion	12646	13523	1180	1150	1840	1450	1280	1380
	Shibor (overnight)	%	2.07	2.63	2.6	2.6	2.6	2.3	2.2	2.5
Price	Consumer price index (CPI)	% YOY	2.0	1.6	1.8	1.8	1.9	2.1	2.3	2.5
	Produce price index (PPI)	% YOY	-1.4	6.3	3.4	4.1	4.7	4.6	4.1	3.6
	Crude oil (WTI)	USD/barrel	43.5	50.9	66.3	69.8	67.3	70.7	67.8	70.1
	Steel (rebar)	RMB/ ton	2476	3878	3858	4065	4097	4120	4426	4524
	Housing price index (70 cities)	% YOY	6.4	8.5	5.3	5.4	5.8	6.6	8.0	8.9

Source: Wind, KPMG Analysis

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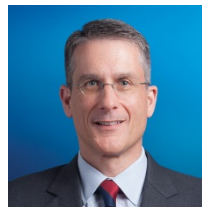
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