# ASIA PERSPECTIVE

China Economic Update Report

**Issue 02, June 2014**

### *This Issue*



## Slowdown continues, but remains manageable (for now)

China's first quarter GDP growth rate was 7.4%, representing the slowest growth since third quarter of 2012, and down 30 basis points compared to last quarter. Fixed asset investment came in slightly below expectations with a 17.6% year-on-year growth. Chinese retail sales grew by 12%, beating expectations by 0.1 percentage points, with March showing surprisingly strong growth reaching 12.2%. Foreign trade volume fluctuated somewhat during Q1, and declined 1% year-on-year, with exports declining 3.4%, effectively refuting earlier predictions that stronger US and European demand would lift exports in Q1.

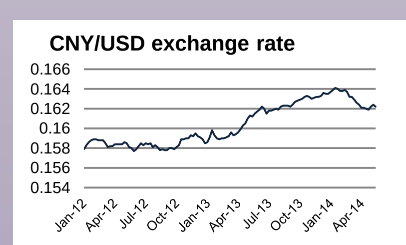
In light of the continued slowdown, economists still do not expect any deviations from the government's earlier statement that short-term growth fluctuations shall not trigger heavy stimulus packages as those launched during the global financial crisis.

The government did however present a "light stimulus" package, consisting of tax breaks for small businesses as well as plans to speed up certain infrastructure projects that already have been approved. It is clear that this stimulus package is aimed at reassuring the market, rather than yielding any real effects on GDP growth.

## Currency volatility hurts speculators

In a surprise move, the People's Bank of China (PBC) caused through a series of actions the RMB to depreciate against the dollar with an hefty 1.4% through a series of actions. The aim was to restrain the massive capital inflows seen during January, and effectively demonstrate that the RMB was not a sure one-way bet.

This caused the RMB to drop to levels not seen since May 2013. Recent years' capital inflows to China have pressured the RMB upwards, and this latest move from the People's Bank of China is seen by some as a way to reduce speculation, and may also be a long-term strategy in preparing for a potential future floatation of the RMB, in which case we should expect much more volatility both up and down in coming years.



# Regional differences increases as slowdown continues

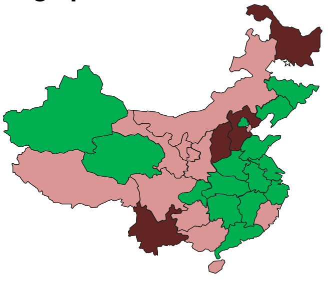
There are constant debates regarding the accuracy of China's growth figures, but two facts remain: the sum of individual provinces' GDP figures often exceeds the national GDP figure, and the majority of provinces report higher growth figures than the national average. What we currently see, in light of recent months' slowdown, is that these trends are changing. The gap is decreasing and more provinces report lower growth rates. While national GDP growth declined by only 0.3 percentage points in Q1, to 7.4%, provincial real GDP growth decreased by an average of 1.8 percentage points.

Furthermore, the current slowdown is unevenly distributed among China's provinces, with inland provinces showing a much steeper decline compared to coastal provinces. This is perhaps not surprising, as these provinces saw a unreasonably strong growth thanks to governmental stimulus and misaligned investments during recent years. Naturally their growth readjusts as debt and investments cool down. In some provinces, however, the adjustments hit harder than others.

The provinces Heilongjiang, Hebei and Shanxi for example have seen their first quarter GDP figures plummet to 4.1%, 4.2% and 5.5% respectively.

These provinces do have some structural commonalities, that explains their disproportionate slowdown. They are all unbalanced economies, dependent on a small set of commodities and heavy industry. Shanxi province, a traditional coal mining center, produces more coal than the entire United States. Hebei, which is known as the most polluted province in China, produces more steel than the entire output of the EU. Heilongjiang is also heavily dependent on energy and metal production, albeit not to the same extent.

These industries have been in particular focus of the central government's recent crackdown on excess capacity and pollution. Hundreds of blast furnaces have been closed down in Hebei alone, which combined with falling coal and steel prices puts unbalanced provinces in a tough spot. Considering China's overall shift away from heavy-manufacturing, they may face even tougher years ahead.




## Shanghai FTZ benefits still unclear

More than seven months after its launch, the benefits of the Shanghai free-trade zone are still vague and unclear. Beyond some niche segments, like distribution of foreign video games, the stepwise economic regulatory loosening related to capital account controls, currency trading and investment rules that was anticipated is still not happening.

With thousands of companies already registered in the FTZ, there is certainly not a lack of interest. The government has also pushed through some reforms within the FTZ, like the regulatory loosening for companies looking to transfer excess RMB holdings overseas. But as this reform was applied on a nationwide basis just months after being implemented in the FTZ, the benefits of setting up your company in the FTZ vs. in Shanghai remain debatable.

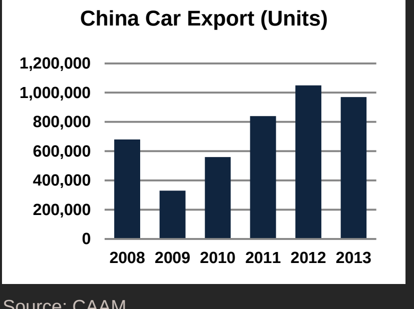
As more cities now are preparing to open FTZs, some put their hopes to higher competition among FTZs as a driver for implementation of more transformational reforms. And considering the amount of prestige the government has invested in the Shanghai FTZ, they will unlikely allow it to be seen as a failure.

# Car sales are up 10.1% during first quarter of 2014

The number of sold cars rose by 10.1% during the first quarter to 4.9 million units. January came in strong, with a record 1.8 million sold units, exceeding the total number of passenger vehicles sold in India during all of 2013.

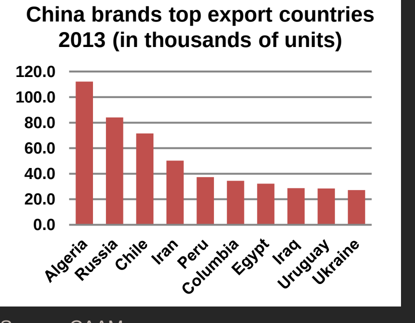
To further cement the importance of China's auto market, the Auto China 2014 exhibition held in Beijing in April hosted an impressing lineup of new models and concept cars. The exhibition, which has transformed from an emerging and often overlooked event into one of the most important forums among inter-national car manufacturers, also saw the unveiling of Lincoln's new car. This is the first time the brand unveiled a new car outside the US, and it highlights the ambition Lincoln has for China as they formally enter the country's luxury car market later this year.

While many international car manufactures are seeing double digit growth figures, domestic brands are struggling. This became evident during the first quarter when German brands overtook the number one position in terms of sedan car market share, 27.1%, from Chinese brands which dropped 3.8 percentage points to a 23.7% market share, according to CAAM.




Source: CAAM

These numbers are of concern to both Chinese car manufacturers as well as policy makers. Some analysts argue that the Chinese brands have entered a downward spiral as an effect of the foreign JV ownership limit. The policy, which was conceived as a way to encourage knowledge and technology transfer from foreign car manufacturers to Chinese manufacturers, has resulted in passivity and laxness among the domestic brands which have enjoyed steady profits from their JV operations.




Source: CAAM

This is a development in the completely opposite direction from what the policy makers were aiming for - to build competitive domestic auto manufacturers who would gain overseas market share through low-cost cars with good quality similar to the way Japanese cars did in the 1970-80's.

Instead, they now find themselves in a situation where they have trouble competing on their own home market, let alone on western export markets. Exports have seen a decreasing trend over the last nine months, and this already from a quite small baseline considering the size of the automotive industry in China.

## Car sales restrictions shifts automaker's focus

During the first quarter of 2014, Hangzhou became the sixth Chinese city to implement car ownership restrictions, the other being Beijing, Shanghai, Tianjin, Guangzhou and Guiyang. All these cities now uses either a lottery or a bidding scheme to reward new license plates. Furthermore, some cities have also implemented driving restrictions, such as time or day limitations where certain license plates cannot utilize inner city roads.

The reasoning behind these restrictions are a combination of increased traffic congestions and pollution.

Interestingly, the short term effects were quite the opposite, with car sales climbing 13% during April as consumers in other cities rushed to dealers in order to secure their new cars in anticipation of nationwide ownership restrictions that are yet to be announced.

For global car manufacturers, these restrictions force them to speed up their efforts in developing new markets in smaller and less developed lower-tier cities. Ford Motor, for example, is opening up 200 new stores, from current 500 stores, of which the majority will be located in lower-tier cities.

# Chinese e-commerce market remains strong as Alibaba prepares for US IPO

The Chinese online retail sector continues its impressive growth streak with a quarterly year-on-year growth of 27.6%, reaching 74.03 billion USD during the first quarter 2014. These are welcoming numbers for Alibaba who is in the midst of preparing their US IPO, scheduled for the later half of 2014. Analysts estimates the company could raise some 20 billion USD from the IPO, making it the largest tech IPO to date, and the fourth largest cross-industry IPO ever, according to WSJ.

Alibaba, which was founded in 1999, has been instrumental in building the Chinese e-commerce architecture, providing services ranging from B2B, B2C, C2C, online payment system as well as logistics services.

It has also turned Alibaba into the world's largest e-commerce player, with a total gross merchandise volume (GMV) of 248 billion USD in 2013.

While China boosts impressive online retail growth figures, perhaps even more impressive is the pace of the industry's current transition from computer to mobile-based shopping.

Research from iResearch shows that the GMV of China's mobile shopping during 2013 reached 27.5 billion USD, a 168.6% increase from 2012. Here Alibaba's rival Tencent has gained significant traction through its popular mobile social media platform WeChat, which already is capable of handling mobile payments.

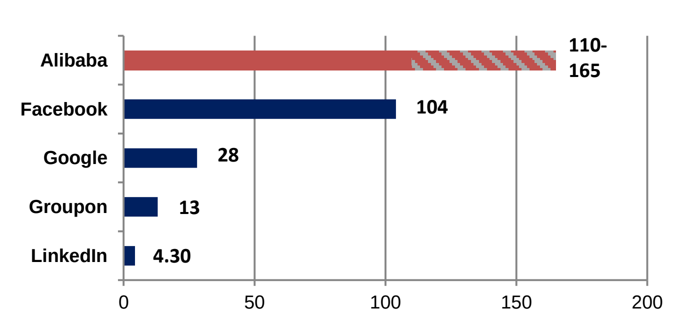
Tencent's position on the mobile shopping market was further strengthened during March this year, when the company acquired a 15% stake in e-commerce site JD.com. They are now looking to integrate JD.com with their WeChat app to create a powerful foundation for future growth within the mobile shopping segment.

## The art of capitalizing on your user base

In contrast to WhatsApp, which focuses on doing one thing and doing it right, Tencent's mobile messaging app WeChat has during recent years launched a cavalcade of services beyond their core message service – games, donations, B2C, booking services, taxi services, and most recently, a wealth management service.

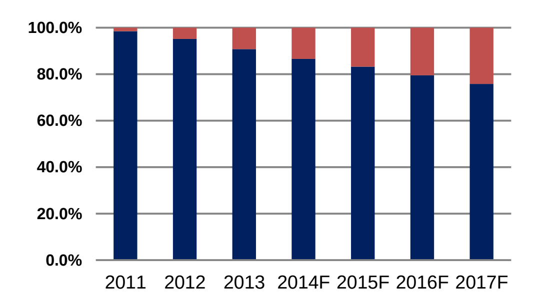
While some argue that sticking to your core business is the way to go, WeChat, with its 300 million users, obviously does something right, with analysts expecting the company to earn around 1.1 billion USD 2014. The average revenue per user for WeChat is 7 USD, while WhatsApp earns 1 USD per user according to Nomura. Furthermore, WeChat shows ambitious plans on expanding from their current geographic Asia focus, and recently launched a 200 million USD marketing campaign across Italy, Spain, India and South Africa. While WhatsApp still boosts a larger user base, the question remains whether they will be able to make it as profitable as WeChat's.

**Company value at time of IPO (in billion of today's USD)**




Source: The Economist, NY Times

**Share of GMV for PC vs. mobile shopping**




Source: iResearch

ASIA PERSPECTIVE

## About Asia Perspective

*Asia Perspective is an independent management consultancy with global presence and local knowledge. We assist our clients with business advisory regarding Analysis, Strategy and Implementation. Our mission is to turn your Asia business vision into reality and add significant value to your business.*

*We offer specialist services covering Procurement & Supply Chain Management, Organizational Improvement, and Growth & Expansion. We support our clients both on a strategic level, but also ensure sustainable savings and improvements through effective implementation support.*

*What differentiates us from our competitors is the knowledge and expertise we have gained after several years in the Asian market. We have experience from a variety of industries and clients including leading international companies from Europe, the US and Asia.*

*With a highly collaborative team of problem solvers and a passion for excellence we will add value to your business. We work closely with our clients to create and deliver insight, advantage and real impact.*


## Contact Us

*If you have any inquires about our services, please contact any of our offices below:*

### Shanghai

Suite 2302, 23/F
885 Renmin Rd
Shanghai 200032
P.R. China
Tel: +86 (0)21 3401 0610
Fax: +86 (0)21 5410 3235
shinfo@asiapersepctive.net

### Hong Kong

Suite 602, 6/F
Taurus Building
21 A/B Granville Road
Tsimshatsui, Hong Kong
Tel: +85 (0)227 399 698
Fax: +85 (0)227 399 313
hkinfo@asiapersepctive.net

### Yangon

Room 101, 1/F
Strand Hotel, Annex Building
92 Strand Rd
Yangon, Myanmar
Tel: +95 (0)1243 377 ext 1812
Fax: +95 (0)1 378 810
yginfo@asiaperspective.net

### San Francisco

60 Corte Patencio
San Francisco, CA 94904
USA
Tel: +1 415 726 8547
sfinfo@asiaperspective.net

### New York

12 Desbrosses St
New York, 10013
USA
Tel: +1 212 461 4017
Fax: +1 917 386 2514
nyinfo@asiaperspective.net

### Stockholm

Grevgatan 53
114 58 Stockholm
Sweden
Tel: +46 (0)8501 645 57
Fax: +46 (0)8501 096 41
stockholminfo@asiaperspetive.net