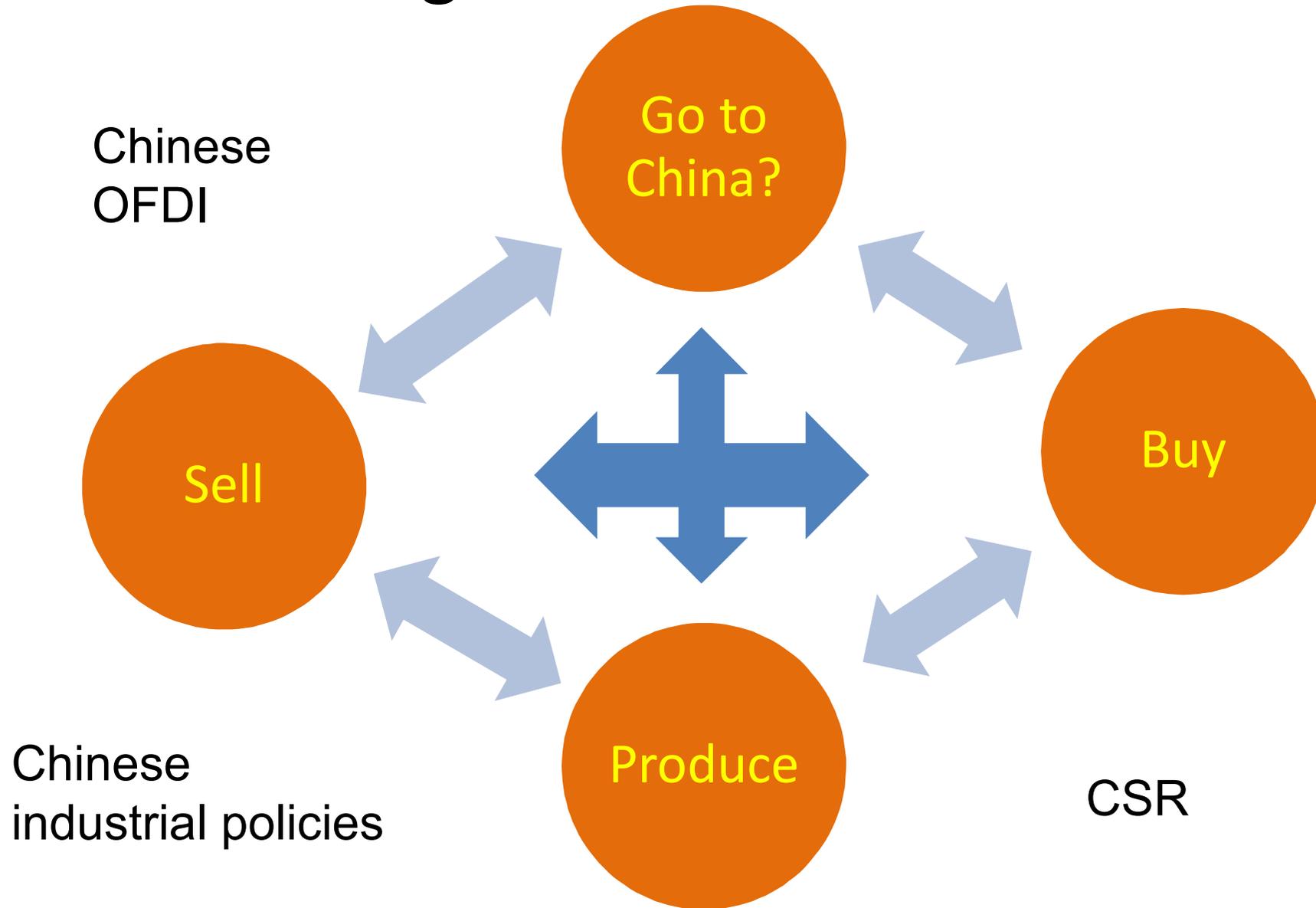


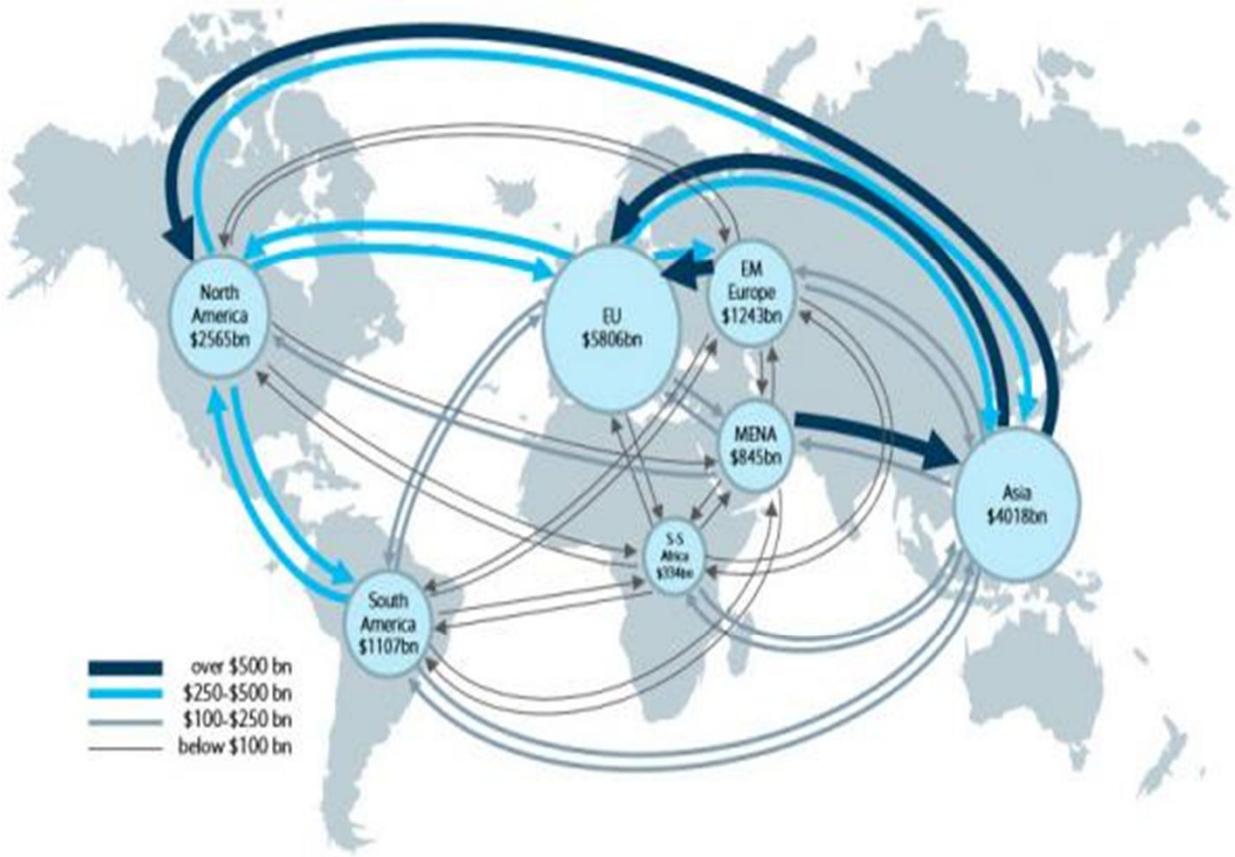
Investing in China



Go to China

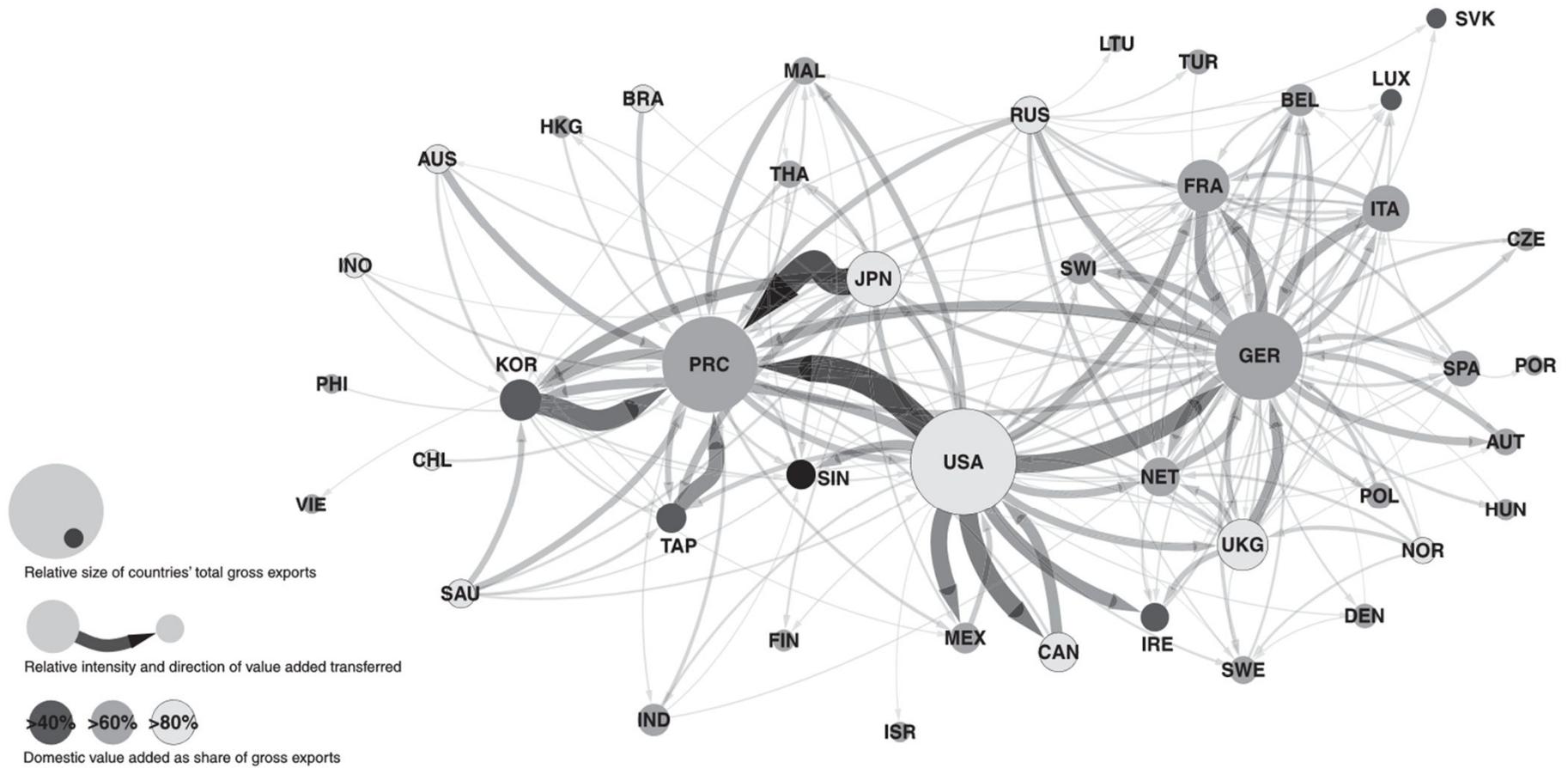
- Understand your industry in your home country and in China (am I ready to pay for a good research paper and to hire the right people like consultants, lawyers, etc?)
- Do you know your company? Who is going to manage entry and operations in China? Do you have the right people?
- Do you know China? (no you don't, and even what you know will change fast)

2012 Global Trade Flows...

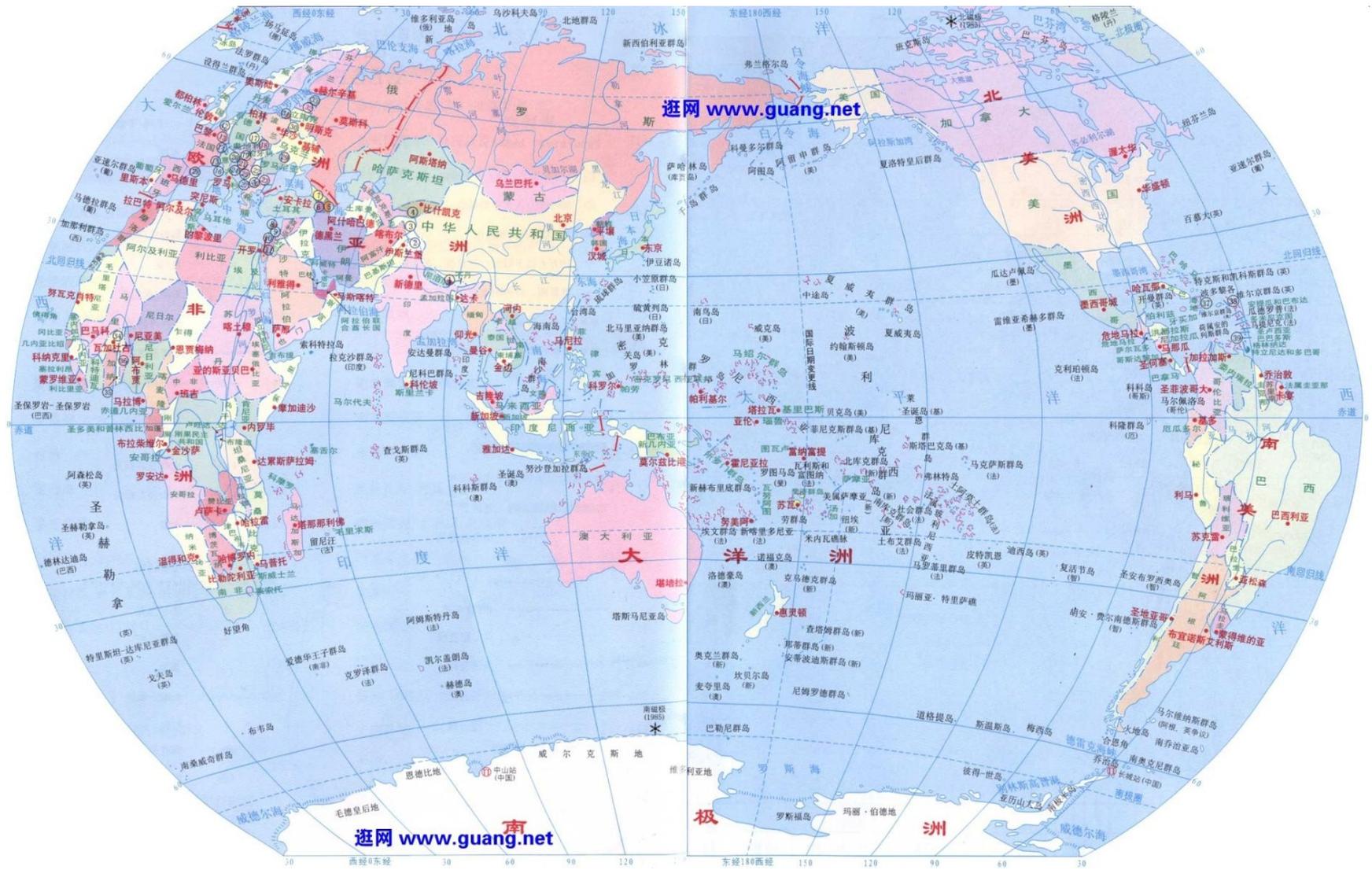


The **world is far more interconnected** - and thus prone to regional problems rippling through the supply chain.

Network di produzione



Go to China Right



“If you know the enemy and know yourself, you need not fear the result of a hundred battles. If you know yourself but not the enemy, for every victory gained you will also suffer a defeat. If you know neither the enemy nor yourself, you will succumb in every battle”

Sun Tzu: “Art of War” 6th century BC

Go to China

- Geography matters
- History matters
- Politics matters
- Economy matters
- Yes, business strategy matters too

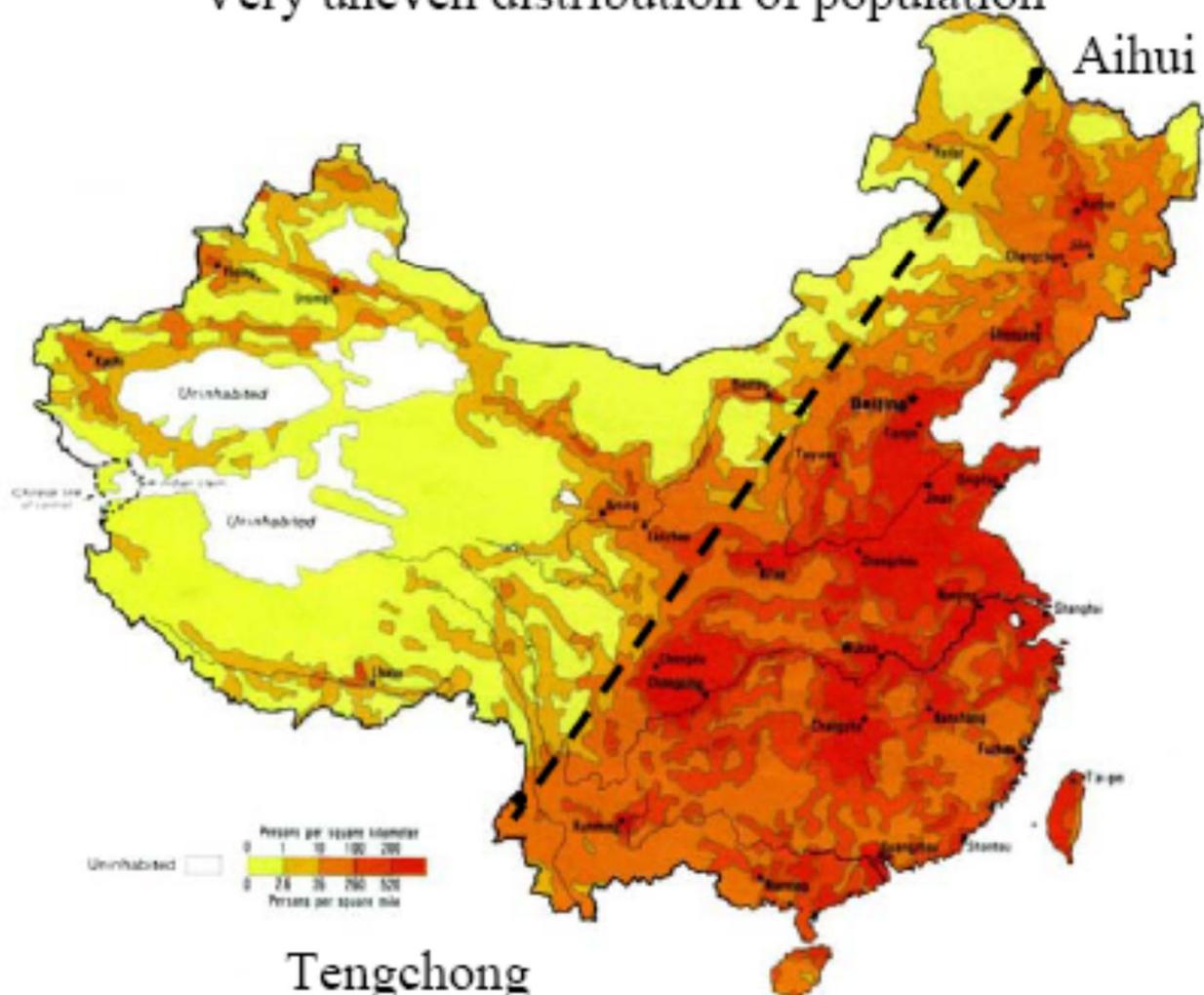
Geography

Geography

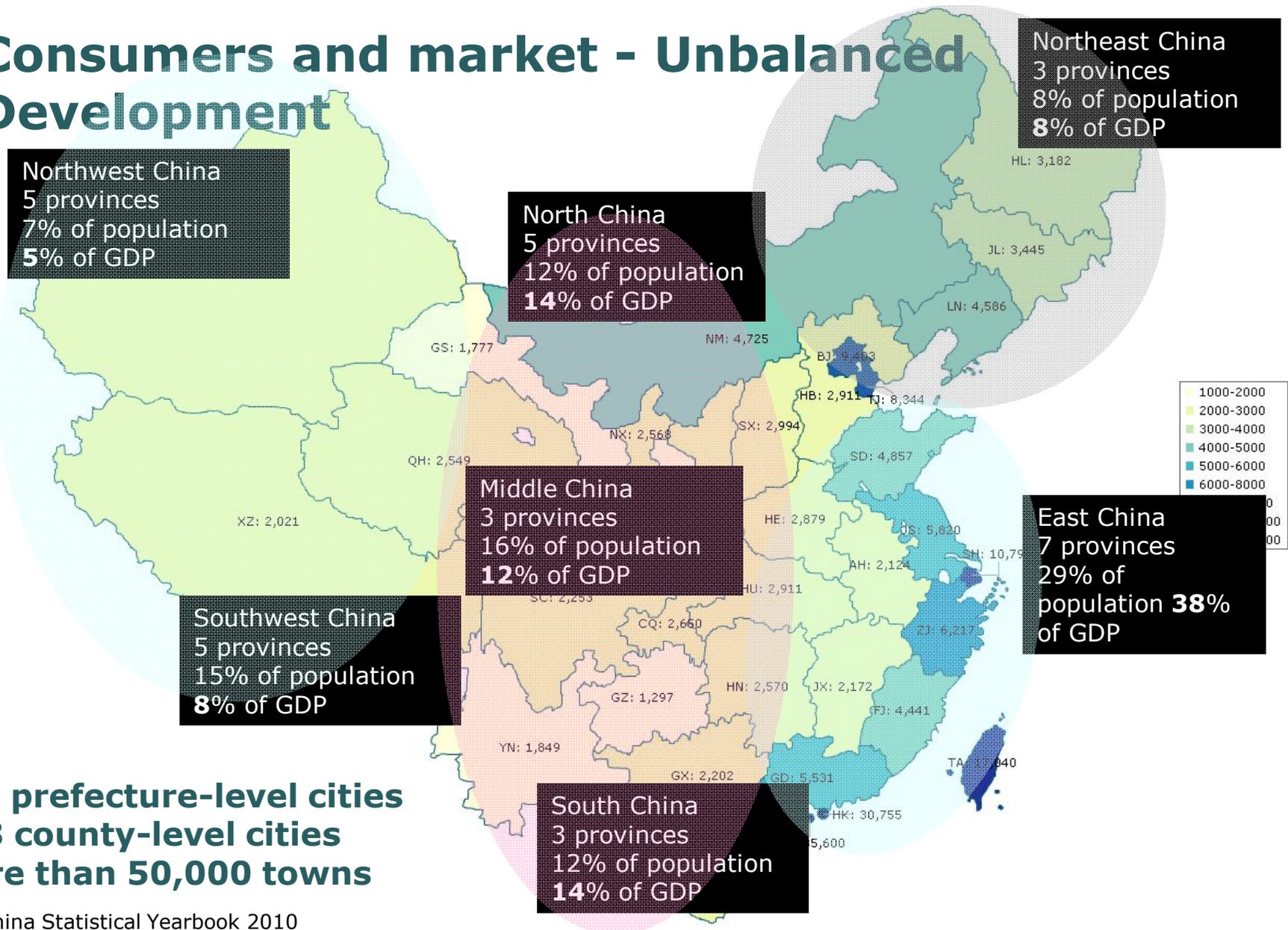


China: Population Density A-Population

Very uneven distribution of population



Consumers and market - Unbalanced Development



- **283 prefecture-level cities**
- **368 county-level cities**
- **More than 50,000 towns**

Source: China Statistical Yearbook 2010

Exports by province

2011, \$bn



○ Industrial clusters



History

History

ca. 1937

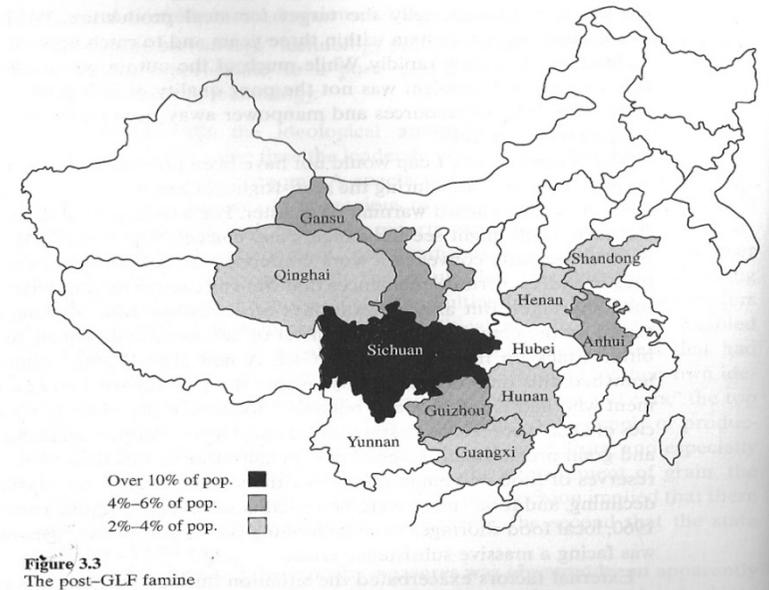
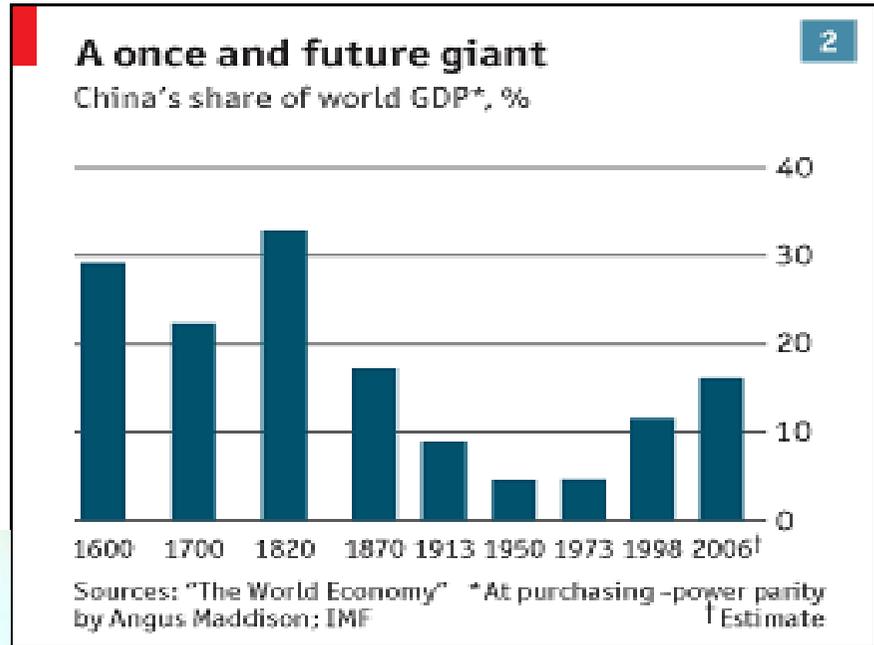
Millions of people all of one mind vow to exterminate the Japanese enemy

Wanzhong yixin shimie

Wokou



The industry of the fatherland develops by leaps and bounds and frightens England so that it trembles with fear 1958



Everybody comes to beat sparrows
1956 (4 plagues rats, fly, mosquitos
sparrows)

Great leap forward: 30
million dead?

Bombard the capitalist headquarters



Politics

POLITICS: Old and new leadership







Why anti corruption is important?

Corruption was demolishing the base of CCP and its credibility

Corruption was pushing for unnecessary investments

Corruption was creating lobbies within the Communist party

Why anti corruption can be a problem

Chain of command at a medium low level is weaker

Lack of trust

People are scared to do investment even if needed

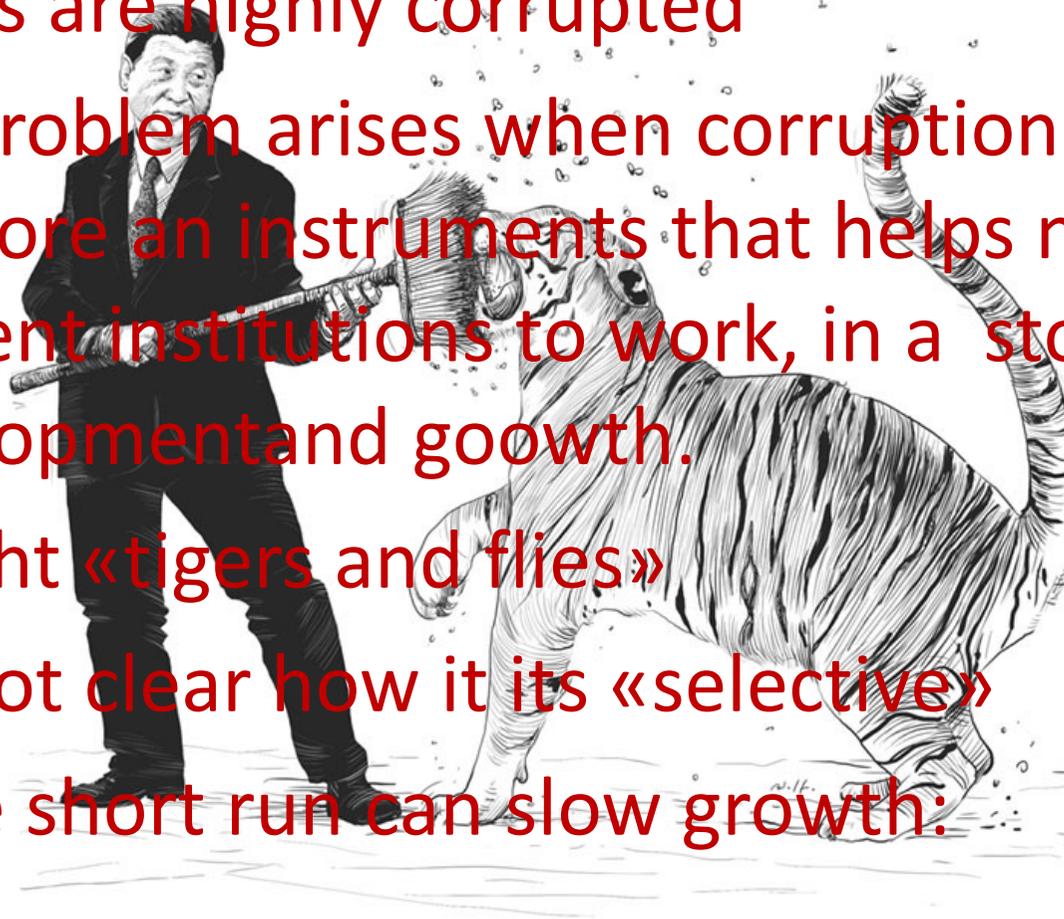
People wait to understand what will happen so this slows down investment

People think about their personal safety

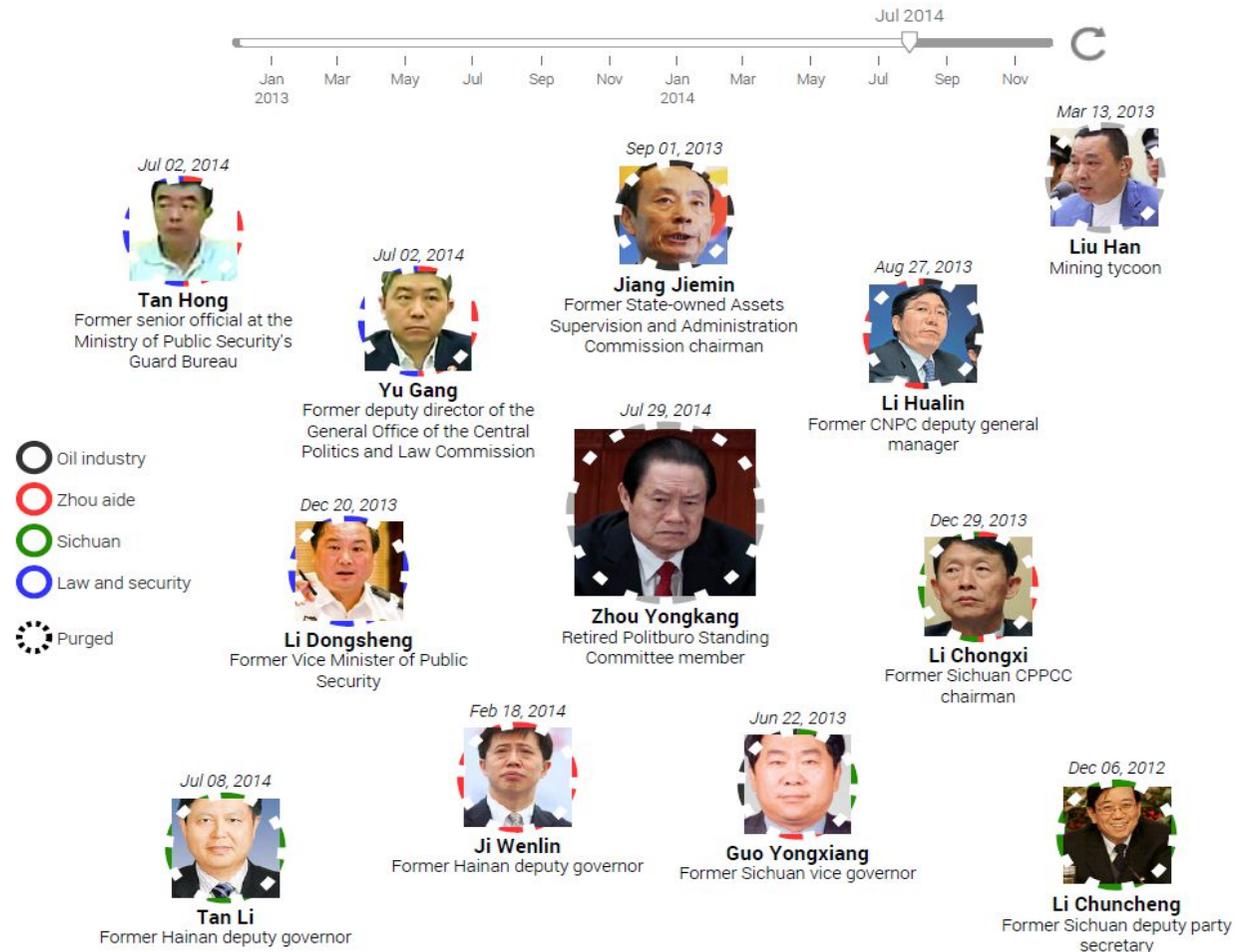
Less corruption means less demand especially for luxury goods

corruption

- All Pvs are highly corrupted
- The problem arises when corruption is not anymore an instruments that helps non efficient institutions to work, in a stop to development and growth.
- To fight «tigers and flies»
- It is not clear how it its «selective»
- In the short run can slow growth:



Fight Tigers and Flies



Ling Jihua



Bo Guanghua

Economy

Economy: data

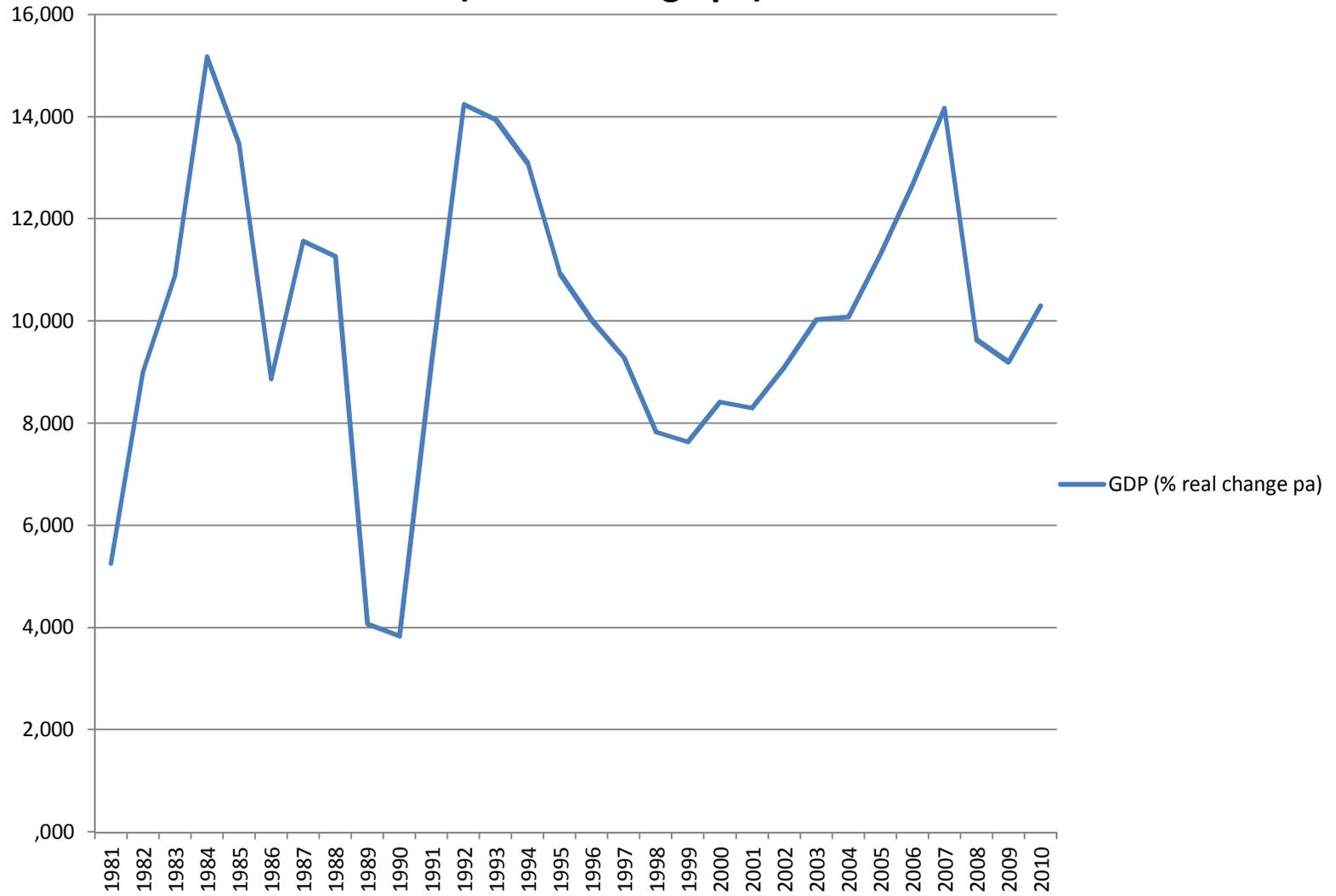
Never ask how statistics and sausages are made. This is true everywhere, even more in China

- Market research are usually not very reliable. Difficult to cross check.
- Gdp is estimated in different ways but remember statistical offices are under the control of the Govern/Party. Still lack of standards.
- Retail data can be even worse because China mix investment and domestic consumption (plus government spending)

Chinese development

time		Reforms	Policies for industrial development
1978 - 1992	Market preparation	Dual track system . Some space for private firms in an increasing number of industries. Foreign firms allowed to operate in China (with constraints) abolishing of State monopoly on foreign trade. GATT (1986); lowering of tariffs (1994)	SEZs development ; FDIs attraction ; undervaluation of the currency , creation of non-tariffs barriers , import substitution; export support
1993 - 2001	Market development	Soes reform , more business oriented, 5 years plan loose importance . WTO (2001)	Less subsidy for enterprises. Support for infant industries. Large investment in infrastructure.
2002 - 2012	Socialist market economy	Market prices , trade reform (2004); establishment of SASAC (2003)	go west strategy; go global strategy; less incentives for FDIs; policies to attract and develop new technologies, Ofdi to enter new market and to “control” raw materials supply

GDP (% real change pa)

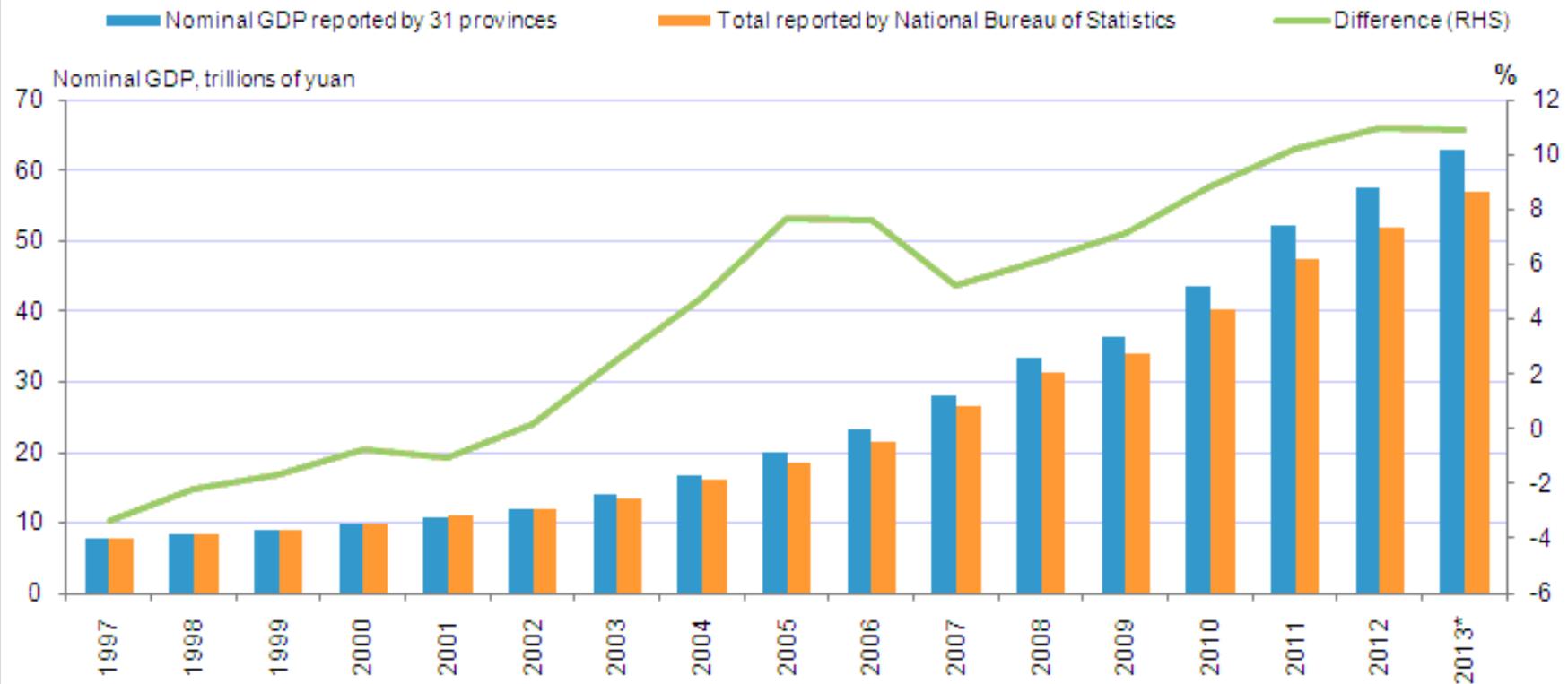


Year-on-year GDP quarterly growth rate, 2011-2014



Source: 'China's Economy Realized a New Normal of Stable Growth in 2014', National Bureau of Statistics of China (NBS), 20 January 2015, http://www.stats.gov.cn/english/PressRelease/201501/t20150120_671038.html

China's GDP: slower and more slippery

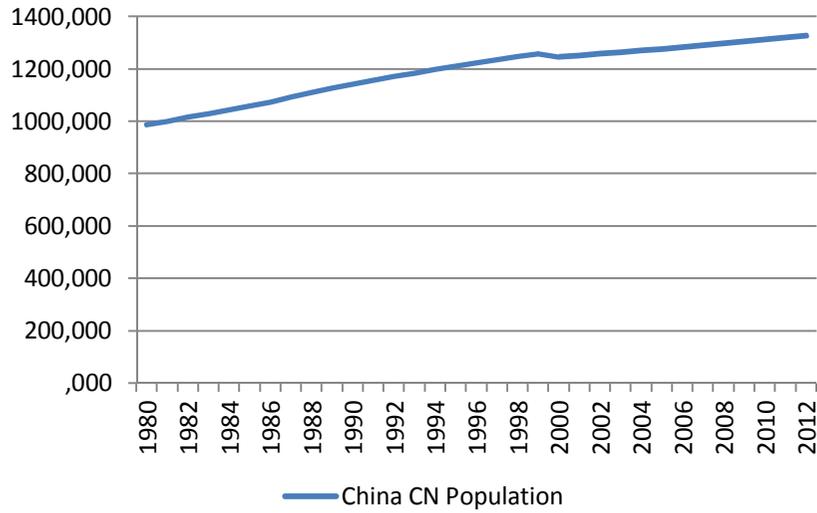


* Note: Assumes the 7 provinces that have not yet reported nominal GDP figures grew at the same rate as 2012.

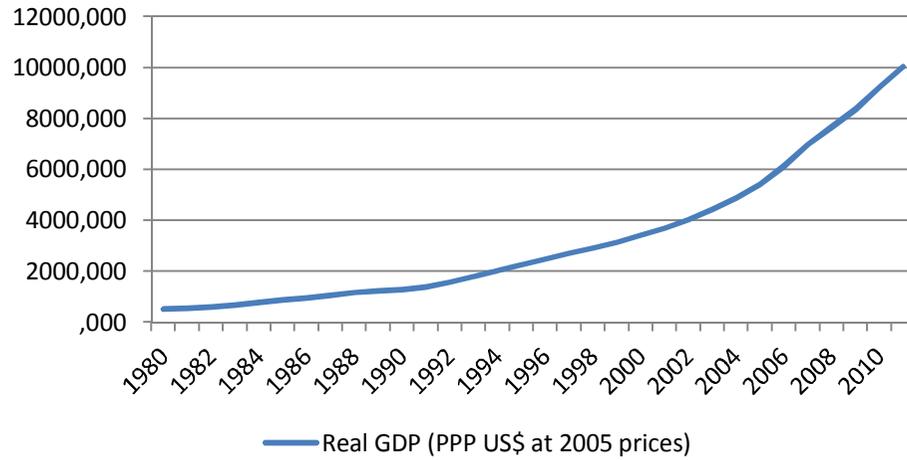
Source: Thomson Reuters

John Foley, Robyn Mak 21/01/2014

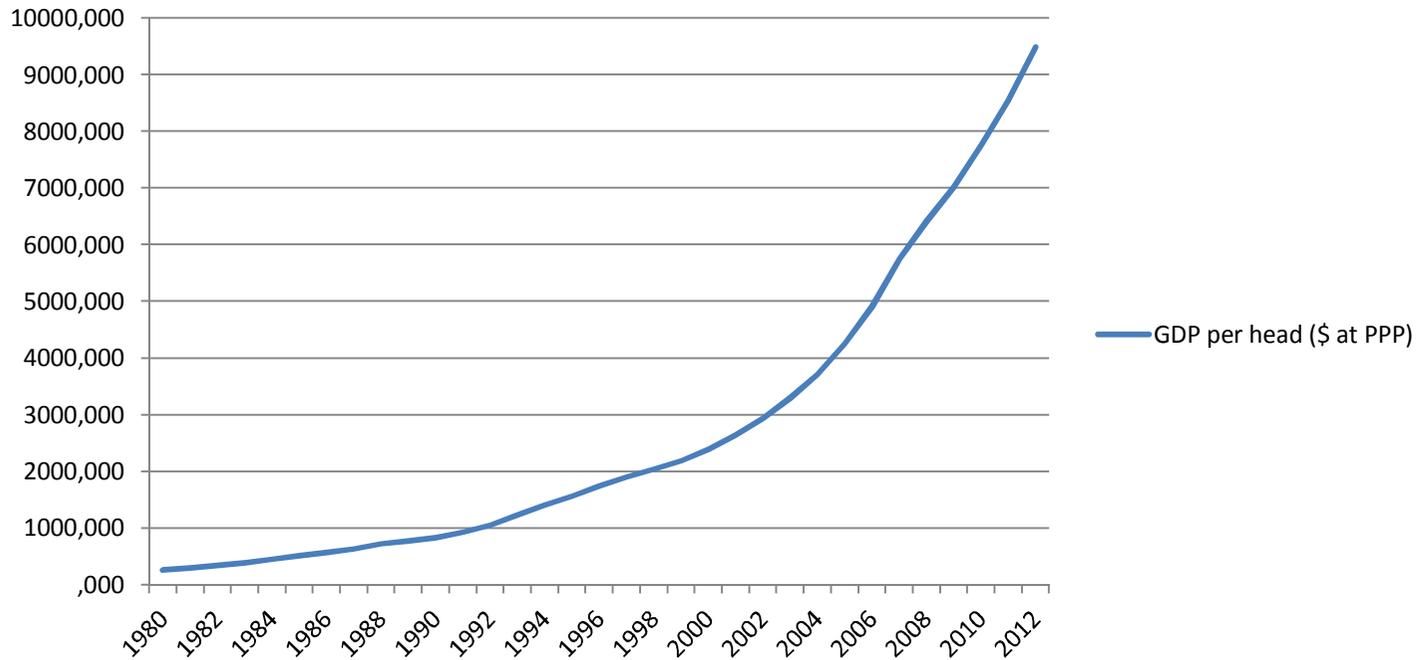
China CN Population



Real GDP (PPP US\$ at 2005 prices)

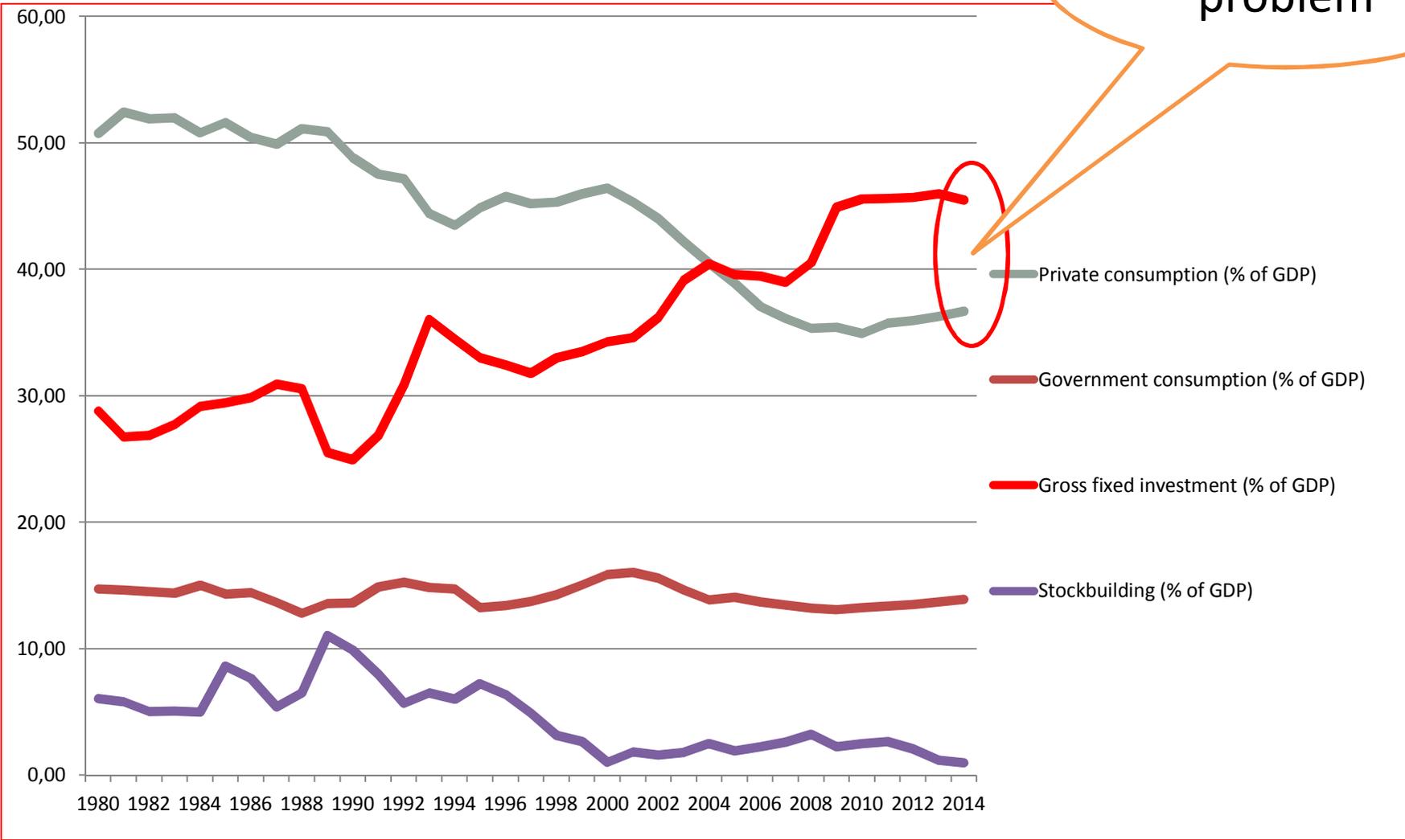


GDP per head (\$ at PPP)



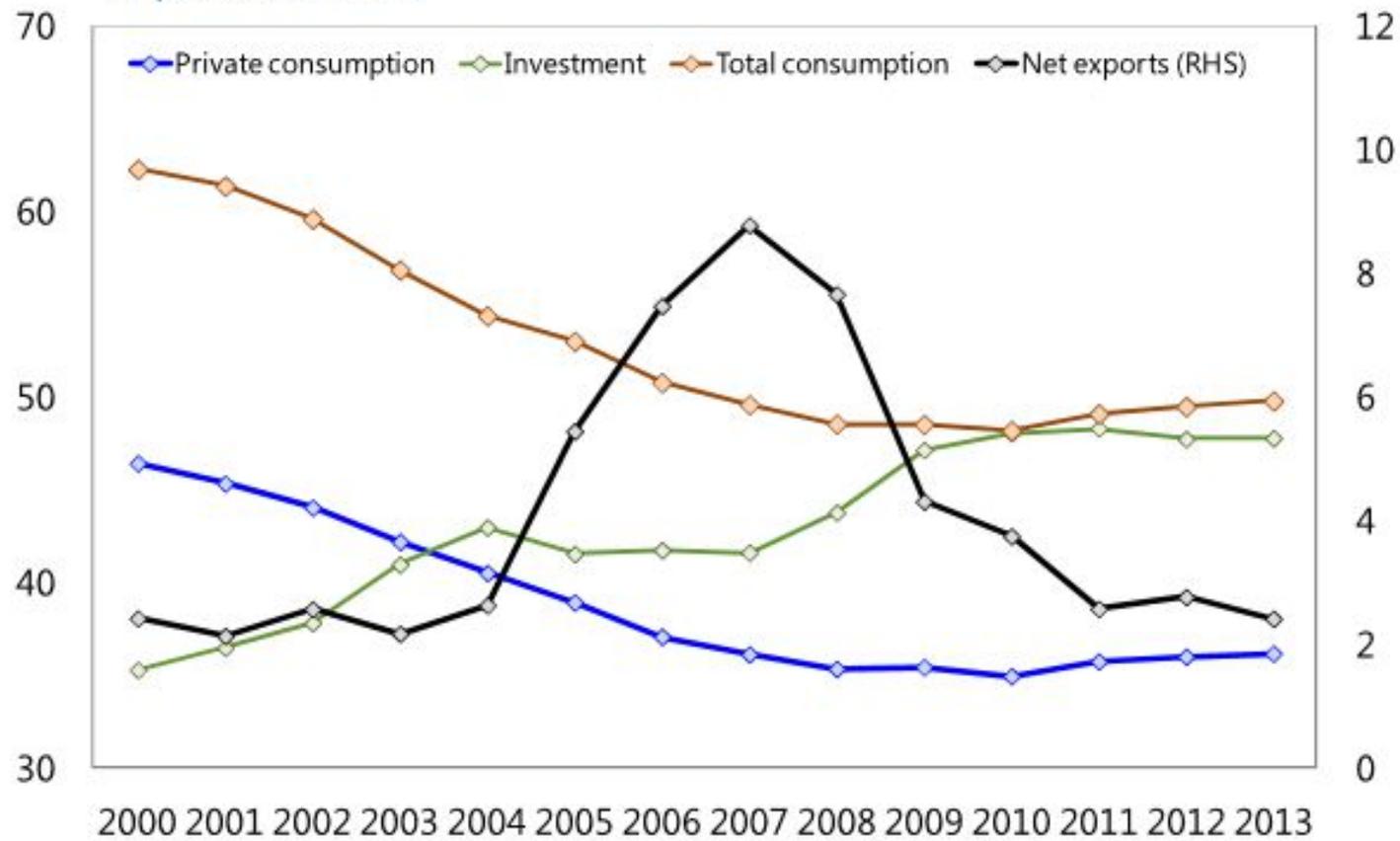
Chinese Gdp

This is the real problem



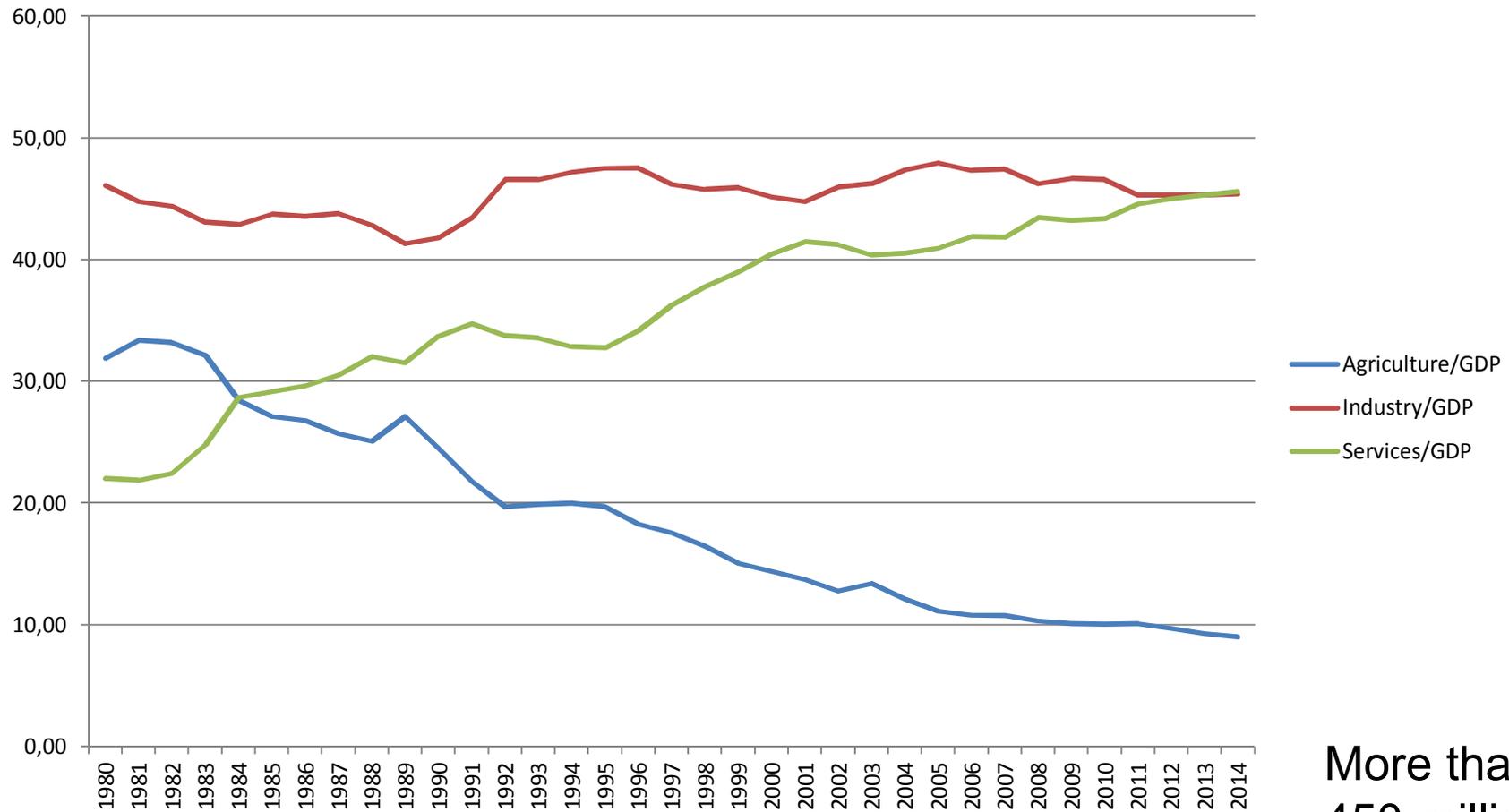
GDP Expenditure Components

(In percent of GDP¹)



¹ Expenditure-based GDP.

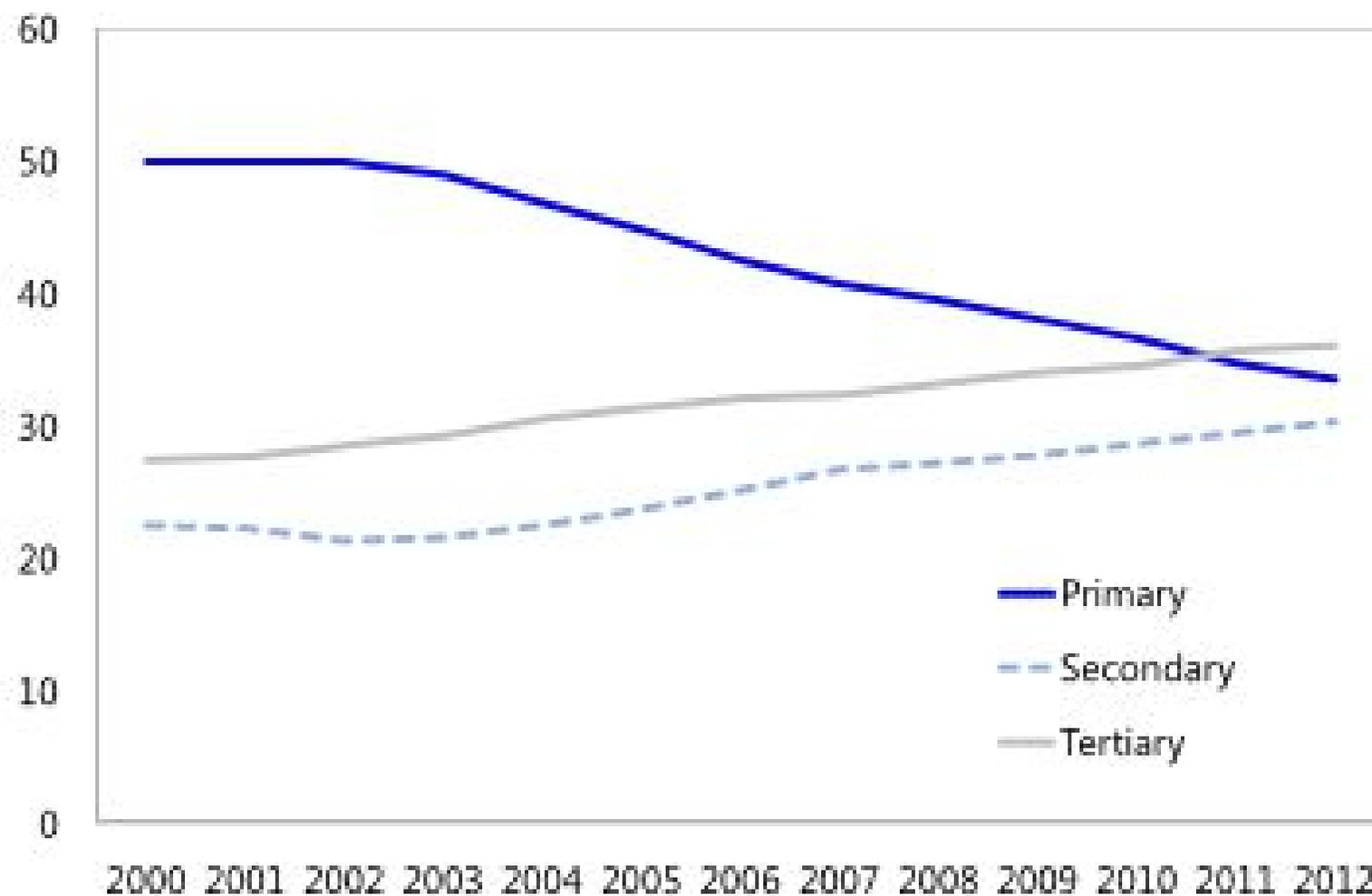
Contribution to Gdp



More than
450 million
Chinese still
in agriculture

China: Employment Shares by Sector

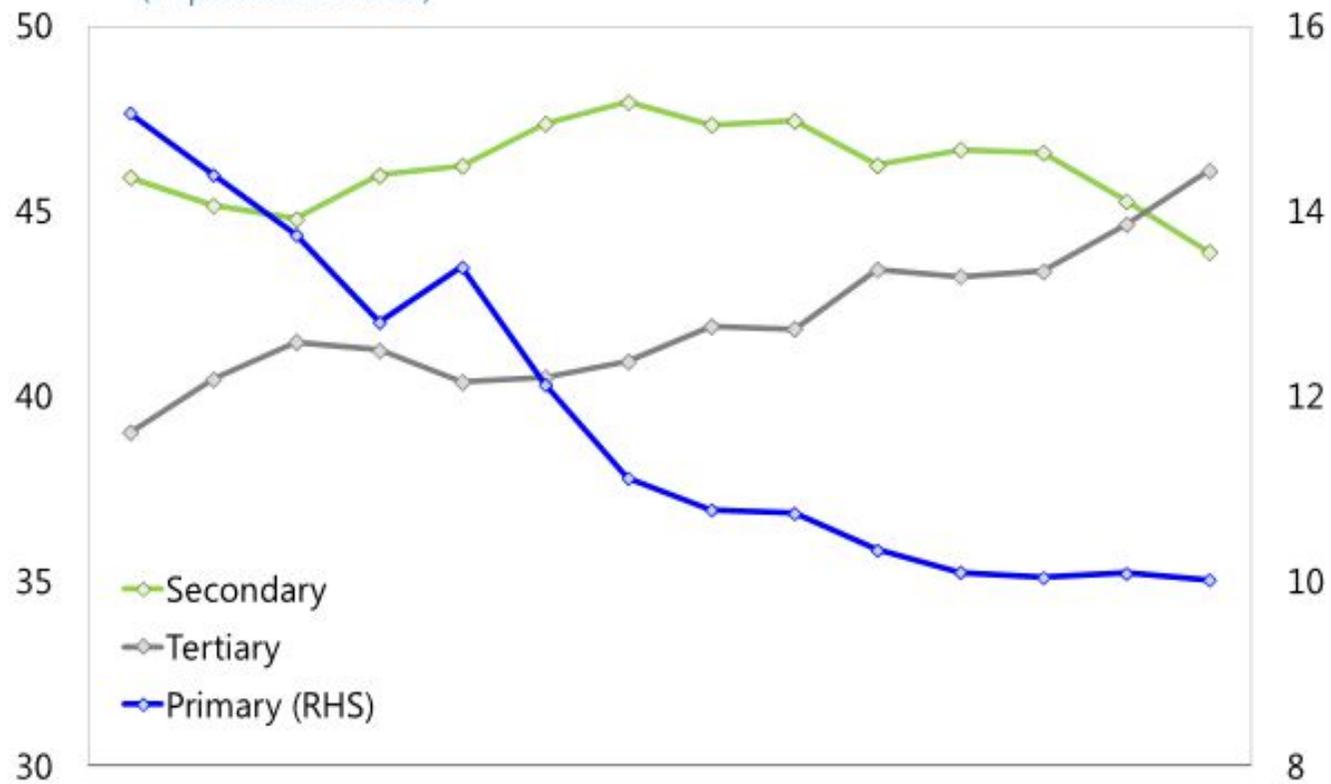
(In percent of total employment)



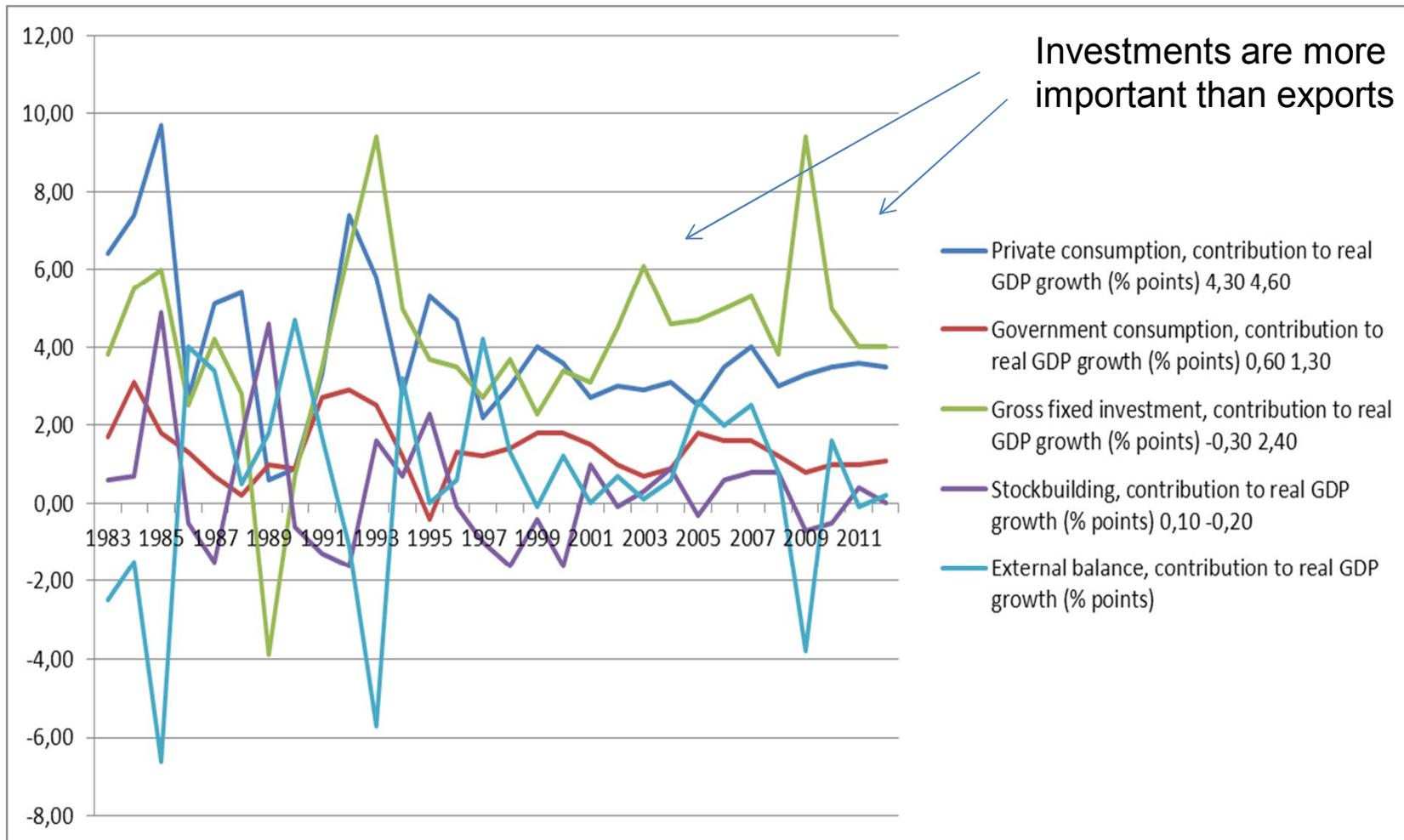
Sources: CEIC Data Company Ltd.; WEO; and IMF staff calculations

China: GDP Shares by Sector

(In percent of total)

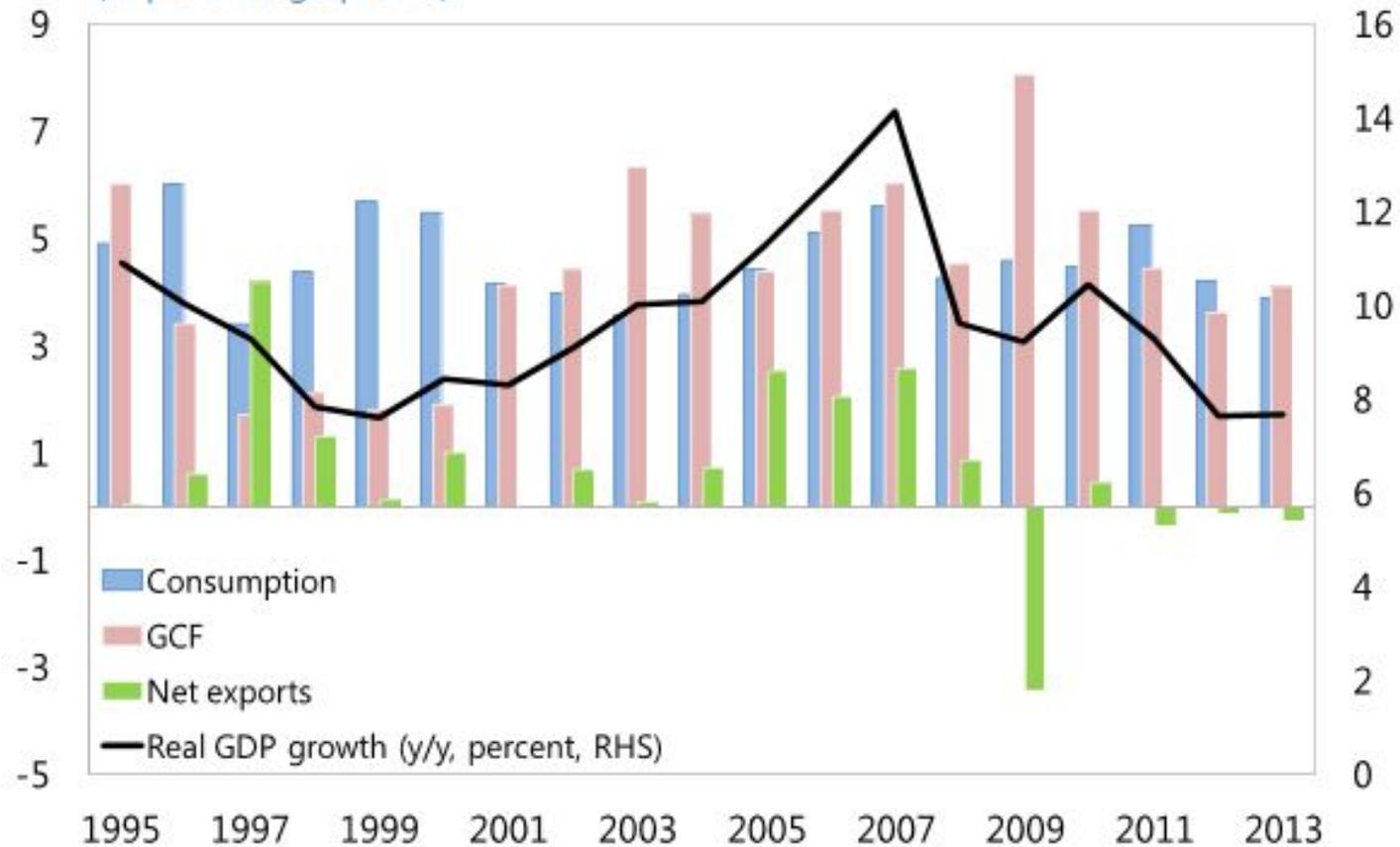


Contribution to Gdp growth



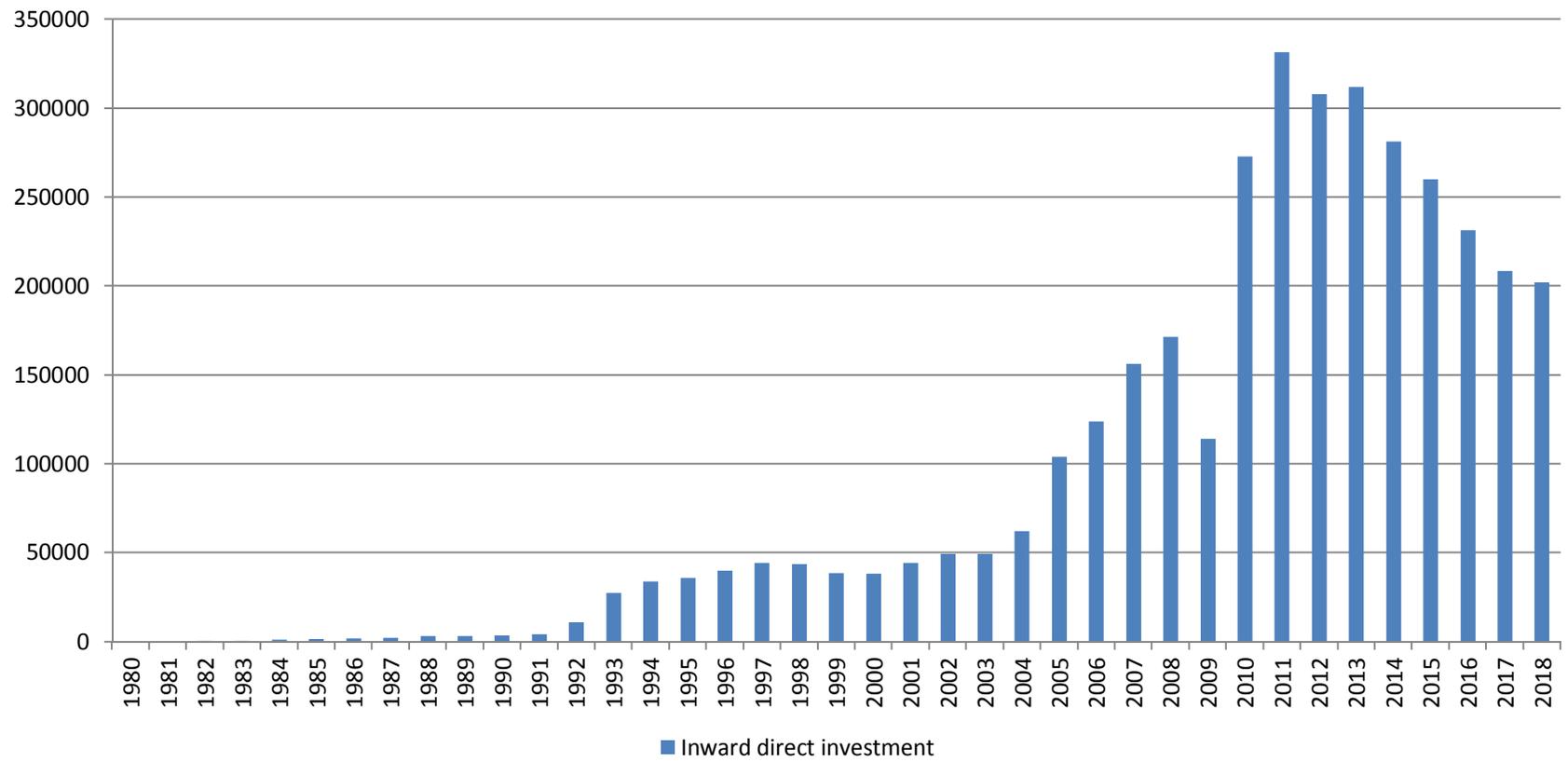
Contribution to Growth

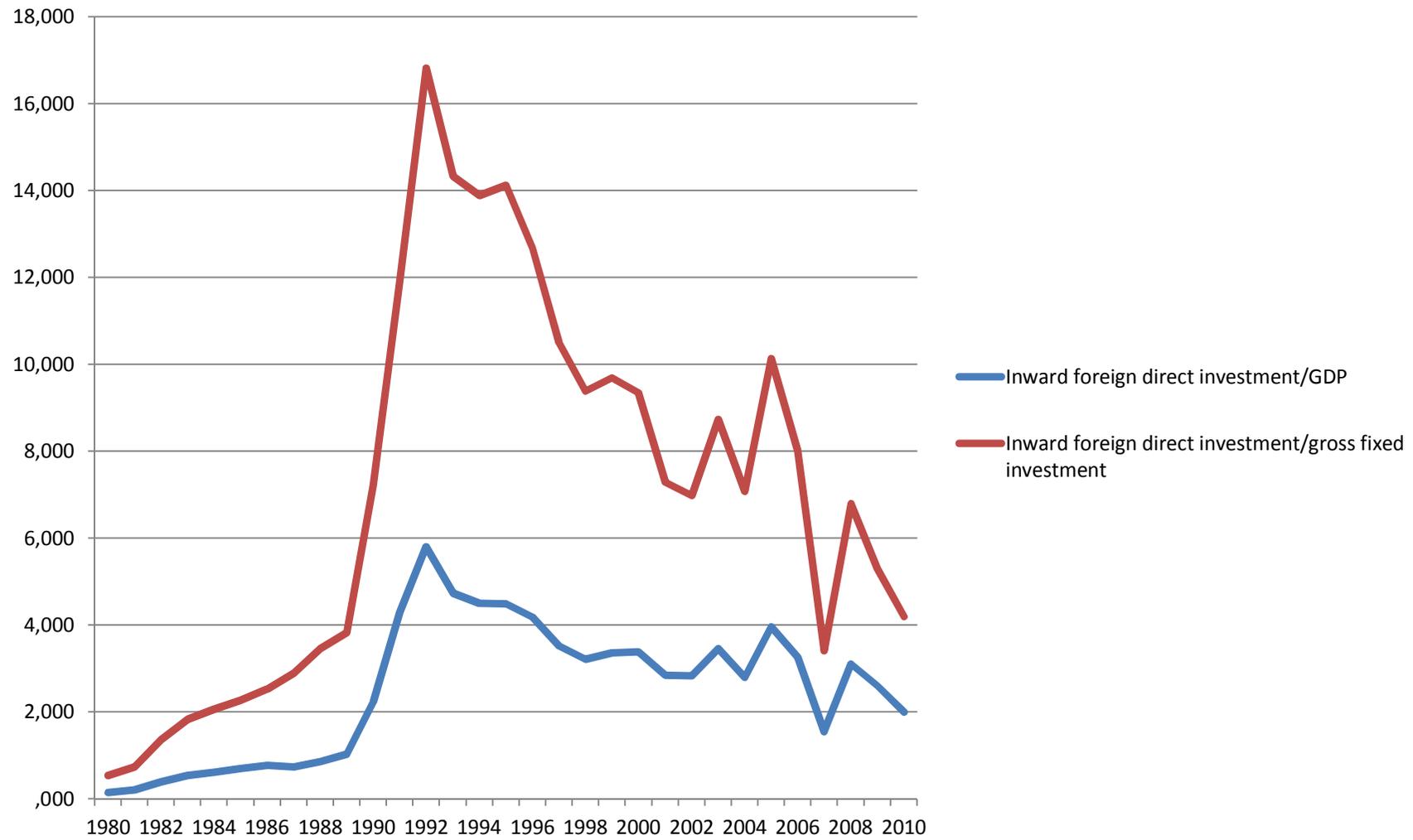
(In percentage points)



Sources: CEIC; and IMF staff calculations.

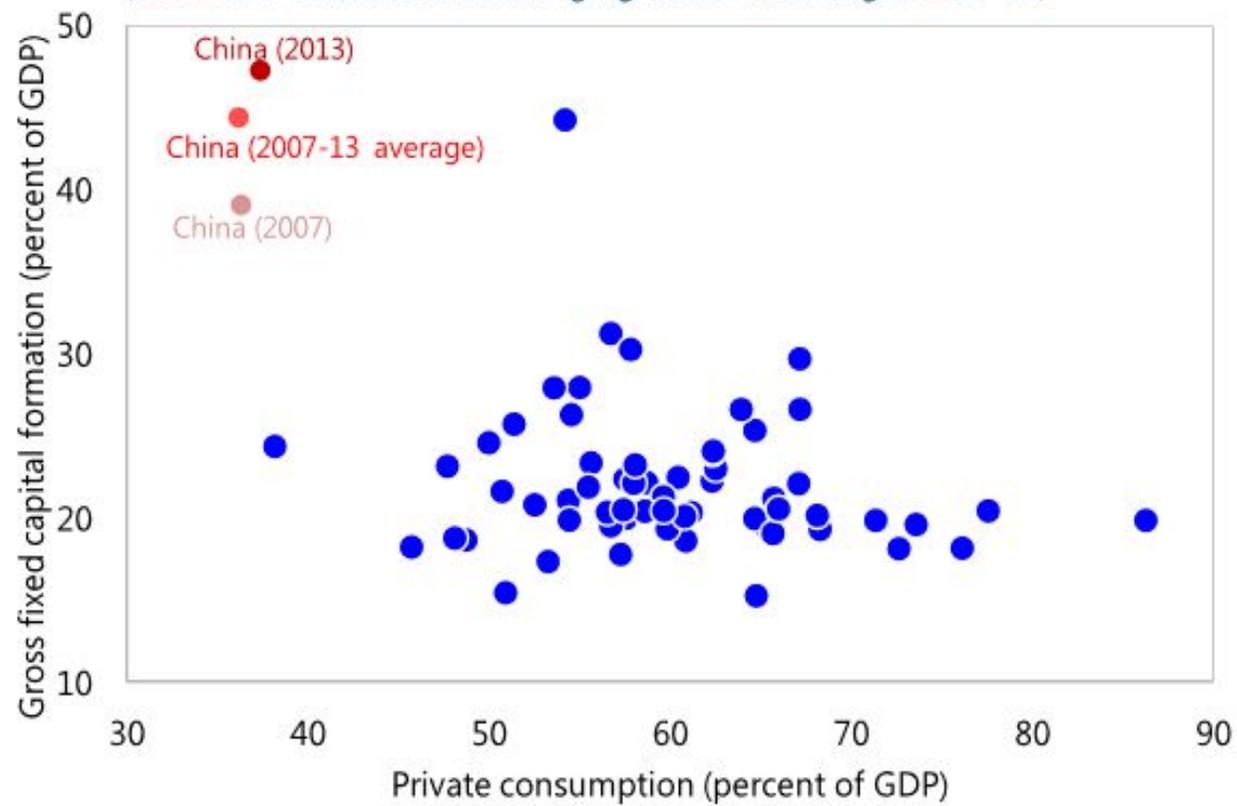
Inward direct investment



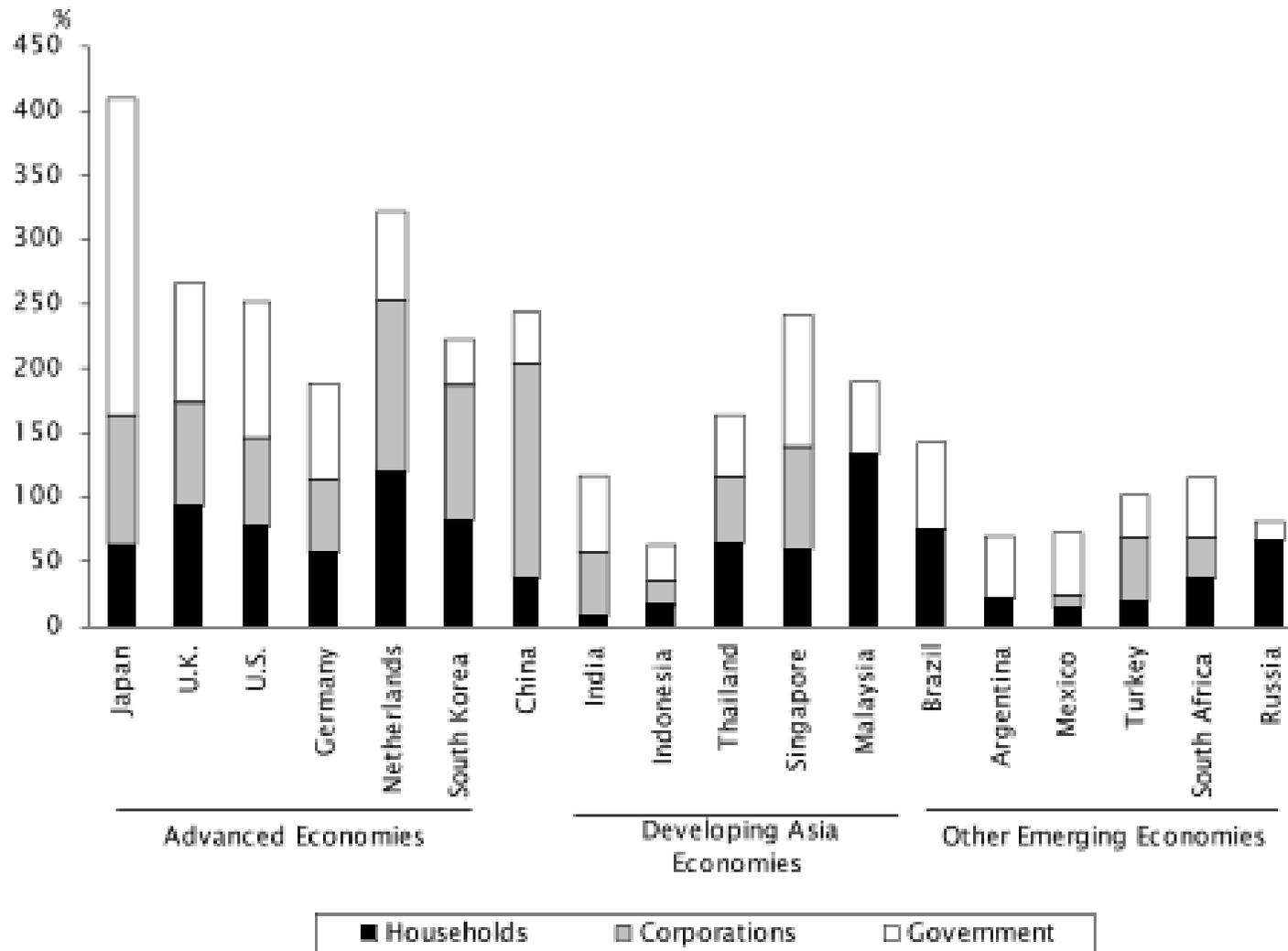


Private Consumption and Investment

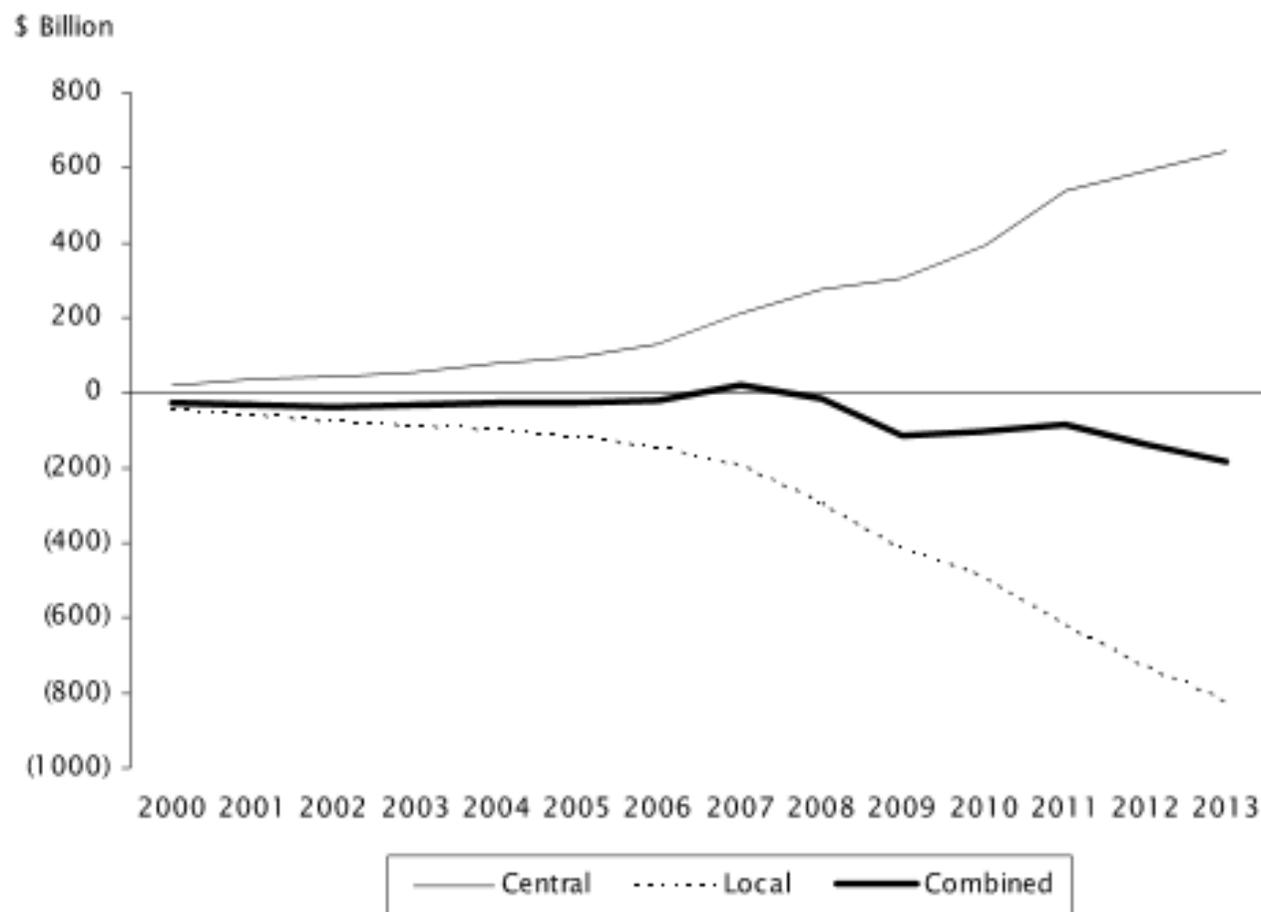
(Industrial Countries and Emerging Markets; average, 2006-13)



Debt as a Share of GDP Q2 2014E

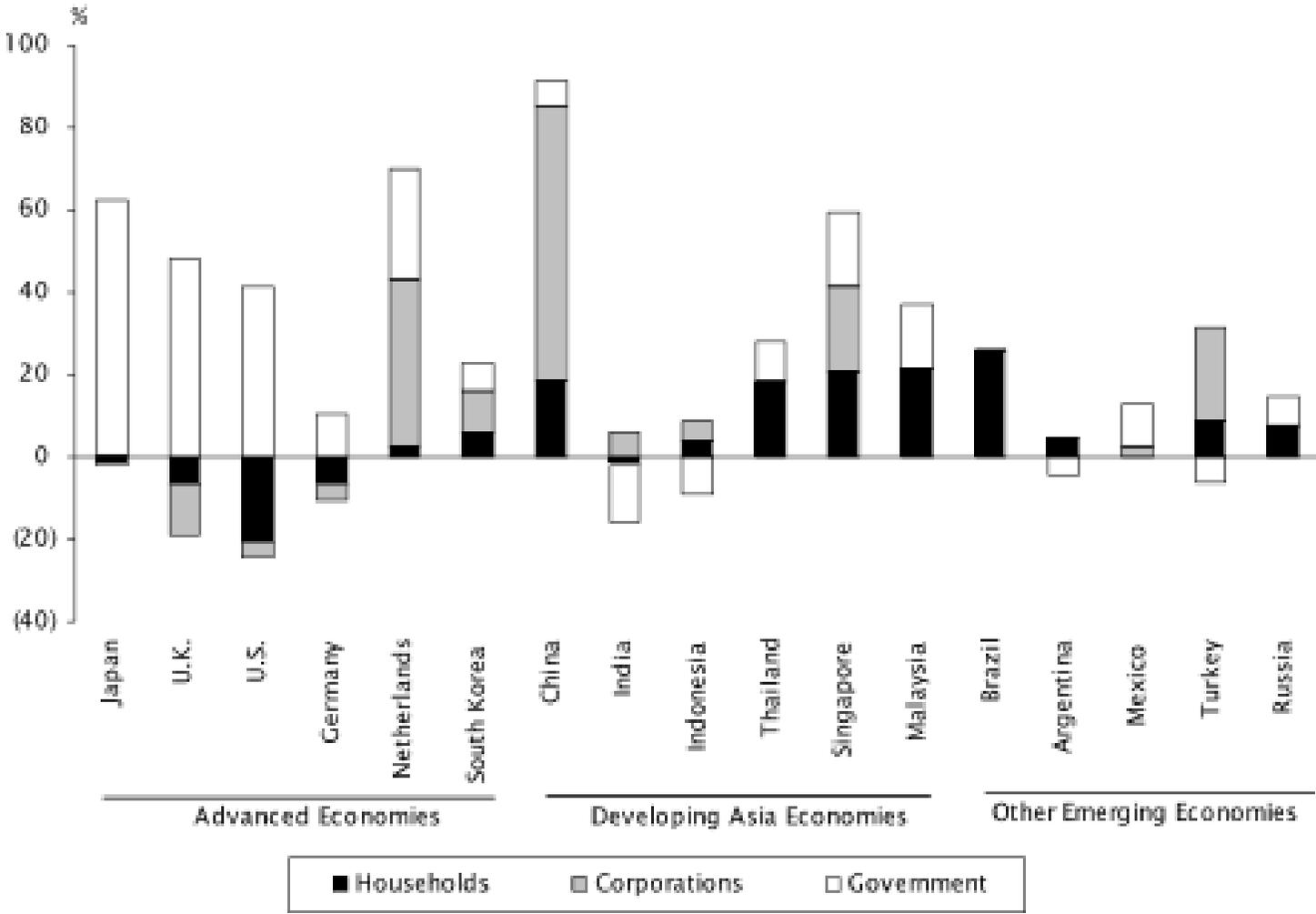


Central and Local Government Budget Surpluses/(Deficits) 2000 Through 2013



Source: CEIC, Empirical Research Partners Analysis.

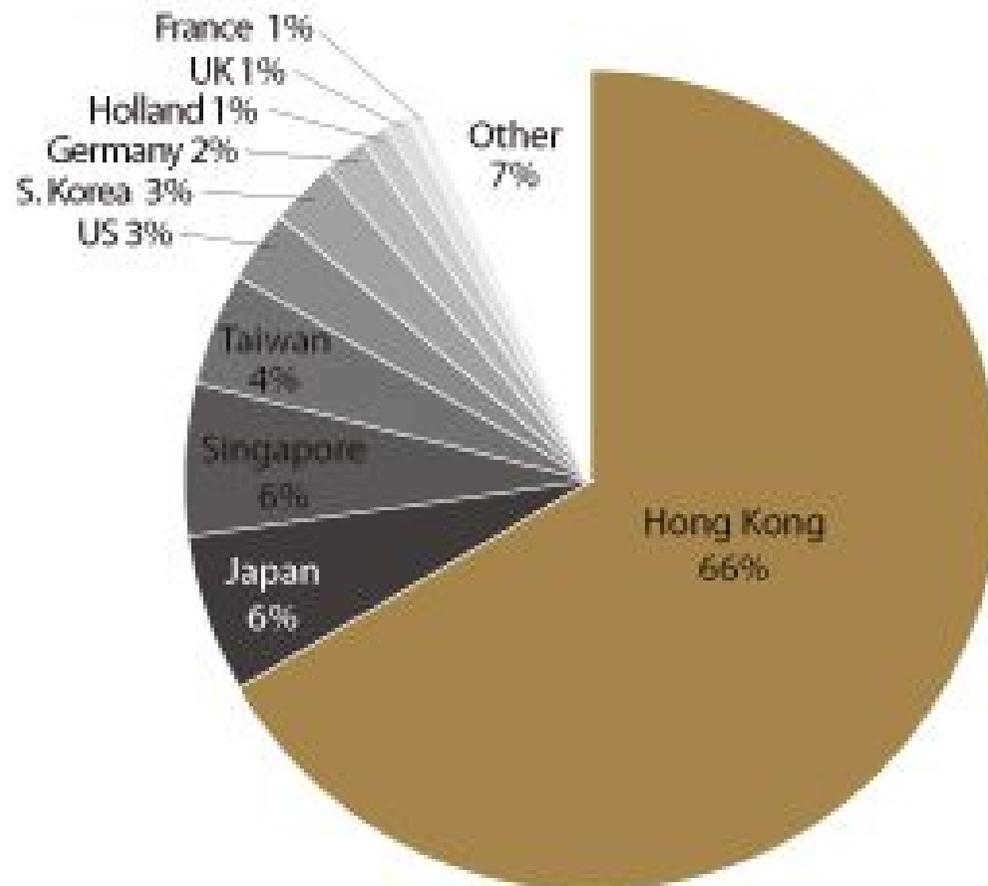
Change in Debt as a Share of GDP Q2 2014E versus 2007



USD billion)

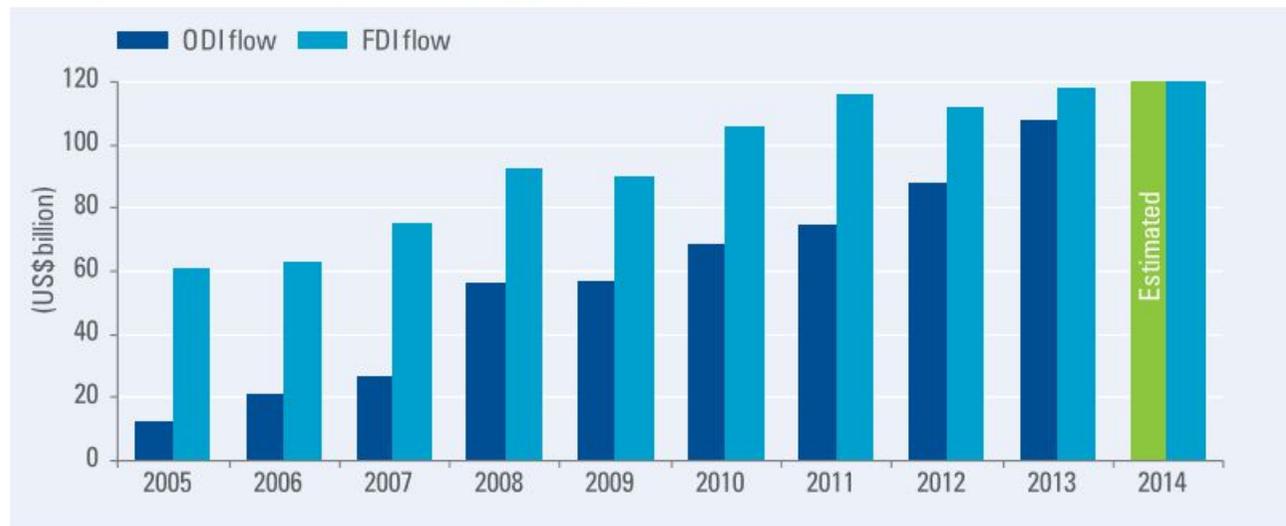
	2007	2008	2009	2010	2011
Hong Kong	15.5	17.95	41.04	46.08	67.47
Taiwan	2.3	2.15	18.99	18.81	6.7
Singapore	2.17	2.2	4.44	3.61	5.66
Japan	2.92	6.53	3.65	4.11	4.24
US	4.38	3.6	2.94	2.55	4.05
South Korea	1.49	5.17	3.14	2.7	2.69
Germany	1.04	1.53	0.9	1.22	0.93
Netherlands	0.79	1.04	0.86	0.74	0.95
France	0.85	0.62	0.59	0.65	1.24
UK	1.16	0.96	0.91	0.68	1.64
Italy	0.21	0.32	0.49	0.35	0.38
<u>Total</u>	40.71	60.33	92.4	90.03	105.74

FDI in China by Country (% , 2013)



Source: MOFCOM: The Beijing Axis Analysis

Value of China's ODI and FDI, 2005-2014



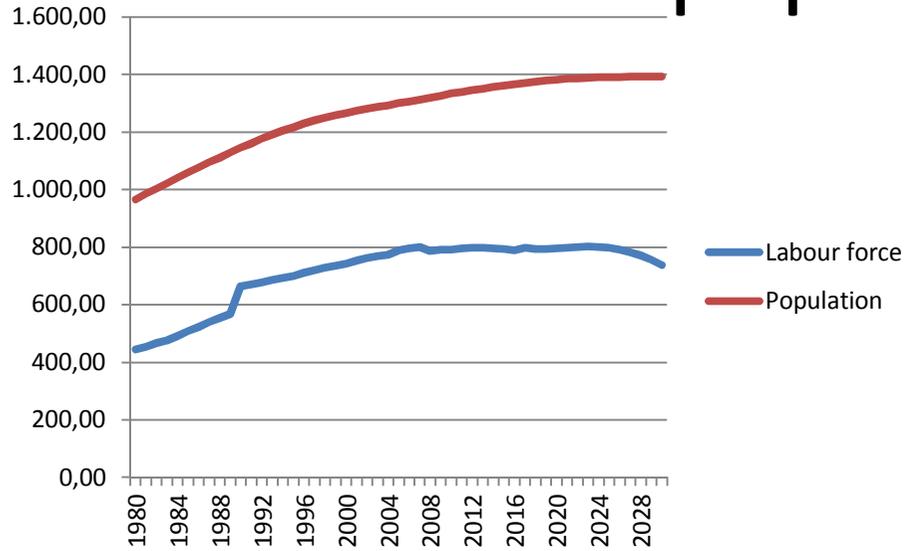
Source: '2013 Statistical Bulletin of China's Outward Foreign Direct Investment', Ministry of Commerce, 21 January 2015, <http://www.mofcom.gov.cn/xwfbh/20150121.shtml>, 27 October 2014, <http://www.mofcom.gov.cn/article/i/dxfw/gzgd/201410/20141000773143.shtml>; '2014 China Statistical Yearbook', NBS, <http://data.stats.gov.cn/english/easyquery.htm?cn=C01>; KPMG Analysis

Urban Rural

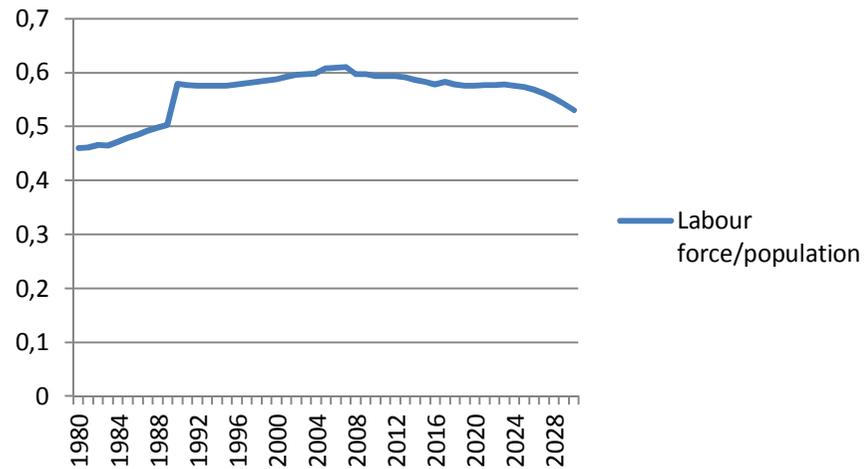
Year	Grouped by Urban and Rural Areas		Urban/Rural
	UrbanAreas	RuralAreas	
1949	57650000	484020000	0,11910665
1979	184950000	790470000	0,23397472
1989	295400000	831640000	0,35520177
2001	480640000	795630000	0,6040999
2010	665570000	674140000	0,98728751

2012 urban/rural 1 to 1

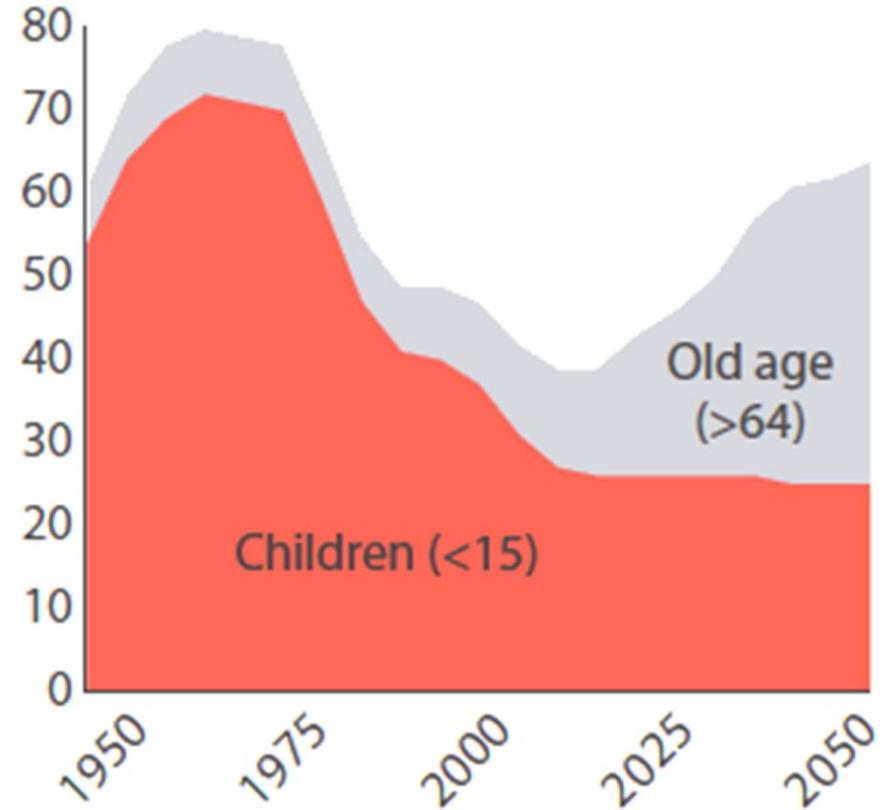
Labour force and population



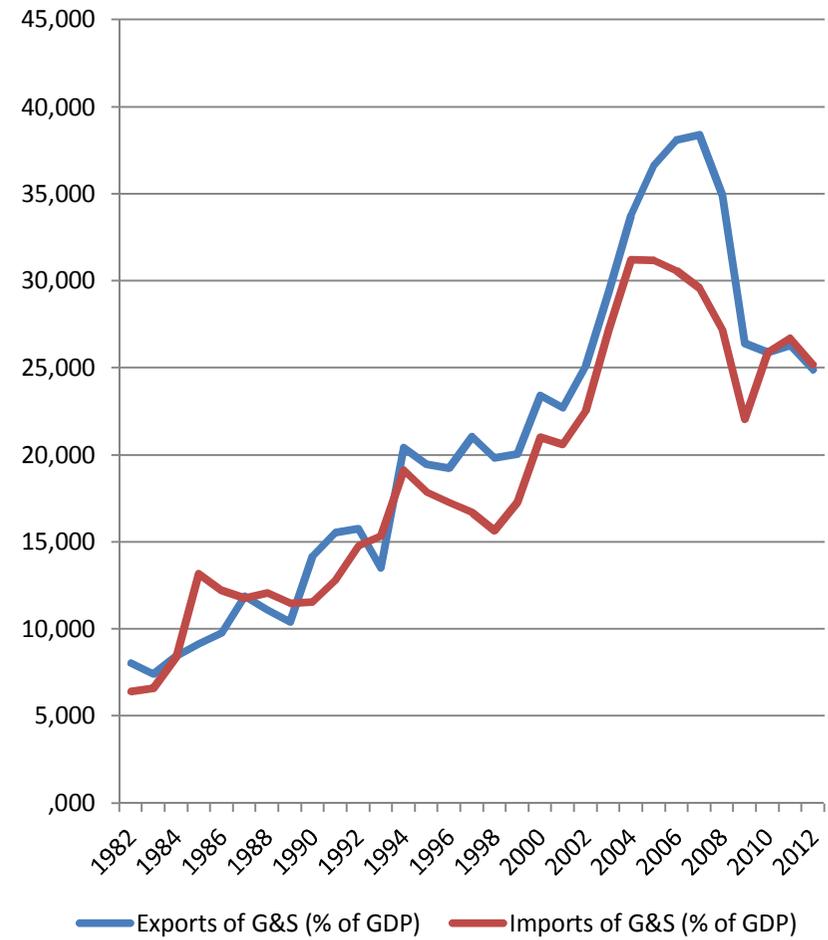
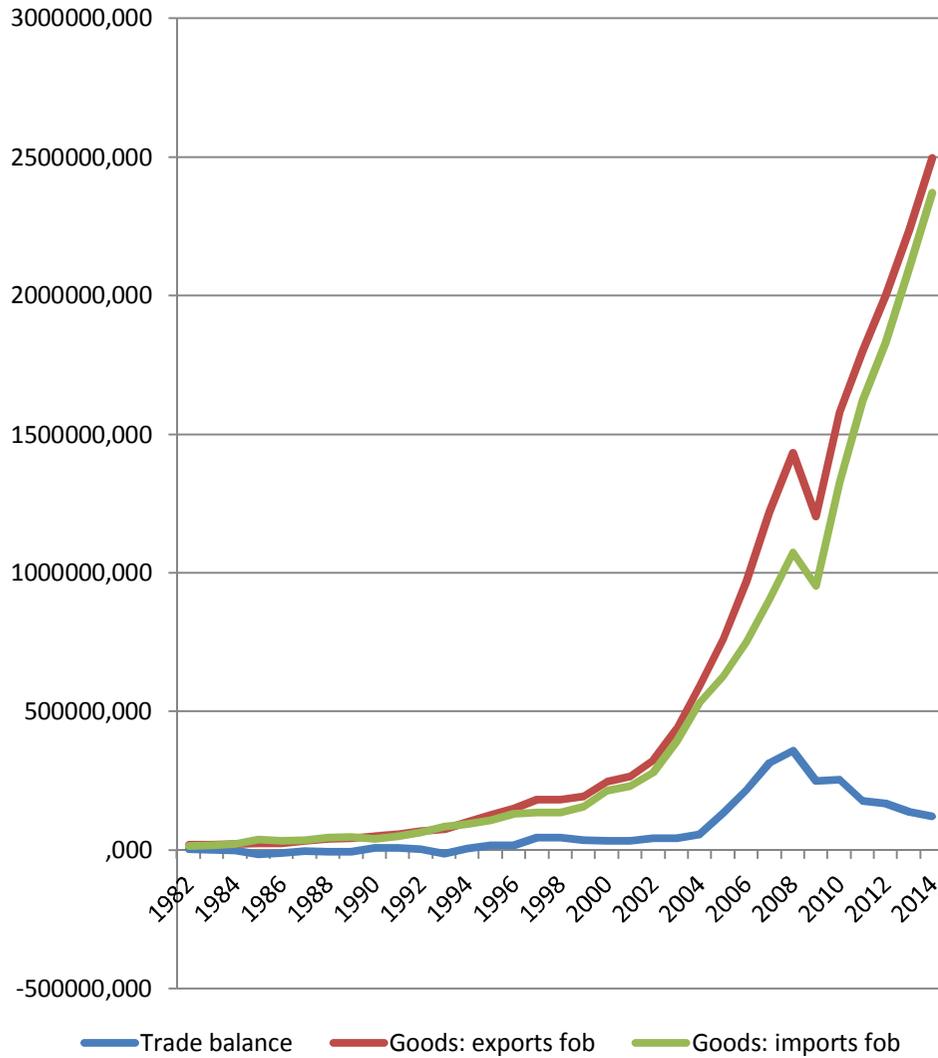
Labour force/population



China getting older



trade



Exchange rate USD/CNY and USD/EUR



EUR per 1 CNY

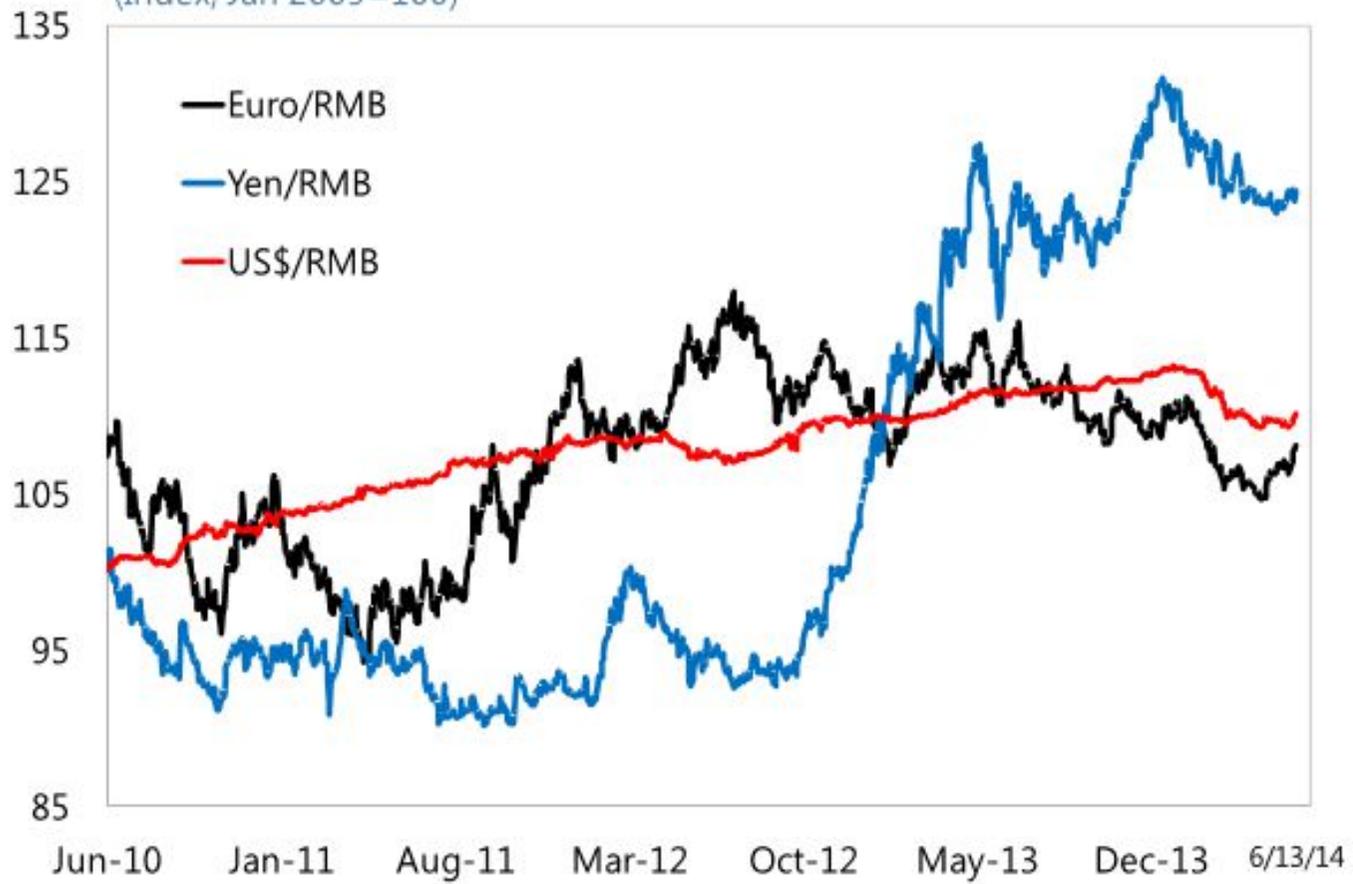
12 Jan 2004 00:00 UTC - 8 Jan 2014 10:47 UTC
CNY/EUR close:0.12162, low:0.08868, high:0.12974



From 2006 2008 Yuan appreciation on US\$ didn't give advantages in EU due to an even weaker dollar compared to €.

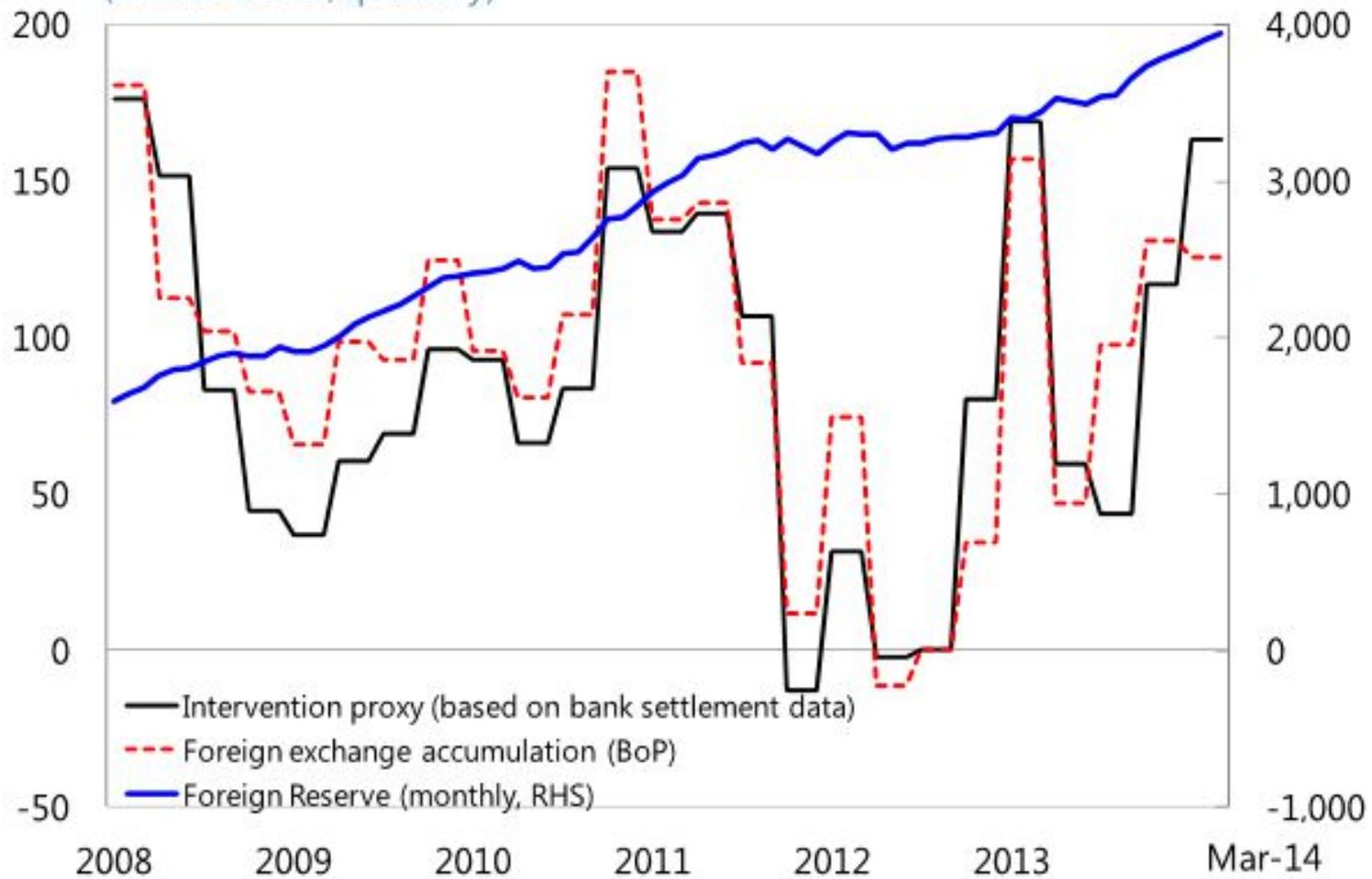
Bilateral Exchange Rate

(Index, Jan 2009=100)

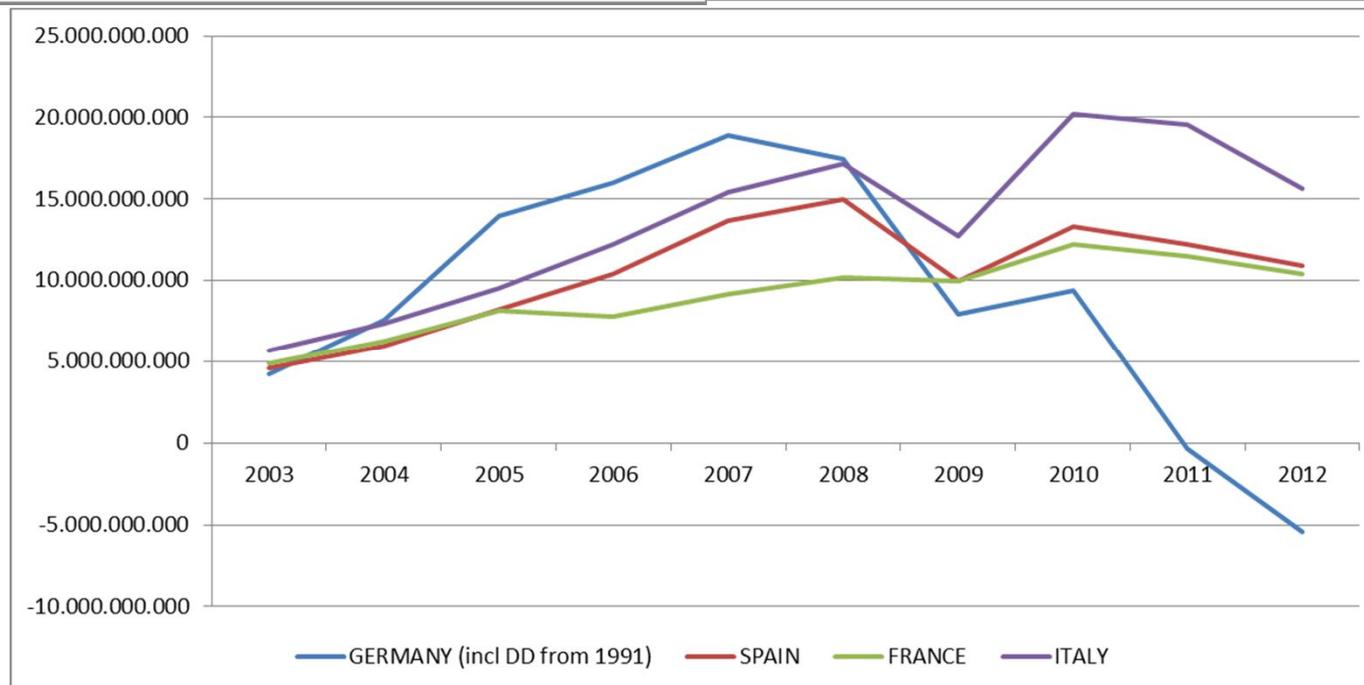
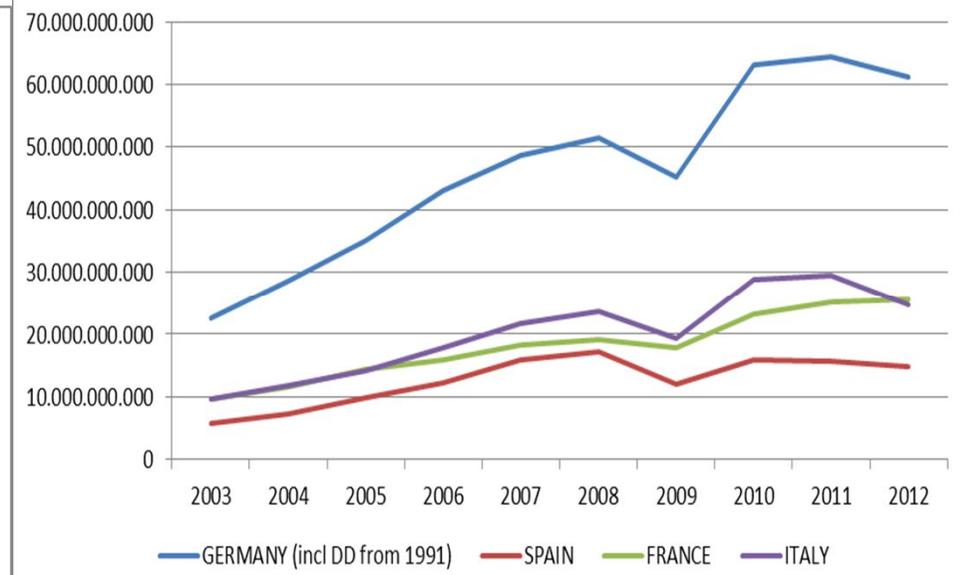
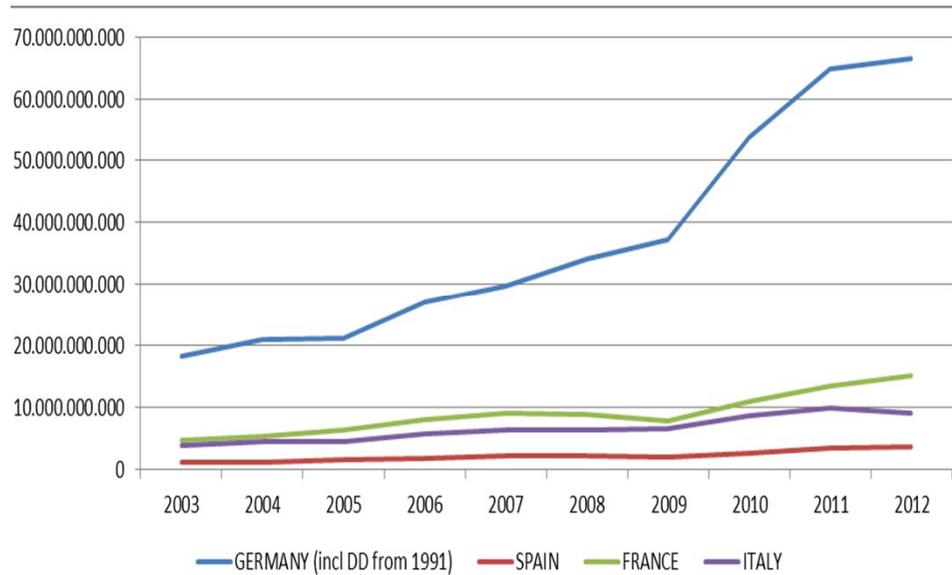


Foreign Exchange Accumulation and Intervention

(In USD billion, quarterly)



Export import and trade balance with China



China export By product (thousand US\$)

Code	Product label	Exported value in 2008	Exported value in 2009	Exported value in 2010	Exported value in 2011	Exported value in 2012
TOTAL	All products	1430693100	1201646800	1577763800	1898388400	2048782200
'85	Electrical, electronic equipment	342083349	301099032	388755010	445756705	487322454
'84	Machinery, nuclear reactors, boilers, etc	268671157	236009996	309813672	353763873	375899473
'61	Articles of apparel, accessories, knit or crochet	60877450	53762969	66710933	80164561	87045225
'94	Furniture, lighting, signs, prefabricated buildings	42832799	38936958	50584032	59336352	77886190
'90	Optical, photo, technical, medical, etc apparatus	43331345	38914169	52109780	60684983	72631372
'62	Articles of apparel, accessories, not knit or crochet	52490143	46716321	54361478	63073873	61224360
'73	Articles of iron or steel	48419118	33781144	39143621	51196168	56156107
'39	Plastics and articles thereof	29808557	25274692	34696577	45420906	55194044
'87	Vehicles other than railway, tramway	39273457	27931282	38397962	49539445	55117129
'64	Footwear, gaiters and the like, parts thereof	29720438	28016268	35633851	41722333	46811268

China Import By product (thousand US\$)

Code	Product label	Imported value in 2008	Imported value in 2009	Imported value in 2010	Imported value in 2011	Imported value in 2012
TOTAL	All products	1132562200	1005555200	1396001600	1743394900	1818199200
'85	Electrical, electronic equipment	266514884	243756119	314282498	350954252	381520999
'27	Mineral fuels, oils, distillation products, etc	169251777	123970041	188965812	275766337	313066988
'84	Machinery, nuclear reactors, boilers, etc	138795536	123717219	172150025	199313752	181960039
'26	Ores, slag and ash	85936803	69590904	109386524	150655638	133727965
'90	Optical, photo, technical, medical, etc apparatus	77708548	66996321	89919369	99140733	106145649
'87	Vehicles other than railway, tramway	26962790	28363242	49504235	65438574	70596739
'39	Plastics and articles thereof	48862558	48513919	63704657	70198652	69424491
'99	Commodities not elsewhere specified	4407629	3304654	18433281	49498449	68769065
'29	Organic chemicals	39237189	36163021	48263067	63131991	60864293
'74	Copper and articles thereof	26051361	29513125	46183467	54251470	54516255

Exporters	Imported value in 2008	Imported value in 2009	Imported value in 2010	Imported value in 2011	Imported value in 2012
World	1132562200	1005555200	1396001600	1743394900	1818199200
Japan	150600041	130937525	176736084	194567856	177832336
Korea, Republic of	112137921	102551712	138339223	162716843	168728402
China	92461200	86413993	106867897	122614384	142929913
United States of America	81585556	77755101	102734185	123124010	133765823
Taipei, Chinese	103338103	85722961	115733646	124910647	132199339
Germany	55789930	55764084	74251272	92726220	91933081
Australia	37435133	39438780	61105168	82667477	84568209
Malaysia	32101396	32330691	50430150	62136640	58304935
Saudi Arabia	31022698	23620244	32829048	49467520	54861126
Brazil	29863443	28280983	38099447	52386750	52281127

Chinese export by country

Importers	Exported value in 2008	Exported value in 2009	Exported value in 2010	Exported value in 2011	Exported value in 2012
World	1430693100	1201646800	1577763800	1898388400	2048782200
United States of America	252843531	221295020	283780323	325010988	352438221
Hong Kong, China	190729035	166216920	218301360	267983737	323445330
Japan	116132455	97910966	121043965	148268708	151626581
Korea, Republic of	73931990	53679877	68766311	82920308	87673764
Germany	59208951	49919564	68047133	76399999	69212732
Netherlands	45918581	36682225	49704161	59499691	58898785
India	31585381	29666560	40913958	50536416	47677452
United Kingdom	36072739	31277364	38767054	44122055	46296693
Russian Federation	33075850	17513771	29612074	38903018	44056551
Singapore	32305805	30066363	32347238	35570137	40750209

Chinese export by country

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India	31585381	29666560	40913958	50536416	47677452
United Kingdom	36072739	31277364	38767054	44122055	46296693
Russian Federation	33075850	17513771	29612074	38903018	44056551
Singapore	32305805	30066363	32347238	35570137	40750209
Australia	22247264	20645567	27220264	33910013	37734920
Taipei, Chinese	25877295	20505295	29674922	35109073	36777357
Malaysia	21455169	19631939	23802061	27886048	36525700
Indonesia	17193114	14720624	21953565	29220944	34285244
Viet Nam	15122133	16300914	23101556	29091568	34212587
Brazil	18807457	14118518	24460652	31836677	33413633
Thailand	15636354	13307098	19741222	25694604	31196768
United Arab Emirates	23643690	18632296	21235461	26812848	29568343
Canada	21795877	17675119	22216134	25266590	28125194
Mexico	13866488	12298991	17872653	23975906	27517963
France	23498662	21611741	27858709	30245913	27195963
Italy	26631139	20244613	31145158	33694562	25657525
Saudi Arabia	10823468	8977852	10366445	14849707	18452901
Spain	20818395	14077808	18178686	19723609	18240174
Philippines	9132231	8584708	11540277	14255388	16732210
Belgium	14871301	10872790	14302162	18973831	16376700
Turkey	10606312	8333535	11942037	15613705	15585293

China Import By product (thousand US\$)

Exporters	Imported value in 2008	Imported value in 2009	Imported value in 2010	Imported value in 2011	Imported value in 2012
World	1132562200	1005555200	1396001600	1743394900	1818199200
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Germany	55789930	55764084	74251272	92726220	91933081
Australia	37435133	39438780	61105168	82667477	84568209
Malaysia	32101396	32330691	50430150	62136640	58304935
Saudi Arabia	31022698	23620244	32829048	49467520	54861126
Brazil	29863443	28280983	38099447	52386750	52281127
South Africa	9234973	8693253	14896422	32095190	44653737
Russian Federation	23832762	21282952	25913994	40362600	44138279
Thailand	25656737	24896942	33193365	39039796	38551206
Angola	22382524	14675831	22815049	24922180	33561897
Indonesia	14322935	13663783	20795189	31337084	31935986
Singapore	20171265	17796637	24728920	28139649	28529563
Iran (Islamic Republic of)	19594195	13286547	18300891	30332973	24869408
France	15644105	13031124	17116565	22078793	24124460
Canada	12673351	12026170	14921961	22167123	23209148
Switzerland	7384708	6949483	17108296	27287232	22884176
Chile	11172814	12790520	17935193	20578293	20631633
Philippines	19504744	11946610	16220255	17992317	19643205
India	20258886	13714289	20846313	23372279	18797191
Hong Kong, China	12915846	8711579	12260255	15492483	17895804
Oman	11626847	5409904	9779204	14876688	16974957
United Kingdom	9541782	7877357	11305193	14556661	16801247
Viet Nam	4336317	4746740	6984262	11116531	16229125
Italy	11639589	11020311	14006447	17578760	16065665
Kazakhstan	7727828	6255600	11108591	15349866	14675447

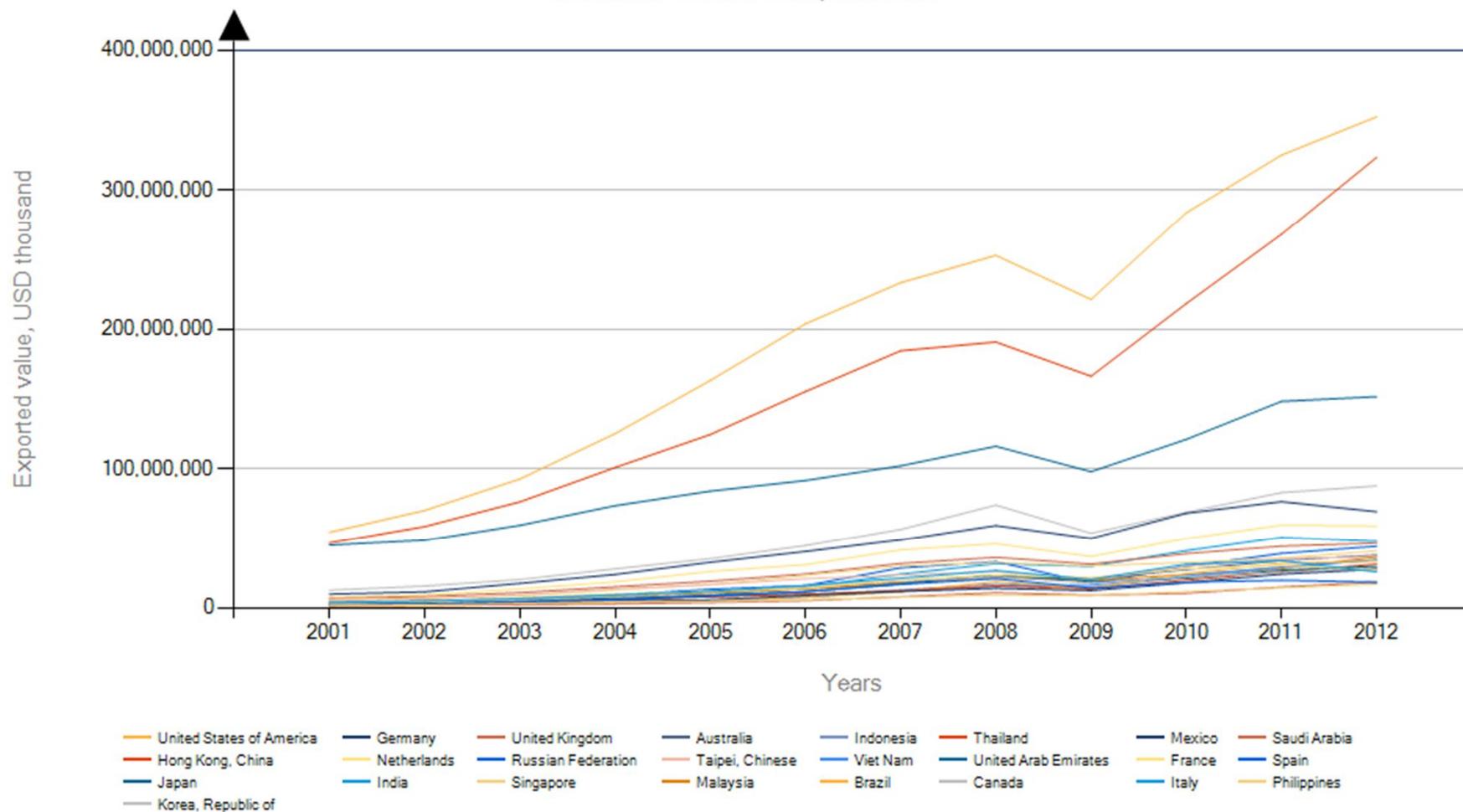
Chinese export % by country

Importers	Share in value in China's Exported, % in 2008	Share in value in China's Exported, % in 2009	Share in value in China's Exported, % in 2010	Share in value in China's Exported, % in 2011	Share in value in China's Exported, % in 2012
World	100	100	100	100	100
USA	17.7	18.4	18	17.1	17.2
Hong Kong, China	13.3	13.8	13.8	14.1	15.8
Japan	8.1	8.1	7.7	7.8	7.4
Korea, Republic of	5.2	4.5	4.4	4.4	4.3
Germany	4.1	4.2	4.3	4	3.4
Netherlands	3.2	3.1	3.2	3.1	2.9
India	2.2	2.5	2.6	2.7	2.3
United Kingdom	2.5	2.6	2.5	2.3	2.3
Russian Federation	2.3	1.5	1.9	2	2.2
Singapore	2.3	2.5	2.1	1.9	2
Australia	1.6	1.7	1.7	1.8	1.8
Taipei, Chinese	1.8	1.7	1.9	1.8	1.8
Malaysia	1.5	1.6	1.5	1.5	1.8
Indonesia	1.2	1.2	1.4	1.5	1.7
Viet Nam	1.1	1.4	1.5	1.5	1.7
Brazil	1.3	1.2	1.6	1.7	1.6
Thailand	1.1	1.1	1.3	1.4	1.5
United Arab Emirates	1.7	1.6	1.3	1.4	1.4
Canada	1.5	1.5	1.4	1.3	1.4
Mexico	1	1	1.1	1.3	1.3
France	1.6	1.8	1.8	1.6	1.3
Italy	1.9	1.7	2	1.8	1.3
Saudi Arabia	0.8	0.7	0.7	0.8	0.9
Spain	1.5	1.2	1.2	1	0.9

Chinese import % by Country

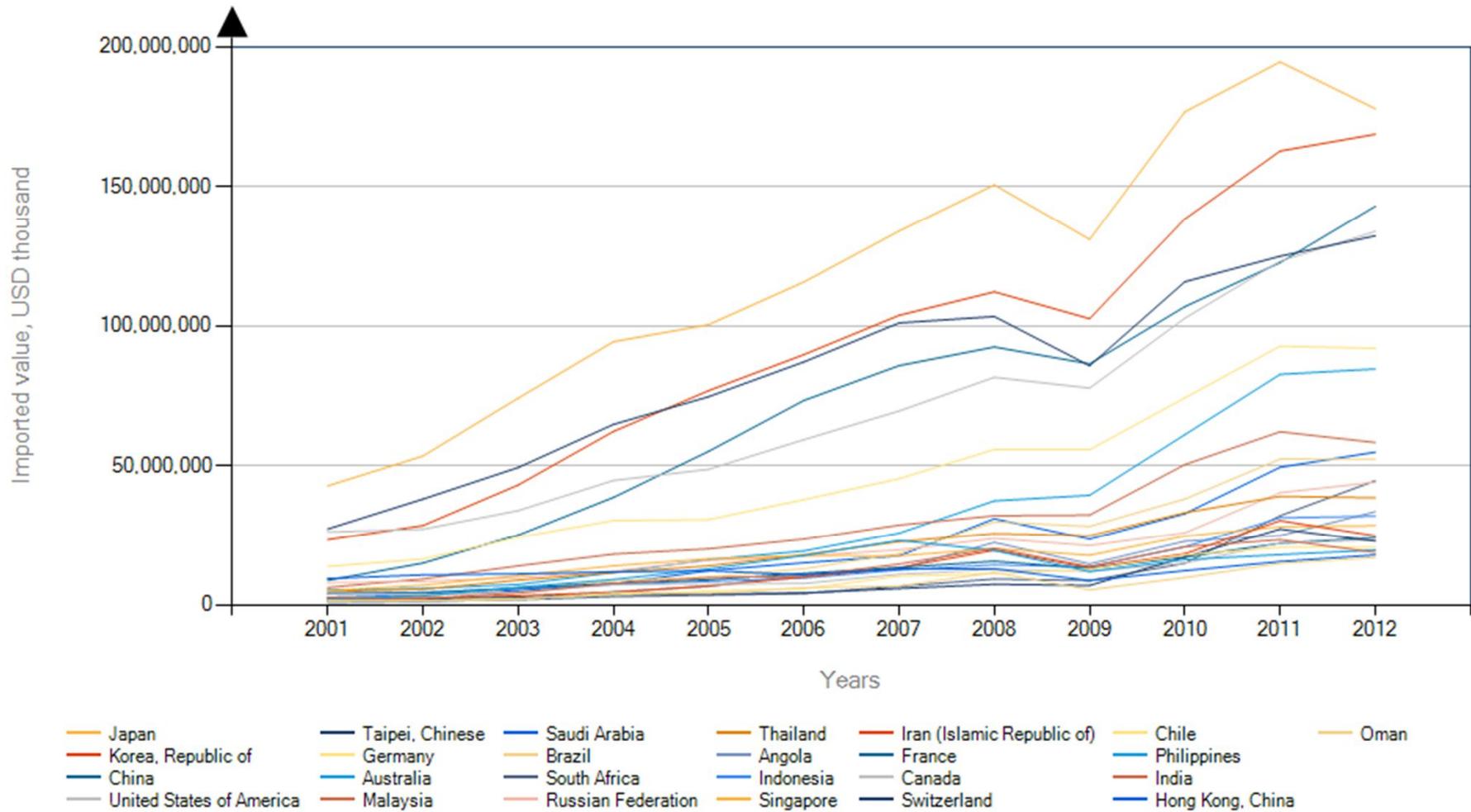
Exporters	Share in value in China's Imported, % in 2008	Share in value in China's Imported, % in 2009	Share in value in China's Imported, % in 2010	Share in value in China's Imported, % in 2011	Share in value in China's Imported, % in 2012
World	100	100	100	100	100
Japan	13.3	13	12.7	11.2	9.8
Korea, Republic of	9.9	10.2	9.9	9.3	9.3
China	8.2	8.6	7.7	7	7.9
United States of America	7.2	7.7	7.4	7.1	7.4
Taipei, Chinese	9.1	8.5	8.3	7.2	7.3
Germany	4.9	5.5	5.3	5.3	5.1
Australia	3.3	3.9	4.4	4.7	4.7
Malaysia	2.8	3.2	3.6	3.6	3.2
Saudi Arabia	2.7	2.3	2.4	2.8	3
Brazil	2.6	2.8	2.7	3	2.9
South Africa	0.8	0.9	1.1	1.8	2.5
Russian Federation	2.1	2.1	1.9	2.3	2.4
Thailand	2.3	2.5	2.4	2.2	2.1
Angola	2	1.5	1.6	1.4	1.8
Indonesia	1.3	1.4	1.5	1.8	1.8
Singapore	1.8	1.8	1.8	1.6	1.6
Iran (Islamic Republic of)	1.7	1.3	1.3	1.7	1.4
France	1.4	1.3	1.2	1.3	1.3
Canada	1.1	1.2	1.1	1.3	1.3
Switzerland	0.7	0.7	1.2	1.6	1.3
Chile	1	1.3	1.3	1.2	1.1
Philippines	1.7	1.2	1.2	1	1.1
India	1.8	1.4	1.5	1.3	1
Hong Kong, China	1.1	0.9	0.9	0.9	1
Oman	1	0.5	0.7	0.9	0.9
United Kingdom	0.8	0.8	0.8	0.8	0.9
Viet Nam	0.4	0.5	0.5	0.6	0.9
Italy	1	1.1	1	1	0.9
Kazakhstan	0.7	0.6	0.8	0.9	0.8

List of importing markets for a product exported by China
 Product: TOTAL All products



Source: International Trade Center

List of supplying markets for a product imported by China
 Product: TOTAL All products



Source: International Trade Center

China trade Balance in billions US\$ 2011

Region	Exports	Imports ^[1]	Total trade	Trade balance
European Union	356.0	211.2	567.2	+144.8
United States	324.5	122.2	446.7	+202.3
Hong Kong	268.0	15.5	283.5	+252.5
ASEAN	170.1	192.8	362.9	-22.7
Japan	148.3	194.6	342.9	-46.3
South Korea	82.9	162.7	245.6	-79.8
India	50.5	23.4	73.9	27.1
Russia	38.9	40.3	79.2	-1.4
Taiwan	35.1	124.9	160.0	-89.8

How is important china as a final market (2011 or 2012)

Region	Percentage
Mongolia	89.0%
Turkmenistan	69.6%
North Korea	67.2% (2011 est.)
Gambia	57.1%
Democratic Republic of the Congo	54.3%
Hong Kong	54.1% (2012 est.)
Mali	52.9%
Sierra Leone	51.1%
Solomon Islands	50.8%
Mauritania	50.5%
Angola	46.3%
Zambia	43.4%
Congo	39.0%
Yemen	37.2%
Oman	31.8%
Australia	29.5%
Taiwan	27.1% (2012 est.)

Burkina Faso	25.9%
Benin	25.0%
South Korea	24.4% (2011 est.)
Liberia	24.0%
Chile	23.3%
Iran	22.1%
Uzbekistan	21.2%
Zimbabwe	21.1%
Peru	19.9%
Kazakhstan	19.3%
Japan	18.1%
Brazil	17.0%
Cameroon	15.2%
Ethiopia	13.0%
South Africa	11.8%
Thailand	11.7%

Importance of China as a supplier

Region	Percentage
North Korea	61.6% (2011 est.)
Kyrgyzstan	55.2%
Hong Kong	46.9% (2012 est.)
Tajikistan	41.2%
Togo	40.4%
Mongolia	37.5%
Benin	37.2%
Burma	36.9%
Macau	32.2%
Kazakhstan	28.0%
Gambia	27.6%
Vietnam	25.8%
Ghana	25.6%
Djibouti	24.4%
Japan	21.3%
Tanzania	21.3%
Angola	20.9%
Vanuatu	20.2%
Chad	20.2%

Pakistan	19.7%
Turkmenistan	19.5%
United States	19.0%
Cameroon	18.7%
Australia	18.4%
Nigeria	18.3%
Bangladesh	17.8%
Madagascar	17.7%
South Korea	16.5% (2011 est.)
Sierra Leone	16.5%
New Zealand	16.4%
Uruguay	16.4%
Yemen	15.5%
Russia	15.5%
Brazil	15.3%
Indonesia	15.3%
Malaysia	15.1%
South Africa	14.4%
Guinea	14.2%
Saudi Arabia	13.5%
Ethiopia	13.1%
Libya	13.0%
Mauritania	12.9%
India	10.7%
Egypt	9.5%

Italian imports according to Broad Economic Categories

	BEC Code	1995	2000	2005	2010	2011	2012	Import US\$	
								World	China
% of total Italian imports coming from China		1.92%	2.71%	4.57%	7.84%	7.40%	6,58%	\$489,104,116,138	\$32,162,562,492
Food and beverages		10.52%	0.90%	0.82%	1.01%	1.07%	0,93%	\$39,974,738,290	\$373,499,228
primary	11	0.64%	0.83%	0.78%	1.09%	1.10%	1,09%	\$15,889,749,595	\$172,602,412
processed	12	0.43%	0.95%	0.85%	0.95%	1.05%	0,83%	\$24,084,988,695	\$200,896,816
Industrial supplies		21.43%	2.15%	3.86%	5.82%	5.83%	5,46%	\$149,516,376,786	\$8,169,387,356
primary	21	1.85%	3.50%	3.59%	3.01%	2.84%	2,79%	\$15,450,678,693	\$430,838,412
processed	22	1.37%	2.00%	3.89%	6.10%	6.18%	5,77%	\$134,065,698,093	\$7,738,548,944
Fuels and lubricants		30.60%	0.19%	0.21%	0.00%	0.00%	0,00%	\$110,234,501,455	\$2,878,300
primary	31	0.21%	0.06%	0.01%	0.00%	0.00%	0,00%	\$88,580,940,409	\$2,555,095
processed	32	1.47%	0.65%	0.99%	0.00%	0.00%	0,00%	\$21,653,561,046	\$323,205
Capital goods (except transport equipment), parts		41.63%	2.50%	5.98%	16.44%	16.82%	15,33%	\$68,366,908,071	\$10,481,638,826
Capital goods (except transport equipment)		41.20%	2.84%	6.35%	14.11%	14.57%	16,98%	\$38,555,134,263	\$6,547,942,768
Parts and accessories	42	1.17%	2.04%	5.42%	18.90%	19.27%	13,20%	\$29,811,773,808	\$3,933,696,058
Transport equipment, parts and relative accessories		50.34%	0.61%	0.95%	5.37%	3.81%	4,07%	\$45,931,548,942	\$1,868,247,500
Transport equipment, passenger motor cars		510.00%	0.00%	0.05%	0.46%	0.25%	0,25%	\$20,262,393,623	\$50,509,362
Transport equipment, other		521.16%	0.67%	0.61%	18.17%	9.44%	9,08%	\$7,237,864,521	\$656,995,260
Parts and accessories	53	0.51%	1.67%	2.97%	5.63%	6.15%	6,30%	\$18,431,290,797	\$1,160,742,878
Consumption goods		69.10%	11.81%	16.38%	19.00%	17.48%	16,26%	\$69,067,204,809	\$11,230,479,932
Durable	61	6.65%	8.57%	16.23%	18.74%	17.24%	16,90%	\$12,017,006,643	\$2,030,815,510
Semi-durable	62	4.27%	19.71%	26.82%	31.87%	29.39%	27,81%	\$28,875,897,260	\$8,029,270,003
Non-durable	63	3.14%	3.73%	4.49%	5.16%	4.72%	4,15%	\$28,174,300,906	\$1,170,394,419
Goods		70.00%	0.02%	0.03%	0.09%	4.19%	0,11%	\$6,012,837,786	\$6,879,350

New growth model?

If the problem is how to increase domestic consumption what shall they do?

Not only one policy: Welfare State (health, education, pensions)

To limit excess of saving...

But saving in China is in line with countries that are at a similar stage of development

The real problem is the excess of saving of companies to do investment.

This happens because the financial system is closed. Not many opportunities of investing savings but also not many opportunities to borrow money if not from the banks

Free interest rate allow a better allocation of resources and this could increase consumption.

Financial system reform

Interest rate are a policy instrument

Administrative constraints are a policy instrument

A close financial system has been crucial for Chinese growth till today

Shift to a new system is not easy

- This system has been very important for the winners of the last decades. How can they change it without losing the support of this strong “constituency”
- But this system also caused overcapacity in many industries
- It also contributed to create the real estate bubble
- It helped banks and local govern to create high level of debts.
- Shadow banking is a ill reply to this system

Liberalize interest rates in China (Collier 2014)

- For borrowers, capital would be allocated according to its returns and not due to the whims of the state
- Savers across the country would no longer be forced to accept below market returns.
- Less pressure on real estate that is one of the few options for savings
- Consumers would have more money in their pockets, and the much hoped for rebalancing of the economy from industry to consumption would be given a quick kick.

So: win –win?

Not so much

- Remember China wants to keep a tight control on Rmb.
- And remember that all financial institutions are interlinked: private firms, State owned enterprises, PBOC, State Banks, Ministry of Finance

Go back to real economy

- What happens when a Chinese company sells something abroad?
- The company is paid with a foreign currency
- The Central bank has to change this foreign currency in Rmb that the firm can deposit, for example, in commercial banks
- So commercial banks have more deposit thus more reserves, and this can increase the level of loans.
- More reserves imply a monetary expansion, *ceteris paribus*

Go back to real economy

- monetary expansion put pressure on inflation
- If you want to avoid inflation (and China, also for historical reasons doesn't like inflation) you need to “sterilize” the monetary expansion linked to exports

How to prevent inflationary monetary expansion?

We have two main options:

1. selling bonds to the banks and thus preventing the expansion of the monetary base
2. To raise the Reserve Requirement Ratio (RRR), withdrawing funds from the system

But at what cost?

- Bonds had to be sold at a price that is the interest rate
- PBOC has a lot of US treasury bonds in its pocket that provide very low returns. Returns are lower than the one that would be accepted by commercial bank to buy Chinese Central Bank Bills. (difference in general is between 1% and 2%)
- This “sterilization” process cost around 1 trillion Rmb each year
- (The larger the trade surplus, the larger are the foreign exchange holdings, the higher is sterilization cost)

So....?

- This system cannot work.
- The cost for the PBOC is too high. It could go bankrupt in a few years
- So What?
- There is a tacit deal between the PBOC, commercial banks (remember, State owned).

The deal

Commercial Banks agree

- to buy central bank bills at below market rates,
- to park a large chunk of their capital (now at around in 20%) in the PBOC in the form of reserves (RRR).

Meanwhile, to ease the burden on the banks, the PBOC has allowed them to

- freeze deposit rates at low level, thus guaranteeing a profit from the spread between deposit and lending rates.

Everybody happy? No!

- Consumers are unhappy (interest rate are usually lower than inflation rate)
- We will see that private firms could be unhappy
- Sometime also banks can be unhappy

What happens if China liberalizes interest rates?

- Consumers very happy because deposit rate will go up. This will bust consumption because they need to save less for future necessities due to higher interest rate (the effect of higher interest rate on consumption is a bit more complicated than that)
- Commercial banks will lose a large part of profits that today are guaranteed by interest rate spread

How much the four big commercial banks could lose?

Two possible interest rate scenarios to compare with retail deposits of commercial banks (1.86%):

1. interest paid to borrow money from the Central Bank and from other banks (2.17%) => $(2.17 - 1.86)$ => drop over 50% of net income)
2. general rate paid to borrow funds from other sources (3.56%) => $(3.56 - 1.86)$ => loss of 104.7 billion)

How can PBOC helps banks?

- 1) Reduce the RRR
- 2) Agree to pay a higher interest rate for bank bills
- 3) Guarantee the state banks interest spread.

Lower RRR

- RRR to 6% as it is for global banks
- Cash could be generated from new loans that are available due to the lower RRR
- If we use the rate of 3.13% the Bank of China pays for debt securities, total bank profits would rise 24% to 538.8 billion RMB.
- Using the higher rate paid for loans of 5.62%, the profit rises 59% to 689.4 billion RMB.
- (but remember inflation)

Agree to pay a higher interest rate for bank bills or
Guarantee the state banks interest spread.

- Chinese public debt could increase fast
- PBOC could end in financial distress

Everybody happy? State owned and private firms

- if interest rate is free will be an important instrument to focus resources where returns are higher, risks are lower, and where resources are more needed
- State owned firms has a privileged access to loans due to political network. For Soes a free interest rate means higher interest rate and lower profit and investment
- For private firms it is the opposite. Lower interest rate means higher profit, probably higher investment in the long run

But...

- Soes are very powerful and well connected
- If State Owned bank that hire more than 15 million people and State Owned firms (30% of manufacturing production, large tax contributors, strong links with the Communist party) are unhappy with this reform difficulties may arise.

And we have kept exchange rate fixed....

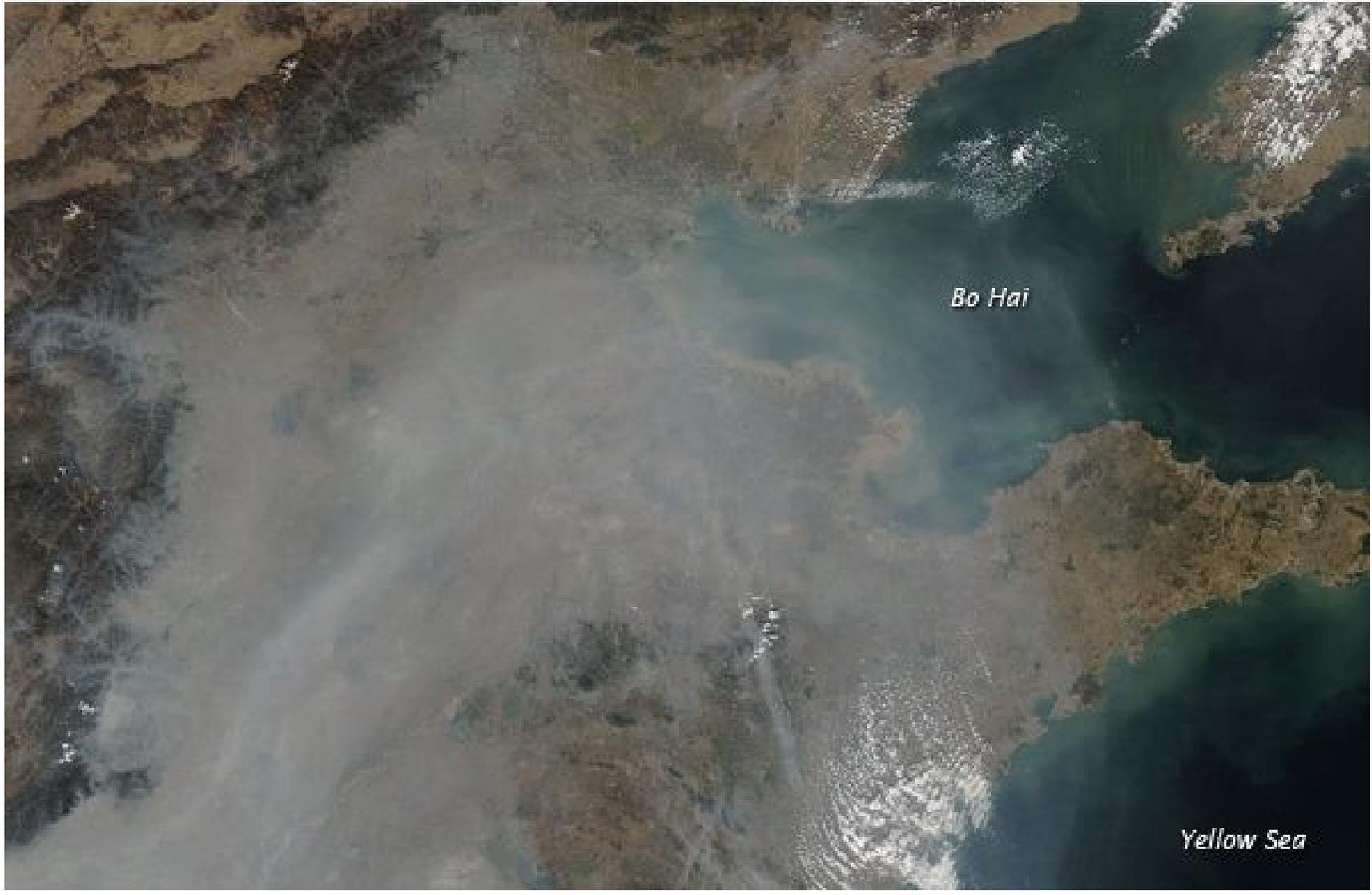
What would happen with a free exchange rate?

- Who knows.....
- Hot money could be a huge problem
- Rmb could appreciate weakening exports
- But someone thinks it could soon devalue

Go to China

- Understand your industry in your home country and in China (am I ready to pay for a good research paper and to hire the right people like consultants, lawyers, etc?)
- Do you know your company? Who is going to manage entry and operations in China? Do you have the right people?
- Do you know China? (no you don't, and even what you know will change fast)

Environment



Bo Hai

Yellow Sea









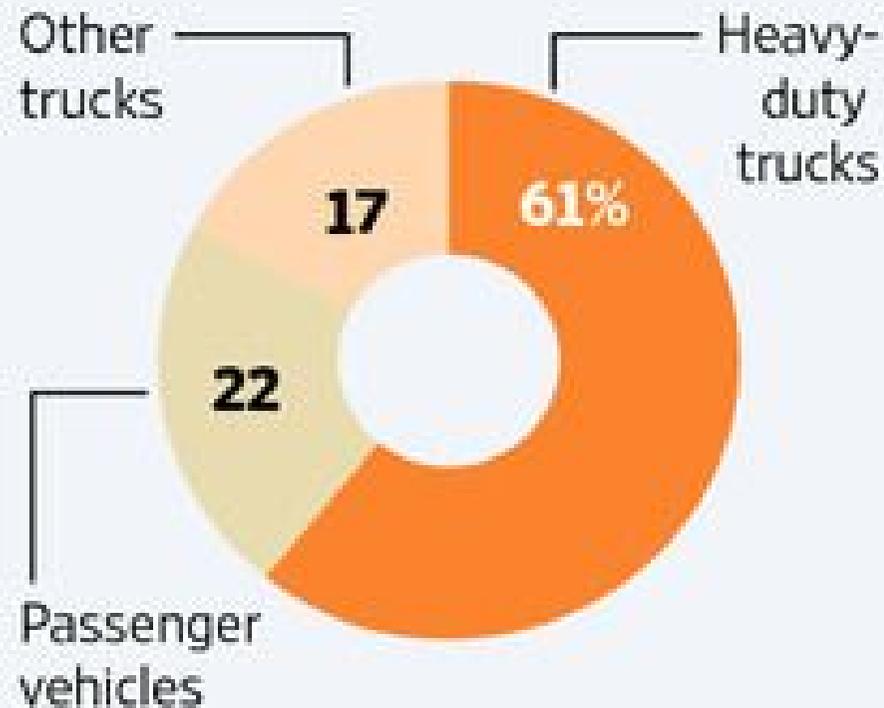
Suggested limit for pm 2.5 =25. in Beijing 200,400,500, 900. (I was there...)

Air pollution

- Industry
- Heating
- Cars

Pollution Sources

Share of particulate matter emitted by vehicle type in China

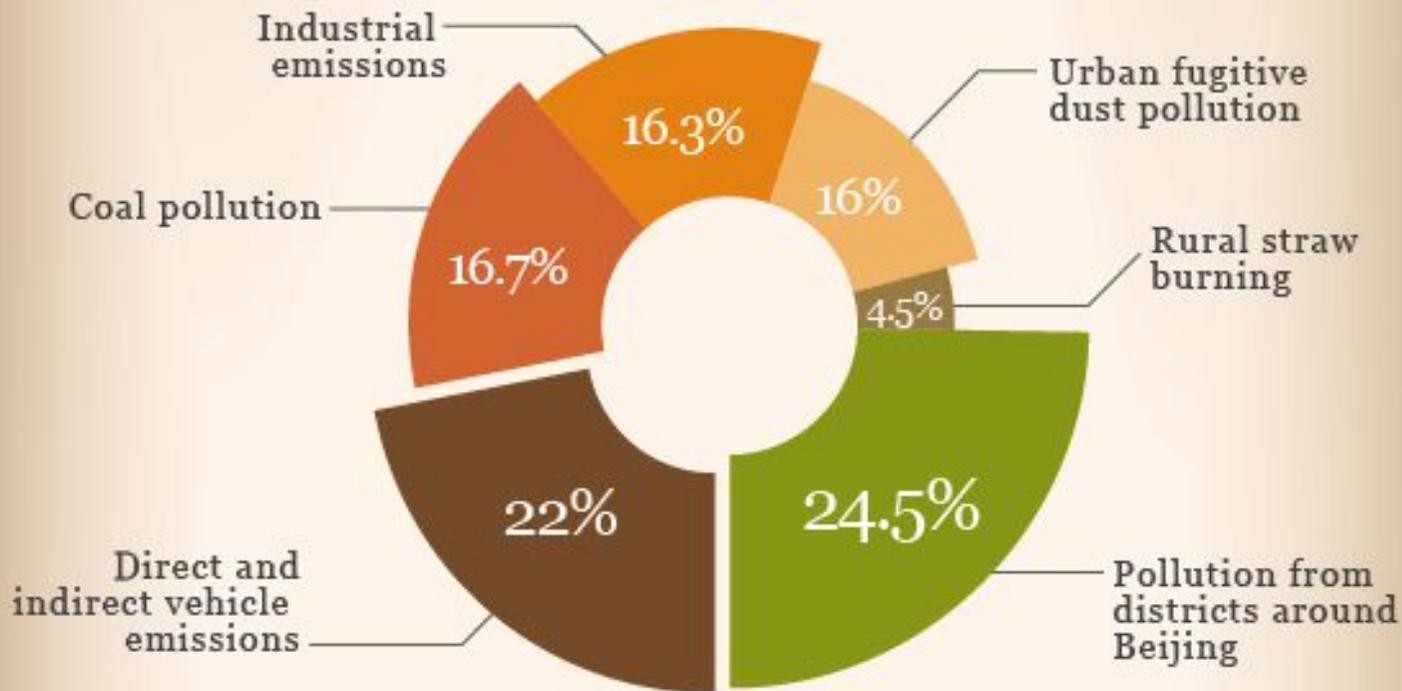


Source: China's Ministry of Environmental Protection
The Wall Street Journal

Where does PM 2.5 come from?

Of the PM 2.5 that comes locally from Beijing, vehicle emissions are the number one source.

Break-down of Beijing's PM 2.5 Pollutants



XII five years plan (2011-2015)

RESTRUCTURING THE ECONOMY

- Growth: no specific number but around 7,5% (like XI five year plan).
- Focus on: [Strategic Emerging Industries](#)
- Demand oriented
- Upgrade industrial system

Strategic emerging industries

- Energy efficient and environmental technologies
- Next generation information technology (IT)
- Biotechnology
- High-end equipment manufacturing
- New energy
- New materials
- New-energy vehicles (NEVs)

XII five year plan (2011-2015)

PROMOTING SOCIAL EQUALITY

- Urban/rural divide
- Regional development
- Income disparity

XII five year plan (2011-2015)

PROTECTING THE ENVIRONMENT

- Energy conservation
- Environmental quality
- New energy

HEALTH CARE

- Health Care System Reform Continued
- Pharmaceutical Sector Restructured
- Biotechnology Promoted as an SEI

XII five year plan (2011-2015)

ENERGY AND THE ENVIRONMENT

Consolidation Continues in Coal Sector

Nuclear and Hydropower Big Winners

Further Development of the Power Grid

Heavy Spending for Energy and Environment Sectors

XII five year plan (2011-2015)

TECHNOLOGY

- Indigenous Innovation Supported
- “Informatization” Increased
- Education Sees Heavy Investment
- Next-Generation Information Technology Singled Out

XII five year plan (2011-2015)

IMPLICATIONS FOR FOREIGN BUSINESS

- Industrial upgrading presents both opportunities and challenges
- Changes to the business environment
- A more complex operating environment
- Seeking views from foreign businesses

European Business in China

POSITION PAPER 2013/2014



European Chamber
中国欧盟商会

EUCCC Executive Summary Key Recommendations

- Strengthen the independence of regulators at both the central and local levels
- Increase governmental resources to ensure corporate compliance with the regulatory framework
- Realign SOEs with the interests of society
- Create a larger role for the private sector, including foreign-owned companies
- Further liberalise interest rates
- Discontinue nationalistic approaches to promote indigenous innovation
- Publish and allow equal access to all subsidies
- Open strategic emerging industries to equal participation and contribution by private and foreign companies

EUCCC Executive Summary Key Recommendations

- Open standardisation processes to ensure that the best technologies reach the market
- Use, and rely on the enforcement of, environmental standards, certification, renewable energy quotas, resource taxes, and efficiency/emission targets to promote and ensure better technology choices
- Defuse tensions with trade partners by substantially reducing market access barriers
- Abolish the Foreign Investment Catalogue
- Issue a comprehensive Government Procurement Agreement offer that includes local governments and
- SOE projects financed with state money
- Engage more deeply and take a leadership role in international standardisation and regulatory harmonisation processes

EUCCC Executive Summary Key Recommendations

- Promote the further liberalisation of global trade rules by promoting the expansion and evolution of the WTO in the Doha Development Round and by negotiating bilateral investment agreements with the European Union and the United States that cover both post- and pre-establishment national treatment.