H2-2019 Semi-Annual Economic and Policy Update

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INTRODUCTION

In 2019, China faced many challenges but pressed on towards its long-term economic goals. Political tensions rose not only with the United States, but also with Canada, Australia, and European countries as governments planned the rollout of 5G and deliberated on whether or not to include Chinese telecoms suppliers in constructing their networks. Regional economic disparities also increased in China, with some industrial regions stagnating. Manufacturing and industrial profits fell throughout 2019, but did see a small uptick in December. However, GDP growth remained within the 6-6.5% target range, and the government continued to pursue its debt de-risking campaign, signaling optimism regarding China's long-term economic prospects. China also resumed pork and soybean imports from the US in December, leading to a slight trade rebound between the two countries.

In the second half of 2019, China's policy focus was on enhancing its trade cooperation with other countries and further improving its investment environment for foreign investors. However, 2019 was a year in which major economic reforms had to share priority with political stability - more so than in recent years. As we move forward into 2020, China will look to combat the effects of the COVID-19 coronavirus outbreak and may continue to optimize its domestic economic structure in order to strengthen trade and investment relationships with other countries.

MACROECONOMIC ENVIRONMENT

According to China's National Bureau of Statistics (NBS), China's Gross Domestic Product (GDP) increased 6.1 percent in 2019, which is in line with China's growth target range of 6-6.5%, and International Monetary Fund and World Bank predictions which were 6.1% and 6.2% respectively. The growth rate fell from 6.3% in the first half to 6% in the second half of the year, reaching its lowest level since the 2008 global financial crisis, a fact that was widely reported on in western media, including in the New York Times. In light of this decline, NBS spokesperson Mao Shengyong said: "Since the beginning of this year, the growth of the world economy and international trade has slowed, and the downward pressure on the domestic economy is more significant. The central government has issued a series of counter-cyclical policies in time to better withstand the downward pressure on the economy." Additionally, the Consumer Price Index (CPI) rose 2.9% in 2019, which is 0.8 percentage points higher than its rise in the previous year. Much of this increase was driven by food and drink prices, which increased 7%, though this is largely accounted for by a spike in the price of pork. Despite this, the overall CPI increase fell within the 3% flexible target set by the central bank and was not seen as challenging China's monetary easing that is being undertaken to combat slowing growth.

According to NBS statistics, China's fixed-asset investment increased by 5.4%, amounting to a total of RMB 55.1478 trillion in 2019. By sector, infrastructure investment increased by 3.8%, manufacturing investment increased by 3.1%, and real estate development investment increased by 9.9%. Moreover, investment in technology-related industries increased by 17.3%, playing an increasingly important role in overall investment. NBS also reports that the service sector grew by 6.9%, the secondary sector by 5.7%, and the primary sector by 3.1%. The fastest growing industries in the service sector were information transmission and software and information technology, which outperformed the overall average by 11.8% and 1.8%, respectively. Even though these growth rates met their target ranges, they exhibited a decreasing trend when compared with the year prior. This suggests that, even before the coronavirus outbreak, downward pressure was taking its toll on the Chinese economy.

The Ministry of Commerce (MOFCOM) released statistics showing an 8.2% decrease in China's non-financial outbound direct investment (ODI) in 2019 versus the year prior, falling to US$110.6 billion. ODI flowed mainly to the lease and business services, manufacturing, and wholesale and retail sectors. Notably, US$15 billion of this investment was made in Belt and Road Initiative (BRI) countries, roughly equal to ODI in 2018. As reported on in the South China Morning Post, the shifts in investment flows in 2019 meant that China's net international investment position declined last year.

According to statistics released by the General Administration of Customs of China, in 2019, the value of China's total imports and exports was RMB 31.54 trillion, an increase of 3.4% since 2018. Of this sum, exports accounted for RMB 17.23 trillion, an increase of 5%, and imports accounted for RMB 14.31 trillion, an increase of 1.6%. China's overall trade surplus increased dramatically to RMB 2.92 trillion, 25.4% higher than the previous year. Notably, the Association of Southeast Asian Nations (ASEAN) became the second largest trade partner followed by the European Union (EU), while trade with the US decreased by 10.7%. Furthermore, private companies have become China's largest foreign trade entity for the first time by trading volume, replacing state-owed enterprises.

China's competitiveness as an exporter grew slightly as its currency fell below seven yuan to the US dollar. Therefore, in US dollar terms, China's exports only increased in value by 0.5% and their imports decreased by 2.8%. China-US trade in goods also fell, with exports from China declining from US$539.7 billion to US$452.2 billion, and imports declining from US$120.1 billion to US$106.6 billion.

China's stock markets performing well for a major market in 2019, as reported in the Financial Times. According to stock market statistics, throughout the year, the Shanghai Composite Index rose 22.3%, and the Shenzhen Composite Index rose by 44.08%, landing it as second place among major stock market indexes. In terms of market value, China's total market capitalization rose to RMB 64 trillion, an increase of more than RMB 16 trillion throughout the year, which signals a reinvigoration of investor confidence.

In 2019, China's central bank, the People's Bank of China (PBoC), signaled prudential monetary policy to support the real economy. The PBoC implemented a series of countercyclical policies to maintain a reasonable scale of market liquidity and support financing in the private economy, especially for small and micro enterprises. In addition, the PBoC used multiple monetary policy tools, including the market-oriented Medium-term Lending Facility (MLF), to guide the flow of funds to the real economy. In December 2019, the average loan interest rate charged for enterprises was 5.14%, 19 basis points lower than the same period last year. Regarding price stability, officials from the PBoC believe that there is no basis for long-term inflation or deflation, despite the rise in pork and food prices in 2019. Additionally, the volatility of the RMB against the US dollar reached roughly 4% last year, reflecting uncertainties about trade negotiations between the US and China. Overall, the PBoC pledges to maintain prudent monetary policy, keep interest rates stable, lower reserve requirements, and fully support economic development in 2020.

NOTABLE EVENTS

Over 2019, the Chinese government worked to further develop protocols to facilitate investment cooperation, foreign aid dispersion, and construction along

Appendix

For further reading on China's economy and economic engagements around the world, please refer to the list below:

US & Canada

- *On July 22nd, the MOFCOM released the announcement on final ruling deciding to impose anti-dumping duties on the stainless steel billet and hot-rolled stainless steel plate/coil originating in the EU, Japan, the Republic of Korea and Indonesia.*
- *On July 29th, the MOFCOM launched the Countervailing Investigation against the Imports of N-propanol Originating in the United States.*
- *On July 29th, the MOFCOM decided to conduct an anti-dumping investigation against the imports of M-Cresol originating in the United States, EU, and Japan from now on.*
- *On July 30-31st, the 12th Round of China-US High-level Economic and Trade Consultations were held in Shanghai.*
- *On September 3rd, the MOFCOM announced the final ruling on anti-dumping investigation against phenol and decided to impose anti-dumping duties on phenol imports from the US, the EU, North Korea, Japan and Thailand.*
- *On October 10-11th, a new round of China-US high-level trade consultations concluded in Washington.*

Central & South America

- *On July 31st, China and Colombia signed a Memorandum of Understanding on E-commerce Cooperation.*
- *On December 3rd, China and El Salvador signed the Memorandum of Understanding on Establishing the Unimpeded Trade Work Group and on Establishing the Investment and Economic Cooperation Work Group.*

Europe

- *On July 15th, the 22nd China-EU Investment Agreement negotiations were held in Brussels.*
- *On September 9-12th, the 16th round of*

the Belt and Road. Some of the most significant results of these efforts were the MOFCOM (1) *Guidelines on Promoting High-Quality Development of Foreign Contracted Projects,* (2) *the Implementation Procedures for the Filing (Approval) Report of Foreign Contracted Projects*, and the acceleration of construction of contact and service platforms for overseas enterprises and outward investors.

Accordingly, the facilitation of outbound foreign investment seemingly improved. From January to November, China's outward direct investment was US$104.4 billion, with outward investment in the real economy, such as in the manufacturing industry, growing steadily in 2019. Chinese enterprises completed 294 merger and acquisition projects in 52 countries around the world, with transaction volume totaling US$29.4 billion.

Overseas contracted projects were encouraged to orient towards higher-quality development. From January to November, the completed foreign contracted projects supplied to clients was US$135 billion, which was mainly in the transportation, general construction, and power engineering construction industries. These projects are estimated to have created 770,000 jobs in China's partner countries. An additional US$12.7 billion worth of equipment and materials related to these projects were exported from China to supply these projects.

China also worked to further develop their network of "overseas economic and trade cooperation zones." By November 2019, the total investment in overseas economic and trade cooperation zones exceeded US$41 billion according to MOFCOM statistics. Approximately 5,400 enterprises participated in various "cooperation zones," creating about 370,000 local jobs and generating US$4.3 billion in tax revenue to the host countries.

According to the American Enterprise Institute's China Global Investment Tracker, Chinese companies made at least twenty outbound direct investments worth over US$1 billion in 2019. The largest of these was in the entertainments industry, with the acquisition of Amer Sports by the Anta Sports Led Consortium. The next two largest investments were in the energy sector and were directed to Russia and Peru. Energy, construction and transport, and Mining were the sectors that received the most outbound foreign investment from China in 2019 overall and H2 2019. Accordingly, the largest Chinese foreign investors in descending order were CNOOC, Anta Sports Led Consortium, CCCC, State Grid, Three Gorges, and Beijing Auto. The majority of large investments came from state owned enterprises, though privately held companies were also a significant source of investment from China.

Lastly, it is worth noting that, over 2019, the Committee on Foreign Investment in the United States was enhanced to more closely scrutinize foreign investment, dampening the China-U.S. investment relationship. As such, Chinese investment in the U.S. declined relative to recent years and is now precarious amid the U.S-China tension and rivalry. While not solely responsible for the decline in China-U.S. investment, it reflects a mistrusting and uncooperative shift in China-U.S. relations that, as a whole, may be to blame for the decrease, despite Chinese investment elsewhere around the world remaining near 2018 levels.

negotiations for the China-Norway FTA was held in Wuhan.

- *On September 17-24th, the 16th inter-sessional conference and the 23rd round of negotiations of the China-EU Investment Agreement were held in Beijing.*
- *On November 5-8th, the 24th round of the China-EU Bilateral Investment Treaty (BIT) negotiations were held in Beijing.*

Asia

- *On July 4th, China and Bangladesh established a new investment cooperation mechanism.*
- *On August 2nd, the first Meeting of the Joint Working Committee of China-Singapore (Chongqing) Demonstration Initiative on Strategic Connectivity held in Beijing.*
- *On August 7th, China signed the United Nations Convention on International Settlement Agreements Resulting from Mediation (the Singapore Mediation Convention) in Singapore.*
- *On August 22nd, the 19th Meeting of the Greater Tumen Initiative (GTI) Consultative Commission was held in Changchun, Jilin.*
- *On August 24th, the opening ceremony of the 12th China-Northeast Asia Expo and the 10th Northeast High-level Asia Cooperation Forum were held in Changchun, Jilin Province.*
- *On September 4th, the First Meeting of the Ministerial Coordination Mechanism of China-Kazakhstan Khorgos International Border Cooperation Center was held in Xinjiang Uygur Autonomous Region.*
- *On October 15th, China and Singapore jointly announced that the Protocol to Upgrade the China-Singapore Free Trade Agreement (Protocol to Upgrade CSFTA) will come into effect on October 16th, 2019.*
- *On October 17th, China and Mauritius signed a Free Trade Agreement.*
- *On October 26th, China attended the third Global Forum on Steel Excess Capacity Ministerial Meeting, which was*

POLICY DEVELOPMENT

In the second half of 2019, China continued its efforts to improve its trade and investment environment and to enhance its cooperation with other countries. Since the establishment of China's first free trade zone (FTZ) in Shanghai in 2013, FTZs have become a major force in attracting foreign investment. To further facilitate high-level opening-up and boost high-quality development through deeper reforms, the State Council published a *General Plan for the Six Newly Established Free Trade Zones* (the Plan) on August 2, 2019. These new FTZs are located in Shandong, Jiangsu, Hebei, Yunnan and Heilongjiang provinces, and the Guangxi Zhuang autonomous region. According to the Plan, the newly established FTZs would carry out different reform tasks based on their geographical advantages to enhance their economic cooperation with other countries and regions.

Furthermore, to optimize China's trade structure, the Communist Party of China's Central Committee and the State Council jointly issued the *Directive for High-Quality Trade Development* (the Directive) on November 28, 2020. With the Directive, China aims to optimize its trade structure, and thus improve trade efficiency by 2022. Specifically, China will continue to develop a modern service sector and integrate it with the advanced manufacturing industry to generate more added value through an advance from processing and manufacturing to research and design, marketing services and brand management.

As per its efforts to improve the domestic investment environment for foreign investors, China published several key policies. To protect the legitimate rights of foreign investors and regulate foreign investment management, the State Council issued the *Regulation on Implementing the Foreign Investment Law of the People's Republic of China* (the Regulation) on December 31. The Regulation highlights a few points regarding foreign investors. First, the government should treat domestic and foreign-invested enterprises lawfully and equally in government funding, land supply, tax and fee cuts, license awarding, standard setting, project application, and human resources policies, among others. Second, foreign investors and foreign-invested enterprises may file an administrative lawsuit against unfair treatment. Third, the government will set up a foreign investment security review system aimed at foreign investment that affects or may affect national security.

To better attract foreign investment, the State Council issued the *Guideline to Improve the Business Environment for Foreign Investors* (the Guideline) on November 7, 2019. The aim of the Guideline is to create a more fair, transparent and predictable business environment for foreign investors. According to the Guideline, China will continue to reduce the negative list for foreign investment access in the national and pilot free trade zones, accelerate the opening-up of the financial sector, lower the cost of cross-border capital use, and optimize the approval process for the use of land for foreign-funded projects. The Guideline also emphasizes that all local governments and government agencies shall treat foreign-funded enterprises equally without discrimination. In addition, the Guideline requires China to improve the intellectual property rights (IPR) protection mechanism

held in Tokyo, Japan.

- *On November 20th, the Ministry of Commerce terminated the final review on anti-dumping measures and decided to remove anti-dumping duties against the imports of pyridine originating from India and Japan.*
- *On November 21st, the Ministry of Commerce decided to terminate the anti-dumping measures applicable to imported methyl ethyl ketone originating in Japan and Taiwan.*
- *On November 24th, the 2nd ministerial meeting of the China-East ASEAN Growth Area Cooperation held in Malaysia.*
- *On November 28-29th, the 16th round of negotiation on China-Japan-ROK Free Trade Zone was held in Seoul, ROK.*
- *On December 1st, Amending Protocol to the Free Trade Agreement between the Government of the People's Republic of China and the Government of the Islamic Republic of Pakistan came into force.*
- *On December 9th, the 19th regular vice-ministerial consultation between the Ministry of Commerce of China and the Ministry of Economy, Trade and Industry of Japan was held in Tokyo, Japan.*
- *On December 22nd, the 12th Economic and Trade Ministers' Meeting among the People's Republic of China, the Republic of Korea and Japan was held in Beijing on December 22.*
- *On December 25th, China and Pakistan announced that tariff reduction arrangements of the Protocol on Amending the Free Trade Agreement Between the Government of the People's Republic of China and the Government of the Islamic Republic of Pakistan will be implemented on January 1, 2020.*

Middle East

- *On November 18-21st, the 7th round of negotiations on the China-Israel Free Trade Agreement was held in Israel.*

Oceania

- *On October 19th, China and Samoa signed the Memorandum of Understanding* for e-commerce and establish a comprehensive and diversified resolution mechanism for intellectual property disputes.

This new foreign investor legislation brings significant change to the regulatory environment in China for foreign investors. Investors are advised to monitor the implementation of these new measures and the repealing of old regulation and to stay abreast with legal interpretations of the regulations. In December, the Supreme Peoples Court issued an interpretation that will likely serve to make voiding agreements in sectors listed under the negatives list easier, while making it harder to do so in sectors not covered under the negatives list. This has led many major financial companies to seek investments in China, with BlackRock, Vanguard, Temasek, Fidelity and others having already initiated or signaled their intention to enter the Chinese financial sector. Altogether, the legislation shows that the Chinese government is trying to open up its financial sector to international investment and enhance financial integration with foreign entities.

To this end, almost two years after the publication of the *Measures for the Administration of Foreign-invested Securities Companies* (the Measures) by the China Securities Regulatory Commission (CSRC), two foreign-owned investment banks, JP Morgan Chase and Nomura, finally obtained their "Securities and Futures Business License" issued by the CSRC in the last quarter of 2019. The introduction of foreign-owned investment banks is expected to bring much needed reforms to the existing structure of the financial service industry and potentially drive domestic investment banks to grow faster through heightened competition.

CONCLUSION

2019 was tumultuous year for relations between China and many of its main trading partners, though China still continued to drive forward a business and investment friendly policy agenda. In light of these challenges, China prioritized outward oriented policy development in the areas of investment and finance. China's government continued to signal optimism about the health of the economy and focused their messaging on the positives of meeting GDP growth, CPI targets, and the long term health of their economy and its ability to adapt to a changing economic environment.

Due to the outbreak of COVID-19 in China, the country's domestic consumption and economic growth will slow for months beginning in 2020. The impacts that COVID-19 is having on the global economy will also be felt deeply within China, where supply chain disruptions and a global economic contraction may challenge Chinese exporters, small businesses, and consumers. In the coming months, China will undoubtedly focus on the fight to contain COVID-19 and recovering its economy. Its economic development, at least in the short term, will be negatively affected.

on E-Commerce Cooperation.

- *On October 20th, China and the Republic of Vanuatu signed the Memorandum of Understanding on E-Commerce Cooperation.*
- *On October 19-20th, during the 3rd China-Pacific Island Countries Economic Development and Cooperation Forum, Samoa, Tonga, Vanuatu, Micronesia and Fiji signed 10 memos of understanding on strengthening cooperation in the field of infrastructure, investment and production capacity with China.*
- *On November 4th, China and New Zealand announced the conclusion of the negotiations to upgrade their free trade agreement.*