



China Investment Strategies

US\$1=RMB6.15

FEATURE ARTICLES

- In the first Feature Article of this report, we discuss the discrepancy for China's gold demand as reported by different organizations and we share our view on the issue.
- The rest of the Feature Articles are reprints of our *China Express* reports between September 16 and September 25, in which we discussed China's gold, nickel, and coking coal markets as well as macro issues such as PBOC's latest liquidity injection and the HSBC Flash PMI for September.

ALSO IN THIS REPORT

- The chart section of this report is divided into three parts. The first part, "Commodities Markets," offers price, supply, and demand data for a wide range of commodities including base metals, steel & iron ore, grains, chemicals, oil, coal, uranium, and pulp & paper products.
- The second part, "Key Macro Trends," covers major macroeconomic data such as key growth drivers, growth rates, growth indicators, inflation and monetary data, and data from China's property and auto markets.
- The third part, "Financial Markets," illustrates key developments in China's equity, currency, and bond markets. It also presents the absolute and relative performance of the 16 industrial sectors on China's domestic equity markets.

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For important disclosures, please see Appendix A.

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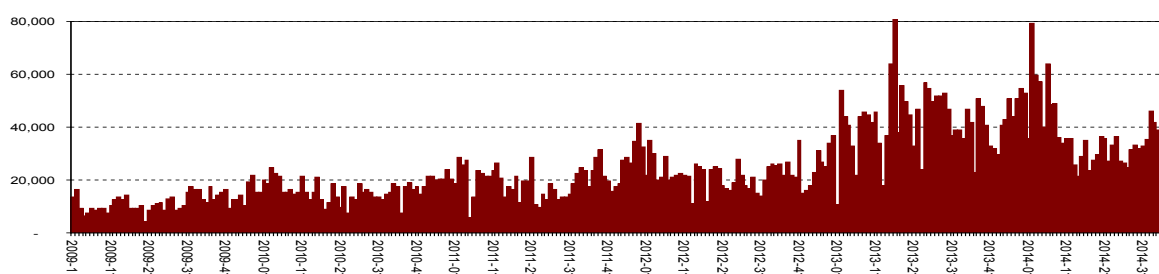
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Feature Article

The Mystery of China's Gold Demand

- Over the years, we, like most investors, track China's gold demand by following the estimates made by the China Gold Association (CGA) and the World Gold Council (WGC). For instance, the China Gold Association said China's total gold demand in 2013 was 1,176.4 tonnes and the World Gold Council said China's total "consumer demand" was 1,065.8 tonnes. So, in 2013, China's gold demand was slightly over 1,000 tonnes, we initially concluded.
- This is why we were shocked by what the Shanghai Gold Exchange (SGE) told us earlier this year. Back in May, we participated in a Canadian institutional investors' trip to China organized by Scotiabank. The Canadian delegation visited the Shanghai Gold Exchange and met with President of the SGE Transaction Department and other senior officials. The delegation was told by our Chinese host that China's gold demand was about 2,200 tonnes in 2013, judged by the withdrawal amount from the SGE vaults.
- Apparently, the SGE's estimate of Chinese demand is much higher than the estimates made by CGA and WGC. **If China's actual gold demand is over 2,000 tonnes rather than slightly over 1,000 tonnes, then the gold market could be a lot tighter than thought.** As such we asked a lot of questions to the SGE executives in the meeting and when we were back, we carefully reviewed the trading mechanism of the SGE in the past few months.
- After all our work, as we wrote on September 25 (see the next Feature Article), we are now of the view that to understand China's real physical gold demand, investors should simply look at the weekly withdrawals from Shanghai Gold Exchange vaults (Exhibit 1). The weekly withdrawal figures provide a much more accurate data series that reflects China's aggregate wholesale demand in a timely way. This is because for tax purposes all gold imported into China and all gold produced within China must pass through the vaults once, and only once, before reaching jewellery makers, investors, industrial users, and consumers.
- We hesitated over the past few months in publishing our findings from our May meeting with the SGE as these findings are non-mainstream. Now, as we are becoming more convinced, we want to share the following comments made by the SGE executives to the Canadian delegation.
- First, the withdrawal data reflects the actual gold wholesales in China. In 2013, the total gold withdrawal from the SGE vaults amounted to 2,196.96 tonnes. The President of SGE Transaction Department (The President) said: "This 2,200 tonnes of gold, after leaving our vaults, they entered thousands of Chinese households in the form of jewellery and investment purchases."

Exhibit 1: Weekly Withdrawals From Shanghai Gold Exchange Vaults (kg)



Source: Shanghai Gold Exchange, CNC.

- Second, none of the 2,200 tonnes of gold was bought by the Chinese central bank. The President said: “The PBOC does not buy gold through the SGE.”
- Third, the financing deals do not exaggerate SGE’s assessment of China’s gold demand. This is because “the financing deals do not take place after the gold leaves the vaults.”
- Fourth, in response to our question about the source of the 2,200 tonnes, he replied: “About 1,500 tonnes from imports, some 400 tonnes from domestic mine output, and the rest is recycled gold.”
- And last, when we asked why the China Gold Association’s number is so low, the President said: “They mainly cover the gold sales through the gold shops. This is their main source of information. And their number is quite useful in that way. However, our system has broader coverage.”
- So here is our current conclusion after several months of deliberation. We think the SGE withdrawal data is a fair representation of China’s wholesale gold demand. Again, this is because for tax purposes all gold imported into China and all gold produced within China must pass through the vaults once, and only once, before reaching jewellery makers, investors, industrial users, and consumers.
- **Lastly, we do note that in recent weeks, the withdrawal number is getting bigger (Exhibit 1). This might indicate the de-stocking process is coming to an end.** We maintain our relatively cautious “market weight” call for the gold sector from a China perspective for the time being. In the meantime, we will closely monitor the weekly withdrawal data to decide whether we should turn more positive.

Feature Article

Measuring China's Gold Demand

• This article is a reprint of our *China Express* dated September 25, 2014.

• Overnight data shows that China's net gold imports from Hong Kong remained low at 27.477 tonnes in August (Exhibit 1). This data point supports our view that China is still in a destocking stage for gold and our relatively cautious "market weight" call on gold from a China perspective.

• However, we do caution that investors should no longer regard China's net imports from Hong Kong as an accurate proxy for China's gold import demand. This is because gold is increasingly flowing into the Chinese market through Shanghai and even Beijing.

• To understand China's real physical gold demand, investors should simply look at the weekly withdrawals from Shanghai Gold Exchange vaults (Exhibit 2). We visited the Shanghai Gold Exchange (SGE) in May and talked to the senior executives of the exchange. After reviewing the exchange's trading mechanism, we are of the view that the weekly withdrawal figures provide a much more accurate data series that reflects China's aggregate wholesale demand in a timely way. This is because for tax purposes all gold imported into China and all gold produced within China must pass through the vaults once, and only once, before reaching jewellery makers, investors, industrial users, and consumers.

• Exhibit 2 presents the weekly withdrawals from SGE vaults by numbered week (each calendar year has 50 trading weeks). As the exhibit shows, in recent weeks China's wholesale gold demand has actually picked up slightly. This is in contrast to the Hong Kong import data. Overall, by mid-September, China's cumulative wholesale demand in 2014 was down 16.2% YOY. This decline is much milder than the Hong Kong import number implies.

Exhibit 1: Net Gold Imports from Hong Kong (Tonnes)

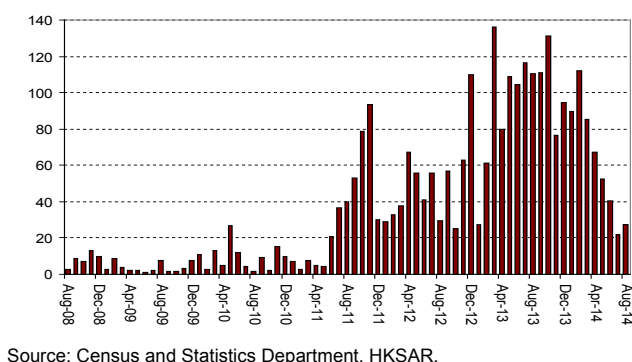
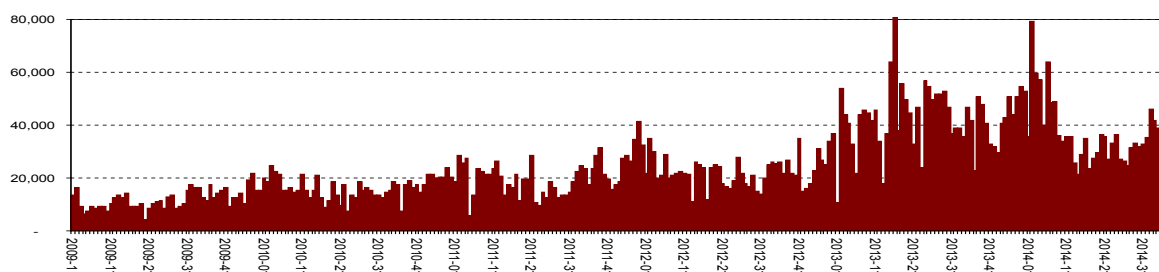


Exhibit 2: Weekly Withdrawals From Shanghai Gold Exchange Vaults (kg)



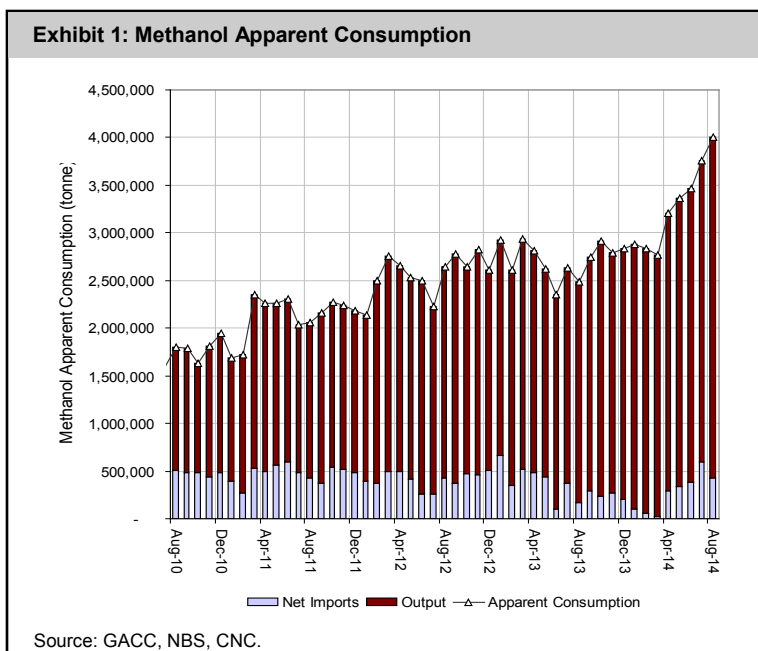
Feature Article

August Methanol Data

• This article is a reprint of our *China Express* dated September 24, 2014.

• In August, China's methanol output reached a record high of 3.58 million tonnes, up 46.4% YOY (red bars in Exhibit 1). This makes methanol a rare commodity among the commodities we follow that registered extremely robust output growth last month. In the first eight months of this year, total Chinese output reached 24.4 million tonnes, up 29.4% YOY.

• On the trade side, China imported 463,500 tonnes of methanol last month, down 26.8% YOY, while exports remained low at 37,100 tonnes. The blue bars in Exhibit 1 show China's net imports of methanol.



• **We expect China's domestic methanol output to remain high and gradually replace import demand.** Beginning in January 2015, China will restrict the production, consumption, and import of coal with high impurity levels in a bid to fight smog. In a statement issued on September 15, the National Development and Reform Commission announced three new quality thresholds that will restrict the use of low-quality coal, with the most stringent requirement banning the use of coal with more than 16% ash and 1% sulphur content in key population centres such as Beijing, the Pearl River Delta, and the Yangtze River Delta. Although the new policy mainly targets thermal coal, it impacts the entire coal industry, including anthracite coal. Our study of the documents leads us to believe that the impact of the new policy might not be significant for China's coal imports, but it should put more pressure on domestic coal producers to push toward downstream integration into chemical production.

Feature Article

HSBC Flash PMI

- This article is a reprint of our *China Express* dated September 23, 2014.

- The HSBC Flash PMI came in at 50.5 for September, higher than August's 50.2 and economist consensus of 50.0. On the surface, this number should help mitigate the prevailing bearish sentiment toward the Chinese economy. However, for China-sensitive raw materials sectors, we do not regard this data point as bullish.

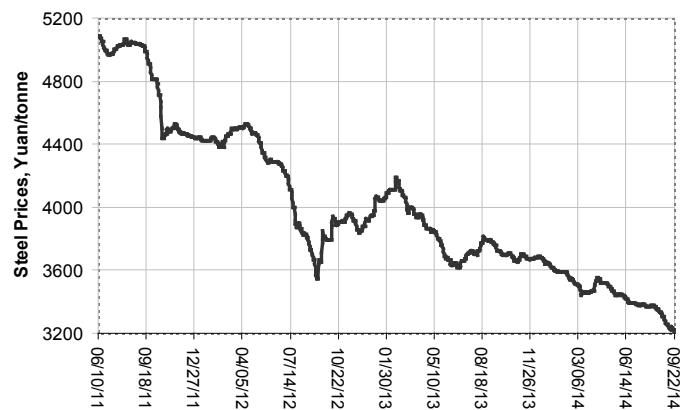
- Yesterday, Chinese Finance Minister Lou Jiwei was quoted as saying that China will not dramatically alter its economic policy because of a single economic indicator. So, if the poor August macro indicators were not enough to trigger any significant policy stimulus, a sequential improvement in the PMI in September would likely only further delay it. For investors seeking more accommodative measures from the Chinese government, this small improvement in PMI survey does not help.

- The same argument goes for other small improvements in macro data. Given how poor the August macro data were, we would not be surprised to see some improvements in the September data. If these improvements are not significant enough, then they would simply imply that economic growth in China is settling into and stabilizing at a lower level – there is no reason for the Chinese government to panic but there is equally no reason for commodity bulls to cheer. At the end of the day, at the current growth level, steel and iron ore prices are setting lows not seen since 2009 (Exhibit 1).

- As such, we would become more positive on China-sensitive raw materials sectors only when at least one of the following three conditions is met: (1) China's housing market shows concrete improvement; (2) solid evidence of higher activity level is apparent at the fall construction sites; or (3) global raw materials sectors continue to drop to a level that begins to price in long-term distressed commodity prices. When we say long-term distressed commodity prices, we mean that these prices have to be assumed as staying at depressed levels long enough to permanently destroy high-cost supplies.

- To date in September, we have not seen evidence that the first two conditions have been met. Weekly home sales are stable but not robust, while demand for steel, cement, diesel, and heavy machinery remains lukewarm. As for the third condition, we leave it to investors to make sector-specific judgment calls. For the time being, we maintain our relatively cautious market weight call for the global raw materials and energy sectors from a China perspective, a call that we have steadfastly maintained since the summer months.

Exhibit 1: Average Weighted Steel Spot Price



Note: 50% Rebar, 30% HRC, 20% CRC.

Source: Antaike, CNC.

Feature Article

Nickel and Coking Coal

• This article is a reprint of our *China Express* dated September 22, 2014.

• Overnight, China published detailed commodity trade data for August. We draw investors' attention to data related to nickel and coking coal.

• First, China's nickel trade data still do not support the bullish case. Refined nickel and alloy imports dropped 32.9% YOY last month to a mere 9,595 tonnes, while exports surged 227.4% YOY to 17,910 tonnes. This left China as a net exporter of refined nickel again – the second time in history (Exhibit 1). On the ore side, China imported 5.42 million tonnes of nickel ore, actually up 3.7% YOY, thanks to an 87.4% YOY surge in imports from the Philippines (Exhibit 2). We have been sceptical about the upside for nickel before year-end, mainly because of hidden inventories in China, and we remain cautious in the near term.

• Second, China's coking coal imports dropped 39.0% YOY to only 3,835,359 tonnes last month (Exhibit 3). This trade pattern is disturbing because import demand is not responding to lower commodity prices. We remain cautious on the coking coal sector from a China perspective.

• With the iron ore price dropping below US\$80/tonne yesterday, a level not seen since mid-2009, the lure of bottom-fishing is getting stronger. However, Chinese rebar prices have dropped to an even worse level. At RMB 2,965 per tonne, the average rebar price has not been seen since 2006. We do not want to miss the inflection point; however, we maintain our view that investors should wait for concrete positive signals from the housing market or the fall construction sites before turning positive on sectors related to steel inputs such as iron ore, coking coal, and nickel.

Exhibit 1: Refined Nickel Trade

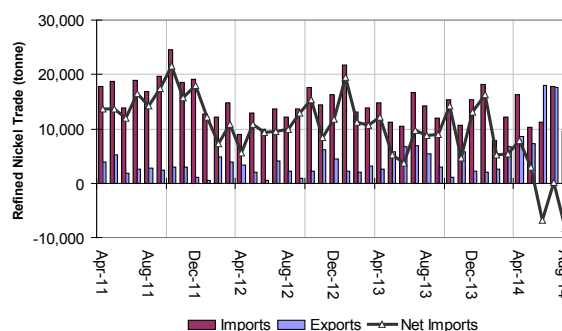


Exhibit 2: Nickel Ore and Concentrate Imports

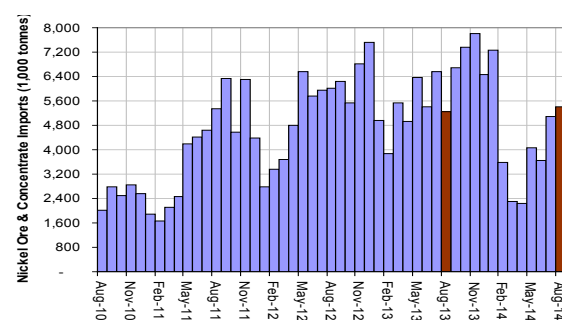
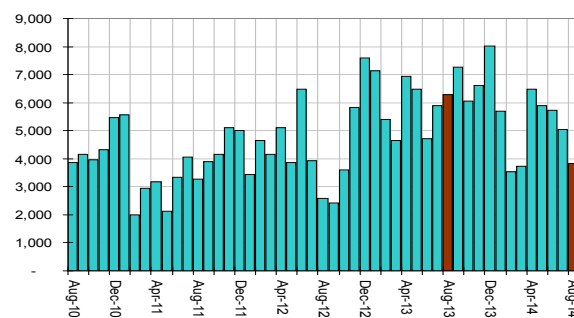


Exhibit 3: China's Coking Coal Imports (Thousand Tonnes)

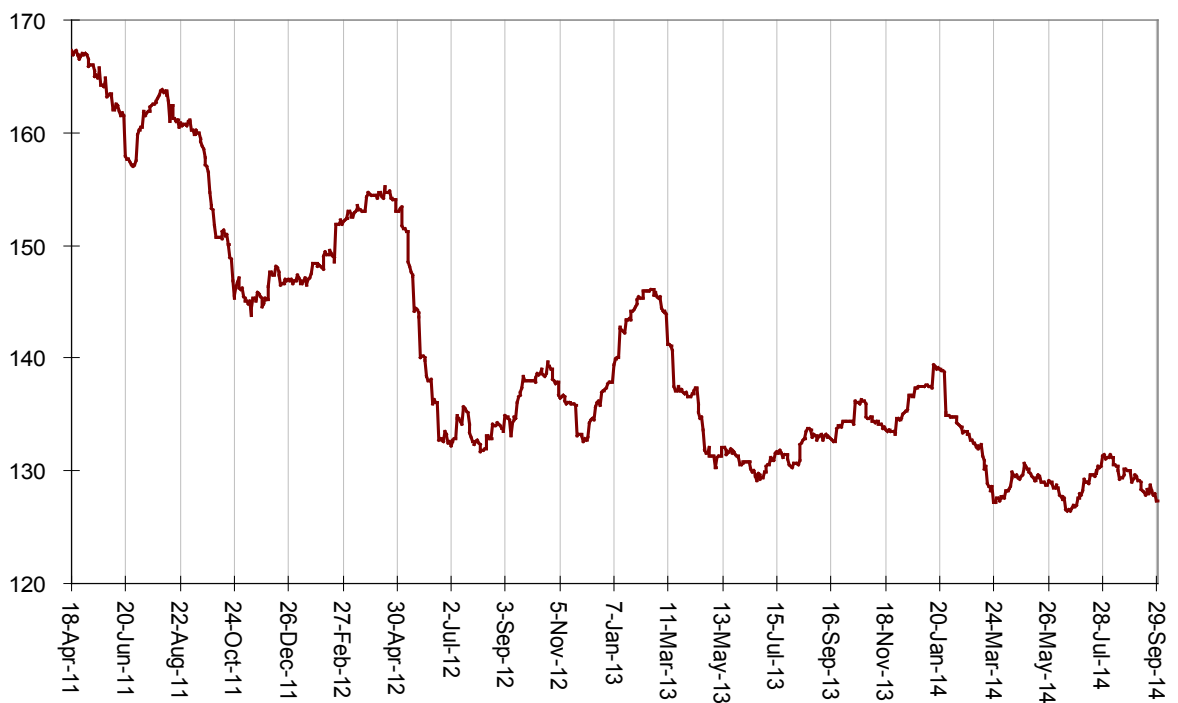


Feature Article

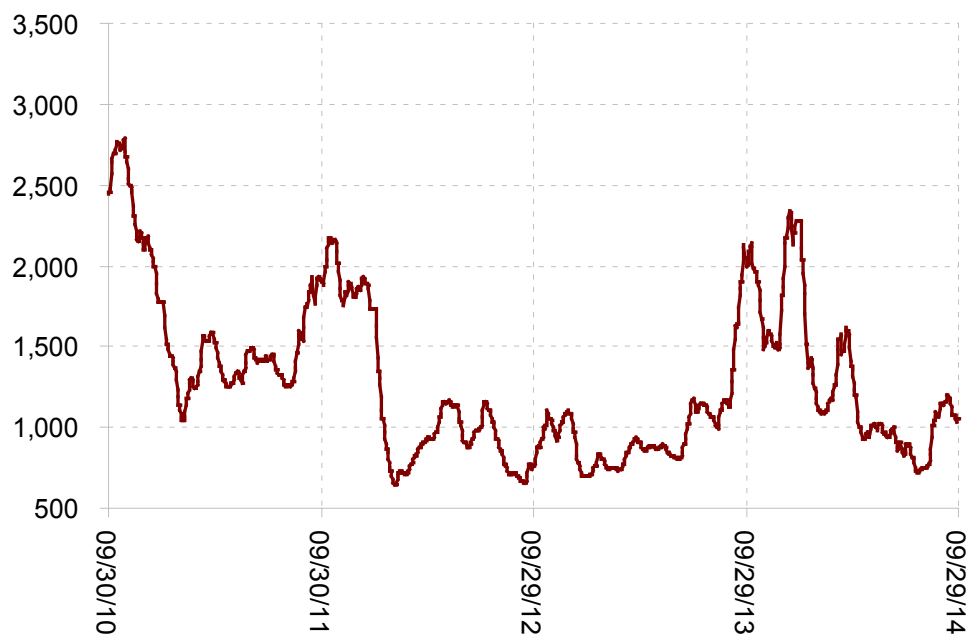
RMB500 Billion Liquidity Injection

- This article is a reprint of our *China Express* dated September 16, 2014.
- Local media just reported that the People's Bank of China has provided RMB100 billion liquidity to each of China's five largest banks, through PBOC's Standing Lending Facility (SLF) with durations of three months. We offer three observations:
 - First, we calculate that the move equals a 45-basis points cut of the required reserve ratio (RRR) for three months. If the market assumes that this facility will be rolled over every three months, which we are not sure about, then the move can be viewed as a permanent RRR cut. In that case the only difference is that the move through SLF carries a higher financing cost for commercial banks, although the interest rate charged under the SLF facility was not disclosed.
 - Second, with this move, the near-term chance of an RRR cut is significantly reduced. It seems that the PBOC still does not want to use high-profile vehicles such as an RRR cut to inject liquidity. This is because an RRR cut or an interest rate cut signals a change in monetary policy.
 - And third, although the move helps restore confidence in the financial market for China-sensitive sectors, the real impact on the Chinese economy might not be significant. In the past few months, new loan growth was muted in China, mainly for two reasons: first, the borrowing cost was a bit too high for some borrowers; and second, the banks were reluctant to lend either due to a risk-averse attitude or due to the constraints of loan-deposit ratio regulation. Therefore, we believe that if the Chinese government really wants to boost near-term growth, it should also cut interest rate. Our current suspicion is that at the current stage the government is still not prepared to cut benchmark interest rates – Premier Li simply wants to use the SLF injection to prevent any further erosion of confidence in the Chinese economy.

Commodities Markets

China Commodities Index

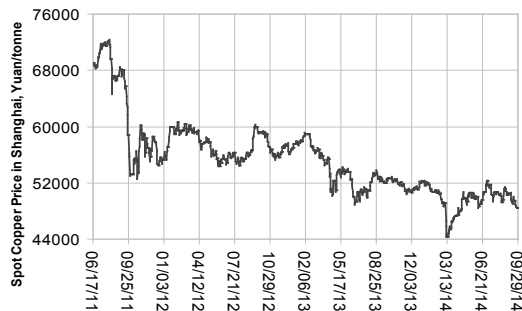
Note: This fixed-weighted index tracks the price performance of a wide range of "cyclical" commodities in the local Chinese spot markets, including copper (12.5% weight), aluminum (12.5%), zinc (5%), re-bar (10%), HRC (7.5%), CRC (7.5%), iron ore (10%), coal (15%, export price), and ethylene (20%, FOB S. Korea). Source: CNC.

Baltic Dry Index

Source: Bloomberg.

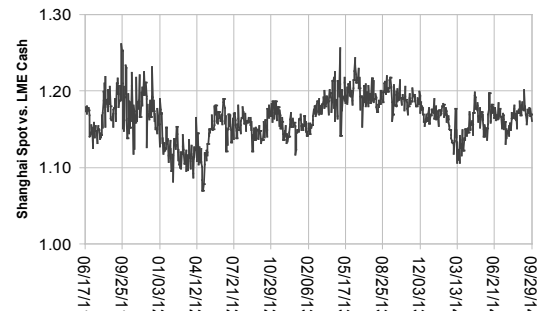
Copper

Average Copper Spot Price



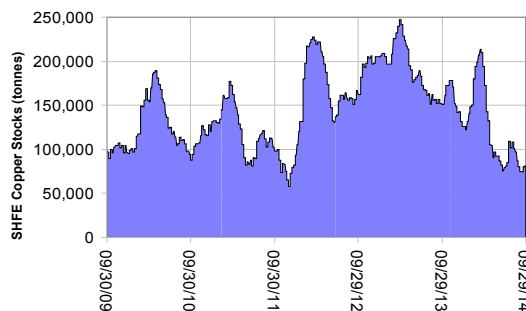
Source: Shanghai Changjiang Non-ferrous Metals Market.

Price Relative: Shanghai Spot vs. LME Cash



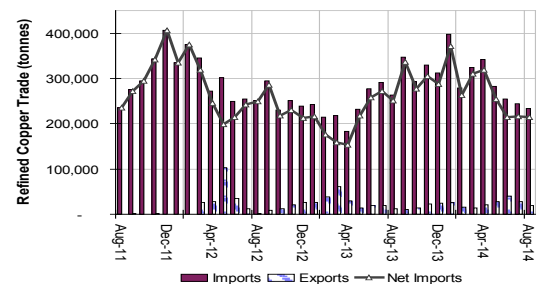
Source: SHFE; LME.

Copper Stocks in SHFE



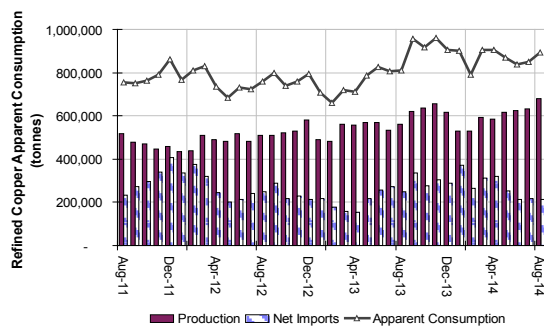
Source: SHFE.

Refined Copper Trade



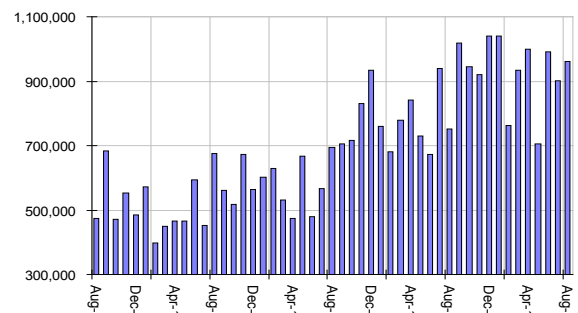
Source: GACC.

Refined Copper Apparent Consumption



Source: GACC; NBS.

Copper Concentrate Imports (Tonnes)



Source: GACC.

Data Snapshot: Copper (tonnes)

	Aug-14	MOM	YOY	Jan-Aug	YOY
Refined Copper					
Production	680,128	7.4%	20.2%	4,930,270	11.2%
Imports	234,462	-4.3%	-10.8%	2,359,970	22.6%
Exports	19,787	-30.5%	57.1%	193,143	-12.1%
Net Imports	214,675	-0.8%	-14.2%	2,166,827	27.1%
Apparent Consumption	894,803	5.3%	9.6%	7,097,097	15.6%
Semi Production	1,419,252	-1.3%	6.1%	11,307,754	15.6%

Source: NBS; Customs; CNC.

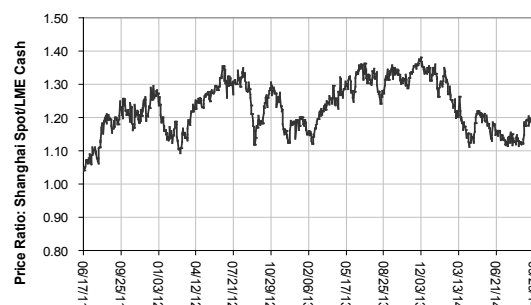
Aluminum

Average Aluminum Spot Price



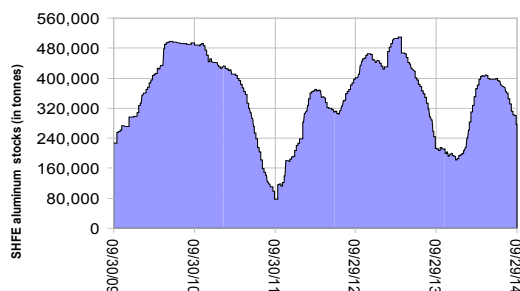
Source: Shanghai Changjiang Non-ferrous Metals Market.

Price Relative: Shanghai Spot vs. LME Cash



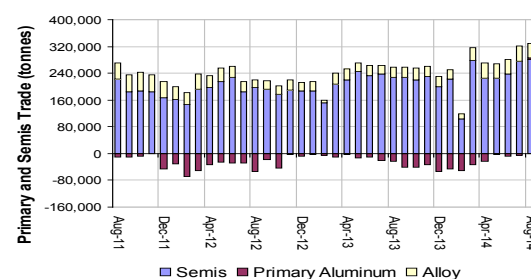
Source: SHFE; LME.

Aluminum Stocks in SHFE



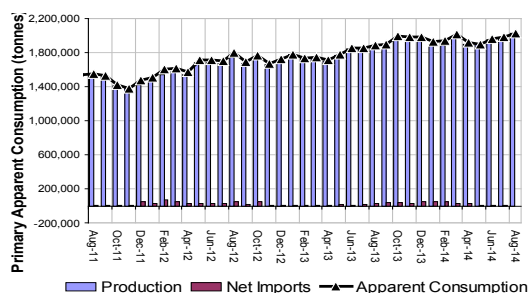
Source: SHFE.

Aluminum Net Exports



Source: GACC.

Primary Aluminum Apparent Consumption



Source: GACC; NBS.

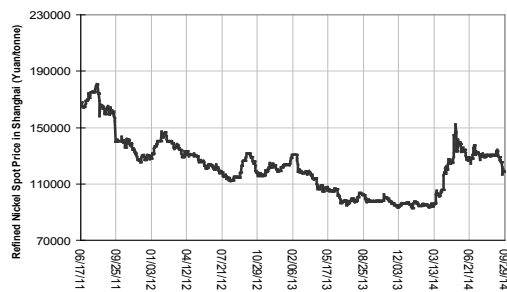
Data Snapshot: Aluminum (tonnes)

	Aug-14	MOM	YOY	Jan-Aug	YOY
Primary Aluminum					
Imports	8,487	-39.8%	-74.6%	249,753	62.9%
Exports	13,177	66.9%	29.5%	81,450	25.4%
Net Imports	(4,690)	-175.6%	-120.2%	168,303	90.5%
Production	2,027,459	2.6%	8.8%	15,546,949	7.6%
Apparent Consumption	2,022,769	2.0%	7.2%	15,715,252	8.1%
Semis Production	4,207,124	2.7%	19.9%	30,817,673	19.3%
Alumina					
Imports	350,410	-24.4%	142.7%	3,578,133	76.6%
Production	3,896,710	-0.9%	1.9%	30,597,935	5.4%
Apparent Consumption	4,247,120	-3.4%	7.0%	34,176,068	10.0%

Source: NBS; Customs; CNC.

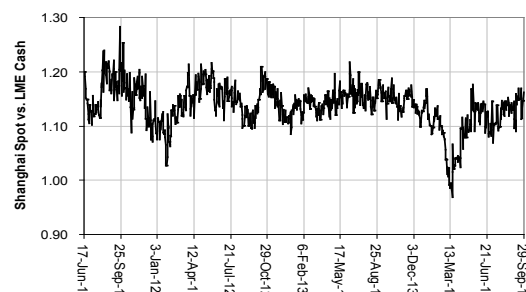
Nickel

Average Nickel Spot Price



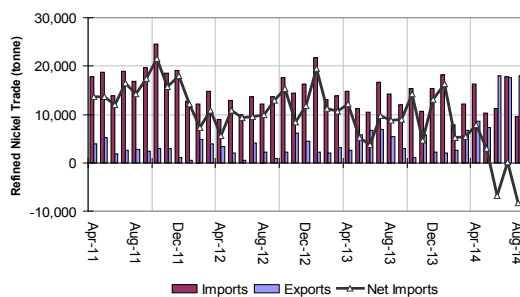
Source: Shanghai Changjiang Non-ferrous Metals Market.

Price Relative: Shanghai Spot vs. LME Cash



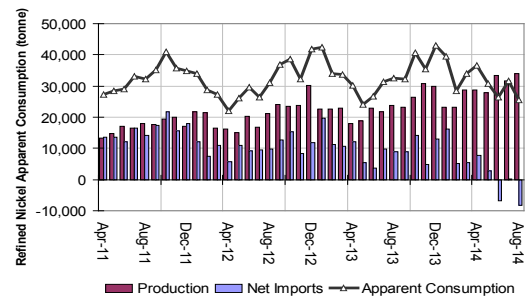
Source: Shanghai Changjiang Non-ferrous Metals Market; LME.

Refined Nickel Trade



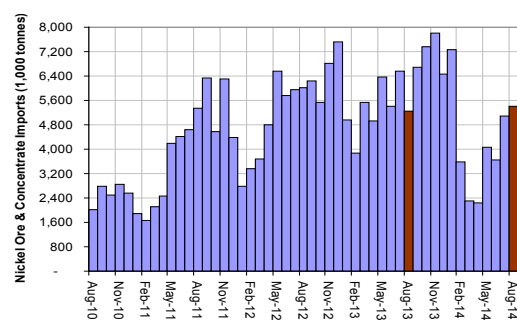
Source: GACC.

Refined Nickel Apparent Consumption



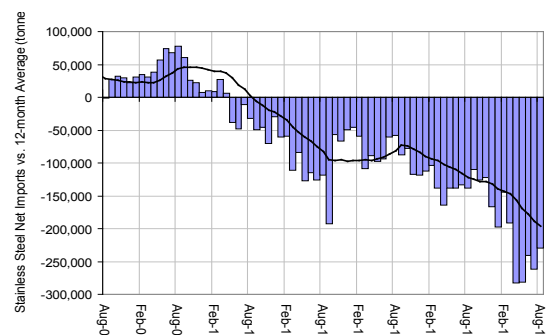
Source: GACC; NBS.

Nickel Ore and Concentrate Imports



Source: GACC.

Stainless Steel Net Imports



Source: GACC.

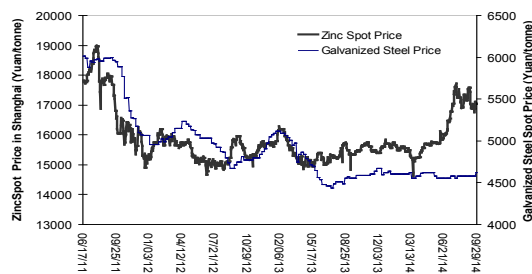
Data Snapshot: Nickel (tonnes)

	Aug-14	MOM	YOY	Jan-Aug	YOY
Refined Nickel					
Imports	9,595	-45.9%	-32.9%	103,306	-11.0%
Exports	17,910	1.5%	227.4%	80,758	130.8%
Net Imports	(8,315)	-11811.3%	-194.2%	22,548	-72.2%
Production	33,967	7.7%	38.1%	228,445	35.0%
Apparent Consumption	25,652	-18.8%	-23.3%	250,993	0.3%

Source: NBS; Customs; CNC.

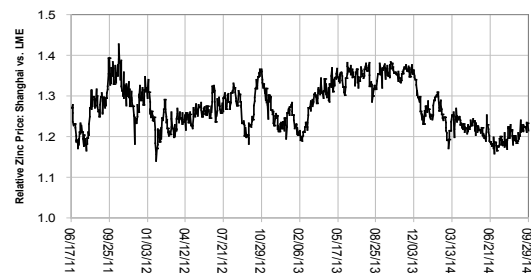
Zinc

Average Zinc Spot Price



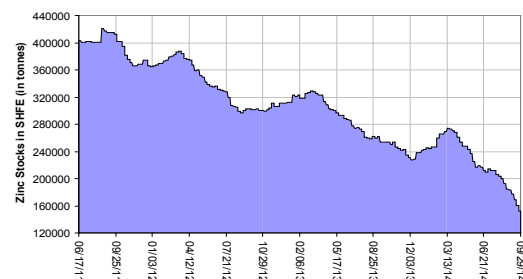
Source: Shanghai Changjiang Non-ferrous Metals Market.

Price Relative: SHFE Spot vs. LME Cash



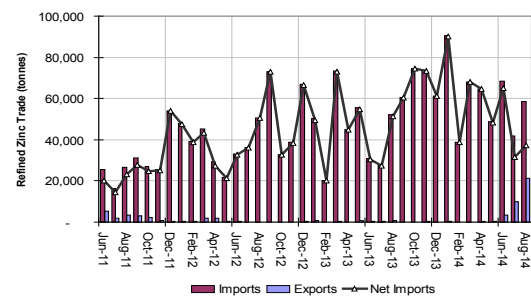
Source: SHFE; LME.

Zinc Stocks in SHFE



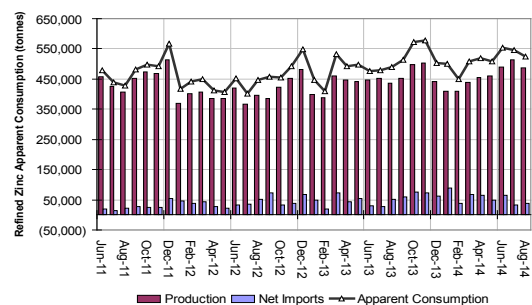
Source: SHFE.

Refined Zinc Trade



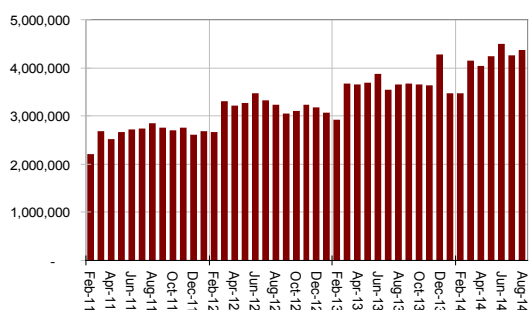
Source: GACC.

Refined Zinc Apparent Consumption



Source: GACC; NBS.

Plated Steel Output (Tonnes)



Source: GACC; NBS.

Data Snapshot: Zinc (tonnes)

	Aug-14	MOM	YOY	Jan-Aug	YOY
Refined Zinc Imports	58,641	40.7%	12.5%	479,771	35.4%
Exports	21,227	111.2%	2881.5%	35,890	1043.9%
Net Imports	37,414	18.3%	-27.2%	443,881	26.4%
Production	486,255	-5.6%	8.3%	3,685,525	3.9%
Apparent Consumption	523,669	-4.2%	4.7%	4,129,406	5.9%
Coated Sheet Output	4,366,998	2.6%	16.0%	32,672,290	13.1%

Source: NBS; Customs; CNC.

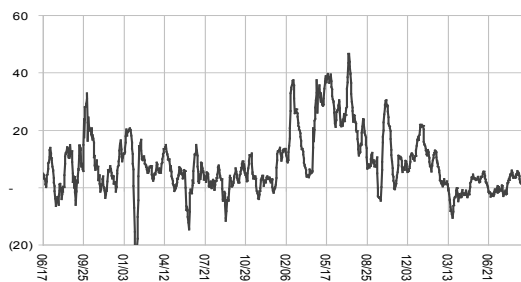
Gold

Gold Price (Yuan per gram)



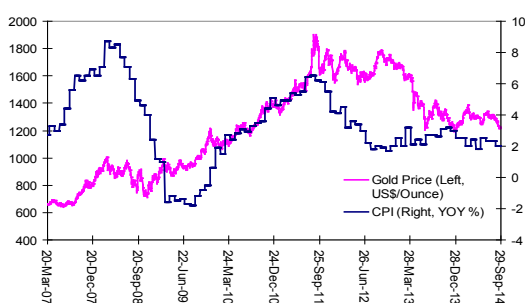
Source: Shanghai Gold Exchange. Note: Au9999.

Shanghai Gold Premium (US\$ per ounce)



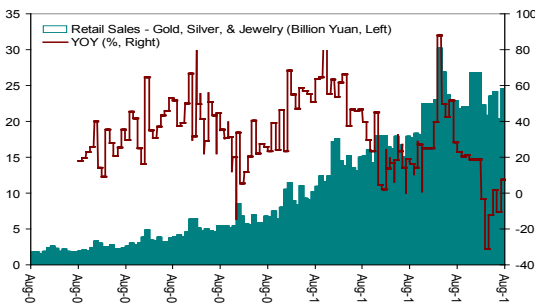
Source: Shanghai Gold Exchange, Bloomberg. Note: Five-day MA.

Gold Price Versus Chinese CPI



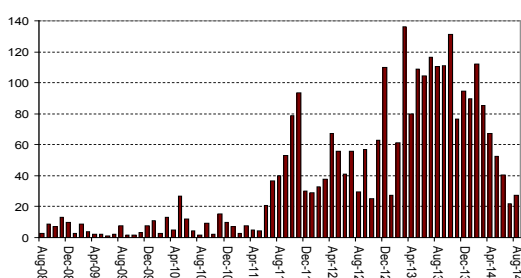
Source: Bloomberg, NBS, CNC.

Monthly Jewellery Sales (Billion yuan, %)



Source: NBS, CNC.

Net Gold Imports from Hong Kong (Tonnes)



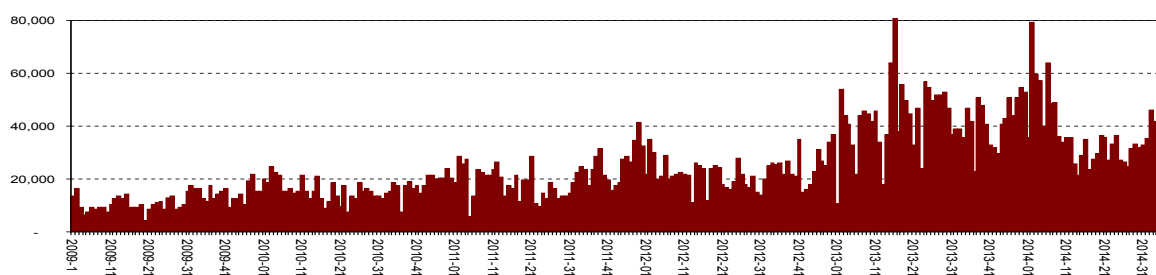
Source: Census and Statistics Department, HKSAR.

Data Snapshot: Gold Consumption (Tonnes)

	H1/14	YOY
Total Consumption	569.5	-19.4%
Jewellery	426.2	11.0%
Bar	105.6	-62.1%
Industrial	26.8	11.3%
Other	11.0	-44.3%

Source: China Gold Association

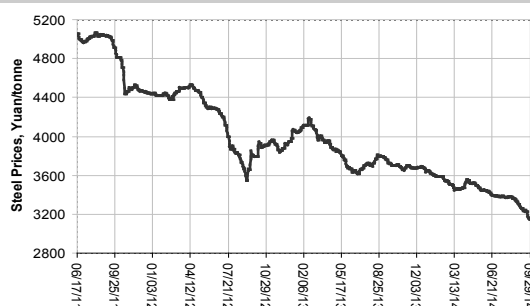
Weekly Withdrawals From Shanghai Gold Exchange Vaults (kg)



Source: Shanghai Gold Exchange, CNC.

Steel

Average Weighted Steel Spot Price



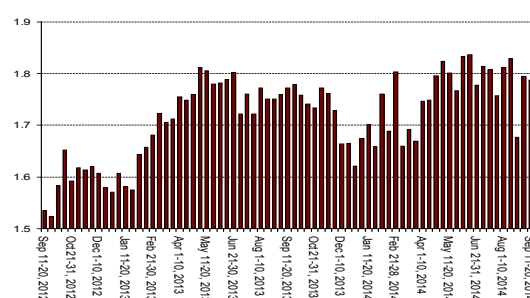
Source: Antaike, CNC. Note: 50% Rebar, 30% HRC, 20% CRC.

Iron Ore Prices



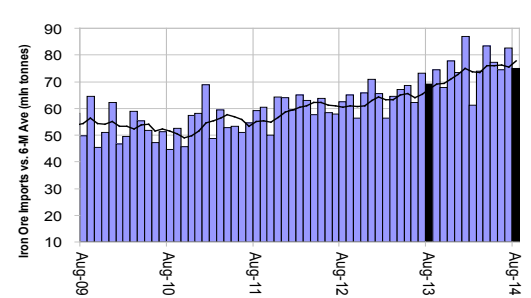
Source: Steel Business Briefing. Note: 62% Fines; Tianjin Spot.

Average Daily Crude Steel Output (million tonnes)



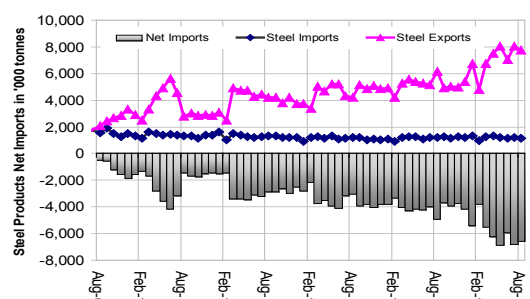
Source: CISA. Note: CISA Members Only.

Iron Ore Imports



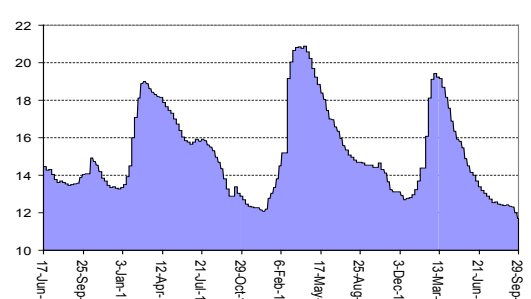
Source: GACC.

Finished Steel Products Trade



Source: GACC.

Steel Products Inventory (million tonnes)



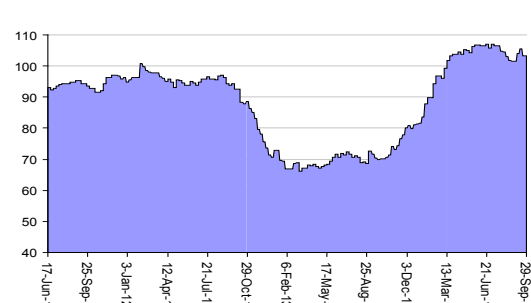
Source: Antaike.

Data Snapshot: Steel (thousand tonnes)

	Aug	MOM	YOY	Jan-Aug	YOY
Iron Ore Imports	74,880	-9.3%	8.5%	614,380	16.9%
Production	136,521	-0.2%	3.9%	986,041	8.5%
Steel Products Imports	1,170	-4.1%	-4.9%	9,640	4.4%
Exports	7,760	-3.7%	26.4%	56,830	35.4%
Net Exports	6,590	-3.7%	34.2%	47,190	44.1%
Production	94,970	0.2%	2.4%	742,100	5.4%
Apparent Consumption	88,380	0.5%	0.6%	694,910	3.5%

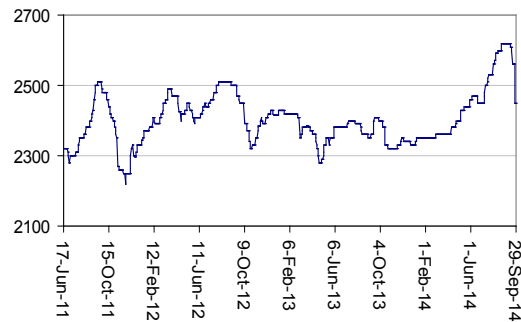
Source: NBS; Customs; CNC.

Iron Ore Port Inventory (million tonnes)

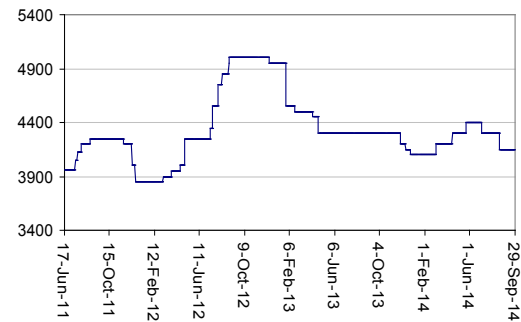


Source: Antaike.

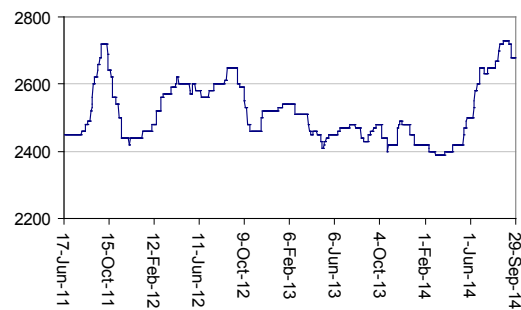
Grain

Spot Corn Price (Yuan/tonne, Dalian)


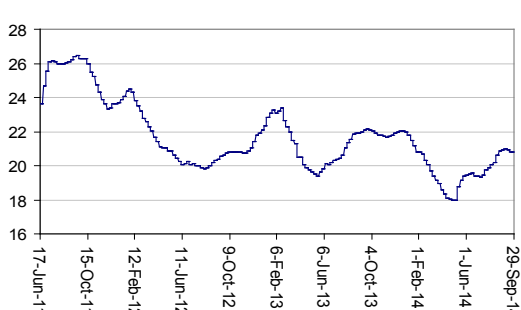
Source: CNGOIC.

Spot Soybean Price (Yuan/tonne, Guangzhou)


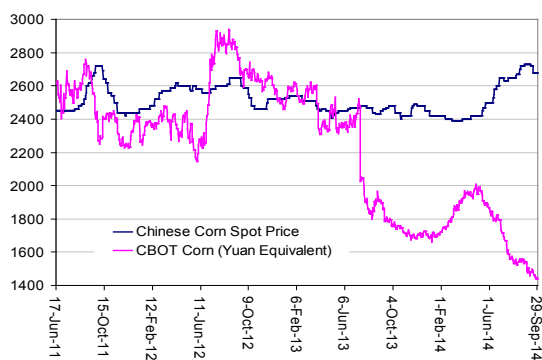
Source: CNGOIC.

Spot Corn Price (Yuan/tonne, Shanghai)


Source: CNGOIC.

Pork Wholesale Price (Yuan/kilogram)


Source: Ministry of Commerce.

Corn Import Economics (Yuan/tonne)


Source: CBOT, CNGOIC, CNC.

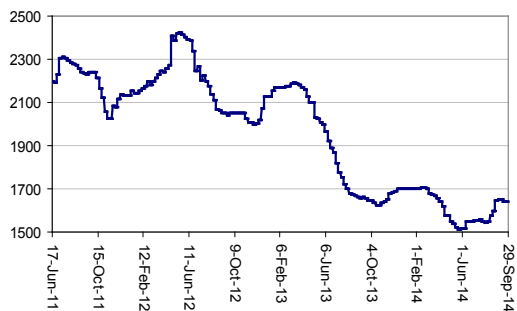
Grain Supply/Demand Projection (000 tonnes)

	Wheat	Corn	Soybean
Beginning Stocks	60,270	77,460	13,240
Production	126,000	217,000	12,000
Imports	2,000	3,000	74,000
Total Supply	128,000	220,000	86,000
Domestic Use	124,000	220,000	84,950
Exports	1,000	100	300
Total Demand	125,000	220,100	85,250
Inventory Change	3,000	(100)	750
Ending Stocks	63,270	77,360	13,990

Source: USDA. Note: 2014/2015 marketing year.

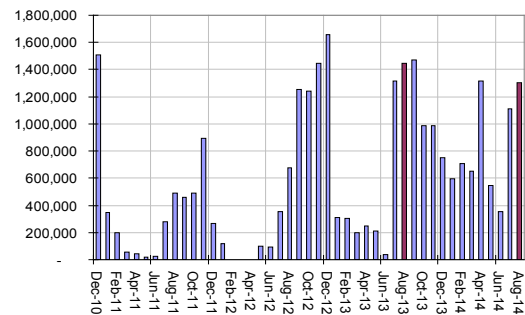
Fertilizer

Average Urea Ex-Factory Price (Yuan/tonne)



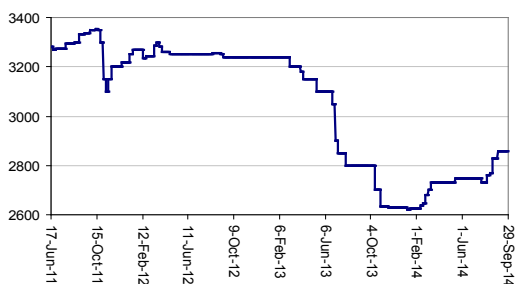
Source: CNCIC.

Urea Exports (Tonnes)



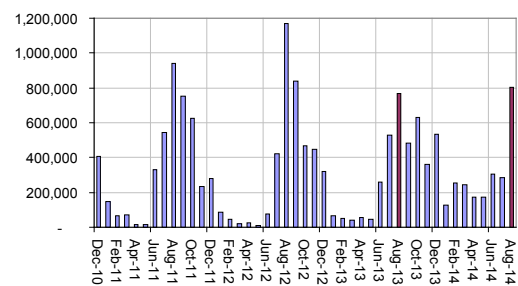
Source: GACC.

Average DAP Ex-Factory Price (Yuan/tonne)



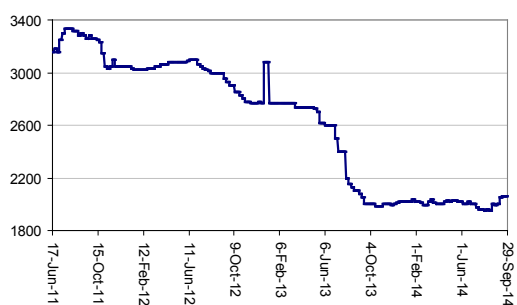
Source: CNCIC.

DAP Trade (Tonnes)



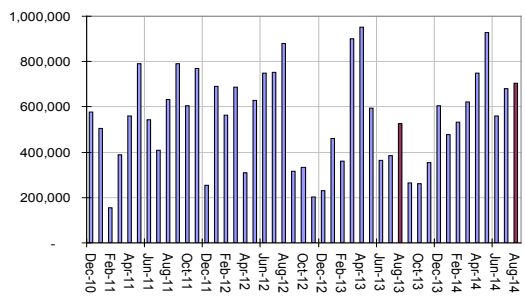
Source: GACC.

Average Potash Ex-Factory Price (Yuan/tonne)



Source: CNCIC.

MOP Imports (Tonnes)



Source: GACC.

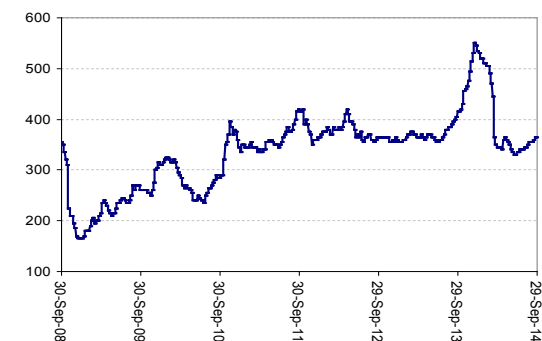
Data Snapshot: Fertilizer (Physical Tonnes)

	Aug-14	MOM	YOY	Jan-Aug	YOY
Urea Exports	1,306,156	17.6%	-9.5%	6,589,242	62.0%
DAP Exports	801,282	181.7%	4.4%	2,358,193	30.0%
MOP Imports	705,043	3.5%	34.2%	5,253,231	15.6%

Source: NBS; GACC.

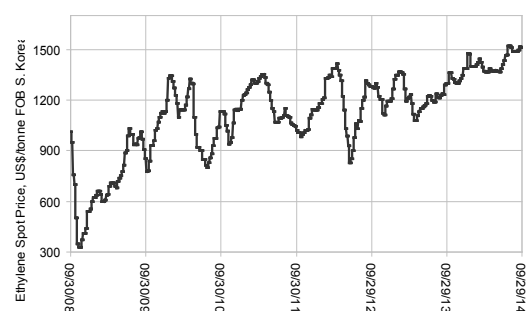
Chemicals

Methanol Spot Price (C&F China, USD/tonne)



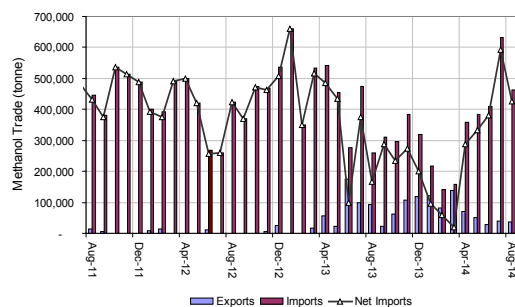
Source: Polymer.

Ethylene Spot Price



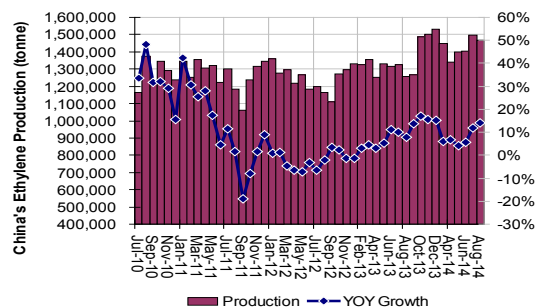
Note: The price is a mainstream quotation on FOB South Korea basis. Source: Polymer.

Methanol Trade



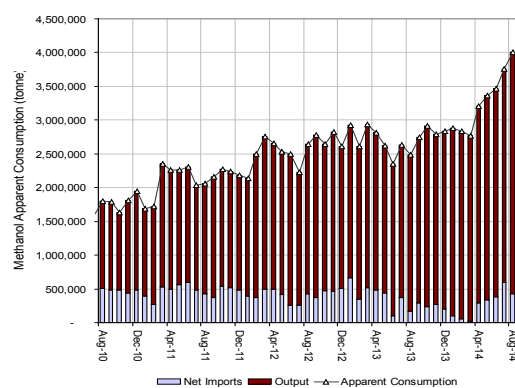
Source: GACC.

Ethylene Production



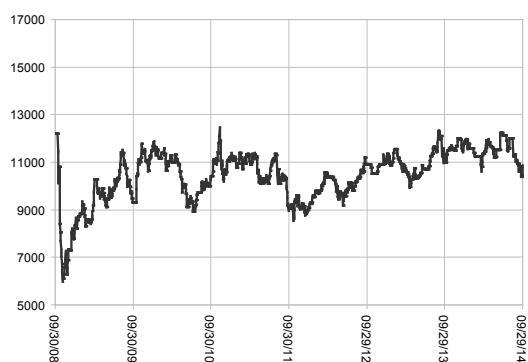
Source: NBS.

Methanol Apparent Consumption



Source: GACC, NBS, CNC.

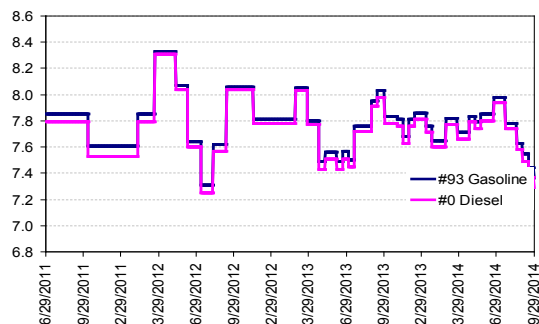
Polyethylene Price (LLDPE, Yuan/tonne)



Source: DCE.

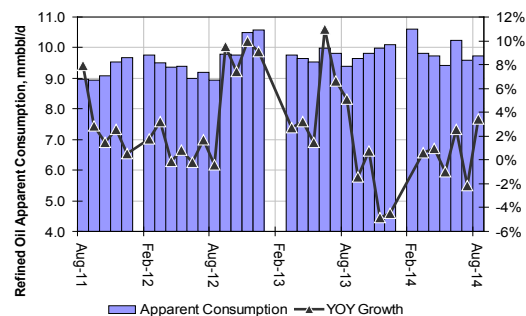
Oil

Oil Product Prices (Yuan/Liter)



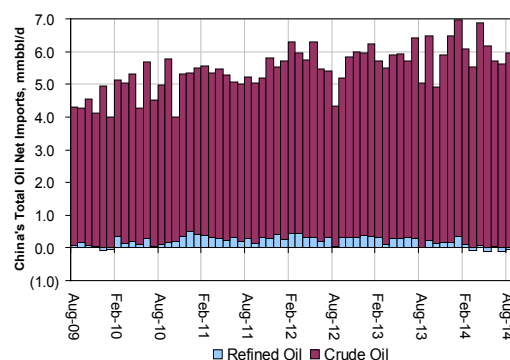
Note: State Guidance Retail Price Set by NDRC for Beijing.

Apparent Consumption of Refined Oil Products



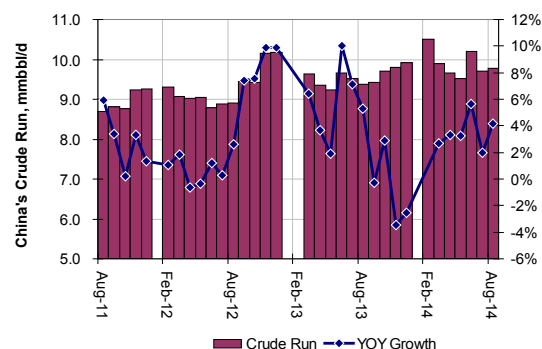
Source: NBS; GACC.

Net Imports of Crude Oil and Refined Oil Products



Source: GACC.

Monthly Crude Run



Source: NBS.

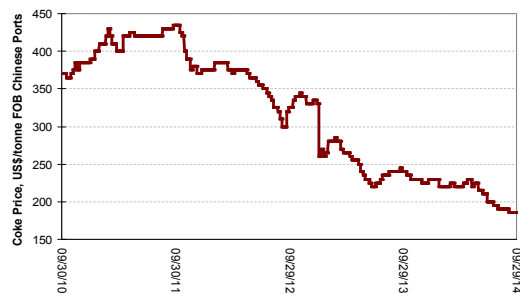
Data Snapshot: Crude and Refined Oil

	Aug	MOM	YOY	Jan-Aug	YOY
Crude Oil (kbb/d)					
Imports	5,948	6.0%	17.5%	6,052	8.4%
Exports	-	N/A	-100.0%	8	-79.4%
Net Imports	5,948	6.0%	18.7%	6,045	9.0%
Production	4,130	0.9%	0.9%	4,169	0.1%
Apparent Consumption	10,078	3.8%	10.7%	10,214	5.2%
Oil Products (kbb/d)					
Imports	597	36.0%	-1.6%	592	-28.3%
Exports	645	18.2%	9.6%	576	-0.5%
Net Imports	(47)	-55.6%	-350.0%	16	-93.5%
Production	9,773	0.8%	4.4%	9,869	3.6%
Apparent Consumption	9,726	1.4%	3.7%	9,885	1.1%

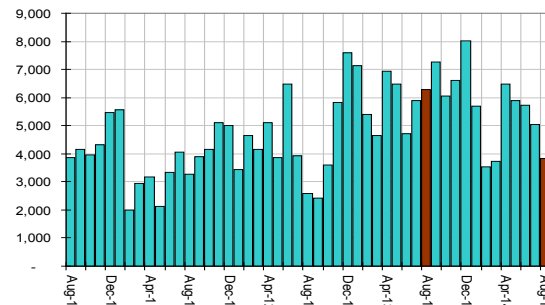
Note: 1 tonne = 7.32 barrels.

Source: Preliminary customs data; NBS; CNC.

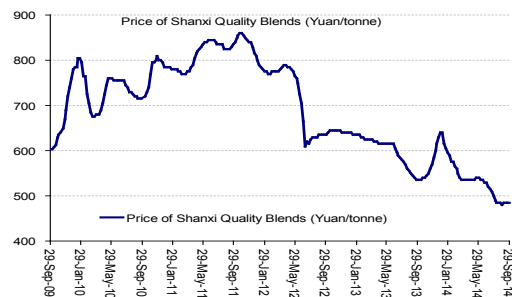
Coal

Export Price of Coke (US\$/tonne)


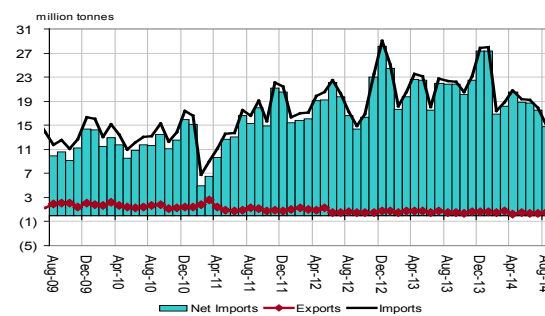
Note: FOB Tianjin. Source: Antaika.

China's Coking Coal Imports (Thousand Tonnes)


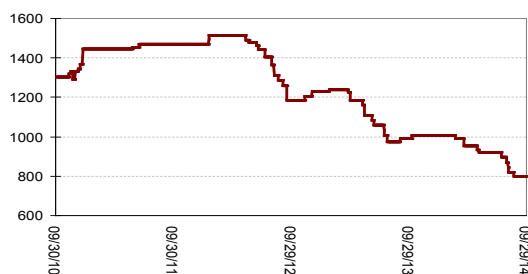
Source: GACC.

Thermal Coal Price (Yuan/tonne)


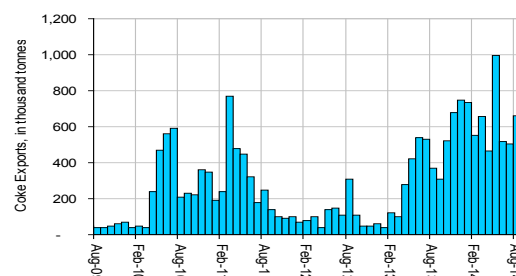
Note: Price quoted at Qinhuangdao Port. Source: SX Coal.

Total Coal Trade (Million Tonnes)


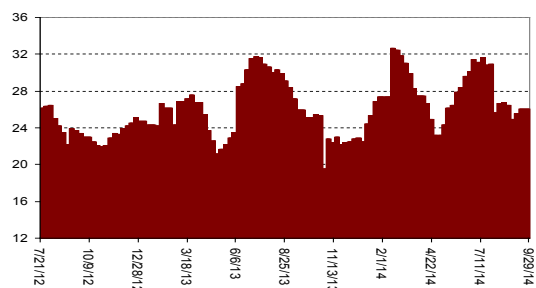
Source: GACC.

Coking Coal Price (Yuan/tonne)


Note: Yinchuan / Pingdingshan Average. Source: Steelhome.

China's Coke Exports (Thousand Tonnes)


Source: GACC.

Coal Inventory at Ten Chinese Ports (Million tonnes)


Source: Port Authority of Qinhuangdao.

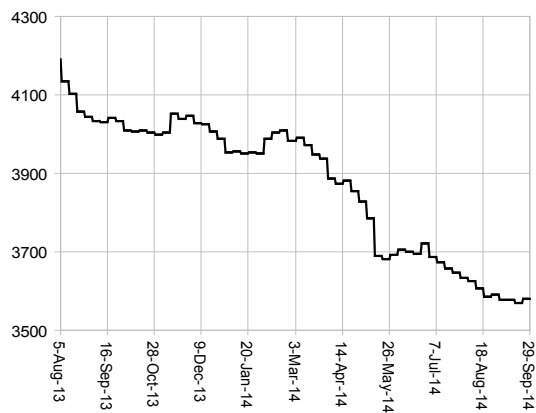
Data Snapshot (Thousand Tonnes)

	Aug-14	MOM	YOY	Jan-Aug	YOY
Coking Coal					
Imports	3,835	-24.0%	-39.0%	39,846	-16.1%
Exports	70	61.7%	-31.5%	554	-29.8%
Net Imports	3,765	-24.8%	-39.1%	39,292	-15.9%
Coke					
Exports	661	31.3%	79.0%	5,090	111.0%
Production	39,920	-0.8%	1.4%	314,290	-0.3%
Apparent Consumption	39,259	-1.2%	0.7%	309,200	-1.2%
Total Coal					
Imports	15,174	-15.0%	-32.0%	156,595	-9.6%
Exports	450	43.9%	-12.2%	3,922	-27.2%
Net Imports	14,724	-16.0%	-32.4%	152,672	-9.2%

Source: NBS, GACC.

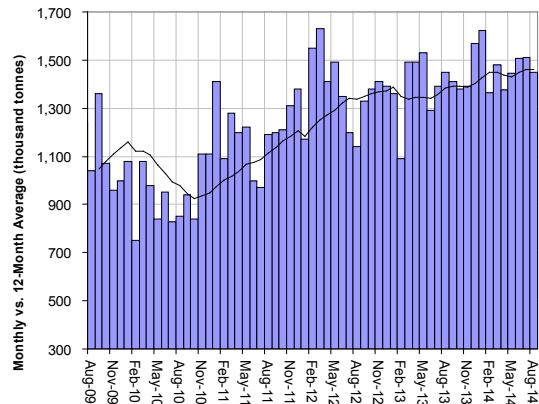
Pulp, Lumber, and Logs

Pulp Price (BHKP, Yuan/tonne)



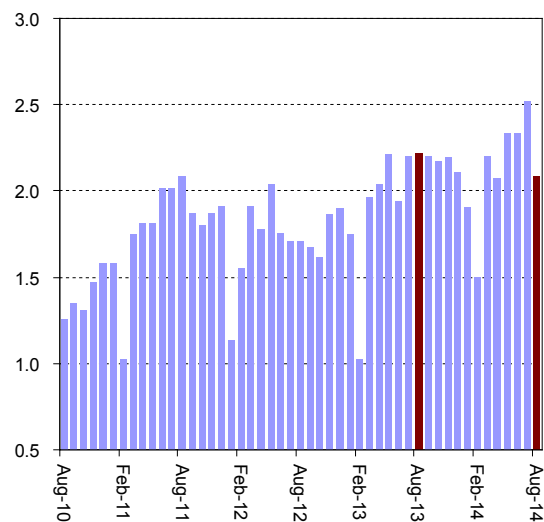
Source: FOEX.

Imports of Paper Pulp



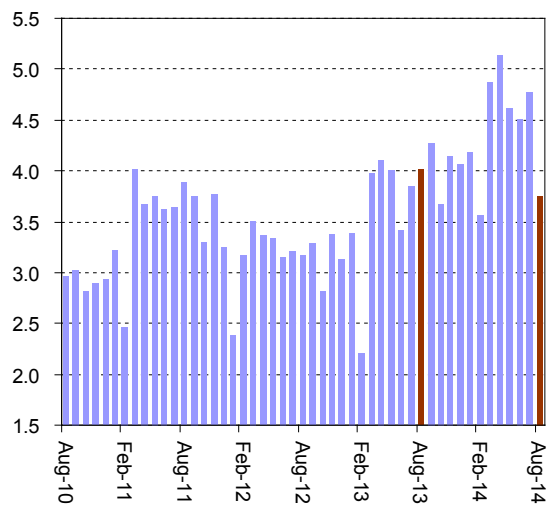
Source: GACC.

Lumber Imports (Million Cubic Meters)



Source: GACC, CNC.

Log Imports (Million Cubic Meters)



Source: GACC, CNC.

Uranium

China's Nuclear Plant Timelines

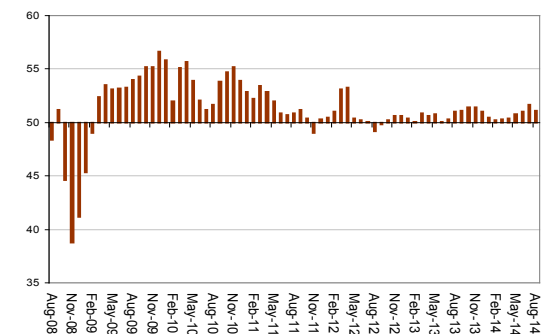
Time	Capacity (GW)			Reactors
April 1991	0.3			Qinshan Phase 1 #1
February 1994	0.984			Da Ya Wan #1
May 1994	0.984			Da Ya Wan #2
April 2002	0.65			Qinshan Phase 2 #1
May 2002	0.99			Ling Ao Phase 1 #1
December 2002	0.7			Qinshan Phase 3 #1
January 2003	0.99			Ling Ao Phase 1 #2
November 2003	0.7			Qinshan Phase 3 #2
March 2004	0.65			Qinshan Phase 2 #2
May 2007	1.06			Tianwan #1
August 2007	1.06			Tianwan #2
July 2010	1.08			Ling Ao Phase 2 #1 (Guangdong); Construction Started in December 2005; Trial Operation Started on July 22, 2010.
October 2010	0.65			Qinshan Phase 2 Expansion #1 (Zhejiang); Commercial Operation Started in October, 2010
August 2011	1.08			Ling Ao Phase 2 #2 (Guangdong); Construction Started in May 2006; Operation Started in August, 2011
2012	0.65			Qinshan Phase 2 Expansion #2 (Zhejiang); Construction Started in January 2007; Operation Started in April, 2012
2013	1			Hongyanhe (Liaoning); Construction Started in August 2007; Commercial Operation Started in February 2013
2013		1		Hongyanhe (Liaoning); Construction Started in April 2008
2014		1		Hongyanhe (Liaoning); Construction Started in March 2009
2015		1		Hongyanhe (Liaoning); Construction Started in August 2009
2016		1		Hongyanhe (Liaoning); Construction Started in July 2010
2016		1		Hongyanhe (Liaoning); Construction Started in July 2010
2013		1		Ningde (Fujian); Construction Started in February 2008
2013		1		Ningde (Fujian); Construction Started in November 2008
2014		1		Ningde (Fujian); Construction Started in January 2010
2015		1		Ningde (Fujian); Construction Started in July 2010
2013		1		Fuqing (Fujian); Construction Started in November 2008
2014		1		Fuqing (Fujian); Construction Started in June 2009
2015		1		Fuqing (Fujian); Construction Started in January 2011
2016		1		Fuqing (Fujian); Construction Will Start in 2011
2017		1		Fuqing (Fujian); Construction Will Start in 2011
2017		1		Fuqing (Fujian); Construction Will Start in 2011
2013		1		Yangjiang (Guangdong); Construction Started in December 2008
2013		1		Yangjiang (Guangdong); Construction Started in August 2009
2015		1		Yangjiang (Guangdong); Construction Started in March 2010
2015		1		Yangjiang (Guangdong); Construction Started in July 2010
2013		1		Fangjiashan (Zhejiang); Construction Started in December 2008
2014		1		Fangjiashan (Zhejiang); Construction Started in July 2009
2013		1		Sanmen (Zhejiang); Construction Started on April 2009
2014		1		Sanmen (Zhejiang); Construction Started on December 2009
2014		1		Haiyang (Shandong); Construction Started in October 2009
2015		1		Haiyang (Shandong); Construction Started in June 2010
2014		1.6		Taishan (Guangdong); Construction Started in October 2009
2015		1.6		Taishan (Guangdong); Construction Started in April 2010
2014		0.65		Changjiang (Hainan); Construction Started in April 2010
2015		0.65		Changjiang (Hainan); Construction Started in April 2010
2015		1		Fangchen (Guangxi); Construction Started in July 2010
2016		1		Fangchen (Guangxi); Construction Started in July 2010
2015		1		Tianwan Phase 2 (Jiangsu); Construction to Start in October 2010
2015		1		Tianwan Phase 2 (Jiangsu); Construction to Start in October 2010
2015		2		Xianning (Hubei); Construction to Start in 2011.
2016-2020			35	
Total	13.528	35.5	35	Total Capacity: 80 GW in 2020. Government Target (Announced Oct 2012): 58 GW in 2020

Source: Chinese media Reports, CNC.

Key Macro Trends

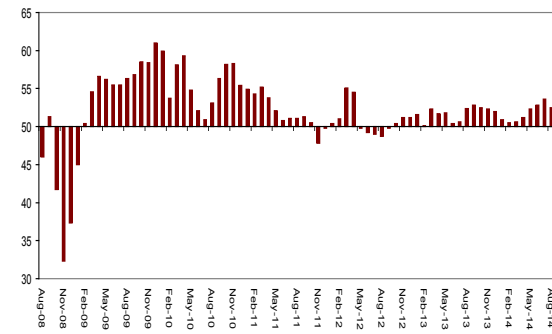
Growth Drivers

Purchasing Manager's Index



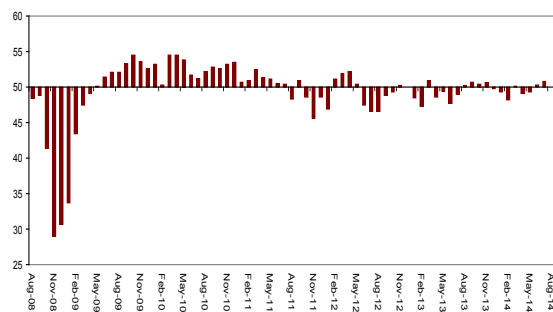
Source: NBS.

PMI – New Orders



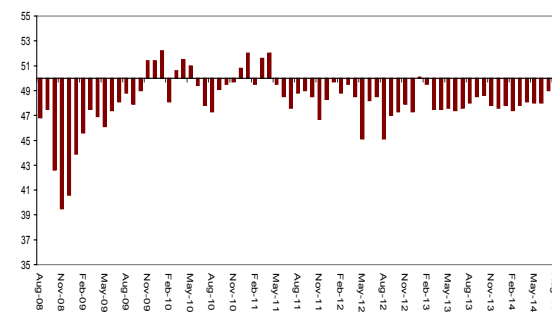
Source: NBS.

PMI – New Export Orders



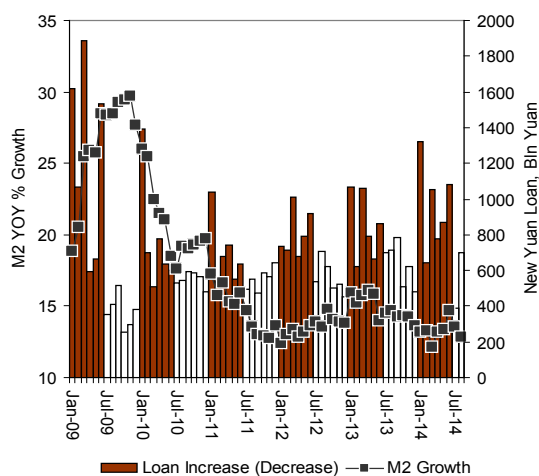
Source: NBS.

PMI – Raw Materials Inventory



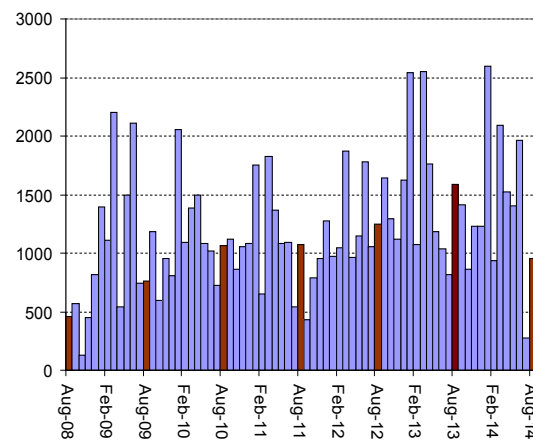
Source: NBS.

New Yuan Loans and M2 Money Supply



Source: People's Bank of China (PBOC).

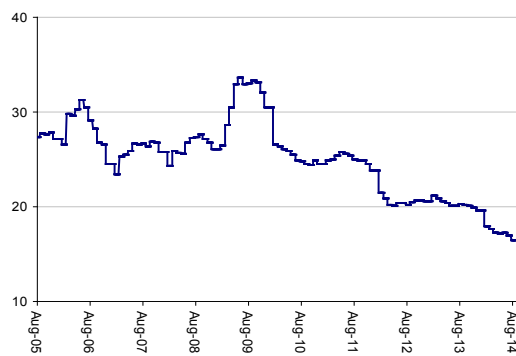
Aggregate Social Financing (Billion Yuan)



Source: People's Bank of China (PBOC).

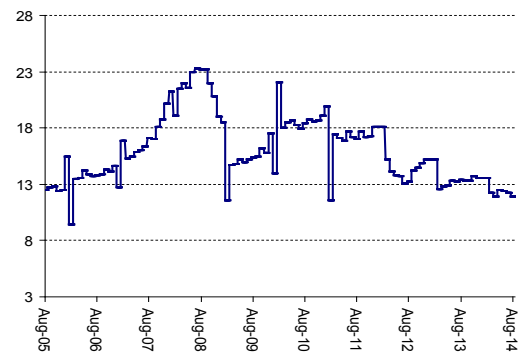
Growth Rates

Fixed Asset Investment (YOY, %)



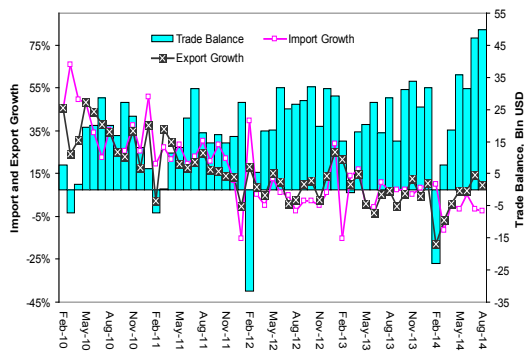
Source: NBS.

Retail Sales (YOY, %)



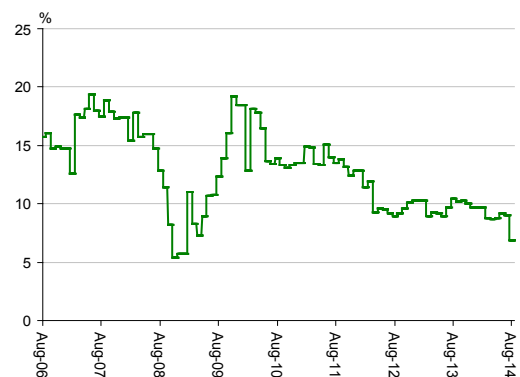
Source: NBS.

Trade



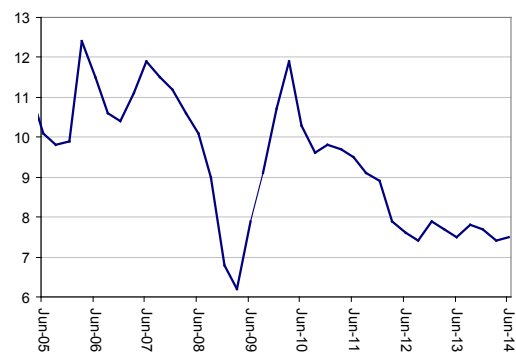
Source: GACC.

Industrial Production (YOY, %)



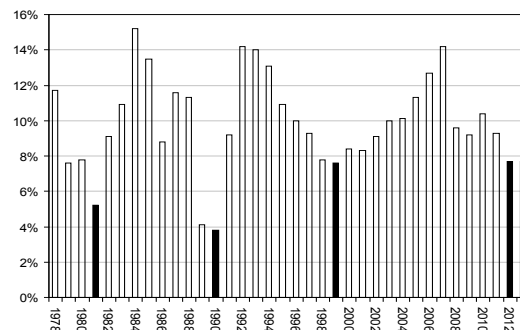
Source: NBS.

GDP (Quarterly, YOY, %)



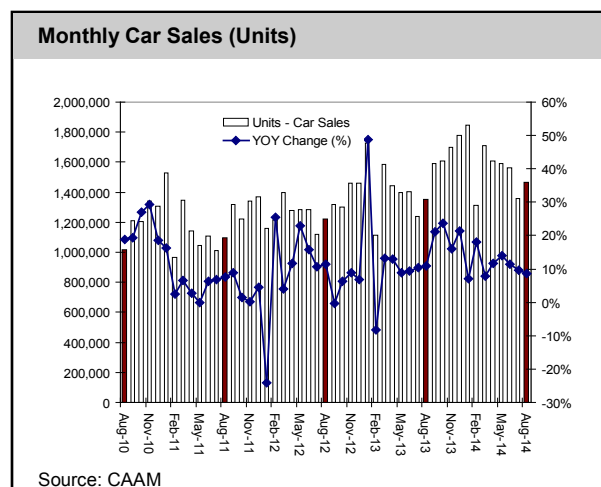
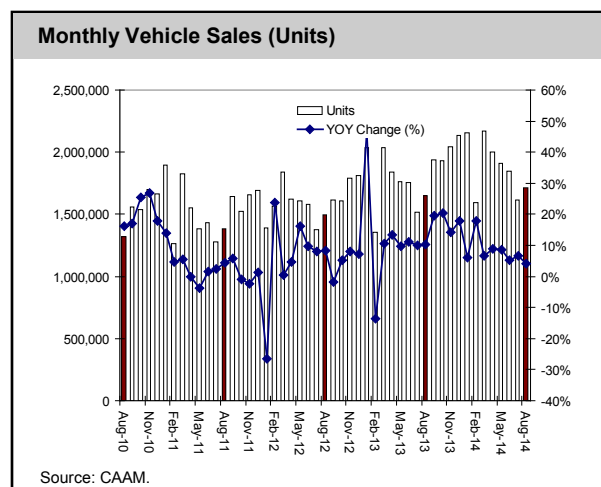
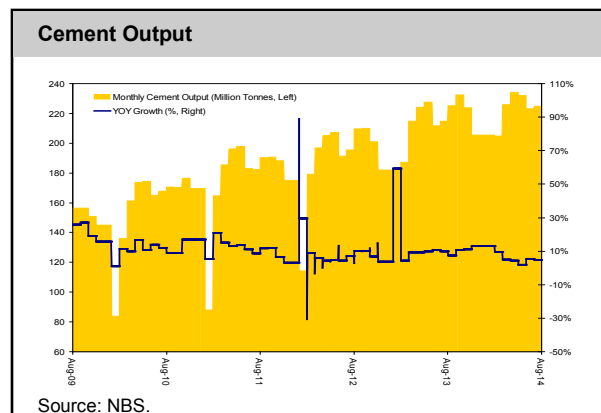
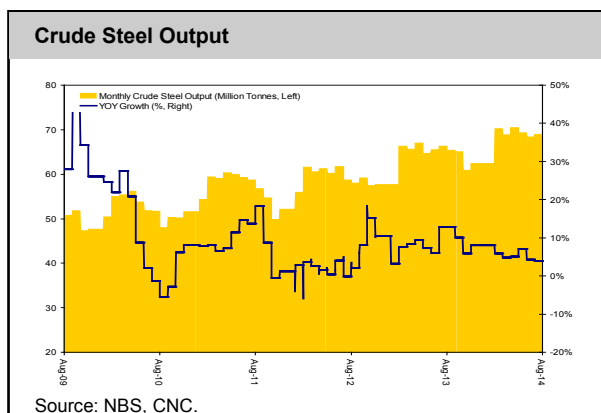
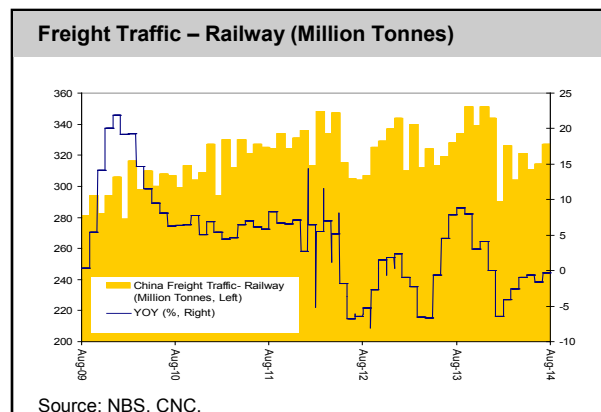
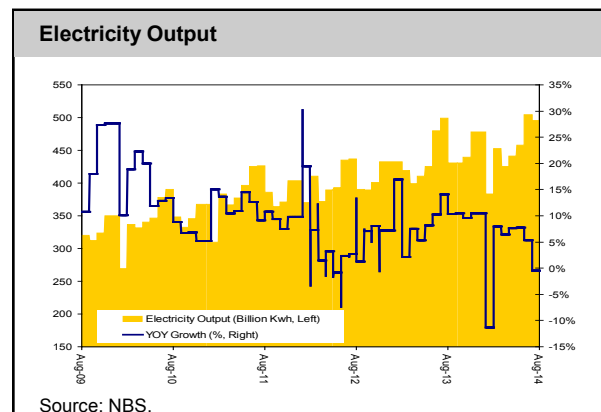
Source: NBS.

GDP (Yearly, YOY, %)



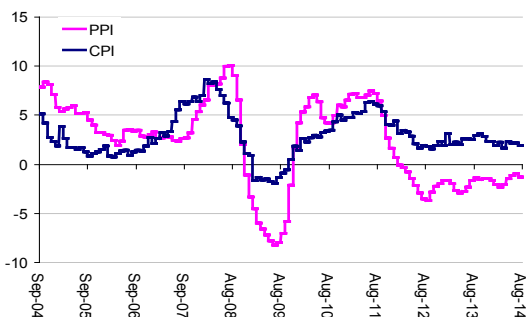
Source: NBS.

Growth Indicators



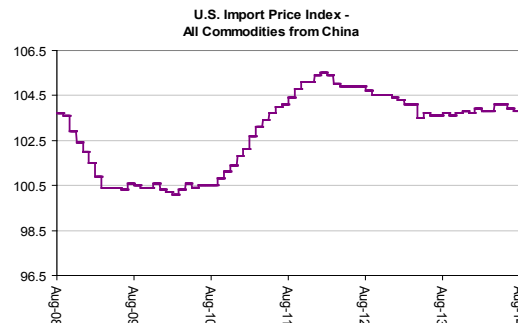
Inflation & Monetary Cycle

CPI & PPI (YOY, %)



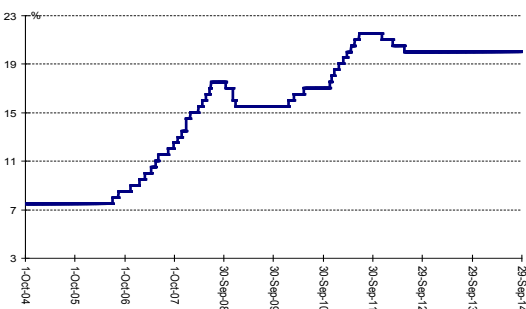
Source: NBS.

What Is China Exporting – Inflation or Deflation?



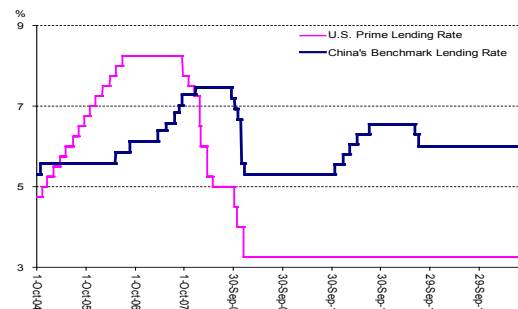
Source: U.S. Bureau of Labour Statistics.

Reserve Ratio



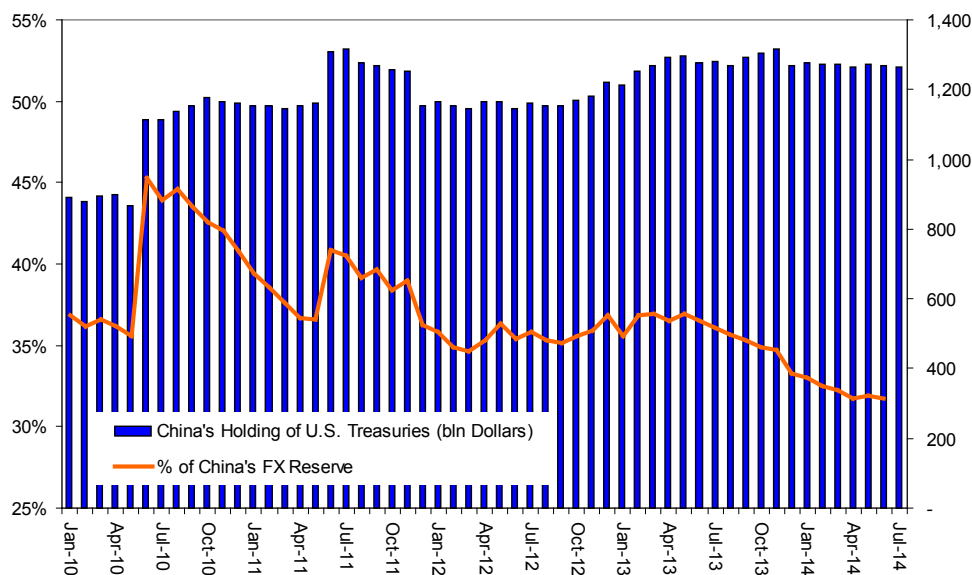
Source: CITIGroup, PBOC

Interest Rate



Source: CITIGroup, PBOC.

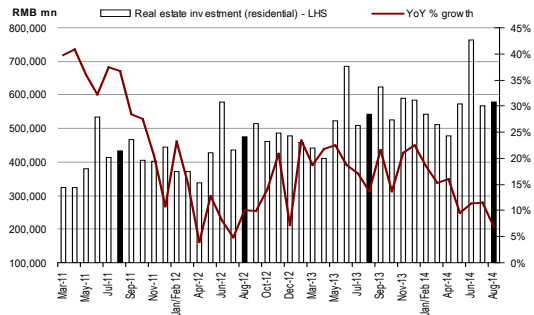
China's Holding of U.S. Treasuries



Source: PBOC, U.S. Department of Treasury.

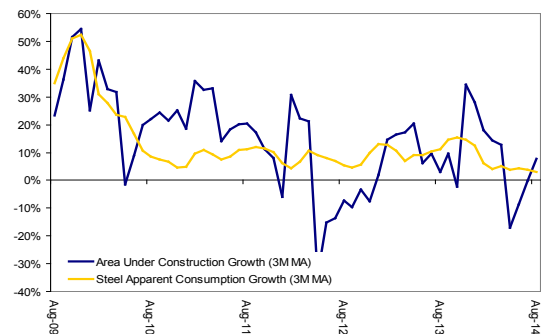
Property Market

Fixed Asset Investment – Residential



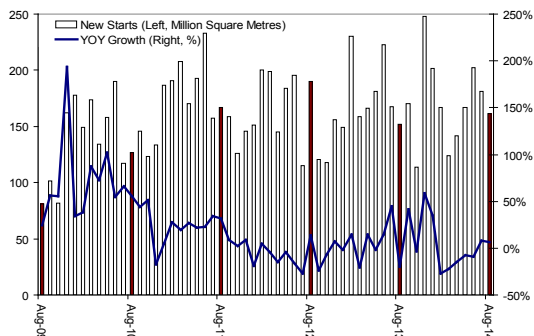
Source: NBS.

New Floor Space Under Construction (YOY, %)



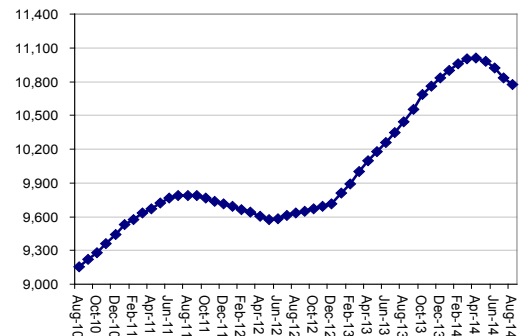
Source: NBS.

New Area Started



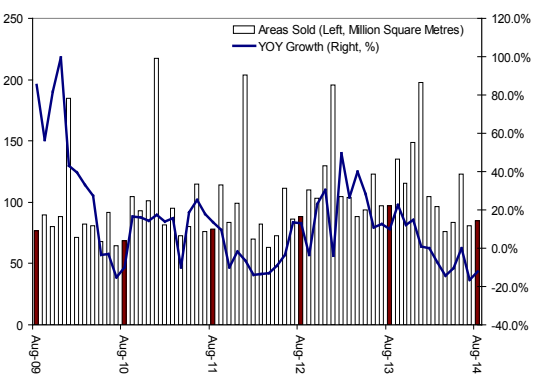
Source: NBS.

Average New Home Price – 100 Cities (Yuan/sqm)



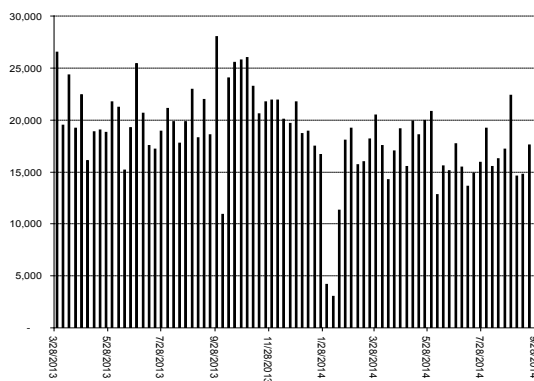
Source: CREIS.

Floor Space Sold



Source: NBS.

Primary Home Sales in Top Cities (Units)

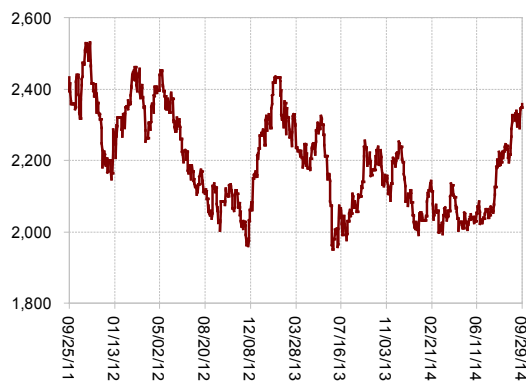


Source: Soufun. Note: Top ten cities.

Financial Markets

Key Financial Markets

Equity Market – Shanghai Composite Index



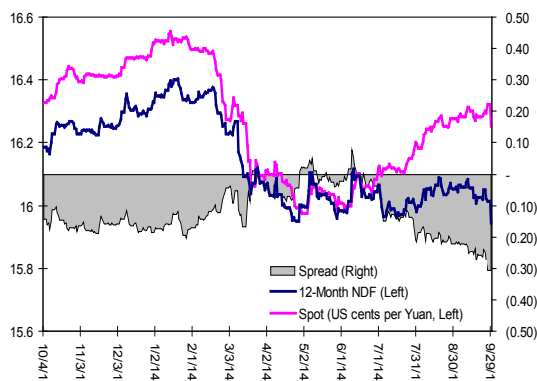
Source: Bloomberg.

Equity Market – Hang Seng China Enterprises Index



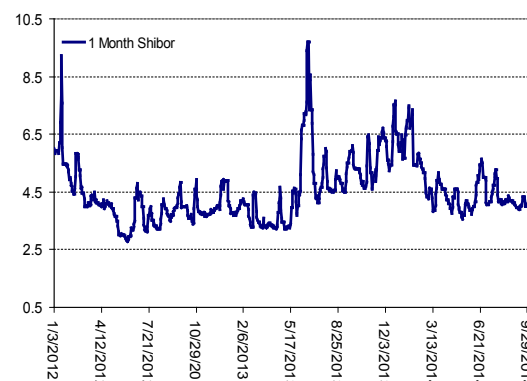
Source: Bloomberg.

Currency Market (U.S. cents per Yuan)



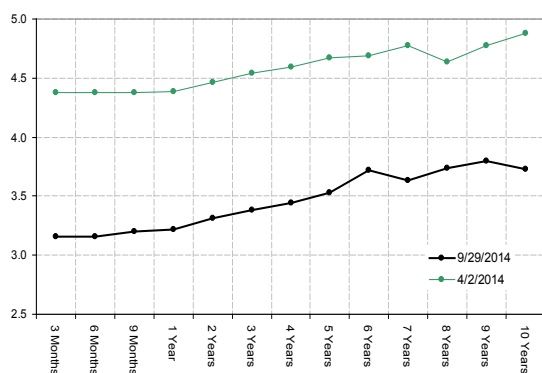
Source: Bloomberg.

Interest Rate – 1-Month Shibor



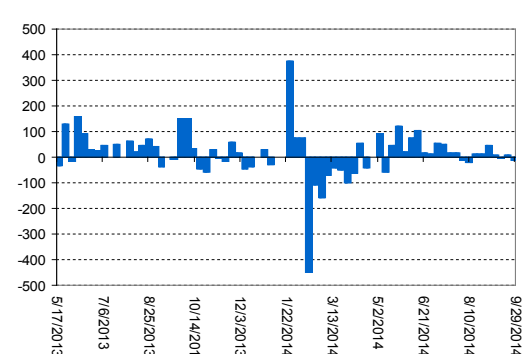
Source: Chinabond.

Yield Curve – CNY Interest Rate Swap



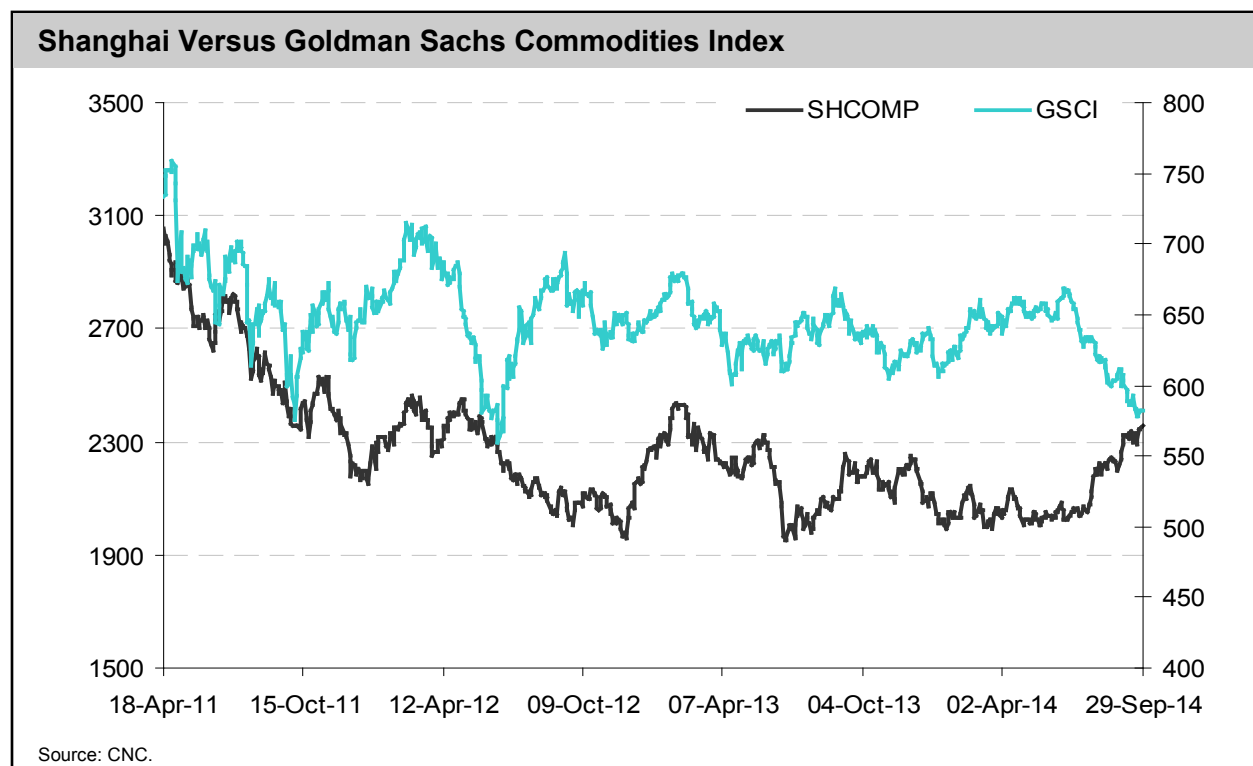
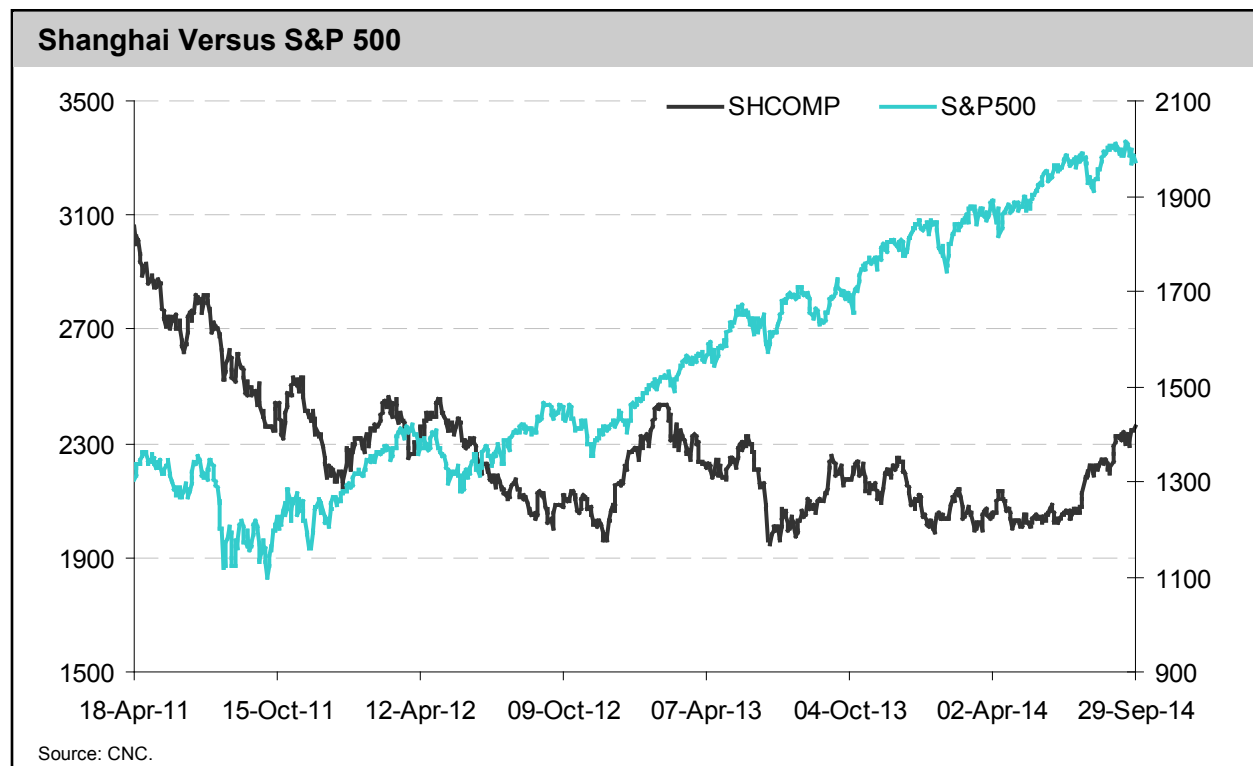
Source: ChinaBond.

PBOC Open Market Operation (Net Input, Billion)



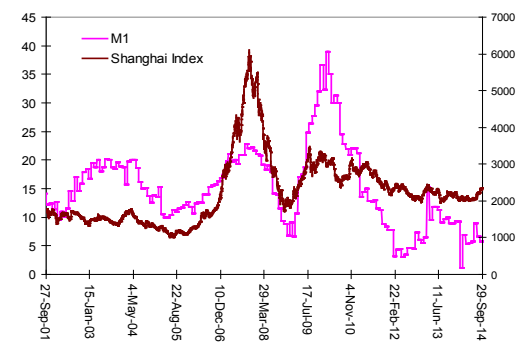
Source: PBOC.

Market Correlation



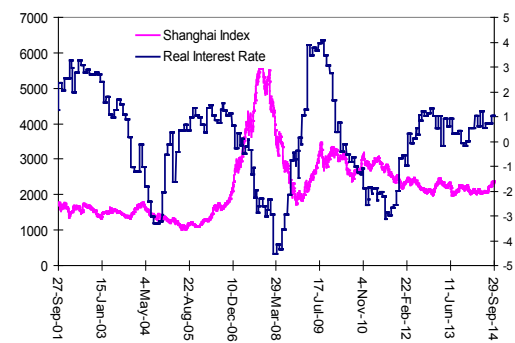
Equity Market Drivers

Liquidity



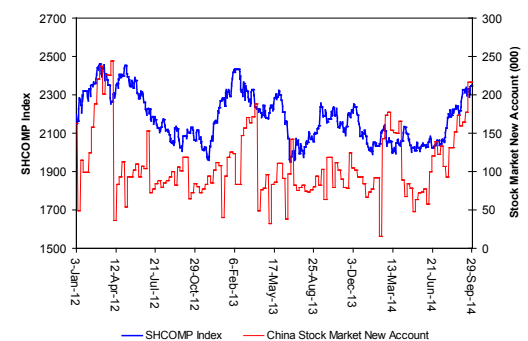
Source: PBOC, Bloomberg.

Real Interest Rate



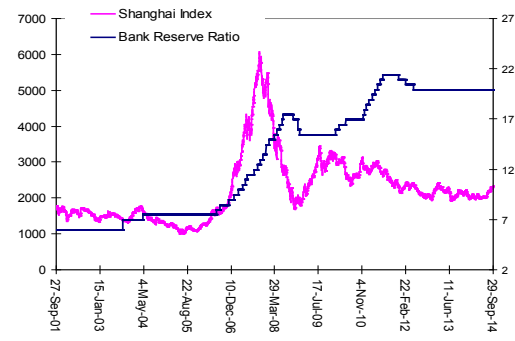
Source: Bloomberg.

Sentiment



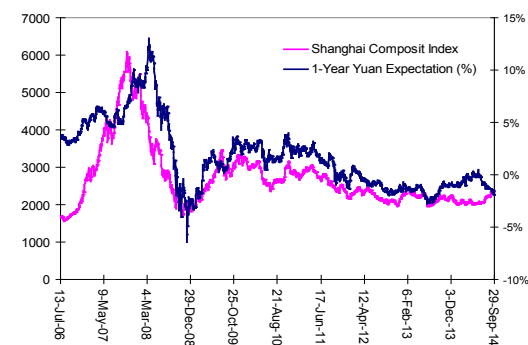
Source: Shanghai Stock Exchange, Bloomberg.

Policy and Monetary Cycle



Source: PBOC.

Expectation of Yuan Appreciation



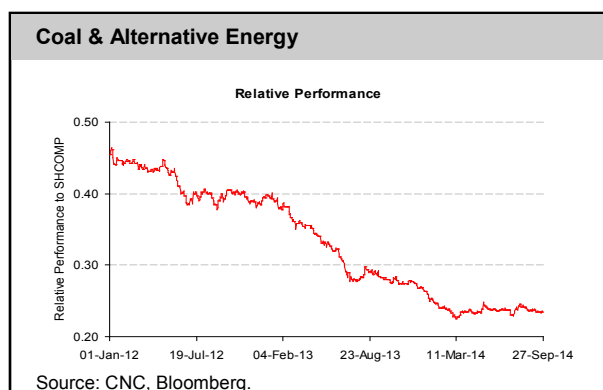
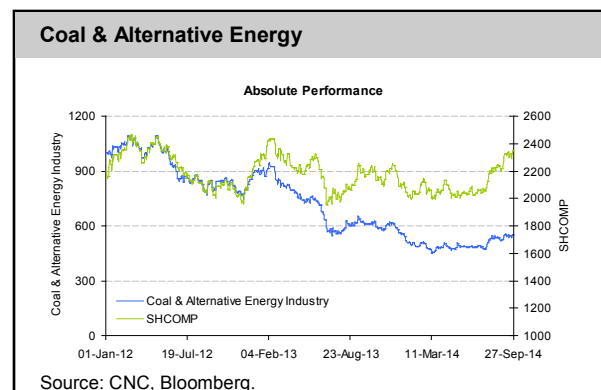
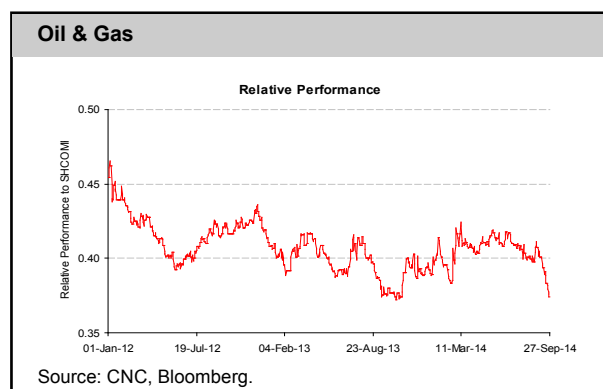
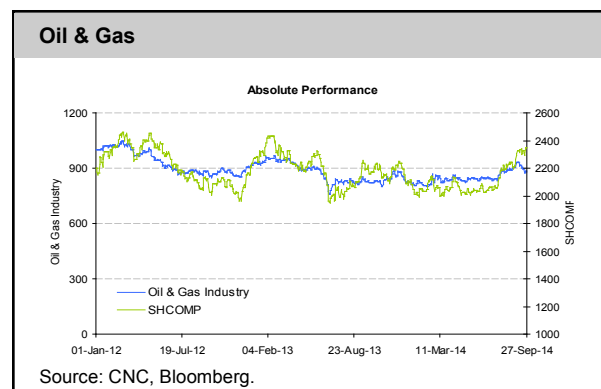
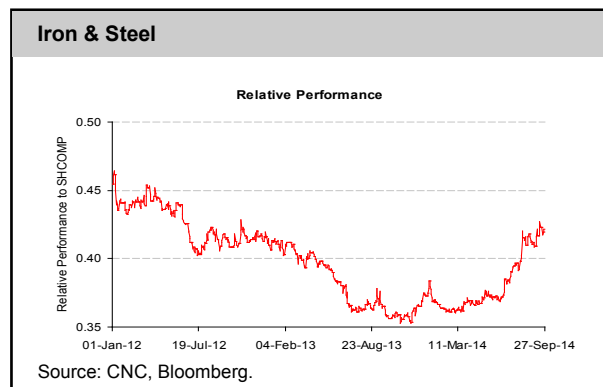
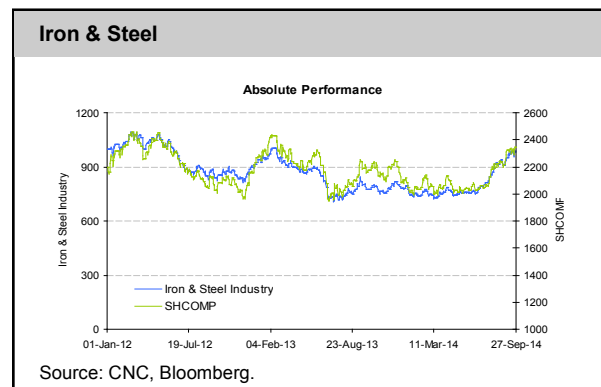
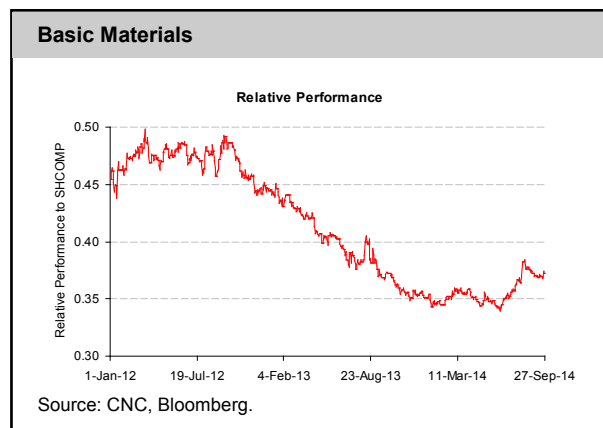
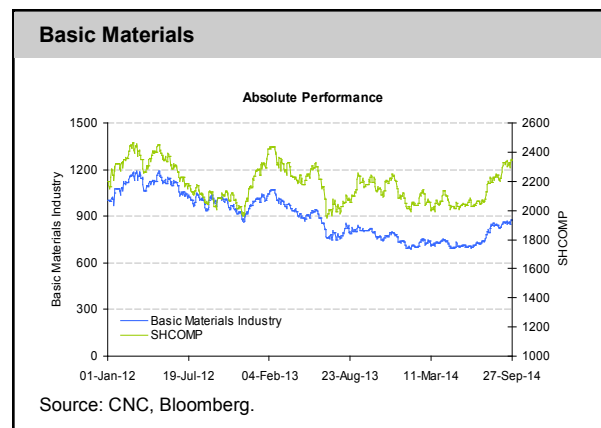
Source: Bloomberg, CNC.

Valuation

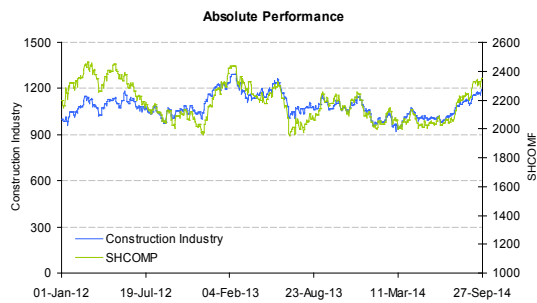


Source: Bloomberg, CNC.

Relative Performance – Absolute & Relative

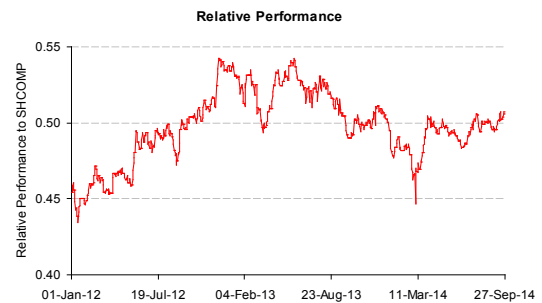


Construction



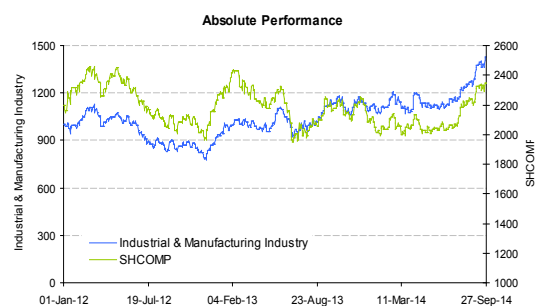
Source: CNC, Bloomberg.

Construction



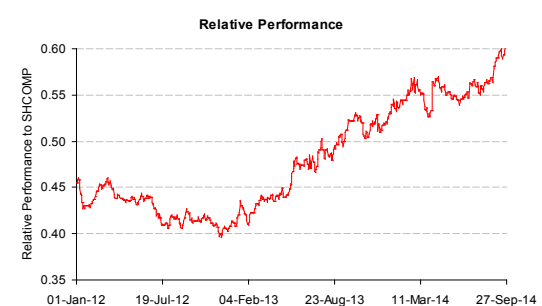
Source: CNC, Bloomberg.

Industrial & Manufacturing



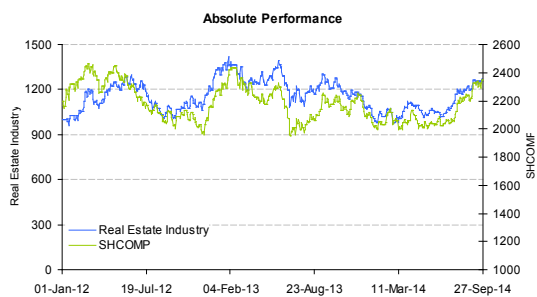
Source: CNC, Bloomberg.

Industrial & Manufacturing



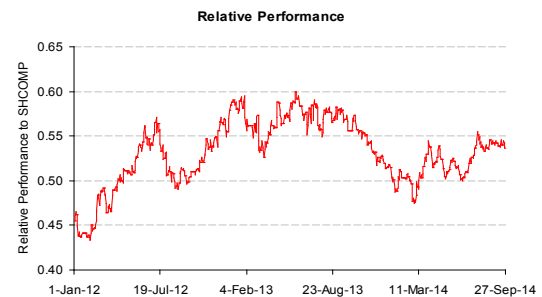
Source: CNC, Bloomberg.

Real Estate



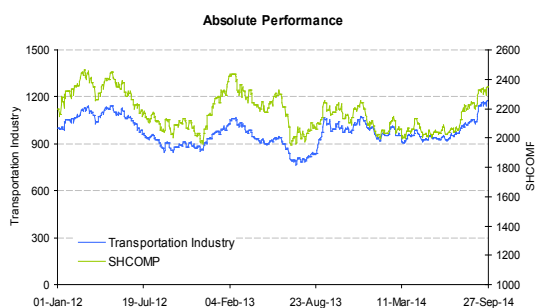
Source: CNC, Bloomberg.

Real Estate



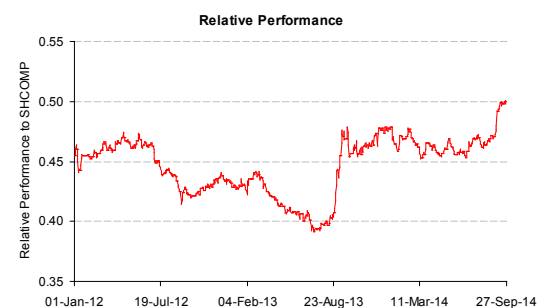
Source: CNC, Bloomberg.

Transportation



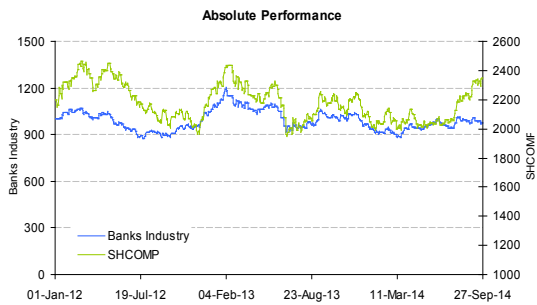
Source: CNC, Bloomberg.

Transportation

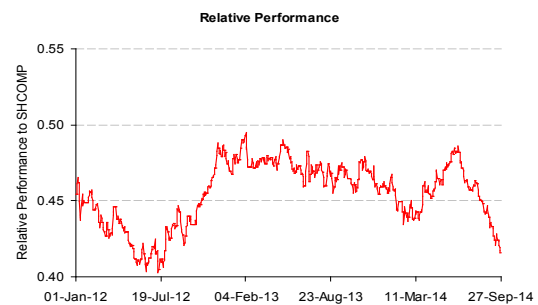


Source: CNC, Bloomberg.

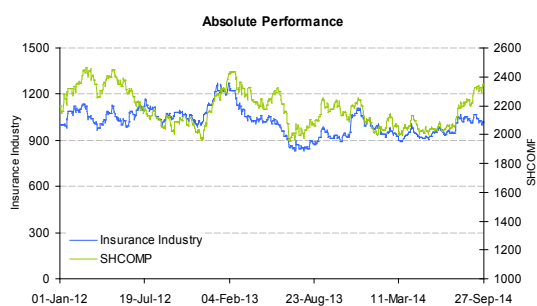
Banks



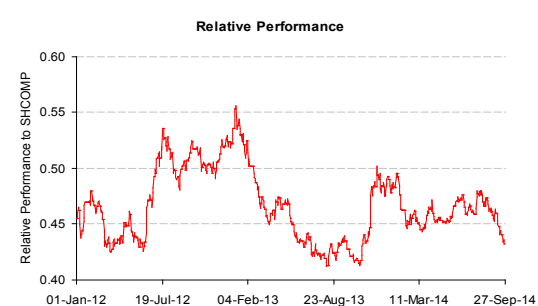
Banks



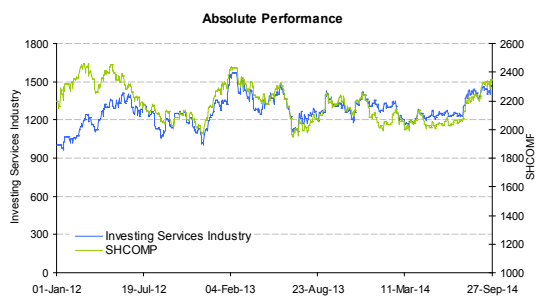
Insurance



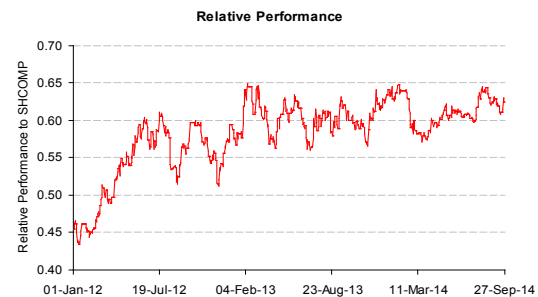
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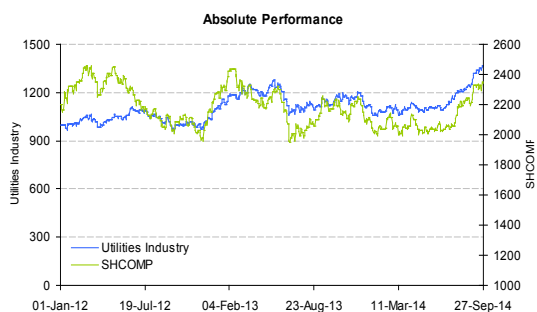
Investment Services



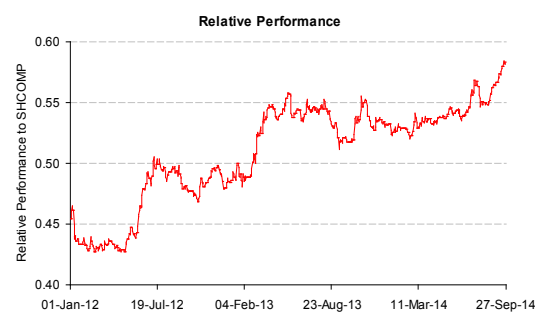
Investment Services



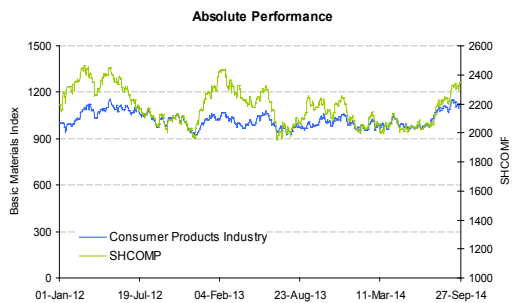
Utilities



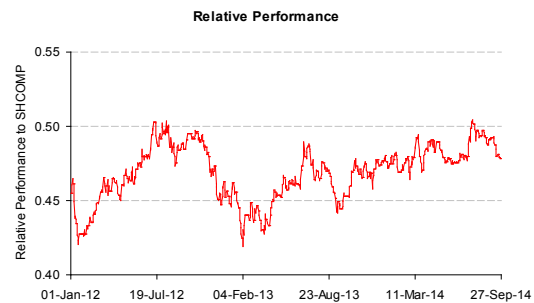
Utilities



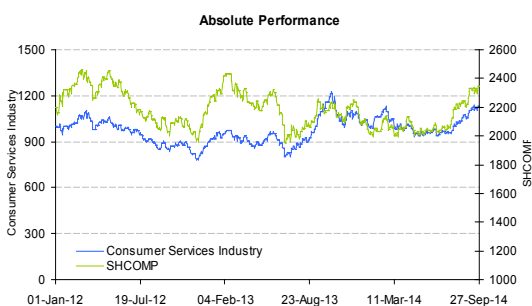
Consumer Products



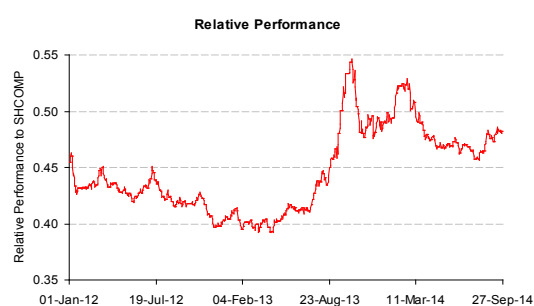
Consumer Products



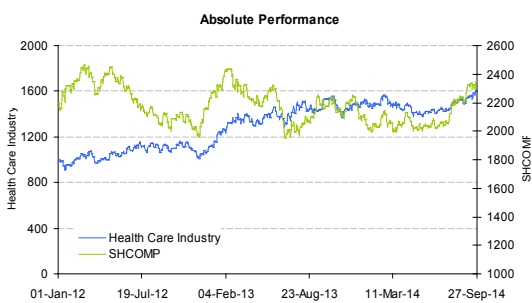
Consumer Services



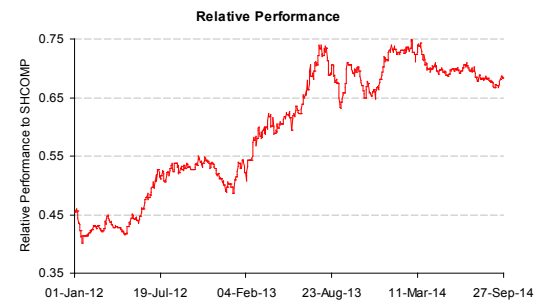
Consumer Services



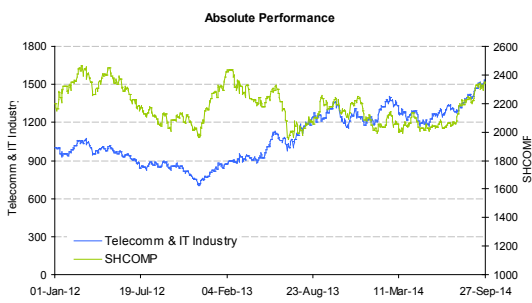
Health Care



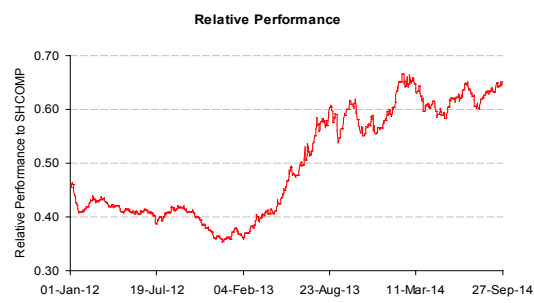
Health Care



IT & Telecom



IT & Telecom



Appendix

Comparing Apples to Apples on China's Debt

- This Appendix is a re-print of a Feature Article in our *China Investment Strategies* report dated April 8, 2014. It is included in this report for marketing purpose.
- Apparently China permabears are holding their breath these days, waiting for their “told-you-so” glory. As the Chinese reformers started to introduce two-way trade for the yuan and began to allow defaults in the bond market, the Minsky moment for China must be imminent, they say. When crunching the numbers and finding that China's total government debt is not unreasonably high as a percentage of GDP, their advice is not to forget other debt in China, particularly corporate debt. Adding together all debt in the economy, the debt-to-GDP ratio for China could be well over 200% – this is clearly unsustainable, they say.
- Our clients are understandably concerned. Routinely we are requested to comment on articles and newsletters that predict implosion scenarios for the Chinese economy. In fact, we ourselves share deep concerns about China's debt issue – the growth rate of debt over the past few years is not sustainable and a deleveraging process is inevitable, in our view. During the deleveraging process, the structural growth of the economy is set to slow down. However, we do not expect to see a sudden collapse of the Chinese economy through an imminent Minsky moment. The reason is simple – the overall debt level in China is actually not that high.
- When the permabears pitch their story about China's debt burden, they rarely compare apples to apples. They usually add up all debt in China to calculate its debt-to-GDP ratio and then compare that with the public debt-to-GDP ratios in other economies. Exhibit 1 below shows an apples-to-apples comparison of China's debt burden in all four categories versus some mature economies. The China number is taken from a detailed study from the China Academy of Social Sciences. This number is fairly accurate, in our view, and it is in line with market consensus. For instance, in early April, Bloomberg surveyed 11 leading economists about China's overall debt-to-GDP ratio; the average estimate is 225% as of end of 2013. For other economies, we use the results of a comparable study by McKinsey & Company published in 2012. The McKinsey results actually underestimated the debt level for certain economies. For instance, if the liabilities of Fannie Mae and Freddie Mac are included, the U.S. total debt-to-GDP ratio would be 360%, not 279% as presented in the table.
- That said, as Exhibit 1 shows, from a static perspective, the gross debt level in China, at 215.7% of GDP as of December 2012, is not exceptionally lofty. The data implies that, before we worry about a systemic implosion in China due to its “heavy” debt, we should worry about the U.S., Canada, the U.K., Japan, and Ireland. Netting out the debt, net assets in China exceeded RMB 300 trillion in 2011, almost three times China's gross indebtedness.

Exhibit 1: Debt-to-GDP Ratios for Selected Countries (Percentage of GDP)

	Household	Non-Financial Corporations	Financial Institutions	Government	Total	Note
China	31.1	113.5	17.6	53.5	215.7	as of Dec 2012; Source: CASS
Canada	91	53	63	69	276	as of Q2/2011; Source McKinsey
U.S.	87	72	40	80	279	as of Q2/2011; Source McKinsey
U.K.	98	109	219	81	507	as of Q2/2011; Source McKinsey
Japan	67	99	120	226	512	as of Q2/2011; Source McKinsey
Ireland	124	194	259	85	662	as of Q2/2011; Source McKinsey

Source: China Academy of Social Sciences; McKinsey & Company.

Note: If asset-backed securities are included, the U.S. number would be 360%.

- Some investors would argue that China should not be compared with mature economies. Instead, it should be compared with the total indebtedness in key developing countries. We disagree. The key difference between China and some key developing countries such as India is very pronounced in that China's debt is predominantly domestic. In other words, China has been borrowing in a currency it can print, while some other developing countries routinely borrow in a currency called the greenback, which they cannot print. China has twin surplus in its balance of payments, its external debt is low, and its foreign exchange reserve is formidable. In a highly extreme situation that would require a systemic bailout, China's Ministry of Finance could raise funds to bail out the banking system simply by issuing bonds to the People's Bank of China – yes, this is called quantitative easing. If QE has not proven a disaster in the U.S., it stands to reason that China could undertake its own experiment when needed.
- Overall debt levels aside, a detailed look at Exhibit 1 actually shows where China's strength and weakness lie. For instance, despite all the discussion about local government debt, China's total government debt (local plus central) is actually the lowest among major economies. And China's households are good savers too. The real issue for China is non-financial corporate debt.
- China's high corporate debt is a direct result of its failure to launch an effective equity market, in our view. As we know, companies have two main channels to receive funding – debt financing or equity financing. Unfortunately, the Chinese equity market has been an ineffective source of financing for companies, and as a result corporate China has had to rely on bank loans and bond issuance. In fact, in the not-too-remote history, bank loans were as high as 80% of China's aggregate social financing. In recent years, other types of financing have developed, from the bond market to shadow banking. However, equity financing is still lacking. In fact, this phenomenon – high corporate debt – is not unique to China. Before their financial markets became more mature and diversified, most of today's mature economies went through a similar stage in their histories. The same issue, the immaturity of equity and bond markets, also explains the high M2 money supply in China, another issue repeatedly warned of by the permabears.
- In fact, the apples-to-apples comparison of China's debt exposures in different categories versus more mature economies illuminates the direction of China's financial reforms. First, to foster a consumer economy, it should help households to leverage up. When consumers feel safe about their retirement and medical care, they will be more likely to use their credit cards. Second, to help corporate China deleverage, China should foster a more mature and effective equity market and increase equity financing's share of total social financing. On this point, the latest IPO reform is a good start. And lastly, as to government debt, the overall level is fine, in our view; however, we believe the central government should leverage up its balance sheet so that local governments can deleverage. This requires the central government to shoulder more spending obligations. Fortunately, all the three areas are targeted in the reform package announced after the 3rd Plenum of the Party last November.

APPENDIX A – IMPORTANT DISCLOSURES

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