• China’s GDP grew by 7.4 percent for the first quarter of 2014, lower than the government target of 7.5 percent, but ahead of most analyst estimates
• First quarter Purchasing Managers’ Index (PMI) remained in positive territory at 50.3, while the Consumer Price Index (CPI) held steady at 2.4 percent (versus the government’s 3.5 percent target for the year)
• ODI in non-financial sector decreased by 16.5 percent year-on-year in the first quarter, but a number of factors should propel total Chinese ODI for 2014 above levels reached in 2013
• Inbound FDI increased by 5.5 percent year-on-year, as China’s services industry buoyed investment growth
Macroeconomic Analysis

**Q1’2014 GDP**

7.4%

**Slower growth, but close to 7.5 percent target**

The Chinese economy grew 7.4 percent in the first quarter of 2014. Although the number narrowly beat most forecasts, it is 0.3 percent less than the same period last year and 0.1 percent below the government’s target. Other statistics also suggest that the Chinese economy is facing headwinds.

**GDP quarterly growth rate, year-on-year**

![GDP quarterly growth rate graph](graph)

Source: National Bureau of Statistics (NBS), KPMG Analysis

Although PMI is still in positive territory (above 50 percent): both fixed asset investment and industrial value-added are seeing slower growth. Investment in real estate is also slowing, the floor space of properties sold has declined, and the value of net exports has also declined versus the same period last year.

**Monthly Purchasing Manager’s Index (PMI)**

![Monthly PMI graph](graph)

Source: National Bureau of Statistics (NBS), KPMG Analysis

Alongside downward pressure on the economy, China is also dealing with three simultaneous ‘impacts’: the impact of down-shifting to slower economic growth; the impact of structural adjustments to the economy; and the impact of side-effects from previous large-scale stimulus measures. Nevertheless, China is speeding up its process of economic restructuring and upgrading, with the value-added percentage from the tertiary industry rising year-on-year.

Peter Fung
Global Chair, KPMG’s Global China Practice

“The government is making a trade-off: a little realignment ‘pain’ in the short-term, as it pushes ahead with reforms that will bring healthy development over the long-term”
Mini-stimulus

On April 2nd, 2014, the State Council executive meeting unveiled three economic promotion measures: greater support for the redevelopment of run-down urban areas; more investment in railways; and tax breaks for small- and micro-enterprises.

On April 10th, 2014, The Monetary Policy Commission of the People’s Bank of China also held its first quarter meeting, stating that China’s overall financial operations are smooth, prices are stable, and the government will continue to implement a prudent monetary policy.

Also on April 10th, Premier Li Keqiang delivered a keynote speech at the opening plenary session of the 2014 Boao Forum for Asia. He said, “We will not opt for a massive short-term stimulus because of ‘temporary’ volatility. Instead, we will focus more on medium- to long-term healthy development.”

Taken together, these developments suggest that:

• The government can tolerate a certain degree of economic volatility in an effort to transform China’s economy to a more consumer-driven economy, while relying less on investment and net exports.

• The main objective of the economic “mini-stimulus” plan is to stabilize economic growth. The policies are in line with the existing government reform roadmap, and almost all the sectors that benefit from the policies are related to people’s livelihood.

• The central bank clearly stated that it would continue to implement a prudent monetary policy, which implies that the economic ‘mini-stimulus’ plan will be unlikely to exacerbate the local debt situation or lead to overcapacity.

According to the National Bureau of Statistics (NBS), private investments accounted for 64.8 percent of total fixed asset investment, up 1.8 percentage points over the same period in 2013, which shows the private sector is becoming more active compared to the State-owned sector.

Growth of average per capita disposable income has outpaced GDP growth in the first quarter of 2014, while employment and inflation indicators are also in line with expectations: overall economic growth still appears to be within the ‘proper range’ forecasted by the central government.

Basic drivers of the economy haven’t gone away

Although economic figures in the first quarter are not stellar, China’s economic drivers are still very much in place. These include:

• Infrastructure investments, such as urbanization construction projects and shantytown renovation projects.

• Emerging industries, such as smart grid, nuclear power generation, environmental protection and new energy.

• International trade and outbound investment: the government is actively pursuing and signing investment treaties and free trade zone agreements, and other initiatives such as the ‘the Silk-road Economic Belt’ and an “Economic Corridor’ between China and Southeast Asian countries.

• The private sector, which is being given new room to grow with the reform of SOEs, the opening of monopoly industries, and the introduction of new tax deduction and exemption rules.

• Expanding domestic demand: the government has made it clear that it will increase wages and income, which will further enhance the consumption function of GDP.

![Total retail sales of consumer goods monthly growth rate year-on-year](image)

Source: National Bureau of Statistics (NBS), KPMG Analysis
Future developments

GDP growth slowed by 0.3 percent year-on-year in the first quarter of 2014: the next few months will be crucial for China’s economic development. With various economic indices holding stable, we predict that the government will implement the “mini-stimulus policies”, speed up the pace of investment projects, and encourage greater private sector participation in more diverse industries to help support sustainable growth.

We also believe that the central bank will continue to implement a prudent monetary policy. If the economy deteriorates, the central bank has enough room to enact loosening measures due to the modest growth of CPI, PPI, and the M2 money supply.

Inflation Indices: CPI & PPI

China’s CPI, the main gauge of inflation, increased by 2.4 year-on-year in March, up from 2 percent in February. The acceleration was mainly driven by food prices, which gained 4.1 percent in March, and accounted for nearly one-third of the weighting.

In the first quarter of 2014, China’s CPI is 2.4% year-on-year, up from 2.0% in Q4 2013. The acceleration was mainly driven by food prices, which gained 4.1% in March, and accounted for nearly one-third of the weighting.

Source: April 2014, National Bureau of Statistics (NBS)

With the above elements in mind, we expect that economic growth in the second quarter of 2014 will still be less than the government-set target of 7.5 percent, as the effects of the “mini-stimulus policies” will take some time to be felt. However, as these policies take effect, and as more diversified sources of investment are able to flow into previous monopolistic sectors, economic growth may again return to reach or exceed government-set targets in the short- and longer-term.
**Q1 Outbound Direct Investment Summary**

<table>
<thead>
<tr>
<th></th>
<th>Q1’2013</th>
<th>Q1’2014</th>
<th>% Change</th>
</tr>
</thead>
<tbody>
<tr>
<td>Non-financial ODI</td>
<td>23.8</td>
<td>19.9</td>
<td>-16.5</td>
</tr>
<tr>
<td>(USD billion)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Overseas contracting</td>
<td>25.2</td>
<td>27</td>
<td>7.2</td>
</tr>
<tr>
<td>project revenue</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>(USD billion)</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Source: Ministry of Commerce accessed 17 April 2014, KPMG Analysis

**ODI policy updates**

Many Chinese local governments are encouraging local companies to expand globally: local governments have already launched initiatives to accelerate overseas investment. Some of these policy measures include streamlining ODI approval process in the Shanghai Pilot Free Trade Zone; offering financial support for local companies’ outbound investment; and setting up industry-specific ‘going out’ alliances.

The State Council issued an “Opinion on Deepening Overall Rural Reform and Accelerating the Modernization of Agriculture” in January, pointing out that ‘going out’ is an important step toward improving the national food security system.

The National Development and Reform Commission (NDRC) has announced measures to decentralize governmental approval requirements and streamline the approval process for outbound investment projects in early April: Chinese-invested overseas projects below USD1 billion will not required NDRC approval, and need only register with the NDRC or local government agencies. This is a significant change that will increase the speed and efficiency of Chinese companies seeking to invest internationally.

The central government initiated several developments following the Third Plenum in late 2013, aimed at creating a more market-driven economy. For example, the government will grant Chinese companies more latitude to engage in overseas infrastructure projects and labor supply contracts, and will allow investors more innovative ways to make green-field, R&D, M&A and joint venture investments.

**Agriculture and Food**

In the first quarter of 2014, COFCO bought a 51 percent stake in Dutch commodities trader Nidera, as well as a majority stake in Hong Kong-based Noble Group’s agribusiness, a new push for Chinese companies into global agribusiness.

The two acquisitions help secure the supply of grains and oils resources, and enhance Chinese companies’ upstream agribusiness value chain by strengthening COFCO’s position in international commodities trading.

The Noble agribusiness acquisition is one of a growing number of partnerships between Chinese investors and foreign enterprises for the purpose of getting into new sectors/markets and acquiring global expertise.

COFCO involved Hopu Investment and other international investors in the Noble acquisition, demonstrating that private equity involvement can be an effective source of additional funding support on outbound deals. PE participation can reduce the deal risk for the Chinese investor, while still enabling it to maintain a controlling interest in the joint venture.

---

1. Ministry of Commerce 17 April 2014
Chinese companies are not only looking to invest in foreign markets, but are also diversifying into different growth sectors within the infrastructure industry. In the first quarter of 2014:

- Dalian Wanda announced plans to invest up to GBP3 billion in urban regeneration projects in the UK.
- Beijing Capital Group acquired 100 percent interest in New Zealand’s largest waste management business, Transpacific New Zealand.
- China Shipping Group agreed to acquire a 24 percent stake in Belgium’s Zeebrugge Terminal, the sixth largest container terminal in Europe.

### M&A Summary

There were a total of 93 announced Chinese overseas M&A deals through the first quarter of 2014, versus 103 through the first quarter of 2013: a 9.7 percent drop year-on-year in deal activity. However, total deal value rose during the first quarter by 9 percent year-on-year, reflecting Chinese companies’ continued interest in acquiring target firms in global markets.

### Top ten outbound M&A deals by deal value in Q1 2014

<table>
<thead>
<tr>
<th>No</th>
<th>Date</th>
<th>Acquirer</th>
<th>Target</th>
<th>Target country (region)</th>
<th>Deal value (USD bn)</th>
<th>Shares acquired (%)</th>
<th>Target sector</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Jan ’14</td>
<td>Lenovo</td>
<td>Motorola Mobility</td>
<td>USA</td>
<td>2.91</td>
<td>100</td>
<td>Telecom</td>
</tr>
<tr>
<td>2</td>
<td>Jan ’14</td>
<td>Lenovo</td>
<td>IBM’s x86 server unit</td>
<td>USA</td>
<td>2.31</td>
<td>100</td>
<td>High-tech</td>
</tr>
<tr>
<td>3</td>
<td>Jan ’14</td>
<td>Fosun International</td>
<td>Caixa Geral de Depositos SA</td>
<td>Portugal</td>
<td>1.36</td>
<td>80</td>
<td>Financial</td>
</tr>
<tr>
<td>4</td>
<td>Feb ’14</td>
<td>COFCO</td>
<td>Nidera Handelscompagnie BV</td>
<td>Netherlands</td>
<td>1.20</td>
<td>51</td>
<td>Agriculture</td>
</tr>
<tr>
<td>5</td>
<td>Feb ’14</td>
<td>Dongfeng Motors</td>
<td>Peugeot SA</td>
<td>France</td>
<td>1.09</td>
<td>14.1</td>
<td>Industry</td>
</tr>
<tr>
<td>6</td>
<td>Mar ’14</td>
<td>Beijing Capital Group</td>
<td>Transpacific Industries’</td>
<td>New Zealand</td>
<td>0.79</td>
<td>100</td>
<td>Industry</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>business in NZ</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>7</td>
<td>Jan ’14</td>
<td>ICBC</td>
<td>Standard Bank plc</td>
<td>UK</td>
<td>0.77</td>
<td>60</td>
<td>Financial</td>
</tr>
<tr>
<td>8</td>
<td>Mar ’14</td>
<td>Tencent Holdings</td>
<td>CJ Games Corp</td>
<td>Korea</td>
<td>0.49</td>
<td>28</td>
<td>High-tech</td>
</tr>
<tr>
<td>9</td>
<td>Feb ’14</td>
<td>China Huaxin</td>
<td>Alcatel-Lucent Enterprise SAS</td>
<td>France</td>
<td>0.31</td>
<td>85</td>
<td>Telecom</td>
</tr>
<tr>
<td>10</td>
<td>Mar ’14</td>
<td>Consortium led by</td>
<td>Tangome Inc</td>
<td>USA</td>
<td>0.28</td>
<td>-</td>
<td>High-tech</td>
</tr>
</tbody>
</table>

Source: Dealogic accessed 1 April 2014, KPMG analysis
Foreign Direct Investment Analysis

Q1 Foreign Direct Investment Summary

<table>
<thead>
<tr>
<th></th>
<th>Q1’2013</th>
<th>Q1’2014</th>
<th>% Change</th>
</tr>
</thead>
<tbody>
<tr>
<td>FDI (USD billion)</td>
<td>29.9</td>
<td>31.55</td>
<td>5.5%</td>
</tr>
</tbody>
</table>

Source: Dealogic accessed 18 April 2014, KPMG analysis

- Total FDI into China increased by 5.5 percent year-on-year in the first quarter.
- China’s service sector FDI exhibited double-digit year-on-year growth, while manufacturing sector continues its decline.
- West and Central China FDI growth significantly outpaced the East region. While the East still reigns supreme in aggregate investor interest.

David Frey
Head of Inbound Investment, KPMG China

“We are seeing an ongoing migration from China’s manufacturing FDI to its service sector. This is due to a number of factors, including the overwhelming central government support for China’s service sector development. Over time, the service sector will be responsible for more jobs in China, while offering more purchase choices for the increasing middle class consumer.”

Service industry pushes FDI higher

FDI into China maintained its momentum from last year, and began 2014 with inflows of over USD31.5 billion. This is a 5.5 percent increase over the first quarter of 2013, a year in which saw FDI break records in China. However, for the first time in 14 months China’s FDI saw a year-on-year decline in March, 2014. Ministry of Commerce spokesman Shen Danyang said it is normal for investments, both inbound and outbound, to have some fluctuations in the face of a changing macroeconomic climate, and FDI looks to hit all targets in 2014.4

China’s service and manufacturing sectors are the primary contributors to FDI. Manufacturing sector FDI dropped by 11.7 percent year-on-year in the first quarter. Due to the central government policy of increasing minimum wage salaries, companies in low-end manufacturing may look for alternative locations. Foxconn⁴, the Taiwanese manufacturer of iPhones and iPads for Apple, announced it is considering moving its low-end manufacturing from China to Indonesia in an attempt to access large labor markets with basic manufacturing skills and relatively lower labor costs.

Keeping overall FDI inflows at a high level, is investment into China’s service sector, which is more than making up for decreasing manufacturing FDI: service sector FDI increased by nearly 21 percent⁶ year-on-year in the first quarter. Services span multiple industries and may include investments in industrials, consumer goods and services, high-technology, healthcare, real estate and financial services.

Regional Analysis

Eastern China took the lion’s share of FDI in the first quarter, at USD25.07 billion, but grew by only 0.11 percent year-on-year. The Central and Western regions received USD3.61 billion and USD2.87 billion, but grew by 45 percent and 21 percent respectively. Xi’an, in China’s Central region, and Chongqing and Chengdu in the Western region remain top regional growth areas for foreign investment.⁷


© 2014 KPMG International Cooperative (“KPMG International”), a Swiss entity. Member firms of the KPMG network of independent firms are affiliated with KPMG International. KPMG International provides no client services. No member firm has any authority to obligate or bind KPMG International or any other member firm third parties, nor does KPMG International have any such authority to obligate or bind any member firm. All rights reserved.
Industrials: Jardine Matheson Holdings acquires a 20 percent stake in Zhongsheng Group Holdings for USD731 million. The deal follows a banner year for automobile sales, which rose by 13 percent in 2013 as China became the first country to sell over 20 million vehicles in a year.

Consumer Goods/Services: Danone acquires a 6 percent stake in Mengniu Dairy Co. for USD664 million. Foreign dairy companies may seek to extend their presence in China’s yogurt market and capitalize on yogurt’s relatively faster growth rate in China than the fresh dairy products sector.

Financial Services: OCBC acquires a 5 percent stake in The Bank of Ningbo for USD532 million.

Jenny Yao
Director, Healthcare, Management Consulting
KPMG China

“In the coming years, with China’s aging population and increasing demand for high quality healthcare services, international healthcare investors and well-known healthcare and elderly care operators have a huge opportunity to grow and expand in China.”

---

Inbound M&A

There were a total of 104 ‘announced’ or ‘completed’ inbound M&A deals through the first quarter of 2014, versus 131 through the first quarter of 2013, representing a 21 percent drop in year-on-year deal activity. Total deal value also dropped off during the first quarter, down 38 percent year-on-year. The drop in M&A deals in Q1 contrasts with overall FDI growth in the first quarter, which was up 5.5 percent year-on-year.

However, according to Mark Harrison, Director, Transactions and Restructuring, KPMG China, “There’s a time lag between when deals are being worked on and when they are announced or completed. We are not seeing a slowdown of M&A into China this year: instead we’re seeing a significant upswing of interest and activity, particularly in high-end manufacturing, consumer goods and services, agribusiness and healthcare.”

China’s industrials and real estate industries saw substantially more investment from Europe, Singapore and Hong Kong in the first quarter of 2013, compared to the current quarter. On the other hand, the value of deals in the financial services sector, agribusiness and materials were all up year-on-year. The Industrials sector includes: industrial services, transportation, general logistics and warehousing, high-end manufacturing and engineering, as well as auto equipment parts and servicing.

Although there were no significant deals in the healthcare sector in the first quarter, the healthcare industry should see greater and continued foreign interest. This is because the advancement of healthcare in China is supported by the 12th Five-Year Plan and China’s National New-Type Urbanization Plan 2014-2020 plan for future growth. Foreign business can participate via M&A, and on January 9th, 2014, a circular by the National Health and Family Planning Commission (NHFPC) announced that Taiwan, Macau, and Hong Kong investors may now run their own hospitals inside China.

---

8. Dealogic accessed 1 April 2014, KPMG Analysis
About KPMG’s Global China Practice (GCP)

KPMG’s Global China Practice (GCP) was established in September 2010 to assist Chinese businesses that plan to go global, and multinational companies that aim to enter or expand into the China market. The GCP team in Beijing comprises senior management and staff members responsible for business development, market services, and research and insights on foreign investment issues.

There are currently over 50 China Practices in key investment locations around the world, from Canada to Cambodia and from Poland to Peru. These China Practices comprise locally based Chinese-speakers and other professionals with strong cross-border China investment experience. They are familiar with Chinese and local culture and business practices, allowing them to effectively communicate between member firms’ Chinese clients and local businesses and government agencies.

The China Practices also assist investors with China entry and expansion plans, and on both inbound and outbound China investments provide assistance on matters across the investment life cycle, including market entry strategy, location studies, investment holding structuring, tax planning and compliance, supply chain management, M&A advisory and post-deal integration.