Charltons - China News Alerts Newsletter - 12 July 2010

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# China News Alert Issue 346

## Capital Markets

### Foreign firms still keen on China

Foreign companies operating in China and other experts have reiterated that the nation is still an attractive destination for investors. The government has been actively trying to remove restrictions and improve the rules and regulations facilitating foreign direct investment, they said.

Concerns that the investment climate in the nation is deteriorating surfaced earlier after the World Bank Group said in a report that restrictive and obsolete laws are acting as impediments to foreign direct investment (FDI) worldwide. The report said poor implementation of laws is resulting in additional investment costs.

Though China is also included in the Investing Across Borders 2010 report, it does not elaborate on the specific nations and regions.

The report is the first by the World Bank Group that offers objective data on the laws and regulations related to FDI worldwide, and covers over 87 nations and regions.

"Clear and effective laws and regulations are vital for ensuring best results for host economies, their citizens and investors," said Janamitra Devan, vice-president of Financial and Private Sector Development under the World Bank Group.

The agency said detailed information on the investment environment in the nations, including China, will be released over the next few days.

The report follows a recent European Chamber of Commerce study that expects the regulatory environment in China to worsen in the next two years.

"I don't think the arguments are representative and fair. To be frank, there were restrictions and unfavourable rules against foreign enterprises. But under the new FDI guidelines there are very few restrictions," said Wang Zhile, director of the research center on transnational corporations under the Ministry of Commerce. "What I am really concerned about is how to implement the new guidelines," he said.

In April, the State Council issued new guidelines that are considered a turning point for China's FDI policies.

"China realises the significance of FDI in stimulating economic growth. There is no doubt that China will welcome more foreign investment," said Wang.

Part of Wang's optimism also stems from the good vibes his delegation received during their recent visit to Europe. "The interviews with most of the companies who have operations in China revealed that they are fairly satisfied with the present regulatory environment," Wang said.

A recent report in the Financial Times said China is turning more hostile against international companies, quoting the chief executive officer of General Electric (GE). Responding to the report, GE China said most of the stories published by the foreign media were taken out of context and, in some instances, reported in an inaccurate and misleading manner.

"With more than US$2 billion invested, GE continues to grow its operations through partnerships with Chinese companies and the government. We have strong confidence and faith in the China market and will continue our commitment to make China our second home," the statement said.

According to the United Nations Conference on Trade and Development, China outperformed the rest of the world in 2009 as a FDI destination. Last year, the FDI that China absorbed dropped 2.6 percent, while the global FDI plummeted by almost 40 percent.

The research center on transnational corporations under the Ministry of Commerce expects FDI to increase this year under the new guidelines.

In a recent interview, John Watkins, chairman of the American Chamber of Commerce in China, said. "China is an opportunity for most American companies, be it the industrial sector, the consumer sector or the retail sector. The nation represents most of the opportunities in the near term for many of our members."

[Source: China Daily](http://www.chinadaily.com.cn/bizchina/2010-07/08/content_10079992.htm) ([see archive](Foreign_firms_still_gung_ho_on_China.pdf))

### Hot money inflow puts Government in a quandary

The government is facing pressure to curb abnormal capital inflow into the country, the State Administration of Foreign Exchange (SAFE) said, even as analysts warned that such pressures would remain given the expected gradual appreciation of the currency.

The rampant dollar carry trade, the interest rate difference between the yuan and the dollar, and expectations of yuan appreciation are causes of such capital inflow, the foreign exchange regulator said in a statement. "The task of promoting the balance of international payments remains challenging," it said.

The interest rate difference between the two currencies is about 2 percentage points, which encourages cross-border carry trade. China's decision to make the yuan more flexible against a basket of currencies on 19th June has fanned expectations that the yuan would appreciate gradually against the dollar.

While analysts said the yuan's value would not change dramatically against the dollar in the short term, it would continue to rise gradually.

"China cannot afford a one-off revaluation of the yuan," said Li Jianjun, an economist with the Central University of Finance and Economics. "The expected gradual appreciation, however, would lead to continued inflows of speculative capital."

According to Li there should have been huge inflow of speculative capital in the first half of the year, taking into consideration the trade and capital account figures. "They may have come into China in the name of trade transactions," he said.

In the long run, thanks to the loose monetary policy of the US, the dollar would turn weak, despite its recent strong rises against a turbulent euro, Li said. That in turn, means that the relatively strong yuan would see more capital inflow.

The regulator, however, said capital flow could be a two-way movement. "If the dollar's interest rate and exchange rate rise continually, it could lead to capital outflows and it cannot be excluded that some accidents hurt market confidence (in Europe) and cause abnormal cross-border capital flow.“

The pressure of net foreign exchange inflows eased in May compared with in April, the peak period for such inflow, the regulator said, because of declining expectations that the yuan would gain.

The yuan has risen more than 0.7 percent against the dollar since the central bank decided to end a two-year yuan peg to the dollar on 19th June. However, the US has said the pace is far too slow, despite widespread concerns within China that fast yuan appreciation would be detrimental to trade and overall economic growth.

The International Monetary Fund said that China's gross domestic product is expected to grow by 10.5 percent year-on-year this year, compared with 11.9 percent for the first quarter.

Top policymakers have expressed concern about an economic slowdown in the second half of this year. The real estate tightening policies, controls on bank lending and external uncertainties, such as the European debt crisis, have dampened growth prospects.

Many economists expect the government to fine-tune its policies after the release of the second-quarter economic indicators on 15th July to prevent a serious slowdown.

The central bank said that it will maintain its moderately loose monetary policy. "[We] will closely monitor the development of the economic and financial situation and ensure proper growth of lending," it said in a statement after a quarterly monetary policy meeting.

[Source: China Daily](http://www.chinadaily.com.cn/bizchina/2010-07/09/content_10085961.htm) ([see archive](Hot_money_inflows_put_govt_in_a_quandary.pdf))

### Green norms for overseas investment soon

The government will soon come out with environmental protection guidelines for domestic companies planning overseas investments, ministry officials have said.

According to experts, the guidelines will enhance the nation's "soft power" in the global arena and foster more investment deals.

Domestic companies that have overseas operations will have to take adequate steps to protect the environment and shoulder more corporate social responsibility (CSR), they said.

The new rules will help improve the quality of overseas investments and are called Chinese Overseas Direct Investment Environment Protection Guidelines, said Yang Zhaofei, director-general of the Department of Policies, Laws and Regulations under the Ministry of Environmental Protection.

The commerce and environment protection ministries and the China Banking Regulatory Commission are also involved in drafting the guidelines.

The rules will include other factors like the evaluation of environmental impact, agreed protection mechanism, compensation and CSR, said Yang without revealing a timeframe for the guidelines.

"Companies that violate the rules will have to pay for their actions, and in some cases stop overseas investments," he said.

The government move comes at a time when Chinese companies have been accused by the foreign media of going ahead with investment plans without considering the impact on the local environment and communities.

"Objectively speaking, there do exist cases that have caused damage and tarnished the reputation of Chinese overseas enterprises. Therefore, there is an urgent need to standardise overseas investments and improve quality," said Zhang Lijun, director of the Department of Asia Affairs under the Ministry of Foreign Affairs.

"The overseas performance of domestic companies reflects the image and influence of the Chinese government, and is also an important indicator of the nation's soft power," Zhang said at a forum on environmental policies in Beijing.

Though a draft proposal was submitted to the Chinese government some time back, negotiations among the concerned ministries are still ongoing.

"It is really difficult to make everyone happy about the guidelines, and there are many uncertainties," said Ge Chazhong, a researcher at the Chinese Academy for Environmental Planning under the Ministry of Environmental Protection. China must have rules to guide and standardise overseas investment, he said.

The global economic crisis has not dampened the overseas investment confidence of Chinese companies. Last year overseas direct investment in non-financial sectors surged 6.5 percent year-on-year to US$43.3 billion. Prospects for this year are also bright, with the Ministry of Commerce expecting overseas direct investment to touch US$60 billion.

Most of the overseas direct investment has been in Asia, Africa and Latin America, in manufacturing, wholesale, retail and commercial sectors. Mining and resource-related sectors are also emerging as a new investment focus for Chinese companies. But along with the growth, there have also been complaints that some investments are not green and socially responsible.

"Many foreign nations are prejudiced against China and its investments. On the one hand, they want more Chinese investment, but at the same time are probably not comfortable with the nation's growing prowess," said Zhang.

[Source: China Daily](http://www.chinadaily.com.cn/bizchina/2010-07/09/content_10085740.htm) ([see archive](Green_norms_for_overseas_investment_soon.pdf))

### China Post to list unit in Shanghai

China Post, the official postal service of China, is planning to list the shares of China Postal Express & Logistics Corporation, its express and logistics unit, in Shanghai or Shenzhen next year, a source familiar with the matter said.

The float will make China Postal Express & Logistics Corporation the first listed express company in China, said Shao Zhonglin, deputy secretary-general of the China Express Association.

The integrated unit was set up with a registered capital of 200 million yuan (US$29.51 million) on 29th June and combines the express and logistics operations of the group.

Liu Andong, general manager of China Post, said the integration of the express unit EMS Corporation and the logistics arm China Post Logistics Company Limited was part of the plans to transform itself into a modernised post group.

EMS was established in 1985 to operate the country's postal express mail service, while China Post Logistics was founded in 2003 to manage comprehensive businesses such as warehousing, distribution, and transportation.

In 2009, EMS earned revenue of around 15 billion yuan, and was the market leader in China, said a 5th July report in the 21st Century Business Herald.

The new entity will own the "all night" cargo aviation network and also have the largest domestic express service network. It will also promote resource sharing between the two sectors and help reduce costs, said the group.

Zhang Hui, an analyst tracking the logistics sector at Donghai Securities, said China Post is likely to use the high quality assets of the express sector to guarantee profits and attract investors. The company may, however, use the float proceeds for the less developed logistics business.

Zhang expects the company to raise no more than 1 billion yuan from the IPO, aided by strategic investors from the airlines sector.

Analysts said the thorniest issue for the new company will be on how to divide the business between Express & Logistics Corporation and the parent group. "That means there will be a lot of overlapping transactions between the two companies. Both companies will have problems on how to factor the relevant costs," said Xu Yong, chief advisor of China Express Consulting Website.

There are problems also, if the company opts for a clear division of its businesses and finances as it may end up facing internal competition, said Zhang.

"The float will not only benefit China Post, but also the private sector," said Wei Dengming, deputy director of the Enterprise Development Department at ZJS Express, a private express delivery company in China.

China Post owned 1.802 million shares of Hunan Copote Science & Technology Company Limited and was planning a back-door listing. However, the plan was abandoned and the shares were transferred to another postal institute in May.

Postal services are generally government-controlled and very few have actually tested the market waters.

German postal operator Deutsche Post was one of the early birds in the market and listed shares of its subsidiary on the Frankfurt bourse in 2000. The subsidiary is the biggest listed logistics company in the world and is now called Deutsche Post DHL.

[Source: China Daily](http://www.chinadaily.com.cn/bizchina/2010-07/09/content_10085565.htm) ([see archive](China_Post_to_list_unit_in_Shanghai.pdf))

### China to keep yuan basically stable

China's foreign exchange regulator said it will keep the exchange rate of the yuan, China's currency Renminbi (RMB), basically stable at a reasonable and balanced level.

In a Q & A statement on its website, the State Administration of Foreign Exchange (SAFE), the regulator, said under the current regulation, the daily trading price of the RMB against the U.S. dollar on the inter-bank foreign exchange market is allowed to float within a band of 0.5 percent from the central parity rate, which is announced by the China Foreign Exchange Trading System each day.

The price difference between quoted non-cash U.S. dollar selling and buying prices offered by banks shall not exceed 1 percent of the central parity, the SAFE said.

The price difference between the quoted U.S. dollar cash selling and buying prices offered by banks shall not exceed 4 percent of the central parity, according to the statement.

The central parity rate of the yuan to the U.S. dollar stood at 6.7768 on 8th July, according to data released by the China Foreign Exchange Trading System.

The yuan-dollar central parity rate was 6.7720 on 2nd July, the strongest since July 2005.

China's central bank announced on 19th June that it would further the reform of the formation mechanism of the yuan exchange rate to improve its flexibility.

The regulator said capital inflow pressures have eased since May partly due to weaker expectations for yuan appreciation.

Net foreign exchange inflows have fallen 56 percent in May compared to April's level, the SAFE added.

[Source: People's Daily](http://english.people.com.cn/90001/90778/90862/7058369.html) ([see archive](China_to_keep_yuan_basically_stable_SAFE.pdf))

## Other

### Resource tax set to boost local economy

China's decision to extend the pilot resources tax to all western areas of the country will squeeze excessive profits out of the country's resource producers through higher tax costs and will promote the efficient extraction of natural resources in the long run, analysts said.

On 8th July, the National Development and Reform Commission (NDRC), the country's top economic planner, announced a plan to extend the pilot tax scheme introduced last month in Xinjiang Uygur autonomous region to all 12 provinces and autonomous regions in the west and soon across the entire nation.

The benchmark rate will be set at 5 percent and vary across commodities, according to the NDRC. The levy will be based on prices instead of the volume of the commodities produced and will be broadened to apply to coal, crude oil and natural gas.

Industry analysts said that the new tax policy will reduce the profitability of major resource producers such as PetroChina Company Limited and China Petroleum and Chemical Corporation, known as Sinopec, as it will result in higher tax costs for them.

"We estimate that PetroChina and Sinopec will see an increase in resource tax payments of 17.9 billion yuan (US$2.64 billion) and 6.4 billion yuan respectively if the reform goes nationwide," said Yan Beina, a Shanghai-based analyst at Guosen Securities.

"That would bring down their earnings per share by 0.07 yuan and 0.06 yuan respectively," she added.

The country's top coal miners, including China Shenhua Energy Company Limited and China Coal Energy Company Limited, will also be affected by the tax, but the impact varies based on their exposure to the region, analysts said.

Almost all of Shenhua's upstream resources are located in the western region, mostly in Inner Mongolia autonomous region and Shaanxi province, while less than 5 percent of China Coal's mines are in the region, according to production figures for 2009.

Jing Ulrich, managing director and chairman of China equities and commodities at JP Morgan Chase & Company, noted in a report that policymakers in Beijing may establish a lower tax rate for coal which serves as the country's mainstay fuel than for natural gas and crude oil amid concerns over inflation and maintaining the profitability of downstream industries.

The resource tax reform is also widely considered a significant move by the central government to support local economies in the resource-rich western regions that remain underdeveloped relative to the country's coastal areas, Ulrich said.

"The reform will help reduce economic imbalances between the lesser-developed but resource-rich regions of western China and the nation's coastal centers," she said. "It will also bolster local government finances since a higher proportion of the resource tax will be paid locally."

The resources tax reform is part of a new round of Beijing's supportive measure to boost the country's western regions which include the 682.2 billion yuan investment in 23 new major infrastructure projects and the continuation of a preferential 15 percent corporate income tax rate for a period of ten years to support the development of favored industries in western regions.

Market watchers said that, in the long term, the favourable policies will boost local economies and market confidence.

[Source: People's Daily](http://english.people.com.cn/90001/90778/90862/7058998.html) ([see archive](Resource_tax_set_to_boost_local_economy.pdf))

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