

—The macroeconomy—

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Summary

September's economic indicators improved slightly on August, particularly when it came to domestic demand. Amid bullish employment and earnings conditions, domestic consumption has been pulled along by the property and automobile sectors (themselves supported by government policy), but with housing policy being tightening in cities with fast-rising property prices, for instance, there are doubts about whether consumption will continue to move bullishly on policy support.

1. September's economic indicators improved slightly, particularly when it came to domestic demand

- **Growth hit +6.7% in July–September too**
- **Production fell slightly**
- **Retail sales of consumer goods accelerated**
- **Exports and imports both fell**
- **The CPI rose; the PPI moved into positive territories**
- **There was a net increase in new loans, with total social financing also increasing**

2. Topic: The State Council announces measures to reduce enterprise leverage ratios and promote debt-to-equity swaps

- **From here on, debt-to-equity swaps will be targeted at reducing enterprise leverage ratios rather than non-performing loans in the banking sector (Wang Zhaoxing, Assistant Chairman of the China Banking Regulatory Commission (CBRC))**

1. September’s economic indicators improved slightly, particularly when it came to domestic demand

•Growth hit +6.7% in July-September too

On October 19, the National Bureau of Statistics (NBS) announced that China’s real GDP (gross domestic product) had grown by 6.7% on the same period last year (all figures from here on refer to ‘same-period previous-year’ unless otherwise specified) in both January–September and July–September¹. This was the same level as recorded in January–March and April–June, when growth had dipped to its lowest levels since January–March, 2009 (+6.2%), some seven years ago. This remained within the government’s target range of between 6.5 and 7 percent (see Figs. 1 and 2). Growth was up 1.8% on the previous quarter.

Fig. 1: GDP and major economic indicators (quarterly)

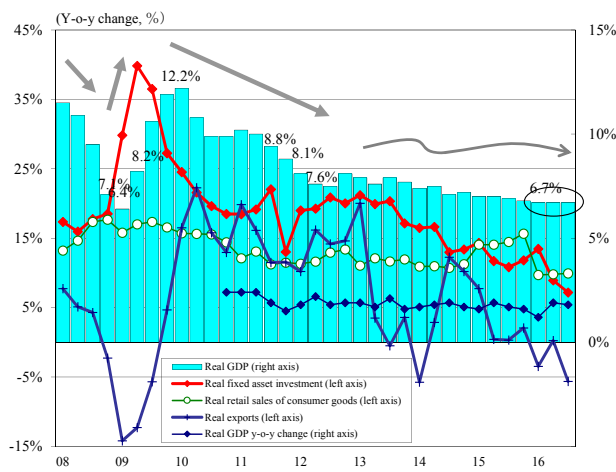
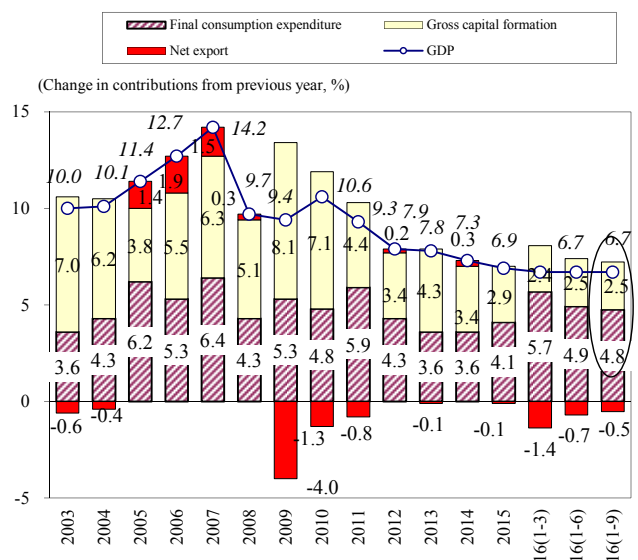


Fig. 2: Breakdown of GDP by demand item



Note: The real RMB value of exports is indexed using the production price index (PPI); the real value of fixed asset investments is indexed using the price index of investment in fixed assets; and the real value of retail sales of consumer goods is indexed using the retail price index (RPI).

Source: National Bureau of Statistics of China, CEIC

Source: National Bureau of Statistics of China, CEIC

Production fell slightly

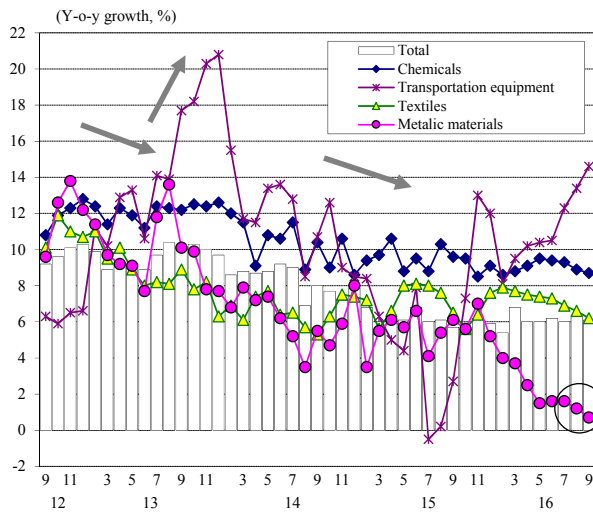
September’s economic indicators improved slightly on August, particularly when it came to domestic demand. The value-added industrial production figure rose by 6.1% in September, a slide on August’s figure of +6.3% (+0.5% month-on-month) (see Fig. 3). At +6.0%, the aggregate figure for January–September was down on 2015’s result of +6.9%. The production of metallic materials (ferrous metal refining and strip processing) dipped, as it had done in August², a phenomenon linked to moves to eliminate overcapacity.

¹ National Bureau of Statistics, October 19, 2016: 前三季度国民经济运行稳中有进、稳中提质 (The National Economy Grew Steadily with Progress Made and Quality Improved in January - September of 2016)

http://www.stats.gov.cn/tjsj/zxfb/201610/t20161019_1411224.html

² At +9.8%, though, the processed metals sector continued to grow faster than overall industrial production.

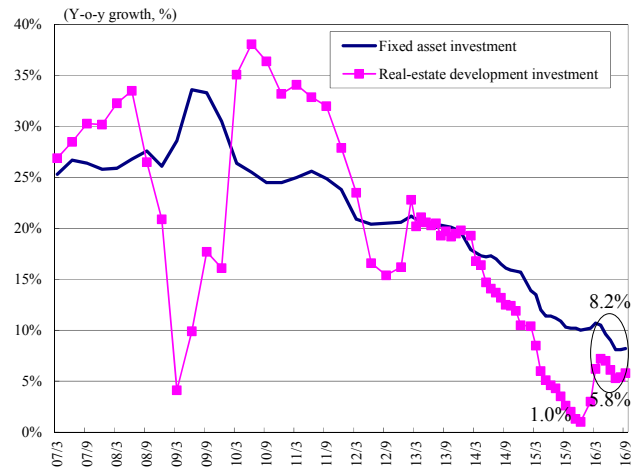
Fig. 3: Value-added industrial production



Note: The value-added industrial production amount. The figure for January shows the aggregate year-on-year change for the period January–February. Transportation equipment has meant automobiles since March 2012.

Source: CEIC

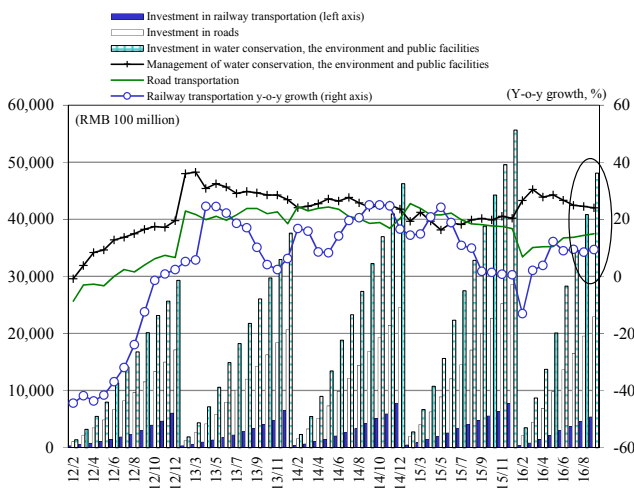
Fig. 4: Fixed asset investment



Note: The figures show a same-period previous-year comparison of the cumulative results for periods lasting from the beginning of the target year until the month in question. The figures for the end of March, June, September, and December were listed until the end of 2012; the monthly figures were listed from 2013 onwards.

Source: National Bureau of Statistics of China, CEIC

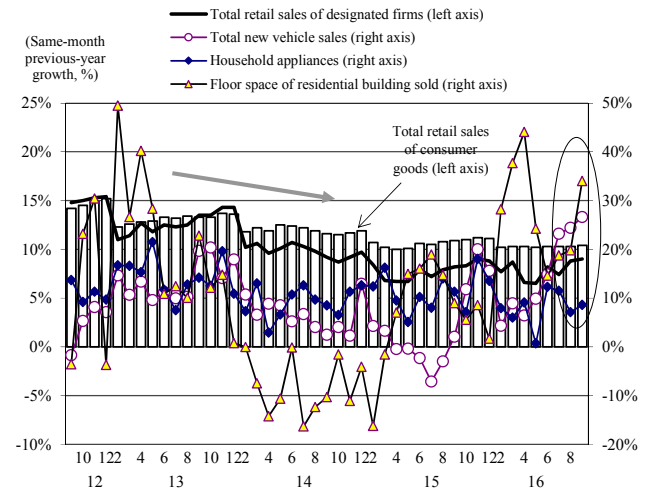
Fig. 5: Fixed asset investments in railways, roads, water conservation and the environment



Note: The figures show the cumulative results and a same-period previous-year comparison for periods lasting from the beginning of the target year until the month in question.

Source: National Bureau of Statistics of China, CEIC

Fig. 6: Retail sales of consumer goods; retail sales by item; floor space of residential building sold



Note: Designated firms: firms with an annual turnover of RMB 5 million or over; the household appliance data also refers to sales by these designated companies; February = the cumulative results for January–February.

Source: CEIC

Nominal fixed asset investment stood at a cumulative +8.2% over January–September, up slightly on January–August’s figure of +8.1%, though this was down on 2015’s result of +10.0% (the standalone m-o-m figure for

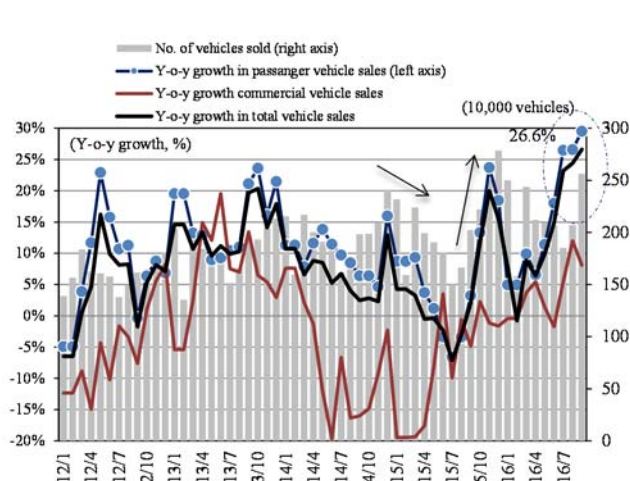
September was +0.5%). At +9.0%³, meanwhile, the standalone figure for September was up on August's figure of +8.2%. The aggregate data for January–September shows investment in real-estate development rising to +5.8% (January–August: +5.4%) (see Fig.4).

Investment in the management of water conservation, the environment and public facilities stood at 24.0% in January–September. Though this was up slightly on 2015's figure of +20.4%, it was down slightly on January–August's figure of +24.5% (see Fig.5).

•Retail sales of consumer goods accelerated

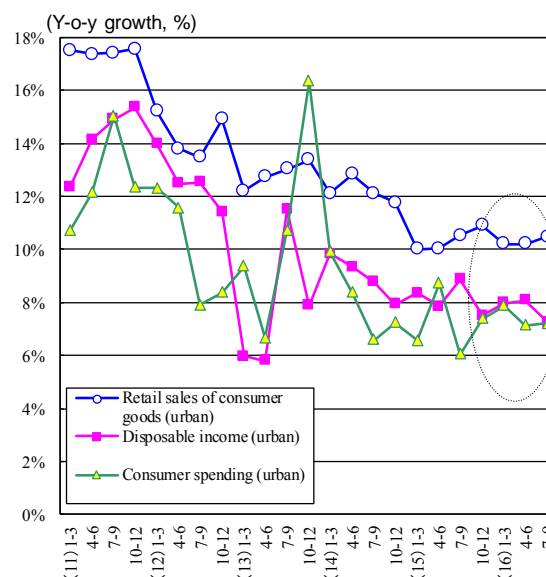
Nominal retail sales of consumer goods grew by 10.7% in September, up on the +10.6% recorded in August. Once inflationary factors were removed from the equation, real growth stood at +9.6%, a deceleration on August's figure of +10.2% (+0.9% m-o-m) (see Fig. 6). The aggregate figure for January–September stood at +10.4%, down on the +10.7% recorded in 2015. Internet retail sales grew by 26.1% to hit RMB 3,465.1 billion (goods: RMB 2,795 billion/+25.1%), with net shopping accounting for 11.7% of all retail sales of consumer goods.

Fig. 7: Number of vehicles sold (by passenger vehicles and commercial vehicles)



Note: The figure for January and February shows cumulative y-o-y growth for the period January–February.
Source: China Association of Automobile Manufacturers, CEIC

Fig. 8: A comparison of (urban) retail and wage statistics



Source: CEIC

The floor space of residential buildings sold grew by 34.0% (177.34 million m²) in September. The aggregate figure for January–September stood at +26.9% (1,051.85 million m²), with the floor space of residential buildings sold expanding for 17 successive months since April 2015, when the standalone monthly figure returned to positive territories for the first time since December 2013. At +34.0%, September's standalone figure was up sharply on August's +19.8%. The recovery in homes sales was supported by moves to prop up the property market. The People's Bank of China (PBOC) lowered deposit and lending rates six times from November 2014, for example,

³ The aggregate figure for January–September was used to calculate the monthly result and the y-o-y rate of change.

while the (lowest) down payment rate for second homebuyers was cut from 60% to 40% (on March 30, 2015) and the down payment rate for first-time homebuyers was lowered to 25% (on September 30, 2015). The buying restrictions pioneering in Shanghai and Shenzhen⁴ have subsequently spread to other cities with surging house prices⁵, so they may impact homes sales in these cities going forward.

2.564 million new vehicles were sold in September (+26.6%), with the number of vehicles sold and the growth rate improving on August (2.071 million; +24.4% (see Fig. 7)). The recovery continues to be propelled by the cut in the purchase tax on small vehicles⁶ (instituted in October 2015). A total of 19.293 million new vehicles were sold over January–September, with sales growing by +13.2% (2015: +4.6%; 2014: +6.8%).

In a press conference on October 19⁷, Sheng Laiyun, Spokesperson of the NBS, said the firm retail sales data was due to relatively robust employment conditions, stable household income growth and firm consumer sentiments⁸. Urban disposable incomes grew by +7.3% in July–September. Though this was down on April–June’s figure of +8.1%, it still represented strong growth (see Fig. 8). Sheng Laiyun said there were three structural factors behind this buoyant consumption: (1) brisk sales of automobiles before the tax cuts on small passenger cars expire at the end of 2016; (2) robust sales of interior decorations, household articles and appliances, etc. following a rise in homes sales; and (3) the ongoing growth of consumption in sectors like culture, education, nursing (elderly care), health and insurance, etc. as consumption grows more sophisticated (consumption structure upgrading). Factors (1) and (2) are the results of government policies and there remain doubts about their sustainability.

⁴ On March 25, Shanghai raised the down payment rate for second homebuyers from 40% to 50–70%. Shenzhen has lifted the down payment rate for second homebuyers from 30% to 40%. Both of these amount to a tightening of the rules on purchases by non-resident buyers.

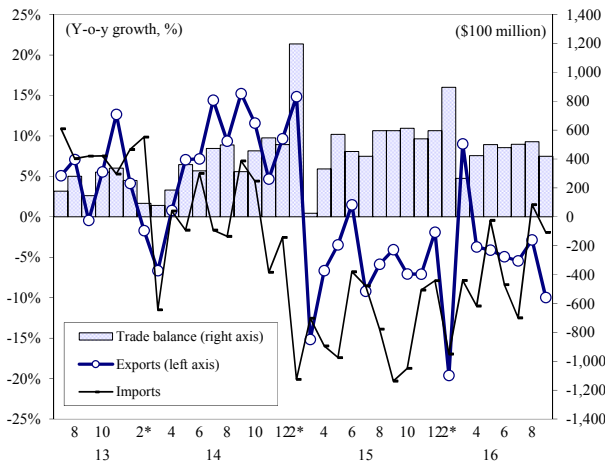
⁵ According to an article entitled 限购、限贷，近期已有 20 城市推出新举措楼市调控因城施策 (Restrictions on housing purchases and loans recently introduced in 20 cities: Restrictions geared to meet the circumstances of each city), published in the People’s Daily on October 11, restrictions on housing purchases were introduced in 20 cities at the time the article was written.
<http://www.fangchan.com/news/6/2016-10-11/6191397283909931925.html>

⁶ On September 29, 2015, the Finance Ministry and the State Administration of Taxation issued Notice No. 104 [2015], 财政部 国家税务总局关于减征 1.6 升及以下排量乘用车车辆购置税的通知 (Finance Ministry and State Administration of Taxation Circular on the lowering of the purchase tax on passenger vehicles with emissions of 1,600cc or less.) 财税[2015]104 号 This announced that the purchase tax on passenger vehicles with emissions of 1,600cc or less would be lowered from 10% to 5% from October 1, 2015 to the end of 2016.
<http://www.chinatax.gov.cn/n810341/n810755/c1827947/content.html>

⁷ National Bureau of Statistics, October 19, 2016: 国家统计局新闻发言人就 2016 年前三季度国民经济运行情况答记者问 (A spokesperson for the National Bureau of Statistics answers press questions about the performance of the national economy over January–September)
http://www.stats.gov.cn/tjsj/sjjd/201610/t20161019_1411444.html

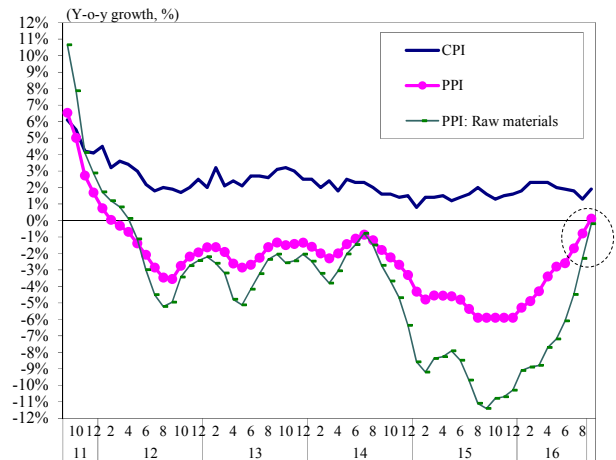
⁸ See footnote 7

Fig. 9: Imports/exports; trade balance



Note: * Same-period previous-year growth and cumulative figures for January–February.
Source: China Customs Statistics

Fig. 10: CPI, PPI

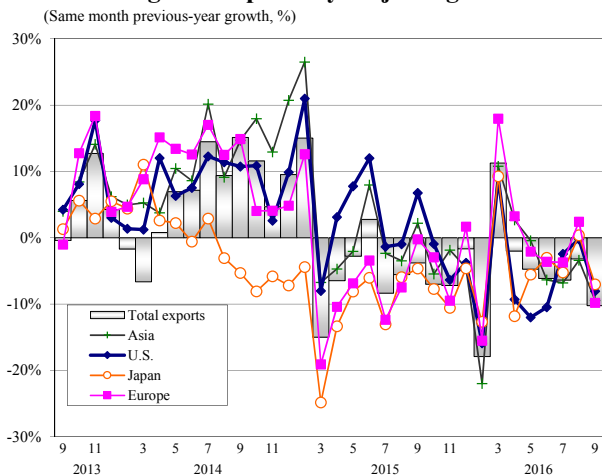


Source: National Bureau of Statistics of China, CEIC

Exports and imports both fell

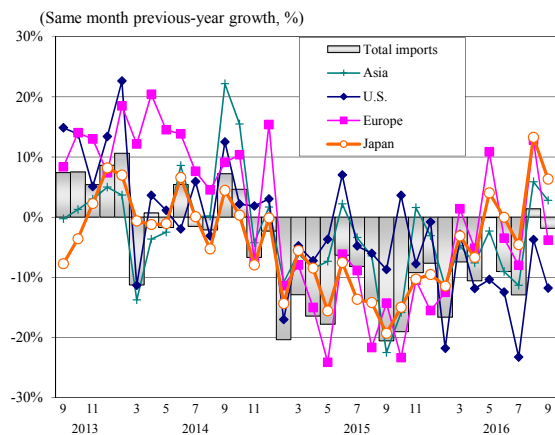
Exports were down 10.0% in September (\$184.51 billion), while imports fell by 1.9% (\$142.52 billion), with the monthly trade surplus standing at \$41.99 billion. Both exports and imports were down on August’s figures of -2.8% and +1.5%, respectively. Aggregate exports for January–September were down by 7.5% (\$1,537.01 billion), while imports fell by 8.2% (\$1,140.66 billion), with the trade surplus hitting \$396.36 billion. Total trade fell by 7.8% in the same period, a slight improvement on January-August’s figure of -7.9% (see Figs. 9, 11 and 12). With total trade having fallen by 8.0% in 2015, it seems the Chinese government is on the way to achieving its 2016 goal of ‘a steady rise in import and export volumes’ (= total trade shrinking at a slower pace).

Fig. 11: Exports by major region



Note: The figure for February shows a same-period previous-year comparison of the cumulative results for January–February.
Source: China Customs Statistics, CEIC

Fig. 12: Imports by major region



Note: The figure for February shows a same-period previous-year comparison of the cumulative results for January–February.
Source: China Customs Statistics, CEIC

•The CPI rose; the PPI moved into positive territories

In September, CPI (Consumer Price Index) growth stood at +1.9%, up on August's figure of +1.3%. CPI growth stood at +0.1% on a monthly basis, down on August's figure of +0.2% (see Fig. 10). At +2.0%, the average figure for January–September came in below the government's target of +3.0%. A breakdown of the CPI data shows food prices rising 3.2% in September, up on August's figure of +1.3% (see Fig. 13). At 54.87 million tons, pork output dipped by 3.3% y-o-y in 2015. As with 2007 and 2011, this pointed to the impact of the pork cycle⁹, with prices continuing to rise on the whole, though price inflation slowed to +5.8% in September¹⁰ (see Fig. 14). At +1.6%, September non-food price rises were up on August (+1.4%).

At +0.1%, the PPI (Producer Price Index) returned to positive growth for the first time since February 2012 (+0.03%) (see Fig. 10). PPI growth stood at +0.5% on a monthly basis, up on August's figure of +0.2%. The NBS said the PPI had been pushed into positive territories primarily by growth in three sectors: Manufacture and Processing of Ferrous Metals (+10.1%), Manufacture and Processing of Non-ferrous Metals (+1.2%) and Mining and Washing of Coal (+4.1%; the first time this sector had recorded positive growth since July 2012). These three sectors contributed 0.8%Pt to the PPI growth rate¹¹.

Production in these sectors had slowed or fallen over the latter half of 2015 on moves to eliminate overcapacity in the steel and coal industries. At the same time, international commodity markets have started to recover, while supply and demand conditions in both industries are being impacted by rising home sales in regions centered around first-tier and second-tier cities. This probably explains why the PPI has returned to positive growth. According to Sheng Laiyun, spokesperson of the NBS, this represented the most immediate impact of the government's structural reforms¹². However, production is recovering and rising in these industries as a result of the aforementioned market improvements, so whether the PPI can remain in positive territories depends on how supply and demand conditions develop from here on.

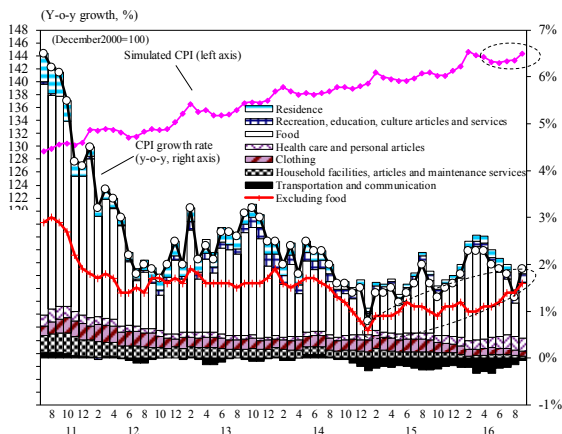
⁹ This is a cycle whereby: farmers respond to lower pork prices by raising fewer pigs→supply falls and prices rise→farmers increase output→supply increases and prices stabilize→farmers raise fewer pigs→ supply falls and prices rise

¹⁰ According to 猪周期未破“进口猪”来袭 生猪缘何难脱价格怪圈 (‘Why can't pork prices escape a vicious circle: ‘Imported pork’ invades China before the pork cycle breaks’), an article published in China Securities Journal on October 17, the recent slowdown in pork price inflation was because (1) market supply increased over September–November after the piglet survival rate rose over March–April and (2) pork imports over January–August more than doubled compared to 2015. In other words, pork imports increased as the U.S. posted a pork surplus.
http://news.xinhuanet.com/info/2016-10/17/c_135759902.htm

¹¹ National Bureau of Statistics, October 14, 2016: 「国家统计局城市司高级统计师余秋梅解读 2016 年 9 月份 CPI、PPI 数据 (Yu Qiumei, a senior statistician at the National Bureau of Statistics, deciphers the September 2016 CPI and PPI data)
http://www.stats.gov.cn/tjsj/sjjd/201610/t20161014_1409508.html

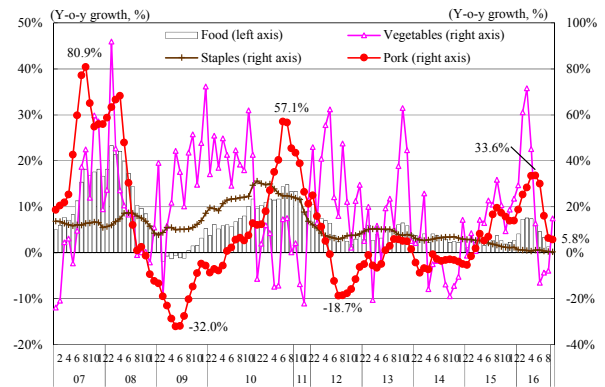
¹² See footnote 7

Fig. 13: CPI; Growth contribution by item



Note: The contribution rate of each item is calculated by Mizuho Bank (China) based on the y-o-y growth rate and consumption expenditure statistics for each item. The simulated CPI data is calculated by Mizuho Bank (China) based on the m-o-m growth rate for each month, with December 2000 as the base month.
Source: National Bureau of Statistics of China, CEIC

Fig. 14: Food prices

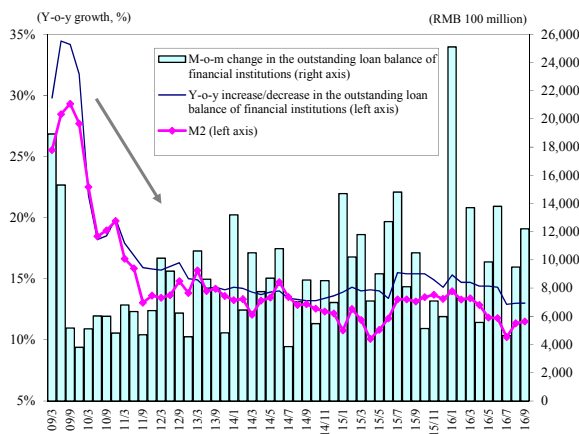


Note: The figures in the graph denote the highest, lowest and most-recent prices of pork
Source: National Bureau of Statistics of China, CEIC

There was a net increase in new loans, with total social financing also increasing

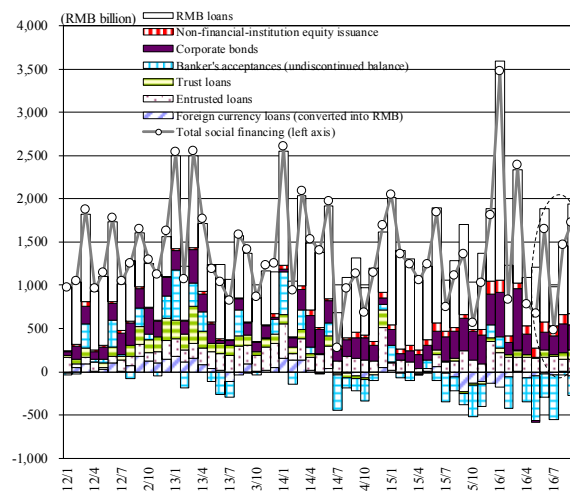
According to the PBOC, the M2 money supply continued to expand in September. It grew by 11.5%, up on August's figure of +11.4%. However, it remained below the government's target of +13% (see Fig. 15). New bank loans increased by a net RMB 1.22 trillion in September, up from RMB 948.7 billion in August. Housing loans to individuals accounted for 39.0% of this figure. They hit RMB 475.9 billion, up sharply by RMB 205.5 billion on the same month last year¹³.

Fig. 15: Financial institution lending; the money supply



Note: The graph shows end-of-quarter figures up until the end of 2013. The figure in the graph shows the y-o-y change in the outstanding loan balance for the most recent month.
Source: PBOC, CEIC

Fig. 16: Total social financing



Source: PBOC, CEIC

Total social financing also expanded by a net RMB 1,720 billion, up from RMB 1,469.7 billion in August. A glance

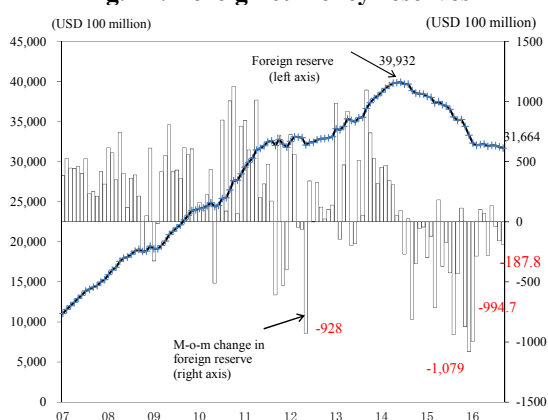
¹³Economic Daily News, October 19, 2016: 金融机构加大力度支持企业贷款融资 (Financial institutions enhance their corporate lending support) http://www.bj.xinhuanet.com/hbpd/jrpd/jrpd/2016-10/19/c_1119747793.htm

at the details reveals that: RMB loans, trust loans and non-financial-institution equity issuances increased; entrusted loans and corporate bonds decreased; and foreign currency loans (converted into RMB) and bankers' acceptances (undiscounted balance) decreased at a faster pace (see Fig. 16).

Zhou Xiaochuan, the governor of the PBOC, spoke about monetary policy at the G20 Finance Ministers and Central Bank Governors Meeting on October 6. He said China would control credit expansion going forward while promoting the healthy development of the housing market¹⁴. He also attracted attention with comments that the PBOC would find it hard to loosen monetary policy further given recent inflationary conditions and expectations for a U.S. rate hike.

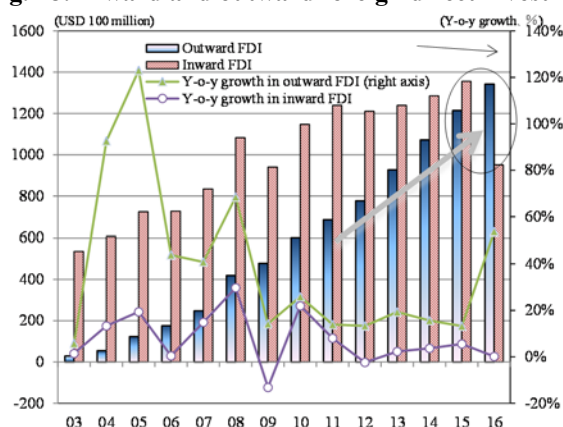
Foreign currency reserves stood at \$3,166.4 billion in September, down \$18.78 billion on August (see Fig. 17). Outward foreign direct investment (excluding financing) rose sharply in January-September, up \$134.22 billion, or +53.7%, on the same period last year¹⁵. This expansion was a factor behind fund outflows and the decline in foreign currency reserves. With Chinese firms involved in a flurry of M&As involving overseas firms, outward foreign direct investment in January-September topped 2015's figure of \$121.42 billion. It also exceeded the amount of inward foreign direct investment over the same period (\$95.09 billion; +0.2%) (see Fig. 18).

Fig. 17: Foreign currency reserves



Note: The foreign reserve data shows the June 2014 peak and the latest monthly figure.
Source: People's Bank of China, CEIC

Fig. 18: Inward and outward foreign direct investment



Note: For 2016, January-September
Source: Ministry of Commerce, CEIC

¹⁴ The PBOC, October 8: 2016 年第四次二十国集团财长和央行行长会议在华盛顿举行 (The Fourth G20 Finance Ministers and Central Bank Governors Meeting in 2016 Held in Washington D.C). Mr. Zhou said China was paying close attention to rising property prices in certain cities, with the government ready to take active measures to promote the healthy development of the housing market. With regards to bank lending, the governor said the long-term rise of lending against GDP reflected Chinese efforts to respond to the weakness of the global economic recovery. China's high savings rate guaranteed high investment, he continued, and with China still a middle-income country, there was considerable room for growth. With China's economy still fraught with overcapacity, meanwhile, the governor said moderate credit growth could act as a countercyclical tool. He also noted that China's dependence on bank lending (as witnessed during last year's stock market bearishness) would ease off after the markets stabilized, with credit growth in China likely to grow more restrained as the global economy recovered.
<http://www.pbc.gov.cn/goutongjiaoliu/113456/113469/3154553/index.html>

¹⁵ Ministry of Commerce: 商务部召开例行新闻发布会 (Regular Press Conference of the Ministry of Commerce (October 18))
<http://www.mofcom.gov.cn/xwfbh/20161018.shtml>
At a press conference on June 17, Ministry of Commerce spokesperson Shen Danyang commented that "some are concerned that the surge in demand for foreign exchange stemming from individual and short-term ODI growth might weigh on China's foreign exchange reserves and balance of payments. Related departments are looking into potential risks in the short term and considering whether this calls for targeted preventive regulatory measures." Since then, there has been no clear moves to tighten the rules governing outward direct investment.
<http://www.mofcom.gov.cn/article/ae/ah/diaocd/201606/20160601340927.shtml>

2. Topic: The State Council announces measures to reduce enterprise leverage ratios and promote debt-to-equity swaps

- **From here on, debt-to-equity swaps will be targeted at reducing enterprise leverage ratios rather than non-performing loans in the banking sector (Wang Zhaoxing, Assistant Chairman of the China Banking Regulatory Commission (CBRC))**

On October 10, the State Council released ‘Opinions of the State Council on Reducing Enterprise Leverage Ratios in an Active and Appropriate Manner’ and “Opinions of the State Council on Conducting Bank Debt-to-Equity Swaps in a Market-oriented Approach¹⁶.” These circulars outlined the State Council’s policy on reducing corporate debt levels. Proposed measures for reducing enterprise leverage include: promoting mergers and acquisitions, enhancing corporate governance, revitalizing stock assets, optimizing debt structures, and carrying out debt-for-equity swap programs (see Fig. 19).

When it came to bankruptcies, the State Council stated that (1) zombie enterprises with no potential for rebound and no chance of survival should be put into bankruptcy and liquidation in accordance with legal procedures, with claims settled, corporate status revoked and proper arrangements made for employees. At the same time, though, it also said that (2) even if enterprises meet the conditions for bankruptcy, if they are still promising enterprises then they should independently enter into discussions about bankruptcy procedures or debt restructuring in a court of law.

In “Opinions of the State Council on Conducting Bank Debt-to-Equity Swaps in a Market-oriented Approach,” the State Council promotes corporate debt-to-equity swaps (DES) as a way to support promising, high-quality enterprises who may be experiencing temporary financial difficulties. With regards to implementing DES, the circulars say market mechanisms should be used when it comes to selecting eligible enterprises, prices or fund raising, etc., though this process should exclude zombie firms or enterprises that contribute to overcapacity.

At a press conference on October 10, Wang Zhaoxing, Assistant Chairman of the China Banking Regulatory Commission (CBRC), emphasized that although DES in the 1990s were used to dispose of bad loans in the banking sector, this round of DES would be used to lower enterprise leverage ratios and alleviate financial burdens, with the DES targeting performing loans as well as non-performing loans. He also insisted that the process would be carried out in a market-oriented and law-based approach, with consultations conducted evenly based on the wishes of the creditor banks and the debtor enterprises. In all, Mr. Wang was keen to point out that the new DES differed from those in the 1990s in terms of background, environment and goals¹⁷.

¹⁶ The State Council of the People’s Republic of China, October 10: 国务院关于积极稳妥降低企业杠杆率的意见 国发〔2016〕54号 (Opinions of the State Council on Reducing Enterprise Leverage Ratios in an Active and Appropriate Manner, No. 54 (2016).) http://www.gov.cn/zhengce/content/2016-10/10/content_5116835.htm

¹⁷ The State Council of the People’s Republic of China, October 10: 新闻办就积极稳妥降低企业杠杆率有关政策情况举行发布会 (China Internet Information Center Holds a Public Meeting about Measures to Reduce Enterprise Leverage Ratios in an Active and Appropriate Manner) http://www.gov.cn/xinwen/2016-10/10/content_5116893.htm

Fig. 19: Measures to reduce enterprise leverage ratios

1. M&As	<ul style="list-style-type: none"> ▪ Encourage cross-region and cross-ownership M&As ▪ Promote M&As in priority industries ▪ Guide businesses to restructure their operations ▪ Strengthen financial support for corporate M&As
2. Enterprise system	<ul style="list-style-type: none"> ▪ Establish and improve a modern enterprise system ▪ Make clear the responsibility subjects for enterprise leverage ratios reduction ▪ Strengthen the evaluation mechanism for state-owned enterprise leverage ratios reduction
3. Stock assets	<ul style="list-style-type: none"> ▪ Classify stock assets ▪ Utilize idle assets ▪ Integrate stock assets ▪ Securitize stock assets
4. Optimizing debt structures	<ul style="list-style-type: none"> ▪ Facilitate debt liquidation and consolidation ▪ Reduce the debt burden on enterprises
5. Bank DES	<ul style="list-style-type: none"> ▪ Conduct DES in accordance with market-oriented and law-based approach ▪ Conduct market-oriented DES to ensure the survival of the strongest companies ▪ Encourage many institutions to participate in market-based DES
6. Bankruptcy	<ul style="list-style-type: none"> ▪ Establish a law-based bankruptcy system ▪ Implement bankruptcy, restructuring, and reconciliation for enterprises in different conditions ▪ Restore the healthy bankruptcy system
7. Fund raising through share issuance	<ul style="list-style-type: none"> ▪ Rapidly put in place a complete equity market ▪ Promote the healthy development of the exchange market ▪ Innovate equity financing tools ▪ Expand financing sources
○Building a sound market policy environment	<ul style="list-style-type: none"> ▪ Supplementary tax incentives ▪ Improve capacity to write-down/deal with non-performing assets ▪ Enhanced regulation on market credit lines ▪ Enhanced credit controls on financial institutions ▪ A fair investor control system ▪ Reduce corporate social contributions ▪ Make arrangements for employees of restructured enterprises ▪ Policies for developing industry ▪ Strict monitoring ▪ Implementation of rule-based procedures ▪ Active government role

Source: The State Council of the People's Republic of China, October 10: 国务院关于积极稳妥降低企业杠杆率的意见
国发〔2016〕54号

http://www.gov.cn/zhengce/content/2016-10/10/content_5116835.htm

Mihoko Hosokawa, Research Executive; Corporate Banking Coordination Division, Mizuho Bank (China), Ltd.

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