TREASURY MANAGEMENT

PNC Shanghai Representative Office (SRO) QUARTERLY UPDATE

4TH QUARTER 2017

	China GDP Growth (Full-Year)	RMB Central Parity Exchange Rate[1] (USD/CNY, End of Period)	Foreign Exchange Reserves (Billions USD, End of Period)
2014	7.3%	6.2066	$3,843.02
2015	6.9%	6.4952	$3,303.62
2016	6.7%	6.9447	$3,010.52
2017	6.9%	6.5342	$3,139.95

FOREIGN EXCHANGE RESERVES (BILLIONS USD)			
2014	2015	2016	2017
$3,843.02	$3,303.62	$3,010.52	$3,139.95

PBOC REFERENCE LENDING RATE	PBOC REFERENCE DEPOSIT RATE
4.35% (6/27/2015)	1.50%

HOT TOPICS

U.S. TAX REFORM, REACTION WITHIN CHINA, AND POTENTIAL IMPACT TO YOUR BUSINESS

The U.S. tax reform that had recently passed in December 2017 has garnered significant attention in China from both U.S. businesses and China's policymakers, and will likely be a topic of interest for the coming months as businesses and policymakers in China adjust their business plans and decisions accordingly.

REPATRIATION OF PROFITS

One of the provisions of the tax reform that would be of interest to U.S. companies operating in China is the ability to repatriate overseas profits at a better tax rate than in the prior tax regime (albeit with an initial tax bill), of which policymakers in China are aware. If U.S. companies with excess cash in China choose to repatriate their earnings due to the tax reform, this would result in capital outflow out of China, which China has been looking to stabilize for some time. After the tax reform bill passed in the Senate in early December 2017, a statement was released by the Chinese government soon after, saying that China pledged to keep a close eye on the impact of the U.S. tax overhaul.

SUPERVISION OF CROSS-BORDER ECONOMIC ACTIVITIES

To be certain, the concern around capital outflow is much more contained from China policymakers' perspective, especially compared to 2016 when the Chinese currency, the Renminbi (RMB), was depreciating, as well as visible efforts by individuals and corporates to move money out of China. In looking at the trend of foreign exchange reserves, the reserves had been decreasing year over year since 2014, with the reserves briefly dipping below the $3 trillion mark at the beginning of 2017 as a result of significant capital outflow through 2016. Through various measures, and a stabilizing RMB exchange rate, the foreign exchange reserves was able to reach a turning point, recovering from $3.01 trillion at end of 2016 to $3.14 trillion at end for 2017. Coupled with the focus on supervising cross-border economic activities through introduction of "code of conduct"[2] for outbound investment, China is continuing to monitor the cross-border outbound investment from Chinese companies. While the "code of conduct" is more applicable on the China "Outbound" direction, i.e., Chinese companies investing outside of China, the continued supervision on cross-border funds flow by the government is, while not a surprise, noteworthy. The government is still wary of the risk that capital outflow could pose to the stability of the economy and financial system.

1 China Foreign Exchange Trade System (CFETS); central parity exchange rate set by the PBOC
2 China Daily: "New guidelines for outbound investment soon".
3 New York Times: "China offers tax incentives to persuade U.S. companies to stay".
4 China Daily: "China to create bigger, stronger State-owned firms".

As a policy response to the U.S. tax reform, China's Ministry of Finance unveiled on Dec. 28, 2017, that "it will exempt foreign companies from paying provisional withholding income tax on profits they reinvest in the country," provided that "foreign companies…meet a string of conditions to be eligible for the exemption."[3] The eligibility requirements are specific, requiring companies to invest earnings in certain sectors, such as railways, mining, technology and agriculture, which are encouraged by the government. A possible explanation for the rollout of this policy is that with the U.S. tax reform, it may trigger U.S. companies who have excess cash in China to move some of the profits out, which would create pressure on China's foreign exchange reserves and RMB exchange rate.

IMPACT OF TAX REFORM STILL IN QUESTION

The full impact of the tax reform to American businesses that have operations in China is still developing. As repatriation for 2017 profits out of China is a multi-step process that requires the companies to complete procedures (covered further under "Profit Repatriation — Considerations for Companies"), ensure annual audit is complete and relevant taxes are paid, etc., what the U.S. companies with excess cash will choose to do in light of the tax reform may not be clear for some time. On the other end, how the Chinese policymakers will continue to react and adjust their policies will also be closely observed.

> While China's SOE reform has occurred and will continue to occur, instead of lessening their size and influence to pave way for the private sector in the economy, the SOEs will instead be tasked to take on a bigger role.

19TH PARTY CONGRESS — WHAT IS IT AND WHAT DOES IT MEAN FOR BUSINESSES?

The most significant event that occurred in October was the widely anticipated Chinese 19th Party Congress held Oct. 18–24, 2017. The Party Congress is held every 5 years to set the policy goals and direction for the Chinese Communist Party (CCP), as well as electing its top leadership. The Party Congress was closely watched by political pundits, international relations practitioners and, no doubt, by Washington, as well as business communities, including U.S. businesses in China. The policy goals set during the Party Congress and the elected top party leadership have a significant impact on the various stakeholders.

Some of the key items from the meeting that may impact foreign businesses in China are:

- Bigger roles of State Owned Enterprises (SOEs) in China's economy

While China's SOE reform has occurred and will continue to occur, instead of lessening their size and influence to pave way for the private sector in the economy, the SOEs will instead be tasked to take on a bigger role. As the article[4] notes, in the past 5 years, the SOEs' "scale and strength have remarkably expanded in the past five years," and China's President Xi Jinping has called on the Congress to further reform the SOEs to make them "stronger, better and larger."

- Call for a level playing field for foreign investors

Foreign companies, including U.S. companies, have long advocated for a level playing field in terms of policies and treatment compared to their local Chinese counterparts. This point was called out during President Xi Jinping's speech, where President Xi pledged that "China won't close its open door — the door will only be opened wider and wider."

- Deepen market-oriented reform in exchange rate and interest rates

President Xi pledged to continue deepening the market-oriented reform in the exchange rate mechanism. This bodes well for the progress of liberalization in foreign exchange and capital account convertibility, which had taken less of a priority the last 2 years given the measures taken in restricting capital outflow and stabilizing the foreign exchange rate.

HOT TOPICS

PROFIT REPATRIATION — CONSIDERATIONS FOR COMPANIES

One of the important considerations with establishing a business in China is the element of profit repatriation. For U.S. companies who are new to the China Market, companies should understand the process and procedure of profit repatriation and plan ahead as part of the business strategy, as well as having appropriate expectations of the time frame that profit repatriation may take.

Profit repatriation in China is different compared to other markets where funds flow is not restricted. Taking U.S. as an example, regardless of the type of cross-border transaction, there is no restriction or central bank reporting requirement. The same is true for other markets with which U.S. companies may be familiar in doing business, such as Canada, U.K., the Eurozone, and countries/regions such as Singapore and Hong Kong, where there is no restriction on funds flow. For the China market, while cross-border funds flow are not completely restricted, it is not fully open either.

Profit Repatriation requires careful planning on the company's part due to prerequisites and document requirements that banks would verify as a result of regulations and tax considerations. Generally speaking, banks would check the following:

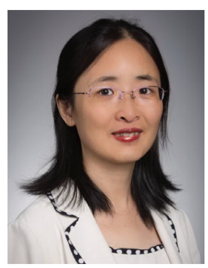
- Resolution of Board of Directors on the distribution of profits
- Latest audit report on the paid-in capital
- Audit report
- Certificate of filing at the tax bureau in case the amount is above $50,000
- Tax payable receipt
- Business license

There are prerequisites that companies would also need to complete, including:

- Complete the external Annual Audit conducted by an accounting firm.
- Settle its income tax liabilities.
- Make up any losses that were carried forward from previous years.
- Set aside a minimum 10% of after-tax profits in a reserve fund until the accumulated reserve fund reaches 50% of the registered capital, which ensures that a portion of the profits are re-invested into the company.
- The remaining amount is distributable profits.
- The withholding tax will be deducted before the dividend can be remitted back to the investors.

Other techniques are available for companies to free up its excess cash in China. For more information, refer to the "China: How to Repatriate Profits" White Paper, available on www.pnc.com/gochina.

SROs' CONTACT INFORMATION



Grace Zhu
Chief Representative
Grace.zhu@pnc.com

Chris Chen
Representative
Chris.chen@pnc.com

Jenny Xu
Deputy Representative
Jenny.xu@pnc.com

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CIB TM PDF 0318-052-736504

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