

**Economic and Industry Outlook after the 20th CPC
National Congress**

Deloitte China
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The Report to the 20th National Congress of the CPC (the "Report") serves as the guiding document for national development. It lays out goals for various areas over the next five years, ten years and beyond. Based on the objectives set out in the Report to the 19th National Congress of the CPC and those in the 14th Five-Year Plan, the Report draws out the pathway for effectively realizing socialist modernization. In other words, from getting rich to becoming strong. Against this backdrop, companies in China will seek to deepen reform and take significant strides on the road to high-quality development and building world-class enterprises. In the following sections, we will summarize the overriding agenda for future development, assess the implications for the macroeconomy and specific industries, and identify opportunities for companies in the future.

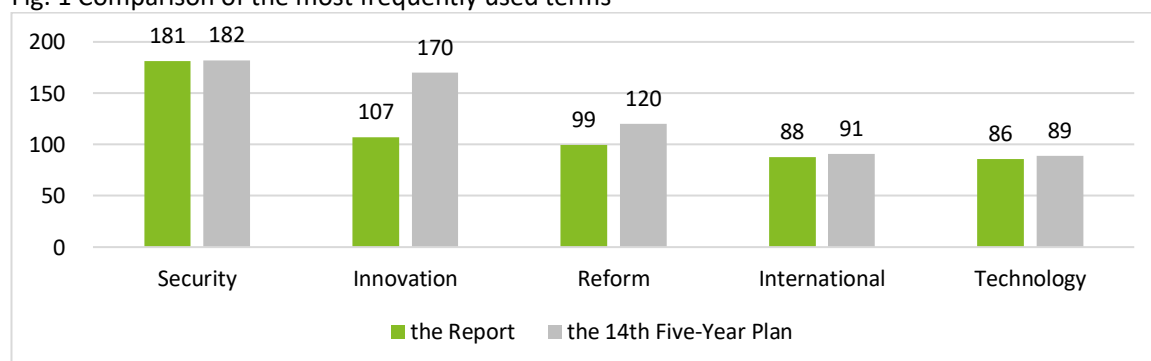
First propose the "Chinese path to modernization" and underscore "security" and "innovation"

The concept of the "Chinese path to modernization" first appeared in the report to the National Congress of the CPC.

The Report identifies that the central task of the Communist Party of China is to lead the Chinese people of all ethnic groups in a concerted effort to realize the Second Centenary Goal of building China into a great modern socialist country in all respects and to advance the rejuvenation of the Chinese nation on all fronts through a Chinese path to modernization. The Chinese path to modernization involves the modernization of a huge population, common prosperity for all, material and cultural-ethical advancement, harmony between humanity and nature, and peaceful development. When the country embarks on a new journey, the Report, in light of actual conditions, emphasizes the coordinated development of material advancement, spiritual advancement and ecological conservation.

The priorities of the 14th Five-Year Plan remain the highlights of the Report. Security, innovation, reform, international, and technology were frequently mentioned in the 14th Five-Year Plan. They continue to be featured throughout the Report. Security and innovation appear most frequently, indicating that they are critical to high-quality development, touching on all aspects of economic and social development. This also shows China's determination and resolve to seek high-quality development in response to severe and intricate international developments.

Fig. 1 Comparison of the most frequently used terms



Source: www.gov.cn

Note: The word frequency of the Report is converted based on the length of the 14th Five-Year Plan relative to that of the Report

New chapters were added to address the issue of invigorating China through science and education, law-based governance, and national security. Compared to the Report to the 19th National Congress of the CPC, the Report added three chapters in the area of development measures, including "Invigorating China through Science and Education and Developing a Strong Workforce for the Modernization Drive," "Exercising Law-Based Governance on All Fronts and Advancing the Rule of Law in China," and "Modernizing China's National Security System and Capacity and Safeguarding National Security and Social Stability". This signifies the importance of science and education, the rule of law, and security.

The Report further clarifies the focus of creating a new development pattern. The Report included the "Creation of a New Development Pattern" into the Long-Range Objectives through the Year 2035 and required accelerated efforts to foster a new development pattern that is focused on the domestic economy and that features positive interplay between domestic and international economic flows. It also states that the country should boost the dynamism and reliability of the domestic economy while engaging at a higher level in the global economy. Boosting the domestic economy will need to focus on expanding domestic demand, optimizing supply structures and removing obstacles. Refining systems, enhancing structures and deepening cooperation are the top priorities for engaging in the global economy in order to further facilitate smooth flows in the domestic economy.

Seven key trends of economic development

We find seven trends that stand out in the Report. These are the real economy, high-quality opening up, expanding domestic demand, scientific and technological innovation, green development, security, and common prosperity.



The real economy is the focus of modernizing the industrial system. According to the Report, the country will continue to focus on the real economy in pursuing economic growth. The manufacturing sector will attach importance to industrial reengineering projects, research projects on major technologies and equipment, and developing companies that use special and sophisticated technologies. The services sector will be further integrated with advanced manufacturing and modern agriculture, while the digital economy will be further integrated with the real economy and internationally-competitive digital industrial clusters will be built.

High-quality opening up underscores institutional opening up and China's transformation into a trader of quality. Regarding institutional opening up, it is imperative for China to actively align with high-quality international economic and trade rules, and create the institutional system and regulatory framework to accompany high-quality international rules. In terms of trade development, the country will seek to upgrade trade in goods while developing new mechanisms for trade in services. Digital trade will be promoted to accelerate China's transformation into a trader of quality. To attract foreign investment, the country underlines the importance of improving the investment structure for foreign businesses and encourages investment in advanced manufacturing and high and new technology. In light of this, multinational companies may make use of their abundant experience in operations, seize opportunities and actively engage in China's high-quality opening up. They can do this by setting up research and development centers in China, collaborating with local businesses to accelerate technological innovation, driving the green transformation across the supply chain in line with international environmental protection standards to achieve industry-specific "dual carbon goals," remaining committed to the vast Chinese market, and tapping into the enormous potential to create better conditions for development in China.

Expand domestic demand while pursuing supply-side structural reform. The Report states that the implementation of the strategy to expand domestic demand is to be integrated with the efforts to deepen supply-side structural reform, to boost the dynamism and reliability of the domestic economy. As consumption is of fundamental importance to economic growth, expanding domestic demand can better leverage the guiding role of consumption and investment in stimulating supply-side structural reform. Improving supply quality and increasing effective supply should be the focus of supply-side structural reform to better meet the people's ever-growing needs for a better life.

Education, technology, and talent go hand in hand with greater significance. For the first time, the Report put the strategy for invigorating China through science and education, the workforce development strategy, and the innovation-driven development strategy within the same chapter. This follows on from the chapter on high-quality

development, recognizing the interconnectivity of education, technology, and talent as key elements of a systematic approach. It highlights the urgency of transitioning the driving forces of development and the necessity of independent innovation amid the situation emerging both inside and outside of China. Talent is inseparable from creating a new development pattern, fostering new growth drivers, and building a new competitive edge. With increasing uncertainty in the international environment, rapidly improving the ability to conduct independent research and making breakthroughs in core technologies is the proper response to overcoming bottlenecks. High-quality opening up requires moving faster to build global hubs for talent and creating comparative strengths in global competition for talent to support industrial upgrading throughout China.

Pursue green development and promote harmony between humanity and nature. A major trend is the transition to a model of green development and the development of a system for new energy sources, which requires a well-planned and step-by-step approach, as well as measures to ensure a stable energy supply and an optimized energy mix to facilitate a smooth and secured transition. The clean and efficient use of fossil fuels has received much attention. New energy development will accelerate, not slow down. Integrating the development of digital technology with the construction of the power grid and facilities for energy storage and replenishment will foster new forms of business and enable the creation of innovative green cooperation and solutions.

Development security is underscored. The Report proposed to "ensure the security of food, energy, and resources as well as key industrial and supply chains." Making sure that China's total area of farmland does not fall below the redline of 120 million hectares and reducing seed dependency will be the top priority concerning food security. Reducing oil and gas dependency and solidly advancing the new energy strategy will be placed front and center of energy security. The security of industrial chains will be achieved by resolving bottlenecks in key technological links of chips and core software, effectively integrating and controlling the resources for industrial chains with a focus on key areas and key links such as AI, quantum information, and integrated circuits. China will also need to enhance the resilience of industrial and supply chains and accelerate the development of an independent and controllable industrial system of next-generation information technology.

Common prosperity becomes more relevant and vital. Since the 19th National Congress of the CPC, common prosperity has increasingly appeared in major documents. The Report further stated that common prosperity is an important feature of Chinese modernization. By proposing "equality of opportunity" and "well-regulated means of accumulating wealth," concrete steps will be taken in various areas to address common prosperity. The Report reiterated that the country would keep distribution according to work as a mainstay, while ensuring more pay for more work and encouraging people to achieve prosperity through hard work. It made clear that, rather than seeking equality of outcome, promoting equality of opportunity should be the key. By regulating the means of accumulating wealth, it is expected that regulations restricting the income sources of and taxing high earners will be refined.

Economic outlook

Opportunities coexist with challenges amid a steady economic recovery

Geopolitical tensions, together with the energy and food crisis, have increased the level of uncertainty in the international environment. Add in persistently high inflation and tightening monetary policies across developed economies and the global economy continues to lose steam. This inevitably creates several external challenges for China's economic growth.

Following a weak performance in Q2, the Chinese economy is recovering with Q3 GDP growth at 3.9% and Q1-3 growth at 3%. Growth was led by consumption which contributed 1.2 percentage points of GDP growth. That said, the consumer confidence index remained below 90 (compared to an average of 120 in 2020) due to recurrent COVID-19 outbreaks in Q2. It will take time for consumer confidence to recover further. The investment structure is improving, with investment in the high-tech industry increasing significantly faster than overall investment growth. In light of slowing real estate investments, it is crucial that policymakers find new growth drivers. Thanks to highly resilient supply chains, China maintains strong growth in foreign trade and continues to attract foreign investment, with exports in 2021 and the first ten months of 2022 growing at 30% and 11% respectively, while growth of foreign direct investment in 2021 and Q1-3 2022 stand at around 20%, underscoring the competitiveness of China-made products and the attractiveness of China for global production factors and resources. However, potential risks from weakening external demand behind the slip in October exports should be guarded against.

After the 20th National Congress of the CPC, maintaining stable economic growth will become even more critical. As Omicron is weakening, the vaccination rate is increasing and the country is more experienced in fighting the pandemic. Optimized COVID-19 control measures are expected to be rolled out according to the situation at hand which will help boost consumer confidence.

Key sectors outlook

Consumer Products & Retail

Expanding domestic demand requires accelerating the upgrading and expansion of consumption

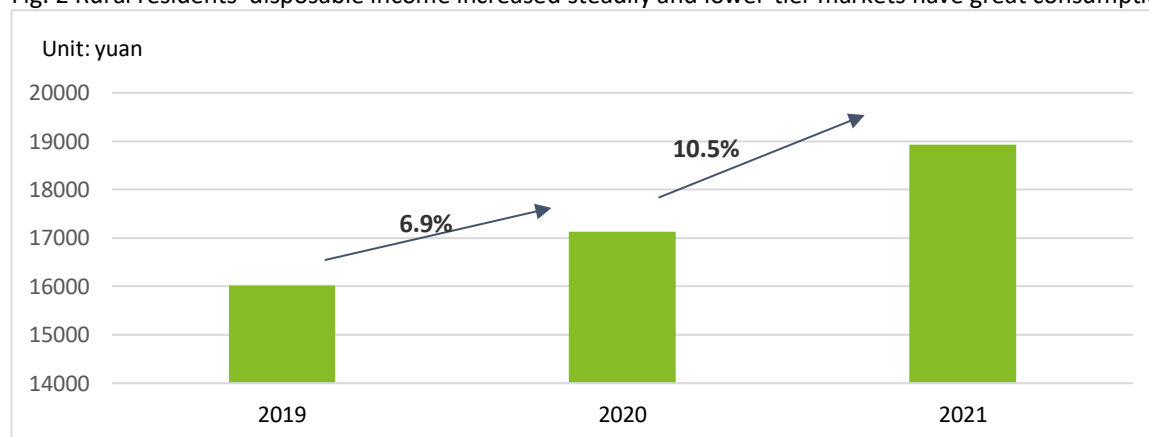
The Report proposed to "expand domestic demand and better leverage the fundamental role of consumption in stimulating economic growth," while setting "green consumption, common prosperity, and innovation-driven development" as key priorities, which is a positive signal to the consumer market. The following areas can offer major opportunities for consumer products and retail.

Extend green consumption to more areas and encourage green ways of consumption. Companies moving faster at living up to their green commitments and embedding green concepts into the whole process of product development and manufacturing will increase buy-in from consumers and receive more policy support.

Expand opening-up and further promote cross-border e-commerce. The Report stressed that the country would remain steadfast in expanding and opening up. More support measures for new forms and models of foreign trade, including cross-border e-commerce, are expected to be rolled out.

Improve consumption supply and spur consumption in lower-tier markets. Efforts in new urbanization and rural revitalization will facilitate the two-way flow of personnel and resources between urban and rural areas, with consumption supply to cities at all levels and rural areas to be improved to effectively promote consumption in lower-tier markets.

Fig. 2 Rural residents' disposable income increased steadily and lower-tier markets have great consumption potential



Source: National Bureau of Statistics of China (NBS)

Digital technology enables innovation in forms and models of consumption. Under the innovation-driven development strategy, companies seeking to speed up their digital transformation while actively exploring emerging application scenarios are more likely to attract capital.

Enhance consumer privacy and data security. In the Report, people's security was held up as the ultimate goal. As relevant policies are to be rolled out and market regulation further tightened, companies need to strengthen consumer data protection, avoiding the negative impact of consumer data breaches.

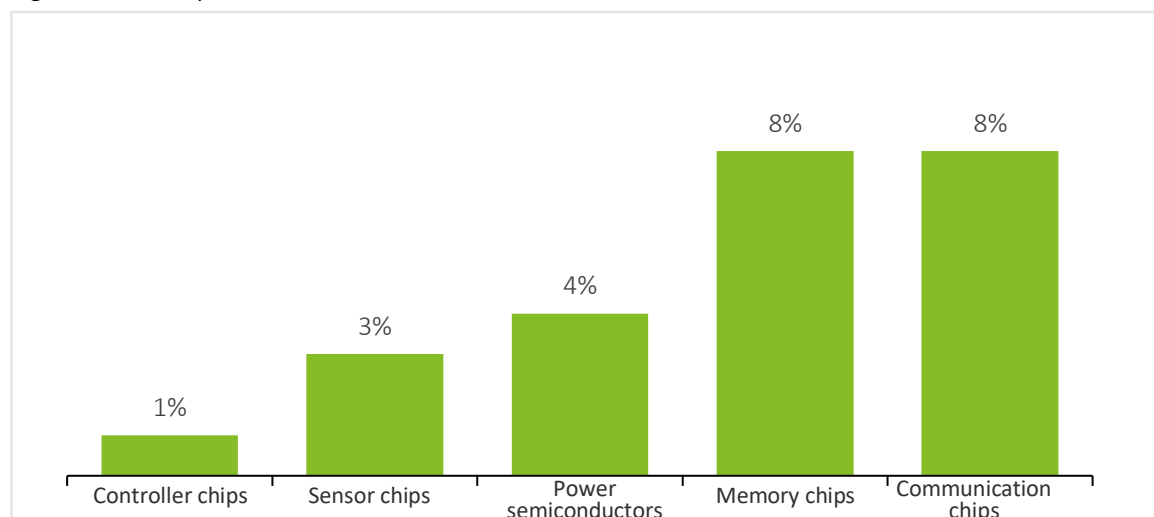
Auto

Balancing innovation, security, and opening-up

Double down on independent and groundbreaking innovation: The auto industry should achieve breakthroughs in electrical and intelligent technologies, adopt a long-term view, make forward-thinking plans for fundamentals and cutting-edge advances, and build a hub of auto innovation to attract companies from across the globe.

Supply chain security should be based on better control instead of 100% independence: The intelligent electric vehicle industry will create a diverse supply ecosystem of crucial parts and technologies. On the one hand, this is critical to improving independent research and development capabilities, making steady progress to independently develop technologies and products in critical areas. On the other hand, exploring alternative solutions beyond mainstream technologies is essential.

Fig. 3 Ratio of chips made in China



Source: TF Securities

The "dual carbon" strategy in the auto industry will foster green investment opportunities: Automakers in China should rapidly work out plans to cut emissions across the supply chain and create a new competitive channel in green technology through product lifecycle decarbonization. They should also increase investments in energy conservation and emission reduction technologies, build a business model based around the circular economy, and increase the green premium of their brand.

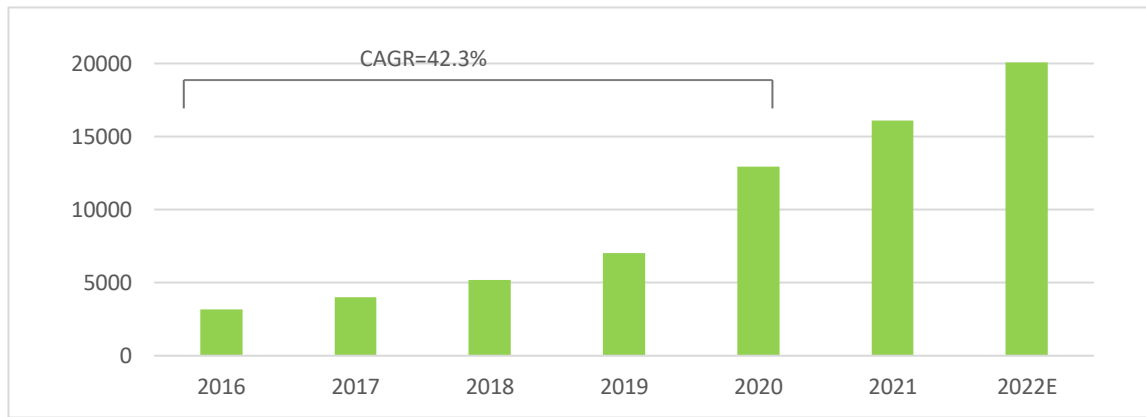
Further improve the environment for foreign investors to increase attractiveness for global innovation factors: The Chinese government will further improve the environment for foreign investors, and steadily expand institutional opening up concerning rules, regulations, management, and standards, attracting automobile and auto parts multinationals to invest in China and share the benefits of emerging technological development.

Logistics

Build a high-quality service system for international and domestic supply chains

Develop a supply chain logistics system catering to dual circulation. Facilitate the smooth running of the foreign trade supply chain, support the development of cross-border e-commerce and overseas warehouses, expand normal cross-border mailing channels such as air, rail, and sea freight, and build up capabilities for the coordinated development of businesses, industries, and regions.

Fig. 4 Total export value of the cross-border e-commerce players in China in 2016-2022 (RMB in 100m)

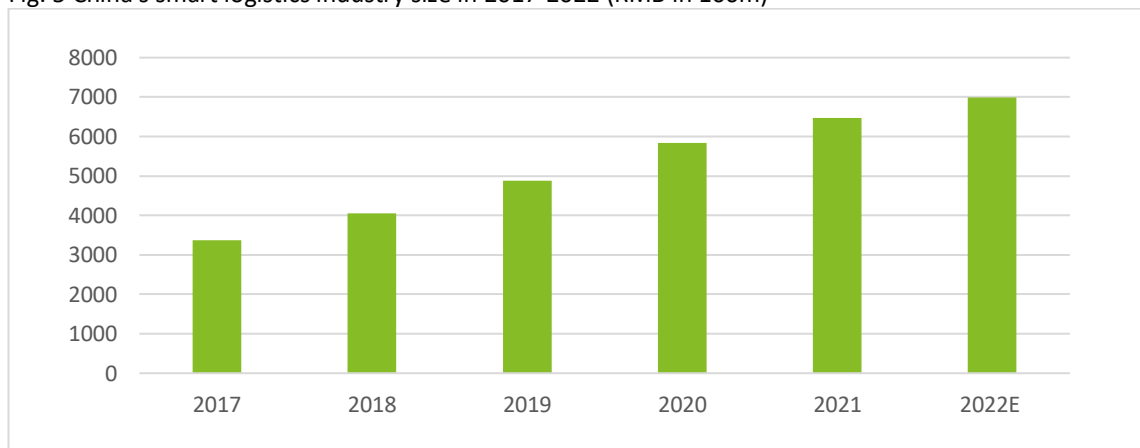


Source: 2021 report on China's cross-border e-commerce export logistics services

Improve the quality of transportation services and achieve the goal of boosting China's strength in transportation. The country will work out plans to improve the comprehensive capabilities of infrastructure and facilitate the flow of production factors between urban and rural areas. It will also further adjust its transportation structure, promote multimodal transport, and increase the efficiency of the integrated transportation system.

Build more resilient supply chains through digitalization. By adopting innovative applications and new models, data and business between upstream and downstream players can be connected and the operational efficiency and performance of logistics companies will be improved.

Fig. 5 China's smart logistics industry size in 2017-2022 (RMB in 100m)



Source: China's smart logistics market outlook and investment forecast 2022

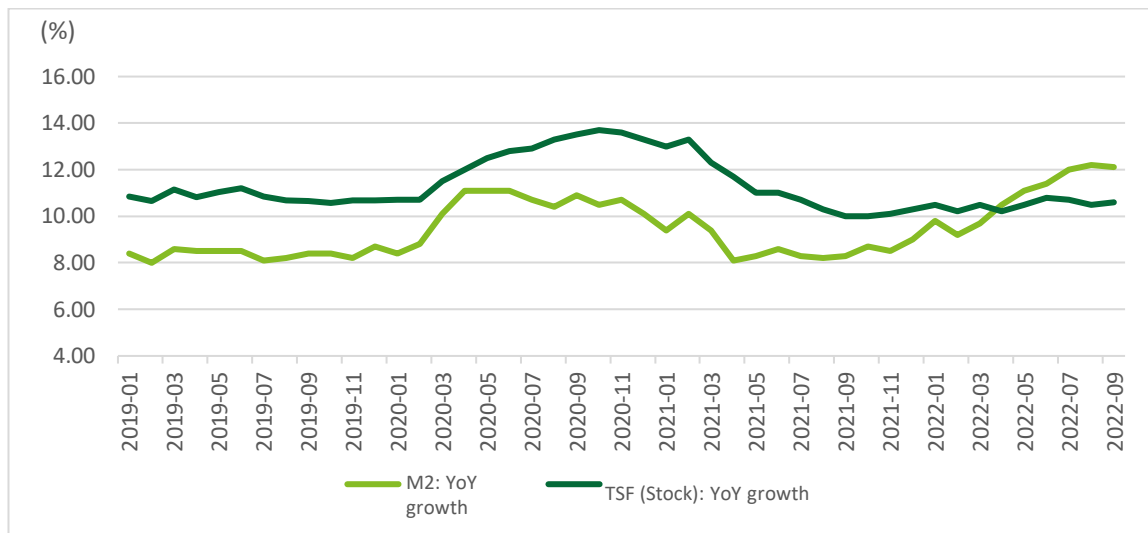
Develop green logistics services. China should connect the links between warehouses, transportation, packaging, and recycling, introduce carbon footprint verification to the logistics industry, promote the development and adoption of green low-carbon technology, and develop green manufacturing and services.

Finance

Continue supporting key areas in the economy to safeguard financial stability and remain committed to reform and opening-up

Continue with a prudent monetary policy. Keep M2 and Total Social Financing (TSF) in line with economic growth, and enhance the stability of total credit growth.

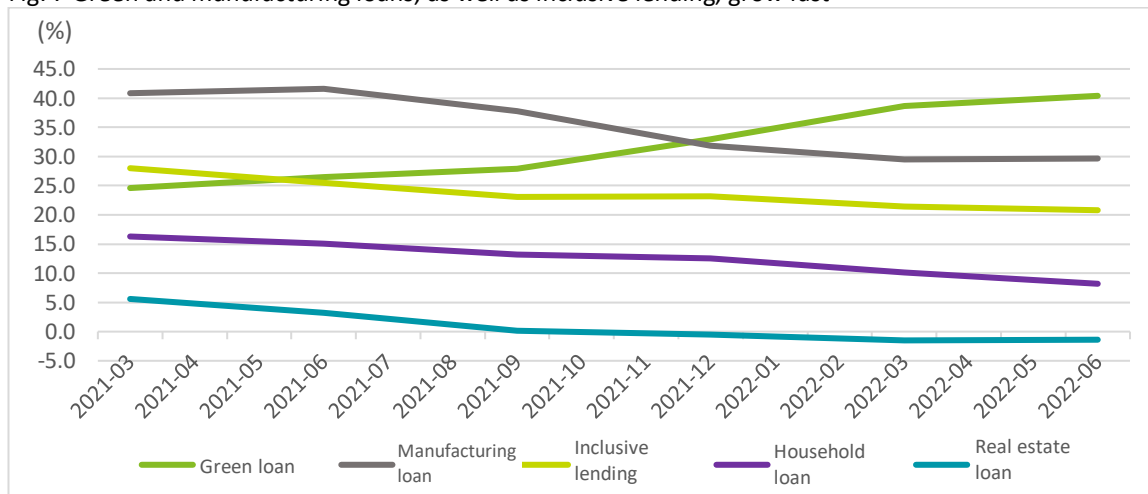
Fig. 6 Scissor gap of M2-TSF continues easing



Source: People's Bank of China (PBOC)

The finance sector continues to support key areas and weak links. Weak areas include the eradication of absolute poverty and inclusive lending to small and micro businesses. Transformation and upgrading mainly focus on advanced manufacturing industries, specialized, sophisticated, distinctive, and innovative ("SSDI"), as well as green industries.

Fig. 7 Green and manufacturing loans, as well as inclusive lending, grow fast



Source: PBOC

Bank credit is still key to steady growth and credit easing. The six largest state-owned banks continue to play a leading role in supporting the real economy with improved and adjusted credit structures.

The asset management industry picks up steam. As their income grows, Chinese residents show rising wealth management awareness and a stronger demand for asset allocation. Wealth management and pension management businesses will see rapid growth and innovation.

Push forward the reform of the multi-tiered capital market. The work to increase direct financing will intensify, and the pace of comprehensive implementation of the stock offering registration system is expected to accelerate.

Financial stability is emphasized, with risk prevention higher on the agenda. Develop direct financing and reduce the accumulation of risk in the banking system, while also establishing and improving the mechanism of using the financial stability facility.

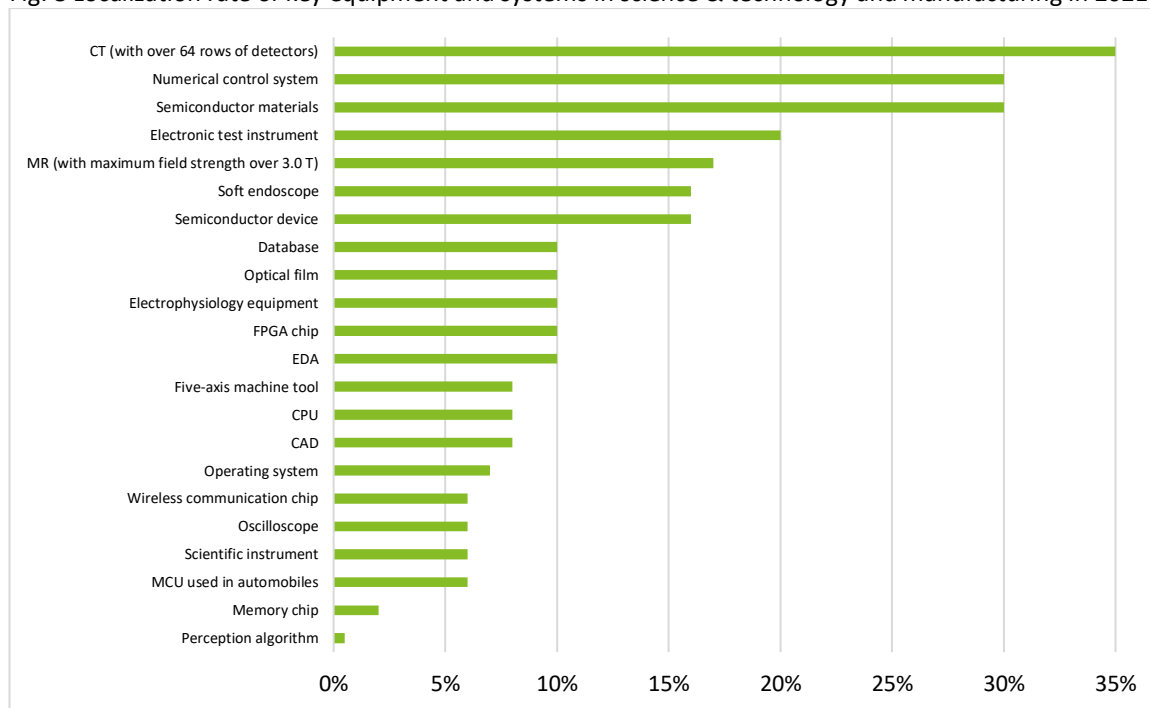
Deepen financial reform and opening up. Press ahead with supply-side structural reform and two-way opening-up in the financial sector. Participate in international financial governance and strengthen the rule of law in the financial sector.

Technology, Media & Telecommunications

Foster an independent and controllable next-generation information technology industrial system and digital industrial ecosystem to achieve high-quality development of the digital economy

Build a modern information technology industrial system by fostering growth drivers in key areas. Foster growth drivers in AI, quantum information, integrated circuits, and other key areas to promote China's international competitiveness. Meanwhile, keep improving originality and innovation in the industry, and accelerate China's growing strength in strategic areas of science and technology to address the issue of bottlenecks in core and critical technologies.

Fig. 8 Localization rate of key equipment and systems in science & technology and manufacturing in 2021

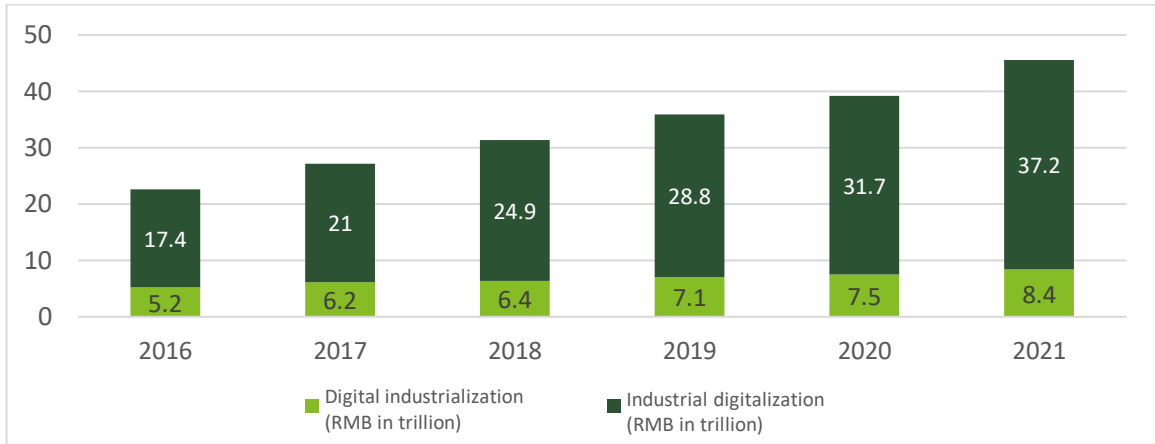


Source: NBS, Wind, and China Academy for Information and Communications Technology (CAICT)

Create a dual circulation system of value and innovation chains. In terms of industrial chain development, advance efforts to build the dual circulation system and form an upstream and downstream network to support scientific breakthroughs and the application of industrial achievements. Improve the capability to optimize and integrate resources within industrial chains while heightening the modernization of supply chains and the degree of resilience to bring down emergent risks of specific links.

Make the digital economy an accelerator of national economic development. In constructing digital information infrastructure, China should press ahead with 5G, the Industrial Internet, Internet of Things and other forms of new modern infrastructure to secure the base from which to develop the information industry. Information infrastructure will be innovated and upgraded to elevate industrial informatization, digitalization, and intellectualization to a higher level. China will firmly seize the opportunities arising from the development of the digital economy to gain the upper hand in building a modern industrial system. The digital economy will also be applied in the agricultural, industrial and transportation, and education fields among others in order to achieve integrated development of the digital economy and real economy and foster new growth drivers of economic development.

Fig. 9 China's digital economy structure in 2021



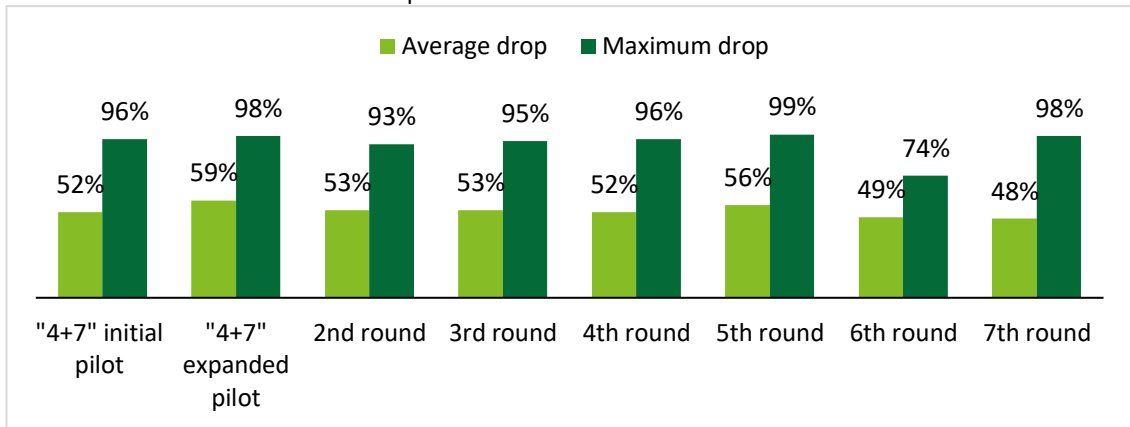
Source: NBS, Wind, and CAICT

Life Sciences & Health Care

Accelerate the construction of a healthy China, improve the social security system and promote the development of both traditional Chinese medicine and Western medicine

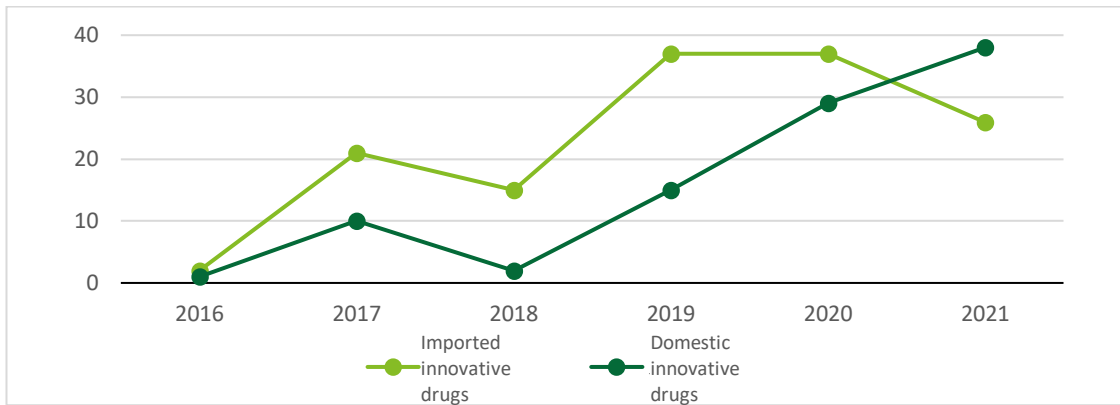
Increase efforts on the Healthy China initiative and realize a people-centric development of pharmaceuticals and medical services: Carry out reform from both the supply and demand sides to address the problems of high drug prices and uneven resource distribution so as to ensure that people have access to comprehensive healthcare services. Keep advancing negotiations around national medical insurance and volume-based procurement to ensure the steady supply of drugs nationwide with both quality and quantity guaranteed, and further stimulate R&D breakthroughs of innovative drugs. Local pharmaceutical enterprises will exert more efforts to push forward R&D in world-class innovative drug products in China. Foreign pharmaceutical companies are expected to proactively include China in early-stage research on global innovation projects.

Fig. 10 Steady price drop of bid-winning products in volume-based procurement significantly reduced the burden of the national medical insurance fund and patients



Source: GBI, National Medical Products Administration (NMPA), and Deloitte Research

Fig. 11 More innovative drugs included in the medical insurance catalog, stronger support for innovative drug R&D



Source: GBI, NMPA, and Deloitte Research

Improve the social security system to cover the whole of society: Maintain a high coverage of health services, roll out supportive policies, and establish medical institutions to address an aging population and increase the birth rate. **China will set up a comprehensive healthcare system with more specialized and personalized medical services for the elderly, pregnant women, infants, and other special groups, and build a more diversified and sustainable healthcare security ecosystem.**

Promote the innovative development of traditional Chinese medicine and create a new environment where both traditional Chinese medicine and Western medicine thrive: Strengthen efforts to drive R&D breakthroughs in traditional Chinese medicine and its popularization, support the coordinated development of traditional Chinese medicine and Western medicine, and promote the innovation and preservation of traditional Chinese medicine.

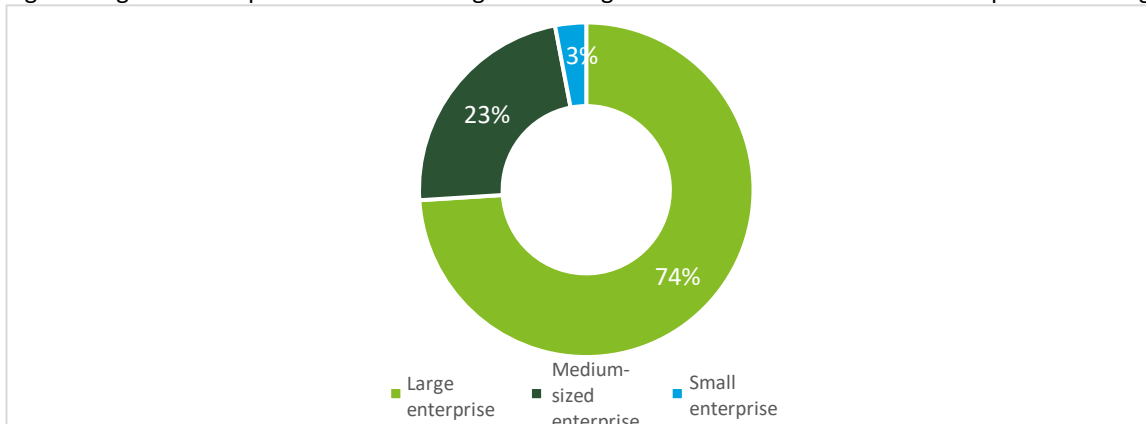
Manufacturing

Focus on fostering strengths and shoring up weaknesses, promote opening up, and push harder on green manufacturing goals

Enhance the resilience and security of industrial supply chains: Boost the resilience and security of industrial supply chains by fostering industrial clusters, investing in core technologies, improving regional supply chains, and enhancing supply chain transparency.

Accelerate the development of SSDI enterprises: The Report explicitly voiced support for the development of SSDI enterprises. Various policies will be introduced to support the R&D and commercialization of highly specialized and core technologies. Domestic substitution becomes the primary strategy for some key technologies. Technology iteration accelerates small and medium-sized enterprises to enter the market, and the digital transformation of SSDI enterprises should speed up.

Fig. 12 Large listed corporations as a leading force of digital transformation with SSDI enterprises catching up in the race



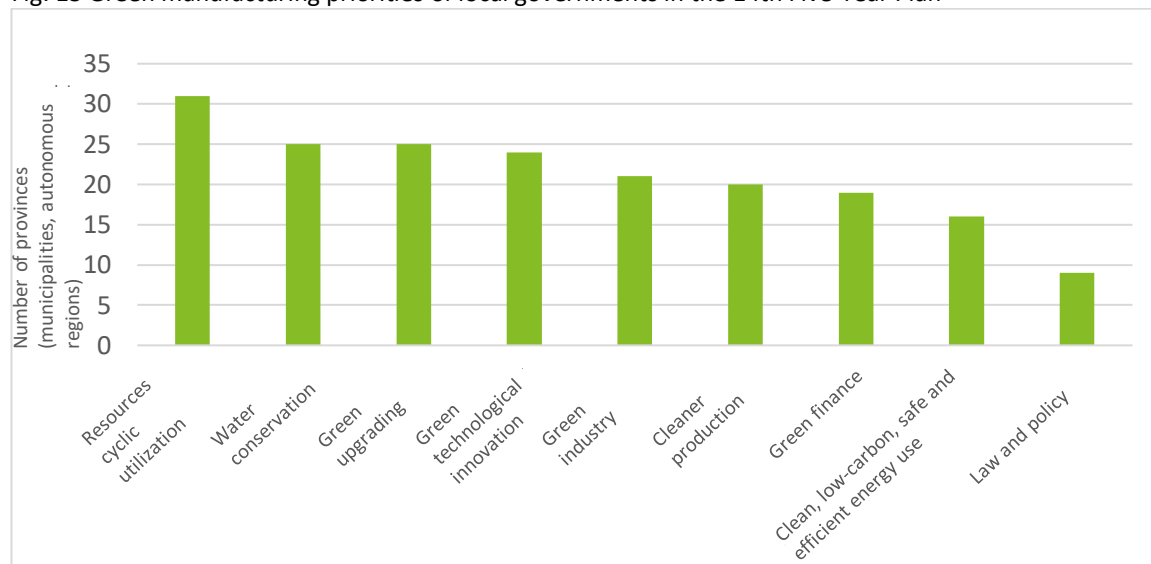
Source: White Paper on Digital Economy of China's Listed Companies (2022)

The manufacturing sector will become the focus of foreign investment: Expand the scope of encouraged foreign investment projects in manufacturing, especially in high-tech equipment, green decarbonization, and industrial upgrading in the central, western and northeastern regions of China.

Support high-tech manufacturing enterprises to go public: Support qualified foreign-invested enterprises to list on the A-share market and issue debenture bonds.

Green transformation: Green manufacturing represents a new development paradigm of future manufacturing, driving the growth of green product design, supply chains, industrial parks and post-market services. The circular economy, shared manufacturing and other new models will also scale up.

Fig. 13 Green manufacturing priorities of local governments in the 14th Five-Year Plan



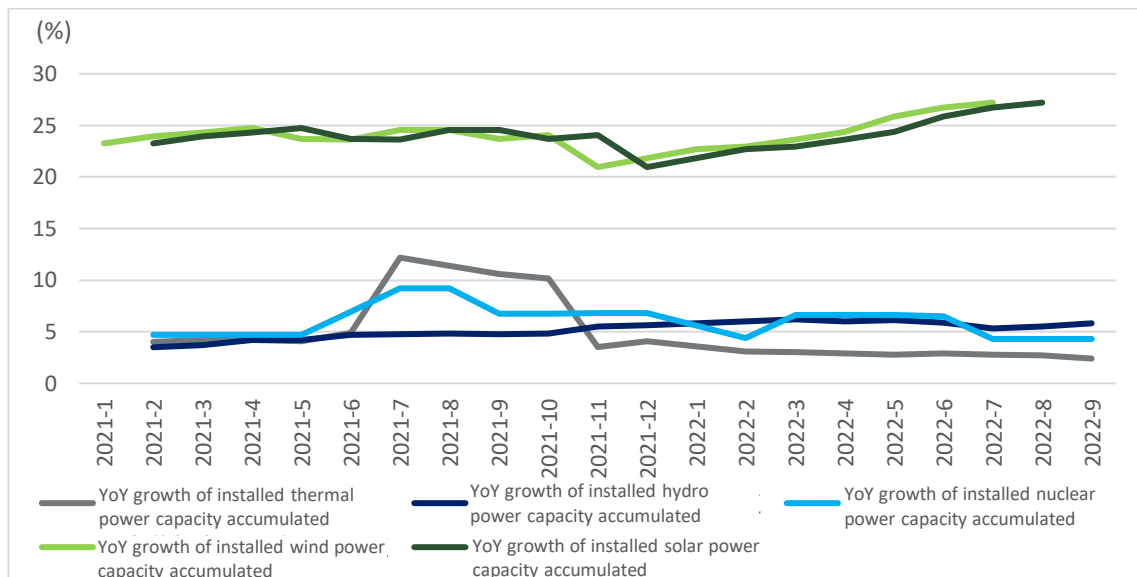
Source: Government Public Information

Energy and Resources

Adopt a "dual-track" approach for energy security and the energy revolution

Put energy security at the top of the agenda: The Report gave high priority to energy security and emphasized that the energy revolution should be carried out in an orderly manner in line with the principle of building the new before discarding the old. In this context, the clean and efficient use of fossil fuels has received much attention. Building a multi-wheel-driven energy supply system of wind, solar, nuclear, water, coal, oil, and gas resources is the ultimate orientation to ensure energy security. Thus, new energy development will speed up rather than slow down.

Fig. 14 Wind and solar power installed capacities surge in the 14th Five-Year Plan period



Source: Wind, Deloitte Research

Technological innovation serves as the primary driving force behind the energy transition: The Report stated again that China will exercise better control over the quantity and intensity of energy consumption, and transition gradually towards controlling both the amount and intensity of carbon emissions. Under the guidance of cutting carbon emissions, the cleaner and more efficient way of utilizing energy represented by Combined Cooling, Heating, and Power technology, the Internet of Things, and other technologies that can help improve energy management efficiency, and "carbon-negative" technologies such as CCUS (carbon capture, utilization, and storage) are key to the transformation of the fossil energy sector. Meanwhile, China's "dual carbon goals" will significantly stimulate the energy consumption transition towards cleaner energy sources, especially in construction, industry, transportation, and other key energy-consumption sectors. Hydrogen and electrification technologies enabling energy end-use transition toward new energy sources are seeing opportunities. With the accelerated penetration of new energy, demand for "green" metals such as lithium and cobalt is thriving. Technologies that can improve the energy transformation, energy density, and recycling efficiency of these metals, such as battery cycling, will become a new growth area.

Shifts in energy sales and supply urgently need new business models and energy solutions: In the development of energy infrastructure, digitalization will be pushed forward with the construction of the power grid and facilities for energy storage and replenishment. Digitalization of the whole link from production to supply, storage, and sales of energy will give consumers and communities more flexibility in energy use. Energy sales and supply will gradually shift to a two-way interaction model. V2G (vehicle-to-grid), optical storage, charging and inspection, and other energy solutions are also expected to be commercialized.

Conclusion and expectation

China is poised at a crucial stage as the country embarks on the journey towards its Second Centenary Goal with various development challenges to tackle. In an increasingly complex and volatile world, external demand is sluggish. At home, the national economy has entered a critical period of transforming the growth model, adjusting the economic structure, and building a new development pattern. The Report identifies China's strategic direction in the next five years and beyond. We believe that China will continue to advance reform and explore new ground, realize the premium of favorable policies and innovation initiatives, engage deeply in the international division of labor, and reshape global value chains to offer China's solutions for a global economic recovery and re-globalization.

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