

SCI China Market Update – December 2012

Dear friends,

“Certainly in my lifetime I’ve never seen a country with as many people rising into the middle class wanting to buy Apple products. The sky is the limit.” -- Apple CEO Tim Cook

As we anticipated in our October and November China Market Updates, Mr. Xi Jinping and Mr. Li Keqiang’s are now the new leaders in Beijing. In general, the transition was smooth and “normal”, but we noticed one interesting new twist. Mr. Xi has been given the titles of *both party chief and head of military at the same time*. This is the first time this has ever occurred. We believe this signifies the party’s desire to increasingly invest power in the office, rather than in the person. In the past, power largely stayed with the person – until he died. Even today, you see Jiang Zemin, long out of office, still seated in the middle of any official line-up. Although long out of office and with no title at all, he still holds much power. This is, of course, so different from the US, where once a person is out of office he or she is really out of power. We believe Mr. Xi’s dual titles represent a small but important step away from China’s tradition of lifelong personal power.

Changes are already occurring. Mr. Xi set the tone by pledging to implement the rule of law, in response to rising social discontent over government corruption and police brutality. "We must firmly establish throughout society the authority of the constitution and the law and allow the overwhelming masses to fully believe in the law," he said on China TV. He went on, "We must establish mechanisms to restrain and supervise power; power must be made responsible; power must be supervised; violations of law must be investigated... We must ensure that the power bestowed by the people is constantly used for the interest of the people." We can't help wondering if means that the party must also submit to the authority of the law in addition to the "overwhelming masses."

We also noticed that China's new leaders have urged an end to "pointless" meetings, speeches and other time-wasting events, in the latest call for improved governance. Of course, Mr. Xi's new government faces economic and political reform challenges. But the latest economic data show China is stabilizing, although its development will "face various challenges that should not be underestimated" next year. Chinese authorities will put "enhancing quality and efficiency of economic growth at the center" next year and will pursue growth driven by innovation. Here is some very recent China market news for your information:

China manufacturing grows for second month

China's manufacturing activity grew in November for the 2nd month in a row, in a further sign of strength after a marked slowdown. The indications of upward momentum were reinforced by a separate survey by British banker HSBC that showed growth for the first time in 13 months.

China's purchasing managers' index (PMI) reached 50.6 last month, up from 50.2 in October and 49.8 in September and the highest since hitting 53.3 in April. The PMI is a widely watched barometer of China's economic health and a reading above 50 indicates expansion. The data eased recent worries of a "hard landing", though experts caution that risks remain and reform are needed for long-term growth. GDP hit a more than three-year low of 7.4% in the third quarter. But there is now optimism that the worst is over. Exports, industrial production, retail sales and fixed asset investment -- a key gauge of infrastructure spending -- have all shown improvement.

Economy may rebound to 8.2% in 2013

Economic growth may climb to as high as 8.2% in 2013, supported by steady investment expansion amid rebalancing of the country's industrial structure, economists predict. They forecast that GDP growth is likely to speed up in 2013 and this may, in turn, provide more room for reform. The growth rate is likely to slow to 7.7% in 2012, from 9.3 percent in 2011. The expected rebound will be based on increased domestic demand for cars, houses and healthcare, as well as investment expansion in road and railway construction.

Demand for steel to rise 4.1% next year

Demand for steel in China is expected to rise 4.1% in 2013, as the nation's economic growth gets back on track. The 2013 China Steel Demand Forecast also predicted a decline in iron ore prices due to increasing supplies and slow growth in the global manufacturing sector. The report, released on Tuesday by the China Metallurgical Industry Planning and Research Institute, forecast that steel demand in China will reach 666 million metric tons in 2013. Actual consumption of steel in China was 640 million tons in 2012, an increase of 3.6% on the previous year. Crude steel output in 2013 will reach 746 million tons, up 4.2%.

NDRC approves 75b Yuan rail projects

China's top economic planner, the National Development and Reform Commission, approved infrastructure projects valued at 75 billion Yuan (\$12 billion), in an effort to stabilize China's slowing economic growth. The projects include a city railway in Fuzhou, the capital of Fujian province, a railway between Fuzhou and Pingtan, an island off the coast about 130 kilometers from Fuzhou, and the 2012-2019 city railway planning of Urumqi, the capital of Xinjiang Uyghur autonomous region in the far West. China City Railway Transportation Association said by 2015 total investment in China's city railways would amount to 1.2 trillion Yuan. By 2020, a total of 40 Chinese cities will have, or will be building, city railways. The length will be 7,000 kilometers, 4.3 times the current level.

China's airport construction takes off

As the global aviation industry is being hit by a downturn due to flagging tourist demand, China is seeing an airport construction boom driven by local governments. For example, Hunan province plans to build 21 general

aviation airports in the next 18 years. And neighboring Hubei province also said it would build 7 commercial airports and 2 general aviation airports in the next 18 years. General aviation airports are designed to handle four to 10-seat aircraft, as well as planes used for agricultural, industrial and rescue purposes.

In July, the State Council issued a document to encourage the development of China's civil aviation industry. In the same month, the Civil Aviation Administration of China (CAAC) said that the country plans to build 82 new airports and expand 101 existing ones across the country from 2011 to 2015. This year alone NDRC approved 24 projects to build new airports and expand existing airports, with an estimated investment of around 100 billion Yuan (\$15.9 billion). China now has only 182 commercial airports. The number is no more than 300 if general aviation airports are also counted.

Starbucks China University launched in Beijing

As coffee giant Starbucks opened its 100th store in Beijing last week, the company also unveiled its ambitious plans to make China its second largest market outside the US by 2014. The ubiquitous green and white coffee chain has set its sights on the burgeoning Chinese economy where the appetite for premium Western brands continues to grow unabated. By 2014, the company plans to have 1,500 stores in China. By 2015, it hopes to become a presence in 70 cities across the country.

Meanwhile, the 100th Beijing outpost is staffed with 'Starbucks Coffee Masters,' baristas who are trained in everything from coffee history to geography, agriculture, coffee sourcing, quality control, roasting and blending. Graduates must also undergo a training and skills exam before being certified and renew their certificates on a regular basis. Simultaneously, the company also announced the launch of a **Starbucks China University**, billed as a corporate university that will offer virtual training curriculums in everything from business, retail, coffee knowledge, culture training and leadership. Starbucks opened its first Chinese outpost in 1999. Currently, there are 700 stores in Mainland China. According to numbers out of Euromonitor International, coffee sales in China are expected to triple to 10 billion Yuan (1.2 billion euros) by 2016.

Jaguar Land Rover opens its 100th Chinese dealership

This week Jaguar Land Rover opened in Beijing its 100th retail space in the country, a key market for the brand since its first showroom in 2010. The new Center is located in the heart of the city and boasts a state-of-the-art repair center as well as a showroom. China is one of the company's leading export markets with over 57,000 vehicles sold in the country between January and October this year (a 75% increase on the same period in 2011), and the company is investing heavily in its Chinese infrastructure.

China pledges \$56 billion to cut air pollution

China announced it will spend 350 billion Yuan by 2015 to curb air pollution in major cities. Local governments will fund most of the programs aimed at cutting the level of harmful particles in the air in 117 cities by at least

5% between 2011 and 2015, the Ministry of Environmental Protection said. Doctors warn that the tiny floating PM 2.5 particles, named for their less than 2.5 micrometer diameter, can settle in the lungs and cause respiratory problems and other illnesses. China began publishing data on the amount of such pollution earlier this year in an effort to address concerns from residents that pollution readings were grossly understated.

China has cited its ongoing reliance on heavy industry as the reason it failed to meet some of its 2011 air and water pollution reduction targets. Earlier government projections gave more ambitious pollution reduction targets. State radio reported in February that Beijing would reduce PM 2.5 levels by 15% by 2015 compared with 2010 levels, and cut overall air pollution levels by 30% over the same period.

For more information about today's China market and opportunities, please visit our website at www.s-c-i.com or call me at the number below, or Dr. Tim Weckesser at 610-828-8060.

Best regards,

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