SCI China Market Update – November 2012

Dear friends,

Dr. Tim Weckesser, President & CEO of SCI, and I just returned from Beijing after back-to-back trips for various projects. The US presidential candidates' tough talk about US-China relations was a hot topic in most of our dinner conversations. Good or bad, it seems China's huge economy and market is now key factors in world politics. Yet just ten years ago, they were hardly on anyone's radar screen. Interestingly, during November 2012 we will see not only the next U.S. president but also whether there is a smooth transition to the next Chinese president-in-waiting, Xi Jinping, and prime minister-in-waiting, Li Keqiang. We guess that whether Obama or Romney becomes the next U.S. president, the impact on the U.S. and world economy may not be very great. However, because the systems are so different, changes in China's top leadership may mean a huge difference in terms of China's economic and political reforms. We hope the impact of the China's new leaders will be positive and will benefit U.S. companies.

Regarding today's Chinese economy, there are signs of growth and recovery. Things are changing. Here is some very recent China market news for your information:

VAT will replace business tax nationwide to stimulate economic growth

We hope all of our clients with operations in China pay attention to this important change and trend. To alleviate the tax burden on companies and encourage industry upgrading, China will widen trials replacing its existing business tax with value-added tax (VAT) over the whole country. Vice Premier Li Keqiang said at a tax reform meeting in Beijing recently that levying VAT to replace business tax is an important part of the country's fiscal reform and a key measure to stabilize growth and adjust the economic structure. He said the government should accelerate such measures so they can benefit more companies.

Under the current tax system, companies pay business tax based on a percentage of revenue. After the reform, they will instead pay VAT, a tax on the value added to a product. This change could help businesses recoup the cost of materials and other taxable inputs. China's economic growth slowed to 7.4 percent in the third quarter this year, the lowest in more than three years. To tackle economic difficulties, economists have called for the government to implement more new policies, including tax reduction that would spur growth. Shanghai started the VAT pilot program early in 2012. It replaced the business tax with an 11% VAT rate on the transport sector and a 6% rate on the service industry. It is said this new system will be especially beneficial to R&D, technical service, and high tech companies as it will make investment in new equipment much more economical. Statistics at last week's meeting showed that the tax reduction has saved companies in Shanghai more than 17 billion Yuan ($2.7 billion) so far. The VAT reform program was expanded in August to nine provincial regions and three cities, including Beijing, Guangdong and Zhejiang provinces. Some companies taking part in the VAT reform disclosed that their tax has been cut by 40% on average. China has more than 10 million small and medium-sized companies, which contribute around half of the country's tax revenue.

Chinese manufacturing expands in October

China's manufacturing activity grew in October for the first time in three months, adding to hopes the economy is finally reenergizing An HSBC survey reinforced these findings.

China's official purchasing managers' index (PMI) rose to 50.2 last month, up from 49.8 in September, which was broadly in line with expectations. A PMI reading above 50 indicates expansion and anything below points to contraction. China's PMI figures are a closely watched barometer of the economic health.

The HSBC index grew to 49.5 in October from 47.9 in September. While it still represents shrinking activity, HSBC data continue a recent uptrend. Qu Hongbin, HSBC's chief economist for China, said that the latest figures indicate "China's industrial activity continues to bottom out following a modest pick-up last month".

China's manufacturing sector has been hit this year by a broader slump in the economy, which has suffered from weaker demand for the country's products in the crucial export markets of Europe and the United States. Beijing last month said GDP grew 7.4% in the three months until September, slowing for the seventh straight quarter and marking the worst performance in more than three years. Analysts suggest the latest news, on top of better export, industrial production and retail sales data, indicate that the worst could be over.

Grace Ng, senior China economist at JPMorgan, told Dow Jones Newswires the official data shows "the economy is on the way to a moderate recovery" and reinforces the message that it has bottomed out. The improving economic outlook comes at a crucial time for China, which is embarking on a once-a-decade leadership transition set to begin at a Communist Party congress on November 8.

China's RMB (Yuan) ends at new record high

China's currency ended at a record high against the US dollar for the second straight day Wednesday, in what analysts said could be a response to US criticism over claims the Yuan is vastly undervalued. The Yuan has strengthened around 2% against the dollar since the end of July, ahead of US presidential elections and amid growing confidence in the Chinese economy, which has shown signs of bottoming out. The Yuan -- which trades in a tightly-controlled band -- ended at 6.2372 to the dollar on Wednesday, marking the strongest finish since 1994, when the country launched its modern foreign exchange market. It closed at 6.2405 Yuan to $1.0 on Tuesday.

China's exchange rate has been a long-running source of friction with the United States and presidential hopeful Mitt Romney recently vowed to brand the country a currency manipulator. Investment bank UBS also said the Yuan's appreciation would slow but predicted more volatility, adding that it would stay in a range of 6.2 to 6.4 over the next 12 months. "Given the weak export growth, we believe the government has no appetite to let the (Chinese Yuan) appreciate steadily and consistently," it said in a research report this week. A stronger currency makes China's exports, the mainstay of its economic growth, more expensive.

China approves Jaguar Land Rover venture

China has approved a joint venture, which will see Jaguar Land Rover (JLR) make and sell luxury cars in China in partnership with domestic company Chery Automobile. State planner the National Development and Reform Commission approved the joint venture seven months after it was announced by the car manufacturers, Xinhua news agency said. The 12-billion-yuan ($1.89 billion) venture was approved in half the time the process commonly takes in China because "Chery was familiar with the approval procedure and did not waste time", a company spokesman told the news agency.

The joint venture will set up a research and development facility and a manufacturing plant in the eastern city of Changshu in Jiangsu province.

It is scheduled to become operational in 2014 and will produce 130,000 vehicles a year, mainly Land Rover and Jaguar vehicles but also some co-branded cars. Sales of JLR cars reached 53,000 in China in the first nine months of the year, up 80% from a year earlier, according to figures from the China Association of Automobile Manufacturers quoted by the news agency. JLR's owner, India's Tata Motors, has revealed plans to double its investment in its subsidiary to 1.5 billion pounds a year. Chery, which makes passenger cars, utility vehicles and engines, is one of China's largest automobile makers and exports to over 60 countries.

China lifts ban on nuclear plant approvals

China has lifted a ban on new nuclear power stations imposed after Japan's Fukushima disaster last year, but will only approve projects proposed for coastal areas, the government said. A "small number" of coastal nuclear power plants will be allowed before 2015, said a statement issued by China's State Council following its meeting on Wednesday that also revised down targets for new atomic capacity.

Seeking to allay safety fears, the State Council said that all new nuclear plants will be constructed according to "third-generation safety standards," which apply to the most recent generation of nuclear reactors. The ban on approvals of inland power plants is likely to halt the construction of three proposed projects. The Pengze nuclear power plant in Jiangxi province, the Dafan plant in Hubei province, and the Taohuajiang plant in Hunan province, all in central China, will be "severely hit" by the ban, the state-run Economic Reference newspaper reported.

China has 15 operational commercial nuclear reactors, and had ambitious plans to expand its nuclear industry, with 27 reactors under construction near coastal areas, according to the World Nuclear Association. The Asian giant reduced its total nuclear energy capacity target on Wednesday to 40 gigawatts by 2015, according to a white paper released by China's State Council, down from a previous government target of 50 gigawatts. China's Ministry of Environmental Protection said in a report this October that the country's nuclear safety situation was "not optimistic", and that the use of differing types of reactors in Chinese plants made the sector "difficult to manage".

China overtakes US as leading FDI destination

China has surpassed the United States for the first time since 2003 to be the world's largest recipient of global foreign direct investment in the first half of 2012, showing that global investors are still confident in the world's second-largest economy despite its economic slowdown. FDI inflows to China amounted to $59 billion in the first half of this year, despite a year-on-year decline of 3% from $61 billion in the first half of last year. Meanwhile, FDI flowing to the US reached $57.4 billion, a decline of 39.2 percent from a year earlier, according to the Global Investment Trends Monitor released by the United Nations Conference on Trade and Development, or UNCTAD, on Tuesday.

"China's biggest attraction to global investment is now its huge market, contrasting the long-time low cost, which is now ranked third or fourth," said Zhang Xiaoji, director of the Foreign Economic Relations Development at the Development Research Center of the State Council, a top government think tank.

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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