SCI China Market Update – September 2012

Dear friends,

As summer comes to the end, we send you our September newsletter focusing mainly on China's economic slowdown. Ironically, some of our client's summer sales in China were pretty good. As reported in earlier newsletters, the impact of China's slowdown is big in certain sectors, for example coal, steel and ship building, as well as real estate. But soon, probably about mid-October, the important 18th National Congress of the Communist Party of China (CPC) will be held in Beijing aimed at grooming a younger, better educated generation of leaders.

It's no secret that if no special problems arise during the 18th National Conference, Mr. Xi Jinping will replace Mr. Hu Jintao to become the new party boss and president of China. Mr. Xi was educated at Tsinghua University and is currently VP of China and of the Party. His wife, Ms. Peng Liyuan, is a famous and beautiful Chinese singer. But his real pedigree comes from his father, Mr. Xi Zhongxun, who was an "old comrade" going back to Mao's time, but was more open minded, like Deng Xiaoping. In fact, it was Xi Zhongxun who strongly recommended to Deng that the first Special Economic Zones (SEZs) be set up in Guangdong Province. This led to the conversion of a sleepy fishing village called Shenzhen into China's first SEZ, which today is larger than New York City. In fact, the SEZ economic development model spread like wildfire along the coast of China for the next 20 years after the Shenzhen success and became a key to "The China Miracle."

At the same time, Mr. Li Keqiang will likely replace Wen Jiabao to become China's new Prime Minister. Mr. Li was born in 1955 and graduated from Beijing University's School of Economics. With "on-the-job" postgraduate education (a China specialty) Mr. Li went on to earn his doctorate in economics. So, a new Xi - Li government will be established in Beijing and will very likely continue and speed reforms needed in the economy.

Below is some very recent China market news for your information:

China approves 25 subway projects in stimulus move

Twenty-five new subway projects have been approved in a new move to stimulate China's slowing economy. This is part of a new wave of investments in public works this year to reverse the country's worst economic slump since the 2008 global financial crisis. The NDRC has announced that, so far, about 840 billion yuan ($133 billion) will be invested in these subway projects. They include new lines in Shanghai, Taiyuan and Guangzhou.

At the same time, Beijing has also approved construction of airports, highways and other public works. Authorities have resisted calls for more aggressive measures after their huge spending in response to the 2008 crisis fueled inflation and a wasteful building boom.

August Import/Export Slow

According to a Reuters poll, China's export growth probably edged up in August from extremely low levels earlier while a slump in imports was seen to worsen reflecting concerns that the world's second-largest economy may have cooled further in the third quarter. Any sign of further slowdown will strengthen expectations that Beijing will take counter measures to boost an economy that has slowed for six straight quarters and is at risk of missing this year's growth target of 7.5%.

The median forecast of 22 analysts surveyed by Reuters showed China's exports grew 3% in August from a year earlier, while annual growth in imports fell to 3.5% from July's 4.7%. The monthly trade surplus declined to $19.8 billion, from July's $25.1 billion. China surprised investors in July when its exports grew a meager 1% from a year ago, the weakest growth in nearly three years, excluding a contraction in January when the Lunar New Year holiday distorted trade flows. China's official factory PMI showed new export orders stabilized at 46.6 in August from July, but still below the 50-point level that separates expansion from contraction.

Coal industry profits drop due to sluggish sales

China's Bohai-Rim Steam-Coal Price Index tracks power station coal prices at six ports. The index rose by 1 yuan (16 cents) a ton this week, the first increase after 13 weeks of declines. However, the industry outlook for the second half of the year is not optimistic due to lackluster demand and overstocking, analysts said. The coal industry is facing a large-scale downturn. Shengyin & Wanguo Research data showed that among 40 listed coal companies that have filed interim reports, 28 had negative growth and six posted losses in the first half of 2012.

The industry outlook for the next half is not optimistic, as coal prices at the origin are seeing constant declines, and overstocking has worsened the situation. Thirty-two out of the 40 companies had an inventory value higher than last year, and 11 had an inventory growth rate of more than 50%. Overall, the range of the coal industry's losses for the first half rose 4.28 points from last year to 17.78%.

Power industry growth rate hits five-year low

The operating income of A-share listed companies in China's power industry in the second quarter increased 4.47% year-on-year, the lowest quarterly increase for the past five years. According to the newly released half-year results, the listed companies had an operating income of 136.7 billion yuan ($21.5 billion) in total. The growth rate of electricity consumption dropped to 4.3%, highlighting China's economic slowdown, though better than the situation in 2008. In terms of net profit, the power industry earned 7.63 billion yuan in the second quarter, representing a year-on-year growth of 13.4%, a bigger increase than the growth in operating income.

However, electricity consumption figures are not suggesting a warming up of the country's macroeconomic situation. In April, the growth rate of consumption dropped to 3.7%, the lowest ever figure since June 2009. Usually, the operating income growth rate in the power industry is much higher than the electricity consumption growth rate. However, the growth rate in operating income in the second quarter was close to the consumption growth rate.

Microsoft to hire 1,000 in China over next year

Microsoft will hire 1,000 staff in China over the coming year, adding to the company's current 4,500 employees, a senior executive said. The move is aimed at strengthening the company's position in a market it considers key to future growth, but where software piracy and regulation remain serious problems. The expansion comes as part of a sales and marketing effort aimed at target customers such as local governments and public institutions, said Ralph Haupter, CEO for Microsoft's Greater China operation Haupter.

China's Lenovo to buy Brazilian electronics company CCE

China's Lenovo Group Ltd., the world's No. 2 PC maker, agreed to buy Brazilian electronics maker CCE, as Lenovo bets that Brazil's promising consumer market can help revive its slowing growth. The deal is valued at a base price of 300 million reais ($148 million), subject to adjustments. Payment is a mix of stock and cash and could include an additional 400 million reais, depending on performance-based indicators over the next four years.

China's Baidu to invest $1.6 billion to set up cloud computing center

China's largest search engine Baidu, Inc. will invest more than 10 billion yuan ($1.6 billion) to set up its cloud computing centre, according to Baidu's chief financial officer Jennifer Li. Baidu, which unveiled its mobile Internet browser at its annual conference in Beijing, is pushing deep into cloud computing as the heart of its mobile strategy.

Weichai Power takes stake in German truck maker

Weichai Power, an automotive and equipment manufacturing firm under Shandong Heavy Industry, bought a one-quarter interest in the German forklift truck maker Kion Group. This 738 million-euro ($922 million) deal marked the greatest direct investment in a German firm made by a Chinese company to date. Under the deal, Weichai Power will invest 467 million euro to acquire a 25-percent stake in Kion Group, and another 271 million euro for a 70-percent majority stake in Kion's hydraulics business. Kion Group is the world's second-largest forklift maker and holds a 15% global market share. The purchase is expected to offer Kion debt-refinancing relief.

Ford taps Chinese heavy-duty truck market

Ford wants to tap the world's largest market for heavy-duty trucks by going through its China affiliate to take over Taiyuan Chang'an Heavy Duty Truck Co. Ford said that Jiangling Motors Co, in which it holds a 30% stake, will acquire Taiyuan Chang'an from its parent companies, China Chang'an Automobile Group and China South Industries Group Corp. The plan is to sell Taiyuan Chang'an for 270 million yuan ($42.4 million). The deal requires approval from the Chinese government. China is the largest market for heavy-duty trucks in the world, with one million sold in 2011, more than in North America, Europe and South America.

VW settles gearbox plant in Tianjin

Volkswagen China broke ground on a new gearbox plant in the western area of Tianjin's Economic-Technological Development Area. "Volkswagen's state-of-the-art gearbox DQ380 and DQ500 will go on stream in the first half of 2014 as scheduled," said He Shushan, chairman of the Administrative Commission of Tianjin Economic-Technological Development Area. "The total investment of the entire project is as high as 900 million euros. The transmission DQ380 and DQ500 represents the most advanced technology in the field. It only took six months from the project initiation to the start of this plant."

"Tianjin is positioned by the nation as the base of the high-end manufacturing industry and research and development transformation. Volkswagen's project in Tianjin is a leader in the manufacturing industry which can not only create output value, but attract many supporting enterprises as well," he said. The first phase of the plant, with an investment of 1.84 billion yuan, is expected to start producing DQ380 gearboxes at the end of 2014 with an annual capacity of 450,000 units. In the meantime, the first phase of the project will create more than 1,500 direct employment opportunities.

China signs deal for 50 Airbus planes

China and Germany signed a series of cooperative documents Thursday, including a procurement deal for 50 Airbus planes. China's ICBC Leasing and Airbus signed the deal for the 50 planes worth some $3.5 billion.

China will need 5,260 new planes by 2031: Boeing

China will need 5,260 commercial jets by 2031 with an estimated market value of some $670 billion, according to a forecast from US aviation giant Boeing. Randy Tinseth, vice president of marketing for Boeing's commercial airplane section, said they had revised expectations upward from last year, when it predicted China would need 5,000 new planes by 2030. Between 2012 and 2031, China will account for 15.5% of the 34,000 airliners to be sold around the world, according to Boeing's projection.

For more information about today's China market and opportunities please visit our website at http://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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