

China Watch

A China Business Report prepared by David Mahon,
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W I N T E R 2 0 0 9 - 2 0 1 0

In adversity everything that surrounds you is a kind of medicine that helps you refine your conduct, yet you are unaware of it. In pleasant situations, you are faced with weapons that will tear you apart, yet you do not realise it.

Huanchu Doaren, 1600

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Consumer nation

The developed economies of the world have an attitude toward China that is a mixture of scepticism and opportunism. Foreign investors and economists are asking themselves if they can rely on the integrity of China's 2009 high GDP growth rates and the central government's aims to alter the mix of China's economic fuel. Last year, China focused heavily on government investment in infrastructure and state-owned industries, and has only just begun the structural reforms to release the deep potential for greater domestic consumption. The contribution of domestic Chinese consumption to GDP growth has nevertheless been more than adequate over the past five years; GDP has increased, in nominal terms, by 20–25% each year, with domestic consumption contributing 3–4% to annual GDP growth.

In the final calculation of China's economic performance for 2009, GDP will be seen to have grown by 8–8.5%. The breakdown will be approximately: 7% in investment, 3% in consumption and –2.5% in trade.

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the growth strategy of recent years, which was becoming unbalanced due to its increasing dependence on foreign trade. In 2010, domestic consumption is likely to increase, and the contribution of foreign trade will be positive, or at least neutral. The shock of the global financial

crisis has nonetheless made many in the developed world and a number of Chinese analysts and professionals deeply fearful, even to the extent that they distrust the universal mechanisms by which economies are measured, often distorting their analyses of the Chinese economy.

'China should not keep pumping money into its domestic economy and strengthening the old command system. But being reminded what it feels like to be Stalinist economic engineers, Chinese government officials will just squeeze the private sector, favouring their own state-owned assets, and create an even more lopsided economy than the one we have now. This country has only delayed an inevitable crash.'

Western fund manager in Shanghai

The least imaginative in China's provincial governments welcome the availability of cheap capital and the freedom to engage in public works of grand scale as ends in themselves. Although the overall GDP growth figure will be a true reflection of the economy in 2009, many small towns and counties have gone to extraordinary lengths to meet the required targets, such as imprudent sales of land, which they will regret in the coming years. In some cities and counties in China, the deployment of the current stimulus package has the characteristics of the political movements of 15–20 years ago.

This recalcitrance will nevertheless be short-lived. The economic imperatives of market forces have shaped China for the last two decades and will continue to do so in the coming decade. The continued emergence of private companies has been one of the key drivers of the expansion of the Chinese economy. Private businesses are already responsible for 60% of the gross value of industrial output and own roughly half the industrial assets in China. The Chinese central government understands that the liberalisation and growth of the private sector are critical to its aims to boost domestic consumption.

The contradictions of consumption and thrift

One key indicator of consumer power in China that is not well understood is the rate of personal savings. For over a decade, China's personal savings rates have averaged 40%. This figure has been cited

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variously as an example of the prudence of Chinese householders or an expression of insecurity in the face of poor social welfare and health services. The propensity of Chinese people to save is a stubborn aspect of their

culture, and so even as health services improve and more investment alternatives become available, this is unlikely to change significantly. High savings rates should not, however, be used as an argument that consumption is weak in China.

Closer analysis of personal savings rates shows that, among the true personal deposits, there are also deposits made by state-owned enterprises (SOEs) in the names of individuals. It is impossible to say what percentage of overall savings these deposits constitute exactly. It may be 7% or 10%,

but it is significant enough to distort the true individual savings figures. Chinese people actually spend more than the statistics indicate. Private wealth has exploded in China over the last 15 years. Total private bank deposits grew from RMB4.6 trillion (approx. US\$550 billion) in the mid-1990s to almost RMB20.5 trillion (approx. US\$3 trillion) at the end of 2009.

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Consumption in China is conspicuous. Property and auto sales are booming; many analysts, including those in Chinese banks, argue that China is creating a giant property bubble and pushing the sale of automobiles through state-owned entities. Yet, outside the

larger coastal and a few inland cities, the housing market is driven by real and not simply speculative domestic demand. As the government continues to curtail approvals for high-end property developments in 2010, the planned shift to a broader middle- and lower-middle-class market will gain more momentum.

'Property speculators outside the county do not come here. Yet the housing prices are already half of those in Shanghai. There are thousands of small- and medium-sized private enterprises in the county, providing strong support to the prices at the current level.'

House buyer from a third-tier city in Zhejiang province

Some foreign analysts argue that the stated demand for automobiles in China is false because state fuel sales do not match the exponentially increasing sales of automobiles in the last 12 months. This is due partly to the fact that state statistics do not take into account the 'teapot' oil refineries around China — illegal refineries that buy their oil from Chinese oil fields and sell the petrol to service stations at discounted prices. Also the point is overlooked that many of the cars purchased recently are small (with engines as small as 800cc), consume less fuel and are only driven short distances, often only to and from work. The Chinese government committed RMB140 billion (approx. US\$20.5 billion) in 2009 as part of a broad programme of tax breaks and subsidies to encourage motor vehicle owners to trade in their existing vehicles. A similar range of subsidies established in 2009 for the purchase of white goods will be extended throughout 2010.

Despite the fact that China's stimulus package of RMB4 trillion (approx. US\$586 billion) was deployed so swiftly in late 2008 and a significant amount was misused, the actual losses to the government have been surprisingly light. The current level of non-performing loans (NPLs) in Chinese banks is no more than 5%. This contrasts with the predicament in which banks found themselves in the 1990s when, after years of flawed policy loan programmes, they were struggling with NPLs in excess of 30%. China had to stimulate its economy, just as all those throughout the world

with the means to do so have had to intervene to try to repair their badly damaged trading and financial systems.

Although government economic stimulus will decrease in 2010, China can afford the amounts of money that it has invested so far, and the wide array of projects that began as a result of government stimulus will continue to have a positive impact on domestic consumption.

'A group of us come from a village in Hubei. We are paid RMB2000 (approx. US\$223) per month to work on this project in Beijing. I would earn no more than RMB300 (approx. US\$44) per month at home. Good? Of course it's good. I can save money here and start a business back home.'

Migrant worker from Hubei on one of Beijing's underground rail construction sites

This man from Hubei province is working through the winter wrapped in padded clothes against temperatures lower than -10°C . He lives with scores of other men in a makeshift plywood hut provided by the construction company. It is fitted with bunks, heated by wood stoves and festooned 24 hours a day with clothes drying on lines strung between the rafters. Throughout his time in Beijing, another worker will use his bunk while he is working his shift. As he worked in the clouds of cold, swirling dust, drivers in Mercedes vehicles and other similarly expensive cars moved impatiently around the obstacles of pile drivers and concrete mixer trucks to enter their gated community, in which the price of the houses averaged RMB10 million (approx. US\$1.5 million).

'They don't notice us, except to sound their car horns when we or our machinery get in their way. They are rich here in Beijing, but by the time I finish this job I will be rich in my village in Hubei and people will have to respect me.'

Migrant worker from Hubei province

...Workers...are slowly rising from mere existences to more prosperous, consumption-oriented lives.

The evolution of this migrant worker and his family is similar to that of the large numbers of workers like him who are slowly rising from mere existences to more prosperous, consumption-oriented lives. For 15 years, hundreds of millions of people have trudged relentlessly from the countryside to work, and eventually live, in the nearest towns or in faraway cities. They will continue to do so in the coming decade in even greater numbers. The current urban population is approximately 600 million (just under 50% of the total population); this figure could reach 1 billion by 2030.

The private sector's struggle

The central government has at its disposal the means to generate even more demand by curtailing its own monopolies in myriad industries, from telecommunications, freight forwarding and the media, to chemical production, mining, transport and infrastructural development. It is remarkable that China, an economy that is driven largely by private

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companies, has thrived so well in an environment that favours the interests of SOEs so heavily. It is evidence that, although government policies and individual Chinese leaders have been given the credit for China's emergence, the real causes are the collective aspirations of the Chinese people and their capacity to suffer hardship and endure.

The argument that the state's heavy hand in the economy has been for the sake of stability has had currency over the years. China is, however, now open to domestic and international economic forces that it must understand deeply and deal with by adopting flexible economic policies.

'Once, we thought first of what the party wanted and made our decisions, then we thought of what the people wanted and how they would react; now we still consider public reaction, but no major decision is made without considering what our major trading partners will think.'

Retired senior party official

This past year of global recession and the current stuttering global recovery presents a challenge China can accept, and within which the nation can find the rationale for further radical economic reform. In order to increase domestic consumption, the confidence of businesses must grow. This can only occur through structural changes to key sectors of the economy.

'We don't really do business in China — we are a pure exporter. With a fall in international demand, the double-digit growth our company experienced over the last eight years has dropped to single digits in the last 12 months. We have come through the recession well so far, but I am anxious that we may now need to engage in our own domestic Chinese economy. Our foreign clients pay their bills and generally keep their contracts. This is not always the case when dealing with local companies. We are a casualty of the collapse of the export sector, and although we are debt-free and relatively stable, I fear for the future. I suppose in many ways I fear the unknown.'

Owner of a light manufacturing company
based in Zhejiang province

The odds against private-sector firms in China are considerable; the strongest are very strong, but many good small- and medium-sized businesses fail needlessly. Private firms such as the white goods manufacturer Haier, beverage group Wahaha and Beijing property company Soho are all dominant in their respective sectors and show how strong private enterprises can become in China. Nevertheless, for all the successes in the private sector, there have been casualties when the state intervenes.

In Shanxi province, private coal mines of scale proliferated over the past years. In 2009, there were 1,500 mostly privately owned mines. Working, with justification, within the policy of improving mining safety, the government closed and consolidated mines across the province. While many private mines were death traps, many others had grown to become as large and sophisticated as any run by the government. In late 2009, their owners were required to sell their assets to the government for as little as 20% of their true value. This confiscation of assets sent waves of anxiety through the province's private sector. It also brought a shock to investors around China who had financed the initial privatisation and development of the Shanxi mining sector. Investors from the city of Wenzhou, Zhejiang province, among some of China's boldest entrepreneurs, suffered substantial losses.

There are many such examples of parts of the state-owned economy purloining assets from the private sector. Although such actions are often motivated by genuine environmental security and safety concerns, they nevertheless become contorted in the labyrinths of local political and economic interests.

Groping for justice

These imbalances and injustices are also the forces driving the evolution of a more active legal system. It is a painful, halting process. Law evolved in the industrial economies of Europe and North America as traders, financiers and industrials, and their patrons within government, moved to protect their assets. To some extent, law also improved because those in political power have always wanted to stem social unrest.

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With a great number of demonstrations and disputes in China in recent years based around disagreement over the confiscation of land and the collapse of companies through corruption, the implementation of law is improving out of necessity. Eventually, the strengthening legal system will be able to take on the gangster-like

practices that exist around large industrial and property deals and in many cash-rich service companies.

'It took us seven years to settle a deal with the developer who bought our property. I had to pay a local official in the county to ensure that I got the full value for our house and land. He now comes back each month and asks for more money. Some of my neighbours, who did not pay anyone in the county government, received less than half the value of their land. We all tried to use the delays and disputes around our relocation by building as many buildings as possible on our land. The more built up a piece of land is, the more you get for it. When you cannot rely on basic justice, you take what you can in any way you can and expect that you will be cheated at some point.'

Resident of a village at the edge of Beijing

All evolving economies have been blighted by various forms of corruption, cronyism and thuggery. To varying degrees these forces exist in every economy today. Due to corruption and unhealthy alliances between governments and businesses that weakened oversight and emasculated regulation, the developed world managed to collapse the global financial system. China, however, is growing so fast and changing so dramatically that it cannot afford to tolerate reviving the sophisticated corruption of the gangsters and secret societies of the past. The imbalances that such lawlessness would create would be unbearable. The Chinese Revolution of 1949 was fought to end such practices. If the government expects private investors to take risks in their own economy, it must provide them with more certainty.

So China must continue to change, for it has little choice but to adapt to the market forces and growing social demands that are now so strong in its economy. As lopsided as development may often be, in any historical context the improvements to the lives of ordinary people in both rural and urban China are still profound. Most Western commentators work within the framework of their own direct exposure to the economy and the society that has taken place in short timespans. Their opinion is only as valuable as the extent to which they have had real exposure to the lives of ordinary people, not just as observers, but as personal participants.

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Westerners viewing China are also too often limited by the fact that their benchmarks are based on their own cultures, with all the biases and historical baggage that goes with them. The Chinese tend to be similarly limited when assessing the West. In this time of global crisis,

the Chinese economy may only be understood within its own historical context that takes into account the past 30 years. Much of the financial world was mistaken in underestimating China in 2009. It would be stubborn folly to make the same mistake in 2010, a year in which there are fewer economic dangers and for which the trends are already evident. ☹