



# ET2C NEWSLETTER



**ET2C International Inc**  
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## Six Thousand, Nine Hundred and Thirty-Three Miles

*China, large as it is, does not run away from its responsibilities and will fulfil them consistent with its status'. Li Keqiang (Chinese Vice-Premier, FT January 10th 2011).*

Written to coincide with China's trade delegation to the UK, Li Keqiang titled his recent comment in the editorial of the Financial Times, 'The World Should Not Fear a Growing China.' China, at least externally, is now facing up to the expectation from other countries and governments that it will need to play a role on the global stage that is befitting of their growing economic might. Similarly, President Hu Jintao submitted written answers to the Wall Street Journal and the Washington Post in the lead up to his State visit to the US - unprecedented by a Chinese President. In the article, he states that the US currency, as an international currency, is a 'product of the past' underlining China's growing confidence on the global stage.

**6.4581**

12 month Non-Deliverable Forward RMB:USD rate earlier this month suggests a 2.7% increase in the next 12 months

There is little doubt that the appreciation of the Chinese currency will continue to be a topic of much debate between the US and China (this was covered in our Oct Newsletter: The Politics of the Yuan), the impact of which is likely to have significant repercussions across many economies around the world. Importantly though, China now feels it can stand its ground and is not simply going to let both domestic and in-

ternational policy be dictated by others (particularly the United States and Europe). The very fact that Chinese leaders are now speaking directly to foreign press on contentious issues and putting across their own point of view is evidence of this. It also lies in stark contrast to the Chinese Government's use of Chinese think tanks in the past, which were aligned to Central Government, as a means of communicating their opinions to the world's media.

Notwithstanding the above, China is still suffering the growing pains associated with any developing nation. In what was a rare appearance in front of the White House press corps, President Hu himself acknowledged that China was a 'developing country with a huge population in a crucial stage of reform' and that these presented 'challenges in both economic and social developments'.

With the development and growth in Asia, inflation continues to be a prevailing factor in most Low Cost Countries and China is no exception. We continue to see a rise in commodity costs as the global economy slowly continues to recover (Consumer Sentiment for January 2011 in the USA jumped to 60.6 from 53.3 in December) which directly impacts cost price but the social development to which Hu Jintao refers has also had an effect. We have seen increasing strike action throughout Asia for improved working conditions and better pay (note that this is not limited to China; for example, Bangladesh's garment export sector has recently been plagued by numerous strikes over the minimum wage). This too fuels the fires of inflation and ultimately feeds into unit cost, especially in labour intensive manufacturing where wages form the largest part of the ex-factory price.



Guangdong Provincial People's congress has recently announced plans to increase wages more rapidly over the next five years and has recognised the need to pay factory workers more in a bid to accelerate the exodus of labour intensive factories to other regions within China. A trend that we have mentioned previously and such action reiterates the necessity not to rely on the Pearl River Delta for labour intensive production.

**4.6%**

Consumer price index falls in December from 5.1% in the previous month.

However, one might argue that the Chinese are best positioned to deal with inflation with their command control governance. The People's bank of China has raised the reserve requirements on state banks six times in 2010, requiring that they set aside 18.5% of their deposits to take money supply out of the economy. Furthermore, the RMB Cross-border Trade Settlement Scheme (started in July 2009) has been expanded to allow 67,000 Chinese companies to settle RMB trades offshore to ease the pressure on the central bank's purchases of foreign exchange. Non-Chinese Individuals, as with HK residents for the past 18 months, will also soon be able to hold savings in RMB as long as their bank has the capability to do so; again, a means of controlling the pressure on the RMB.

It is also important to realise that inflation is by no means a Chinese (nor even Asian) phenomenon. From a Chinese perspective, it is often the case that other Low Cost Countries in Asia are purchasing raw material from China, taking on the inflation as well as the incremental costs of freight, import duty etc. The inflation rate in Indonesia was 6.96% and 3.00% in the Philippines in December of 2010. India and Pakistan are currently fighting rampant inflation and Brazil also reported an inflation rate of 5.91% in December of 2010.

Within the supply chain, inflation will certainly be one of the challenges in 2011. Any increases in unit price will be further exacerbated by the reluctance to pass on the increase to the high street because of the fragile state of the global economy. It is, therefore, paramount that companies continue to look for additional (and more competitive) suppliers, with which they can develop long-term partnerships. This is important because it should be possible to mitigate the cyclical shocks and fluctuations thereby helping reduce the import of inflation through the supply chain. An ability to both manage vendors and resource new manufacturers at local level should therefore form a key strategic part of any companies supply chain. We expect the trend of vendor migration to continue and therefore the identification of manufacturers based further inland and away from the traditional manufacturing bases (i.e. South and East China) will be more likely to offer better pricing.

Compared with other manufacturing export countries, we still feel that China has the population to provide sustainability of production and an infrastructure to provide additional efficiencies.

**6933**

Distance in miles between Beijing and Washington DC

China is now clearly a permanent fixture on the global stage as evidenced by the recent State visit of President Hu to the White House. Common ground between the US and China may be sought, but there are still distinct differences of opinion (currency appreciation, security, military, Tibet, diplomacy etc) and with the latter's new found confidence and growing strength, there is still some distance to go before China yields to others' demands.

## China Facts & Figures

**2**

Number of pandas loaned to Edinburgh Zoo as a gift to the people of UK from China

**10.3%**

Yearly GDP growth in China for 2010 showing Chinese economy grew quicker than expectations

**53.9**

China's PMI fell by 1.3 points in December from 55.2 in November indicating a slowdown in the pace of manufacturing growth.

**\$35 Billion**

Amount identified as embezzled or misused by China National Audit office by Government in

**-24.7%**

Year on year cotton prices in January 2011 have fallen compared with January 2010.

**75%**

Approximate percentage of China's inflation that relates to higher food prices.

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Please note that ET2C's China Offices will be closed from the 2nd February to 8th February for the New Year Holiday. Happy Year of the Rabbit!