A Quick Overview

During the past month I have spent most of my time in Europe on holiday with family and giving talks on the state of the NZ economy to various audiences in London, Paris, Dublin and Hamburg. Therefore this month’s GWC issue is much smaller than normal. In addition, my Facebook page on China has been only minimally updated recently. However I have attempted to keep growing a pdf file containing a lengthening list of reasons why westerners are apprehensive about China. You can find the file here. 

That apprehension has shown itself in numerous forms over just the past four weeks. The two Presidential candidates in the United States for instance have been scathing in their attacks on China and the “unfair” way in which it grows its economy through trade with America. The Republican candidate Mitt Romney has promised to label China a “currency manipulator” on his first day in office which would lead immediately to special sanctions against imports into the US from there.

The US President meanwhile late in September did what no other President has done for 22 years and that was to block a foreign business deal. This one involved a China firm, Rails Corporation, seeking to buy four wind farm projects in northern Oregon which lie near a naval base where unmanned drones are flown on training missions.

The previous veto 22 years ago was by President Bush which involved the sale of a manufacturing facility to Chinese buyers.

Chinese firm Huawei is also to unwind its purchase of a US computer firm following the deal’s rejection by the Committee on Foreign Investments in the United States.

Following the report the UK’s Parliamentary Intelligence and Security Committee said that it is investigating the business of Huawei in the UK.

A recent survey also showed that only 13% of Australians approve of a Chinese-led consortium’s purchase of the massive Cubbie Station in Queensland.

A Pew study has also found that over the past two years the proportion of Chinese who feel that the relationship between China and the United States is one of cooperation has fallen from 68% to just 39%.
The clearest sign perhaps was the US Congressional Intelligence Committee report released on October 9 suggesting that the United States bar the use of companies Huawei Technologies Company and ZTE Corporation in the US telecommunications system. The report considers that both firms represent a security risk and comes at the same time as debate has heated over about cyber-attacks on the United States with Iran, North Korea and China considered to be the main sources of such attacks – as outlined by US defence Secretary Leon Panetta.

But while one problem facing China is Western reluctance to see their assets sold outside their civilisation to a one party state, a problem facing the west and Japan is the way China uses economic weapons as “punishment” for things it does not like. The main example of this is restrictions on rare earth exports to Japan in October 2010. But there are many others as listed in a Wall Street Journal editorial of October 2.

They include new inspection requirements for Norwegian salmon causing a 60% fall in trade after the 2010 Peace Prize was awarded to Chinese dissident Liu Xiabo. A dispute over the Scarborough Shoal with the Philippines saw extra inspections of Philippines banana imports into China earlier this year. German researchers have also found a 12.5% average fall in developed country high value exports to China following a visit by the Dalai Lama.

Trade and political tension between China and the West is clearly building - at the same time as the long running dispute between China and Japan over the Diaoyu/Senkaku Islands has once again flared up. In the case of this latter dispute there has been a clear economic impact with Japanese car makers reporting falls in sales in China in the past month of over 50% from a year earlier - though the resulting fall in Japan's exports to China comes at the same time as exports have also fallen to other parts of the world as well.

Will the widening trade discord (which is also manifesting itself in a growing number of cases being brought before the WTO alleging product dumping) lead to much economic weakness?

History shows that it is to possible to reasonably predict such things especially as there are so many uncertain elements. It at least there are few signs at this stage that China's overall growth rate is falling to a substantial degree.

The pace of GDP growth has slowed to 7.4% in the third quarter from 7.8% in the second quarter and an 8.1% pace at the start of the year. But the common expectation has become that growth will improve slightly to near 7.7% in the fourth quarter with full year growth finishing close to the same pace and just above the official target of 7.5% for the year.

The signs of stabilisation in China's growth rate are important for New Zealand both directly and via the impact on Australia's growth. And should China's growth rate lift slightly next year this will come at the same time as the NZ economy begins to receive a much greater boost from the expected rebuilding of Christchurch and a lift in Auckland residential construction and general infrastructure spending as well.
An ounce of prevention is worth a pound of cure

In 2002, I was involved in my first ‘real’ business transaction with China. The company I worked for received an email requesting a quotation and also made three bold claims.

First, the mystery man from Beijing claimed to ‘know everything’ about our niche technology. Next, he claimed he was connected to all the ‘right people’ in our industry in China and could produce sales for us with high profile customers. Finally, he claimed he was able and willing to be our “exclusive” distributor for China.

The first reaction could have been: Woo-hoo! My China problem is sorted!” But in fact, such emails are often the first in a series of communications that can result in unsuspecting victims being fleeced of thousands of dollars.

In our case, the story ended well. This man proved to be legitimate and we eventually appointed his company as one of several distributors, and he went on to sell millions of dollars of our products in China. From his email came a durable personal friendship and my subsequent ‘love affair’ with China.

So were we lucky or were we smart? Frankly, a bit of both. We were lucky to be contacted by a reputable person and didn’t have to invest time hunting for the proverbial needle in the haystack. But we didn’t take his bold claims at face value. We pressed the man to learn how he discovered us and how he ‘knew everything’ about our technology and its application. He claimed to have worked for a US competitor which we verified using our industry contacts. We also noted he was a speaker at a few industry conferences, so his technical credentials stacked up.

Then came time for us to fulfil orders. We shipped our first orders on the strictest of terms - full payment in advance of shipment. Our new distributor never complained - he understood the need to build up a credit history with us - and over time we gradually relaxed our credit terms.

Within one year, we started quarterly visits to Beijing, as well as hosting our distributor in New Zealand. This was an important part of building a durable relationship that spanned a decade. We wanted to ensure that our distributor remained happy with us, was not being courted by our competitors, and was providing good quality after-sales service to our final customers. Investigating the distributor’s credibility and maintain the relation was not cheap or effortless, but it was worth it.

So why do I recount this story? Well, I was recently made aware of the resurgence of a scam that has been going on in China for years which on the surface has all the earmarks of the events I described above, but with some key differences.

1. A flattering email is sent to you extolling the virtues of your wonderful company, product and/or service, often including flowery references to how famous your company is in China. (First alarm bell…how can your company be famous in China when you have never advertised there?)

2. Either in the same email, or in subsequent exchanges, a meeting is requested in China promising a contract signing that will lead to orders, potentially worth millions of dollars. (Second alarm bell…product orders are almost never signed at any first meeting.)

3. The Chinese counterparts insist that you stay at the hotel of their choosing. They provide interpreters, restaurants, ground transportation. In essence, they orchestrate your every move. While this may seem to be excellent hospitality, it’s a tactic to prevent you exploring on your own and learning that the company is a shell.

4. During your visit, you are asked to pay for meals or other entertainment. (Normally, your ‘host’ would pay for group meals and entertainment.)

5. You are advised that the contract you signed has to be “notarised” to be legal in China and you are driven to a notary office of their choosing. You are then asked to pay the notary fee which is a percentage of the contract value and can be
thousands of dollars. (Paid, in fact, to a fraudulent notary public company that is part of the scam.)

6. So far, your Chinese host has paid for nothing.

7. You return to New Zealand, and are soon notified that to consummate the deal a site inspection must be carried out. You are asked to make a deposit to fund air tickets for a delegation to visit your company, which may include people you have never met, but whose titles sound important.

8. You might be asked to deposit funds for legal fees for product compliance registration, trademark registrations, etc.

9. The delegation never turns up.

If you arrive at step 8 or 9, you might have paid thousands of dollars. When written down, the scam appears ridiculous and easy to spot, but these scammers are ‘artists’ with honed deception skills who can be persuasive and convincing - and the dollar amounts they promise are mouth-watering.

So how do you separate fact from fiction and protect yourself from scams?

NZTE can refer you to independent third-party commercial verification firms who provide various levels of commercial investigation and the fee can be as low as NZ$500.

After the ‘host’ company is confirmed as legitimate, NZTE can discuss the merits of any proposal that exposes you to financial risk, especially when the opposite party is unknown to you or you are meeting them on their home turf. There are patterns to these scams that can be recognised by someone in market.

NZTE can also refer you to reliable interpreters, notary offices and transportation companies if required, instead of relying on those recommended by the host company. Demonstrating that you are confident in the market and have good connections may scare away the scammers.

China remains a lucrative market with enormous growth potential for many New Zealand companies, but like many markets, it is not entirely without risks. For a fraction of the cost of an air ticket, even basic level due diligence should be performed at the start of any financial transaction.

For more information go to www.nzte.govt.nz or phone 0800 555 888.
China’s Economy

Each month we will review the most significant Chinese data releases and developments in China’s economy.

Data Show Soft Landing

There are literally hundreds if not thousands of forecasters focussing on the Chinese economy and we choose here to highlight the growth prediction changes made by just one of them, The World Bank. Back in May the World Bank lowered their expectations for growth this year from 8.4% to 8.2%. Now they have cut their forecast further to 7.7% but expect some improvement next year to 8.1%. This 8.1% pick is however down from an 8.6% forecast six months earlier.

The key factor behind the growth downgrade is reduced demand for goods out of Europe, though up to date evidence of the impact of the ending of the 2009-10 growth stimulus package also plays a role.

As it is, last week the national accounts data for the September quarter were released and they showed that growth has slowed to a 7.4% pace in the third quarter from 9.1% pace a year earlier. Annual growth is now at it's slowest pace in 13 years but is believed to have bottomed out with assistance to growth coming from over $1 trillion worth of accelerated infrastructure projects announced recently and banks being encouraged to make more credit available.

In that regard there is a strong expectation that the reserve ratio requirement will be cut by another 1.5% over the coming year but there is less certainty that interest rates will again be cut. This arises because of worries about house prices. To wht ......

Housing

It has been made clear that Beijing is not going to risk an easing of monetary policy or relaxing of housing restrictions which will propel prices higher again and worsen the societal discord which is already very high regarding poor affordability of housing. Late in September an official at the Ministry of Housing and Urban-Rural Development said “All local Governments and agencies should unswaveringly continue the property market controls, and resolutely curb speculative investment in housing…”

What this means in practice is continued restrictions on non-locals buying in major cities, and high deposit requirements for multiple home owners.

In September the Soufun Real Estate agency measure of house sales prices across 100 cities rose by 0.17% after rising 0.24% in August. The rise was the fourth in a row but the decrease in pace from August suggests the housing market is not embarking upon a rise which could place renewed strains on China’s social fabric.

Perhaps rising despair about prospects for being able to afford an apartment lie behind the results in a recent Regus survey of workers in a number of countries. When asked whether they felt more stressed than a year earlier 75% of respondents in China said yes compared with an average 48% across all surveyed countries.

Then again the results might not be all that meaningful as in Germany the result was 58% but in France which has performed less well economically than Germany the percentage was just 42.

Manufacturing

For a change there was a positive number for China’s manufacturing released this month. The official Purchasing Managers Index firmed to 49.8 in September from 49.2 in August. This still means however that the sector has been shrinking for two months.
However just this week the unofficial preliminary PMI reading released by HSBC improved by more than expected to a reading of 49.1 from 47.9 in September.

The annual pace of growth in industrial production improved slightly also, to 9.2% from 8.9% in August.

**Inflation**

China’s annual rate of inflation dipped marginally to 1.9% in September from 2% in August thus perhaps giving the PBOC a tad extra room to ease monetary policy should they choose.

![CHINA - INFLATION RATE](image)

**Exports**

This was the surprisingly good piece of data released over the past week. The annual rate of growth in exports lifted to 9.9% in September from just 2.7% in August. The rate of change in the September quarter from a year earlier however slowed to 4.5% from 10.5% during the June quarter.

There is a risk that the bounce in export growth in September merely reflected some movement of exports from the previous month. Reports of low attendance by foreigners at the six monthly Canton Fair would appear to back up a cautious interpretation needing to be made of the September rise in export growth.

**Retailing**

The pace of growth in retail spending picked up slightly like so many other indicators for China last month with a rise to 14.2% growth from 13.2% in August. This pace was still appreciably slower than 17.7% a year earlier but the improvement does feed into a story of growth stabilising.

Lending growth was however slightly worse than expected with banks advancing 623 billion Yuan whereas growth of 650 billion had been expected.

The upshot of the good data is that China appears to have engineered a soft landing for its economy - if one is to believe the data and some don’t.
Social Media in China and NZ Businesses

Earlier this year, news of fake beer containing cancer-causing industrial chemicals swept through China. A few months later, it was poisoned preserved fruit. With every food scandal, China’s social media users come out en masse, spreading the news like wildfire. That’s great for businesses exporting food to China: 61% of Chinese consumers are less confident about local food than in 2011, and 28% expect to replace domestic purchases with imports according to Ipsos research.

Although food scandal statistics in China are unreliable, increasing Government clampdowns means they’re unlikely to have increased. However many Chinese are buying less local food due to heightened awareness from social media.

Social media’s growth in China is astonishing. The inherent lack of trust of state-controlled TV, newspapers and radio, means Chinese are much more likely to believe information on social media. Sina Weibo, the Twitter-Facebook hybrid, is China’s most influential social network. Launched just 3 years ago, it now has 368 million users, mostly the sought-after middle class urbanites who buy foreign products.

Although Weibo launched after the infamous melamine milk scandals of 2008, there have been 5 million mentions of tainted milk and melamine on the service. That’s great news for New Zealand: 77% of participants in the Ipsos survey purchased imported dairy products, more than any other category. But social media in China offers many more opportunities for New Zealand than just increasing demand for commodities; it enables businesses to better understand and pursue Chinese consumers without a big budget.

Better understanding Chinese consumers

Before entering the Chinese market you need to localise your products. That’s not just a Chinese brand name and labels. Most Chinese consumers have noticeably different tastes and needs than the average kiwi - I discovered that when I moved here buying green tea-flavoured toothpaste, thinking it was mint. The best known example is KFC, which adapted to the local market, whereas McDonalds virtually duplicated their US menu. KFC now has more than three times as many restaurants as McDonalds in China.

While most New Zealand businesses couldn't afford the scale of research KFC did, it’s prudent to gage how Chinese feel about your products. Social media can help balance research with insights into what Chinese think about brands and product variations in your category. 50% of online Chinese believe Weibo is a way to make complaints to a business, and 55% have participated in a conversation on Weibo about a foreign brand, so you’ll find helpful information out there.

Social media also gives insights into how Chinese consumers view the retailers and partners potentially selling your products. Going forward, you can monitor your brand and competitors to keep pace of the rapidly changing Chinese marketplace.

Pursuing Chinese customers

56% of Weibo users follow at least one business account and the average Weibo user follows four businesses. 27.4% of Weibo searchers look for brand information and opinions. Over the past couple of years in China, I’ve noticed businesses increasingly using their Weibo address in all advertising.

It’s not just the big businesses who’ve found success on Weibo. There are street vendors selling noodles who’ve grown their income 10x by giving Chinese customers what they want on Weibo. Good things spread fast, so if your business has a great promotion, new way of doing something, a creative venture, video or something with feel-good factor, it’s not uncommon to be forwarded and commented on 10,000’s of times.

Social media is well suited to New Zealand business-sized budgets as an effective way to understand, enter and get ahead in the Chinese market. Shanghai-based Mark Tanner is the founder of China Skinny, a Chinese social media monitor currently being developed. Chinaskinny.com publishes a free weekly newsletter giving the latest insights, statistics and opinions on marketing in China. Mark offers advice on web, social media and general marketing. mark@chinaskinny.com
Update On Xijiao Agricultural Trade Centre

In the first issue of GWC which was released in February this year we included a piece by Gary McElroy of The Kiwi Food Company and Hushang International New Zealand.

Having returned from our recent trip to Shanghai, we thought we would give an update on our development. Over the last few months we have been busy grinding out progress for our food products and also building up to launch our NZ Wine Pavilion.

Our trip coincided with the clearance of 12 New Zealand vineyards, covering 46 varieties. In one move we will have the largest platform for NZ wines in Shanghai. But we have also made steady progress in adding food exporters to the Pavilion. In that light, we felt that we should share our observations and to further explain how our strategy is evolving.

First, as a general perspective, much attention is given to creating distribution channels into China. By working with us, we are not targeting one route in working with a specific type of buyer. Rather, we have created a platform to showcase NZ exports. So this is not just a shelf of one companies products. We can then enjoy many synergies with this multiple representation and in time, the market will see our footprint.

Secondly, this is not a short term play. Much is said about how difficult it is to break into the market. Though for many, expectations do not reflect this. With our ( NO COST ) business model, exporters have a seat at the table without having to pay for the privilege. But progress will take time, whether this comes about because of the difference in culture, in terms of how products are processed and approved, or the importance of building relationships.

We have the right partners, now we have to rely on the fact that it will take them time to trust and recommend our products.

Third, our wholesale success will depend upon the traffic coming to the Xijiao Agricultural Trading Centre. For the very few who have seen this, it would appear to be isolated. But this too is evolving. The Centre is gradually filling out and infrastructure development around the Trade Centre continues at a staggering pace (compared to Western developments). If the Centre was fully operational and there was a great deal of wholesale traffic, we could not offer this business model. For many, the opportunity to have a hand in the game, would not exist. This too, is a long term government sponsored plan. See the latest web link http://www.xjgj.com/en/index_en.aspx

Fourth, we will soon have a new retail facility. Located in the basement of Hotel Baoan,800 Dongfang Rd.,Pudong, Shanghai. This floor space exceeds 1000 square metres in the heart of Shanghai. It will encompass a cafe, ice cream parlour, retail shelving (dominated by New Zealand products ), a wine shop and lounge (dominated by New Zealand wine ) and new head-quarters for Hushang China.

Pudong has over 100 of the World 500 Companies located here along with 20 multi-national HQs. Pudong Airport services international arrivals into Shanghai, and the World Expo ( 2010 ), are both located in this district. With a population of over 4 million residents, this gives us access to a great deal of pro-Western retail food and wine buyers. The facility should be open early December.

Fifth, new markets come at a cost. It took a great deal of effort to process 46 varieties of wine. Thanks go out to the support of the vineyards and our logistical people. But we had one bad label on a magnum of wine and it cost us RMB 2000 ( NZ$400 ) for a " negotiated clearance fee ", or we risked the return of the entire shipment. It is that sort of detail that we face. We also lost 9% of our stock for testing purposes. This was the problem in shipping so many wines, but we felt we had to give consumers choices and vineyards opportunities.

We will be contacting all our suppliers individually to grind out this progress. We will soon be putting prices on our promotional stock, but we will need their assistance in calculating shipping costs associated with individual items. Having said that we cannot sell anything until these products are CIQ ( China ) registered/approved. Similar to the work required by the vineyards, this will require a great deal of input from exporters (primarily labels and certificates).
NZ-China Economic Data

Unfortunately due to time limitations this month this section has been left unchanged.

Trade Data
China contributes 15.2% of NZ’s export receipts, up from 7% in October 2008.

Tourism Flows
Some 201,000 visitors from China and Hong Kong in the year to June accounted for $600mn or 10.7% of tourist spending in NZ of $5.6bn. More info = http://www.tourismnewzealand.com/markets-and-stats/china/

Migration Flows

Education Exports
There is no official measure of the contribution of education exports to the NZ economy beyond an Infometrics report of 2008 which estimated benefit of $2.7bn. Roughly updated to 2011 we estimate education of Chinese in New Zealand contributes between $760mn and $1.2bn in export receipts.
Exchange Rates

China maintained a fixed exchange rate against the USD until July 2005. It then allowed slow appreciation of the RMB each month against the USD until August 2008 when worries about slowing export growth saw the peg re-established, albeit with the RMB 16% higher. In June 2010 flexibility was once again introduced and RMB appreciation against the USD has been around 7% per annum achieved within a restriction of a maximum 0.5% RMB appreciation per day against an unspecified basket of currencies. That 0.5% band was widened to 1% on April 15 2012.

Yuan Strengthens

The continuing printing of money by the US Federal Reserve is leading to increasing worries in China and other Asian currencies about destabilising capital flows and volatile commodity prices as the extra cash in the US and therefore global financial system searches for a home. Some Asian analysts have been calling for an acceleration of moves toward reducing dependency upon the USD though such calls are unlikely to prompt the Chinese to hasten their slow moves to liberalise trading in the Yuan.

Over the past month the Chinese Yuan has however risen firmly (by the standards of the Yuan's generally slow shifts) with a gain of near 1% over the past month to reach close to 6.24 from 6.31 a month ago.

There has been no indication from the Chinese authorities regarding whether they feel the Yuan's recent strength is desirable or not and in the absence of any sign of US money printing ending soon it is likely that the Yuan will gain further against the USD. Against the NZD gains will be less strong however as the NZF is also a beneficiary of US money printing plus commodity prices have shown some renewed strength recently which will tend to keep the NZD firm.

Exporters may want to maintain a steady hedging policy but increase hedging should renewed worries about the European or US economies lead to a global shift in risk tolerance downward once again.
Growing With China

Upcoming NZ-China Events

To have your events placed here email me. Tony.alexander@bnz.co.nz

24 – 26 October
China Business Training – NZTE
Auckland
http://www.prclive.com/china_training/cbt_calendar

30 – 31 October
China Business Training – NZTE
Hawera
http://www.prclive.com/china_training/cbt_calendar

5 – 18 November
Semi FIT Training 2012 and China International Travel Mart
Shanghai, Beijing, Guangzhou, Hangzhou and Hong Kong

12 - 13, 14 – 15 November
China Business Training – NZTE
Wellington
http://www.prclive.com/china_training/cbt_calendar

13 November
The challenges of building the social sector in China
Wellington
NZ Contemporary China Research Centre

14 – 16 November
FHC China
Global food and hospitality sector exhibition
Shanghai

15 November
China Import Formula Seminar
Auckland
http://www.eventfinder.co.nz/2012/china-import-formula-seminar2/auckland/ellerslie

Key NZ Inc. Resources

Ministry of Foreign Affairs and Trade

New Zealand Trade and Enterprise


Asia: New Zealand Foundation
http://www.asianz.org.nz/

NZ China Trade Association
http://www.nzcta.co.nz/

Export New Zealand
http://www.exportnz.org.nz/

Kea (Kiwi Ex-Pats Abroad)
http://www.keanewzealand.com/

NZ Export Credit Office
www.nzeco.govt.nz

Growing With China is written by Tony Alexander, Chief Economist at the Bank of New Zealand. The publication is one of a stable of regular releases which include the Weekly Overview which examines latest economic data and financial market developments, BNZ Confidence Survey which reports on business sentiment each month, and the BNZ-REINZ Residential Market Survey. This latter survey provides information from a survey of over 10,000 licensed real estate agents on the current state of the residential property market in New Zealand. He has also written a weekly newspaper column since 1998. All publications plus research into impediments to NZ’s economic growth are available on his website. www.tonyalexander.co.nz

Discussion of China is also undertake at www.facebook.com/tonyalexandernz

Tony Alexander has been Chief Economist at the BNZ since 1994 and apart from publications and advising management spends considerable time on the road around New Zealand making presentations and speaking with the media. He travels to the UK and Europe twice a year to assess economic conditions and present at numerous functions.
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