Growing With China

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Mission Statement

To help NZ businesses benefit from China's growth and development.

This publication is written by Tony Alexander. The views expressed are my own and do not purport to represent the views of the BNZ. No endorsement is implied for any company mentioned here. To receive this publication monthly email tony.alexander@bnz.co.nz stating your name, company, and if relevant your connection with China. Back copies of the GWC, which has been published since February 2012, can be found here http://tonyalexander.co.nz/topics/china/

The China-Australia-NZ Link

The key theme regarding China currently is worries about the pace of growth. Export growth is stalling yet there is little sign of a broad switch in the overall driver of growth toward consumption and away from fixed asset investment and exports. Amidst these growth worries concerns are growing about the true level of government debt, or more especially regional government debt, and the quality of lending by China's largely state-owned banking sector.

As these worries grow the impacts are being felt in our largest trading partner Australia. There has been generalised downward pressure on commodity prices which coupled with concerns about a structural shift downward in China's average GDP growth have caused cancellation of many large minerals sector projects and declines in forecasts for the overall pace of growth in Australia's economy.

This worsening outlook for Australia has generated a new deterioration in the Federal Government's budget deficit projections and as unemployment rises migration flows between NZ and Australia are changing. A year ago the net loss of new Zealanders to Australia was 39,809. Now it is 31,246.

This is one way in which changes in China's economy are relevant to us. Perversely, the weaker the outlook for China the weaker the outlook for Australia, the lower the net loss of Kiwis across the ditch therefore the greater the population growth rate in New Zealand and the greater the upward pressure on the NZ housing market!

Yet slowing Chinese growth would appear also to be a depressing factor for the NZ economy – especially as now 18.7% of our export receipts come from China and 9.5% of our visitors compared with 7% and 5.7% respectively just before the Free Trade Agreement became effective in October 2008.

True. But followers of the long term economic debate in Australia will be aware that Federal and State development efforts are shifting toward how to position Australia less as a supplier of minerals to China and more as its food bowl. This change is driven partly by the structural easing in China's rate of growth in demand for minerals, and partly by a realisation that soaring middle income earner numbers are demanding safe, quality food. That is what NZ supplies already.

Therefore, although much of the commentary we shall read about China in the near future is likely to be of downbeat nature, for New Zealand the situation is not as bad as for Australia given our high and still rising exports of quality food products to China.

Financial Services Opportunities

David Thomas, CEO, Think Global Consulting writes the second half of a two part article on opportunities in the financial services sector. This section concentrates RMB internationalisation then funds management.

The story of the internationalisation of the RMB is strongly supported by the data. Since the expansion of the Renminbi trade settlement program in June 2010, the number of RMB denominated trade settlements has grown to 14% of China's volume of total trade in the third quarter of 2012. In addition, the number of RMB deposits in Hong Kong have substantially increased since 2009 for two main reasons – the increase in the proportion of trade settled in RMB, and the expectation in the market of RMB appreciation.

Countries with the appropriate financial architecture, a willingness to grow RMB liquidity and the vision to develop RMB-related financial products and services will be well positioned to benefit from the anticipated changes in financial markets arising from the internationalisation of the RMB. Australia's position has recently been enhanced by two recent announcements arising from the Prime Minister's successful visit to China in April 2013:

- The announcement on 24th April 2013 by the Reserve Bank of Australia (RBA) to invest approximately 5% of the country's foreign reserves in Chinese government securities, an investment worth at least A$1.6 billion and the first time that the RBA has invested directly in a sovereign bond market of an Asian country other than Japan.

- The announcement on 9th April 2013 of an agreement between the People's Bank of China and the Australian Government to launch direct trading on the China Foreign Exchange Trade System (CFETS) and the Australian foreign exchange market between the Australian Dollar and the Chinese Renminbi (CNY).

3. Funds Management Sector

In less than 15 years, from a standing start, China's unit trust industry, has grown to USD2 trillion in size and, with a national average savings rate of over 50% (USD4 trillion per annum) this is only just the beginning.

Recent negotiations between the Hong Kong Securities & Futures Commission (HKSFC) and the China Securities Regulatory Commission (CSRC) regarding the mutual recognition of unit trusts in each other's jurisdictions will allow them to be sold to retail investors in both markets in the future. This is a potential "game-changer" for the funds management Industry, specifically those based in Hong Kong. This treaty will increase both the depth and breadth of RMB related financial activity, which will also be crucial in the process of the internationalisation of the RMB. Currently, 200 funds (approx.) will qualify for this recognition scheme, around 10% of HKSFC authorised funds.

The mutual recognition scheme will offer an opportunity for fund managers around the world to take advantage of the lower costs of establishing a fund in Hong Kong, simpler regulatory and legal issues and the ability to allow direct investment into China's A Shares. In addition, it will open up a myriad of opportunities for financial advisers.

As some Hong Kong funds will need to be denominated in RMB, the new products offered will be unfamiliar to many, and there will be an increasing demand on financial advisers to provide accurate information on the products, returns, portfolios in order to make informed decisions. This scheme has the potential to place Hong Kong as the dominant international location for fund establishment in the Asia-Pacific, a regional "funds management hub". This should be of great interest to Australian fund management companies who can seek to take advantage of the mutual recognition arrangements between ASIC and the HKSFC.

With such opportunities and development at the forefront of China's modernisation, the scale and enormity of the change in the financial services industry will be significant. Although China's gradual step-by-step approach to change may appear unbearably slow, the sheer size and scale of the opportunity will propel industry growth well beyond that of the Western world at present. Australia's presence and industry participation in China will play a crucial role in its reputation and strength in the region as a major financial services player.

Some Contributed Thoughts

I am a regular reader of your weekly newsletter. This week I had a particular interest in your email correspondence with the Chinese journalist.

As a New Zealand citizen of Asian Chinese descent, I can shed light on why few Chinese persons provide a response within a public forum. There are two main culture factors as follows:

Firstly, Chinese are brought up to be humble. Obviously there are various degrees of humbleness between individuals. Generally to speak in public about one's money (wealth) is to be a crude show off. It is also viewed to be an open invitation for attacks from the more jealous folks around you; or worse its announcing one is ripe as a potential victim for theft or as a rich target for kidnapping.

Secondly, Chinese tend to mind their own business as they value social harmony. Unless it’s a potential/immediate harm to their family or close friends, other persons’ expressed viewpoints are "not our problem" and "Why invite trouble or disagreement if it doesn't concern us?" Western society tends to value individualism and appreciate a person's ability to express an (original) opinion.

House Buying

“To list the reasons why Chinese buy NZ houses, particularly in Auckland, I would like to tell a number of stories/facts and leave anyone interested to draw their own conclusion:

An apartment, yes apartment (not a house which is something only a billionaire can afford in China), located at Xinhua Rd., Puxi (western Shanghai) was sold for RMB6,500.-/m2 in 2000 and the current price is around RMB50,000.-/m2.

An apartment located at Huamu Rd., Pudong (eastern Shanghai, east side of Huangpu River) was priced at RMB5,500.-/m2 and the current price is around RMB40,000.-/ m2.

A house of 300m2 plus small garden maximum 100m2, or villa we call in China, at Huamu Rd., next to the apartment above, cost about RMB30 million in 2000 and I have no idea what it might cost right now.

Last year a couple (Chinese wife and American husband) visited a site selling villas, in which any single one would cost more than RMB30 million, the sales just handed them over a brochure and did not bother to show them around due to huge demand. Another story is that pre-registration is needed for some sites so that the property developer can check the viewer can afford to buy the villa then they will be served for viewing.

An apartment of 180m2 located near Olympic Park in Beijing bought in 2010 with RMB3 million now worth RMB6 million.

An advertisement from an immigrant agency: If you own an apartment within 4th ring road in Beijing, which means your personal wealth is more than RMB3 million (about USD half million), then you are able to migrant to US under business category in which the visa only cost about USD50,000.-.

There are only three countries in the world currently running an immigration policy in which you can apply for a residency visa before you go to live in there (which is what I did in 2001): Australia, New Zealand and Canada.

One survey found out that 20% of private entrepreneurs have already had permanent residency of some developed country, mainly US, Canada, Australia or New Zealand, and 80% of the rest are considering migration.

There is a new Chinese term: Luoguan, or naked official, which means the official has sent everything, except him/herself, out to another country so he/she can run away once he/she smells something wrong with regard to his/her accumulated wealth.

One Chinese student would cost their parents around NZD25,000.-/year: 15,000.-+ for tuition fee plus 10,000.- living cost. Four years study, one last year for high school plus three years of university, would cost at least NZD100,000.-, or RMB half million. Second part of this kind of story is bit sad. I went to a SAAB dealer in Beijing in 2009 and found out both the receptionist and the sales graduated from Lincoln University. I would be surprised if their monthly salary is over RMB3,000.-/month.

Opening Doors To China

Bridging the leadership gap
Kevin Parish, Trade Commissioner, Hong Kong

New Zealand is in the enviable position of having free trade agreements with China, Hong Kong and Chinese Taipei. In horse racing terms this would give New Zealand the Greater China Trifecta – with hopefully similar economic benefits.

Leaders bridging the gap between both countries from the public and private sectors will be crucial in ensuring New Zealand achieves the potential of these agreements.

In April, the Prime Minister led one of the largest ever trade missions to China with delegates looking to better understand this complex market, but more importantly leverage the excellent relationship the PM has with his Chinese counterparts. And since 2008, when New Zealand was the first OECD country to sign a comprehensive FTA with China, numerous political leaders from China have visited New Zealand.

New Zealand has also established the New Zealand China Council, which is mandated to bring together leading New Zealanders from both public and private sectors to collaborate and ensure that the relationship reaches its potential. The leadership in this organisation is exceptional with Sir Don McKinnon as Chairman and a range of senior business leaders on the executive board.

The political relationship we enjoy needs to (and, in some cases, already does) cascade down to the companies that are either doing significant business in China or those that see China as a future growth market. This means having senior management, including the chairman and board, visiting the market regularly to hold discussions with the senior executives of their Chinese partners. This will lead to a 'leadership bridge' – a place where the exchange of ideas, philosophies, deeper relationships and future growth can occur.

Many of our companies, including Comvita, Fonterra and Mainfreight have committed senior staff to China – they understand the importance of having a strong senior presence in market. Recently, Westland Milk Products hosted customers in Shanghai and the Chairman, two directors, the CEO and several senior managers travelled to China to attend.

For those without that capability, having senior people visit the market will demonstrate commitment to Chinese partners. In the Chinese business world, the chairman and the board are integral parts of companies' management structure.

Companies can also take a leaf out of Maori and Chinese cultures, and take a long-term approach to leadership by identifying the 'rising stars' in business and preparing a plan to get them exposed to the China market earlier. These 'rising stars' could be involved in trade missions, business trips, hosting Chinese partners in New Zealand and being seconded to the market. NZTE's China Business Training is a good starting point for rising stars, with over 1000 people from 635 companies having attended in the last three years.

Language training is another consideration, and Trade Minister Tim Groser recently highlighted that language was important for all companies undertaking business in China.

We could also learn from author Malcolm Gladwell and start to identify more 'connectors' who know a large volume of people across cultural, economic and political circles, but with the added skill that they can transcend cultural and geographic boundaries. Where do we find such people? One often overlooked place is…New Zealand. Last year, 24,412 Chinese students were studying in New Zealand. Many of these students embrace the Kiwi culture during their time in the country and have a good understanding of our unique characteristics. Another group is Kiwis who have embraced the Chinese way of life and made China their home, and they can be identified through KEA, LinkedIn and University Alumni associations.

To fully maximise the economic opportunity in front of us, New Zealand must bridge the leadership gap at all levels and embrace the cultural and social aspects of doing business in China. Only then will this lead us to fully understand, comprehend and succeed in our relationship with China.

Western versus Eastern Culture

This article has been written by Tony Smale for our upcoming Brain Gain publication but as it is so relevant to issues involving China we have included it here as well.

When it comes to engaging with other people, no dimension of national culture has a more fundamental impact than **Universalism-Particularism**. In simple terms, the Universalist approach is somewhat black and white. What is good and right, or bad and wrong can always be defined, applies in all circumstances and can be codified in rules, regulations and contracts.

Contracts are absolutely sacrosanct and obligations are related to contracts and rules and regulations. Particularists by contrast pay far greater attention to the uniqueness of circumstances and to the obligations of relationships. They believe that what is right or wrong, good or bad depends upon circumstances.

Anglo-Saxon Kiwis are Universalists. The French, Asians, most South Americans and Maori are much more particularist. When our engagements were largely with people from similar cultures to ourselves we got by, but as we engage more and more with quite dissimilar people the challenges escalate.

As Kiwis our universalism causes us to expect that our business engagements and transactions will be governed by rules and conventions familiar to us – not because we are wittingly deterministic but because that is the very nature of being Universalistic. By contrast, Particularists expect that the rules and conventions that apply will vary according to context. In a sports analogy they anticipate that the game plan will constantly change.

The Universalist-Particularist divide has deep implications. We “think for our customers”, assuming that what we believe is important and what we take for granted will be the same as for our customers. We thus miss the opportunity to align our offerings as closely as possible with our customers’ needs. Quite contrary to what we expect, we are viewed as dis-interested in our customers’ needs and conventions and as having a “take-it-or-leave-it” approach that undermines the value we harvest. It’s not that we are not capable, it’s just that we don’t think how we engage is as important as do our customers.

When Universalists find in a Particularist context that a business employs the children, nieces and nephews of the owners, we are suspicious, making the assumption that they have been chosen for nepotism reasons. Yet the Particularists choose those people specifically because of their special obligations to look after the family’s business interests. “Who could you trust more than your own nephew?”

Universalists working with Particularists will look at them and ask “How can you possibly do business with them – everywhere you look is nepotism?” Conversely, Particularists look at Universalists and ask “How can you possibly do business with them, you can’t even rely upon them to look after their friends and family!”

From our point of view, the security of the business engagement relies upon attempting to define within the contract, all the possible eventualities and what happens if things go wrong. If it’s not in the contract then it is not taken account of. No account is taken or expected of any changes that occur outside the scope of the contract.

For instance if there is an economic downturn or an unexpected shift in exchange rates, that is just good fortune for one party and bad luck for the other. Contracts tend to be lengthy and detailed. Conversely, Particularists have a diametrically opposed point of view. They start from the perspective that not everything can or should be defined in a contract. Instead, the parties to the engagement need to have the trust and confidence that should something go wrong, or that circumstances change, then the agreement will be adjusted or renegotiated to accommodate these changed circumstances. Contracts tend to be brief and not the principal instrument of the transaction. For us Universalists that is an entirely foreign concept. As a general rule, there are many more commercial lawyers in Universalist countries than in Particularist countries.

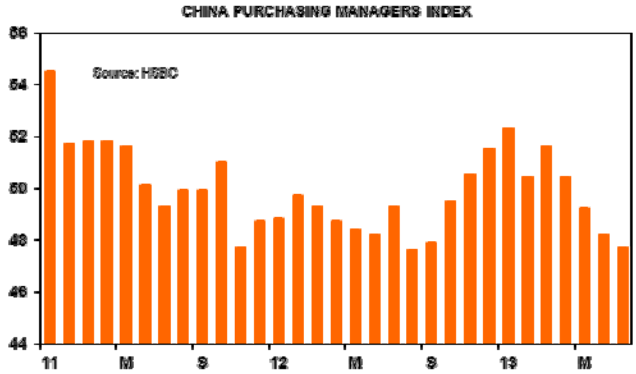
To optimise our opportunities in our developing new export markets, and to work most productively with our increasingly cosmopolitan workforces, we must factor in the science of national culture, none more so than the fundamental difference between Universalism and Particularism.
Tony Smale, Forte Management, tony@forte-management.co.nz

China's Economy + RMB

Each month we will review the most significant Chinese data releases and developments in China's economy. Additional commentary in the NAB China Economic Update is here. http://business.nab.com.au/tag/global-economic-research/

Growth Increasingly Worrisome

By and large recently released economic indicators in China show growth continuing to slow with an increasing probability that this year's official target of 7.5% GDP growth will not be achieved. The manufacturing sector in particular is displaying weakness. Both the official and unofficial Purchasing Managers Indexes sit at weak levels with the HSBC measure falling to an 11 month low of 47.7 in July from 48.2 in May.



But not all sectors are quiescent. The housing market remains buoyant in terms of price rises, land sales, and construction – much to the dismay of the central authorities. It is desired that the key source of China's growth shifts from exports to the domestic economy. But while that explicitly includes the housing sector there is concern about the impacts of rapidly rising house prices should a correction occur – or should they keep rising and undermine home ownership goals.

The monthly index of house sale prices in the top 100 cities compiled by Soufun Real Estate rose by 0.8% in both May and June and prices on average in June were 7.4% up from a year earlier. In May the annual rate of change was 6.4% and a year earlier close to -1.9%.

Strong efforts have been made to curb a huge rush of money into residential property but seemingly without success People appear to have found ways around rules regarding the purchase of second properties with regional governments possibly facilitating the purchases. This is because regional governments in many instances gain the bulk of their revenue from land development so suffer tremendously and build dangerous debt levels when building development activity stalls. People have divorced in order to get around the one purchase rule and methods have been developed to reclassify apartments as commercial property.

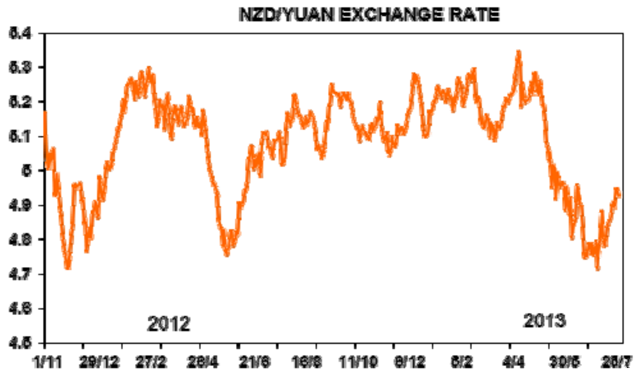
The People's Bank of China may have had the housing market in mind when during the second half of June they allowed overnight money market rates to soar and penalise banks. They may have been sending a signal of their displeasure at continued financing of speculative home buying and construction activity.

On the face of it there appears to be a bubble with pyramid-like characteristics underway in large city residential real estate markets and there is a clear risk that should it burst – perhaps even through ham-fisted policy implementation – there could be a strong rise in societal disorder.

A key economic problem is that at the same time as this bubble may be underway manufacturing performance is worsening, worries about public debt and bank lending quality are soaring, and export growth is faltering. In the June quarter export receipts were ahead less than 4% from a year ago following over 18% growth in the March quarter and 10.5% growth a year earlier.

Renmimbi

The RMB has changed by little against the USD over the past month but the NZD has risen near 3%. China continues to make slow moves toward internationalisation and improved convertibility of the Yuan. But whereas a couple of years ago thoughts swirled around how much the Chinese currency would rise, now there is a growing camp of analysts who believe that the Yuan may instead weaken as people increasingly shift private funds out of China to perceived "safer" investments elsewhere – such as foreign residential property.



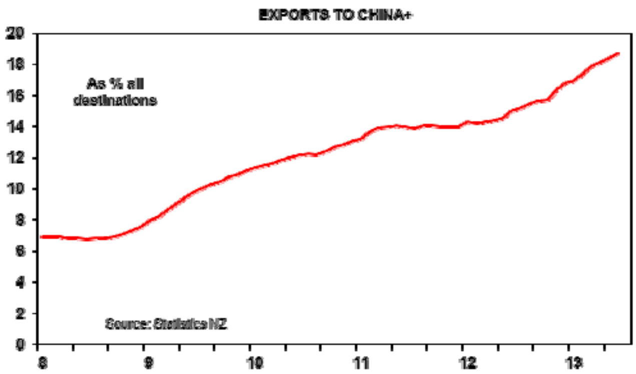
NZ-China Economic Data

Trade Data

China contributes 18.7% of NZ's export receipts, up from 7.1% in October 2008 and 15% a year ago.

The rate of growth in NZ exports to China and Hong Kong remains very strong at 22.2% in the year to June from 8.8% a year ago, 30.1% two years ago, and 18% in the year to June 2010. China and Hong Kong now take 18.7% of all NZ merchandise exports and at this pace will soon depose Australia as our largest trading partner. In the year to June Australia's proportion was 20.9% from 22.4% a year ago.

Excluding China+ New Zealand's exports fell 6.4% in the year to June. China now takes around 22.2% of our primary exports and 4.4% non-primary from 7.9% and 3.5% in the year to September 2008 just before the Free Trade Agreement came into force. The bulk of our growth in exports to China+ therefore has been from the primary sector. Note that in the latest year non-primary exports to China+ fell by 7.6% and declined 7.2% to all other countries.



Tourism Flows

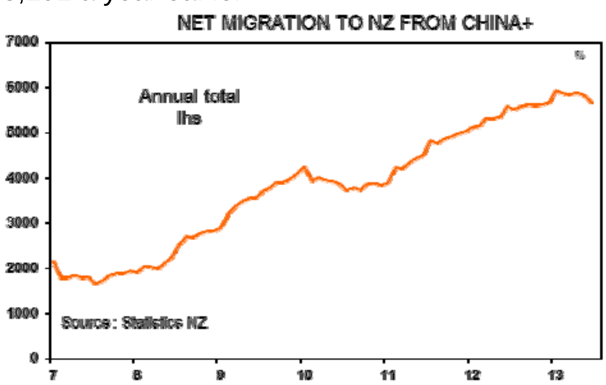
Some 239,000 visitors from China and Hong Kong in the year to March accounted for $753mn or 13.7% of tourist spending in NZ of $5.5bn. More info = http://www.tourismnewzealand.com/markets-and-stats/china/

The number of visitors to New Zealand from China+ was ahead 20% in June this year from June last year and up 24.3% for the full year. The growth rates for all other sources were 4.6% and -2.1% respectively. These changes mean that China+ now supplies 9.5% of all NZ visitors from 7.7% one year ago, 6.2% two years ago, and 5.2% three years ago.

Migration Flows

New Zealand experienced a net population gain in the year to June of 7,907 people. The contribution to this from China including Hong Kong was 5,655 from 5,573 a year ago. There is therefore little growth occurring in net migration to NZ from China and it pays to note that while China accounts for most of the overall net migration gain this past year, so too does India at 5,120, and the UK at 6,304.

The big negative offset is the net NZ population loss to Australia which was 31,246. A year ago this loss was 39,809 and this turnaround accounts for the bulk of the change in the overall net migration flow for the year to 7,907 from -3,191 a year earlier.



Key NZ Inc. Resources

Ministry of Foreign Affairs and Trade
http://www.mfat.govt.nz/NZ-Inc/6-Opening-doors-to-China/index.php

New Zealand Trade and Enterprise
http://www.nzte.govt.nz/explore-export-markets/North-Asia/doing-business-in-china/Pages/Doing-business-in-China.aspx

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/

NZ Export Credit Office
www.nzeco.govt.nz

Education New Zealand
http://www.educationnz.govt.nz/

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