The China Monitor

October 2005

A Publication of:
The Centre for Chinese Studies
Faculty of Arts, University of Stellenbosch

Contents

Editorial

The Centre for Chinese Studies at Stellenbosch recently attended and participated in the World Economic Forum's China Business Summit held in Beijing from 9th -10th September.

Considering China and Africa's growing commercial interaction, it was surprising that Stellenbosch University was the only African organization participating in the Summit. African, South African business in particular, does not sufficiently consider the strategic implications of China's growth trajectory. Southeast Asian economies and companies are effectively repositioning themselves to counter Chinese competition, rather than wilt from it. African enterprises need to follow the lead of their Southeast Asian counterparts to boost competitiveness.

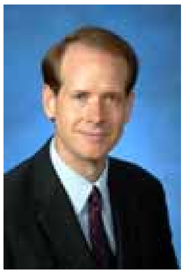
This month's *China Monitor* focuses on the WEF's China Business Summit. The lead piece from Jonathan Anderson, Chief Asian Economist at UBS, Hong Kong, brings a sense of realism to China's banking sector reform.

Thomas Bevan from the Centre writes of his personal experience of the China Business Summit and highlights some bankable insights from the event. The China Monitor also includes an extended section highlighting China-Africa interaction in the business, political and social arenas.

The South African Customs Union (SACU) is soon to begin negotiating a free trade agreement with the People's Republic of China. The China Monitor will shortly be evaluating possible outcomes from these negotiations and the outlook of trade between SACU and China. It has become a contentious debate in South Africa, and objective analysis is required.

Dr Martyn J. Davies
Director, Centre for Chinese Studies

Letter from China



The Great Chinese Bank Sale

By Jonathan Anderson
Chief Asian Economist, UBS

The hedge-fund manager sitting across the table shuts his eyes in frustration and slaps his palm to his forehead. "What on earth are they thinking? This is Latin America all over again. Everybody jumps in on a whim, and then they spend a decade digging themselves out. Plus they lose a truckload of our money in the process. This time is no different."

The place is New York, in one of the countless hedge-fund offices populating east midtown. The time is mid-June 2005, and the reference is to Bank of America's announcement that it would purchase a 9% stake in the P.R.C.'s China Construction Bank for the princely sum of $3 billion—making it the most expensive banking acquisition (or, for that matter, any acquisition) in China's history.

> **"…global financial institutions and banks were nominally invited to the "China party," but they weren't even seated in the same room as the main participants."**

To see what the fuss is about, remember that for most of China's postwar history it had pointedly ignored foreign banks; and for their part, foreign banks paid precious little attention to China. Of course, global financial institutions and banks were nominally invited to the "China party," but they weren't even seated in the same room as the main participants. Their foreign branches were limited to one or two per bank, and then only for foreign-currency business; as a result, even after 20 years of greenfield development, the 200-odd foreign commercial banks active in the mainland still accounted for a paltry 1% of total loans and deposits, and a total capital commitment of no more than a few billion dollars.

The same applied for acquisitions of existing institutions. The government began cautiously allowing foreigners to buy minority shares in domestic commercial banks in the late 1990s—but only for isolated transactions in smaller niche players such as Shanghai Pudong Development Bank, Xi'an City Commercial Bank or Minsheng Bank. As late as the end of 2003, accumulated foreign equity stakes in Chinese banking institutions barely exceeded $500 million, or 0.3% of the estimated total value of mainland bank capital.

This strategy made a lot of sense for China. The government's main priority was to protect the stability of big state-owned commercial banks, of which the five largest—the Industrial and Commercial Bank of China, the Agricultural Bank of China, the China Construction Bank, the Bank of China and the Bank of Communications (BOCOM)—control more than 60% of the country's loans and deposits. For the most part, these banks were technically insolvent, with a crushing burden of bad loans reflecting decades of lending to poorly run state-owned enterprises and ill-advised projects, and simply could not withstand the shock of being forced to compete on an equal basis with experienced foreign institutions.

Strange as it sounds, this strategy actually made a lot of sense for foreign banks as well. As much as overseas players grumbled about their lack of access, it was hard to imagine any serious institution actually putting down money to buy shares in one of China's bankrupt state-owned behemoths if offered the chance. And, although most banks would have been happy to enter the mainland market under their own flag, government restrictions in fact saved them from getting caught up in the disastrous bubble (and ensuing bust) that overwhelmed the mainland banking system in the 1990s.

All that changed radically beginning in 2003. In March of that year, Premier Zhu Rongji—who almost single-handedly managed macroeconomic affairs for more than half a decade—formally stepped down from his position as head of China's civil government, turning over the reins to incoming Premier Wen Jiabao and a new team of senior ministers. During the Zhu administration, official policy toward large state commercial banks was simple: no free lunch, and no privatization. The government performed an initial cleanup in 1998-99, removing more than 12% of outstanding loans from state banks' books, but from then on banks would have to learn to be better lenders, grow their own way out of their problems, and maybe then China could open its market to foreign investment and competition.

A Different Tack

By the time the Wen government was coming to power, however, two points had become clear. First, better accounting practices showed that the size of the problem was much bigger than previously imagined, with many independent estimates pointing to a remaining nonperforming loans ratio of 40% or more. And second, efforts to encourage state banks to "grow their way out of the problem" were leading to another bubble. By the end of 2002, banks were caught up in a wave of speculative lending to property developers as well as redundant industrial and infrastructure projects, and the authorities were increasingly worried about macroeconomic stability.

"…it was hard to imagine any serious institution actually putting down money to buy shares in one of China's bankrupt state-owned behemoths…"

This situation called for a radically different tack—and sure enough, by the end of 2003, the government had effectively made a full 180-degree turnaround on banking policy. The first element of the new strategy was a massive injection of state funds to clean up banks' balance sheets; the People's Bank of China alone has already spent over $100 billion on recapitalization and bad loan write-downs over the past 18 months, with more still coming from banks' own profits and government tax breaks. Official NPL ratios have dropped precipitously as banks have literally written off everything they can find.

And then came the sell-off. During the course of 2003, the authorities made it clear to state commercial banks that instead of being coddled at home, they were going to be pushed out the door. Suddenly large banks found themselves incorporating, with a newly minted board of directors and supervisors. Suddenly every bank had a preparatory listing committee. And suddenly the government was advertising high and low for foreign "strategic investors" to come in and take a sizeable stake, prior to the banks going public.

That was all foreign institutions needed to hear—and indeed, the response has been truly staggering. From that paltry half-billion dollar cumulative outlay going into 2004, overseas investors committed an additional $18 billion to the Chinese banking system in the past 12 months alone.

The ball got rolling in late 2004, when HSBC bought a 19.9% stake in BOCOM for a total cost of $2.25 billion. This year, the megatransactions have come rolling in like an avalanche: Bank of America announced its $3 billion investment in CCB in June; one month later, a consortium led by the Royal Bank of Scotland agreed to take a 10% share in BOC for $3.1 billion; not to be outdone, Singapore's Temasek took a similar stake for the same price (UBS is also reported to be buying a smaller share for $500 million); Temasek also committed $2.5 billion to invest in CCB; and last month, a Goldman Sachs-led group signed an agreement to lay down $3 billion for a 10% share of ICBC.

"At this pace, by the close of 2007 foreign banks and other foreign investors could conceivably control more than one-sixth of the entire Chinese banking system."

This is by no means the end of the story, as the market is still rife with reports of new transactions. And the above figures don't even include the bulk of the proceeds from overseas equity listings. BOCOM already issued $1.9 billion worth of shares on the Hong Kong stock exchange last month, and over the next year we expect another $20 billion in initial public offerings for CCB, BOC and ICBC.

At this pace, by the close of 2007 foreign banks and other foreign investors could conceivably control more than one-sixth of the entire Chinese banking system. It seems the only brake on the process is the 25% ceiling on cumulative foreign ownership of individual banks—a restriction likely to be eased in the near future.

Disaster...or Euphoria?

Needless to say, this sudden turnaround has inspired radically different interpretations. According to the press announcements of the overseas banks themselves, this is one of the greatest investment opportunities of the new century: a chance to enter a financial market with $4 trillion in assets, and what's more, a market that is growing at double-digit rates with no slowdown in sight. Chinese per-capita income is only $1,500, and consumers are just beginning their love affair with mortgage and credit card debt; imagine what riches lie ahead over the next decades as incomes double and double again.

For more cynical observers, of course, this is just the latest in a long string of disastrous banking follies. Perhaps the most engaging read of the past year was Tim Clissold's *Mr. China*, a story of two private equity entrepreneurs who collected hundreds of millions of dollars from global investors in order to buy into the "greatest growth story of the century" and transform the Chinese corporate landscape in the process, but ended up pissing away most of the funds down the black hole of mainland economic reality.

So it will be with the banks. According to detractors, Chinese banking problems have simply been glossed over through state bailouts and creative accounting. Nothing has changed in the economy, as civil servants still dutifully shovel money into moribund state enterprises with no regard for repayment prospects. Once the next downturn hits, banks will face a tidal wave of new bad loans, and the foreign giants will be forced to write down tens of billions of dollars in worthless investments in the process.

"According to detractors, Chinese banking problems have simply been glossed over through state bailouts and creative accounting."

Not a Great Growth Story

So which is it? A once-in-a-lifetime opportunity, or a pending disaster? In fact, neither. The truth of the matter is that China's financial system is neither an explosive minefield nor a beckoning gold mine, but rather a profoundly middle-of-the-road investment option.

On the one hand, the banking system is clearly not going to collapse—not now, and not in the foreseeable future. Large state banks may have been insolvent, but they have always been very liquid, propped up by China's enormous national savings rate as well as the lack of alternative financial assets. And with the government now busy vacuuming up nonperforming assets and throwing in new capital, insolvency is no longer even an issue; with the exception of ABC, the state banks are solidly back in black (and we should soon see a bailout and restructuring program for ABC as well).

But won't banks get right back into trouble in the coming years, with a flood of new NPLs overwhelming the system? The short answer is no, and the common view that banks are unreconstructed dinosaurs turns out to be a myth. In a recent detailed study of the banking system, UBS found that the banking environment has changed radically over the past 10 years, with better regulation and supervision, better macroeconomic policy making, better internal controls and better borrowers. This does not mean that Chinese banks are now making fully sound lending decisions. Indeed, the one area where large banks have not changed over the past decade is their 100% state ownership, and this is the root of many continued problems. However, it does guarantee that the magnitude of new NPL flows will be much more manageable than in the past.

On the other hand, Chinese banks are hardly the greatest growth story of the 21st century. The plain truth is that—glaringly alone among poor developing countries—China is already significantly overbanked. Just look at the numbers: Commercial bank deposits account for nearly 200% of GDP, and loans in the banking system currently stand at 130% of GDP. This makes China a near world-record holder; of all major economies across the globe, only Taiwan and Hong Kong have higher banking ratios, and the average for the developed world is much, much lower.

What accounts for these huge numbers? It's really very simple. For two decades mainland firms have had no other source of outside financing, and mainland households have had no place else to put their savings. But this could change quickly. As China's nascent equity, bond and property markets mature, we expect a steady deleveraging on the part of companies, and a steady diversification on the part of Chinese savers. So while consumer banking is a promising development area, corporate lending isn't. We're not saying that the banking system can't grow at all—but at some point, it will begin to grow much slower than GDP.

Moreover, the profits earned by Chinese banks on that growth are far from impressive. Last year, global banking institutions recorded a 1.2% overall return on assets, while the figure for Chinese banks was 0.4%. The rate of return on equity was closer (11% compared to 16%, respectively), but only because mainland institutions have lower capital adequacy. Of course, Chinese banks will gradually learn to generate more fee-based income, but keep in mind that margins on regular lending operations are currently propped up at artificially high levels because of state-controlled deposit rates. Once these are decontrolled (which should happen fairly soon), deposit rates will rise, putting further pressure on profitability. The only way for China's large banks to show high rates of earnings growth will be to cut costs aggressively, a fairly unlikely outcome for the foreseeable future.

Still "Win-Win"

So where do we end up? Even after bringing euphoric expectations back down to reality, the bottom line is that buying into the Chinese banking system is still a "win-win" proposition. China does benefit from having foreign investors buy in, and foreign investors benefit from being there.

"The key question is where to find new owners."

The gains for China are easy to see. The government has done everything it can for banks—except to privatize them. And as long as senior management is made up of civil servants with a mandate to support official policy, banks will never be fully market-oriented institutions. What China needs to make financial-system reform and restructuring "stick" is to get the state out of the business of running banks.

The key question is where to find new owners. The authorities could easily list state banks on the domestic Shanghai and Shenzhen equity markets, but China's short-term retail investors have done a notoriously poor job of providing outside governance to date. Simply handing banks over, Russian-style, to the current management presents similar problems (not to mention the risk of escalating social tensions).

The answer is to turn to foreign investors, just as China has done consistently over the past five years

when deciding how to reform large state enterprises in other sectors. In this sense, the Chinese authorities are now following what we might call the "PetroChina model," named after one of the first large mainland SOEs to be listed abroad. In this model, the purpose of selling to foreigners is never to get money; indeed, most large state firms were already awash with cash when they went to the market, just as the large state banks are awash with recapitalization funds today.

Instead, the government found that overseas investors provided a "one-stop shop" for enterprise reforms. Global management consultants, human resources and investment banking firms took the reins of the restructuring process, identifying and stripping off unproductive assets, clarifying pension liabilities, carrying out audits, and redefining governance responsibilities. Once the listings were complete, state firms also inherited a professional investor base intent on scrutinizing accounts and management decisions. In most cases, the result has been better-managed, more profitable and transparent companies, and this is exactly what China is now hoping to achieve by selling off stakes in the large banks.

"Instead, the government found that overseas investors provided a "one-stop shop" for enterprise reforms."

What do foreign investors get? We already showed that China's overbanked financial system is not the world-beating growth story it is often made out to be—but this is exactly why foreign banks are better off pursuing an acquisition and restructuring strategy than trying to do new greenfield investment. And, ironically, with their nationwide branch networks and consumer databases, the large state commercial banks are probably ideally placed to compete in banking segments that will provide growth opportunities going forward, such as mortgage and credit card lending.

So there are perfectly valid reasons for overseas banks to be investing in their Chinese counterparts, as long as they are not overpaying for the assets, which brings us to the final issue of price. Based on market information, the average price-to-book value ratio for the recent multibillion dollar BOC, CCB and ICBC transactions was a very moderate 1.2—well below the 1.9 ratio commanded by large global banks, not to mention ratios in excess of two for smaller, promising high-growth plays. In other words, foreign investors don't seem to be wearing rose-colored glasses; they paid pretty much what you would expect them to pay for a stable, low-growth, low-margin business. And when all is said and done, this gives confidence that the Chinese "gold rush" won't leave a deserted, desolate ghost town.

This article originally appeared in volume 168, no 8, September 2005 of the Far Eastern Economic Review

Market Watch

Innovation, Talent, and Competitiveness: The 2005 World Economic Forum China Business Summit

By Thomas Bevan
Centre for Chinese Studies

China has achieved great success in attracting foreign investment. It has the ability to produce virtually anything cheaper than most other countries. Yet, it still faces a number of challenges to ensure continued foreign investment, high economic growth, whilst maintaining social stability. Challenges include an ageing population, lack of infrastructure development, financial sector reform, and its drive to create truly global Chinese multinationals. These have become topics of debate not only within China, but also among some of the most prominent companies and organizations currently involved in the world's most dynamic economy.

As diverse as these issues are, the recent World Economic Forum (WEF) China Business Summit revealed that many of the challenges facing China seem to have many of the same hurdles. Held on the 9th and 10th of September in Beijing, the China Business Summit brought together over 600 participants from 35 countries. It provided a forum for individuals and organizations from all industries with an interest in China to identify and discuss the numerous challenges facing China, and obstacles that might impact its growth. Despite hosting a number of what would appear to be vastly different topics of discussion, the summit revealed that across all industries and interests, concerns about remaining competitive within China, and against Chinese companies, was a key issue. And central to competitiveness were problems of promoting innovation and retaining skilled and talented personnel.

"…concerns about remaining competitive within China, and against Chinese companies, was a key issue."

Stimulating innovation

With the current tension in China-US relations, the summit held a dedicated session titled "The Future of China-US Relations: Always Spicy?" Unsurprisingly, the discussion leant towards psychological evaluations of US perceptions of China, and its role in the world. It was clear that political tensions remain high between China and the US. Despite the political focus, concerns were raised about

America's ability to remain competitive in terms of China. And key to this is its continued technological advantage, based on its nurturing of innovative talent and thinking.

Similar issues of technological innovation and competitiveness became evident in a debate around the ICT sector. It is apparent that innovation is central to success in the ICT sector, globally and within China. Concerns have been raised about the China's external reliance on new technology, whilst relying on its cost and labour advantages for competitiveness. Following this strategy, Chinese companies risk falling behind foreign rivals.

The importance of innovation in terms of remaining competitive was highlighted in "Innovation in China: Smart Money or Smart Strategy?" Cheng Siwei, Vice-Chairman, Standing Committee of the National People's Congress, described China as a "body country", rather than a "head country", suggesting that China relies far too much on its advantages in labour, and does not focus enough on innovation as a driver of competitiveness. Some companies have been successful, such as Huawei, which was noted for its human capital investments, but the reiteration of the similar points in different sessions highlighted the importance of innovation to China's continued economic success.

The right people for the job

Innovation cannot occur without the right people or training. Even discussions on government policies brought these to the fore. Prominent was a session dedicated to China's infrastructure. "China's Infrastructure: Building for Changing Needs" touched on a number of growing problems in the Chinese economy, from finance, to education, to rural development. Infrastructure development is key to China's sustained economic growth.

"Innovation cannot occur without the right people or training."

The PRC government's drive to develop its central provinces and Western regions relies heavily on its ability to attract qualified people to these areas. However, a recurring issue was that of attracting, training, and retaining such qualified personnel. Due to enormous market opportunities, talent retention is a key challenge for firms in China, both foreign and local. As one speaker from the construction industry stated "[m]y company has provided a whole team of talents for other companies."

Job-hopping is a recurring problem within China across all industries. It hampers government initiatives, and bleeds private companies. Hiring and training the right people is one problem. Holding on to them is proving to be an even bigger one.

Not in the headlines

The WEF China Business Summit also provided an arena to discuss and debate some of the topics that have been gaining international headlines. Banking reform, revaluation of the Renminbi, China's financial markets, the automotive sector, and the growing role of Chinese multinational's all received significant attention. And these have been making headlines for a reason. China's economic growth and stability is increasingly important to a large number of interests, from multinational firms to developing economies. A growth slowdown in China's economic situation will have severe consequences for the global economy.

However, in the final session of the WEF, an informal poll among the delegates revealed that the major concerns in ensuring competitiveness and success in China were not necessarily issues making the headlines. China has always been famous for its vast human resources. And from investing in China, to promoting economic growth within China, to stimulating innovation, the consensus was that developing human talent is central to China's future growth.

Thomas Bevan is the Projects Manager at the Centre for Chinese Studies, and was a participant at the World Economic Forum 2005 China Business Summit in Beijing. Photographs from the World Economic Forum

Business Briefs

Significant business developments in China over the past month

Canada plies China with Softwood. Canadian Prime Minister Paul Martin, in talks with Chinese President Hu Jintao, strongly encouraged the purchase of Canadian softwood by China, as a means to decrease Canada's reliance on the United States market. Canada has been engaged in a softwood trade dispute with the US and is adopting an aggressive strategy to enter into the Chinese market. There was also talk of forming a strategic partnership with a focus on areas ranging from technologies to natural resources. President Hu reciprocated by affirming his commitment to improving Sino-Canadian trade, hoping to raise two-way trade to US$9.5 billion by 2010.

India's Matrix to acquire China's Mchem. India's Matrix Laboratories Ltd. announced on 26 September that it has signed a deal to purchase 60% of China's Mchem Group. This will see the company expand its AIDS medicines to new markets, with the deal concluded by December 2005 following regulatory approvals. This is Matrix's third acquisition in less than a week, including Switzerland's Explora Laboratories, and South Africa's Aspen Pharmacare. The Indian company claims that Mchem will aid in consolidating its position as a major global supplier of active pharmaceutical ingredients, particularly antiretrovirals. The Xiamen-based Mchem has a current turnover of US$ 35 million.

Nortel set for US$150 million GSM deal in China. Leading operator China Mobile, announced on 29 September that is has chosen Canadian vendor Nortel to expand its wireless network in six regions under contracts worth US$150 million. The deal will see subscriber capacity increase to 3.48 million, bringing the total number of subscribers to 18 million across all regions with network optimisation allowing for the standardisation of service pricing. The expansion will also support China Mobile's National Rural Network Project in the northern and western provinces of Hebei, Shaanxi and Liaoning, the municipality of Tianjin, the Xinjiang Uygur Autonomous Region, and the eastern province of Hunan.

China delays 3G rollout until 2006. Chinese telecom officials announced that their version of 3G cellular technology had overcome feasibility problems. The Time Division Synchronous Code Division Multiple Access (TD-SCDMA) is China's domestically developed third generation mobile telecommunications standard. The Chinese government has invested over US$123 million on research and development. China is likely to have completed testing of all 3G-related technologies during the course of this year and may issue licenses in early 2006.

China achieves breakthrough in super-large generating sets. On 16 September, Chinese Vice-Premier Zeng Peiyan, commissioned an additional 700 000 kilowatt set in the massive Three Gorges Project in central China's Hubei Province. All of the fourteen 700 000 kilowatt water turbine generator sets in the northern bank power station are operational. The operational success of the sets may prompt the further construction of large-scale hydroelectric projects. The original plan for the Three Gorges Project was estimated at a cost of US$21.7 billion, with 26 generators producing a combined generating capacity of 18.2 million kilowatts.

China's catering sector up 17.6% from January to August. China's Ministry of Commerce reported on 19 September that the country's catering sector produced US$66.9 billion in retail sales revenue generated in the first eight months of 2005, up 17.6% from the same period in 2004. The catering sector alone, achieved a retail sales volume of US$8.8 billion in August this year, accounting for 14.1% of China's total retail sales. The Ministry revealed that foreign investors have established 567 catering businesses in the first eight months of 2005, but that this figure had dropped by 1.1% from the previous year. However, the contracted foreign investment in the catering industry surged by 27.53% to US$643.09 million year-on-year.

Bank of Beijing extends line of credit to small enterprises. The Bank of Beijing announced on 18 September, that it would extend a 4-6 billion yuan credit line to small enterprises in China. The additional line of credit accounts for 20-30% of the bank's annual credit growth. The move is an attempt to adjust the bank's credit pattern focusing on medium and long-term loans.

Washington pushes for further currency reforms. The United States has been in discussions with China on the country's currency reforms and ways to reduce the rapidly increasing US trade deficit. Treasury Undersecretary, Tim Adams, said on 23 September that the US would like to hold further discussions on stimulating China's domestic demands.

China-ASEAN hold talks on FTA. The fourth consultation between ASEAN senior economic officials and China's Ministry of Commerce kicked off on 25 September, focusing on the ASEAN-China Free Trade Area. The discussion was based on progress reports on the establishment of the FTA, and the draft of the ASEAN-China Trade in Services Agreement. Preparations for the second China-ASEAN Trade Fair, scheduled for mid-October, were also discussed. China intends to reduce, and in some cases, eliminate tariffs to achieve the FTA with ASEAN members Brunei, Indonesia, Malaysia, the Philippines, Singapore and Thailand by 2010, and Cambodia, Laos, Myanmar and Vietnam by 2015. China and ASEAN have enjoyed an annual growth in trade of 30-50% in the past few years, with ASEAN becoming China's fourth largest trading partner in the first half of 2005. Two-way trade has reached US$59.8 billion, an increase of 25% against the same period last year.

Bird International to Set Up Plant in India. Chinese mobile phone manufacturers, Bird International, are considering establishing a handset manufacturing plant in India. Other options include either sharing the manufacturing plant or sourcing a local firm to set up the production facility by providing the required technology and equipment. Bird is planning to expand its operations in India from the current market share of less than 1% to 5% by 2007.

UBS Acquires Stake in Bank of China. Switzerland's UBS has confirmed its US$500 million dollar investment in Bank of China. UBS now owns a 1.6% share of the Chinese bank. Furthermore, UBS and Bank of China are moving towards a strategic partnership deal in investment banking and securities.

ICBC Sells 10% Share to Investors. A consortium of investors comprising Goldman Sachs, Allianz, and American Express are to acquire a 10% stake in the Industrial and Commercial Bank of China (ICBC). The three firms will collectively invest US$3 billion in the venture.

DaimlerChrysler Increases Stake in Chinese Joint Venture. DaimlerChrysler is increasing its stake in Beijing Benz DaimlerChrysler Automotive from 42% to 50%. The company anticipates Mercedes car sales in China to rise by 20% this year.

Temasek to invest in Bank of China. The Bank of China is to receive a US$3.6 billion investment from Singapore's Temasek Holdings, the largest foreign direct investment in a Chinese bank to date. Temasek will invest US$3.1 billion for a 10% share in the bank, and US$500 million will be spent on buying shares in the bank during its initial public offering. The deal is subject to government authorisation and regulatory approvals.

China's steel production may increase 25% this year. China, which is the world's third largest producer of steel, could potentially increase its output in steel production by 25% in 2005. China's crude steel production may well reach 340 million metric tons this year. A large increase in production will mean a drop in steel prices and an increase in demand for raw materials such as iron ore and coking coal. Analysts are concerned that the increased production will decrease the demand for steel, resulting in excess surplus and stockpiling.

China launches emergency fund for stock investors. China has opened an emergency multi-million dollar fund to protect investors when brokers go under. A group of three influential government economic agencies will manage the fund.

China to lift limits on private light aircraft. China is expected to remove restrictions on the use of its low-altitude airspace around 2010 to private light aircraft. The country employs strict control of the use of airspace below 3 000 meters, which has hampered China's aviation industry.

Lee takes up post as Google head in China. Kaifu Lee, at the centre of an ongoing legal dispute between Microsoft and Google, has assumed his post as head of Google in China. Lee, former vice-president with US Microsoft, recently received permission to work for Google and said that the company's development centre will soon be established in China.

Google has a representative office in Shanghai and has signed deals with several advertisement agencies in preparation for its formal launch. The company intends to build a world-class centre in China, which will work on the localization of its products and services, and on cutting-edge technologies for its global operations.

Airbus intent on capturing 50% of China's aviation market. Airbus intends to take over half of China's aviation market before 2013. The European aircraft company also aims to increase procurements from China, and enhance technology transfer to the country. Airbus has increased its market share in China from 7% in 1995 to 34% in 2005, with the rest of the market dominated by US rival Boeing. Airbus has received 69 orders from five Chinese airlines this year to the end of August. Airbus plans to boost its procurement volume in China from the current US$15 million per year, to US$60 million per year, by 2007, and US$120 million by 2010.

China's economy to grow 9.2% in 2005. China's central bank said on 26 September, that it expects the economy to grow by 9.2% and expand by 8.7% in the first half of 2006. The People's Bank of China has also predicted that consumer prices would increase by 2% in 2005 and 2.1% in the first half of 2006. The annualised figures are indicative of a slowing economy, as China's gross domestic product grew 9.5% in the first half of 2005. Economists have cautioned that China's economy could slowdown significantly following Beijing's measures to cool the economy, with some warning that the country may even face deflation by 2008.

China-US textile talks end. China and the United States have concluded talks in the textile dispute with no progress made on the issue. It is not certain whether the US will initiate further caps on Chinese products.

China clamps down on online news services. Online news sites in China containing fabricated information, pornography, gambling or violence, will face severe punishment or closure. The measures are part of a new regulation on online media services introduced on 25 September by the State Council Information Office and the Ministry of Information Industry. The regulation also stipulates that media attached to the central government or directly under provincial governments are not allowed to provide any stories to other online news sites without official approval.

China's growing middle class seeks Luxury Wines. China's second-largest winemaker, Dynasty Fine Wines Group, predicts that the country's wine market will expand by 10-12% in the next few years. Rapid economic growth has created a booming middle class, increasing consumer demand for luxury goods. A bottle of Dynasty Dry Red, sells for approximately US$7, about 30% less than the average imported wine. Dynasty is controlled by state conglomerate Tianjin Development Holdings, and France's Remy Cointreau has a 25% stake in the wine company. Wine consumption currently accounts for merely 1% of alcohol consumption in China, which is the world's biggest beer market by volume. Shares in Dynasty have increased to 39% since its initial public offering in January this year. China's wine industry is dominated by three players, which control half the market.

China Southern Airlines to buy 10 Boeing 787 aircraft. China Southern Airlines announced on 5 September that it has purchased 10 Boeing 787 aircraft. The acquisition is indicative of the company's strategy to enhance its competitiveness in the international marketplace. The first of the 787 aircraft is expected to be delivered to China Southern in July 2008, one month before the start of the 2008 Summer Olympic Games. The remainder of order should be delivered before 2010.

China approves new GM cotton. China, the world's leading producer of genetically modified cotton, has approved a new hybrid variety, which is expected to bridge the shortfall in cotton production. The new variety is insect resistant Bt cotton, and yields 26.4% more cotton than current strains. In the 12 months to August 2006, China, the world's top cotton consumer, is likely to import over 3.2 million tons of cotton, the largest quantity ever imported by a single country.

Carrier calls for end to fuel supply monopoly. China Eastern Airlines, one of the country's leading three carriers, has called for an end to the fuel supply monopoly held by the China Aviation Oil Holding Company in the domestic market, claiming that the monopoly has adversely affected its profits. Airlines in China have spent more than US$409 million on fuel in the first half of 2005, an increase of 44% from 2004.

Corning to boost China sales. Corning Inc. is looking to capitalise on its sales of glass used in the production of LCD panels for computer and flat-screen televisions. The company is aiming to increase its China sales in 2005 to grow at triple the rate of the Chinese economy. The Chinese economy is expected to grow by more than 9% this year, and Corning's target translates to an 18% growth rate. The company is considering investing in a glass-making facility in China.

Dow chemicals cite China as its biggest market. The United States largest chemical company, Dow Chemicals, expects double-digit sales growth in China over the next few years. The company says that its China operations are likely to merge with other chemical companies in China. At present, China is Dow's third-largest market after the US and Germany, but may become its largest market by 2030. Dow recorded US$2.2 billion in China sales in 2004, an increase of 40% from the previous year. The company intends to establish a research and development center in Shanghai, in addition to the 10 factories and business centers already established in five major Chinese cities.

China-Japan meets over East China Sea dispute. China and Japan have met this month to resolve the dispute over claims to undersea oil and gas deposits in the East China Sea, following new drilling activity in the Tianwaitian oil field, by China.

Russia-China discuss trans-national gas pipeline. Russia's OAO Gazprom, the world's largest gas producer, has entered into discussions with China National Petroleum Corp (CNPC) to finalise a gas pipeline running from Russian into China. The pipeline would have a capacity to carry 20-30 billion cubic metres of gas annually.

Peabody reveals China plans. The Peabody Energy Corp, one of the world's leading coal companies by revenue, opened its Beijing office in September, and announced its plans to garner a minimum 20% stake in a joint venture or in local companies in China in the coming 12 months. The company predicts that China's coal market will grow by 70-80% in the next 15 years.

CRE begins Ningbo, Tianjin expansion. China Resources Enterprise is set to purchase two supermarket chains for US$51 million in an attempt to enter markets in Tianjin and Ningbo. The Chinese conglomerate will acquire 95 Zhejiang Cikelong supermarkets in Cixi, Ningbo for US$35 million and all 28 Tianjin stores of Yuetan for US$16 million.

Starbucks announces China education fund. Starbucks announced a US$5 million fund to support education in China, an effort meant to raise

the company's profile in a country that it has targeted as its second largest market outside of the US.

China seeks to increase investment in Australian mines. Chinese metals companies, among them Beijing Shougang, are in talks to invest almost US$7.7 billion in Australian mines, a move which could increase China's investment in Australia six-fold over the next five years. Of the proposed investments, half are in iron ore, 30% in coal, and the remainder in natural gas and other metals.

Baidu to appeal guilty verdict. Baidu.com Inc announced that it will appeal a Beijing court ruling that found the search engine guilty of violating copyrights held by a local affiliate of music major EMI Group PLC. The court ruled that Baidu's website provided access to illegal MP3 files of music copyrighted by Shanghai Push, EMI's China-based associate. Baidu has to pay out US$8.408 million in compensation for the 34 company copyrights violated and has to cease downloads related to Shanghai Push songs. Baidu's MP3 search page has attracted the attention of Sony BMG, Vivendi Universal, and Warner Music Group, some of whom may sue the Chinese company.

Ad spending up 20% in China. Expenditure on advertising in China rose 20% in the first half of 2005, with spending on television, newspaper, and magazine ads across 166 cities amounting to US$17.7 billion. Foreign firms account for 30% of ad expenditures, and China may become the world's second largest market for advertising by 2010.

Murdoch's China venture hits 'brick wall'. News Corp chief Rupert Murdoch has said that his company has 'hit a brick wall in China'. He stated that the country was not opening up its vast markets to international media companies. News Corp is currently under investigation by Chinese authorities for alleged cooperation with unapproved local cable networks.

Mittal steel plant share purchase approved. Mittal, the word's largest steel producer, has been granted approval from China's Ministry of Commerce to purchase a 36.7% stake in Hunan Valin Steel Tube and Wire for US$316 million. The deal makes Mittal the Chinese HVSTW's second-largest shareholder, and gives the company access to the Chinese steel market.

Fourth Hong Kong based airline for Guangzhou. Hong Kong Express, the fourth local scheduled air passengers carrier opened in September with a Hong Kong-Guangzhou commuter service. The airline intends to serve as a bridge to second-tier mainland cities.

New Employment Regulations in China to Impact Taiwan, Hong Kong and Macau Residents. In an attempt to restructure the employment administration of Taiwan, Hong Kong and Macau's residents working in China, the Ministry of Labour and Social Security has issued a new employment regulation effective from 1 October this year. The new regulations will amend existing employment requirements and require that residents who are from Taiwan, Hong Kong and Macau working in

China, enroll in the Chinese social security system.

China Telecom blocks Skype access. China's biggest fixed-line phone carrier is blocking access from Skype Technologies SA, a European-based Internet telecom services provider, based in Shenzhen. China Telecom provides access to Skype through its broadband Internet service, and may block access to Skype's coverage area throughout China. Skype enables users to make calls from their PC's, to regular phones and subscribers can dial to major Western countries for as little as US 2.5 cents per minute compared to the US$ 1 per minute charged by China Telecom. Long distance business is an important revenue source for both China Telecom and China Netcom, accounting for about 20 % of China Telecom's total revenue in 2004.

Boeing's 2005 China forecast. Boeing has released its 2005 Current Market Outlook for China. The report predicts that China will require 2 600 new airplanes worth US$213 billion over the next 20 years. Over the forecast period, China is set to be the largest market outside of the United States for new commercial airplanes. The sustained growth of China's aviation market will see its fleet quadruple to more than 3 200 airplanes at the end of the forecast period.

China investigates navy dispute with Indonesia. China will send a working group to Indonesia to deal with the confrontation that occurred in September when the Indonesian navy opened fire on a Chinese fishing boat. The working group is comprised of members of the ministries of Agriculture and Foreign Affairs, the municipal government of Dalian, and officials from the town where the vessel company is registered. The vessel company will request compensation from Indonesia, since the company paid compensation to the family of a crew- member who died in the confrontation, and the Chinese government is demanding the early release of the detained vessel and crew. The confrontation took place in the Arafura Sea off Papua Island.

Hong-Kong still prime location for regional operations. The numbers of regional headquarters and regional offices in Hong-Kong reached record highs this year. According to a report from the Census and Statistics Department (C&SD) of the Hong Kong government, there are 1167 regional headquarters (RHQ) and 2631 regional offices (RO) in Hong-Kong as of 1 June 2005. According to the Hong-Kong government, the report suggests that investors from traditional

markets such as the USA, Japan and the UK still view Hong-Kong as a strategic location for managing their regional business.

China receives HK legislators – including democrats. All 60 members of the Hong Kong Legislature, including the 25 pro-democracy members, embarked on a 2-day tour of Guangdong in September. However, according to one of the delegates, the Guangdong Communist Party made it clear that any discussion of democracy or the 1989 Tiananmen Square protests would not be tolerated. Notwithstanding, the general tone of the visit was described as "positive". China's position has shifted from one of isolation to one of willingness to cooperate.

China announces new measures to assist developing countries. Chinese President Hu Jintao announced China's new measures for assisting developing countries at the summit of the 60th anniversary of the United Nations. The measures include agreeing to zero-tariff treatment of particular products from all of the 39 Least Developed Countries (LDCs) that have diplomatic ties with China. Furthermore, China will extend its aid programmes to Heavily Indebted Poor Countries (HIPCs) and LDCs. In addition, China will forgive any overdue debts owed by HIPCs since the end of 2004 on interest-free and low-interest government loans within the next two years. China will make available US$10 billion in concessional loans and preferential export buyer's credit to developing countries. Assistance will also be forthcoming in the fields of medicine and human resources development.

Bush to visit China. US President Bush will visit China in November, following a summit of the Asia Pacific Economic Cooperation (APEC) in the Republic of Korea. President Bush and Chinese President Hu Jintao held talks in New York during September, where Hu attended the summit of the 60th anniversary of the United Nations. Discussions included ways in which to alleviate trade friction between their countries, and to address the imbalance of bilateral trade.

Hong Kong Disneyland opens. Chinese Vice President Zeng Qinghong, attended the opening ceremony of Hong Kong Disneyland on 12 September. Zeng noted that the development would boost Hong Kong as a tourist venue for local citizens.

Sourced from: China View, New York Times, Reuters, Bloomberg, Xinhua

China & Africa

The latest updates on Chinese activity on the African continent.

Zisco to pay US$8 million to Shougang. The Zimbabwean Iron and Steel Company (ZISCO), is set to pay US$8 million to the Shougang International Trade and Engineering Corporation of China. The Chinese company seeks to rehabilitate the giant steelworks and revive business relations after Shougang reneged on a deal that would have provided ZISCO with US$200 million. Both companies have entered into an agreement of technical cooperation and Shougang may even be allocated equity participation in the Zimbabwean company, at a later stage of the project, which may take up to two years to complete.

SADC to develop cooperation with China.

The Southern African Development Community (SADC) countries seek to foster mutually beneficial cooperation with China in areas of trade, investment and social and technical fields. The remarks were made at an event at the Tanzanian embassy in

Beijing, marking the 25th anniversary of the founding of the regional organisation. SADC also seeks to form ties with the business community in China, and intends to establish formal mechanisms of exchange of views to increase cooperation.

Nigeria and China launch joint Agricultural Development Project. The Nigerian government is implementing a joint agricultural development programme alongside Chinese agricultural experts under the banner of the Food and Agricultural Organisation (FAO). Initiated in the Kebbi State and Fadama area in Wara, Ngaski Local Government area, on 14 September, the Nigerian government aims to provide agricultural machineries and transport facilities with the Chinese agriculturalists providing a variety of seedlings and experts. In addition to fishing, the Chinese will aid Nigerian farmers in adopting modern techniques to produce rice, fruits and other vegetables, with a short period of yield, produced in vast quantities for processing and export. The Nigerian government and farmers will take 40 % of the agricultural produce, with the remaining 60%, which must be processed, packaged and sold or exported, going to the Chinese experts.

South Africa sends tourism exhibition to China. South Africa has sent its largest single travel exhibition this year to Shanghai, China in an attempt to enter the country's booming tourism industry. The exhibition was held from 22-24 September at the Shanghai Exhibition Centre, touted by South African Tourism as the most ambitious global tourist promotional and marketing project ever.

Deputy Minister Pahad visits China. South Africa Deputy Foreign Affairs Minister Aziz Pahad, on 24 September, concluded his official visit to China. During the visit, Deputy Minister Pahad held bilateral political and economic discussions in Beijing with Vice Foreign

Minister Qiao Zonghuai, Vice Foreign Minister Dai Bingguo and Ji Peiding, the Vice Chairperson of the Foreign Affairs Committee of the National People's Congress. The Minister congratulated China on its role in the Six Party Talks, and both parties expressed mutual satisfaction with bilateral, political and economic relations. China and South Africa have exchanged numerous bilateral political visits this year, and bilateral trade has reached US$4 billion in the first seven months of 2005, compared with US$6 billion in 2004.

Kagiso Media's exhibitions to enter China. The exhibitions division of South Africa's Kagiso Media is looking for opportunities to enter the Chinese market. The CEO of Kagiso Exhibitions, Mr. Jerry Mabena, said on 13 September that they were considering signing a joint venture agreement in order to establish a project office in China. This decision comes amidst rising growth in Kagiso's exhibitions division.

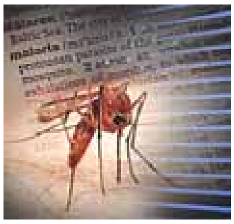
Tigers in Africa? Zimbabwe is due to receive four Siberian Tigers from China by the end of the year for breeding in captivity as part of a wildlife exchange programme. Chinese wildlife experts have declared Zimbabwe's environmental conditions as suitable for the captive breeding of tigers. The tigers will be held in protected areas, and will be used for educational purposes and tourism.

Limpopo Province Promotes itself in China. The premier of Limpopo Province, South Africa, led a 17-person delegation to China in September in an effort to promote and market the province's investment opportunities for Chinese investors. The trip coincided with the South African Tourism Week in Shanghai, which took place from 21-28 September, where the delegation promoted potential investments in mining, agriculture and tourism in Limpopo Province.

Chinese-Ghanaian Joint Venture to Produce Generic AIDS drugs. A joint venture between Ghana's Danpong Pharmaceuticals and China's Adam's Pharmaceuticals, called DanAdams Pharmaceuticals, has begun producing generic anti-retroviral drugs for Aids patients in Ghana. This venture will decrease Ghana's government expenditure on anti-retrovirals by 45%.

Zambia to Land M60 from China. The Chinese government and the Zambian government are currently negotiating the procurement of an M60 aircraft to assist in transporting ballot boxes during Zambia's 2006 elections.

China supports anti-malaria campaign for Africa. China has devised a programme to help combat malaria in Africa. Chinese pharmaceutical company, Holleypharm has put forward an anti-malaria proposal that includes distributing mosquito nets, the distribution of prophylaxes and raising community awareness of the disease. The programme is sponsored by the Chinese government. Pilot projects have been proposed for Tanzania and Cameroon and the Chinese government is hoping to implement the pilot in two additional African countries.



SABMiller to expand market share in China. South Africa's SABMiller is scouting for opportunities to buy smaller breweries in China in an effort to increase their market share in the country. SABMiller has indicated that the Yangtze River Delta and Sichuan Province are possible target areas. Currently SABMiller owns around 13% of shares in the beer market in China.

Spur into China. South African steakhouse chain, Spur, has opened its doors in Shanghai. This is the first of three Spurs that are planning to open in China by the first half of 2006.

China sends peacekeepers to Sudan. China will send 435 peacekeepers to Sudan on a UN mission to help restore the damage following the civil war. The first 165 troops are set to leave in October. Amongst the peacekeeping force will be engineers, medical officers and a transportation unit. The peacekeeping force will help to restore infrastructure in Sudan and offer medical services.

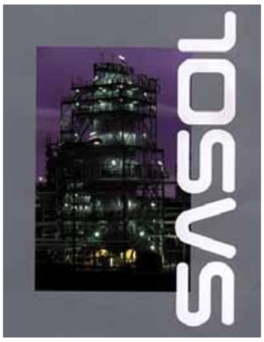
Uganda approved tourist destination. The Chinese government has added Uganda to its list of approved tourist destinations. There are twelve other African countries on the list.

Chinese mining firm targets Angola. The China-based firm Pan Asian Oasis Inc. is planning to begin mining copper in Angola in the next two years. A US$211 million loan from the Chinese government to rebuild roads in Angola will facilitate the project and help to reduce costs.

Mozambique to import buses & medical supplies from China. The government of Mozambique will import buses, medicines, and hospital equipment directly from China. According to Mozambican Prime Minister Luisa Diogo, direct imports from China will be more cost-effective than importing such equipment from European and American markets.

Zimbabwe, China sign media agreement. China Radio international has signed an agreement with the Zimbabwe's official news agency, New Ziana. The agreement facilitates the exchange of news as well as the coordination of training programmes between the two agencies.

Sasol might help curb China's oil imports. China is considering expanding its utilisation of



coal-to-liquids (CTL) technology, which it already employs at a small-scale, in attempt to keep oil imports to a minimum. The South African firm, Sasol, is undertaking feasibility studies in the Ningxia autonomous region and Shaanxi province with the view to entering into joint ventures to produce 80 000 barrels a day in those regions, using CTL technology. Much depends on whether or not Sasol's potential partners will yield a 50% equity share in the projects.

CNPC Awarded Oil Permit in Libya. The Libyan government held an auction in Tripoli on 2 October for permits to extract oil and natural gas. The China National Petroleum Corp., along with Japan's Nippon Oil Corp., was awarded a permit to search offshore.

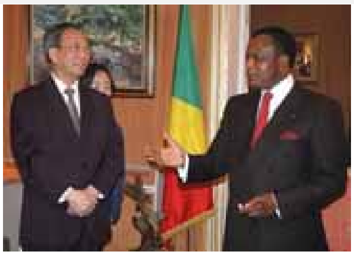
Nigeria Purchases Military Aircraft from China. The Nigerian government has approved a US$251 million transaction to procure 12 fighter airplanes and 3 training aircraft from China's National Aero-Technology Import and Export.

Lenovo to Penetrate the Kenyan Market.

Chinese computer firm Lenovo is preparing to set up distribution structures in Kenya. The firm will establish a regional office in Nairobi. Kenya is one of seven African countries in which Lenovo will be investing directly. The firm is also contemplating setting up assembly plants in Africa.

China Cancels Africa's Debt. The Chinese ambassador to Rwanda, Qi Deen, recently announced that debts that Rwanda and other poor African countries owed to China prior to 2004 will be cancelled. The Ambassador said that the cancellation of these debts is in order to assist in improving Africa's development.

Congolese President visits China. The President of the Republic of Congo Denis Sassou-Nguesso, began a five-day state visit



to China on 26 September, at the invitation of his Chinese counterpart, Hu Jintao. Sassou will hold talks with Hu and meet separately with China's top legislator Wu Bangguo and Premier Wen Jiabao in Beijing. The Congolese President has visited China several times, and last visited the country in March 2000.

700 Kenyan Businessmen to Tour China. A group of more than 700 Kenyan businessmen are scheduled to visit China from mid-October through November in search of potential business opportunities. The tour is part of an initiative by Barclay's Business Club in Kenya to provide members with networking opportunities. The businessmen will visit different firms and factories that deal in and manufacture electronics, textiles, footwear and telecommunications equipment, amongst others.

China deepens business presence in Kenya. China's First Automobile Group Corporation also known as First Automobile Works (FAW) announced on 29 September that it intends to revolutionise the local motor industry with cheap vehicles. The company opened another branch in Mombasa in partnership with Transafrica Motors Limited, as their local agents. FAW also intends to set up another branch in Nairobi in the next two months to meet increasing demand.

South Africa proposes new bid to limit Chinese textile imports. South Africa's Trade and Industry Department intends to enter into a bilateral agreement with China in a new effort to minimise the damage incurred on South Africa's domestic textile industry as a result of cheap textile imports from China. The mounting dissatisfaction within the South African textile industry and labour unions has the potential to escalate into a detrimental trade dispute between South Africa and China. The recent increases in Chinese imports have resulted in the closure of a number of factories in South Africa as well as significant losses of jobs in the industry. The South African government is reluctant to impose quotas or import duties against China in fear of Chinese retaliation in the form of sanctions against the import of South African export commodities such as iron ore and chemicals.

Chinese Communist Party delegation visits Mozambique. A delegation representing the Communist Party of China was received by Mozambican Prime Minister Luisa Diogo on Monday 19 September. Issues regarding cooperation between the two countries were discussed. According to Prime Minister Diogo, cooperation between the two countries has the potential to be mutually beneficial, especially due to the combination of China's technology and Mozambique's productive potential. Diogo also said that there is great potential for cooperation in business ventures.

Funo Agritech continues to support Zimbabwe's Agrarian Reform. Funo Agritech Zimbabwe, a marketing agency for Chinese firm Funo International and one of Zimbabwe's largest suppliers of agricultural equipment and electric motors, has pledged to continue supplying high-tech farming equipment in support of Zimbabwe's agrarian reform programme. The equipment and machinery supplied by Funo are imported directly from China.

Nigerian workers ban CNPC from Kaduna refinery.

Workers of the Kaduna Refining and Petrochemical Company (KRPC) have banned the China National Petroleum Company (CNPC) from entering its premises. The CNPC, a key investor in the Nigerian National Petroleum Company (NNPC), is set to take over the management of the Kaduna Refinery. According to Mr. Suleiman Ennessy, spokesperson for the National Union of Petroleum and Natural Gas (NUPENG) and the Natural Gas Senior Staff Association of Nigeria (PENGASSAN), the Kaduna workers have declared that the Chinese firm is 'unwanted'. Ennessy stated that the ban was due to the 'deliberate refusal' of government officials to enter into mutual discussions regarding labour matters connected to the proposed takeover of the Kaduna refinery by the Chinese firm. Ennessy said that the ban would be lifted as soon as the government revoked its decision and entered into discussions with the workers and labour unions.

African business people receive training from China. A group of thirty business people from various African countries attended a two-week training course in China in the beginning of September. The seminar concentrated mostly on the management of business chambers. Last year China hosted a similar training course for 33 business people from 18 African countries.

Sourced from: China View, New York Times, Reuters, Bloomberg, Xinhua, Allafrica

The China Forum

Recent Events

Western Cape China Business Seminar

The Centre for Chinese Studies co-hosted a business executive seminar with WESGRO on the 13th October. The seminar brought together speakers from the agriculture, clothing, mining, shipping, wine, and trade research industries in South Africa and highlighted a number of opportunities and challenges and opportunities provided by China to Western Cape businesses. The November China Monitor will contain a more detailed account of the event. If you are interested in obtaining summaries of the event, please contact Thomas Bevan at the Centre for Chinese Studies at tbevan@sun.ac.za.

Contact Us

Centre for Chinese Studies

Tel: +27 21 808 2840

Fax: +27 21 808 2841

Email: ccsinfo@sun.ac.za