



Transformation of US and China Economy

February 9, 2011

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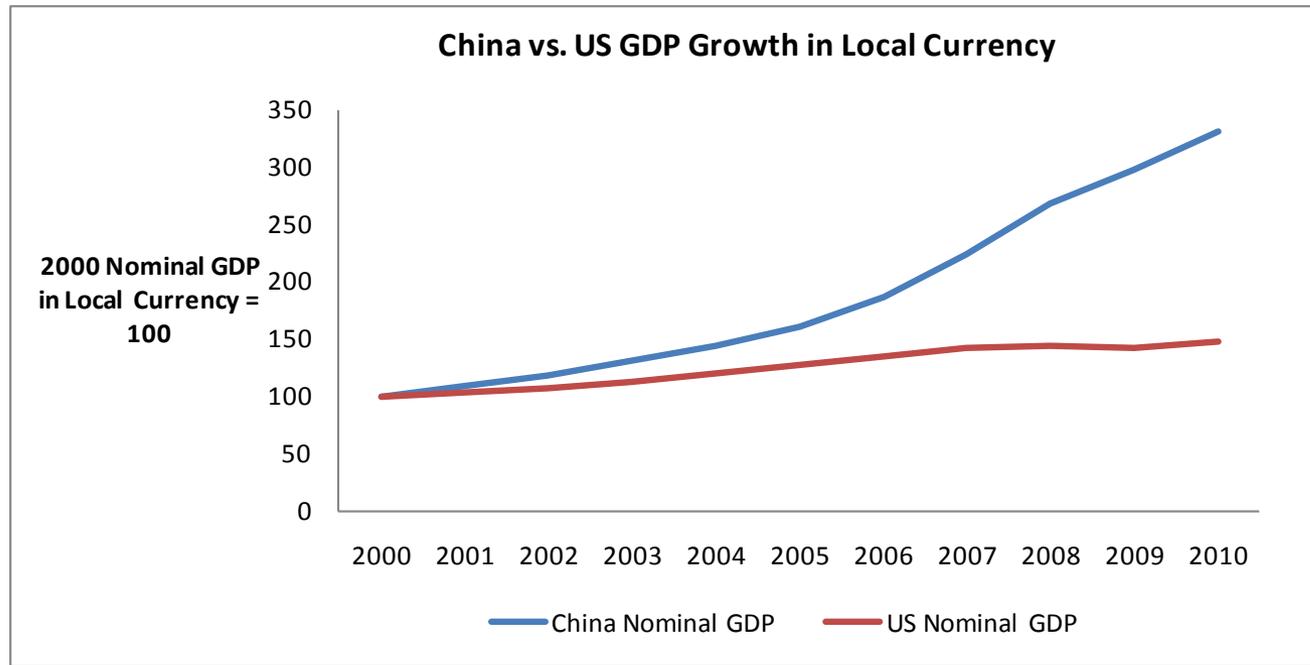


Chinese Economic growth



China's economy has grown 14.5% per year since 2000, narrowing the GDP gap with the US by 15%

- 14.5% average annual growth in China for the past 10 years vs. 3.9% annual growth in the US
- China's nominal GDP was 88% lower than the US in 2001, but only 74% lower in 2010.

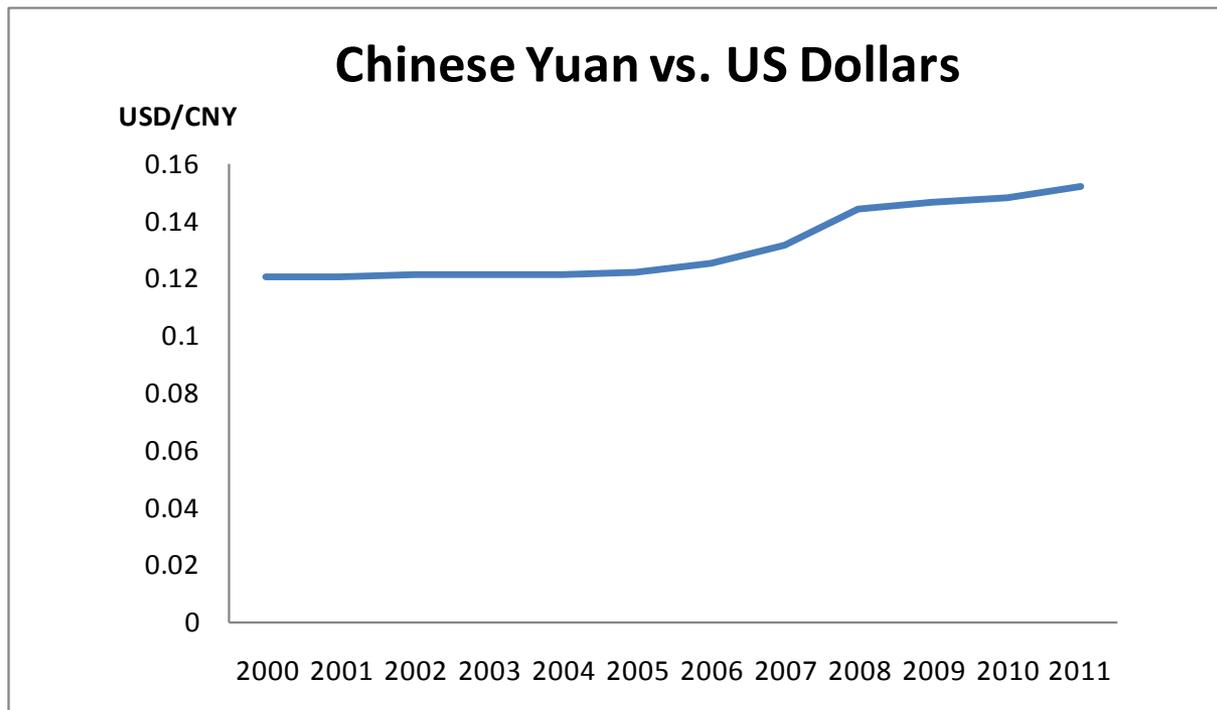


Source: Boston Strategies International analysis of data from EIU



The RMB has appreciated 25.6% since 2000

- The value of Chinese Yuan started to increase against the US dollars in 2007, and its value has risen 15% since then.



Source: Boston Strategies International analysis of data from EIU



China and US Trade



Chinese exports have tripled in value since 2000, increasing to 27% of China's GDP in 2010

- Chinese exports reached \$1.5t in 2010, with an average annual increase of 13% in the past 10 years.
- Exports as a percentage of GDP increased from 23% in 2000 to 27% in 2010



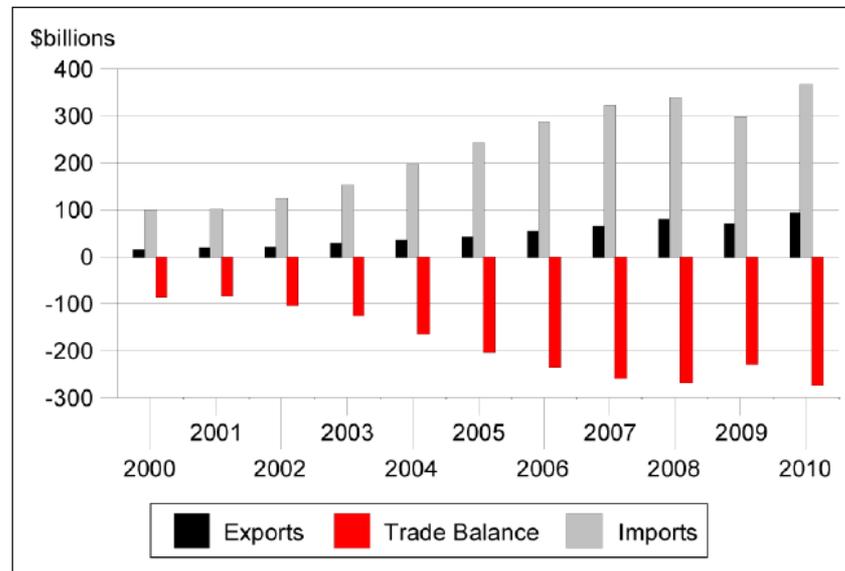
Source: Boston Strategies International analysis of data from EIU



US-China Trade

- Total US-China trade rose from \$2 billion in 1979 to \$459 billion in 2010.
- China is currently the US' second-largest trading partner, the third-largest export market, and the biggest source of imports for US.

Figure 1. U.S. Trade With China: 2000-2010



Source: U. S. International Trade Commission DataWeb.

Note: Data for 2010 estimated, based on January-October 2010.



Major US Exports to China

- China is a large, growing market for US exporters due to its large population and fast economic growth.
- China was also the 3rd largest importer of agriculture, fish, and forest products from the US in 2009.

Top Five US Exports to China (\$ millions)

NAIC Number and Description	2005	2006	2007	2008	2009	Percent Change 2008–2009 (%)
1111 Oilseeds and grains	2,339	2,593	4,145	7,316	9,376	28.1%
9100 Waste and scrap	3,670	6,071	7,331	7,562	7,142	-5.5%
3344 Semiconductors and other electronic components	4,015	6,830	7,435	7,475	6,042	-19.2%
3364 Aerospace products and parts (mainly aircraft)	4,535	6,309	7,447	5,471	5,344	-2.3%
3252 Resin, synthetic rubber, and artificial & synthetic fibers & filament	2,127	2,548	3,290	3,524	4,036	14.5%

Source: USITC DataWeb. Top five U.S. exports to China in 2009.



Major China Exports to US

- China was the US' largest source of imports in 2009 at \$296b.

Top Five Chinese Exports to US (\$ millions)

NAIC Number and Description	2005	2006	2007	2008	2009	Percent Change 2008–2009
3341 Computer equipment	35,467	40,046	44,462	45,820	44,818	-2.2
3399 Misc. manufactured commodities	26,449	28,888	34,827	35,835	30,668	-14.4
3342 Communications equipment	14,121	17,977	23,192	26,618	26,362	-1.0
3152 Apparel	16,362	19,228	22,955	22,583	22,669	0.4
3343 Audio and video equipment	15,287	18,789	19,075	19,715	18,243	-7.4

Source: U.S. International Trade Commission DataWeb.

Note: North American Industry Classification system, 4-digit level.



Trend: from low value products to technologically advanced products

- Between the 1980s and 1990s, almost all Chinese exports were low value, labor intensive products, such as toys, footwear, and textiles.
- Advanced technology products (ATP) accounted for 30% (\$90b) of total Chinese exports to the US in 2010, up from 19% (\$29b) in 2003. Chinese exports represented 30% of total US ATP imports, up from 14% in 2003.



US-China Trade Friction



Major US-China Trade Issues

- A manipulated currency policy distorts the Chinese Yuan's value.
- Health and safety concerns for certain Chinese products
- China has failed to fully meet its obligations to the WTO
- Chinese government required producers to source from local suppliers to promote development of certain industries



A brief history of China's currency policy

Year	Policy	Appreciation
1994-2005.7	Pegged its currency to the US dollar at about 8.28 RMB/USD	0%
2005.7 - 2009.7	Moved to a “managed float” based on a basket of major foreign currencies	21.1%
2009.7 - 2010.6	Halted appreciation and kept exchange rate relatively constant at 6.83 RMB/USD to limit the impact of global recession	0%
2010.6 - present	Began to let the RMB appreciate again but committed to keeping fluctuations incremental	3.5%

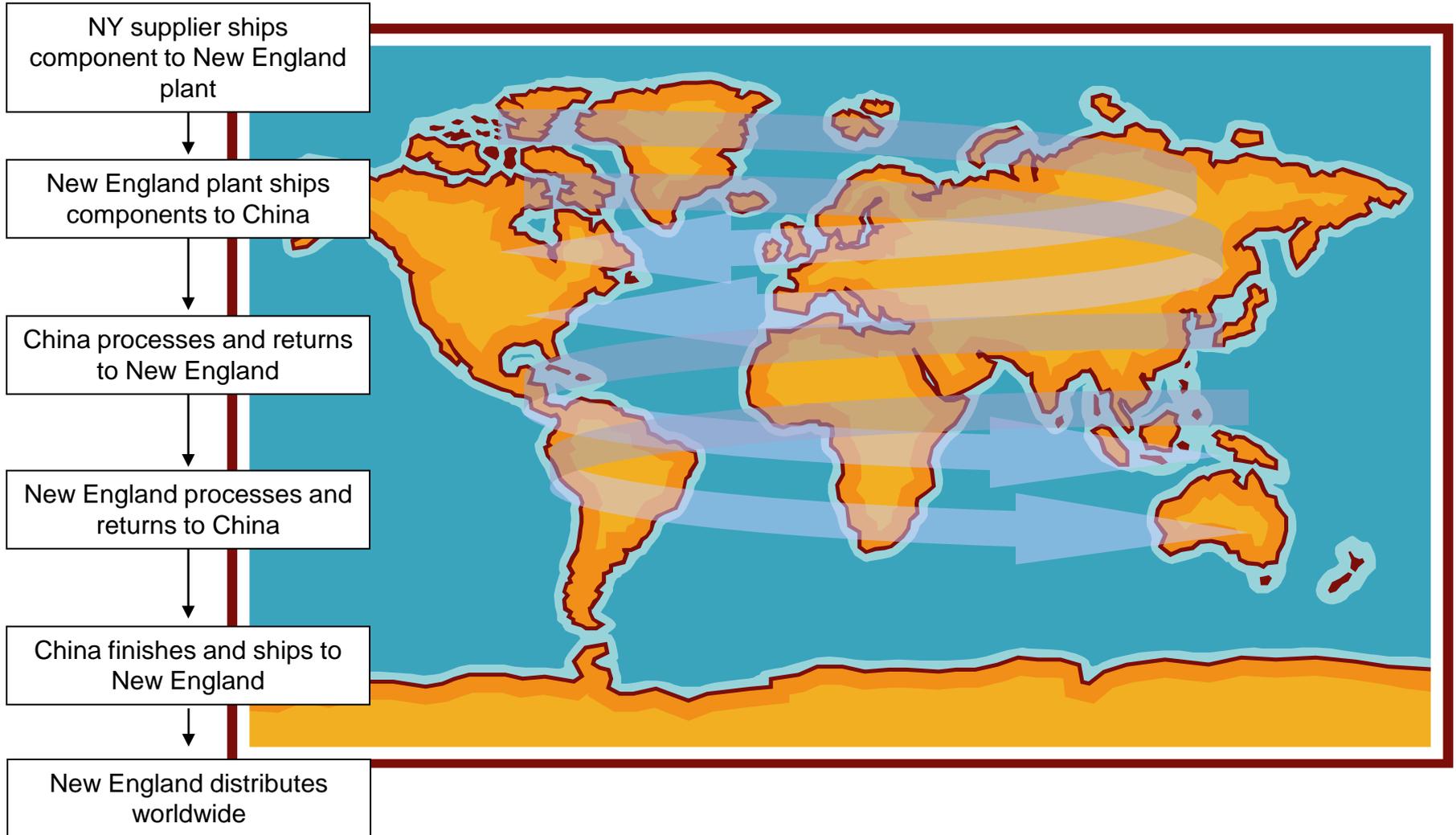


53% of the trade is to process semi-finished materials imported into China then exported out.

- A large number of US importers have moved their production facilities to China
- 53% of China's international trade is processing imported goods that are then re-exported
- Foreign-backed companies account for up 83% of China's total processing trade
- Foreign-backed companies in China accounted for 56% of China's total exports, representing 65% of the trade surplus
- Almost half of the trade benefits go to foreign-backed companies



Supply Network – Streamlining Flows



Apple's Example

- A study on the production of a 2005 Apple 30GB iPod by researchers at the University of California
- Total unit production costs were about \$144
 - \$4, 2.8% of the total cost, was contributed by Chinese workers who assembled it.
 - All other production costs were attributable to parts producers in Japan and other countries
- Supply chain costs – transportation, distributors, and retail were about \$75
- The product was sold for \$299, and Apple earned more than \$80 per iPod
- Conclusion: Only 1.3% of the price went to Chinese manufacturers, and Apple earn the majority 27% of the benefits.



Will a fast increase in the RMB bring jobs back to the US?

- Chinese imports will become more expensive, increasing component costs for US manufacturers
- US-based manufacturers won't return to the US market for procurement, and they will search for options in South Asia or other low-cost developing regions.
- It takes time and money to re-establish another low cost supply chain to maintain current margins. Therefore, a sharp increase in the RMB won't benefit either the US or China



Health and safety concerns about Chinese products

- China's record of enforcing health and safety regulations and standards for food consumer products, and medicines is poor
 - Some imported toys from China contained dangerously high levels of lead and cadmium (toxic chemicals used in paint)
 - In 2007, certain toothpaste products from China was found to contain poisonous chemicals.
 - In 2007, the FDA recalled over 150 brands of pet food from China, believing that it caused the sickness and deaths of numerous pets in the US.



China's issues with WTO compliance

- Failure to enforce intellectual property rights effectively, especially for products such as movies, books, and music
- Industrial policies and national standards that promote Chinese firms
- Discriminatory and unpredictable health and safety rules on imports (especially agricultural products)



Protectionism & Industrial policies

- 70% of China's R&D is government-funded
- As government procurement favors domestic firms, it's almost impossible for any non-Chinese companies to participate in the government procurement market
 - Eg. Turbine production



Is China still an attractive market for you?



Understand Chinese consumer behaviors and wealth distributions

- Chinese love saving
- Chinese consumer view US-made products:
 - High quality, high price
 - A symbol of wealth
- Wealthy population is concentrated in the East coast, Yangtze Delta and Pearl Delta



Chinese consumers and corporations save more than 50% of their total income

- Low consumption and high savings
 - Private consumption spending accounts for only 37% of GDP in China vs. 71% in US
 - Gross national saving rates: 54% in China vs. 9% in US
- Chinese consumer behavior rationale
 - High housing prices
 - Weak social security and health care system
 - Immature student loan market



Extremely high housing prices spur savings

- Housing payback period (Housing price / Annual Wage) is 29 years in China – the same ratio is 10 in the US
- Chinese consumers need to save more to afford a home

City	Average Housing prices	Average Personal Income	Payback period
Beijing	1,978,101	56,075	35
Shanghai	1,849,441	64,200	29
Shenzhen	2,125,794	63,360	34
Hangzhou	1,537,186	59,760	26
Nanjing	927,568	45,360	20
Average	1,683,618	57,751	29



Weak social security and health care systems

- China started building its social security system no more than 20 years ago and the pool is not large enough to handle the large amount of aging population
- Due to the privatization of a large number of the state-owned enterprises, many Chinese citizens lost their previous “free coverage” for health care insurance.
- Most private employers do not provide health insurance for their employees.



The student loan market is immature

- Most families pay for their children's tuitions and living expenses in college from personal savings
- Government-subsidized student loans are almost the only one available
- Only 12% of students in Guizhou Province secure student loans, the highest student loan ratio in China



Urban income does not support increased spending

- Disposable income : RMB 17 trillion, 44.5% of GDP
- 76% of total income goes to mortgage, retirement and education.
- 39% of businesses are in major high growth areas
- Total income available for extra expenditure in developed areas: RMB 1.6 trillion



The Chinese upper middle class is small

- Only 1.5% of the Chinese households (20m) can afford US living standards
- A typical upper middle class Chinese family has \$15.5k for expenditure
 - Expenditure is defined as income left after tax payment, mortgage payment, retirement and education savings.



Exchange rates will increase Chinese expenditure income

- Based on 9% annual GDP growth and no change in exchange rates, China will have 27m middle class households with \$20k in disposable income in 2015
- If the exchange rate increases a cumulative 25%, there will be 36m middle class households in China in five years, each with \$20k of disposable income



Marketing strategies for China

- Focus on establishing brand recognition and creating luxury feelings for consumers
 - Market for American-branded products is large, but it takes time to build brand recognition
 - Competition with other foreign companies is intense in consumer goods and household durable goods
 - Market for American-made products is small and concentrated in urban areas because the goods are more expensive (due to higher labor costs)
- Emphasizing “healthy”, “natural” and “premium quality” concepts
 - Lower middle class Chinese consumers are willing to pay high premium for imported health products and children’s food.



How to sell to China

- Fully understand the Chinese market
 - Competition is stronger for low-cost goods, requiring a higher degree of product differentiation
 - High-tech goods face more government regulations
- Find the right partner(s)
- Take advantage of government incentives to encourage joint ventures and direct investment from foreign companies , which differ by region



Should you continue to buy from China?



Source high tech products from the East coast and labor intensive products from the West

- Source technologically advanced products from the East coast of China to leverage its growing highly educated labor force
- Source labor-intensive products from inland China – The wage difference between inland cities and those on the east coast is 3-5X



Conclusion

- No rapid changes in trade conditions due to a smooth RMB appreciation policy
- A big market for American-branded but locally made products
- A small market for American-made luxury products.
- Establishing strong brand recognition is essential to enter the Chinese market .
- Source technologically advanced products from the East coast.
- Source labor-intensive products from the West.
- An efficient supply chain is the key to a successful low-cost strategy





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