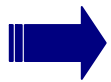


Welcome to the May 2009 edition of Pragma's China Newsletter, prepared by Jesa



## News from Jesa

The global financial crisis was undoubtedly the crucial event of 2008. Its outcomes will be felt for the next half-decade or more.

In the West, the credit crunch resulted in the collapse of several august financial institutions and triggered a severe decline in house prices and domestic consumption. In Asia, the financial crisis turned on the spotlights on China. Is China going to save the World from the downturn or is the crisis going to reduce to dust all the efforts made by this country to reach such an incredible pace of growth?

Surely the effects of the crisis were intensely visible in China: 400.000 firms shut down, more than 20 million people lost their job, exportations dropped down to 24% and growth slowed down to 6.1%. However, if these are the only figures newspapers write about overseas, they are missing one of the most relevant parts of the picture.

Its huge domestic market and its willingness to balance growth counting on consumption rather than exports make China an extremely appealing market. Companies should not only direct their productive efforts towards China but should especially look at the Chinese market to establish a new and promising customer-base out of a potential market of one billion people, half of which will belong to the middle class in less than 20 years and which will enjoy higher salaries and improved welfare.

What this financial crisis is highlighting sharply is that area such as Guangdong, Beijing and Shanghai are deeply affected. Moreover the evidence is that different areas have been hit in very different ways.

The most affected is the South of China. GDP in Guangdong Province, heart of the Economic Miracle of Deng Xiaoping, in 2009 is expecting to growth only at 5.1%.

Due to the geographical position, the companies in this area have always been export-oriented. The export drop has inevitably caused disasters there: many companies shut down and many workers became unemployed, increasing the risks of delinquency and social distress. The luckiest ones are moving to other areas and accepting lower salaries.

Not only China is not doomed to lose its attractiveness for foreign investors but also, the Country that so far has been the most popular destination for Foreign Direct Investments, is now embarking on the challenge of being itself an international investor (Chinese Direct Investments or CDI).

This topic has been the main focus of another conference that took place in Chile, during which Jesa presented the potential, the willingness and the ability of China to invest abroad. The availability of an abundant amount of foreign currency, the necessity of ensuring natural resources of which Chile is rich and to build partnerships for the development of strategic industries, together with the capability of transferring the know-how accumulated in the years of growth immediately appealed to Chilean funding-seekers.



by Saro Capozzoli  
Founder and GM of  
Jesa Investment &  
Management Co., Ltd

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## Jesa in Chile and Canada



Scott Sun introduced Jesa during Pragma's Investors Forum in Chile last April

In April 2009, Jesa approached for the first time Chile and Canada as new sources of opportunities.

Jesa participated to the first Pragma Investments Forum hosted by Cuevas Abogados in Chile.

The forum was supported by Corfo, the Chilean Economic

Development State Agency that supports companies interested in investing in Chile. This country is currently in excellent conditions to be used as platform to export to third markets, taking advantage of the numerous free trade agreements in force.

On the way back to Asia, Jesa stopped in Canada.

After almost 11 years of activities in China and Mongolia, Jesa is now ready to explore opportunities abroad for its Chinese customers, but also supporting more and more foreign companies in these parts of the world.

## Notice on Chinese Visa Restriction

China has announced a new policy aimed to guarantee security for the upcoming anniversary celebrations marking the founding of the People's Republic of China on October 1st 2009.

The security campaign will be similar to the measures taken last year for the Beijing Olympic and it will include visa restrictions that will limit the entry of foreigners in the country.

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## Domestic demand as China's lifeline

The world financial crisis has had the merit of challenging Chinese economy's heavy reliance upon exports. As export sales slumped, new drivers are strongly emerging as promising sources of growth: the immeasurable potential of Chinese domestic demand is possibly bound to be China's lifeline against the economic collapse.

As implied by the meaning of the Chinese word for crisis – wei-ji – that is a combination of the two characters for danger and opportunity, a brighter prospect always lies beyond a time of troubles. And the opportunity offered to China is embodied in its consumer market, one of the world fastest growing and the second largest in Asia after Japan.

The tumbling demand from the United States and Europe is being counteracted by sales in China: goods ripe for exports and without a market overseas are apparently being sold in the local market. The nation's leaders are actually counting on domestic consumption to help meet China's growth target of 8% over 2008.

While exportation dropped by 25% in February 2009 year-on-year, the total retail sales of consumer goods from January to February 2009 reached 2,008.04 billion Yuan, accounting for an increase of 15.2% over the same period in the previous year.

The Chinese retail market is one of the only retail markets around the world which are showing signs of growth. Particularly striking is the case of automobile sales that reached the peak of 735,000 vehicles sold in January 2009 – passenger cars accounting for the 73% of the total amount of car sold – for the first time outperforming the 656,976 vehicles sold in the United States the same month (down by 41.3% from an year earlier).

As a matter of fact, the Chinese market already appealed to big foreign companies: with Barbie sales falling 21% in Q4 of 2008, Mattel is looking to the Chinese market for new potential revenues and has opened in March a \$30 million Barbie flagship store in Shanghai.

The most profitable consumer segment is the emerging Chinese middle-class located in urban areas – defined as those earning from US\$6,000 to \$25,000 – that accounts for the majority of China's current consumption. Its remarkable importance is known but its dramatic ascendance is definitely worth mention. From 1995 to 2006, the population of China's middle class grew from almost zero to 130 million and it is expected to grow three-fold in ten year, eventually reaching 50% of the total population by 2026. Even a niche in this big and fast-growing market could be an opportunity that business should not miss.

However, saving rates are extremely high in China - between 30 and 35% - and this is the main reason why China's private consumption accounts for less than 35% of the total GDP, much lower than other markets (India 56%, Japan 57%, EU 58%, USA 70%). Measures have been taken by the Government in the form of tax reductions, increase of minimum welfare and subsidies to increase purchasing power and stimulate spending.

Although the ascendant middle class is leading the boom of domestic consumption, an equivalent potential is contained in the rural population for which the Government has also set precise plans to boost retail sales.

Those undeveloped clients account for 85% of China's total population and represent an unexplored but potentially super-profitable target.

## China and Chile: Opportunities to explore

Chile was the first South American country to establish diplomatic relations with China. In 1999, Chile was the first

## Notice on Chinese Visa Restriction

(from page 1)

Under the new policy, [all new business visas](#), also called F Visa, [issued recently will expire on September 15](#).

[Existing F visas](#) that expired after September 15 [would not be affected](#) as they were issued before the introduction of the new policy. Visa procedures for tourists and students had not been affected yet.

More policies will probably be released as National Day approaches.

Jesa will follow the evolution of the policy and will provide further and updated information.

## What is Jesa?



Pragmas and Jesa's logos in Shanghai

Jesa is a service company headquartered in Shanghai specialising in facilitating start-up of new industrial productions while providing reliable management and control solutions. We operate 4 main branches in China and a foreign office in Ulaan Baatar (Mongolia).

Since 1998, Jesa has built a team of 70 specialized employees in addition to 25 save technicians following "in loco" projects. Commercial relationships are exclusive and strictly confidential, ensuring the highest expertise on every single commercial and technical issue.

Jesa is a leader in managing manufacturing processes and eliminating any industrial and regulatory problems while helping our clients financial resources and time.

Jesa is currently expanding its services providing support to those companies seeking to develop distribution network and retail system in China as well as in Mongolia.

We also perform HR audit and investment analysis (trouble-shooting analysis) to verify performances in support to companies already established in China, and we provide tax and accounting consultancy.

among Latin American countries to reach a bilateral agreement with China on China's entry into WTO and, in 2002, China supported Chile running for non-permanent member of the UN Security Council for 2003-2004.



Chinese President  
Hu Jintao with  
Chilean President  
Michelle Bachelet

The milestone of this relationship has been the Free Trade Agreement (FTA) - signed in November 2005 - which accorded duty exemption on most product categories objects of trade. For China this was the first bilateral agreement ever signed. In 2008 and 2009, other rounds of the agreement took place, respectively involving services and investments.

Trade between Chile and China has been growing fast during the last years. China has become the largest single economy market for Chile's exports, replacing the USA in 2007, at the same time as it has become the second largest source of imports, trailing behind the United States after surpassing Argentina and Brazil.

Metal, forestry and chemical products are the main exportations from Chile to China. Copper accounts for the 77.8% of the total amount of exportations and agro-products (like bottled wine, grape and other fruits, salmons and trout) grew by 69.1% in 2008 over the last year. On the other hand, Chinese exports to Chile experienced a strong growth in computers and communications technology, electronic products and automobile.

Why would China put an effort in the cooperation with a medium-sized Latin American country half way across the world, whose GDP is one sixteenth (\$100 billion) of its own (\$1.6 trillion)? The relationship between China and Chile has been characterized by a mutual economic interest, especially with respect to China's awareness of the potential of Chile, as critical backing to Chinese economic growth.

China's "Going global strategy" took off in 2003 when local corporations started directing their investments abroad. Since then Chinese Outward Direct Investments (ODI) have been growing exponentially to reach \$18.7 billion in 2007 and \$25.7 billion only in the first semester of 2008. The top 3 target industries are mining (accounting for more than the 30%) followed by manufacturing and IT. Asia and Latin America account for the 80% of the total investments.

China has got the necessity to invest abroad to balance growth and ensure natural resources, plus the willingness and ability in terms of money, given the abundance of its foreign reserves (the only China Investment Corporation contains \$200 billion to be invested abroad).

Yang Zhimin, researcher on Latin American studies at the Chinese Academy of Social Sciences, says that China's interest into Chile is a natural one because "Chile is one of the most important trading partners for China in Latin America. It is one of the most well-developed and open countries in the region. And it has the fewest trade frictions with China." China is working hard on its relationship with Chile because it is the world's biggest source of copper, as well as an abundant source of other natural resources like forestry and fishery into which China might be willing to take an interest.

China would play a significant role in the economic growth of Chile, offering the know-how developed in the years of growth as a complementary resource - especially in the fields of transportation and telecommunication infrastructure - while considering co-exploration opportunities in less developed sectors like biotech, renewable energies and IT.

## China's massive attack against the world economic downturn

Worth 14% of GDP, the two-year stimulus package approved in November by the State Council - China's highest decision-making body - allocates 4 trillion Yuan (\$586 billion) to programs aimed at embanking the effects of the crisis and maintaining a steady pace of growth through fiscal, regulatory and monetary measures. Beijing's huge economic stimulus package is the biggest in the world. As a term of comparison, in the Asian financial crisis of 1998, China responded with a package worth just 1.2% of its gross domestic product.

The package entails both capital spending and income/consumption support measures to boost economic demand in the face of a slumping export market - which is the major responsible of the rapid slowdown of growth -and includes huge government investment, tax reform, industrial restructuring, scientific innovation, social welfare and promoting employment.

A hefty portion of China's huge economic stimulus package is being spent on major infrastructure construction projects, particularly roads, railways, airports and the power grid; on raising rural incomes via land reform; and on social welfare projects such as affordable housing and environmental protection.

About \$220 billion will be spent on infrastructure, \$59 billion on housing security, \$55 billion on rural reconstruction, \$31 billion on energy saving and emission reduction and \$22 billion on social security. In the first two months of this year, total fixed investment was 30% higher in real terms than a year earlier, and investment in railways tripled.

The Government also pledged \$147 on post-disaster reconstruction spending from last winter's abnormally severe

weather, the Sichuan earthquake in May and other natural disasters.

The economic package is expected to exert substantial influence on consumption.

Crucial reforms raising confidence in the social security net and health care are designed to boost domestic consumer spending and reduce household savings.

Improving social welfare programs and living standards are keys to a sustainable economy: Cai Fang, a specialist at the Institution of Population and Labour Economics, Chinese Academy of Social Sciences, argues that the strength of the social security system can affect the way consumers plan their lives and spending, while higher consumption levels can help China progress toward a sustainable economic growth. Some local governments have also outlined plans for boosting consumption. For instance, the city of Hangzhou recently became the first in China to launch a consumption stimulus program by issuing coupons for a wide range of goods and services, from education programs to grocery items. The city government issued coupons worth 200 million Yuan, and as of late February some 65 million Yuan had been spent.

However, the actual stimulus amounts to much higher figures. Apart from the 4-trillion-yuan package, China will cut tax by 600 billion Yuan, raise the old-age pension for retired workers, hike the salaries of 12 million teachers, increase farmers' income and provide them with more subsidies. The country also plans to spend 850 billion Yuan on reforming the health care sector within the next three years.

The need for China to shift the mix of growth from exports to consumption has become more urgent and these measures intend to maintain and balance China's economic growth also closing a destabilizing gap between the rich coastal cities and the poorer interior countryside.

Contributions:

Scott Sun (Supervisor)  
Saro Capozzoli  
Elena Veneziani  
Maria Grazia Lezza

For any inquiry regarding this newsletter or for any other concern, please contact us at:

**Marco Gentili** [marco@jesa.com.cn](mailto:marco@jesa.com.cn)  
**Maurizio Bottoni** [m.bottoni@interconsulting.mi.it](mailto:m.bottoni@interconsulting.mi.it)  
**Nathalie Facon** [info@pragma-eu.com](mailto:info@pragma-eu.com)

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