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Transforming the Economic Model

Economic Prospects in the Yangtze Delta Region (YDR)
(With latest Swiss Presence Data in the YDR)

I. What the numbers tell

There are two schools of thoughts about China's economic perspective. Pessimists see a terminal decline on the way, accelerated with the bursting of the property bubble and further shrinking of external demand, while optimists forecast a soft landing within reach with controllable uncertainties. Both find enough supporting evidence in China's economic complexity. The world's second largest economy is heading toward a slowdown but remained in 2011 a bright spot in the region and global community with its **9.4%** growth rate for the first three quarters of 2011. The official annual growth forecast was more than **9.2%**[1]**,** well above the 8% target.

A closer look at the figures shows further moderation of growth in China's most developed regions, with double-digit expansions shifting to western and central areas. **Beijing, Shanghai, Zhejiang and Guangdong** bottomed the GDP growth race with reported rates of 8%, 8.3%, 9.5% and 10.1% respectively (Table 1). These regions are the pillars of China's Bohai Bay Area, Yangtze Delta Region and Pearl Delta Region, the main economic powerhouses of the past 30 years.

Table 1: GDP & Growth rate Jan. – Sep. 2011

	GDP (100 mio RMB)	Growth Rate
China	320692	9.4
Shanghai	13726	8.3
Jiangsu	35113	11.2
Zhejiang	22627	9.5
Anhui	11078	13.8
Guangdong	36953	10.1
Beijing	11404	8.0

(source: Chinese authorities)

[1] The Chinese Academy of Social Sciences (CASS)

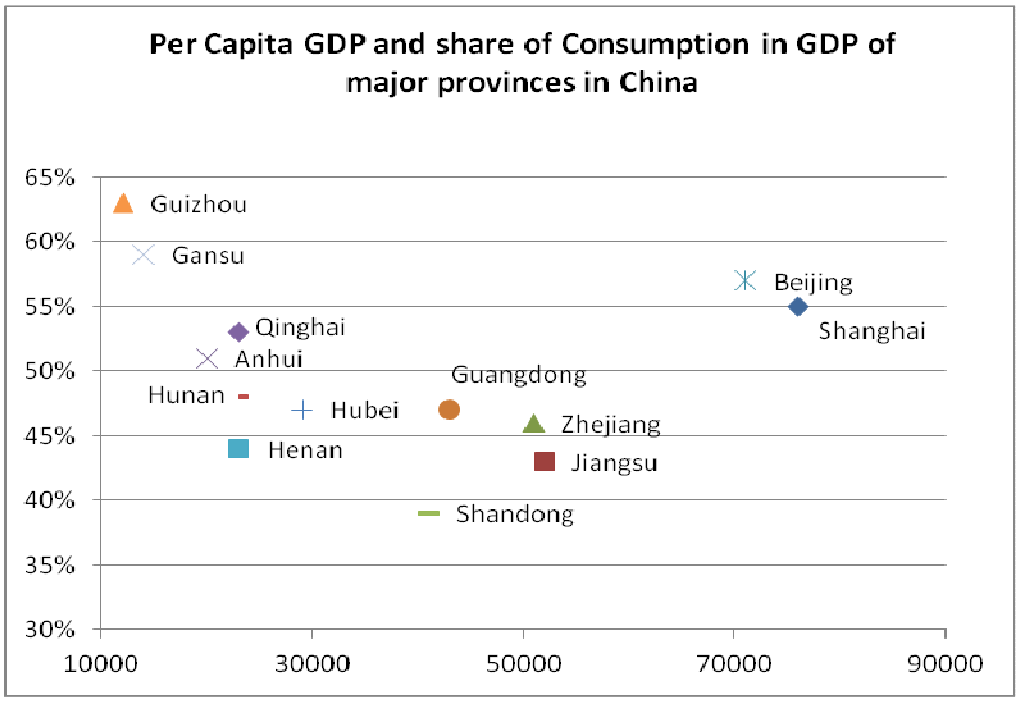
The coastal and export-oriented regions have been affected by the escalating European debt crisis and sluggish American consumer spending. The slowdown in these regions also showed "pains" when they prioritised their economic restructuring for sustainable development against a backdrop of tightening monetary policies and increasing costs.

On the other hand, **China shifted its investment focus from the coastal regions to the interior** in recent years. Vast resources have been spent on developing the region's transportation infrastructure to attract greater investment. The municipality of **Chongqing** and **Tianjin** topped the GDP growth list with both 16.5% increase. The A-performance group included also Inner Mongolia, Shaanxi, Ningxia and Qinghai, reporting growth rate of 15.5%, 14.9%, 15.6% and 15.3% respectively. The GDP of Sichuan, Hubei and Guizhou grew all over 14%. Among them the Northwest regions, Inner Mongolia and Shaanxi gained mainly from their rich energy and natural resources.

Continuous price increase of raw materials has transferred industrial profits from the downstream to upstream sectors. Guangdong, Zhejiang and Shanghai all reported declining growth in industrial profits[2]. That reflects again the issue of "unsteady, unbalanced, uncoordinated and unsustainable" development (Premier Wen Jiabao). The nation's 12th Five Year Plan (FYP) is trying to terminate this GDP growth race and de-link GDP figures from officials' performance evaluation. **Quality and efficiency will gradually replace speed for measuring development.**

Table 2 shows China's regional disparities measured by per capita GDP. The wealth gap between the coastal and interior regions is still big. Meanwhile the higher consumption-to-GDP ratio in both coastal regions and less developed interior reflects stronger purchasing power in the mega and coastal cities, and low exports from the western part. Investment and consumption were the only two major gears to drive the rapid growth in that region.

Table 2: Per capita GDP (RMB) and Share of Consumption in major provinces[3]



Source: compiled with official data from the authorities

[2] Guangdong 3.0%, Zhejiang 4.9%, Shanghai 1.3% (Provincial Statistics Bureau)
[3] China's final consumption rate is around 47%, while household consumption rate is about 35% (Chi Fulin, China Reform & Development Research Institute)

II. 2012: Another "most difficult" year

In 2008, China's Premier Wen Jiabao said that it would probably be the most difficult year for the Chinese economy. But the past looks simpler than the present at the beginning of 2012. **There are worrying signs for all the three economic drivers**: the European crisis and fragile US recovery are hurting China's exports, while the real estate sector[4] is stagnant under the restrictive policy to avoid a crash in this overheated industry. Consumption, however, has still not developed enough to take the driver's seat. High inflation and declining growth pose challenges to the policy makers. Furthermore, the government doesn't have the same resources as in 2008, when RMB 4 trillion was injected into the economy in the form of a huge stimulus package, which led to local governments' indebtedness in many regions. Furthermore, 2012 will see the once-in-a-decade[5] leadership transition which will result in a change of the top leaders including the president and premier.

In the mid of December, Chinese top officials held their annual Central Economic Work Conference to set tune for the planning of the next year. China will maintain a **proactive fiscal policy and a prudent monetary policy in 2012**. Although keeping the same general outlook, the policy of 2011 focused on taming inflation, while 2012 will stress on stabilising growth through economic restructuring.

Despite the "extremely grim and complicated" international and domestic situation, there are reasons to look positively in middle to long term projections.

1. Endogenous power

China's urbanization continues at a high pace. According to China's City Development Report, during the past 60 years, China's urbanization pace has passed from 10.6% in 1949 to 46.6% in 2009; the number of cities grew from 132 at the beginning of 1949 to 655 by 2009. It is estimated that by 2020 almost 50% of the Chinese population will live in cities, and by 2050, the percentage would grow to 75%[6]. That means 20 million Chinese people will move to live in the cities every year. The move will constantly fuel the growth of urban infrastructure fixed-asset investments. The growth potential of China's vast central and western regions, together with the rapid development of small cities and towns, could keep the economy on the fast track for at least the next decades.

2. Government's capability to intervene in the economy

Policy flexibility will be the best tool for the Chinese government to deal with international and domestic uncertainties. Fine-tuning of the monetary policy is actually already on its way by easing the reserve ratio to make more money available for lending. More monetary and fiscal measures will be introduced as needed. In this regard, China's centralised decision making process is more efficient than a typical western system and the government has enough power to ensure the implementation of needed steps. Furthermore the government is willing and ready to experiment with reforms in certain regions and expand the successful experience to the whole nation if wanted.

3. Stable leadership transition in reach

The transition is already gradually in process. Despite increasing social unrests caused by widening income gaps, unaffordable housing and forced relocation for land transfer, the political system is still in its stability mode. Economic cycles can be observed along with the

[4] Real estate sector has a multiplied effect throughout the economy, directly affecting the construction, steel, concrete power and alliance industries. About 50% of China's GDO is linked to real estate sector (Stephen Green, Standard Chartered)

[5] Maximum two consecutive five-year terms.

[6] The world average urbanization ratio is 50%, and in developed countries 85%.

change of leadership every five years[7]. While stability will be the key theme for the first year, more meaningful reforms could possibly be anticipated from the second year.

4. Consumption and investment to offset the reliance on export

China's economic reforms of the past three decades have gradually transformed the pattern and level of material consumption for millions of Chinese. **Household consumption is set to continue to rise and become increasingly important in China's overall economy**. Increasing wages and more welfare spending will further boost private consumption. Furthermore, the nation's fiscal revenue has been rising at an average rate of 20% to 30% annually. Government spending of public funds on receptions, official vehicles and overseas travel accounted for large shares of the total consumption. Transferring wealth from the state to households to fuel consumption will be the key to sustain the future growth.

The government is also trying to boost investment in public-housing projects to compensate for the construction slump. The construction of 10 million units has already started in 2011. Another 36 million units will be built during the 12th Five-Year- Plan.

III. The YRD: to maintain its championship of new model

China's export and investment led growth has been at the cost of energy, resources and environment, and has created significant overcapacities. It cannot last also due to the changing demographic structure and worrying external situation. After two decades of rapid expansion, the country has been backed into a corner and forced into a transition phase. The YDR, China's major economic powerhouse, is again at the frontier of the transformation.

1. Shanghai: to be the champion of modern service sector

As the dragonhead of the YDR, Shanghai had reported a two-digit growth for 16 consecutive years from 1992 to 2007, two percent higher than the national average. Since 2009, its growth rate has been below the average and ranked bottom together with Beijing this year.

In response to the concerns of the slowdown, Shanghai government explained that the city has already gone through its high-growth period and has entered a stage of economic transition and industrial restructuring; therefore GDP is no longer the key benchmark in a city like Shanghai. Instead the city will work out a new system that will measure the scope and depth of transformation, placing a greater value on moving up the value chain and on high-tech, rather than low-tech industries. The added value of a knowledge-intensive service sector, social security index and environment quality index will be taken into the NEW evaluation system.

The city authority pointed out that the data for the first three quarters of 2011 already showed **positive signs for a new growth model**. Fixed assets investment reported negative growth of -2.2%, compared with national average of 24.9%. It was the first decline in twelve years. Its reliance ratio on the real estate sector dropped below 8% from 15% in 2005.

Shanghai has been leading the traditional pillar industries, including steal, automobile and petrochemical industry but no more new investment will be fueled into the heavy industry sector, whose weight within the whole industry has dropped from 23.9% in 2005 to current 20.6%. On the other hand, the **service sector started to drive the city's economy** which contributed 60% of the GDP, provided half of Shanghai's jobs and 70% of the fiscal revenue. The service sector is targeted to grow to 65% of the city's total economy in the 12 Five-Year-Plan.

[7]Prof. Xu Xiaonian, CEIBS

In an effort to build the city into an international financial, shipping, trade and economic center by 2020, Shanghai already became the world's largest port in 2011 and has attracted the largest number and variety of foreign financial institutions in China. The city is now aiming at being "a hub with inter-connected market network that is capable of allocating resources across the world" (Shanghai's Mayor Han Zheng).

Pudong Area has been the east engine of Shanghai's development which is home to the Lujiazui Financial Zone, Zhangjiang High-Tech Park, Jinqiao Export-Processing Zone and Waigaoqiao Free Trade Zone. It hosted the Shanghai Expo 2010. The post-expo development started with the construction of the **International Tourism Resort District** with the Disney project as the core. Another part will be built into a headquarters district of central enterprises with Commercial Aircraft Corporation of China, Ltd. (COMAC), CHINALCO, Baosteel, and State Grid Corporation signing in already. Later the area will further try to embrace the headquarters cluster of famous enterprises and become a **first-class international business district.**

As the **new highlight** of the city's further development, **Shanghai Hongqiao Central Business District** unveiled its blueprint in 2011. The new engine in the west of Shanghai has a planned area of 86 km², with the Hongqiao integrated transport hub that provides multiple transports means at its heart. The concept of this district is a trade platform + low-carbon practice area + commercial community + urban complex + smart city. It aims to meet the economic development in Shanghai as well as the neighboring areas with focus on modern service industries. **A national grand exhibition centre,** to be constructed in Hongqiao Central Business District, is supposed to become **the largest top-class exhibition complex in the world**. The project will cost RMB 23 billion (USD 3.6 billion), and the first-phase was kicked off at the end of 2011.

2. Jiangsu & Zhejiang: further regional integration

The economic cluster with Shanghai at its core and the two wealthy provinces of Jiangsu and Zhejiang as major pillars has been the growth locomotive of China. Shanghai's circumstances are mirrored throughout the neighboring provinces. Both are pursuing economic restructuring while trying to maintain a stable, moderately fast growth.

As the result of the intensive investment in the transportation network in recent years, more and more cities from Jiangsu and Zhejiang Province are included into the **"2-hour economic circle" and "4-hour economic circle"**. Neighboring cities such as Suzhou, Hangzhou and Kunshan have established competitive edges in terms of geographic location, business environment and talent pool. The circle is expanding while the 1st tier cities are getting increasingly expensive. In the meantime, the two provinces are developing their own pillar industries. **Jiangsu produces 70% of China's total photovoltaic products** and is striving to grow an advanced software sector. **Zhejiang focuses on the development of marine industry** and tourism, as well as the support of **its dynamic private sector** to climb up the value chain.

3. Anhui: accelerated development from industry transfer

Anhui province has been actively participating in the pan YRD region development. The major breakthroughs took place after huge investments poured into the infrastructure and transportation in 2008. At the beginning of 2010, the State Council approved the plan of Anhui to undertake **industry transfer along the Yangtze River** and to construct the Anhui Demonstration Region.

While coastal regions are facing problems such as environmental and resource constraints, the vast and resource-rich central and western regions have favorable conditions to undertake the transfers. The relocation of low-end industries from developed areas to this low-cost region has brought the province's development to enter a fast track. The province

reported **13.4%** growth for the first half of 2011, and **13.8%** for the first three quarters, ranking number two in the central provinces.

IV. Swiss Presence: keeps the momentum

Despite the European crisis and the strong currency, **Swiss export to China has kept its momentum**. The major products to Shanghai in 2011 were photographic apparatus, optical items, watches, industrial machinery and equipment. Exports to Jiangsu were mainly machinery, measuring and testing equipments and machine tools, while to Zhejiang were textile machinery, transformers and rectifiers. **Switzerland still enjoys a trade surplus with China.** The surplus with the YRD region was USD 2'228 mio for the first half of 2011, with Shanghai contributing nearly 80% of it.

In the backdrop of a global slowdown, **China is getting more interesting for Swiss companies**. While all major big companies are already here, most are planning to increase their investments. Moreover, many small and medium-sized companies are coming here for the first time.

During the year 2011, the Consulate participated in over two dozen company openings, ground breaking, and expansion ceremonies. **For the first half year, 42 Swiss invested projects have chosen to locate in the YRD region**, with over USD 560 mio investment.

The rising labor cost and industry upgrading call raised the demand for Swiss high-end automation machinery and technology know-how. On the other hand, companies with a competitive edge in China's emerging industries find golden opportunities to invest in the sectors such as healthcare, new material, design and consulting service. Furthermore, China is at the very beginning of releasing its private spending power. The second tier and third tier cities are getting wealthy and opening their markets. Even high end Swiss consumer products are facing a market of over 50 cities, compared with 10 to 15 first tier cities in the past[8]. Of course, the sheer scale market is very diverse and complicated, demanding high flexibility.

To conclude, the year ahead looks cautiously optimistic and China's economy remains on a solid footing, with serious issues of structural adjustment. The Shanghai led YDR is working hard to transform its economic model to self-sustain its development.

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[8] Inter-China Consulting.

Table 3: Current Economic Indicators* of the Swiss Consular Area

Year		2010.1-6		2011.1-6	
		Volume	Growth	Volume	Growth
GDP (billion RMB)	**China**	**17'284.0**	**11.1**	**20'445.9**	**9.6**
	Shanghai	798.02	20.7	916.4	8.4
	Jiangsu	1'900	14.5	2'291.83	11.4
	Zhejiang	1'190	13	1'465.36	9.9
	Anhui	553.72	15.4	688.33	13.4
	Consular Area	**4'441.74**		**5'361.92**	
Total Retail Sales of Consumer Goods (billion RMB)	**China**	**7'266.9**	**18.2**	**8'583.3**	**16.8**
	Shanghai	292.10	17.5	325.6	11.5
	Jiangsu	648.33	18.4	774.2	17.2
	Zhejiang	476.26	19.0	564.02	16.9
	Anhui	193.21	19.1	230.79	17.8
	Consular Area	**1'609.9**		**1'894.61**	
Completed Investment in Fixed Assets (billion RMB)	**China**	**11'418.7**	**25.0**	**12'456.7**	**25.6**
	Shanghai	220.77	2.2	197.6	-5.8
	Jiangsu	1'021.17	23.5	1'181.13	23.9
	Zhejiang	516.4	17.7	610.7	25.9
	Anhui	511.11	30.9	556.23	35.5
	Consular Area	**2'269.45**		**2'545.66**	
Exports (billion USD)	**China**	**705.1**	**35.2**	**874.3**	**24**
	Shanghai	83.51	33.5	98.2	17.6
	Jiangsu	122.48	44.4	147.49	20.4
	Zhejiang	82.22	39.7	100.49	22.3
	Anhui	5.45	36.4	7.6	39.7
	Consular Area	**293.66**		**353.78**	
Imports (billion USD)	**China**	**649.8**	**52.7**	**829.37**	**27.6**
	Shanghai	88.30	52.3	109.7	24.2
	Jiangsu	92.12	56	109.9	19.4
	Zhejiang	35.29	45.2	44.17	25.1
	Anhui	5.47	89.5	6.75	24.6
	Consular Area	**221.18**		**270.52**	
Foreign Direct Investment (during the period)					
Projects	**China**	**12'400**	**18.8**		
	Shanghai	1'687	14.92	1'831	8.5
	Jiangsu	2'268	13.6	2'336	2.8
	Zhejiang	890	36.3	817	
	Anhui	123	-1.6		
	Consular Area	**4'968**			
Contracted (billion USD)	**China**				
	Shanghai	7.48	12.20	9.7	30.1
	Jiangsu	27.14	10.8	31.24	14.7
	Zhejiang	8.52	38.1	10.46	
	Anhui	0.68	53.8	1.43	110
	Consular Area	**43.82**			
Actually Utilised (billion USD)	**China**	**51.43**	**19.58**		
	Shanghai	5.37	4.11	6.0	12
	Jiangsu	15.21	16.5	16.70	9.7
	Zhejiang	5.32	9.2	6.28	
	Anhui	2.47	25	3.85	55.7
	Consular Area	**28.37**			

Source: Chinese Authorities

Table 4: Swiss - Yangtze-Delta Region Trade Relations

	Import from Switzerland				Export to Switzerland			
	2010.1-6		2011.1-6		2010.1-6		2011.1-6	
	Million USD	Growth rate %	Million USD	Growth rate %	Million USD	Growth rate %	Million USD	Growth rate %
Shanghai	1284	43.54	1971	53.5	152	7.55	244	60.15
Jiangsu	424.96	51.7	964	126.9	238.1	43	313	31.3
Zhejiang	150	11	180	26	300	19	330	8
Anhui	12.43	-28.6	27.8	124	6.7	109	6.2	-7.5
Delta Region	1'858.96	42.2	3'115	67.6	690.1	22.14	887	28.6
China	8'415.42*	179.9*	12'870*	52.9*	1'282.47*	1.1*	1'820*	41.6*

Source: Chinese authorities
* Statistics are different from the Swiss authority due to different statistical methods

Table 5: Swiss Investment in Delta Region

	Swiss Investment						Accumulated by end of June 2011		
In the Region	**Project**		**Contracted** million USD		**Actually** million USD		**Project**	**Contracted**	**Actually**
	2010. 1-6	**2011. 1-6**	**2010. 1-6**	**2011. 1-6**	**2010. 1-6**	**2011. 1-6**			
Shanghai	10	28	76.78	110.18	N/A	N/A	394	1'396.7	N/A
Jiangsu	5	12	8.76	58.5	35.91	36.35	198	1'160.5	891.35
Zhejiang	3	2	18.55	39.5	44	202	72	530	470
Anhui	1	0	8.18	0.47	6.16	0.63	6	48.51	N/A
Delta Region	**18**	**42**	**104.09**	**208.18**	N/A	N/A	**586**	**3'087.2**	**N/A**
China	**38**		**N/A**		**140.4**		**1'262**	**N/A**	**3'370**

General remarks:

1. All statistics not including Taiwan, Hong Kong and Macao;
2. GDP volumes are at prices of the reported years (not adjusted).
3. GDP growth rates are price-adjusted.
4. All figures are based on the unrevised data of China's statistical authorities.