Shanghai Flash

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The Yangtze River Delta (YRD): Current Economic Situation and Opportunities for Swiss Investments

(With the latest figures of Swiss presence in the region)

- ***Despite of macro economic difficulties and natural disasters in some regions of China, economic growth stays robust in the Shanghai led YRD, with a strong 2007 and steadily cooling-down 2008***
- ***Swiss exports to the region continued to grow with a total volume of USD 2'319.5 million and a 36.4% increase in 2007, while imports from the region grew 32.3%, resulting a 43.2% growth of trade surplus with USD 1'148.8 million in favour of Switzerland.***
- ***This shows a sign of economic decoupling from the global slowdown with a significant increase of consumption trend. In the meantime, business environment gets complicated with persistent inflation and margin pressure, but both challenges and opportunities exist.***
- ***Shanghai is taking off with the support from the central government to work closer to be an international financial centre***

2008 marks the 30th anniversary of China's economic reform, which is bringing the country closer to the world 3rd largest economy. For Shanghai, the locomotive of the Yangtze River Delta, it marks also the 18th anniversary of Pudong's[1] birth from a farm land. After decades of remarkable economic growth, the year is turning a page with more challenges and turbulences. Adding to the economic difficulties of overheating, inflation, and weaker demand from overseas, the snow storm in south China early this year and the tragic earthquake disaster in Sichuan in May severely hit the country, but in the same time inspired a national unity for relief and reconstruction.

1. Current Economic situation of the YRD

1.1 General situation: remains robust in 2007, steadily cooling down in 2008

As China's economic power house, the Shanghai led Yangtze River Delta[2] maintains its leadership position, with growth rates still ahead the national level. In 2007, the region reported a **GDP of RMB 4'667.2 billion** with an increase of **14.8%**, **2.9% higher than the national growth rate**. The growth rates of service industry (15.9%) and private consumption (16.8%) have outperformed GDP

[1] Pudong New Area: located on the east side of the Huang Pu River and consists of Lujiazui Financial Area, Jinqiao Export Development Zone and Zhangjiang Industrial Park. It is the economic engine of Shanghai.
[2] The Yangtze River Delta region here refers to Shanghai and 15 surrounding cities in Zhejiang and Jiangsu Provinces. These are 8 more developed cities in Jiangsu Province and 7 in Zhejiang Province.

growth, changing the growth pattern from an investment-dependant one towards more service and consumption driven. With less than 2% of the country's land area and 6.3% population, the aggregate GDP of the region contributed to **22.5% of China's total**.

With the domestic tightening policy and weakened overseas demand, the GDP growth rate of the YRD **slowed down** in the **1st quarter of 2008**. The region reported a GDP of RMB 1'178.3 billion with an increase of 13.1%. This is 1.9% lower than in the same period last year, but still 2.5% higher than the national level. The **export growth rate declined** 6.5%, but **service industry** picked up further to **a 43% contribution of the GDP**.

The region remains a **solid foreign investment destination** and still takes the lead in China's foreign trade. In 2007, the region reported **USD 881.5 billion of foreign trade**[1] in value, accounting for **37% of China's total,** with **35.5% increase**. The **trade surplus** in the region amounted to **USD 140.4 billion,** accounting for **63.2% of China's total trade surplus**. In terms of foreign direct investment (**FDI**), **34.6%** of the foreign invested projects were located here, actually utilising USD 40.18 billion capital, accounting for **48.6%** of the country's total utilised foreign investment.

1.2 Shanghai: Dragonhead of the Yangtze River Delta

Shanghai is defined as the nucleus of the regional development. Its economy expanded **13.3%** in 2007, **marking the sixth consecutive year of double digital growth** with a GDP of RMB 1.2 trillion. The contribution ratio of the three industries is **1%, 47.3% and 51.7%.** Last year, **c**onsumption grew faster (14.5%) than fixed assets investment (13.6%) and GDP, recording the fastest growth in the last decade.

The **boom of the consumption trend** continued in the 1st quarter of 2008. The retail sales boosted 16.9%, with new types of consumption of autos, household items and dining at restaurants leading the growth with 43.5%, 22.9% and 20.3% increase respectively. The economy continued to expand steadily but cooled down to **11.5% growth**, while contribution ratio of the three industries changed to **0.5%, 47.2% and 52.3%, with bigger share of the service industry.**

Under the framework to build the city into the **international economic, trade, financial and shipping centre**, **cargo shipment** through Shanghai ports reached 560 million tons in 2007, boasting it world No. 1 port for three years, while container shipment reported 26.15 million TEU, ranking 2nd largest in the world. **Imports and exports** value via Shanghai ports amounted to USD 520.9 billion with a 21.5% increase, accounting for **1/4 of China's total**; the trade value by the city reported a value of USD 283 billion with an increase of 24.4%, accounting for 1/8 of the country's total.

While foreign investment projects slowed down in China and other provinces of YRD, Shanghai still reported an FDI inflow of **USD 7.9 billion** (11.4% increase) with 4'206 newly approved foreign investment projects and an **accumulation of USD 74.7 billion**. It is noticeable that the **tertiary industry has utilized** 67.1% of the city's FDI in 2007, amounting to USD 5.3 billion. High tech manufacturing industry is the 2nd major sector to attract FDI.

During the same period, the investment **outflow from Shanghai was USD 649 million** with an increase of 22.6% and an accumulation of USD 3.2 billion. With its "**go global**" efforts, the city government encourages international M&A and expansion of overseas recourses joint development programs. **Economic Development Zones** have been set up in 12 countries and regions in Africa and Asia.

[1] USD 475.96 billion exports and USD 335.53 billion imports.

2. Swiss Trade and Investment in the YRD

The Shanghai led Yangtze River Delta plays an important role in the Sino-Swiss bilateral economic relation: in 2007, nearly **40%** of the Sino-Swiss bilateral trade, in terms of both imports and exports, is conducted through the YRD. **Swiss exports** to the region continued to grow with **a total volume of USD 2'319.5 million and a 36.4% increase**. Shanghai and Zhejiang, which are richer in the region measured by per capita GDP, saw a remarkable increase in imports from Switzerland with 39.4% and 56.2% growths respectively, showing rising appetite for high quality and luxury Swiss products in this region. In the meantime, the YRD exported to Switzerland a total volume of USD 1'150 million which represents an increase of 32.3%, resulting **a trade surplus of USD 1'148.8 million** in favour of Switzerland. The surplus was 43.2% higher than the year before and contributed to more **half of the total Sino-Swiss trade plus.**

The major imports of goods from the region were watches and components, machinery, chemicals and pharmaceuticals, as well as apparatus and electronics. **Exports to Switzerland** were dominated by machinery, garments and accessories, as well as textiles and shoes.

At present, there are **297** Swiss invested companies (among which 240 are wholly owned) and **138** chief representative offices present in Shanghai and **nearly 500** Swiss companies in the region, with a total amount of direct investment of **USD 2'639.5 million**. Switzerland is presented in this region not only by well-known multinational companies such as ABB, Roche, Nestlé, and Novartis, but also by small and medium sized enterprises, many of which are operating quite well and expanding quickly. These companies are mainly operating in the fields of chemicals, pharmaceuticals, machinery and machine tools, food and processing, precision instruments, watches and jewellery.

In 2007, **52** new Swiss invested projects have chosen to locate in the region, accounting for **51%** of the total Swiss invested projects in China.

3. Challenges and Opportunities: old and new

3.1 Persistent inflationary pressures

Rising inflation has topped Chinese government's agenda and poses a serious challenge to the economy. The Consumer Price Index (CPI), a main gauge of inflation, jumped 8.5% in April 2008, rebounding from 8.3% in March, with the last decade high of 8.7% in February. Although the inflation has primarily been driven by higher food prices, especially of pork, the staple meat, it has spread to non-food sectors, together with the spill-over of the rise energy and raw material prices.

As a measure of price levels as finished goods leave the factory gate, the Producer Price Index (PPI) in China jumped to 8.1% in April, the highest in four years and after an 8% hike in March. In the meantime, the factory-gate prices of raw materials, fuel and power were up 11.8%. In return, it will transfer to CPI, making it difficult for China to hit this year's 4.8% inflation target.

Furthermore, the massive reconstruction in the earthquake-hit areas will push up the price for raw materials and keep inflation high. The disaster happened on 12th May 2008 has claimed more than 60,000 lives and could rise to 80,000 or more, but its impact on macro economy is likely to be modest. Sichuan province accounts for only 3.9% of the nation's total GDP and the epicentre of the quake is a mountainous area with limited industrial production. However, the reconstruction will increase demands for construction and other raw materials, pushing up further production price index. Many small and medium sized manufacturing firms in Shanghai and the YRD will suffer from the raw material price hike, and additionally a short of migrant workers, as Sichuan province is a main exporter of migrant workers.

In an effort to tackle the inflation problem, interest rate has been raised 6 times in 2007; Required Reserve Ratio (RRR) has been hiked 10 times in 2007 and 4 times in 2008. More tightening policies are expected to come this year. Other measures to protect and subsidise agriculture are likely.

While high inflation is addressed as the biggest threat to China's economy, it could be perceived as beneficial if kept under control to certain extend. Inflation at moderate degree will help to correct the twisted pricing in China's export and eventually lead to higher domestic consumption. Investment on technology and research in agricultural sector will be boosted. It is also a good chance for foreign invested companies to increase RMB assets by acquiring bigger piece of land in some 2nd tier cities, where the land price has not yet skyrocketed.

3.2 Profit margin pressures

For a rising number of manufacturing sectors, the operating margin in Shanghai and the YRD is shrinking as a result of a combination of many reasons: hiking raw material costs, weakened overseas demands, RMB appreciation and rising labour costs after the launch of the new Labour Law. Above all, more fierce competition forces the manufacturers to struggle with squeezed margin to maintain their market share. Many private companies owned by Zhejiang Province entrepreneurs have reportedly relocated their factories from Shanghai to other cities. Particularly, low value-added and labour-intensive industries are hit more seriously. According to the China National Textile and Apparel Council, profit margins in China's textile industry averaged 3.9% in 2007, and two-thirds of companies claimed an average profit margin of 0.62%.

On the other hand, foreign invested enterprises (FIE) which are normally operating in higher value-added end of the industry with bigger margin or active in service sectors are less affected. Last year FIEs in Shanghai achieved a total profit of RMB 107.6 billion, with a 37.9% increase from the year before. Swiss companies' high-technology and strong R&D capacity present competitive advantages in this arena. Furthermore, Chinese companies in an effort to move up the industry ladder and to improve the productivity will increase their demands in energy efficient technology and high-tech machines, which will create opportunities for some Swiss enterprises and service providers.

3.3 Development of a financial centre in Shanghai

On China's economic stage Shenzhen and Pudong play the two leading roles. The former as the 1st economic special zone in the south Guangdong Province pioneered China's reform and opening-up in the early 1980s, and the latter, with its opening 10 years overdue, symbolized the extension of the reform in the 1990s. After 30 years of development, as the major manufacturing base in the South China, Shenzhen is now facing the problems of shrinking industry margins and phase-out of labour-intensive low-end manufacturers. As for Pudong and the city it represents, the strategic goal of becoming China's global financial centre is still finding its way to be closer to the reality.

Apart from already established regional financial centres like Tokyo, Singapore and Hong Kong, Shanghai is also challenged by other Chinese cities, such as Beijing and Tianjin in the north and Wuhan in central China, as they also receive favourable policies to develop financial functions. Until recently, however, the central government has showed its supportive gesture to develop the city into China's only financial centre. Put in line with the national development picture, Shanghai is set to be concentrated with all the financial activities, institutions and personnel, while all other cities could share from the functions, economic benefits and services from the Shanghai global financial centre.

Shanghai has already established a relatively complete modern financial complex with a stock exchange, gold exchange and futures exchange all in place. By the end of last year, it hosted 493 financial institutions, half of which hailed from other countries and regions; 12 of the country's 18 locally incorporated foreign banks; 26 of the nation's 54 fund management companies; and 5 of its 9 insurance asset management companies. The total capital of the banks in Shanghai reached RMB 737.09 billion with 54.7% increase from the previous year.

However, the limits on the capital market and the inconvertibility of the RMB in capital accounts pose the biggest hurdle to further develop the financial sector in the city. With the deepening of the financial reform, Shanghai will be more integrated with the global market. Some experimental reforms, such as a RMB convertible zone, or incentives for multinational companies to be listed in the city's stock market, are likely to come in the near future.

On the other hand, on its way towards a financial centre Shanghai is bottlenecked with the shortage of financial managers and talented professionals. With its international reputation, Swiss expertise and financial know-how would be most welcome in the city.

3.4 A new consumption-driven economy?

A consumption-driven economy has been the goal of the Chinese government for several years. According to the National Bureau of Statistics, the retail sales in the 1st quarter of 2008 grew 20.6%, while the growth rate for Shanghai stood at 16.9%. Although it's too early to conclude the transformation, the persistent moderate inflation, continued appreciation of RMB, as well as the robustly-growing economy, will continue to support domestic consumption and imports from both developed and developing countries.

The weak social security system in China is obviously the biggest obstacle to promote private consumption and lower the household saving rate. Higher government spending on healthcare, education and social security has been perceived in recent years. However, China still needs the support of long term sustainable fast economic growth to build up a sound social welfare system and to fill the wealth-poor gap. If it succeeds with broad results in stimulating consumers' confidence, the economy will change drastically.

Nevertheless, China is not a unified homogeneous market. Even in the YRD region, spending power and consumption behaviours are different between cities. Shanghai is China's largest market for a great range of goods and fosters an emerging middle-class and more sophisticated consumers groups. The consumption behaviour of the middle-class is very much influenced by leading brands and luxury items. Jiangsu's consumer economy is relatively small compared to Zhejiang and Shanghai. Different market strategies apply for different categorised (prosperous, emerging or poor) markets. While high end and niche markets, where Chinese competition is less, place many lucrative windows of opportunities, the mass markets are the next frontier for many FIEs in China, which will make "Made in China" eventually for China.

To tackle the mass markets, a joint venture with leading Chinese players could be a re-emerging approach. Over years of development and frog-leap effects, these companies have consolidated their capacity and strength with local business insights and strong clients' base. If the joint venture partnership is managed properly, it will be very useful for entering China's mass markets.

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Table. 1

Current Economic Indicators* of the Swiss Consular Area

Year		2006 Volume	2006 Growth Rate (%)	2007 Volume	2007 Growth Rate (%)
GDP (billion RMB)	**China**	**21'192.30**	**11.6**	**24'953.0**	**11.9**
	Shanghai	1'029.70	12.0	1'200.12	13.3
	Jiangsu	2'154.84	14.9	2'556.01	14.8
	Zhejiang	1'564.90	13.6	1'863.84	14.5
	Anhui	614.19	12.9	734.57	13.9
	Consular Area	**5'363.63**		**6'354.54**	
Total Retail Sales of Consumer Goods (billion RMB)	**China**	**7'641.0**	**13.7**	**8'921.0**	**16.8**
	Shanghai	336.04	13.0	384.78	14.5
	Jiangsu	662.32	16.2	783.81	18.3
	Zhejiang	532.53	15.0	621.4	16.7
	Anhui	202.94	15.0	240.37	18.4
	Consular Area	**1'733.83**		**2'030.36**	
Completed Investment in Fixed Assets (billion RMB)	**China**	**10'987.0**	**24.3**	**13'723.9**	**24.8**
	Shanghai	392.51	10.8	445.86	13.6
	Jiangsu	1'006.37	20.3	1'227.06	21.8
	Zhejiang	759.30	13.8	843.28	11.1
	Anhui	354.47	40.6	510.59	44.0
	Consular Area	**2'512.65**		**3'026.79**	
Exports (billion USD)	**China**	**969.10**	**27.2**	**1'218.0**	**25.7**
	Shanghai	113.57	25.2	143.93	26.7
	Jiangsu	160.42	30.5	203.73	27.0
	Zhejiang	100.90	31.4	128.3	27.2
	Anhui	6.84	31.7	8.82	29.0
	Consular Area	**381.73**		**484.78**	
Imports (billion USD)	**China**	**791.60**	**20.0**	**955.80**	**20.8**
	Shanghai	113.91	19.1	139.05	22.1
	Jiangsu	123.58	17.7	145.94	18.1
	Zhejiang	38.25	25.1	48.54	26.9
	Anhui	5.41	37.7	7.11	31.3
	Consular Area	**281.15**		**340.64**	
Foreign Direct Investment (during the period)					
Projects	**China**	**41'485**	**-5.76**	**37'888**	**-8.69**
	Shanghai	4'061	-0.7	4'206	3.6
	Jiangsu	6'541	-8.2	5'986	-8.5
	Zhejiang	3'583	5.5	2'919	-18.5
	Anhui	592	40.6	520	-12.2
	Consular Area	**14'777**		**13'631**	
Contracted (billion USD)	**China**	N/A	N/A	N/A	N/A
	Shanghai	14.57	5.4	14.87	2
	Jiangsu	38.78	-15.2	43.58	12.4
	Zhejiang	19.1	18.5	20.4	6.8
	Anhui	2.50	60.9	3.57	42.8
	Consular Area	**74.95**		**82.42**	
Actually Utilised (billion USD)	**China**	**69.47**	**-4.06**	**82.66**	**13.8**
	Shanghai	7.11	3.8	7.92	11.4
	Jiangsu	17.43	32.2	21.89	25.6
	Zhejiang	8.89	15.1	10.37	16.6
	Anhui	1.39	102.4	3.0	120
	Consular Area	**34.82**		**43.18**	

Source: Chinese Authorities

* All statistics not including Taiwan, Hong Kong and Macao; Figures of the year 2007 is the revised ones (10th April 2008); Growth rates are price-adjusted.

Table. 2

Swiss - Yangtze-Delta Region Trade Relations*

	Import from Switzerland				Export to Switzerland			
	2006		2007		2006		2007	
	Million USD	Growth rate %	Million USD	Growth rate %	Million USD	Growth rate %	Million USD	Growth rate %
Shanghai	1,121.59	14.51	1,563	39.38	264.14	17.3	318.0	20.31
Jiangsu	427.00	24.2	520.0	21.88	345.00	63.93	442.0	28.41
Zhejiang	151.42	4.75	236.46	56.16	272.45	33.71	401.43	47.34
Anhui	28.95	45	20.61	- 28.8	12.59	34.75	14.35	13.98
Delta Region	**1’700.01**	**15.88**	**2’319.46**	**36.40**	**881.59**	**37.98**	**1’161.43**	**31.74**
China	**4’583.14**	**18.1**	**5’842.79**	**37.3**	**2’260.14**	**16.1**	**3’600.60**	**43.5**

Source: Chinese authorities

Table. 3

Swiss Investment in Delta Region

	Swiss Investment						Accumulated by end of 2007		
In the Region	Project		Contracted million USD		Actually million USD		Project	Contracted	Actually
	2006	2007	2006	2007	2006	2007			
Shanghai	23	31	62.25	56.76	N/A	N/A	297	1’633.0	N/A
Jiangsu	15	20	44.97	195.06	83.61	196.26	136	786.0	633.0
Zhejiang	10	1	101.16	5.39	45.45	39.24	55	220.49	144.23
Anhui	1	0	3.07	0	N/A	0	6	39.86	N/A
Delta Region	**48**	**52**	**211.45**	**257.21**	**N/A**	**N/A**	**488**	**2’639.49**	**N/A**
China	**123**	**102**	**375.60**	**N/A**	**196.60**	**299.8**	**1’050**	**N/A**	**2’801.4**

General remarks:

1. GDP volumes are at prices of the reported years (not adjusted).
2. GDP growth rates are price-adjusted.
3. All figures are based on the unrevised data of China’s statistical authorities.