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This Week in China

Financial Crisis Has Validated the Strength of China's Economy

China's decision makers came together last week in Beijing to attend The Central Economic Work Conference, an annual meeting during which attendees work to strategize and promote economic policies to be enacted the following year. The first event was held over a decade ago, following China's declaration that it would continue to move towards a proactive fiscal policy as well as a moderately easy monetary policy. The primary goals of this year's conference focused on determining the best ways to cope with the impact of the international financial crisis and lay the groundwork for economic recovery.

According to analysts from government think-tank Development Research Center of the State Council, "...dealing with further impact of the international financial crisis will remain a major task for China in 2010. In order to achieve full economic recovery, China needs to continue the fiscal and monetary policies and implement and enrich the economic

stimulus package."

Despite this cautious outlook, it must be noted that China's economy has already shown tremendous resiliency throughout the crisis. Recent official purchasing managers' index (PMI) data confirmed that China's manufacturing sector expanded for the ninth consecutive month in November.

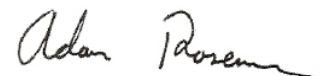
The post-crisis China has become a more confident nation that has gained global recognition for its economic steadfastness.

According to an article in China Daily, "China has emerged from this crisis economically more diversified, less dependent on the foreign markets and with a strengthened economy. Its vast currency reserves afford China many opportunities at a time when 'cash is king'. With the failure of the world's dominant economic model and China's impressive growth rate, at a time when most other economies are contracting, China stands taller."

The article goes on to point out that "...while the 'wealthy' world is trying to fix its industries of today, China is investing huge sums into developing the

industries of the next century that will create millions of new jobs to compensate for the almost 40 million jobs lost by the crisis." China's heavy push towards alternative energy and reduction of carbon intensity will enable the country to gain an edge in not only manufacturing the equipment that supports the alternative energy technologies but also, in many cases, the intellectual property behind the technologies. This could provide the country with an enduring competitive advantage in global energy.

ARC China's primary focus since entering China has been on investing in companies that will benefit from the transformation of China's economy to a more consumption based model and from the emergence of China as a global center of alternative energy technology. That the financial crisis has made these trends even more apparent has served to increase our confidence in this investment thesis.



Adam Roseman,
Founder & CEO
ARC China

This Week in China (cont'd)

Goldman Sees 20-Year Fund Flow to Developing Nations

China and other fast growing developing nations will lure more funds away from advanced economies through the next two decades, according to Goldman Sachs Group Inc.

Those flows will counter any impact on China's capital markets from government measures aimed at curbing asset bubbles, said Thomas Deng, Goldman Sachs' head of China strategy. Corporate profit growth in China, estimated at between 20 percent and 30 percent on average next year, will fuel an equity market rally, Deng said. He recommended buying shares in China's auto and healthcare industries, and companies with large land reserves in Shanghai ahead of next year's World Expo.

"Western countries' money is moving to oriental

Services Trade Marked as Next Big Thing after Crisis

China is aiming to cut its reliance on manufacturing and boost its services trade to facilitate domestic economic restructuring going into the post-crisis world market.

Trade in goods, which mainly generate from labor-intensive manufacturing industries and accounts for about 90 percent of the country's total trade, has caused an

imbalance in trade structure and hurt the country's exports amid the economic slowdown, analysts said ahead of the Central Economic Work Conference.

countries, and that means developed world money is flowing into developing countries," Deng told reporters in Hong Kong. "This will be a trend in the next 10 to 20 years."

Developing economies will expand 5.1 percent in 2010 compared with 1.3 percent growth in advanced nations, according to the International Monetary Fund. Asia-excluding-Japan equity funds posted net inflows of \$975 million in the week ended Nov. 25, bringing the total for the year to \$18 billion, EPFR Global said on Dec. 1. Flows into China equity funds reached a year-to-date high of \$827 million, according to EPFR, which tracks funds holding \$10 trillion worldwide.

An unprecedented \$1.3 trillion of loans this year and a \$586 billion stimulus package pushed China's economy to record 8.9 percent growth in the third quarter, the fastest expansion in a year. The

China's five largest banks have submitted plans to regulators for raising money after record lending eroded their capital, according to four people with knowledge of the matter.

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credit boom helped the Shanghai Composite Index rally 79 percent this year and Hong Kong's H-share index surge 70 percent. Home prices in 70 major cities in China climbed at the fastest pace in 14 months in October, the government reported Nov. 10.

Real estate in China is "slightly expensive, but not a bubble," Deng said. The nation needs a gradual exit strategy to prevent a bubble, he said.

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Source: Wall Street Journal

positively next year, partly due to the tiny base this year and China's long-term competitive advantage. But in consideration of trade protectionism, shrinking expenses and consumer psychology, I hold a conservative viewpoint for the growth rate," Chen said.

In the first 10 months of 2009, China's exports slumped 20.5 percent year-on-year to \$957 billion.



Source: Goldman Sachs; Euromonitor

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This Week in China (cont'd)

Imports decreased to \$798 billion, down 19 percent compared to a year earlier, according to official data.

Meanwhile, exports of goods are facing escalating trade frictions.

A total of 19 nations and regions have initiated 88 trade-remedy probes against China in the first nine months, the Ministry of Commerce said.

"Exports generated from services sectors, especially capital-intensive and knowledge-intensive, won't trigger trade conflicts," Ni Yueju, a trade researcher at the Chinese Academy of Social Sciences, said.

To offset the declining exports and adjust its trade structure, Commerce Minister Chen Deming last week urged to promote the services trade and predicted

China Focuses on Boosting Rural Demand

China will take steps next year to boost rural demand while trying to curb overcapacity in numerous industrial sectors, the government said at the end of its annual closed-door gathering to discuss economic policy.

Beijing promised to bolster rural demand by raising agricultural subsidies, increasing the minimum purchase prices for grain crops, investing more in infrastructure and improving public services to outlying areas.

China's service imports would reach \$1 trillion in the next five years.

Though China enjoys a trade surplus in goods, it suffers large trade deficit in services. In the first half of the year, China's trade deficit in services increased fourfold to \$16.7 billion, official figures show.

A low starting point also means vast room for development, said Xing Houyuan, a director with the Chinese Academy of International Trade and Economic Cooperation affiliated with the Ministry of Commerce.

Traditional service sectors, such as shipping, tourism and construction, make up the majority of China's services trade, and the government vowed to foster emerging hi-tech service sectors, including

The nation's leaders also vowed to maintain ultra-loose monetary and "proactive" fiscal policies, while improving the quality of economic growth through "structural adjustment" that will involve restrictions on industries deemed to be suffering from overcapacity. But the government warned it would maintain a balance between "fast and stable" economic growth and dealing with predicted inflation next year.

The annual economic policy meeting, known as the Economic Work Conference, helps establish policy priorities

telecommunications, software, and financial services.

Exports of some of the emerging sectors, like IT outsourcing, maintained a positive growth in the first half of this year despite the economic downturn.

China's coastal cities such as Shanghai and Guangzhou have shown strong capability in carrying out international outsourcing projects.

But a variety of barriers such as the lack of talent, policy and fiscal supports have held back the development of trade in services, analysts said.

China's service industries account for only 40 percent of the national gross domestic product (GDP), lagging far behind the average of 69 percent

Source: China Daily

for the next year.

The meeting often lays the foundations for a series of more specific proposals over the coming weeks and months.

As a result, analysts expect the government to introduce new measures to stimulate rural consumption, on top of existing policies aimed at encouraging spending on vehicles and household appliances that have helped to maintain rising rural sales this year.

Source: Financial Times

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Consumer / Retail

China Looks to Amass Distressed Auto Assets

A quarter of a century ago, China set out to create a modern automobile industry, almost from scratch. It seemed a daunting prospect.

But now the global financial crisis has catapulted China into pole position as the world's largest auto market, and the financial strength of China's carmakers has made them bidders of last resort for some of the western world's favorite distressed auto assets.

Chinese policymakers were pleased to see that last week China's biggest automaker, SAIC, gained control of Shanghai GM, its car-making joint venture with General Motors – and one of GM's most attractive businesses.

GM insisted that the deal, which gives SAIC 51 per cent of Shanghai GM, was worth it, since it paved the way for a potentially profitable joint venture between Detroit and Shanghai to sell low-cost vehicles to emerging markets starting with India. With a new \$650 million joint venture in India, this would give SAIC-GM joint ventures in all the important Asian markets bar Japan (where foreign automakers do not normally get much of a look in).

Then came news that another big state-owned Chinese automaker, Beijing Automotive Industry

Holding Corporation (BAIC), had arranged a RMB 20 billion (\$2.9bn) line of credit with Bank of China. BAIC has made no secret that it is interested in GM's Saab brand, which the Detroit carmaker plans to sell if it can find a suitable buyer by year end. BAIC, which has already approached Saab's management about buying machinery to produce its outgoing 9-5 model, now has the money to buy the brand, should GM be ready to sell to a Chinese competitor.

Earlier in the week, banking sources said Geely, one of China's largest privately-owned automakers, had arranged \$1bn in finance for its bid for Volvo.

Many auto market analysts remain skeptical of whether Chinese automakers can make a success of distressed brands that failed under US or European management. Some question whether the deals will ever get done: the Volvo sale has dragged on for months, and GM said this week it would give its attempt to find a buyer just one more week after a bid led by Sweden's Koenigsegg that included BAIC as a minority partner fell apart.

The only such deal yet signed – in which GM will sell its Hummer unit to the heavy equipment maker, Sichuan Tengzhong for about \$150 million – has not yet gained Chinese government approval.

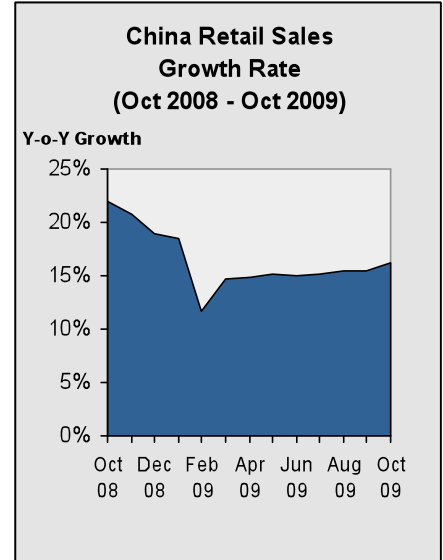
But SAIC's deal with GM to sell cheap cars and mini commercial vehicles to India could be different. Its strong financial position could help GM take a bigger share of the Indian market, while giving SAIC a foothold in one of the world's fastest growing car markets.

"This could be what China always wanted: forget BAIC and Saab, Geely and Volvo – what SAIC has done is potentially much bigger," said one Shanghai-based auto analyst. It is still early days in the quest for global power of the Chinese automaker. But this was a potentially significant day in the story of foreign automakers in China, at the very least.

Many analysts were baffled by GM's decision to give up control of one of fastest growing and important joint ventures. "It's ceding precious ground," says Mike Dunne, an auto analyst who focuses on Asian markets. "Nobody in the industry wants to give up ownership".

But Ashvin Chotai, managing director of Intelligence Automotive Asia, a UK-based consultancy, said that the decision to team up with SAIC in India – which unlike China does not require foreign carmakers to take a local partner – could be interpreted as a sign of GM's confidence in the two companies' relationship.

Source: Financial Times



Source: Bloomberg

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Healthcare

China Seeks to Reform Health Care System

The Chinese government has launched a three-year, RMB 850 billion (\$124-billion) effort earlier this year to rebuild the country's health care system.

China once provided rudimentary but universal care to everyone. But as the country has shifted from socialism to a market economy over the past 30 years, health care frayed. Medical costs have soared faster than incomes, and treatment today depends on one's ability to pay. Nearly a third of the poor say that health is the most important cause of their poverty, according to the World Health Organization.

"People are paying too much out of pocket for their services for their health care. Many are becoming impoverished in the process," said John Langenbrunner, a World Bank health economist in Beijing. "The level of dissatisfaction, at the local level, is very high and the government is responding to this."

Affordable medical services also could help reduce China's dependence on exports by encouraging people to stop saving so much for potential medical costs and spend their earnings on consumer goods instead.

The government's goals include:

1) Improving health services, in part by building 2,000 county hospitals and 29,000 township hospitals and ensuring that each of the country's nearly 700,000 villages has a clinic.

2) Expanding state health insurance from 70 to 90 percent of the population, or an additional 200 million people — equivalent to two-thirds of the U.S. population.

3) Reducing drug costs by controlling prices for medications deemed essential.

Longer term, the government is seeking ways to cut back on unnecessary treatment and drug prescriptions that are blamed for skyrocketing fees at public hospitals.

The challenges are daunting.

"In a country with 1.3 billion people, to achieve the goal of health for all is by no means an easy job, particularly at a time of global financial crisis and economic downturn," Health Minister Chen Zhu wrote in *The Lancet*, a British medical journal, earlier this year. "However, we are determined to transform these challenges into opportunities."

Eight months into the three-year plan, reform remains a work in progress. Sixty percent of the funding is supposed to come from regional governments, and it's unclear how poorer ones will come up with the money.

"The challenge for China is

to evaluate the various kinds of schemes that it is trying and then see which schemes seem to work better and adopt them," said William Hsiao, a China health policy expert at Harvard University.

Shenmu County in Shaanxi Province is offering free health care for its 390,000 residents. The southwestern metropolis of Chongqing is trying to manage urban and rural insurance programs together to save money.

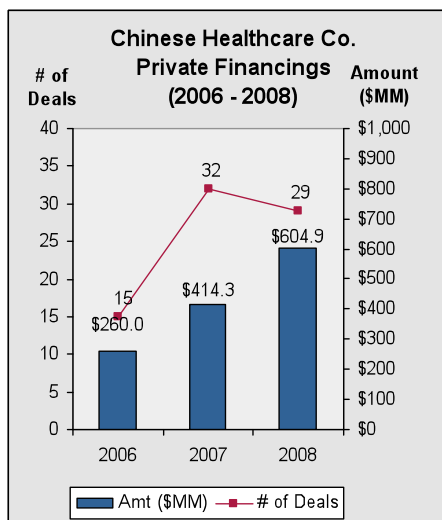
In Ningxia, an inland region in the west, farmers now pay RMB 30 (\$4.40) a year to join a rural cooperative insurance program that allows them to see a village doctor for 30 common illnesses including colds, bronchitis and diarrhea for only one yuan, including medication.

In earlier days, workers were provided cradle-to-grave medical care while an army of "barefoot doctors" — rudimentarily trained paramedics — vaccinated children and improved sanitation in the countryside.

That all broke down following China's free market reforms.

Now many don't seek care until it is too late, while others resort to risky measures. A national health survey last year found that about 70 percent of people forgo recommended hospitalization because they cannot afford it.

Source: Yahoo! News 5



Source: Capital IQ

The Chinese government has launched a three-year, RMB 850 billion (\$124 billion) effort earlier this year to rebuild the country's health care system.

Recent Transactions

ICBC in talks to acquire stake in Cathay Financial

Industrial and Commercial Bank of China (ICBC) is in talks to buy a stake in Taiwan's Cathay Financial, sources said yesterday, in a deal that could be worth more than \$3 billion.

The talks come amid an easing of cross-Straits relations between the mainland and Taiwan, in hopes of boosting both economic and political ties.

Wugang to Pay \$400 Million for Stake in MMX

Steelmaker Wuhan Iron & Steel Group (Wugang) is acquiring a 21.52 percent stake in Brazilian iron ore miner MMX Mineracao e Metalicos SA for \$400 million to bolster its iron ore supplies.

Rio de Janeiro-based MMX, controlled by Brazil's richest man Eike Batista, will issue new shares at an equivalent price of \$3.93 each.

Wugang has also agreed

Discovery Takes Stake in Ping An Health

South Africa's largest health-care insurer Discovery Holdings Ltd. will pay nearly 900 million rand (\$121.5 million) for a nearly quarter stake in Ping An Health Insurance Co., a unit of China's second-biggest life insurer by premiums.

The deal, which is likely to be finalized by the second quarter of next year, would mark the first foray into China by the South African

One source said that ICBC was interested in buying a roughly 20 percent stake in Cathay Financial, Taiwan's top listed financial holding group, which has a market capitalization of around \$17 billion.

ICBC and Cathay hope to make an announcement soon after Taiwan and the mainland sign a free trade pact, which Taiwan aims to sign early next year, the

to build a 5-million-ton steel plant in Brazil with MMX's parent EBX.

The Hubei-based steel maker will become the second-biggest shareholder in MMX and will also appoint two board members.

China's largest steel producer Baosteel and Brazilian mining giant Vale had earlier planned to build a steel mill in Brazil, but deferred the plan in March as global steel demand slumped and

health-care cover and life insurer.

Adrian Gore, chief executive officer of Discovery, said the total price isn't expected to exceed 5% of Discovery's market capitalization.

China's population of more than 1.3 billion people has attracted a steady stream of foreign insurers and banks to the country, with the likes of German health insurer DKV Deutsche Krankenversicherung AG and American International

source said.

Cathay Financial Group was established in Taiwan on Dec 31, 2001, with a registered capital of NT\$120 billion. The company has become a full-functioning financial conglomerate composed of insurance, securities, banking and other financial institutions.

Source: China Daily

steel mills started cutting existing output.

If the deal gets approved, Wugang will become China's first steelmaker to build a steel mill in Brazil.

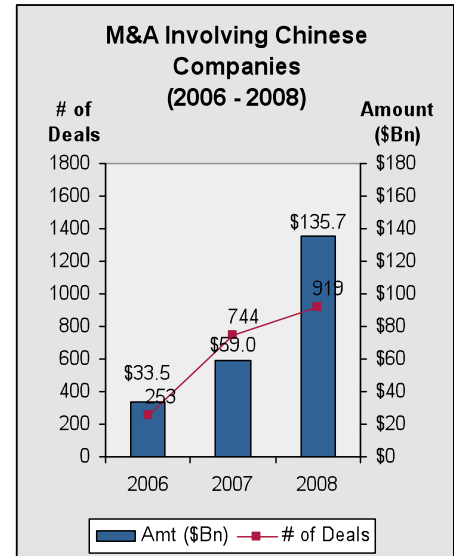
MMX, which currently has the capacity to produce 10.8 million tons of iron ore a year from its Sudeste and Corumba mines, is expected to increase its iron ore capacity to 40 million tons by 2013.

Source: China Daily

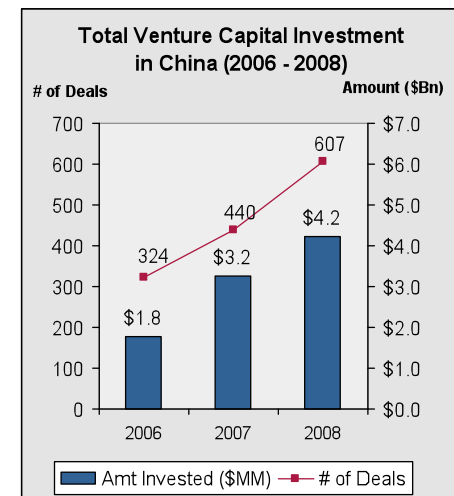
Group Inc. each already holding minority stakes in Chinese insurers.

Some foreign companies have also set up joint ventures in China, while others have bought stakes in Chinese lenders in order to cross-sell their products through banks' branch networks. But overall, the market share as measured by premiums for foreign insurers in China remains just a fraction of their domestic counterparts'.

Source: Wall Street Journal



Source: Capital IQ



Source: Zero2IPO