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U.S. Chinese Services Group

Deloitte LLP

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China’s Economic Slowdown – How to Respond?

China Issues: Monthly Commentary on Cross-Border Investment with China

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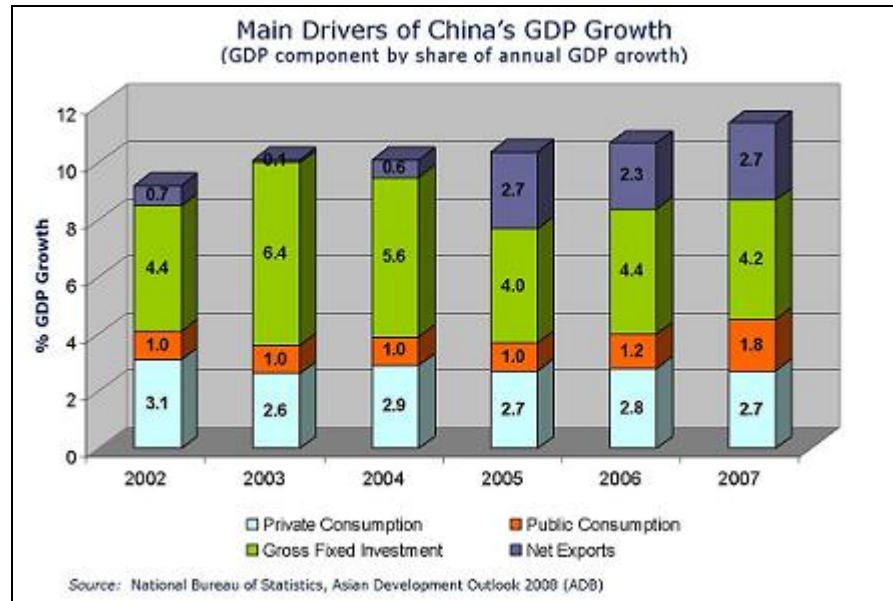
The Chinese Services Group of Deloitte LLP provides a monthly commentary on cross-border investment with China reflecting on key trends in the marketplace. For further information or to explore the broader implications, please contact us at uscsg@deloitte.com or visit www.deloitte.com/us/csg.

Imagine a China country manager for a major U.S. corporation flying in this month for a meeting with his CEO to discuss the firm’s China strategy. For more than a year, both have been closely tracking the global economic slowdown and looking to China as a back-stop to maintain top-line revenue growth. Then news breaks that China’s economy is slowing as well. The CEO kicks off the meeting by asking – given recent events, do we need to adjust our China strategy?

A quick review of the facts. On October 20, China’s National Bureau of Statistics (NBS) released its economic report for the first three quarters of 2008. Year-on-year GDP growth was 9.0% in the third quarter, down from 10.1% in the second quarter and 10.7% in the first quarter. Other recent indicators across the main drivers of China’s growth show a mixed picture:

- **Fixed-Asset Investment:** Overall investment growth for the first three quarters of 2008 was up 1.3% over the same period in 2007.

- **Exports:** China's export growth through September 2008 slowed 4.8% from the same period in 2007.
- **Consumption:** While retail sales growth accelerated 6.1% to 22.0% in the first three quarters, auto sales declined for a second straight month in September.



Looked at in isolation, news of a slowdown could be seen as aligned with the Chinese government's long-standing goal of lowering GDP growth to a more sustainable level. But the speed of the downturn, coupled with the deepening global credit crisis, has clearly heightened concern that China's GDP growth rate could drop below the 8.0% level widely considered necessary to generate employment and maintain social stability.

The response by the Chinese government has been swift. Two days before the NBS announcement, the State Council, China's executive cabinet, presented the broad outlines of an economic stimulus package. Over the next several days, individual ministries announced specific implementation measures. The stimulus plan addresses each of China's growth drivers:

- **Fixed-Asset Investment:**
 - The plan includes pledges to accelerate key projects in agriculture, water conservation, energy, transportation and urban infrastructure, especially in China's less-developed interior. In fact, this is one of the few occasions in the past five years where the central government is urging local governments to step-up,

rather than slow down, project approvals.

- **Exports:**

- The Ministry of Finance announced that effective November 1, VAT rebate rates on 3,486 export items, representing 25.8% of China's exports in 2007, would be raised.

- **Consumption:**

- The State Council said that it may slash taxes on housing transactions, and there are also indications that it may make long-promised income tax reductions as well.
- The stimulus includes increased agricultural subsidies and higher floor prices for grains, including a 15.3% increase in the minimum price for wheat, starting next year.
- The plan also calls for higher lending to China's small and medium-sized enterprises, which are responsible for much of China's job growth in recent years.

Returning to our meeting between the CEO and the country manager, the question remains – does the company need to change its China strategy because of the downturn? Given that China might not be able to compensate for a slowdown in top-line growth, should the firm scale back its China ambitions and take a “wait and see” approach to investing in the market?

The answers to these questions depend on the company. But one thing is sure – a smart company will be looking not just to weather the potential downturn, but to better position themselves to seize opportunities when the economy inevitably turns around. Its executives would start by reassessing China's relative role in the firm's long-term global strategy, and closely monitor what competitors are doing. Just as China is seeking growth from all drivers of its economy, the firm would also reexamine its own plans within each of these areas, among others:

- **Fixed-Asset Investment:** Can the company provide any products or services in connection with new infrastructure investments? Once new infrastructure is in place, how will that change the market potential in each of China's regions?
- **Exports:** Given the new measures to boost exports, should the company continue to reduce its dependency on China for its sourcing needs? Does it need to take a fresh look at its

global sourcing strategy?

- **Consumption:** Can the firm find new opportunities arising from government efforts to stimulate demand, especially through SMEs or the agricultural sector?

If you have any questions, or to add or remove a name from our mailing list, please email us at uscsg@deloitte.com.



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