

**EAST IS EAST AND WEST IS WEST ...
AND THEY WILL HAVE TO WORK TOGETHER
IN A MUTUALLY INTERDEPENDENT RELATIONSHIP**

As we enter a new year, the questions that just about every businessman and investor of the Hongkong Special Administrative Region (HKSAR) of the People's Republic of China (PRC) want answered include:

1. What will the new year bring?
2. Should one buy, sell or hold?
3. Will the economy of the PRC continue to grow and, if so, at what pace?
4. How will the HKSAR fare, given that the PRC's economy will continue to power ahead at breakneck speed with the PRC Government, from time to time, tightening the reins on the pace of growth?

Here are some of the answers, according to **TARGET's** economists.

Inflation

One of the biggest challenges that the PRC faces, today, is trying to contain inflation.

Last Tuesday, the Government of the PRC announced that inflation in the country for the month of November was running at an 11-year high of 6.90 percent.

Year-On-Year, that is an increase of about 6.15 percentile points.

Increases in the prices of staple foods, such as pork (up 56 percent) and other meat and poultry products (up 38.80 percent), were major causes of the high inflation rate.

The Government of the PRC has to tackle the problem of inflation as a matter of urgency because, left alone, it could lead to social unrest as the inhabitants of the country find it increasingly difficult to make ends meet.

It could be held that the PRC Government has been dragging its feet in regulating the economy with regard to the relatively high inflationary tendency, especially, concentrating more on encouraging exports as the Number One priority.

In other words, the main consideration of the past has been to increase the quantity of exports in order to fuel economic growth rather than consideration, being given to the quality of economic growth.

If inflation is not brought to heel, like a cancer, it will eat away at the gains of economic growth.

Left alone, it could create havoc throughout the economy in due course.

Eventually, if inflation continues to gallop away, unrestrained, the managements of various industries will not be able to meet the demands of labour on the assembly lines for higher pay and perquisites, should push come to shove, because, in the main, profit margins for many products, manufactured in the PRC and sold to customers, such as the United States, are small, in some cases as low as 3 percent.

Due to the rising cost of energy, many former PRC manufacturers have, already, closed shop in the south of the country because the situation is that the cost of a loaf of bread has become cheaper than the cost of the flour, yeast and sugar, combined, used in the baking process.

This is pointedly true for many plastics manufacturers of Guangdong because, in their case, the finished products have become cheaper to the importer/consumer than the cost of the raw materials, used in the production of the goods.

The PRC is not just another economy of the world: It has become one of the strongest economies of the world – certainly, it is the fastest-growing economy of the world – and it is, in the next decade, destined to become an arch economic rival of the United States.

It will leave the economy of Japan in its wake if its present economic growth can be maintained.

The re-emergence of the PRC on the world stage, as an economic power as well as being a political power, is the most-important, geopolitical events of the past few centuries.

But the greater the power of a country, the greater is the level of responsibility that has to be exercised if that power is to be maintained.

The irresponsible use of power leads to an erosion of that power in due course.

Thus far, the Government of the PRC has proved to be very responsible, in the main, at least.

Overlapping with the interests of the United States, one sees trade issues, national security, and even consideration about the effects of climate change.

What happens in the PRC, today, affects the world, one way or another, either today or tomorrow.

When the key indices of The Shenzhen Stock Exchange and/or The Shanghai Stock Exchange fall out of bed, the thud of the fall is heard around the world – immediately.

The interdependence of the PRC's economy with other major economies – the US, Germany, the United Kingdom, etc – is becoming increasingly more noticeable.

It is mandatory, in today's world, that economic powerhouses work together for their own welfare as well as the welfare of those economies which are not as fortunate as theirs.

Grudgingly, the US has had to admit that the PRC is a world player as no other world player, today, or any other day.

The trade figures do not lie; they are undeniable.

Statistics, compiled by the US Census and Statistics Department, show that, over the past 5 years, US exports to the PRC have grown from \$US18 billion to \$US52 billion.

At the same time, the PRC has sold to the US, products and services, the value of which has risen from \$US102 billion to \$US287 billion.

As this medium has stated on a number of occasions in the past, the universe as we know it, the one in which we live, today, is analogous to the production of an apple pie in the world's kitchen: Leave out just one key ingredient and the apple pie loses a goodly part of its traditional taste and most of its appeal to apple-pie connoisseurs.

Closer relationships between the PRC Government and its trading partners, and the US Government, especially, will be a must in the years ahead.

It is a must because, inter alia, many of the aspects that are shaping the future growth of the PRC are, also, causing heartaches (and some headaches) to other economies.

The United States and the PRC are the largest consumers of energy in the world, today.

The United States and the PRC are, also, the largest polluters of the atmosphere.

Interdependence and understanding are essential for the welfare, not just of the United States and the PRC, but for the welfare of the entire world.

The Tensions

Whereas, in the past, trade and investment were considered sources of stability for trading nations, today, sadly, such considerations are becoming sources of tensions.

Just this week, the PRC's Vice Premier, Ms Wu Yi (), took aim at the US Government for imposing trade barriers as well as 'exaggerating' the quality of a number of PRC-manufactured products.

The attack was launched by the PRC's 'Iron Lady' at the opening of the 18th US Joint Commission on Commerce and Trade.

Ms Wu Yi said, among other things:

'These (unharmonious notes) are marked by a rise in the amount of (US) Congressional Legislation against China, obviously politicisation of economic and trade issues and tightening control on imports from China ...'.

The pot, calling the kettle, black?

Maybe.

Tensions, such as the above-mentioned, tend to strain good relations between trading nations.

Both the PRC and its trading nations benefit from free economic engagements.

Isolationism is a non-starter in today's world as North Korea learned when vast numbers of its 23 million human population went hungry, causing The General Secretary of the Korean Workers' Party, Mr Kim Jong Il, who is the supreme power of the country, to cave into pressure from the United States and, obliquely, to beg for help.

North Korea was forced, mainly due to domestic pressures, to agree to dismantle its nuclear programme in exchange for food and oil.

On Tuesday, the first train from South Korea crossed the heavily fortified border with North Korea, carrying much-needed goods to the once reclusive North Korea.

The train returned to South Korea, carrying garments and piece-goods, manufactured in North Korea.

It was the first time in the past 50 years that such an event had taken place, or, for that matter, even anything remotely resembling cooperation between the once sworn enemies of the Korean Peninsula, both of whom share the same language and ethnicity.

The political thaw has begun.

Economic protectionism, as history has proved, is not protectionism, at all.

Economic and social imbalances within a country eat away at the very fabric of a country in record-breaking time as General Secretary of The Korean Workers' Party, Mr Kim Jong Il, discovered.

Without a strong and viable government policy, any country's economic growth becomes unsustainable.

The PRC Government is learning this lesson, today, if it has not, already, learned it.

Another major problem, facing the Government of the PRC, is that its economy is geared toward the promotion of heavy industry, coupled with record-breaking, high energy consumption, capital intensiveness and high dependence on exports.

The path of the PRC's economy must veer somewhat away from this direction so as to have more reliance on domestic demand, the production of services and a sharing of the national income with those who helped to fashion the PRC's economic miracle: The workers of the country.

The PRC, no doubt, will take its place alongside its trading partners as a responsible economic power.

There are definitive signs that, in fact, this will be case, if it is not, already, apparent because the PRC Government has made investments in some of the poorest countries of the world.

The PRC has become a huge source of foreign aid, building roads, bridges, airports, harbour installations, etc, and assisting the populations of many of the poorest nations with technical know-how as to the best way forward, not by just giving handouts, but by teaching the countries' populations how to use a fishing line in order to catch fish for themselves rather than feeding the populations with PRC foodstuffs.

The economic and geopolitical landscape of tomorrow's world will, without question, be influenced by the United States and the PRC.

One can imagine this taking place throughout the entire 21st Century.

These 2 nations must work together for their common good; and, it appears that they will be forced to work together for their mutual financial benefit.

There is no alternative.

Conclusion: Stick with the East as **TARGET** () has stated in the past.

Invest where growth is, just about, assured in the years to come.

There will be financial ups and downs, gains and losses, to be sure, but, ultimately, the HKSAR and the PRC will continue to be huge growth areas for investors.

The border between the Guangdong and the HKSAR will start to fade until the megapolis will emerge as the largest financial powerhouse of the south of the most-populous country of the world and become a huge source of revenue for the PRC Government.

For investors of the HKSAR, it would appear that investments in real properties, select service industries and specialised retailers of luxury goods will reap high rewards in the next few years.

Whereas the economy of the US may well suffer slower growth in 2008 than it did in the 2006-Year and the 2007-Year, the PRC and the HKSAR will not be affected, to any great extent, by this slowdown.

The reason for **TARGET**, stating this, is because the PRC has diversified its markets over the past few years, relying less on sales to The Land of The Free and The Home of The Brave than in days of yore.

The US housing crisis will, more than likely, come to an end by the second half of 2008.

The chaos on international credit markets will be relegated to history in the next quarter or so as Central Banks come to the party, putting financial fingers in leaking dykes.

The PRC, in the meantime, will continue to be the tailor of the world, etc, and one of the preferred regions for US investment because the Middle Kingdom remains a prime target for the multinational, wanting to put a foot in this country's door.

The potential growth for the PRC in the years ahead, with its population of about 1.30 billion people, is a magnet that no businessman, anywhere in the world, can afford to disregard.

Investors of the HKSAR will ride on the back on the coming, new PRC economic wave.

Stay for the party.

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This **TARGET** Intelligence Report, Volume IX, Number 237,
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The next **TARGET** will be on Subscribers' desks on Monday, January 7, 2008.

This medium takes this opportunity to wish all **TARGET** Subscribers

**MERRY CHRISTMAS
AND
A VERY HAPPY NEW YEAR**

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