

### **WHERE HAVE ALL THE CRISES GONE ?**

Since the beginning of the year, one has heard horror stories from quite a number of manufacturers with industrial bases in the People's Republic of China (PRC), proper, being distinct from the Hongkong Special Administrative Region (HKSAR) of the PRC, to the effect that the HKSAR manufacturers are unsure of their future prospects because:

- a. The Government of the PRC has imposed new (and onerous) labour laws that have cut a terrible swath through profit margins. The Labour Contract Law, which was promulgated on June 29, 2007, and came into effect on January 1, 2008, has the following features:
  - 1 Employers will enter into written employment contracts with their employees;
  - 1 All employees' remunerations will not be less than the minimum standard as promulgated by the local governmental authority from time to time;
  - 1 All employees with fixed-term, employment contracts will automatically become non-fixed term employees if their fixed-term employment contracts have been renewed twice; and,
  - 1 If employers choose not to renew employees' fixed-term contracts, they will have to make severance payment to the employees;
- b. The translation value of the renminbi vis-à-vis the US dollar and the euro has made it difficult for HKSAR manufacturers to obtain a reasonable return on investments;
- c. Suitable labour is difficult to obtain in the PRC, proper, today, unlike the '*old days*'; and,
- d. The economic slowdown in the US, which is having a knock-on effect in Eurozone, with consumers, cutting back on expenditures in the High Street, is bound to affect exports from the Middle Kingdom.

All very logical and, seemingly, disturbing.

But things are just not panning out as expected: HKSAR industrialists, with their manufacturing bases in the PRC, proper, continue to take their profits to banks on a very regular basis.

Things don't seem to have changed that much, after all, even with all of the problems, hanging over the heads of the manufacturers.

Further, the doomsday scenario to the effect that many factories in the southern part of the PRC, proper, would have to close down due to the many problems, facing the managements of these factories, has not come to pass.

So, for what reason have not these industrialists closed down their PRC facilities and relocated them?

### **Crying With Loaves Of Bread Under Each Arm**

The industrial growth of the PRC, proper, over the past 3 decades, has been phenomenal.

And it is far from being over, clearly.

Between 2002 and 2006, exports from the PRC, proper, mainly to the US and Europe, have risen by about 30 percent, Year-On-Year, unabated.

According to The National Bureau of Statistics of the Government of the PRC, the **Compound Annual Growth Rate (CAGR)** of the **Gross Domestic Product (GDP)** grew between the 6 years to 2006 at about 13.40 percent.

The following table is calculated by **TARGET** (), illustrating the growth of the Nominal GDP of the PRC, during those 6 Fiscal Years:

|                                                | 2000                                                                                          | 2001   | 2002   | 2003   | 2004   | 2005   | 2006   |
|------------------------------------------------|-----------------------------------------------------------------------------------------------|--------|--------|--------|--------|--------|--------|
|                                                | <b>All Figures Are Denominated In Renminbi'Millions</b><br>(except where otherwise specified) |        |        |        |        |        |        |
| Nominal GDP <sup>1</sup>                       | 9,921                                                                                         | 10,966 | 12,033 | 13,582 | 15,988 | 18,387 | 21,087 |
| Percentage Increase, Year-On-Year <sup>2</sup> |                                                                                               | 10.53  | 9.73   | 12.17  | 17.02  | 14.32  | 14.04  |

1. GDP = The annual total value of goods produced and services provided in a country, excluding transactions with other countries.

2. These are **TARGET**'s calculations.

In the 2007 Fiscal Year, the growth of exports in the PRC, proper, slowed to about 20 percent, Year-On-Year.

Tut-tut!

Needless to state, the PRC, proper, continues as the fastest-growing exporter in Asia.

In the first quarter of 2008, however, things cooled, considerably, for PRC exporters due to a number of factors, with transportation disruptions, being the Number One problem.

Since the end, or amelioration, of those problems, things have been fast returning to normal.

Recent statistics, annualised, suggest that growth of PRC exports still measured about 15 percent, Year-On-Year.

Which is hardly a tragedy for HKSAR industrialists.

The PRC, proper, continues to hold onto its market share, globally, and, in fact, in Eurozone, it appears that more inroads have been made of late.

Even with the slowdown in the US economy, exports to that market from the PRC, proper, have been maintained.

In Eurozone, in the first quarter of 2008, the PRC's share of imports into this market, which is about 25 percent larger than the US, climbed to the record level of more than 40 percent.

As for the US, imports from the PRC, proper, into the largest, single economy of the world, was about 34 percent.

As for dwindling profit margins for HKSAR industrialists, engaged in light manufacturing in the southern part of the PRC, they have not come to pass, apparently.

Because HKSAR industrialists just pass on increased manufacturing costs to US and Eurozone importers.

Even for the most, labour-intensive industries, such as furniture producers, manufacturers of toys, food processors, etc, margins of profits have been maintained, plus or minus a percentage point or so.

And even with the 10-percent growth in the translation value of the renminbi vis-à-vis the US dollar, it has made little impact on the bottom lines of most PRC producers of garments, furniture, pots and pans, condoms, toys, etc.

Many HKSAR industrialists saw the writing on the walls a few years ago and did not even consider repatriating renminbi funds, preferring to keep them in the country in order to pay for raw materials, settle staff costs and be used for monthly overheads.

These industrialists, today, are sitting on hundreds of millions of renminbi deposits.

It is a given that the translation value of the renminbi will continue to appreciate by about 5 percent against the US dollar before the year is out.

The PRC continues to be the tailor shop for many countries of the world, as well as being the world's largest, single producer of condoms, toys, microwave ovens, refrigerators, air-conditioners, etc, etc, etc.

As such, manufacturers in the PRC, proper, collectively, have very material pricing power – and are employing it.

As for the suggestion, made earlier in the year, that many HKSAR industrialists will move their factories, located in the south, further north into the hinterlands of the PRC, well, it has not come to pass.

So much for the fear factor.

The truth is that it would be very costly to move a factory, producing toys or what-have-you, just 100 miles from its present southern base, not to mention the prospects of facing other problems, not yet identified.

Better the devil you know ...

It is obvious that HKSAR industrialists cannot, forever, pass on additional manufacturing costs to importers of the US and Eurozone because, by so doing, it would tend to erode their competitive position with regard to emerging markets of the Asian-Pacific region.

But that will be another story and, when it unfolds, it will be interesting to see how industrialists of the HKSAR and the PRC, proper, cope with that situation.

In **TARGET**'s opinion, however, there will be answers to any and all future problems and the PRC, proper, will continue to be a large supplier of light industrial goods to the developed economies of The West.

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