

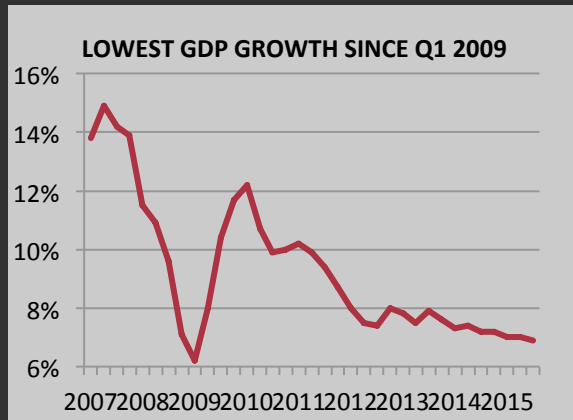


### Slowing growth and stimulus measures

China's GDP growth slowed to a 6.9% year-on-year rate during the third quarter of 2015. The noted growth rate beat most economists' expectations but is still the lowest obtained growth rate since the first quarter of 2009. Robust consumption have been one of the main highlights of the economy with retail sales beating forecasts with a 10.9% year on year increase. Services have so far been the main growth driver with the service sector expanding by 8.4%. The secondary industry sector grew by 6.1% while agriculture expanded by only 3.5%. Growth estimates for the economy as a whole for the last quarter of 2015 ranged between 6.4% and 7.2% with an average of 6.8% according to 50 economists surveyed by Thomson Reuters.

Even though the obtained growth is officially considered within the government's target of "approximately 7 %" it is definitely increasing the pressure to further expand the economical stimulus measures. In fact, the authorities have already been rolling out an extensive stimulus package to save the economy, not least supporting the faltering steel industry. Government spending was up by 27% in September compared to last year. Decreasing consumer inflation and overall risk of deflation puts additional pressure on authorities to increase capital supply. The recently announced fifth interest rate cut since November last year and the lowered bank reserve requirement were thus no surprises.

Ahead of China now lies the challenges of overcapacity in its industries, not least the steel industry, and falling investments. The fears of a hard landing for China, however, seems overblown as the country now emerges as a more diversified economy than ever, relying more on services and consumption than on industry.



### 13th Five-Year Plan

China's communist party recently published an outline of the 13th consecutive 5-year plan.

The full content has not been relieved yet but it is clear that the priority will be the continued economic development. According to Vice-President Zhang Gaoli the proposal sets a target of "maintaining medium-high level growth".

The supported areas will be green technology, information technology, biotechnology, new energy and high-end equipment. Zhang added that the government will participate more in global governance and trade.

Indications were made that focus will also be on ongoing anti-corruption campaign, renewing industrial infrastructure, increasing domestic demand as well as improving China's energy pricing structure.

## Chinese steel is flooding the world

Surging Chinese steel exports are sending shock waves around the globe - putting multinational steel conglomerates such as TATA in distress but also giving rise to great opportunities for cutting procurement costs.

China is the world's largest steel producer and accounts for more than half of the global output of 1.6 billion tons of steel per year. The Country's steel exports have more than doubled since 2010. In September this year alone, the exports were up by 32 percent compared to 2014, reaching 11.5 million tones and thus almost surpassing Britain's total annual output. By the end of this year China is expected to have exported 110 million tones of steel, putting its exports alone at par with the total annual output of Japan, the worlds second largest steel producer. In fact, China's steel exports are expected to surpass the total output of Japan during next year.

China's dominant position in steel production gives China a huge pricing power. The increasing exports have thus caused a major oversupply on the global steel market and prices have felt by more than 50% in the past 12 months.

The reasons for China's drastic growth in steel exports is a mixture of faltering domestic demand and government subsidizing. Domestic steel supply has taken a heavy blow because of the slowing economy and in particular the decreased investments in real estate and heavy

industries. Now, amidst faltering domestic demand, the Chinese government has armed the steel industry with extensive subsidies in order to keep production up and to save the industry from collapse.

The oversupply is being exported at dumped prices. Even though the prices of iron ore, the main ingredient in steel making, has been falling drastically by a whopping two-thirds since 2011, it has not been enough to keep China's steel producers from making huge losses. 90.2% of china's steel producers are currently operating at a deficit and the total losses in the countries steel industry have totaled 24.7 billion RMB during the first eight months of 2015. Zhu Jimin, the deputy head of the China Iron & Steel Association explained the development: "China's steel demand evaporated at unprecedented speed as the nation's economic growth slowed. As demand quickly contracted, steel mills are lowering prices in competition to get contracts." Steel production might soon be decreased by 20% according to the Shanghai Baosteel Group Corp.

All this are bad news for steel producers. It is however great news for any purchaser of raw steel or steel products. With steel prices at their lowest level in more than two decades there is an opportunity to renegotiate with suppliers and cut steel purchasing costs.



## Aluminum Overcapacity

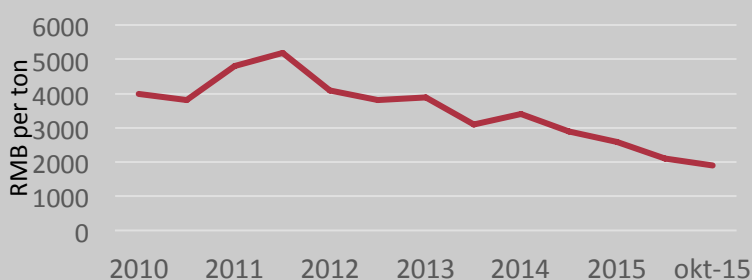
China is by far the world's largest producer of aluminum. In fact, China is expected to have accounted for nearly 55% of the global production of aluminum in ... 2015 - an impressive from just 24% in 2005.

October prices for aluminum on the London Metal Exchange were down at \$1,491.50 per ton - their lowest since 2009. At the same time aluminum on the Shanghai Futures Exchange was down to 30% of the price in the summer of 2004. This indicates market expectations of further decreasing prices. The situation is causing tension with China's production rivals. For example, the entire aluminum industry in the US is at risk, since it will imply more job losses and make the country completely reliable on import.

Measures to counteract overcapacity are however often conflicting with other interests. The country's largest aluminum producer Chalco had plans to shut down its largest plant representing around 14% of the company's capacity. The plans were however cancelled when the local government in the Gansu province, where the plant is located, offered a deal with significantly lowered power prices in order to save the plant and thus also local jobs.

In fact, China's aluminum production is estimated to increase by 11% (over 30 million tons) this year according to Morgan Stanley. Adding that additional production will further increase the overcapacity and further depress global aluminum prices.

Price of steel



## Changing consumption patterns

Steady growth of incomes is propelling China's transition to a consumption driven economy. Wages grew on an average of 7% across the country during the second quarter of 2015 and low income workers are experiencing an even faster increase in salaries. Migrant workers, who tend to belong to the least privileged working class, experienced an average increase of income by 10 % during the corresponding period of time.

Low-income earners tend to consume a larger share of their income and their salary increases are thus more directly translated into increased consumption. This effect can definitely be observed in China. Retail sales grew by 10.8% year on year in September and they are growing even faster in certain sectors. The demand for furniture, home electronics and renovation materials have surged in the wake of a recovery in the property market and sales were up by 17% in August. Increasing income is also fueling tourism with the amount of Chinese tourists going abroad increasing by 19.5% last year, reaching 107 million.

However, the average Chinese consumer is still financially conservative even amidst the surging consumption. The household savings rate in China at 30% is still among the highest in the world.

It is symptomatic for the Chinese consumers that the older generation that lived through times of

considerably lower prosperity and perhaps tends to be financially conservative and accumulate their wealth while the new generation raised in the booming economy of the 90s are consuming at a much higher rate.

According to Planet Retail, a leading provider of global retailing information, price is valued higher than quality by the older generation while the younger generation is more willing to pay for higher-end products. This indicates that the Chinese consumer market will continue its shift away from low quality and low price towards high quality products.

As dispensable income and preferences change so do consumption patterns. The annual discretionary spending of the average Chinese consumer is expected to grow annually 7% between 2010 and 2020. In the meantime, in the category "semi necessities" (for example household products, housing and utilities, health care, apparel) a annual growth of 6%-7% is expected.

According to Planet Retail the consumer product categories that will experience a rapid growth within the next 5-10 years are: convenience food, pet products, healthy food and products, baby products, toys, products for the elderly, personal care products and auto products.



## Alibaba and mobile e-commerce

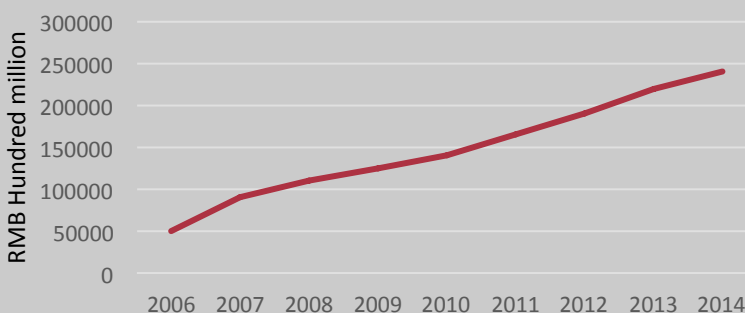
Ali Baba accounted a revenue of 22.1 billion RMB in the third quarter of 2015 - a 32% top-line year on year growth, exceeding the expectations of financial analysts.

An explosion of Ali Baba's mobile use is part of the explanation. At the end of the third quarter of 2015 Ali Baba had 346 million active monthly mobile users, an increase by nearly 60% compared to the last year. This generated an increase in revenue from mobiles by almost 200%. Mobiles accounted for a whopping 62% of Ali Babas Gross Merchandise Volume during the third quarter of 2015.

With mobile use surging Ali Baba faced the problem that smaller screens generally generate less advertising revenue than e-commerce through traditional computers. Ali Baba has however improved its ability to allow sellers to advertise on mobile screens. The conversion rate of the total value of mobile transaction into profit increased from 1.87% a year ago to 2.39% this quarter.

The company's market share in mobile e-commerce is currently approaching 85% in China. According to eMarketer it is a result of an "optimization of its search [function] and advertising for mobiles, as well as the ease with which it is possible for consumers to use mobile payments". Other IT-companies should take lesson from this.

Total Consumer Spending in China





## About Asia Perspective

*Asia Perspective is an Independent Management Consultancy with global presence and local knowledge. We assist our clients with business advisory regarding Analysis, Strategy and Implementation. Our mission is to turn our clients' Asia business vision into reality and add significant value to your business.*

*We offer specialist services covering Supply Chain Management, Purchasing, Market Entry, and Financial Advisory. This includes market entry research and strategy sourcing and pricing strategy, M&A advisory, risk management, operational improvements etc.*

*What differentiates us from our competitors is the knowledge and expertise we have gained after several years in the Asian market. We have experience from a variety of industries and clients including leading international companies from Europe, the US and Asia.*

*With a highly collaborative team of problem solvers and a passion for excellence we will add value to your business. We work closely with our clients to create and deliver insight, advantage and real impact.*



## Contact Us

*If you have any inquires about our services, please contact any of our offices below:*

### Shanghai

Room 2005  
885 Renmin Road  
Shanghai 200010  
P.R. China  
Tel: +86 (0)21 3401 0610  
Fax: +86 (0)21 5410 3235  
shinfo@asiaperspective.net

### Hong Kong

Suite 602, 6/F  
Taurus Building  
21 A/B Granville Road  
Tsimshatsui, Hong Kong  
Tel: +85 (0)227 399 698  
Fax: +85 (0)227 399 313  
hkinfo@asiaperspective.net

### Yangoon

Room 101, 1/F,  
Strand Hotel, Annex Building,  
92 Strand Rd  
Yangon, Myanmar  
Tel: +95 (0)1243 377 ext 1812  
Yginfo@asiaperspective.net

### San Francisco

60 Corte Patencio  
Greenbrae, CA 94904  
USA  
Tel: +1 415 726 8547  
sfinfo@asiaperspective.net

### Stockholm

Grev Turegatan 60  
114 38 Stockholm  
Sweden  
Tel: +46 (0)8 410 737 10  
Fax: +46 (0)8 501 096 12  
stockholminfo@asiaperspective.net