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# China News Alert Issue 343

## Capital Markets

### Beijing boosts holdings of US Treasury debt

China has boosted its holdings of United States Treasury debt for the second straight month as total foreign holdings of US debt increased.

The development should help ease concerns that lagging foreign demand will force the US government to pay higher interest rates to finance its debt.

China's holdings of US Treasury securities rose by US$5 billion to US$900.2 billion in April, the US Treasury Department said. Total foreign holdings rose by US$.8 billion to US.96 trillion.

China is the largest foreign holder of Treasury securities. The monthly gains in March and April came after six consecutive months when China was either reducing its US holdings or keeping them constant. The stretch raised concerns that China might shift money away from Treasury securities.

The 1.9-percent rise in total holdings of US debt in April followed an even bigger 3.5-percent increase in March.

The sizable gains are being driven by fears that Greece and other European governments could default on their debt. On 14th June s Moody's Investors Service slashed Greece's credit rating to junk status, the latest blow to the debt-ridden nation.

Fear of possible defaults has sparked a flight to safety, which has benefited US Treasury securities. Treasuries are considered the world's safest investment―the US government has never defaulted on its debt.

The US Treasury reported that net purchases of long-term securities, covering US government debt and the debt of US companies, increased by US$83 billion in April. It follows a record monthly gain of US$140.5 billion in March.

Higher interest in US bonds has helped push interest rates lower, a welcome development for the US government, which faces the task of financing record federal budget deficits. The federal deficit hit an all-time high of US$1.4 trillion last year. It is expected to remain above US$1 trillion this year and in 2011 as well.

Japan, the No 2 foreign holder of US Treasury securities, also increased its holdings in April. It boosted them by US$10.6 billion to US$795.5 billion.

[Source: China Daily](http://www.chinadaily.com.cn/china/2010-06/16/content_9979639.htm) ([see archive](Beijing_boosts_holdings_of_US_Treasury_debt.pdf))

### Chinese entrepreneurs confidence falls in Q2

Chinese entrepreneurs' confidence about the macro economy was lower in the second quarter than the first, on concerns of rising production costs and shrinking demand, according to a survey report issued by the People's Bank of China (PBOC).

The entrepreneurs confidence index fell by 0.5 percentage points in the second quarter to 83.9 percent from the first quarter, ending a rising trend since the first quarter of 2009, said the PBOC in the report.

Production cost pressures have increased as the production material price index, a measurement of production costs, rose 2.3 percentage points to 64.1 percent from the first quarter, the highest since the end of 2008, according to the report.

The report also showed the nation's entrepreneurs were "prudently optimistic" about export demand as the exports order index declined slightly from the first quarter.

The index was calculated on the basis of a survey targeted at 5,000 entrepreneurs nationwide.

Data from the National Bureau of Statistics (NBS) showed Chinese factories production slowed in May, as year-on-year growth for industrial value-added output was down 1.3 percentage points from April to 16.5 percent.

The report also showed the bankers confidence index fell to 64 percent in the second quarter, down 5.8 percentage points from the first quarter.

The government has reiterated it would continue its proactive fiscal policy and moderately loose monetary policy, but also make proper adjustments according to changes in economic conditions.

NBS data showed new yuan-dominated loans in May fell to 639.4 billion yuan (US$93.6 billion) from 774 billion yuan in April.

[Source: China Daily](http://www.chinadaily.com.cn/bizchina/2010-06/18/content_9989011.htm) ([see archive](Chinese_entrepreneurs_confidence_falls_in_Q2.pdf))

### Looking into China's local government debts

China's China's market, among the worst performers in the world this year, is waiting for another drop before a substantive rally is possible. As investors have sold off shares of real estate and banks amid Beijing's bids to decelerate the frenzied property chase and home profiteering, a new woe is popping up on the horizon―revelation of cascading debts incurred by local governments.

China's law does not allow provincial, city and county level governments to sell debt on the market, but, mysteriously, Beijing has allowed local governments to raise money through their financing and investing arms. Nobody knows exactly how much they have borrowed, including bank loans, diversions from other sources and even IOUs.

At the beginning of 2010, Beijing was alerted to a local debt that is reportedly increasing by the day. The country's bank regulators first brought this issue to Beijing's attention, as they found steeply rising loans “bestowed” to the local financing units that were guaranteed by provincial, city and county governments. The local debt expanded to 7.38 trillion yuan at the end of last year, said the country's banking regulatory commission, and perhaps well exceeded 8 trillion yuan by the end of May, according to analysts.

It's no secret that China's banks, mostly state majority-owned, tend to rain loans on government-sponsored projects, while shunning private businesses. The bankers are often not concerned at government borrowing, because past experience has meant they can ignore the risk of bad loans, which are borne by governments and tend to be written off by Beijing.

However, the colossal debt of local governments, skyrocketing more than 70 percent last year alone, has worried economists and Central Government officials who are worried about the viability of loans, negative impact on the banking system, and a ripple effect on the wider economy.

Chinese leaders know perfectly well that the debts suffered by U.S. banks in 2008, and now suffocating some Euro-zone economies, could be financially perilous, which if not replenished with adequate funds, may cause financial disaster.

The problem of mounting local debts is particularly acute now, at a time when Beijing has launched a campaign to rein in runaway home prices. As housing sales have tumbled, and prices spiral down, local governments' land-selling revenue, a major income for them, will dry up.

On 10th June, Premier Wen Jiabao's State Council issued a decree, ordering all provinces to implement a thorough check of their debts, plug all loopholes for illicit fund-raising acts, clear irregular local financing and investing arms, and report to Beijing by the end of 2010 their efforts to fix debt woes.

This clearing-up is very necessary, as the financing of local repetitive and energy-guzzling industrial projects will be terminated, and the ability of local governments' to repay bank debts be enhanced. It is strongly recommended that the over 5,000 local financing and investing companies, affiliated to various levels of government, be reduced by at least half.

Some outside observers worry about the bulging debt dragging China down, and wrecking havoc on China's overall economy. However, this is unlikely to materialise, as rescue measures are being taken, and China's Central Government is well financed, among the best in the world, and well equipped to prevent any worsening of the debts.

Nevertheless, Beijing's order to repudiate some local projects, while concentrating on completing mostly infrastructure projects, will slow down the economy. It also serves as a wind-down of Beijing's US$586 billion stimulus plan.

Chinese authorities should draw lessons from the awkwardness of heavy local debts, disseminate the need for strict fiscal discipline and financial oversight at all levels of government, and set quotas or ceilings for each provincial government's borrowing from banks.

In the long run, systematic reform of China's central-local government finances should be carried out, changing the current practice of the Central Government receiving the majority of tax revenue changed. Will Beijing do this? The fear is that if local governments get bigger slices of the pie, the authority of the centralised government will diminish, first economically and then politically.

[Source: People's Daily](http://english.people.com.cn/90001/90776/90884/7029962.html) ([see archive](Looking_into_Chinas_local_government_debts.pdf))

## Corporate & Commercial

### Strike at Toyota parts supplier ends quickly

A supplier to Toyota Motor Corp in Tianjin was shut down temporarily on 15th June after workers chose to strike for better wages, but returned to work the following day after wage talks were held.

The strike began at 11 am on Tuesday 15th June in the Tianjin Star Light Rubber and Plastic Company Limited, a joint venture 50 percent owned by Toyota parts unit Toyoda Gosei Company, according to a company spokesman, surnamed Zhu. Tianjin Star employs 827 people and produces body-sealing products.

Zhu said production resumed on Wednesday, despite it being a Chinese national holiday, and had no impact on its parts supply.

"The company and the workers achieved an agreement on an acceptable pay rise," said Zhu. "But we have not yet calculated the exact figures and rates for the salary hike."

He also told China Daily that the other eight plants under Toyoda Gosei in China are aware of the problem and have already spoken with workers this week. "Based on their feedback, there won't be any more similar strikes occurring in Toyoda Gosei."

"In this sensitive period, Toyota will take the initiative to actively communicate with workers in any of our plants to understand their mindset and requirements," said Niu Yu, spokesman for Toyota China.

Niu too is not worried about further strikes as "the company always regards staff with respect. In Toyota, it's common for managers to talk with every worker at least twice per year".

Toyoda Gosei's Zhu admitted workers were likely influenced by the recent strike at a Honda parts supplier. That strike hit four of its parts factory in the Pearl River Delta region earlier this month.

Zhong Shi, an independent auto analyst based in Beijing, suggested other automakers raise wages if the added labour cost is not be a heavy burden. "And the other manufacturers, especially located near the strike areas, should be warned.

Xu Changming, a research director at the State Information Center, agreed with Zhong. "Automakers in China are able to raise pay levels appropriately as most of them have a relatively high profit margin here, especially after last year's brisk sales."

Su Hainan, vice-president of the China Association for Labor Studies, said that all manufacturers in China should first evaluate their own salary systems. "If the salary is too low, employers should plan for or promise workers a future pay rise. If the company cannot afford the wage hike, they should actively communicate with the employees."

[Source: China Daily](http://www.chinadaily.com.cn/bizchina/2010-06/18/content_9987676.htm) ([see archive](Strike_at_Toyota_parts_supplier_ends_quickly.pdf))

### Cisco confident in long-term growth

Network equipment maker Cisco Systems Incorporated is optimistic about its long term development in China, and sees huge growth potential in the nation's massive urbanisation process.

" Cisco has a long-term commitment to China, and is the only multinational IT company with a stand-alone pavilion at the 2010 Shanghai World Expo," said John Chambers, chairman and chief executive officer of Cisco, the world's biggest maker of routers and switches.

Chambers said he had a "high perspective" for China and expects Cisco's business to grow by 15 to 20 percentage points faster here compared with its global business growth over the next 10 to 20 years.

In 2007, Cisco committed to invest US$16 billion in China to expand its procurement, manufacturing and research and development capacity.

In November 2009, the company agreed to buy the set-top box business of Hong Kong-based DVN Holdings Ltd for US$44.5 million, which was Cisco's first acquisition in China.

It also signed a memorandum of understanding in September last year with Chongqing municipal government to help the city develop its telecom and IT manufacturing capability. China's urbanisation process will also provide huge market opportunities for Cisco, Chambers said.

During the next 10 to 20 years, over half of China's 1.3 billion population are expected to move from rural areas to cities. That will increase demand for networking equipment in areas like healthcare, transportation and education.

Net sales of Cisco increased 27 percent year-on-year to US$10.4 billion for the third quarter ending 1st May. The company said it has witnessed a return to strong balanced growth between geographies, products and customer segments that Cisco hasn't seen since the global economic challenges began.

In January, Cisco said it was elevating the status of the China market to a higher level as part of the company's efforts to grow in the country. Under the new arrangement, the mainland, Hong Kong and Taiwan will fall under the company's new Greater China Theater, "which is the only theater that consists of only one country among Cisco's five theaters", Chambers said.

Chambers said that refocusing on China's market is the most important decision that he has ever made since he started to lead Cisco in 1995. He said the company did not come to China just for sales, but also for manufacturing, procurement and research and development.

[Source: China Daily](http://www.chinadaily.com.cn/bizchina/2010-06/18/content_9987867.htm) ([see archive](Cisco_confident_on_long-term_growth.pdf))

### Double-dip recession very unlikely

The Chinese economy is sizzling with full steam, and the U.S. economy is healing and will avoid a relapse into recession, which argue well for global recovery, economists said.

The American Bankers Association's economic advisory committee gave the prediction that Europe's sovereign debt turmoil, which began in Greece and is feared may spread to other countries, would inflict minimal damage on the U.S. economy, aside from trimming exports.

On average, the economists gauged real U.S. economic growth at a healthy 3.2 percent in 2010 and 3.0 percent in 2011.

Earlier, the World Bank predicted that China's economy will expand at 10.4 percent for 2010, and 9.9 percent for 2011.

Although the 3.2 percent U.S. growth rate is not robust enough to repair its ailing labour market, the committee unanimously agreed that a double-dip recession for the global economy as very unlikely.

"The economy is moving ahead in a lengthy rehab process and will eventually return to full health and strength," said Stuart Hoffman, chief economist with PNC Financial Services Group and the ABA committee's chairman.

The economists expected 2.2 million new jobs in 2010, and 2.5 million in 2011. However, that will replace only about half of the total jobs lost during the 2008-2009 Great Recession.

The economists predicted that unemployment would come down only gradually, dropping to 8.5 percent by the end of next year. It currently stands at 9.7 percent.

High unemployment and low inflation will keep the Federal Reserve's interest rate near zero through the end of the year, they said. By June 2011, the economists thought the benchmark fed funds rate would reach 1 percent.

As for Europe, they thought a backstop of nearly US$1 trillion provided by European leaders and the IMF would help restore confidence and contain financial market contagion from spreading. While the crisis will weaken economic growth in Europe, it will also keep U.S. government and mortgage borrowing costs low, providing a benefit to the U.S. economy.

"The most notable effect on the U.S. will be lower U.S. exports globally due to a weakening European economy and a strengthening dollar," the economists said.

The European debt woes will have similarly limited impact on China's economy too, hurting its exports to Europe by as much as 30-40 percent, but it is not expected to have a dent on the world's major developing economy.

China's exports picked up momentum in May, with imports jumping by 46 percent and exports by 48 percent, another verification that its economy has regained fire after a sluggish performance in 2009.

[Source: People's Daily](http://english.people.com.cn/90001/90776/90884/7027429.html) ([see archive](Double-dip_recession_very_unlikely_Economists.pdf))

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