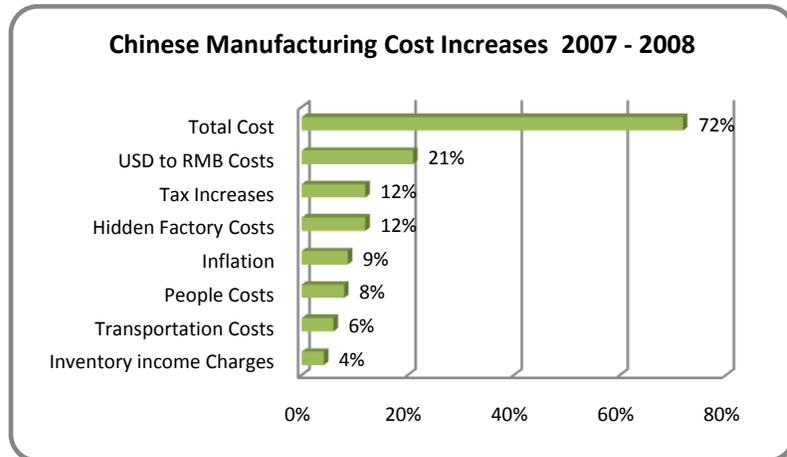
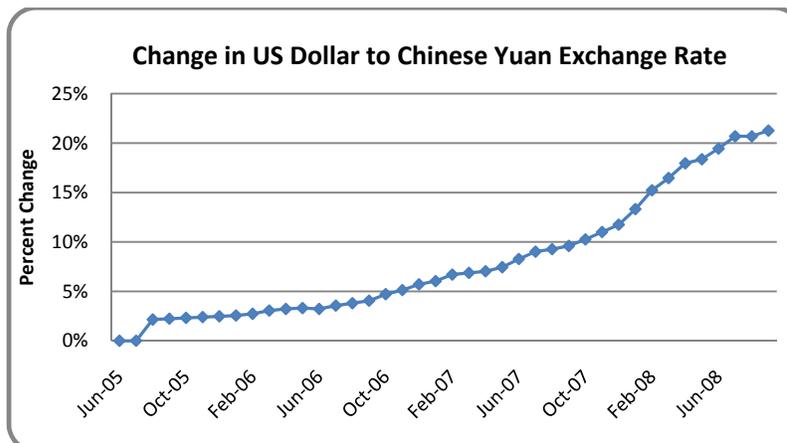


## What's Happening in China Today?

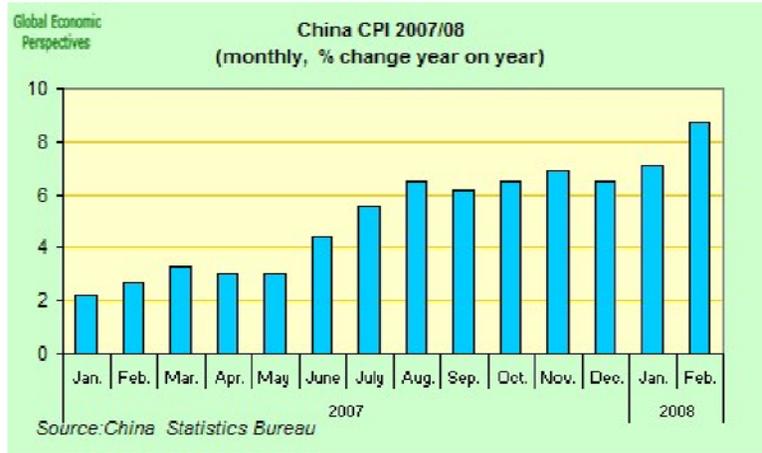
The total landed cost of products manufactured in China and exported to the U.S. has increased by 72% since 2007, and the cost increase for larger, heavier, and more expensive products is even higher. For these products, Mexico and the U.S. are nearing parity with China when transportation, inventory, exchange rate, taxes and people costs are taken into consideration. What is happening inside China to cause this?



Since the Chinese government allowed the Yuan to float within a tightly controlled band, the U.S. Dollar to Yuan to relationship has increased nearly 22%, possibly heading for 30% to 40% in the next few years.



The Chinese government has been issuing vast sums of currency each week from the country's trade surplus and investment inflows in order to buy up dollars at inflated prices, in an attempt to keep the value of the RMB artificially low. Chinese banks, backed by the government, have also been lending aggressively creating a surge in money circulating in the country's economy. The Chinese M1, M2, and M3 money supplies continue to increase, with M2 raising 18.5% year-over-year to 39.3 Trillion RMB. A continuation of this policy is certain to drive inflation.



### [China's Inflation and Labour Shortage Problem, It's The Fertility Stupid!](#)

By Edward Hugh: Barcelona

Inflation in China increased 8.7% over 2007, with food driving the numbers up from last year. Meat and eggs have increased from 25% to nearly 40% year-over-year, an increase higher than any in the last 11 years.

Because of high fuel costs, more products are being transported by container ship. At the current price of oil, the transportation cost for a container has gone from \$3k to \$8K and as high as \$12K, one way, increasing the cost of goods by 9%. As a consequence, the shipping time has increased to as much as 6 to 12 weeks, doubling, tripling and in some cases, quadrupling inventory costs.

Corporate Income Tax in China has been 33% (30% federal and 3% local tax) for domestic companies. Companies owned by non-residents, benefit from tax holidays and other forms of tax relief that considerably reduce their tax burden. According to a recent study by the Chinese Academy of Social Sciences, foreign companies doing business in China pay a real average tax rate closer to 13%. After many years of discussion, the National People's Congress approved the unification of China's corporate income tax system, which was put in effect January 1, 2008, increasing the income tax rate for foreign corporations to 25%.

According to the McKinsey Quarterly article, "Time to rethink offshoring?", wage rates have been increasing at a rate of 19% per year since 2003. Engineering, white collar and clerical workers are leading the increase, with some Chinese plants seeing increases as high as 40%, while multinationals have been increasing at a rate of 12%, but wages in these plants were high to begin with. Many companies have been requiring workers to work up to 100 hours per week, however new overtime policies limit overtime to 35 hours per month. This raises the number of workers required to operate the factory and raises the overall cost of labor up to 50%.

The 1979 law, which restricted Chinese families to one child, coupled with an influx of new factories, is beginning to create a shortage of workers (18 – 35 age bracket) in some areas, contributing to the increase in wages. Chinese officials admit that while there is no overall shortage of labor, there is a shortage of young workers willing to accept the lower wages that prevailed in the 1990s. The Guangdong Labor Ministry estimates that 11% of the workers did not return from the rural areas, after the 2007 Chinese New Year; other estimates are as high as 30%. This is an indication that workers are becoming more selective when considering where to work, and aren't willing to sacrifice as much. Turnover has increased substantially, and ranges from 3% to 20% per month,

with much of this in the Shanghai and Suzhou areas where complex products are being built. This level of turnover can be devastating to companies that require highly skilled labor to build quality products.

Other hidden factory costs are being driven by new Chinese laws, including the elimination of energy subsidization and the reduction or elimination of tax rebates for 2,831 items representing 37 percent of the total number of items listed on the customs tax regulations. The decision to eliminate the rebates is seen as a means to suppress overheated export growth and ease frictions between China and its trade partners. The move, targets labor intensive, high polluting and high-energy-consuming industries in east China, chiefly those in Beijing, Tianjin, Shanghai, Liaoning, Hebei, Shandong, Jiangsu, Zhejiang, Fujian and Guangdong. All of this contributes to the rising cost of goods sold and substantially lowers the product margin of the companies involved.