



北京华通人商用信息有限公司

ALL CHINA MARKETING RESEARCH CO., LTD.

ACMR Newsletter

China Industry and Economic Review

June 2011



Economic Spotlight:

Persisting Inflation Pressure Renders Imminent Interest Rates Hike Very Likely

Statistics released by National Bureau of Statistics on June 14th showed that monthly CPI in May 2011 reached 5.5%, a record high in the past 34 months. On the same day, the central bank, People's Bank of China, announced to raise reserve requirement ratio (RRR) by 0.5 percentage points to 21.5%. To curb inflation, China chose to raise RRR instead of interest rates. Since 2010, China has increased RRR 12 times but interest rates only 4 times. In the long term, however, higher level of interest rates is very necessary to control runaway inflation.

Limited Room for Further RRR Increase

After continuous RRR hikes, RRR for large financial institutions and small financial institutions have reached 21.5% and 19.5%, respectively. Compared with interest rate hikes, rising RRR has even greater impact on credit volume, especially on small and medium-sized banks and enterprises. After RRR hikes in the past year, there are basically no extra reserves except required reserves for many small banks. High RRR creates great financing difficulties for SMEs.

Higher Interest Rates Restrain Inflation

Higher interest rates help to attract deposits and stabilize inflation expectations. Since February 2010, CPI has been higher than one-year deposit interest rate, or negative real interest rates, for nearly 17 months. Long term negative real interest rates greatly encroach on people's savings, and then people tend to invest or spend their money, which leads to higher product price. Therefore, higher interest rates help to mitigate spending and inflation.

For lending interest rates, the level is largely determined by banks, especially for loans to small and medium-sized private enterprises. In the context of tight credit, lending interest rates on loans to leading enterprises, other enterprises, and SMEs are generally 5%, 10%, and 30% higher than benchmark interest rates. Therefore, higher benchmark interest rates have very limited impact on local government debts and large enterprises, and even less on SMEs.

RMB Appreciation Helps to Combat Inflation

Appreciation of Chinese currency mitigates international-trade-induced inflation. On the one hand, RMB appreciation lowers price of imported commodities, hence lower prices of industrial products. A large proportion of rapid growth of imports in May was contributed by higher commodity prices. For instance, import volume of natural rubber, crude oil, refined oil, and soybean in May increase by 33.3%, 20.8%,



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6.6%, and 4.4%, respectively, from May 2010, while import value increased by 110.4%, 69.5%, 47.4%, and 40.5%. On the other hand, RMB appreciation reduces trade surplus, which in turn reduces RMB equivalent of foreign exchange reserves.

Inflation on the Rise

Although CPI hit record high in May, this round of inflation has not yet reached its turning point. CPI in June will exceed 6%, even if assuming the same price level of food and non-food products in June as in May, not to mention rapidly rising food price and inflation spread to industrial products. It is generally estimated that CPI in June will reach 6.1%-6.4%, mostly likely to be 6.3%. If the estimation comes true, negative real interest rate will grow and the central bank will probably increase interest rates.

Luxury Market in China: Stepping into Rapid Growth Period

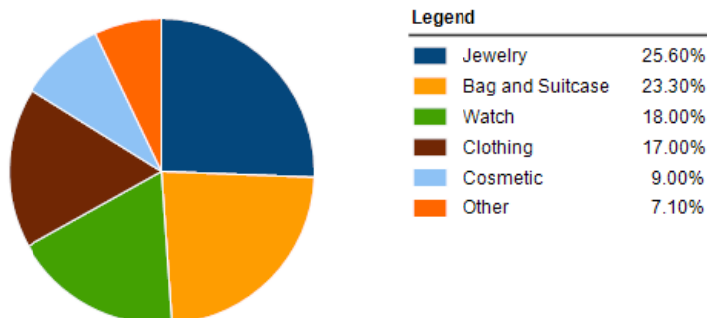
China's Luxury Market Overview

In recent years, as China's economy grows steadily, Chinese personal disposable income levels have increased at a rapid pace, which promotes the expansion of China's middle class group and help relax the consumption power of this group. China's luxury market (referring to luxury watches, cosmetics, bags and suitcases, clothes, jewelry and shoes, not including luxury cars) is gradually cultivated in this period.



According to the statistics of World Luxury Association, growth of China's luxury market has been the fastest in the world in recent years. Benefited from strong economic recovery and the release of consumption power in China's second and third tier cities, total value of China's domestic luxury market reached \$10.7 billion in 2010, up 13.8% over 2009. The Chinese consumers' overall demand from is even larger as many of them travel abroad to buy luxury products which are not available in mainland China.

Product Segmentation of China's Luxury Market, 2010



Data Source: World Luxury Association, ACMR Industry Research

Major products in China's luxury market are jewelry, bags and suitcases, watch, clothing and cosmetics. With the rapid increase in demand for personal use and business gift, bag and suitcase has been the second largest luxury market segment. Watch is the third largest market segment with a share of 18%, which is mainly supported by the strong sales of medium-priced watches and increasing collection demand for high-end watches among men consumers in recent years. Cosmetic is the fifth largest market segment with an estimated share of 9% in 2010. As Chinese young and middle aged women consumers' attention on high-end cosmetics increases, sales of major cosmetics brands such as Chanel and Dior has been growing rapidly in mainland China.

In the next several years, ACMR Industry Research expects that total value of China's luxury market will still increase at fast rate as Chinese government pays great efforts to the expansion of domestic consumption market and the number of middle class homes expands.

Major Drivers

Major drivers behind the fast expansion of China's luxury market are primary the growing of China's top cities and increasing number of high-income urban families in recent years.

China's luxury market is mainly concentrated in top 25 cities including Beijing and Shanghai, whose total social consumption value accounted for 54.5% of that in China's all 287 cities in 2009. Commercial economies are developed and per capita GDP levels are comparatively high in these cities compared with the country's level. The growing number of middle class group and improving sales outlets of luxury brand in these cities has promoted the fast development of luxury market.

ACMR Industry Research estimates that around 19.6 million families have annual disposable income above \$10,000 in 2006 and around 43 million families have average annual disposable income above \$10,000 in 2009 in China. This shows a rapid increasing trend in the number of middle class families, which provides solid growth base for China's luxury market in recent years.

Current and Future Expansion of Major Luxury Brands in China

Major famous luxury brands have been entering and expanding rapidly in China to grasp great potential chance in this emerging market. There have been over 100 luxury brands opening stores in China. As it is shown in the table above, major luxury brands are relatively concentrated China's first tier cities such as Beijing and Shanghai and are expanding into increasing second and third tier cities. ACMR Industry Research estimates that more luxury brands will have a nationwide operation in China as the geographic expansion trend goes on.

In 2010 and 2011, major brands accelerated the expansion in China. According to statistics of ACMR Industry Research, during August 2010 and May 2011, Six brands including Hugo Boss, Dunhill, Burberry, Bally, Gucci and Hermes has opened 64 new stores in mainland China. They are expected to expand more rapidly in the near future. Tiffany plans to increase the number of stores in China to 24 in the future and Burberry expects to have its specialty stores reach 100 in five years. PRADA plans to open over 30 specialty stores as of 2014 in China to cater the great demand and expand its brand in the second and third tier cities.

Financial Performance of Some Luxury Companies (Brands) in China in 2010

Name	Sales Value in 2010 (US Million)	Growth Rate (%)
Richement	1505.1	17.3
Samsonite	91.8	38.3
Milan Station	5.9	103.1
Gucci	N/A	33.8
Bottega Veneta	N/A	52.2

Data Source: Annual Report, ACMR Industry Research

Computer Body Manufacturing in China: Growing Domestic Demand Along with Rising Production Costs

With a population of over 1.3 billion, China has a reputation as a giant for both computer manufacturing and consumption. In 2010, Computer Body Manufacturing industry reported revenue of \$162.03 billion, up 35.1% from 2009. In the same year, domestic demand increased by a higher 41.3%.

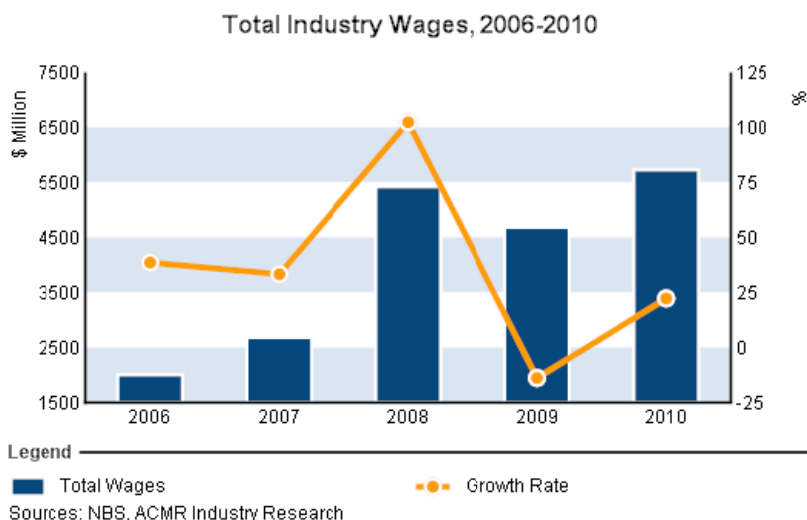
Easier Internet Access Boosts Demand for Computers

Internet networks developed remarkably in recent years. During the Eleventh Five-year Plan, \$7.39 billion was directly invested on the project of Telecommunication throughout Villages, resulting in 100% of internet coverage in villages and towns. In the next five years, Internet access will reach out to more remote areas.

Moreover, internet users surged. By the end of 2010, internet users in China had amounted to 457 million, with penetration rate climbing up to 34.3%.

Sharp Rises in Labor and Raw Materials Costs

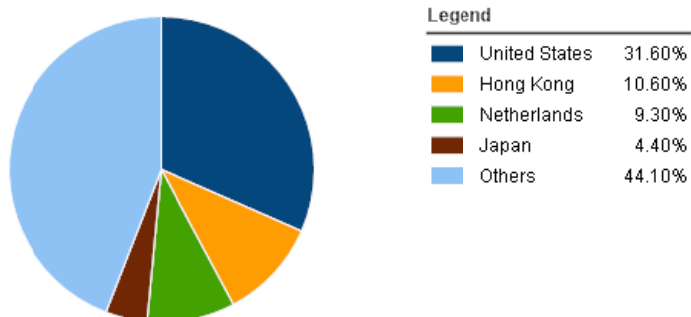
In 2010, while industry revenue and exports rebounded with the recovery of world economy, rising costs encroached on industry profit margin. In early 2011, there was even labor shortage. In the five-year period to 2011, total wages of the industry increased at an annualized rate of 26.8%, twice the growth rate of industry revenue.



Slower Growth in Industry Exports

During the first quarter of 2011, exports of computers increased by merely 13%, 20 percentage points less than the same period last year. Exports to Japan declined due to the earthquake. Meanwhile, exports to Hong Kong grew rapidly, and its proportion turned out to be five percentage points higher than the first quarter in 2010.

Major Destinations of Exports in the First Quarter of 2011



Sources: China Customs, ACMR Industry Research

Carbonated Soft Drink Manufacturing Develops toward Mature in China

With the development of technology, people have recognized the negative effect of carbonated soft drink to human body. Sales volume of carbonated soft drink shows a downward tendency in the world. However, Carbonated Soft Drink Manufacturing in China is developing toward mature.

Growth of Sales Volume Slows Down

Carbonated Soft Drink Manufacturing in China has maintained steady development in recent years. Consumers' increasing concerns on health have affected their consumption of carbonated soft drink. With too much sugar and calorie, the traditional carbonated soft drink is considered as one of the main factors leading to fat, affecting consumers' health. In the developed countries and regions, development of carbonated soft drink is pushed out in recent years, and the share of Coca-Cola and Pepsi kept declining. In China, the consciousness of healthy consumption is penetrating, and many consumers especially the parents have listed carbonated soft drink in "blacklist". The popularity of juice, tea and some other healthy drink has led to slowdown of sales volume of carbonated soft drink.

Growth of Output Slows Down

With increases of people's disposable income and improvement of the consumption level, the sales volume and output of carbonated soft drink kept increasing, however, the growth rate slow down. Consumers' increasing concerns on health have restrained the output growth of carbonated soft drink to some degree. In addition, various kinds of healthy drink, including milk drink, tea drink, juice drink, etc. have substituted carbonated soft drink to some degree, leading to declining share of carbonated soft drink in total soft drink.

According to the National Bureau of Statistics, the total output of soft drink in 2010 reached 99.8 million tons, up by 18.3% from 2009; while the output of carbonated soft drink only increased by 0.81% to 12.65 million tons in the same period, obviously falling down from 2009.

Intensifying Competition between Two Industry Giants

Coca-cola and Pepsi are actively expanding the non-carbonated business all over the world. Minute Maid of Coca-cola has earned certain market share in China, and Tropicana of Pepsi also expanded into China from 2007. These to carbonated soft drink giants will further expanded their market shares in the non-carbonated business area.

In September, 2008, Coca-cola tries to purchase China Huiyuan Juice Group at \$24 hundred million, and the plan failed in March, 2009. Despite the failed plan, Coca-cola announced to invest \$20 hundred million more on building new factories, strengthening the distribution system, marketing and improving

the innovation ability. Coca-cola will further expanded China's non-carbonated markets.

Pepsi also seek new breakthrough points at home. Despite failed acquisition of Wanglaoji, its "Caobenle" characteristic with nourishing and health preserving came into the market in succession. From 2009 to 2012, Pepsi plans to invest \$1 billion for new factory construction and products development in China, laying stress on non-carbonated business. The competition between these two giants in the non-carbonated business will tend to be increasingly fierce.

Despite declining share of carbonated soft drink in total soft drink, it does not represent decline of Carbonated Soft Drink Manufacturing in China. It is normal phenomenon that Carbonated Soft Drink Manufacturing in China develops toward mature after rapid development. The grow up of juice and tea drink just reflect the consumption diversification of Chinese people and the improvement of living standard, instead of the declining of Carbonated Soft Drink Manufacturing in China.

Key Statistics of the Carbonated Soft Beverage Manufacturing in China, 2010 (current price)

Indicator	Value	Year-on-year Growth (%)
Industry Revenue (USD Million)	9441.8	9.7%
Exports (USD Million)	134.0	2.1%
Imports (USD Million)	57.8	26.2%
Carbonated Beverage Output (Million Tons)	12.7	0.8%

Source: National Bureau of Statistics, China Customs, ACMR

Major Industry Participants List

Company Name
Coca-Cola (China) Beverages Limited
Pepsi (China) Limited
Uni-President China Holding Limited
Hangzhou Wahaha Future Cola Beverages Co., Ltd.

Source: National Bureau of Statistics, ACMR



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What's New?

We currently have 177 China industry reports available across 18 economy sectors, and the number of reports is expected to reach 182 by the end of June 2011.

Recent reports and reports to be released include:

Published in May 2011:

- 0330** Poultry Farming in China
- 3421** Metal Cutting Tools Manufacturing in China
- 3761** Aircraft Manufacturing and Repairing in China
- 5110** Inter-urban Railway Transportation of Passengers in China
- 5531** Airports in China
- 7220** Realty Management in China

To be released in June 2011/July 2011:

- 0916** Aluminum Ore Mining in China
- 1320** Pet Food and Animal Feed Manufacturing in China
- 1451** Canned Food Manufacturing in China
- 4062** Bare Printed Circuit Board Manufacturing in China
- 7230** Real Estate Intermediation (Brokers and Agents) in China

Updated in May 2011

- 0790** Support Activities for Oil and Gas Mining in China
- 7440** Advertising Agencies in China
- 8511** General Hospitals in China
- 0810** Iron Ore Mining in China
- 2614** Organic Chemical Material Manufacturing in China
- 1711** Cotton Fabric and Yarn Manufacturing in China
- 3613** Building Construction Equipment Manufacturing in China
- 3070** Plastic Parts Manufacturing in China
- 3931** Wire and Cable Manufacturing in China
- 2411** Stationery and Office Supplies Manufacturing in China
- 6620** Motels in China
- 2421** Sporting Equipment Manufacturing in China
- 6592** Mail-order and Electronic Shopping Operators in China
- 8441** Higher Education in China
- 6020** Internet Services in China
- 4411** Thermal Power Generation in China
- 1440** Liquid Dairy and Dairy Products Manufacturing in China



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7433 Business Management Consulting Services in China

4042 Computer Network Equipment Manufacturing in China

6930 Securities Investment in China

0610 Coal Mining in China

3726 Automobile Repair Services in China

0221 Timber Logging in China

5320 Underground Rail and Subway Transportation in China

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