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China's Falling Exports Force Multinationals to Change Plans

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07/26/13 - 05:48 AM EDT

TAIPEI (TheStreet) -- China recorded a 3.1% drop in exports in June compared to a year earlier. Now, do long-term investors hold a celebration or a funeral?

The state-run *Xinhua News Agency* called the fall to $174.32 billion "surprising." But people who follow China's effort to retool -- and cool -- its economy will be less than startled by last month's official tally. It's part of a slow yet profound shift in the economy.

Exports have been gathering rust since about 2010 as an economic growth engine for China. It's not that multinational corporations (MNC) can't still make money off made-in-China, but wages tripled from 2000 to 2010, gaining 15% in some years, and the yuan is holding firm against other world currencies. Factory exports have naturally lost some shine.

Just for example, investment from Taiwan declined 17% last year as companies from the manufacturing center just offshore found better bargains in Southeast Asia and in a few cases went home. Taiwan is one of China's oldest and steadiest sources of outside investment.

This means that an MNC expecting forever high returns from its China exports alone may need to manufacture its own coffin unless it moves offshore or starts to produce for increasingly wealthy though increasingly picky Chinese consumers.

The export decline in June also may reflect weak global demand, trade friction with other countries and dodgy domestic spending habits, *Xinhua* said.

I'd bet my widgets the Chinese government wanted it this way. Its 2011-2015 five-year economic plan calls for fostering an environment to induce spending to parallel wage hikes and unstable demand in the West. In another sign of the same shift, the Communist leadership said in March that China needed better balance between its aggregate supply and demand.

After a decade of growth that raised as much world fear as excitement, the leaders aren't afraid of a few slower years as they pursue better balance. Economic growth came in at 7.8% last year, the slowest since 1999, and at 7.7% in the first quarter of this year. That's down from an average of 9%-10% per year in the decade from 2001.

For reasons against which it's hard to argue, China doesn't want to depend excessively on sluggish America or debt-addled Europe as export markets, and since the ultra-nationalistic days of Mao Zedong the country's leaders have insisted that China should be self-sufficient.

So go ahead and wear white at the export funeral. "I think this development is a consequence of structural efforts to rebalance the economy," figures Wai Ho Leong, regional economist with Barclays Capital in Singapore.

Manufacturers that produce at "high productivity, low-cost" bases such as Bangladesh, Indonesia, Mexico and the Philippines have already gotten it right, says James Berkeley, managing director of the London-based management advisory service Ellice Consulting. Those choices imply they could make more money on exports by avoiding overreliance on China.

MNCs active in those low-cost, high-productivity centers include **Chevron** (CVX), which calls itself the largest producer of natural gas in Bangladesh, and **Nestle** (NSRGY), a Swiss snack food producer that spread has spread the chocolate to Bangladesh as well as the Philippines.

Suppliers of raw materials and commodities to Chinese manufacturers of low-value stuff will particularly struggle, Berkeley suggests.

But China's new formula is no overnight fix. It's also not just about retooling its economy to stoke consumption among moneyed Chinese consumers. Household spending is hovering around 35% of the nation's GDP despite hype about an expanded economic role. The government is also trying to control lending and property purchases, two drivers of consumption.

And *Xinhua* quotes General Administration of Customs spokesman Zheng Yuesheng urging more "efforts on trade restructuring" to sustain global trade market share.

These policies of the moment signal that the post-export transformation of China's economy will take time as the re-morphing ensures numerous policy changes, some of which may sting business. The whole turnaround could take 20 to 30 years.

But if it's sustainable as China's leadership hope, that's cause for celebration because MNCs will be able to predict the business environment.

For now, it's hard to pick winners in an economically restructured China. People I've polled come up with wildly varying answers, if any at all. Foreign food, apparel and consumer electronics have been considered safe investments for a while. Chinese consumers consider

them high quality and they may require little or no onshore manufacturing.

But once the post-export-era restructuring tops out and companies can see what it means for them, those that have planned for it all along -- expecting bumps along the way -- will see strong revenue growth.

Among those might be the **Hilton** hotel group, which has grown quickly to about 50 properties in China today, and **Pearson** (PSO), which publishes higher-education books that are ever-popular with China's ambitious learners.

An investment in such non-export dependent companies today should give back more than celebratory champagne in a couple of decades.

At the time of publication the author had no position in any of the stocks mentioned.

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