Reports out of China these days are a jumble of mixed messages and conflicting imagery. One night network business news programs spotlight video of empty shopping malls and deserted residential developments. The next night the screen fills with scenes of booming cities teeming with life and landscapes covered with soaring new towers under construction.

One thing is clear: for more than a decade China’s economy produced historic, unprecedented double digit annual growth, churning out the type of numbers that make economists swoon. The country turned from sleeping giant to economic power, sending out tsunami-like ripples through markets around the world. It was a wild, jaw-dropping era – and, by most accounts, it is over. The economy is slowing to rates not seen in a decade, government data shows.

But China’s slowdown is another country’s halcyon days. While the United States and EEU zones stutter, China’s GDP is expected to grow by 8% this year. Even within the slowdown, the country’s business and industry is forecast to expand to record levels, as the government pushes to meet the needs of its dramatically changing country.

China is in the midst of a historic transition, a shift that will profoundly change the global economy, analysts agree. At its heart is a rapidly forming middle class, a new generation of well-educated Chinese with disposable income.

“The demographic change going on is unmatched in human history,” said Michael Klibaner, head of research in China for Jones Lang LaSalle. In Shanghai, for example, the number of residents earning US$5,000 or more a year will rise from 15% in 2006 to 51% in 2045, according to JLL data. “The same trend is happening all over the country,” Mr. Klibaner said. “That is a massive opportunity.”

Global Reality

A large portion of China’s current economic woes are attributable to forces beyond the country’s control. Once isolated, China is now directly linked to the global economy. In the last year slowdowns in Europe and North America undercut China’s best customers. “The reality is that we are seeing a slowdown in China’s economy through 2012 due to a lagging economic recovery in Europe and the United States impacting China’s manufacturing and export sectors,” said Ben Cavender, Associate Principal of China Market Research Group (CMR).

Foreign direct investment in 2011 was down 2.8% in the first quarter from a year earlier, in part due to a 30% drop from Europe, which has been wrestling with its own issues. “With the European Union accounting for one-third of global import demand, a recession there will inevitably take its toll on East Asia,” the World Bank noted in a recent statement.

The residential property market, one of the key drivers of tall building construction, has been one of the areas hardest hit by the country’s economic twists. After a decade of record price escalations, sales have slowed in the wake of government measures designed to dampen an overheating market. With new homes far out of reach of the typical Chinese family’s income, the government enacted measures to limit the number of homes any one person can purchase and increased the restrictions on financing, hoping to deter speculators.

On one level, the measures have had the desired effect. Prices for new build homes in 20 major cities dropped 6% from the peak in the third quarter of 2011 to the end of June, 2012, according to Knight Frank data. Prices are expected to fall further in the next six months.

Real estate accounted for 10% of the country’s GDP in the boom years, with residential the biggest contributor. “There was a huge dependence on the [real estate] sector, even after the peak of the market in the United States in 2007,” Mr. Klibaner said. Uncertainty has stalled many projects, particularly developments targeting the luxury markets in Tier 1 cities such as Shanghai and Beijing. “The high end of the market, where foreign investors typically played, was impacted more significantly by policies,” Mr. Klibaner said.

Chinese developers were particularly hard hit by the recent economic shifts. Many were heavily leveraged to banks – a scenario familiar in Western markets. “Weak property developers in China are likely to face a test of their survival this year,” Standards & Poor concluded in a report issued this spring.
With so many factors buffeting the economy, China’s economic growth slipped to 8.1% in the first quarter of 2012, the fifth consecutive quarter of slowing expansion. The decreasing rate of growth is expected to continue through the rest of 2012, led by sliding prices and slower sales in residential housing. Some analysts are even more pessimistic. Deutsche Bank AG has reduced China’s growth estimate for this year to 7.9%, while Credit Suisse Group AG lowered its forecast to 7.7%. The predictions compare with a 9.2% expansion in 2011.

“Clearly the economy is much, much weaker than most people thought until recently,” Diana Choyleva, a China economist in the Hong Kong office of Lombard Street Research, told the New York Times this spring. “They have a real mess on their hands.”

State of Transition

But even the most pessimistic analysts recognize that China’s leaders hold an extraordinary ability to manipulate the economy. In the first half of 2012 the government enacted a series of stimulus measures to help stabilize the economy, including an estimated 1 trillion Yuan (US$157 billion) of spending on everything from road and bridge projects to subsidies for home appliance purchases. Interest rates were cut for the first time in three years.

While nowhere close to the size of the stimulus package put together in 2008 – which sparked three years of growth, despite the global slowdown – the measures were a clear signal the government was responding to the realities of the market. Premier Wen Jiabao announced China will continue to focus on the continued growth of the economy, rather than concerns about inflation, in line with the China’s 12th Five Year Plan, released in 2011. The plan calls for a focus on scientific development and emerging industries, as well as transportation and energy infrastructure.

In the wake of the economic slowdown, from January to April of this year the National Development and Reform Commission

Developers Eyeing New Markets, New Cities

China’s slowing residential market is attracting headlines, but other segments of the property industry continue to surge. Demand for office and retail space is still driving development, especially in inland cities eagerly creating new central business districts.

Office rents increased last year in all 15 major cities tracked by the property firm CB Richard Ellis. Office rates in Beijing jumped 80% from 2010 to 2011, while the price of Shanghai space jumped 25%, according to CBRE.

The vacancy rate in Beijing was a skimpy 3.5%, while only 6.7% of Shanghai space was available, Knight Frank reports. Outside a few high profile projects, the next wave of office towers is not expected to hit Beijing and Shanghai until 2015 and 2016.

“Occupier demand remains strong in Tier One cities but it is rising rapidly in emerging markets, particularly in gateway cities such as Chengdu,” said Andrew Slevin of CBRE.

But developers are shifting their focus to Tier Two and Three cities, which are trying to woo regional operations away from the high prices of the big cities. “Many large domestic and international companies are in the process of shifting their operations from first tier cities like Shanghai and Beijing to these other cities as infrastructure improves and the operation costs . . . are significantly more favorable,” said Ben Cavender of CMR

Retail development is also attracting renewed interest, despite the oft-reported glut of space. China’s continued move to a consumer-driven economy as the retail sector “poised for a major update. . . and we expect its impact to be significant,” Jones Lang LaSalle reports.

Major international retailers such as Tiffany and Marks & Spencer continue to make their first foray into such cities as Nanjing, Chongqing and Wuhan. For investors, it is “hard to find retail assets in China anywhere,” said Michael Klibaner of Jones Lang LaSalle.

China 2011: $11 trillion (GDP PPP*)

China 2020: $21 trillion (GDP PPP*)

Tier 1 Cities vs China50 in 2011

Tier 1 Cities vs China50 in 2020

*PPP is Purchasing Power Parity

Sources: BII, IMF, IHS Global Insight, and Jones Lang LaSalle Real Estate Intelligence Service, 2012
Note: China50 refers to the next top 50 non-Tier One Cities

Comparison of China’s Tier 1 cities vs China50 economic growth in 2011 and 2020.
approved 868 investment projects, compared to 363 in the same period a year earlier, including steel mills and water treatment plants. Clean energy projects accounted for as much as 70% of approvals in April.

By June, real estate prices and the economic slowdown showed signs of stabilizing. “Lowering reserve ratios and making it easier for small businesses and consumers to take out loans is going to create demand for property and should help the market bounce back somewhat without pushing prices up too dramatically,” said Ben Cavender of CMR.

China’s economy “remains strong overall,” Mr. Cavender said. “The slowdown is real but it does not represent a crisis or an end to strong growth in China, more a short term response to global economic conditions.”

Analysts disagree about the extent of China’s economic woes, but there is consensus that China’s economy will need to make a fundamental shift in the next few years. For the first time, China is going to turn into a consumer driven economy, led by the

Doing Business in China

Demeanor
In Chinese culture, self control is an honored attribute. This includes speaking in a low voice, maintaining formal business relationships, and at all times remaining calm, controlled, collected and attentive. Self control and wisdom garner respect.

Greetings
When shaking hands, it is important not to be too aggressive. Shake hands firmly but gently, coupled with a slight nod. Remove hats and sunglasses before shaking hands. Limit or exclude physical contact when possible. It’s not a slap-on-the-back culture. Quickly moving to an informal relationship is frowned upon. It is considered polite to give your full name, job position and place of work upon introduction.

Business Cards
Business cards are always exchanged upon an initial meeting. A business card is a gift: receive it with two hands and immediately read it. Place it gently on the table in front of you or put it in a case. Never shove a card into your pocket or forget it on the table. Bring a good supply of your own cards, translated into Chinese on one side.

Naming Convention
Do not be afraid to ask which name to call someone. It is important to determine which name is the surname and to always use Mr. or Ms. Surnames are almost always one syllable, which can sometimes be helpful in determining which name to use.

Gifts
All gifts and favors are reciprocated. Present and receive gifts with two hands. Always wrap gifts. Don’t use white or black paper – these colors signify death. Red, the color of joy and luck, is a good choice.

Wardrobe
Chinese business people dress conservatively. White and black are acceptable.

Interpreters
Hire a reliable interpreter. When meeting with someone, don’t speak directly to the interpreter, speak to your counterpart and wait for the interpreter. Remain patient during pauses and never interrupt.

Meetings
Start meetings with an agenda. It is an acceptable practice to forward the company your agenda before the meeting. Meetings should be structured by discussing the biggest ideas first and leaving less important topics for later. It is polite to prelude the meeting with some small talk, to become more acquainted. When a group enters a room, the most important person enters and is greeted first.

Negotiations
It is not unusual for negotiations to stretch out much longer than in other parts of the world. Some Chinese businesses may ask for further concessions after a contract is signed. Patience is a virtue.

Numbers
Eight is the luckiest number because it sounds like the word for prosperity. The opening ceremony of the Summer Olympics in Beijing began on 8/8/08 at 8 seconds and 8 minutes past 8 p.m. local time. Two is lucky because it sounds like the word for happiness. Four is extremely unlucky because it sounds like the word for death. Many tall buildings in China skip the fourth floor.

Etiquette
Don’t point with your index finger; instead, gesture with an open hand. To bring someone towards you, don’t beckon with an upturned finger. Wave them over with your fingers turned down, as if sweeping something toward you. Always deny compliments, modesty is a virtue.

Jennifer Doty
PPP is Purchasing Power Parity

$12.3 trillion

Rest of China

Average Score on OECD Literacy Test

1731

59%

66%

Japan

1556

Australia

8%

$1.7 trillion

7%

$0.8 trillion

Tier 1 cities

China50

1458

1376

Israel

5

Source: National Bureau of Statistics

Increases in Wages v. GDP

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China population growth prediction from 1995–2025 (figures in millions).

Note: Cities listed by 2012 size based on urban agglomeration.

China Economic growth in 2011.

Natural Gas Consumption in billions of m³/year

USA

515

414

Russia

138

129

USA

314

248

Stock of Domestic Credit in billions of dollars

USA

115.0

113.0

China

4.5

4.4

China population growth prediction from 1995–2025 (figures in millions). (Source: Urban Land Institute)

Growing spending power of the population, analysts agree. The disposable income of the typical Chinese household has tripled in the last 20 years. By 2017 domestic retail sales could rise from 30% to as much as 50% of sales, some analysts suggest.

In the past, China was primarily an investment driven economy, despite the gaudy growth numbers, analysts say. “Probably the biggest lie the Western media tells about China is that it is an export-led economy,” said Mr. Klibaner. In 2009, 50% of the government investments went to infrastructure projects and only 10% to manufacturers, according to Peterson Institute data. The balance of investments is already shifting, as the government moves to create more opportunities for the white collar workers increasingly important to the country’s economy.

“There is a clear drive by the government to change the economy to be more focused on consumption and tertiary industries,” said Andrew Slevin, Managing Director of East China for CB Richard Ellis.

The Future of Construction

This shifting economic focus will directly impact the construction industry. While the government has been moving to stimulate different segments of the economy, it has sent clear signals that there is no plan to ease the restrictions on property purchases. There is still a fear that rising home prices would weigh on the domestic expansion. After the stimulus package was announced, the Housing Ministry announced it would “steadfastly” retain housing curbs.

“Structurally, China’s economy must change and it’s changing,” Hong Kong developer Ronnie Chan, Chairman of Hang Lung Properties Ltd. told Bloomberg Television at the time. “Personal consumption is one area that’s increasing, so in the coming five to ten years that will be one of the main games.”

The government is likely to emphasize more affordable housing projects in the next few years, instead of the high-end developments that attracted developers and international...
investors in the past. It has already moved to slow the development of villas and low density projects.

“We are likely to see a lag in mid-range and high-end residential construction as there is something of a market glut right now,” Mr. Cavender said. But affordable housing is a low-margin business for developers. Many of the large domestic developers are now shifting their focus to commercial developments and to the interior provinces and cities, Mr. Cavender said. “The strongest growth over the next two to three years will probably be in third and fourth tier cities that are either satellite cities in coastal regions or primary cities in more centrally located provinces.”

Land is more readily available and demand remains high in the smaller cities. Interest in top level space remains high in Beijing, Shanghai, and other top tier markets, but dozens of projects which started five years ago are now coming to fruition. “As the market matures there is likely to be a reduction in underlying demand particularly in Tier One and major Tier Two cities where urbanization is at a late stage,” said Mr. Slevin of CBRE. “Construction activity in Tier Three and Four cities should remain at a high level, along with the ongoing urbanization.”

The push for iconic tall building development, which was centered on China’s biggest cities in recent years, will now shift to cities looking to establish themselves in a competitive market, analysts say. After several well-publicized failures, there is already a renewed focus on projects that make economic sense, industry executives say. “There has always been an element of ego and status attaching to tall building construction in China and these issues are likely to remain,” Mr. Slevin said. “However tighter land supply, increased costs and a more demanding occupier base are going to drive further development of tall, better quality developments.”

Developers who don’t adjust to the market changes will struggle, analysts predict. “It is... likely that we will see the continuing trend of non-specialist developers, who joined the market in the boom years, exiting the market, with further consolidation in the development market likely,” Knight Frank said in a recent report.

But construction will continue at a rapid pace, in order to address this growing consumer society. A recent survey of real estate industry executives by the Urban Land Institute (ULI) found Chengdu, Shanghai, Hangzhou, Wuhan, and Shenzhen as the top-rated cities for investment prospects, with Chengdu, Shanghai, and Wuhan as the highest rated for development prospects. “Of the existing mature investment destinations, only Shanghai and Shenzhen continue to hold on to their rank in the top five of the 28 cities [surveyed],” ULI noted in its report. “Shanghai, despite the vast scale and depth of its real estate market, also impressed the survey respondents as a city that still has room for development.”

The government has been pushing to develop inland cities, directing investment, and promotional efforts to areas that received little attention in the past. Businesses are moving from the big cities to take advantage of the less expensive operating costs inland. Chengdu, Wuhan, Xi’an, and Changsha are among the cities benefiting from the trend, according to ULI. “A number of inland cities have begun to participate directly in China’s information technology boom, and they are now better positioned to retain college graduates, who previously flocked to Beijing and Shanghai,” ULI noted.

The Next Era

Fueled in large part by the growing manufacturing and technology base, China will move past the United States as the world’s largest economy by 2017, according to IMF forecasts. But it is still a relatively immature economy by global standards, economists point out. Most of the residential housing industry wasn’t privatized until 1998. “It’s difficult to put mature market metrics” on China’s economy, Mr. Klibaner said. Few analysts believe China will return to double digit growth anytime in the near
"China’s economy has already shown resilience to the ebbs and flows of the global economy. A repeat of the roller coaster rides that gripped Asia in the past is unlikely…"

future. The headwinds of the global economy and the inability to sustain the level of investment of recent years will have a long-term impact, they say. And while the population is growing more affluent and active, it is also growing older – by 2050 more than 26% of the population will be older than 65, compared to 8.2% now. That will put a greater burden on social programs and government spending in the decades ahead.

However, China’s economy has already shown resilience to the ebbs and flows of the global economy. A repeat of the roller coaster rides that gripped Asia in the past is unlikely, economists say. After continued slowing in 2012, China’s growth could pick up as early as the middle of 2013, CMR predicts. Retail spending, which could develop as a key barometer of the economy, could grow by double digits in the next year.

In a speech earlier this year to the China Development Forum, IMF Managing Director Christine Lagarde praised China’s responses to the economic turmoil. “As other countries are struggling to overcome the crisis and get back on a solid growth path,” Ms. Lagarde said, “China stands as a symbol of what can be accomplished.”

The Basics

Currency
The Renminbi (RMB) is the official currency. Renminbi refers to the whole Chinese money system. Yuan pronounced, "you-on," is the base unit of Renminbi. Yuan is also commonly called kuai. Yuan is used to denominate bills, and is the unit in which prices are measured (Approximate exchange rate; RMB1.00 = US$0.16 and US$1.00 = RMB6.36).

Language
Standard Chinese is the official, standardized form of spoken Chinese based on the Beijing dialect of Mandarin Chinese, referred to as Guānhuà or Bēifānghuà in Chinese.

Travel Information
Traveling to China requires a visa. To obtain a visa, your passport must have at least six months validity remaining. You should apply for a visa three to four weeks before your trip at a Chinese Embassy.

Upon arriving, you must register with the police within 24 hours. If you are staying in a hotel, the staff will automatically do this for you. Chinese law requires that you carry a valid U.S. passport and Chinese visa at all times.

Travel Tips
Always have the name of your destination written in Chinese to show the taxi driver, and get a receipt when you arrive at your destination.

Ask your Health Insurance Provider whether your policy will apply out of the United States and if it will cover emergencies.

Remember, pedestrians never have the right of way on Chinese roads!

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