

JESA INVESTMENT & MANAGEMENT CO. LTD.

NEWSLETTER
DECEMBER 2008

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NEWS FROM JESA!

By Saro Capozzoli, Founder and GM of JESA Investment & Management Co., Ltd

As the 2008 is going to its end, it's time to make balance and Jesa has reached important targets and results during this year.

We have relocated in Shanghai, in an old-style Villa, newly decorated. The opening ceremony took place on November 18th at the presence of Italy General Consul, S.E. Massimo Roscigno. Clients, Chinese Institutions and friends joined this event that enforces our growth.

The relocation in the new offices is a milestone in Jesa's history.



S.E. Massimo
Roscigno (in the
middle).

During ten years of activities, Jesa has followed 500 Million Euro of Foreign Direct Investment and enlarged its range of services providing HR audit, investment analysis and accounting and professional tax advisor services in China.

We are also glad to announce that Jesa received the prize "Lombard Elite", as the best consulting company in China.

The prize has been assigned by a jury led by **Cesare Romiti** *President Fondazione Italia Cina* e **Paolo Panerai** *Vice-President and Managing Director of Class Editori* and composed by **Sun Yuxi** *PRC Ambassador in Italy*; **Sergio Balbinot** *Managing Director Gruppo Generali*; **Alessandro Barberis** *President of Chamber of Commerce of Torino*; **Franco Bechis** *Director Italia Oggi*; **Gabriele Capolino** *Director and Associate Publisher MF -Milano Finanza*; **Osvaldo De Paolini** *Director MF -Milano Finanza*; **Alcide Luini** *General Manager Fondazione Italia Cina*; **Pierluigi Magnaschi** *Vice-President Gruppo Class Editori*; **Victor Uckmar** *Professor Emeritus in Scienza delle Finanze all'Università di Genova*.



Mr Sun Yuxi, PRC
Ambassador
during the award
ceremony in
Milan on
November 27th

This prize is for all Jesa reason of proud. It signs a goal but it is also and mainly a new starting point in facing with new upcoming challenges.

Despite the world financial crisis, Chinese market still represents a growing market and an interest area of investment.

During the past decades main investments were on production fields aimed to exploit cost advantages. Today China is still attractive on a productive point of view but should more and more analyzed as a consumer market, that needs services and products.

IMPACT OF THE GLOBAL FINANCIAL CRISIS ON CHINA'S MARKET

Even if the financial crisis that has spread all over the most advanced countries didn't have any tangible impact on the China's market over the last months, it seems that this situation is not meant to remain the same for too much longer. This analysis has the purpose to look into the effects, current and potential, that the financial crisis has brought and is bringing to the Chinese business context, with particular focus on the impact on foreign investments attractiveness and opportunities.

In order to get a better understanding of the consequences led by the financial crisis to the Chinese market, it might be useful to focus the analysis mainly on China's top trade partners. According to the US-China Business Council reported data, China's top trade partners for 2007 are the follows shown in the table:

China's Top Trade Partners 2007 (\$ billion)

*Percent change over 2006

Source: PRC General Administration of Customs, China's Customs Statistics

Rank	Country/Region	Volume	% Change*
1	United States	302,1	15,00%
2	Japan	236	13,90%
3	Hong Kong	197,2	18,80%
4	South Korea	159,9	19,10%
5	Taiwan	124,5	15,40%
6	Germany	94,1	20,40%
7	Russia	48,2	44,30%
8	Singapore	47,2	14,40%
9	Malaysia	46,4	25,00%
10	The Netherlands	46,3	34,30%

If we consider the whole European Union as a unique China's trade partner, it will be at the top of the rankings with its total trade value of 302,2 € billion(399,02 billion \$).

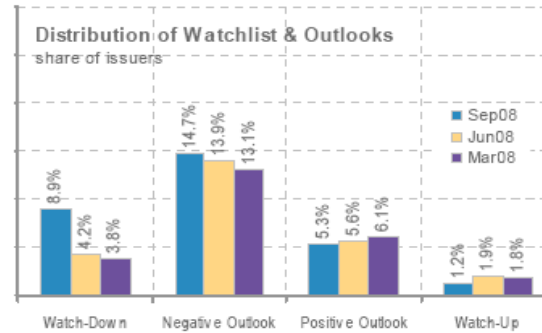
Introduction to the financial crisis and main impacts on developed countries

The ongoing global financial crisis has roots in the collapse of the U.S. subprime mortgage market and it's characterized by contracted

liquidity in global credit markets and banking systems triggered by the failure of mortgage companies, investment firms and government sponsored enterprises which had invested heavily in subprime mortgages. The crisis turned to be tangible with the shock of the American housing bubble in the august 2007 due to decreasing house prices, and it has passed through various stages. Indeed, it entered a tumultuous new phase in September 2008 when intensifying solvency concerns have triggered a cascading series of bankruptcies, forced merges and public interventions in the United States and western Europe: the most noteworthy trigger was the declared bankruptcy of investment bank Lehman Brothers that owned more than 80 \$ Billion in securities linked to subprime mortgages. Major banks and other financial institutions around the world have reported losses of approximately US\$435 billion as of 17 July 2008. Both the European Central Bank and the FED have been pushing money in the financial markets by cutting interest rates (the last of these Bank intervention happened in the 9th of October with the ECB offering \$100 billion at the financial sector) .With the failure of the bank

system to face this liquidity shortage, the impact of the crisis spread out also into the real market. Indeed, the higher the need for liquidity, the less the number of loans issued by the banks to the private sector. That is, industrial companies are facing more and more difficulties in financing their investments and operating activities leading to a decrease in the productivity in most of the main industries. Manufacturing and trading companies are struggling with this lower productivity and with a continuously decreasing value of their equity. The direct consequences of this process was that many of them couldn't deal with the refund of their outstanding debts and so entered financial troubles that often have led to bankrupt. As an evidence of this higher company's default rate it's possible to refer to the last Moody's report about recent changes in credit quality. Moody's rating actions, reviews and outlooks for third quarter 2008 reports that "the number of rated issuers on review for downgrade doubled in the third quarter. At the end of the third quarter of 2008, 8,9% of rated issuers were on review for downgrade up from 4,2% at the end of the second quarter. Both of these percentages are higher than the

corresponding reviews for upgrade, which stood at 1,2% of rated issuers at the third quarter". This negative trend in the quality of credit is shown in the figure below:

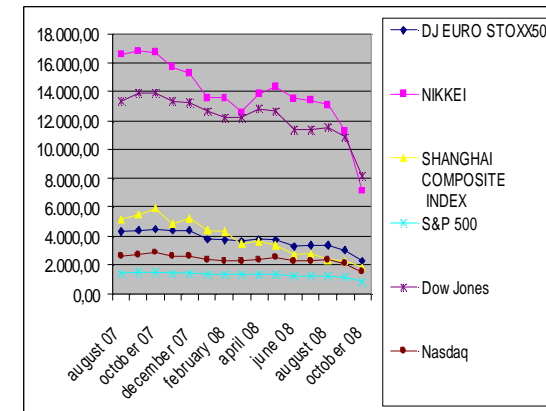


Financial distresses, low productivity and companies' failure bring not only to a slower growth rate for the most affected countries but they also have some social implications. This last point refers mainly to all the problems related to unemployment and increasing real cost of living. As reported by the International Labour Organization, job losses have been much higher than expected and job losses are likely to be greatest in sectors such as construction, car

manufacturing, tourism, finance, service and real estate.

All this, basically represents a brief summary of what happened in the countries that have been most affected by the crisis, such as United States, European Union and Japan as well.

The impact of the crisis all over the financial markets, can be shown by the graph below that presents the monthly trends for all the major stock indexes in the world from august 2007 to current days:



As we can see from the graph, all the indexes followed a negative trend over the last and half year, destroying billion and billion of dollars. In order to have a better appreciation of the decreasing value of the reported indexes hereby are the % changes rates:

	27 october 2008	31 august 2007	% change
Dow Jones Standard & Poors 500	8.175,77	13.240,84	-38%
Nasdaq 100	1.505,90	2.596,36	-42%
Shanghai Composite Index	1.839,62	5.218,83	-65%
Nikkei DJ	7.162,90	16.569,09	-57%
EUROSTOX X50	2.333,28	4.294,56	-46%

Real Market Crisis: consequences

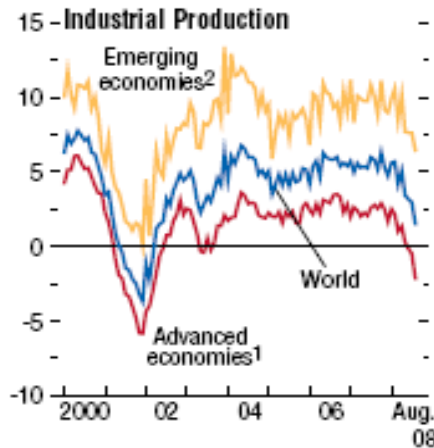
The U.S. financial crisis has taken a serious turn for the worse and continues to spread across the globe. During 2008 economic growth has slowed markedly as a result of the financial crisis revealing its wallops on the real markets

worldwide. The main impacts suffered by real markets can be summarized as follow:

I Lower Productivity: due to the higher cost and difficulties in financing led by the liquidity crunch, an increasing number of companies have found troublesome to sustain their activity and production level. Another cause that influenced companies' production lies on a decreasing demand for commodities and in the real estate market. This lower demand is due to inflation that over the last few years, in particular for the advanced economies, has been growing sharply, making the cost of living less affordable. As an evidence of the lower productivity we can report in the following tables, the falling GDP's growth and down warding industrial production level trend.

	ACTUAL		EXPECTED	
	2006	2007	2008	2009
World Output	5,1	5	3,9	3
United States	2,8	2	1,6	0,1
European Union	3,3	3,1	1,7	0,6
Italy	1,8	1,5	-0,1	-0,2
Germany	3	2,5	1,8	NA
France	2,2	2,2	0,8	0,2
Spain	3,9	3,7	1,4	-0,2
United Kingdom	2,8	3	1	-0,1
Japan	2,4	2,1	0,7	0,5
Hong Kong	7	6,4	4,1	3,5
Korea	5,1	5	4,1	3,5

Source : Global Prospects and Policies, International Monetary Fund

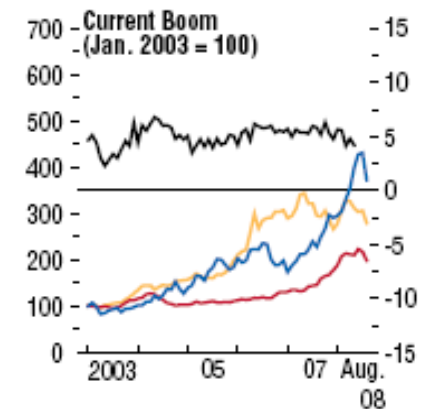


	ACTUAL		EXPECTED	
	2006	2007	2008	2009
United States	4,6	4,6	5,6	6,9
European Union	8,7	7,4	7,6	8,3
Italy	6,8	6,2	6,7	6,6
Germany	9,8	7,4	7,6	8,3
France	9,2	8,3	7,7	8,3
Spain	8,5	8,3	11,2	14,7
United Kingdom	5,4	5,4	5,4	6
Japan	4,1	3,8	4,1	4,5
Hong Kong	4,8	4,1	3,5	3,6
Korea	3,5	3,3	3,1	3

I Fear of increasing Unemployment Level : led by lower production and companies facing serious financial troubles, often being unable to face the crisis and so turn into failures and bankruptcies, the fear for an increasing unemployment level is forthcoming and is taking step into market awareness. Hereby are reported the statistics of the unemployment level as % of labor force :

I Inflation: Continuing inflation risks arise from the large increase in commodities prices. The main factors that have been driving commodity prices up can be resumed as the growth acceleration in emerging and developing countries that increased notably the demand; the speculative wave characterized by purchases of commodities (mainly oil) with the intent to resale them rather than to use them for commercial purposes.

In particular, oil price more than doubled between December 2006 and mid-July 2008, and food prices (mainly referred to corn, wheat, rice, soybean) raised by 50% during the same period. The higher inflation has impacted on exports and also on consumer confidence, both of them decreased as a result. As we can see from the graph, commodity prices surged during the past year and a half.



Commodity Prices and Industrial Production

— Oil — Metals
— Food — Global industrial production (year-over-year change, right scale)



IMPACTS ON THE CHINESE MARKET

After having showed the main effects that the financial crisis in combination with the raising inflation have had on the real economy of most advanced countries, with particular emphasis on China's top trade partners, the analysis shifts its focus on the implications related to the Chinese market. In particular, we want to give an overview on how the financial crisis has affected the main drivers of China's economic growth and the role played by the Chinese market in this scenario.

For much of the past year China seemed to be immune to the negative impacts that the financial crisis has spread out worldwide. Chinese financial system so far has been slightly affected by the Wall Street financial crisis with the entity of the loss kept under control. In fact, as declared by the Vice Governor of Chinese Central Bank, Ma Delun, Chinese banks are exposed for less than 10 Billion dollars on subprime mortgages and only 7 banks present an exposed position on Lehman Brothers corporate bond. Even though the situation in the

financial system seems to be under control, China's economy has started to suffer the consequences of the global crisis. The main reason is linked to the high dependence of the Chinese economic boom to its international trading relationships with the United States, European Union and Japan: the most affected economies by the financial turmoil so far.

As we said earlier, the consequences of the financial crisis on the real markets of China's top trade partners have brought a slowing demand for goods and lower production, causing a decrease in the demand for Chinese goods and consequently an increase in some commodity prices. Secondly, the liquidity crunch and the financial distresses are bringing uncertainty among the foreign operators which are revisiting their investment plans down, so leading to a likely drop in future foreign investment (FDI) in China. The combined effect would be a marked slowdown in China's economic growth. This process has already stepped into reality with the last China GDP growth rate slowed more sharply than expected. For this last 2008 quarter, China economy registered a growth rate of 9%, the lowest quarter growth rate over the last five

years. The Chinese yearly and quarterly GDP growth rates are reported in the table below:

	'03	'04	'05	'06	'07	'08 E	'09 E	
Yearly Growth	10,0 %	10,1 %	10,4 %	11,1 %	11,4 %	9,7%	9,3%	
					1 st Q	2 nd Q	3 rd Q	4 th Q (E)
Quarterly Growth 2008					10,6%	10,1%	9,0%	9,1%

From 2007 to 2008 the Chinese GDP recorded a drop of almost 2% and the industrial production expanded 11,4% in September, down from 12,9% in August. Chinese equity market that experienced the largest run up in prices in recent years (during 2005-2007 prices more than quadrupled) have declined of about 65% over the last year and a half. This unfavourable trend will be likely to continue in 2009 as we can see from the estimated growth rate table. Basically, the main impact of the financial crisis on the Chinese market results in a slower growth driven by a reduction in the overseas demand for Chinese products and services with falling

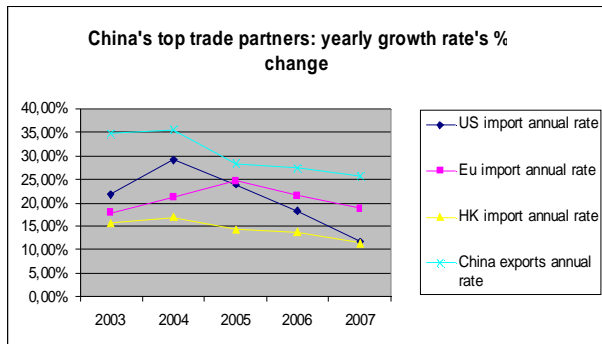
exports and a following decrease in the FDI in China. These two matters are explained separately ahead in the paragraph.

Impacts on China's exports

First of all, it's import to point put that exports account for more than a third of China's economic growth and 10% of the overall GDP. This high incidence of export on economic development makes China highly vulnerable to shocks in the international trades, since the internal market is not so developed and still presents a relatively low demand. Until September 2008, exports have continued to grow at an annual rate of more than 20% in spite of the economy slowdown in financial markets. In September China registered a new trading surplus record of 29,3 Billion dollars, contributing to increase its foreign reserves in excess of the trade surplus amounting up to 2 Trillion dollars. So apparently even if the most important China's top trade partners suffered sharp decreases in imports and presented a marked reduction in demand for made in China products, China 's economy seemed to be

immune. In the following graph and table are exposed the yearly imports from China and imports from China growth rates for China's main three trade partners over the last 5 years.

Billion of EURO	2003	2004	2005	2006	2007	% 2007-2006
US imports	115,42	148,97	184,41	217,96	243,49	
US import annual rate	21,70 %	29,10 %	23,80 %	18,20 %	11,70 %	6,50 %
EU import	106,22	128,69	160,32	194,83	231,56	
Eu import annual rate	17,83 %	21,16 %	24,58 %	21,52 %	18,85 %	2,67 %
HK Imports	81,67	95,45	109,08	124,01	138,22	
HK import annual rate	15,50 %	16,87 %	14,28 %	13,69 %	11,46 %	2,23 %
PRC exports	331,87	449,33	577,10	733,94	922,45	
PRC exports annual rate	34,60 %	35,40 %	28,40 %	27,20 %	25,70 %	1,50 %



As we can note from the graph, China, Us, Eu and HK all presented remarkable high growth rates, even if decreasing over the period. We can also see that by the mid of 2007 all the rates presented an acceleration in the decrease trend. The most notable thing is that even if it's considered normal to have a decreasing import growth rate, the difference between the 2007 growth rate and the 2006 one is higher for all the trade partners (but in particular for the United States) than the difference reported by China of 1,5%. That is, imports from China for those countries have been declining faster than the rate at which China whole imports have done. So basically it came up that with the beginning of the financial crisis China's trade partners, deep affected by the crisis, started to slow down their trade activity with China implying a reductions in Chinese exports. Even if there weren't enough data available for the year 2008, there are several evidences that this trend has been worsening over the current year. A significant example is represented by the car industry: in September all the main American and Japanese car manufacturers suffered heavy losses in sales,



in details Ford -34%, GM -15,8%, Chrysler -33%, Honda -24% and -Toyota 32%.

The reasons that explain China's ability to keep its export growing at a rate higher than 20% per year, should be found in the increasing imports by developing and emerging countries. Over the 2007 and 2008 those countries enhanced their trading activity in the global markets, in particular with the Chinese government: the trade relationships with India increased by 55% in the first nine months of 2008, in respect of the same period in 2007.

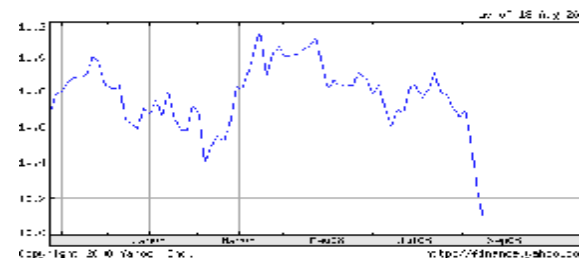
This situation has started to change, since the amount of imports to developing countries is anymore able to balance the losses from the developed countries. In the second half of September the fear of a slowdown in China's economy became reality. All the main commodities suffered a marked decrease in foreign demand. Iron ore, nickel and crude oil price are all half of what they were in the middle of the year and also steel production has fallen in response to weak exports of products that use metal. China's auto market has weakened as well, Great Wall Motors (China's largest independent Suv maker) reported sales down

22.18% than the previous month. Power and cement producer also got seriously affected by the oncoming crisis. As reported by Bloomberg, Huaneng Power International Inc., a unit of the nation's No. 1 power producer sank 9.9 percent after reporting a \$322 million third-quarter loss on higher coal prices and tariff caps. Western Mining Co. China's fourth-largest producer of zinc concentrate, declined 0.17 Yuan, or 2.6 percent, to 6.40. Third-quarter profit sank 32 percent to 282.8 million Yuan on weaker demand and lower metals prices. At least, available data for the third quarter suggest a further slowdown in particular affecting low-tech Chinese exports and indeed forward-looking indicators suggest that the economy is likely to contract in the current quarter and into early 2009. That means that the real effect on China's economy still has to come.

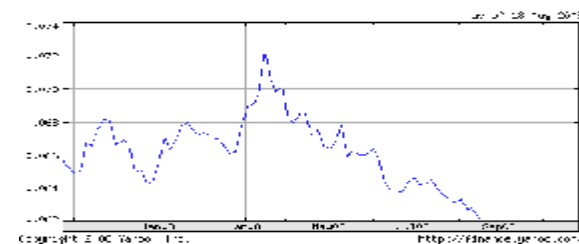
The impact on China's exports can be brought back to two main factors. At first as we said, there is the financial crisis and the growing inflation that have been eroding China's top trade partners economies. At second, the other factor that contributed to decrease China's exports is the appreciation of the RMB over the

last months against all the China's top trade partners' currencies. A picture of the appreciation trend is given by the tables under here that report the monthly exchange rates all over the 2008 between the Chinese CNY and US \$, € and Japanese Yen.

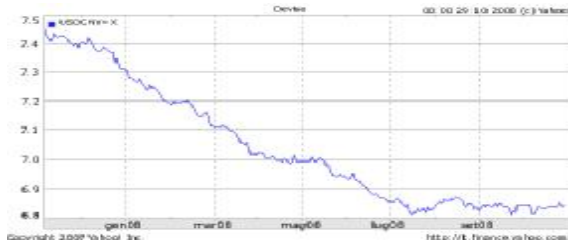
CNY/EUR



CNY/JPY



CNY/USD



As we can see from the graphs, the remarkable appreciation of RMB started in January and kept on going throughout the all year until nowadays. RMB appreciation began as a response of the Chinese government to fight rising inflation, in order to contain mainly increases in domestic food prices. The government indeed adopted relatively tight fiscal policies that brought consumer price inflation down to 4.6% in September from a peak of 8.7% in February. Appreciation was also an important point of China's broader strategy to shift the source of growth toward internal demand and to increase the effectiveness of monetary policy.

Impacts on Foreign Direct Investments

Foreign direct investment (FDI) is playing a growing role in economic globalisation. For the investing firms, it means access to new markets and marketing channels, possibly cheaper production facilities, access to new technology, products, skills and financing. For a host country or the firm which receives the investment, it can provide a source of new technologies, capital, products and management skills, which can lead to higher competition and give an impetus to economic development. FDI have been one of the major driver of China's economy growth and development. For these reasons, FDI can be considered the second matter that can better reflect the impacts of the financial crisis on China's economy.

Over the last few years, China has remained the most attractive destination for FDI in the developing world despite the financial crisis, followed by India, the United States, the Russian Federation, Brazil and Viet Nam. The flow of FDI that have been realized in China so far, are characterized by two main features. At first, the

majority of these investments have focused mainly on the manufacturing industry, which takes about half of the overall capital inflow, but the proportion is falling, as more investors look to the service sector. Indeed, in the early days, most foreign investors came to the country to set up factories, now, more corporations have established their regional headquarters in Chinese cities such as Beijing and Shanghai. In second place, it's important to underline the marked relevance of other Asian countries in particular Hong Kong (China's largest source of inbound FDI with 37,1 % of the total), Taiwan and Macao.

As an evidence of the China's strong investment position, in the table below are reported the stock and the inflows of FDI received by China during the last three-four years, and realized by the United States and the European Union.

CHINA'S FDI STOCK				
Billion of Euro	2004	2005	2006	2007
EU27 FDI stock	22,5	28,2	32,7	34,5
EU27 FDI stock change%		25,33%	15,96%	5,50%
Usa FDI stock	13,3	14,4	17,7	21,4
Usa FDI stock change %		8,01%	23,09%	20,94%

CHINA'S FDI INFLOWS				
Billion of Euro	2004	2005	2006	2007
Total China's FDI inflow	45,89	54,83	55,05	63,23
Total China's FDI inflows change %	NA	19,47%	0,41%	14,86%
Usa FDI inflows	3,40	1,43	2,95	4,32
Usa FDI inflows change %	NA	-57,78%	105,26%	46,15%
EU27 FDI inflows	NA	5,7	6	1,8
EU27 FDI inflows change %	NA	NA	5,26%	-70,00%

China received € 63,23 billion of FDI in 2007, and that figure has already climbed to € 45.97 billion for the first seven months of this year, up 44.5 percent year-on-year, according to commerce ministry statistics. China presented in 2007 a total amount of global realized FDIs of € 1,388 billion up to 30 percent increase from 2006.

So from these figures it comes up that the financial crisis didn't have any tangible effects on China's investment attractiveness over the 2007.

As reported in the United Nations' "World Investment Report" the effects of the liquidity crisis in money and debt markets of many developed countries started to appear at the beginning of 2008: " As a result, M&A activity has decelerated markedly. In the first half of 2008, the value of such transactions was 29% lower than that in the second half of 2007. Corporate profits and syndicate loans are also declining. Based on available data, estimated annualized FDI flows for the whole of 2008 are expected to be about 1,600\$ billion, representing a 10% decline from 2007".

So in China, even if FDI flows rose 39,9% year on year in the first 9 months of 2008, in September they were only 5,02 billion €, much lower than the monthly average of about 6,28 billion €, according to the Ministry of Commerce. In particular the crisis has affected mainly the real estate market with specific regards to property market. Prices began to fall in August compared with the previous month and figures

for units of housing sold and property under construction have also shown significant drops. The next table shows all the major national investment and real estate related indexes and the change in value that those indexes reported over September. As we can see from the table, as an evidence of the beginning downturn in the real estate market, all the indexes presented losses in value on a month on month basis.

	Value in September	Monthly change (Sept-Oct)
The national real estate climate index	101,15	-0,63
The investment index of real estate development	103,22	-1,18
The index of capital source	95,13	-2,13
The index of land space development	95,69	-0,73
The index of floor space of buildings under construction	104,56	-0,66
The index of vacant floor space of commercial buildings	103,54	-0,36

The average prices of residential and commercial real estate in China are falling, having peaked earlier this year and the number of transactions has plunged, according to industry observers. In some areas prices have dropped by 10 to 40%. In other parts of the country transactions have fallen but prices have only started to follow. This downturn comes as the growth rate of Chinese exports has slowed and stock markets have plummeted. The confluence of events has resulted in what economists describe as a deceleration in China's economic growth. One last consideration should be done to this regards. It must be said that is difficult to isolate the exact impact of this reduction as a consequence of the financial crisis, because in addition to the financial crisis in China there are some other factors that may have enhanced the difficulties met by other countries that want to invest in the country, such as an increasing nationalism, unpredictable policy for M&A and barriers to market entry including capital requirements and licensing.

So in the end, it's seems that the global financial crisis has started to affect the amount of resources invested in China even if it's difficult to

quantify the real impact. And for what concerns the future, from the last "World Investment Prospect survey" 2008-2010 disclosed by the United Nations at the end of September, China will remain the most attractive destination for FDI in the next 2 years even if the amount of FDI will be likely to be less that the current level.

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