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IRISH exporters association

China syndrome

By Barry J whyte

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CHINA SYNDROME

With Chinese stock markets being hit by extreme volatility, could Irish businesses that seek to tap into this vast market be affected?

Barry J Whyte

Hugh Kelly knows China very well.

Kelly is the president of the Irish Exporters' Association as well as manager of an Irish company called Associated Marketing, which helps businesses establish themselves in China.

He's spent years in China and understands international markets, and last week gave a speech to the Ireland-China Business Summit on the issue of finding local partners to succeed in China.

Nevertheless, Kelly told *The Sunday Business Post*, the wild fluctuations in the Chinese stock markets in the last few weeks are a concern.

"It's not just a concern for the impact it'll have on the Chinese market, but on all other economies," he said. "There are those that'll be more directly affected than others. Australia, for example, will be directly hit if China goes through a prolonged period of slowdown, but it'll be felt globally."

At the last count, Chinese investors have seen nearly $4 trillion wiped off the value of their investments. A year ago the Shanghai stock index was trading at around 2,000 points before ballooning in value to a peak in June of over 5,100 – driven largely by speculative investors and a lot of borrowed money. That collapsed in the last month to 3,700. The Shenzen index raced to a high of 3,100 in June before collapsing to 1,900 in July.

The People's Bank of China – China's central bank – has been making some dramatic interventions in recent weeks attempting to halt the declines, including cutting interest rates, slashing the amount of reserves some banks had to hold, suspending stock market flotations and injecting huge amounts of liquidity into the market.

It has now suspended the trading in shares of more than a thousand listed Chinese companies – 1,476 out of 2,808 in all.

Expansion bubble

According to Philip O'Sullivan, chief economist with Investec, loose monetary policy from the People's Bank of China has driven the rapid expansion in the stock market, rather than any underlying growth in the country's economy. In short, this is a bubble.

The obvious question is: what does this mean for Ireland?

Ireland's direct trade with China is relatively small, according to O'Sullivan, compared to the amount of trade that it does with the European Union and the US.

In 2013, for example, according to CSO figures, €2.4 billion of merchandise or goods was exported to China, a quarter of which was food, 35 per cent of which was chemical and pharmaceuticals and 18 per cent of which was machinery. The chemical exports were dominated by multinationals, O'Sullivan said, while the food exports were from indigenous companies such as Kerry and Fyffes.

Ireland well insulated?

In the services sector, it was similarly small. Just €2.4 billion worth of services, which constituted 2.6 per cent of the country's overall volume of trade for the year.

Most of Ireland's publicly listed companies were fairly well insulated against any shock in China, O'Sullivan said. Companies like Aryzta, C&C, Origin Enterprises, Total Produce, and Donegal Investment Group have little or no exposure to China, for example.

Other Irish companies do have Chinese exposure – albeit slight. O'Sullivan pointed out Fyffes, which set up a ripening and distribution business in China in late 2013 on a joint venture basis with a Philippines-based partner; and construction company CRH, owner of a 25 per cent stake in a Chinese cement company which constitutes less than 1 per cent of its net income.

Meanwhile, Ireland's multinationals are generally defensive in nature and are well placed to withstand any ripples from China, according to Davy Stockbrokers' chief economist Conall Mac Coille.

"Take the pharmaceutical sector," he said. "That's a defensive sector, and it sells mostly to the US and Europe, and people still need to buy drugs that make them well again."

Ireland's dairy sector is probably Ireland's most successful export to China – and therefore its most exposed one, should China's economy suffer from the equity market turmoil. Infant milk formula accounts for 50 per cent of the total dairy imports. But "if the economy goes through a bad time, will Chinese mums stop buying imported milk formula?"

Gamble on food

While Kerry Group does not break out Chinese business in its results reports, its accounts show that around 14 per cent of group revenue comes from the Asia Pacific region, and it has a factory in China employing 500 people.

In 2012, it entered into a partnership agreement with Beingmate – a leading Chinese manufacturer of infant formula products – to supply Irish dairy ingredients for infant nutrition applications in China. Last year, it launched a new brand of infant formula milk into the market.

Glanbia, too, has made forays into China, with an attempt to sell its UHT long-life milk into the market.

Meanwhile, Ireland's food sector is betting big on China, even if the figures don't yet bear that out yet. In 2014, Ireland sold China just €547 million of food and drink, though that was a 50 per cent increase on 2013. But that coincided with an opening up of China's beef market – but only to Ireland, with the market staying closed to the rest of the European Union. Meanwhile, at much smaller volumes, China is Ireland's second-biggest market for pig meat."

Trouble with China

For plenty of other Irish companies, China's troubles could well turn out to be their troubles.

For more than a decade, since the IDA's first official visit in 2004, Ireland has seen

China as a source of potential trade and economic growth. An Enterprise Ireland guide for small businesses from 2013, for example, pointed out that "in 2011, trade between Ireland and China hit €8 billion, an 8.6 per cent increase over the previous year". Critically, it claimed that a HSBC trade report had projected that for Ireland predicted exports to China will grow by 11 per cent a year from 2016 to 2030.

And in the last 18 months alone, plenty of Irish companies have gone east. In June of last year, for example, rival travel booking companies Datalex and Openjaw opened Chinese offices, in Beijing and Hong Kong respectively.

Bearing fruit

Fruit company Keelings founded a €1 million joint venture with massive Chinese company Bright Food Group Corporation in the same year.

Cork-based Zenith Technologies has partnered with the Chinese division of ABB, a major electronics multinational, to help in the development of China's €500 billion life sciences sector; Clavis Insight opened an office in Shanghai; Galway medical technology firm ArraVasc won a €3.5 million contract with medical device distributor Shanghai Micro Medical in June 2014; Dublin building energy company Cylon Controls formed a €6 million joint venture with giant iron ore importer Sinosteel. The IDA has offices in Beijing, Shenzen and Shanghai, while Enterprise Ireland estimates that nearly 300 small to medium-sized Irish companies have engaged in trade with China, while more than 100 have offices there.

For Irish companies, any slowdown in the Chinese economy could mean a slowdown in their growth plans, Kelly said. And those are growth plans that are already slow, thanks to the unique nature of Chinese commerce.

"The Dutch did a study and, on average, it takes four years for a new entrant to the Chinese market to break even. The market doesn't just flick on and flick off," he said.

"The numbers are vast – we're talking to a potential channel partner for one of our clients at the moment and they have a contract to supply 8,000 hospitals in China. There are fewer than 200 in Ireland. The consequences are that the deal takes longer to do."

MacCoille believes that, so far, any wobble in China is just that: a wobble.

He points to China's substantial firepower, not least in the significant savings of individual Chinese households. "There may be a temporary rebalancing of the economy away from China's current export focus towards consumer names and the Chinese domestic economy," he said. "That could slow Chinese growth and hold back investment a little bit."

Ireland is not Australia

But for MacCoille, the fundamentals of the Chinese economy remain sound.

The problems of the stock markets are not connected to the problems of the economy, he said. "The government is panicking because there are going to be asset bubbles and ordinary households are getting hit by these corrections."

Juliet Tennent, economist with Goodbody Stockbrokers, agreed that the Chinese government was worried largely about the potential social effect. But she also believed that the potential effect on markets was wider, too.

For Ireland, a small, open economy attempting to navigate between the EU, the US and Asia, that kind of contagion is a much graver threat.

"We're not Australia, which is a very big commodity trader with China. That would have a direct impact from China but not so much here," she said. "But China has a global impact so that would impact Ireland indirectly. What impacts China impacts the US, and what impacts the US impacts Ireland."

Paul Sommerville, of Sommerville Advisory Markets, said: "What we don't need is huge amounts of volatility in the market place. We're likely to see that over the next couple of years. The main point is asset bubbles are being blown all over the world and this is just one of many that is likely to burst over.

"The panic and volatility in China is not over by any means," he said.

So far, according to Tennent, despite the wobbles in the markets and the spikes in the various volatility indices, the markets haven't yet given indications that they're quite panicking.

But markets can turn quickly, she pointed out, "particularly if events in China continue as they are. They're talking about trillions being wiped off the value of stocks. It has the potential to be pretty significant for global markets".

And for Ireland, too.

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Is the future still Chinese?

"The pivot of global growth is headed east," said Philip O'Sullivan, chief economist of Goodbody stockbrokers.

While western economies are growing in the low single digits, China has been growing at around 7 per cent in recent years.

According to Conall Mac Coille of Davy Stockbrokers, the Chinese economy is still in robust health and that the equity bubble is not indicative of a longer term problem with the country's financial health.

"Exports have been bouncing around through the years, and they've slowed of late, but retail sales are up 10.3 per cent year to date, that's strong growth in retail sales," he said. "The consumer is becoming a much bigger part of the Chinese economy. Money supply growth is still very strong. The fundamental story is still there."

China's gross domestic product had slipped somewhat in recent years, he pointed out. "People are getting upset that the levels that had been seen in previous years – of of 12 per cent and 13 per cent –aren't there any more. That 7 per cent is the slowest since 2009. But it's still expanding sharply and there's room for productivity increases."

Not everyone agrees that China's economy is as sound as it appears. Paul Sommerville of Sommerville Advisory Markets said: "The Chinese GDP figures of 7 per cent growth are absolute bullshit. The idea that China is growing at over 7 per cent, when you've got iron ore and zinc plummeting and the stock market plummeting, is unbelievable.

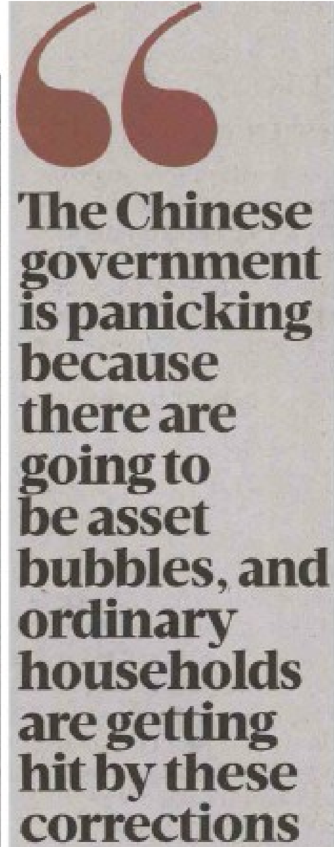
"That panicked response from the Chinese government shows that they are much more worried about their economy than they're letting on," he said. "The Chinese economy probably isn't performing as well as they would like you to believe."

Sommerville said the safest exposures to China were consumer-related stocks exposed to China but listed in Europe or the US.

But for Hugh Kelly of the Irish Exporters' Association, while the short term future may be turbulent, he told *The Sunday Business Post* that he was committing to China. "I'm doing business in China and at the moment," he said. "I'm pushing on, because the share of the market and the volumes I'm hoping to do are pretty modest in the context of China, and the niches are still going to be big enough."

For Kelly, he's sticking to his guns despite the market turmoil. "We're business accelerators. We help people to open the Chinese market, to de-risk it. We've got people on the ground in China, so we provide business with the local presence, and I'm not changing my strategy."

The key, both in individual deals and with China generally, he said, is patience. "The Chinese story is always going be a long play. No one's going to make a quick buck in China. It's like students studying civil engineering in 2008, but then the property crisis hits and it looks like they've made a bad decision. Well, they're doing their Master's degrees now and it's great, because there's a shortage of good engineers – so panic slowly."



China's stock market meltdown
Feb 4: the People's Bank of China cuts the reserve requirement ratio for banks by 0.5 percentage points.
Feb 28: the People's Bank of China cuts interest rates by 0.25 per cent.
March 5: China's GDP growth target is cut from 7.5 per cent to 7 per cent.
April 19: the People's Bank of China cuts the reserve requirement ratio by one point.
May 10th: the People's Bank of China cuts interest rates by 0.25 per cent.
July 5: IPOs are suspended, brokers launch a market stabilisation fund and the central bank announces emergency supports.
Bloomberg