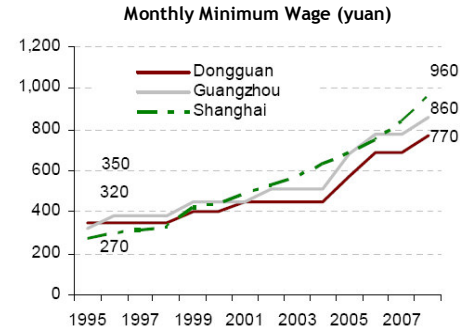


IS CHINA BRINGING MORE CHANGES TO THE WORLD?

For years, the entire planet has benefited from China's decision to open itself to the global economy by becoming an aggressive exporter and trader on the world scene. Prices of countless goods have come down as a result of China's central government decision to foster its role as manufacturer to the world, a decision motivated in part by the need to provide jobs to the millions of workers making the transition from the country side to the industrial cities each year. Recent changes to government policy and labour laws could foster a new direction for China and the world. This week's Marker examines the causes and some potential consequences to this new course of action.

NEW RULES, NEW DIRECTION

One should never overlook the fact that the Chinese economy is centrally planned. Over the past 15+ years, its planners have focused on the twin pursuits of growth in exports and urbanization, two objectives that would serve to create jobs necessary to maintain a low unemployment rate and social peace. Starting in 2006, the central government signalled its desire to foster greater development of the domestic economy, which means providing for a stronger consumer. In practical terms, one achieves such a goal by making sure consumers have money to spend through higher wages, as well as time to spend it in the form of shorter work weeks. This new direction became policy in 2008 when a new set of labour laws came into effect. In essence, the new laws raise China's labour standards to international levels with previously unheard of provisos such as overtime pay, contributions to social and pension funds, and severance upon termination. Why is this worth mentioning? China's export sector had heretofore taken for granted 80-hour weeks while often ignoring basic workers' rights in the process. The accompanying chart illustrates how migrant workers' wages are on a strong uptrend and have essentially doubled over the past three years.



Sources: Provincial bureaus of Human Resources and social security, Credit Suisse

END OF A TREND?

The ongoing realignment of the Chinese economy is already being felt through export price increases of which the western world is the end receiver. Could the coming years see the reversal of one key deflationary force, often referred to as the Wal-Mart effect, from which so many have benefited? Bear in mind that these price increases are occurring without a strong appreciation of the yuan. Should the Chinese currency be allowed to appreciate as so many wish, the inflationary pressures would only increase. Of course, the domestic economy, which includes services and consumer goods, is growing at a faster rate, thus creating a host of investment opportunities, albeit more challenging and definitely less supportive of western economies, for investors to exploit.



Sources: US Bureau of Labor Statistics, Credit Suisse

NATCAN WEEKLY MARKER

China's economy is following the normal evolutionary path from emerging to developing to soon-to-be developed. This will benefit the world in the long run, but carries the prospects for great dislocations as well as threats and opportunities for savvy investors. Input costs and pricing power could become differentiating factors among global companies in the coming months. Ignoring the Chinese behemoth's direction could once again be a source of great risk for investors.

Michael Quigley, CFA
Senior vice president, Distribution

FINANCIAL MARKETS

RETURNS AS AT JUNE 6, 2008 (%)	MTD	QTD	YTD	RATES AS AT JUNE 6, 2008	
S&P/TSX	1.77	12.62	9.42	CAD/USD	1.02
S&P 500	-0.19	2.57	-4.07	CAD/Euro	1.60
S&P/TSX Small Cap	0.98	6.16	1.86	US Treasuries yield 10-yr/30-yr	3.94/4.65
Russell 2000	1.58	7.08	-0.35	GOC bond yield 10-yr/30-yr	3.65/4.11
MSCI EAFE	1.06	4.19	-1.32	Fed Fund Rate (target)	2.00
MSCI World	0.50	4.01	-1.66		
DEX Universe Bond	0.27	-0.41	2.54		

Note: Returns in Canadian dollars, London 4h exchange rates. Source: Datastream, PC Bond, MSCI-Barra, and Bloomberg. PC-Bond, a business unit of TSX Inc. Copyright © TSX Inc. All rights reserved.

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