



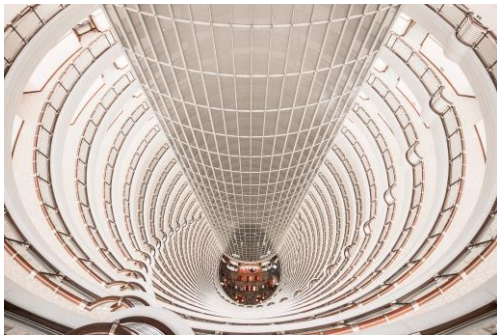
FOCUS on

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The Chinese market – a huge consumption potential waiting to be unleashed



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The greatest potential of the Chinese economy lies in consumption by its 1.4 billion people... Boosting consumption is a key step to expanding domestic demand. We need to restore the structural role of consumption in the economy.

**Li Keqiang, China's previous premier,
December 2022**

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In December 2022, during a zigzagging re-opening, China held its Central Economic Work Conference, with one key takeaway: **growth**. Growth will be the focus of China's economic agenda for 2023. Among many measures that the Chinese government is about to take, a significant focus has been placed on **consumption**. As an increasing number of Chinese people aspire to a better life, the Chinese government has let consumption take a leading role in China's economic growth.

Since 2008, consumption has already become the biggest contributor to Chinese GDP growth, at 65.4% in 2021. But private consumption accounted for only 38% of GDP, significantly lower than the ratios of developed economies (e.g., 68% in the US).

DRIVER 1: CONSUMPTION UPGRADE

“Consumption upgrade” in China refers to changes in consumption modes, the changing

needs of Chinese consumers, and consumption's greater importance in China's economy structure.

1. The path of China's consumption upgrades.

Consumption upgrades have provided enormous growth opportunities to various industries during the 44 years of China's economic reform and opening since 1978. In the 1980s, demand for food and clothing brought about a boom in the China's food and textile industries. In the 1990s, demand for durable goods created a boom in the home appliance industries. Since the 2000s, demand for cars has led to a flourishing auto car sector. From 1978 to 1990, the food industry's total output value reached 136 billion yuan, increasing at a 9% CAGR; total output of colour TVs had increased from 3.8 thousand in 1978 to 85 million in 2007, that of refrigerators, from 28 thousand in 1978 to 44 million; by 2020, the number of registered cars in China had grown from 11 million in 2001 to 280 million (Source: Chinese government website).



2. Trend towards wellness, digital technology, and local brands

Wellness relief from too much pressure. If you have Chinese friends living in China, you may be surprised by how much they care about wellness but how “unhealthy” their work hours could be. For example, in big Chinese cities, many work from 9am to 9pm, six days a week in Internet or real-estate sectors, with five days of paid leave per year. If you ask them, why? They would answer: competition, with 1.4 billion other people. On the one hand, Chinese consumers stay up late, spending long hours in front of their screens for work and after-work leisure, and drinking alcohol for business activities and after-work fun; on the other hand, they take expensive nutrition and healthcare products to protect their eyes and livers from too much screen exposure and alcohol. Many companies are profiting from this. The stock prices of Kweichow Moutai*, a Chinese producer of premium *baijiu* (white liquor) and Chinese premium liver nutrition maker Pientzehuang Pharmaceutical* have both increased more than 10-fold in 10 years (as of 1 February 2023).

Digital technology throughout the purchase journey: Alibaba*, Tencent*, JD*, Pinduoduo*, ByteDance* (TikTok), etc. – these Chinese Internet giants have transformed consumers’ expectations, personalised campaigns, one-click payment, instant deliveries, and so on. In recent years, live e-commerce (promoted by influencers through live streaming) has become a new trend. China’s live e-commerce market size exceeded USD 300 billion in 2021. One of the top influencers, Xinba, managed to sell EUR 254 million in 12 hours on the Chinese social media platform Kuaishou*. Alibaba* and ByteDance* are also active in this new form of e-commerce. This trend has come to the US and France. Galeries Lafayette* and Printemps* have joined this Chinese digital consumption trend for occasions like Black Friday.

Favour local leading brands. A decade ago, it was fashionable to buy foreign products. Foreign brands could charge high premiums on

Chinese markets. Now local brands are winning market share. High cost-effectiveness, improving quality, tailored design, accessibility in lower-tier cities, together with Chinese consumers’ stronger cultural confidence are driving the wave of “China-chic” across a variety of sectors such as food and beverages, cosmetics, household appliances, cell phones, and electric vehicles. For example, Chinese brands had captured more than 80% local market share in home appliances and 64% in cell phones by 2022. Expansion by Chinese local brands into global markets has strengthened Chinese consumers’ confidence in these domestic players. These include leaders such as Tsingtao Brewery* (Chinese beer), Haier* (home appliances), and Xiaomi* (consumer electronics), BYD* (electric vehicles), and Florasis* (a popular cosmetic start-up), etc.

DRIVER 2: A STRONGER AND LARGER MIDDLE CLASS

No other country has seen such an annual expansion in its middle class as China. According to the latest McKinsey estimates, from 2023 to 2025 China is expected to add more than 71 million upper-middle-class families (i.e., with more than CNY 160,000 in income per year). By 2025, the upper middle class could account for 54% of total Chinese households (vs. 12% in 2015). Disposable income per person increased at CAGR of 8.1% from 2013 to 2022 (7.2% in urban areas and 8.8% in rural areas), revealing the huge potential of the Chinese consumer market.

DRIVER 3: SAVING FOR TOMORROW

Instead of “live in the moment”, what most Chinese people do, wealthy or not, is “save for tomorrow”. Covid has increased the pressure to save. According to the People’s Bank of China, China’s private deposits increased by RMB 17.84 trillion, higher than 2021 (RMB 9.9 trillion), but disposable income per capita still grew in 2022 by 5%. The high amount of savings could translate into big consumption potential. For this to happen, boosting propensity to consume is crucial.

**This does not constitute an investment recommendation.*



DRIVER 4: REOPENING

Two factors that influence Chinese' willingness to consume, social stimulus and income expectation, were both impacted by Covid in 2022, but could benefit from China's reopening and real-estate supports.

Once physical interactions recover, social stimulus could take effect, which creates desire to consume. When you see your friends buy one thing, you may want it as well. The more you have, the more you may want. A new suit needs a pair of new shoes, dining in a fine restaurant maybe calls for a new bag, or for driving there in a new car.

Chinese consumers' income expectations may have bottomed out. The unemployment rate in urban areas has decreased from 6.1% (April 2022) to 5.5% (December 2022). The fear of plummeting housing prices has gradually faded away with strong government support for real estate. Chinese stock market prices have increased by 12% in EUR terms in the past four months. Secure employment and house price stability will be the main tasks for Chinese authorities in strengthening income expectations.

CONCLUSION: OPPORTUNITIES DRIVEN BY HUGE CONSUMPTION POTENTIAL EXIST IN BOTH GROWTH AND MATURE SECTORS.

At China's last Central Economic Work Conference, three key words were specifically mentioned: housing improvements, new energy cars, and elderly services. They correspond to the long-term challenges in China's economic transition, i.e., fulfilling unmet needs for residency while controlling leverage ratios of real-estate developers; improving energy self-sufficiency; transitioning to a higher-end producer while lower-end factories move out of China; and taking care of the aging population, in order to lower saving rates. Meeting these challenges create long-term opportunities for growing businesses, such as rental housing, new energy, healthcare, pension funds, etc.

Opportunities can also be found in mature consumption sectors, such as electric two-wheelers. Leaders with strong competitive edges in mature sectors have gone through fierce competitions / price wars. They are consolidating market shares and leading the premiumisation trends in products. These domestic leaders could therefore improve their net profit margins and generate alpha for long-term investors.

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