



VICTORIA
CONSULTING LTD

PEOPLE'S REPUBLIC OF CHINA

COUNTRY REPORT

2018

About the report

In this report we addressed the research with the aim of providing an unbiased analysis of The People's Republic of China to enable potential investors to have an objective view about the country as well as to be able to make fact-based business decisions.

Methodology

The research was based on primary and secondary data gathered from different sources that were judged reliable by Victoria's research team.

The report encompasses two parts, first the macro-environmental analysis part which addresses the country's macro-environment and provides insights about the country's Political, Economic, Social, Technological, Environmental as well as Legal aspects. The second part contains a sectoral analysis that sheds light on the country's potential and risks associated with the sectors analysed.

Victoria Consulting Country Reports Committee

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Special Report Committee of the Present Edition

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About Victoria Consulting

Victoria Consulting is a fast-growing boutique consultancy firm based in Dubai International Financial Centre (Dubai, UAE) with strong network in Europe, Africa, Asia. Founded by former Deloitte and Euronext senior executives with over 60+ years of combined work experience in strategy, finance and management consulting.

We hold ourselves accountable to our value delivered standards by engaging strongly with our clients to reach high value created by our joint efforts.

In today's complex and ever-changing business environment the stakes and the risks are incredibly high. Getting the right advice matters. You need the right partner to help you identify the right strategy for your organization, and execute it with certainty, speed, and impact...

We help our clients make sustainable improvements to their performance and realize their most important goals.

Helping organizations make the changes needed to succeed is Victoria Consulting's main objective. We serve a broad mix of public, private and social sector institutions. We help our clients make noteworthy improvements to their performance and realize their most important goals.

Our guiding principles of working together are based on fundamental standards that are extremely high.

At Victoria Consulting, high value creation requires that our advice delivers insight and change in the mindset of our clients. Hence, our work leads directly to clients acting and executing their strategy in better ways. We enhance client capabilities and deliver both competitive advantage and bottom-line impact.

As committed management consultants, we want to create sustainable impact for our clients.

We leverage our strategic knowhow, industry expertise and relevant strategic networks with emerging and mature markets to provide your organization with valuable advice.

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Executive Summary

The People's Republic of China is the world's most populous country and is regarded as one of the biggest markets in terms of size. As the Chinese government encourages a shift towards a consumption driven economy, the country will remain attractive to many foreign businesses. Furthermore, Chinese consumers are going through a process of modernization, and most of them are confident that their incomes will increase significantly over the next 5 years. More than 75% of China's urban consumers will earn between 60,000 to 229,000 renminbi (US\$9,000 to US\$34,000) a year—in purchasing-power-parity terms, somewhere between the average income of Brazil and Italy. A mere 4 percent of urban Chinese households were in this range in 2000.¹

China ended its decades of old one child policy in 2016 and permitted couples to have two children as the population of elderly rose with declining numbers of young people. However, China's Population will be 65% of India's by 2050 due to 'Low Fertility Trap'.

Chinese Government aspires to achieve major progress in terms of improving education quality and fairness, and optimising allocation of resources. The government is also keen to develop education in rural and urban areas and speed up the development of modern vocational education.

¹ The Modernization of the Chinese Consumer, Mckinsey and Company, 2016.

China is a global digital leader with around 700 million internet users and 282 million digital natives (internet users less than 25 years old) eager to adopt new technology.

China's economy continues to perform strongly—with GDP growth projected at 6.6% for 2018. Four decades of reform have transformed China from one of the poorest countries in the world to the second largest economy.² China's strong GDP growth continues with the country now accounting for one-third of global growth. Over 800 million people have been lifted out of poverty and the country has achieved upper middle-income status. China's per capita GDP continues to converge with that of the United States, albeit at a more moderate pace in the last few years.

China began its path on gradual reforms and opening up four decades ago in 1978 under the leadership of Deng Xiaoping as it slowly transitioned to a socialist market economy from a centrally planned system. The policies undertaken by the government have resulted in rapid economic performance over the past 40 years and have transformed the economy to become the second largest in the world. The administration led by President Xi Jinping will continue on the path of reforms and liberalisation over the coming years. There is an effort to ensure that China continues on its path of economic development and moves towards the Communist Party of China (CPC)'s aims of doubling GDP per capita by 2020 from 2010's CNY30,876 (\$4,561) and turning the country into a leading power by 2050.³

China now focuses on high-quality growth. China is at a historic juncture. After decades of high-speed growth, the government is now focusing on high-quality growth. Even with a gradual slowdown in growth, China could become the world's largest economy by 2030.

The trade war that erupted between the United States and China carries a major risk of escalation that could weaken investment, depress spending, unsettle financial markets and slow the global economy.

The ultimate source of political power in China has always been the Communist Party since the founding of the People's Republic of China (PRC) in 1949.

Xi Jinping's government is strengthening policies to tackle corruption and bolster bureaucratic reforms, which have yielded efficiency gains for some of the procedures required to open a new business. China has also bolstered its contract enforcement capabilities and can therefore offer increased protection to investors involved in contractual disputes. However, corruption, lack of judicial independence and curtailments of civil liberties combine to give China a relatively moderate investment risk profile.

China has become a global leader in policy and diplomacy on limiting the effects of climate change, but still needs to take significant steps to curb its own carbon dioxide emissions. Unprecedented growth has led to record levels of pollution in China's air, water and soil. Also,

² IMF Country Focus, 2018.

³ China's Reforms 40 Years On, What's Next? BMI, Fitch, 2018.

China's falling food supply sufficiency and the release of pollution survey data have helped spur rising concerns about pollution among policymakers and the wider population.

The country is arguably the world's most important manufacturer and industrial producer. Those two sectors alone account for more than 40% of China's gross domestic product. China is also the world's largest exporter, the second largest importer, and the fastest-growing consumer market. Major industries include manufacturing and services.

Manufacturing dominates the Chinese economy. The country is widely recognised as a global manufacturing hub, producing goods such as computers, automobiles and technology components for well-known multinational companies such as Apple, Honda and IBM. Manufacturing sector value in gross value added (GVA) terms stood at an estimated \$4.6 trillion in 2017.

Beijing's 'Made in China 2025' campaign encourages manufacturers to move up the value chain and produce more advanced technology, rather than cheap and imitated merchandise. The tertiary sector remains the largest in terms of output, with GVA forecast at approximately \$6.5 trillion in 2018, reflecting a rise in service demand and presenting growth opportunities in consumer-related fields. Activities such as mining represent a smaller share of output, with primary sector GVA forecast at \$1.7trn in 2018, growing at a much slower pace than the tertiary sector, which demonstrates China's structural shift toward a consumer and service-driven economy.⁴

Real estate has been a key engine of China's rapid growth in the past decades. Bank lending to the sector makes up 25% of total bank loans and about half of all new loans in 2016. After a temporary slowdown in 2014-2015 China's real estate market rebounded sharply in 2016. As signs of overheating emerged, the government turned to tighten real estate markets through a range of macro-prudential and administrative measures.

In the past couple of years, Retail was a bright spot and grew 10.4% in 2016.⁵ This trend will continue, with retail sales growth expected to contribute more than 70% of the country's economic growth in the next coming years.

Retail sales continue to post robust growth on a monthly basis, growing by 9.4% y-o-y in April 2018, according to China's National Bureau of Statistics of China (NBS). Retail sales have picked up considerably in 2018 after plateauing over most of 2017. This is a trend that could be attributed to the Chinese government implementing cuts in import tariffs on 187 consumer goods from an average rate of 17.3% to 7.7% in December 2017 in an effort to stimulate domestic spending.

The Chinese IT market is set for healthy growth in 2018 and over the next coming years. A number of factors will drive positive spending in the IT market and these will include nationwide initiatives to speed up technological uptake, expansion of various industries and economic

⁴ China Trade and Investment Risk Report, 2018, Fitch Solutions.

⁵ The 2017 Global Retail Development Index™, AT Kearney.

verticals under the 13th Five-Year Plan (2016-2020) and the growing IT software and services bills of the enterprise market. Enterprise computer adoption rates remain low in the country and there is a significant scope for growth. Furthermore, the sheer size of the country and rising levels of private and government consumption will support IT spending across all major segments. Cloud computing and the Internet of Things (IoT) are key to market expansion over the medium term due to their immense potential for industrial application.⁶

⁶ China Information Technology, BMI, 2018.