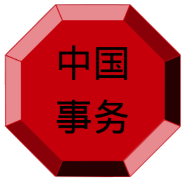


China
Matters

China 2020: Powering the next growth wave

Keynote Address by Alistair Nicholas to the AsiaLink Business and CPA Australia Forum, Sydney (and national webcast) 29 November 2019

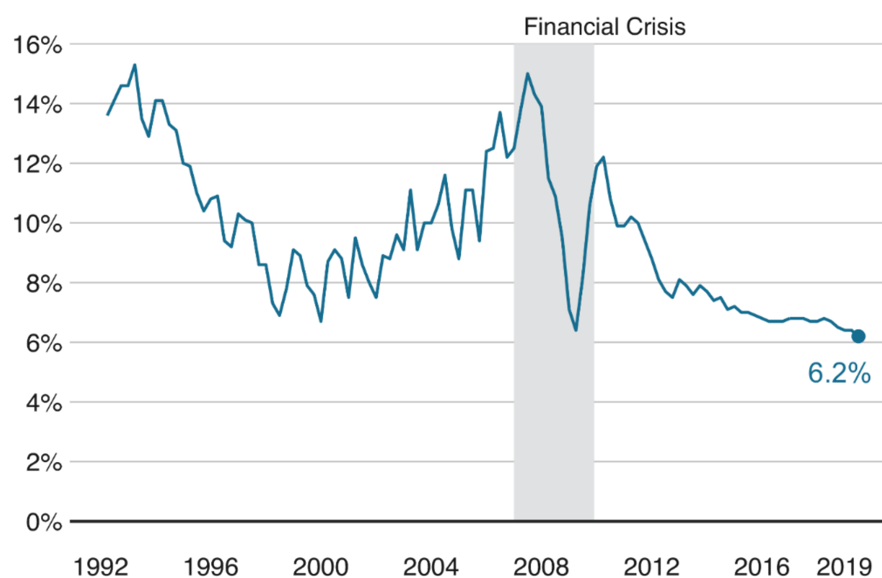
Alistair Nicholas

Introduction

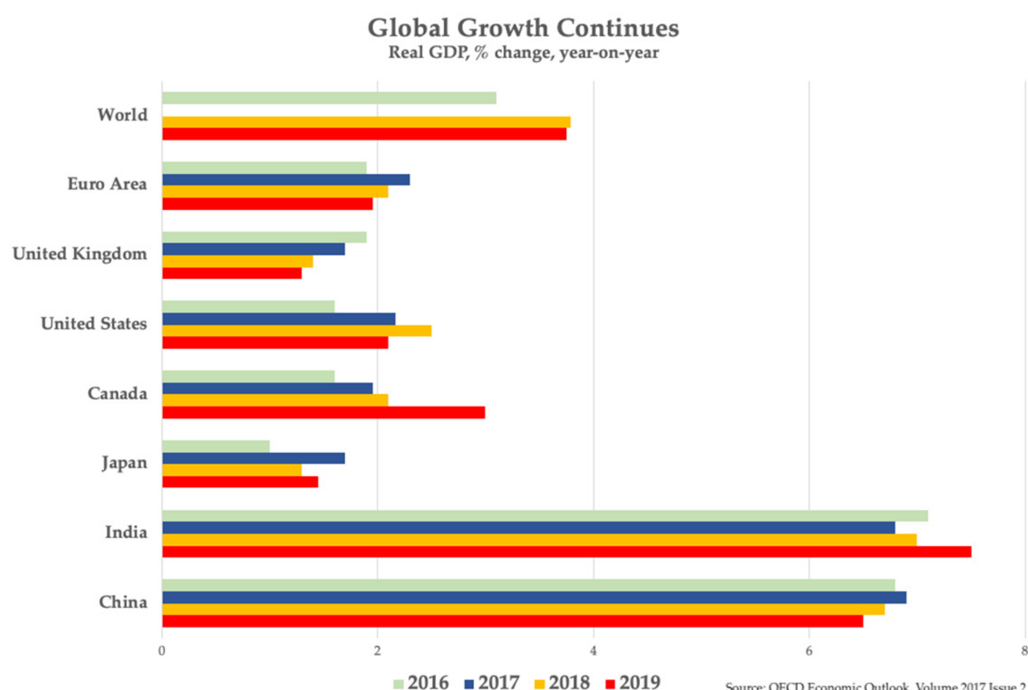
Thank you to AsiaLink Business and CPA Australia for the invitation for me to speak here today. And thank you David for that kind introduction.

A Brief Economic History of Contemporary China

My interest in China started almost 30 years ago, not too long after Deng Xiaoping opened up the People's Republic of China (PRC) and commenced the liberalisation of its economy. From my earliest engagement with the PRC I could see it was going to be a major world economy one day and therefore a major trading partner for Australia. I should point out, not because of any special gifts or insights of my own, but because of what people far smarter than I were saying at the time.



But for the Global Financial Crisis of 2008-09 the PRC might have maintained its high economic growth for longer. Beijing's powerful fiscal stimulus saw it recover in 2010-11, something that not only helped China avoid an economic hard landing (and growth of less than 7.5% at the time would have been tantamount to a recession for Beijing), but that stimulus package also helped Australia dodge a recession. Ongoing demand for iron ore and coal in China proved a saviour for our own economy. Indeed, PRC demand for our resources kept our economy in good shape relative to much of the rest of the world.



But apart from that brief period of economic stimulus following the GFC, China has not been able to sustain its hitherto high growth rates. In fact, its rate of economic growth has been consistently falling since 2011-12, and it is no longer the world's fastest growing economy. Last year, India grew faster than the PRC, and is expected to do the same again this year; in fact the rate of growth gap between China and India is an ever widening one.

What's going on and what does it mean for Australia in 2020 and beyond?

Stay calm, there's a plan

PRC state media has for the past two years often decried global concerns about China's slowdown as "overblown" and have called on the international community to stay upbeat about the PRC economy.

But Australia and the rest of the world continue to fear that the PRC is in for an economic hard landing in 2020. In August China Matters published a policy brief on that subject entitled "What should Australia do about A PRC economic 'hard landing'?" It was written by PwC's chief economist Jeremy Thorpe. You can download a copy from our website should you be interested.

The main reason I'm not going to linger on the question of whether China is in for a hard landing or not is because I don't think it is. The graph you are looking at suggests we are seeing a controlled and planned slowdown of the PRC economy. That slowdown has been taking place since 2014 and appears to have been well managed by Beijing. Most observers anticipate the PRC's economic growth will come in at around 5.3 per cent this year and 5.1 per cent next year.

A second reason I don't think the PRC will experience an economic hard landing in 2020, even given a number of external shocks that could impact it, like the US-China trade conflict or a slowing of the US and other global economies, is that Beijing will intervene and pull the necessary levers if and when it should, just as it did at the time of the GFC.

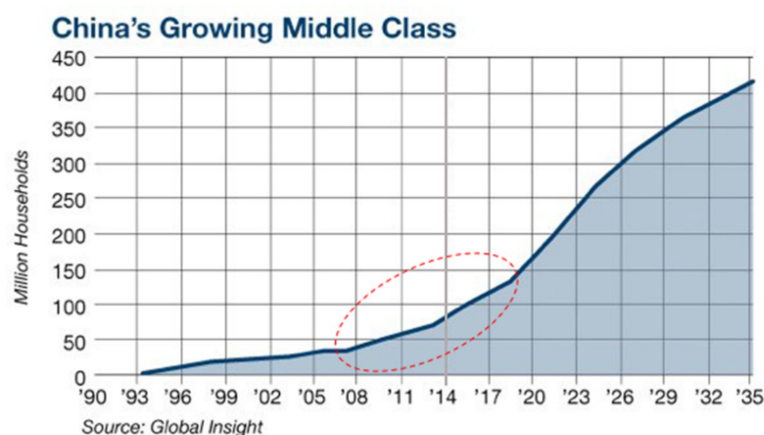
It should be noted that, should the PRC pull the fiscal stimulus lever, the Australian mining sector would be a major beneficiary just as it was when Beijing pulled that lever during the GFC. Other levers Beijing could pull include tax cuts to stimulate spending and possibly easing of some of the current restrictions on the shadow banking sector, which would stimulate private sector investment.

Rather than heading towards a hard landing, the PRC's leadership looks to be engineering a slowdown to achieve sustainable economic growth as it struggles with an ageing population and the need to shift from manufacturing and export-driven growth to a services economy driven by domestic consumption. There is an expectation that a slowing of the economy will put in place the rigour to drive efficiencies, productivity improvements and competitiveness across the economy.

Even if the PRC economy dips to 5.1 per cent growth next year, that level of growth would add nearly $700 billion to the size of its economy. To put that in context, it would be tantamount to adding a country the size of Switzerland's economy to its own, or roughly half the size of the Australian economy to its own. That is significant growth any way you want to look at it.

My kind of middle income trap

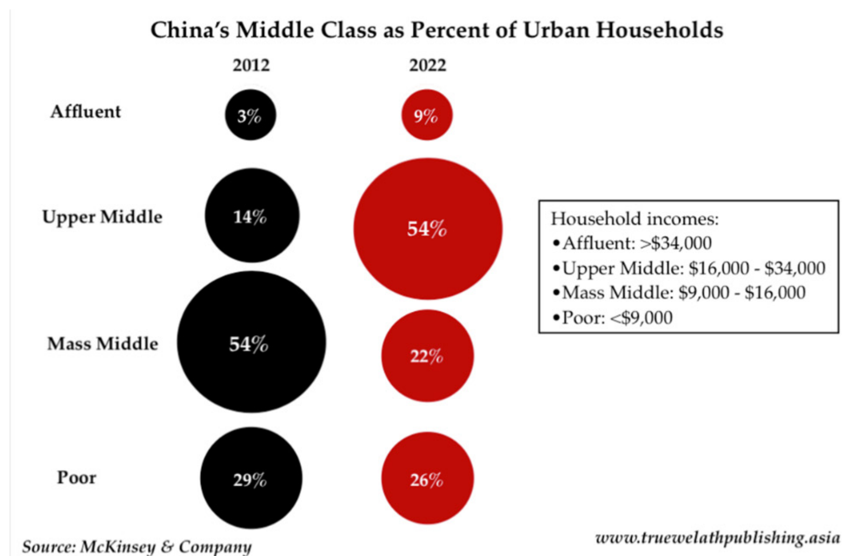
It is especially significant if you think about where the opportunities lie for Australia in that growth. Much of the opportunities will be found in the growing PRC middle classes.



We often hear that 850 million people have been lifted out of poverty in China since Deng Xiaoping's economic reforms were introduced in 1980. Lifting that many people out of poverty – we are talking about abject poverty of getting by on less than US$2 per day - was a phenomenal achievement.

Something just as extraordinary has been happening since 2014, if you look at the graph. Thanks to China's economic reforms and the high growth rates posted over nearly 30 years, a phenomenal number of PRC citizens have been entering the ranks of the country's middle classes, defined as having household incomes of more than US$20,000 per annum. The graph you're looking at shows

you that by 2020 some 150 million households (households, not people) will be in that category. And it is estimated this will reach 400 million households by 2035.



This McKinsey & Co graph shows the projected migration from "poor" through "mass middle", "upper middle" and on to "affluent" from 2012 to 2022.

Like middle classes everywhere, mainland Chinese spend their disposable income on data communications (mobile phones and other devices), education, travel, and health and well-being. Let's break down what that means for Australia.

As you know we do not make and sell mobile phones and other communication devices to China. But we certainly benefit from what PRC citizens are using those devices for, namely online shopping. To take one example, Alibaba's Double 11 sales day has been seeing phenomenal year-on-year growth. Even amidst concerns of a slowing PRC economy, this year's Double 11 sales on the platform were up 26% on last year, amounting to AUD$56 billion. Australian retailer Chemist Warehouse, which operates the biggest cross-border store on Alibaba's Tmall Global platform, made more than AUD$20 million in just three hours and fifteen minutes during this year's Double 11 day. And Australian brands did very well in 10 key categories:

1. Dietary food supplement
2. Infant nutrition
3. Adult milk powder
4. Maternal nutrition
5. Infant formula

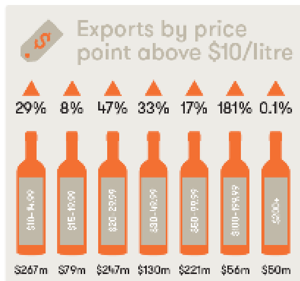
6. Facial masks
7. Wine
8. Emulsions and lotions
9. Facial care sets
10. Eye care

China's shopping malls may look like ghost towns, but online sales and e-commerce are booming. The number of Chinese shopping online is fast approaching one billion people.

Nearly 5 years ago, if you attempted to pay by credit card in a restaurant, the proprietors would look at you sideways. Today, if you go anywhere in the PRC without a mobile payment method, you won't be served. Even beggars in the streets of Beijing and Shanghai will show you their QR codes for electronic funds transfer.

The importance of e-commerce platforms, such as Alipay and WeChat for making payments is something Australians will increasingly need to come to terms with. Whether you are selling your products online to China or visiting on business or for tourism you will need to be able to pay via a mobile app. If you sell souvenirs in the tourist districts of Sydney or Melbourne or run a restaurant attracting PRC tourists in Australia you will need to be able to take payments via these apps. I was pleasantly surprised to find out recently that the dealership I bought my motorcycle at was able to take payment via China Unionpay – the reason: they rent motorcycles to many Chinese adventure tourists who come here to tour Australia on Harley Davidson and Royal Enfield bikes.

Wine Australia
Export report
1 Oct 2018 to 30 Sep 2019



Value of exports to the top 10 markets

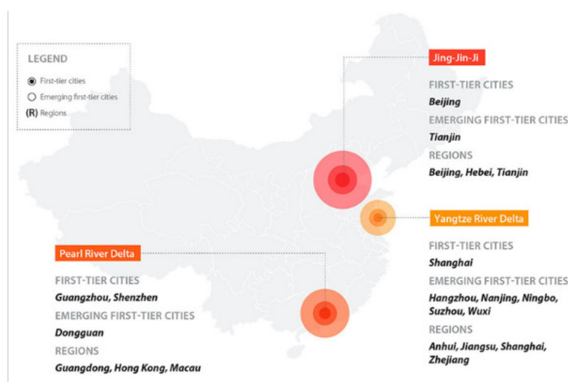
Market	Value	Change
China Inc. HK and Macau	$1.2b	▲ 18%
United States	$436m	▲ 3%
United Kingdom	$365m	▼ -4%
Canada	$188m	▼ -6%
New Zealand	$94m	▲ 1%
Singapore	$91m	▲ 1%
Japan	$51m	▼ -7%
Germany	$49m	▼ -12%
Netherlands	$44m	▲ 17%
Malaysia	$36m	▲ 1%

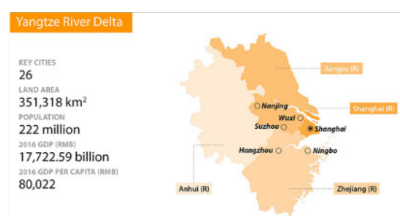
Volume of exports to the top 10 markets (9L cases)

Market	Volume	Change
United Kingdom	25.8m	▼ -2%
China Inc. HK and Macau	16.4m	▼ -16%
United States	16.3m	▼ -9%
Canada	6.7m	▼ -15%
Germany	3.6m	▼ -13%
New Zealand	3.6m	▼ -1%
Netherlands	2.1m	▲ 1%
Japan	1.9m	▲ 2%
Denmark	1.5m	▲ 20%
Belgium	1.1m	▲ 5%

The fact is we do well and will continue to do well across the board of items middle class PRC citizens like to spend their discretionary incomes on. The FTA has helped with that – consider for example that China is today our largest market for wine exports, more than double the size of the second largest market, the US, with sales topping AUD$1 billion per annum. Growth of exports in the product categories that appeal to China's middle classes and affluent will continue to rise in line with the increasing size of its middle classes.

Super size me, now



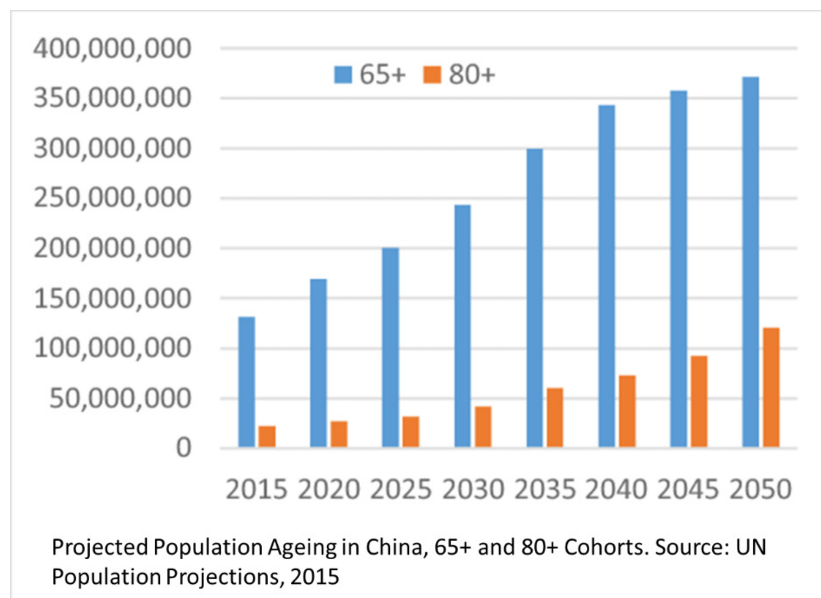


China's super regions and city clusters have emerged as a necessity of a growing population that would otherwise suffer from urbanisation, congestion and burgeoning cities. The most famous three clusters are the Yangtze River Delta, the Pearl River Delta and now the Jing-Jin-Ji region. The Yangtze River Delta region alone is said to account for approximately 40% of China's GDP.

The rationale behind these super regions and mega-cities however is not just about accommodating and housing the PRC's increasing urban population, but about shifting China's growth strategies. As I mentioned earlier, Beijing is seeking to shift its focus away from export and investment led growth, to consumption-led growth. These hubs then present opportunities for growth in two different ways —first, in the infrastructure necessary to build and sustain these clusters; and second, the range of services that will need to be provided in these mega-tropolises.

The investments in public infrastructure in these city clusters will mean rising demand for iron ore, coal and other resources Australia supplies to China. We could be on the cusp of the next mining boom.

Silver Linings



Projected Population Ageing in China, 65+ and 80+ Cohorts. Source: UN Population Projections, 2015

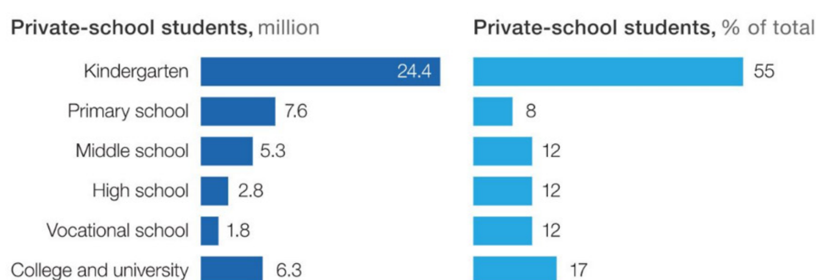
On top of that, these mega-regions and city clusters will need services like any metropolitan hub. But in an environment where the population is ageing, and the legacy of the one-child policy persists, aged care services and the construction of aged care infrastructure will be paramount. Just consider that by 2050, the PRC's aged population will equal the population of the US. And more than 100 million people will be aged 80 or more, and probably in need of high levels of care.

Australia is well positioned to take advantage of these opportunities. Companies like Lendlease have announced this year their intention to capitalise on the ageing affluent market in the Yangtze River Delta, committing $400 million to the construction of retirement villages in the region. And, ProvectusCare has announced the establishment of several of its own retirement villages in mainland China in the past few years.

In other services, Australia can benefit greatly from providing some of our expertise in the broader healthcare services industries. For example, every year, 4 million people in Mainland China are diagnosed with cancer. LEK Consulting predicts that the PRC’s healthcare expenditure will increase threefold, amounting to $US2.2 trillion by 2030. Australian companies with leading cancer therapies, like GenesisCare (a partner of China Matters), are well placed to assist China with its growing needs in this area.

There are of course other opportunities emerging for Australia as more Chinese enter the ranks of the nation’s middle classes, and as the super regions grow.

More Chinese families are paying for private education for their children.



Source: McKinsey 2018 Consumer Report; Ministry of Education of the People’s Republic of China

McKinsey&Company

The graph you are looking at shows growing Chinese spending on private education – and not just at the tertiary levels, but all the way down to even kindergarten. To give some context, private kindergarten fees in mainland China currently range from AUD$150 per month to about AUD$4,000 per month.

As we all know, the Australian higher education sector has been doing well in terms of exports to the PRC. But, one opportunity we have perhaps missed is that of providing sought-after Australian education services in-country. Consider that the University of Nottingham established a campus in Ningbo in 2004. It has since been joined by UC Berkeley, Duke University, NYU and the University of

Michigan. These provide access to sought after foreign education and internationally recognised degrees without students having to leave China. Could there be opportunities for Australian higher education providers, including providers of student accommodation, to establish operations in the PRC's emerging super regions and cluster cities?

Follow the Yellow Brick Road

Finally, I'd like to look at two aspects of the Belt and Road Initiative. Let me start by saying what many businesspeople think, namely, that Australia should sign up to the BRI. Canberra's rationale for not signing an MOU which focuses on BRI projects in Australia is three-fold:

1. That the PRC could use its economic power through a BRI agreement to achieve its geopolitical objectives;
2. The benefits of signing up are not immediately tangible;
3. Concerns about lack of governance and transparency of specific projects and the fact that the PRC, as the larger partner in any project, could exert considerable control.

The problem with Canberra's assessment is that it overlooks the fact that China, as our largest trading partner, already is the more powerful partner in our relationship. If the PRC wants to use its economic power to achieve its geopolitical objectives in relation to Australia, it doesn't need an MOU on the BRI to do so.

To be sure, our current relationship with the PRC is becoming ever more complex. We have growing concerns over the treatment of Uyghurs in Xinjiang, and allegations of PRC espionage activities in Australia to subvert our democratic processes. While human rights and our sovereignty need to be defended vigorously, it is naïve to think that not signing an MOU on the BRI would influence better outcomes on either of these. Nor would signing an MOU make these matters any the worse.

We are going to have to continue to trade with the PRC and deal with Beijing on these tough issues. That, after all, is what diplomacy is.

The real benefits of signing an MOU with Beijing for BRI projects in Australia would be to give face to Beijing on a matter of great economic importance to it. And that could relieve some of the tension currently present in our relationship with the PRC. It might even open the door for real conversations on some of the tough issues we do need to discuss with Beijing.

Going beyond that and looking at the BRI in third markets, considerable opportunities are likely to emerge for Australia. Let there be no mistake, the BRI is part of the PRC's economic strategy to diversify both its markets and its sources of raw materials. It is about growing its exports, about "outsourcing" dirty manufacturing industries, and about ensuring it is not dependent on security of supplies from food to energy on any single market.

For Australia BRI contains both risks and opportunities. We will need to mitigate the risks and maximise the opportunities. At least we have signed an MOU with Beijing to cooperate on BRI projects in third countries. But I think we could go further. For example, by creating a role of Austrade Trade Commissioner for the Belt and Roads Initiative. I believe this Mandarin-speaking Trade Commissioner should be based in Beijing with the specific task of targeting SOE's for Australian exports into BRI projects in third countries. The opportunities range from food and supplies to SOEs working on projects, to high-end medical services, through to supply of raw materials for projects or to industries being established to support projects in BRI third countries. There is likely considerable detail to be assessed in such an idea, but I hope it is one "out of the box" idea the Government would entertain to support Australian businesses in capturing the opportunities that will emerge from the BRI.

Conclusion

I did my hard yards in China over 13 years, including running my own business for seven of those years, and advising numerous foreign investors on issues in the market. Therefore, I'd be the last person to advise a new-to-exporting business to dip their toe into the China market. But if you have cut your teeth in other export markets and you have a product that will meet a market demand in China, particularly in food, health and well-being, education, and aged care, there's no better time to dive in, even as the PRC's growth is slowing. Do the math – 5% GDP growth is pretty good. Where else are you going to find a country the size of Switzerland every year to export to? And we already have an FTA with the PRC.

This speech was delivered by China Matters CEO Alistair Nicholas as the keynote address to the AsiaLink Business and CPA Australia Forum in Sydney and as a webcast on 29 November 29.