

China – Part One: Economic Insights

Recently as part of my MBA programme here in Manchester I got the opportunity to travel to China to experience the culture, receive lectures from some leading universities, as well as visit some interesting local companies that are aiming to make a name in a more globalised economy. This is the first part of a number of articles I shall be writing about these experiences and my subsequent thoughts on a very interesting but complex country that is becoming increasingly connected to Western markets and therefore businesses.

1949

At first glance this might seem to be an arbitrary year, but four years after the end of World War II was important in many ways and in hindsight, some significant events of this year still affect and shape the world we live in today. To name but some of these events, NATO was ratified, the federal republic of Germany was officially founded, and Winston Churchill made a landmark speech to lend his weight behind the concept of a European Union, while at the same time South Africa embarked on a period of apartheid. On a lighter note, BBC radio started broadcasting for the first time and probably covered the fact that the Old Trafford Stadium was finally open to host football after being bombed in the war, and Don Bradman had played his last ever innings in cricket. One event though has impacted, and in all likelihood will continue to impact, global trade and the wider economy in the years ahead. On the 1st of October 1949 Chairman Mao Zedong proclaimed the People's Republic of China.

As part of my Executive MBA, which I completed here in Manchester, I recently had the opportunity to travel to China to see first-hand how the country has evolved over the last 60 years, and how local people and companies are addressing some of the challenges that they face in the future. If you want to question the esteem in which Mao is held, especially within the elderly population, you only have to travel to Tiananmen Square in Beijing. There is an endless stream of people silently shuffling past his glass coffin housed within the mausoleum built for him in the middle of the square in 1977, eager to get just the briefest glimpse of their hero. There is an eerie serenity to the experience but it is difficult to shake the feeling that despite this grandeur and steady flow of entranced people, something is not quite right. As you exit the memorial building this sense of unease is justified as the throng of people amassing in the square are punctuated with uniformed guards, police, and army men stood like statues scanning the crowds with fire extinguishers at the ready.

Growth

This scene is indicative of wider aspects of China and how it relates to the West, and importantly what it means for investors and companies who would like to benefit from the reported growth rates which are eye watering in many aspects. To put this into context, in 1949 the UK had an estimated population of 50 million people compared to China's 540 million, while these respective figures are currently in the region of 60 million and 1.3 billion. It is not only the growth and corresponding size of the local markets that are distinguishing factors here, but there is a huge population of what savvy Chinese businesses are classing 'the mass affluent'. This branding has been coined by recent local research in China which suggests that

there are currently over 15 million individuals in China who have between \$100,000 and \$1m of savings to invest in equity markets or more adventurous P2P investment schemes. As politicians and influential businessmen comment on the importance of China in a new global economy, for the individual investor or SME business, there is often a sense of uncertainty with respect to what this means to you. Understanding the driver for this growth as well as the economic challenges that lie ahead for China is important as the Chinese government actively courts foreign direct investment with promises of sweeping structural economic reforms.

Economic Change

Fundamentally China is going through some seismic changes as it aims to alter its economic engines in the years ahead. Asian markets are becoming ever more important, and open, to Western investors, something evidenced by Vanguard's recent decision to invest in Chinese A-Shares with its flagship emerging market fund and the MSCI's consideration of including these local shares as part of their global benchmark. The risks associated with this has been highlighted over the last few weeks as Chinese markets have collapsed before further intervention from the government in Beijing has resulted in some sort of a recovery, but how stable this is remains to be seen. Further to this market level view there are some important economic differentiators that need to be considered as investors weigh up the implications of these decisions. Currently domestic consumption only accounts for around 50% of GDP in China compared to 70-80% of the rest of the World, meaning that much of the contribution to growth in China is due to government spending such as the ¥4 trillion (\$586 billion) stimulus packages launched in 2008. There are also continuing concerns about transparency, liquidity, and ownership rights that transcend everything from day-to-day business to equity markets. Overall the common perception is that China is an imitation economy heavily reliant on exports of its cheap and broad network of products, but speaking to academics in China there is a concerted effort by the national government to alter this. In order to do this they are turning to some familiar Western ideas.

East Meets West - Entrepreneurism

In 2005 net exports accounted for almost 25% of the GDP of China, that figure is now in the low single figure region. The government is still desperate to get the general consumer and that 'mass affluent' to contribute more to the economy in the years ahead, and they propose to do this in two ways. The first of this is to encourage a whole new population of creative and innovative entrepreneurs, and these new economic drivers have been given the mandate to develop a quality and efficiency based production and manufacturing economy. This headline might have been drawn from the introduction of an east coast of North America business manual, but how this translates into a culture where people are used to being watched at every turn and the concept of intellectual property is still just that, a concept, this might be a bumpy ride. However there is no lack of conviction or hard work, and with a track record of making things happen, it would be difficult to bet against them.

Central to this reform are a series of incubation zones. You could be forgiven for thinking that this refers to some 'X-files' quarantined area where alien life forms are being developed for world dominance. I suppose in some ways they are, as this is a very different atmosphere to what has been described to me elsewhere in China. When you travel into the incubation zone in central Beijing you are confronted with a series of coffee shops, not dissimilar to central Manchester, but upon further investigation they are filled with young tech-savvy people all furiously tapping away on their laptops and smartphones desperately

trying to establish their fledgling online business. Of course, nearly all of this is state sponsored and in all likelihood state owned, but the project life cycles are short. Six months and then you are on your own if you haven't been able to secure private investment. As you walk around the various rooms and shops there are constant reminders of the rewards on offer for the successful few as Apple, Amazon, and Alibaba as well as other case studies are decoratively displayed nearly everywhere you look. These are the highlights but provide sufficient inspiration to fuel a willing new population of Chinese entrepreneur.

Social Reforms

Along with this rhetoric about the 'internet of things' or 'internet plus', it is also suggested by government academics that there is a new willingness to address the public sector and welfare issues that cause such widespread derision. With much of what is on evidence, it is difficult to confirm whether this is anything more than lip service, but it is hard to argue that the Chinese government is not aware of the scale of the problems that faces their economy and the consequences should they get the reformations wrong. Top of their current agenda are tax and fee reforms for SMEs, a lighter touch approach to price controls, as well as the development of a multi-tiered capital market through the liberalisation of interest and exchange rates. The recent adoption of the Asian Infrastructure Investment Bank by 57 countries, including the UK as a founding member, shows the appetite of Western governments, America not included, to hop skip and jump east along the 'Silk Road' in order to access a market that many economists and businessmen believe to be vital for the future growth of an increasingly interconnected global economy.

Summary

Given all this the question still remains, in a new low yield slow growth environment, how much clarity and understanding of some complex cultural and structural dislocations are we willing to forgo in the hunt to seek out greater returns for our future savings? The last 66 years has proven that China has the ability to move very fast in comparison to the typically slow bureaucratic systems of Western governments, and the aim in China is to cut this red tape even further. The impact these reforms will have on the Chinese economy is hard to judge, especially as there are growing social inter-generational tensions that could alter these intended political and economic outcomes. What is important though, is that as the outcomes from these reforms take effect and global economies and capital markets become even more entwined, the consequences here in the UK become more real. How the 'mass affluent' in China decided to spend their savings will in all likelihood impact you whether you live in London, Liverpool, or anywhere in between.

In future articles, I will be looking at the demographic challenges in China and how this is affecting policies, businesses and the economy at large. Together with this I will be reviewing three companies that I visited who might not be household names in the UK, but they are in China. I found listening to how these companies are attempting to become competitive in a global market interesting and there are some important considerations, especially in the light of recent stock market turmoil in China.

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