



A cornerstone of China's 12th Five-Year Plan (5YP) is the goal to increase domestic consumption.

Five-Year Plan themes influencing consumer markets:

- Increase domestic consumption
- Stabilise prices
- Reduce wealth disparity

Consumer Markets: Spending is encouraged

- China's National People's Congress approved a new national economic and social development strategy for the next five years (2011 to 2015) in March 2011.
- Boosting domestic consumption is a key theme in the Five-Year Plan and is likely to improve the outlook for consumer markets.
- The government is employing different economic tools to orchestrate higher consumer spending. These tools to spur domestic demand include:
 - Improving the social welfare network
 - Boosting wages
 - Creating new jobs
 - Promoting urbanisation and supporting affordable housing
 - Adjusting taxes
 - Increasing consumer goods imports.

Income targets

- Disposable income of urban residents: increase over 7% per year
- Net income of rural residents: increase over 7% per year

Economic targets that will impact consumption

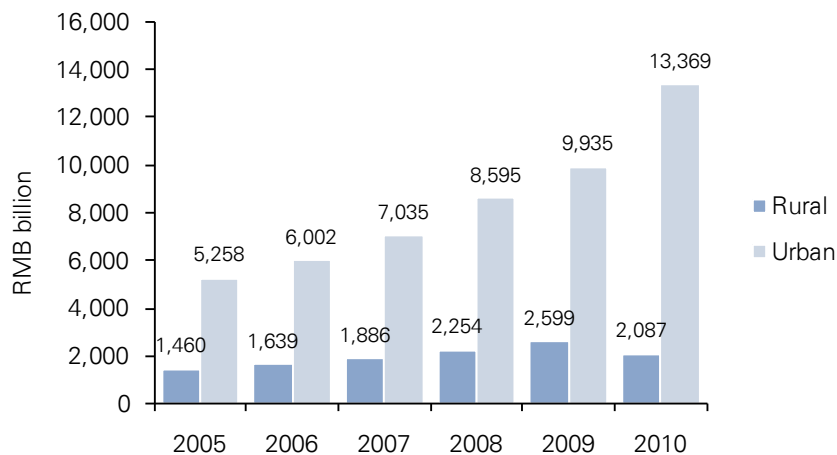
- Annual GDP growth: 7%
- Increase urbanisation from 47.5% to 51.5%
- Hold inflation (CPI) at or below 4% per year
- Create 45 million new urban jobs

Social welfare targets: indirect effect on consumer markets

- Housing target: build 36 million units of low-income housing
- Urban pension target: 357 million people covered
- Health insurance target: 70% payment of medical bills

Source: China 12th Five-Year Plan

Retail sales of consumer goods (RMB billion)



Source: China National Bureau of Statistics (<http://www.stats.gov.cn/tjsj/>)

Consumption overview

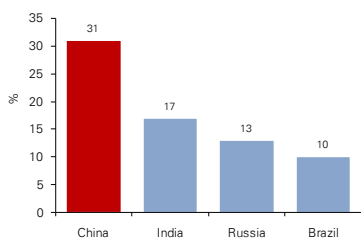
- Domestic consumption as a percentage of GDP fell to 36 percent in 2009, compared to about 45 percent a decade earlier. China's 5YP aims to change this GDP structure by increasing domestic consumption and relying less on low-end manufacturing.
- Social safety nets play a key role in raising consumption. If the government upgrades the provision of pension, health insurance, public education, and affordable housing, citizens will have more money available to buy consumer goods and other items.
- In the 5YP, China aims to increase the income level of its citizens
 - Disposable income of urban residents: increase over 7 percent annually
 - Net income of rural residents: increase over 7 percent annually.

Market forecasts

- Market forecasts are broadly consistent with China's ambitious plan to increase both overall income levels and private consumption.
- According to Credit Suisse, China's household income is expected to rise to RMB 55.8 trillion in 2015, up from RMB 24.2 trillion in 2010.
- Tracking the pattern of rising income, retail sales in China are predicted to more than double to RMB 40.5 trillion in 2015, up from RMB 15.4 trillion in 2010.⁽¹⁾⁽²⁾



Savings rate in various countries (%)



Source: Credit Suisse China Consumer Survey 2011

Disposable income: social welfare measures

- Many believe China's relatively high savings rate (31 percent of household income) is linked to the absence of a social safety net: concerns over health insurance and pension means that Chinese citizens feel the need to save money in the event of future health issues or retirement.^(a)
- In the 12th 5YP, the government intends to boost social welfare spending and thereby reduce Chinese citizens' need to save; this "freed up" money would presumably be injected into the economy as consumer spending.
- To address skyrocketing property prices, the government plans to build 36 million homes for low-income households.
- National medical insurance will cover up to 70 percent of medical bills, reducing citizens' out-of-pocket expenses.
- A pension scheme under the 5YP will enable more comfortable retirement for Chinese citizens
 - Urban pension: China aims to have 357 million people covered by urban pensions, up from 257 million in 2010
 - Rural pension: all rural residents will be covered.

Disposable income: Boosting after-tax income

- In addition to reducing the need for citizens to save, the government will also more directly increase after-tax income during the 5YP.
- An important step is increasing minimum wages, which will increase by more than 13 percent per year under the plan.
- Another measure is raising the personal income tax threshold: no specific number was released in the 5YP, but industry analysts believe the tax threshold is likely to rise from RMB 2,000 to RMB 3,000.⁽³⁾
- Job creation: 45 million new urban jobs will be created, increasing aggregate spending power.
- The 5YP has set a target to keep unemployment below 5 percent.
- Promote urbanisation: rural workers migrating to cities will generally enjoy higher income levels (but gains may be offset to some extent by higher expenses). The 5YP target aims to increase urbanisation by 4 percentage points from 47.5 percent to 51.5 percent.



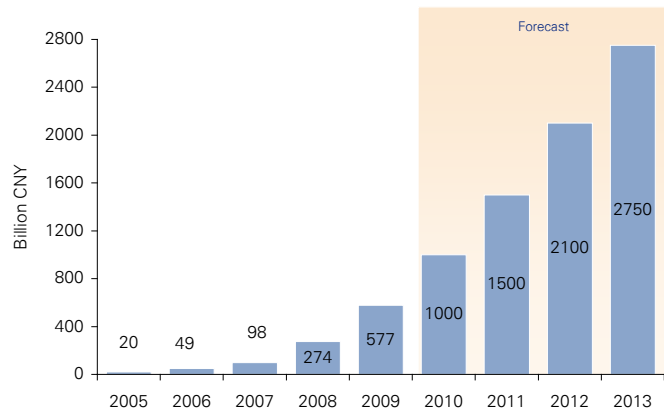
Note: Some observers point out that China's gender imbalance is another factor behind China's high savings rate, since families with male children save money to increase the odds of finding a wife



Trends and the 5YP

- Some emerging trends may gain additional momentum through support in the 5YP. Although consumer sectors are not identified among the seven priority industries in the 5YP, the plan's strong consumption focus and the status of next-generation IT as a priority industry are likely to create a favorable environment for the consumer areas below:
 - Group-buying: China's group-buying market, which leverages the internet, is expected to rise sharply from RMB 8.86 billion in 2010 to RMB 24 billion in 2011 (nearly triple).⁽⁴⁾
 - Online shopping: the online shopping format is expected to have increasing traction. B2C logistics (e.g. – express delivery) could benefit from online shopping trends, although importing strategies of "brick and mortar" retailers.
 - Mobile shopping: mobile online shopping is gaining popularity. This shopping format may see greater acceptance in line with continued improvements in China's network and mobile technology.
 - Online payment market: Non-financial companies such as Alipay, Tenpay, and YeePAY offer online payment services. This growing area, at the intersection of e-commerce and banking, will benefit from the expected continued rise in online shopping.

Online transaction volume, China (2005-2013)



Source: iResearch

- The 5YP could also influence demographic trends, and hence buying patterns in some consumer segments:
 - Mainland China's elderly population is projected to reach 200 million people, or 15 percent of the total, by the end of 2015
 - The government's 5YP target to increase average life expectancy by one year (to 74.5 years) will add strength to the elderly segment ("grey yuan" buying).

Which priority industries affect consumer markets?

Priority Industries

Energy conservation and environmental protection

- China's emphasis on environmental protection may affect distribution logistics that support consumer markets
- More environmentally friendly packaging might be introduced

New IT

- E-commerce may benefit from the government's focus on next-generation IT

Sector Leader

Ellen Jin

Partner in Charge, Consumer Markets

ellen.jin@kpmg.com



Business opportunities

- Greater spending power is likely to spark interest in higher-end goods, which might benefit foreign players.
- Chinese are most willing to trade up in two categories of consumer goods: (1) baby products and (2) consumer electronics.⁽⁵⁾ These categories are potential opportunities for companies targeting more prosperous consumers.
- Higher import levels will generally be favorable to foreign players (the government has stated its intention to "increase consumer goods imports in a proper manner") but the details are currently under discussion.
- In light of the government's goal to develop western and central regions, a stronger customer base could emerge in these areas.
- Wealthier Chinese customers outside of large cities also represent an opportunity for consumer goods companies. BCG estimates that around 200 million affluent and middle-income consumers will emerge in China's smaller cities in the next decade, compared to only 60 million affluent and middle-income consumers in large cities.⁽⁵⁾ This suggests that companies entering or expanding in China need to select their target regions carefully.

Challenges and risks

- Rising wages in the next five years could place pressure on companies, especially smaller companies in coastal areas that rely on exports.
- Higher consumption could contribute to inflationary pressure and challenge the government's goal of keeping the rise in CPI at or below 4 percent per year.
- Disposable income could flow to other areas of the economy such as housing and stock markets, increasing the likelihood of asset bubbles.
- Distribution channels for consumer products are highly fragmented, making distribution channel management an important competence for organisations.

CEO checklist

- Do you have or plan to develop a strategy to reach customers in China's western and central regions?
- If you have operations in China, have you carefully assessed the impact of rising wages on your cost base?
- Is your business taking advantage of available e-commerce platforms?
- Do you currently have or plan to build a strong distribution network in tier 2 and tier 3 cities?

Sources: (1) Vincent Chan and Peggy Chan, Credit Suisse analysts
(2) China National Bureau of Statistics (<http://www.stats.gov.cn/tjsj/>)
(3) Xinhua, China initiates new round of income distribution reform, 16 March 2011
(4) Agence France-Presse, Bargain-minded Chinese embrace group-buying craze, 27 March 2011
(5) BCG, Big Prizes in Small Places, Nov 2010

DISCLAIMER: The information herein has been obtained from public sources believed to be reliable. The views and opinions in this memo are those of the authors. KPMG makes no representation as to the accuracy or completeness of such information.