China Powerhouse Fuels Opportunities for Group Businesses

As the world’s largest trader and with an economy that is contributing 25% to global GDP growth, China is having a greater impact on the global economy than at any other time during its modern history. Closer to home that impact is reflected in China’s growing importance to the Jardine Matheson Group, which today manages investments in Greater China of some US$36 billion, of which over US$8 billion is in mainland China. As we enter the New Year, we look at China’s prospects and how the Group can grasp the opportunities being presented by this developing economic powerhouse.

2015 will probably be remembered as a tumultuous year for China’s economy. During the summer, stock market values fell significantly, the devaluation of the Renminbi (RMB) sparked exaggerated fears that China was headed for a serious downturn, and for the first time since the global financial crisis, quarterly GDP growth dipped below 7%. 2016 also got off to a shaky start with 7% wiped off the value of stocks on the CSI 300 on the first day of trading.

“China is currently going through a major transition of its economy, which has implications for the Jardine Matheson Group,” said Deputy Managing Director Adam Keswick, who is responsible for the Group’s strategic development in China. “Against a backdrop of global economic headwinds and increasing uncertainties, it might seem that China faces a tough rebalancing act, yet we see tremendous opportunities for the Group as increasing wealth in the country and the emergence of a significant middle class plays to our strengths.”

China 2015
GDP growth at

6.9%

Services
make up

51%

of GDP

Chinese R&D
reaches

US$311b

China's GDP
per capita to reach

US$10,000

by 2020

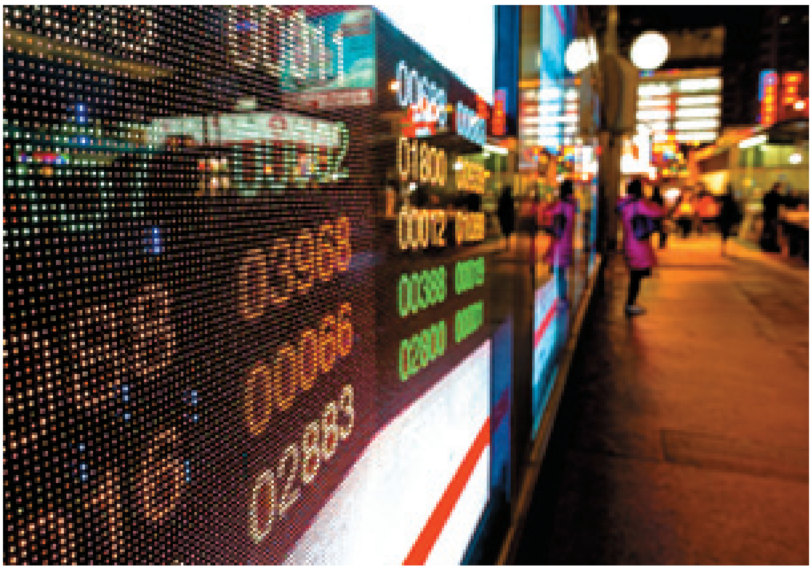
1 in 4 people in
China will have a GDP
per capita of

US$20,000

by 2020

To understand why China is rebalancing its economy, one needs to look back at its recent history. During the early 2000s China experienced almost a decade of unprecedented double-digit growth, but the 2007-8 financial crisis hit exports and growth stalled. In response, Chinese policy makers made available a RMB4 trillion (US$608 billion) package to stimulate the economy. Too much money, however, went into property to meet demand for asset investment and infrastructure projects that offered only average returns, further fuelling speculative activities. This had a knock-on impact on financing in the real economy.

Manufacturing output continued to outstrip demand, while the investments in infrastructure and property had the effect of driving up global commodity prices. For example, China used more cement from 2012-2015 than the US used in the entire 20th Century. Credit also rose dramatically and state-owned enterprises (SOEs) and local governments were inclined to borrow heavily. During 2009-2012, the increase in China's M2 – a broad measure of money circulating in the economy – was greater than the accumulated period from 1949-2008.



With all this surplus money available in the economy, unscrupulous practices became a temptation.

At the same time China's changing demographics presented another challenge, that of acute labour shortages in the coastal areas coupled with an ageing workforce and rising costs.

"It became obvious that there needed to be changes to the country's growth model, which had also had a considerable impact on the environment," explained Jardine Matheson Group China Chairman David Hsu. "In addition, there was the risk of China being caught in the 'middle income trap,' i.e. stagnating at middle-income levels and failing to move forward. The new administration led by President Xi Jinping, who came to office in 2013, was acutely aware of all these factors and that the time for China to reform had arrived."

The New Normal

China's 'new normal' has become the descriptor for this new era of economic development. First mentioned by President Xi during a visit to Henan in May 2014, the 'new normal' essentially describes China's transition from a high growth to mid-to-high rate growth economy with an emphasis on sustainable qualitative, rather than quantitative, growth.

Its goal is to build a moderately prosperous society by 2020 with the specific aim of doubling 2010 GDP and GDP per capita levels to create a larger middle class. A key part of this strategy is to increase urbanization, boost domestic consumption and reduce overcapacity in the economy. Qualitative growth will also place a greater focus on employment rather than raw GDP numbers. This means more space for service industries to develop and, as part of China's declared commitment to reduce emissions, an emphasis on low carbon industries and higher energy efficiency.

The government has also set down political doctrine recognizing the key role of the market in the allocation of resources and seeking to reduce government intervention and bureaucracy. Subsequent policy meetings have underlined the importance of the rule of law. Policy planners want to restructure the economy towards a more market-based system that encourages private entrepreneurship and innovation, and to shift from a Keynesian demand-side model to a supply-side one.

Making Reforms Work

It will take some time for such reforms to filter down through the economy, so the current slowdown is not unexpected. There are also downside risks as the restructuring tries to deal with high leverage, over capacity and high financing costs.

"The reforms that are necessary if China is to grow sustainably and strongly over the next decade...will surely take a toll on growth in the short run," wrote Harvard University professor and former US Treasury Secretary Lawrence Summers in November 2015.

> *Although some industries are down, emerging sectors like e-commerce are booming.*

Put into perspective, however, although GDP growth in 2015 slowed to 6.9%, 6.9% of US$10.3 trillion is still a very large number and is the same as adding an economic equivalent of Switzerland each year. There is also still ample room for both monetary and fiscal easing.

In an editorial published by *The Economist* in November 2015, Premier Li Keqiang said, "Yet this transition from 'bigger is better' to 'less is more' is a good thing. I would otherwise worry whether the reforms were working as intended."

Current GDP figures give a limited overview. Although some industries are down, emerging sectors like e-commerce are booming. On 11th November 2015, China's 'Singles Day', Alibaba registered RMB91.2 billion in sales (US$13.9 billion), breaking previous records. Exports have become less important as services now account for 51% of GDP compared to 44% in 2011.

China is also showing economic divergence comparable to Europe across its large geographical mass. First tier cities such as Beijing, Shanghai and Shenzhen remain competitive, but second, third and fourth tier present a more mixed picture. Reflecting on how different the UK and Germany economies are compared to that of, say, Greece, one can see that some differentiation is required rather than viewing China as one homogenous market.

Adding to the slowdown have been the stock market falls and RMB devaluation. While both the New Year and summer stock market declines were dramatic, the figures have shown a limited impact on the real economy. Stocks represent less than 15% of household assets and just 5% to 10% of the population is exposed to the market volatility. The surprise RMB devaluation in August 2015 might have been seen as an attempt to help struggling exporters, but the true purpose was to meet conditions set by the IMF for the RMB to be included in its Special Drawing Rights reserve currency basket.

Focus on Innovation and Sustainable Development

So what are the prospects for China in the short term? At the top of the agenda is the 13th Five Year Plan, China's economic and social development blueprint for 2016-2020. This calls for a stronger emphasis on innovation and sustainable development and is the perfect embodiment of President Xi's leadership style – self-confident, independent, prudent and decisive. To address China's ageing society, couples will henceforth be able to have two children instead of just one. There is also expected to be more progress in the reform of SOEs to seek greater efficiencies and improve corporate governance.

Innovation is a key focus. Chinese R&D has doubled in the past five years, achieving as much as US$311 billion. There will be a strong push for policies such as 'Made in China 2025', which aims to encourage more homegrown technology and create added value. The 'Internet Plus' initiative is based on Germany's 'Industry 4.0' whereby traditional industries are being encouraged to adapt to the Internet age.

Innovation is also being extended to the financial sector to spur domestic reforms and lower the cost of capital.

Information and communications technology solutions giant Huawei, which was first established in Shenzhen in the late 1980s, is now a global market leader and a successful 'Made in China' example.

Opportunities for the Group in China

It is projected that by 2020, China's GDP per capita will reach US$10,000, compared to over US$7,000 in 2014 and that a quarter of the population will have a GDP per capita of US$20,000. This means that about 350 million people in China will have a spending power bigger than the current population in the United States.

"In other words, by 2020, there will be a market inside China that is equal to the size of the US market. That makes me very excited about China's future," said David Hsu.

"The focus of Group businesses in China has been to provide premium products and services to the high to middle income group in the country. This aligns with our investment focus as we aim to provide a better living quality and environment for this market segment," he added.

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>
> Jardine Matheson Group
> China Chairman
> **David Hsu**

Hongkong Land has set new standards of design and quality in its residential developments in mainland China such as seen here at Landmark Riverside in Chongqing.

Leading retailer Yonghui Superstores, in which Dairy Farm holds a 19.99% interest, offers excellent opportunities for growth in mainland China.

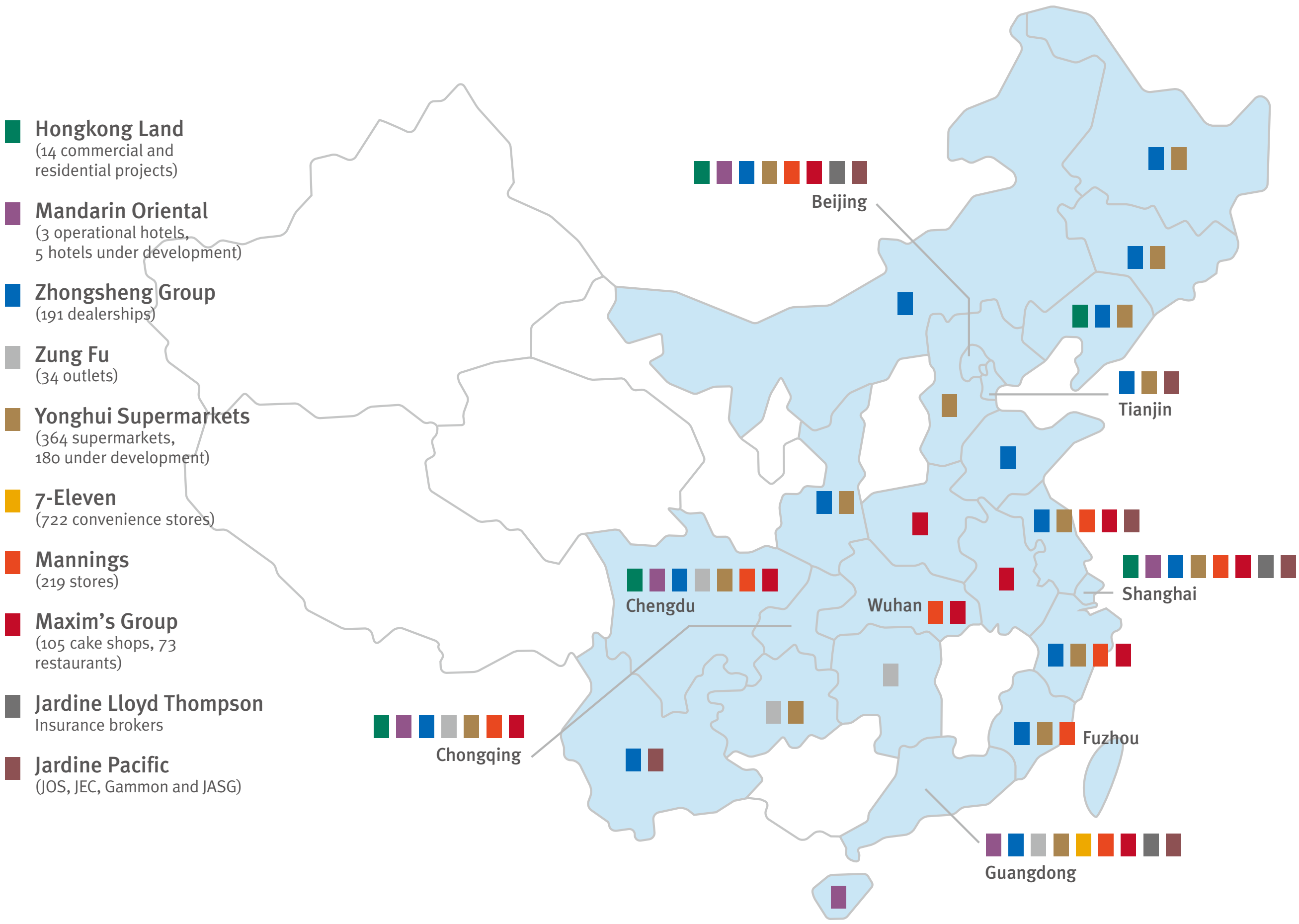
The Group's involvement in China covers many aspects of life there. For example, Hongkong Land has set new standards in design and quality in its residential developments in many cities including Beijing, Chengdu, Chongqing, Shanghai and Shenyang. Hongkong Land will also soon be opening 'WF Central', a premier retail development in the heart of Beijing. Along with new investments in Shanghai, Hongkong Land plans to continue to expand its mainland portfolio and further enhance its position for the future.

Pan-Asian retailer Dairy Farm is seeing strong demand from more sophisticated Chinese consumers seeking better quality food products and has increased its exposure to the mainland market through its 19.99% shareholding in leading retailer, Yonghui Superstores. Yonghui also has a leading role in China's SOE reforms. In April 2015, it took a 21.17% stake in Lianhua Supermarket, a major SOE retailer in East China, and was also awarded the operational management rights to turn Lianhua's business around. This partnership will put Yonghui supermarkets in a strong position to develop its brand and market penetration, while a recent tie-up with JD.com will accelerate Yonghui's development of its e-commerce platform.

"As a Group, we believe that the ability to innovate is more crucial than ever, along with a determination to see the job through, which has always been a hallmark of our businesses," said Mr Hsu. "Jardines is not afraid to go against the flow and take risks, but this is always balanced by prudent financial management."

The Group's IT solutions provider, JOS, recently unveiled an extended range of mobility solutions to drive growth for businesses in China. With mobility being a key pillar of China's Internet Plus strategy, JOS' enhanced offerings can provide a solid foundation for businesses to realize their ambitions. JOS has also been working closely with retailers to develop their online to offline offerings

The Group's Footprint in Mainland China



and shopping analytics. Separately, Zung Fu and Zhongsheng Group are well positioned to meet the demands of the increasing numbers of aspirational Chinese consumers who can afford luxury cars.

A number of Jardine Matheson Group companies, such as Mandarin Oriental Hotel Group, which will have five hotels in operation in mainland China by the end of 2017, including two in the capital Beijing, have now set up WeChat platforms to engage with their customers and hope to expand this programme further. WeChat has evolved from instant messaging to offer a multitude of services, with enormous potential for the future.

"Looking ahead there are also other possibilities to be explored particularly with China's changing demographics. Its ageing society and the easing of the one-child policy will definitely create new opportunities in the healthcare and education sectors," said Mr Hsu.

"As the economic centre of gravity shifts eastward, China will remain, for the foreseeable future, an incredibly exciting market. Although the positive benefits of China's current reforms may take some time to be realized, it is up to us as a Group to position our businesses to make the most of them," he concluded.

With facilities such as this 4S showroom in Guangzhou, Zung Fu is well positioned to meet the demands of Chinese consumers who aspire to own a luxury car.