Blue Book Series

June 2022

Outlook of China’s Commercial Sector during the 14th Five-Year Plan Period

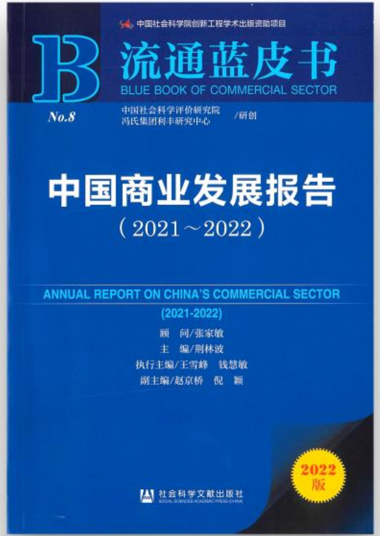
Blue Book of China's Commercial Sector:
Annual Report on China's Commercial Sector (2021 -2022)

Introduction

In March 2021, the *Outline of the 14th Five-Year Plan (2021-25) for National Economic and Social Development and the Long-Range Objectives Through the Year 2035* (hereafter the "14th FYP") was approved by the Fourth Session of the 13th National People's Congress. The 14th FYP addressed the need to accelerate the establishment of a "dual circulation" development pattern, in which the domestic market plays a leading role, while the international market remains its extension and supplement. In the next five years, China will continue to deepen supply-side structural reforms and expand domestic demand, address supply chain bottlenecks, and further promote the development of the domestic commercial sector.

China will also continue to promote a high-level of opening up, lower barriers to market entry, and work to promote the coordinated development of domestic and international markets, to create new opportunities for domestic and foreign enterprises and to achieve more sustainable growth.

This report discusses the outlook and prospects of China's commercial sector during the 14th FYP period and forecasts five major development trends. The content of this report is based on our recently published *Blue Book of China's Commercial Sector (2021-2022)* (in Chinese).



Key Development Trends of China’s commercial sector during the 14th FYP period

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Boosting domestic demand and upgrading consumption

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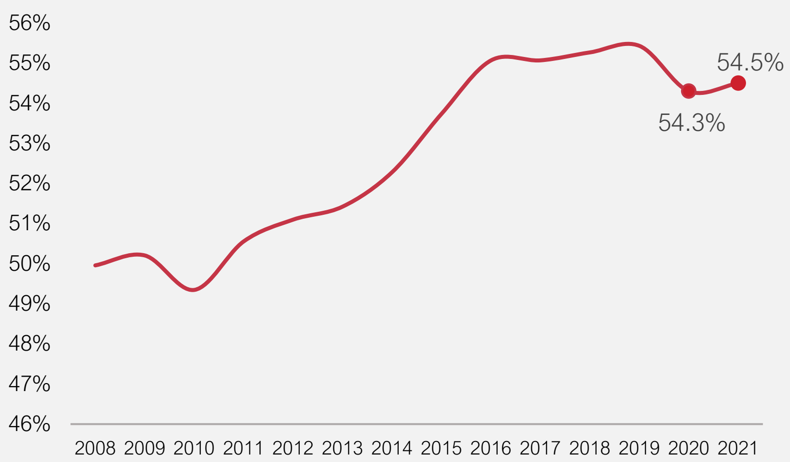
Boosting Domestic Demand and Upgrading Consumption

Over the years, consumption has become a key driving force of China’s economy

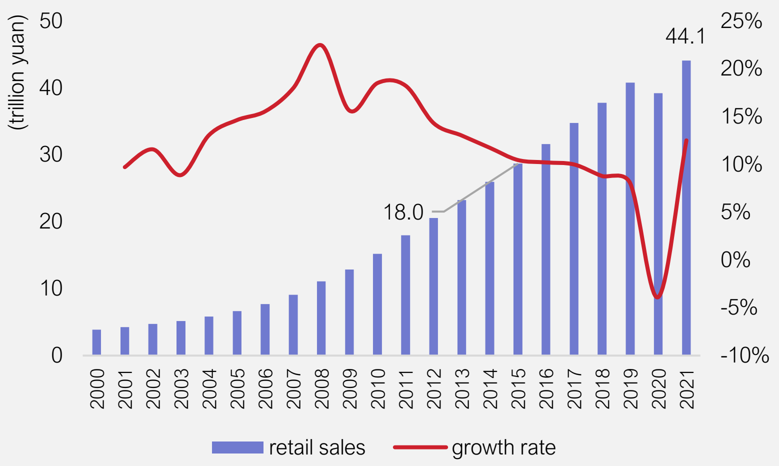
China is expected to become the world's largest consumer market during the 14th FYP period

China‘s final consumption expenditure as a share of GDP (2008-2021)



The average consumption rate between 2011-2019 was 53.4%. Despite the impact of the pandemic, the proportion of final consumption expenditure to GDP in 2020 and 2021 reached 54.3% and 54.5%, respectively.

Growth of total retail sales of consumer goods since 2000



The total retail sales of consumer goods increased from 18.0 trillion yuan in 2011 to 44.1 trillion yuan in 2021 over the past 10 years.

Source: National Bureau of Statistics

Four trends that shaping the retail and consumer goods market during the 14th FYP period

- Rise of domestic brands
- Shifting from exports to domestic sales
- More policies to promote duty-free shopping
- Flourishing night-time consumption

(1) Rise of domestic brands

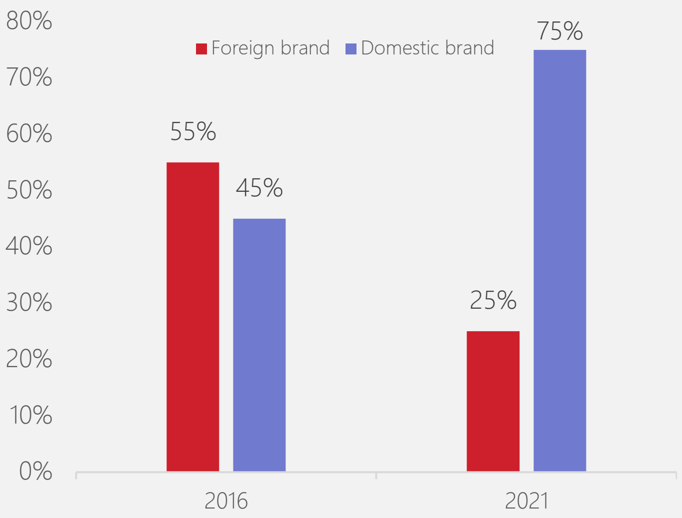
Home-grown domestic brands ("国货") experienced strong growth in 2020 and more domestic brands are expected to gain market recognition during the 14th FYP period. To stimulate domestic demand, the government aims to enrich domestic market supply by expanding the supply of high-quality consumer goods, mid-to-high-end and luxury products, and imported goods. The 14th FYP states that Chinese companies should take the lead in cultivating a number of high-end brands in the consumer goods sector, especially in cosmetics, clothing, home textiles, and electronic products.

Rise of China as an economic powerhouse: According to the National Bureau of Statistics, China's GDP exceeded 100 trillion yuan and posted a 2.3% yoy growth in 2020. In 2021, China's GDP grew 8.1% over the previous year, making it one of the best performers among the world's leading economies. The nation will continue to upgrade itself from a global "supply centre" to a "dual centre of supply and demand".

Higher level of national Pride: Millennials and Generation Z grow up in an era where China is catching up quickly with its western peers. They have a strong sense of national identity. Meanwhile, the escalating trade and political tensions between China and the U.S. have also accelerated the pace of domestic substitution as strengthening patriotism pushes more Chinese consumers to favour domestic brands over foreign brands.

Improving quality of Chinese brands: In line with the consumption upgrade trend of the 14th FYP, various domestic brands have improved product quality and brand concepts through R&D and innovation.

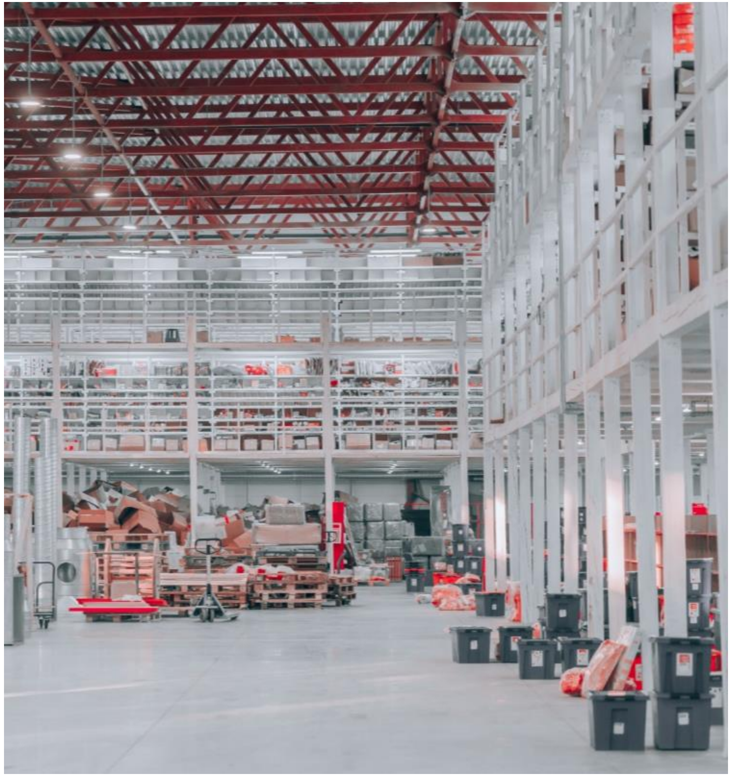
Consumer interest in foreign and domestic brands



Source: People's Daily Online Research Institute, compiled by FBIC

(2) Shifting from exports to domestic sales

Over the decades, both China's domestic economy and the global economy has undergone profound changes. Externally, the global economic downturn exacerbated by COVID-19, geopolitical tensions and rising protectionism has led to a slowdown on the global demand side. Internally, following decades of high-speed growth driven by exports and investments, Chinese authorities have been making efforts to shift China's economic development to a more balanced one driven by consumption, investment, and exports. Many export-oriented companies have begun to shift their focus towards the domestic market. The central and local governments have introduced various measures to help export-oriented companies expand into the domestic market and assist them in connecting with e-commerce platforms to sell their products.



Key development trends of export-oriented businesses during the 14th FYP period include:

1. The government will continue to promote the integration of domestic and foreign trade laws and regulations, quality standards, certification and accreditation processes to further accelerate the integration of domestic and foreign trade

2. Stronger cooperation between foreign trade enterprises and e-commerce companies; the consumer-to-manufacturer (C2M) model will be further upgraded to more accurately meet consumer needs

3. Foreign trade enterprises will extend upstream and downstream along the supply chain and some will create their own brands to enhance their value and competitiveness

(3) More policies to promote duty-free shopping

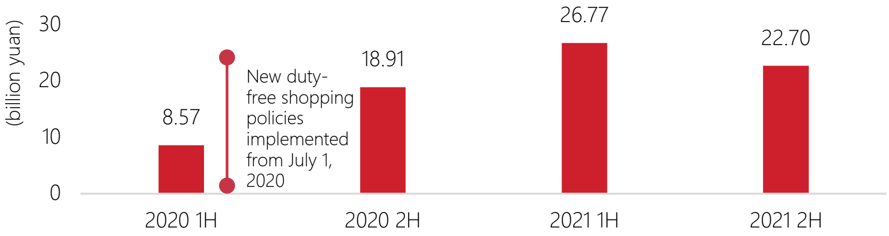
The 14th FYP proposes that the government will cultivate international consumption centres across the nation and will further promote the development of the duty-free industry to bolster consumer spending domestically.

In June 2020, China released the *Overall Plan for the Construction of the Hainan Free Trade Port (FTP)* to facilitate trade and investment in Hainan and to build the island into a globally influential duty-free shopping center.

An integral part of the construction of the Hainan FTP is to enhance duty-free shopping policies to stimulate domestic consumption and re-channel overseas travel-related spending back to the home market.

The government has enhanced duty-free shopping policies such as raising duty-free shopping limits, lessening restrictions on the number of purchases, expanding the variety of duty-free goods offered, as well as offering different pick-up methods to collect duty-free goods.

Hainan offshore duty-free sales



Source: Haikou Customs, compiled by FBIC

Duty-free shopping policies in Hainan pre & post July 1, 2020

	Before July 1, 2020	After July 1, 2020
Annual duty-free shopping quota	30,000 yuan per person	100,000 yuan per person
Duty-free limit for a single product	8,000 yuan	Unlimited
Product categories of duty-free items	38 categories	45 categories
Products subject to limit on purchase quantity	All products were subject to a limit on purchase quantity	No limits on purchase quantity except for cosmetics, mobile phones and alcoholic products
Eligible operators	Only offshore duty-free operation license holders	All qualified duty-free retail operators in China

Source: Ministry of Finance, compiled by FBIC

(4) Flourishing night-time consumption

China’s “night-time economy” is a diversified economy that covers sightseeing, performing arts, shopping, entertainment, night tours, culture, etc.

Night-time economy has become an important part of local economic development. The Chinese government has released various policies and guidelines to promote the development of the night-time economy to boost consumption. In particular, the government has called for enriching the arts and performance market and cultivating night-time cultural tourism markets to better meet people’s social and leisure needs.

According to iiMedia Research, the scale of China's night-time economy was expected to reach 36 trillion yuan in 2021.

We expect that the night-time economy will continue to prosper during the 14th FYP period, effectively promoting consumption, creating jobs, and showcasing regional cultures.

Advancing the development of the circulation sector

(1) Promote high-quality development of the logistics, wholesale and retail industries

The 14th FYP emphasizes the need to further enhance the efficiency and competiveness of the circulation sector, with a focus on high-quality development of the logistics, wholesale and retail industries. China's "Internet +" strategy and digitalization initiatives will play a critical role in the upgrading and transformation process.

Logistics

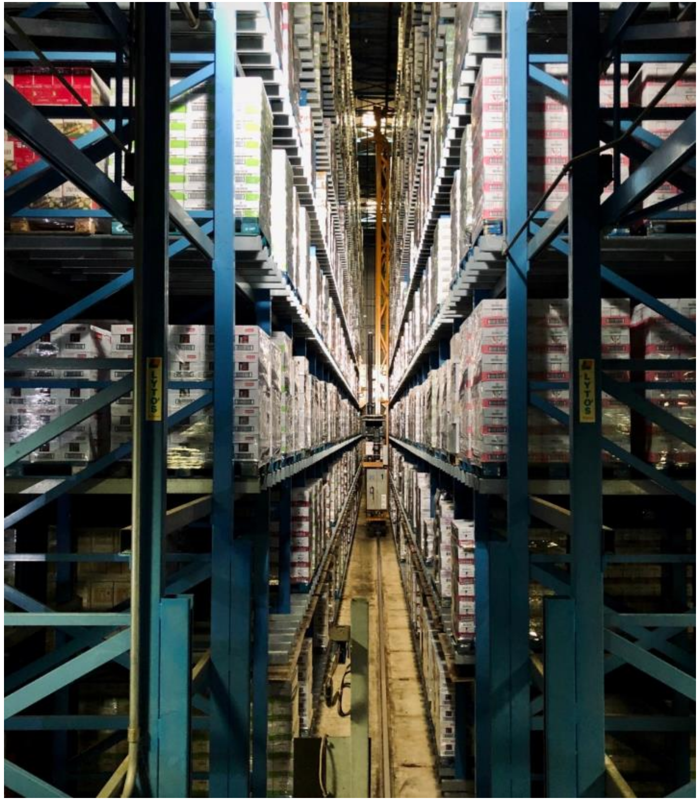
- Further investment in improving logistics and transportation infrastructure
- Promote innovation and the application of new technologies
- Encourage innovative business models
- Strengthen industry standards and regulations

Distribution

- Upgrade traditional wholesale markets to modern wholesale trading platforms
- Cultivate internationally competitive large-scale wholesalers

Retail

- Cultivate new consumption channels and business models (e.g. smart retail, livestreaming e-commerce) through innovative technologies
- Technologies such as big data and AI allow retailers to gain in-depth insights into consumer needs, which will help drive innovation and improve operational efficiency



(2) Improve the efficiency of agricultural product distribution and supply chains

The rural revitalization strategy will be fully implemented during the 14th FYP period through developing rural logistics networks and improving the efficiency of agricultural product distribution and supply chains.

The COVID-19 pandemic has changed people's consumption habits for agricultural products. During the pandemic, the transaction volume of traditional offline distribution channels dropped sharply, while farm produce e-commerce platforms showed explosive growth.

Traditional agricultural distribution enterprises are encouraged to explore new business formats and models, and adopt supply chain innovations and technologies to better meet consumer needs.

The 14th FYP proposes to strengthen the storage and preservation of agricultural products, construct cold chain facilities, strengthen the supervision of quality and safety of agricultural products, and improve traceability systems.

Consumer demand for high-quality imported agricultural products remains strong. Consumption upgrade and a growing middle class will continue to drive the consumption of imported agricultural products.

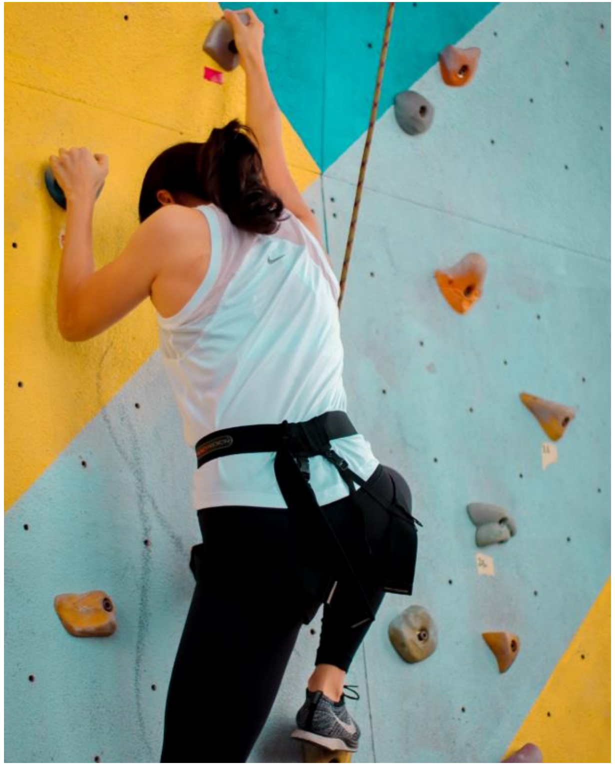
Huge growth prospects for the lifestyle services sector

(1) Health-related consumption is gaining traction

Consumers have become more health conscious since the COVID-19 pandemic began.

The 14th FYP proposes accelerating the development of local lifestyle services industries such as healthcare, tourism, culture, sports, elderly care, etc.

In terms of food and fast-moving consumer goods, consumers are paying more attention to food safety, nutrition and health, and natural/organic products. In the catering industry, quality control for food safety has been strengthened, alongside improvements in products, services, dining environments, and supply chains.



61%

of respondents said they plan to spend more time exercising after the pandemic

>80%

of respondents will increase spending on fitness

60%

of urban consumers want to buy healthier foods and often check ingredient lists on the outer packaging

55%

of respondents look for healthy and natural ingredients in the products they buy

Source: China Sporting Goods Federation, *2020 National Fitness Behaviour and Consumption Research Report;* McKinsey, *2020 China Consumer Survey Report"*; compiled by FBIC

(2) High demand for community-based retail and services

The 14th FYP promotes community-based retail and smart communities.

The government is committed to building "15-minute community living circles“, which provide residents with comprehensive services available within walking distance in their own community, including shops, restaurants, barbershops, clinics, elderly care and childcare facilities, education and entertainment facilities, etc.

An increasing number of community malls will be upgraded to become “one-stop retail plus lifestyle” destinations.

The pandemic has also led to explosive growth in the community group buying market, where local residents collectively purchase fresh produce and daily necessities, etc., at a discount, and pick up the goods in the community.

The rapid development of e-commerce and contactless delivery services in China will continue to reshape the way consumers make everyday purchases.

Digitalization and technology drive business model innovation

(1) Technological advances will accelerate innovations in business models

- The COVID-19 pandemic has accelerated digitalization across the board. The 14th FYP calls for deeper industrial integration of various technologies. Technological upgrades have also opened up new opportunities and accelerated the transformation and reforms in the retail industry.

- The government has proposed various initiatives to drive consumption and innovation, including establishing a "Smart" ecosystem, constructing the next generation of IT infrastructure, encouraging online-offline integration, and promoting new modes of consumption.

- In the retail industry, many businesses have applied technologies such as artificial intelligence (AI), virtual reality (VR) and augmented reality (AR) across their supply chains and core operations to enhance operational efficiency and deliver more fulfilling customer experience. By leveraging new technologies, e-commerce platforms are offering consumers immersive retail experiences, as well as integrating O2O, livestreaming, and in-app shopping experiences.

- Businesses have been improving their operational efficiency by utilising big data and cloud computing to optimise their inventory and develop targeted marketing strategies; they are also establishing flexible digital supply chains. Smart technology will also be used in various modes of manufacturing.

- In terms of logistics, smart devices, such as automated warehouses and smart storage systems, will be more extensively used.

(2) Omnichannel strategies continue to lead in retail

Having an effective omnichannel / online-to-offline (O2O) strategy is particularly important for brands and retailers in China. The ability to seamlessly integrate the consumer journey between multiple online and offline touchpoints in real-time will be essential for long-term success.

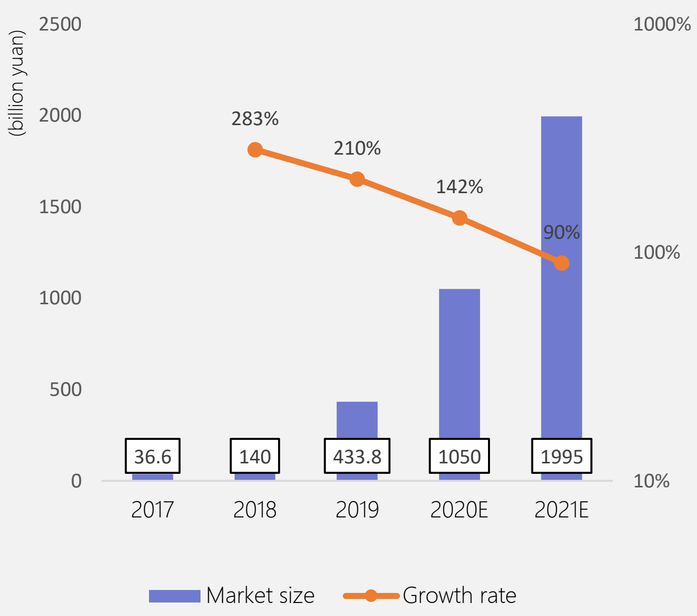
Livestreaming as key online strategy

1. Livestreaming e-commerce experienced explosive growth in 2020 due to offline store closures during the pandemic
2. Livestreaming e-commerce is more engaging and entertaining than traditional e-commerce. Consumers can interact with hosts in real-time, ask questions and receive instant feedback
3. The 14th FYP period will see higher industry standards and sustainable development within the industry

Improving in-store customer experience offline

1. The main goal for offline retail is attracting foot traffic and returning customers
2. Offering diverse experiences, such as pop-up stores, exhibitions and animation IP based events, can extend customers' staying time and drive sales
3. Renovation and infrastructure upgrades will create a fresh image and strong visual appeal to attract customers

China's livestreaming e-commerce market



Source: KPMG, compiled by FBIC

Promoting high-level opening up

(1) Construction of the Hainan Free Trade Port

The 14th FYP proposes further opening up of the economy and improving business environment by streamlining and liberalising trade and investment. In June 2020, the State Council issued *the Overall Plan for the Construction of the Hainan Free Trade Port*, which aims to transform the entire Hainan Island into a high-level free trade port. The plan covers liberalization and facilitation on six fronts, namely: trade, investment, cross-border capital flows, movement of people, transportation, and secure and orderly flow of data.

A zero-tariff rate will eventually apply to most imported goods into Hainan island, which will be treated as a customs bonded area. Prior to this, certain categories of imports are entitled to import duty, import VAT and consumption tax exemptions. A new duty-free shopping policy for visitors to Hainan has been implemented since 1 July 2020. Preferential corporate and individual income tax policies will apply for Hainan FTP, and market access in selected sectors will be relaxed.

Road map for Hainan FTP development

2020

- Begin construction of the free trade port
- Strengthen the construction of special customs supervision zones

2025

- Preliminary establish the free trade port system focusing on trade and investment liberalisation
- Zero tariffs on most imported goods
- Reduced restrictions on cross-border service trade
- Streamlined procedures for market entry and investment
- Expedited financial opening-up

2035

- Further optimize the operation and system of the free trade port
- Fully liberalize trade, investment, cross-border capital flows, movement of people, transportation, and secure and orderly flow of data
- Simplify tax system with lower tax rates for individuals and enterprises

2050

- Complete the goal of transforming Hainan into a globally influential high-level free trade port

Source: FBIC

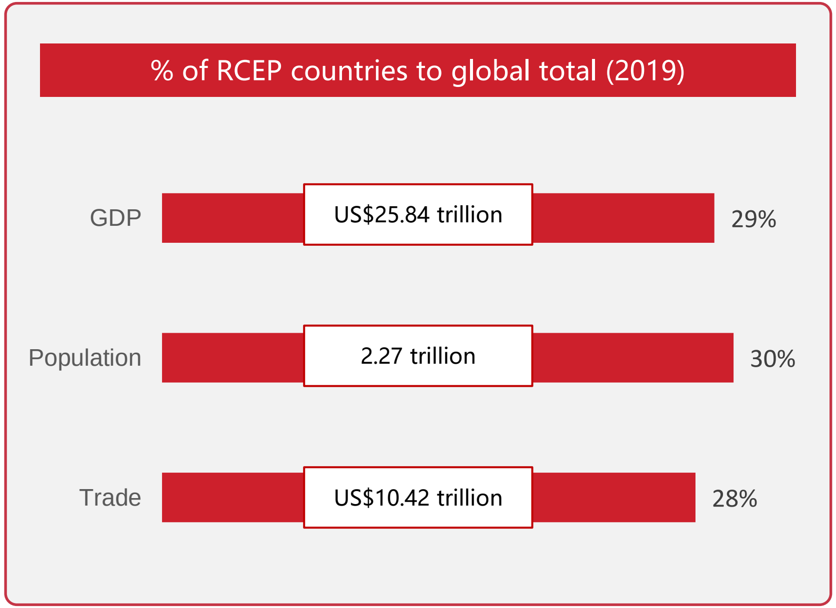
(2) RCEP to foster a more open and competitive market environment

The Regional Comprehensive Economic Partnership (RCEP) trade agreement was officially signed in November 2020 between 15 economies in the Asian-Pacific region. It is the world's largest plurilateral trade agreement.

RCEP will progressively eliminate tariffs on at least 92% of goods traded and open up at least 65% of service sectors.

RCEP will provide member countries with unified rules of origin and streamlined customs procedures, strengthen the regional supply chains in the Asia-Pacific region, promote economic and trade integration in the Asia-Pacific region, and give a strong boost to China's cross-border e-commerce sector by reducing transaction costs.

Chinese products can enter the markets of RCEP member states more easily; China will also become the main consumer market for other RCEP member states. More high-quality imported goods will also be made available to meet the needs of China's growing middle class.



Source: World Bank, ITC Trade Map, compiled by FBIC

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