

China Economic Update

by NAB Group Economics

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Growth in online sales highlights the opportunities in China's new economy

China's online retail sales have rapidly expanded in recent years, as rising disposable incomes and growing internet penetration have supported the sector's growth. This trend was highlighted by the recent Singles' Day sales – November 11 – which set a new global record for online sales, making it the biggest global online shopping day of the year. Growth in online sales also points to the stronger performance of China's services sector, relative to the deterioration in heavy industry.

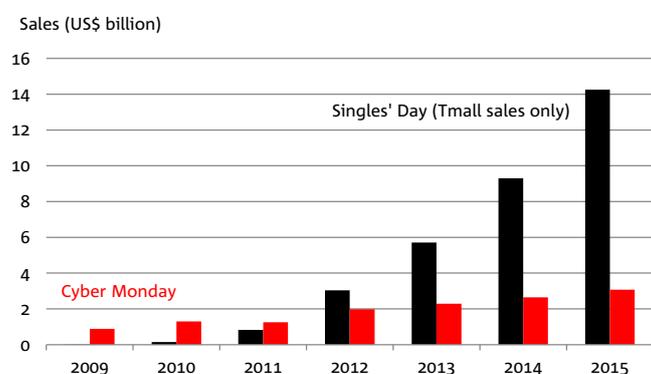
What is Singles' Day and why does it matter?

Singles' Day started as a joke among single university students in the early 1990s. Unable to find partners, single students celebrated Singles' Day as an anti-Valentine's Day by purchasing gifts for themselves and their single friends.

From this modest beginning, Chinese online giant Alibaba created the modern event in 2009, when it started a major marketing drive around the day, with large discounts across a range of products on its main shopping platforms Tmall (a business to consumer site likened to Amazon) and Taobao (a consumer to consumer site likened to eBay). While competitors have also seized the opportunities of Singles' Day, Alibaba is the dominant player, and data on its sales is the most readily available.

In 2015, Singles' Day sales on Tmall totalled over RMB 91 billion, equivalent to around US\$14 billion, with total sales for the day (across China's online retail sales sites) estimated at RMB 122 billion (around US\$19 billion) (China Internet Watch). By comparison, Cyber Monday – the high profile United States online sales event – generated sales of just over US\$3 billion in 2015 (Adobe).

Singles' Day has grown to become the world's largest online shopping day



Source: China Internet Watch, Adobe Digital Index, NAB Economics

As Singles' Day has grown, it has expanded outside Chinese brands – with a wide range of Australian brands taking part on Alibaba's trading platforms, including Chemist Warehouse, Metcash, Blackmores, Foodworks and Jurlique

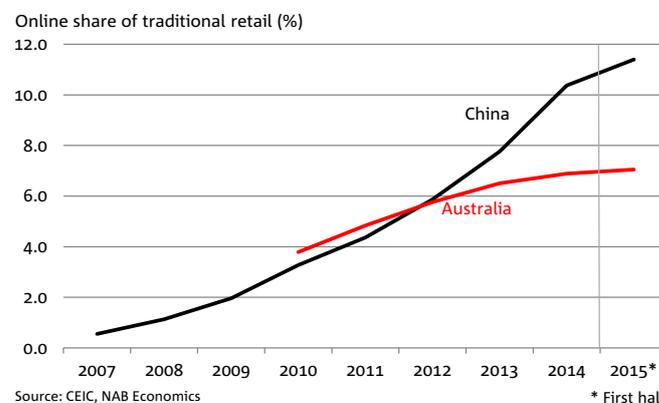
(SMH), while retailers from the United States, Japan, South Korea and Germany also featured prominently. Sites like Tmall allow foreign firms to enter the Chinese consumer market with comparatively minimal set up costs – both in terms of investment in physical storefronts as well as avoiding requirements to acquire a business licence.

As a result, Singles' Day presents a major opportunity to access a large and rapidly growing market that is often difficult to access for foreign firms.

Online retail far more than just Singles' Day

While Singles' Day has become a major event, it is only part of the broader growth in China's online retail sector. In the first half of 2015, online retail sales increased by 42% yoy to RMB 1.6 trillion – equivalent to around 11.4% of the traditional retail sales over this period. In comparison, Australian online sales – as measured by NAB's Online Retail Sales Index – accounted for around 7.1% of bricks and mortar sales in the first half of the year – roughly the same level as the United States as reported by the US Commerce Department.

China's online sales represent a larger share of the traditional retail sector than Australia

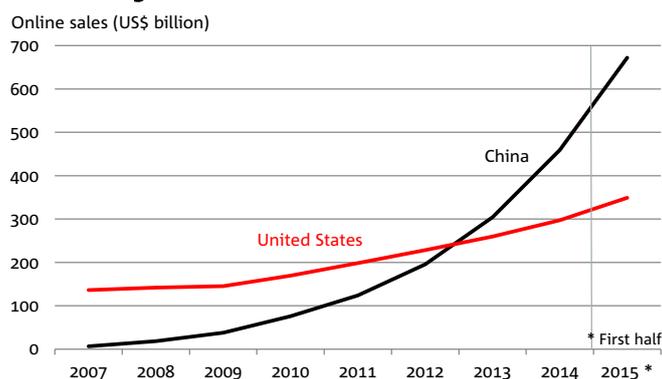


Source: CEIC, NAB Economics

* First half

According to research by eMarketer, China will account for just over 40% of global online retail sales in 2015 – almost double the level of sales in the United States. Comparing US and Chinese data at market exchange rates suggests that the value of Chinese online retail sales overtook the US in 2013.

China overtook the United States in 2013 to become the world's largest online retail market

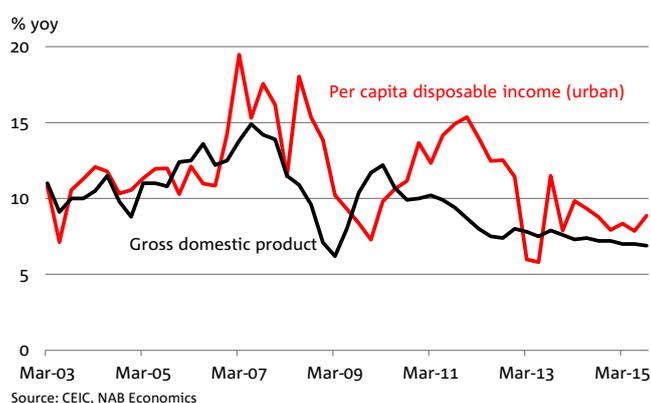


That said, on a per capita basis US online retail spending comfortably outpaces China's – with average spending in the United States of around US\$930 per person in 2014, compared with just US\$337 per person in China. However, reflecting the relative growth rates in online spending, Chinese consumers are gradually closing this gap.

What is driving the growth in online retail?

In part, the spectacular growth in China's online retail is reflective of the continued emergence of the country's consumer class. Despite the economic slowdown – driven largely by the downturn in the industrial sector – disposable incomes for China's households continue to grow. Urban per capita disposable income grew by around 8.9% yoy in the September quarter – a little above the trend level for the past two years, while rural areas recorded growth of around 9.7% yoy.

Disposable incomes have maintained growth, despite the slowing trend in China's economy



This growth in incomes has supported the expansion in retail sales more generally – with real retail sales increasing by around 10.5% yoy over the first ten months of the year. While the growth in online sales is almost four times the rate of the traditional sector, this also reflects the relatively short history of online sales, which has recorded rapid growth off a small base across a range of countries, including Australia and the United States.

Wider technological adoption has also driven growth in online retail – particularly the growth in mobile internet access. In the first ten months of 2015, the total flow of mobile network data doubled, with online retail a driver of this trend. According to iResearch, mobile purchases will account for just over 50% of China's online sales in 2015, up from one-third in 2014 and just 14% in 2013.

Online retail has also provided greater opportunities for China's rural residents, who lack the range of traditional retail options of their urban peers. Reports suggest that Alibaba is investing considerable capital in China's logistics sector to support the growth of rural online consumption.

Intellectual property remains a challenge for the sector

While growth in online retail has been impressive, issues related to counterfeiting, intellectual property and quality remain issues for the broad sector (concerns that also exist within China's traditional retail sector). According to a report from state news agency Xinhua, around 40% of goods sold online in 2014 were either counterfeit or of poor quality.

Alibaba argue that these issues are addressed on the Tmall platform, since shopfronts are operated by either brand owners or their licensed agents, who are required to provide an anti-counterfeit security deposit of US\$25,000. That said, this does not apply to the Taobao platform, which the Trademark Working Group describes as the largest online platform for the sale of counterfeit goods.

Failure to adequately address these intellectual property concerns provides some risk to the longer term growth prospects for the sector – such as the impact of international litigation or a loss of confidence among consumers.

Conclusions

Record sales in 2015's Singles' Day, combined with strong growth more generally across the first half of the year highlights the opportunities in China's new economy – with growth in the services sector generally less observed than the slowdown in heavy industry. Even though China is already the largest online retail market, the modest per capita spend suggests growth can continue, particularly if household incomes continue to grow in coming years.

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