JESA INVESTMENT & MANAGEMENT CO., LTD.

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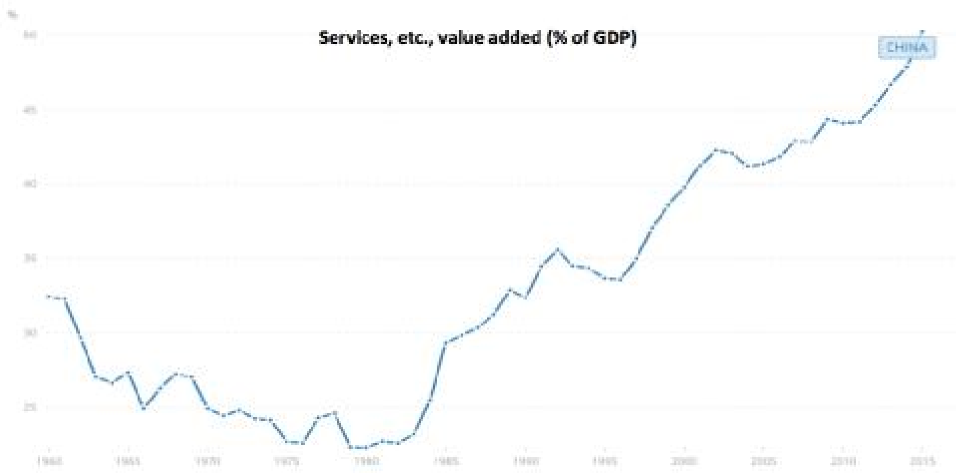
NEWSLETTER – JUNE 2017

How much does the service industry impact on China's GDP? Data of a changing country

By Saro Capozzoli, Badr Lahlou – Jesa

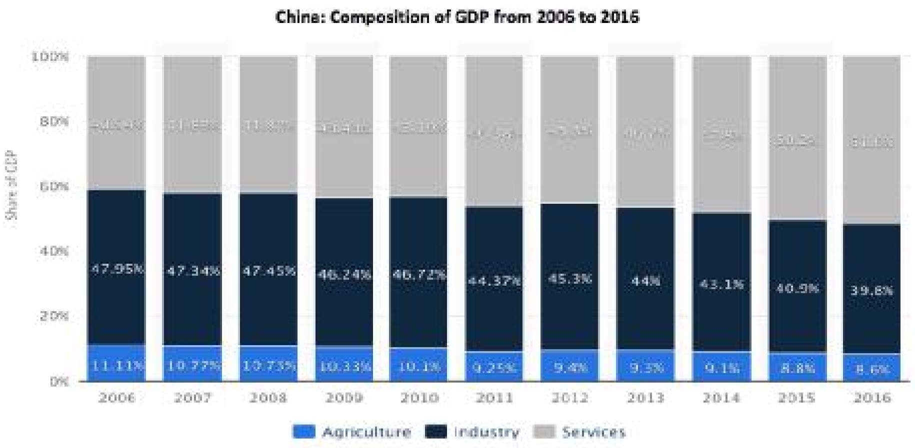


Source: The World Bank

The Gross Domestic Product (GDP) is a monetary value of all final goods and services produced within a country in a period of time (usually on annual or quarterly basis), which is used to determine the overall economic performance of a country or region.

By analyzing the part services take in the GDP's composition, we found out that all developed countries have a high services industry composition, which accounts between 70 and 80% of the total GDP. Indeed, France, USA, Italy and Germany services account respectively of 79.8%, 79.7%, 73.8% and 71.1% of the GDP.
China's services, on the other hand, account for around 52% of China's GDP.

The tertiary sector consists of the activities where people offer their knowledge and time to improve productivity, performance, potential, and sustainability. The main characteristic of this industry is that the product is an intangible good. Those services include advice, access, experience, and may involve the transport, distribution, sales, entertainment...



Source: statista

As we can see on the graph, industry was taking the biggest part of GDP in 2010, with 46.72%.

Since 2012, it is progressively decreasing in favor of the services industry. This is a criterion that shows how China is not only relying on industry anymore. From being the factory of the world, China is becoming a services platform. The country's economic transformation into an economy led by services is pursuing. During the first quarter of 2017, the services sector, which continues to outperform (up 7.7 per cent), accounted for 62% of the headline growth and represented 56% of total GDP, compared to only 42% back in 2006.

As disposable incomes rise in China, consumers are more and more able to buy services and goods. This is a factor that leads to the expansion of new services, ranging from food deliveries to financial services.

To support this shift in the economy, the Chinese government plans to set up a CNY 30 billion ($4.17 billion) fund to boost high value services exports, such as technology, finance, intellectual property and culture.

The Chinese government will be contributing 16.7% of the fund and non-government investors contributing the rest. The fund will be available to both state-owned and private enterprises, and is the first fund promoting service exports towards China.

Moreover, foreign investors are very keen on getting into the Chinese market. Indeed, from January to November 2016, foreign investment in services was as high as 513.3 billion RMB ($74.6 billion USD), an increase of 8% year on year. The IT services industry accounted for 88.14 billion RMB ($12.8 billion USD). Foreign investment is the highest in consulting and retail services.

In October 2016, a service reform made investing easier than before by reducing restrictions in elder care, private education and sports services.

Data show that China is progressively switching from a manufacturing country to a service-led economy. And the progression is actually fast, as well as sure.

Some difficulties remain for international services companies who want to operate in China. Indeed, to operate locally means that a good understanding of Chinese culture needs to be mastered. Another obstacle is that companies find themselves swallowed by their Chinese competitors (for example Uber China, who was bought by DiDi).

China's market transformation from a manufacturing country to a service-led economy shows that China's market is more and more mature and less relying on manufacture and heavy industry. Government's directives are set to help this trend going forward, with the set up of a CNY 30 billion fund, and the relaxation of policies.
China would be able to maintain the service sector's growth thanks to the demand, and investments, from abroad. The rise of e-commerce (Taobao, JD, Vip.com, Tmall ...) and technology are also huge catalysts to the services industry's expansion.
In addition, higher incomes come from the increase of employment in the high added value industry, which leads to higher consumption, and ultimately, in growth.

China shouldn't be seen just as a production base anymore. It became a services base, not only for consulting services that are now widespread in the country, but also for services related to robotics, IT, security, and finance (just to name a few). This shift in the Chinese economic composition could bring new opportunities for service companies, working in different sectors. As China seems more and more hungry for growth and improvement, overseas companies should not let it fade.

How is China going to evolve regarding the average salary's growth in the upcoming years?

By Saro Capozzoli, Tristan Gonnord – Jesa

China has been the World's factory for numerous years, and foreign companies benefited from the low costs of both raw materials and salaries to outsource production activities. Things have changed. China evolved into a developed country, especially in coastal areas and in first to third tiers cities. The worker class evolved following the economic boom of the early and mid-2000s and transforming itself into a new middle class, with a high expense power. Indeed, things have significantly changed: in the past 10 years the minimum wage rose to 2300 RMB/month and is expected to increase by around 7% in 2017.

China is about to experience something new in its recent history, since companies are relocating their production from China to Bangladesh or Vietnam for example.

Will unemployment become the norm? It seems this won't be the case. According to Morgan Stanley's forecasts, wages will continue to increase and will reach a GNI of above $12,500 by 2027. This means China will turn into a high-income society. Not only people will have money to spend, but also they will consider themselves as too qualified to accept certain jobs. Consequently, companies may face, and some are already tackling the problem, a lack of blue collars. The lack of human resources normally pushes companies in paying more to attract them. For example, this phenomenon in late 2015 obliged the Guangdong Provincial Government to freeze the average salary for two years in order to let companies cut costs.

Nevertheless, a growth in the average salary can be very positive. For example, some positive effects can be listed as below:

-**The working environment can improve and ameliorate, as workers may be motivated and perform well; as a consequence, profits may increase;**

-**The company can easily retain talents (loyalty);**

-**Workers can shop and spend, they can have choices and rise expectations; consequently, the whole economy may benefit;**

-**Workers can have good living standards.**

Reasons to explain why salaries in China are growing are quite interesting. One of the main reasons is that China could have reached the Lewis Turing point that is when the demand of labour force is bigger than the supply. Given the lack of labour force, salaries might have risen to attract it. In addition, public concern related to low salaries and inequalities have helped convincing the Chinese government to include a new provision in the 5-years plan. This states that firms must increase wages by at least 13% every year. Moreover, other reasons can be found in the access to education, which is more and more widespread every year (investments in education were worth 4% of 2016's GDP). This surely produces skilled workers. Also, the young generations' trend to travel and study abroad take a strong part in creating a high-skilled labour force.

China aims to transform its value chain, turning from a labour based economy into a services based one, focusing also on healthcare and environmental sustainability. This transformation might allow changing the current society into a high-income one, with equally distributed high living standards. China's economy would be based on services and consumption (around 47% of its GDP by 2030) becoming the third country with more than 20 million inhabitants, after Poland and South Korea, to undergo this major change.

VAT Normal Invoice Information

Please kindly be noted that from July 1st 2017, as required by National Tax Bureau through regulation number No.16 [2017] issued on May 26, 2017, VAT Normal Invoices shall also indicate entitled company's tax ID number and other details.

Otherwise, they cannot be recognized by tax bureau and used for bookkeeping as well.

Before, this requirement was applied only to VAT Special invoices.

For this, we take the chance to explain you briefly the difference between VAT Normal Invoice and VAT Special Invoice for your reference and a better understanding.

For a special invoice the company obtains the invoices from the venders and suppliers, the special invoices need to be verified through the scanner into the tax declaration system. This can be referred to as the VAT input. When the company has the revenue, the VAT output is generated. Furthermore, VAT input can be deducted from the VAT output paid or not. When a company obtains a normal invoice from vendors and suppliers, the invoice can′t be deducted from the VAT output.

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