



Macro Economy Thematic Report

Chinese service catching up with Chinese manufacturing

Highlights

- ❖ **International experiences showing that the service sector will boom when GDP per capita reaches a certain level.** The service sector will be structurally upgraded, as the share of production-service in GDP is to go up rapidly, that of logistics service to down gradually; service trade is to shift from resource/labor intensive traditional service to knowledge/technology/capital modern service.
- ❖ **China's service embarking a fast development path.** Opportunities have currently shown up for acceleration of service growth. China's GDP per capita has reached a certain point where service is to grow fast. The new 36 rules is to break state control on the service sector and therefore to promote private investment. Urbanization is accelerating leading to urbanization ratio from 1% to 5%, as a result of reform on "hu kou" system. FDI investment in service has surpassed that in manufacturing as a result of an accelerating transfer of global service to China. All these will greatly promote service development in China. We expect the size and structure of China's service sectors to be improved significantly, leading the nation from a big player to a strong player in international trade. China's service import and export in global service trade will increase from the current 4% and 5% to 8% and 9% respectively, making China the second largest player of global service trade.
- ❖ **Production services with the highest growth potential.** Production service as an advanced input in manufacturing is to leap. Production service includes information transmission, computer service & software, finance, leasing & commercial service, scientific research, technological service and geological exploration. We expect production service to grow by over 20% in the coming five years, higher than the sector average. In the long run, the share of production services in the total service will reach to 50%. Energy conservation & environmental protection, leasing and commercial services will outperform.
- ❖ **Steady growth of consumption services.** With release of labor bonus, increase of income per capita and the aging population, demand for life-enrichment service will gradually increase, which will lead to a steady growth of personal consumption services including education, health care, culture and entertainment. At present, the creative entertainment service accounts for 3% of China's GDP, and this ratio is likely to reach 8% going forward as that in the developed countries.
- ❖ **Wholesale & retail services enjoying more room of development.** The wholesale and retail services account for a relatively small share in China's GDP, less than 1/2 of that in the US and Japan. Furthermore, both of its scale and the market concentration are at the low side. For example, the asset size of China's largest retailer, Suning Appliances, is only 1/54 of that of the world leader Wal-Mart; the combined market share of the three largest health care wholesalers in China is 20% in comparison with the US's 90% and Japan's 67%. The gap indicates more room for China's wholesale & retail service development.
- ❖ **Transportation, warehousing and postal services emphasizing industrial upgrade.** Although the share of transportation, warehousing and postal services to China's GDP is similar to that of OECD countries, their labor productivity is significantly lower. Furthermore, the GDP share and investment growth of these three services have shown downward trend. The future focus is to be structural upgrading.

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Performance of stock or sector relative to MSCI-China over next 6 months after research publications

	Rating	Remark
Stock rating	Buy	Relative performance over MSCI-China Index >20%
	Overweight	Relative performance over MSCI-China Index 5% ~ 20%
	Hold	Relative performance over MSCI-China Index -10% ~ 5%
	Sell	Relative performance over MSCI-China Index > -10%
	NR	Not rated
Sector rating	Outperform	Relative performance over MSCI-China Index >10%
	Neutral	Relative performance over MSCI-China Index -10% ~ 10%
	Underperform	Relative performance over MSCI-China Index > -10%

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