

## Bright Spots as China Reopens



China's zero-Covid policy has led to extensive lockdowns in major cities and disrupted businesses in many sectors of the economy. Though China will likely continue with zero-Covid until after the National Party Congress in October of this year, we anticipate China to gradually shift towards a softer approach to Covid outbreaks based on regular mass testing. As restrictions are relaxed, we are seeing early signs of a consumption recovery and expect select sectors of the economy to benefit more than others from China's reopening.

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## Domestic travel and duty free shops

As mobility and travel restrictions ease, the domestic travel sector is experiencing continued improvement. In the near term, Chinese consumers prefer short-distance travel and plan day trips as opposed to international travel due to uncertainty around future outbreaks and travel policies. In Shanghai, the lifting of restrictions on June 1, has already led to a pick-up in travel activity with additional domestic flights scheduled in the first few weeks after lockdown. During the popular Dragon Boat Holiday (June 3-5) this year, there were 79.6 million domestic trips (up from 48.8 million in 2020).<sup>1</sup> Though this was approximately 87% of pre-pandemic levels, it was a meaningful improvement from 2020 levels and presents a catch-up opportunity. Local provinces are also encouraging travel-related spending with more than 20 provinces issuing consumption coupons worth billions of yuan for hotels, dining, package trips, and cultural landmarks.

### Weekly domestic flight schedules across select Chinese cities

(Indexed to 2019 Average Domestic Schedules)

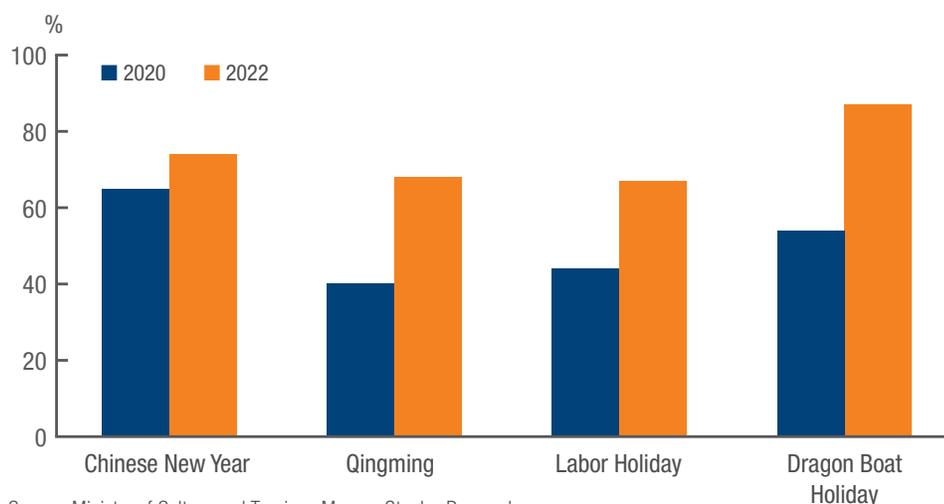
	MAY 30	JUNE 6	JUNE 20	JULY 11	AUGUST 1	AUGUST 22
Beijing	44	76	79	95	101	106
Shanghai	36	63	75	97	96	103
Shenzhen	75	95	99	104	102	109
Guangzhou	59	92	102	112	107	108

Source: OAG Schedules Analyzer, JP Morgan

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### Total domestic tourist volume

(as a percentage of 2019 levels during the same period)



Source: Ministry of Culture and Tourism, Morgan Stanley Research

In addition to airports, a return to travel should also be positive for related industries such as duty-free shopping. China's Hainan Island, a top tropical vacation destination and designated free-trade zone, is a popular duty-free shopping location for Chinese tourists. Duty-free sales in Hainan Island climbed to 60.2 billion yuan (\$9.4 billion) in 2021, up 84% from a year earlier.<sup>2</sup> The island's booming duty-free market and the Chinese government's push to repatriate outbound spending by Chinese travelers should provide substantial upside potential for companies like China Tourism Group, a major duty-free network operator in China.

Though travel has not reached pre-pandemic levels, the demand for travel should increase as consumer confidence stabilizes. We anticipate confidence in domestic travel to rebound as mobility restrictions continue to be relaxed and Covid outbreaks are controlled.

<sup>1</sup>Ministry of Culture and Tourism, Morgan Stanley Research

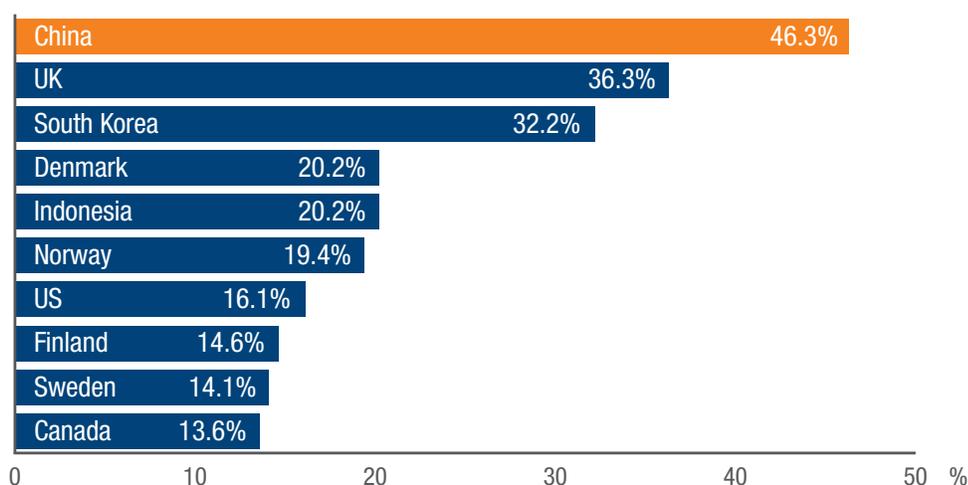
<sup>2</sup>The State Council the People's Republic of China, Jan 2022

## Leading e-commerce and retail names

Boosting consumption will be key to China's economic recovery. Even before the Covid-19 pandemic, China was already the world's largest e-commerce market and lockdowns have accelerated the ongoing shift from traditional retail to online channels, making e-commerce an essential part of life. E-commerce usage is no longer only for young and tech-savvy consumers. Lockdowns have conditioned a wider demographic to shop online. Older consumers, aged 45 and over, are one of the fastest growing groups to convert from offline to online shopping, growing 35% year-over-year<sup>3</sup> and this trend is likely to remain in a post Covid-19 environment. Top e-commerce companies, such as Alibaba and JD.com, with large user bases and vast ecosystems, should be able to capitalize on a wide range of customer segments and fast-changing consumer demands. The Chinese government's crackdown on the tech sector which started at the end of 2020 appears to be easing and there are signs that tech companies are entering a more supportive regulatory environment.

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Top 10 countries, ranked by retail ecommerce share of total retail sales 2022 (percentage of total retail sales)



Note: includes products or services ordered using the internet via any device, regardless of the method of payment or fulfillment; excludes travel and event tickets, payments such as bill pay, taxes or money transfers, food services and drinking place sales, gambling and other vice good sales.

Source: eMarketer, January 2022.

In 2021, China announced the National Fitness Plan (2021-2025) to promote the development of the fitness industry and encourage healthier lifestyles. The 5-year program includes establishing or expanding sports parks, fitness facilities and public stadiums within a 15-minute walk for residents. The goal of the National Fitness Plan is to increase the market size of the sports industry from RMB 2.95 trillion (\$463 billion) in 2019 to RMB 5 trillion (\$785 billion) by 2025.<sup>4</sup> As the government emphasizes the importance of a health-conscious society, the demand for personal fitness products has significantly increased. Leading local sportswear brand, Li Ning, grew its revenue 56% year-over-year in 2021<sup>5</sup> as the company benefited from the increasing popularity of athleisure wear and rising health awareness.

<sup>3</sup>Alibaba Investor Day Presentation, Y-o-y growth number is for the twelve-month period ended 9/31/21.

<sup>4</sup>National Bureau of Statistics

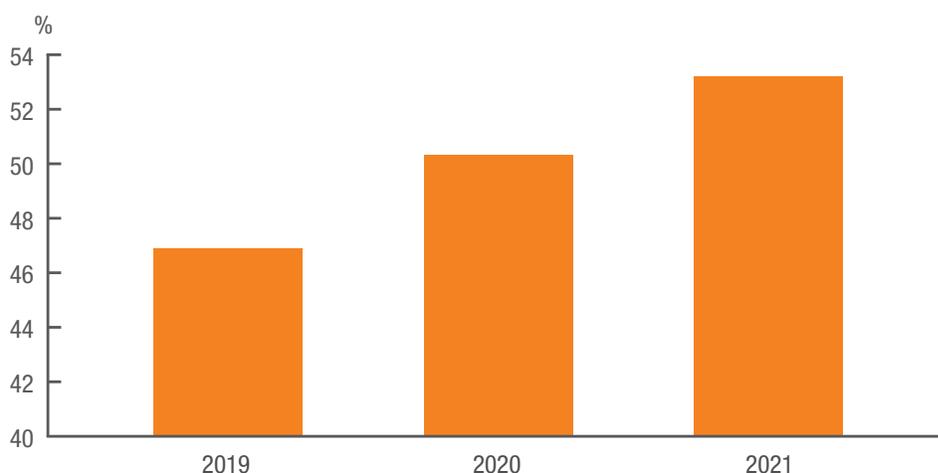
<sup>5</sup>Li Ning Annual Report 2021

## Outside of China

China's large consumer base has a long reach and a reopening in China is also favorable for markets and sectors outside of China. Chinese consumers are a significant market for many Korean brands, especially for cosmetics and personal goods. Korean beauty brands are generally regarded as quality products, innovative and have accessible price points. In 2021, China was the largest importer of South Korean cosmetics products, accounting for 53.2% of the market.<sup>6</sup> The demand for Korean cosmetic and skincare products should continue to attract Chinese consumers as they re-emerge from their homes and social distancing rules are lifted.

China's path to a robust economic recovery will come from a broad reopening. The government's zero-Covid policy has created substantial pent-up demand for travel and discretionary spending and any further easing of restrictions should lead to a stabilization in consumer confidence and a revival in domestic demand.

### China's market share for Korean beauty products



Source: CosmeticDesign-Asia, GlobalCosmeticsNews, Ministry of Food and Drug Safety.

## A Gradual Consumption Rebound

China's path to a robust economic recovery will come from a broad reopening. The government's zero-Covid policy has created substantial pent-up demand for travel and discretionary spending and any further easing of restrictions should lead to a stabilization in consumer confidence and a revival in domestic demand. Though the travel recovery is still in the early stages, the desire and demand for travel remain, and the increased interest in domestic travel has created new growth opportunities in the sector. Leading e-commerce companies can also tap into new online shopping trends born out of the lockdowns that will likely continue as life normalizes. The Chinese government has also unveiled measures to help spur consumption which should support a discretionary spending rebound.

<sup>6</sup>GlobalCosmeticsNews, Ministry of Food and Drug Safety

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As of 8/31/22: Top 10 holdings of the Emerging Markets Great Consumer Fund are Li Ning (7.5%), Alibaba Group (5.4%), BYD Company (4.7%), Apollo Hospitals (3.6%), Meituan (3.3%), Asian Paints (3.2%), China Tourism Group Duty Free (3.1%), HDFC Bank (2.9%), Reliance Industries (2.8%), and PT Bank Central Aisa (2.8%). Top 10 holdings of the Emerging Markets Fund are ICICI Bank (3.9%), Alibaba Group (3.8%), Tencent (3.4%), Taiwan Semiconductor (3.3%), Meituan (2.6%), Hyundai Motor (2.4%), IHH Healthcare (2.4%), JD.com (2.4%), HDFC Bank (2.3%), and Tongwei (2.2%). Holdings are subject to change at any time.

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