

MORGAN CREEK

CAPITAL MANAGEMENT

ALTERNATIVE THINKING ABOUT INVESTMENTS

New China Perspectives



Welcome to the latest issue of Morgan Creek's **New China Perspectives**. This issue is comprised of research from Morgan Creek's China-based investment team together with curated articles of interest. In addition to timely political and economic news covering greater China, Morgan Creek's China team seeks to provide in-depth perspectives on investing in the technology, consumer and healthcare sectors in the region. Our research leverages the "on the ground" insights of our team together with

Morgan Creek's decades-long experience in covering the region. To learn more about our team and investment offerings, please email chinateam@morgancreekc.com.

Best Regards,

Handwritten signature of Mark W. Yusko in black ink.

Mark W. Yusko
CEO & CIO

NOTES FROM THE BUND¹

This is the fourth installment of a five-part series exploring China's dual circulation model. In the prior newsletter, we discussed the approaches by which China is actively improving its productivity. In this newsletter, we will dive deeper into China's playbook to boost its consumption as the sustainable driver of economic growth.

China's playbook to stimulate consumption

The Chinese government is trying to shift the driving force of economic growth to the domestic market, where they plan to leverage China's approximately 400 million middle-class citizens, the largest in the world. China announced this policy most recently in its 20th National Congress, where it sought to enhance the "fundamental role of consumption in driving China's future economic development".²

China has grown by deliberately pooling limited national resources into certain regions and industries and "let[ting] some get rich first". While this model was successful in growing China's GDP, it also brought about unequal development and resulted in significant wealth and social inequalities. In 2021, the five Chinese provinces with the highest GDP generated 40% of the national GDP with only 7% of the total land area, while the lowest five only generated 2% of the national GDP with 26% of the total land area.³

Deng Xiaoping's economic theory of "Early and Common Prosperity" had two parts: after achieving the means, the economic "haves" who benefitted from China's initial concentration of resources should assist the "have-nots", with the goal of bringing the whole country towards prosperity. This is more easily said than done, and the central government is experimenting with various policies to increase the size of the consumption pie and change the structure of consumption – which is currently over-concentrated in property, education and healthcare, the so-

called “three great mountains”.

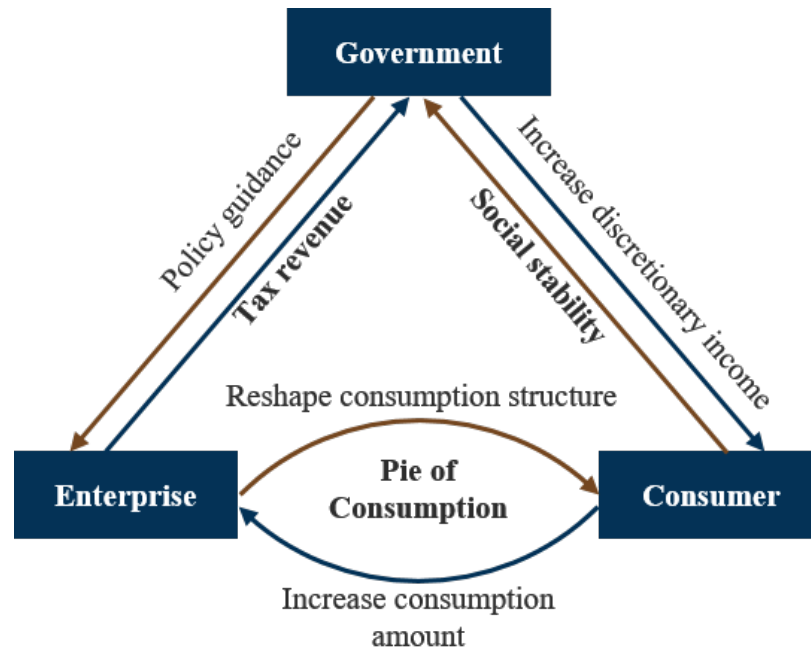


Figure 1: Government Playbook to Stimulate Consumption

The blue arrows in the cycle shown above illustrate how the government plans to encourage increased consumption by increasing its citizens’ discretionary income. This extra consumer spending finds its way back to companies in the form of higher profits and to governments in the form of increased tax revenue. Moving counterclockwise, the brown arrows demonstrate how the government inserts its influence on consumption with policy tools. The Chinese government has a robust toolkit of policies including subsidies and loans to encourage the production (and consumption) of goods and services that bring positive benefits to society; and taxes and controls on goods and services that bring negative externalities to society. The ultimate goal of the government is stability – which can only be achieved with a contented/peaceful society.

Increase consumption pie

In the short term, the PBC⁴ has maintained low-interest rates to encourage consumption. In addition to the loose monetary policy, during the pandemic, municipal governments distributed large amounts of consumer vouchers to stimulate local consumption. In 2020, RMB 19 billion worth of vouchers were issued across 170 Chinese cities.⁵ In 2022, three additional rounds of vouchers in excess of RMB 1 billion in total value were issued to citizens in Shanghai.⁶

In the long term, China plans to increase the purchasing ability of its population at all levels. As an example, China reached its milestone in poverty alleviation and declared the elimination of abject poverty⁷ in 2020; this level was as high as 17% a decade earlier. Government aid focuses on households struggling with poverty while high value-added and labor-intensive industries are transferred to lesser-developed inland regions to create more job opportunities.

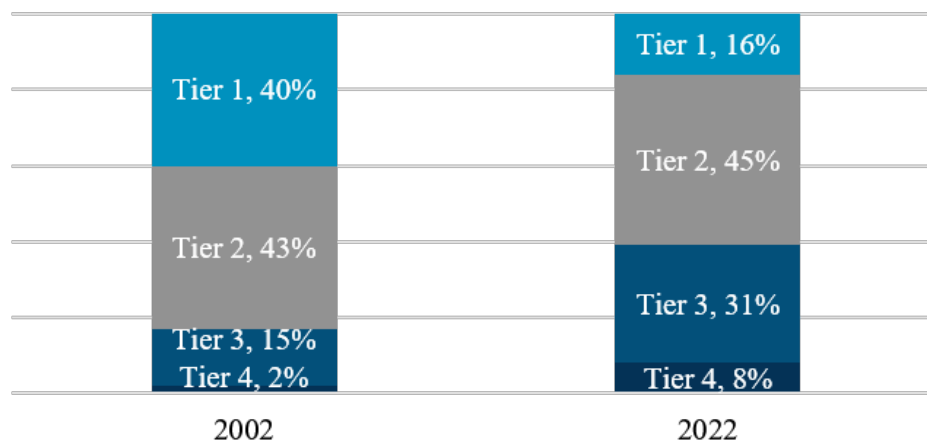


Figure 2: Share of Middle Class by City Tiers⁸

Since the 2010s, Chinese citizens' disposable income has grown rapidly at an annual pace of 9.4%, compared with 3.4% in the US. By 2022, more than 75% of China's urban consumers earn \$9,000-\$34,000 annually to reach urban middle-class status, as defined by McKinsey. In the past two decades, the geographical distribution of the middle class has rebalanced to some extent, symbolized by the middle-class share almost doubling in tier 3 cities. The rise of middle-class purchasing power in lower-tier cities has facilitated the consumption market. In the meantime, the higher-end consumer brands have opportunities to expand their business from urban to rural cities.

Change the structure of consumption

China has one of the largest national savings rates in the world at 40% of disposable income, compared to the global average of 20%, and 15% for emerging economies.⁹ China's high savings rate is a function of a lack of a social safety net, but also unsustainably high living expenses, including the "three great mountains" of property, education and healthcare. For a typical family in China, almost 43% of disposable income spending is in these three categories alone. The authorities have tried to mitigate this burden on families through a mix of regulations and increased social spending in certain areas.

Property

Chinese people have one of the highest home ownership rates in the world and multiple home ownership is higher than that of many developed countries.¹⁰ Home ownership can be a precondition for marriage¹¹ in many cases, and where one lives is also a primary determinant of where one's child is allowed to enroll in school. Like other places in the world, homes in China are sometimes viewed as investments to park excess savings and are sometimes subject to speculation. For all these reasons, since 2011, overall home prices across China have grown by more than 50%, with Tier 1 city prices more than doubling over the same period. The government has published a series of policies aimed at curbing speculation and moderating housing prices, including indemnificatory housing¹², price caps on new homes and stricter developer regulation. Combined with demand-side restrictions like purchase quotas and qualifications, China has managed to moderate the growth of housing prices in recent years.

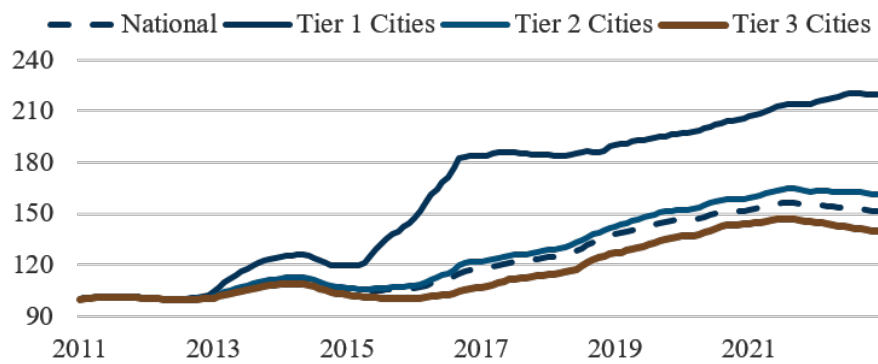


Figure 3: China Housing Price Index (2011=100)¹²

Education

The root cause of China’s challenge in education is the lack of education resources as measured relative to its massive population. Many Chinese believe that education is the key to a good career, and an overwhelming majority aim for admissions into the best universities in China: Beijing University, Tsinghua University and Fudan University, etc. The admissions rate for Beijing and Tsinghua is 0.03% and 0.05%, respectively¹³, compared to 3.9% for Harvard. To gain access to quality tertiary education, Chinese student families pay heavily for afterschool tutoring making the average cost of raising a child in urban China, at almost \$100,000, higher than that of Japan or the US. The government is now determined to shift the financial burden away from families towards the public by increasing the supply of good domestic universities through additional funding for teaching and research. In 2022, China for the first time surpassed the US on a major ranking of the world’s best 2,000 universities, with 338 Chinese universities making the list compared to 280 from the US.¹⁴

Healthcare

The idea of saving for possible future health conditions is still prevalent in China. For this reason, the government is pushing national healthcare insurance forward to reduce patients’ private expenditures. Currently, the National Reimbursement Drug List (2017) covers 2,967 drugs, 771 more compared to the list in 2009, and continues to grow with up to 100 new drugs added annually.¹⁵ National healthcare insurance currently focuses on increasing the social safety net and reducing the chance of family poverty due to unexpected serious illnesses.

Expectations in 2023

China will attempt to reorient its economy towards domestic consumption by increasing consumer spending and changing the structure of consumer spending. In Premier Li Keqiang’s final Government Work Report in 2023, he announced that China has set its goal of resident income growth at 5% in the coming year. He also unveiled RMB 3.8 trillion in special municipal bonds to stimulate government-led investment and domestic consumption.¹⁶

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CHINA NEWS SPOTLIGHT

China’s War Chest: How Beijing is Using its Currency to Insulate Against Future Sanctions:

For more than a decade, Beijing has been trying to reduce its reliance on the dollar, motivated by risks emerging from the US economy – such as the financial crash of 2008 – and the desire to boost its own sphere of influence. But in the last year, a drive to insulate China’s economy from dollar-based sanctions has emerged as possibly the most important incentive for decoupling from the dollar, as China looks to prepare for the possibility of conflict with Taiwan. [Read More.](#)

China's Service Sector Remains a Bright Spot as Factory Data Disappoints, Caixin Reading Shows: China's services activity remained well within growth territory in April, even as a private survey showed a softer reading compared with March. The Caixin/S&P Global services purchasing managers' index fell to 56.4 in April from 57.8 in the previous month. That's still the second-highest figure recorded since November 2020. [Read More.](#)

Xi to Chair China-Central Asia Summit : President Xi Jinping will chair the China-Central Asia Summit on May 18 and 19 in Xi'an, Shaanxi province, Foreign Ministry spokeswoman Hua Chunying announced. The summit will bring together President Kassym-Jomart Tokayev of Kazakhstan, President Sadyr Japarov of Kyrgyzstan, President Emomali Rahmon of Tajikistan, President Serdar Berdimuhamedov of Turkmenistan, and President Shavkat Mirziyoyev of Uzbekistan, she said. [Read More.](#)

Chinese President Xi Jinping Says Economic Growth Plans Must Focus on Manufacturing and Technology: China should rely on advanced manufacturing and technology and cultivate talent to drive future growth, President Xi Jinping has told a meeting discussing the country's development strategy. The country should "focus on the real economy" – meaning the production and sale of physical goods and services – instead of areas such as finance and property that may lead to bubbles, Xi told a meeting of the Central Financial and Economic Affairs Commission on Friday. [Read More.](#)

CATL Unveils Battery that may Power Electric Airplanes and 1000km-range EVs: At a recent Shanghai auto expo, the world's largest battery maker unveiled a battery it claimed could power electric aircraft or propel electric vehicles (EVs) beyond 1,000 kilometres on a single charge. Chinese Amperex Technology Limited (CATL), which makes one-third of the world's EV batteries, shared few details about the technology but said it would start mass production later this year. [Read More.](#)

Infineon Signs Long-term Agreement with Chinese Silicon Carbide Supplier TankeBlue: Infineon Technologies is diversifying its silicon carbide (SiC) supplier base and has signed a long-term agreement with Chinese SiC supplier TankeBlue to secure additional competitive SiC sources, according to the Germany-based IDM. [Read More.](#)

Iflytek Unveils ChatGPT Rival Amid China Oversight: Chinese voice-recognition company Iflytek Co. has entered the race to build a rival to OpenAI Inc.'s ChatGPT, with a live demonstration of its artificial intelligence model for educational and enterprise uses, even as Beijing signaled more oversight of the industry. Chairman Liu Qingfeng unveiled its SparkDesk at an event in the eastern city of Hefei, employing voice-recognition prompts to ask the chatbot in Chinese and English to assess student essays and compose hypothetical stories about Confucius' attendance at the 2008 Olympics in Beijing. [Read More.](#)

BeiGene Receives New Approvals for BRUKINSA® (zanubrutinib) in China: BeiGene (NASDAQ: BGNE; HKEX: 06160; SSE: 688235), a global biotechnology company, announced the China National Medical Products Administration (NMPA) approved four applications for BRUKINSA (zanubrutinib), the company's Bruton's tyrosine kinase inhibitor (BTKi), including two Supplemental New Drug Applications for treatment-naïve adults with chronic lymphocytic leukemia (CLL) or small lymphocytic lymphoma (SLL) and Waldenström's macroglobulinemia (WM), and two Supplemental Applications for conversions from conditional approval to regular approval. [Read More.](#)

China Cancer Antibodies Market Size Clinical Trials Companies Insight: China has emerged as one of the predominant clinical research and development epicenters leading the development of cancer antibodies in the global pharmaceutical industry landscape. In order to remain relevant and competent in the industry, Chinese researchers and pharmaceutical companies have tried to encapsulate all developments happening on the global landscape in the regional market as well. This has led to the entry of multispecific antibodies in China's pipelines at various drug development stages. [Read More.](#)

¹The Bund is a historic waterfront area in central Shanghai, where Morgan Creek's office is located. From the 1860s to the 1930s, it was the rich and powerful center of the foreign establishment in Shanghai, operating as a legally protected treaty port. The picture above is part of the historical waterfront.

²Source: Xi Jinping: Hold High the Great Banner of Socialism with Chinese Characteristics and Work Together to Build a Modern Socialist Country in an All-round Way—Report at the Twentieth National Congress of the Communist Party of China, <http://www.gov.cn/>, Oct 25th, 2022

³Source: National Bureau of Statistics

⁴ Note: People's Bank of China, the central bank of China

⁵ Source: A total of more than 19 billion consumer vouchers have been issued in over 170 cities across the country, which has a significant effect in promoting consumption, <https://m.thepaper.cn/>, May 13th, 2020

⁶ Source: First time in Shanghai! The 1 billion "big red envelope" is here and will be distributed in three rounds! Alipay, WeChat, and Cloud QuickPass are all available, People's Information, Aug 18th, 2022

⁷ Note: Minimal annual spending of \$340 per person, according to "2010 standard".

⁸ Source: Mapping China's middle class, <https://www.mckinsey.com/>, Jun 1st, 2013

⁹ Source: China's High Savings: Drivers, Prospects, and Policies, <https://www.elibrary.imf.org/>, Dec 11th, 2018

¹⁰ Source: Introduction to special issue: unpacking the Chinese dream of homeownership <https://link.springer.com/>, Feb 20th, 2021

¹¹ Source: For Many Chinese Men, No House Means No Marriage <https://cardiffjournalism.co.uk/>, Aug 31st, 2020

¹² Note: Indemnificatory housing complexes are government subsidized apartments offering affordable rent options to low-income families in China

¹³ Source: National Bureau of Statistics

¹⁴ Source: China on the rise in latest global university rankings <https://www.thenationalnews.com/>, Oct 28th, 2022

¹⁵ Source: Best Global Universities in China <https://www.usnews.com/>, 2022

¹⁶ Note: National Healthcare Security Administration

¹⁷ Source: Government Work Report - Premier Li Keqiang at the First Session of the Fourteenth National People's Congress on March 5, 2023, <http://www.gov.cn/>, Mar 14th, 2023

Important Disclosures

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Morgan Creek Capital Management | 301 W. Barbee Chapel Road, Suite 200, Chapel Hill, NC 27517

[Unsubscribe ljacob@morgancreekcap.com](mailto:ljacob@morgancreekcap.com)

[Constant Contact Data Notice](#)

Sent by myusko@morgancreekcap.com