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Executive summary

The Chinese consumer has finally come of age. The traditional drivers of China's economy, investment and exports, are struggling, but the country's consumers keep spending. Private consumption is now the main driver of economic growth in China, and The Economist Intelligence Unit (The EIU) expects it will grow in real terms by 5.5% a year on average in 2016-30 – boosting its share of the overall economy to nearly 50%. The incremental growth we expect in private consumption in China over the next 15 years is more than current level of consumer expenditure in the EU.

In this report we use The EIU's bespoke China data and forecasts, covering each of the country's 31 provinces and nearly 300 prefecture cities, to highlight trends and developments in the consumer market that will be vital for companies to understand if they are to grasp hold of opportunities. In this report our analysts show how income distribution is set to change radically over the next 15 years, as more consumers move into the middle-class income bracket; identify the regions of the country that will see the highest concentrations of high-income individuals; and use cross-country comparisons to identify parts of the Chinese consumer market that are set for "take-off" growth. Among the key takeaways in this report:

- We expect nearly 35% of the population, or around 480m consumers, to meet our definitions of upper middle-income and high-income by 2030. That represents a sharp increase on the 10% (132m) at present. The emergence of this large population, with a personal disposable income of at least US$10,000, will alter the consumer landscape in China.

- Income will become more dispersed, rather than concentrated in first-tier cities on the eastern coast. Major interior cities, such as Changsha, Chengdu, Chongqing and Wuhan are set to see sizeable leaps, with each having at least 2m high-income consumers by 2030. Nevertheless, smaller cities and those undergoing industrial restructuring risk being left behind, suggesting that high levels of income inequality will persist.

- Rising discretionary income will drive changes in consumer tastes and preferences. Around 30% of the spending by the average Chinese consumer is still allocated to food, compared with only 15% in South Korea. As income levels rise, consumers will look to upgrade consumption habits and switch to more expensive and premium brands. We pinpoint how this will play out in the automotive, tourism and financial services sectors.

Understanding these trends and the scope for regional divergence in China will be critical for consumer goods firms. Access to robust data and local knowledge will be essential. There are also challenges to navigate. China's economic trajectory has become more uncertain, and firms will need to monitor risks accordingly in order to stay ahead of the curve.

Introduction

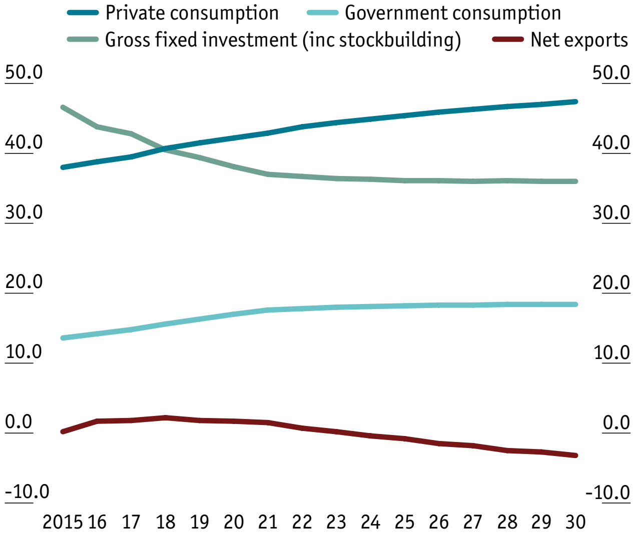
The Chinese economy is slowing and financial risks have mounted, but one bright spot remains and that is consumption. Sustained income growth, the introduction of e-commerce and the increased sophistication of consumers continue to underpin consumer spending, even as other drivers of economic expansion falter. In 2015 real private consumption rose by 8.4%, against overall GDP growth of 6.9%, according to estimates by The Economist Intelligence Unit (EIU), and we forecast that it will increase at an average annual rate of 5.5% in the next 15 years.

This will reshape the Chinese economy: by 2030 private consumption is forecast to represent 47.4% of nominal GDP, compared with 38% in 2015. The incremental gain that we anticipate in Chinese private consumption over the next 15 years will be bigger than the entire consumer economy of the EU today. We expect that Chinese consumer purchasing power in 2030, measured in terms of nominal GDP per head (in purchasing power parity terms), will be roughly akin to that of South Korea today or the US in 2000.

The rapid evolution of China's consumer market will make it tough for companies to keep up. The EIU's forecasts show that the portion of the population defined as low-income will shrink from 36.9% in 2015 to just 11% in 2030. There will be a corresponding bulge in the middle-income bracket, with a growing portion of the population falling within its upper reaches. The share of high-income consumers, with annual disposable income of above Rmb200,000 (US$32,100), will rise from just 2.6% in 2015 to 14.5% in 2030. China will look and feel like a more middle-class society, although inequalities in wealth will remain an important social challenge.

Structure of nominal GDP

(%)



Source: The Economist Intelligence Unit.

Meeting the needs of consumers will be complicated by geographical divergences. High-end consumption is currently concentrated within a handful of major coastal cities, but some dispersion ought to take place in the next 15 years. Significant high-income populations will emerge in interior provincial capitals such as Chongqing, Xi'an and Changsha. Less-developed parts of the country will still offer opportunities for consumer goods companies, as discretionary spending rises. However, such firms will need to be aware that consumption prospects in some regions will be weighed down by industrial restructuring challenges. Economic growth in China has become increasingly bifurcated.

Finally, consumer preferences will shift alongside changes in income levels and the wider adoption of middle-class lifestyles. Based on comparisons with more developed Asian economies and the fact that Chinese spending on food and housing is still relatively high, there remains plenty of scope to expand spending across several discretionary consumer goods and services categories. The emerging middle class will look to upgrade their consumption, shifting to higher quality and more branded products. Meanwhile, consumption in some currently underdeveloped areas, such as financial services, is set to pick up rapidly as the number of high-income consumers expands.

The arrival of the middle class

The EIU expects China's middle-income bracket to bulge in the next 15 years, with important implications for consumer habits and spending. The income growth we anticipate in the period to 2030 will result in a significant reduction in the share of the population with low or minimal incomes, and a corresponding jump in the demographic that could be broadly defined as middle-class. At the top end of the income spectrum, there will also be strong expansion in the number of affluent consumers, from a relatively low number in proportional terms in 2015.

In this paper we define four types of consumers in China: low-income consumers, whose personal disposable income is less than Rmb13,000 a year (equivalent to US$2,100 in 2015); lower middle-income consumers, with a disposable income of Rmb13,000–67,000 (US$2,100–10,800); upper middle-income consumers, with a disposable income of Rmb67,000–200,000 (US$10,800–32,100); and high-income consumers, with disposable income above Rmb200,000 (US$32,100). These thresholds are in 2015 prices, which we hold constant in making our forecasts to 2030 to allow for a like-for-like comparison.

We have fixed our thresholds according to assumptions about the purchasing power associated with different levels of disposable income. Low-income consumers are those with enough income only to cover the purchases of necessities such as food, clothing and basic services. Lower middle-income consumer have the ability to make small discretionary purchases, including of household appliances. Upper middle-income consumers are able to purchase cars, branded goods and properties in first- and second-tier cities. Finally, financial services, overseas travel and high-end consumer goods and services will be accessible to high-income individuals. These thresholds appear low when compared with international standards, but they reflect a lower cost of living in China.

Accounting for "grey income"

While all data estimated from surveys are subject to measurement errors, NBS income data are widely regarded as problematic. The main reason is that survey respondents underreport income in order to avoid tax and other complications. The problem is particularly prevalent among wealthy individuals. In addition, in-kind compensation that many employees receive in the form of benefits and allowances is not included in the NBS data, and this can be a sizable source of income.

To overcome deficiencies in the data, The EIU has used academic surveys to correct for unreported income. The most comprehensive work in this field has been led by Wang Xiaolu, a researcher affiliated with a domestic institute, the China Reform Foundation. His most recent available work, published in 2011, estimated that the average personal disposable income of the richest 20% of the urban population was Rmb54,900—around twice the official NBS number. The difference between the two is accounted for by grey income. As income levels go down, grey income also falls, according to Mr Wang's survey results. For the poorest 20% of the population, grey income was equivalent to less than 1% of the officially reported income.

The EIU's national and regional income distributions have been adjusted to account for grey income, using the survey data provided by Mr Wang's research as a foundation.

The EIU's income distribution figures are based on survey data provided by the National Bureau of Statistics (NBS), which we aggregate at the regional level to generate national-level figures and forecasts. NBS survey data are provided on a household basis, from which we calculate per head figures (based on the total population) that are a more helpful indicator for private consumption. Importantly, we also internally adjust official income data to account for unreported (or "grey") income. This allows us to provide a more accurate picture of income distribution in China, both at present and in the future. Our data therefore differ from those presented by the NBS, which we believe underestimates levels of income, particularly among high earners.

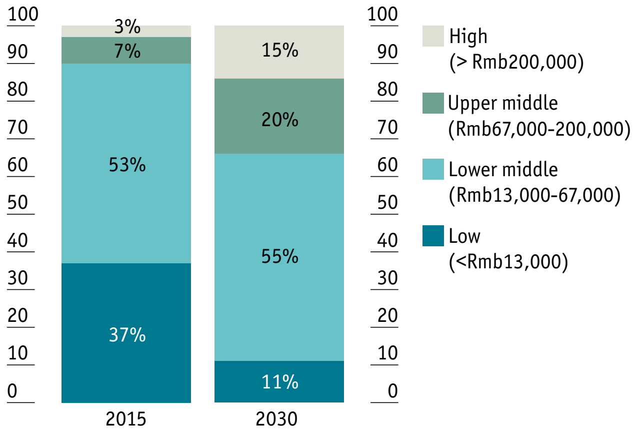
One of the main takeaways from our projections is the sharp narrowing in the low-income population over the next 15 years. According to The EIU's estimates, 36.9% of the total population, or around 503m people, belonged to this income bracket in 2015. By 2030, however, we expect only 11% of the population (or 155m) to be defined as low-income.

The majority of the low-income stratum will have moved into the lower middle-income bracket by 2030. This segment's share of the total population will remain roughly unchanged over the next 15 years, at just over 50%. This masks considerable flux, however, because as well as inflow from the low-income group there will also be considerable outflow to the upper middle-income bracket. The upper middle-income consumer population will expand from 97m in 2015 to 276m in 2030, boosting its share of the population from 7.1% to 19.7%. This demographic shift will create significant demand for consumer upgrade to higher quality consumer goods and services.

The group of high-income consumers, representing 2.6% or 35m of the population in 2015, was tiny in comparison with the other groups. Yet the size of this bracket will expand more quickly than any other income category, to 204m people in 2030, accounting for 14.5% of the population. The purchasing power of this segment of the population represents a huge opportunity for fostering the consumption of high-end consumer goods, international tourism and financial services—areas that have already begun to see strong demand growth.

By 2030, then, China will have many of the characteristics of a middle-class society, according to our baseline projections. Around three-quarters of the population could be defined as middle-income, although there will be significant variation in income levels between the upper and lower parts of that overall category. The creation of a high-income consumer class—compared with a relatively small elite at present—will also create new social dynamics. While a reduction in the size of the low-income group will be welcomed, wealth inequalities will persist and a failure to cater for those left behind could create social fissures.

Annual disposable income per capita distribution
(% of total population, grey income-adjusted, constant 2015 prices)



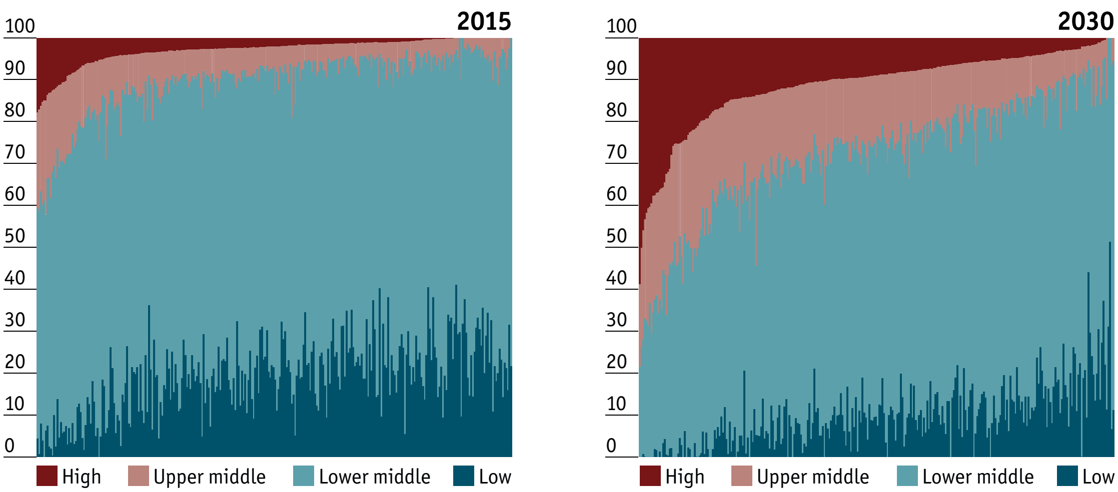
Source: The Economist Intelligence Unit.

Spreading the wealth

Understanding how these anticipated changes in income distribution will be distributed across China's geography is imperative if companies are to seize commercial opportunities. Variations in income levels will affect what type of goods and services will grow most rapidly, and in which areas. Regional disparities also provide an opportunity for companies to refocus their businesses once growth becomes stagnant in saturated markets. The EIU's data and forecasts covering 286 prefecture-level cities in China make us uniquely qualified to map these dynamics.

High-income and upper middle-income consumers will remain clustered in key urban areas and conurbations in the coming 15 years. In 2015 around 60% of the high-income and 48% of the upper middle-income consumer population lived across 20 cities. By 2030 these corresponding ratios will fall to 56% and 35% respectively, pointing to a modest spreading of consumers across these upper-income thresholds. Nevertheless, this diffusion probably falls short of the hopes of the government, whose urbanisation plans are focused on boosting the prospects of smaller third- and fourth-tier cities.

Prefectural distribution of disposable income per capita, 2015 & 2030
(% of total population, grey income-adjusted, constant 2015 prices)

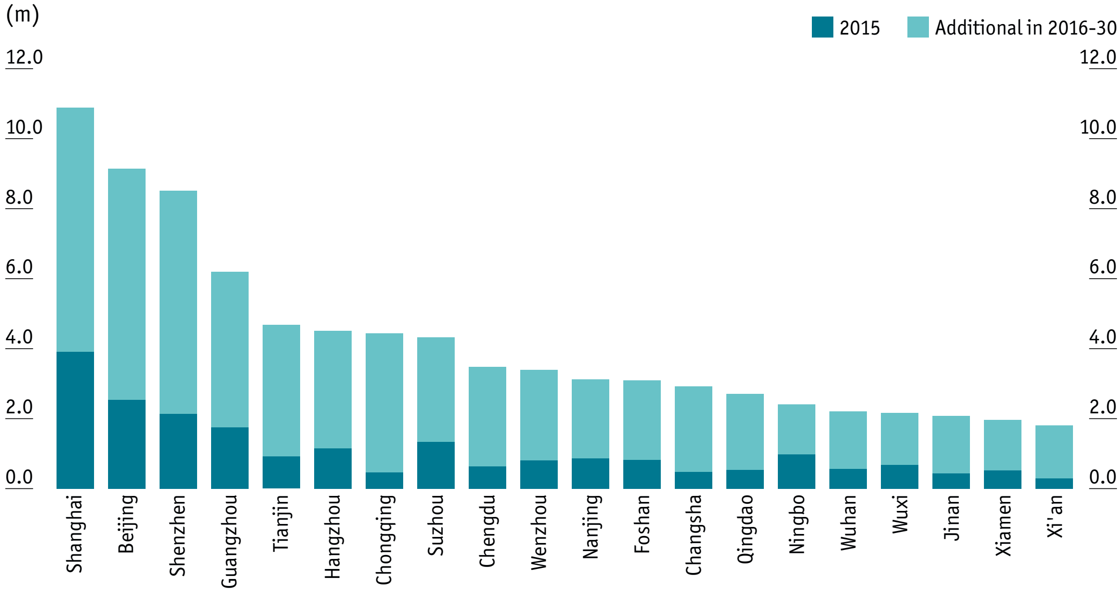


Note: Dataset includes 286 prefectures.
Source: The Economist Intelligence Unit.

A closer look at these 20 cities offers provides some interesting insights. The first-tier cities of Beijing, Guangzhou, Shanghai and Shenzhen will continue to lead the way in terms of the number of resident high-income consumers. Over the next 15 years the number of local residents with a disposable income per head of above Rmb200,000 will double in each of these cities, with Shanghai crossing the 10m mark (43.2% of its population). These megalopolises are followed by second-tier cities located along the eastern coast.

However, the strongest growth in high-income residents will come from a series of inland cities. The number of high-income consumers in the western municipality of Chongqing, for example, will increase almost tenfold in the coming 15 years, raising the overall number above 4m. Comparable gains will be made by interior provincial capitals such as Chengdu (Sichuan), Xi'an (Shaanxi) and Changsha (Hunan). All three cities have used cheaper labour and land to attract foreign and domestic companies looking to escape rising costs on China's eastern seaboard. This in turn has helped to boost levels of local income, employment and wealth creation.

Number of high-income consumers



Note: high-income consumers refer to individuals with a grey income-adjusted disposable income of above Rmb200,000 per year at 2015 constant prices.
Source: The Economist Intelligence Unit.

While these 20 cities ought to serve as the starting point for firms looking to tap wealthy consumers, there will also be opportunities elsewhere. Some of China's richest cities do not make the top 20 in absolute terms because of their relatively small populations. However, we estimate that high-income consumers in Zhuhai (Guangdong) and Shaoxing (Zhejiang), to take two examples, will account for 36% and 26% of the local populations respectively by 2030, much higher than the national average. This highlights the potential for pockets of demand for high-value-added goods and services outside major conurbations.

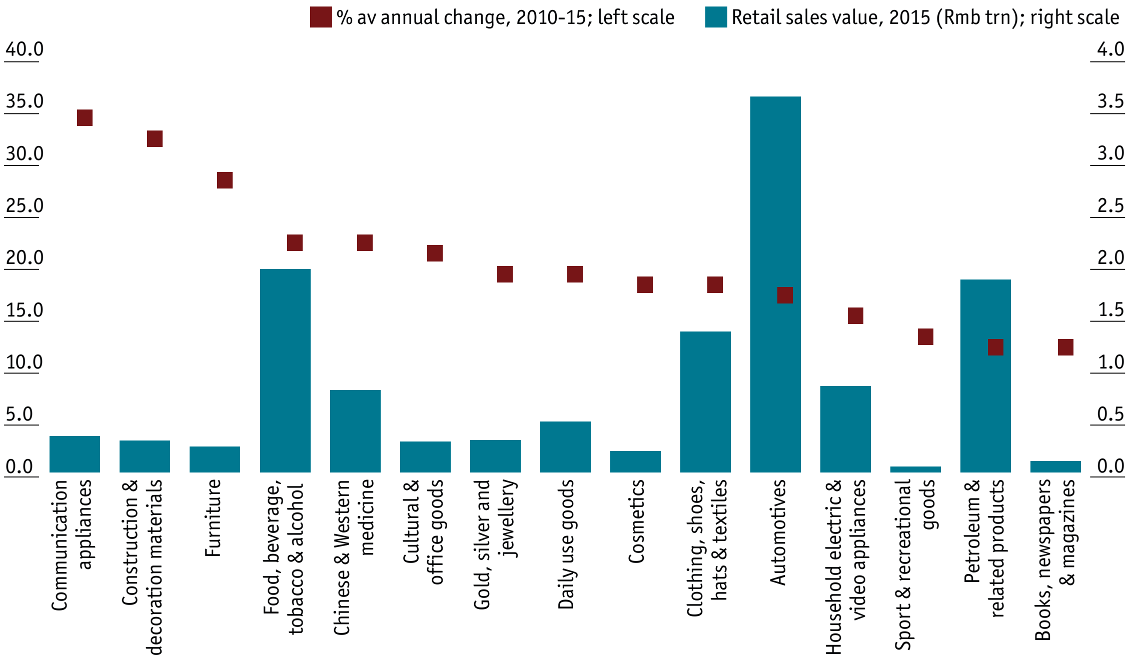
New patterns of consumption

These anticipated rises in income levels mean that Chinese consumption habits will also change. Individuals moving into the lower middle-income bracket will have greater room for discretionary spending on goods and services. Those entering the upper middle-income segment will be looking to upgrade their spending towards branded and premium products. Meanwhile, the growth in the high-income population means that new, emerging forms of high-end consumption, such as wealth management and insurance services, will become increasingly widespread. Understanding the likely way in which Chinese consumer behaviour will evolve in the next 15 years will be important if companies are to stay ahead of the curve.

The pattern of Chinese consumption has already changed drastically over the past decade. The most notable change has been a reduction in the proportion of spending on basic necessities. The proportion of average nominal consumption expenditure spent on food, beverages and tobacco fell to 30% in 2015, from 37% in 2005, according to calculations based on NBS household survey data. This is consistent with international practice: as incomes rise, consumers increase spending across a broader range of categories.

The fall in the proportion of spending on food is mirrored by a sharp rise in the allocation to housing. Spending on housing, which encompasses rents, utilities and imputed rents, jumped to

Value and growth of retail sales of consumer goods



Sources: National Bureau of Statistics; The Economist Intelligence Unit.

22% of total average expenditure in 2015, from just 10% a decade earlier. This reflects the rapid development of the local property market, as well as changes in how the NBS accounts for imputed rent. A growing share of expenditure has also gone to transport and communications.

Data on retail sales confirm these trends. Among the 15 categories tracked by the NBS, sales of communication appliances (mainly mobile phones and smartphones), building and decoration materials and furniture registered the highest average annual growth rates in 2010-15. The latter two categories are tied to the growth of the property market, while the first reflects a rise in discretionary consumer spending.

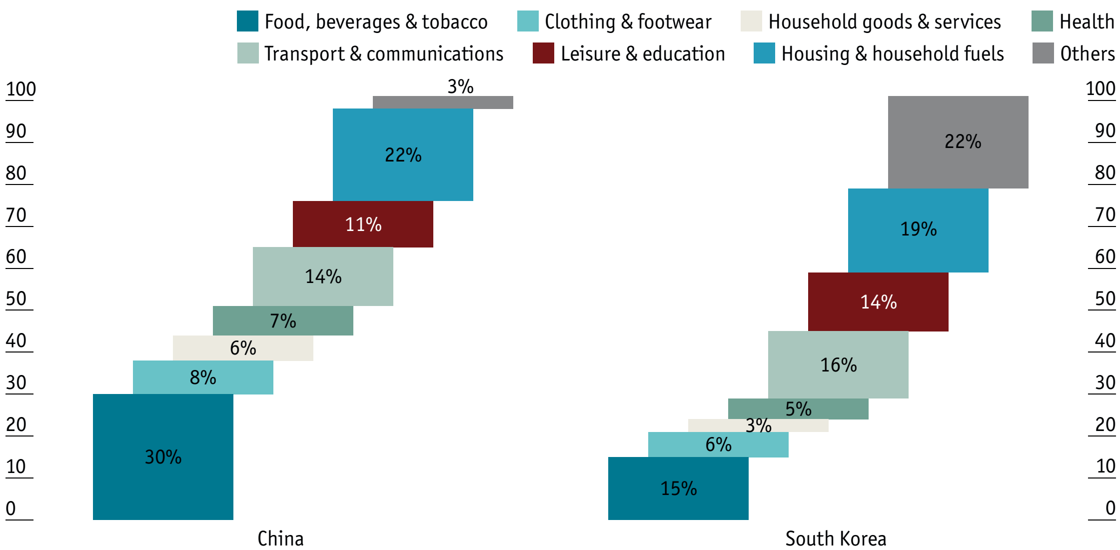
The largest retail sales categories in value terms remain automotives and food, beverage, tobacco and alcohol. They also experienced above-average rates of expansion in 2010-15. Sales of petroleum and related products, although sizeable, have grown relatively slowly in recent years, dampened by lower global oil prices.

Looking ahead, comparing Chinese consumer expenditure with that in South Korea—a richer country that has transitioned to more consumer-led growth—is instructive. Data on household spending in South Korea suggest that consumer spending on necessities has fallen. On average, expenditure on food accounted for around just 15% of total South Korean household expenditure in 2015. China may well follow that track.

Based on the South Korean comparison, as spending on food declines proportionally, categories that are likely to see growth in expenditure include transport and communications and leisure and education. One barrier to realising this transition might be excessive housing-related expenditure. Chinese spending on housing is already higher in proportional terms than in South Korea, suggesting that an inflated property market is acting to constrain a rebalancing of consumption.

Composition of nominal consumption per head in China and South Korea, 2015

(% of total)



Sources: National Bureau of Statistics; The Economist Intelligence Unit.

Preparing for take-off

International comparisons suggest that China is still at an early-to-middle stage of development in terms of per capita consumption, roughly at the level of Malaysia in the 2000s. For many categories of goods and services, China (at the national level) is still approaching the point in the consumer goods cycle when spending accelerates (although this type of consumption is already evident in major eastern cities). This points to strong potential for more discretionary spending in the coming years, as well as for switching to more expensive and premium brands.

In the charts below we benchmark spending in key consumer goods and services categories across several Asian economies in 2005-15 against levels of US-dollar disposable income per head (in this instance, using official Chinese income data rather than figures adjusted for grey income, to enable an international comparison).

According to this analysis, Chinese spending on health, as well as leisure and education, is likely to experience strong growth in the coming years, as average disposable income levels pass the key thresholds at which spending in these areas has taken off in other countries. There is also strong potential for growth in expenditure on transport and communications, with Chinese spending in this category currently below that of Malaysia when incomes in that country were at the same level.

The "others" category mainly covers spending on financial services, which is also likely to see strong expansion. Consumption in food, beverages and tobacco, as well as clothing and footwear, will see milder growth in the period to 2030, because market demand is mostly met.

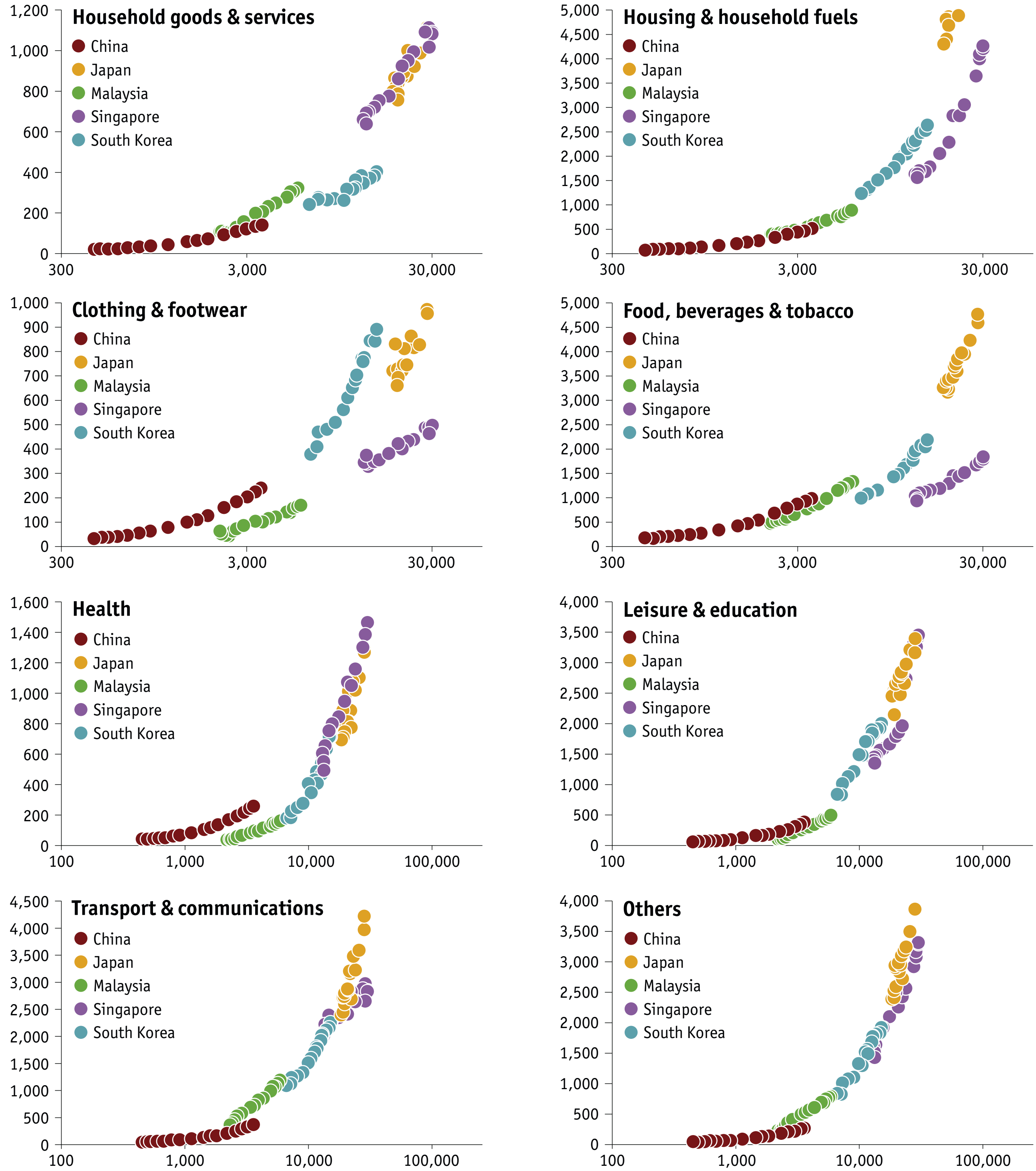
Automotive

Digging into specific goods and services categories helps to bring out these trends. China is now by a wide margin the biggest passenger car market in the world. This is not surprising, given that 132m Chinese consumers (upper middle-income and high-income consumers) have enough income to afford a car, based on The EIU's calculations. Yet there remains room for growth: China has only around one car on the road for every five people, compared with one for every 1.3 people in the US. As China's population gets richer, that gap is likely to narrow.

Regional differences are also apparent, especially when comparing car ownership rates to levels of local disposable income. Relatively developed provinces are heading towards the end of the high-growth sales phase; this is the case in Beijing and Zhejiang, where growth in ownership rates has begun to soften. Other provinces, including Ningxia, Shanxi, Guizhou and Chongqing, appear to be entering the high-growth period. Meanwhile, some provinces, including Shaanxi and Gansu, are still lagging behind in terms of car ownership.

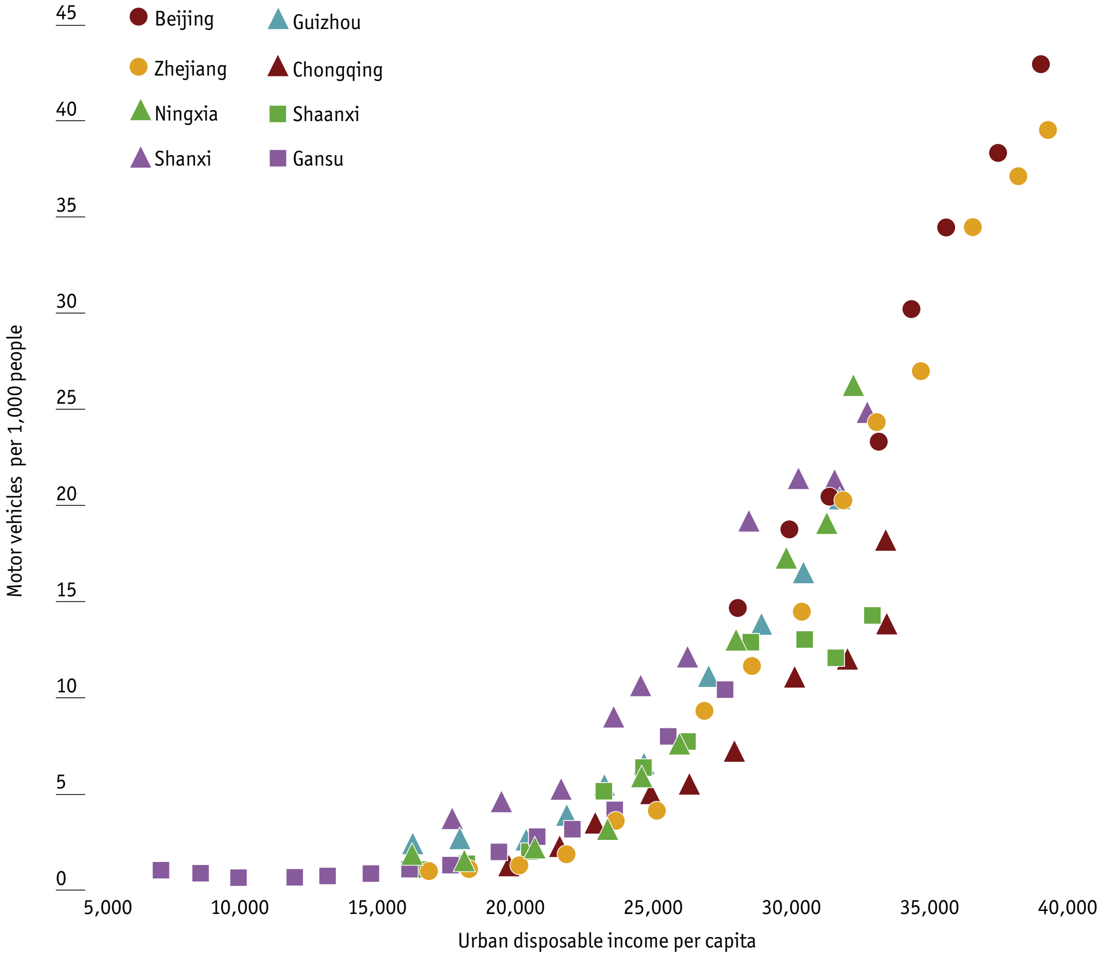
Provincial variations present opportunities for companies looking for new markets. Car ownership in first-tier cities and coastal provinces has reached a high point, owing to better infrastructure, as well as easier access to car loans and other services. In fact, Beijing, Shanghai and Hangzhou (among others) have imposed restrictions on automotive purchasing because of high levels of traffic and air

Cross-country comparison of spending on consumer goods and services and disposable income per head, 2000-15
(US$)



Source: The Economist Intelligence Unit.

Provincial vehicle ownership and urban disposable income, 2005-2014



Sources: National Bureau of Statistics; The Economist Intelligence Unit.

pollution. Growth in their car sales has slowed accordingly. In these markets, the focus of companies is likely to be on persuading consumers to trade upwards and to purchase premium models, rather than expanding levels of ownership.

In contrast, developing provinces such as Ningxia and Shanxi have just entered the high-growth phase, and there will remain opportunities for selling vehicles to new consumers. Those provinces also have higher potential for urbanisation and, thus, for faster growth in car consumption. However, the low quality of roads and other infrastructure, as well as the lack of local maintenance services, may still be a constraint in the next few years.

At the same time the nature of automotive demand is shifting, notably from lower-priced sedans to more costly sport-utility vehicles (SUVs). This reflects the growth of the high-income section of the population. In 2010 SUVs accounted for around 10% of automotive sales by value; in 2015 that level was more than one-third. Facilitated by higher incomes, the SUV boom has also been underpinned by a desire for safer and smoother driving, in addition to the social status associated with luxury vehicle ownership.

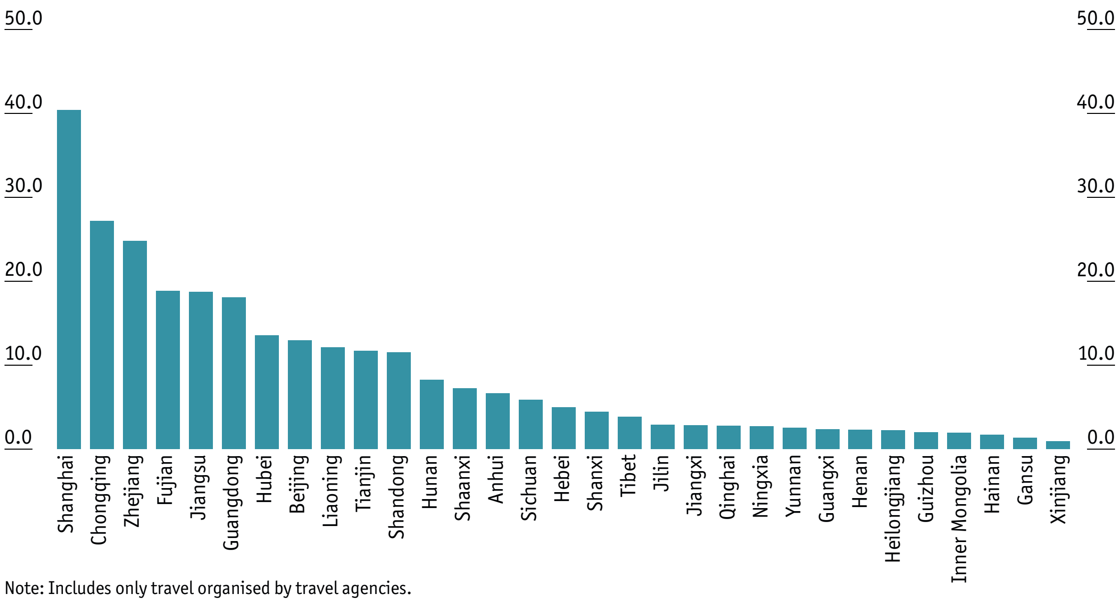
Tourism

International travel by Chinese tourists has surged over the past decade, changing the landscape of the global travel industry. In 2015 there were 120m outbound visitors from China and they spent US$104.5bn, marking increases of 12% and 16.7% respectively, according to the National Tourism Administration (NTA). Hong Kong, Taiwan, South-east Asia, Japan and South Korea are among the most popular tourism destinations for outbound mainland Chinese travellers.

There are important regional variations to consider when assessing the Chinese outbound tourism market. Much of the surge in outbound travel has been driven by higher-income consumers, who are mainly clustered in major urban centres. While Chinese data on outbound tourist flows by area of residence are not available, figures from the NTA on domestic travel organised by travel agencies provide an indication of potential interest in foreign travel. According to 2015 data, Shanghai, Chongqing and Zhejiang had the highest percentage of people that travelled domestically. Besides higher incomes, travel by local residents of these areas has been helped by convenient transport links.

Proportion of provincial population that travelled domestically, 2015

(%)



Note: Includes only travel organised by travel agencies.
Sources: National Tourism Administration; The Economist Intelligence Unit.

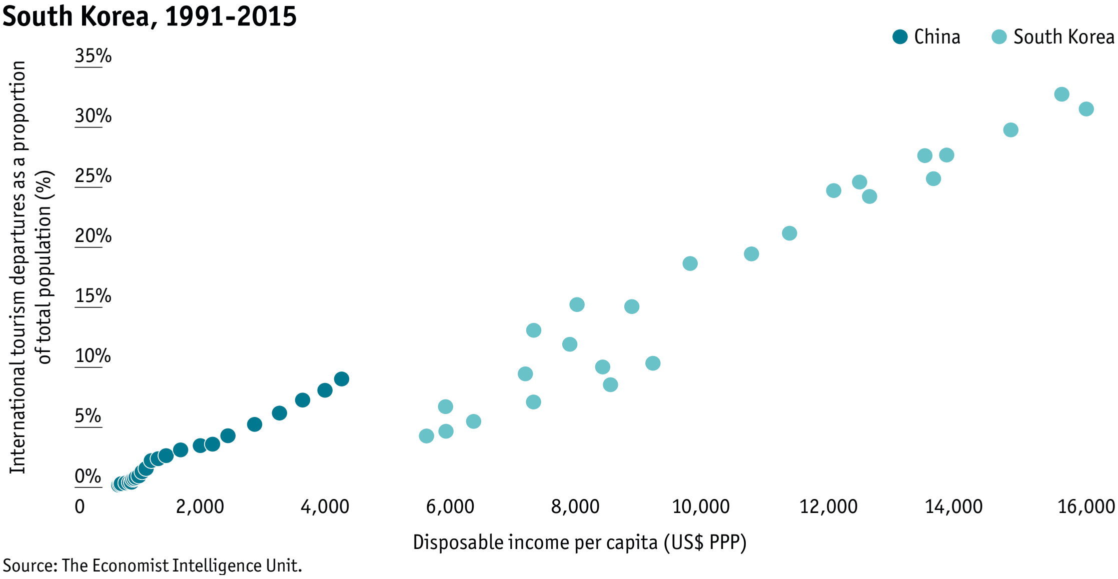
Baidu Index, an online tool that compiles data on the keyword searches on China's major search engine, can help to identify trends in overseas travel more closely. According to these data, since 2014 there has been a notable drop in interest in travelling to Hong Kong—traditionally the first "overseas" destination for Chinese tourists. This reflects rising incomes, which have opened up more expensive destinations to mainland tourists, as well as concerns about cost and the welcome received by mainland Chinese in the special administrative region.

As Hong Kong's popularity has dimmed, rival destinations have emerged. Keyword searches for travel to Thailand jumped in 2013, as the country benefitted from the domestic popularity of a Chinese

film, *Lost in Thailand*, released the previous year. Searches for the country have subsequently remained elevated. Japan has emerged as a popular destination since 2014—a period that has coincided with a weakening of the yen against the renminbi. South Korea is another common choice. Baidu's keyword data make clear that consumers will make direct comparisons between regional destinations when making decisions about travel, comparing issues such as cost, exchange rate, visa policy and "must-buy" shopping lists.

As incomes rise further, the potential for more outbound tourism is considerable. As incomes rise, travel to more expensive and time-consuming destinations ought then to become more commonplace. Europe, North America and Australasia remain relatively unpopular choices for China's tourists (outside of student-related travel), but their popularity is set to grow. Taste and preferences will also shift. While shopping and cost issues will still shape travel choices, other factors such as culture, experience and adventure will become more important, particularly as the segment of independent tourists expands.

International tourist departures and disposable income per capita in China and South Korea, 1991-2015



Source: The Economist Intelligence Unit.

One emerging niche area in the sector is overseas medical trips. The trips could be for medical checks and the treatment of serious diseases, but cosmetic surgery is the major driver. According to the China Association of Plastics and Aesthetics, South Korea is the top destination for Chinese to have plastic surgery: in 2014 around 60,000 Chinese had procedures in South Korea, up by 45% from the year before. Taiwan and Thailand are also looking to cater to this demand.

Financial services

Financial services, including insurance and wealth management, are also set for a period of growth as the population of upper middle-income and high-income consumers expands. China's state-dominated banking system remains poorly geared to meet the needs of consumers, as it traditionally served to

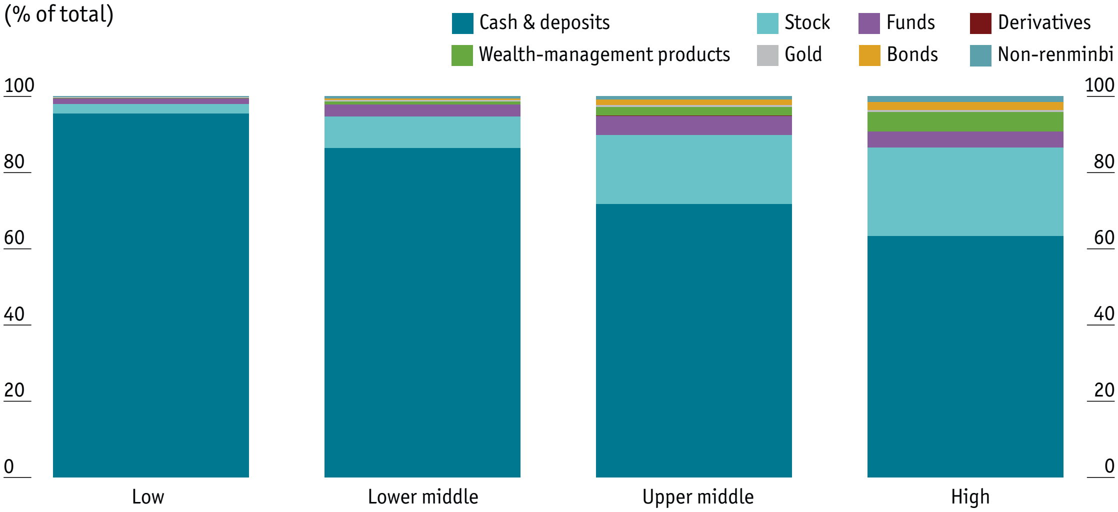
facilitate lending to local governments and state-owned enterprises. However, financial liberalisation has begun to provide new channels and options for consumers. Internet finance and the non-bank wealth-management industry have grown rapidly.

To assess future consumer demand for financial services, we looked at the China Household Finance Survey (CHFS), overseen by Gan Li of Texas A&M University and the Southwestern University of Finance and Economics, and modelled on the US Federal Reserve's Survey of Consumer Finances.

According to the survey, individuals held financial assets worth around Rmb120,000 on average in 2012. A dominant 76% of this wealth was in the form of cash and demand deposits. However, the higher the income bracket, the more people moved towards more sophisticated financial assets, mostly in the form of stocks, funds and wealth-management products (WMPs). We have adjusted the data according to our own income thresholds in the chart below.

Composition of financial assets by personal disposable income group, 2012

(% of total)



Sources: China Household Finance Survey; The Economist Intelligence Unit.

With incomes set to rise, the saving and investment characteristics associated with today's upper middle income and high-income consumers will become more widely prevalent, pointing to strong demand growth for financial services.

There also remain many untapped asset classes, according to the CHFS. Even among high-income consumers, holdings of derivatives, gold, bonds and non-renminbi assets are almost non-existent. This is partly because domestic investors lack experience in these forms of financial investment. In addition, tight government restrictions have limited the variety of investment vehicles available to consumers.

This helps to explain why the financial asset holdings of Chinese households are dwarfed by non-financial assets, principally housing and land (the latter for rural residents only). The average Chinese household held property assets worth Rmb416,000 in 2012, according to Mr Li's survey. This suggests that holdings of financial assets still have a lot of room to expand, as consumers gradually move away from property assets that entail high transaction costs and low liquidity into more sophisticated financial products.

The US example might serve as an instructive comparison about how the Chinese financial sector could evolve. Comparing household financial holdings in China to those in the US, Chinese households have, on average, a far larger portion of their financial assets allocated to cash and deposits. While the proportion of financial assets invested in stocks appears similar for Chinese and US households, the latter in fact have more assets invested in equities. This is because a large proportion of their household wealth is parked in retirement funds such as 401k or IRA accounts, both of which can be invested in stocks, bonds and other securities.

Composition of household financial assets in China and US, 2012
(% of total)

	China	US
Cash & deposits	75.7	15.3
Stocks	15.5	15.9
Funds	4.1	14.8
Bonds	1.1	3.5
Other managed assets	2.4	7.6
Other	1.3	1.5
Retirement accounts	n/a	38.8
Cash value life insurance	n/a	2.7
Total	100	100

Note: "Other" includes wealth- management products, gold, derivatives and other assets.

Sources: US Federal Reserve Consumer Finance Survey; The Economist Intelligence Unit.

With demand for financial services set to rise, much will depend on whether supply-side reforms—principally relating to excessive government regulation—move quickly enough to allow the market to realise its potential. One area that will bear careful observation will be whether the authorities loosen restrictions on purchases of overseas bonds and stocks. At the moment, individuals can invest directly in foreign financial markets by opening a brokerage account overseas or in Hong Kong, although such transactions are still fixed to a limit of US$50,000 per person per year. Another option is to purchase qualified domestic institutional investor (QDII) funds, although the total amount of funds running through the QDII programme is also subject to an annual quota (currently US$90bn). The People's Bank of China (the central bank) has periodically tightened restrictions on outbound flows when concern mounts about downward pressure on the renminbi's exchange rate.

Conclusion

China's consumer economy is set for an exciting period of development and expansion. As we have argued in this paper, a large middle-class population is likely to emerge in the next 15 years, opening up an array of opportunities. New middle-income consumers will purchase some goods and services for the first time, while those moving up the income ladder will upgrade to premium and branded offerings. Areas such as education and healthcare, financial services and leisure and entertainment look particularly set to benefit from rising discretionary spending power.

For companies, the challenge will be how to tap into this opportunity. Geographical disparities are sharp; each region of China has its own consumption patterns, determined by differing levels of income, age, prices and retail infrastructure. The tastes of Chinese consumers are not only evolving in general, but also in different directions at regional level. While consumers in rich provinces such as Beijing, Shanghai and Zhejiang may look to prioritise quality above cost-effectiveness, consumption in other regions will only just be shifting away from daily necessities.

Consumer goods firms that fail to understand these divergent trends will struggle to succeed. Robust data and local knowledge will be essential when making decisions about investment and marketing. Intense competition in the marketplace and the disruption caused by e-commerce make this even more imperative.

The idea of a large Chinese middle class holds a powerful allure, but realising the potential of private consumption will not be without challenges. Restructuring in the industrial sector could have an impact on the labour market and consumer confidence. More consistent regulatory enforcement is needed to ease concerns about food and product safety. The frothy property market is also a concern, given its importance as a store of household wealth.

Meanwhile, although parts of China's consumer economy are vibrant and world-leading, such as e-commerce, other areas are held back by heavy state interference. There is huge scope to improve the offerings available to consumers by opening up state-dominated service sectors, such as media, financial services and telecommunications to greater competition.

The risk that there will not be sufficient progress across these policy areas means that companies should be alert to potential downsides to our baseline scenarios and monitor risks accordingly. In the past, China's economic growth depended on using the deep pockets of the state to finance investment. In the future, however, meeting the needs of a booming and more demanding middle-class group of consumers will be fundamental to economic sustainability.

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