

The Evolving Growth Story of China's Economy: The S&P China Consumption Index

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China is undergoing a significant economic transformation, shifting its focus from traditional manufacturing and investment to a consumer and service-oriented market. This pivotal change, catering to the demands and preferences of an expanding middle class, is reshaping the investment landscape and may offer new opportunities and challenges for investors. While recent market fluctuations are noteworthy, they do not diminish the long-term trajectory of this economic evolution. This paper examines how the [S&P China Consumption Index](#) is strategically positioned to reflect these ongoing developments.

Executive Summary

- The expansion of China's middle class (expected to grow by 80 million by 2030) and service sectors (now accounting for 50% of GDP) underscore how China's economic shift signals the need for a more focused index-based investment strategy.
- Government policies fostering innovation in business models have been instrumental in the transformation in consumer behavior.
- The S&P China Consumption Index reflects these trends, and the index historically outperformed broader Chinese indices by focusing on the sectors and industries most affected by these changes.
- Outperformance was driven by sector allocation effects, as the index strategically emphasizes Consumer Discretionary, Communication Services and Consumer Staples, while excluding traditional sectors like Energy and Materials.

China's Economic Growth Story

The economic climate in 2023 and the beginning of 2024 was characterized by increasing interest rates and lingering inflation, and major economies worldwide have been navigating varied challenges and recovery paths. Within this context, China's narrative still stands out. Despite facing its own set of challenges, China's economy, once driven by manufacturing and investment, is transitioning toward a more consumption-centric and service-driven model.^{1, 2} This shift is evident in the IMF's forecast growth rate for China of 5.4% in 2023,³ poised to surpass the more modest growth expectations for the U.S. (2.1%) and Europe (0.7%), where recession risks loom.⁴

China is witnessing a significant expansion of its middle class, which is projected to grow by 80 million by 2030, establishing an affluent consumer segment.⁵ Further fueling this evolution, over one-half of China's GDP is now attributed to the services sector, signifying a substantial deepening of the consumer market.⁶

The evolution in Chinese consumer behavior, alongside the robust economic growth trajectory of the world's most populated country, offers a unique opportunity for investors. Recognizing the need for a nuanced, adaptive approach to take full advantage of this ongoing economic growth, the introduction of the S&P China Consumption Index comes at a crucial point in time. The index focuses on subtle shifts in the Chinese consumer market, providing a sophisticated tool to measure China's dynamic economic landscape.

China's Evolving Consumer Market: Challenges and Innovations

The Chinese consumer market has faced growth challenges but has also witnessed rapid innovation in consumption patterns and business models. The government's policies have been instrumental in expanding domestic demand and encouraging new forms of consumption, thereby driving high-quality growth. This reflects a significant phase in the development of China's consumer market.⁷ Post-pandemic, Chinese consumers have become more pragmatic, emphasizing product quality and value. This shift has favored domestic brands, viewed as more cost-effective and attuned to Chinese consumer habits.

¹ Chen, Xilu, Guangyu Pei, Zheng Song and Fabrizio Zilibotti, "[Is China Becoming a Service Economy?](#)" VoxChina, Oct. 12, 2022.

² Zeng, Liyu, Priscilla Luk and Sun Yan, "[China's New Economy Sectors: How Are They Doing?](#)" S&P Global, Jan. 9, 2020.

³ Whiting, Kate, "[China's growth forecasts upgraded, Eurozone recession fears and other economy news to read this week,](#)" World Economic Forum, Nov. 24, 2023.

⁴ Reid, Jenni, "[IMF hikes U.S. growth forecast for 2023, leaves global outlook unchanged,](#)" CNBC, Oct. 10 2023.

⁵ Chen, Cinthia, Stacey Li, Florence Li and Ben Chen, "[The Next Chapter in China's Consumer Story,](#)" Boston Consulting Group, June 22, 2023.

⁶ Mullen, Andrew, "[China's services sector: what is it and why is it important to the economy?](#)" South China Morning Post, March 3, 2021.

⁷ Deloitte, "[2023 China Consumer Insight and Market Outlook,](#)" March 3, 2023.

Technological advancements and policy incentives have helped foster innovation in business models. New retail channels like live streaming and instant retail have seen increased adoption, with a significant rise in the “home economy” driven by leisure consumption at home.⁸ Increasing evidence suggests that China's push for sustainable development is influencing consumer behavior, with some showing a willingness to pay more for eco-friendly products.⁷

The strategic positioning of the S&P China Consumption Index, with its focus on consumer-driven sectors, aligns well with these trends. By offering comprehensive market coverage and focusing on China’s evolving economy, the index presents a unique measurement of China's dynamic economic landscape.

Key Constituents in the S&P China Consumption Index

In the evolving landscape of China's economy, five companies within the S&P China Consumption Index distinctly demonstrate the trends shaping this evolution.⁹ These constituents reflect China's current market dynamics, but also signal its future economic path, demonstrating a shift toward technological dominance, digital evolution and financial sophistication.

AIA Group (8.1% weight): AIA Group is a multinational insurance and financial services company and the largest publicly listed life insurance group in APAC.

Tencent (10.8% weight): Tencent is a large conglomerate with a diverse range of digital services, including social media, online gaming and various internet-related services. It is a well-known entity in the digital and technology areas.

Alibaba (9.7% weight): Alibaba is a leading e-commerce company in China with a strong presence in digital payment solutions. It is one of the key players in the online retail and technology market.

JD.com (3.6% weight): JD.com is a major online retailer and technology company, known for its direct sales model and a wide range of products spanning from electronics to apparel. The company is also involved in logistics and technology-driven services, playing a significant role in the e-commerce landscape of China.

⁸ Zipser, Daniel, Daniel Hui, Jia Zhou and Cherie Zhang, “[2023 McKinsey China Consumer Report: A Time of Resilience](#),” McKinsey & Company, Dec. 8, 2022.

⁹ Current Constituents and Weights as of March 28, 2024. The methodology rules dictate eligible constituents as of each rebalance and the above is illustrative of the composition at the specified date.

BYD (2.6% weight): BYD specializes in the manufacturing of electric vehicles and battery technology with a strong presence in the automotive and renewable energy sectors. The company overtook Tesla as the largest electric car manufacturer in Q4 2023.¹⁰

Understanding Stock Selection and Weighting in the S&P China Consumption Index

The S&P China Consumption Index, comprising certain companies from the S&P Total China & Hong Kong Domestic BMI, is designed to be a broad representation of China's evolving consumption-driven economy. The index primarily includes stocks that are listed in China and Hong Kong, focusing on companies domiciled in these regions. It encompasses both A-shares and offshore listings of Chinese companies on the Hong Kong exchange.

Key criteria for inclusion are:

- **Eligibility:** Companies must have a free-float market capitalization (FMC) of at least USD 2.5 billion, with multiple share classes combined to measure the company's FMC. A three-month average daily value traded (ADVT) of at least USD 8 million, and an investable weight factor (IWF) of at least 15% are also required. Stocks designated as Special Treatment (ST and *ST) by the Shanghai or Shenzhen stock exchanges are ineligible.
- **GICS® Classification:** Eligible stocks must fall within the specified Global Industry Classification Standard (GICS) categories listed in Exhibit 1.
- **China A-Share Inclusion:** China A-shares are capped at 15% and must be accessible through the Stock Connect program to be eligible, ensuring representation of accessible A-share companies to foreign investors.
- **Selection and Weighting:** The index selects the largest 100 stocks by FMC, with a 20% buffer. It employs an FMC weighting, with a single stock weight cap of 10% and a cumulative weight cap for A-shares at 15%, maintaining diversification and accommodating foreign ownership limits.
- **Rebalancing Schedule:** The index undergoes semiannual rebalancing, effective after the close of the third Friday of June and December, with the reference date being the last trading day of the previous month.

¹⁰ He, Laura and Chris Isidore, "[China's BYD is selling more electric cars than Tesla](#)," CNN, Jan. 2, 2024.

Exhibit 1: S&P China Consumption Index GICS Inclusion Criteria

GICS Sector	Consumption Focus	Index Weight (%)
Consumer Discretionary	Consumer Discretionary	40.03
Communication Services	Communication Services	22.67
Financials	Insurance	13.66
Consumer Staples	Consumer Staples	10.05
Health Care	Health Care	6.26
Industrials	Electrical Components & Equipment	4.74
	Air Freight & Logistics	
	Passenger Airlines	
	Rail Transportation	
	Airport Services	
Information Technology	Software & Services	1.31
	Communications Equipment	
Utilities	Independent Power and Renewable Electricity Producers	1.28

Source: S&P Dow Jones Indices LLC. Data as of March 28, 2024. Table is provided for illustrative purposes.

A Focused Approach to Chinese Market Dynamics

Comprehensive Market Coverage: By including major Chinese share classes such as A-shares and Hong Kong listings, the S&P China Consumption Index offers a thorough representation of the Chinese market. The exclusion of non-China- and non-Hong Kong-listed stocks ensures a focus on companies primarily engaged in the Chinese and Hong Kong markets, providing a more direct reflection of the region's economic activities.

Focused Insight into China's Evolving Economy: The index's adherence to the outlined GICS sectors and selected industries helps align it with China's shift toward a consumption-centric economy. This targeted approach offers investors a unique perspective, differentiating it from traditional benchmarks that may be heavily concentrated in sectors like Financials.

Enhanced Liquidity and Accessibility: The selection of the largest 100 stocks by FMC, subject to liquidity thresholds, ensures that the index comprises large, liquid stocks. This characteristic facilitates more efficient market replication, which could be beneficial for passive investors seeking exposure to specific segments of China's economy. Additionally, the index's semiannual rebalancing schedule allows it to adapt and stay current with market developments.

Risk Management through Diversification: The index's weighting methodology, which includes a single-stock weight cap of 10% and a cumulative weight cap for A-shares of 15%, prevents over-reliance on individual stocks and helps maintain diversification. This approach seeks to mitigate risk and could align with the investment strategies of those seeking a balanced measurement of the Chinese market.

Strategic Positioning: S&P China Consumption Index versus Leading Chinese Market Indices¹¹

To evaluate and highlight the unique performance and composition features of the S&P China Consumption Index, we performed a comparative analysis with other market indices targeting the Chinese stock market. As benchmarks, the MSCI China Index and FTSE China 50 Index are selected as both are among the largest China-focused indices as measured by their linked assets under management (AUM).¹² The MSCI China Index offers a broad view of the Chinese stock market, covering a wide range of company sizes and equity types that account for about 85% of the Chinese equity universe.¹³ Meanwhile, the FTSE China 50 Index provides a focused look at the top 50 Chinese companies by market capitalization listed on the Hong Kong Stock Exchange, representing the performance of some of the largest and most well-known Chinese companies.¹⁴

While each is focused on the Chinese market, the three strategies tell a different story of market focus and strategy. The S&P China Consumption Index, with an annual total return of 2.9% through its full back-tested history¹⁵ (see Exhibit 2), demonstrated a preference for consumer sectors, as evidenced by its significant allocation to Consumer Discretionary (40%), Communication Services (23%), Consumer Staples (10%), Financials (14%) and Health Care (6%), while excluding companies from the Energy, Materials and Real Estate sectors.

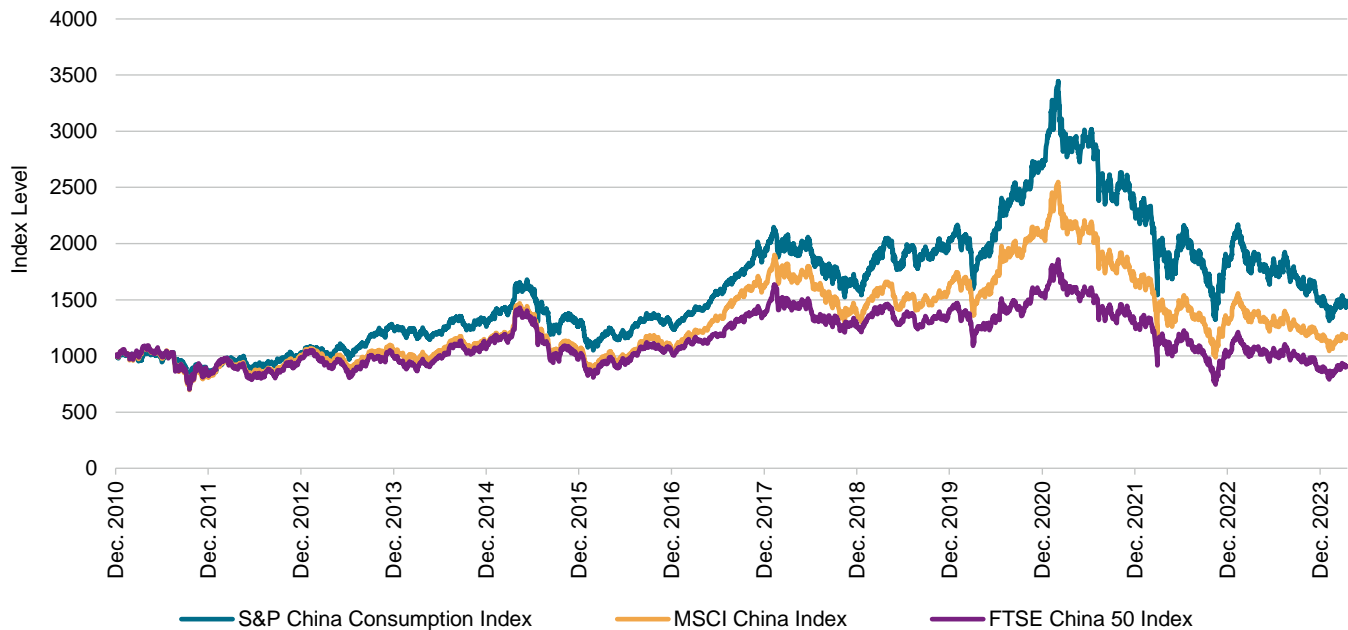
¹¹ As proxies for these indexes, the performance and composition of the iShares MSCI China ETF, representing the MSCI China Index, and the iShares China Large-Cap ETF, corresponding to the FTSE China 50 Index, are used, with FactSet data as of Dec. 29, 2023.

¹² [VettaFi](#), data as of end of October 2023.

¹³ [MSCI China Index Factsheet](#), March 29, 2024.

¹⁴ [FTSE China Index Series: FTSE China 50 Index Review Changes Overview - March 2020](#).

¹⁵ From Dec. 17, 2010, to March 28, 2024.

Exhibit 2: Historical Performance

Source: S&P Dow Jones Indices LLC and FactSet. Data from Dec. 17, 2010, to March 29, 2024. Indices rebased to 1000 on Dec. 17, 2010. The S&P China Consumption Index was launched on March 19, 2024. All data prior to such date is back-tested hypothetical data. Index performance based on total return in CNY. Chart is provided for illustrative purposes and reflects hypothetical historical performance. Please see the Performance Disclosure at the end of this document for more information regarding the inherent limitations associated with back-tested performance.

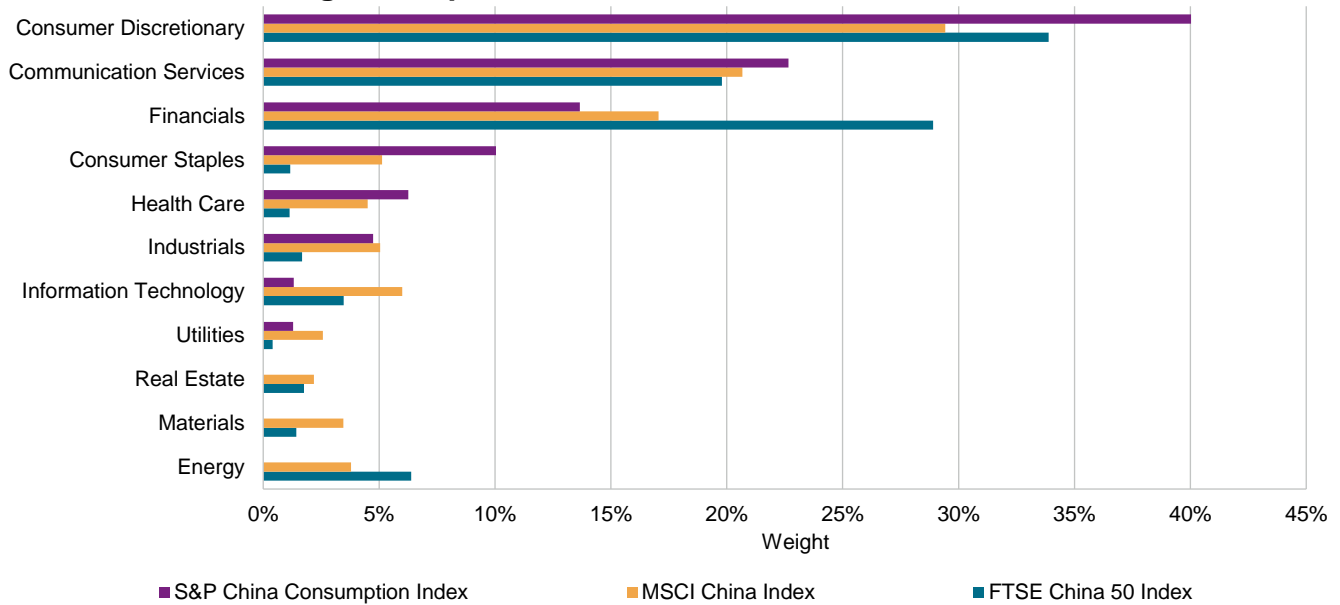
In contrast, the FTSE China 50 Index, including all sectors, allocated a substantial 29% to Financials, 34% to Consumer Discretionary and a modest 1% to Consumer Staples. Its annual total return over the same time period was -0.68%¹⁶ (see Exhibit 3). Meanwhile, the MSCI China Index offered a diversified size distribution, including 80% in mega and large caps, 19% in mid caps, and 1.4% in small caps. Its performance, however, lagged the S&P China Consumption Index, with an annual total return of only 1.18%.¹⁷

The different sector weightings and size distributions across these indices underscore the distinct investment philosophies they represent. The S&P China Consumption Index, with its focus on consumer-driven sectors, appears well-positioned to reflect the nuances of China's evolving economic landscape, contrasting with the more diversified or financially oriented approaches of the FTSE and MSCI indices.

¹⁶ <https://www.blackrock.com/us/individual/products/239536/ishares-china-largecap-etf> (as of Dec. 31, 2023)

¹⁷ <https://www.blackrock.com/us/individual/products/239619/ishares-msci-china-etf>

Exhibit 3: Sector Weight Comparison



Source: S&P Dow Jones Indices LLC and FactSet. Data as of March 28, 2024. Chart is provided for illustrative purposes.

Conclusion

The transformation of China’s economy signals the need for a more nuanced indexing approach, as traditional strategies may not effectively track new market dynamics. The S&P China Consumption Index offers a sophisticated perspective by reflecting consumer and service-oriented sectors observed to be at the forefront of this evolution. Its strategic emphasis aligns well with the changing consumer behavior in China, where a growing preference for quality, value and sustainable products can be found.

Innovations in consumption patterns and business models, driven by technological advancements and government policies, are also reshaping China's consumer market. These changes are reflected by the constituents in the S&P China Consumption Index that focus on technological dominance, digital innovation and financial sophistication.

The S&P China Consumption Index thereby presents a strategic tool to engage with the dynamic and evolving economic landscape of China. Its focused approach aligns with the country's shifting economic priorities and offers a valuable perspective for those looking for an index tracking the burgeoning sectors of the Chinese economy.

Performance Disclosure/Back-Tested Data

The S&P China Consumption Index was launched on March 19, 2024. All information presented prior to an index's Launch Date is hypothetical (back-tested), not actual performance, and is based on the index methodology in effect on the index launch date. However, when creating back-tested history for periods of market anomalies or other periods that do not reflect the general current market environment, index methodology rules may be relaxed to capture a large enough universe of securities to simulate the target market the index is designed to measure or strategy the index is designed to capture. For example, market capitalization and liquidity thresholds may be reduced. In addition, forks have not been factored into the back-test data with respect to the S&P Cryptocurrency Indices. For the S&P Cryptocurrency Top 5 & 10 Equal Weight Indices, the custody element of the methodology was not considered; the back-test history is based on the index constituents that meet the custody element as of the Launch Date. Also, the treatment of corporate actions in back-tested performance may differ from treatment for live indices due to limitations in replicating index management decisions. Complete index methodology details are available at www.spglobal.com/spdji. Back-tested performance reflects application of an index methodology and selection of index constituents with the benefit of hindsight and knowledge of factors that may have positively affected its performance, cannot account for all financial risk that may affect results and may be considered to reflect survivor/look ahead bias. Actual returns may differ significantly from, and be lower than, back-tested returns. Past performance is not an indication or guarantee of future results.

Please refer to the methodology for the Index for more details about the index, including the manner in which it is rebalanced, the timing of such rebalancing, criteria for additions and deletions, as well as all index calculations. Back-tested performance is for use with institutions only; not for use with retail investors.

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