The InsightBureau Briefings

From the Desk of...

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Speaker on China and the Middle East

Issue No.66 - April 2012

The rise of Asia's middle-class: Ben Simpfendorfer – a leading independent economist and publisher of *China Insider* – examines the significance of Asia's middle class in the world economy.

Who is Asia's middle-class? At a time when Europe and the United States remain threatened by economic stagnation, Asia's middle-class represent a potentially large source of demand for goods and services—from buying a new 4-door family sedan to signing up for private health insurance. Sure, purchasing power is lower in Asia than it is in Europe and United States. But the region's vast populations help to make for that. In fact, Asia has 7 out of the world's top 20 most populated countries–it is no wonder multinationals are turning to the region. That said, it is also possible to destroy a middle-class, not just create one. Indeed, the Asian-crisis in 1997 pushed many middle class families towards, or even below, the poverty line. Today, a sudden burst of food or energy inflation, as witnessed in 2008, could equally reverse the trend. What follows is an analysis of the changes at work. We measure the size of the middle-class, analyze its drivers, and look at the risks to its growth.

It's the actual purchasing power that counts: Who is middle-class? Ask Asian households themselves and the answers will vary widely by country, in spite of their relative wealth. Indeed, Indonesia and India have a similar per capita GDP, yet over 80% of Indonesians consider themselves to be middle-class compared to 51% of Indians, according to recent academic surveys. China and Thailand also have a similar per capita GDP, but 65% of Thais see themselves as middle-class compared to just 48% of Chinese. Perception and reality is not always the same thing. Households might claim to be middle-class for cultural, social, or historical reasons. Yet many fall outside the definition and could be considered working-class on the basis of their actual purchasing power. Many genuinely middle-class families equally view themselves as working class.

Asia's 'middle-class' implies a range of possibilities: For companies selling to Asia, what the middle-class can actually afford to buy, either through discretionary income or consumer credit, is more important than what the middle-class aspire to buy. With that in mind, there's no single measure of who or isn't middle-class, but rather a range of possibilities. Consider the multinational Unilever, selling low-cost sachets of high-end beauty products in China, and so effectively tapping into the lower middle-class. Or India's Gotham Model Schools, providing private education to similarly lower middle-class families in Hyderabad: many families would barely rank as middle-class, even measured by our lowest threshold. Low-cost airlines—Air Asia, Tiger Airways, and Cebu Air—are meanwhile benefiting from a growing number of middle- to upper- middle-class families travelling abroad, whether it's Chinese scuba-diving in Malaysia or Indians enjoying Bali's traditional Hindu culture. The region's private healthcare providers, such as Singapore's Parkway, are meanwhile expanding rapidly, by delivering medical and surgical services to upper middle-class families in hospitals that look much like 5-star hotels.

How big is the middle class? So how big is Emerging Asia's middle-class? Academics popularly define the middle-class as anyone with an annual income of between $1,000 to $20,000. But that's a big range, and the difference matters. Our own estimates based on academic models use three different benchmarks for per capital annual income— $3,700, $5,500, and $7,300—as measured in US dollars, Purchasing Power Parity (PPP) terms. The results vary hugely. If we use the lower threshold of $3,700 then Emerging Asia's middle-class is a vast 740 million, or roughly equal to the population of Europe, with China accounting for the largest share at around two-thirds, and the rest evenly split between ASEAN and South Asia. If we raise the threshold to $5,500 then the size of Emerging Asia's middle-class drops to 400 million. Raise the threshold again to $7,300 and the middle-class shrinks to just 220 million, with China still accounting for a large share. So which is the correct level? It really depends on the goods being sold: for instance, a shampoo manufacturer might target workers earning above the $3,700 level, whereas a car manufacturer is more likely to focus on those earning more than $7,300.

China is the region's middle class giant: The Chinese middle-class households might be the region's biggest spenders, but how many are there and what are they spending on? We prefer to focus specifically on the 'urban' middle-class and rely on Chinese urban income data to improve the reliability of estimates. But, in short: at $3,700 per capita annual income (PPP-basis) the middle-class numbers 412 million; at $5,500 it falls to 237 million, and at $7,300 it is 161 million. The differences between the upper and lower thresholds is stark: for instance, the average individual, earning $7,300 per year, spends 10% less on food than an individual earning $3,700, but 3% more on recreational and educational services, and an even more on transport and communication services. In short, the wealthier middle-class spends more on holidays, schools, and cars, a conclusion consistent with popular anecdote.

Services are the biggest winner: China's high-income middle class are likely to spend more on services than they are for other consumer goods. But is that true for the rest of the region? Hong Kong and Taiwan offer a useful guide as to how the rest of the region's middle-class may one day start to spend—the two are developed economies with an average GDP per capita ($43,000) or eight times that of the rest of still developing Asia ($5,500). In Hong Kong, high-income households spend just 20% of their total outlays on food, compared to 40% for low-income. Part of the difference is accounted for by spending on luxury goods such as watches and high-end electronics (4% of total outlays). But spending on education also jumps sharply to 6% of total outlays. That's the same as Taiwan, where spending on education accounts for a similarly large 6%, as against 4% for the average worker in the industrial sector (and just 2% for the unemployed). With this in mind, India's private education sector is one of the country's fast-growing service industries. Private schools are popular owing to better facilities, less teacher absenteeism, and an earlier emphasis on English language teaching.

Maharishi Vidya Mandir Schools, Gotham Model Schools, Indus World Schools, and Kidzee are just some of the many hundreds of companies providing private education. Neither are private schools limited to urban areas, with many low-cost schools also found in rural areas. Singapore's Parkway Health is another beneficiary. Based in Singapore, the firm has 16 hospitals, nearly 3,500 beds, and multiple clinics in Singapore, Malaysia, Brunei, India, China, and Abu Dhabi. The firm is benefiting from the region's affluent aged population many who made their money establishing export factories over the past four decades.

Tourism is another service sector that has benefited from the region's rising middle-class, especially the Chinese middle-class—the number of Chinese travelling to other Asian countries has surged from just 5 million to 30 million between 2000 and 2010. Hong Kong receives the largest share, but Korea and Taiwan each receive around 1.8 million annually. Indeed, intra-Asian tourism is generally on the rise owing to rising discretionary income and the entry of budget airlines. For instance, the number of Indians visiting Indonesia has more than doubled in the past five years, from 60,000 to 140,000, with Indians especially attracted by Bali and its traditional Hindu culture. Korea is equally popular among nationals from Indonesia, Malaysia, Thailand, and Singapore. Total arrivals from these ASEAN countries have almost doubled in the past five years from 600,000 to 1,100,000 visitors.

A mile wide, but inch deep: It is tempting to assume that the rise of Asia's middle-class is a straight-line trajectory. But it is as easy to destroy a middle-class, as it is to create one. Even an individual earning above the $5,500 annual income threshold, on a PPP-based might have limited discretionary income and is vulnerable to a sudden rise in food and energy prices. By our estimates of national CPI baskets, food and energy can account for an average 40% of the consumer basket, with the actual figures ranging from 36% of total spending China, 45% in Indonesia, to an especially high 57% in India. But what does that mean in practical terms? If food and energy prices were to rise 20% over the course of the year (certainly possible), then the ranks of the middle-class above the $5,500 threshold might fall by up to 100 million (or 15 million, excluding China).

The full report from which this article has been taken is available **here.**

About Ben Simpfendorfer and The Insight Bureau

Ben Simpfendorfer is Managing Director of Silk Road Associates, a Hong Kong-based corporate and economic consultancy. He is also publisher of the monthly "China Insider" and author of "The New Silk Road". Ben is sought after as a presenter because of insights into the Chinese economy and importantly its impact upon the rest of the world. He provides briefings and participates in conferences and business forums around the world. www.insightbureau.com/BenSimpfendorfer.html

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