Putting China in context

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The past month has seen news coming out of China that paints an apparently worrying picture for business. Drilling down, the concern is not so much about China itself however, but a broader global economic slowdown, in particular among emerging markets, a term that includes but is not limited to China. It is therefore important to consider events in the context of longer-term macro-economic trends, several of which are key for UK businesses and the British economy as a whole. Increasing consumption and domestic demand, a rising middle class, the shift in focus away from raw materials and the advent of new trade agreement opportunities will ensure that China continues to be a critical trading partner for the UK, as well as Europe, for the forseeable future.

Much of China's meteoric rise to economic powerhouse status has been attributed to its incredible export drive during the first decade of the millennium, although the economic reform programme embarked upon in 1979 laid many of the foundations for this growth expansion. In 1995, exports accounted for 15 per cent of the country's GDP; by 2004 this share had risen to 30 per cent, with an export growth rate seven times higher than the export growth rate recorded by the world as a whole. But accompanying these extraordinary statistics were inevitable questions about the sustainability of this overall growth rate, and the new focus of the government shifted from export capacity to addressing domestic consumer demand.

This shift is still 'work in progress', but that fact offers good news for the balance of trade of other countries. With the current slowdown in some of its traditionally important European target export markets, China can no longer rely on external global demand to sustain its economic expansion. The new market on which to focus in order to help absorb its output is the Chinese consumer, and with a steadily growing middle class, we are likely to see a continuing rise in imports as consumer preferences change over time.

Urbanisation policies in China have been a key focus of the government to attract millions of people from farms into the cities and spur wage growth and the development of household wealth. While this trend has not been fully consolidated, it is an all but irreversible one, and holds significant opportunities for economies like the UK, which exports services and high-value consumer goods. Young people in urban areas are key drivers of the growth of China's middle class, with a significant interest in the world beyond the country's borders – chiefly through technological means.

Their appetite for Western brands and know-how in these areas – the gaming sector based in Glasgow is one notable example – means that the UK's creative industries have a huge market to tap into. In fact, despite the acknowledged potential for British professional services to gain a foothold in China, the gaming industry has been among the fastest to convert opportunity to reality. The rapid growth of game companies in the UK focusing on developing games for online platforms has made accessing that market even easier. British success story Inspired Gaming recently won a contract to supply China's national sports lottery with a host of virtual games, and the government's recent move to lift a 15-year ban on video games will ensure this important trend continues to develop.

The appetite for recognised luxury goods has also been a growing phenomenon as Chinese household incomes have risen. While some are still sensitive to price, older professionals are now interested in the name recognition of established brands to display improving social status. Interestingly, a significant share of these are bought by consumers while abroad, and the demand for "Made in Britain" or "Made in Italy" labels are popular amongst Chinese shoppers. This pattern is but one reason for the decision taken by Home Secretary Theresa May last year to simplify visa procedures for Chinese visitors to the UK.

The increasing sophistication of consumer preferences is also a trend unfolding in Chinese investment interests abroad. A decade ago, these interests focused primarily on raw materials and extractive minerals, with Africa being a more natural target market of choice. Now Chinese companies are increasingly looking to set up manufacturing bases overseas and in developed economies, with far more attention being concentrated on harnessing innovation, research and design abroad, rather than simply trying to compete on price. Urban infrastructure and development in the UK is attracting huge interest from China, with energy, property and transport being among the most attractive to investors. This focus on local manufacturing will help to improve the perception of the expansion of China's share of foreign goods markets over the past two decades.

One particularly welcome aspect of this increasing investment expansion into British and European markets is that Chinese companies will need to co-ordinate their operating standards with UK and EU regulations. On everything from labour market rules to planning permission, this provides an opportunity to bring China into line with international best practices. And for a UK economy still hamstrung by tackling debt and deficit levels, yet trying to upgrade and invest in infrastructure at the same time, this [co]financing will be of immense value to doing the latter affordably. China's shift in focus to investing in advanced, innovative economies will continue to be a trend over the next decade, as an estimated £105 billion of Chinese capital is expected to flow into the UK between now and 2025.

Activity on regional trade agreements continues to be a priority for China, although there is some hesitation in Europe. While the EU recently opened negotiations on an investment deal with Beijing, it has been resistant to the idea of doing the same for a free trade agreement. China has made no secret of its desire to move on both fronts, a call endorsed by David Cameron but seen as pre-emptive by the European Commission. Should investment negotiations proceed, however, – and there will doubtless be some sticky discussions over intellectual property, in particular, which many UK businesses should be following – then movement on the latter may be possible. China recently won a pledge from the EU to consider a joint feasibility study into a free trade agreement, which is a very welcome pre-step in the direction.

For the IoD, China continues to be a strong focus for international trading activity – 28 per cent of our exporting members sell to, or operate, in the country – representing 16 per cent of the total membership overall. To increase this share, further economic and legal reforms to ensure UK businesses and investors become more comfortable about operating in the country are needed. President Xi has signalled his commitment on this front to let the market play a 'decisive role' in the economy, but this needs to be reflected in the on-the-ground reality. Standardising tax incentives, treatment for foreign investors and simplifying the pre-approvals process across the regions will be crucial to achieving this objective. The opportunities are endless, and further business-to-business engagement on best practice will be crucial to converting them into reality for IoD members, who place great emphasis on good corporate governance and transparency when making the decision to trade abroad.

The stock market volatility emanating from China will continue to set the scene in the near term, but the macroeconomic trends are what UK businesses will rely on when deciding whether to boost trade and investment links with the country. The extent to which these troubles will act as a drag on its economic growth is questionable, particularly given the comparatively low level of household financial assets that are comitted to its stock market. The government's asset accumulation over its explosive growth period is significant, easily outstripping the size of China's GDP. It is essential to read beyond the headlines – something that British business knows only too well. Digging deeper, it is clear that opportunity for closer commercial links between the united Kingdom and China is as ripe as ever. F

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Screen teens: the UK gaming industry has been quick to convert opportunity into reality in China