

The Long View

Investment Insights

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The Changing
Face of the Global
Consumer

The Changing Face of the Global Consumer

“The demographic changes and the growth we’re seeing in China, India and other parts of the developing world are having a profound effect on the global economy, and they also have significant implications for companies in the U.S. and other parts of the developed world.”

Jody Jonsson, Portfolio Manager

Consumer spending, long a driver of the global economy, is undergoing sweeping change. Whether it’s housing for millennials or health care for baby boomers, a significant shift in the way people spend money is underway in both advanced economies and the developing world.

One thing about spending money hasn’t changed. Americans do a lot of it. Last year Americans spent more than \$11 trillion, accounting for two-thirds of the nation’s gross domestic product. But the way Americans spend money is changing. Since 2000, there has been a rotation in spending away from goods and towards services, especially travel and leisure.

That dynamic may also be at work in China, as the country continues on the path to having the world’s largest consumer economy. Consumers there are starting to spend less money on necessities and more money on activities such as family trips and going to the movies.

“What we are seeing is that the Chinese are primarily spending their money online, on lifestyle and on experiences,” Capital Group’s China affairs specialist, Andrew Dougherty, says. “From an investment standpoint, these are secular opportunities worth paying attention to. China is the largest e-commerce market in the world and is still growing by double digits.”

Portfolio manager Rob Lovelace says two demographic groups will have a major impact on the future of the global economy.

“The first one is baby boomers. They’re obviously moving into retirement. Health care is one of the big aspects of that,” Rob says. “At the other end are millennials, one of the largest generations and one that’s grown up with the internet and technology.”

Millennials were born from 1980 to 2000. There are about 80 million in the U.S., but most of the world’s 2 billion millennials are living in emerging markets. In Brazil, India and China they outnumber baby boomers.

Globally, millennials are estimated to have a combined spending power of nearly \$2.5 trillion. They are about to reach their prime working and spending years, and their impact on the world’s economy could be huge.

“During the next 10 years, developing countries are expected to add about a billion people to the middle class and above,” says portfolio manager Noriko Chen.

“These emerging economies will account for nearly half of total global consumption. I believe that is going to have a transformational impact on the world’s economy.”

At the other end of the spectrum, many baby boomers globally may be done working, but they’re not done spending.

While that means increased health care spending, boomers will also be spending on travel, leisure and financial services.

“The demographic changes and the growth we’re seeing in China, India and other parts of the developing world are having a profound effect on the global economy, and they also have significant implications for companies in the U.S. and other parts of the developed world,” says portfolio manager Jody Jonsson.

Key Takeaways

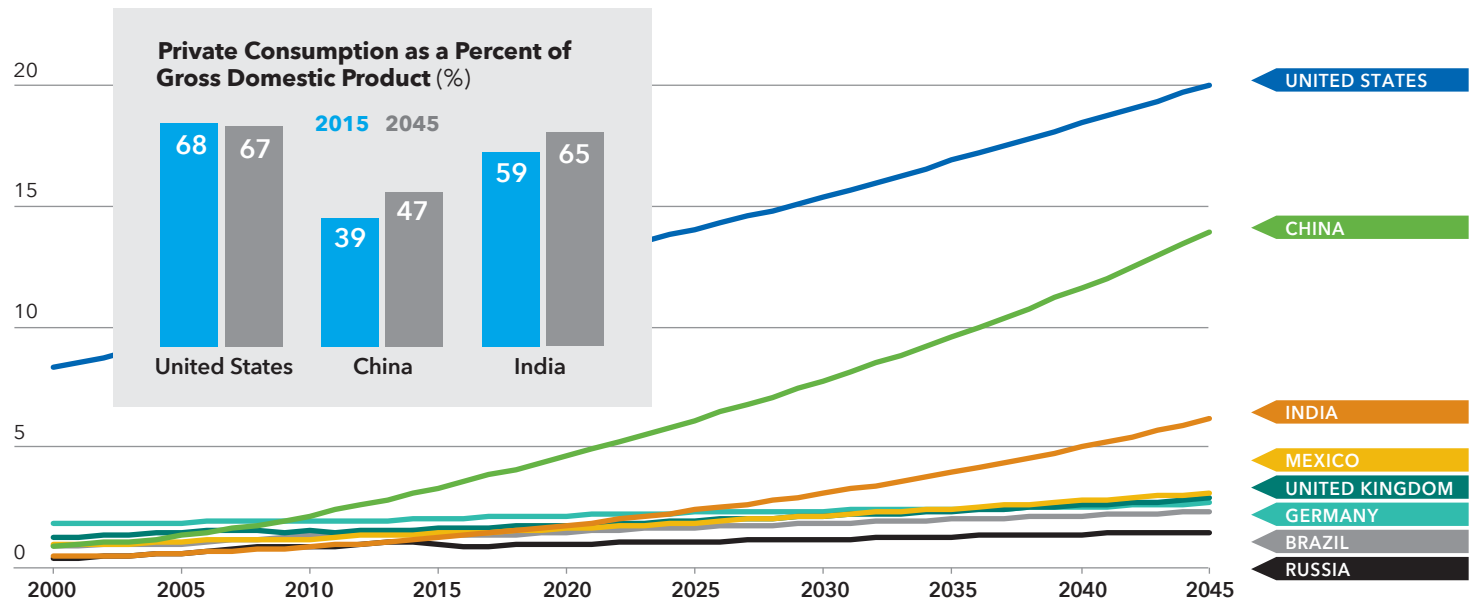
We live in a transformational time

- A significant shift in consumer spending may be underway across the world.
- From baby boomers to millennials, a new breed of consumers is set to transform spending habits.
- Companies that can take advantage of this transition have the potential to reap new profits, and reward investors.

Big Spenders: Consumers Play a \$43 Trillion Role in Global Economy

India and China Are Joining the U.S. as Major Drivers of Economic Growth

\$25 **Private consumption** (trillion U.S. dollars)



“The increasing affluence and the emergence of consumer classes in developing countries is a durable trend that should continue for many decades to come. It’s a trend that has the potential to be one of the primary engines of economic growth.”

Rob Lovelace, Portfolio Manager

Source: Thomson Reuters Datastream. Please see back cover for additional information.

- In less than a decade, something will happen for the first time in history. By 2025, 4.2 billion people will be part of the consuming class. That means the number of people with discretionary income will exceed the number still struggling to meet basic needs – a phenomenon that may well be the biggest opportunity in the history of capitalism. This improvement in the standard of living represents a remarkable transformation for the global economy and companies around the world.
- Consumer spending has long been a significant element of the world’s economic expansion. The gross domestic product (GDP) in the U.S., for example, is nearly \$18 trillion. About two-thirds of that comes from consumer spending on goods and services, including cars and furniture, food and beverages, and health care and housing. Global GDP is about \$75 trillion, and consumers account for about 57% of that amount, or about \$43 trillion. Consumer spending represents a majority of spending in all advanced nations, and the way people spend money is undergoing a major shift in many countries.
- An April 2016 report from the McKinsey Global Institute found that although demand for goods is still growing at a respectable rate in many economies, consumption is shifting toward services. In short, as per capita incomes rise, less money is spent on necessities such as groceries, and more money is spent on services like restaurants, hotels, recreation and cultural activities. This evolution is well underway in developing countries around the world as millions move into the middle and upper-middle classes.

In China, Spending Is a Family Affair

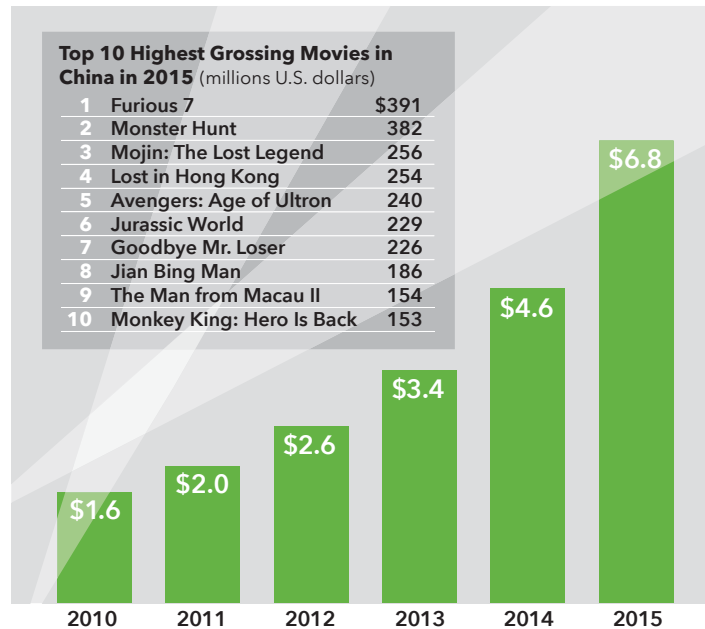
Chinese Consumers Are Expected to Spend \$3.6 Trillion This Year

“China’s service sector has surpassed the manufacturing and agricultural sectors as the leading sector in the economy and now represents more than half of China’s GDP. So, that’s a good indicator that the economy is rebalancing away from manufacturing and investment and toward services and consumption.”

Andrew Dougherty, Capital Group China Affairs Specialist

Box Office Revenue in China

(billion U.S. dollars)



International Tourism Expenditure of Chinese Tourists

(billion U.S. dollars)



Sources: (China) State Administration of Radio, Film and Television, Statista Inc. and Xinhua News Agency (box office revenue); Box Office Mojo at www.boxofficemojo.com (top 10 movies); and Statista Inc. and United Nations World Tourism Organization (international tourism expenditure). Please see back cover for additional information.

- Never underestimate the power of the Chinese consumer. Complex and massive, volatile and unpredictable, the 1 billion consumers in China are not exactly clinging to their yuan. Despite a relatively sluggish economy, the Chinese are projected to spend \$3.6 trillion this year, or double what they spent in 2006. They are also expected to increase their spending by 10% a year through the end of the decade. They are not just filling the basket with consumer staples – for some, shopping is about the experience.
- Going to the movies and taking family trips abroad have become part of Chinese life. More than 70 million Chinese tourists spent \$292 billion on outbound travel in 2015, or nearly three times the level in 2012. Many of those trips are booked through Ctrip, an online travel firm partly owned by Priceline and Baidu, the Chinese internet search giant. The surge in Chinese outbound travel is a multidecade theme driving structural growth in the airline, gaming and internet industries.
- China’s box office revenue is projected to reach \$8.4 billion in 2016, and grow to \$15 billion in 2020. What Hollywood movie has made the most money in China? *Furious 7* took in \$391 million at the box office last year. For many, spending is about going places with the family, a dynamic that’s benefiting Disney, which opened a \$5.5 billion theme park in Shanghai in June – the company’s biggest investment outside Florida. By August, the theme park had already welcomed its millionth visitor.

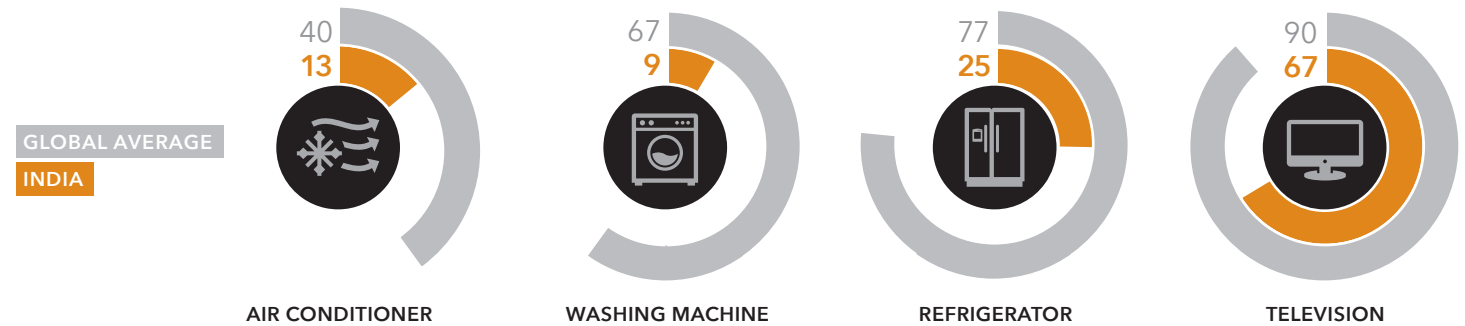
India Emerges as a Massive Market

The Country May Still Be on the Ground Level as a Consumer Society

“India has a lot going for it in terms of favorable demographics, the possibility of a downward trend in inflation and a substantial reform agenda. If reforms are forthcoming, its economy could really take off, similar to the way China’s did.”

Nick Grace, Portfolio Manager

Households That Own Durable Goods (%), as of 2015



Key Players in the Consumer Appliance and Electronics Market				
BOSCH		●	●	
LG	●	●	●	●
SAMSUNG	●	●	●	●
SONY				●
WHIRLPOOL		●	●	

Source: Euromonitor International. Data are based on possession rate, which is a measure of how many of the population units used (e.g., households) own at least one unit of a certain product, as defined by Euromonitor.

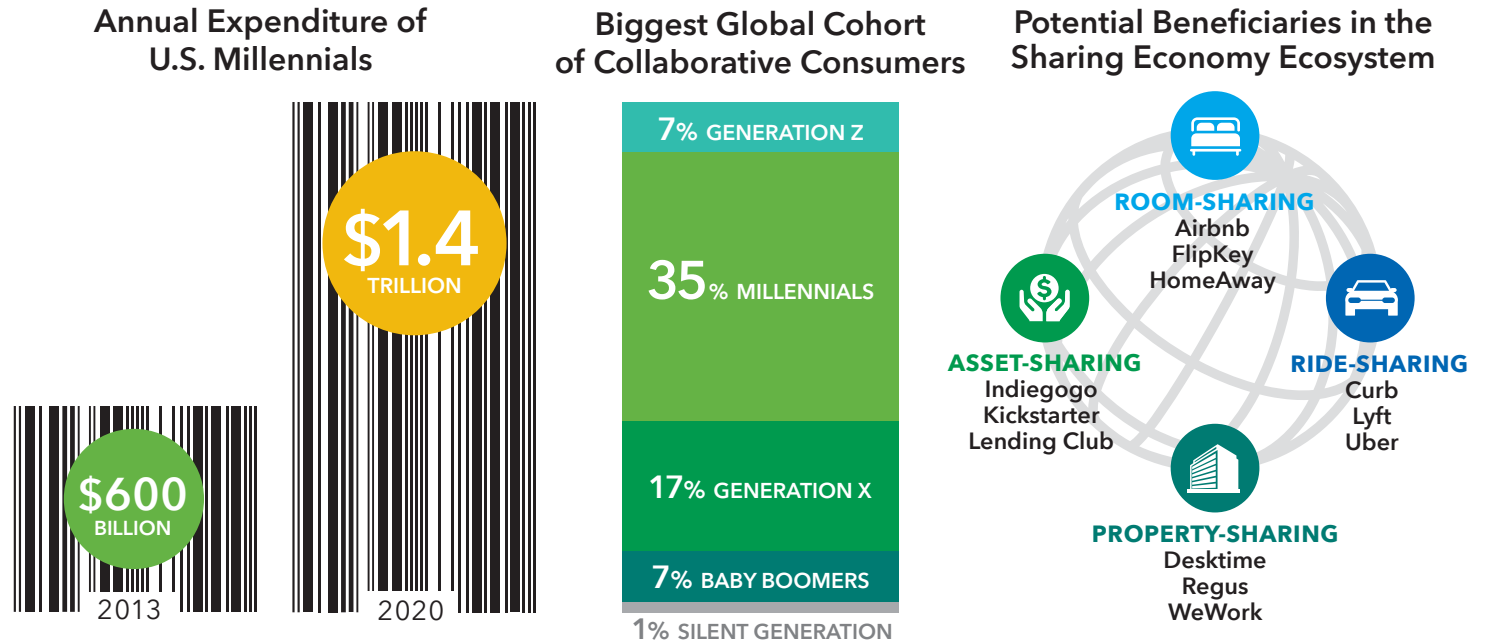
- India embarked on a journey about 25 years ago, opening its doors to globalization and world markets. Since then, the country has become one of the most important components of the global economy. India’s growth has overtaken that of fellow Asian giant China. One of the key components of the country’s economic growth is brisk consumer spending, which propelled growth in India’s economy to 7.6% as of March 31, the end of the country’s fiscal year – the fastest pace in at least four years.
- When it comes to being an economic powerhouse, India may just be getting started. The chart shows that the country still lags much of the world in having items such as refrigerators and air conditioners. But modernization is progressing at a relatively rapid rate, both in terms of personal consumption and modernizing infrastructure. Under Prime Minister Narendra Modi, highways, airports and railways are being improved, which could provide opportunities for companies and boost the economy.
- India also stands to benefit from a demographic tailwind during the coming decades. India has about 440 million millennials and 390 million members of Gen Z (born after 2000) that make up its 1.3 billion population. Over the next decade, about 150 million new people will enter India’s workforce. That’s about the present size of the entire U.S. workforce. A swelling workforce makes it likely India will continue to be a massive market for consumer companies and a major economic force.

Millennials: Aren't They About Ready to Start Buying ... Everything?

Collaborative and Disruptive, Millennials Are Beginning to Flex Their Financial Muscles

"Millennials still consider home ownership important. I think they will become more active buyers of traditional single family houses after they resolve financial constraints."

Alex Sheynkman, Investment Analyst



Sources: Statista Inc. (annual expenditure of U.S. millennials) and *The Sharing Economy*, Credit Suisse, September 18, 2015 (percent of collaborative consumers). The figure for annual expenditure of U.S. millennials for 2013 is an estimate, and for 2020, it is a forecast. The percent of collaborative consumers by generational cohort is based on a 2014 survey conducted by The Nielsen Company and Credit Suisse research.

- Talk about pent-up demand. Millennials have been battered by the Great Recession, swamped with student debt and stuck in their parents' basements for years. They've put off getting married, having kids and buying a car, much less a house. But those days may be coming to an end. In fact, the members of the biggest generation in U.S. history may be about ready to flex their financial muscles. There are about 80 million millennials in the U.S. alone, and they are already spending at least \$600 billion a year.
- Millennials are also taking a collaborative and disruptive approach to consumption. Technology has made sharing assets relatively inexpensive and possible on a large scale. In the sharing economy, people rent rooms, cars or luxury purses directly from each other via the internet. Some companies facilitating this collaborative consumption now have multibillion market caps, including Airbnb, Uber and HomeAway. By 2025, according to consulting firm PricewaterhouseCoopers, the sharing economy may account for \$335 billion in global spending.
- While millennials are already a potent force, they will truly come into their own by 2020, when their spending in the United States is expected to reach \$1.4 trillion annually. Some of that money may go to purchases that have been put off in the wake of the Great Recession. As millennials enter their peak home-buying years, for example, their reluctance to enter the housing market could change. The cohort's size, plus its desire to settle down in the future, could lead to a surge in household formations and home sales.

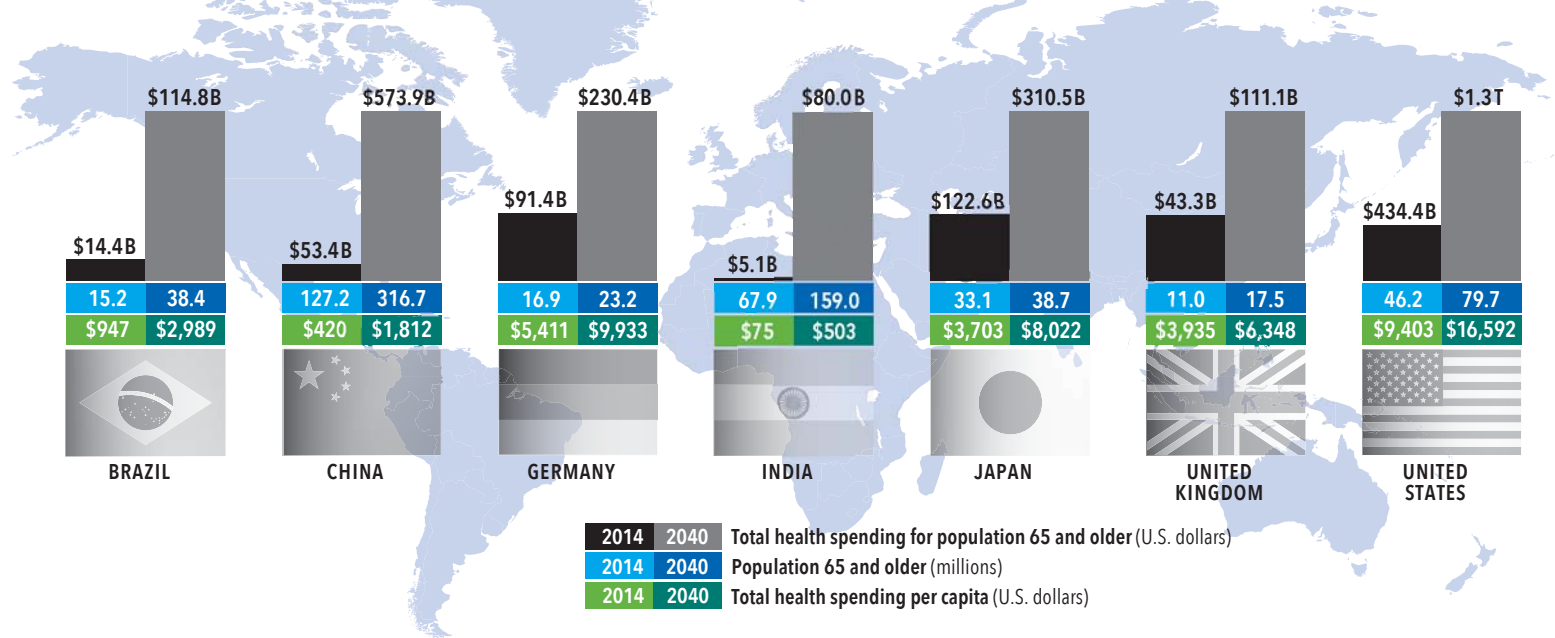
1.3 Billion Shades of Gray

Silver Will Be the New Black as Populations Age

“In coming decades, many forces will shape our economy and our society, but in all likelihood no single factor will have as pervasive an effect as the aging of our population.”

Ben Bernanke, former Chairman, Federal Reserve

As Populations Age, Health Care Spending Is Expected to Soar



Sources: OECD (population 65 and older); The World Bank (health spending for 2014); and “National Spending on Health by Source for 184 Countries Between 2013 and 2040,” *The Lancet*, Dr. Joseph L. Dieleman et al., June 18, 2016 (health spending for 2040). Please see back cover for additional information.

- A striking demographic change is taking place worldwide, as people live longer than ever before and fertility rates fall in many regions. Globally, the number of those aged 65 and over is growing at around twice the rate of the overall population. By 2040, the global population of people aged 65 and older will double to almost 1.3 billion. The implications of a demographic shift of such magnitude are far reaching. Globally, the spending power of consumers age 60 and older will hit \$15 trillion by the end of this decade, up from \$8 trillion in 2010, according to Euromonitor, a global research firm.
- Health care and pharmaceuticals, leisure and tourism and financial services are seen as some of the key sectors likely to benefit. They will not be alone: consumer goods, food and beverages, retail and technology companies are also expected to find new opportunities. For some specialized companies, longevity already offers significant growth opportunities.
- Companies that already sell primarily to older consumers, such as health care and medical device manufacturers, see a potential bonanza coming. One example is Smith & Nephew, which sells replacement hip and knee joints, largely to an older population, and lists aging populations as one of its key drivers of growth. This age cohort is now the fastest growing primary segment of the world’s population and its growth rate is outstripped only by that of an older subgroup – those aged 80 and above.

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The following information pertains to the charts on the pages specified below.

Page 1: Private consumption represents the volume of goods and services consumed by households and nonprofit institutions serving households. Data, based on 2010 constant prices not seasonally adjusted, from 2016 and forward are forecasts for all countries shown; for China, forecasts are from 2015. Values for consumption as a percent of gross domestic product (GDP) are expressed as a share of nominal GDP.

Page 2: The figures for box office revenue were converted from Chinese yuan into U.S. dollars using one exchange rate as of December 31, 2015; these figures, therefore, are estimates. The top 10 highest grossing movies for 2015 are based on box office results updated in August 2016. The figure for international tourism expenditure for 2015 is a forecast.

Page 5: Data for population 65 and older for 2014 and 2040 are from the Organisation for Economic Co-operation and Development (OECD); United Nations *World Population Prospects, The 2010 Revision* (Brazil, China and India); Destatis (Germany); National Institute of Population and Social Security Research (Japan); Office for National Statistics (United Kingdom); and U.S. Census Bureau (United States). Historical population data and projections (1950-2050) were accessed via OECD's Demography and Population database at <https://stats.oecd.org> on August 29, 2016. Data for health spending for 2014 are from The World Bank, World Development Indicators, World Health Organization Global Health Expenditure database. Data, which represent the sum of public and private health expenditures as a ratio of total population, are in current U.S. dollars. Health spending per capita projections for 2040 are from Joseph L. Dieleman, PhD, Tara Templin, BA, Nafis Sadat, MA, Patrick Reidy, BA, Abigail Chapin, BA, Kyle Foreman, PhD, Annie Haakenstad, MA, Tim Evans, MD, Christopher J. L. Murray, MD, and Christoph Kurowski, MD, as published in "National Spending on Health by Source for 184 Countries Between 2013 and 2040," *The Lancet*, Volume 387, Issue 10037, Pages 2521-2532, June 18, 2016, [http://dx.doi.org/10.1016/S0140-6736\(16\)30167-2](http://dx.doi.org/10.1016/S0140-6736(16)30167-2). Data were extracted from the World Health Organization's Health Spending Observatory and the Institute for Health Metrics and Evaluation's Financing Global Health 2015 report. Data were converted to a common purchasing power-adjusted and inflation-adjusted currency. A series of ensemble models and observed empirical norms were used to estimate future government out-of-pocket private prepaid health spending and development assistance for health. Each country's estimates were aggregated to generate total health spending from 2013 to 2040. These estimates were compared with each other and internationally recognized benchmarks. Data for total health spending for population 65 and older were not plotted on the same scale for the countries shown.