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Buyers beware: China's consumers have remained subdued during the COVID-19 recovery

NAB Group Economics

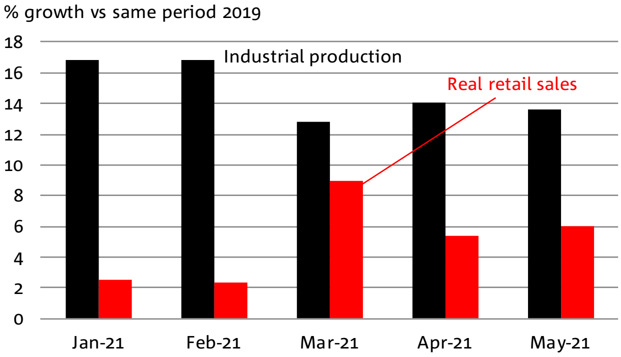
When compared with other partial indicators of China's economic performance, recent trends in retail sales have been comparatively weak – highlighting the concerns that China's consumers have been lagging behind other parts of the economy in the country's recovery from COVID-19. Chinese authorities may need to address a series of structural constraints if they intend to support long term growth in household consumption.

INDUSTRY HAS DRIVEN CHINA'S RECOVERY; SPENDING HAS BEEN WEAK

The industrial sector has been a critical driver of China's recovery from the COVID-19-related economic downturn. Compared with the same period in 2019, industrial production was around 13.6% higher in real terms in May 2021, led by growth in a range of higher value-added manufacturing sectors including electronics, machinery and equipment and pharmaceuticals. Strong global demand for these products has underpinned growth in exports.

CHINA'S INDUSTRIAL LED RECOVERY

Real retail sales have lagged



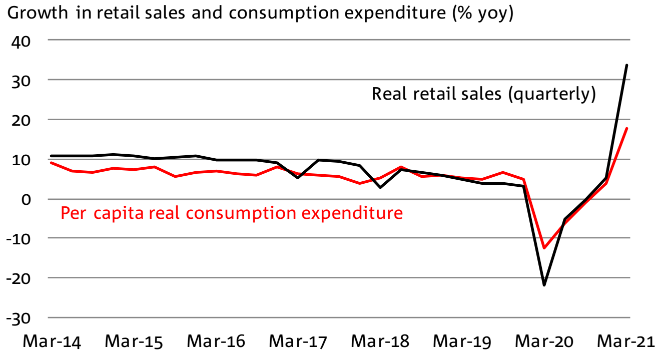
Source: CEIC, NAB Economics

In contrast, real retail sales rose by just 6.1% between May 2019 and May 2021. It is worth noting that retail sales are not analogous to household consumption, as retail sales includes government purchases of goods while it also excludes spending in a range of services sectors – including education and healthcare. Given the gaps in services spending and the lack of disaggregation between public and private spending in the retail sales data, these do not provide a complete picture around consumer spending, but clearly point towards its recent weakness.

An alternative indicator that supports this view is real per capita consumption expenditure from the National Bureau of Statistics' Household Survey. These data show that per capita consumption fell by 4.0% in 2020, with a larger fall (6%) in urban areas. When compared with the levels in Q1 2019, per capita consumption was 2.9% higher in Q1 2021 across China, and just 0.1% higher in urban areas. This survey is less timely than retail sales data, however it presents a similar trend in terms of weaker growth in spending than pre-pandemic.

CONSUMPTION AND RETAIL SALES

Looking through the trough and peak, survey data supports view of weaker consumption growth post-pandemic



Source: CEIC, NAB Economics

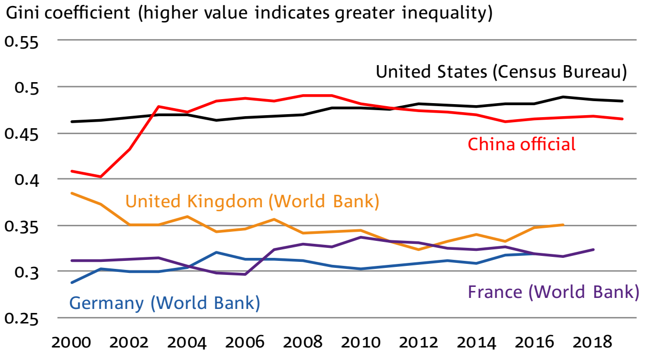
THE PANDEMIC SLOWED INCOME GROWTH, PARTICULARLY AT THE BOTTOM

One factor contributing to weakness in consumption has been the negative impact of COVID-19 on household incomes. Data from the NBS Household Survey shows that per capita disposable income rose by 2.1% in 2020 – compared with 5.8% in 2019 and 6.5% in 2018. Growth in urban areas was weaker, at just 1.3%.

That said, average measures of income do not paint an accurate picture, given China's high degree of income inequality. When compared with advanced economies, China has marginally less income inequality than the United States, but far higher inequality than the UK, France or Germany. China's official measure of its Gini coefficient fell between 2008 and 2015 – indicating less inequality – before subsequently trending marginally higher. Although data for 2020 is not yet available, it is widely believed that inequality rose due to the pandemic. Job losses and wage cuts disproportionally impacted low-income earners – which reduced consumption as low-income earners spend a larger proportion of their income.

INCOME INEQUALITY

China's income inequality is greater than many advanced economies

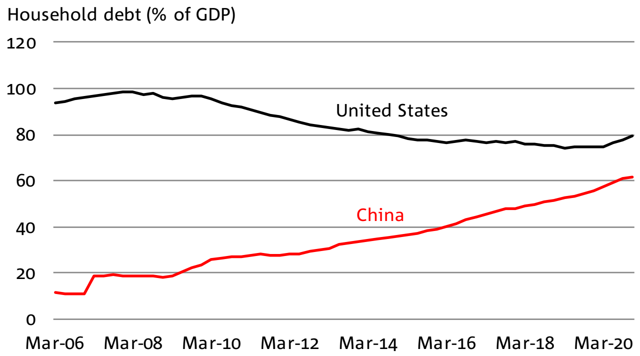


Source: Refinitiv, CEIC, US Census Bureau, NAB Economics

Household debt has trended higher in China since late 2008 – up from almost 20% of GDP to almost 62% of GDP at the end of 2020. Much of this debt is tied to property mortgages, however consumer credit has also expanded rapidly in recent years. Given the relatively modest reduction in interest rates in China in 2020 (in contrast to larger cuts in many advanced economies) it is likely that debt servicing costs have continued to trend higher – adding a further constraint to disposable income, and by extension, consumption going forward.

HOUSEHOLD DEBT

China's debt levels have risen in recent years



Source: BIS, NAB Economics

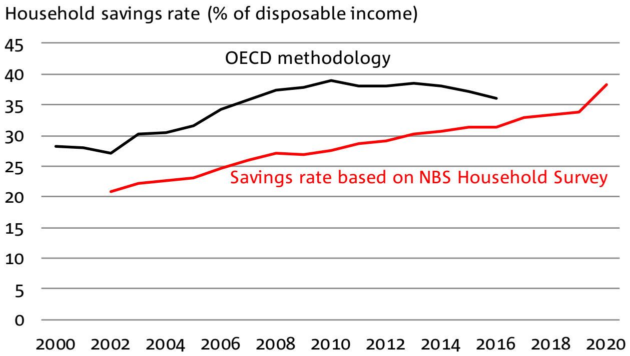
Financial support from China's government was largely directed towards business rather than households (unlike a broad range of programs in advanced economies). This allowed firms (particularly in the industrial sector) to drive the post-COVID-19 recovery, however it also meant that households largely lacked the income support seen in many advanced economies as unemployment trended higher. While China continues to lack high quality labour force data, anecdotal evidence points to a significant jump in unemployment related to the pandemic, particularly among migrant workers.

UNCERTAINTY HAS SEEN HOUSEHOLD SAVINGS CLIMB

Since the start of the COVID-19 pandemic, China's households have chosen to save a larger proportion of their disposable incomes. A simple estimate of household savings, based on disposable income and expenditure from the NBS Household Survey, showed that savings rose from around 33% of disposable income pre-pandemic to around 38% in 2020. OECD calculations for household savings include additional income (including employment related pension schemes), which has historically elevated its measure of saving above that of the survey approach. While OECD data for China are only available up to 2016, based on historical comparison, this could indicate a household savings rate well in excess of 40% in 2020.

CHINA'S HOUSEHOLD SAVINGS

Savings jumped in 2020

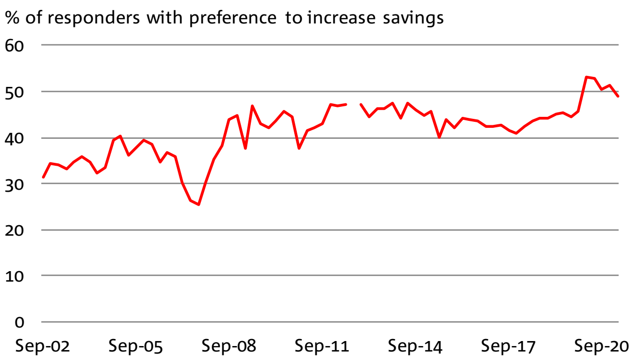


Source: CEIC, OECD, NAB Economics

In part, the increase in savings reflect the impact of COVID-19 restrictions on opportunities for consumers to spend – as travel restrictions and business closures limited activity in retail, tourism, hospitality and other services. However, the People's Bank of China's Urban Depositor Survey also showed a sharp increase in the number of respondents intending to increase their savings – from around 45% pre-pandemic to 53% in March 2020 – which likely reflects a greater degree of financial conservatism in a period of high uncertainty. This share has subsequently declined in subsequent surveys – down to 49.1% in March 2021, however this outcome remains higher than at any point prior to the pandemic (with the survey dating back to September 2002).

SAVING INTENTIONS

PBoC survey shows greater preference to save in 2020



Source: CEIC, NAB Economics

Reflecting China's high levels of income inequality, savings are far from evenly distributed across households. A survey conducted by the People's Bank of China in 2019 showed that the top 10 percent of households by income controlled around 58% of financial assets, compared with just 5% for the bottom 40% of households. By necessity, lower income households typically consume a larger proportion of their disposable income.

GOVERNMENT SUPPORT HAS BEEN COMPARATIVELY WEAK

A contributing factor to the increase in household savings in 2020, and indeed the relatively high rates pre-pandemic (when compared with other countries), is the limited nature of China's social safety nets. In part this reflects the fact that the bulk of social spending is provided by local governments, leading to inconsistent programs across the country.

The IMF have noted that unemployment benefits remain very limited, with coverage provided for only one in three people in the urban labour force, fewer than one in five for migrant workers and even thinner coverage in rural areas.

Similarly, China's total spending on welfare and health is comparatively low. The IMF estimate that China's spending on this area in 2020 was around 3.5% of GDP, compared with an average of over 6% for other emerging market economies.

The weak social safety net means that households tend to save at higher than average rates to provide their own security in the event of employment loss, to fund healthcare spending and to fund their retirement – thereby limiting their potential to consume.

CONCLUSIONS

In the near term, it is likely that strengthening economic growth will support stronger increases in income, leading to a recovery in measures such as retail sales. However, addressing structural constraints – such as the inadequate social safety net – and income inequality may be necessary to properly transition China's economy towards consumption-led growth. Although such a transition is at the core of the "dual circulation" growth model that has been promoted by Chinese authorities since 2020, the bulk of reforms proposed under the latest Five Year Plan have been focussed on the supply side of the economy. It remains to be seen whether current weakness in spending may drive any demand side policy changes.

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