China Economic Update September 2023

Are authorities unable or unwilling to address the real problem in China's economy?

NAB Group Economics

Back in March, when China unveiled a 5% growth target for 2023 that (at the time) appeared easily attainable, household consumption was identified as the key driver for growth this year – given that weakness in the housing market was likely to constrain investment and slower growth in advanced economies would limit exports. However, policy measures unveiled at the National People's Congress were directed at the supply side of the economy – largely intended to improve the flow of goods following the disruptions of the COVID-19 pandemic – with nothing to address consumption. Subsequent proposals – including loosening monetary policy and tax incentives – similarly do little to address the underlying problem.

Consumers have not come to the party post-zero-COVID

Household consumption in China is difficult to track. Unlike most major economies, China does not produce quarterly GDP by expenditure data, meaning that it is necessary to rely on imperfect measures such as retail sales to indicate the underlying conditions. Retail sales excludes a broad range of services consumption (such as travel, education and healthcare among others) while also including goods consumption by the public sector.

Retail sales

Real sales weak post-pandemic

Source: Macrobond, NAB Economics

In real terms, retail sales growth was extremely weak during the zero-COVID period. A lack of fiscal support for households and the risk of sudden (and potentially long lasting) lockdowns due to COVID-19 outbreaks encouraged residents to save as much income as possible – albeit accumulated savings were nowhere near as sizeable as those in most advanced economies. After abandoning its zero-COVID policies in December 2022, retail sales briefly surged (peaking in year-on-year terms in April 2023 at over 18% yoy, albeit this was boosted by base effects), before slumping to weak growth rates in June and July that were similar to those during zero-COVID.

It is somewhat difficult to ascertain why real sales have slowed once again, however there are a broad range of factors that may have influenced this trend. First, households could be increasing consumption of services that are not included in the retail sales series. The Caixin services PMI has remained firmly in positive territory since zero-COVID ended, and the National Bureau of Statistics announced in August that consumption of services rose by 20% yoy in the first seven months of the year (a series that had not previously been released).

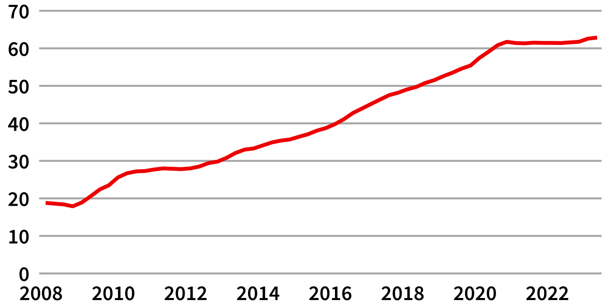
Second, consumption of big-ticket household items is likely impacted by the severe downturn in the housing market – since purchases of household goods are often associated with people establishing new homes.

Third, households balance sheets may be considerably tighter than they were prior to the pandemic. On one side of the equation, household debt, as a percentage of GDP, steadily climbed from 17.9% in Q4 2008 to 61.9% in Q4 2020, before essentially plateauing across the zero-COVID period. Meanwhile, there are various anecdotes that point to weakness on the income side – with youth unemployment data (that was not necessarily comparable to advanced economy measures) steadily trending higher to an all-time high in June, along with reports of wage cuts in various sectors – including finance, healthcare and education, along with civil servants in some of the highly indebted local governments.

Household debt

Debt levels rose substantially prior to the COVID-19 pandemic

Household debt (% of GDP)



Source: Macrobond, NAB Economics

Weak consumption has been a long run problem

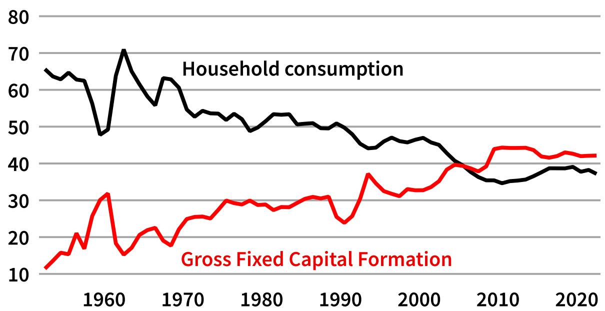
China's rapid industrialisation across the 1990s and 2000s followed the same model as post-war Japan and South Korea across the 1970s and 1980s, adopting a policy of financial repression, with strict capital controls, to generate a large pool of low-cost funds that could be deployed for domestic investment. Between 1990 and 2010, the household consumption share of GDP fell from around 50% to less than 35%. While this supported the rapid growth of the manufacturing sector, and China's emergence as the dominant global goods exporters, this model had long been identified as unsustainable.

As far back as December 2004, then Premier Wen Jiaobao announced the government's plans to transition away from investment and export-led growth towards a consumption-based economy. Instead, the consumption share of China's economy continued to fall until 2010, down to 34.6%, and despite some recovery between 2010 and 2019, it has not reached the rate it recorded in 2004.

Consumption and investment

China's consumption share of GDP has barely risen from 2010's low

Consumption and investment (% of GDP)



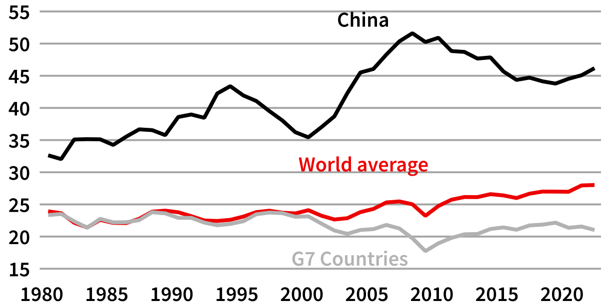
Source: Macrobond, NAB Economics

China continues to save too high a proportion of its income, constraining its capacity to grow consumption. China's gross national savings (which comprises both private and public savings) totalled 46% of GDP in 2022 – way above the global average of 28% and the G7 total of 21%. In part this high rate reflects an inadequate social safety net along with the impact of demographic changes – with workers forced to save a considerable proportion of their income to support future retirement or if they suffer unemployment. The former has become an increasingly important issue, given the decline in the working age population since 2013 has increased China's older age dependency ratio – with fewer workers to support a growing retired population.

National savings

China saves rather than consumes

Gross national savings (% of GDP)



Source: Macrobond, NAB Economics

This suggests fundamental changes to the structure of social security system (rather than modest tweaks to policy levers) may be necessary to support the transition towards a consumption-based economy. However, it appears that Chinese authorities are reluctant to make such changes. For several years, various public officials, including President Xi, have warned of the dangers of welfarism, expressing concerns that expanded social security could negatively impact productivity – something that seems more ideologically aligned to 1980s era Reaganism than that of a nominally Communist state.

Even if policy makers accept the need to address the need to rebalance the economy, the past decade has demonstrated that implementing reform can be challenging. According to the Asia Society, of the ten broad categories for reform announced at 2013's Third Plenum, five have clearly gone backwards, one stalled and the remaining four seen some modest advancement.

Conclusions

China's economic planners have long identified the need to transition its economy towards consumption, having identified the limits of the investment-led model. To that end, it is somewhat surprising that policy makers have been either unable or unwilling to implement measures that would support this transition. Some of this may reflect various barriers to reform (including ideological constraints) that can limit progress. Failure to transition towards consumption would likely lead to a poorer and slower growth China in the longer term.

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