

Taking the pulse of Chinese household spending

Cyclical and structural challenges as consumption patterns change

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FLASH NOTE

SUMMARY

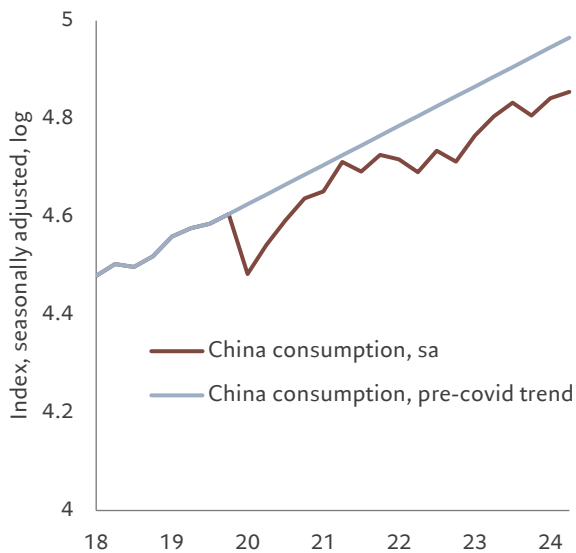
- The recovery in household consumption in China has been relatively sluggish since the pandemic and spending is still well below the pre-covid trend in nominal terms. This primarily reflects price effects, as in real terms the gap between pre-covid trends is much smaller. This is in stark contrast with other major economies, where nominal consumption is above the pre-covid trend, but real consumption is still below (with the possible exception of the US).
- Currently, household income, which is closely correlated with GDP growth, is the main drag on consumption in China, with the savings ratio roughly back to pre-covid levels. In addition, a significant downturn in the equity and property markets and the government's fiscal difficulties have weighed on households' income from assets and transfer income. The divergence from the pre-covid trend for both these sources of income is significant.
- Consumption patterns have also been changing. With a relatively slow recovery in personal income and worsening income inequality, discretionary consumption has underperformed essential spending significantly for some time now. This may to some extent reflect changes in consumer behaviour beyond cyclical factors. Declining momentum in discretionary spending while spending on essential items holds up could remain a trend for a while yet as Chinese consumers become more price sensitive and engage less in impulse buying.
- Structurally, the ratio of household consumption to GDP in China is still the lowest among major economies. This can be explained by: 1) a high propensity to save; 2) elevated income inequality; and 3) a low ratio of household disposable income to GDP. To increase household spending as a share of GDP, the government needs to further push urbanisation and labour market reforms, improve public spending on social insurance and subsidies for lower-income groups, and facilitate the development of services sectors etc. Cyclically, the outlook remains challenging for household spending in China.

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WHAT ARE THE CYCLICAL FACTORS DRAGGING ON HOUSEHOLD SPENDING?

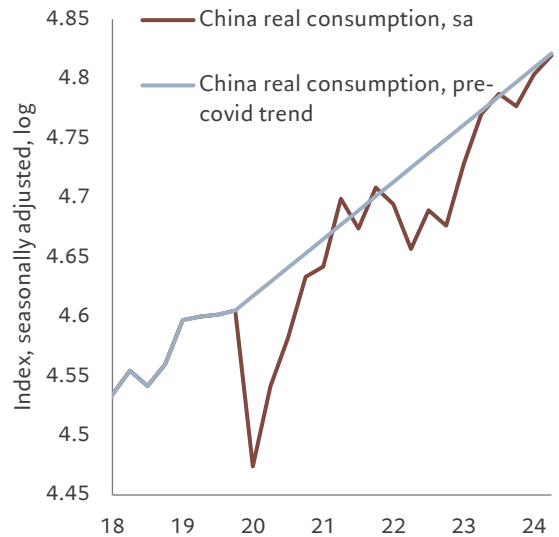
Household consumption in China remains well below the pre-covid trend in nominal terms (*chart 1*). This primarily reflects significantly lower inflation since 2020. But the divergence in household spending from its pre-covid trend is much smaller in real terms (*chart 2*). This is in stark contrast with other major economies where, as a result of an upsurge in inflation since the pandemic (largely due to energy and supply-chain issues that are less salient in China), household consumption has risen above the pre-covid trend in nominal terms (*chart 3*). However, with the possible exception of the US, real consumption in these same economies is still below the pre-covid trend (*chart 4*).

Chart 1: Chinese household consumption in nominal terms



Source: Pictet Wealth Management, Wind, as of 30.06.2024

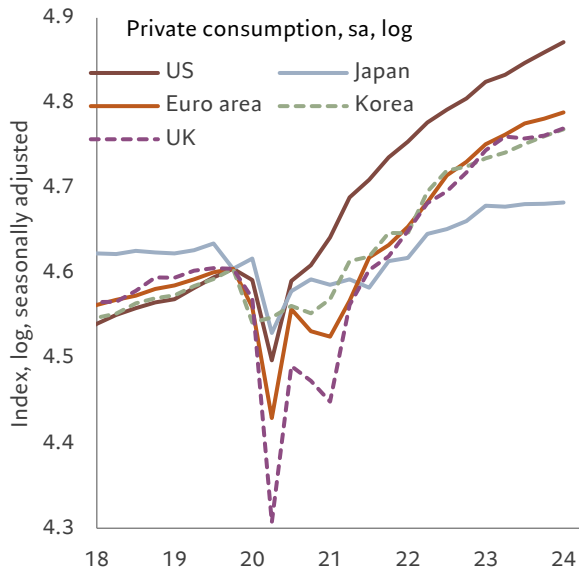
Chart 2: Chinese household consumption in real terms



Source: Pictet Wealth Management, Wind, as of 30.06.2024

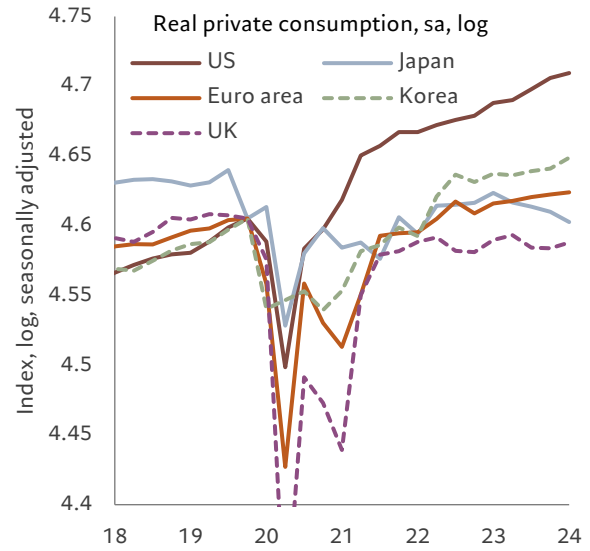
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Chart 3: Nominal household consumption in major economies



Source: Pictet Wealth Management, Wind, as of 31.03.2024

Chart 4: Real household consumption in major economies

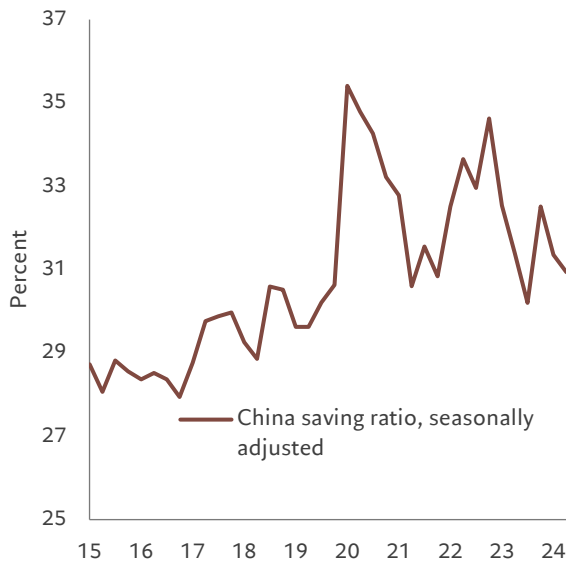


Source: Pictet Wealth Management, Wind, as of 31.03.2024

If we look separately at two of the biggest drivers of household spending, we can see that the main reason for the slowdown in spending growth is personal income (*chart 5*) while the savings rate (*chart 6*) in China is back to pre-covid levels. Income growth is closely correlated with GDP growth, particularly wage and business income (*chart 7*). In more detail, there has been a significant dip from pre-covid trends in terms of transfer income and income from assets (*chart 8*). This reflects downturns in the equity and property markets and the government’s fiscal challenges (with a decline in transfers within families another possible factor).

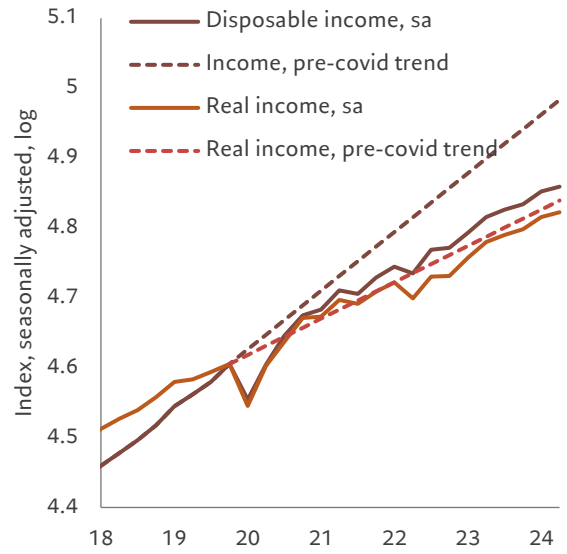
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Chart 5: Chinese household savings ratio



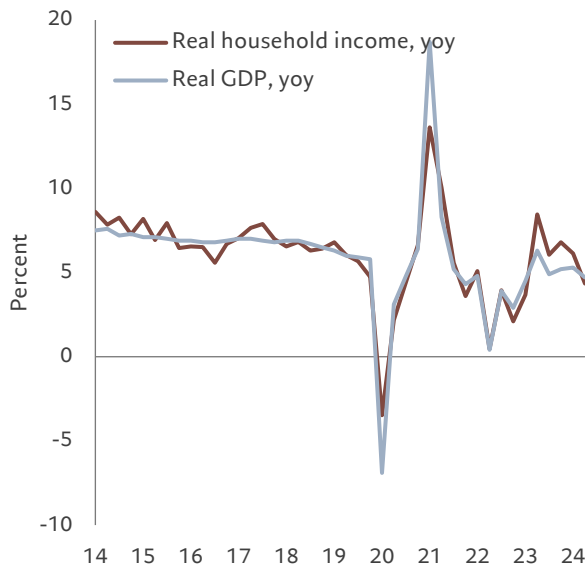
Source: Pictet Wealth Management, Wind, as of 30.06.2024

Chart 6: Chinese household income levels



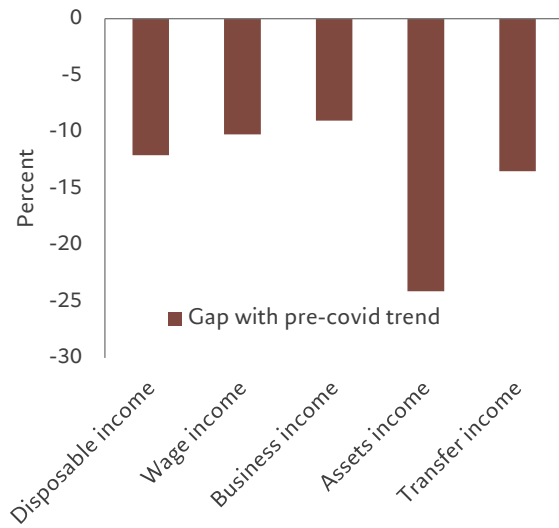
Source: Pictet Wealth Management, Wind, as of 30.06.2024

Chart 7: Chinese household income and GDP, yearly change



Source: Pictet Wealth Management, Wind, as of 30.06.2024

Chart 8: Trends in Chinese household income by category



Source: Pictet Wealth Management, Wind, as of 30.06.2024

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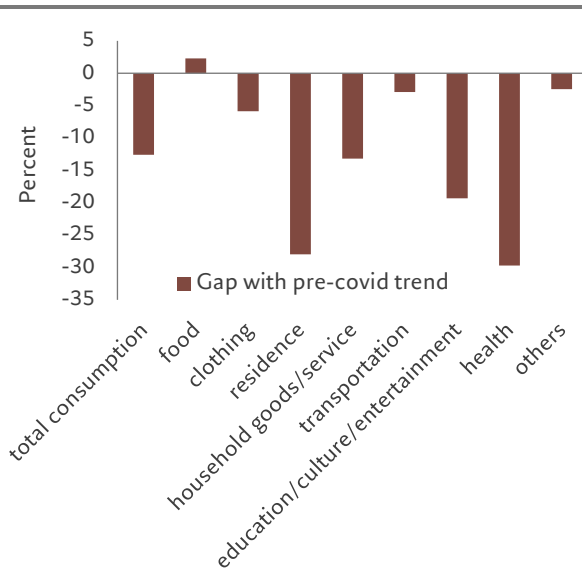
HOW HAS THE PATTERN OF CONSUMPTION CHANGED?

In addition to aggregate changes, there have been some changes in consumption patterns in China since the pandemic:

- 1) Given a relatively slow recovery in income and worsening income inequality in China, discretionary spending has broadly been weaker than spending on essential items (food and clothing, for example). Thus, the divergence from pre-covid trends is much bigger for discretionary goods and services (*chart 9*), exacerbated by the housing downturn. Price effects may also have contributed, especially in terms of residence and health spending, with inflation in these two categories since 2020 notably below pre-covid averages.
- 2) Different categories' share of consumer spending has also shifted (*chart 10*). Spending on food, which had been trending down before covid, has increased noticeably as a share of total consumption since 2020. (Interestingly, according to Engel's Law, the percentage of food spending in total consumption should decline as incomes rise.) The decline in spending on clothing as a percentage of total consumption that was evident before the pandemic has continued, but at a slower pace. Spending on other discretionary items, which typically increases as households grow richer, has declined or grown more slowly since the pandemic. While increases in food's share of household spending and other recent trends may not persist indefinitely, recent shifts in consumption patterns may to some extent reflect changes in consumer behaviour beyond near-term, cyclical factors.
- 3) Linked to the previous point, Chinese consumers seem to have become more price conscious. Media reports and other evidence suggest as much. For instance, so called "Ping Ti (平替)", which means replacing expensive foreign brands with cheaper domestic ones without any significant loss of quality, is very popular.

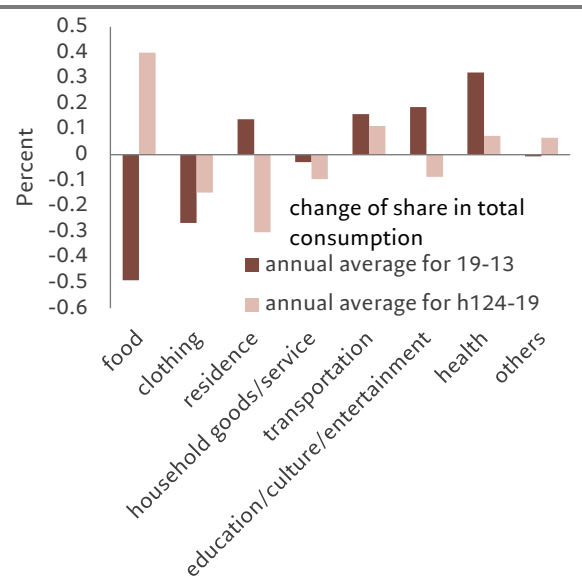
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Chart 9: Chinese household consumption by major category



Source: Pictet Wealth Management, Wind, as of 30.06.2024

Chart 10: Share of consumption by major category



Source: Pictet Wealth Management, Wind, as of 30.06.2024

WHAT IS THE STRUCTURAL OUTLOOK FOR CHINESE HOUSEHOLD SPENDING?

Chinese household spending as percentage of GDP is still the lowest among major economies (while the percentage of fixed investment is the highest, *chart 11*), even though the government has been pushing to rebalance growth towards domestic consumption for many years (*chart 12*). There are three main factors why household spending in China is comparatively low: 1) Disposable income accounts for a low share of GDP ratio (reflecting the distribution of national income between labour and capital); 2) high income inequality; and 3) households' high propensity to save.

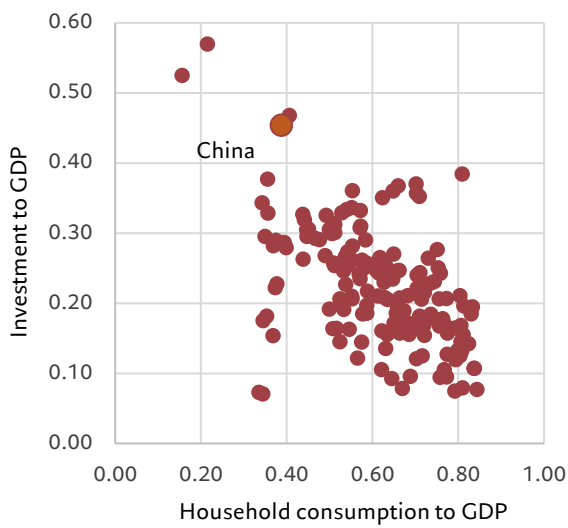
If we dig deeper, we see a number of structural factors holding back Chinese consumer spending:

- 1) Flimsy social security leads to high levels of precautionary saving, while the Hukou household registration system impedes labour mobility (and plays a role in willingness to spend).
- 2) While there has always been a huge disparity in household income between urban and rural China, in recent years income inequality has also become an issue within urban centres as well.
- 3) Before the housing bust, to get on the property ladder Chinese consumers had to save a lot. All else being equal, fading enthusiasm for housing should mean that consumers unburdened with a mortgage should have more disposable income. This should have a positive impact on consumer spending. On the other hand, the knock to consumer confidence from the downturn in the property market, as well as the decline in housing-related purchases, could have a negative effect on spending more generally.

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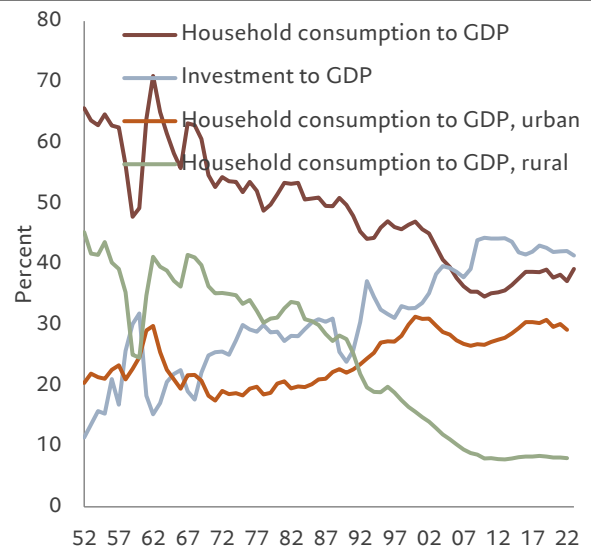
In order for it to meet its aim of lifting household consumption’s share of GDP, the government needs to push structural reforms, including reforms to the labour market and further urbanisation. It will also have to improve public spending on social insurance, provide subsidies for lower-income groups and encourage the development of services sectors. While the outlook for consumer spending in China is challenging in the short term, successful structural reforms could ensure it forms a bigger part of the Chinese economy in the years to come.

Chart 11: Consumption/investment to GDP ratio for major economies



Source: Penn World Table

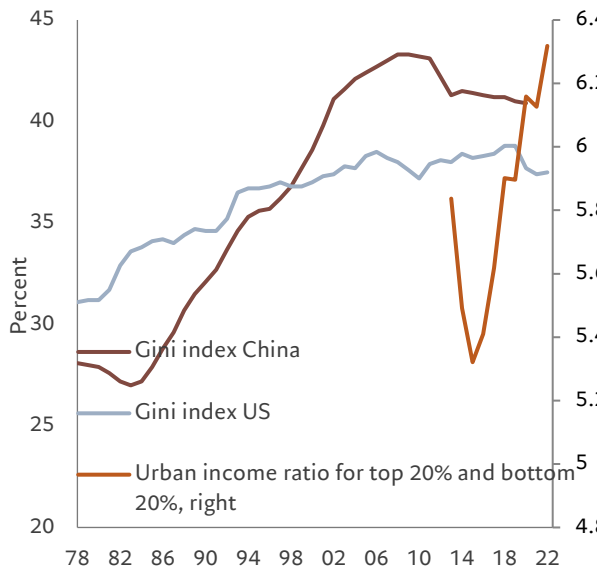
Chart 12: Consumption/investment to GDP ratio in China



Source: Pictet Wealth Management, Wind, as of 31.12.2023

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Chart 13: Income inequality in China



Source: Pictet Wealth Management, Wind, as of 31.12.2022

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