

China Economic Spotlight

Consumption recovering but only slowly

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Economics - China

- ◆ China's economic growth faces headwinds in H2 2021
- ◆ Stable consumption growth is needed but constrained by labour market recovery and more leveraged households
- ◆ Continued and stepped-up support to SMEs could help

Growth stability now at the top of Beijing's agenda

The People's Bank of China (PBOC) surprised the market on Friday with data that the credit supply was much stronger than the consensus expectation and by making a swift and broad-based cut of 0.5% to the reserve requirement ratio (RRR), which followed the hint by the State Council on Wednesday. Although we do not think the change implies an inflection point in the central bank's monetary policy, we believe it does highlight that Beijing now puts the stability of growth as its top priority.

6% growth target not hard to meet but economic structure short of desired

Beijing's concern, however, is not the growth rate. Indeed, its conservative target of 6% real GDP growth this year is not hard to achieve, in our view, given the low base effect in 2020. The GDP number for Q2 illustrated this point as the 7.9% y-o-y growth rate was only slightly lower than the market consensus of 8.0%. The 2-year compound growth rate (CAGR) in fact improved to 5.5% for Q2 from 5.0% for Q1. But a more balanced growth environment, such as with strong consumption, is still lacking: the CAGRs for disposable income and consumption expenditure were both still less than the pre-pandemic levels with the latter gradually creeping up to two-thirds of the growth rate for 2019 (Chart 1). The household savings rate remains elevated as precautionary saving continues given the uncertain income prospects. In comparison, savings rates are off their highs in Australia and Japan while those of US and Germany have bounced back mainly due to the new or extended stimulus packages targeting households.

Challenging labour market and household leverage drag on consumption growth

What has held back the consumption recovery? The relatively weak labour market and slightly stretched household balance sheets. The surveyed unemployment rate has fallen back to the pre-pandemic level, but the youth unemployment rate remains high (Chart 3), potentially even more so for young people with college degrees. The National Bureau of Statistics of China (NBS) sporadically discloses the unemployment rate among those aged 20-24 with associate degrees and above; this rate was 19.3% in June 2020, about 4 percentage points higher than the unemployment rate for all those aged 16-24 at 15.4%, indicating the ongoing challenges for the labour market. As young people have a higher propensity to consume, the elevated youth unemployment rate is weighing on the consumption recovery. Household leverage has also risen rapidly: the household debt to GDP ratio has shot up quickly in recent years although it is still lower than that of the US and the average of advanced economies (Chart 4).

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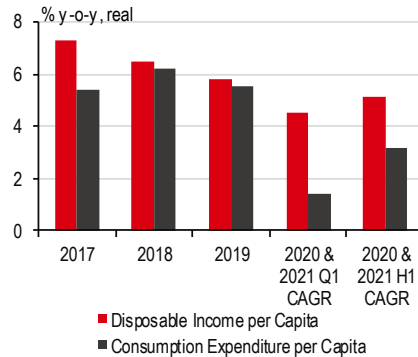
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Chart 1: Recovery of income and consumption still weak


Source: CEIC, HSBC

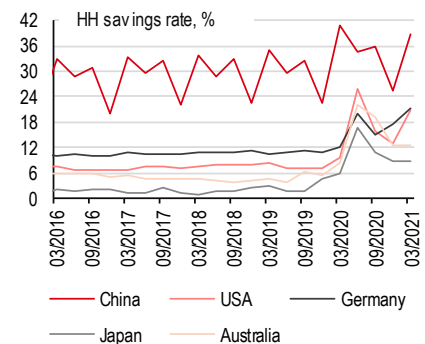
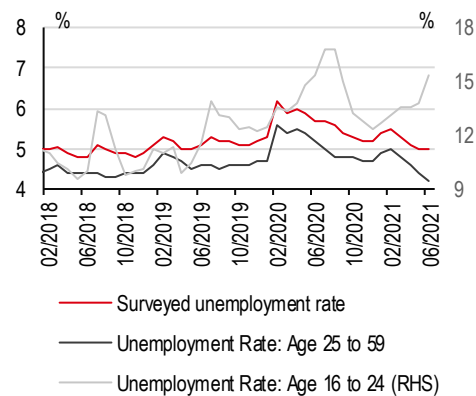
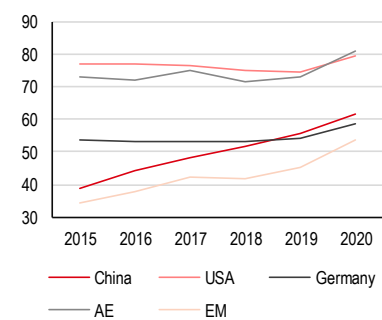
Chart 2: Precautionary savings rate remains high

 Note: China does not publish household saving rate data. The values are calculated from the disposable income and consumption expenditure.
 Source: OECD, National Bureau of Statistics of China, HSBC

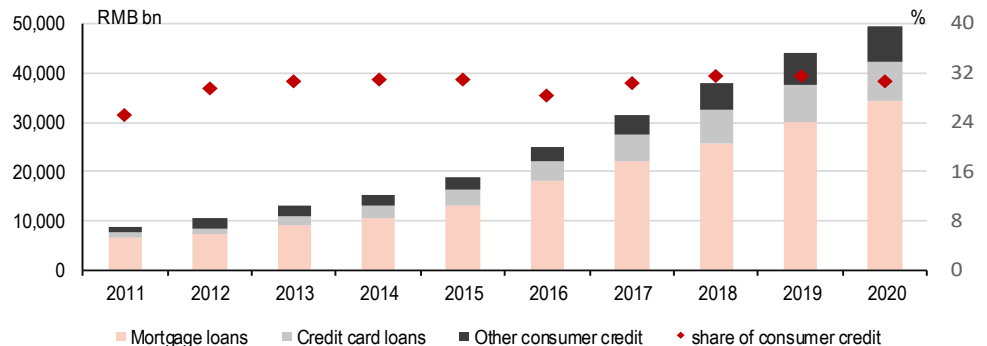
Chart 3: Youth unemployment rate high


Source: CEIC, HSBC

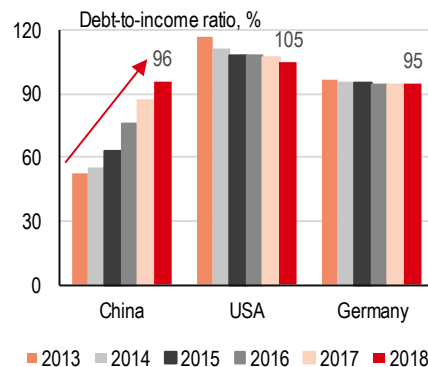
Chart 4: China's household leverage up

 Note: AE: average of advanced economies; EM: average of emerging economies
 Source: BIS, HSBC

Rising household debt is being driven by increasing mortgage loans against the backdrop of the decades-long housing boom and the exponential growth of consumer credit from a relatively low base (Chart 5). The official statistics only take stock of consumer credit extended by regulated financial institutions; thus, they likely understate the actual growth. Indeed, internet consumer finance had witnessed significant expansion before Beijing decided to enact disciplinary measures in 2020.

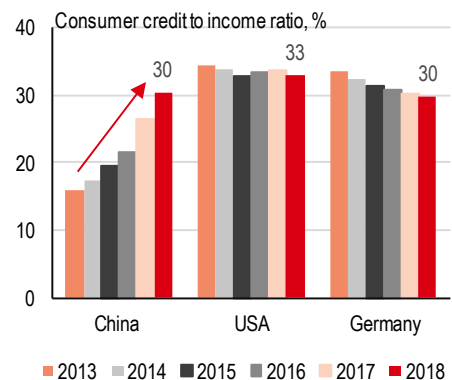
How about the debt affordability? We examined the question by looking at the debt-to-income ratio. To make a fair comparison with other countries, we excluded household business loans from the household debt as they are essentially loans to small- and medium-size enterprises (SMEs). Chinese households are leveraging up while US households are deleveraging and German households are staying put (Chart 6). The story is nuanced when it comes to mortgages because the debt-to-income measure ignores the wealth effect associated with housing price appreciation. Therefore, we focus on the consumer credit to income ratio (Chart 7). Chinese households are roughly on par with US and German households on this measure. However, the upward trend of the debt-to-income ratio adds pressure to the debt affordability and, hence, the consumption recovery.

Chart 5: China's consumer credit growing fast, now accounting for one-third of all household debt


Note: Household business loans are excluded as they are SME loans by nature. Source: CEIC, HSBC

Chart 6: China's household debt-to-income ratio close to that of US and Germany


Note: Household business loans are excluded from China's household debt for fair comparison with the US and Germany. Source: CEIC, HSBC

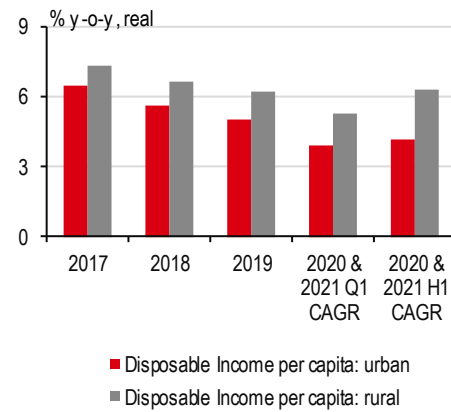
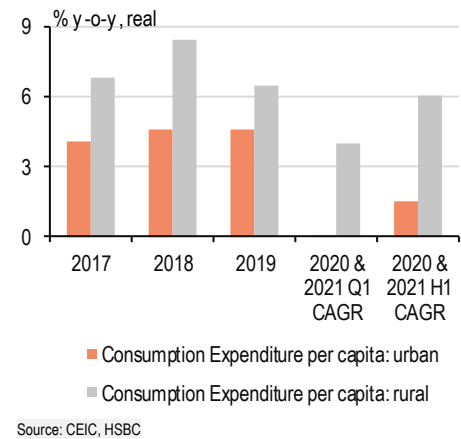
Chart 7:... especially for the consumer credit subcategory


Note: Household business loans are excluded from China's household debt for fair comparison with the US and Germany. Source: CEIC, St. Louis Fed, HSBC

Policy outlook: support to SMEs likely to continue or be enhanced

Labour market pressure and somewhat stretched household balance sheets have constrained the consumption recovery. Going into H2 2021, the best-performing segments of the economy so far – the robust property investment and strong exports – may slow down. For the former, the key leading indicators are poised for moderate slowdowns while for the latter, the continued recovery in Western countries will likely lead to a rotation of consumer spending from goods to services, weighing on China's exports. Thus, stable growth in China is more dependent on domestic consumption bouncing back.

What is Beijing doing to facilitate consumption growth? Like most other developing countries, stimulus policies are aimed at anchoring businesses rather than households. With the aim of boosting consumption, Beijing's support is focused on SMEs as they account for over 85% of employment. Their performances directly influence household disposable income. However, SMEs are more likely to face financial constraints than larger firms even in normal times let alone during a once-in-a-century health and economic shock. For example, SMEs in the manufacturing sector face persistent pressures from soaring raw material prices and shipping costs due to their relatively weak bargaining power while SMEs in the services sectors are suffering from softer consumption than the levels before the pandemic. The majority SMEs in manufacturing and services sectors are in urban areas, which explains why the consumption recovery in urban areas is lagging that in rural areas.

Chart 8: Rural leads urban in disposable income recovery...

Chart 9: ... as well as in consumption recovery


The broad-based 0.5% RRR cut effective on 15 July is intended to provide long-term stable funds to support SMEs. We expect the same policy stance for the rest of the year.

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