The Chinese Consumer – Scared And Deleveraging

Newsletter for July 2023

Summary

The one conundrum of the past eight months since the re-opening of the Chinese economy has been the slow recovery of consumption demand. Even where demand has recovered, it has been a muted recovery and the recovery has flattened out earlier than expected. This is driven primarily by a sharp drop in consumer confidence as the post-COVID economic recovery has been slower than expected. But there are also structural issues at play such as lower corporate earnings growth, wage growth, demographics, etc. In this thought piece, we will elaborate on this slow growth and a few of its causes.

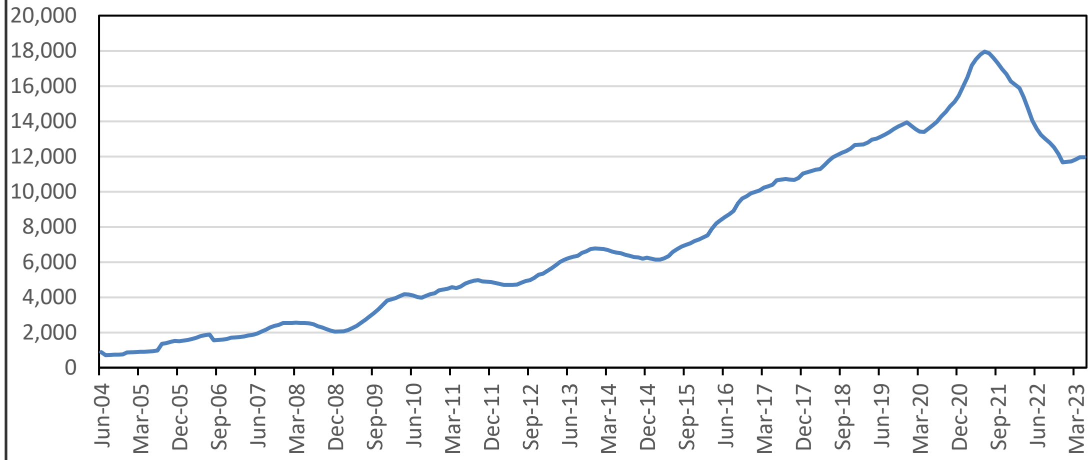
Broadly, Chinese consumers are low on confidence and hence are marrying less, having fewer kids, buying fewer properties, deleveraging their balance sheets, flying less, spending less at retail outlets, etc. Some of the reasons for this are structural, but some others will normalise upwards. Also, a consumption strike by definition cannot go on forever as the natural human instinct is to consume once confidence comes back. A similar point can be made on deleveraging. This has created opportunities which we are hoping to capitalise on.

The Crash in Property Sales

This has been the biggest drop. It is both a symptom of this drop in confidence and one of causes. On a 12-month rolling basis, property sales have dropped by approximately a third from the peak of about two years ago, going back to the sales level of 2018. This is a huge drop. Given that at the peak the property sector directly and indirectly contributed to about 24% of GDP, the broader impact is large. Also, this is a large part of household wealth. Hence, the negative wealth effect has a strong impact on consumer confidence.

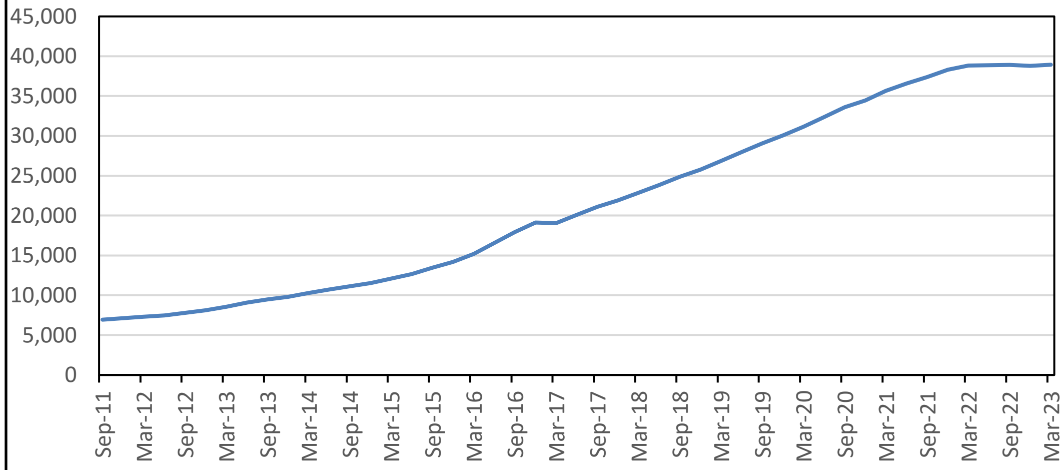
The other important impact of this is a flattening mortgage loan book for the past two years. Hence, since January 2022, the Chinese buyer has bought over Rmb 16 trln. of property, but the outstanding mortgage has remained constant at about Rmb 40 trln. To put it in context, the Chinese residential buyer has bought about Rmb 143 trln. of residential properties in the last twenty years whose current value is more than Rmb 200 trln. This means that the leverage on property has moved from a low 22% to an even lower 20% over the last eighteen months.

Property sales 12 months rolling (Rmb bln.)



Source: Bloomberg

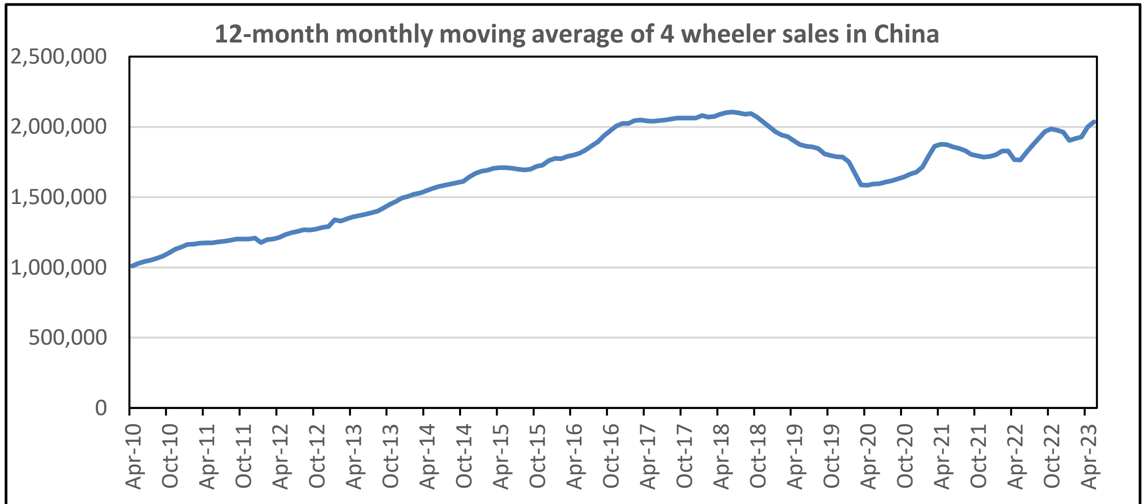
Outstanding mortage (bln. Rmb)



Source: Bloomberg

Vehicle sales just reaching pre-COVID levels

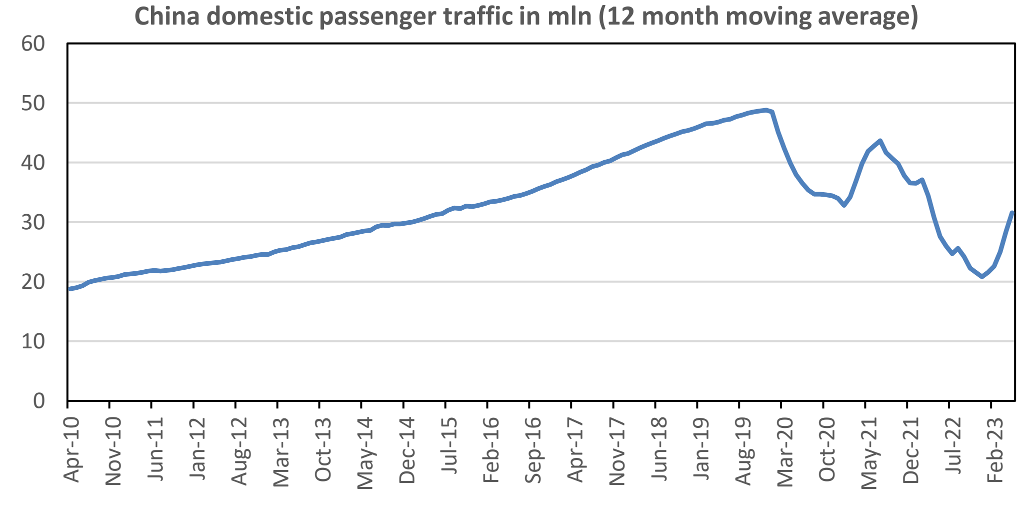
Despite large government incentives, especially for EVs, Chinese vehicles sales have just about crept back to pre-COVID levels. Moreover, this is in an environment where borrowing costs are much lower than in 2019.



Source: Bloomberg

Air traffic slowly recovering – domestic more than international

Air traffic, which has been one of the strong post-COVID recovery metrics in most markets, has still not fully normalised in China. While domestic traffic has recovered to about 70% of pre-COVID levels (on a 12m rolling basis), international traffic is only at about a third of the pre-COVID levels. On a single month basis the recovery is stronger, but still weaker than the post-COVID recoveries in other markets. Part of the reason for this is a slower recovery of capacity, but a lot is to do with demand only moving up slowly. Regional markets like Thailand and Indonesia which were waiting for the hordes of Chinese tourists to come back have been disappointed so far.



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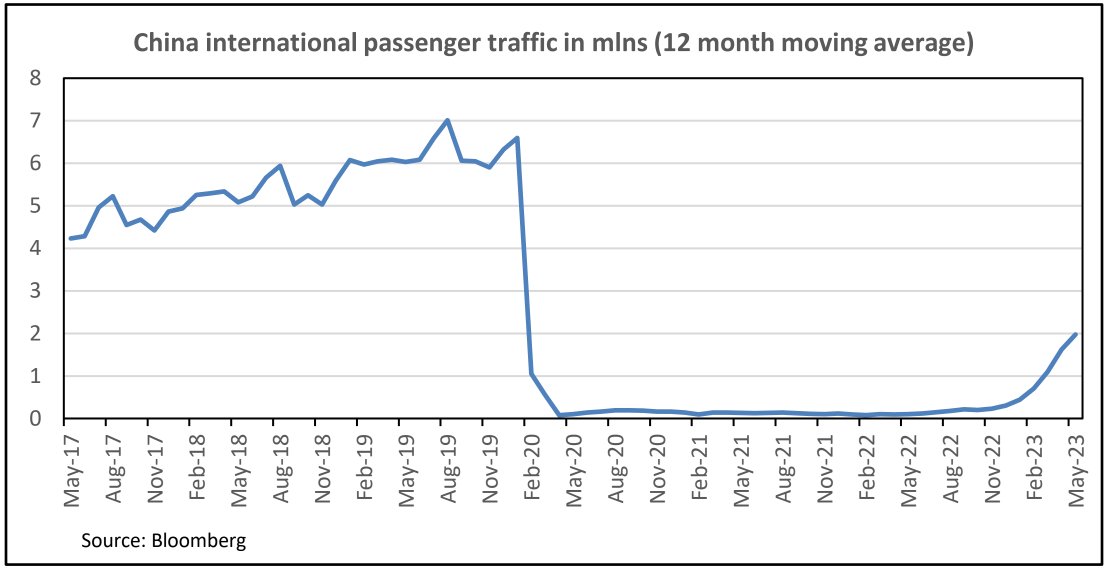
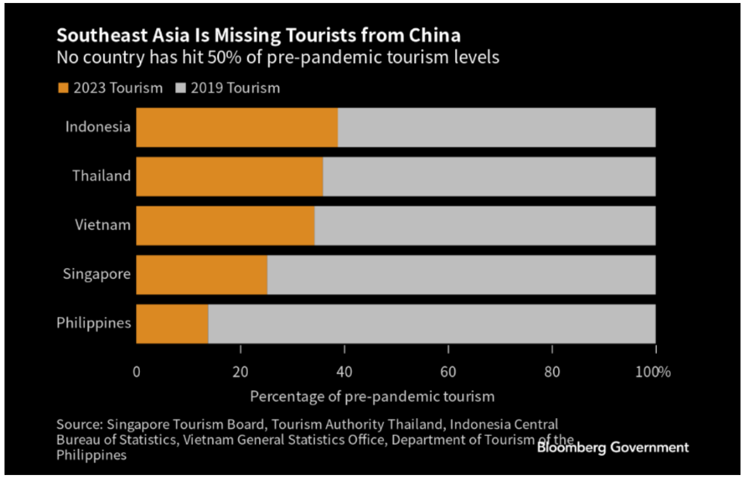
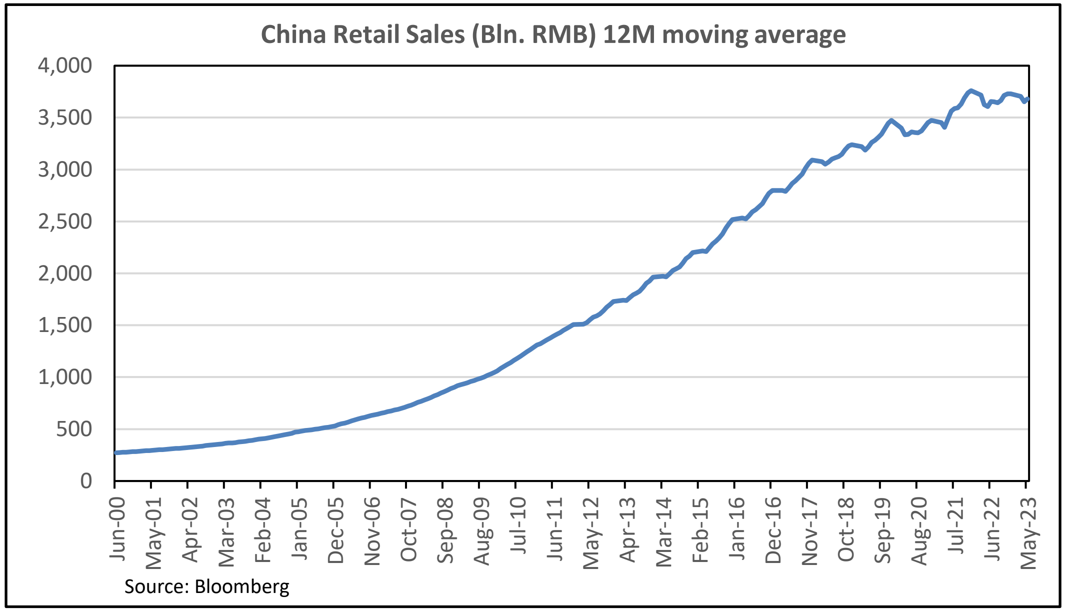




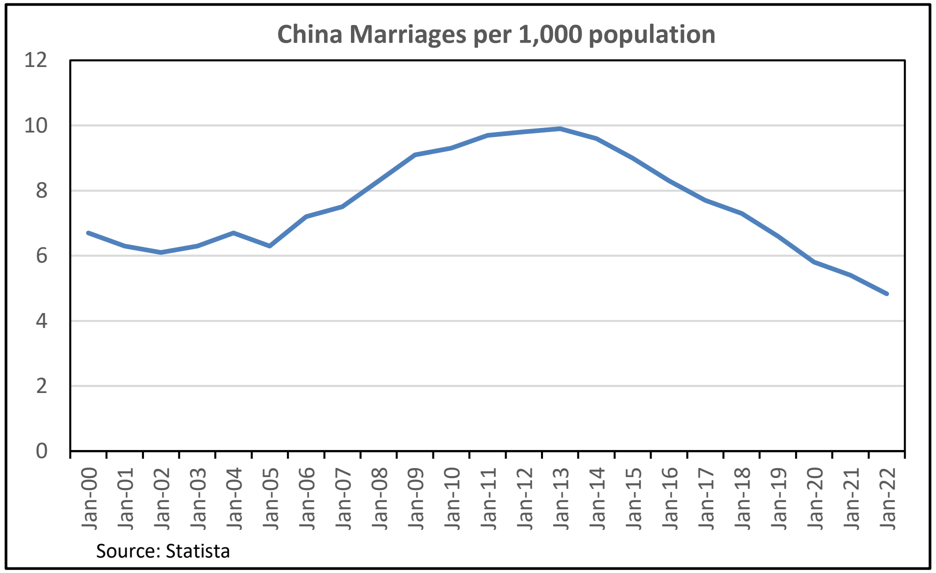
Retail sales struggling to gain momentum

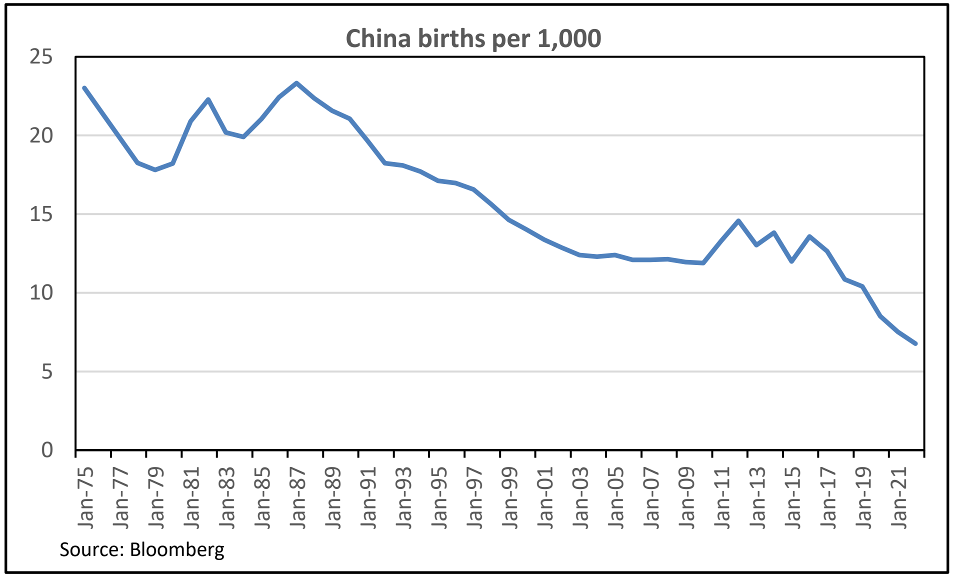
Since 2021, aggregate retail sales in China have flattened out. This is partly a price effect but flattening sales volume also is a large contributor.



Marriages and childbirth dropping structurally

Other than property, the other long term commitments a couple makes are to marriage and having children. When people have low confidence about their financial future, they postpone or avoid getting married/ having children. China has seen a precipitous drop in both marriages and childbirth over the past few years. Since Xi came to power in 2012, marriages and child birth have both dropped by 50%. This shows a stark drop in financial confidence (among other things). These trends are difficult to reverse.

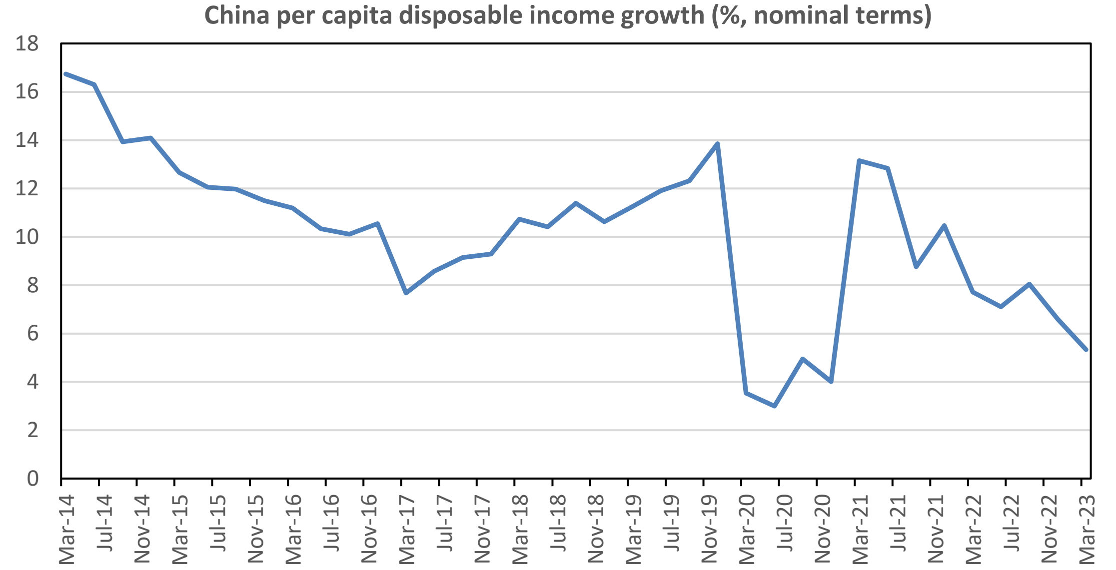




Sharp drop in disposable income growth

Disposable income growth for Chinese households has been slowing dramatically. In Q1 2023, nominal disposable income growth has come down to levels nearer those seen at the peak of the COVID crisis in 2020.

This, combined with the uncertainty in the property sector (which is a large part of household wealth), are the bulk of the reason for the consumption weakness. Add to this an increased uncertainty in job prospects and you have a confluence of negatives.



Source: Bloomberg

Hence the low consumer confidence. But that will turn

The above factors (and a few more) have added up to very weak consumer confidence in China at present. The good news is that, though the change at the margin is negative for some of the factors driving it, the absolute levels still give hope. For example, the consumer is deleveraging on mortgage assets, but does not need to keep doing this as the mortgage levels are already quite low. Even income growth will bottom out as the GDP goes past some of the large corporate resets in sectors like technology and real estate. A few other negatives remain as this reset happens, but they too should finish by 2024. Hence, our view is that this sentiment will slowly inflect. Combine this with the low current valuation, and the risk-reward remains in favour of exposure to assets in this market.

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