Economics

DBS Focus

China: How far can consumption drive the economy?

Economics/Growth/Monetary/Rates

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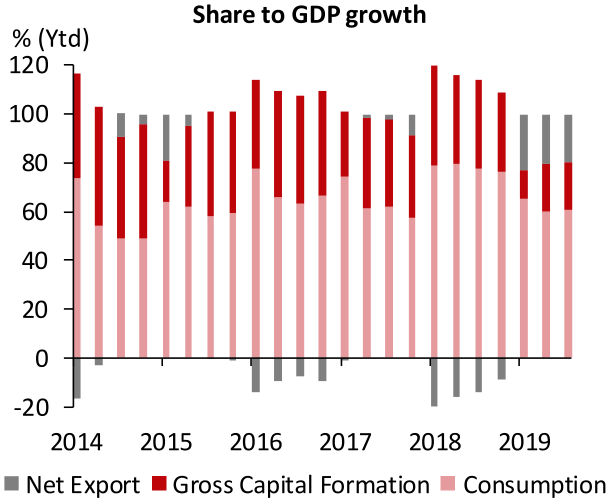
- *GDP growth edged down from 6.2% YoY in 2Q to 6.0% in 3Q, the slowest since 1Q92.*
- *Consumption revived in September thanks to policy supports, but the bounce doesn't look sustainable.*
- *Tepid private investment and contracting export growth heighten risks for sub-6% growth.*
- *Additional public spending is warranted.*
- *A further loosening of both monetary and fiscal policy may put a floor under growth by mid-2020.*

China's GDP growth edged down from 6.2% YoY in 2Q to 6.0% YoY in 3Q, in line with our forecast. It marks the slowest quarterly figure since 1Q92, yet still within Beijing's target range of 6.0-6.5%. On a sequential basis, GDP growth dipped from 1.6% QoQ to 1.5% QoQ. The contribution of consumption expenditure and capital formation rose 0.4-0.6 percentage points to 60.5% and 19.8% respectively. Net exports fell to 19.6% from 20.7%.

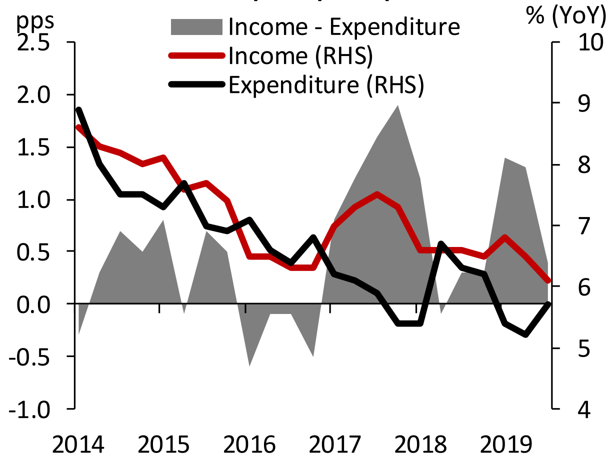
Share to GDP growth



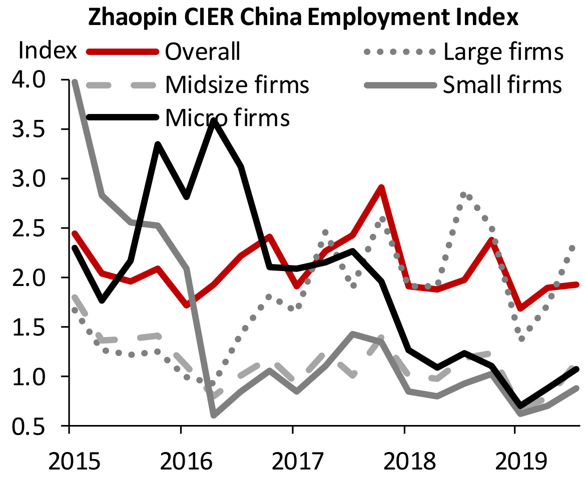
Source: CEIC, DBS

There were some positive signs. Growth in industrial production picked up from 4.4% in August to 5.8% in September. The jump came despite shrinking export growth (Sep: -3.2%). Stronger consumer spending helped, with retail sales bouncing from 7.5% to 7.8%. Policy supports were at play. The State Council announced 20 measures in August to boost consumption, from encouraging night markets to improving commercial pedestrian streets.

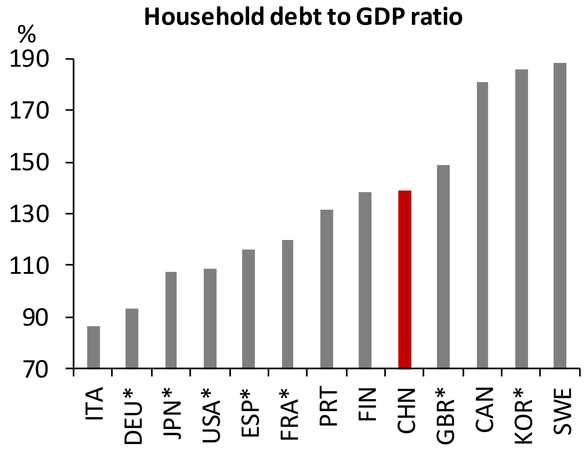
Income and consumption per capita in real terms



Source: CEIC, DBS



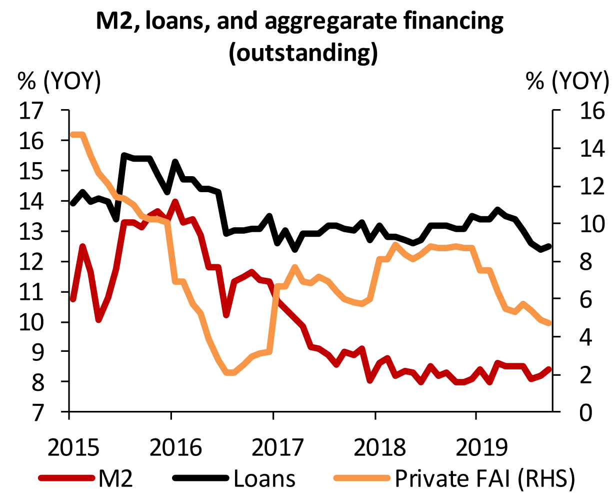
Source: Bloomberg, DBS



Note: (*) 2017 data, the rest are 2018 data.
Source: BIS, CEIC, OECD, DBS

Spurring consumption is crucial. But subdued wage growth casts doubt on the sustainability of the latest rebound, in our view. Real growth in disposable income, a leading indicator of consumption, fell further to 6.1% from as high as 8% in 2015. And the persistent gap between growth in income and expenditure points to a decline in consumer optimism. Several factors are behind this.

Ongoing trade tussle with the US have tempered hiring in export industries. The "phase one" trade deal reached last week was encouraging. Though two thirds of China's exports to the US (~USD360bn) are still subject to punitive tariffs between 15%-25%.

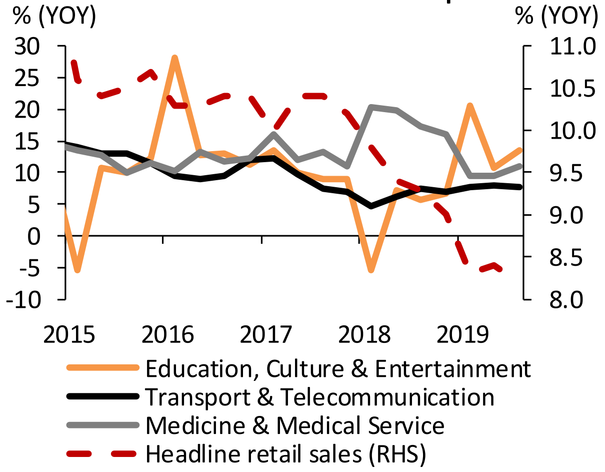


Source: CEIC and DBS Group Research

Businesses are grappling with shrinking foreign orders and soaring domestic costs. Weak money growth and strained credit suggest reluctance of enterprises to invest, let alone hiring. PMI's employment index hovered around 47 in 3Q, the lowest since February 2009. Ratio of vacancies to jobseekers dropped to the lowest level in four years. Employment has fallen even in once-booming sectors such as the internet and online game start-ups.

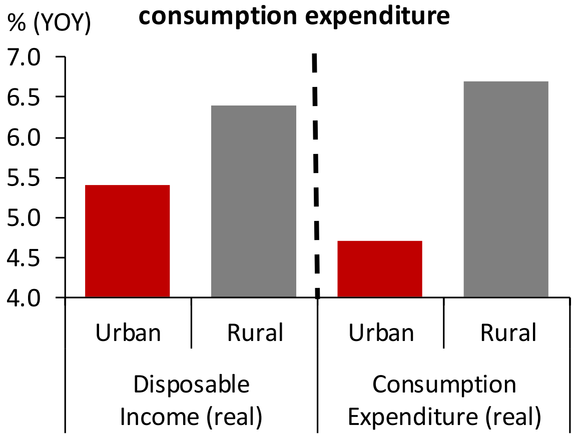
Strong property prices is another concern. Average prices of new homes rose for 52nd straight month in August. A multi-year housing boom has left households with overstretched balance sheets. Household debt to disposable income has soared from 91% in 2013 to 139% at end-2018, higher than that in the US, Japan, and France. Financial constraint has been compounded by a collapse in peer-to-peer lending platforms and falling returns on wealth management products. We expect household spending to become more conservative, dampening growth on discretionary sectors from automobiles to smartphones.

Retail sales and services consumption



Source: CEIC, DBS

1-3Q19 Disposable income and consumption expenditure



Source: CEIC, DBS

Spending on education, medical, and culture & entertainment stayed healthy. The resilience of the tertiary sector was reflected by the service business activities index, which remained well in expansion thus far. Particularly for those in lower tier cities and the countryside, where cost of living is less expensive. Per capita disposable income and expenditure for these groups are growing faster than their urban counterparts. Even so, this is not sufficient to offset the deceleration of overall consumption.

Weak consumption, together with tepid private investment and contracting exports, raises the spectre of sub-6% GDP expansion. Additional public spending is warranted to shore up growth. Local governments issued RMB3.04tn of new bonds from January September, collectively using up 98.6% of their new debt quota.

Early assessment on how much debt needs to be issued next year is already in progress. Part of the quota will be allocated in advance to ensure funding availability at the beginning of 2020. This should lend some support to infrastructure investment such as metro lines and waterscape park in the months ahead. In a bid to supply liquidity, the PBoC is expected to lower banks' required reserve ratio by another 50-100bps in 4Q. We also see the authority guiding the one-year loan prime rate down gradually. **A further loosening of both monetary and fiscal policy may put a floor under growth by mid-2020.**

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Sources: Data for all charts and tables are from CEIC, Bloomberg and DBS Group Research (forecasts and transformations).