With Chinese Consumers Missing In Action, What's Next For China's Economy?

By Drew Bernstein

Heading into 2023, many economic forecasters predicted that China was primed for a tsunami of revenge spending by consumers who had been cooped up for three years under the world's strictest COVID containment regime.

After all, China had contributed more than 20% of global luxury spending in 2021. And thrifty Chinese savers had socked away $2.6 trillion in 2022, or about one-third of their household income. Global fund managers expected that the urge to splurge would power robust growth in China's GDP, and they bid up consumer stocks accordingly.

But as American consumers are primed to head for the malls for Black Friday, China's consumers have been largely missing in action.

China's online shopping goliaths Alibaba Group (NYSE: BABA) and JD.com (NASDAQNDAQ: JD) declined to provide sales numbers for the second year in a row for China's annual bargain shopping extravaganza known as "singles day" that ended on November 11th (11.11). However, independent data analysts suggested gross merchandise value declined by about 1%.

Alibaba's shares tumbled when it reported earnings a few days later and announced it was shelving plans to spin off its cloud services and AI unit and put the planned IPO of its Freshippo retail grocery chain on hold due to "market conditions."

Alibaba's core e-commerce sites, Taobao and Tmall, grew by 4%, compared to the 13% revenue growth AmazonAMZN reported for the third quarter. While investors had expected a big bump in value from the cloud intelligence group carve-out, that unit's revenues only notched 2% growth in Q3, and the company said the U.S. restrictions on sales of advanced chips required for AI may materially and adversely limit its growth prospects.

Competitor JD.com posted anemic revenue growth of 1.7% for the third quarter, although it increased profitability by trimming overhead and R&D spending. Investors have concluded that China's e-commerce market is reaching saturation, and the shares of Alibaba and JD.com have dropped by 35% and 57% from their January highs, respectively.

LINYI, CHINA - NOVEMBER 05: A live streamer sells clothes via live streaming on a smartphone at an e-commerce park ahead of China's Double 11 shopping festival on November 5, 2021 in Linyi, Shandong Province of China. (Photo by VCG/VCG via Getty Images)VCG VIA GETTY IMAGES

Reluctant to Splurge

Enticing consumers to open their wallets is essential to China's long-term goal of rebalancing its economy. Given the strained balance sheets of local governments and real estate developers, China can no longer rely on infrastructure and real estate investment to drive sustainable growth.

As of 2021, consumption accounted for just 54% of China's GDP, compared to more than 80% in the United States. Nudging up consumer spending would go a long way toward meeting China's growth goals. However, the consumer's share of the economy has been declining since 2019.

With China's economy forecast to grow at 5% this year and nonexistent domestic inflation, why are the Chinese so reluctant to indulge in retail therapy?

Getting an accurate read on consumer confidence has become tricky since China's National Bureau of Statistics stopped publishing its index in March of 2023 after a series of gloomy readings.

While many Chinese households have ample savings, they may feel less wealthy due to the steady decline in real estate prices since July 2021. Real estate has served as the primary source of wealth for China's urban middle class for decades, with many households owning multiple apartments. However, with youth unemployment running at more than 20% and China's overall population starting to contract, it's not clear who will eventually fill all those pricey flats.

China's consumers have responded to economic uncertainty by trimming unnecessary expenses or trading down to save money. This might mean vacationing in China's Hainan - rather than Bali or Paris - or converting a StarbucksSBUX habit to lower-priced Luckin Coffee or even cheaper Cotti Coffee. According to a recent article in Bloomberg, China's younger generation rarely visits the upper floors of malls where glittering international brands can be found, sticking to the basement crammed with discount domestic shops, the so-called "B1B2" shopping style.

People sit on a couch inside a clothing store at a shopping mall in Beijing on July 20, 2023. (Photo by Jade Gao / AFP) (Photo by JADE GAO/AFP via Getty Images)AFP VIA

Restoring Confidence Is Key

The good news for China's leaders is that a change in tone can go a long way to turning around consumer sentiment.

President Xi Jinping's summit in San Francisco was an essential first step. While short on economic substance, it showcased Xi as a confident international leader seeking to de-escalate conflicts with the United States and restore normalcy to business and diplomatic relations. China now has the opportunity to mend fences with its neighbors and major trading partners in Asia, which would go a long way to restoring business confidence.

The APEC summit was followed this week by China's announcement of a "white list" of 50 real estate developers cleared for support by state-owned banks. While it will take several years to work through the excesses of speculative development, the government appears committed to containing the damage to homeowners who pre-purchased unbuilt apartments.

The most challenging audience to convince is perhaps China's private sector, which holds the key to putting the next generation to work and reigniting dreams of a more prosperous future. A century ago, an American president observed, "The chief business of the American people is business. They are profoundly concerned with producing, buying, selling, investing, and prospering in the world."

Alongside America, there is no nation with greater commercial genius, drive, and resources than China. The most crucial step to restoring consumer confidence is providing full-throated support for the role of private enterprises in realizing the China dream.