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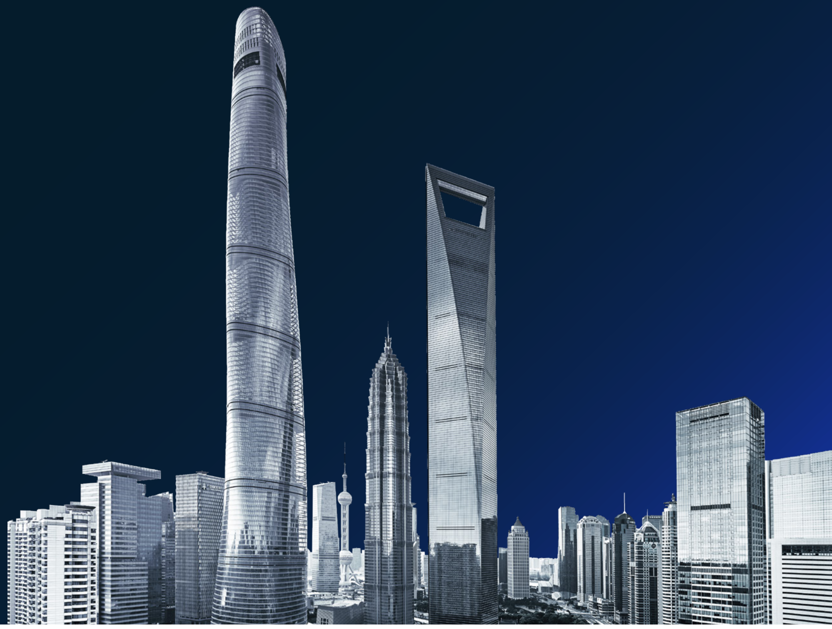

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China Brief

China Consumption: Start of a New Era

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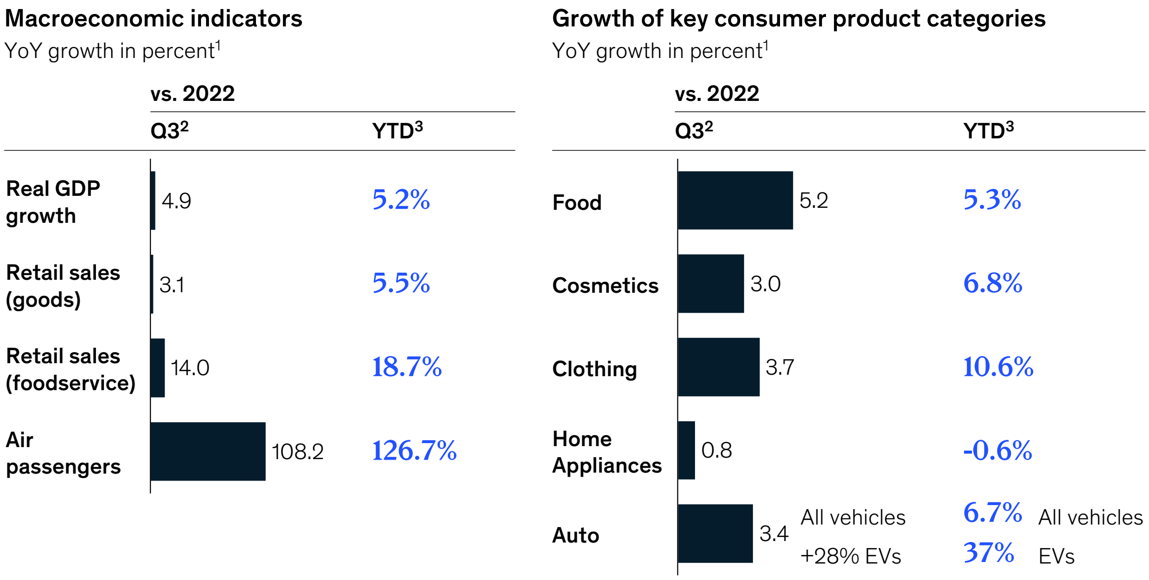
After an encouraging start in the first quarter of this year, second-quarter and third-quarter consumption data confirms what many in the industry have already come to accept: the era of double-digit growth in China's retail sector is over.

Third-quarter retail sales of goods grew by only 3 percent, with the recent Double Eleven shopping festival eking out a mere 2 percent increase over the previous year. This slowdown is evident across various categories, including cosmetics (3 percent), clothing (4 percent), and appliances (0.8 percent), when compared to the already subdued third quarter of the pandemic-impacted 2022. Despite a promising 7.5 percent uptick in retail sales in October, there are currently few indications that China will see a fundamental reversal in this trend. (Exhibit 1)

Exhibit 1

China macroeconomic and consumption indicators



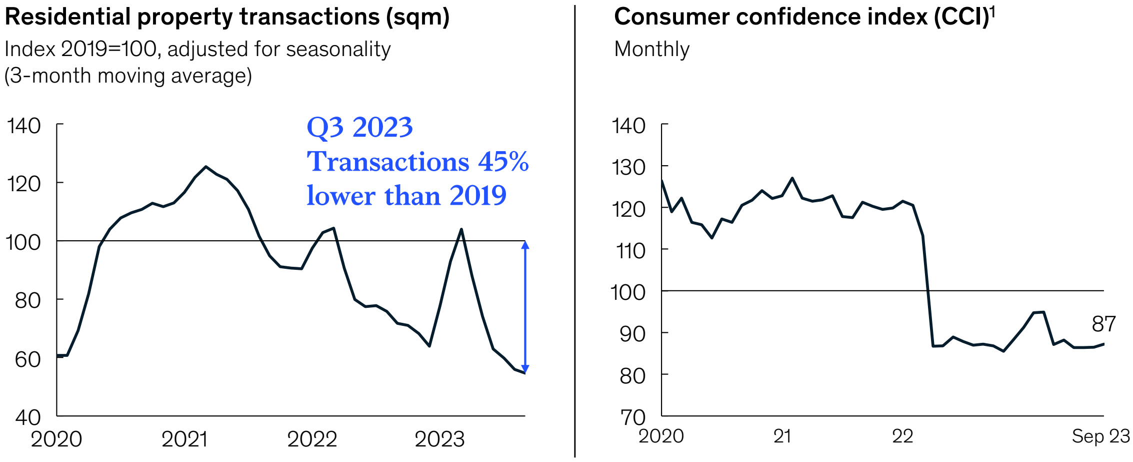
1. Volume for autos (CATARC), value for other categories
2. Q3 growth data is calculated based on monthly value data, except for GDP growth which is directly released by NBS
3. January-September 2023

Source: NBS, CATARC, CAAC

Despite initial signs of recovery in consumer sentiment earlier in the year, it has since plateaued, hovering around its all-time low since April. Factors contributing to this include a significant drop in residential property transactions—a past pillar of wealth creation—alongside declining exports and concerns about geopolitical tensions. (Exhibit 2)

Exhibit 2

Residential property transactions and consumer confidence



1. The index/sub-index ranges between 0 and 200. 100 is the median, indicating that consumer confidence is neutral. 0 indicates extreme pessimism; 200 reflects extreme optimism

Source: NBS

Despite a 5 percent surveyed unemployment rate in urban areas and a continued 6 percent annual increase in disposable incomes, including in 2023, consumers remain cautious about spending, especially on properties. Household savings rates are still significantly higher than pre-COVID levels (34 percent versus 30 percent), with limited signs yet of the additional RMB 53 trillion in savings accumulated since 2020 being funneled into consumption. This equates to an extra RMB 38,000 in the bank accounts of each consumer, awaiting expenditure.

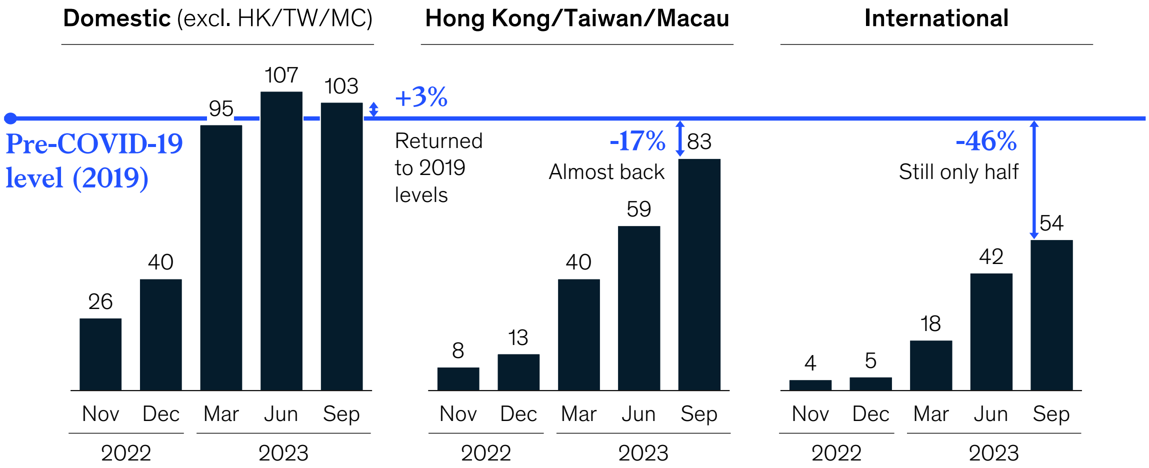
A notable exception is the service sector, particularly in travel and entertainment. After years of restricted mobility, there's renewed enthusiasm for travel and socializing in restaurants and bars (both sectors topped the list in terms of rate of growth in McKinsey's most recent ConsumerWise[1] survey of Chinese consumers). Foodservice sector growth—a robust 19 percent year-to-date and 14 percent in Q3 over 2022—is partly due to a lower comparative base from previous years and consumers' increased spending on dining and travel.

Domestic travel has rebounded to surpass 2019 levels, and travel to Hong Kong, Taiwan, and Macao is approaching pre-pandemic figures (83 percent of 2019 levels in September). While international travel remains at around half of 2019 levels, this is primarily attributed to visa restrictions and high flight prices. The shift from product to service consumption is expected to continue into 2024. (Exhibit 3)

Exhibit 3

Growth in air travel

Pre-COVID-19 level = 100, month-by-month comparison



Source: CAAC

1. For more information about ConsumerWise visit: https://www.mckinsey.com/industries/consumer-packaged-goods/how-we-help-clients/consumerwise

Double Eleven

Double Eleven, the world's largest shopping festival, warrants closer examination. This year, while sales inched up by just 2 percent over last year, it nonetheless reached a staggering RMB 1.1 trillion in GMV across all platforms, surpassing the annual consumption of some entire economies. The event's sheer scale offers valuable insights into Chinese consumer behavior:

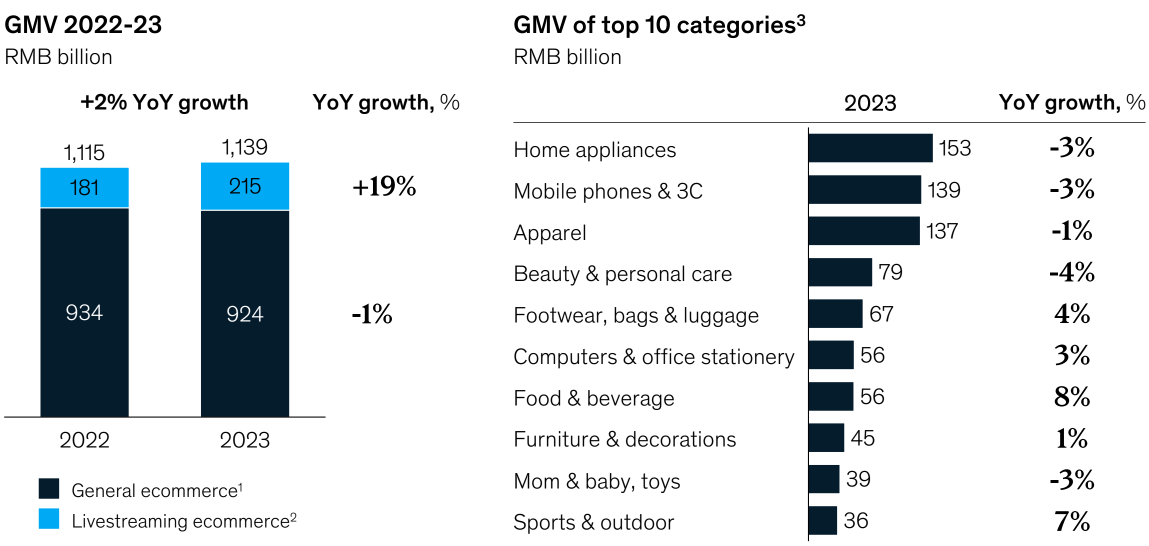
— The 2 percent growth over an already flat 2022 was driven by discounts and promotions, with the average selling price (ASP) declining for major brands compared to last year. Categories experiencing growth are consistent with trends observed throughout the year, such as footwear, food and beverage, and sports and outdoor. Appliances and—for the first time—beauty and personal care have seen notable declines compared to last year.

— Livestreaming continues its upward trajectory. Traditional e-commerce slightly declined during Double Eleven, while livestreaming surged by approximately 20 percent, contributing to 20 percent of the total GMV. This growth, amplified by strong platform support, reflects ongoing trends in 2023. Major platforms have heavily invested in traffic support and product subsidies, with Kuaishou alone providing RMB 2 billion in product subsidies and 18 billion in traffic support. Over 60 percent of the top 58 Tmall/Taobao livestreaming channels, each with over RMB 100 million in GMV, are operated by brands rather than KOLs. This underscores how, more than ever, brands are embracing livestreaming as a powerful shopping channel. We anticipate further innovation in this area, with brands increasingly focusing on content over discount-driven strategies and exploring ways to leverage their physical retail infrastructure.

— Premium brands continue to perform well and many gained share during Double Eleven. Premium brands saw their average selling prices decline due to intense promotional activity and consumers switching to lower-priced platforms or purchasing smaller package sizes. This trend is consistent with what we've seen throughout the year. Top skincare brands on Tmall, for instance, reported lower ASPs during 2023's Double Eleven compared to the previous year, a pattern that is evident in other categories. (Exhibit 4)

Exhibit 4

Double Eleven shopping festival GMV growth



1. B2C ecommerce including Tmall, JD, PDD, et.al.
2. Including Diantao(Taobao livestreaming), Douyin, Kuaishou, et.al.
3. GMV on General B2C Ecommerce platforms, e.g., Tmall, JD, PDD, and Diantao; Top 10 categories comprise 82.2% of total GMV

Source: Press search; Syntun

Widening performance gap between the winners and the losers

Our analysis of 80 leading, publicly-listed consumer companies with a majority of revenues from mainland China reveals a nuanced picture. These companies, mostly Chinese with a few multinational corporations having spun off their China businesses, span various sectors and show varying performance levels. While overall growth trends towards low single-digits, we observed substantial differences among these companies.

One-quarter of these companies experienced year-to-date double-digit growth, while 12 percent suffered double-digit declines. Success appears to be linked to innovation in brand launches and business models, and quick, agile responses to changing market and consumer dynamics.

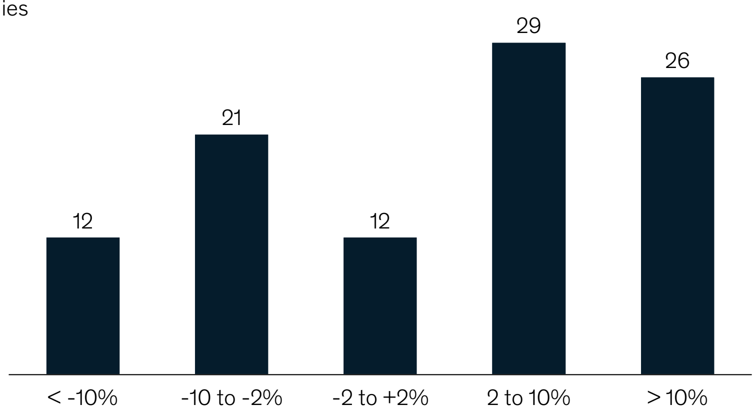
Performance discrepancies can also be attributed to sectoral differences. Restaurants and pharmacies, for instance, have generally outperformed offline retail. However, within individual sectors, there's a growing divide between high-performing and low-performing companies. As consumer demand no longer expands at past rates, we anticipate further widening in company performance. Factors such as high-quality products, premium branding, and rapid, insights-driven responses to market changes will continue to be key success indicators. (Exhibit 5)

Exhibit 5

Revenue growth of consumer companies in China

Sample of 80 listed consumer companies with majority of revenues in Mainland China

2023 YTD revenue growth
Percent of companies



Source: McKinsey CPA

Still cautious, still optimistic

So, what does this mean for the future, and where does it leave my cautious optimism? It's still very much present. China's economy is steadily evolving towards being more consumption-driven. Retail growth, encompassing both products and services, is expected to rise by 5 percent this year, with similar projections for the coming years. Given China's vast market size, this translates to an additional RMB 10 trillion in retail sales over the next 5 years. To put things into perspective, such growth would make China the single-largest growth market globally. Incremental growth at this scale would be equal to the combined retail sales of India, Indonesia, and South Korea today.

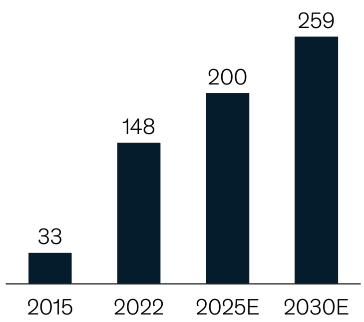
While recovery may be slower than anticipated and low consumer sentiment could dampen growth rates in the coming months, the long-term prospects of the Chinese market remain robust. According to simulations by the McKinsey Global Institute the number of upper-middle and high-income households may reach 200 million by 2025 and 260 by 2030. The number of high-income cities are projected to hit 82 by 2025 and 93 by 2030. Continued urbanization and rising income levels are expected to sustainably drive consumption growth in the medium to long term. (Exhibit 6)

Exhibit 6

Number of upper-middle and high income households in China

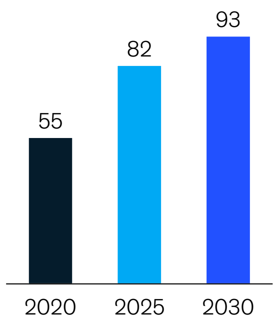
2020 real RMB

Number of upper-middle and high income households (>160,000 RMB annual household income)
Million



Upper-middle and high income households as % of all urban households	12%	41%	52%	62%

Number of high-income cities in China



Share of China's population	27%	39%	44%
Share of China's GDP	47%	58%	64%

1. Cities with per capita GDP higher than $12,695

Source: MGI Insights China macro model

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