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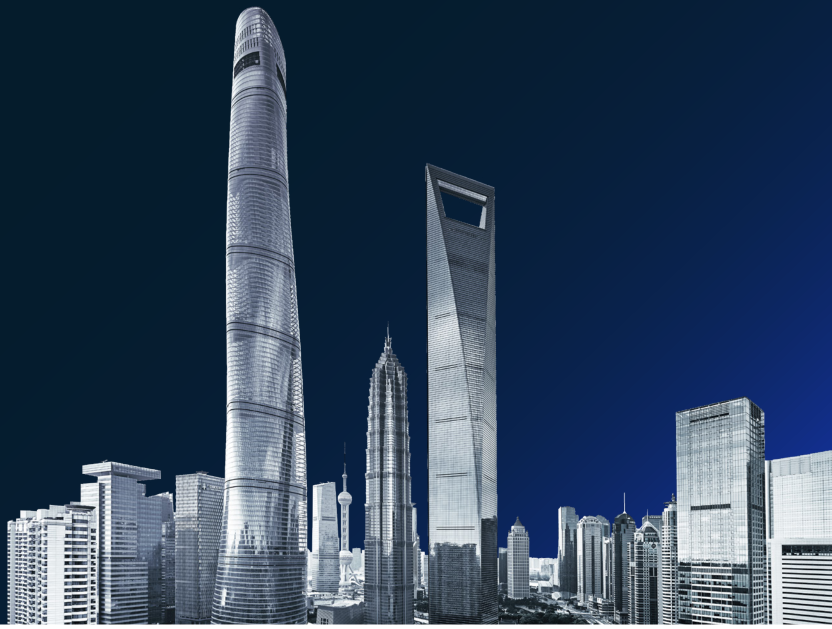

September 2024

China Brief

The Truth About Chinese Consumption

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Looking back over the past few months since our last China Brief update in April, not much has changed. China's GDP grew at a steady 5 percent during the first half of the year, while retail sales ticked modestly upward by 3.7 percent during this period.

We see few signs that this picture of single-digit growth in consumption will change for the foreseeable future. Indeed, some observers are warning that it could get worse before it gets better. Most agree that some of the underlying issues that are putting a damper on consumption, like the historically low consumer sentiment and the property slump, could take another 12-18 months to turn around. (Exhibit 1)

It's important to keep in mind, however, that while some of the top-line consumption numbers may be discouraging, there continue to be pockets of consumer confidence and growth in consumption. Simply focusing on aggregate measures usually doesn't offer a complete picture of the reality on the ground. The key is to take a more granular look, as we suggested in our recently published 2024 McKinsey China Consumer Report.

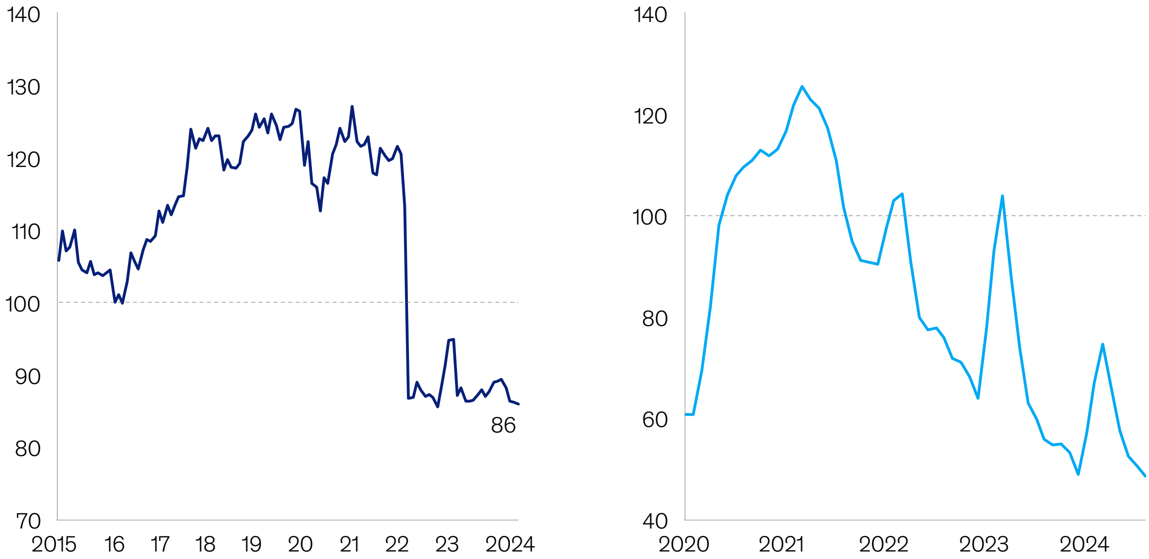
In this edition of China Brief, I'll share three common myths about Chinese consumption that I've been hearing often from senior executives in China, and provide some facts with a view to offering a more balanced perspective on the current state of the market.

Exhibit 1

Consumer confidence in China remains at an all-time low.

Consumer confidence index (CCI)
Index

Residential property transactions (sqm)
Index 2019 = 100, adjusted for seasonality
(3-month moving average)



Source: NBS

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Myth 1: Chinese Consumption is Facing a Crisis

One of the most prevalent misconceptions is that the Chinese economy is facing a crisis. Indeed, while consumer sentiment remains low, and the anticipated post-pandemic recovery has not fully materialized, the overall picture is far from bleak.

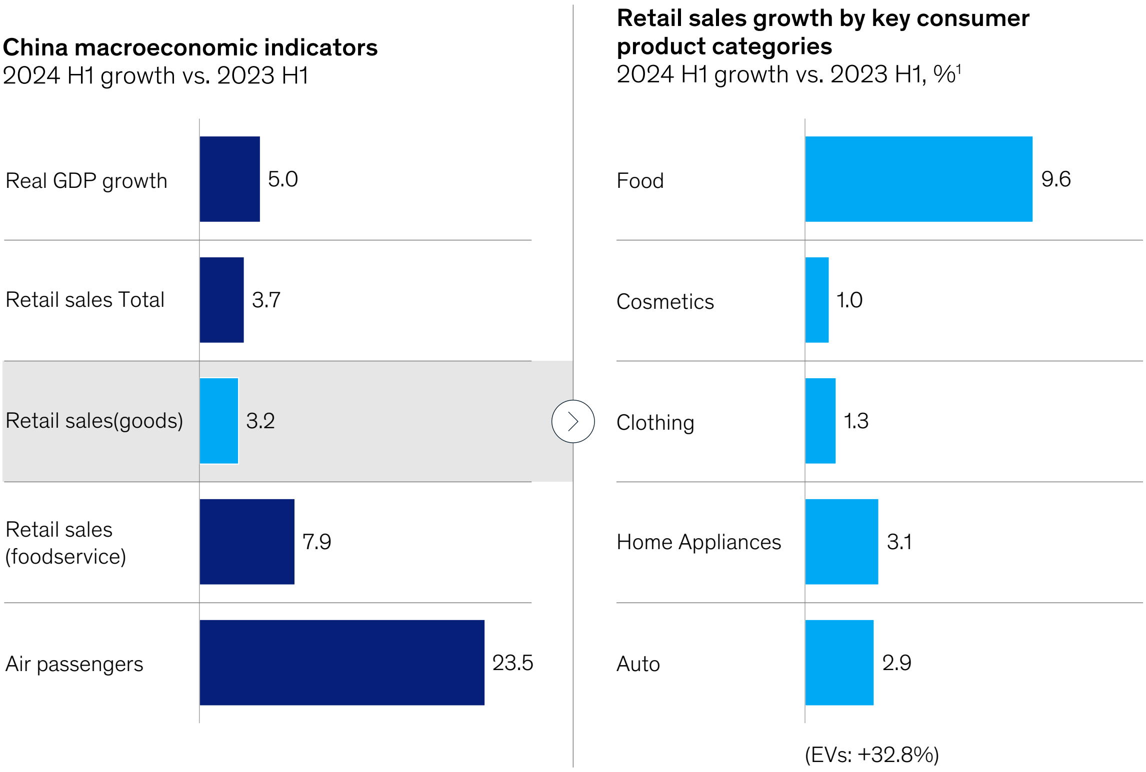
Despite concerns, China continues to post GDP growth figures of around 5 percent. While this macro growth rate represents a significant number given the sheer scale of the Chinese economy, it does not necessarily translate into growth at the micro level, and is therefore not felt by some businesses in the sectors where they play.

Nonetheless, China contributed one-third of global GDP growth in 2023 and continues to show resilience in 2024. Domestic consumption, though modest, is growing. Some sectors, such as services and tourism, are experiencing robust growth, indicating that the economy is not in uniform decline but shows varied performance across different sectors and regions. (Exhibit 2)

Exhibit 2

Growth in services remains a bright spot in China's economy.

H1/2024



[1]Volume for autos (CATARC), value for other categories.
Source: NBS; CATARC; CAAC

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Moreover, while product consumption may appear flat overall, some sectors such as sportswear, urban outdoor apparel, and consumer health have seen double-digit growth, reflecting the continued strength of these markets.

It's essential to look beyond aggregate measures and recognize the pockets of higher consumer confidence and positive growth within the market. According to a recent McKinsey survey of Chinese consumers, confidence levels vary widely between millennials in higher-tier cities and those in lower-tier cities, with confidence levels in some lower-tier cities exceeding 80 percent. (Exhibit 3)

Exhibit 3

Confidence among Chinese consumer groups varies widely.

Confidence in the economy and share of daily consumption
Percentage of optimistic respondents[1], share of daily consumption[2], n = 11,930

Percent of optimistic respondents: <65% | 65-70% | 70-76% | 76-87% | >88%

Most optimistic group | Most pessimistic group | Percent of consumption | Expected growth in daily consumption

City tier	City tier share	Monthly household income (RMB)		GenZ (18-25)		Millennial (26-41)		GenX (42-57)		Baby Boomer (58-65)		Total			Income total
1st tier cities	74%	High	> 30.1K[3]			76%	1.6%	82%	1.2%	95%	1.0%	86%	4.8%	High	82%
	21%	Middle	14.5-30.1K	87%	3.3%	60%	6.5%	71%	5.2%	88%	0.8%	70%	13.9%		17%
	2.9%	Low	< 14.5K			61%	0.3%	78%	0.5%	81%	0.7%	80%	2.3%		3.1%
2nd tier cities	74%	High	> 21K									81%	3.8%	Middle	75%
	35%	Middle	14.5-21K	83%	3.9%	67%	13.4%	72%	12.2%	82%	5.5%	73%	21.1%		50%
	2.3%	Low	< 14.5K									74%	10.1%		2.5%
3rd tier cities	82%	High	> 21K			83%	1.1%	93%	0.4%	87%	1.2%	87%	3.5%	Low	75%
	24%	Middle	14.5-21K	89%	2.3%	81%	4.0%	93%	5.3%	92%	0.5%	89%	10.7%		34%
	2.5%	Low	< 14.5K			66%	2.9%	74%	3.4%	80%	3.0%	75%	10.0%		2.0%
4th tier cities	82%	High	> 14.5K			77%	1.5%	75%			0.9%	80%	2.9%		
	11%	Middle	7.6-14.5K	88%	2.5%	83%	0.4%	86%			0.5%	86%	2.1%		
	1.9%	Low	< 7.6K			71%	1.0%	83%			4.6%	82%	6.4%		
Rural	67%	High	> 7.6K	77%	0.2%	72%	0.5%	68%			0.7%	71%	1.5%		
	9%	Middle	5-7.6K	86%	0.3%	47%	0.7%	62%			1.1%	60%	2.2%		
	1.9%	Low	< 5K	74%	2.0%	86%	1.4%	51%			1.5%	68%	4.9%		
		Total by age group		83%	15%	70%	35%	76%	34%	79%	16%	76%	100%		
					2.6%		2.6%		2.0%		2.6%		2.4%		

[1]Some consumer groups with similar confidence levels were combined for simplicity.
[2]Contribution of consumption by each group is measured.
[3]Average monthly disposable income, in RMB.
Source: 2024 McKinsey China Consumer Report - Getting Granular: In Search of Pockets of Growth in China; Team analysis

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It's also helpful to place China in a global context. According to McKinsey's ConsumerWise survey of consumers, Chinese consumers are among the most confident in the world. In the latest August round of survey results, 59 percent of Chinese consumers said the economy would rebound within the next 2-3 months, compared with just 41 percent of American consumers, 30 percent of UK consumers, and 13 percent of Japanese consumers. (Exhibit 4)

Exhibit 4

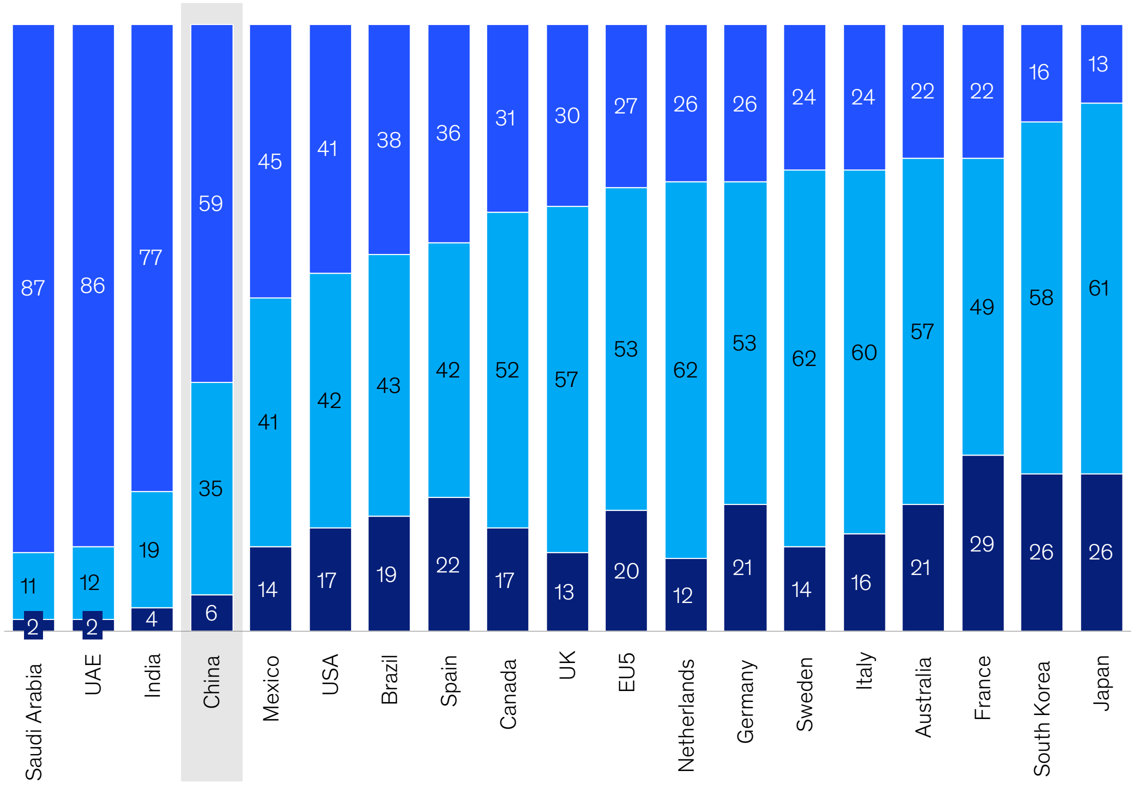
Despite low consumer confidence, Chinese consumers remain relatively more confident than consumers in many developed markets.

Confidence level in own country's economic conditions[1], % respondents

Pessimistic
The economy will be impacted long-term and will lead to a recession/one of the worst recessions we have seen

Mixed
The economy will be impacted for 6-12+ months and will take a longer time to recover

Optimistic
The economy will rebound in 2-3 months, and that the economy will grow the same or faster than before



[1]Q: What is your overall confidence level surrounding economic conditions in China? Rated from 1 "very optimistic" to 6 "very pessimistic". Top, middle, and bottom 2 boxes of scale aggregated to "Optimistic", "Neutral", and "Pessimistic". Figures may not sum to 100%, because of rounding. Question prior to Aug 2022 framed as: What is your overall confidence level surrounding economic conditions after the coronavirus (COVID-19) crisis subsides (i.e., once there is herd immunity)?
Source: McKinsey ConsumerWise Global Sentiment Data, August 2024

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Myth 2: Chinese Consumers Have Lost Their Appetite for Luxury Goods

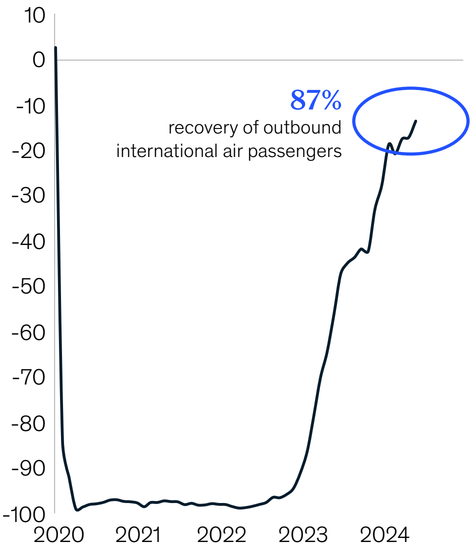
Since the luxury holding companies released their Q2 results, hardly a day has gone by when I was not asked why luxury brands are seeing their sales decline in Mainland China.

It is easy to forget that prior to the COVID-19 pandemic, Chinese consumers made 60 percent of their luxury purchases outside of China. This trend is now returning. Most surprisingly, overseas spending on luxury goods in just the first half of 2024 has already exceeded 2019 levels. We all expected a return of overseas spending, but few would have expected it to happen so fast. Even less so given that outbound travel activity is still lagging behind 2019 numbers. (Exhibit 5)

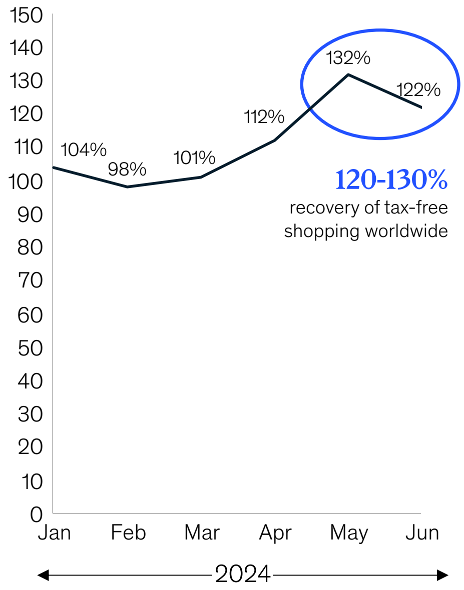
Exhibit 5

Chinese spending overseas already exceeds 2019 levels.

Recovery rate of outbound international air passengers[1] from Mainland China
Change vs. 2019, %



Recovery rate[2] of tax free shopping worldwide from Mainland Chinese shoppers
Change vs. 2019, %



[1]Including air passengers travelling to Hong Kong, Taiwan, Macau and international destinations.
[2]Recovery rate is equal to 2024 sales issued in store divided by 2019 sales issued in store, and is calculated using a like-for-like comparison (i.e., not counting new store openings or closings and at constant exchange rates).
Source: CAAC; Global Blue

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Total overseas luxury spending in May was 32 percent higher than 2019 levels, followed by 22 percent growth in June. The depreciation of the Japanese yen, which drove substantial increases in spending in Japan, provides a partial explanation for this surge, but spending in Italy and France has also been on the rise.

This trend suggests that Chinese consumers have not lost their desire for luxury goods; they are simply choosing to make these purchases outside of China. This phenomenon could be driven by various factors, including price differentials, the experience of shopping abroad, and the allure of acquiring exclusive items not readily available in the domestic market. Additionally, while luxury sales in mainland China have softened, overall spending on luxury by Chinese consumers, when including overseas purchases, remains robust.

How are luxury brands responding? With overseas spending outgrowing domestic spending, luxury brands are shifting their investments from opening new stores to stepping up their marketing spend. Expansion projects have been put on hold, with 111 new stores opened in the first half of 2024 compared to 150 during the same period in 2023. At the same time, marketing activity increased, with offline events and art installations rising from 36 in 2023 to 53 as of July of this year.

Myth 3: Foreign Companies are Exiting China in Droves

The third myth that has been circulating is that foreign companies are rapidly pulling out of China due to a perceived decline in market opportunities. While there have been instances of companies reducing their investments or even exiting the Chinese market, this narrative does not capture the full picture.

In reality, the situation is much more nuanced. While some lower-performing companies have indeed scaled back their operations, others, particularly those from Europe, are shoring up their investments in China. Driven largely by the automotive industry's desire to protect their China investments, Germany poured 7.3 billion euros of foreign direct investment (FDI) into China in the first half of 2024, exceeding the 6.4 billion euros it invested in all of 2023, according to Bundesbank.

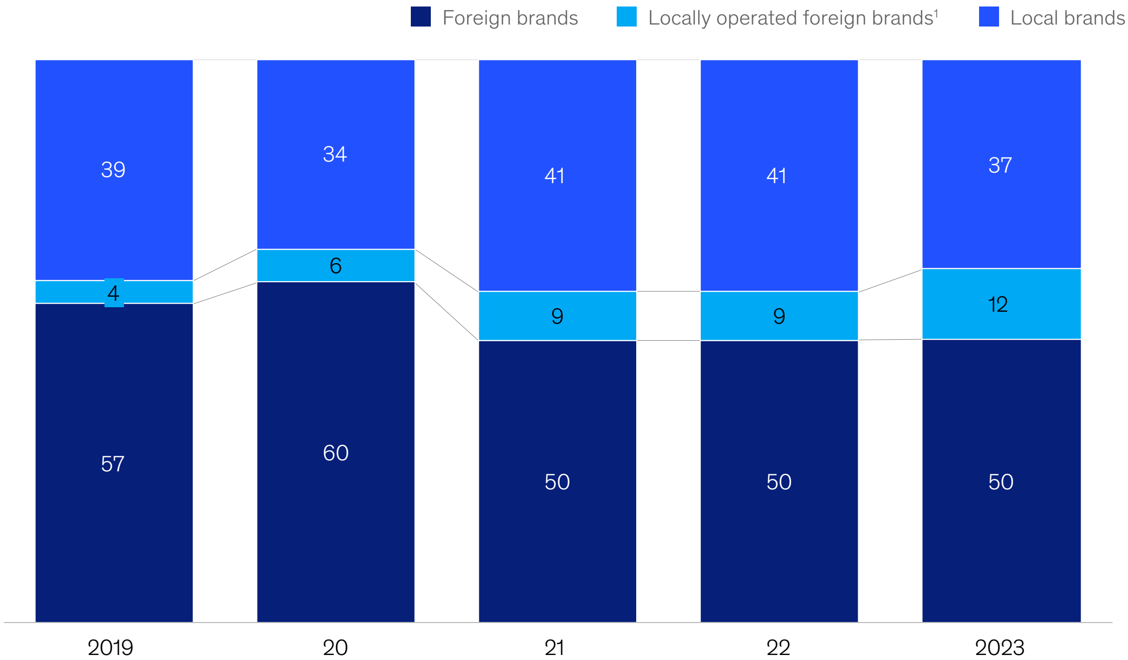
Moreover, foreign brands continue to hold significant appeal among Chinese consumers, particularly in the premium and luxury segments. The sportswear sector, for example, has seen foreign brands, including those operated by local Chinese partners, gain substantial market share post-COVID-19. Between 2019 and 2023, even as the share of foreign-owned brands on Tmall dropped from 57 percent to 50 percent, locally-owned foreign sportswear brands tripled their share from 4 percent to 12 percent. (Exhibit 6)

Amer Sports, a sportswear holding company owned in part by China's ANTA Group, recorded USD 598.9 million in revenue in China in the first half of 2024, a 52.3 percent increase. Some wholly foreign-owned premium brands, such as lululemon, have experienced exceptional results this year. According to their financial report, the company generated USD 618.0 million in net revenue in Mainland China during the two quarter period starting in February and ending in July, a 44 percent increase on a constant dollar basis.

Exhibit 6

Locally operated foreign brands have been winning in sportswear.

Rolling top 20 sports brands market share on Tmall by origin, %, 2019-23



[1]Locally-operated foreign brands include brands that have been acquired by Chinese companies or are operated in China by a Chinese company in a JV or with a licensing agreement.
Source: BigOne; Press search

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Conclusion: A Nuanced Reality

The narrative of a Chinese consumption crisis, a waning appetite for luxury, and a mass exodus of foreign companies from China does not hold up under closer scrutiny. Instead, the reality is more complex, characterized by selective growth, continued enthusiasm for luxury goods (albeit increasingly purchased abroad), and a mixed but still significant presence of foreign brands in the market.

Understanding these nuances is crucial for anyone looking to navigate or invest in the Chinese market. As the global economic landscape continues to evolve, maintaining a balanced perspective will be key to recognizing the opportunities that still exist within China's vast and dynamic economy.

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