

China's Consumption Myth

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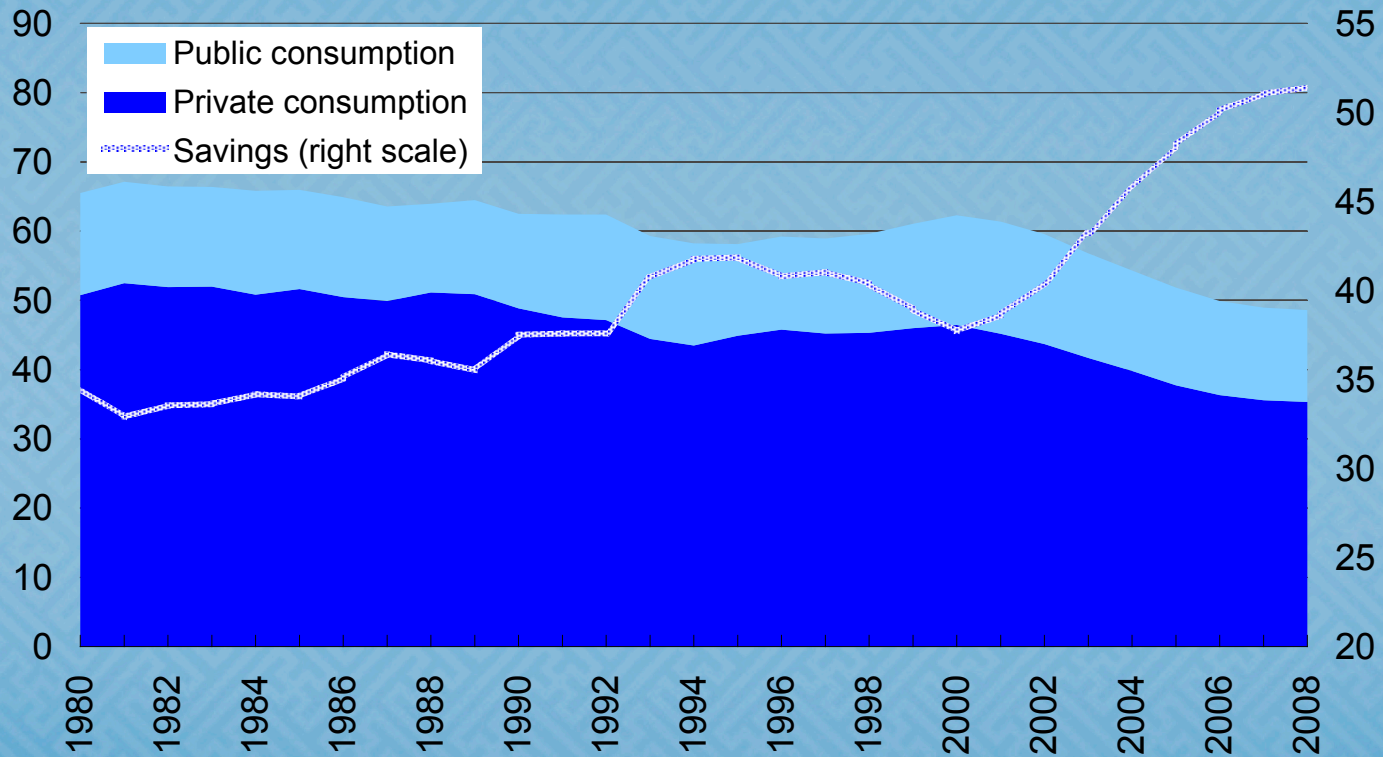
Presentation at the PBoC / IMF Workshop of “Catalyzing Domestic Demand”, held in Beijing, January 21, 2010

***The views do not necessarily reflect those of the HKMA.**

China's Low and Falling Consumption

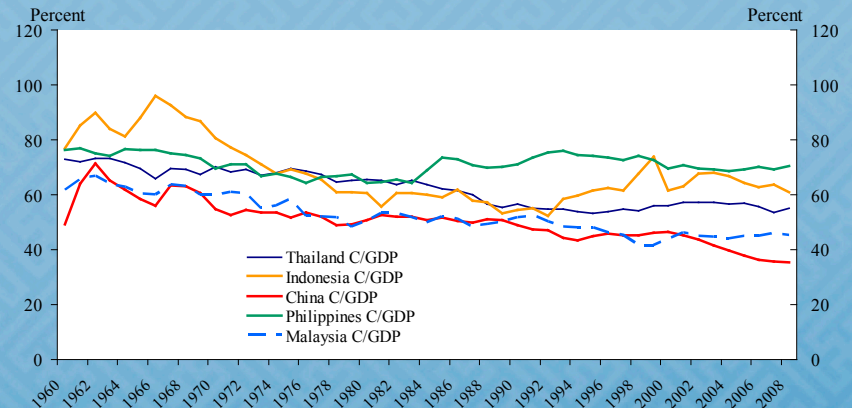
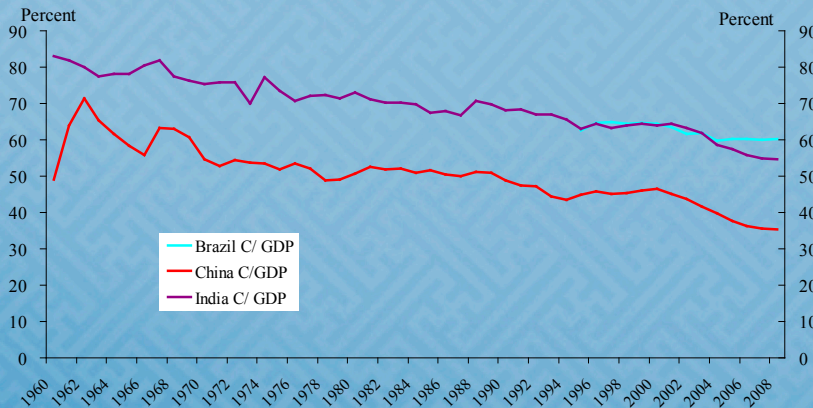
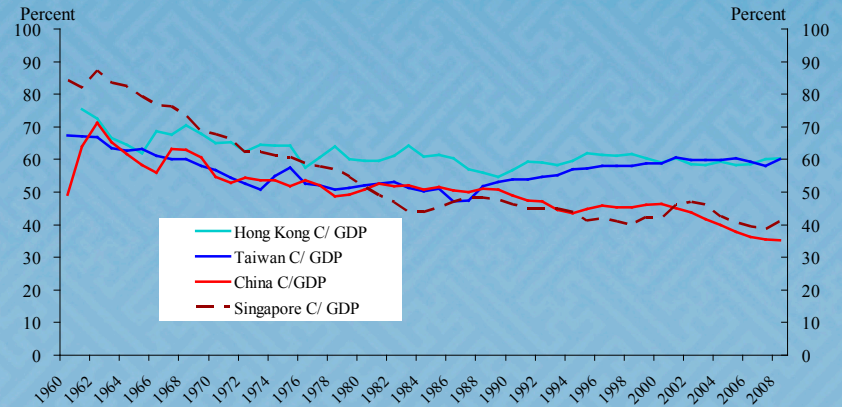
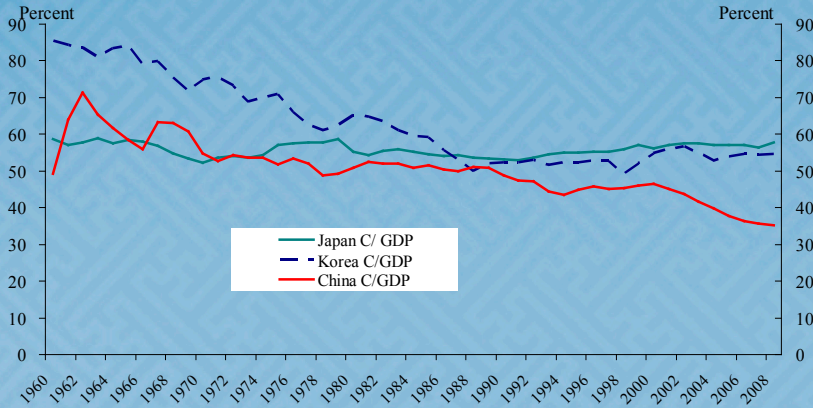
China: Consumption and Savings

(In percent of GDP)



Source: CEIC Data Company LTD and author's estimates

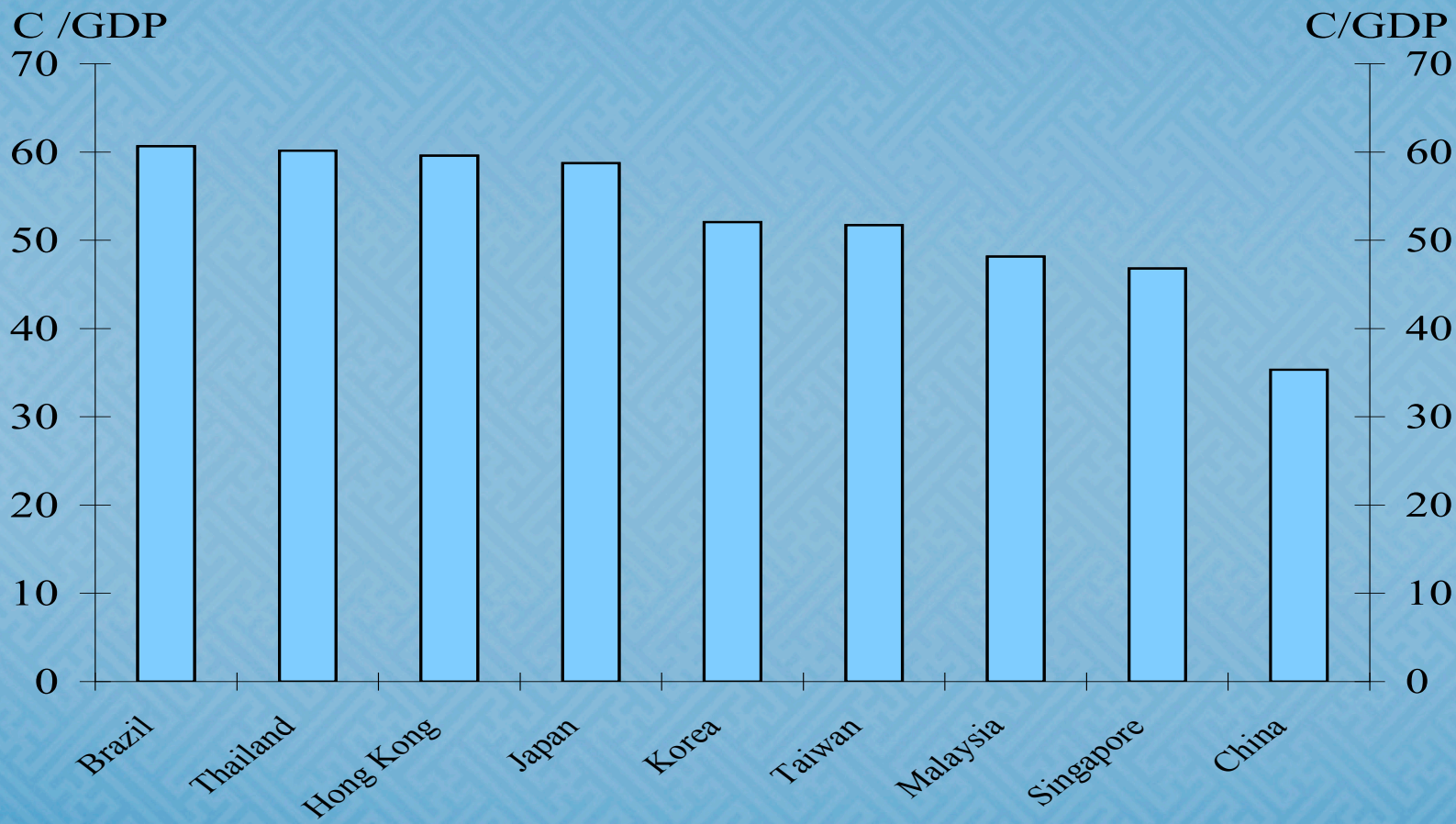
China has not been the only one with C/GDP falling...



Source: CEIC Data Company LTD and author's estimates

But China is an outlier among Asian peers if the income level is considered

C/GDP ratio across countries at China's current per capita income level



Source: Penn World Table, CEIC Data Company LTD and author's estimates

China Consumption may be even lower than meet the eye

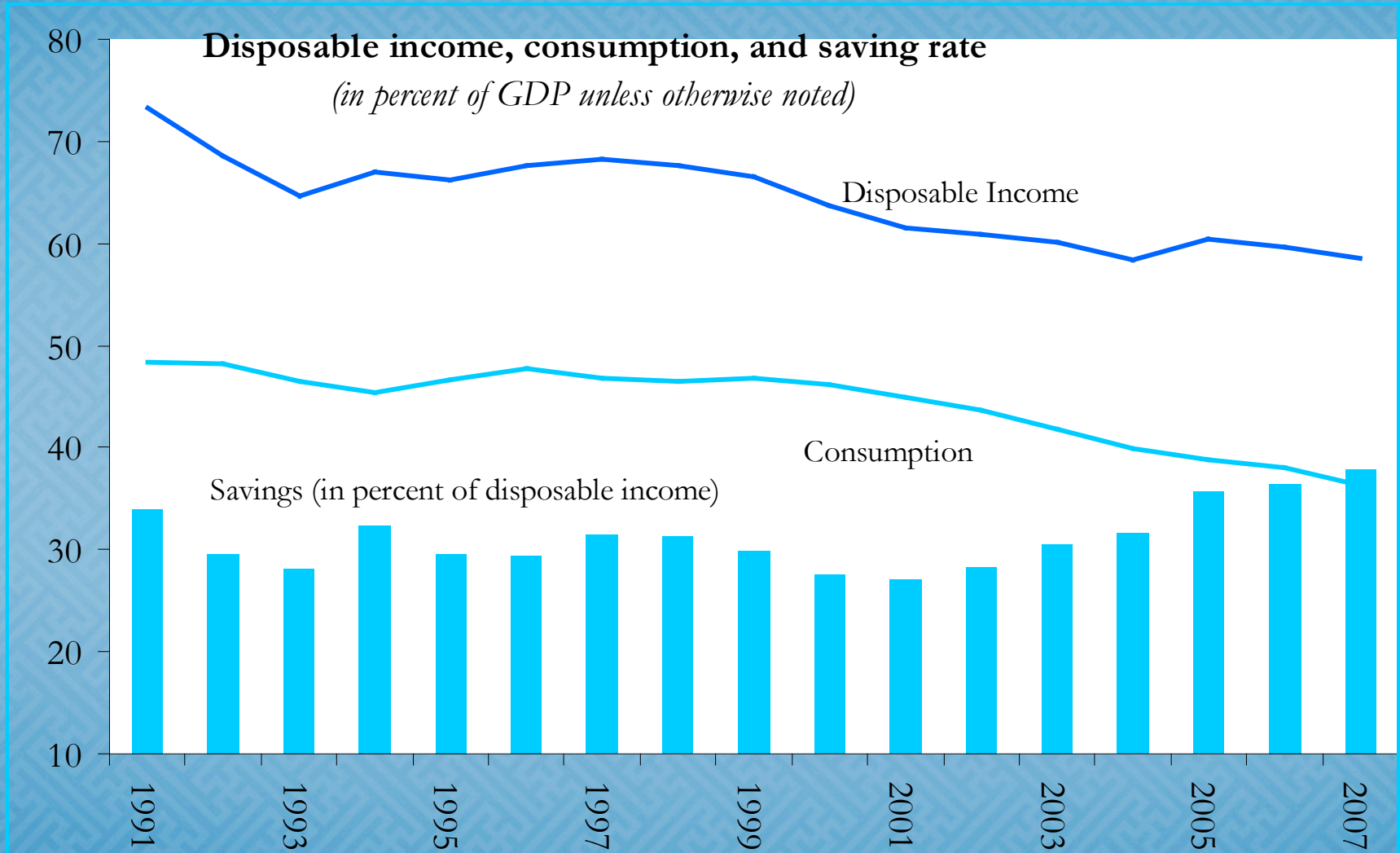
Selected Countries: Consumption, 2004

(In percent of GDP, unless otherwise indicated)

	Personal Disposable Income	Taxes on personal income ¹	Personal Consumption/Disposable Income	Personal Consumption	Labor Income	Government Consumption on health and education ²	Adjusted Personal Consumption ³
US	74	9	95	70	57	10	80
UK	66	10	98	65	56	12	77
Australia	58	12	103	60	49	11	71
Canada	58	12	96	56	50	7	63
Korea	54	3	95	51	44	5	56
France	62	8	90	56	52	6	62
Germany	66	9	88	57	51	6	63
Italy	67	11	90	60	42	12	72
Japan	59	8	96	57	51	5	61
India	84	2	76	67	...	4	70
China	58	1	68	40	56	3	43

Source: Aziz and Cui, “Explaining China's low consumption, the neglected role of household income”, IMF working paper, 2007

Why is Consumption Low?





The Fall in Household Income/GDP

The fall reflects:

- Decline in labour income share, as capital intensive industry dominates and employment growth lags behind
- Low return of bank deposits (but this has been revised up?)

The Counterparts of the decline

- Rise in corporate saving/GDP and government saving/GDP
- Rise in banks' profits (Financial intermediation concentrated in banks + Banks mandated margin)

The Rise in HH savings rate

- Precautionary savings given the inadequate social safety net and rising health care and education costs for households
- Under-developed financial system, making it difficult to borrow against future income, pool risks among individuals
- Other factors: population aging, one-child policy, rising income disparity

Policies discouraging consumption

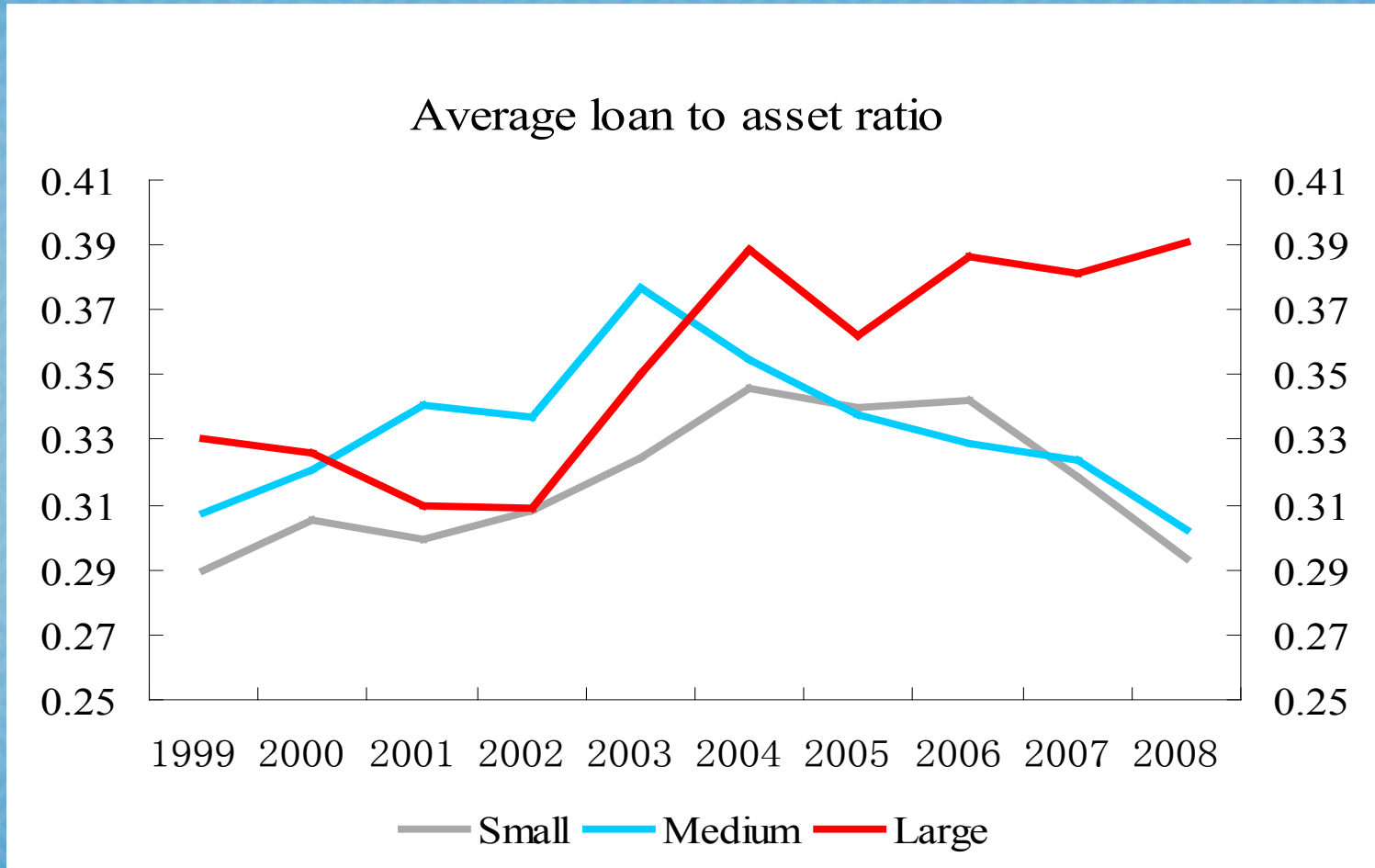
- Low input prices, tax policies encouraging investment
- Inadequate social safety net and rising health care and education costs for households
- Under-developed financial sector
 - Financing constraints encourage corporate to save (and increase pro-cyclicality of investment)
 - Employment growth muted as smaller firms have more constraints to financing
 - Difficulty in borrowing against future income, pooling risks among individuals
 - Lowering investment income for households

Estimating the Impact of financing Constraint on Chinese firms 1/

Coefficients	MLE	t-stat	Coefficients	MLE	t-stat
Loan-demand			Loan-supply		
Constant	0.029	[6.22]	Constant	0.035	[4.89]
Sales	0.060	[10.33]	Tangible assets	0.603	[17.50]
Cash flow	-0.233	[-7.91]	Broad money growth	0.572	[1.80]
Interest rate	-0.029	[-33.30]	Solvency of Non-SOE	-0.002	[-2.41]
Direct finance	0.076	[4.34]	Solvency of SOE	-0.005	[-5.09]
Solvency	-0.009	[-32.23]	SOE dummy	0.234	[3.92]
			Large-cap dummy	0.144	[9.10]
			Mid-cap dummy	0.065	[5.02]
Resid S.D.:	0.170	[68.03]	Resid S.D.:	0.181	[45.91]
R-square				42.7%	

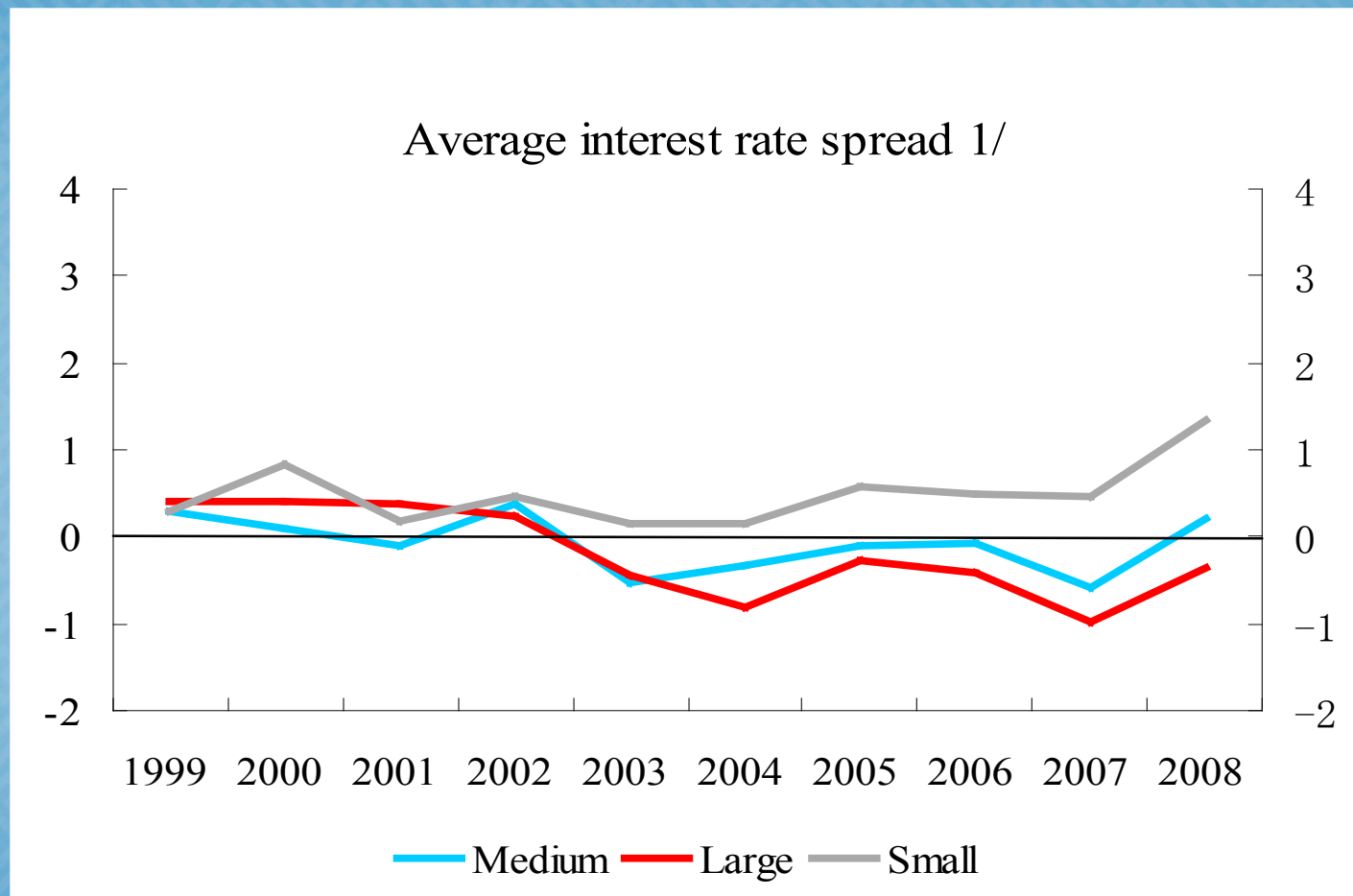
Source: Wind database and author's estimates
 1/ Estimated using a disequilibrium model.

Size matters - Smaller firms are able to borrow less



Source: Wind database and author's estimates

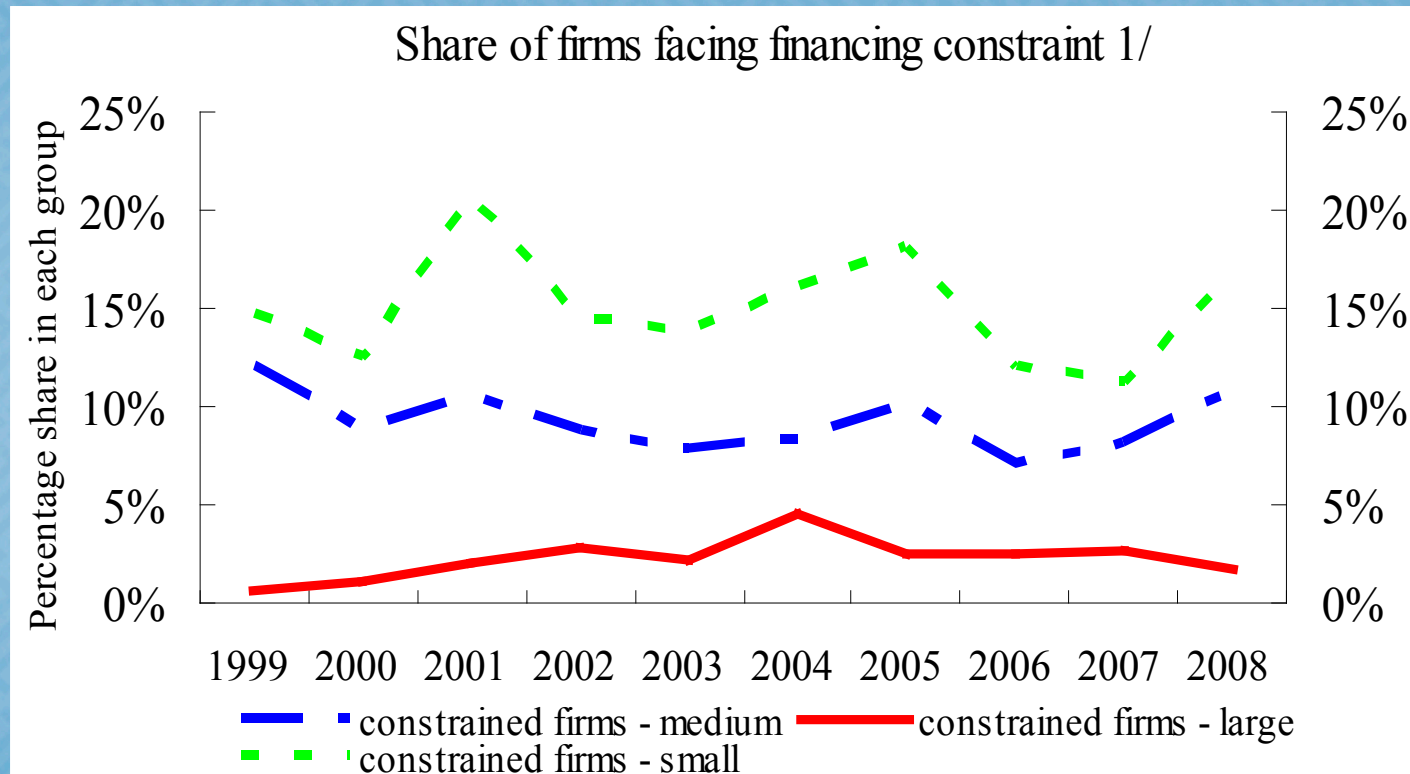
...at higher interest rate



Source: Wind database and author's estimates

1/ Interest rate spread is defined as actual interest rate minus benchmark 5-year loan rate, and the actual interest rate is calculated as interest expense / average loan outstanding.

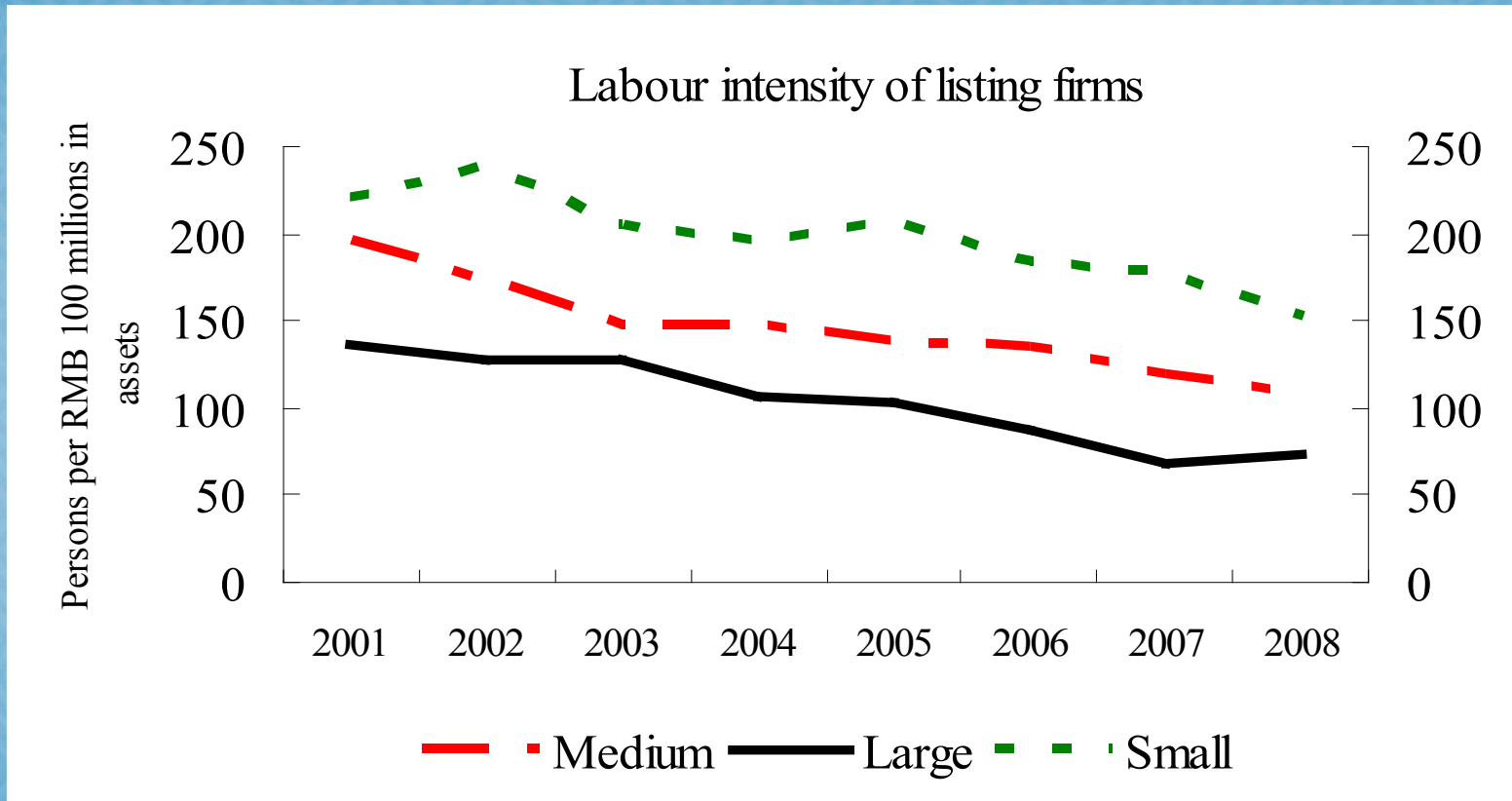
Smaller firms are more constrained in access to financing



Source: Wind database and author's estimates

1/ Estimated using a disequilibrium model.

Small firms tend to be more labour intensive



Source: Wind database and author's estimates

Financial reforms are needed

- Interest rate reforms; eventually remove the guaranteed bank margin
- Capital market development
- Capital account reforms – more participants and greater competition