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China Brief

China Consumption: Still Cautiously Optimistic?

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It has been three months since McKinsey's last update on China's consumption recovery, when we expressed a "cautiously optimistic" view. It seems appropriate to reflect on how consumption has progressed over the first half of the year, and assess the growth prospects for consumer and retail companies in China amid the sweltering summer.

Yes, the term "cautiously optimistic" still aptly describes our perspective, although the emphasis on "cautious" may have increased recently due to a softer outlook among consumers and companies towards China's economic recovery. It's an assessment based on dozens of conversations I've had over the past few months with business leaders at both domestic and multinational firms.

Let's start with what's encouraging. Most economic and consumption data for the first half of the year have been trending well. Retail sales of goods increased by approximately 7 percent compared to the same period last year. Foodservice sales—comprising restaurants and nightlife—even saw double-digit growth.

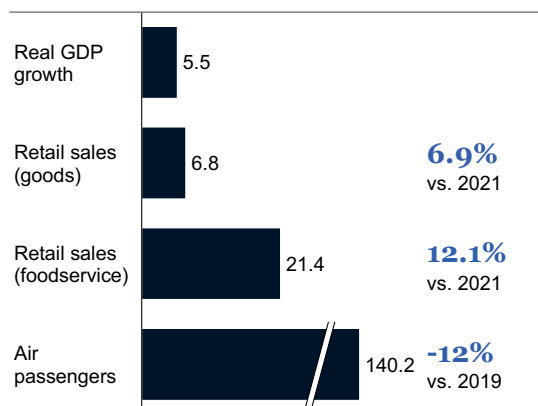
Clothing, cosmetics, and even autos experienced growth at or near double-digit rates compared to last year, showing gains against the record year of 2021. Despite reports about a less vibrant 618 Shopping Festival, general ecommerce platforms still generated a 5 percent increase in gross merchandise value (GMV), while livestreaming platforms saw double-digit growth. (Exhibit 1)

Exhibit 1

China macroeconomic and consumption indicators

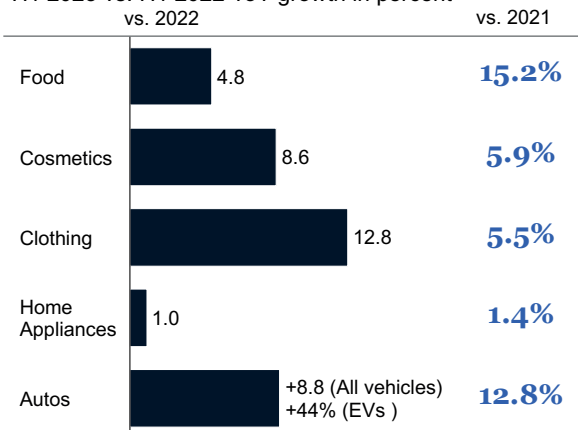
Macroeconomic indicators

H1 2023 vs. H1 2022 YoY growth in percent¹



Growth of key consumer product categories

H1 2023 vs. H1 2022 YoY growth in percent¹



1. Volume for autos (CATARC), value for other categories

Source: NBS, CATARC, CAAC

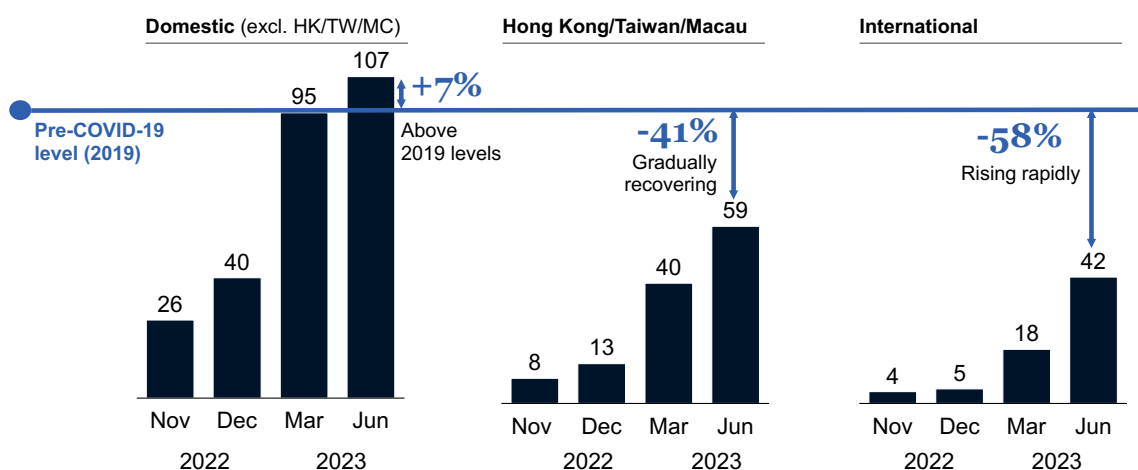
Looking at travel and tourism, China is approaching its record-setting peak in 2019. This is primarily due to domestic travel to tier-1 cities and tourist hotspots like Hainan and Yunnan. International travel is also recovering rapidly, even in the face of high prices and difficulties obtaining visas. The number of international flights jumped from less

than 20 percent of 2019 levels in March to over 40 percent in June. Undeniably, the desire to travel both domestically and internationally is evident among Chinese consumers after several years of restricted mobility. (Exhibit 2)

Exhibit 2

Growth in air travel

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



Source: CAAC

Despite these encouraging indicators, we are unlikely to see a substantial surge in consumption in the near term. The most troubling numbers are from the real estate sector. While the first quarter of 2023 saw a strong recovery in residential property transactions (even exceeding 2019 levels), the second quarter witnessed a steep drop, and is now 37 percent below pre-COVID-19 transaction levels.

This mirrors last year's stagnant numbers and undermines consumer and investor confidence.

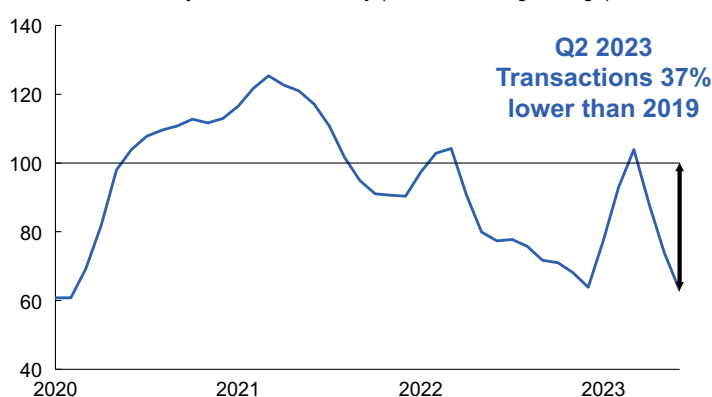
Declining exports (7.5 and 12.4 percent year-on-year drops in May and June, respectively) and a persistently high youth unemployment rate of over 20 percent further undermine consumer and investor confidence. (Exhibit 3)

Exhibit 3

Residential property and other macro indicators

Residential property transactions (sqm)

Index 2019 = 100, adjusted for seasonality (3-month moving average)



Exports

-12.4%
(June 2023 vs. 2022)

Youth unemployment

21.3%
(June 2023)

Consumer confidence

94.9%
(March 2023)

Source: NBS

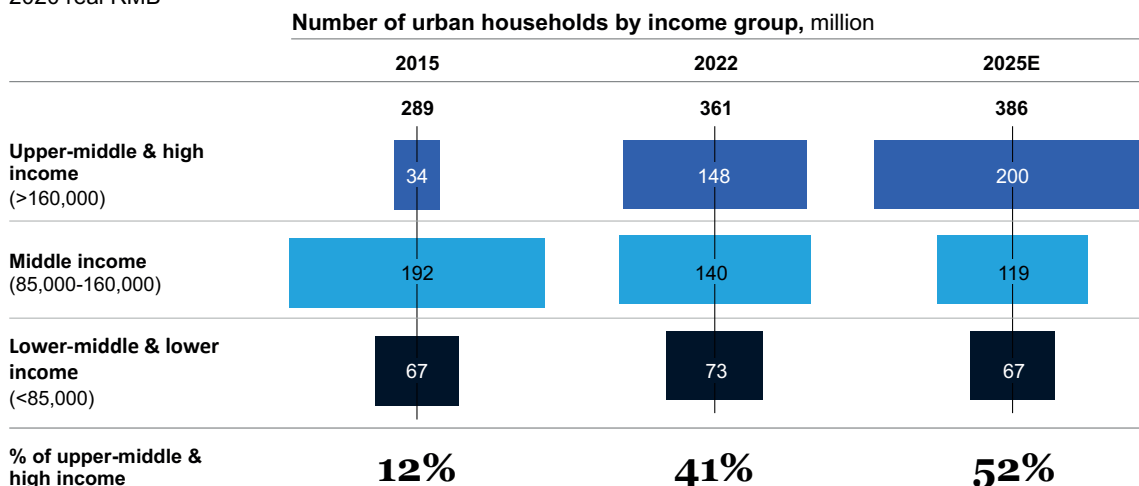
Despite these headwinds, however, our medium-term outlook on China's consumption remains positive. The latest simulation from the McKinsey Global Institute (MGI) suggests an additional 50-plus million households may reach the upper-

middle-class by 2025, forming the majority of urban households. This demographic has been fueling consumption growth and is leading an increasingly consumption-driven economy. (Exhibit 4)

Exhibit 4

Annual household disposable income in China

2020 real RMB



Source: MGI Insights China macro model

I'll now address some of the questions I often receive from executives regarding the current state of consumption:

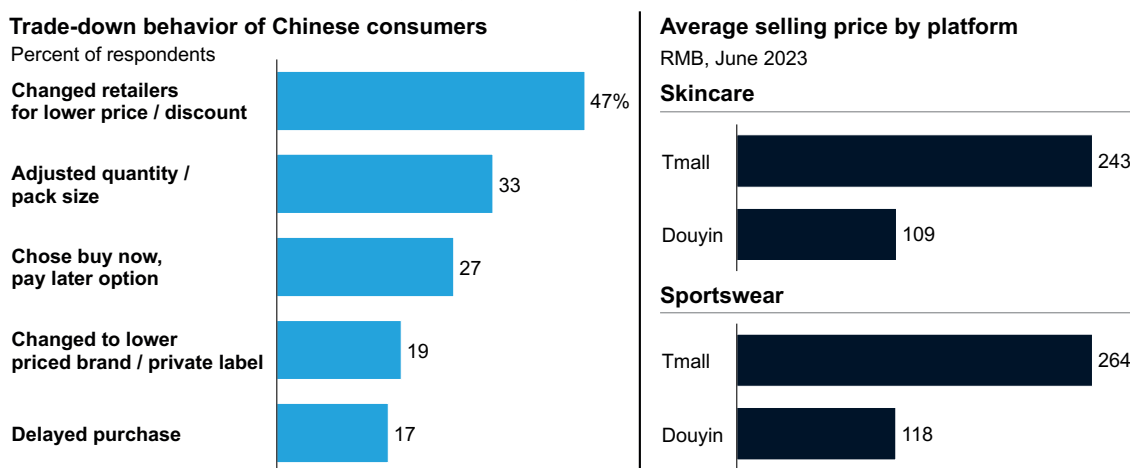
1) Are Chinese consumers opting for lower-priced brands during uncertain times?

The answer isn't a simple "yes or no". Only one fifth of consumers indicate they're switching to cheaper brands, while premium and luxury brands continue to rise. For instance, imports of Swiss watches grew by almost 30 percent year-on-year in the first half of 2023. Yet, we continue to see what we described

as "smart shopping" in our 2023 China Consumer Report. Around half of consumers suggest they buy from channels where they can find their preferred brands at lower prices or on sale. This is evidenced by the rising popularity of platforms like Douyin and Pinduoduo, where average transaction prices are often half or less than on more mature ecommerce platforms. Net net, consumers aren't necessarily shifting to cheaper brands, but are instead finding ways to trade up at a lower cost via different platforms, promotions, or by adjusting quantity or pack size in their purchases. (Exhibit 5)

Exhibit 5

Trade-down behavior and average selling price



1. Q: Within the past 3 months, have you done any of the following when purchasing (asked across multiple categories)? Trade down behavior includes one or more of the following answer choices: shopped from a lower priced retailer, shopped from lower priced brand, bought private label, bought a brand for which you had a coupon, used buy now pay later, delayed a purchase, bought a larger size pack for lower price, bought smaller size or quantity, made more shopping trips in search of discount

Source: McKinsey China Consumer Pulse Survey, conducted 4/26-5/2/2023, n=1,000 sample size and weighted to match China's general population of 18+ years

2) Which consumption categories have been the “recovery winners”?

In a survey of Chinese consumers conducted in May by McKinsey’s ConsumerWise insights team, 68 percent of respondents said they planned to “splurge” on themselves. Not surprisingly, travel and restaurants top the list of categories they plan to spend on. Apparel ranked a close third after restaurants, a category that is benefitting from consumers’ desire to invest more in their wardrobes in line with increased mobility. Electronics and household essentials ranked lower on their list of intended purchases, possibly due to the decline in property transactions and the reluctance to spend on higher-ticket, non-essential items.

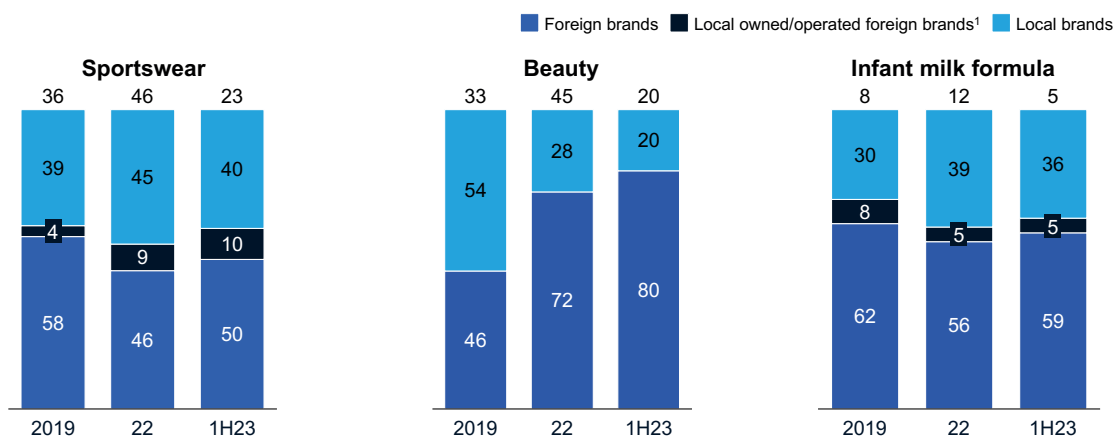
3) How are foreign brands faring?

As we’ve reported previously, Chinese companies have been gaining market share over the past few years in categories like sportswear and nutrition. There were hopes that this trend might reverse with many CEOs of foreign companies visiting China and reaffirming their commitment. Indeed, we have seen a slight shift, with foreign brands regaining share on Tmall in sportswear and nutrition, and continuing to gain in beauty. It’s too early to determine if this is a trend reversal or an anecdotal observation based on six months of data. At the very least, we can say that the trend of local brands gaining share hasn’t accelerated in recent months. (Exhibit 6)

Exhibit 6

Tmall top 20 brand share by brand origin

Rolling top 20; total in RMB billion; share in percent



1. Incl. foreign brands acquired or operated by local players
Source: BigOne

The Chinese consumer market is in flux and requires agile and responsive strategies. While uncertainties linger and there may well be headwinds ahead, we remain confident in the long-term prospects of China for consumer companies.

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