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The economy is faltering? Chinese consumers aren’t buying it

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Liaoning (遼寧), in China’s rust-belt northeast, is in recession. Output growth has not merely slowed since the boom times, it’s turned negative. This is just the second time that a shrinking provincial economy has been confirmed since the National Bureau of Statistics began collecting quarterly gross domestic product data in the late 1990s. The other was in 2009, when Shanxi (山西) fell into a six-month slump.

Liaoning is a powerful example of the problems afflicting China’s economy today. It is weighed down by debt, heavy-industry overcapacity and inefficiency, and a government reform programme that has fallen behind schedule.

All the more remarkable, then, that official data indicates retail sales in Liaoning growing at 8.1 per cent, a respectable figure against the national rate of 10.3 per cent. This might be written off as misreporting by local authorities, were it not for household surveys also showing disposable income per capita still expanding at 6.9 per cent. Thus, Liaoning presents a paradox.

Yes, the government must quicken the pace to cull excess capacity. Yes, it needs to do more to stem the flow of credit to unproductive firms. Yes, it has to resolve the bad debts already sitting on the banks’ books.

But a spotlight is also shone on perhaps the biggest mistake that China bears make – to imagine that their pessimism is shared by the country’s consumers.

A debt crisis is widely, and rightly, viewed as the chief risk for China’s economy in the medium term. According to data released by the Bank for International Settlements last month, China’s debt-to-GDP ratio now stands at 255 per cent. That’s on a par with the US, where per capita incomes are nearly four times greater in purchasing power parity terms.

Yet the bank also notes that more than three-quarters of China’s debt is owed by the corporate and government sectors. Meanwhile, the household debt-to-GDP ratio is a relatively modest 40.7 per cent. That compares with 78.4 per cent in the US.

In the first half of 2016, consumption accounted for nearly three-quarters of China’s 6.7 per cent GDP growth. This means that if the household sector was already highly leveraged, the near-term outlook might look especially vulnerable. But that’s not the reality on the ground.

When the Shanghai stock market collapsed in June last year, retail sales didn't skip a beat.

At the beginning of this year, some excited commentators claimed that panicked locals were sending money abroad en masse. But cooler heads saw that consumers were still emptying their pockets on big-ticket discretionary items like cars.

It may be that households will eventually tighten their purse strings, succumbing to weaknesses elsewhere. But even starring down the barrel of some formidable long-term challenges, such as unfavourable demographic shifts, the Chinese population remains overwhelmingly positive.

According to a Pew survey released this month, nine out of 10 people in China describe the economy as being in good shape. Might they simply be deluded by being fed a constant diet of government propaganda?

Eighty-two per cent of the same Pew respondents nominated corrupt government officials as the country's top concern, so it can hardly be said that they swallow the Communist Party line easily.

In the long run, whether household incomes continue to increase depends on productivity, not debt or anything else.

Of course, as long as Beijing remains stuck in authoritarian mode and the rule of law remains weak, China may never approach living standards in the US. But even if per capita incomes in the rest of the country only manage to catch up with its own best performing cities like Shenzhen, then its economy would still be three times larger than it is today.

Later this month, we'll know whether Chinese consumers managed to buoy the economy through the third quarter. Along with some government-sponsored investment stimulus, there's a fair bet they did: the International Monetary Fund just slashed its 2016 growth forecast for the US but left its expectations for China unchanged.