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Topics Personal consumption is becoming a drag on China's economy

At the National People's Congress in March, the Chinese government set a growth rate target of "around +5%" for 2024. However, personal consumption as well as investment is expected to remain tepid, and the hurdles to achieving the target are high.

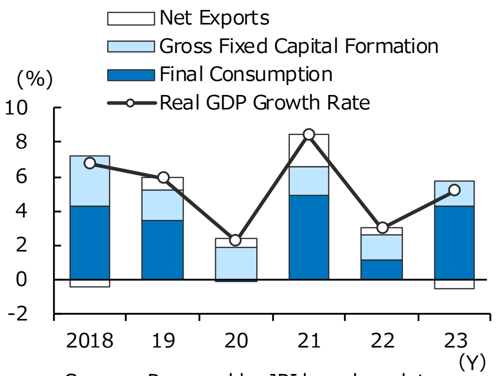
■ Personal consumption holds the key

An examination of the contribution of each demand item to real GDP growth in 2023 makes the difficulty of China achieving economic growth of "around +5%" this year plain to see. The contribution of gross fixed capital formation (GFCF) remained low at 1.5 percentage points, having come in below two percentage points since 2019, before the COVID pandemic struck. A real-estate slump symbolized by a series of defaults by property developers and a local government debt crisis symbolized by excessive debt among local-government financing vehicles (LGFVs) have emerged, making debt reduction an urgent task. A rapid turnaround in GFCF therefore looks unlikely.

On the other hand, the contribution of final consumption in 2023 was 4.3 percentage points, accounting for 80% of the +5.2% growth rate. Final consumption is the sum of personal consumption and government consumption, and since personal consumption accounts for 70% of this total, hopes that it can drive growth are rising. However, the high contribution of final consumption in 2023 was largely due to the rebound from 2022, when personal consumption was suppressed by the zero-COVID policy, and it is too early to conclude that similar growth can be expected in 2024.

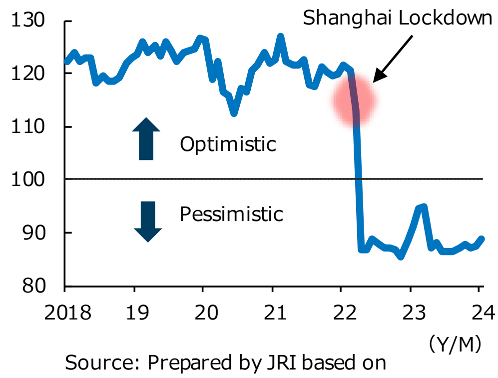
The consumer confidence index published by the National Bureau of Statistics fell sharply in April 2022 in response to the Shanghai lockdown and has remained low, with no recovery in 2023, when the zero-COVID policy was abandoned. Results from the People's Bank of China's Urban Depositor Survey show that households are prioritizing savings over consumption as they believe the employment environment has become harsher as a result of the pandemic and do not expect their incomes to grow. In light of these factors, it is reasonable to assume that personal consumption will stay subdued.

<Contributions of Demand Components to China's Real GDP Growth Rate>



Source: Prepared by JRI based on data from CEIC

<China's Consumer Confidence Index>



Source: Prepared by JRI based on data from CEIC

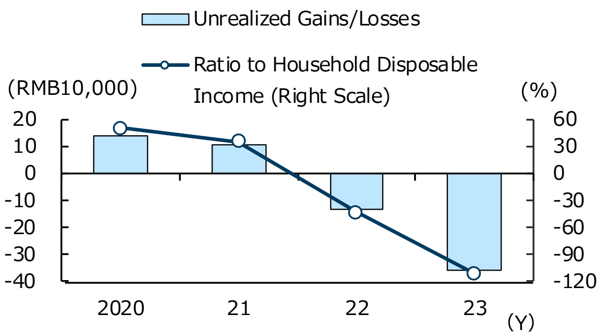
■ The reverse wealth effect is intensifying

One of the reasons households lack eagerness to consume is the reverse wealth effect, whereby declining housing prices causes paper losses on assets held to swell, dampening consumption.

According to the Survey of Urban Residents' Household Assets and Liabilities Status conducted by the People's Bank of China in October 2019, assets per urban household in that year averaged RMB3.179 million, 25.7 times the disposable income per urban household of RMB123,688. Of these assets, housing accounted for 70%. China's homeownership rate is very high at 96%, way above Japan's 61.2%. And since housing had been a target of speculation, many families possess more than one home, with 31.0% of homeowning households owning two homes and 10.5% owning three or more homes. As a result, unrealized gains and losses on the assets of households fluctuate greatly depending on housing prices.

The effect is most evident among the wealthiest 20% of households. This top 20% possess RMB10.02 million's worth of urban household assets, or 63.0% of the total. Assuming that housing makes up 70% of their assets, if we calculate the paper gains/losses on these housing assets compared to the previous year by multiplying the value of the assets by the rate of change in the prices of used homes, and then express that as a percentage of household disposable income, we see that unrealized gains equivalent to 50.7% and 35.4% of disposable income were generated in 2020 and 2021, but that in 2022 there was a complete reversal, with unrealized losses amounting to 42.7% of disposable income. And then, in 2023, these paper losses swelled to 110.7% of disposable income.

<Ratio of Unrealized Gains/Losses to Household Disposable Income of Wealthiest 20% of Urban Households>



Source: Prepared by JRI based on data from CEIC and local media reports
Notes: The rate of change in used home prices is the median for 70 cities.Disposable household income is calculated based on a household size of 2.92 persons.

Although there are differences depending on housing ownership status, it is natural for most households to curb consumption since most of them have incurred unrealized losses since 2022. Although the government stated at the National People's Congress that it would stimulate personal consumption by launching a consumption promotion campaign in 2024, it is reasonable to assume that consumer spending will be a drag on the Chinese economy rather than a driver, given that unrealized losses are expected to further expand in the future due to declining housing prices.

■ Reform of the household registration system as a measure to stimulate personal consumption

China's gross national income (GNI) per capita of $12,850 in 2022 puts it among upper middle-income countries, but its GFCF as a percentage of GDP is 43.3%, which is 13.6 percentage points higher than that of other upper middle-income countries excluding China. On the other hand, its personal consumption as a percentage of GDP is 37.0%, a figure 29.8 points lower than that of other upper middle-income countries excluding China. China has a peculiar economic structure that can be characterized by "high investment and low consumption," so the impact on the economy of boosting personal consumption will be weak.

In light of the uncertain outlook for households, the government declared at the National People's Congress that it would seek to stabilize employment and increase incomes by ramping up fiscal and financial support for industries with plenty of capacity to take on more workers. However, it is unclear whether this will dispel the anxiety felt by households. The Manufacturing Purchasing Managers' Index (PMI) announced by the National Bureau of Statistics was 49.2 in January, remaining below 50, the borderline between economic expansion and contraction, for the fourth consecutive month. Exports are also unlikely to grow significantly due to the restructuring of supply chains as Western countries try to become less dependent on China.

Reform of the household registration system is attracting attention in China as a potential trump card for reviving personal consumption. Migrant workers from the countryside are not registered as urban households, and therefore do not have access to urban social security programs. As such, they have a lower propensity to consume than urban household registration holders. Cai Fang, an economist who serves on the Monetary Policy Committee of the People's Bank of China, contends that if family registration system reform allowed migrant workers to receive the same treatment as urban household registration holders, personal consumption would be boosted by RMB1 trillion.

However, because household registration system reform could undermine the privileges enjoyed by urban household registration holders or significantly increase the financial burden on local governments, it is one of those policies that has not been implemented to date, despite many arguing that it is necessary. At the National People's Congress, reform of the household registration system was again listed as one of the government's tasks for 2024. Can China begin to address long-standing issues and make the transition from an investment-driven economy to a consumption-driven economy? The answer to that question will depend on the skills of the Xi Jinping administration.

(Yuji Miura)

Topics *Why India's inward FDI is declining*

India, with its continued high growth, has long garnered attention as an investment destination for foreign companies. However, India's inward foreign direct investment (FDI) has been declining in recent years due to economic slowdowns in the investing countries and protectionism in India.

■ Despite high growth, inward FDI in India is falling

The Indian economy has remained resilient. Since the April-June quarter of 2023, real GDP has continued to grow at high rates in the 8% range year over year (YoY) for three consecutive quarters. Now in 2024, India's economy is still going strong, and it is looking increasingly likely that its GDP will overtake Germany's and Japan's in the next few years, allowing it to leapfrog to third place in the world after the U.S. and China. The ongoing uncertainty surrounding China's political and economic situation has been a factor in getting companies from various countries much more interested in doing business in India as it raises its national profile in the global economy. According to the latest PwC Consulting survey of attitudes among corporate executives in various countries, India has jumped from ninth in the previous survey to fifth place for votes as the most important overseas business destination for future earnings.

However, inward FDI in India is on a declining trend after peaking in 2020, and there is a large gap between global firms' interest in India business and their actual investment behavior. Looking at inward FDI by country/territory, investments from the U.S., Singapore, and the Cayman Islands have fallen. By industry, investment in IT-related industries, construction, and retail/wholesale trade have dropped significantly.

■ Economic slowdowns in investing countries are dampening FDI

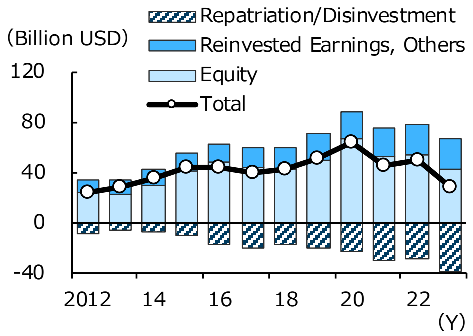
Reasons for the decline in India's inward FDI can be divided into two types: those related to investing countries and those related to India.

One investing-country factor is the impact of monetary tightening in developed countries, which account for about 70% of global FDI. Tighter monetary policy puts downward pressure on foreign investment through channels such as higher corporate financing costs and lower earnings due to the deterioration of the real economy. In addition, the higher interest rates resulting from monetary tightening cause the home country's currency to appreciate, making investors likelier to bring their returns on investments abroad back home rather than re-investing them locally. Since 2022, FDI has actually been declining across the globe against the backdrop of rapid interest rate hikes in Western countries to curb inflation.

■ Indian protectionism is also pushing down inward FDI

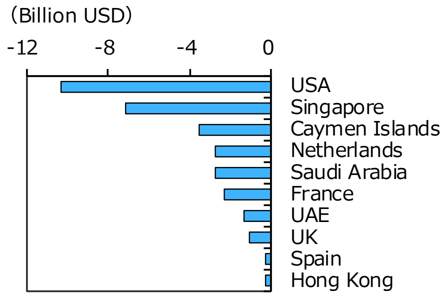
The following two factors on the Indian side have also

<India's Inward FDI>



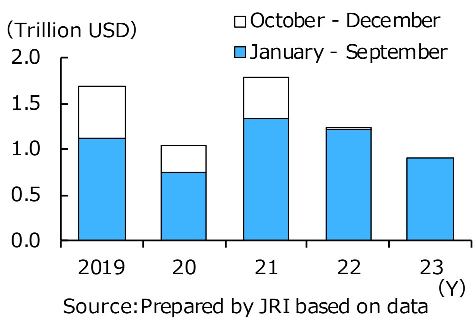
Source:Prepared by JRI based on data from Reserve Bank of India

<India's Inward FDI by Country (Change from 2020 to2023) >



Source:Prepared by JRI based on data from Department for Promotion of Industry and Internal Trade

<Global FDI Flow>



Source:Prepared by JRI based on data from OECD
Note: Figures in 2023 are January to September

been exerting downward pressure on inward FDI in recent years:

The first is growing protectionism. In 2020, the Indian government switched from automatic approval to case-by-case approval for FDI from neighboring countries, with the aim being to prevent Chinese companies from taking advantage of COVID-driven stock market falls to acquire Indian firms. Furthermore, even investments from non-neighboring countries were made subject to case-by-case approval if they were being financed by companies from countries bordering India. As a result, the view spread that even companies listed in developed countries would be hit by the curbs if their shareholders included financial institutions from mainland China or Hong Kong. Even after stock prices began to rise as the pandemic subsided, the Indian government left the controls in place, and in 2023 it rejected a proposal by Chinese EV (electric vehicle) giant BYD to build a plant in India, demonstrating that its priority is to keep a lid on economic security risks rather than promoting industrial development through the acceptance of FDI.

<Examples of Recent Downsizings/Withdrawals from India Business Reported in the Media>

Company	Details
Ford	In September 2021, the U.S. automotive giant Ford announced that it would cease vehicle production in India
Citi	In March 2022, Citibank, a major U.S. financial institution, announced the sale of its India operations to a local bank
Amazon	In November 2022, Amazon, a major U.S. online retailer, announced it would be shutting down its online education and meal delivery service businesses
Viatris	In October 2023, Viatris, a major U.S. pharmaceutical company, announced the sale of its active pharmaceutical ingredient manufacturing business in India to a local pharmaceutical company
Wistron	In October 2023, Wistron, a leading Taiwanese EMS (Electronics Manufacturing Services) company, announced the sale of its India operations to a local conglomerate
Blackstone	In December 2023, it was reported that Blackstone, a major U.S. investment fund, was planning to exit its real-estate investment trust (REIT) business in India

Source: Prepared by JRI based on various media reports

In addition, growing concerns that the Indian government will tighten restrictions on cross-border data transfers have deterred investment in India's digital sector. In December 2019, when the Digital Personal Data Protection Bill, which included provisions for data localization (obligation to store personal data in India) and the obligation for government agencies to inspect data processing equipment, was introduced in Parliament, speculation mounted that costs for global companies would increase due to the need to install data servers in India. This made them less enthusiastic about investing in India. Ultimately, a watered-down version of the bill, with stringent rules such as the localization clause absent, was passed in August 2023. Nevertheless, it is still unclear what additional regulations will be included in subordinate enforcement rules and notices when the law takes effect, so companies' concerns have not been completely allayed. Worries about the possible introduction of regulations that would make it difficult for global companies to recoup their investments, such as caps on royalty payments for trademarks and technologies provided by foreign parent companies, have also exacerbated the avoidance of investing in India.

The second is the difficulty of developing business in India. India is a promising market with high growth potential over the medium to long term, but at the same time, it poses various challenges to entrants, including 1) stiff competition from other companies, 2) uncertainty regarding application of the legal system, and 3) slow development of infrastructure for logistics, energy, etc. As a result, not a few companies come up against unforeseen problems after entering the market, forcing them to drastically revise their business plans. Since the COVID pandemic, major companies in the U.S. and Taiwan have announced that they are downsizing their Indian operations or pulling out of the country altogether, which is one reason for the rise in cash flows back to home countries.

Looking ahead, with a soft landing predicted for the world economy, corporate foreign investment is expected to pick up again. Whether India will be able to take advantage of this tailwind to attract foreign investment and accelerate its economic growth over the medium to long term will depend on whether the new government, which will be inaugurated after the Lok Sabha (lower house) general election in the spring, will avoid excessive protectionism and succeed in taking steps to improve the business environment.

(Shotaro Kumagai)