

# Economic Transition and Weak Consumption<sup>1</sup>

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**Abstract:** *Currently, the overall growth rate of China's economy is sluggish, with a distinct weakness in total demand. Economic transformation is a potent measure to promote economic growth. The process of economic transformation mainly includes two aspects: transitioning to a higher-level industrial structure and shifting towards an enhanced consumption-driven model. From the perspective of industrial structure, China's industry is gradually transitioning towards higher-end manufacturing and modern services, which can be validated by economic data and capital markets. From the perspective of consumption-driven transition, the impact of the pandemic has significantly weakened the consumption capacity of the working-age population, creating a strong contraction effect on the economy and obstructing the shift towards higher consumption. In the current economic environment, appropriate measures should be taken to stimulate consumption and stabilize the long-term expectations of the working-age population, focusing on promoting consumption growth as the main thrust of economic transformation.*

In recent years, China's overall economic growth rate has been sluggish, with total demand significantly weak. In response to this situation, two different viewpoints exist in the market. One viewpoint argues that weak total demand will trigger a series of negative chain reactions, and strong stimulus policies should be implemented to quickly restore the balance between total supply and demand and achieve a relatively moderate inflation level. The other viewpoint contends that insufficient total demand is an unavoidable cost as the economy transitions from a traditional growth model to a high-quality growth model. In this context, adopting a deluge of strong stimulus policies may render previous efforts in economic transformation futile or even cause regression. The two viewpoints have significantly influenced policy choices. This article proposes a more granular observation around the

issue of economic transformation to further enrich and deepen the understanding of this problem.

When exploring the topic of economic transformation, it is evident that different individuals have varying definitions and understandings. In my view, economic transformation includes at least two important aspects: first, the transition of the industrial structure towards medium- to high-end manufacturing and modern service industries; second, shifting the driving force of economic growth from reliance on investment and export-led growth to consumption-driven growth. This article will focus on these two aspects and analyze relevant data.

## I. Examining Industrial Structure Transition Through Listed Companies' Revenue and Market Capitalization

First, we focus on data related to industrial structure transition. This process involves the rise of emerging industries, the decline of traditional industries, and the

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stability of certain sectors. Based on data from listed companies and according to specific industries, we can categorize them into three types: supporting industries, neutrality industries, and restrictive industries.

Supporting industries are those backed by policy support and represent the direction of economic transformation. These include industries like electrical equipment, electronics, national defense and military industry, and automobiles, including the “New Three.” This category comprises a large number of listed companies, about 2,341 in total.

Relatively declining industries are affected by changes in the policy environment and shifts in the intrinsic growth logic of the economy. Examples include real estate, media, software and services, and non-bank finance. This category includes nearly 500 listed companies, both on the A-share market and overseas listings.

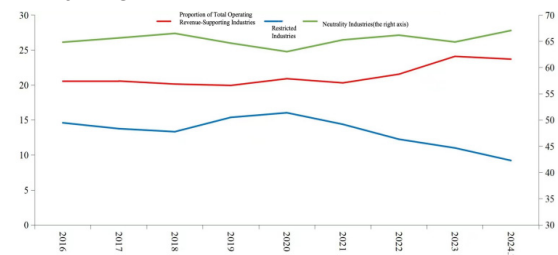
Among all listed companies, a considerable portion operates in industries where the industrial structure has remained relatively stable amid long-term economic changes. The policy environment for these companies is generally neutral, and the intrinsic logic of economic growth and development has not significantly altered their proportion in the economy. These include industries like commercial retail, pharmaceuticals and biotechnology, public utilities, and transportation, which we collectively term as “neutrality industries.” There are over 2,600 listed companies in this category. Neutrality industries are important because they provide a crucial reference point for observing and analyzing changes in the economic structure. With this as a foundation, we can more clearly identify the authenticity and evolution trajectory of the rise and fall of other industries.

We analyze the composition and changes of listed companies based on their total operating revenue. Within the neutrality industries we have defined, their operating revenue accounts for 60%–70% of the total revenue of listed companies. This proportion has remained unchanged over the past decade, aligning with our definition that neutrality industries are less

affected by short-term policy environments and economic development logic.

Industries marked by the red line represent rising, ascending, and emerging industries, signifying the direction of policy. Since 2020, the proportion of these industries has climbed from about 20% to nearly 25% currently. The blue line represents industries in decline or slowdown, facing a unfavorable policy environment. Before 2020, their operating revenue accounted for about 15%, but it has now fallen below 10%. Over the three to four years since 2020, the overall proportion of neutrality industries has remained stable, while the proportion of industries adversely affected by policy has experienced a significant decline. This downward trend contrasts sharply with the noticeable increase in the proportion of industries encouraged by policy. Especially after 2022, the gap between the red and blue lines has further widened, highlighting profound changes in economic transformation at the industrial structure level. Additionally, it is worth noting that even in 2016–2017, the proportion of policy-supported industries in operating revenue was already significantly higher than that of restrictive industries, and this gap has now expanded from 5 percentage points to over 10 percentage points.

**Figure 1 Proportion of Total Operating Revenue by Different Industry Categories**

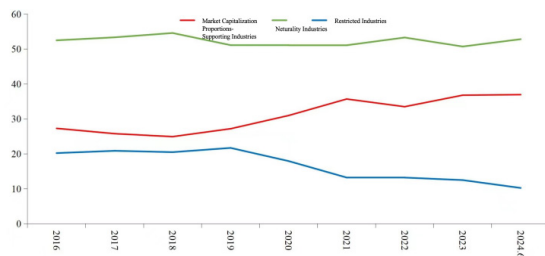


Sources: Author's calculation using a fixed sample, Wind and Guotou Securities

The distribution of total market capitalization shows a trend similar to that of operating revenue proportions. For neutrality industries, their total market capitalization accounts for 50%–60%; industries favored by policy initially accounted for close to 30%, now rising to over 35%; the proportion of other industries has further shrunk from the original 20% to about 10%. Since 2020, the rise of the red line, the decline of the blue

line, and the relative stability of the green line have all been particularly pronounced. The changes in total market capitalization and operating revenue of listed companies reflect investors' perceptions of these companies. From this, we can analyze that economic transformation is underway: industries that align with policy direction and represent future development trends are clearly on the rise, while other industries are significantly declining.

**Figure 2: Market Capitalization Proportions by Industry Category**



Sources: Author's calculation using a fixed sample, Wind and Guotou Securities

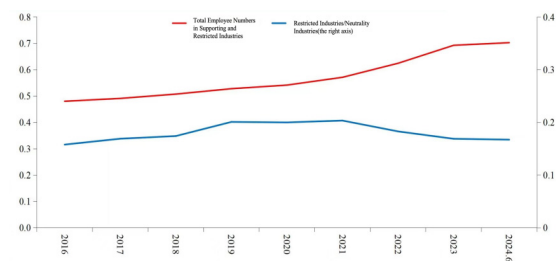
## II. Examining Industrial Structure Transformation from the Perspectives of Investment Returns and National Economic Accounting

Similar conclusions can be drawn from the dual perspectives of investment returns and national economic accounting. Given the relative stability of neutrality industries, we have adopted a simplified calculation—using the metrics of neutrality industries as the baseline (denominator) to compare the performance of specific industries (numerator). For the net profit, we clearly observe that since 2020, industries restricted by policies have experienced a significant stepwise decline in net profit. In contrast, industries supported by policies have maintained overall stability in their net profit share, or have even seen a slight increase. A similar trend is evident in net profit margins.

From the labor market perspective, a comparable pattern emerges. Since 2021, the proportion of total employees hired by policy-supported industries has shown a noticeable increase relative to neutrality

industries, while the employee share in policy-restricted industries has significantly decreased. This indicates that labor is gradually moving away from industries that are policy-restricted and in decline, shifting toward industries that are emerging and on the rise. In the charts, the gap between the red and blue lines began to appear before 2021 and has continued to widen after that.

**Figure 3: Trends of Employee Numbers in Supporting and Restricted Industries Compared to Neutrality Industries**



Sources: Author's calculation using a fixed sample, Wind and Guotou Securities

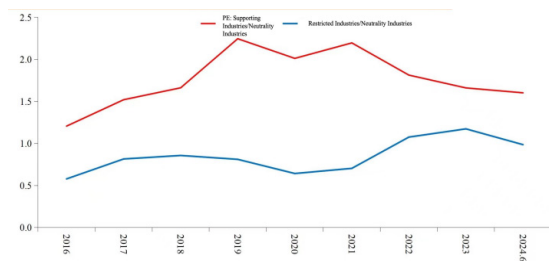
A similar pattern can be seen when examining capital expenditures (CAPEX) or capital formation. Since 2020, the proportion of capital input obtained by supporting industries has experienced significant growth, with current levels far exceeding those of 2019 and even before 2017. Conversely, capital expenditures in restrictive industries have markedly declined. Further analyzing the internal structure of capital expenditures, whether the capital is sourced through credit or equity financing, similar trends are observed. This suggests that in the allocation pattern of input factors within the national economy, more capital and labor have been directed toward emerging industries since 2020. On the other hand, declining industries are receiving relatively less capital and labor.

The capital market's reaction these changes can be deeply analyzed through valuations. Before 2018, the price-to-earnings (P/E) ratio represented by the red line was more stable compared to the blue line. However, after 2019, the valuation gap between the two widened significantly until stabilizing around 2022. Looking further at the price-to-book (P/B) ratio, the trend is similar with slight differences. Specifically, before 2019, the red line's valuation was slightly higher than the blue line, with the gap remaining

relatively stable. But since 2019, this gap has sharply widened, and by the first half of 2024, the valuation advantage of the red line over the blue line far exceeds levels seen before 2018. Combining these valuation indicators, it is evident that the capital market currently believes industries represented by the red line have higher returns on net assets compared to those represented by the blue line, and this advantage is more pronounced than before 2018.

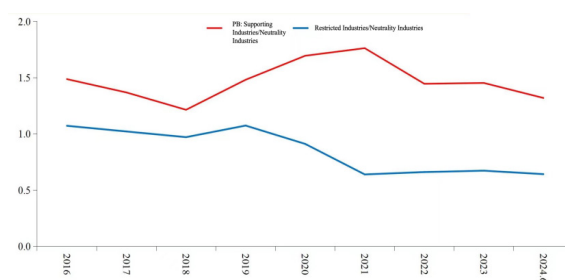
From the perspective of profit growth, industries represented by the red line experienced significant acceleration in profit growth between 2018 and 2021. Although growth rates have slowed after 2023, the relative advantage in profit growth compared to blue-line industries has only returned to pre-2018 levels, while returns on net assets remain high. Combining changes in these financial indicators with other evidence, it's clear that the capital market believes red-line industries offer higher relative returns on net assets and higher valuation levels, thereby attracting more capital and labor inflows. This series of phenomena undoubtedly provides strong evidence for economic transformation.

**Figure 4: Changes in PE (Price-to-Earnings Ratio) of Supporting and Restricted Industries Compared to Neutrality Industries**



Sources: Author's calculation using a fixed sample, Wind and Guotou Securities

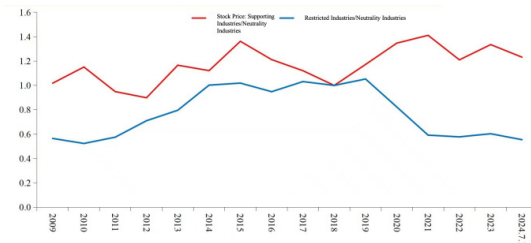
**Figure 5: Changes in PB (Price-to-Book Ratio) of Supporting and Restricted Industries Compared to Neutrality Industries**



Sources: Author's calculation using a fixed sample, Wind and Guotou Securities

Looking at stock prices, we set the 2018 stock price to 1—that is, the stock prices of supportive (red line) and restrictive (blue line) industries relative to neutrality industries are standardized to 1 for that year. It's evident that since 2018, the red line has generally shown a fluctuating upward trend, while the blue line has undergone a significant, almost unilateral decline. This means that stock prices of emerging industries representing future trends have achieved substantial growth, while those of relatively declining industries have suffered sharp drops. Looking back before 2018, the situation was the opposite: from 2009 to 2018, industries represented by the blue line saw more significant stock price increases, while those represented by the red line grew more modestly. The year 2018 became a turning point, with trends completely reversing thereafter. This change in stock prices is also substantial evidence of economic transformation.

**Figure 6: Stock Price Changes in Supporting and Restricted Industries Compared to Neutrality Industries**



Sources: Author's calculation using a fixed sample, Wind and Guotou Securities

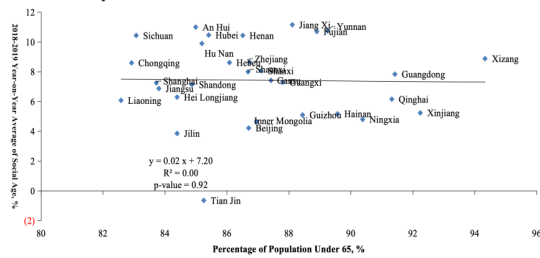
Based on the above analysis, from the perspective of industrial structure, since 2019–2020, influenced by multiple factors, the economic industrial structure has been gradually transforming toward higher-end manufacturing and modern service industries. This transformation has been consistently reflected in multiple dimensions of economic data and has formed a stable pattern in the capital market.

### III. Post-Pandemic Increased Uncertainty in the Working Population and Weak Consumer Spending

Next, we observe changes driven by consumption. The following scatter plot horizontally analyzes the

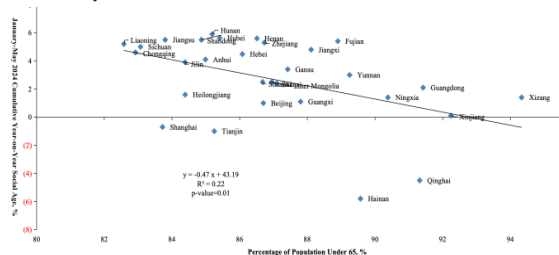
correlation between the proportion of middle-aged and young populations and the rate of consumption growth in Chinese administrative provinces. The x-axis shows the proportion of the population under 65 in each province, and the y-axis represents the pre-pandemic growth rate of retail sales of consumer goods. Before the pandemic, there was almost no correlation between these two variables, with elasticity near zero; after the pandemic, a significant negative correlation appeared, indicating high elasticity. Post-pandemic, provinces with a higher proportion of young people exhibited lower consumption growth rates, while those with a lower proportion of young people showed higher rates. This correlation was not evident before the pandemic, thus providing an effective comparative sample. Through this comparison, we can clearly understand the profound and intense impact of the pandemic or related shocks on the economic structure. In the realm of consumption, the more young people there are, the lower the consumption growth rate.

**Figure 7: Relationship Between Year-over-Year Growth in Retail Sales and the Number of Middle-aged and Young Population by Province Before the Pandemic**



Sources: Author's calculation using a fixed sample, Wind and Guotou Securities

**Figure 8: Relationship Between Year-over-Year Growth in Retail Sales and the Number of Middle-aged and Young Population by Province After the Pandemic**

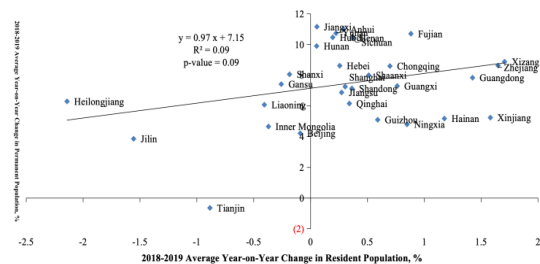


Sources: Author's calculation using a fixed sample, Wind and Guotou Securities

Observations from the perspective of population mobility yielded consistent results. Specifically, the

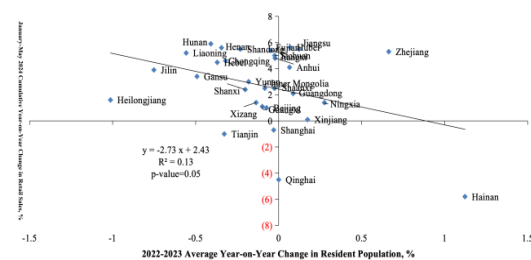
x-axis in the chart measured the growth rate of the permanent population in each province, where population inflow led to continuous growth; the y-axis reflected the growth rate of total retail sales of consumer goods in these provinces. Before the pandemic, a significant positive correlation and an elasticity coefficient close to 1 were evident, meaning the more people that moved into a province, the higher the consumption growth. However, applying the same data structure post-pandemic revealed the opposite result: provinces with more population inflow experienced lower consumption growth. This finding aligns with the observed impact of the young population's proportion on consumption growth rates.

**Figure 9: Pre-Pandemic Consumption Levels in Provinces with Higher Influx of Population (Higher Proportion of Young People)**



Sources: Author's calculation using a fixed sample, Wind and Guotou Securities

**Figure 10: Post-Pandemic Lower Consumption in Provinces with Higher Proportions of Young People**



Sources: Author's calculation using a fixed sample, Wind and Guotou Securities

To interpret these results deeply, we conducted panel regression analysis and other relevant studies, which time constraints prevent us from detailing fully. In brief, the core reason for this change lies in the deep psychological impact the pandemic and its accompanying shocks have had on the working population. Specifically, facing shocks related to the pandemic, the working population's expectations for

future income growth, certainty, and even job security significantly declined. In this context, they tended to drastically reduce consumption expenditures, with a more intense impact in provinces with a higher proportion of young people, thus leading to the results mentioned earlier.

In contrast, the elderly population demonstrated greater stability. Their primary sources of income, such as social insurance and company pensions, are well-protected, and the amount of pension they receive each month is stable and predictable. This high degree of certainty and stable growth in income means that the consumption patterns of elderly people were unaffected, making consumption more stable in areas with a higher proportion of elderly people. The series of social shocks post-pandemic posed significant challenges to the long-term income expectations and certainty of the working population, thereby triggering significant contractions in consumption activities, which is a crucial background to the current insufficiency of total demand. The impacts on stock and housing prices are detailed in the panel model, which will not be expanded upon here.

If we divide the process of economic transformation

into two directions—one toward a higher industrial structure and the other toward a higher consumption-driven transformation—the data indicate that while the transformation of the industrial structure is very robust, the shift toward a higher consumption-driven transformation is developing in the opposite direction. Adverse impacts on the working-age population have weakened their consumption capacity, creating a strong contraction effect on the economy. We might compare economic transformation to turning a car on a highway. Slowing down and timely adjusting direction is necessary to maintain safety and stability while driving at high speed. Continuing to turn at high speed not only makes it difficult to steer correctly but could also likely cause accidents; conversely, if the speed is too slow, there might be a risk of being rear-ended, or even stalling due to poor vehicle performance. Looking back on recent efforts, it can be said that the “steering wheel” has been adjusted in the relatively correct direction, but the current “speed” is too low, posing a risk of stalling. Therefore, in the current economic environment, appropriate measures should be taken to stimulate consumption and stabilize the long-term expectations of the working-age population, focusing on promoting consumption growth as the main thrust of economic transformation. 📌