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CHINESE CONSUMER SPENDING LAGS INCOME GROWTH A Marketing Opportunity

China has a preponderance of consumers whose income is growing more rapidly than their propensity to spend. Marketers have an enormous opportunity to stimulate consumer spending in China, as they did in the USA following World War II.

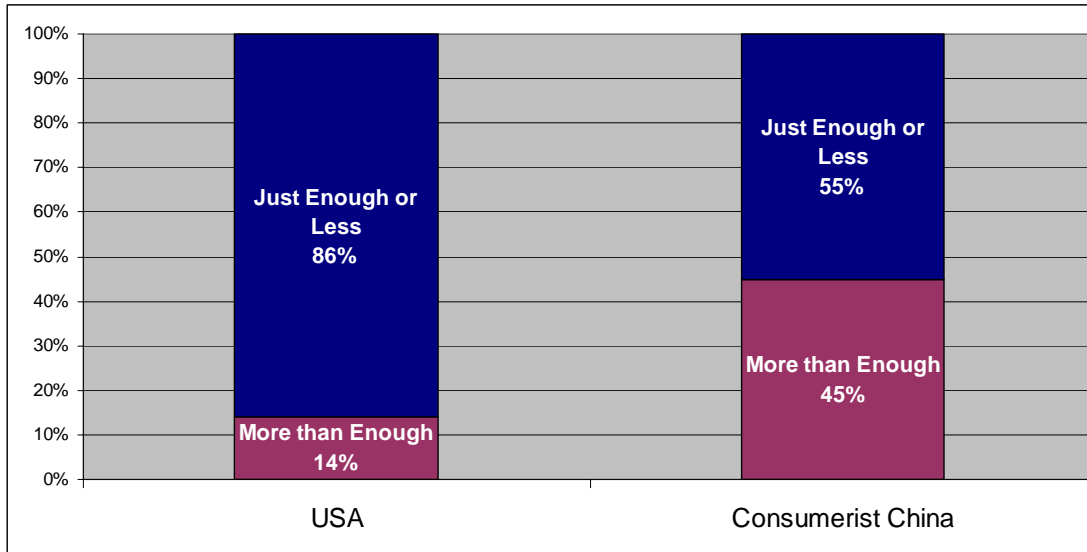
China is so complex that it is useful to think of it in parts. “Consumerist China” – as we will call it – consists of roughly 300 million residents of China’s urban areas who have landline phones.¹ These consumers represent nearly one-fourth of the total population and an estimated 40% to 45% of all consumer spending in the People’s Republic of China. The population of Consumerist China is comparable to the total USA population.

Our September/October 2006 survey of 1,814 consumers is drawn in roughly equal numbers from Consumerist China and the USA. In making comparisons between the surveys, keep in mind that Consumerist China is a segment of a national population, representing only one of every four Chinese.

PERCEPTION OF ABUNDANCE

The survey finds that consumers in the two nations differ in how they regard their income. Over three times as many Consumerist Chinese (45%) as USA consumers (14%) report having “more than enough money” coming in than they need to live comfortably and securely.

“Taking everything into account, do you feel that you have more or less or just enough money coming in to live comfortably and securely?” (September/October 2006)

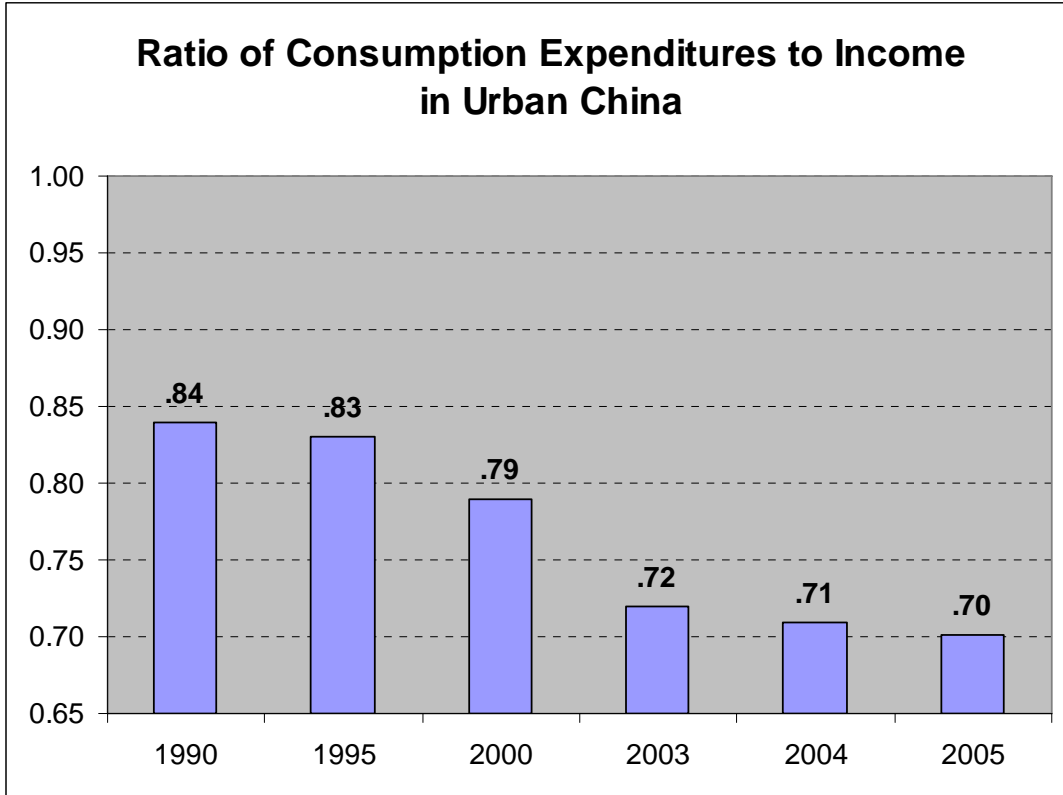


Far from explaining this difference in perception, absolute income only magnifies the difference between the two countries. The average annual income of urban Chinese households is just one-tenth as much as households have in the USA (about \$6,000 in urban China compared to over \$60,000 in the USA).

INCOME SURGING AHEAD OF SPENDING

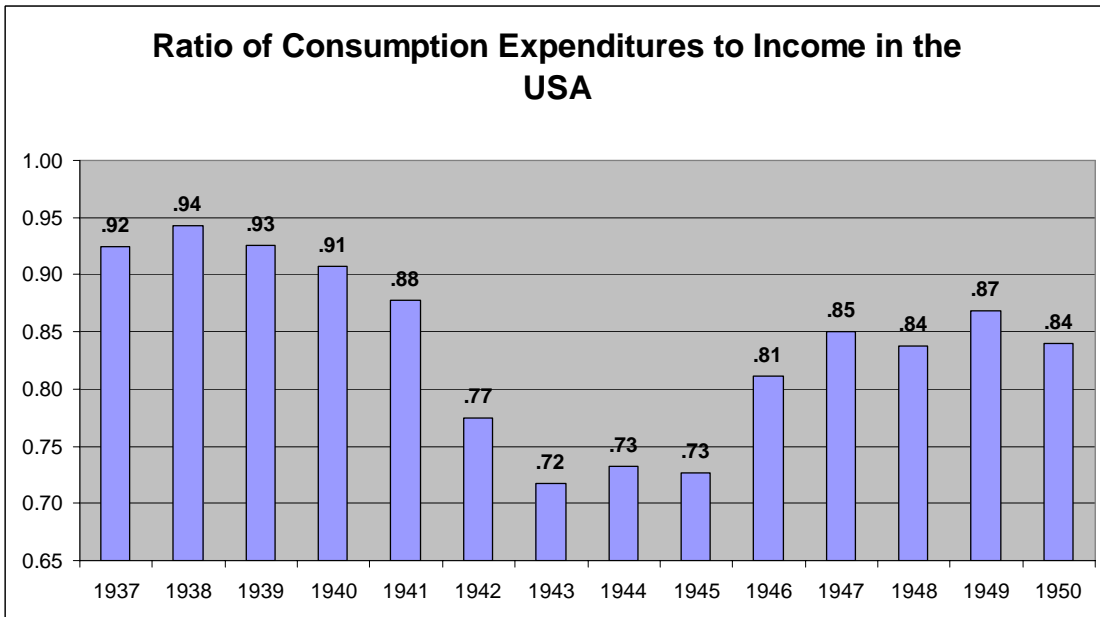
Although Chinese Consumerists' perception of abundance is partially explained by the low cost of living in China, a more significant reason is their rapid income growth. In 2006, per capita disposable income of urban Chinese rose 12%. It has risen by 10% or more in each of the past five years.² Nearly all of the increase in urban Chinese income is real, not a result of inflation. During the past five years, the average annual inflation rate for urban China was about 1.2%. With income rising much faster than prices, the spending power of urban Chinese is skyrocketing.

Among Chinese Consumerists, perception of what constitutes "living comfortably and securely" has not changed as rapidly as real income. Consequently, Chinese Consumerists are spending a progressively smaller proportion of their income on consumer goods. From 1990 to 2000, the proportion of income that urban Chinese spent declined from .84 to .79; in the next five years, it dropped more rapidly, falling to .70 in 2005.



SOURCE: National Bureau of Statistics of China

The current surplus of unspent income in China is reminiscent of the USA during World War II. During the war, USA consumer income outstripped propensity to spend. After the war ended, America's advertising media and services grew exponentially as manufacturers spent heavily on marketing to generate demand for the flood of products and services they were able to produce. These efforts helped to launch a lengthy economic boom.



SOURCE: U.S. Census Bureau

CONSUMERS WITH “MORE THAN ENOUGH” INCOME

Chinese Consumerists are poised for an economic boom if advertisers and marketers can encourage them to spend more of their rising income. Understanding what it means to Consumerist Chinese to have “more than enough” income helps to clarify the challenges of reaching this target market.

With one of the highest savings rates in the world, the inclination of Chinese consumers to save money is widely known. More Chinese Consumerists report having saved money in the past month than USA consumers (64% vs. 46%). Chinese Consumerists who feel they have “more than enough” income are more likely to save than the others (78% vs. 53%). However, they are not more likely to save than their USA counterparts who also feel they have “more than enough” income.

Having saved money, consumers who feel they have “more than enough” income are less inclined to make a major purchase in urban China than in the USA. In urban China, 43% feel now is a good time to make a major purchase, compared to 62% in the USA.

This effect applies to smaller as well as larger purchases. Consumers with “more than enough” income are less likely to be spending freely for day-to-day needs in China than in the USA. Despite their feelings of abundance, 22% say they are cutting back on their standard of living in China, compared to just 3% in the USA. Similar results are observed for specific categories of spending, such as food and clothing.

	<u>Total</u> 100%	<u>“More Than Enough” Income</u> 100%	<u>Not “More Than Enough” Income</u> 100%
<u>Saving and Spending</u>			
Saved money in past month			
Consumerist China	64	78	53
USA	46	84	39
Feel it is a good time for a major purchase			
Consumerist China	38	43	34
USA	33	62	29
Cutting back on standard of living			
Consumerist China	32	22	40
USA	38	3	44
Cutting back on food purchases			
Consumerist China	32	23	40
USA	42	14	46
Cutting back on clothing purchases			
Consumerist China	38	25	48
USA	45	12	51

One reason for Consumerist Chinese to hold back on spending is the way they perceive their financial security. Compared to USA consumers who feel that their income is “more than enough,” those in China are twice as likely to report that a family member was laid off in the past year (18% vs. 8%) and that they “could not get along” if their primary wage earner were unemployed (34% vs. 15%).

	<u>Total</u> 100%	<u>“More Than Enough” Income</u> 100%	<u>Not “More Than Enough” Income</u> 100%
<u>Employment Security</u>			
Family member laid off in past year			
Consumerist China	25	18	32
USA	24	8	26
Could not get along if primary wage earner were unemployed			
Consumerist China	52	34	66
USA	41	15	46

CONCLUSIONS

Many Consumerist Chinese feel they have more money than they need to live “comfortably and securely” but are reticent to spend it. As they build their savings, their sales potential for marketers grows. To unlock this potential, marketers need insight into what hinders consumer spending in China and how to overcome such obstacles.

Note: This report is a product of Leo J. Shapiro & Associates, L.L.C. For more information, call Matthew Smith at 312-321-8111 or visit www.ljs.com.

¹ The China Poll excludes the northwestern provinces and the autonomous regions.

² Figures are from the National Bureau of Statistics of China news release dated January 25, 2007 and the China Statistical Yearbook 2006.