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Stock markets threatened by collapse in Chinese consumer demand

A shocking slump in Chinese consumer demand will undermine World economic growth and stock markets

The third Plenary Session of the 18th Communist Party of China Central Committee last week adopted a series of decisions aimed at comprehensively deepening reform in China. Photo: EPA

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The capitulation of the Chinese consumer threatens to drag stock markets around the world into a death spiral as one of the pillars of global growth is undermined.

Figures from the world's largest consumer goods groups last week laid bare the shocking weakness of consumer demand in China, which threatens to pull down global stock markets that have been priced to perfection by more than five years of extraordinary monetary policy and asset price inflation.

For China to avoid a hard landing it was essential for consumer spending to pick up from where centrally planned infrastructure spending left off, but there are signs this simply isn't happening. Unilever, the world's third largest

consumer goods company, said they were surprised by the "unusually rapid" slowdown in Chinese consumer demand.
The company said that sales growth had slumped to about 2pc during the nine months ended September, down from about 8pc growth last year. The slowdown in Chinese sales growth to about 2pc is also an average – there are pockets where trading is far worse. The company added that sales to the big hypermarkets in the country are less than 2pc or even negative in some cases.
Nestle, the worlds largest food company, recently reported falling sales for the first nine months of the year and also warned of "challenging" Chinese trading conditions. The fear of China going backwards is now becoming a reality, as the Chinese consumer is not picking up from where capital investment left off.
Immediately after the 2008 banking crisis China launched the largest stimulus package and infrastructure investment program the world has ever seen.
China has used 6.6 gigatons of cement in the last three years compared to 4.5 gigatons the USA has used in 100 years.
The stimulus package increased fixed capital investment to 50pc of GDP, while domestic consumption withered to only 35pc. The lopsided economy led Hu Jintao, the President of China until 2012, to call the period of growth "unstable, unbalanced, uncoordinated and unsustainable." The hope was it would eventually kick start consumer spending.
Those hopes have been shattered by the bursting of the Chinese housing bubble that is having a devastating impact on consumer confidence. Chinese house prices in September have fallen for the fifth month in a row and wiped out all the gains of the past year, according to National Bureau of Statistics (NBS) data last week.
House prices across 70 major Chinese cities declined by 1.3pc in September from a year earlier. The housing correction is widespread with prices falling month-on-month in a record 69 out of 70 major cities, up from 68 in August, according to NBS data. This will have wide ranging effects on the Chinese economy as according to French bank Societe Generale: "the aggregate exposure of China's financial system to the property market is likely to be as much as 80pc of GDP."
The unravelling of the China housing bubble is a serious problem for the world economy. China is expected to be the largest constituent with almost $1 trillion of global GDP growth in 2015. Combined with the US the two countries are estimated to generate more than 90pc of growth. In stark contrast the next largest contributor is the UK with less than $200bn.

Undershooting global growth targets wouldn't usually be a problem but stock markets around the world are priced to perfection after more than five years of extraordinary monetary policy. Last week the S&P 500 rallied by more than 3.7pc to 1,957, and has now nearly erased October's sharp losses. According to the Shiller price earnings valuation for US markets they are 54pc overvalued.

The US markets cheered signs that the Federal Reserve and the European Central Bank could act in concert to pump more money into the system after the October selloff spooked investors. The Vix, the so-called "fear index" that measures market volatility, has fallen back to more normal levels in a sign investors believe everything is ok. The Vix spiked to two year highs in mid-October as growth fears gripped markets.

UK markets are likewise staging a tentative recovery. The FTSE 100 index of leading shares was up 1.3pc to 6,388 last week, still some way short of highs of 6,904 in early September.

While stock markets may have been lulled into a false sense of security by the soothing words from central bankers, investors should take a look out of the window at the brutal reality in the real world.

The number of UK companies issuing profit warnings in the third quarter has reached the highest total since the 2008 banking crisis, according to this mornings survey from accountants EY. Having spent the past five years pushing through price increases while wages remained static many companies have now hit a profit ceiling.

Consumer's disposable income is also reaching breaking point. In order to shift goods retailers are facing a deflationary spiral. Unilever last week reported European sales down 4.3pc, far worse than market consensus for a 1pc decline. Worryingly the group reported sales volumes down 1.7pc, and price deflation of 2.7pc during the third quarter.

It is not just those exposed to consumers that are experiencing a sharp slowdown. Engine maker Rolls-Royce, shocked investors with its second profit warning of the year, blaming the shaky economy and the effect of Russian trade sanctions for a revenue crunch this year and no earnings growth next year.

The profit warnings are no longer isolated to one-off weather events, or industries either, the slowdown is engrained in the real economy.

Bellwether corporates in the US such as MacDonald's, Coca-Cola and Ford have all reported dismal numbers. McDonald's was particularly eye opening, as last week the company said that U.S. same-store sales fell 4.1pc in

September, the worst monthly drop in more than a decade, and that profits plunged 30pc in its third quarter.

Historically the last week in October tends to be good for UK stocks, but investors shouldn’t use this as a buying opportunity. The clouds are gathering and the 2015 global growth story looks holed beneath the water line.