Trivium China Markets

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August macro picture: A false dawn?

August's econ numbers surprised to the upside. Growth in fixed-asset investment, industrial value-added output, and retail sales accelerated last month. Alongside this, China also saw an improvement in the urban unemployment rate.

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hq@triviumchina.com

Key takeaways

- However, this uptick has been met with a healthy dose of skepticism. One issue is that y/y growth in August was boosted by the low base from the previous year. The seasonally adjusted m/m pace of expansion was less impressive.
- There are also concerns about how long this recovery can be sustained in the face of zero-COVID and ongoing issues in the property sector. There are signs that more unfinished housing developments are now getting completed. However, any boost to real estate investment or construction activity is being undermined by developers still slashing spending on new projects.
- Zero-COVID and still-weak housing markets mean that the pick-up in economic growth in August relied heavily on spending by state-owned enterprises and infrastructure investment. The problem is that neither is happening on a large enough scale to drive a big enough economic recovery to restore household and business sentiment. To drive a faster pick-up in consumer spending and get private firms to stop retrenching requires a more forceful stimulus boost to growth.
- However, there is no sign of that as Beijing continues to be conservative with stimulus funds. The prospect of a scaled-up infrastructure stimulus is also undermined by local governments' mounting fiscal difficulties, which are forcing spending cutbacks.
- August's recovery, therefore, looks like something of a false dawn. Until there is a sign of change on the zero-COVID, property, or stimulus front, it is hard to see how economic momentum can build further from here.

August's econ numbers provided a rare moment of relief in what has become an increasingly concerning macro-outlook for China.

Fixed-asset investment (FAI) growth accelerated from 3.5% in July to 6.5% last month, the fastest since March. Value-added industrial output increased 4.2% y/y, up from 3.8% in July and also the biggest rate of expansion since March.

Consumer spending also improved in August. Retail sales rose 5.4% y/y, compared with 2.7% y/y growth in July – the fastest pace of growth since the first two months of the year. The unemployment rate continued to fall, dropping to a six-month low of 5.3% in August. Graduate unemployment remains high, but the proportion unemployed fell 1.2 percentage points last month to 18.7%.

This uptick, however, has been met with a healthy dose of skepticism. One issue is that y/y growth in August was boosted by the low base in August 2021, when China was combatting Delta outbreaks in many parts of the country. In m/m terms, the recovery has been less impressive. Industrial value-added output increased by just 0.32% m/m in August in seasonally adjusted terms, slower than the 0.38% rise in July [FIG 1]. Retail sales, in fact, dropped in August from the previous month. On a seasonally adjusted basis, spending dipped 0.05% m/m [FIG 2].

Fig. 1 – Industrial value-added output, seasonally adjusted

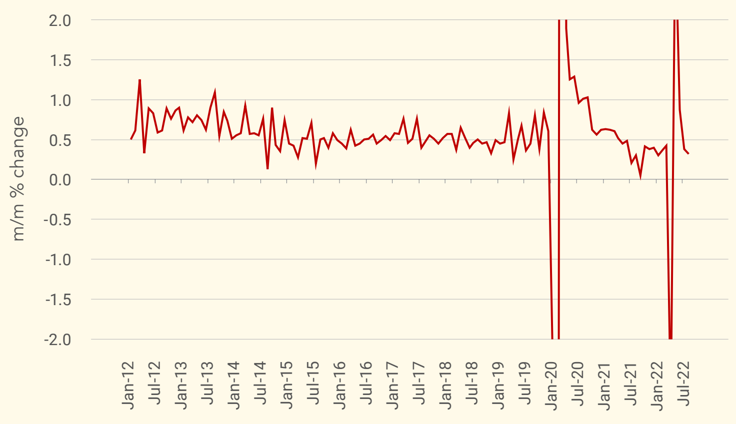
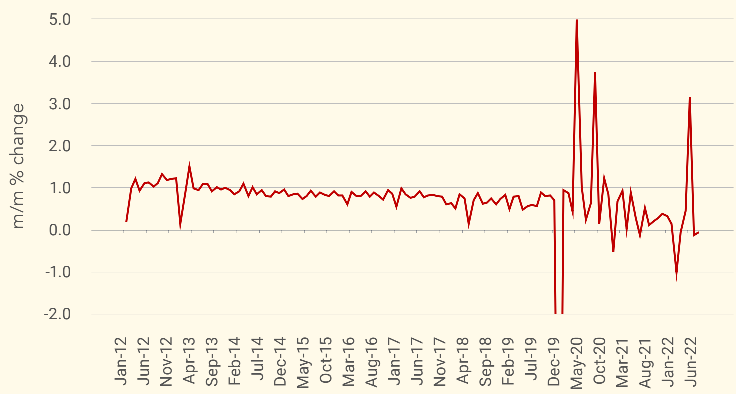


Fig. 2 – Retail sales, seasonally adjusted



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The main reason, however, for skepticism about the August rebound in economic activity, particularly how long it can be sustained, are the twin headwinds of zero-COVID and real estate policy tightening.

China's latest round of COVID-19 outbreaks may be coming to an end, but there is no sign of restrictions being dialed back as the country gears up for the 20th Party Congress in mid-October.

There are also no signs of change on the real estate front. Home sales dropped 20.9% y/y by value in August. This was a bit of an improvement from the 28.6% y/y contraction recorded in July, but still points to a worryingly weak level of housing demand despite multiple mortgage rate cuts.

One positive sign from the industry is that the government push to get developers to complete properties sold off-plan appears to have yielded some results. Floor space completed in the real estate sector contracted by 2.6% y/y in August, an improvement on the 23.3% y/y fall in the first seven months of the year, and the smallest pace of decline since last December.

There were also signs that the freeze on bank lending for developers may be thawing as financial institutions come under pressure to provide credit to unfinished housing developments. Developers' funding from domestic loans fell by 17.2% y/y in August, compared with a 36.8% y/y drop in the first seven months of 2022. This was the smallest fall in financing since July 2021.

The problem, however, is that developers continue to cut back on new projects, meaning getting more projects done has done little to boost overall real estate investment or construction activity. Despite the faster rate of completions last month, real estate investment dropped 13.8% y/y. This was a further step-down from the 12.1% y/y drop in July, which, besides February 2020, was the largest fall in spending on record. Real estate floor space under construction, meanwhile, fell 45.6% y/y in August – compared with a 45.2% y/y drop in July – due to a 45.2% y/y fall in the amount of floor space newly started – versus a 45.8% y/y fall the month before.

Stimulus push

These twin threats to growth of zero-COVID and a still weak property sector will make a continued acceleration in household and business spending difficult. Indeed, the August pick-up in FAI growth was driven by state-owned enterprises (SOEs) rather than private firms. Spending at private-sector companies dropped 0.5% y/y in August. That compared with the 13.5% y/y growth in FAI at SOEs – faster than the 11.8% y/y increase in spending in July [FIG 3].

This pick-up in FAI at SOEs reflects the increase in stimulus spending last month, and the extent to which August's better numbers relied on this artificial boost. Infrastructure FAI jumped 15.4% y/y in August, up from 11.5% y/y growth in July and the largest increase since March 2021 [FIG 4].

Fig. 3 – Fixed-asset investment

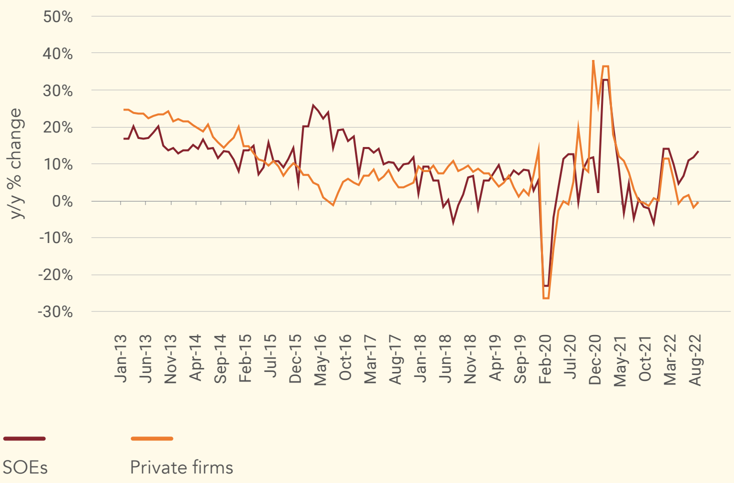
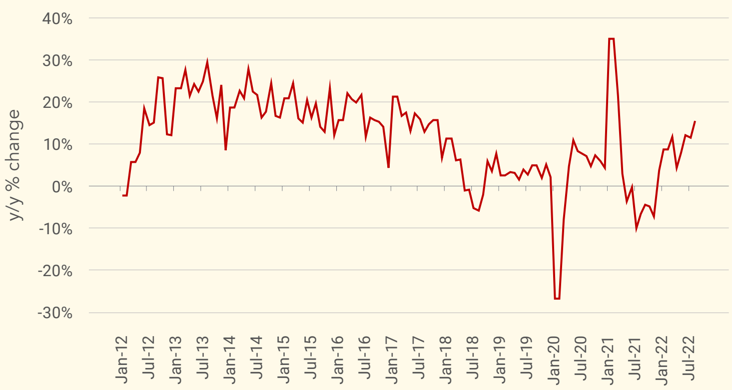


Fig. 4 – Infrastructure FAI

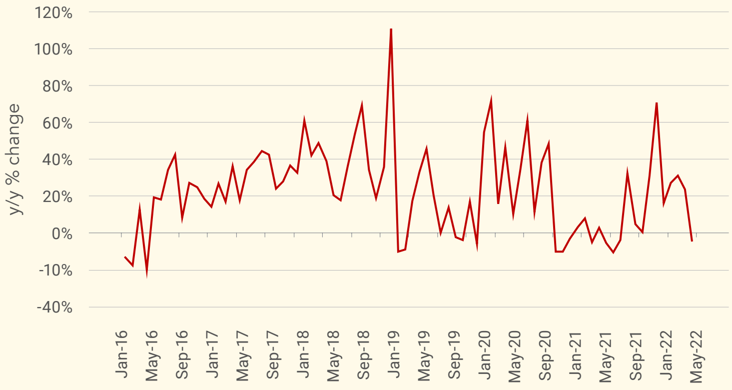


The problem, however, is that net of the headwinds to growth from zero-COVID and the real estate sector, this stimulus spending is not big enough to make a meaningful difference. August's pick-up in economic activity was not anything near large enough to restore household and business confidence.

Moreover, there is still little sign that officials are willing to meaningfully scale up infrastructure stimulus. Hopes that local governments would be allowed to use the RMB 1.5 trillion in special-purpose debt that remains untapped have been dashed, with officials permitted to utilize just RMB 500 billion of this.

Infrastructure spending for the remainder of the year will also be hampered by the mounting fiscal difficulties that local governments face. Fiscal expenditure in the government-managed funds budget – the main channel for government spending on infrastructure – fell 8.8% y/y in August [FIG 5]. This follows the 25.5% y/y collapse in fiscal revenue in this budget over the first eight months of the year, driven by the 28.5% y/y drop in land sales. The fiscal funding situation remained concerning last month, with revenue in the government-managed funds budget down 1.9% y/y and land sales dropping 5.4% y/y.

Fig. 5 – Fiscal expenditure in the government-managed funds budget



An additional problem is that the boost to economic activity from more infrastructure investment will be limited by the high inventories plaguing upstream heavy industry sectors (see [China's looming destocking cycle: Are investors ready?]). This situation is likely why steel and cement output was still muted in August, despite the acceleration in infrastructure spending. Cement output fell 13.1% y/y, compared with a 7.0% y/y drop in July. Steel production increased 0.5% y/y, versus a 6.4% y/y fall the previous month.

August's better econ read, therefore, looks like something of a false dawn. With zero-COVID and property tightening weighing on growth and large-scale stimulus still absent, it is hard to see how momentum can build further from here.