

China's econ recovery still not on a solid footing

Despite the usual paucity of econ data for the year's first two months, some distinct trends are emerging.

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Key takeaways

- While consumer activity has recovered, household demand for credit remains extremely weak. In contrast, borrowing in the corporate sector has hit record highs, despite still weak levels of economic activity in the real estate, infrastructure, and manufacturing sectors.
- The weak household lending numbers suggest that although spending has bounced back from the depressed levels seen during zero-COVID, consumer confidence is still fragile. Families are buying more but are not confident enough to increase purchases on credit.
- The disconnect between the better corporate credit numbers and the fact that the drivers of business capex remain weak could potentially signal an imminent recovery in the latter. That, however, seems unlikely given the still poor numbers for the real estate and manufacturing sectors. The more plausible explanation is that the recovery in corporate borrowing mainly reflects government-directed lending.
- Our concern, therefore, is that despite the more positive indicators in some areas, the bigger picture for the first two months of this year is that economic recovery is not yet on a solid footing. The rebound in consumer spending appears to largely be a function of the depressed levels of previous activity rather than households feeling more confident in their finances. At the same time, stronger corporate credit demand likely reflects government-directed rather than market-driven borrowing.

The econ numbers that are available so far for 2023 show something of a strange disconnect. Those parts of the economy that are performing the best are also those sectors with the weakest credit demand, while the areas that have not yet seen an improvement in activity are the ones that have taken out the most loans.

Take the retail and leisure sector, for example. Travel over the 40 days around the Lunar New Year holiday was up 51% over last year. During the seven-day holiday period, revenue from tourism and hospitality jumped by 130% y/y, while domestic tourism trips increased by 23.1% y/y. Box office receipts increased 12% y/y.

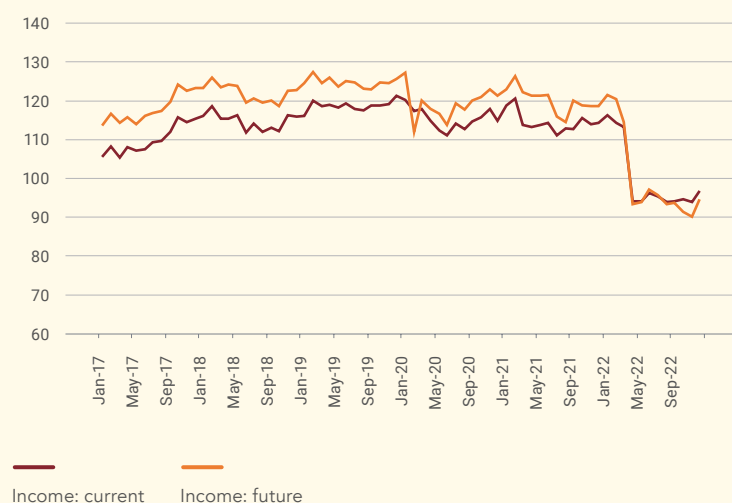
Set against this, however, is the continued weakness in household credit. Household borrowing from banks fell 69.5% y/y in January. Short-term consumer credit was down 66.1% y/y, while medium- and long-term loans dropped 69.9% y/y.

China's holiday schedule makes it difficult to draw firm conclusions from January's economic data. This year, China's weeklong Lunar New Year holiday was in January, whereas last year, it was in February. Consequently, there were five fewer workdays in the first month of 2023 than 2022.

Nonetheless, the size of the change in credit demand points to two things.

First, while households are spending more, they don't feel confident enough to increase purchases on credit. Households' nervousness about their economic prospects even as zero-COVID restrictions were lifted is also reflected in the December results of the stats bureau's (NBS) monthly consumer sentiment survey (the most recent data that is available) **[FIG 1]**. This shows that families were less positive about their future income than they were about current earnings.

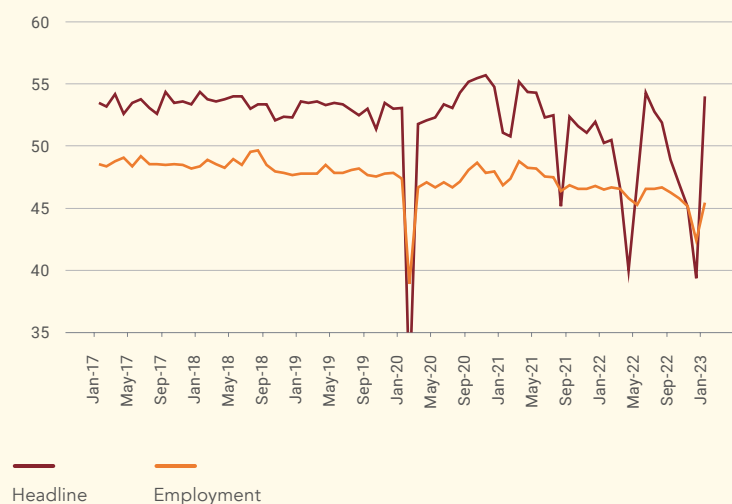
Fig. 1 – NBS Consumer Sentiment Survey



Source: NBS, Trivium

January's services PMI data suggests that households are right to be concerned. The employment subindex recovered by less than the headline index and remains relatively low in historical terms [FIG 2]. This suggests that these companies are still cautious about hiring despite stronger demand for their services.

Fig. 2 – Services PMI



Source: NBS, Trivium

The second trend emerging from the weak consumer lending data is that while households spent more on leisure during the holiday period, demand for big-ticket items, which require long-term financing, remains weak. This is also reflected in auto sales being down 38% y/y in January, while property sales at China's 100 largest developers dropped 32.5% y/y by value.

Weak demand for big-ticket items again points to low consumer confidence. While families are increasing spending on a sequential basis, this appears to mainly reflect the depressed level of consumption during zero-COVID rather than a fundamental improvement in household finances that can sustain this recovery going forward.

Indeed, although spending over the Lunar New Year holiday period increased y/y, it was still below 2019 levels. Revenue from tourism and hospitality was only 80.7% of pre-pandemic levels. Domestic tourism trips were 88.6% of 2019 levels.

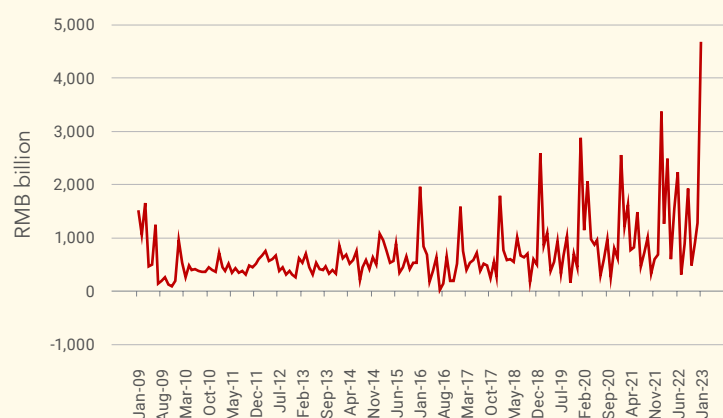
A further rebound in consumption depends on whether households spend down the "excess" savings they accumulated last year. In 2022, Chinese households increased their bank deposits by RMB 17.8 trillion, up 80% from the previous year. Much of those savings would typically have been invested in stocks or property, both of which performed poorly last year. Nonetheless, a significant amount was likely the result of deferred consumption. If households are concerned about their finances, they'll be less willing to spend their "excess" savings, bringing into question the sustainability of the rebound in consumption seen so far this year.

Corporate contradictions

While the household credit data suggests that investors should be cautious about the stronger econ numbers for the sector so far in 2023, the lending data for the corporate sector appears to signal the complete opposite.

Bank lending to the corporate sector jumped 39.3% y/y in January to reach a record high of RMB 4.68 trillion in January **[FIG 3]**, suggesting that firms feel more confident about their economic prospects. While the pick-up in bank lending partly reflects the fact that bond financing fell 74.5% y/y in January, the combined total of the two was still up 22.0% y/y last month.

Fig. 3 – Net new bank lending to the corporate sector



Source: PBoC, Trivium

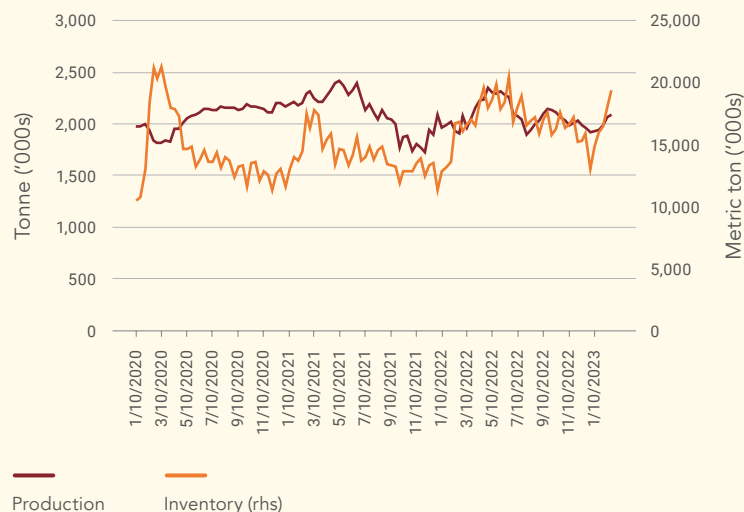
What is especially bullish about the corporate lending numbers is that companies cut back last month on “low-calorie” bill financing (see [Low-calorie loans: How bankers’ acceptances are undermining the impact of credit growth](#)), while increasing medium- and long-term loans. The former dropped 330.8% y/y in January, while the latter rose 66.7% y/y.

More medium- and long-term loans generally signal that firms intend to increase capex. This, however, conflicts with the econ numbers, which suggest that the usual drivers of fixed-asset investment are absent.

Such spending mainly falls into three buckets: Real estate, infrastructure, and manufacturing investment. However, data so far this year is pointing to moribund activity in all three areas. Home sales remain extremely weak. There is little sign of an increase in infrastructure construction: A rise in steel production has corresponded with a sharp increase in inventories, suggesting that demand for these products remains weak **[FIG 4]**. Meanwhile, exports to China from South Korea, one of the main sources of components for the Chinese manufacturing sector, dropped 31.4% y/y in January. Car production in China was down 33.9% y/y that month. The scale of the y/y drop in both was likely influenced by

the timing of the Lunar New Year holiday. Still, the January drop in South Korean exports builds on the 27% y/y fall seen in December, while the fall in auto production in January mirrors the drop in sales.

Fig. 4 – Steel production versus inventories



Source: CEIC, Trivium

This disconnect between the better corporate credit numbers and the fact that the drivers of business capex remain weak could point to an imminent recovery in the latter. Developers may be expecting a recovery in home sales, and manufacturers may be expecting better demand for their products, while infrastructure projects could be intending to ramp up investment. While the latter is possible, a more positive outlook for property and manufacturing seems unfounded, given the weak data from these sectors.

A more plausible explanation is that the recovery in corporate borrowing mainly reflects government-directed lending. In particular, banks have been under pressure to ramp up lending to real estate firms to enable healthier developers to buy up the assets of their struggling peers. Banks have also been incentivized to increase credit to manufacturers through various relending programs, whereby cheap central bank funds are given to financial institutions that lend to certain areas. These programs include financing for equipment purchases and technological upgrades.

The concern, therefore, is that despite the more positive indicators in some regards, the bigger picture for the first two months of this year is that the economic recovery is not yet on a solid footing. The rebound in consumer spending appears to largely be a function of the depressed level of activity previously. At the same time, stronger corporate credit demand was likely driven by companies tapping into government programs to boost lending to targeted sectors or firms being directed to borrow more for policy reasons.

While China's economic situation is undoubtedly improving, until we see solid evidence that household and business confidence has recovered, questions over the sustainability of this post-COVID rebound will remain.