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Trivium China

## Markets Note

# Promising green shoots in August, but the private sector still lags

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## Key takeaways:

- China's August econ numbers showed some promising green shoots of recovery, which is particularly welcome after months of deteriorating momentum.
- Indeed, this print very well could be an early sign of a bottoming in activity, with better days ahead in 2024 – but to achieve such an outcome, officials still have work to do to broaden momentum beyond the state sector, to private businesses.
- Last month's recovery rested heavily on state-owned firms increasing capex and industrial SOEs raising output – trends that were underpinned by still elevated levels of infrastructure spending in China.
- In contrast, activity at private firms remained weak in August. This reflects the still low levels of growth in the consumer-focused parts of the economy that private companies are more exposed to. While retail sales growth accelerated last month, this was driven by service sector spending rather than purchases of consumer goods, which typically generates more of an uplift to business activity.
- Unsurprisingly, the state-led increase in economic activity has done little to bolster private sector confidence. Despite the stronger headline econ numbers in August, there was plenty of evidence that households and businesses in China still lack sufficient confidence in the country's economic prospects to increase spending – for example, the still high levels of time deposits at banks (i.e. high savings rates).
- To address this ongoing private sector confidence deficit, officials either need to aggressively scale up state spending such that it generates a large enough recovery to restore confidence across the economy, or they need to focus government policy on trying to boost activity in those parts of the economy that the private sector is more exposed to, such as real estate.
- There are signs that Beijing is now pivoting to the latter approach, but the measures being implemented are still relatively conservative. Officials want to balance their desire to lift private sector confidence, by stabilizing activity in the property sector, with the need to keep a lid on real estate risks. Whether there is a way of achieving both these goals is the key question.
- If officials can manage to offer enough support to start to turn the tide of private sector confidence, the economy could finally be past the worst.

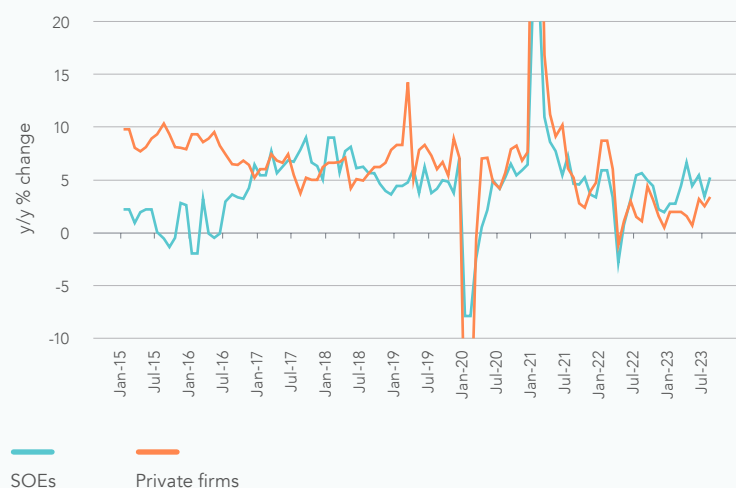
The August econ numbers showed some promising green shoots of recovery, which is particularly welcome after months of deteriorating momentum.

This print could be an early sign of a bottoming in activity, with better days ahead in 2024 – but to achieve such an outcome, officials must broaden momentum beyond the state sector, to private businesses.

The pick-up in economic activity last month rested heavily on state-owned firms increasing capex and industrial SOEs raising output. Fixed asset investment (FAI) at SOEs rose 6.1% y/y in August, up from 4.9% y/y growth in July. In contrast, investment spending at private firms fell 2.2% y/y last month, compared with a 2.3% y/y fall in July.

Industrial value-added output showed a similarly divergent trend, growing 5.2% y/y and 3.4% y/y for SOEs and private firms respectively, compared to growth of 3.4% y/y and 2.5% y/y in July [FIG 1].

**Fig. 1 – Industrial value-added output**



Source: NBS, Trivium

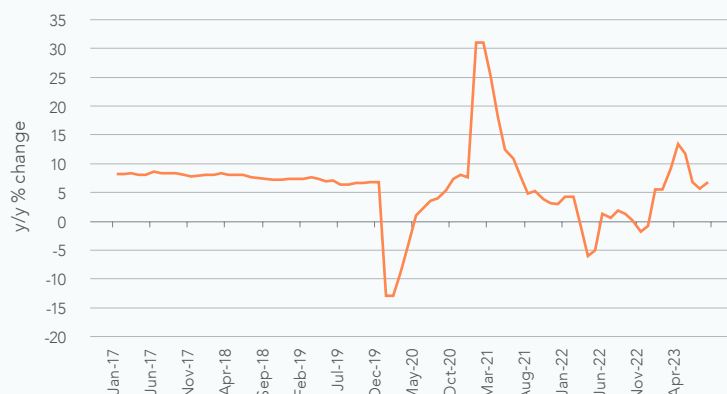
This discrepancy between private firms and SOEs reflects the current drivers of economic activity in China. Infrastructure investment continues to outpace total FAI, with the former rising 6.2% y/y in August compared with 1.8% y/y growth in the latter. This benefits firms that operate in the heavy industry sector – typically state-owned – located upstream to infrastructure construction. Value-added output at steel producers, for example, jumped 14.5% y/y in August.

Private firms that are more exposed to the consumer-facing parts of the economy and the export sector are faring less well. Industrial firms reported a 2.6% y/y drop in renminbi sales revenue from exports in August.

Additionally, while retail sales posted stronger growth in August, increasing 4.6% y/y compared with 2.5% y/y growth the previous month, this mainly rests on stronger activity in the domestic services sector. Catering sales jumped 12.4% y/y in August, while the stats

bureau's service production index – which measures growth in the sector in real terms – also shows strong levels of spending in this part of the economy [FIG 2].

**Fig. 2 – NBS Service Production Index**



Sources: NBS, Trivium

Shorter supply chains in the service sector mean that an increase in activity tends to generate less of an uplift to business activity than a recovery in demand for manufactured goods. Sales of consumer goods increased only 3.7% y/y in August, up from 1.0% y/y growth in July, but still considerably below the pace of expansion before the pandemic. Retail sales of consumer goods increased 7.9% y/y in 2019.

## Circular problem

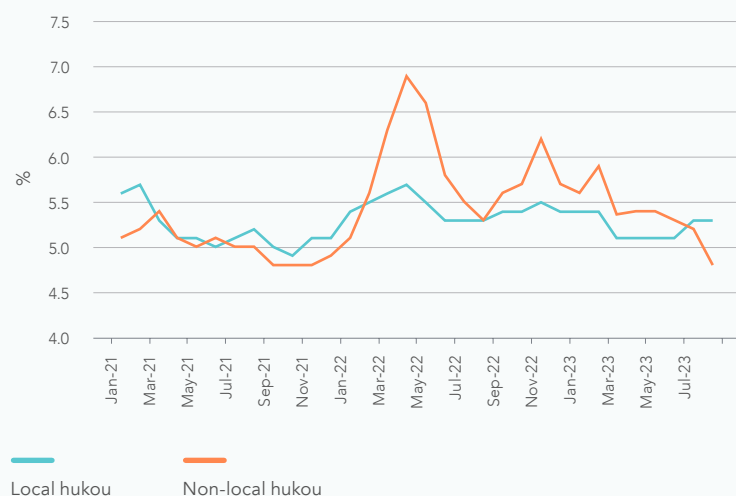
This is a circular problem. State owned firms are more exposed than their private peers to the economic benefits generated by increases in government spending. The more that growth is driven by such investment, the harder it is to reverse private sector retrenchment. But this means that the government needs to continue spending to keep the economy on an even keel, compounding the challenges for private entities.

Despite the stronger headline econ numbers in August, there is plenty of evidence that households and businesses in China still lack sufficient confidence in the country's economic prospects to increase spending. Growth in demand deposits, for example, is now slowing sharply, even as the rate of expansion in time deposits remains extremely high, suggesting that households and firms are choosing to lock away cash rather than have it readily available [FIG 3].

There are also signs in the employment data that companies are still nervous about China's economic prospects. While the overall unemployment rate edged down slightly last month from 5.3% to 5.2%, the still high unemployment rate for local hukou holders likely reflects students that have returned home to their parents because they are struggling to find employment in the cities where they studied [FIG 4]. This suggests that firms are still wary about hiring younger, less experienced workers (China hasn't published data for graduate unemployment since July).

**Fig. 3 – Time versus demand deposits**

Source: PBOC, Trivium

**Fig. 4 – Urban unemployment rate**

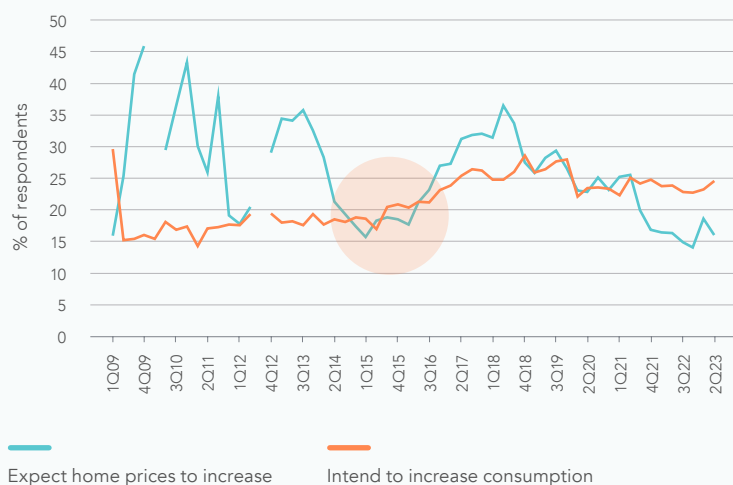
Source: NBS, Trivium

To address this ongoing private sector confidence deficit, authorities either need to pull harder on the lever of state stimulus and engage in a large enough increase in spending to restore confidence across the economy, or they need to focus supportive measures on those parts of the economy that the private sector is more exposed to.

Real estate is the obvious candidate here. This was the strategy deployed in 2015, when the primary stimulus focus as the economy slowed was on loosening real estate policy in order to restore private sector confidence. This approach worked back then. The central bank's quarterly survey of households showed that their inclination

to consume recovered after they became more positive about the prospect of home price increases [FIG 5].

**Fig. 5 – PBOC household survey: proportion of respondents that expect home prices to increase and that intend to increase consumption**



Source: PBOC, Trivium

## A conservative pivot

There are signs that officials are now pivoting to such an approach. Minimum downpayment ratios have been reduced for both first- and second-time buyers. Households wanting to upgrade to a bigger home are now able to access preferential mortgage rates and downpayment ratios that were previously only available to first-time buyers. Local home purchase restrictions that dictate who can buy property are also being lifted in some cities.

This is a more conservative approach than was deployed in 2015-2016, however. For example, by August 2023, the weighted average interest rate throughout the economy had fallen 151bp from its end-2021 high of 5.63%, according to the central bank. That compares with a total reduction of 244bp between 2014 and 2016 from 6.96% to 4.52%.

This more cautious approach reflects the different aims that the government has this time around. Having exerted considerable effort to bring down home prices, Beijing does want to reflate the sector like in 2016 – home prices were up 10.8% y/y by the end of that year. The aim now is to instead draw a line in the sand for home prices (which were down 0.29% m/m in August) so households can be confident that the value of their properties will not decline any further, and thus stop weighing on their inclination to spend.

More broadly, officials want to reduce the risk that falling property sales revenue may trigger a financial crisis as developers struggle to service their debt. Funding at real estate developers plunged 25.4% y/y in August, having already dropped 21.9% y/y in August 2022. Again, however, the goal here is to stimulate an increase in home sales in

order to reduce developers' financing stresses and prevent contagion to the broader financial system, rather than to increase activity in the real estate sector overall – and especially by a large enough margin to drive a full-blooded economic recovery.

While the recent set of loosening measures should help to stem the bleeding in the real estate sector, the question is also whether these moves will be enough to lift private sector confidence and broaden out the current economic recovery.

For now, we are beginning to turn cautiously optimistic that China's economy has bottomed – making the monthly data prints throughout the fall critical to understanding any potential path toward ongoing recovery.

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