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Trivium China

Markets Note

Q1 economic performance: A mixed bag

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Executive Summary

→ China's Q1 economic performance was more of a mixed bag than some bullish headlines suggest.

→ Retail sales recorded a strong bounce-back, particularly in March. However, household income growth remains weak. Employment levels are also high, leading households to save a large share of their earnings. That suggests that the recovery in consumption has fragile foundations.

→ Business confidence also appears fragile. Fixed-asset investment (FAI) fell m/m in seasonally adjusted terms in March for the first time outside of zero-COVID. Weak wage growth also suggests that firms are not confident about economic prospects.

→ Real estate was more of a bright spot, but there needs to be a pick-up in property construction for the recovery in home sales to boost broader economic activity. The number of new projects started by developers continued to fall in March, however, and real estate investment remained weak.

→ Still-weak property construction may explain why industrial activity remains moribund despite high levels of infrastructure investment. Sluggish industrial sector activity also raises doubts about how genuine the recovery in exports reported for March is.

→ China's economic recovery is not the open-and-shut case that some are arguing. Pockets of strength sit alongside areas where activity remains weak. Officials will likely wait and see how the next few months play out before making policy adjustments. But it is still too early for them to completely take their foot off the pedal.

The first quarter GDP data and econ numbers for March were a mix of pockets of strength and areas of weakness.

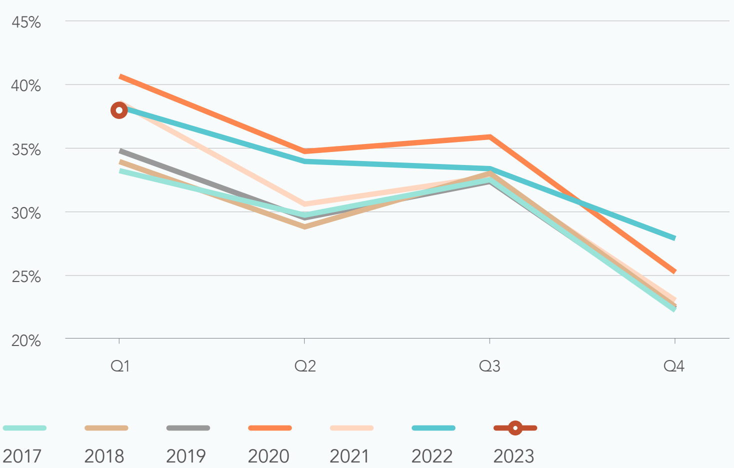
The primary source of economic strength was consumption. Retail sales jumped 10.6% y/y in March, up considerably from 3.5% y/y growth in the first two months of 2023 and higher than the 8.1% y/y growth recorded pre-pandemic in 2019. Significantly, unlike in the first two months of 2023, when the pick-up was mainly focused on the leisure sector, the recovery was spread right across the consumer space. Catering and accommodation sales increased 26.3% y/y in March, building on 9.2% y/y growth in January-February. Sales of consumer goods also recorded stronger growth, rising 9.1% y/y, having only increased 2.9% y/y in January-February.

While the March numbers point to a strong rebound in consumer spending, other data raises doubts about how sustainable this pace of growth is. Urban household income increased by only 2.7% y/y in real terms in Q1. For the full year of 2022, urban household income grew by only 1.9% y/y. By contrast, in pre-pandemic 2019, it grew by 5.0% y/y.

Another concerning data point is urban unemployment, which remained high in March at 5.3%. While this was down from 5.5% and 5.6% in January and February, respectively, it was similar to the 5.4% average rate during the pandemic, suggesting that reopening has had only a marginal impact on job creation. Concerningly, graduate unemployment increased in March, rising from 18.1% in February to 19.6%. This was the highest rate of graduate joblessness since July and the largest March reading since at least 2018 when records began.

High unemployment and moribund household income growth meant that households continued to save a large share of their earnings. The household savings rate was 38% in Q1, compared with an average 39% proportion in the first quarter of 2020-2022 and the 34% pre-pandemic average between 2017-2019 [FIG 1]. Household deposit growth also continued to accelerate from levels that were already historically high. By the end of March, the outstanding value of deposits was up 18.0% y/y versus 17.4% y/y at the end of 2022.

Fig. 1 – Household savings rate



Sources: PBOC, Trivium

Lingering uncertainty

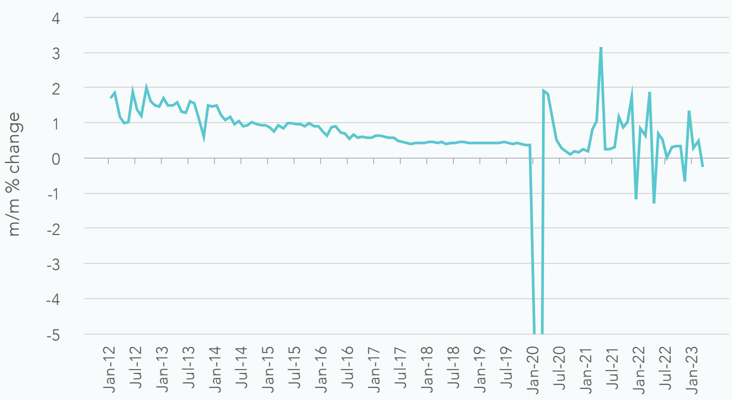
The strong consumer spending data, therefore, sits oddly with the signs of continued financial pressure on households and lingering uncertainty about their economic prospects.

This concern about economic prospects was also evident in the corporate sector. Respondents to the central bank's Q1 survey of industrial firms rated general business conditions in the first quarter as little improved from the pandemic [FIG 2]. This sentiment is also reflected in the still-weak rates of fixed-asset investment (FAI) in March. Investment increased 4.7% y/y last month, down from 5.5% y/y growth in January-February. More concerning was that seasonally adjusted spending dropped 0.25% m/m in March – the first time outside of zero-COVID that this reading has dipped below zero [FIG 3].

Fig. 2 – Industrial firms' general business conditions sentiment index

Sources: PBOC, Trivium

Fig. 3 – Seasonally adjusted fixed-asset investment



Sources: NBS, Trivium

The drivers of FAI growth also point to a worrying trend. Growth in capex has rested almost entirely with state-owned enterprises (SOEs), where FAI rose 9.6% y/y in March. Spending at private firms, in contrast, increased just 0.4% y/y last month.

The fact that household income growth is still depressed also reflects weak corporate confidence. The wage component of this data shows that earnings growth increased just 5.0% y/y in nominal terms in 1Q23 vs 4.2% y/y in 4Q22 and a 6.2% y/y average growth rate during the pandemic. Wage growth for migrant workers is also poor, increasing just 1.5% y/y in nominal terms in the first three months of 2023.

Fragile foundations

The consumption-driven pick-up in GDP growth in the first quarter, therefore, lies on fragile foundations.

We have similar concerns about the other areas of strength seen in the econ numbers.

Real estate was another bright spot. The value of new home sales in March was 11.1% higher than a year ago – the fastest pace of growth since May 2021. Home prices increased 0.44% m/m in March, according to the NBS – also the fastest since May 2021.

However, the worry is that this pick-up is not translating into construction activity, which is the primary way a real estate recovery would boost broader economic growth. New construction starts in the real estate sector fell 29.1% y/y in March. The floor space under construction also dropped, falling 34.1% y/y in March.

Developers do not appear confident enough about the sector's prospects to increase new projects. This lack of confidence is also reflected in the continued weakness in property investment. Real estate investment worsened from a 5.7% y/y contraction in the first two months of 2023 to a 5.9% y/y fall in March. This fall came despite developers having plenty of funding: Financing for real estate development jumped 3.0% y/y in March, the most since June 2021.

As well as concern about how long the sales recovery will last, another restraint on developers starting new projects is the pressure they are under to complete existing ones, especially housing that has been sold off-plan but has not yet been finished. It appears that developers are consequently funneling increased sales revenue into completions, with the floor space of properties completed jumping 32.0% y/y in March, the biggest increase since June 2021.

Weak property construction may explain why industrial activity remains sluggish despite high levels of infrastructure investment. The latter increased 9.9% y/y and 10.8% y/y in Q1. Industrial value-added output growth was up only 3.9% y/y in March and 3.0% y/y for the quarter.

The poor reading for industrial activity also raises doubts about how genuine the 14.8% y/y jump in exports reported for March is. Rather than reflecting an improvement in overseas demand, it seems more likely that this represents exporters playing catch-up and fulfilling orders disrupted due to COVID at the end of last year.

China's economic recovery is not the open-and-shut case that some are arguing. Pockets of strength sit alongside areas where activity remains weak. The outlook for consumer spending is concerning given still-weak household income growth, and for the real estate recovery to boost overall growth, there needs to be a pick-up in construction. Infrastructure stimulus is not large enough to make up for this still-weak level of property construction.

Officials will likely wait and see how the next few months play out before making any policy adjustments. But it is still too early for them to completely take their foot off the pedal.

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