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Crashing cars: how deleveraging has hit China's automotive sector

NAB Group Economics

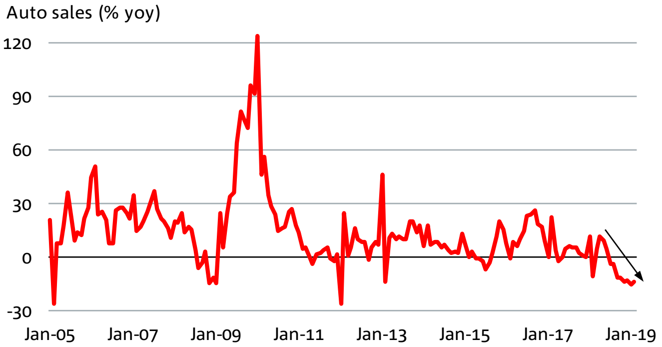
Falling Chinese auto sales have attracted a lot of attention since the second half of 2018. The broader industry has grown enormously over the past two decades, with China the world's largest automotive manufacturer (at almost 30% of global output in 2018) and largest market for new sales. The sector is seen by some observers as a barometer for the overall health of the Chinese economy, but rather than a symptom of the country's industrial woes, the falling sales figures are in part an unintended consequence of the deleveraging campaign.

PUSHING THE BRAKES ON AUTO SALES

Until the second half of 2018, China's auto sales increased at an impressive pace. Data from the China Association of Auto Manufacturers shows that the volume of auto sales increased at an annual average rate of 16.7% between 2000 and 2017, compared with real economic growth of 9.3% a year over the same period. However, auto sales fell in 2018 – down by around 3.1% for the full year, having recorded an increase of around 5.6% yoy in the first half.

GROWTH IN CHINA'S AUTO SALES

Sales have slumped since H2 2018

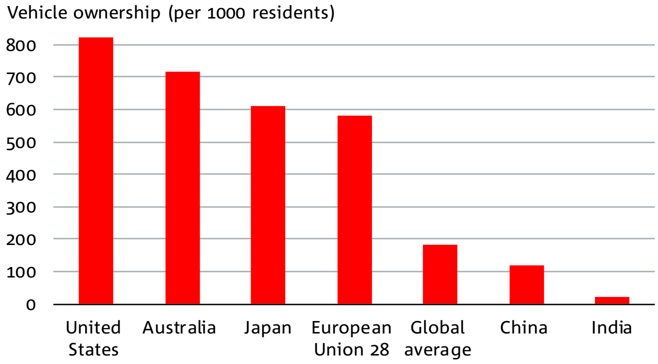


Source: CEIC, NAB Economics

In part, the earlier rapid growth was possible because China was coming off such a low base in terms of auto ownership. According to the International Organization of Motor Vehicle Manufacturers (OICA), China had around 118 vehicles per 1000 residents in 2015, compared with a global average of 182 vehicles and 821 vehicles in the United States. Subsequent years have seen the total for China rise to 166 vehicles per 1000 residents in 2018 – still below the 2015 global average.

VEHICLE OWNERSHIP RATES

China lags the global average



Sources: OICA, NAB Economics

The sheer scale of China's population – almost 1.4 billion in 2018 – and high population density of many major cities means that reaching advanced economy ownership rates appears unlikely. That said, its still low ownership rates provide opportunity for longer term growth in auto sales.

The historically low rate of ownership has limited the supply of vehicles to the used market, but this market has been building. The China Automobile Dealers Association reported used sales of 13.8 million in 2018, an increase of around 11.5%. The online market for used car sales is growing much more rapidly – with 3.2 million vehicles sold in 2018 (just under a quarter of the total), almost double the level in 2017.

Falling sales have impacted auto dealers – with Bernstein Research estimating inventories in excess of 1 million vehicles in early 2019 – and manufacturers, with vehicle output falling by 4.5% in 2018 and a further 14% yoy in the first two months of 2019. This has a flow through effect for producers of

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automotive components and raw materials – such as steel and aluminium.

POLICY CHANGES CRIMPING SALES – LEAD BY CREDIT

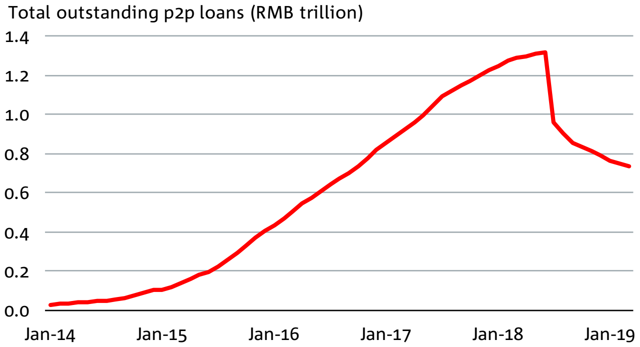
In 2018, China's new credit issuance – comprising bank loans, corporate bonds and some parts of shadow banking – declined in year-on-year terms, as tighter regulation constrained the broad market. In part, the deleveraging campaign was designed to address China's high corporate debt levels. However, such a blunt approach can have unintended consequences, as other non-targeted areas are impacted.

One such area is the automotive sector. In recent years, auto sales have been increasingly connected to credit, as younger, more financially savvy purchasers have entered the market. In 2014, estimates suggested that around 85% of all auto purchases were paid for in cash (Reuters), but by 2018, GM Financial estimated that around 40% of Chinese purchases were made using credit. This suggests that more restrictive credit environment would be a negative for auto sales.

While more comfortable with making credit-based purchases, younger Chinese residents often lack sufficient credit ratings or asset security to access traditional bank lending. This has meant that many have been forced to use shadow bank lenders instead – including previously lightly regulated peer-to-peer (p2p) platforms.

P2P LENDING HAS SLUMPED

Lending has dropped since mid-2018



Source: CEIC, NAB Economics

According to Bernstein, p2p auto loans totalled RMB 264 billion in 2017. This represented around 10% of total vehicle purchases, or roughly a quarter of total auto lending (if the GM Financial estimate is correct). However, p2p lending was one of the sectors targeted by Chinese authorities during the deleveraging program. The sector is comparatively risky – with a number of instances of fraudulent practices and platform failures worrying Chinese authorities. The outstanding balance of p2p loans fell from a peak of RMB 1.3 trillion in June 2018 to RMB 733 billion in March 2019. The Bernstein research suggests that p2p auto loans fell by 18% yoy in the first half of 2018.

More broadly, tighter policy and supervision of bank lending appears to have impacted pricing on Chinese auto lending. The average Wenzhou private lending rate for auto loans has increased considerably since late 2016 – climbing from around 11.2% in November 2016 to 14.8% in February 2019. Similarly, anecdotal evidence suggests that China's banks have been less willing to lend for auto purchases in recent times.

To a lesser extent, tax policy has also impacted the affordability of auto purchases for consumers. In late 2015 – a time where China's economy was likely underperforming – authorities halved the sales tax on small vehicle purchases (engines sized under 1.6 litres), which accounted for around 70% of total sales. This temporary tax cut expired at the end of 2016, returning the tax rate to 10% last year. A similar tax cut was mooted in October 2018, but this was dismissed by the National Development and Reform Commission (NDRC) in November. Given the relatively small scale of any tax change, it is unlikely that this would be sufficient to reverse weak sales trends in an environment of constrained debt financing.

CONCLUSIONS

Although the deleveraging campaign appears to have had a major impact on the slowdown in auto sales, it appears that Chinese authorities are not keen for this trend to continue. Overall, auto sales account for almost 30% of goods retailing and a sizeable share of manufacturing (the broader transport sector was around 10% of the sector in 2017) – meaning that a sustained downturn in the auto industry would be a negative for China's economy.

Reflecting its importance, some measures are expected this year to boost consumer demand for motor vehicles. In late January, the NDRC announced that it would loosen restrictions on the second-hand market, while "appropriate" subsidies will be introduced to boost auto sales in rural areas and new energy vehicles across the country. The full details of these policies remain unclear, meaning that it is not certain that these will be sufficient to support sales without some easing in financial conditions.

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