AUSTRALIAN CONSTRUCTION INSIGHTS
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Construction Brief

11 September 2017

China's Debts Cast a Shadow

Update: The International Monetary Fund (IMF) has warned that China's current credit trajectory risks a disruptive adjustment involving a marked growth slowdown.

Insight: In a working paper, Resolving China's Corporate Debt, the IMF explains the challenges that lie ahead for the Chinese economy. Economic history shows that the pathway towards becoming a developed economy is usually potholed with sharp corrections. This paper warns of similar challenges for China.

Chinese debt rose to 256 per cent of GDP in 2016 and is forecast to reach 290 per cent of GDP by 2022. This in itself is not unique to China or a problem in itself as debt is a major indicator of future growth. Challenges arise when the debt is relatively unproductive and does not lead to increased growth.

Credit productivity is a measure of the amount of credit required to achieve an increase in nominal GDP. In China's case this has deteriorated since 2007/08 when $6.50 in new credit would raise nominal GDP by around $5 per year. In 2015-16, the credit efficiency has fallen so that it now requires $20 to achieve the same effect.

The IMF argues that the cause of the decline in credit efficiency is that most credit has been taken on by inefficient state owned enterprises (SOEs). This is the distinguishing feature of the Chinese debt situation compared with other countries, especially the US and Australia which also have high debt rates.

To China's credit they are managing this problem and there are countervailing factors. These mitigating factors include high savings, a current account surplus, a small external debt, and various buffers. A current account surplus and small external debt reduces the possibility external funding difficulties. A low bank-to-deposit ratio could help prevent a domestic funding crisis as well.

Despite the rising debt situation, in China corporate balance sheets have also benefitted from asset values that have increased more than liabilities. The People's Bank of China can provide liquidity if required. The IMF maintains that these factors may only postpone the short-term risks and will not alleviate the eventual adjustment.

Correcting the unproductive debt situation requires China to grow fast, but this will in turn lead to higher loans by Chinese SOE's, reducing the debt efficiency even further. Other remedial considerations include stopping the flow of capital out of China, increasing the productivity in the economy and most importantly putting ceilings on the loans used by Chinese SOE's. All these solutions will take time to implement.

Home Renovations Boost GDP Growth

***Update:* Solid growth in home renovations activity contributed to a pick up in the pace of economic growth during the June 2017 quarter.**

Insight: Real GDP rose by a solid 0.8 per cent in Q2 after a modest 0.3 per cent lift in Q1. The result was consistent with expectations. The data indicate that output in the Australian economy picked up over Q2 in line with the improvement in the labour market. The annual growth rate is a below trend at 1.8 per cent. But that rate should lift substantially next quarter when the 0.4 per cent fall in Q3 2016 GDP drops out of the annual calculations.

This positive growth was shaped by a strong pick up in housing renovations and public expenditure with a strong rise in both public consumption and investment. Household consumption and business investment both posted moderate rises. Wage and inflation growth rates remain weak. It is widely expected that improving labour market conditions will lead to wages growth as well as a reduced unemployment rate in the near future.

The data also show that house renovations activity grew by 2.2 per cent during the June 2017 quarter, eclipsing the contraction of 0.8 per cent in new dwelling construction over the same period. The contraction in new dwelling construction is from the record highs achieved in 2016 and a large backlog of work is still to be completed. HIA expects this decline in new dwelling construction to continue for a number of years.

Overview of economic indicators

Update: The Australian economy appears to be recovering from a 'mini-slowdown'.

Insights: A quick overview of last week's data shows that the Australian economy appears to be accelerating away from a slow patch at the end of 2016 and early 2017. In summary:

- Corporate earnings are up a by whopping 16.8 per cent in annual terms. Mining companies have contributed substantially to the rise in company profits. Commodity prices have firmed so far in Q3 which means that nominal GDP growth and company profits will stay buoyant in the near term.
- A pick-up in business investment for the first time in many years is an indication that this trend will continue in the third quarter this year.
- The HIA's and AI Groups Performance of Construction index also reports very positive market conditions.

- The latest Australian Government monthly financial statements puts 2016/17 revenue $6.3bn ahead of the Revised Budget profile.
- Consumer spending grew by 0.7 per cent over the June quarter after a particularly weak Q1.

There was also positive news for the building industry, with last week's data showing that there is upside to the slowdown in building activity. The Housing Finance data showed us that First Home Buyers are returning to the market in droves.

- New FHB incentives in NSW and VIC helped achieve an 18.8 per cent increase in the number of FHBs loans.
- Investor financing is also holding up well against other Government policy initiatives intended to cramp investor lending. HIA reported a 3.9 per cent fall in investor lending in July 2017 (as a result of changes to Stamp Duty and regulatory restrictions in Australia and China) but this levels the level of investor lending almost identical to where it was in July 2016.

Proportion of First Home Buyers – Australia

The fortnight ahead – key dates and releases

Monday 11 September

ABS Lending Finance, 11.30am

Thursday 14 September

ABS Labour Force 11.30am

Tuesday 19 September

ABS Residential Property Price Index 11.30am

Wednesday 20 September

HIA-CoreLogic Construction Outlook Breakfast, Melbourne

HIA-COLORBOND® steel Housing 100 2016/17 10am

Thursday 21 September

HIA-CoreLogic Construction Outlook Breakfast, Sydney

HIA-CoreLogic Construction 100 2016/17 10am

Friday 22 September

HIA-CoreLogic Construction Outlook Breakfast, Brisbane.

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