Managing the Dragon Blog Post

2018: A Tough Year For China Autos

By: Jack Perkowski | September 5, 2018

2018 is shaping up to be a tough year for China autos. While total vehicle sales increased by 5.6 percent to 14.1 million units for the first six months of the year, the rate of growth has slowed dramatically in recent months. As a result, year to date growth through July dropped to 4.3 percent, and the prospects for the balance of the year are not promising. Overall auto demand is especially weak in China's lower tier cities.

As a major capital item, auto sales are a good barometer for economic health, and weak auto sales this year indicate that all is not well with the Chinese economy. While the Chinese government's efforts to reduce corporate debt are having their intended effect, they have also resulted in higher interest rates, tighter credit and a slowing economy, all of which are hurting auto sales. Mortgage loan rates spiked to an average of 5.64 percent in June, up 0.75 point on the year, and there is evidence that some banks have pulled back from offering auto financing. During the second quarter, China's GDP growth slowed to 6.7 percent from 6.8 percent in the previous quarter.

A worsening economic picture, plus the overhang of the trade dispute with the United States, has taken its toll on China's stock market and its currency, reducing consumer confidence and purchasing power in the process. The Shanghai Composite Stock Exchange index is off over 13 percent, and the renminbi has weakened by almost 8 percent, since the end of March when President Donald Trump first announced that the United States would impose tariffs on goods exported by China to the United States.

As 2018 demonstrates, a weakening economic picture and sluggish stock market are not good for auto sales in general. This year, however, there are additional factors at work that are making the market even more difficult. One of these is the collapse of P2P, or peer-to-peer, online lending, which has played a major role in financing auto purchases in recent years.

P2P lending is a method of debt financing that directly connects borrowers, whether they are individuals or companies, with lenders. The world's first online lending platform was founded in the United Kingdom in 2005, and China's online lending industry has seen rapid growth since 2007 when the country's first online lending platform was introduced. P2P platforms have become popular with investors because the underlying loans made by P2P lenders typically mature within a year and have 8 to 12 percent interest rates, much higher than the 2.75 percent rate that investors can receive from three-year fixed bank deposits. China's P2P platforms have about 50 million registered users and 1.3 trillion yuan ($190 billion) of outstanding loans.

China's P2P loan industry has been a major casualty of tighter credit and increased regulation. Alarmed by reports of defaults, sudden closures and frozen funds, investors in P2P lending platforms have rushed to pull money from peer-to-peer lending platforms in 2018. In many cases, investors have demanded early repayment, causing many platforms to collapse. At least 80 platforms closed in June, the largest monthly total in two years.

In recent years, many of the P2P loans have gone to finance auto purchases. In a recent report, Bernstein, a well-regarded securities research firm that covers China's auto industry, said that P2P auto loan transaction volume reached RMB 264 billion ($38.6 billion) in 2017, financing the purchase of approximately 2.2 million cars, or 10 percent of the vehicles purchased. During the first half of 2018, however, P2P auto loans fell by 18 percent. According to Bernstein, the customer base for PP auto loans contains large numbers of young adults early in their careers, with limited wealth and credit histories. Because many of these young borrowers live in China's lower tier cities, the collapse of the

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P2P lending sector may explain much of the weakness in auto sales in these cities.

Unless the government's economic policies change; the trade war with the United States is resolved one way or the other; and the Chinese economy stabilizes, the balance of 2018 will likely continue to be difficult for auto sales. Because the auto industry contributes such a large percentage of China's GDP, there is some hope that the government will reverse its policies and begin to stimulate the economy in order to boost sales. Only time will tell.

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