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Topics The debt situation and competitiveness of large Chinese companies

In China's general-purpose, production, and commercial machinery manufacturing industry, as well as in its automotive sector, which is centered on electric vehicles (EVs), the debt situation of large enterprises has improved. These Chinese companies are enhancing their competitiveness and significantly increasing their value added.

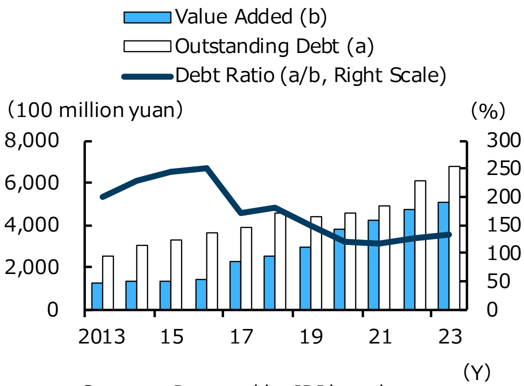
■ The debt situation in the general-purpose, production, and commercial machinery industry has improved

Overall, Chinese companies remain saddled with excessive debt. According to the Bank for International Settlements (BIS), the outstanding debt of China's non-financial corporate sector as a percentage of GDP stood at 138% as of the end of 2023, well ahead of the equivalent figures for Japan (115%), the U.S. (77%), and Germany (70%).

However, in some industries, even as companies have taken on more debt, the value added by their business activities has increased at a faster pace, so debt ratios have improved. These industries include 1) general-purpose, production, and commercial machinery manufacturing, 2) the automotive sector, which is centered on EVs, and 3) information/communications equipment, electronic components, and device manufacturing.

In general-purpose, production, and commercial machinery manufacturing, the total outstanding debt of 713 listed companies increased from 255.7 billion yuan in 2013 to 679 billion yuan in 2023, while the value added rose from 128.3 billion yuan to 507.5 billion yuan during the same period. As a result, the debt ratio improved from 199% to 134%.

<Debt situation in the general-purpose, production, and commercial machinery industry>



Sources: Prepared by JRI based on financial data on 713 companies and data from Wind

As background factors, sales of these industrial products have increased rapidly due to the expansion of the Chinese market and improvements in quality (i.e., the competitiveness of Chinese companies). For instance, the number of industrial robots installed in China annually surged from 22,987 units in 2012 to 290,258 units in 2022. According to the International Federation of Robotics (IFR), China is by far the largest market for industrial robots in the world, dwarfing second-placed Japan with its 50,413 units installed in 2022. The U.S. and South Korea took the third and fourth positions, with 39,576 units and 31,716 units, respectively.

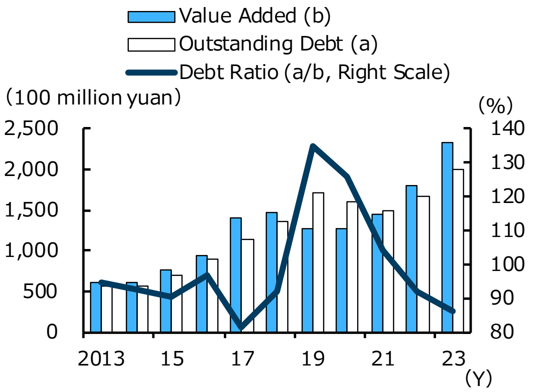
In the supply of products to the Chinese market, which used to be dominated by imports and products manufactured locally by foreign companies, Chinese companies have been catching up in terms of technology, so their competitiveness has been steadily increasing. According to research firm MIR, the share of domestic brands in China's industrial robot market has risen from 18% in 2015 to 45% in 2023.

Looking ahead, the value added by general-purpose, production, and commercial machinery manufacturing companies is expected to increase further due to the expansion of capital investment to boost productivity at home and overseas and the improvement of the technological capabilities of Chinese companies. The "robotics+" action plan, announced by the Chinese government in January 2023, aims to double the number of robots in operation per 10,000 manufacturing workers by the year 2025 compared to the 2020 level (246 per 10,000 workers). As Chinese companies continue to actively invest in R&D, the market share of domestic brands is expected to keep expanding.

■ The debt situation in the automotive industry has improved, with EVs the driving force.

In the automotive industry, the public and private sectors worked together to rapidly increase EV production capacity, but when market growth stalled in 2019-2020, the sense that companies were carrying excessive debt intensified temporarily. This can be confirmed from the financial data for BYD, GAC Group, and SAIC Motor. The total outstanding debt of the three companies increased significantly from 56.5 billion yuan in 2013 to 172.4 billion yuan in 2019. In contrast, the value added by the firms only rose from 59.8 billion yuan in 2013 to 127.9 billion yuan in 2019. As a result, the debt ratio jumped from 95% in 2013 to 135% in 2019.

<Debt Situation of Three Major Automakers>



Sources: Prepared by JRI based on financial data on BYD, GAC Group, and SAIC Motor and data from Wind

In China, EV sales increased from 14,000 units in 2013 to 970,000 units in 2019, but this level of 970,000 units was far below initial expectations. In January 2019, the China Association of Automobile Manufacturers predicted that 2019 sales of "new energy vehicles," i.e., EVs, plug-in hybrid vehicles (PHVs), and hydrogen fuel cell vehicles would be 1.6 million units. However, sales of new energy vehicles that year were 1.2 million units, 25% lower than the forecast.

The weak competitiveness of EVs in comparison with engine vehicles can be pointed to as one of the reasons for the sluggish growth in EV sales in China during this period. For example, there were problems with battery performance, which affects cruising range and recharging time, and the prices were too high. Many consumers worried that their travels for business or pleasure could be ruined by a dead battery during a long trip. The high cost of batteries was a direct cause of the poor price competitiveness of EVs compared to engine vehicles. A lack of charging stations was also a major problem. They were insufficient in number and some geographical areas had more than others. First of all, when an individual wanted a charging point to be installed in their apartment complex, they found it difficult to obtain the consent of the other residents. In addition, related services such as vehicle insurance were still in their infancy.

However, the public and private sectors began working together to address the various problems related to EVs one by one, and regulations on engine vehicles were tightened. As a result, EV sales have surged since 2021. Sales of EVs jumped from 1.12 million units in 2020 to 6.69 million units in 2023. EV sales in January-September 2024 were up 11.3% year over year (YoY), and if this pace of increase is maintained, sales for the full year of 2024 are projected to reach 7.4 million units.

In addition, according to the China Association of Automobile Manufacturers, the share of domestic brands in China's passenger car market has risen from 38% in September 2020 to 68% in September 2024. The increase in the market share of Chinese brands is an indication of the enhanced competitiveness of Chinese automobile companies.

In tandem with the expansion of the Chinese market and improvement of the competitiveness of Chinese companies, the value added by major Chinese automobile firms has increased significantly, and their debt ratios have decreased. In 2023, the outstanding debt of the three leading firms combined had risen to 200.8 billion yuan, but their value added had increased to 233.5 billion yuan and their debt ratio had fallen to 86%.

The value added by BYD, GAC Group, and SAIC Motor accounts for 40% of the total value added by the 186 listed Chinese automakers. A look at EV sales in 2023 reveals that BYD, Aion (a GAC Group EV brand), and Wuling (a SAIC Motor brand), sold 2.87 million units, 480,000 units, and 470,000 units, respectively. As for the global EV sales rankings in the same year, BYD was top with 21.0% of the total, followed by Tesla with 13.2%, BMW with 3.7%, and Aion, Volkswagen, and Wuling with 3.5% each.

Currently, the industries in which the debt situation is improving in China are characterized by the presence of highly competitive Chinese companies like these. Their competitors in other countries are being forced to confront the question of how they will deal with such Chinese firms going forward.

(Shinichi Seki)

Topics South Korea's central bank is cautious about further rate cut

In October, the Bank of Korea (BOK) cut interest rates for the first time in four years and five months. However, there are serious concerns about a reheating of the real-estate market and an accumulation of household debt, so the BOK is determined to be careful in conducting policy.

■ Interest rate cut stood against a backdrop of easing inflationary pressures and weak domestic demand

The BOK decided to reduce its policy rate by 0.25 percentage points to 3.25% at its regular meeting in October. The move largely reflected the easing of downward pressure on the Korean currency following the U.S. interest rate cut in September. However, the following three domestic factors can also be pointed to as playing a role in the decision:

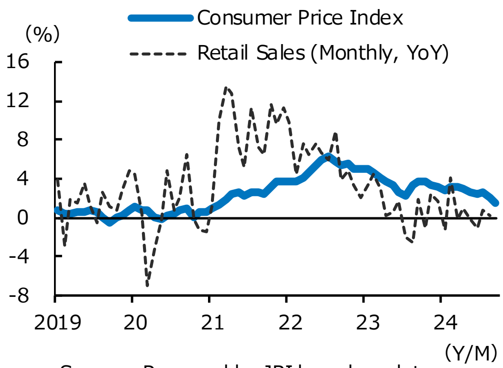
The first factor is the easing of inflationary pressures. In September, consumer price inflation dropped to 1.6%, falling below the 2% inflation target. Core inflation, which excludes food and energy, also declined to 2.0%. In its August meeting, the Bank of Korea (BOK) had projected an annual inflation rate of 2.5% for 2024. However, at the latest meeting, it indicated that this forecast would be slightly revised downward. The second factor is the slowdown in the real estate market. Last year, housing prices, especially for condominiums, rose sharply. However, this rapid increase has been subsiding as the government works to expand the rental housing supply and tighten lending regulations. Specifically, the government has announced a plan to provide over 100,000 private rental housing units by 2035, available for long-term leasing. In addition, the second-phase implementation of the Stressed Debt Service Ratio (DSR) rules began in September, meaning that a stress interest rate of up to 0.75 percentage points will be added to the rate applied to all loans to households. Banks are now also obliged to calculate and manage DSR information relating to household lending , making it more challenging to extend new loans to households. Although outstanding mortgages from financial institutions at the end of August stood at their highest level since December 2015, these measures are expected to slow the pace of increase in lending from September onwards.

<Results of regular meetings of Bank of Korea>

	Decision	Outlooks			
		Real GDP Growth Rate (YoY)		Inflation Rate	
		2024	2025	2024	2025
July	Maintain Interest Rate (Unanimous)	2.5%	-	2.6% or less	-
August	Maintain Interest Rate (Unanimous)	2.4%	2.1%	2.5%	2.1%
October	Reduce Interest Rate (5 in Favor vs. 6 Against)	2.4%	2.1%	2.5% or less	2.1%

Source: Prepared by JRI based on data from the Bank of Korea

<Consumer Price Index and Retail Sales>



Source: Prepared by JRI based on data from CEIC

The third factor is weak domestic demand. Real GDP contracted by 0.2% quarter-on-quarter (QoQ) in the April–June period, marking the first negative growth since October–December 2022 (-0.5% QoQ). The breakdown shows that while foreign demand was strong, domestic demand was tepid, with both fixed capital formation and personal consumption falling. Since July, personal consumption has continued to weaken, as evidenced by slower growth in the retail sales index. Additionally, the employment situation appears to be worsening, with a slowdown in the growth rate of employment. Young people, especially those in their 20s, are experiencing financial pressures due to high interest rates and prices, leading to a rapid rise in credit card and other debt delinquencies. As of July 2024, 65,887 people in their 20s were registered as "credit delinquents," indicating missed debt repayments—a 25% increase from 2021.

Concerns Over a Reheating Real Estate MarketThe BOK has taken a cautious stance regarding further interest rate cuts. At a news conference, Governor Rhee Chang-yong described the recent cut as a "hawkish cut," emphasizing that financial stability will remain a key policy focus. Looking ahead, five out of six board members agreed that holding the rate steady at 3.25% over the next three months would be appropriate, reflecting caution over the potential for the real estate market to overheat.This seems to reflect a sense of caution about the possibility of the real-estate market heating up again. As mentioned earlier, While the real estate market as a whole has been cooling, conditions are polarized: the Seoul metropolitan area is experiencing a very different market than regions further from the capital. By September, the average number of bidders for each condominium unit sold in Seoul under South Korea's housing application scheme had reached the high level of 140, but in provincial areas, most properties were only attracting a single bidder.

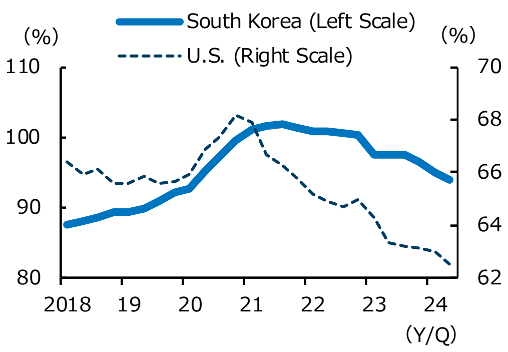
One of the structural factors boosting housing demand in the Seoul metropolitan area is the concentration of educational institutions there. In South Korea, there are clear differences in rates of admission to top universities depending on the area of residence, so wealthy people flock to the capital seeking an advantageous educational environment. In particular, with the announcement of a policy to convert all autonomous private high schools, foreign language high schools, and international high schools in Seoul into standard high schools from 2025, the "Gangnam Eighth School District (elementary, junior high, and high school district in Gangnam-gu and Seocho-gu)," which is home to numerous schools with strong track records in getting students into the top-ranked universities, is becoming even more attractive, and demand for housing there is surging. Until the interregional disparity in educational environments is corrected, the influx of population into the Seoul metropolitan area will continue, and the housing market there is likely to become even tighter. The probability of housing prices in the Seoul metropolitan area continuing to rise in the future is therefore high.

■ A monetary policy stalemate could also pose a recession risk

There is also concern that the number of households taking out large mortgages to purchase high-priced housing, especially in the Seoul metropolitan area, will increase. By international standards, South Korean households are heavily indebted, and this trend could be exacerbated. In South Korea, the ratio of outstanding household debt to GDP is above 90%. This is the highest among OECD countries, a situation that has continued for four consecutive years. Household debt in South Korea is high even compared to the U.S., where loan demand is generally strong. It is difficult to say that the debt burden on Korean households—which had increased significantly during the COVID-19 pandemic—has been adequately reduced by the tight monetary policy in place until the recent rate cut.

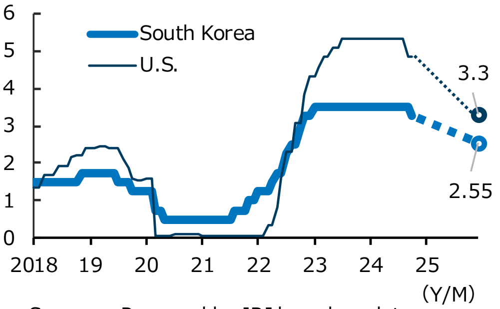
Market economists expect South Korea's policy rate to fall to 2.55% in 2025, implying a slower pace for rate cuts than in the U.S. If the real-estate market heats up again and household debt swells further, the BOK is likely to hold off on further interest rate cuts. If that happens, the BOK will find itself at a policy

<Household Debt in U.S. and South Korea>



Source: Prepared by JRI based on data from CEIC

<Policy Interest Rates in U.S. and South Korea>
(Average of Market Economists' Forecasts)



Sources: Prepared by JRI based on data from CEIC and Bloomberg L.P.

stalemate, facing even more difficulty in buoying sluggish domestic demand. And with interest rates remaining elevated, upward pressure would be exerted on the South Korean currency, which could squeeze the exports on which the country's economy depends. Going forward, close attention will need to be paid to the impact on monetary policy of developments in the urban real-estate market.

(Wu Zijing)