

Groundwork

today's financial research - 31 March 2016

FLASH CAPACITY RELEASE

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Based upon the latest high frequency industrial capacity data, in some cases just from a few days ago, there is some evidence that output may be strengthening. Though it is too early to tell if this is due to a post-Chinese New Year output bump or if it will be more sustained; at worst, capacity levels appear to have stabilized.

Throughout 2015 and early 2016, operating rates across Chinese industry exhibited persistent declines at low rates. With some exceptions, operating and capacity utilization rates across Chinese industry linger below profitable rates through 2015 and early 2016.

Post-Chinese New Year however, has seen a stabilization and slight uptick in operating rates across a variety of industries. There are two major themes for industrial capacity since the beginning of 2015. First, industrial operating rates are extremely low across the Chinese economy. The median operating rate for the Chinese chemicals industry is 52% with only three industries operating above 70%.

Second, most industries saw declines in operating rates or capacity utilization prior to Chinese New Year in the year before Chinese New Year. Despite strong official industrial production and GDP growth rates, declining operating rates and capacity utilization are not reassuring signals. This may indicate greater weakness than admitted.

However, there is some indication that maybe the industrial decline in China has stopped and in some cases maybe even begun to reverse. Coking coal and steel mills have seen upticks in capacity utilization and operating rates that began around the first of the year and have continued post-Chinese New Year.

This expansion does not appear limited though, to heavy industry. LNG and PTA operating rates have inched up since the first of the year, and in March indicating broad based economic activity beyond stimulus fueled investment. The median chemical industry operating rate inched up to 52% from 50% last month. Glass output is not increasing, in line with changes in real estate investment, but has stabilized its downward decline.

We expect official and unofficial March PMI in both manufacturing and non-manufacturing sectors to exhibit similar stabilization with potential small gains. Given the data presented here and the weight of other evidence, there is strong reason to believe stabilization or gains in PMI data out April 1.

There remains, however, little evidence that this marks a reversal of the longer term economic slow-down or that this increased activity can be maintained longer term. The economic slowdown that began in 2014 has been marked by data with either seasonal or temporary increases. We would need to see more sustained economic gains before believing this was more than a seasonal post-Chinese New Year upturn.

Furthermore, there is little reason to believe this will be sustained. Excluding continued large fiscal stimulus, it is difficult to see significant gains to operating rates. It is worth noting that there is evidence of hidden fiscal stimulus beginning in later 2015 via official public channels and increased credit growth. This would track closely with the uptick in plant operating rates that we are seeing. Excluding these factors, we should expect continued longer term declines in output and operating rates.

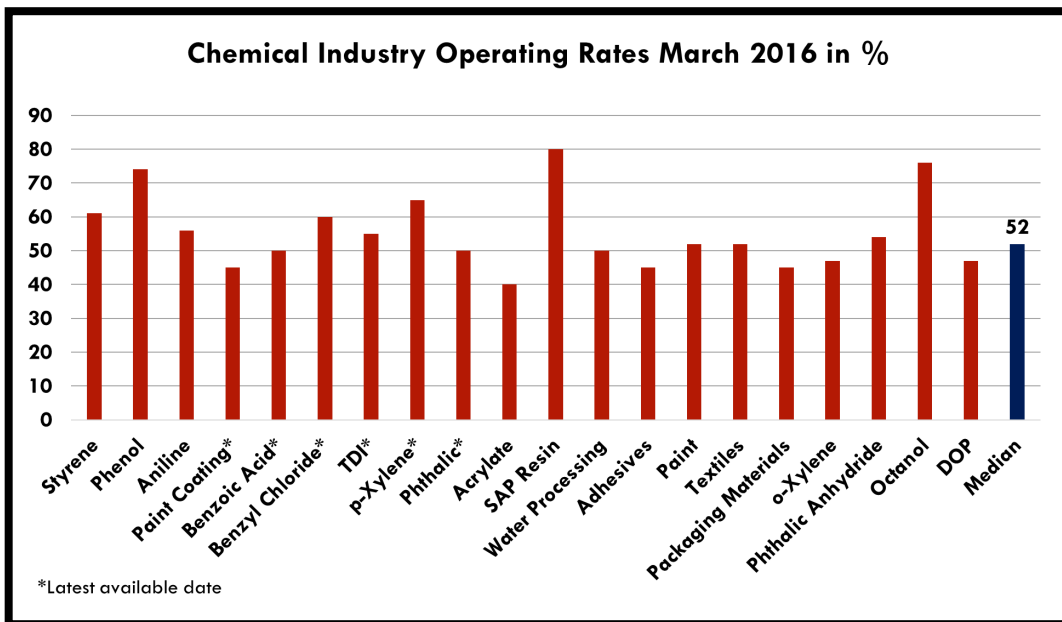


Fig. 1

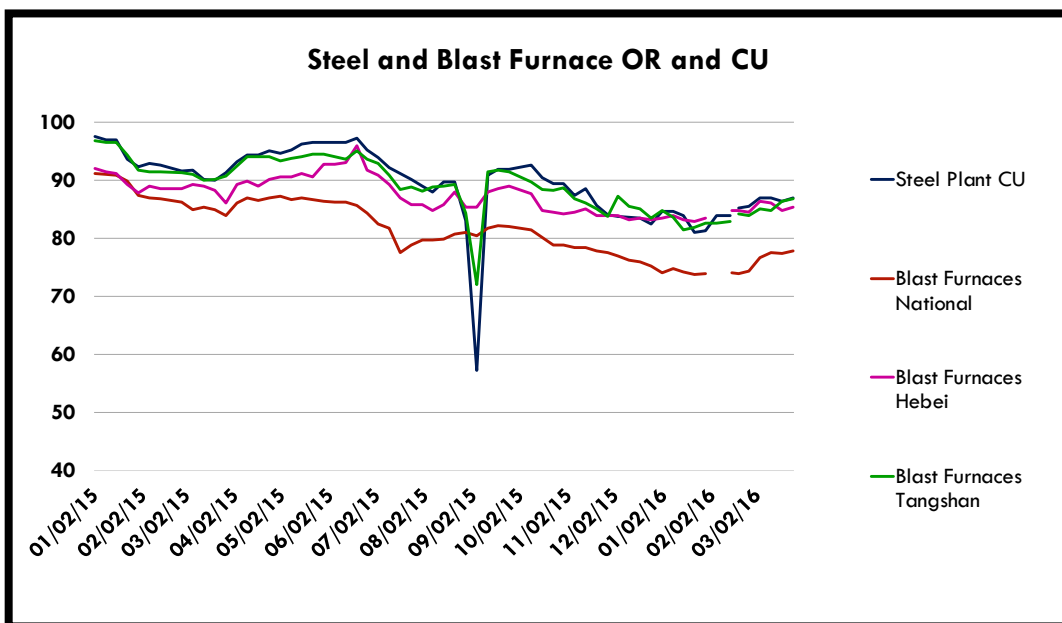


Fig. 2

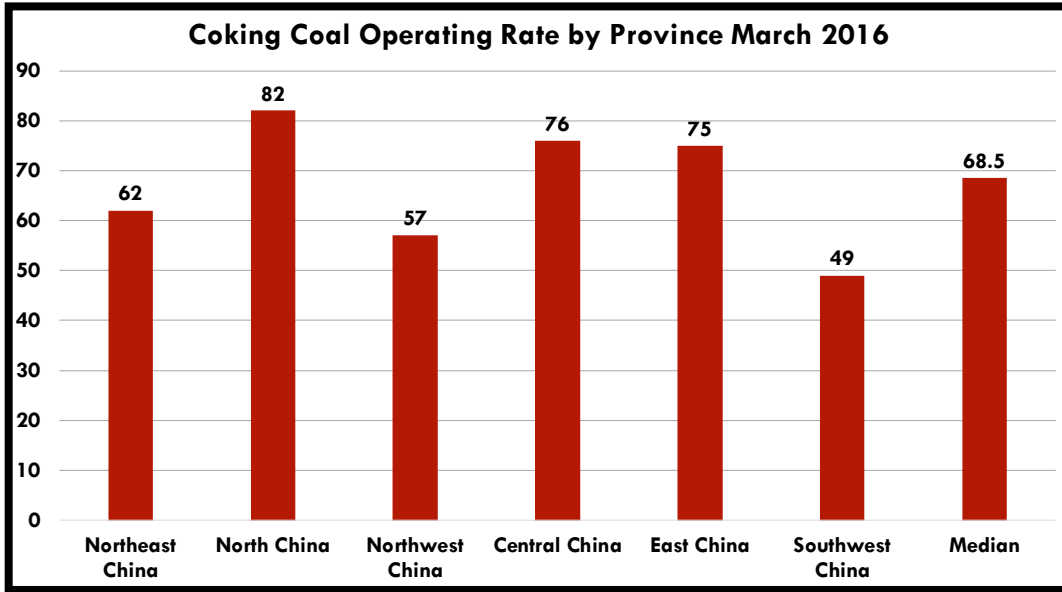


Fig. 3

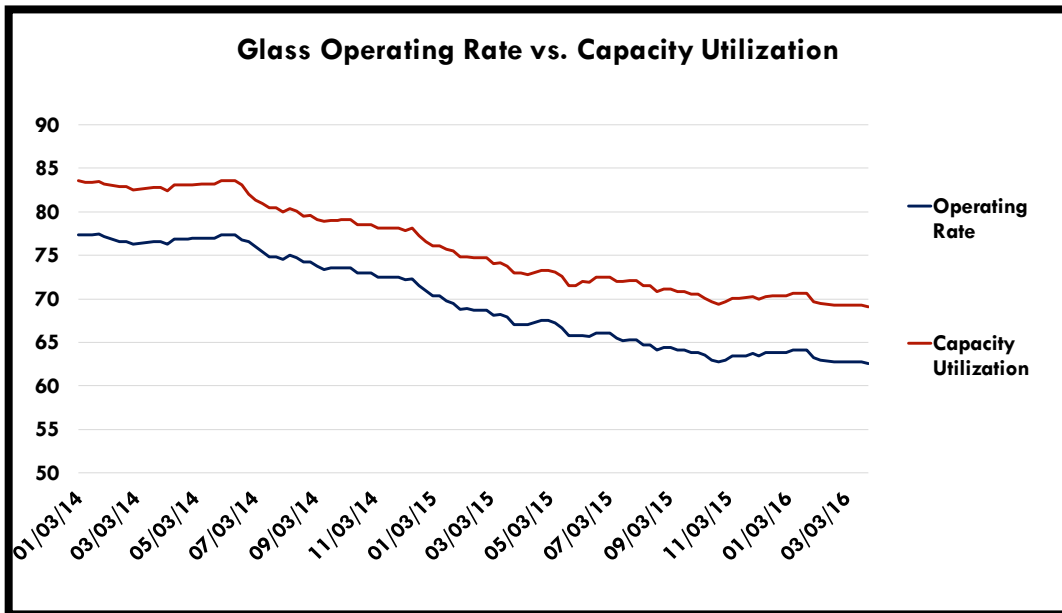


Fig. 4

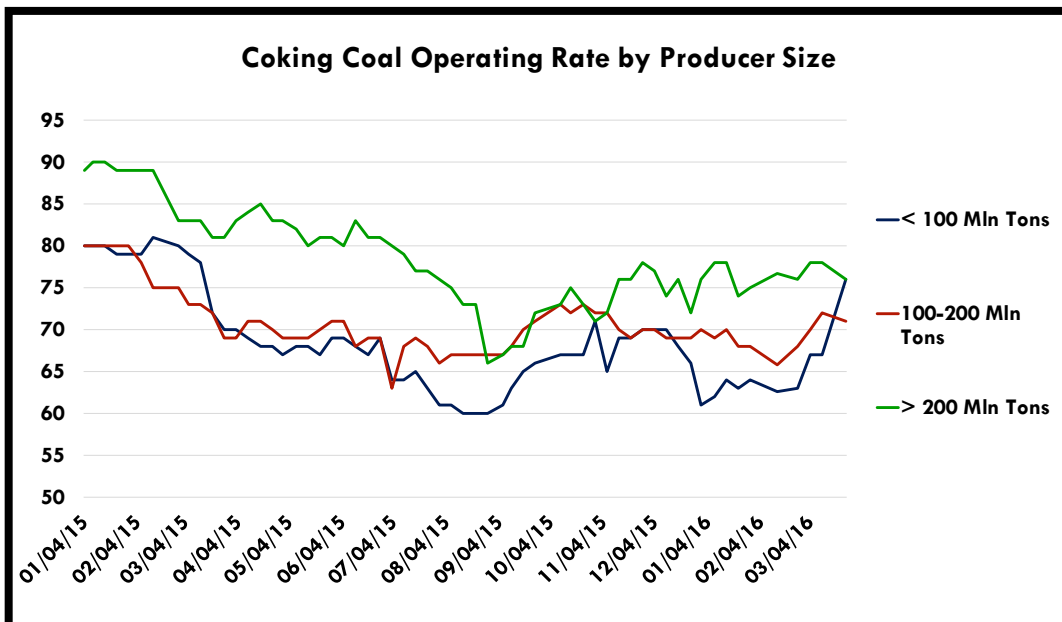


Fig. 5

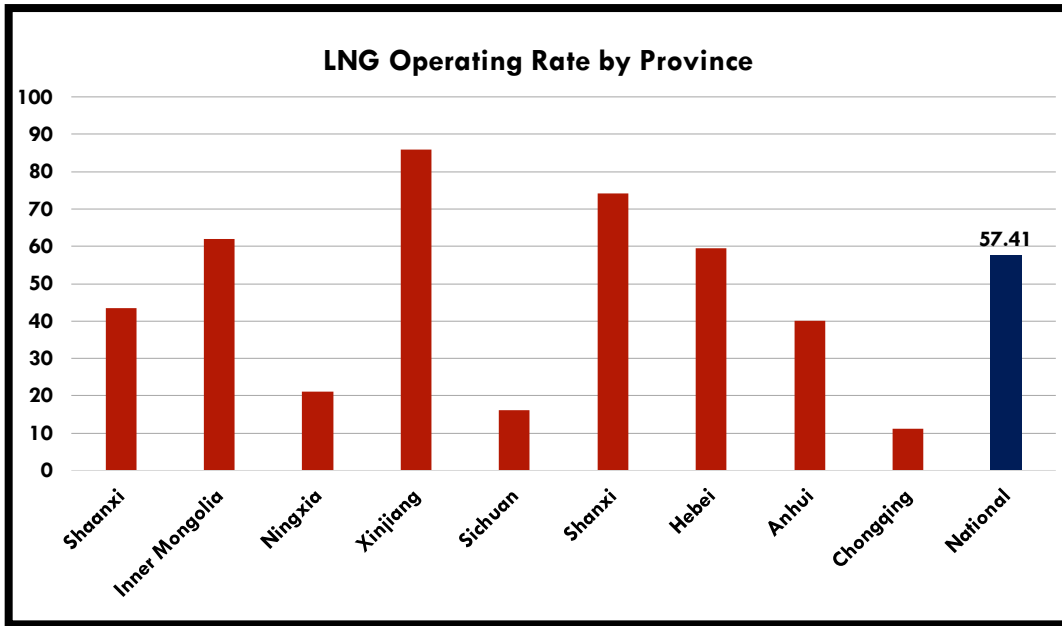


Fig. 6

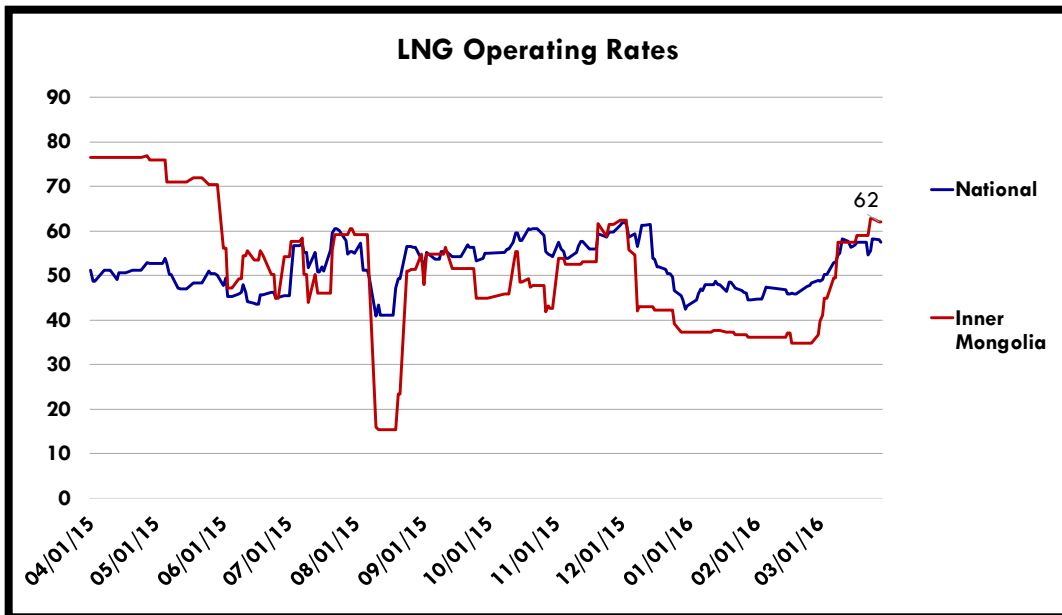


Fig. 7

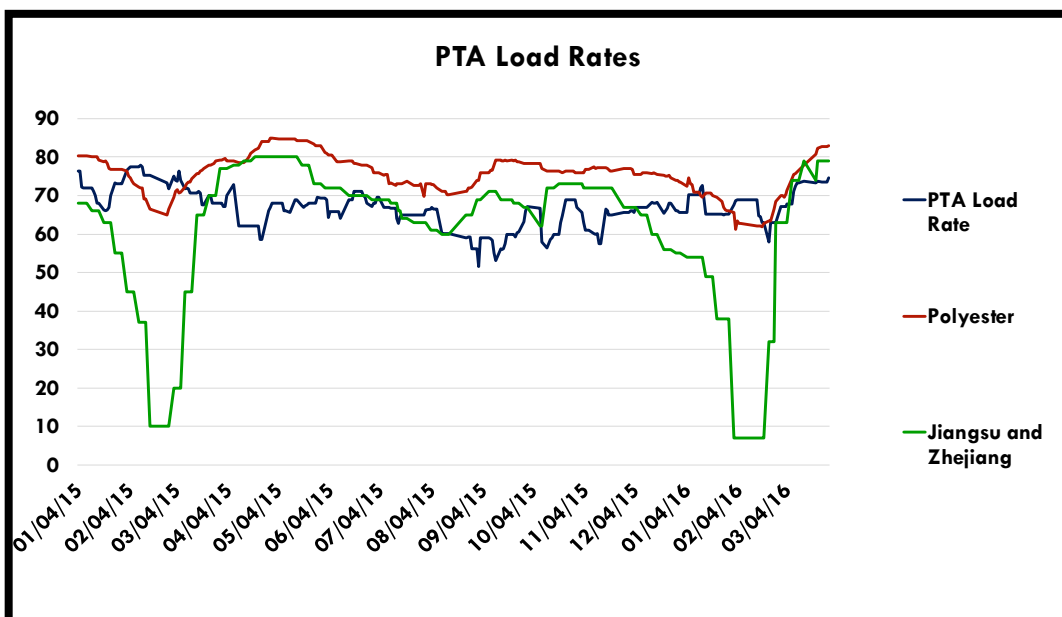


Fig. 8

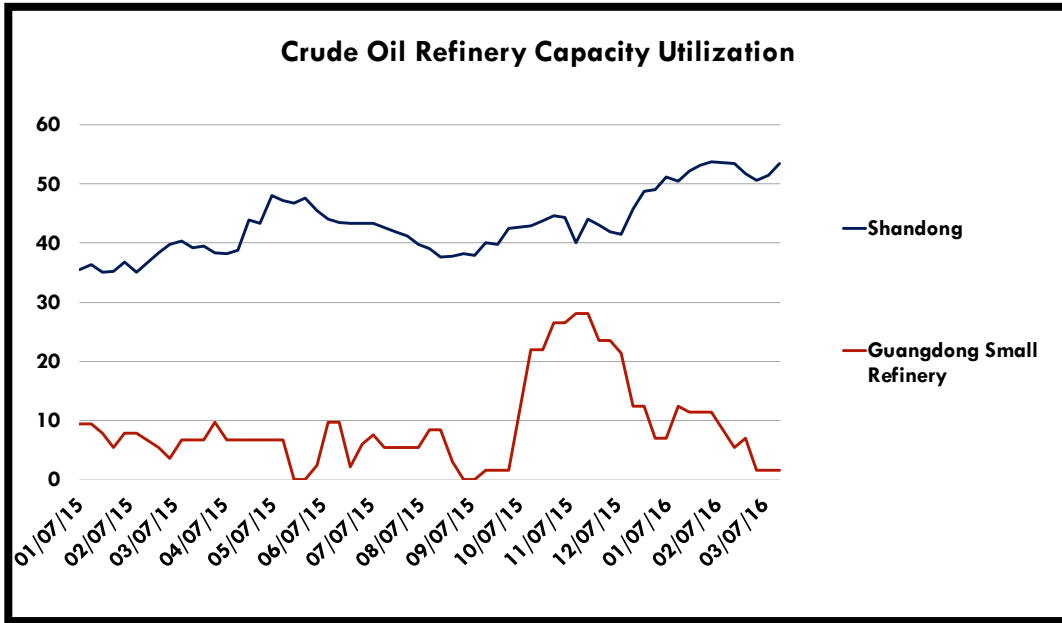


Fig. 9

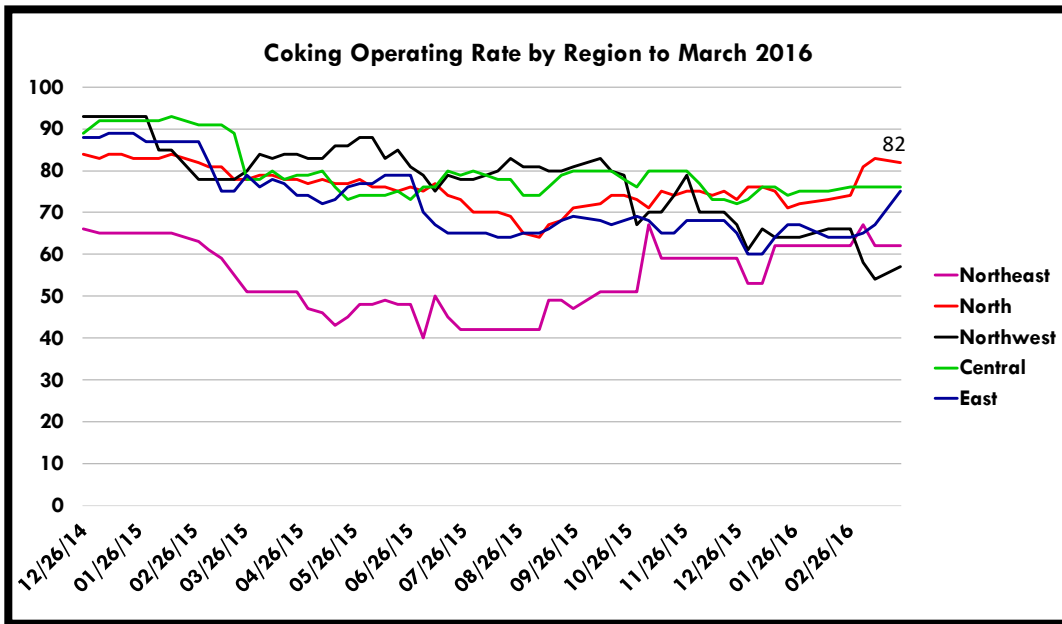


Fig. 10