

China: high growth in industrial profits thanks to supply side reform

2017 shows that overcapacity cuts have had beneficial effects on some companies. Those that have survived supply-side reforms have enjoyed higher profit growth. But how long could this last?



China coal

21%

China industrial profit growth

2017

Overcapacity cut came out as a profit-generator for some companies

For companies that survive the supply-side reforms, higher profit growth is often the outcome, as cuts have pushed up the prices of their final goods - usually raw materials for other companies. For example, coal mining and washing companies had nearly a 3-fold increase in profits in 2017 according to the Statistics Bureau.

However, for electricity generation companies, some of whom use coal as a raw material, profit growth was miserable in 2017 (-15%).

Black metal smelting and rolling processing industries also recorded strong profit growth of 178% in 2017.

295%

Profit growth in coal mining and washing industry

2017

But how long can this last?

We believe that overcapacity cuts will continue in 2018. This includes coal and raw materials sectors, e.g. cement and glass.

But the high base in 2017 will make some sector's profit growth looks dim, even if profits continue to rise. For example, coal has been under overcapacity cuts since 2017. Its profit growth could continue in 2018 but not nearly as fast as in 2017.

Not easy for shipbuilding

Although shipbuilding's profit is not a standalone item shown by the Statistics Bureau, we understand that this industry has been in overcapacity condition since 2007.

To solve the shipbuilding overcapacity problem is not easy because each company is large in scale and in debt. Shutting down one company may put pressure on its creditors, which includes banks and bondholders. The government will, therefore, be very careful when addressing overcapacity in shipbuilding.

If global trade growth continues to rise, the outlook for shipbuilding could improve. But even that would not solve the issues, only alleviate the condition.