China: Strong fiscal revenue and slower spending led to a narrower deficit in July

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Bottom line:

On-budget fiscal revenue growth rose further to 11.7% yoy in July despite lower PPI inflation and weaker activity growth, led by faster tax revenue growth, while anecdotal evidence suggests some local governments have tightened tax collection recently. On-budget fiscal expenditure growth slowed to 0.5% yoy in July and its gap with fiscal revenue growth widened further. Property-related government revenue remained weak in July, although its year-on-year contraction narrowed from June. Combining on-budget and off-budget financing channels, our proprietary "augmented fiscal deficit" (AFD) metric narrowed further in July on a 12-month moving average basis, implying that policy support has not been significantly stepped up and fiscal policy has remained a growth drag in early Q3. Given recent policy signals from the July Politburo meeting and today's Ministry of Finance press conference, we expect the government to accelerate disbursement of existing fiscal resources and keep the door open to additional easing later this year if growth continues to slow.

Key numbers:

Fiscal revenue growth: +11.7% yoy in July (+3.7% mom sa non-annualized, estimated by GS), vs. +8.7% yoy in June (+2.8% mom sa non-annualized).

Fiscal expenditure growth: +0.5% yoy in July (-0.3% mom sa non-annualized), vs. +4.0% yoy in June (+2.5% mom sa non-annualized).

Land sales revenue growth: -27.1% yoy in July (+5.1% mom sa non-annualized), vs. -42.1% yoy in June (-8.9% mom sa non-annualized).

Property-related tax revenue growth: -1.1% yoy in July, vs. -12.3% yoy in June.

Effective fiscal deficit ratio (after GS seasonal adjustment): -3.7% of GDP 3mma and -4.5% 12mma as of July, vs. -3.9% of GDP 3mma and -4.7% 12mma as of June.

Augmented fiscal deficit (AFD) ratio (after GS seasonal adjustment): -7.2% of GDP 3mma and -9.8% 12mma as of July, vs. -7.2% of GDP 3mma and -10.2% 12mma as of June.[1]

Main points:

[1] Our measure of augmented fiscal deficit is a sum of effective on-budget fiscal deficit and off-budget fiscal deficit. We estimate the off-budget spending by major channels that finance quasi-fiscal activities, which include new local government special bonds (LGSB), land sales revenue, local government financing vehicle (LGFV) bonds, policy banks support, shadow banking loans, etc.

1. On-budget fiscal revenue growth rose further to +11.7% yoy in July from +8.7% yoy in June (Exhibit 1) despite lower PPI inflation and weaker activity growth, as faster tax revenue growth (to +13.9% yoy in July from +10.8% yoy in June) more than offset slower non-tax revenue growth (to -5.4% yoy from +2.9% yoy). Anecdotal evidence suggests fiscally strained local governments have tightened tax collection recently, while markets continue to assess the impact of new taxes on offshore trusts and income from offshore issuance products. The June-to-July acceleration in year-on-year tax revenue growth was led by VAT, consumption tax and individual income tax, and corporate income tax revenue growth remained elevated at 22% yoy in July.

2. Year-on-year growth in on-budget fiscal expenditure fell to +0.5% in July from +4.0% in June, as slower spending growth in social security & employment, urban & rural community affairs, and energy saving & environmental protection more than offset faster spending growth in agriculture & water conservancy. Based on our estimates, growth in infrastructure-related on-budget fiscal spending[2] slowed to -3.6% yoy in July from -1.8% yoy in June, broadly consistent with the wider year-on-year contraction in infrastructure investment.

3. Property-related government revenue remained weak in July despite an improvement from June — year-on-year contraction in off-budget land sales revenue narrowed to -27.1% in July from -42.1% in June, and on-budget property-related tax revenue growth rose to -1.1% yoy from -12.3% yoy (Exhibit 2).[3] Combining these two items, we estimate that government revenue directly from the property sector contracted 17.8% yoy in July (vs. -31.6% yoy in June). Despite recent green shoots in home prices in some large cities, most property activity indicators such as land sales, new home starts and property investment were weaker than market expectations so far this year. We continue to expect land sales revenue to decline by around 20% yoy this year, given the prolonged property downturn (especially for construction activity) and still-stretched funding conditions for many developers.

4. Taking into consideration the general public budget and government-managed fund budget, we estimate year-on-year growth in total government revenue rose to +6.9% in July from +1.8% in June, and the year-on-year contraction in total government expenditure narrowed to -4.4% from -12.0%. Further incorporating more off-budget financing channels, our proprietary “augmented fiscal deficit” (AFD) metric narrowed further in July, on a 12-month moving average (12mma) basis, although it stabilized on a 3mma basis (Exhibit 3).

5. July fiscal data suggest that policy support has not been significantly stepped up and fiscal policy has remained a growth drag in early Q3, despite further growth slowdown and stronger easing rhetoric from the July Politburo meeting, owing partly to the time required for policy coordination and local execution. During the 17 August State Council plenary meeting, Premier Li Qiang called for more efforts to “fulfill the country’s annual economic and social development targets”. At the Ministry of Finance (MOF) press conference today (21 August), Deputy Minister Liao Min pledged to accelerate fund utilization, intensify efforts to expand domestic demand, and strengthen supervision

[2] We define infrastructure-related fiscal spending as fiscal spending on energy saving & environment protection, agriculture & water conservancy, transportation, and urban & rural community affairs.

[3] Property-related taxes include property tax, deed tax, land appreciation tax, urban and town land use tax and farmland occupation tax.

and guidance over regions with persistently slow expenditure progress. He also highlighted that "the MOF will introduce pragmatic and effective incremental policies in H2, depending on macroeconomic conditions."

6. As of end-July, we estimate available government funding capacity for the remainder of this year at RMB7.1tn, including RMB5.7tn of unused new government bond issuance quota (48% of the RMB11.9tn full-year quota), this year's RMB800bn new policy-based financial instrument (up from RMB500bn last year) and a more-than-RMB600bn year-on-year increase in outstanding fiscal deposits. Given recent policy signals, we continue to expect the government to accelerate the pace of bond issuance and proceeds spending in coming months, speed up implementation of the new policy-based financial instrument, and keep the door open to additional easing later this year if growth slows further and the full-year growth target of "4.5-5.0%" comes under pressure. These expected policy efforts may help turn the fiscal impulse from a growth drag in Q2 to a modest driver in H2, though the pace could be more gradual than we previous envisaged (Exhibit 4).

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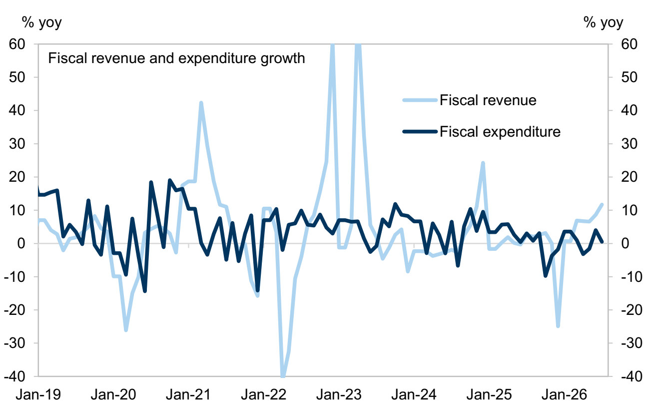
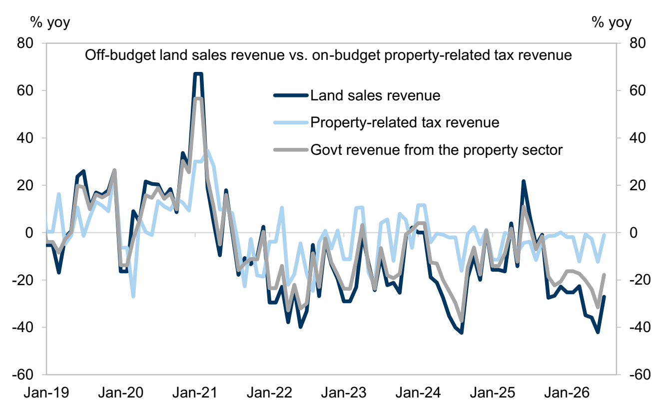
Exhibit 1: Fiscal revenue growth rose further in July, while expenditure growth slowed



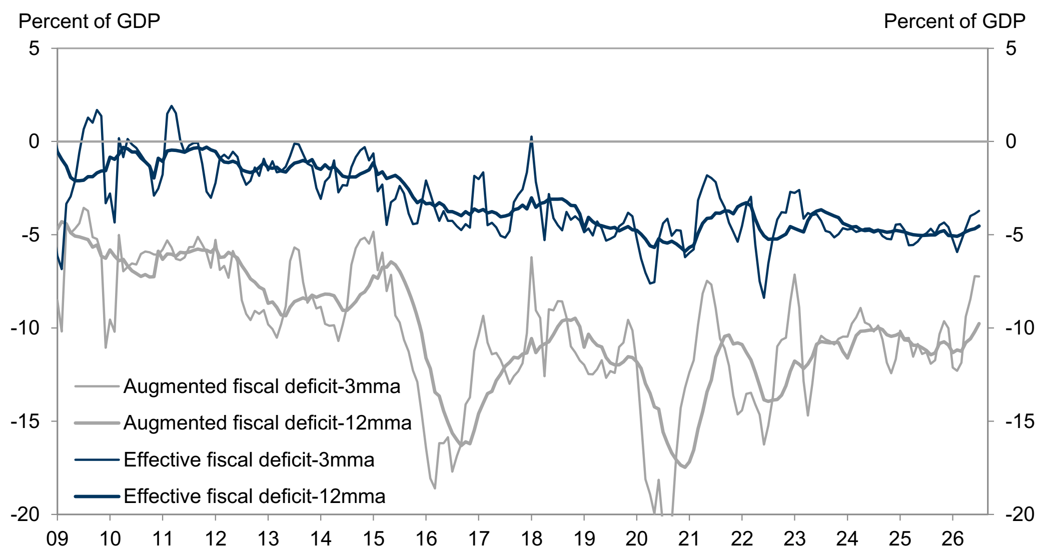
Source: Wind, Data compiled by Goldman Sachs Global Investment Research

Exhibit 2: Year-on-year contraction in property-related government revenue narrowed in July



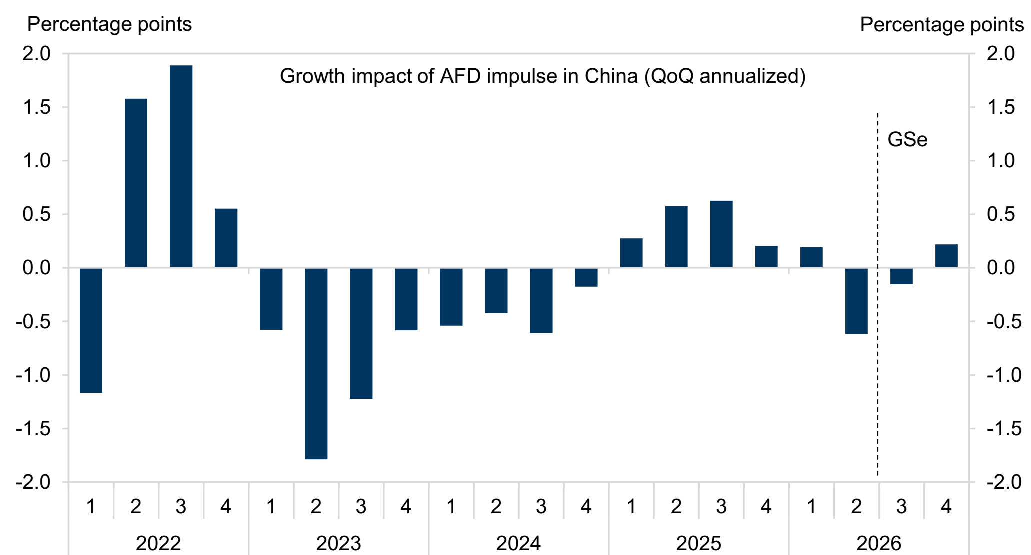
Source: Wind, Data compiled by Goldman Sachs Global Investment Research

Exhibit 3: Our augmented fiscal deficit (AFD) metric narrowed further on a 12-month moving average basis in July



Source: Wind, CEIC, Goldman Sachs Global Investment Research

Exhibit 4: We expect the negative fiscal impulse in Q2 to be gradually reversed in H2



Source: NBS, Haver Analytics, Goldman Sachs Global Investment Research

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