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July 24, 2024

Exporters to China Feel Demand Pinch

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- Commodity and energy suppliers to China face slowing growth
- Chipmakers are the only manufacturing exporters benefiting
- Services exports to China are diversifying beyond tourism

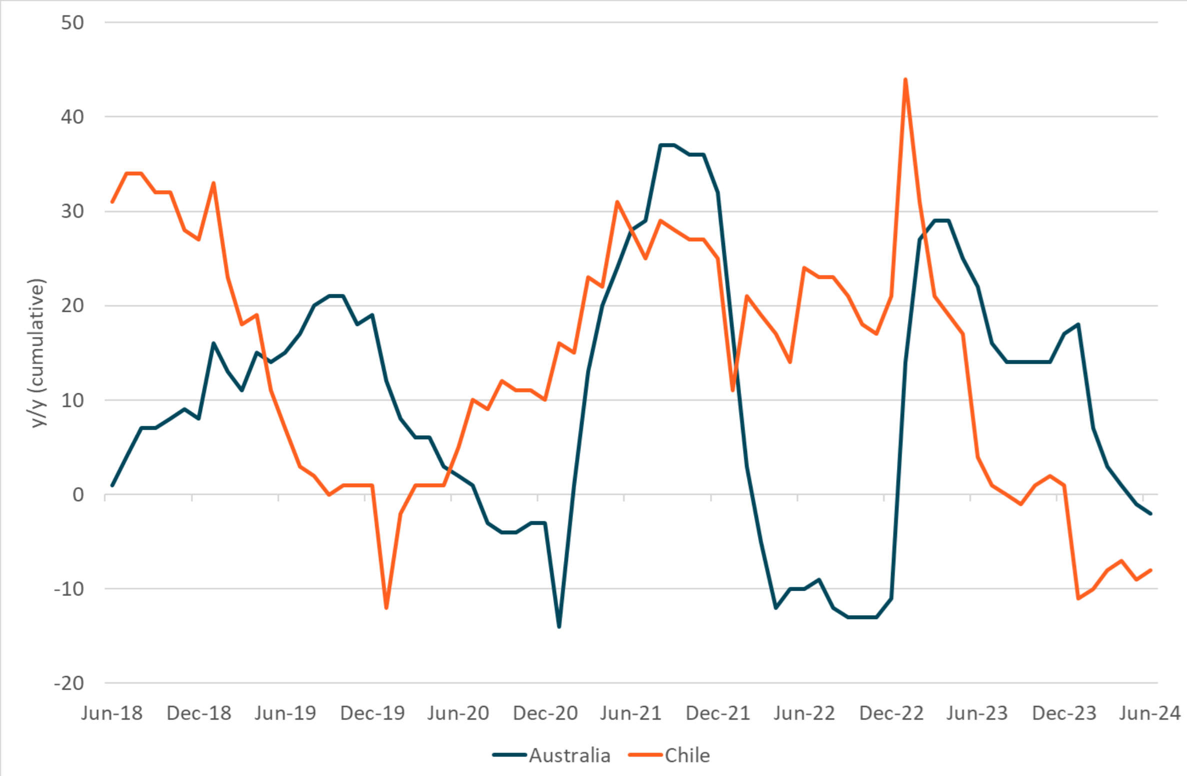
China's trade partners are managing growth expectations post-plenum

The recent plenum in Beijing has not been market moving. Asset prices have been more reactive to external events and policy adjustments, though in the context of the upcoming economic priorities, the loan prime rate (LPR) cuts announced by the People’s Bank of China on Monday can already be seen as a downpayment for growth measures for the rest of the year. Given how Chinese assets have performed, there is very little prospect of assets of economies with high growth exposures to China reacting positively in any meaningful way. Looking at exporters of commodities, goods and services with a high China ‘beta’, H1 indicates broad-based demand weakness, all of which will have corresponding growth, fiscal and monetary policy implications.

Generally, the most immediate reaction to key policymaking events in China takes place in commodity-related assets. While the commodity super-cycle is over, marginal changes in Chinese demand will continue to have an impact on the mining and materials sector. The advent of China’s new-energy vehicle (NEV) sector has also reshaped the commodity market, changing the terms of trade composition for countries such as Chile and Indonesia. In contrast, Australia is still seen in a traditional – i.e. real estate – context, where iron ore demand is crucial to AUD performance, despite the structural issues in China's real estate market. The latest data show that Chinese imports from Chile and Australia (Exhibit #1) are still growing, but at declining rates. Even considering the base effect from reopening-related surge demand last year, the outlook points to a lack of momentum as prices for such commodities have also fallen. Beijing's pledges to resolve outstanding inventory issues in the real estate market point to an extended period of weakness for iron ore demand. We believe that this has long been factored into risk premia for the Australian economy and is one of the reasons that the AUD continues to struggle despite the Reserve Bank of Australia's (RBA) status as one of the most hawkish central banks within developed economies.

Meanwhile, Chile expected copper to gradually decline in relative contribution to terms of trade, to be replaced by lithium. However, even though Beijing has reaffirmed its strategy to increase its dominance in NEV and related battery production, China's import value growth from Chile has stalled, though this is likely due to the price effect from falling lithium prices. More broadly, global auto manufacturers have also been revising their demand estimates for NEVs lower, and there are additional concerns for the sector arising from increasing trade tensions. As such, even though Chile's real rate position is relatively favorable, CLP's terms of trade face downside pressure as the country's biggest customer for commodities faces its own headwinds. Falling export receipts and lack of fresh capital expenditure in the mining sector risks sharply weaker growth, ultimately leading to a fiscal reaction. Recent events show that the market has very limited tolerance for such policy shifts.

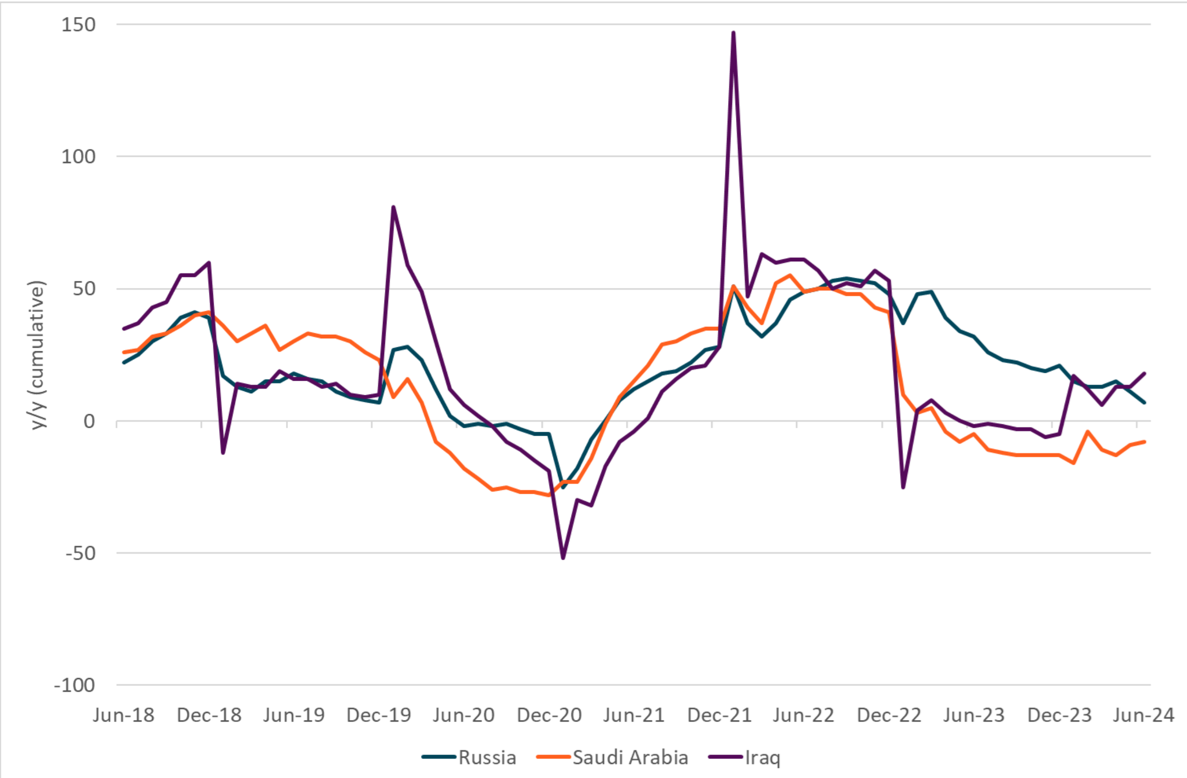
Exhibit #1: Chinese Import Growth, Commodity Producers



Source: Bloomberg, BNY

While Australia and Chile are exposed to sector-specific issues in China, the marginal price changes in the energy market are also exposed to China's growth dynamics. While coal remains dominant in China's primary energy exposure and the country is transitioning toward renewables at pace, oil still ranks second as an energy source and China is a crucial market for key producers. The trade has also taken on geopolitical connotations, which renders demand analysis more complex. Exhibit #2 shows China's total imports from Iraq, Saudi Arabia and Russia – its three largest oil suppliers. Although Russia supplanted Saudi Arabia as China's main supplier last year, growth rates continue to decline and could enter contraction at some point in H2 – most likely with geopolitical considerations in mind. In contrast, imports from Iraq have continued to rise, while there are some signs of a recovery in imports from Saudi Arabia. Lower prices will likely have an effect, though we can see that in a Chinese growth context, there wasn't a reopening surge in 2023, as opposed to commodity interest. Growth rates in Chinese oil demand may have reached equilibrium levels, but only at rates that would not prove supportive for the terms of trade for OPEC nations.

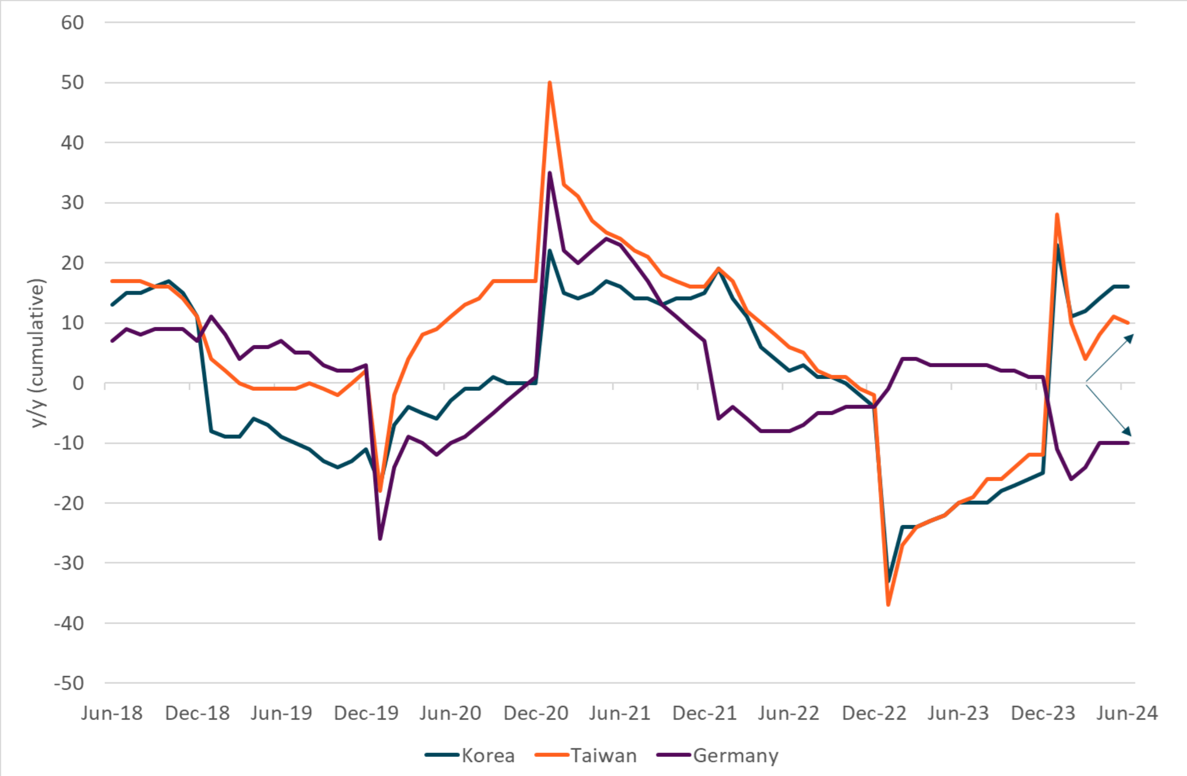
Exhibit #2: Chinese Import Growth, Oil Producers



Source: Bloomberg, BNY

As for manufacturers, China's shift toward high value-added exports and reshaping its own supply chains looks set to be one of the biggest shocks to global trade in the coming years. This is already playing out in the political space as tariffs against Chinese NEV exports are proliferating, though this does not appear to have come at the expense of total exports yet. For the sake of supply chain resilience, traditional suppliers of industrial goods to China, especially in Europe, could also face demand declines ahead, both due to growth weakness and strategic reasons. However, semiconductors and the associated supply chain remain the exception. We recently highlighted how Dutch and German manufacturing PMIs were diverging sharply, with the former showing very strong growth, most likely due to the country's expertise in lithography. Similarly, we can see that there has been a surge in Korean and Taiwanese exports to China over the past six months, while Chinese imports from Germany have barely grown since 2021 – which is surely a structural issue that will have material ramifications for the German and Eurozone economies in the coming years. For manufacturing exporters, being able to produce goods for which Chinese demand is strategic and inelastic is a growth catalyst. However, such economies will also need to straddle geopolitics, which will only become more difficult over time.

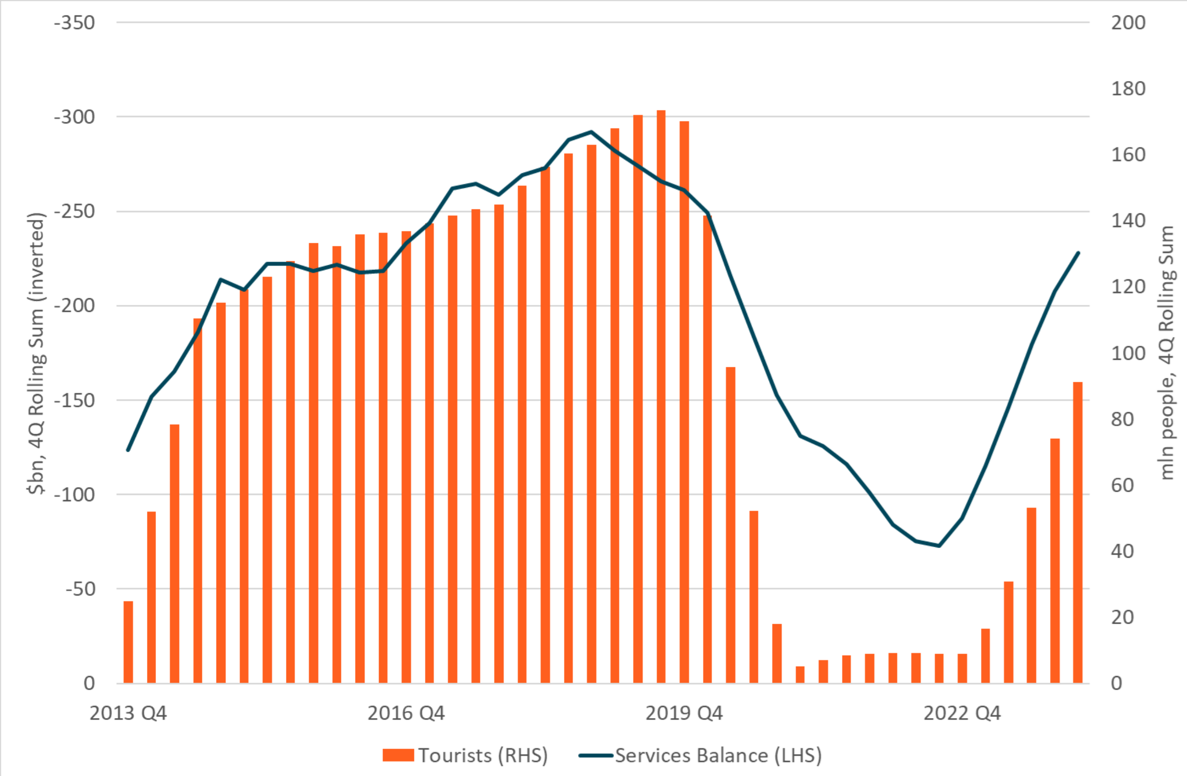
Exhibit #3: Chinese Import Growth, Manufacturers



Source: Bloomberg, BNY

Finally, one area where hopes for Chinese demand growth have not totally vanished yet is in services. Although borders have fully normalized, Chinese tourism does not appear to have hit pre-pandemic highs, and softer household disposable income growth is an additional constraint. As Exhibit #4 shows, the current four-quarter rolling sum of outbound tourists is barely above 52% of the pre-pandemic high. Even for Japan, one of the few countries where costs for Chinese tourists have declined, the most recent four-quarter sum is 37% of the 2019 level. However, China's services balance has widened back to a deficit of well above $200bn as of Q1 2024, which is not far off the 2018 high when demand growth was strong. As such, there are likely other sources of demand growth making their way into the global economy. This is also a signal that rebalancing in favor of consumption is taking place, and global services providers will have a role to play in China's future development, which was also made clear in the plenum's final communique.

Exhibit #4: China Services Balance and Outbound Tourism



Source: Bloomberg, BNY

We remain of the view that there will be a more concerted push for growth in China for H2 as the country seeks to hit growth targets. Having confirmed a meaningful fiscal push is coming, key trading partners should still be prepared for improvement in Chinese demand, but markets looking for opportunities need to be extremely mindful of specialization.

Disclaimer & Disclosures

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