BNY

iFlow

MACRO MORNING BRIEFING

September 4, 2024

Limited External Gains If China Recovers

Light tailwinds for global economy from any growth push by China

- Semiconductors and related supply chain the main source of demand growth
- Services demand gap improving but not a strong offset
- Flow trends indicate some initial positioning for consumer improvement

World needs to adjust to changes in China's import structure

The surprisingly weak Australian current account print from Tuesday triggered a substantial decline in the AUD, likely due to renewed fears over the country's terms of trade. As much as we have protested that the market continues to overemphasize the external component of Australian fundamentals, especially regarding Chinese demand for raw materials, price action suggests that the prospect of a weak Chinese economy will continue to adversely affect the economies of the APAC region.

Assuming that such concerns are valid and there is broad symmetry in the impact of China's external demand, then any form of upside surprise in economic support from Beijing should also favor a strong risk recovery in associated markets and asset classes. Last week's PBoC operations and statements, alongside news of broader support for households to refinance their mortgages, suggests that more forceful easing is afoot. Mathematically speaking, a very strong final quarter is required for China to hit its full-year growth targets, but such a growth push is currently not the market's central scenario based on how traditional "China-betas" are performing.

Therein lies the issue – China's economic structure and policies have evolved to the extent that the traditional "China-betas" no longer apply. Depending on where certain economies

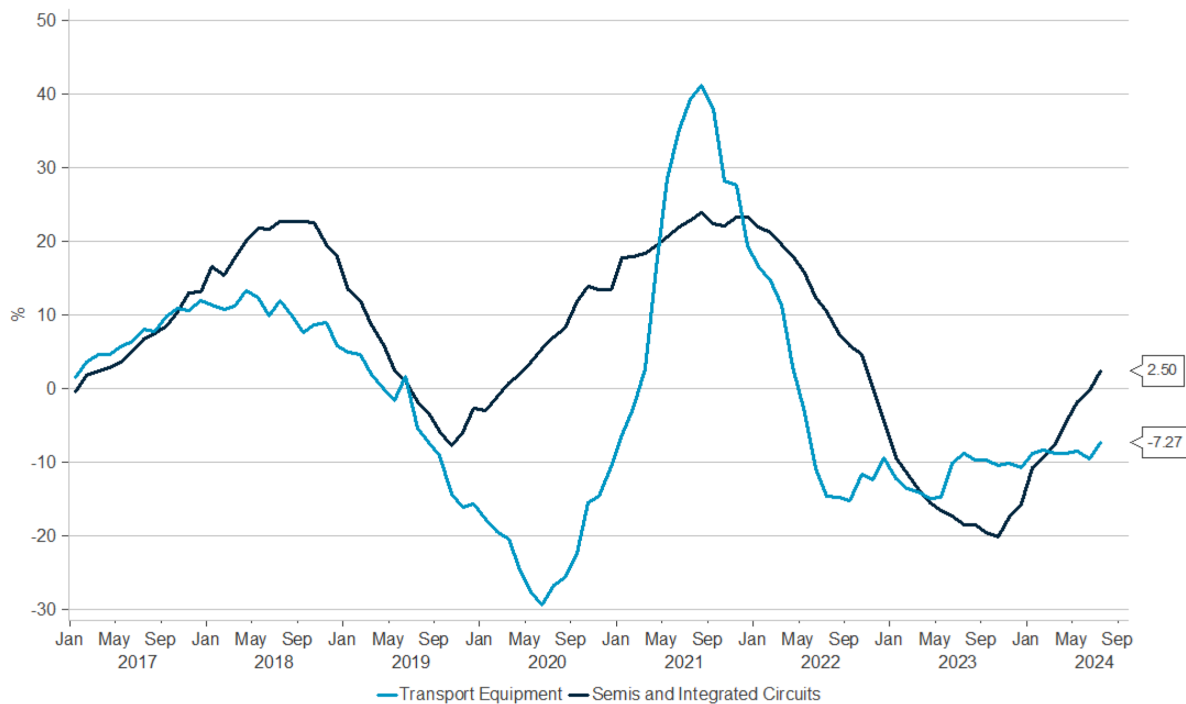
and companies are in the industrial chain as envisaged in China's economic restructuring, a growth push may not have as strong a positive effect as in the past, whereas others may find even greater marginal demand.

In the context of China's current industrial policy, exporters to China should already be concerned that there is a structural decline in Chinese demand irrespective of growth figures. The news out of Germany this week regarding further retrenchment of car production has sent shockwaves across Europe, but this is something that the Purchasing Manager Indices have warned for some time now. Monday's final German manufacturing PMI for August warned that "[China] is stepping up its game, competing head-to-head with German industrial companies – not just in China, but also in Germany and in other key markets, especially in the automotive and mechanical engineering sectors."

As such, if China's economy recovers strongly and, for the sake of argument, strengthens both the consumption and production side of the economy, Europe could potentially face greater headwinds rather than find any support. Germany and Europe have traditionally relied heavily on automotive and other higher value-added exports to China, while also producing in the country for re-export elsewhere. However, as Chinese names have been faster in moving toward battery-electric vehicles in scale, traditional developed-market advantages have been eroded. And as the PMI report warns, these economies now face competition in their home markets, tariffs notwithstanding. As Exhibit #1 shows, Chinese imports of transport equipment started falling sharply in 2021, and on a 12-month rolling sum basis the annualized rate of change remains firmly in negative territory.

In contrast, the one area of growth in Chinese demand, which we have for some time highlighted as being somewhat neutral to the Chinese economy, is semiconductors. The sector is now considered strategic by countries around the world, and barriers to the free trade of goods will likely continue to rise. However, even as imports of passenger vehicles have declined, China's demand for semiconductors (semiconductor devices and electronic integrated circuits, based on the harmonized system of customs codes) has rebounded strongly, and nominal values would likely have been even higher without restrictions.

Exhibit #1: Manufacturing Import Growth

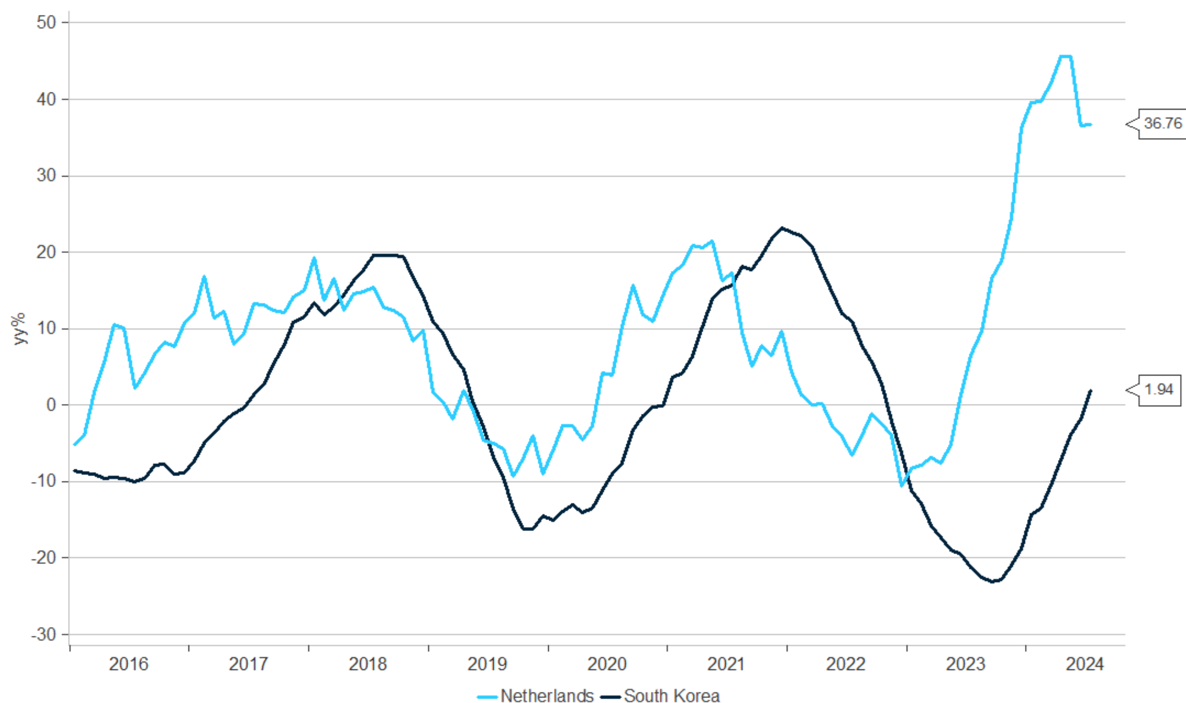


Source: Macrobond, BNY; annualized change in 12-month rolling sum

We also highlighted several months ago that amid deterioration in manufacturing PMIs in Europe, the Netherlands was one bright spot with an expansion in full view thanks to the country's expertise in lithography. This is also clear in customs data from China, where imports for finished products (from producers such as Korea) and key production components (e.g., the Netherlands) remain very high. Any uplift in Chinese growth or stimulus would likely result in an acceleration of investments in these areas, especially if the high value-added goods produced are expected to be purchased by onshore consumers rather than create a rise in demand for imports of finished goods.

We concur with the warnings in European PMI reports that many of the changes are now structural. So the global manufacturing community should not count on a boost from Chinese demand, even with a stimulus, and should redouble their efforts to improve competitiveness, especially on their home turf. The picture is similarly challenging for commodity producers and, therefore, we no longer see the likes of Australia and Chile as high "China-beta" currencies. Even for the latter, Chinese demand for lithium is not translating into improved export prices.

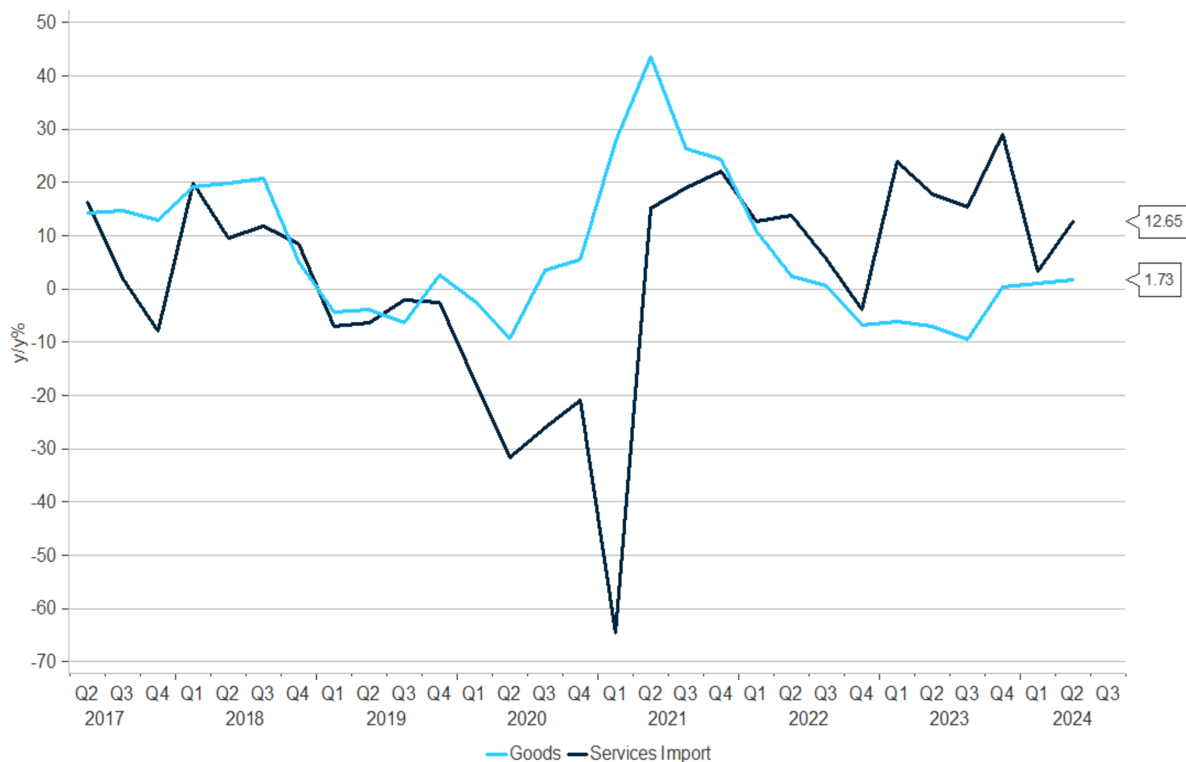
Exhibit #2: China Export Prices and Volumes



Source: Macrobond, BNY; annualized change in 12-month rolling sum

The key area of growth in external demand from China remains in services. We can see that China's services import growth (4Q rolling sum basis) has been stronger than goods imports since early 2022 and the gap was particularly wide in 2023. This is where the nature of the stimulus – if realized – could make a difference but the result may yet be highly asymmetric. Investment growth-based stimulus could help goods imports but only on a one-time basis, except perhaps for very highly value-added goods in the semiconductor supply chain. In contrast, if the stimulus is household-oriented and lifts purchasing power through improved cashflow or incomes, then services demand will benefit far more due to a lack of substitutes. Most importantly, the low base for consumption growth and household demand means that services demand is more durable. The key beneficiaries will look different compared to previous rounds of growth adjustment, and asset allocation will need to apply new assumptions.

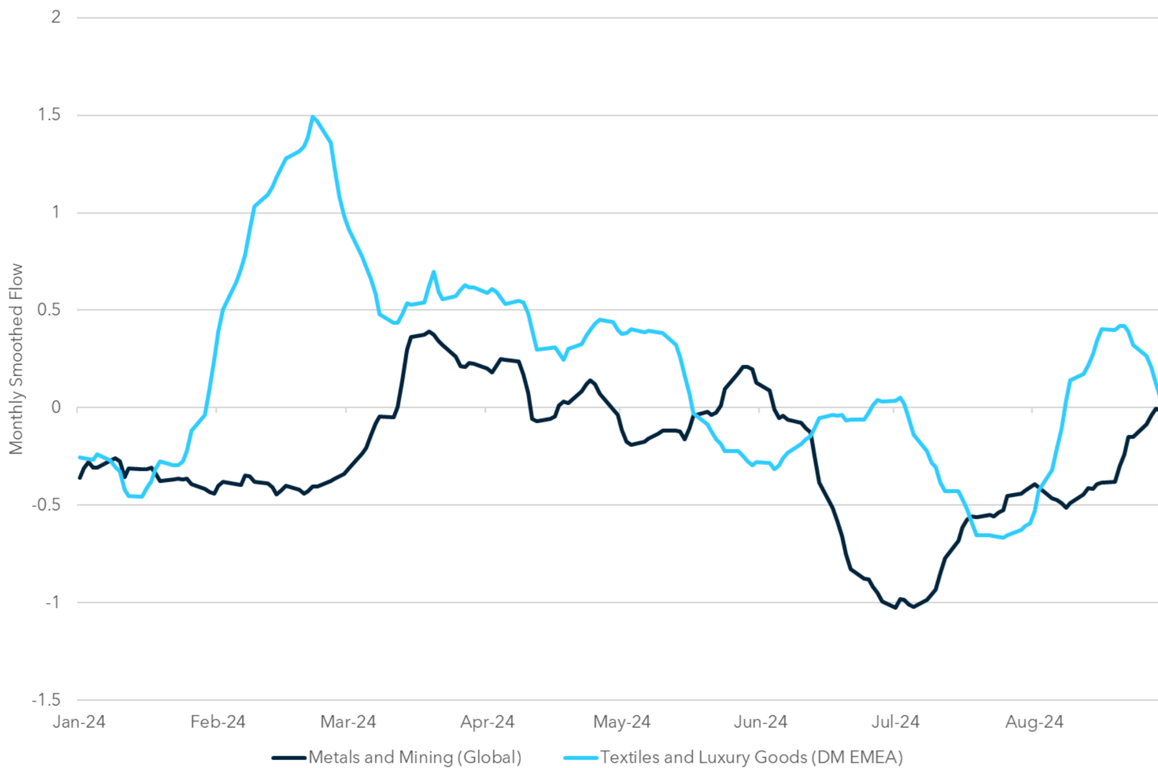
Exhibit #3: Change in Goods and Services Imports



Source: Macrobond, BNY; annualized change of 4Q

The US election and Fed policy will be the dominant drivers of global flows for the rest of the year, but tactically there is also a case for looking at China's economy on an idiosyncratic basis, especially if there is follow-through in economic support after recent signaling. Given the low levels of positioning beforehand, tactical rotation will face little resistance and there are some initial signs of this taking place already. We can see that flows into the global metals and mining industry (Exhibit #4) have improved to the highest levels in almost a quarter, and we have also seen a substantial return flow into European textiles and luxury goods. However, these are very tentative and volumes are light. This can be interpreted as a "less bad" narrative for Chinese investment and consumption growth by equity investors. Their skepticism is warranted, but risk-reward is also favorable as long as asset allocation remains selective and recognizes the new realities of China's external demand.

Exhibit #4: High "China Beta" Industry Flows



Source: BNY

Disclaimer & Disclosures

Please direct questions or comments to: iFlow@BNY.com

Geoff Yu

EMEA MACRO STRATEGIST

CONTACT GEOFF

Can't see the email? View online

iFlow

We can gauge how the world's money moves.
Because a fifth of it moves through us.

Learn More

Contact Us

We take our data protection and privacy responsibilities seriously and our privacy notice explains how we collect, use, and share personal information in the course of our business activities. It can be accessed here.

This email was sent to WeeKhoon.Chong@bnymellon.com, and was sent by The Bank of New York Mellon 240 Greenwich Street, New York NY 10286.

Your privacy is important to us. You can opt out from receiving future Newsletters by unsubscribing via this link at any time. You can also select the topics that you want to receive by managing your preferences.

This message was sent from an unmonitored email box. Please do not reply to this message.

Contact Us | iflow@bnymellon.com

© 2024 The Bank of New York Mellon Corporation. All rights reserved.

This message was sent from an unmonitored email box. Please do not reply to this message.

.