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iFlow

MACRO MORNING BRIEFING

October 4, 2024

Monitoring the China Rally

High-frequency data can track confidence shifts

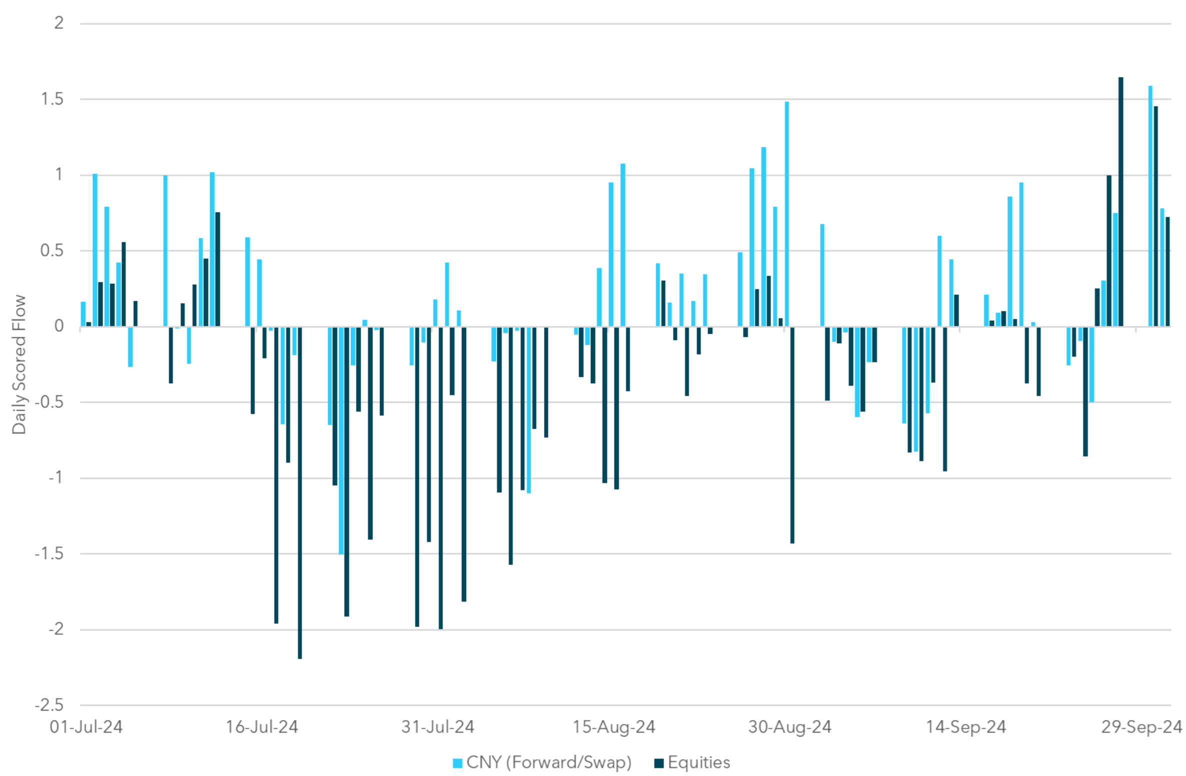
- iFlow shows strong buying of CNY and Chinese equities after announcements
- Surge in margin account transactions reminiscent of previous episodes
- Real estate and consumer prices yet to move

Sentiment key as China returns from holiday week

China will return from a week of holidays next week and international investors will be keen to see whether the record-breaking rally can continue. As we highlighted recently, there are reasons for skepticism and many investors who normally have an extended investment process will probably choose to wait for data confirmation. However, this will take time: the announced measures may have to wait until November at the earliest to filter through to the economy, which means that data support will come in early December. For strategic asset allocators, it does make sense to wait for data and incorporate any meaningful changes into their capital market assumptions for next year. However, for those with a short-term time span or underperformance pressure due to the swift rise in tracking errors, there are high-frequency indicators which are worth monitoring as well. Below we list several which not only track the economic impact of the measures, but also those with an asset-market focus, which after all sometimes can detach materially from fundamentals due to "fear of missing out." Many have moved aggressively already, and it is valid to ask whether, at least on a tactical basis, much of the positivity is in the price.

Firstly, we continue to track net flows into Chinese assets in iFlow. Exhibit #1 lists net daily scored inflows in the renminbi (CNY and CNH) and Chinese equities by our custody clients. The quarter-end surge in reaction to the stimulus news is unmistakable. In our month-end rebalancing analysis we noted that although the scale of the returns registered in both Chinese assets and the currency is large, they probably happened too late for any rebalancing – directed toward reducing exposures relative to benchmark – to materialize. On the other hand, the decisions being made now in asset allocation pertain to an immediate need to increase allocations relative to the benchmark. If the purchase streak continues, and given the long-term nature of custodial clients, an extended streak of high flow scores will certainly change the asset allocation narrative for China. Equities in particular can benefit as liquidation has been the norm for the entire year so there is massive scope for mean reversion.

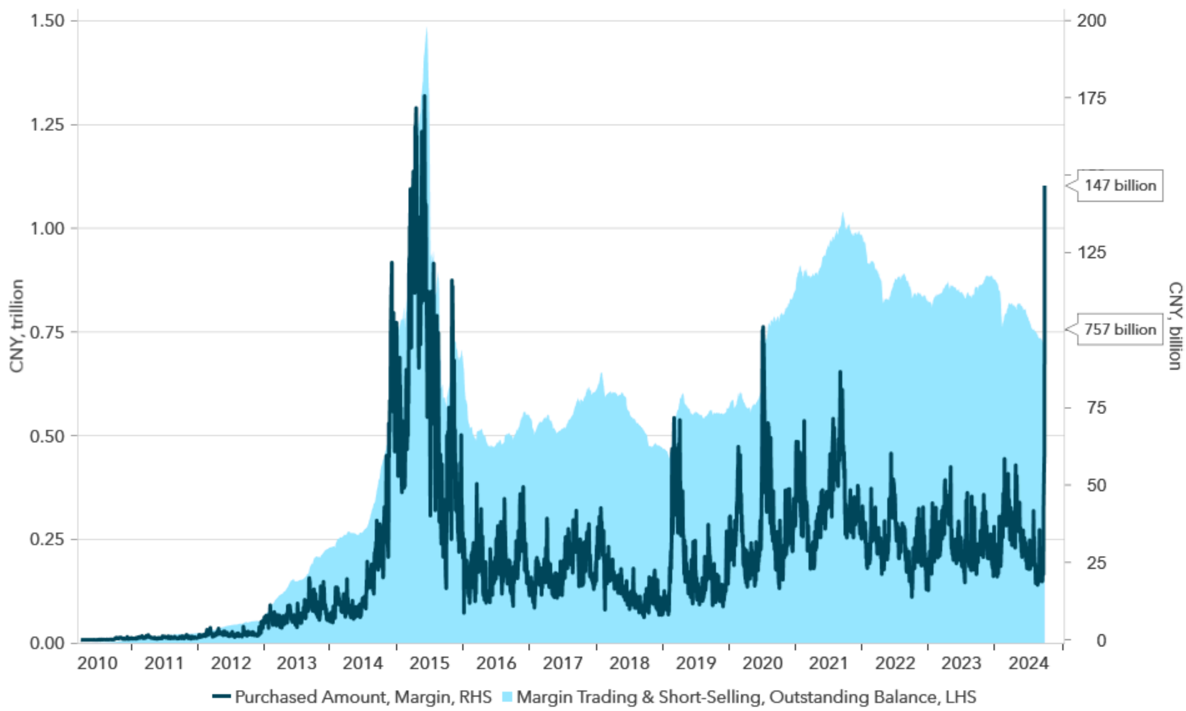
Exhibit #1: iFlow – CNY and Chinese Equities in Q3



Source: BNY

Given the nature of participants in China's equity markets, the surges seen toward month-end had to have entailed some degree of retail participation. Regardless of the efficacy of the measures over any specified timeframe, a surge in retail participation cannot be ignored simply on a tactical or risk management basis. Chinese exchanges continue to publish daily updates of margin trading activity and Exhibit #2 shows the current state of play. Outstanding margin balances remain near five-year lows, but the purchased amount on margin on September 30 was the largest for a single day since 2015. Economic and financial conditions are evidently very different compared to 2015. Market structures are very different as well given the Hong Kong-Shanghai stock connect was launched at that time. Without taking a view on fundamentals, we believe a repeat of 2015 is highly unlikely and any large normalization in margin account activity does not necessarily mean a decline in the underlying index looms, but it is an important aspect of calibrating the investment process as institutional investors should avoid being “crowded in” by retail.

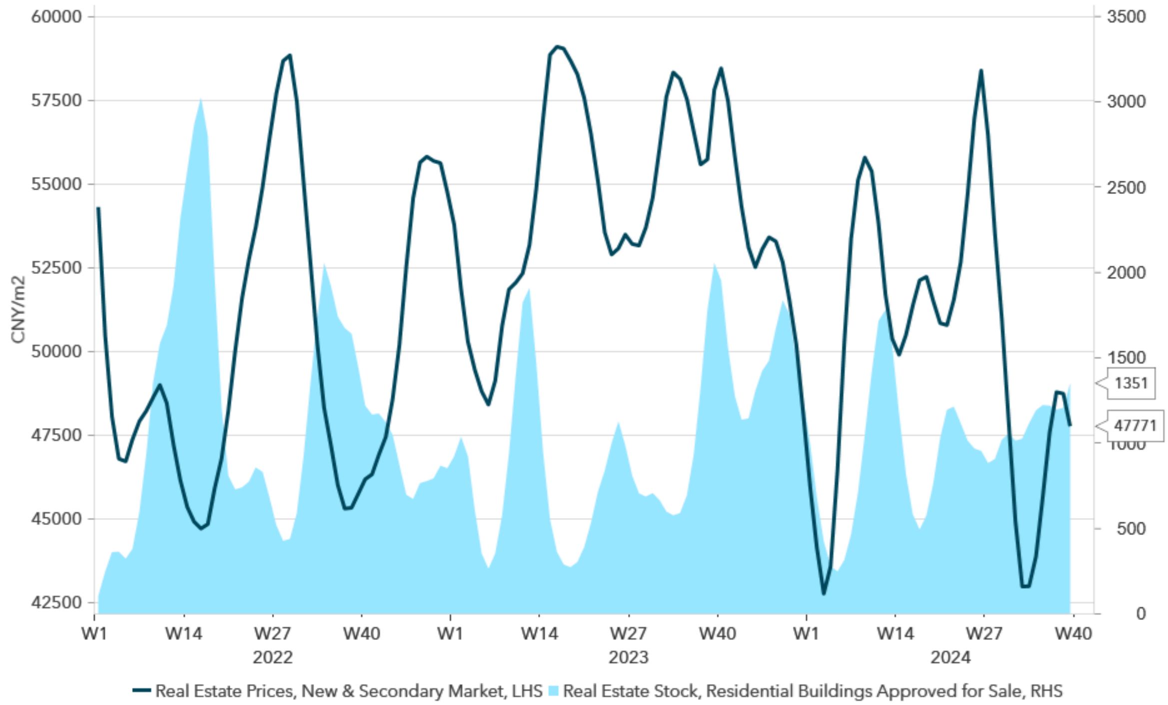
Exhibit #2: Margin Accounts in Shanghai



Source: Macrobond, BNY

Moving to the real economy, our primary focus remains on the real estate market. There has been comprehensive liberalization of real estate purchase restrictions, and this could help stabilize prices. The structural issues are well-known but tracking sentiment shifts is important. There are major differences in the real estate market among Chinese cities, according to region, size and development tier. However, each major city has publicly available weekly activity indicators. For example, Exhibit #3 shows real estate prices in the new and secondary market for Beijing, along with the inventory of buildings for sale. The relationship between the two is dynamic, and there is no clear indication as to what will move first. Even if sentiment improves, approved inventory may rise first and keep a cap on prices in even the most desirable of locations. Ultimately, if weekly transaction levels rise with average selling prices, the confidence boost through the wealth effect alone will certainly support growth.

Exhibit #3: Beijing Real Estate Transactions and Prices



Source: Macrobond, BNY

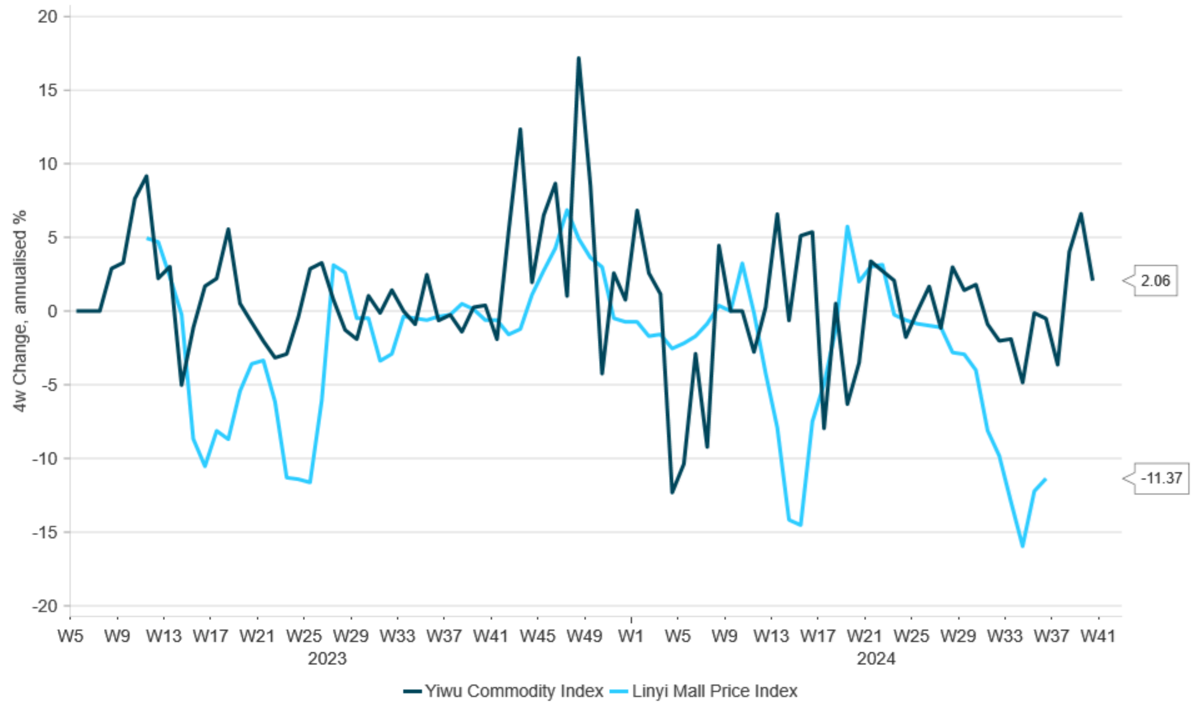
Even though we believe any stimulus from China should remain focused on consumption demand rather than real estate-based investment growth, stabilization or even a turnaround in the real estate market itself will have material implications for the terms of trade of global commodity producers. Unsurprisingly, iron ore futures have already rallied strongly (Exhibit #4) in hopes that real estate and other forms of industrial activity will start to pick up again. A sharp recovery in iron ore will also have material implications for currencies such as AUD and BRL. On the other hand, markets will need to bear in mind that the country's growth strategy is now reorienting toward high value-added technologies rather than investment growth. China's disruption of the global car industry is well documented and the long-term strategy for green energy means sustained demand for raw materials in the supply chain. In contrast to iron ore, lithium hydroxide futures have not moved, suggesting that markets are not seeing any immediate boost to electric vehicles or associated products. Overcapacity remains a concern and as sufficient national- and local-level support has already been deployed in recent years, it is understandable that markets are not looking for marginal growth in these areas.

Exhibit #4: Iron Ore and Lithium Hydroxide Prices

Source: Bloomberg, BNY

Finally, household consumption is where the success of the program will be judged by international markets. There has been some degree of repricing in relevant equity sectors exposed to the Chinese consumer, but for a country facing disinflationary pressures, signs of demand gains will lie in sales prices. The National Development and Reform Commission and Ministry of Commerce have several weekly price indices designed to track consumer demand. For example, the NDRC tracks Beijing wholesale grocery prices, Hainan tourism prices and wholesale goods prices in Linyi Mall, which is one of the oldest, largest and most important wholesale centers in the country. The Ministry of Commerce also produces the Yiwu Commodity Index, tracking sales prices at the Yiwu International Business and Trade City, which is considered to be the world's largest small commodities market. The Yiwu Index (Exhibit #4) appears to be showing signs of movement already, but as this market has heavy export reliance, international conditions will play a role in prices. In contrast, the Linyi Mall index better reflects domestic demand, and it is no surprise that the index has been negative for much of the year. If both indices start to lift strongly in the coming weeks, it will be a clear sign of demand shifts taking place domestically and internationally and provide earlier confirmation than PMI or retail sales surveys.

Exhibit #5: Wholesale Price Indices



Source: Macrobond, BNY

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