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MACRO MORNING BRIEFING

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Pick The Right China Trade

China "FOMO" may dominate markets in the near-term

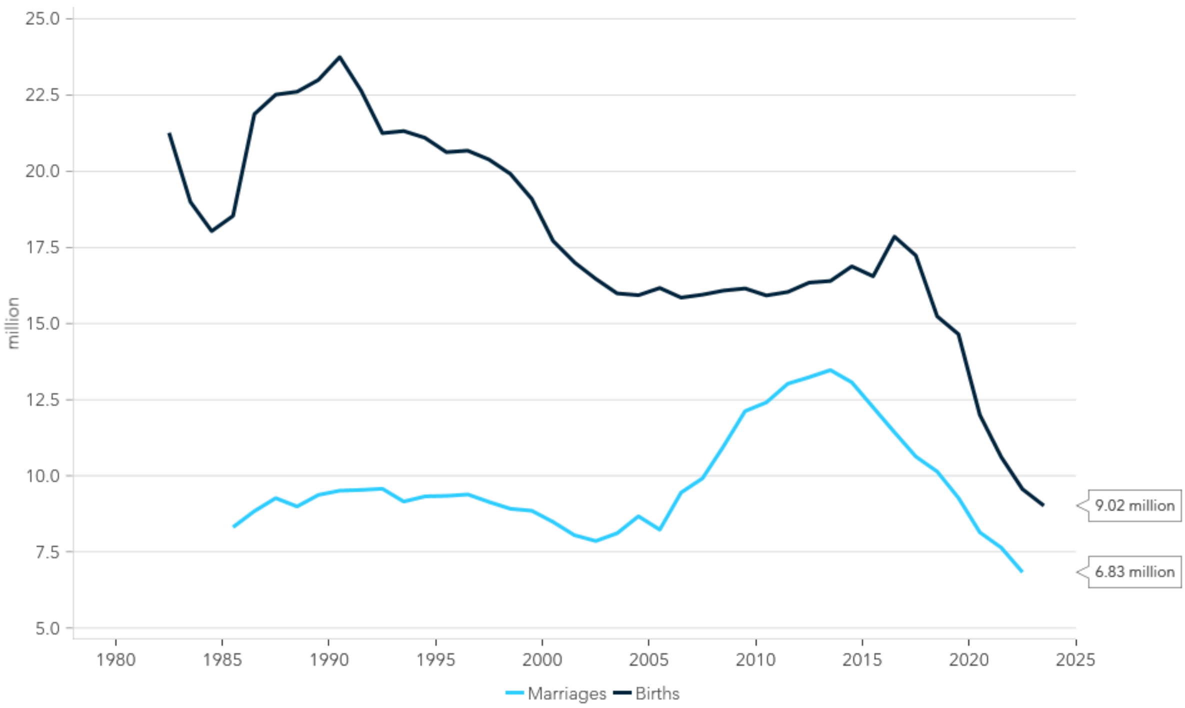
- More stimulus details likely through coming weeks
- "Consumption beta" far more relevant than "Investment beta"
- Confirmation of fiscal plans still needed for more meaningful moves

Focus on consumption and services demand, selectively

In recent years, the acronyms FOMO ("fear of missing out") and TINA ("there is no alternative") entered the market vocabulary used to describe US equities. The notion of US exceptionalism led to material changes in asset allocation, leading to self-reinforcing flows into US equities – especially in tech. Given the performance of US equities year to date, "FOMO" still applies to the US, but perhaps now there is an alternative, at least in the short term. China's exhaustive list of stimulus measures (and more may yet arrive) has propelled performance in local equities and a host of other asset classes which are seen to benefit. Given that we have just seen the best week in Chinese equities since 2008, there is an air of the 2009 stimulus about markets, and a fear of missing out on what could prove a major risk boost in a generally softer global growth environment. This will be the case not just for Chinese assets, but also external.

However, we would highlight that this is a very different environment compared to 2008 and it would not be prudent to assume that the themes which worked during that stimulus round will work this time. The usual caveats surrounding real estate markets and investment growth certainly apply as China's economy is supposed to rebalance toward household consumption. Even assuming that this round of stimulus is targeted to support the household, for now we would see it in a tactical context only to ensure that this year's growth target is achieved, and not take a view on future trends or policy. The most significant announcement last week – yet to be confirmed onshore – is the prospect of material cash support for households with more than one child. Household formation (Exhibit #1) is clearly a challenging issue in China at present. The recent increase in the pension age was another sign of fiscal pressures introduced by demographics. This is why a major cash injection for households would be a huge surprise as it marks a departure from prior policy. For example, the last round of major fiscal support for households in 2019 was centered on taxes, base adjustment, and changes to social security contributions. The cost of the reported childcare allowance would also be quite large. According to the latest available data, the number of second childbirths in 2022 was 38.9% while the range since policy liberalization was 50%-60%. We estimate that the total cost of such a scheme, at CNY800 per month, would be more than CNY500 bn over the next calendar year, which would be well above the national education budget for 2024 (CNY428.9 bn). If the measures can help support demographics over the medium to longer term, the associated improvements in potential growth would mean that the fiscal situation would even improve. However, the record for pro-natal policies over the past few decades in developed and developing countries alike has left much to be desired, so certain sectors such as childcare and baby formula – a major China-fueled growth industry for the staples sector 10-15 years ago – should remain reserved in their expectations.

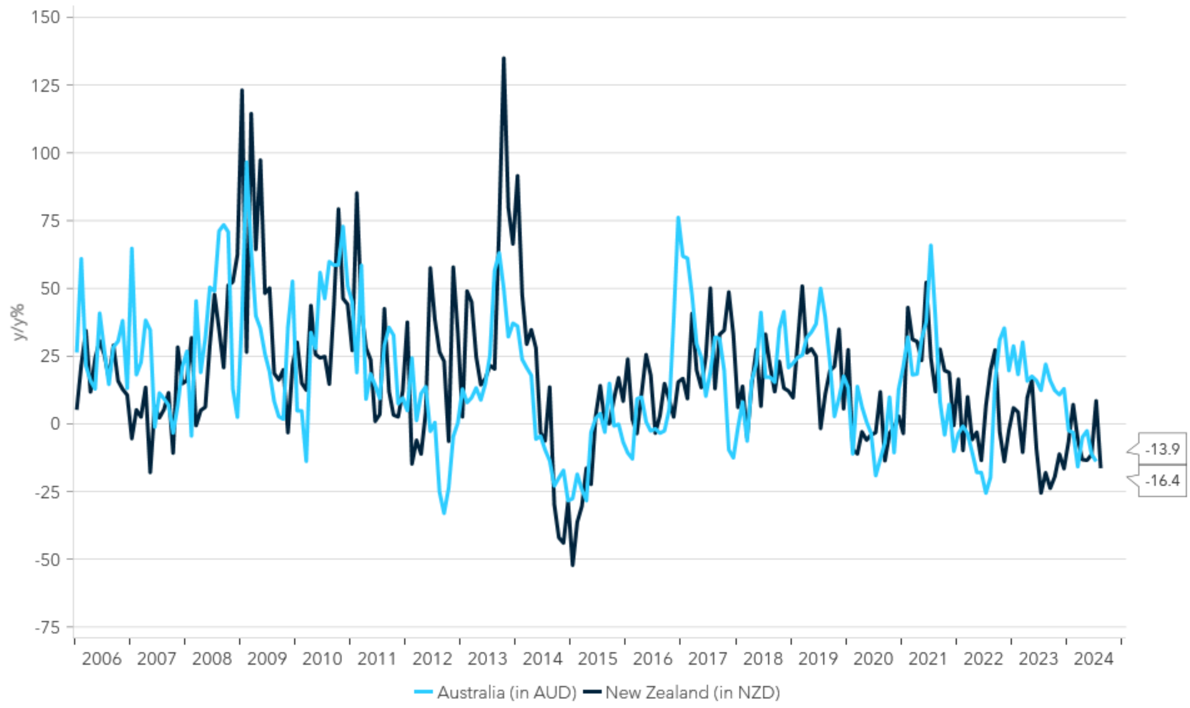
Exhibit #1: China Household Formation



Source: Macrobond, BNY

Along the same lines, there was a time when Chinese demographics were also critical for NZD and New Zealand's agricultural sector based on the protein trade. While dairy products remain a crucial source of exports for New Zealand and the global price of powdered milk remains as crucial for New Zealand's terms of trade as oil prices for the Gulf region, China's impact is not as strong as in the past. Protein consumption in general is expected to remain strong as diets change, but marginal growth rates are expected to decline over time. AUD on the hand, has always enjoyed a higher “China beta” on account of base metals exports as well as agricultural products and other consumer goods. As a result, the recent rally in the AUD is perhaps more justified. Export growth to China for both countries has been weak year to date (Exhibit #2), and a bigger decline has been seen in Australia, which is to be expected as the country’s mining sector is closely associated with real estate, steel and other industrial sectors. Stabilization in real estate is a core part of the stimulus plans, and on top of improved consumption preferences for households, Australia can look forward to a material terms of trade lift.

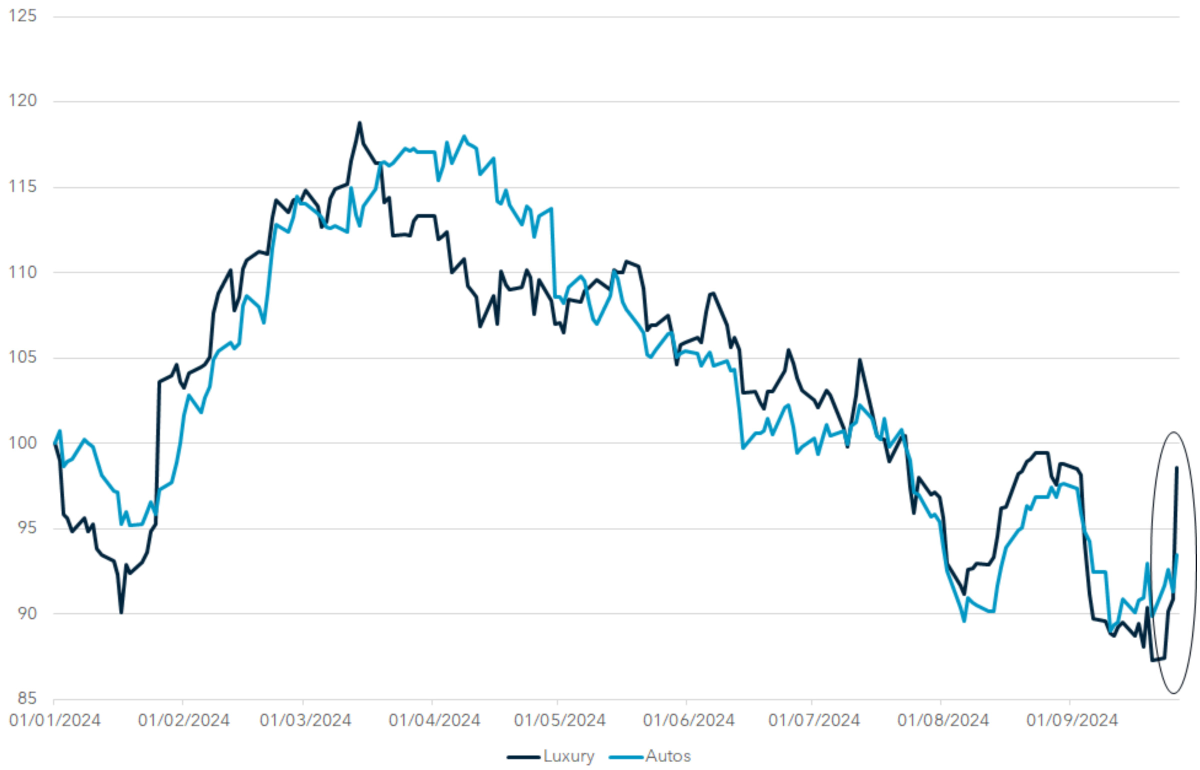
Exhibit #2: New Zealand, Australia Export Growth to China



Source: Macrobond, BNY

For global sectoral performance, the luxury goods sector arguably has the highest beta to a recovery in Chinese household consumption. The earnings reports year to date of every single global luxury goods company has cited a weak China consumer as a reason for a more cautious outlook. The stimulus news has generated the strongest week for European luxury this year, but equity investors need to be careful about short-term tactical recovery versus genuine re-rating due to strong Chinese demand on a structural basis. Cashflow improvement is always welcome for households, but addressing liabilities is no substitute for raising nominal and real economies, and therein lies the medium-term challenge for all middle-income economies. One European sector which probably won’t benefit from any amount of Chinese stimulus is the auto sector. Structural changes are afoot, as highlighted by German carmakers themselves. China’s industrial policy will not be affected but short-term stimulus plans and will be a competitor to most global carmakers for many years to come in the new energy vehicle (NEV) segment.

Exhibit #3: European Luxury vs. Autos



Source: Macrobond, BNY

The bottom line for the global economy is that a sudden injection of Chinese demand will help stabilize growth outcomes for Q4. Even the Fed would welcome such tailwinds even though the trade exposure for the US is small on a relative basis. However, as we have highlighted in the past, one area where China's household demand will grow to the benefit of developed market economies is in services. Tourism and education aside, the recent news opening up China's healthcare sector to foreign hospital providers is a statement of intent by Beijing not only to attract foreign direct investment, but also to signal renewed economic openness. The demographic outlook for China means health and social care will be one of the largest growth areas of the Chinese economy. Running a larger services deficit over the medium to longer term is almost a benchmark for modernization and rebalancing into a services-based economy. We can see that China's services imports growth rates already outpace those of goods imports (Exhibit #4), and renewed vigor in the household can only further strengthen such demand.

Exhibit #4: Chinese Export Growth

Source: Bloomberg, BNY

Disclaimer & Disclosures

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

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