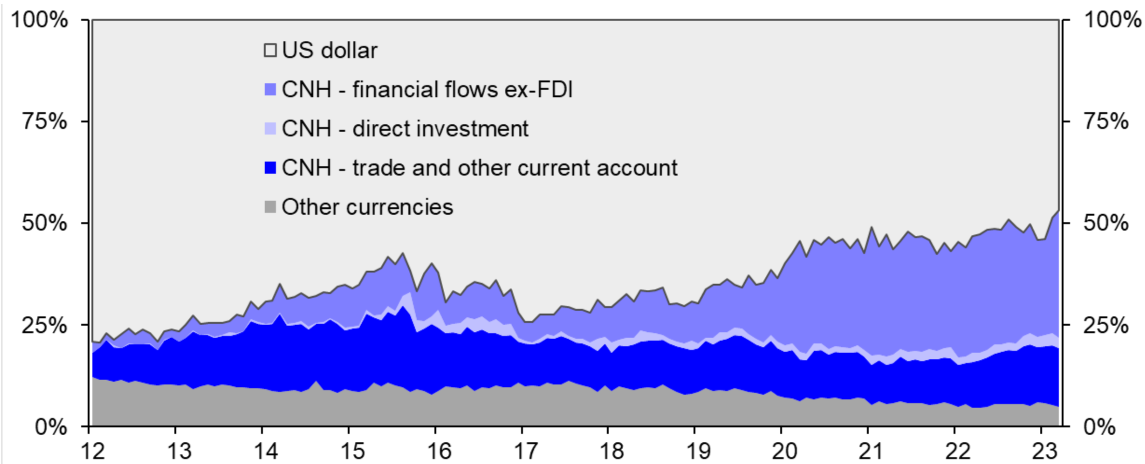
CAPITAL ECONOMICS 凯投宏观

CHINA CHART BOOK

Financial flows, not trade, leading CNH expansion

- The renminbi surpassed the US dollar to become the most-commonly-used currency in China's cross-border transactions for the first time last month. Part of the increase – the part that has received plenty of attention – is due to wider adoption of renminbi settlement in trade flows: nearly a quarter of China's current account transactions are now being settled in CNH, up from 17% just before the US and its allies imposed financial sanctions on Russia a year ago. But most of the increase in cross-border use of the renminbi is due to strong growth in CNH-settled financial flows. (See Chart 1.) And most of these financial flows are not with "foreign" partners but with entities in Hong Kong, which is the conduit for flows into China's onshore markets through the Stock and Bond Connect schemes and also an offshore base for many Chinese firms. The renminbi is crossing the border more often but for the most part it isn't going far.
- **Output & activity indicators** show the rapid rebound has largely been service-driven.
- **Consumer indicators** suggest households are more confident and are returning to normal spending patterns.
- **Business indicators** suggest weakness in construction activity likely weighed on industrial demand in Q1.
- **Property indicators** point to a budding turnaround in housing demand while developers remain cautious.
- **External indicators** jumped unexpected, but this may not reflect rising foreign demand.
- **Inflation indicators** signal that the inflationary impact of reopening has been marginal.
- **Monetary indicators** suggest that credit demand is recovering.
- **Financial markets** point to that reopening rally in China's stock market has lost some momentum.
- **Hong Kong indicators** suggest that exports and the return of tourist kick started the recovery in Q1.

Chart 1: Settlement Currency Used in China's Cross-Border Transactions



Sources: CEIC, Capital Economics

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Output & Activity

- The economy rebounded strongly in Q1 following the end of zero-COVID. GDP expanded 2.2% q/q on the official figures. Our in-house alternative, the China Activity Proxy (CAP), shows a much larger 7.0% q/q rebound out of a deeper trough than was acknowledged by official GDP **(2)**. The boost was concentrated in the services sector, with the most significant improvements seen in transport, retail and hospitality **(3)** – the sectors hit hardest by zero-COVID controls. One other sector that saw a marked turnaround was real estate services, thanks to the recent recovery in new home sales.
- Activity continued its robust recovery in March. Services continued to regain lost ground. Industrial production was strong too but construction activity still shows no sign of a lasting pick-up **(4,5)**. Optimism surrounding reopening appears to have supported manufacturing investment **(6)**. And the front-loading of government borrowing this year shored up infrastructure investment. But property investment softened further as developers continued to err on the side of caution.
- More timely data suggest that the industrial sector softened this month **(7)**. A relatively short-lived reopening bounce in industry would not be entirely surprising given the smaller hit to the sector from zero-COVID.

Chart 2: CE China Activity Proxy & Official GDP (2019 = 100, seas. adj.)

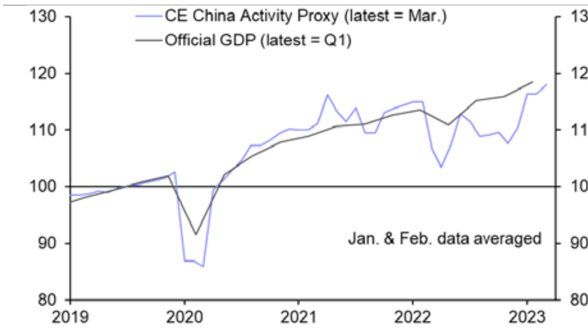


Chart 3: Contribution to Year-on-Year GDP Growth by Sector (%-pts, seas. adj.)

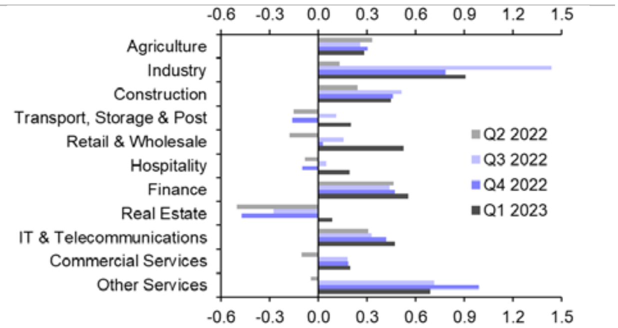


Chart 4: CAP – Sector Proxies (2019 = 100, seas. adj.)

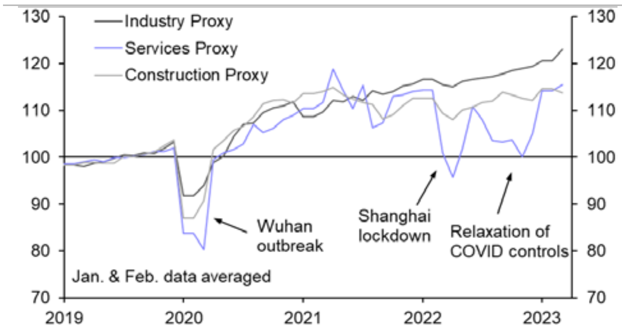


Chart 5: CE Industrial Output Index (2019 = 100, seas. adj.)

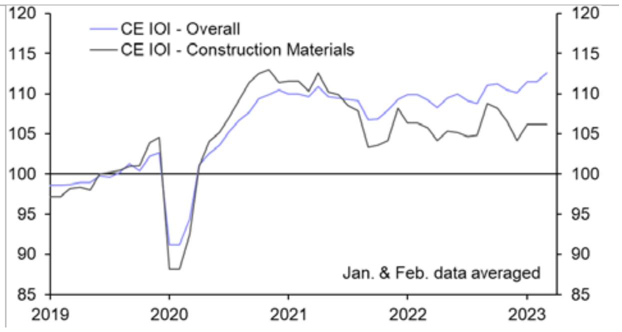


Chart 6: Fixed Investment (Dec. 2019 = 100, seas. adj.)

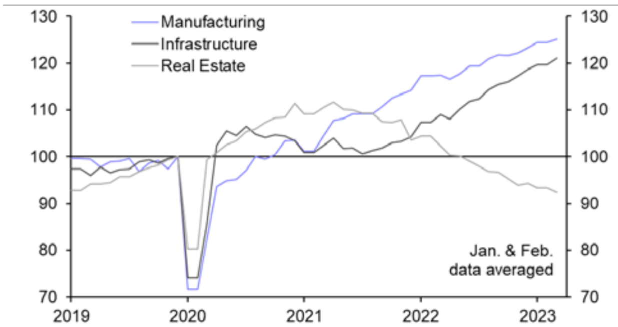
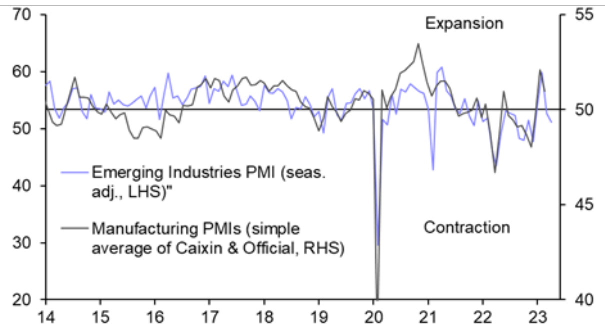


Chart 7: Manufacturing & Emerging Industry PMIs



Sources: CEIC, Wind, S&P Global, Capital Economics

Consumer Spending

- After a sharp contraction in Q4, consumer spending rebounded strongly in Q1 according to the household survey **(8)**. Retail sales are now 9% above the November low, and there is scope for a further pick-up. In-person services such as catering have been the main beneficiaries from reopening **(9)**. This largely reflects an improvement in sentiment **(10)** thanks to the removal of virus restrictions and fading fear of infection. Our mobility tracker suggests in-person activity has stabilised at 25% above 2019 levels recently **(11)**.

- The increase in consumption can partly be explained by a sharp fall in the savings rate **(8)** which suggest that households have become more comfortable about returning to normal spending patterns. A tightening labour market probably also played a part. There is scope for further declines as labour-intensive consumer-facing service industries continue to bounce back following the pivot away from zero-COVID and given that pockets of weakness remain among the young **(12)**

- Outbound travel is now back to roughly 30% of its pre-pandemic level **(13)**. As supply-side constraints – such as insufficient capacity on international airline routes and in tourism sectors in destination countries – ease, numbers should rise much further. Our forecast is for outbound tourism to reach 75% of pre-pandemic levels by the end of the year.

Chart 8: Household Consumption & Saving

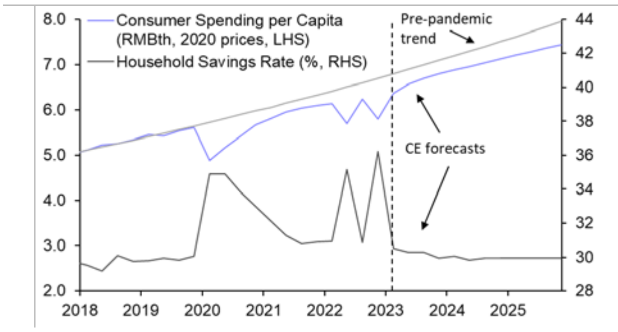


Chart 9: Retail Sales (Dec. 2019=100, seas. adj.)

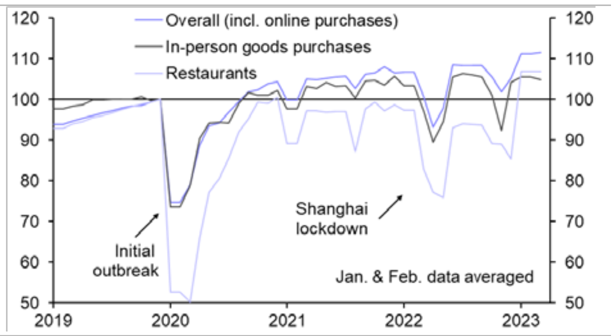


Chart 10: Consumer Confidence Indices

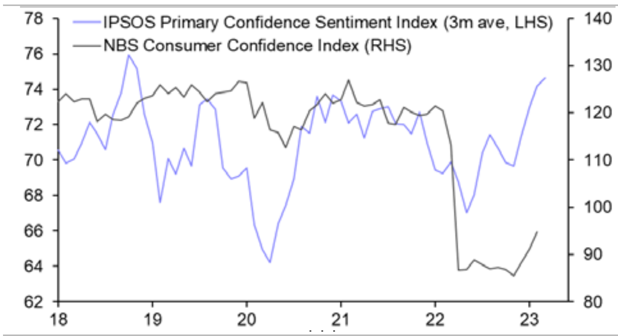


Chart 11: CE China Mobility Tracker (% of 2019)

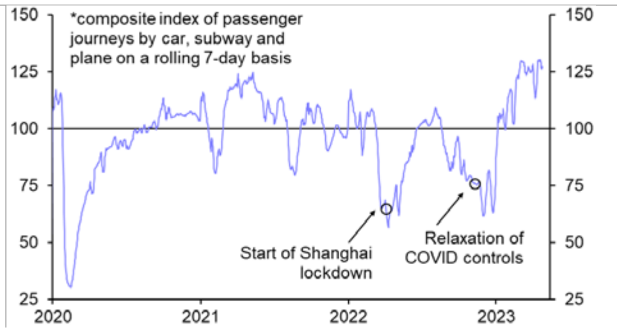


Chart 12: Surveyed Unemployment Rate (%, seas. adj.)

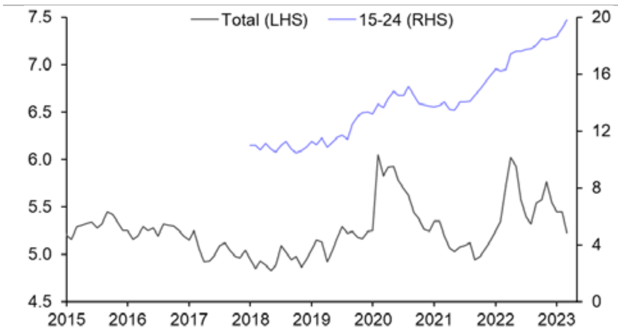
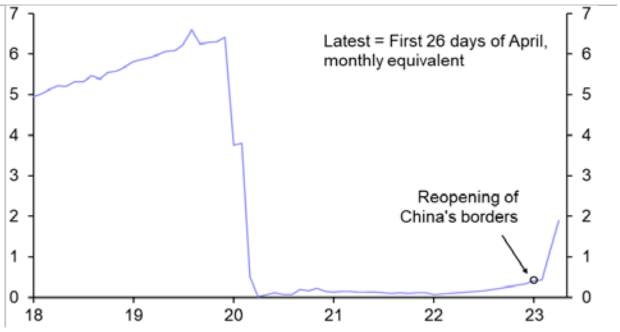


Chart 13: International Flights (person-km bn, seas. adj.)



Sources: CEIC, Wind, S&P Global, Capital Economics

Business

- Surveys suggest that most supply-chain problems eased quickly on reopening **(14)**. But profit margins of industrial firms remained under pressure at the end of Q1 **(15)**. Stubbornly high inventories of finished goods relative to sales **(16)** and falling capacity utilisation **(17)** suggest that persistent weakness in demand is to be blamed. Note that the industrial survey is skewed towards heavy industry – this demand weakness may reflect the lack of momentum in construction activity shown above **(4)**.
- The partial recovery in export sales from industry has stalled **(18)**. While this contradicts the message of strength in the customs export data, it probably is a better gauge of global demand (see the External Trade section below).
- Although the current operating environment remains challenging for some parts of industry, the dismantling of the zero-COVID policy has removed one key source of uncertainty. Survey-based measures of corporate investment intentions have rapidly improved **(19)**.

Chart 14: Manu. PMIs – Suppliers' Delivery Times (Official & Caixin Ave.)

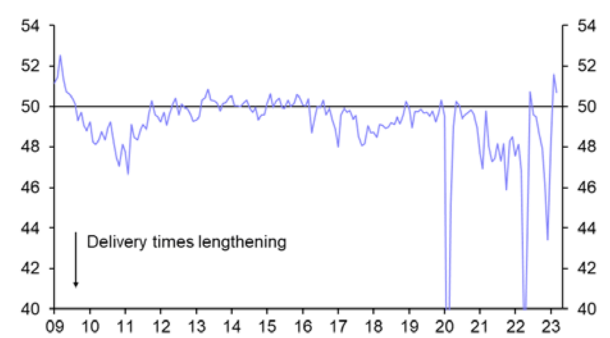


Chart 15: Net Profit Margins (%, seas. adj.)

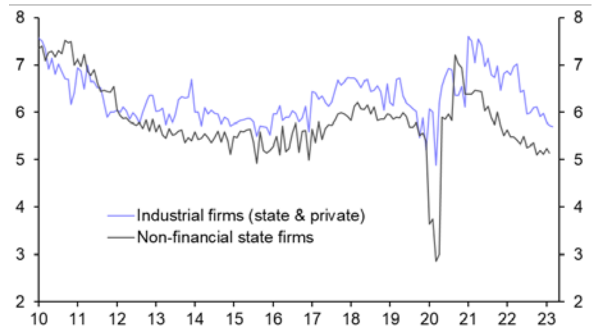


Chart 16: Final Goods Inventory (days of sales, seas. adj.)

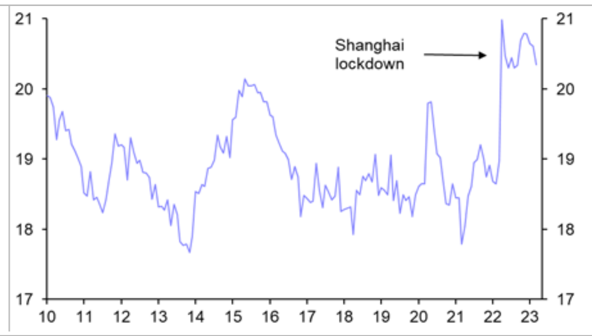


Chart 17: Industry Capacity Utilisation Rate (%)

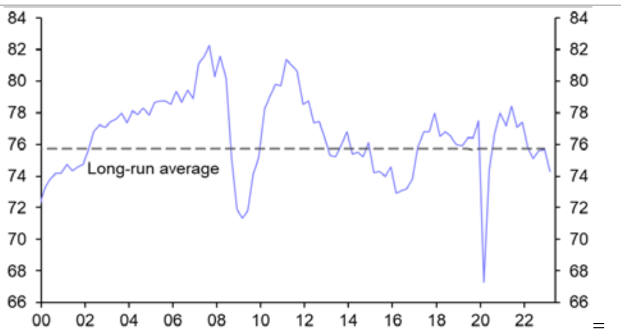
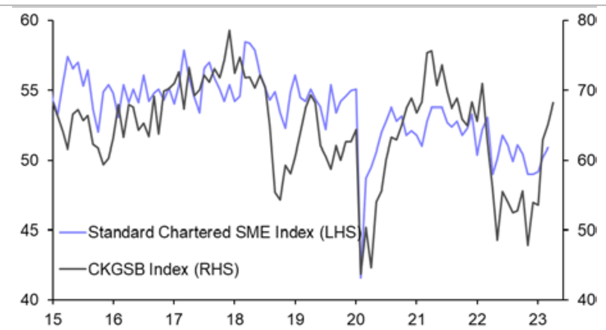


Chart 18: Industrial Sales (Dec. 2019=100, seas. adj.)

Chart 19: Future Investment Intentions



Sources: CEIC, S&P Global, Bloomberg, Capital Economics

Property

- A modest turnaround appears underway in the housing market. Signals on housing demand have been positive since the turn of the year. Admittedly, sales in large cities have reversed some gains in recent weeks. But they remain 25% above the November low **(20)**. And home prices rose by the fastest clip in 21 months in March **(21)**. Part of the reason has been substantial policy easing, including faster mortgage loan disbursement, and sharp declines in mortgage rates and downpayments **(22)**. Support has also been extended to developers to ensure that stalled projects are completed. Together with the lifting of the zero-COVID policy, these moves have boosted homebuyers' sentiment.

- However, a pick-up in sales hasn't translated into an acceleration in construction activity, evidenced by the glut of cement in storage **(23)**. The relaxation of constraints on developer access to financing has not resulted in much of a pick-up in their borrowing **(24)** – developers remain cautious and focused on repairing their finances. Indeed, after taking into account existing projects that have yet to be completed, the level of new housing starts is still consistent with a further fall in property construction in the coming months **(25)**.

Chart 20: New Home Sales (million sqm, seas. adj.)

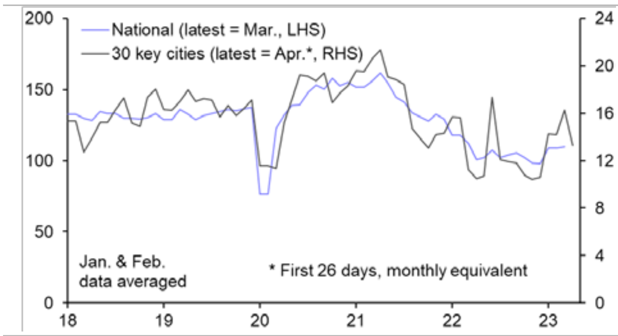


Chart 21: New House Price (% m/m, 70 city ave.)

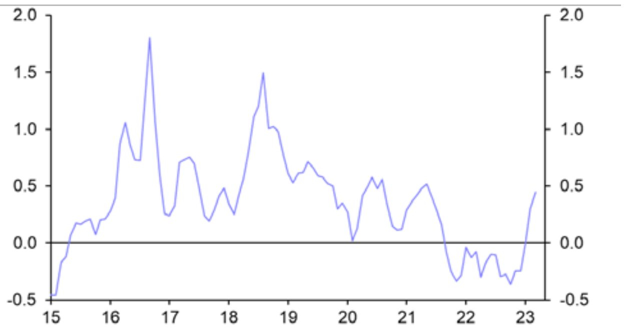


Chart 22: Proxies for Property Controls

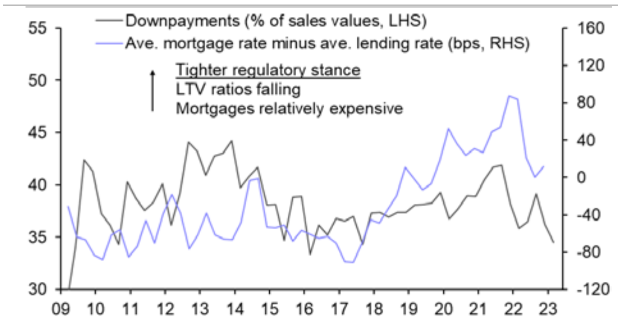


Chart 23: Cement Inventories (% of storage capacity, seas. adj.)

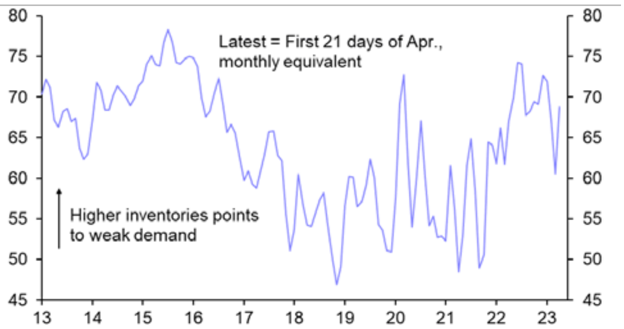


Chart 24: Developer Financing (% of trend GDP, seas. adj.)

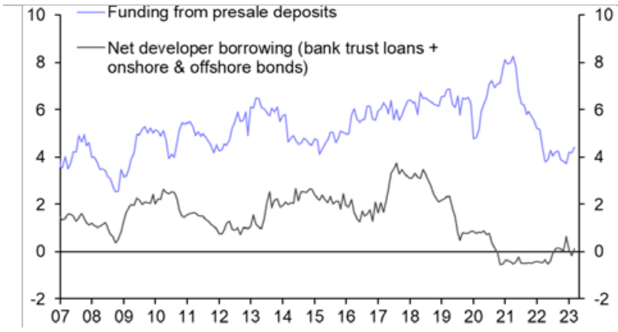
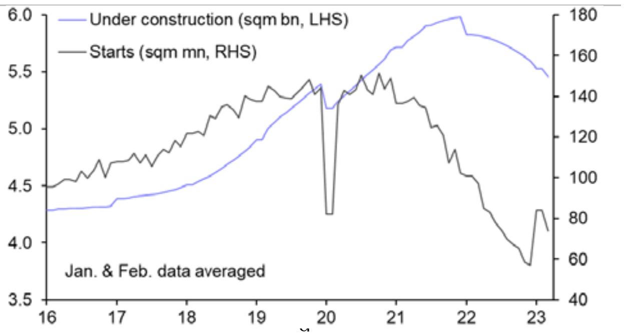


Chart 25: Property Construction Activity (seas. adj.)



Sources: CEIC, Wind, Capital Economics

External Trade

- Customs reported a large, unexpected jump in exports last month **(26)**. But we're not convinced this is the result of rising foreign demand. The trade data are noisy, especially at the start of the year, and may have been further distorted by the end of zero-COVID restrictions. The less volatile industrial export sales data point to a slight decline in exports in March **(27)**, which would be consistent with the export data from others in the region **(28)**. Freight rates point to demand still cooling too **(29)**.
- Over the past year, China's exports to ASEAN have increased sharply **(30)**, while shipments to the US have declined considerably. This could be due to re-routing of trade through ASEAN to avoid US tariffs, as happened when tariffs were first introduced, or a sign that final assembly of goods is leaving China.
- Import volumes rose to a 13-month high in seasonally-adjusted terms last month **(26)**, with a particularly large rise in energy imports as orders placed as China emerged from zero-COVID reached China's shores **(31)**. We expect imports to pick up further in the near term.

Chart 26: Goods Trade ($bn, seas. adj. 2010 prices)

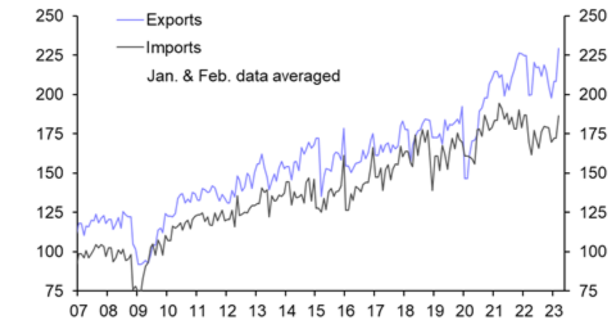


Chart 27: Exports & Industrial Export Sales ($, Dec. 2019=100, CE seas. adj.)

Chart 28: Goods Exports ($, Dec. 19 = 100, seas. adj.)

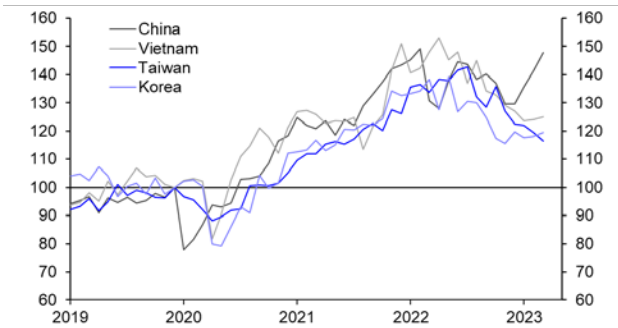


Chart 29: Container Freight Rates for China/Asia Outbound Routes (Dec. 19 = 100)

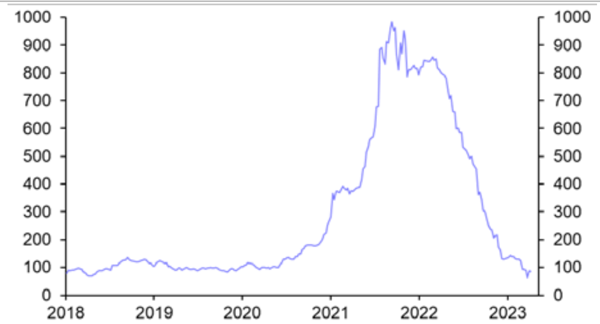


Chart 30: China Exports by Destination ($bn, seas. adj.)

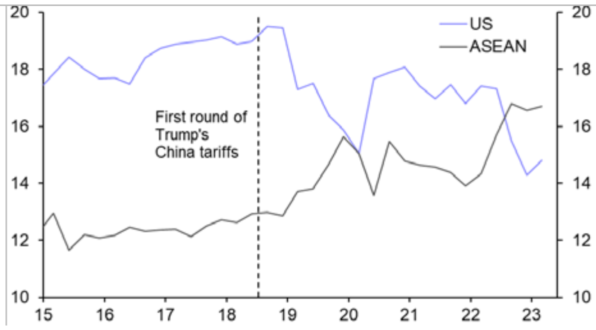
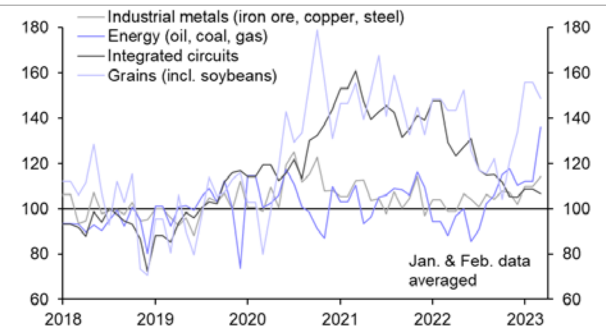


Chart 31: Imports Volumes by Product (2019 = 100, seas. adj.)



Sources: CEIC, Refinitiv, CPB, Capital Economics

Inflation

- Consumer price inflation dropped below 1% in March for the first time in over a year **(32)**. Core inflation declined after rising for the past couple of months, as inflation in travel **(33)** and other in-person services dropped back. Even in these sectors, the inflationary impact of reopening has been very small.
- Fuel inflation retreated into negative territory for the first time since the start of 2021 **(34)**. This was due to a higher base for comparison – oil prices surged early last year. We think that fuel price inflation will remain negative in the coming months thanks to a strong base for comparison.
- Producer price deflation deepened further last month to a 33-month low **(35)**. Consumer durable prices are once again falling **(36)**, which was the norm before the pandemic. Weekly data suggest that output prices at Chinese factories have edged down again in recent weeks **(37)**.

Chart 32: Consumer Prices (% y/y)

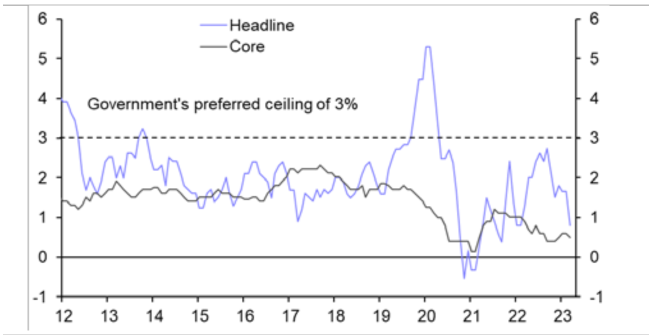


Chart 33: CPI – Tourism Services (% y/y*)

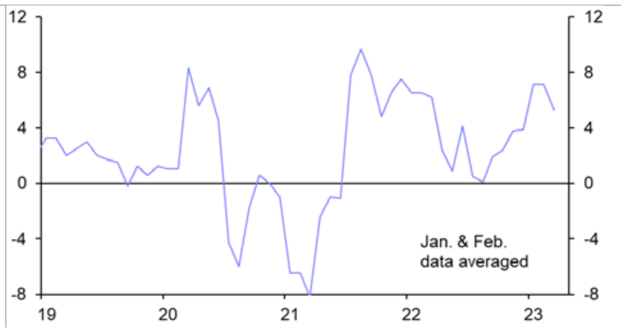


Chart 34: Oil & Vehicle Fuel Prices (% y/y)

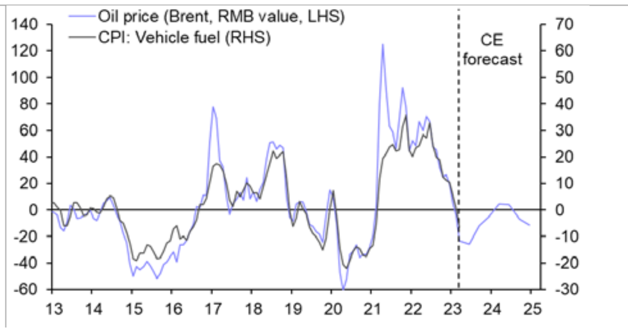


Chart 35: Producer Prices

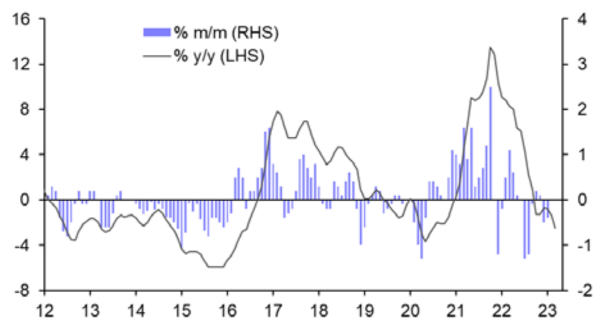


Chart 36: PPI – Durable Consumer Goods (% 3m/3m)

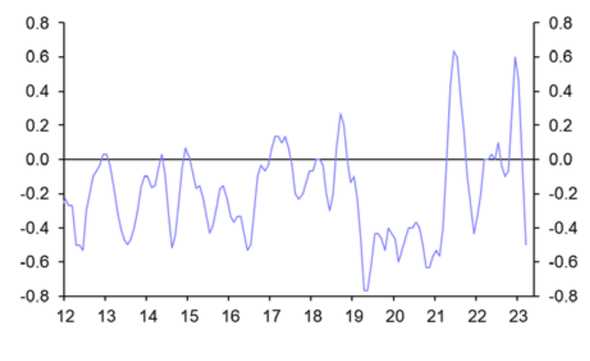
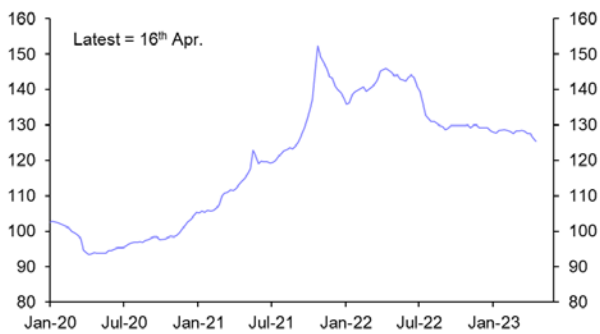


Chart 37: Weekly Producer Prices (23rd Feb. 20 = 100)



Sources: CEIC, Refinitiv, Capital Economics

Monetary

- The PBOC has kept its key policy rates unchanged since the shift away from zero-COVID **(38)**, except for a 25bp cut to the RRR. We don't expect the PBOC to cut rates in the near term, as credit demand is already recovering. The PBOC bank survey suggests that loan demand increased the most last quarter in over a decade **(39)**. Interbank rates also point to recovering credit demand -- they have converged with the rate offered by the PBOC, despite a RRR cut by the PBOC **(40)**.
- Credit growth has started to recover. Bank loan growth jumped to a 17-month high last month **(41)**, driven by faster lending to households thanks to stronger demand for mortgages. Broad credit growth also rose to its highest since December **(42)**. Admittedly, these year-on-year growth figures are still relatively low. But considering the strong base for comparison from one year ago when regulatory controls were relaxed, they point to a considerable rise in credit demand.
- We expect credit growth to rebound further before slowing from the middle of the year. Lending will bump up against regulatory constraints **(43)**, with the focus of the PBOC shifting to containing financial risks.

Chart 38: PBOC Policy Rates (%)

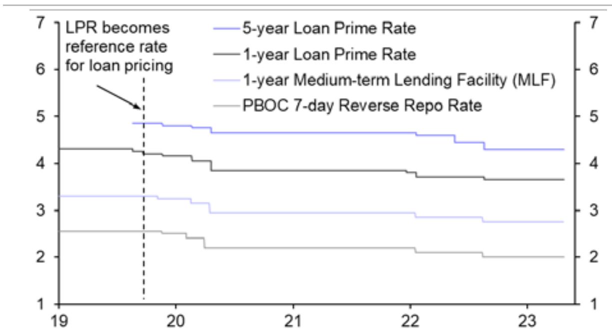


Chart 39: PBOC Banking Survey on Loan Demand (diffusion indices)

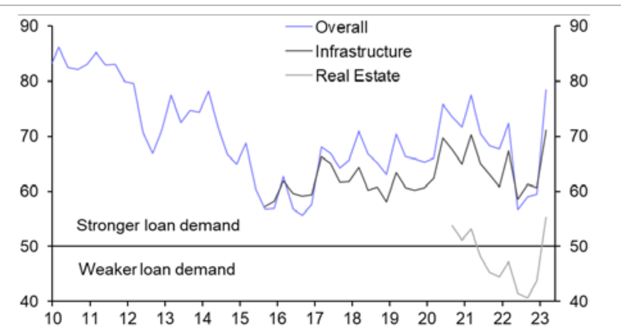


Chart 40: 7-Day Pledged Repo Rate (%)

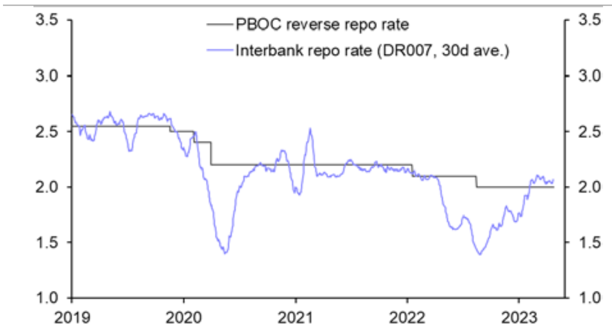


Chart 41: RMB Bank Loans (Outstanding, % y/y)

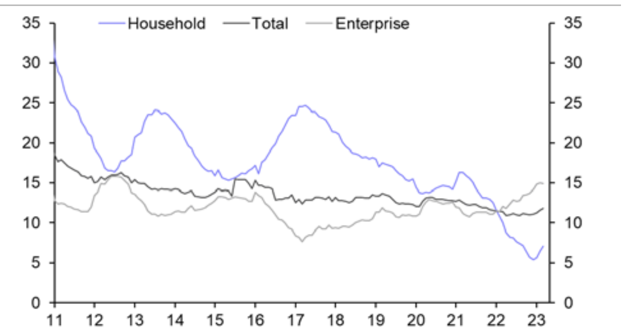


Chart 42: Growth of Outstanding Credit (% y/y)

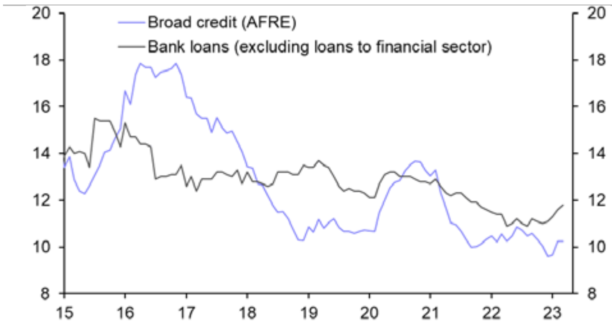
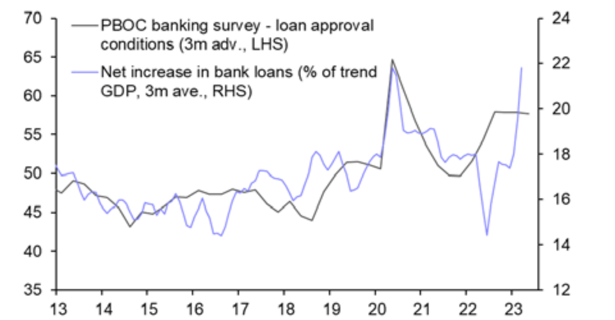


Chart 43: Bank Lending & Loan Approval Conditions



Sources: CEIC, Wind, Refinitiv, Capital Economics

Financial Markets

- The reopening rally in Hong Kong equities has stalled since early this year, despite encouraging macro data from China. The reopening rebound was less marked onshore, but the markets in Shanghai and Shenzhen also weakened after this month's release of better than expected data for Q1 **(44)**. And the surge in foreign flows into Chinese stocks earlier this year has slowed **(45)**. IT stocks had been recent outperformers **(46)**. Despite a lacklustre performance so far this year, we think low valuations give Chinese equities a springboard to do better over coming months **(47)**.
- Downward pressure on the renminbi against the dollar has eased **(48)** along with shifting expectations for monetary policy in the US.
- The reopening rally in offshore bonds has also partially reversed over the past couple of months **(49)**.

Chart 44: Equity Indices (20th Jan. 2020 = 100)

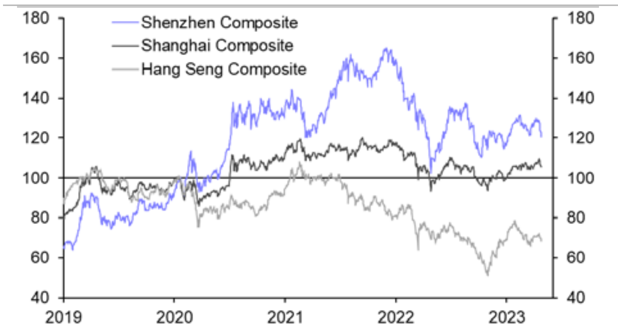


Chart 45: Net Inflows to Mainland Equity Markets via SH-HK & SZ-HK Stock Connect ($bn, 30d ave.)

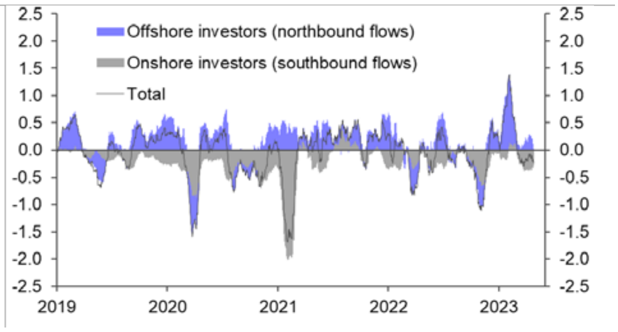


Chart 46: CSI 300 (20th Jan. 2020 = 100)

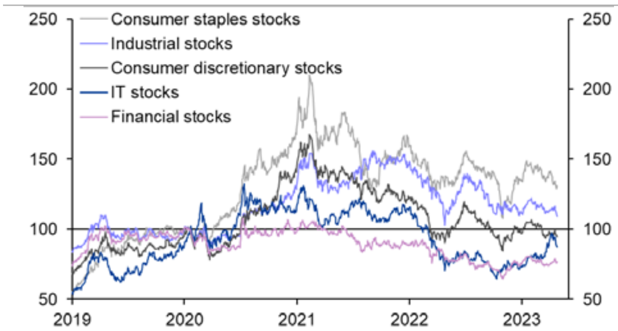


Chart 47: MSCI China vs MSCI World Forward PE Ratio

Chart 48: Renminbi Exchange Rate

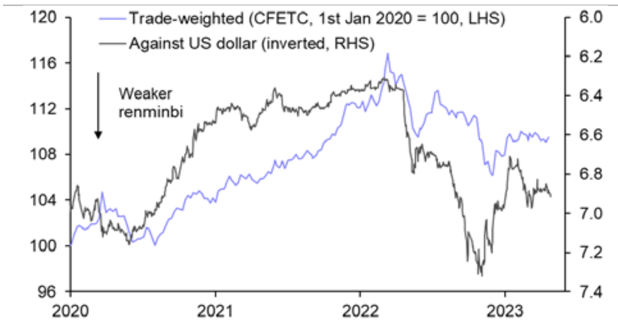
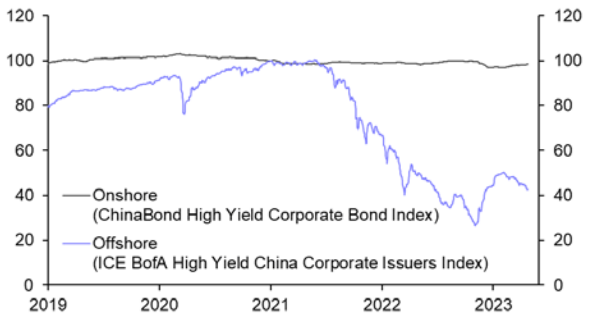


Chart 49: China High Yield Corporate Bond Indices (4th Jan. 2021 = 100)



Sources: CEIC, Refinitiv, Wind, Bloomberg, Capital Economics

Hong Kong

- Most signs suggest that Hong Kong's economy bottomed out in Q4 and that a rebound was underway last quarter. This was largely thanks to the removal of almost all virus-related measures and a surge in foreign visitors returning, particularly those from the mainland **(50)**. Their return has boosted the retail and hospitality sectors **(51)**. Goods exports have been unexpectedly strong too, providing an additional support to the economy **(52)**. The wider improvement in economic conditions so far has helped to bring the unemployment rate back down near its pre-pandemic levels **(53)**.
- That said, pockets of weakness remain. With the global picture unlikely to improve until later this year, softer foreign demand will start to weigh on exports again before long. And even though interest rates are likely to drop back later in the year, they will remain high for some time **(54)**. Encouragingly, there are some signs that home prices have stabilised after reaching a five-year low **(55)**. This partly reflects an improvement in sentiment, but it also suggests that policy support for the property sector is taking effect.

Chart 50: Hong Kong Passenger Arrivals Breakdown (mn, seas. adj.)

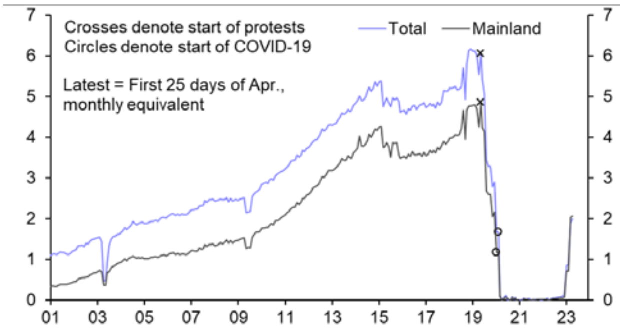


Chart 51: Retail Sales Volumes (May 2019 = 100, seas. adj.)

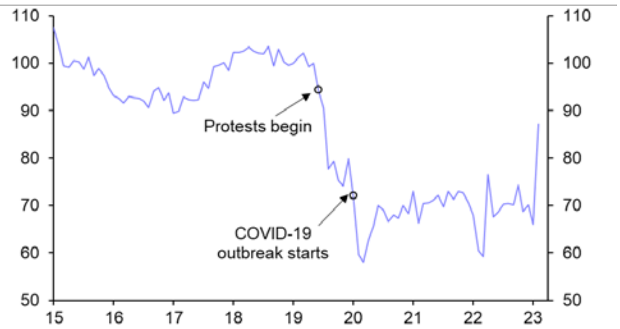


Chart 52: Goods Exports (Dec. 2019 = 100, seas. adj.)

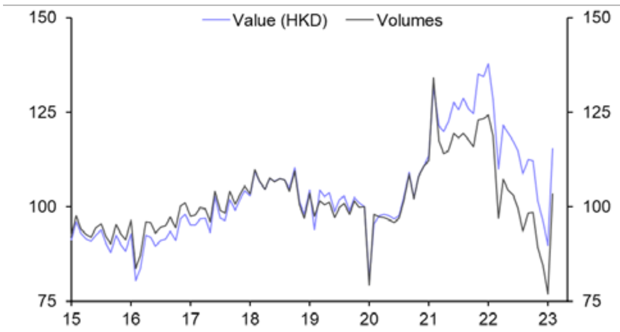


Chart 53: HK Unemployment Rate (%, seas. adj.)

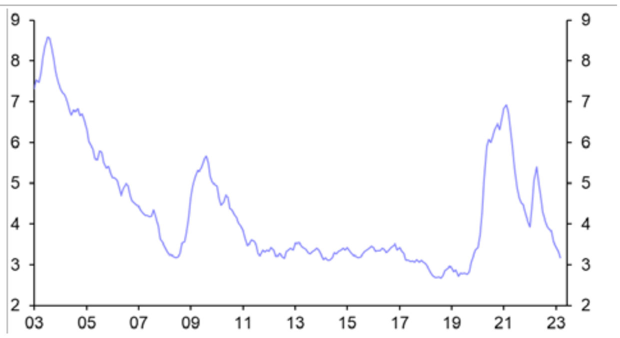


Chart 54: Interest Rates (%)

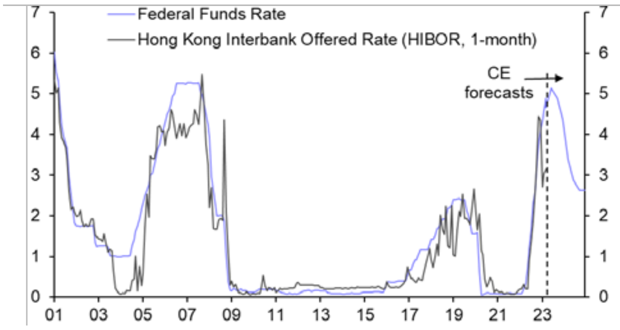
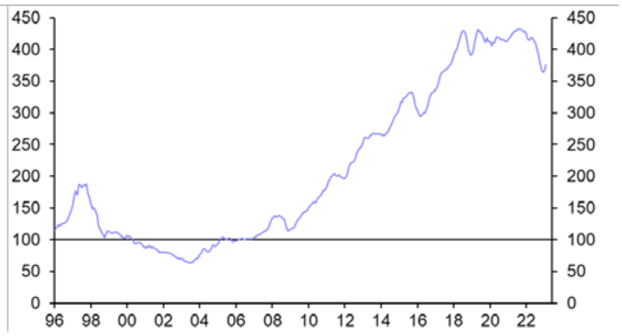


Chart 55: HK Residential Property Prices (2005 = 100)



Sources: CEIC, Capital Economics

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