CHINA ECONOMICS WEEKLY

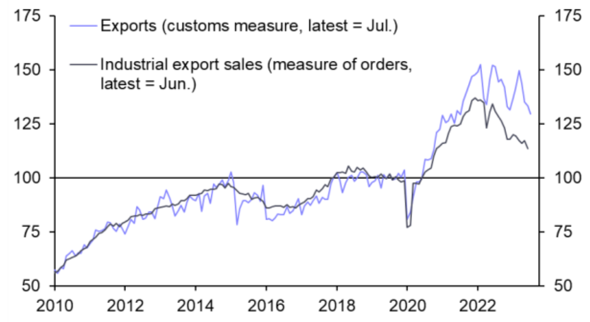
Export pullback understated, foreign travel to pick up

Exports may be weaker than they appear

China's exports fell 14.5% y/y in July, undershooting the analyst consensus. But given the sharp fall in export prices recently, what's more surprising to us is that export values haven't fallen even more. On paper, the customs data imply that export *volumes* are only 3% below their peak and still 14% above pre-pandemic levels.

That seems at odds with wider evidence of a more substantial pullback in foreign demand. As of May, the volume of exports from the rest of Emerging Asia was down 7% from their peak. And the export orders components of China's manufacturing PMIs, which ignore price effects, have been in contractionary territory for 24 of the past 26 months. Most striking of all is the data on exports sales reported by China's industrial firms. Historically, this has aligned well with the customs data. But it currently suggests that export values ought to be 15% lower. (See Chart 1.)

Chart 1: Exports & Industrial Export Sales ($, 2019=100, seas. adj.)



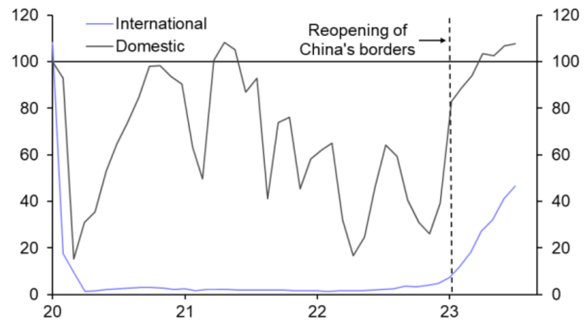
Sources: CEIC, Capital Economics

The reasons for this discrepancy are unclear. But it is possible that firms are misreporting the value of exports to customs in order to benefit from higher tax rebates or to conceal capital flows. Whatever the cause, the customs figures appear to have become less reliable recently and subject to unusually large revisions. The March export figure was recently reduced by $10.6bn, the largest adjustment on record. Downward revisions were also made to other months this year and in 2022. We wouldn't be surprised to see more such revisions in future.

More overseas group tours cleared for take-off

International flights to and from China stand at around half of 2019 levels. (See Chart 2.) We doubt this reflects a lack of demand – domestic flights are now above pre-pandemic levels, suggesting plenty of appetite to travel. Instead, the constraints to the recovery have been on the supply-side, including limited flight routes and restrictions on group tours.

Chart 2: China Flights (person-km, % of 2019 level)



Sources: CEIC, WIND, Capital Economics

The good news is that these constraints are easing. China's tourism ministry lifted restrictions on outbound group tours to 78 countries yesterday, adding to the 60 countries that were approved earlier in the year. The new additions include the US, Japan, Korea, and Australia which accounted for almost a fifth of all outbound Chinese tourists prior to the pandemic. With Chinese groups making up 40% of all trips abroad and accounting for roughly 60% of spending abroad, the latest round of easing should provide a boost to these countries.

With barriers to overseas travel being dismantled, we continue to think that outbound Chinese departures will return to 75% of the pre-pandemic level by the end of this year. It should then surpass 100% before end-2024, though it is unlikely to fully return to the pre-pandemic *trend* given slower growth in household wealth and incomes in China.

The week ahead

We think the PBOC will cut rates on Tuesday as it heeds the Politburo's call to step up policy support. Activity and spending data, due the same day, will probably point to further weakness last month.

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Data Previews

Tue. 15th Aug. – Medium-term Lending Facility Rate (Aug.)

Forecasts	Time (China)	Previous	Consensus	Capital Economics
MLF Rate (1-year) (15th Aug.)	09.20	2.65%	2.65%	2.55%

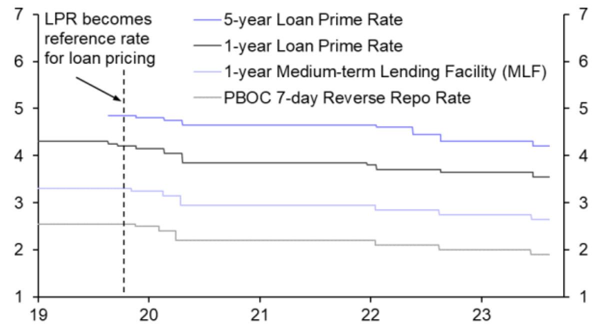
PBOC to heed Party's call for more support

We expect the PBOC to resume policy rate cuts next week, following a round of 10bp reductions in June. (See Chart 3).

Admittedly, downward pressure on the renminbi has resurfaced recently, which would normally encourage the PBOC to hold back. But recent data, especially the negative CPI reading and very weak credit figures, will put pressure on them to act.

More importantly, the dovish readout from last month's Politburo meeting suggests that the Party leadership, who ultimately call the shots when it comes to policy rates, want stimulus to be stepped up. More monetary easing has since been promised by PBOC officials, who are no doubt keen to show their bosses in Zhongnanhai that they are doing their part to support the economy.

Chart 3: Policy Rates (%)



Sources: CEIC, Capital Economics

Tue. 15th Aug. – Activity & Spending (Jul.)

Forecasts	Time (China)	Previous	Consensus	Capital Economics
Industrial Production (% y/y)	10.00	(+4.4%)	(+4.3%)	(+4.4%)
Fixed Asset Investment (ytd % y/y)	10.00	(+3.8%)	(+3.8%)	(+3.7%)
Retail Sales (% y/y)	10.00	(+3.1%)	(+4.0%)	(+2.0%)

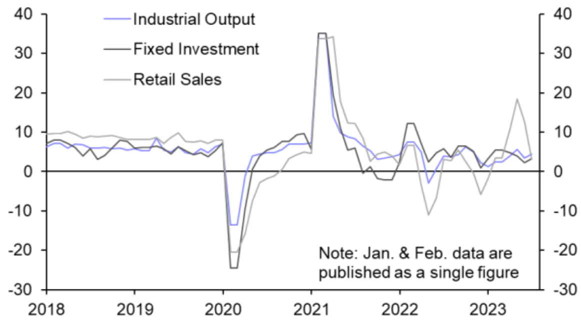
Economy continued to struggle in July

Headline growth in retail sales slowed sharply at the end of Q2, while fixed investment and industrial output accelerated. (See Chart 4.) But these were distorted by base effects. In seasonally adjusted m/m terms, the indicators point to economic stagnation in June. We think the economy failed to make any gains in July.

Most signs, including car sales and services PMIs, suggest retail sales and wider service sector activity continued to struggle for momentum in July. Industry is likely have fared even worse. The manufacturing PMIs and export data point to further weakness in both foreign and domestic demand.

Fixed investment is unlikely to have made much headway either. In response to falling utilisation rates, manufacturers probably pared back their capital spending. Property investment almost certainly tumbled further given signs that the sector remains in a rut. And although infrastructure spending should pick-up from this month, amid a push to accelerate local government bond issuance, that won't show up in the July data.

Chart 4: Activity & Spending (% y/y)



Sources: CEIC, Capital Economics

Economic Diary & Forecasts

Upcoming Events and Data Releases

Date	Country	Release/Indicator/Event	Time (China)	Previous*	Median*	CE Forecasts*
August						
Tue 15th		**Chn** 1-Year Medium-Term Lending Facility (MLF) Auction (Jul.)	(09.20)	2.65%	2.65%	2.55%
		Chn Industrial Production (Jul.)	(10.00)	(+4.4%)	(+4.3%)	(+4.4%)
		Chn Retail Sales (Jul.)	(10.00)	(+3.1%)	(+4.0%)	(+2.0%)
		Chn Fixed Asset Investment (Jul., ytd y/y)	(10.00)	(+3.8%)	(+3.8%)	(+3.7%)
		Chn Property Investment (Jul., ytd y/y)	(10.00)	(-7.9%)	(-8.0%)	(-13.5%)
		Chn Surveyed Unemployment Rate (Jul.)	(10.00)	5.20%	-	5.20%
		Chn Foreign Exchange Net Settlement and Receipts (Jul., RMB)	-	+89.5bn	-	-
Wed 16th		**Chn** Home Prices (70 Cities) (Jul.)	(09.30)	-0.1%	-	-
Thu 17th		**HK** Unemployment Rate (Jul.)	(16.30)	2.90%	-	2.90%
Also expected during this period:						
11th – 18th		**Chn** Foreign Direct Investment (Jul., RMB)	-	(-2.7%)	-	-
TBC		**Chn** PBOC Balance Sheet Data (Jul.)	-	-	-	-

Selected future data releases and events:

August

Mon 21st		**Chn** 1-Year Loan Prime Rate (Aug.)
		Chn 5-Year Loan Prime Rate (Aug.)
		HK Consumer Prices (Jul.)
Wed 23rd †		**Chn** Trade – Detailed Breakdown (Jul.)
Thu 24th		**HK** Trade Data (Jul.)
Also expected during this period:		
TBC		**Chn** Government Revenue and Expenditure (Jul.)
TBC		**Chn** CBRC Data on Assets and Liabilities of Financial Institutions (Jul.)

Main Economic & Market Forecasts

%q/q annualised (%y/y), unless stated	Latest	Q3 2023	Q4 2023	Q1 2024	Q2 2024	2022	2023f	2024f	2025f
Official GDP	+0.8(+6.3)*	(4.7)	(5.3)	(4.2)	(4.5)	(3.0)	(5.5)	(4.5)	(4.0)
GDP (CE CAP-derived estimates)	+2.5(+11.3)*	(5.8)	(8.3)	(5.6)	(3.9)	(-3.4)	(7.0)	(4.0)	(2.5)
Consumer Prices	(-0.3)**	(-0.2)	(0.0)	(0.9)	(1.0)	(2.0)	(0.5)	(1.0)	(1.0)
Producer Prices	(-4.4)**	(-2.9)	(-2.6)	(-2.2)	(-1.0)	(4.2)	(-3.0)	(-1.5)	(-0.5)
Broad Credit (AFRE)	(+8.9)***	(10.0)	(10.8)	(9.5)	(9.3)	(9.6)	(10.8)	(8.9)	(8.3)
Exports (US$)	(-14.5)**	(-16.0)	(-5.5)	(-10.0)	(-4.0)	(7.0)	(-8.0)	(-3.0)	(2.5)
Imports (US$)	(-14.5)**	(-11.0)	(-3.0)	(15.5)	(6.5)	(1.0)	(-7)	(7.5)	(1.5)
RMB/$†	7.24	7.05	6.90	6.80	6.70	6.95	6.90	6.50	6.40
7-day PBOC reverse repo† %	1.90	1.80	1.80	1.80	1.80	2.00	1.80	1.80	1.80
1-year Loan Prime Rate† (LPR) %	3.55	3.45	3.45	3.45	3.45	3.65	3.45	3.45	3.45
1-year MLF Rate† %	2.65	2.55	2.55	2.55	2.55	2.75	2.55	2.55	2.55
10-year Government Bond Yield† %	2.65	2.80	2.80	2.70	2.70	2.85	2.90	2.70	2.60
RRR (major banks)† %	10.75	10.50	10.25	10.25	10.25	11.00	10.25	10.25	10.25
CSI 300 Index†	3,884	3,920	3,950	4,088	4,225	3,872	3,950	4,500	5,100
Hong Kong GDP	(+1.5)*	(7)	(10.5)	(7)	(10.5)	(-3.5)	(5.5)	(9)	(6)
Hang Seng Index†	19,125	19,300	19,750	24,375	25,250	19,781	19,750	23,500	27,000

Sources: Bloomberg, Refinitiv, CEIC, Capital Economics *Q2; **Jul.; † End of period