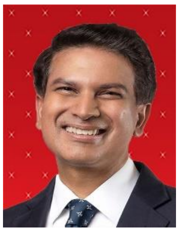
Macro Insights Weekly

What will mark China's trough?

Group Research August 14, 2023



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- *China's cyclical soft patch keeps deepening, as underscored by a wide range of recent data spanning from retail sales to credit, prices to exports. We examine what is needed for a trough to form.*
- *Post pandemic recovery has been underwhelming due to weak business and consumer confidence*
- *Intersection of weak property prices and a mountain of debt in the sector is a major fault line*
- *What's needed? (i) decisive move to address local government debt*
- *(ii) targeted measures to restructure property sector, with active private sector participation*
- *(iii) easing of regulations on entrepreneurial activities*

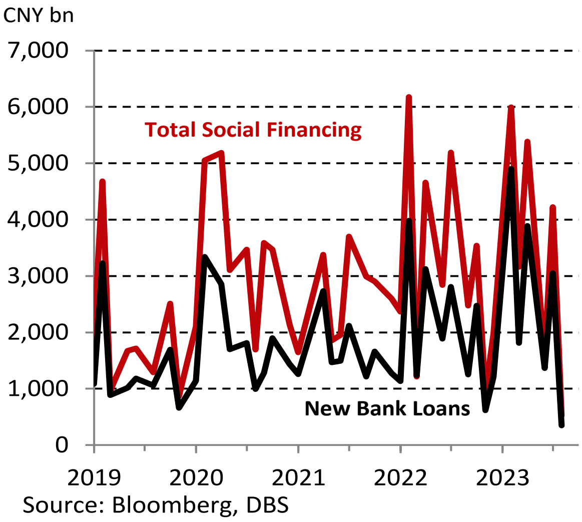
Key data release and events this week:

- *PBOC should keep its 1Y MLF rate unchanged for now, with a cut likely in Sep*
- *BSP is likely to extend its pause on rates, though a hawkish tone is expected*
- *RBNZ should hold rates unchanged for a third meeting*

Chart of the Week: Weak demand for loans and liquidity in China

Demand for consumer loans and financing has gone from tepid to downright weak in China this year, with bank loan creation falling to a 14-year low in July. Looking past weak seasonality, it is clear that Chinese consumers are scaling back borrowing and cutting back on investments, from properties to stocks. What will mark a turnaround? A major package to revive the property market and regulatory relief for capital formation, in our view.

China: Credit Growth and Liquidity

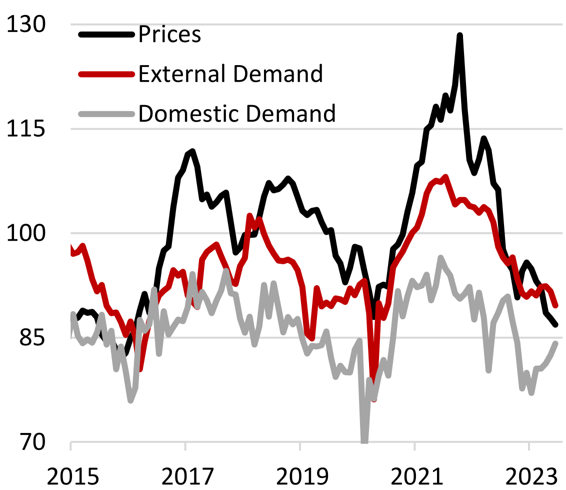


Source: Bloomberg, DBS

Commentary: What will mark China's trough?

China's cyclical soft patch keeps deepening. Data from a wide range of indicators, including credit growth, investment in capital markets and properties, industrial production, retail sales, construction, exports, and manufacturing and agricultural product prices reveal an overall loss of economic momentum.

CICC Cyclical Momentum Index



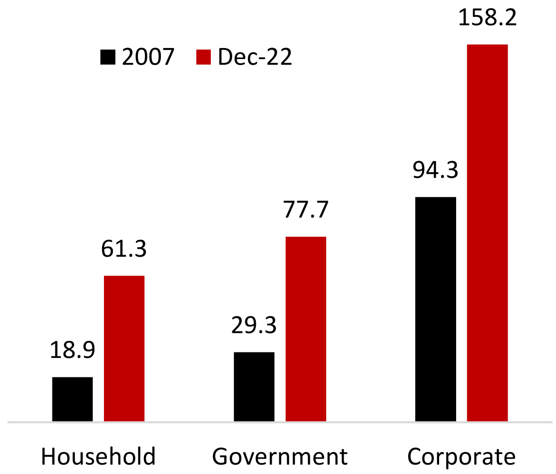
Source: Bloomberg, DBS

Taking these data points into account, our China GDP Nowcast model sees real economic growth slowing to 4.7%yoy in 3Q23, compared to a base-effect aided 6.3%yoy in 2Q. Our recently revised (downward) 2023 forecast of 5% growth for the year already looks subject to further downside risks.

In addition to lacklustre economic data, a long-simmering threat to economic and financial stability, the intersection of weak property market prices and a mountain of debt in the sector, is causing considerable concern. A key property developer has commanded headlines in the recent weeks as it struggles to avoid default of near-term obligations. Beyond property developers, another major source of worry is the state of local government financing vehicles (LGFVs), created to finance roads, airports, and power infrastructure. LGFV debt now amounts to over 50% of GDP, with many such entities struggling with cashflow from their real estate portfolios to cover debt service. The sector is in urgent need of refinancing and restructuring support.

Provincial governments are ultimately exposed to the liabilities of LGFVs and other off-balance sheet issuers. Recent announcements that a trillion RMB worth of bonds would be issued to help refinance some LGFV debt is a step in the right direction, but much more needs to be done given the overall magnitude of debt stock.

China's debt stock, % of GDP



Source: CEIC, DBS

We think three key steps would help economic activities and sentiments to bottom—(i) decisive move to address local government debt, (ii) targeted measures to restructure the property sector, with active private sector participation, and (iii) easing of regulations on entrepreneurial activities. A turnaround in external demand would help, but other than allowing for weaker currency, there isn't much policy can do in that area in the near-term.

Taimur Baig

Key forecasts for the week

Event	DBS	Previous
Aug 14 (Mon)		
India: exports (Jun)	-17.2% y/y	-22.0% y/y
- imports	-14.5% y/y	-17.5% y/y
- trade balance	-USD20bn	-USD20.1bn
India: CPI inflation (Jul)	6.9% y/y	4.8% y/y
Aug 15 (Tue)		
Japan: GDP (2Q P)	4.1% q/q saar	2.7% q/q saar
China: 1Y MLF Rate	2.65%	2.65%
China: industrial production (Jul)	4.2% y/y	4.4% y/y
- retail sales	3.0% y/y	3.1% y/y
- fixed asset investment	3.5% ytd y/y	3.8% ytd y/y
Indonesia: exports (Jul)	-19.8% y/y	-21.2% y/y
- imports	-18% y/y	-18.4% y/y
- trade balance	$3bn	$3.5bn
Aug 17 (Thu)		
Japan: exports (Jul)	0.5% y/y	1.5% y/y
- imports	-15.8% y/y	-12.9% y/y
- trade balance	JPY225.5bn	JPY43.1bn
Singapore: NODX (Jul)	-14.4% y/y	-15.5% y/y
Philippines: BSP overnight borrowing rate	6.25%	6.25%
Hong Kong: Unemployment rate (Jul)	2.9%	2.9%
Aug 18 (Fri)		
Japan: CPI (Jul)	3.3% y/y	3.3% y/y
Malaysia: GDP (2Q)	3.3% y/y	5.6% y/y
- exports (Jul)	-13.5% y/y	-14.1% y/y
- imports	-15.4% y/y	-18.9% y/y
- trade balance	MYR15.9bn	MYR25.8bn

Central bank policy meetings

People's Bank of China (August 15): The 1Y MLF rate is expected to stay at 2.65%. Yet, the weak credit data called for further stimulus such as rate cut in the months ahead. We expect another 10bps on MLF cut or LPR cut in September. A 25bps RRR cut is also in sight. New increase in aggregate financing fell from RMB4224.1bn in Jun to RMB528.2bn in Jul, the lowest level last seen since 2017. This also represented a 32.2% YoY contraction. New corporate loan plunged by 17.3% YoY, indicating a weak investment sentiment. New household loan also recorded a net drop of RMB201bn in the month as property transaction remained sluggish. Other indicators are also expected to stay weak in Jul. Retail sales growth is expected to ease further from 3.1% YoY in Jun to 3.8% in Jul. Labour market remained sluggish, with youth unemployment rate soared to over 20%. Income growth also lagged the pre-COVID average during 2015-2019. On industrial front, production is expected to edge down from 4.6% YoY in Jun to 4.2% in Jul. Leading indicator such as Manufacturing PMI stayed in contraction zone for the third month in a row, at 49.3. Output sub-PMI eased from 50.3 to 50.2. New Order and New Export Order sub-indices also stayed in contraction zone for the 4th consecutive month. Mirroring these, investment growth should have eased further from 3.8% YoY YTD to 3.5%. Private sector investment, in particular real estate investment should have remained subdued as developers continued to stress over repaying debt.

Reserve Bank of New Zealand (August 16): We expect the RBNZ to hold the official cash rate at 5.50% for a third meeting. The central bank believes keeping interest rates restrictive at current levels would bring inflation back to target. CPI inflation slowed to 6% YoY in 2Q23, its lowest since 4Q21. RBNZ noted that monetary conditions have continued to tighten, with previous monetary tightening passing through to households moving off lower fixed rates and adjusting to higher mortgage payments. Interest rate futures see the RBNZ rate cuts around mid-2024.

Bangko Sentral ng Pilipinas (August 17): The BSP is likely to extend the pause on rates this week, notwithstanding the miss in the 2Q23 GDP data. The economy expanded 4.3% yoy, lower than consensus, owing to a high base, fading post-pandemic consumption and high financing costs weighing on investment activity. Inflation will be the bigger watch factor. Even as the headline is on course to return to the target by 4Q, upside in global energy and food commodities are posing fresh risks to the trend. In all, we expect the benchmark rate to be unchanged with a hawkish tone to the guidance.

Forthcoming data releases

India: Of the releases this week, markets will watch the July CPI inflation closely. We expect the headline to jump sharply to 6.9% yoy from 4.8% in Jun, due to a near secular rise (barring oils) in the food segments, led by vegetables. The RBI acknowledged near-term risks to the price trajectory at the last week's review, on adverse weather and rising global food commodities. While arrival of harvests might help temper perishable inflation, policymakers will eye spillover risks to core readings and inflationary expectations. June trade deficit is expected to stay wide at $20bn following a recent hardening of oil prices but soft exports excluding electronics.

Japan: The 2Q GDP and July inflation data will be released this week. While the impressive headline GDP figures are likely to be well-received by investors, there may be a disappointment upon closer examination. The implications for BOJ monetary policy are expected to be neutral. Headline CPI inflation is projected to remain stable, hovering around 3.3% YoY in July.

Malaysia: Malaysia is set to report its weakest growth since 3Q21 in its 2Q23 GDP release. Real GDP growth likely stepped down to 3.3% YoY from 1Q23's 5.6%. We think unfavourable base effects from a year ago, global headwinds to export-oriented manufacturing, and post-pandemic services and private consumption normalisation dampened 2Q23 growth. July's exports likely contracted YoY, reflecting global external headwinds.

Singapore: We expect July's non-oil domestic exports (NODX) to remain stuck in contraction for the 10th straight month, dropping by 14.4% YoY. From a statistical angle, unfavourable base effects would stay in place through 3Q23, especially for non-electronics shipments. Electronics exports, a key area to watch, likely continued to fall in YoY terms. Yet, the pace of decline could narrow, in tandem with the slower contraction in July's electronics PMI.

Indonesia: July trade data is expected to show a normalisation in imports from the bunched-up increase in May, while exports tread water as prices of soft commodities stabilise, but are weighed by base effects. We expect a surplus of circa $3bn, reaffirming our expectations that the year is on course to register a narrow current account surplus.

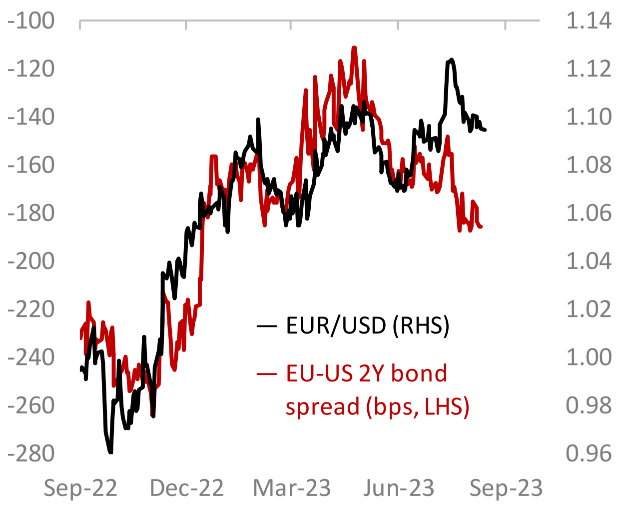
Hong Kong SAR: The jobless rate is expected to stay low at 2.9% in May-Jul, just 0.1% point up from 2.8% of the pre-social unrest level. Domestic economic condition remained largely favourable. Although GDP decelerated from 2.9% YoY in 1Q to 1.5% YoY in 2Q23, it was largely dragged by weakness in external sector and government spending. Private consumption expenditure growth (60% of GDP) grew by 8.5% in 2Q. Retail sales growth also accelerated from 18.5% in May to 19.6% in Jun. Recovery of inbound tourism was also on track. Daily Mainland visitor arrival returned to 80.0% of 2019 average in Jul.

Economics Team

FX: USD is in a better shape than peers

DXY appreciated 0.8% to 102.84, its **highest weekly close since 30 June**. Unlike the first week of July, the USD was resilient to a larger-than-expected drop in US nonfarm payrolls and a smaller-than-expected rise in CPI inflation (the first YoY increase in 13 months). On 16 August, the FOMC minutes could lift the greenback if Fed officials see another hike in one of the remaining three meetings of the year. Although interest rate futures believed the Fed delivered its final hike in July, the US Treasury 2Y yield firmed to 4.89%, its highest level since 1 August. The Atlanta Fed GDPNow model sees US GDP growth rebounding to 4.1% QoQ saar in 3Q23 after rising to 2.4% in 2Q23 from 2% in 1Q23. At the last FOMC meeting, Fed staff stopped forecasting a US recession.

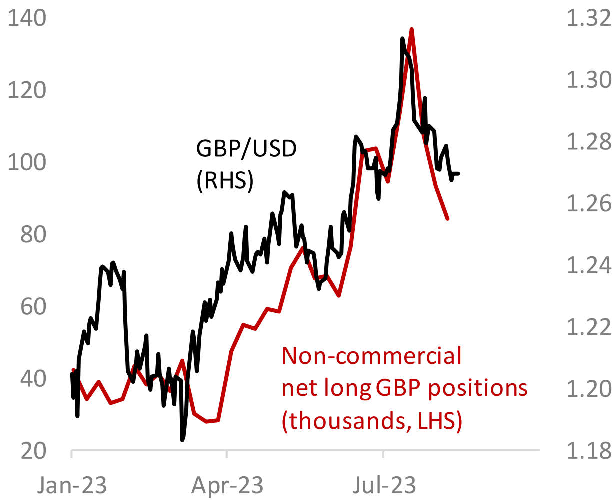
Negative yield differential dragging EUR lower



Sources: DBS Research, Bloomberg data

EUR/USD depreciated 0.5% to 1.0949, **its first weekly close below 1.10** since 7 July. EUR will eye its mid-year low around 1.0835 if its breaks below 1.0930, its 100-day-moving average. Unlike the Fed, the European Central Bank warned that the outlook for the Eurozone economy has deteriorated. Markets do not rule out ECB pausing hikes and downgrading its economic forecast at the governing council on 14 September. The prime ministers of Italy and Portugal, countries facing recession risks, have criticized the ECB for repeated rate hikes. The ECB's bank lending survey noted the substantial falls in credit demand for companies and households from banks further tightening lending criteria on higher borrowing costs amid stagnant growth.

Speculators kept trimming long GBP positions

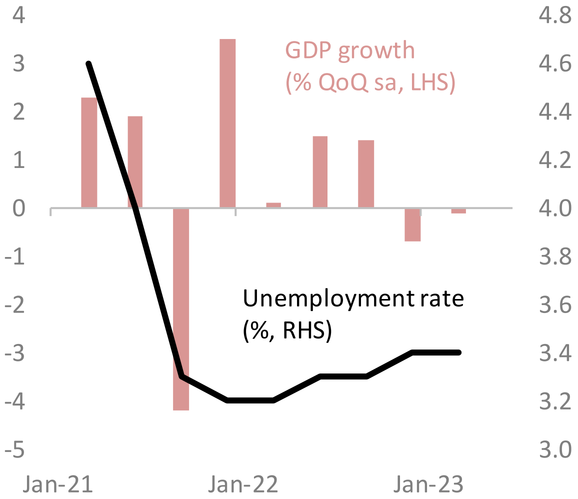


Sources: DBS Research, Bloomberg data

GBP/USD depreciated a fourth week by 0.4% to 1.2696, its **weakest weekly close since 9 June**. According to the Commodity Futures Trading Commission (CFTC), net long non-commercial GBP positions peaked at 66k contracts in the 18 July week, around which UK's CPI inflation fell to 0.1% MoM in June from 0.7% in May. Over the next three weeks, speculators trimmed their net long positions to 46k. Pay attention to the CPI data on 16 August. Bloomberg consensus sees CPI inflation falling by 0.5% MoM in July, its first decline since January. In YoY terms, headline inflation is expected to drop to 6.8% in July from 7.9% and core inflation to 6.8% from 6.9%. On the same day, consensus sees RPI inflation falling to 9% YoY in

July, its first single-digit print since March 2022. Although UK GDP growth was 0.2% QoQ sa in 2Q23 vs 0.1% the previous quarter, the National Institute of Economic and Social Research (NIESR) forecasted an economic recession in 2024 with GDP growth turning negative as early as end-2023.

NZ's technical recession & rising jobless rate



Sources: DBS Research, Bloomberg data

NZD/USD depreciated 1.8% to 0.5984, its worst weekly close **below 0.60 since early November**. On 16 August, the Reserve Bank of New Zealand should keep its official cash rate unchanged at 5.50% for a third meeting. The central bank believes keeping interest rates restrictive at current levels will bring inflation back to the 1-3% target. RBNZ sees the 525 bps of hikes since October 2021 passing through to households moving off fixed mortgage rates. The NZ economy entered a technical recession in 1Q23, with the seasonally adjusted unemployment rate rising to 3.6% in 2Q23 from 3.4% in the previous quarter. Due to the cost-of-living crisis, the ruling Labour Party is trailing behind the opposition National Party ahead of the general elections scheduled on 14 October.

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