

Warm on the outside cold on the inside

Tommy Xie Dongming
Economist
+65 6530 7256
xied@ocbc.com

- China's total trade hit a record high level and was less affected by recent negative headline news.
- China's record high trade surplus with the US could be the catalyst for partial removal of trade tariff.
- China's domestic centric data are more sensitive to recent event risks such as regulatory tightening, credit default risks and power shortage.
- The recent regulatory tightening may have dampened the demand for long term credit
- Passthrough effect emerged from higher raw material prices and power shortage.
- The prolonged widening gap between PPI and CPI may argue for more policy supports to SMEs. There is the room for more RRR cut.

I have noticed an interesting divergence recently between regular China watchers and non-regular China observers. China watchers I talked to recently have been increasingly more worried about the Chinese growth prospect as they focused more on those event risks while non regular China observers are more relaxed as they paid more attention to the systemic risk. Both make sense to me.

The first batch of September data released in the past two days gave us a good overview about the stacked effects of recent looming event risks in China such as regulatory tightening, credit defaults and power shortage.

Warm on the outside

China's exports beat market expectation again with total trade hit a record high of US\$544.7 billion in September. The demand from the advanced economies for Chinese goods remained strong partially due to the replacement demand as a result of pause of supply chain shift amid the spread of delta variants in emerging markets.

There are two takeaways from September trade figures. **First, there is diminishing impact of US-China trade war on Chinese exporters.** China's exports growth to the US accelerated to 30.56% with exports in absolute term hit a record of US\$57.4 billion. In addition, China's trade surplus with the US also hit record high of US\$42 billion. The latest China data probably proved US Treasury Secretary Yellen's concern that tariffs are taxes on US consumers but failed to address the fundamental problems with China. We think the latest China export could also be the catalyst for the partial removal of tariff.

Second, I have received a few enquiries recently that "why did China's export remain so strong despite power shortage?" Well, there is probably lagging effect there. But from cause-and-effect perspective, one thing we

need to take note is that the recent disruptions to productions was partially due to the strong demand for Chinese goods, which those manufacturing hubs have frontloaded their quota on energy intensity and energy consumption in the first half of 2021. As such, the net impact of those disruptions on exports may be more mixed.

Cold on the inside

As compared to trade data, China's domestic centric data are more sensitive to recent event risks such as regulatory tightening, credit default risks and power shortage.

China's credit data disappointed in September. Despite rising expectation on easing credit, growth of stock of aggregate social financing decelerated further to 10% yoy in September from 10.3% yoy in August, lowest since December 2015. Other than high base effect, the deceleration of aggregate social financing growth in September was also attributable to three factors including weak demand for credit, softening direct financing activities due to looming credit risks in the property space and behind the curve issuance of local government special bond.

Regulatory tightening may have dampened the demand for long term credit

In particular, the weak medium to long term loan could be the cause for concern. China's medium to long term loan increased by CNY1.16 trillion in September, CNY542 billion short of the level in September 2020. For breakdown, medium to long term loan to household sectors increased by CNY466 billion, CNY169 billion short of the level during the same period last year while medium to long term loan to corporate sector only increased by CNY694.8 billion, CNY373.2 billion short of the level in September 2020. The latest loan data showed that recent regulatory tightening across the different sectors may have dampened the demand from both household sector and corporate sector for long term credit.

Passthrough effect from higher raw material prices.

Although China's CPI moderated to 0.7% yoy in September from 0.8% in August, China's PPI accelerated further to 10.7% yoy.

There is the sign of transmission from rising raw material prices as well as supply side shock to end consumers as prices of cement, LNG and passenger car increased month-on-month. However, the supply side driven rise of consumer prices was offset by the falling travel related costs due to sporadic outbreak of delta variants in early September, which weighed down the costs of travel and accommodation.

As PPI is more sensitive to the change of global macro backdrop such as China's dual control of energy intensity and energy consumption and global natural gas crisis, the recent surge of PPI reading reflected the supply side driven rising commodity prices. Given the recent reform of electricity pricing mechanism, which will further push up producer prices, PPI is

expected to stay elevated in October and November. It may only retreat from December onwards due to base effect.

The gap between PPI and CPI widened further to a fresh high. This implies further pressure on profitability in the downstream sectors. Although CPI is unlikely to be the constraint to policy making this year, the prolonged widening gap between PPI and CPI may argue for more policy supports to SMEs which are facing margin squeeze due to rising raw material prices. As such, we think there is the room for China to cut RRR further to support SMEs echoing their supports in early July.

Chart 1: Gap between PPI and CPI widened to record high level.

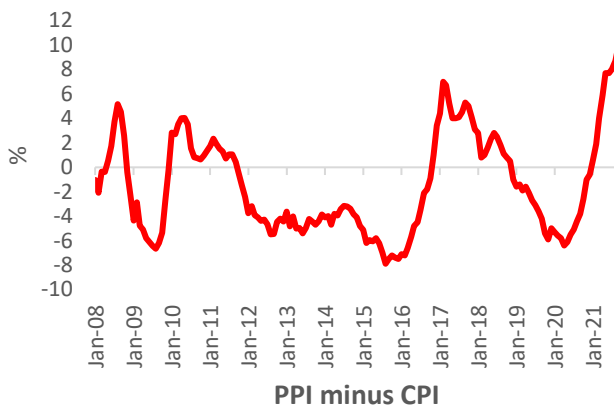
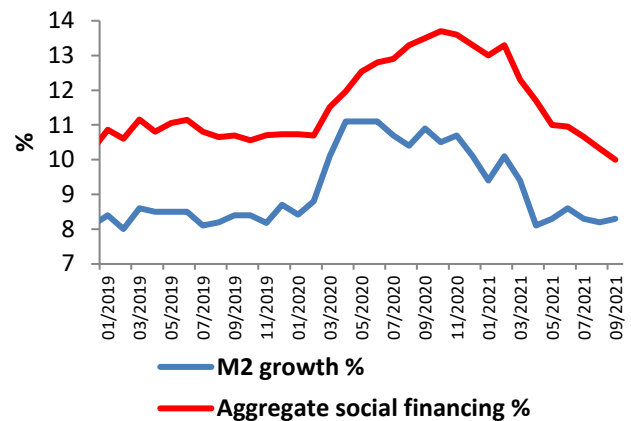


Chart 2: Aggregate social financing growth decelerated further despite stabilizing M2 growth



Source: Wind, CEIC, OCBC Bank

This publication is solely for information purposes only and may not be published, circulated, reproduced or distributed in whole or in part to any other person without our prior written consent. This publication should not be construed as an offer or solicitation for the subscription, purchase or sale of the securities/instruments mentioned herein. Any forecast on the economy, stock market, bond market and economic trends of the markets provided is not necessarily indicative of the future or likely performance of the securities/instruments. Whilst the information contained herein has been compiled from sources believed to be reliable and we have taken all reasonable care to ensure that the information contained in this publication is not untrue or misleading at the time of publication, we cannot guarantee and we make no representation as to its accuracy or completeness, and you should not act on it without first independently verifying its contents. The securities/instruments mentioned in this publication may not be suitable for investment by all investors. Any opinion or estimate contained in this report is subject to change without notice. We have not given any consideration to and we have not made any investigation of the investment objectives, financial situation or particular needs of the recipient or any class of persons, and accordingly, no warranty whatsoever is given and no liability whatsoever is accepted for any loss arising whether directly or indirectly as a result of the recipient or any class of persons acting on such information or opinion or estimate. This publication may cover a wide range of topics and is not intended to be a comprehensive study or to provide any recommendation or advice on personal investing or financial planning. Accordingly, they should not be relied on or treated as a substitute for specific advice concerning individual situations. Please seek advice from a financial adviser regarding the suitability of any investment product taking into account your specific investment objectives, financial situation or particular needs before you make a commitment to purchase the investment product. OCBC Bank, its related companies, their respective directors and/or employees (collectively "Related Persons") may or might have in the future interests in the investment products or the issuers mentioned herein. Such interests include effecting transactions in such investment products, and providing broking, investment banking and other financial services to such issuers. OCBC Bank and its Related Persons may also be related to, and receive fees from, providers of such investment products.

This report is intended for your sole use and information. By accepting this report, you agree that you shall not share, communicate, distribute, deliver a copy of or otherwise disclose in any way all or any part of this report or any information contained herein (such report, part thereof and information, "Relevant Materials") to any person or entity (including, without limitation, any overseas office, affiliate, parent entity, subsidiary entity or related entity) (any such person or entity, a "Relevant Entity") in breach of any law, rule, regulation, guidance or similar. In particular, you agree not to share, communicate, distribute, deliver or otherwise disclose any Relevant Materials to any Relevant Entity that is subject to the Markets in Financial Instruments Directive (2014/65/EU) ("MiFID") and the EU's Markets in Financial Instruments Regulation (600/2014) ("MiFIR") (together referred to as "MiFID II"), or any part thereof, as implemented in any jurisdiction. No member of the OCBC Group shall be liable or responsible for the compliance by you or any Relevant Entity with any law, rule, regulation, guidance or similar (including, without limitation, MiFID II, as implemented in any jurisdiction).