Warm on the outside cold on the inside

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- **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.

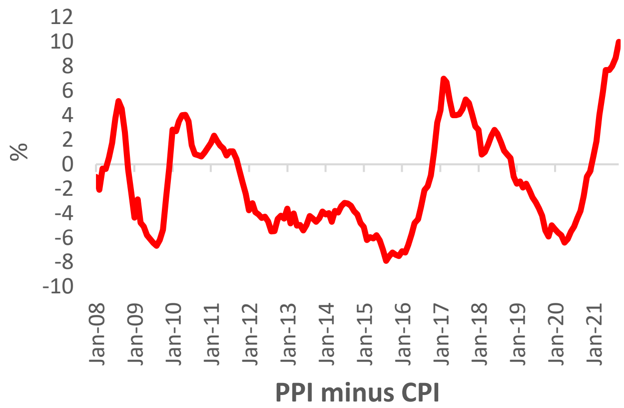
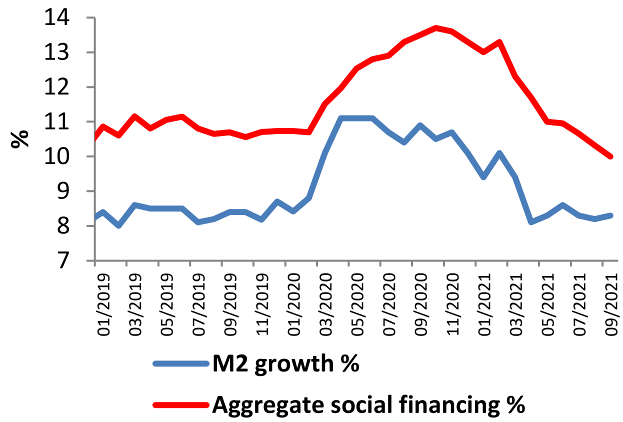


Chart 2: Aggregate social financing growth decelerated further despite stabilizing M2 growth



Source: Wind, CEIC, OCBC Bank

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