

#1

FULL HOUSE

*China's warehouses are full, and
it is spilling over to the global economy*

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Executive Summary

- China's inventory levels remain elevated, as domestic demand has only staged a partial recovery from last year's lockdown, while industrial output – except for construction-related sectors – has barely been touched by the pandemic.
- With domestic demand still lagging, clearing these inventories would require selling them at discounts or abroad (or both).
- China is thus exporting its deflation, and its growth this year will be achieved partly at the expense of worsening trade balance for the rest of the world.
- Despite longer-term fears of higher inflation, then, in the short-term the global economy will likely be dominated by slowing growth outlook and falling inflation rates.
- For Indonesia, the influx of cheap goods from China have lowered core inflation, but it seems to have negative effects particularly on domestic textile and metal industries.
- China's reopening has also boosted export volumes, but partly offset by lower commodity prices. Oversupply of coal and a weaker demand for steel from construction will likely remain a headwind for Indonesian producers in the near-term.

Intro to the first edition

What is Collideascope?

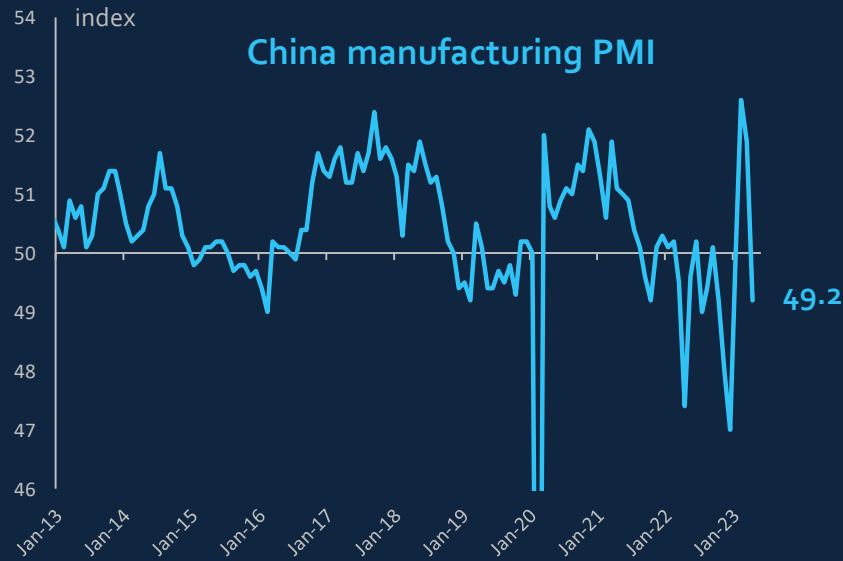
- This is a new series of macro report produced by **BCA's Economy and Industry Research** team. It is intended, above all else, as a more freeform exploration of data, in a way that may be difficult to accommodate in our other reports.
- Here is how we would describe our current macro publications:
 - **Monthly** and **Quarterly Economic Briefing** continue to be our flagship macro report, with timely commentary of Indonesia's latest macroeconomic data. *It is our equivalent of an economist getting interviewed on news media*
 - **The Focal Point** is our weekly commentary on the market, with particular focus on issues that might be relevant in the near future. *It is our equivalent of articles in weeklies like **Majalah Tempo** or **The Economist**.*
 - **Collideascope** will be far less restrained in terms of schedule, length, and format, the only constant being pretty charts and an obsessive dissection of economic data. *Its closest equivalent may be book chapters or academic papers, but much more fun and colorful ☺*

Why this topic?

- In our **Global Economic Outlook** for the year, we saw China's high inventory levels as a sign of future disinflation, after a year of high inflation. Thus far our hypothesis has remained on track (*see pg. 6-7*).
- In March, the Indonesian Ministry of Trade began cracking down on imports of used clothing, calling it a threat to the local textile industry. Clearly there is a worrying import surge lately ... but is it just used clothing?
- In April, Alibaba launched a budget section called *99 Temai* on *Taobao*, which was seen as part of a "price war" against its rivals JD.com and Pinduoduo. Clearly household consumption in China is recovering ... but does it take discounts to do it?
- So this issue – **China's excess production and its global spillover** – is something that has been on our radar for a while. But here we try to present a more comprehensive look at the situation, taking into the supply, demand, global trade, and monetary aspects of the situation.

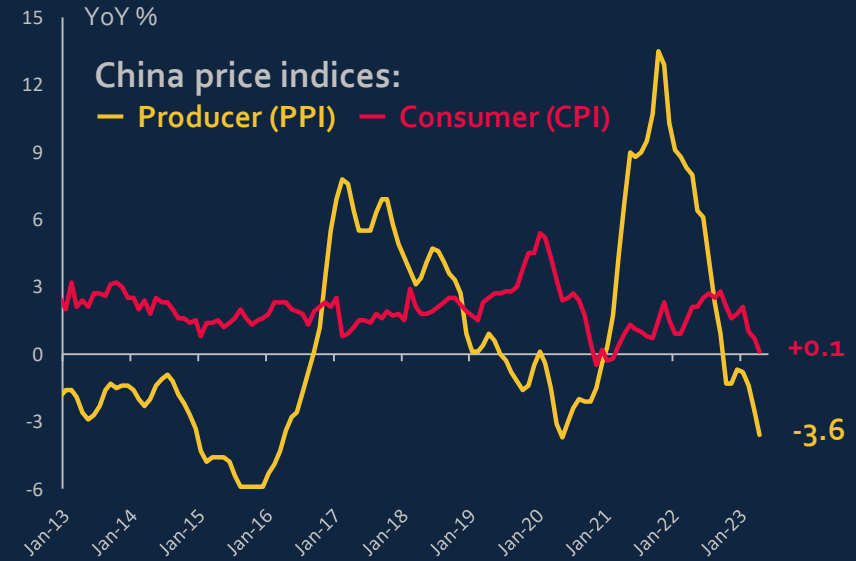
China's recovery has barely started, but it seems to be faltering

China's manufacturing surprisingly contracted in April ...



Source: Bloomberg

... while declining prices may indicate weaker demand



Source: Bloomberg

- China's GDP growth in Q1-23 (the first after the lifting of zero-Covid policy) was a robust 4.5%, but April's numbers were underwhelming.
- Industrial production grew only 5.6% YoY (expected 10.9%), fixed-asset investment was at 4.7% (expected 5.7%), while retail sales were at 18.4% (expected 21.9%). The retail figure may appear strong, but it was mostly the product of low base effects from last year's Shanghai lockdown, and actually represented a steep decline in MoM terms (-7.8%).

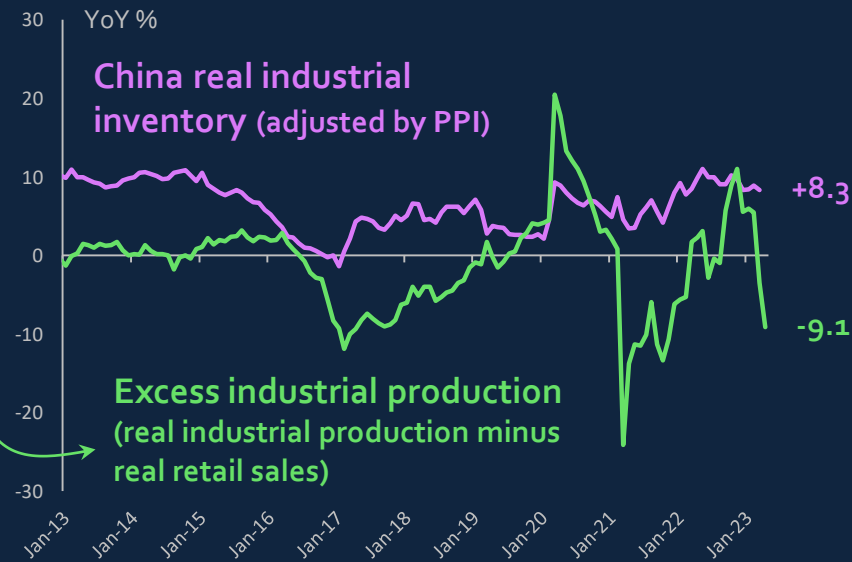
Inventories built up during zero-Covid need to be cleared ...

Since Covid, production and demand rarely aligned ...



Source: Bloomberg, calculations by BCA Economist

... and it led to massive inventory growth during 2022

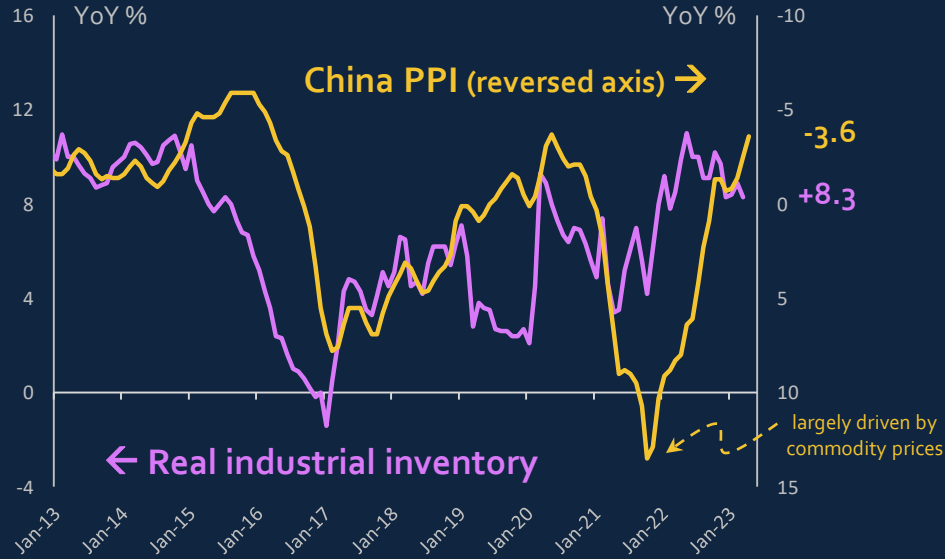


Source: Bloomberg, calculations by BCA Economist

- China is prone to cycles of inventory buildup followed by a drop-off in production, due to its export-oriented and domestically imbalanced (overproducing/under-consuming) economic model.
- Since the pandemic, the swings have become more extreme. Last year's lockdowns led to fresh increase in inventories, which is supposed to ease as domestic demand returns after reopening. However, retail sales is only starting to outpace industrial production recently.

... which points towards further disinflation in China

Real inventory explains part, but not all, of China's PPI ...



Source: Bloomberg, calculations by BCA Economist

... but nominal inventory is a more all-inclusive measure

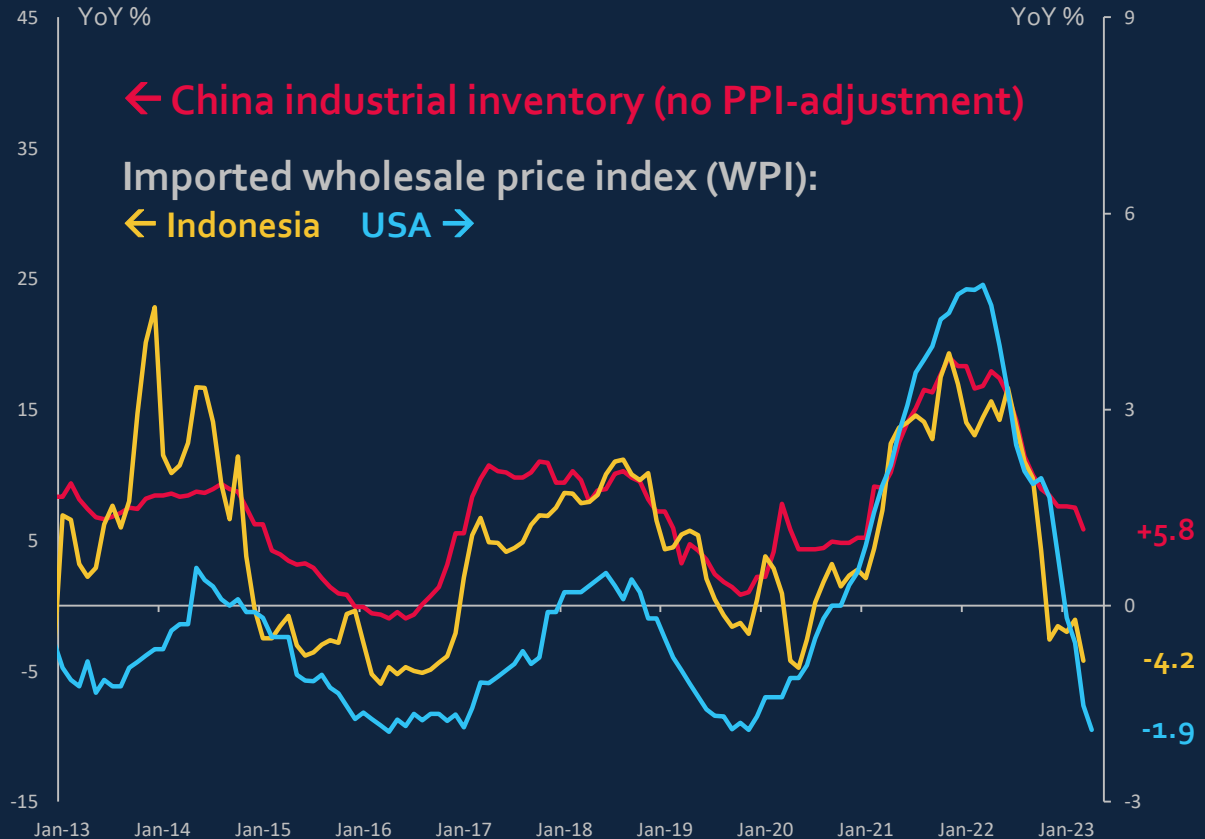


Source: Bloomberg, calculations by BCA Economist

- High real inventory levels is associated with lower factory prices (and vice versa). However, changes in PPI could also be attributed to other factors, most notably the global commodity cycle.
- The unadjusted inventory data, then, is a better indicator of China's inflation as it incorporates the commodity effect. Note that inventories and commodity prices may have a bi-directional relationship, as high inventory levels could signal lower future demand for commodities.

Disinflation could spread to the rest of the world ...

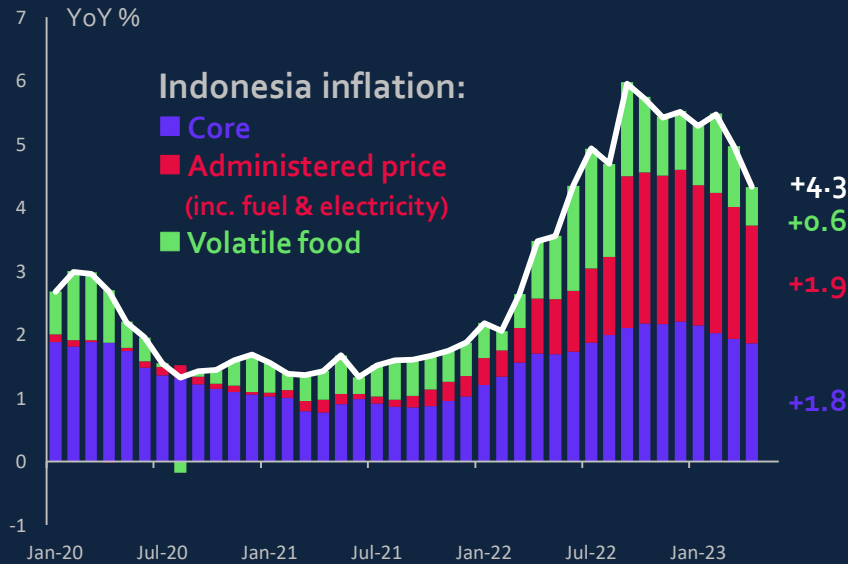
- As the world's premier manufacturing hub, China's factory prices could impact prices in other countries. China's inventories, then, is also an indicator of global inflation.
- Its high (real) but falling (nominal) growth is a sign of an ongoing disinflationary process that may continue in the near-term.
- The first wave of global disinflation (Q3-22 to Q1-23), arguably, was driven more by the US rather than China, as Fed hikes and SPR release pushed down commodity prices.
- A second wave could then come from the correction of China's supply-demand imbalance, as inventory volumes are normalized through price discounts.



Source: Bloomberg, BPS, calculations by BCA Economist

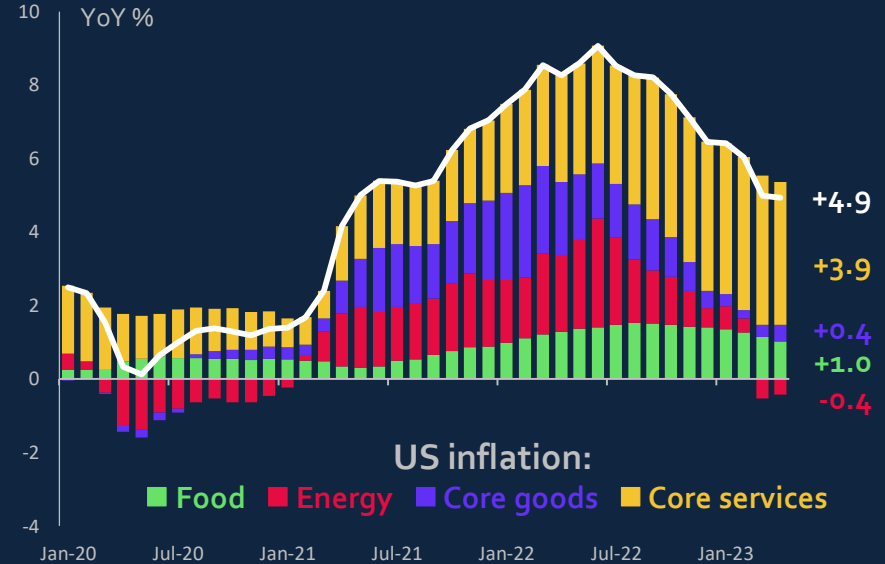
... and it may yet tame the “stubborn” core inflation

Indonesia’s core inflation is starting to decline ...



Source: BPS, calculations by BCA Economist

... while services inflation remains the “X factor” in the US

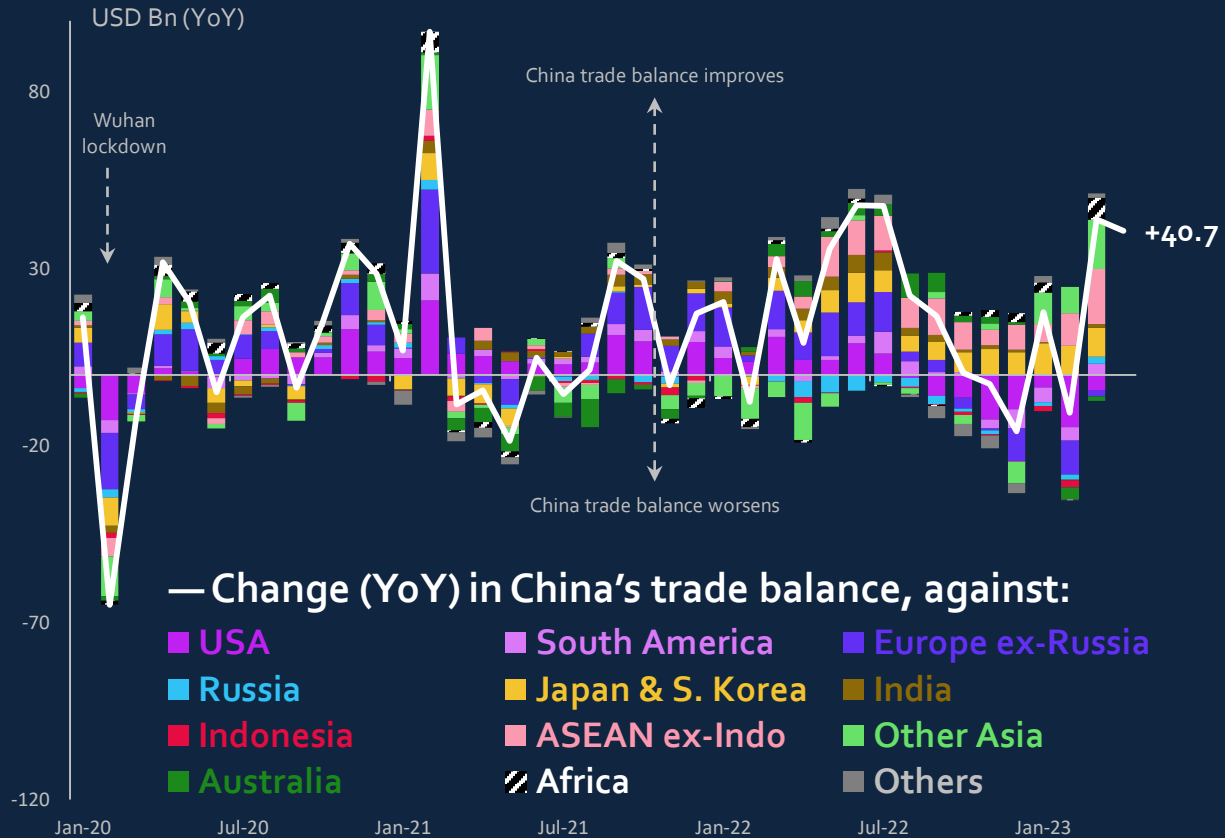


Source: US BLS, calculations by BCA Economist

- If true, this could help bring down core consumer inflation, which has declined more slowly than energy prices.
- The disinflationary effect may be more apparent for Indonesia, whose imports from China have increased recently. In contrast, US imports from China are actually declining (*see pg. 9-10*) which limits further impact on core goods, while the relationship of Chinese inventory to US core services is less obvious.

Exporting deflation, cultivating friendship

- The “clearance sale” of Chinese inventories are showing up in the form of rising exports – widening China’s already-huge surplus vis-à-vis the rest of the world.
- This influx of cheap Chinese goods is a boon for consumption in recipient countries, but it might be detrimental to local industries in the longer-run.
- Interestingly, China’s recent export growth is mostly directed towards emerging or low-income economies (*see pg. 10-11*).
- Thus, as exports to the West declines amid slowing demand and strategic decoupling, China increasingly relies on Russia and the “Global South” to absorb its excess output.
- We may need to assess China’s recent diplomatic overtures from this lens, not just the longer-term “de-Dollarization” or other geo-political agenda.



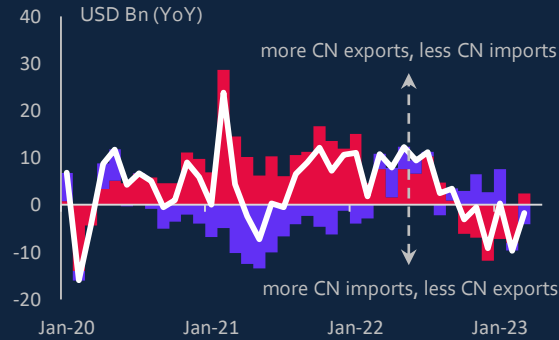
Source: Bloomberg, calculations by BCA Economist

China's exports to the West are falling after Covid-era boom ...

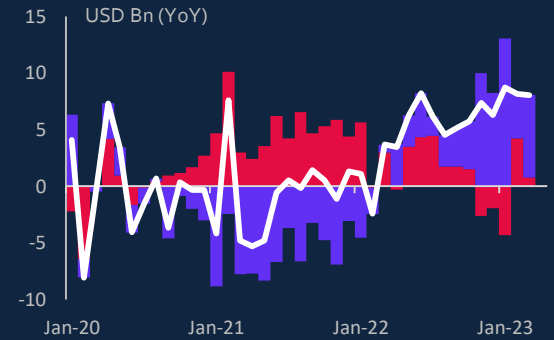
USA



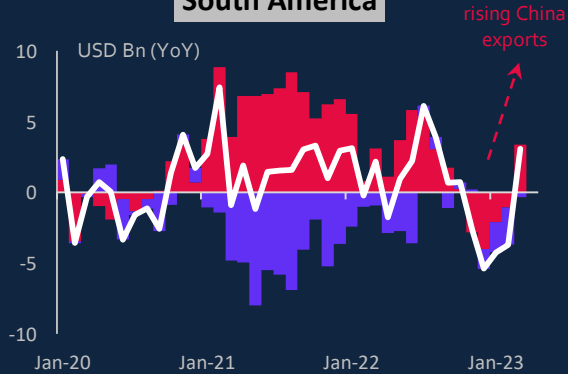
Europe ex-Russia



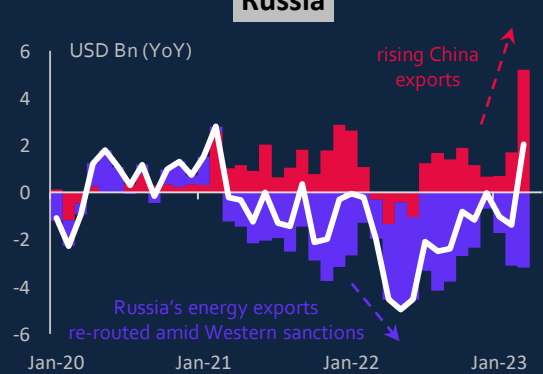
Japan & S. Korea



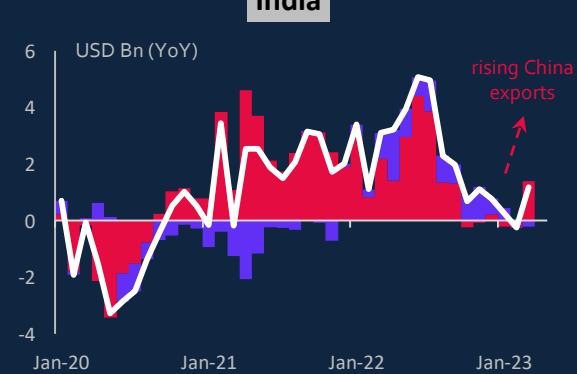
South America



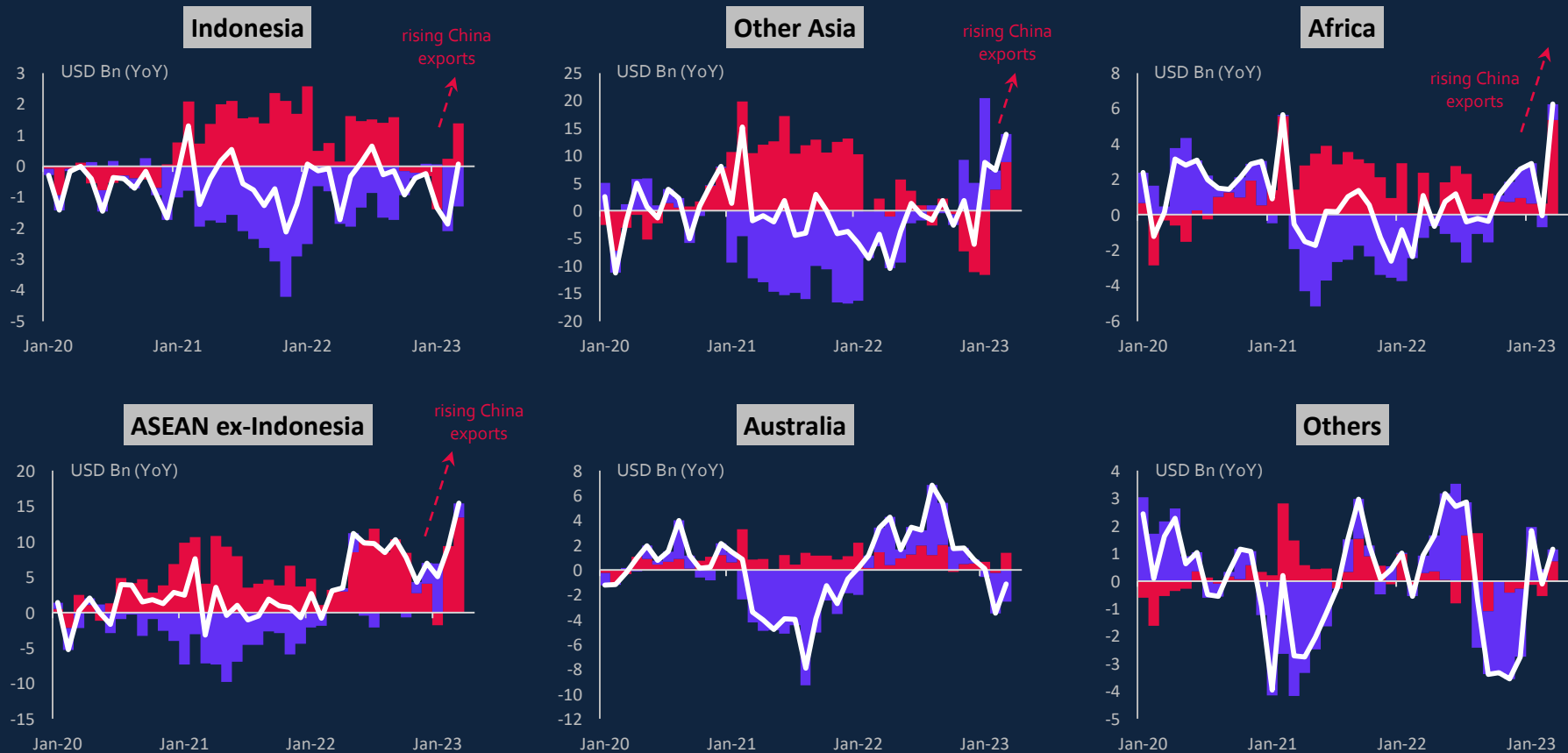
Russia



India



... but it is finding new markets in the rest of the world



Source: Bloomberg, calculations by BCA Economist

Indonesia's textiles and metals hit by cheap Chinese imports

- The flow of Chinese goods is apparent from Indonesia's trade data. Of the 98 categories of goods (by 2-digit HS code), 41 saw more import volumes at lower prices in Q1-23.
- The impact seems clearest along two supply chains. One is metals, where China is known to have massive excess capacity, particularly in steelmaking. The other is textiles.
- We know that Indonesia's textile industry is strongest in manmade fibers and apparels, but reliant on imported cotton and fabrics.
- The fact that Chinese imports are growing for the first two but shrinking for the latter two should raise alarm about the prospects of the industry.
- But not all Chinese imports are detrimental for Indonesia. Rising capital goods imports, for one, is a sign of continued investment growth – especially FDI from China.

Indonesian imports from China, Q1-23 vs. Q1-22 (by 2-digit HS code)

LOWER VOLUMES, HIGHER UNIT PRICES (19 categories)

HS	Δ Weight	Δ Price
8 Fruits & nuts	-16.8%	1.9%
23 Food residues	-12.5%	7.2%
26 Mineral ores	-88.3%	40.1%
34 Soaps	-14.6%	9.9%
64 Footwear	-0.3%	11.9%

HIGHER VOLUMES, HIGHER UNIT PRICES (13 categories)

HS	Δ Weight	Δ Price
33 Perfumes, cosmetics	6.7%	6.3%
85 Electrical & electronics	0.4%	11.4%
86 Train & parts	24.5%	128.8%
95 Toys & sports equip.	22.0%	4.2%

LOWER VOLUMES, LOWER UNIT PRICES (25 categories)

HS	Δ Weight	Δ Price
29 Organic chemicals	-9.9%	-15.7%
52 Cotton	-17.1%	-6.4%
60 Knitted fabrics	-34.4%	-0.7%
69 Ceramic products	-14.0%	-15.1%
76 Aluminium & products	-8.6%	-14.9%
84 Machinery	-12.0%	-4.5%

HIGHER VOLUMES, LOWER UNIT PRICES (41 categories)

HS	Δ Weight	Δ Price
27 Mineral fuels	205.8%	-39.9%
31 Fertilizers	21.2%	-32.0%
39 Plastics & products	10.0%	-19.0%
54 Manmade filaments	14.2%	-23.9%
61 Apparels, knitted	24.7%	-36.6%
72 Iron & steel	46.0%	-52.7%
73 Iron & steel products	33.4%	-18.5%
74 Copper & products	25.4%	-19.9%
87 Vehicles & parts	13.0%	-2.3%
94 Furniture	4.1%	-14.6%

■ Textiles
 ■ Metals & derivatives
 ■ Capital goods

Source: BPS, calculations by BCA Economist

China reopening boosts export volumes more than prices

- For Indonesia, the increase in imports from China has been more than offset by growing exports. This is unlike the situation in most other nations, whose trade balance tends to deteriorate versus China.
- The export growth is strongest for raw materials like coal, CPO, and rubber, where the increase in export volumes have more than compensated for the decline in prices.
- As for manufacturing, there might be a few beneficiaries from China's reopening, most notably pulp and paper.
- The growth of (ferro-)nickel exports can be seen as a success for Indonesia's industrial policy, in a way that is complementary to – rather than competing with – China.
- As we know, much of the FDI into nickel has come from China, and the exported outputs are very much geared towards China's steel and EV industries.

Indonesian exports to China, Q1-23 vs. Q1-22 (by 2-digit HS Code)

LOWER VOLUMES, HIGHER UNIT PRICES (25 categories)

HS	Δ Weight	Δ Price
3 Fish & seafood	-6.1%	19.7%
26 Mineral ores	-66.7%	32.7%
62 Apparel, non-knitted	-12.2%	11.3%
64 Footwear	-30.8%	6.0%
84 Machinery	-38.2%	22.2%
85 Electrical machinery	-17.6%	19.9%

HIGHER VOLUMES, HIGHER UNIT PRICES (13 categories)

HS	Δ Weight	Δ Price
19 Flour & products	38.1%	4.8%
23 Food residues	193.4%	74.9%
47 Pulp	1.8%	19.1%
73 Iron & steel products	41.0%	63.0%

LOWER VOLUMES, LOWER UNIT PRICES (22 categories)

HS	Δ Weight	Δ Price
21 Misc. edible products	-9.5%	-7.2%
69 Ceramic products	-53.8%	-1.7%
74 Copper & products	-21.5%	-6.6%
76 Aluminium & products	-34.2%	-10.5%
87 Vehicles & parts	-11.7%	-3.0%

HIGHER VOLUMES, LOWER UNIT PRICES (32 categories)

HS	Δ Weight	Δ Price
9 Coffee, tea, spices	18.2%	-18.6%
15 Vegetable oils	122.8%	-69.9%
27 Mineral fuels	87.5%	-11.8%
40 Rubber & products	66.6%	-40.0%
42 Leather products	14.4%	-0.4%
48 Paper & products	39.9%	-35.7%
72 Iron & steel	8.3%	-7.1%
75 Nickel & products	199.3%	-59.8%

■ Raw materials
 ■ Metals & derivatives
 ■ Pulp & paper

Source: BPS, calculations by BCA Economist

The clearance sale still has some way to go

- Shifting our gaze back to China, it is clear that excess inventory still plagues many industries, and it might take several more months of strong exports – or improved domestic demand – to clear it.
- A few sectors, like furniture and apparels, do show a reduction in inventory levels. But others like the mining sector are in fact seeing further increase in inventory.

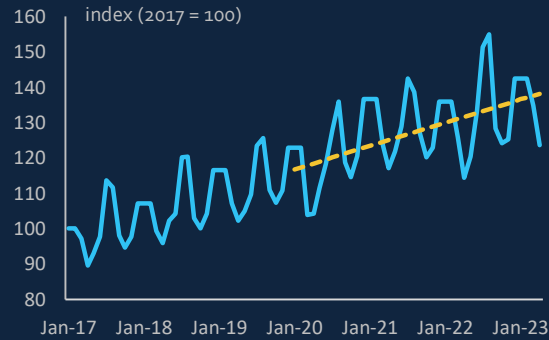
China industrial inventory (YoY %)			2020												2021												2022												2023			
			J	F	M	A	M	J	J	A	S	O	N	D	J	F	M	A	M	J	J	A	S	O	N	D	J	F	M	A	M	J	J	A	S	O	N	D	J	F	M	
Agriculture	Processing of agri byproducts																																							+10.2		
	Food																																							+14.9		
	Beverages																																							+14.7		
Mining & Derivatives	Mining	Coal																																						+16.9		
		Ferrous metal ores																																						+2.2		
		Non-ferrous metal ores																																						+11.6		
	Smelting	Non-metal ores																																						+40.7		
		Ferrous metals																																						-1.5		
	Manuf.	Non-ferrous metals																																						+10.5		
Metal products																																							+3.8			
Heavy Industry	Non-metal mineral products																																							+10.6		
	General purpose machinery																																							+5.3		
	Electrical machinery																																							+9.1		
	Electronic equipments																																							+0.6		
	Vehicles																																							+7.0		
	Measuring instruments																																							+12.2		
Chemical Industry	Special purpose machinery																																							+12.9		
	Raw chemicals & products																																							+8.3		
	Rubber & plastic products																																							+3.7		
Textile Industry	Medicines																																							+5.6		
	Chemical fibers																																							-1.5		
	Textiles																																							+0.4		
Other Industries	Apparels & accessories																																							-1.5		
	Paper & paper products																																							+10.1		
Other Industries	Furnitures																																							-7.4		
	Cultural, education, & sport articles																																							+4.6		

Source: Bloomberg, calculations by BCA Economist

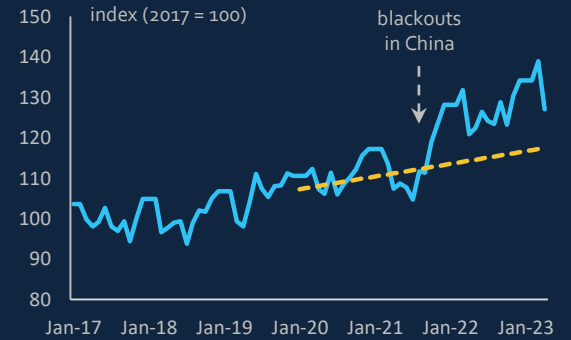
Severe oversupply in China's mining sector ...

- Coal's oversupply is one of the most severe, and it explains why prices have declined so sharply despite China's reopening.
- Beijing had greenlit the opening of multiple new coal mines in 2022, following a series of energy crisis, droughts, and geopolitical tensions that threaten its energy security.
- At the same time, demand for coal has not risen commensurately. China's power generation is growing more or less on par with pre-pandemic trend, but a larger share of it is now coming from wind and solar.
- Demand for metallurgical coal, meanwhile, is stymied by one major issue facing China's steel industry ...

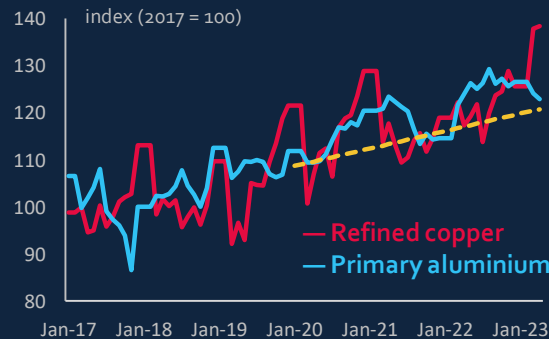
Electricity generation



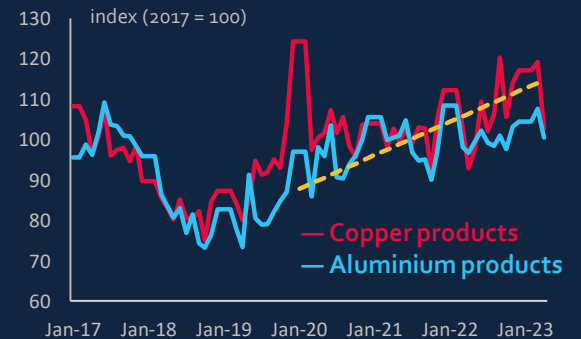
Coal production



Metal processing



Metal products

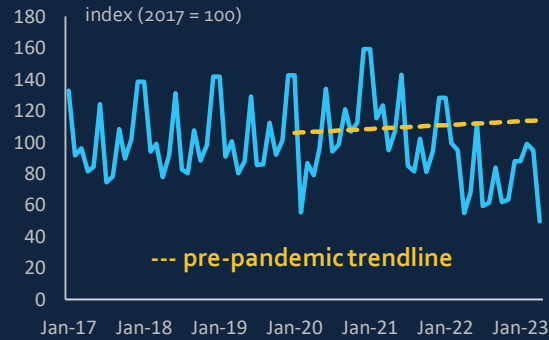


Source: Bloomberg, calculations by BCA Economist

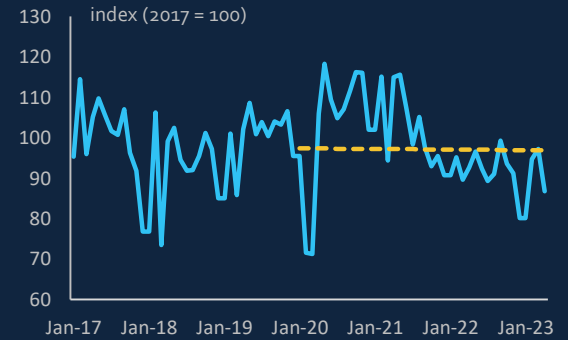
... meets trouble in construction-related sectors

- ... which is the slowdown in China's property sector. Evergrande's default in 2021 marked the start of a downturn in housing demand which continues to this day. In fact, sales in Apr-23 was lower than during lockdowns.
- In the past, China could rectify this through infrastructure buildout, which would absorb large quantities of steel and cement.
- But this is now hampered by the provincial governments' financial problems, which are exacerbated by declining land sales to real estate developers.
- Nickel is still mostly (60-70%) used for steel instead of batteries (~10%), while nickel pig iron (for steelmaking) accounts for the bulk of Indonesian nickel exports to China.
- So while FDI into Indonesian nickel may not be unduly impacted, the short-term effects on mining revenues could be substantial.

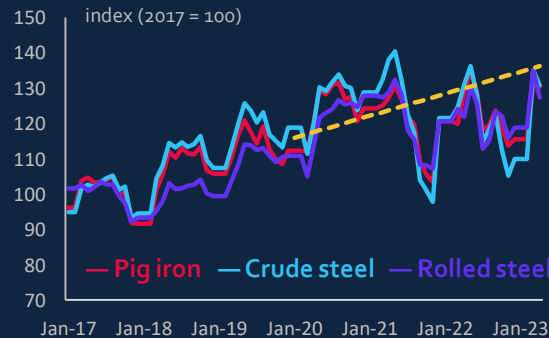
Residential floor space sold



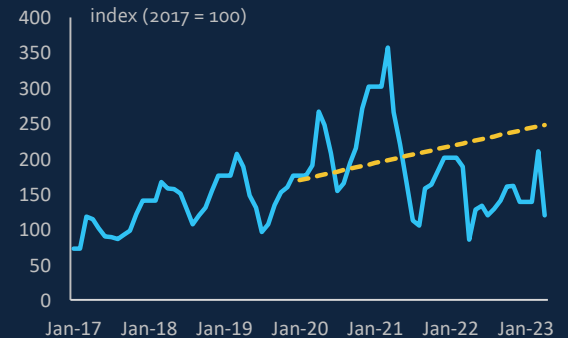
Cement production



Iron/steel production



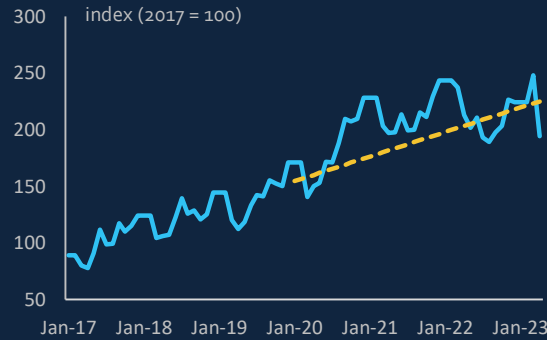
Excavator production



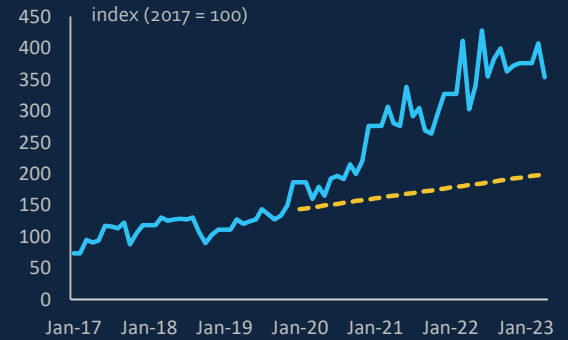
China's hot pursuit of "new-tech" industries ...

- Other than mining, the area where China's output has accelerated the most since 2020 is emerging technologies: EVs, renewables, robots, and semiconductors.
- This is partly the result of a deliberate push by the government (*Made in China 2025*) to dominate industries seen as critical for the future. US efforts to throttle China's technological advance has only served to boost investment in these areas.
- China's bid for "new tech" does not mean it is losing its traditional edge in the more "old school" industries, however.
- China does seem to be moving away, albeit slowly, from labor-intensive industries such as textiles. But its dominance over capital-intensive upstream parts of the global value chains (GVC), like basic chemicals, is actually increasing (*see pg. 18*).

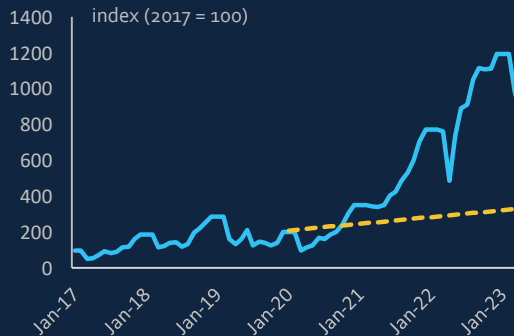
Lithium ion batteries production



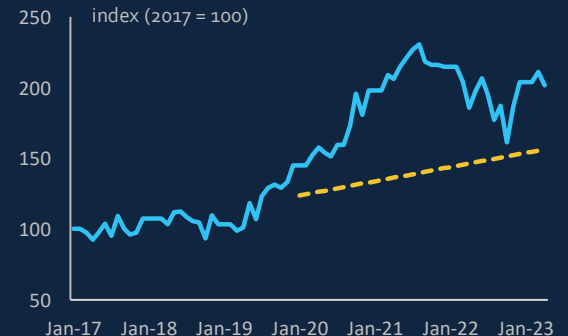
Industrial robot production



Electric vehicle production



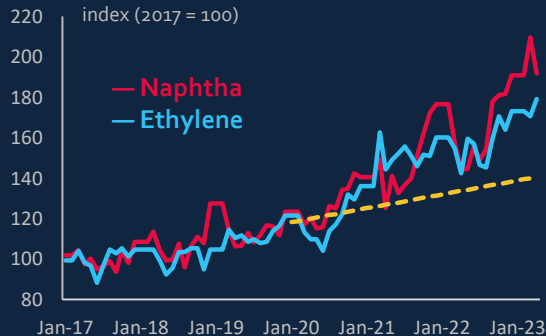
IC (chips) production



Source: Bloomberg, calculations by BCA Economist

... does not mean it abandons "old-tech" industries

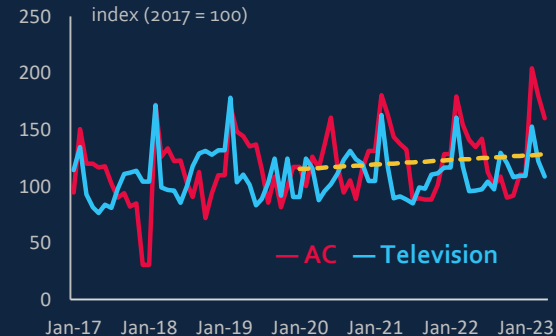
Chemical feedstock



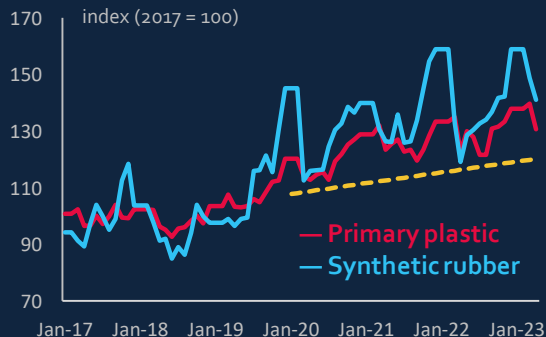
Synthetic fiber production



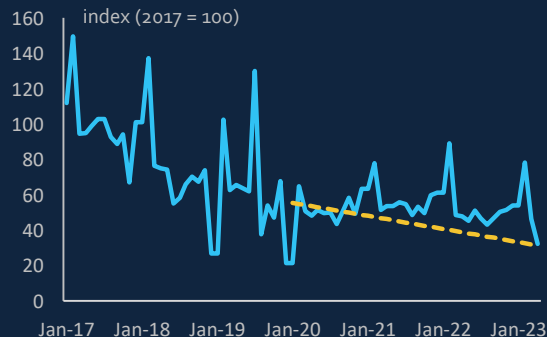
Consumer electronics



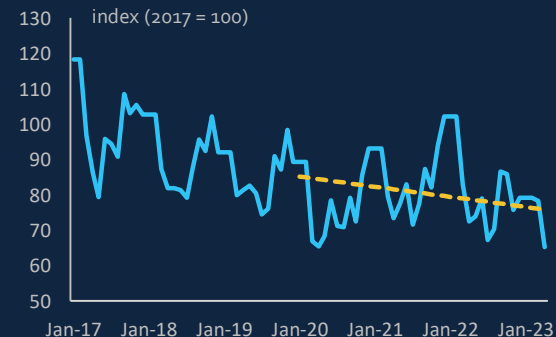
Chemical products



Cloth production



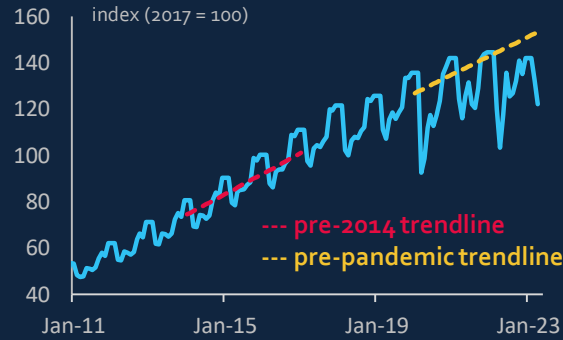
Smartphone production



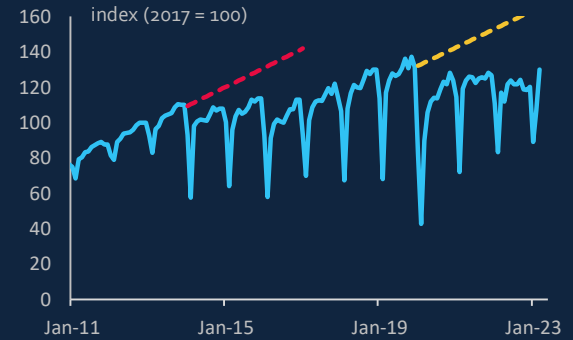
Chinese demand is only making partial recovery

- If China's industry output is mostly at par or stronger than pre-pandemic, the same is expressly not true for its consumer demand.
- We have seen the situation with retail sales, but indications from the transportation data may be even clearer. Freight and passenger traffic are recovering, but they are still way below their pre-pandemic trends.
- It is also a grim sign that China's outbound tourism is far lower than its pre-2020 levels. Without tourism outflows and with commodity prices still low, there is little to balance out China's exports to the rest of the world.
- Essentially, then, China's growth in 2023 will likely come at the expense of other nations – quite contrary to the earlier expectations that its reopening would help global growth.

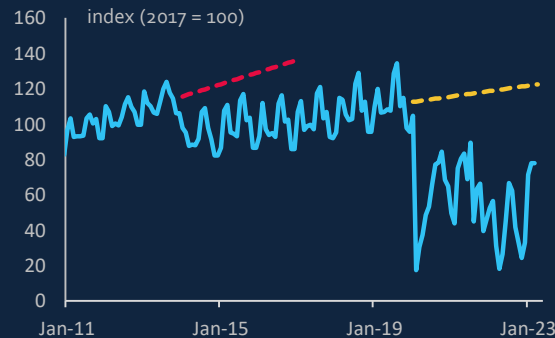
China retail sales



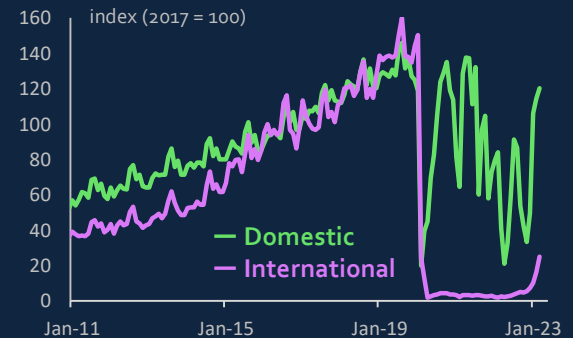
China freight traffic



China passenger traffic

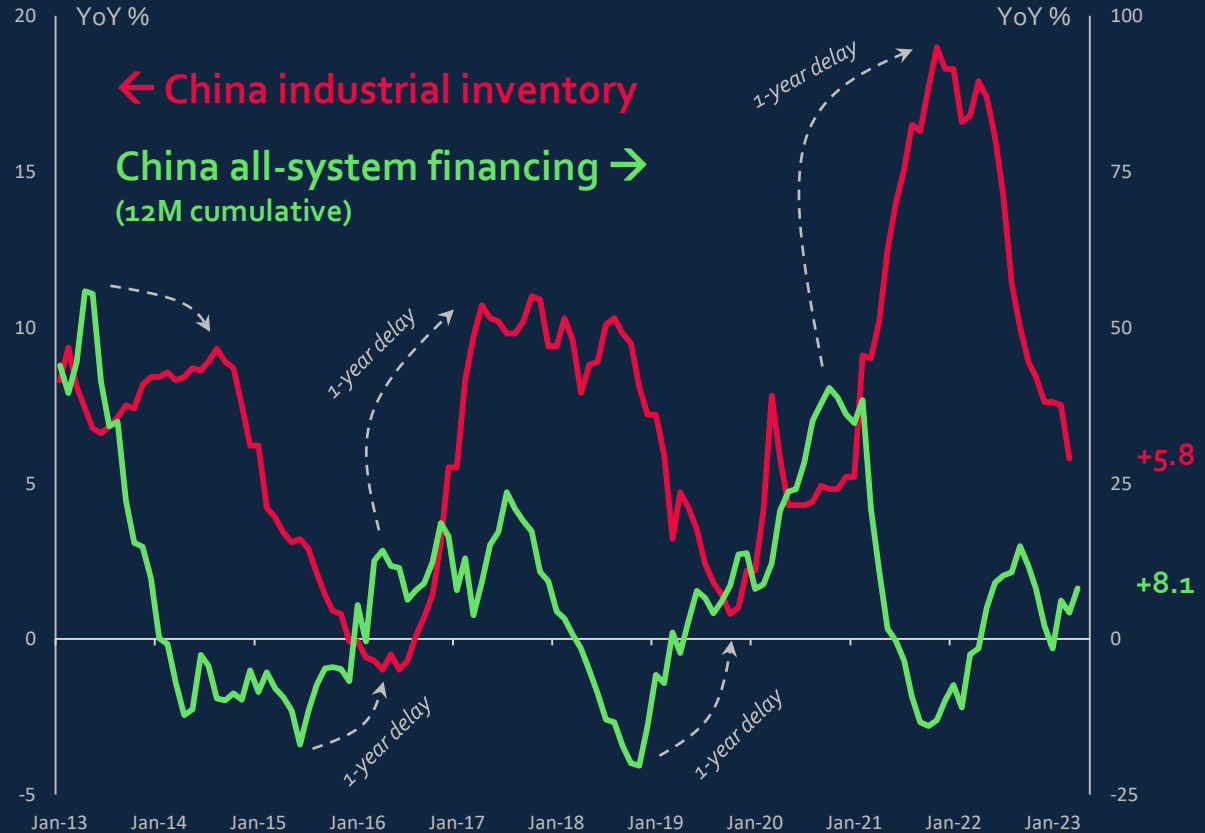


China airline traffic



Financing data might signal where inventories are heading ...

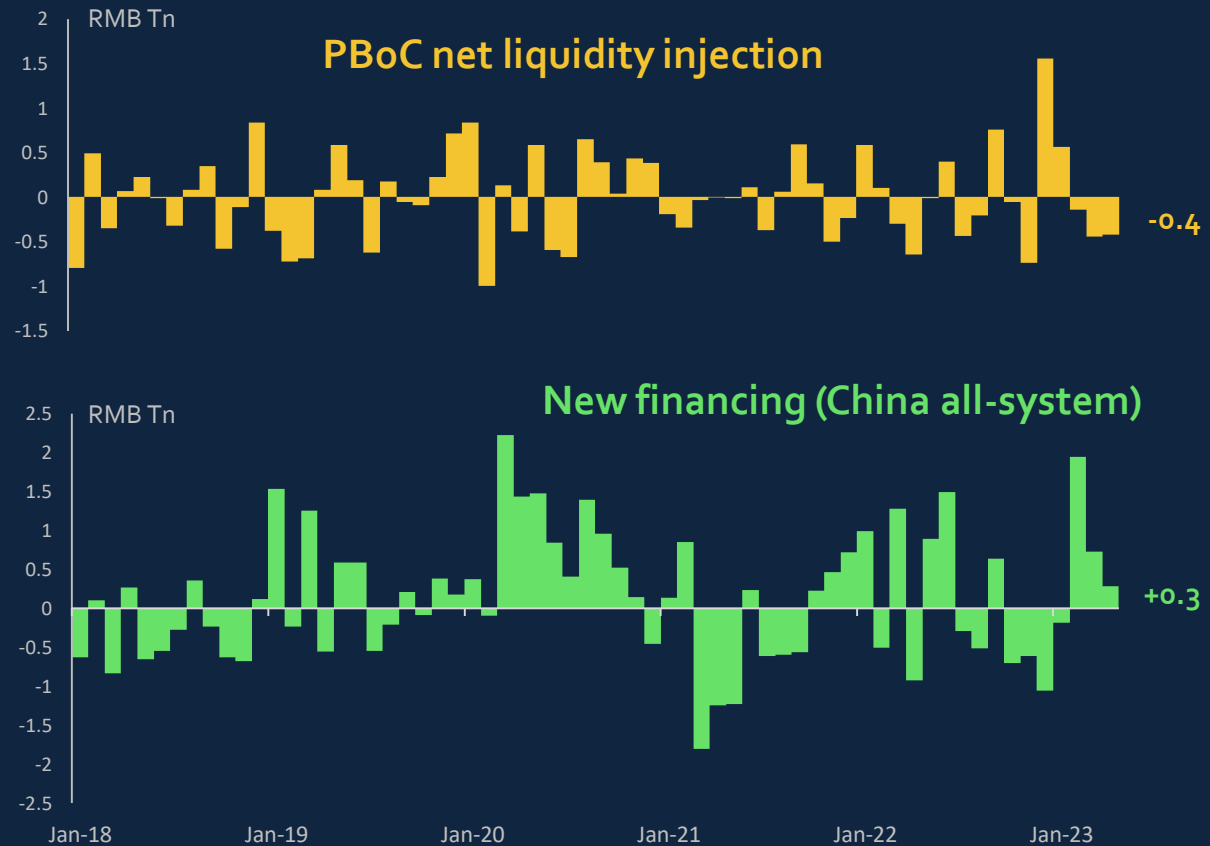
- The ideal way out of this impasse, then, is for Chinese demand to make a full recovery. But this is easier said than done, given the structural and real estate issues.
- Monetary stimulus – as is often the case – is an easier way out, even if it only “kicks the can” and may worsen global imbalance.
- One such scenario is the Fed pivoting back to QE, which would unleash demand from the US and other countries to better absorb China’s excess output.
- Alternatively, a surge of credit in China may allow companies to shrug off the demand gap or even expand production. In turn, this could spur demand for commodities which would reflate the global economy.
- As we can see, China’s credit cycle typically precedes its inventory cycle by one year. If this were still true, inventory levels should have already bottomed out by now.



Source: Bloomberg, calculations by BCA Economist

... but authorities are wary of providing stimulus

- The fact that they have not speaks to the scale of the problem, and also to the weakness of current credit impulse compared to previous cycles (*see pg. 20*).
- This sluggish financing may reflect Beijing's fear of reigniting the real estate bubble. It is notable that China has been eschewing the usual Keynesian stimulus when dealing with recent economic snags.
- Both PBoC liquidity injection and new credit from banks are also slowing after a massive increase at the start of reopening.
- This wariness is paralleled by the Fed, which persists with its inflation-busting priority in spite of liquidity problems among US banks.
- The lack of stimulus from either side is ultimately why a deflationary recession may be coming, despite other factors – *geopolitical tensions (!) decoupling (!) energy transition (!) climate change (!)* – seemingly screaming high inflation in the longer-term.



Source: Bloomberg, calculations by BCA Economist

Projections of macroeconomic indicators

	2018	2019	2020	2021	2022	2023E
GDP growth (% YoY)	5.2	5.0	-2.1	3.7	5.3	5.0
GDP per capita (USD)	3927	4175	3912	4350	4784	5285
CPI inflation (% YoY)	3.1	2.7	1.7	1.9	5.5	3.4
BI 7-day Repo Rate (%)	6.00	5.00	3.75	3.50	5.50	5.75
10Y government debt yield (%)	7.98	7.04	5.86	6.36	6.92	6.60
USD/IDR exchange rate	14,390	13,866	14,050	14,262	15,568	15,173
Trade balance (USD Billion)	-8.5	-3.2	+21.7	+35.3	+54.5	+35.3
Current account balance (% of GDP)	-3.0	-2.7	-0.4	+0.3	+1.0	-0.7

Source : BPS, Bloomberg, BCA Economist calculations

Notes:

- BI 7-day Repo Rate, 10Y yield, and USD/IDR exchange rate all refers to end of year position
- 10Y yield and USD/IDR exchange rate projections refer to fundamental values; actual market values may vary depending on current sentiment and technical factors



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