

## Will another wave of China's inventory upcycle incoming?

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### Summary

- Successful trade negotiations with the US seem to follow a pattern that entails agreeing to trade diversion, thereby posing a threat to other export-oriented economies such as China.
- The limited outlook for its domestic demand means that China has to continue relying on export demand to absorb its excess production, with Indonesia and other emerging markets may play an increasing role, given European consumers' diverted import demand.
- Another wave of cheap imports may benefit Indonesian customers, while the manufacturing sector seems to be more prepared thanks to the exchange rate effect.

- Southeast Asia may have become the centre of global attention in the past week, all thanks to the emerging military conflict across the Thailand-Cambodia border. Fortunately, the conflict does not seem to be especially relevant to the region's macroeconomic context. Bond yields continue to drop across ASEAN, including in the SBN market, as the benchmark 10Y yield dropped 1.2bps WoW to 6.51% as the market closed last Friday. While declining bond yields may be a symptom of slowing growth momentum across the region, the robust foreign demand for SBN should not be overlooked, as the SBN market recorded another USD 223.1 Mn in foreign inflows throughout the past week.
- Likewise, recent development in the global backdrop presents limited immediate risks to ASEAN and Indonesian financial markets. The fog of trade war continues to subside, courtesy

of US President Trump's recent announcement of a breakthrough in the US-EU trade talks. The tariff rate on US imports from the EU has now been set at 15% in exchange for the EU setting the tariff at 0%. Following the mould of other trade negotiations, the EU has also committed to increasing its share of imports from the US, with an emphasis on energy and defence-related goods.

- While financial markets often react positively to US trade deal announcements, the US government's demand for its negotiating counterparts to divert their import demand to the US may translate negatively to global macroeconomic growth. Trade diversion, by definition, is a zero-sum game, as increased import demand from one trading partner results from the reallocation of demand previously directed toward other exporters. A US-EU trade deal, then, is bad news for other

economies looking to export their products into the EU, which may bear some relevance to

Indonesia, given the recently announced breakthrough in IEU-CEPA negotiations.

### Better prepared to weather the import waves

- However, given the current context, the recently announced US-EU trade deals may especially be bad news for the Chinese economy. While indicators tracking China's manufacturing activities remain quite robust in June 2025, the strong numbers result from the stable external demand, in which exports from the EU market play a large part (*see Charts 1 & 2*). This strategy, however, may not be reliable for much longer, as the commitment to increase purchases from the US may prompt European importers to scale back orders from Chinese suppliers.
- Meanwhile, China's chronic industrial overcapacity problem is no secret. Earlier in the year, talks on the need to rejuvenate domestic demand to balance industrial production amidst the threat to export demand dominated China's Two Sessions<sup>1</sup>, resulting in the decision to increase the 2025 fiscal deficit target to a record 4% of GDP. Fast forward a couple of months, and the Chinese economy continues to grapple with subdued inflation (-0.1% MoM in June 2025) and anaemic retail demand (-0.16% MoM), suggesting limited improvements in its aggregate demand condition.
- The Chinese government, of course, does not seem to be taking the urgency to boost its

*"The US demand for trade diversion may threaten the growth outlook in China and other export-driven economies"*

domestic demand condition lightly. Analysts have projected that China's central government fiscal deficit in 2025 is on track to exceed the 5% of GDP mark, surpassing both the official 4% target for FY 2025 and the 4.8% deficit recorded in 2024. The challenge, however, seems to lie in the limited transmission of fiscal expansion to private sector activity. Despite the increased public spending, the tepid 7.08% YoY growth in bank loans shows that private demand remains subdued, as the still-elevated real interest rates continue to favour creditors over debtors.

- Given the structure of China's industrial sector – characterised by a dominance of small-scale, family-owned enterprises across the supply chain – margin compression across multiple sectors may also weigh on household income prospects, complicating efforts to sustainably bolster domestic demand. These challenges, as we know, unfold against the backdrop of a continued downturn in China's residential property market, with prices declining by 0.3% MoM in June 2025, further dampening household sentiment through the negative wealth effect.
- The odds, therefore, appear to be stacked against the Chinese government's efforts to revive its domestic aggregate demand,

<sup>1</sup> Annual plenary sessions for China's National People's Congress and National Committee of the Chinese People's Political Consultative Conference.

indicating that the economy may continue to look externally for growth. However, as trade tensions between Europe and the US appear to be normalising, Chinese exporters may increasingly turn to non-Western markets to shift their inventory, which portends another wave of cheap imports coming Indonesia's way (*see Chart 3*).

- As in previous episodes (which transpired between late 2021-2023), cheaper imports driven by the upcycle in China's manufactured goods inventory are likely to have divergent impacts across different segments of the Indonesian economy. For the household sector, the deluge of cheap imports may be seen as a lifeline, as lower prices may help to restore their purchasing power amidst the limited outlook for household revenue. This emerging dynamic may thus pave the way for a real recovery in private consumption in the second half of the year, while the normalising central government expenditures provide an additional boost in nominal terms.
- Meanwhile, for the business sector, competition from low-cost imports is likely to be a drag on growth, as margin compression may compel local manufacturers to consolidate, thereby limiting their capacity for expansion. Fortunately, the domestic manufacturing sector may be more prepared than in the previous episodes of China's inventory upcycle. For instance, Indonesia has been growing in sectors such as base metals and chemicals, areas where China does not

appear to be facing oversupply pressures (*see Table 1*). China's piling inventory in sectors such as machinery and electrical equipment may even complement the expansion in Indonesia's capital-intensive sectors, further advancing the integration of China-built industrial systems within Indonesia's manufacturing sector.

- Another, equally crucial factor that may better protect the domestic manufacturing sector against the deluge of cheap Chinese imports is the Rupiah. While the Rupiah has been stable against the USD recently, the currency continues to depreciate against CNY (the IDR depreciates 3.28% YTD against CNY vs. -1.49% YTD against USD), highlighting Bank Indonesia's success in orchestrating a targeted and gradual depreciation against trading partners' currencies. It could be the case, then, that Indonesia's manufacturing sector may have bottomed out in Q2-2025. A more solid recovery, however, may remain disrupted by headwinds and speed bumps, unless Chinese authorities quickly solve this ongoing involution and consolidate its manufacturing capacity to better meet the new demand condition.

***“The targeted and gradual depreciation of the IDR against trading partners' currencies may help to protect domestic manufacturers from imports”***

Chart 1

### A tale of two (Chinese) cities

China's export-oriented companies are still reporting an expansion in their manufacturing activities, while muted consumer demand continues to cripple domestic-oriented companies

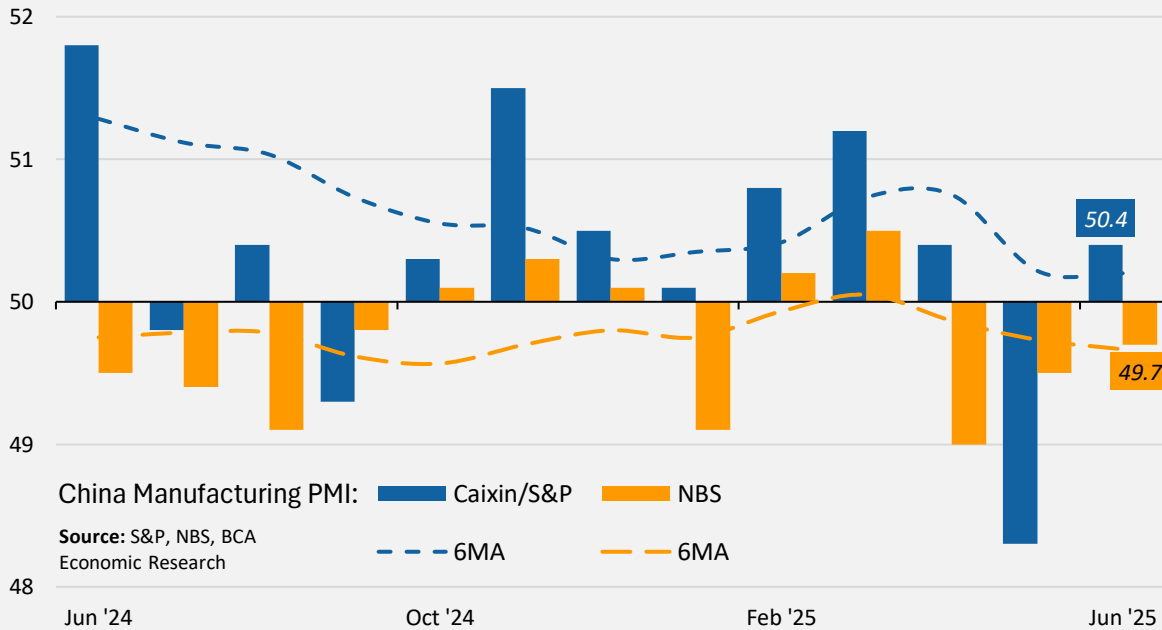


Chart 2

### Kicked out of Europe

The EU play an important role in driving the demand for Chinese exports, a trend that may not hold much longer given the EU's commitment to increase imports from the US

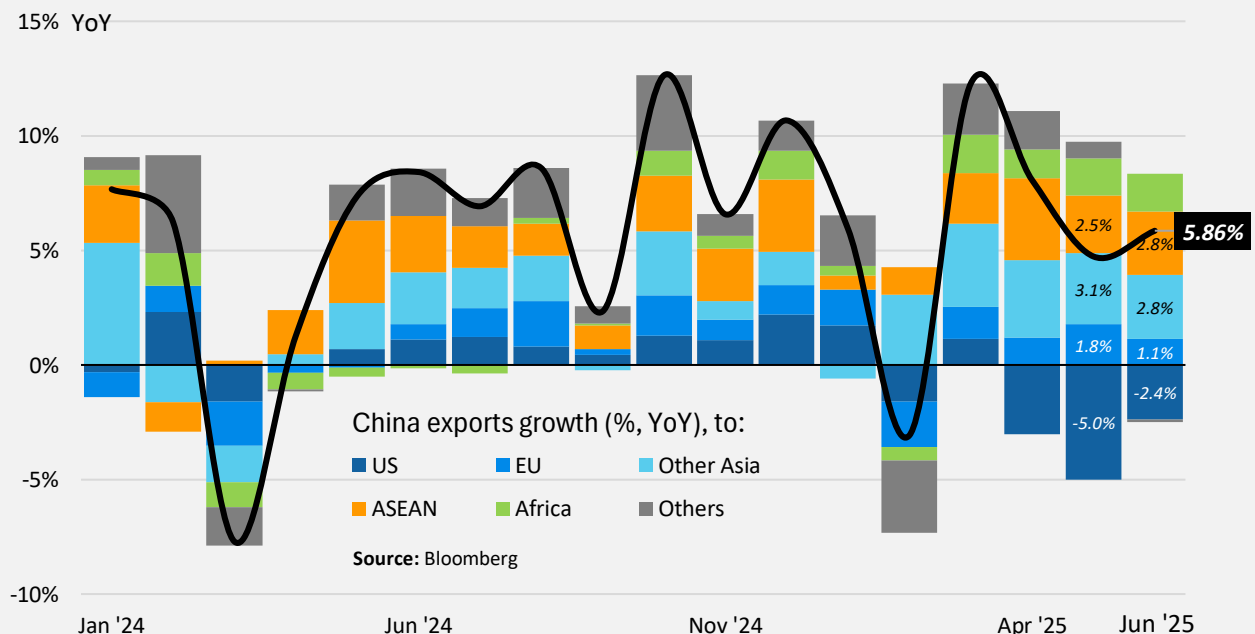


Chart 3

### Imported discounts

An uptrend in China's inventory cycle often followed by a drop in Indonesia's core inflation, helping households to maintain their consumption despite the feeble purchasing power

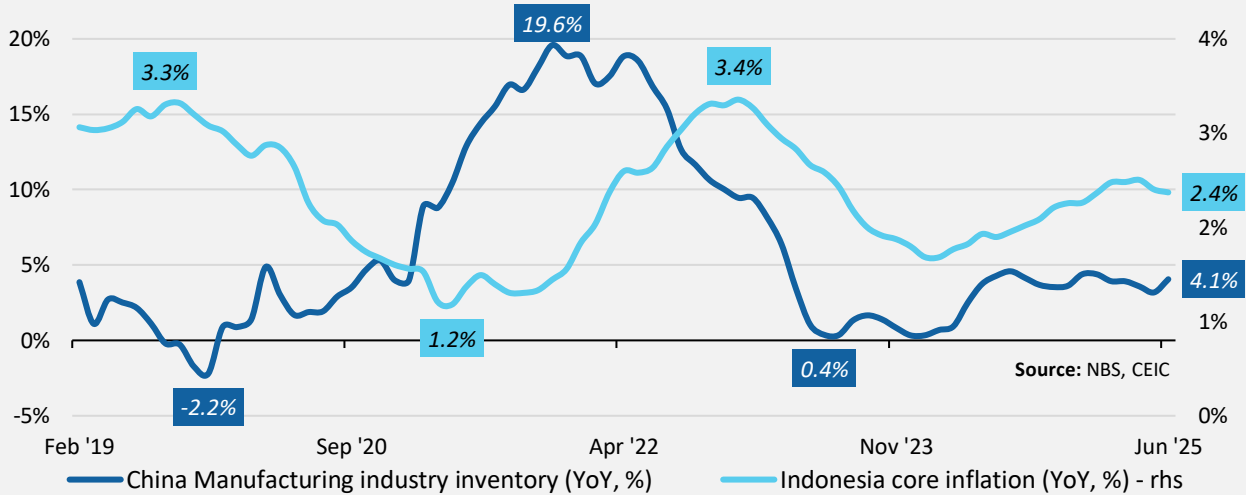


Table 1

### Dumping grounds

Rising inventory levels strengthen the urgency for Chinese manufacturers to sell their products in the export market, with Indonesia being one of the targets

	China inventory growth	Indonesia import growth (Apr-May 25 avg vs. 2024 avg)	
	YoY, %	%	USD Mn
Agricultural products	1.7%	0.5%	1.0
Filaments & staple fibre	0.5%	18.8%	51.1
Chemicals	3.5%	20.1%	122.0
Electrical machinery, Electronics	7.8%	23.8%	289.5
Toys, Games, and Sport requisites	0.3%	19.7%	7.9
Boilers & machinery	4.8%	15.9%	230.7
Hides, Skins, and Leathers	-0.1%	2.6%	1.0
Beverages	8.0%	64.0%	0.5
Base metals	1.8%	19.6%	136.8
Vehicles	1.7%	43.8%	145.5
Pharmaceutical products	2.9%	67.3%	5.0
Textiles & Apparel	-1.3%	25.2%	18.2
Tobacco	4.3%	51.5%	9.9
Food products	4.8%	2.1%	1.8
Furniture	-4.9%	4.3%	5.3
Paper and products	2.7%	19.1%	11.2
Rubber, Plastics	5.1%	5.2%	19.4

Source: China NBS, BPS, BCA Economic Research

Economic Calendar				
		Actual	Previous	Forecast*
01 July 2025				
ID	S&P Global Manufacturing PMI	46.9	47.4	48.5
ID	<b>Trade balance (May-25), USD Bn</b>	<b>4.3</b>	<b>0.16</b>	<b>1.0</b>
ID	<b>Inflation Rate YoY, %</b>	<b>1.87</b>	<b>1.6</b>	<b>1.7</b>
US	S&P Global Manufacturing PMI	52.9	52	52
03 July 2025				
US	Trade balance, USD Bn	-71.5	-60.3	-72
US	Non Farm Payrolls, th	147	144	100.0
07 July 2025				
ID	<b>Foreign Exchange Reserves, USD Bn</b>	<b>152.6</b>	<b>152.5</b>	<b>157.0</b>
EA	Retail Sales YoY, %	1.8	2.7	1.7
ID	Motorbike Sales YoY, %	-0.3	-0.1	-
08 July 2025				
ID	Consumer Confidence	117.8	117.5	123
09 July 2025				
ID	Retail Sales YoY, %	1.9	-0.3	0.3
ID	Car Sales YoY, %	22.6	-16.1	-
CN	Inflation Rate YoY, %	0.1	-0.1	0.1
14 July 2025				
CN	Trade balance, USD Bn	114.77	103.22	100
15 July 2025				
CN	GDP Growth Rate YoY, %	5.2	5.4	5.3
CN	Retail Sales YoY, %	4.8	6.4	6.1
US	Inflation Rate YoY, %	2.7	2.4	2.6
16 July 2025				
ID	<b>BI-Rate Decision, %</b>	<b>5.25</b>	<b>5.5</b>	<b>5.25</b>
ID	Loan Growth YoY, %	7.77	8.43	8.5
17 July 2025				
US	Retail Sales YoY, %	3.9	3.3	3.6
22 July 2025				
ID	M2 Money Supply YoY, %	6.5	4.9	-
29 July 2025				
ID	<b>Foreign Direct Investment YoY, %</b>		<b>12.7</b>	-

\*Forecasts of some indicators are simply based on market consensus

Bold indicates indicators covered by the BCA Monthly Economic Briefing report

### Selected Macroeconomic Indicator

Key Policy Rates	Rate (%)	Last Change	Real Rate (%)	Trade & Commodities	25-Jul	-1 mth	Chg (%)
US	4.50	Dec-24	1.80	Baltic Dry Index	2,257.0	1,681.0	34.3
UK	4.25	May-25	0.65	S&P GSCI Index	545.1	542.0	0.6
EU	2.15	Jun-25	0.15	Oil (Brent, \$/bbl)	68.4	67.1	1.9
Japan	0.50	Jan-25	-2.80	Coal (\$/MT)	115.5	113.4	1.9
China (lending)	2.00	Sep-24	4.25	Gas (\$/MMBtu)	3.10	3.30	-6.1
Korea	2.50	May-25	0.30	Gold (\$/oz.)	3,337.3	3,323.7	0.4
India	5.50	Jun-25	3.40	Copper (\$/MT)	9,715.8	9,819.9	-1.1
Indonesia	5.25	Jul-25	3.38	Nickel (\$/MT)	15,115.3	14,721.6	2.7
Money Mkt Rates	25-Jul	-1 mth	Chg (bps)	CPO (\$/MT)	997.2	943.1	5.7
				Rubber (\$/kg)	1.79	1.64	9.1
Bank Rates (Rp)	Apr	Mar	Chg (bps)	External Sector	May	Apr	Chg (%)
SPN (1Y)	5.32	5.92	-60.0	Export (\$ bn)	24.61	20.74	18.66
SUN (10Y)	6.51	6.74	-23.1	Import (\$ bn)	20.31	20.59	-1.32
INDONIA (O/N, Rp)	4.81	5.14	-32.8	Trade bal. (\$ bn)	4.30	0.16	2,608.75
JIBOR 1M (Rp)	5.87	6.15	-28.8	Central bank reserves (\$ bn)*	152.5	152.5	0.01
Currency/USD	25-Jul	-1 mth	Chg (%)	Prompt Indicators	Jun	May	Apr
UK Pound	0.744	0.734	-1.30	Consumer confidence index (CCI)	117.8	117.5	121.7
Euro	0.852	0.861	1.15	Car sales (%YoY)	-22.6	-15.1	5.0
Japanese Yen	147.7	144.9	-1.86	Motorcycle sales (%YoY)	-0.3	-0.1	-3.0
Chinese RMB	7.170	7.172	0.03	Manufacturing PMI	Jun	May	Chg (bps)
Indonesia Rupiah	16,315	16,350	0.21	USA	52.9	52.0	90
Capital Mkt	25-Jul	-1 mth	Chg (%)	Eurozone	49.5	49.4	10
JCI	7,543.5	6,869.2	9.82	Japan	50.1	49.4	70
DJIA	44,901.9	43,089.0	4.21	China	50.4	48.3	210
FTSE	9,120.3	8,759.0	4.13	Korea	48.7	47.7	100
Nikkei 225	41,456.2	38,790.6	6.87	Indonesia	46.9	47.4	-50
Hang Seng	25,388.4	24,177.1	5.01				
Foreign portfolio ownership (Rp Tn)	Jun	May	Chg (Rp Tn)				
Stock	3,336.8	3,435.7	-98.91				
Govt. Bond	918.7	995.6	-76.96				
Corp. Bond	4.3	5.2	-0.92				

Source: Bloomberg, BI, BPS

Notes:

\*Data from an earlier period

\*\*For changes in currency: **Black** indicates appreciation against USD, **Red** otherwise

\*\*\*For PMI, >50 indicates economic expansion, <50 otherwise



## Indonesia – Economic Indicators Projection

	2019	2020	2021	2022	2023	2024	2025E
Real GDP growth (% YoY)	5.0	-2.1	3.7	5.3	5.0	5.0	4.8
Nominal GDP growth (% YoY)	6.7	-2.5	9.9	15.4	6.7	6.0	6.6
GDP per capita (USD)	4175	3912	4350	4784	4920	4960	4996
CPI inflation (% YoY)	2.7	1.7	1.9	5.5	2.6	1.6	2.0
BI Rate (%)	5.00	3.75	3.50	5.50	6.00	6.00	5.00
SBN 10Y yield (%)	7.04	5.86	6.36	6.92	6.45	6.97	7.02
USD/IDR exchange rate (average)	14,141	14,529	14,297	14,874	15,248	15,841	16,350
USD/IDR exchange rate (end of year)	13,866	14,050	14,262	15,568	15,397	16,102	16,625
Trade balance (USD Bn)	-3.2	21.7	35.3	54.5	37.0	31.0	26.0

**Notes:**

- USD/IDR exchange rate projections are for fundamental values; market values may diverge significantly at any moment in time

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