# Bidding farewell to China's inventory cycle

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**Summary**

- China's high-inventory cycle has ended following the tepid manufacturing activities since Apr-23. China's dwindling inventory levels may put an end to the China-driven global goods disinflation.
- The Chinese government's different approach regarding fiscal stimulus limits the impetus for manufacturing expansion in China, limiting the risk of renewed inflationary pressure in the commodity market.
- Diminishing competition from cheap imported goods and normalising industrial commodity prices may improve the outlook for Indonesia's manufacturing sector in the upcoming period.

- The global economy continued to emulate the US economy by delivering positive surprises throughout Q2-2023. Despite the prevailing challenges, the UK economy expanded by 0.4% YoY in Q2-2023, defying the flat growth or recession expectations. In Europe, Germany also recorded a trade surplus of EUR 18.68 Bn last month, marking the highest surplus since Russia's invasion of Ukraine in Q1-2022.
- But the situation in Asian economic powerhouses seems to have taken a turn for the worse. In contrast to the robust condition in Germany, exports from China sunk by 14.5% YoY to USD 281.76 Bn last month, the steepest decline since February 2020 when the pandemic first hit China's main export markets. The steep decline in exports marks another development that raises the question mark on China's economic virility in 2023. Somnambulant domestic demand, coupled with the mounting inventory level, increases Chinese manufacturers' dependence on the export market following the economic reopening. Indeed, our previous report *(Collideascope #1: China's warehouses are full, and it is spilling over to the global economy)* has discussed at length the rationale behind the increase in Chinese exports albeit with a diminishing margin.
- The sustained decline in external demand, whether resulting from waning economic impulses or geopolitical considerations as in the case of the US and Japan, would ultimately render China's export-at-all-cost strategy financially unviable. **Chinese manufacturers then, were forced to scale back their operations**, as evident from the manufacturing PMI (NBS) number which has been contracting since April 2023.
- Weakening growth in the manufacturing sector would reverberate badly in the economy, especially in industrial production-driven China. Contracted manufacturing activities would limit employment opportunities in China, which adds to the unemployment problem facing the Chinese

economy. The ongoing unemployment problem is particularly rampant among the younger demographic, although the youth unemployment level is likely to be exacerbated by the mismatch in China's labour market.

- **The increasingly widespread case of unemployment presents another challenge for the Chinese economy: its eroding consumer confidence.** Although the hitherto fragile consumer sentiment in China is primarily linked to the still-volatile property sector, the decline in production activities did not help to solve the issue, prompting consumers to cut back spending in favour of precautionary savings ***(see Chart 1).***

- The issue of sluggish domestic aggregate demand growth is not novel for China. We have argued that China's economic recovery would rely more on the export market rather than domestic demand. As early as April 2023, it is quite evident that **the prospect of a post-pandemic revival of China's brand of consumerism remains uncertain**, leading to the negative price pressure that resulted in -0.3% YoY inflation in July 2023. The People's Bank of China (PBoC), of course, has gone to some lengths to counteract the decline in domestic aggregate demand. Alas, stimuli implemented thus far appear to yield limited results. China's all-system financing fell to CNY 528.2 Bn in July 2023, marking its lowest level in at least the past 8 years as businesses and households remain cautious about increasing leverage amidst the prevailing uncertainty.

***"A looser monetary policy environment in China would primarily benefit local governments, particularly in terms of infrastructure spending"***

- Monetary easing seems to have a limited impact on household and business spending. Indeed, prominent China watchers have contended that a looser monetary policy environment would primarily benefit local governments, particularly in terms of infrastructure spending which the central government aims to restrict and rebalance. However, the expansion of Chinese government expenditures is not a straightforward matter ***(see Chart 2)***. Certain arguments lean towards philosophical debates, while others emphasise the inefficiency of adopting US-style direct cash transfers to stimulate the consumption level of China's nervous household sector as a source behind the government's lack of Keynesian activism.

- **The central government, then, may look to rejuvenate consumer confidence by first stabilising the property sector**, as evident from recent developments such as the relaxed Hukou system that could potentially encourage urban migration (not necessarily to the capital city). Such a policy would keep the onus of financing China's economic growth on local governments ***(see Chart 3)***, allowing the central government to maintain its mirage of fiscal conservatism. This policy, however, would also mean that liquidity would continue to flow to the property and construction sector, potentially diverting resources from the household and manufacturing sectors which are also in dire need of fiscal interventions.

- Despite the bleak short-term outlook, the decline in production activities may be a necessary sacrifice for China's private sector. Manufacturers, of course, cannot be expected to operate with compressed margins for an extended period, and the ongoing slowdown in production activities would help to roll back China's oversupply problem. Even with declining external demand, the deceleration in China's manufacturing activities since April 2023 has played a role in diminishing inventory levels ***(see Chart 4)***, allowing Chinese manufacturers to exert better control over their margins while also creating an impetus to restart production in the foreseeable future.

- The conclusion of China's 2021-2023 inventory cycle could impact the Indonesian economy in several ways. **For consumers, the diminishing availability of cheap imported goods might not be something to cheer about**. As previously discussed in our *Q2-2023 GDP report*, the decline in the deflator figure that explains Indonesia's surprisingly positive GDP growth in the last quarter could be attributed to the disinflation of goods imported from China. Consequently, the decrease in China's inventory levels and import volume from China might decelerate the disinflation process in Indonesia's core CPI, potentially resulting in reduced goods consumption in terms of volume. This scenario may hamper the outlook for Indonesia's real GDP, although not necessarily the nominal GDP.
- The end of China-imported goods disinflation does not mean that China will stop contributing to the ongoing global disinflation trend. Instead, lower production activities in China could result in decreased demand for industrial commodities, thus alleviating concerns over a renewed rally in the industrial commodity market. Unfortunately, this scenario might adversely impact Indonesia's commodity-producing sector, particularly domestic mineral and metal-producing sectors. Slowing manufacturing activities in China has fostered a consensus among commodity traders could face oversupply challenges in the short-to-medium term. Alas, those metals include nickel and aluminium, which is hitherto the focus of Indonesia's industrial down-streaming policies.
- On the bright side, **the limited risk of rising industrial commodity prices brings positive tidings for Indonesia's manufacturing sector**. Normalising industrial commodity prices would help domestic manufacturers recover their margin, while the timing also aligns well with the anticipated fiscal expansion in Indonesia. Indonesia's manufacturing sector, which was whipsawed by increasing competition from imported goods and high input prices throughout last year, may find a more solid footing in the upcoming quarter, which explains the corporate sector's expansionist sentiment in the past two quarters and our controlled optimism regarding the prospect for the domestic economy in upcoming days.

***"The decrease in China's inventory levels and import volume from China might decelerate the disinflation process in Indonesia's core CPI"***

**Chart 1**

**Saving for rainy days**

Chinese consumers tendency to save ahead of uncertain times continue to dampen the domestic aggregate demand level while also resulting in large source of untapped liquidity

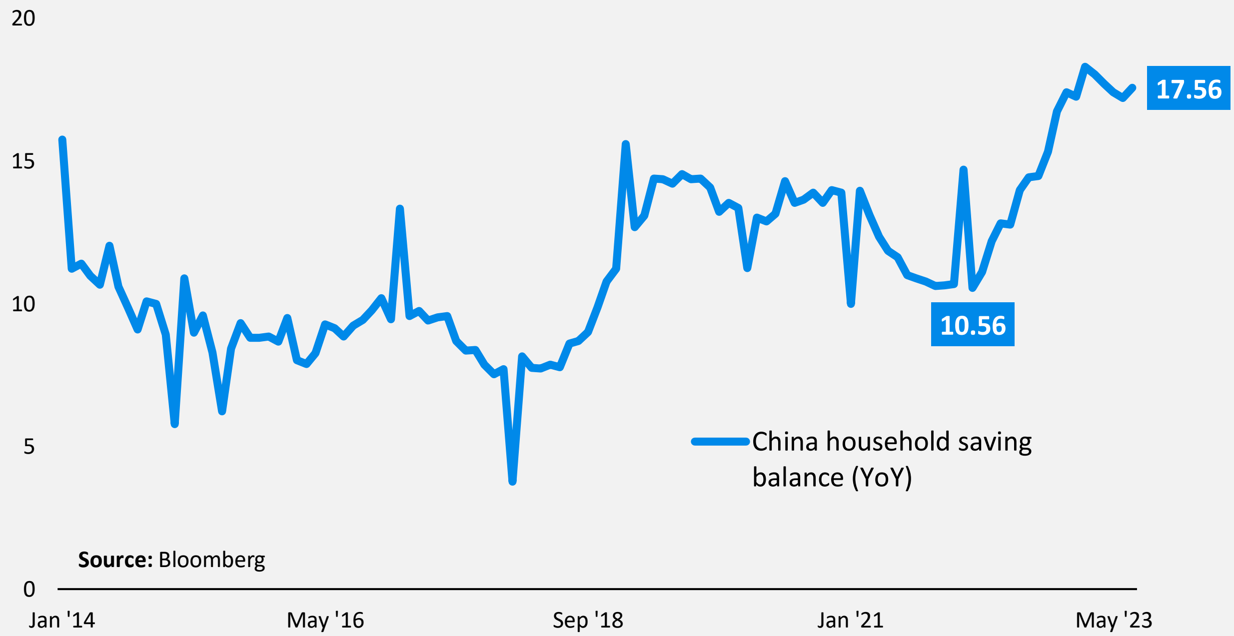



**Chart 2**

**Never a big spender**

Despite the mounting liquidity, the central government remains unwilling to break away from its conservative budget tradition to provide more direct fiscal interventions for consumers

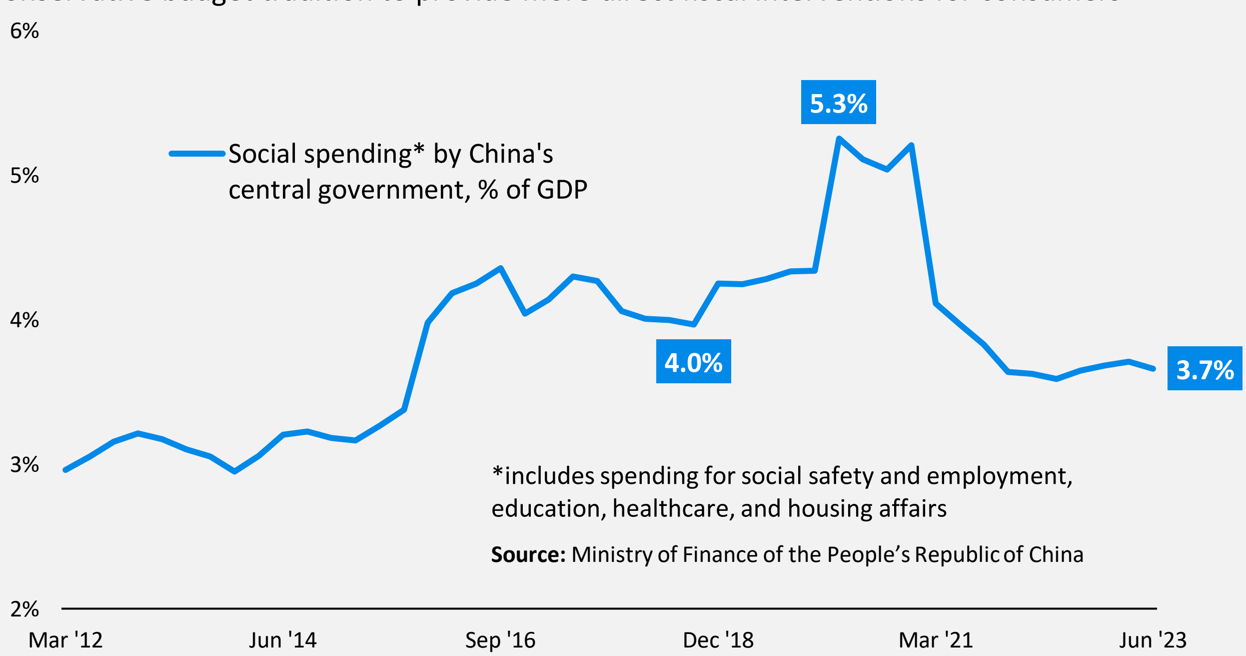


Chart 3

**Relying on the locals**

The Chinese government's strategy to improve the condition in the property sector first to restore consumer confidence may keep the onus of financing China's growth on local governments

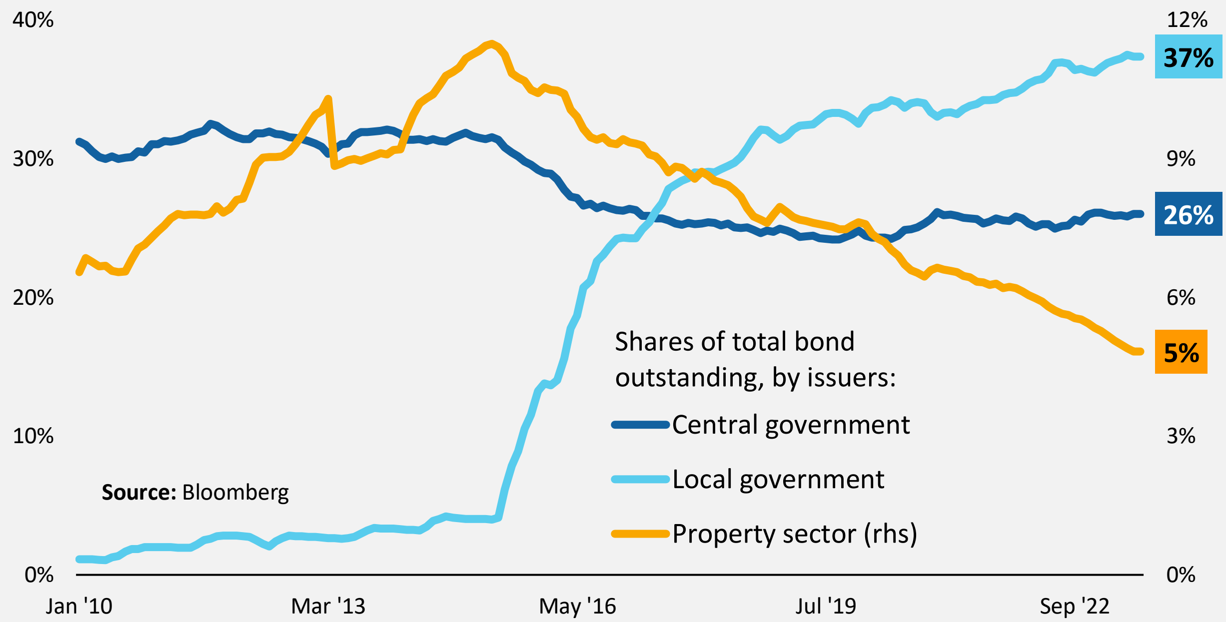
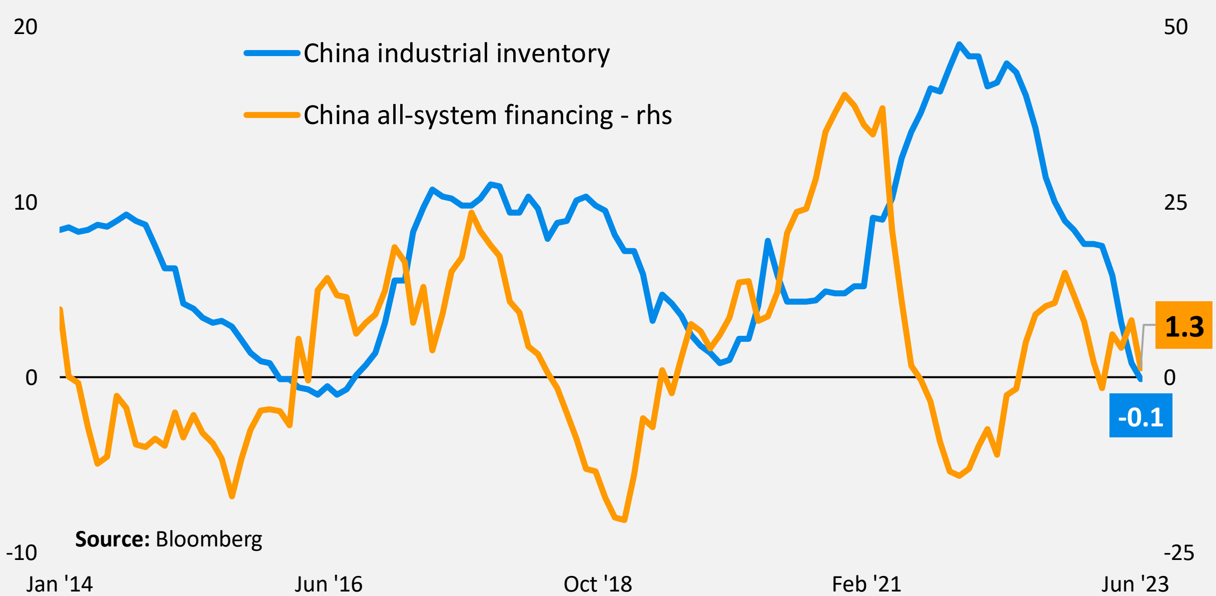



Chart 4

**Keeping an eye on the next cycle**

Weak demand for loans from Chinese businesses and thus limited expansion in production capacity helps to unwind China's mounting inventories despite suppressed domestic and external demand.



## Economic Calendar

| | | Actual | Previous | Forecast* |
|---|---|---|---|---|
| 1 August 2023 | | | | |
| ID | S&P Manufacturing PMI | 53.3 | 52.5 | 52 |
| **ID** | **Inflation Rate YoY** | **3.08%** | **3.52%** | **3.2%** |
| CN | Caixin Manufacturing PMI | 49.2 | 50.5 | 50.3 |
| US | S&P Manufacturing PMI | 49 | 46.3 | 49 |
| US | JOLTs Job Opening | 9.582 | 9.616 | 9.6 |
| 3 August 2023 | | | | |
| UK | BoE Bank Rate Decision | 5.25% | 5.00% | 5.00% |
| 4 August 2023 | | | | |
| US | Unemployment Rate | 3.5% | 3.6% | 3.6% |
| US | Non-Farm Payroll ('000) | 187 | 185 | 200 |
| 7 August 2023 | | | | |
| **ID** | **Foreign Exchange Reserves (USD (Bn)** | **137.7** | **137.5** | **140.0** |
| **ID** | **GDP Growth Rate YoY** | **5.17%** | **5.03%** | **5.1%** |
| CN | Foreign Exchange Reserves (USD Tn) | 3.20 | 3.19 | 3.19 |
| 8 August 2023 | | | | |
| ID | Consumer Confidence | 123.5 | 127.1 | 127.5 |
| CN | Balance of Trade (USD Bn) | 80.6 | 70.6 | 69 |
| US | Balance of Trade (USD Bn) | -65.5 | -69 | -65.1 |
| 9 August 2023 | | | | |
| CN | Inflation rate YoY | -0.3% | 0% | -0.3% |
| ID | Motorbike Sales YoY | 45.6% | 66.6% | - |
| 10 August 2023 | | | | |
| US | Inflation rate YoY | 3.2% | 3% | 3.1% |
| ID | Car Sales YoY | -6.7% | 4.6% | - |
| 15 August 2023 | | | | |
| **ID** | **Balance of Trade (USD Bn)** | **-** | **3.46** | **-** |
| CN | Retail Sales YoY | - | 3.1% | - |
| US | Retail Sales YoY | - | 1.5 | - |
| 16 August 2023 | | | | |
| ID | Retail Sales YoY | - | -4.5% | - |
| 18 August 2023 | | | | |
| ID | Current Account (USD Bn) | - | 3.0 | 1.5 |
| 24 August 2023 | | | | |
| **ID** | **Interest Rate Decision** | **-** | **5.75%** | **5.75%** |

*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 (%) |
|---|---|---|---|
| US | 5.50 | Aug-23 | 2.30 |
| UK | 5.25 | Aug-23 | -2.65 |
| EU | 4.25 | Aug-23 | -1.05 |
| Japan | -0.10 | Jan-16 | -3.40 |
| China (lending) | 4.35 | Aug-23 | 4.65 |
| Korea | 3.50 | Jul-23 | 1.20 |
| India | 6.50 | Aug-23 | 1.69 |
| Indonesia | 5.75 | Jul-23 | 2.67 |

| Money Mkt Rates | 11-Aug | -1 mth | Chg (bps) |
|---|---|---|---|
| SPN (1M) | 3.96 | 4.92 | -95.8 |
| SUN (10Y) | 6.31 | 6.20 | 11.2 |
| INDONIA (O/N, Rp) | 5.61 | 5.64 | -2.9 |
| JIBOR 1M (Rp) | 6.40 | 6.40 | 0.5 |

| Bank Rates (Rp) | May | Apr | Chg (bps) |
|---|---|---|---|
| Lending (WC) | 8.93 | 8.92 | 0.35 |
| Deposit 1M | 4.19 | 4.18 | 1.37 |
| Savings | 0.67 | 0.67 | 0.00 |

| Currency/USD | 11-Aug | -1 mth | Chg (%) |
|---|---|---|---|
| UK Pound | 0.788 | 0.773 | -1.83 |
| Euro | 0.913 | 0.908 | -0.55 |
| Japanese Yen | 145.0 | 140.4 | -3.17 |
| Chinese RMB | 7.240 | 7.210 | -0.41 |
| Indonesia Rupiah | 15,215 | 15,140 | -0.49 |

| Capital Mkt | 11-Aug | -1 mth | Chg (%) |
|---|---|---|---|
| JCI | 6,880.0 | 6,796.9 | 1.22 |
| DJIA | 35,281.4 | 34,261.4 | 2.98 |
| FTSE | 7,524.2 | 7,282.5 | 3.32 |
| Nikkei 225 | 32,473.7 | 32,203.6 | 0.84 |
| Hang Seng | 19,075.2 | 18,659.8 | 2.23 |

| Foreign portfolio ownership (Rp Tn) | Jul | Jun | Chg (Rp Tn) |
|---|---|---|---|
| Stock | 2,892.9 | 2,755.0 | 137.88 |
| Govt. Bond | 846.9 | 846.9 | 0.00 |
| Corp. Bond | 11.3 | 11.3 | -0.03 |

| Trade & Commodities | 11-Aug | -1 mth | Chg (%) |
|---|---|---|---|
| Baltic Dry Index | 1,129.0 | 1,032.0 | 9.4 |
| S&P GSCI Index | 590.8 | 557.7 | 5.9 |
| Oil (Brent, $/brl) | 86.8 | 79.4 | 9.3 |
| Coal ($/MT) | 151.5 | 135.9 | 11.5 |
| Gas ($/MMBtu) | 2.61 | 2.57 | 1.6 |
| Gold ($/oz.) | 1,913.8 | 1,932.2 | -1.0 |
| Copper ($/MT) | 8,255.6 | 8,305.0 | -0.6 |
| Nickel ($/MT) | 19,953.0 | 20,501.0 | -2.7 |
| CPO ($/MT) | 821.7 | 828.8 | -0.9 |
| Rubber ($/kg) | 1.28 | 1.31 | -2.3 |

| External Sector | Jun | May | Chg (%) |
|---|---|---|---|
| Export ($ bn) | 20.61 | 21.71 | -5.08 |
| Import ($ bn) | 17.15 | 21.28 | -19.40 |
| Trade bal. ($ bn) | 3.45 | 0.43 | 708.66 |
| Central bank reserves ($ bn)* | 137.5 | 139.3 | -1.25 |

| Prompt Indicators | Jul | Jun | May |
|---|---|---|---|
| Consumer confidence index (CCI) | 123.5 | 127.1 | 128.3 |
| Car sales (%YoY) | -6.8 | 4.7 | 65.2 |
| Motorcycle sales (%YoY) | 45.6 | 66.6 | 113.4 |

| Manufacturing PMI | Jul | Jun | Chg (bps) |
|---|---|---|---|
| USA | 46.4 | 46.0 | 40 |
| Eurozone | 42.7 | 43.4 | -70 |
| Japan | 49.6 | 49.8 | -20 |
| China | 49.2 | 50.5 | -130 |
| Korea | 49.4 | 47.8 | 160 |
| Indonesia | 53.3 | 52.5 | 80 |

Source: Bloomberg, BI, BPS
Notes:
^Data for January 2022
*Data from an earlier period
**For changes in currency: **Black** indicates appreciation against USD, **Red** otherwise
***For PMI, **>50** indicates economic expansion, **<50** otherwise

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## Indonesia – Economic Indicators Projection

| | 2018 | 2019 | 2020 | 2021 | 2022 | 2023E |
|---|---|---|---|---|---|---|
| Gross Domestic Product (% YoY) | 5.2 | 5.0 | -2.1 | 3.7 | 5.3 | 5.2 |
| GDP per Capita (US$) | 3927 | 4175 | 3912 | 4350 | 4784 | 5285 |
| Consumer Price Index Inflation (% YoY) | 3.1 | 2.7 | 1.7 | 1.9 | 5.5 | 2.7 |
| BI 7-day Repo Rate (%) | 6.00 | 5.00 | 3.75 | 3.50 | 5.50 | 5.75 |
| USD/IDR Exchange Rate (end of the year)** | 14,390 | 13,866 | 14,050 | 14,262 | 15,568 | 15,173 |
| Trade Balance (US$ billion) | -8.5 | -3.2 | 21.7 | 35.3 | 54.5 | 35.3 |
| Current Account Balance (% GDP) | -3.0 | -2.7 | -0.4 | 0.3 | 1.0 | -0.7 |

*Estimated number

** Estimation of the Rupiah's fundamental exchange rate


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