Sucden Financial

Coming of Age?

China Economic Outlook

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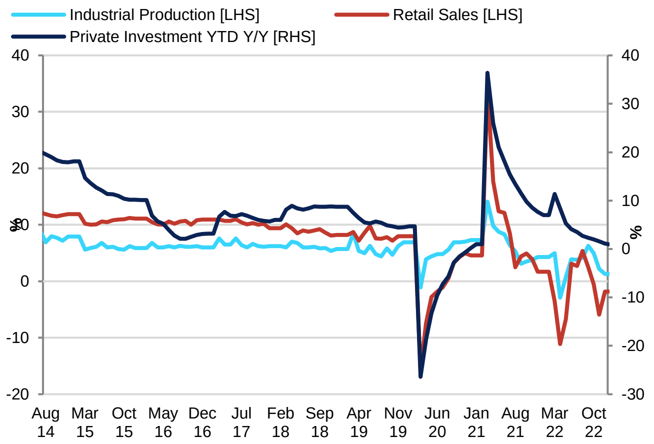
Coming of Age?

China held the National People's Congress in early March, drawing thousands of delegates to the biggest reshuffle of China's economic policy team. In this note, we look at the impact of the latest NPC meeting to help gauge the impact of new policies on longer-term economic prospects from the region. The GDP target of 5% was set by the government; this was below market expectations but is in line with their long-term higher quality growth, not just fiscal stimulus-backed support through infrastructure, property, etc. Important to note that 5% GDP is above 2022's, and the economy will perform better in 2023, with better consumption. The export market could be weaker in 2023, which could cap the strength of some electronics, computing, and goods markets.

Key China Indicators

Only retail sales are recovering from the removal of lockdown restrictions.



Source: National Bureau of Statistics

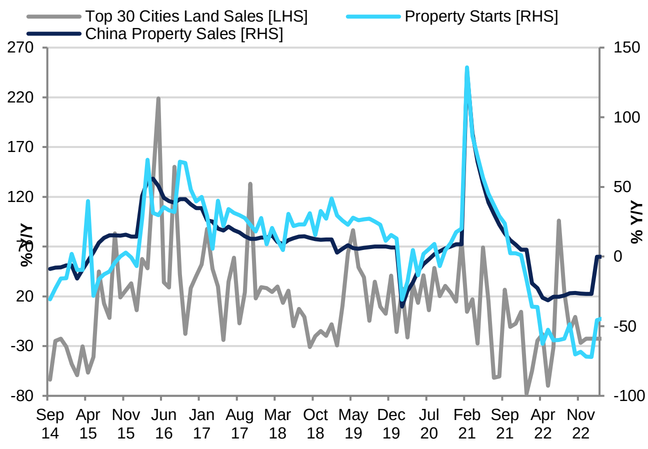
Fixed Asset Investment & Property

Fixed Asset growth, ex-rural, stood at 5.1% for December, when the economy was still under the threat of lockdown restriction; we expect the February and March data to be higher as there are more positive signs from the economy and after clarity from the NPC. However, foreign direct investment and confidence in China may be hit by the uninspiring growth targets.

- Fixed Asset Investment in Real Estate was -8.1% Y/Y in December, given the decline in residential sales. Coupled with the scale of COVID-19 measures last year, we believe there is a long way to go before society is willing to buy new housing.
- New property regulations should improve sentiment, but two thirds of developers in the top 30 cities crossed at least one of the three red lines, meaning that the regulators can then place limits on the extent to which they can grow annual growth in debt. This could cap the availability of funds for property planners.
- Given property sector contribution of 28% to China's GDP, there is a big hole to fill and one that will not be filled in the near term. The sector shrunk by 5.0% in 2022, but below data highlights the deeper pain of the property sector.
- Top 50 cities' land sales were down 22.68% Y/Y in December 2022
    - Land areas purchases declined by 53.4% Y/Y
    - Floor space of newly started houses fell 44.29% Y/Y. This data point has had at most 3 quarters of positive data since Q4 2020.
    - Floor space under construction declined by 7.3% Y/Y, and this figure has been in consecutive decline since April 2022.

China Land Sales vs Property Starts and Sales

The property sector deteriorated for the tenth consecutive month, and the government is struggling to provide necessary support.



Source: National Bureau of Statistics

- Lending by banks into the property market has exceeded the upper age limits on applicants getting a mortgage, which were previously a loan period plus formulation age of a 70yr limit; this has now been increased to 90-100 years.
    - For instance, a 70yr old can get a 25yr mortgage if the applicants' children agree to support by their inflated minimum monthly income.
    - The move appears to urge people to purchase homes to help revive the slumping housing market.
- Still, we do not expect consumers to buy houses even if mortgage conditions for applicants improve.
- As house prices fall, the younger middle class will likely get on the property ladder, but we do not expect the household debt to reach the highs seen in 2020; this is likely to have declined in the last 2 years.

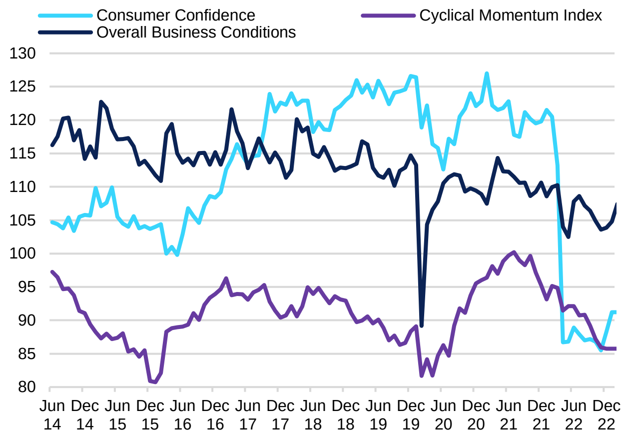
Consumer Confidence and Spending

The consumer confidence index was the lowest ever recorded at 85.50 in November 2022 (since 1996) and is now off the lows at 88.3; the previous low was 97.0 in November 2011. This highlights a major issue in the Chinese economy: consumers are unwilling to purchase goods, and as a result, imports are forecast to be low at -5.5% Y/Y for February 2022.

- Factories of smaller goods are running hot, but capital goods, white goods, and cars expenditure has been poor and more metal intensive.
- The low demand for white goods is in line with weaker housing data, as these goods are usually consumed towards the completion stage of housing.
- Weak sales, slow starts, and low completion suggest growth in this area will be lacklustre, and the weak export market could compound this.

China Confidence Indicators

Consumer and Business confidence improved in January, thanks to the removal of lockdown restrictions.



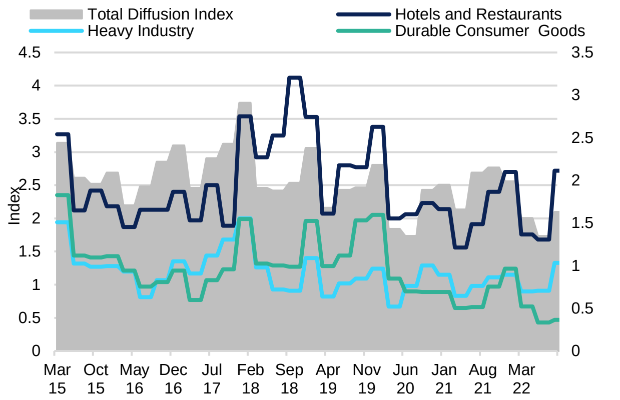
Source: Standard Chartered Bank, National Bureau of Statistics, China International Capital Co

Consumer confidence is rising but is still very low, and we expect this spending to be focussed on luxury clothing, holidays, and experiences, as consumers use their pent-up demand in the coming months. However, this may not be bullish for China as Chinese consumers may travel to Europe and the U.S. We are cautious that a large proportion of people will instead travel domestically, given the prevailing fears of getting COVID and that the re-entry policy might change during the trip.

To achieve 5% growth, there will need to be a much greater focus on domestic demand, which is currently weak. Both industrial production and fixed asset ex-rural, while recovering, are forecast to remain low at 2.6% and 4.5% y/y, respectively. This will come from the lower tier cities, which currently have a worried and anxious demographic, concerning themselves about their ability to pay rent, job security, and paying off debts, especially given a higher loan-to-deposit ratio at 83% in September 2022. When assessing the demographics and spending areas for different age groups, food and beverage, dining, health and sports are in the top 3 spending categories out of 4 age groups. This suggests it is a food and agricultural play. Luxury fashion is in the bottom 3 of the 4 age groups and is only increasing for baby boomers. This highlights the uniform approach for many consumers to spend more on areas of wellbeing and socialisation than purchase of traditional non-perishable goods. The service sector is likely to benefit the most from the transition. At the same time, 77% of consumers looking for value for money, through pricing and promotions, a more rational approach to spending.

Employment Index by Sector

Services continue to dominate labour market performance.



Source: Zhaopin Ltd.

Youth Employment is a problem in China, and graduates struggle for employment. The unemployment rate is 17.7% for ages 16-24. This is an improvement from 19.9% in September. By 2021, around 44m undergraduate students were enrolled in degree programmes at public colleges and universities in China. Gen Zs worry about prospects as long-term growth flows; however, there will be significant opportunities.

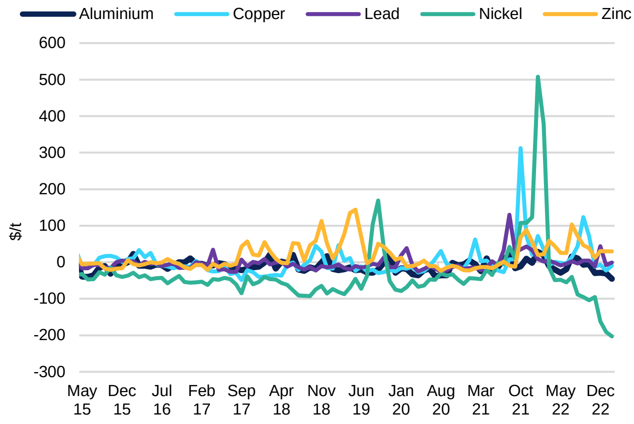
- GEN Zs in tier 1 are more optimistic about their prospects than lower tiers.
- We attribute this to higher level of education and opportunities in tier 1 cities than in lower tier.

Metals

Sentiment soured across the base metals following the China's NPC releases, as the government pointed to a slower-than-expected growth projection for the year but also below-forecast stimulus support, as policymakers hope to stimulate the economy through the consumer segment. This has further weighed on metal consumption outlook from the region. A combination of subdued domestic demand in China and a robust macroeconomic picture in the US has weighed on base metals in recent weeks. Even with higher PMI and improved home sales in China, sentiment struggled to pick up. Within the PMI production index increased to 56.7, new orders were 54.1, and delivery time was 52 suggesting lower lead times. However, we do not expect to see a strong recovery in prices until the Chinese recovery is proven to be sustainable. With hard data for economic performance not to be released until mid-March, markets will continue to pay attention to the global economic and monetary policy environment, and in particular, the dollar moves.

Base Metals Cash to 3-month spreads

Spreads have deepened into a deep contango on the back of weak domestic demand.



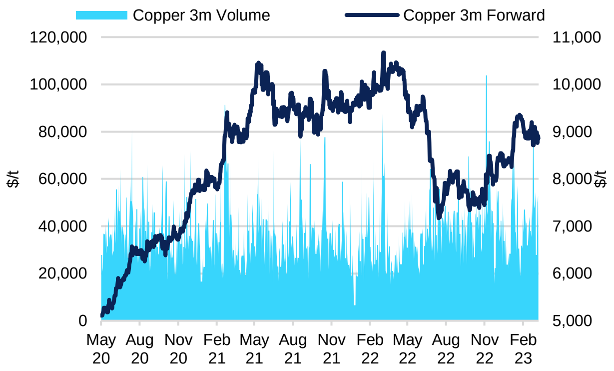
Source: Bloomberg

Widening spreads and continued accumulation of social inventory in China further highlights the lack of demand from the region, and with stronger emphasis back on the Fed from the macroeconomic standpoint, metals' prices struggled in recent weeks. Cash to 3-month spreads on the LME remain in contango, except for zinc. The contangos are relatively deep, with nickel -$212/t, aluminium -at $47/t, and copper -$30/t. Zinc tightness is due to low availability of material in China and Europe due to offline capacity. Lower gas prices, higher zinc prices, TCs and premiums should boost smelter economics, and we expect utilisation rates to pick up to high 80%s later in the year. This will improve availability, reduce premiums, and weaken the spread and LME prices as demand is lacklustre shown by contractionary construction PMIs.

Copper prices have been supported at $8,800/t in recent months, but Chinese prices have been at a discount until recently when spot turned to premiums and inventory declined. This suggests an improvement in consumption, but we expect this to be insignificant, given the consumption issues and softer-than-expected targets from the government.

Copper 3m Forward vs Volume

Copper remained under pressure in recent weeks but support at $8,800/t is holding firm.



Source: Bloomberg

- Downstream players saw restocking as copper prices declined, and consumption is picking up, copper cathode demand is improving.
- On the LME, $8,800/t is an attractive level at the moment and is well-defended.

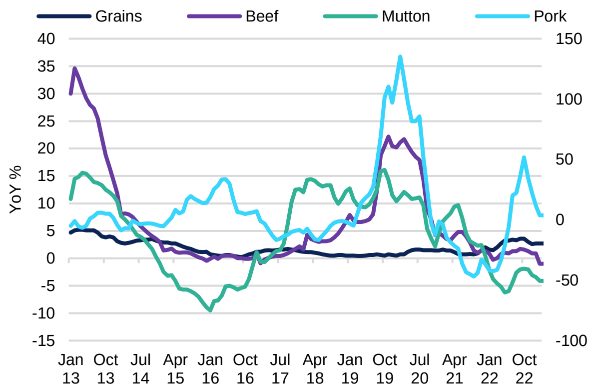
Spreads have not been tightening at the time of metal price rallies, and with a large proportion of China prices in discount, there needs to be more indication of a robust and sustainable demand. We expect discounts to narrow immediately as downstream demand improves, but the rally will fade until China is consistently strong. At the same time, the tightening cycle is still not over, more pain is to come, and the real impacts of previous hikes are still to filter through. The interest rates from the Fed will stay higher for longer, suggesting that the USD will not let up until you see sustained weakness in economic data and the employment market.

Agriculture

The Chinese consumer favouring food & beverages, dining out, and experiences could lend itself to the agriculture market. Lean hogs, poultry, soybeans, wheat, and other grains should benefit. The rise of China's middle class has different dietary needs. World Bank data suggests that in 2000, China's middle class was 3.1% of the total population; this was 50.8% in 2018, an increase of 47.7%. The middle class consumes more meat, and while well-being is increasing in China, dietary preferences favour pork 88%, poultry 77%, beef 66%, and fish and seafood 66%. However, the health concerns are threatening the consumption of pork in favour of beef as a healthier meat alternative. 28% of Chinese consumers surveyed by McKinsey state their intent to reduce pork consumption. Around 80% of meat purchases happen offline, but as younger consumers increase in prominence, convenience and tech will be more significant factor.

China Food CPI

Grain prices remain resilient while meat prices continue to decline.



Source: National Bureau of Statistics

Imports of grains have been strong for China in recent months, and this suggests stronger consumption due to the economy re-opens and restaurants & bars being busy. Fertiliser prices are high, which could impact grain yields in the U.S. and South America. The resumption in China, demand, volatile weather and high fertiliser prices could present an upside to the agriculture market. Geo-political tensions are also a threat.

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- Views on future potential price moves

Coffee Market Outlook

This report drills down into the detail of the coffee market and is produced three times a year, we also produce shorter more concise updates. We undertake a macroeconomic assessment of major consuming and producing regions before analysing the recent earnings reports from Starbucks, Nestle, Luckin Coffee, Dunkin Donuts, and Costa. This helps us highlight new sales and marketing techniques and any consumption changes, which has been particularly popular during COVID-19. The largest chunk of this report is where we assess the Supply and Demand outlook using our primary data for the coffee market and where we apply our fundamental models. We showcase our crop forecasts and highlight any changes before providing prices forecasts and trading strategies with futures and options.

EV and Battery Materials Reports

A suite of reports looking at how the global automobile market is changing, and as vehicle manufacturers look to transition to a more environmental fleet of autos we have outlined how prepared the energy markets in the U.S., China, Japan, and Europe are to aid this transition. Electric vehicles go a long way reduce GHG emissions in the auto market, we are not disputing this, and when you factor in the lifecycle of batteries EVs are a lot greener. However, these reports assess the energy mix in these specific regions and outlines what governments are doing to promote renewable energy and transition away from fossil fuels. Using the energy mix we provide emission analysis for different EVs compared to ICE vehicles in that country.

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