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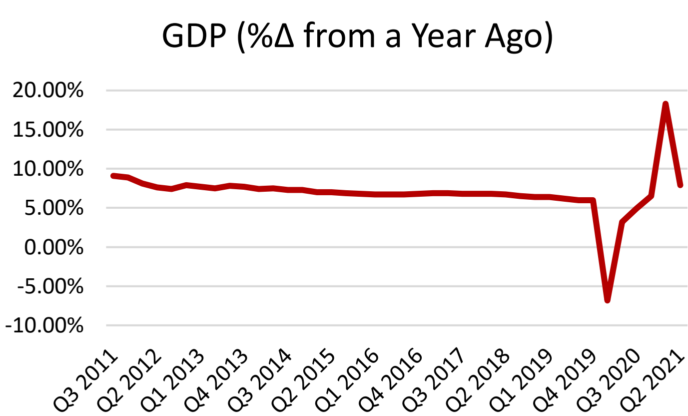
China Macro Report

Economic Profile	
Country	China
Currency	Renminbi
Population	1.445 Billion
Economy	Developed
GDP	¥14.6 Trillion
GDP per Capita	¥10,484
Largest Trading Partner	United States
Market Outlook	
Point in Economic Cycle	Left-of-Trough
Outlook	Bearish



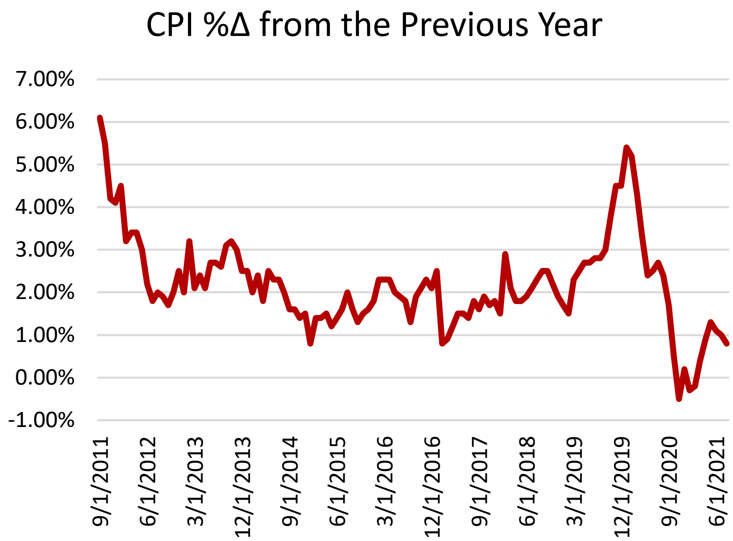
Gross Domestic Product, %Δ from a year ago, since 2011 (Source: Thomas Reuter's Eikon)

Macroeconomic Thesis:

After analyzing a variety of leading, lagging, and coincidental indicators, I believe that China is currently left-of-trough of the business cycle. Furthermore, my economic outlook is bearish for the near future, and I believe the Chinese economy will contract due to high raw material prices, the Delta variant of COVID-19, and the Evergrande Group situation.

By researching indicators such as CPI, Manufacturing PMI, and Services PMI, I maintain a negative outlook on the Chinese economy. August 2021 saw China's largest sectors, services and manufacturing, contract significantly. A 9.5% increase in PPI from the previous year reflects rising aluminum, copper, zinc, and iron ore prices. This price increase, in addition to increased environmental regulation enforcement, has placed pressure on manufacturing companies. Simultaneously, the Delta variant has caused issues in catering, transportation, accommodation, and entertainment. Finally, the overleveraging of Evergrande Group, the largest real-estate developer in China could lead to contagion affecting both the banking sector and home buyers. The multitude of headwinds the Chinese economy currently faces renders economic growth unlikely.

Economic Indicators



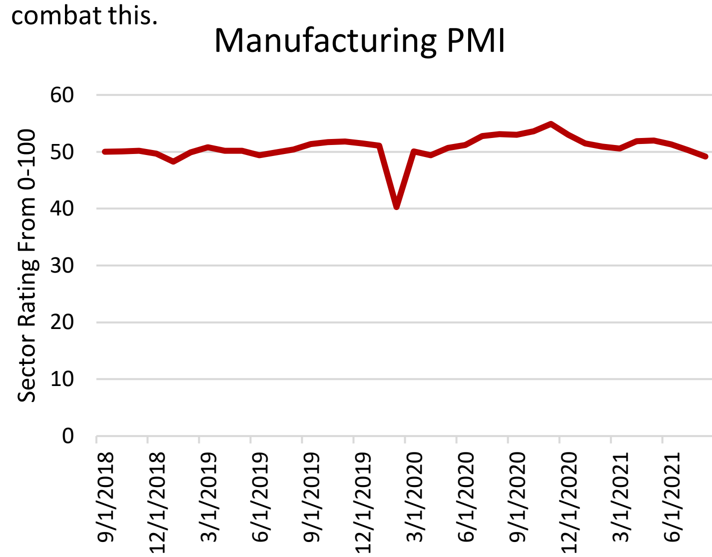
Consumer Price Index, %Δ from a year ago, since 2011 (Source: Thomas Reuter's Eikon)

Consumer Price Index

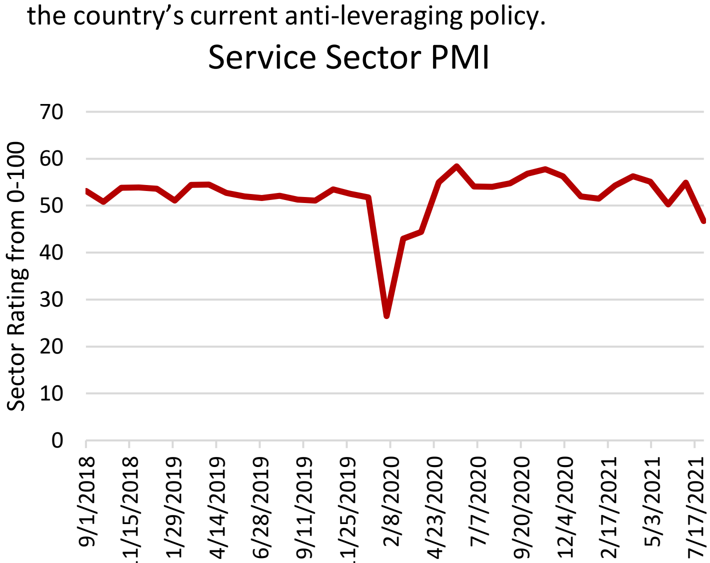
The Consumer Price Index is used to determine periods of inflation or deflation by examining the prices of a fixed basket of goods. While an exceptionally high CPI is an indicator of a damaging amount of inflation, decreasing CPI indicates deflation. China's economy rebounded vigorously from the COVID-19 pandemic, however it lost momentum in July and August of 2021. This deflation is largely due to the emergence of several economic headwinds including the Delta variant and high material prices. China will likely implement policies designed to stimulate the economy to combat this.

Manufacturing Sector

Manufacturing PMI is an index that indicates the predominant economic trend of the manufacturing sector. A value of >50 indicates expansion whereas a value of <50 indicates contraction. China's August manufacturing PMI is 49.2 (almost 4 points lower than it was a year ago) which indicates a contraction. Manufacturing accounted for 26.18% of China's GDP in 2020 meaning that a contraction within the sector would have a significant negative effect on the overall health of the economy. Additionally, Chinese manufacturing companies will not be able to borrow to manage increased raw material prices due to the country's current anti-leveraging policy.



Historical Chinese Manufacturing PMI, since 2018, (Source: Thomas Reuter's Eikon)



Historical Chinese Service PMI, since 2018, (Source: Thomas Reuter's Eikon)

Service Sector

Service PMI is an index that indicates the predominant economic trend of the service sector. A value of >50 indicates expansion whereas a value of <50 indicates contraction. China's August service PMI is 46.7 (over 7 points lower than it was a year ago) which indicates a contraction. In 2019 the services sector accounted for 54.27% of China's GDP meaning that a contraction would have a significant negative effect on the overall health of the economy. This service sector contraction is due to a resurgence of Coronavirus cases.

Geopolitical Factors

Evergrande Crisis

Evergrande Group, a firm that indirectly creates 3.8 million jobs and owns 1,300 real estate projects in China, is expected to default due to a series of bond payments due in September, October, November, and December. The company has liabilities of $300 billion, much of which was lent by Chinese banks, creating contagion concerns. The company was expected to default on 09/23, however it has remained silent on whether it will be able to fulfill its commitment to investors. The company is already in technical default on loan interest that was due on 09/20. Evergrande has sought to soothe market concerns by reassuring domestic investors that it would fulfill its interest payment on a mainland-traded yuan-denominated bond that was also due 09/23. However, analysts are also concerned that Evergrande may prioritize paying off domestic debts over foreign ones, creating potential for international contagion. If the real-estate development titan finally does collapse, it may lead to increased social unrest, turmoil within the banking system, and a flooded real-estate market. Therefore, it is likely that the Chinese economy will remain volatile until the situation is fully resolved.

Increasing Corporate Legislation

China has recently released a 5-year economic blueprint calling for increased regulation in national security and technology, and for monopoly probes against companies like Alibaba Group Holding. In addition, the Chinese economy has begun a campaign to tighten high-polluting sectors and the property development industry. These increased regulations may negatively impact manufacturing, real-estate, and technology as firms are forced to adjust to the new regulations or fold in the face of adapting their business model. Perhaps the most significant policy-attitude shift is that of anti-leveraging. Xi Jinping appears poised to shift China's growth strategy away from debt-driven construction. This would potentially prevent situations like that of Evergrande and would allow for more consistent growth, albeit at a reduced rate. The most pressing consequence of this economic shift is that short-term growth will be compromised.

Relations with the US

Tensions between the US and China further escalated in June following the indictment of two Chinese hackers and the shutdown of the Chinese consulate in Houston. According to Jimmy Chang, chief investment strategist at Rockefeller Asset Management, this will likely lead to a more polarized global economy, causing significant changes to supply chains and trade patterns. Similarly, periods of volatility can be expected going forward as the US continues to impose trade sanctions on Chinese firms. In the long run China may reap significant rewards from reducing dependency on the US, however, before then it is likely to create periods of economic shock for both countries.

Delta Variant

The Delta Coronavirus Variant has shaken consumer confidence in recent months, causing retail sales growth to slow to just 2.5% in August. COVID-19 outbreaks have stymied travel and summer holiday spending, significantly affecting the service industry. While the measures employed this summer (including strict quarantines, and over 100 million administered tests) seem to have been successful in slowing the virus, and cases appear to be falling, the economic consequences are still being felt throughout the service sector.