BNY

iFlow

MACRO MORNING BRIEFING

November 13, 2024

Opportunities in Every Outcome

US election an opportunity for global structural reform

- China flags meaningful changes in monetary and fiscal strategy
- Domestic stimulus more pressing than ever for savings economies
- Managed, public investment-based reflation viable in China and Germany

A good time to rethink and rebalance export-driven growth models

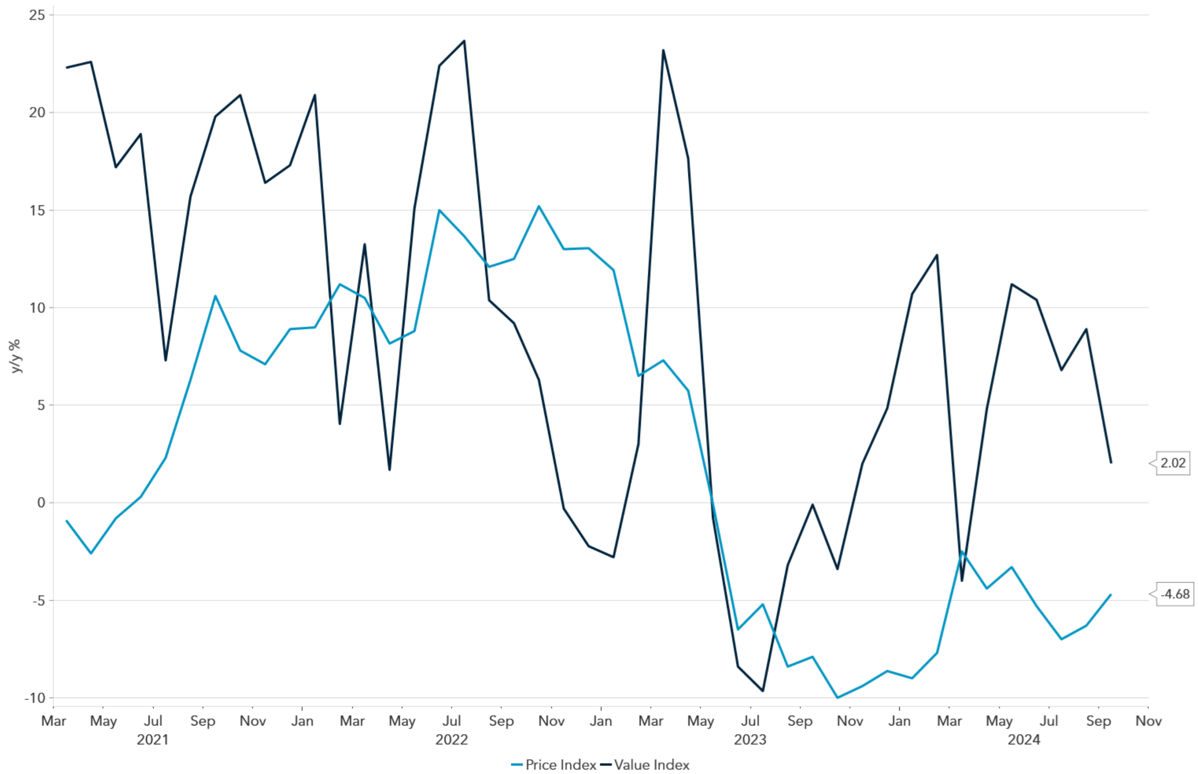
Much to the protestations of linguists who claim that the adage is demonstrably false, the business community often says in strategic planning that Chinese word for "crisis" is a combination of the characters for "danger" and "opportunity." However, Beijing will appreciate that although the return of President Trump poses new challenges and uncertainty, it also presents an opportunity for a serious economic rethink. Such work was already taking place based on domestic circumstances, even though the focus has been on monetary and fiscal stimulus. For example, on Monday the People's Bank of China (PBoC) explicitly stated that "the recent round of stimulus should not be seen as simple stimulus, but also a significant change in policy logic. The measures are not just intended to expand demand in the short term, but there are many reforms and structural adjustments." We would go further and state that there is no better time than now to push for a shift in the structural composition of Chinese growth and strengthen the push to boost household consumption. Yesterday's announcement by Beijing adding more public holidays is another sign of a renewed consumption focus, but this needs to be structural rather than tactical. Consumer goods price growth remains stuck in contraction (Exhibit #1) but is at levels which could prove easier to turn around compared to producer prices, and there is less of an external element to consider.

Exhibit #1: China Consumer and Producer Inflation

Source: Macrobond, BNY

There has not been much reaction from the PBoC or China's Ministries of Finance and Commerce to the US election result. The theme of tariffs on Chinese exports to the US has been present for some time and markets felt that staying defensive against the CNY was the best position in response. The shift in rate differentials alone between the US and Asia-Pacific economies has also supported the dollar in this respect. The PBoC has not pushed back assertively against these moves in FX markets, and we doubt there will be any changes in this approach unless FX markets become much more volatile. This itself already marks a shift in the PBoC's thinking, in letting the market factors determine the CNY's level and even reprice if the facts on the ground change. This will matter for expectations as well given China's export prices have been negative for well over a year (Exhibit #2) and price expectations are becoming entrenched, which will trickle down to similar weakness in household income and demand. The shift in CNY expectations alone will be material in managing general economic price expectations up ahead, and there is no reason for the PBoC to push back against such a change if the pace is manageable – and the fixing activity so far this week suggests that the pace will continue to be managed. Nonetheless, in the context of structural changes, simply recognising that pass-through inflation sometimes can support a reflationary process would mark a departure from previous policy norms.

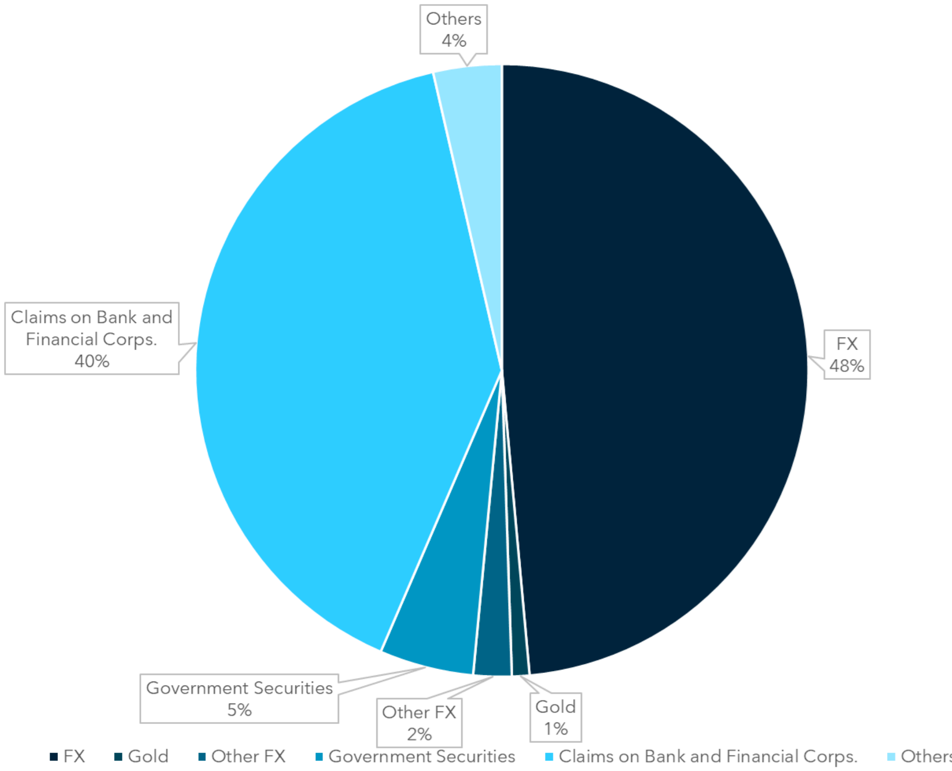
Exhibit #2: China Export Price/Value Growth



Source: Macrobond, BNY

Last week the PBoC also announced in its Q3 Monetary Policy Operation Report that the country's "monetary policy framework will gradually move away from focusing on a quantitative target; the quantity of money [will be used] as an observational, reference and expectations indicator." This all but confirms that the PBoC will shift towards an explicit "price" framework led by interest rates. This means numbered are the days of markets focusing on a required reserve ratio (RRR) cut to "release liquidity" as a policy and risk appetite indicator. This is also a signal of structural change which would have very little bearing on policy in the near term and should not be seen as a sign that the PBoC is averse to continuing to expand its balance sheet. Until exchange controls are fully loosened, the assets on the PBoC's balance sheet will mostly comprise foreign assets and any reserve buildup will continue to result in balance sheet expansion. However, sterilisation ratios will be very high to ensure that bank reserves are at levels consistent with the desired price of money. This could also even involve rebalancing the PBoC's assets away from foreign to domestic assets, which can entail asset purchases domestically without balance sheet expansion. The share of domestic assets on the PBoC's balance sheet currently stands at 52% (Exhibit #3). This is far lower than the BoJ equivalent, which is closer to 80%, when incorporating the FX reserves held by the Japanese Ministry of Finance.

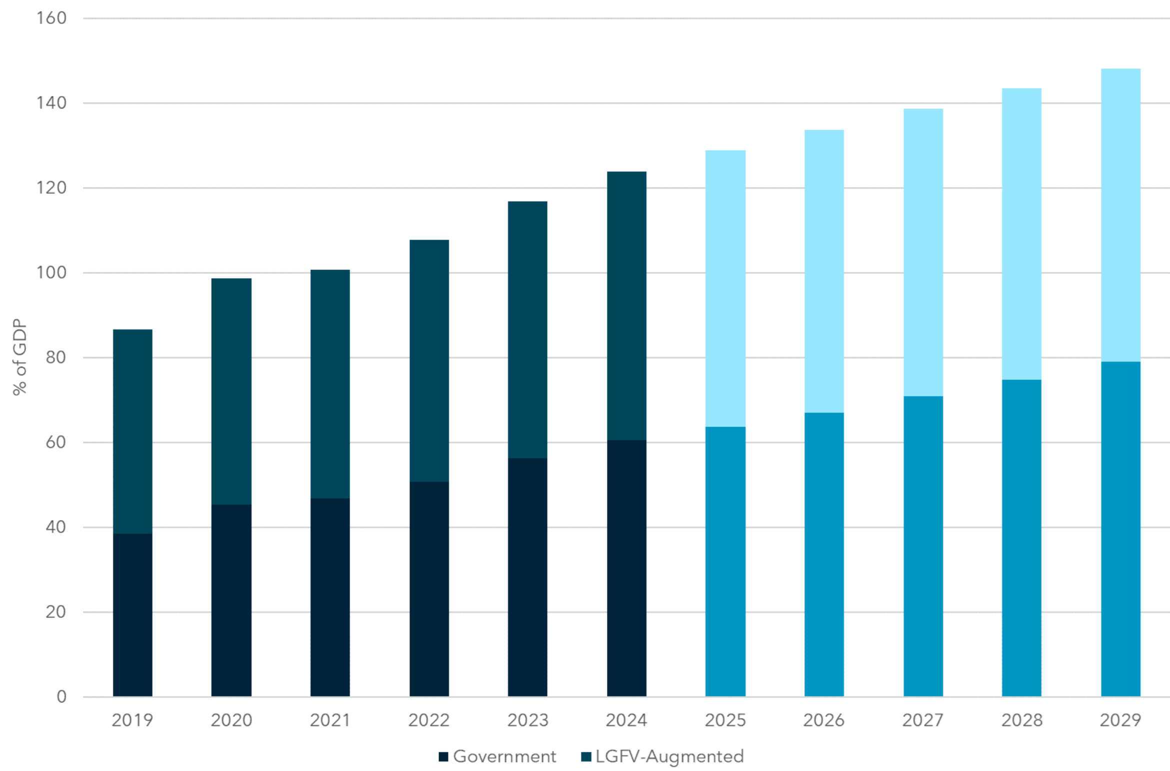
Exhibit #3: PBoC Asset Composition



Source: Macrobond, BNY

In another comment made on Monday, the PBoC also talked up expectations of a stronger role for fiscal to play. While the numbers have been gradually accumulating, including another CNY 10tln in fiscal assistance to ease local government financing pressures, the market continues to express disappointment at the lack of a direct injection into the economy, be it for the corporate sector or, more importantly, the household sector. Furthermore, the Ministry of Finance's assessment that the scale of local hidden debt currently stands at CNY 14.3tln is at odds with other estimates. For example, the International Monetary Fund (IMF) estimates that that local government financing vehicle balances were above CNY 60tln at the end of 2023 (Exhibit #4). The PBoC has already engaged in effective "maturity-extension" operations this year for centrally issued special bonds, which can help underpin fiscal stimulus without any additional nominal expansion of either the PBoC's balance sheet or debt stock. Furthermore, maintaining potential growth through productivity improvements will matter just as much as "growing out of debt" should not be discounted as an option. This is where some degree of rebalancing industrial strategy away from the external (export) sector and more towards internal investment can help achieve improvements in real incomes and debt servicing.

Exhibit #4: Chinese Public Debt



Source: IMF, BNY; forecasts from 2025 onwards

Ultimately, as the IMF itself has highlighted, "[a]ddressing the existing debt stock without further reforms would only (at best) postpone fiscal risks. To secure fiscal sustainability going forward, it is necessary to upgrade fiscal reporting and monitoring frameworks and implement reforms to close local government fiscal gaps and reduce future debt-generating flows." Greater fiscal expansion will be the way forward for China, and we expect further confirmation at the December Central Economic Work Conference, leading up to confirmation at next year's NPC. Just as the relevant policymakers are taking a longer-term focus, probably so too should the market. The size and quantity of stimulus – especially fiscal – will matter far less than the quality up ahead.

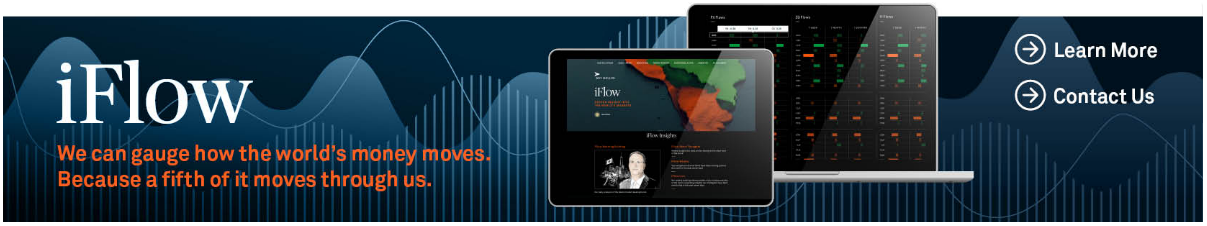
Disclaimer & Disclosures

Please direct questions or comments to: iflow@bny.com

Geoff Yu

EMEA MACRO STRATEGIST

CONTACT GEOFF



This message was sent from an unmonitored email box. Please do not reply to this message.