

17 May 2023

## Global Economics & Market Strategy

### China: Satellites Don't Lie, Economy Slowing Big Time-China Bulls Go Home

- ◆ We have been warning since the beginning of 2023 that China's re-opening will disappoint market expectations of a V-shaped recovery. This view is materializing nicely and we expect a further slow-down in economic activity for the better part of 2023 based on our proprietary satellite images of China's economy by sector as of May 13, 2023.
- ◆ The implications for China's financial markets are that we maintain our following views: 1) sell the MSCI China Index on rallies with a target of around 60 in the near-term and 58.5 by end-2Q23. Our 2023 total returns target for the MSCI China Index remains unchanged at around -10%. We remain long Indian equities, 2) on May 8, we had indicated to sell the China CSI300 Financials Index (SH000914) on rallies since the massive upsurge was unsustainable based on our forward looking view of a deceleration of China's economy. This view has materialized (quite impeccably on May 8) and we foresee further downward pressure with our near-term target being 5400 followed by 5200 by end-2Q23, 3) sell CNHINR on rallies with our near-term target of 11.76 having already materialized and we extend this trade to 11.60 in the near-term as net capital inflows to India's equity market accelerate while we expect net capital outflows from China's bond and equity market. Our USDCNH end-2Q23 forecast of 7.00-7.10 is on track and we foresee upside risks of a print of 7.10-7.20, and 4) we continue to avoid China high yield credit, a view we have had since early 2023 and this thesis is working nicely.
- ◆ The bottom line is that despite China's government having reduced access by overseas firms to domestic data, we have absolutely no worries about our ability to forecast the path of China's economy, eg "Satellites Don't Lie". Our proprietary real time data using machine learning to transform satellite images of China's economy by sector to numerical data puts us in a good position to assess the momentum of economic activity in the giant economy in real time, which is signalling weakness across most sectors.
- ◆ We maintain our 2023 GDP growth forecast of 4.0% YoY, versus the Bloomberg consensus estimate of 5.7%. Our estimate of 2Q23 GDP growth is 4.2% YoY versus the Bloomberg consensus estimate of 8.0% and 1Q23 print of 4.5%.

**Group Chief Economist & Head, Market Research**

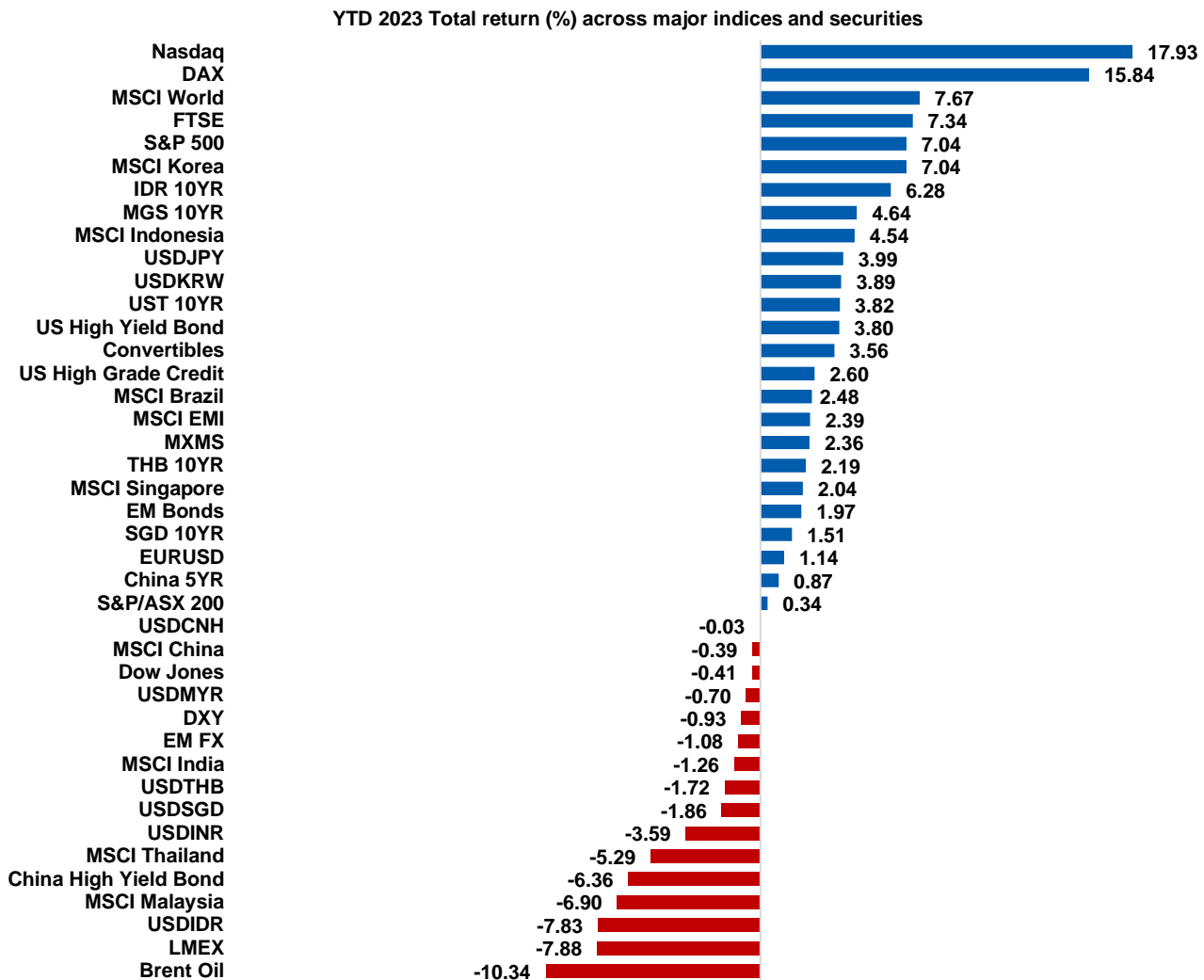
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- ◆ On a high frequency basis, our proprietary indicators based on machine learning derived data emanating from satellite images of China's economy dated May 13, 2023 suggests that the momentum of the economy at an aggregate and sub-sector level shows weakening (Figure 8-13, 15-18). Hence, the May PMIs could print readings well below 50. The key message is that the re-opening of the economy doesn't mimic "switching on the lights" and goods and services domestic economic activity automatically enters a V-shaped recovery path. The re-orientation of labour, capital, and other inputs to production sector takes time, hence the supply side response to China's "re-opening" will likely remain muted for the remainder of 2023. In addition, the back drop on the demand side of the economy is weak as discussed below. Hence, the intersection of supply and demand dynamics of China will result in a well below trend level of output and thus ruling out a V-shaped recovery path.
- ◆ Evidence from close to real time data as of May 13, 2023 suggests that the manufacturing sector momentum is decelerating (Figure 8) despite the re-opening of the economy. Traffic at airports is showing a very mild recovery but still well below trend as of May 13 (Figure 9). In addition, inland logistics centre activity as of May 13 (which is a proxy for domestic demand from a bottoms up perspective), is decelerating and remains well below trend (Figure 10). Proxies for the consumer sector such as auto sales is decelerating as of May 13 (Figure 12).
- ◆ In the external sector, we expect China's trade data releases in 2Q23 to surprise on the downside due to continued supply chain congestions and reduced dependency by the Western allies on China for parts and components in the electronics and electrical (E&E) sector. As of May 13, we still notice significant supply chain congestions at China's ports along with weak external demand for China's products and this explains the weak momentum of activity at China's harbours (Figure 13).
- ◆ Lastly, what we are observing from close to real time data as of May 13 is that activity in some major commodity sectors is weak. Hence, if indeed the economy was headed for a V-shaped recovery path, we should be observing a significant acceleration in steel, coal, and copper sector output (Figure 15-17). This simply isn't happening and that's because the economic outlook for the country is weak.
- ◆ Our below consensus 2023 GDP growth forecast of 4.0% YoY is predicated on the view that the trajectory of consumer spending will remain weak. Consumption GDP accounts for around 50% of quarterly headline GDP, while gross fixed capital formations accounts for around 48.5% of quarterly GDP according to our calculations and net exports around 1.3%. The single most important driver of consumer spending is real urban disposable income and we believe the momentum is going to remain fairly weak for much of 2023 (Figure 18). Real urban disposable income is mainly generated from the industrial sector (Figure 19) and the real estate sector (Figure 20). Both of these sectors are likely to remain weak and in fact there are feedback loops between the two sectors (Figure 21).
- ◆ For further details on our view on China's markets and economy, please refer to our February 23, 2023 thematic report ([China: Time to Exit, MSCI China Will Fall Around 10 to 15% in 1H23](#)).

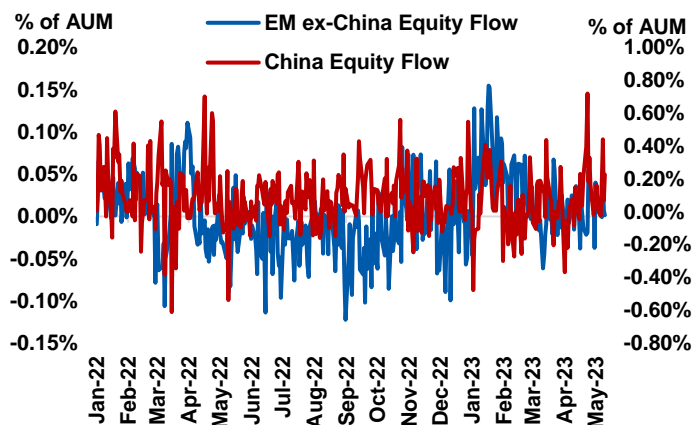
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Figure 1: MSCI China Index likely to print a total returns of around -10% in 2023



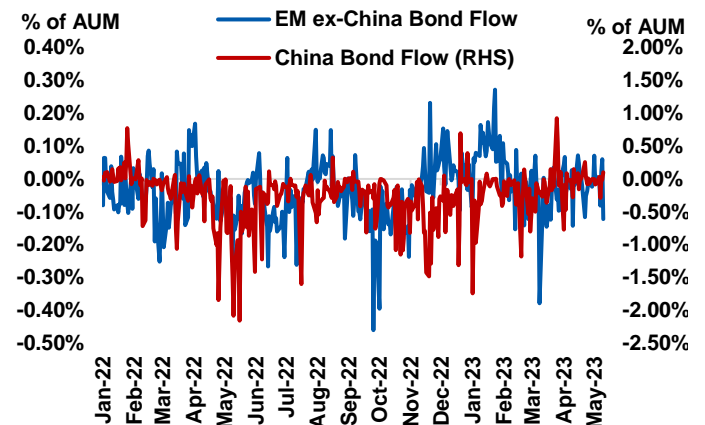
Source: Bloomberg, RHB Economics &amp; Market Strategy. Above figures are on year-to-date total return from 3 Jan 2023 to 16 May 2023

Figure 2: Positioning lightening up in China equity and...



Source: EPFR, RHB Economics and Market Strategy. Last data point is May 12

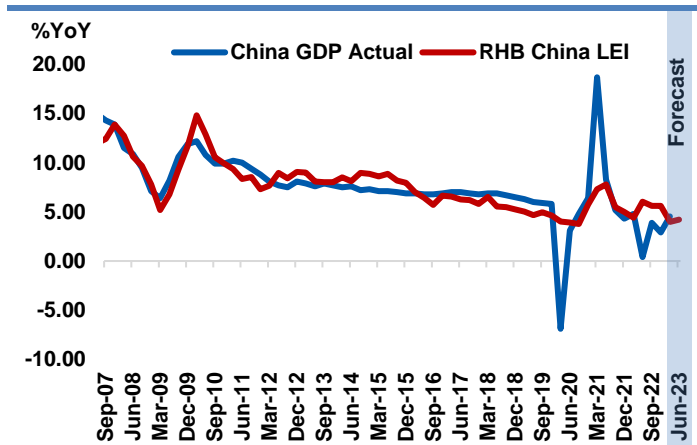
Figure 3: ...bond funds. More to come in next 1-2 months



Source: EPFR, RHB Economics and Market Strategy. Last data point is May 12

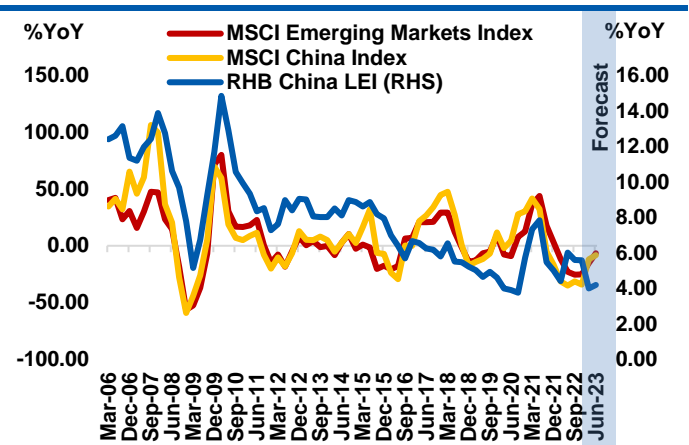
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Figure 4: RHB China Leading Economic Indicator headed...



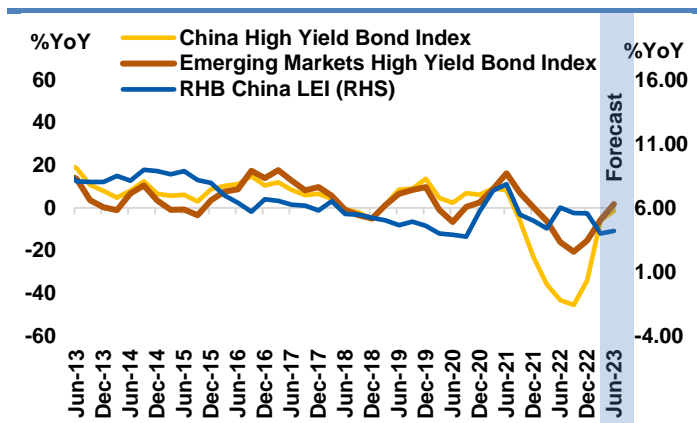
Source: Bloomberg, RHB Economics and Market Strategy. Last actual data point is 1Q23 and forecasted value is at 2Q23.

Figure 5: ... south, MSCI China Index big drop coming



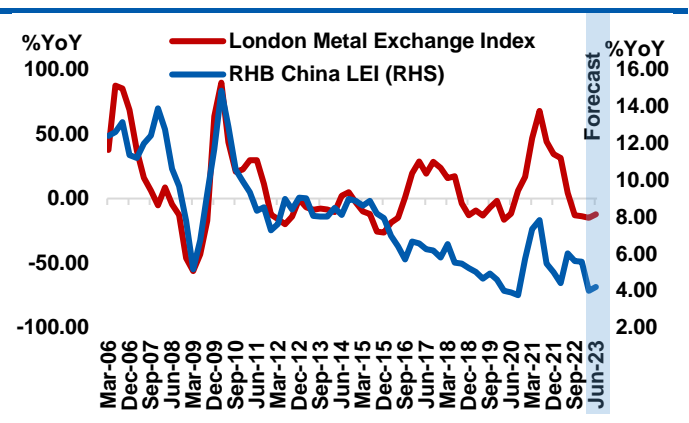
Source: Bloomberg, RHB Economics and Market Strategy. Last actual data point is May 16 and forecasted value is at 2Q23.

Figure 6: RHB LEI suggests China High Yield, ...



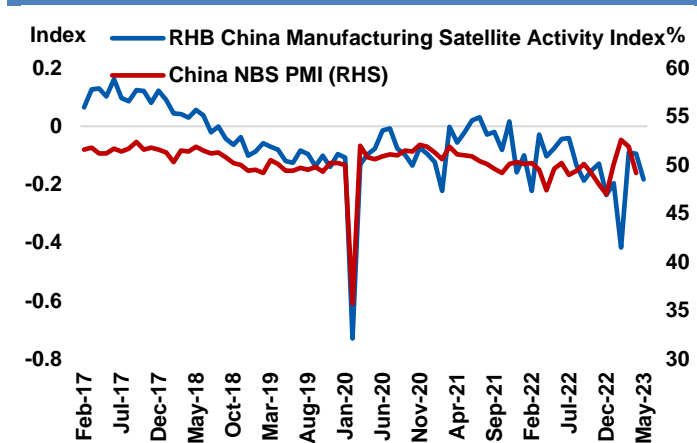
Source: Bloomberg, RHB Economics and Market Strategy. Last actual data point is May 16 and forecasted value is at 2Q23.

Figure 7: ...and metals prices headed south in near-term



Source: Bloomberg, RHB Economics and Market Strategy. Last actual data point is May 16 and forecasted value is at 2Q23.

Figure 8: As of May 13, manufacturing sector starting to decelerate



Source: Bloomberg, SpaceKnow, RHB Economics and Market Strategy. Last data point is May 13 for RHB China Manufacturing Satellite Activity Index and Apr 2023 for China NBS PMI

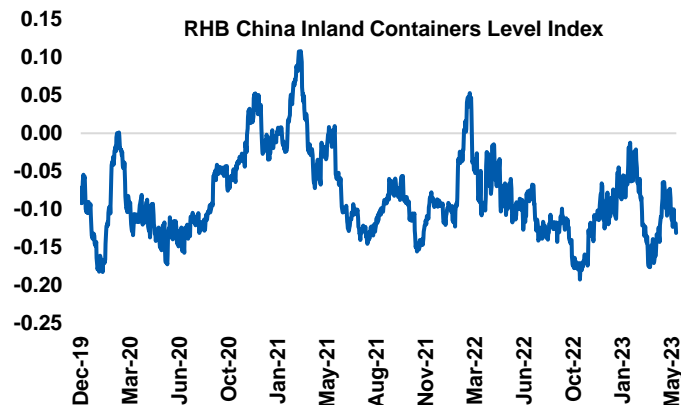
Figure 9: Airport traffic is well below trend as of May 13



Source: SpaceKnow, RHB Economics and Market Strategy. Last data point is May 13

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Figure 10: Logistics sector activity weak...



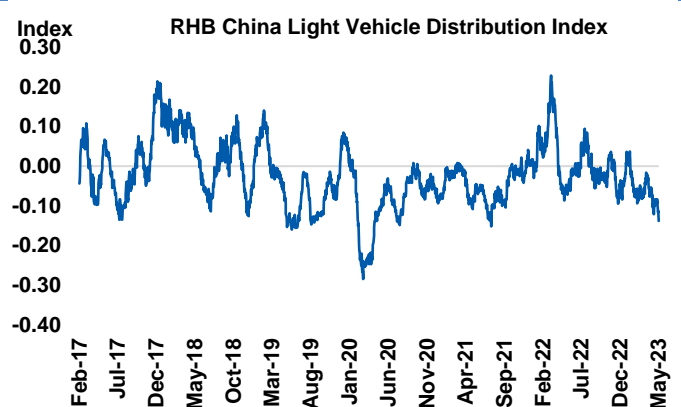
Source: SpaceKnow, RHB Economics and Market Strategy. Last data point is May 13

Figure 11: ...with auto manufacturing and auto sales...



Source: SpaceKnow, RHB Economics and Market Strategy. Last data point is May 13

Figure 12: ...still well below trend as of May 13



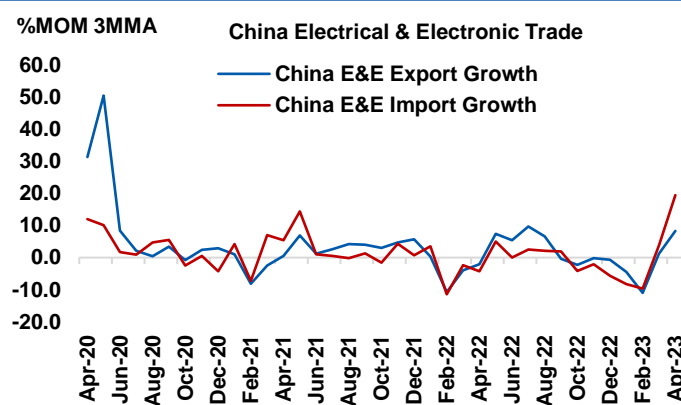
Source: SpaceKnow, RHB Economics & Market Strategy, last data point is May 13

Figure 13: Activity at ports well below trend as of May 13



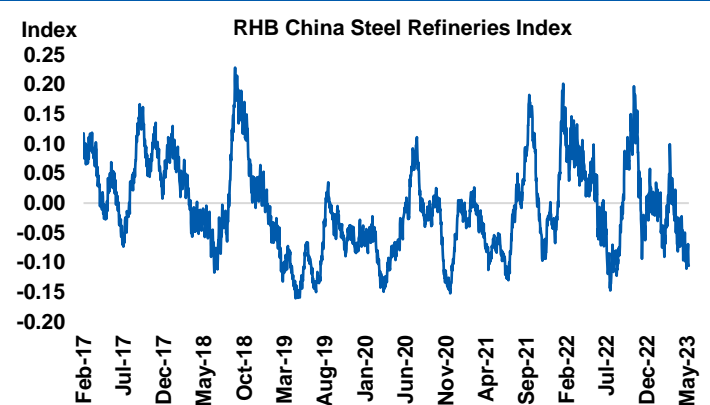
Source: SpaceKnow, RHB Economics and Market Strategy. Last data point is May 13

Figure 14: Recovery in E&amp;E exports sector



Source: CEIC, RHB Economics & Market Strategy. Monthly data with last data points as of Apr 2023

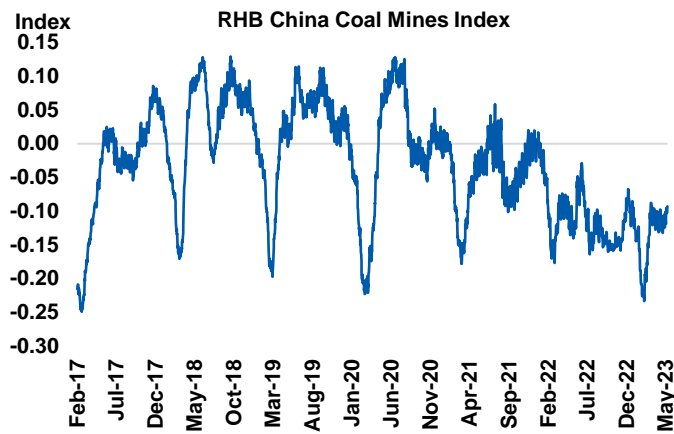
Figure 15: Evidence from commodities sectors as of...



Source: SpaceKnow, RHB Economics & Market Strategy. Last data points is May 13

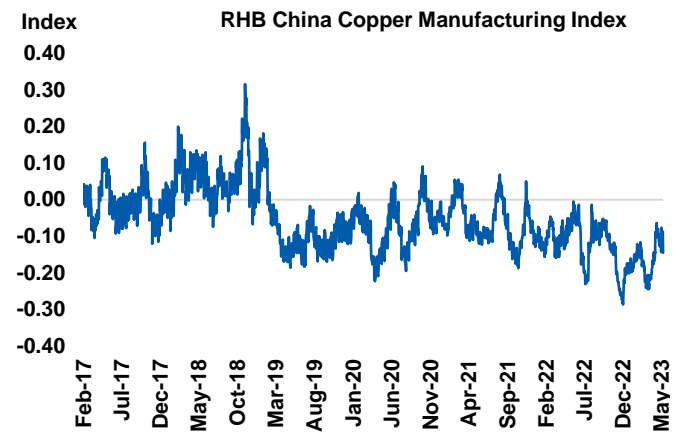
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Figure 16: ...May 13 suggests an across....



Source: SpaceKnow, RHB Economics &amp; Market Strategy. Last data points is May 13

Figure 17: ...the board weakness



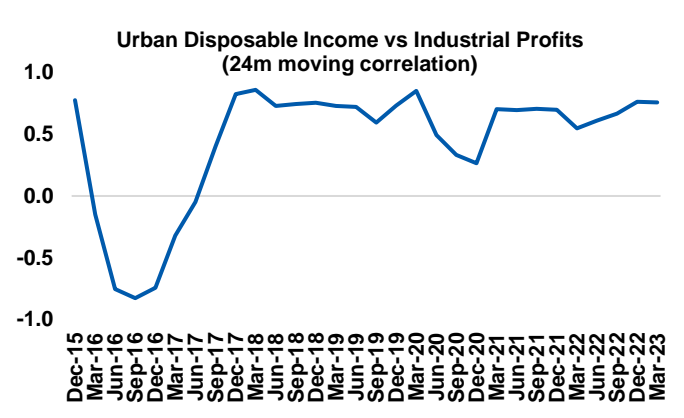
Source: SpaceKnow, RHB Economics &amp; Market Strategy. Last data points is May 13

Figure 18: Real retail sales mainly driven by urban disposable income...



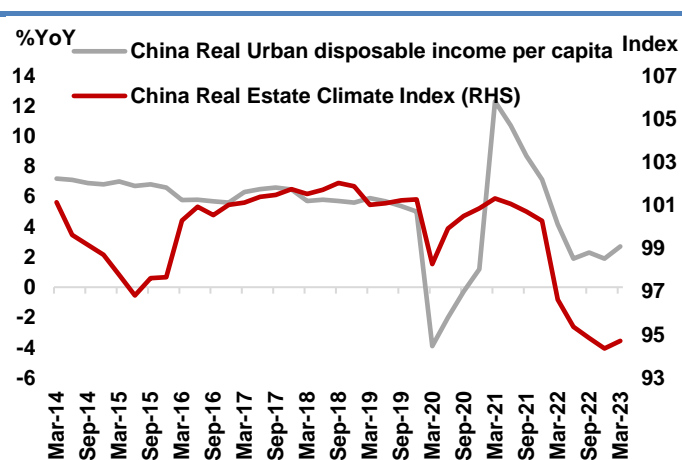
Source: Bloomberg, RHB Economics and Market Strategy. Last data point is 1Q23

Figure 19: ...which is driven by industrial sector profits...



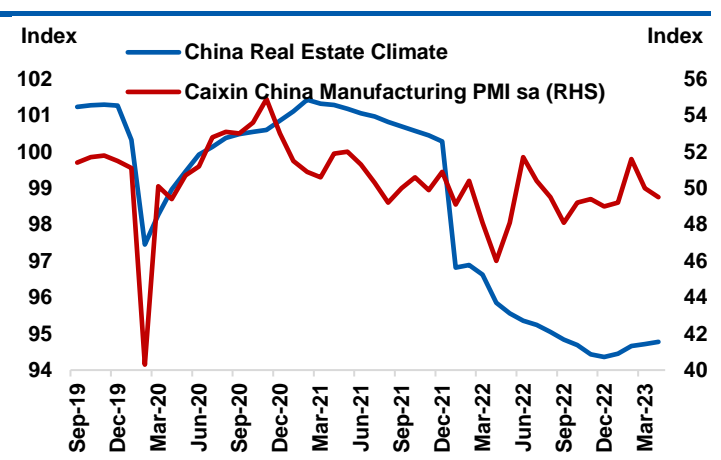
Source: Bloomberg, RHB Economics and Market Strategy. Last data point is 1Q23

Figure 20: ...and activity in the real estate sector...



Source: Bloomberg, RHB Economics &amp; Market Strategy, Quarterly data with last data point is 1Q23

Figure 21: ...which is likely to remain weak



Source: Bloomberg, RHB Economics and Market Strategy. Monthly data with last data point is Apr 2023



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