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RESEARCH NOTE

No Stopping China's Restocking

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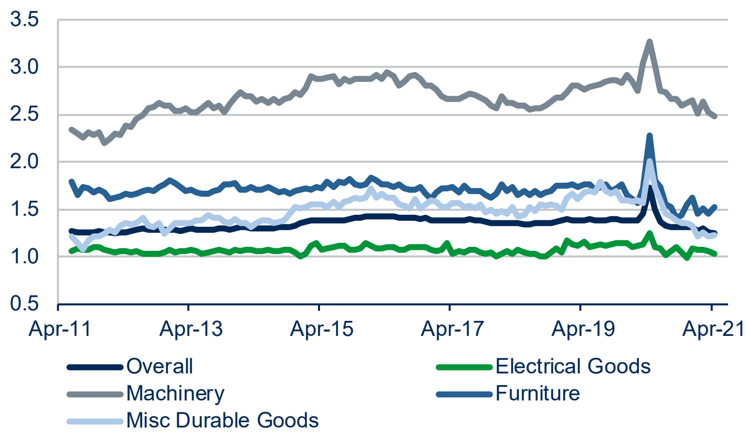
FIFO gives China the global distribution edge across export sectors, even those that fell.

More than a year after the initial lockdowns, who would have thought that vehicle availability or home furniture inventories would still be driving shoppers crazy. It's even spread to things like cardboard boxes and aluminum cans.

While analysts worry about China's slowing growth, the tailwinds from global restocking—in part a result of widespread supply bottlenecks and exceptional goods demand—should continue to be supportive. **It should help facilitate a smooth transition from growth led by external demand to that of one in consumption and investment.** Exports may have peaked and will likely diminish with time but, in the near-term, shouldn't present a major risk to the growth outlook. **In the U.S., supply chain bottlenecks are evident across the economy, with inventory-to-sales (I-S) ratios far below pre-crisis levels.** While this is certainly a function of resilient demand boosted by fiscal stimulus, supply side constraints are also at play. With expectations of a protracted pandemic, management teams opted to cut production and instead rely on inventories. In certain industries, companies also opted to draw down their inventories to preserve cash flow; in some sectors like consumer staples, companies also cut back on their product counts. The resulting combination saw inventory levels decline to historically low levels.

Supply shortages appear to be most significant in retail and wholesale trade, particularly in durable goods. **It's a broad-based story but particularly acute in areas where China's export share to the U.S. is the largest.** The general trend shows I-S ratios at 2018 (or further) lows for electronics, machinery, furniture, and other miscellaneous durable goods.

U.S. MANUFACTURING AND TRADE INVENTORY-TO-SALES RATIO

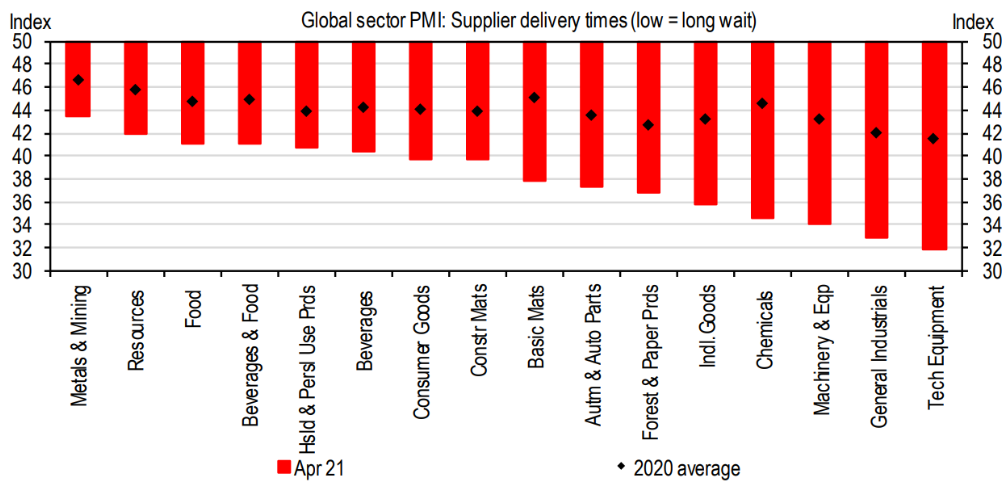


Source: Bloomberg. As of April 30, 2021.

An element of logistical bottlenecks may be involved, but exports from China in these categories have rebounded steadily and, in some cases, are well above trend. **This suggests that booming goods demand has been a larger driver of the inventory drawdown than production constraints.**

Of course, these shortages are not a story unique to the U.S. PMI survey data suggest that supplier delivery times have been elevated globally. **Though some sectors feel the pinch more than others, Chinese exports in categories such as in electronics, equipment and household products make up over 50% of global export share.** Indeed, these same export categories from China saw sizable increases throughout the pandemic.

12. Supply shortages are making delivery times slower and slower

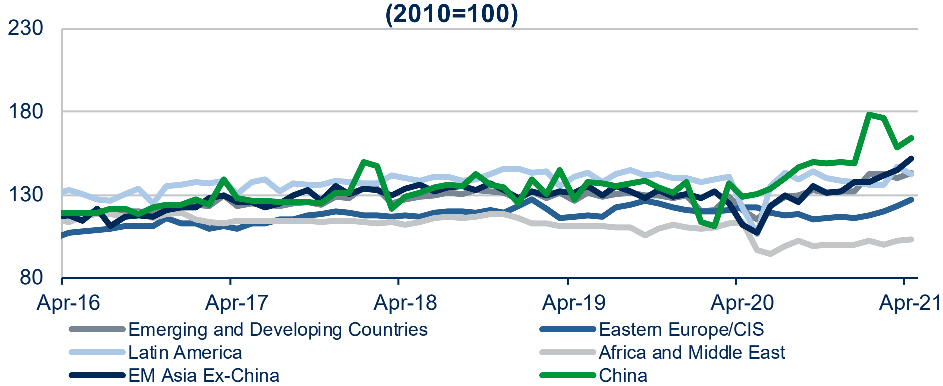


Source: IHS Markit. Note: This sub index is only available for some sectors.

Source: HSBC. As of June 3, 2021.

Uniquely positioned to supply the world with goods given its "first-in, first-out" status during the initial stages of the pandemic, China gained global export market share last year, rising from 13% of global trade in 2019 to 15% in 2020. **High levels of export resilience have allowed China to gain across a variety of export sectors, even when those sectors have experienced overall decline.**

EXPORT VOLUME INDEX (2010=100)



Source: Haver. As of April 30, 2021.

As we get further removed from the depths of the pandemic, longer-term structural forces facing China—such as increasing labor costs and focus on domestic rather than foreign demand—will start to take over again, and we'll likely see export dominance shift towards EM Asia, a slow, gradual process. **Overall, a perfect storm of elevated demand and lingering supply chain pressures triggered by the pandemic has helped China capitalize on its manufacturing strength, allowing it to take a greater share of global exports since 2019.** With many companies also running down inventories as a cost-saving measure at the beginning stages of the pandemic, it's likely that the boon to exports for China still has some legs to it, even as the fiscal impulse in the U.S. gradually fades through the year. As longer-term structural trends right themselves, **China's export strength will also have to moderate eventually, but in the near-term, the drop will likely be gradual.** This should facilitate a smooth hand off to its next pillars of growth, particularly private investment and internal consumption.

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