China's covid congestion

More disruptions at China ports creates the potential for more pricing pressures, and not just in Asia

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Pricing pressure grows

There is a growing theme of pricing pressure right now. So far, markets are playing fairly cool with this. But the scope for a larger market reaction is growing.

Let's start with the news we woke up to in Asia from the US overnight. There, the July PPI data reinforced what we had already learned from CPI earlier in the week, namely that pipeline pricing pressures in the US continue to mount. The main PPI index rose 1.0%MoM, and took the annual final demand PPI inflation rate to 7.8%, up from 7.3%. James Knightley in the US thinks that with firms finding they can pass on their cost increases in the current climate, more of this will spill over into CPI prices than has been usual in recent decades.

But we also have some pricing pressure increases building closer to home. China's daily Covid case numbers continue to look quite moderate by many standards. Yesterday saw 111 confirmed (symptomatic) cases, and today already 80 more cases have been logged. But the location rather than the number of cases is the added complication to this data and has led to more ports closures. These closures, though only partial, could spell outsize logistics disruption relative to the scale of the infections being recorded.

Iris Pang in Hong Kong writes "Zhoushan port at Ningbo, which is usually ranked the third busiest port in the world after Shanghai and Singapore, is only operating partially due to Covid. Shanghai's port is similarly affected. The port at Zhoushan is important for imports of commodities like crude, gas and coal (sounds like Australia could be hit hard by this). Zhoushan is also an important container port. Although these days, Shanghai's port has lost some ground to Zhoushan in terms of throughput, it remains important because when Zhoushan is only operating at partial capacity, some container ships can divert to Shanghai as they are quite close to one another. But with both ports operating partially, this could lead to significant congestion of freight around these ports.

This will affect imports as well as exports. September is usually the peak month for exports, and the experience from Yantian port's congestion tells us that clearing the ensuing freight congestion could take at least 4 weeks. This could affect the delivery of goods for Black Friday shopping in the west".

Freight costs were already high prior to this partial closure. Both the Baltic Dry Freight Index and composite container freight indices are already at recent highs and looking to push higher. higher transportation costs can only add to already high pricing pressures for final demand and intermediate goods. And with a little lag, may prevent consumer price inflation from easing lower as we head into the back of the year.

As if that wasn't enough...

Further disruption to ports spells bad news for production locally, and perhaps globally in the coming months. But it is not the only impediment to growth stemming from China. News reports of China's new legal 5-year plan are being interpreted by some as reinforcing the recent clampdown on certain industries, such as Fintech, education and gaming that have emerged recently and weighed on China's equity markets.

It's not quite so straightforward though. Again Iris suggests "The market is focussing on the Chinese government's new 5-year legal plan, which talks about filling the legal gap in the digital economy, fintech, AI, big data, cloud computing, etc. There is concern that this could mean there will be more regulations coming during the period 2021-2025 on the technology sector. But it is important to emphasise that the 5-year legal plan is not a new thing in Mainland China. Every 5 years there is a theme for legal system policy direction. So some more regulations are very likely on their way. But it does not mean that they have to happen imminently"

Elsewhere in Asia...

Covid is also dominating the macro newsflow elsewhere in Asia. Malaysia and Hong Kong both release GDP data today. Both will show chunky looking year-on-year growth thanks to the big slump in economic activity a year ago. But both are likely to exhibit meaningful declines from the previous quarter.

Prakash Sakpal says "Malaysia's 2Q21 GDP report will reflect the extent of the damage to the economy caused by the latest Covid-19 outbreak. We expect GDP to post a -6.5% QoQ fall, although a much bigger fall a year ago (-16% QoQ) will flatter the year-on-year GDP comparison, which will come in at about 11%. Our view compares with the market expectations centred on about -2.0% QoQ and +14% YoY. The sustained high daily infection rate of over 20,000 and slow vaccinations point to continued economic suffering ahead - a recession seems to be more likely than not. We expect the authorities to downgrade their 2021 growth outlook, currently 6% to

7.5%, to something around 4% (ING forecast 4.4%). However, the downgrade won't mean much for future policy direction given that policy has exhausted almost all options, while escalated political risk will keep any further stimulus from forthcoming".

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