

China Economy

PMI contracted as policy easing continued

China's manufacturing PMI came in below market expectations in May as it slid into contraction again amid weakening demand both domestically and externally. Supply continued to outrun demand as production remained one of the few major indices in expansion. Deflation pressure alleviated as both purchasing material prices and ex-factory prices expanded after the continued rebounding of commodities prices. Employment remained sluggish, hindering the recovery of consumer confidence. Service index inched up while construction moderated. The policy easing has fuelled recent equity rallies but investors remained hesitant on economic recovery as the property market continued to slump and deflation pressure persisted. China may continue to loosen policies ahead to boost market confidence and economic growth momentum. China economy may gradually improve with smaller declines of housing sales, deflation alleviation and recovery of corporate earnings. We maintain our forecast on China's GDP growth at 5% for 2024.

■ Manufacturing activities dropped to contraction amid weaker demand.

China's manufacturing PMI in May dropped to 49.6% from 50.4% in Apr, returning to contraction after two months of expansion. New order and export order index notably shrank to 49.6% and 48.3% from 51.1% and 50.6%, indicating a softer demand both domestically and externally and a larger downside risk of export data in May. Existing order stayed subdued at 45.3%. Production index eased to 50.8% from its one-year peak of 52.9% in Mar, as production grew at a much slower pace. Corporate procurement also receded as material purchase volume dipped to 49.3% from 50.5%. De-stocking sustained as raw materials inventory and finished goods inventory edged down to 47.8% and 46.5% from 48.1% and 47.3%. Breaking down by sector, production of general equipment, transport equipment other than vehicles and computer & electronic equipment remained in expansion for three consecutive months while textile and rubber & plastic dropped to contraction. PMI of medium and small enterprises significantly plummeted to 49.4% and 46.7% from expansion zone, while large enterprises increased to 50.7% from 50.3% in Apr, as a sign of the Matthew Effect in recent economic trends when large enterprises especially the SOEs enjoyed the preferential support, while private sector that mainly consists of SMEs endured significant pressure.

■ **Deflationary pressure continued to alleviate driven by rising raw materials prices.** Ex-factory price index rose to 50.4% in May from 49.1% in Apr, expanding for the first time since Sep 2023, as manufacturing material purchase prices increased for the third consecutive month to 56.9% from 54% due to recent rallies of commodities prices. The persisting rebound in ex-factory prices may indicate the MoM growth of PPI may rebound to positive in upcoming months. Meanwhile, service price index further declined to 47.5% from 49.5% while construction price rose to 49.7% from 48.7%. Looking forward, China's deflation pressure may marginally improve as CPI gradually rebounds within the lower positive range and PPI narrows its YoY decline due to the base effect, surging commodities prices and improving export activities.

■ **Service index inched up while construction moderated.** Non-manufacturing PMI edged down to 51.1% from 51.2%, lower than market expectation. PMI in service notably inched up to 50.5% in May from 50.3% thanks to the national holidays in May. New order index slightly rebounded to 47.4% from 46.5%. Breaking down by sector, activities in postal services, TV & broadcast, internet & information technology, and sports & entertainment

Bingnan YE, Ph.D

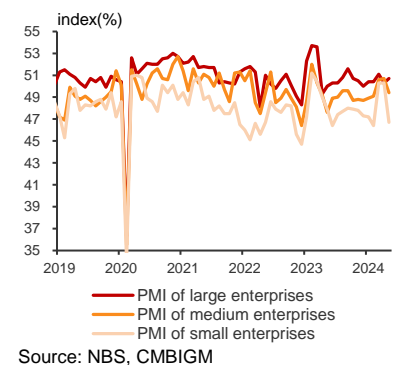
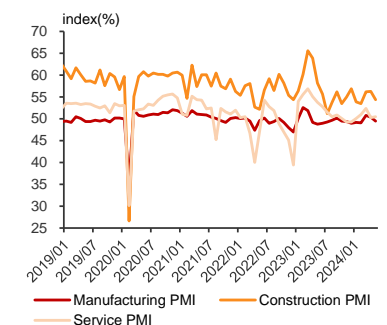
(852) 3761 8967

yebingnan@cmbi.com.hk

Frank Liu

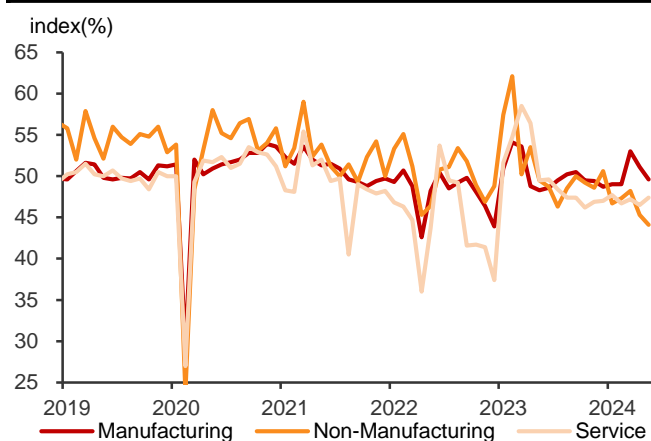
(852) 3761 8957

frankliu@cmbi.com.hk

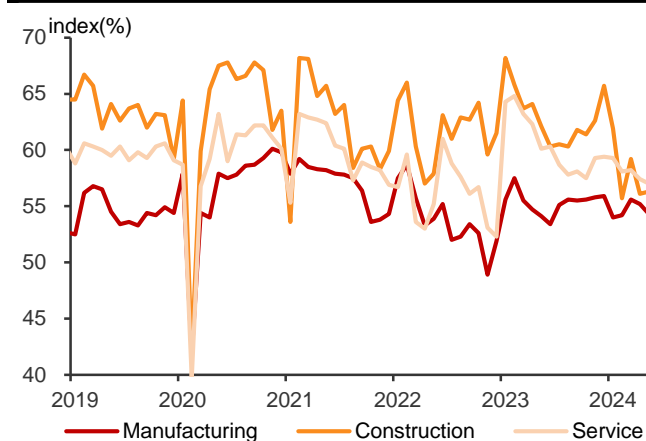


reached above 55% while real estate and capital market services continued to contract. Construction PMI moderated to 54.4% from 56.3%, as new starts of housing continued to drop.

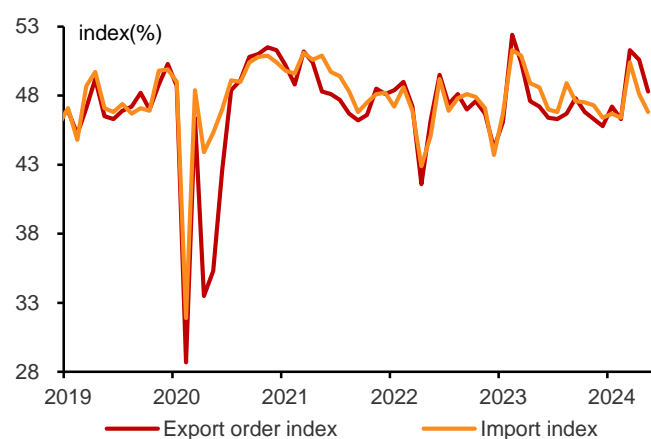
- **Employment remained subdued.** Employment indexes in manufacturing inched up to 48.1% from 48% in Apr while employment in service and construction both dropped to 46.7% and 43.3% from 47.4% and 46.1%. The sluggish employment condition remained the major headwinds for economic recovery, especially for consumption, property purchase and private business sentiment.
- **China may continue to loosen policies ahead.** The policy easing has fuelled the recent equity rallies but investors remained hesitated on economic recovery as housing market continued to slump and consumer deflation persisted. China may continue to loosen policies to boost market confidence and economic growth. After the recent policy easing, average new mortgage rates may drop to 3.3% for first-home buyers and 3.8% for second-home buyers. Mortgage rates may further decline if housing sales remain weak in future. To protect banks' NIMs, the PBOC may guide banks to further lower deposit rates. Local governments are encouraged to buy completed yet unsold projects from developers and turn them into affordable houses. Local government financing vehicles and SOEs would benefit first. China economy may gradually improve with smaller declines of housing sales, deflation alleviation and earning recovery. We maintain our forecast on China's GDP growth at 5% for 2024.

Figure 1: New Order Index

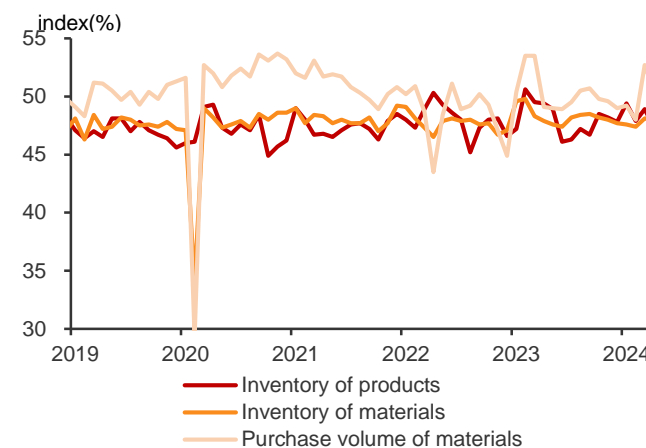
Source: Wind, CMBIGM

Figure 2 : Business Sentiment Index

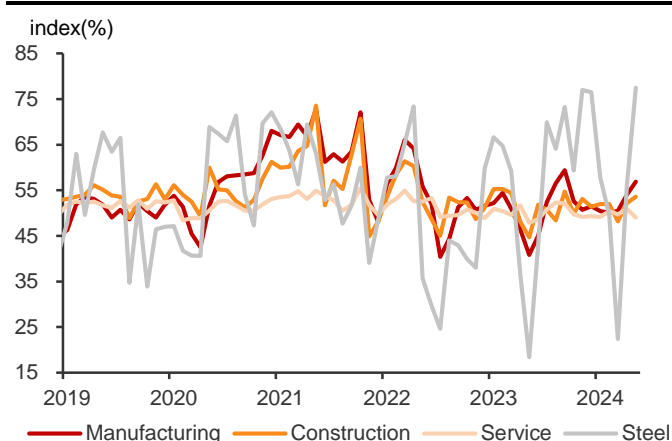
Source: Wind, CMBIGM

Figure 3: Export Order Index and Import Index

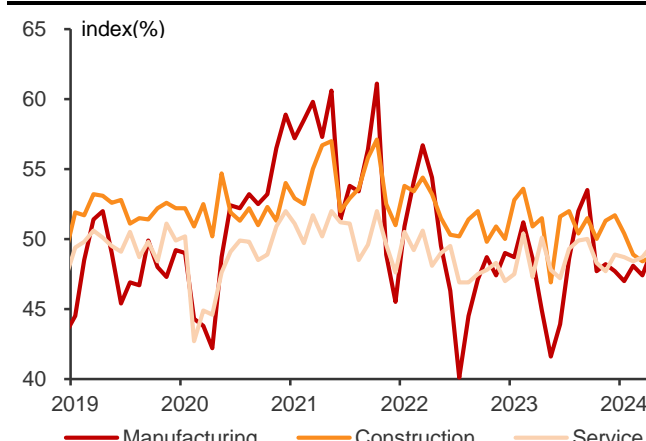
Source: Wind, CMBIGM

Figure 4: Inventory Index

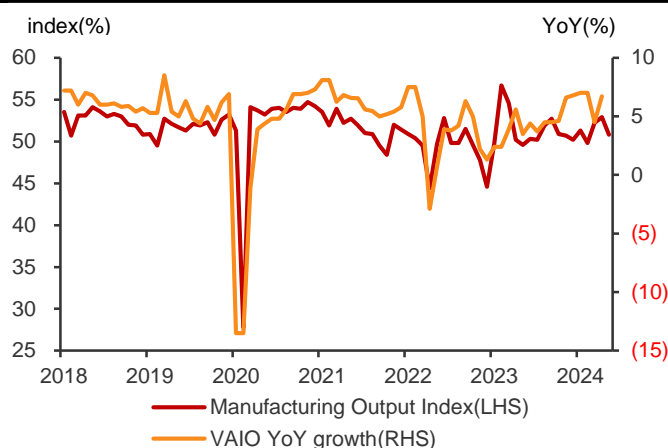
Source: Wind, CMBIGM

Figure 5: Material Purchase Price Index

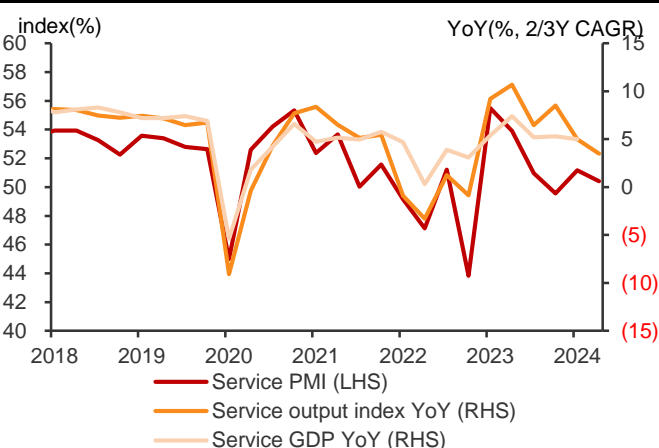
Source: Wind, CMBIGM

Figure 6: Ex-factory Price Index

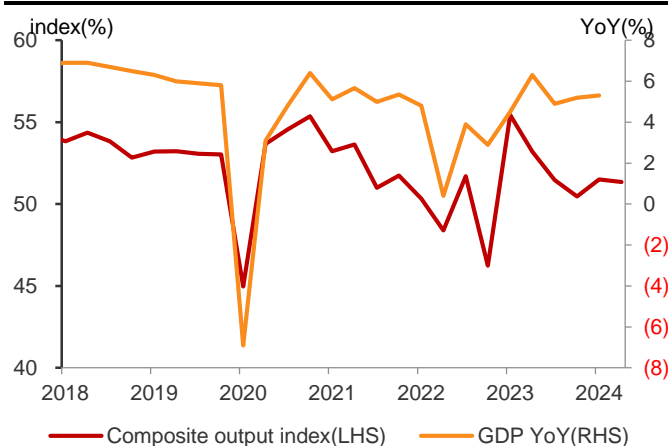
Source: Wind, CMBIGM

Figure 7: Manufacturing Output Index

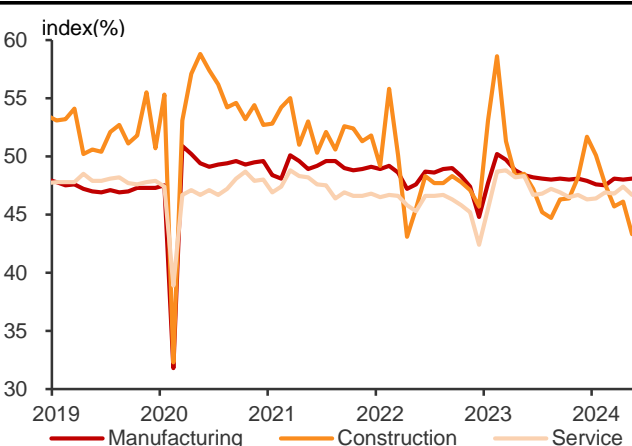
Source: Wind, CMBIGM

Figure 8: Service PMI & Output Index

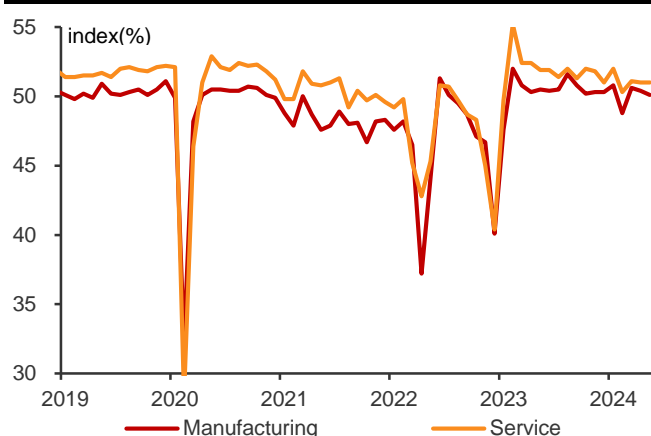
Source: Wind, CMBIGM

Figure 9: Composite Output Index

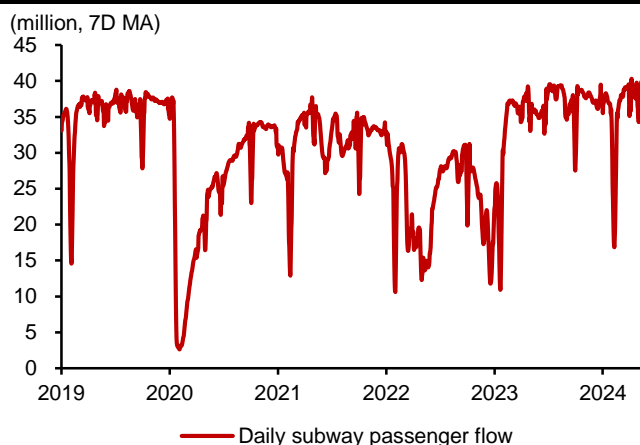
Source: Wind, CMBIGM

Figure 10: Employment Index

Source: Wind, CMBIGM

Figure 11: Supply Delivery Index

Source: Wind, CMBIGM

Figure 12: Subway passenger flow in tier-1 cities

Source: Wind, CMBIGM

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CMB International Global Markets Limited

Address: 45/F, Champion Tower, 3 Garden Road, Hong Kong, Tel: (852) 3900 0888 Fax: (852) 3900 0800

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