

China Economy

PMI showed demand-side weakness

China's manufacturing PMI inched down to 49.1% in Feb, and remained in contraction in 10 out of the past 11 months. New order and export order continued to deteriorate as both overseas and domestic demand remained dismal. Businesses remained reluctant to increase procurement and inventory amid weak confidence. Service PMI continued to expand thanks to Chinese New Year (CNY) holiday; while construction slowed down due to the suspension of infrastructure investments in debt-laden provinces. Ex-factory price indexes in manufacturing subtly rebounded, indicating a narrowing PPI decline in Feb. The PMI indicated that demand remained weak, and China needs demand-side stimulus to stabilize the housing market, boost consumption and defy deflation. The country has shown tentative signs of policy shift towards demand-side stimulus recently. However, we need more time to observe the policy dynamics. We maintain the forecast on GDP growth for 2024 at 4.8%.

- Manufacturing activities remained dreary.** China's manufacturing PMI in Feb edged down to 49.1% in Feb from 49.2% in Jan, remaining in contraction in 10 out of the past 11 months. Production index dropped to 49.8% from 51.3% due to the CNY holiday and weak demand. New order stayed in contraction, while export order and existing order contracted at a faster pace, showing minimal demand-side improvement. Material purchase volume and import order continued to drop to 48% and 46.4% from 49.2% and 46.7%, indicating corporates remained reluctant to increase procurement and inventory, likely due to a pessimistic economic outlook. Both raw materials inventory and finished goods inventory edged down from 47.6% and 49.4% to 47.4% and 47.9% in Feb, as enterprises carried on their de-stocking cycle. Breaking down by sector, business sentiment indexes in wood processing and furniture, transportation equipment and electrical machinery reached above 58% in high prosperity interval. PMI of medium and small enterprises continued to contract while large enterprises stayed unchanged in expansion.
- Deflation pressure slightly eased.** Ex-factory price index moderately rebounded to 48.1% in Feb from 47% in Jan, while manufacturing material purchase price eased to 50.1% from 50.4%, indicating the decline of PPI is likely to narrow in Feb. Service price index stayed in contraction and inched down to 48.4%, while construction price declined to 48.9% from 50.4%. Looking forward, China's CPI may return to positive in 2Q24, while PPI may gradually narrow its decline due to base effect and the end of the de-stocking cycle.
- Service sector continued to expand while construction moderated.** Non-manufacturing PMI accelerated to 51.4% from 50.7%. PMI in service expanded to 51% from 50.1% thanks to CNY holiday. New order index dropped to 46.7% from 47.7%, pointing to a weak Mar service PMI. Breaking down by sector, activities in catering services, land & air transportation and money market service, and recreational services reached above 55%, while real estate and resident series remained in contraction. Construction PMI slowed down to 53.5% from 53.9%, in-line with deceleration of government bond issuance and suspension of infrastructure investment in 12 debt-laden provinces. Business sentiment indexes in construction and services both dropped but remained in expansion zones.
- Employment further crumbled due to weak manufacturing and construction activities during CNY.** Employment indexes in manufacturing continued to drop from 47.6% to 47.4%, deteriorating for the third consecutive

Bingnan YE, Ph.D

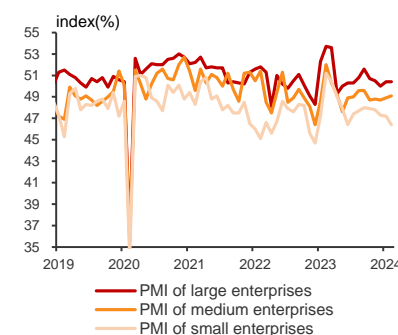
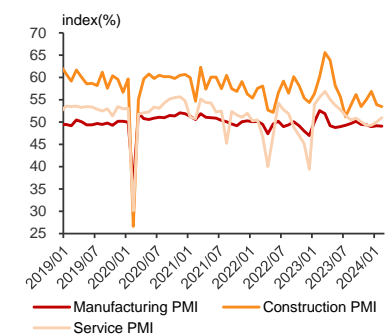
(852) 3761 8967

yebingnan@cmbi.com.hk

Frank Liu

(852) 3761 8957

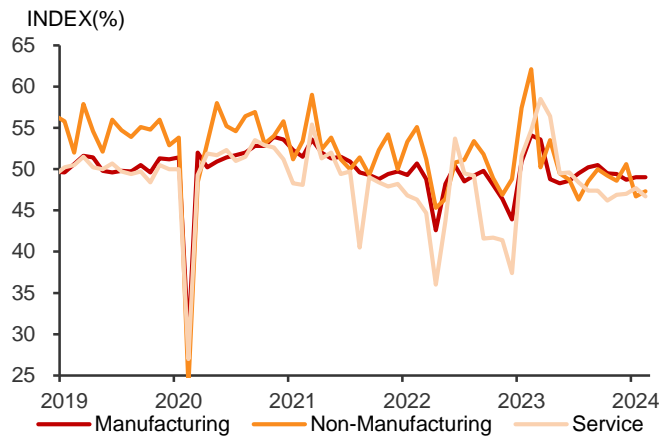
frankliu@cmbi.com.hk



months. Employment in construction dropped to contraction from 50.1% to 47.6% while service moderately rebounded from 46.4% to 46.9%. The employment condition remained acute, weighing on future economic recovery momentum from the household sector.

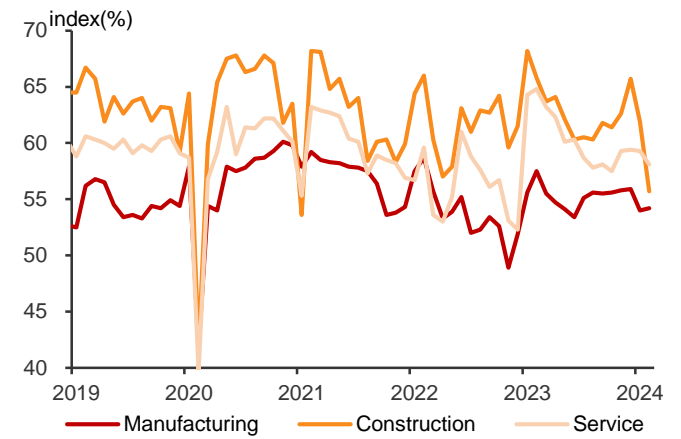
- **The major challenges for China's economy require demand-side stimulus.** The major challenges for the economy are slumping property market, weak consumption and continuous deflation. The recent policies have shown tentative signs of a shift of policymakers' focus from the supply side to the demand side. But we need more time to observe the magnitude of the possible policy changes especially in mortgage rates and fiscal stimulus on consumption. We maintain our forecast of additional RRR cuts by 50 bps in total and LPR cut by 10 bps in the remaining of the year and broad fiscal deficit at 7.1% of GDP, with possible upside surprise on policy support.

Figure 1: New Order Index



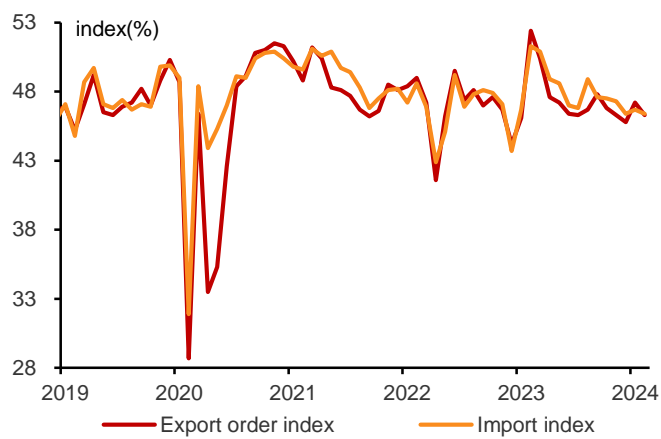
Source: Wind, CMBIGM

Figure 2 : Business Sentiment Index



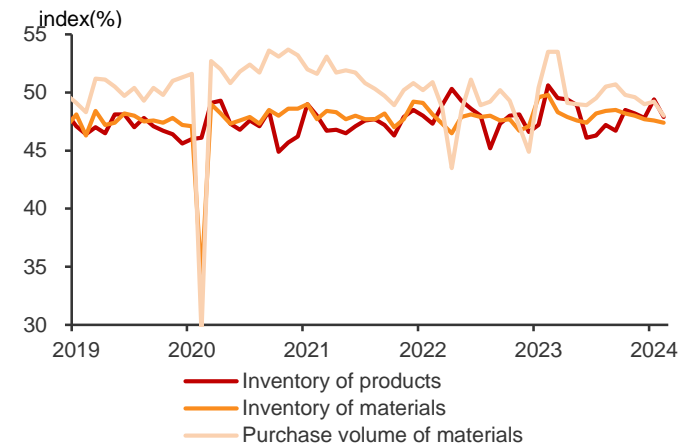
Source: Wind, CMBIGM

Figure 3: Export Order Index and Import Index



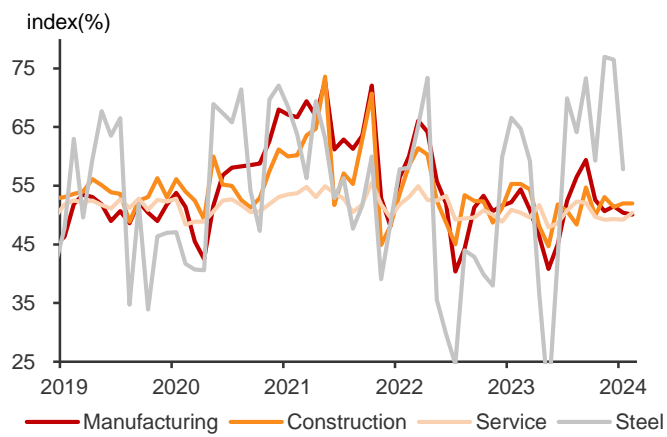
Source: Wind, CMBIGM

Figure 4: Inventory Index



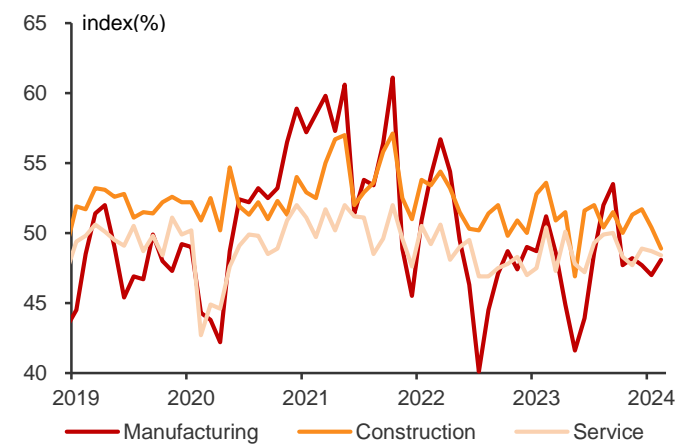
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Figure 5: Material Purchase Price Index



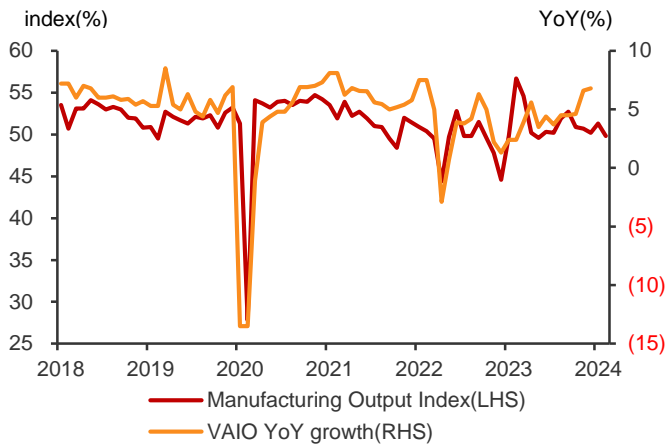
Source: Wind, CMBIGM

Figure 6: Ex-factory Price Index



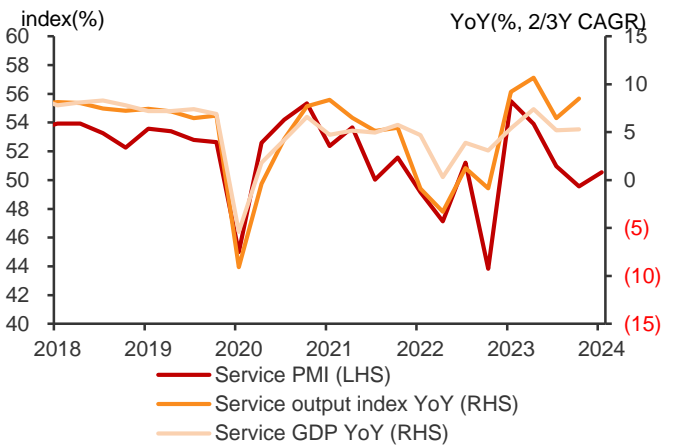
Source: Wind, CMBIGM

Figure 7: Manufacturing Output Index



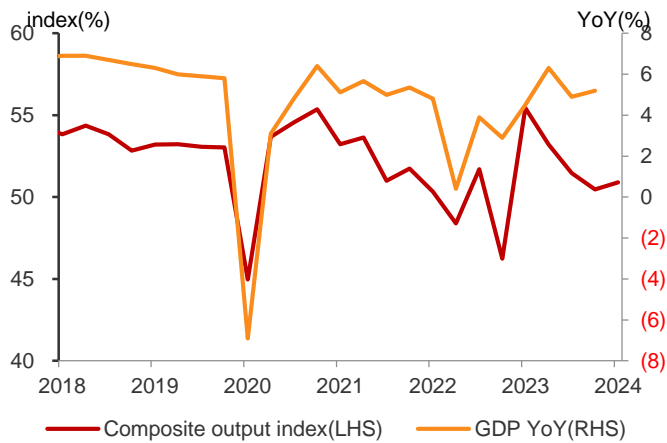
Source: Wind, CMBIGM

Figure 8: Service PMI & Output Index



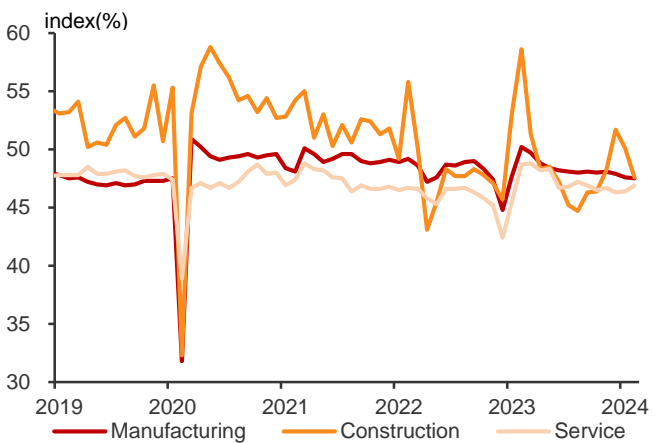
Source: Wind, CMBIGM

Figure 9: Composite Output Index



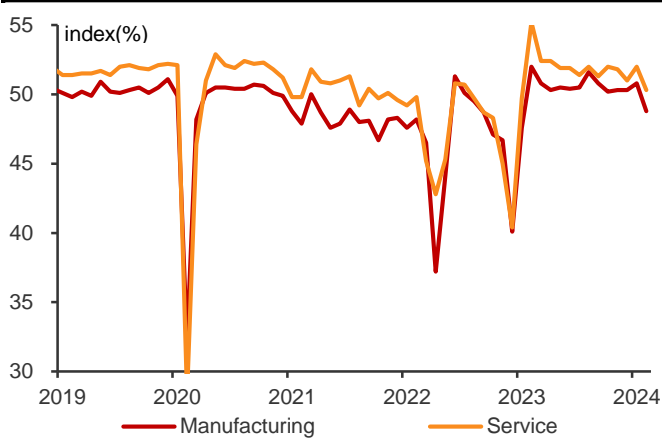
Source: Wind, CMBIGM

Figure 10: Employment Index



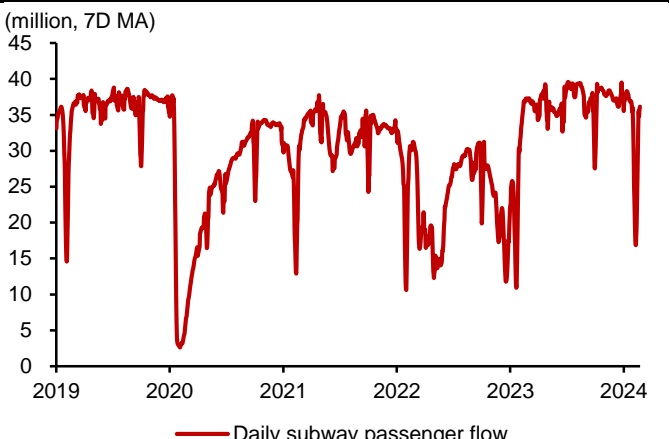
Source: Wind, CMBIGM

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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