

China Economy

PMI contraction indicates continuous policy easing in 2024

China's manufacturing PMI contracted for the third consecutive month as it fell to the lowest point since June 2023. All sub-indexes worsened while headline PMI has contracted eight in the past nine months. New order, export order and existing order further contracted, signalling continuous deterioration on the demand side. Corporate procurement activities remained subdued as both material purchase volume and import order edged down. Raw materials and finished goods inventory further fell as the proactive de-stocking from enterprises continued. Ex-factory price index further dipped while manufacturing material purchase price rebounded, showing the intensified price competition from the production side albeit a higher input cost. Employment further crumbled in manufacturing and services. Service PMI remained in contraction while construction rebounded thanks to fiscal expansion. The weak economy indicates continuous easing macro policies ahead. Fiscal policy would be more expansionary with the broad fiscal deficit probably at over 8% in 2024. The PBOC may lower LPRs in January or February and cut RRR twice within 2024. We maintain our forecast for GDP growth at 5.3% in 2023 and 4.8% in 2024.

■ **The contraction of manufacturing activities accelerated due to the sluggish domestic and external demands.** China's manufacturing PMI came in below expectation once again and contracted to 49% in Dec from 49.4% in Nov. Production index dropped to 50.2% in Dec from 50.7% in Nov. The contraction of new order and export order further expanded, falling to 48.7% and 45.8% from 49.4% and 46.3% while existing orders remained in contraction at 44.5%, showing the further deterioration from the demand side, both domestically and externally. Material purchase volume and import order decreased from 49.6% and 47.3% to 49% and 46.4%, indicating a weakened corporate procurement activities. Both raw materials inventory and finished goods inventory edged down to 47.7% and 47.8% from 48% and 48.2%, as the proactive de-stocking from enterprises continued. Breaking down by sector, new order indexes in metal products, computers & electronic equipment and other transportation equipment reached above 50% while most industries indicated insufficient market demand. The PMI worsened in Dec across large, medium and small enterprises, while small and medium enterprises remained in contraction since April.

■ **Reflation still lacked momentum due to weak demand and tough supply competition.** Ex-factory price index further dipped to 47.7% from 48.2%, while manufacturing material purchase price rebounded from 50.7% to 51.5%, showing the intensified price competition from the production side albeit a higher input cost. Service price index moderately rebounded but stayed in contraction, while construction price continued to rebound. Looking forward, China's CPI and PPI still faced downward pressure in Dec but may gradually recover in 2024 thanks to the base effect, demand improvement and the easing of de-stocking cycle.

■ **Service sector remained in contraction while construction continued to expand.** Non-manufacturing PMI inched up to 50.4% from 50.2%. PMI in service stayed flat at 49.3%. Breaking down by sector, activities in postal service, TV & broadcast, money market service and insurance remained above 55% while water transportation, capital market service and real estate stayed in contraction, possibly indicating that people are retracting money

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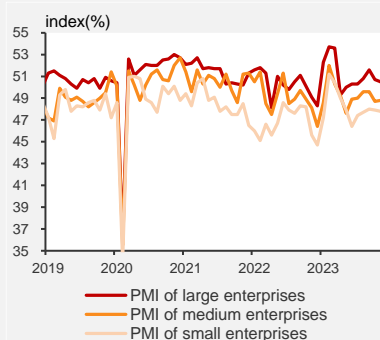
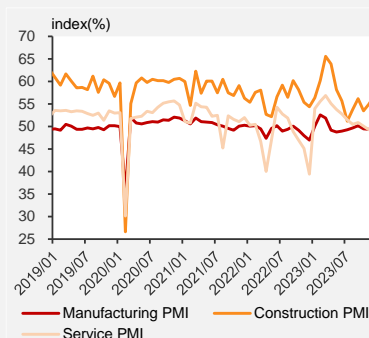
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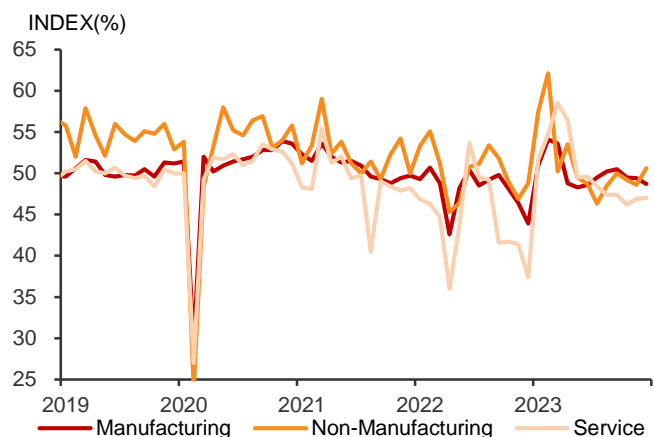
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from capital market to safer means of investment such as deposits in banks and insurance companies, indicating a change in risk appetite partly due to a pessimistic expectation. Construction PMI bounced to 56.9% from 55% thanks to the continuing expansion of fiscal stimulus. Business sentiment indexes in construction and services both improved and remained in high expansion zones.

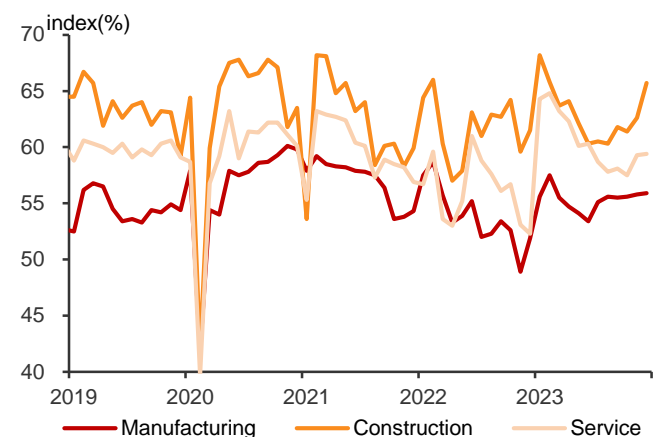
- **Employment in manufacturing and service worsened again while employment in construction continued to improve.** Employment indexes in manufacturing and service further dropped to 47.9% and 46.3% from 48.1% and 46.7% in Nov. Employment in construction recovered to expansion at 51.7% from 48.2%. The still-weak employment condition will restrain the recovery momentum of household consumption and cast a shadow on future economic growth, in our view.
- **The weak economy indicates continuous easing macro policies ahead.** The worsening manufacturing and service activities driven by subdued domestic demand, the distresses in property market and soft external demand all indicate a still-sluggish economy. While policymakers might still maintain the GDP growth target at 5% for 2024, the weak economy indicates continuous easing macro policies ahead. China may adopt more expansionary fiscal policy and further loosen monetary policy & property policy to boost growth. The broad fiscal deficit ratio may reach 8% of GDP in 2024. The PBOC may launch additional cuts in RRR, deposit rates and LPRs in 1H24. Municipal governments may further loosen property policy to stabilize the property sector. We maintain the GDP forecast for 2023 at 5.3% and that for 2024 at 4.8%.

Figure 1: New Order Index



Source: Wind, CMBIGM

Figure 2 : Business Sentiment Index



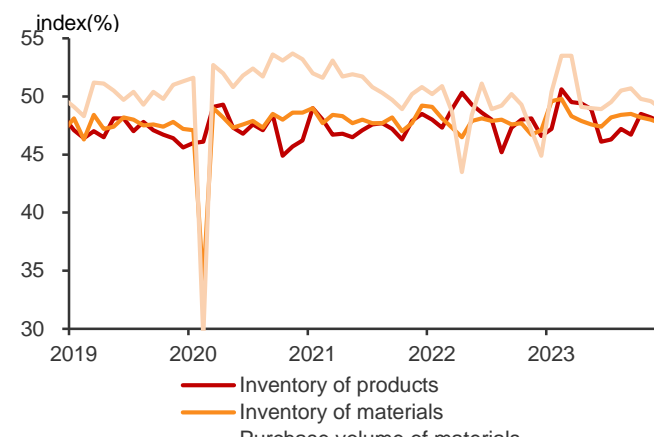
Source: Wind, CMBIGM

Figure 3: Export Order Index and Import Index



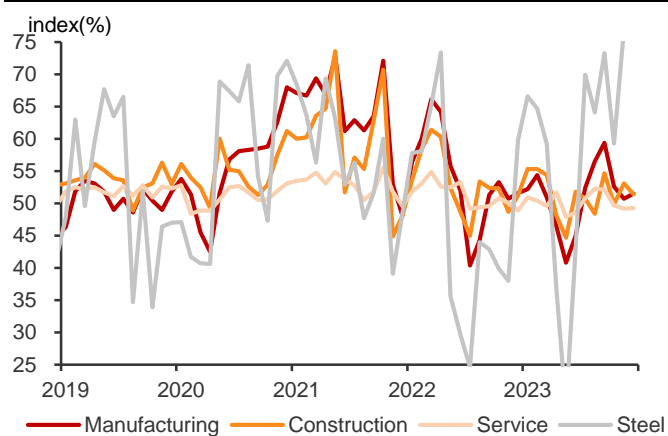
Source: Wind, CMBIGM

Figure 4: Inventory Index



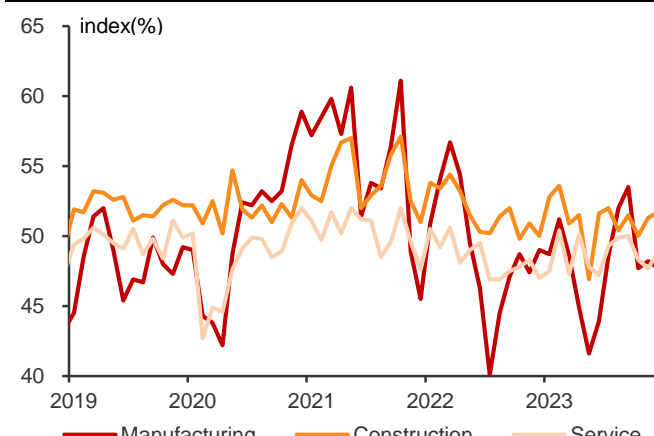
Source: Wind, CMBIGM

Figure 5: Material Purchase Price Index



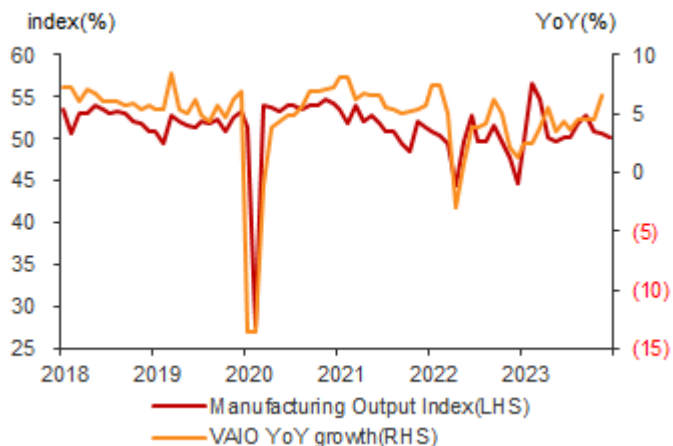
Source: Wind, CMBIGM

Figure 6: Ex-factory Price Index



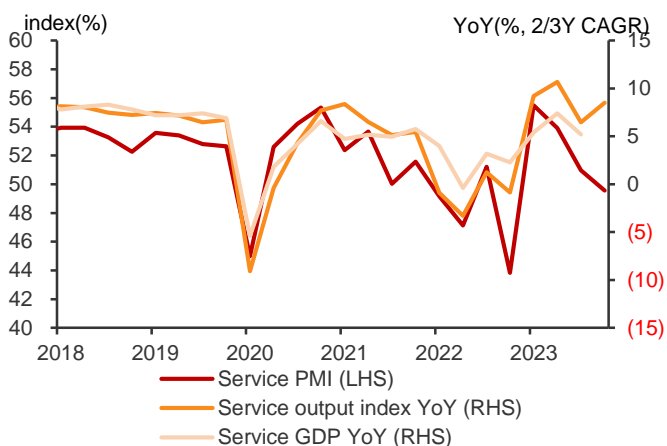
Source: Wind, CMBIGM

Figure 7: Manufacturing Output Index



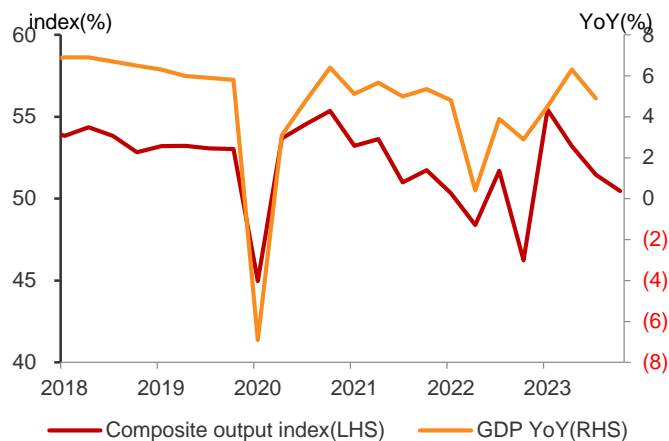
Source: Wind, CMBIGM

Figure 8: Service PMI & Output Index



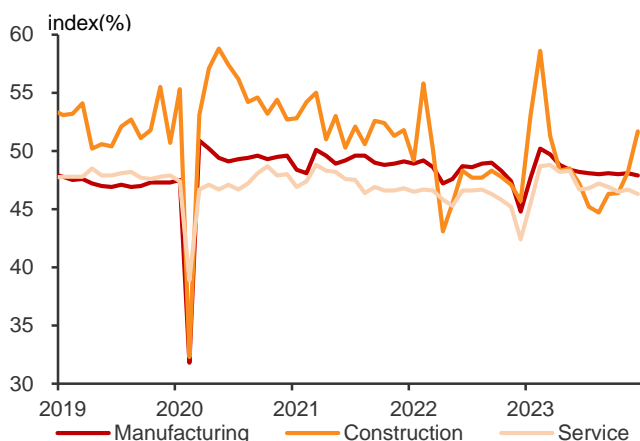
Source: Wind, CMBIGM

Figure 9: Composite Output Index



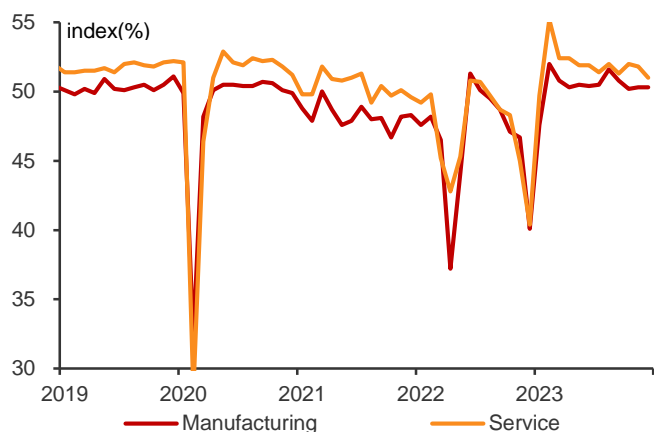
Source: Wind, CMBIGM

Figure 10: Employment Index



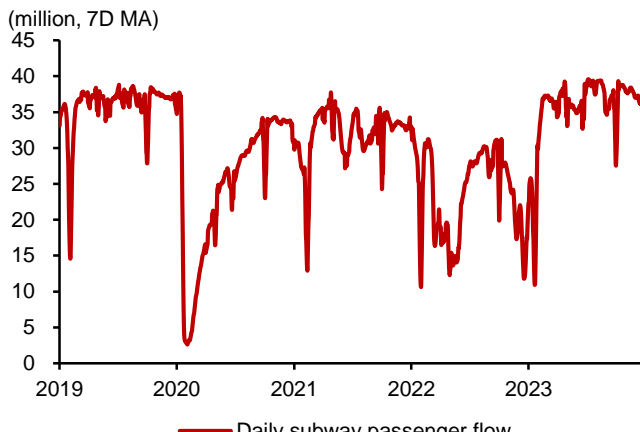
Source: Wind, CMBIGM

Figure 11: Supply Delivery Index



Source: Wind, CMBIGM

Figure 12: Subway passenger flow in tier-1 cities



Source: Wind, CMBIGM

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