

China Economy

PMI returns to expansion as sign of economic recovery

China's manufacturing PMI in Sep rose to 50.2 and beat market expectations, after contracting for five straight months. Manufacturing activities in large enterprises maintained its strong recovery while small and medium enterprises still stayed in contraction. Production, new order and purchase volume continued to expand, indicating a recovery on domestic demand side. Export order slightly improved and import indexes further dipped while both remained below 50%, indicating continuous declines in foreign trade activities. Due to the resurgence of energy and commodity prices, material purchase price index and ex-factory product index increased substantially. We expect further shrinkage of YoY declines in the PPI in next several months. Employment in manufacturing remained tedious due to weak demand and industrial upgrade towards higher labour productivity. Service PMI rebounded although the pent-up summer travel demand softened as transport service, lodging and catering service dropped into contraction. Recently, China has signalled stronger policy loosening ahead. The country has eased property restrictions across cities, loosened credit supply and started to implement a package of local government debt resolving plans. We expect further local government refinancing bonds issuance and credit supply loosening in next several months. China's economy may gradually improve in next four quarters. We maintain our forecast on China's GDP growth at 5.1% in 2023 and 4.8% in 2024.

- Manufacturing activity returned to expansion with more positive outlook.** China's PMI in manufacturing came in above expectation and rose to 50.2% in September from 49.7% in August. Production index continued to expand from 51.9% in August to 52.7% in Sep. New order and material purchase volume continued to expand respectively from 50.2% and 50.5% in August to 50.5% and 50.7% in Sep, indicating a sustaining improvement on the demand side. Breaking down by sector, indexes in equipment manufacturing, high-technology manufacturing and consumer goods reached above 50%, while energy-intensive industries remained in the contractionary range. Export slightly improved and import indexes continued to worsen while both remained in contraction, indicating a narrowing trade surplus in September. PMI of large enterprises expanded noticeably from 50.8% in August to 51.6% in Sep, while both small and medium enterprises remained in contraction.
- Reflation trend entrenched driven by rising energy and commodity prices.** Material purchase price index and ex-factory price index continued to rally from 56.5% and 52% in August to 59.5% and 53.5% in Sep, indicating a reflation trend in the industrial sector, possibly driven by rising energy and commodity prices. Inventory for materials and finished products marginally remained in contraction, as businesses were cautious to increase inventory investment. Construction price remained in expansion and service price index moderately increased. We expect China's CPI and PPI to continue its gradual rebound in next several quarters along with a mild recovery of aggregate demand.
- Non-manufacturing sectors improved amid fading momentum in holiday travel demand.** Non-manufacturing PMI rebounded by 70bps to 51.7% in Sep. PMI in service further rose from 50.5% in August to 50.9% in Sep. Breaking down by sector, output in water transportation, postal service, TV & broadcast,

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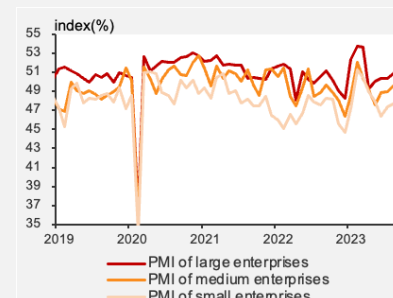
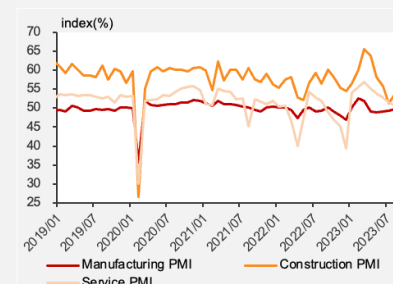
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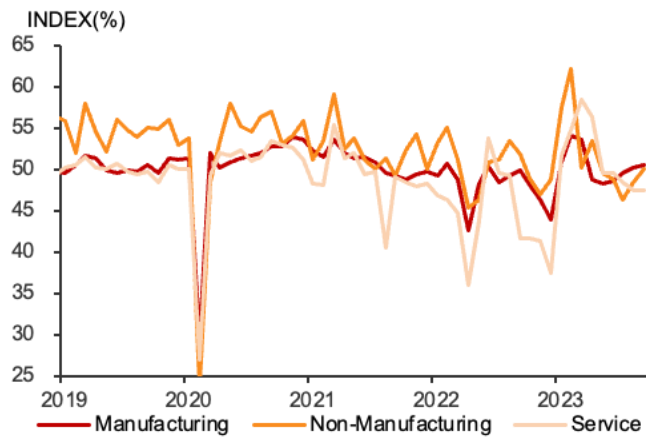
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IT service and financial service noticeably expanded while railroad & air transportation, lodging and dining services fell below 50%. Business sentiment indexes in railroad transportation, postal service, financial service, and TV & broadcast came in above 60%. Construction PMI increased to 56.2 in Sep from 53.8 in August. The new order index rallied to 50 after four months of contraction.

- **Employment still struggled as employment index further deteriorated.** Employment remained in deep contraction as employment indexes in manufacturing and construction marginally increased to 48.1 and 46.3 in Sep from 48 and 44.7 in August while employment in service further dipped to 46.9 in Sep from 47.2 in August. The weak employment condition will restrain the recovery momentum of household consumption in China and be a major drag on the economic growth.
- **Stronger loosening policies and local government debt resolving plans coming in as China's economy may gradually improve ahead.** Policymakers have adopted a broad spectrum of supportive policies including loosening property policies, expanding credit supply, and activating capital market. Looking ahead, stabilizing property market and relieving local government debt pressure will be major policy goals in next two quarters. Municipal governments may further loosen property policies while the PBOC may further ease credit supply with possible additional cuts in RRR, deposit rates and LPRs. Local governments may have refinancing bond quotas to replace the matured contingent debt. Meanwhile, banks will be encouraged to roll over the local government contingent debt. China's economy is expected to gradually improve in next four quarters. We maintain our forecast on the GDP growth at 5.1% for 2023 and 4.8% for 2024.

Figure 1: New Order Index



Source: WIND, CMBIGM

Figure 2 : Business Sentiment Index



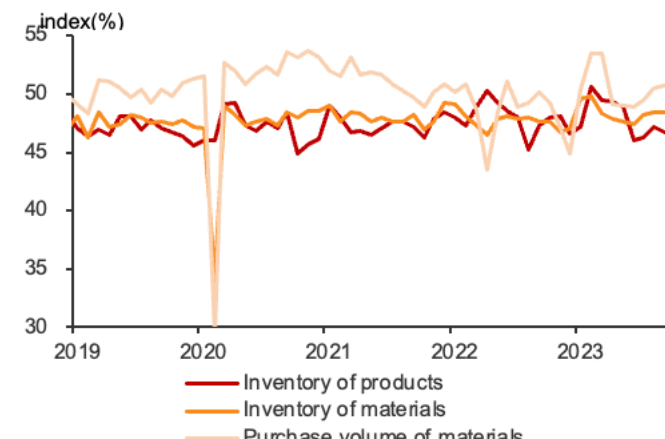
Source: WIND, CMBIGM

Figure 3: Export Order Index and Import Index



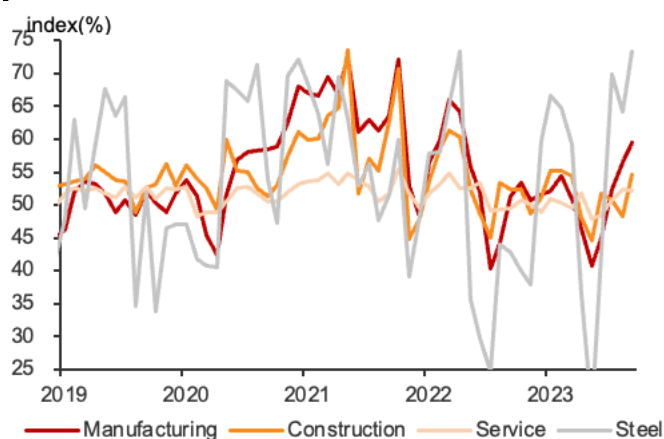
Source: WIND, CMBIGM

Figure 4: Inventory Index



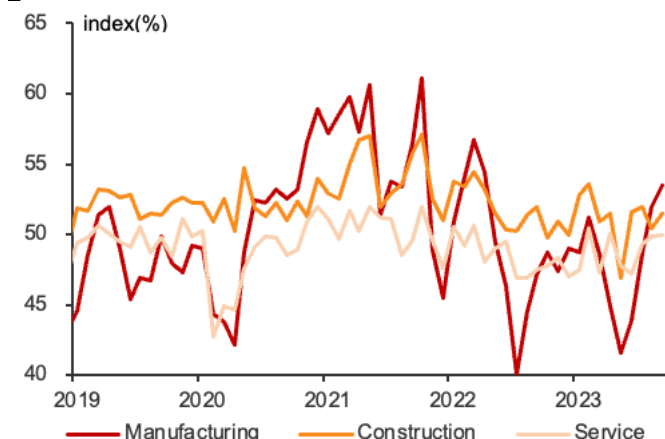
Source: WIND, CMBIGM

Figure 5: Material Purchase Price Index



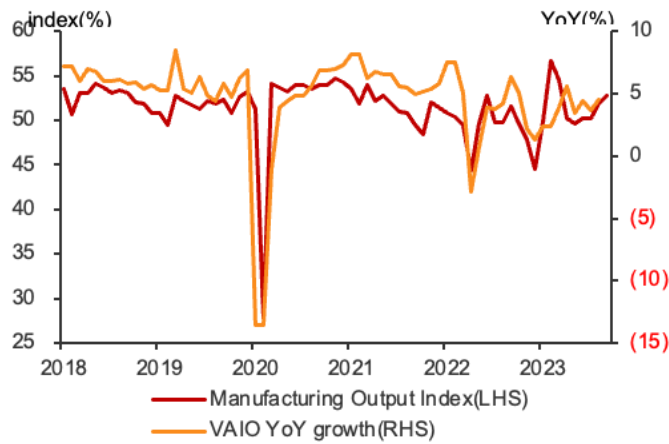
Source: WIND, CMBIGM

Figure 6: Ex-factory Price Index



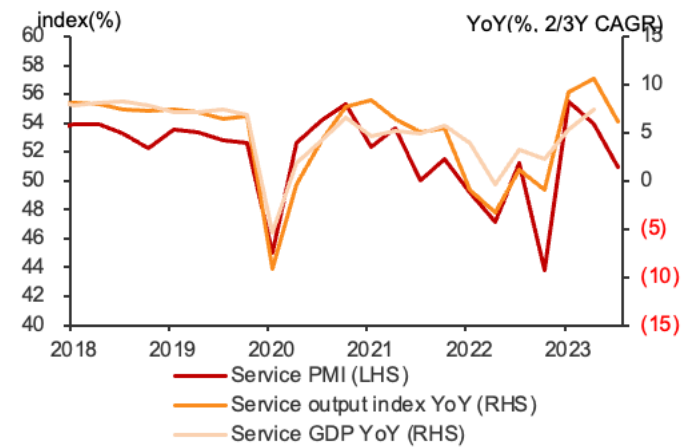
Source: WIND, CMBIGM

Figure 7: Manufacturing Output Index



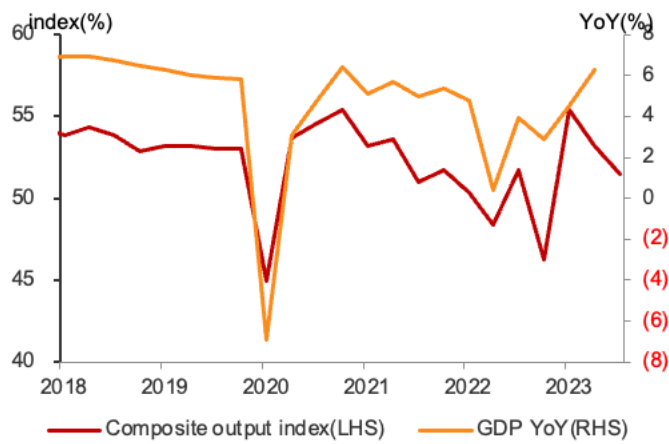
Source: WIND, CMBIGM

Figure 8: Service PMI & Output Index



Source: WIND, CMBIGM

Figure 9: Composite Output Index



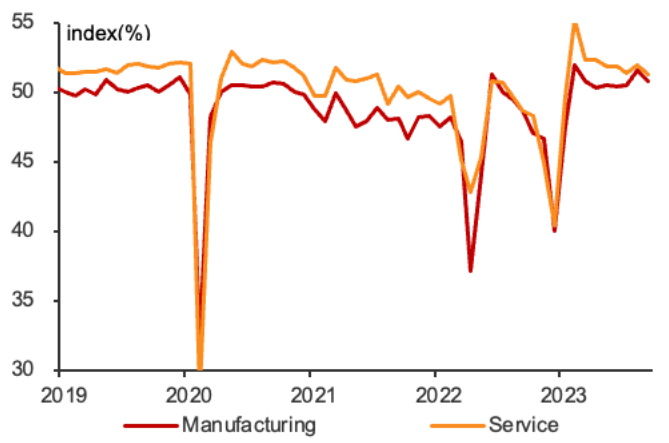
Source: WIND, CMBIGM

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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