

China Economy

Going through the darkness before dawn

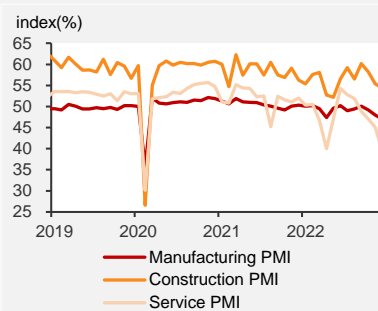
China's PMI sharply declined in December to the lowest since February 2020 as the virus outbreak after reopening prompted people to stay home and businesses to close. Output, new orders and employment all contracted, while the delivery times of suppliers increased due to temporary supply disruptions. We believe China is going through the darkness before dawn after reopening as the pandemic may have peaked in most cities recently. Population mobility and outdoor activities should gradually improve from January, pointing to the first wave of resumption in some consumer goods and services ahead. China's reflation pressure after reopening should be moderate as domestic demand resumption is gradual, overseas demand softens and the pandemic has limited impact on the labor participation. China will maintain easing monetary policy and proactive fiscal policy in 2023. Meanwhile, new leaders will take efforts to stabilize property market and boost business confidence. We expect the GDP growth to rebound from 2.7% in 2022 to 5.1% in 2023.

- PMI slumped to the lowest since February 2020.** PMI in manufacturing and service respectively dropped from 48% and 45.1% in November to 47% and 39.4% in December, the lowest since February 2020. The indexes in retail trade, road transportation, accommodation, catering and inhabitant service dropped to below 35% in December as those sectors are quite sensitive to population mobility. PMI in food and medicine remained above 50% because of stable demand in those staple sectors. PMI in construction slowed from 55.4% in November to 54.4% in December, yet still above 50% thanks to strong growth of infrastructure investment. PMI in air transportation rebounded to above 60% in December as the number of flights increased noticeably after reopening. PMI in telecom service, internet service and financial service also remained above 50% as demand in those sectors was relatively stable. Looking forward, PMI in most service sectors will gradually rebound along with the improvement of population mobility and confidence.
- Overseas and domestic demand deteriorated.** New order index significantly dropped from 46.4% in November to 43.9% in December. Both overseas demand and domestic consumption deteriorated with downside pressure on most manufacturing industries. The export order index and import index respectively decreased from 46.7% and 47.1% in November to 44.2% and 43.7% in December. The sharp decline of population mobility also cooled down service activity. New order index in service slumped from 41.4% in November to 37.4% in December. However, new order index in construction and steel product rose from 46.9% and 34.5% in November to 48.8% and 38.9% in December, indicating less downside pressure in those sectors.
- Material cost rebounded with temporary supply disruptions.** Material cost index in manufacturing & construction reached 51.6% and 51.2% in December, up from 50.7% and 48.7% in November. Steel product sector saw a significant rise of material cost index from 38% in November to 59.8% in December. The increase of material costs may be due to two causes. First, China's reopening boosted the sentiment and demand prospect in commodity market. Second, the virus outbreak after reopening caused temporary supply disruptions, as some workers had to stay at home after being infected. However, we believe China's reflation pressure after reopening should be moderate. For one thing,

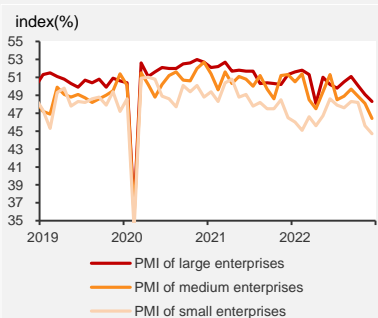
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Source: NBS, CMBIGM

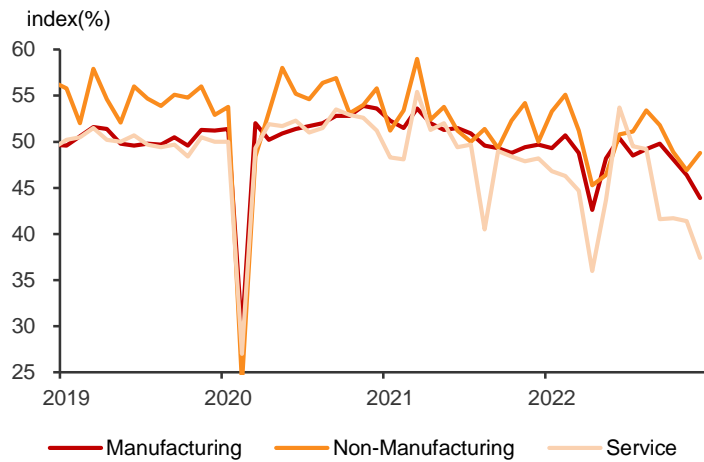


Source: NBS, CMBIGM

the resumption of domestic demand especially in housing and durables should be gradual without overheating risk. Overseas demand should significantly decline as the recession is coming. For another thing, the pandemic has very limited impact on the labor participation in China due to high unemployment pressure. The employment index in manufacturing and service significantly dropped from 47.4% and 45.2% in November to 44.8% and 42.4% in December, the lowest since February 2020. We note the ex-factory price indexes in both manufacturing and service remained weak in December. We expect China's CPI to increase 2.2% in 2023 after rising 2% in 2022. The PPI is expected to drop 0.5% in 2023 after increasing 4.3% in 2022.

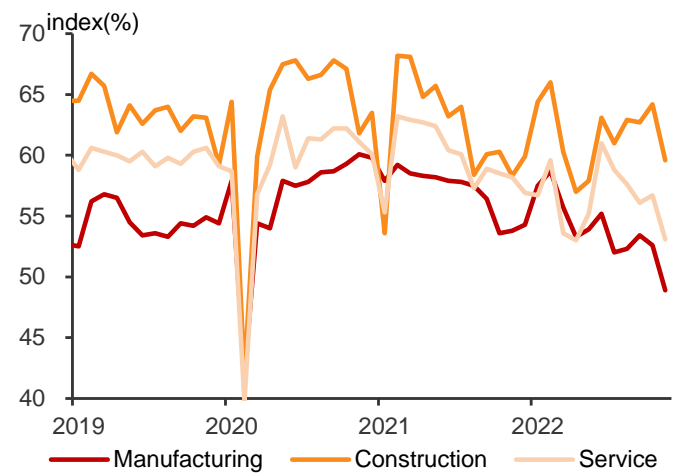
- **China economy is in a gradual resumption in 2023-2024.** China economy is bracing for a gradual resumption while overseas economy is moving from stagflation into a recession. China's new leaders are trying to reopen economy, stabilize property market and restore market confidence as soon as possible with a pro-business stance. China's monetary policy remains accommodative with ample liquidity supply and easing credit policy. The PBOC may further cut RRR & LPRs for 1-2 times. US/RMB rates may decline from 6.9 at end-2022 to 6.65 at end-2023. Fiscal policy will be more proactive with broad deficit ratio up from 5.8% in 2022 to 6.2% in 2023 and policy banks' special loans & SOEs' debt continue to expand. We expect China's GDP growth would rise from 2.7% in 2022 to 5.1% in 2023. Health care, transportation, catering, travel, hotel & recreation services should see a rapid recovery, while durables & housing market may have a gradual resumption.

Figure 1: New Order Index



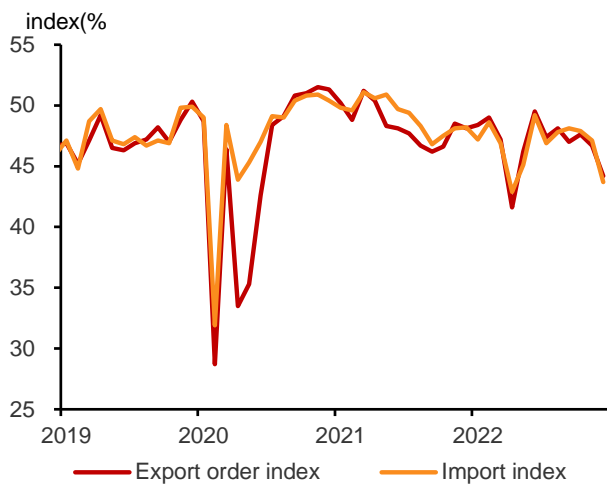
Source: NBS, CMBIGM

Figure 2: Business Expectation Index



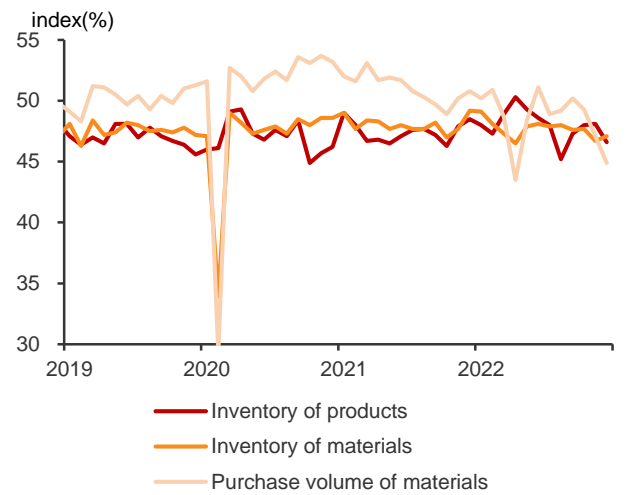
Source: NBS, CMBIGM

Figure 3: Export Order and Import Index



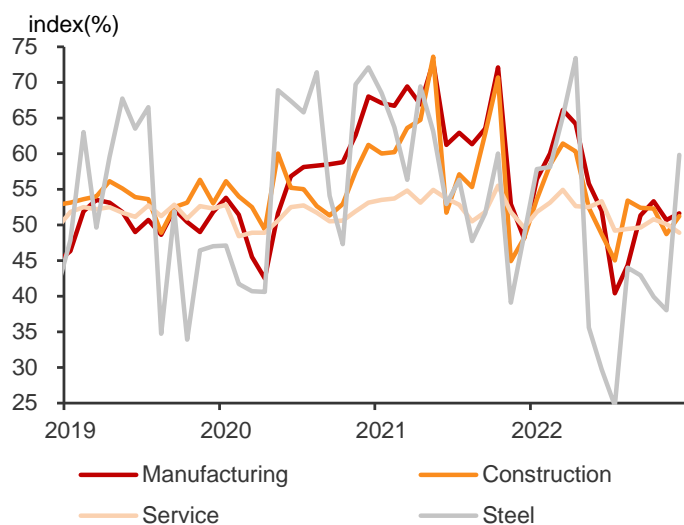
Source: NBS, CMBIGM

Figure 4: Inventory & Material Purchase Index



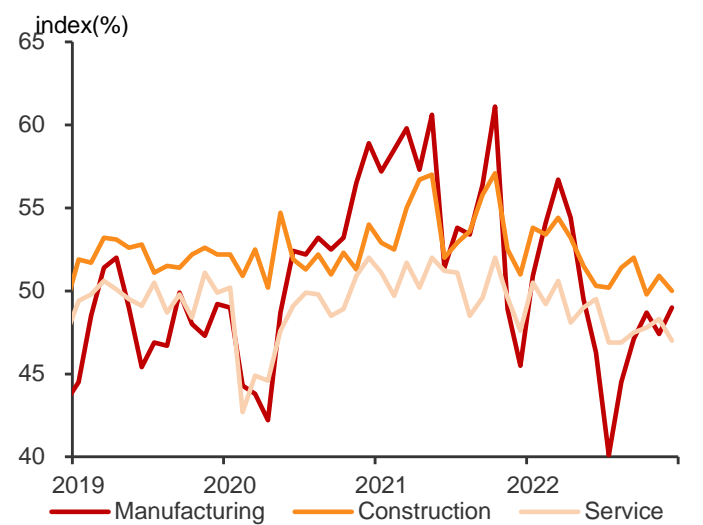
Source: NBS, CMBIGM

Figure 5: Material Cost Index



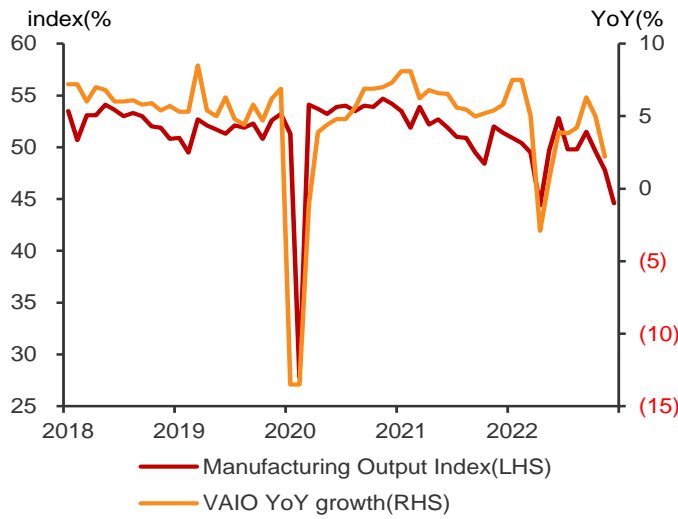
Source: NBS, CMBIGM

Figure 6: Ex-factory Price Index



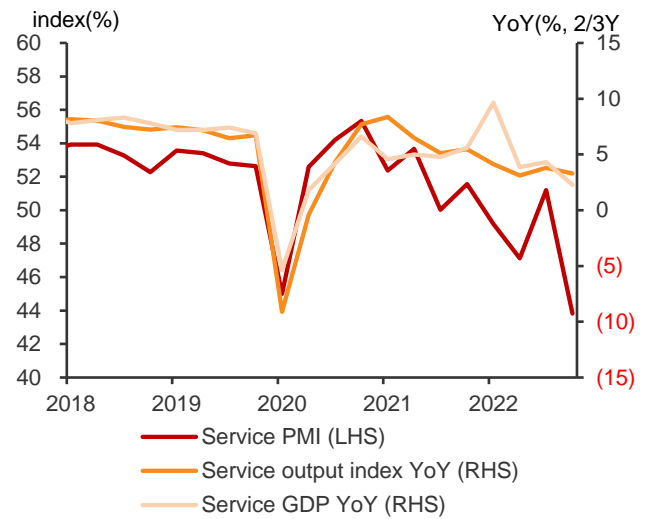
Source: NBS, CMBIGM

Figure 7: Manufacturing Output Index



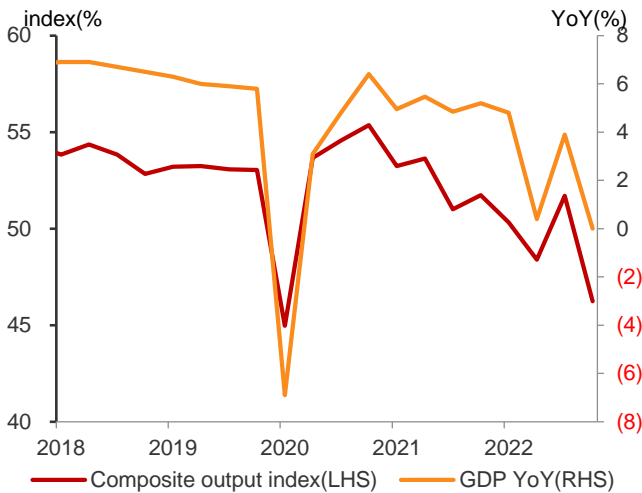
Source: NBS, CMBGM

Figure 8: Service Output Index



Source: NBS, CMBGM

Figure 9: Composite Output Index



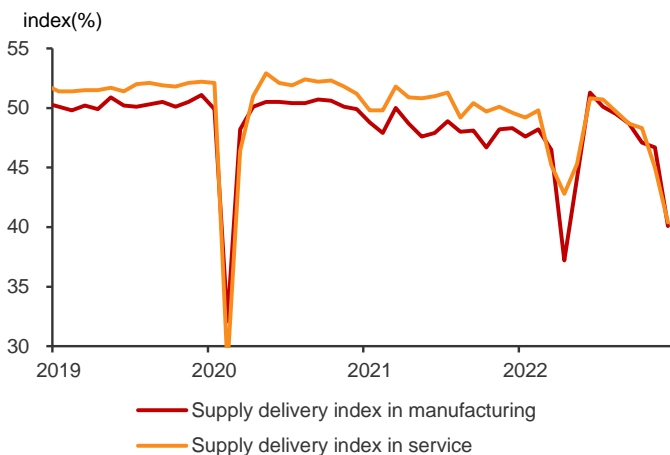
Source: NBS, CMBGM

Figure 10: Employment Index



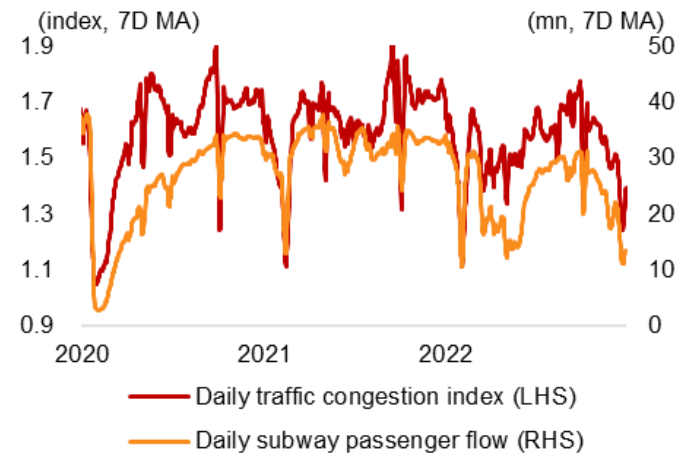
Source: NBS, CMBGM

Figure 11: Supply Delivery Index



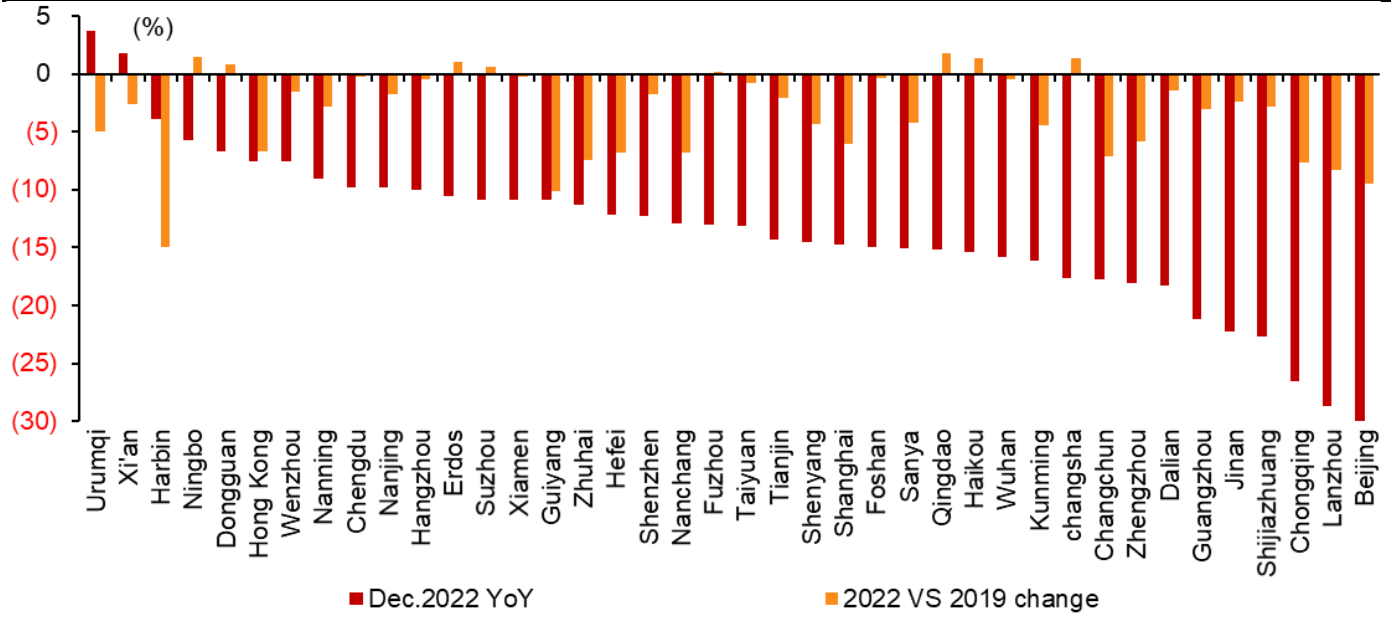
Source: NBS, CMBGM

Figure 12: Traffic Flow Index in Shanghai



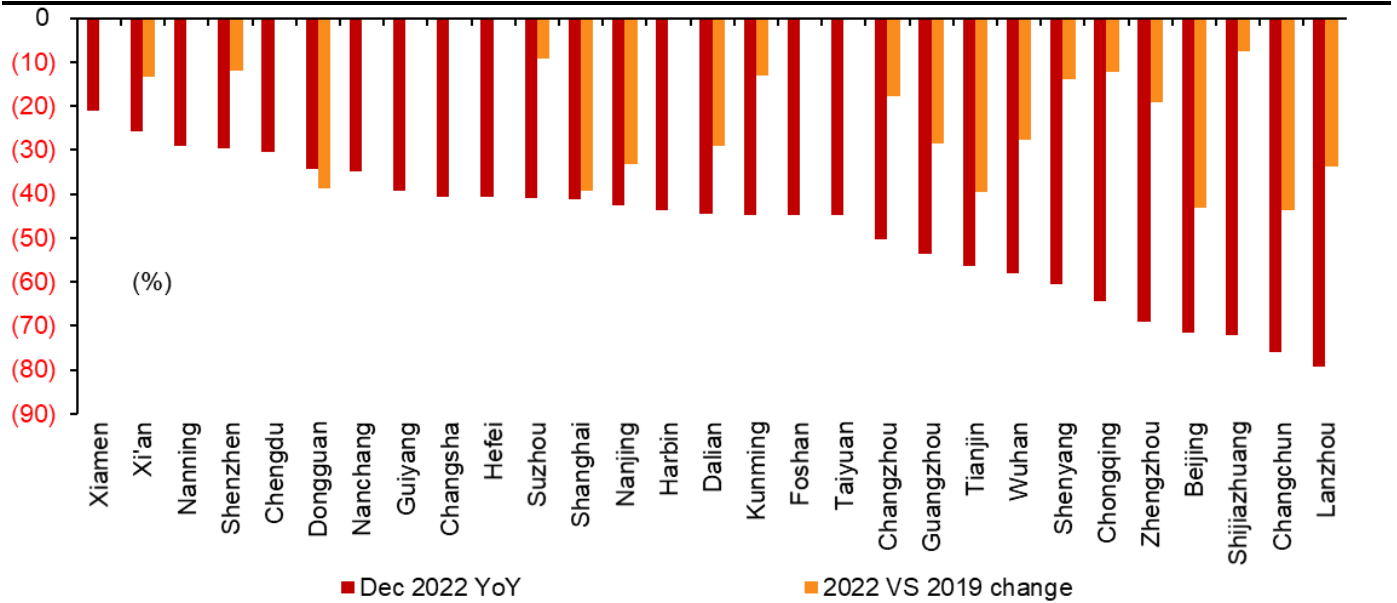
Source: Wind, CMBGM

Figure 13: Change of Traffic Congestion Index in Main Cities



Source: Wind, CMBIGM

Figure 14: Change of Subway Passenger Flow in Main Cities



Source: Wind, CMBIGM

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