

China Economy

PMI signals weak demand & continuous deflation

China's manufacturing PMI subtly edged up in Jan yet remained in contraction for the fourth consecutive month. The production index modestly improved while new order and export order continued to contract as demand remained weak. Inventory and material purchase indexes remained in contraction as businesses were cautious to increase inventory amid weak demand prospect. Service PMI came out of the woods while construction slowed down. Ex-factory price indexes in manufacturing and service further contracted, indicating escalated deflation pressure in Jan. Employment remained acute as private business confidence was still weak. Considering the experience from Japan in 1990s, faltering economy with asset price decline and real sector deflation require more aggressive policy support before it is too little too late, including drastic and unconventional monetary easing, fiscal expansion and structural reform. Looking forward, the PBOC may lower LPRs by 10 or 20 bps in February and further cut deposit rates to alleviate the pressure on banks' NIMs. The authority may further lower mortgage rates for first-home buyers and municipal governments may continue to loosen home purchase restrictions in future to boost housing market. The MoF would moderately increase the magnitude of fiscal policy as broad fiscal deficit is expected to rise from 6.4% of GDP in 2023 to 7% of GDP in 2024. We maintain our forecast for GDP growth at 4.8% in 2024.

- Manufacturing activities continued to shrink with weak demand.** China's manufacturing PMI came in below expectation and marginally rebounded to 49.2% in Jan from 49% in Dec, contracting for the fourth consecutive month. Production index rose to 51.3% from 50.2% in Dec. New order and export order further contracted but at a slower pace, edging up to 49% and 47.2% in Jan from 48.7% and 45.8% in Dec; while existing orders further dropped to 44.3%, showing limited signs of alleviation from the demand side. Material purchase volume and import order marginally picked up from 49% and 46.4% to 49.2% and 46.7%, indicating still-soft corporate procurement activities. Raw materials inventory continued to decline from 47.7% to 47.6% in Jan while finished goods inventory notably increased from 47.8% to 49.4. Breaking down by sector, new order indexes in equipment manufacturing, high-tech manufacturing and consumer goods reached above 50%, while most industries indicated insufficient market demand. PMI of medium and small enterprises remained in contraction while large enterprises rebounded and resumed expansion.
- Deflation pressure may escalate due to weakening demand and overcapacity of supply.** Ex-factory price index further dropped to 47% in Jan from 47.7% in Dec, while manufacturing material purchase price eased to 50.4% from 51.5%, indicating that PPI may have remained in severe deflation in Jan. Service price index stayed in contraction and inched down to 49.2%, while construction price slowed down to 50.4% from 51.7%. Looking forward, China's CPI and PPI still face downward pressure in the short term due to slack demand and supply overcapacity.
- Service sector came out of the woods while construction slowed down.** Non-manufacturing PMI inched up to 50.7% from 50.4%. PMI in service rebounded to 50.1% from 49.3%, back to expansionary territory. Breaking down by sector, activities in retails, land & air transportation and catering services resumed expansion while rail transportation, postal service and

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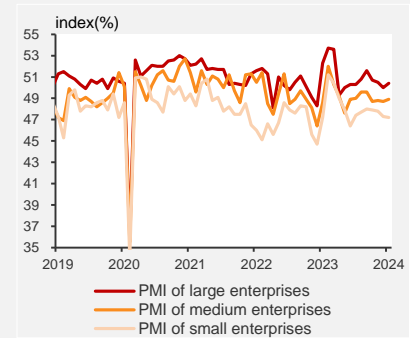
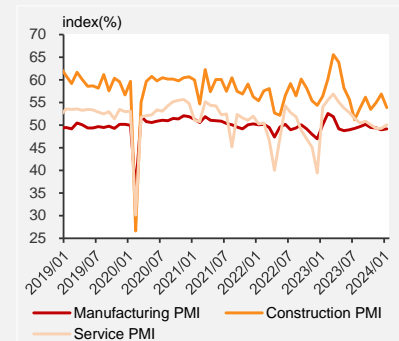
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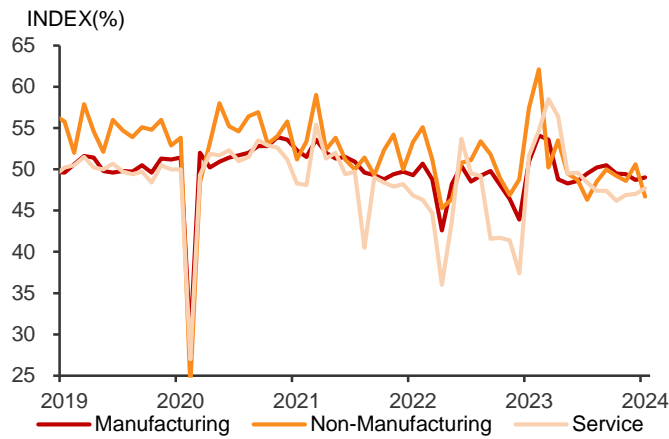
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money market service remained above 60%. Capital market service and real estate remained in contraction. Construction PMI slowed down to 53.9% from 56.9, in line with the deceleration of government bond issuance in Jan. Business sentiment indexes in construction and services both slightly dropped but remained in expansion zones.

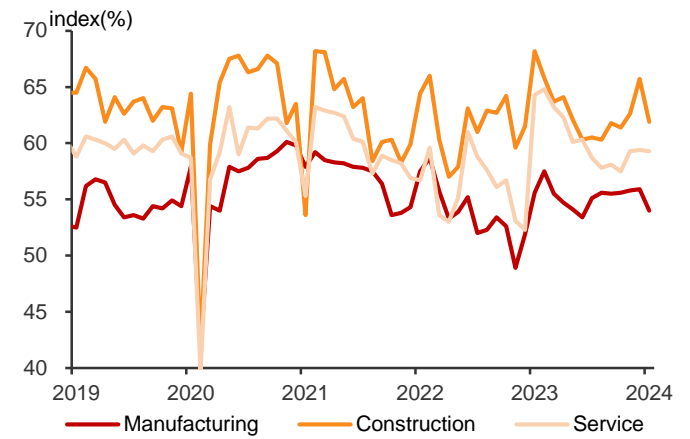
- **Employment remained acute.** Employment indexes in manufacturing and service further contracted at 47.6% and 46.4% from 47.9% and 46.3% in Dec. Employment in construction dropped to 50.1% from 51.7%. The sluggish employment condition showed that private sector is yet to gain significant momentum in driving economic recovery.
- **The faltering economy requires more aggressive policy support.** Policymakers have ramped up policy support recently by cutting RRR, stabilizing financial markets and loosening property policies. But China needs more aggressive policy moves as continuous asset price slump and real sector deflation could easily turn into a downward economic spiral. Given Japan's experience in 1990s, China needs a package of strong policies including aggressive mortgage rate cuts, substantial fiscal transfers to households and market-oriented structural reforms. Looking forward, we expect the PBOC to cut LPRs by 10 or 20 bps in Feb and to further lower deposit rates in future to alleviate the pressure on banks' NIMs. The authority may also lower mortgage rates for first-home buyers and municipal governments may continue to loosen home purchase restrictions. The MoF would moderately increase the magnitude of fiscal policy as broad fiscal deficit is expected to rise from 6.4% of GDP to 7% of GDP in 2024. We maintain the GDP forecast for 2024 at 4.8%.

Figure 1: New Order Index



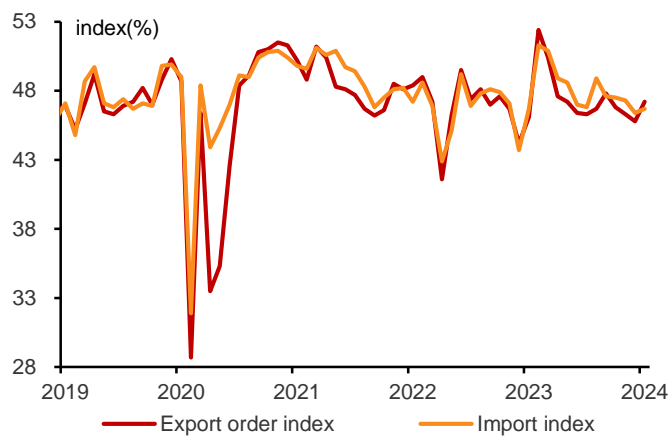
Source: Wind, CMBIGM

Figure 2 : Business Sentiment Index



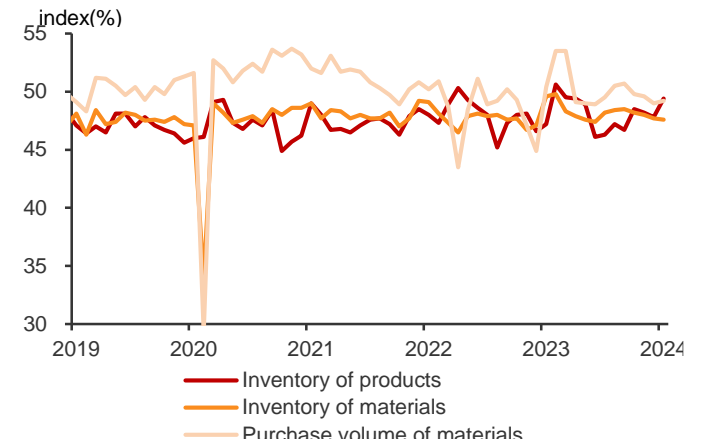
Source: Wind, CMBIGM

Figure 3: Export Order Index and Import Index



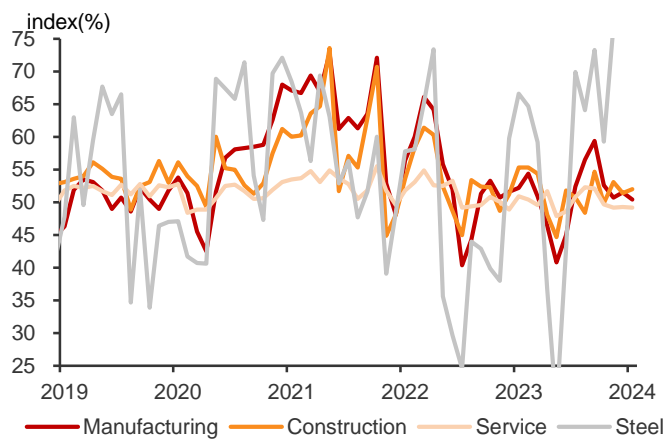
Source: Wind, CMBIGM

Figure 4: Inventory Index



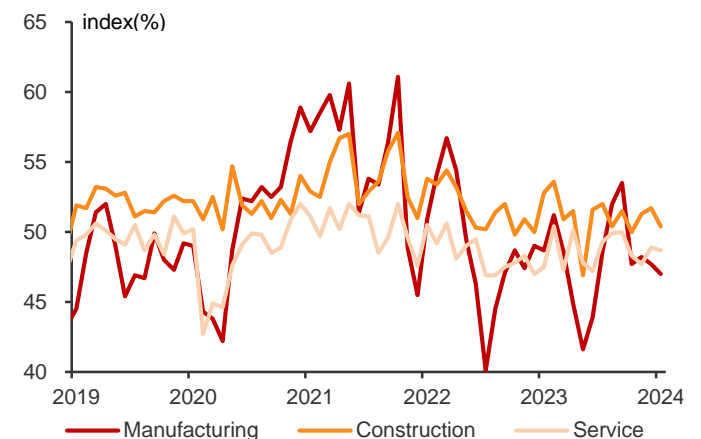
Source: Wind, CMBIGM

Figure 5: Material Purchase Price Index



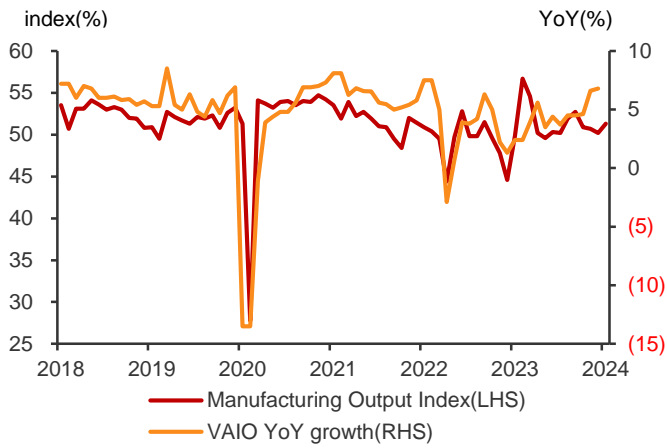
Source: Wind, CMBIGM

Figure 6: Ex-factory Price Index



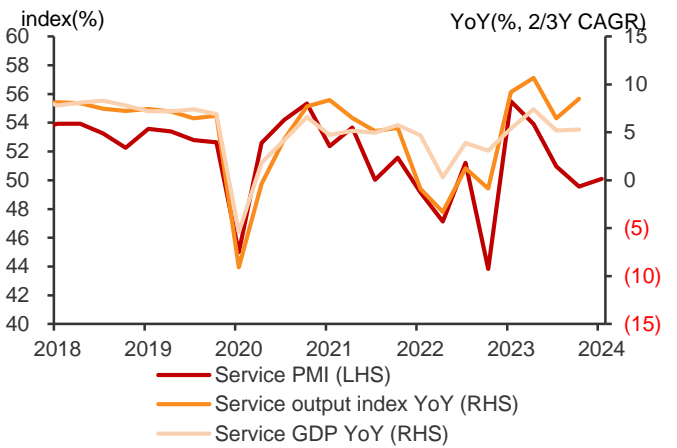
Source: Wind, CMBIGM

Figure 7: Manufacturing Output Index



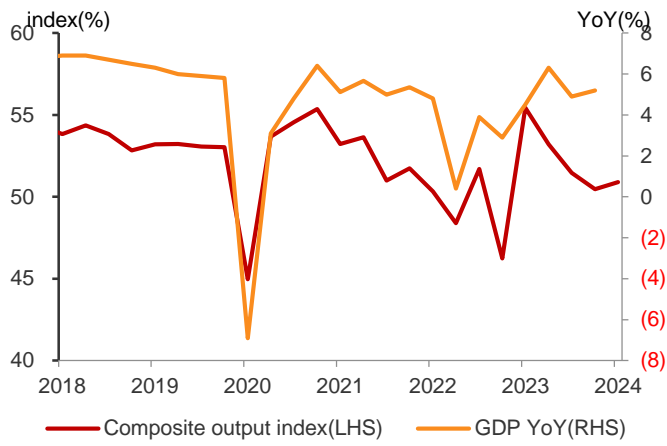
Source: Wind, CMBIGM

Figure 8: Service PMI & Output Index



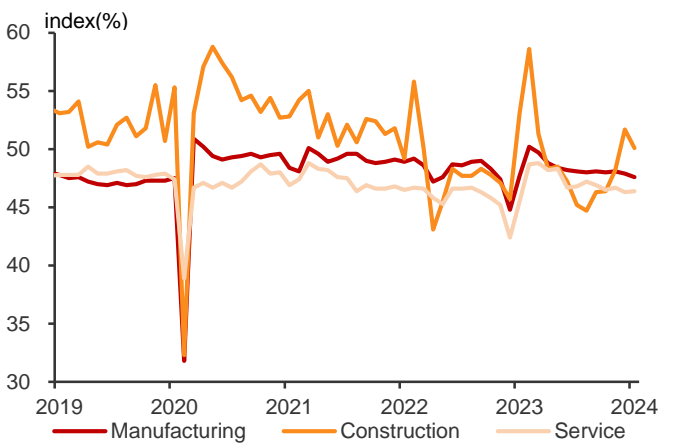
Source: Wind, CMBIGM

Figure 9: Composite Output Index



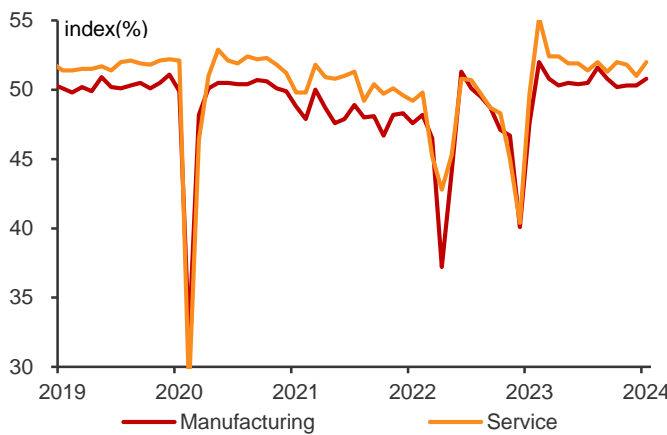
Source: Wind, CMBIGM

Figure 10: Employment Index



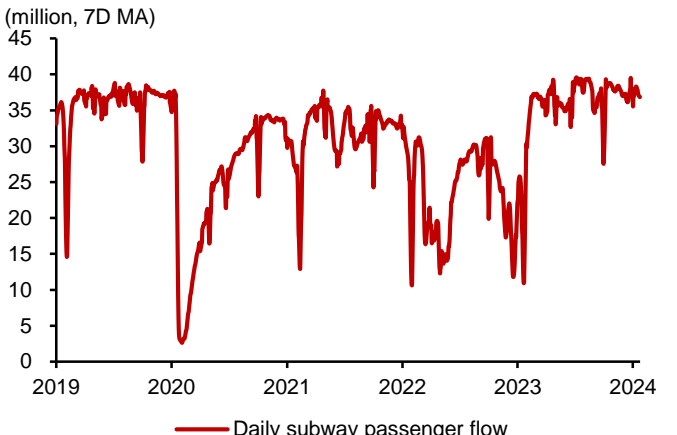
Source: Wind, CMBIGM

Figure 11: Supply Delivery Index



Source: Wind, CMBIGM

Figure 12: Subway passenger flow in tier-1 cities



Source: Wind, CMBIGM

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