

China Economy

Economy further weakens with gradual policy easing ahead

China's manufacturing activities experienced another contraction in June, falling below market expectations. However, service sector continued to expand, albeit at a slower pace compared to previous months. There was a slight improvement in the new order index with less decline in ex-factory prices, but export order index and import index further deteriorated. In response to these economic dynamics, Chinese policymakers moderately eased policy with additional LPR cut by 10bps and possible specific measures to boost home-related consumption. With continuous recovery in service activity and moderate policy easing, China's economy may mildly improve with a pick-up in 2Y CAGR of GDP in 2H23. We maintain our forecast on China's GDP growth at 5.7% for 2023 and 4.8% for 2024.

- **Manufacturing activities further contracted in June as post-recovery growth lost more momentum.** China's PMI in manufacturing slightly improved in June to 49.0% from 48.8% in May, while still remaining in the contraction territory. New order index in manufacturing also slightly improved to 48.6% in June from 48.3% in May. Breaking down by sector, indexes in automobile, railway & other transport equipment, and electrical equipment remained in the expansionary range. Export and import indexes both declined in June to 46.4% and 47.0% from 47.2% and 48.6% in May, showing faltering demand both domestically and globally.
- **Service activities continued to expand but showed signs of slowdown.** PMIs in construction and service declined from 58.2% and 53.8% in May to 55.7% and 52.8% in June, respectively. China's consumer spending slowed down after a robust rebound in 1Q23, while property sector remained under stress. New order index in construction sector declined to 48.7% in June from 49.5% in May, while that in service sector slightly improved to 49.6% in June from 49.5% in May. By sector, indexes in air transport, postal services, telecom service, TV & broadcast, financial and insurance services remained above 60%.
- **Deflation pressure tended to ease as ex-factory price saw less decline.** Ex-factory price index in manufacturing improved to 43.9% in June from 41.6% in May, while that in construction improved significantly to 51.6% in June from 46.9% in May and service price index dropped slightly. Product and material inventory indexes declined again from 48.9% and 47.6% in May to 46.1% and 47.4% in June, respectively, as businesses strived to keep inventories at low levels. Looking forward, we expect CPI and PPI to mildly rebound in 2H23-2024.
- **Youth unemployment surged to record high as private businesses were reluctant to expand.** Employment index in manufacturing dropped to 48.2% in June from 48.4% in May. Unemployment rate among youth and fresh graduates jumped to 20.8% in May from 20.4% in April, and this trend is expected to continue as more young job seekers are set to enter the labor market upon graduation.
- **China may gradually loosen policy as the economy may mildly improve in 2H23.** The deterioration of economic activities and market confidence in 2Q23 has made policymakers to review their optimistic views on China's economy in April. The PBOC announced LPR cut by 10bps, pointing to

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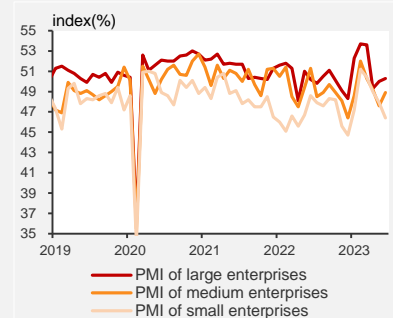
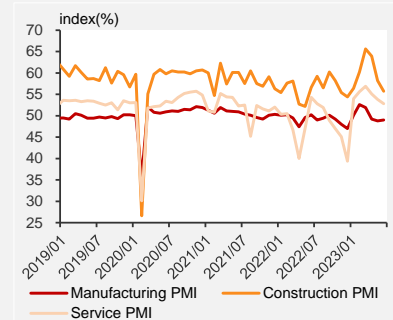
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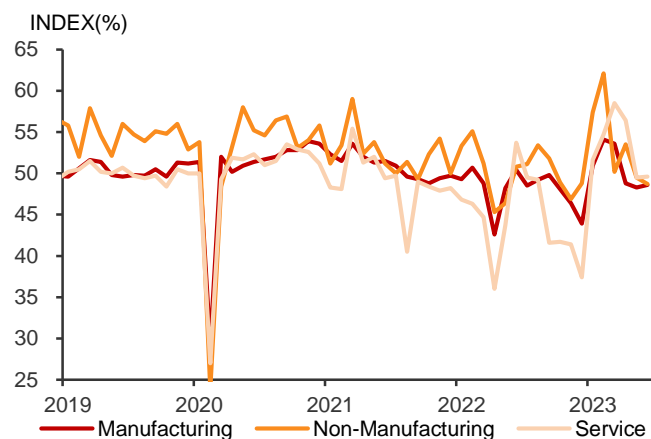
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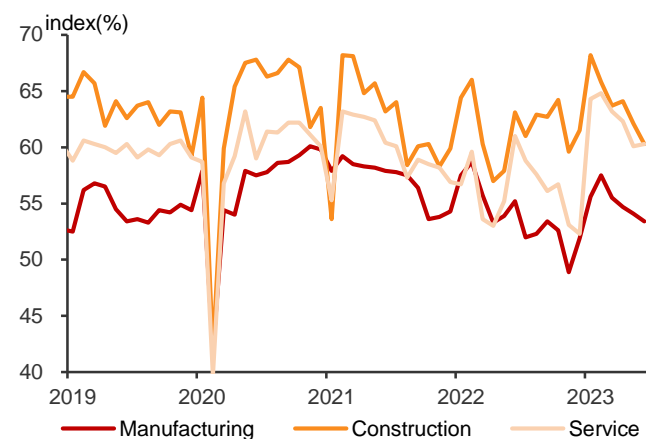
moderate policy easing ahead. The State Council said to take specific measures to promote consumption of home decoration, furniture and home appliances. Possible measures include individual tax deduction with limit for specific consumption or fiscal subsidy to households to update their old appliances with new ones. Meanwhile, more cities will moderately loosen property policies in the second half year. With continuous recovery in service and gradual policy easing, China's economy may mildly improve in 2H23. The 2Y CAGR of GDP may rebound to 4.3% in 2H23 after slowing to 3.9% in 2Q23 from 4.6% in 1Q23.

Figure 1: New Order Index



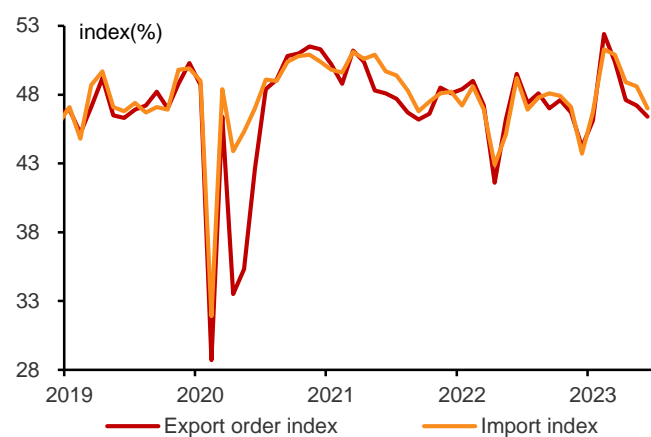
Source: WIND, CMBIGM

Figure 2: Business Sentiment Index



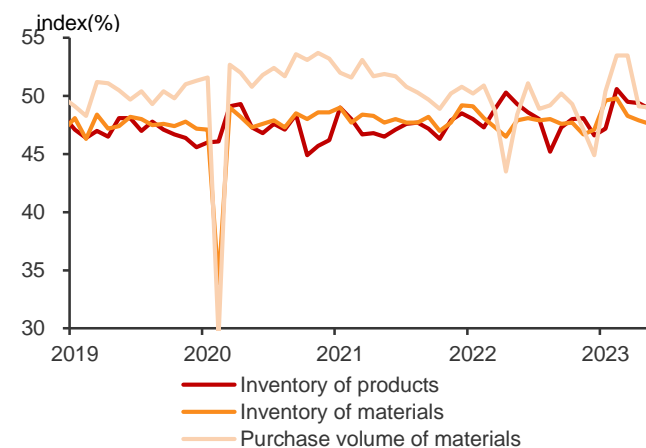
Source: WIND, CMBIGM

Figure 3: Export Order Index and Import Index



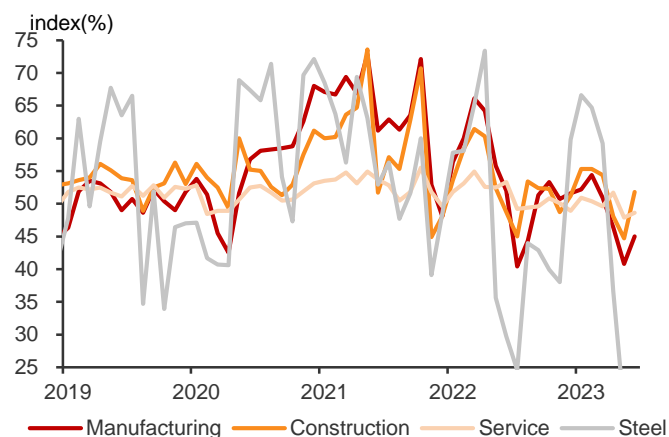
Source: WIND, CMBIGM

Figure 4: Inventory Index



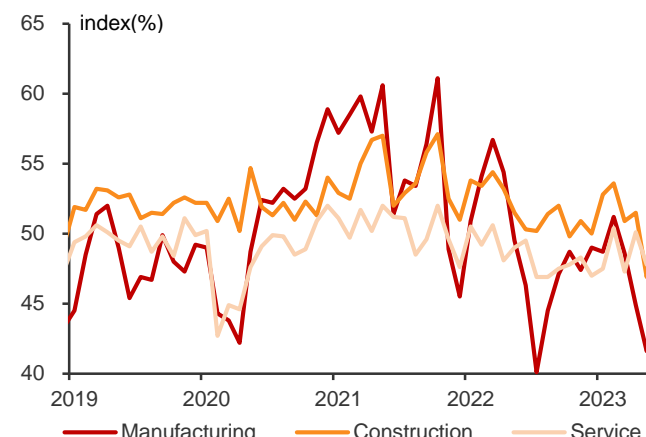
Source: WIND, CMBIGM

Figure 5: Material Purchase Price Index



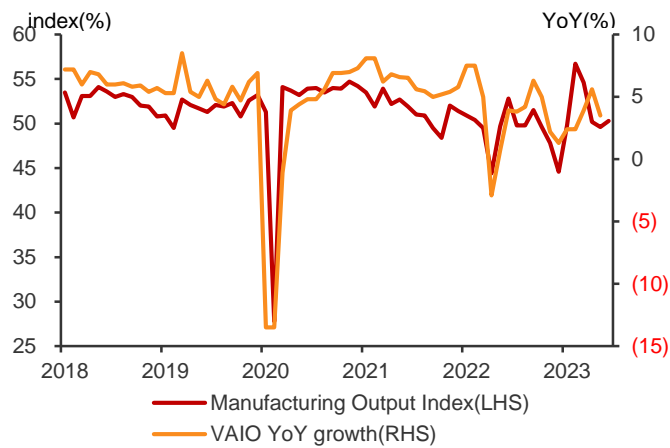
Source: WIND, CMBIGM

Figure 6: Ex-factory Price Index



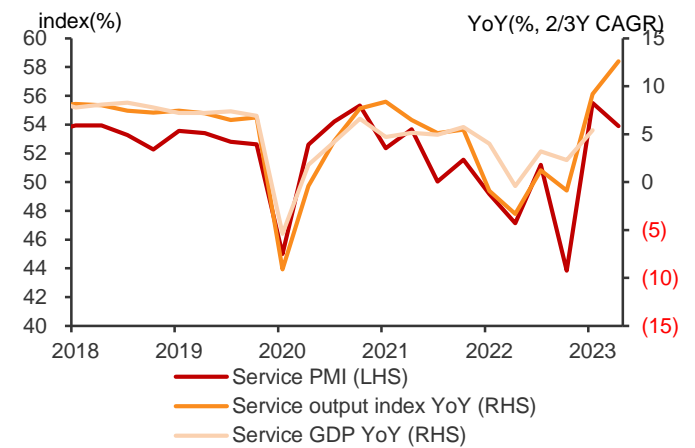
Source: WIND, CMBIGM

Figure 7: Manufacturing Output Index



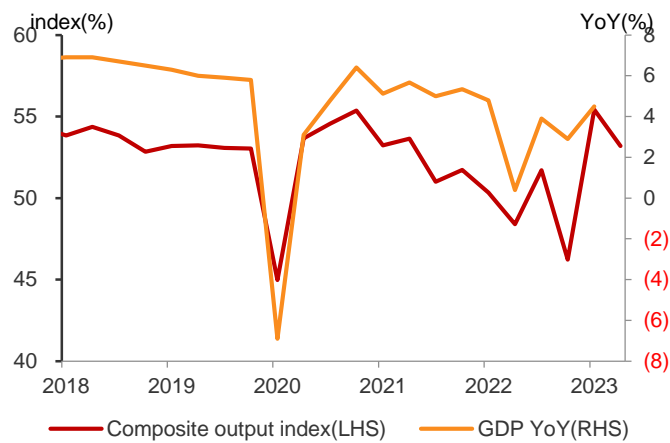
Source: WIND, CMBIGM

Figure 8: Service PMI & Output Index



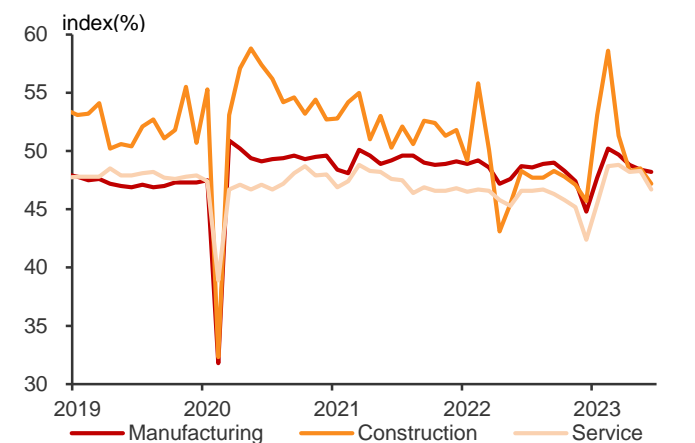
Source: WIND, CMBIGM

Figure 9: Composite Output Index



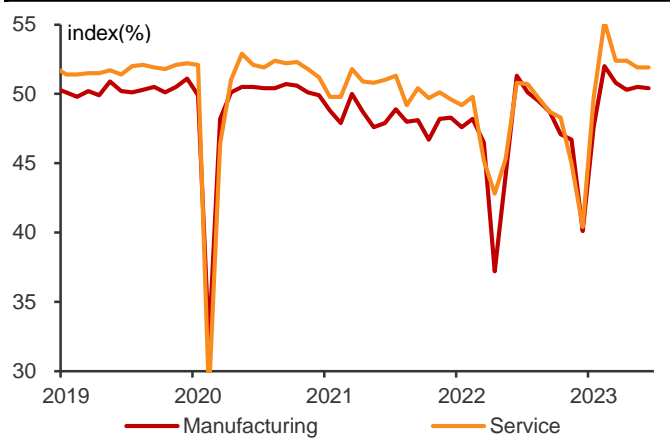
Source: WIND, CMBIGM

Figure 10: Employment Index



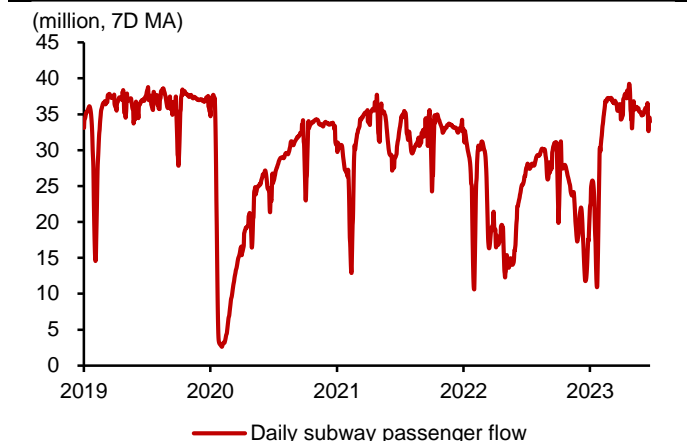
Source: WIND, CMBIGM

Figure 11: Supply Delivery Index



Source: WIND, CMBIGM

Figure 12: Subway Passenger Flow in Tier-1 Cities



Source: WIND, CMBIGM

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