

A mixed picture requires more clarification

China's latest PMI survey has rekindled hopes for a rebound in both manufacturing and construction sectors. The question, however, is whether this upswing signals a genuine revival in domestic demand or merely reflects seasonal tailwinds ahead of the Lunar New Year, and our view leans towards the latter.

Turning to other indicators expected in following weeks, export growth is likely to be constrained by the high base from December 2024, even as trade headwinds ease. Credit expansion is expected to stay sluggish, weighed down by local governments' efforts to resolve debt and the ongoing weakness in investment sentiment. Additionally, China's activity data for December will likely paint a mixed picture—industrial production may show modest improvement, while retail sales and fixed asset investment face persistent headwinds. Consumer inflation will probably edge up slightly on the back of higher vegetable and fruit prices.

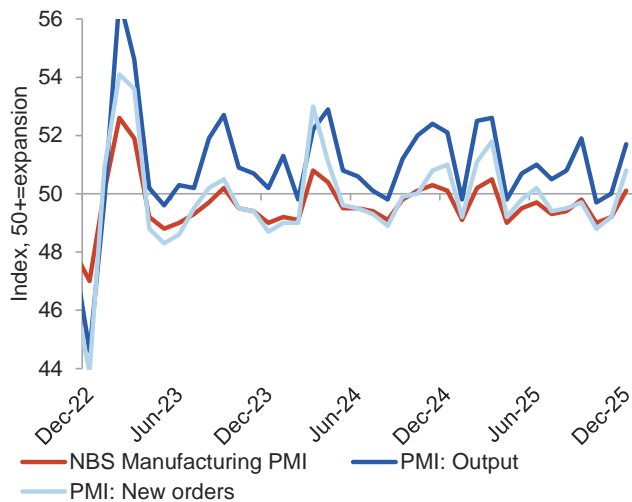
At its annual work conference ended earlier this week, the PBoC reaffirmed its commitment to deploying a range of monetary tools, including cuts to the Required Reserve Ratio and policy rates, in a flexible and efficient manner to foster high-quality growth and guide a reasonable rise in prices. However, we doubt the timing of the next round of easing will be imminent, given Beijing's cautious stance on stimulus and the pressure on bank interest margins. In short, China's economic outlook will probably get worse over the next several weeks before they get better with more forceful government support.

Fig 1 Our forecasts for China's major economic indicators

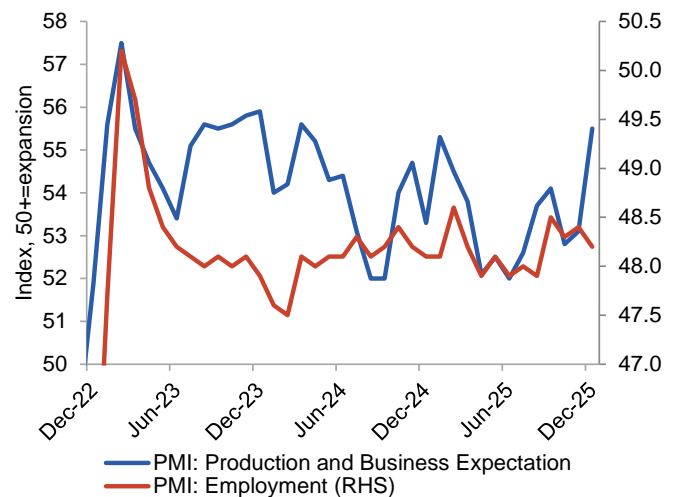
Indicators	Sep	Oct	Nov	Dec (forecast)
Export growth (YoY %)	8.3	-1.1	5.9	2
Import growth (YoY %)	7.4	1.0	1.9	-1
Trade balance (USDb)	90.5	90.1	111.7	114
CPI (YoY %)	-0.3	0.2	0.7	0.8
PPI (YoY %)	-2.3	-2.1	-2.2	-1.8
New loans (CNYb)	1290	220	390	800
Total social financing (CNYb)	3530	816	2489	1800
M2 (YoY %)	8.4	8.2	8.0	7.8
VAI (YoY %)	6.5	4.9	4.8	4.9
Retail sales (YoY %)	3.0	2.9	1.3	1.0
FAI (YTD YoY %)	-0.5	-1.7	-2.6	-3.1
GDP (YoY %)	4.8 (Q3)	--	--	4.4 (Q4)

Source: Bloomberg, Mizuho

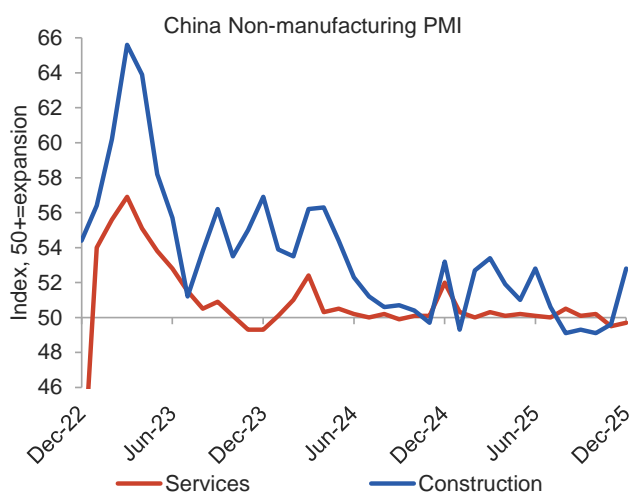
China's **official Manufacturing PMI** for December surprised on the upside and rose above the expansion threshold for the first time in nine months to 50.1. The improvement was broad-based, supported by both demand and supply, with sub-indices for new orders and production rising to 50.8 and 51.7 respectively (Fig 2). However, part of this optimism may be exaggerated, due to ramped up new orders and production ahead of the Chinese New Year holiday. Notably, sectors such as agricultural and food processing, beverages, and refined tea, which are typically boosted by holiday demand, reported exceptionally strong business expectation in December.

Fig 2 A broad-based recovery in China's Manufacturing PMI

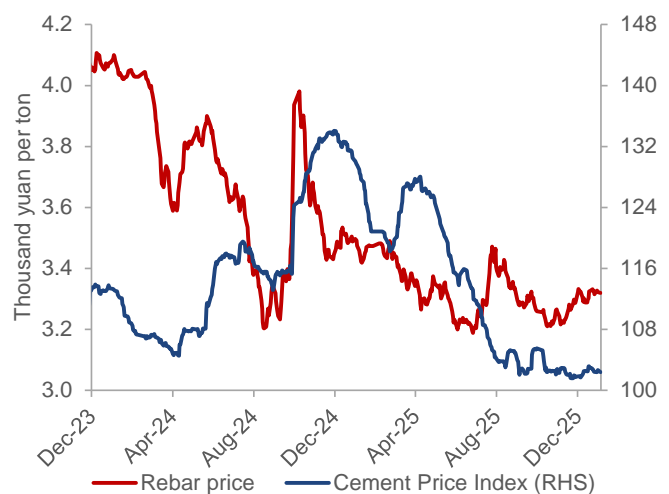
Source: CEIC, Mizuho

Fig 3 Strong business expectation without a rise in employment

In the **non-manufacturing sector**, the PMI also strengthened, reaching 50.2 in December from 49.5 in November. This rebound was driven primarily by a sharp recovery in construction activity, where the PMI surged to a six-month high of 52.8 (Fig 4), aided by favorable weather and accelerated project timelines ahead of the holiday season. Rebar prices, in particular, have risen nearly 4% from their October lows (Fig 5). Meanwhile, the services PMI remained subdued at 49.7, as retail and catering activity continued to contract. In fact, China recorded 142 million domestic trips during the three-day New Year holiday, yet per capita spending was 2.4% below pre-pandemic levels in 2019, underscoring persistently soft consumer sentiment.

Fig 4 Construction PMI surged to a six-month high

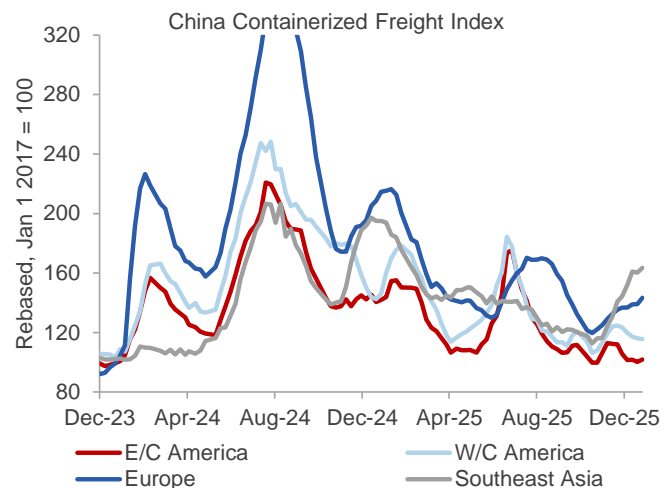
Source: CEIC, Wind, Mizuho

Fig 5 Rebar prices have risen nearly 4% from their October lows

Trade-related PMI indicators suggest easing headwinds in December. The new export orders index climbed to a nine-month high of 49.0, despite continued weakness in the import index (Fig 6). High-frequency shipping data also indicates a sustained recovery in demand for outbound shipments (Fig 7). However, the elevated base from December 2024—driven by concerns over upcoming tariffs under President Trump—will likely result in notably slower export growth this December. Imports are expected to remain subdued.

Fig 6 Improvement was only seen in new export orders

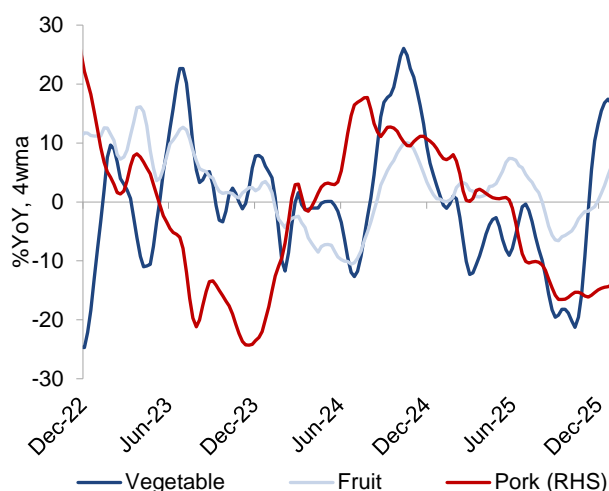
Source: CEIC, Wind, Mizuho

Fig 7 A continued recovery in demand for outbound shipments

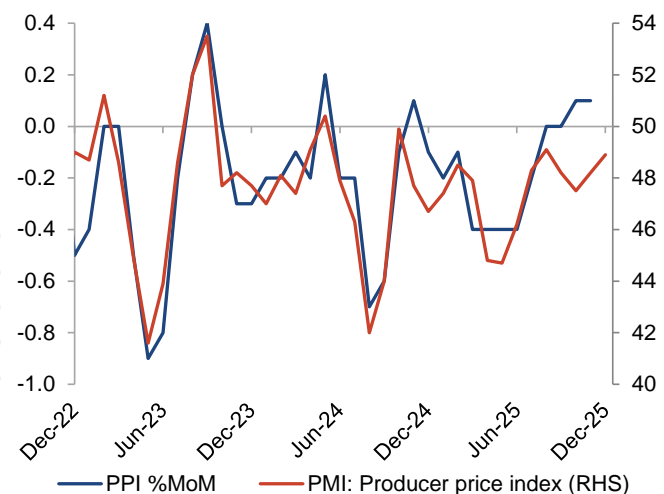
Furthermore, **credit growth** is also likely to moderate further in December. Net loan increase is expected to stay weak as local governments continue to repay their hidden debt with proceeds raised from bond issuance and investment sentiment remains soft. Net government bond issuance is projected to decline to around RMB 500 billion in December, down roughly 60% MoM and 70% YoY. Consequently, M2 growth should slow moderately, despite the PBoC boosted net liquidity injections to RMB803b during the month, more than double November's RMB314b.

Meanwhile, **activity indicators** are expected to be mixed. **Industrial production** will likely accelerate modestly YoY in December, reflecting improvements in manufacturing PMI. **Retail sales** growth, however, is expected to remain sluggish due to last year's high base, when the government's trade-in subsidies were introduced. Year-to-date **fixed asset investment** (FAI) is anticipated to decline at a faster pace. While the monthly contraction may ease slightly from the -12% YoY in the past two months, the YTD decline is expected to deepen.

Deflationary pressures persist. **Consumer inflation** is likely to edge higher in December, driven by rising vegetable and fruit prices. High-frequency data shows fresh vegetable and fruit prices increased by 17% and 6% YoY, respectively (Fig 8). Non-food inflation should remain supported by price gains earlier this year, particularly in precious metals. **On the producer side**, deflationary pressure may slightly ease, with the PMI producer price index rising to a four-month high of 48.9 in December, albeit below the expansion threshold of 50 (Fig 9).

Fig 8 Both fresh vegetables and fruits led to faster CPI increase

Source: CEIC, Mizuho

Fig 9 Deflationary trends continued in the producer segment

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