Mizuho China Macro

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Divergence Remains the Theme

Divergence remains the defining theme of China's economy. The official Manufacturing PMI for May points to little improvement in overall sentiment from April, while sector performance remains highly uneven: high-tech and equipment manufacturing continued to outperform, but consumer goods and basic raw materials weakened further.

Looking ahead to other May indicators, we expect trade growth to remain broadly resilient, supported by steady external demand. The gap between PPI and CPI inflation is likely to widen further, as manufacturers struggle to pass higher input costs downstream amid still-subdued domestic demand. This margin compression should have weighed on May industrial activity. Credit and investment demand also likely remained soft, pushing onshore rates lower despite liquidity withdrawals by the PBoC.

Against this backdrop, we expect the PBoC to favor targeted liquidity support over broad-based easing for now. A shift toward more aggressive easing would likely require a further squeeze on corporate margins, potentially triggered by escalating Middle East tensions or fading prospects for a near-term US-Iran peace agreement.

Fig 1 Our forecasts for China's major economic indicators

Indicators	Feb	Mar	Apr	May (forecast)
Export growth (YoY %)	39.6	2.5	14.1	**13**
Import growth (YoY %)	13.8	27.8	25.3	**28**
Trade balance (USDb)	90.8	51.1	84.8	**84**
CPI (YoY %)	1.3	1.0	1.2	**1.2**
PPI (YoY %)	-0.9	0.5	2.8	**4.0**
New loans (CNYb)	900	2990	-10	**450**
Total social financing (CNYb)	2384	5227	625	**1700**
M2 (YoY %)	9.0	8.5	8.6	**8.5**
VAI (YoY %)	6.3 (Jan-Feb)	5.7	4.1	**3.8**
Retail sales (YoY %)	2.8 (Jan-Feb)	1.7	0.2	**-1.0**
FAI (YTD YoY %)	1.8 (Jan-Feb)	1.7	-1.6	**-3.0**

Source: Bloomberg, Mizuho

China's official **Manufacturing PMI** eased to 50.0 in May, pointing to muted sentiment improvement from April weighed by weakness in new orders (Fig. 2). Beneath the headline, however, sector performance remained highly uneven. By industry, high-tech and equipment manufacturing continued to outperform, with PMIs rising to 52.9 and 52.1, respectively, marking the strongest readings since 2024 and 2023. In contrast, consumer goods and basic raw materials lagged, with both sectors slipping below the expansion threshold of 50 (Fig. 3).

Fig 2 Manufacturing PMI weighed by softness in new orders

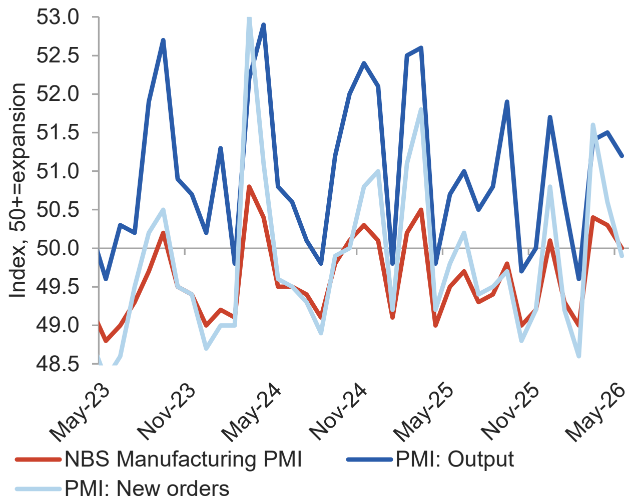
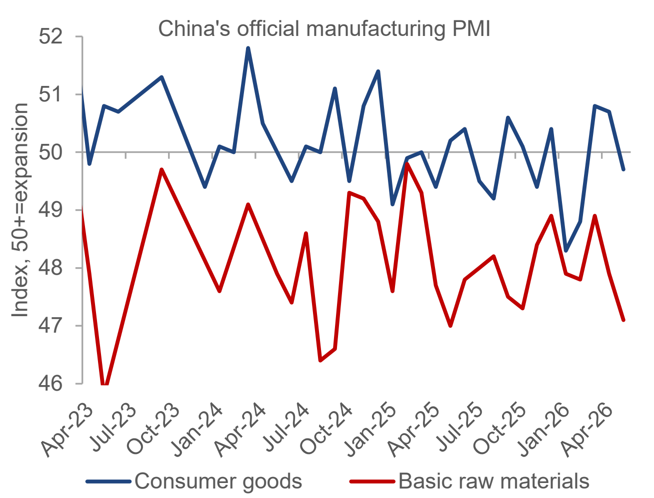


Fig 3 Consumer goods and raw materials underperformed in May



Source: CEIC, Mizuho

Divergence was also evident across firm sizes. Large manufacturers remained resilient, with PMI readings holding above 51, while small and medium-sized ones fell back into contraction territory (Fig. 4). This likely reflects SMEs' greater exposure to rising input costs and margin compression.

Meanwhile, **non-manufacturing** activity surprised to the upside, defying expectations of moderation as the PMI edged up to 50.1 in May. The services PMI climbed to a nine-month high of 50.3, supported by stronger sentiment in sectors such as rail transportation, telecom services, as well as insurance. Although the construction PMI came in at 48.8, it rebounded meaningfully from April's trough, suggesting eased contraction (Fig. 5).

Fig 4 Smaller factories are less resilient to oil supply shocks

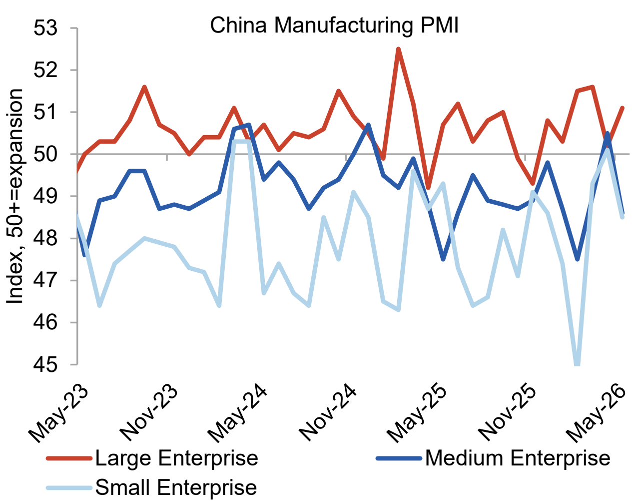
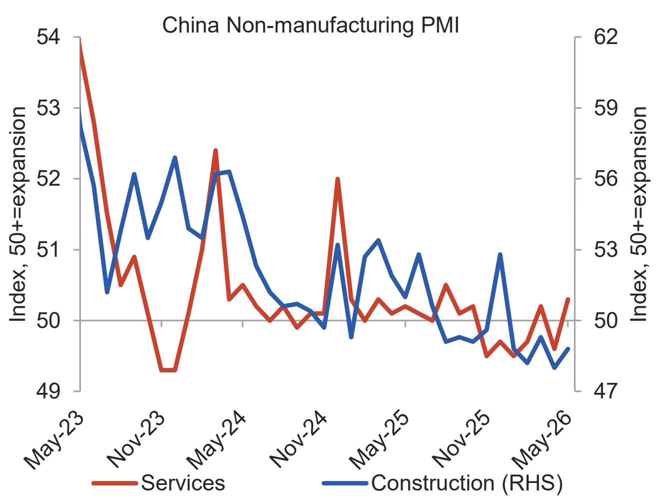


Fig 5 Service PMI outperformed unexpectedly

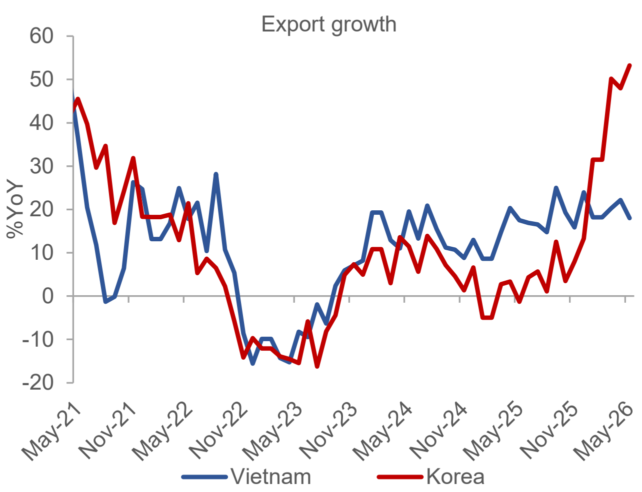


Source: CEIC, Mizuho

Trade-related PMI indicators weakened in May, pointing to challenges amid disruptions to raw material supply. Both the new export orders index and the import index fell below 49, retreating from above-50 readings in April (Fig. 6) That said, underlying external demand appears relatively resilient: exports from Korea and Vietnam recorded another month of double-digit growth YoY (Fig. 7), while the RatingDog manufacturing PMI, more reflective of export-oriented private firms, remained firmly in expansionary territory at 51.8.

Fig 6 Trade-related sentiment weakened in May

Fig 7 External demand appears relatively resilient



Source: CEIC, Mizuho

On the inflation front, imported inflation pressures continued amid the ongoing stalemate in US-Iran negotiations. While PMI gauges for raw material costs and producer prices moderated from recent peaks, both indices remained in expansionary territory for a fifth consecutive month (Fig. 8). The difference between the two measures stayed near a four-year wide, underscoring manufacturers' ongoing difficulties in passing higher input costs downstream against a backdrop of still-subdued domestic demand. In this sense, we expect **PPI** inflation to accelerate to around 4% YoY in May.

Turning to the consumer sector, **CPI** inflation is expected to remain broadly stable in May, as higher fuel costs are offset by softer food prices and passthrough to core inflation remains relatively muted. Domestic fuel prices are estimated to have risen by an average of 27% YoY in May, accelerating from April's 22% increase. Meanwhile, food prices are likely to exert downward pressure on headline inflation, driven by declines in pork and fresh vegetable prices (Fig. 9). Notably, wholesale pork prices remain near their lowest levels since 2010, reflecting significant oversupply that is likely to persist in the near term.

Fig 8 Widening gap in raw material costs and producer prices

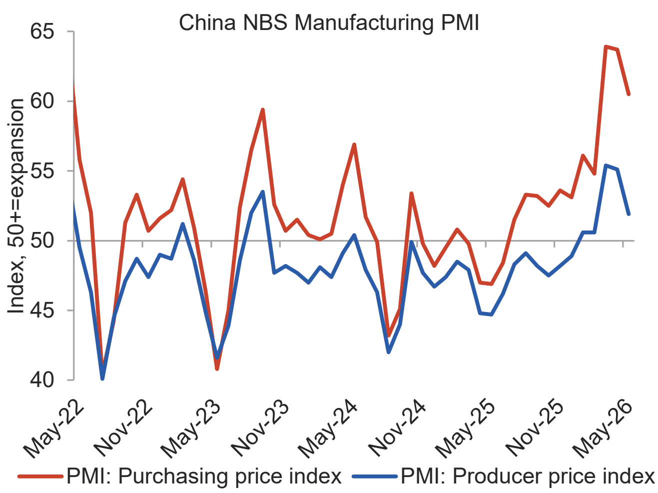
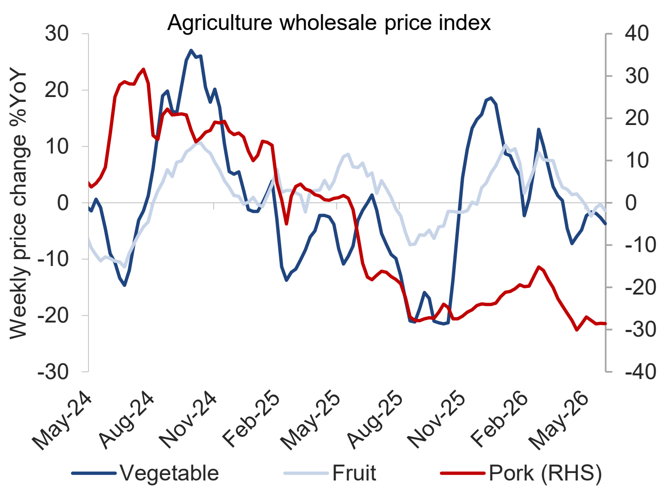


Fig 9 Pork and fresh vegetables led the decline in food prices



Source: CEIC, Wind, Mizuho

China Government Bond (CGB) yields continued to trend lower in May despite another month of liquidity withdrawals by the PBoC (Fig. 10), pointing to subdued credit demand and weak investment momentum. Across the curve, declines were most pronounced in the 5-year and 10-year tenors, which fell by 6bp and 4bp, respectively. In contrast, ultra-long-end yields remained relatively supported (Fig. 11), as local governments increasingly rely on such issuance for financing. Ongoing local government debt resolution is expected to continue crowding out corporate borrowing. In this context, year-on-year growth in credit and money aggregates is likely to soften moderately from their April rates.

Fig 10 Another month of liquidity withdrawal by the PBoC

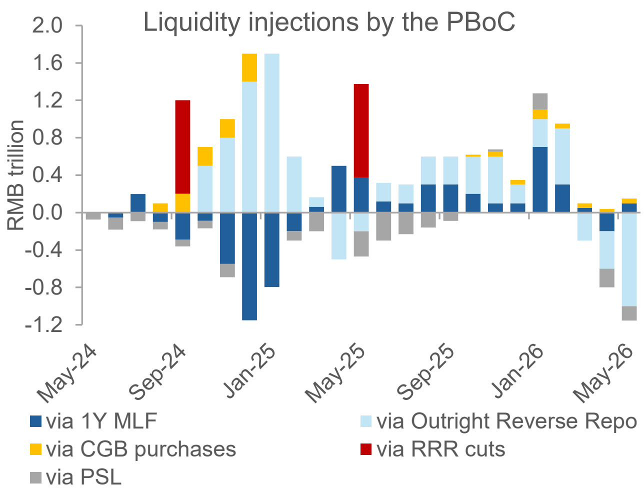
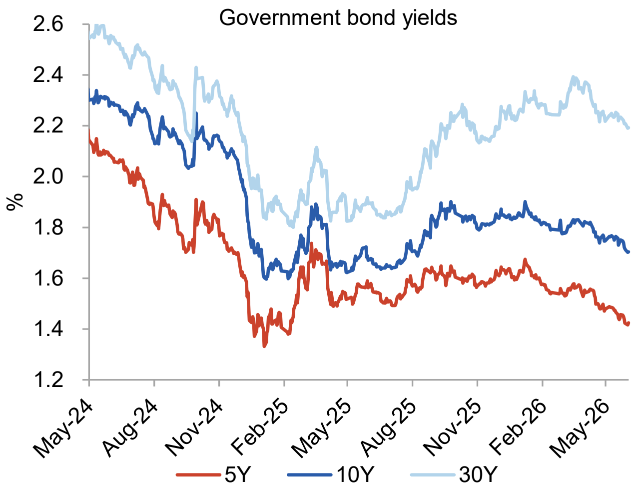


Fig 11 Ultra-long-end yields relatively supported



Source: CEIC, Mizuho

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