On Our Minds - China

Some green shoots, but challenges remain

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The economy has made a decent start to 2025. In the first two months of this year, both retail sales and investments picked up decently, aided by stimulus measures and technological drivers. These factors have helped the manufacturing sector weather the slowdown in exports for now, as US tariffs have started to take effect. However, the stabilization in housing remains fragile, with top-tier cities showing better signs, while low-tier cities are still trying to find a bottom due to the large inventory overhang. Overall credit demand remains feeble. As for inflation, there have been fewer intense price cuts in consumer durables, and rental deflation seems to have bottomed out, but a convincing uptrend has yet to be established.

Given the better data, 1Q GDP will probably print above 5%, which means the PBoC may not be in a rush to add stimulus in the near term, as fiscal policy is doing the heavy lifting while being mindful of FX risks. However, the sustainability of the recovery remains in question, given US tariffs and the easing impact of consumption subsidies. The 20% US tariffs will likely knock 0.8 percentage points off China's GDP growth, according to our estimates. Beyond subsidies, a durable recovery in consumption hinges on housing, income, and consumer confidence.

At this month's National People's Congress, policymakers emphasized the importance of consumption, and the 'special plan' announced over the weekend is yet another attempt by policymakers to boost consumer spending. Most measures in the plan are not new, but if they are implemented effectively and forcefully—such as reducing inventories in low-tier cities, providing generous childcare and birth subsidies, and supporting the stock market by mobilizing more long-term funds—they have the potential to end the deflationary trajectory. Execution and funding support remain key.

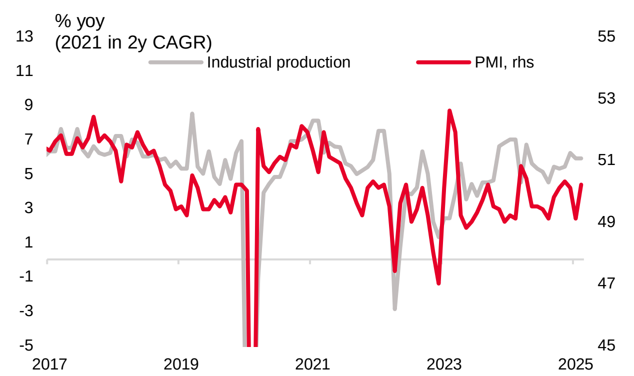
[All growth rates are in yoy terms, unless specified otherwise.]

Industrial activity remains resilieint supported by domestic demand

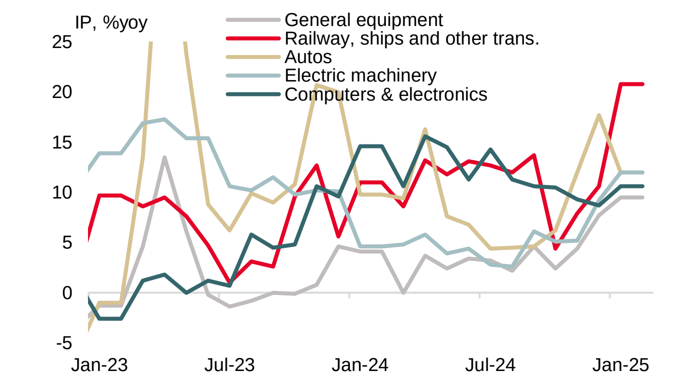
Following the jump in December, industrial production (IP) growth moderated less than the markets and we expected, decreasing from 6.2% to 5.9% in the first two months of this year. Part of the reason was a rebound in mining production, which increased from 2.4% to 4.3%, while manufacturing production slowed more than IP, from 7.4% to a still solid 6.9%. The resilience in manufacturing was propelled by domestic demand as stimulus measures kicked in, which more than offset the impact of softer exports and US tariffs for now.

Focusing on manufacturing, we observe resilience in high value-added sectors, such as computers and electronics, electric machinery, and general equipment. The computer and electronics sector, which rose from 9% to 11%, likely received a strong boost from the government's trade-in scheme, which has been broadened to include consumer tech such as mobile phones and PCs. Meanwhile, transportation equipment excluding autos accelerated strongly from 11% to 21%, which could be attributed to the 'low-attitude economy' initiative and the ramp-up of transportation investments. Electric machinery, which has been under pressure due to oversupply in solar, also oddly strengthened from 9% to 12%. The NBS also cited strong performance in industrial and service robots, which have gained significant traction in capital markets recently.

Industrial production and PMI



IP growth by sector



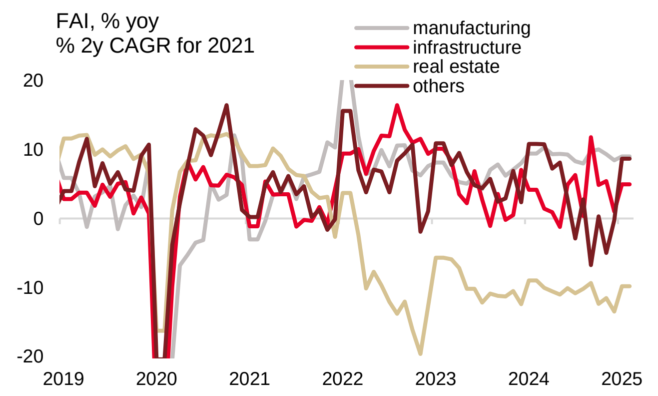
Source: NBS, CEIC, SG Cross Asset Research/Economics

Investments rebound on stimulus and tech resilience

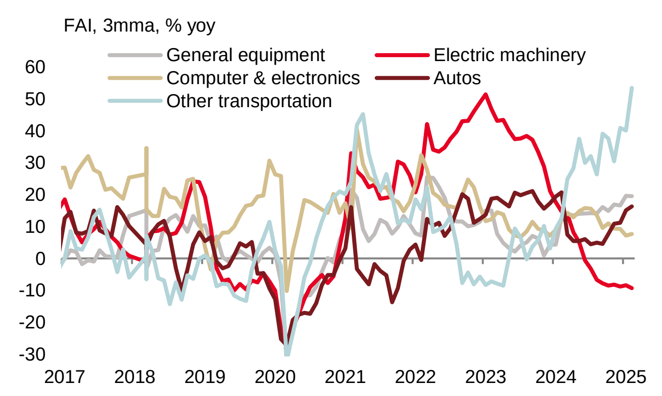
Turning to the demand side, fixed asset investment (FAI) growth also beat market expectations, rebounding from 2.3% in December 2024 to 4.1% in the combined January-February period. The recovery was mainly driven by infrastructure investments, which bounced back from 1.0% to 5.0% due to the faster implementation of projects in water conservancy and transportation. The completion of all projects under the 14th Five-Year Plan (2021-2025) is one supportive factor for infrastructure investments this year, although we are concerned that continued LGFV deleveraging and the containment of implicit debt by local governments may still hinder the implementation of other infrastructure projects.

Meanwhile, manufacturing investments remained healthy as usual, ticking up from 8.4% to 9.0%. The bright spots were autos (+27%), transportation excluding autos (+37%), and general equipment (+22%). Among traditional industries, food manufacturing (+21%) also stood out. Outside of manufacturing, high-tech information services recorded a 66% jump, probably thanks to accelerated deployment of generative AI models.

FAI



FAI – selected subindustries



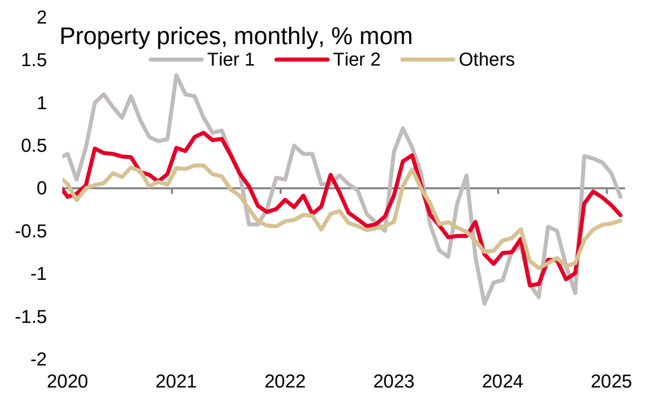
Source: NBS, MoF, CEIC, SG Cross Asset Research/Economics

Property: Divergence between Tier-1 and other cities continues

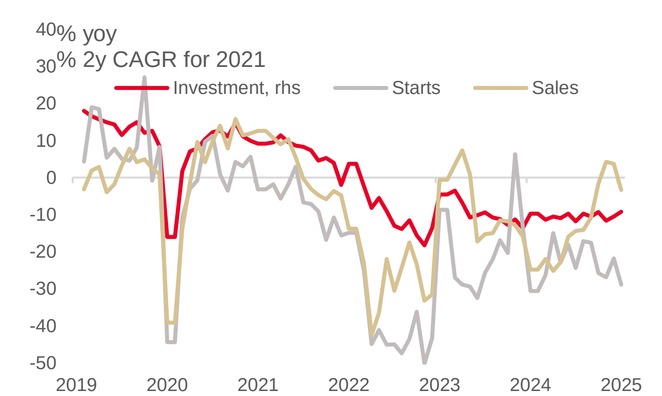
Regarding the property sector, there seems to be some softening momentum compared to last December at the margin. New home sales weakened from 3.7% in December to -3.4% in the combined January-February period. Based on CRIC data, first-tier cities continued to outperform, given the relaxation of purchase restrictions and reduced inventory pressure. As for house prices, new home prices have held up better compared to used home prices, which declined at a slightly faster pace after some improvement in recent months in Tier-1 and Tier-2 cities. Overall, our view remains that prices in Tier-1 cities and some top-tier cities should be on course to stabilize this year, while lower-tier cities will continue to seek a bottom.

Regarding supply, housing investments recovered slightly, with the year-on-year contraction narrowing from -13.5% in December to -9.8% in the combined January-February period, while housing starts remained depressed, with a year-on-year contraction of nearly 30%. The speed of improvement will depend on the implementation of urban village redevelopment, which has been slow due to profitability issues and sustainability concerns.

Used home prices by city tier



Housing indicators

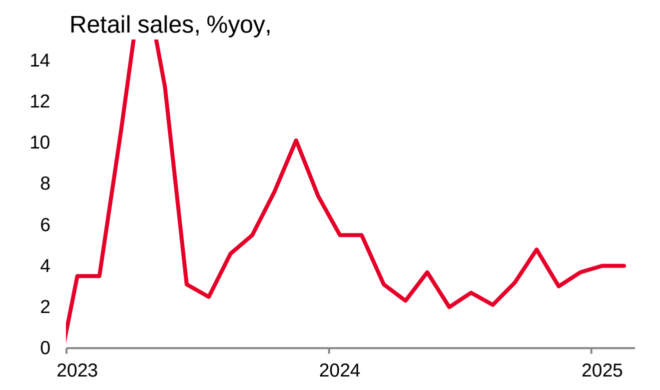


Source: NBS, CEIC, Wind, SG Cross Asset Research/Economics

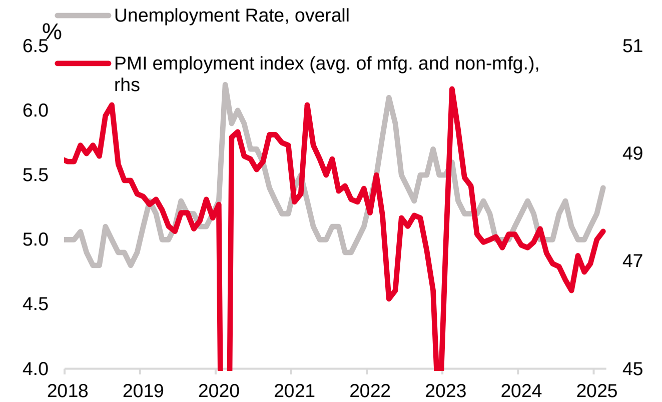
Retail sales recover further with the help of stimulus

Retail sales recovered further from 3.7% in December to 4.0%, supported by the government's trade-in program and the Chinese New Year holiday, which contributed to a rebound in catering from 2.7% to 4.3%. However, spending on goods only stabilized at 3.9%, unchanged from December. On a positive note, there seems to be some broad-based improvement across different types of goods. Based on retail sales from firms above designated size, mobile phones improved most notably from 14% to 26% due to consumption subsidies. However, both home appliances and autos moderated, from 39% to 11% and from 1% to -4%, respectively, as the impact of subsidies faded. Clothing, jewelry, and sports products accelerated quite decently, but it remains to be seen if the recovery is sustainable, given that labor market conditions have remained challenging. The surveyed unemployment rate ticked up to 5.4%, which was higher than the same period last year.

Retail sales



Surveyed unemployment rate and PMI surveys



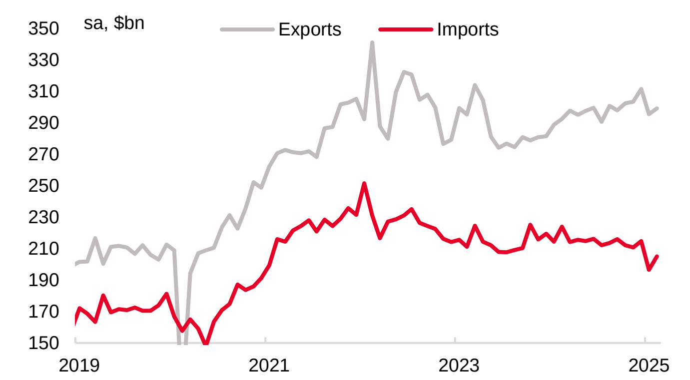
Source: NBS, CEIC, Wind, SG Cross Asset Research/Economics

Tariffs and the reversal of frontloading start to hit exports

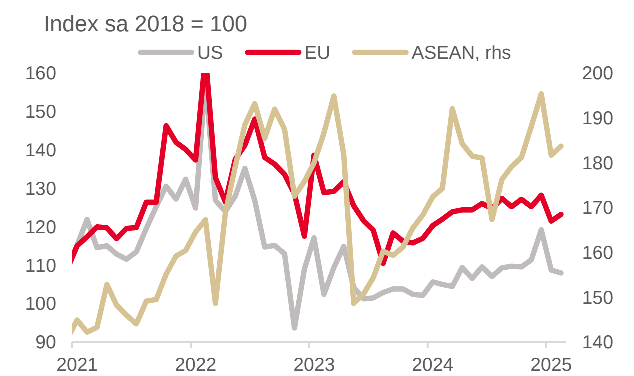
In contrast to the improvement in domestic demand, exports began to sour. Export growth plunged from 10.7% in December to 2.3% in the combined January-February period in USD terms, well below market expectations of 5.9%. The decline was a result of negative base effects and the reversal of December's strength, as exporters ramped up production ahead of US tariffs. It is also important to note that the 10% US tariffs became effective on February 4.

Considering the base effects, the underlying trend was not as weak as the headline figure suggests. We do expect to see exports decelerate more meaningfully beyond the first quarter due to US tariffs. We estimate that a 20% increase in US tariffs should knock 3 percentage points off China's total export growth, with some potential mitigation from trade rerouting and cost absorption by wholesalers. Given the already thin margins of China's exports, the room for further price cuts may be limited.

China's nominal trade



Exports by destination



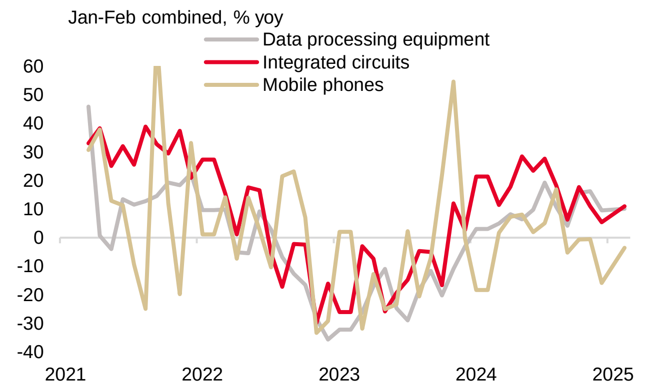
Source: China Customs, CEIC, SG Cross Asset Research/Economics

By destination, exports to the US dropped notably from 15.6% in December to 2.9%. Exports to other major trading partners also softened, with EU-bound shipments dropping from 8.8% in December to 1.0% and ASEAN-bound shipments plunging from 5.4% to 1.9%. In contrast, exports to India rebounded from 0.0% to 7.6%.

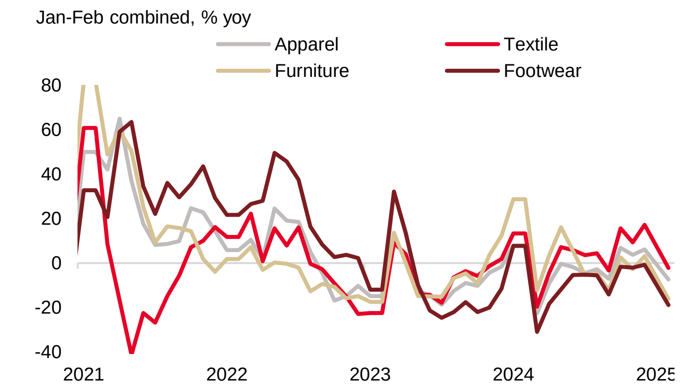
By product, we observe a broad-based slowdown across major categories. Traditional consumer goods exports (including clothing and footwear, furniture, toys, etc.) eased from 2.7% to -13.0%. Electronics and machinery equipment also dropped from 12.1% to 3.8%. However, high-tech products held up and picked up slightly from 4.3% to 5.0%. We note that products such as integrated circuits (up from 5.3% to 11.0%) and PCs (up from 9.5% to 10.1%) were not significantly affected.

Meanwhile, imports also plunged from 1.0% to -8.4% following the recovery in December, indicating a still fragile recovery in domestic demand. The decline was mostly driven by falling imports of iron ore (from -12% to -31%) amid continued weakness in construction activities. Beijing's plan to reduce steel production may weigh further on iron ore imports. There was also some softening in integrated circuit imports (down from 9.6% to 2.3%), although imports of PCs and parts remained solid, expanding by over 50% year-on-year, supported by developments in advanced technology. Auto imports also remained weak, plunging from -28.3% to -50.3% as domestic substitution continues.

Exports – High-tech products



Exports – Traditional consumer products



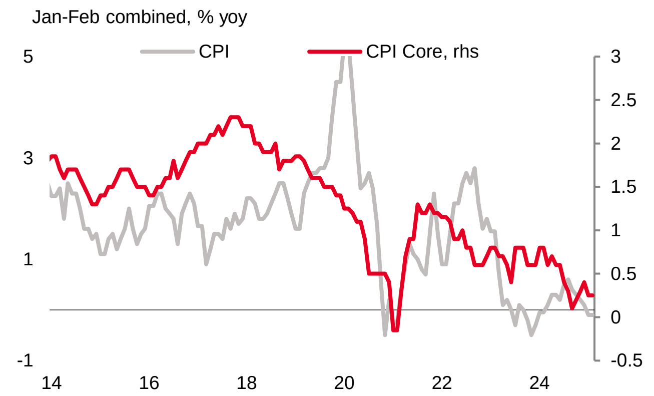
Source: China Customs, CEIC, SG Cross Asset Research/Economics

A convincing uptrend in prices is yet to be established

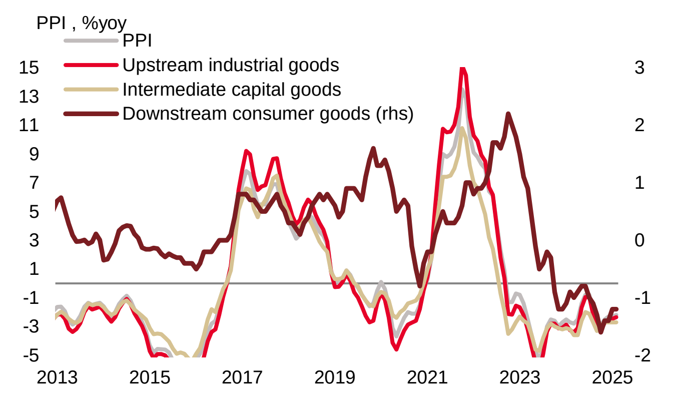
Headline CPI fell further from 0.1% in December to -0.1% in the combined January-February period. The decline reflected easing food inflation as well as core CPI, which moderated from 0.4% in December to 0.3% in the combined Jan-Feb period, ending the streak of improvement that began in October 2024. Looking beyond holiday factors, rental inflation improved modestly from -0.3% to -0.2%, and the CPI for selected consumer durable goods, such as autos and mobile phones, seems to have troughed at least, thanks to the government's trade-in program. However, deflationary pressure remains persistent in some categories, such as household goods and services (from -0.3% to -0.9%) and healthcare (from 1.1% to 0.8%). A more widespread recovery in CPI items remains distant.

Turning to factory gate prices, the Producer Price Index (PPI) only picked up marginally from -2.3% in January to -2.2% in February. On a sequential basis, the PPI dropped by 0.1% month-on-month, driven entirely by producer goods, while consumer goods prices stabilized. Prices in the upstream sector remained under pressure due to weak construction activities, with the PPI for ferrous metal manufacturing and non-metallic minerals (cement and glass) still under pressure, more than offsetting the pick-up in oil prices and non-ferrous metals. Meanwhile, the development of consumer goods PPI was mixed and did not show clear signs of recovery yet. The PPI for consumer durables stabilized after a 0.2% month-on-month increase in January, while that for food and clothing continued to ease.

CPI



PPI

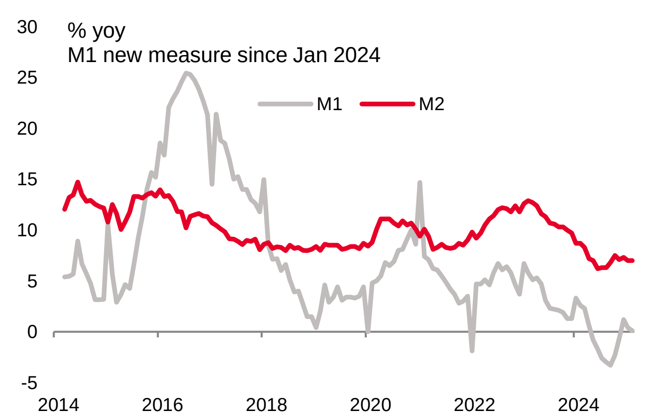


Source: NBS, CEIC, SG Cross Asset Research/Economics

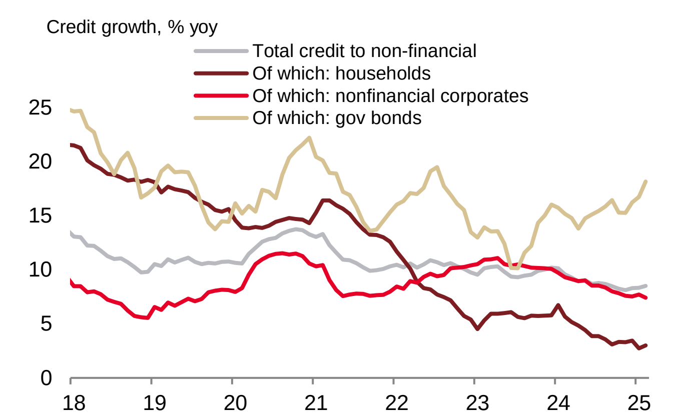
Corporate liquidity is improving with the help of local government debt swaps

Credit demand weakened again after the rebound in January. New RMB loans came in at RMB 1,010 billion, which was down RMB 440 billion year-on-year. The key culprit was corporate loans, as banks were reported to have rushed to ramp up credit in January, leading to weakness afterward. On the other hand, household loans saw some improvement due to the low base last year but remained tepid. Despite the weakness in loans, total non-financial credit growth still picked up further from 8.4% to 8.5%, thanks again to the rampant government bond issuance of RMB 1.7 trillion as the local government debt swap continued to take place fairly quickly. Meanwhile, M2 growth remained stable at 7.0%, but we observe that corporate deposits have continued to pick up, suggesting easing deleveraging pressure as a result of the local government debt swap.

M1 and M2 growth



Credit growth



Source: PBoC, CEIC, SG Cross Asset Research/Economics

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