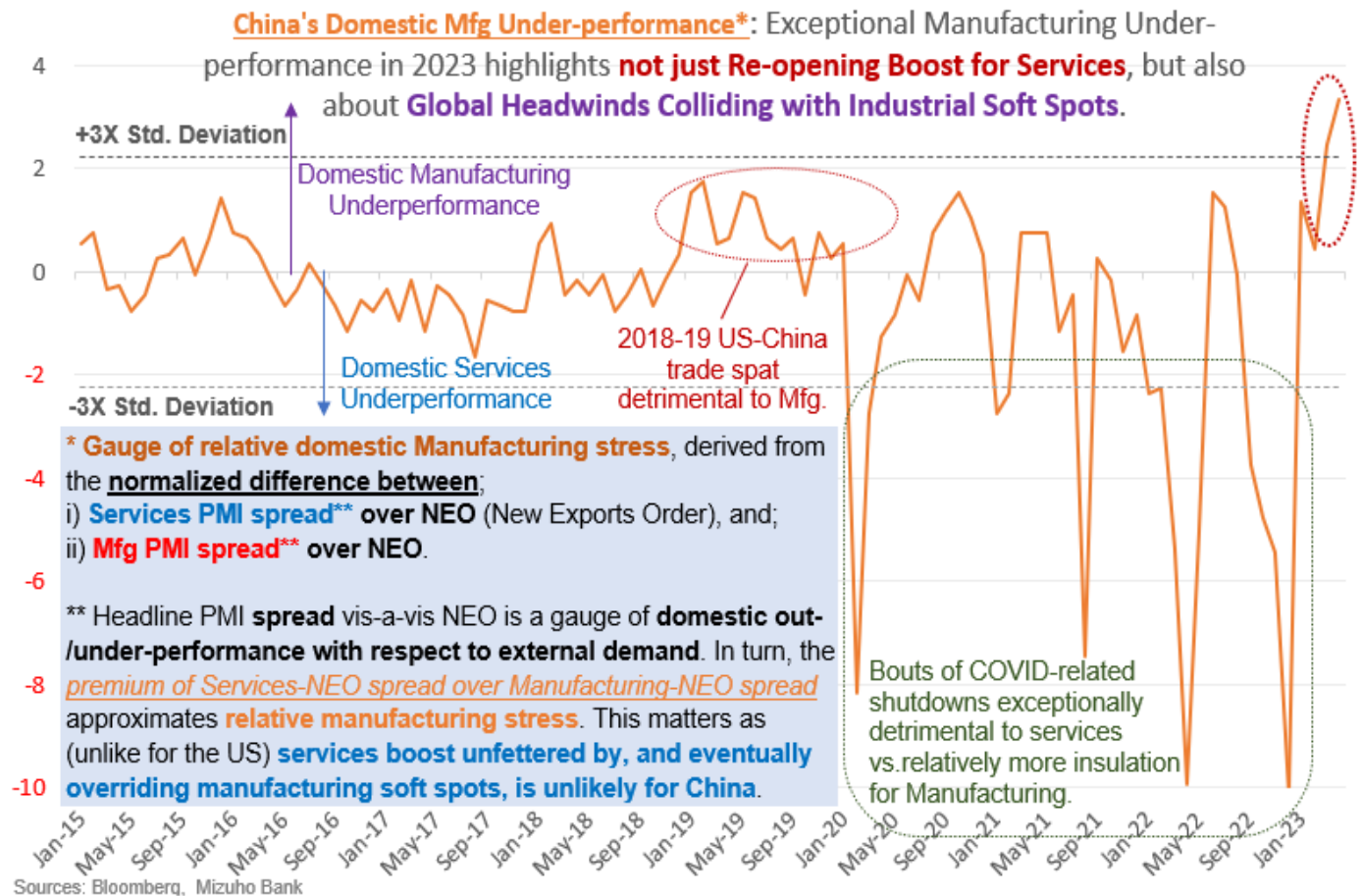


## Manufacturing Pain



“Hard to see, the dark side is” – Master Yoda

**In a Nutshell:** A conspiracy of *self-inflicted policies* undermining confidence, *inherited structural risks* (such as credit/financial stability constraints and demographics) imposing binding constraints and *imposed geo-political stresses* infer are **manufacturing pain** for the Chinese economy. And so, the current **travails of the manufacturing sector should not be dismissed as a passing headwind** owing to the global goods-to-services re-balancing compounded by global inflation-driven policy tightening crimping aggregate demand. Instead, it should be recognized for risks associated with **political, structural and binding geo-economic dimensions** that may impede, if not **chronically impair**, prospects of restoration to pre-COVID strength. The “*dark side*” of manufacturing pain may be “*hard to see*”; but that doesn’t mean it’s not there.

- **Underwhelming China activity** data in April **validate our repeated warnings\*** of **overstated re-opening optimism**, and resultant **blind spots** to China’s structural and geo-political challenges.
- Sure, **earlier exuberance hinged on unsustainable “revenge consumption”** has been **tempered by retail sales disappointment** that followed worryingly soft credit and imports. But despite this reality check, the **extent of industrial sector stress and attendant spill-over economic pain**

*imposed by confidence deficit and geo-political risks* that **may not be fully appreciated**.

- For one, the **extent of manufacturing under-performance is unprecedented**; at least by some compelling measures (Chart). Specifically, not only has this **manufacturing stress gauge exceeded three standard deviations**, *qualifying as a “tail risk” proper*, but is notably *even more acute than* what was experienced *during the 2018-19 US-China trade spat*.
- Admittedly, it may be **tempting to (mis-)attribute relative manufacturing under-performance to benign optics of comparative shortfall of sharp services catch-up**; as unexpected and abrupt **lifting of “Zero COVID” restrictions provide disproportionate services boost**. In particular, flattered *by reversal of asymmetric tail-risk territory of service sector pain* (from COVID lockdowns slamming shut services, even as manufacturing bubbles were maintained).
- But such *“it’s not you, it’s me”* type of **brush-off of manufacturing woes as comparative optics due to stellar services** would be a **fatally-flawed mischaracterization**. Crucially because it **fails to recognize binding structural and geo-political impediments that may linger long after the cyclical headwinds to global goods demand**, be it from the goods-to-services re-balancing on a global scale or from global policy tightening dampening aggregate demand, **pass**.
- A key factor that may result in **endemic, underlying weakness denying a complete reversion to pre-COVID strength in manufacturing** is arguably **shortfall in private sector confidence**, which amongst others, **notably accrues from home-grown and self-inflicted uncertainty from the long shadow of “Common Prosperity”**. The property sector fall-out, whose negative industrial spill-over from the convergence and possible resonance of; i) supply-chain/peripheral activity drag; ii) impaired business investment appetite and; iii) adverse household wealth effects; is but one manifestation.
- Another is **pre-existing structural constraints**. These prominently include, but are not limited to; i), *elevated leverage* sharpening trade-off between credit stimulus and financial stability credit, therefore restraining scope for stimulus boost for the economy, and; ii) *ageing demographics exacerbated by skills mismatch*, resulting in high youth unemployment despite labour strains in manufacturing that drive up costs and drag productivity. such as elevated leverage
- Above all, geo-political risks manifesting as proximate **geo-economic threats** as *US clamping down on China’s industrial dominance* from the higher-end (starting with high-tech chip sanctions). Broadening conflict spilling over into the economic arena will *drive up costs* from **sanctions, strategic stockpiling** of, and **competition** for, key resources and inevitably *impair supply-chain efficiencies* as well as *impede unfettered global market access*.
- The upshot is that expectations of China’s industrial sector returning to the rude health of last decade is a failure to recognize the dark clouds of **political, structural, and binding geo-economic risks** that credibly threaten impede, if not **chronically impair**, China’s underlying growth drivers. The *“dark side”* of manufacturing pain may be *“hard to see”*; but that doesn’t mean it’s not there.

\* Please see Mizuho Flash - China: Flattered Growth & Flustered Commodity Bulls, 18<sup>th</sup> Apr 2023

### Important Information

This publication has been prepared by Mizuho Bank, Ltd. (“Mizuho”) and represents the views of the author. It has not been prepared by an independent research department and it has not been prepared in accordance with legal requirements in any country or jurisdiction designed to promote the independence of investment research and is not subject to any prohibition on dealing ahead of the dissemination of investment research.

### Disclaimer

Unless otherwise stated, all views or opinions herein are solely those of the author(s) as of the date of this publication and are not to be relied upon as authoritative or taken in substitution for the exercise of judgement by any recipient, and are subject to change without notice. This publication has been prepared by Mizuho solely from publicly available information. Information contained herein and the data underlying it have been obtained from, or based upon, sources believed by us to be reliable, but no assurance can be given that the information, data or any computations based thereon are accurate or complete. This publication provides general background information only. It is information in summary form and does not purport to be complete. This publication has been prepared for information purposes only and is not intended by Mizuho or its affiliates to constitute investment, legal, accounting, tax or other advice of any kind and all recipients of this publication are advised to contact independent advisors in order to evaluate the publication, including, without limitation, the suitability of any security, commodity, futures contract or instrument or related derivative (hereinafter, a “financial instrument”), product or strategy herein described. This publication is not intended to be relied upon as advice to investors or potential investors and does not take into account investment objectives, financial situation or needs of any particular investor. It is not intended for persons who are Retail Clients within the meaning of the United Kingdom’s Financial Conduct Authority rules nor for persons who are restricted in accordance with US, Japanese, Singapore or any other applicable securities laws.

This publication has been prepared for information purposes only and is not intended by Mizuho to market any financial instrument, product or service or serve as a recommendation to take or refrain from taking any particular course of action or participate in any trading or other strategy. This publication is not an offer to buy or sell or a solicitation of any offer to buy or sell any security or any of the assets, businesses or undertakings described herein, or any other financial instrument, nor is it an offer to participate in any trading or other strategy, nor a disclosure document under applicable laws, rules, regulations or guidelines. Nothing contained herein is in any way intended by Mizuho or its affiliates to offer, solicit and/or market any financial instrument, product or service, or to act as any inducement to enter into any contract or commitment whatsoever. Neither the author, Mizuho nor any affiliate accepts any liability whatsoever with respect to the use of this publication or its contents or for any errors or omissions herein.

Mizuho and its affiliates, connected companies, employees or clients may take the other side of any order by you, enter into transactions contrary to any recommendations contained herein or have positions or make markets or act as principal or agent in transactions in any securities mentioned herein or derivative transactions relating thereto or perform or seek financial or advisory services for the issuers of those securities or financial instruments.

All of the information contained in this publication is subject to further modification without prior notice and any and all opinions, forecasts, projections or forward-looking statements contained herein shall not be relied upon as facts nor relied upon as any indication of future results. Opinions stated in this publication are subject to change without notice. Future results may materially vary from such opinions, forecasts, projections or forward-looking statements. The information contained in this publication may not be current due to, among other things, changes in the financial markets or economic environment. Mizuho has no obligation to update any information contained in this publication. Past performance is not indicative of future performance.

This is a strictly privileged and confidential publication. This publication contains information addressed only to a specific individual and is not intended for distribution to, or use by, any person other than the named addressee or any person or entity in any jurisdiction or country where such distribution or use would be contrary to law or regulation. Save with Mizuho’s prior written consent, you may not disclose, divulge, reproduce or furnish any information contained herein to any other party. Please notify the sender immediately if you have mistakenly received this publication.

**Singapore:** Mizuho is licensed as a bank under the Banking Act (Chapter 19) of Singapore, and is regulated by the Monetary Authority of Singapore.

**Japan:** Mizuho is authorised and regulated by the Financial Services Agency of Japan.

**United Kingdom / European Economic Area:** In the UK, Mizuho is authorised by the Prudential Regulation Authority and subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority. Details about the extent of MHBK’s regulation by the Prudential Regulation Authority are available upon request. This publication may also be distributed by Mizuho International plc (“MHI”). MHI is authorised by the Prudential Regulation Authority and regulated by the Financial Conduct Authority and the Prudential Regulation Authority.

**United States:** This publication is not a “research report” as defined in Commodity Futures Trading Commission (“CFTC”) Regulations 1.71 and 23.605. The content of publications distributed by Mizuho Securities USA Inc. (“MSUSA”) is the responsibility of MSUSA. The content of publications distributed directly to US customers by Mizuho is the responsibility of Mizuho. US investors must effect any order for a security that is the subject of this report through MSUSA.

© 2014 Mizuho Bank Ltd