

Flash Note

China: August PMIs

Domestic demand still solid, but exports may have peaked

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China's official manufacturing PMI in August came in at 51.7, rising slightly from July (51.4), and remaining firmly in expansionary territory. The Markit PMI extended its ascendance for the third consecutive month to reach 51.6 in August.

Domestic demand seems to be holding up well. The production, new orders and imports sub-indices of the official PMI, which are closely related to Chinese domestic demand, are all showing a healthy upward trend.

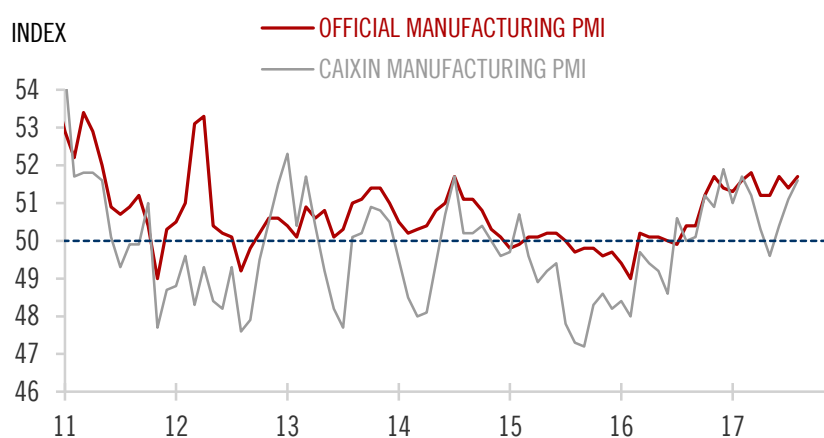
The new export order sub-index of the official PMI has been declining for the second consecutive month, suggesting export growth may have peaked.

The recent rise in the input price sub-index of the PMI suggests that a rebound in the PPI is likely in the near term.

China's official manufacturing purchasing manager index (PMI) in August came in at 51.7, rising slightly from July (51.4), and still firmly in expansionary territory. The Markit PMI (also known as Caixin PMI) extended its ascendance for the third consecutive month to reach 51.6 in August (*Chart 1*).

The upbeat PMI readings suggest industrial activity in China remains solid and that any slowdown in growth in the second half of the year will likely be modest.

Chart 1: Chinese manufacturing PMIs



Source: Pictet WM - AA&MR, National Bureau of Statistics of China, Markit

Several points are worth highlighting from an analysis of recent economic data.

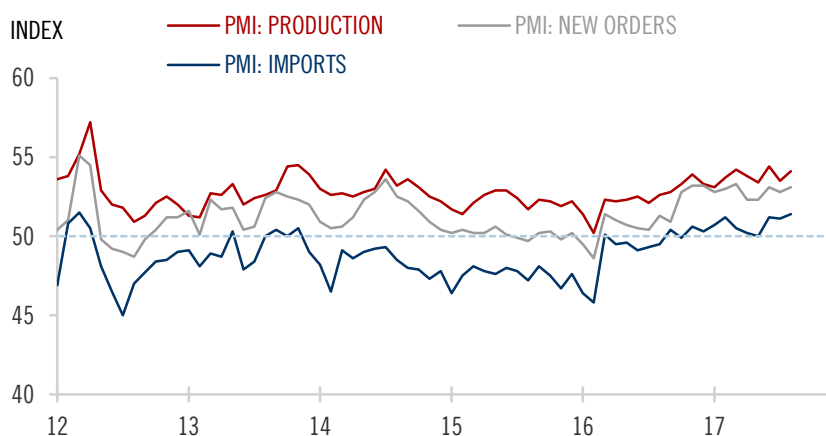
First, domestic demand seems to be holding up well. The production, new orders and imports sub-indices of the official PMI, which are closely related to Chinese domestic demand, are all showing a healthy upward trend (*Chart 2*). While previously released data on fixed asset investment and industrial production in July indicate a moderation in growth momentum, the more upbeat PMI gauges suggest that the slowdown may be fairly modest.

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Chart 2: Select PMI sub-indices (production, new orders and imports)

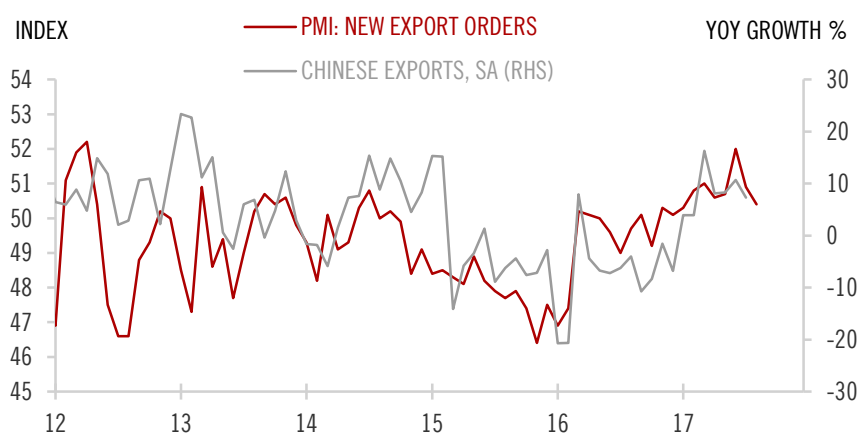


Source: Pictet WM - AA&MR, National Bureau of Statistics of China

Second, in contrast to robust domestic demand, the growth in Chinese exports seems to have peaked. The new export order sub-index of the official PMI declined for the second consecutive month in August. This is consistent with the decline in the year-over-year (y-o-y) growth rate of Chinese exports in recent months (*Chart 3*). Data from other major Asian exporters (Japan, for example) show a similar pattern.

One of the reasons for the slowdown is simply a less favourable base effect. Roughly speaking, Asian exports started to pick up strongly in the second half of 2016. Entering Q3 2017, the very positive base effect started to fade. The recent weakening of the US dollar against the renminbi may have also played a role in dampening US demand for Chinese goods.

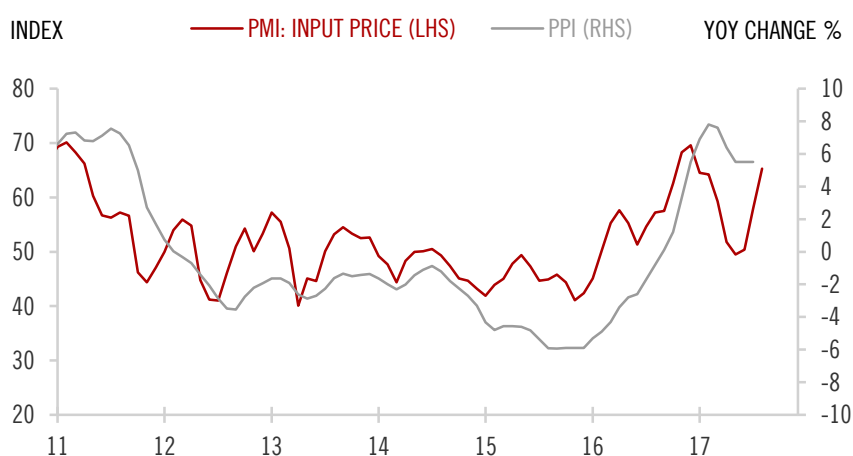
Chart 3: New export order sub-index of PMI and China's export growth



Source: Pictet WM - AA&MR, National Bureau of Statistics of China, China Customs

Third, industrial inflation may see some rebound in the near term. Since peaking at 7.8% in February, China's industrial inflation, measured by the y-o-y change in the producer price index (PPI), has been declining. However, the recent rise in the input price sub-index of the PMI suggests that a rebound in the PPI is likely in the near term (*Chart 4*).

Chart 4: Input price sub-index of PMI and y-o-y change of Chinese PPI



Source: Pictet WM - AA&MR, National Bureau of Statistics of China

The rise in PPI was one of the key drivers of the surge in China's nominal GDP in the first half of 2017, leading to a significant improvement in the profitability of China's upstream heavy industrial sector. The potential rebound in Chinese PPI will likely support this positive trend for longer.

In summary, the upbeat manufacturing PMI report for August indicates that industrial activity in China remains solid, mainly driven by domestic demand. The potential slowdown in China's growth momentum in H2 2017 could be fairly modest. Hence, we have decided to keep our Chinese GDP forecast for 2017 unchanged at 6.8%.

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