CAPITAL ECONOMICS 凯投宏观

CHINA RAPID RESPONSE

PMIs (Jul.)

Construction downturn deepens

- *This page was first published on Monday 31st July, covering the official PMIs. We added commentary on the Caixin manufacturing PMI on Tuesday 1st August.*
- *This report has been updated with additional analysis and charts since first publication.*
- **The PMI surveys suggest that China's economic recovery continued to lose momentum in July. Downward pressure on manufacturing intensified, construction activity decelerated sharply, and services activity cooled further. Policy support should drive a turnaround later this year. But with officials taking a restrained approach to stimulus, any reacceleration in growth is likely to be modest.**
- We learned on Monday that the official manufacturing PMI edged up from 49.0 in June to 49.3 in July (the Bloomberg consensus was 48.9 and our forecast was 49.0). Tuesday's release, by contrast, showed that the Caixin manufacturing PMI declined from 50.5 to 49.2 (Bloomberg: 50.1, CE: 49.5).
- **The average of the two fell to a four-month low and is consistent with a further deterioration in factory activity last month.** (See Chart 1.) Given differences in the composition of the firms surveyed, the decline in the Caixin index suggests that the recent outperformance of smaller firms and those located in export-dependent coastal regions has now unwound.
- We think it makes sense to average across both PMIs to gauge conditions in industry and get a sense of what they mean for the hard data. On this basis, the output component returned under 50. This appears to reflect increased downward pressure on domestic and foreign demand. Both the new orders and exports orders components fell to their lowest since reopening. The latter points to a further drop in exports. (See Chart 2.)
- The official non-manufacturing PMI fell from 53.2 to 51.5 (Bloomberg: 53.0, CE: 52.0). (See Chart 1 again.) (We won't get the Caixin services PMI until Thursday.) This was largely due to a decline in the construction index which tumbled from 55.7 to 51.2, the second lowest reading on record. **This suggests that infrastructure spending, which had helped to offset further weakness in real estate earlier this year, unwound rapidly in July amid a slowdown in local government bond issuance.**
- Meanwhile, the services index declined further, from 52.8 to 51.5, its lowest since reopening and far below pre-pandemic levels – the average in 2019 was 53.1. The services sector appears to have lost momentum as it settles into a new post-pandemic normal of slower growth.
- **All told, the official composite PMI dropped back to 51.1 which, outside of the pandemic, is its lowest level on record**. **As a result, the labour market appears to be softening again**. The composite employment index weakened for a third straight month and hints at a further uptick in the unemployment rate. (See Chart 3.)
- Despite the deterioration in activity and employment, there are some signs that disinflationary pressures eased last month. The average of the manufacturing PMIs output price component rose sharply, but remained under 50, pointing to a smaller decline in producer prices. (See Chart 4.) The official services PMI sales prices component painted a similar picture for the services sector.
- **Looking forward, policy support is needed to prevent China's economy from slipping into a recession**, not least because external headwinds look set to persist for a while longer. Last week's Politburo meeting provided some assurance that the leadership is serious about shoring up the economy and that some stimulus is on its way. However, unless concrete support is rolled out soon, the recent downturn in demand risks becoming self-reinforcing. And even if we do get the promised stimulus, it is likely to be fairly restrained. Even in a best-case scenario, growth over the second half of this year looks set to be modest.

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Chart 1: Official PMIs

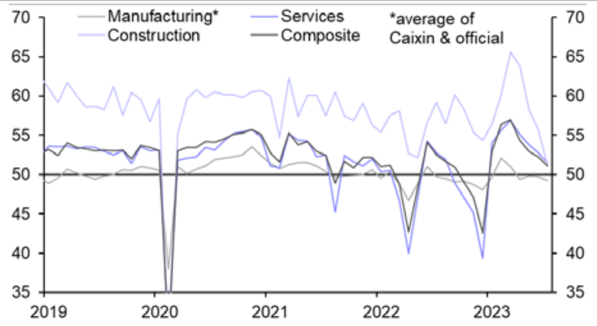


Chart 2: Exports & PMI – Export Orders

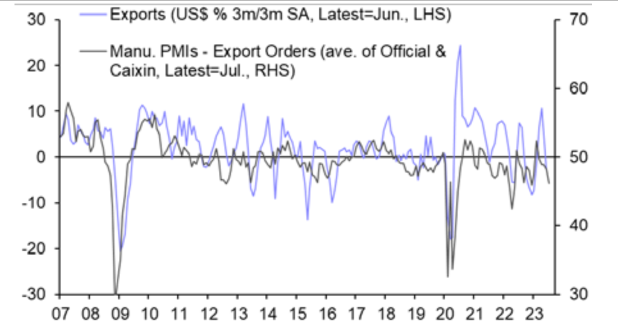


Chart 3: Unemployment Rate & Composite PMI

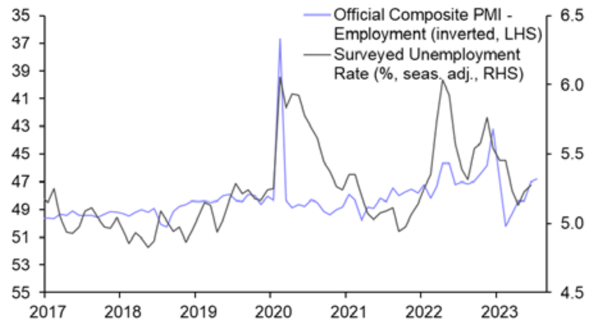
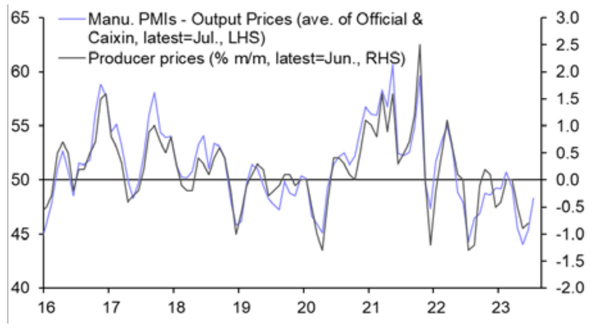


Chart 4: Producer Prices & PMI Output Prices



Sources: CEIC, Capital Economics

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