CHINA RAPID RESPONSE

PMIs (Aug.)

Policy support prevents a further slowdown

- *This report was first published on Thursday 31st July, covering the official PMIs. We added commentary on the Caixin manufacturing PMI on Friday 1st September, and Caixin Services and Composite PMIs on Tuesday 5th September.*
- **The PMI surveys suggest economic momentum stabilised in August after months of slowdown. Downward pressure on manufacturing activity appears to have dissipated, while construction activity accelerated. These have offset a further softening in services activity. Overall economic momentum is still weak, but assuming policymakers continue to step up support then a modest cyclical recovery is likely.**
- We learned on Thursday that the official manufacturing PMI increased from 49.3 in July to 49.7 in August (the Bloomberg consensus was 49.2 and our forecast was 49.0). Friday's release showed that the Caixin manufacturing PMI jumped from 49.2 to 51.0 (Bloomberg and CE: 49.0).
- **The average of the two rose to a five-month high and is consistent with factory activity remaining largely unchanged last month.** (See Chart 1.) Given differences in the composition of the firms surveyed, the smaller increase in the official index suggests that larger firms and those located in inland regions continue to face bigger headwinds.
- 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 above 50. This appears to reflect an improvement in domestic demand – the new orders component rose and is now above 50. Downward pressure on foreign demand eased as well – the export orders component edged up. But it remains under 50 and continues to point to a further drop in exports. (See Chart 2.)
- **The pick-up in domestic demand for manufactured goods appears to reflect stronger construction activity.** The official construction PMI, also released on Thursday, rose from 51.2 to 53.8. The main prop seems to have been a pick-up in fiscal spending on infrastructure projects – local government bond issuance jumped on the back of directives in early August instructing local governments to fully utilise annual quotas for special bonds by the end of September.
- But this was not enough to prevent a fall in the official non-manufacturing PMI, from 51.5 to 51.0 (Bloomberg: 51.2, CE: 51.5). That's because the much larger service sector continued to struggle. The official services PMI declined from 51.5 to 50.5, its lowest since reopening. Tuesday's release of the Caixin services PMI showed a fall as well, from 54.1 to 51.8 (Bloomberg: 53.8, CE: 52.0). **Taken together, the average of the two services PMIs fell to an 8-month low of 51.1.** (See Chart 1 again.) **That is well below its 2019 average of 52.8, and consistent with a further loss of momentum in the sector last month.**
- **All told, the average of the official and Caixin composite PMIs was unchanged at 51.5, ending a four-month run of declines. But it remains well below pre-pandemic levels** – the average in 2019 was 52.5. Thanks to the latest improvement in factory and construction activity, pressure on the labour market appears to have eased slightly, with the composite employment component edging up – consistent with the jobless rate dropping back. (See Chart 3.) There are also some signs that disinflationary pressures eased last month. The average of the manufacturing PMIs output price components rose, pointing to producer prices holding

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largely stable after months of declines. (See Chart 4.) And the average of the services PMIs sales price component suggest price pressures were largely unchanged in the services sector too.

- **Although the economy appears to have avoided a further slowdown, it is still facing some major challenges.** External headwinds look set to persist for a while longer, while troubles among property developers are weighing on sentiment among homebuyers and firms. The current prop from fiscal policy could also prove short-lived – local governments have been told to spend all special bond proceeds by end-October, after which infrastructure investment will drop back unless more fiscal firepower is provided. **Encouragingly, wider stimulus efforts finally seem to be gaining momentum**. A support package to boost the property sector was announced on Thursday while state banks started cutting deposit rates on Friday. **The latest moves support our base-case for a modest reacceleration in growth over the coming quarters**.

Chart 1: PMIs (average of Official and Caixin)

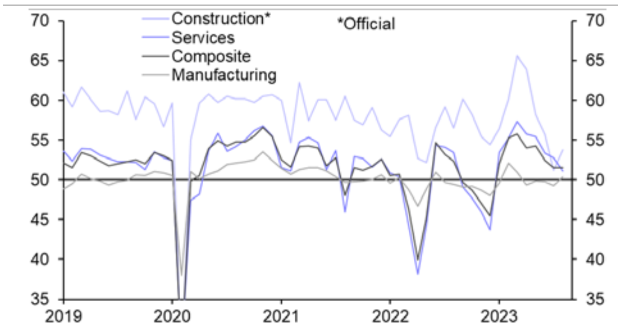


Chart 2: Exports & Official PMI – Export Orders

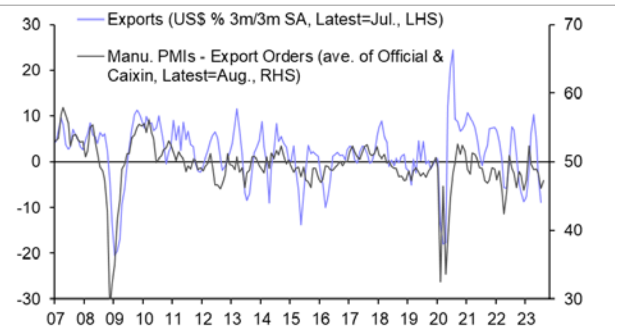


Chart 3: Unemployment Rate & Composite PMI

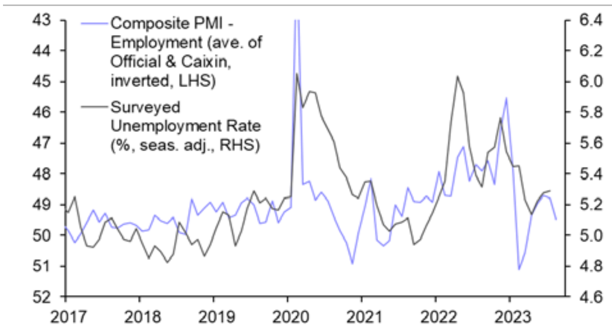
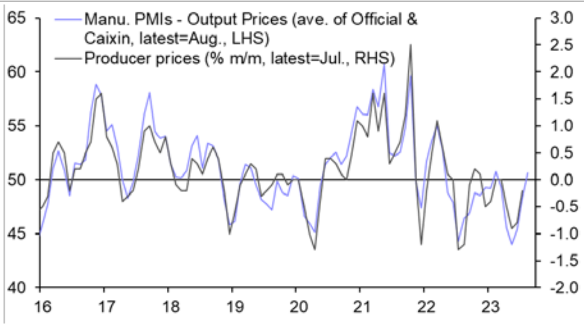


Chart 4: Producer Prices & PMI Output Prices



Sources: CEIC, Capital Economics