

Economic Analysis

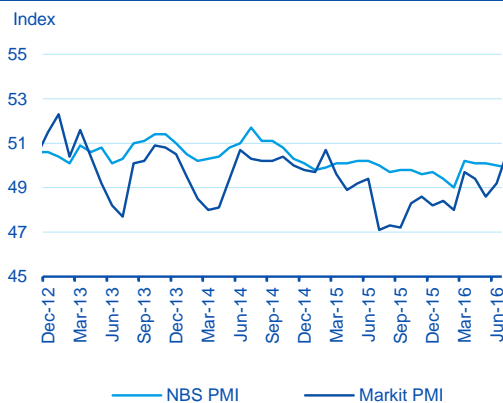
China | July PMIs depict mixed picture, exerting pressure on PBoC to implement more monetary easing

Carlos Casanova / Le Xia

China's official factory gauge contracted in July after expanding for four consecutive months, falling below the key 50 level separating growth from contraction and missing economist expectations. The NBS PMI came out at 49.9 in July (Consensus: 50), down from 50.2 in June. In contrast, the Caixin PMI, which tracks private sector SMEs, increased to 50.6 in July compared to 48.6 last month (Figure 1). The latest outturns indicate that stimulus-led growth may have started to "lose some steam", instigating a debate on whether PBoC should implement more monetary easing. We believe that the policy stance will remain pro-growth going forward, and expect three additional RRR cuts in addition to one interest cut in the remainder of the year. Despite persistent headwinds to growth, we don't foresee a hard-landing this year, and so maintain our growth forecast at 6.4% for 2016 (the official target is 6.5%).

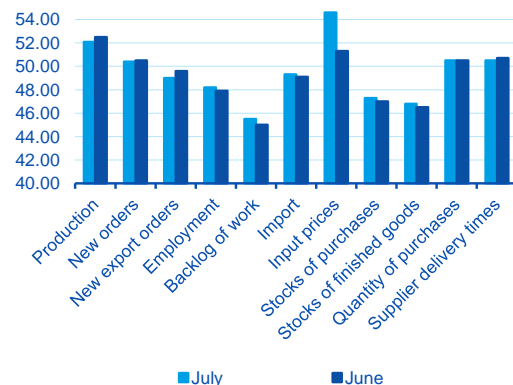
- Subcomponents of the NBS PMI reflect diverging trend:** The NBS PMI edged down slightly in July despite a significant increase in input prices (+3.3 points) and an uptick in the employment index (+0.3 points). The latter remains below the watershed level of 50 points, indicating a contraction in manufacturing labour. Furthermore, July's PMI results show signs of weakness on the external and domestic demand fronts. New orders edged down marginally while new export orders experienced a more significant decline of -0.6 points. Stocks of finished goods and purchases increased marginally (+0.3 points each) further confirming this trend. Together, these factors contributed towards a slowdown of manufacturing production growth from 52.50 in June to 52.10 in July (Figure 2).
- Pressure on PBoC to implement more monetary policy easing:** Stimulus measures have aided the stabilization of growth in 1H16; but headwinds to growth persist as this recovery is fundamentally reliant on government spending and credit. Fundamentals remain sluggish. Furthermore, external demand will remain weak as uncertainties surrounding Brexit are bound to negate any positive spill-overs stemming from the delay in the Fed's pace of interest rate hikes. Accommodative monetary as well as fiscal policy stances will be necessary in order to prop up domestic demand in the interim. We expect three more RRR cuts in addition to one interest cut in the remainder of the year. We maintain our growth forecast at 6.4% for 2016.

Figure 1
NBS PMI versus Caixin PMI



Source: CEIC and BBVA Research

Figure 2
Subcomponents of the NBS PMI



Source: NBS and BBVA Research

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