China Flash

A positive surprise to July PMI provides some respite from worries of a hard landing

The official NBS PMI for July rose to 50.3 (BBVA: 50.0; consensus: 49.8) from 50.1 in June, maintaining a +50 reading for a 10th consecutive month (Chart 1). The increase was broad-based, as readings for both large and small firms rose, reflecting an improvement in both domestic and external demand. However, some caution is in order as the private HSBC (Markit) PMI, also released today, fell to 47.7 (exactly in line with last week's Flash estimate) from 48.2 in June, recording a sub-50 reading for a third month in a row. The reason for divergence between the two series is not clear, and could reflect differences in sample size and focus (the HSBC indicator is oriented toward smaller and more export-oriented firms that have been struggling more than their larger domestically-focussed counterparts). Nevertheless, the positive official PMI outturn is a sign that the growth slowdown is not especially severe (Q2 GDP growth, after all, was 7.5% y/y), and together with policy support measures announced by the government in recent days, adds confidence that growth should remain at the official 7.5% target in 2013, although uncertainty lingers for 2014. We await monthly activity indicators on August 8-9 (inflation, trade, industrial production, retail sales, and investment) for the next reading on growth momentum.

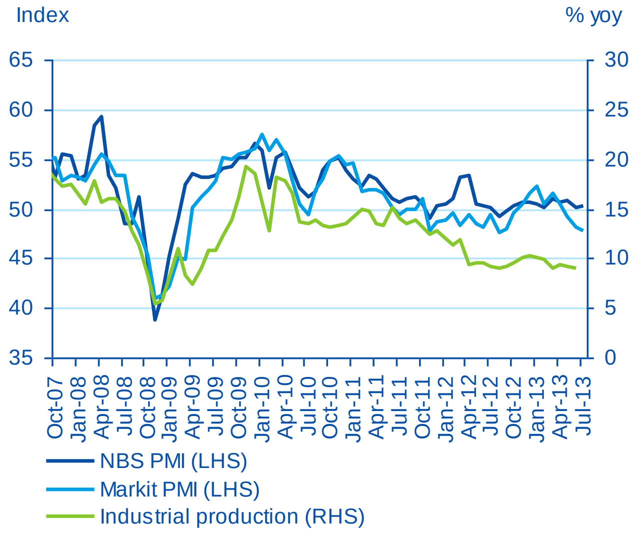
- **The improvement in the official PMI was broad-based.** The production sub-index in July increased to 52.4 from 52.0 in June, and new orders edged up to 50.6 from 50.4 (Chart 2). Raw material inventories rose to 47.6 from 47.4, on a deceleration in destocking by firms, while employment improved to the highest since April, to 49.1 from 48.7 in June. Encouragingly for external demand prospects, new export orders jumped to 49.0 from 47.7, after export growth slumped to a disappointing -3.1% y/y in June. As noted above, caution is in order due to the continued weak HSBC PMI readings, which have diverged from the official readings in recent months. Such a divergence last occurred in mid-2012, when the economy was also decelerating (see Chart 1).
- **While the policy stance continues to be restrained to curtail financial fragilities, the authorities are implementing fine-tuning measures to support growth.** Fiscal policy remains growth supportive, underpinned by infrastructure spending, tax cuts, and public housing construction. Monetary policy, meanwhile, has been focused on maintaining adequate liquidity, while restraining rapid credit growth and shadow banking activities. In recent days the government has announced a series of small measures to support growth, such as waivers of value-added and business taxes for select SMEs, simplification of export procedures, and steps to facilitate private investment in public services. We will continue watching monthly activity indicators, including next week's release of key data, and beyond that the Annual Party Meeting in October, where the government will establish its policy targets for 2014 and longer-term reform agenda.

Stephen Schwartz
stephen.schwartz@bbva.com.hk
+852 2582 3218

Fielding Chen
Fielding.chen@bbva.com.hk
+852-2582-3297

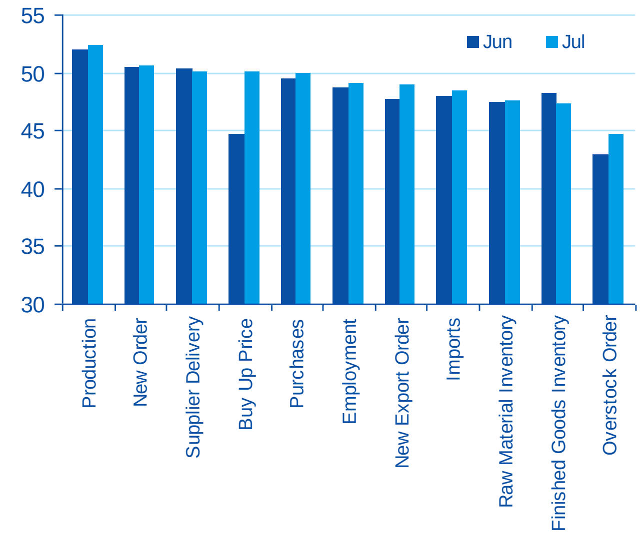
George Xu
george.xu@bbva.com.hk
+852-2582-3121

Chart 1
Official PMI ticks up and remains above the expansion zone…



Source: CEIC and BBVA Research

Chart 2
… and the improvement is broad-based across most major subcomponents



Source: CEIC and BBVA Research

BBVA RESEARCH | 10/F., Two IFC, 8 Finance Street, Central, Hong Kong | Tel.: +852 2582 3111 | www.bbvaresearch.com