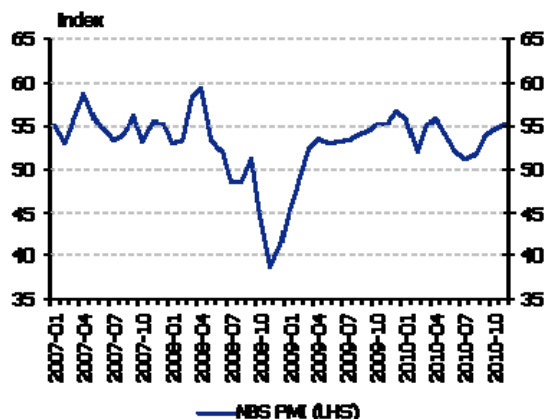


Summary: Following a recent string of strong activity readings, China's November Purchasing Managers' Index (PMI) came out higher than expected for a fourth straight month, at 55.2 (BBVA: 54.9; consensus: 54.8), providing further indication of robust domestic and external demand. The PMI outturn is likely to reinforce concerns about overheating and inflation, and make it even more likely in our view that the authorities will implement further monetary tightening measures, as previously anticipated. We continue to anticipate further hikes in reserve requirements over the coming year of around 100bps, and interest rate hikes of up to 100bps by end-2011. Indeed, we would not rule out an interest rate hike before the end of this month, and we will watch for the next batch of monthly indicators and inflation due out on December 13.

November PMI signals stronger growth momentum

- China's official (NBS) PMI for November rose to 55.2% from 54.7% in October, ahead of expectations for a fourth straight month (BBVA: 54.9% Consensus: 54.8%). (A reading above 50 indicates economic expansion). The PMI has been trending up for four consecutive months since July (Chart 1), indicating stronger growth momentum after a lull in mid-2010. We expect GDP growth to reach at least 9.1% y/y in Q4, which would bring full-year growth for 2010 to 10.1%.
- The two largest components of the PMI index, "production index" (with a weight of 25%) and "new orders index" (with a weight of 30%), rose 0.6 and 0.1 percentage points respectively.
- New export orders index gained 0.6 percentage points to 53.2%, indicating robust external demand. Inventories of finished goods and of raw materials rose to 47.7% and 49.7%, respectively. Perhaps more notably, input price index increased further from 69.9% to 73.5%, which could be a sign of inflationary pressures in the pipeline (recall that October CPI inflation reached a two-year high of 4.4%, well ahead of previous expectations).
- We expect the authorities' increasingly aggressive approach to monetary tightening to continue, along with further measures to curb inflation and tame the rise in property prices. As mentioned by PBoC Deputy Governors Hu and Ma in recent weeks, the central bank will continue to watch price increases closely, along with trends in market liquidity and economic growth, and will take "responsive" measures accordingly. They indicated a shift in the monetary stance from "accommodative" to "normalizing".
- The latest data set the stage for the upcoming "Central Economic Work Conference" in mid December, in which 2011 policy targets will be set. It is expected that the inflation projection (or "target") may be increased from 3% to 4%, along with a lower target for new loan growth.

Chart 1 PMI has been trending upward since July



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