

# BBVA Research Flash

China

## October PMI below expectations; still in line with soft landing

China's Purchasing Managers Index (PMI) fell to 50.4% in October after two consecutive months of increases (from 50.7% in July to 51.2% in September). The October outcome was well below expectations (consensus: 51.8%; BBVA: 51.7%) and is the lowest reading since March 2009, with the decline attributable to lower "new orders", including for exports due to weakening external demand. While the lower-than-expected outcome could reflect dimming growth prospects, it is still within the expansion zone (+50). In addition, the private sector (Markit) index rose for the month (see below). Importantly, we believe the trend is in line with our soft-landing scenario, in which we expect a moderation in Q4 GDP growth to 8.4% y/y from 9.1% y/y in Q3 (resulting in a projected annual growth outcome of 9.1% for 2011). On the policy front, the softer PMI reading increases the likelihood of some selective monetary policy easing, which could in the coming months include further measures to expand credit to SMEs and possible cuts in required reserve ratios for smaller banks. Interest rate cuts are unlikely at this juncture given the authorities' ongoing concern about inflation.

- China's October PMI outcome ended two consecutive monthly increases and fell to 50.4% from 51.2% in September (Chart 1) (BBVA: 51.7%; consensus: 51.8%). The weaker-than-expected outcome is mainly due to lower new orders, including for exports, which may reflect a continuation of the trend of falling export growth evident in the September data (17.1% y/y). The private-sector (HSBC) PMI, also released today, actually increased to 51.0% from 49.9% in September, rising above the +50 expansion zone for the first time since July 2010. This may help offset some of the market concern about the pace of the decline in the official PMI. It is difficult to reconcile the disparity of the two indices, which normally tend to move in the same direction (the Markit index is based on a set of smaller and more export-oriented companies).
- By category, the subcomponent of new orders (with a weight of 30%) declined to 50.5% in October from 51.3% in the previous month, mainly driven by falling new export orders, which slipped into contraction, at 48.6%, from 50.9% in September. The subcomponent of imports also fell to 47.0%, down by 3.1 percentage points compared with September. Encouragingly, the subcomponent of production (with a weight of 25%) remained buoyant, declining only marginally, to 52.3% in October from 52.7% in the previous month (Chart 2).
- Overall, the PMI outcome of October further indicates that the rising external headwinds are having an influence on the Chinese economy. However, the moderation of PMI has been gradual and remained consistent with a soft-landing track. Notably, the sub-index of input purchase prices declined by 10.4 percentage points, to 46.2% in October, suggesting a further easing inflation pressure in the pipeline. This increases the room for selective policy easing, as noted above. Scope for such easing may be a factor for the modest market response to the release, with the Shanghai equity index flat at the time of writing.
- In the coming week (November 9-15), a stream of important real activity indicators will be released, including inflation, trade, industrial production, investment, sales, money supply, and foreign reserves. These will be watched closely for further signs of the resilience of the economy in the face of weakening external demand (Chart 3).

Chart 1: PMI turned down in October

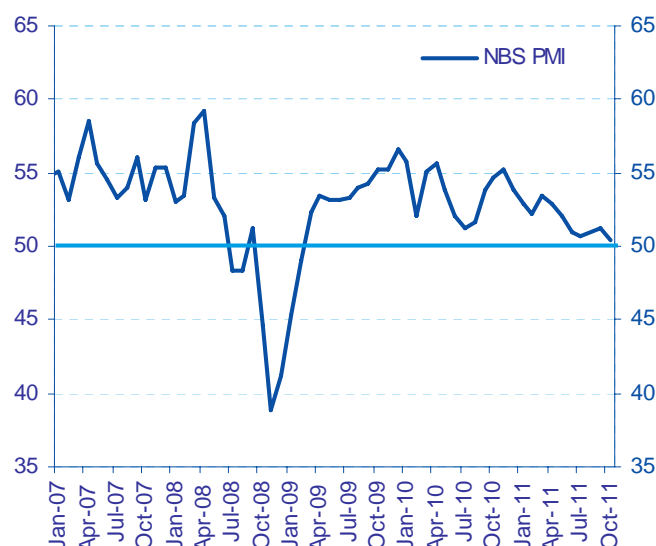
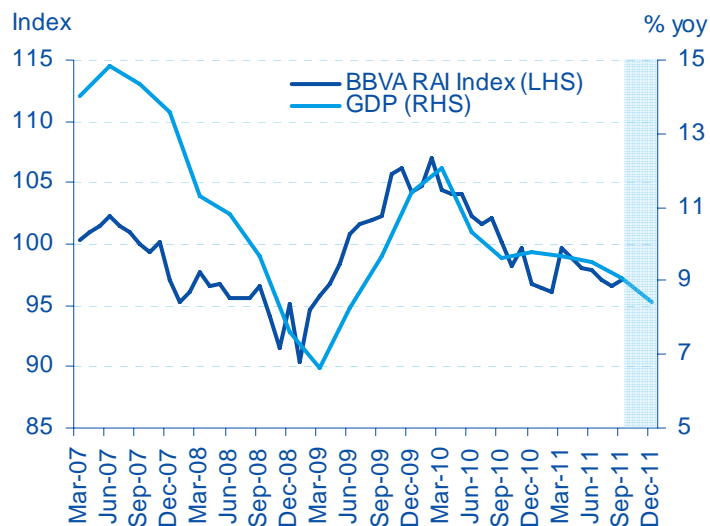


Chart 2: PMI components weakened



Chart 3: GDP growth is moderating gradually



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