

# China Flash

## November PMI signals weakening growth, as PBoC cuts RRR

China's Purchasing Managers Index (PMI) for November registered a weaker-than-expected outturn of 49.0% (BBVA: 50.2%; Consensus: 49.8%), down from 50.4% in October. Significantly, the outturn (below 50) means that the index has slipped into contraction territory for the first time since February, 2009 (Chart 1). Although the decline in the index was relatively broad-based across key subcomponents (Chart 2), the slowdown appears tilted toward deteriorating external demand. The private sector (Markit) index, also released today, showed an even steeper decline (not surprisingly, given its orientation toward export-oriented companies). Taken together, the economy now appears to be slowing at a faster pace than we had projected ([China Outlook](#)), potentially posing downside risks to our 8.9% growth forecast for 2012. We expect the authorities to respond with more expansionary policies. This explains the earlier-than-expected 50bp cut in the required reserve ratio announced late yesterday (Chart 3), and we would anticipate another such cut in early 2012. Although we still do not anticipate interest rate cuts, they too may be forthcoming during the course of 2012 if the external environment does not stabilize.

- **China's November PMI outturn fell to 49.0% from 50.4% in October (Chart 1) (BBVA: 50.2%; consensus: 49.8%),** slipping into the contraction zone (<50%) for the first time since February, 2009, when China was recovering from the global financial crisis. The private-sector (HSBC) PMI (the Markit index), which is based on a set of smaller and more export-oriented companies, also released today, decreased even more steeply, to 47.7% from 51.0% in October.
- **By subcomponent (Chart 2), the decline was across the board.** Only 3 of the 11 subcomponents were above 50 ("production", "supplier delivery" and "finished goods inventory"). In particular, new orders (with a weight of 30%) declined to 47.8 in November from 50.5 in the previous month, mainly driven by falling exports. The imports subcomponent increased compared to last month, perhaps due to still buoyant domestic demand. Encouragingly, the production subcomponent (with a weight of 25%) remained in expansion zone, at 50.9% from 52.3% in October.
- **Although the PMI outturn shows that external headwinds are weighing on China's growth, and increasing downside risks, we hold to our soft-landing scenario.** Importantly, the authorities are shifting their restrictive policy stance to a more supportive one, as reflected in yesterday's RRR cut (Chart 3). This 50bp cut lowers the RRR of large commercial banks to 21.0% from 21.5%, effective December 5, and reduces that of small and medium size banks to 19.0% from 19.5%. In aggregate, it is expected to inject liquidity of around RMB 370-390 billion (USD 60 billion) to the banking system.
- **A stream of important real activity indicators will be released next week (December 9-15), including inflation, trade, industrial production, investment, and retail sales, among others.** 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

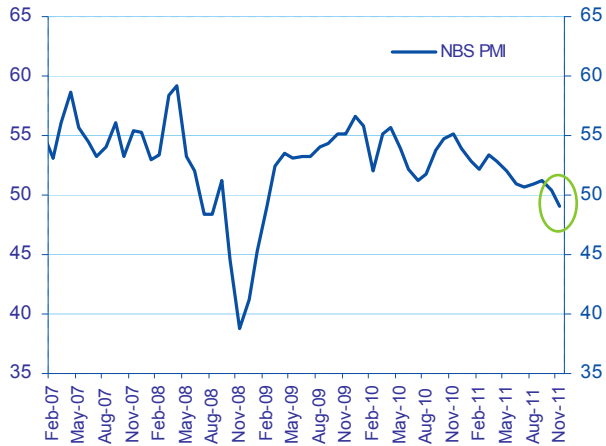
**PMI turned down in November**

Chart 2

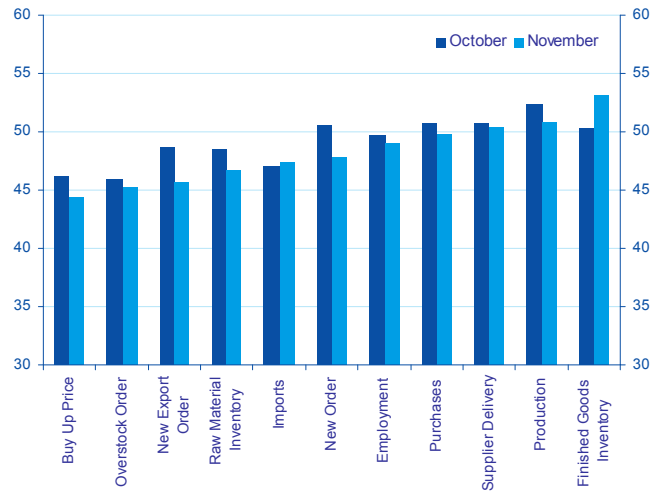
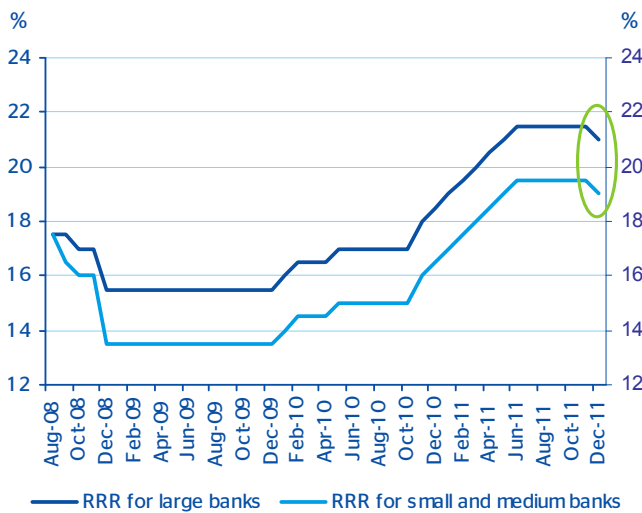
**PMI components weakened**

Chart 3

**RRR cut for the first time since December 2008**

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