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# China Flash

## China's August manufacturing PMI disappoints, adding to downside risks and raising expectations of more policy easing

China's official NBS Manufacturing Purchasing Managers Index (PMI), released on September 1, declined to a weaker-than-expected 49.2% (BBVA: 49.6%; Consensus: 50.0%), from 50.1% in July (Chart 1). The index fell to below 50 for the first time since November 2011, reflecting weaker production, as well as both domestic and external demand components (Chart 2). Meanwhile, the private-sector (Markit) PMI, released today, also weakened sharply, to 47.6 (compared to a flash estimate on August 23 of 47.8) from 49.3 in July. Taken together, the data releases reveal that China's growth momentum has yet to rebound, raising the likelihood of further policy stimulus in the form of further cuts in the RRR and interest rates (Charts 3 and 4). With inflation well contained at around 2%, we anticipate 100-150bps cuts in the former and up to 50bp cuts in the latter by year-end. These measures are being accompanied by fiscal support at both the central and local government levels. Key August activity indicators will be released on September 9, including retail sales, industrial production, and investment. Our full-year GDP growth projection of 7.8% remains intact, although downside risks are increasing due with the weak economic data.

- **The official PMI for August shows broad-based decline in production and demand.** On the supply side, the production subcomponent (with a weight of 25%) eased to 50.9% from 51.8% in July. The employment subcomponent (with a weight of 20%) also declined, to 49.1% in August from 49.5%. On the demand side, the overall new order subcomponent (with a weight of 30%) moderated to 48.7% from 49.0% in the previous month, reflecting weaker market demand ahead. Meanwhile, the new export order subcomponent remained flat at 46.6%, still the lowest since December 2011.
- **The PBoC and fiscal authorities are likely to step up their policy response to support growth.** The PBoC has refrained from cutting the RRR since May, although it implemented back-to-back interest rates cuts in June and July. In the meantime, the central bank has been aggressive in expanding liquidity injections through open market operations. The weak economic data are likely to tilt the PBoC toward further easing, despite concerns about fueling increases in housing prices (which can be contained through macro prudential and tax measures). We expect further fiscal support, in addition to the recent announcements by several local governments of ambitious infrastructure spending plans.
- **A batch of important economic indicators in August will be released in the coming days (September 9-15),** including inflation, industrial production and retail sales on September 9, trade on September 10, and credit aggregates on September 11-15. These indicators will be watched closely for further signs of growth momentum and economic outlook.

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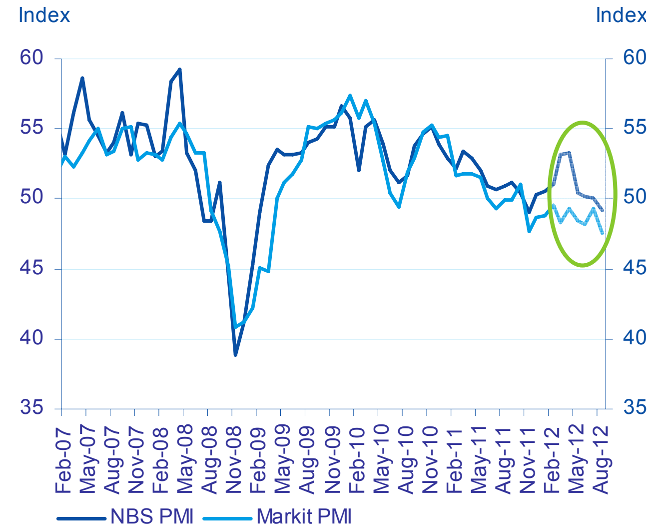
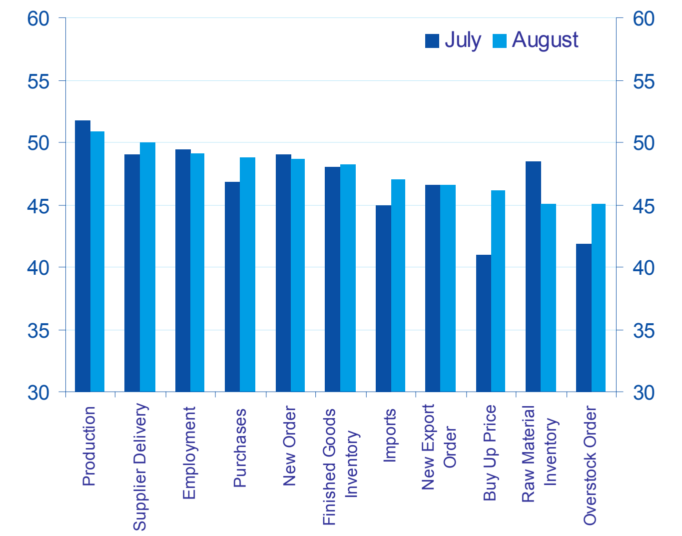
Chart 1
**PMI points to weakening growth momentum**



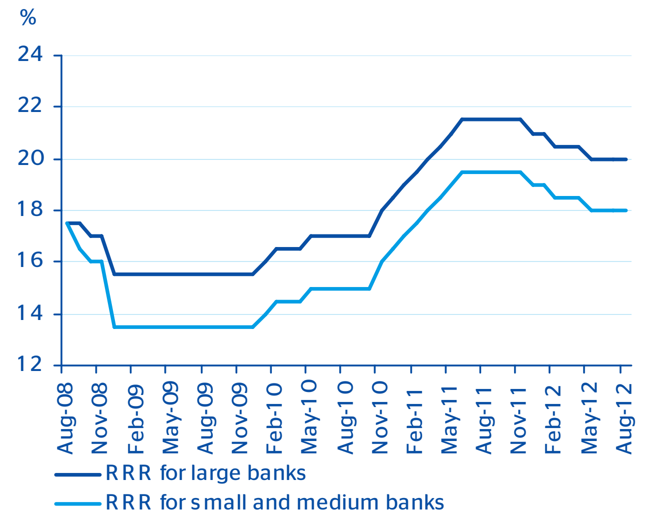

Source: CEIC and BBVA Research

Chart 2
**… as new production and new orders further declined**



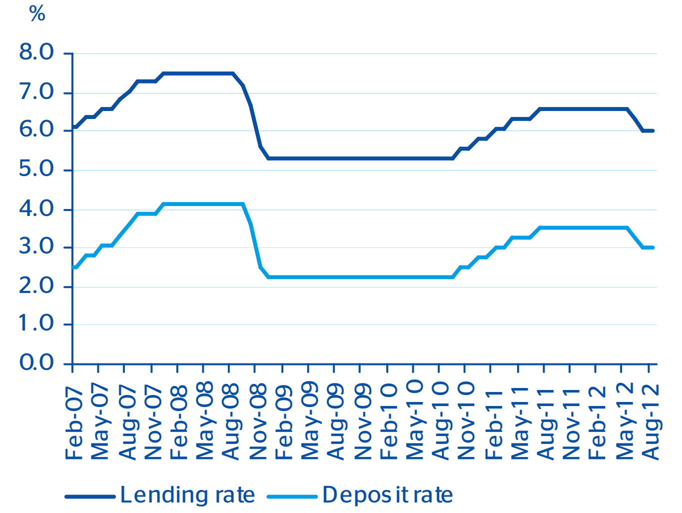

Source: CEIC and BBVA Research

Chart 3
**Further cuts in the RRR are anticipated…**




Source: CEIC and BBVA Research

Chart 4
**… on top of 1-2 more cuts in interest rates by year-end**




Source: CEIC and BBVA Research

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