China Flash

November PMI affirms gradual economic pickup

China's official PMI for November (released over the weekend on December 1) rose for a fourth consecutive month, to 50.6 (BBVA forecast: 50.9; Consensus: 50.8) and was above the 50 expansion threshold for a second month in a row (Chart 1). While slightly below expectations, the outturn confirms an economic pickup in Q4 after bottoming out in Q3. Encouragingly, new orders and production continue to gain pace, and the material inventory sub-component is increasing, suggesting an end to the inventory destocking cycle – all of which bode well for production in the coming months, consistent with last month's batch of strong activity indicators (for details, see *China Flash*), and our projected increase in GDP growth in Q4 to 7.5-8.0% y/y, which would bring full-year growth to 7.6% in 2012 and 7.9% in 2013. The private-sector Markit/HSBC PMI (which represents smaller manufacturers) was released today at 50.5, above the 50 expansion level for the first time in 13 months. Given uncertainties in the global economy, benign inflation, and downside risks to the outlook, we expect further policy easing in the coming months, especially if the external environment remains weak. This will entail further fiscal support and monetary easing in the form of further RRR cuts and up to one more interest rate cut.

- **The official PMI for November shows broad-based increases, led by new orders (Chart 2).** The new order sub-indicator jumped to 51.2 from 50.4 in September, while the new export order sub-indicator rose above 50 for the first time in 6 months to 50.2 from previous 49.3. The pick up in both sub-indicators encouragingly points to the improving demand both from domestic and external. In the meantime, the production improves steadily to 52.2 from previous 52.1, suggesting industrial production is likely to improve further over the coming months. Nonetheless, the employment sub-indicator fell to 48.7, the lowest since February, underscoring employment –- one of the major concerns of the Chinese government -- is likely to fall behind economic recovery.
- **We will be watching for the outcome of the annual Central Economic Work Conference (CEWC) in mid-December, along with November activity indicators.** The CEWC may result in the setting of next year's growth target, widely expected to be in the 7.0-7.5% range, along with further clarity on the course of economic policies. In the meantime, we will also be watching for November activity indicators. We expect inflation to rise slightly towards 2.0% y/y in November (from 1.7% y/y in October) on rising food prices, and to rise to only 2.6% by end-year. Other indicators such as industrial production, retail sales, and fixed asset investment should also show a further pickup from September.
- **There is room for further policy easing over the coming year.** Given downside risks to the outlook and limited inflationary pressures, we still see room for a possible interest rate cut (increasingly an out-of-consensus call), as well as 1-2 more cuts in the RRR over the coming year. The strength of incoming activity indicators, external demand, and domestic liquidity will be key factors for the authorities in determining their monetary stance. Further fiscal support could also be forthcoming, especially as the leadership transition is fully complete in March (the 18th National Communist Party meeting in November has selected Politburo members and Standing Committee, paving the way for the new the new President and Premier to be installed in March).

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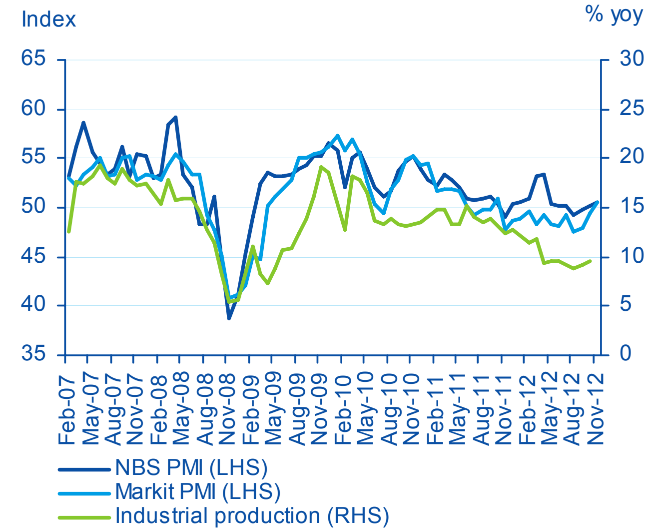
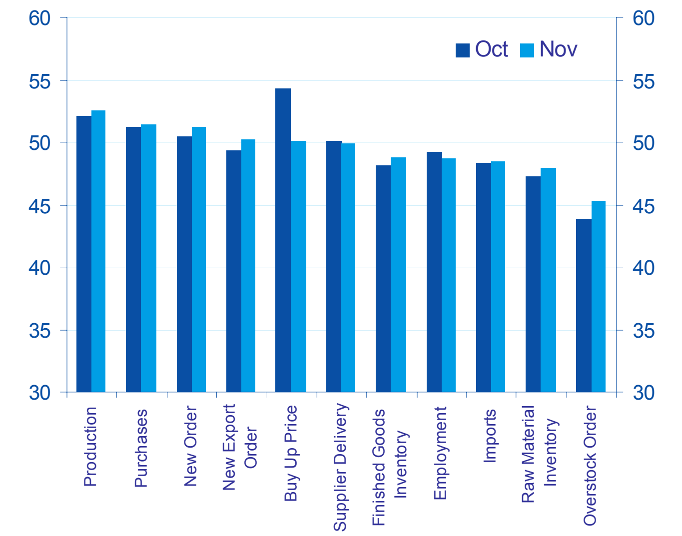
Chart 1
Official PMI remains above the expansion zone…



Source: CEIC and BBVA Research

Chart 2
… as production and new orders further improve



Source: CEIC and BBVA Research

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