China PMI: domestic driven growth but exports are a looming risk

China's Caixin manufacturing PMI rose in October, even though the official manufacturing PMI for the same month fell (though remained above 50). Combined with the non-manufacturing PMI, it looks like domestic demand is holding strong. But it still faces the risk of falling export demand as a result of rising Covid-19 cases in Europe and the US.

Woman wearing a face mask to help curb the spread of Covid-19 as her friends prepare to set up a picnic cloth on a scenic mountain in Yanqing, outskirt of Beijing, China

Source: Shutterstock

Strong domestic demand

From a combination of the Caixin manufacturing PMI (which surveys smaller firms), which increased to 53.6 from 53.0, and the official manufacturing PMI, which edged down slightly to 51.4 from 51.5, and a strong non-manufacturing PMI at 56.2, it is clear that China's economy is growing.

Sub-indices of stronger growth in new orders compared with new export orders imply that this growth has come mainly from domestic demand. In October, there is a long holiday in Mainland China, and tourism activities were reflected in the strong non-manufacturing PMI.

But the risks of weak external demand are rising and could hurt domestic demand

Looking ahead, we expect external demand to remain weak due to the increases in Covid-19 cases in Europe and the US, which are leading to stricter social distancing measures and may affect China's exports in the coming months.

This will affect not only manufacturing activities in China but also employment in this sector. More workers are moving from manufacturing to services due to more cross-provincial travel, but there could be a limit to how many more staff the service sector can take.

A squeeze on manufacturing employment could feed through to the lower-skilled service sector, weighing on wages and reducing the spending power of the large low-income class.

This worry is not imminent but could be something worth keeping in mind if Covid cases continue to at high levels.