

China PMI surprisingly low but don't worry

Though China's manufacturing PMI looks alarming, almost at the 50 borderline, it is largely a holiday effect. We are positive for coming months' trend. Non-manufacturing PMI disappointed, which shows that consumption still has room to grow to offset low activity from financial and real estate service sectors



Source: Shutterstock

Don't worry, even manufacturing was surprisingly low

Manufacturing PMI went down to 50.3 in February, which is the month of Chinese New Year in 2018. It came down from 51.3 in January.

It seems alarming, but looking at the breakdown of the index we can see that new orders from domestic market were still good at 51.0, and expectations of business activity stood at 58.2, higher than January's 56.8. These numbers imply that the low reading is likely driven by holiday effects, rather than by any underlying slowdown in coming manufacturing activity.

Overcapacity cuts and environment protection to continue in 2018

Supply side reform that leads to the closing down of factories that produce materials inefficiently or with high pollution will continue in 2018. We expect overcapacity cuts to move from iron, steel and coal in 2017 to cement and glass in 2018.

This may not be as bad as it seems. Cutting production should mean lower GDP. But the factories that remain in business in those sectors should enjoy higher prices and therefore higher profits.

Environmental protection should force factories to upgrade their facilities to meet environmental regulations. These investments by factories will add to GDP.

All in all, we are still positive on manufacturing in 2018.

Lower non-manufacturing data shows that consumption still has room to grow

Non-manufacturing PMI declined to 54.4 from 55.3 in January. On the one hand, this is understandable as the banking, financial and real estate sectors were off for at least two weeks in the month. But on the other hand, it shows that consumption, tourism, and the travel sectors did not balance off the lower activities during the long holiday period.

That implies there is still room for consumption to increase. Our view is positive on future consumption trends, that is, we may see higher non-manufacturing PMIs during long holidays when consumption continues to catch up as China is building up its middle-income class. Even so, that may not happen in 2018, however, it could be a likely scenario around 2020.