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Snap

## China PMI will continue to drop but remain above 50

We expect that China's manufacturing PMI and non-manufacturing PMI will continue to drop but show that activity is still expanding, thanks to tax cuts and other stimulus measures.

### Manufacturing activity could expand more slowly

We expect the manufacturing PMI to fall from 50.8 last month to 50.3 in October.

The main reason for this is that the trade war will be hurting manufacturing activity as tariffs imposed by the US are too costly for Chinese exporters to fully absorb. But we still expect the reading to be above 50 because we think that stimulus measures (e.g. export tax rebates) and salary and corporate tax cutting measures should support domestic consumption for the time being. Therefore manufacturing activity for the domestic market should continue to rise.

### Services will continue to expand, but again more slowly

We expect the non-manufacturing PMI will also fall from 54.9 to 54.5 in October.

Real estate activity will be the main drag on the non-manufacturing PMI. But this may not last long because if home prices start to fall across the whole country, some local governments will have to re-think their attitude to mortgage borrowing. We expect that some locations may ease housing constraints a bit to avoid home price falling steeply. This would help real estate's sub-index in the non-manufacturing PMI.

Banking activities slowed in October. This may be reversed in November as we expect a rise in financial activity as easing measures boost bank lending to SMEs and other private-owned entities.

### Domestic demand is now crucial to support the economy

With an escalating trade war between China and the US, the Chinese government is using both fiscal and monetary stimulus measures to support local demand.

We see domestic demand as a crucial factor to support the whole economy as it will avoid massive job losses and drive activity from export demand to local demand. As we have claimed before, the current Chinese economy is now advanced enough to absorb goods that are designed for export, which is very different from 10 years ago, when exported goods did not match local market demand due to big differences in purchasing power.

### We keep our forecast of USDCNY at 7.0 by end 2018

Tariff news will continue to weaken the yuan, and USDCNY is heading towards 7.0. We believe that USDCNY will hit 7.0 a few times before crossing over, so it will not create any surprise to the market when it happens.

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