China: PMIs show shrinking domestic demand

The Caixin PMI (like the official PMI), fell below 50 in December, which means manufacturing activities are contracting. Even more eye-catching was that "new orders" in both PMIs fell from expansion in November to contraction in December. This confirms our view that the economy is weak and that stimulus needs to arrive quickly.

Workers at en electronic factory in Eastern China

PMIs show manufacturing activities shrinking

Today's December Caixin manufacturing PMI fell from 50.2 in November to 49.7. This echoes the official manufacturing PMI, which fell from 50.0 to 49.4. The sub-indices of both PMIs tell us more.

New orders of the two PMIs also fell from expansion to contraction. This means not only that the export sector faces shrinking manufacturing activities but that the domestic manufacturing sector in general also faces contraction.

Combining with other activity data, the economy is weak

Together with a fall in industrial profits of 1.8%YoY in November from +3.6%YoY in October, and softer retail sales growth (8.1% in November from 8.6% in October), we can confirm that the economy is weakening.

The trade war has affected domestic demand

We believe that the data reflect that not only has the trade war damaged growth in the export sector. It has also hurt export-related supply chain companies and in turn, domestic demand.

If domestic demand is not supported by fiscal stimulus quickly, then further weakening will pose a risk to job security. That could create a vicious downwards cycle.

As a result, we expect the Chinese government to speed up the delivery of infrastructure investment to support the economy, which will mainly be through projects governed by local governments, e.g. new metro lines.

GDP at 6.3%

We currently estimate CNY 4 trillion fiscal stimulus (though if the economy weakens much more, this figure is likely to rise) as well as 4 further required reserve ratio cuts (0.5% to 1% each) and two interest rate cuts (5bps each) in 2019 to support the economy. If needed, local governments will ease housing measures. These measures should help support our forecast of 6.3% GDP growth for 2019.