China’s PMIs show growing risk from slowing external demand

Looking at the official and Caixin manufacturing PMI, we can get a more accurate picture of the recovery of the Chinese economy. The recovery is not smooth and we note that external demand is still fragile, which could pose a risk to domestic demand. The government might need to beef up fiscal stimulus quickly

China's manufacturing PMI rose to 50.1 in October

Official and Caixin manufacturing PMIs

The official manufacturing PMI covers large companies that are not covered by Caixin, and looking at both of these indices can give us a more accurate picture of China's manufacturing sector.

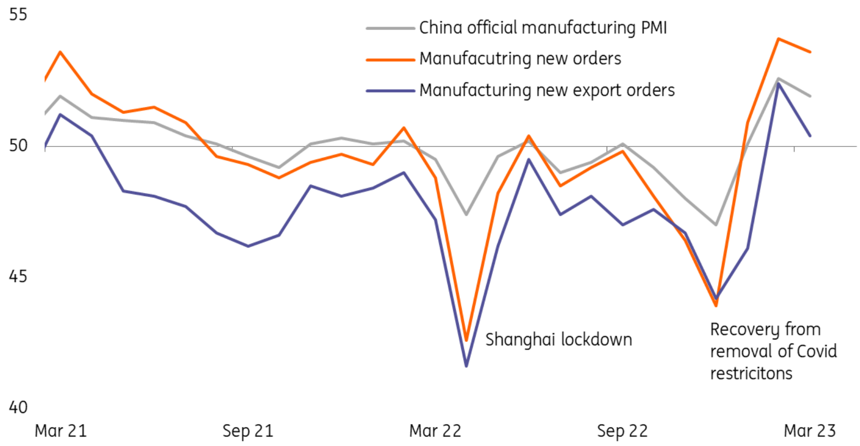
The official manufacturing PMI came in at 51.9 in March, down from 52.6 in February, but this is not too important as PMI is a monthly growth figure and the high PMI in February indicates an economic recovery after the long Chinese New Year holiday. More importantly, the March reading exceeded the market consensus of 51.6. The good news came from the new export orders sub-index, which continued to be in expansion at 50.4. This exceeded my expectations as export demand in the US and Europe should have slowed.

Comparatively, the Caixin Manufacturing PMI, whose sample covers more SME exporters, showed no month-on-month increase in manufacturing activity, with a reading of 50.0 in March compared to 51.6 in February. The smaller exporters in the Caixin sample should be hit harder by the slowdown in external demand than the exporter sample in the official manufacturing PMI.

Both official and Caixin manufacturing PMI sub-indices showed that new orders for the domestic market grew faster than new export orders. This reflects the divergence of growth in the Chinese market and the external market.

But the hit to the external market could be passed on to the domestic market in the second half of the year through less employment in manufacturing and thus wage growth across the economy. If external markets continue to slow, we cannot ignore this risk.

New export orders vs new orders sub-indices in official manufacturing PMI data



Source: CEIC, ING

Real estate contributed positively to official non-manufacturing PMI

The official non-manufacturing PMI jumped sharply to 58.2 in March from 56.3 in February, with the jump coming mainly from construction activity. Considering that this is a monthly comparison, the big increase in construction activity came from a month-on-month recovery in residential real estate construction. This is a good sign but doesn't signal a full recovery in the real estate sector.

Apart from the construction sector, the rest of the non-manufacturing activities also stayed well above 50.0, indicating that services grew faster than manufacturing activities in China.

We may see proactive fiscal support from the government

If foreign trade data continues to trend weaker, the government may need to be more proactive in providing fiscal support for infrastructure investment, and domestic market stimulus measures, such as consumption stimulus (not limited to automobiles), may be needed.

In short, the domestic market is stronger than the export market, and the service sector is stronger than the manufacturing sector. The economic recovery is gradual. This is largely consistent with our previous forecasts. Our GDP forecast for China at 5% remains reasonable. We lower our GDP growth estimate to 3.8% year-on-year for the first quarter from 4.5% due to slower external demand. As we expect the government to potentially increase fiscal stimulus after the weak GDP report for the first quarter, GDP growth from the second quarter on could be faster. As such, we revise our GDP growth estimate upward for the second quarter to 6.0% YoY from 5.2%.

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