

## Non-manufacturing PMI in contraction from Chinese government clampdown

The contraction in non-manufacturing activity was unexpected. Some negative factors, including government clampdowns, will continue to put downward pressure on the non-manufacturing PMI in the coming months. To support the economy, China needs a lower interest rate to fund infrastructure projects. A weaker yuan is expected



Source: Shutterstock

### Contraction in non-manufacturing activity comes from Covid and the clampdown on technology and education centres

China's manufacturing PMI was 50.1 in August, down from 50.4 in July, while the non-manufacturing PMI fell below 50 to 47.5 from 53.3 a month earlier.

For manufacturing activity, chip shortages are important, since production capacity for electronics is close to a bottleneck, if not already there. This affects production as well as export orders.

In contrast, the sudden contraction in the non-manufacturing sector comes from several parts of the economy.

- Policies aimed at reforming the technology industry e.g. data privacy, and the clampdown on education centres to reduce the costs of raising children. Both of these have hit non-manufacturing activity.
- The weakness of non-manufacturing activity also came from suspended port operations due to social distancing measures after some Covid cases were found in two ports and one airport in August.
- People have deferred cross-provincial trips as they are worried about being under lockdown away from their home cities in case Covid cases are found in a tourist city.

## Some damage is short-term but some is not

Localised lockdowns from Covid and the suspension of ports and airports will be short-lived. Covid is subsiding in China and these measures should not affect manufacturing activity in a prolonged way unless new Covid cases are found again at ports.

But the chip shortage could be a problem that lingers on into at least 2022 and perhaps even into 2023 as chip manufacturers install more production lines. This is not going to happen overnight and will continue to affect the manufacturing PMI.

Some changes in the technology industry are happening, especially on data privacy after the clampdown. This could be positive for the industry. But shutting down tuition centres is hurting the jobs market. The most recent policy to cap the time spent on online games for youngsters may also create redundancies.

Consequently, we expect both manufacturing and non-manufacturing PMIs to be lower in the coming months. The contraction in non-manufacturing activity is likely to continue in September as the job market has become shakier and this will affect consumption.

### Weaker yuan

As the government needs to find a way to support economic growth, infrastructure will likely be the first choice. The central bank will keep injecting liquidity into the financial system to suppress market interest rates so that local governments can fund infrastructure projects at a lower cost. This is in contrast to the Fed's tapering talk. As such, we expect the yuan to weaken to 6.7 against the US dollar by the end of the year.