

China

Growth slowdown signalled by China's manufacturing PMI

PMI sub-indices fall below 50

At a 14-month low of 50.4, China's Manufacturing PMI¹, produced on behalf of HSBC by Markit, approached the 50.0 'no change' level in June. Furthermore, the index has lost almost five points in the past two months, signalling the steepest slowdown since the height of the financial crisis in late 2008.

Several key sub-indices from the survey fell below 50 (meaning negative replies exceeded positive responses), including output, new orders, new export orders, backlogs of work, the amount of goods factories bought for use in production, stocks of inputs, and both input and output prices.

In fact the PMI only held above 50 because of a further rise in employment (itself a lagging indicator) and a lengthening of supplier delivery times.

However, the sub-50 readings do not necessarily mean an outright fall in the comparable official data, such as industrial production, because PMI numbers correspond to different growth rates of official data for different countries, depending on the structural change occurring in each country².

Slowdown in industrial production

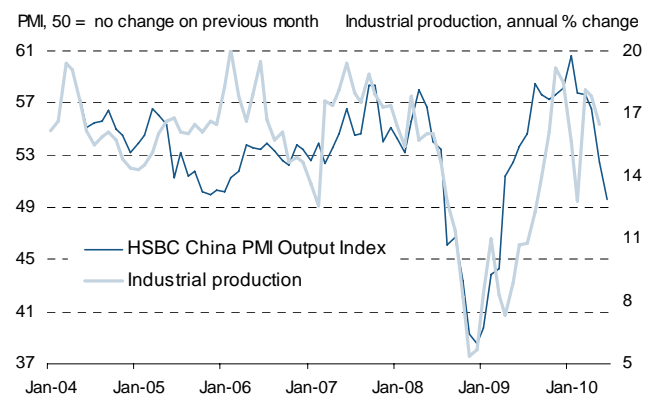
It is difficult to accurately estimate what the China PMI data translate into in terms of actual per cent changes in comparable official data because of the short history of the PMI series, which extends back to early 2004. However, working on what we have available, we estimate that the recent fall in the Output Index from its 60.6 point high at the start of the year to 49.6 in June suggests that the annual rate of growth of industrial production slipped from the near-20% rate seen at the end of last year to around 12-13%.

¹ The manufacturing PMI is a composite index based on five survey variables, including output, new orders, employment, pre-production inventories and supplier lead times.

² The PMI surveys, for example, only capture changes occurring in a stable panel of companies and as such does not measure growth in the number of companies throughout the year. Note, however, that the composition of the survey panel is reviewed each year in the light of new official data on the structure of the sector, to take into account the changing importance of each industry.

We estimate that it would need the Output Index to fall to perhaps as low as 25 before an outright year-on-year fall in industrial production were to be indicated.

Industrial production

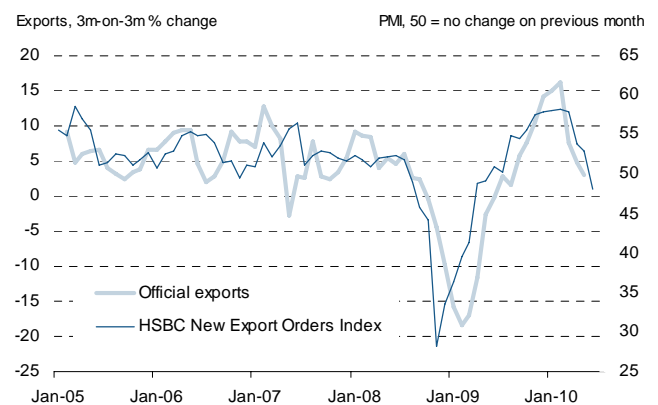


Sources: Markit, National Bureau of Statistics.

Export growth weakest since March 2009

The recent weaker growth of industrial production is linked to an easing in export order inflows in June. At 48.2, the latest New Export Orders Index reading from the PMI survey is approximately consistent with a near stagnation in the quarterly rate of growth in the official (National Bureau of Statistics) exports series, down from a surging 16.2% at the start of the year.

China export orders



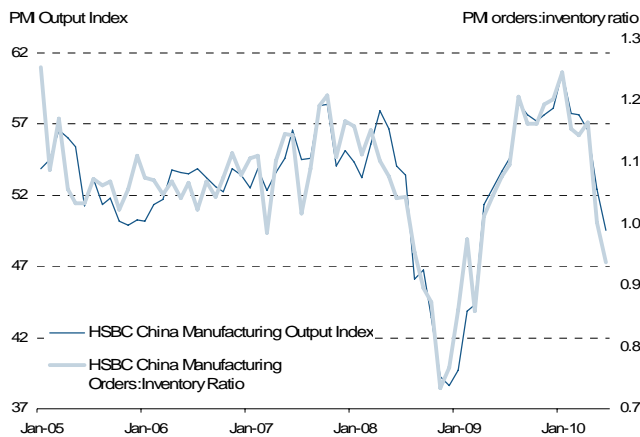
Sources: Markit, National Bureau of Statistics.

Inventories rise as order inflows weaken

The slower growth of export orders in recent months in part reflects a peaking in global trade flows, which is in turn being driven by the inventory cycle. While still supportive of growth, the temporary stimulus to manufacturing created by the restocking of factories has shown signs of fading in recent months (see <http://www.markit.com/en/about/news/commentary/markit-economics/markit-economics.page?>).

An indicator of the stimulus from inventory rebuilding is the ratio of new orders to inventories of finished stock. For China, this ratio has fallen from a peak in January to a 15-month low, as new orders fell in June for the first time since March of last year and stocks of finished goods rose for the third time in four months, in part due to weaker than expected sales. The low level of the orders:inventory ratio therefore suggests that stock building is providing little impetus to growth.

Output and the inventory cycle



Source: Markit.

Manufacturing order books and purchasing



Source: Markit.

Companies contributing to the manufacturing PMI survey responded to the latest deterioration in new orders by cutting back on their purchases of inputs, which fell for the first time since March of last year.

The sub-50 index readings in June do not indicate falling industrial production, but with manufacturers seeing their order book inflows deteriorate and inventories rise (while at the same time cutting back on their input buying from suppliers), the short-term growth outlook has clearly further deteriorated.

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