

China | Solid recovery continues in July

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Despite a lull of moderation in April-May, China's economic recovery has staged a comeback at mid-year. The official manufacturing PMI (released by NBS yesterday) in July remained in the expansionary territory at 51.4 (consensus: 51.5), although slightly below the previous strong reading at 51.7. Notably, the official PMI has been in the expansionary territory for 17 months in a row. Meanwhile, the Caixin China Manufacturing PMI, which includes a survey sample tilting toward SMEs and exporters, significantly surged to 51.1 from 50.4 in the previous month, beating the market consensus at 50.4. (Figure 1) The soaring Caixin PMI and strong NBS PMI outturns suggested that growth momentum continued into the third quarter, thanks to the expansionary fiscal policy, still buoyant property market in smaller cities as well as the reviving manufacturing sector. Now it is increasingly likely that this year's growth could surpass the official target of 6.5%.

The continuing stronger-than-expected momentum has provided a valuable window and policy room for the authorities to press ahead with their deleveraging campaign in both financial sector and over-capacity industries so as to maintain the long-term financial stability, as pledged in the recently concluded national financial work conference. That being said, the authorities will continue its prudent stance of monetary policy and deploy more measures to crack down rampant shadow banking activities and debt overhang. Looking ahead, it remains a challenge for the authorities to balance between defusing financial risks and maintaining a decent growth rate.

NBS PMI sub-categories indicate a strong growth momentum remains:

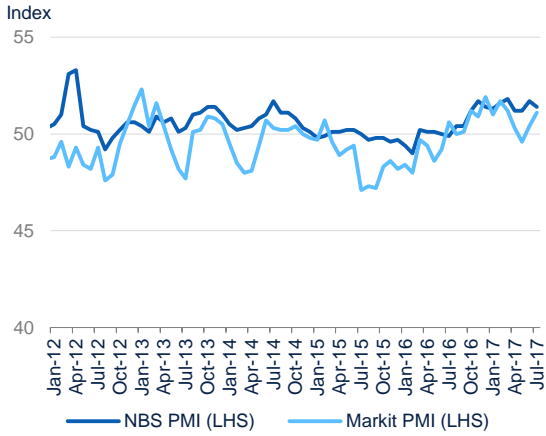
On the supply side, production index decelerated to 53.5 from the last month's reading at 54.4, the main factor to drag on July NBS PMI, but it is in line with the historical July outturns, mainly due to the hot weather and floods effect in summer. Both finished goods inventory index and raw material inventory index declined, indicating stronger demand pushed forward de-stocking for enterprises. In addition, the business activity expectation index surged to 59.1 from 58.7, suggesting a continuing positive market sentiment.

On the demand side, several price indicators, such as raw material price index and PPI index significantly picked up (57.9 and 52.7 respectively), mainly due to the soaring global commodity price and ongoing supply side reform, which will increase the profits for industrial enterprises. Moreover, new order index marginally decreased to 52.8 from 53.1 previously, but still remained in the expansionary region for 17 months, as manufacturing sector has gained its momentum; new export order index and import index, marginally decreased due to the seasonal effects as well, but still remained above the watershed level of 50. (Figure 2)

More policy room for tightening measures and financial deleveraging:

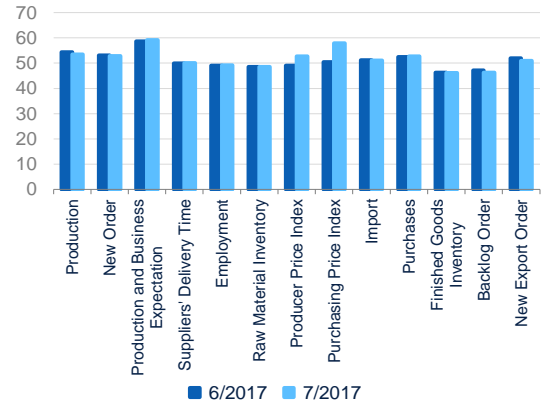
The upbeat Caixin PMI and expansionary NBS PMI reflected the better-than-expected growth momentum continues in Q3. It could reinforce the government's confidence of pursuing stricter regulations to correct the existing financial vulnerabilities, such as debt overhang, shadow banking and housing bubbles. Although the recent growth momentum continues to be strong in the short run, we believe that the deleveraging measures, both in the financial and real sector, will drag on growth through credit channel over the medium to long term.

Figure 1. Caixin PMI picked up significantly while NBS PMI marginally decreased due to seasonal effect



Source: BBVA Research, CEIC

Figure 2. The sub-NBS PMI outturns indicate growth momentum continues



Source: BBVA Research, CEIC

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