

Flash Comment

China: HSBC PMI declines but still suggests soft landing

- The flash HSBC manufacturing PMI dropped from 51.6 in May to 50.1 in June after having been largely unchanged for three months. The weakness in June appears to have been driven mainly by continued inventory cuts and weaker exports. However, there continue to be signs of stabilisation with the new order-inventory balance improving for the third month in a row.
- While the weakness in exports is a concern, the development in PMI is still consistent with GDP growth slowing to the 7-8% q/q AR range in Q2 and Q3. In addition, today's PMI also shows decreasing inflationary pressure at the factory gates in China.
- In terms of monetary policy, it is the pace that will ease and the People's Bank of China will probably go on hold later this year.

Details

The flash HSBC manufacturing PMI dropped markedly in June from 51.6 to 50.1 after having been largely unchanged for three months. There appear to be two main reasons for the weakness in the PMI. First, there are signs that weaker global growth is starting to take its toll on China's exports as the export order component fell markedly in June from 49.7 to 46.7 and is now at its lowest level since March 2009. Second, Chinese manufacturers apparently continue to cut inventory as the finished goods inventory component declined significantly from 48.6 to 46.9 – also the lowest level since March 2009.

Despite the renewed decline in HSBC manufacturing PMI, there continue to be signs that the Chinese economy is bottoming out. Our measure for the new order-inventory balance improved for the third month in a row despite the decline in new orders. In addition, the purchase of input component has been stable in recent months, suggesting that China's import volumes have stopped deteriorating (see charts on next page).

Finally, on a positive note, the output price component continued to decline, suggesting that inflationary pressure in China is easing. At just 51.1, the output price component has now declined substantially since its peak at 66.6 in November 2010.

Assessment & outlook

While the weakness in export orders is a concern the development in HSBC manufacturing PMI is consistent with our view that GDP growth in China will slow to the 7%-8% q/q AR range in Q2 and Q1 from about 10% q/q AR in Q1 (according to our own seasonal adjusted data) and start to improve again from Q4. Looking at the development in the manufacturing PMI the current slowdown looks more like the one China experienced in Q2 and Q3 last year than the rather sharp slowdown China experienced in late 2008. If we are right we might see PMI decline below 50 in the coming months, but it should start to improve in late Q3. While year-on-year inflation will remain elevated in coming months the question is not whether inflation will drop or not in late 2011, but rather by how much it will drop in late 2011.

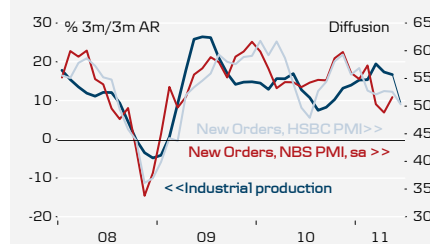
For monetary policy, the implication is that it will ease and that the People's Bank of China will probably soon go on hold albeit monetary tightening might have to be resumed at some stage next year. We still expect another rate hike in China soon, but admittedly our case for a second rate hike later this year is starting to look weak.

HSBC manufacturing PMI

	June	May
Total	50.1	51.6
-Output	50.0	51.6
-New orders	50.3	52.6
-Export orders	46.9	49.7
-Output prices	51.3	54.3

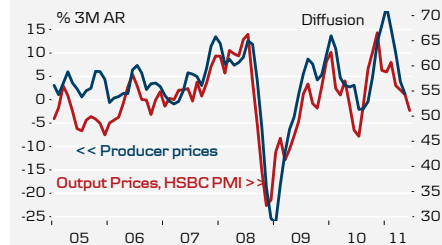
Source: Markit

New orders still suggest a soft landing in China



Source: Reuters Ecowin and Danske Markets

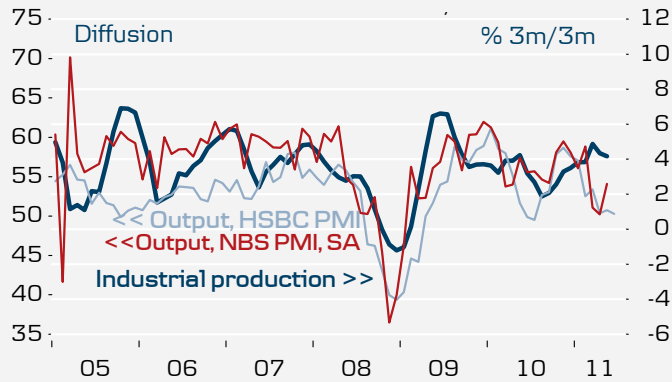
Inflationary pressure appears to be easing



Source: Reuters Ecowin, and Markit

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Moderation rather than a sharp slowdown



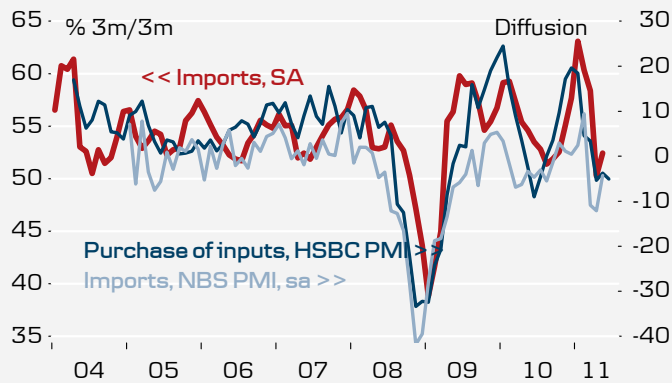
Source: Reuters Ecowin, Markit and Danske Marketst

Slower growth globally now appears to have an impact on China's export



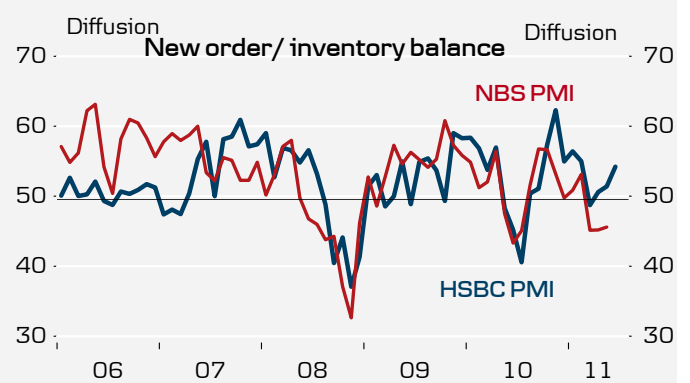
Source: Reuters Ecowin, Markit and Danske Markets

Purchase of inputs still suggests that China is bottoming out



Source: Reuters Ecowin, Markit and Danske Markets

The new order/ inventory balance has started to improve for the third month in a row



Source: Reuters Ecowin, Markit and Danske Markets

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