

China

PMI surveys show slight gain in growth momentum in May

- PMI signals expansion for fifteenth successive month
- Faster growth in services but manufacturing slows
- Firms reduce prices for first time in 15 months

The Chinese economy gained a little momentum in May, but the upturn was insufficient to quell widespread expectations of softer GDP growth in the second quarter. IHS Markit expects China's economic growth rate to slow to 6.7% in the second quarter, down from 6.9% in Q1.

The headline **Caixin China Composite PMI Output Index** rose slightly from 51.2 in April to 51.5 in May, signalling the fifteenth successive month of output growth. However, the latest reading was the second weakest in 11 months.

May survey data saw diverging growth in the manufacturing and service sectors. There was an encouraging pick-up in services activity to the fastest since January, buoyed by increased client demand. The improved performance of the service sector is welcome news for the government as it seeks to transition the economy towards domestic consumption.

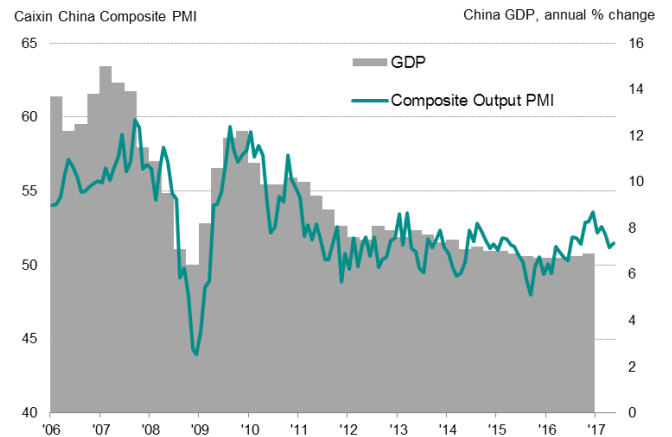
In contrast, manufacturers reported the smallest rise in production since a decline last June, amid lacklustre export sales and tighter environmental regulations. The production slowdown contributed to the first sub-50.0 reading of the headline manufacturing PMI for nearly a year.

There were mixed signs for the outlook. Business confidence about the year ahead strengthened slightly, but inflows of new work increased at a rate identical to April's seven-month low. Moreover, employment fell for the second month running in May, suggesting that firms remained cautious about growth prospects.

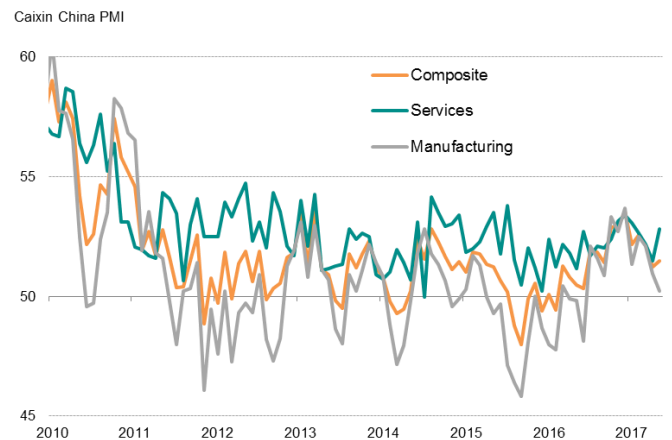
Lower industrial profits?

Alongside reduced demand and slower cost increases has come a deterioration in firms' pricing power. Average prices charged by firms for their goods and services fell for the first time since February of last year, albeit fractionally.

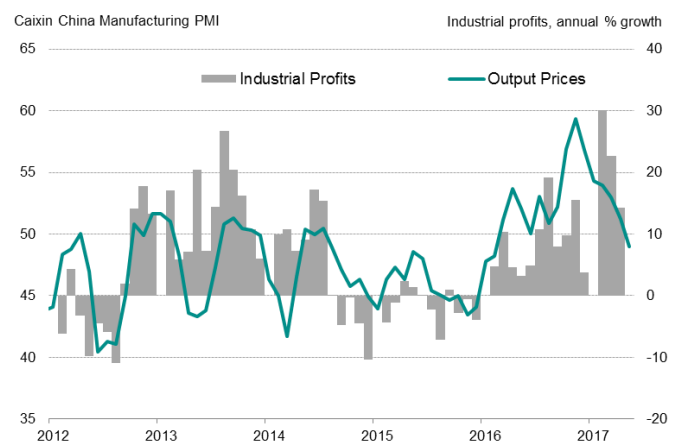
China PMI and GDP compared



Diverging growth in manufacturing and service sectors



China PMI Output Prices and industrial profits



Reduced pricing power may affect company profits, which could in turn have a negative impact on growing corporate debt levels. In the manufacturing sector, the return of factory price inflation early last year coincided with improving industrial profits, which have been welcomed by manufacturers with high debt levels.

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