Economic Research

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China

Manufacturing recovery accompanied by rising price pressures

- **Caixin General Manufacturing PMI down from 51.2 in October to 50.9**
- **Second-strongest expansions of output and new orders since July 2014**
- **Input prices spike higher, but wider inflationary pressures constrained by good supply**

China's manufacturers are enjoying their best quarter for over three-and-a-half years, but are also facing sharp rises in input prices due to surging raw material costs.

The Caixin General Manufacturing PMI for China, compiled by Markit, dipped slightly from 51.2 in October to 50.9 in November. However, with the index down only marginally from what was a 27-month high in October, the survey is indicating that the manufacturing sector is enjoying its best performance for just over three-and-a-half years so far in the fourth quarter.

November saw both production and new orders grow at slower rates than October, but in each case the rate of expansion was the second-highest since July 2014.

Price hikes

While the November survey showed welcome signs of the manufacturing economy continuing to revive from the malaise seen through 2015 and the first half of 2016, the data also highlighted the extent to which the manufacturing revival has been accompanied by rising prices.

The November PMI survey saw manufacturers' input costs surge higher, showing the largest monthly increase since March 2011 (see chart 1). By contrast, input prices had been falling sharply at the start of the year, when production had also been in decline.

Firms are having increasing success in passing these higher costs on to customer, in many cases made easier by the upturn in demand. Average prices for goods leaving the factory gate rose sharply in November, increasing at the steepest rate since February 2011.

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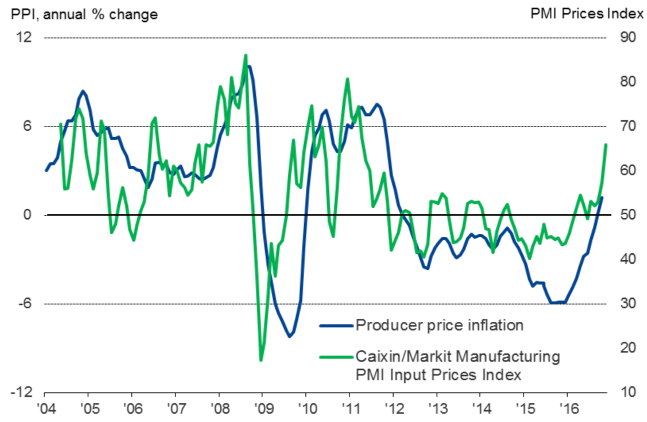
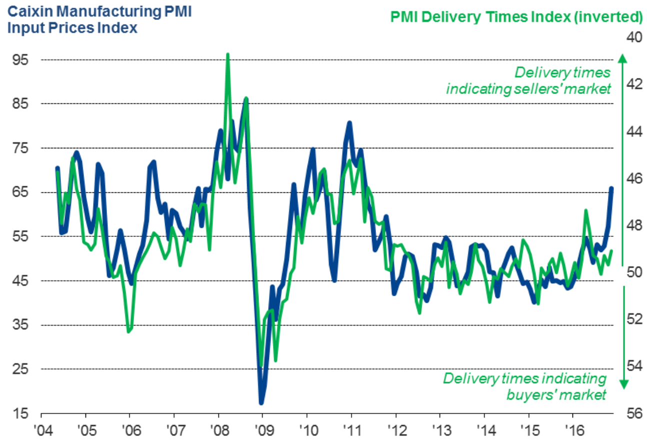
Chart 1: Producer prices



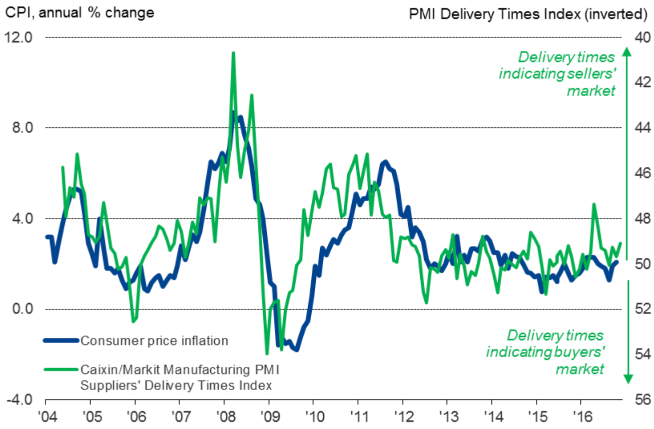
Sources: IHS Markit, NBS.

Chart 2: Manufacturing prices & capacity constraints



Sources: IHS Markit, Caixin, NBS.

Chart 3: Consumer price inflation & capacity constraints



Sources: IHS Markit, Caixin, NBS.

Few capacity constraints

However, while strengthening demand for inputs from manufacturers may be helping suppliers push prices higher, there is little evidence that these demand-pull inflationary pressures are currently being exacerbated by supply-side constraints. The absence of supply shortages should help to constrain inflation, providing of course that such an abundance of supply persists.

To track supply shortages we use the suppliers' delivery times index, which is a key gauge of whether supply is running behind demand. During periods of strong demand for inputs from manufacturers, suppliers' delivery times tend to lengthen, and vice versa. This lengthening in turn increases the ability of suppliers to hike prices.

Such periods of strong demand, insufficient supply, longer delivery times and rising prices were seen in China in the lead-up to the global financial crisis and during the two years following the crisis (see chart 2).

However, the current upturn in prices has not been accompanied by longer delivery times, at least not yet. The current situation is looking more like 2006 than 2008 or 2010, with price hikes not being driven by supply shortages (see chart 2), which in turn suggests that consumer price inflation should be constrained (see chart 3). Demand, it seems, has further to rise before capacity is stretched and inflation rises sharply.

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