Markit Economic Research

China

Manufacturing sector upturn offset by stagnation in services

- **Stronger manufacturing growth while business activity stagnates in service sector**
- **Inflationary pressures remain relatively muted**

The HSBC/Markit China PMI™ surveys pointed to the third successive monthly expansion of output in July, a return to growth which adds to the likelihood of the economy hitting the government's 7.5% GDP growth target for the year. However, the expansion in July was largely driven by goods exporters, and it remains possible that the authorities may need to step up their stimulus measures again amid signs that the domestic economy is losing momentum.

Manufacturing sector expands while service sector struggles

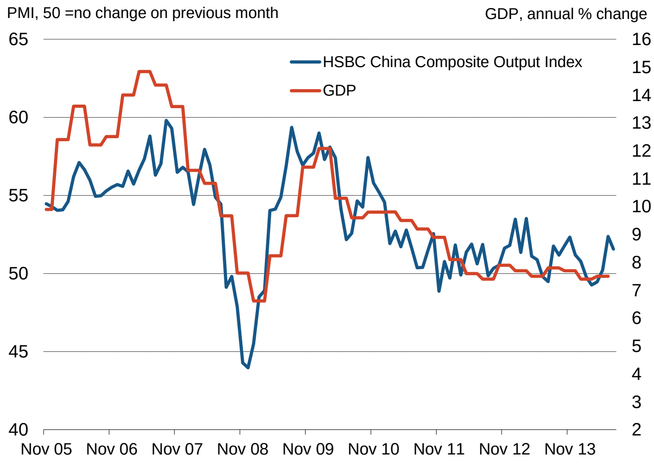
The Composite PMI Output Index (which combines manufacturing and services) signalled that the pace of expansion eased slightly from June, down from 52.4 to 51.6. Although still above the 'no change' level of 50.0, scratching beneath the surface of the latest improvement shows the expansion was entirely driven by manufacturers, where the PMI hit its highest level since January 2013.

Manufacturing growth was fuelled in particular by a further rise in new export orders, with companies benefitting from stronger demand in developed nations. Greater volumes of new work also indicate that growth momentum in the manufacturing sector will be sustained in upcoming months, and signal industrial production growth will improve upon the 9.2% year-on-year expansion recorded in June.

Meanwhile, the China Services PMI Business Activity Index posted its lowest reading since data collection began in 2005, signalling a stagnation of activity in the sector. The slowdown in the service sector, which is of a similar size to the manufacturing economy, could pose a downside risk to economic growth, and the government's growth target.

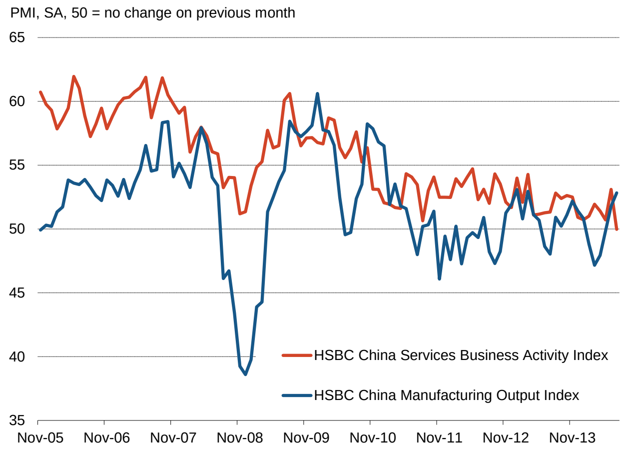
New business at service providers was meanwhile little-changed from the previous month in July, suggesting that activity in the sector may struggle to recover unless demand picks up.

China Composite Output Index vs GDP



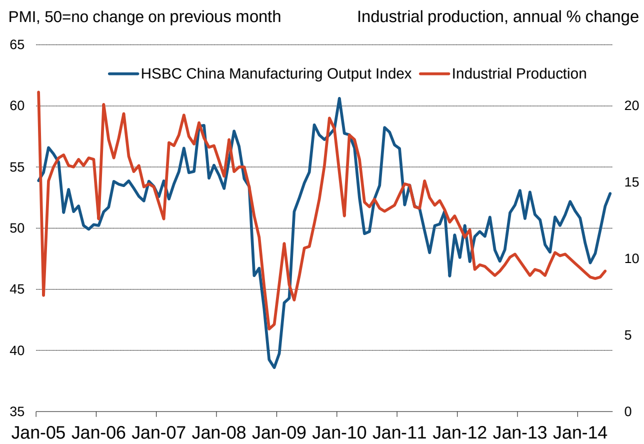
Sources: HSBC, Markit, NBS (via EcoWin)

Sector Breakdown



Sources: HSBC, Markit

Manufacturing PMI vs Industrial Production



Sources: HSBC, Markit, NBS (via EcoWin)

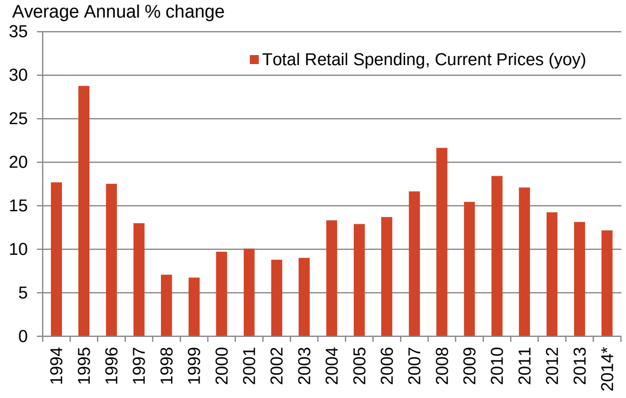
Muted inflationary pressures leave room for further stimulus

On a positive note, input price inflation remained relatively muted in July, and was consistent with CPI of around 3% year-on-year (below the governments limit of 3.5%). This leaves the authorities with some wiggle room if they wish to increase their policy efforts, which so far this year have included reducing bank lending reserve requirements, tax breaks to small businesses and further infrastructure investment, in order to stimulate growth and domestic demand.

For the moment, it seems the economy is in part being lifted by stronger growth in developed nations; however, latest data suggest there is a need for further measures to help boost domestic demand, and in particular address the cooling of the property market, which can also support a service sector recovery to leave the economy less dependent on exports and investment. The government appears to be favouring targeted sector-specific measures, rather than a broad-based policy initiative to boost the economy.

The August HSBC Flash China Manufacturing PMI will be released on 21st August 2014.

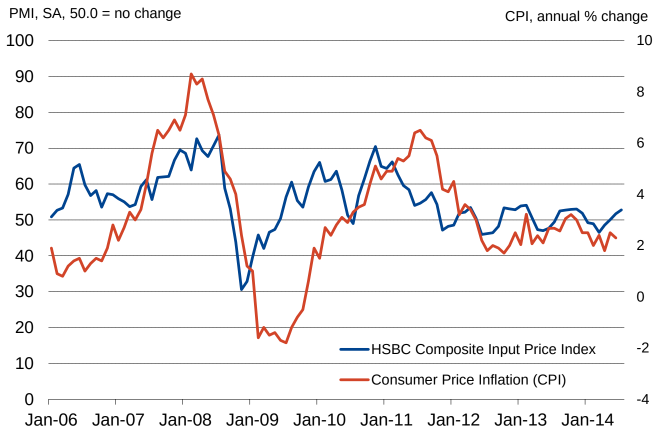
Retail Sales



*Based on Jan-Jun 2014 data

Source: EcoWin

Consumer Price Inflation



Sources: HSBC, Markit, NBS (via EcoWin)

Chris Williamson

Chief Economist,
Markit
Tel: +44 207 260 2329
Email: chris.williamson@markit.com
Click here for more PMI and economic commentary.
For further information, please visit www.markit.com

Annabel Fiddes

Economist,
Markit
Tel: +44 1491 461 010
Email: annabel.fiddes@markit.com