China’s Manufacturing Gains on Stronger Domestic Demand: Economy

By Bloomberg News - Aug 22, 2013

A Chinese manufacturing index unexpectedly expanded in August from an 11-month low, adding to signs the world’s second-biggest economy is strengthening after a two-quarter slowdown.

The preliminary reading of 50.1 for a Purchasing Managers’ Index (EC11FLAS) released today by HSBC Holdings Plc and Markit Economics compares with a final figure of 47.7 in July. The number exceeded all 16 estimates in a Bloomberg News survey and was the first reading since April above the 50 mark that divides contraction from expansion.

Domestic demand fueled the gain after Premier Li Keqiang rolled out measures to support growth, including tax breaks for small businesses and an increase in railway investment. An index of export orders slid at a faster pace, indicating limits on the boost that China can expect from overseas orders as the U.S. Federal Reserve considers winding back stimulus.

“Domestic demand is strong enough to support 7.5 percent growth in 2013,” said Ken Peng, senior economist at BNP Paribas SA in Beijing. “Almost all of China’s economic data since July has shown improvements and suggests a rebound is underway.”

The 2.4-point jump in the preliminary PMI reading was the biggest gain since August 2010 when the gauge rose 2.5 points to 51.9, according to data compiled by Bloomberg.

China’s benchmark stock gauge, the Shanghai Composite Index (SHCOMP), gave up earlier gains of as much as 0.5 percent and was 0.3 percent lower at 2:18 p.m. local time. The MSCI Asia Pacific Index was 1 percent lower at 3:24 p.m. in Tokyo after minutes released yesterday from the Federal Open Market Committee showed officials support stimulus cuts this year if the economy strengthens.

Concerns Recede

The main cause of China’s improved performance is increased confidence as Communist Party leaders indicate a commitment to sustaining growth and concerns recede after an interbank lending squeeze in June, said Lu Ting, head of Greater China economics at Bank of America Corp. in Hong Kong.

Li has unveiled measures to support growth after a two-quarter slowdown. China will reach the government’s 7.5 percent growth target this year and maintain that pace in 2014, a Bloomberg News survey of economists indicates.

HSBC’s PMI “confirms that the economy has stabilized in the short term and downside risks for the second half have declined,” said Zhang Zhiwei, chief China economist for Nomura Holdings Inc. in Hong Kong. Zhang sees “upside risks” to his forecast of 7.4 percent growth this quarter.

Credit Boom

The report adds to better-than-estimated gains in industrial output and imports in July, which improved the nation’s outlook even as Li grapples with containing financial risks after a
credit boom. The State Council last month ordered the first nationwide audit of government debt in two years.

HSBC’s survey, known as the Flash PMI is based on about 85 percent to 90 percent of responses to surveys sent to more than 420 manufacturers. The final reading is due Sept. 2.

The National Bureau of Statistics and China Federation of Logistics and Purchasing will release their own survey of purchasing managers on Sept. 1. The gauge’s July reading unexpectedly strengthened to 50.3 from 50.1 the previous month.

The biggest contribution to the gain in today’s PMI reading was from production and new orders, said Yao Wei, China economist at Societe Generale SA in Hong Kong. “Domestic demand is being driven by recovery in the property sector” while government support for infrastructure will start to show an effect in the next two months, she said.

“The problem is whether such stimulus is sustainable,” she said. “We are still relying on investment for growth and there will be downside risks beyond the third quarter.”

**Sustain Growth**

Investors are looking ahead to a meeting later this year where the Communist Party's new leaders may unveil a blueprint for policy measures to sustain growth in coming years as higher labor costs and a shrinking working-age population weigh on the pace of expansion.

Manufacturing data is due today for economies including Germany and the euro area, while Brazil and the U.S. release some jobless numbers. U.S. house-price numbers and the Bloomberg Consumer Comfort Index are also scheduled.

Signs that China is strengthening may help to counter investor pessimism about emerging economies that has been fueled by the Fed’s indications that it will rein in stimulus. Minutes from a July 30-31 Fed gathering showed officials were “broadly comfortable” with Chairman Ben S. Bernanke's plan to start reducing bond buying later this year, with a few saying tapering might be needed soon.

**Capital Outflows**

Emerging-market stocks are set for the biggest weekly decline since June 21 on concern capital outflows will accelerate. The MSCI Emerging Markets Index has dropped 4.6 percent this week as of 1:18 p.m. in Tokyo.

Investors pulled $7.6 billion out of emerging-market funds in the first seven months of this year, while $155.6 billion poured into developed-market equity exchange-traded products, according to BlackRock Investment Institute. The Indian rupee fell to a record low this week, Thailand is in recession and Indonesian stocks have slumped about 20 percent since their peak.

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