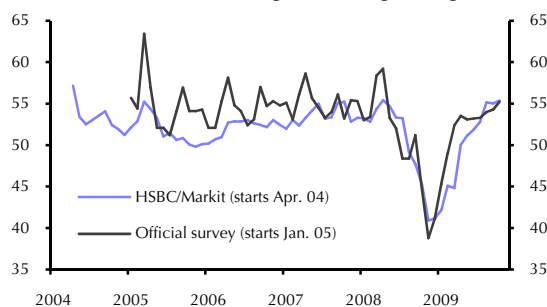


People's Bank signals sharp growth slowdown in China

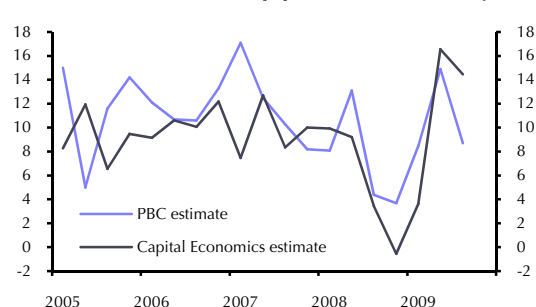
- **The latest PMI data support our view that growth in China remains strong. However, the People's Bank appears to disagree, with potentially major implications for the policy outlook.**
- China's official PMI, produced for the National Bureau of Statistics (NBS) and released yesterday, rose to 55.2 in October from 54.3 in September. October is usually a weak month on this series (it is supposed to be seasonally-adjusted, but the adjustment seems ineffectual), with falls in each of the previous four Octobers of its existence averaging more than three points. Hence this year's rise is perhaps more impressive than at first appears. We prefer the alternative index, produced by Markit and released today, which has been less volatile in the past and has the advantage of being comparable with equivalent indices produced by Markit for other major economies. This PMI rose to 55.4 from 55.0 in September. (See Chart 1.) **At face value, the PMIs suggest that China's economy accelerated further in October.**
- The breakdown confirms that most of the strength is coming from domestic demand. On both indices, the new orders sub-index is well above that for new export orders. But the gap has narrowed as exports have picked up over the past few months. New export orders in October expanded at the fastest pace since June 2007 on the Markit measure and since April 2008 on the official series.
- This message of economic strength tallies with the bulk of evidence from elsewhere. Our own China Activity Proxy (CAP), which is based on a broad range of indicators, points to annualised GDP growth of just under 15% in Q3, only a slight slowdown on Q2.
- **However, this bullish view is not shared by all. According to the People's Bank (PBC), the economy grew at a seasonally-adjusted, annualised rate of just 8.7% q/q in Q3**, following growth of 14.9% in Q2 (the Q3 estimate was published on Friday in the Bank's quarterly macroeconomic overview, "2009年三季度宏观经济形势分析"). Clearly, given our own estimate, we are sceptical. The PBC's are the closest we have to official q/q growth estimates (the NBS won't start releasing its estimates until next year). But they are subject to many of the same doubts that surround the official y/y GDP data. We think they understate the extent of the slowdown last year: according to the PBC, growth bottomed out at an annualised 3.7% in Q4, whereas we suspect the economy contracted. (See Chart 2.) Without low quarterly growth in Q3 this year, the implied annual rate of growth (obtained by compounding the PBC's quarterly growth numbers) would have overshoot the official NBS estimate that the economy expanded by 8.9% y/y in Q3.
- However, if the slowdown shown by the PBC is taken seriously, this implies that the current loose stance on monetary, fiscal and exchange rate policy will have to remain in place much longer than most observers – ourselves included – currently think. **Annualised growth of 8.7% for a quarter in which exports rebounded and the economy benefitted from strong fiscal support and a surge in loan-financed investment would be deeply disappointing.**

Chart 1: China Manufacturing Purchasing Manager Indices



Sources – Markit, Thomson Datastream

Chart 2: China GDP (% q/q, annualised, seas. adj.)



Sources – PBC, Capital Economics