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China – Activity Turns Up

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Key Points:

- **Let's acknowledge the clear message of China's March PMIs: Activity turned up**
- **Whether that means stronger as in 6.5% growth or stronger as in 5.5% growth nobody can tell from just PMI**
- **So far, though, it appears to be entirely domestic demand driven**
- **So China's recovery, thus far, has few coattails for the rest of Asia**
- **Sufficiently high interindustry prices remain important**
- **NBS was quite upbeat in its interpretation**
- **And hinted heavily that March PPI and VAI will report out faster**

[Production Note: This is a new product, meant to capture more macro newsflow. We will write these up in more thematic style and less elevator economics (up, down, up, down). We hate writing elevator economics, but maybe less than you hate reading them. This should provide more context for our monthly Foreign Exchange Outlooks.]

The Story So Far …

It'd be miserly to not acknowledge the clear, combined messages of China's official and private PMIs: ***activity in March turned up.*** *We think official messaging on growth has downshifted closer to our view, which is that we won't stabilize in 1Q but may in 1H, while we are watchful for what sort of recovery, if any, we can expect in 2H. But the same PMI #s may just as well signal growth turned up from 5 to 5.5% as indicate a pickup from 6 to 6.5%. In terms of hitting the 2019 6.0-6.5% growth target, we are far more focused on consumption and services than on infrastructure projects. NBS all but foreshadowed PPI and VAI will be stronger in March. If authorities are truly confident in March figures, they'd back off stimulus now. But we don't think they're that confident. Initial asset reactions were in line with our expectations: Commodities, equities up; authorities, while trade talks continue, may not want USD/CNY too far below 6.70; and we expect onshore rates to be capped.*

PMI ≠ Growth

There is no stable relationship between China PMIs and the *rate* of growth

We continue to treat China's PMIs as a statement about direction of change, NOT the pace of growth. When we shift from < 50 to > 50, we can surmise - since both CFLP and Caixin zigged this time (below) - activity in China picked up in March. But the same PMI shift could be consistent with a rise from 6.0% underlying GDP growth to 6.5%, say, and equally as well with a rise from 5.0% growth to 5.5%. We have not seen a stable pattern of matching PMI levels to GDP growth rates (such as what exists in, eg, Europe). Some commentary that attribute a direct mapping into growth rates seems a little fanciful to us.

At best, PMIs are an indicator of the *direction* of change

On the pace of GDP growth: We were actually more encouraged by the rise in non-manufacturing PMI on this question than by manufacturing, because we think the key towards achieving the country's growth target this year (6-6.5%) will primarily depend on consumption and services.

The #s

For the record:

All China PMIs beat in March

China March CFLP manufacturing PMI 50.5 > consensus 49.6 > last 49.2 < January 49.5; 3mma 49.7 > last 49.6.

China March CFLP non-manufacturing PMI 54.8 > last 54.3 < January 54.7; 3mma 54.6 > last 54.3.

Caixin/Markit March manufacturing PMI 50.8 > consensus 50.0 > last 49.9 > January 48.3.

And It Was All Domestic Demand

It was all domestic demand = no coattails for Asia

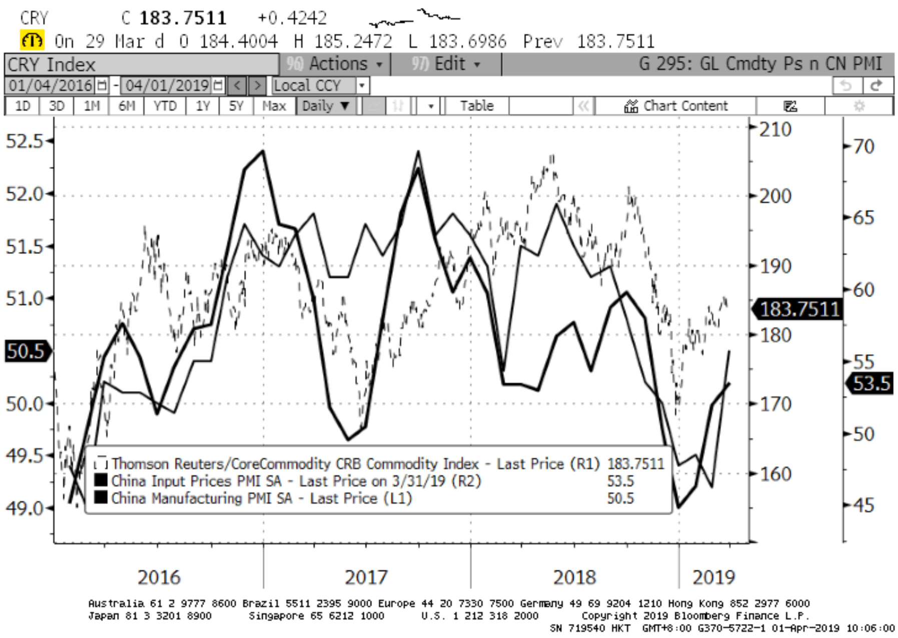
In the CFLP manufacturing measure, external conditions were still subdued (new export orders 47.1 > last 45.2 < January 46.9) so, as such, this rise in March PMI is **almost all domestic demand led.** That means a turnaround in Chinese manufacturing production will NOT be all that helpful for other export-dependent economies in Asia (eg, Taiwan, South Korea, Singapore, even Thailand).

Interindustry Pricing Still Important

The relationship between input prices and PMIs remains important

There's a chart we've been using on and off for the past few years. It shows (we think) the general importance of interindustry producer prices for a manufacturing PMI rebound. With the March data in, here's the latest look:

CHINA: RISING INPUT PRICES HELP INDUSTRIAL RECOVERY



Source: Bloomberg, MUFG Bank

Interindustry prices > marginal costs promotes production

The interpretation we gave this chart in 2016 was that prices were so low then that many domestic SOEs had shut down (revenues were not even covering marginal costs), but with a recovery in pricing, plants were able to come back online, boosting domestic demand and the PMI, etc.

But a persisting correlation suggests less overcapacity taken out

Though a positive correlation between input prices and the manufacturing PMI is probable at all times, had China shut down more industrial overcapacity in the last three years, we would have guessed this correlation would have weakened. That we're still in this pattern may suggest not enough overcapacity was taken out.

(You will notice a disconnect between PMI and input Ps in mid-2018; that was a PMI recovery we didn't quite believe at the time.)

NBS Upbeat

The National Bureau of Statistics was quite upbeat on its website commentary, so we list some of their +ve highlights with some of our own commentary:

That seasonality explanation, again

NBS characterized March production as having gradually returned to normal after the Chinese New Year holiday. [By the way is it only us who find it odd that the Chinese statistical agency seems to be the only statistical agency in Asia that does not seem to know how to adjust for Chinese New Year seasonality? The answer is, of course, they know how to do it (eg, they do it for trade) – they have as many Ph.D. statisticians as anywhere else – they just don't want to report it.]

New orders at a 6-month high

It noted new orders (the domestic demand part) was, at 51.6, at a 6-month high.

Strong suggestion March PPI will be faster

Despite a weak PPI reading in February (which caused some heart flutters among the commentariat), price sub-diffusions for input and output prices were, respectively, 53.5 and 51.4 (as we'd noted above). This suggests **the PPI reading for March will be faster.** To boot, price sub-diffusions in oil processing, ferrous metal smelting were also > 56.0.

And so will VAI

And, like Paris, we will always have output, 52.7, a 3.2pt rise and also a 6-month high.

NBS noted the high-tech sector had a sub-diffusion of 52.0. [If high tech is doing better, we have to see how, if any, that affects recent news of layoffs in the sector.]

NBS also all but guaranteed **March VAI will be stronger,** rattling off sub-sectors that make up VAI doing better in terms of production:

Equipment manufacturing 51.2;
Consumer goods 51.4;
Food processing, pharma > 53.0.

Employment Could Be Turning

But while CFLP indicated little new joy in employment

Employment sub-diffusions in both the manufacturing and non-manufacturing CFLP surveys showed little life: Manufacturing 47.6 > last 47.5 but < January 47.8; non-manufacturing 48.7 > last 48.6 = January.

Caixin said employment hasn't been this good since January 2013

But though both headline manufacturing PMIs zigged, in breakdowns for employment the Caixin measure showed a big difference. To quote Caixin:

The employment subindex surged to a high not seen since January 2013. Data from the National Bureau of Statistics showed that the surveyed unemployment rate in urban areas for February was the highest since early 2017, causing concerns about the job market. The situation improved significantly in March, indicating easing pressure on employment.

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