

## PMI: Correction of excessive bearish sentiment

Friday, April 01, 2016

### Highlights:

- Both official and Caixin PMI surprised on the upside partly due to seasonal effect. Although PMI is seasonally adjusted in theory, the historical pattern shows that the March reading is always higher than February reading.
- The rebound of PMI also benefited from two factors including improving demand and stabilized market sentiment.
- The rally in equity market and commodity prices in March as well as stabilization in RMB helped calmed down the fragile sentiment of manufacturers.
- The stronger than expected manufacturing PMI was the result of correction of excessive bearish sentiment. However, it may be too early to call for the turnaround as challenges remain this year in both domestic and international front.

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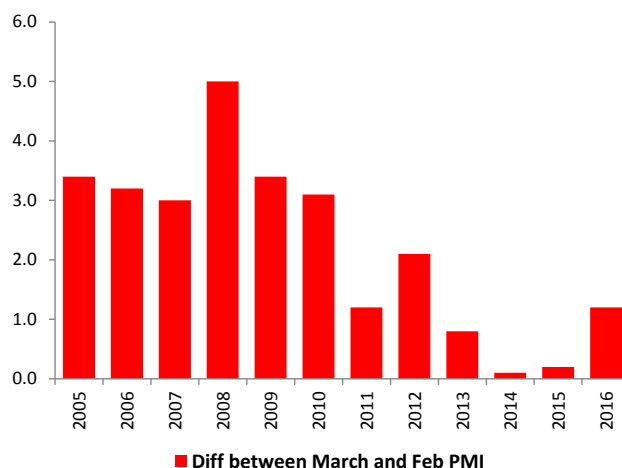
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Both China's official PMI and Caixin PMI surprised on the upside in March. Official PMI rose back to the expansion territory at 50.2 from 49, for the first time since August 2015 while Caixin PMI also spiked to 49.7 from 48.

The rebound of PMI in March was partly attributable to seasonal effect. Although PMI is seasonally adjusted in theory, the historical pattern shows that the March reading is always higher than February reading without fail since the birth of PMI data in 2005 as shown on the chart below. This is probably due to lunar New Year effect.

**Chart 1: March PMI is always higher than Feb PMI**



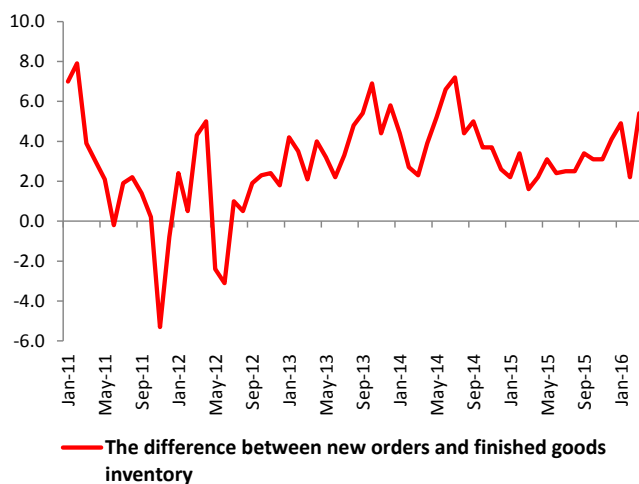
In addition to usual seasonal distortion, we think the rebound of PMI also benefited from two factors including improving demand and stabilized market sentiment.

First, March turned out to be a good month for China's financial market. The benchmark Shanghai index rose by more than 11% while Shenzhen index rebounded by more than 16%. Commodity prices ranging from Iron Ore and Copper continued to climb up. More importantly, RMB stabilized after volatile start of the New Year with the USDCNY slipped back to 6.40 range. The improving sentiment in financial market as well as stabilization in RMB helped calmed down the fragile sentiment of manufacturers.

Second, there is also early sign of recovery in manufacturing sector. China's industrial profit rebounded by 4.8% in the first two months of 2016 ending 7-month decline. Despite the on-going stress in the upstream industry, industry profit in the downstream industry started to recover. Profit for manufacturers rebounded by 12.9% in the first two months, lending positive sentiment to PMI.

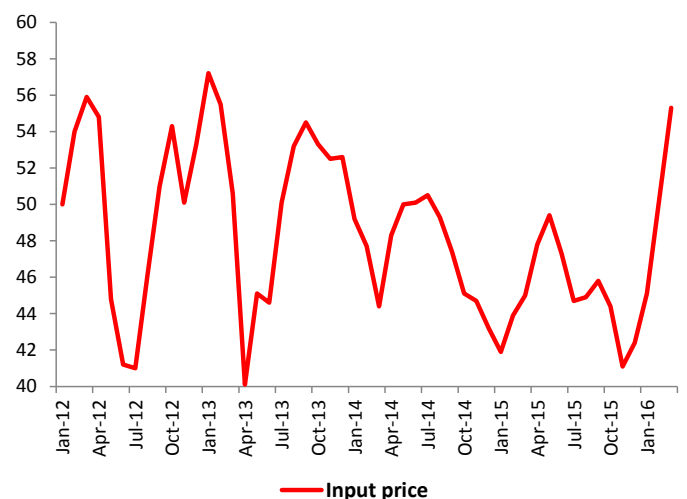
For the breakdown, both new orders and new export orders went back to above 50, showing signs of improvement in demand. The 20-month high of the difference between new orders and finished goods inventory may be positive for production outlook in the coming months. In addition, input prices rebounded sharply to 55.3 in March up from 50.2 due to recovery of commodity prices. As such, we expect the contraction of producer prices to narrow further in March to -4.7% from -4.9%.

**Chart 2:** The diff between new orders and finished goods inventory widened to 20 month high



Source: NBS, OCBC

**Chart 3:** Input prices rebounded sharply in March, alleviating deflation pressure in producer prices.



Overall, we think the stronger than expected manufacturing PMI was the result of correction of excessive bearish sentiment. However, it may be too early to call for the turnaround as challenges remain this year. Domestically, account receivable situation

continued to deteriorate as a result of slowdown in growth. Meanwhile, the rise of credit default may also continue to cap the sentiment. Internationally, global trade outlook remains murky due to the structural change in global value chain and rising protectionism. In addition, although the correction of US dollar in March after G20 meeting supported the global sentiment, the upside risk for dollar cannot be ruled out given the Fed is still on track to raise its interest rate as early as in June.

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