PMIs suggest the worst may be over for EM industry

- While we would interpret the May PMIs with caution, the small rise in the EM manufacturing PMI last month tallies with high-frequency indicators and suggests that EM activity is probably past the worst.

- The increase in the EM manufacturing PMI to 45.4 in May, from 42.7 in April, suggests that the y/y pace of contraction in EM industrial production has eased slightly. (See Chart 1.) The surveys strengthened in 14 out of the 16 EMs which have released May readings so far, including China, India, South Africa, as well as much of Emerging Europe and Emerging Asia. (See Chart 2.)

- We would err on the side of caution when interpreting the PMIs. For one thing, the rise in the suppliers’ delivery times component weighed on headline indices, even though this probably reflects the easing of lockdowns and reduced supply chain disruptions. The output sub-index is probably a better indicator of industrial activity, and this rose much further across the board last month. (See Chart 3.)

- Another reason for caution is that most headline and sub-indices remained below 50 – the theoretical point which separates contraction from expansion compared to the previous month. At face value, this suggests that EM manufacturing conditions deteriorated in May compared to April, which seems unlikely. Many firms may have compared their activity to pre-virus levels, instead of the month before. This uncertainty raises doubts about the ability of the PMIs to reflect the true scale of output falls or recoveries.

- Nonetheless, the May PMIs are consistent with high-frequency data which show that EM activity reached a trough in April. Many countries in Emerging Asia and Emerging Europe have successfully slowed the spread of coronavirus and were able to ease restrictions last month. But that has not been the case in major EMs including India, Russia, Brazil and Mexico, and their headline PMIs were among the lowest in May.

- Overall, it appears that EM activity is on the long road to recovery, and conditions should improve further in the coming months as restrictions continue to be eased. But any recovery will be slow-going. In particular, the new export orders component of the EM PMI suggests that export volumes will be very weak in the coming months. (See Chart 4.) The possible resumption of US-China trade tensions would be another external headwind to EM manufacturers.

**Sources:** Refinitiv, Markit, Capital Economics
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