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HSBC China Services PMI

Activity growth in the Chinese service sector lost further traction in June.

Key findings:

- Slower increases in business activity and new orders signalled.
- Weaker employment growth.
- Future expectations the lowest in fifteen months.

After accounting for seasonal factors, the headline HSBC Business Activity Index pointed to further growth of services output in China. However, a drop in the index from 56.4 to 55.6 signalled that business activity continued to lose growth momentum in the final month of Q2 2010, with the latest rise the slowest since March 2009. Where an increase in activity was signalled, panellists often linked growth to higher intakes of new orders.

Although new business continued to rise in June, the rate of growth lost further ground on the strong expansion seen at the start of Q2 2010. Those respondents that reported a rise in new business often linked this to solid client demand. In contrast, a number of companies mentioned that state policies aimed at restricting property development had contributed to the overall slowdown in new business growth. Gains in new work have now been signalled for nineteen successive months.

Unfinished business in the Chinese service sector fell in June for the fourth time in the past five months. The rate at which backlogs of work were depleted was solid, having accelerated to the fastest since February 2009. Evidence provided by the survey panel suggested that outstanding business was reduced in response to weaker gains in new orders.

Services employment in China rose for the seventeenth month running in June. The pace of job creation was solid, albeit the slowest in four months. According to respondents, employment growth reflected greater inflows of new business and, in some

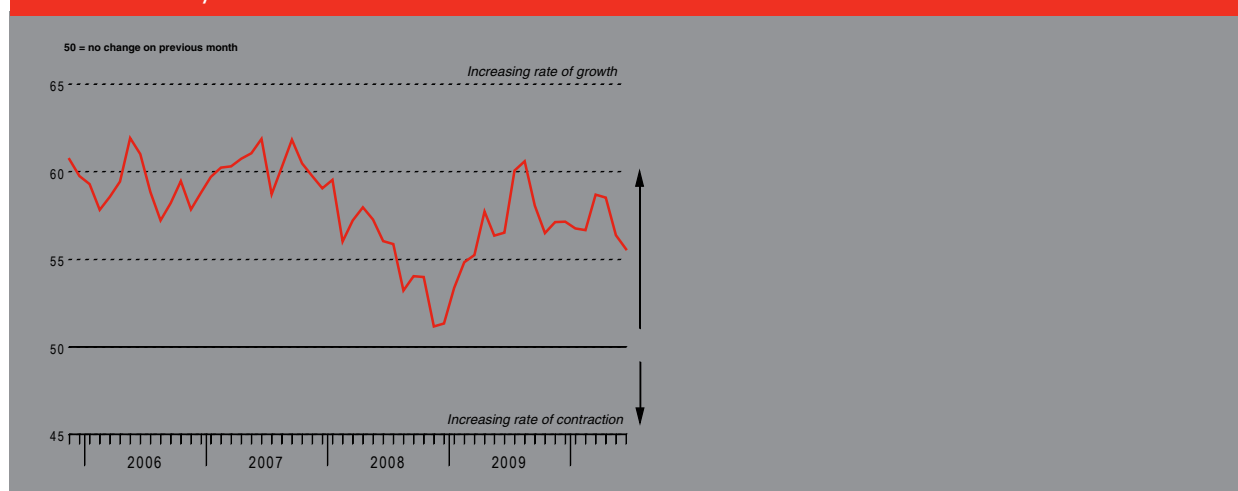
cases, business expansion plans.

Output prices set by Chinese service providers rose further in June. However, the rate of inflation was only modest, and the slowest in that sequence. Anecdotal evidence suggested that solid client demand had enabled firms to raise their output charges. Conversely, some survey participants reported reducing their prices charged in an attempt to attract new business. Output price inflation has now been signalled for six months in a row.

In line with the trend observed since November last year, average input costs faced by Chinese service providers rose in June. The rate of inflation was solid, and slightly faster than in the previous month. Those survey respondents that reported a rise in cost burdens often attributed this to higher raw material prices. Increased salary costs were also cited by a number of panellists.

According to the latest data, Chinese service sector companies remained confident about the one-year outlook for business activity in June. Although still considerable, the degree of optimism was the weakest in fifteen months. Positive expectations were linked to hopes that new business growth will gain traction in the forthcoming year, while future plans to expand business operations were also mentioned. Conversely, those respondents that were pessimistic about future activity levels cited state policies aimed at curbing the overheated property market.

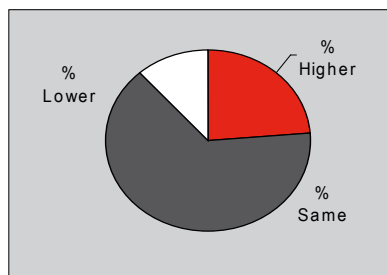
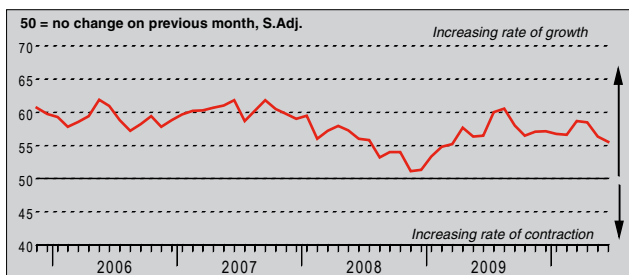
Business Activity Index



The survey uses a methodology identical to the HSBC China Manufacturing PMI. The survey uses a panel of regularly participating companies to monitor trends in business conditions in the private sector services economy. The panel has been carefully selected to accurately replicate the true structure of the Chinese services economy. Questionnaires are dispatched at mid-month, requesting comparisons of the current situation with that of one month previously.

Business Activity Index

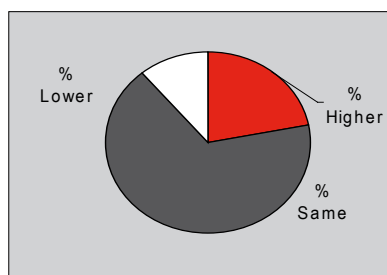
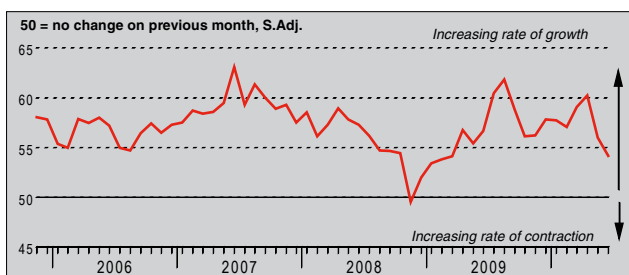
Q. Please compare the level of business activity (i.e. gross income, chargeable hours worked, etc) in your company this month with the situation one month ago.



Business activity in the Chinese service sector continued to rise in June, with almost 24% of the survey panel reporting an increase from the preceding month. This was around twice the proportion that signalled a decrease. However, the rate of expansion was the slowest in fifteen months. Where a rise in services output was signalled, panellists often linked this to higher intakes of new business. Activity growth has been signalled throughout the series history.

New Business Index

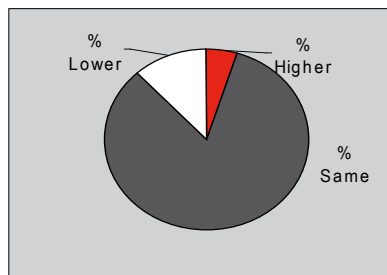
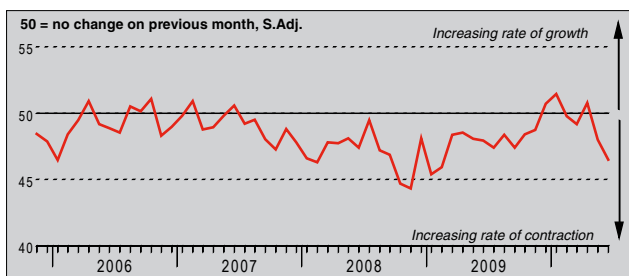
Q. Please compare the level of new orders/business placed at your company (whether already fulfilled or not) this month with the situation one month ago.



The level of new business received by Chinese service providers rose further in June. Nonetheless, growth of new orders continued to lose momentum, with the latest rise the slowest in fifteen months (similar to the trend in overall activity). Exactly 22% of companies reported an increase in new work, which they generally attributed to firmer client demand. There were also reports of successful promotional activities and, in some cases, new product launches.

Outstanding Business Index

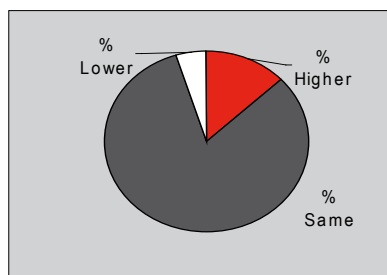
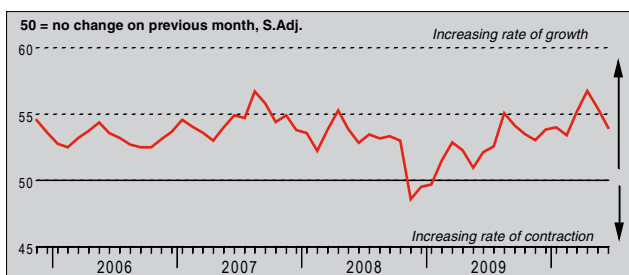
Q. Compare the level of outstanding business (i.e. work in hand but not yet completed) in your company this month with the situation one month ago.



As in the previous month, outstanding business levels fell in June. Moreover, the rate at which backlogs of work were depleted was the fastest in sixteen months. Exactly 12% of firms reported a decline in work-in-hand (but not yet completed), versus around 5% that indicated a rise. Evidence provided by the survey panel suggested that reduced unfinished business reflected a slower rise in new work. Backlogs of work have now fallen in four of the past five months.

Employment Index

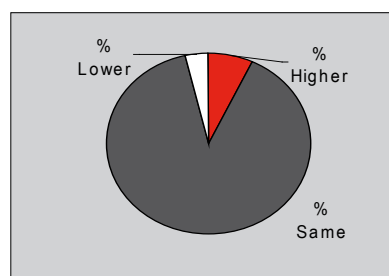
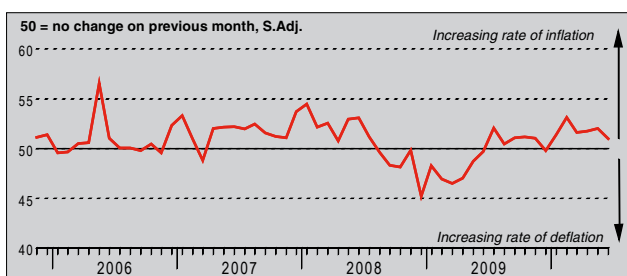
Q. Compare the number of people employed this month with the situation a month ago (treat two part as one full-time and ignore temporary labour).



The seasonally adjusted Employment Index remained above the neutral level of 50.0 in June, pointing to further growth of services employment in China. Despite easing to the slowest in four months, the rate at which firms added to their staff numbers was solid, and faster than the long-run series average. Employment growth was primarily linked by panellists to greater inflows of new business. There were also some reports of company expansion plans.

Prices Charged Index

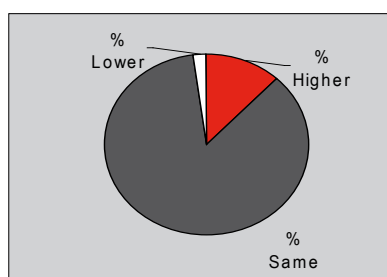
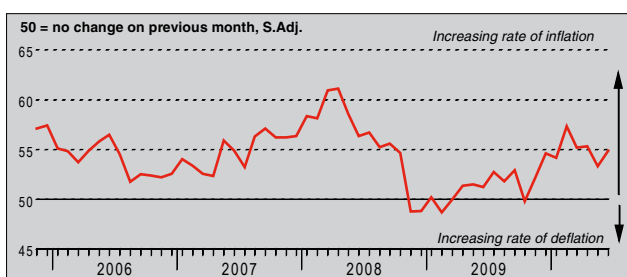
Q. Compare the average prices charged by your company (e.g. prices charged per item or unit of time) this month with the situation one month ago.



Output prices set by Chinese service providers continued to increase in June. However, the pace at which firms raised their output charges was only modest, and the slowest in the current six-month period of inflation. Of those companies that reported an increase in output charges since May (around 7%), the majority linked this to firmer client demand. Conversely, those panellists that reported a decline frequently linked this to policies aimed at attracting new business.

Input Prices Index

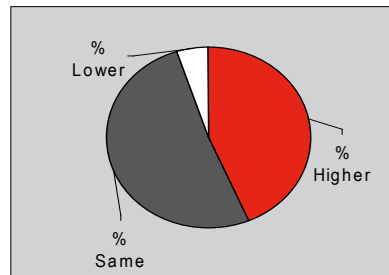
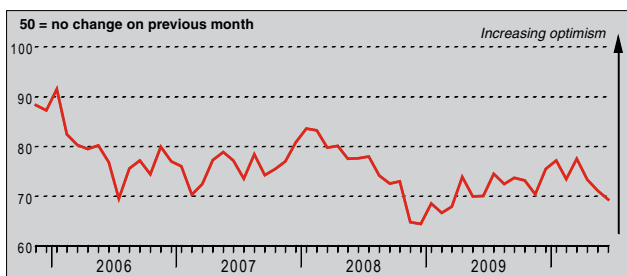
Q. Please compare the average prices paid by your company for all purchases, wages and salaries, etc. this month with the situation one month ago.



Data signalled that average input costs rose further in June, with approximately 12% of the survey panel reporting a rise since May. The rate of inflation was solid, and slightly faster than the long-run series average. Survey respondents cited higher raw material prices as having led to the latest rise in cost burdens, while there were also reports of increased labour-related costs. Input price inflation has now been signalled for eight months in succession.

Business Expectations Index

Q. In twelve months' time, do you expect overall activity at your business unit to be higher, the same or lower than now?



Chinese service providers remained optimistic about the one-year outlook for business activity in June, mainly reflecting expectations that new business growth will gain momentum in the year ahead. Some respondents also mentioned business expansion plans. Nonetheless, the degree of positive sentiment was the least marked in fifteen months. Highlighting this, a number of panellists cited government policies aimed at curbing the overheated property market as having dampened business confidence in the Renting & Business Activities sector.

Notes on the Data and Method of Presentation

The China Services PMI covers transport & communication, financial intermediation, business services, personal services, computing & IT and hotels & restaurants.

Each response received is weighted each month according to the size of the company to which the questionnaire refers and the contribution to total service sector output accounted for by the sub-sector to which that company belongs. This therefore ensures that replies from larger companies have a greater impact on the final index numbers than replies from small companies.

The results are presented by question asked, showing the percentage of respondents reporting an improvement, deterioration or no change on the previous month. From these percentages an index is derived such that a level of 50.0 signals no change on the previous month. Above 50.0 signals an increase (or improvement), below 50.0 a decrease (or deterioration). The greater the divergence from 50.0, the greater the rate of change signalled.

The indexes are calculated by assigning weights to the percentages: the percentage of respondents reporting an "improvement/increase" are given a weight of 1.0, the percentage reporting "no change" are given a weight of 0.5 and the percentage reporting a "deterioration/decrease" are given a weight of 0.0. Thus, if 100% of the survey panel report an "increase", the index would read 100. If 100% reported "no change" the index would read 50 (100 x 0.5), and so on. Markit do not revise underlying survey data after first publication, but seasonal adjustment factors may be revised from time to time as appropriate which will affect the seasonally adjusted data series.

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