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HSBC China Manufacturing PMI™

Output growth continues to ease from October's peak, but remains strong with domestic market a key driver of expansion.

Key findings:

- New business growth quickens.
- New export business increases only modestly.
- Cost inflation remains strong, despite easing to four-month low.

PMI survey data signalled that China's manufacturing sector started 2011 on a strong footing, with both output and new business rising steeply since December. This prompted firms to raise their input buying and allocate resources to meeting incoming new orders, with backlogs of work rising solidly, which in turn encouraged manufacturers to hire additional staff on average. Meanwhile, companies continued to pass on strong cost inflation to clients through increased output charges.

Posting 54.5, up slightly from 54.4 in December, the headline seasonally adjusted HSBC China Manufacturing Purchasing Managers' Index™ (PMI™) held relatively steady at the start of 2011, signalling a solid improvement in manufacturing sector operating conditions. The latest reading was comfortably above the long-run trend of 52.3, but still down on the series-record high recorded one year ago.

New orders rose steeply in January, with the rate of growth quickening from a month earlier, but still down on November's recent peak. Where a rise in new work was signalled, respondents commonly linked growth to stronger client demand. Intakes of new export orders also increased in January, although the pace of expansion was much slower than that for overall new business, suggesting that growth was centred on the domestic market in the latest survey period.

January data pointed to another rise in Chinese manufacturing production, reflective of stronger growth of overall new

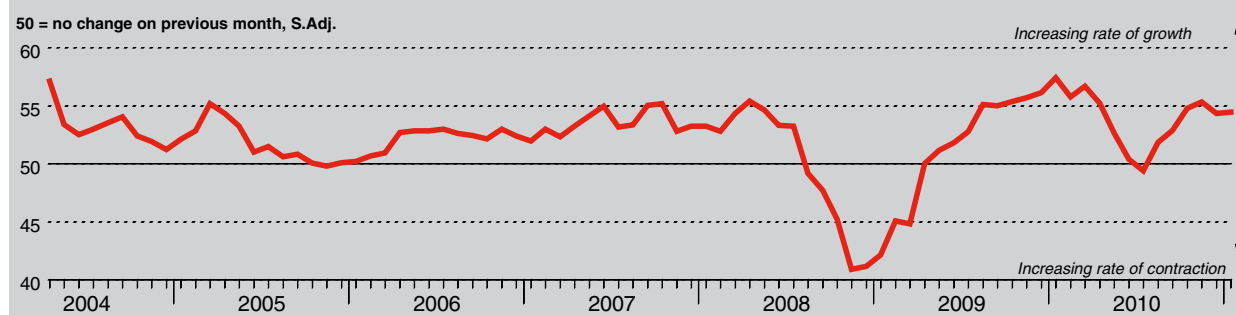
business. Despite easing to the slowest in four months, the rate of output growth was steep, and sharper than the 2010 series average. Nonetheless, capacity pressures continued to build at the start of 2011, with backlogs of work rising at the second-fastest rate since last May. Firms commented that resources had been switched to dealing with incoming new orders.

In response to growing capacity constraints, firms continued to hire additional staff in January, although the rate of job creation was only slight. The latest increase stretches the current period of growth to three months.

Purchasing rose sharply in January, with panellists attributing growth to higher output requirements. Some manufacturers also reported raising their input buying in anticipation of strong future sales. Despite this, stocks of purchases fell in January, as firms had to frequently utilise their existing inventories to accommodate for delays in the supply chain. Panellists often linked longer lead times to supply shortages at vendors.

The rate of input cost inflation eased to the slowest in four months, but remained considerable in the context of historical data. Prices paid for copper, steel and fuel were reported as having risen since December. As a result, firms continued to pass on higher costs to clients through increased output charges. Similar to the trend in input prices, the rate of output price inflation eased to a five-month low, but remained much stronger than the long-run series average.

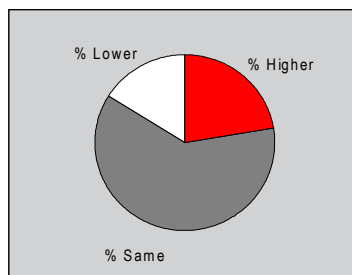
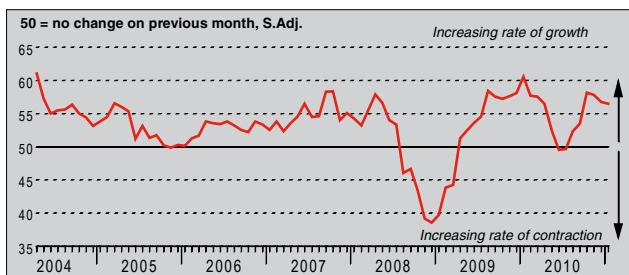
HSBC China Purchasing Managers' Index™ (PMI™)



The HSBC China Purchasing Managers' Index™ (PMI™) is a composite indicator designed to provide an overall view of activity in the manufacturing sector and acts as a leading indicator for the whole economy. The indicator is derived from individual diffusion indices which measure changes in output, new orders, employment, suppliers' delivery times and stocks of goods purchased. A reading of the PMI below 50.0 indicates that the manufacturing economy is generally declining; above 50.0, that it is generally expanding. A reading of 50.0 signals no change. The greater the divergence from 50.0, the greater the rate of change signalled by the index.

Output Index

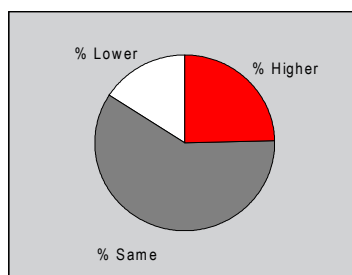
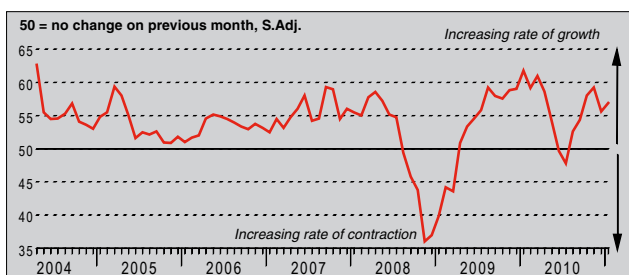
Q. Please compare your production/output this month with the situation one month ago.



Posting 56.5 in January, down slightly from 56.8 in December, the seasonally adjusted Output Index pointed to a further rise in Chinese manufacturing production. The rate of growth continued to ease from October's recent peak, but remained strong in the context of historical data. The latest increase stretches the current period of expansion to six months. Manufacturers that reported a rise in output often linked growth to greater inflows of new business.

New Orders Index

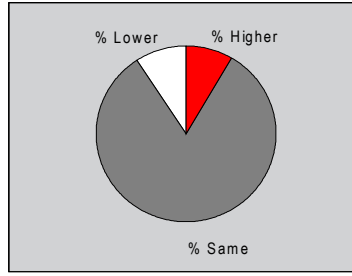
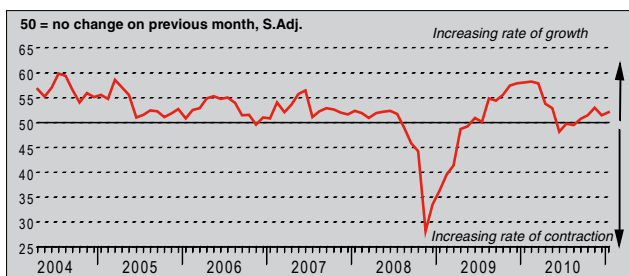
Q. Please compare the level of new orders received (China and export) this month with the situation one month ago.



New business received by Chinese manufacturing firms increased again at the start of 2011, with almost one-quarter of panellists signalling a rise since December. The seasonally adjusted New Orders Index climbed to a level indicative of a steep rate of growth, but was still down on November's recent peak. New order levels have now risen continuously since last August. Respondents to the latest survey suggested that overall new business growth reflected stronger client demand.

New Export Orders Index

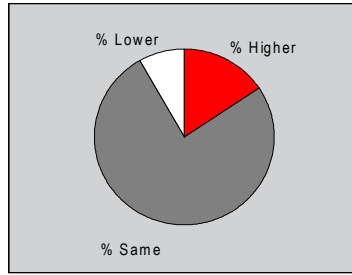
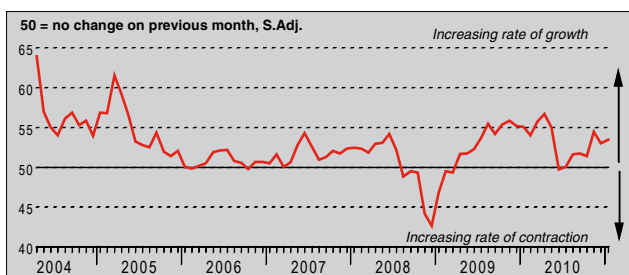
Q. Please compare the level of new export orders received this month with the situation of one month ago.



January data pointed to another rise in new export business received by Chinese manufacturing firms. However, the rate of growth was relatively lacklustre, with the vast majority of panellists (around 82%) reporting that new export orders were unchanged since December. Furthermore, a faster increase in overall new business relative to new export orders suggested that growth was centred on the domestic market in the latest survey period.

Backlogs of Work Index

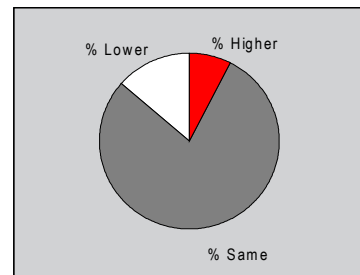
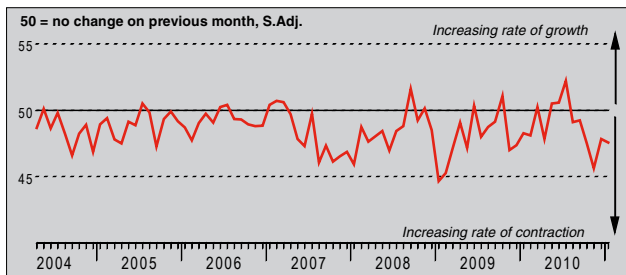
Q. Please compare the level of outstanding business in your company this month with the situation one month ago.



Outstanding business in the Chinese manufacturing sector rose in January, extending the current period of growth to seven months. The seasonally adjusted Backlogs of Work Index climbed to a level indicative of a solid rate of backlog accumulation that was the second-fastest since last May. Of those manufacturing firms that reported an increase in work-in-hand (approximately 16%), the majority commented that resources had been switched to meeting incoming new orders.

Stocks of Finished Goods Index

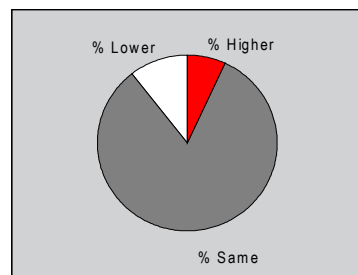
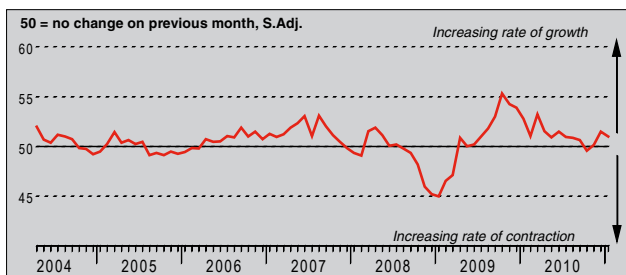
Q. Please compare your stocks of finished goods (in units) this month with the situation one month ago.



Stocks of finished goods in the Chinese manufacturing sector fell further at the start of 2011, as higher new order requirements prompted firms to utilise their post-production inventories. The rate at which manufacturers reduced their stock holdings was moderate, and faster than the long-run series average. Inventory levels have now fallen continuously since last August. Almost 14% of panellists reported a reduction in post-production inventories from a month ago, compared to around 8% that signalled a rise.

Employment Index

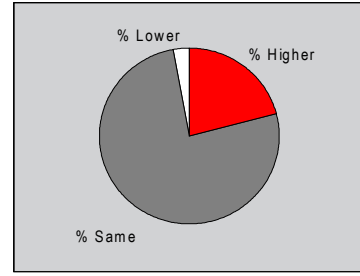
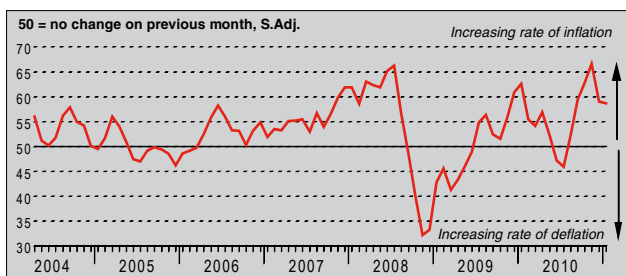
Q. Please compare the level of employment at your unit with the situation one month ago.



Manufacturing employment in China rose for the third successive month in January, although the rate of job creation was only slight. The vast majority of panellists (around 83%) reported that staffing levels were unchanged since December. Panel members reported hiring additional staff in response to higher production requirements. Where a decrease in workforce numbers was signalled, this was generally attributed to compulsory employee retirement.

Output Prices Index

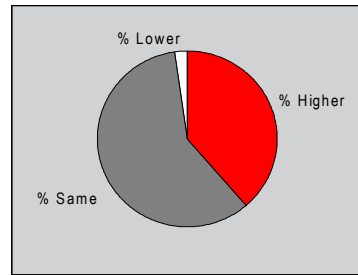
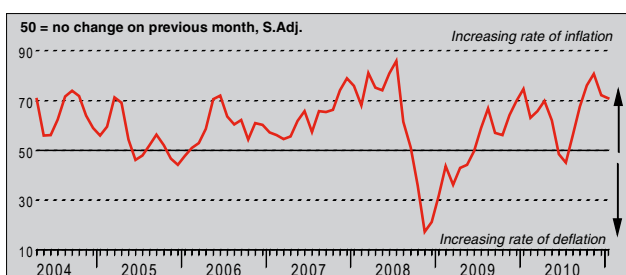
Q. Please compare the average price that you charge per unit of output (volume weighted) this month with the situation one month ago.



China's manufacturing firms continued to pass on higher input costs to clients through increased output charges in January, with the seasonally adjusted Output Prices Index posting above the neutral 50.0 threshold for the sixth month in succession. Despite easing further from November's survey peak, the rate of factory gate price inflation was sharp, and faster than the 2010 average. Almost 21% of panellists reported a rise in output prices since December, compared to only 3% that signalled a decrease.

Input Prices Index

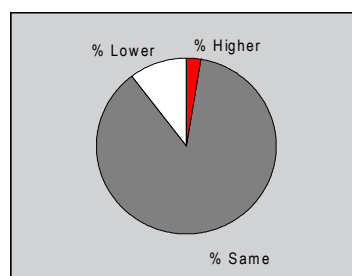
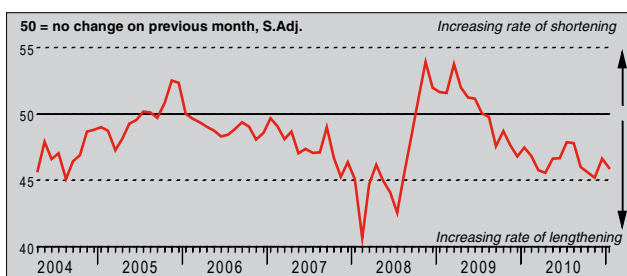
Q. Please compare the average price of your purchases (volume weighted) this month with the situation one month ago.



The seasonally adjusted Input Prices Index remained elevated at the start of 2011, despite falling to a four-month low, pointing to a substantial rate of input cost inflation in the Chinese manufacturing sector. Higher raw material and fuel prices were cited as key drivers of inflation in the latest survey period. Copper, steel and food products were all reported as having risen in cost since December. The latest increase extends the current period of inflation to six months.

Suppliers' Delivery Times Index

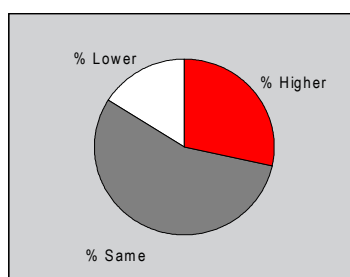
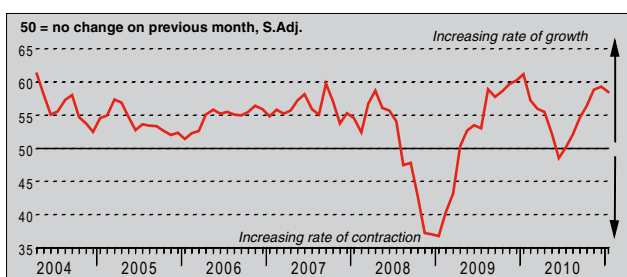
Q. Please compare your suppliers' delivery times (volume weighted) this month with the situation one month ago.



The average time taken by vendors to deliver inputs to Chinese manufacturing firms lengthened in January, with around 10% of the survey panel reporting a deterioration in vendor performance since December. This compared to only 3% that signalled faster lead times. As a result, the pace at which supplier performance deteriorated was solid, and quickened from one month ago. Respondents linked longer delivery times to a lack of supply at vendors. There were also reports of transportation difficulties and adverse weather conditions.

Quantity of Purchases Index

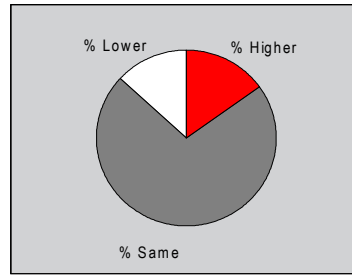
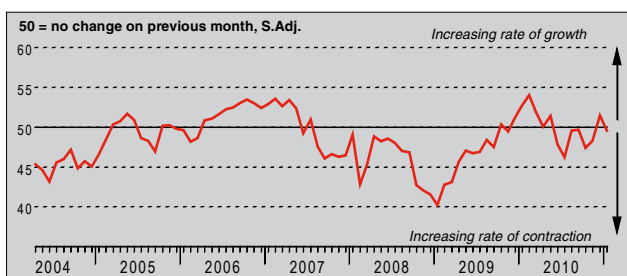
Q. Please compare the quantity of items purchased (in units) this month with the situation one month ago.



Stronger new business growth and a subsequent rise in production requirements prompted firms to raise their input buying for a seventh successive month in January. There were also reports of stockpiling in anticipation of future new business wins. Despite slipping to a three-month low, the seasonally adjusted Quantity of Purchases Index was at a level indicative of a substantial rate of purchasing growth that was much faster than the long-run trend.

Stocks of Purchases Index

Q. Please compare your stocks of purchases (in units) with the situation one month ago.



Stocks of raw materials and semi-manufactured goods fell in the Chinese manufacturing sector at the start of 2011, following a modest increase one month earlier. However, the rate at which firms reduced their inventory levels was only fractional. According to respondents, reduced stock holdings partly reflected delays in the supply chain. Where an increase in pre-production inventories was signalled, firms commonly linked growth to increased purchasing.

Notes on the Data and Method of Presentation

The Purchasing Managers' Index™ is based on data compiled from monthly replies to questionnaires sent to purchasing executives in over 430 manufacturing companies. The panel is stratified geographically and by Standard Industrial Classification (SIC) group, based on regional and industry contribution to Chinese Industrial Production. Survey responses reflect the change, if any, in the current month compared to the previous month based on data collected mid-month. For each of the indicators the 'Report' shows the percentage reporting each response, the net difference between the number of higher/better responses and lower/worse responses, and the 'diffusion' index. This index is the sum of the positive responses plus a half of those responding 'the same'.

The Purchasing Managers' Index™ (PMI™) is a composite index based on five of the individual indexes with the following weights: New Orders - 0.3, Output - 0.25, Employment - 0.2, Suppliers' Delivery Times - 0.15, Stock of Items Purchased - 0.1, with the Delivery Times index inverted so that it moves in a comparable direction.

Diffusion indexes have the properties of leading indicators and are convenient summary measures showing the prevailing direction of change. An index reading above 50 indicates an overall increase in that variable, below 50 an overall decrease.

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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