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HSBC China Manufacturing PMI™

Further moderation in manufacturing output growth accompanied by easing inflationary pressures in May.

Key findings:

- Only modest increase in output signalled.
- Backlogs of work rise at weakest rate since July 2010.
- Input cost inflation eases to slowest in nine months.

May survey data pointed to only modest growth of China's manufacturing sector, as both output and new orders rose at marginally slower rates. Despite this, the pace of job creation quickened to a five-month high. The overall slowdown in output growth was accompanied by an easing in inflationary pressures, with average input costs rising at the weakest rate since August 2010. As a result, the pace of inflation at the factory gate moderated for a third successive month. Meanwhile, firms reduced their holdings of pre-production goods in an attempt to mitigate against delays in the supply chain, following a further deterioration in average vendor performance.

The seasonally adjusted HSBC *Purchasing Managers' Index™* (PMI™) dropped to a ten-month low of 51.6 in May, down from 51.8 in April, signalling only a modest improvement in manufacturing sector operating conditions.

New business increased for a tenth successive month in May, although the rate of expansion remained relatively subdued in the context of historic data. This primarily reflected subdued demand from both domestic and external markets. The latter was highlighted by a decline in new export business for the first time in three months. Companies in the Electrical & Optical sector reported that the earthquake in Japan had contributed to the decline in new export orders.

Sluggish new business growth meant that additional resources were assigned to progressing existing workloads in the latest

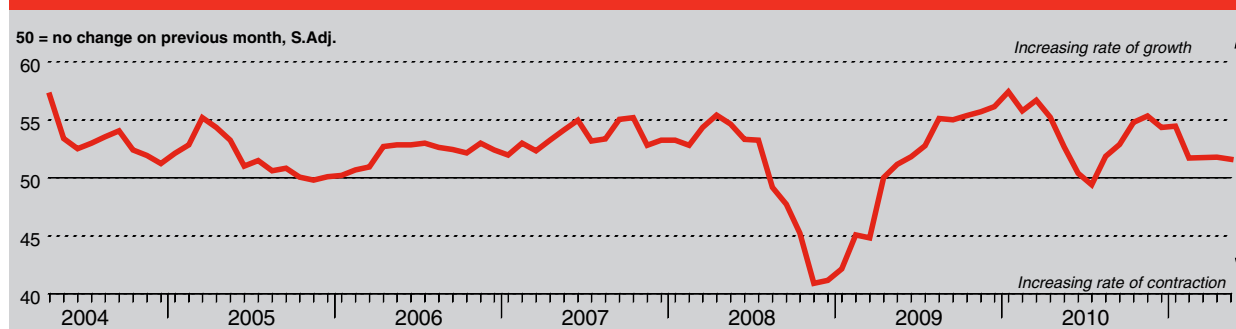
survey period. Consequently, the rate of backlog accumulation eased to the slowest since July 2010. A weaker increase in new orders also contributed to a slower rise in manufacturing production. The index measuring month-on-month movements in output dropped to a ten-month low, and to a level indicative of a lacklustre rate of expansion. Machinery maintenance, and shortages of both electricity and raw materials were also cited as having restricted the overall pace of growth.

Manufacturing employment rose for the third month running in May. Despite quickening to a five-month high, the rate of job creation was only modest. Where a rise was signalled, panellists linked growth to rising workloads (new and outstanding).

Reflective of subdued production growth, the rate at which firms acquired inputs was relatively lacklustre in May. A number of manufacturing firms instead opted to utilise their stocks of purchases in an attempt to mitigate against delays in the supply chain. This was indicated by a further lengthening of lead times in May. Delivery delays were linked by panellists to raw material shortages at vendors.

The rate of input cost inflation eased to a nine-month low in May, but remained strong nonetheless. Rising raw material prices were cited as the key driver of inflation. Firms attempted to offset part of the rise in costs by increasing their prices charged. However, similar to the trend in input costs, the pace of inflation eased to the slowest since August 2010.

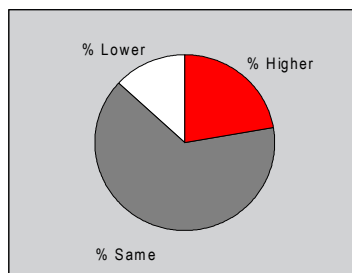
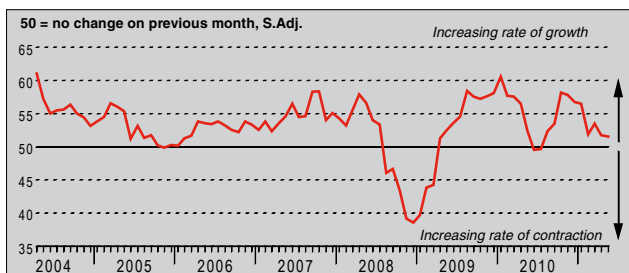
HSBC China *Purchasing Managers' Index™* (PMI™)



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. *Purchasing Managers' Index™* and *PMI™* are trade marks of Markit Economics Limited, HSBC use the above marks under licence. Markit and the Markit logo are registered trade marks of Markit Group Limited.

Output Index

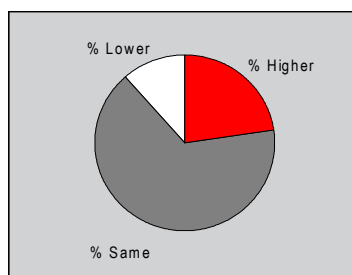
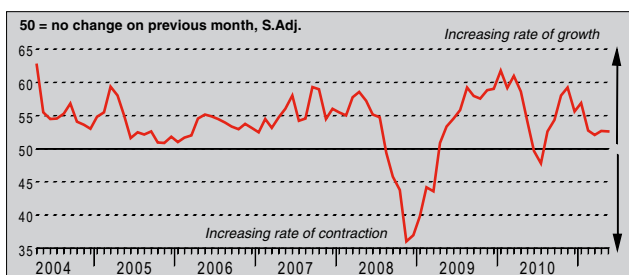
Q. Please compare your production/output this month with the situation one month ago.



Manufacturing production in China rose further during May. However, the rate of expansion was only modest, and eased to the slowest in the current ten-month period of growth. According to respondents, the weaker increase in output predominantly reflected relatively lacklustre growth of incoming new business. Machinery maintenance, and shortages of both electricity and raw materials were also cited as having restricted the overall pace of growth.

New Orders Index

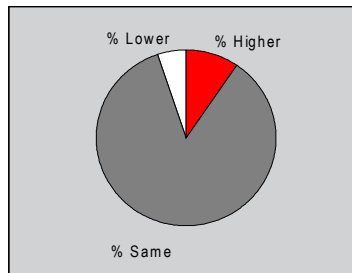
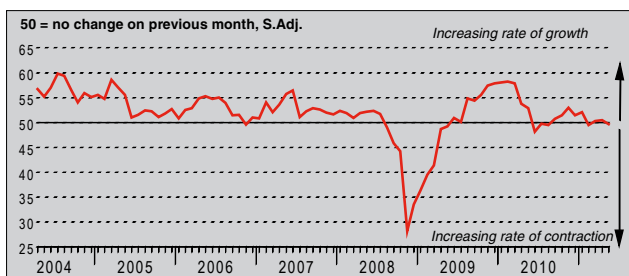
Q. Please compare the level of new orders received (China and export) this month with the situation one month ago.



After adjusting for seasonal trends, the New Orders Index signalled a moderate increase in new business received by Chinese manufacturing firms during May. However, the rate of new order growth was relatively lacklustre in the context of historic data. Almost 23% of panellists reported a rise in new work since April, which they generally linked to firmer client demand. New order levels have now risen continuously since August 2010.

New Export Orders Index

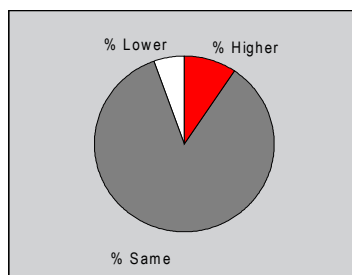
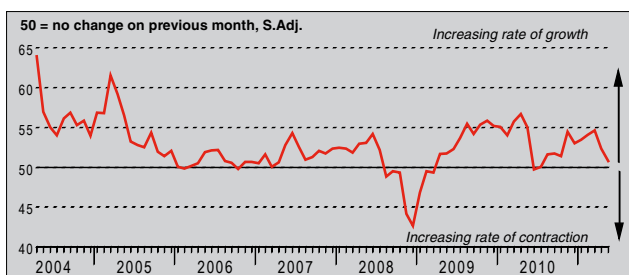
Q. Please compare the level of new export orders received this month with the situation of one month ago.



New export business fell for the first time in three months during May, although the rate of contraction was only marginal. The vast majority of respondents to the latest survey (around 85%) reported no difference in new export orders compared to one month earlier. Where new business from abroad decreased, panellists mentioned sluggish demand from external markets. Companies in the Electrical & Optical sector also reported that the earthquake in Japan had contributed to the decline in new export orders.

Backlogs of Work Index

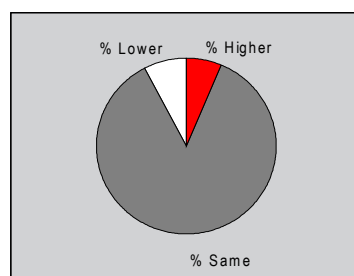
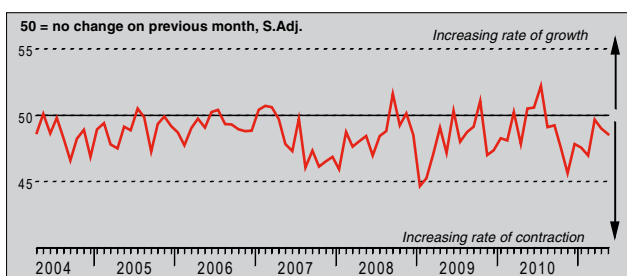
Q. Please compare the level of outstanding business in your company this month with the situation one month ago.



May data pointed to another rise in outstanding business at Chinese manufacturers' plants. The seasonally adjusted Backlogs of Work Index has posted above the neutral 50.0 threshold, signalling expansion, for eleven months in succession. Nonetheless, the Index dropped to a ten-month low, a level consistent with only a marginal rate of increase. According to survey respondents, sluggish new order growth meant that resources had been assigned to completing existing workloads.

Stocks of Finished Goods Index

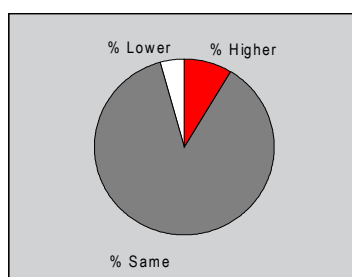
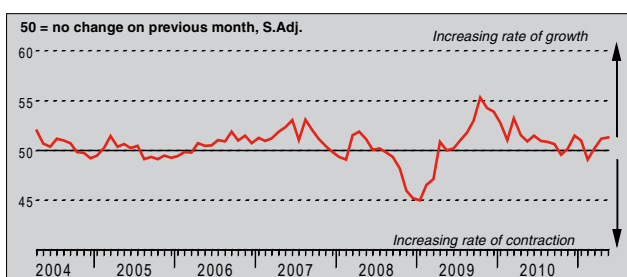
Q. Please compare your stocks of finished goods (in units) this month with the situation one month ago.



After adjusting for seasonal variation, the Stocks of Finished Goods Index dropped to a three-month low in May, signalling a modest rate of stock depletion that was in line with the long-run series average. Inventory levels have now fallen for ten months in succession. Survey participants mentioned that greater inflows of new business relative to output growth had prompted manufacturers to utilise their stocks of post-production goods in the latest survey period.

Employment Index

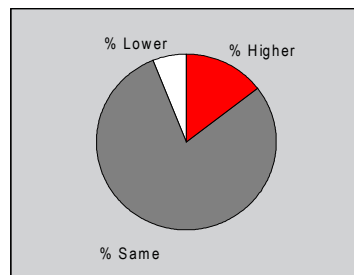
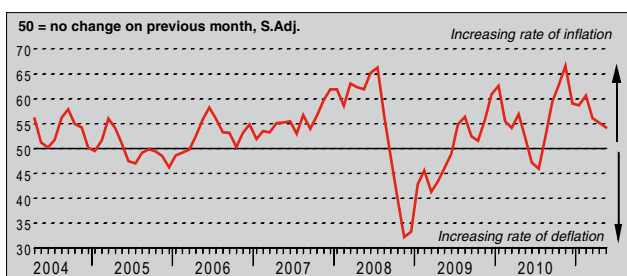
Q. Please compare the level of employment at your unit with the situation one month ago.



Manufacturing employment in China rose for a third successive month during May. Although only modest, the rate at which firms added to their workforce numbers accelerated to a five-month high. Of those survey participants that recorded a rise in staff levels (around 9%), the majority attributed growth to higher workloads (new and outstanding). Manufacturers that reported a fall in employee numbers liked this to a combination of retirements and resignations.

Output Prices Index

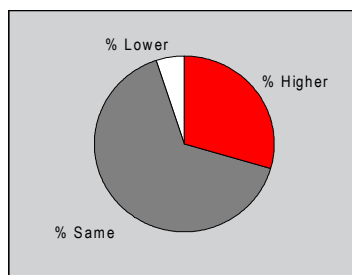
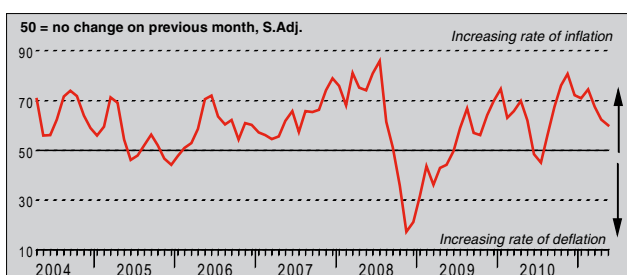
Q. Please compare the average price that you charge per unit of output (volume weighted) this month with the situation one month ago.



China's manufacturing firms continued to pass on higher input costs to clients through increased output charges in May, with the seasonally adjusted Output Prices Index posting above the neutral 50.0 threshold for the tenth month in succession. However, similar to the trend in input costs, the rate of inflation moderated to the slowest since August 2010. Almost 15% of panellists reported an increase in charges at the factory gate since April, compared to 6% that signalled a reduction.

Input Prices Index

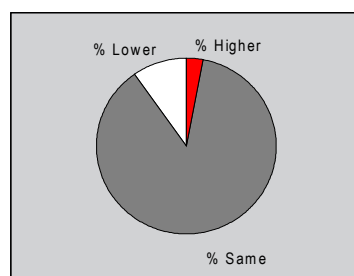
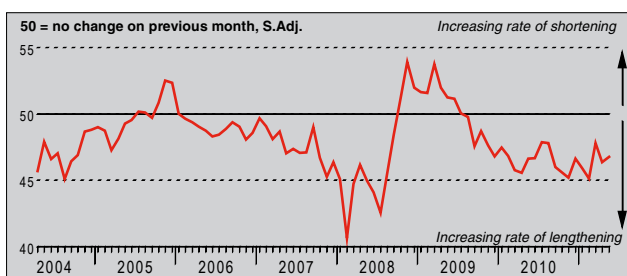
Q. Please compare the average price of your purchases (volume weighted) this month with the situation one month ago.



May data pointed to a further rise in average cost burdens faced by Chinese manufacturers, with almost 30% of the survey panel reporting a rise since the preceding month. Although sharp, the rate of purchase price inflation eased for the third successive month to the slowest since August 2010. Moreover, the latest increase was weaker than the long-run series average. 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 April.

Suppliers' Delivery Times Index

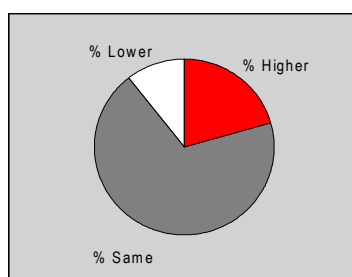
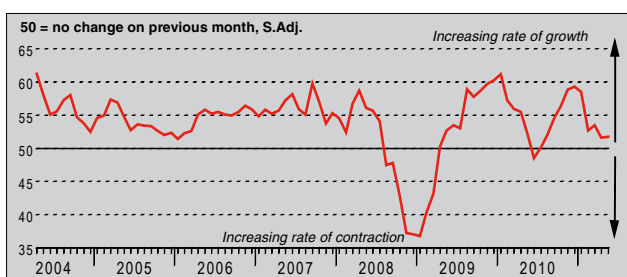
Q. Please compare your suppliers' delivery times (volume weighted) this month with the situation one month ago.



The average time taken by vendors to deliver inputs to manufacturers lengthened for a twenty-second successive month during May, with almost 10% of the survey panel recording slower lead times. This compared to only 3% that signalled an improvement in supplier performance. The resulting extent of the lengthening of delivery times was solid, and more marked than the long-run trend. Delivery delays were linked by panellists to supply shortages at vendors. Firms in the Electrical & Optical sector also mentioned the earthquake and tsunami in Japan.

Quantity of Purchases Index

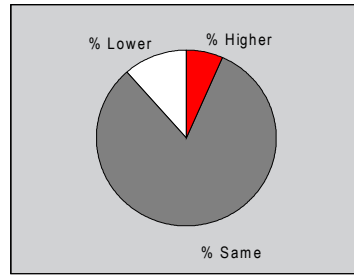
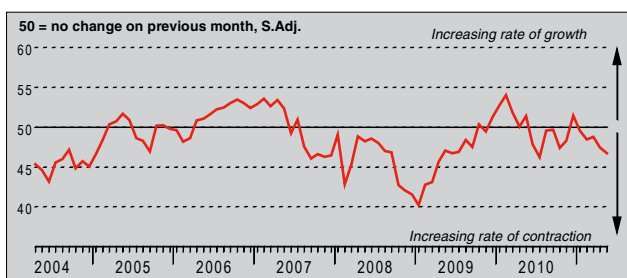
Q. Please compare the quantity of items purchased (in units) this month with the situation one month ago.



Purchasing in the Chinese manufacturing sector rose again during May, extending the current period of growth to eleven months. However, the seasonally adjusted Quantity of Purchases Index was at a level indicative of only a modest rate of expansion that was markedly slower than that seen at the start of the year. Anecdotal evidence provided by the survey panel suggested that lacklustre growth of input buying predominantly reflected a weaker rise in manufacturing production.

Stocks of Purchases Index

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



In an attempt to mitigate against delays in the supply chain, manufacturing firms further utilised their holdings of pre-production goods during May. The rate at which firms reduced their stock levels was solid, and quickened to the fastest since July 2010. Almost 12% of the survey panel recorded a decline in pre-production inventories, versus around 7% that saw a rise. The seasonally adjusted Stocks of Purchases Index has now posted below the neutral 50.0 threshold, signalling contraction, for five months in succession.

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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