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HSBC China Manufacturing PMI™

Manufacturing sector operating conditions deteriorate for first time in a year

Key findings:

- Modest decline in manufacturing production
- New business growth eases to only marginal rate
- Slowest rate of lead time lengthening for 21 months

PMI survey data signalled that Chinese manufacturing production continued to fall in July, as total new order growth eased to near-stagnation amid reports of lacklustre global demand. Purchasing activity fell for a second successive month as a result, which in turn contributed to a steeper decline in stocks of pre-production goods. Meanwhile, input cost inflation accelerated, but remained subdued in the context of historic data. Consequently, manufacturers raised their factory gate charges only marginally in the latest survey period.

At 49.3, down from 50.1 in June, the seasonally adjusted HSBC Purchasing Managers' Index™ (PMI™) – a composite indicator designed to give a single-figure snapshot of operating conditions in the manufacturing economy – signalled a deterioration in manufacturing sector operating conditions for the first time in a year. Although at a level indicative of only a marginal rate of contraction, the index reading was the lowest since March 2009.

The rate of new business growth in China's manufacturing sector eased to near-stagnation during July, mainly reflecting a continued softening of underlying market demand. Moreover, new export orders fell for a third month in succession, albeit at a slower rate than in the preceding month.

The near-stagnation of new business contributed to a second successive monthly decline in manufacturing production during July. Machinery maintenance and shortages of both

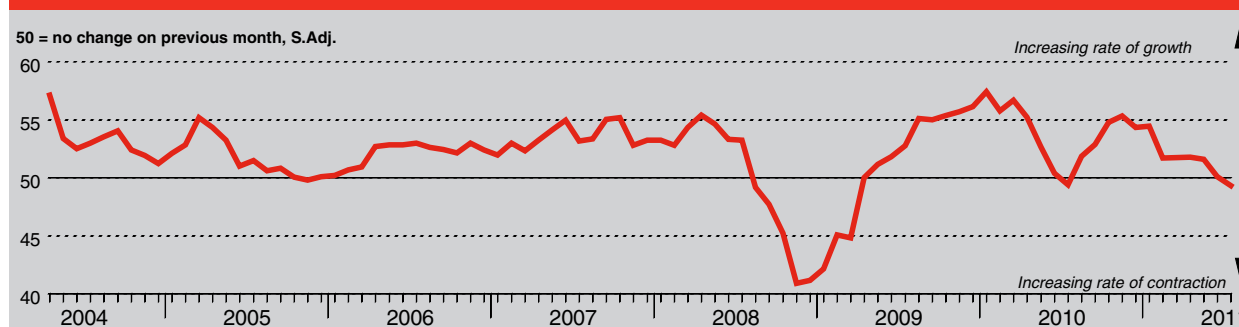
electricity and raw materials were also mentioned by a number of panellists. Although only modest, the rate of contraction was the sharpest since March 2009.

Purchasing activity in the Chinese manufacturing sector fell for a second successive month in response to lower output requirements. As a result, stocks of purchases fell at the fastest rate since March 2009, and average vendor performance deteriorated at the slowest rate in 21 months. Where longer lead times were recorded, survey respondents cited supply shortages at vendors. There were also reports of tight credit conditions.

Staff numbers in the Chinese manufacturing sector fell for a second successive month during July. Although only marginal, the rate of decline was the steepest in five months. Anecdotal evidence suggested that reduced employment predominantly reflected the weak trend in new business and, in some cases, employee retirements.

On the prices front, manufacturers indicated that cost inflation remained muted in July, despite rising slightly since the preceding month. Companies that reported an increase in cost burdens generally commented on higher raw material prices. Meanwhile, prices charged by manufacturers for their final product rose only marginally, with the rate of inflation easing to the slowest in the current one-year period of higher average tariffs.

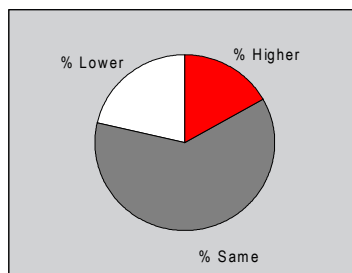
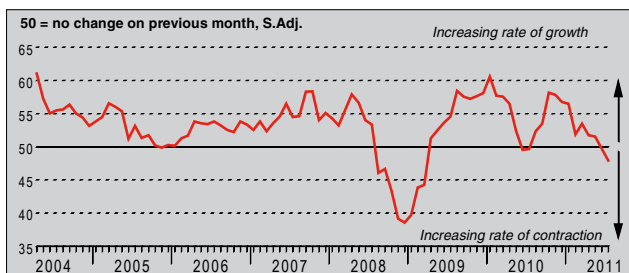
HSBC China Purchasing Managers' Index™ (PMI™)



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

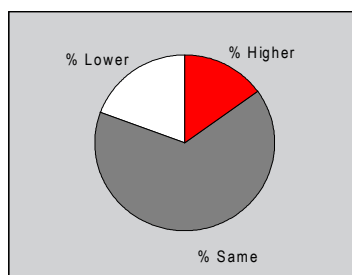
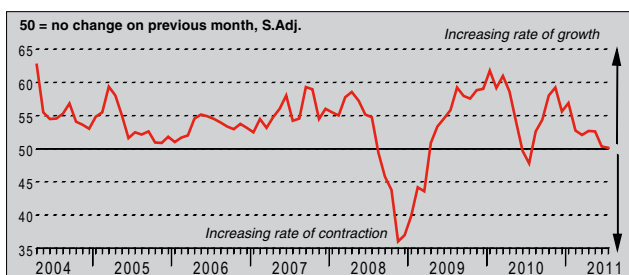
Q. Please compare your production/output this month with the situation one month ago.



Manufacturing production in China decreased for a second successive month during July, with around 21% of panellists recording a decline since the preceding month. This compared to almost 17% that registered an increase. Although only modest, the resulting pace of reduction was the sharpest since March 2009. Machinery maintenance, and shortages of both electricity and raw materials were mentioned as reasons for lower output.

New Orders Index

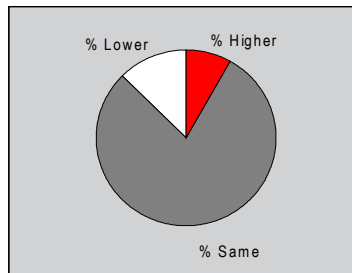
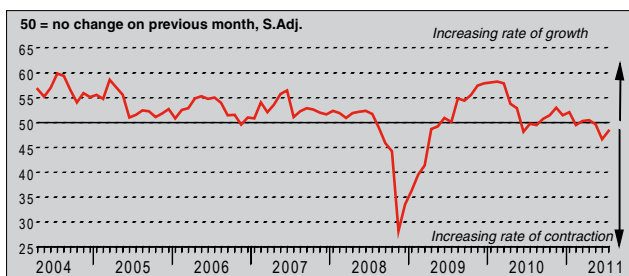
Q. Please compare the level of new orders received (China and export) this month with the situation one month ago.



Growth of incoming new business was recorded for a twelfth successive month during July. Nonetheless, the pace of expansion eased to near-stagnation. Highlighting the loss of growth momentum, the seasonally adjusted New Orders Index has fallen almost seven points since the start of the year. According to respondents, the moderation in new order growth predominantly reflected a continued softening in underlying market demand.

New Export Orders Index

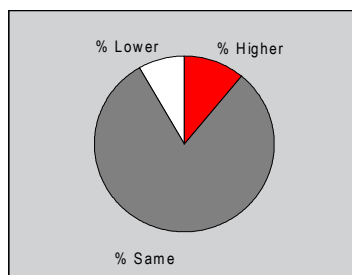
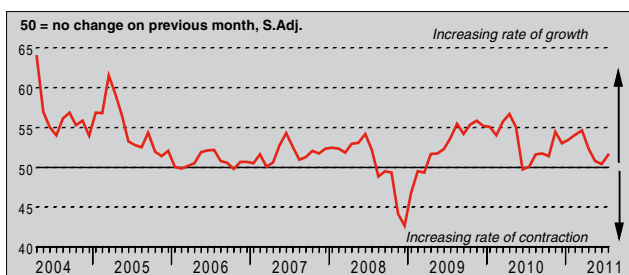
Q. Please compare the level of new export orders received this month with the situation of one month ago.



The seasonally adjusted New Export Orders Index signalled a further decline in new export business placed at Chinese manufacturing firms during July. However, the rate of decline was only modest, and slower than in the preceding month. Where new business from abroad decreased, panellists mentioned sluggish demand from external markets. The index has now posted below the neutral 50.0 threshold, signalling contraction, for three months in a row.

Backlogs of Work Index

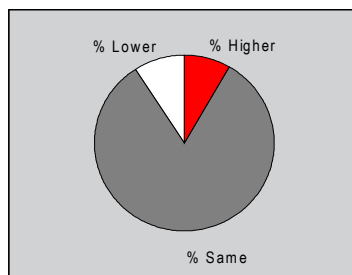
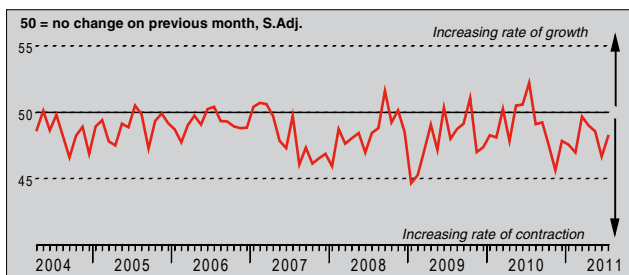
Q. Please compare the level of outstanding business in your company this month with the situation one month ago.



Outstanding business in the Chinese manufacturing sector continued to rise during July, with the seasonally adjusted Backlogs of Work Index posting above the neutral level of 50.0 for the thirteenth month in succession. Despite reaching a three-month high, the index was at a level consistent with only a modest rate of backlog accumulation.

Stocks of Finished Goods Index

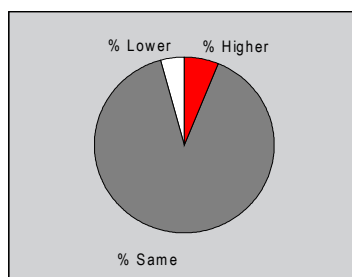
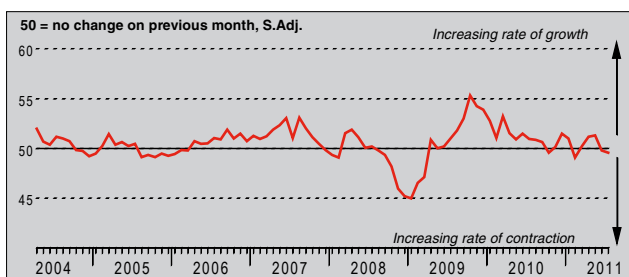
Q. Please compare your stocks of finished goods (in units) this month with the situation one month ago.



Stocks of finished goods in the Chinese manufacturing sector decreased again during July, extending the current period of contraction to 12 months. Around 9% of survey participants reported a drop in stock levels since June, which the majority attributed to lower production requirements. Nonetheless, the rate of inventory depletion was only modest, and eased since the preceding month. The majority of panellists (almost 83%) signalled that inventory levels were unchanged compared to one month earlier.

Employment Index

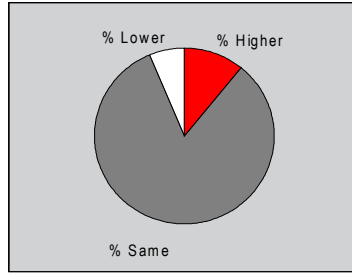
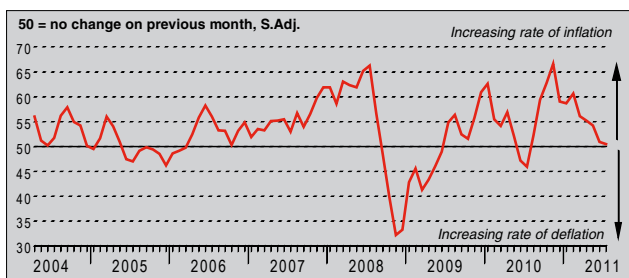
Q. Please compare the level of employment at your unit with the situation one month ago.



According to the latest data, manufacturing employment in China decreased for the second successive month during July, although the rate of job shedding was only slight. The vast majority of panellists (almost 90%) mentioned that their staff numbers were unchanged since the preceding month. Anecdotal evidence suggested that reduced employment predominantly reflected lacklustre growth of incoming new business and, in some cases, employee retirements.

Output Prices Index

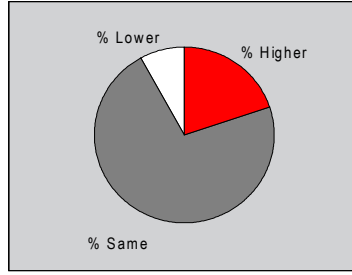
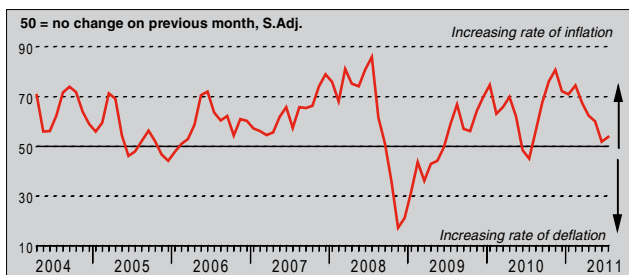
Q. Please compare the average price that you charge per unit of output (volume weighted) this month with the situation one month ago.



The seasonally adjusted Output Prices Index posted above the neutral 50.0 threshold in July, signalling a further rise in prices charged by Chinese manufacturers for their final products. Reports from survey respondents suggested that rises in raw material costs had resulted in higher factory gate charges. However, the index was at a level indicative of only a marginal rate of inflation that was the weakest in the current one-year period of rising average tariffs.

Input Prices Index

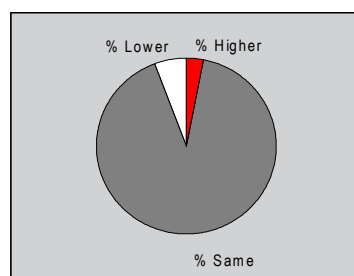
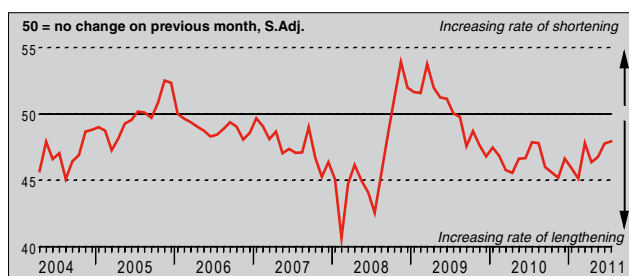
Q. Please compare the average price of your purchases (volume weighted) this month with the situation one month ago.



Average input costs faced by Chinese manufacturing firms increased for a twelfth successive month in July. Despite quickening from one month earlier, the rate of input price inflation was subdued in the context of historic data. Almost one-fifth of the survey panel recorded a rise in purchasing costs, compared to 8% that signalled a decrease. Companies that reported an increase in input prices generally commented on higher raw material costs. Anecdotal evidence suggested that inflation emanated from domestic markets in the latest survey period.

Suppliers' Delivery Times Index

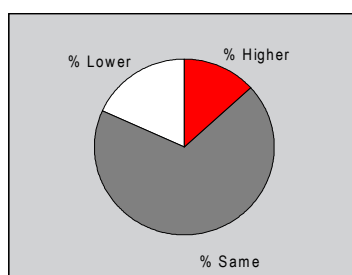
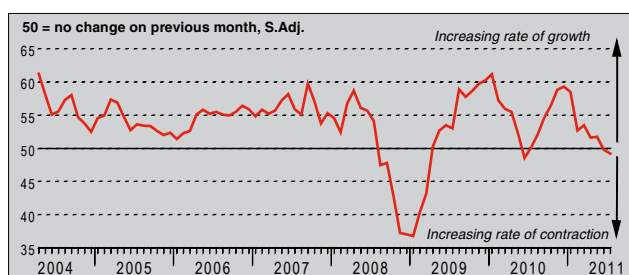
Q. Please compare your suppliers' delivery times (volume weighted) this month with the situation one month ago.



The average time taken by suppliers to deliver inputs to Chinese manufacturers lengthened further during July. Where a deterioration in average vendor performance was recorded, panellists often linked this to shortages of stock at suppliers. There were also reports that tight credit conditions and a lack of labour had restricted the ability of some suppliers to meet delivery schedules. Nonetheless, the rate of delivery time lengthening was the slowest in 21 months.

Quantity of Purchases Index

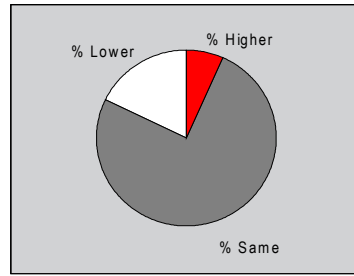
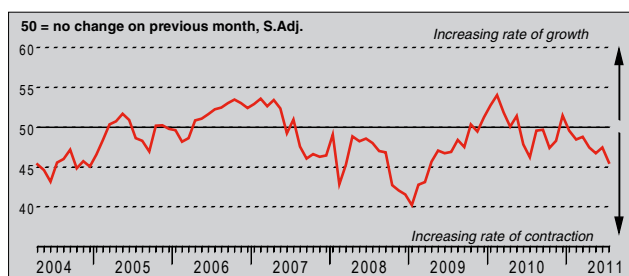
Q. Please compare the quantity of items purchased (in units) this month with the situation one month ago.



After adjusting for seasonal factors, the Quantity of Purchases Index signalled that Chinese manufacturers purchased fewer inputs compared to the previous month, with approximately 18% reporting a decline from one month ago. Despite quickening to the fastest in over a year, the rate of decline was only marginal. According to survey respondents, reduced purchasing reflected lower production requirements.

Stocks of Purchases Index

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



Stocks of semi-manufactured goods and raw materials in the Chinese manufacturing sector decreased for a seventh successive month during July. The rate of stock depletion was solid, and the sharpest in 28 months. Almost 18% of panellists reported a reduction in inventories since the preceding month, compared to around 7% that signalled an increase. Anecdotal evidence provided by the survey panel suggested that the latest net decline reflected reduced input buying.

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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