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HSBC China Services PMI™

Chinese service sector activity rises at slowest rate in three months

Key findings:

- Slower activity growth reflects weaker rise in new business
- Job creation eases to slowest since May 2009
- Business optimism remains subdued

Growth of China's service sector eased for the second successive month during July. The moderation was underpinned by a weaker rise in new business, which also contributed to an easing in the pace of job creation. Meanwhile, service sector business optimism remained subdued in the context of historic data. On the price front, the pace of input cost inflation eased to a five-month low, but remained marked nonetheless. However, competitive pressures limited the pass through of higher costs to clients, with output charges rising only marginally during the latest survey period.

The headline seasonally adjusted Business Activity Index – which is based on a single question asking respondents to report on the actual change in business activity at their companies compared to one month ago – dropped to a three-month low of 53.5 in July, from 54.1 in June, signalling a solid expansion of business activity in China's service sector. The index has posted above the neutral level of 50.0, signalling growth, since the start of the series in November 2005. According to survey respondents, the weaker increase in services output primarily reflected a moderation in new business growth. There were also reports that activity growth was restricted by state-led policies aimed at cooling the property sector.

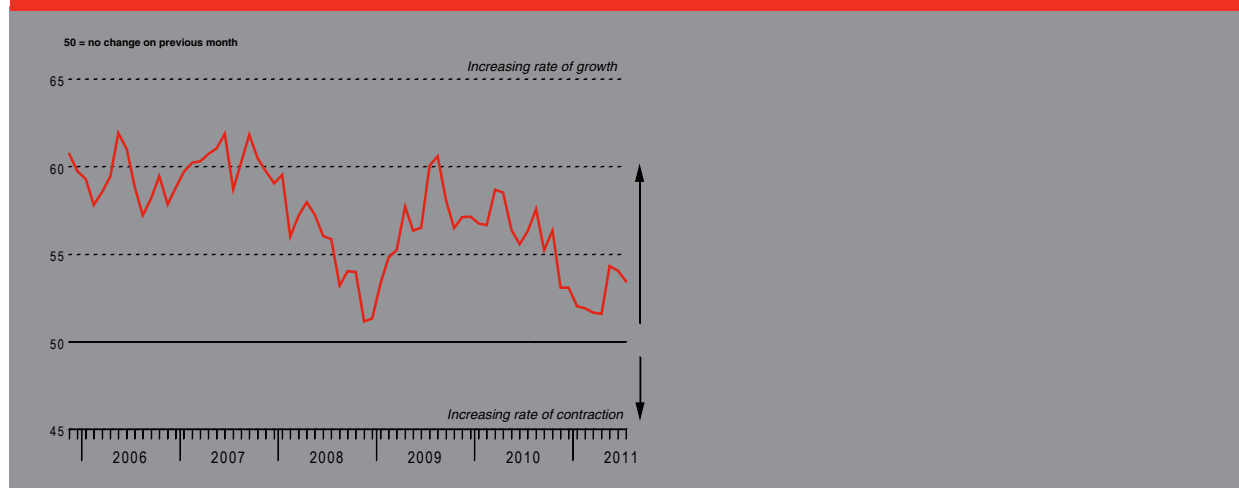
New business rose further during July, with firms commenting on stronger client demand, the success of promotional activities and new product launches as factors supporting the latest increase. However, growth of new orders eased to a pace that was only slightly stronger than April's 28-month low.

Employment growth was recorded for the thirtieth month running during July. Recruitment was predominantly attributed by survey respondents to increased workloads. However, the pace of job creation was only modest, and eased to the slowest since May 2009. Those survey participants that signalled a decline in employment often linked this to policies aimed at reducing overall costs.

Average input costs rose markedly in July, although the pace of inflation eased to the slowest in five months. Higher labour-related costs were cited as the primary driver of input cost inflation. A number of survey respondents also mentioned rising raw material and fuel costs. Despite cost rises, service providers raised their output charges only marginally amid growing competition for new business in the sector. The rate of output charge inflation was the slowest in the current 19-month period of rising tariffs.

When questioned about the prospects for business activity at their units over the next 12 months, service providers in China expressed continued optimism regarding the short-term business outlook. Positive sentiment was attributed by panellists to expectations of better economic conditions, new product launches and the success of commercial activities. That said, the degree of optimism was only slightly higher than June's series-record low. Companies operating in the Renting & Business Activities sector cited policies aimed at cooling the property sector as having dampened business confidence.

Business Activity Index

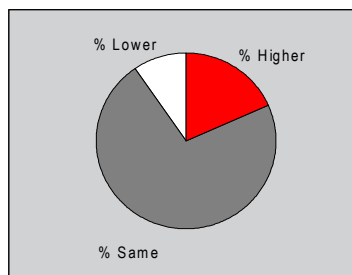
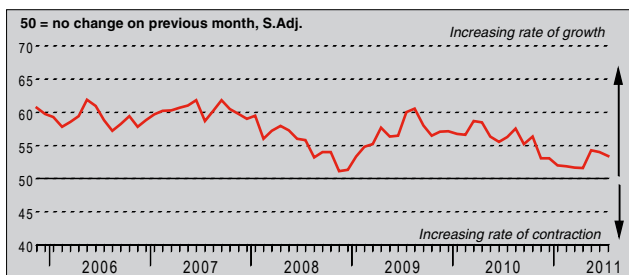


The survey uses a methodology identical to the HSBC China Manufacturing PMI™. The survey uses a panel of regularly participating companies to monitor trends in business conditions in the private sector services economy. The panel has been carefully selected to accurately replicate the true structure of the Chinese services economy.

Questionnaires are dispatched at mid-month, requesting comparisons of the current situation with that of one month previously. 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.

Business Activity Index

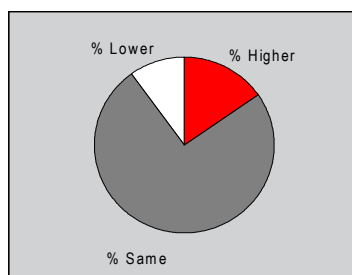
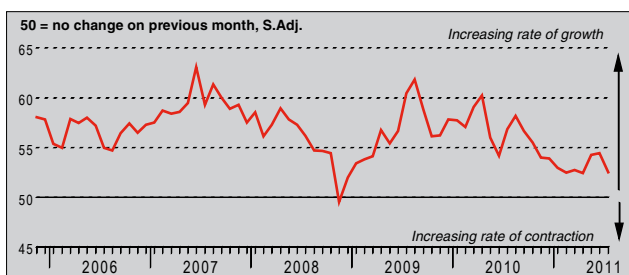
Q. Please compare the level of business activity (i.e. gross income, chargeable hours worked, etc) in your company this month with the situation one month ago.



After adjusting for seasonal variation, the Business Activity Index posted above the neutral level of 50.0 in July, signalling a solid increase in Chinese service sector activity. Despite slipping to a three-month low, the latest index reading was above the average for 2011 to date. According to survey respondents, the weaker increase in services output primarily reflected a moderation in new business growth. There were also reports that activity growth was restricted by state-led policies aimed at cooling the property sector.

New Business Index

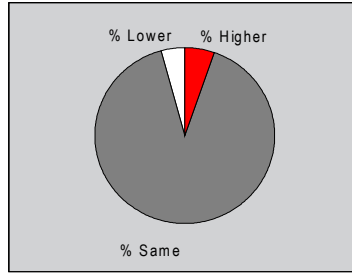
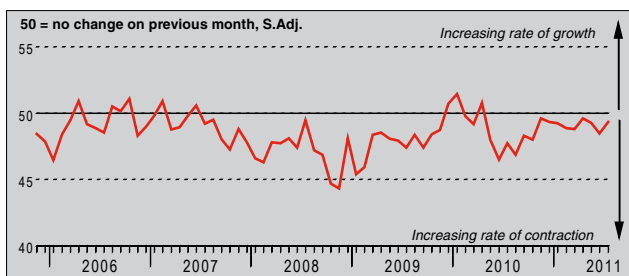
Q. Please compare the level of new orders/business placed at your company (whether already fulfilled or not) this month with the situation one month ago.



The level of new business received by Chinese service providers continued to increase in July. Those panellists reporting a rise in new work commented on stronger client demand, the success of promotional activities and new product development as factors supporting the overall expansion. However, the rate of new order growth eased for the first time in three months, with the seasonally adjusted New Business Index posting a reading only marginally higher than April's 28-month low.

Outstanding Business Index

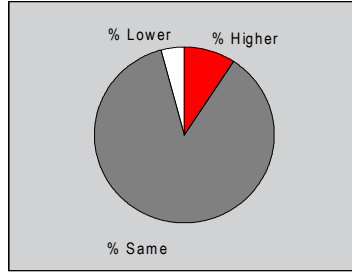
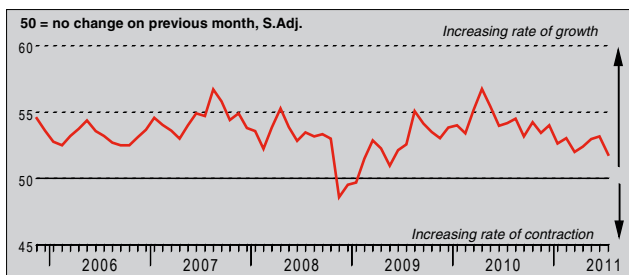
Q. Compare the level of outstanding business (i.e. work in hand but not yet completed) in your company this month with the situation one month ago.



Backlogs of work in the Chinese service sector decreased further during July, suggesting limited pressure on firms' capacity amid below-par growth of incoming new business. Nonetheless, the rate of backlog depletion was only marginal, and the least marked in three months. The vast majority of panellists (around 90%) reported no difference in unfinished work from one month earlier. The seasonally adjusted Outstanding Business Index has now posted below the neutral level of 50.0, signalling contraction, for 15 months in a row.

Employment Index

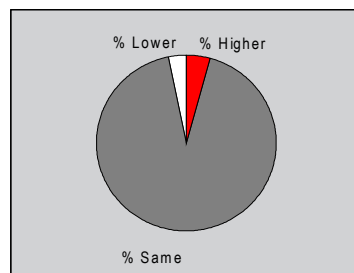
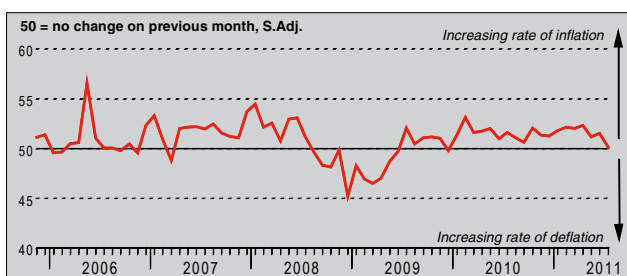
Q. Compare the number of people employed this month with the situation a month ago (treat two part as one full-time and ignore temporary labour).



Staffing levels continued to rise in July, extending the trend observed since February 2009. Recruitment was predominantly attributed by survey respondents to increased workloads. However, the seasonally adjusted Employment Index dropped to a 26-month low, a level consistent with only a modest rate of job creation. Moreover, the latest increase was slower than the long-run trend. Of those companies that recorded a drop in employee numbers (around 4%), many linked this to policies aimed at reducing overall costs.

Prices Charged Index

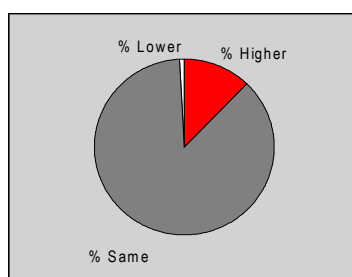
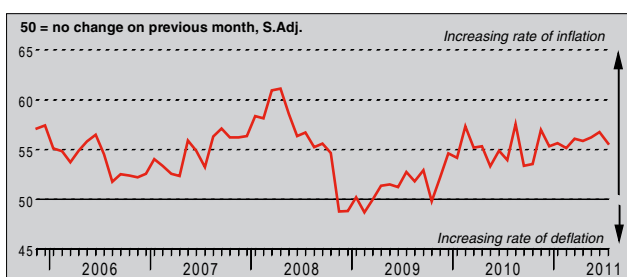
Q. Compare the average prices charged by your company (e.g. prices charged per item or unit of time) this month with the situation one month ago.



July data signalled a rise in prices charged by Chinese service providers. Where an increase in average tariffs was indicated, this was generally attributed to higher input costs. Nonetheless, the seasonally adjusted Prices Charged Index was at a level indicative of only a marginal rate of inflation. In addition, the latest increase in charges was the slowest in the current 19-month period of rising tariffs. Those respondents that recorded a decline in output prices commonly linked this to increase competition for new business.

Input Prices Index

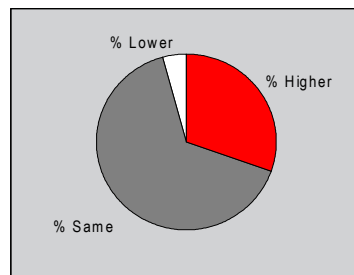
Q. Please compare the average prices paid by your company for all purchases, wages and salaries, etc. this month with the situation one month ago.



Average cost burdens faced by monitored companies operating in the Chinese service sector increased for the twenty-first consecutive month during July. The rate of input price inflation remained marked, despite easing to a five-month low. Around 12% of survey participants registered a rise in average costs since June, compared to less than 1% that recorded a decline. Anecdotal evidence suggested that input prices had risen in response to increased salary costs. Some panellists also mentioned higher raw material and fuel prices.

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?



Business optimism among service providers remained positive during July. Around 30% of panellists anticipate a rise in activity during the next twelve months, compared with only 4% that expect a fall. Panellists commented on improving economic conditions, new product launches and successful commercial activities as factors underpinning confidence. However, the degree of optimism was only slightly higher than June's series-record low. Firms operating in the Renting & Business Activities sector cited policies aimed at cooling the property sector as having dampened confidence.

Notes on the Data and Method of Presentation

The China Services *PMI*TM 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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