HSBC *Purchasing Managers' Index*™ 2011

compiled by markit

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HSBC Hong Kong PMI®

Private sector operating conditions deteriorate only marginally in October

Key findings:

- At 49.0, PMI close to neutral 50.0 level
- Output contraction eases as decline in new orders decelerates from September
- Charge inflation rises as cost pressures remain strong

The health of Hong Kong's private sector economy deteriorated again during October, albeit at a slower rate than in September. Operating conditions continued to worsen amid suppressed confidence, as new orders fell further. A strengthening in demand from Mainland China and a reduction in backlogs were not sufficient, however, to prevent another contraction in overall activity. As a result, private sector employment continued to decline. Cost pressures did ease over the month, but not by enough to prevent a rise in output price inflation.

The headline HSBC Hong Kong *Purchasing Managers' Index*™ (*PMI*™) – a composite index designed to provide timely indications of changes in prevailing business conditions in Hong Kong's private sector economy – registered 49.0 in October, up from 45.9 in September. The latest figure signalled that the deterioration in the overall operating conditions for Hong Kong's businesses was marginal, slowing notably from September (which marked the worst monthly fall in over two years). The sub-50 headline index for October was underpinned by modest contractions in business activity, new orders and employment.

Private sector companies operating in Hong Kong continued to reduce their backlogs of work during October, as domestic and foreign demand remained subdued. While the marginal rate of reduction in outstanding business was insufficient to generate activity growth, it did, however, contribute to the slower pace of contraction in output.

The deceleration in the pace of output contraction was also aided by a slowing in the rate at which total new orders fell over the month.

In contrast, Mainland China's demand for Hong Kong's goods and services remained reasonably buoyant, as new export orders from the Mainland rose at a moderate pace.

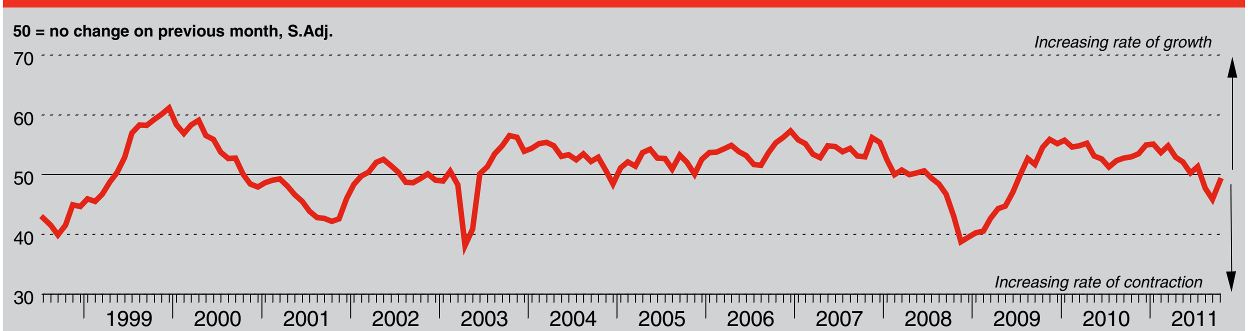
Firms in Hong Kong's private sector economy remained cautious in their purchasing activity though. Purchases of inputs fell at the fastest rate in over two-and-a-half years in October. As a result, stocks of pre-production inventories fell for their second successive month.

In line with the overall worsening in operating conditions, private sector employment in the Hong Kong economy fell marginally in October. A number of panellists reported voluntary staff resignations.

Hong Kong's businesses increased their output prices during the month, as they continued to record rising cost pressures. Factory gate prices rose at a solid rate, but slower than the sharp pace registered earlier in the year. While softer demand conditions helped to lower the rate of input price inflation, it remained sharp.

Suppliers' delivery times lengthened for the first time in six months during October. However, the deterioration in vendor performance was only marginal.

HSBC Hong Kong *Purchasing Managers's Index*™ *PMI*®



The HSBC Hong Kong *Purchasing Managers' Index* (*PMI*) is a composite indicator designed to provide an overall view of activity in the Hong Kong 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 Economis Limited, HSBC use the above marks under licence. Markit and the Markit logo are registered trade marks of Markit Group Limited.

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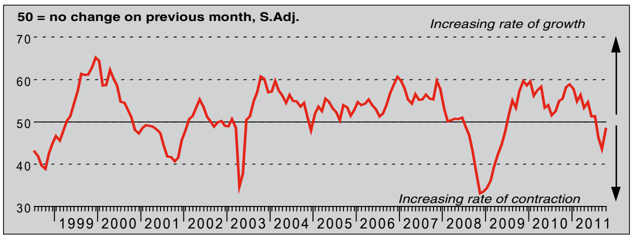
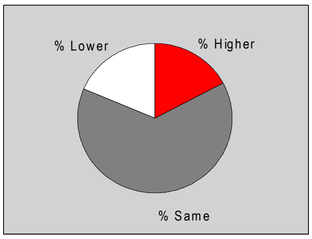
Output Index

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

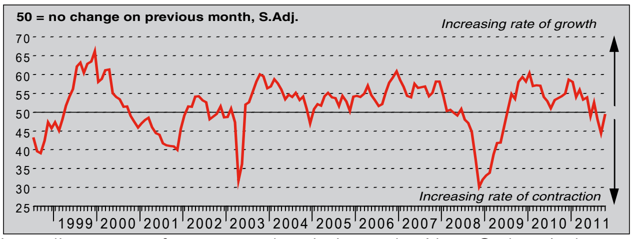


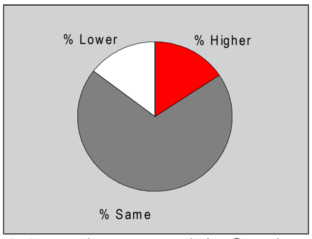


Output at private sector companies in Hong Kong decreased only moderately during October, after a marked decline in September. The seasonally adjusted Output Index remained below the 50.0 no-change mark for the third month running, but rose sharply from the previous survey period. Approximately 17% of panellists indicated a fall in output, and anecdotal evidence linked the decline in production to a fall in new orders amid weaker economic conditions.

New Orders Index

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

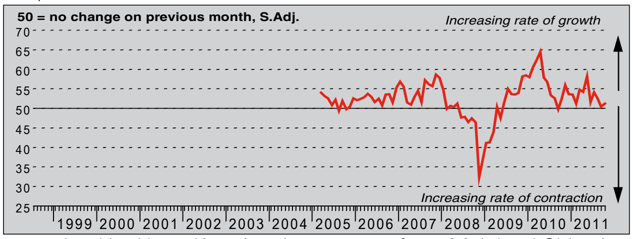


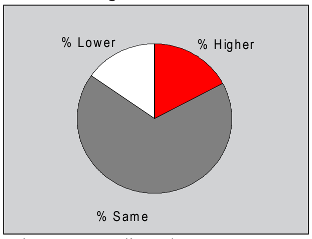


After making adjustments for seasonal variations, the New Orders Index posted below the 50.0 no-change mark in October. This extended the current sequence of consecutive falls in new business to three months. However, the rate of contraction in new business was only marginal, and slowed sharply from September. Survey members cited tight credit conditions and subdued demand as the primary reasons for lower levels of new orders.

New Orders Index: Mainland China

Q. Please compare the level of new business received from mainland China this month with the situation one month ago.

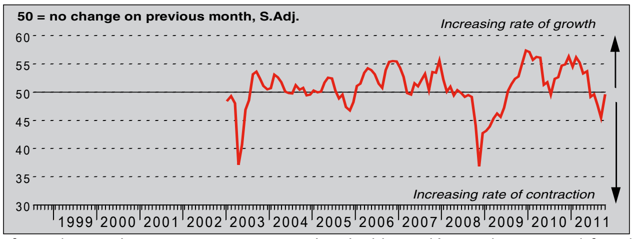


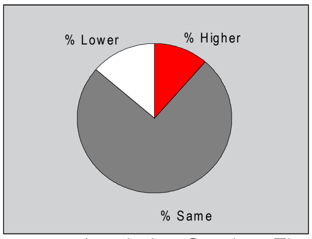


New orders received by Hong Kong's private sector from Mainland China increased during October, extending the current sequence of expansion to over a year. The rate of expansion in new orders from the Mainland was only marginal, but quickened from September (which was the slowest pace registered in the current sequence). Over 17% of respondents reported higher orders, while approximately 15% recorded a fall.

Backlogs of Work Index

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

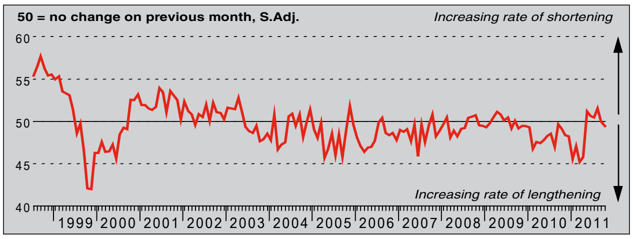


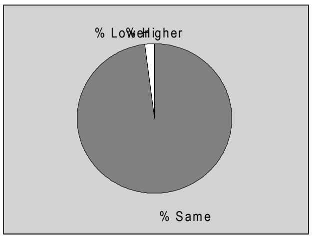


Backlogs of work at private sector companies in Hong Kong decreased for the fifth month in succession during October. The rate of contraction slowed over the month, however, after a sharp fall in outstanding business was recorded in September. According to the latest anecdotal evidence, the primary contributor towards the reduction in backlogs was a fall in the volume of new orders. Just less than 14% of respondents registered a decrease in outstanding business.

Suppliers' Delivery Times Index

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

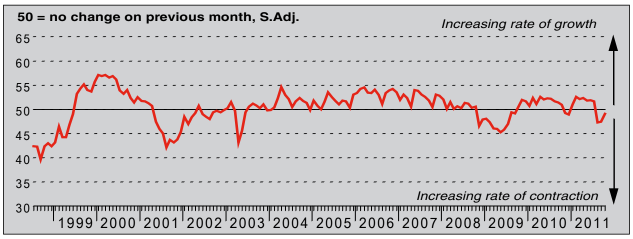


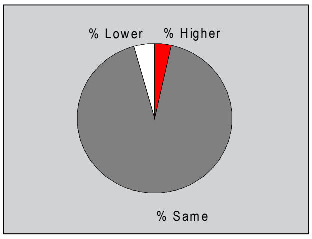


The seasonally adjusted Suppliers' Delivery Times Index fell below the 50.0 no-change threshold during October, signalling that vendors' performance deteriorated over the month. This marked the first month in six that suppliers' delivery times had lengthened. That said, just 2% of the survey respondents reported longer lead times and, as a result, the overall deterioration was marginal.

Employment Index

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

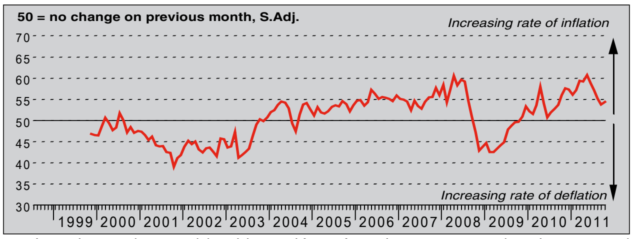


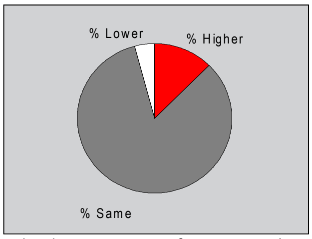


Private sector companies in Hong Kong continued to reduce employment during October. This was the third successive month in which headcounts at business units have fallen. The rate of decline in staff numbers was marginal, however, and eased for the second month running. Anecdotal evidence suggested that the fall in headcounts at private sector companies was due to a combination of a fall in new order volumes and staff resignations.

Prices Charged Index

Q. Please compare the average prices you charged this month with the situation one month ago.

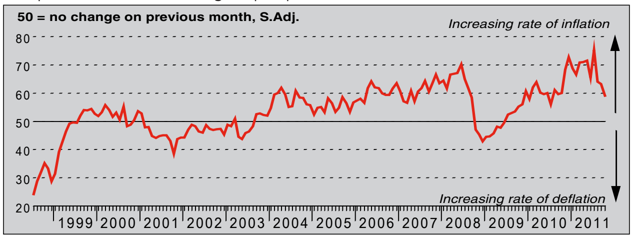


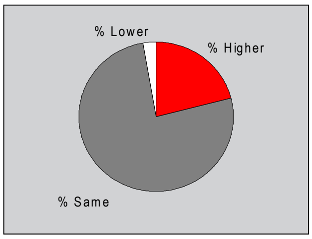


The increase in prices charged by Hong Kong's private sector businesses during October marked two years of consecutive monthly increases. Furthermore, the pace of inflation quickened during the latest survey period to a solid rate, having eased in each of the four previous months. Panellists reported raising prices further as overall input costs continued to rise. Just 4% of survey members registered lowering factory gate prices over the month.

Overall Input Costs Index

Q. Please compare the overall average input prices this month with the situation one month ago.

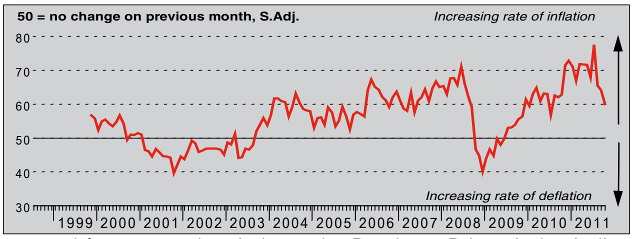


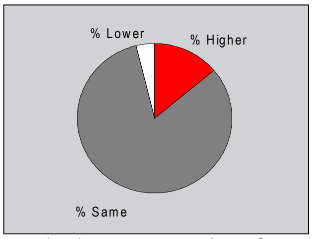


Overall cost inflation in Hong Kong's private sector remained high in October. The seasonally adjusted Overall Input Costs Index was well above the 50.0 no-change mark, indicating a sharp rise in overall input costs. However, October was the third month running in which the rate of inflation has slowed. Just over a fifth of respondents reported higher input costs, while less than 3% of panellists stated lower input costs.

Input Costs: Purchase Prices Index

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

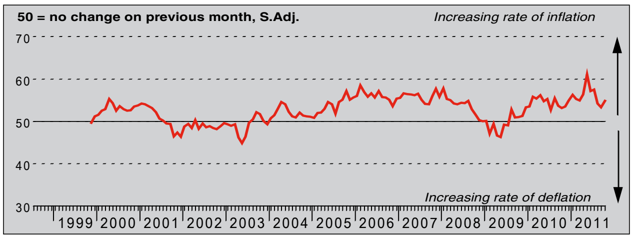


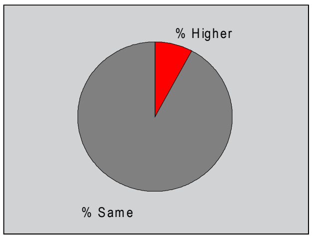


Having accounted for seasonal variations, the Purchase Prices Index indicated a sharp increase in the average price of purchases. The month-on-month rate of inflation eased for the third successive survey period, however, to the slowest pace recorded since July 2010. Higher prices for raw materials dominated the anecdotal evidence provided by the 14% of panellists who reported higher purchasing prices. Purchasing prices have now increased in each of the last 28 months.

Input Costs: Staff Costs Index

Q. Please compare the average prices you paid for salaries/wages this month with the situation one month ago.

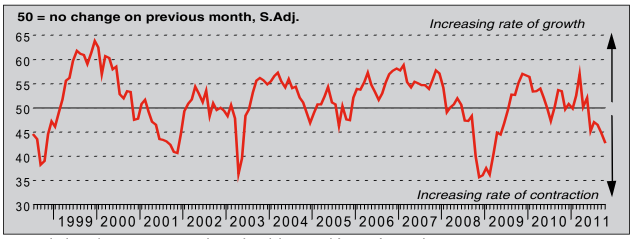


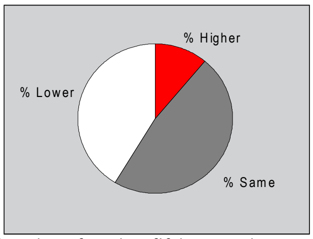


Wages paid by private firms operating in the Hong Kong economy were reported to have increased during October, as the impact of salary adjustments continued to increase business costs across the private sector economy. Furthermore, the rise in staff costs accelerated over the month to a strong rate. Salary inflation in the private sector of Hong Kong's economy has been maintained for 27 months.

Quantity of Purchases Index

Q. Please compare the quantity of goods/services purchased this month with the situation one month ago.

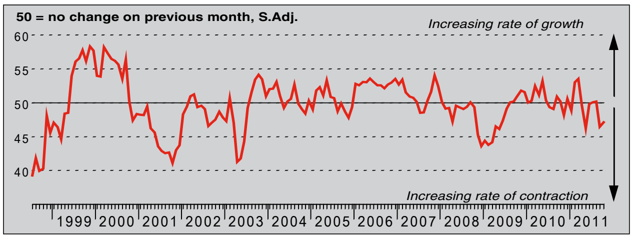


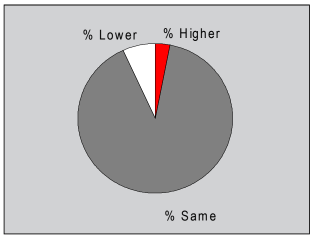


Purchasing activity by companies in Hong Kong's private sector economy decreased in October for the fifth month running. The reduction in month-on-month input buying was marked, and the rate of contraction quickened for the third survey period in a row. According to panel members, the primary driver of lower purchasing activity was a fall in the volume of new business received.

Stocks of Purchases Index

Q. Please compare your stocks of purchases this month with the situation one month ago.



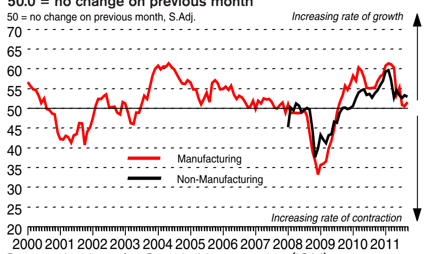


In line with lower purchasing activity over the month, stocks of purchases held by private companies in Hong Kong contracted during October. The rate of depletion was solid, despite slowing from the robust pace of decline registered in September. More than double the proportion of respondents reported a fall in stocks of purchases than those that recorded an increase. However, the vast majority (over 90%) indicated that their stocks of purchases remained unchanged over the month.

International *PMI*

US Purchasing Managers' Index

50.0 = no change on previous month

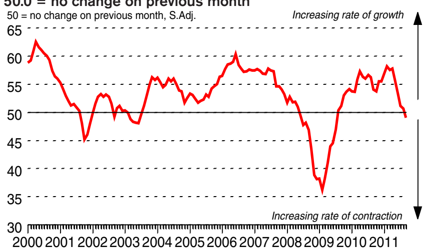


Source: Institute for Supply Management (ISM).

The ISM US Manufacturing PMI rose from August's 25-month low of 50.6 to a three-month high of 51.6 in September, pointing to a stronger improvement in business conditions. The pick-up in the headline index reflected renewed growth or output and stronger gains in employment. In contrast, the Non-Manufacturing Index slipped marginally to 53.0, from 53.3 in the previous month.

Eurozone *Purchasing Managers' Index™*

50.0 = no change on previous month

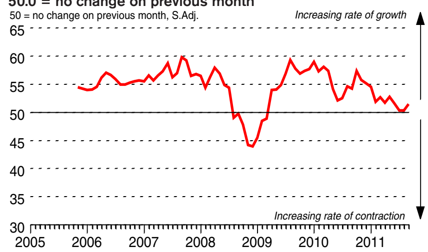


Source: Markit.

At 49.1, down from 50.7 in August, the final Eurozone PMI Composite Output Index for September signalled the first drop in private sector activity since July 2009. The final reading was broadly unchanged on the earlier flash estimate of 49.2. The average reading for the third quarter as a whole was just 50.3 – signalling a stagnation of activity – down from 55.6 in Q2 and 57.6 in Q1.

China *Purchasing Managers' Index™*

50.0 = no change on previous month



Source: HSBC; Markit.

September data showed growth of China's manufacturing and service sectors strengthened from near-stagnation in August. This was signalled by a rise in the seasonally adjusted HSBC Composite Output Index to a three-month high of 51.5. However, the index was well below the long-run series average (54.6). Moreover, for Q3 as a whole, the index averaged its lowest quarterly reading since Q1 2009.

Notes on the Data and Method of Presentation

The *Purchasing Managers' Index* is a monthly publication, researched and published by Markit Economics, featuring original research data from a survey of purchasing managers in companies operating in Hong Kong. The survey panel comprises around 300 companies that have been carefully selected to accurately represent the true structure of the Hong Kong economy, including manufacturing, services, retail and construction. The panel is stratified by Standard Industrial Classification (SIC) group, based on industry contribution to GDP.

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 tables show 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 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, Stocks of Items Purchased - 0.1, with the Delivery Times Index inverted so that it moves in a comparable direction. 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.