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HSBC China Services PMI™

Chinese service sector activity growth holds steady at solid rate

Key findings:

- Both activity and new order growth remain below-trend
- Employment growth slowest in current three-year period of expansion
- Business optimism again subdued in context of historic data

January data showed Chinese service sector activity increasing at a solid pace, in part supported by stronger growth of incoming new business. Job creation eased to only a marginal pace, however, and companies again expressed below-trend optimism about the one-year business outlook. Meanwhile, input price inflation continued to moderate, and companies kept their average tariffs broadly unchanged compared to the preceding month.

After adjusting for seasonal factors, the headline Business Activity Index – which is based on a single question asking survey respondents to report on the actual change in business activity at their companies compared to one month ago – was unchanged at 52.5 in January, signalling a solid expansion of business activity in the Chinese service sector. The latest index reading was nonetheless much lower than the long-run series average of 56.8.

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 outlook. Expectations of new business wins and better market conditions were cited by survey participants as having supported positive sentiment. However, the degree of optimism was subdued in the context of historic data. This reflected expectations of strong competitive pressures and concerns surrounding the future path of economic growth.

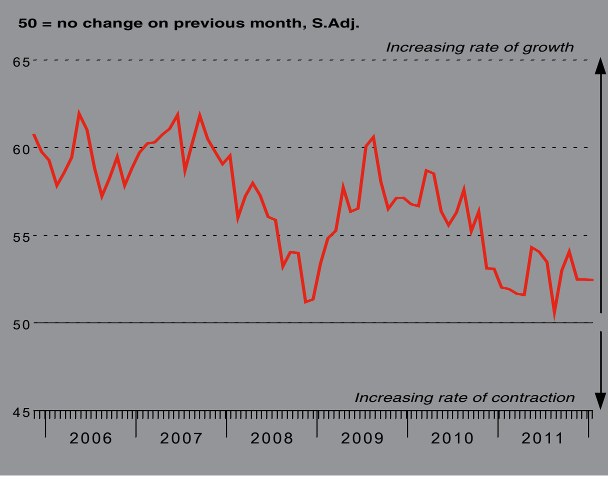
Behind the latest increase in business activity was a further expansion of incoming new orders. Better market demand was cited as the principal driver of new business growth in the latest survey period. Despite accelerating to a three-month high, the pace of new order growth was comfortably below the long-run trend for the survey.

Chinese service sector companies added to their staff numbers at a marginal rate at the start of 2012. In fact, the latest increase in employment was the slowest in the current three-year period of expansion. Sub-par new order growth was cited by survey participants as the main drag on employment growth. Meanwhile, backlogs of work returned to growth in January, with the index measuring monthly trends in outstanding business signalling expansion for only the second time in 21 months. That said, the rate of accumulation was only marginal.

The latest survey findings pointed to a further increase in average cost burdens faced by Chinese service sector companies. The rate of inflation was nonetheless only modest, and the weakest in the current 27-month period of higher input prices. According to survey respondents, input cost inflation reflected rising raw material prices. There were also reports of increased labour-related costs.

Companies kept their output charges broadly similar to that seen in the final month of 2011. Where an increase in average tariffs was signalled, this was generally linked by survey respondents to higher average cost burdens. Service providers that mentioned a reduction in charges attributed this to increased competition for new business and, in some cases, client requests for lower charges.

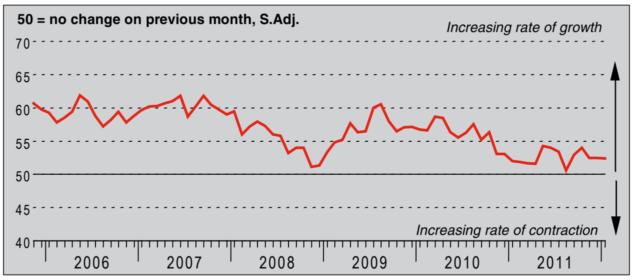
Business Activity Index

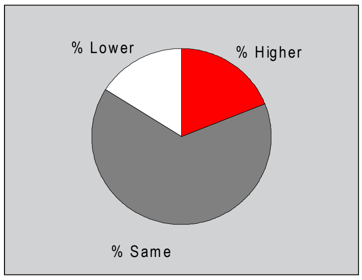


The survey uses a methodology identical to the HSBC China Manufacturing *PMI*™. The survey uses a panel of regularly participating companies to monitor trends in business conditions in the private sector services economy. The panel has been carefully selected to accurately replicate the true structure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

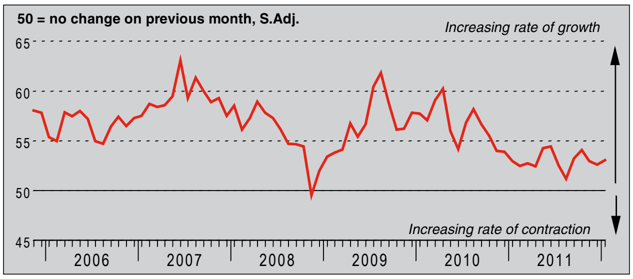


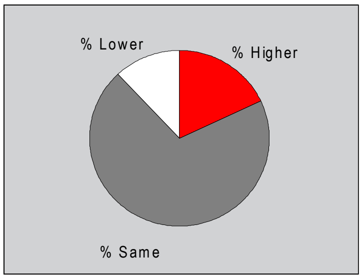


Chinese service providers continued to report growth of business activity at the start of 2012, with almost 19% signalling an increase since the preceding month. Additionally, the seasonally adjusted Business Activity Index was unmoved at a level indicative of a solid rate of expansion in services output. The latest index reading was nonetheless well below the long-run series average. Where a rise in activity levels was recorded, this was often linked to higher volumes of new business.

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.

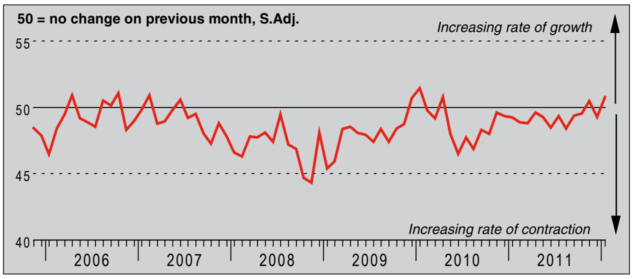


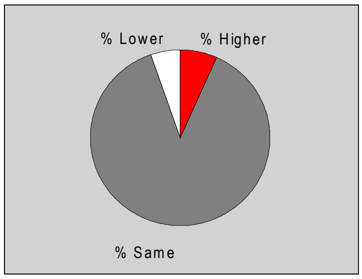


After adjusting for seasonal factors, the New Business Index registered above the neutral 50.0 threshold in January, signalling a further expansion of new order volumes at service providers. With exactly 18% of companies recording a rise in new business, compared to 12% that noted a decrease, the rate of expansion was solid. Similar to the trend for business activity, however, the latest increase in new orders was muted in the context of historic data.

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.

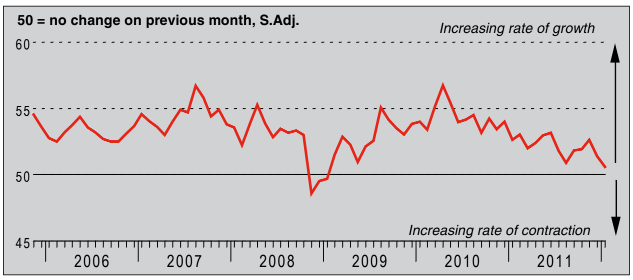


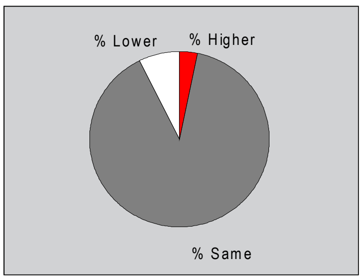


The latest survey findings signalled a renewed expansion of unfinished work in the Chinese service sector, with the seasonally adjusted Outstanding Business Index posting above the 50.0 no change mark for only the second time in the past 21 months. However, the rate of backlog accumulation was only marginal. Anecdotal evidence provided by survey respondents attributed growth of work-in-hand (but not yet completed) to greater inflows of new orders.

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).

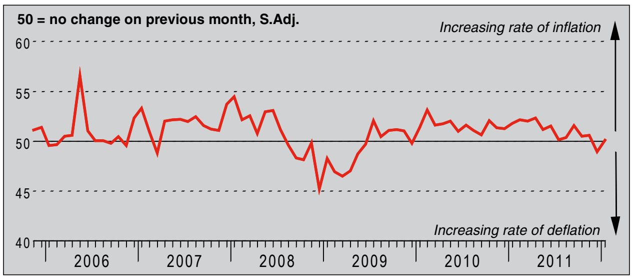


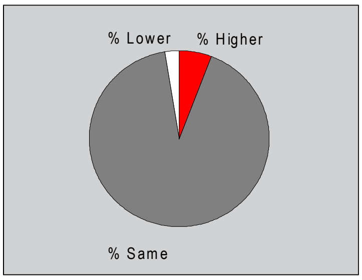


Chinese service providers further added to their staff numbers at the beginning of 2012. The rate of job creation was only marginal, however, and the slowest in the current three-year period of growth. Moreover, the vast majority of panellists (around 89%) signalled no change in employment from one month earlier. Sub-par new business growth was cited by survey participants as the principal drag on job creation during the latest survey period.

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.

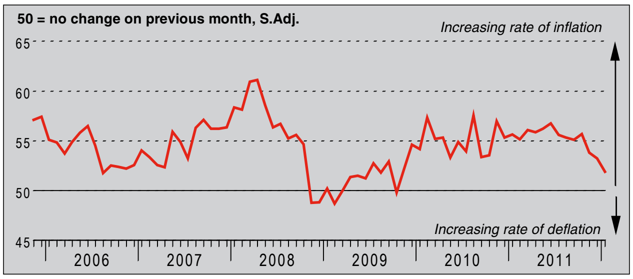


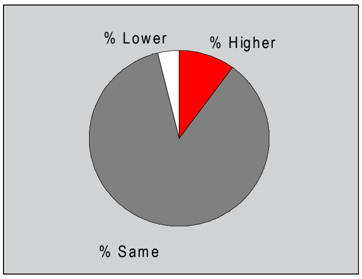


Prices charged by Chinese service providers were broadly unchanged compared to the preceding month, with almost 92% signalling no difference since December. Where a rise in output charges was registered, this was attributed by panellists to the passing on of higher input costs to clients. Of those survey respondents that noted a reduction in average tariffs (around 3%), many mentioned increased competition for new business. There were also reports of client requests for lower charges.

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.

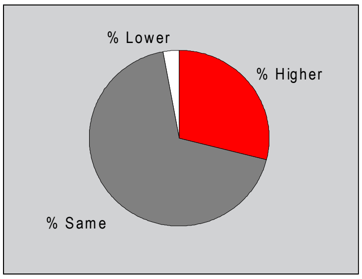




January data showed input price inflation in the Chinese service sector easing for the third successive month to only a modest rate. In addition, the latest seasonally adjusted Input Prices Index reading was the lowest in the current 27-month period of inflation. Higher prices paid for raw materials was mentioned by panellists as having led to the overall increase in average cost burdens. On the other hand, companies that noted a decrease in input prices mainly linked this to lower raw material costs.

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?



Chinese service providers continued to express optimism in the one-year outlook for business activity. Survey participants linked positive sentiment to expectations of new business wins and better market conditions. Despite rising from December's series-record low, the Business Expectations Index again signalled a subdued degree of optimism in the context of historic data. Competitive pressures and concerns surrounding the future path of economic growth reportedly dampened business confidence in the latest survey period.

Notes on the Data and Method of Presentation

The China Services *PMI™* 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.

Warning