HSBC *Purchasing Managers' Index*™ 2012

compiled by markit

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HSBC China Services PMI™

Activity growth quickens in July, but remains below-trend

Key findings:

- Business activity and new orders up at faster rates
- Input cost inflation only modest
- Business optimism falls to seven-month low

Chinese service providers reported a further expansion in business activity during July, as new orders rose for a forty-fourth successive month. In both cases, however, rates of growth remained muted in the context of historic data. Moreover, companies again expressed below-trend optimism in the one-year business outlook, with the level of positive sentiment the lowest in seven months. Companies added to their staff numbers at only a modest rate in the latest survey period, while backlogs of work were broadly unchanged. On the price front, output charges declined marginally, while input cost inflation remained muted overall.

After adjusting for seasonal factors, the Business Activity Index posted 53.1 in July, up from 52.3 in June, signalling a continued expansion of services output in China. Despite the uptick in the headline index, the rate of activity growth was again lower than the long-run trend for the survey. Behind the latest rise in business activity was a sustained increase in new order volumes. Indeed, the rate of new business growth accelerated since the month before, but remained below-trend nonetheless. Respondents to the latest survey commented on better client demand and, in some cases, new product developments.

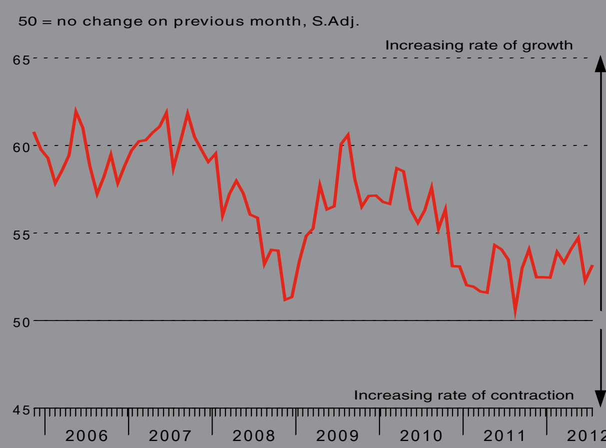
Sub-par new order growth meant that capacity was little tested in during the month, with backlogs of work falling for a sixth month in a row. However, the rate of depletion was only slight.

Jobs growth in China's service sector also remained below trend in July, despite picking up since the month before. The latest increase in services employment was the forty-second in as many months, and largely reflected higher intakes of new business. Company expansion plans was also cited as a factor contributing to job creation.

The rate of input price inflation quickened slightly since the month before, but nevertheless remained lacklustre, and below the long-run trend. The latest increase in input costs extends the current period of inflation to 33 months. According to survey respondents, input cost inflation reflected increased labour-related costs. Meanwhile, companies reduced their average tariffs further, albeit at only a marginal rate. Respondents attributed reduced output charges to client requests for lower tariffs and competitive pressures.

Chinese service providers remained confident regarding the one-year outlook for activity in July. New product developments and buoyant economic prospects were cited by panellists as having supported positive sentiment in the latest survey period. Around 30% of companies expected business activity to be higher in 12 months' time, versus only 4% that anticipate a fall. That said, the degree of optimism was weak in the context of historical data, with the relevant index almost ten points lower than the long-run series average.

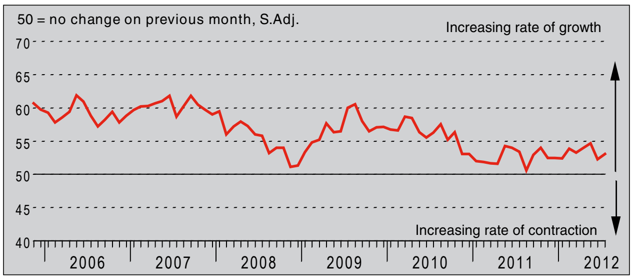
Business Activity Index

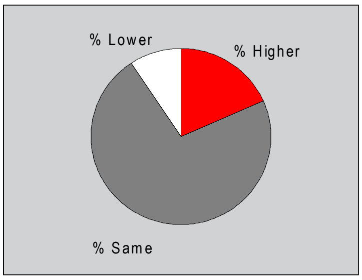


The survey uses a methodology identical to the HSBC China Manufacturing *PMI*™. The survey uses a panel of regularly participating companies to monitor trends in business conditions in the private sector services economy. The panel has been carefully selected to accurately replicate the true structure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

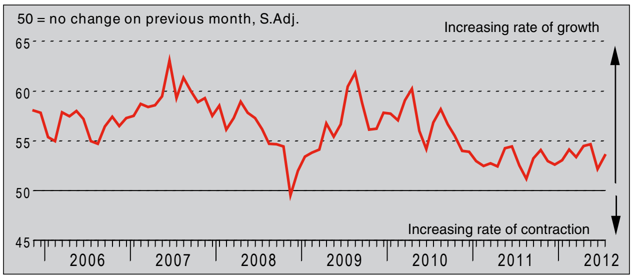


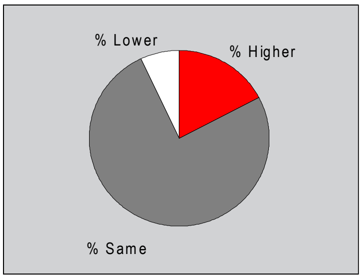


Business activity in the Chinese service sector continued to increase during July, with around 18% of panellists signalling a rise from one month earlier. This compared to 9% that indicated a reduction. The rate of activity growth was moderate, and stronger than in June. However, the seasonally adjusted Business Activity Index remained below the long-run series average. The expansion of services output mainly reflected a further rise in new business, according to survey respondents.

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.

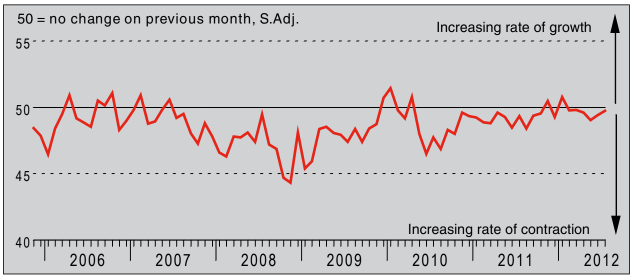


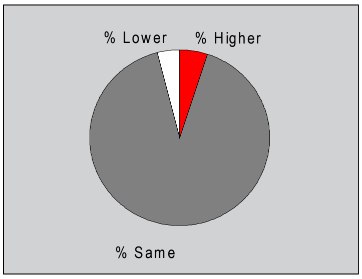


After adjusting for seasonal factors, the New Business Index signalled an increase in new order volumes for the forty-fourth successive month during July. Although solid, and sharper than in June, the rate of expansion in new orders was slower than the long-run trend for the survey. Around 17% of survey respondents reported a rise in new work since the month before, which the majority attributed to better demand conditions.

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.

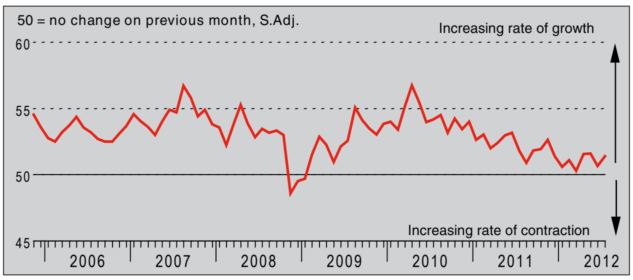


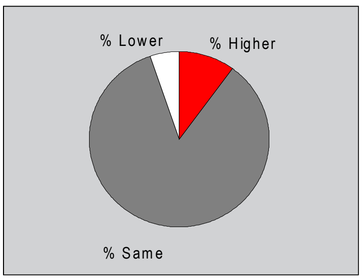


Outstanding business in the Chinese service sector fell again during July. Nonetheless, the rate of backlog depletion was only marginal, with the vast majority of panellists (approximately 91%) reporting no change since the preceding month. The latest decline stretches the current period of contraction to six months. Of those firms that signalled a reduction in work-in-hand, most attributed this to sub-par growth of incoming new business.

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).

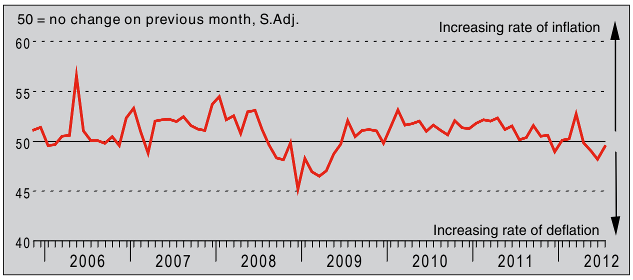


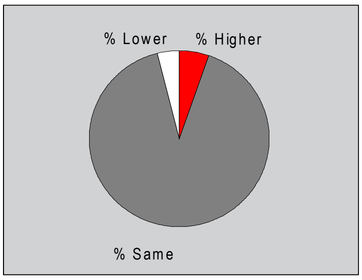


Chinese services employment continued to rise during the month. The rate at which companies added to their workforce numbers was only modest, however, and still slower than the long-run series average. Anecdotal evidence suggested that employment growth reflected new product developments and, in some cases, company expansion policies. Where a reduction in staff numbers was signalled, firms generally linked this to retirements and resignations.

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.

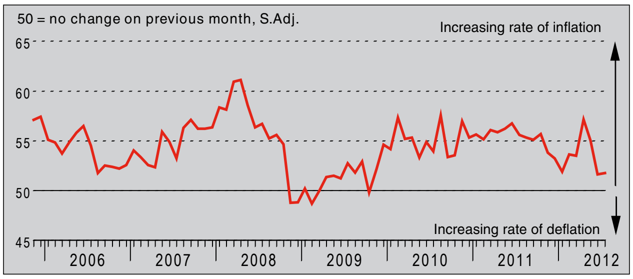


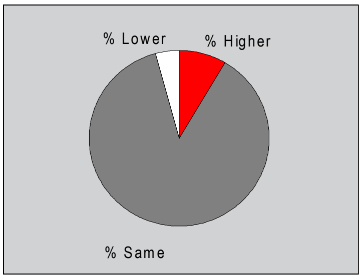


Output prices set by Chinese service providers continued to fall in July, with the seasonally adjusted Prices Charged Index posting below the neutral 50.0 threshold for the fourth month running. The latest index reading was nonetheless consistent with only a marginal rate of output price discounting. Respondents attributed reduced output charges to client requests for lower tariffs and competitive pressures. There were also some reports of panellists passing on reduced input costs to clients.

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.

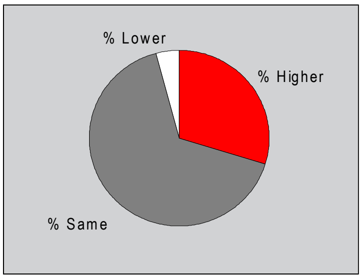




After adjusting for seasonal variation, the Input Prices Index indicated a further increase in average cost burdens faced by Chinese service providers during July. Anecdotal evidence primarily linked higher input costs to increased labour-related costs. Input price inflation has now been recorded for 33 months in succession. However, the latest index reading pointed to only a modest rate of input price inflation that was almost unmoved on June's near three-year low.

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 sector firms were confident that activity would be higher than present levels in one year's time, largely reflective of optimism regarding the economic outlook and expectations that client demand will strengthen in the coming year. Business expansion plans were also mentioned by a number of panellists. However, the degree of positive sentiment was the weakest in seven months, and muted in the context of historical data.

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