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HSBC China Manufacturing PMI™

Operating conditions deteriorate for first time since last October

Key findings:

- Both total new orders and new export orders decline
- · Output growth maintained, but at marginal rate
- Purchasing activity falls for the first time in eight months

Operating conditions in China's manufacturing sector deteriorated for the first time in seven months during May. Conditions worsened over the month as both total new orders and new exports declined, while output expanded at the weakest pace in the current seven-month sequence. Weak demand led to a modest reduction in payroll numbers, and the first reduction in purchasing activity since last September. On the price front, both input costs and output charges fell sharply over the month amid reports of falling raw material costs.

After adjusting for seasonal factors, the HSBC *Purchasing Managers' Index*TM (PMI^{TM}) – a composite indicator designed to provide a single-figure snapshot of operating conditions in the manufacturing economy – posted at 49.2 in May, down from 50.4 in April. This signalled the first deterioration in operating conditions in seven months, albeit at only a marginal pace.

Despite operating conditions worsening, manufacturing output rose for the seventh month in a row during May, albeit marginally. Behind the meagre expansion of output, total new orders declined modestly and for the first time since last September. Demand from abroad also weakened over the month, with new export orders falling for the second month in a row. A number of panellists suggested reduced client demand, particularly in the US, had led to the overall reduction in export orders.

Staff numbers fell for the second month in a row in May. The

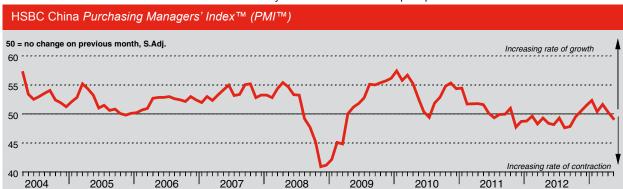
rate of job shedding was modest, and linked to both employee resignations and companies down-sizing. Backlogs of work also declined over the month, and at the fastest pace in nine months. Anecdotal evidence suggested that lower new order volumes helped free up capacity at some plants.

Purchasing activity in the manufacturing sector decreased in May. Though the rate of reduction was only slight, it was the first time input buying had declined since last September. Consequently, stocks of purchases fell for the fourth month in a row. The reductions in both purchasing activity and stocks of purchases were attributed to lower production requirements by a number of firms.

As a result of weaker demand for inputs, suppliers' delivery times shortened for the second month in a row (albeit marginally).

Overall input costs declined for the third month in a row in May. Furthermore, the rate of reduction remained sharp. Panellists reported that lower raw material costs, particularly for metals, drove down purchasing prices. Output charges also decreased sharply over the month, with a number of firms passing on reduced operating costs to clients.

Finally, stocks of finished goods increased over the month, and at a modest pace. Anecdotal evidence suggested that a combination of higher output and fewer new orders led to the accumulation of post-production inventories.



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.

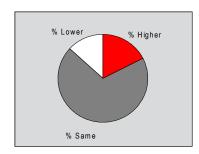




Output Index

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



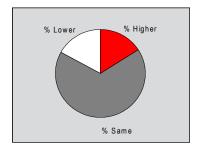


Production at manufacturing plants in China increased for the seventh successive month in May. However, the seasonally adjusted Output Index signalled only a marginal rate of expansion that was the weakest in the current sequence. Just over 17% of survey respondents reported increased output over the month, while approximately 13% cut their production levels. Firm client demand accommodated higher production levels at some producers.

New Orders Index

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



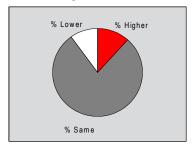


Total new orders placed at Chinese manufacturers fell for the first time since last September during May. After adjusting for seasonality, the rate of contraction was modest, with exactly 17% of panellists recording a reduced level of new business. Anecdotal evidence suggested that weaker client demand stemmed from deteriorating market conditions.

New Export Orders Index

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



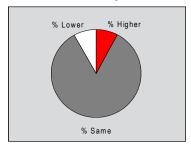


The seasonally adjusted New Exports Orders Index signalled a decreased amount of new export orders for the second successive month in May. That said, the rate of reduction eased slightly since April and was marginal overall. A number of respondents suggested reduced international demand, particularly in the US, led to the overall decline in export sales.

Backlogs of Work Index

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



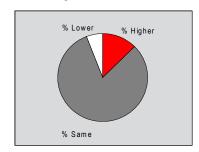


Backlogs of work at Chinese manufacturing plants fell during May following a fractional accumulation in April. This was the ninth time the seasonally adjusted Backlogs of Work Index posted below the 50.0 no-change mark in the past year. The rate of backlog depletion was marginal overall, with around 8% of respondents recording a lower level of work-in-hand. According to panellists, lower new order volumes created spare capacity at some firms.

Stocks of Finished Goods Index

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



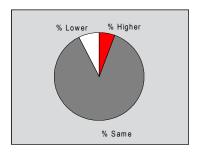


Stocks of post-production goods at manufacturing plants increased for the third consecutive month in May. After adjusting for seasonality, the rate of accumulation was modest, with more than 12% of survey respondents reporting a rise in inventories. Anecdotal evidence suggested the accumulation of stock was due to a combination of higher output and fewer new orders at some plants.

Employment Index

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



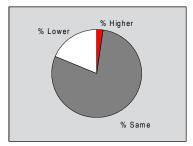


The seasonally adjusted Employment Index signalled a second month of job cuts in China's manufacturing sector during May. Though modest, the rate of job shedding was the quickest in seven months. Reduced payroll numbers were attributed by a number of panellists to both employee resignations and overall down-sizing.

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.



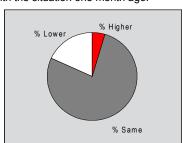


Output prices set by goods producers in China decreased for the third successive month in May. Furthermore, the rate of reduction was the sharpest in nine months, with nearly 19% of respondents cutting their tariffs, while just over 2% raised their prices. Some firms lowered their average tariffs in response to weaker client demand, which was accommodated by a sharp fall in input costs.

Input Prices Index

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



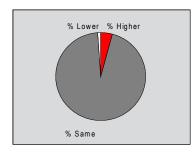


Average input costs at Chinese manufacturing plants decreased for the third month running in May. After adjusting for seasonal factors, the rate at which overall input costs declined was sharp and similar to that recorded in April. Furthermore, over 18% of panellists signalled lower operating costs. A number of respondents suggested that a fall in raw material costs (metal prices in particular) drove down production costs.

Suppliers' Delivery Times Index

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



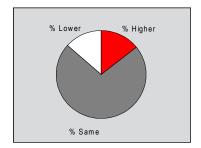


Suppliers' delivery times in the Chinese manufacturing sector improved for the second consecutive month in May. That said, the rate at which times shortened was only marginal, with just over 4% of survey respondents recording quicker delivery times. A number of panellists mentioned that fewer new orders placed at vendors led to the overall improvement.

Quantity of Purchases Index

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

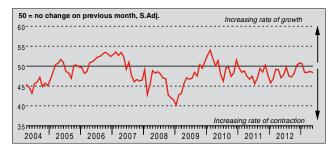


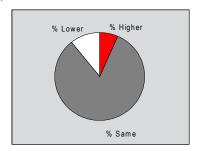


Goods producers in China signalled a lower level of purchasing activity for the first time since last September in May. However, after adjusting for seasonal factors the rate of reduction was only slight. A number of survey respondents suggested that input buying declined in line with lower production requirements.

Stocks of Purchases Index

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





Following on from the reduction in input buying, stocks of purchases at manufacturing plants fell for the fourth successive month in May. After adjusting for seasonality, the rate of depletion remained modest, with nearly 11% of panellists recording lower pre-production stocks. Anecdotal evidence linked the fall in inventories to reduced purchasing activity, as client demand softened in the sector.

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 420 manufacturing companies. The panel is stratified geographically and by Standard Industrial Classification (SIC) group, based on industry contribution to Chinese 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 '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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