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China

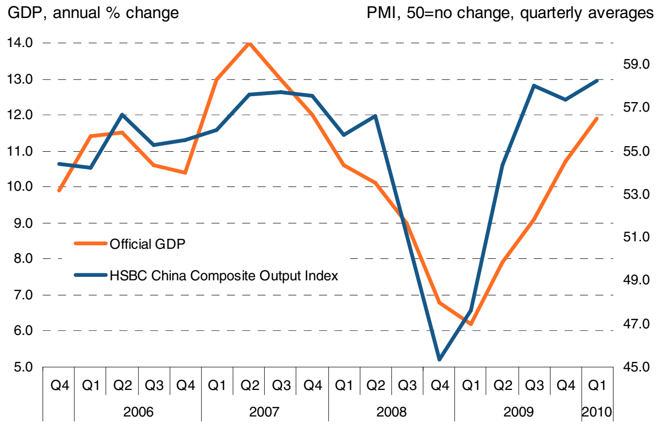
Faster-than-expected rise in Q1 GDP signposted in advance by PMI data

- **GDP rose by 11.9% in Q1 2010, beating forecasts but in line with PMI data.**
- **Strong GDP growth bolsters overheating fears in China.**

China shows no signs of slowing

Official data released by the National Bureau of Statistics (NBS) showed that China's economy expanded by 11.9% on a year ago in the first quarter of 2010. Faster economic growth in China raises fears that the world's largest emerging nation is at risk of overheating, adding to the case for further monetary tightening. However, although supply chain price pressures are building, inflation appears to remain under control at present.

Chart 1: China Composite PMI and GDP



Sources: Markit, NBS.

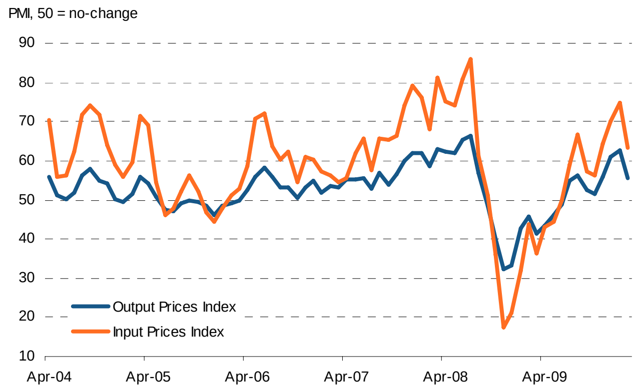
The extent of the rise in GDP was the fastest in over two years and surpassed consensus forecasts (a poll conducted by Reuters had expected growth to reach 11.5%). However, PMI data provided an advance indication of the faster-than-expected increase in GDP. Using regression analysis[1] to compare trends in survey data with GDP growth rates, the HSBC Composite PMI Output Index (based on surveys compiled by Markit covering both manufacturing and services) was consistent with growth of approximately 12% in Q1.

Additional data released by the National Bureau of Statistics signalled that industrial production rose by 18.1% on an annual basis in March, broadly in line with the consensus forecast of 18.2% growth. Regression analysis suggests that the HSBC China Manufacturing PMI was consistent with a 17.8% rise in activity at factories and workshops across China in March.

Inflationary pressures driven by supply-side forces

PMI data also indicate that price pressures intensified in the first quarter of 2010, with both input and output price measures in the manufacturing sector recording quarterly averages last seen prior to the onset of the financial crisis (although rates of increase did ease in March).

Chart 2: PMI Output and Input Prices



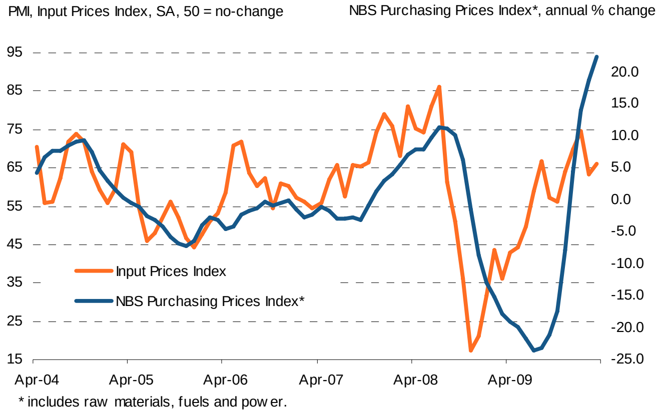
Source: Markit.

Whilst reflecting a combination of rising commodity prices and ultra-loose monetary policy, the rapid build-up of price pressures has also been driven by bottlenecks in the supply chain. After destocking rapidly during the downturn, manufacturers have responded by rebuilding inventories. For Q1 as a whole, the PMI measure relating to the amount of inputs purchased by manufacturing firms averaged its highest reading since

[1] The PMI data produced by Markit have a good track record against official growth estimates. Since the start of the series in November 2005, the headline HSBC Composite Output Index has achieved a **correlation of 0.78** against annual rates of change in GDP.

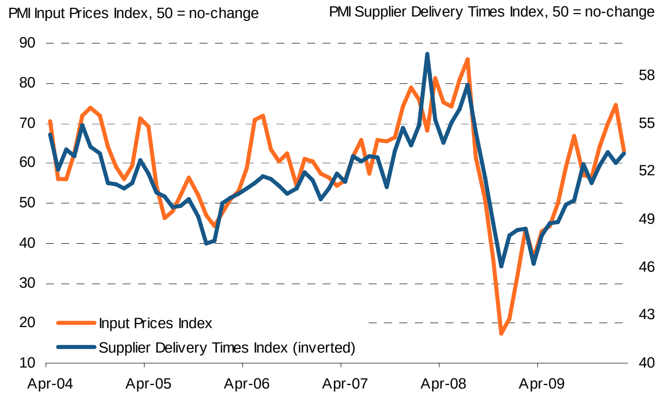
Q1 2007. However, reduced stock holdings at suppliers have led to widespread shortages and a rapid rise in the incidence of delivery delays. According to the latest PMI survey, the average time taken by suppliers to deliver inputs to manufacturers lengthened for the eighth month running in March, and at the fastest rate since August 2008. This imbalance between demand and supply has strengthened the ability of vendors to raise their prices, and has subsequently contributed to rising inflationary pressure in China's manufacturing economy.

Chart 3: PMI Input Prices vs. Purchasing Prices



Sources: Markit, NBS.

Chart 4: China PMI Input Prices v. Delivery Times



Source: Markit.

Despite these supply chain price pressures, official data for March signalled that Consumer Price Inflation (CPI) eased to 2.4% from 2.7% in the previous month. The slower rise in the average price of consumer goods and services reflected lower food inflation and tighter monetary control (lending by Chinese banks fell by 43% on an annual basis in the first three months of the year. This occurred despite a surge in bank lending in the first two weeks of 2010, which saw banks lend one-tenth of the total lending seen during the whole of 2009.)

Outlook for 2010

In the remainder of 2010, China's policymakers face the challenge of stimulating further economic growth while attempting to successfully manage inflation. China's economic recovery and positive results for Q1 have also increased focus on its interest rate and currency decisions. These are two policies that are of global significance and both will be watched carefully in 2010.

Strong economic growth is widely expected to persist in 2010. This is affirmed by the latest KPMG Business Outlook survey[2], compiled by Markit, which signalled that optimism amongst both Chinese manufacturers and services providers has returned to those levels last seen prior to the onset of the financial crisis. Business activity, revenues and new orders in both sectors are forecast to be considerably higher come February 2011.

The first insight into the performance of China's economy in the first month of Q2 2010 will be provided by the HSBC China Manufacturing PMI for April, released 4th May, followed by the HSBC China Services & Composite PMI on 6th May. To find out how to receive PMI data for China, please contact **economics@markit.com**

2 The KMPG Business Outlook Survey for China Manufacturing and Services is based on a survey of over 850 manufacturers and service providers that are asked to give their thoughts on future business conditions. The reports are produced on a tri-annual basis, with data collected in February, June and October.

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