

China

Fight against inflation led by state-owned enterprises

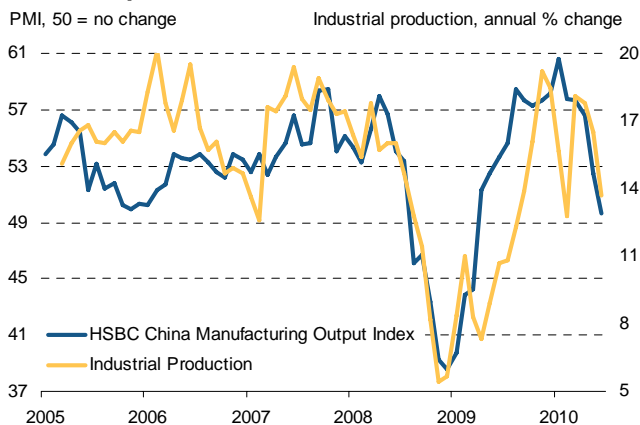
PMI signals sharp slowdown

The HSBC China Manufacturing PMI™, produced using the same methodology used by Markit for PMIs in 20 countries, is signalling the steepest slowdown since the height of the financial crisis in late-2008. Weaker output growth is evident in both state-owned and private enterprises, though the former are leading the fight against inflation.

Output growth slows at both private and state-owned companies

In our commentary note of 1 July¹ we estimated that the recent fall in the PMI's Output Index from its 60.6 point high at the start of the year to 49.6 in June 'suggested that the annual rate of growth of industrial production slipped from the near-20% rate seen at the end of last year to around 12-13% in June'. Data subsequently published by the National Bureau of Statistics showed industrial production growth easing to 13.7% in June (analysts were forecasting 15.3%).

Industrial production

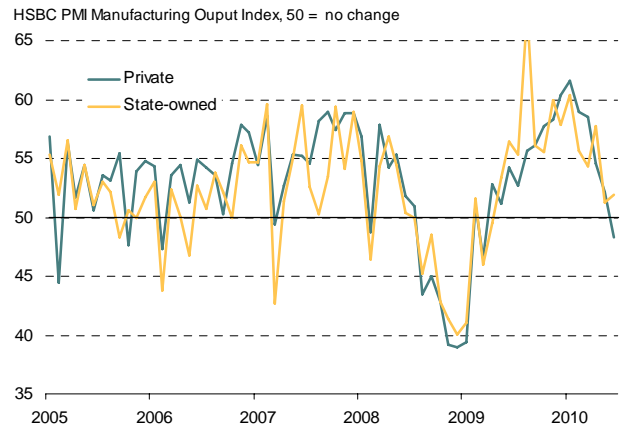


Sources: Markit, National Bureau of Statistics.

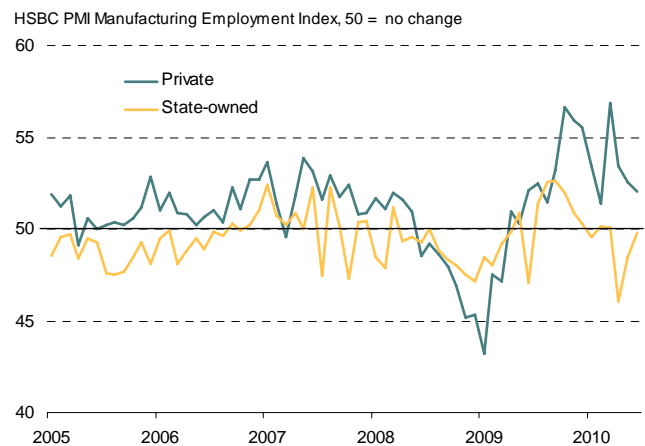
The slowdown has been at least in part attributable to deliberate policies designed to prevent overheating by the authorities. This is corroborated by an analysis of the PMI data which shows that production growth has

¹ http://www.markit.com/assets/en/docs/commentary/markit-economics/2010/jul/china%20manufacturing_10_07_01.pdf

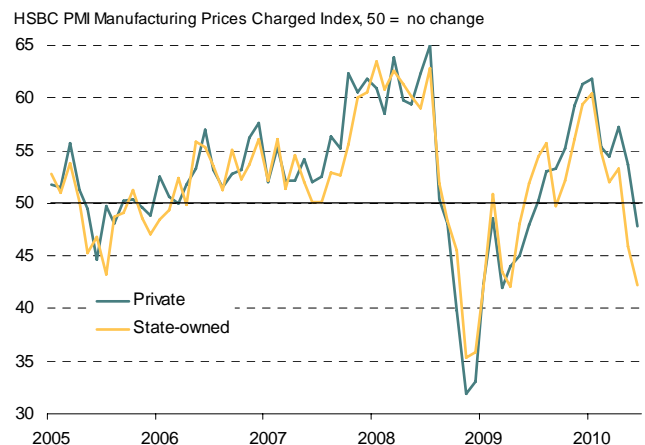
Manufacturing output



Manufacturing employment



Manufacturing prices



Source: Markit.

slowed sharply in both state-owned and private enterprises.

The seasonally adjusted Output Index for state-owned enterprises has fallen from a peak of 61.1 in January to just 50.8 in June. The equivalent index for privately-owned enterprises has fallen from a peak of 62.4 in January to 47.7 in June.

Falling headcounts at state-owned firms

More significant than the output growth differential, however, has been the difference between employment and price setting trends at state-owned and private companies.

The seasonally adjusted index relating to manufacturing employment at state-owned enterprises signalled falling staffing levels for the third successive month in June whereas private sector employment continued to rise. The average reading of the state-owned enterprises Employment Index has been 48.1 in the second quarter compared to an average of 52.7 for private enterprises.

State enterprises lead the fight against inflation

Perhaps most telling of all in the fight against overheating-induced inflation is the extent to which prices charged by state-owned enterprises are now falling: factory gate prices fell for the second month running in June, dropping at the fastest rate since April of last year. Factory gate prices also fell at privately-owned manufacturers in June, but to a much lesser degree than government-owned plants.

These data therefore suggest that the Chinese authorities actions to stem rising inflationary pressures are having a clear impact and, at the moment, are reducing producer prices while allowing manufacturing growth to run at a slower but still robust pace.

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