4th floor
Ropemaker Place
25 Ropemaker Street
London
EC2Y 9LY
United Kingdom

tel +44 20 7260 2000
fax +44 20 7260 2001
www.markit.com

Markit Economic Research

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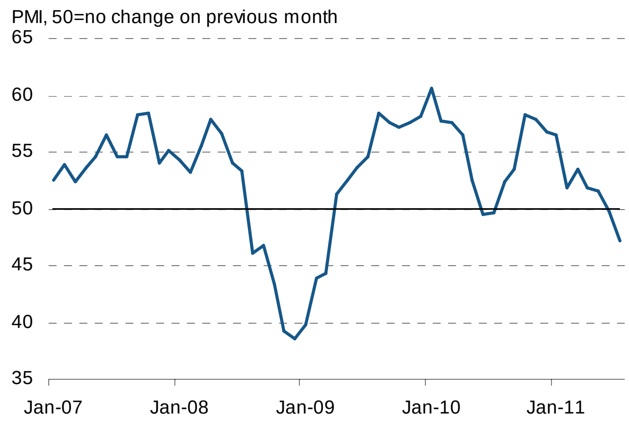
China

Flash PMI™ signals manufacturing contraction

- **PMI hits 28-month low in July**
- **Output falls as order books deteriorate**
- **Fewer supply delays than earlier in the year bodes well for inflation**

The HSBC Manufacturing PMI™ for China fell from 50.1 in June to 48.9 in July, according to the flash reading, dropping below the 50.0 no-change level for the first time in a year. The latest reading signalled the largest deterioration of manufacturing sector operating conditions since March 2009.

Flash HSBC China Manufacturing PMI



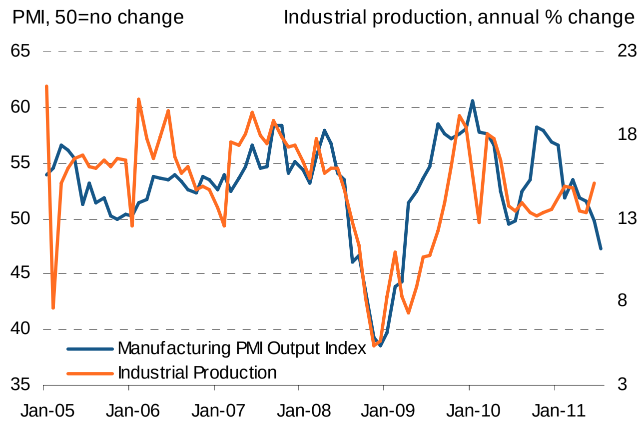
Sources: Markit, HSBC.

The sub-50 reading reflected a renewed contraction of output, which fell at the steepest rate for 28 months, and a reduction in inflows of new orders for the first time in a year. Export orders showed particular weakness, dropping for the third month running (though to a lesser extent than in June).

Employment also fell, albeit only slightly, and manufacturers cut back on their purchases of inputs for the second successive month to help further drive down their inventory holdings. The deliberate reductions to headcounts and inventory levels suggest that manufacturers are cautious about the outlook.

The decline in the PMI bodes ill for growth of industrial production in China. The latest official data showed the annual rate of growth of production accelerating from 13.3% in May to 15.1% in June – the strongest pace since May 2010. The PMI suggests that this rate could cool to around 10%, although that still remains well above the low of 5.4% reached in November 2008[1].

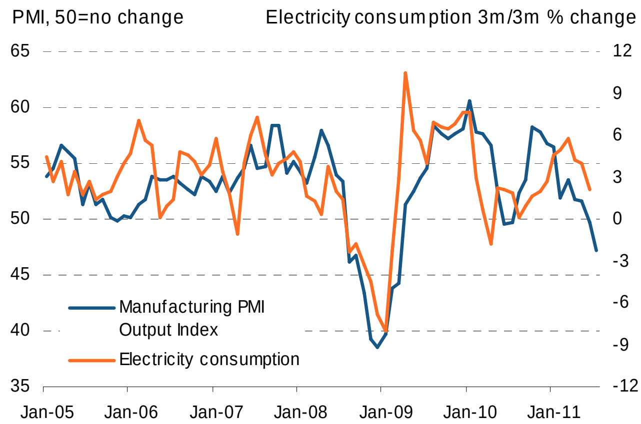
Manufacturing PMI and industrial production



Sources: Markit, HSBC, NBS.

Note that while the PMI has shown a different trend to industrial production since late last year, it has followed a more similar trend to electricity consumption, which also hints at a slowing in the rate of growth following an upturn earlier in the year.

PMI and electricity consumption



Sources: Markit, HSBC, NBS.

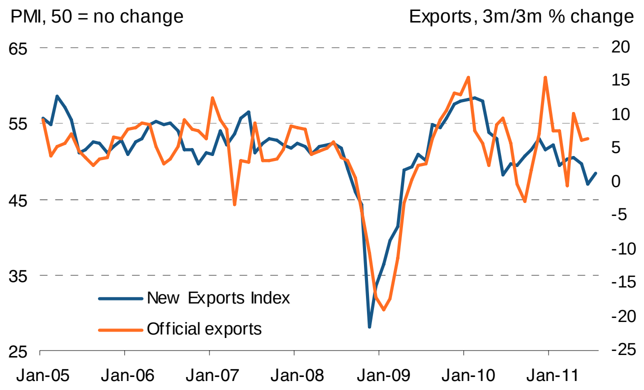
[1] It should be noted that comparisons are difficult because the official data tend to exhibit greater volatility than the PMI and are also available only on a year-on-year basis whereas the PMI measures month-on-month changes.

The recent cooling in the rate of industrial expansion is likely to have in part reflected the further tightening of policy by the People's Bank of China, who earlier in July raised interest rates in a further attempt to slow the rate of consumer price inflation, which currently stands at a three-year high of 6.4%.

Export slowdown

However, the PMI survey also indicates that export demand continued to deteriorate in July. Growth of new export orders peaked early last year according to both the PMI and official data, and the PMI has depicted a gradual easing in the underlying trend in export performance over this period.

New Export Orders



Sources: Markit, HSBC, NBS.

The PMI Exports Index is broadly consistent with no growth of exports in the latest three months compared to the previous three month period, suggesting that Chinese manufacturers are experiencing the toughest export situation since early-2009.

Smaller firms suffer

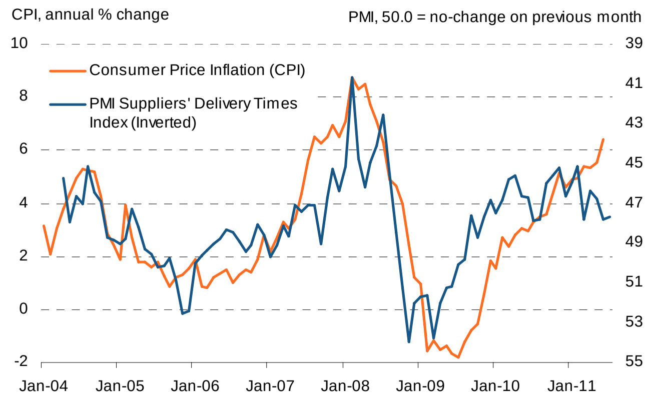
The PMI data also indicate that smaller manufacturers have fared worse in their export performance than larger companies in recent months, and have consequently reported steeper declines in output and employment than larger companies. However, output growth at larger firms has also now slowed to stagnation, meaning the differential between companies of different sizes has narrowed.

Supply chain delays have eased

Supply chain pressures have eased as a result of the reduction in the amount of inputs purchased by manufacturers in July. The average time taken by suppliers to deliver inputs to manufacturers continued to lengthen, but the number of delays grew at a slower rate than earlier in the year, though this also reflects the diminishing impact of supply chain disruptions caused by Japan's earthquake in some cases.

The PMI Suppliers' Delivery Times Index has acted as a good leading indicator of consumer price inflation in China. As longer delivery times tend to be associated with demand exceeding supply, meaning suppliers have greater scope to raise prices, the recent easing in the number of supply chain delays augurs well for inflation in coming months.

Consumer Price Inflation



Sources: Markit, NBS.

Final HSBC China Manufacturing PMI™ data are published 1 August. To find out how to receive PMI data, please contact **economics@markit.com**

Chris Williamson
Chief Economist
Markit
Tel: +44 20 7260 2329
Email: chris.williamson@markit.com
http://twitter.com/WilliamsonChris

Alex Hamilton
Economist
Markit
Tel: +44 1491 461 076
Email: alex.hamilton@markit.com

For further information, please visit www.markit.com