

China

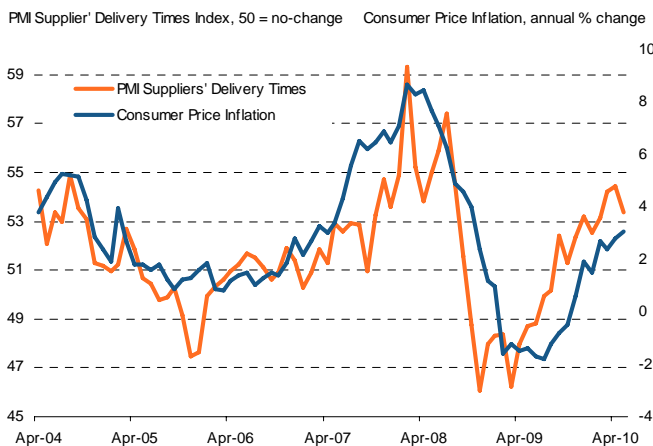
China's cooling continued in May, despite mixed messages from official data

- Official data present mixed message about overheating concerns...
- ...but PMI figures provide advanced indication of slowdown in Chinese private sector activity growth.

CPI inflation hits 19-month high in May

Official data published 11 June signalled that China's Consumer Price Inflation quickened from 2.8% to 3.1% in May, surpassing the consensus forecast of a 3.0% rise. The reading was particularly newsworthy as it was above the authorities' 3.0% target rate, highlighting the possibility of further monetary tightening in the coming months.

Consumer Price Inflation (CPI)



Sources: Markit, NBS.

It was not just the inflation data that stoked fears of tighter policy designed to cool growth, which accelerated to 11.9% in the first quarter. Beijing also reported a strong surge in export volumes in May, contrasting with weakening survey data and reviving fears that China's economy is overheating. Furthermore, wage pressures continue to build in the economy, suggesting that a higher rate of inflation may become entrenched in the months ahead.

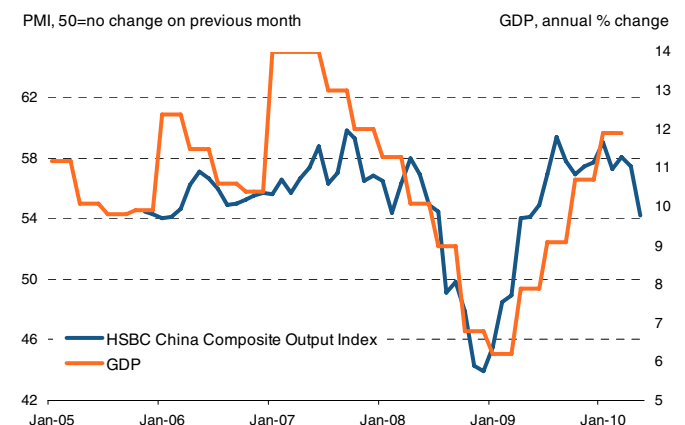
PMI data suggest GDP growth eased in the second quarter

However, the case for further monetary tightening is not clear-cut, as existing measures and external factors appear to have already caused growth to slow.

First, official data showed that industrial production growth eased from 17.8% to 16.5% in May, and the number of new investment projects fell 12% on an annual basis – reflective of existing credit restraining measures.

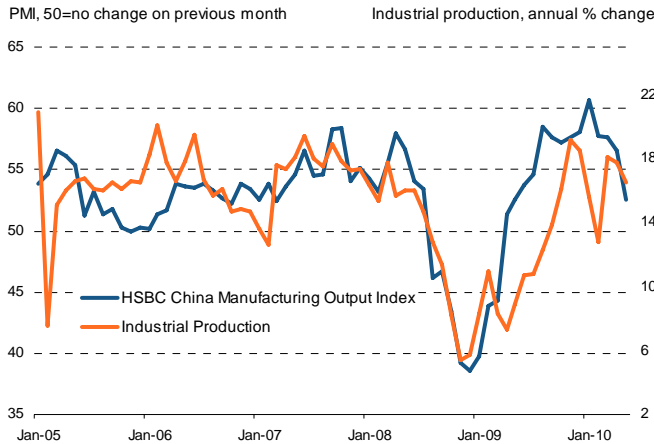
Second, fears surrounding the stability of external demand, particularly from the crisis-hit Eurozone, also pose threats to the sustainability of economic growth in the world's largest emerging nation and subsequently across the wider world. This easing trend is affirmed by the PMI data, which have pointed to a slowdown in private sector activity growth in Q2, with May's **HSBC China Composite Output Index** falling from 57.4 to a twelve-month low of 54.2. The month-on-month falls in the manufacturing output and new orders indexes were among the largest in the survey's six-and-a-half-year history.

Gross Domestic Product (GDP)



Sources: Markit, NBS.

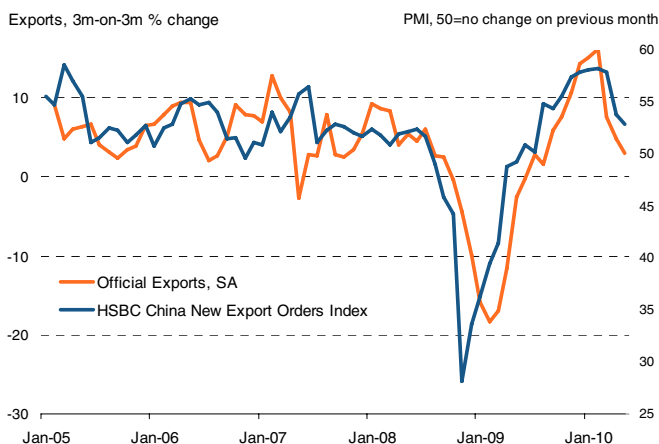
Industrial Production



Sources: Markit, NBS.

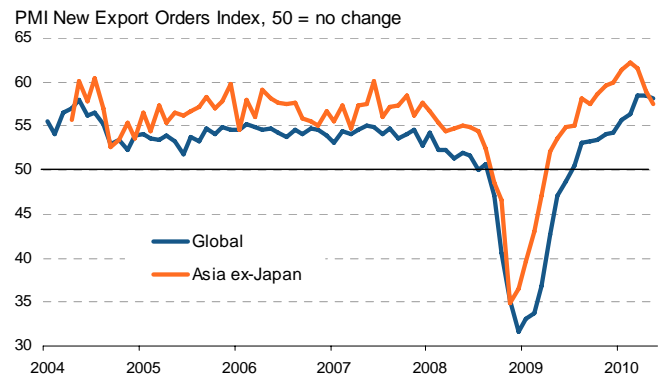
Third, although official figures signalled that exports rose at an annual rate of 48.5% in May, surpassing expectations for a 32.0% increase, this official export series is well known for its volatile nature, which limits the ability of analysts to determine the true direction of growth. Running these figures through a seasonal adjustment programme provides a better insight into the underlying trend of the official series. This adjusted series displays a high correlation (**0.80**) with the export component of the manufacturing PMI data and also affirms the weakening trend in exports signposted by the manufacturing PMI survey. This slowdown in export growth has been seen throughout Emerging Asia, and suggests that global trade flows will slow in the second half of 2010 – Asian manufacturers often act as a bellwether for global trade.

Exports



Sources: Markit, NBS.

Emerging Asia Exports



Sources: Markit, JPMorgan.

Outlook for H2 2010

The available data therefore seem to continue to support the widely-held view that China's inflation rate will cool in the second half of the year, as demand eases from both home and abroad, and possibly without the need for further policy tightening. As a result, GDP growth is expected to moderate, with the IMF forecasting growth of 10.0% in 2010 (unchanged on its January 2010 prediction). Note that the latest PMI findings suggest that GDP growth will have already eased in the second quarter, with survey data currently available for April and May consistent with GDP growth of under 11.0% on an annual basis.

The first insight into the performance of China's economy for June will be provided by the HSBC China manufacturing PMI, released 1 July, followed by the HSBC China Services & Composite PMI on the 5 July. To find out how to receive PMI data for China, please contact economics@markit.com.

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