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China manufacturing

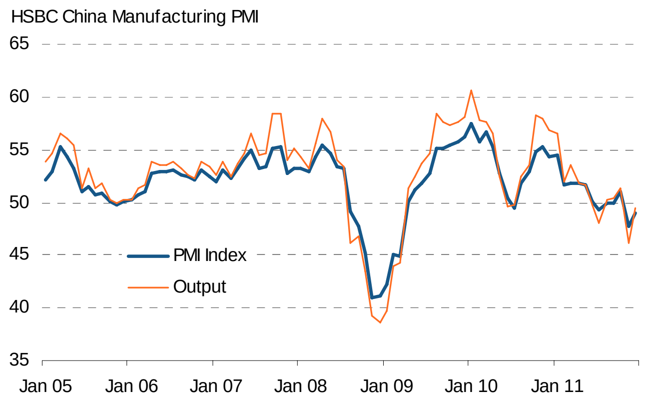
Price pressures fade as downturn continues in December

- **Manufacturing contracts at slower rate, but order book decline remains steep**
- **Industry prices fall sharply for second month running**

The HSBC Manufacturing PMI™ for China, compiled by Markit, rose from 47.7 in November to 49.0 in December, according to preliminary 'flash' data based on 85% of normal monthly replies. The sub-50 reading signalled a deterioration of manufacturing business conditions for the second month running and for the fifth time in the past six months, although the upturn in the index signalled that the rate of deterioration moderated compared to November.

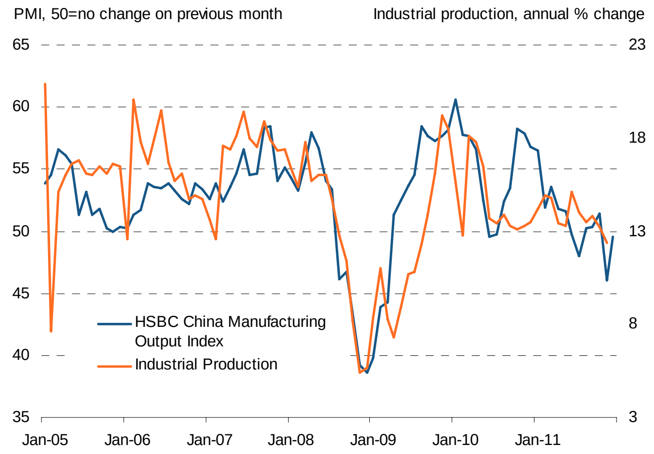
The ongoing weakness of the PMI reflected further falls in output and new orders, which both decreased for the second month in a row. Although orders fell at a reduced rate compared to November, helping to drive a moderation in the rate of decline in production, orders are falling faster than at any time in the survey's seven-year history other than late-2008 and early-2009.

Manufacturing PMI and Output Index



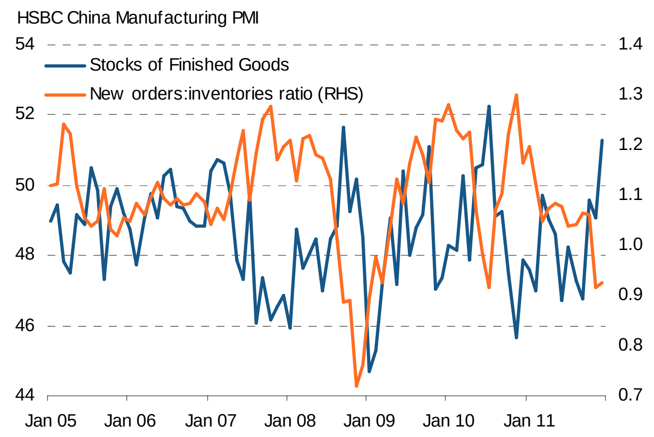
The drop in new orders caused stocks of finished goods to rise for the first time in 17 months. This combination of falling orders and the accumulation of unsold stock meant that the orders-to-inventories ratio showed little change on November's 16-month low, a level consistent with further falls in production in coming months.

Industrial production



New orders

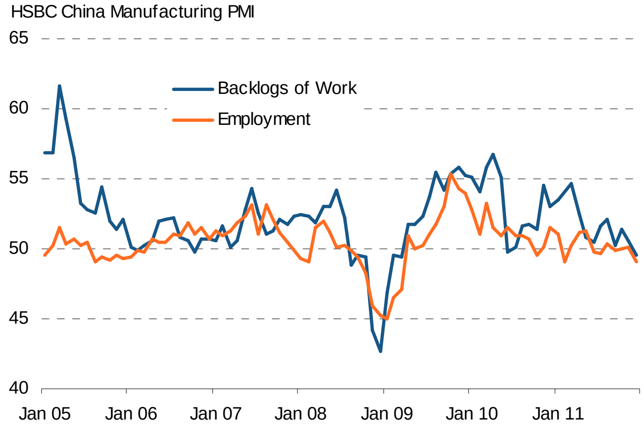
Inventories



The loss of new orders also led to a decline in manufacturers' backlogs of orders. Although only slight, the decline was noteworthy in being the first since June 2010.

The weak order book situation prompted manufacturers to start cutting employment again, with job losses rising to the highest since February and the second-highest since early-2009 (although the rate of decline remained only modest, especially compared to the 2008-09 job cutting).

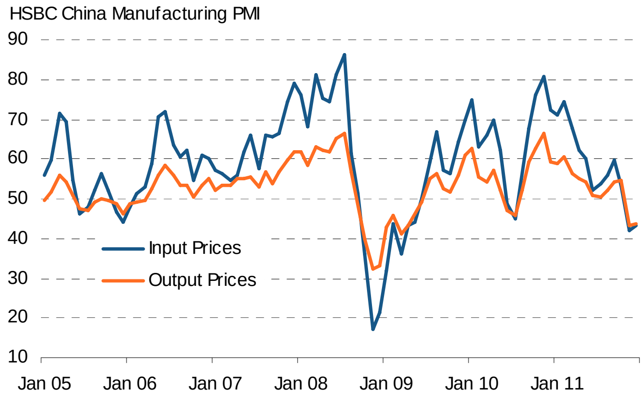
Employment and order book backlogs



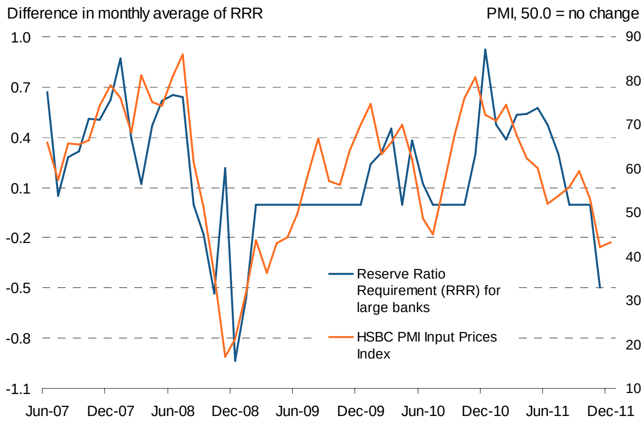
Both input prices and selling prices meanwhile fell sharply as a result of weakened demand. Both declined for the second consecutive month, with rates of reduction easing only slightly on November, which saw the largest declines in both measures since early-2009.

The combination of a manufacturing downturn and fading price pressures looks likely to encourage policymakers to loosen policy further in the new year, especially in the absence of any firm resolution to the Eurozone's financial crisis. The People's Bank of China have clearly been swift in adjusting policy in response to changing economic conditions (see policy and price pressure chart), and the data suggest a further reduction of bank's required reserve ratio may soon be forthcoming following the first cut in three years earlier this month.

Industrial prices



Policy and price pressures



Sources: Markit, HSBC, People's Bank of China.

All sources: Markit, HSBC, official data via Ecowin.

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