Markit Economic Research
Embargoed until: 01:45 (UK time) 23 January 2014

China

Manufacturing slides back into contraction at start of 2014

- **Manufacturing PMI slips below 50 neutral level for first time in six months**
- **Order books hit by weak domestic demand and second monthly fall in exports**
- **Inflationary pressures ease as price indices drop sharply**

The Chinese manufacturing economy contracted for the first time in six months in January, according to the flash PMI produced by Markit for HSBC.

As well as indicating slower economic growth, the survey also pointed to a steepening rate of job losses and a marked decline in inflationary pressures

The PMI fell for a third month running, down from 50.5 in December to 49.6 in January, slipping below the 50.0 neutral level to its lowest level since July of last year.

The survey provides the first indication of the health of the Chinese economy at the start of 2014, and suggests that economic growth is on course to have slowed again in the first quarter. Annual GDP growth dipped to 7.7% in the fourth quarter, down from 7.8% in the third quarter, finishing off a year in which the economy grew by 7.7% (the same as in 2012).

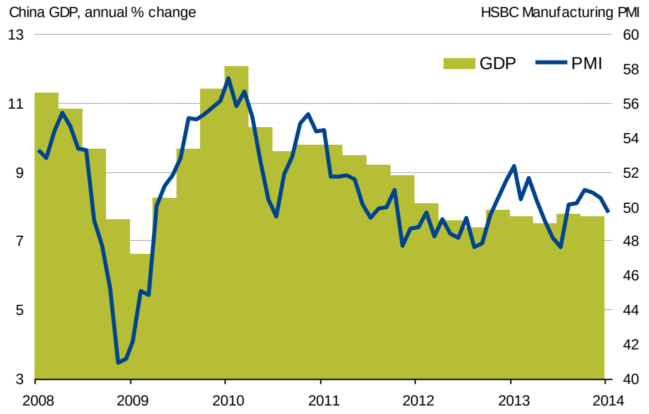
The drop in the PMI in January therefore adds to widespread suspicions that China may struggle to grow by more than 7.5% in 2014 as it seeks to manage a transition from export and investment led growth, which would be the worst year since 1990 (though of course still stellar by developed world standards).

Output growth slows amid falling demand

The January survey showed output rising only modestly, growing at the weakest rate since October, as new orders fell - albeit just marginally - for the first time since July.

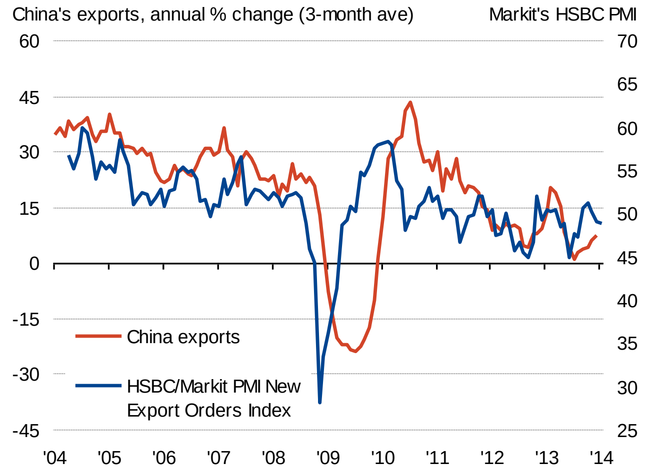
New export orders declined for a second successive month, dropping at a slightly faster rate than December. The renewed downturn in exports contrasts with the modest growth seen in the three months to November.

Economic growth and the PMI



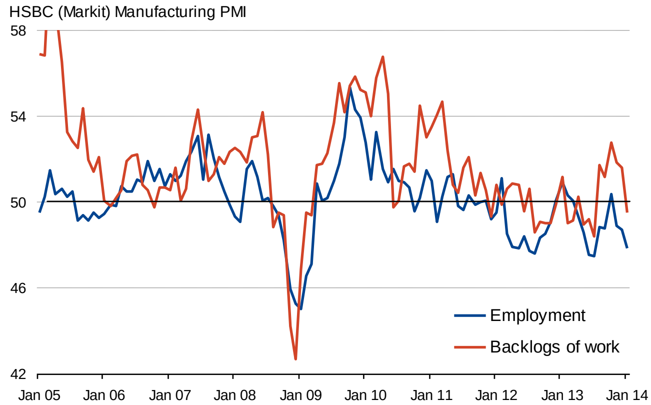
Sources: Markit, Ecowin.

Goods exports



Sources: Markit, NBS (via Ecowin).

Manufacturing jobs and order book backlogs



Source: Markit.

However, the overall weakness of order books also reflected subdued growth of domestic demand, the renewed weakening of which has also been signalled by the service sector PMI survey.

Backlogs of uncompleted orders fell for the first time since July, signalling a shrinking pipeline of work-in-hand for manufacturers. Stock of finished goods meanwhile showed the biggest rise for eight months, linked to slower than anticipated sales.

With demand conditions at home and abroad deteriorating, companies reduced their workforce numbers at the fastest rate since July. Employment has fallen in each month since April, with the sole exception of a marginal upturn in October, as companies restructured by reducing capacity in line with a weakened demand outlook.

Inflationary pressures fall sharply

An excess of capacity was also indicated by a shortening of suppliers' delivery times, which showed the biggest improvement for just over one-and-a-half years.

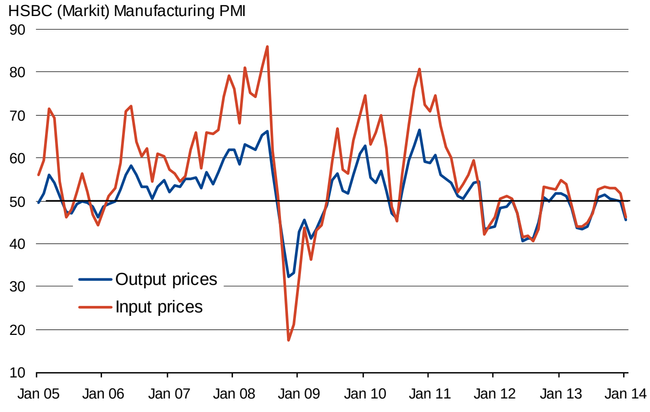
Faster deliveries are generally a reflection of suppliers being less busy and therefore able to meet demand more promptly. Such a situation is also often accompanied by suppliers cutting their prices to stimulate sales.

Manufacturers input prices fell accordingly, dropping sharply and at the fastest rate since last June, contrasting with the increase in prices seen over the prior five months.

Manufacturers' output prices also fell sharply, as firms cut prices to win sales. As with input prices, the drop in selling prices was the steepest since June.

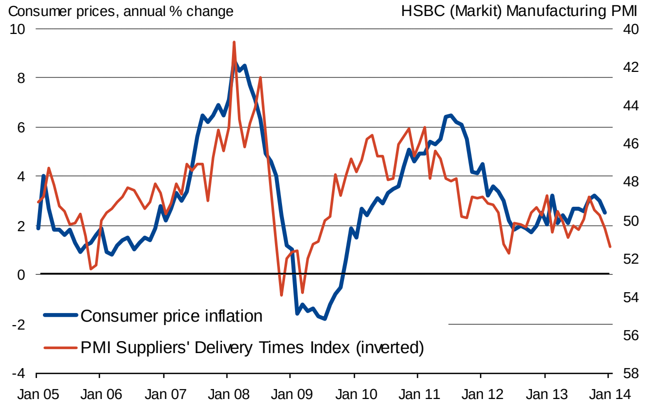
The drop in producer prices and the improvement in supplier lead-times indicate a general easing of price pressures which suggests that consumer price inflation will also fall further in coming months. Inflation dropped to a seven-month low of 2.5% in December, with the survey suggesting a move towards 2% is likely during the first quarter.

Input and output prices



Source: Markit.

Suppliers' delivery times and inflation



Source: Markit, NBS via Ecowin.

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