Nikkei Hong Kong PMI™

Business conditions improve further in January

Key points:

- Faster rises in both output and new business, including sales to China
- Optimism hits highest since late 2014
- Input cost inflation remains strong

Data collected January 12–26

Growth in Hong Kong's private sector economy extended into 2018, buoyed by further expansions in both output and new orders. Notably, a sustained increase in Chinese demand supported business activity. Higher sales led to a rise in backlogs. However, lower employment and reduced inventories weighed on the headline PMI. On the price front, firms continued to struggle with higher costs, especially from increased input prices, and sought to protect their margins by raising selling prices. Encouragingly, business confidence remained positive.

The seasonally adjusted headline **Nikkei Hong Kong Purchasing Manager's Index™ (PMI™)** came in at 51.1 in January, down from 51.5 in December, but marking a further improvement in the health of the sector.

Higher output and new orders were reported in January, reflecting a strengthening of client demand. In both cases, faster rates of expansions were seen. Output saw the largest monthly increase for nearly four years, while new business growth was the highest since February 2015, supported also by greater Chinese demand. Anecdotal evidence suggested an improved economic climate and promotional activity as reasons for increased sales.

Meanwhile, higher order book growth placed pressure on operating capacity. January data showed a renewed rise in the level of unfinished work. Furthermore, growth in backlogs was at a six-month high. In part, a drop in employment contributed to the rise in outstanding work. Having risen marginally in December, employment fell in January, with firms citing cost savings as a reason.

Hong Kong's private sector continued to face rising costs. Overall input price inflation was up again in January, with the rate of increase remaining solid.

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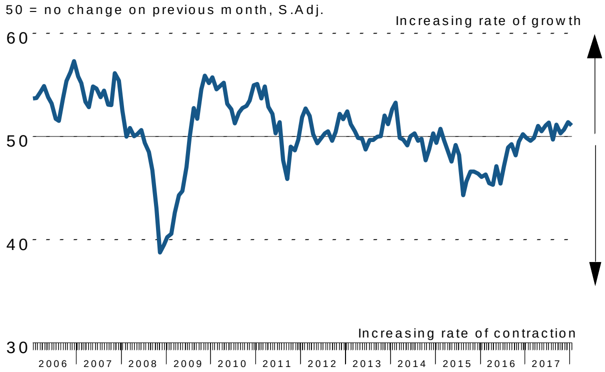

Sources: Nikkei, IHS Markit.

While wage inflation added to higher costs, the sharp pick-up in paid prices for inputs was the key driver of inflation. Purchase costs rose at one of the fastest rates in the past six years. While firms raised selling prices further, the rate of increase remained below that of input cost inflation, implying a further squeeze on margins.

Firms continued to scale up buying activity in response to higher new business. Purchasing activity rose for a fourteenth consecutive month, though the rate of growth was down from December. Increased appetite for inputs strained supply chains further. Vendor performance deteriorated in January, albeit at a slower rate compared to the previous month. Firms attributed a difficulty in sourcing raw materials for the longer delivery times. Supply shortages also contributed to a drop in input inventories at the start of the year, according to survey data. Input stocks fell for the first time since October 2016.

Business confidence about the outlook in the year ahead improved further, with the Future Output Index hitting almost a three-and-a-half-year high. Factors driving the optimism included improved business conditions, rising e-commerce, new product launches, higher sales forecasts and promotional activity.

Comment:

Commenting on the Hong Kong PMI survey data, **Bernard Aw,** Principal Economist at IHS Markit, which compiles the survey, said**:**

"Hong Kong's private sector economy started 2018 on a positive note, recording both output and new business growth in January. Perhaps more important was that businesses remained positive about the outlook in the year ahead, suggesting that companies are setting aside the pessimism seen in the past three years as economic growth improves.

"The latest Nikkei Hong Kong PMI is running at a pace broadly consistent with a GDP annual growth rate of around 4% in January. This is in line with the government's expectations that economic activity will build on the momentum in 2017.

"Survey data showed that both domestic and overseas demand is improving, with total new orders and sales to China growing at faster rates. The Future Output Index also rose to the highest level since late 2014, reflecting growing business confidence.

"Meanwhile, renewed capacity pressure in Hong Kong's private sector suggests that businesses may step up hiring in coming months. However, with Hong Kong's jobless rate at the lowest in nearly 20 years during December, the tight labour market will likely dampen future employment growth as companies find it increasingly difficult to source suitable employees.

"An area of concern is higher costs. Input price inflation remained strong and was driven mostly by increased raw material prices. There was survey evidence of companies limiting staff numbers as part of efforts to save costs. While firms were able to raise their selling prices, the rate of increase remained below that of cost inflation, indicating an ongoing squeeze on corporates' profit margins.

"Nevertheless, the overall picture for Hong Kong's economy continues to brighten into 2018. PMI survey indicators suggest that economic activity will likely gain momentum in coming months."

-Ends-

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Notes to Editors:

The Nikkei Hong Kong *PMI™* is based on data compiled from monthly replies to questionnaires sent to purchasing executives in over 300 companies. The panel is stratified by company size and by Standard Industrial Classification (SIC) group, based on industry contribution to Hong Kong GDP. Survey responses reflect the change, if any, in the current month compared to the previous month based on data collected mid-month. For each of the indicators the 'Report' shows the percentage reporting each response, the net difference between the number of higher/better responses and lower/worse responses, and the 'diffusion' index. This index is the sum of the positive responses plus a half of those responding 'the same'.

The Purchasing Managers' Index™ (PMI™) is a composite index based on five of the individual indexes with the following weights: New Orders - 0.3, Output - 0.25, Employment - 0.2, Suppliers' Delivery Times - 0.15, Stock of Items Purchased - 0.1, with the Delivery Times index inverted so that it moves in a comparable direction.

Diffusion indexes have the properties of leading indicators and are convenient summary measures showing the prevailing direction of change. An index reading above 50 indicates an overall increase in that variable, below 50 an overall decrease.

IHS Markit do not revise underlying survey data after first publication, but seasonal adjustment factors may be revised from time to time as appropriate which will affect the seasonally adjusted data series. Historical data relating to the underlying (unadjusted) numbers, first published seasonally adjusted series and subsequently revised data are available to subscribers from IHS Markit. Please contact economics@ihsmarkit.com.

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