

# China SMEI – Broad-based improvement in May

- **Headline SMEI rose to 51.7 in May from 50.9 in April; manufacturing sector outperformed services sector**
- **Activity accelerated, led by production; domestic demand picked up; outlook improved**
- **Banks' credit support to SMEs remained strong, but financing costs did not decline further**

## The recovery continues

Our monthly proprietary SME survey shows that China's recovery is gaining traction in May. Headline SMEI (SCCNSMEI <index>) rose to 51.7 in May from 50.9 in April (Figure 1), with a rebound in the growth momentum indicator (new orders minus finished-goods inventory). The 'current performance' sub-index rose 1.7pts to 51.7 (the first above-50 reading in four months), suggesting an acceleration in real activity among SMEs. The 'expectations' reading edged up 0.3pts to 52.4, indicating guarded optimism on the recovery prospects (Figure 2).

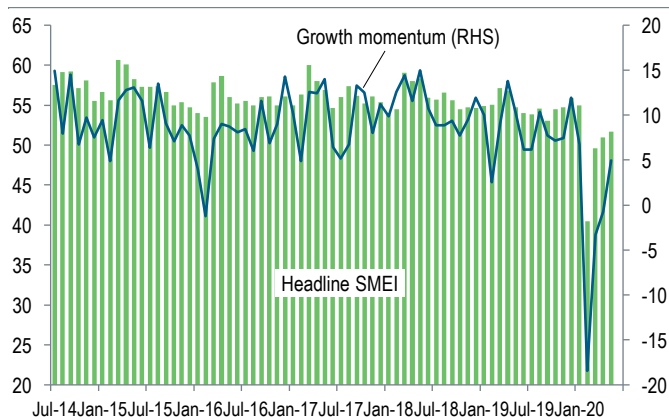
Production continued to lead the recovery, and domestic demand gained momentum. As capacity utilisation continues to rise, we think the strength of the recovery in domestic demand will determine if production acceleration can be sustained. Employment improved to above 50, indicating a pick-up in hiring. However, overseas demand remained sluggish, clouding SMEs' outlook and weighing on their business expansion appetite. Finished-goods inventory continued to decrease, with no signs yet of restocking. The services sector expanded only slightly in May, while the manufacturing sector continued to outperform.

SMEs' financial conditions are improving modestly. Banks' credit support to SMEs remains strong amid policy support. As a result, SMEs' cash flows have largely resumed, with surplus cash starting to increase again in May after three consecutive months of contraction. However, their borrowing costs from both banks and non-bank financial institutions did not ease further, implying that further efforts are needed to lower financing costs for small businesses.

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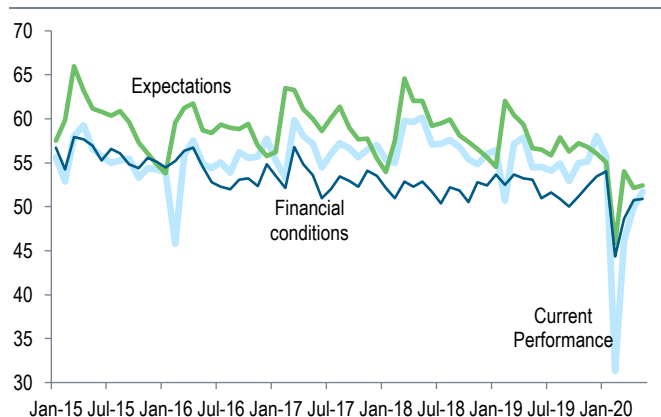
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**Figure 1: Headline SMEI picked up further in May**  
 Headline SMEI and growth momentum indicator



Source: Standard Chartered Research

**Figure 2: Current performance accelerated; expectations and financial conditions improved slightly**  
 Current performance, expectations and financial sub-indices



Source: Standard Chartered Research

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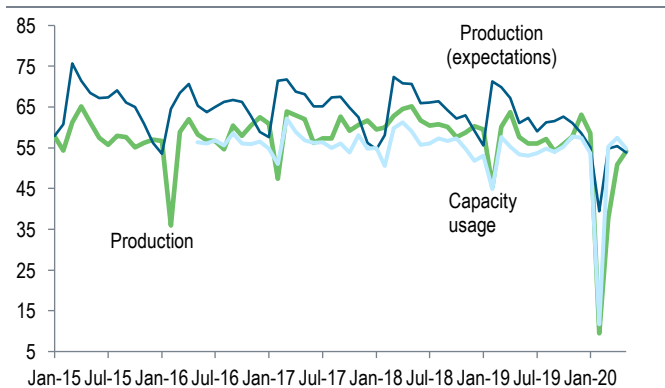
### Improved performance and better outlook

Real activity gained pace in May as China's economy continued to recover. The 'current performance' sub-index rose 1.7pts to 51.7 in May, marking the first above-50 reading since February. The 'outlook' sub-index edged up 0.3pts to 52.4, indicating expectations of a continued recovery. The manufacturing sector outperformed the services sector (Figure 8).

**Production activity accelerated; domestic sales picked up, while export orders remained sluggish**

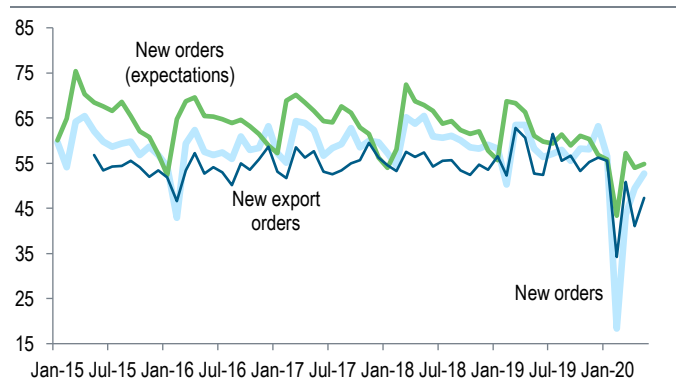
- Business performance improved, driven by accelerated production. The current performance reading of 'production' rose to 54.2 in May from 50.8 in April. Capacity usage continued to rise, suggesting near-complete resumption of operations. The outlook reading eased 1.6pts to 53.8 (Figure 3).
- Domestic demand picked up, but export orders remained weak. The current performance reading of 'new orders' rose 3.4pts to 52.8 in May, back to expansionary territory after three months of contraction (Figure 4). The 'new export orders' reading stayed weak at 47.4, versus 41.0 in April, indicating a continued decline in overseas orders (albeit at a slower pace). The expectations reading for 'new orders' rose to 54.8 from 54.0 prior; the domestic demand recovery remained a key driver of sales volume.
- The labour market improved. The current performance reading of 'employment' gained 2.1pts to 51.5 in May, ending three consecutive months of contraction and indicating more hiring activity in May (Figure 5). The expectations reading of employment edged up 0.4pts to 52.1.

**Figure 3: Accelerated production leads the recovery**  
Current performance and expectations sub-indices



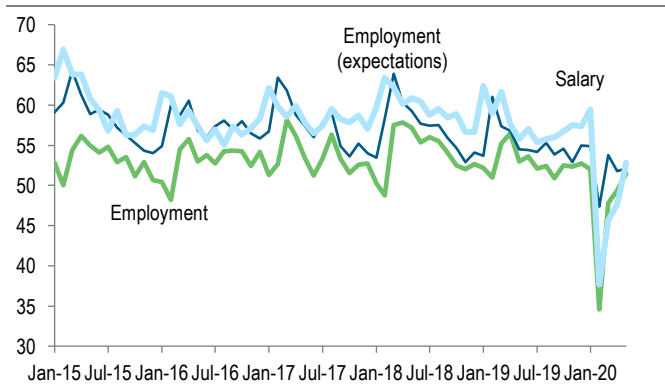
Source: Standard Chartered Research

**Figure 4: Domestic demand increased, while export orders remained sluggish**  
(current performance and expectations sub-indices)



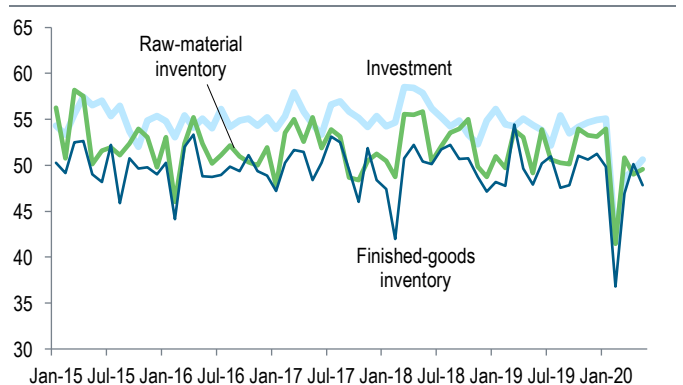
Source: Standard Chartered Research

**Figure 5: SMEs increased hiring**  
Current performance and expectations sub-indices



Source: Standard Chartered Research

**Figure 6: Expansion appetite remained weak amid passive destocking**  
(current performance sub-indices)



Source: Standard Chartered Research



**SMEs' investment activity remains subdued on an uncertain economic outlook**

- Business expansion appetite remained relatively weak on an uncertain outlook. The current performance reading of 'investment' rose to slightly above 50 in May. SMEs' raw-material inventory shrank again as did their finished-goods inventory amid passive destocking, according to our survey results (Figure 6).
- Prices rose slightly and profitability improved. The 'output price' sub-component retreated 0.9pts to 50.9 and the 'input price' component fell 3pts to 54.2 (Figure 7). Profit margins started to rise, with the 'profitability' sub-component reading advancing to 52.3 in May from 48.8 in April.

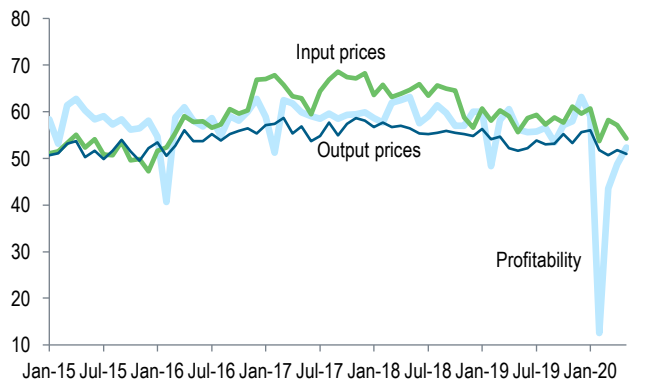
**SMEs' borrowing costs continued to rise**

SMEs' financial conditions improved modestly. The 'financial conditions' sub-index inched up to 50.9 in May from 50.7 in April (Figure 2). Banks' credit support to SMEs was strong, but SMEs' financing costs did not decline further. The 'bank credit access' reading stayed high at 63.8 in May amid policy makers' call for banks to enhance credit support to small businesses (Figure 9). As a result, SMEs' cash flows largely resumed, and their 'surplus cash' started to increase again in May after three consecutive months of contraction.

**Banks' credit support to SMEs remains strong, but financing costs did not fall further**

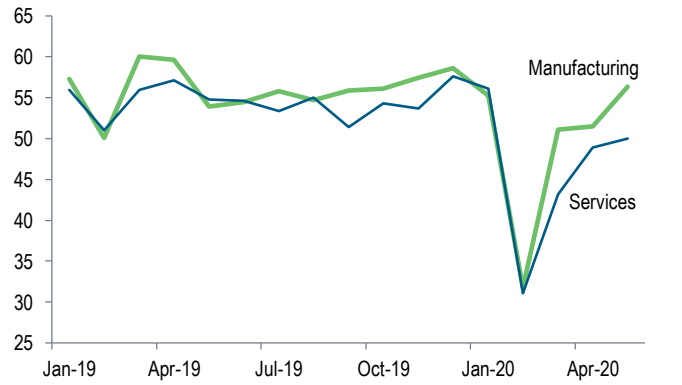
However, SMEs' bank credit costs continued to trend up, with the sub-component falling to 46.7 from 50.3 prior; financing costs of non-bank financial institutions also stopped declining (Figure 10). Money-market rates rose in May; the People's Bank of China (PBoC) kept the medium-term lending facility (MLF) rate and the loan prime

**Figure 7: Price levels remained low in May**  
Current performance sub-indices



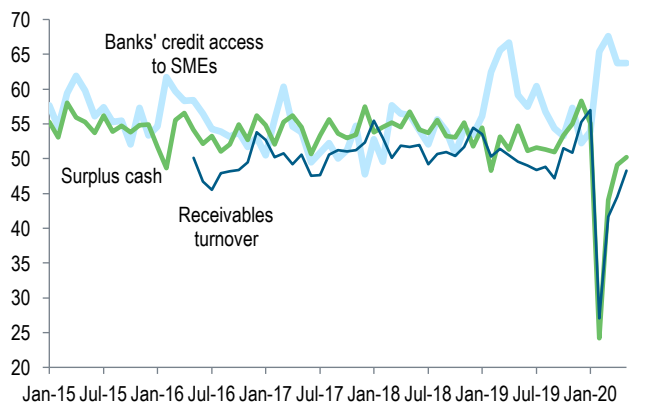
Source: Standard Chartered Research

**Figure 8: Manufacturing outperformed services sector**  
Current performance sub-indices



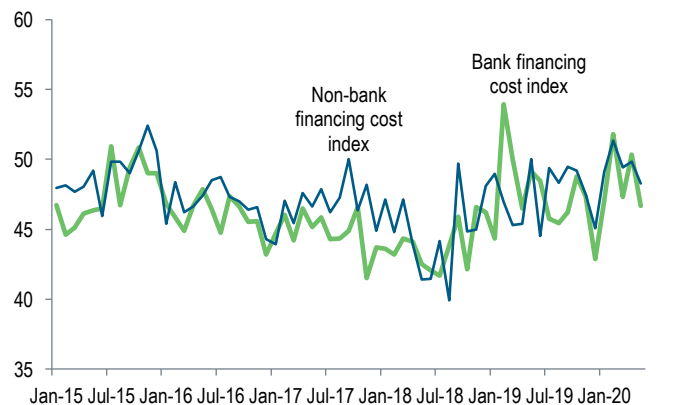
Source: Standard Chartered Research

**Figure 9: Banks' lending to SMEs remained strong**  
Current performance sub-indices



Source: Standard Chartered Research

**Figure 10: SMEs' borrowing costs edged up**  
Current performance sub-indices\*



\*Note: Index above 50 indicates lower cost. Source: Standard Chartered Research



rate (LPR) on hold for the month. We believe stubbornly high costs of banks' liabilities have impeded their ability to lower lending rates at the expense of profitability. We maintain our view that the PBoC will cut the benchmark deposit rate by 25bps in Q2 to enable banks to lower lending rates further (see [China – Banks' NIM narrowed by 10bps in Q1](#)).

**Figure 11: SMEI headline index and sub-indices**

	May-19	Jun-19	Jul-19	Aug-19	Sep-19	Oct-19	Nov-19	Dec-19	Jan-20	Feb-20	Mar-20	Apr-20	May-20
<b>Headline index</b>	54.7	54.0	53.8	54.5	53.1	54.5	54.7	55.8	55.0	40.5	49.6	50.9	51.7
Performance sub-index	54.5	54.5	54.1	54.9	52.9	55.0	55.1	58.0	55.8	31.3	46.2	50.0	51.7
Expectations sub-index	56.6	56.5	55.8	57.9	56.2	57.2	56.8	56.0	55.0	45.8	54.0	52.1	52.4
Credit sub-index	53.1	50.9	51.6	50.9	50.0	51.2	52.4	53.5	54.0	44.3	48.6	50.7	50.9
<b>Sub-components of performance sub-index</b>													
Production	57.5	56.1	56.0	57.1	54.2	56.0	57.8	63.1	58.5	9.5	37.7	50.8	54.2
New orders	58.2	56.3	57.1	57.9	55.6	58.2	58.1	63.2	56.6	18.4	43.6	49.4	52.8
Employment	53.0	53.6	52.1	52.4	50.9	52.5	52.4	52.8	52.0	34.6	47.8	49.4	51.5
Raw-material inventory	49.2	53.9	50.6	50.3	50.1	54.0	53.3	53.1	54.0	41.5	50.8	49.0	49.6
Output prices	51.7	52.2	53.9	53.0	53.1	55.2	53.25	55.6	56.0	51.8	50.6	51.8	50.9
Investment	54.4	53.8	52.2	55.4	53.5	54.2	54.6	55.0	55.1	41.6	48.7	49.5	50.6
Finance	52.3	55.7	54.0	53.6	49.6	52.2	52.6	55.0	54.3	46.4	50.5	51.6	53.1
Profitability	56.2	55.6	55.8	56.6	53.5	57.1	57.9	63.2	59.1	12.6	43.5	48.8	52.3
<b>Headline indices by industry</b>													
Manufacturing	54.4	53.8	54.8	54.1	55.0	55.4	56.4	56.9	54.5	42.0	54.0	52.1	54.8
Services	54.9	54.1	53.4	54.8	52.1	53.9	53.8	55.1	55.2	39.7	47.0	50.1	50.5
<b>Headline indices by company type</b>													
Domestically focused	54.5	53.0	52.9	54.2	52.2	54.7	53.7	55.1	54.3	40.2	49.0	51.7	51.7
Export-oriented	55.1	57.3	56.7	55.5	55.7	53.9	57.1	58.3	56.7	41.6	51.3	49.2	51.5

Source: Standard Chartered Research



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