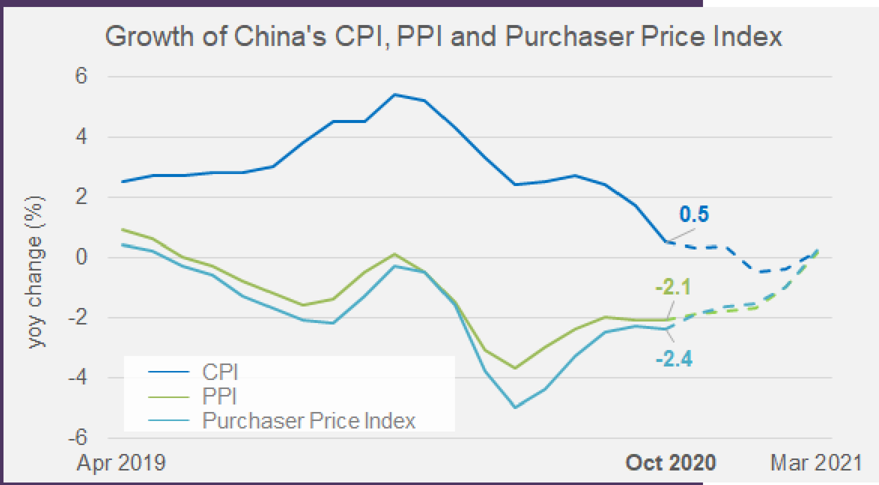
China Sourcing Update

Major Price Indicators

CPI growth hits 11-year low while factory gate deflation and upstream deflation continue



Key indicators

- CPI growth dropped to an 11-year low of 0.5% in October due mainly to a plunge in pork prices.
- Factory gate deflation stayed flat in October as the year-on-year growth in PPI came in at minus 2.1% in October.
- Year-on-year growth rate of the purchaser price index of industrial products went down to minus 2.4% in October, indicating a slight deterioration in upstream deflation.

Our forecasts

- We project that China's CPI growth will continue to go down in the coming months and fall into negative territory in 1Q21 amid a continued decline in pork prices and a high base for comparison in late 2019 and early 2020.
- Both the year-on-year growth and month-on-month growth of PPI will go up in the near future, given an improving industrial demand and the boost from greater infrastructure investment near year-end.
- As the demand for production inputs is likely to improve further, both the year-on-year growth and month-on-month growth in input prices will pick up in the coming months.

Helen Chin
Vice President
E: helenchin@fung1937.com

William Kong
Senior Research Manager
E: williamkong@fung1937.com

Fung Business Intelligence
1/F LiFung Tower
888 Cheung Sha Wan Road
Kowloon, Hong Kong
T: (852) 2300 2470
F: (852) 2635 1598
E: fbicgroup@fung1937.com
W: http://www.fbicgroup.com

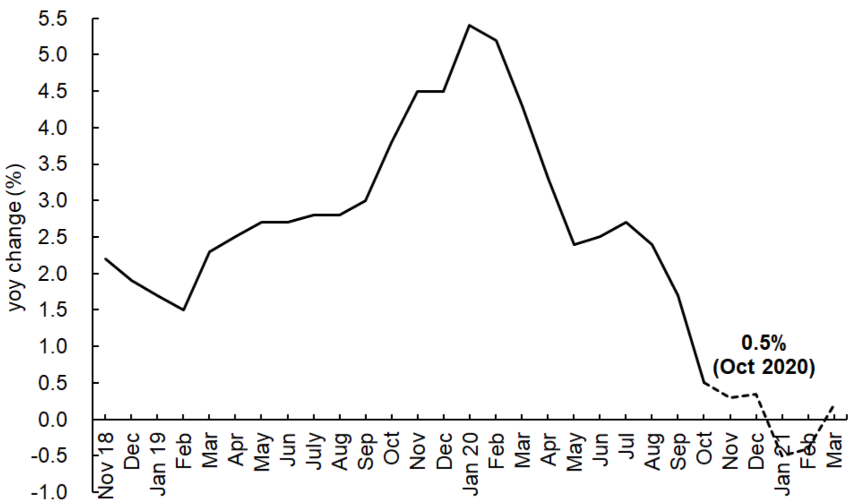
1. CPI growth drops to 11-year low of 0.5% in October

The year-on-year growth rate of China's consumer price index (CPI)[1] declined from 1.7% in September to 0.5% in October, the lowest level since October 2009 (see exhibits 1 & 2). The sharp fall in CPI growth in October was attributed to the deflation in food prices caused by a plunge in pork prices: The year-on-year growth in pork prices slumped from 25.5% in September to minus 2.8% in October.

Looking ahead, we project that China's CPI growth will continue to go down in the near future and fall into negative territory in 1Q21 for two reasons. First, a continued decline in pork prices will drag down food inflation. Besides, a high base for comparison in late 2019 and early 2020 will weigh on CPI growth in the coming months.

Exhibit 1: China's CPI growth and forecasts, November 2018 to March 2021

FY19	Nov 19	Dec	Jan 20	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct
2.9%	4.5%	4.5%	5.4%	5.2%	4.3%	3.3%	2.4%	2.5%	2.7%	2.4%	1.7%	0.5%



Source: National Bureau of Statistics

Exhibit 2: China's CPI growth by commodity, May to October 2020

yoy growth (%)

	May 20	Jun	Jul	Aug	Sep	Oct
Clothing	-0.4	-0.4	-0.5	-0.5	-0.4	-0.3
Household articles and services	0.1	0.0	-0.1	-0.1	-0.1	-0.1
Education, culture and recreation	2.2	1.9	0.3	0.0	0.7	1.1

Source: National Bureau of Statistics

[1] The CPI, compiled by the National Bureau of Statistics (NBS) of China, measures the price of a basket of goods and services purchased by a typical household.

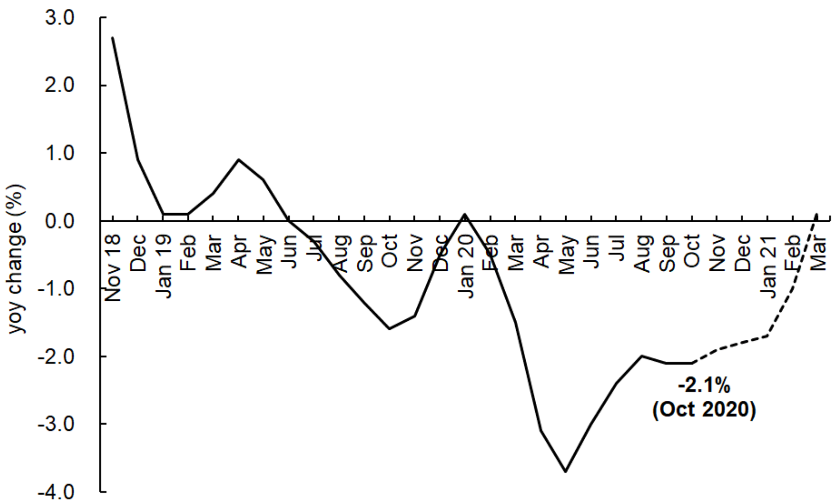
2. Ex-factory prices of industrial products stay flat month-on-month in October

China's factory gate deflation remained steady in October as the year-on-year growth in the producer price index of industrial products (PPI) came in at minus 2.1% in October, the same as in September (see exhibits 3 & 4). On a month-on-month basis, the PPI stayed flat in October over the previous month. In October, a rise in the ex-factory prices in the coal and chemical industries was offset by a fall in the crude oil and natural gas industries due to a decline in global crude prices.

Going forward, the demand for industrial products is likely to improve as the domestic economy is set to recover further. Besides, greater infrastructure investment near year-end will also push up domestic prices of production inputs, adding cost pressures on manufacturers. Therefore, we expect that both the year-on-year growth and month-on-month growth of the PPI will go up in the near future.

Exhibit 3: China's PPI growth and forecasts, November 2018 to March 2021

FY19	Nov 19	Dec	Jan 20	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct
-0.3%	-1.4%	-0.5%	0.1%	-0.5%	-1.5%	-3.1%	-3.7%	-3.0%	-2.4%	-2.0%	-2.1%	-2.1%



Source: National Bureau of Statistics

Exhibit 4: China's PPI growth by selected industry, May to October 2020

yoy growth (%)

	May 20	Jun	Jul	Aug	Sep	Oct
Textile	-5.4	-5.6	-6.0	-5.8	-6.0	-5.4
Textile wearing apparel and ornament	-1.0	-0.9	-1.3	-1.5	-1.7	-1.6
Processing of timbers, manufacture of wood, bamboo, rattan, palm, and straw products	-0.7	-1.3	-1.4	-0.9	-1.0	-1.1

Source: National Bureau of Statistics

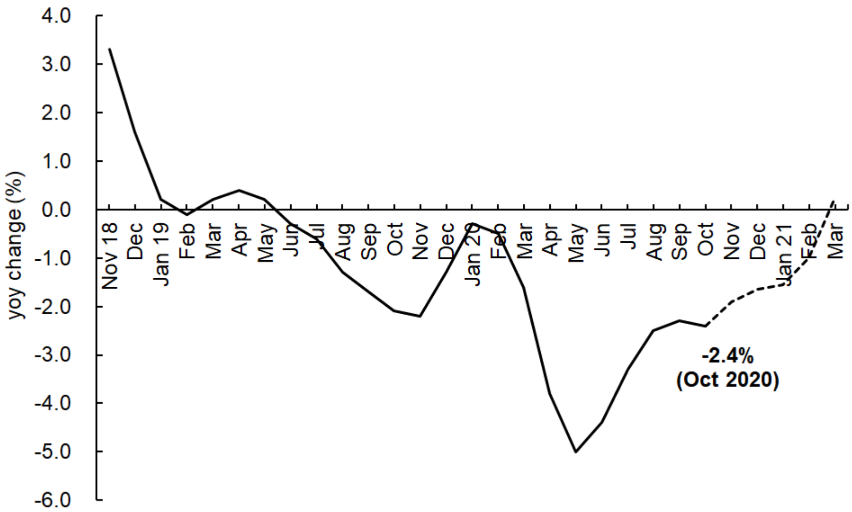
3. Domestic prices of production inputs rise month-on-month in October

The year-on-year growth rate of the purchaser price index of industrial products went down from minus 2.3% in September to minus 2.4% in October, indicating a slight deterioation in China's upstream deflation (see exhibits 5 & 6). On a month-on-month basis, the purchaser price index went up by 0.2% in October, after rising by 0.4% in September.

Going forward, as domestic industrial production has continued to expand and infrastructure investment is likely to accelerate near year-end, the demand for production inputs is expected to improve in the near future. Therefore, we predict that both the year-on-year growth and month-on-month growth in input prices will pick up in the coming months.

Exhibit 5: Growth and forecasts of China's purchaser price index of industrial products, November 2018 to March 2021

FY19	Nov 19	Dec	Jan 20	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct
-0.7%	-2.2%	-1.3%	-0.3%	-0.5%	-1.6%	-3.8%	-5.0%	-4.4%	-3.3%	-2.5%	-2.3%	-2.4%



Source: National Bureau of Statistics

Exhibit 6: China's purchaser price index of industrial products by selected commodity, May to October 2020

yoy growth (%)

	May 20	Jun	Jul	Aug	Sep	Oct
Fuel and power	-15.5	-14.2	-10.8	-9.8	-9.3	-9.9
Non-ferrous metal materials and wires	-5.5	-3.3	-0.3	2.9	2.9	3.0
Chemical raw materials	-10.3	-9.4	-8.9	-8.4	-7.8	-7.0
Wood and pulp	-3.3	-2.9	-2.1	-1.4	-0.8	-0.8
Textile raw materials	-4.1	-4.0	-3.9	-3.9	-3.8	-2.9

Source: National Bureau of Statistics

Fung Business Intelligence

Fung Business Intelligence collects, analyses and interprets global market data on sourcing, supply chains, distribution, retail and technology.

Headquartered in Hong Kong, it leverages unique relationships and information networks to monitor, research and report on these global issues with a particular focus on business trends and developments in China. Fung Business Intelligence makes its data, impartial analysis and specialist knowledge available to businesses, scholars and governments through regular research reports and business publications.

As the knowledge bank and think tank for the Fung Group, a Hong Kong-based multinational corporation, Fung Business Intelligence also provides expertise, advice and consulting services to the Group and its business partners on issues related to doing business in China, ranging from market entry and company structure, to tax, licensing and other regulatory matters.

Fung Business Intelligence was established in the year 2000.

Fung Group

Fung Holdings (1937) Limited, a privately-held business entity headquartered in Hong Kong, is the major shareholder of the Fung Group of companies, whose core businesses operate across the entire global supply chain for consumer goods including trading, logistics, distribution and retail. The Fung Group comprises over 30,000 people working in more than 40 economies worldwide. We have a rich history and heritage in export trading and global supply chain management that dates back to 1906 and traces the story of how Hong Kong and the Pearl River Delta emerged as one of the world's foremost manufacturing and trading regions. We are focused on both creating the Supply Chain of the Future to help brands and retailers navigate the digital economy as well as creating new opportunities, product categories and market expansion for brands on a global scale.

Listed entities of the Group include Global Brands Group Holding Limited (SEHK: 00787) and Convenience Retail Asia Limited (SEHK: 00831). Privately-held entities include Li & Fung Limited, LH Pegasus, Branded Lifestyle Holdings Limited, Fung Kids (Holdings) Limited, Toys "R" Us (Asia) and Suhyang Networks.

For more information, please visit www.funggroup.com.