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CFLP

July 2023

PMI Quarterly on China Manufacturing

PMI 2Q23
Downward pressure on China's manufacturing sector

Policy Outlook
China to introduce more policies to support economic growth

3Q23 Forecasts
Real GDP growth to fall to 4.5% yoy while PMI to gradually rise above 50.0

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Issue 53

PMI points to downward pressure on the manufacturing sector in 2Q23

Our observations

- Large enterprises continue to fare better than small and medium enterprises.
- Manufacturing output resumes expansion in June.
- Overall market demand deteriorates at a slower pace.
- Manufacturers lower ex-factory prices of their products.
- Employment in manufacturing sector slightly decreases.

Policy outlook

- The Chinese government is likely to introduce more policies to support economic growth.
- It will put in more efforts in making proactive fiscal policy more effectual and prudent monetary policy more targeted and effective so as to create synergy for expanding demand, which is key to sustained economic recovery and growth.

Our forecasts for 3Q23

- We project a mild recovery in manufacturing production in 3Q23.
- Headline PMI will gradually rise above 50.
- Real GDP growth will fall to 4.5% yoy as the low base effect fades.
- VAIO growth will recover to 4.0% yoy.
- Exports will register a high single-digit year-on-year drop.
- Year-on-year growth rates for the purchaser price index and the PPI will rise in 3Q23, due to a recent rebound in global commodity prices and a low comparison base in 3Q22.

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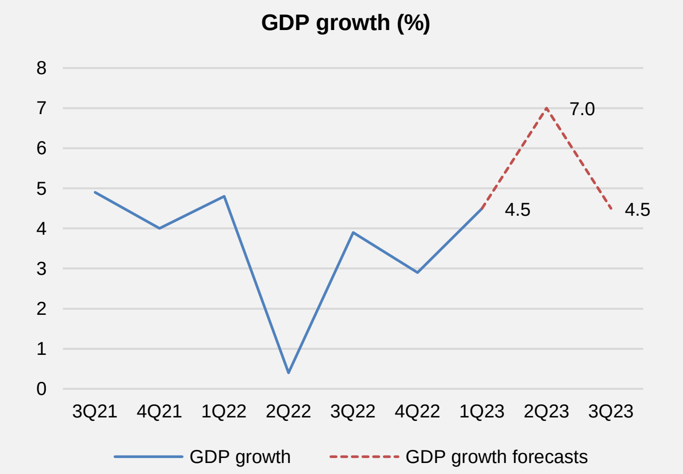
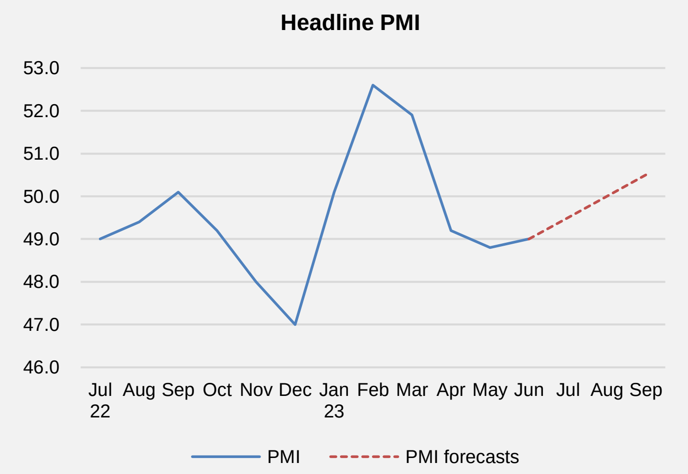




IN THIS ISSUE:

1. PMI points to downward pressure on the manufacturing sector in 2Q23

We project that China's real GDP growth will fall to 4.5% yoy in 3Q23, as the low base effect fades.

China's manufacturing sector in 2Q23

China's manufacturing PMI dropped from 49.2 in April to 48.8 in May, before picking up to 49.0 in June. The index has stayed below the critical 50-mark for three consecutive months, pointing to continued downward pressure on China's manufacturing sector. However, the slight uptick in the June reading might indicate that the downward pressure is easing. (See exhibit 1)

Manufacturing output has resumed its expansion recently, as the output index rose above the critical 50-mark to 50.3 in June. Meanwhile, the overall market demand has contracted at a slower pace lately as the new orders index picked up from 48.3 in May to 48.6 in June.

Prices of industrial products continued to fall: The ex-factory prices index has remained below the watershed level of 50 since March. The drop in product prices was partly attributed to the recent decline in the prices of materials: The input prices index dipped into contractionary territory in April and stayed there since then.

Exhibit 2 shows the contributions of the sub-indices to the change in the headline PMI. The decrease in the headline PMI in 2Q23 was due largely to the fall in new orders index (which weighs 30% in the computation of the headline PMI) and the output index (which weighs 25%). Among the 12 sub-indices (i.e., excluding the suppliers' delivery time index), the indices of new orders, new export orders, backlogs of orders, stocks of finished goods, stocks of major inputs, purchases of inputs, input prices, ex-factory prices and employment have remained in the contractionary zone over the past three months. Meanwhile, only the business expectations index has stayed in the expansionary zone over the same period. (See exhibit 3)

Policy outlook

Looking ahead, we expect that the central government is likely to introduce more policies to support China's economic growth. A meeting of the Political Bureau of the Communist Party of China (CPC) Central Committee was held on 28 April. The meeting noted that the key to sustained economic recovery and growth lies in the recovery and expansion of demand. The meeting called for more efforts in making proactive fiscal policy more effectual and prudent monetary policy more targeted and effective so as to create synergy for expanding demand. On 16 June, a spokesperson for the National Development and Reform Commission (NDRC) said that the NDRC would formulate and introduce policies to boost domestic consumption, accelerate the construction of major projects and key infrastructures, etc., to further inject impetus to China's economic recovery.

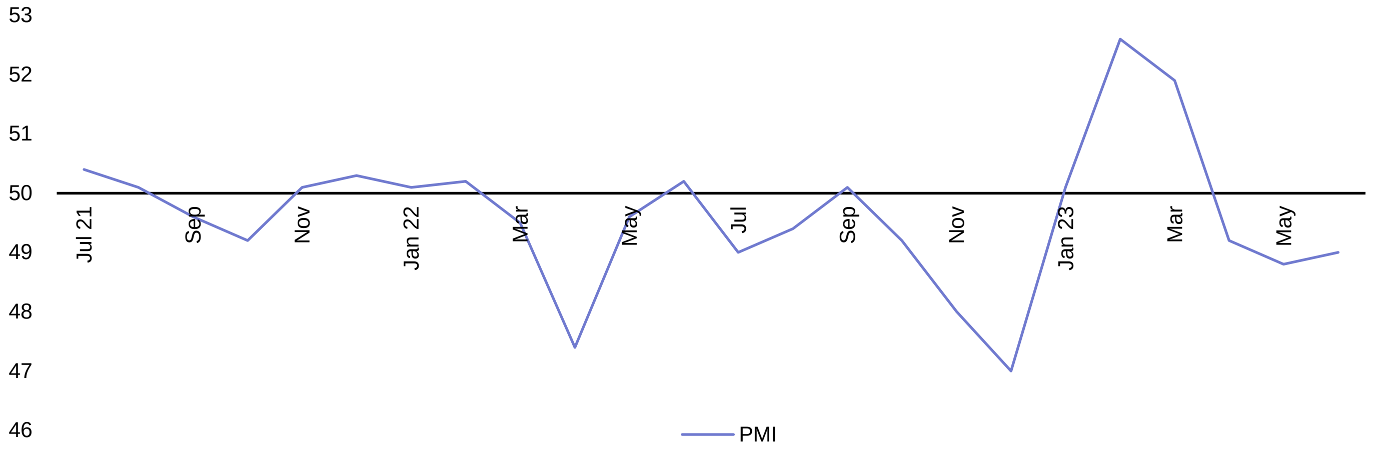
These signal that China will continue to adopt an expansionary macro policy in the second half of 2023, which will help alleviate the downward pressure on the Chinese economy, in our view.

Forecasts for 3Q23

Since June, the Chinese government has introduced various support measures for the economy, which are likely to promote a mild recovery in industrial production in the coming months. Overall, we predict that the headline PMI will gradually rise above 50 in 3Q23, while industrial production growth will recover to 4.0% yoy in the quarter.

Exhibit 4 plots the quarterly real GDP growth rates versus the monthly PMIs since January 2018. We project that China's real GDP growth will fall to 4.5% yoy in 3Q23, as the low base effect fades.

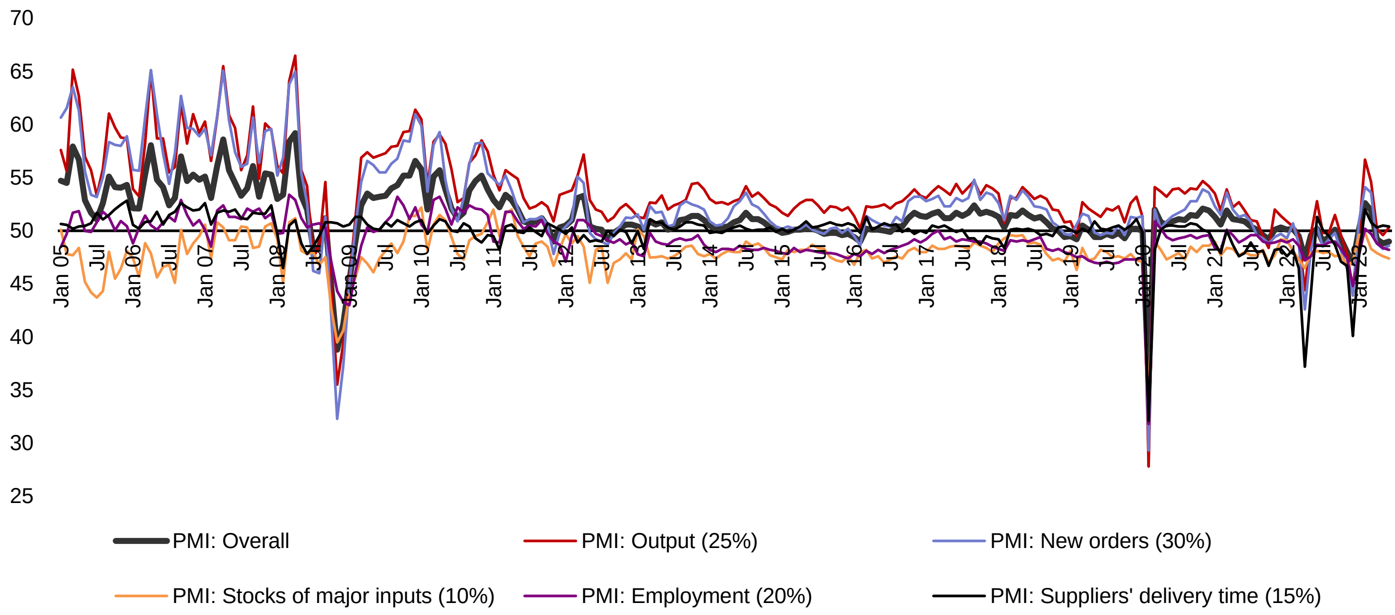
Exhibit 1: Headline PMI, July 2021 to June 2023



Source: China Federation of Logistics & Purchasing, China National Bureau of Statistics

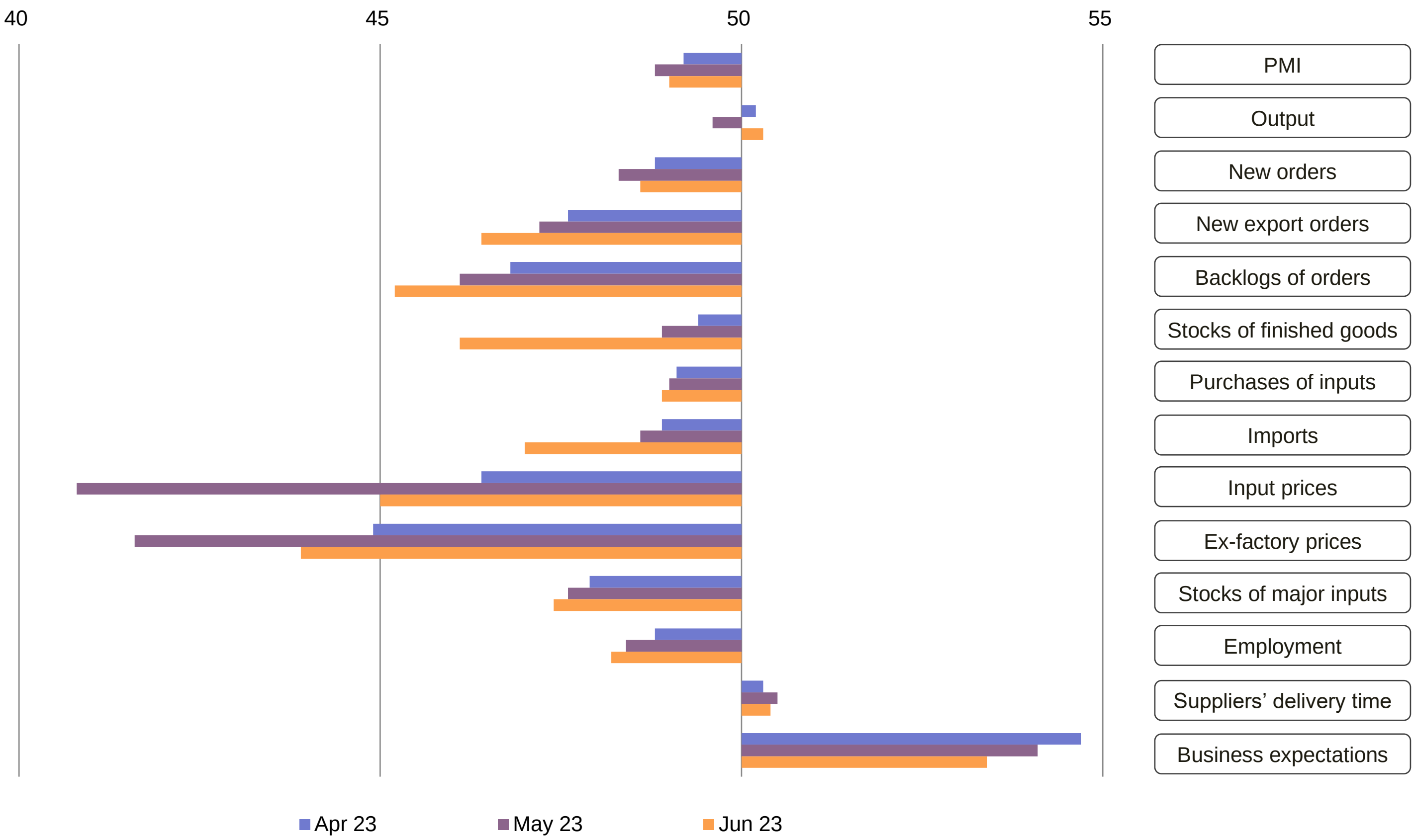
Exhibit 2: Headline PMI and sub-indices, January 2005 to June 2023

PMI = Output x 25% + New Orders x 30% + Stocks of Major Inputs x 10% + Employment x 20% + (100 - Suppliers' Delivery Time) x 15%



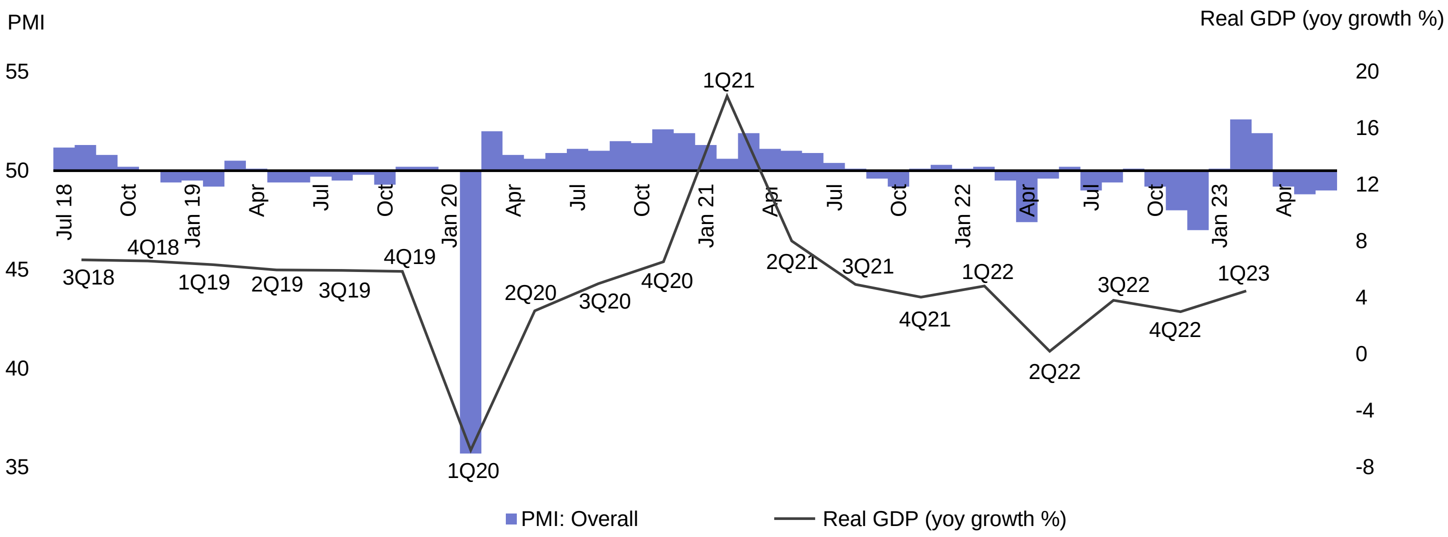
Source: China Federation of Logistics & Purchasing, China National Bureau of Statistics

Exhibit 3: Headline PMI and all sub-indices, April to June 2023



Source: China Federation of Logistics & Purchasing, China National Bureau of Statistics

Exhibit 4: Headline PMI and real GDP growth, July 2018 to June 2023



Source: China Federation of Logistics & Purchasing, China National Bureau of Statistics

2. What the PMI tells us about the performance of enterprises of different sizes

Large enterprises recover lately

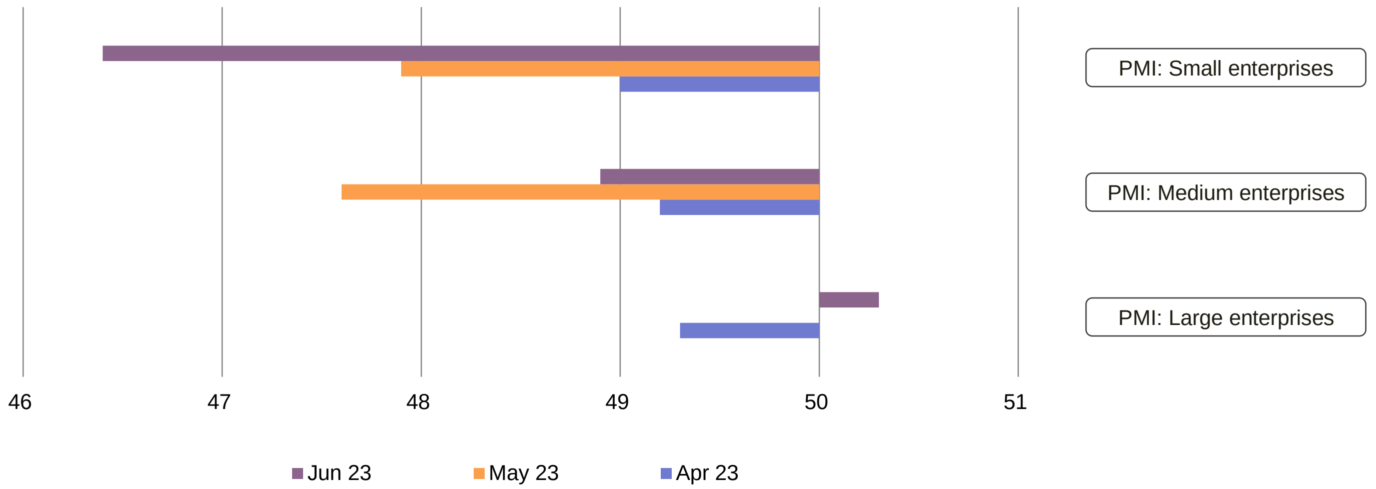
The PMI of 'large enterprises' climbed from 49.3 in April to 50.0 in May and further to 50.3 in June. The index reading has risen above the critical 50-mark lately, indicating a recovery of large enterprises.

Large enterprises have continued to fare better than small and medium enterprises, a trend that has started since the second half of 2020.

Small and medium enterprises continue to contract

The PMI of 'medium enterprises' dropped from 49.2 in April to 47.6 in May, and then picked up to 48.9 in June. Meanwhile, the PMI of 'small enterprises' went down from 49.0 in April to 47.9 in May and further to 46.4 in June. The index readings of both 'small enterprises' and 'medium enterprises' stayed below the watershed mark of 50 throughout the quarter, indicating that small and medium enterprises have been facing difficulties in production and operations lately. (See exhibit 5)

Exhibit 5: PMIs of large enterprises, medium enterprises and small enterprises, April to June 2023



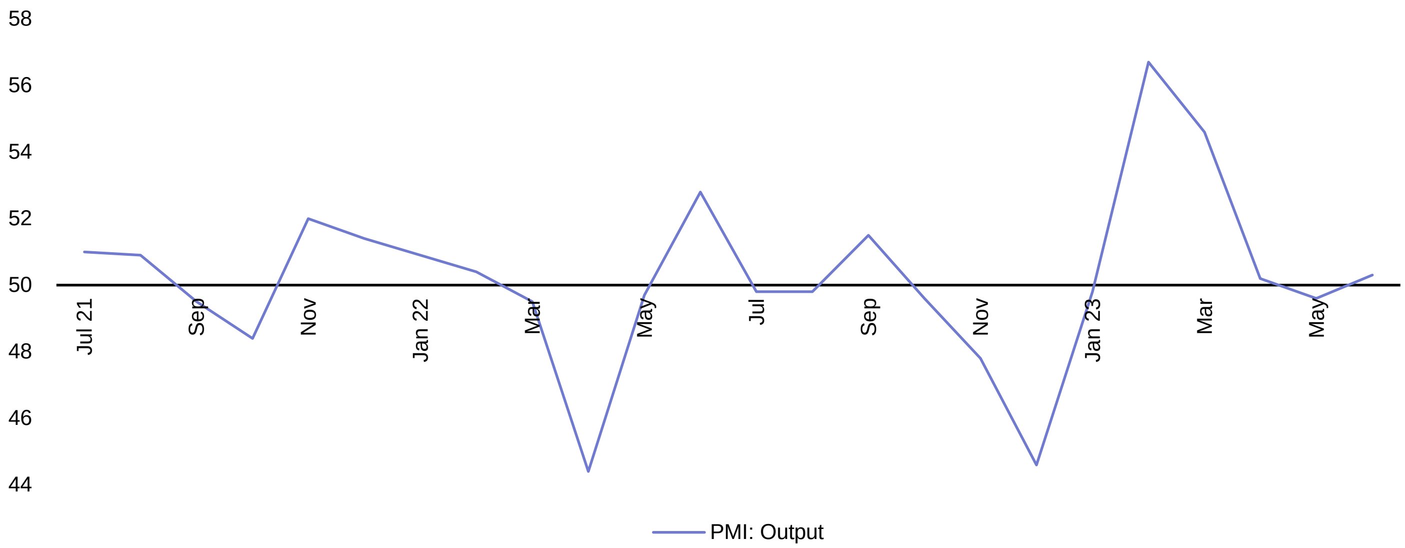
Source: China Federation of Logistics & Purchasing, China National Bureau of Statistics

3. What the PMI tells us about manufacturing production

Manufacturing output resumes expansion in June

After falling from 50.2 in April to 49.6 in May, the output index rebounded to 50.3 in June, returning to the expansionary territory, which indicates a recovery in manufacturing production lately. (See exhibit 6)

Exhibit 6: Output index, July 2020 to June 2023



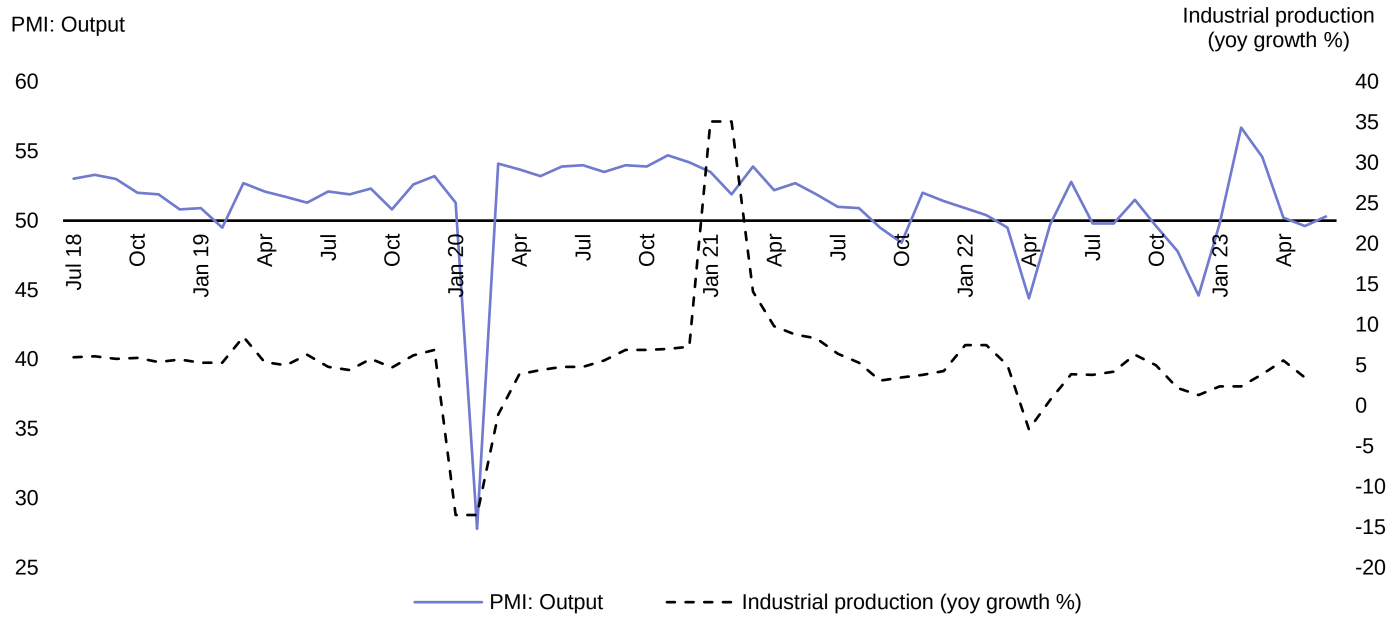
Source: China Federation of Logistics & Purchasing, China National Bureau of Statistics

Growth in manufacturing production to recover in 3Q23

Exhibit 7 demonstrates the correlation (with some lags) between the output index and the year-on-year growth of value-added of industrial output (VAIO). We project that China's VAIO growth will stay low at 3.0% yoy in June as the industrial sector struggled with a weak domestic and export demand. However, we expect the VAIO growth to recover to 4.0% yoy in 3Q22, as the government's support measures for the economy are likely to bolster industrial growth. Still, challenges facing Chinese manufacturers include the global economic downturn, ongoing trade frictions between China and the US, strong government's determination to reduce industrial carbon emissions, and intense competition in the international market.

We expect China's VAIO growth to recover to 4.0% yoy in 3Q22, as the government's support measures for the economy are likely to bolster industrial growth.

Exhibit 7: Output index and industrial production growth, July 2018 to June 2023



Source: China Federation of Logistics & Purchasing, China National Bureau of Statistics

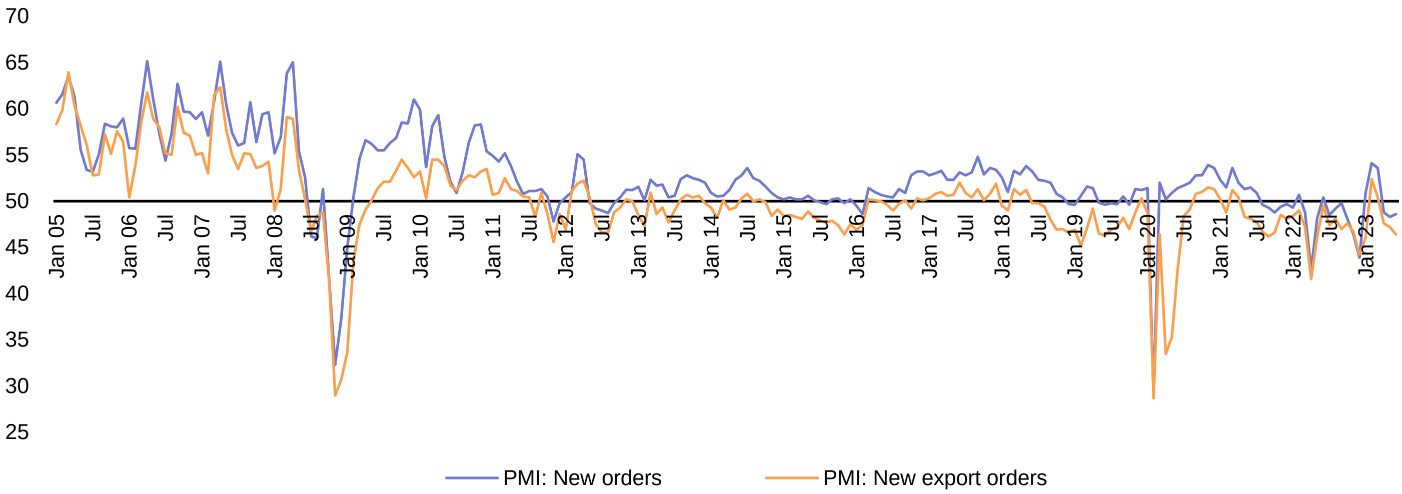
4. What the PMI tells us about the overall market demand

Overall market demand deteriorates at a slower pace

The new orders index declined from 48.8 in April to 48.3 in May and then picked up to 48.6 in June. The latest index reading indicates that new orders and the overall market demand have contracted at a slower pace lately.

Meanwhile, the new export orders index dropped from 47.6 in April to 47.2 in May and further to 46.4 in June, pointing to greater downward pressure on China's exports. (See exhibit 8)

Exhibit 8: New orders index and new export orders index, January 2005 to June 2023



Source: China Federation of Logistics & Purchasing, China National Bureau of Statistics

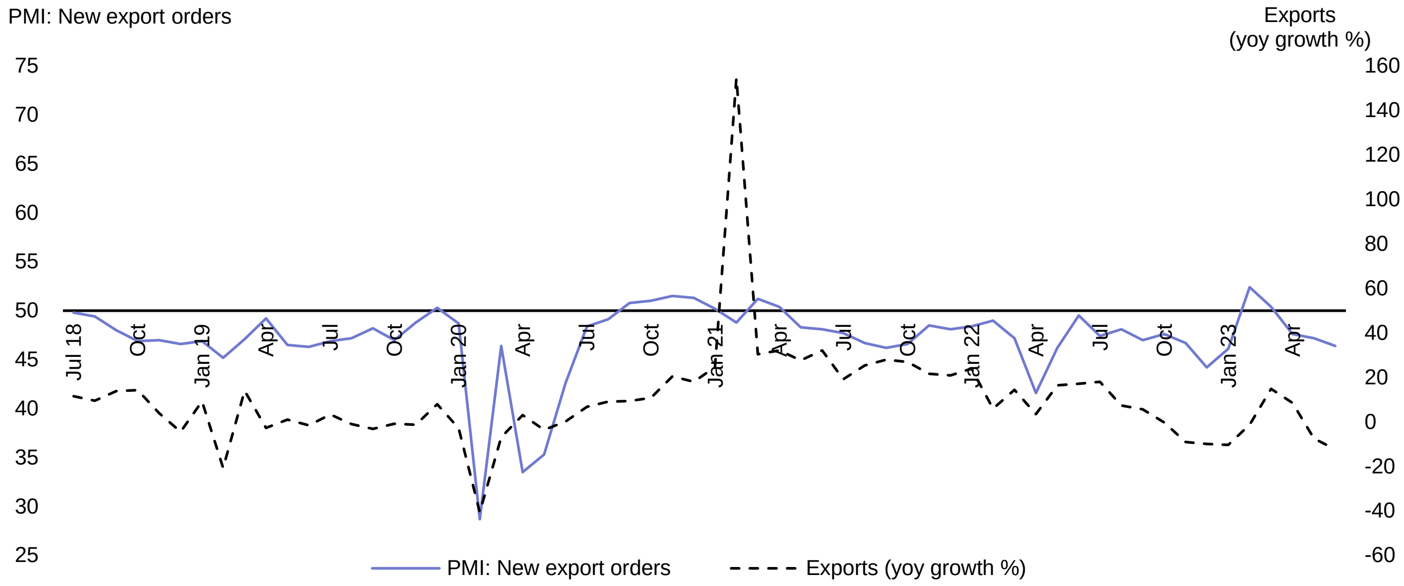
China's exports to register a high single-digit year-on-year drop in 3Q23

Exhibit 9 plots the new export orders index against the year-on-year growth rates of China's exports. From exhibit 10 we can see that the new export orders index has been strongly correlated to the external economies. The OECD's G20 composite leading indicator[1] has stayed low recently, suggesting a sluggish global economy. All in all, we forecast that China's exports will register a high single-digit year-on-year drop in 3Q23.

With a sluggish global economy, we forecast that China's exports will register a high single-digit year-on-year drop in 3Q23.

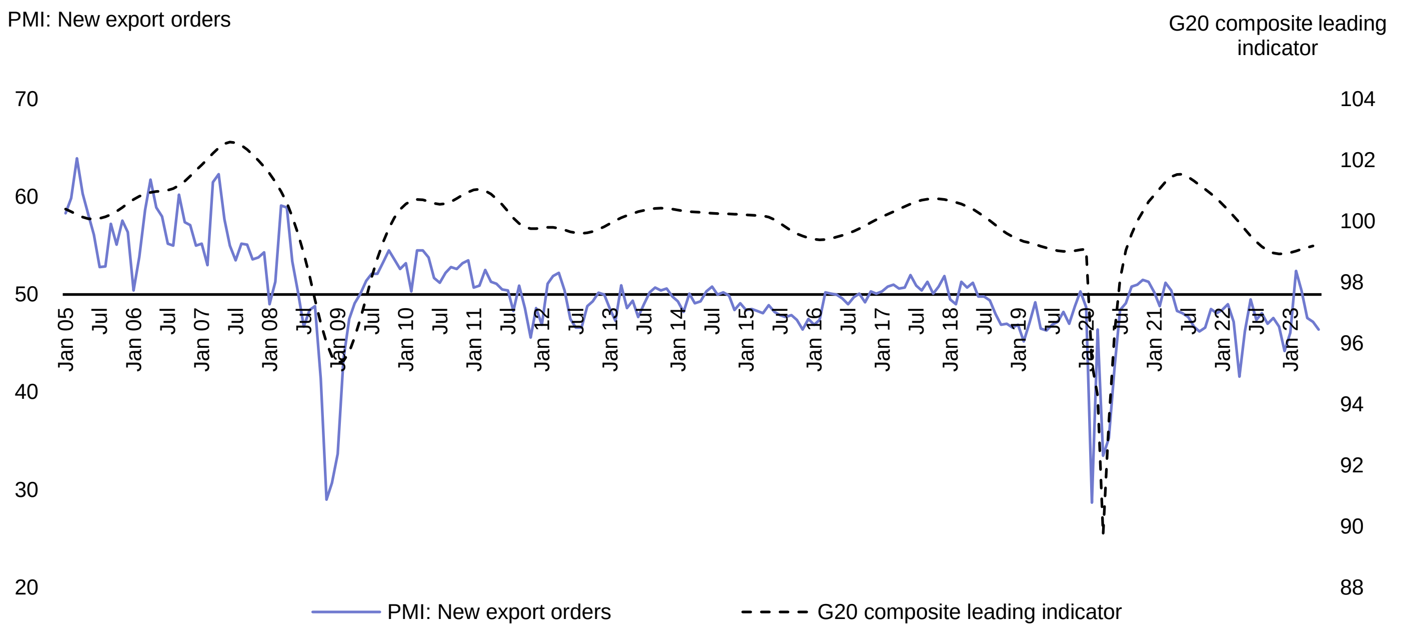
1 The G20 composite leading indicator, compiled by the Organization for Economic Cooperation and Development (OECD), is designed to provide early signals of turning points (peaks and troughs) between expansions and slowdowns of economic activity, and covers Australia, Brazil, Canada, China, France, Germany, India, Indonesia, Italy, Japan, Korea, Mexico, South Africa, Turkey, UK, and the US.

Exhibit 9: New export orders index and export growth, July 2018 to June 2023



Source: China Federation of Logistics & Purchasing, China National Bureau of Statistics, China Customs

Exhibit 10: New export orders index and G20 composite leading indicator, January 2005 to June 2023



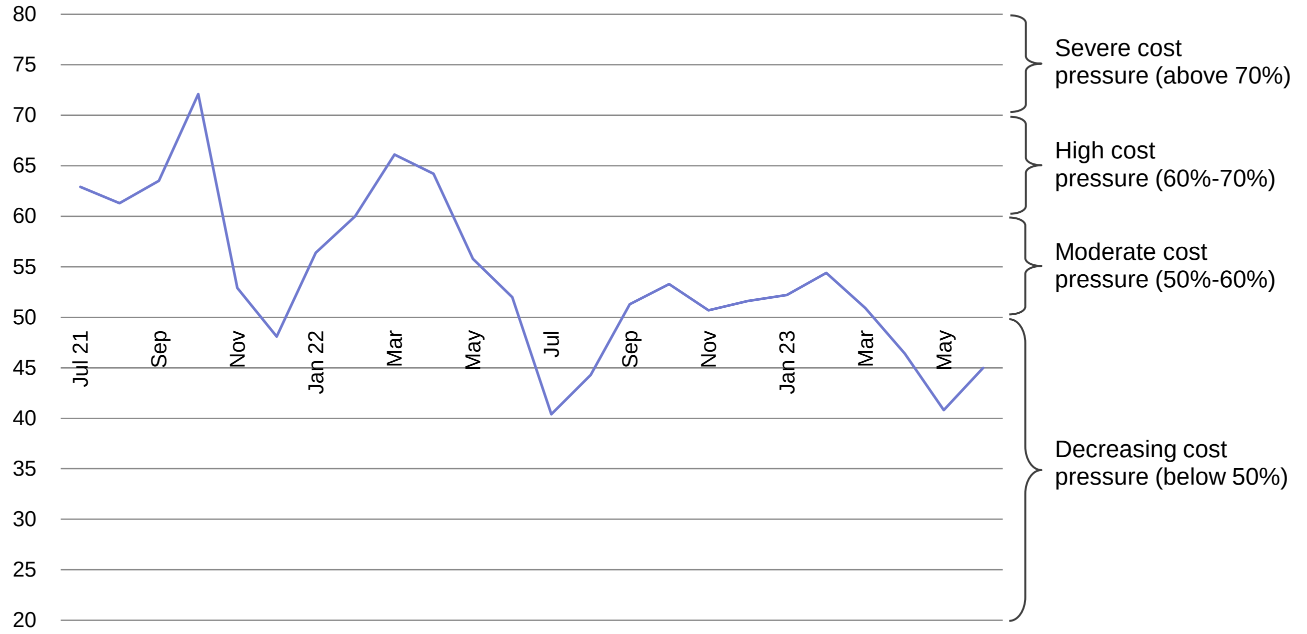
Source: China Federation of Logistics & Purchasing, China National Bureau of Statistics, Organization for Economic Cooperation and Development

5. What the PMI tells us about upstream and midstream prices

Cost pressure on Chinese manufacturers eases amid decreasing upstream prices

After dropping from 46.4 in April to 40.8 in May, the input prices index went up to 45.0 in June. The index readings have stayed below the critical 50-mark, indicating a sustained decline in the prices of production inputs recently. Manufacturers have continued to experience a drop in the costs of major inputs.

Exhibit 11: Input prices index, July 2021 to June 2023

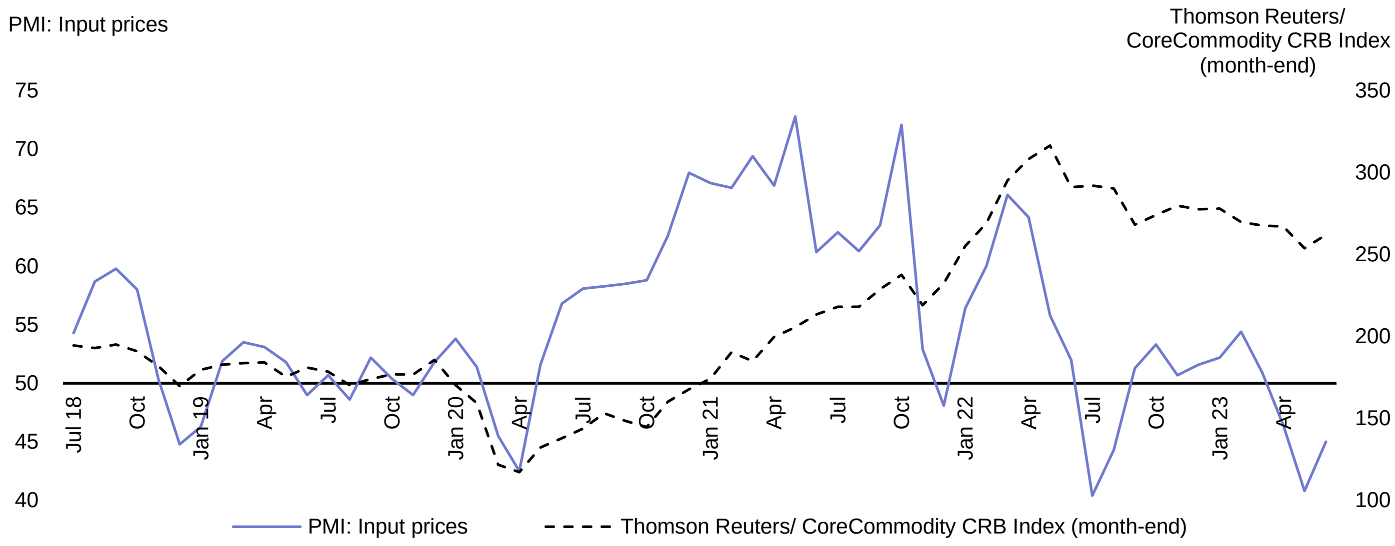


Source: China Federation of Logistics & Purchasing, China National Bureau of Statistics

To see the extent to which input costs of Chinese manufacturers are affected by global commodity prices, exhibit 12 puts together the input prices index and the Thomson Reuters/ CoreCommodity CRB index.[2]

2 The Thomson Reuters/ CoreCommodity CRB Index, which comprises 19 commodities such as crude oil, aluminum, corn, cotton, gold, natural gas, soybeans, etc, has served as one of the most recognized measures of global commodity prices.

Exhibit 12: Input prices index and Thomson Reuters/ CoreCommodity CRB Index, July 2018 to June 2023

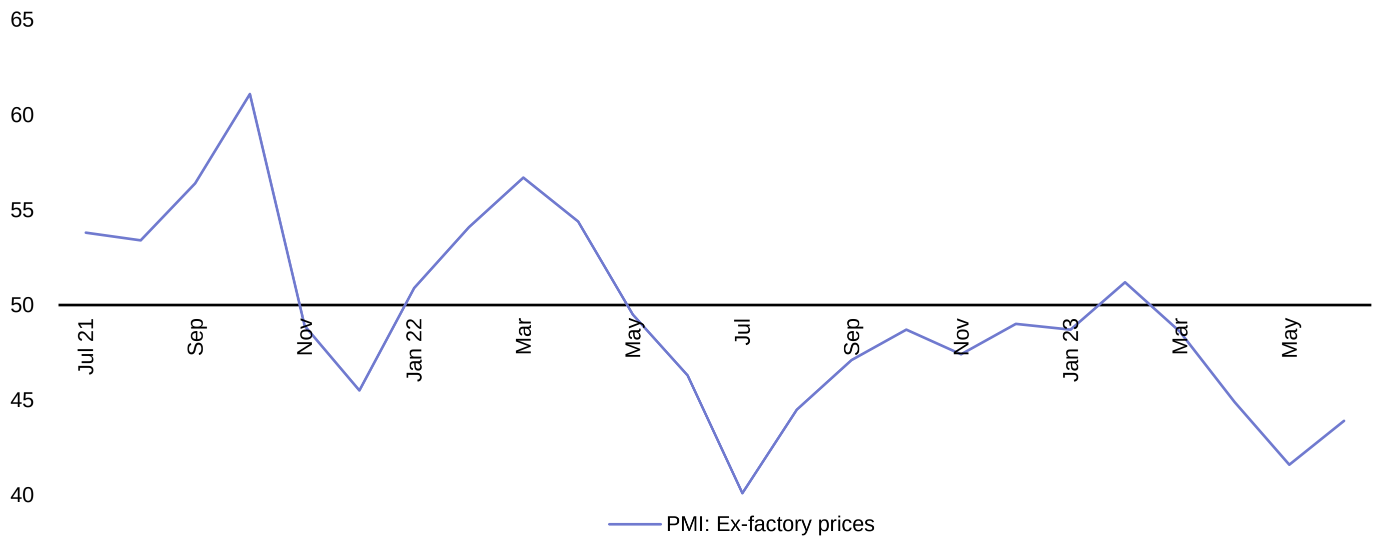


Source: China Federation of Logistics & Purchasing, China National Bureau of Statistics, Thomson Reuters

Manufacturers lower ex-factory prices of their products

The ex-factory prices index dropped from 44.9 in April to 41.6 in May, before rebounding to 43.9 in June. The index has stayed below the critical 50-mark, indicating that Chinese manufacturers have been lowering the ex-factory prices of their finished products amid easing cost pressure and a challenging sales environment.[3]

Exhibit 13: Ex-factory prices index, July 2021 to June 2023



Source: China Federation of Logistics & Purchasing, China National Bureau of Statistics

3 The ex-factory prices index has been released since January 2017.

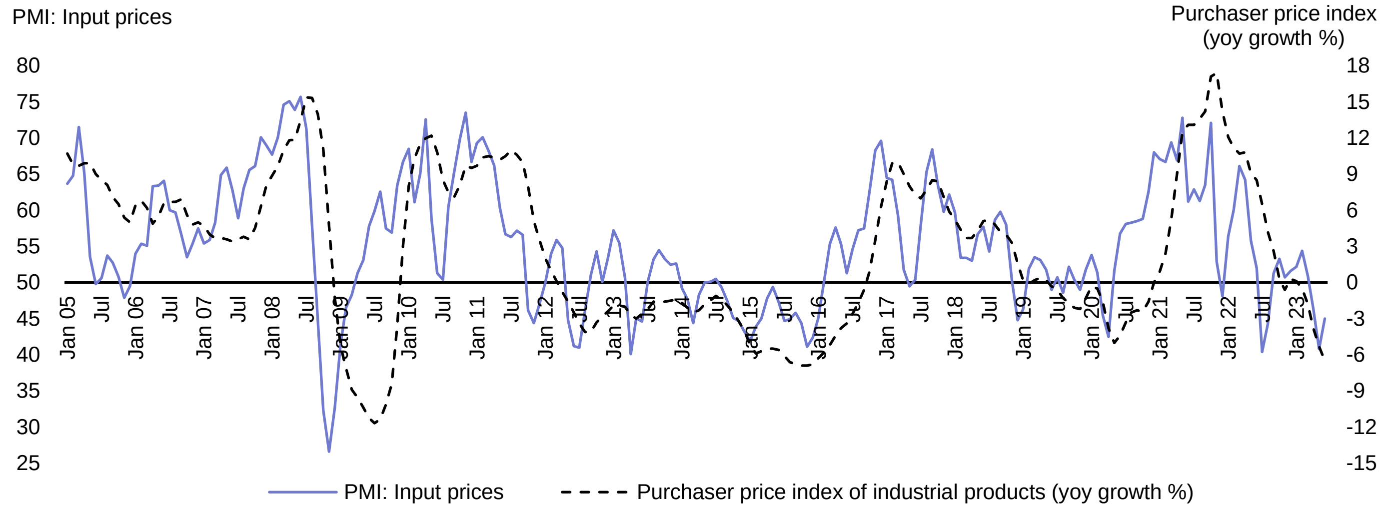
Growth in input prices and ex-factory prices to pick up in 3Q23

Exhibit 14 shows that the input prices index is useful as a leading indicator of upstream prices. To show the association between the input prices index and 'midstream' prices, we plot the input prices index against the year-on-year growth of the producer price index (PPI)[4] in exhibit 15.

Going forward, we expect that the year-on-year growth rates for both the purchaser price index and the PPI will rise in 3Q23, due to a recent rebound in global commodity prices and a low comparison base in 3Q22.

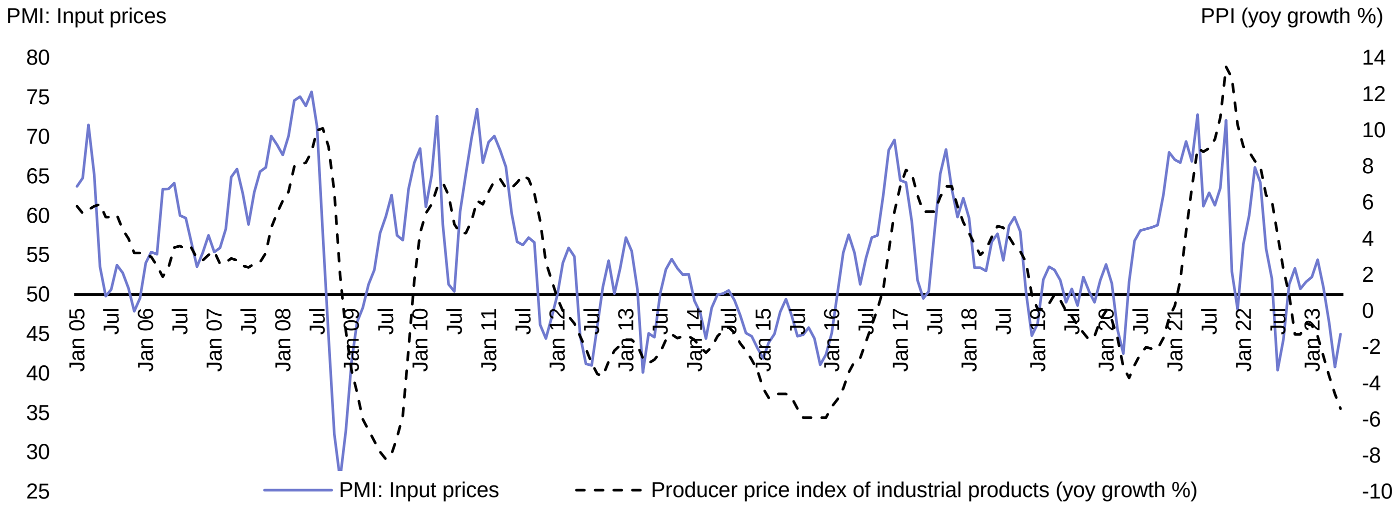
We expect that the year-on-year growth rates for both the purchaser price index and the PPI will rise in 3Q23, due to a recent rebound in global commodity prices and a low comparison base in 3Q22.

Exhibit 14: Input prices index and purchaser price index of industrial products, January 2005 to June 2023



Source: China Federation of Logistics & Purchasing, China National Bureau of Statistics

Exhibit 15: Input prices index and producer price index, January 2005 to June 2023



Source: China Federation of Logistics & Purchasing, China National Bureau of Statistics

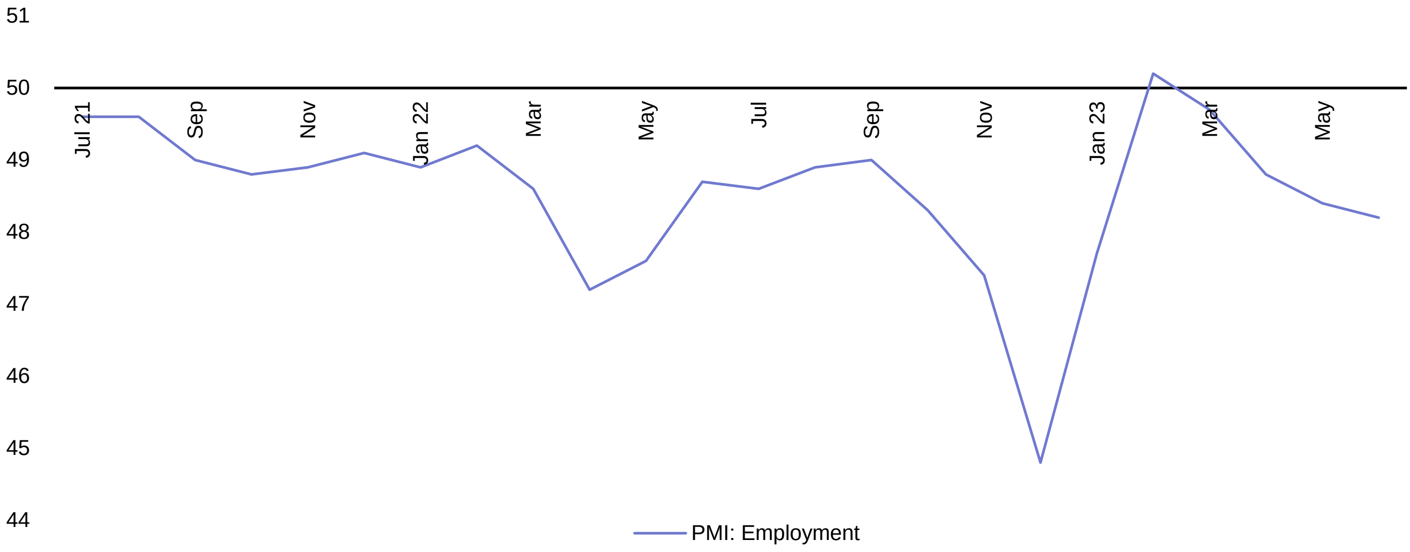
[4] The producer price index of industrial goods (PPI), compiled by China National Bureau of Statistics, measures the prices of industrial products when they are sold for the first time after production.

6. What the PMI tells us about manufacturing employment

Employment in manufacturing sector slightly decreases

The employment index declined from 48.8 in April to 48.4 in May and 48.2 in June, staying in the contractionary zone for three consecutive months. The index readings indicate that employment in the manufacturing sector has slightly decreased recently. (Exhibit 16)

Exhibit 16: Employment index, July 2020 to June 2023



Source: China Federation of Logistics & Purchasing, China National Bureau of Statistics

Exhibit 17 shows that the employment in China's manufacturing sector has relied heavily on the export sector. Exhibit 18 and 19 give our readers some ideas about the extent to which the employment situation improves or deteriorates with the manufacturing sector and the overall economy. Given a steady growth in overall Chinese economy, we expect that the employment situation in the manufacturing sector will stabilize in 3Q23.

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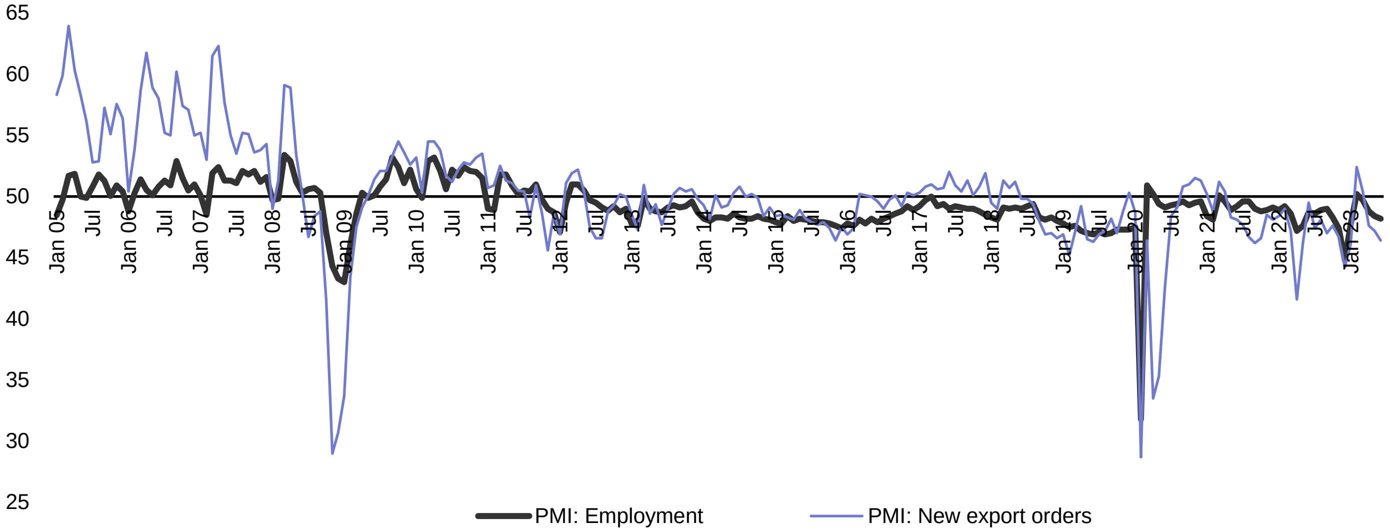
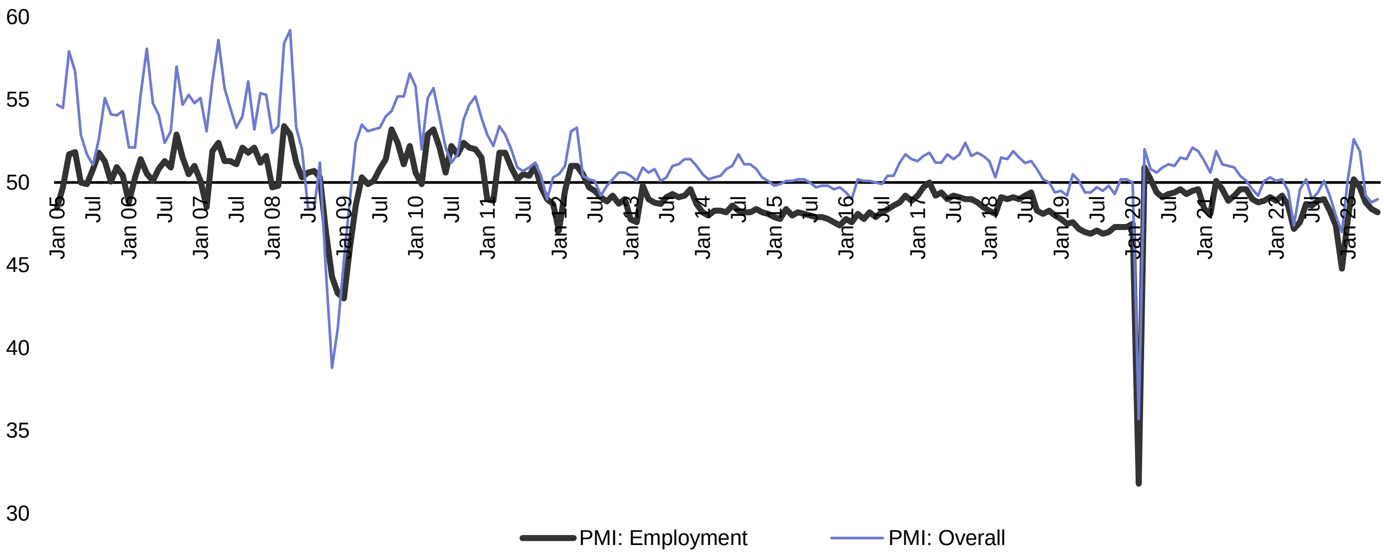
Exhibit 17: Employment and new export orders, April 2005 to June 2023



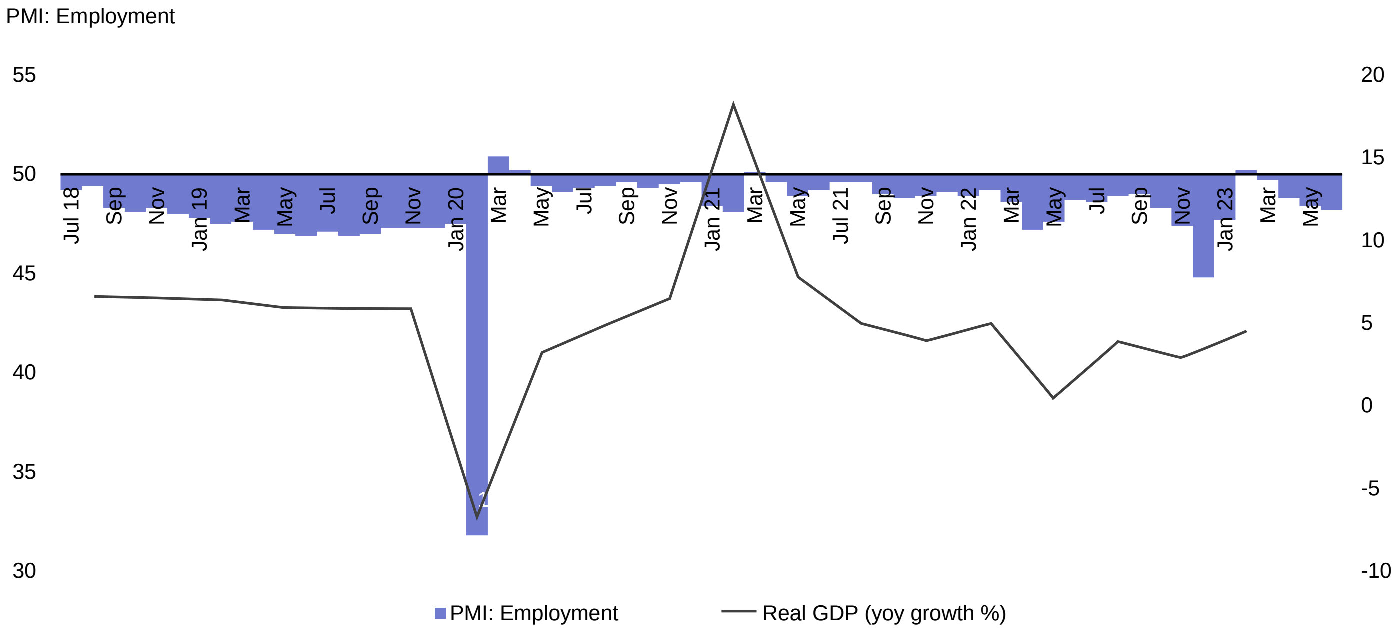
Source: China Federation of Logistics & Purchasing, China National Bureau of Statistics

Exhibit 18: Employment index and headline PMI, April 2005 to June 2023



Source: China Federation of Logistics & Purchasing, China National Bureau of Statistics

Exhibit 19: Employment index and real GDP growth, January 2018 to June 2023



Source: China Federation of Logistics & Purchasing, China National Bureau of Statistics

About China Manufacturing PMI:

China Manufacturing Purchasing Managers' Index (PMI) provides an early indication each month of economic activities in the Chinese manufacturing sector. It is jointly published by China Federation of Logistics & Purchasing (CFLP) and the National Bureau of Statistics (NBS). Fung Business Intelligence is responsible for drafting and disseminating the English PMI report.

Every month questionnaires are sent to 3,200 manufacturing enterprises all over China. The data presented herein is compiled from the enterprises' responses about their purchasing activities and supply situations. CFLP makes no representation regarding the data collection procedures, nor does it disclose any data of individual enterprises. The PMI should be compared to other economic data sources when used in decision-making.

3,200 manufacturing enterprises in 31 industries from Eastern, Northeastern, Central and Western China are surveyed. The sampling of the enterprises involves the use of Probability Proportional to Size Sampling (PPS), which means the selection of enterprises surveyed is largely based on each industry's contribution to GDP, and the representation of each geographical region.

There are 13 sub-indicators in the survey: Output, New Orders, New Export Orders, Backlogs of Orders, Stocks of Finished Goods, Purchases of Inputs, Imports, Input Prices, Stocks of Major Inputs, Ex-factory Prices, Employment, Suppliers' Delivery Time and Business Expectations. An index reading above 50 indicates an overall positive change in a sub-indicator; below 50, an overall negative change.

The PMI is a composite index based on the seasonally adjusted indices for five of the sub-indicators with varying weights: New Orders—30%; Output—25%; Employment—20%; Suppliers' Delivery Time—15%; and Stocks of Major Inputs—10%. A PMI reading above 50 indicates an overall expansion in the manufacturing sector; below 50, an overall contraction.

Currently there are more than twenty countries and regions conducting the PMI survey and compilation, based on an internationally standardized methodology.

About the Organizations:

China Federation of Logistics & Purchasing

China Federation of Logistics & Purchasing (CFLP) is the logistics and purchasing industry association approved by the State Council. CFLP's mission is to push forward the development of the logistics industry and the procurement businesses of both government and enterprises, as well as the circulation of factors of production in China. The government authorizes the CFLP to produce industry statistics and set industry standards. CFLP is also China's representative in the Asian-Pacific Logistics Federation (APLF) and the International Federation of Purchasing and Supply Management (IFPSM).

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 26,000 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 http://www.funggroup.com.