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PMI Quarterly on China Manufacturing

PMI 3Q21
Downward pressure in manufacturing production and economic activity

Policy Outlook
China to step up policy support for economy

4Q21 Forecasts
Real GDP growth to ease to 3.5% yoy while PMI to fluctuate between 49.0 and 50.5

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Issue 46

PMI points to downward pressure in manufacturing production and economic activity in 3Q21

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Our observations

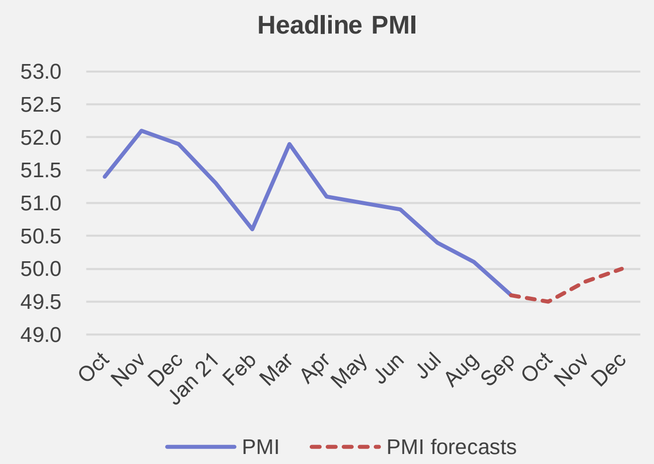
- Large enterprises continue to fare better than small and medium enterprises.
- Manufacturing production contracts for first time since February last year.
- Overall market demand deteriorates.
- Manufacturers raise ex-factory prices of their products amid high cost pressure as prices of production inputs continue to rise.
- Manufacturing employment remains steady.

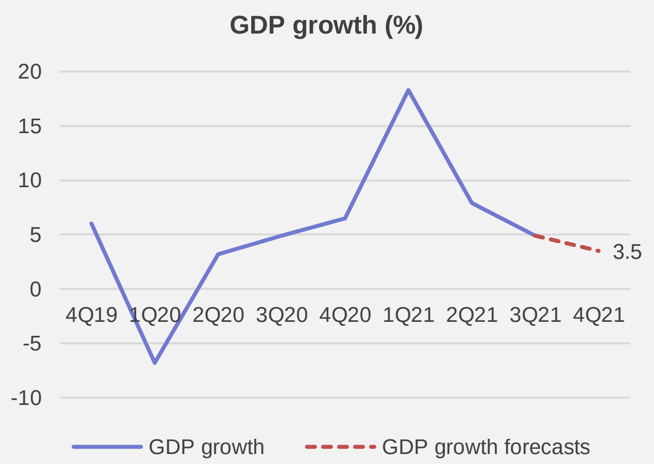
Policy outlook

- The Chinese government is likely to step up policy support for the economy.
- The proactive fiscal policy should generate greater effect, while the prudent monetary policy should maintain reasonably ample liquidity and support the continued recovery of small and medium-sized enterprises and stressed industries.
- The government has adopted measures to ensure energy supplies, so as to mitigate the impact of power shortages on industrial production.

Our forecasts for 4Q21

- We project a slowdown in manufacturing production and economic activity in 4Q21.
- The headline PMI will fluctuate between 49.0 and 50.5.
- Real GDP growth will ease to 3.5% yoy.
- VAIO growth will moderate to 3.0% yoy.
- Exports will register high single-digit year-on-year growth.
- Year-on-year growth rates for the purchaser price index and the PPI will not see an uptick due to a weakening industrial demand and a high comparison base in 4Q20.





IN THIS ISSUE:

1. PMI points to downward pressure in manufacturing production and economic activity in 3Q21

We expect that a combination of a weak manufacturing sector and a high comparison base last year will drag down GDP growth to 3.5%yoy in 4Q21.

China's manufacturing sector and economy in 3Q21

China's manufacturing PMI dropped from 50.4 in July to 50.1 in August and 49.6 in September. The latest headline PMI reading has slipped into the contractionary zone, indicating downward pressure on China's manufacturing sector and economy amid the disruptions in manufacturing production due to the 'energy dual controls' (on energy consumption and energy intensity) and nationwide power shortages. (See exhibit 1)

Manufacturing output has started to decline lately, as the output index in September dipped below the critical 50-mark for the first time since February last year. The contraction in manufacturing output was partly attributed to a reduction in new orders: The new orders index fell to 49.3 in September, indicating a deterioration in the overall demand lately.

Prices of industrial products have continued to increase at a fast pace lately: The ex-factory prices index rose from 53.4 in August to 56.4 in September. The jump in product prices was due partly to the surge in the prices of materials: The input prices index went up from 61.3 in August to 63.5 in September, well above the neutral level of 50.

Exhibit 2 shows the contributions of the sub-indices to the change in the headline PMI. The fall in the headline PMI in 3Q21 was due largely to the decrease in the output index (which weighs 25% in the computation of the headline PMI) and the new orders index (which weighs 30%). Among the 12 sub-indices (i.e. excluding the suppliers' delivery time index), the indices of input prices, ex-factory prices and business expectations have remained in the expansionary zone over the past three months. Meanwhile, the indices of new export orders, backlogs of orders, stocks of finished goods, imports, stocks of major inputs and employment have stayed in the contractionary zone over the same period. (See exhibit 3)

Policy outlook

Looking ahead, we expect the Chinese government to step up policy support for the economy. A meeting of the Political Bureau of the Communist Party of China (CPC) Central Committee was held on 30 July to make arrangements for the economic work for the second half of the year. The meeting stressed maintaining consistent, stable and sustainable macro policies, and keeping the Chinese economy running within an appropriate range. The proactive fiscal policy should generate greater effect, while the prudent monetary policy should maintain reasonably ample liquidity and support the continued recovery of small and medium-sized enterprises and stressed industries, as pledged in the meeting. Compared with the April meeting, the July meeting highlighted an increasingly challenging external environment and emphasized the need for policy autonomy. It also dropped the previous pledge of 'no sharp turns in policy'. These changes in wordings could mean a relatively loose macro policy in 2H21, which will help alleviate the downward pressure on the Chinese economy, in our view.

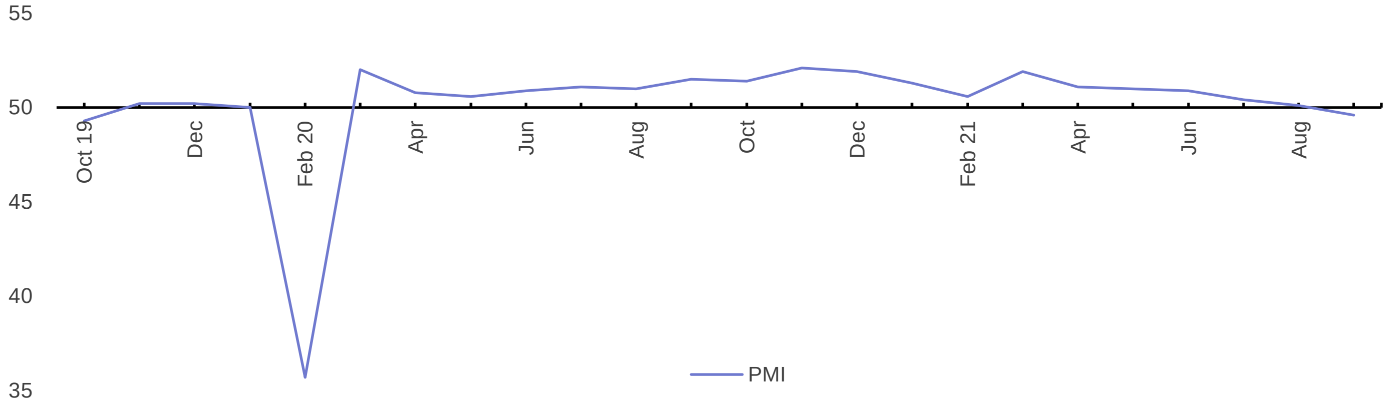
The State Council held a meeting on 8 October and decided to take six measures to ensure energy supplies, including urging coal mines to raise output, supporting coal-fired power plants to increase power generation, and raising the cap on electricity prices, etc. We believe that these measures will mitigate the impact of power shortages on industrial production.

Forecasts for 4Q21

China's industrial production is set to slow down in the near term, as the manufacturing sector is still facing disruptions caused by the 'energy dual controls' and power shortages. Overall, we predict that the headline PMI will fluctuate between 49.0 and 50.5 and the industrial production (VAIO) growth will moderate to 3.0% yoy in 4Q21.

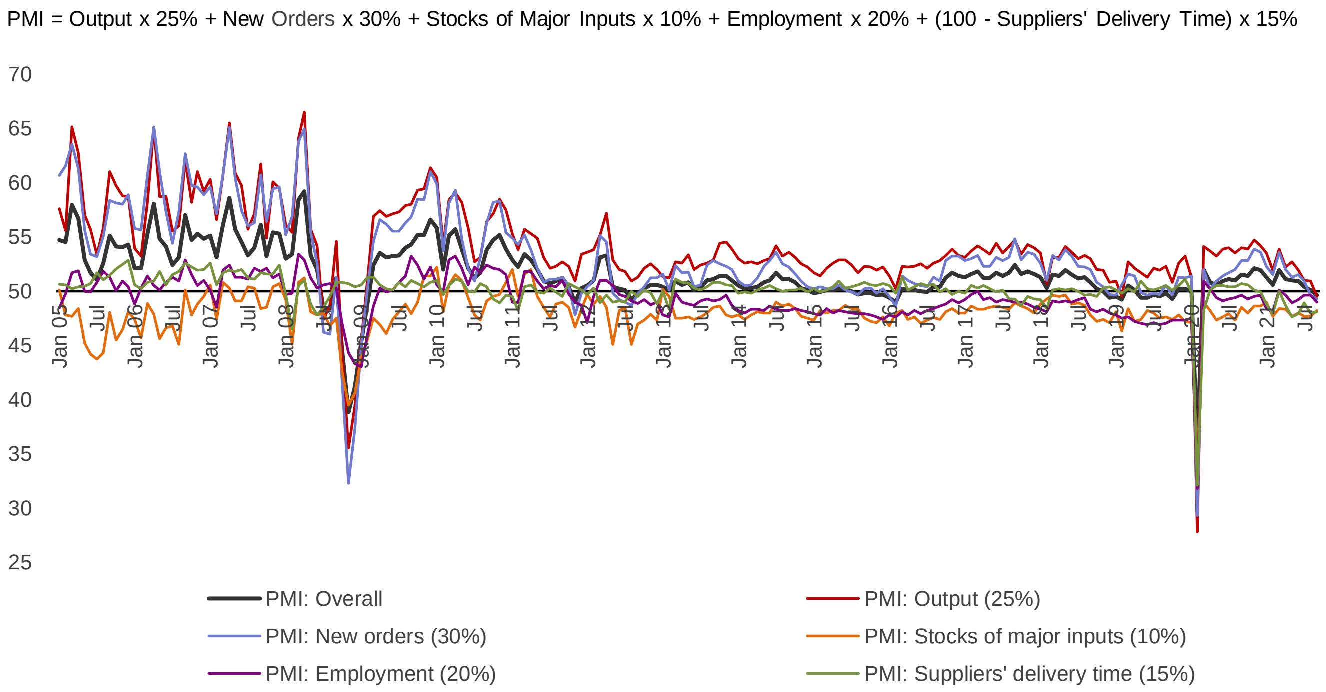
Exhibit 4 plots the quarterly real GDP growth rates versus the monthly PMIs since July 2016. We project that China's real GDP growth will ease to 3.5% yoy in 4Q21 due to a weak manufacturing sector and a high comparison base in the same period last year.

Exhibit 1: Headline PMI, October 2019 to September 2021



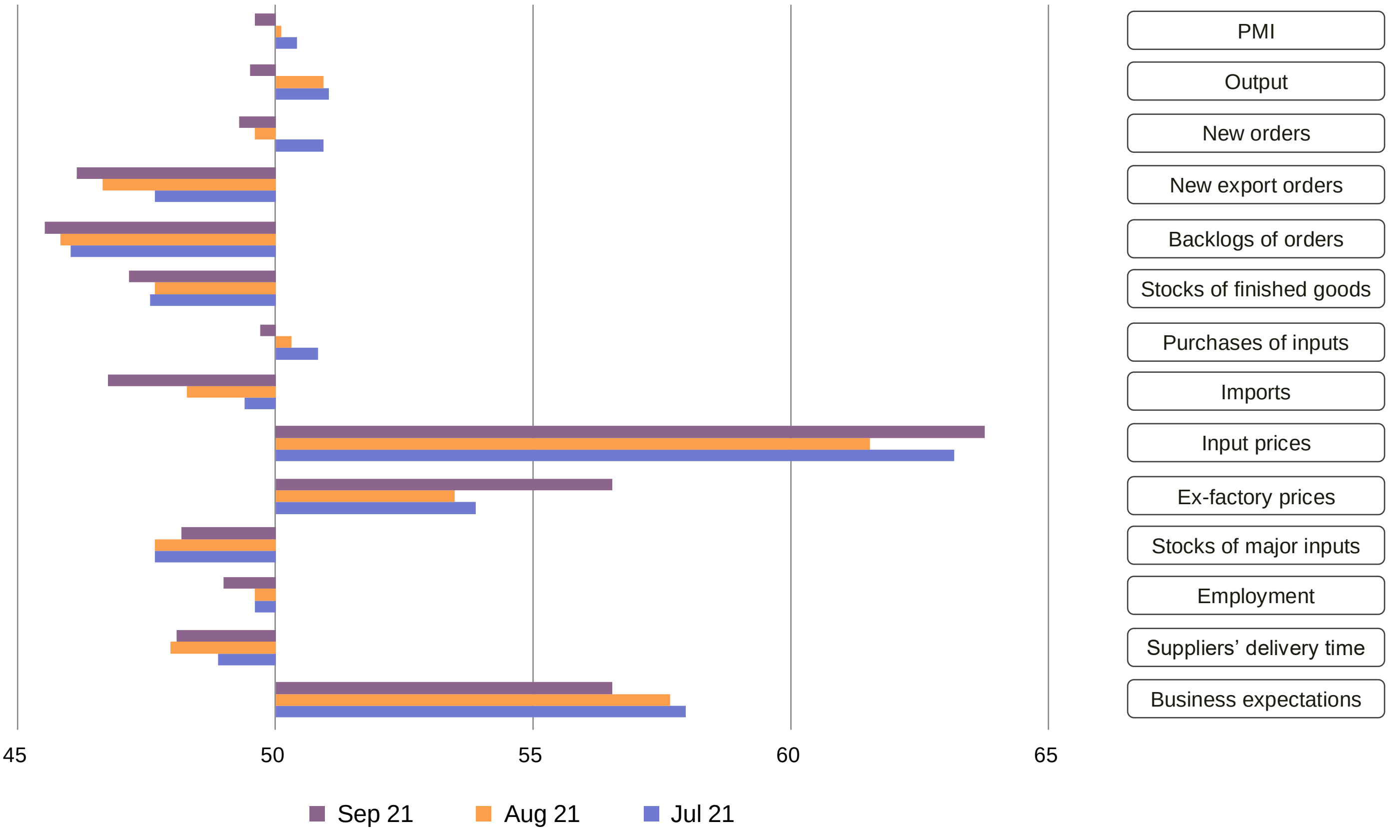
Source: China Federation of Logistics & Purchasing, China National Bureau of Statistics

Exhibit 2: Headline PMI and sub-indices, January 2005 to September 2021



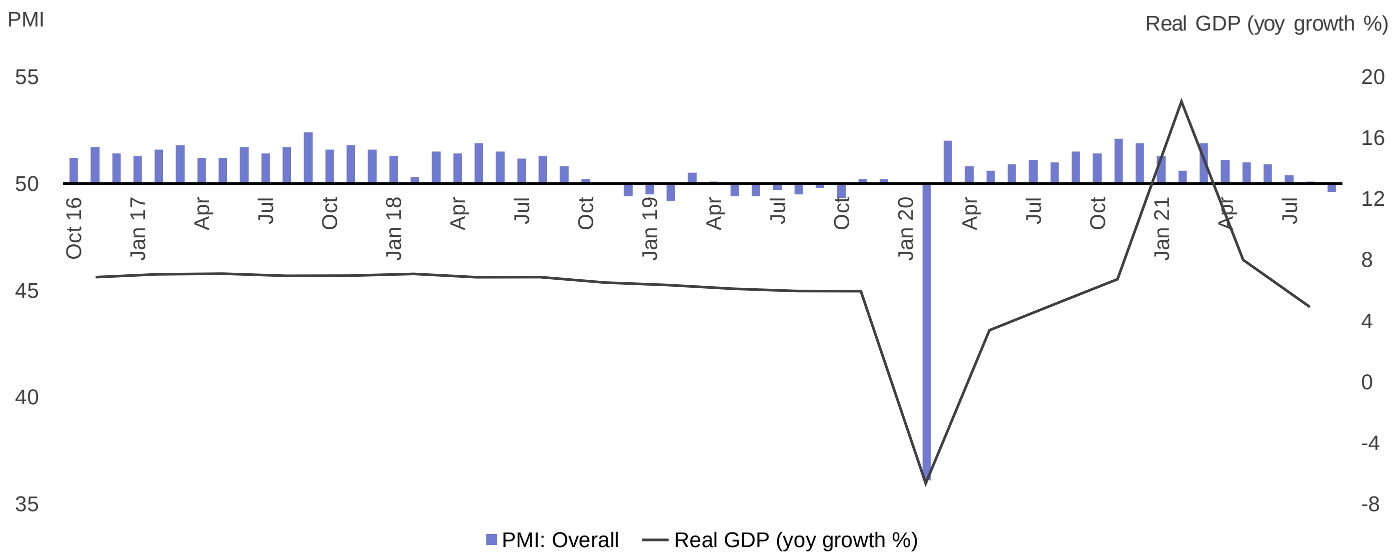
Source: China Federation of Logistics & Purchasing, China National Bureau of Statistics

Exhibit 3: Headline PMI and all sub-indices, July to September 2021



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

Exhibit 4: Headline PMI and real GDP growth, October 2016 to September 2021



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 continue to expand

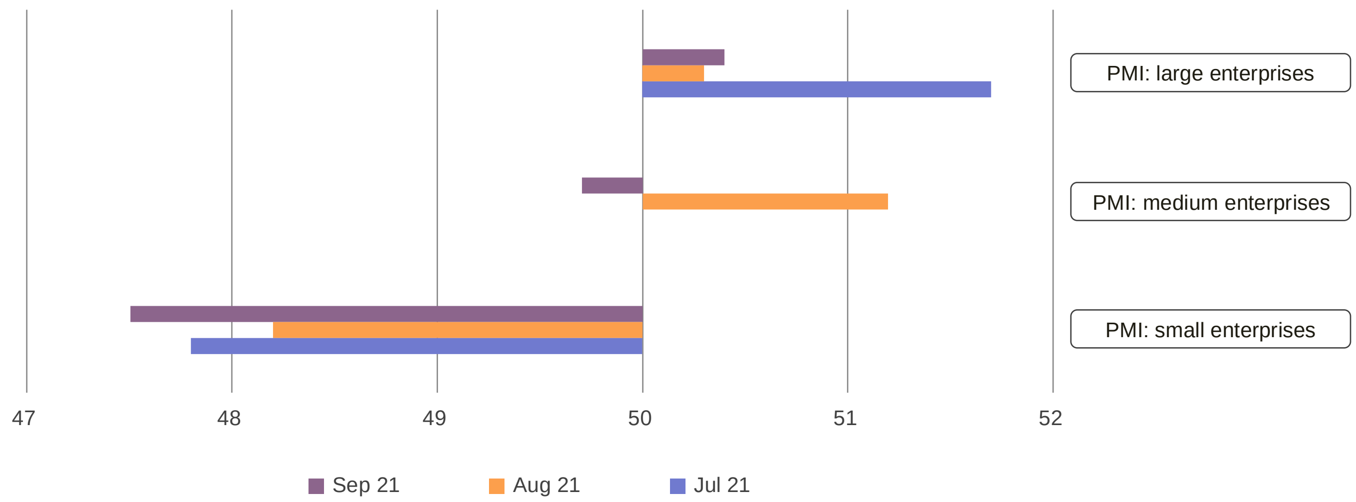
The PMI of 'large enterprises' stayed above the watershed mark of 50 throughout July to September, registering 51.7, 50.3 and 50.4 in July, August and September, respectively. The index readings show a continued expansion of 'large enterprises'. However, it remains to be seen whether large businesses could sustain their growth momentum in the coming months, amid the blow to industrial activity from the 'energy dual controls' and power shortages.

Small and medium enterprises experience contraction

After rising from 50.0 in July to 51.2 in August, the PMI of 'medium enterprises' dropped below the critical 50-mark to 49.7 in September. Meanwhile, the PMI of 'small enterprises' hovered around 48.0 throughout the three-month period. The index readings indicate that small and medium enterprises have been facing difficulties in production and operations lately. (See exhibit 5)

Large enterprises have continued to fare better than small and medium enterprises, but it remains to be seen whether large businesses could sustain their growth momentum in the coming months, amid the blow to industrial activity from the 'energy dual controls' and power shortages.

Exhibit 5: PMIs of large enterprises, medium enterprises and small enterprises, July to September 2021



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

3. What the PMI tells us about manufacturing production

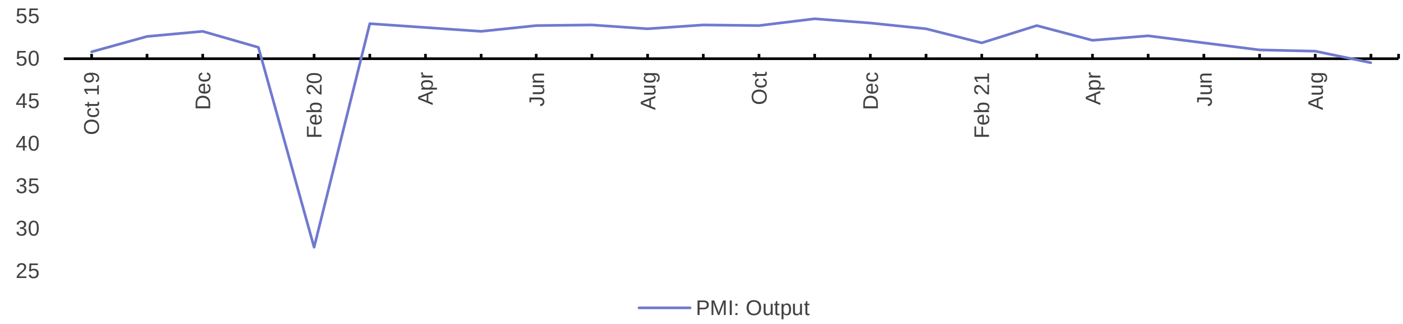
Manufacturing production contracts for first time since February last year

The output index edged down from 51.0 in July to 50.9 in August, and then fell to 49.5 in September. The latest index reading dipped into the contractionary zone for the first time since February last year, and it also matches the second-lowest reading since January 2009, indicating an unusually weak manufacturing output lately. (See exhibit 6)

Reduction in new orders leads to contraction in manufacturing production

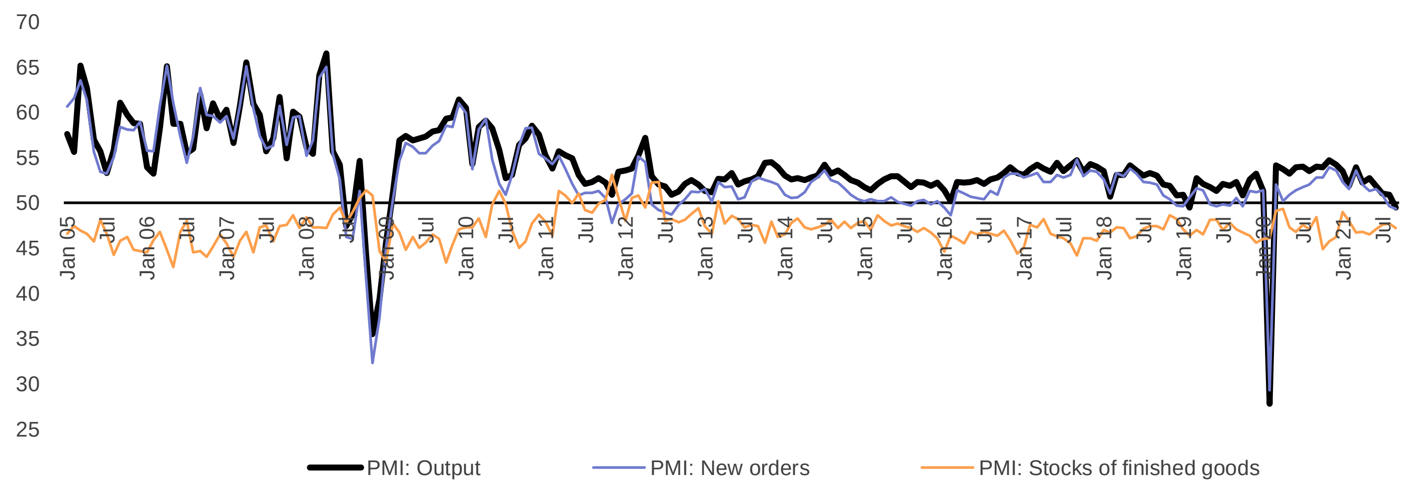
Exhibit 7 shows that the output decline in September was mainly caused by a reduction in new orders instead of destocking activities, as the stocks of finished goods index has remained stable and fluctuated within a narrow range of 47.1 to 47.7 since June.

Exhibit 6: Output index, October 2019 to September 2021



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

Exhibit 7: Output, new orders and stocks of finished goods, January 2005 to September 2021



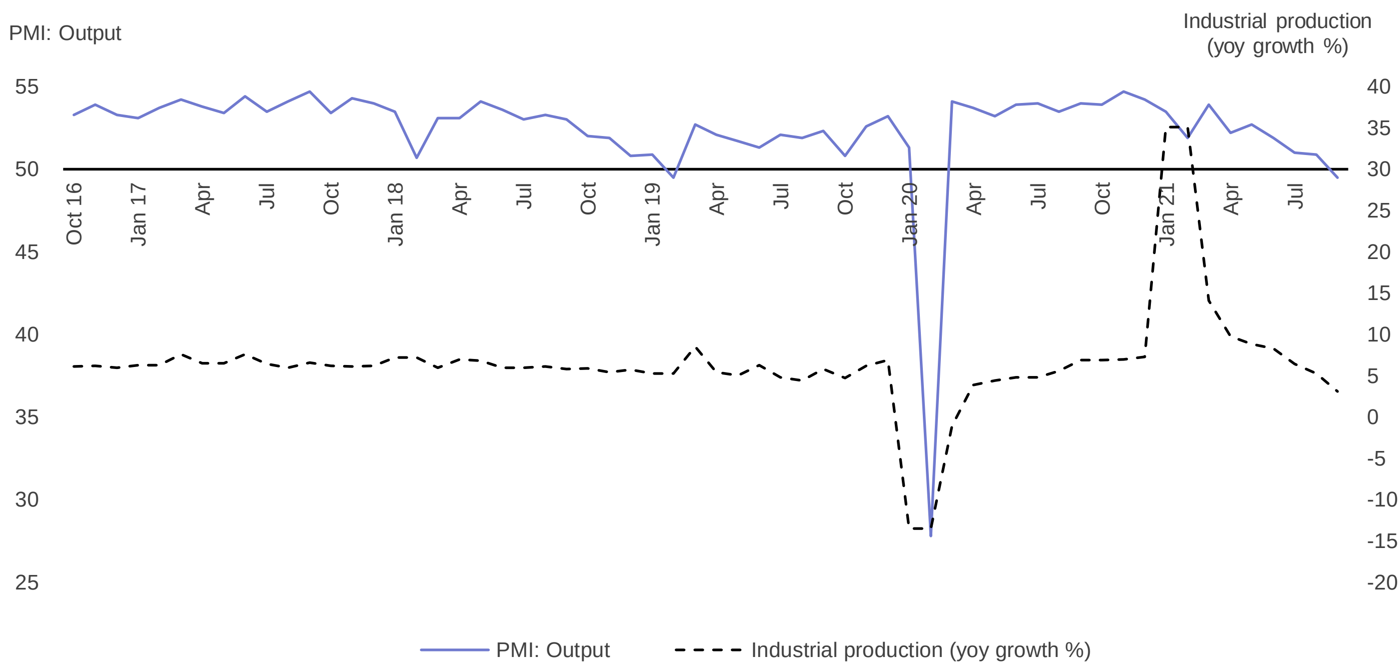
Source: China Federation of Logistics & Purchasing, China National Bureau of Statistics

Growth in manufacturing production to slow down in 4Q21

Exhibit 8 demonstrates the correlation (with some lags) between the output index and the year-on-year growth of value-added of industrial output (VAIO). Looking ahead, we expect that China's VAIO growth will moderate to 3.0% yoy in 4Q21, as the 'energy dual controls' and nationwide power shortages will continue to put a drag on China's industrial activities in the coming months. Other challenges facing Chinese manufacturers include ongoing trade frictions between China and the US, and intense competition in the international market.

We expect that the VAIO growth will moderate to 3.0% yoy in 4Q21, amid the 'energy dual controls' and nationwide power shortages.

Exhibit 8: Output index and industrial production growth, October 2016 to September 2021



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

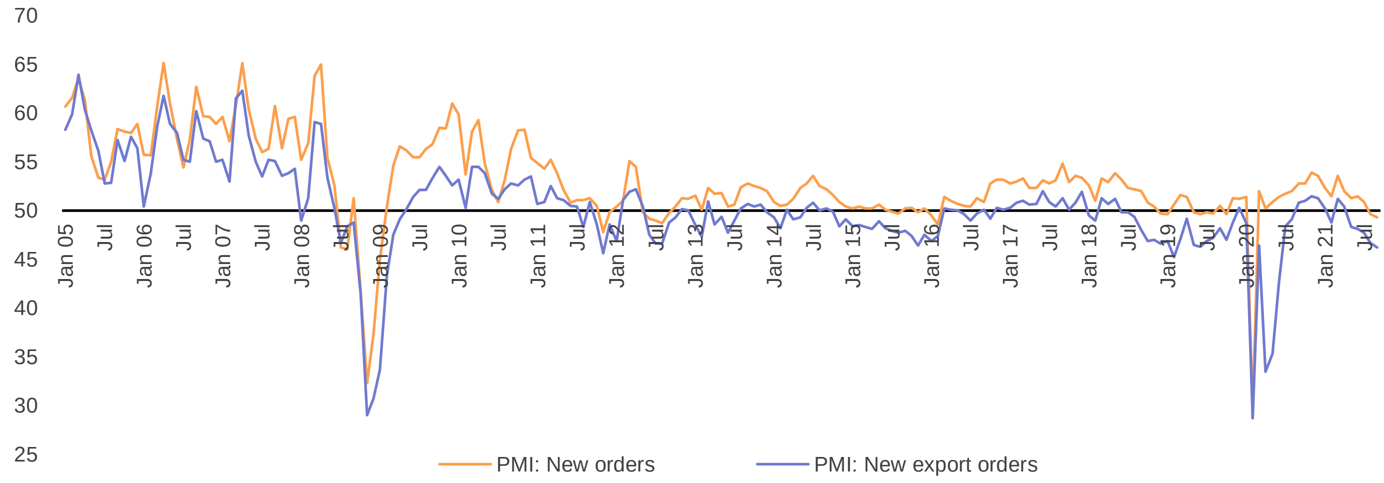
4. What the PMI tells us about the overall market demand

Overall market demand deteriorates

The new orders index fell from 50.9 in July to 49.6 in August and further to 49.3 in September, indicating a reduction in new orders and a deterioration in the overall demand lately.

Meanwhile, the new export orders dropped from 47.7 in July to 46.7 in August and went down further to a 15-month low of 46.2 in September, pointing to persistent downward pressure on China's exports. (See exhibit 9)

Exhibit 9: New orders index and new export orders index, January 2005 to September 2021



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

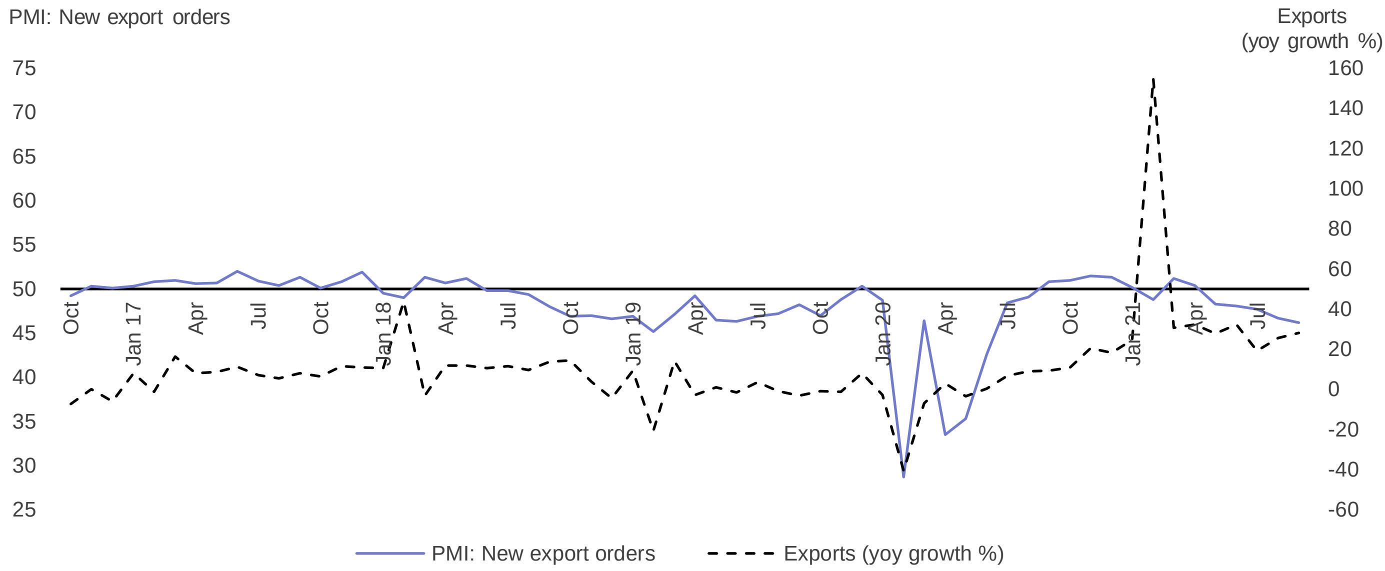
Sustained recovery in external demand continues to support China's export growth

Exhibit 10 plots the new export orders index against the year-on-year growth rates of China's exports. From exhibit 11 we can see that the new export orders index has been strongly correlated to the external economies, especially the developed economies. The OECD composite leading indicator[1] continued to pick up in 3Q21, suggesting a sustained recovery in external demand for China's exports. All in all, we forecast that China's exports will record high single-digit year-on-year growth in 4Q21.

With a continued improvement in external demand, we forecast that China's exports will record high single-digit year-on-year growth in 4Q21.

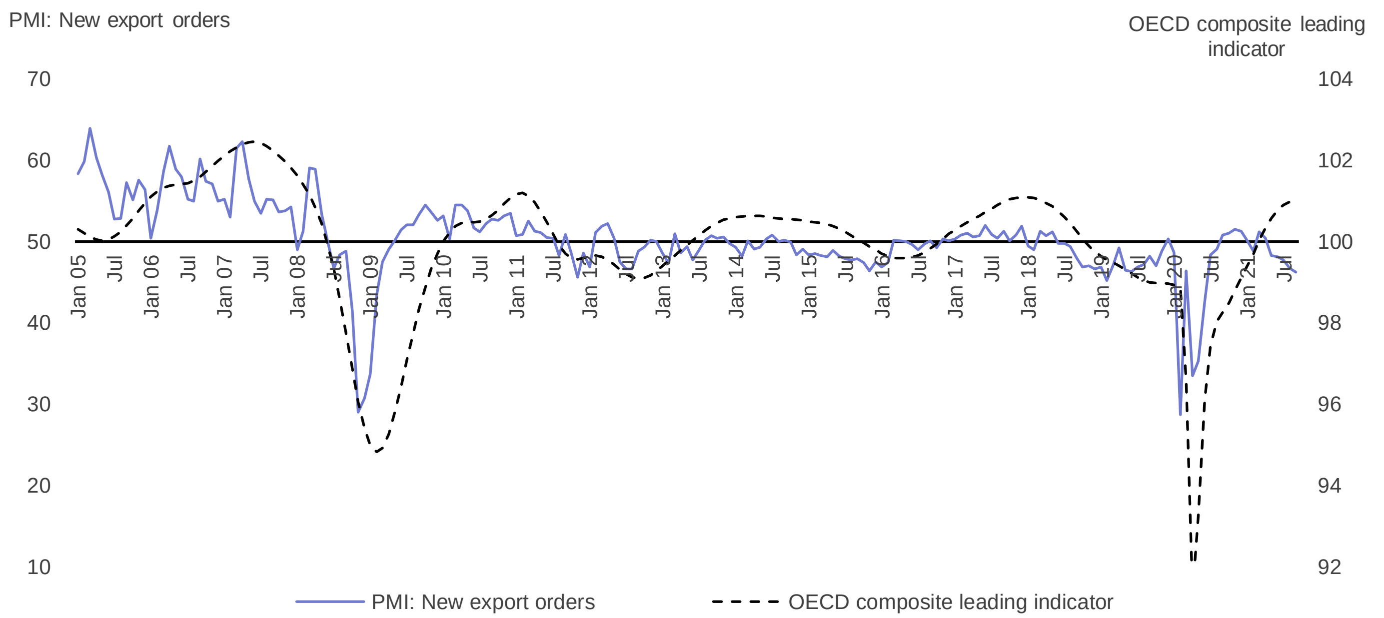
1 The OECD composite leading indicator, compiled by the Organization for Economic Cooperation and Development, is designed to provide early signals of turning points (peaks and troughs) between expansions and slowdowns of economic activity, and covers Australia, Austria, Belgium, Canada, Czech Republic, Denmark, Finland, France, Germany, Greece, Hungary, Ireland, Italy, Japan, Korea, Luxembourg, Mexico, Netherlands, New Zealand, Norway, Poland, Portugal, Slovak Republic, Spain, Sweden, Switzerland, Turkey, United Kingdom and United States.

Exhibit 10: New export orders index and export growth, October 2016 to September 2021



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

Exhibit 11: New export orders index and OECD composite leading indicator, January 2005 to September 2021



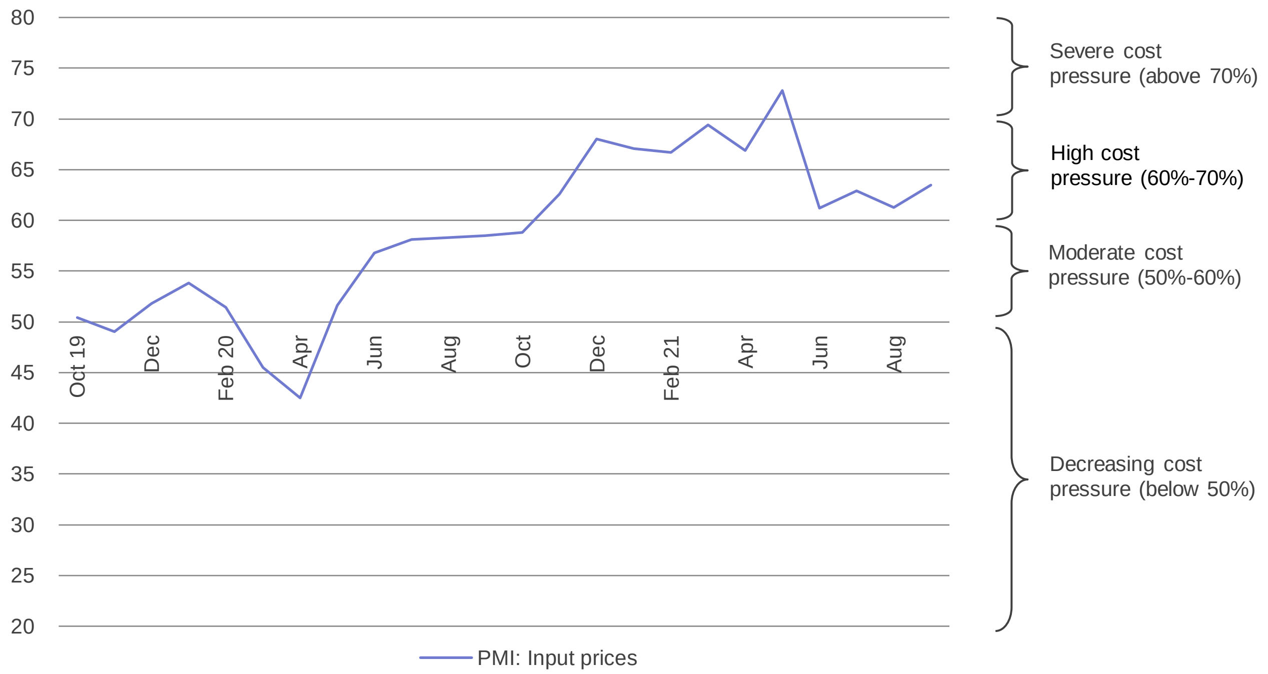
Source: China Federation of Logistics & Purchasing, China National Bureau of Statistics, Organization for Economic Cooperation and Development

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

Rising upstream prices exerts high cost pressure on manufacturers

After falling from 62.9 in July to 61.3 in August, the input prices index went up to 63.5 in September. The index readings were well above the critical 50-mark, indicating a rapid increase in the prices of production inputs lately, which would raise the cost pressure on manufacturers. (Exhibit 12)

Exhibit 12: Input prices index, October 2019 to September 2021



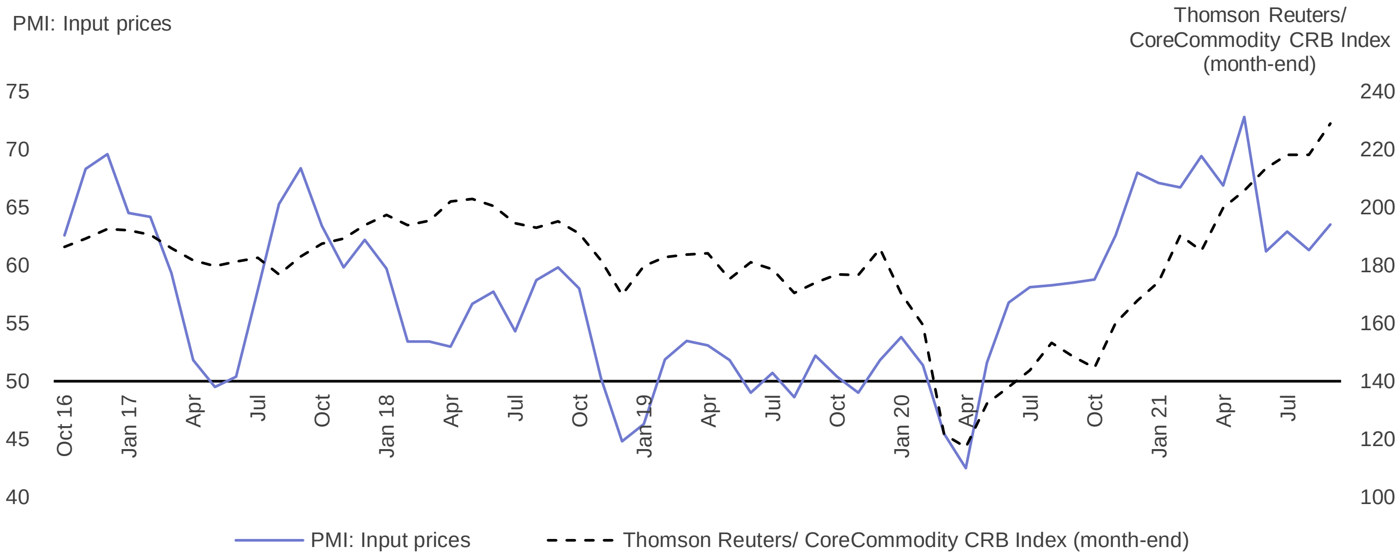
Source: China Federation of Logistics & Purchasing, China National Bureau of Statistics

To see the extent to which input costs of Chinese manufacturers are affected by global commodity prices, exhibit 13 puts together the input prices index and the Thomson Reuters/ CoreCommodity CRB index.[2]

The increasing input costs facing Chinese manufacturers are attributable to the surge in global commodity prices: The CRB index is now at a seven-year high, driven by escalations in prices of commodities ranging from crude oil to steel, to cotton, and to live cattle, etc.

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 13: Input prices index and Thomson Reuters/ CoreCommodity CRB Index, October 2016 to September 2021

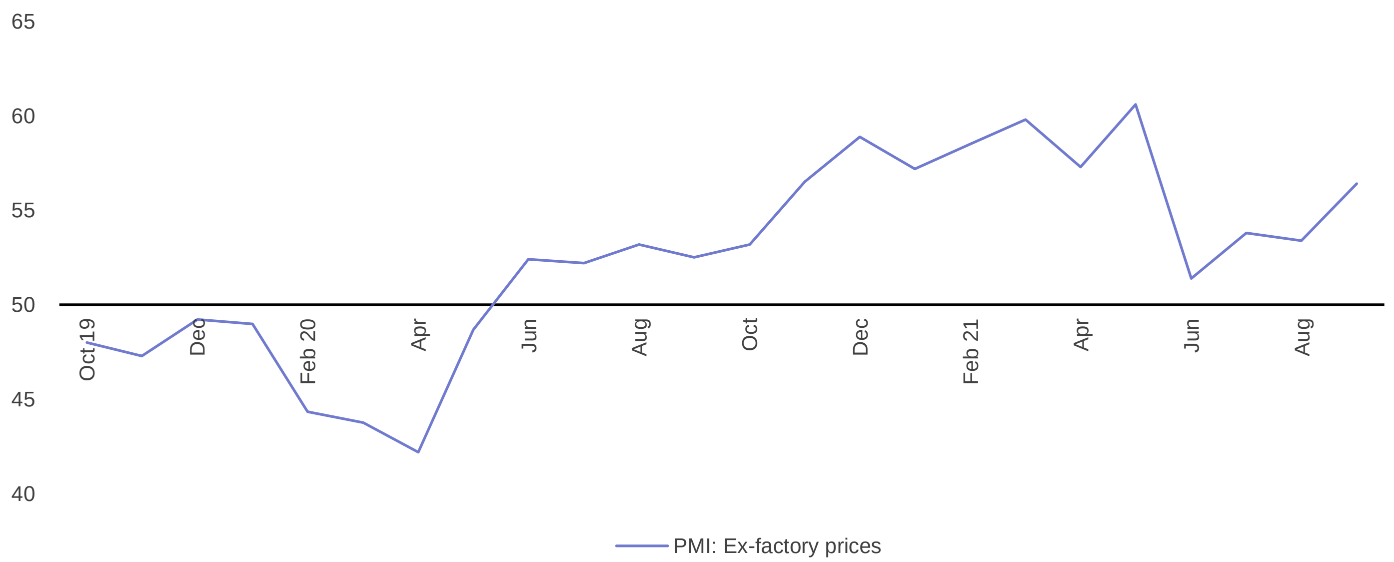


Source: China Federation of Logistics & Purchasing, China National Bureau of Statistics, Thomson Reuters

Manufacturers raise ex-factory prices of their products

After dropping from 53.8 in July to 53.4 in August, the ex-factory prices index climbed to 56.4 in September. The index readings indicate that Chinese manufacturers have continued to raise the ex-factory prices of their finished products lately amid rising cost pressure.[3] (Exhibit 14)

Exhibit 14: Ex-factory prices index, October 2019 to September 2021



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

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

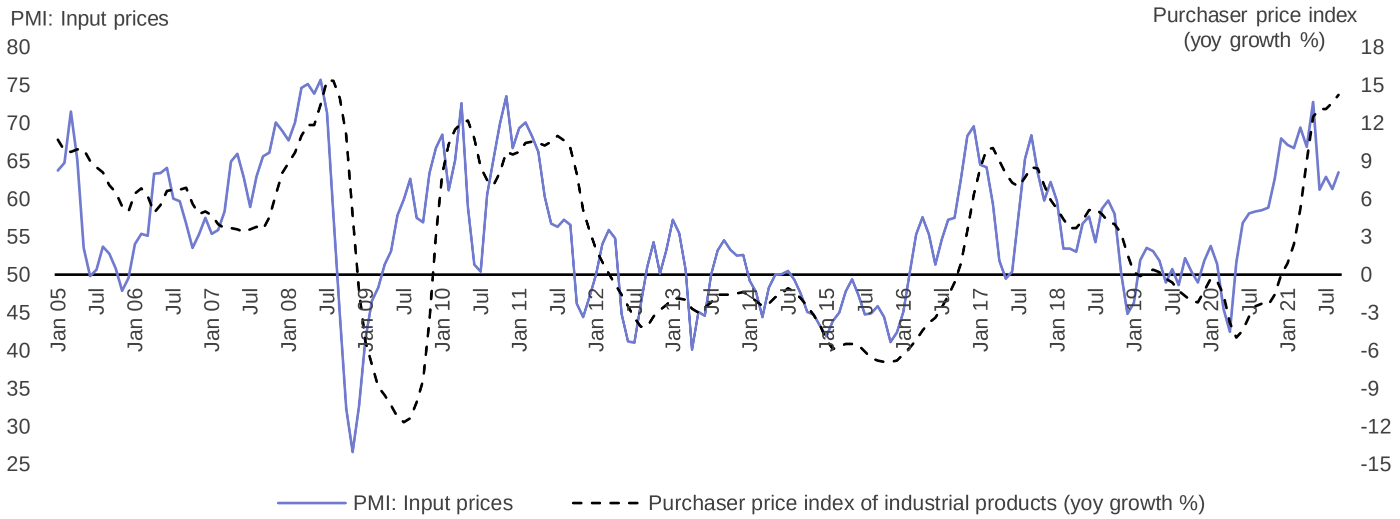
Input prices and ex-factory prices to stay high in 4Q21

Exhibit 15 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 16.

Going forward, we expect both input prices and ex-factory prices to stay high in 4Q21 in view of escalations in global commodity prices. However, we do not expect an uptick in the year-on-year growth rates in the purchaser price index and the PPI due to a weakening industrial demand and a high base for comparison in 4Q20.

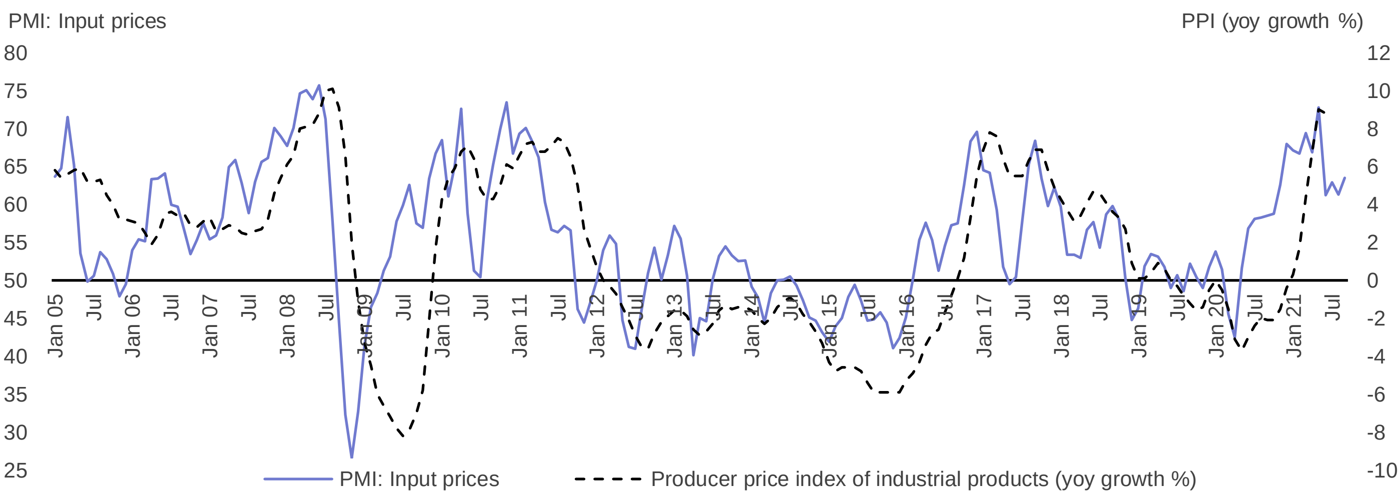
We do not expect an uptick in the year-on-year growth rates in the purchaser price index and the PPI in 4Q21 due to a weakening industrial demand and a high base for comparison in 4Q20.

Exhibit 15: Input prices index and purchaser price index of industrial products, January 2005 to September 2021



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

Exhibit 16: Input prices index and producer price index, January 2005 to September 2021



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

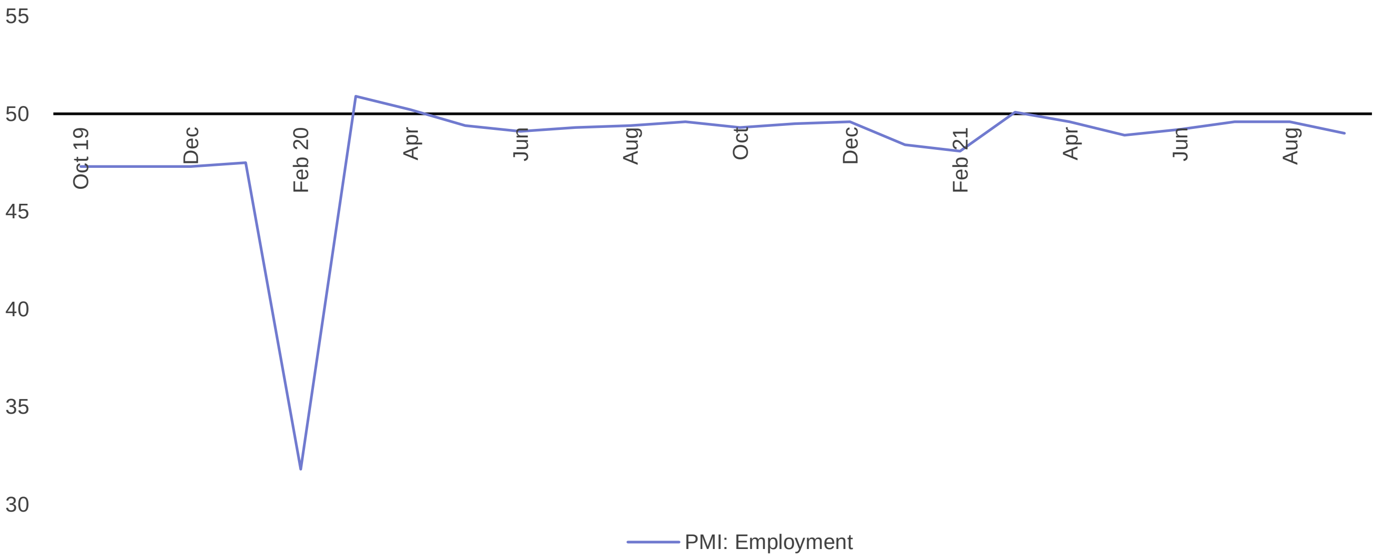
[4] The producer price index of industrial goods (PPI), compiled by China National Bureau of Statistics, measures the prices of industrial products when they are sold for the first time after production.

6. What the PMI tells us about manufacturing employment

Stabilization of employment index indicates steady employment situation in manufacturing sector

The employment index registered 49.6 in July and August, and 49.0 in September. The index has stabilized around 49.0 since June, indicating the steady employment situation in the manufacturing sector in the past few months. (Exhibit 17)

Exhibit 17: Employment index, October 2019 to September 2021



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

Exhibit 18 shows that the employment in China's manufacturing sector has relied heavily on the export sector. Exhibit 19 and 20 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 slower growth in the export sector and the overall economy, we expect that the employment situation in the manufacturing sector will deteriorate in 4Q21.

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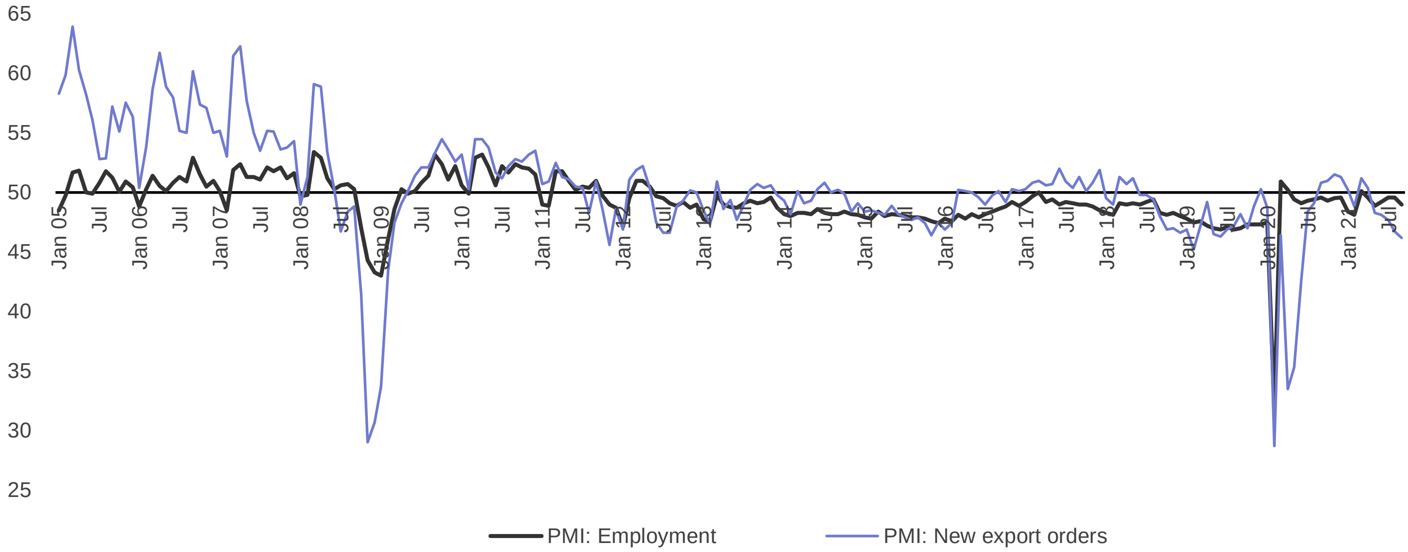
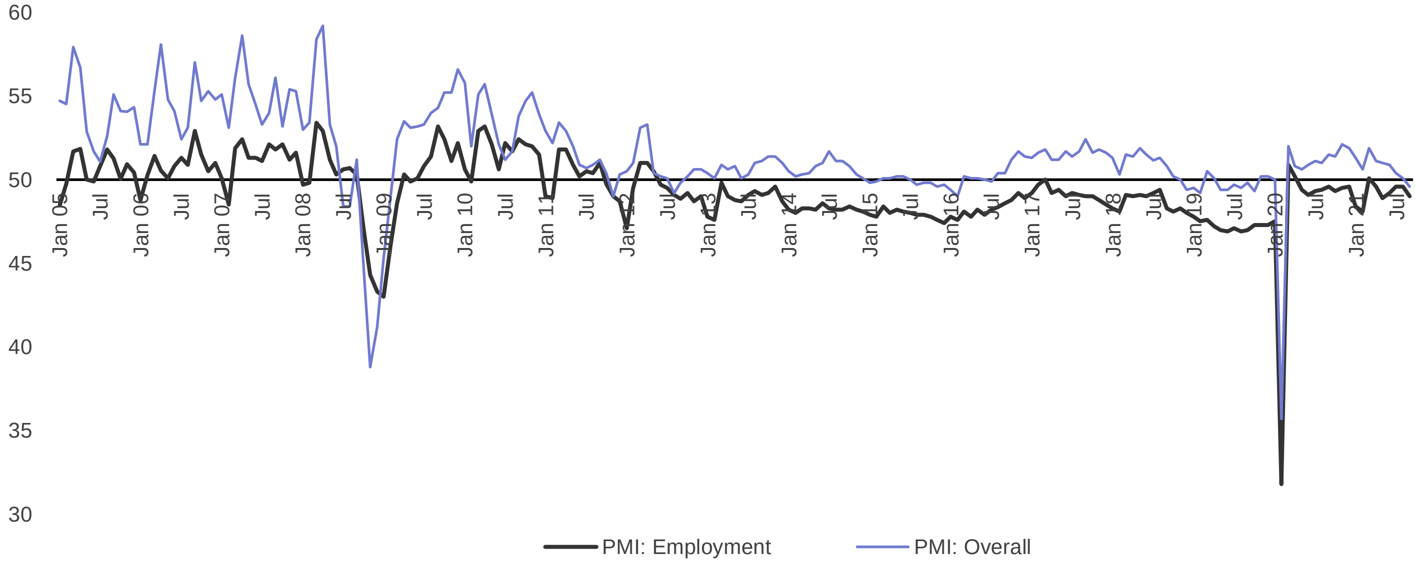
Exhibit 18: Employment and new export orders, January 2005 to September 2021



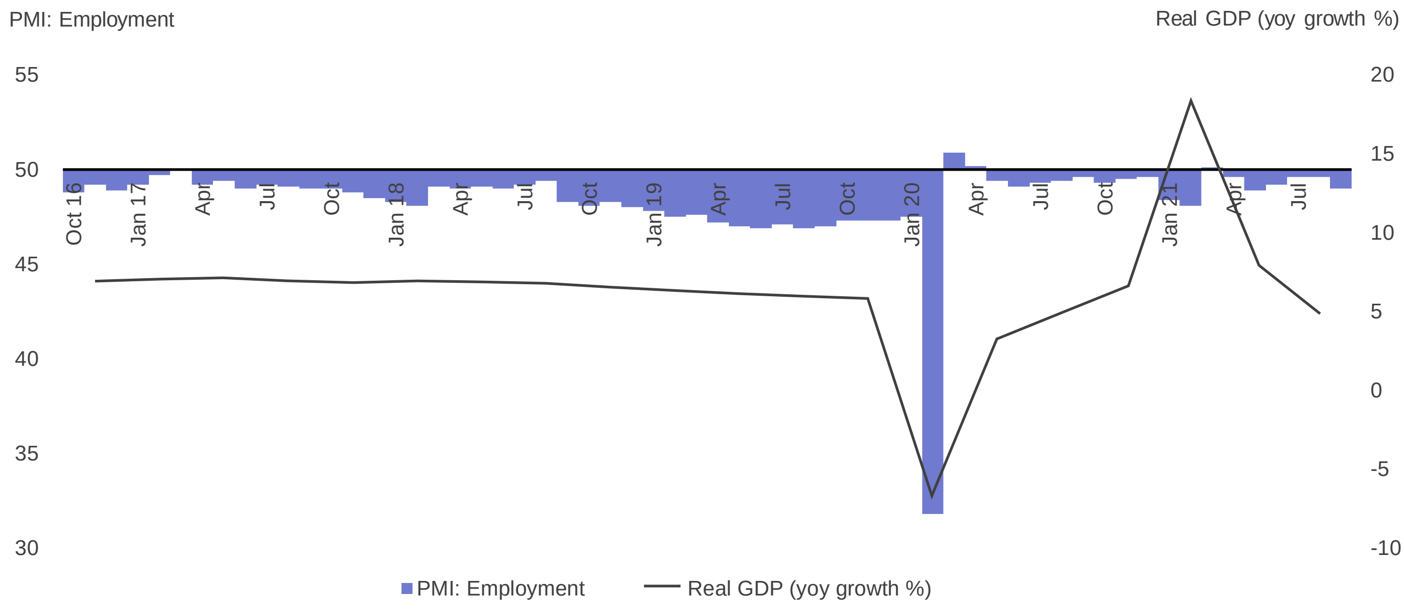
Source: China Federation of Logistics & Purchasing, China National Bureau of Statistics

Exhibit 19: Employment index and headline PMI, January 2005 to September 2021



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

Exhibit 20: Employment index and real GDP growth, October 2016 to September 2021



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 3,000 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.

3,000 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 Organisations:

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.