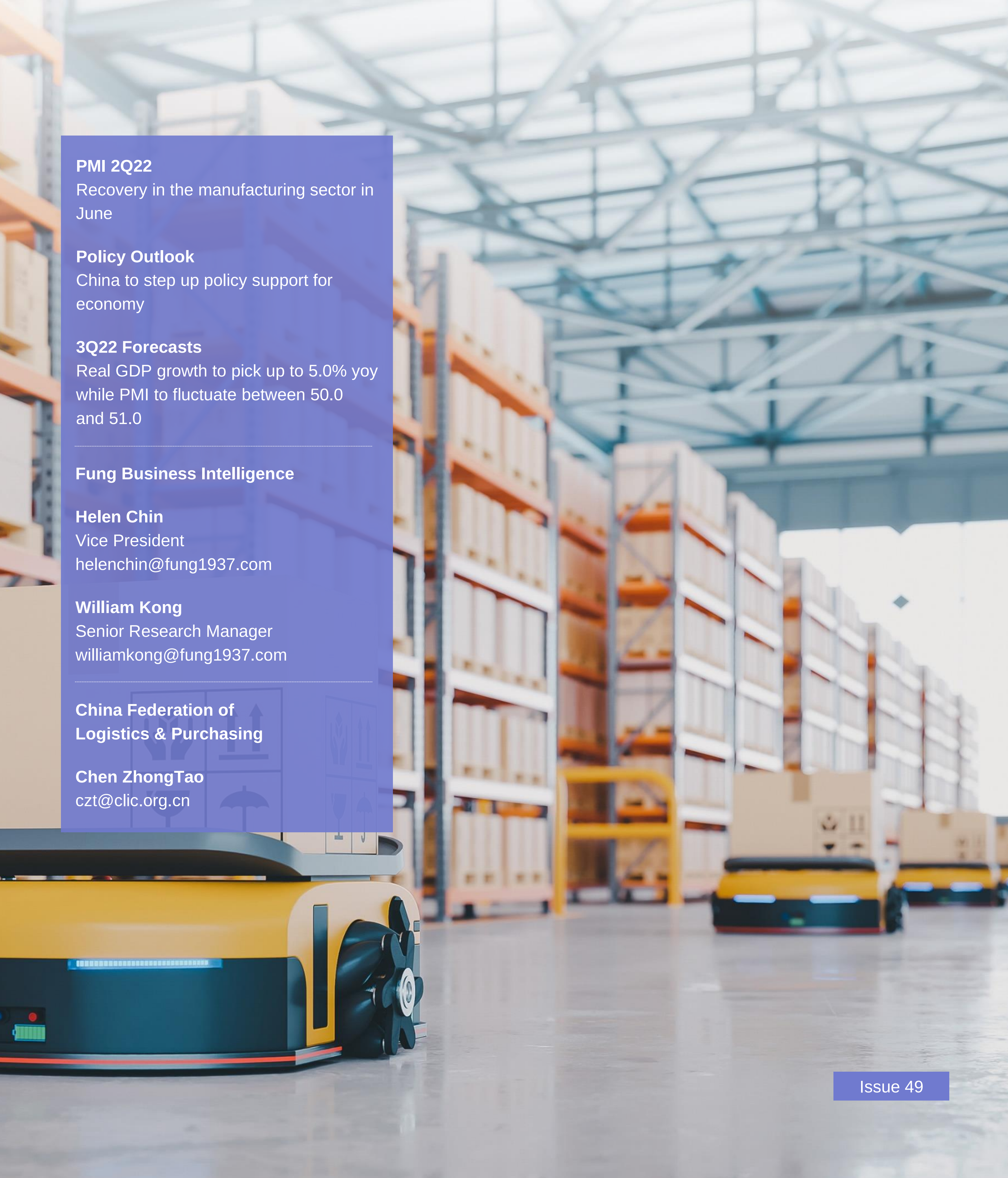
FUNG BUSINESS INTELLIGENCE CFLP July 2022

PMI Quarterly on China Manufacturing



PMI 2Q22
Recovery in the manufacturing sector in June

Policy Outlook
China to step up policy support for economy

3Q22 Forecasts
Real GDP growth to pick up to 5.0% yoy while PMI to fluctuate between 50.0 and 51.0

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Issue 49

PMI points to recovery in the manufacturing sector in June

Our observations

- Large and medium enterprises continue to fare better than small enterprises.
- Manufacturing production returns to expansion in June.
- Overall market demand improves in June.
- Manufacturers lower ex-factory prices of their products.
- Manufacturing employment starts to stabilize.

Policy outlook

- The Chinese government will actively step up policy support for the economy.
- We expect faster implementation of previously formulated policies, further tax and fee cuts, and utilization of various monetary tools.

Our forecasts for 3Q22

- We project a further recovery manufacturing production and economic activity in 3Q22.
- Headline PMI will fluctuate between 50.0 and 51.0.
- Real GDP growth will pick up to 5.0% yoy.
- VAIO growth will rise to 5.5% yoy.
- Exports will register single-digit year-on-year growth.
- Year-on-year growth rates for the purchaser price index and the PPI will fall in 3Q22 due to a recent retreat in global commodity prices and a high comparison base in 3Q21.

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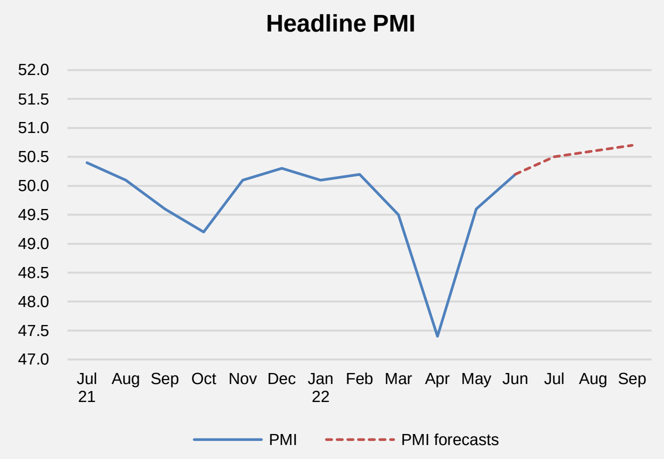
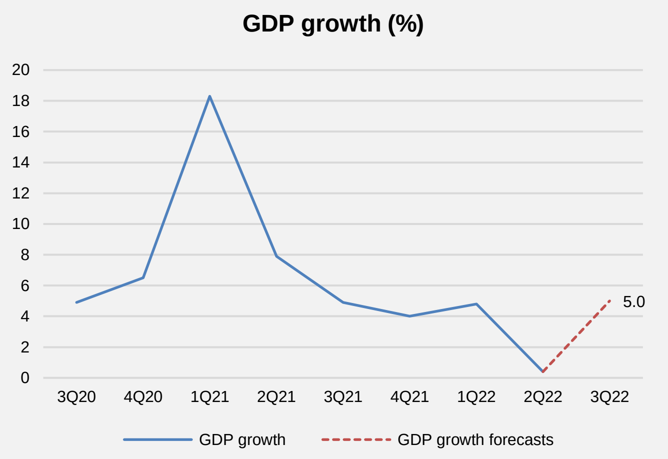




IN THIS ISSUE:

1. PMI points to recovery in the manufacturing sector in June

We project that China's real GDP growth will recover to 5.0% yoy in 3Q22 due to a further recovery in manufacturing production and consumer spending amid the easing of the COVID-19 outbreak and gradual lifting of mobility restrictions.

China's manufacturing sector in 2Q22

China's manufacturing PMI rebounded from 47.4 in April to 49.6 in May and 50.2 in June. The headline PMI readings have returned to the expansionary territory lately, indicating a recovery in China's manufacturing sector from the earlier disruption caused by the resurgence of COVID-19 infections in various provinces and major cities in March and April. (See exhibit 1)

Manufacturing output has resumed its expansion, as the output index rose above the critical 50-mark in June. The growth in manufacturing output was partly attributed to an increase in new orders: The new orders index returned to the expansionary territory in June, indicating an improvement in the overall market demand lately.

Prices of industrial products have dropped lately: The ex-factory prices index has remained below the neutral level of 50 since May. Meanwhile, the prices of materials have continued to rise, albeit at a slower pace: The input prices index went down from 64.2 in April to 52.0 in June, still above the critical 50-mark.

Exhibit 2 shows the contributions of the sub-indices to the change in the headline PMI. The increase in the headline PMI in 2Q22 was due largely to the rise 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 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 major inputs, imports, 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 actively 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 29 April. The meeting pledged to strengthen macroeconomic policy adjustment to provide strong support for a stable economic performance and to keep major economic indicators within an appropriate range. The meeting called for faster implementation of policies that have already been formulated, noting that tax and fee cuts should be further implemented and various monetary tools should be well utilized. Moreover, all-out efforts should be made to expand domestic demand, give full play to effective investment, speed up infrastructure construction and promote consumption.

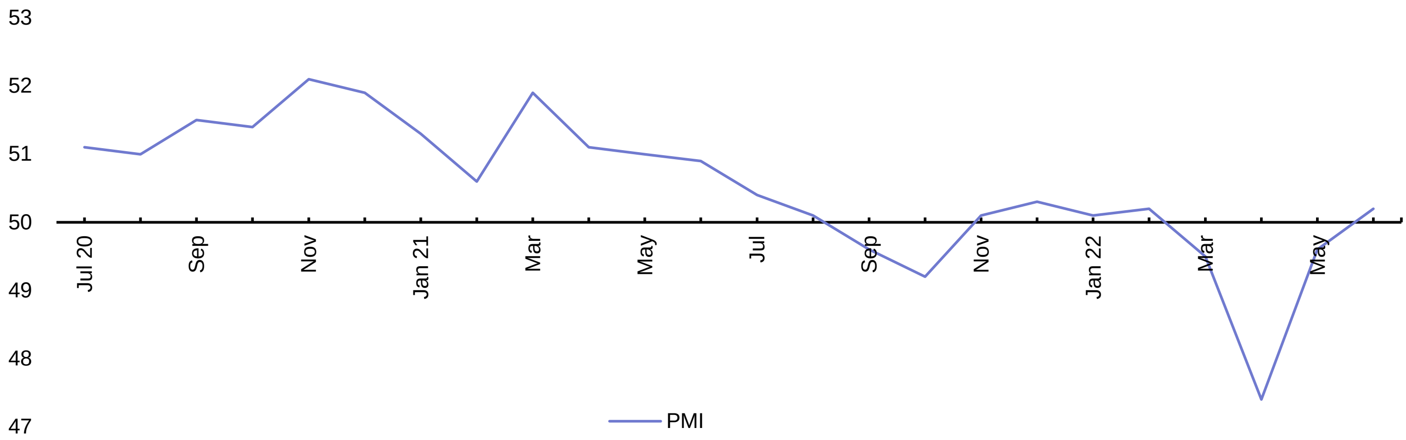
These wordings could mean a relatively expansionary and loose macro policy in the second half of the year, which will help alleviate the downward pressure on the Chinese economy, in our view.

Forecasts for 3Q22

The growth in China's industrial production is set to recover further in the near term, amid the easing of the COVID-19 outbreak and an increase in infrastructure investment. Overall, we predict that the industrial production (VAIO) growth will rise to 5.5% yoy in 3Q22, and the headline PMI will fluctuate between 50.0 and 51.0.

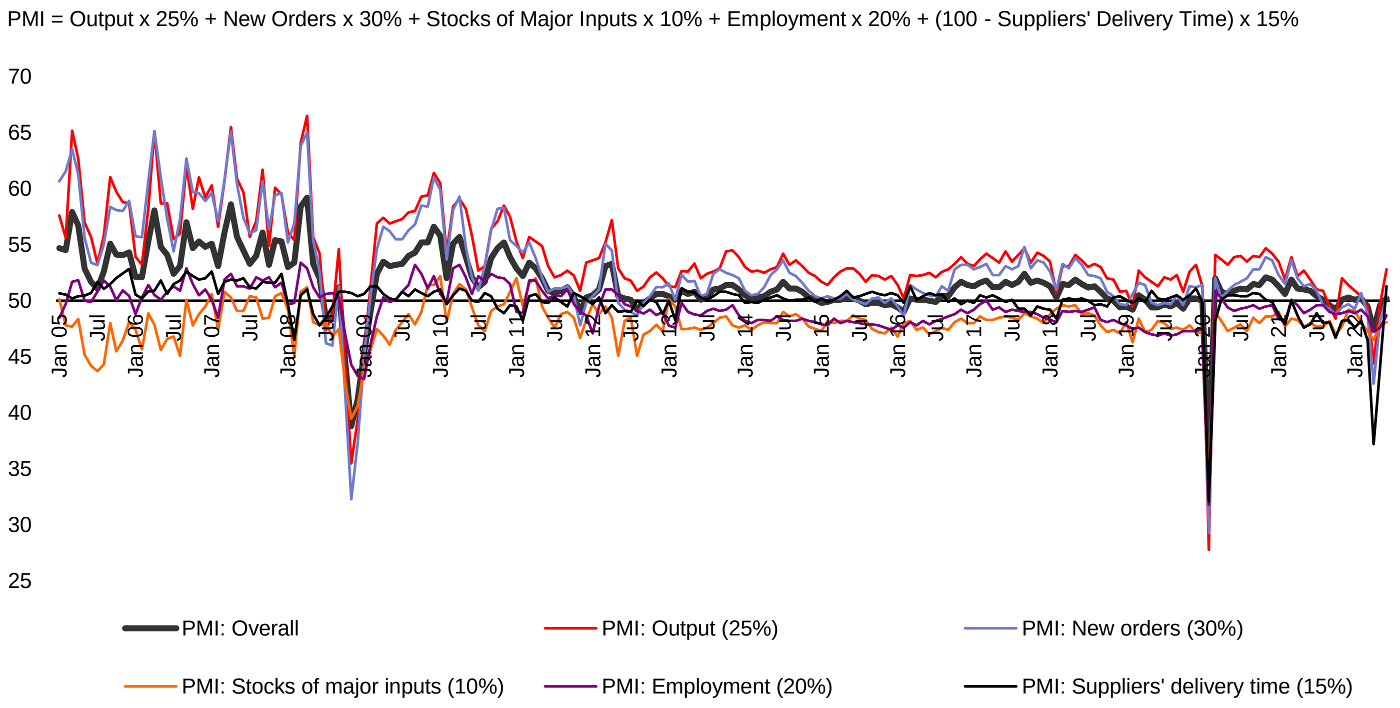
Exhibit 4 plots the quarterly real GDP growth rates versus the monthly PMIs since July 2017. We project that China's real GDP growth will go up to 5.0% yoy in 3Q22 due to a further recovery in manufacturing production and consumer spending amid the easing of the COVID-19 outbreak and gradual lifting of mobility restrictions.

Exhibit 1: Headline PMI, July 2020 to June 2022



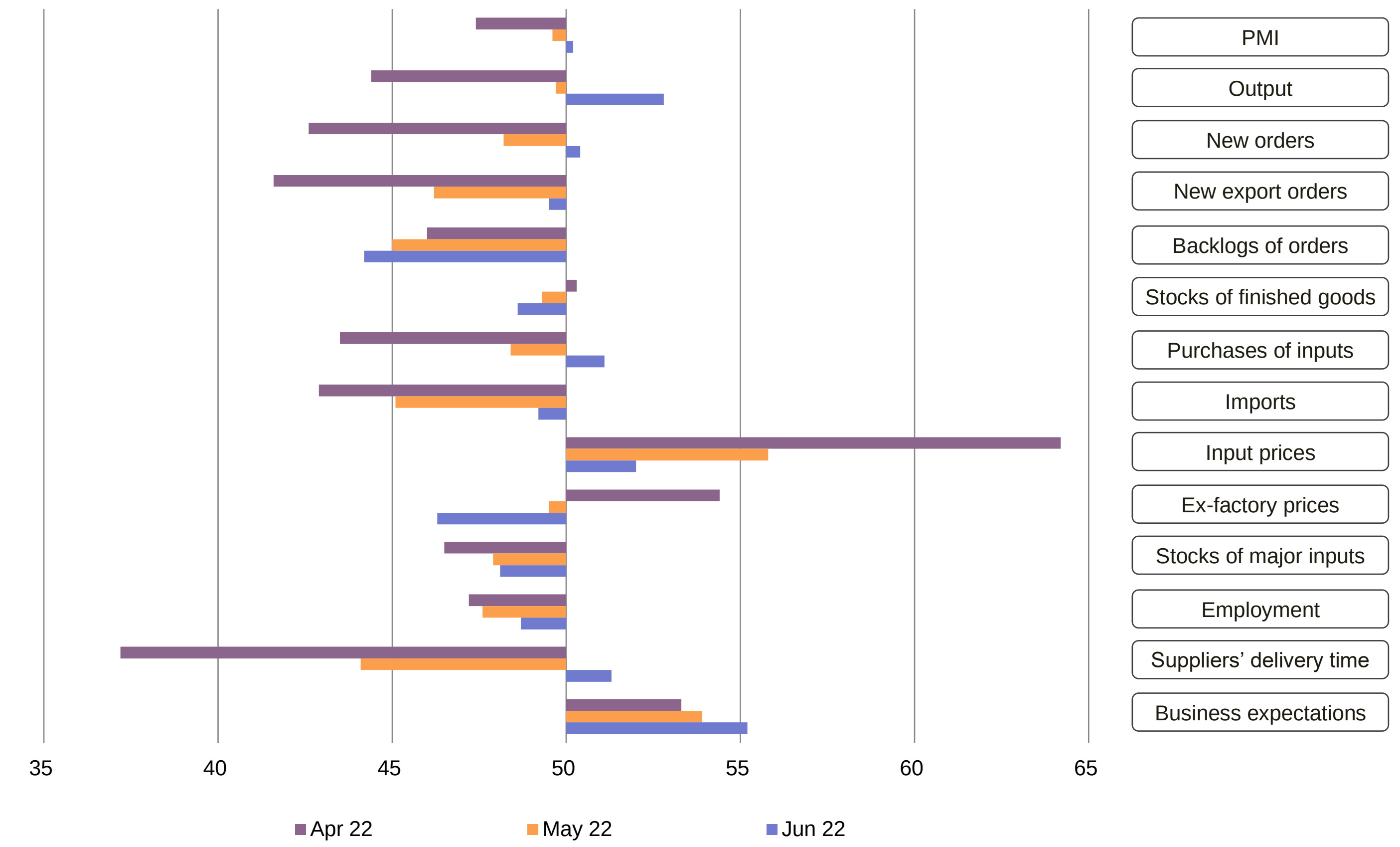
Source: China Federation of Logistics & Purchasing, China National Bureau of Statistics

Exhibit 2: Headline PMI and sub-indices, January 2005 to June 2022



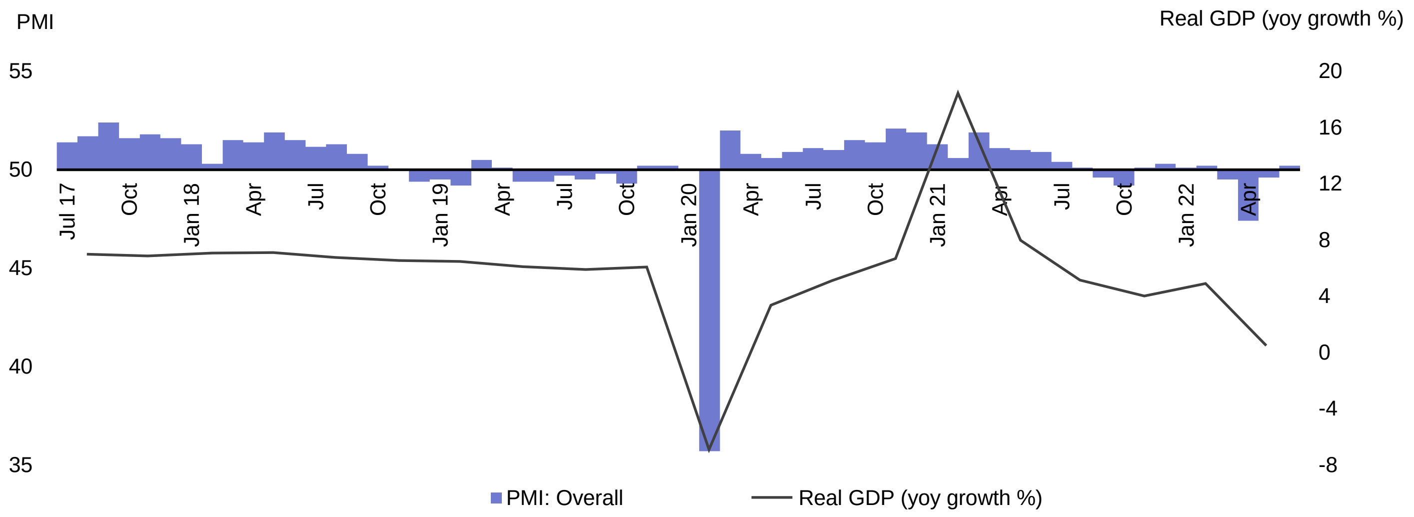
Source: China Federation of Logistics & Purchasing, China National Bureau of Statistics

Exhibit 3: Headline PMI and all sub-indices, April to June 2022



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

Exhibit 4: Headline PMI and real GDP growth, July 2017 to June 2022



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 and medium enterprises return to expansion lately

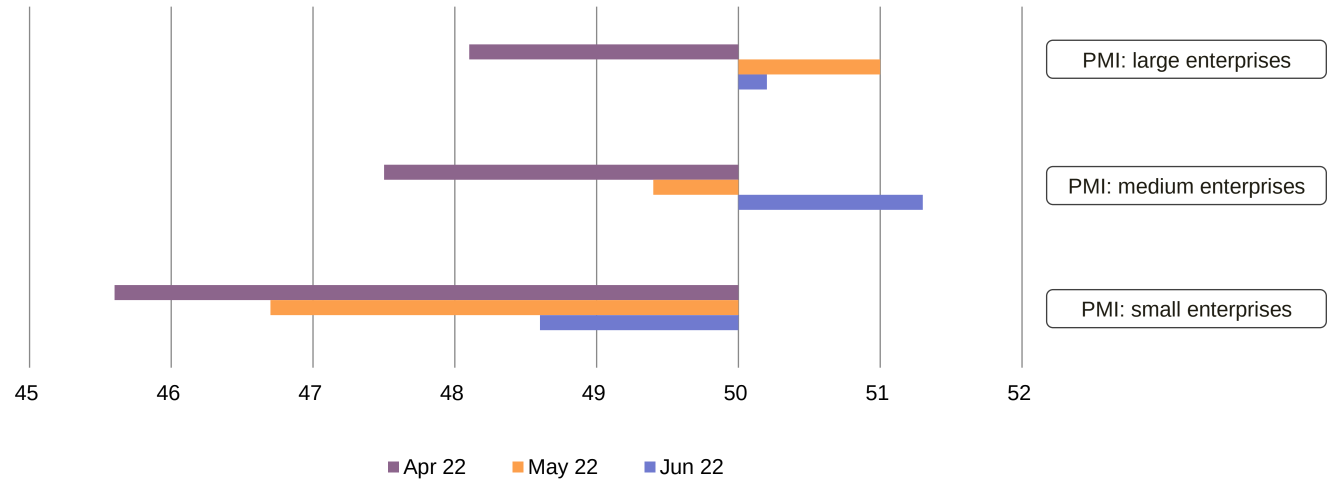
After rebounding from 48.1 in April to 51.0 in May, the PMI of 'large enterprises' retreated to 50.2 in June, still staying above the watershed mark of 50. Meanwhile, the PMI of 'medium enterprises' picked up from 47.5 in April to 49.4 in May and 51.3 in June. These index readings indicate that both large and medium enterprises have recovered from the production disruptions brought about by COVID-19 outbreaks in various provinces and cities in March and April.

The recovery of small enterprises has lagged behind that of large and medium enterprises, a trend that started in the second half of 2020.

Small enterprises continue to contract

The PMI of 'small enterprises' went up from 45.6 in April to 46.7 in May and 48.6 in June, staying below 50 throughout the quarter. The index readings indicate that the recovery of small enterprises has lagged behind that of large and medium enterprises. (See exhibit 5)

Exhibit 5: PMIs of large enterprises, medium enterprises and small enterprises, April to June 2022



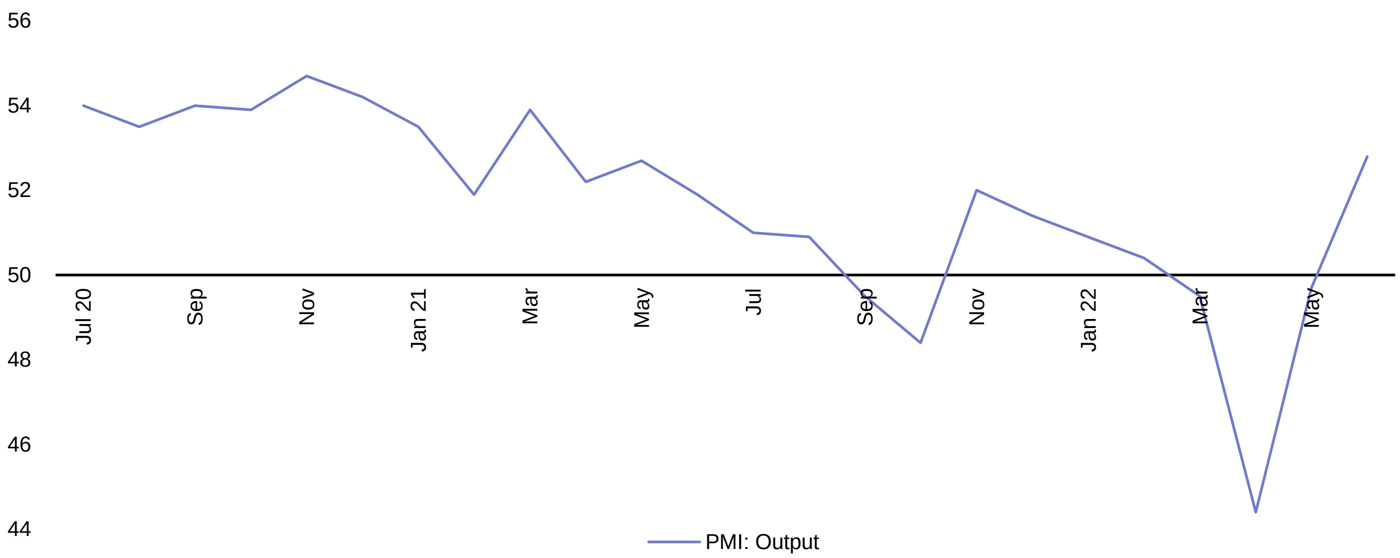
Source: China Federation of Logistics & Purchasing, China National Bureau of Statistics

3. What the PMI tells us about manufacturing production

Manufacturing output returns to expansion in June

Amid COVID-19 resurgence, the output index plunged to a two-year low of 44.4 in April, indicating a contraction in manufacturing output. Then, the output index rebounded to 49.7 in May and further to 52.8 in June, returning to the expansionary territory as the COVID-19 outbreak was brought under control. (See exhibit 6)

Exhibit 6: Output index, July 2020 to June 2022



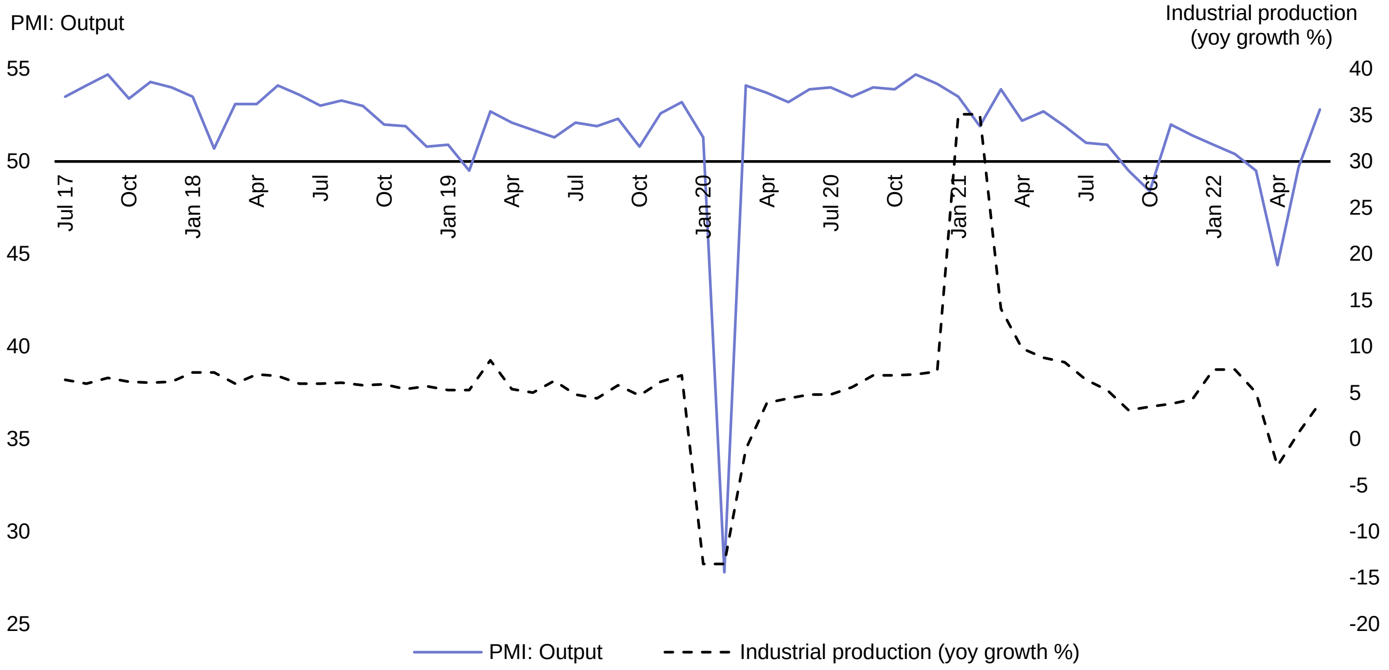
Source: China Federation of Logistics & Purchasing, China National Bureau of Statistics

Growth in manufacturing production to rebound in 3Q22

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). Looking ahead, China's industrial production is set to further recover in the near term, boosted by the easing of the COVID-19 outbreak and an increase in infrastructure investment. We expect that China's VAIO growth will rise to 5.5% yoy in 3Q22. Challenges facing Chinese manufacturers include the global economic downturn caused by the Russia–Ukraine conflict, 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 the VAIO growth to rise to 5.5% yoy in 3Q22, boosted by the easing of the COVID-19 outbreak and the government's efforts to increase infrastructure investment.

Exhibit 7: Output index and industrial production growth, July 2017 to June 2022



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

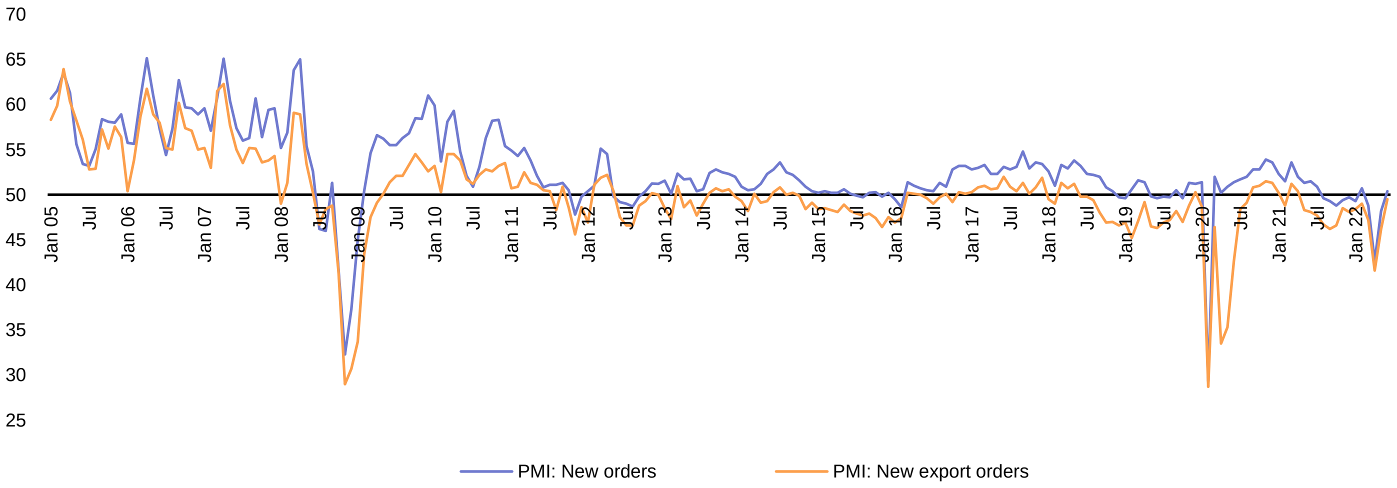
4. What the PMI tells us about the overall market demand

Overall market demand improves in June

The new orders index rebounded from a two-year low of 42.6 in April to 48.2 in May and further to 50.4 in June. The latest index readings indicate a recent improvement in new orders after the overall demand contracted in April and May.

Meanwhile, the new export orders picked up from a two-year low of 41.6 in April to 46.2 in May and 49.5 in June, still below the critical 50-mark, pointing to persistent downward pressure on China's exports. (See exhibit 8)

Exhibit 8: New orders index and new export orders index, January 2005 to June 2022



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

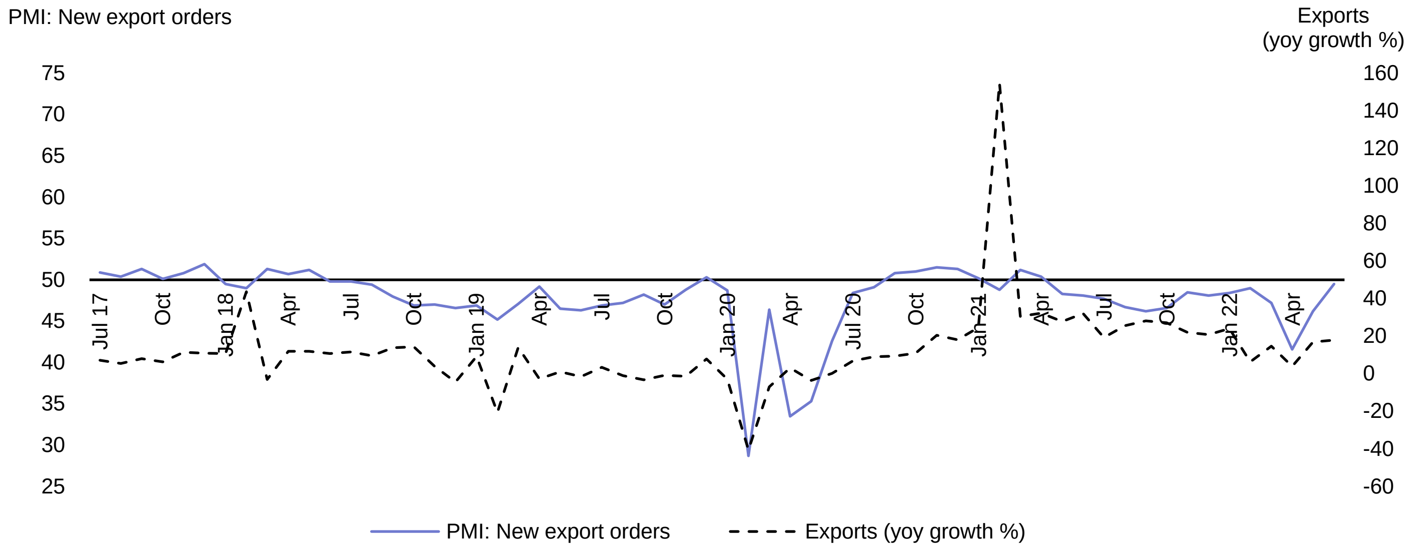
China's export growth to slow amid slowdown in global economy

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, especially the developed economies. The OECD composite leading indicator[1] has been on a downward trend since July last year, suggesting a moderation in the growth of the global economy. The Russia–Ukraine conflict and the energy and food crises it worsened are also likely to continue to drag down global growth in the short term. All in all, we forecast that China's exports will only register single-digit year-on-year growth in 3Q22.

With global growth slowing, we forecast that China's exports will only register single-digit year-on-year growth in 3Q22.

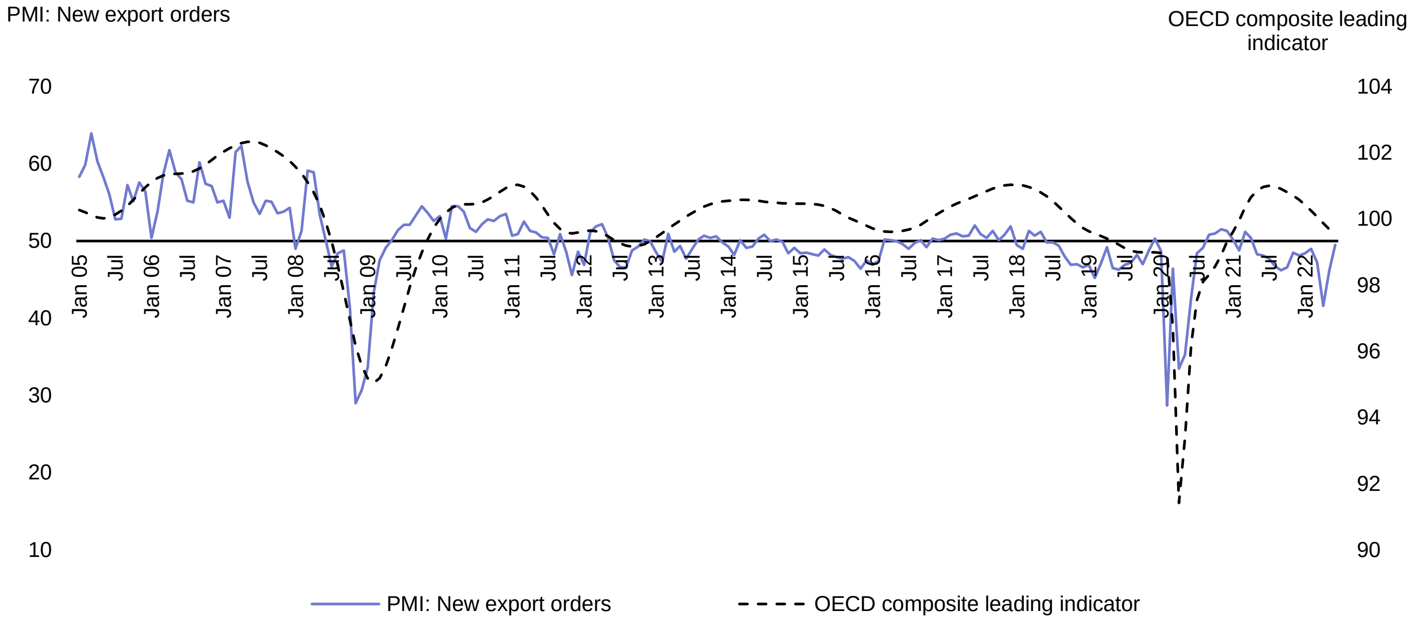
1 The OECD composite leading indicator, compiled by the Organization for Economic Cooperation and Development, is designed to provide early signals of turning points (peaks and troughs) between expansions and slowdowns of economic activity, and covers Australia, Austria, Belgium, Canada, Czech Republic, 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 9: New export orders index and export growth, July 2017 to June 2022



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

Exhibit 10: New export orders index and OECD composite leading indicator, January 2005 to June 2022



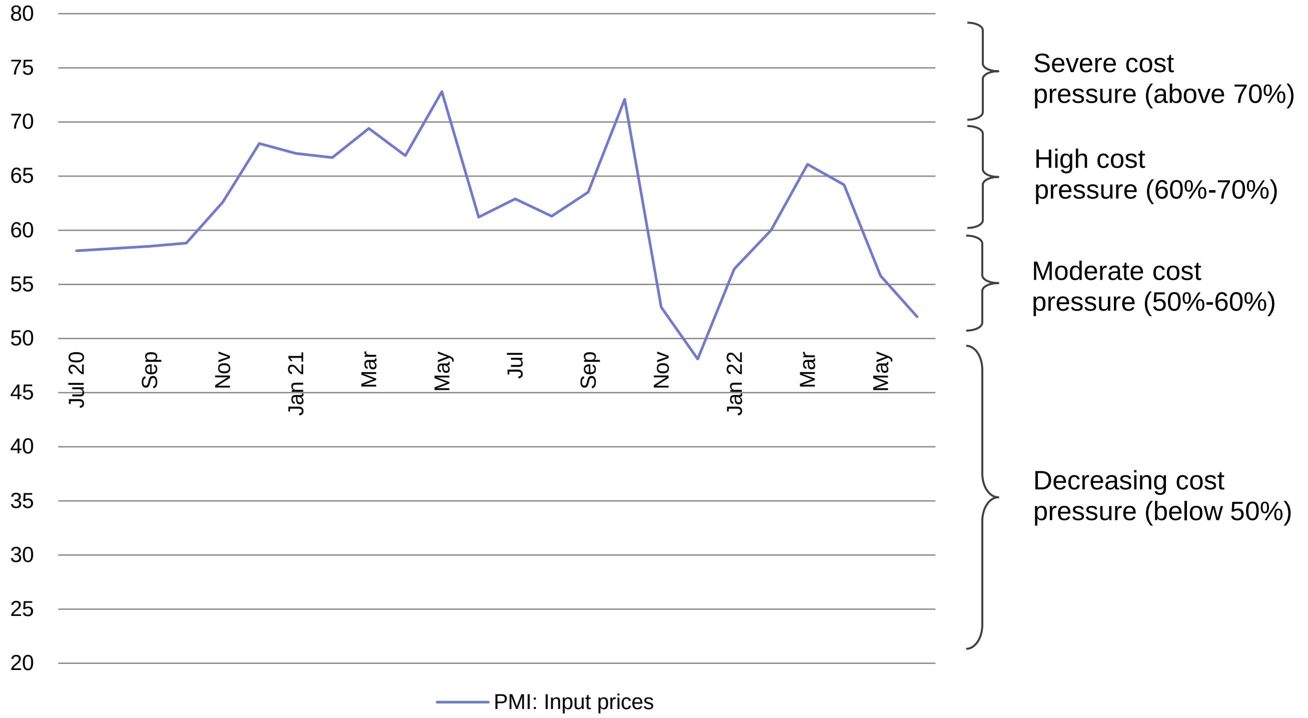
Source: China Federation of Logistics & Purchasing, China National Bureau of Statistics, Organization for Economic Cooperation and Development

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

Rising upstream prices exerts moderate cost pressure on manufacturers

The input prices index fell from 64.2 in April to 55.8 in May and 52.0 in June. The latest index reading remained above the critical 50-mark, indicating a persistent increase in the prices of production inputs lately, which continues to exert moderate cost pressure on manufacturers. (Exhibit 11)

Exhibit 11: Input prices index, July 2020 to June 2022



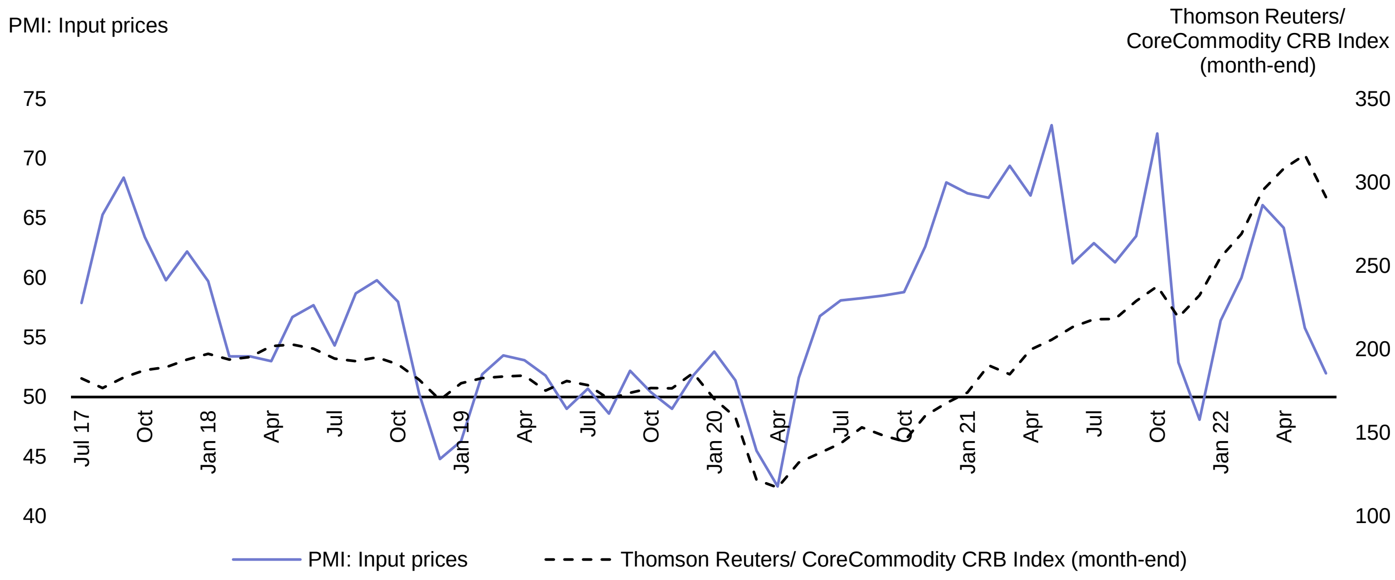
Source: China Federation of Logistics & Purchasing, China National Bureau of Statistics

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]

The increasing input costs facing Chinese manufacturers are attributable to high global commodity prices: The CRB index, despite a recent retreat, is still near a 10-year high, driven by high prices of commodities ranging from crude oil to copper, and to cotton, 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 12: Input prices index and Thomson Reuters/ CoreCommodity CRB Index, July 2017 to June 2022



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 went down from 54.4 in April to 49.5 in May and further to 46.3 in June. The index readings indicate that Chinese manufacturers have been lowering the ex-factory prices of their finished products lately.[3] (Exhibit 13)

Exhibit 13: Ex-factory prices index, July 2020 to June 2022

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

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

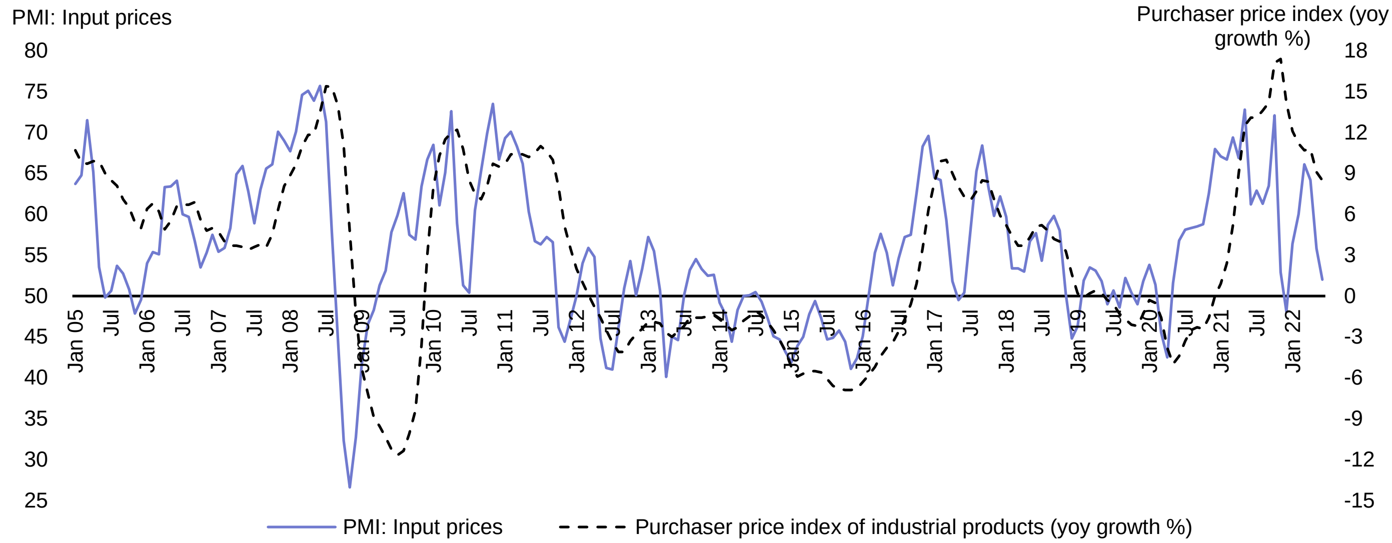
Growth in input prices and ex-factory prices to decline in 3Q22

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 fall in 3Q22, due to a recent retreat in global commodity prices and a high comparison base in 3Q21.

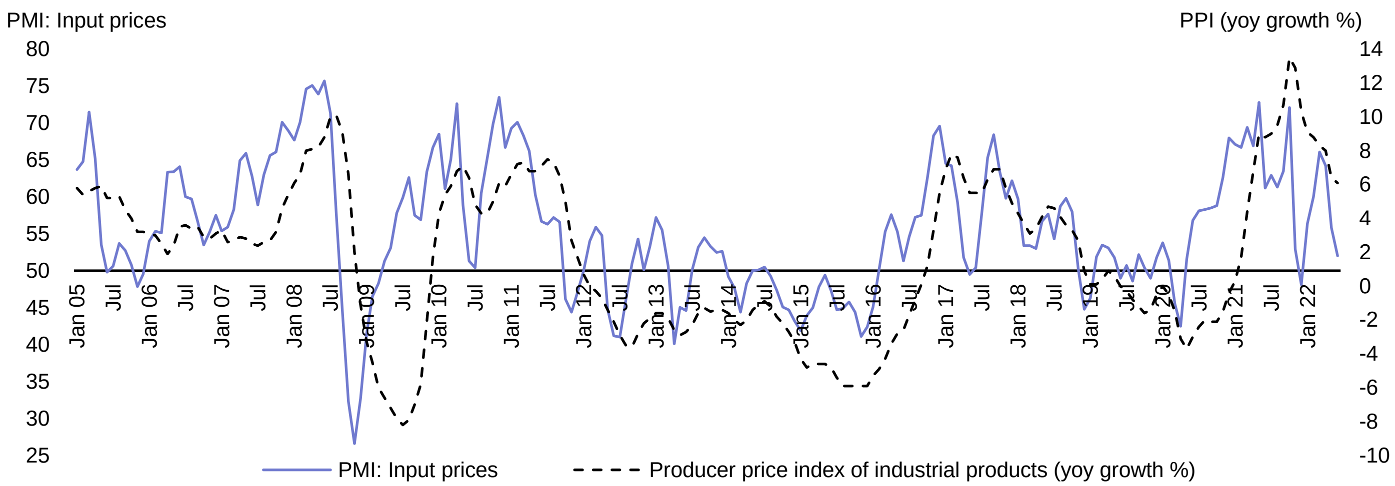
We expect that the year-on-year growth rates for both the purchaser price index and the PPI will fall in 3Q22, due to a recent retreat in global commodity prices and a high comparison base in 3Q21.

Exhibit 14: Input prices index and purchaser price index of industrial products, January 2005 to June 2022



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

Exhibit 15: Input prices index and producer price index, January 2005 to June 2022



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

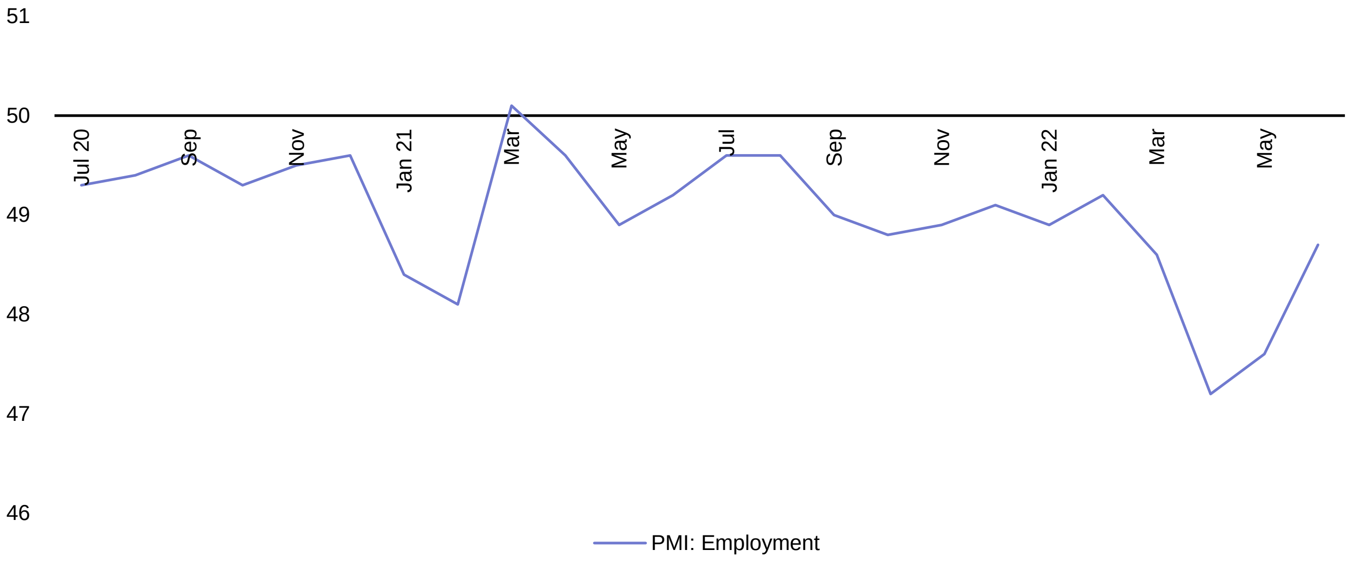
[4] The producer price index of industrial goods (PPI), compiled by China National Bureau of Statistics, measures the prices of industrial products when they are sold for the first time after production.

6. What the PMI tells us about manufacturing employment

Manufacturing employment starts to stabilize

The employment index picked up from 47.2 in April to 47.6 in May and 48.7 in June, indicating that employment situation in the manufacturing sector has started to stabilize lately. (Exhibit 16)

Exhibit 16: Employment index, July 2020 to June 2022



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 the export sector and the overall economy, we expect that the employment situation in the manufacturing sector will remain steady in 3Q22.

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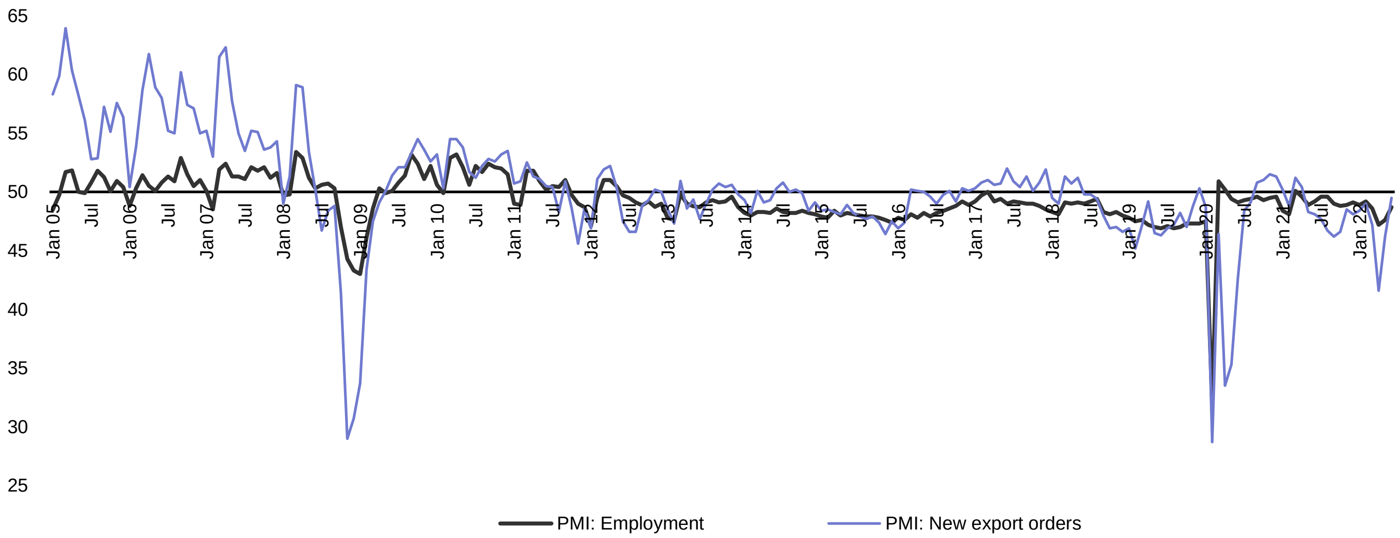
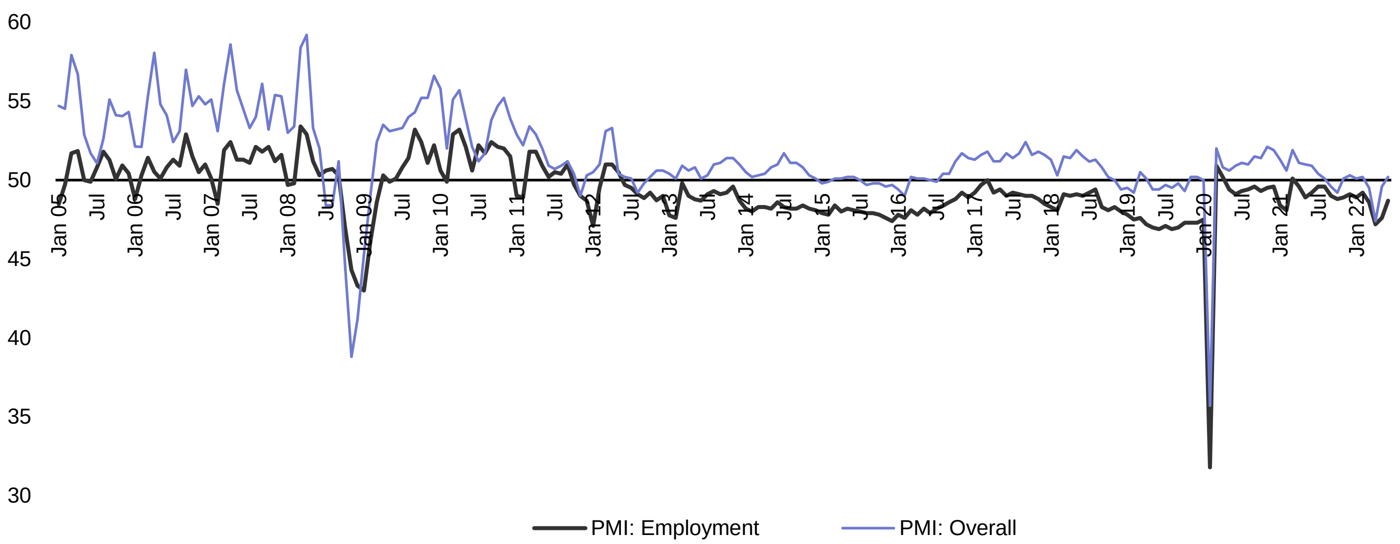
Exhibit 17: Employment and new export orders, January 2005 to June 2022



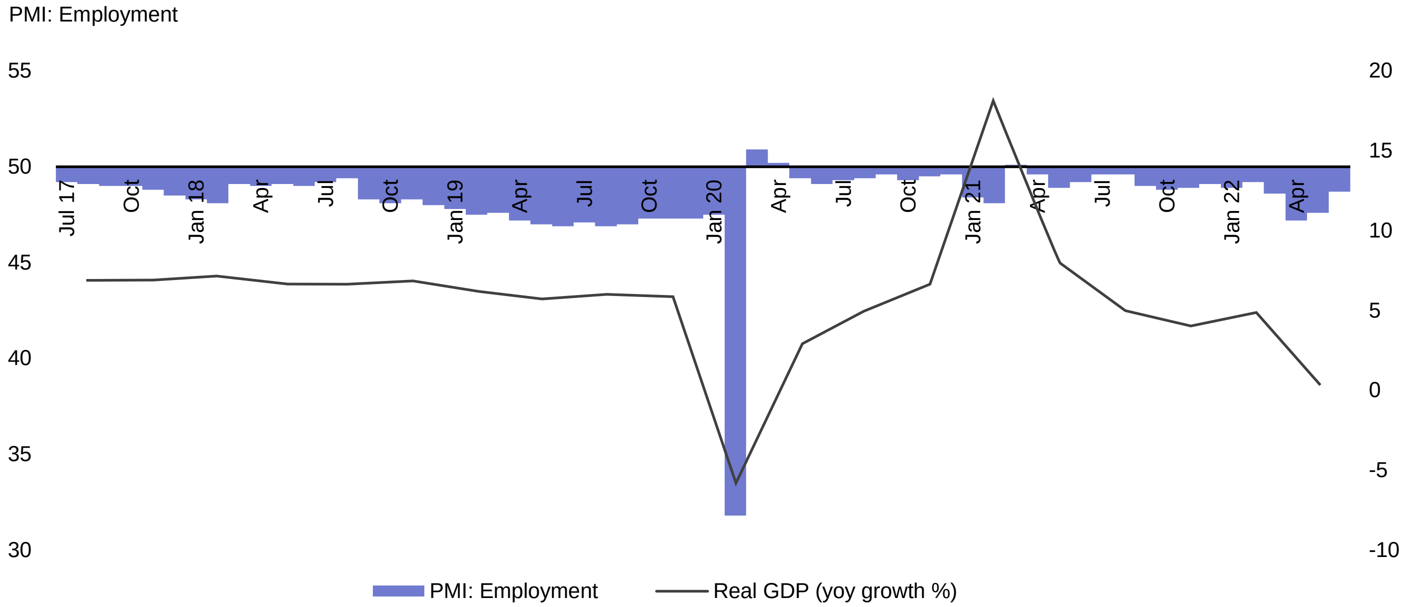
Source: China Federation of Logistics & Purchasing, China National Bureau of Statistics

Exhibit 18: Employment index and headline PMI, January 2005 to June 2022



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

Exhibit 19: Employment index and real GDP growth, July 2017 to June 2022



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 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.