PMI Quarterly on China Manufacturing

PMI 4Q23
Heightened downward pressure on the manufacturing sector

Policy Outlook
China to step up policy support for the economy

1Q24 Forecasts
GDP to register a 4.6% yoy growth while PMI to gradually rise above 50.0

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Issue 55

PMI points to heightened downward pressure on the manufacturing sector in 4Q23

Our observations

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

Policy outlook

- The Chinese government will continue to step up policy support for the economy.
- It will strengthen counter-cyclical and cross-cyclical adjustments of macro policies and continue to implement a proactive fiscal policy and a prudent monetary policy with strengthened innovation and coordination of policy tools.

Our forecasts for 1Q24

- We project a steady growth in manufacturing production.
- Headline PMI will gradually rise above 50.0.
- Real GDP growth will come in at 4.6% yoy.
- VAIO growth will register 5.0% yoy.
- Exports will register a low single-digit year-on-year drop against a high comparison base in 1Q23.
- Year-on-year growth rates for the purchaser price index and the PPI will remain low in 1Q24, due largely to a recent retreat in global commodity prices.

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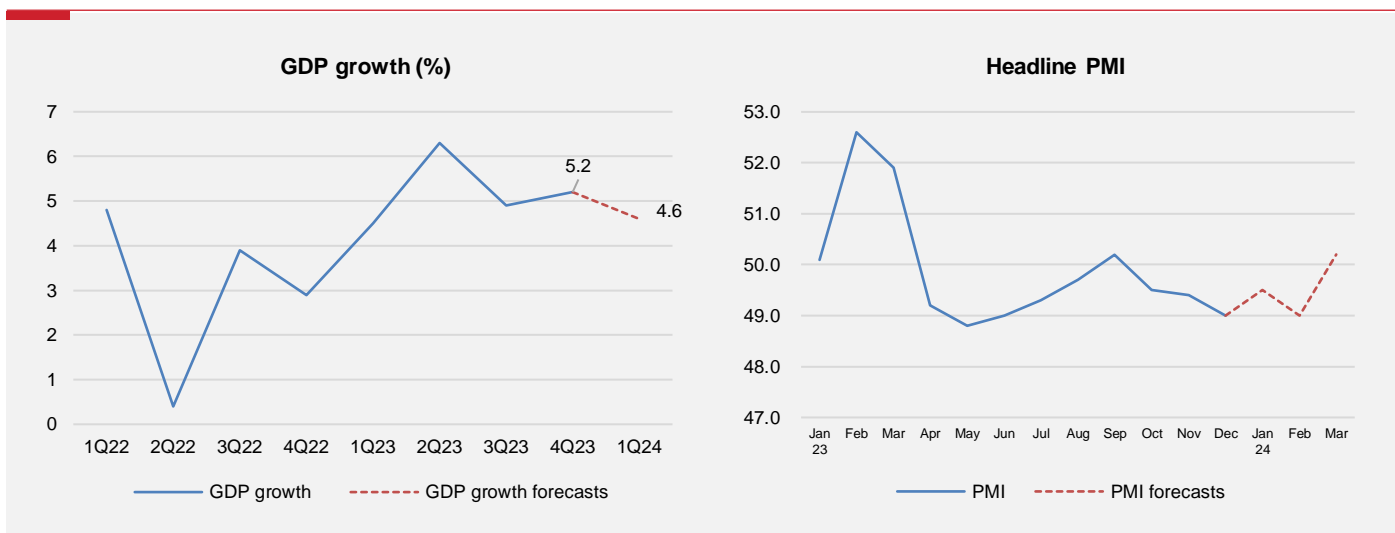**Chen ZhongTao**
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GDP growth (%)

Headline PMI

IN THIS ISSUE:

1. PMI points to heightened downward pressure on the manufacturing sector in 4Q23

China's manufacturing sector in 4Q23

China's manufacturing PMI declined from 49.5 in October to 49.4 in November and 49.0 in December. The headline PMI readings have stayed in the contractionary territory and continued to fall throughout the quarter, indicating heightened downward pressure on China's manufacturing sector. (See exhibit 1)

Manufacturing output growth has slowed lately, as the output index decreased from 50.9 in October to 50.7 in November and further to 50.2 in December. The growth moderation was due largely to a decline in overall new orders: The new orders index has stayed below 50 since October, indicating a continued contraction in the overall market demand lately.

Prices of industrial products have continued to decline, as the ex-factory prices index has dipped below 50 since May 2022. Meanwhile, the prices of materials have increased recently: The input prices index has remained above the critical 50-mark throughout October to December.

Exhibit 2 shows the contributions of the sub-indices to the change in the headline PMI. The decrease in the headline PMI in 4Q23 was due largely to the fall 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 output, input prices, and business expectations have stayed in the expansionary zone over the past three months. Meanwhile, the indices of new orders, new export orders, backlogs of orders, stocks of finished goods, stocks of major inputs, purchase of inputs, imports, ex-factory prices, and employment have stayed in the contractionary zone over the quarter. (See exhibit 3)

Policy outlook

Looking ahead, we expect the Chinese government to continue to actively step up policy support for the economy. The Central Economic Work Conference, a meeting which sets the tone for the economic tasks this year, was held on 11-12 December 2023. Regarding the economic work this year, the meeting called for efforts to pursue progress while ensuring stability, consolidate stability through progress, and establish the 'new' before abolishing the 'old'. The government should strengthen counter-cyclical and cross-cyclical adjustments of macro policies and continue to implement a proactive fiscal policy and a prudent monetary policy with strengthened innovation and coordination of policy tools, the meeting said.

These signal that a more expansionary macro policy will be adopted in 2024, which will help alleviate the downward pressure on the Chinese economy, in our view.

We project that China's real GDP growth will come in at 4.6% yoy in 1Q24, due to a steady growth in manufacturing production and consumer spending amid the expansionary macro policies.

Forecasts for 1Q24

China's industrial production will continue its steady growth in the near term amid an increase in infrastructure investment. Overall, we predict that the headline PMI will gradually rise above 50.0 in 1Q24, while industrial production growth will register 5.0% yoy in the quarter.

Exhibit 4 plots the quarterly real GDP growth rates versus the monthly PMIs since January 2019. We project that China's real GDP growth will come in at 4.6% yoy in 1Q24, due to a continued growth in manufacturing production and consumer spending amid the expansionary macro policies.
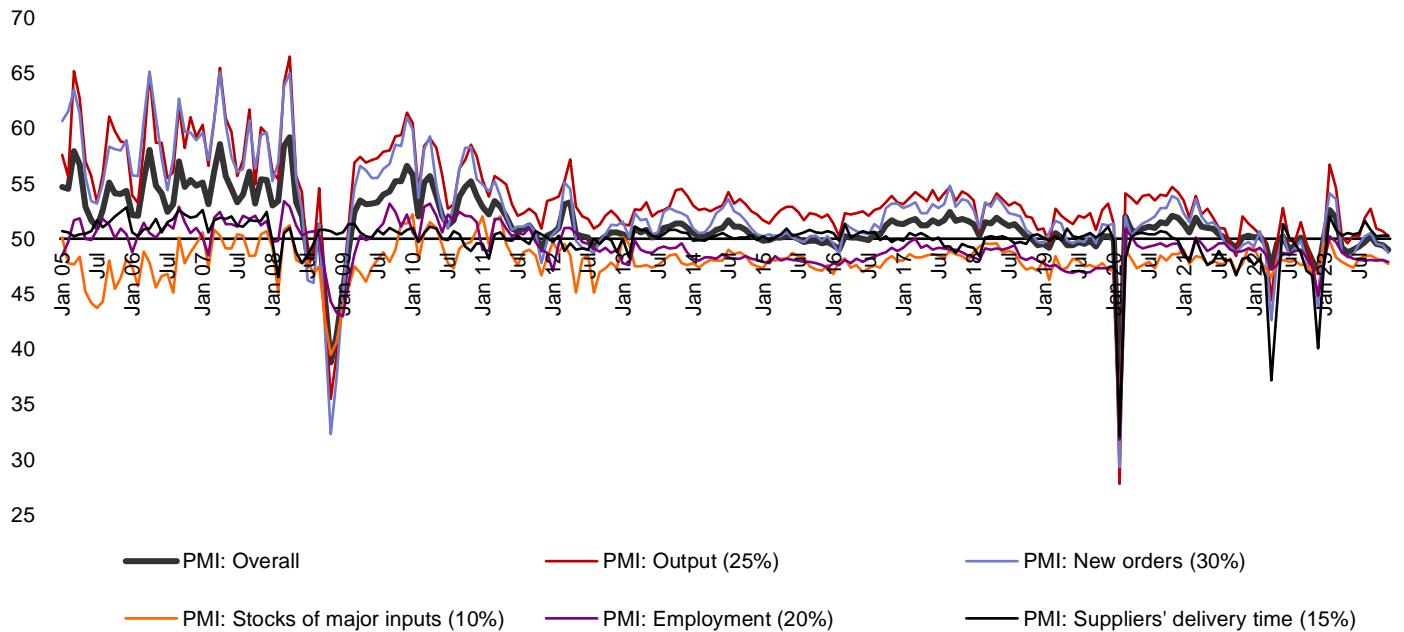
Exhibit 1: Headline PMI, January 2022 to December 2023
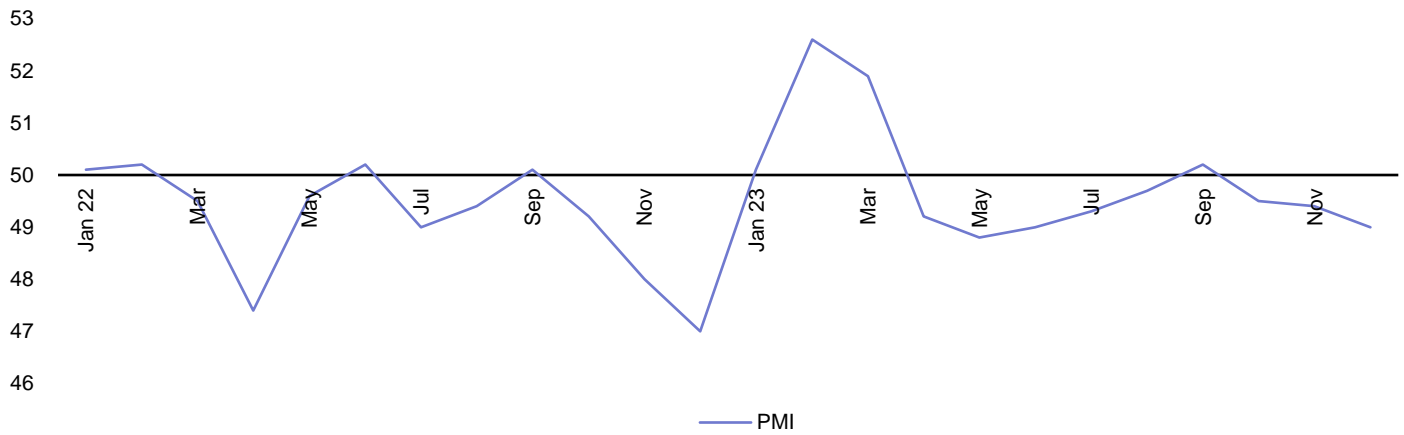
Source: China Federation of Logistics & Purchasing, China National Bureau of Statistics

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

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

PMI: Overall   PMI: Output (25%)   PMI: New orders (30%)

PMI: Stocks of major inputs (10%)   PMI: Employment (20%)   PMI: Suppliers' delivery time (15%)
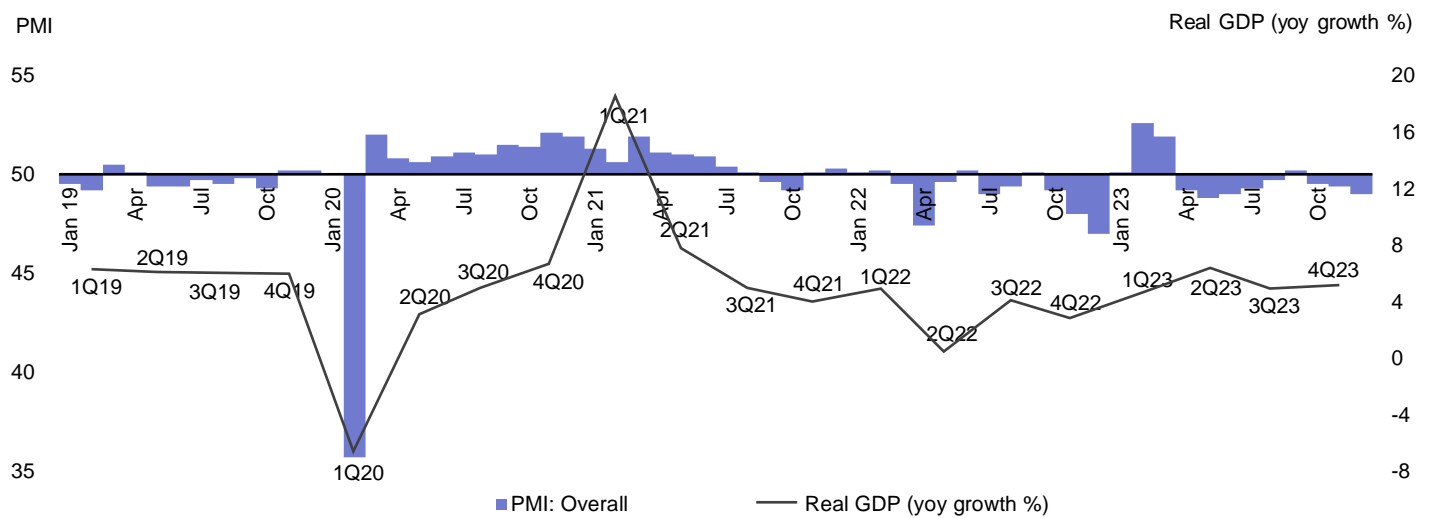
Source: China Federation of Logistics & Purchasing, China National Bureau of Statistics

Exhibit 3: Headline PMI and all sub-indices, October to December 2023
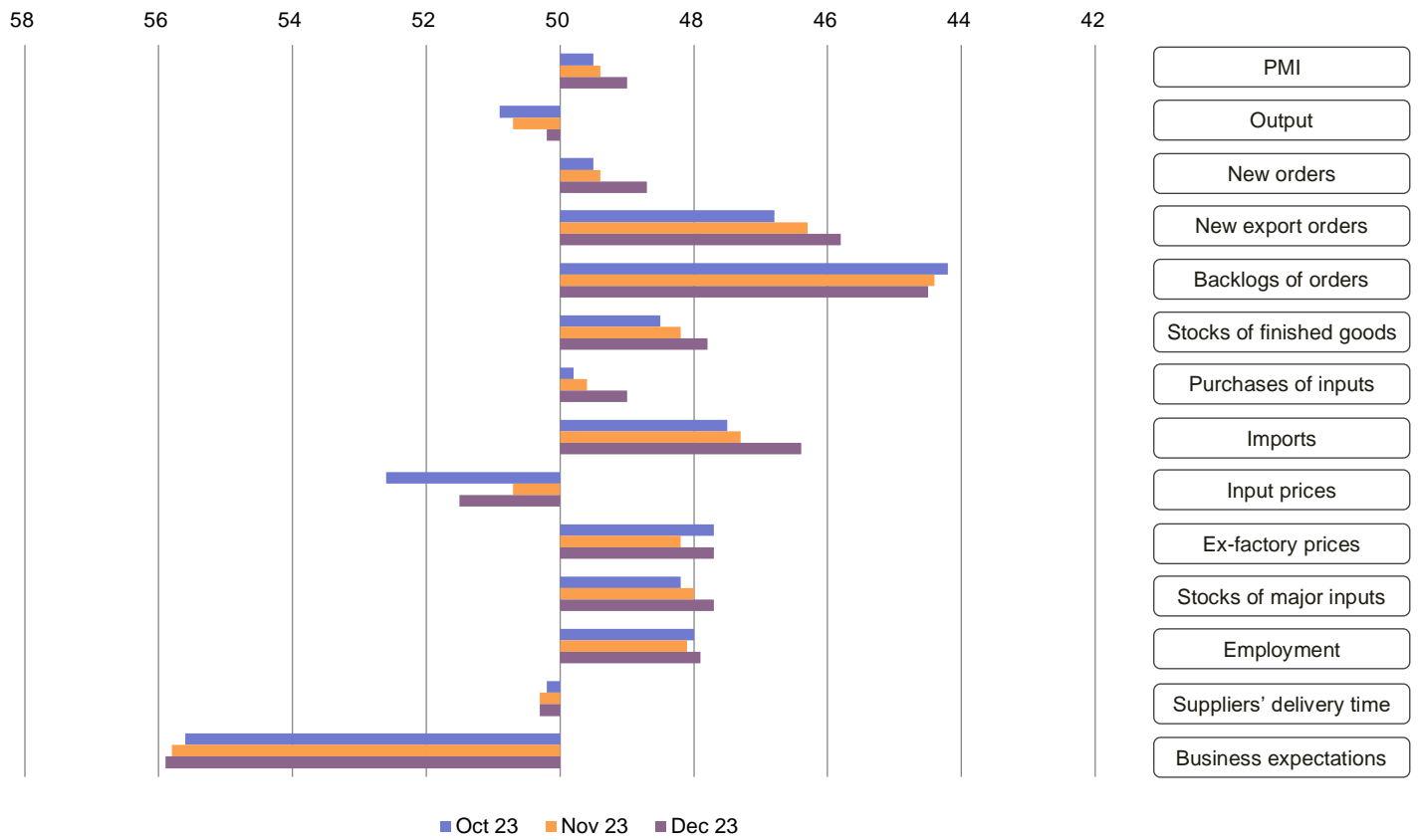
■ Oct 23   ■ Nov 23   ■ Dec 23

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

Exhibit 4: Headline PMI and real GDP growth, January 2019 to December 2023

■ PMI: Overall   —— Real GDP (yoy growth %)

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

Expansion of large enterprises halts

The PMI of 'large enterprises' fell from 50.7 in October to 50.5 in November and then 50.0 in December. The index reading declined to the threshold level of 50 in December, indicating a halt of the expansion of 'large enterprises' recently.

Small and medium enterprises continue to contract

The PMI of 'medium enterprises' hovered between 48.7 to 48.8 from October to December. Meanwhile, the PMI of 'small enterprises' went down from 47.9 in October to 47.8 in November and 47.3 in December. The index readings of both 'small enterprises' and 'medium enterprises' stayed below 50 throughout the quarter, indicating 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, a trend that has started since the second half of 2020.

Exhibit 5: PMIs of large enterprises, medium enterprises and small enterprises, October to December 2023
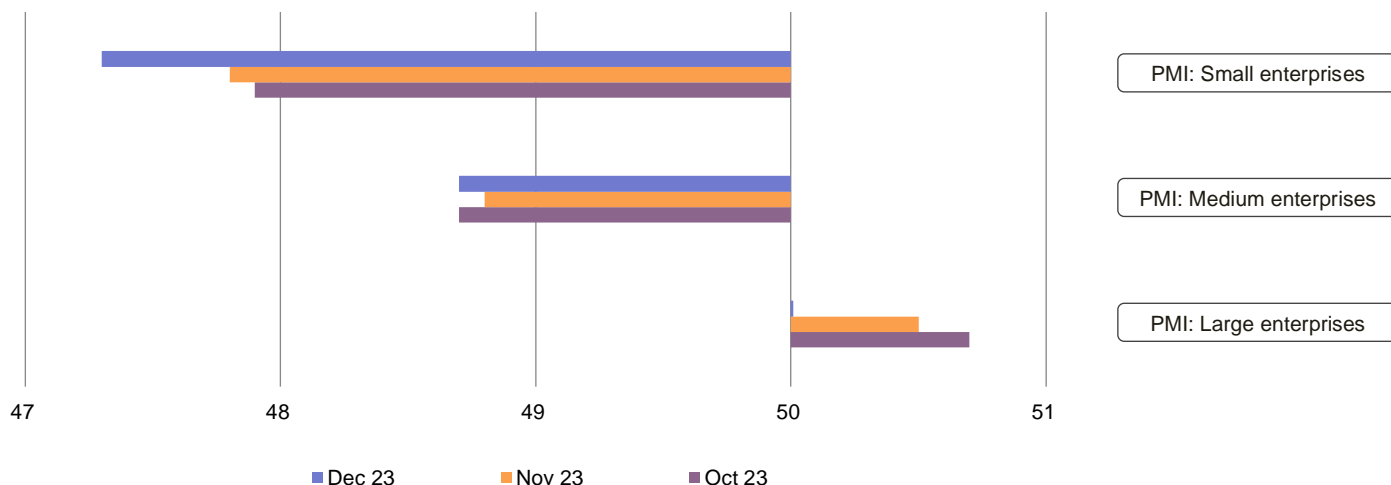
Source: China Federation of Logistics & Purchasing, China National Bureau of Statistics
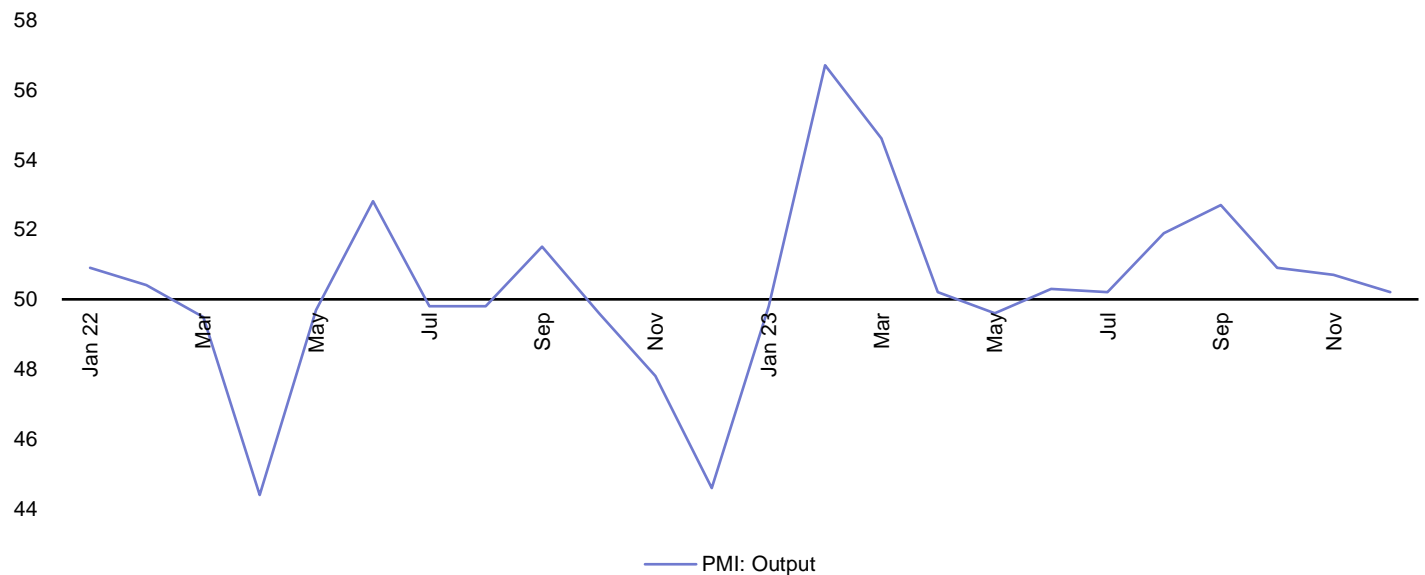
3. What the PMI tells us about manufacturing production

Manufacturing output growth moderates

The output index went down from 50.9 in October to 50.7 in November and further to 50.2 in December, indicating a moderation in manufacturing output growth recently. (See exhibit 6)

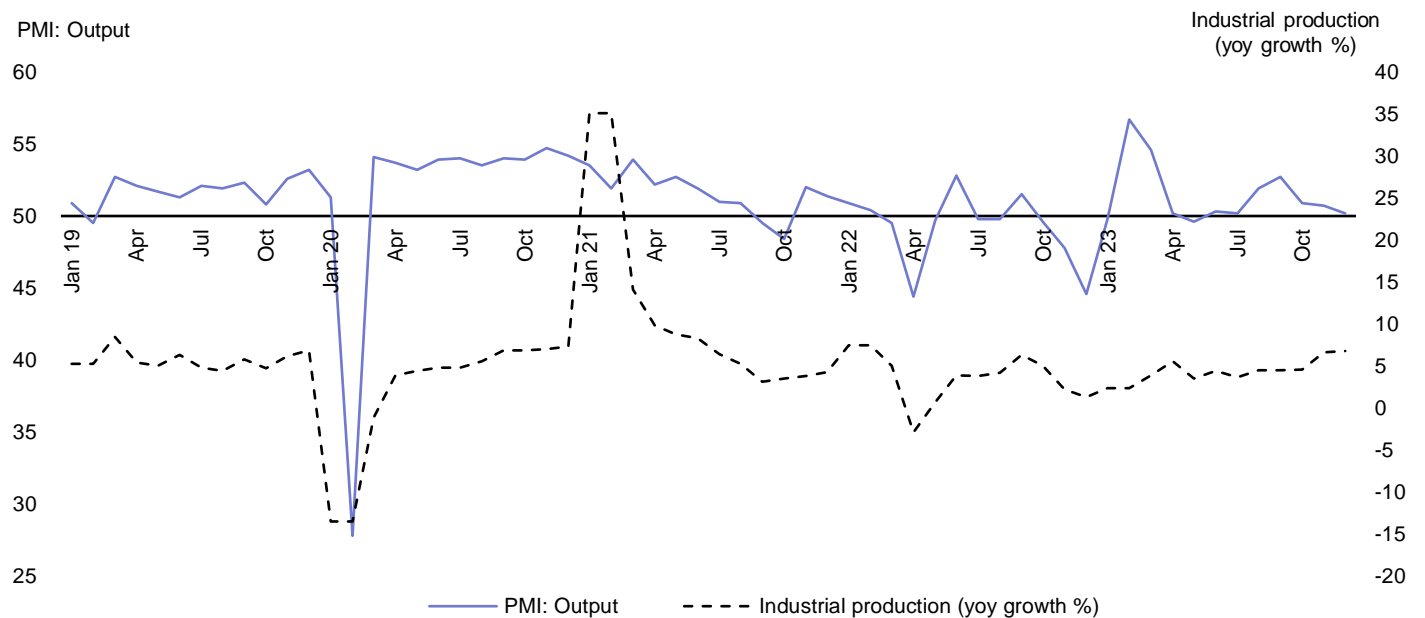**Exhibit 6: Output index, January 2022 to December 2023**

PMI: Output

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

Growth in manufacturing production to decelerate in 1Q24

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 expect the VAIO growth to decline to 5.0% yoy in 1Q24, as the low-base effect fades. 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 decline to 5.0% yoy in 1Q24, as the low-base effect fades.

Exhibit 7: Output index and industrial production growth, January 2019 to December 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 faster pace

The new orders index fell from 49.5 in October to 49.4 in November and further to 48.7 in December, indicating that new orders and the overall market demand have contracted at a faster pace lately.

Meanwhile, the new export orders also went down from 46.8 in October to 46.3 in November and 45.8 in December, pointing to a persistent drop in new export orders recently. (See exhibit 8)

Exhibit 8: New orders index and new export orders index, January 2005 to December 2023
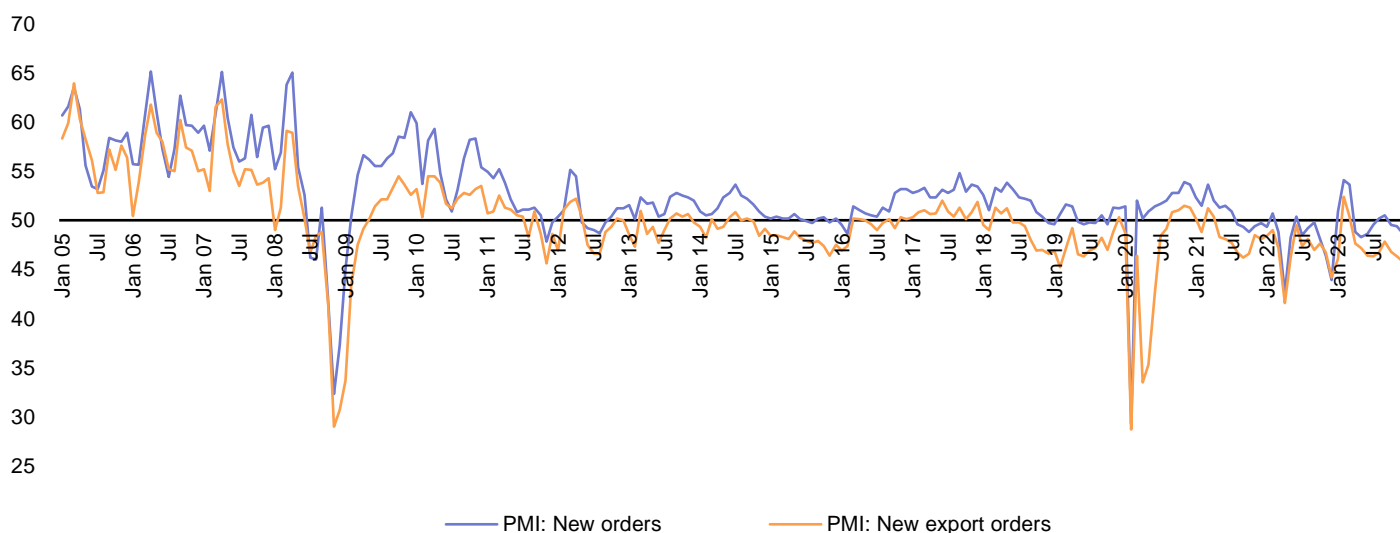
Source: China Federation of Logistics & Purchasing, China National Bureau of Statistics

China's exports to register a low single-digit year-on-year drop in 1Q24

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 increased recently, suggesting a mild recovery in global economy. Nevertheless, we forecast that China's exports will register a low single-digit year-on-year drop in 1Q24 against a high comparison base in 1Q23, when exporters rushed to fulfil a backlog of orders that had been disrupted by the huge wave of COVID-19 infections nationwide in late 2022.

We forecast that China's exports will register a low single-digit year-on-year drop in 1Q24 against a high comparison base in 1Q23.

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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, January 2019 to December 2023
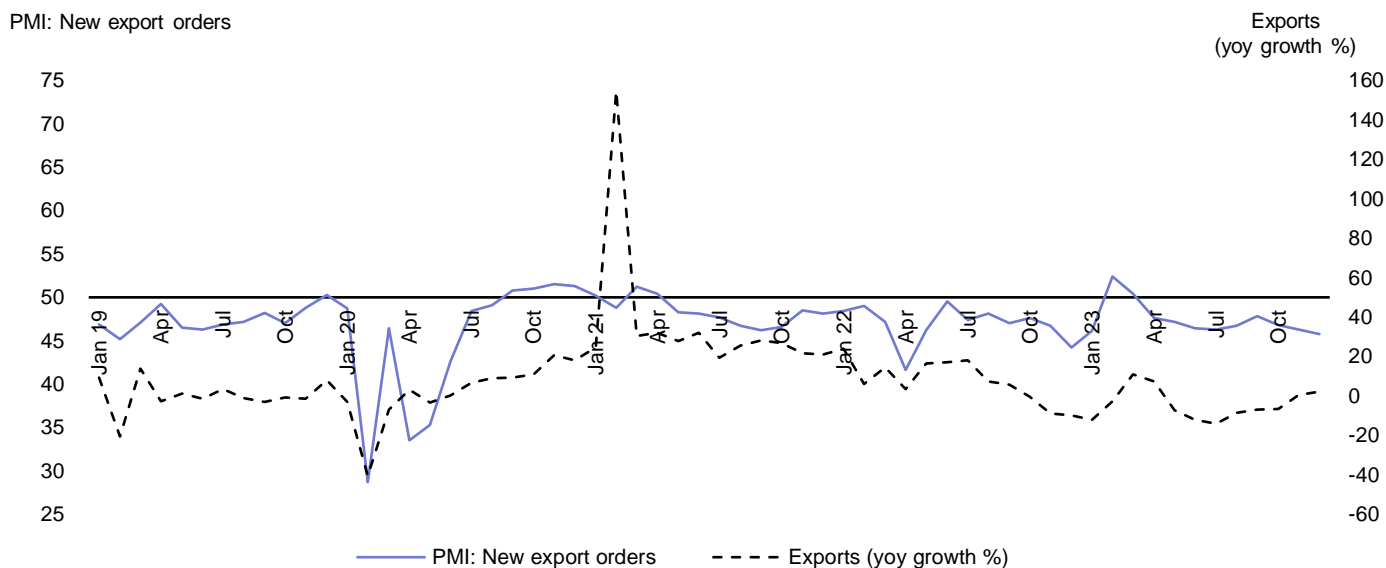
PMI: New export orders

Exports
(yoy growth %)

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 December 2023

PMI: New export orders

G20 composite leading
indicator
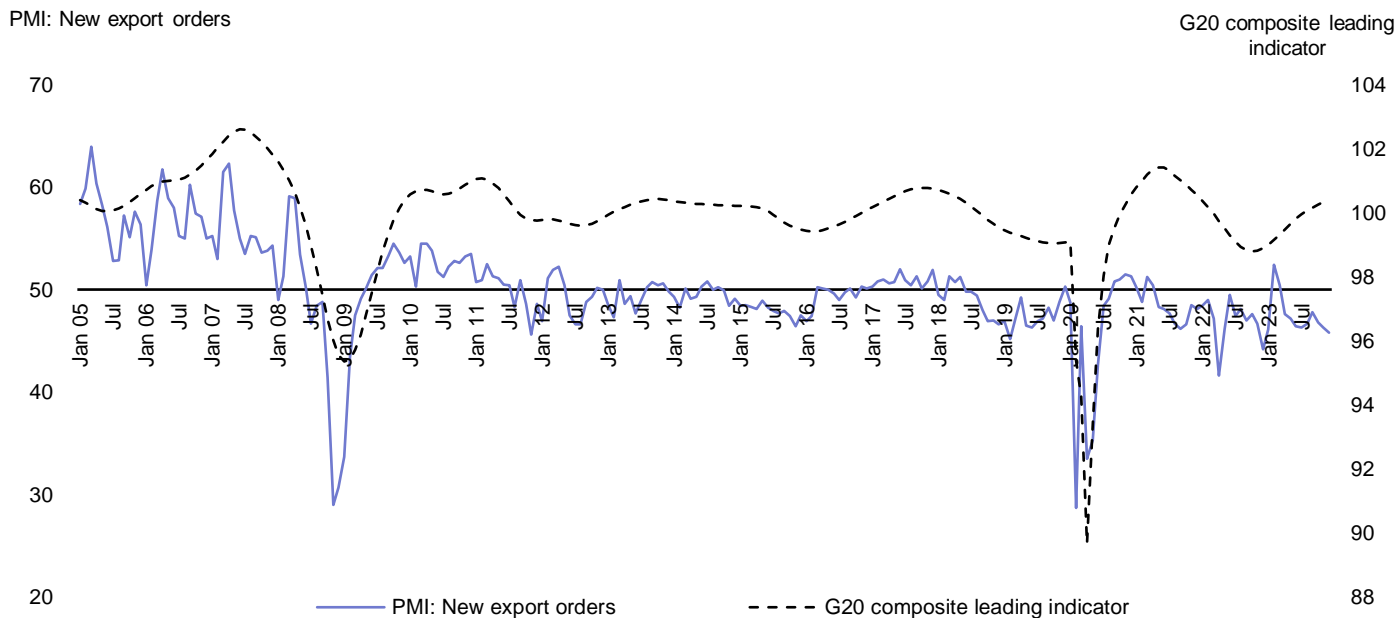
Source: China Federation of Logistics & Purchasing, China National Bureau of Statistics, Organization for Economic Cooperation and Development

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

Rising upstream prices exert moderate cost pressure on manufacturers

After falling from 52.6 in October to 50.7 in November, the input prices index rebounded to 51.5 in December. The index readings have stayed above the critical 50-mark throughout October to December, indicating a sustained increase in the prices of production inputs recently. This would raise the cost pressure on Chinese manufacturers.

**Exhibit 11: Input prices index, January 2022 to December 2023**

Severe cost pressure (above 70%)

High cost pressure (60%-70%)

Moderate cost pressure (50%-60%)

Decreasing cost pressure (below 50%)
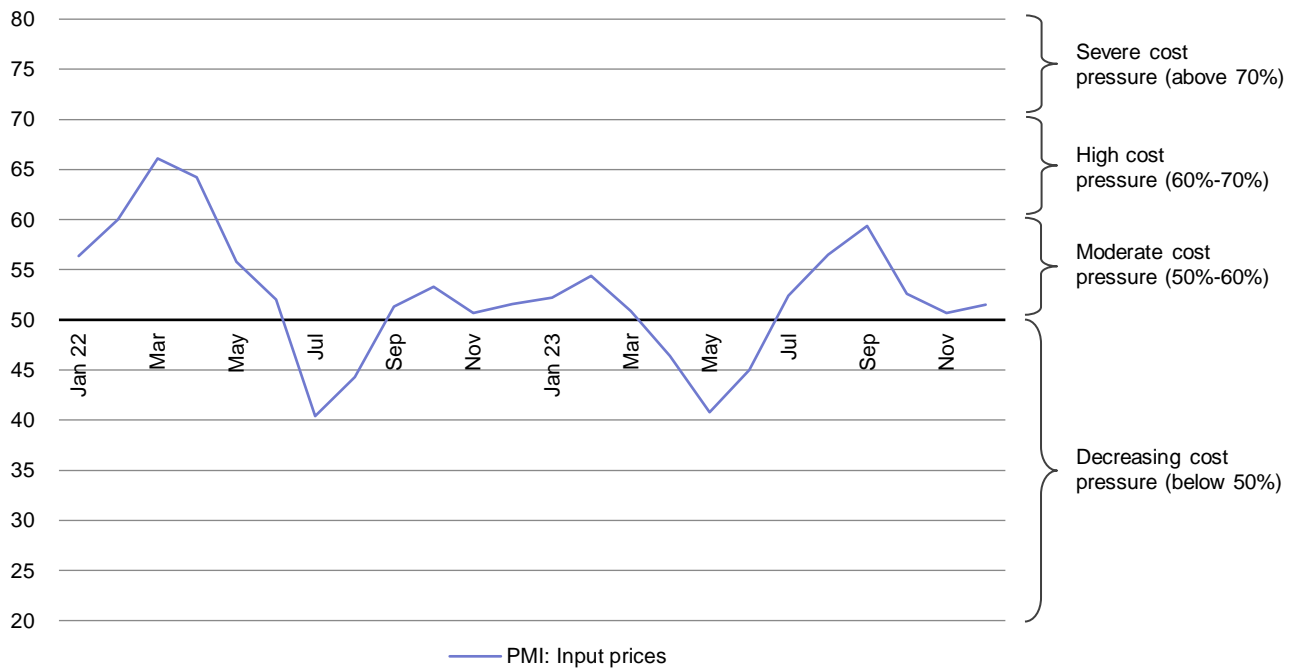
— PMI: Input prices

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]

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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, January 2019 to December 2023**

PMI: Input prices

Thomson Reuters/
CoreCommodity CRB Index
(month-end)

PMI: Input prices — — — Thomson Reuters/ CoreCommodity CRB Index (month-end)
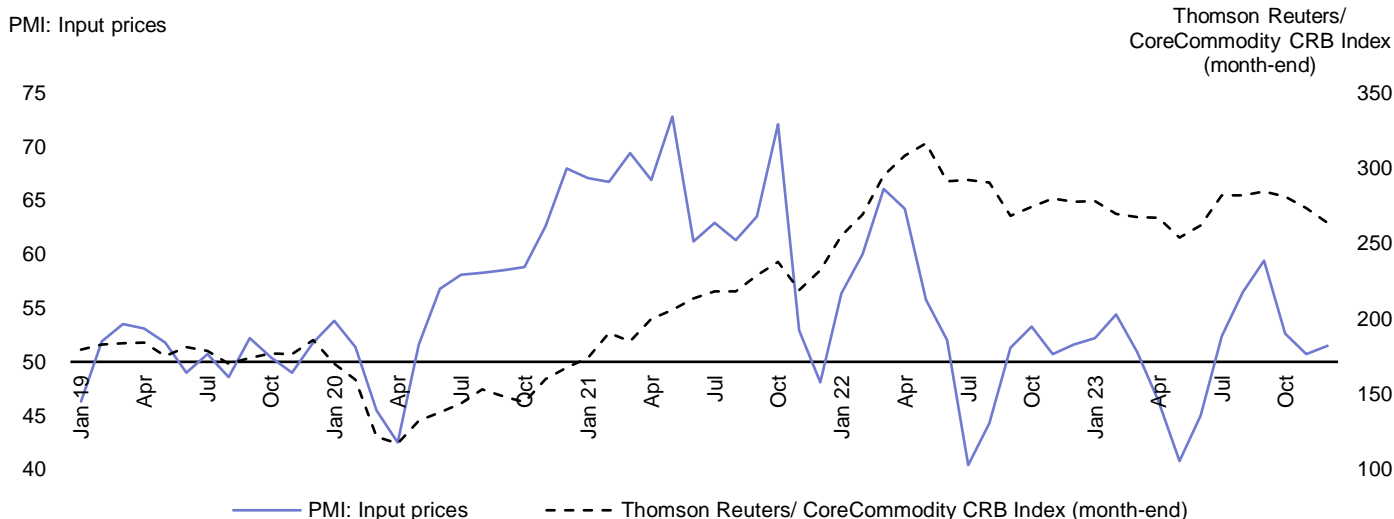
Source: China Federation of Logistics & Purchasing, China National Bureau of Statistics, Thomson Reuters

Manufacturers lower ex-factory prices of their products

After rising from 47.7 in October to 48.2 in November, the ex-factory prices index fell to 47.7 in December. The index readings indicate that Chinese manufacturers have been lowering the ex-factory prices of their finished products lately.[3]

Exhibit 13: Ex-factory prices index, January 2022 to December 2023

PMI: Ex-factory prices
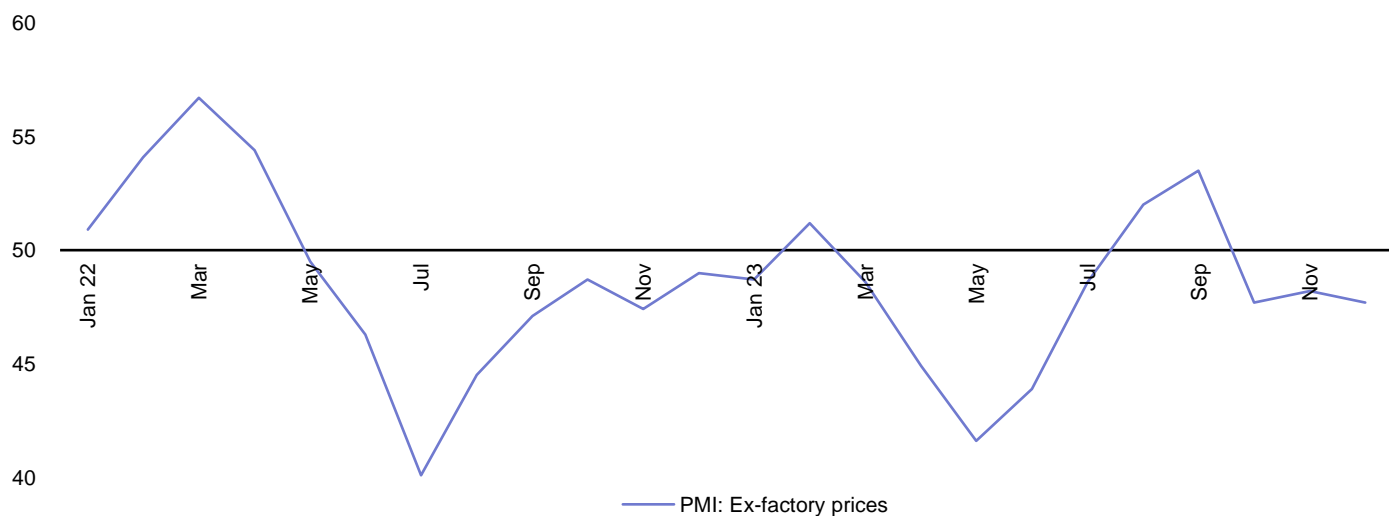
Source: China Federation of Logistics & Purchasing, China National Bureau of Statistics

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

Growth in input prices and ex-factory prices to remain low in 1Q24

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 remain low in 1Q24, due mainly to a recent retreat in global commodity prices.

> **We expect that the year-on-year growth rates for both the purchaser price index and the PPI will remain low in 1Q24, due mainly to a recent retreat in global commodity prices.**

Exhibit 14: Input prices index and purchaser price index of industrial products, January 2005 to December 2023
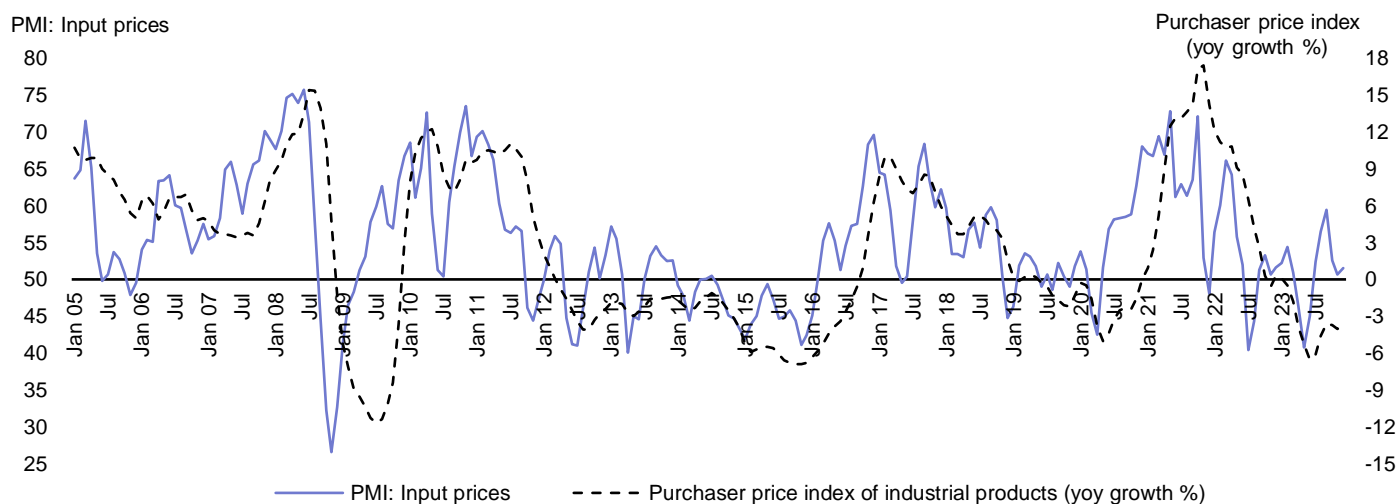
Source: China Federation of Logistics & Purchasing, China National Bureau of Statistics

Exhibit 15: Input prices index and producer price index, January 2005 to December 2023
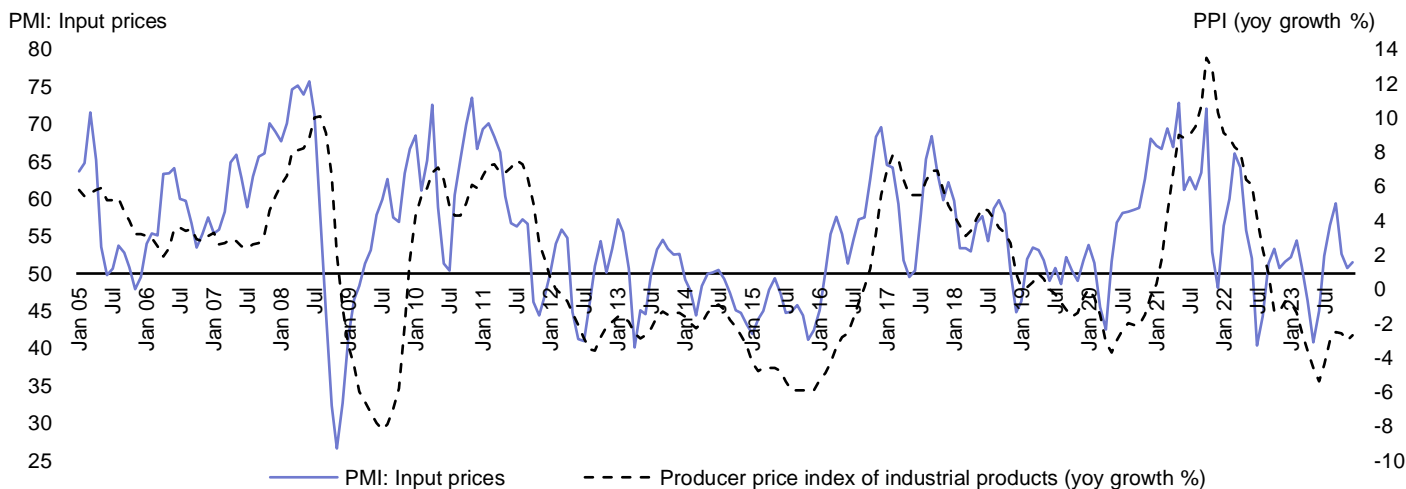
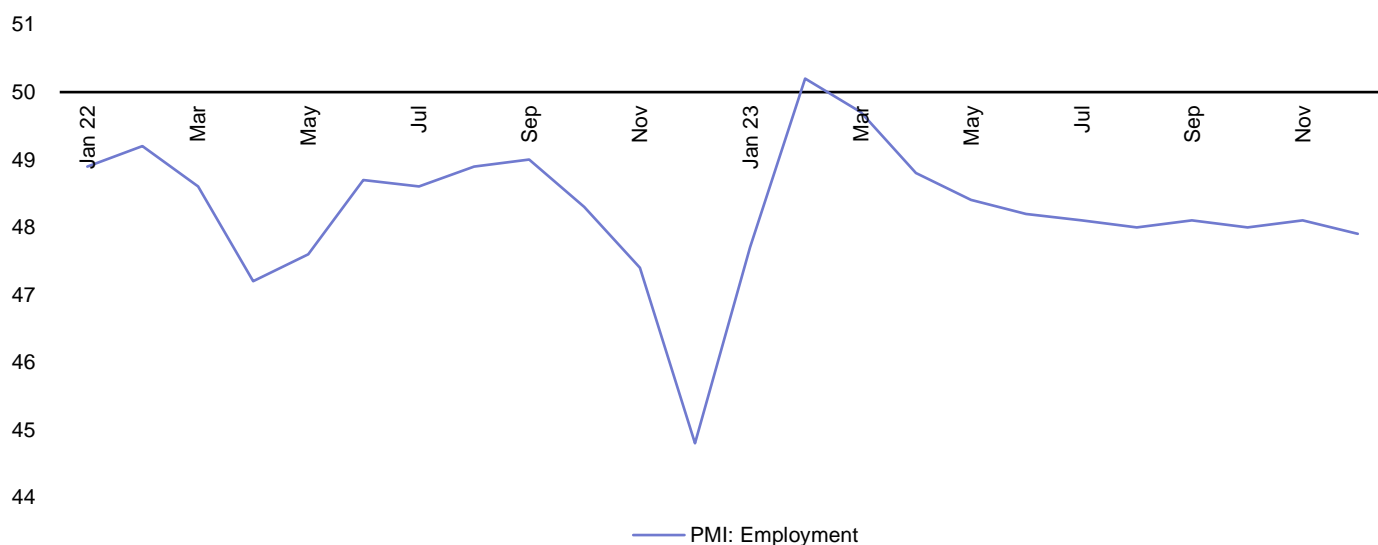Source: China Federation of Logistics & Purchasing, China National Bureau of Statistics

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[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 stayed low and fluctuated around 48.0 throughout October to December. The index readings indicate that employment in the manufacturing sector has slightly decreased recently. (See exhibit 16)

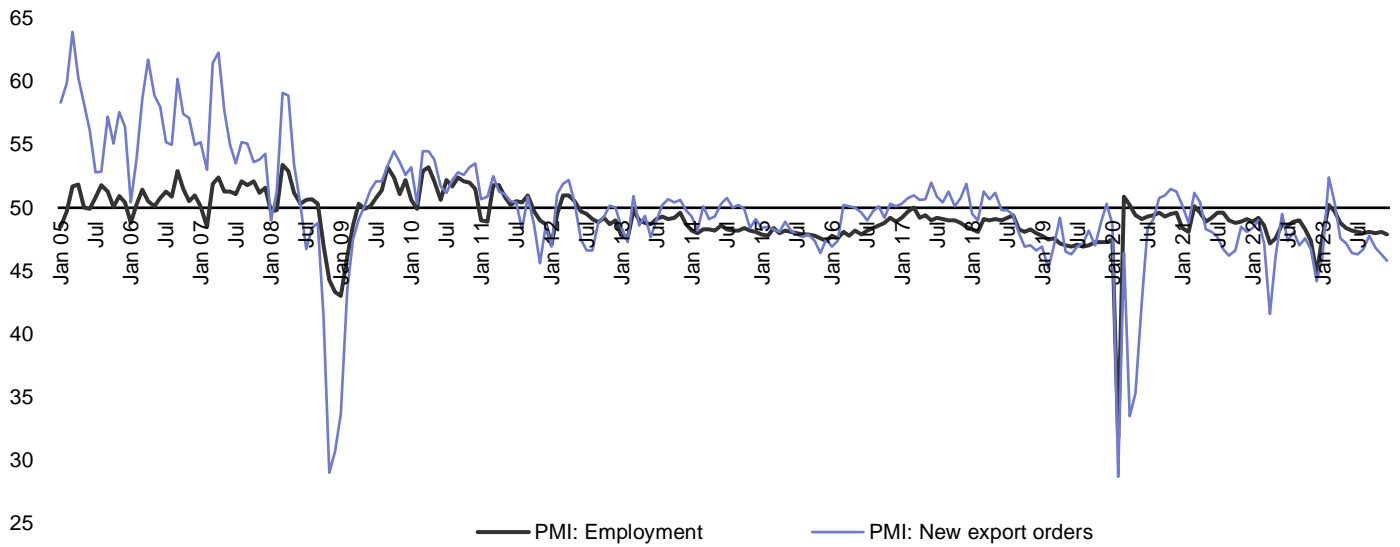**Exhibit 16: Employment index, January 2022 to December 2023**

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 the employment situation in the manufacturing sector to stabilize in 1Q24.

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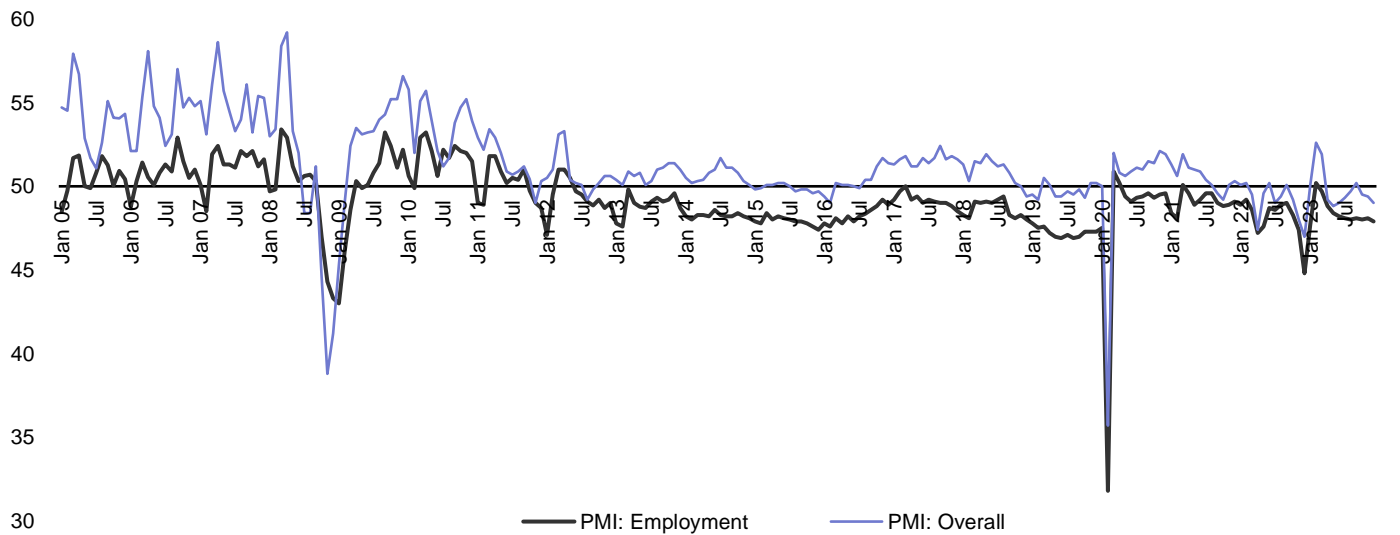
Exhibit 17: Employment and new export orders, January 2005 to December 2023

Source: China Federation of Logistics & Purchasing, China National Bureau of Statistics
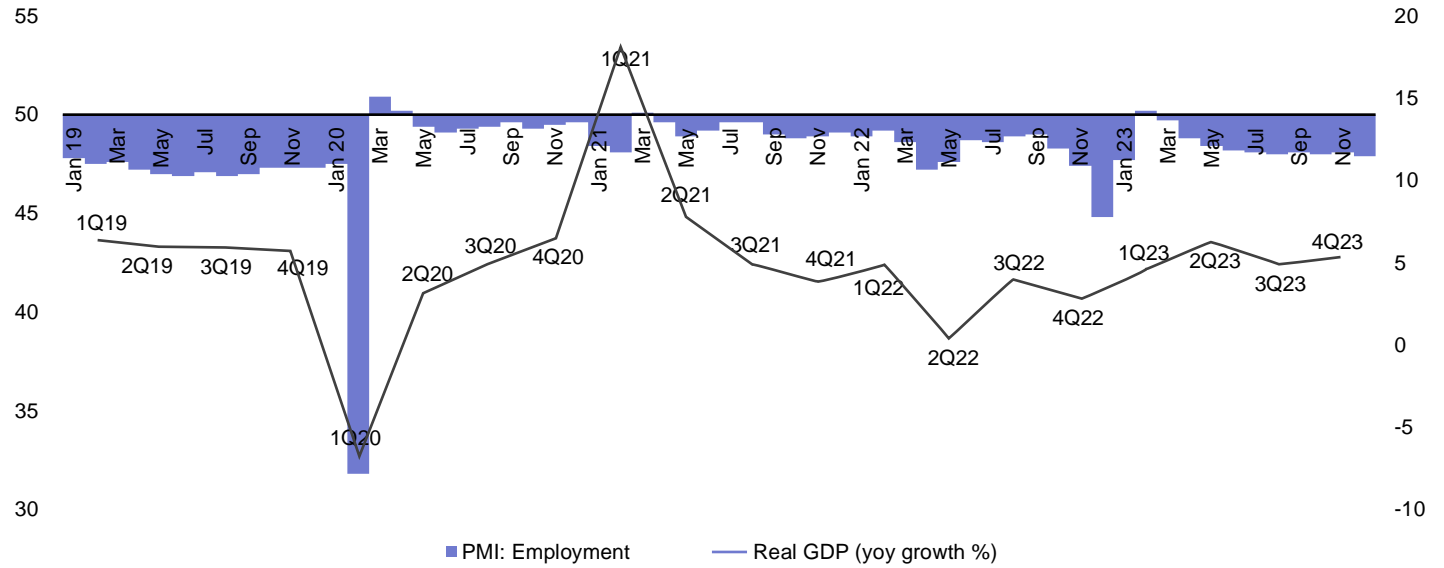
Exhibit 18: Employment index and headline PMI, January 2005 to December 2023

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

Exhibit 19: Employment index and real GDP growth, January 2019 to December 2023

PMI: Employment

■ PMI: Employment ——— Real GDP (yoy growth %)

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 15,000 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.

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For more information, please visit http://www.funggroup.com.