MONTHLY REPORT

TRADE SERVICING

– WUSATA

March 2023

Monthly Trade Servicing Report

Market: China & HK **Submitted by**: China In-market Representative **Month & Year:** March 2023

Executive Summary

Following years of heady economic growth and rising consumer spending, recent macroeconomic pressures have sapped Chinese consumer sentiment. Chinese consumers' increased propensity to save their money rather than spend it has been evident in the rapid growth in savings deposits, which swelled by RMB 14 trillion during the first 9 months of 2022.

Despite these economic headwinds, and the decline in consumer confidence, China’s economy continues to exhibit a certain level of resilience, especially high-income consumers. As economic pressures drive them to be more discerning, they are increasingly choosing products for quality and functionality.

According to the latest research by McKinsey, high-income consumers in China are spending more, rather than less, across almost all fast-moving-consumer goods categories. Thirty-seven percent are prepared to increase their spending on international spirits, compared with 35 percent for sports drinks, and 32 percent for juice, for example.

Meanwhile, in a landmark change, domestic brands are now preferred over foreign ones on both criteria. Companies that respond quickly when these conditions change will outperform their competitors as China’s consumer market continues to expand.

Market Intelligence Update

China's economy shows gradual recovery after COVID reopening

China's economic activity picked up in the first two months of 2023 as consumption and infrastructure investment drove recovery from pandemic disruption, despite challenges of weak global demand and a persistent downturn in the property sector.

China's abandonment of COVID-19 controls late in 2022 has reinvigorated an $18 trillion economy that has suffered one of its lowest growth rates in nearly half a century, with analysts expecting momentum to improve further in coming months.

Industrial output in the January-February period was 2.4% higher than a year earlier, data by the National Bureau of Statistics (NBS) showed on Wednesday, slightly missing expectations for a 2.6% gain in a Reuters poll. The reading accelerated from a 1.3% annual rise in December.

Retail sales in the first two months jumped 3.5% from a year before, reversing a 1.8% annual fall seen in December. The result was in line with analysts' expectation and with hopes for an economic revival led by consumption as flagging global demand weakens Chinese exports.

The data followed signs of strength in February purchasing managers indexes (PMIs) published on March 1.

"Overall, the data confirm what more timely indicators, including the PMIs, had already suggested - that the fading of virus disruptions led to a rapid improvement in economic conditions at the start of the year," said Julian Evans-Pritchard, head of China economics at Capital Economics, in a note.

The COVID-sensitive catering sector has notably reaped benefits from the reopening, with January-February revenue surging 9.2% from a year earlier, compared with an annual 14.1% fall seen in December, when widespread infections kept people at home.

"We expect China's growth momentum to improve further in coming months, driven mainly by the ongoing consumption recovery and still-accommodative macro policy," analysts at Goldman Sachs said in a note.

Nomura analysts pointed to shrinking exports and weakness in the property sector holding back recovery. They forecast first-quarter gross domestic product would be 3.6% higher than a year earlier, compared with the fourth quarter's 2.9% annual rise.

The NBS publishes combined January and February data to smooth out distortions caused by the Lunar New Year holiday, which fell in January this year but was in February in 2022.

"The economy is gradually recovering this year, but it must be noted that the pandemic damaged corporate and personal balance sheets over several years, and they still need time for repair," NBS spokesman Fu Linghui told reporters.

China has set a modest annual growth target of around 5% this year after significantly missing its target for 2022.

Fu said reaching around 5% would be challenging, "but we must be aware that we have the conditions, foundation, and confidence to achieve the growth target."

Unilever seeks to ride boom in sales of condiments

British consumer goods company Unilever Plc said in the post-COVID era, the domestic catering sector has witnessed a boom, making the company highly confident in the growth potential of its condiment products in the Chinese mainland market, and it plans to continue to increase investment.

Currently, China stands as the largest market globally for Unilever's condiment business. In the past two decades, its condiment sector's compound annual growth rate has been in double digits.

"In China, we mainly focus on businesses related to Chinese food and sales of condiments products in the Chinese fast food category grew the fastest. We will continue to strengthen efforts in local research and development and manufacturing," said Star Chen, chief executive officer of Unilever Food Solutions.

"China's catering pattern is huge. Chinese consumers are pursuing healthier diets in the post-pandemic era and a lot of classic cuisines are back in fashion. Our management team of the category is composed of Chinese people who deeply understand the local cuisines," Chen said.

The company launched a second-phase production line of seasoning sauces at its Tianjin manufacturing site, which went into operation last year. The estimated annual output value of the second line is 740 million yuan ($108 million), and the company's integrated manufacturing site of condiments in Tianjin now stands as the biggest such plant in North Asia.

The site makes products such as chicken sauce, chicken powder, spicy sauce and salad dressings. The total annual output is expected to exceed 80,000 metric tons, the company said.

"China's condiment sector is experiencing rapid growth and new products have been constantly emerging. The category structure has also shifted from single to composite," said Bai Yan, general secretary of the China Condiment Association.

"Chinese consumers have shown a demand for new consumption concepts and brought new challenges to the catering sector. Major industry players should share their experiences in advanced digital R&D and production, and help the whole sector with transformation and upgrading," Bai said.

Meanwhile, the Tianjin plant has been selected as a "lighthouse factory", becoming the first such factory in the condiment sector globally. Lighthouse factories refer to cutting-edge manufacturing sites that are pioneers in sustainable and profitable growth. It was recognized by a global initiative launched by the World Economic Forum and consultancy McKinsey in 2018.

Entire dairy chain feeling pressure

According to a new report from Rabobank, participants all along the dairy value chain are being squeezed. Producers' milk prices have tumbled from 2022's lofty levels while feed prices are at record highs. Processors and dairy cooperatives entered the year discounting expensive inventory made with high-priced milk. Meanwhile, higher inflation and rising interest rates are pressuring consumers toward more frugal purchasing behavior.

Greater year-on-year milk production growth has emerged in 2023 in the key export regions, compared to 2022's low levels. At the same time, farmgate milk prices are catching up to global commodity market trends and have moved lower. Expensive input costs remain a clear headwind worldwide and, combined with lower milk prices, are resulting in farm-level margin pressure. In response, dairy cow slaughter rates have escalated.

"Milk production from the Big 7 export regions is anticipated to grow by 0.7% year-on-year in 2023, following 2022's decline of 0.9%," says Mary Ledman, Global Sector Strategist for Dairy at Rabobank. "Rabobank downgraded its 2023 forecast from last quarter's estimate of 1%. This slower growth is attributed to increased culling in the US and weather-related production challenges in New Zealand, Brazil, and Argentina."

Dairy market price uncertainty remains across regions and dairy products. A little more milk and a little less demand have contributed to weaker dairy commodity prices in Q1 2023. However, stock levels in the key exporting regions are not burdensome. Cheese and butter prices have performed the best, while skim and whole milk powder markets have yet to find sound footing.

Consumers are part of the story. In a complex macroeconomic environment, with core services inflation remaining strong, there are increased signs of a slowdown in household consumption, which is likely to continue deteriorating over the coming months. "Consumers haven't left the dairy aisle," says Ledman, "but they are looking for value."

Lower global cheese, milk powder, and whey prices, year-on-year, are expected to support exports. Still, much depends on internal Chinese policies and broader demand resilience to support dairy product prices in 2023.

Global dairy trade in 2022 was better than expected, despite China's retreat. Exports to key importers including Mexico, Indonesia, Japan, Algeria, and South Korea, among others, surpassed 2021 levels. "Through November 2022, trade in total dairy product volume was within 1.5% of the previous year, despite about a 20% reduction in China's imports," notes Ledman. With China's reopening, Rabobank forecasts foodservice revenues there to improve by 1% to 2% compared to pre-Covid levels. "Looking ahead, China's dairy imports in the first quarter of 2023 are expected to fall short of year-ago levels, with renewed buying interest developing in the second quarter of the year. We expect a mild year-on-year increase in imports in the second half of 2023."

➢ *Activities & Achievement*

This month's activity is mainly related to the Seafood Inbound Mission and trader contact for Mainland China and Hong Kong markets.

• *Trade Visits*

Dates:	*March 2023*
Context:	*Building relationships with local traders and importers; Develop new traders*
Objective:	*Introduce WUSATA services and advantages of U.S. agricultural products to new traders.*
Strategy:	*Visit and communicate with local traders in all target markets including Eastern China, Southern China, Northern China and Hong Kong & Macau.*

• *ATO Liaison*

<u>China Seafood Inbound Mission</u>
SMH brought 6 companies from Mainland China and Hong Kong to the Seafood Inbound Mission at the Seafood Expo North America in Boston, MA on March 10 to 17, 2023. During the mission, SMH coordinated with activity managers Elisa Daun (WA) and Amanda Swanson (AK) for daily itinerary which includes buyers meeting with 11 WUSATA seafood suppliers and market tour, the group also traveled to Seattle, WA for facility tours at several seafood suppliers.

Thank You!

Submitted by SMH, China/Hong Kong In-market Representative