What's Going to Happen to "The China Price?"

After Years of Upward Pressure, Now a Retreat, as Buyers Gain Upper Hand; How Long will it Last?

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The "China Price" dynamic has gone through several iterations.

First, Western manufacturers were panicked over the prices coming from Chinese competitors, which were often 20-30% less than they could make it for domestically.

Next, companies in almost all industries looked to outsource production, directly or indirectly, to China's increasingly sophisticated manufacturing sector. While many found the true net savings somewhat elusive or at least less than expected, unit manufacturing costs went down substantially for most companies which took this path.

Then, given the huge growth in manufacturing and the Chinese economy overall, Chinese labor started to rise substantially. In 2007-08, this really began to eat into the savings companies had achieved by moving to China. As a result, especially for low value-added manufacturing, many companies moved further west into inland China chasing lower wage rates, or considered other lower costs countries such as Vietnam.

But then, the financial crisis hit, and China's export volumes dropped dramatically. Tens of thousands of factories in the country have closed, and reports are that millions of urban workers without jobs in Eastern China have moved back to the countryside. This change is putting a heavy brake, for now, are rising labor costs, as suddenly labor demand is much weaker than supply, after the reverse was true for the past several years.

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Between lower wage pressures and the fact that most Chinese factories operating at low levels of utilization, Western buyers are gaining more pricing clout than they have had in years. The Chinese government, for example, says the value of China's exports fell 25.7 percent year over year in February, accelerating from a tough 17.5 percent decline in January.

Last month, Li & Fung, the world's largest trade sourcing company, said that the prices of Chinese-made goods are falling again as bargaining power shifts back to overseas buyers. It calls the trend in China prices "deflationary."

Hong Kong-based Li & Fung said export prices for Chinese manufactured goods began to fall in the second half of 2008 but ended the year about where they started, given increases in the first half of the year.

"This year prices are falling considerably and I expect that to continue for the full year," **Bruce Rockowitz**, president of Li & Fung's trading arm, said recently. He believes that prices from China were down "at least 5-10 percent" right now compared with 2008.

How Long Will It Last?

"Deflation [in China pricing] is here to stay," be-

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lieves **William Fung**, managing director and Li & Fung. "Buyers have more of an upper hand again."
That's because export volumes to the weak economies of the US, Europe and Japan show no signs of recovering soon. However, there are signs that China's manufacturing sector is recovering on its own, without much help from export customers, as the country's economic stimulus plan and focus on bolstering the internal economy start to pay off.

China's manufacturing sector expanded in April for the first time since July, according to a survey by Hong Kong brokerage firm CLSA. That's consistent with similar data from the official Chinese Purchasing Managers Index, which also saw a strong increase last month. New order levels also picked up for the first time in nine months, mostly due to a boost in domestic demand from China's fiscal measures, including tax breaks for manufacturers, infrastructure spending and subsidies for consumers

CLSA agreed, however, that pricing was still weak, even as the employment picture brightened a bit there. Part of that is related to overall supply and demand, but some is also the result of falling input prices for steel, energy and other commodities.

So for now, it may be time to revisit pricing with existing Chinese suppliers, or postpone moves further inland or to other countries. But mid-term, the pricing pressure on Chinese goods is likely to return, especially if the US dollar starts to fall, as many predict it will as the printing presses run to monetize the growing US deficit.