China Economic Monitor

Q2 2020

KPMG China

August 2020

kpmg.com/cn

Contents

Executive summary

In 2020Q1, China's economic growth plunged to -6.8% amid COVID-19, the first contraction since 1992, when quarterly records were first published. But the overall economy should continue to recover during the rest of the year.

- The value added of secondary industry saw the largest decrease in the growth rate at 9.6%, amid the overall deceleration of all three industries. Among them, the Manufacturing and Construction sectors were the largest drags on GDP with a double-digit decline. The Accommodation and Catering sector was hit hardest by the pandemics, its value added shrank by 35.3% YOY, indicating 41.3% slower growth over the same period last year. However, this was partially offset by growth in the Information Transmission, Software and Information Technology (13.2%), and Finance (6.0%) sectors, resulting in a 5.2% decrease in value added for the service industry as a whole.

- On the demand side, the COVID-19 pandemic hit China hard in terms of consumption, investment and net exports. In 2020Q1, the contribution of final consumption to GDP was -4.4%. Although the total retail sales of consumer goods continued to drop by 15.8% YOY in nominal terms, the decline rate narrowed by 4.7% compared to Jan–Feb. The consumption of consumer staples, such as foods, remained strong, while consumer discretionary purchase — for instance, automobiles — stayed low.

- In 2020Q1, industrial value added decreased by 6.5% YOY, down 14.9 percentage points from the same period last year. China has been accelerating its reopening efforts since March, with the pandemic largely under control across the country. The YOY growth rate of the industry began to pick up speed, and the -1.1% decline was significantly (12.4%) narrower than the -13.5% during Jan–Feb. The rebound in economic activity was also seen by other indicators, including power generation, coal consumption and excavator sales.

- In 2020Q1, investment fell by 16.1% YOY, 8.4% narrower than during Jan–Feb. Q1's cumulative real estate investment fell by 7.7% YOY, significantly lower than manufacturing (-25.2%) and infrastructure investment (-16.4%). However, even the latter two improved significantly compared with Jan–Feb — 6.3% and 10.6% narrower, respectively — indicating recovering investment.

- In 2020Q1, cumulative exports were down by 13.3% YOY and cumulative imports down by 2.9%. Nonetheless, China's exports and imports have been gaining speed since March. Exports were 6.6% lower than the same period last year, 10.6% narrower than during Jan–Feb. As China accelerated its reopening efforts, a huge backlog of orders was fulfilled to help improve exports in March. ASEAN exceeded the EU for the first time as the largest trade partner of China. In 2020Q1, China's cumulative imports/exports with ASEAN totalled USD 142.19 billion, up 3.7% from the previous year, representing 15.1% of China's foreign trade. The volume of China-ASEAN trade grew by 3%, which was powered in part by rapid growth in integrated circuit trade. We expect to see stronger connections between China and Asian countries, including ASEAN members, in the future.

China has been strengthening counter-cyclical adjustments to cushion the impact of the COVID-19 pandemic at home and abroad. More flexible monetary policies and proactive fiscal policies were in place to mitigate companies' financial pressure, help companies get back on track as quickly as possible, improve employment, boost real economy investments and consumption, as well as offset the downward risks.

The People's Bank of China (PBOC) has undertaken a broad range of measures since February, including interest/RRR cuts, re-lending and re-discounting, to keep banking system liquidity at a reasonably ample level and to address the financial difficulties of small- and medium-sized enterprises:

Table 1: Monetary policy

Item		Actions
Interest Rates Cuts	Seven-Day Reverse Repo Rate	Seven-day reverse repo rate cut by 30 bps through open market operations on 3 February and 30 March
	One-Year MLF	One-year MLF cut by 30 bps in total on 17 February and 15 April
	One-Year LPR	One-year LPR cut by 30 bps in total on 20 February and 20 April
	Five-Year LPR	Five-year LPR cut by 15 bps in total on 20 February and 20 April
Reserve Requirement Ratio Cuts	Across-the-board RRR Cuts	6 January: The PBOC announced across-the-board RRR cuts of 0.5 percentage points for financial institutions, releasing about RMB 800 billion of liquidity into the financial system.
	Targeted RRR Cuts for Inclusive Finance	16 March: The PBOC announced RRR of 0.5-1 percentage points for banks that have met inclusive financing targets, and another 1 percentage point for qualified joint-stock commercial banks, releasing RMB 550 billion in total.
	Targeted RRR Cuts for Small and Middle Banks	3 April: The PBOC announced RRR cuts for rural banks and small city commercial banks will be lowered by 100 bps, with half the cut taking effect on 15 April and the rest on 15 May, to release RMB 400 billion in total.
Re-lending and Re-discounting	Targeted Re-lending Funds to Epidemic Control	7 February: The PBOC offered RMB 300 billion targeted re-lending funds to those companies included in the Key Enterprise List, with loan rates below 1.6%.
	Re-lending and Re-discount for SMBs	26 February: The PBOC announced a new batch of RMB 500 billion of re-lending and re-discounting quota, including a RMB 300 billion of re-lending quota to smaller firms, a RMB 100 billion re-lending quota to agricultural firms, and a RMB 100 billion of re-discounting quota. 31 March: The State Council meeting pledged another RMB 1 trillion of funding through the central bank's re-lending and re-discounting programme for small commercial financial institutes.
	Policy Banks' Special Credits	26 February: The PBOC increased policy banks' loan quota by RMB 350 billion to loan at preferential rates targeting private, small and medium enterprises.
Miscellaneous	Allowing for temporarily delayed repayment of capital and interest for small- and medium-sized enterprises; reasonable regulatory tolerance of NPL for banks in the worst-hit areas; lowering re-lending rate for smaller and agricultural firms by 0.25% to 2.5%; reducing the PBOC's Interest Rate on Excess Reserves (IOER) for financial institutions from 0.72% to 0.35%	

Source: Public information, KPMG analysis

The Ministry of Finance (MOF) has also announced a set of fiscal policies targeted at individuals, firms and local governments since the outbreak:

Table 2: Fiscal policy

Targets		Actions
Individuals	COVID-19 Patients (Confirmed and Suspected Cases)	Healthcare costs incurred by individuals, i.e. after basic medical insurance, serious disease insurance and medical assistance coverage, will be paid by the government.
	Front-line Healthcare and Disease Control Professionals	200-300 RMB/Day subsidy from the central government, depending on the risk levels; doubled temporary working subsidies for frontline healthcare professionals in Hubei (including medical teams sent to Hubei). The payable working days of frontline healthcare professionals working with serious and critical cases will be calculated as 1.5 times of actual working days.
Businesses	Key Enterprises in Pandemic Control 2020	The central government will provide interest subsidy (no longer than one year), aside from the preferential rates provided by financial institutions in PBOC's targeted re-lending funds programme.
	Hard-hit Companies/Industries in Financial Difficulties	The maximum carryforward period for losses incurred in 2020 is extended from five years to eight years.
	All	Starting from February 2020, enterprises enrolled in China Social Security Schemes in all provinces, autonomous regions, municipalities and Xinjiang Production and Construction Corps may reduce employer contributions to medical insurance schemes by 50% for no longer than five months.
	In Hubei	From 1 March 2020 to 31 May 2020, for small-scale taxpayers of value added tax in Hubei Province, the taxable sales income with 3% collection rate shall be exempted from value added tax; the prepayment of prepaid value added tax items with 3% pre-collection rate shall be suspended. Starting from February 2020, all Hubei enterprises enrolled in China Social Security Schemes (excluding government agencies and public institutions) are exempt from making employer contributions to pension, unemployment and work-related injury insurance schemes for no longer than five months.
	Small- and Medium-Sized Enterprises	From 1 March 2020 to 31 May 2020, for small-scale taxpayers of value added tax outside Hubei Province, a 1% rate shall be applied on taxable sales income with 3% collection rate and prepaid value added tax items with 3% pre-collection rate'.
		Starting from February 2020, all small- and medium-sized enterprises enrolled in China Social Security Schemes outside Hubei are exempt from making employer contributions to pension, unemployment and work-related injury insurance schemes for no longer than five months.
	Large Enterprises	Starting from February 2020, large enterprises enrolled in China Social Security Schemes outside Hubei (excluding government agencies and public institutions) may reduce employer contributions to pension, unemployment and work-related injury insurance schemes by 50% for no longer than three months.
Local Governments		The central government has permitted all local governments to increase their respective retention rate of fiscal revenues as working capitals by 5% for four months this year (1 March 2020 to 30 June 2020).

Source: Public information, KPMG analysis

At the Political Bureau meeting on 19 April, it was announced that China will further strengthen fiscal support through "higher deficit ratio, COVID-19 national bonds and special bonds of local governments", emphasizing "Six Guarantees" (ensuring residents' employment, people's basic livelihood, market players, food and energy security, stable industrial chain and supply chain, and operation of the grassroots political authority) for the first time based on "Six Stabilities" (stabilising employment, finance, foreign trade, foreign investment, investment and expectations). It was evident that the Chinese government used the bottom-line thinking and took a more pragmatic policy stance.

Globally, the spread of the COVID-19 pandemic has resulted in acute economic fallout, plummeting prices of bulk commodities, soaring unemployment figures, and declining investor and consumer confidence. There is tremendous uncertainty regarding the business outlook. IHS Markit data show that the April PMI of advanced economies, including the US, the EU, Japan and the UK, was at a worse-than-expected historic low. On 14 April, International Monetary Fund (IMF) downgraded World Economic Outlook projection by 6.3%, saying "the global economy is projected to contract sharply by 3% in 2020". Meanwhile, "the global economy is projected to grow by 5.8% in 2021 as economic activity normalises", 2.4% higher than previous forecasts. The report indicated "the world economy may experience the worst recession since the great depression". Quarantines, lockdown and social distancing — all these measures may cause drastic economic contraction all over the world in the short term. Given the extreme uncertainty around the duration of the COVID-19 pandemic, demands, industry value chains, as well as financial and bulk commodities markets will be under intense pressure, severely impacting the world economy.

Special study: Focus on the COVID-19 pandemic's impact on foreign investment in China

The impact of COVID-19 on the world economy is reflected by changes in Foreign Direct Investment (FDI). A recent United Nations Conference on Trade and Development (UNCTAD) survey of 5,000 multinationals shows that around 80% of the respondents have lowered earnings outlook by 30% on average since February. Considering that lower earnings are bound to put pressure on FDI, UNCTAD expects to see a 30–40% decrease in global FDI during 2020–2021.

In fact, global FDI has been dwindling for the fourth year in a row — even before the pandemic — as the result of stalling globalisation. By contrast, China's FDI has steadily grown to 10% of global total, a great outcome amidst the current situation. Despite a 10.8% YOY decrease in Q1, China's FDI stabilised in March with significantly narrower decrease than in February. Foreign investors are showing stronger confidence in China, where the pandemic is largely under control and the government leading global reopening efforts.

Unlike portfolio investments, cross-border investments may be affected by short-term factors like pandemics, however, such investments tend to focus more on market environment and long-term outlook. The favourable macroeconomic outlook, economic resilience, improving operating environment, scaled-up opening, complete industry chains and outstanding resources of China still have a strong appeal to foreign investors, making it one of the most important FDI destinations.

Notably, here are four areas that will likely see more FDI in the future.

- In China, for China: China is becoming the world's largest consumer market. In the global market, a country's economic strength might be best attested by its "buying power". The booming urbanisation in China, especially the rapid development of central cities and city clusters, will help release colossal consumption potential at all levels. In addition, the vast market determines that "In China, for China" will be a core strategy of multinationals investing in China.

- Improved IP protection to attract more high-tech investments: "Innovation-driven Growth" is a key strategy of China, which could be realised with effective intellectual property (IP) protection. In recent years, China has reinforced its commitments to IP by signing many bilateral or multilateral agreements with other countries. Notably, IP protection is one of the core topics in the US-China Phase 1 Trade Deal. Improved IP protection will help China attract more high-tech investments.

- Great potential in green industry: Recently, environment-friendly development has been one of the top priorities of the Chinese government. However, environmental protection investments — despite their rapid growth — remain a relatively smaller portion of GDP, presenting greater potential. In the latest version of Foreign Investment Guideline, green manufacturing, energy conservation and environmental protection are listed as key areas of foreign investment.

- Faster growth in healthcare sector expected: The healthcare sector is gaining traction amid the pandemic. Considering the strong demand and policy support, we expect to see further growth in the sector. As China opens its healthcare market to foreign investors, FDI in the healthcare sector may speed up in the future.

The COVID-19 pandemic could be the largest challenge to the world economy since the Great Depression, in terms of both temporal economic impacts, and profound ramifications for global politics, economy, science, trade and investment in the medium to long term. Some countries are considering "paying the moving fees of companies leaving China" to encourage manufacturing reshoring. Some officials are also calling for reducing over-dependence on Made-in-China medicines and devices, such as APIs and respirators. However, reshaping the global value chain based on a high degree of labour division is by no means easy. Fundamentally, it is a business trade-off for profitable balance across corporate strategy, market, costs and benefits. Market proximity, lower costs and complete value chains are the key to enterprises' investment decisions.

Economic laws determine that some labour-intensive industries will be relocated to areas with higher cost efficiency. That's what happens now when China faces demographic changes and rising costs. Against this background, we could say, that on the one hand, the enormous market size and a complete and efficient industrial chain are the major reasons for companies to invest in China; on the other hand, China must fully recognise the future risks and challenges, which entails scaled-up opening and accelerated industrial upgrading and transformation. Only through stable economic growth can China continue to be considered one of the most attractive FDI destinations.

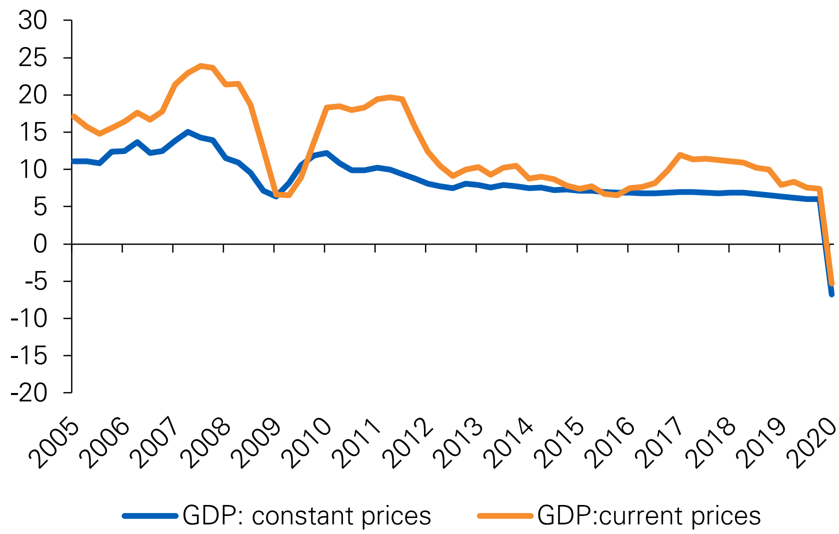
1

Economic trends

Historically low Q1 economic growth due to the pandemic

In 2020Q1, China's real GDP growth rate was dragged down by the COVID-19 pandemic and hit a historic low of -6.8% YOY — the first-ever negative number recorded since the establishment of the quarterly GDP accounting system. The real growth in Q1 was 12.8% and 13.2% lower than in 2019Q4 and 2019Q1, respectively, indicating a far worse impact on China's economy than the 2008 global financial crisis. The nominal GDP growth in Q1 was 7.8% YOY, down 12.7 and 13.2 percentage points from Q4 and Q1 last year, respectively.

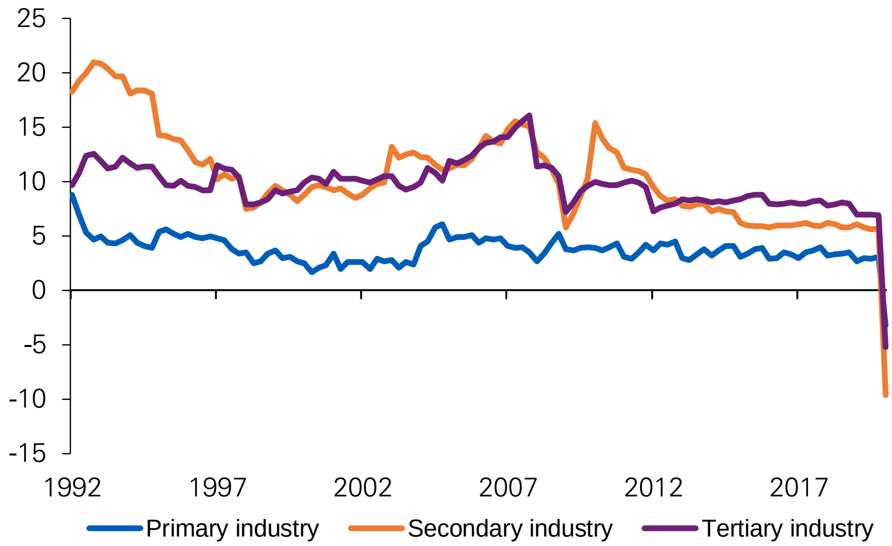
Figure 1: GDP growth rate, quarterly YOY, %



Source: Wind, KPMG analysis

By industry, the secondary industry was the largest drag on GDP with a 9.6% decrease in the growth rate of value added, amid the overall deceleration of all three industries. Among them, the primary industry (-3.2%) was relatively less impacted, but the animal husbandry sector was hit hard. The manufacturing (-10.2%) and construction (-17.5%) sectors were the major reason for the sharp drop in the secondary industry — both showed a double-digit decline in cumulative YOY terms, which was 16.7% and 23.7% lower than the same period last year, respectively. The service industry recorded a 5.2% drop, as the accommodation and catering sector was hit the hardest by the pandemic, whose added value shrank by 35.3% in cumulative YOY terms, indicating a 41.3% slower growth over the same period last year. However, this was partially offset by the strong performance of the emerging service industry. The information transmission, software and information technology sector grew by 13.2%, driven by the rising online education and remote diagnosis services during the pandemic. In addition, the finance sector grew by 6.0% in cumulative YOY terms.

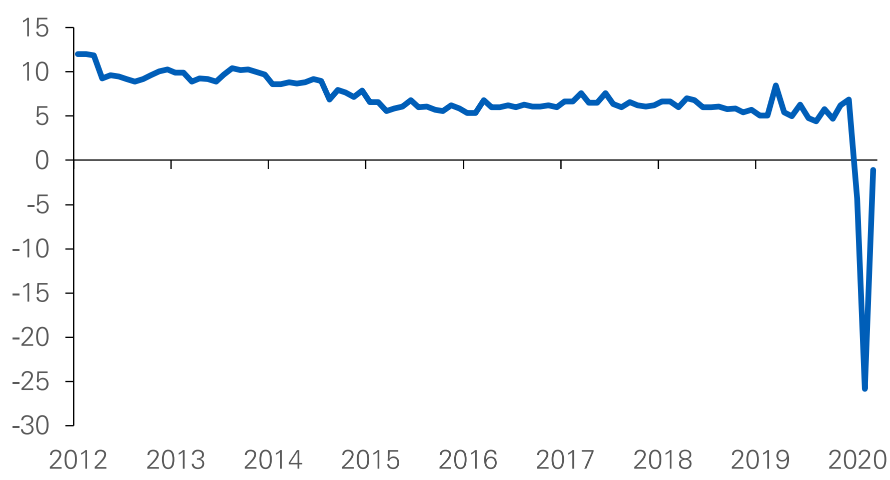
Figure 2: Growth rate by sector, cumulative YOY, %



Source: Wind, KPMG analysis

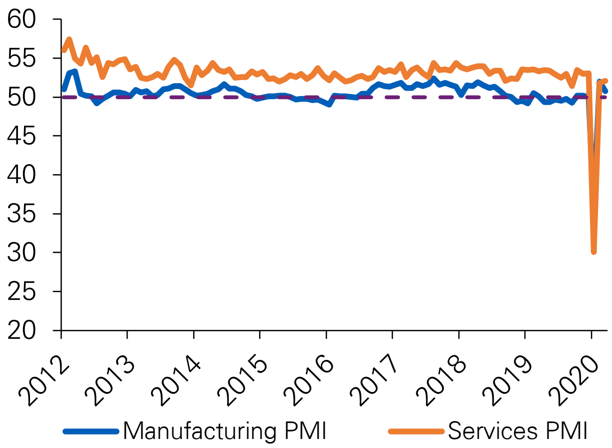
In 2020Q1, the value added of the industrial enterprises decreased by 8.4% YOY, down 14.9 percentage points from the same period last year. China has been accelerating its reopening efforts since March, with the pandemic largely under control across the country. The YOY growth rate of the industrial value added began to pick up speed, and the -1.1% decline was significantly (12.4%) narrower than the -13.5% during Jan–Feb. The was also reflected by other indicators, including power generation, coal consumption and excavator sales. In March, manufacturing PMI exceeded the threshold at 52.0. The 16.3% increase over February indicated rapid recovery of economic activities and outstanding stress tolerance of the manufacturing sector. Despite the narrowing decrease in growth rate, exports will be under greater pressure, and the outlook for continuous recovery is far less than optimal as the global pandemic continues to spread.

Figure 3: Industrial value added , monthly YOY, %



Source: Wind, KPMG analysis

Figure 4: China manufacturing and services PMI, current month value, %

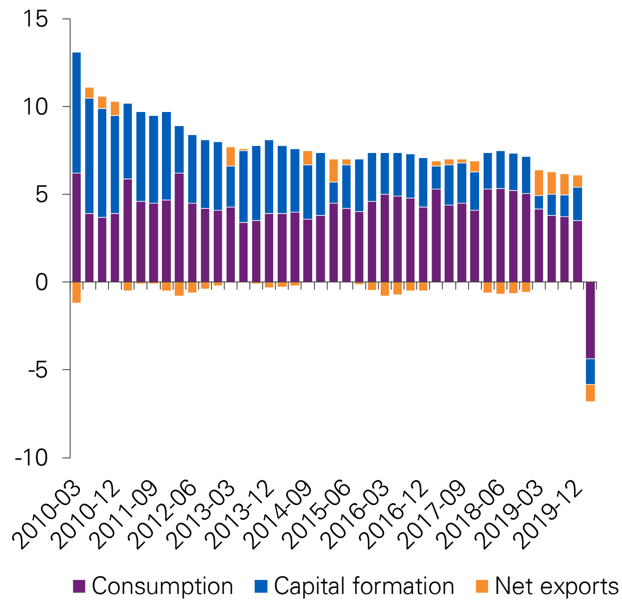


Source: Wind, KPMG analysis

In Q12020, and particularly in February, the suspension of industrial activities due to the pandemic outbreak resulted in negative growth in value added across all major sectors. The automobile sector was impacted the most, with Q1 growth rate declining sharply by 26%-26.2% over the same period last year. Other sectors, such as general equipment, textiles, rubber and plastics, metal products, also recorded double-digit decline in the growth rate of value added, which was far below the average of enterprises above designated size. Nevertheless, a series of supportive policies have been implemented since March to accelerate the reopening efforts. As a result, the growth rate of value added in all major sectors improved drastically. Notably, computers and communications increased by 23.7% from in Jan–Feb, while pharmaceuticals rose 22.7%.

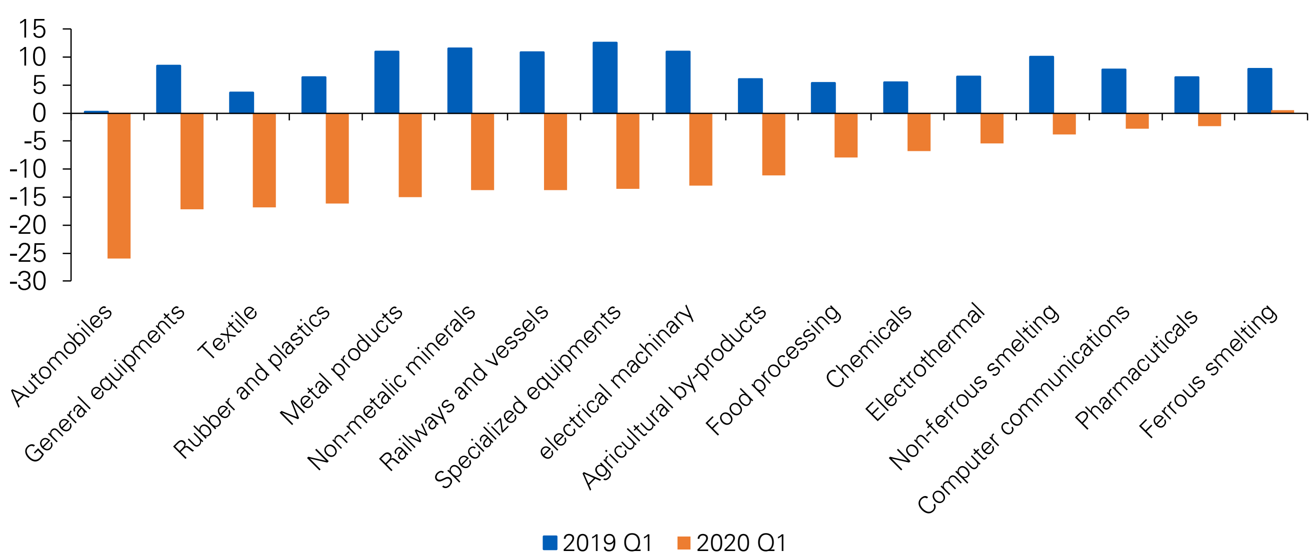
On the demand side, the COVID-19 pandemic hit China hard in terms of consumption, investment and net exports. In Q1, the contribution of final consumption expenditure to GDP reached 64.1%, dragging economic growth down by 4.4 percentage points; total capital formation, 21.5%, down 1.5 percentage points; and net exports, 14.4%, down 1.0 percentage points.

Figure 6: Growth of GDP by activity type, cumulative value, %



Source: Wind, KPMG analysis

Figure 5: Growth rate of value added in major sectors, cumulative YOY, %

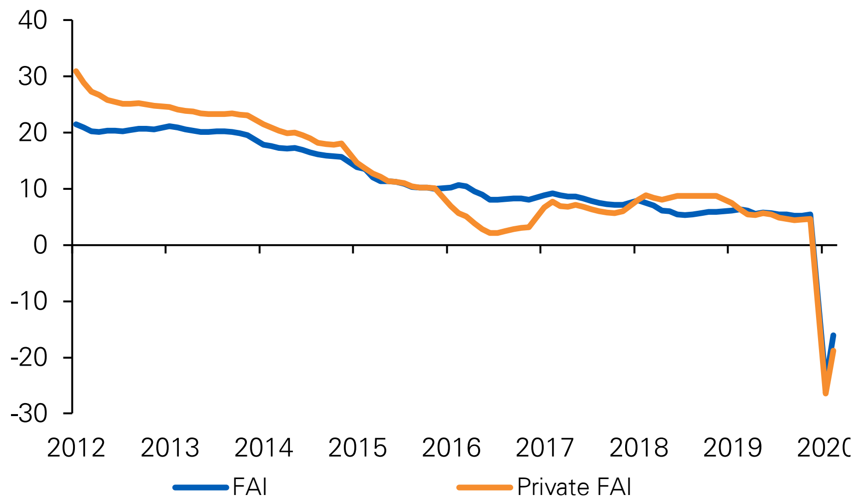


Source: Wind, KPMG analysis

Decline in fixed asset investment narrowed

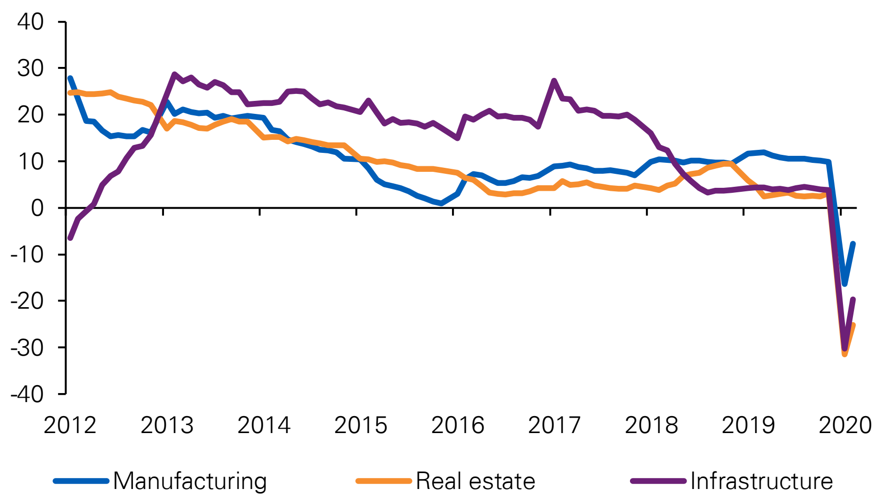
In 2020Q1, the growth rate of fixed asset investment fell by 16.1% YOY, 21.5% lower than in 2019 but 8.4% narrower than in Jan–Feb. In 2020Q1, the growth rate of private fixed asset investment fell by 18.8% YOY cumulatively, 23.5% lower than in 2019 but 7.6% narrower than in Jan–Feb.

Figure 7: Fixed asset investment, cumulative YOY, %



Source: Wind, KPMG analysis

Figure 8: Fixed asset investment by subsector, cumulative YOY, %



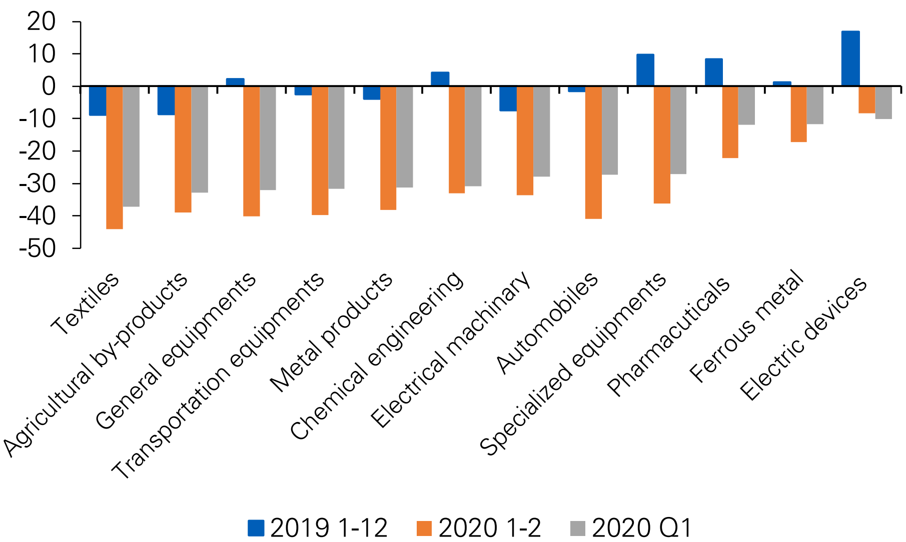
Source: Wind, KPMG analysis

Manufacturing investment stagnant due to weak external demand

In 2020Q1, the growth rate of manufacturing investment fell by 25.2% YOY, 28.3% lower than in 2019 but 6.3% narrower than in Jan–Feb. All subsectors showed higher-than-industry-average decline in investment, except for pharmaceuticals (-11.9%), non-ferrous metals (-11.6%) and electronics (-10.2%). In Q1, investment in high-tech sectors was 12.1% lower YOY. Notably, the decrease in both high-tech manufacturing (-13.5%) and high-tech service (-9.0%) was much higher than the industry average.

This could be explained by weak external demand and exports amid the global pandemic — fewer companies intend to invest, in spite of monetary and fiscal policies on enterprise financing and tax reduction/exemption announced since February.

Figure 9: Investment growth rate of manufacturing subsectors, cumulative YOY, %



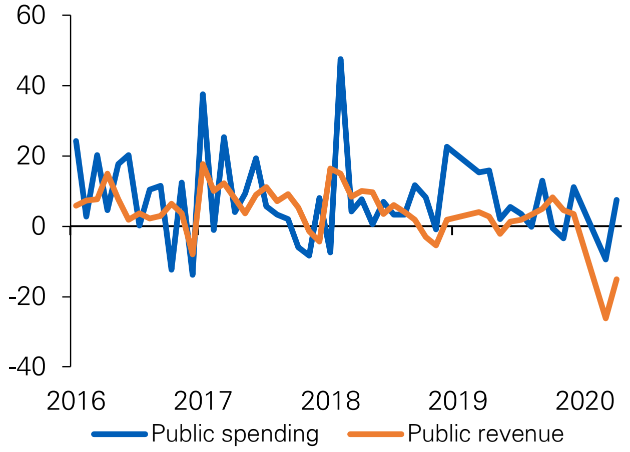
Source: Wind, KPMG analysis

Remarkably narrower decline in infrastructure investment; rebound expected in Q2

In 2020Q1, infrastructure investment (excluding electricity) fell by 16.4% YOY cumulatively, 19.7% lower than in 2019 but 10.6% narrower than in Jan–Feb. By subsector, railway transport was the major drag, falling by 28.6% YOY (3.1% narrower than in Jan–Feb), which was below average in infrastructure investment.

As a result of the pandemic and continuing influences of taxes and fees reduction, the growth rate of public revenue dropped further from -9.9% YOY in Jan–Feb. to -26.1% in March, the lowest level since 1990. The cumulative growth rate (-14.3%) of public fiscal revenue also saw a similar trend in Q1'.Consequently, the cumulative growth rate of public fiscal expenditures in Q1 dropped by 5.7% YOY.

Figure 10: Public fiscal revenue and expenditure, monthly YOY, %



Source: Wind, KPMG analysis

The government has accelerated and scaled up bond issuance to ensure sufficient funds for offsetting the pandemic's impact on the national economy. In November 2019, the State Council, entrusted by the NPC, announced a special debt limit of RMB 1 trillion in advance for 2020, and an additional debt limit of RMB 848 billion in advance in February 2020 (comprising a general debt limit of RMB 558 billion and a special debt limit of RMB 290 billion). The total of RMB 1,848 billion was equal to 60% of last year's total and the maximum amount within NPC's authority.

From January to March 2020, local bonds valued at RMB 1610.5 billion were issued. Among them, RMB 1542.4 billion were newly added, 83.5% of quotations announced in advance. RMB 459.5 billion were general debts (82.3% of quotation) and RMB1082.9 special debts (83.9% of quotation). [1]

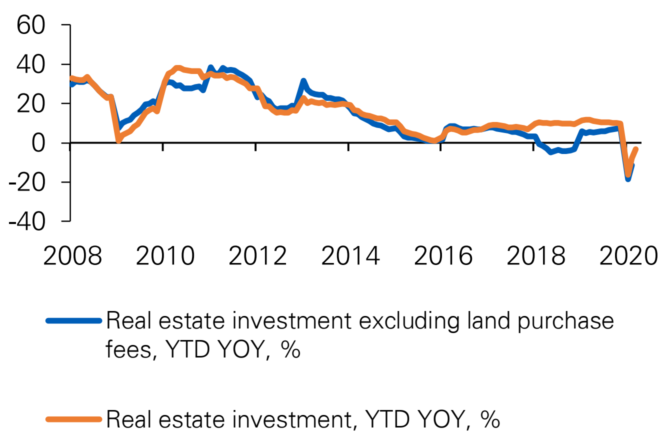
Conventionally, the remaining additional debt limits of local governments will be announced after approval by NPC in March every year. This year was an exception, when the annual NPC and CPPCC sessions were postponed until late May due to the pandemic. In order to avoid delays in local debt issuance, on 20 April MOF announced the third round of RMB 1 trillion debt limits in advance, as per the decision of the State Council executive meeting, making the debt limits add up to RMB 2.29 trillion. These efforts were aimed at expanding investment to offset weak domestic and external demand amid the pandemic. In addition, the central government has expanded the focus of special debts from infrastructure and livelihood to old building renovation, public health and emergency healthcare. MOF has also encouraged local governments to complete the issuance of RMB 2.29 trillion of special debt to boost infrastructure investment in Q2.

In April, many provinces announced increased investment in traditional and new infrastructure alike. The transport sector will be a key focus for traditional infrastructure. Jiangsu and Zhejiang have revealed their ambition of "building provincial strength in transport", and some "transport mega-projects" with a total investment of over RMB 3 trillion will be under way in Zhejiang. Fujian, Jiangxi and Guangdong included new infrastructure in their digital economy blueprint, planning to increase investments in 5G and data centres. [2]

Significant improvement/growth in real estate investment

In 2020Q1, the growth rate of real estate investment fell by 7.7% YOY cumulatively, which was 17.6% lower than in 2019 but 8.6% narrower than in Jan–Feb, and significantly higher than that of manufacturing and infrastructure investment. Excluding land acquisitions, the Q1 growth rate of real estate investment fell by 11.3% YOY cumulatively, which was 19.3% lower than in 2019 but 7.3% narrower than in Jan–Feb.

Figure 11: Real estate development investment growth vs. investment growth, excluding land acquisitions, Cumulative YOY, %

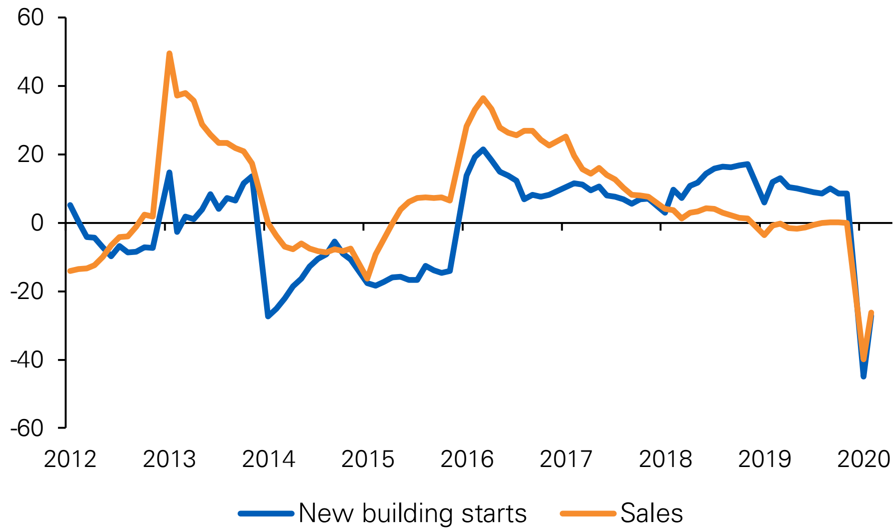


[1] Local Government Bond Issuance and Outstanding Debt in March 2020. 7 April 2020. http://www.gov.cn/xinwen/2020-04/07/content_5499955.htm

[2] Local Governments Reinforce Commitments to Stabilizing Investment with Proliferating Traditional and New Infrastructures. 22 April 2020. Xinhuanet. http://www.xinhuanet.com/fortune/2020-04/22/c_1125888306.htm

As for real estate sales, the Q1 growth rate of total sales of commercial housing nationwide dropped by 26.3%, 13.6% narrower than in Jan–Feb. This was mainly because of the housing demand released by online sales and higher discounts. Driven by an increase in sales and reopening, new construction area of housing showed signs of recovery in March. The growth rate of new construction area of housing fell by 27.2% YOY, 35.7% lower than in 2019 but 17.7% narrower than in Jan–Feb.

Figure 12: New construction and sales area of real estate, cumulative YOY, %



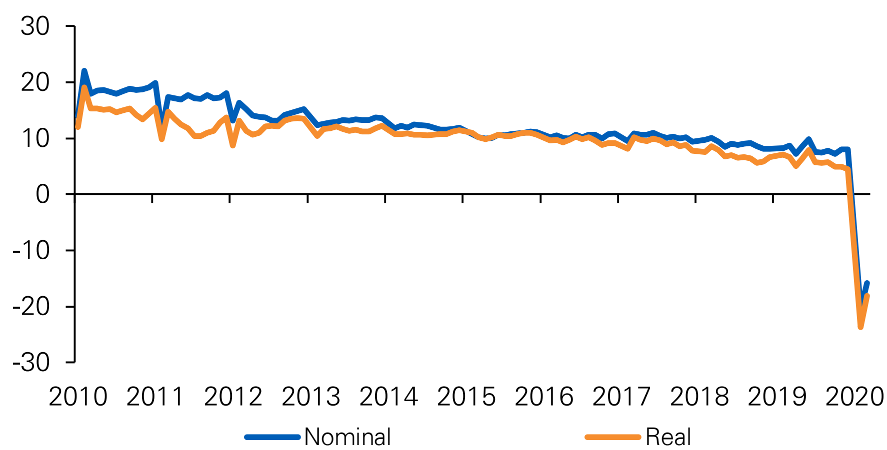
Source: Wind, KPMG analysis

The Political Bureau meeting on 17 April reaffirmed the tone for real estate regulation: "Housing is for living in, not for speculation". We expect to see "city-specific" regulations on real estate and policies on both supply and demand to stabilise expectations, stimulate "rational" home ownership and ease the financial pressure on businesses. In the future, real estate investments and sales will be supported by increased land supply relaxation of requirements/rules of household registration system, and old/run-down area renovation. However, the pandemic's impact on housing demands and financial pressure will not fade quickly.

Consumption of consumer staples remained strong while overall consumption was hit hard

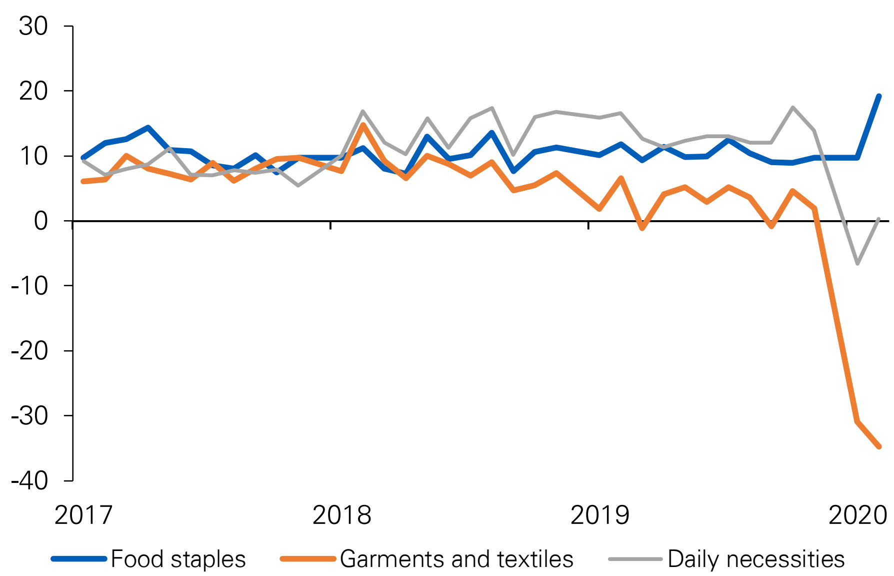
In March, the total retail sales of consumer goods staged a weak rally, dropping by 15.8% and 18.1% YOY in nominal and real term, respectively, 4.7% and 5.6% narrower than in Jan–Feb. The cumulative YOY growth rate was -19.0% in Q1, down 27 percentage points from the previous year. More specifically, consumption of consumer staples remained strong: the growth rate of foods consumption was up by 19.2% in March, and that of daily necessities turned positive to 0.3%. The textile and garment sector was the only exception, with its growth rate further sliding -34.8% as a result of stay-at-home measures during the pandemic.

Figure 13: Total retail sales of consumer goods, YOY, %



Source: Wind, KPMG analysis

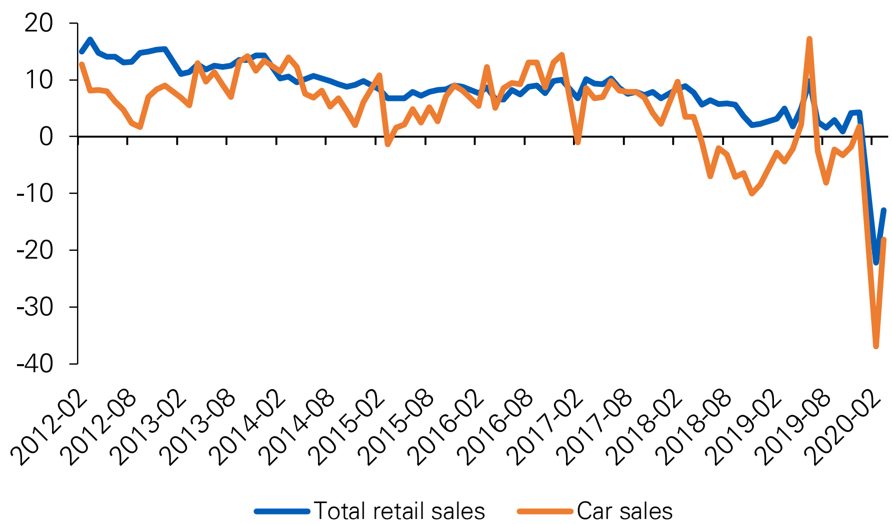
Figure 14: Total retail sales of consumer staples, YOY, %



Source: Wind, KPMG analysis

In the consumer discretionary purchase arena, automobile-related consumption remained stagnant in March with a decrease of 18.1% YOY, although 18.9% narrower than in February. At the State Council executive meeting on 31 March, three actions to stimulate automobile consumption were announced: first, the subsidy and purchase tax exemption for NEVs will be extended for another two years; secondly, the Central Government will take a "rewarding-instead-of-subsidising" approach in supporting key areas, i.e. Beijing, Tianjin and Hebei, in order to discontinue the use of diesel vans under National III Emission Standard; thirdly, a 0.5% additional tax will be imposed on used vehicle sales from 1 May, 2020 to 31 December, 2023. The Ministry of Industry and Information Technology MIIT also said there would be more incentives to boost automobiles consumption. We expect to see improved automobiles consumption in Q2 with these policies.

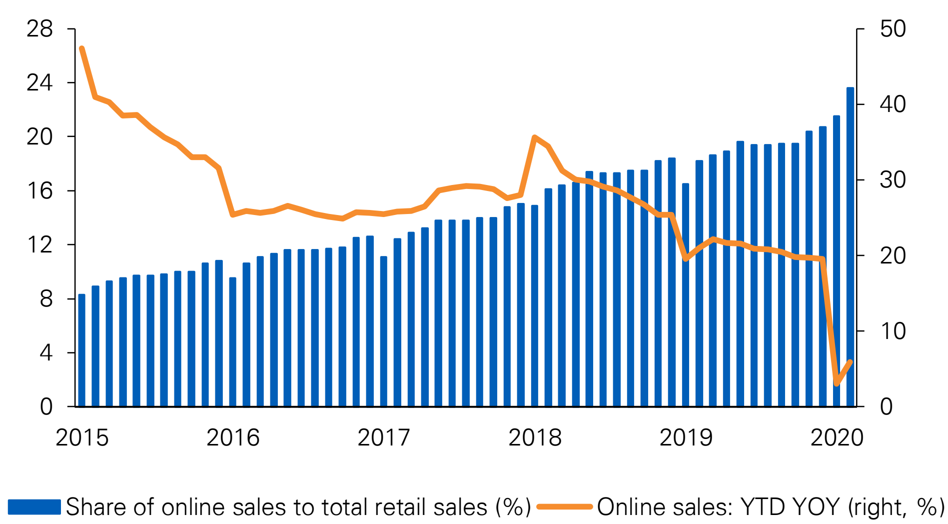
Figure 15: Total retail sales vs. car sales, YOY, %



Source: Wind, KPMG analysis

In 2020Q1, the online consumption of physical goods increased by 5.9% YOY. Although the growth rate was 13.6% lower than in 2019, it was 2.9% higher than in Jan–Feb, and much higher than the overall growth rate of retail sales. The proportion of online sales sales continued upward to 23.6%, 2.1% higher than in Jan–Feb.

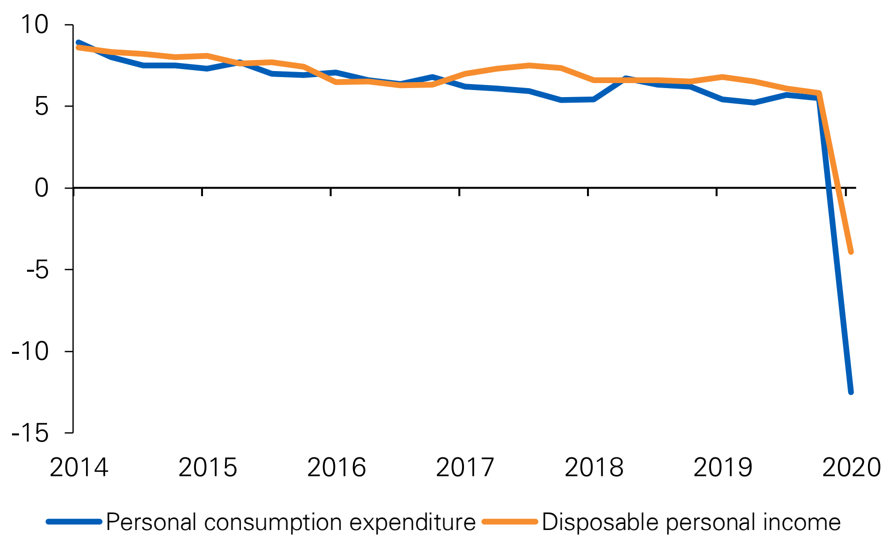
Figure 16: Online consumption purchases and share of total retail sales, %



Source: Wind, KPMG analysis

In 2020Q1, the per capita household disposable income decreased by 3.9% YOY (9.7% lower than in 2019) and the per capita consumption expenditure growth rate was -12.5% YOY (18% lower than in 2019) — both slumping to historic lows. Worse still, the employment situation was very challenging. In March, the surveyed urban unemployment rate remained at a high level, showing a slight drop from 6.2% in February to 5.9%. In 2020Q1, 2.29 million jobs were created, 29.3% less than the same period last year. In contrast, the number of 2020 college graduates will soar to a historic high at 8.7 million. In addition, the labour released from offline service and export sectors — the worst-hit sectors — will further add pressure on the demand-supply balance in the employment market. At the Political Bureau meeting on 17 April, the "Six Priorities" concept was introduced for the first time, i.e. ensuring stability in the Six Key Areas — employment, people's livelihoods, the development of market entities, food and energy security, stable operation of industrial and supply chains, and smooth functioning at the community level. The only connection between "Six Priorities" and previous "Six Stabilities" (stabilising employment, finance, foreign trade, foreign investment, investment and expectations) is "employment", a stark illustration of its importance to the Central Government.

Figure 17: Per capita household disposable income vs. per capita household consumption expenditure, actual cumulative YOY, %



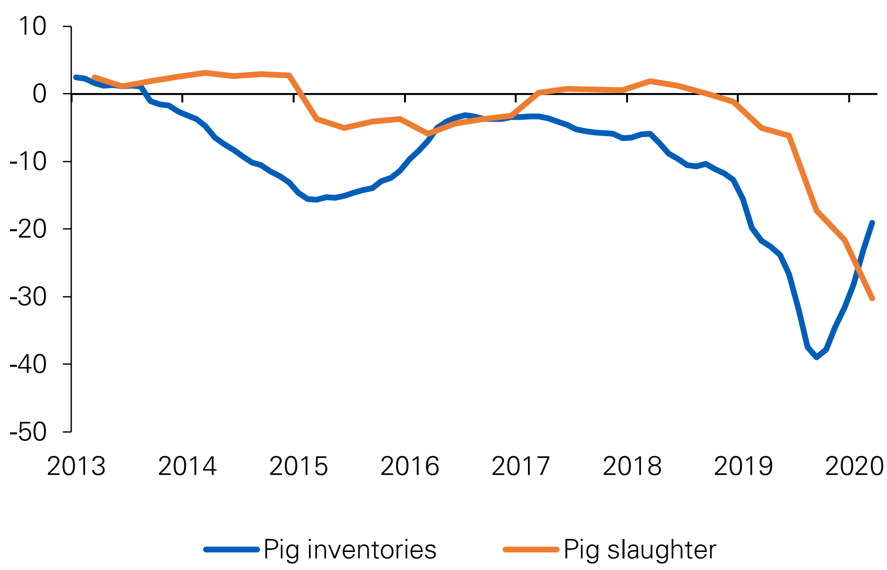
Source: Wind, KPMG analysis

Consumer price inflation expected to fall as pork supply restored

In 2020Q1, Consumer Price Index (CPI) grew by 5% YOY, 0.7% higher than in 2019Q4 and a new high since 2012. The growth rate of CPI in Jan–Feb rose by 5%+ YOY due to the Spring Festival and quarantine, before declining to 4.3% in March — a 1.2% decrease month-on-month. However, hog production continued a downward trend in Q1, leading to a 122.5% price increase YOY. This was the main reason behind the high level of CPI.

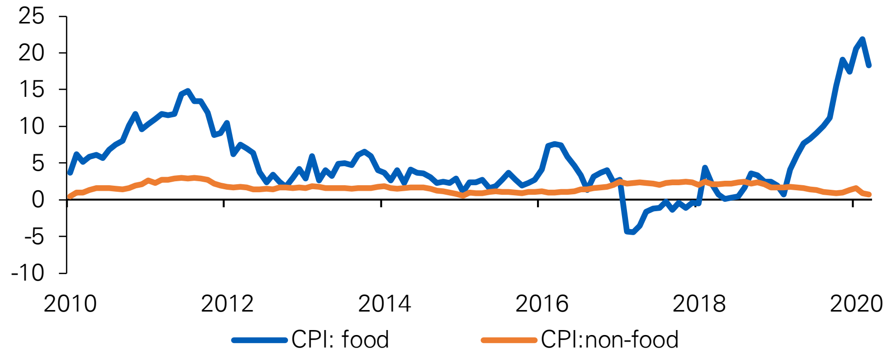
Notably, as the pandemic was put under control in March, China gradually removed restrictions on logistics, hog slaughter and transport. The government also strengthened supply of pork reserves. All these factors contributed to the decline of YOY growth rate of pork prices from 135% in February to 115% in March. On the other hand, sow stocks bottomed out last September and have risen since then. Pork supply is expected to gradually recover by mid 2020, and pork prices should move downward. Meanwhile, CPI is also expected to drop significantly YOY, affected by the structural high base of CPI in the second half of 2019.

Figure 18: Pig inventories and slaughtering , YOY, %



Source: Wind, KPMG analysis

Figure 19: Food and non-food CPI, monthly YOY, %

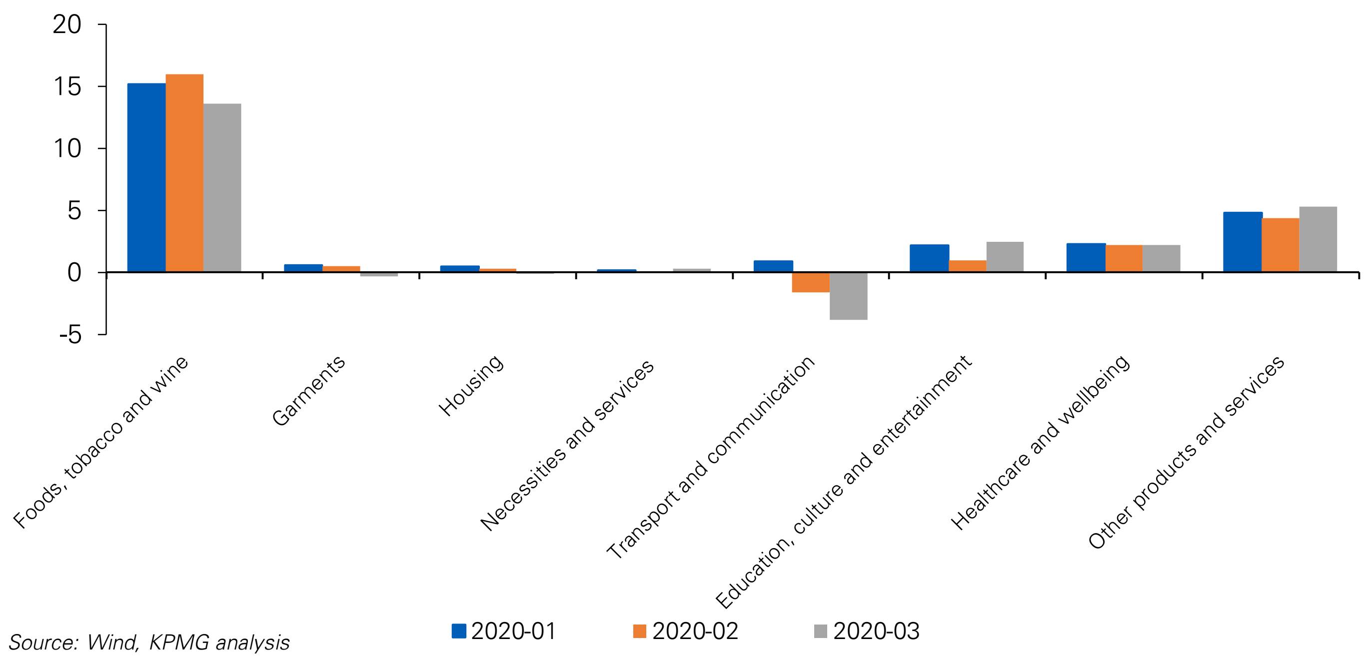


Source: Wind, KPMG analysis

The spillover effect of soaring pork prices also kept the growth rate of beef/sheep prices high in Q1. The prices of fresh vegetables also rose, by 14% YOY in Jan–Feb, due to logistic restrictions caused by the pandemic, before being dragged down by many factors in March, such as seasonal yields, recovering logistics and enhanced supply. Notably, although food export bans by some countries have caused food price to rise, China is largely immune to such price fluctuations as China does not rely on imports for almost all staples — with soybeans. Being an important exception, global food prices are nearly irrelevant to China, and this was reflected by the 0.6% increase in food price in Q1.

At the same time, a weaker demand, reduced mobility and plunging oil prices contributed to slower growth rate of non-food CPI in Q1, narrowing from 1.6% YOY in January to 0.7% in March. The prices of garments, housing, daily necessities and services remained at the previous year’s level, while those of mobility and communications were down by 3.8% in March, and fuel down was by 14.6% — the main reason for lower non-food CPI. In addition, the 1.2% YOY growth of core CPI (excluding foods and energy) was relatively low: this will set the stage for monetary policies.

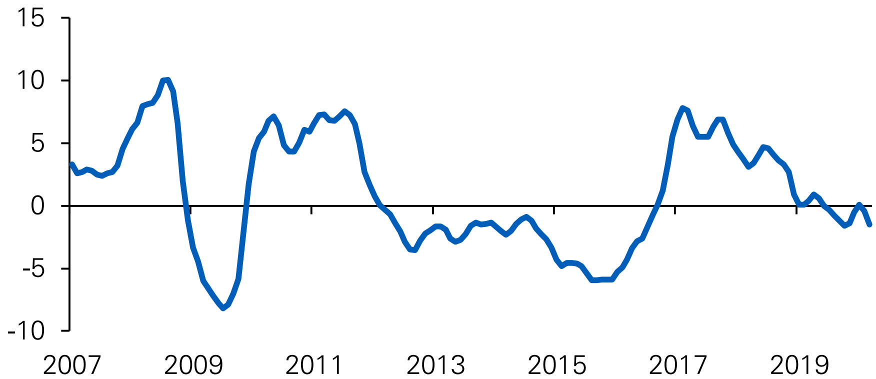
Figure 20: CPI by categories, YOY, %



Source: Wind, KPMG analysis

In 2020Q1, the producer price index (PPI) dropped by 0.2% YOY, down 0.6 percentage points from Q4 2019. By month, the temporal positive PPI growth in January, powered by a slight increase in industrial production, was the major reason for narrowed decline of PPI in Q1. However, it turned negative again in February, due to postponed production related due to pandemic control, weak demand and declining oil prices. In March, the global spread of COVID-19 and failures of OPEC+ deals on oil production cuts led to the slumping of oil price, and in turn, widened YOY decrease in PPI to 1.5%.

Figure 21: Industrial PPI, YOY, %

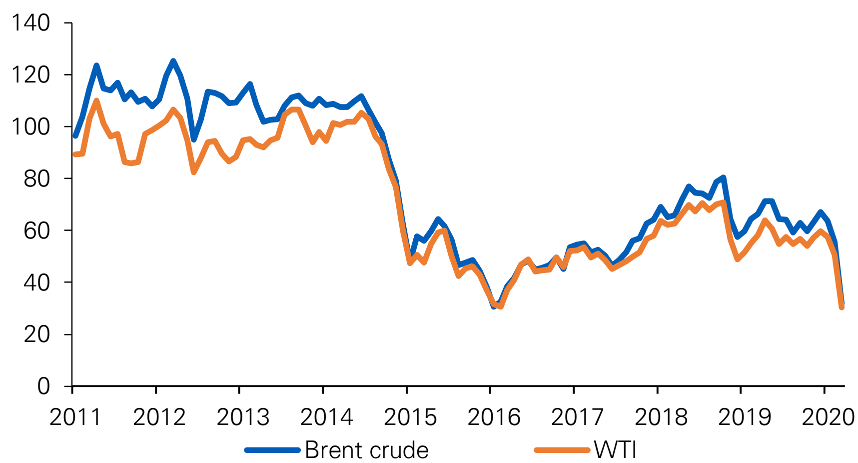


Source: Wind, KPMG analysis

By industry, industries closely related with oil, such as oil and gas production (-21.7%), oil/coal/fuel processing (-10.6%), chemical materials (-5.3%), and fibres (-12.4%), were seeing large price drops, and therefore, widened decrease in PPI. Ferrous/non-ferrous metals processing industries also saw a similar trend as the prices of bulk commodities dropped. In addition, the domestic reopening efforts were still in progress in March. This, plus weak demands, resulted in lower prices YOY in textile and garment, wood processing, and rubber and plastics industries.

In middle-late March, more countries implemented stricter social distancing and lock-down practices, leading to further shrinking of external needs. PPI is expected to continue to decline in Q2, considering the contracting demands for bulk commodities due to plant shutdown; low level of oil, coal and steel prices; and the effects of high base in 2019.

Figure 22: Monthly average crude oil spot price, USD/barrel

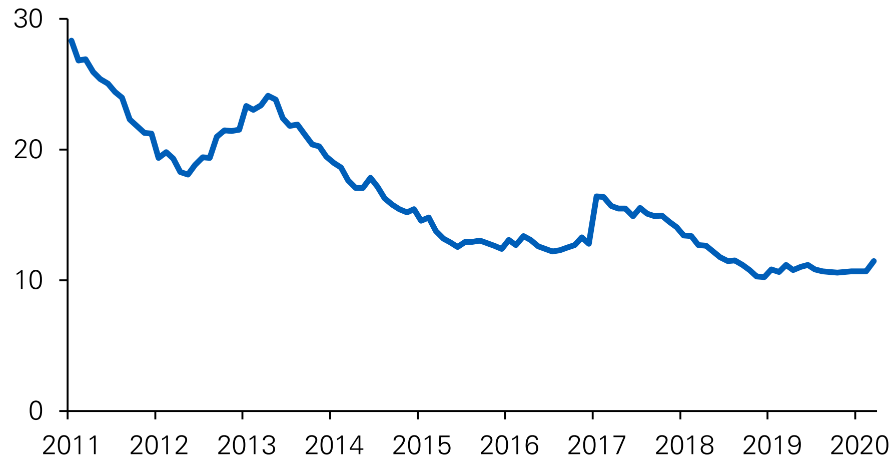


Source: Wind, KPMG analysis

TSF growth picked up speed amid strong enterprise financing needs

As of the end of March, the stock of Total Social Financing (TSF) totalled RMB 262.24 trillion, increasing by 11.5% YOY; new TSF was RMB 5.16 trillion, a historic new high with a YOY increase of RMB 2.2 trillion. Meanwhile, broad money supply (M2) grew by 10.1% YOY, with a 1.3% higher growth rate compared with the previous month — also a historic new high since April 2017. The strong growth in TSF and M2 reflected the government's enhanced counter-cyclical adjustments to offset downward risks.

Figure 23: TSF stock, monthly YOY, %



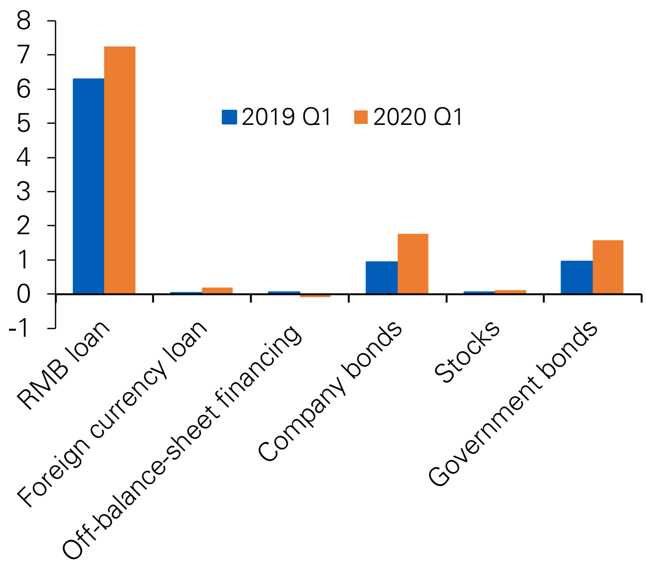
Source: Wind, KPMG analysis

Figure 24: Broad money supply (M2), monthly YOY, %

Source: Wind, KPMG analysis

In Q1, new TSF increased by RMB 11 trillion yuan, RMB 2.5 trillion more than the same period last year. Of this, new RMB loans totalled RMB 7.25 trillion, an increase of RMB 1 trillion yuan over the same period last year; non-standard financing (including entrusted loans, trust loans and undiscounted bank acceptance bills) only decreased by RMB 84 billion over the same period last year, thanks to the significant increase in off-balance-sheet bill financing; new enterprise bonds totalled RMB 1.77 trillion, an increase of RMB 0.85 trillion over the same period last year; and new stock financing totalled RMB 130 billion, an increase of RMB 70 billion over the same period last year. Local government special bonds issued in advance constituted the majority of government bonds, which totalled RMB 1.58 trillion in Q1, an increase of RMB 600 billion over the same period last year.

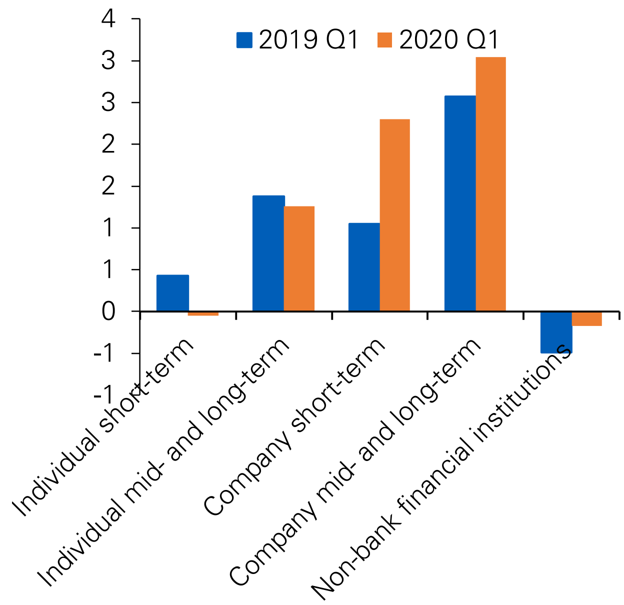
Figure 25: Composition of new TSF, RMB trillion



Source: Wind, KPMG analysis

By proportion, new RMB loans, enterprise bonds and government bonds were the most important sources of TSF growth in Q1. In particular, new RMB loans accounted for 67% of new TSF. Structurally, short-term enterprise loans totalled RMB 2.3 trillion in 2020Q1, almost doubling over the same period last year; mid- and long-term enterprise loans and long-term enterprise loans totalled RMB 3.04 trillion, an increase of RMB 500 billion. This could be attributed to the strengthened government support to enterprise credits and successful reopening. Notably, both short-term and mid- and long-term household loans showed a slight drop from 2019; however, they rebounded to 19.8% and 2.9%, respectively, after bottoming out in February. We expect to see higher household loans as the automobiles and real estate markets transition back to "business as usual".

Figure 26: Composition of new RMB loans, RMB trillion



Source: Wind, KPMG analysis

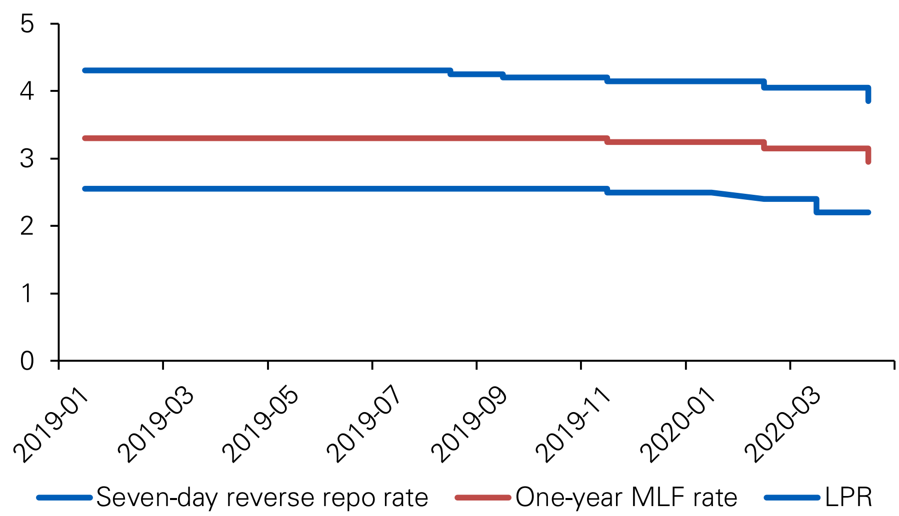
In Q1, the percentage of enterprise bonds in new TSF increased by 5.4% over the same period last year to 16.3%. As enterprises resumed to "business as usual" in March, financing needs and lower interest rates pushed enterprise bond financing to increase by RMB 600 million, compared with that in February. As per the instructions released/announced at the State Council executive meeting on 31 March, the net financing of corporate credit bond will increase by RMB 1 trillion over the previous year. Meanwhile, as a registration system was implemented for corporate debt and enterprise debt issuance, approval efficiency will be improved. We estimate that RMB 1.4 trillion in new corporate debt will be issued in the last three quarters of 2020. In addition, considering the issuance of special national bonds and the scaling-up of local government special bonds, we expect TSF to continue to remain at a high level in 2020Q2, which, in turn, will accelerate the growth of M2.

Strengthened monetary policies to offset the economic impact of the pandemic

In order to tackle the negative impact of the COVID-19 pandemic on the economy, PBOC has taken a series of actions, including interest cuts, RRR cuts, re-lending and re-discount, to provide loans to the worst-hit areas, industries (such as agriculture and foreign trade) and enterprises (including SMBs). These measures are aimed at offsetting the economic impacts of the pandemic at home and abroad by investing in the real economy and stimulating consumption.

The Seven-Day Reverse Repo Rate has been adjusted down two times this year alone, from 2.5% at the end of 2019 to 2.2%. Since the LRP (Loan Prime Rate) reform in August 2019, PBOC has established a "standard" route from Reverse Repo Rate adjustments to the MLF (Mediumterm Lending Facility) rate and then LPR rates, aiming to make the price transmission system smoother. The results were impressive — the transmission efficiency from policy rate adjustments to downward loan market rates was significantly improved. Currently, both the one-year MLF rate and LPR were 30 bps lower than earlier this year (or 2.95% and 3.85%, respectively), which helped reduce the financing costs of the real economy. Notably, the five-year LRP did not follow the downward trend of open market operations and MLF rate. The 15 bps decline earlier this year not only highlighted the principle of "Housing is for Living in, not for Speculation" but also to some extent encouraged the banks to reinforce their support to mid-and-long-term investments, such as those in infrastructure.

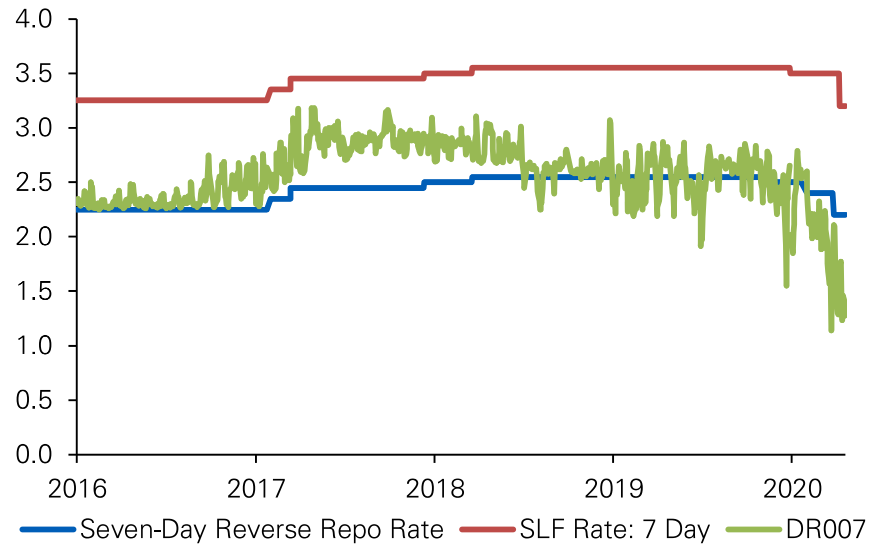
Figure 27: Loan market rate transmission efficiency, %



Source: Wind, KPMG analysis

As for liquidity supply, after cutting RRR by 0.5% across the board to release RMB 800 billion funds in early January, PBOC announced three more targeted RRR cuts on 16 March, 15 April and 15 May to release RMB 950 billion in funds. PBOC's other measures in Q1 included: RMB 300 billion targeted re-lending funds for pandemic control; RMB 500 billion targeted re-lending and re-discount for SMBs; and RMB 350 billion loan quota for policy banks. All these, together with supportive fiscal policies, were designed to "keep liquidity in the banking system at a reasonably sufficient level". As of the end of March, allocated amounts were RMB 228.9 billion out of the RMB 300 billion targeted for re-lending funds, and RMB 276.8 billon out of the RMB 500 billion targeted for re-lending and re-discount to SMBs (Small and Medium-sized Enterprises). Meanwhile, interbank market rates remained low in Q1. As the most important monetary interest rate indicator representing the average financing cost of the market, the deposit institutions' seven-day pledge-style repo rate (DR007) was a long way from the upper limit of the interest rate corridor (standing loan facility (SLF)), indicating a sound, slightly accommodative stance of the overall monetary policy.

Figure 28: Interbank market rate, %



Source: Wind, KPMG analysis

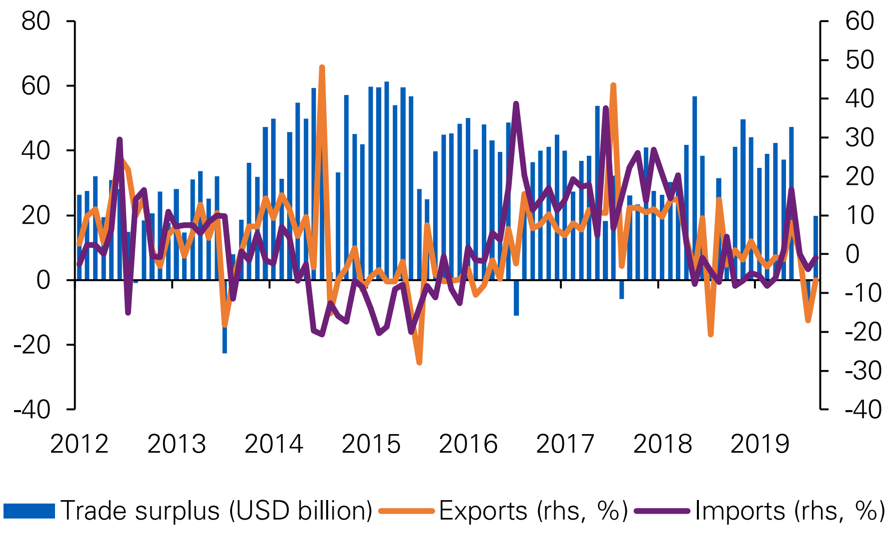
At the Central Politburo meeting on 17 April, a "more flexible and moderate" approach to the monetary policy was announced, aimed at leveraging diversified tools, such as rate cuts, RRR cuts and re-lending, to keep liquidity at a reasonably sufficient level and to lead the downward trend of loan market rates, so as to support the real economy, especially SMBs.

Weak external demands bring exports under pressure amid the pandemic

In 2020Q1, China's total imports and exports stood at USD 943.01 billion, down 8.5% YOY in cumulative terms; exports, USD 478.03 billion, were down by 13.3%; and imports, 464.97 billion, were down 2.9% YOY. The trade surplus shrank sharply to USD 130.6 billion from USD 728.7 billion in the same period last year.

However, China's exports and imports began to pick up speed in March. In March, the total imports and exports of China stood at USD 350.36 billion, down 4.0% YOY. Exports, at USD 185.15 billion, were 6.6% lower than the same period last year, but 10.6% narrower than in Jan–Feb. As China accelerated its reopening efforts, a huge backlog of orders was fulfilled to help improve exports in March. Imports totalled USD 165.21 billion, 1.0% lower than the same period last year, but drastically narrower than in February (-4%). This could be attributed to the released potential in domestic markets, thanks to the counter-cyclical adjustments, such as consumption and investment stimulations. The trade balance was turned around to a surplus of USD 19.93 billion.

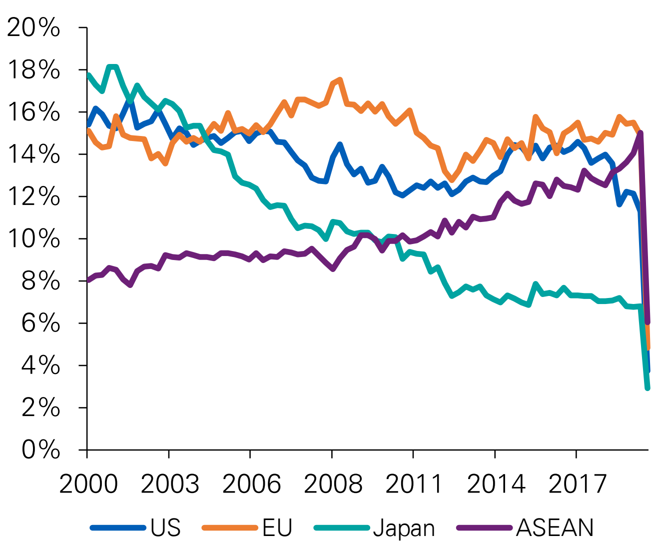
Figure 29: Import and export activities, monthly value



Source: Wind, KPMG analysis

By country and region, ASEAN exceeded the EU for the first time as the largest trade partner of China. In 2020Q1, China's cumulative imports/exports with ASEAN totalled USD 142.19 billion, 3.7% up from the previous year, representing 15.1% of China's foreign trade. Imports/exports with the EU totalled USD 125.74 billion, 12.3% down from the previous year, representing 15.1% of China's foreign trade; trade with the US, USD 95.73 billion, 20.1% down, 10.1%; and with Japan, USD 66.88 billion, 10.1% down, 7.1%. The volume of China-ASEAN trade grew by 3.3%, which was mainly driven by the significant/impressive growth in IC (Integrated Circuit) trade. As a critical link in the global semiconductor industry chain, China has been fostering a close relationship with ASEAN countries such as Malaysia, Singapore and Vietnam in IC imports/exports. We expect to see China strengthening its connections with ASEAN, East Asia and Central Asia countries, driven by economic factors and geopolitical concerns.

Figure 30: Share of major countries in China's foreign trade, current quarter, %



Source: Wind, KPMG analysis

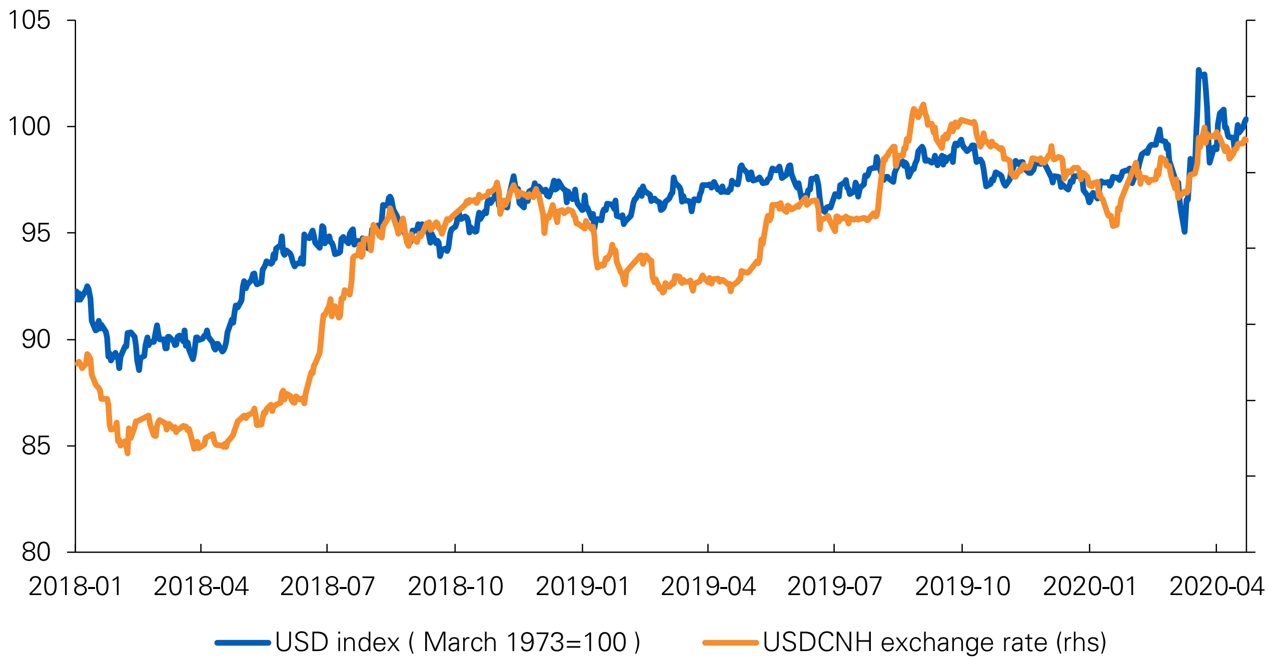
Due to the pandemic and the prolonged Spring Festival, in 2020Q1, China's exports to the US were RMB 476.55 billion, down 23.6% YOY. Exports of mechanical and electrical products were RMB 292.57 billion, down 24.1%, which accounted for 61.6% of total exports. In this category, mobile phone exports were RMB 36.17 billion, down 10.3%; and automatic data processing equipment and components were RMB 51.63 billion. In the same period, labour-intensive product exports were RMB 105.77 billion, down 26.1%; medicines and materials, RMB 5.25 billion, up 6.3%.

As for imports, with the implementation of the Phase I Deal with the United States, soybeans, pork and cotton imports from the US saw rapid growth. In Q1, agricultural product imports from the US grew by 10% to RMB 35.56 billion, including 7.814 million tons of soybeans (RMB 21.88 billion), up 2.1 times; 168,000 tons of pork (RMB 3.04 billion), up 16 fold; 124,000 tons of cotton (RMB 1.59 billion), up 43.5% in volume and 17% in value.

In 2020Q2, we expect to see more impacts of the pandemic on global supply chains and demand. With weak external demand, exports may face additional decline in the short term. Even if the pandemic is effectively controlled in Q2, other countries may take longer to return to "business as usual", considering their pandemic control efforts. Therefore, we expect negative growth of exports by Q3. For imports, the domestic demand is recovering as people's lives return to normal. The counter-cyclical adjustments, plus implementation of the Phase I Deal, will provide strong support to imports.

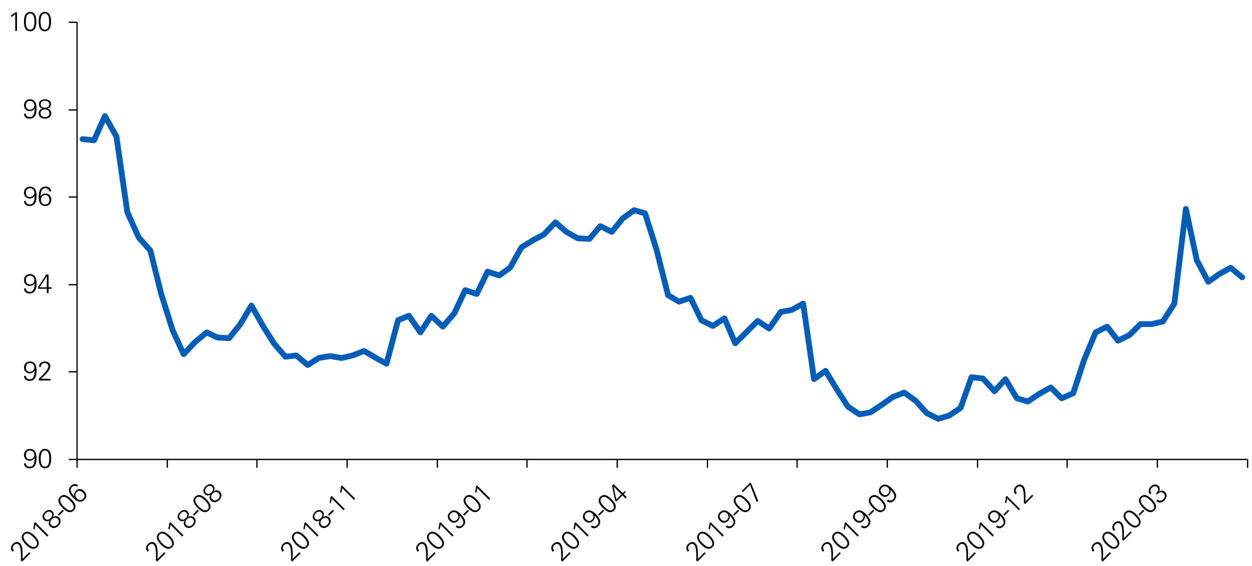
In Q1, there were wide fluctuations of USD indexes, which once surged to the high level of 100. The US dollar remained strong. In contrast, the RMB has been devaluing. In Q2, the gigantic uncertainties in the world economy will continue to highlight the importance of risk hedging. However, the Chinese government has maintained its sound stance on the monetary policy under the context of the US Federal Reserve's QE Infinity. Therefore, we expect to see a relatively stable RMB.

Figure 31: USD index and RMB spot exchange rate



Source: Wind, KPMG analysis

Figure 32: China Foreign Exchange Trade System (CFETS) exchange rate index

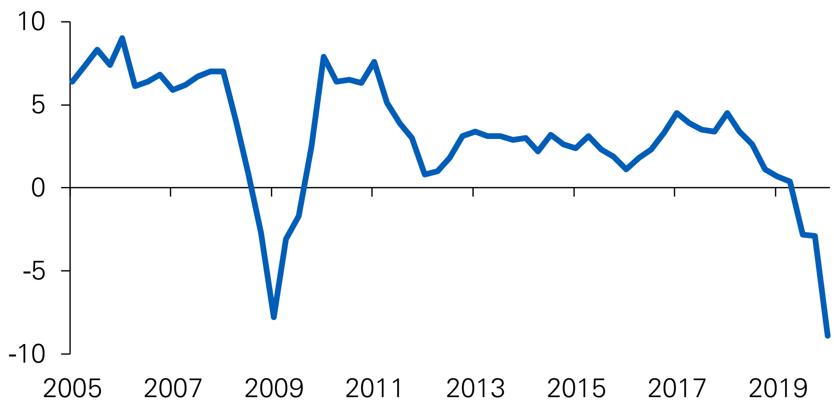


Source: Wind, KPMG analysis

Hong Kong SAR Economy

The protests in Hong Kong related to around the Extradition Law Amendment Bill since 2019Q3 gave a blow to the employment market, causing low consumer and business confidence. Hong Kong's economy has seen negative growth for the second quarter in a row since the second half of 2019. In addition, the pandemic certainly exacerbated the crisis — as of 24 April, the cumulative confirmed COVID-19 cases in Hong Kong totalled 1,035, deaths 4 and 725 cured cases. With tourism, retail and food sectors impacted, the growth rate of real GDP in Q1 dropped by 8.9% YOY. The IMF expected a -4.8% annual growth rate of real GDP for Hong Kong in 2020, with the unemployment rate soaring to 4.5% from 2.9% in 2019.

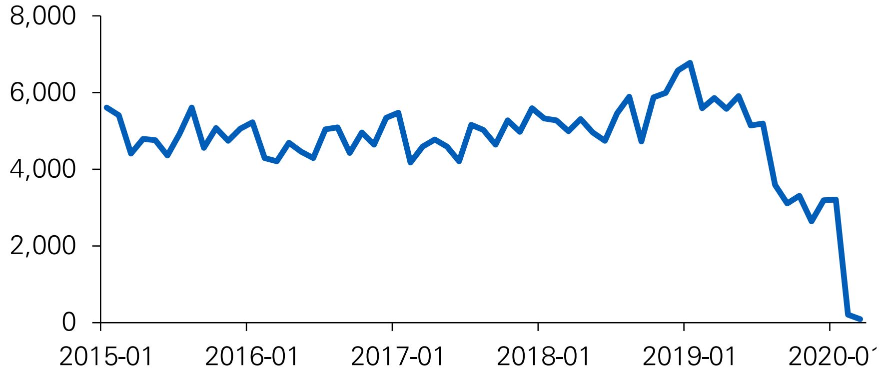
Figure 33: Real GDP growth rate of Hong Kong, quarterly YOY, %



Source: Wind, Hong Kong SAR Census and Statistics Department, KPMG analysis

Tourism: HKTB (Hong Kong Tourism Board) data showed that the total visitor arrivals in March was 82,000, a 99% YOY decrease, 27,000 of which were from Mainland China, also a 99% YOY decrease. In fact, daily visitor arrivals had declined to 3,000-4,000 before mid-March due to the pandemic. On 19 March, the Hong Kong government imposed a mandatory quarantine on visitors from abroad, bringing visitor arrivals down to 1,000/day; on 25 March, the government announced that "all non-Hong Kong residents coming from any overseas country or region by plane are denied entry into or transit through Hong Kong", further reducing visitor arrivals to 300/day. In early April, daily visitor arrivals even dropped to under 100, causing catastrophic effects on the tourism and retail sectors of Hong Kong.

Figure 34: Visitor arrivals to Hong Kong, monthly, in 1,000 persons



Source: HKTB, KPMG analysis

Financial services: On 8 February, Hong Kong closed traced to Mainland China due to pandemic concerns, virtually putting all business activities on hold. This was a heavy blow to the finance industry of Hong Kong, which put an increasing number of mid-/small-sized securities firms on the verge of ceasing trading. HKEX announcements showed that 18 securities firms have filed for voluntary cessation of trading in 2020, already more than last years' total [3]. HKSA (Hong Kong Securities Association) expected to see at least 30 securities firms cease trading this year, and called for government relief efforts.

Foreign trade of commodities: Hong Kong SAR Census and Statistics Department [4] data showed that in 2020Q1, Hong Kong's commodity exports and imports declined by 9.7% and 10%, respectively, compared with the same period last year; and in March, these declined by 5.8% and 11.1%. Considering the severe contraction of economic activities caused by the spread of the COVID-19 pandemic since March, Hong Kong's exports are not likely to improve in the near term.

By country and region, exports to the US (-27.4%), Germany (-26.4%), Japan (-17.9%) and Singapore (-15.5%) suffered the largest YOY decline in 2020Q1. Exports to Mainland China also dropped by 1.8%. In contrast, exports to Vietnam and Taiwan rose by 3.0% and 1.5%, respectively. Imports from the US (-19.0%), Mainland China (-16.9%), Malaysia (-7.8%) and Thailand (-6.0%) declined, while those from Vietnam (34.4%), Taiwan (15.0%), Korea (12.1%) and Singapore (7.5%) increased.

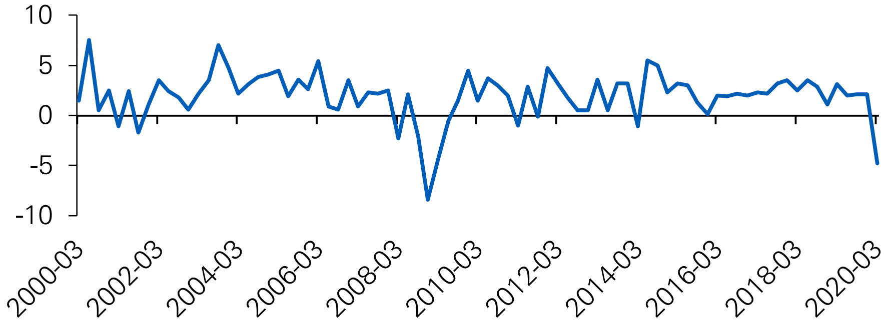
By commodity category, Communications, Recording and AV Equipment (-19.7%); Non-metallic Mineral Products (-37.2%); and Miscellaneous (mainly jewellery, gold and silver ware) (-20.4%) exports experienced a significant decrease, while Electric Machine, Equipment, Tools and Parts (2.1%) and Power Generating Machine and Equipment (34.3%) exports increased. Communications, Recording and AV Equipment (-16.6%); Non-metallic Mineral Products (-45.6%); and Office Machine and Automatic Data Processing Devices (-15.9%) imports slumped, while Power Generating Machine and Equipment (43.7%) and Electric Machine, Equipment, Tools and Parts (2.2%) imports rose.

[3] Data source：https://sc.hkex.com.hk/TuniS/www.hkex.com.hk/Services/Circulars-and-Notices/Participant-and-Members-Circulars?sc_lang=zh-CN&Year=2020&IssueBy=&Theme=&Keyword=停止营业&currentCount=20
[4] Hong Kong SAR Census and Statistics Department：
https://www.censtatd.gov.hk/gb/?param=b5uniS&url=http://www.censtatd.gov.hk/hkstat/index_tc.jsp

United States

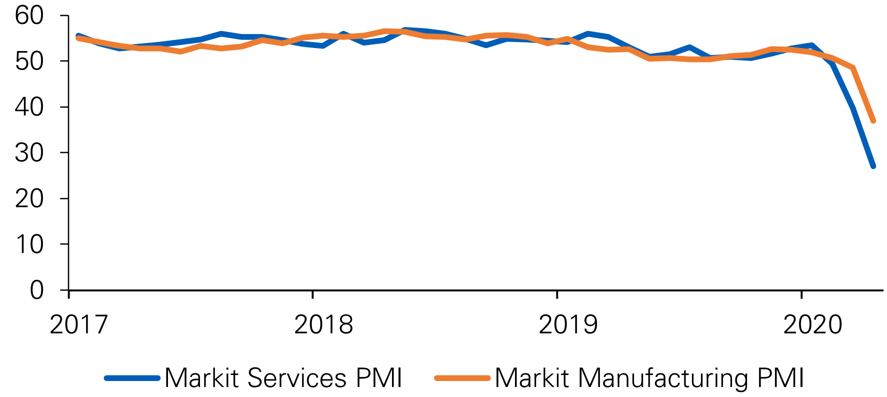
In April, the IMF lowered the US's economic growth outlook for 2020 to -5.9%. Q1 data showed that the quarter-on-quarter annualised growth rate of the US's real GDP was -4.8% — the lowest since 2008Q4 — which put an end to the longest economic expansion in the US's history since the subprime crisis. Markit's US Manufacturing and Service PMIs hit a historic low at 36.9 and 27 in April, respectively, indicating deep concerns over the economic outlook. The employment market was also facing significant pressure. In March, seasonally adjusted Non-Farm Payrolls (NFP) decreased drastically by 701k, bringing to an end the longest NFP growth period (113 months) in the history of the US. The US's unemployment rate has reached at historic lows before surging from 3.5% to 4.4% in March. That was the largest monthly increase since January 1975. At the same time, as of 11 April, 11% of the US labour force filed claims for unemployment benefits, the highest number ever recorded.

Figure 35: US real GDP, QoQ seasonally adjusted annualised rate, %



Source: Wind, KPMG analysis

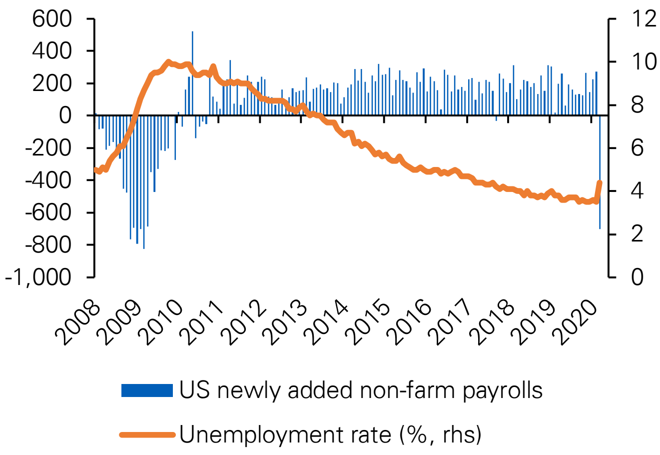
Figure 36: US Markit Manufacturing Industry and Service Industry PMIs, seasonally adjusted



Source: Wind, KPMG analysis

[5] US jobless claims of 4.4m take pandemic toll to a record 26m. FT. 24 April 2020.

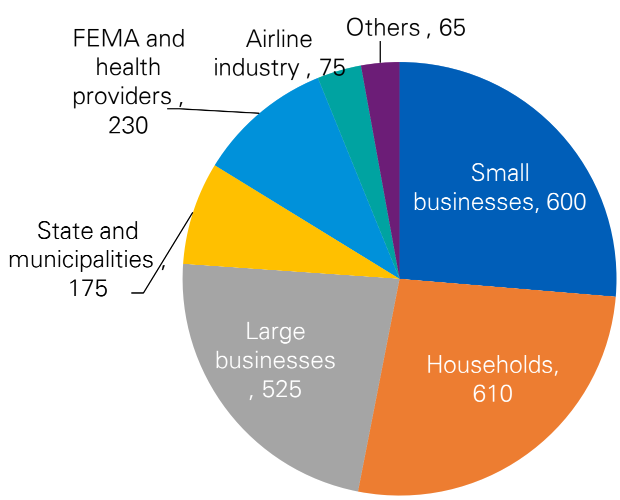
Figure 37: US newly added non-farm payrolls and unemployment rate



Source: Wind, KPMG analysis

The US government has launched the USD 2.3 trillion CARES Act to support pandemic-affected business and people. On 24 April, the House passed a USD 484 billion relief bill, which was the fourth economic rescue and stimulus bill in the past few months. These relief packages — USD 2.8 trillion in total — accounted for 12% of US GDP in 2019.

Figure 38: Fund allocation in CARES Act, USD Billion



Source: Committee for a Responsible Federal Budget, KPMG Analysis

Euro Zone

Caught between the global financial crisis and the European debt crisis, EU countries have been facing challenge on their path to economic recovery. In 2019, the GDP growth rate in the Eurozone was 1.2%, the lowest level since the European debt crisis. Germany, a tradition economic pillar of the Eurozone, recorded a minuscule GDP growth of 0.6%, the lowest level in the past six years. Its exports and manufacturing will be adversely impacted by the pandemic. Italy, which has been the worst hit, is facing an even more challenging situation. In 2019, Italy's economy growth almost came to a standstill (0.2%), while in the start of 2020, the north of the country — the country's economic engine — had to be locked down amid the pandemic outbreak. That was a heavy blow to its manufacturing and supply chains. In April, the IMF lowered the Eurozone's economic growth outlook for 2020 to -7.5% (Germany: -7.0%; France: -7.2%; Italy: -9.1%; and Spain: -8.0%).

The EU combined monetary and fiscal policies to take a dual approach in mitigating the impact of the pandemic. Considering that the benchmark rates in the EU have already been negative, there is limited room for rate cuts. Although the European Central Bank (ECB) continued to take an accommodative stance in its latest rate decision and expanded its asset purchase programme by EUR 120 billion, no plans of rate cut was announced. On 9 April, EU finance ministers agreed on a EUR 540 billion package of measures to combat the economic fallout of the coronavirus pandemic, which included: 1) a joint employment insurance fund worth EUR 100 billion to help EU member countries enhance their public fiscal strength in tackling unemployment risks; 2) a European Investment Bank instrument intended to supply EUR 200 billion of liquidity to companies, especially SMBs; 3) credit lines of up to EUR 240 billion from the European Stability Mechanism — the euro area's bailout fund — to backstop states as they go on a spending spree to help economies get back on their feet[6]. In addition, EU leaders have agreed to create a fund that could raise at least EUR 1 trillion to rebuild regional economies ravaged by the coronavirus pandemic.

[6]EU Finance Ministers Agreed a €540 Billion Package. 11 April 2020. Xinhuanet

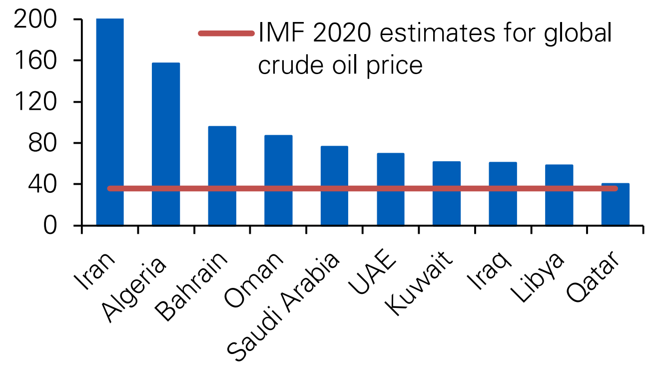
European countries have also launched their own relief packages. For instance, Germany announced a package worth up to EUR 750 billion, which would provide unemployed people one-time aid during the pandemic. Italy launched a EUR 7.5 billion relief package and a EUR 25 billion "Rome Plan" for healthcare, temporary tax cuts, debts and housing loan forbearance. Italy also pledged to the EU for "more flexibilities in fiscal policies" to allow for higher debts than technically allowed, and to increase 2020 deficits to EUR 20 billion.

We expect to see more impacts of the pandemic on the economies of the US and the Eurozone in Q2, and more relief packages on the way. These measures may help prevent widespread bankruptcy and extended unemployment, so as to reduce pressure on financial and capital markets, but under one condition — the pandemic would be effectively contained in the first half of 2020. Based on this assumption, the IMF expects to see a 4.7% growth rate in both the US and the Eurozone in 2021.

Middle East oil-producing countries

Slumping oil prices was another reason for the fluctuations of the world economy in Q1. On 6 March, major producers failed to reach an agreement to reduce production at the OPEC+ meeting, and oil prices plummeted after Saudi Aramco initiated a price war. Meanwhile, oil demand was further reduced by the stagnant production and transportation during the pandemic. As of the end of March, Brent crude oil price plunged to USD 18/barrel from USD 66/barrel in early January, declining by more than 30%. The IMF's latest estimates showed that oil prices will stay under USD 40/barrel in the next two years, a 40% drop compared with the USD 61/barrel average in 2019. Although OPEC+ members reached a production cut deal in early April, it did not meet the market expectations. Therefore, we expect to see frequent fluctuations at low points in the energy market through 2020. Economies with higher oil production costs or those heavily reliant on oil exports will be adversely impacted, in terms of FX reserves, balance of payments and exchange rates. These oil exporters might dump their assets for oil dollars to offset the decline in fiscal incomes, which in turn may impact the global capital market.

Figure 39: Fiscal breakeven points of major MENA (Middle East and North Africa) oil exporters, USD/barrel



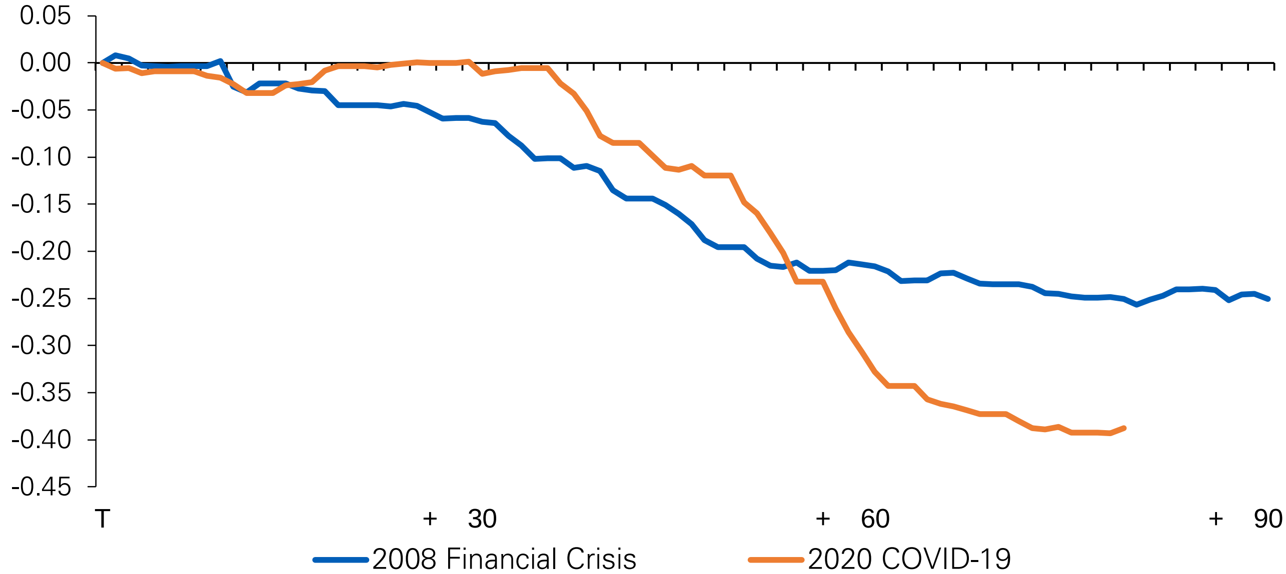
Sources: IMF, KPMG Analysis

Emerging markets and developing economies

According to IMF estimates, the economic growth of emerging markets and developing economies will be -1.0% in 2020 and 6.6% 2021, 5.4% lower and 2% higher than the previous estimates in January 2020. Notably, the decline will expand to 2.2% if China is excluded from this group. The lowered outlook reflected the pressure on emerging markets and developing economies, such as from pandemic control, price fluctuations of bulk commodities and deteriorating financial markets.

By mid-April, the spread of the COVID-19 pandemic had been accelerating in developing countries including Brazil, Russia, India and Mexico. With poor healthcare infrastructure and insufficient testing capacities, these countries are facing more challenges in controlling the pandemic. Both Brazil and Russia are major exporters of bulk commodities, including coal, oil, iron ores and agricultural products. The slumping prices of bulk commodities, caused by weak demand, will be adversely impacting these countries' exports. On the other hand, the worsening pandemic in these export bases may slow down global reopening by disrupting raw material supply. As for capital flow, emerging markets are facing significant currency devaluation and higher risks of a debt crisis, due to many factors, such as tightened liquidity in the financial markets of developed economies, investors are becoming more risk-averse to dump national debt and securities from emerging markets for cash .

Figure 40: Capital flow of securities investments in emerging markets, % GDP



Source: Wind, KPMG analysis

2

Policy analysis

CPC Central Committee promotes the reform of market-based allocation of factors

On 9 April, the Chinese Communist Party Central Committee and the State Council jointly issued the Opinions of the CCP Central Committee and the State Council Concerning the Establishment of Improved Systems and Mechanisms for Market-based Allocation of Factors of Production [7] (the Opinions), to deepen the reform of market-based allocation of production factors, stimulate the orderly and free flow of factors, improve the efficiency of factor allocation, and promote "top-level design". The introduction of the Opinions is of great significance to deepening reform in the economic system, resolving contradictions within the economic structure, and promoting high-quality development.

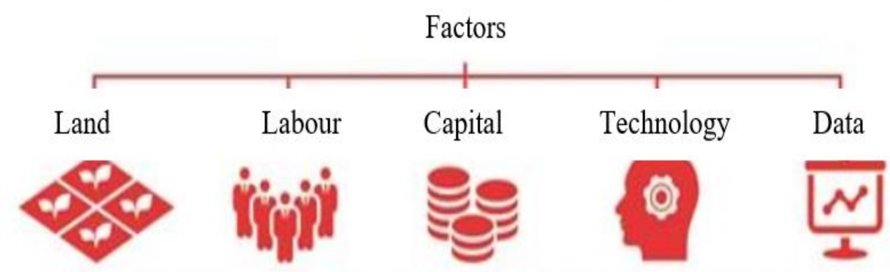
"Factors" refer to the basic elements or conditions required in production [8], such as land, capital or data, which are different from commodities. After four decades of reform and opening up, China's commodity market has become relatively mature with over 97% of prices for commodities and services market-determined. Although there has also been great progress in the construction and reform of the factors markets, development of the factors markets in areas such as land, labour, capital, technology and data have lagged behind the commodity and service markets. This has curbed the markets' ability to play a decisive role in resource allocation and has become a striking flaw in the construction of a high-standard market system.

Properly managing the relationship between the government and the market while promoting market-based allocation of factors is essential — this means continuously expanding the scope of market-determined factors and cultivating market trading platforms while also making better use of the government's role, establishing sound system-wide rules, improving government regulation and supervision, and guiding the coordination of various factors to focus around more advanced production capabilities. Meanwhile, it is also necessary to accelerate the transformation of governmental functions, further reduce the government's direct allocation of factors, deepen institutional reform of state-owned enterprises and state-owned financial institutions, and ensure enterprises of all ownership types obtain equal access to factors through market strategies such as competition [9].

To this end, the Opinions has proposed the following: adherence to market decisions and orderly flow; a robust system and regulatory innovations; problem-oriented, targeted policies; the pursuit of steady progress, and step-by-step implementation to promote the market-based allocation reform of the five major factors of land, labour, capital, technology, and data.

[7] http://www.gov.cn/zhengce/2020-04/09/content_5500622.htm
[8] The Dictionary of Economics and Management, China Social Sciences Press, 1985
[9] Building Improved Systems for Market-based Allocation of Factors – Interview with NDRC Authority, Xinhua Press, April 2020
http://www.gov.cn/zhengce/2020-04/09/content_5500622.htm

Figure 41: The Five Major Factors: Land, Labour, Capital, Technology and Data



Source: KPMG analysis

Land

The goal is to enhance the flexibility of land management to meet economic and social development needs. Allow flexible industrial land uses, strengthen industrial land use market supply systems such as long-term leasing, lease-then-sell arrangements, flexible supply periods, capital contributions (shareholding), and exploration to increase the supply of land for mixed industries. Allow flexible management of land planning indicators; provincial governments should take on more responsibility for land use indicators in urban and rural construction. Land use reform is given priority, indicating its importance. The land factor acts as the vector for production and life, as well as one of the most fundamental production factors for economic development, and the efficiency of land distribution has a tremendous impact on the balance between economic and social development. The reform of the land market will aid in the promotion of urbanisation, act as a safeguard for rural revitalisation and urban-rural integration, and drive China’s reindustrialisation.

Labour

The goal is to guide labour factors for an appropriately smooth and orderly flow. Open up channels for residence registration; adjust and improve points-based settlement policies for megacities and megacity behemoths. Explore and promote the cumulative, mutual recognition of years used for residence registration access and pilot a household registration system based on usual places initially in urban clusters such as the Yangtze River Delta and the Pearl River Delta. Allow unimpeded access to channels for the auditing of professional titles; establish professional standards with professional capabilities as the core; further dismantle restrictions based on household registration, region, identity, records and personal affiliations; allow unimpeded access to channels for the declaration of professional titles for non-public economic entities, social entities and freelance technical professionals; and promote the socialisation of the auditing of professional titles. Reform of the labour market is conducive to further unleashing rural labour forces and augmenting an increase in the provision of labour while also improving the efficiency of the allocation of labour resources and allowing for freer flow within the labour market.

Capital

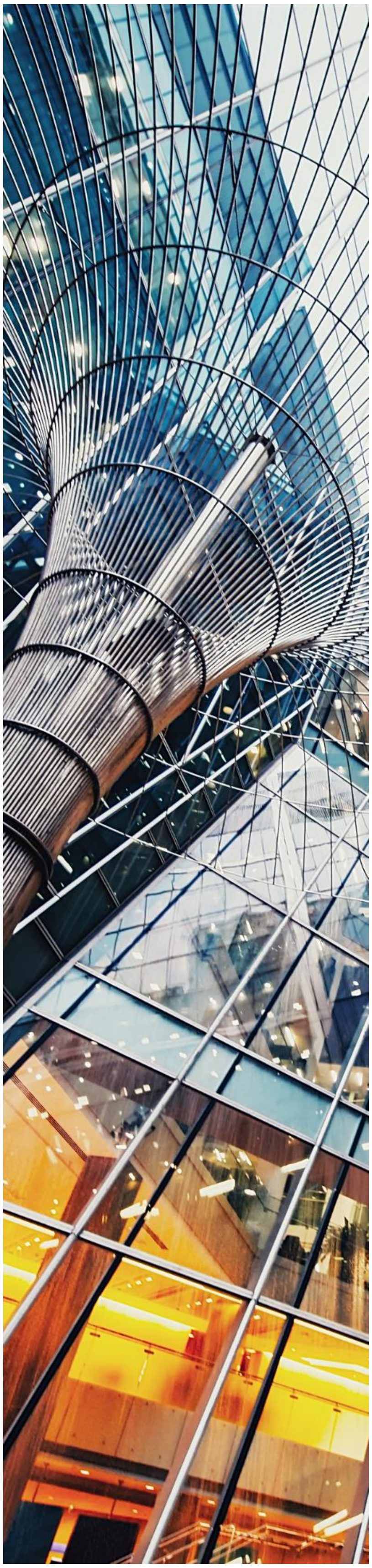
The goal is to improve the multi-level capital market system. Improve the construction of the foundational stock market system; reform and improve systems for stock market issuance, trading and delisting; encourage and provide guidance for listed companies' cash dividends; improve systems for investor protection; and promote and improve the civil litigation system for securities with Chinese characteristics. Improve the establishment of unified standards for the bond market; create unified standards for disclosure of corporate credit bond information; and explore the implementation of a management system for registration issuances for corporate credit bonds. The reform of the capital market factor will aid in the further expansion of enterprises' financing channels, bring into play the value discovery function of the capital market, and upgrade China's finance industry.

Technology

The goal is to stimulate vitality in the supply of technology and facilitate the transformation of achievements in science and technology. Initiate property rights incentives; deepen the reform of usage rights for technological achievements as well as disposal rights and income rights; launch pilot projects granting scientific and technological achievement ownership rights or long-term usage rights to scientific research personnel, while simultaneously promoting pilot projects for the reform of the "three rights" of professional achievements and the reform of ownership rights. Invigorate technology transfer institutions and technical managers, and strengthen the construction of national technology transfer regional centres. Support collaboration between technology companies, and universities and scientific institutions for the establishment of new research and development (R&D) institutions such as technical R&D centres, industrial research institutes, and pilot test bases; establish a national training system for the transfer of technical talent; improve professional service capabilities for technical transfers. The technology factor is a driving force for long-term economic growth as well as a critical element that drives change in human history. Accelerating reform in the technology market aids improvement in the level of science and technology R&D in China and achieving high-quality development.

Data

The goal is to accelerate the cultivation of the data factor market and comprehensively increase the value of the data factor. Optimise the basic economic governance database and draft new lists for data sharing responsibilities. Support the establishment of scenarios for standardised data development and utilisation in the fields of agriculture, industry, transportation, education, security, urban management and public resources trading. As a new production factor in the digital economy age, promoting reform of the data factor helps unlock the value of underlying data, accelerate the process of data becoming asset , as well as speed up the emergence of new retail formats and models in the digital economy.



KPMG analysis:

As the CPC Central Committee's first document on the allocation of market factors, the Opinions further break down the concept of "let the markets play a decisive role" as proposed at the Third Plenary Session of the 18th Central Committee. The Opinions suggest the further reduction of the government's direct allocation of factors so that the markets may play a more important role. This is a significant move for accelerating the improvement of the socialist market economic system and resolving deep-seated structural contradictions.

Of particular note is that "data" is clearly included within the scope of production factors in the Opinions, reflecting the importance placed on the new data-based economy. As the economy continues to develop, production factors inevitably change. Production factors have continued to develop and multiply, from the two major factors — land and labour in the agricultural era, to the addition of capital becoming one of the major production factors in the industrial era, to the introduction of the technology factor in the technological revolution. In the current age in which the digital economy is flourishing and developing, data plays an increasingly important role in economic development and holds an important place in the factors that constitute economic growth. Listing the factor of data along with traditional elements such as land, labour, capital and technology, provides a clear direction for accelerating the cultivation of production factors and lays a foundation for moving the development of China's digital economy into the fast lane.

Banks and insurance companies pilot futures trading on government bonds

On 21 February, the China Securities Regulatory Commission, the Ministry of Finance, the PBOC, and the Banking and Insurance Regulatory Commission jointly issued an announcement [10] allowing qualified pilot commercial banks and insurance agencies with investment management capabilities to participate in trading of national debt future's on the China Financial Futures Exchange. The first group of pilot institutions include the Industrial and Commercial Bank of China, the Agricultural Bank of China, the Bank of China, China Construction Bank, and the Bank of Communications.

It was made clear in the announcement that under the precondition that commercial banks and insurance institutions are compliant, risk factors are controllable and their businesses are sustainable, they may participate in treasury futures trading. Commercial banks and insurance institutions participating in treasury futures trading should also establish and perfect a comprehensive risk management and internal control system as well as a business processing system, and they should have a professional management team as well as standardised business operations processes to prevent and control trading risks. The China Financial Futures Exchange and the China Banking and Insurance Regulatory Commission have revised and drafted the relevant documentation to pave the way for banks and insurance institutions to enter the market.

Treasury futures are important financial derivatives in the international market, and China's treasury futures market is currently in the development and improvement phase. The China Financial Futures Exchange launched five-year treasury bonds in September 2013: after more than six years of development, a treasury bond system consisting of two-year, five-year and 10-year futures has been established. While the global financial market has been extremely unstable since the beginning of this year, China's financial futures market has remained relatively stable and has developed further. In the first quarter of 2020, there were a total of 4.8 million trades in the national treasury futures market, an increase of 72.5% over the same period last year. As of 31 March, the main contract settlement prices for China's two-year, five-year and 10-year treasury futures were RMB 101.72, RMB 102.56 and RMB 101.86, respectively, an increase from the end of 2019 of RMB 1.30, RMB 2.61 and RMB 3.71.

[10] http://www.csrc.gov.cn/pub/newsite/zjhxwfb/xwdd/202002/t20200221_371032.html

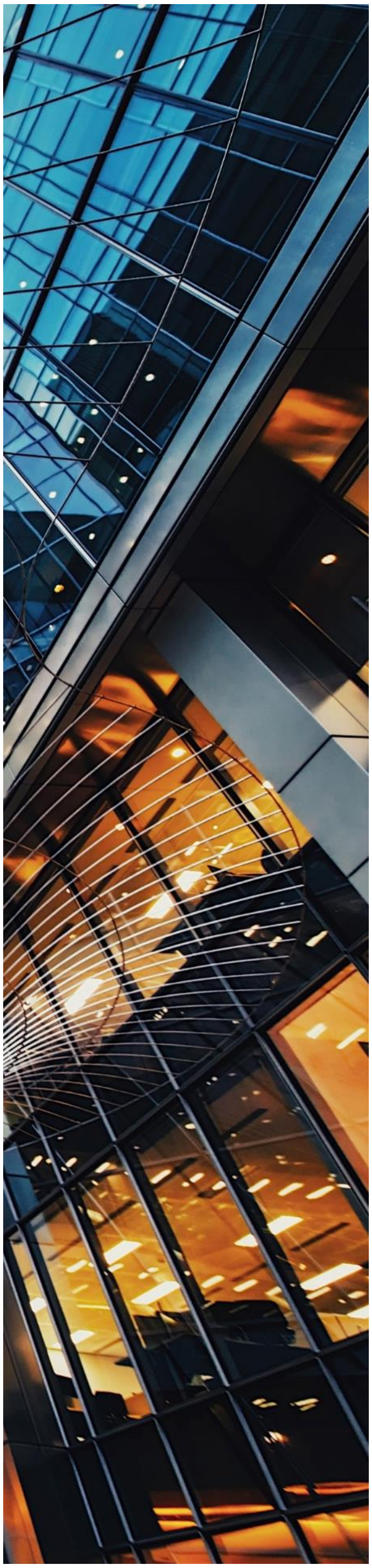
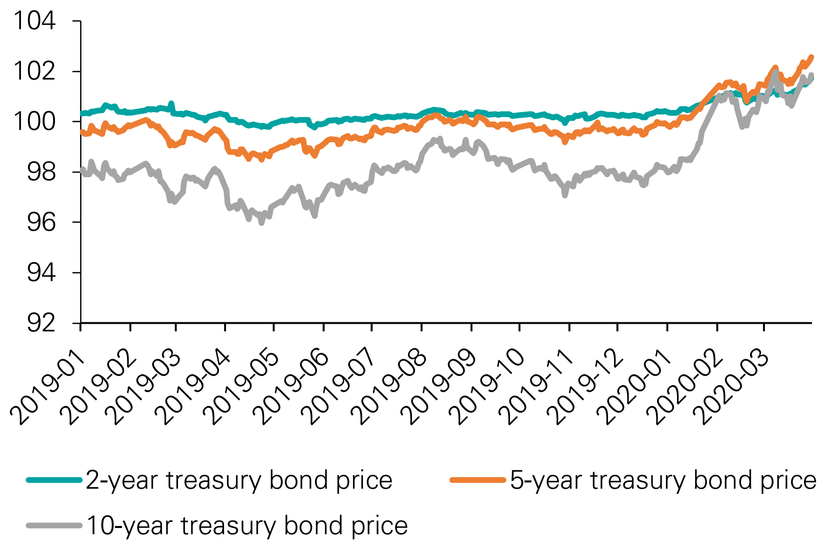


Figure 42: Treasury futures contract settlement price trends



Source: Wind, KPMG analysis

Previously, the primary investors in treasury bonds included securities companies, fund institutions and futures asset management companies. Participation in the national treasury futures market on the part of commercial banks and insurance institutions — as primary holders of national debt — will further improve the investment structure. Fang Xinghai, Vice Chairman of the China Securities Regulatory Commission, said that after participating in treasury bond futures transactions, commercial banks will be able to make full use of treasury futures instruments to manage interest rate risks and stabilise the value of assets. In addition, when there is volatility in the bond market, the banks will be able to take advantage of good liquidity and fast transactions in treasury futures; selling pressure will be diverted in the bond market and fluctuations in the spot market will be eased, thus promoting the generally stable functioning of the bond market[11]. In addition to commercial banks, the Chinese treasury futures market will also welcome another heavyweight among government bond holders — insurance institutions.

The entry of these two major institutional investor groups — commercial banks and insurance institutions — is expected to boost diversity in the national treasury bond market, enhance the elasticity and resilience of the bond spot market, further promote the development of China's bond market, and aid in deepening reform in the financial sector.

[11] Vice Chairman Fang Xinghai's speech at the launch ceremony for commercial banks' participation in treasury bond trading, China Securities Regulatory Commission, April 2020
http://www.csrc.gov.cn/pub/newsite/zjhxwfb/xwdd/202004/t20200410_373673.html

SOE bonds and corporate bonds take the lead in full execution of the registration system

The new Securities Law took effect from 1 March. The National Development and Reform Commission issued *the Notice on Matters Regarding the Implementation of the Registration System for the Issuance of SOE Bonds*[12]. With immediate effect, the issuance of enterprise bonds was changed from an approval system to a registration system with the National Development and Reform Commission as the legal registration authority for SOE bonds. That same day, the China Securities Regulatory Commission issued the *Notice on Matters Regarding the Implementation of the Registration System for the Public Issuance of Corporate Bonds*[13]. The registration system for the public issuance of corporate bonds was implemented with immediate effect. The stock exchanges are responsible for the acceptance and audit of the public issuance of corporate bonds and report to the China Securities Regulatory Commission to carry out issuance registration procedures. The Shanghai and Shenzhen Stock Exchanges subsequently issued relevant notices to market participants.

According to the new Securities Law and relevant supporting policies and provisions, the China Securities Regulatory Commission and the National Development and Reform Commission are the registering institutions for the public issuance of corporate bonds and the issuance of SOE bonds, respectively, and have designated their own acceptance and audit institutions. In addition, the National Development and Reform Commission has eliminated the provincial-level forwarding and reporting step for SOE bonds, facilitating SOE bond issuance. The marketisation and reform of the corporate bond and SOE bond issuance system have been further deepened, and the bond market's ability to serve the real economy is expected to further improve.

[12] https://www.ndrc.gov.cn/xxgk/zcfb/tz/202003/t20200301_1221966.html

[13] http://www.csrc.gov.cn/pub/newsite/zjhxwfb/xwdd/202003/t20200301_371309.html

Table 3: Division of responsibilities in bond registration system

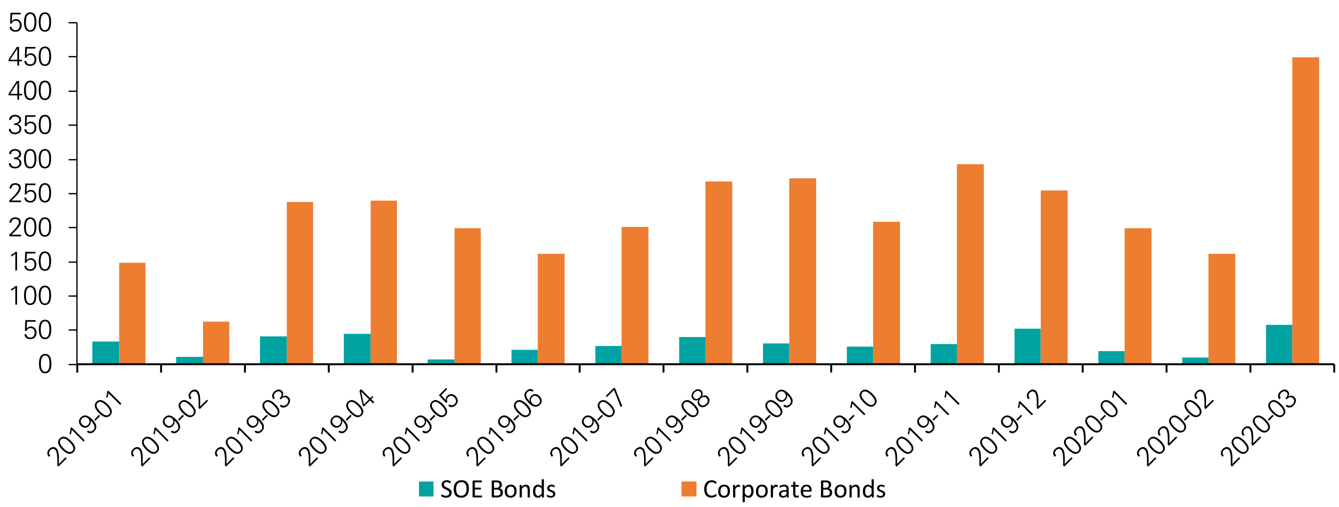
Bond Type	Accepting Agency	Inspecting Agency	Registering Agency
SOE Bonds	Central Treasury Bonds Registration and Settlement Co. Ltd.	Central Treasury Bonds Registration and Settlement Co. Ltd. China Interbank Market Dealers Association	National Development and Reform Commission
Corporate Bonds	Stock Exchange	Stock Exchange	Securities Regulatory Commission

Source: National Development and Reform Commission, China Securities Regulatory Commission, KPMG analysis

The registration system for bond issuances has greatly simplified approval procedures and shortened the time for approval; efficiency of bond issuances has been significantly improved. According to a report from Shanghai Securities News, in the past, the issuance of SOE bonds took 2–6 months, or even longer in some cases. After the implementation of the registration system, the time required is likely to be greatly reduced to between two weeks and two months[14].

As for issuance conditions, the new Securities Law has done away with the corporate bond public issuance requirement that the net assets of a corporation can be no less than RMB 30 million, and the net assets of a limited liability company can be no less than RMB 60 million, thus expanding the scope of those qualified to issue bonds. This opens up new financing channels for asset-light enterprises, small-to-medium enterprises, emerging industry enterprises, and science and technology enterprises. It is anticipated that SOE bonds and corporate bonds would allow for significant expansion in the future. According to data from Wind, as of 31 March, the balance of bond reserves in China was RMB 100.8 trillion, of which SOE bonds accounted for RMB 2.29 trillion, or 2.28%, and corporate bonds accounted for RMB 7.53 trillion, or 7.47%.

Figure 43: Corporate and SOE bond issuances from January 2019 to March 2020



Source: Wind, KPMG analysis

[14] The Transition Thirteen Years Later: Full Execution of the SOE Bond Registration System, Shanghai Securities News, March 2020.http://finance.sina.com.cn/stock/y/2020-03-01/doc-iimxyqvz6986285.shtml

The new Securities Law has also eliminated the provision requiring that the cumulative bond balance must not exceed 40% of a company's net assets. This puts decision-making power into the hands of the enterprises themselves, avoiding a "one size fits all" approach across varying industries due to financial leverage issues. Additionally, in the *Notice on the Work Regarding the Implementation of the Revised Security Law*, the State Council clearly requires that "issuers applying for the public issuance of corporate bonds, in addition to complying with the conditions stipulated in *the Securities Law*, must possess a reasonable asset and bond structure, and a normal cash flow." Issuers, with the bond issuance threshold lowering and their financial autonomy rising, shall strengthen management of the company's liquidity, debt, and investment and financing, as well as improve financial management.

Two chapters have been added to the *new Securities Law*: "Information Disclosure" and "Investor Protection." Issuers and intermediary agencies will assume greater legal responsibility in the area of information disclosure. In response to a reporter's question on the implementation of the registration system for the public issuance of corporate bonds, the Shanghai Stock Exchange noted that it would strengthen information disclosure, further implementing its audit system for issuances and listings with information disclosure as the core. Additionally, reporting will be integrated into the scope of supervision, reinforcing the responsibilities of issuers and securities service institutions. Under the registration system, the guidance and auditing role of intermediary agencies throughout the issuance process will be further strengthened, and as responsibilities increase, so too will opportunities for development. As responsibilities are returned to the relevant market participants, the further marketisation of China's bond market and the development of the capital markets will be promoted.

The acceleration of Shanghai as an international finance centre

On 14 February, the PBOC, the China Banking Regulatory Commission, the China Securities Regulatory Commission, the Foreign Exchange Bureau and the Shanghai Municipal Government jointly issued the *Opinions on Further Accelerating the Establishment of Shanghai as an International Financial Centre and Supporting the Integrated Development of the Yangtze River Delta in the Financial Sector* [15] (the Opinions), launching 30 specific measures, including actively advancing finance trial projects in Lingang New Area, accelerating the opening up of finance in Shanghai, providing financial support for the integrated development of the Yangtze River Delta, accelerating the construction of the Shanghai International Finance Center, and supporting the integrated development of the Yangtze River Delta.

Shanghai and the Yangtze River Delta are among the regions in China with the most vibrant economic development, highest degree of openness and strongest innovation capabilities; these regions play a decisive role in the overall trend of the modernisation of China. In recent years, the establishment of Shanghai as an international centre of finance has been accelerated, and the opening up of finance to the outside world has continued to expand. A number of major projects that play a nationwide demonstration role have come to Shanghai one after another, including Allianz (China) Insurance Holdings, Nomura Orient International Securities and JP Morgan Chase International Securities. Shanghai has become a new investment hotspot for top international financial institutions. On 26 March, the 27th Global Financial Centres Index (GFCI 27) [16]report was released, jointly prepared by the China (Shenzhen) Development Institute and Z/Yen Partners, a British think tank. Shanghai ascended in the ranking of global financial centres, listed as fourth place in the world.

Table 4: Global financial centre rankings, top 20

Ranking	Region	Score	Ranking	Region	Score
1	New York	769	11	Shenzhen	722
2	London	742	12	Dubai	721
3	Tokyo	741	13	Frankfurt	720
4	Shanghai	740	14	Zurich	719
5	Singapore	738	15	Paris	718
6	Hong Kong	737	16	Chicago	717
7	Beijing	734	17	Edinburgh	716
8	San Francisco	732	18	Luxembourg	715
9	Geneva	729	19	Guangzhou	714
10	Los Angeles	723	20	Sydney	713

Source: GFCI 27, KPMG analysis

[15]http://www.pbc.gov.cn/goutongjiaoliu/113456/113469/3971334/index.html

[16] The Global Financial Centres Index 27, Z/Yen and CDI, March 2020, http://en.cdi.org.cn/component/k2/item/652-the-global-financial-centres-index-27-gfci-27

The starting point of the Opinions was to better bring into play the leading role of financial reform and innovation of Lingang New Area of the China (Shanghai) Pilot Free Trade Zone in order to support the establishment of Shanghai as an international financial centre and clarify the pioneering role of Lingang New Area and the Yangtze River Delta.

As for Lingang New Area, the Opinions proposed to actively promote advance finance trials. Seven specific measures were launched to support commercial banks in establishing professional wealth management subsidiaries and investment subsidiaries for investments such as equity in unlisted companies, improvement of the facilitation of cross-border trade and investments, and an energetic push to develop financial technology. It creatively proposed supporting wealth management subsidiaries of commercial banks and financial asset investment companies to establish professional subsidiaries in Shanghai; investing in equity in key construction projects in Lingang New Area and the Yangtze River Delta; as well as participating in relevant business restructuring, equity investments, direct investments and other projects, thus better supporting the development of key industries with competitive potential on the international stage such as integrated circuitry, artificial intelligence, biomedicine, and aerospace.

The Opinions focused on three major aspects of work for integration in the Yangtze River Delta:

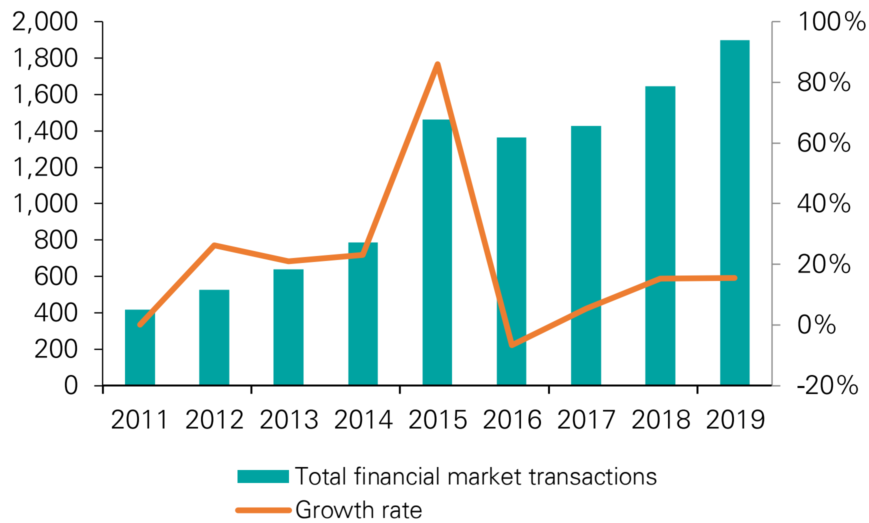
1. Promote inter-provincial (or inter-city) collaboration to improve the overall efficiency and level of financial services in the Yangtze River Delta. Taking financial institution cooperation as an example, explore the establishment of joint credit facilities for loans to optimise financial support for inter-provincial (or inter-city) basic infrastructure projects in the Yangtze River Delta. In terms of policy implementation, support financial institutions to make use of funds from secondary loans and rediscounted funds. Expand credit support for agriculture, rural areas and rural residents, innovative science and technology enterprises, as well as small and micro private enterprises, etc.

2. Improve financial support services and advance innovation and development in the Yangtze River Delta. This mainly includes actively promoting the expansion of bond financing for relevant G60 Science and Innovation Corridor institutions, supporting the listing and financing of qualified science and technology enterprises, strongly enhancing capital support for the science and technology capital market, and exploring the establishment of an integrated credit system to better serve small and micro enterprises' credit financing.

3. Establish information sharing mechanism and strengthen coordination on financial policies. For example, promote the sharing of financial data within the Yangtze River Delta, compile a financial stability index for the Yangtze River Delta, strengthen cooperation on litigation-free resolutions for financial consumer disputes, and promote general exchanges of experiences in finance within the Yangtze River Delta.

2020 is a very significant year for establishing Shanghai as an international centre of finance. According to the *Opinions on Promoting Shanghai to Accelerate the Development of the Modern Service Industry and Advanced Manufacturing Industry and Build Shanghai as International Financial Centre and International Shipping Centre* released in 2009 by the State Council, by 2020, Shanghai should be essentially built up as an international financial centre in keeping with China's economic strength and the Renminbi's international position. Jie Dong, Director of Shanghai's Local Financial Supervisory Administration, stated at the annual China Chief Economist Forum held in early 2020 that the total turnover in Shanghai's financial markets reached RMB 1900 trillion in 2019, and direct financing exceeded RMB 12 trillion. Shanghai has achieved its targets to transform itself into an international financial centre .

Figure 45: Turnover in Shanghai's major financial markets, 2011–2019



Source: Shanghai Yearbook, KPMG analysis

The Opinions provide specific provisions for China's measures to open up its financial industry, and it is the first document this year to outline the development plan for integrated development of the Yangtze River Delta and support the construction of Lingang New Area. This shows the government's concerted efforts to achieve robust development of the domestic financial market. The establishment of Shanghai as an international centre of finance will promote a new cycle of higher-level financial openness while also enhancing the secondary effect on the Yangtze River region, driving the Yangtze River Delta to attain a higher level of development.

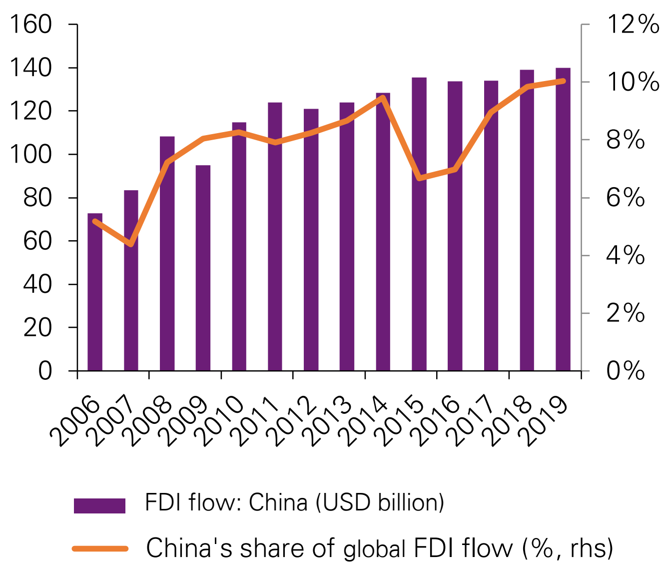
3

Focus on the COVID-19 pandemic's impact on foreign investment in China

COVID-19 pandemic deals a blow to global FDI

Although global FDI flows had declined for four consecutive years, foreign investments in China had been maintaining steady growth since 2016. According to the most recent data from UNCTAD, global FDI in 2019 was USD 1.394 trillion, down 1.3% from 2018; in that same period, China's FDI was USD 140 billion, up 0.7%, and its share of global FDI further increased to 10%.

Figure 46: China's FDI and its global share



Source: UNCTAD, KPMG analysis. 2019 data are estimated values.

However, the rapid worldwide spread of the novel coronavirus has brought about great uncertainty over global economic development and dealt a direct blow to FDI. 1. In order to control the spread of the virus, countries have been introducing measures to restrict the movements of people and goods, which has significantly curbed cross-border investment activities and greatly reduced investment efficiency. 2. The pandemic has caused a significant slowdown in the economic growth rate — it has impacted corporate incomes, and a drop in profits will reduce capital expenditures and earnings reinvestments on the part of multinational companies, thus impacting the scope of global multinational investments. 3. The pandemic's impact varies by industry; some industries hit relatively hard may be more cautious in their multinational investments for the foreseeable future.

According to UNCTAD's most recent Investment Trends Monitor report on global investment trends[17] , the novel coronavirus outbreak will result in a significant drop in FDI worldwide of up to 30%-40%. Additionally, the world's 5,000 largest multinationals play an important role in direct investment and act as bellwethers for FDI. Due to the impact of the epidemic, nearly 80% of these companies have lowered their profit forecasts since 1 February by 30% on average. As the novel coronavirus continues to spread globally, this downward trend is likely to continue.

Table 5: Projected average earnings adjustments and reinvested earnings as a share of FDI for the 5,000 largest multinationals worldwide

Region/Economy	Projected Average Earnings Adjustment	Reinvested Earnings as a Share of FDI (2018)
Worldwide	-30%	52%
Developed Economies	-35%	61%
Developing Economies	-20%	40%
Developing Economies in Asia	-21%	41%
Singapore	-30%	N/A
Thailand	-28%	72%
South Korea	-29%	22%
Malaysia	-26%	N/A
China	-21%	N/A

Source: UNCTAD, KPMG analysis. Data is for 1 February 2020 to 23 March 2020.

[17]Investment Trends Monitor, UNCTAD, 26 March 2020, https://unctad.org/en/PublicationsLibrary/diaeiainf2020d3_en.pdf

From a regional perspective, as the epidemic has continued to spread throughout Europe, the US and other developed economies, the earnings of multinationals in those areas have dropped by as much as 35%, which is a greater reduction than the 20% seen in multinationals in developing countries. Of those, Chinese multinationals have seen a 21% reduction in profits, which is lower than most developing countries in Asia. By industry, the energy industry has been hit the hardest, with a 208% decline in forecasted earnings, primarily due to the recent crash in crude oil prices from the novel coronavirus epidemic. It is followed by the aviation, automobile manufacturing, and food and travel industries, respectively, at 116%, 47% and 41%.

Furthermore, countries such as the US, France, Germany, the UK and the Netherlands that have been severely impacted by the epidemic are major sources of foreign investment for China. The rapid spread of the virus has dealt a serious blow to corporate revenues in these countries; profit forecasts have been lowered and enterprises have chosen to reduce capital expenditures and postpone new investments. This has subsequently had an adverse effect on these countries' direct investments in China.

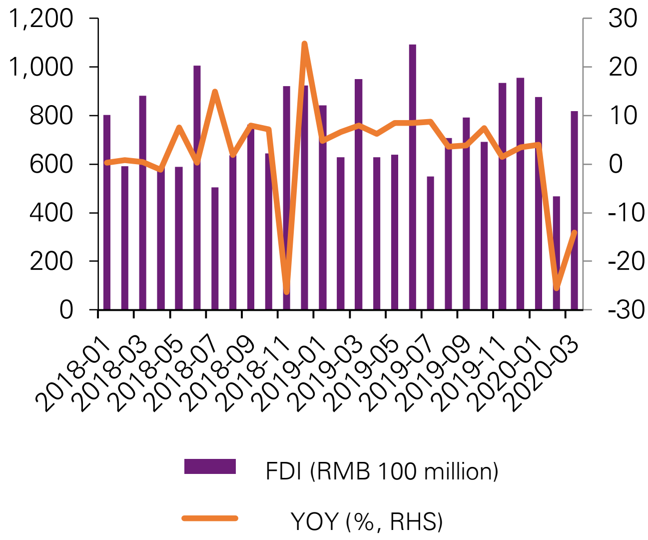
Table 6: Confirmed COVID-19 cases in select countries and their direct investment in China

Country	Confirmed Cases	FDI Flow（in USD million, 2018）
US	588,435	2,689
Spain	170,099	171
Italy	159,516	233
France	137,877	1,011
Germany	130,162	3,674
UK	89,571	2,482
Belgium	30,589	148
The Netherlands	26,712	1,273

Epidemic data as of 13 April 2020
Source: Wind, KPMG analysis

Between January and March of this year, FDI in China totalled RMB 216.19 billion, a decrease of 10.8% from the same period the previous year, but signs of stabilisation appeared in March. China's FDI in March was RMB 81.78 billion, down 14.1% from the same period the previous year, and a contraction of 11.5 percentage points from February. In January and February, [18]due to the impact of the novel coronavirus and the Chinese New Year holiday, movements of people and goods were impeded and enterprises carried out large-scale production stoppages, leading to limited investment activity and an increased "wait-and-see" attitude from investors. These are the primary reasons behind the change in the trend of actual usage of FDI in China, from rising to falling. Going into March, the transmission rate of the epidemic outside of China accelerated while it was gradually brought under control in China. The daily increase in cases was significantly reduced, and work and production were resumed in an orderly fashion. Thus, the rate of decline lessened although FDI decreased in March.

Figure 47: China's FDI and growth rate, monthly values

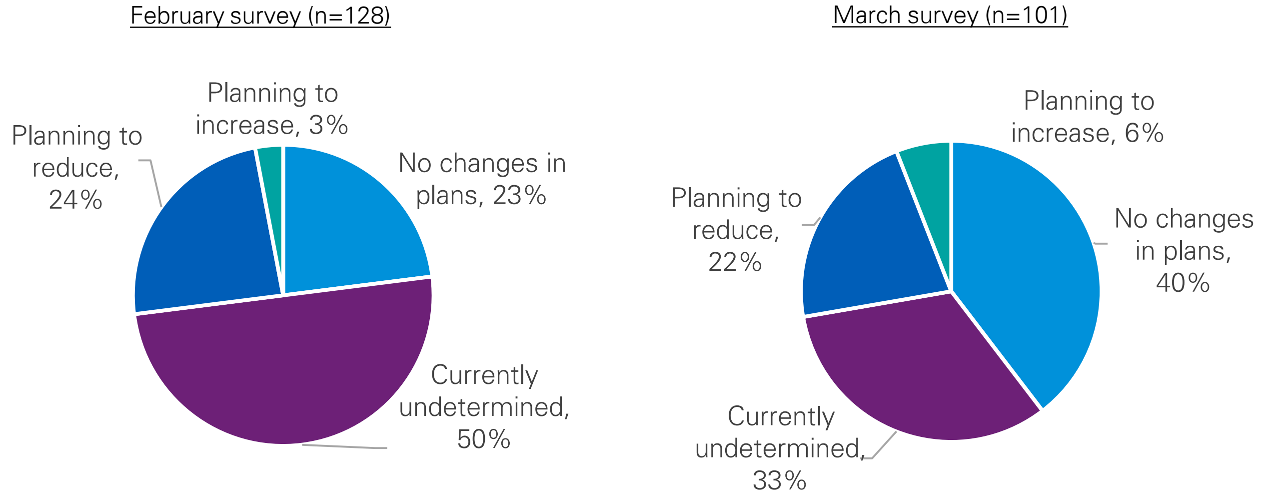


Source: Ministry of Commerce, KPMG analysis

[18] The person in charge of the Foreign Investment Department in the Ministry of Commerce discussing national absorption of foreign capital in the first quarter of 2020 http://www.mofcom.gov.cn/article/ae/sjjd/202004/20200402955393.shtml

Some surveys targeting foreign investors have also shown that their investment confidence in China has recovered since the peak of the epidemic in February. For example, the results of surveys carried out by the American Chamber of Commerce in China (AmCham China) in February and March showed that the proportion of enterprises that held to their original investment plans in China increased from 23% in February to 40% in March. The proportion of enterprises planning to decrease their investments in China fell by two percentage points, while those planning to increase their investments in China increased by three percentage points.

Figure 48: COVID-19's impact on foreign investors' planned investments in China, 2020



Source: AmCham China, KPMG analysis

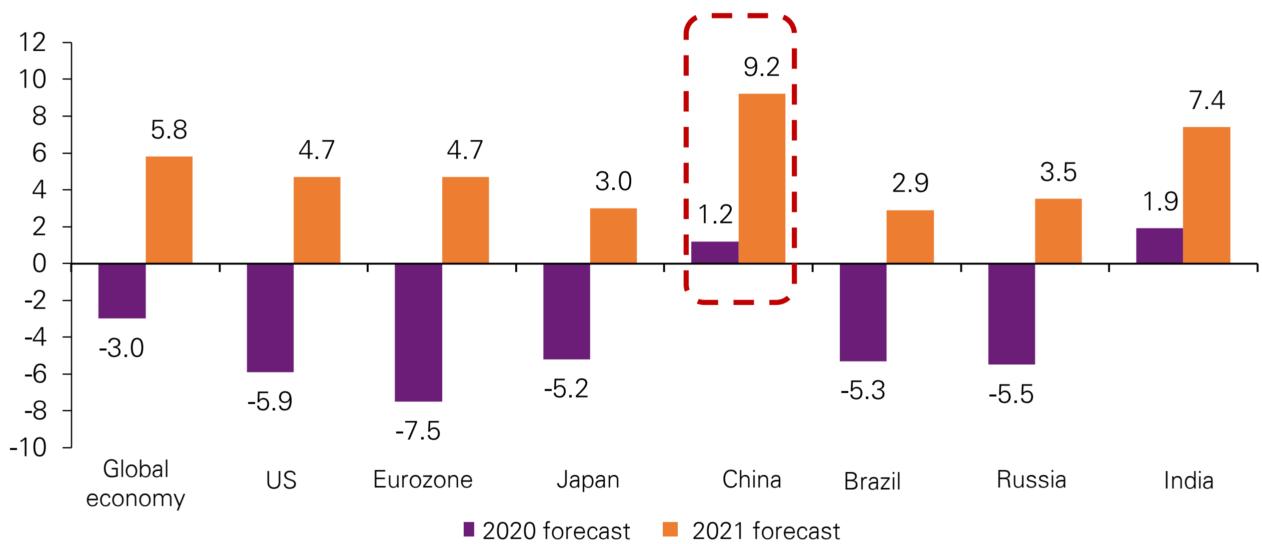
Foreign investment in China remains attractive

The novel coronavirus has spread rapidly overseas, and while the resultant general atmosphere of declining foreign investment worldwide has impacted China, the epidemic is now essentially under control in China and China has taken the lead globally in the resumption of work and production. More importantly, although international investment will be impacted by factors relating to the epidemic in the short term, it is more focused on the market environment and long-term development prospects of investment locations. We believe that with the prospects and resilience of China's macroeconomic development, the ongoing improvement of the business environment, the continual opening up to the outside world, as well as a complete upstream and downstream industrial chain and high-quality resources for factors of production, China remains attractive for foreign investors in a number of ways, and remains one of the most important targets for foreign investment.

Broad development prospects and resilience of China's macroeconomy

Despite the greater downward pressure on China's economy in 2019, economic performance was generally steady. In 2019, China's GDP topped USD 14 trillion, ranking second globally, and its actual growth rate continued to rank highly among the world's major economies, while per-capita GDP broke through the critical USD 10,000 mark. In spite of the current novel coronavirus epidemic enveloping the entire world, the latest World Economic Outlook released in April by the IMF shows that while the global economic growth rate has fallen to -3% in 2020 and the per capita incomes in over 170 economies around the world are shrinking, the Chinese economy maintains positive growth and the forecasted growth rate for 2021 may be as high as 9.2%: its economy remains fundamentally strong.

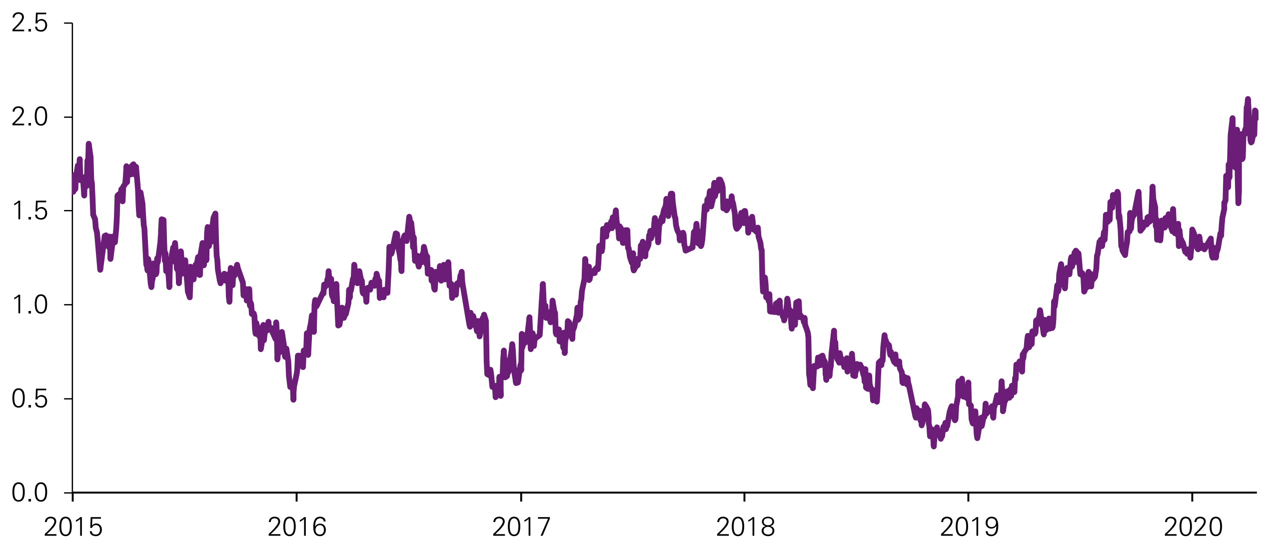
Figure 49: Projected short-term economic growth of major economies, %



Source: April 2020 IMF World Economic Outlook, KPMG analysis
Note: Data for India is for the local fiscal year (April to the following March)

In addition, China's current policy room to maneuver is relatively large. In order to cope with impact of the COVID-19 pandemic , fluctuations in oil prices and the temporary lack of liquidity in the financial markets, the US Federal Reserve rapidly lowered the policy interest rate target to 0% to 0.25% in two significant cuts to interest rates after the outbreak. China's monetary policy, on the other hand, has remained relatively stable. Currently, the interest rate yield spread on 10-year China-US treasury bonds has increased to 200 base points (2%), reaching a new high for recent years. Higher returns have also added to China's attractiveness for inflows of foreign capital.

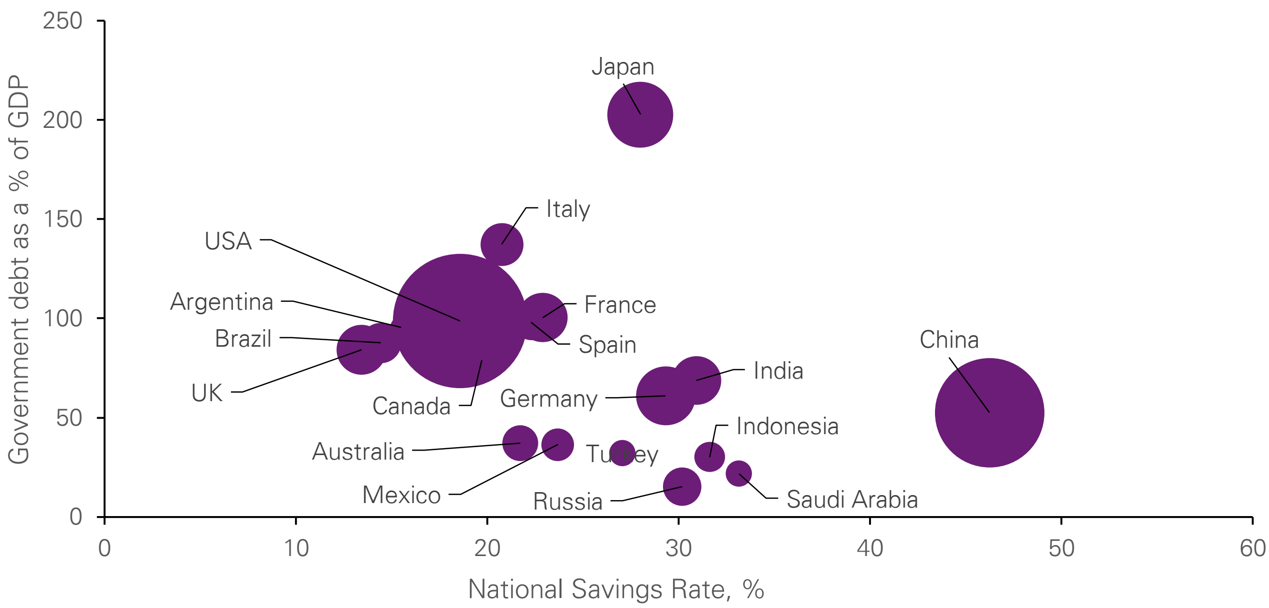
Figure 50: China-US interest rate yield spread on 10-year treasury bonds, %



Source: Wind, KPMG analysis

Likewise, there is also quite a bit of flexibility in China's fiscal policy. Compared with other major economies, China's national savings rate is relatively high and the ratio of government debt to GDP is relatively low. In the face of a crisis, the government is able to make use of ample fiscal room to manoeuvre as well as a wealth of monetary policy tools to combat external impacts.

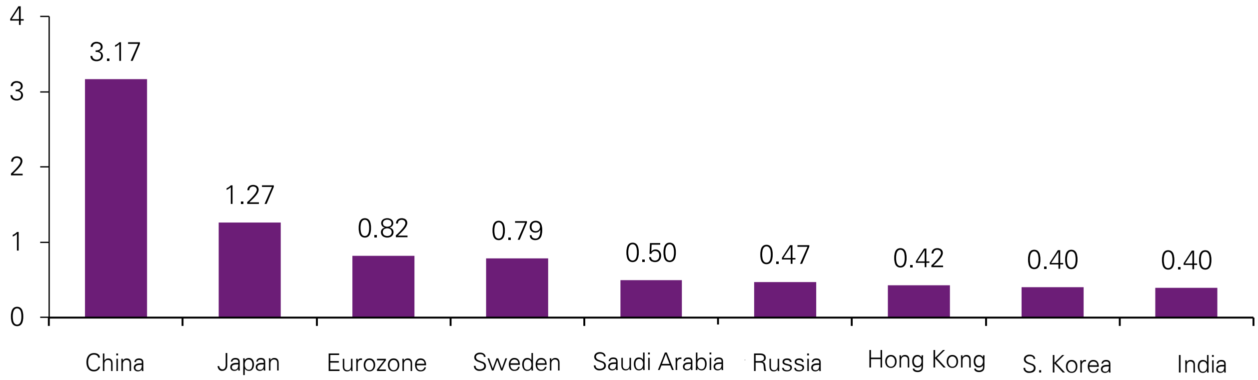
Figure 51: National savings rates of major global economies and proportions of government debt to GDP, %



Note: Bubble sizes represent each economy's GDP volume in USD.
Source: BIS, World Bank, KPMG analysis

Another factor is that China's national savings rate is first in the world; a surplus is maintained in current accounts the majority of the time, which can effectively handle capital flow shocks and maintain a stable exchange rate. Generally speaking, China has a long-term upward trend for its macroeconomy and adequate policy allowances to respond to the crisis to enhance its ability to attract foreign investment.

Figure 52: Foreign exchange reserves of major global economies (USD 1 trillion)



Source: IMF, KPMG analysis

Continuous improvement of the business climate and greater openness to the outside world to further attract foreign capital

In the coming years, China's ongoing improvement of its business climate will also increase its attraction of foreign capital. The World Bank's Doing Business 2020 report stated that China has made significant progress in its business climate over the last two years. China's current business climate ranks 31st in the world, 15 places higher than its position the previous year.

From a governance perspective, though currently faced with natural disasters and the pandemic, China's strong resource mobilisation capabilities, excellent execution at all levels of government, as well as trust and cooperation in all social sectors aid in the rapid, effective control of the spread of a disaster. There was a series of measures that greatly improved the efficiency of the prevention and control of the epidemic in China, including: wearing masks, locking down cities, implementing community management, and other coordinated protection and control mechanisms; comprehensive inspections of highways, railways, airports and other transport hubs; the rapid construction of Huoshenshan and Leishenshan Hospitals; medical staff and equipment being urgently dispatched to Hubei Province. All these measures enabled China to more quickly gain control over the spread of the epidemic and laid a foundation for resuming work and production, and for gradually restoring normal economic operations.

The government is seriously prioritising the stabilisation of foreign capital and foreign trade since the effective control of the novel coronavirus epidemic within China, and has proposed a number of policies to prioritise supporting work and production resumption in foreign-funded enterprises. According to a March report from the South China AmCham, of the 399 member enterprises surveyed, over 93% believed that the Chinese government agencies can provide effective help for enterprises[19]. We believe that the stable development of society is a fundamental guarantee for primary market entities' ability to carry out production and operational activities, and in this global novel coronavirus outbreak, China's anti-epidemic defence capabilities are evident for the world to see. This will also increase China's attractiveness for foreign investment.

Furthermore, China's foreign investment climate has continued to develop legally with further openness to the outside world. This is the first year of China implementing its Foreign Investment Law, which requires that all types of enterprises be treated equally in terms of enterprise support policies, government procurement, setting of standards and administrative approvals. The list of exceptions for foreign investment in China was shortened from 93 items in 2015 to 40 items in 2019. In addition, at the State Council executive meeting on 7 April this year, it was clearly stated that China would continue to expand the scope of industries that encourage foreign investment.

[19] Special Report: Impacts of the Novel Coronavirus Epidemic, South China American Chamber of Commerce, March 2020 http://amcham-southchina.org/amcham/static/publications/specialreport.jsp

Table 6: China's policy documents issued since the outbreak of the novel coronavirus

Date	Department	Policy/Meeting	Content
10 February	Ministry of Commerce	Notice on Actively Responding to the Novel Coronavirus Epidemic and Strengthening Services for Foreign-funded Enterprises and Investment Promotion	Actively assist foreign-funded enterprises in an orderly resumption of normal production and operations; strengthen service and guarantees for major foreign-funded protection; innovate and optimise methods for attracting foreign investment; provide targeted regional assistance; continue to optimise the commercial climate
18 February	Ministry of Commerce	Notice on Stabilising Foreign Investment and Promoting Consumption in Response to the Novel Coronavirus Epidemic	Coordinate audit departments' accelerated handling of procedures for the resumption of work; enhance tracking services for major foreign-invested projects, and innovate and optimise investment promotion methods; improve dynamic monitoring of foreign-funded enterprises and provide targeted improvement of services and guidance; make good use of regional supporting funds, spur social capital, and fully support the stabilisation of foreign trade in order to stabilise foreign investments and promote consumption.
28 February	Ministry of Commerce	Video and Teleconference on Work in Response to the Novel Coronavirus by the National Business System	More proactively and effectively use foreign capital, strive to stabilise any reserves, seize opportunities for major foreign investment, and innovate methods for attracting investment.
6 March	Ministry of Commerce, Ministry of Finance	Notice on Using Special Funds for Domestic and Foreign Trade to Support the Stabilisation of Foreign Trade and Foreign Investment and Promote Consumption	Make good use of special funds for the development of foreign trade and fully support the stabilisation of foreign trade and foreign capital; make good use of service industry development funds and increase support for the promotion of domestic consumption; strictly regulate fund management and continue to improve fund management performance.
9 March	Development and Reform Commission	Notice on Further Deepening Reform for Foreign-funded Projects in Response to the Epidemic	Require proactive assistance for foreign-funded projects and the resumption of work and production for foreign-funded enterprises, strengthen tracking and inventory of foreign-funded projects, improve convenience of filing for foreign-funded projects, simplify foreign-funded project approval processes, optimise and encourage a tax-free confirmation process for imported equipment for foreign-funded projects.
11 March	State Council Executive Meeting	Identification of New Measures to Stabilise Foreign Trade and Foreign Investment in the Face of the Epidemic	Continue to expand access to the outside world and take measures to stabilise foreign trade and foreign investment; focus on the further reduction of the list of exceptions for foreign investment, and expand the catalogue of industries encouraging foreign investment so that foreign investment may enjoy preferential policies (including taxation) in more industries.
24 March	Ministry of Commerce	Notice on Overall Planning for Prevention and Control of the Novel Coronavirus Epidemic and Comprehensive Management of Economic Development in National Economic Development Zones	Propose 10 work requirements such as promoting enterprises' resumption of work and production, increasing policy support, improving assessment and evaluation mechanisms, deepening promotion of the reform of "deregulation and decentralisation", and strengthening of investment promotion. Promote national development zones to enhance priority tasks such as expanding, opening up and attracting investment. Play a greater role in the "six stabilities" work, particularly in stabilising foreign trade and foreign investment.
27 March	Ministry of Commerce	2020 National Foreign Investment Work Conference	In response to the current grave situation for stabilisation of foreign capital, clarify work at the central and local levels for specific projects in six key aspects — promoting the resumption of work and production in foreign-funded enterprises, following policies that stabilise foreign investment, implementing information reporting systems, improving the promotion and attraction of investments, promoting the establishment of different types of open platforms, and continuously optimising a climate for foreign investment.
1 April	Ministry of Commerce	Notice on Furthering Reform and Opening-up In Response to the Epidemic to Stabilise Foreign Investments	Propose 24 measures to stabilise foreign investment from five aspects — fully supporting foreign-funded enterprises to restore normal production and operation, promoting a higher level of opening up, further promoting the reform of "deregulation and decentralisation" in the commercial field, strengthening foreign investment services and work advancement, and continuing to optimise the climate for foreign investment.
1 April	Ministry of Commerce	Notice on the Further Development of the Role of China Railway Express in Combating the Novel Coronavirus to Stabilise Foreign Trade, Stabilise Foreign Investment, and Promote Consumption	Ensure the support policies for China Railway Express are equally accessible to foreign-funded enterprises. Guide foreign-funded enterprises to make full use of the support policies and measures for China Railway Express, and treat domestic and foreign enterprises entirely equally. Support multinational companies' use of China Railway Express's logistical network to mitigate the impact of the epidemic on their supply chains and industrial chains, and stabilise the confidence of foreign-funded enterprises.

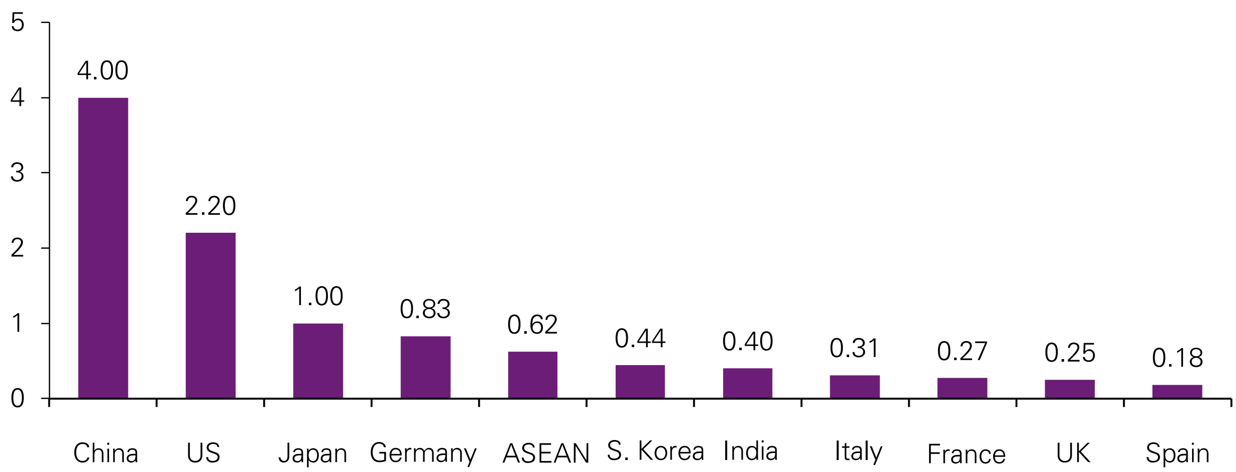
Note: Data as of 10 April 2020.
Source: Online public data, KPMG analysis

Complete upstream and downstream industrial chains are also important considerations for foreign investment

In the face of the epidemic, some national governments have proposed the encouragement of a return to manufacturing, and have even considered subsidising and supporting enterprises' relocation costs to avoid over-reliance on overseas resources. However, it is our belief that reshaping a highly divided global industrial chain is a complex process that is both capital- and time-intensive for enterprises, and their long-term strategic decisions are based upon some governments' relocation subsidies. Proximity to product markets, reduction in production costs, and the improvement of upstream and downstream industry chains are perhaps sounder fundamental considerations for enterprises' investment decisions.

China does offer a complete industrial system with robust industrial chains. According to World Bank data, in 2018, the added value of China's manufacturing industry reached USD 4 trillion, accounting for 28% of the total worldwide. China's manufacturing value added (MVA) approaches the total MVA of the US, Japan and Germany. Its relatively complete industrial chains can ensure a more convenient and efficient upstream and downstream process for enterprises from R&D, production, to sales. The Yangtze River Delta, for example, is China's key industrial production zone, and is a cluster with obvious advantages. As for the automotive industrial chain, the level of innovation and R&D is higher in Shanghai, there is a concentration of labour resources in surrounding Jiangsu, Zhejiang, and Anhui, and it is strong in intelligent manufacturing capabilities. A large number of Chinese auto parts producers are concentrated in the Yangtze River Delta, and the entire industrial chain for automobiles is complete. This has also drawn in many multinational automobile enterprises for positioning, investment and factory construction in the region.

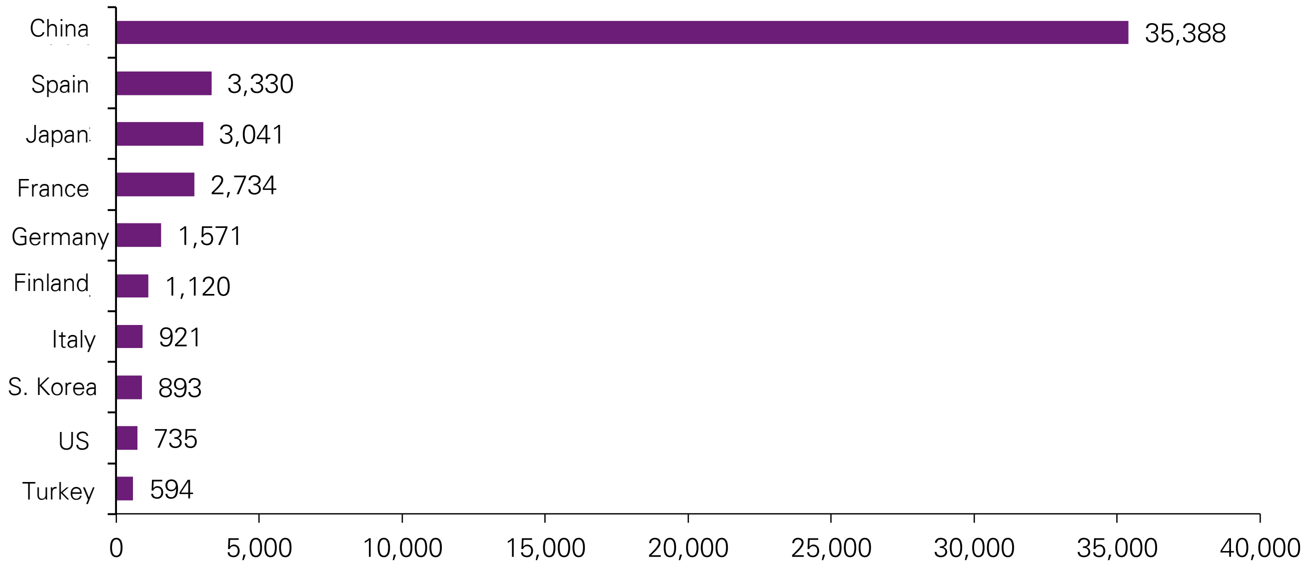
Figure 53: Manufacturing value added in major global economies (USD 1 trillion)



Source: World Bank, KPMG analysis

Secondly, mature infrastructure and strong supporting capabilities in transportation are fundamental considerations for enterprises' investment choices and location selection as well as critical for the support of industrial development. Problems such as insufficient railway capacity and power supply shortages hinder the development of most manufacturing industries. China was ranked at the forefront worldwide in the World Bank's access to electricity index in its business climate evaluation system. In addition, China's highway and high-speed railway operation are already ranked first in the world and are capable of aiding enterprises in achieving physical connectivity, as well as the sales of goods over long distances.

Figure 54: Global high-speed railway operating mileage (in km)



Source: UIC, KPMG analysis

[20] Data Source: National Bureau of Statistics, World Intellectual Property Organization (WIPO)

Future development for foreign investment in China

Below we highlight four areas that will likely see more FDI in the future.

In China, for China

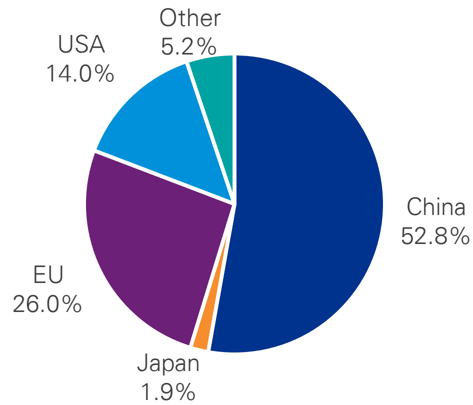
China has the largest consumer market in the world, and in recent years it has placed great importance on the development of its domestic consumer market. In 2019, total retail sales of consumer goods increased by 8%, and final consumption contributed 57.8% to GDP. The steady growth of consumption activity has been like a ballast in maintaining economic stability.

At the same time, developing central cities and city clusters have become part of an important strategy for China's regional economies development. As the household registration and land systems undergo reform, the government will further promote the effects of urban agglomeration through the development of new infrastructure and the digital economy, unleashing the potential of China's consumer market. The steadily growing middle-income group will also bring about more new demand through the upgrading of the consumption structure. The vast market hinterlands and the large numbers of consumers will push the development of international investments in the direction of "In China, for China."

For example, in late November 2019, a German chemical giant invested USD 10 billion for the construction of a new, integrated chemical production base in Guangdong. The German firm expressed that China is the largest market for chemicals in the world, accounting for about 40% of the total market, and that it plays a leading role in the global growth of production of chemicals. The major factors for choosing Guangdong were its large population and the fact that important clients in relevant industries are located there. This project is the German firm's largest overseas investment project to date; it will build streamlined production facilities for basic chemicals to consumer products, and form an integrated industrial chain that will provide support for growing industries in China such as consumer products and transportation.

Similarly, China is the world's largest market for new energy vehicles. EV volumes data show that in 2019, approximately 1.2 million new energy vehicles were sold in China, up 3% from the prior year and accounting for 52.8% of total sales worldwide. Tesla, the electric vehicle industry giant, has decided to construct its first overseas factory in China. Its decision was based on China's well-developed industrial system and efficient manufacturing capabilities as well as its market for new energy vehicles. We expect that, through the "In China, for China" investment model, an increasing number of multinational corporations will develop hand-in-hand with China's markets.

Figure 55: Proportion of new energy vehicle sales in major economies in 2019, %



Source: Public information, KPMG analysis

Stronger IP protection for more high-tech investment

China has strengthened domestic protection of IP rights in order to foster a positive environment for foreign investment in China. China's legal system concerning IP has over 20 laws and regulations, including trademark laws, patent laws, copyright laws, anti-unfair-competition laws and regulations on customs protection for IP. There are also other laws and regulations that are closely linked to IP protection such as contract laws, corporate laws, advertising laws, foreign trade laws and anti-trust laws.

Additionally, China has signed legal documents such as bilateral and multilateral agreements and memorandums with relevant countries on pertinent issues of IP. For example, in the phase 1 China-US trade deal signed early this year, the two sides reached consensus on strengthening IP protection in several areas, including protection of trade secrets, IP issues related to pharmaceutical products, extension of the validity of patents, geographical indications, fighting piracy and counterfeits on ecommerce platforms, fighting the production and export of pirated and counterfeit products, fighting malicious trademark registrations, as well as strengthening judicial enforcement and processes for IP.

China’s strengthening of IP rights protection is beneficial for the protection of innovations, which is favourable for an increase in foreign IP rights entering China. In May 2019, the Business Confidence Survey 2019 released by the EU Chamber of Commerce in China showed that approximately 60% of the surveyed EU enterprises located in China believe that administration and judicial protection for IP in China have been significantly strengthened, and the general attractiveness of the R&D environment is increasing rapidly.

The increase in the elevation in China’s capabilities for innovation and the strength of its IP protection will attract more foreign investment in high-tech and high value-added industries. Data from the Ministry of Commerce show that in the first quarter of 2020, although the overall use of foreign capital declined by 10.8% YoY, the actual use of foreign capital in high-tech industry increased 15.5% YoY, accounting for 29.9% of the service industry. Within this, information services, e-commerce services and professional technical services increased by 28.5%, 62.4% and 95% YoY respectively.

Great potential for green industries

Over 40-plus years of reform and opening up, China’s economic achievements have drawn attention of the entire world, however, it has paid a considerable price in resources and in environmental aspects. Such rapid development at the expense of the environment is clearly unscientific and unsustainable. In recent years, as the country’s economic development structure has continued to improve, the concept of “green hills and clear waters are gold and silver” has become more deeply rooted in the people’s hearts. The government has started prioritising environmental sustainability and green development. As early as 2016, China issued its Outline of the Yangtze River Economic Belt Development Plan, which is focused on green, sustainable development.[22] In September 2019, President Xi Jinping personally chaired a symposium on ecological protection and high-quality development in the Yellow River Basin, in which he stressed the need for environmental protection and high-quality development.[23]

[22] Promoting the Development of the Yangtze River Belt is of the Utmost Significance, the People’s Daily Online, 12 September, 2016
http://politics.people.com.cn/GB/n1/2016/0912/c1001-28707585.html
[23] Xi Jinping chairing a symposium on the ecological protection and high-quality development in the Yellow River Basin, Chinese Government Online Portal, 19 September, 2019
http://www.gov.cn/xinwen/2019-09/19/content_5431299.htm

China's environmental protection industry has maintained a steady trend of growth in recent years; however, the proportion of GDP of investments in environmental protection has been on an annual decline since 2012, and it dropped to 1.16% in 2017. A number of environmental policies were introduced in 2018 to further intensify efforts toward environmental protection and conservation, after which environmental protection rebounded to 1.48% of GDP. The experiences of developed countries indicate that containing a worsening trend in environmental pollution can only be achieved when the proportion of environmental protection of GDP is between 1% and 1.5%, while only a proportion between 2% and 3% can improve the quality of the environment.[24] This shows great potential for China's environmental protection industry. According to forecasts in the Analysis Report on China's Environmental Protection Industry (2019)[25], total business earnings in China's environmental protection industry are expected to exceed RMB 2.1 trillion in 2020.

Green industries not only show enormous market potential but are also priority industries for China to attract and encourage foreign investment. In the most recent *Catalogue of Industries for Encouraged Foreign Investment* released in June, green manufacturing, and energy conservation and environmental protection are both focal points for China to absorb and utilise foreign investment. Driven by the size of market and favourable policies, green industries — represented by energy efficiency, environmental protection and green manufacturing — will become a particular point of interest for foreign investment.

More rapid development expected in the medical and health industries

Since the onset of the epidemic, some multinationals have likely considered factors resulting from the impacts of dispersal of supply chain risks, and decreased regional supplies of medical products in emergencies, and have as a result explored a more reasonably distributed supply chain layout in order to ensure the supply of medical products and devices. However, it should be noted that this epidemic has also had far-reaching impacts on China's medical and health industries. On the one hand, this epidemic can be considered to be an unprecedented education in health for the entire populace; people at all levels of society are focusing more on the health industry, and future health-related expenditures are expected to increase substantially. On the other hand, this epidemic has also exposed insufficiencies in China's medical resources, inadequacies in diagnostic and treatment systems at different levels as well as varying levels of development in different regions, inadequate informatisation, and major shortcomings in pharmaceutical R&D. The medical and health industries are bound to receive greater attention in the future. According to the forecasts in the Healthy China 2030 Planning Outline, the overall scale of the health industry will exceed RMB 8 trillion in 2020 and RMB 16 trillion in 2030. Catalysed by this epidemic, the industry scale is expected to improve.

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[24] 2019 NDRC Industrial Structure Adjustment Guidance Catalogue– Comprehensive Utilizations of Environmental Protection and Resource Conservation Category (Consultation Draft)
https://new.qq.com/omn/20190528/20190528A03KNQ.html
[25] http://huanbao.bjx.com.cn/news/20191225/1031245.shtml

Driven by medical and health needs as well as policy, prior to the epidemic, the health industry had already become a hotspot for capital. The capital for the major health industry currently comes largely from real estate and medical institutions, insurance companies, financial institutions, as well as online medical and smart pension companies that are technology leaders in "health and smart technology." In recent years, restrictions on external access to the medical and health industries have gradually been relaxed, particularly in healthcare industries related to care for the elderly. For example, in April 2018, Beijing released its Opinions of the Beijing Municipal People's Government on Further Opening Up to the Outside World and Improving the Utilisation of Foreign Capital which mentioned encouraging foreign-invested enterprises to establish for-profit nursing facilities, integrating medical and nursing services, community pension service stations, and professional nursing service institutions in Beijing to provide diversified pension services. We trust that as the Foreign Investment Law is in force and as policies to attract foreign investment in the medical and health industries continue to evolve, foreign investment is expected to see rapid growth.

Summary

While there have been magnificant developments in China's economy, obvious shortcomings in many areas remain. For example, China's manufacturing industry may be large, but it is not robust; many key segments still heavily rely on imports, there is a deficiency in fundamental R&D capabilities, there is low value added, and so on. Foreign investment continues to possess great significance to China's future development, consumption upgrades and industrial upgrades.

The novel coronavirus epidemic is considered to be the greatest challenge the world economy has faced since the Great Depression of 1929. This epidemic not only has put incredible pressure on short-term economic growth but also is likely to have a profound impact on medium- and long-term political, economic, technological, trade and investment patterns worldwide.

As China's demographic changes and labour costs rise, the movement of some labour-intensive industries toward areas with lower costs is in line with the laws of economic development. At the same time, some enterprises may make adjustments in the layout of their industrial chains based on considerations of factors such as dispersing supply chain risks and reducing localised constraints on product supplies.

In such a context, we would like to see that China's enormous and quickly growing market, and its well-developed and efficient industrial chains act as the foundation for attracting foreign investment. But on the other hand, however we must also have a clear understanding of the future risks and challenges, quicken the pace of opening up, as well as accelerate the transformation and enhancement of science and technology. Unlike investments in securities, FDI is more stable and more important for a country's long-term development prospects. As long as China maintains its momentum in stable development, it will maintain its high attractiveness for FDI.

[26] Beijing Eases Restrictions on Foreign Investment in Six Key Areas and Encourages Foreign Investment in Beijing Elderly Caring Institutions, Chinese Government Online Portal, April 17, 2018, http://house.people.com.cn/n1/2018/0417/c164220-29930450.html

Appendix: Key indicators

			2018	2019	2019			2020		
	Indicator	Unit	Annual	Annual	Oct	Nov	Dec	Jan	Feb	Mar
Economic activity	Nominal GDP	Trillion RMB	91.9	99.1		27.8			20.7	
	Real GDP	% YOY	6.7	6.1		6.0			-6.8	
	Industrial production	% YOY	6.2	5.7	4.7	6.2	6.9	-4.3	-25.9	-1.1
	Industrial profit	% YOY YTD	22.0	-3.3	-2.9	-2.1	-3.3	0.0	-38.3	-36.7
	Retail sales	% YOY	9.0	8.0	7.2	8.0	8.0	0.0	-20.5	-15.8
	Fixed asset investment	% YOY YTD	5.9	5.4	5.2	5.2	5.4	0.0	-24.5	-16.1
	Property starts	% YOY YTD	17.2	8.5	10.0	8.6	8.5	0.0	-44.9	-27.2
	Property sales	% YOY YTD	1.3	-0.1	0.1	0.2	-0.1	0.0	-39.9	-26.3
	Land purchases	% YOY YTD	14.2	-11.4	-16.3	-14.2	-11.4	0.0	-29.3	-22.6
	Manufacturing PMI	Index	50.9	49.7	49.3	50.2	50.2	50.0	35.7	52.0
International trade and investments	Exports	% YOY	9.9	0.5	-0.8	-1.3	8.1	0.0	-17.1	-6.6
	Imports	% YOY	15.8	-2.7	-6.1	0.9	16.7	0.0	-3.9	-1.0
	Trade balance	USD billion	350.9	421.4	42.4	37.3	47.2	0.0	-6.9	19.9
	Foreign direct investment (FDI)	USD billion	132.0	138.1	10.0	13.6	13.8	12.7	N/A	N/A
	Outbound direct investment (ODI)	USD billion	120.5	110.6	9.5	8.3	11.8	8.3	7.2	8.7
Financial market	RMB exchange rate	USD/RMB	6.62	6.90	7.07	7.02	7.01	6.92	6.99	7.01
	RMB real effective exchange rate	Index	122.6	122.0	120.9	122.6	122.2	124.8	126.4	126.1
	Shanghai Composite Index (Period end)	Index	2494	3050	2929	2872	3050	2977	2880	2750
	Money supply (M2)	% YOY	8.1	8.7	8.4	8.2	8.7	8.4	8.8	10.1
	Stock of total social financing (TSF)	% YOY	12.0	10.7	10.6	10.7	10.7	10.7	10.7	11.5
	New TSF	RMB billion	19440	25575	868	1994	2103	5070	858	5149
	New bank loans	RMB billion	16166	16817	661	1390	1140	3340	906	2850
	Shibor (overnight)	%	2.48	2.18	2.47	2.20	1.86	1.92	1.64	1.31
Price	Consumer price index (CPI)	% YOY	2.1	2.9	3.8	4.5	4.5	5.4	5.2	4.3
	Producer price index (PPI)	% YOY	3.5	-0.3	-1.6	-1.4	-0.5	0.1	-0.4	-1.5
	Crude oil (WTI)	USD/barrel	64.9	57.0	54.0	57.1	59.8	57.6	50.6	30.5
	Steel (rebar)	RMB/ ton	4177	3933	3801	3926	3885	3773	3597	3561
	Housing price index (70 cities)	% YOY	7.3	9.7	8.0	7.3	6.8	6.5	5.9	5.4

Source：Wind，KPMG Analysis

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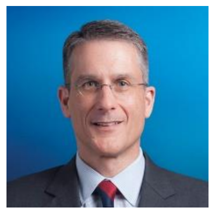

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Publication number: EN-MKT20-0002C

Publication date: August 2020