China Economic Monitor

Q3 2020

KPMG China

October 2020

kpmg.com/cn

Contents

Executive summary 2

1 Economic trends 5

- Economic revival continues as 2020Q2 growth turns positive 6
- Continuously narrowed decline in fixed asset investment and accelerated improvement in real estate and infrastructure investment 9
- A long way to go before the full recovery of consumption 13
- Inflation driven higher by floods but the downward trend is not likely to change in the long run 16
- Adequate money supply and record TSF stock growth rate in recent years 19
- More targeted monetary policies to channel special funds into the real economy 21
- Recovering external exports may boost foreign trade, pandemic supplies bolster exports 22
- Hong Kong SAR economy 25
- Global economy 27

2 Policy analysis 30

- Release of the Master Plan for the Construction of the Hainan Free Trade Port 31
- Financial support for the development of the Guangdong-Hong Kong-Macao Greater Bay Area 34
- Implementation of Growth Enterprise Market reform and pilot registration system 37
- New foreign investment negative list released 39
- China's public offering REITs pilot officially launched 41

3 Special focus: China-ASEAN regional economic Integration 44

- Overview of economies of Southeast Asian countries 45
- Trade, investment, merger and acquisition between China and ASEAN 49
- Prospects for China-ASEAN economic and trade cooperation 57

Appendix: Key indicators 58

Executive summary

As the COVID-19 pandemic continues to hit the global economy hard, the biggest challenge since the Great Depression looms closer. Amid such a grim outlook, China has been seem to be mounting an effective response with regard to pandemic control and reopening, showing continual recovery from the impact of the COVID-19 outbreak. In 2020Q2, China posted better-than-expected results with GDP bouncing back strongly at 3.2% YOY.

- All three economic sectors began to pick up speed, led particularly by the secondary industry. Specifically, the quarterly growth of value added of the primary sector turned positive to 3.3% YOY in 2020Q2, or 0.9% for 2020H1 cumulatively. The secondary sector saw the largest increase, as the growth rate of value added jumped to 4.7% quarterly YOY in 2020Q2, or -1.9% for 2020H1 cumulatively, 7.7 percentage points up from 2020Q1. This was driven by the strong rebound in the manufacturing and construction sectors — both are closer to their average in terms of growth rate — where the quarterly growth rate YOY went up 14.6 and 25.3 percentage points, respectively, from 2020Q1. Meanwhile, the value added of the service sector grew by 1.9% quarterly YOY in 2020Q2, or -1.6% for 2020H1 cumulatively. Emerging services like information transmission and finance remained stable, up 2.5 and 1.2 percentage points, respectively, from 2020Q1. Even accommodation and catering, the most heavily impacted sector amid the pandemic, showed early signs of recovery with a -18.0% quarterly growth YOY, 17.3 percentage points higher than the previous quarter.

- In 2020Q2, the value-added of industrial growth decreased by 1.3% YOY, down 7.3 percentage points from the same period last year but 7.1 percentage points narrower than Q1. With the pandemic well under control across China, reopening efforts continued to gain momentum. In Q2, the YOY industrial growth remained positive for three months in a row, hitting 4.8% in June — 5.9 percentage points up from March. The manufacturing PMI stayed above the threshold of so for the fourth consecutive month, and the accelerated recovery was further evidenced by other indicators, including power generation, coal consumption and excavator sales

- On the demand side, although the contribution of investment to economic growth rebounded significantly, the consumption remained flat. In 2020Q2, the contribution of consumption expenditure to economic growth slumped to -73.3%, dragging it down by 2.3 percentage points. However, the growth of online consumption was substantial, accounting for 25.2% of total retail sales of consumer goods, 1.6 percentage points up from Q1. As the government loosens pandemic restrictions, offline services return to normal and consumer demands rally over time, offline consumption may become a new economic highlight in H2 2020.

- In 2020H1, the growth rate of fixed asset investment fell by 3.1% YOY, but it was 13 percentage points narrower than in 2020Q1. Real estate development investment increased by 1.9% YOY cumulatively, turning positive for the first time in June, and outgrowing manufacturing (-11.7%) and infrastructure (-2.7%) investments in the same period. However, the latter two also saw an upturn: in 2020H1, the decrease in manufacturing investment was 13.5 percentage points narrower than in Q1, and infrastructure investment has been registering YOY growth for the third consecutive month in monthly terms.

- In 2020H1, cumulative exports were down by 6.2% YOY and cumulative imports were down by 7.1%. Higher-than-expected exports in 2020Q2 added some momentum to the positive economic growth. In June, China's exports and imports continued to pick up speed, both recording positive growth. The 0.5% increase YOY in exports was mainly driven by soaring overseas demands for pandemic control and “stay-at-home” resources, especially medical supplies and home electronics, due to the rapid spread of COVID-19 all over the world. In 2020Q2, China’s imports and exports with ASEAN— the largest trade partner of China — continued to climb, totalling USD 297.89 billion in 2020H1, a 2.2% increase YOY. That equated to 14.7% of China’s foreign trade, 1.2 percentage points higher than in the same period last year. The closer partnership in value chains like electronics manufacturing, and increased investments, boosted the imports and exports in turn. We expect to see stronger connections between China and Asian countries, including ASEAN members, in the future.

To counteract the economic impact of COVID-19, the People's Bank of China (PBOC) took an accommodative policy stance by cutting the deposit reserve ratio twice and the Loan Prime Rate (LPR) twice in January–April, aiming to improve liquidity and market confidence. As China’s economy revives with accelerated reopening, the Government Work Report 2020 took a “more flexible and moderate” approach to the monetary policy, saying it will support real economy with “remarkably higher-than-last-year” growth in Broad Money Supply (M2) and Total Social Financing (TSF), as well as innovative monetary policy tools.

In 2020Q2, the PBOC turned from further interest/RRR cuts to “more moderate and precise” measures in funding the real economy. First of all, it extended the RMB 1.8 trillion re-lending and re-discounting program launched in 2020Q1 for pandemic control and SMB (Small and Medium-sized Enterprises). Secondly, it launched the Inclusive Facility for Deferred Repayment of SMBs and Inclusive Credit Loan Program for SMBs, adding RMB 40 billion and RMB 400 billion, respectively, to the re-lending funds for SMBs. The PBOC has announced this year’s second round of re-lending rates cut by 0.25%, effective as of July 1, expecting to improve commercial banks’ access to lower-cost funds, which in turn reduces the funding costs of agricultural and smaller firms.

As for fiscal policies, the Government Work Report demanded a “more proactive” stance, including a 3.6%+ deficit rate, a deficit of RMB 1 trillion more than the previous year, RMB 1 trillion of COVID-19 national bonds, and newly added local government special bonds of RMB 3.75 trillion, to support taxes/fees reduction, rental/rates reduction and consumption/investment boosting initiatives.

As of 2020H1, public fiscal expenditures totalled RMB 11.6 trillion, with an RMB 600 billion jump from Q1 to Q2. Most went to social security, employment, healthcare and poverty relief programs. RMB 2.24 trillion of RMB 3.75 trillion newly added local government special bonds have been issued as of July 14, while the remainder will be issued by the end of September. For special national bonds, RMB 720 billion was issued as of July 16, and the remainder by the end of July.

Despite the promising outlook of economic revival, many challenges still exist —struggling SMBs, high unemployment rate of key groups, and lower per capita disposable income than before the pandemic, to name a few. Meanwhile, geopolitical risks and the global economic slowdown are exposing China’ economy to greater challenges. We believe the PBOC will continue a relatively accommodative stance to credit policies in 2020H2. Fiscally, as the fiscal revenue growth rate rebounds, fiscal expenditures will be accelerated with special bonds and national bonds fully funded. In addition, investments in new infrastructure, new urbanisation and healthcare are expected to grow under the “new normal” of pandemic control.

Globally, the spread of COVID-19 pandemic was temporarily contained in 2020Q2 in developed economies, including the US and the EU, thanks to isolation, lockdown and social distancing. However, the US has recently started witnessing a second wave of the outbreak, and the spread is accelerating in emerging markets such as Brazil, Russia, India and South Africa. Considering the impact on the world economy in 2020H1, the International Monetary Fund (IMF) downgraded its growth projection in the World Economic Outlook (WEO) Update, June 2020 by 1.9% to -4.9%, stating “the global economy is projected to grow by 5.4% in 2021 as economic activity normalises”, 0.4% lower than previous forecasts. According to the WEO, “The slower recovery path in the updated forecast reflects persistent social distancing into the second half of 2020… and a hit to productivity as surviving businesses ramp up necessary workplace safety and hygiene practices. For economies struggling to control infection rates, a lengthier lockdown will inflict an additional toll on activity.” All these will add a higher-than-usual degree of uncertainty — and impacts — to the global economic recovery.

Special study: China-ASEAN economic integration

The Association of Southeast Asian Nations (ASEAN) is a regional intergovernmental organisation of 10 Southeast Asian countries built on economic cooperation. As of 2019, ASEAN covered an area of 4.49 million sq. km with 660 million people and had total GDP of over USD 3 trillion. Amid the slowdown of the global economy and trade in recent years, ASEAN is emerging as one of the most important manufacturing hubs and consumer markets, thanks to its large population, increasing per capita income, strong foreign remittances and stable commodity prices.

China has been expanding its cooperation with ASEAN in trade, investment and M&A as well.

In December 2011, China and ASEAN announced the China-ASEAN Free Trade Area (CAFTA) in Brunei. In less than two decades, tariffs on over 90% of the commodities traded in CAFTA have been reduced to zero. In 2020H1, China's imports and exports with ASEAN reached USD 297.89 billion — about 14.7% of China's foreign trade — outperforming the whole sector in terms of YOY growth. By country and region, ASEAN has replaced the EU as the largest trade partner of China; among the ASEAN countries, Vietnam is China's largest partner, followed by Malaysia, Thailand and Singapore. Meanwhile, China has been the largest trade partner of ASEAN for 10 years in a row. Mechanical and electronic products, minerals, metals and metalworks, textile materials and articles, and plastics/rubbers and finished goods represent the bulk of China-ASEAN foreign trade.

By investment, ASEAN accounts for about 5.8% of utilized foreign direct investment in China, with Singapore ranked as the second-largest FDI source. China is the third-largest FDI source for ASEAN. As of 2018, China surpassed the EU and the US in terms of FDI stocks to ASEAN (USD 102.9 billion). Meanwhile, China's investment structure in ASEAN is also shifting, as manufacturing overtakes infrastructure as the most important investment area.

At the same time, China is expanding its M&A activities in ASEAN — 524 M&A cases in multiple sectors were completed in 2000-2019, and Singapore has become the preferred destination of Chinese companies "going abroad", attributable to its mature business environment. However, we have also noticed the formidable roadblock in the way of Chinese companies, for example, the "risk, regulation and talent" challenges from information asymmetry. KPMG is committed to empowering Chinese companies in the global market by assisting them in developing targeted overseas investment strategies and detailed implementation plans.

As China helps accelerate the economic integration of the region, the economic and trading agreements between China and ASEAN will help create a more convenient institutional environment to further drive investment and trade. In the post-pandemic era, global trade and investment are facing a deceleration as developed economies like the US and the EU weaken, and industrial chains will further converge within the region. The year 2021 marks the 30th anniversary of China and ASEAN's dialogue relations. Considering the key role of ASEAN in the Belt and Road Initiative, we expect to see closer economic integration in this region. China aims to strengthen its industrial synergy with ASEAN by leveraging the geographic proximity and production factors of Southeast Asian countries. The increase in investments will add more momentum to trade, which would benefit the long-term healthy cooperation and development of regional industry chains. In addition, bilateral cooperation on environment protection, marine industry, smart city and e-commerce will also be enhanced to drive regional economic growth.

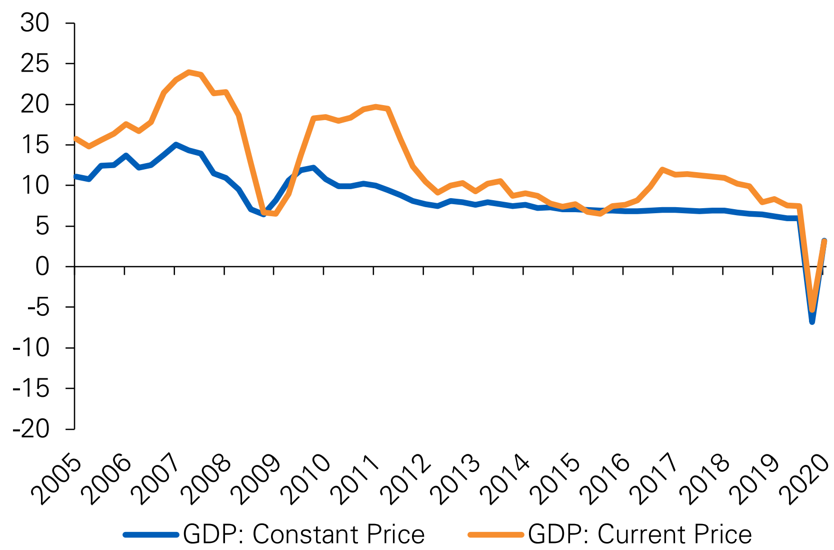
1

Economic trends

Economic revival continues as 2020 Q2 growth turns positive

As China has contained the COVID-19 outbreak in 2020Q2, its real GDP YOY growth turned up to 3.2%, higher than market forecast of 2.9% and 10 percentage points up from 2020Q1. Despite the strong rebound, the growth rates in 2020Q2 and 2020H1 were still 3 and 1.6 percentage points lower than the same period last year, respectively. In 2020Q2, the nominal GDP growth was 7.8% YOY, 8.4 percentage points up from 2020Q1 but 5.2 down from 2019Q2.

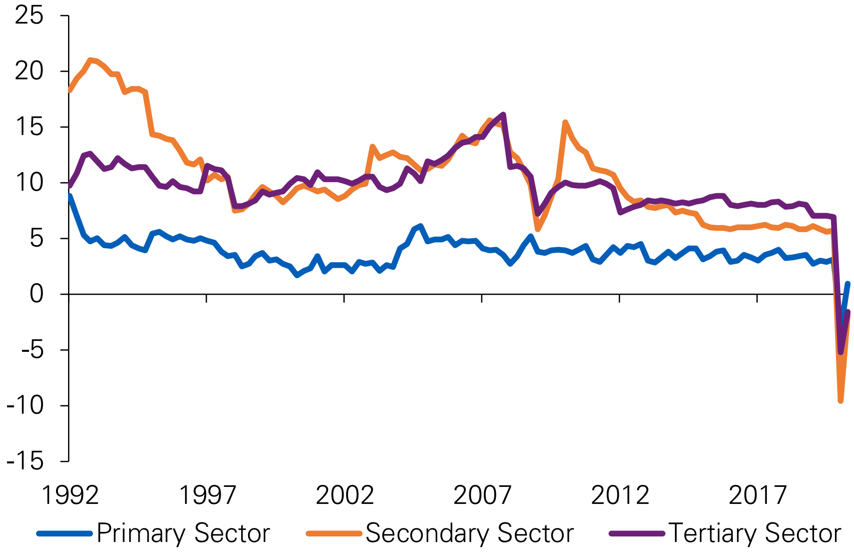
Figure 1: GDP growth rate, quarterly YOY, %



Source: Wind, KPMG analysis

The secondary sector provided the largest boost to GDP, amid the overall rally of all three economic sectors. Specifically, the growth rate of value added of the primary sector turned positive to 3.3% quarterly YOY in 2020Q2, or 0.9% for 2020H1 cumulatively. The secondary sector saw the largest increase, as the growth rate of value added jumped to 4.7% quarterly YOY in 2020Q2, or -1.9% for 2020H1 cumulatively, 7.7 percentage points up from 2020Q1. This was especially driven by the strong rebound in the manufacturing and construction sectors — both are close to their average terms of growth rate — where the quarterly growth rate YOY went up 14.6 and 25.3 percentage points, respectively, from 2020Q1. Even Accommodation and Catering showed early signs of recovery from the impact of the pandemic with a -18.0% quarterly growth YOY, 17.3 percentage points higher than the previous quarter. Emerging service sectors such as information transmission and finance remained stable, 2.5 and 1.2 percentage points up, respectively, from 2020Q1. As the pandemic severity eases, demand for online services, such as online education and remote working, may slow down, while we expect to see an upturn in offline demand, including Accommodation and Catering, in H2 2020.

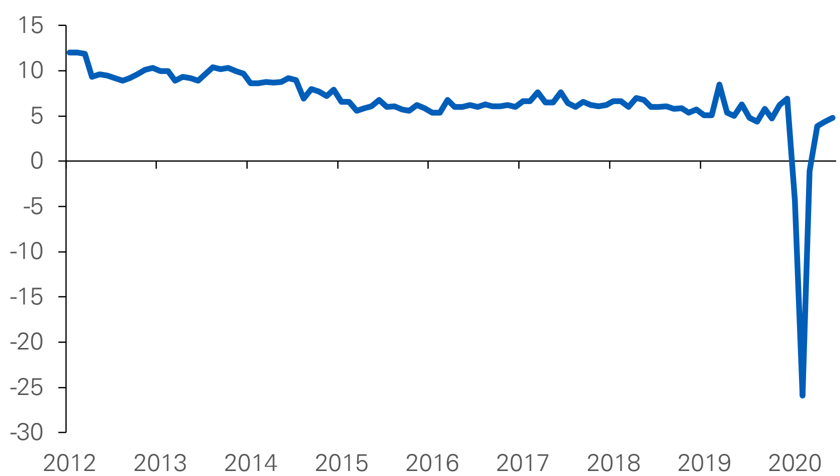
Figure 2: Growth rate by sector, cumulative YOY, %



Source: Wind, KPMG analysis

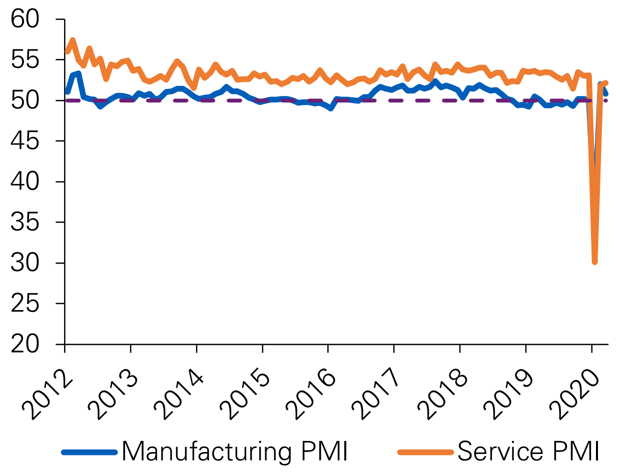
In 2020Q2, the value-added of the industrial enterprises above designated size decreased by 1.3% YOY, down 7.3 percentage points from the same period last year but 7.1 percentage points narrower than Q1. With the pandemic well under control across China, reopening efforts continued to gain momentum. In Q2, the YOY growth rate of the industry remained positive for three months in a row, reaching 4.8% in June — 5.9 percentage points up from March. The Manufacturing PMI recorded 50.9% in June, or 0.3 percentage points up from the previous month, marking the fourth consecutive month above the 50% threshold. This indicated stable recovery of manufacturing activities and continuous improvement of fundamentals. Notably, while the rise of manufacturing PMI in March-May was bolstered by the production index, the numbers in June revealed strong demand and supply: the New Orders Index went up two months in a row, and exports accounted for 42.6% of new orders — 7.3 percentage points up from the previous month — signalling a recovery in external demand. The continual upturn was also evidenced by the improvement of other indicators over the previous month, including Service PMI and Composite PMI Output Index.

Figure 3: Industrial value added , monthly YOY, %



Source: Wind, KPMG analysis

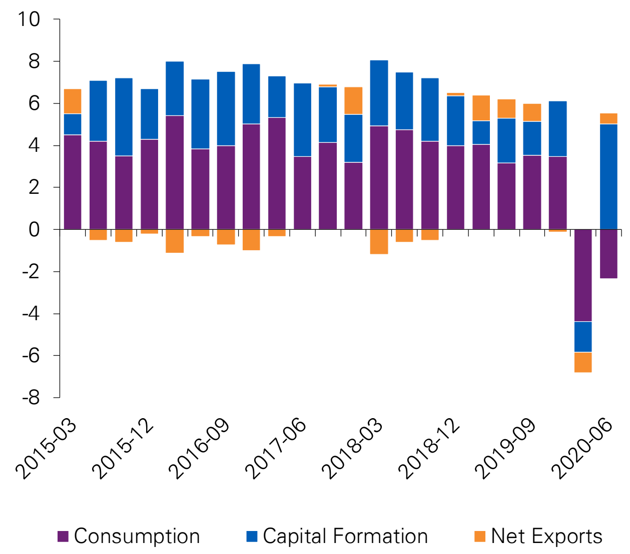
Figure 4: China manufacturing and services PMI, current month value, %



Source: Wind, KPMG analysis

All major sectors recorded significantly higher growth rates of value added in 2020Q2 as industrial production regained momentum, led particularly by the rapid recovery of production and investment in the high-tech sector. Since the successful turnaround in March, the high-tech sector has recorded an 8.9%-10.5% growth rate of value added for the fourth consecutive month, or 4.5% YOY cumulatively in 2020H1, which was 5.8 percentage points higher than the average of enterprises above designated size. In contrast, the Food Manufacturing and Agricultural Processing sector posted below-average growth rates of value added in 2020Q2, under the short-term impacts of the COVID-19 outbreak at the Xinfadi market in Beijing: Food Manufacturing was down from 6.3% in May to 1.3% in June, and Agricultural Processing was down from -0.5% in May to -2.4% in June. Computer & Communications and Pharmaceuticals continued to boom in June, up 12.6 and 3.9 percentage points from April-May, respectively.

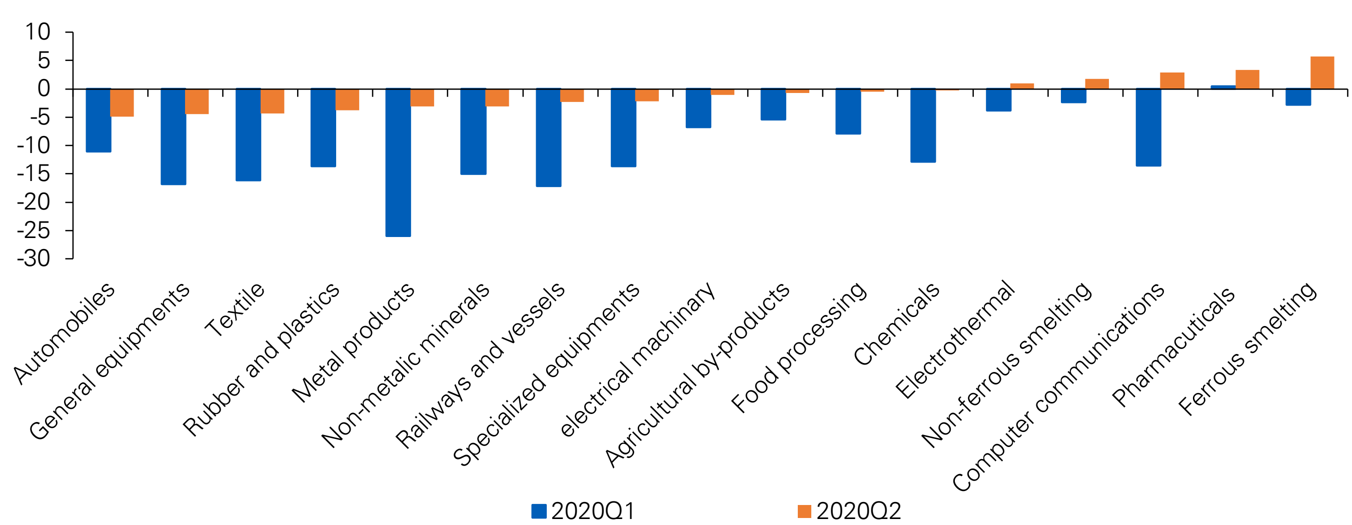
Figure 6: Growth of GDP by activity type, cumulative value, %



Source: Wind, KPMG analysis

On the demand side, although the contribution of investment to economic growth rebounded remarkably, consumption remained flat. In 2020Q2, final consumption expenditure's contribution to GDP slumped to -73.3%, dragging economic growth down by 2.3 percentage points; total capital formation reached 156.7%, up by 5 percentage points; and net exports of goods and services stood at 16.6%, up by 0.5 percentage points.

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

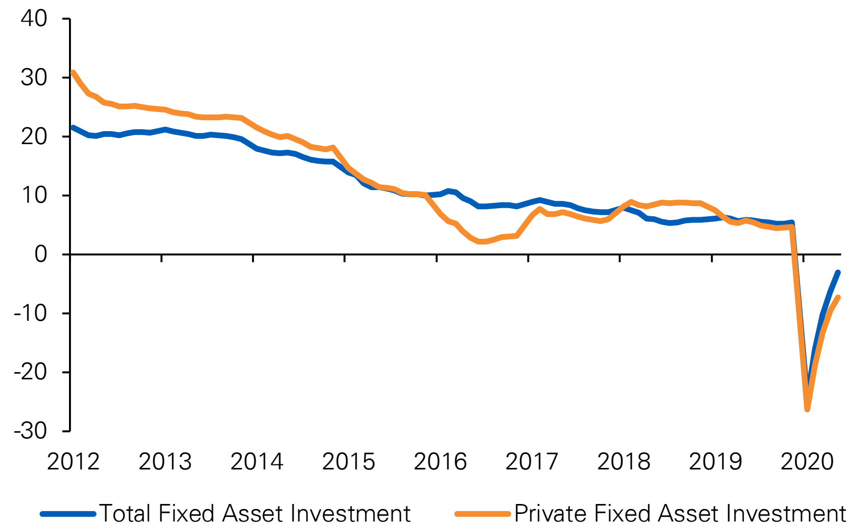


Source: Wind, KPMG analysis

Continuously narrowed decline in fixed asset investment and accelerated improvement in real estate and infrastructure investment

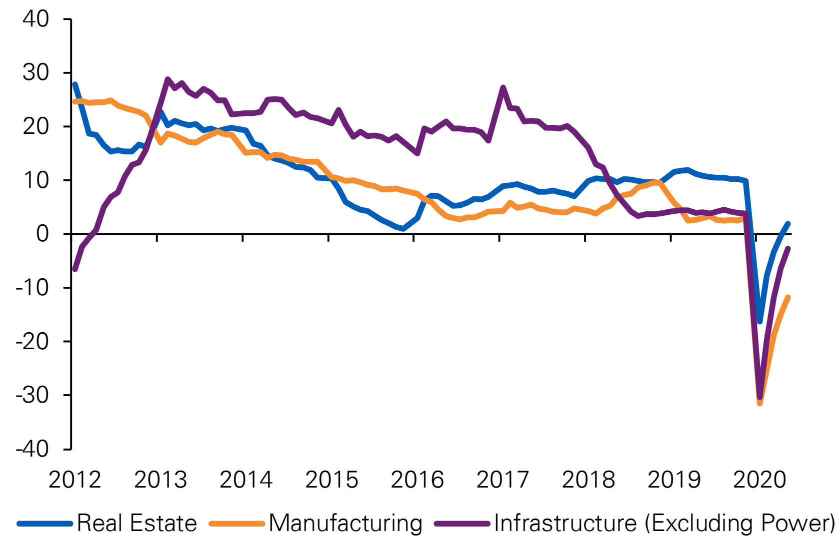
In 2020H1, the growth rate of fixed asset investment fell by 3.1% YOY, 9 percentage points down from the same period last year but 13 percentage points narrower than in 2020Q1. The growth rate of private fixed asset investment fell by 7.3% YOY cumulatively, 13 percentage points lower than in H1 2019 but 11.5 percentage points narrower than in 2020Q1.

Figure 7: Fixed asset investment, cumulative YOY, %



Source: Wind, KPMG analysis

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



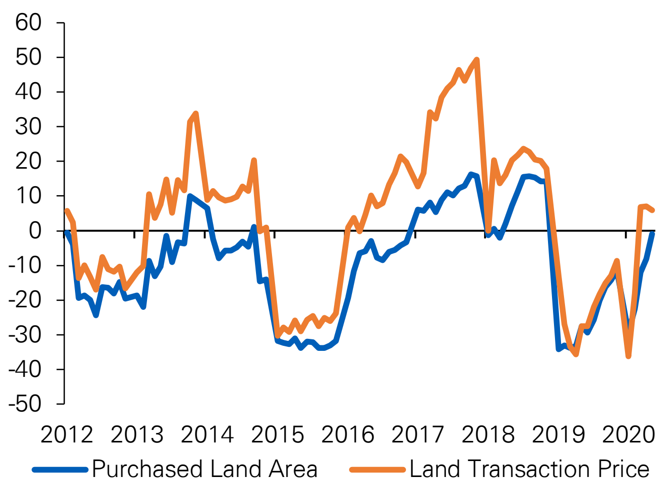
Source: Wind, KPMG analysis

Continuously improving real estate investment

In 2020H1, cumulative real estate development investment turned positive for the first time YOY, outgrowing manufacturing and infrastructure investment in the same period. As of 2020Q2, the YOY growth rate of real estate development investment reached 1.9% cumulatively, 9 percentage points down from the same period last year but 9.6 percentage points up from 2020Q1.

The growth rate of total sales of commercial housing nationwide dropped by 8.4% in 2020H1, 18 percentage points narrower than in 2020Q1. As previously suppressed housing demand was addressed by online sales and mid-year discounts, sales of commercial housing continued to record strong MOM growth in terms of both floor area and value in 2020Q2, which marked the second consecutive month of YOY growth as well. Driven by increased sales and reopening, land purchases and new construction area of housing showed signs of recovery too — the growth rate of new construction area of housing fell by 7.6% YOY, 17.7% lower than in 2019 but 20 percentage points narrower than 2020Q1.

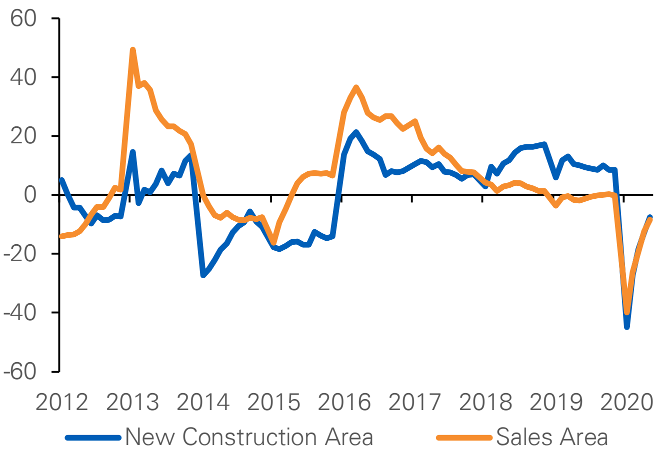
Figure 9: New construction and sales area of real estate, cumulative YOY, %



Source: Wind, KPMG analysis

With sufficient liquidity in the market, real estate companies' funding continued to improve. The growth rates of loans, self-financing and individual mortgage turned positive, while real estate investment entered a period of "stabilisation and recovery". Meanwhile, preferential policies on land transfer, for instance, removing some restrictions and increasing the supply of high-quality land, contributed to the rally of land transaction prices in 2020Q2, resulting in a 5.9% rise YOY cumulatively in 2020H1.

Figure10: Purchased land area and land transaction price, cumulative YOY, %



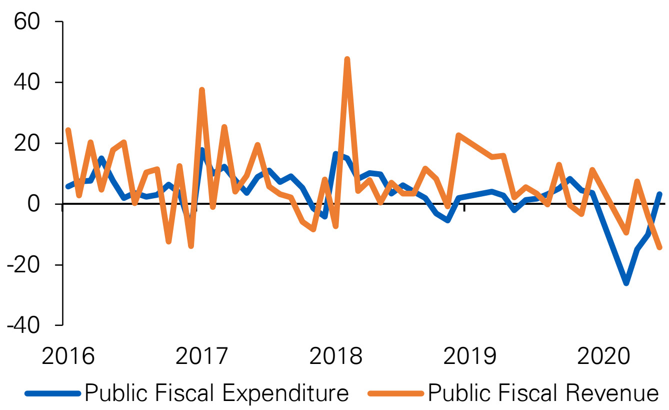
At the Real Estate Seminar chaired by the Vice Premier of the State Council Han Zheng on 24 July, the Central Government reaffirmed the tone for real estate regulation, i.e. "Housing is for Living in, not for Speculation", vowing not to use real estate as a short-term economic booster. Rather, city-specific, differentiated measures would be taken to "regulate the real estate market in a targeted and scientific way", to curb rising real estate prices, and to ensure "the stable and healthy development of the market". The Central Government is committed to achieving this goal. In the future, the government will rely more on reforms, such as land policy and household registration system reforms, for more targeted, region-specific controls, aiming to build a stable and healthy real estate market to support long-term economic development in China.

Remarkably narrower decline in infrastructure investment, continual rebound expected in H2

Infrastructure investment (excluding power) declined by 2.7% YOY cumulatively in 2020H1, 6.8 percentage points down from the same period last year. However, with accelerated reopening efforts following an improvement in the pandemic situation, the government increased investments in both traditional (for instance, transport) and new (digital economy-related) infrastructure in 2020Q2, pushing the growth of infrastructure investment to positive three months in a row. The cumulative YOY growth was down by 17 percentage points, remarkably narrower than in 2020Q1. By subsector, investment in Information Transmission grew by 9.2%; Railway Transport, 2.6%; Road Transport, 0.8%; and Water Resource Management, 0.4%.

As the stabilising economy added more momentum to production activities, public fiscal revenue totalled RMB 9.6 trillion in January-June, declining by 10.8% YOY but narrower than the 14.3% in 2020Q1. In June, monthly public fiscal revenue grew by 3.2% YOY, turning positive for the first time in 2020. Structurally, this could be attributed to the growth of monthly tax revenue, which was 9 percentage points higher YOY, mainly driven by the turnaround in revenues from consumption tax, income tax and land/property tax in the same period.

Figure 11: Public fiscal expenditure and revenue, monthly YOY, %



Source: Wind, KPMG analysis

In 2020H1, public fiscal expenditure dropped by 5.8% YOY to RMB 11.6 trillion, which was on a similar level with 2020Q1. In June, public fiscal expenditure declined by 14.4% YOY, mainly attributable to the high basis effect, i.e. the astronomical expenditure in the same period last year; however, the YOY decline in public fiscal expenditures was still less than in public fiscal revenue. In terms of absolute value, public fiscal expenditure rose by about RMB 600 billion from 2020Q1 to 2020Q2, and by about RMB 1 trillion from May to June. Although public fiscal revenues shrank due to pandemic control and enterprise relief efforts (such as tax/fee reduction and tax deferral), public fiscal expenditure remained robust. Most of the expenditure was attributable to social security, employment, healthcare and poverty relief programs.

Newly added local government special bonds and RMB 1 trillion of COVID-19 national bonds provided substantial funds for the government in its tax/fee reduction, rental/rate reduction and consumption/investment boosting initiatives. As of 14 July, RMB 2.24 trillion of the RMB 3.75 trillion newly added local government special bonds had been issued, up 58% YOY. Of these, RMB 1.9 trillion, or 85% of issued bonds, has been spent. The remaining RMB 1.5 trillion bonds will be issued by the end of September. For special national bonds, RMB 720 billion was issued as of July 16, and the rest by the end of July.

At the State Council executive meeting, the government has pledged to accelerate the issuance and utilisation of local government special bonds in support of the construction of "new infrastructure, urbanisation and key projects" and public healthcare facilities, by increasing investment and improving fund utilisation. While recent floods may to some extent slow down infrastructure construction, they serve as a reminder to the government of increasing disaster relief investment and strengthening construction of major hydraulic engineering projects, so as to enhance the resilience against natural disasters. Meanwhile, the Government Work Report during the NPC and CPPCC sessions announced an additional RMB 100 billion National Railway Construction Fund to accelerate railway construction.

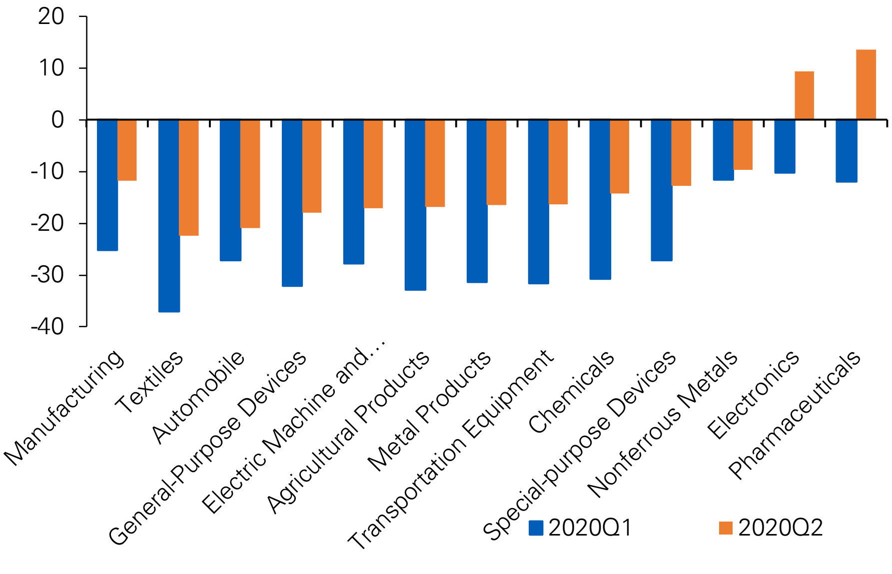
We believe that as the fiscal revenue growth rate rebounds, fiscal expenditure will be accelerated with special bonds and national bonds fully funded. In addition, investments in new infrastructure, new urbanisation and healthcare are expected to grow under the "new normal" of pandemic control.

Investment growth rate accelerating in some manufacturing subsectors

In 2020H1, the growth rate of manufacturing investment fell by 11.7% YOY, 14.7 percentage points down from 2019H1 but 13.5 percentage points narrower than in 2020Q1. By subsector, the decline in cumulative YOY investment growth rates narrowed in most subsectors, compared with those in 2020Q1. As a result of strong exports, the cumulative YOY investment growth rates of Pharmaceutical and Computer & Electronics have turned positive. Non-ferrous Metals also saw a decline in investment, which was lower than the industry average. Impacted by the worse-than-expected car sales and weak external demand, investment in Automobile and Textiles continued to stall, creating a drag on manufacturing investment.

In addition, the cumulative YOY investment growth rate of High-tech turned positive in May, growing by 6.3% YOY in 2020H1, 18.4 percentage points up from 2020Q1. Investment in High-tech Manufacturing increased by 5.8% cumulatively YOY in 2020H1, 19.3 percentage points up from 2020Q1 and significantly higher than the manufacturing sector average.

Figure 12: Investment growth rate of manufacturing subsectors, cumulative YOY, %



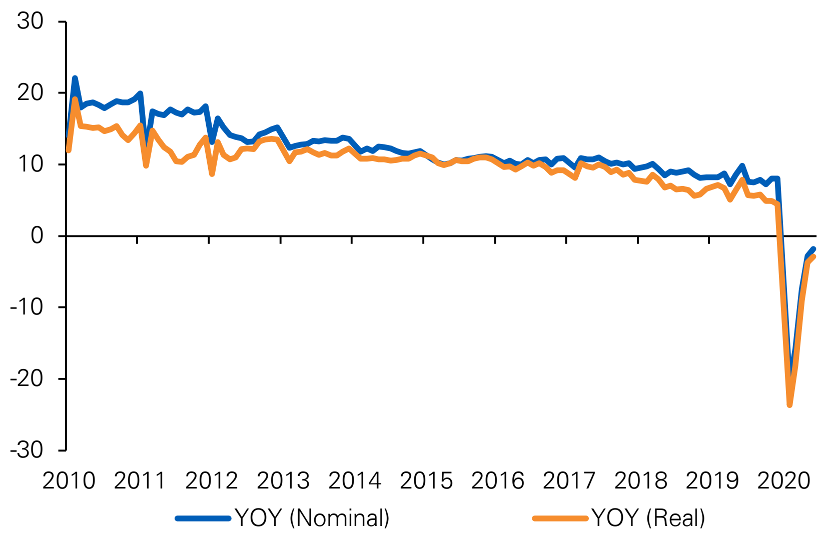
Source: Wind, KPMG analysis

Notably, the rebound in investment has boosted production and sales of construction machinery: in 2020H1, excavators and scraper-conveyors saw YOY production growth soar, while excavator sales remained strong. The accelerated recovery was further evidenced by other indicators, including power generation and coal consumption. Fixed asset investment is expected to continue the upward trend in 2020H2.

A long way to go before the full recovery of consumption

In June, the total retail sales of consumer goods rallied, but more feebly than in April-May, dropping by 1.8% and 2.9% YOY in nominal and real term, respectively, 1 and 0.8 percentage points narrower than in May. The cumulative YOY growth rate was -11.4% in 2020H1, down 20 percentage points from the previous year and 7.6 percentage points narrower than in 2020Q1. By category, the growth rate of consumption of Consumer Staples slowed in 2020Q2, falling to normal levels after the May peak. The growth rate of food consumption was 13.4% in 2020Q2, and daily necessities 14%.

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

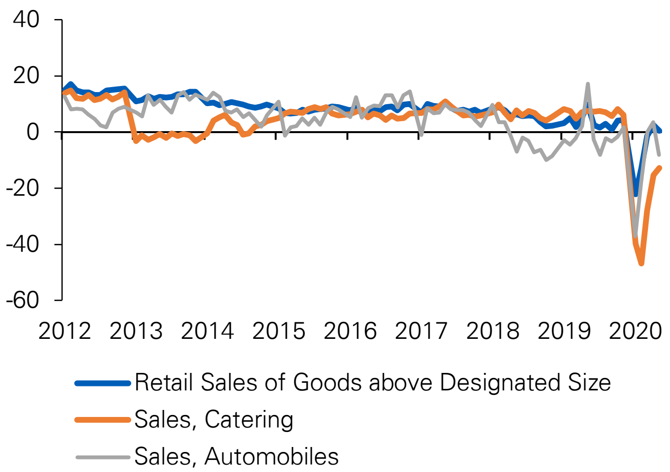


Source: Wind, KPMG analysis

In terms of consumption of Consumer Discretionary goods, automobile-related consumption decreased by 15.2% YOY in 2020H1, 15 percentage points narrower than in 2020Q1. In 2020Q2, the YOY growth rate of automobile-related consumption turned positive for April and May, thanks to the enhanced government support for automobile-related consumption and the release of previously suppressed demand. Despite the slight dip in growth rate in June — mainly because of the high basis effect of last June when Stage VI emissions standards took effect— automobile-related consumption in 2020Q2 was roughly on the same level with the same period last year in terms of absolute value. As the high basis effect is a short-term situation, we expect a continual upward trend in automobile-related consumption in 2020Q3.

On the other hand, the catering sector was also recovering in 2020Q2 as the government gradually lifted pandemic restrictions. However, the recovery of consumption involving groups was curbed by the outbreak at the Xinfadi market in Beijing in June, which dragged down the total retail sales of consumer goods in June.

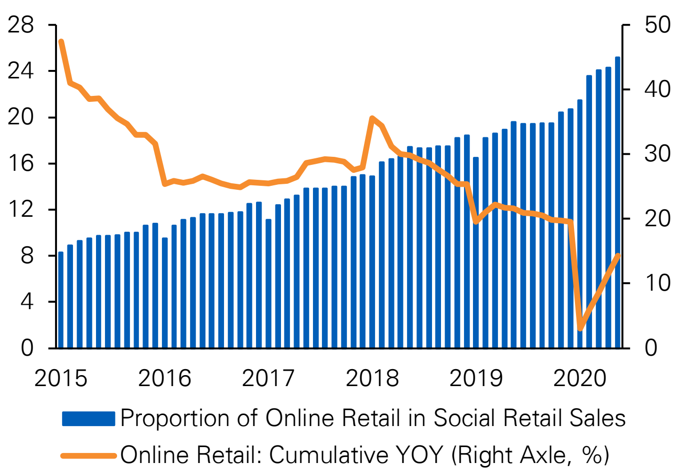
Figure 14: Retail sales vs. sales of catering and automobiles, YOY, %



Source: Wind, KPMG analysis

In 2020H1, the online consumption of physical goods increased by 14.3% YOY, 8.4 percentage points up from 2020Q1. Although 7.3 percentage points down from 2019H1, it was still much higher than the overall growth rate of social retail sales. The proportion of online sales in social retail sales continued upward to 25.2%, 1.6 percentage points higher than in 2020Q1.

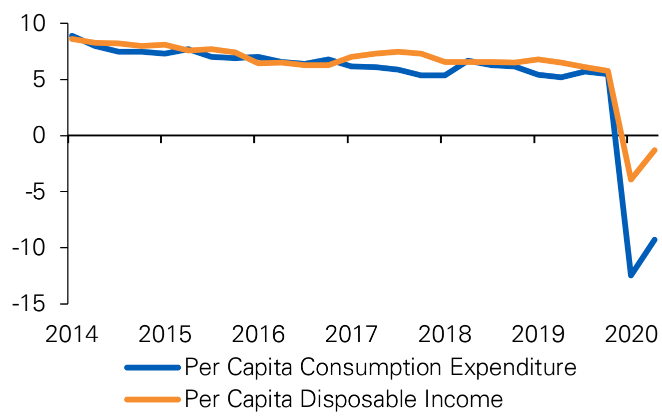
Figure 15: Proportion of online consumption of physical goods in social retail sales and its growth rate, %



Source: Wind, KPMG analysis

In 2020H1, per capita household disposable income decreased by 1.3% YOY, 7.8 percentage points lower than in 2019H1 but 2.6 percentage points narrower than in 2020Q1. In 2020H1, the actual YOY growth rate of per capital consumption expenditure was -9.3%, 14.5 percentage points lower than in 2019H1 but 3.2 percentage points narrower than in 2020Q1. As we can see, household income and consumption expenditure still have a long way to go before full recovery. Households are inclined to save more in unforeseen contingencies, which will lead to less consumption. The major cause of stagnant consumption demands in 2020H1 was the diminishing marginal propensity to consume.

Figure 16: Growth rate of per capita consumption expenditure and per capita disposable income, cumulative YOY, %



Source: Wind, KPMG analysis

Employment is the key to the income problem. While the surveyed urban unemployment rate dropped in June as the result of economic recovery, the unemployment of key groups is of concern. In 2020H1, 5.64 million jobs were created, which equated to 63% of the annual goal, a progress slower than the same period last year. The number of migrant workers decreased by 2.7 percentage points YOY, and the surveyed urban unemployment rate in the age group of 20-24y labour with college degree and above went up 3.9 percentage points YOY to 19.3%. As the primary tasks of "Six Priorities" and previous "Six Stabilities", securing the employment of key groups and people's livelihood will remain the top focus of the government in 2020H2. To this end, the government plans to take various measures such as increasing higher education enrolment, encouraging start-ups, subsidising business to employ more people and leveraging Internet innovations to boost employment.

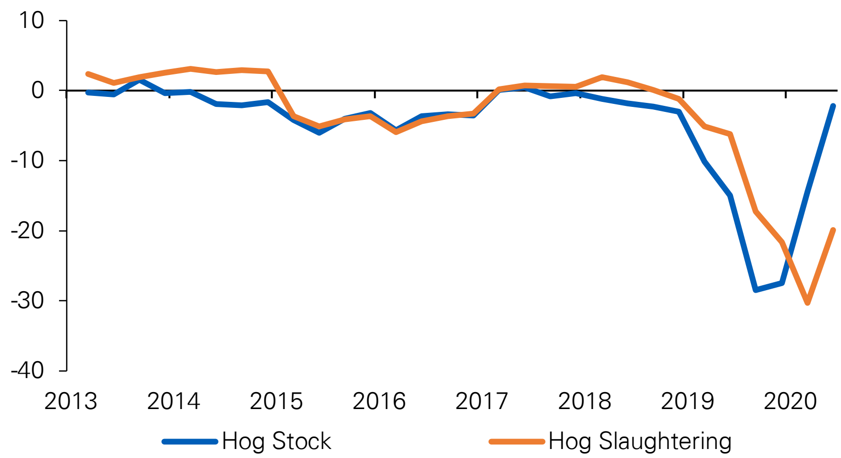
The government has demonstrated strong capabilities in terms of pandemic control, as evidenced by the containment of the COVID-19 outbreak at the Xinfadi market. The government has gradually lifted some pandemic restrictions, such as reopening of cinemas in low-risk areas on 20 July and allowing cross-province group tours. The consumption demands will also recover as economic growth rises to the pre-pandemic level. We believe as offline services return to normal and consumer demand rally over time, offline consumption may become a new economic highlight in H2 2020.

Inflation driven higher by floods but the downward trend is not likely to change in the long run

In 2020Q2, the Consumer Price Index (CPI) grew by 2.7% YOY, 2.3% lower than in 2020Q1, driven down by an improvement in the pandemic situation, recovering logistics and enhanced supply. By month, the growth rate of CPI was down one point in March, fell to 3.3% in April, and further to 2.4% in May due to a drop in pork prices. The slight rise in consumer goods prices in June was mainly caused by the COVID-19 outbreak at the Xinfadi market, and the impact of floods in southern provinces on the supply of vegetables and hogs.

As governments at all levels took a series of actions to restore hog production, hog stocks have been increasing YOY for three consecutive quarters. Consistent with production cycles, hog slaughters began to climb up YOY after bottoming out in 2020Q1, pulling the YOY growth rate of pork price down to 87% in 2020Q2 from the high of 123% of the previous quarter. While hog production showed a strong rebound, we must point out the impact of some short-term uncertainties on pork supply. For example, the floods in southern provinces have resulted in a 3.6% MOM rise in pork price, the highest among consumer good prices. Considering the high basis effect in 2019H2, the pork price is likely to continue the downward trend in 2020H2 despite the recent short-term rise.

Figure 17: Hog stock and slaughtering, YOY, %

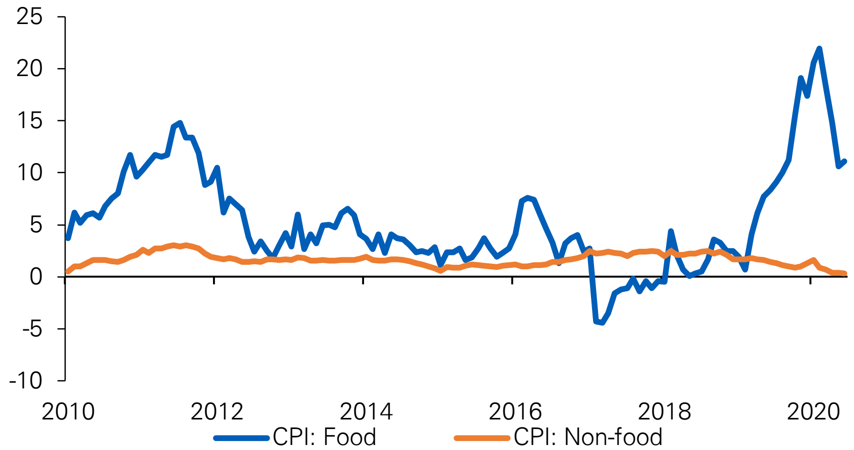


Source: Wind, KPMG analysis

The COVID-19 outbreak at the Xinfadi market and the floods in southern provinces have impacted the production, storage and transport of vegetables in some regions, causing a temporary shortage of supply. As a result, the growth rate of vegetable price rose from -8.5% in May to 4.2% in

June, a notable m-o-m increase of 2.8 percentage points. The prices of other foods remained stable. Considering the fact that most floods take place in June-August, their impact on vegetable supply will not last long, and food prices will remain stable overall.

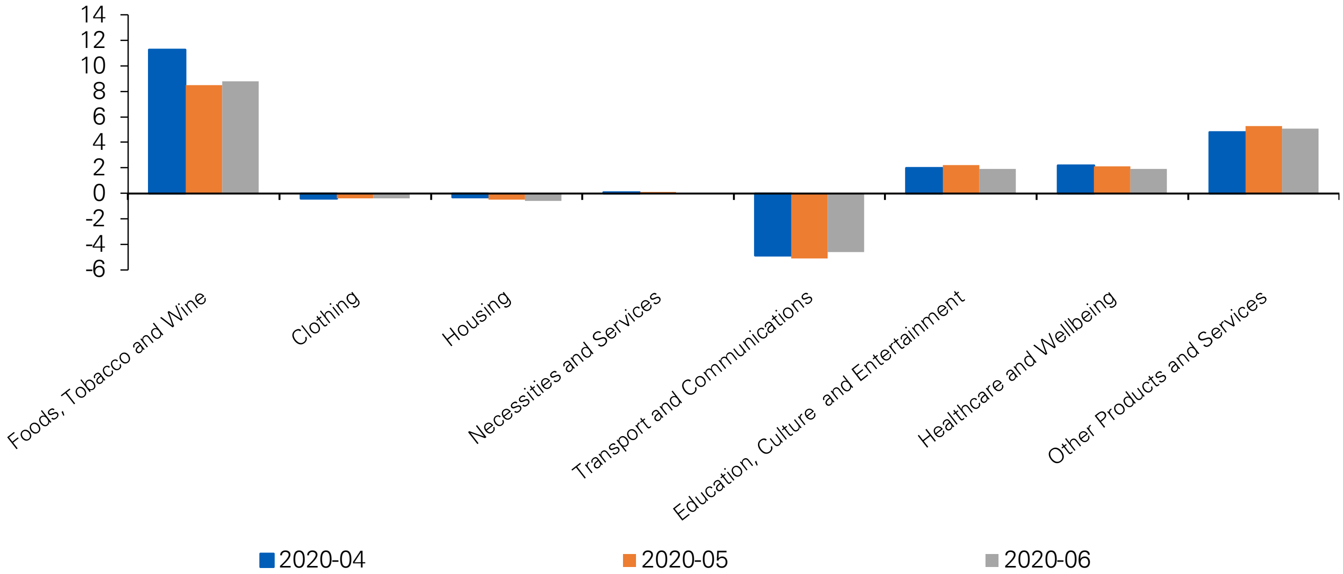
Figure 18: Food and non-food CPI, monthly YOY, %



Source: Wind, KPMG analysis

Deflation continued, with global oil prices hovering at a low level. The YOY growth rate of non-food CPI dropped from 1.6% in January to 0.3% in June. The prices of clothing, housing, daily necessities and services remained at the previous year's level, while those of mobility and communications continued the downward trend since March, down by 5 percentage points YOY in 2020Q2. The drop in fuel price widened by 20% YOY — the main reason for lower non-food CPI. In addition, the 0.9% YOY growth of core CPI (excluding foods and energy) remained relatively low. In general, considering the structural high basis of consumer goods prices in 2019H2, CPI is expected to continue the downward trend.

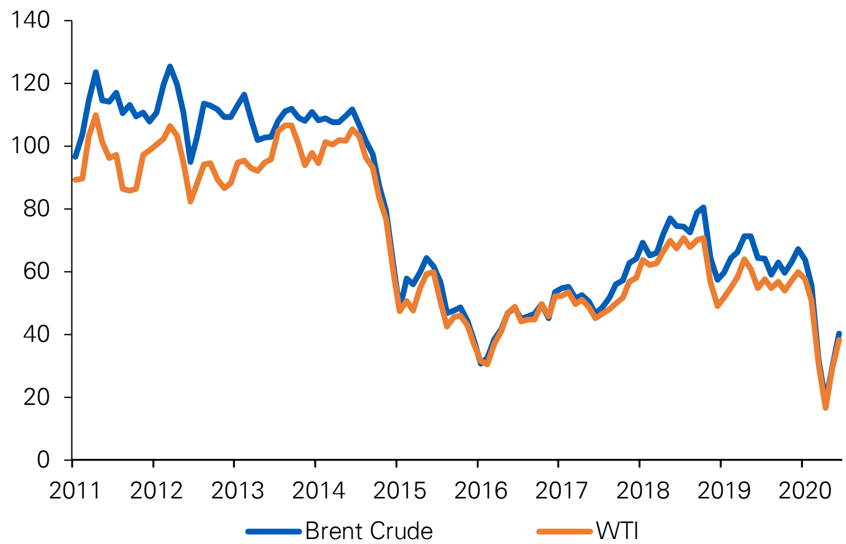
Figure 19: CPIs by category, YOY, %



Source: Wind, KPMG analysis

In 2020H1, the Producer Price Index (PPI) dropped by 1.9% YOY, continuing the negative YOY growth rate in the past 12 months, except for the temporary turnaround in December 2019. As per 2020Q2 data, the decline in PPI widened to the lowest level in the last four years, but m-o-m growth was slightly up from -1.3% in April to -0.4% in May. Slumping petrochemical prices were still the major cause of declining PPI in 2020Q2. Thanks to accelerated reopening, industrial production and infrastructure construction began to pick up speed, and upstream sectors like ferrous/non-ferrous metals mining and dressing have recorded positive price growth m-o-m. Furthermore, the upturn in global oil price in June drove the 38.2% m-o-m price increase in the oil and gas production sector, which helped to turn m-o-m PPI growth rate positive, to 0.4 percentage point. The YOY decline was also narrowed.

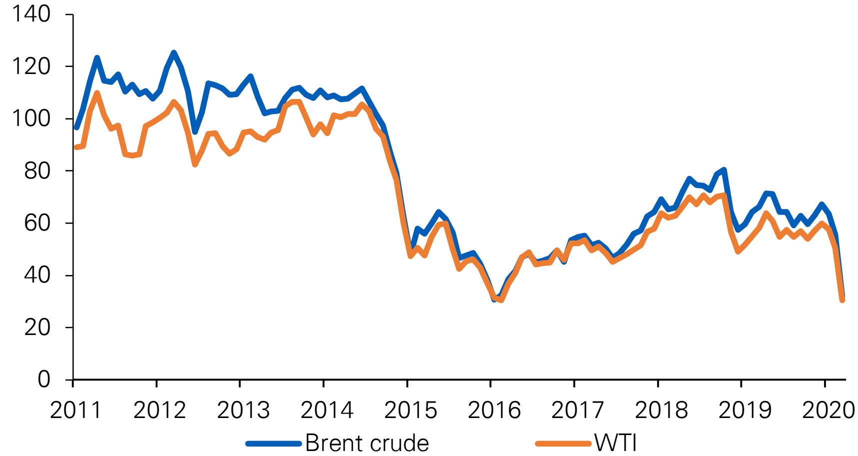
Figure 20: Industrial PPI, YOY, %



Source: Wind, KPMG analysis

Despite the surge in COVID-19 cases globally, many countries have been taking measure to reopen since July, bringing back demands for bulk commodities. Considering a possible contraction of supply at major exporters during the pandemic, the prices of crude oil, coal and steel may continue the upward trend. We expect weak recovery of PPI in 2020Q3 YOY.

Figure 21: Monthly average crude oil spot price, USD/barrel

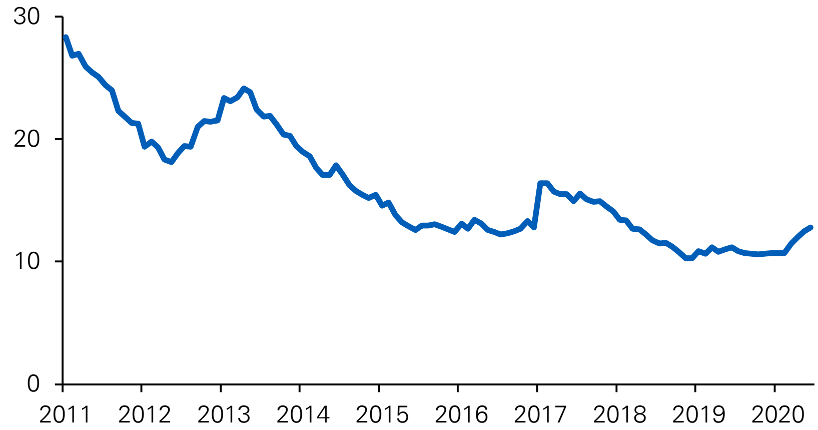


Source: Wind, KPMG analysis

Adequate money supply and record TSF stock growth rate in recent years

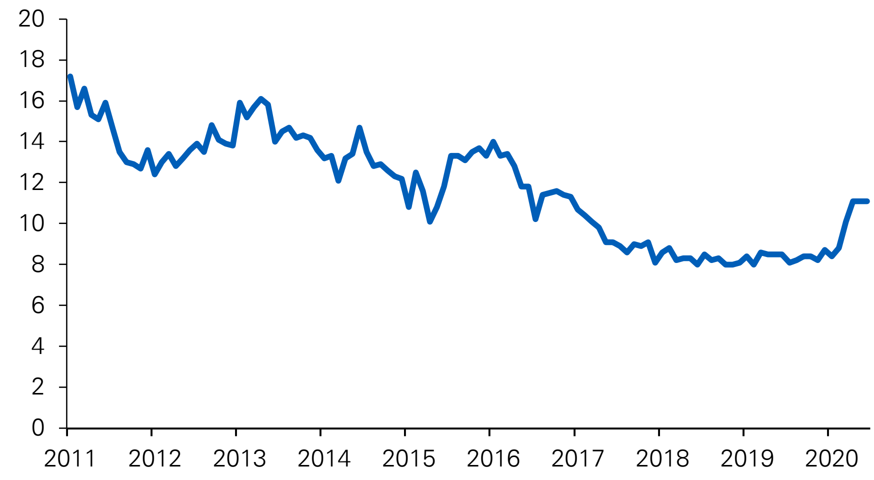
As at the end of June, stock of TSF totalled RMB 271.8 trillion, increasing by 12.8% YOY, the highest growth rate since March 2018. New TSF reached RMB 3.43 trillion in June, a YOY increase of RMB 0.8 trillion. Meanwhile, M2 grew by 11.1% YOY, 2 percentage points up from the previous quarter — a new high since 2017. The significant growth of TSF and M2 is consistent with the goals of Government Work Report, i.e. "significantly higher growth rates of M2 supply and TSF than last year". In general, the PBOC has infused sufficient liquidity into the market to counteract the economic impact of the pandemic.

Figure 22: TSF stock, monthly YOY, %



Source: Wind, KPMG analysis

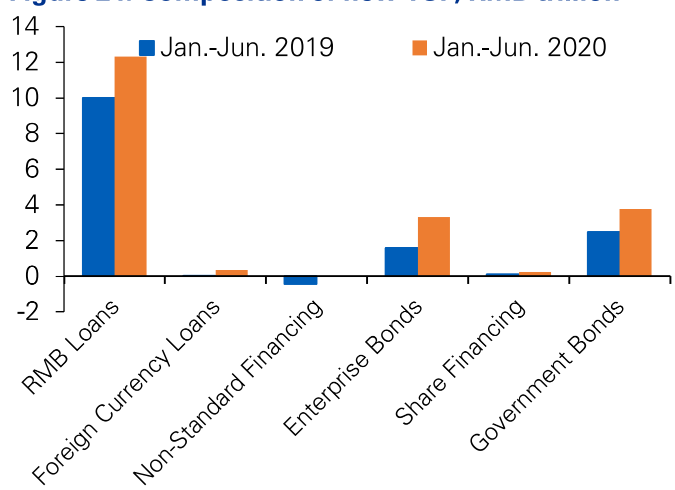
Figure 23: Broad money supply (M2), monthly YOY, %



Source: Wind, KPMG analysis

New TSF increased by RMB 20.8 trillion in 2020H1, and by RMB 9.7 trillion in 2020Q2 — RMB 3.7 trillion more than the same period last year. Of this, new RMB loans totalled RMB 12.3 trillion, an increase of RMB 2.3 trillion yuan in 2020H1 over the same period last year. Off-balance-sheet financing (including entrusted loans, trust loans and undiscounted bank acceptance bills) increased by RMB 26.1 billion, as a result of an RMB 360 billion increase in enterprise off-balance-sheet bill financing from 2020Q1 to 2020Q2. New enterprise bonds totalled RMB 3.3 trillion, an increase of RMB 1.7 trillion over the same period last year; and new stock financing totalled RMB 250 billion, an increase of RMB 130 billion over the same period last year. Local government bonds issued totalled RMB 2.2 trillion in 2020Q2, an increase of RMB 1.3 trillion in 2020H1 over the same period last year.

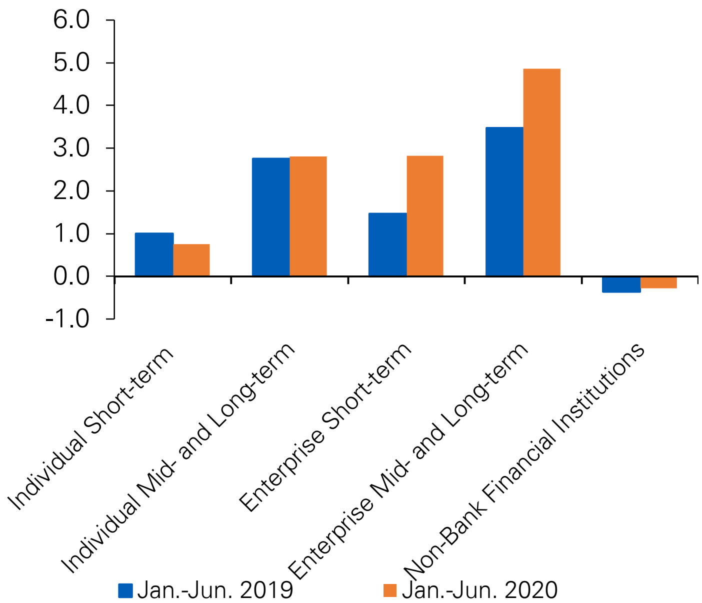
Figure 24: Composition of new TSF, RMB trillion



Source: Wind, KPMG analysis

By proportion, new RMB loans, enterprise bonds and government bonds were the most important sources of TSF growth in 2020H1. In particular, new RMB loans dropped slightly to 59% of new TSF. Structurally, short- and long-term enterprise loans accounted for the majority of RMB loans in 2020H1. Of this, short-term enterprise loans almost doubled in 2020Q1 on last year's basis, most of which were used to tackle operational issues, such as temporal cash flow shortage; while in 2020Q2, the mid- and long-term loans were a bright spot, recording doubled YOY growth rate on average. In 2020H1, new loans totalled RMB 4.86 trillion, RMB 1.4 trillion more than in 2019H1. The government's enhanced focus on structural regulation to channel low-cost funds directly to the real economy, as well as SMB relief efforts and reopening initiatives were the major drivers of the increase in enterprise loans. The revival of infrastructure construction and manufacturing also fuelled the growth of mid- and long-term loans. Driven by the rebounding automobile sales, household short-term loans kept moving upward in 2020Q2. Of this, the YOY growth rate stood at 109% in April, and 20% in May-June. The strong performance of the real estate market in June helped to push mid- and long-term loans to the similar level of last year's new total, with a 30% YOY growth rate in June. "

Figure 25: Composition of new RMB loans, RMB trillion



Source: Wind, KPMG analysis

In 2020Q2, the percentage of enterprise bond in new TSF increased to 16%. As enterprises went back to "business as usual" in April, the rise in financing needs pushed enterprise bond financing to increase by RMB 920 million in April, continuing the upward trend since March. Bond financing also registered strong YOY growth in May and June. In addition, the Government Work Report announced an RMB 3.75 trillion issuance plan of local government special bonds to strengthen investment. With the steady rollout of special bonds, the proportion of government bonds in new TSF rose to 18.2% — one of the main causes for the record high growth rate of new TSF in 2020Q2.

We believe that in the light of the well-controlled pandemic situation and the economic fundamentals of recovering growth, the need for large-scale liquidity expansion will weaken. At the 12th Lujiazui Forum on 18 June, PBOC Governor Yi Gang said that the monetary policy will continue to focus on "keeping liquidity at a reasonably sufficient level" in 2020H2. It is estimated that new loans will total at about RMB 20 trillion, and new TSF over RMB 30 trillion. We expect TSF to remain at a high level in 2020H2, with new TSF of RMB 7.9 trillion, which is 11% higher than the same period last year.

More targeted monetary policies to channel special funds into the real economy

To counteract the economic impact of COVID-19, the PBOC (People's Bank of China) took an accommodative policy stance by cutting the reserve requirement ratio (RRR) three times and cutting the Loan Prime Rate (LPR) twice in January-April, aiming to improve liquidity and market confidence. At the same time, the Government Work Report 2020 took a "more flexible and moderate" approach to monetary policy, saying it will support the real economy with "remarkably higher-than-last-year" growth in M2 and TSF, as well as innovative monetary policy tools.

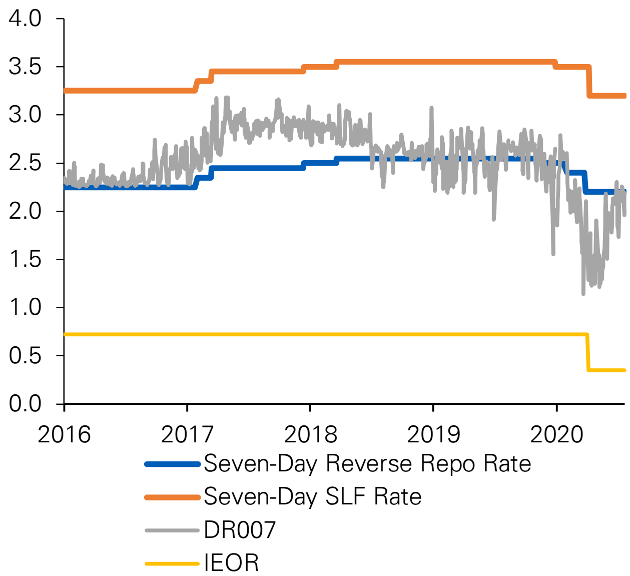
In contrast with the significant rate cuts in 2020Q1, the Seven-Day Reverse Repo Rate, MLF Rate and LPR remained unchanged in 2020Q2. On 3 April, the PBOC announced an RRR cut by 100 bps for rural banks and small city commercial banks, with half the cut taking effect on 15 April and the rest on 15 May, to release RMB 400 billion in total. Moreover, it extended the RMB 1.8 trillion re-lending and re-discounting program launched in 2020Q1 for pandemic control and SMBs. As of 30 May, RMB 280 billion, out of the RMB 300 billion targeted re-lending funds, was allocated to 7,400 companies as loans, and RMB 480 billion, out of the RMB 500 billion for targeted re-lending and re-discount to SMBs, as prime rate loans.

In 2020Q2, the PBOC turned from further interest/RRR cuts to "more moderate and precise" measures in funding the real economy. In early June, the PBOC launched the Inclusive Facility for Deferred Repayment of SMBs and Inclusive Credit Loan Program for SMBs, adding RMB 40 billion and RMB 400 billion, respectively, to the re-lending funds for SMBs. The PBOC also announced this year's second round of re-lending rates cut by 0.25%, effective as of 1 July, expecting to improve commercial banks' access to lower-cost funds, which reduces the funding costs of agricultural and smaller firms.

Meanwhile, the PBOC reduced open market operations and the balance of standing loan facility (SLF) to keep monetary market rates in a reasonable range. As one of the most important indicators of the average financing cost of the market, the deposit institutions' seven-day pledge-style repo rate (DR007) raised slightly from 1.3% in 2020Q1 to 2.1% in late June.

At the regular meeting on monetary policy in 2020Q2, the PBOC highlighted the importance of the RMB 1 trillion inclusive re-lending and re-discounting quota in channelling funds directly into real economy, saying it will support qualified local legal-person banks in granting credit loans and allowing for temporarily delayed repayment of capital and interest for SMBs. We believe the PBOC will provide more targeted financing support to SMBs and the private sector, while "keeping liquidity at a reasonably sufficient level" in 2020H2.

Figure 26: Interbank market rate, %



Source: Wind, KPMG analysis

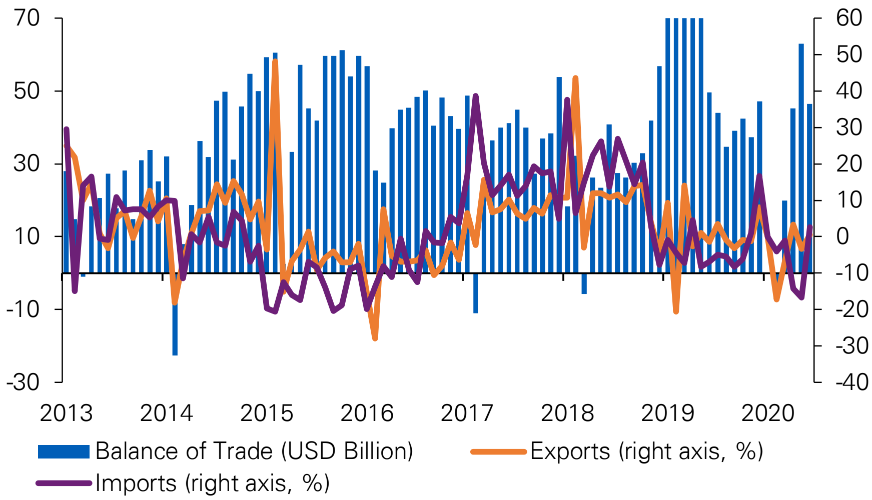
Recovering external exports may boost foreign trade, pandemic supplies bolster exports

In 2020H1, China's total imports and exports stood at USD 2 trillion, down by 6.6% YOY in cumulative terms but 1.9 percentage points narrower than in 2020Q1 — exports totalled USD 1,098.75 billion, down by 6.2% YOY cumulatively, while imports totalled USD 930.95 billion, down by 7.1% YOY cumulatively. Trade surplus shrank to USD 167.8 billion from USD 176.77 billion in the same period last year. The higher-than-expected exports in 2020Q2 added some momentum to the positive economic growth.

In June, China's exports and imports continued to pick up speed, both recording positive growth. The total imports and exports reached USD 380.73 billion in June, up by 1.5% YOY; exports stood at USD 213.57 billion, up by 0.5% YOY. This can be partly attributable to the strong supply capacity of China, which led global reopening. On the other hand, the fast spread of the COVID-19 outbreak all over the world since 2020Q2 increased global demands for pandemic control and "stay-at-home" resources, especially medical supplier and home electronics. Textile exports (including masks) jumped by 32.4%, while drugs and medical instruments & devices rose by 23.6% and 46.4%, respectively, in value (RMB). Driven by the "stay-at-home" economy, export of laptops and mobiles increased by 9.1% and 0.2%, respectively.

In June, imports rose 2.7% YOY to USD 169.15 billion, rebounding strongly from -16.7% in May. This was mainly because of higher demands for industrial material bulk commodities including crude oil, coal and oil ore, as well as parts and components of mechatronic products, as China accelerated reopening. Meanwhile, the recovery of production in other countries also contributed to the higher growth rate of imports. As imports recovered faster than exports in June, the trade balance narrowed from May, with a trade surplus of USD 464.2 billion, resulting in a slightly lower YOY growth rate.

Figure 27: Import and export activities, current month value

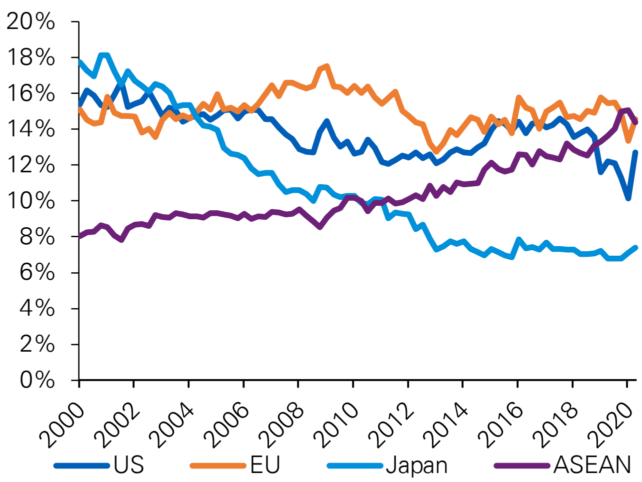


Source: Wind, KPMG analysis

By country and region, ASEAN remained the largest trade partner of China. In 2020H1, China's cumulative imports/exports with ASEAN totalled USD 297.89 billion, 2.2% up from the previous year, representing 14.7% of China's foreign trade. Imports/exports with the EU totalled USD 284.16 billion, 4.9% down from the previous year, representing 14% of China's foreign trade; with the US, USD 233.99 billion, 9.7% down, 11.5%; and with Japan, USD 147.09 billion, 2.9% down, 7.2%.

Thanks to effective pandemic response, ASEAN's share in China's foreign trade saw a 1.2 percentage points YOY increase in 2020Q2 with growing imports and exports. The closer partnership in value chains like electronics manufacturing, and increased investments, also boosted imports and exports in turn. In 2020H1, IC (Integrated Circuits) imports from ASEAN totalled RMB 226.81 billion, growing by 23.8%; and IC exports to ASEAN stood at RMB 89.68 billion, up by 29.1%. The IC sector alone drove China-ASEAN trade 3.2 percentage points higher. In Section III: Case Study, we analyse the economic and trading relations between China and ASEAN in detail.

Figure 28: Proportion of major countries in China's foreign trade, current quarter, %



Source: Wind, KPMG analysis

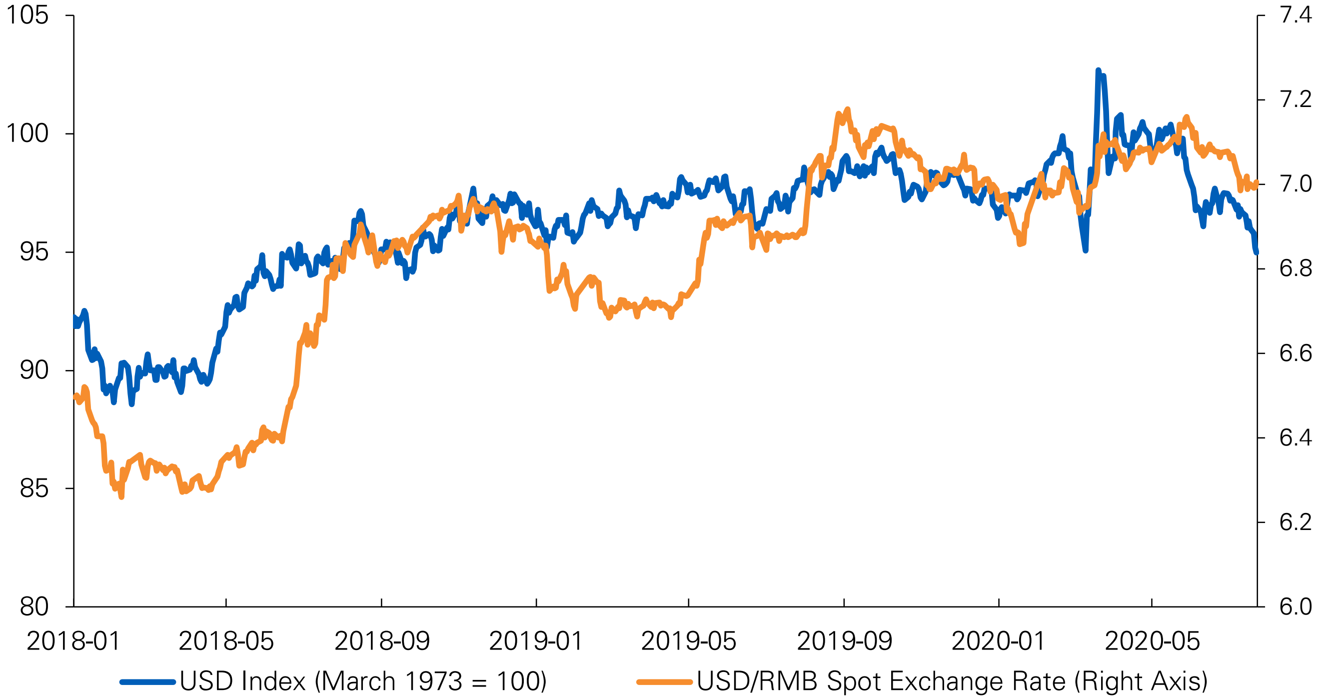
China's imports and exports with all major trade partners recorded positive growth in 2020Q2, narrowing the cumulative YOY decline in imports and exports with the US, the EU and Japan from 2020Q1. In 2020H1, China's exports to the US totalled USD 177.55 billion, down by 11.1% YOY cumulatively but 14 percentage points narrower than in 2020Q1. By category, as of May, China's Mechatronic Product exports to the US totalled RMB 63.7 billion, down by 13.6% YOY, representing 46.3% of total exports to the US; and Textiles (including masks), USD 7.8 billion, up by 130% YOY, 5.7%. In 2020H1, total imports from the US were USD 564.3 billion, down by 4.8% YOY in cumulative terms but 2.8 percentage points narrower than in May. Our estimates show that, as of May, China's imports from the US in line with the Economic and Trade Agreement Phase One were USD 33.5 billon, or 19.4% of the 2020 goals, of which manufactured goods accounted for USD 25.1 billon, agricultural goods USD 7.57 billion and energy products USD 780 million.

In 2020H2, we expect to see strong support to exports from buoyant demands for pandemic and "stay-at-home" resources, as the COVID-19 pandemic continues to plague the world. As developed markets, including the EU and the US, gradually reopen, the New Orders Index is expected to rise in 2020Q2. Meanwhile, China is also accelerating reopening. Exports in the manufacturing sector are expected to rise. For imports, the domestic demands are recovering as people gradually go back to their normal lives. In addition, the implementation of the Economic and Trade Agreement Phase One should boost imports. We expect to see China strengthening its connections with ASEAN, East Asian and Middle Asian countries to build a more complete industrial chain within Asia, driven by economic factors and geopolitical concerns.

In 2020H1, the RMB exchange rate remained stable overall stable, although with some bi-directional volatility. The surge in COVID-19 cases in Q2, along with the tremendous uncertainties in the economic and trade relation between China and the US, fuelled risk aversion sentiment in the market. The USD Index fluctuated on a high level, and the RMB exchange rate sank slightly. Since this June, as pandemic control becomes "the new normal", weakening risk aversion sentiment lowered demands for the US dollar. Meanwhile, the large-scale expansive policies of the Federal Reserve since March also drove the USD Index downward. As China leads global reopening and recovery, the RMB-USD exchange rate has been rebounding since June, as a result of high spread and strong performance of the capital market.

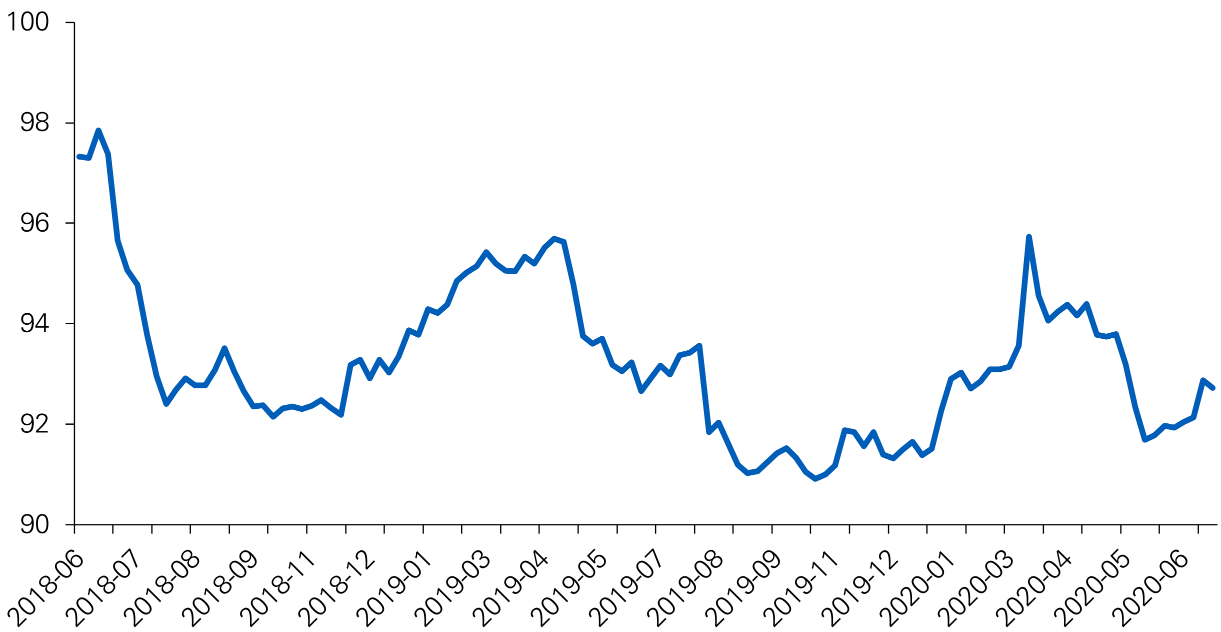
In 2020H2, the pandemic and the uncertainties in China-US relation will become the decisive factors affecting the RMB exchange rate. However, as China accelerates reopening, the favourable economic fundamentals are expected to last; and the PBOC has shifted from an accommodative stance to "flexible, moderate and targeted" monetary policies. We expect the RMB exchange rate to continue the stable and upward trend in June.

Figure 29: USD index and RMB spot exchange rate



Source: Wind, KPMG analysis

Figure 30: China Foreign Exchange Trade System (CFETS) exchange rate index

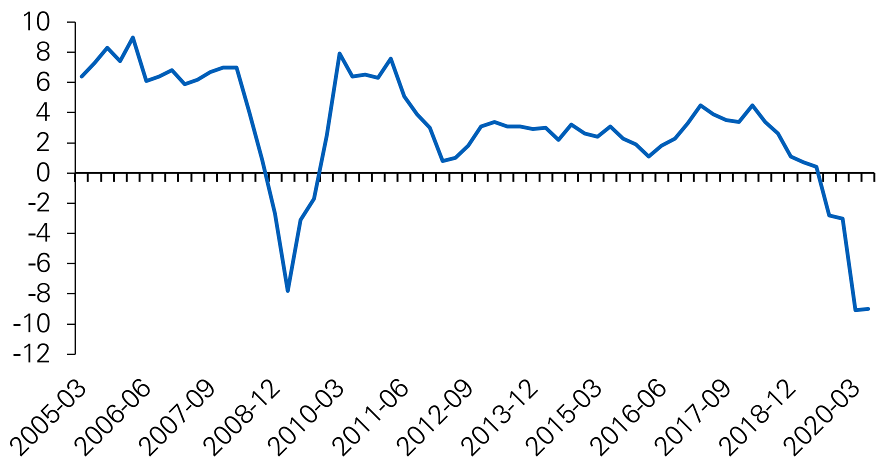


Source: Wind, KPMG analysis

Hong Kong SAR Economy

As of 21 July, Hong Kong had recorded a total of 2,018 cumulative confirmed COVID-19 cases, 14 deaths and 1,324 cured cases. In July, the number of cases rose again with 1,044 new confirmed cases, posting even greater challenges to the local economy. Hit hard by the pandemic, Hong Kong's GDP slumped by 9 percentage points YOY in 2020H1. 2020Q2 alone saw a 9% drop YOY, or 0.1 percentage points down from the previous quarter after seasonal adjustments. In addition, the latest unemployment rate hit a 15-year new high at 6.2%, 0.3 percentage points up from the previous quarter. In order to tackle the dual challenge of a pandemic and a weak economy, the Hong Kong SAR government has launched an unprecedented HKD 287.5 billion relief program, including two rounds of pandemic control funds and relief financial budget plan, to ensure people's livelihood

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



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

Hong Kong SAR Census and Statistics Department data showed[1], in 2020H1, Hong Kong's commodity exports and imports declined by 6.9% and 9.4%, respectively, compared with the same period last year, recording a trade deficit of HKD 175.2 billion. In June, Hong Kong's commodity exports and imports declined by 1.3% and 7.1%, respectively, compared with the same period last year, or 6.1 and 5.1 percentage points narrower from May.

By country and jurisdiction, exports to India (-26%), the US (-23.9%), Germany (-21.6%) and Singapore (-19.3%) suffered the largest decline YOY in 2020H1, while exports to Taiwan and Mainland China climbed 10.7% and 2.3%, respectively. Imports from the US (-20.7%),

[1] Data Source: Hong Kong SAR Census and Statistics Department
https://www.censtatd.gov.hk/gb/?param=b5uniS&url=http://www.censtatd.gov.hk/press_release/index_tc.jsp

Mainland China (-13.6%) and Japan (-5.4%) declined, while imports from Vietnam (48.0%), Taiwan (15.8%), Korea (7.5%) and Singapore (4.2%) increased. Considering the global nature of the COVID-19 pandemic, Hong Kong's foreign trade is expected to remain weak in the short run.

In the finance sector, the return of China Concept Stocks in 2020Q2 created new opportunities for the Hong Kong stock main board market. In 2020H1, 54 more Chinese companies were listed on the of the HKEX through IPO. Although this number was 23% less than in 2019, these companies raised HKD 92.5 billion in total, an increase 29.5% YOY. JD and NetEase together accounted for 63.6% of the total. We expect to see more Chinese companies list on HKEX through Secondary Public Offerings(SPOs), which would boost the total amount raised in Hong Kong. In addition, the combined contribution of six high-tech giants — Alibaba, JD, Meituan, Xiaomi, NetEase and Tencent — to turnover reached 25-38%. Of this, Tencent, Meituan and Xiaomi, which have been included in the Hong Kong Stock Connect Program (HKCP), contributed to 10%-20% in total. In the future, an increasing number of China Concept Stocks in the new economy arena is expected to be listed on HKEX, and included in the Hang Seng Index (HSI) and Hong Kong Stock Connect (HKSC), to improve the vitality of the Hong Kong stock market.

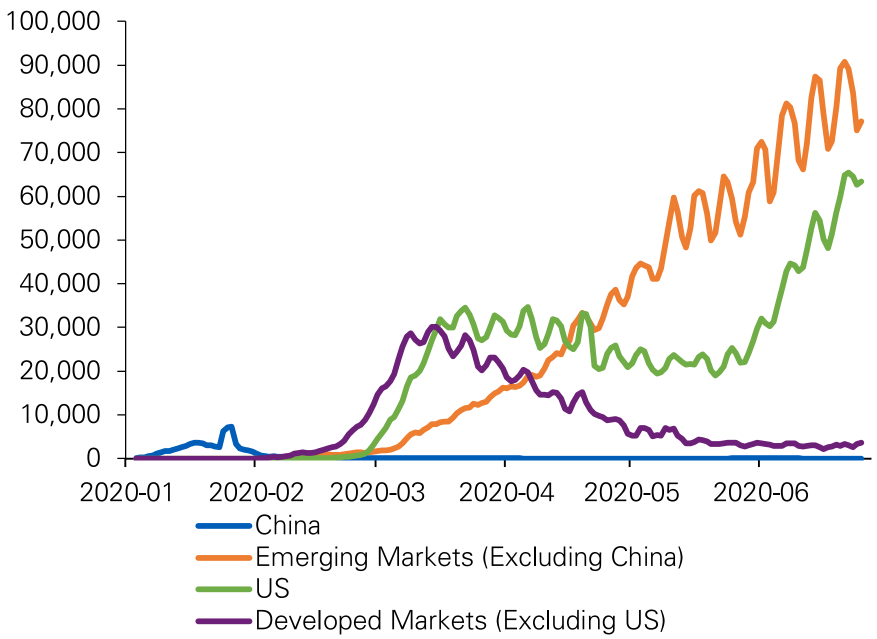
On 27 May, HKEX announced a licensing agreement between its subsidiary Hong Kong Futures Exchange (HKFE) and MSCI, which enabled HKFE to launch a series of futures and options products for MSCI Emerging Markets (EM) Asia Index. As the only market fully connected to both China and the world, HKEX's new move will complement the current portfolio of shares, index futures and options to provide opportunities to global investors wanting to invest in Asia. It will also attract more funds from Chinese mainland to improve the breadth and depth of Hong Kong's financial market.

In other service subsectors the retail and tourism-related subsectors (i.e. retail, accommodation and caterings) recorded a slightly higher combined unemployment rate of 10.7% in April-June, a new high since SARS in 2003; this was due in large part to the slow recovery from the pandemic. The unemployment rate of the catering subsector was 14.7%, while the aviation, transport and construction sectors were also hit hard, affecting many workers. We expect consumption and tourism to remain sluggish as a result of the pandemic. The unemployment rate may continue upward, but at a lower rate.

Global Economy

Globally, the spread of the COVID-19 pandemic was temporarily contained in 2020Q2 in developed economies, including the US and the EU, thanks to isolation, lockdown and social distancing. However, the US is witnessing a second wave of the outbreak, and the spread is accelerating in emerging markets including Brazil, Russia, India and South Africa. Considering the impact on the world economy in 2020H1, the IMF downgraded its growth projection in the World Economic Outlook (WEO) Update, June 2020 by 1.9% to -4.9%, stating "the global economy is projected to grow by 5.4% in 2021 as economic activity normalises", 0.4% lower than previous forecasts. According to the WEO, "The slower recovery path in the updated forecast reflects persistent social distancing into the second half of 2020… and a hit to productivity as surviving businesses ramp up necessary workplace safety and hygiene practices. For economies struggling to control infection rates, a lengthier lockdown will inflict an additional toll on activity." All these will add a higher-than-usual degree of uncertainty — and impacts — to the global economic recovery.

Figure 32: Global COVID-19 Pandemic Statistics, Daily New Cases (as of 14 July)



Source: Wind, KPMG analysis

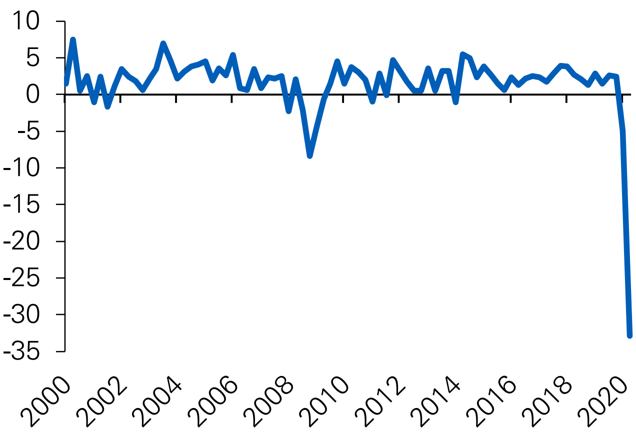
Note: Three-day moving average of daily new cases. Emerging Markets (excluding China): India, Iran, Turkey, Russia, Brazil, Mexico and Peru; Developed Markets (excluding the US): the UK, France, Germany, Italy, Spain, Canada, Belgium, Japan and South Korea.

US

The number of COVID-19 cases has been fluctuating in the US since 2020Q2. In April-May, "Stay-at-Home" orders helped in reducing daily new cases from the April peak of 35,000 to 19,000 in early June. The improving situation encouraged states to reopen and gradually restored consumer confidence. In June, the University of Michigan Consumer Sentiment Index increased by 6 percentage points from April to 78.1, and retail sales rose by 29 percentage points from April m-o-m.

However, as the state and local governments eased pandemic controls, the number of COVID-19 cases has been surging since mid-June, with more than 60,000 daily new cases in early July. The deteriorating situation triggered re-shutdowns across some, and brought states, the University of Michigan Consumer Sentiment Index down to 73.

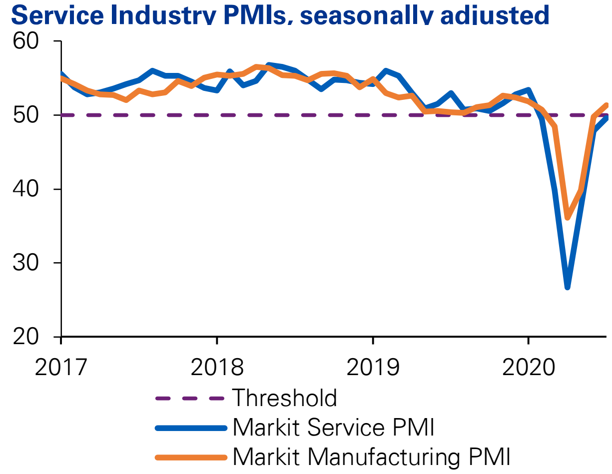
Figure 33: US real GDP, QOQ seasonally adjusted annualised rate, %



Source: Wind, KPMG analysis

Affected by the pandemic, 2020Q2's economic data showed a "down-and-up" curve. In 2020Q2, the real GDP of the United States fell 32.9% from the initial value of the annualized growth rate, a 9.5% drop on a quarterly YOY basis, which was 28 and 10 percentage points lower than 2020Q1 respectively — an historic low. Of this, the quarter-on-quarter annualised growth rates of private consumption and private fixed asset investment dropped by 34.6% and 29.3%, respectively. As most states reopened in middle and late May, the Markit Manufacturing PMI and Service PMI of the US jumped to 47.9 and 49.8, respectively, in June from April's low. The quarter-on-quarter annualised growth rate of industrial production was 6.9 percentage points up from April. However, the second wave of the COVID-19 outbreak lowered enterprises' expectation of economic recovery, resulting in a slower growth rate of the aforementioned PMIs in July (49.6 and 51.3 respectively).

Figure 34: US Markit Manufacturing Industry and Service Industry PMIs, seasonally adjusted

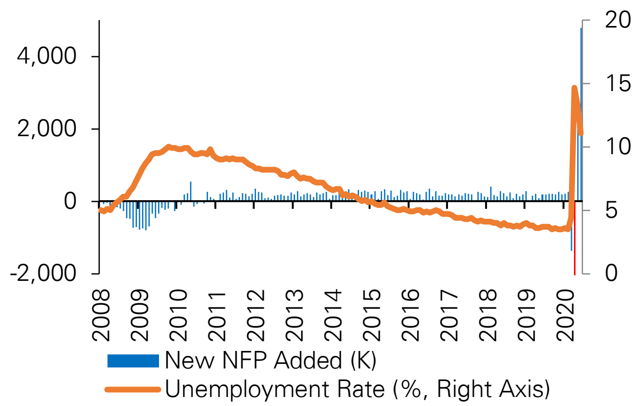


Source: Wind, KPMG analysis

The jobs market is slowly recovering but it is still below the pre-pandemic level. In June, the seasonally adjusted non-farm payrolls (NFP) climbed slightly to 138 million, or 7.5 million more than the April low of 130 million. The unemployment rate in the US remained at a low level before surging from 4.4% to 14.7% in April. Although the unemployment rate dropped to 11.1% in June, it was still at a record high since 1948.

In June's World Economic Outlook (WEO) Update, the IMF lowered the US's economic growth outlook for 2020 to -8%, 2.1 percentage points lower than the previous forecast. As reopening was interrupted by the second wave of COVID-19 outbreak across the US, and economy activity slowed, the economic recovery of the US in 2020H2 may be more challenging.

Figure 35: US non-farm payroll added and unemployment rate



Note: New NFP in orange column; down by 207.87 million.
Data Source: Wind, KPMG analysis

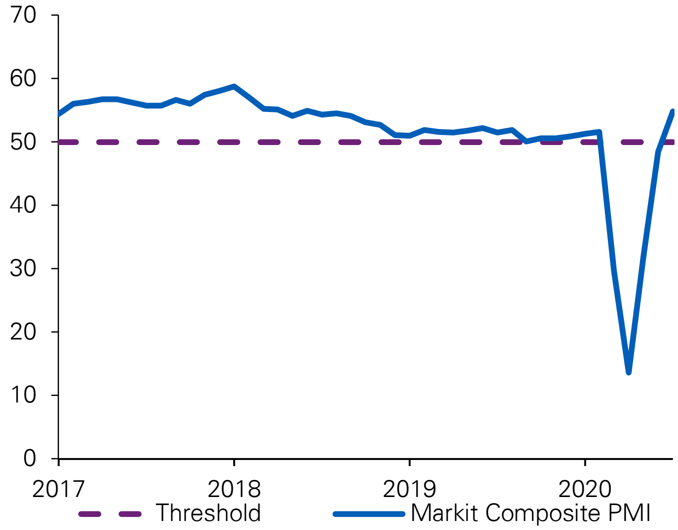
Eurozone

In 2020Q2, the quarter-on-quarter annualised growth rate of real GDP in the Eurozone was -12.1%, down by 15 percentage points on a quarterly YOY basis — the lowest level since the European debt crisis. By country, the YOY growth rate of real GDP in 2020Q2 was -11.7% for Germany, -19% for France, -17.3% for Italy and -22.1% for Spain. Due to the larger-than-expected economic impact of the pandemic, the IMF lowered The Eurozone's economic growth outlook for 2020 to -10.2%, 2.7 percentage points lower than the previous forecast (-7.8% for Germany, -12.5% for France, -12.8% for Italy and -12.8% for Spain).

Most EU countries have been taking strict pandemic control measures in 2020Q2, and daily new cases and deaths were notably down, indicating a well-controlled situation. The European Commission also published reopening guidelines on 20 May, stating that member states may be qualified for reopening if 1) daily new cases were on a steady decline; 2) healthcare systems were sufficiently equipped with beds, drugs and devices; 3) the state had the ability to track, test and isolate close contacts. As of 15 July, some countries had already lifted border restrictions within the EU. On 1 July — 106 days after the EU and Schengen Area countries shut down their external borders on 17 March — the European Commission decided to phase out border restrictions on a conditional basis.

High frequency data also indicated the gradual recovery of The Eurozone. For example, the quarter-on-quarter annualised growth rate of retail sales in Germany turned positive to 13.4% in May, 20 percentage points up from April; and the Industrial Production Index rose to 9.7% in May from -20% in April. France and Italy showed the same trend of recovery. In addition, the Markit Composite PMI Index of The Eurozone stood at 54.8 in July, Manufacturing PMI at 54 and Service PMI at 55.1 — all at a two-year high. As production restored, payrolls increased and previously suppressed consumption demands were released, businesses were optimistic about the future recovery.

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



Source: Wind, KPMG analysis

On 21 July, the EU reached an agreement on an EUR 1.074 trillion long-term budget for 2021-2027, including an EUR 750 billion Next Generation EU Fund. Of this, EUR 390 billion will be used as gratuitous grant or project funds, and EUR 360 billion as low-rate loans to help heavily hit members, including Italy, Spain and East European countries, with economic revival. The passage of financial stimulation plans will add more momentum to the post-pandemic recovery of the EU, and drive the transformation to a more green and digital economy.

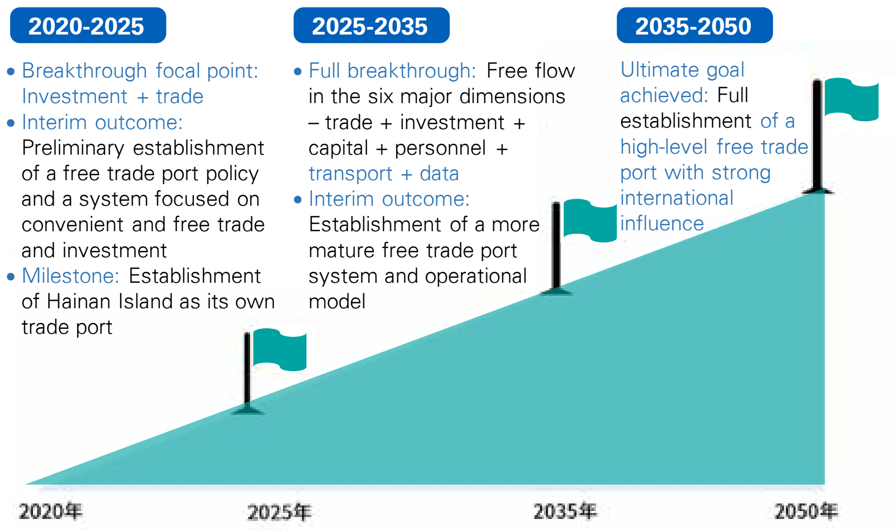
2

Policy analysis

Release of the Master Plan for the Construction of the Hainan Free Trade Port

On 1 June, the CCP Central Committee and the State Council issued the *Master Plan for the Construction of the Hainan Free Trade Port*[2]. The objectives of the Master Plan are the preliminary establishment of a free trade port policy system focused around convenient and free trade by 2025, making the port a new hotspot for an open economy in China by 2035, and the comprehensive establishment of a high-level free trade port with strong international influence by the middle of the century.[3]

Figure 37: The Five Major Factors: Land, Labour, Capital, Technology and Data

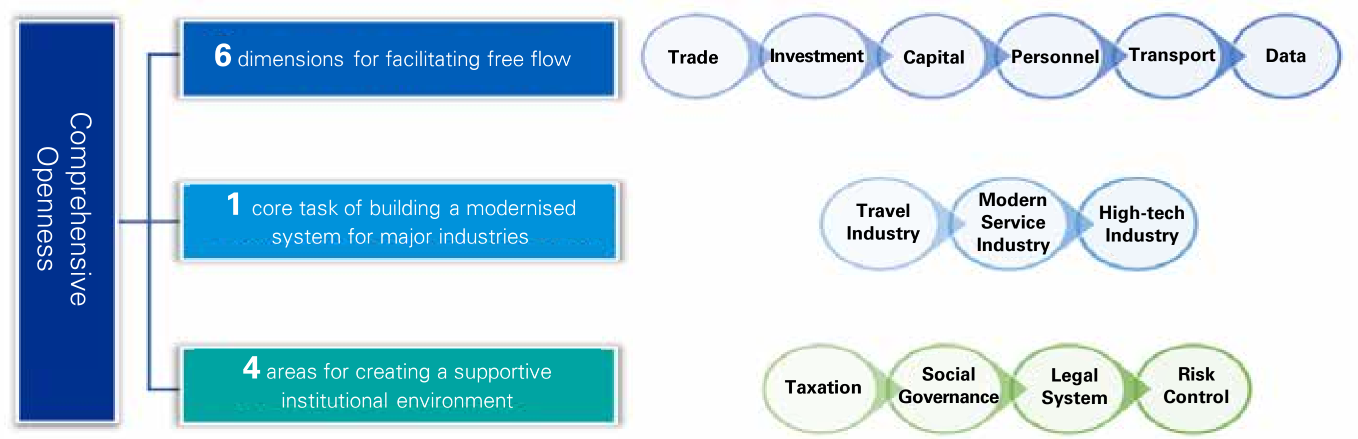


Source: KPMG analysis

The Master Plan covers 11 regions and is based on free flow in six major dimensions: trade, investment, finance, personnel, transport and data. It also prioritises the building of modernised industrial systems in industries such as tourism, the modern service industry and advanced technology. The Hainan Free Trade Port model of "zero tariffs, great openness" is also further improved through support in the institutional environment in the four major areas of taxation, social governance, legal system and risk control.

[2] http://www.gov.cn/zhengce/2020-06/01/content_5516608.htm
[3] For details, please see KPMG's brief analysis of the Master Plan for the Construction of the Hainan Free Trade Port, "Openness from the Top, Step-by-step Progress, and Full Support" by KPMG China, June 2020. https://www.sohu.com/a/399745031_120070887

Figure 38: Systems in the Master Plan for the Hainan Free Trade Port



Source: KPMG analysis

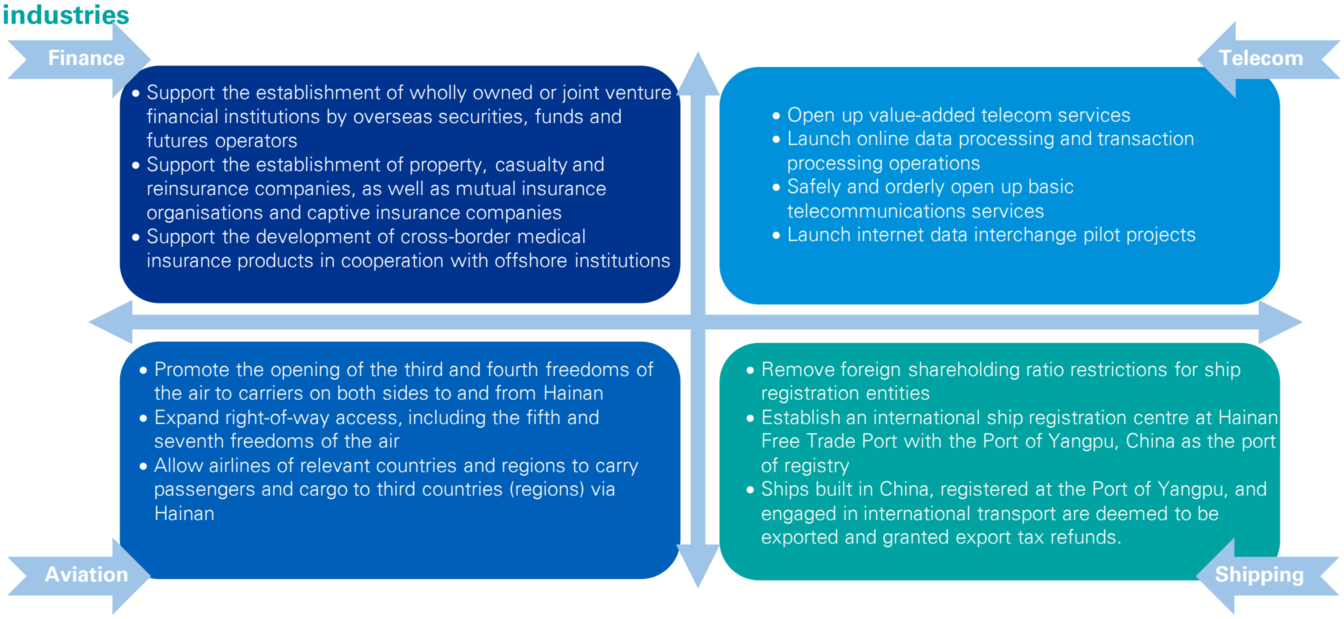
The Master Plan clarifies a number of specific liberalisation policies that demonstrate China's willingness to open up to the world.

In the realm of taxation, a taxation system unprecedented in any of China's other pilot free trade zones has been announced, including a scheme for greater liberalisation and convenience with "zero tariff" as its central tenet, as well as a series of preferential tax incentives (such as a 15% corporate income tax rate in encouraged industries and a personal income maximum tax rate of 15% for high-value and in-demand talent).

As for industry, there is greater market openness with clear guidance for increasing openness in aviation, shipping, telecommunications, finance and other fields, laying a solid foundation for the future development. The Plan introduces a special list for market access liberalisation and a negative list for foreign investment access to the Hainan Free Trade Port.

In the longer term, the Plan grants full legal authority to the Hainan Free Trade Port, and declares that of the reform policies and measures within the Plan, all those involving modifications to existing laws or administrative regulations will take effect upon the joint authorisation of the National People's Congress and the Standing Committee of the State Council. The Hainan Free Trade Port is also encouraged to develop and introduce laws for itself to resolve concerns surrounding future development restrictions imposed by laws with greater supremacy.

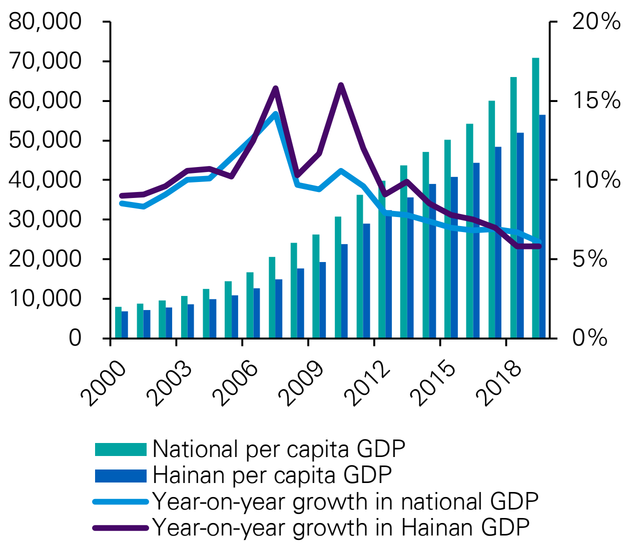
Figure 39: Specific measures in the Master Plan for the Hainan Free Trade Port to liberalise selected industries



Source: KPMG analysis

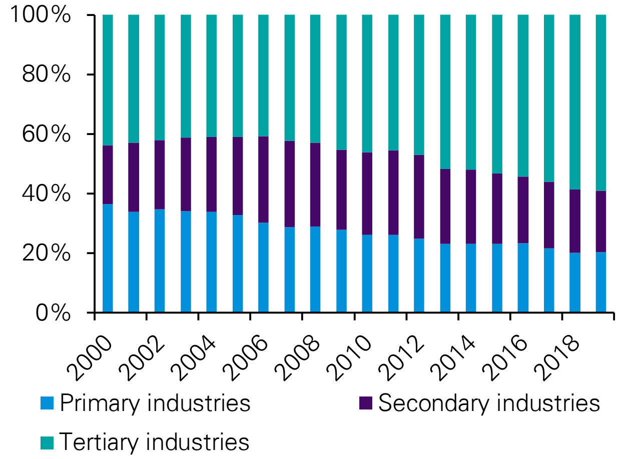
Hainan Province's GDP was RMB 530.9 billion in 2019, ranking 28th in the country and accounting for just 0.54% of the national GDP. Hainan's per capita GDP was about RMB 56,500, ranking 16th out of the 31 provinces, municipalities and autonomous regions, and below the national average of RMB 70,900 per capita. As for its industrial structure, in the last decade or so, the proportion of primary and secondary industries in Hainan Province has gradually declined while its tertiary industries have grown rapidly. In 2019, Hainan's primary and secondary industries accounted for 20.35% and 20.70% of provincial, respectively, while tertiary industries accounted for nearly 60%. This is the result of aggressive development of Hainan's tourism industry in recent years. The Plan proposes that, after the construction of the Hainan Free Trade Port, great efforts would be made to develop tourism, the modernised service industry and the high-tech industry, and to develop a modernised industrial system, with the hope of further increasing the share of the tertiary industries.

Figure 40: Comparison of the per capita GDP and GDP growth rate between Hainan Province and all of China



Source: Wind, KPMG analysis

Figure 41: Changes in the proportions of the three major types of industry in Hainan Province, 2000-2019



Source: Wind, KPMG analysis

KPMG analysis[4]:

The construction of a top-tier free trade port with Chinese characteristics demonstrates China's resolve to continue promoting greater openness toward the outside world and to build an open economy. Hainan is China's largest special economic zone, and the city of Haikou is the administrative centre of the province as well as the preferred base for the headquarters of major enterprises establishing locations in Hainan. Hainan possesses unique advantages in comprehensively deepening reforms and testing policies with the greatest degree of openness. As a continuation of the Guiding Opinions of the CPC Central Committee and the State Council on Supporting Hainan in Comprehensively Deepening Reform and Opening Up, the Master Plan for the Construction of the Hainan Free Trade Port is the blueprint for opening up an important gateway to the rest of the world, to display China's openness to the world in a way that encourages openness from the top, with step-by-step progress and full support. It is a milestone in China's process of reform and opening up, marking the beginning of a new stage in the opening-up process.

[4] For details, please see "KPMG and the Haikou Municipal Government Co-host a Discussion of the New Policy for the Hainan Free Trade Port," KPMG China, June 2020
https://www.sohu.com/a/399745031_120070887

Financial support for the development of the Guangdong-Hong Kong-Macao Greater Bay Area[5]

On 14 May, the PBOC, the China Banking and Regulatory Insurance Commission, the China Securities Regulatory Commission, and the Bureau of Foreign Exchange issued *Opinions Concerning Financial Support for the Establishment of the Guangdong-Hong Kong-Macao Greater Bay Area*[6] (hereafter referred to as the "Opinions") with 26 specific measures in five areas, including promoting the facilitation of cross-border trade and investment in the Greater Bay Area (GBA), increasing the opening up of the financial sector, promoting the interconnectedness of financial markets and financial infrastructure, driving innovation in financial services in the GBA, and effectively preventing cross-border financial risks. These measures are expected to greatly enhance financial services capabilities in the real economy in the GBA, promote coordinated development of the regional economy, and provide robust financial support for the development of a vibrant and internationally competitive first-rate area and a world-class cluster of cities.

The Guangdong-Hong Kong-Macao Greater Bay Area, the frontier of China's reform and opening up, is home to the three financial centres of Hong Kong, Shenzhen and Guangzhou. Since the release of the Outline Development Plan for the Guangdong-Hong Kong-Macao Greater Bay Area (hereafter referred to as the "Outline"), interconnectivity between financial markets has continued to progress, and now the Opinions have more clearly proposed a program for the financial development of the GBA, focusing on financial reform in five major aspects.

► Promoting cross-border trade and facilitating investment in the GBA

The Opinions simplify the management of foreign exchange in the aspects of traditional trade, new forms of trade and cross-border payments for insurance businesses, greatly improving the convenience of converting and using both local and foreign currencies. As for the liberalisation of capital projects, the Opinions promote the establishment of cross-border wealth management mechanisms; initiate cross-border loans, cross-border asset transfers and cross-border pooling of local and foreign currencies; as well as support the use of private equity funds in conducting cross-border pilot investment projects.

On 29 June, the PBOC and the Hong Kong and Macao monetary authorities jointly announced the launch of a "Cross-border Wealth Management" pilot project in the GBA. The pilot project will aid in meeting the needs of residents of the region for independent investments and flexible allocation of assets, in facilitating cross-border investments by local residents, and further deepening financial cooperation throughout Guangdong, Hong Kong and Macao. At the same time, it will strongly promote diversification in investments and financial management within the GBA, facilitate flows of capital within the region and promote the internationalisation of the Renminbi. This will strengthen Hong Kong's position as an international financial centre and a hub for offshore Renminbi business.

In 2019, cross-border receipts and payments between Hong Kong/ Macao and the nine Mainland cities of the GBA totalled RMB 2.32 trillion, with a YOY increase of 17.3% and accounting for 45.4% of foreign currency cross-border receipts and payments (5.8 percentage points higher than the entire country). The Renminbi has continued to become the second-most-used currency for cross-border payments between Guangdong, Hong Kong and Macao. Hong Kong has become the world's largest offshore Renminbi business centre, and Macao's Renminbi clearing bank has taken preliminary steps to set up a Renminbi clearing network covering Portuguese speaking countries. Regarding the cross-border Renminbi financing business, enterprises in the nine Mainland cities raised RMB 83.984 billion in funds through the full-scale cross-border financing business as at the end of 2019.

[5] For further details, please see the Interpretation of Opinions Concerning Financial Support for the Establishment of the Guangdong-Hong Kong-Macao Greater Bay Area by KPMG China, May 2020, https://home.kpmg/cn/zh/home/insights/2020/05/interpretation-of-the-opinions-concerning-financial-support-for-the-establishment-of-the-guangdong-hong-kong-macao-greater-bay-area.html
[6] http://www.pbc.gov.cn/goutongjiaoliu/113456/113469/4023428/index.html

For cross-border Renminbi fund pooling, these nine cities established a total of 580 cross-border two-way Renminbi fund pools, totalling RMB 1.42 trillion in receipts and payments as at the end of 2019. In order to facilitate the investment of equity funds by Hong Kong and Macao in the GBA, RMB 20 billion of Macao's financial reserve introduced by the Guangdong-Macao Cooperation and Development Fund in qualified foreign limited partner (QFLP) form has been fully remitted, providing strong support for infrastructure construction and other key projects in Guangdong[7].

► Further opening up the finance sector to the outside world to deepen financial cooperation between the Chinese mainland and Hong Kong/ Macao

The Opinions propose the further opening up of the banking, securities and insurance sectors, leading the way to launch a variety of measures to open up the GBA to the rest of the world. The focus will be on supporting financial institutions such as banks, securities and futures companies in the region to expand their potential for development.

As the industrial structure in the GBA is upgraded, it is certain to become a hub for global top-tier industries and wealthy individuals; the demand for asset management is bound to rise while cross-border financing needs will become increasingly urgent as construction in the GBA progresses. The Opinions explicitly propose promoting cooperation in training and exchanges for talented personnel in finance between Guangdong, Macao and Hong Kong. A new phase of financial cooperation between these three areas will continue to develop through active exploration, reform and innovation in the areas of products, services, capital, talent and regulations. Banking institutions within the GBA will be able to carry out cross-border Renminbi lending, Renminbi foreign exchange forwards, as well as cross-agent sales of Renminbi-related derivatives and wealth management products, allowing Chinese mainland residents to purchase financial products sold by banks in Hong Kong and Macao. Senior management in some Hong Kong and Macao banks have carried out long-term strategic planning for distribution throughout the GBA, making major time and manpower investments. Distribution of branches will be essentially within the scope of the GBA, but differentiation in distribution will also be prioritised. In addition to traditional banking business, active efforts will be made to open new subsidiaries and engage in new types of business.

► Promoting connectivity in financial markets and financial infrastructure between Guangdong, Hong Kong and Macao

The Opinions put forward that it is necessary to: provide support for Hong Kong and Macao to develop offshore Renminbi business and specialty finance and drive forward cooperation on green finance in the GBA; support the strengthening and consolidation of Hong Kong's position as a global hub for offshore Renminbi business and an international finance centre; and support the establishment of Macao as a Renminbi clearance centre for Portuguese-speaking countries.

Supporting the development of Hong Kong and Macao's offshore Renminbi business as well as strengthening Hong Kong's position as a global offshore Renminbi business hub will gradually expand both the scale and scope of cross-border Renminbi use as well as promote convenient cross-border Renminbi circulation and exchange in the GBA. This will provide investment and financing services for M&A for Chinese enterprises wishing to enter the global market, aid the Belt and Road Initiative, promote the internationalisation of the Renminbi and enhance its international competitiveness.

► Further promote innovation in financial services in the GBA

The Opinions propose support for the GBA in exploring diversified financial support models for the development of science and technology as well as the establishment of a system for investment and financing for innovative science and technology. It also proposes to deepen cooperation in financial technology, improve platforms for blockchain trade finance information services and promote the interoperability of mobile payment tools within the GBA.

[7] What Impact Will the 26 Financial Support Policies Have in the Greater Bay Area? Sina Finance, May 2020. http://finance.sina.com.cn/wm/2020-05-15/doc-iircuyvi3326986.shtml

The GBA's existing advantages in industrial structure and technology can be actively utilised to focus on innovation in financial technology. Shenzhen possesses the advantage of being innovation-driven and a first mover, while Hong Kong boasts an internationalised financial services system. This can generate a double impetus of "technology + finance" in the GBA, creating a favourable environment for innovation and development in financial technology. In both the PBOC's Fintech Development Plan (2019-2021) (issued in August 2019 regarding the importance of financial technology and its development path) as well as the recently issued Opinions, eligible innovative enterprises are encouraged to pursue financing and get listed in Hong Kong and Macao. Traditional financial enterprises can fully utilise internet concepts and technology; construct a cooperative environment with financial technology enterprises; shift in the direction of intelligence, refinement, efficiency and openness; focus on innovation in their management systems; re-examine the balance between innovation and risk; prioritise client cultivation and client experience; create methods for innovation in social products and services; and reconstruct client contact points. These measures would help the GBA gain competitive advantage.

► Effective prevention of cross-border financial risks

The Opinions propose bolstering cooperation on financial regulations between Hong Kong, Guangdong and Macao; promoting the improvement of oversight in the financial innovation sector; establishing and improving a system for early warning, prevention and resolution of financial risks; and ensuring that no system-level threats occur.

Risk management is critical to financial development. The ongoing opening up and development of the financial sector in the GBA is inextricable from financial risk control in Guangdong, Hong Kong and Macao, as is effective communication and coordination between financial regulatory authorities in these three locales. Risk management also cannot be separated from the support and advancement of risk control and compliance management systems for financial enterprises.

Against the backdrop of open, innovative and integrated development in the GBA, enterprises should follow the trend of business diversification; break through internal and external barriers; and build flexible, agile, comprehensive, accurate, intelligent and harmonious environments for open internal control and compliance by fostering core management capabilities in risk control. The first component is improving the internal control and compliance governance infrastructure, promoting the transformation of management responsibilities of the second line of defence - from traditional risk prevention and supervision during and after any event to risk disclosure and assessment during and before any event - as well as improvement of the timeliness and effectiveness of risk warning, prevention and resolution. The second component is strengthening data governance, exploring more extensive application of financial technology in the risk control compliance field, and enhancing the quality and efficiency of risk control compliance management. The third component is enhancing the output of risk control compliance management experience; establishing unified standards and tools within the internal risk control field; realising intelligent internal control compliance to empower business, management, internal mechanisms, the general environment, and other participants within the ecosystem, thus improving the entire ecosystem's ability to avoid risks and allowing healthy operations.

KPMG analysis:

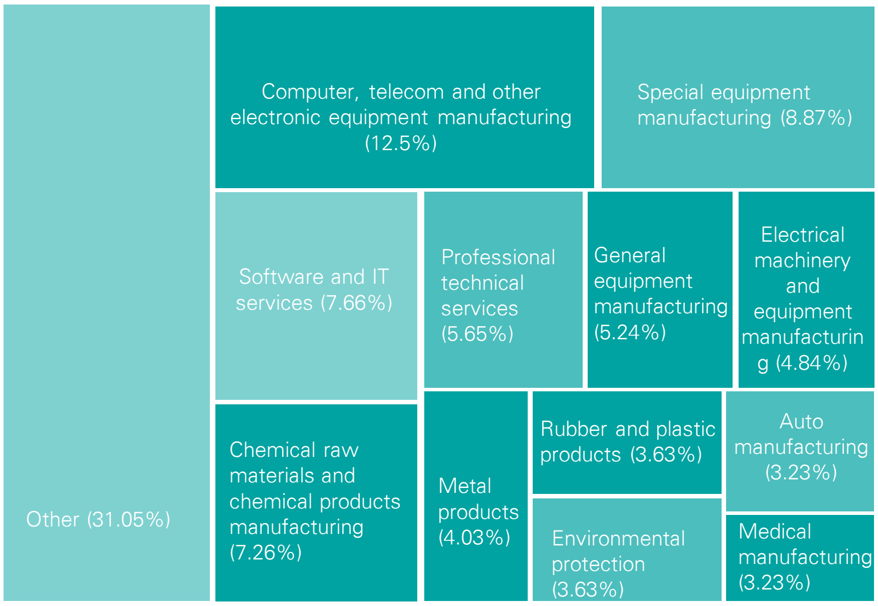
The current international climate and the pandemic have dealt a joint blow to the world economy. However, without a doubt, the Opinions will create significant opportunities for a general increase in development opportunities for the finance industry in the GBA. The new policy is expected to provide strong financial support to create an internationally competitive first-class Bay Area and world-class city clusters, as well as promote greater openness of China's capital markets to the world, achieving economic transformation and industrial upgrade.

Implementation of Growth Enterprise Market reform and pilot registration system

On 12 June, the China Securities Regulatory Commission[8] issued regulations for Growth Enterprise Market reform and the pilot registration system in its *Measures for the Administration of Initial Public Offering of Shares on the Growth Enterprise Market (Trial)* and the *Measures for the Administration of Securities Issuances by Listed Companies on the Growth Enterprise Market (Trial)*. The Shenzhen Stock Exchange released a total of eight major business regulations and 18 supporting rules, guidelines and notices for Growth Enterprise Market reform and the pilot registration system at the same time. The Growth Enterprise Market registration reforms have officially kicked off.

On 15 June, the Shenzhen Stock Exchange began officially accepting applications for IPOs, refinancing, M&A, and restructuring of enterprises under review for the Growth Enterprise Market. As of 8 July, it had received 248 IPO applications. Applicant are distributed across 46 different industries, with the top three being computer, telecommunications and other electronic equipment manufacturing; manufacturing of professional equipment; and software and information technology services, accounting for 12.5%, 8.9% and 7.7%, respectively.

Figure 42: Distribution by industry of applicants in the Growth Enterprise Market Registration System



Source: Shenzhen Stock Exchange, KPMG analysis

8 http://www.csrc.gov.cn/pub/newsite/zjhxwfb/xwdd/202006/t20200612_378199.html

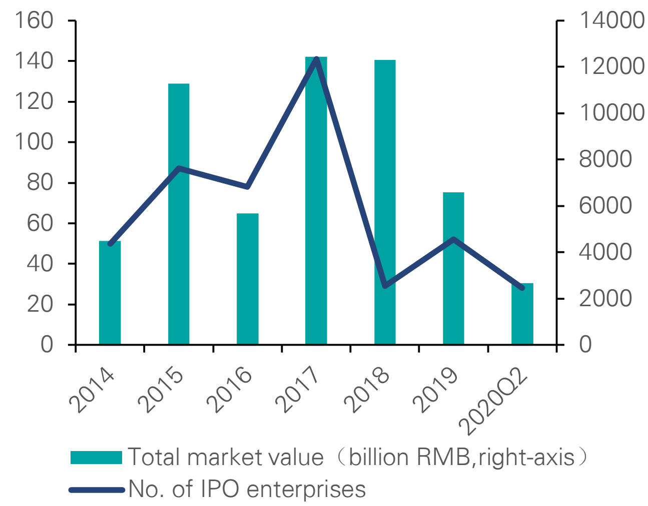
In accordance with the Interim Provisions for the Reporting and Recommendation of Enterprises Issued and Listed on the Shenzhen Stock Exchange, the Growth Enterprise Market is positioned to comply with national economic development strategies and industrial policy guidance to thoroughly implement an innovation-driven development strategy; adapt to the greater trend of development relying on innovation, creativity and originality; primarily serve growing, innovative enterprises oriented in the general direction of high-tech and strategic emerging industries; and support the deeper integration of traditional industries with new technologies, new industries, new formats and new models, enhancing their ability to serve diversified enterprises of various types.

It is worth mentioning that the Growth Enterprise Market has creatively set up an industry negative list, listing 12 industries that are not allowed to apply, although traditional industries that are deeply integrated with internet, big data, cloud computing, automation, artificial intelligence and new energy can still be listed on the Growth Enterprise Market.

The Science and Technology Innovation Board emphasizes "science and technology" with regard to innovation, as well as services for enterprises in the six leading "hard science and technology" fields — information technology, high-end equipment, new materials, new energy, energy conservation and biomedicine. The Growth Enterprise Market, on the other hand, emphasizes "innovation." It supports enterprises that deeply integrate traditional industries with new technology, new industries, new industry formats and new models, targeting "soft technology" to effectively achieve high growth but leaning towards the pilot registration system in traditional industries to promote innovative development in traditional industries.

Under the registration system, the strategically differentiated developmental positions of the Growth Enterprise Market and the Science and Technology Board not only aid in the sustainable and healthy development of markets and sectors with different characteristics and positioning but may also effectively serve innovation-driven strategies and the real economy. It can also help enterprises — especially those in the new economy — obtain capital support more effectively, easily and quickly, helping capital markets achieve rapid development, further improving the fundamental capital market system, enhancing capital market functions, and promoting the unleashing of capital market vibrancy and drive.

Figure 43: IPOs and total market value on the growth enterprise market, 2014-2020



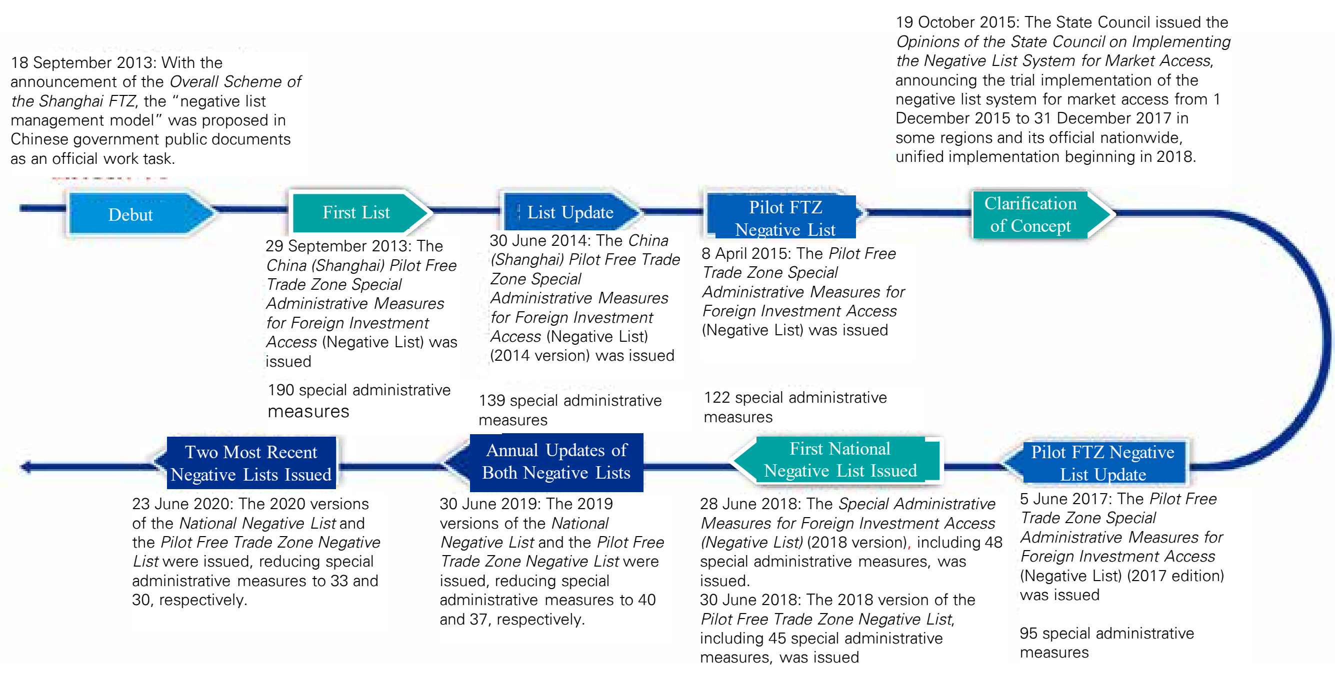
Source: Wind, KPMG analysis

New foreign investment negative list released

On 23 June, the National Development and Reform Commission and the Ministry of Commerce jointly issued the *Special Administrative Measures on Access to Foreign Investment (2020 edition)* [9] and the *Special Administrative Measures for Foreign Investment Access in Pilot Free Trade Zones* (Negative List) (2020 Edition)[10] , further reducing the negative list for foreign investment access. This marks China's use of its negative list system for market access to further open up the market to foreign investment, with a wider and deeper scope. This demonstrates China's resolve to promote the establishment of a new, more open economic system through systematic opening.

In recent years, China has continued to explore the implementation of a management system for foreign investment of pre-entry national treatment along with a foreign negative list, in order to raise the level of openness. The Foreign Investment Law and its implementation regulations, introduced in 2019, have officially established the management system for foreign investment of pre-entry national treatment with a foreign negative list at the legal level; the negative list for foreign investment access lists the sectors in which investment is prohibited or restricted and grants national treatment for foreign investment outside of the negative list. The negative list for foreign investment access applicable to the country and pilot free trade zones was revised for four consecutive years from 2017 to 2020, with restrictions for the former reduced from 93 to 33, and restrictions for the latter reduced from 122 to 30. A special series of major liberalisation measures were introduced in the financial and automotive sectors. Confidence in foreign investment has been bolstered through this increased openness. Against the backdrop of an ongoing downward trend in global cross-border investment, foreign investment in China stood at USD 136.3 billion in 2017, USD 138.3 billion in 2018 and USD 141.2 billion in 2019, ranking second worldwide[11].

Figure 44: History of the negative list system for market access



Source: KPMG analysis

[9] https://www.ndrc.gov.cn/xxgk/zcfb/fzggwl/202006/t20200624_1231938.html
[10] https://www.ndrc.gov.cn/xxgk/zcfb/fzggwl/202006/t20200624_1231939.html
[11] The National Reform and Development Commission answers reporters' questions on the 2020 negative list for foreign investment access, NDRC, June 2020 https://www.ndrc.gov.cn/xxgk/jd/jd/202006/t20200624_1231943.html

This round of changes to the negative list primarily include three changes. The first is to accelerate the process of opening up in key service sectors. In the financial sector, restrictions on the foreign equity ratio for securities companies, securities investment fund management companies, futures companies and life insurance companies have been eradicated. In the infrastructure sector, the requirement that the construction and operation of water supply and drainage systems in cities with a population of 500,000 or more must be Chinese-managed has also been eliminated. The second change is to relax access to the fields of manufacturing and agriculture. In the manufacturing sector, the limitations on the ratio of foreign investment in the manufacturing of commercial vehicles has been relaxed, and regulations prohibiting foreign investment in the smelting and processing of radioactive minerals and the production of nuclear fuel have been lifted. In the agricultural sector, requirement that the breeding of new wheat varietals and seed production should be under Chinese control has been relaxed to requiring that at least a 34% share be held within China. The third change is to continue to open up pilot projects within free trade zones. Pilot free trade zones continue to be a priority endeavour based on the global liberalisation measures. In the pharmaceutical sector, the ban on foreign investment in Traditional Chinese Medicine preparations has been lifted. In the educational sector, the establishment of foreign-funded vocational educational institutions is now permitted.

Comparing the 2020 version of the *National Negative List and the Pilot Free Trade Zone Negative List*, relative to other regions in China, the pilot free trade zones still possess significant access advantages for foreign investment in sectors including agriculture, fisheries, publication and printing, Traditional Chinese Medicine manufacturing, telecommunications and artistic performances, while *the Pilot Free Trade Zone Negative List* provides clearer and detailed requirements for a portion of the special administrative measures[12].

Figure 45: Comparative analysis of the national negative list and the pilot free trade zone negative list

Pilot FTZ Negative List VS National Negative List

Pilot FTZs possess clear market access advantages in the following sectors

Lower Chinese ownership share in the breeding and seed production of new maize varieties (the national version requires Chinese controlling ownership and at for FTZs the Chinese share must be at least 34%)
Investment in fishing in maritime waters under China's jurisdiction and in inland waters permitted
No limitations regarding the percentage of Chinese ownership for the printing of publications
Investment allowed in the application of processing technologies of TCM drugs such as steaming, frying, cauterization and calcining, or in the production of Chinese patent drugs with confidential prescriptions
Removal of foreign equity ratio restrictions for storage and forwarding services, call centre services, domestic multi-party communications services, and internet access services for users; foreign equity ratio for domestic VPN services may not exceed 50%
Investment in cultural performance groups allowed under the condition of controlling ownership by the Chinese party

Source: KPMG analysis

The above comparison and analysis of policies show that by continuing to shorten the Market Access Negative List, China has created a more open market environment and provided an broader investment space for the majority of foreign-invested enterprises. It is believed that by continuing to encourage the construction of an open economy and implementing high-level policies for freedom and convenience in investment, in the future more foreign-funded enterprises will come to China to invest in developing areas, thus achieving more shared gains and development along with the Chinese economy.

[12] For further details, please see: A Further "Reduction" in the Foreign Investors Negative List to Help Foreign Enterprises Ride China's Development Wave, KPMG China, July 2020 https://www.sohu.com/a/405259835_120070887?_f=index_pagefocus_6

China's public offering REITs pilot officially launched

On 30 April, the Securities Regulatory Commission and the Development and Reform Commission jointly issued *the Notice on Promoting the Pilot of Real Estate Investment Trust Funds (REITs) in the Infrastructure Sector*[13] (hereafter referred to as the "Notice"), clarifying the basic principles, pilot project requirements and pilot work arrangements for REIT pilots in the infrastructure sector. The Securities Regulatory Commission solicited public feedback[14] on the *Guidelines for Public Offering of Infrastructure Securities Investment Funds (Trial) (Draft for Comments)* (hereafter referred to as the "Guidelines") at the same time. The release of these two documents signals the official launch of the trial of public offering REITs in China's infrastructure sector.

Public REITs refer to publicly listed standardised financial products that utilise securitisation to convert real estate assets or interests with continuous and stable income into listed securities with strong liquidity. REITs are relatively mature in foreign markets; real estate assets are held for the long term with the majority of the proceeds used for dividends, and include multiple asset types such as infrastructure and commercial properties.[15] According to the Notice, this pilot prioritises support for industries that can make up for infrastructural deficiencies, including warehousing and logistics, toll roads and other transportation facilities, water, electricity, gas, heat and other municipal projects, urban sewage and waste treatment, solid and hazardous waste treatment, and other pollution control projects. Pilot projects are encouraged for new forms of infrastructure such as information networks as well as national strategic and emerging industrial clusters, high-tech industrial parks and special industrial parks to carry out pilot projects. It also focuses on key regions for development such as Beijing-Tianjin-Hebei, the Yangtze River Economic Belt, the Xiong'an New Area, the Guangdong-Hong Kong-Macao Greater Bay Area, Hainan and the Yangtze River Delta.

REITs originated in the US, which is currently the largest, highest-yielding and most mature REIT market in the world, out of 39 countries or regions worldwide with REITs. Ten other countries, including China, are now in the preparatory stage for issuing REITs.

China proposed to launch a REIT pilot as early as 2008, and in recent years, various government ministries have been gradually encouraging the development of infrastructure REITs. On 16 January 2020, the Securities Regulatory Commission held a working meeting for the 2020 system wherein it expressed the desire to "steadily promote infrastructure REIT pilots." The Notice, jointly issued by the Securities Regulatory Commission and the Reform and Development Commission at this time, also provides a fast track for the development of infrastructure REITs.

[13] https://www.ndrc.gov.cn/xxgk/zcfb/fzggwl/202006/t20200624_1231939.html
[14] http://www.csrc.gov.cn/pub/zjhpublic/zjh/202004/t20200430_374847.htm
[15] Steadily Promoting the Public Offering REIT Pilot to Deepen the Marketization and Reform of Capital Elements, Shanghai Stock Exchange

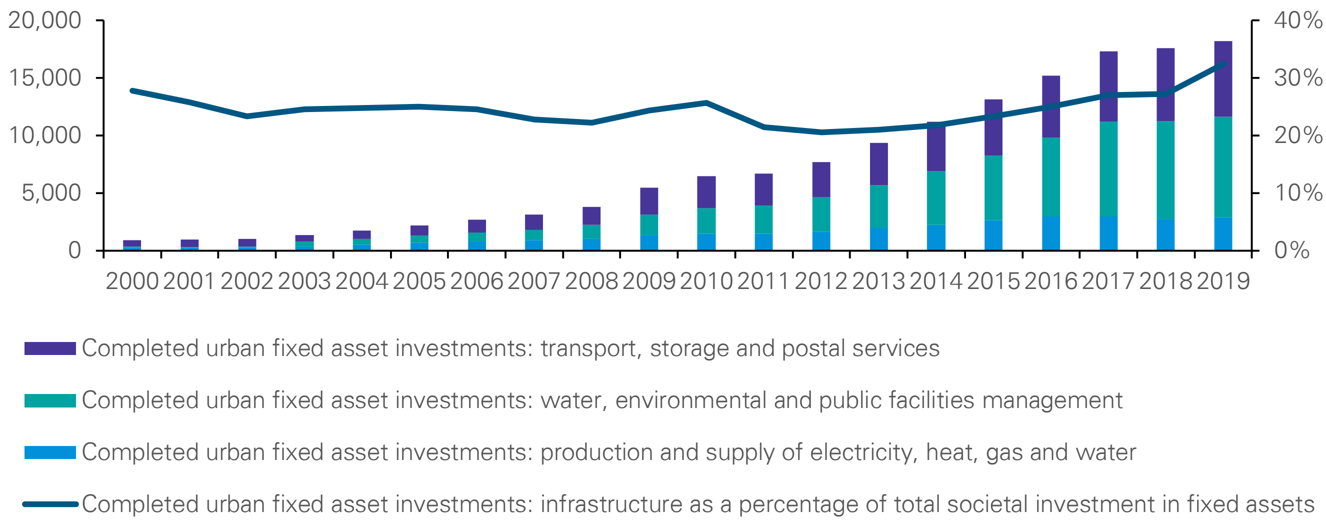
Table 1: Policy documents related to REITs

Date	Document	Issued by	Summary
2008/12/20	The Opinions of the General Office of the State Council on Promoting the Sound Development of the Real Estate Market	The State Council	Support enterprises with relatively good credit to issue corporate bonds upon approval and launch pilot real estate investment trusts to broaden direct investment channels.
2014/9/29	The Notice of China Banking Regulatory Commission on Further Improving Financial Services for Housing	CBRC	Proactively and cautiously launch pilot REITs.
2015/1/6	The Guiding Opinions on Accelerating the Fostering and Development of the Housing Rental Market	Ministry of Housing and Construction	Actively promote pilot REITs.
2016/3/16	The Outline of the Thirteenth Five-Year Plan for National Economic and Social Development of the People's Republic of China	NPC	Promote mergers and reorganisations in the real estate industry, increase industry density and launch pilot REITs.
2016/5/17	The Opinions of the General Office of the State Council on Accelerating the Fostering and Development of the Housing Leasing Market	The State Council	Support qualified housing rental enterprises in issuing bonds and real estate securitisation products. Continue to promote pilot REITs.
2016/12/26	The Notice on Promoting Asset Securitisation Public-Private Partnership (PPP) in the Traditional Infrastructure Sector	NDRC, CSRC	Jointly promote REITs to further support the construction of traditional infrastructure projects.
2018/4/24	The Notice on Promoting Work for the Securitisation of Housing Leasing Assets	CSRC, Ministry of Housing and Construction	Focus on supporting housing leasing enterprises to issue equity asset securitisation products with the real estate properties held as the underlying assets, actively promoting diverse asset securitisation products with debt, and pilot REITs.
2019/5/28	The Opinions on Increasing the Innovativeness of National Economic and Technological Development Zones to Create a New Highland for Reforms and Opening-up	The State Council	Support the launch of pilot projects such as facilitating the income settlement from capital projects and REITs in suitable state-level economic and development zones.
2020/4/30	The Notice on Promoting the Pilot Work of Real Estate Investment Trust Funds (REITs) in the Infrastructure Sector	NDRC, CSRC	Clarify the basic principles and requirements for pilot projects and working arrangements of pilot infrastructure REITs.
2020/4/30	The Guidelines for Public Offering of Infrastructure Securities Investment Funds (Trial) (Draft for Comments)	CSRC	Clarify the product definition and structure, professional competency requirements for managers, custodians and other institutions, fund share offering methods, standardised fund investment management and project operation and management, and strengthened supervision and management.

Source: Wolters Kluwer, KPMG analysis

Investments in fixed assets in China's urban infrastructure exceeded RMB 10 trillion in 2002. By 2019, China's investment in urban infrastructure fixed assets reached RMB 18 trillion, accounting for 32.46% of the total investment in fixed assets throughout China and reaching a new 20-year high. This demonstrates that the infrastructure industry has potential for further development.

Figure 46: Changes in completed totals for fixed asset investments in urban infrastructure



Source: Wind, KPMG analysis

KPMG analysis:

Infrastructure REITs are characterised by high liquidity and relatively stable returns, which aid in the revitalisation of reserve assets, broaden investment channels for social capital, increase the proportion of direct financing and enhance the quality of capital market services for the real economy. Over the short term, these are helpful for raising significant project capital, reducing debt risks, and are an effective policy tool for stabilising investments and strengthening areas of weakness. In the long run, these are helpful for converting savings into investments, reducing real economy leverage and promoting the healthy development of marketized and standardised infrastructure investment and financing. The State Council's Report 2020 on the Work of the Government proposed a particular focus on supporting "two new and one major" construction (the construction of new infrastructure and new urbanisation, as well as major projects such as transportation and irrigation). China's infrastructure construction is currently undergoing a transformation and is being upgraded; the launch of infrastructure REITs will help promote this transformation and upgrading, promote the development of high-end industries, as well as strongly promote a transformation and upgrade in China's economy.

3

Special focus: China-ASEAN regional economic integration

COVID-19 pandemic deals a blow to global FDI

The ASEAN region comprises 10 economies located in Southeast Asia, organised on the basis of economic cooperation — Indonesia, Malaysia, the Philippines, Singapore, Thailand, Brunei, Vietnam, Laos, Myanmar and Cambodia. It covers a total area of 4.49 million square km with a total population of about 660 million, and had a USD 3 trillion economy as of 2019.

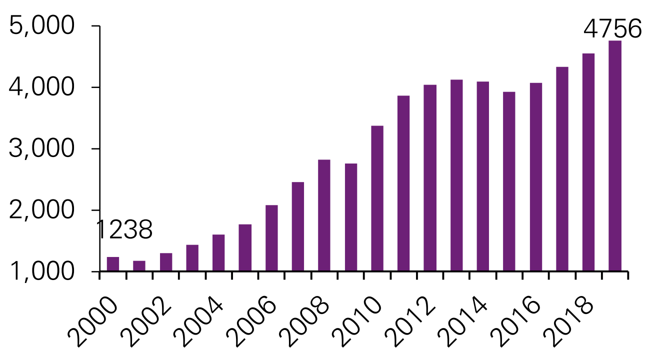
Although the ASEAN countries continue to strengthen their integration, great disparities in their economic development remain. There is Singapore with one of the highest levels of per capita income in the world, but also several relatively less well-off countries, such as Laos, Cambodia and Myanmar. Overall, despite the slowdown in global economic and trade activity in recent years, thanks to a significant population base, consistently rising per capita incomes, relatively robust remittances from overseas workers and stable prices, the ASEAN economies have gradually developed into an important global production base and emerging consumer market.

Table 2: Overview of key economic indicators for the ASEAN countries

Country	Population (millions)	Average Economic Growth （2015-2019） (%)	GDP (USD billions)	GDP per capita （USD）	Unemploy-ment Rate	Average FDI （2015-2019） （% GDP）	Business Environment Ranking （2019）
Indonesia	266.9	5.0	1119.2	4193.0	5.3	1.7	73
Philippines	108.2	6.4	359.4	3318.9	5.1	2.0	95
Vietnam	96.5	6.9	261.9	2714.6	2.2	6.3	70
Thailand	68.0	3.4	543.6	7990.2	1.1	1.2	21
Myanmar	54.3	6.5	69.0	1269.5	4.0	5.1	165
Malaysia	32.6	4.9	364.7	11193.5	3.3	2.9	12
Cambodia	15.8	7.1	27.1	1717.6	-	12.4	144
Laos	7.1	6.4	18.5	2621.0	0.6	6.7	154
Singapore	5.7	2.9	372.2	65248.8	2.3	22.5	2
Brunei	0.5	0.5	13.5	29828.6	9.3	1.7	66

Source: ADB, IMF, UNCTAD, World Bank, KPMG analysis.

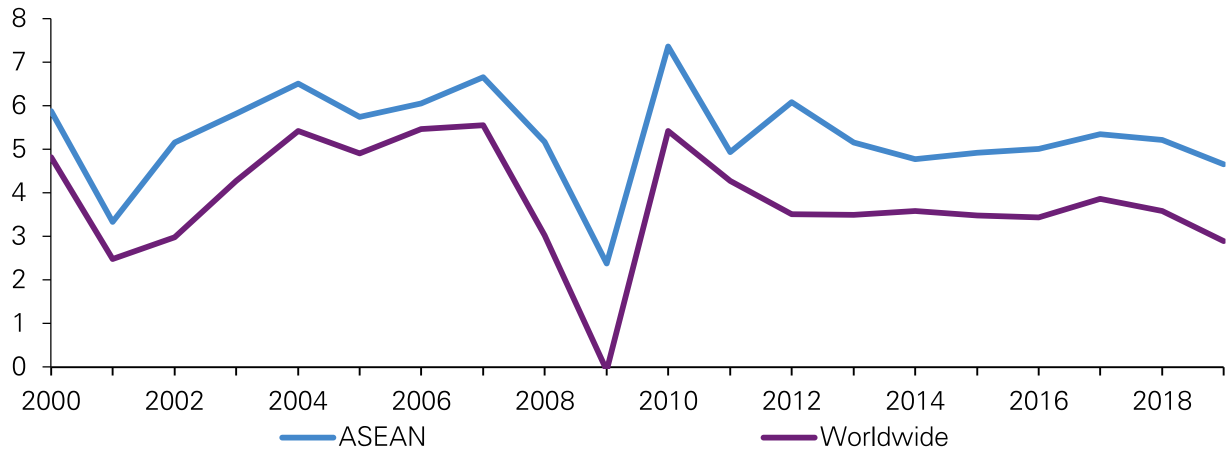
Figure 47: ASEAN per capita GDP, USD



Note: The data are averages weighted with each country's population.
Source: IMF, KPMG analysis

The governments of ASEAN countries have also focused on infrastructure and advanced technology as well as launched some major projects; investment in the public sector has also increased. In addition, ASEAN trade in goods has grown by nearly USD 1.3 trillion over the past decade; FDI rose from USD 114.2 billion in 2015 to USD 155.8 billion in 2019, increasing its global share from 5.6% to 10%. Growth in foreign trade and private sector investment has also supported the region's rapid economic development to a certain extent, enabling the ASEAN countries' real economies to grow at a slightly higher rate than the world's emerging and developing economies as a whole.

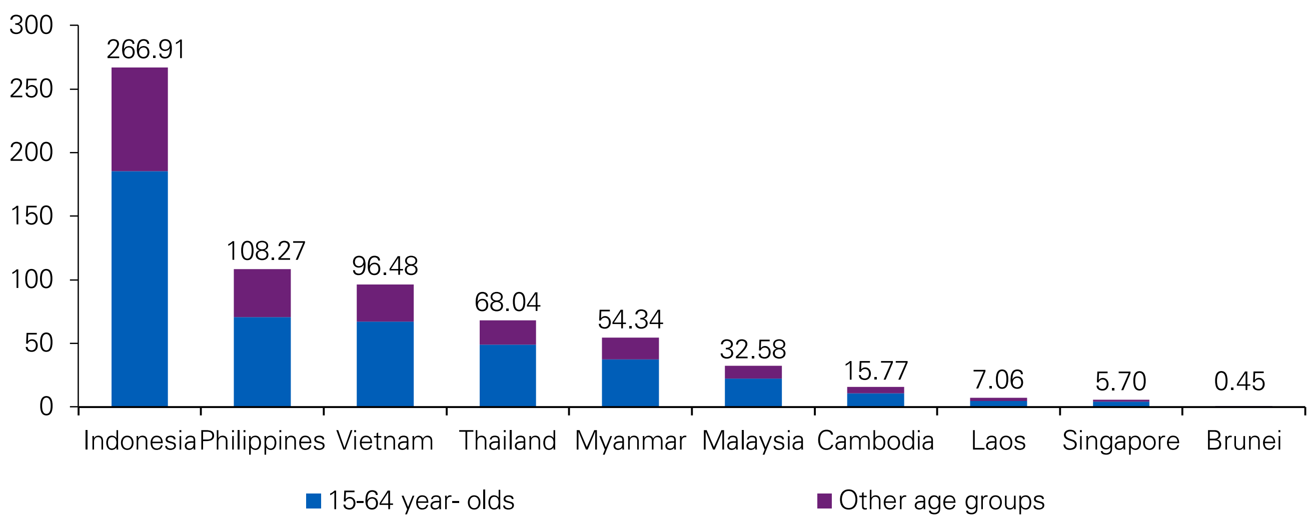
Figure 48: ASEAN real GDP growth, %



Source: IMF, KPMG analysis.

From the perspective of demographics, ASEAN countries' labour force between the ages of 15 and 64 is approximately 450 million, representing 68% of the total population. This is slightly higher than the average of 65% for developing countries and equates to one child or elderly person being supported by two working persons. As labour resources are abundant with a relatively light burden, they are able to meet the production needs of labour-intensive industries. This is also extremely beneficial for the region's ongoing economic and social development.

Figure 49: ASEAN 2019 population, millions



Source: ADB, KPMG analysis.

Geographically, ASEAN is bordered by the Pacific Ocean to the east and the Indian Ocean to the south with relatively long coastlines. It also encompasses the Strait of Malacca, which connects the Pacific Ocean to the Indian Ocean as well as 475 international ports, making it critical for transportation. Another consideration is that Southeast Asia is a tropical area and the majority of the Malay Archipelago has a tropical rainforest climate, which means agricultural crops are sown and harvested throughout all four seasons. This has also made the Southeast Asian region an important global production base for industries such as agricultural production, natural rubber and electromechanical equipment manufacturing.

Overview of major ASEAN economies

► Indonesia

Indonesia, the land of a thousand islands, is the largest island group nation in the world and the largest economy in ASEAN. Its geographical area, population and economic output all account for about 40% of the total of the ASEAN countries. It is also an important component of China's Belt and Road Initiative, and its relatively rich natural resources and oil and gas resources provide China with large quantities of materials necessary for its manufacturing industries. Indonesia ranks fourth in the world in terms of population with a total population of approximately 270 million; the 15-64 age group accounts for nearly 70% of the total population, providing a relatively abundant labour force. Despite of Indonesia's stable growth environment, fairly suitable demographics and massive market potential, FDI has averaged about USD 20 billion in the past five years, only 1.8% of GDP. As its infrastructure continues to improve, we expect foreign investment in Indonesia to have greater potential for growth.

► Thailand

Thailand's economy has continued to grow steadily in recent years, with a GDP of about USD 543.6 billion in 2019, ranking second in ASEAN. Agriculture, electromechanical equipment, automobile manufacturing and tourism are the mainstay industries of its economic development. Nearly a third of the country's workforce is engaged in agricultural production, but the drought in recent years has led to a decline in food production and exports, lowering the incomes of residents. Meanwhile, residents' relatively high leverage has depressed consumption capacity and kept inflation at a low level due to weak domestic demand. In spite of this, the Thai government has carried out several rounds of economic reforms and strengthened its financial system regulations in the aftermath of the Asian financial crisis, with adequate policy space to handle global economic and trade friction as well as to stimulate investment and domestic consumption. Another factor is Thailand's steady economic growth, which has kept its unemployment rate at around 1% in recent years, the lowest in ASEAN. However, this has been accompanied by a slight increase in labour costs, reducing its overall competitiveness compared with its neighbours, Laos and Cambodia. It is worth noting that in recent years, the Thai government has placed greater emphasis on research and development and investment in advanced technologies; it has also strengthened policy incentives for the digital economy and high-end manufacturing and services, which may attractive more foreign investment.

► Singapore

As a major shipping hub in Asia and an international financial centre, Singapore has overtaken the US as the world's most sustainably competitive country in the 2019 Global Competitiveness Report. Singapore is among the best in the world in infrastructure development and maintenance of the labour market, and it is the world's most open economy. Singapore's economy is centred around industry and services due to its particular geographical location, with services accounting for as much as 70% of its GDP. The computer and electronic equipment, and chemical and biopharmaceutical manufacturing industries are also pillar industries. As of 2019, its GDP was USD 372.2 billion and its per capita GDP was USD 65,000, among the highest in the world. Its strong international competitiveness has attracted a great deal of foreign investment, averaging about 22% of its GDP over the past five years, primarily in the following industries: financial and insurance, wholesale trade of goods, and scientific research and technology services. Singapore has also been strengthening its R&D and innovation infrastructure in recent years, with R&D investment rising YOY, primarily in engineering and biomedical science research. We predict that this favourable business environment will continue to help Singapore attract foreign investment and gradually develop into a global innovation hub.

► Malaysia

Malaysia's economy has maintained steady growth in recent years, with an average GDP growth rate of about 5% over the past five years. Unemployment, inflation levels and trade surpluses have all remained within a moderate range. Relatively stable development has also led to a modest increase in per capita GDP, reaching about USD 11,000 in the last two years. Malaysia is an export-oriented country, with total exports of goods and services accounting for about 65% of its GDP. Although Malaysia's exports plummeted in 2020Q1 due to the novel coronavirus pandemic, its relatively high per capita income levels will support domestic consumption to a certain extent. In addition, Malaysia's policy on interest rates has undergone three significant adjustments this year, with the target rate falling to 1.75%, but there is still plenty of policy space to balance internal and external risks.

Malaysia ranks second only to Singapore within the ASEAN in terms of global competitiveness, with an average foreign investment of about 3.1% of its GDP over the past five years. This is significantly higher than the regional economies of Indonesia, Thailand and the Philippines. Relatively concise laws, regulations and rules are also an advantage. With regard to infrastructure, its long coastline has raised the level of its maritime transport, but inland roads still need to be developed. As in other countries, Malaysia has identified high-tech manufacturing and services as strategic industries that it has been continuing to promote, and it ranks among the best in the world in terms of the quality of its workforce and the level of its technology. We believe that more foreign investment will be attracted as the Malaysian market becomes increasingly open.

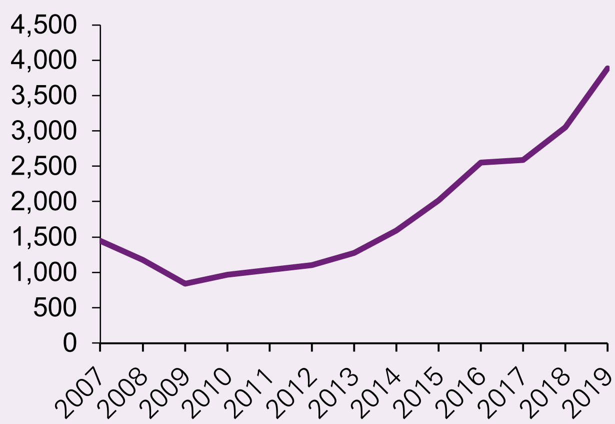
► The Philippines

The Philippines has maintained a relatively fast economic growth rate in recent years, averaging 6.3% over the past decade, with the service industry, focused around tourism, becoming the mainstay of the country's economy. The frequent occurrence of natural disasters in recent years exacerbated by climate change has also accelerated the national economy's structural transformation, with primary industries' share of GDP falling from 14% to 7.7% over the past 20 years while the service sector's share of GDP has risen from 50% to 58%. It is worth noting that the Philippines has the highest Gini coefficient among the ASEAN countries, reflecting a significant wealth gap issue. In addition, the Philippines is export-oriented, similar to Malaysia, with total exports of goods and services accounting for about 60% of its GDP. China has become the Philippines' number one trading partner since 2016 as well as its primary source of imports. Looking at the long term, a large population, a suitable demographic structure and a high-level workforce are the Philippines' major advantages for attracting foreign investment. The government will continue to increase investment in infrastructure to attract foreign investment and create a favourable business environment in order to spur faster economic growth.

► Vietnam

Vietnam ranked 67th out of 141 economies in the world in the latest Global Competitiveness Report, up 10 places from 2018, making it the economy with the largest improvement in the world. Specifically, the emphasis on vocational workforce training, the improvement of transportation facilities, the increase in the efficiency of government processes and the gradual increase in market openness have all contributed to Vietnam's continually growing competitiveness. In recent years, Vietnam's economic structure has gradually shifted from agriculture (8%) to industry and services (92%). Due to economic and trade frictions between the US and China, large multinational groups and SMEs from developed economies have been gradually expanding their business, shifting it to Vietnam. The number of foreign investment projects in Vietnam has increased rapidly, with the average FDI reaching 6% of the GDP over the past five years. The country's economy has also remained in a high growth phase of around 7%, and despite the severe impact of the novel coronavirus on global growth, Vietnam's growth rate has remained steady at 2.7% through 2020, one of the few economies in the world to maintain positive growth, according to the IMF's World Economic Outlook report released in April. In addition, a fairly suitable demographic structure, low labour costs, a unique geographic location and a political environment that supports stable economic growth will all continue to help Vietnam attract foreign investment and promote rapid economic development.

Figure 50: Number of FDI projects in Vietnam



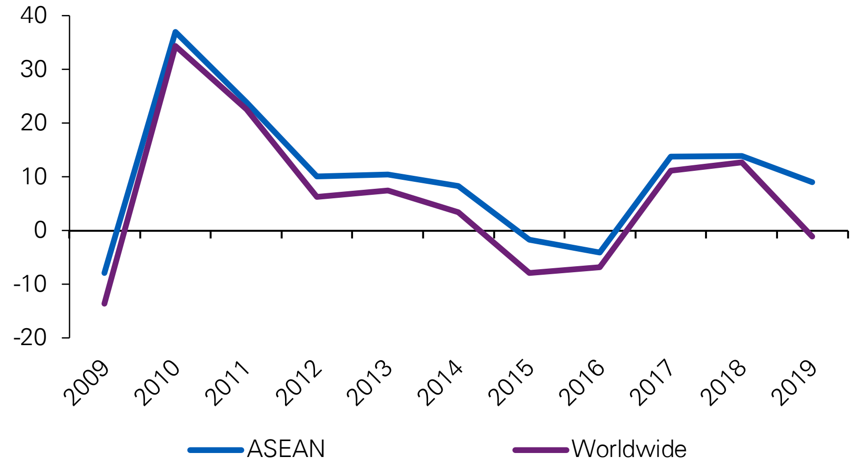
Source: Wind, KPMG analysis.

Trade, investment, merger and acquisition between China and ASEAN

Trade

In November 2001, China and the ASEAN countries announced the establishment of the China-ASEAN Free Trade Area in Brunei. Nearly 20 years on, over 90% of goods from both sides have achieved zero tariffs within the framework of the China-ASEAN Free Trade Area. In 2019, China's total trade in goods with the major ASEAN economies[16] reached RMB 620 billion, an increase of about 11 times since 2002, with an average growth rate of 6% over the past five years and accounting for 14% of China's total trade volume, up from 9% in 2002. In spite of the impact of the pandemic, China's total imports and exports with ASEAN reached USD 242.4 billion in the first five months of this year, accounting for 14.7% of the total value of China's foreign trade. The YOY growth rate for these imports and exports is higher than the overall growth rate of China's foreign trade for the same period. ASEAN has also surpassed the EU to become China’s largest trading partner, and China has been ASEAN's largest trading partner for 10 consecutive years.

Figure 51: Growth of China's trade in goods exports and imports, %



Source: Wind, KPMG analysis.

Vietnam is China's largest trading partner in Southeast Asia, followed by Malaysia, Thailand and Singapore. The primary trade goods relate to electronics, mineral products, metals and their products, raw textiles and their products, as well as plastic and rubber and their products.

[16]Asean major economies include Indonesia, Thailand, Singapore, Malaysia, the Philippines, Vietnam, Myanmar.

Table 3: Type and share of goods traded between China and ASEAN (2019)

Country	Total Imports (billion USD)	Type of Goods (Top 3)	Total Exports (billion USD)	Type of Goods (Top 3)
ASEAN Total	271.1	Electrical, electronic, AV equipment and parts thereof (39%) Fossil fuels, mineral oils and their products, bitumen, etc. (12%) Nuclear reactors, boilers, machinery, instruments and parts thereof (10%)	349.0	Electrical, electronic, AV equipment and parts thereof (25%) Nuclear reactors, boilers, machinery, instruments and parts thereof (14%) Fossil fuels, mineral oils and their products, bitumen, etc. (5%)
Indonesia	34.1	Fossil fuels, mineral oils and their products, bitumen, etc. (29%) Animal and vegetable oils, fats and waxes, refined edible fats and oils (12%) Ore, slag and ash (10%)	45.6	Electrical, electronic, AV equipment and parts thereof (19%) Nuclear reactors, boilers, machinery, instruments and parts thereof (19%) Iron and steel (4%)
Thailand	46.1	Nuclear reactors, boilers, machinery, instruments and parts thereof (24%) Electrical, electronic, AV equipment and parts thereof (19%) Rubber and its products (9%)	45.6	Electrical, electronic, AV equipment and parts thereof (21%) Nuclear reactors, boilers, machinery, instruments and parts thereof (18%) Iron and steel (5%)
Singapore	35.2	Electrical, electronic, AV equipment and parts thereof (29%) Jewellery, precious metals and their products, imitation jewellery, hard currency (14%) Nuclear reactors, boilers, machinery, instruments and parts thereof (11%)	54.7	Electrical, electronic, AV equipment and parts thereof (25%) Fossil fuels, mineral oils and their products, bitumen, etc. (16%) Nuclear reactors, boilers, machinery, instruments and parts thereof (16%)
Malaysia	71.8	Electrical, electronic, AV equipment and parts thereof (54%) Fossil fuels, mineral oils and their products, bitumen, etc. (19%) Nuclear reactors, boilers, machinery, instruments and parts thereof (5%)	52.1	Electrical, electronic, AV equipment and parts thereof (27%) Nuclear reactors, boilers, machinery, instruments and parts thereof (12%) Furniture, bedding, lamps, mobile homes (5%)
Philippines	20.2	Electrical, electronic, AV equipment and parts thereof (52%) Nuclear reactors, boilers, machinery, instruments and parts thereof (21%) Ore, slag and ash (9%)	40.8	Electrical, electronic, AV equipment and parts thereof (19%) Nuclear reactors, boilers, machinery, instruments and parts thereof (9%) Fossil fuels, mineral oils and their products, bitumen, etc. (9%)
Vietnam	57.3	Electrical, electronic, AV equipment and parts thereof (62%) Shoes, boots, leggings and similar articles and parts thereof (4.5%) Cotton (4.2%)	97.9	Electrical, electronic, AV equipment and parts thereof (31%) Nuclear reactors, boilers, machinery, instruments and parts thereof (11%) Plastic and its products (4%)
Myanmar	6.4	Fossil fuels, mineral oils and their products, bitumen, etc. (28%) Special traded goods and unclassified goods (22%) Ore, slag and ash (15%)	12.3	Electrical, electronic, AV equipment and parts thereof (14%) Nuclear reactors, boilers, machinery, instruments and parts thereof (10%) Iron and steel (7%)
Brunei	0.3	Fossil fuels, mineral oils and their products, bitumen, etc. (50%) Organic chemicals (49%) Wood pulp and other fibrous cellulose pulp, waste paper and cardboard (1%)	1.6	Nuclear reactors, boilers, machinery, instruments and parts thereof (34%) Iron and steel products (26%) Electrical, electronic, AV equipment and parts thereof (8%)
Laos	2.0	Ore, slag and ash (31%) Special traded goods and unclassified goods (20%) Wood and wood products, charcoal (11%)	1.5	Nuclear reactors, boilers, machinery, instruments and parts thereof (23%) Electrical, electronic, AV equipment and parts thereof (19%) Iron and steel products (9%)
Cambodia	1.4	Knitted or crocheted clothing and clothing accessories (21%) Fur, artificial fur and its products (16%) Copper and its products (10%)	6.0	Knitted or crocheted clothing and clothing accessories (26%) Cotton (10%) Nuclear reactors, boilers, machinery, instruments and parts thereof (8%)

Note: Types of goods are coded by two-digit HS classification; data for Brunei, Laos and Cambodia are from 2018.
Source: Wind, UNCTAD, KPMG analysis

In terms of the structure of trade in goods, as an important production base for the global electronics industry within the Asia-Pacific region, electromechanical products are the main commodities traded between China and ASEAN countries, accounting for 42% of the total value of bilateral foreign trade. In 2020Q1, China imported RMB 105.65 billion of integrated circuits from ASEAN, an increase of 25.8%, and it exported RMB 42.75 billion of integrated circuits to ASEAN, an increase of 28%.

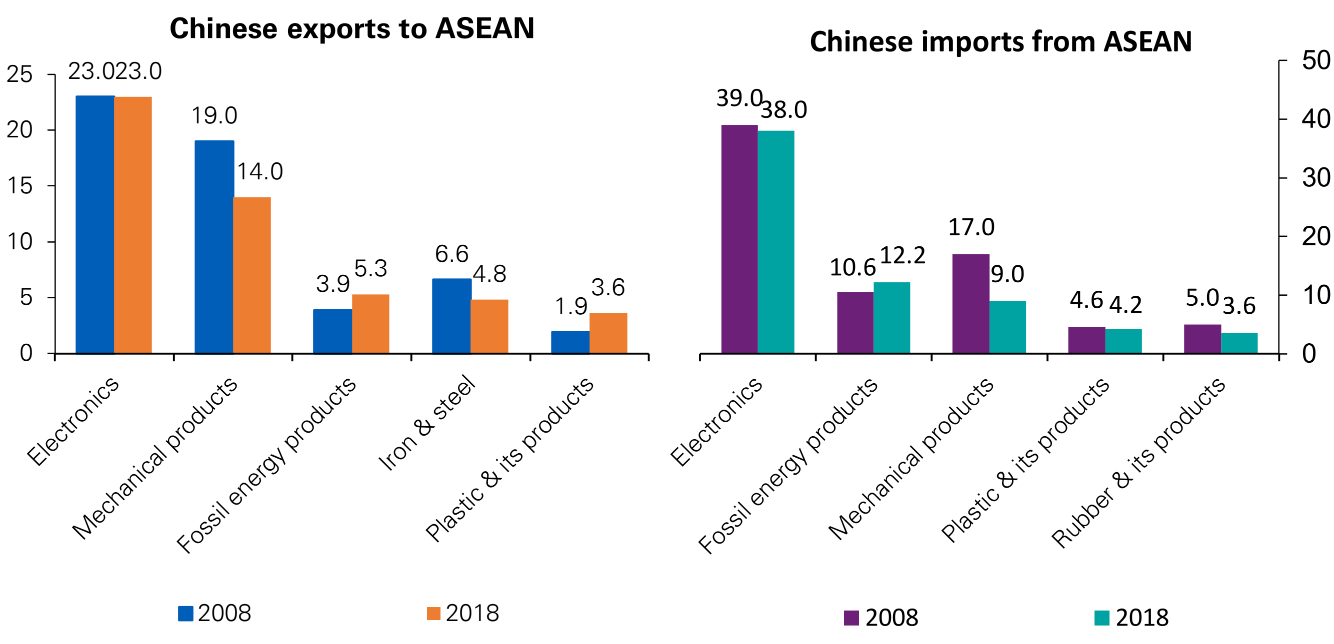
Compared with the early years, when China mainly imported product components from ASEAN, China's exports of mechanical and electrical products to ASEAN countries in recent years have grown rapidly, essentially reaching a balance. The average growth rate of imports and exports has been more than 10% over the last 10 years, and is an important industry for driving the growth of China's trade with ASEAN. As ASEAN countries focus more on computer electronics, the digital economy and other high-tech industries, the electromechanical industry chain will become increasingly integrated within the Asia-Pacific region. China acts as the industrial chain hub; demand for components from the above regions and the supply of the relevant finished products will also continue to grow.

Due to the rapid development of the manufacturing industry, China's strong demand for industrial raw materials has also expanded imports of raw materials such as oil, coal and natural rubber from Indonesia, Malaysia, Singapore and other countries, while mineral energy and chemical products also occupy a significant share of China-ASEAN bilateral trade.

Over the past decade, the stimulus effect of China's increasing scale of foreign investment has increasingly become apparent. As China’s industry has gradually formed certain advantages in production capacity, Chinese enterprises have also begun to make use of their own advanced technology and standards to expand international cooperation and achieve complementary production capacity. For example, by taking advantage of the abundant raw materials and low-cost labour in the ASEAN region, China has strengthened investments in manufacturing and processing industries such as textiles and garments, equipment, automobiles and ships, and has helped these countries improve their public infrastructure. In this process, China's exports of steel and other metal products to ASEAN countries have increased, and China has provided a great deal of machinery and equipment required for processing the trade production, and trade in textiles and garments has also seen a large increase in volume.

It is worth noting that at present, the number of confirmed novel coronavirus cases in ASEAN countries ranges from the hundreds to thousands. It is still on the rise in Indonesia, the Philippines and other countries, and the pandemic’s inflection point is still difficult to predict. The resumption of work and production in enterprises, transportation and shipping controls, and other measures in these countries have a definite impact on China's industrial chains.

Figure 52: Changes in structure of China’s trade with ASEAN, %



Note: Types of goods are coded by two-digit HS classification.
Source: Wind, UNCTAD, KPMG analysis

From an upstream perspective, China is more dependent on mechanical and electrical parts produced in ASEAN, with China's imports of such products from seven ASEAN countries accounting for about 19% of global imports. Aside from mechanical and electrical products, China also imports large amounts of (a) plastic, rubber and cotton, and (b) chemical fibres and other raw textiles from Southeast Asia, accounting for 22% and 21% of the global import share, respectively. It should be noted that Southeast Asia is the world's main production base for natural rubber, and so, out of total global imports, the proportion of China's imports of rubber and its products from this region is 52%, indicating a high degree of dependence.

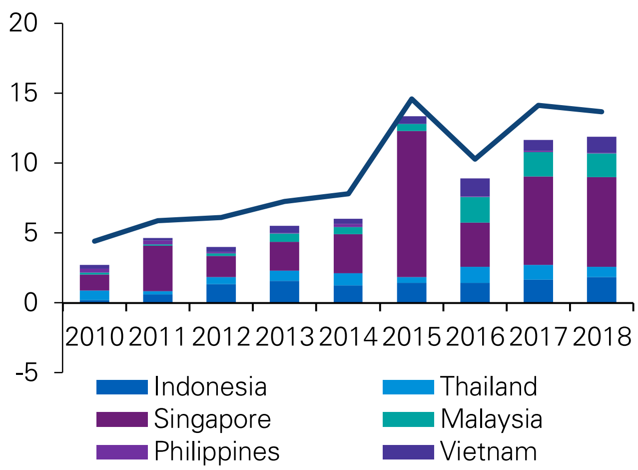
From a downstream perspective, as a result of development in infrastructure construction, ASEAN has gradually become the main export market for China's mineral and metal products, with these two product types accounting for a larger share of China's total foreign trade value, at 36% and 19%, respectively. In the face of the new normal since the pandemic, China must continue to strengthen cooperation with neighbouring countries in the fight against the pandemic, mitigate its negative impact on people's livelihoods and on the economy and society, as well as strive to guarantee smooth supply chains and maintain the stability of the regional industrial chains.

Investment

In 2019, China's actual FDI was USD 138.1 billion with ASEAN countries accounting for about 5.8%. Among them, Singapore ranked second for China's FDI sources, only after Hong Kong SAR. It is also the largest among ASEAN countries in terms of actual direct investment in China, at USD 7.6 billion in 2019. From January to May 2020, China's actual FDI totalled USD 51.21 billion, a 6.2% YOY decrease, while investment from the ASEAN was USD 3 billion, a 10.1% YOY increase. Overall, with China's Foreign Investment Law coming into force this year, the continually shrinking negative lists for foreign investment access and the ongoing optimisation of the business environment, China will remain a major destination for ASEAN outbound investment.

As for foreign investment, China's outward FDI flows rose rapidly from USD 2.85 billion in 2003 to USD 196.2 billion in 2016, before declining to USD 117.1 billion in 2019. According to a report by UNCTAD[17], in 2019, China's outward FDI stock amounted to USD 2.1 trillion, accounting for 6% of the total global stock and rising from 25th to 3rd place. China has now become a major driver of global cross-border FDI growth. At the same time, China's investment flows to the ASEAN also increased from USD 120 million (4%) in 2003 to USD 13.7 billion (10%) in 2018, making it the third largest source of FDI in ASEAN. As of 2018, the country's total investment stock in ASEAN was USD 102.8 billion (5.2%), ranking second only to Hong Kong SAR, and higher than the EU and the US.

Figure 53: China's direct investment flows in major ASEAN economies, USD billions



Source: Wind, KPMG analysis.

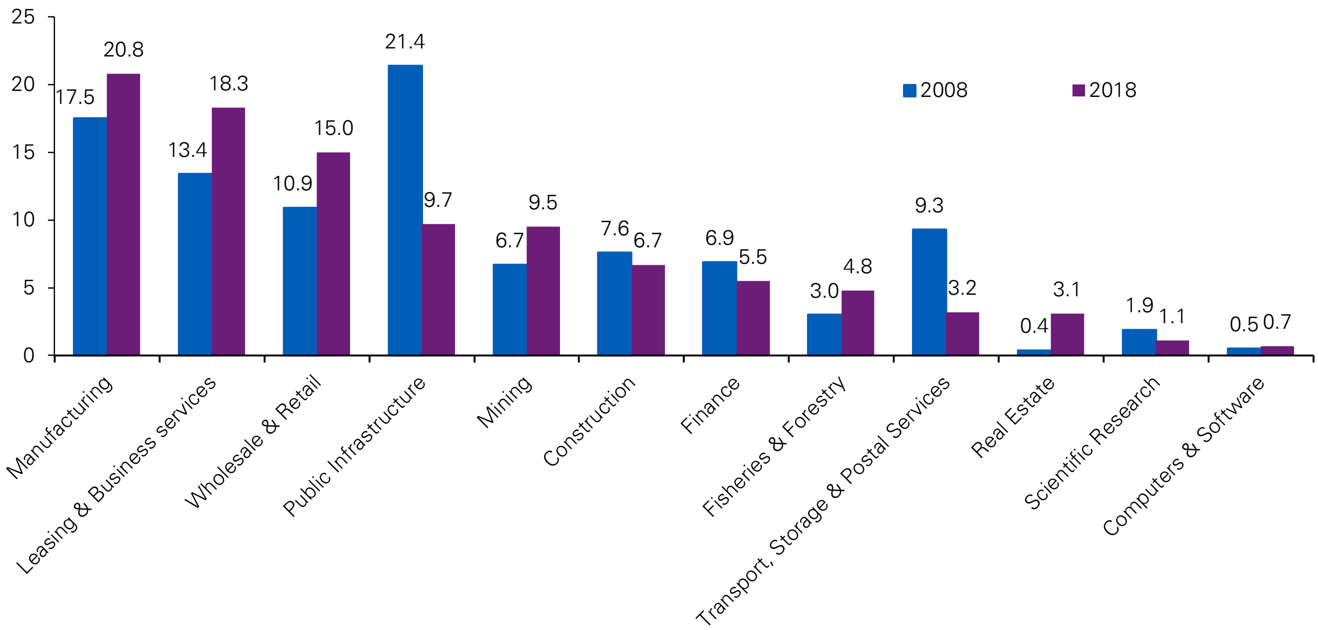
The structure of Chinese investments in ASEAN is also undergoing changes. Infrastructure, which previously dominated China's investment in ASEAN, has been replaced by manufacturing as the major focus of Chinese investment in recent years.. Abundant production materials and relatively low labour costs have attracted Chinese investment in ASEAN's manufacturing industry, rising from 17.5% in 2008 to 20.8% in 2018, an increase of 3.3 percentage points. Leasing and business services and wholesale and retail trade are two other key areas of China's investment in ASEAN, with its investment stock accounting for 18.3% and 15.0%, respectively, in 2018. The largest increase in the share of Chinese investment in ASEAN was in the real estate sector, with the 2018 stock 128 times greater than the 2008 stock. In addition, as a number of ASEAN economies have strengthened their focus on the development of high-tech industries in recent years, and along with a tendency toward preferential policies for investment in areas such as taxation, China's foreign investment in information transmission, computer services and software industries has in turn grown fairly rapidly.

.

[17] *Global Investment Report 2020*, UNCTAD, June 2020 .https://unctad.org/en/PublicationsLibrary/wir2020_en.pdf

However, the share of Chinese investment in ASEAN in public infrastructure, transport, warehousing and postal services has declined over the past decade. The share of public infrastructure investment out of its total investment decreased from 21.4% in 2008 to 9.7% in 2018.

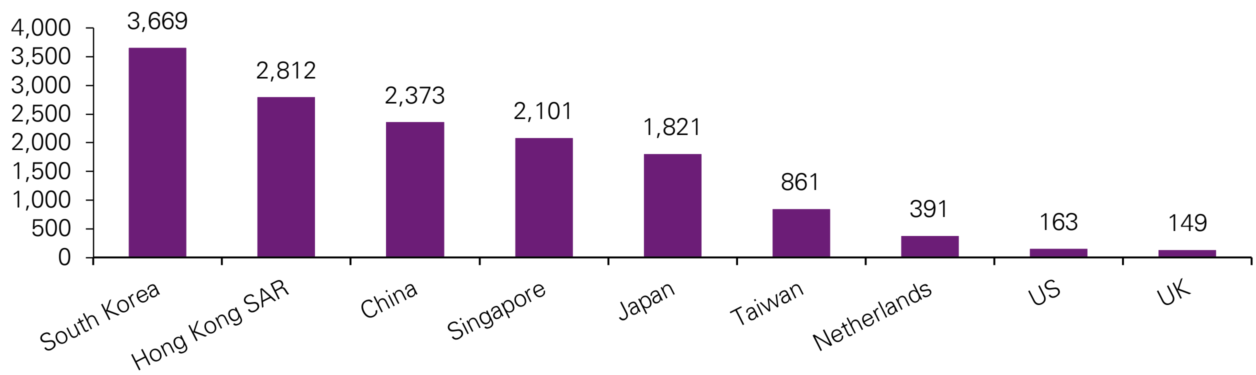
Figure 54: Structure of China's investments in ASEAN, percentage of stock, %



Source: 2018 Statistical Bulletin of China's Outward Foreign Direct Investment, KPMG analysis

- **Vietnam:** Vietnam's FDI volume has risen rapidly as the country has accelerated its opening up and as a result of the impact of US-China economic and trade frictions, reaching a record high of USD 16 billion in 2019. China's investment in Vietnam has also seen a rapid increase. According to Vietnam's Bureau of Statistics, registered capital with a Chinese source in Vietnam was USD 2.37 billion (14%) in 2019, making it Vietnam's main source of FDI. Sectors such as manufacturing, real estate, public infrastructure, accommodation and catering are the main areas for foreign investment in Vietnam.

Figure 55: Major global economies' registered capital in Vietnam in 2019, USD million



Source: Wind, KPMG analysis.

- **Thailand:** The Eastern Economic Corridor (EEC) proposed by the Thai government anticipates that eastern Thailand will be transformed into a world-class economic centre, trade and investment centre, and transportation and logistics hub through strong developments in infrastructure and the implementation of a series of major investment incentives to attract new industries. This plan is also now changing the structure of China's investment in Thailand, shifting from manufacturing to the digital economy. For example, Alibaba has invested THB 11 billion in the Eastern Economic Corridor (EEC) to build "a smart digital hub for the five countries, Cambodia, Laos, Myanmar, Vietnam and Thailand," and Huawei is expected to invest USD 10 million to construct the largest cloud data centre in Southeast Asia.

- **Singapore:** As the investment hub of Southeast Asia, China's direct investment in Singapore rose from USD 20 million in 2005 to USD 6.41 billion in 2018, accounting for 47% of China's total investment in ASEAN and making it the fifth largest destination for China's foreign investment. Making use of Singapore's strategic, central geographical location and its advantage as an international financial centre, in recent years China has also been expanding its investments in wholesale and retail trade, in leasing and business services (with investment holdings as the primary purpose), and in financial services.

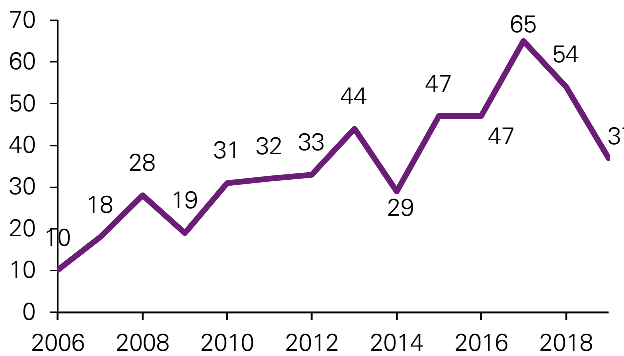
- Chinese investment in **Indonesia, Malaysia, Laos** and other countries is also growing rapidly. Chinese investment accounts for 80% of all FDI in Laos. Investments in these countries are currently dominated by the industries of manufacturing, and electricity/heat/gas and water production and supply. According to the Malaysian Investment Development Authority, Chinese mainland invested RMB 15.7 billion in Malaysia in 2019, second only to the US and ahead of Japan; China became the largest source of investment in the manufacturing sector for the fourth consecutive year with RMB 15.3 billion in 2019.

In the post-pandemic era, as developed economies such as the US and Europe fall into recession, global trade and investment will come to a phase of deceleration and industrial chains will be reshaped to further cluster within regions. Economic and trade relations between China and the US will also remain uncertain for the long term. China will make full use of the advantages of neighbouring countries and utilise the advantageous factors of Southeast Asian countries, strengthening the complementarity of industries between the two regions and promoting the long-term and steady cooperative development of the regional industrial chain by expanding the scale of investment and using investment to lead trade.

Mergers and acquisitions

In recent years, China's M&A endeavours have been expanding in the ASEAN region; as many as 524 deals involving a wide variety of industries were completed between 2000 and 2019. As Chinese enterprises continue the process of "going global," they are not only expanding their own businesses but also making contributions to building up local economies, including providing jobs, training technical workers, participating in the construction of local infrastructure, and more.

Figure 56: Number of Chinese M&As in ASEAN

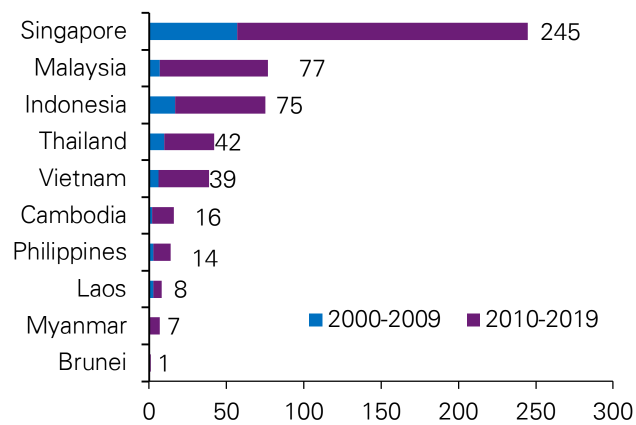


Source: Dealogic, KPMG analysis

With its mature environment for M&A, Singapore has become a major destination for Chinese enterprises to "go global," with more such projects completed in the past two decades than in Malaysia, Indonesia, Thailand, Vietnam and the Philippines combined. Prior to 2010, Chinese enterprises were involved in 57 new M&A projects, primarily in sectors such as public infrastructure. Chinese enterprises were "going global" at an accelerated pace between 2010 and 2019, as the nation grew steadily stronger and a massive industrial scale was created in some industries. During this period, Chinese enterprises completed a total of 188 M&A transactions in Singapore, and the industrial investment mix has also undergone some change, shifting toward computer electronics, real estate, transportation, and medical and health industries.

Over the past decade, as many ASEAN economies have been increasing their focus on high-tech industries, Chinese enterprises have taken the opportunity to accelerate their expansion in Southeast Asia. The number and dollar value of completed M&A projects are among the highest in the industry. At present, the global electronics industry chain has gradually formed a pattern with China as the hub and the Asia-Pacific region as the core, and the computer and electronics industry is becoming a mainstay of the ASEAN economy, helping it build the industrial internet and drive the digital transformation and upgrading of the manufacturing industry. For example, in 2016, Alibaba announced the acquisition of Lazada, the largest online shopping site in Southeast Asia, based in Singapore, and established the world's first digital free trade zone (eWTP) in Malaysia to help transform Southeast Asia's digital economy by building infrastructure and innovations in logistics, payments, customs clearance and big data[18].

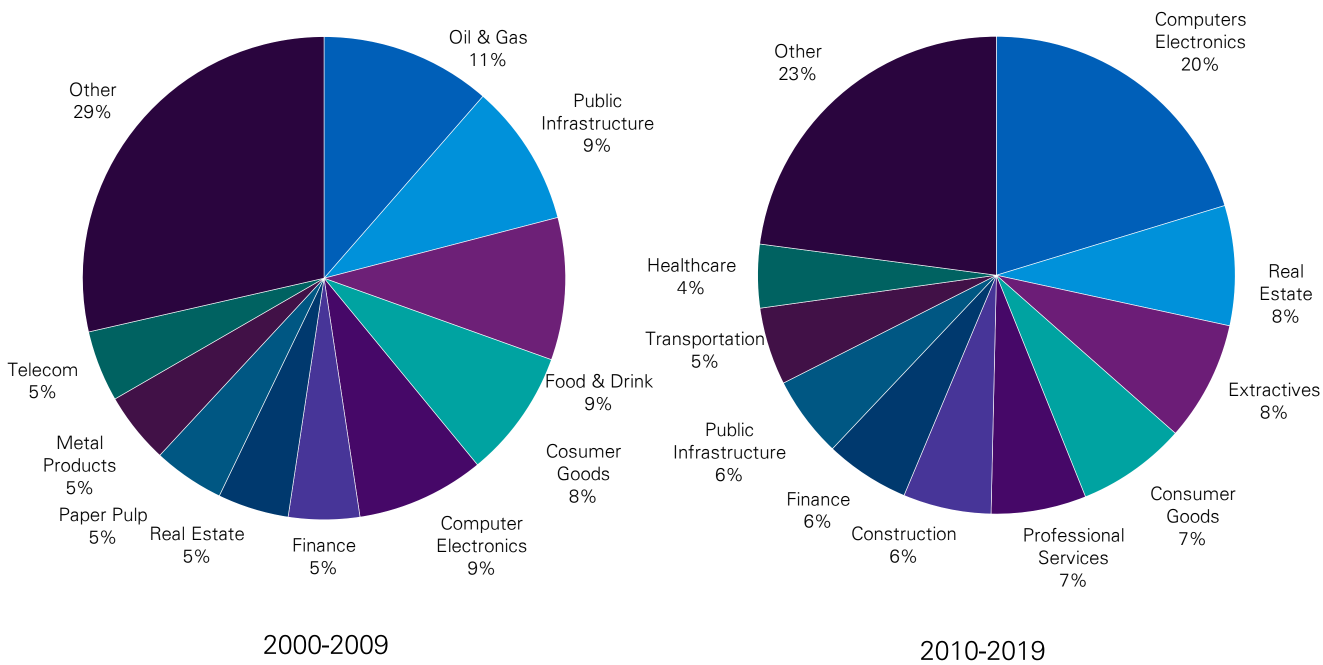
Figure 57: M&A deals by Chinese enterprises in ASEAN



Source: Dealogic, KPMG analysis.

[18]Alibaba acquires a controlling stake in Southeast Asian e-commerce Lazada; the world's first eWTP "test zone" landed in Malaysia Jack Ma once proposed to write into the G20 Bulletin
http://tech.sina.com.cn/i/2016-04-12/doc-ifxrcizu4057136.shtml
http://finance.cnr.cn/gundong/20170322/t20170322_523671769.shtml

Figure 58: Comparison of the industry mix of M&As by Chinese enterprises in the ASEAN



Source: Dealogic, KPMG analysis

It is evident that Chinese enterprises are "going global" at an accelerated pace. But many issues come along with it, including the challenges of "risk, supervision and talent" brought about by unequal information, which tends to force enterprises to stretch in the face of changes and challenges. KPMG has been aiding Chinese enterprises in formulating targeted overseas investment development strategies and detailed landing plans, acting as an escort for enterprises "going global."

Prospects for China-ASEAN economic and trade cooperation

In recent years, China has accelerated regional economic and trade integration and signed a number of economic and trade agreements with ASEAN. This will facilitate an institutional environment conducive to the future growth of investment and trade between the two sides.

The China-ASEAN FTA Upgrading Protocol was formally signed in Malaysia in November 2015 as the outcome of the China-ASEAN FTA upgrading negotiations. Both sides agreed to further promote the optimisation and upgrading of the manufacturing sector as well as the development of trade in goods between the two sides by improving the rules of origin and trade facilitation measures. This also included an agreement to expand the liberalisation of services; promote cooperation to facilitate investments; and create a stable, beneficial and transparent business environment for investors. Both sides also agreed to develop their economic and technical cooperation in more than 10 fields, including agriculture, forestry and fisheries, cross-border e-commerce, information technology, tourism, transportation and intellectual property rights. The agreement first entered into force between China and Vietnam in July 2016 and entered into full force for all members of the agreement in October 2019. This will facilitate the further expansion of investment and trade markets for all parties, promote deeper industrial integration and inject new energy into the economies on both sides.

Additionally, after seven years of negotiations, the Regional Comprehensive Economic Partnership (RCEP) agreement as well as the market access negotiations were finalised in November 2019 and are planned to be signed this year. This was initiated by ASEAN, participated in by five countries — China, Japan, South Korea, Australia and New Zealand — and involving a total of 15 countries. According to 2019 data, the 15 RCEP member countries have a population of 2.3 billion, a GDP of approximately USD 25.5 trillion and exports totalling USD 5.5 trillion, and attract foreign investment flows of approximately USD 360 billion, accounting for about 30% of the global total. The RCEP provides further refinement on the foundation of the various "10+1" free trade agreements, making it the free trade zone with the largest population, the most diverse membership structure and the greatest development potential in the world.

Through the RCEP, the openness for trade goods can reach 90% or higher, which means a variety of tariff and non-tariff barriers will be lifted. This will help enterprises that import raw materials and components from within the region reduce their operating costs, reduce uncertainties and risks, and facilitate the construction of regional supply chains and value chains.

The RCEP's negative list approach to investment entry negotiations and the formation of a unified system of rules will help attract investment. The agreement also incorporates provisions for economic and technical cooperation, including e-commerce, intellectual property rights, policies on competition, government procurement and SMEs. It also grants some transitional arrangements for the least developed countries such as Laos, Myanmar and Cambodia, providing these members states with more favourable conditions so that they could more effectively join in the regional economic integration.

Next year will mark the 30th anniversary of the establishment of the China-ASEAN talks. As ASEAN is one of the key regions in the Belt and Road Initiative, we expect China to further strengthen its economic integration with ASEAN and make full use of ASEAN countries' advantages including geographical placement, labour forces and natural resources, further cooperating in areas such as environmental protection, marine production capacity, smart cities and e-commerce to drive economic development.

Appendix: Key indicators

			2018	2019	2020					
	Indicator	Unit	Annual	Annual	Jan	Feb	Mar	Apr	May	Jun
Economic activity	Nominal GDP	Trillion RMB	91.9	99.1	20.7			25.0		
	Real GDP	% YOY	6.7	6.1	-6.8			3.2		
	Industrial production	% YOY	6.2	5.7	-4.3	-25.9	-1.1	3.9	4.4	4.8
	Industrial profit	% YOY YTD	22.0	-3.3	N/A	-38.3	-36.7	-27.4	-19.3	-12.8
	Retail sales	% YOY	9.0	8.0	N/A	-20.5	-15.8	-7.5	-2.8	-1.8
	Fixed asset investment	% YOY YTD	5.9	5.4	N/A	-24.5	-16.1	-10.3	-6.3	-3.1
	Property starts	% YOY YTD	17.2	8.5	N/A	-44.9	-27.2	-18.4	-12.8	-7.6
	Property sales	% YOY YTD	1.3	-0.1	N/A	-39.9	-26.3	-19.3	-12.3	-8.4
	Land purchases	% YOY YTD	14.2	-11.4	N/A	-29.3	-22.6	-12.0	-8.1	-0.9
	Manufacturing PMI	Index	50.9	49.7	50.0	35.7	52.0	50.8	50.6	50.9
International trade and investments	Exports	% YOY	9.9	0.5	N/A	-17.1	-6.6	3.4	-3.2	0.5
	Imports	% YOY	15.8	-2.7	N/A	-4.0	-1.1	-14.2	-16.6	2.7
	Trade balance	USD billion	350.9	421.4	N/A	-6.9	20.1	45.2	63.0	46.4
	Foreign direct investment (FDI)	USD billion	132.0	138.1	12.7	N/A	N/A	10.1	9.9	16.7
	Outbound direct investment (ODI)	USD billion	120.5	110.6	8.3	7.2	8.7	9.4	8.6	9.3
Financial markets	RMB exchange rate	USD/RMB	6.62	6.90	6.92	6.99	7.01	7.07	7.10	7.09
	RMB real effective exchange rate	Index	122.6	122.0	124.8	126.4	126.2	125.7	123.6	121.7
	Shanghai Composite Index (Period end)	Index	2494	3050	2977	2880	2750	2860	2852	2985
	Money supply (M2)	% YOY	8.1	8.7	8.4	8.8	10.1	11.1	11.1	11.1
	Stock of total social financing (TSF)	% YOY	12.0	10.7	10.7	10.7	11.5	12.0	12.5	12.8
	New TSF	RMB billion	19440	25575	5052	874	5184	3102	3187	3434
	New bank loans	RMB billion	16166	16817	3340	906	2850	1700	1480	1810
	Shibor (overnight)	%	2.48	2.18	1.92	1.64	1.31	1.01	1.25	1.74
Prices	Consumer price index (CPI)	% YOY	2.1	2.9	5.4	5.2	4.3	3.3	2.4	2.5
	Producer price index (PPI)	% YOY	3.5	-0.3	0.1	-0.4	-1.5	-3.1	-3.7	-3.0
	Crude oil (WTI)	USD/barrel	64.9	57.0	57.6	50.6	30.5	16.7	28.7	38.3
	Steel (rebar)	RMB/ ton	4177	3933	3773	3597	3561	3552	3645	3731
	Housing price index (70 cities)	% YOY	7.3	9.7	6.5	5.9	5.4	5.2	4.9	4.9

Source: Wind, KPMG Analysis

Contact Us

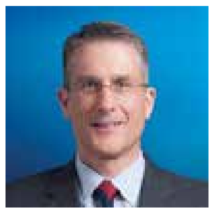
Jacky Zou
Senior Partner, Northern Region
KPMG China
+86 (10) 85087038
jacky.zou@kpmg.com

William Gong
Senior Partner, Eastern & Western Region, KPMG China
+86 (21) 22122999
william.gong@kpmg.com

Ricky Wong
Senior Partner, Southern Region
KPMG China
+86 (20) 38138833
ricky.wong@kpmg.com

Andrew Weir
Senior Partner, Hong Kong
KPMG China
+852 28267243
andrew.weir@kpmg.com

Raymond Ng
Head of Markets
KPMG China
+86 (10) 85087067
raymond.kk.ng@kpmg.com



Thomas Stanley
COO of Markets
KPMG China
+86 (21) 22123884
thomas.stanley@kpmg.com

Kevin Kang
Chief Economist
KPMG China
+86 (10) 85087198
k.kang@kpmg.com

For advisory services related to ASEAN countries，please contact：

Linda Lin
Senior Partner
Deal Advisory
KPMG China
+86 (21) 22123525
linda.l.lin@kpmg.com

Andy Qiu
Partner, Financial Services
KPMG China
+86 (21) 22123572
andy.qiu@kpmg.com

Lisa Li
Partner, Deal Advisory
KPMG China
+86 (10) 85085885
lisa.l.li@kpmg.com

Research team：
Macro and policy analysis: Yuan Zeng, CFA; Wei Wang; Lorna Meng; Abby Zheng; Lychee Fan; Jane Dong (Intern)
Design: Lynne Li

kpmg.com/cn/socialmedia

For a list of KPMG China offices, please scan the QR code or visit our website: https://home.kpmg.com/cn/en/home/about/offices.html.

Publication number: EN-MKT20-0003C

Publication date: October 2020