China Economic Monitor

Issue: 2021Q1

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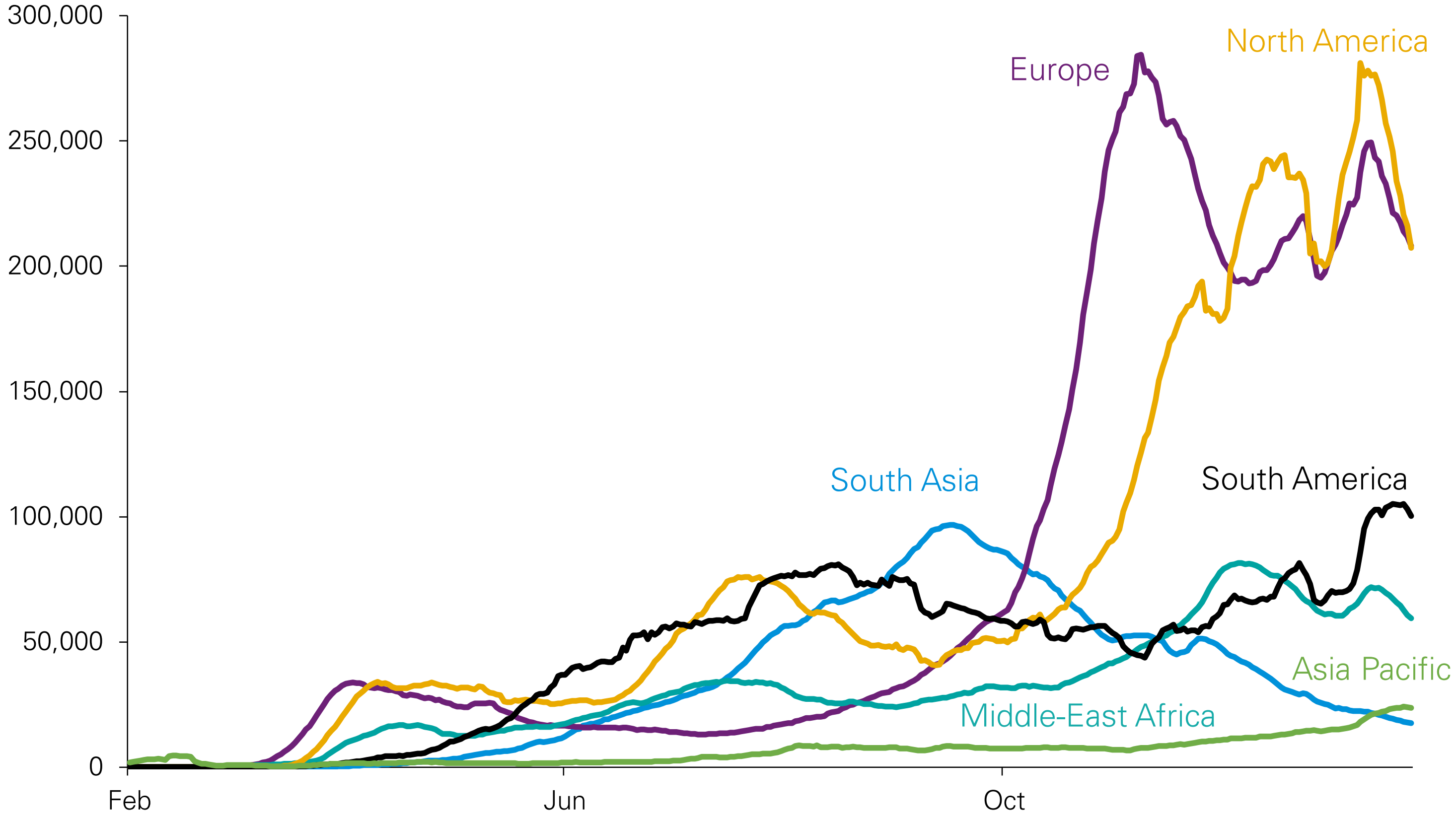
Key takeaways

- China's GDP grew 6.5% year-on-year in Q4, up from 4.9% in Q3 and higher than the market forecast (6.2%). China's economy grew 2.3% in the full year of 2020 and its GDP surpassed the RMB 100 trillion mark for the first time. We expect China's economy to continue its recovery and to grow 8.8% in 2021.
- Q4 economic performance was largely driven by strong industrial production and export growth. Industrial production growth reached 7.3% in December, the highest since April 2019. Driven by strong external demand for medical supplies, electronic products and holiday goods, China's exports grew by 16.7% in Q4, pushing its trade surplus to a record high of USD211 billion.
- Real estate investment grew 7% in 2020, faster than overall investment growth. Looking ahead, the government has reaffirmed its stance to rein in the housing sector. New measures were announced to control developers' debt levels and limit the share of real estate and mortgage loans issued by banks. Real estate investment growth is expected to moderate somewhat in 2021. Meanwhile, manufacturing investment is expected to see continued recovery, driven by rising profits.
- Growth of total social financing, a measure of liquidity provided to the real economy, increased by nearly RMB35 trillion in 2020, exceeding the annual target of RMB30 trillion and RMB10 trillion higher than 2019. Bank loans and government bond issuances were the major drivers for the liquidity expansion. We expect the central bank to keep interest rates and required reserve ratios unchanged in 2021.
- Foreign direct investment (FDI) into China grew 6.2% in 2020, compared to the 42% decline expected for the global FDI. China surpassed the US to become the world's largest FDI recipient last year. Profits of foreign industrial companies in China increased 7% in 2020, higher than that of all industrial enterprises (4.1%).
- As of 22 January, over 60 million doses of COVID-19 vaccines have been administered around the world. The US and China have both administered over 15 million doses. However, the global vaccination rate is still low. A coordinated global effort is still needed to fully contain the pandemic and to reach herd immunity (60%-70%).

COVID-19 is still spreading worldwide

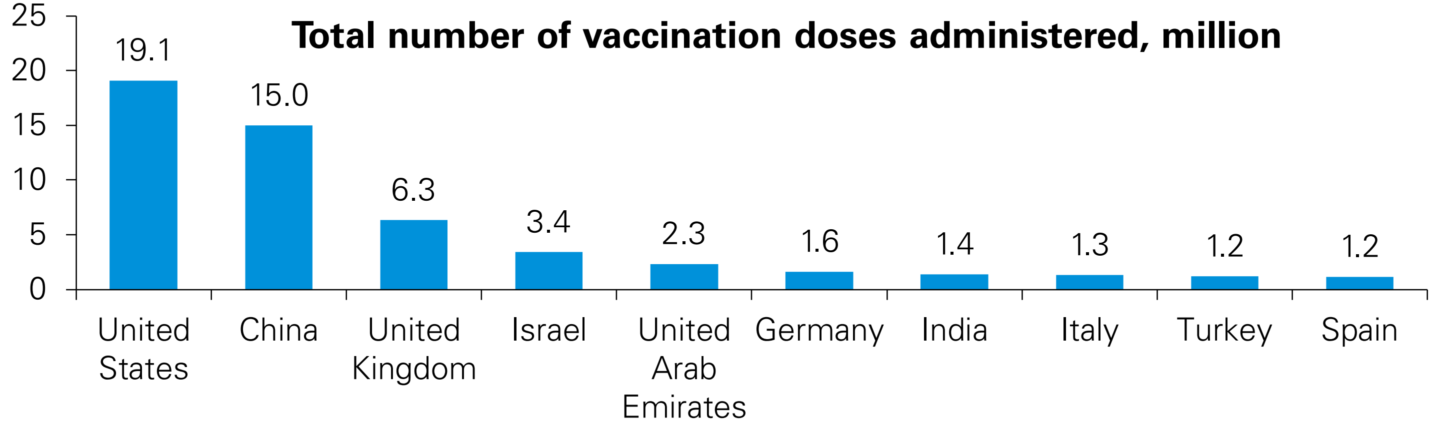
Daily new cases by region, 7-day moving average

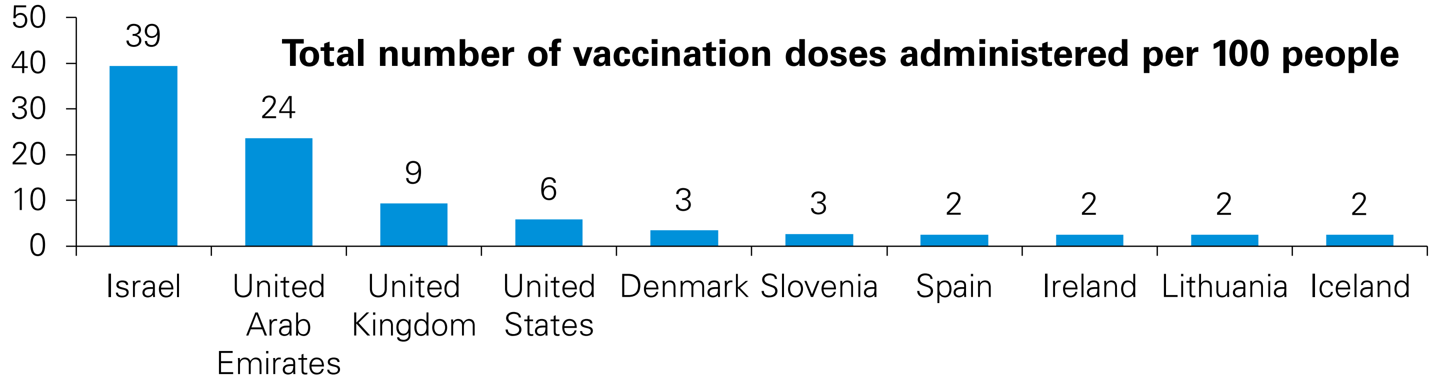


Source: Wind, KPMG analysis. Data through 22 January 2021.

- Global cases totalled nearly 100 million, with over 2 million deaths as of 22 January. 18 countries have recorded more than 1 million cases: 6 advanced economies, and 12 developing countries.
- Average daily new cases in the US exceeded 200,000 in December. Total infections in the US reached 25 million with over 400,000 deaths.
- Europe has seen another wave of resurgence since October and many countries reinforced their quarantine measures.
- The pandemic continues to spread in many developing economies. Total confirmed cases in India have surpassed 10 million, the second highest behind the US, but the number of daily new cases have been moderating.

COVID-19 vaccines are being rolled out around the world



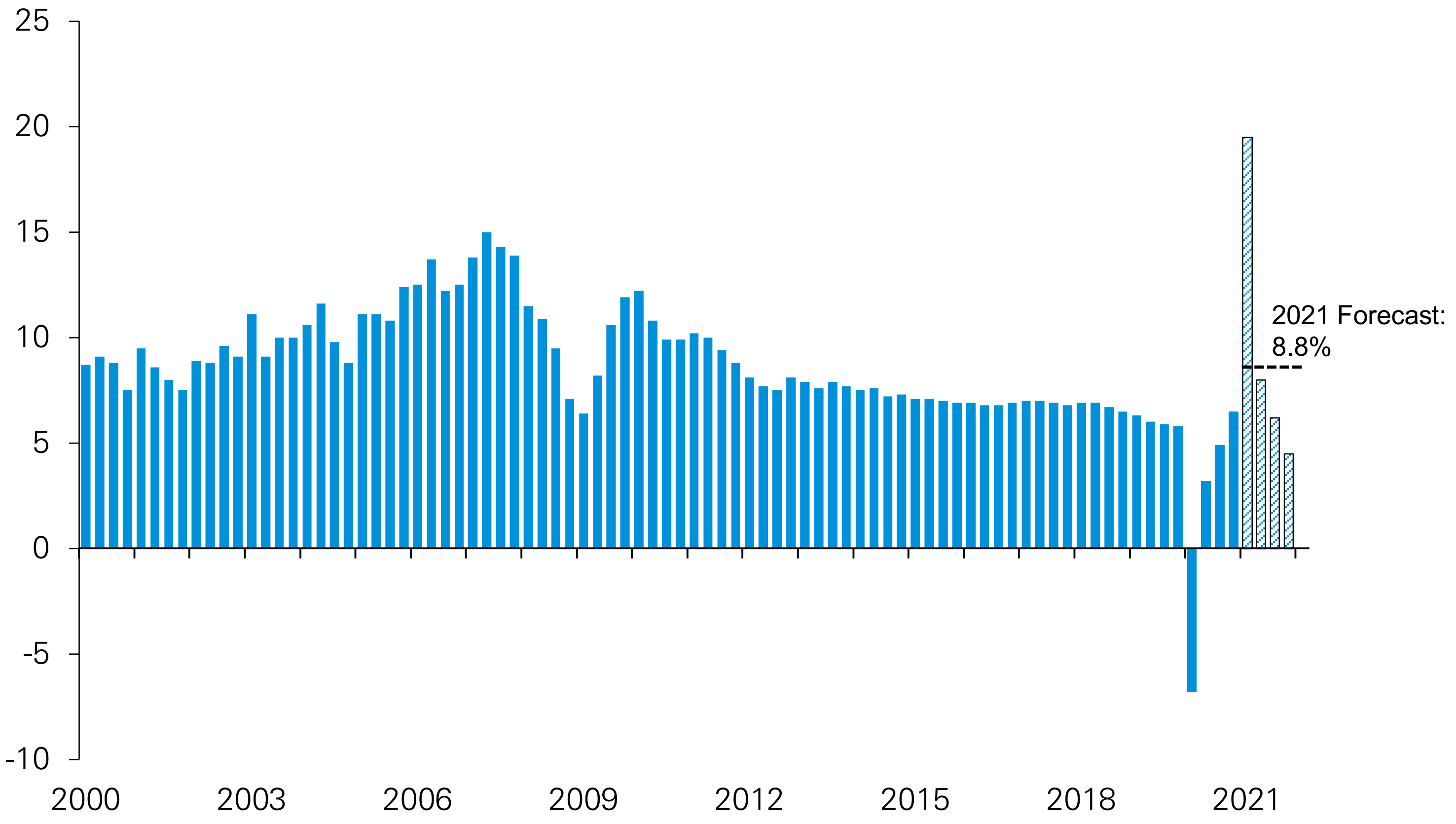


Source: Our World in Data, Data through 22 January 2021. KPMG analysis

- As of 22 January, over 60 million doses of COVID-19 vaccines have been administered around the world. The US and China have both administrated over 15 million doses and the UK has administered 6.3 million doses. The number of administered doses in other countries is still relatively small.
- In terms of the number of vaccination doses administered per 100 people, Israel and the UAE rank top, with administered doses of 39 and 24 per 100 people respectively. China's vaccine administration rate is currently 1.04.
- According to the WHO, there are currently 68 vaccines in clinical trials worldwide, among which 15 (6 in China) are already in the final stage of testing as of Jan 19th.
- Global, coordinated efforts are needed before the vaccination rate reaches the threshold of herd immunity (60%-70%).

China's economy has continued to recover and grew 2.3% in 2020

China real GDP growth rate, year-on-year, %



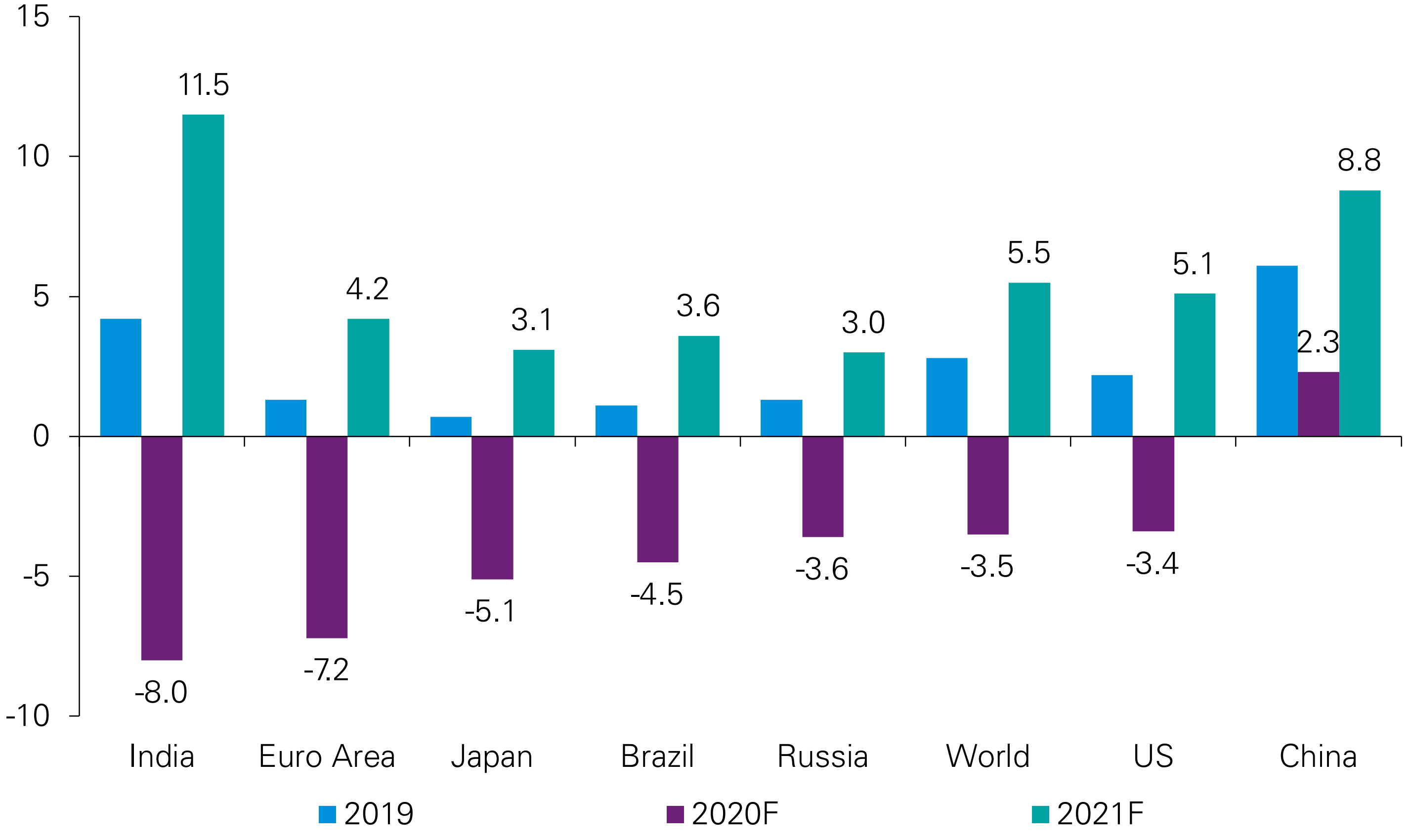
Source: Wind, KPMG analysis

- China's GDP grew 6.5% year-on-year in Q4, up from 4.9% in Q3 and stronger than the market forecast (6.2%). China's economy grew 2.3% in the full year of 2020 and is expected to be the only major economy to achieve positive growth last year. China's economy surpassed the RMB 100 trillion mark for the first time.

- Q4 GDP growth was mostly attributed to the continuous recovery of industrial production, which was driven up by exports and industrial profits. Growth of the secondary industry (manufacturing, construction and mining) climbed to 6.8% in Q4. The service sector also grew 6.7% in Q4, supported by strong activity in the financial, real estate and information technology sectors.

- We expect China's economy to continue to recover and to grow 8.8% in 2021.

China is expected to be the only major economy with positive growth in 2020

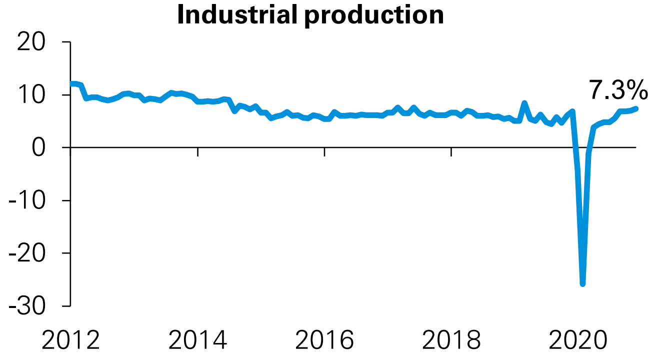


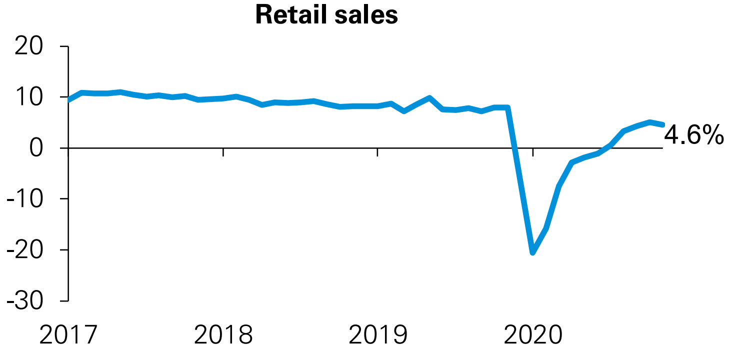
Source: IMF, KPMG analysis. For China, 2020 is actual growth rate and 2021 is KPMG forecast.

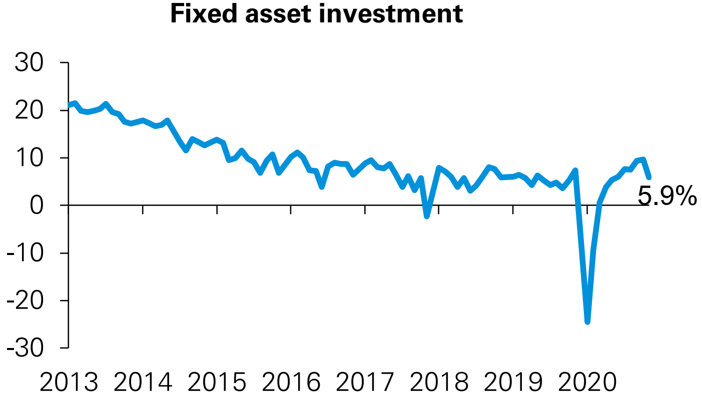
- In IMF's January update, it revised up its 2020 global GDP forecast from -4.4% to -3.5%, reflecting stronger-than-expected momentum in the second half of 2020
- However, as the pandemic continued to spread and new variants occurred, the recovery will likely be lengthy, uneven, and uncertain. The GDP of the advanced economies is projected to fall 4.9% in 2020 and grow by 4.3% in 2021. Developing economies are expected to fall 2.4% in 2020 and rebound by 6.3% in 2021.
- Based on IMF's global forecast, China is expected to be the only major economy to show positive economic growth in 2020.

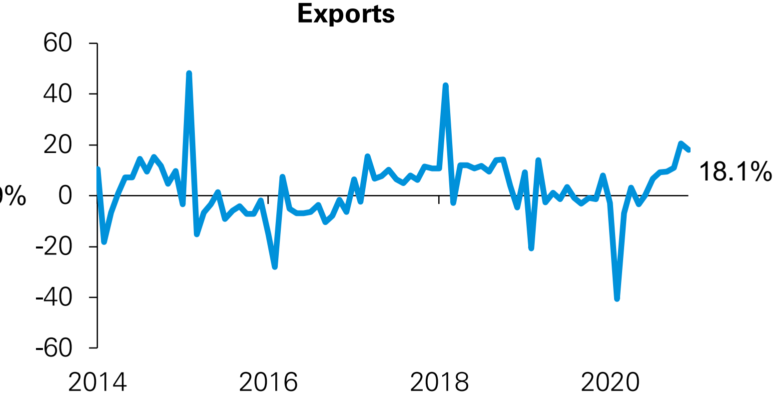
Key indicators show broad-based recovery, led by industrial production and exports

Year-over-year, %







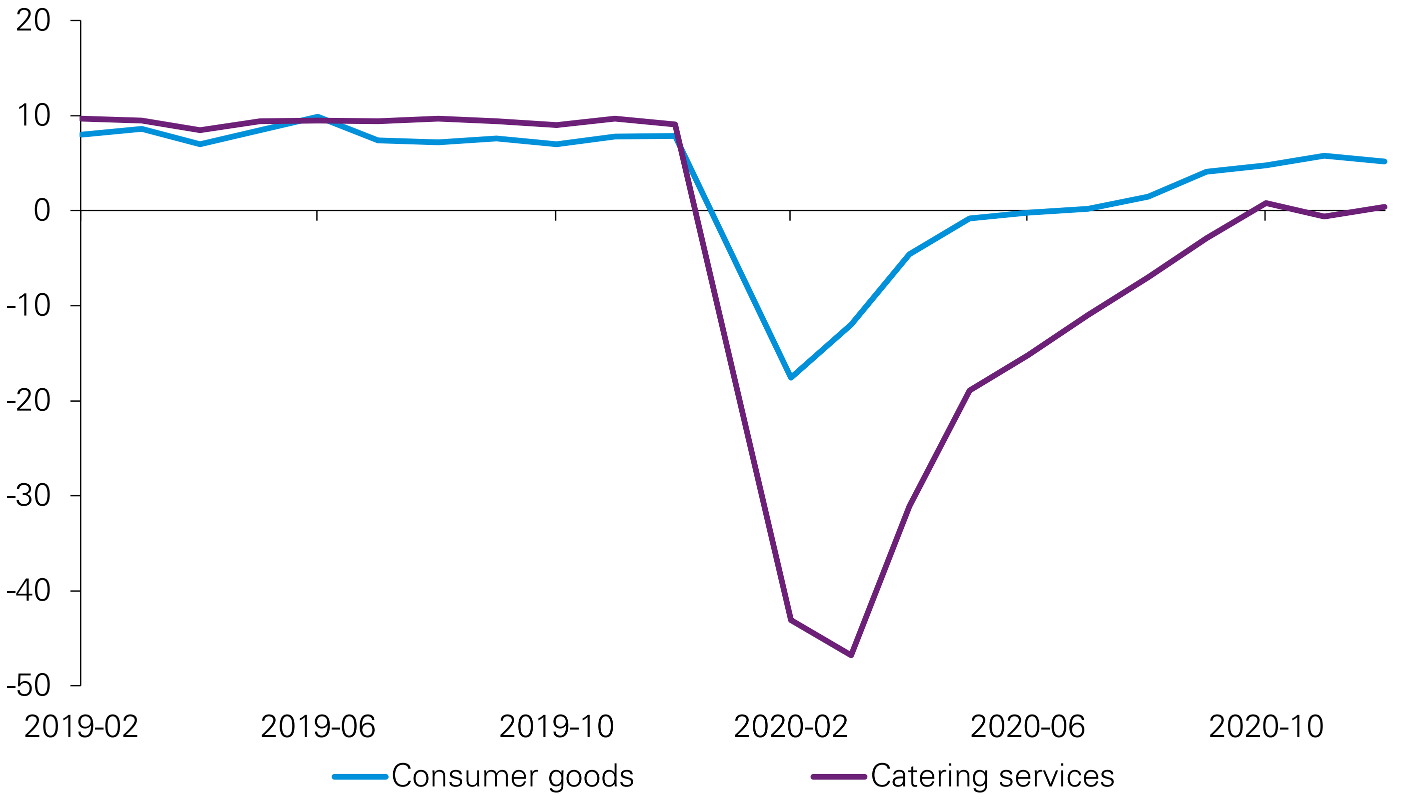


Source: Wind, KPMG analysis. Data through December 2020.

- Industrial production growth improved to 7.3% in December, the highest since April 2019. The Mining and Utilities sectors are also showing good growth on higher commodity prices and heating demand, thanks to cold weather.
- Investment continued to improve mainly on strong manufacturing investment, while infrastructure and real estate investment softened in Q4.
- As the labour market has continued to improve and household disposable income growth has rebounded to 2.1%, retail sales growth recovered from 0.9% in Q3 to 4.6% in Q4. However, new COVID-19 cases in some parts of North China re-triggered quarantine measures, affecting consumption recovery around the Chinese New Year holiday season.
- Q4 exports continued to accelerate with strong consumption demand from advanced economies for medical supplies, electronic products and holiday goods. Import growth also picked up to 6.5% in December.

Service consumption is improving but the pace of recovery is still lagging

Growth of retail sales & catering sales, monthly year-on-year, %

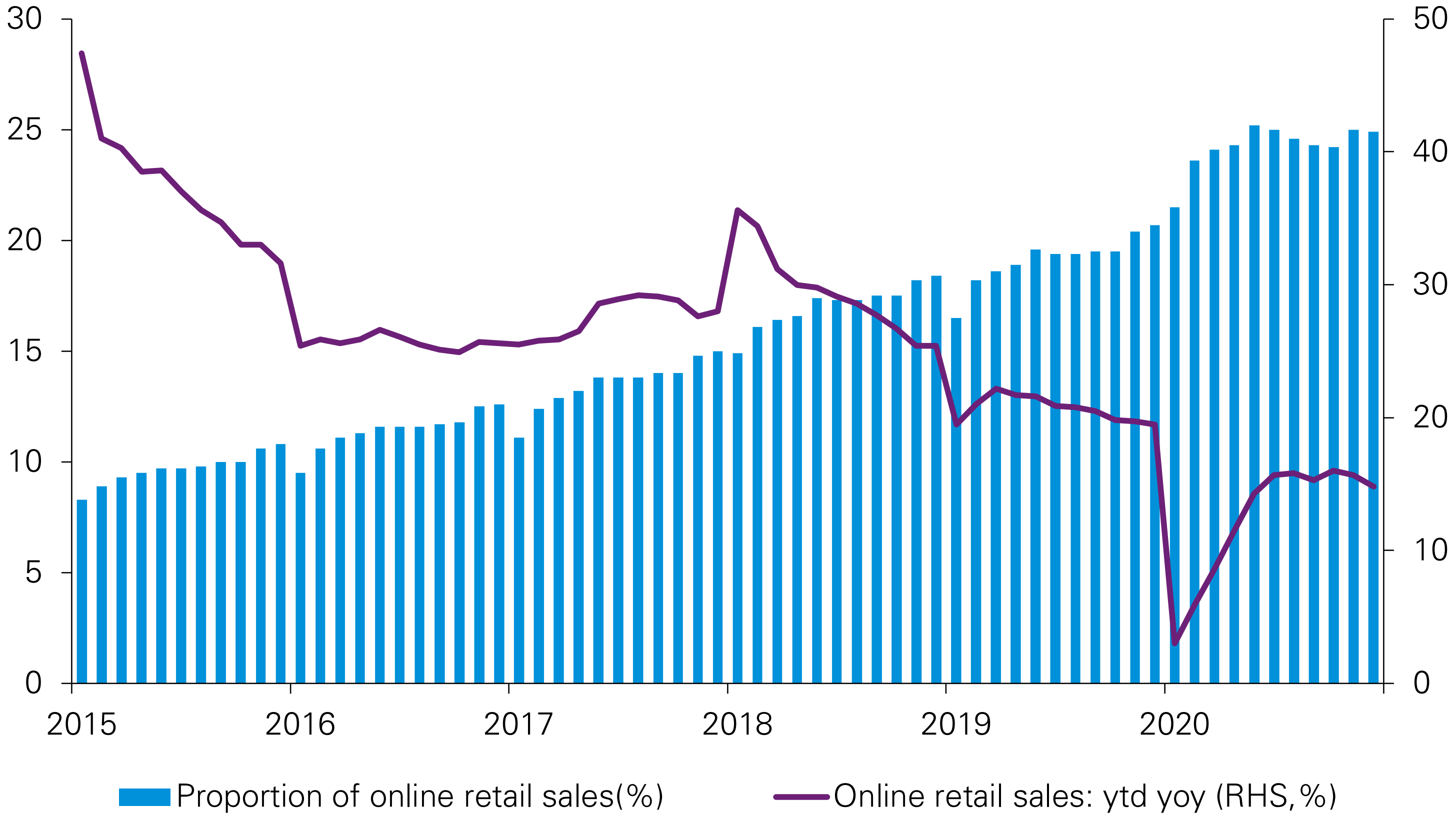


Source: Wind, KPMG analysis

- Compared to the strong rebound on the production side, recovery in consumption, especially in service related consumption, has been lagging.
- Retail sales of consumer goods have turned positive since July but the growth of catering services is still quite flat.
- Growth of consumer goods softened slightly in December, partially due to softening in the auto sector. With a higher base in 2019, auto sales grew 6.4% in December, down from 11.8% in the previous month. The auto sector has enjoyed a strong recovery since Q2, after plunging in Q1. For the full year of 2020,China remained the world's largest auto market, with 25.3 million vehicles sold, down 1.9% from a year ago.

Online shopping has seen rapid growth and accounted for a quarter of total retail sales

Proportion and growth rate of online retail sales of consumer goods,%

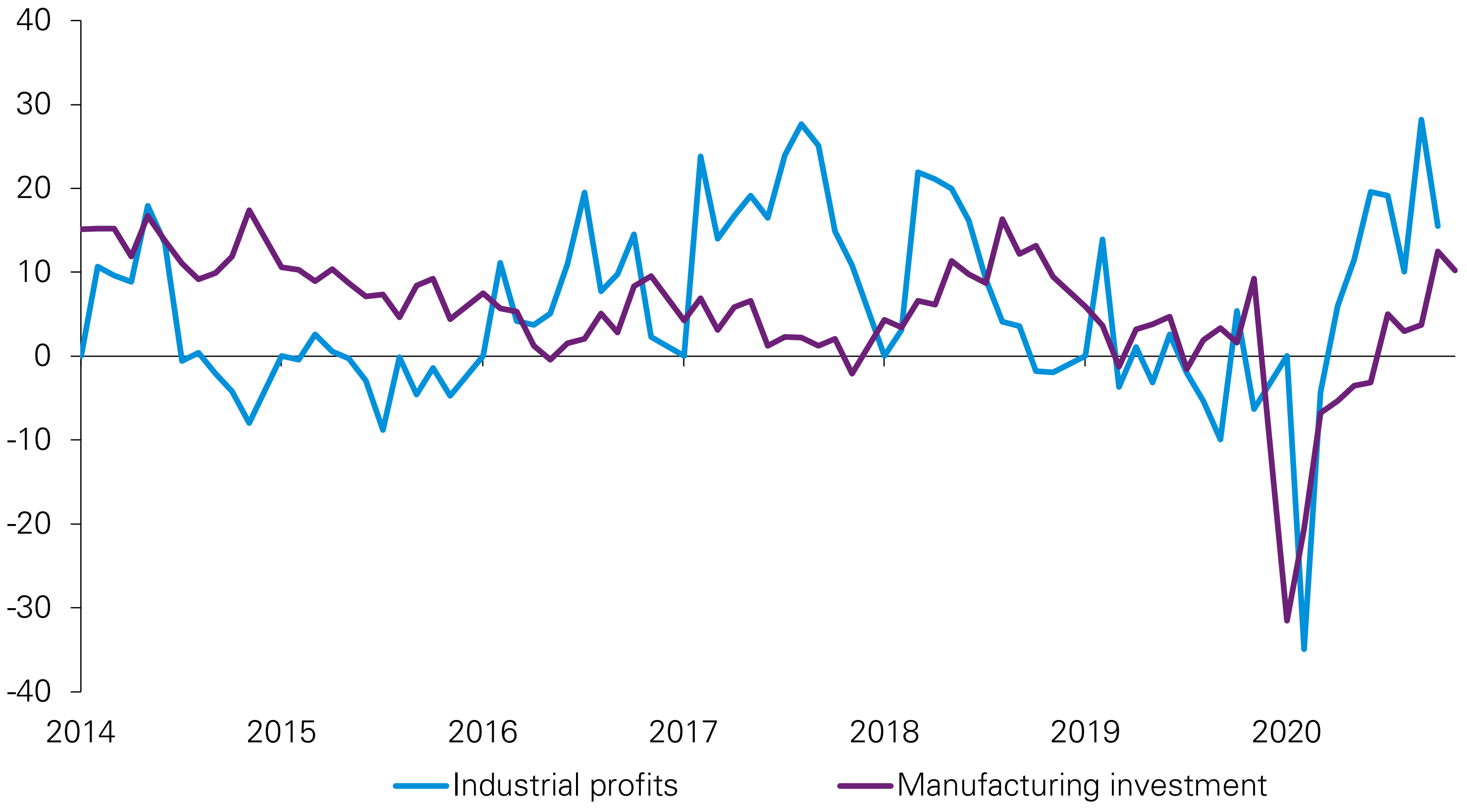


Source: Wind, KPMG analysis

- The COVID-19 pandemic has boosted China's online retail sales and its share of total retail sales continued to rise.
- In 2020, total online retail sales in China grew by 10.9% year-on-year, 14.8 ppt higher than that of total retail sales. Specifically, sales of online consumer goods were up by 14.8% year-on-year, accounting for 24.9% of total retail sales, and 4.2 points higher than that of 2019.
- Many companies have accelerated the transition to online business amid the pandemic, and some new retail models such as livestreaming e-commerce have thrived.

Manufacturing investment growth is accelerating

Industrial profits and manufacturing investment, year-on-year, %

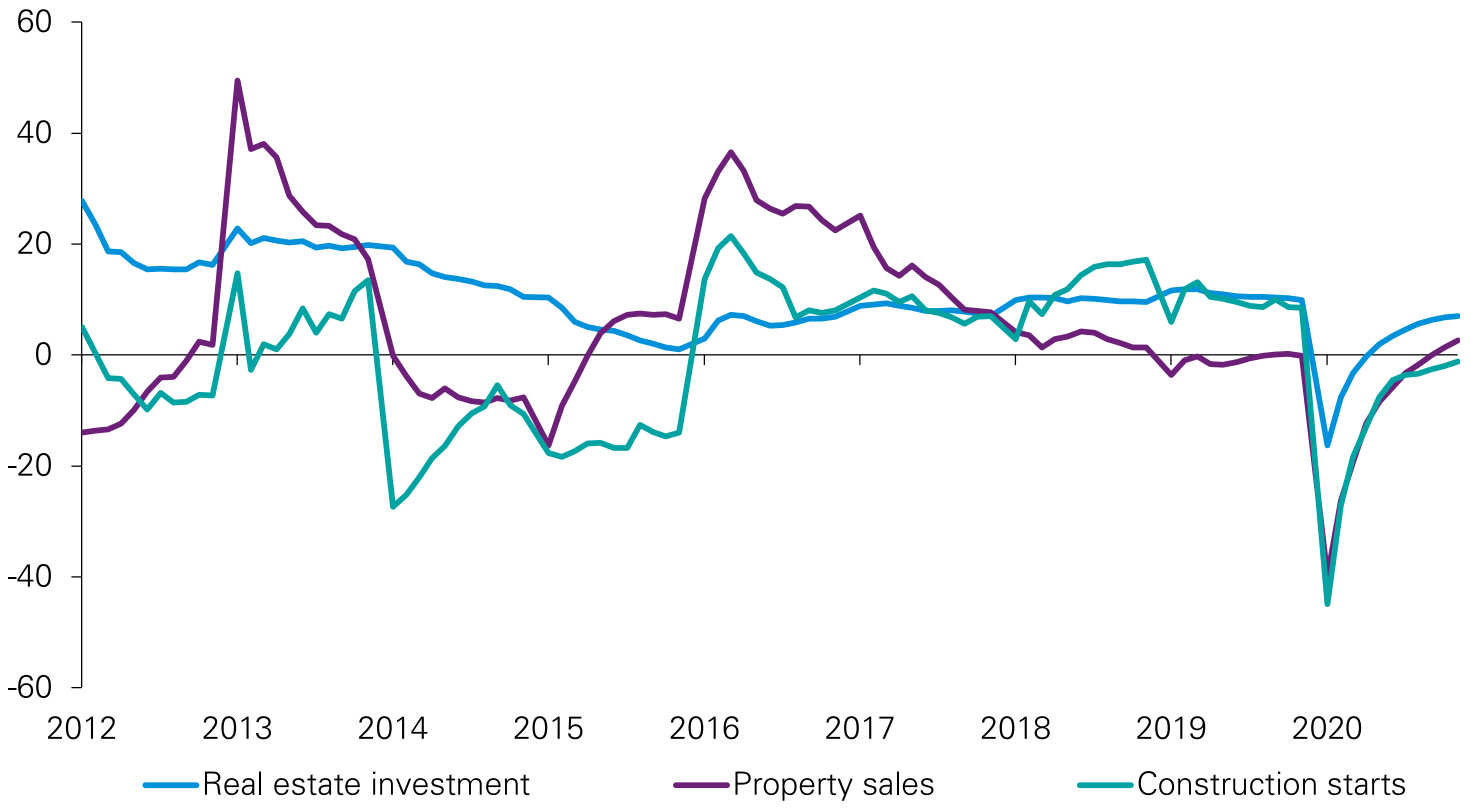


Source: Wind, KPMG analysis

- Industrial profits have experienced strong growth since June and grew 28.2% year-on-year in October, the highest rate since 2012.
- The manufacturing PMI, a leading indicator for industrial activity, has remained in the expansionary range since March. It came in at 51.9 in December, suggesting continued expansion in the month ahead.
- Capacity utilization has increased from 67.2% in Q1 to 78.4% in Q4 and corporates have started to build up inventory. Strong orders and tightened capacity should support manufacturing investment in 2021.

Property investment has remained robust but is expected to moderate in 2021

Property sales and construction starts, year to date, year-on-year, %

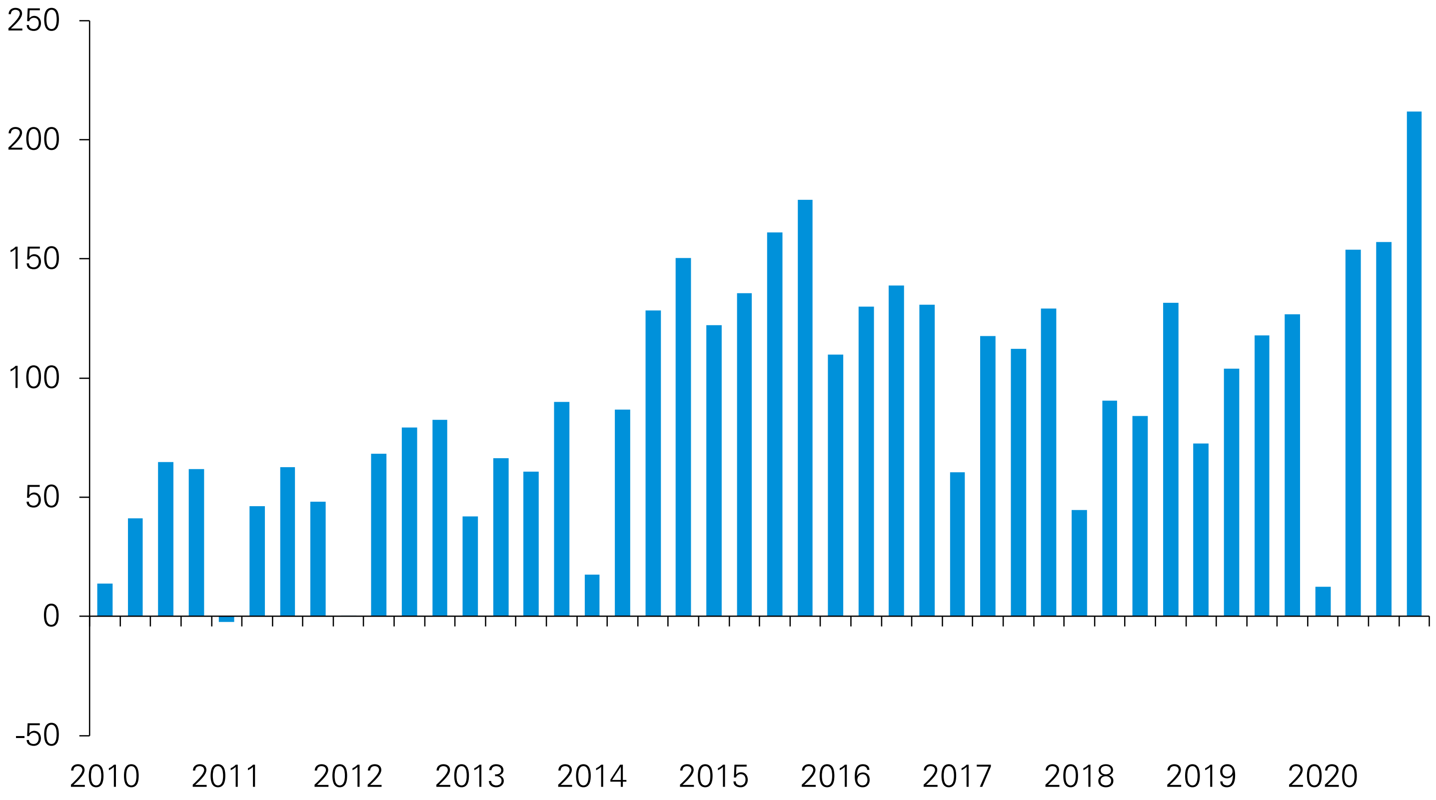


Source: Wind, KPMG analysis

- Property sales shot up with an average growth of 12.7% in Q4, from 9.9% in Q3. Construction starts continuously recovered in Q4 as well; the decline has narrowed to -1.2% in December. Real estate investment remains robust with a growth of 7% for the full year of 2020.
- In an effort to rein in housing overheating in the market, the government has introduced new regulations to reduce potential risks to the financial system. Last August, regulators convened some major property developers to warn against high debt levels ("three red lines"). In addition, a new measure was introduced in December that set limits on the proportions of property loans and mortgage loans at banks. We expect property investment growth to moderate in 2021.

Trade surplus hits a record high in Q4

China's trade surplus by quarter, USD billion

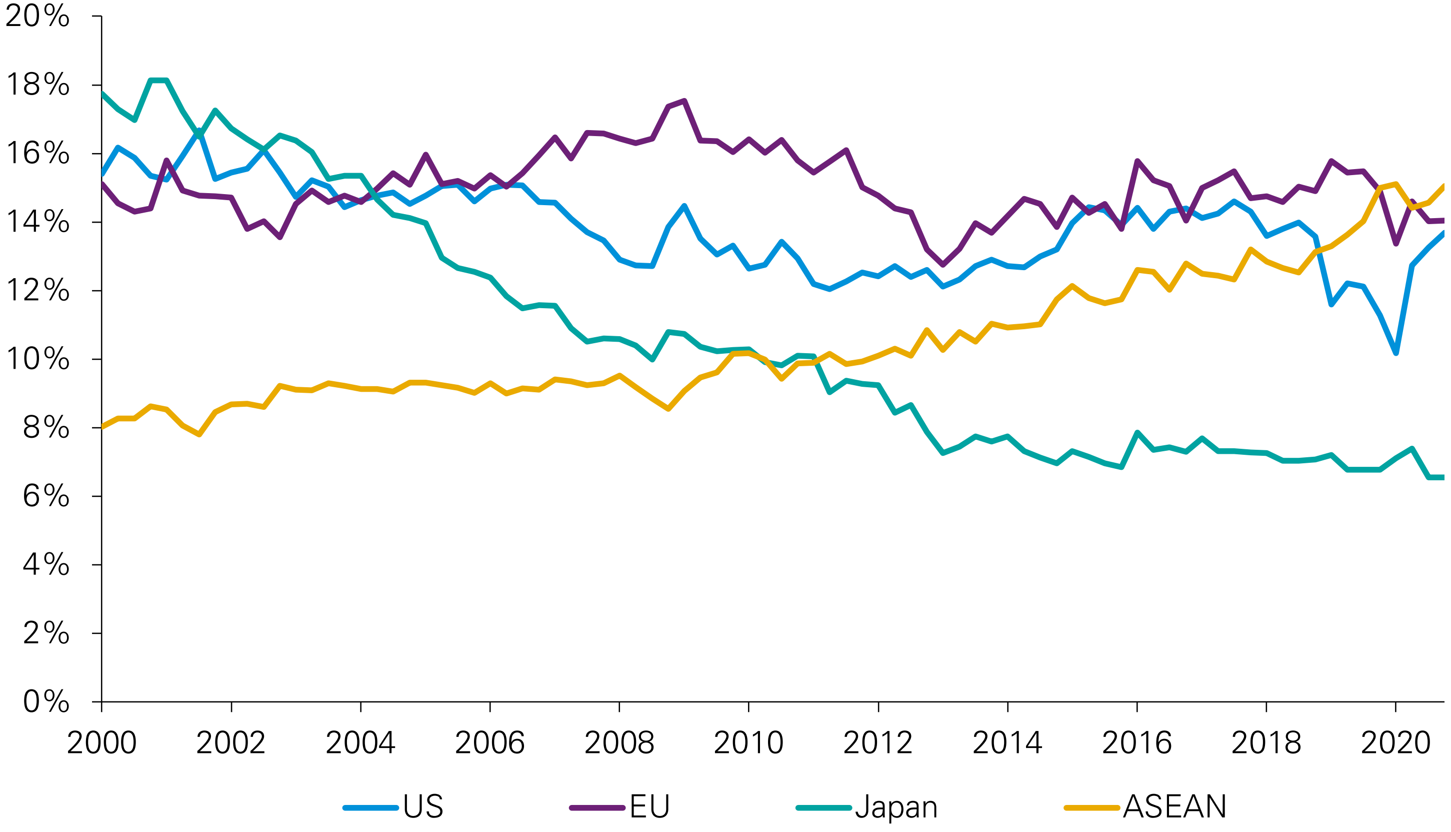


Source: Wind, KPMG analysis

- Driven by strong external demand for medical supplies, electronic products and holiday goods, China's exports grew by 16.7% in Q4, pushing its trade surplus to a record high of over USD210 billion. For the full year, China's trade surplus reached USD 535 billion in 2020, the second highest year, after 2015.
- With the pandemic still spreading globally, production recovery is still slow in many parts of the world. The supply-demand gap is expected to remain in the near future, which should benefit China's export sector in the near future.
- As the global economy gradually normalizes with the roll-outs of vaccines, China's export growth may moderate in the second half of 2021.

AESEAN becomes China's largest trade partner

Share of China's total goods trade by country (region), quarterly

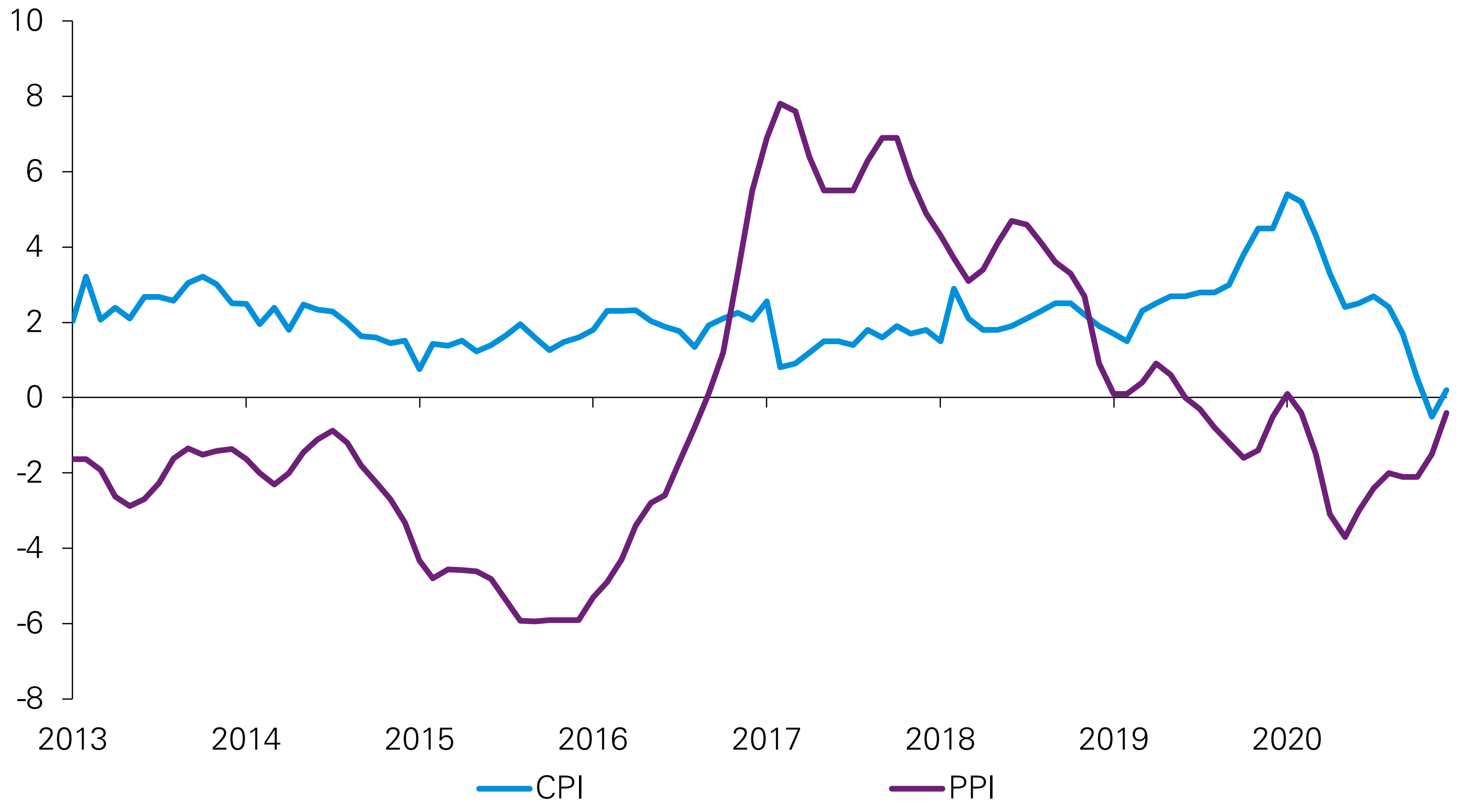


Source: Wind, KPMG analysis

- ASEAN has surpassed the EU to be become China's largest trading partner in 2020. China's trade with ASEAN totalled USD 687 billion and accounted for 14.8% of China's total trade in 2020.
- Trade with the US continues to improve with its share of China's total trade rising from 13.3% to 13.7% in Q4, registering the highest growth since 2018Q4.
- China accelerated its imports from US to fulfil the Phase 1 commitments. US goods exports to China for products in the Phase 1 deal totalled $100.5bn by the end of 2020, 58% of the 2020 annual target.

Inflation remains subdued

Consumer price index (CPI) and producer price index (PPI), year-on-year, %

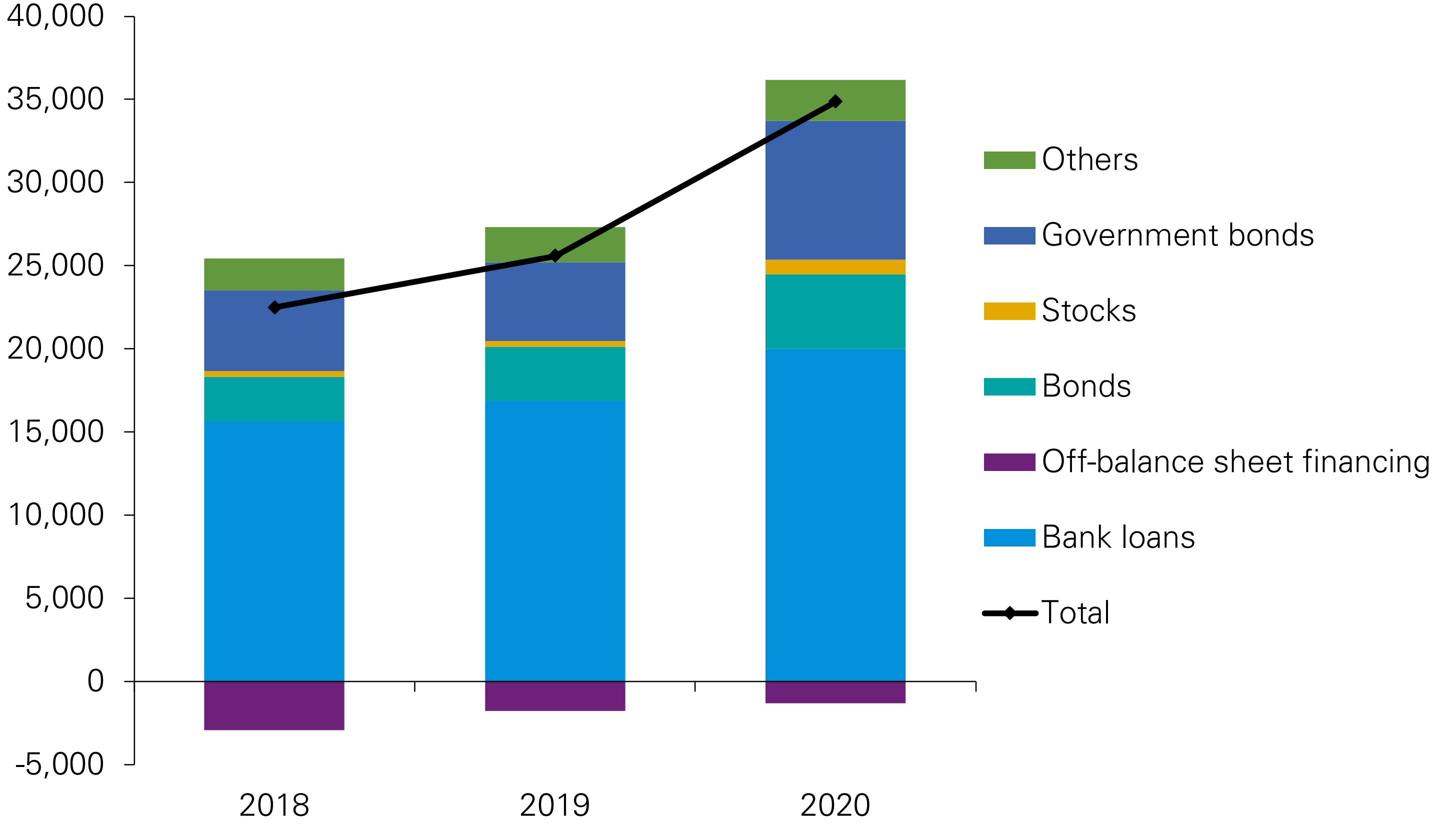


Source: Wind, KPMG analysis

- Consumer price inflation spiked in the first half of 2020 due to rising food prices, especially pork. With a gradual recovery in pork supply and a high base effect, inflation growth moderated in the second half of the year and even dropped to -0.5% in November, the first time negative territory in 11 years.
- PPI rose from -2.1% to -0.4% in Q4. The decline of PPI has narrowed mainly due to improving industrial production and higher commodity prices. The cold winter has also boosted the consumption of electricity and coal.
- Looking forward, we expect consumer price inflation to remain tamed and producer price inflation to turn positive with continued economic recovery and a low base effect.

Bank loans and government bonds contribute the most to liquidity growth

Change in total social financing, RMB billion

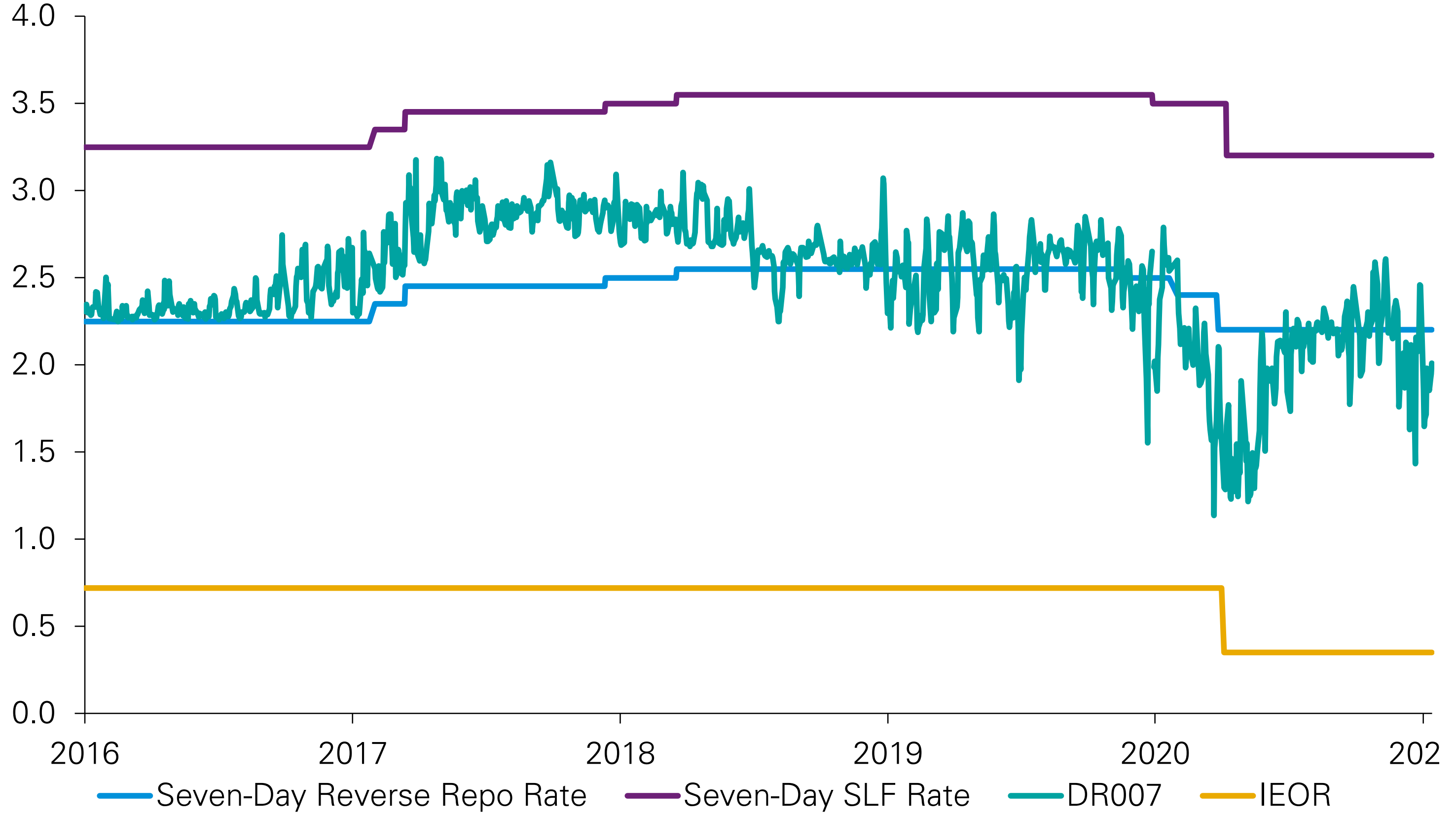


Source: Wind, KPMG analysis

- New total social financing (TSF), a measure of the total liquidity provided by the financial sector to the real economy, increased by nearly RMB35 trillion in 2020, RMB10 trillion higher than 2019. It is also above the target of RMB30 billion set by the central bank.
- Bank loans are the main driver for the TSF growth, reaching RMB20 trillion and nearly 3.2 trillion higher than one year ago.
- In response to the COVID-19 pandemic, Chinese's government has launched modest fiscal stimulus. Government bonds accounted for 24% of the increase in TSF, 5 points higher than the level of last year.
- New issuance of corporate bonds declined from RMB 770 billion in Q3 to 353 billion in Q4, mainly reflecting investors' concerns of credit defaults on State-Owned Enterprises (SOEs). Thanks to the registration-based reform of stock markets, financing from stocks increased 150% from one year ago, and will play an important role in 2021.

The central bank is expected to maintain its current monetary policy stance

Interbank market rate, %

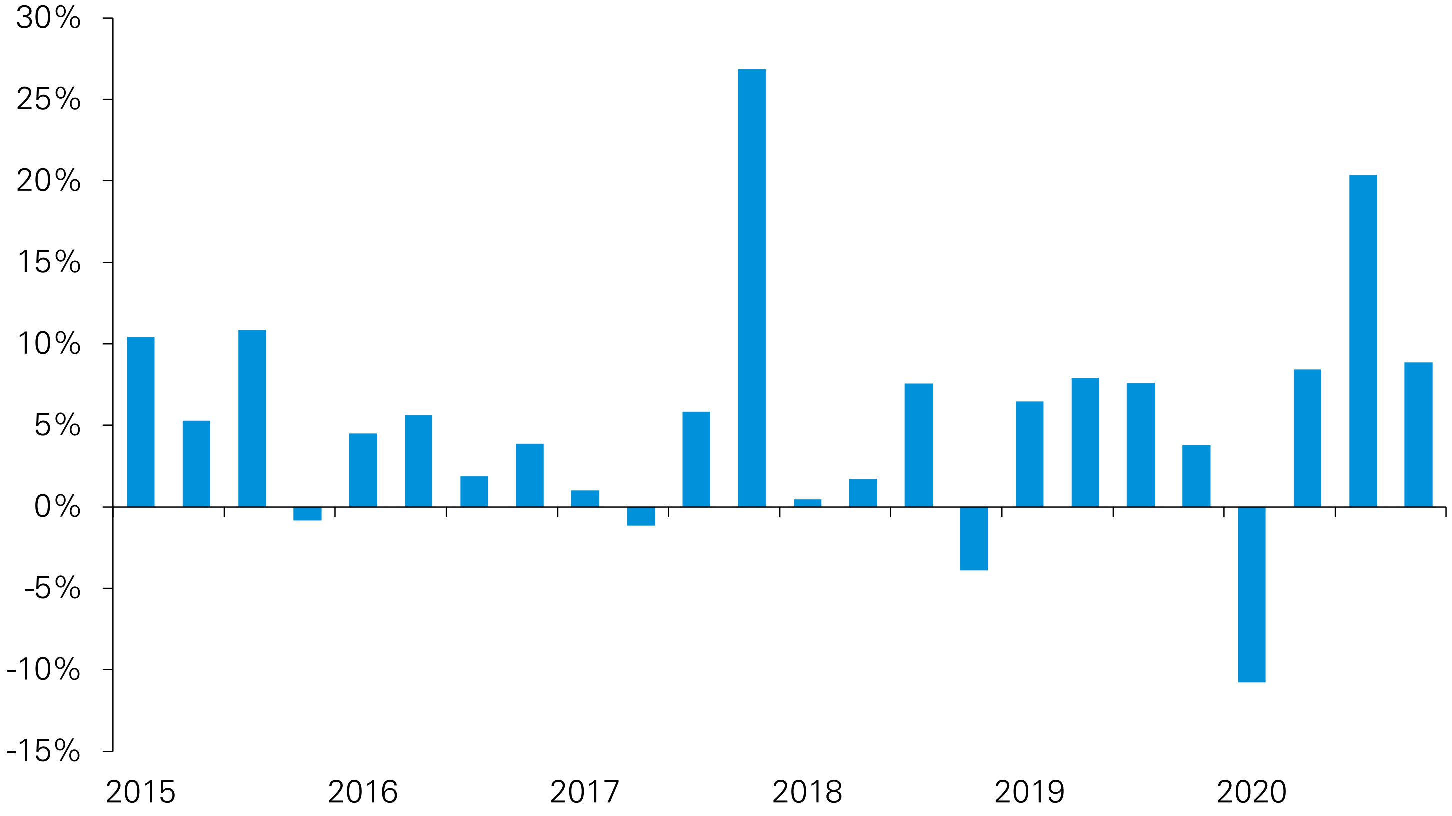


Source: Wind, KPMG analysis

- The central bank cut the Loan Primate Rate (LPR) twice by a cumulative 30 bps in 2020 to help boost the economy. Amid the support, the weighted average interest rate of corporate loans fell to 4.61% in December, 51 bps lower than one year ago. The low rates help corporate loans, which reached RMB 11 trillion in 2020, 3.7 trillion higher than last year.
- DR007, a measure of average cost of funds for banks fluctuated around 2%, reflecting good liquidity in the market.
- The average required reserve ratio (RRR) of financial institutions is 9.4%, the lowest level since the global financial crisis. The central bank is expected to maintains its current monetary policy stance and leave both the LPR and RRR unchanged in the near future.

Foreign direct investment saw a strong rebound after Q1

China's foreign direct investment (FDI) by quarter, RMB terms, year-on-year growth, %

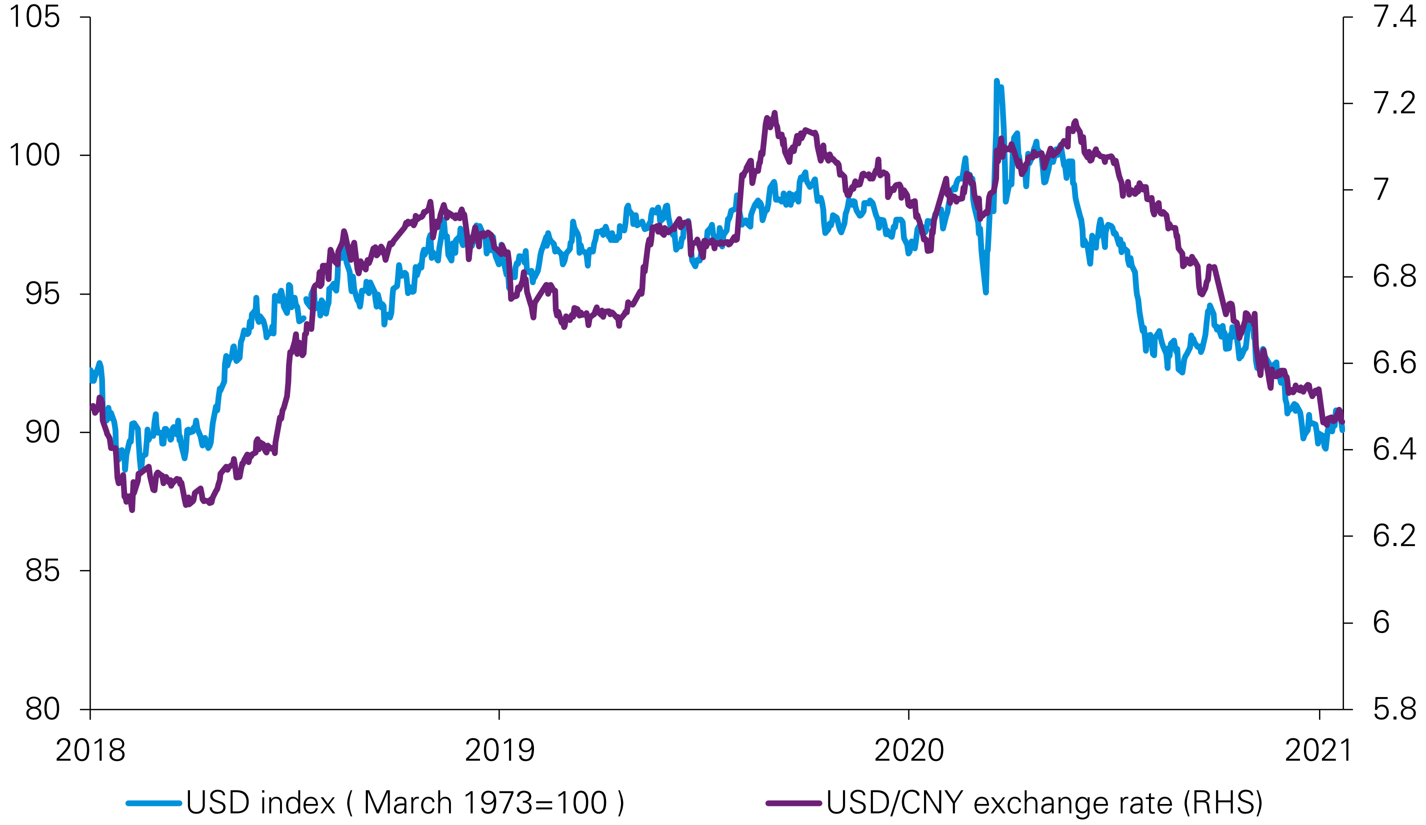


Source: Wind, KPMG analysis

- Foreign direct investment (FDI) has continued to show robust growth, up 8.9% in Q4. For the full year of 2020, FDI increased 6.2%, a sharp contrast to the 42% decline of global FDI. China has become the world's largest FDI recipient.
- Profits of foreign industrial companies in China increased 7% in 2020, higher than that of industrial enterprises overall (4.1%).
- The signing of the Regional Comprehensive Economic Partnership (RCEP) and the conclusion of the EU-China Comprehensive Agreement on Investment negotiations will further strengthen regional economic integration.

The RMB exchange rate should remain relatively strong

USD index and USD/CNY exchange rate



Source: Wind, KPMG analysis

- Due to the impact of the COVID-19 and the global financial market turmoil, the RMB exchange rate depreciated to 7.15 against the US dollar in early 2020. However, the RMB has strengthened since June with China's rapid economic recovery and a weakening USD, and the RMB exchange rate appreciated about 10% to 6.52 in January 2021.

- We expect the RMB exchange rate to remain relatively strong in 2021. The gap between production and demand in many markets is expected to sustain China's trade surplus in the near future. The 10-Year government bond spread between China and the US has remained at 200 basis points. In addition, China is increasing opening up its financial sector and foreign holdings of the RMB financial assets have been rising.

Highlights from the Central Economic Working Conference

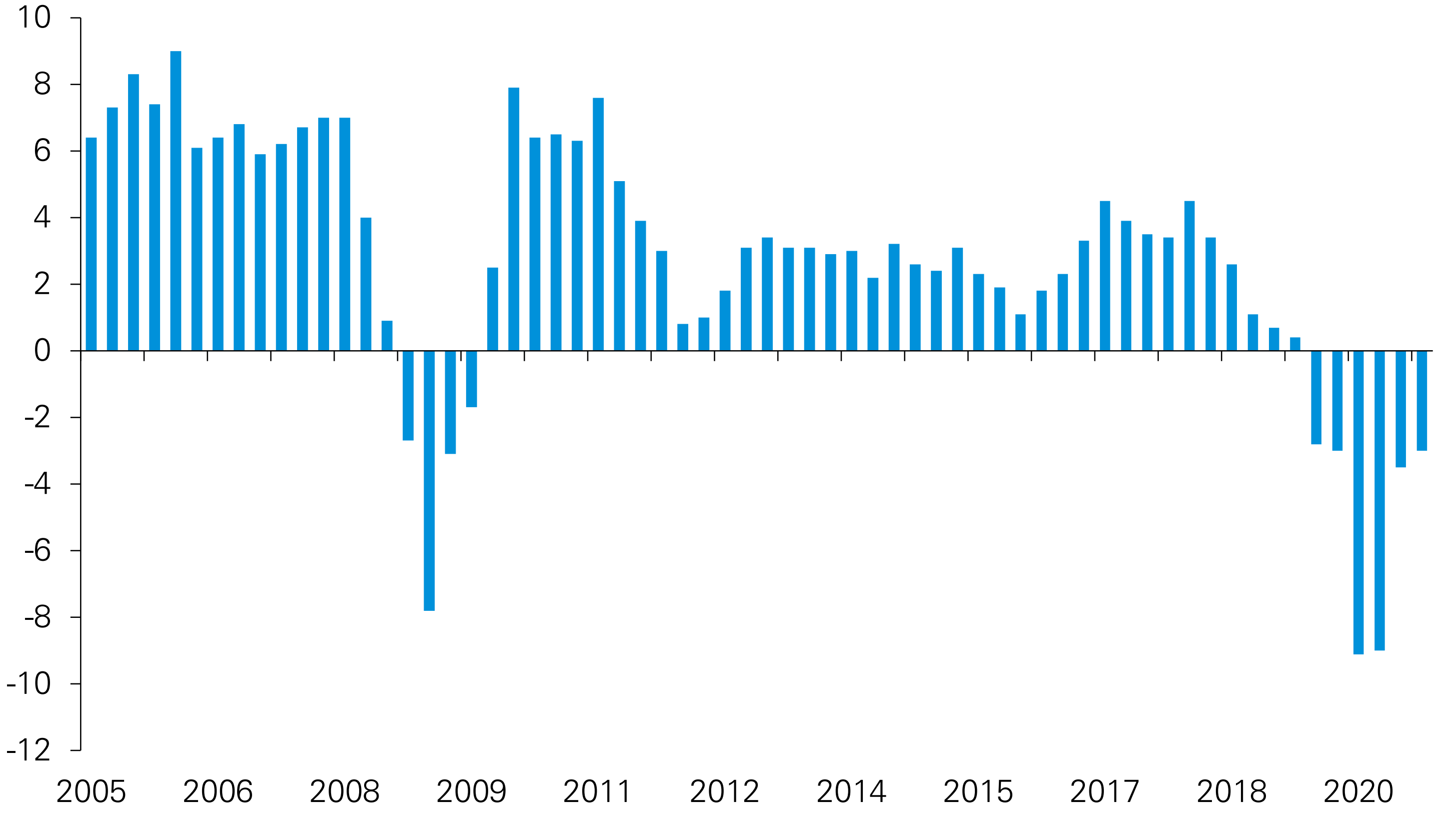
The Central Economic Work Conference (CEWC) is annual meeting held near the end of each year to formulate economic policy direction for the upcoming year. The latest meeting was held in Beijing during 16-18 December. Some key messages from the meeting are as follows.

- The CEWC emphasized that economic policy in 2021 should "maintain continuity, stability, and sustainability" and not make "sharp turns", in light of the recovery still being at an early stage and significant uncertainty remaining.
- However, avoiding "sharp turns" does not mean that *no* turn will be made. We do expect the fiscal and monetary stimulus will be pulled back somewhat in 2021. For example, we expect the fiscal deficit ratio to be reduced from this year's record high of 3.6% of GDP to around 3.0% in 2021. The pace of policy normalization is expected to be measured and to be dependent on the pace of economic recovery path.
- Innovation is undoubtedly the top priority for the nation and the government aims to rely on the power of the whole state to advance R&D, especially in basic research. More state and provincial R&D centers will be established and collaboration between leading companies and universities/research institutions will be encouraged.
- The conference discussed strengthening antitrust measures and preventing "unorderly expansion of capital". It also stressed that financial innovations must be conducted on the basis of prudential regulation.
- The conference reiterated its stance to control overheating in the housing market, especially in larger cities. This reflects the fact that China's property market is highly uneven – housing supply is tight for large cities where the population continues to grow, but inventory is building up in lower-tier cities with net population outflows. To mitigate this issue, the government called for greater efforts to develop affordable rental and long-term rental markets.
- China aims for its carbon emissions to peak by 2030 and to achieve carbon neutrality by 2060. This has important implications for China's energy structure and presents more opportunities for sectors such as NEVs, renewable energy, smart grids, environment restoration, and resource recycling.

Source: KPMG analysis

Hong Kong's economy is gradually recovering from a deep recession

Hong Kong real GDP growth rate, yoy %



Source: Wind, KPMG analysis

- Hong Kong's economy is seeing sequential recovery in Q4. GDP fell 3% in Q4 from a year ago, the sixth consecutive quarter of decline, but the rate of decline has diminished.
- The labor market is improving with the unemployment rate dropping from 6.6% in October to 6.3% in December. However, a new wave of epidemic has broken out in Hong Kong since November, casting some shadow on the continued recovery.
- The cumulative growth of Hong Kong's exports and imports of goods declined by 1.5% and 3.3% in 2020 respectively.
- Hong Kong's capital market has had a better performance amid COVID-19. There were 144 IPOs in 2020, including 9 Chinese companies securing a secondary listing in Hong Kong. The total amount raised was HKD397.5 billion, up 53.8% from HKD314.2 billion in 2019.

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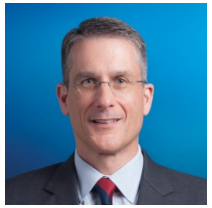

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