China Economic Monitor

Issue: 2021Q2

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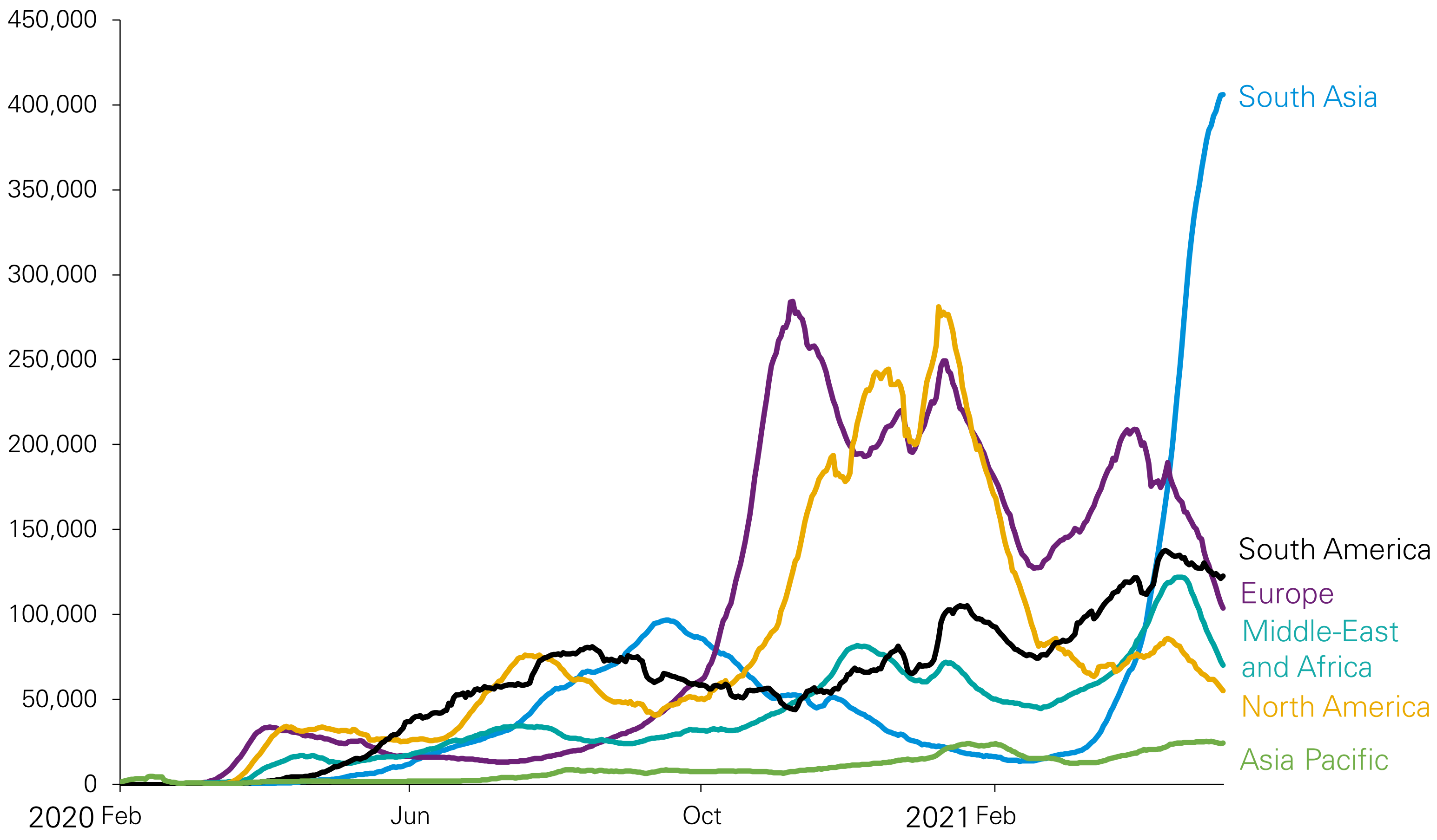
Key takeaways

- Thanks to a low base comparison, China's GDP grew 18.3% year-over-year (yoy) in Q1, up from 6.5% in Q4 2020. However, on a sequential basis, the economy grew 0.6% compared with the previous quarter, down from 3.2% posted in Q4 last year. We expect China's economy to continue to recover, and we maintain our 2021 GDP forecast at 8.8%.
- Most major economic indicators surged significantly in Q1 on a low base effect. Industrial production and exports growth remained strong. The "Stay-put" policy implemented by many local governments during the Chinese New Year period expedited post-holiday production resumption, with industrial production surging 24.5% in Q1. Meanwhile, Q1 exports continued to accelerate with strong external demand from advanced economies for manufacturing and electronic products.
- Consumption is also recovering, with service consumption rebounding from a very low base. March sales of catering services surpassed the pre-pandemic level (i.e. March 2019), surging 92% from a year ago. With accelerating vaccine rollouts, we expect consumption to play a more important role in the next phase of China's recovery.
- Inflationary concerns are rising. The consumer price index (CPI) moved up in March, while the producer price index (PPI) jumped 4.4% in March due to rising commodity prices. The government has set a CPI target of 3% for 2021, and we expect consumer price inflation to remain modest this year as pork prices fall. However, global commodity prices are likely to remain elevated in the near term and put further upward pressure on PPI, affecting the profitability of downstream firms.
- China surpassed the US to become the world's largest recipient of foreign direct investment (FDI) last year and FDI remained strong in Q1, up 39.9%. With a vast domestic market, steady economic growth and more opening-up, China remains an important destination for foreign investments.
- As of 7 May, over 1.26 billion doses of COVID-19 vaccines had been administered around the world. China and the US administered over 300 and 250 million doses, respectively. However, the global vaccination rate is still low and uneven across countries. Advanced economies have purchased 60% of the world's total vaccines, while developing economies with 86% of the global population have secured only 40%. Global coordination is still needed to eradicate the COVID-19 pandemic.

New COVID-19 infections are gradually declining in most countries but are surging in India

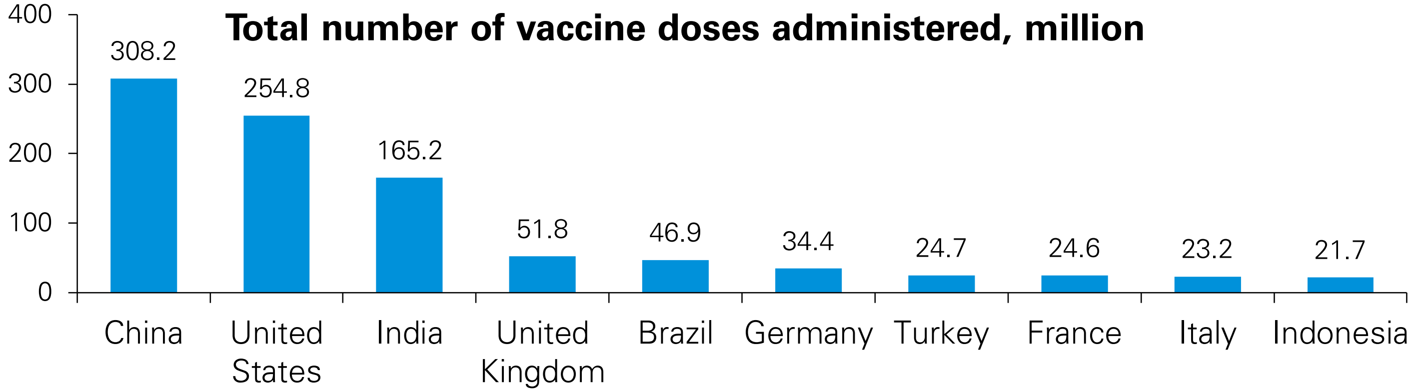
Daily new cases by region, 7-day moving average

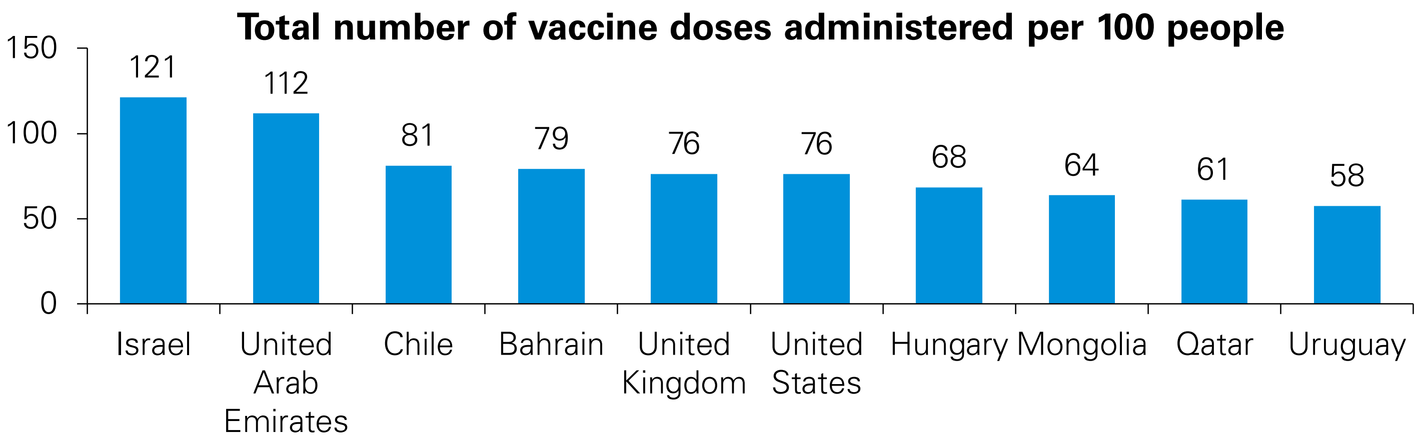


Source: Wind, KPMG analysis. Data through 7 May 2021.

- Global infections reached nearly 160 million cases with over 3 million deaths as of 7 May. 28 countries have recorded more than 1 million cases, comprising 10 advanced economies and 18 developing countries.
- The pandemic has sharply worsened in India since late March. Average daily new infections exceeded 400k cases in early May. The public health crisis in India is a reminder that the world still needs to remain vigilant of COVID-19 and its variants.
- Average daily new cases in the US have stabilised below 100k with fast vaccine rollout in recent months. Cumulative infections in the US totalled 33 million with 590k deaths.
- Europe saw a new wave of resurgence after mid-February. Many countries reinforced their quarantine measures and the pandemic has retreated since April. There are total 45 million confirmed cases in Europe.

Vaccinations are picking up, but the rollouts are uneven across countries

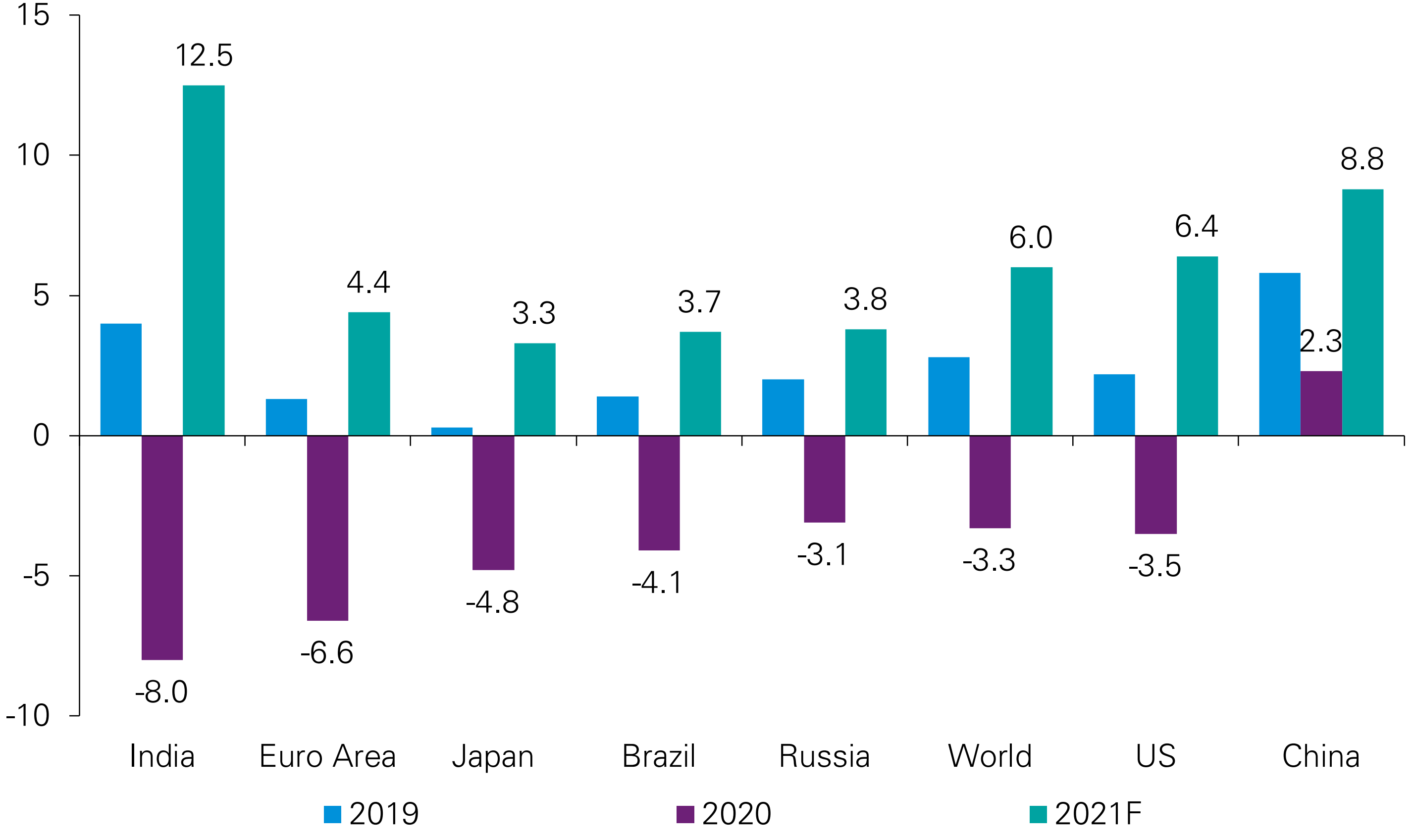




Source: Our World in Data, Data through 7 May 2021. KPMG analysis

- As of 7 May, over 1.26 billion doses of COVID-19 vaccines had been administered around the world. China and the US administered over 300 and 250 million doses, respectively. The number of administered doses in other countries is still relatively small.
- In terms of the number of vaccine doses administered per 100 people, Israel and the UAE rank at the top, with administered doses of 121 and 112 per 100 people, respectively. China's vaccine administration rate currently stands at 21 per 100 people.
- According to the WHO calculation, there are currently 88 vaccines in clinical trials worldwide, of which 16 (5 in China) were already in phase 3 stage as of 16 April.
- On vaccine procurement, advanced economies purchased 4.7 billion doses, accounting for 60% of the world's total. Global coordinated efforts are needed before the vaccination rate reaches the threshold of herd immunity (60–70%).

The IMF revised up its 2021 global forecast on vaccine rollouts and further fiscal stimulus

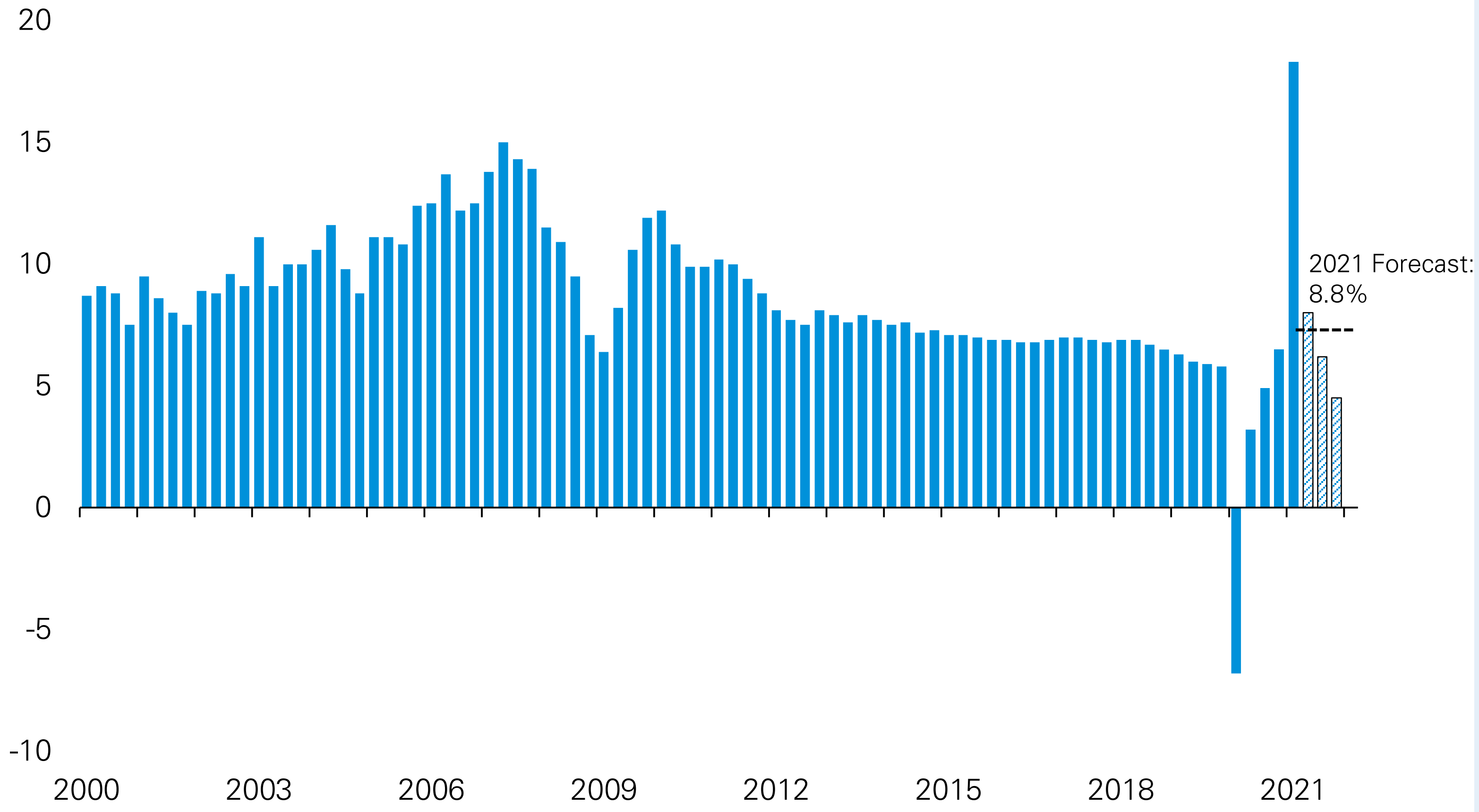


Source: IMF, KPMG analysis. China's 2021 forecast is by KPMG and the other forecasts are by the IMF.

- The IMF revised its world growth forecast upward to 6.0% in 2021, 0.5 ppt higher than the January projection. Stronger fiscal stimulus of advanced economies and increasing vaccine rollouts are the main drivers for the stronger growth outlook.
- However, the recovery momentum is likely to vary significantly among countries. 2021 GDP is projected to rise by 5.1% in advanced economies and 6.7% in developing economies. We expect the IMF to revise down India's growth forecast in light of the recent resurgence of COVID-19.

China's economy continued to recover and grew 18.3% in Q1

China real GDP growth rate, yoy, %

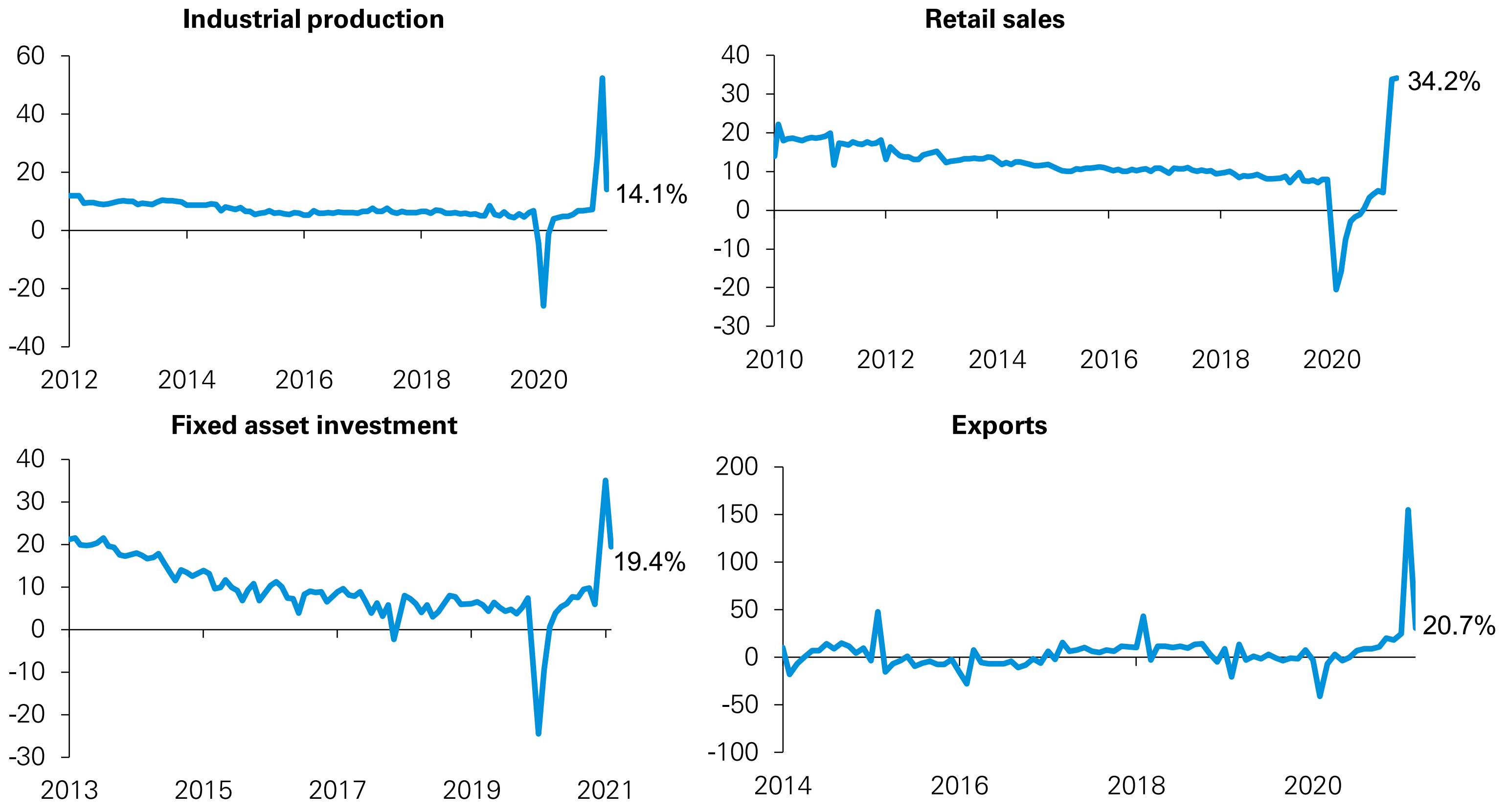


Source: Wind, KPMG analysis

- Due to a low base comparison, China's GDP grew 18.3% yoy in Q1, up from 6.5% in Q4 2020. However, on a sequential basis, the economy grew 0.6% compared with the previous quarter, down from 3.2% posted in Q4 last year.
- On the production side, growth of the industrial sector rebounded to 24.4%. High-tech manufacturing continued to expand, up 31.2% in Q1. Due to fast vaccine rollout, medical and pharma sectors experienced rapid growth.
- Going forward, as the pace of vaccine rollout accelerates, consumption should play a more important role in the next phase of China's economic recovery. We expect the economy to continue recovering and grow 8.8% in 2021.

Major economic indicators surged significantly year-over-year due to the low base effect

YoY, %

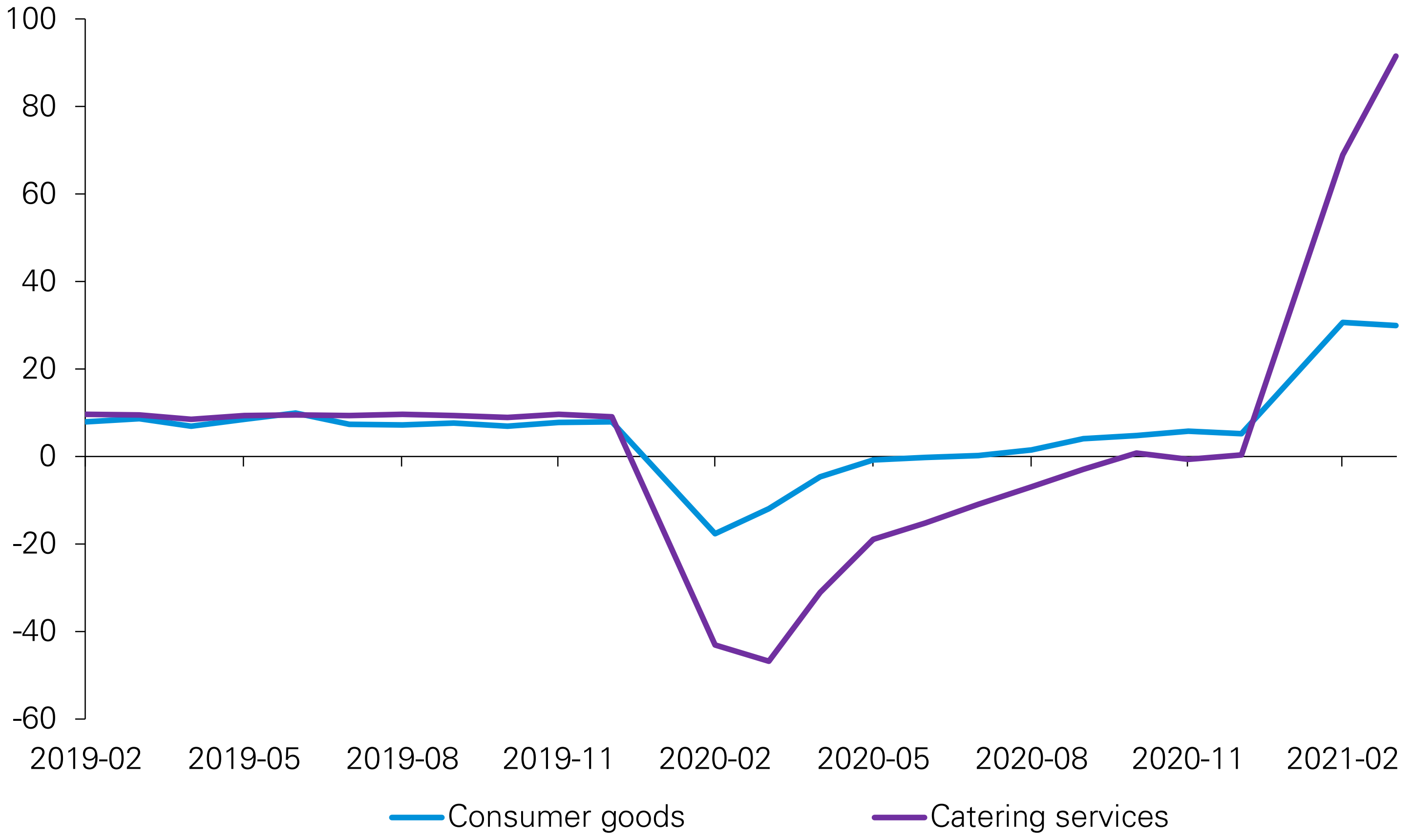


Source: Wind, KPMG analysis. Data through March 2021.

- Due to the low base effect, all major economic indicators surged significantly in Q1.
- To control the pandemic resurgence, many areas adopted a "stay-put" policy during the Chinese New Year holiday. These measures expedited post-holiday production resumption. Industrial production growth reached 24.5% in the first quarter of this year.
- The monthly data reflects divergent performance in domestic activity in March: stronger recovery in retail sales but weaker performance in industrial production and investment.
- Q1 exports continued to accelerate with strong external demand from advanced economies for manufacturing and electronic products. Imports also rose 38.1% in March, the highest rate since March 2017.

Services are seeing faster recovery

Growth of goods and catering sales, monthly yoy, %

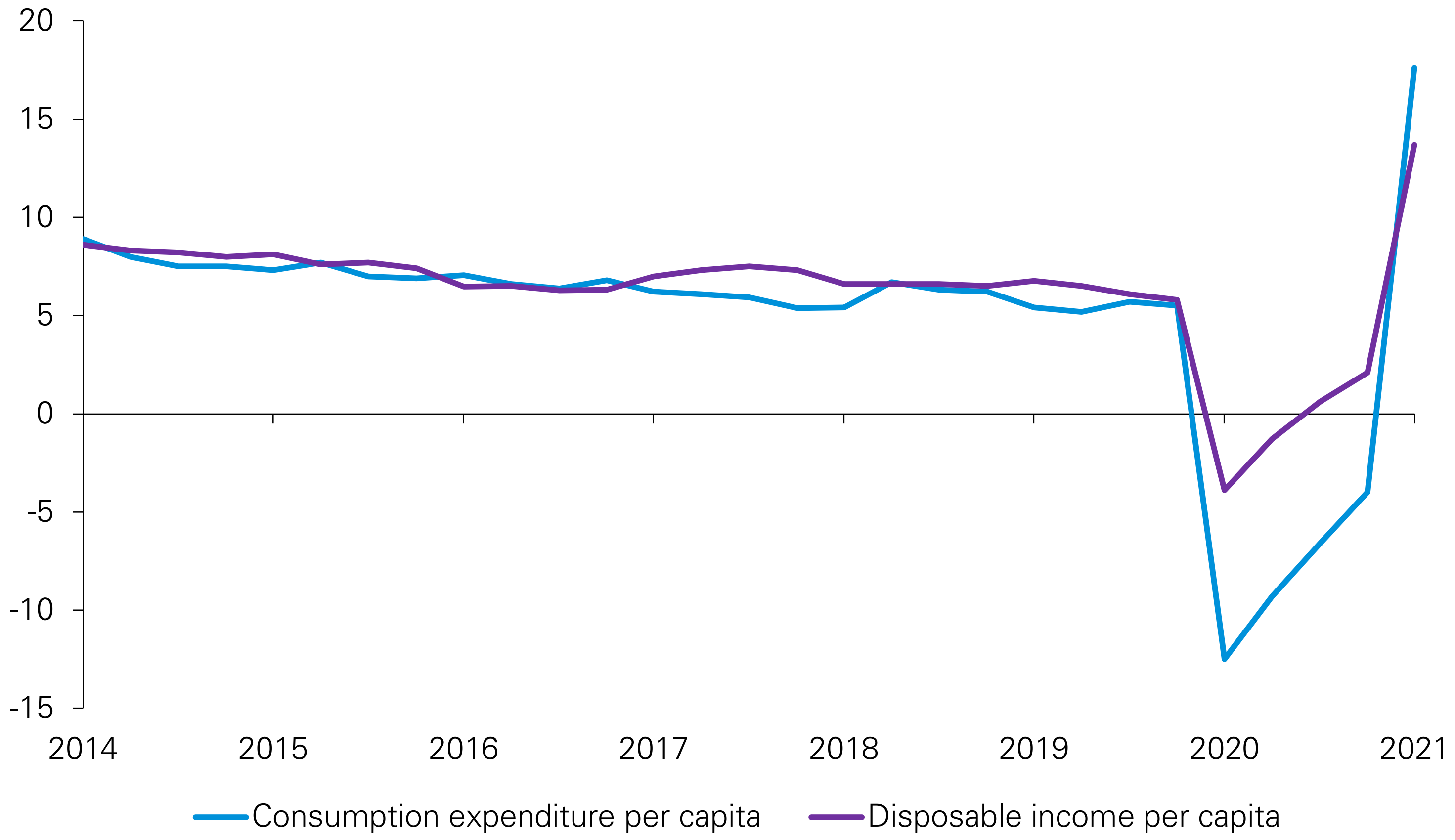


Source: Wind, KPMG analysis

- With quarantine measures continuously being lifted, service consumption saw a sharp rebound in Q1. Sales of catering services surpassed its pre-virus level in March 2019, surging 92% from a year ago. Consumer goods sales also grew 29.9% yoy in March.
- Discretionary spending rose in Q1. Construction materials and furniture sales performed well, reflecting strong property sales. Auto, communication devices, jewellery and cosmetics goods also saw a strong recovery.
- With recovering offline sales, growth of online sales has moderated slightly. The share of online in total goods sales dropped to 21.9% in Q1 from 24.9% in 2020.

Resumed household income growth should support consumption recovery

Growth of consumption expenditure per capita and disposable income per capita, in real terms, yoy, %

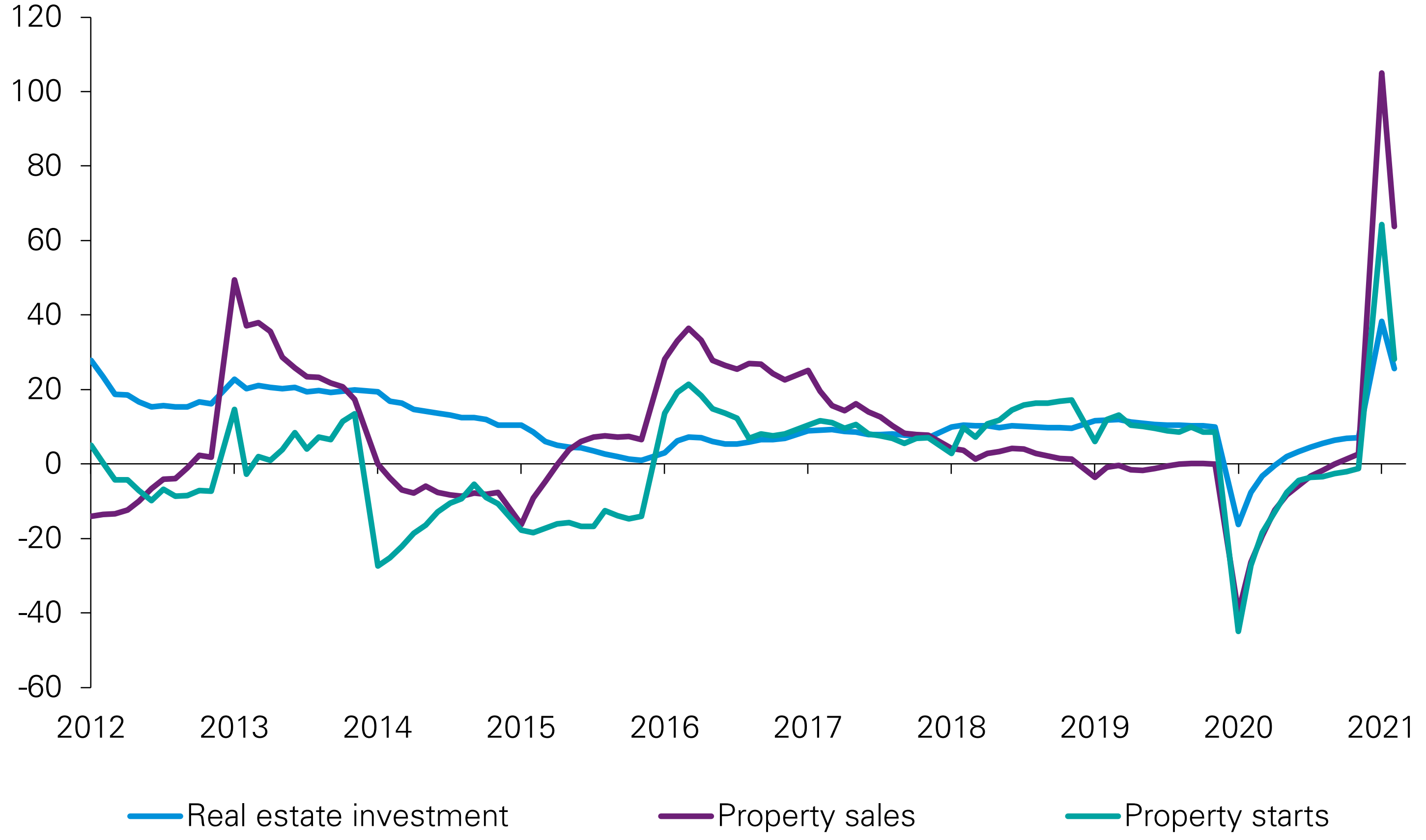


Source: Wind, KPMG analysis

- The labour market continues to improve. The urban survey-based unemployment rate dropped from 5.5% in February to 5.3% in March. Urban new job creation came in at 2.97 million in Q1, 680k more than a year ago.
- Real growth of average household expenditure per capita accelerated to 17.6% in Q1 from 3.2% in Q4 2020. This rebound was supported by a strong recovery in household disposable income, up 13.7% in Q1.
- With an improving labour market and growing consumer confidence, we expect household consumption to continue to recover this year and further support economic growth.

The property market remained robust in Q1 but is expected to moderate in H2

Property sales and construction starts, year to date, yoy, %



Source: Wind, KPMG analysis

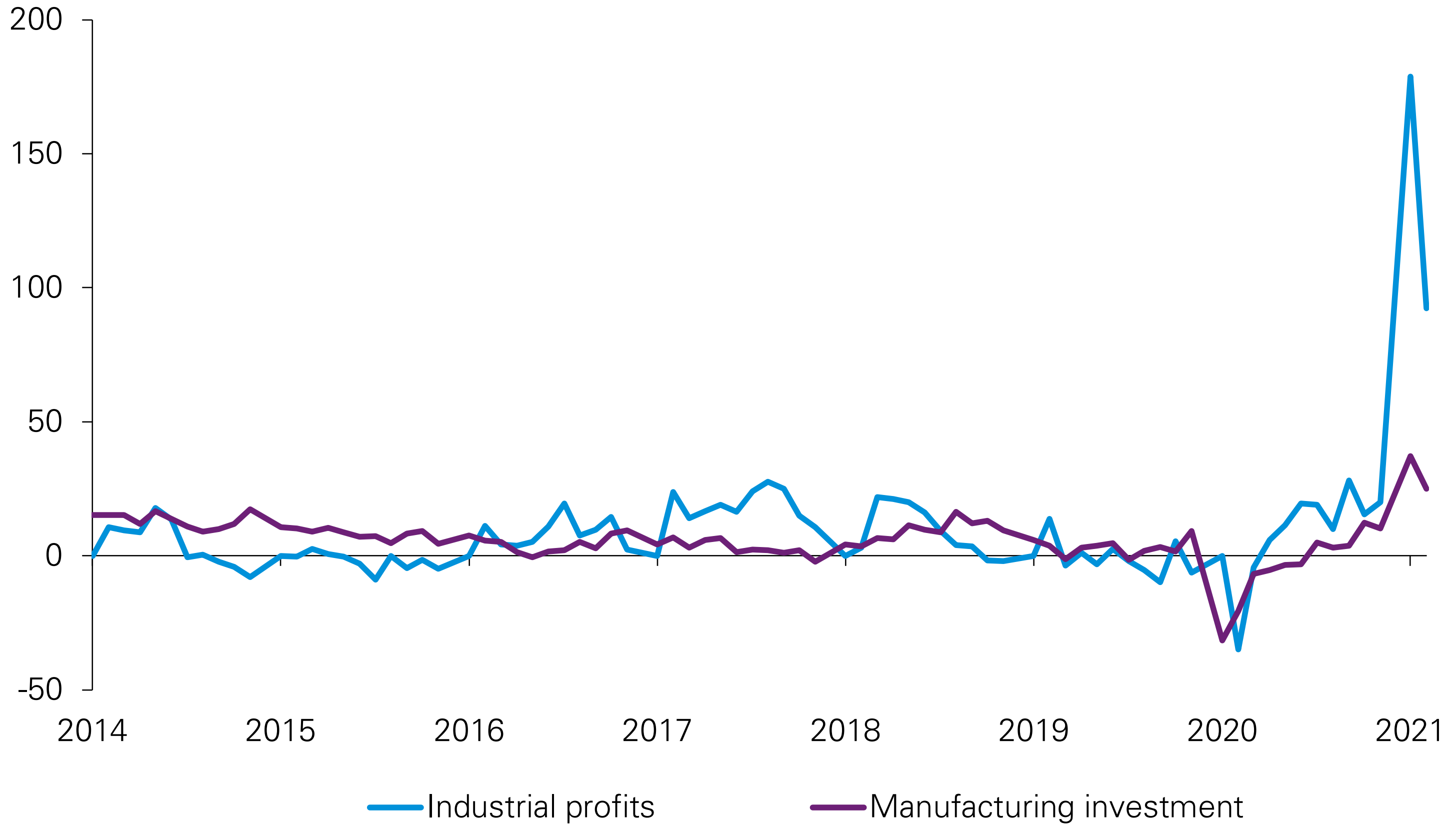
- Property sales grew 63.8% in Q1 from a very low base last year, moderating to 38.1% in March. Property starts grew 28.2% in Q1, with a notable decline to 7.2% in March. Growth of real estate investment also moderated to 14.7% in March and 25.6% in Q1.

- The government has introduced a series of regulations to prevent overheating in the housing market since the second half of 2020, including measures such as the "three red lines" to control developers' debt levels and limiting banks' exposure to real estate loans.

- A new policy on land supply, issued in late February, will significantly reduce the frequency of residential land auctions in major cities to no more than three times per year. The policy is aimed at making developers more rational at land auctions and at mitigating rising land prices. We expect property investment growth to moderate in 2021.

Manufacturing investment growth is accelerating

Industrial profits and manufacturing investment, yoy, %

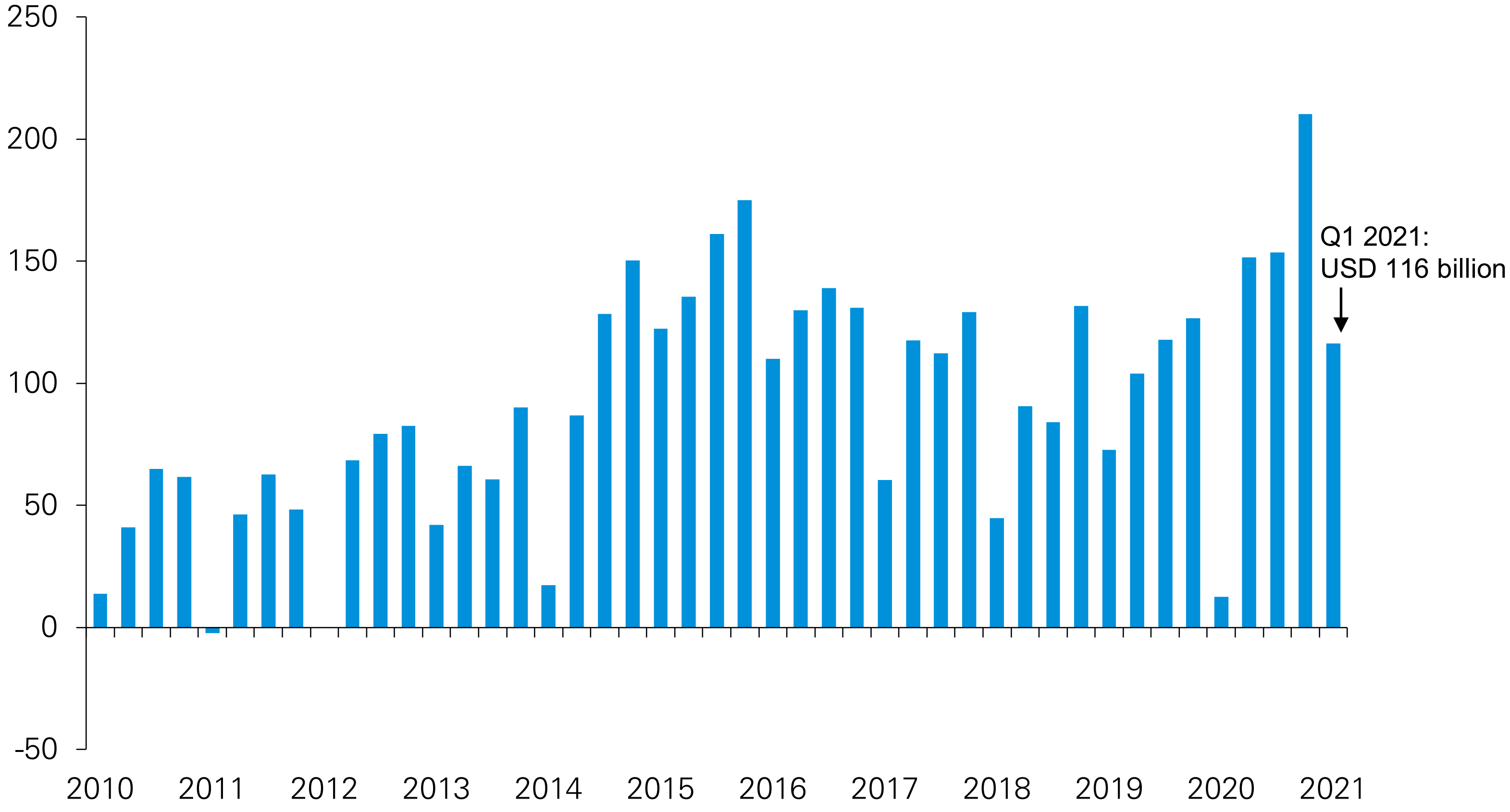


Source: Wind, KPMG analysis

- Manufacturing investment grew 29.8% in Q1 from a low base last year. It is still below the 2019 level, but the gap is narrowing.
- Industrial profits grew significantly, surging 137.3% to RMB 1.8 trillion in Q1.
- Manufacturing PMI, a leading indicator for industrial activity, has remained in the expansionary range since last March. It came in at 51.9 in March 2021, suggesting continued expansion in the months ahead.
- Capacity utilisation declined marginally, from 78% in Q4 2020 to 77.2% in Q1 2021, but is still 9.9 ppt higher than Q1 2020.
- Strong earnings growth and robust orders should support manufacturing investment in 2021.

China's exports are benefitting from strong external demand

China's trade surplus by quarter, USD billion

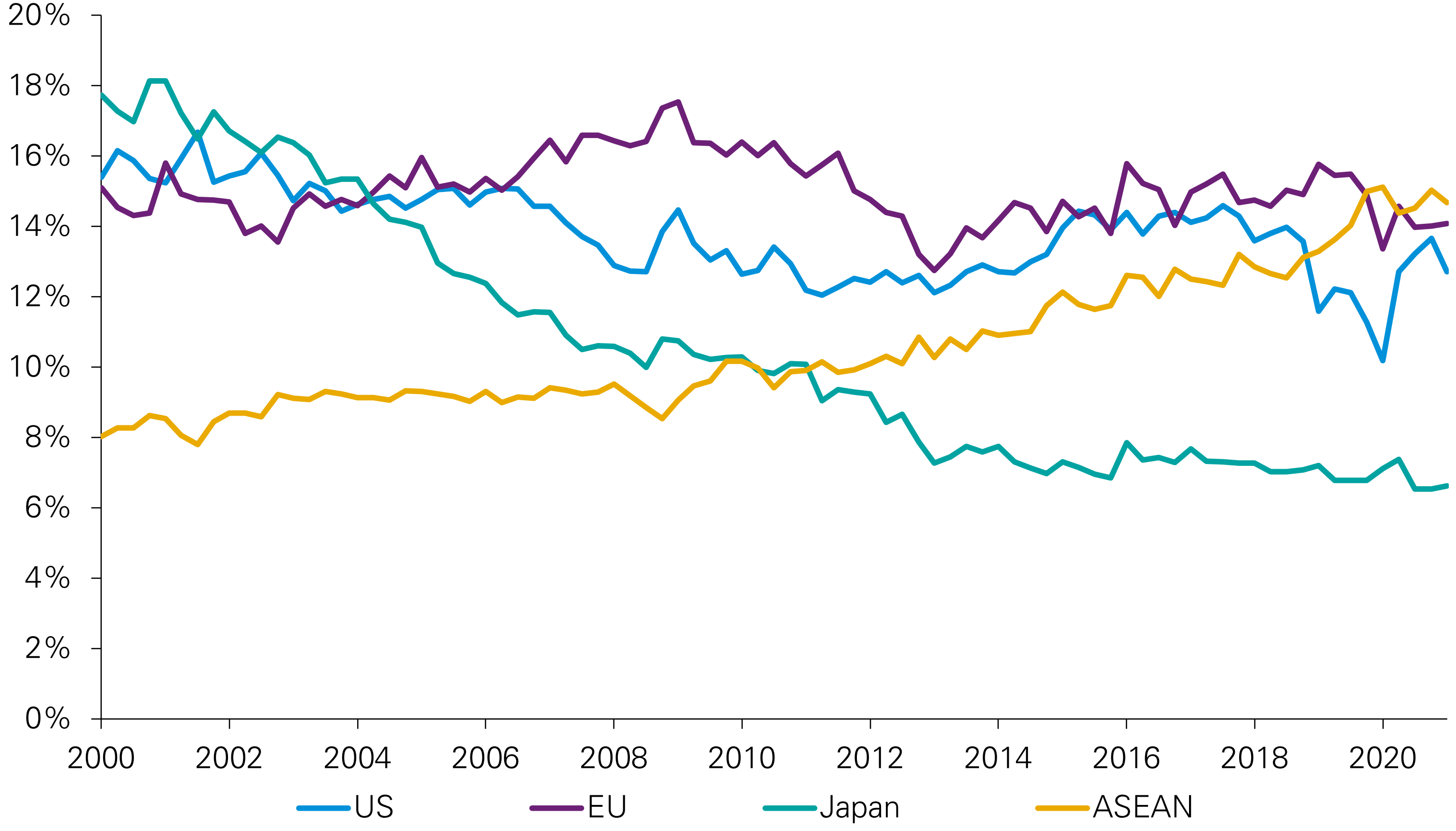


Source: Wind, KPMG analysis

- With the global economy recovering and some advanced economies introducing additional large stimulus, demand for China's products, especially for capital goods and electronic products, has remained strong. China's exports grew by 49% in Q1, pushing its trade surplus to USD 116 billion, USD 44 billion higher than the level in the same period of 2019.
- With the virus still spreading, production is only gradually coming back to the pre-pandemic level in many parts of the world. The global supply-demand gap is likely to remain in the near future, which should support China's exports.

ASEAN, the EU, the US and Japan were China's top trading partners in Q1

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

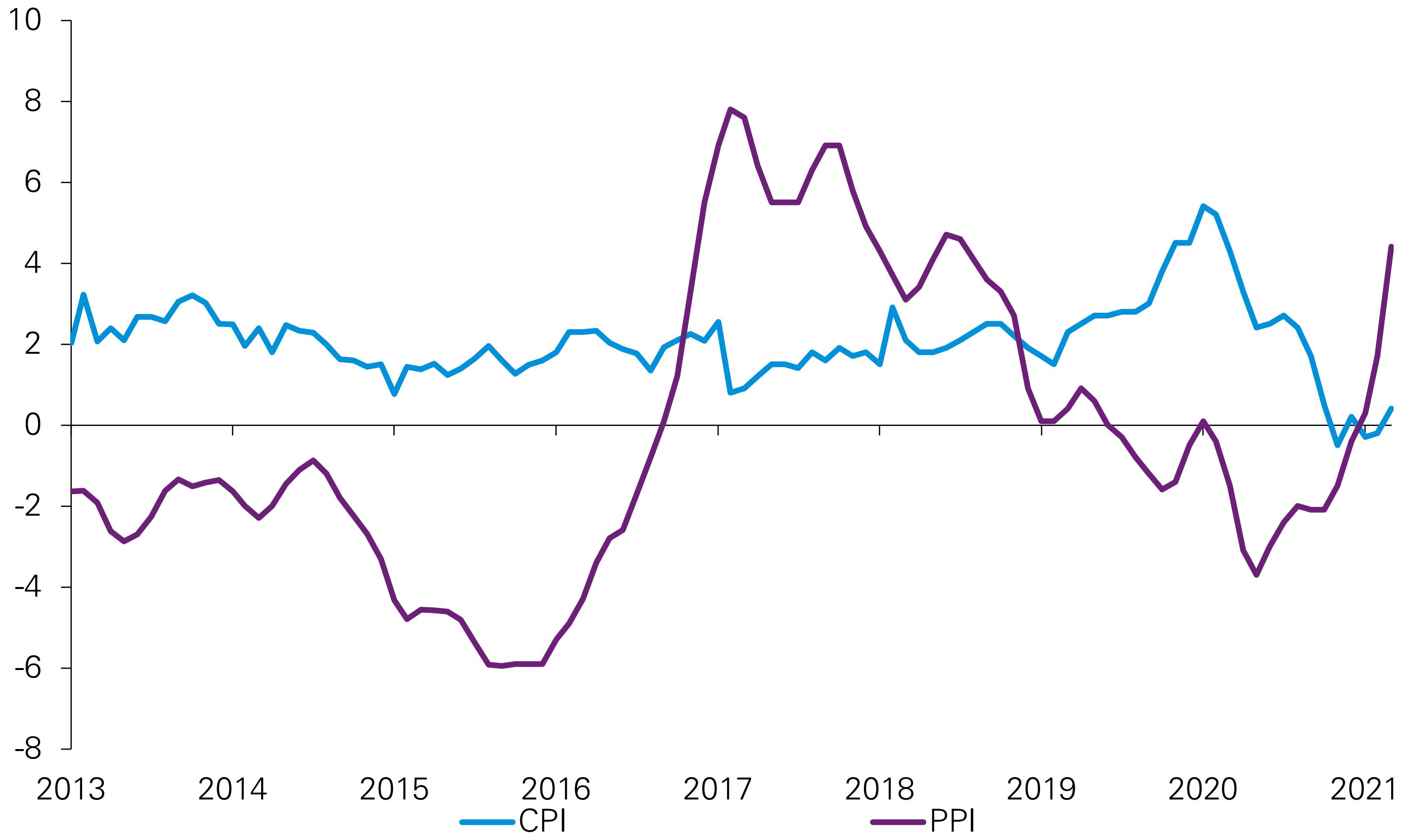


Source: Wind, KPMG analysis

- China's trade with ASEAN, its largest trading partner, totalled USD 191.3 billion and accounted for 14.7% of China's total trade in 2021Q1.
- Trade with the US surged to USD 165.7 billion in Q1, USD 46.2 billion higher than the level in the same period of 2019. In addition, the trade surplus with the US has narrowed. China accelerated its imports from the US as part of the Phase 1 US-China trade agreement. US exports of products in the Phase 1 deal totalled USD 36.7 billion by March, 17.8% of the original 2021 annual expectation.
- China's trade with other countries in the Regional Comprehensive Economic Partnership (RCEP) grew 22.9% yoy to USD 410.3 billion in Q1, representing nearly one-third of China's total trade.

Concerns about inflation are rising

Consumer price index (CPI) and producer price index (PPI), yoy, %

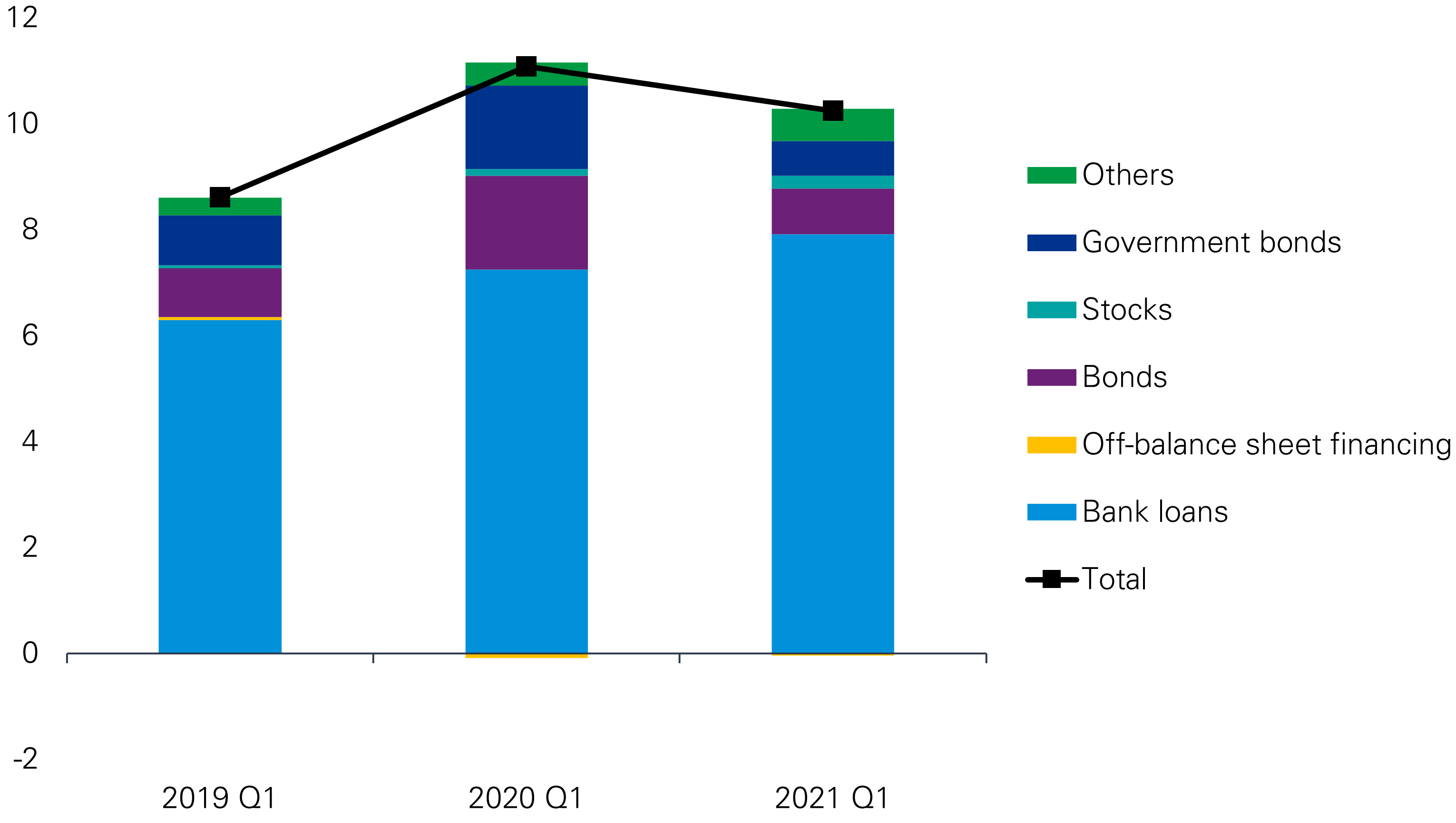


Source: Wind, KPMG analysis

- Consumer price inflation turned positive in March. With recovering pork supply and a high base effect, food price inflation remained tamed in Q1. Meanwhile, higher energy prices and improving economic activity are driving non-food prices higher.
- PPI rose from 0.3% to 4.4% in Q1. This rise of PPI was a result of both low base effect and rising commodity prices, driven by supply shortage and recovering global demand.
- The government has set a CPI target of 3% for 2021, and we expect consumer price inflation to remain modest this year with falling food prices. However, global commodity prices are likely to remain elevated in the near term and may put further upward pressure on PPI, affecting the profitability of downstream firms.

New total social financing retreated from last year's high level but remained supportive

Change in total social financing, RMB trillion

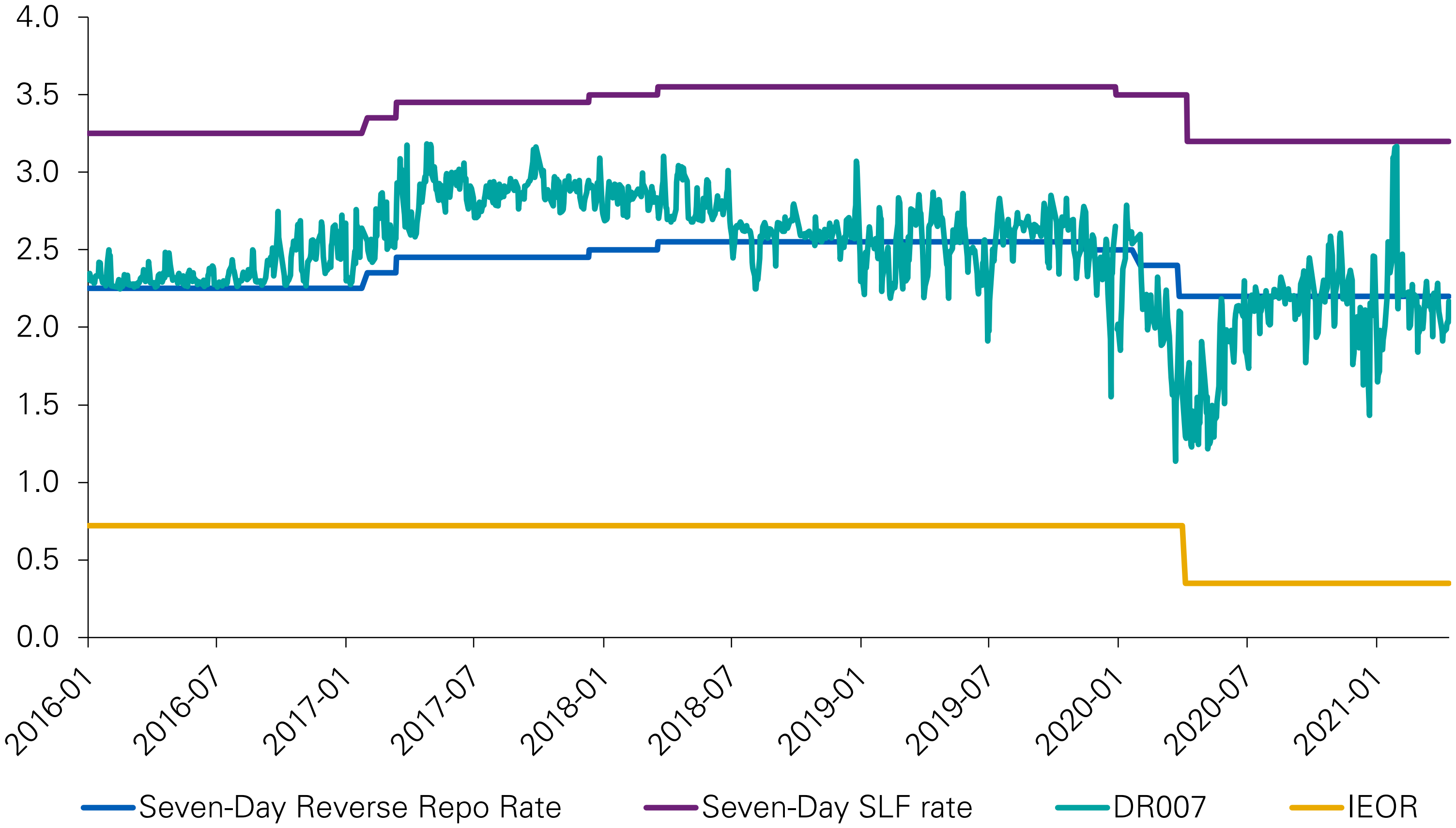


Source: Wind, KPMG analysis

- We expect the People's Bank of China, China's central bank, to gradually slow down the pace of liquidity injection from last year's high levels. However, the adjustment will be measured as the recovery is still at an early stage and significant uncertainty remains for the global economy.
- New total social financing (TSF), a measure of the total liquidity provided by the financial sector to the real economy, increased by RMB 10.2 trillion in Q1. It was RMB 0.9 trillion lower than Q1 2020, but still higher than the level in the same period of 2019.
- Bank loans are the main driver for the TSF growth, reaching RMB 7.9 trillion and accounting for 77% of the increase in TSF, 12 ppt higher than that of Q1 2020. The issuance of local government special bonds slowed to RMB 660 billion in Q1.
- Advanced manufacturing, the green economy and indigenous innovation are expected to attract more funding support in the future.

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

Interbank market rate, %

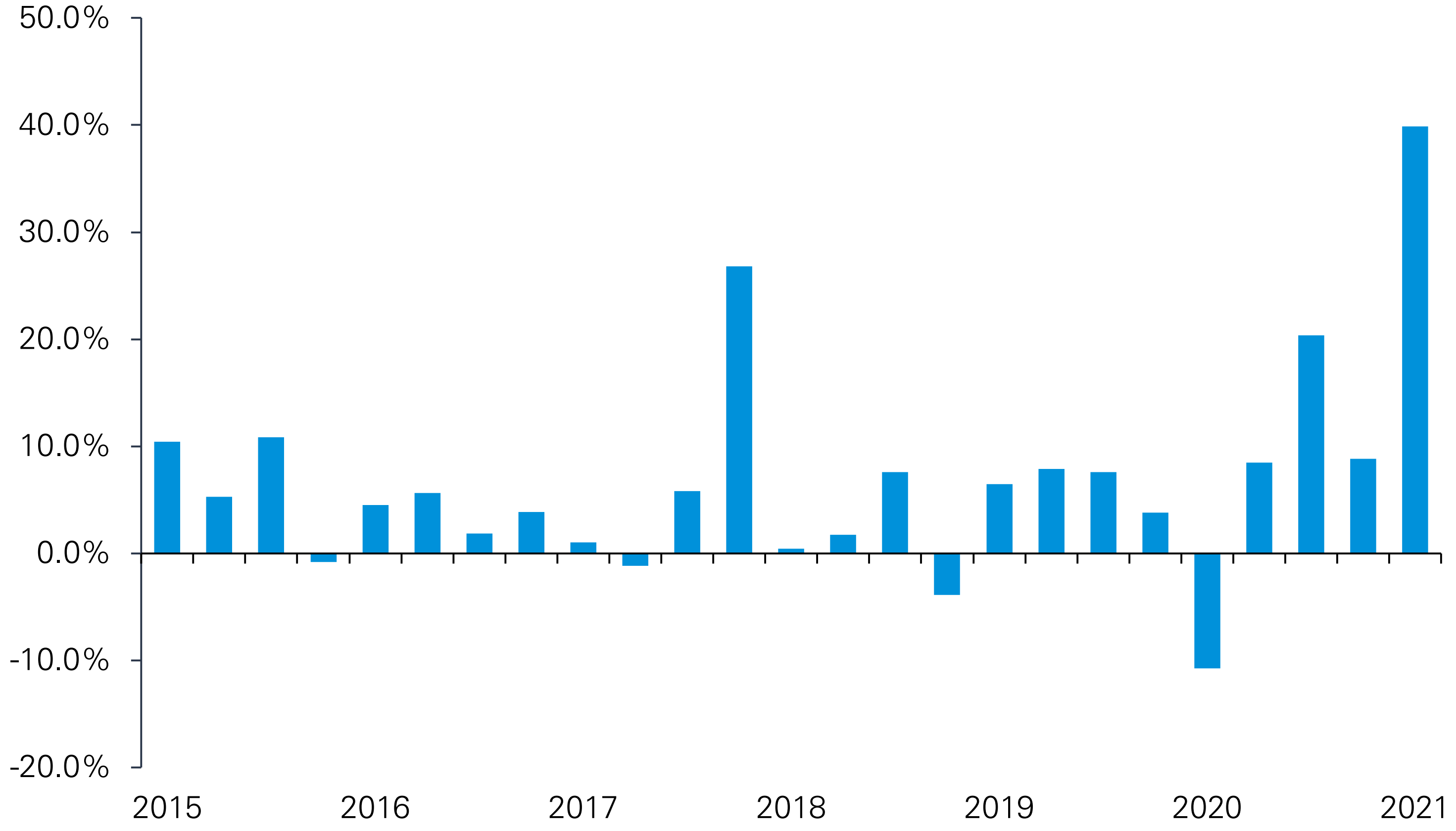


Source: Wind, KPMG analysis

- Policy rates remained unchanged in Q1. The central bank mainly relies on open-market operations to keep liquidity at appropriate levels. DR007, a measure of the average cost of funds for banks, fluctuated around 2%, below the long-term average of 2.5%.
- To support the real economy, the weighted average interest rate of corporate loans fell to 4.56% in February. In addition, loans to small and micro-enterprises by large commercial banks increased over 50% in 2020; the government is targeting a further 30% in 2021.
- We expect the central bank to keep both the policy rates and required reserve ratio unchanged in the near future.

FDI continued to see strong growth in Q1

China's FDI by quarter, RMB terms, yoy growth, %

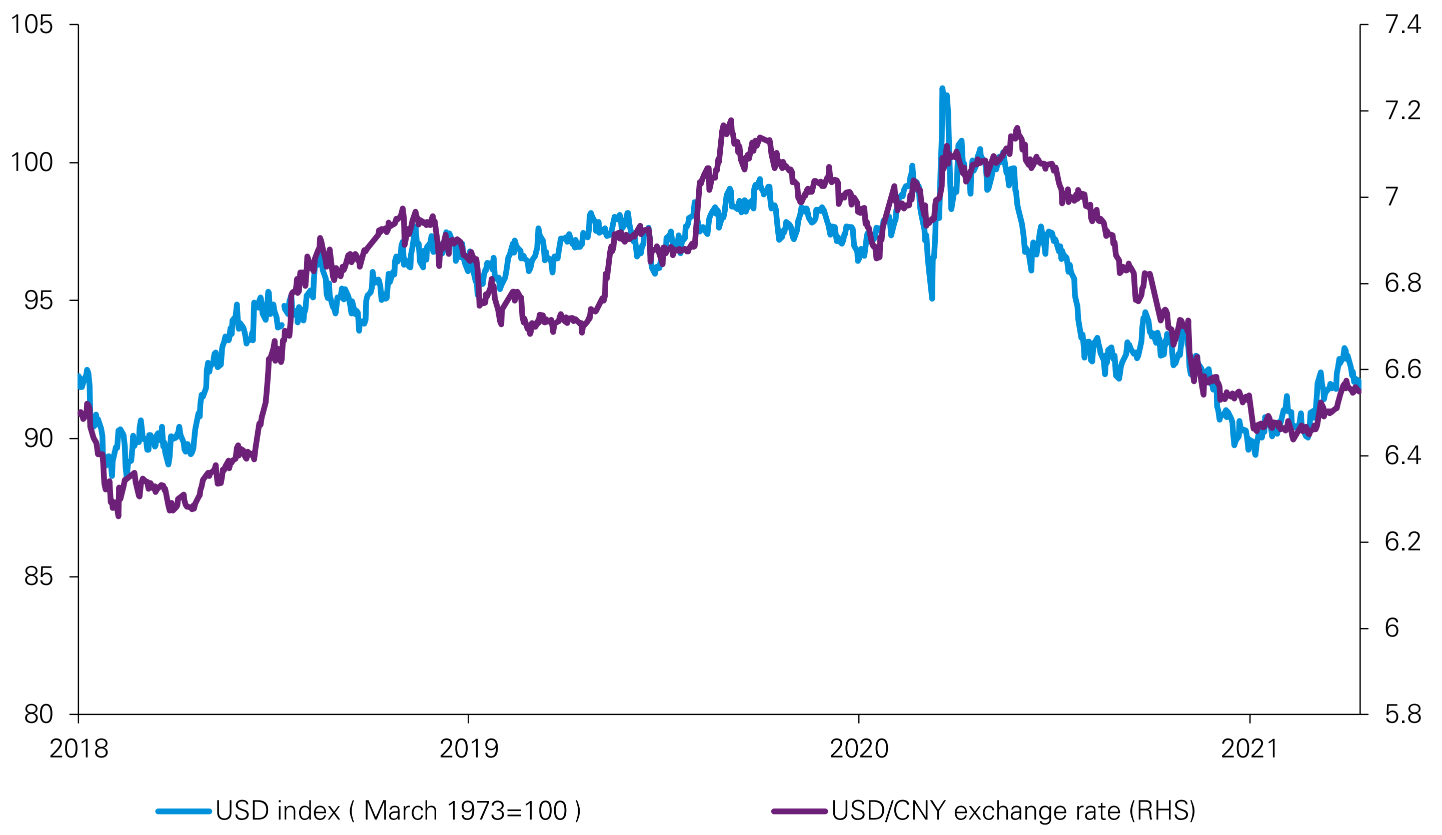


Source: Wind, KPMG analysis

- China surpassed the US to become the world's largest recipient of foreign direct investment (FDI) last year. FDI remained strong in Q1, up 39.9%.
- The share of the service sector is rising, accounting for 78.6% of the total FDI in Q1. Meanwhile, FDI in China's western region also grew faster, up 91% in Q1. Rich natural resources and relatively cheaper labour cost are raising the attractiveness of the western region to FDI.
- With a vast domestic market, steady economic growth and more opening-up, China remains an important destination for foreign investments.

The RMB exchange rate returns to two-way movements

USD index and USD/CNY exchange rate

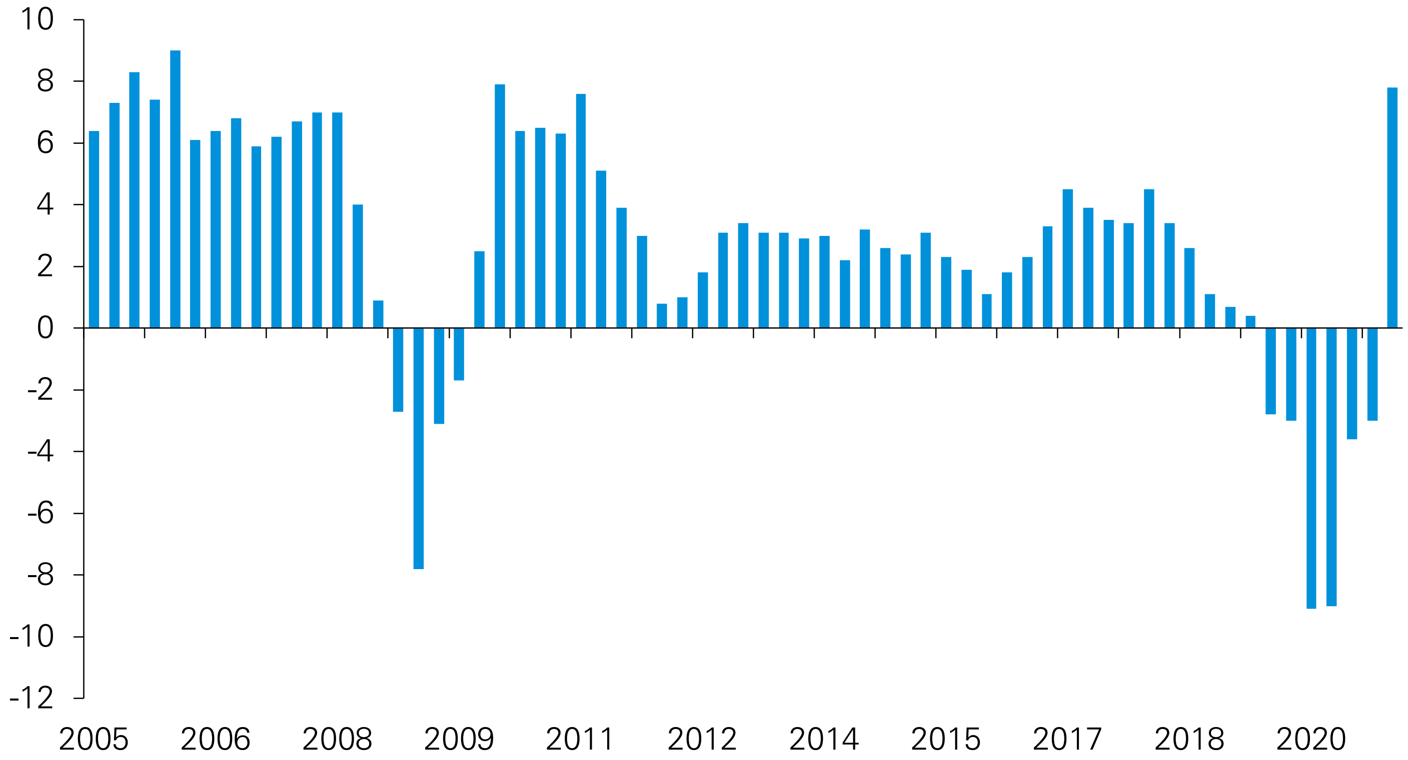


Source: Wind, KPMG analysis

- The RMB saw steady appreciation against the USD in the second half of 2020, up over 10%. However, the USD regained some strength entering 2021, supported by accelerated vaccination rollouts, additional stimulus measures and robust Q1 economic growth. Against a stronger USD, the RMB has weakened moderately in recent months.
- We expect the RMB to experience a two-way movement against the USD and remain stable in the near future. On the one hand, the US economy continues to improve and the 10-year government bond spread between China and the US has been narrowing since 2021. On the other hand, China's trade surplus remains strong and should support the RMB.

Hong Kong's economy is expected to resume growth in 2021

Hong Kong real GDP growth rate, yoy, %



Source: Wind, KPMG analysis

- After six quarters of continuous decline, Hong Kong's economy finally returned to positive growth in Q1. The economy grew by 7.8% in Q1, an 11-year high. The large increase was mainly attributable to strong external trade and the low base of comparison last year.
- However, overall economic activity is still below the pre-recession level and the recovery is uneven across sectors. Tourism and retail are still struggling to recover.
- The unemployment rate rose from 6.6% in December to 6.8% in March. The government announced plans of easing social distancing measures on 12 April. Normalisation of pandemic containment measures should help service-related consumption and the labour market in 2021.
- Hong Kong's economy is expected to continue to recover and grow 5.2% in 2021.

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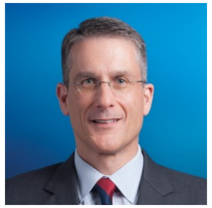

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