

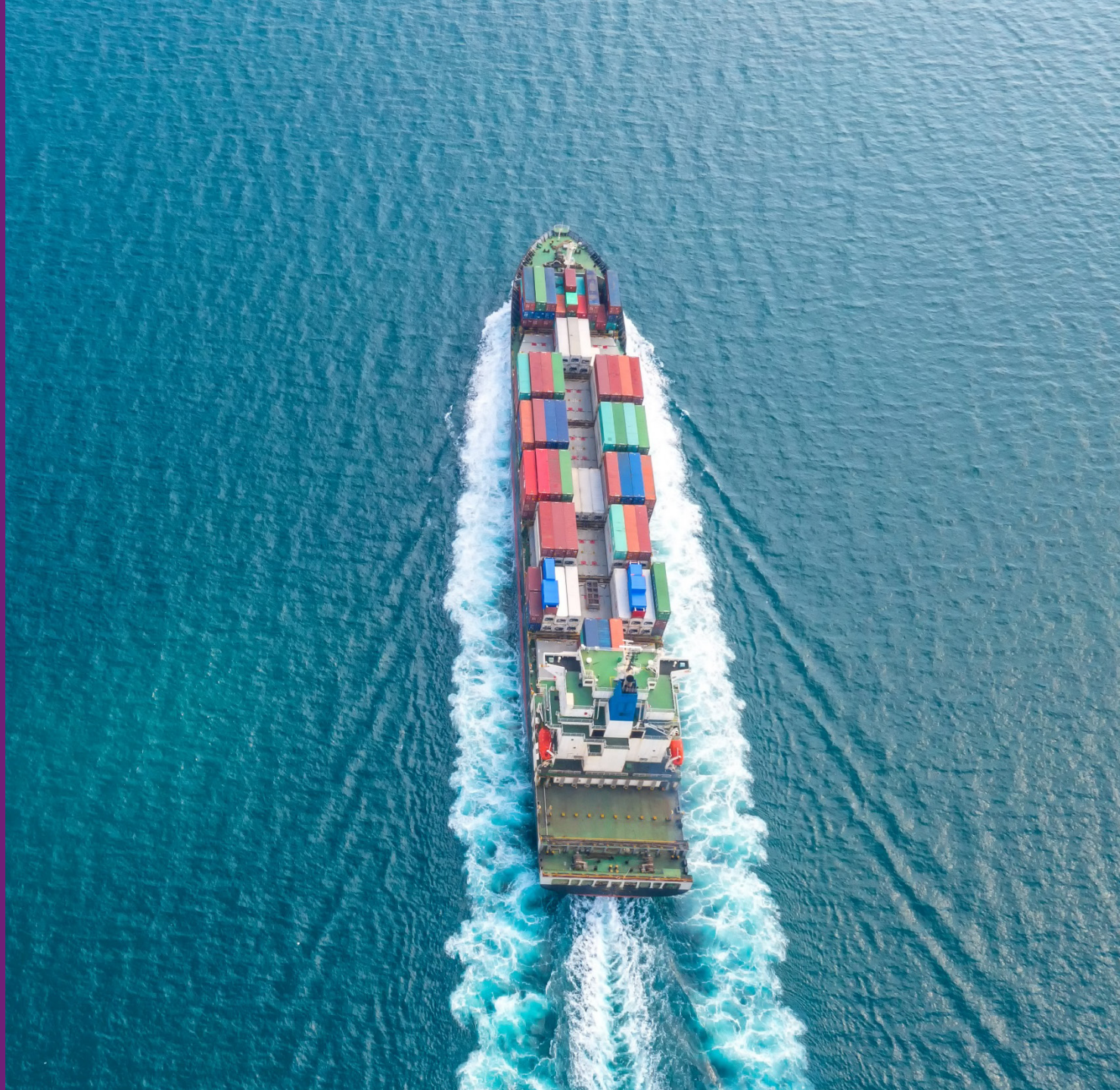


China Economic Monitor

Issue: 2021Q3

August 2021

kpmg.com/cn





Key takeaways

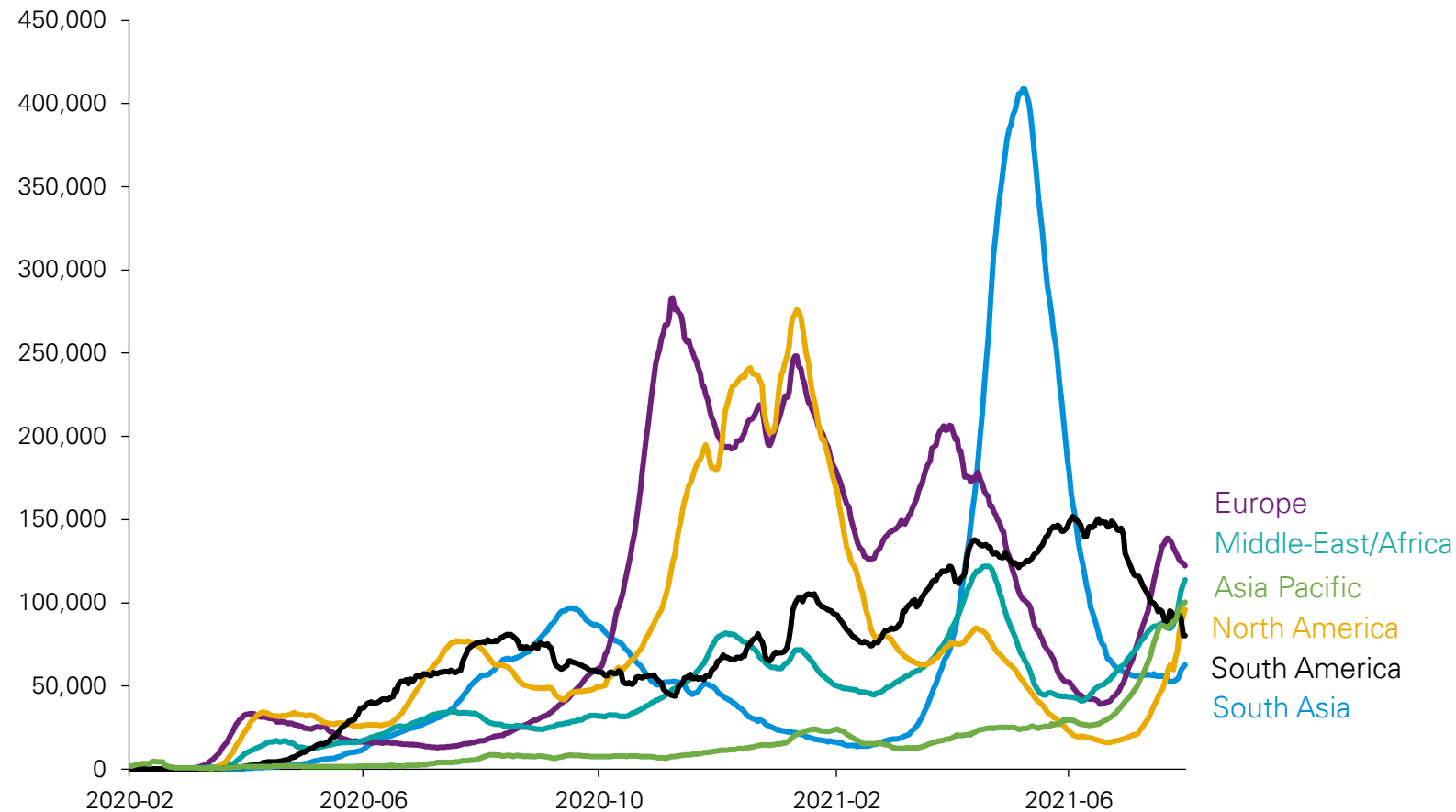
- China's GDP grew by 7.9% from a year ago in Q2, moderating from the 18.3% pace in Q1 2021. This is attributable to a higher base for year-over-year (yoy) comparison and resurgence of COVID-19 cases in some areas. Taking the past two years together, the annualised average growth rate improved from 5.0% in Q1 to 5.5% in Q2. However, we expect economic growth to face more challenges in H2 due to a higher base, lingering pandemic controls and uncertainty in the global environment. Overall, the economy grew 12.7% in the first half of the year and we maintain our GDP forecast of 8.8% for the full year 2021.
- Growth of overall industrial production has moderated slightly, whereas high-tech manufacturing continues to see faster growth. Manufacturing investment growth also picked up from 13.5% in May to 16.4% in June, supported by rebounding corporate profits and accelerating growth in the high-tech sector.
- China's exports remained strong in H1, boosted by a solid recovery of global demand. China's imports also reached a record high in H1. Exports have been a major driver of China's economic recovery since the pandemic and we expect its growth pace to moderate somewhat in H2.
- Consumption has seen a good rebound from a low base. But in contrast to strong growth of industrial production and exports, the trend of consumption recovery, especially services, is still below the pre-pandemic level. Looking forward, we expect consumption to continue to gradually recover as consumer confidence improves.
- Driven by rising commodity prices, the producer price index (PPI) jumped 5.1% in H1, 3 ppt higher than that in Q1. The government has taken a series of measures to rein in commodity prices and PPI growth edged down by 0.2 ppt to 8.8% in June. Meanwhile, OPEC+ reached a deal to increase oil production from August, a move that could help ease oil prices. We expect producer prices to stay at relatively high levels but the pace of increase should decelerate in H2.
- The central bank announced a 50bps cut on banks' required reserve ratio, releasing about RMB 1 trillion liquidity. Despite the cut, the central bank emphasized that it has not changed its "prudent" monetary stance. We think the cut is a pre-emptive move to mitigate growth pressure in H2 and to ease liquidity pressure in the financial system.
- New COVID-19 infections have moderated in South Asia and South America but have picked up in Asia Pacific and Europe recently. According to WHO, the Delta variant of COVID-19 virus has shown higher transmissibility and remains a global threat.





New COVID-19 infections have moderated in South Asia but are picking up again in other regions

Daily new COVID-19 cases by region, seven-day moving average

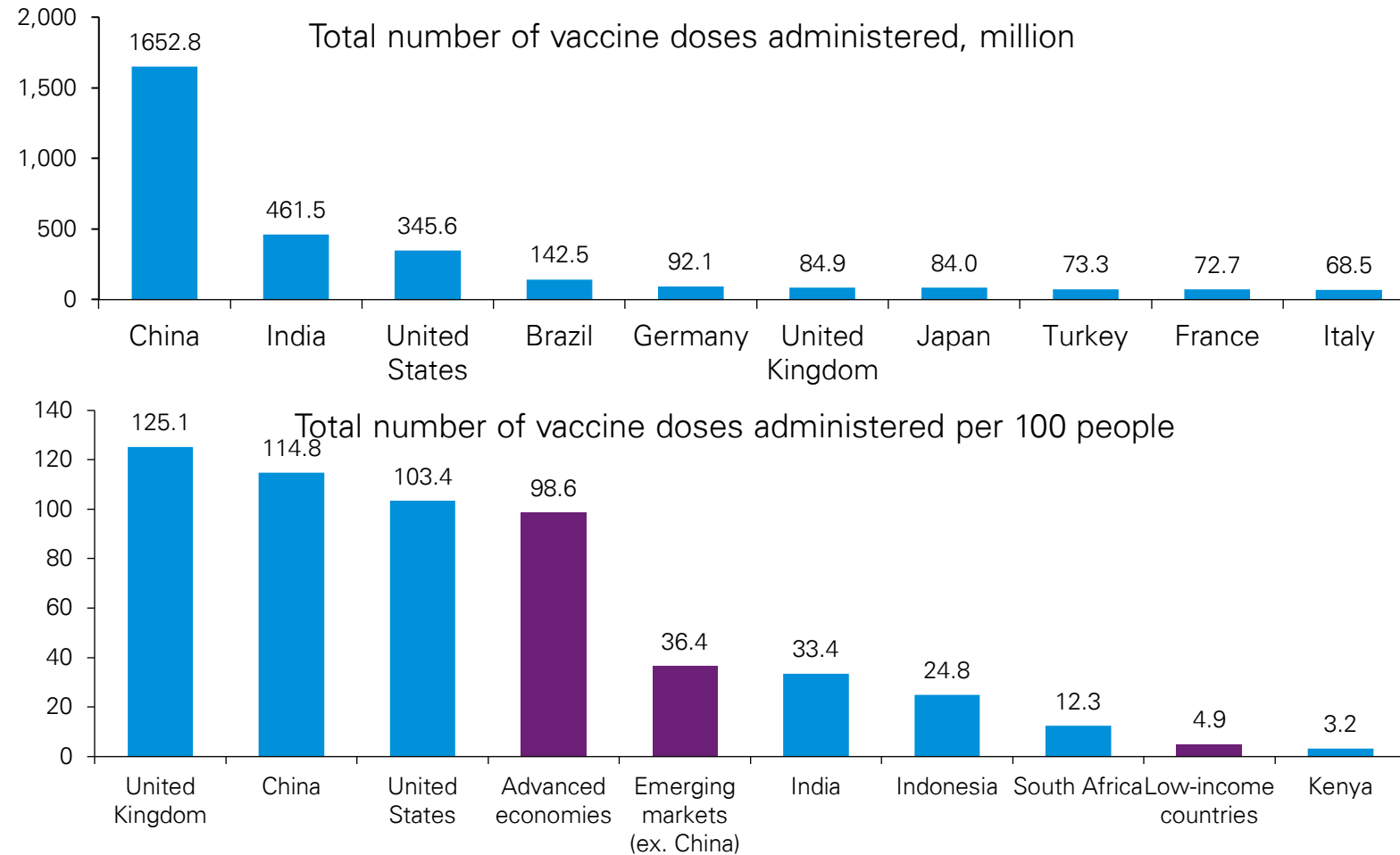


Source: Wind, KPMG analysis. Data through 31 July 2021.

- Global confirmed COVID-19 cases stood at nearly 200 million including over 4 million deaths as of 31 July. After a decline in May and June, new cases are increasing again in many regions.
- India's new infections have retreated after the spike in May, but daily new cases increased again to around 70k in the US and 30k in UK as of 31 July.
- China has also seen a resurgence of infections in certain areas, such as Guangdong, Yunnan and most recently Nanjing.



Vaccine administrations are uneven across advanced and emerging economies



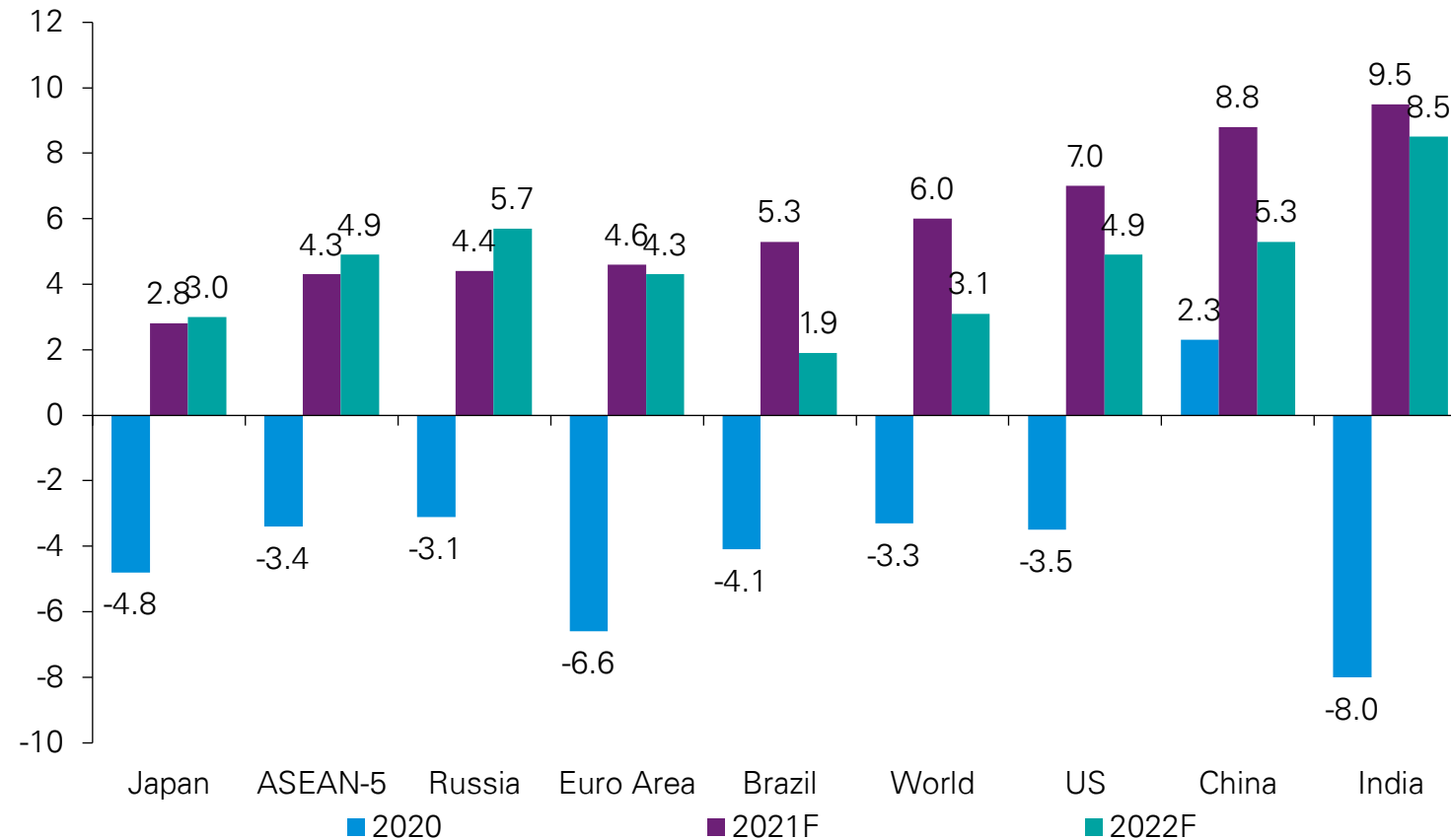
- As of 31 July, over 4.14 billion COVID-19 vaccine doses had been administered around the world. China administered over 1.6 billion doses (about 1 billion doses were administered during May–July).
- Vaccine penetration varies significantly across countries — nearly 99 doses per 100 people in advanced economies but only 36 in the emerging markets (ex. China) and less than 5 doses in low-income countries.
- According to WHO, the Delta variant has shown higher transmissibility and remains a global threat in the coming months. The available evidence suggests full vaccination provides protection against severe disease and death for this variant.
- China has shipped over 570 million doses of COVID-19 vaccines overseas. However, more global efforts are needed to secure vaccines around the world.

Source: Our World in Data, Data through 31 July 2021. KPMG analysis



The US and China are still the key engines of the global economic recovery

Real GDP growth and forecast, %



- In the latest update, the IMF maintained its global GDP forecast at 6.0% for 2021, the same as the April projection, but with various revisions for different regions.
- With continued vaccine rollouts and fiscal support, advanced economies' growth was revised up by 0.5 ppt to 5.6% in 2021. Growth of developing economies has been downgraded by 0.4 ppt to 6.3% this year, mainly due to the emergence of the Delta variant in India and some developing Asian economies.
- The developing economies are expected to face more uncertainties in the second half of this year, such as uneven vaccine distribution, and tight financial and fiscal conditions.

Source: IMF, KPMG analysis.

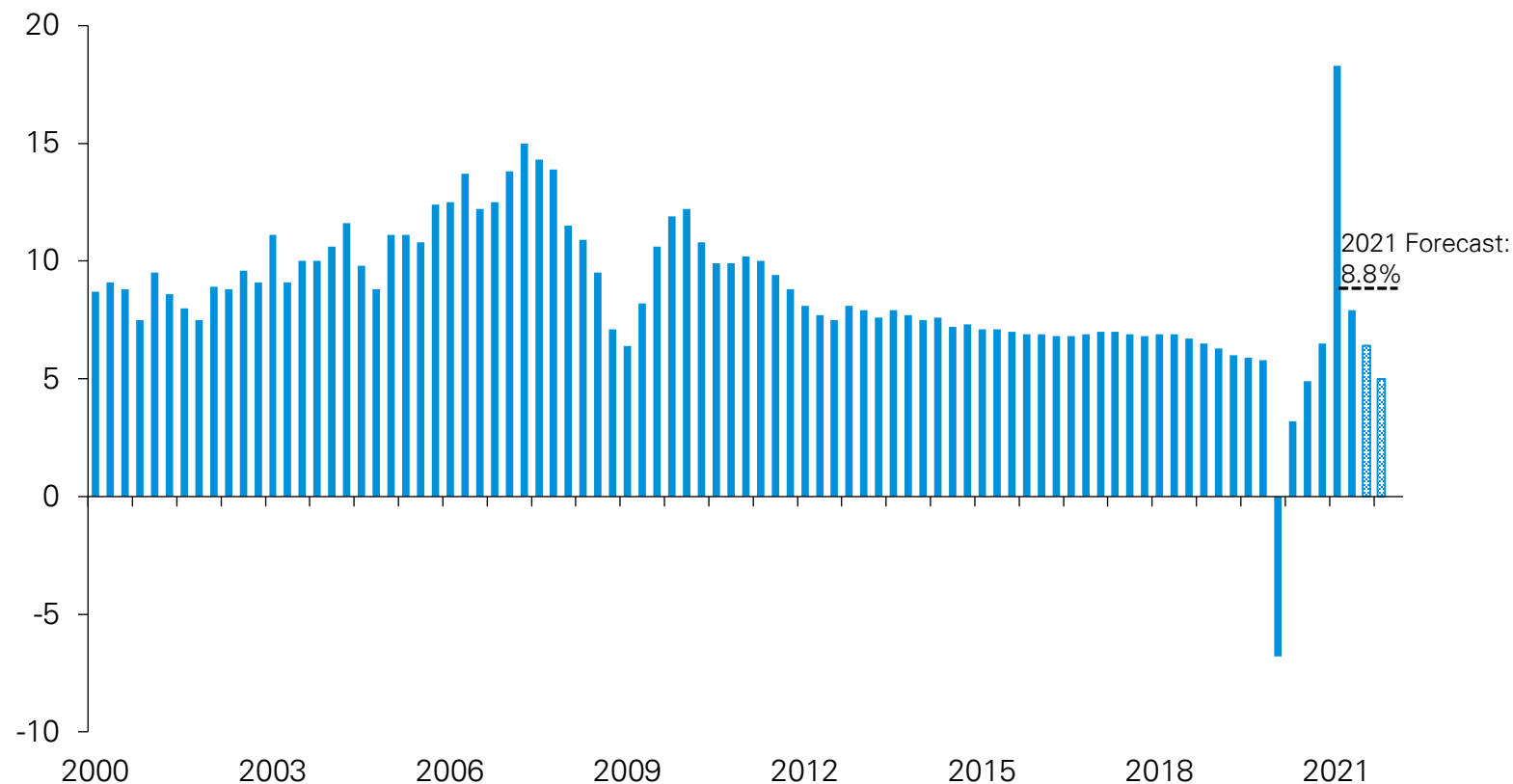
Note: China's 2021 forecast is by KPMG and the other forecasts are by the IMF. ASEAN-5 includes Indonesia, Malaysia, Philippines, Thailand, Vietnam.





China's economy is expected to continue to recover but the pace will likely moderate in H2

China real GDP growth rate by quarter, yoy, %



- China's GDP grew by 7.9% in Q2, down from the 18.3% pace in Q1 2021. The moderation is due to a higher base for year-over-year comparison and new COVID-19 cases in some areas in recent months. Overall, the economy grew 12.7% in H1.
- Industrial production grew 11.8% in H1. The high-tech manufacturing and utilities sectors continued to expand, up 22.6% and 13.4%, respectively.
- Going forward, we expect economic growth to moderate in H2 due to both a higher base for comparison and uncertainties in the global economy. We maintain our GDP forecast of 8.8% for 2021.

Source: Wind, KPMG analysis





Drivers of China's recovery are shifting from industrial production/exports to consumption/investment

Annualised growth rate of the past two years, yoy, %

	2017–19 Average	2021 Q1	2021 Q2	2021 H1
GDP	6.6%	5.0%	5.5%	5.3%
Industrial production	6.2%	6.8%	6.6%	7.0%
Retail sales	9.0%	4.1%	4.6%	4.4%
Fixed asset investment	6.2%	2.7%	5.6%	4.5%
Exports	6.1%	13.4%	14.2%	13.8%
Imports	9.8%	11.7%	13.9%	12.8%
Income per capita	6.5%	4.5%	7.9%	5.1%
Fiscal revenue	5.8%	3.2%	5.2%	4.2%
Fiscal spending	8.2%	0.1%	-1.5%	-0.8%

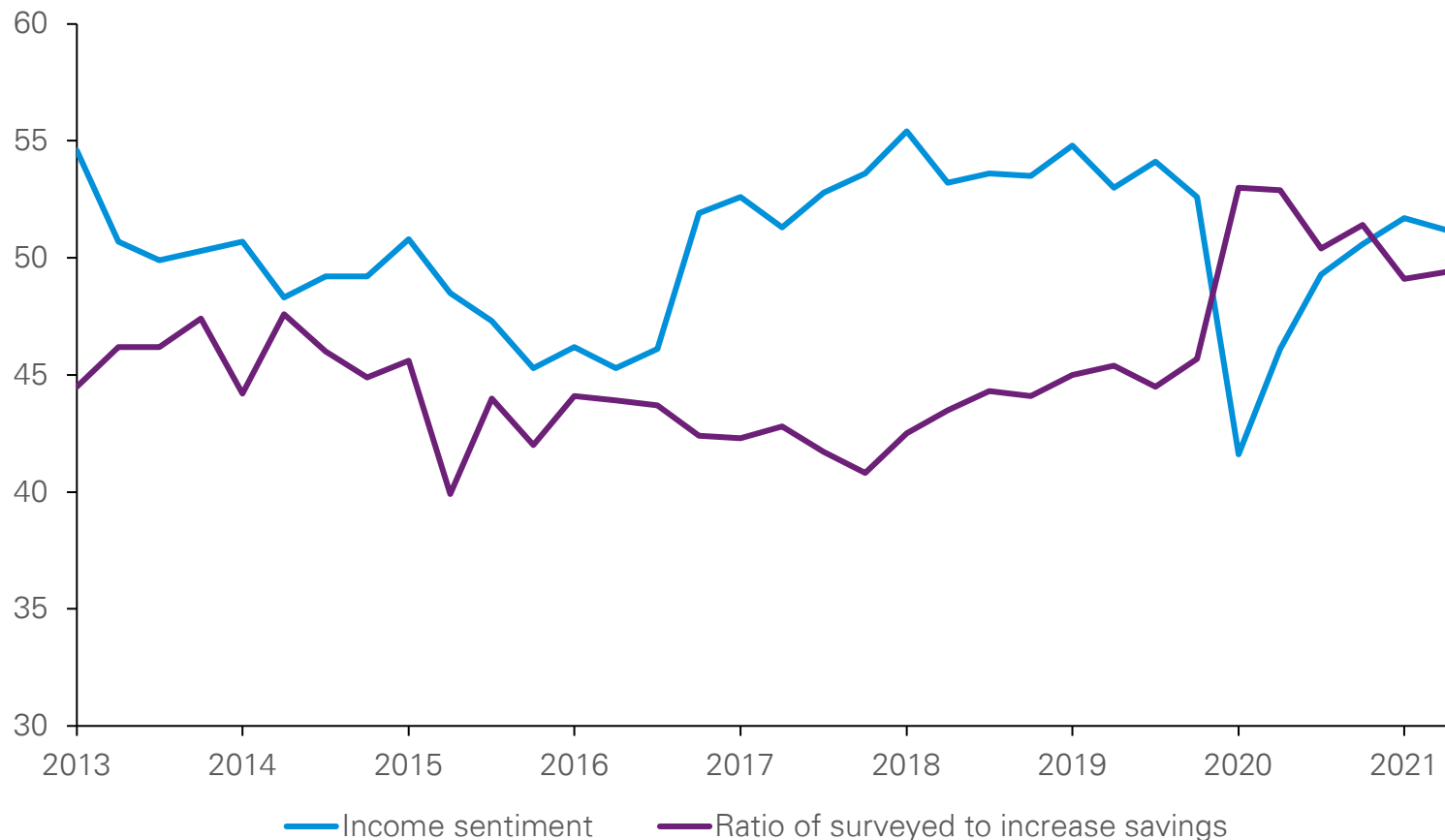
Source: Wind, KPMG analysis

- To adjust for the various base effects, we calculated the average annualised growth rate of the past two years (from 2019 to 2021) to better gauge the true recovery momentum.
- Growth rates of both industrial production and exports were significantly higher in H1 than the pre-pandemic level, and they have been the key drivers of China's economic recovery. In contrast, growth of retail sales and investment were still below normal levels.
- Meanwhile, growth of retail sales and investment improved from Q1 to Q2, and we expect both to play a more important role in China's future recovery.



Consumers' income sentiment is improving but yet to regain pre-pandemic levels

Household confidence (survey of banks' urban depositors), diffusion index



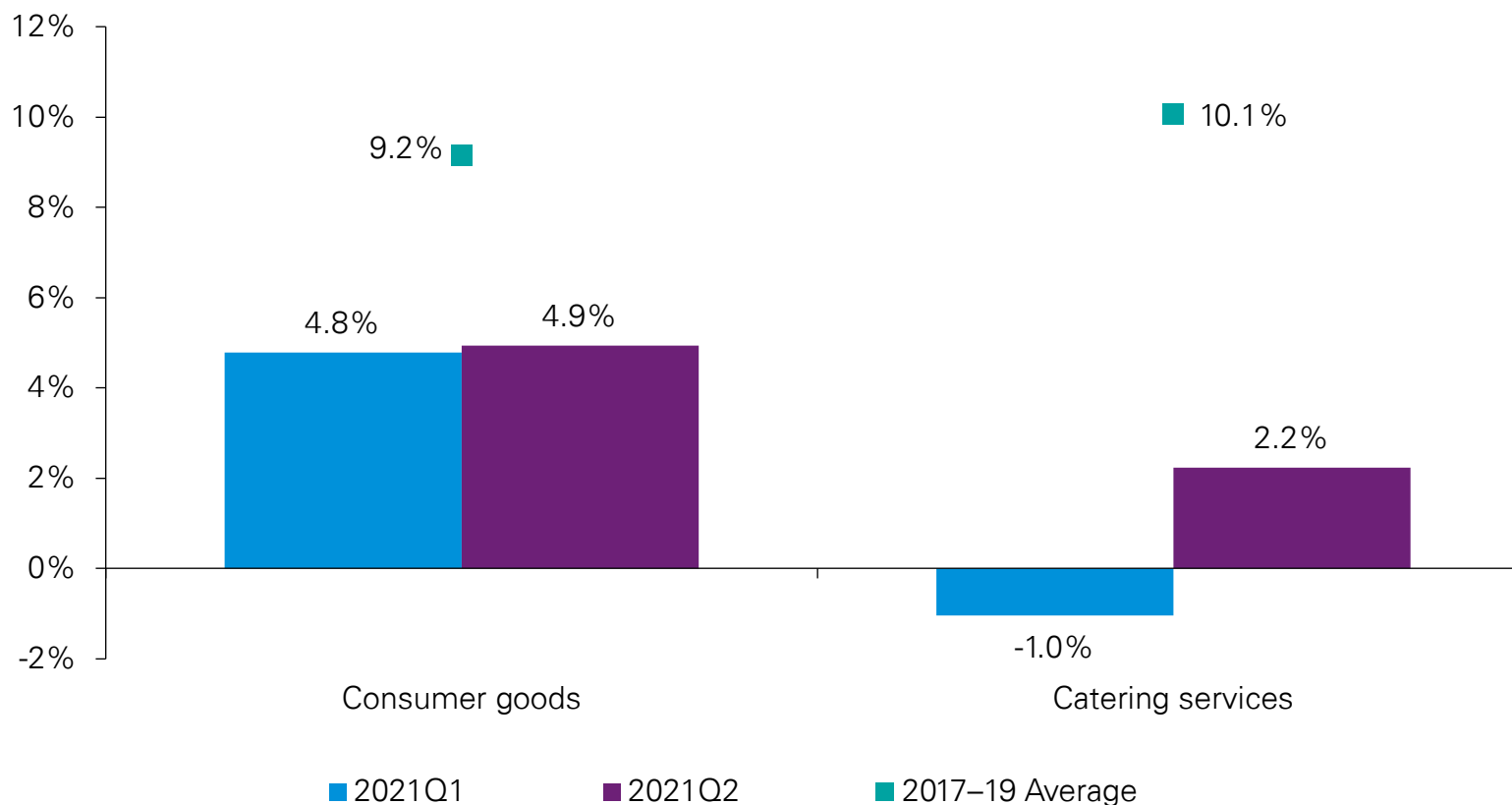
- Based on a survey by the People's Bank of China (PBoC), household sentiment for income is recovering from a historical low in Q1 2020 at the peak of the pandemic, but it has not fully regained the level seen in 2017–19.
- As a result, households still tend to be cautious on consumption and the inclination to save is still relatively high.
- With the continued economic rebound, income sentiment is improving and tendency of saving is gradually retreating. This should provide some support for future consumption growth.

Source: the PBoC, KPMG analysis



Recovery of service consumption is still lagging due to lingering pandemic control measures

Growth of goods consumption and catering sales, two-year annualised average growth rate, %



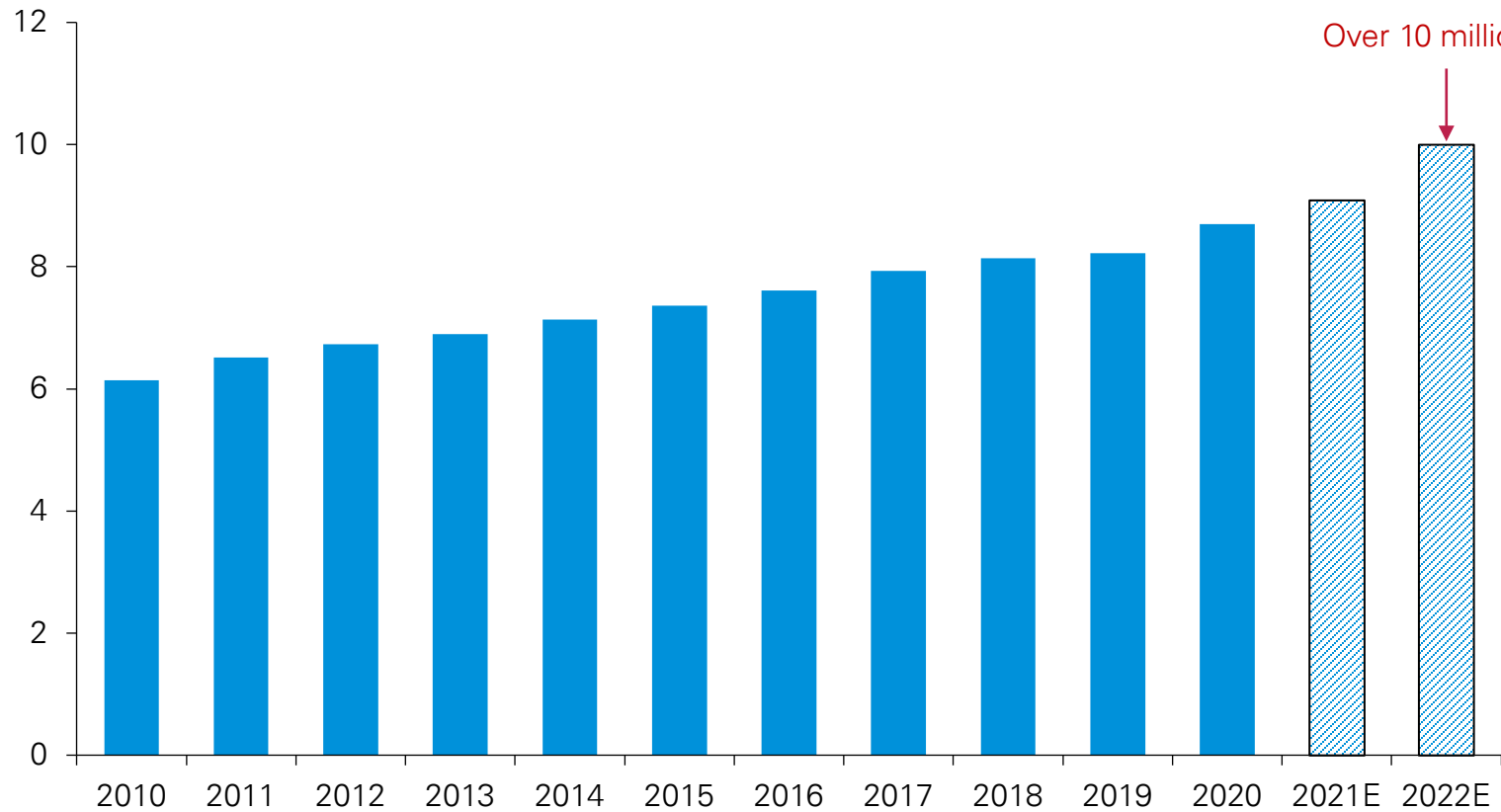
- Compared with the relatively strong rebound on the production side, recovery in consumption, especially in service-related consumption, has been lagging. The two-year annualised average growth of catering services was 2.2% in Q2, which was far below the average growth during 2017-19.
- Online goods sales grew 18.7% in H1, 4.4 ppt higher than that of last year, accounting for 23.7% of total goods sales. The volume of express deliveries exceeded 50 billion units from January to early July, close to the annual volume of 2018.

Source: Wind, KPMG analysis



Employment continues to improve but record numbers of college graduates will put structural pressure on the job market

Number of college graduates by year, million person



- The labour market continued to improve. The urban surveyed unemployment rate stayed at 5.0% in June, 0.7 percentage points lower than a year ago. Urban new job creation came in at 6.98 million in H1, amounting to 63.5% of the annual target.
- The number of college graduates has continued to rise in China in recent years. About 9.1 million and over 10 million people are expected to graduate from colleges in 2021 and 2022, respectively. Providing employment opportunities for those young graduates will be important.

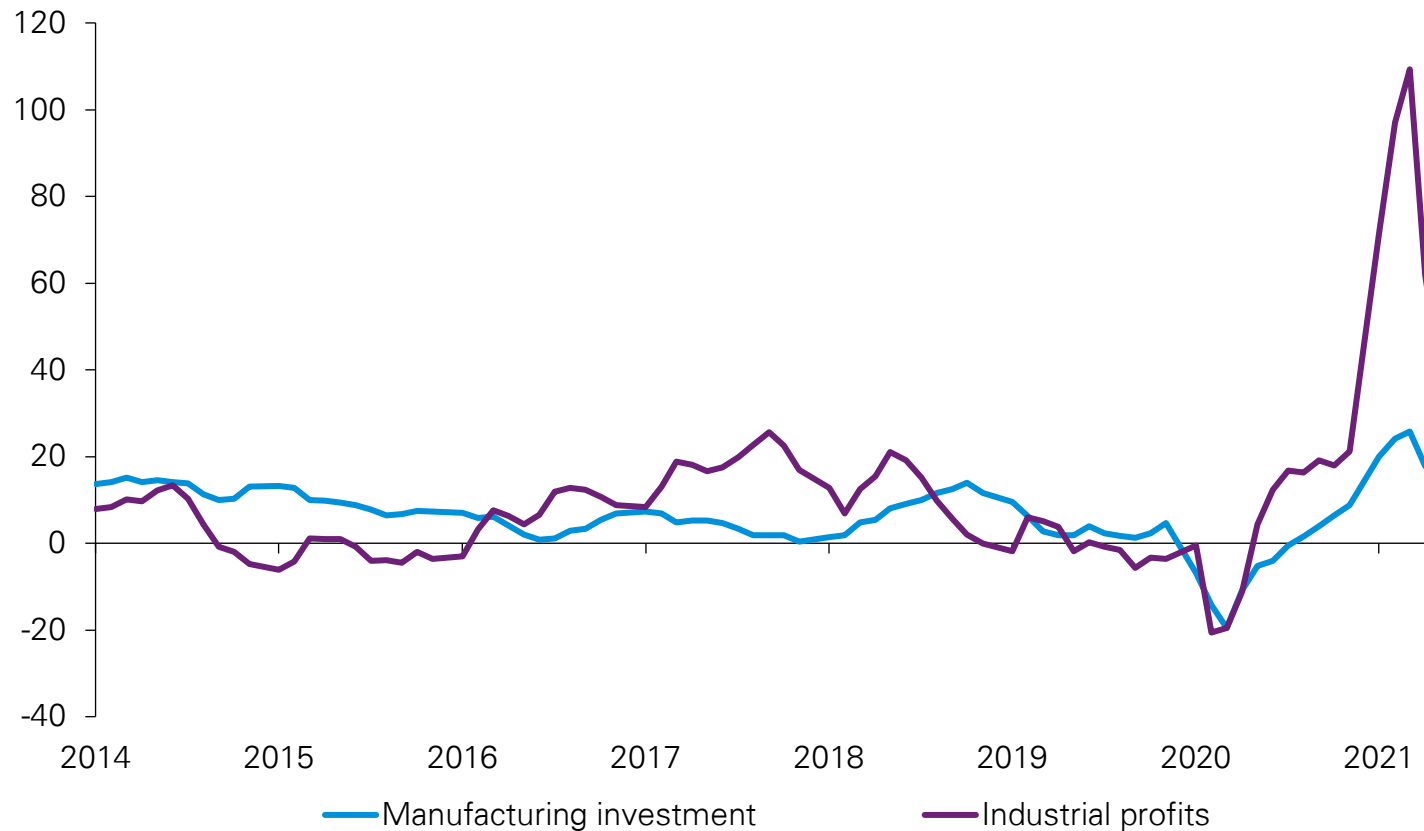
Source: China Statistics Abstract 2021, Wind, KPMG analysis





Manufacturing investment is rising with strong corporate profits

Industrial profits and manufacturing investment, yoy, three-month moving average, %



- Manufacturing investment returned to the 2019 level in Q2, and the growth momentum picked up from 13.5% in May to 16.4% in June. The acceleration is supported by rebounding corporate profits and accelerating growth in the high-tech sector.
- The banking sector is also increasing supports to the industrial sector. The outstanding medium- and long-term loans to manufacturing rose 41.6% yoy in H1, 16.9 ppt higher than the same period of last year.
- Industrial capacity utilisation improved from 77.2% in Q1 to 78.4% in Q2, 4 ppt higher than Q2 2020. Strong earnings growth and tightened capacity should support manufacturing investment in 2021.

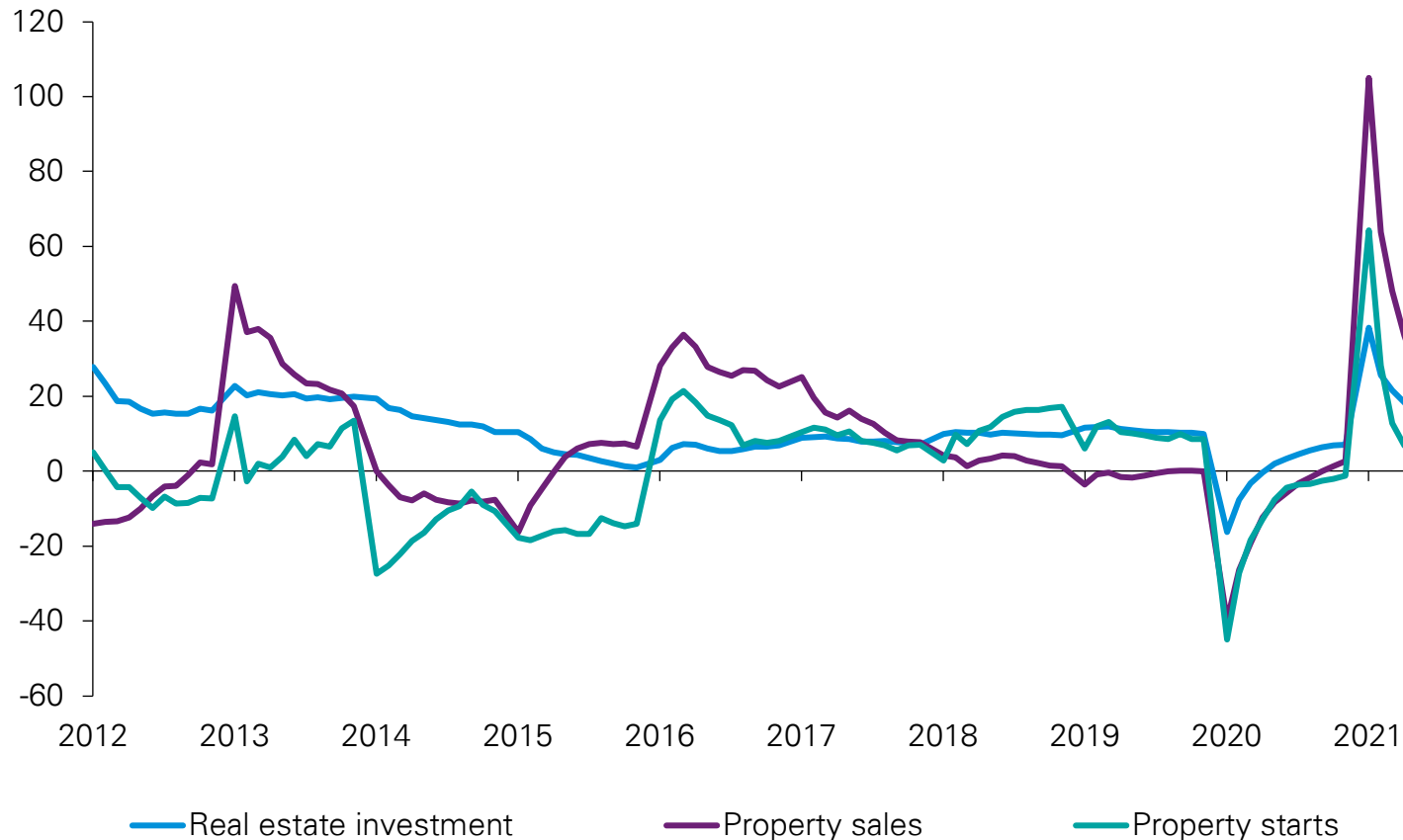
Source: Wind, KPMG analysis





Growth of the property market is expected to moderate due to continued regulatory tightening

Growth of property market, year to date, yoy, %



- Growth of property investment continued to slow, and moderated to 15% in H1.
- The government has introduced a series of regulations to cool the housing market since the second half of 2020, including measures such as the “three red lines” to control developers’ debt levels, limiting banks’ exposure to real estate loans, concentrating land auctions and raising mortgage interest rates in some cities.
- We expect the property market to continue to moderate for the rest of the year.

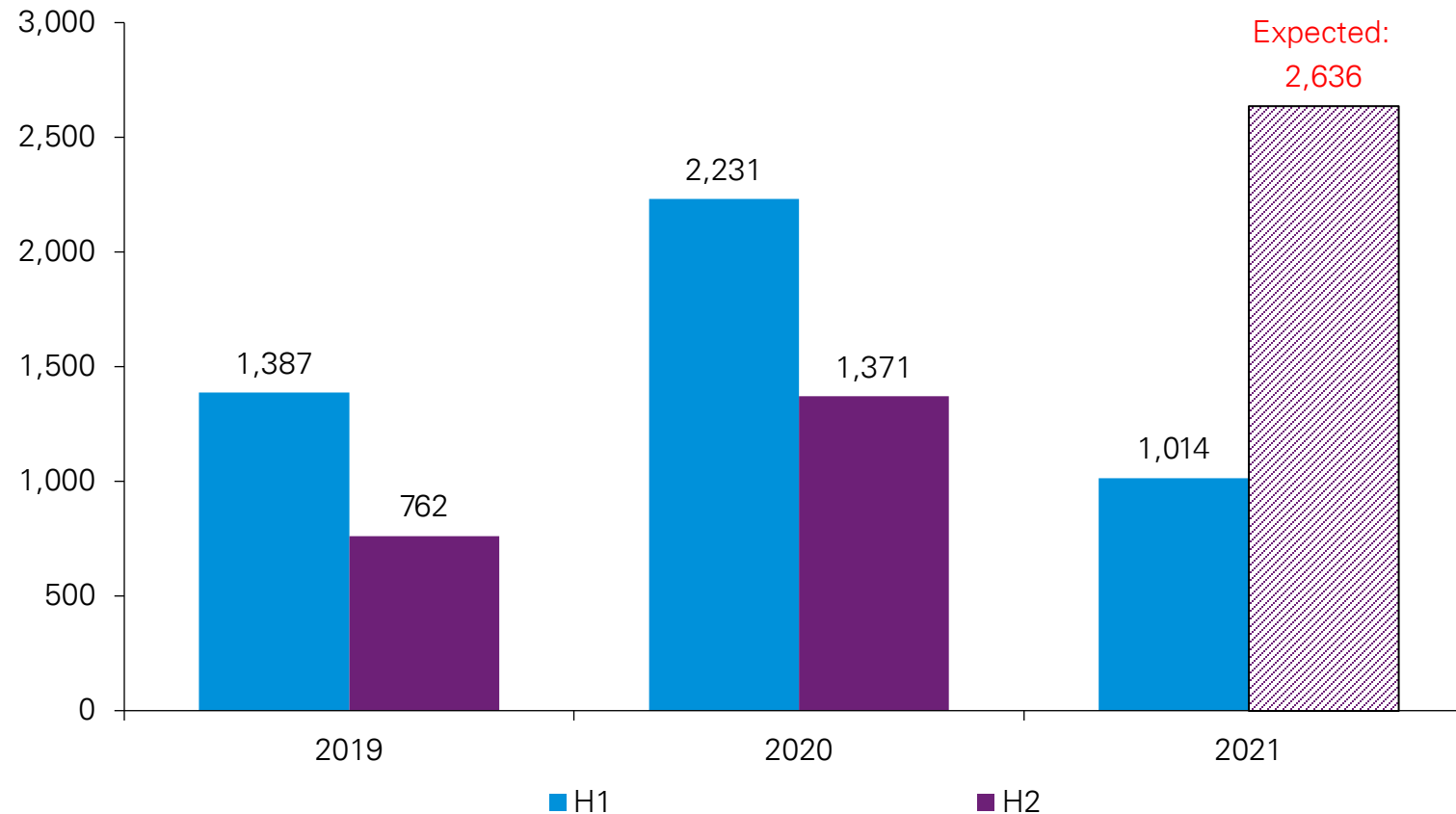
Source: Wind, KPMG analysis





Issuance of local government bonds should accelerate in H2, providing some support to infrastructure investment

New issuance of local government special bonds, RMB billion



Source: Wind, KPMG analysis

- China's fiscal revenue has returned to pre-pandemic levels and was 9% higher in H1 than 2019. But fiscal spending was still 2% below that of 2019. The government has kept a relatively tight fiscal stance to control the financial risk of local governments.
- New issuance of local government special bonds totalled RMB 1 trillion in H1 2021, comprising only 27% of the annual target. To achieve the full-year target (RMB 3.65 trillion), we expect the issuance to significantly pick up in H2, providing some support to infrastructure investment in the coming months.



China's exports remain resilient as the global economy recovers

OECD leading indicator and China's export growth



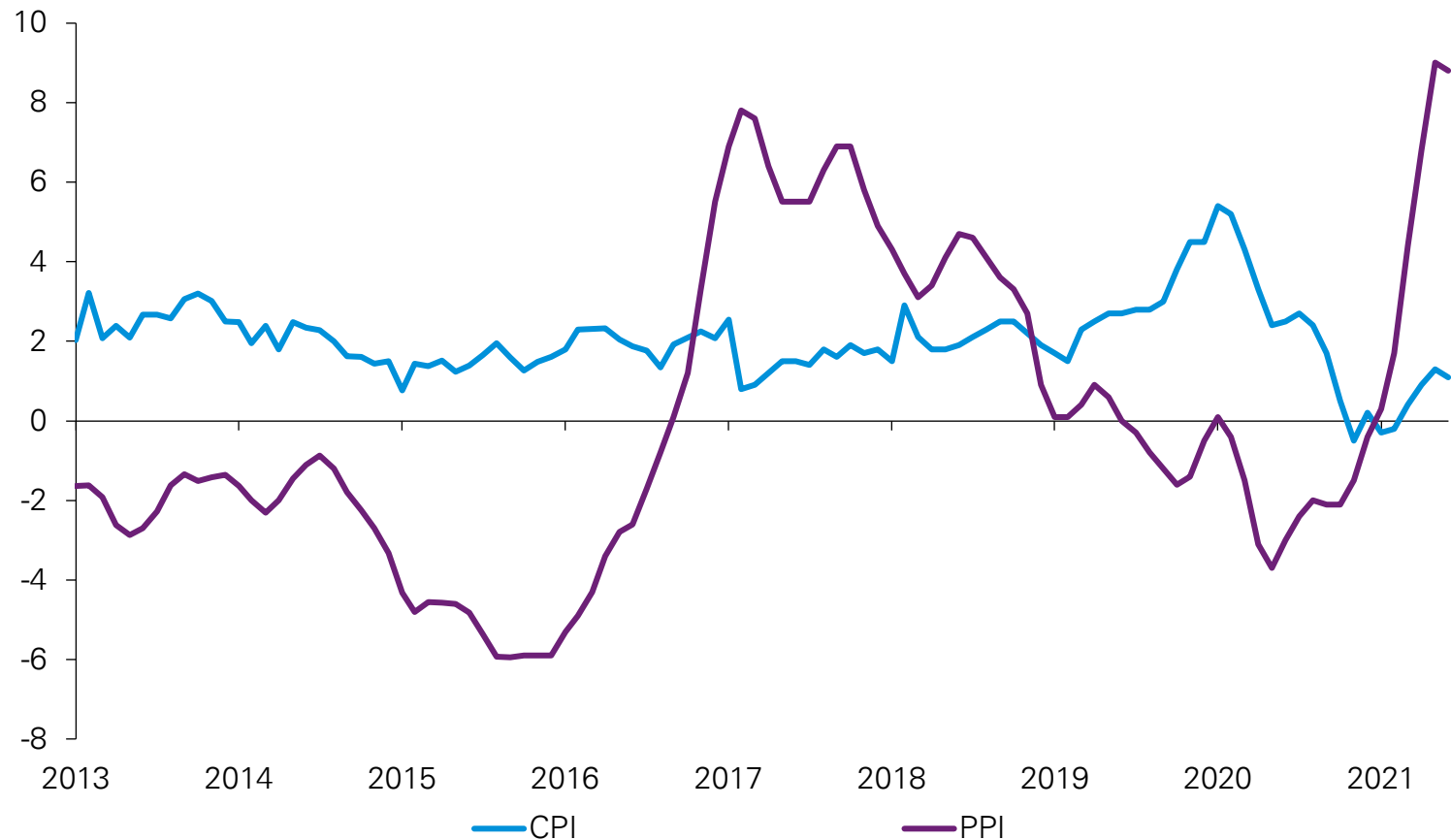
- As the global economy recovers, China's export growth showed resilience and continued to expand in Q2. China's exports surged by 39% in H1, pushing its trade surplus to the second highest level on record in H1. Export growth is expected to moderate in H2 due to a higher base for comparison.
- China became the largest trade partner of the European Union (EU) in 2020. As the European economy is gradually recovering, China's total trade with the EU grew 36% in H1 from a year ago.

Source: Wind, KPMG analysis. China's export growth is 3-month moving average.



Consumer inflation has remained muted but producer prices surged on rising commodity prices

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



- Consumer price inflation (CPI) rose 0.5% in H1, up 0.5 ppt from Q1. In June, CPI grew 1.1%, 0.2 ppt lower than May. Low consumer inflation is mostly due to falling food prices. Pork prices have fallen for nine consecutive months and were down 19.3% in H1.
- Producer price inflation (PPI) rose 5.1% in H1, 3 ppt higher than that in Q1. Thanks to various measures taken by the government, growth of commodity prices has moderated slightly and June PPI has edged down by 0.2 ppt to 8.8%.
- The government has set a CPI target of 3% for 2021, and we expect consumer price inflation to remain modest this year with a decline in food prices. Meanwhile, OPEC+ has reached a deal to increase oil production from August, a move that could help ease the pressure on oil prices in the coming months.

Source: Wind, KPMG analysis





The central bank cut RRR to increase liquidity and mitigate growth pressure in H2

Recent RRR cuts

Announced date	Effective date	Overall/Targeted cut	Change in RRR (basis point)	Gross liquidity injection (RMB billion)
4 Jan 2019	15 Jan 2019	Overall	100	1500
	25 Jan 2019			
6 May 2019	15 May 2019	Targeted	300	280
	17 Jun 2019			
	15 Jul 2019			
6 Sep 2019	16 Sep 2019	Overall	50	800
	15 Oct 2019	Targeted	100	100
	15 Nov 2019			
1 Jan 2020	6 Jan 2020	Overall	50	800
13 Mar 2020	16 Mar 2020	Targeted	50/100+100	550
3 Apr 2020	15 Apr 2020	Targeted	100	400
	15 May 2020			
9 Jul 2021	15 Jul 2021	Overall	50	1000

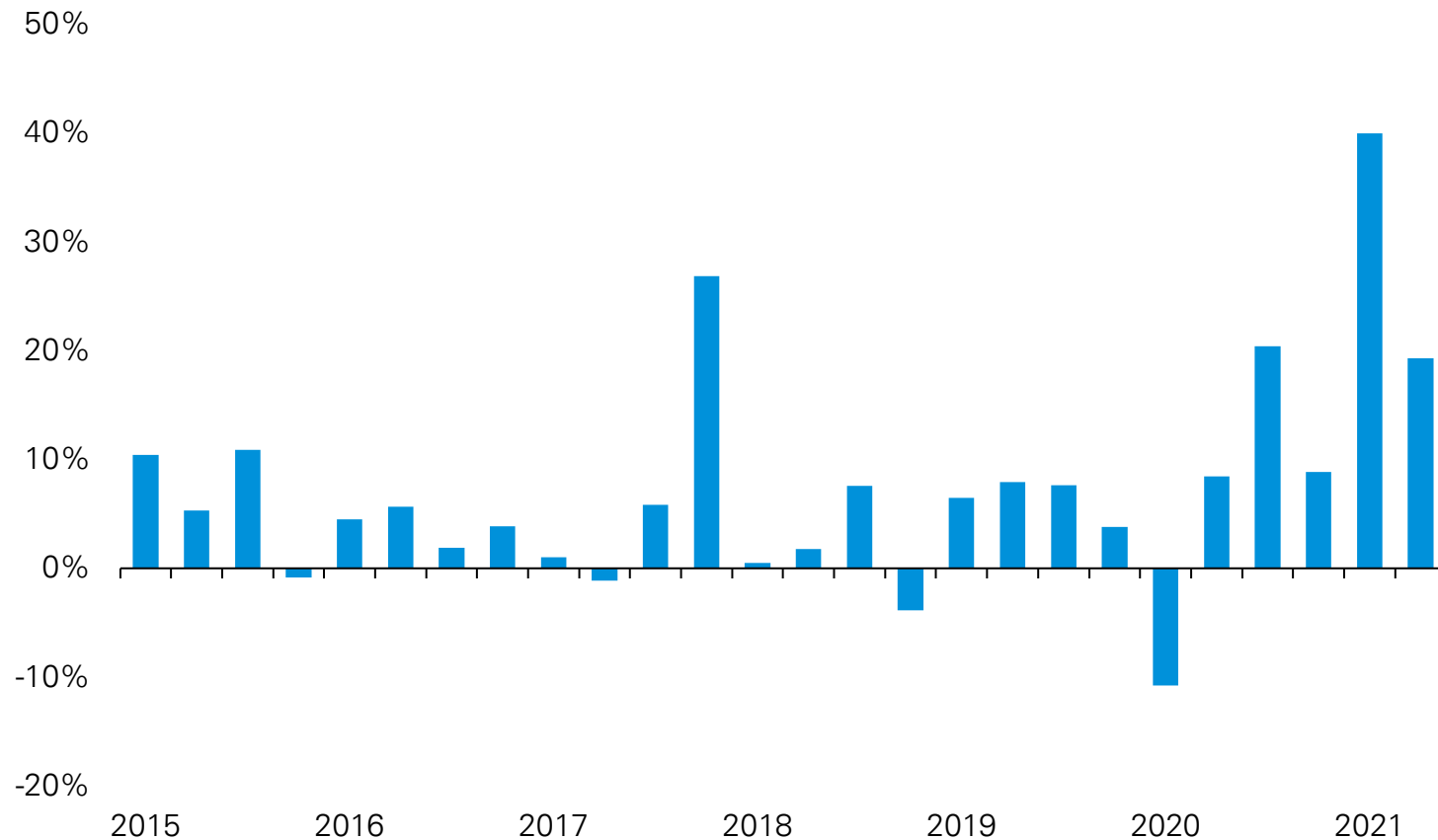
Source: PBoC, KPMG analysis

- In a surprise move, the PBoC announced a universal 50-basis-point cut on the required reserve ratio (RRR) on 9 July (effective 15 July), releasing about RMB 1 trillion of liquidity. The additional fund will be used to replace maturing MLF and offset liquidity shortages during the tax payment season in mid to late July.
- According to the PBoC, the RRR cut is aimed at lowering funding corporates' costs and mitigating the negative impact of higher commodity prices, especially on SMEs. In addition, the cut does not change the government's overall "prudent" monetary policy stance.
- We believe the cut is a pre-emptive move to mitigate growth pressure in H2 and to increase liquidity in the financial system. Looking forward, if growth pressure increases rapidly in H2, it cannot be ruled out that the central bank may roll out additional 1–2 RRR cuts.



FDI continued to see strong growth in Q2

China's FDI by quarter (in RMB terms), yoy, %



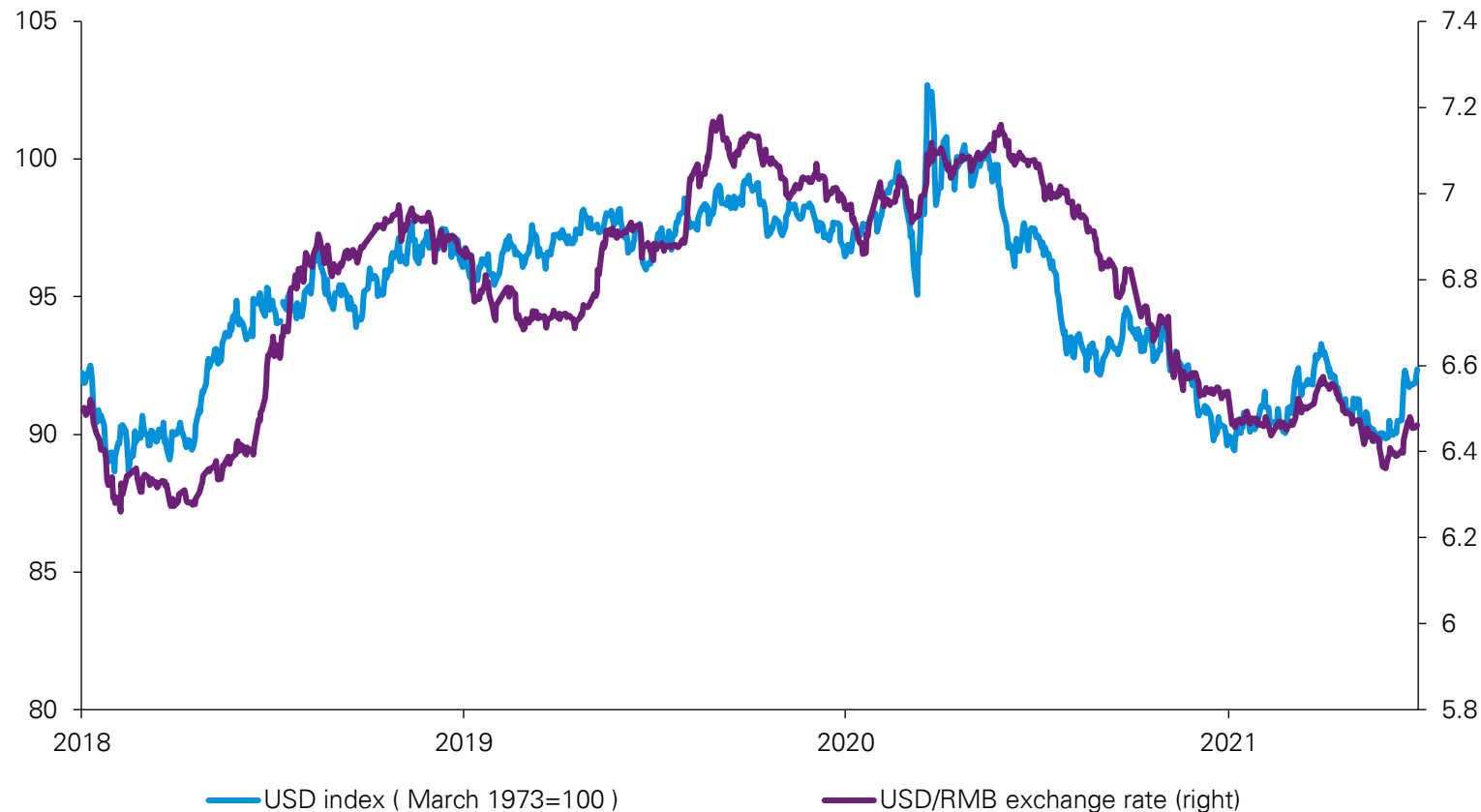
Source: Wind, KPMG analysis

- Foreign direct investment (FDI) surged 28.7% yoy to RMB 607.8 billion (USD 91 billion) in H1, underscoring the importance of the China market to MNCs.
- Industrial production of enterprises funded by foreign investors (including Hong Kong, Macao and Taiwan) grew 17% yoy in H1 2021, faster than the overall growth (15.9%).
- By sector, the share of the service sector in FDI is rising, accounting for 79.4% of total FDI in H1. Thanks to supportive policies, the high-tech sector increased by 39.4% in H1.



The RMB exchange rate saw a two-way movement against the USD and is expected to remain relatively stable in H2

USD index and USD/RMB exchange rate



- The RMB saw a moderate appreciation against the USD with a two-way movement in the first half of 2021.
- The RMB exchange rate strengthened by 3.4% against the USD in April–May, due to dollar weakness. To mitigate the rapid appreciation, China increased the RRR of foreign exchange deposits for the first time since 2007, up 2 ppt to 7%. As a result, the RMB weakened modestly in June.
- We expect the RMB to experience a two-way movement against the USD and remain stable in the near future.

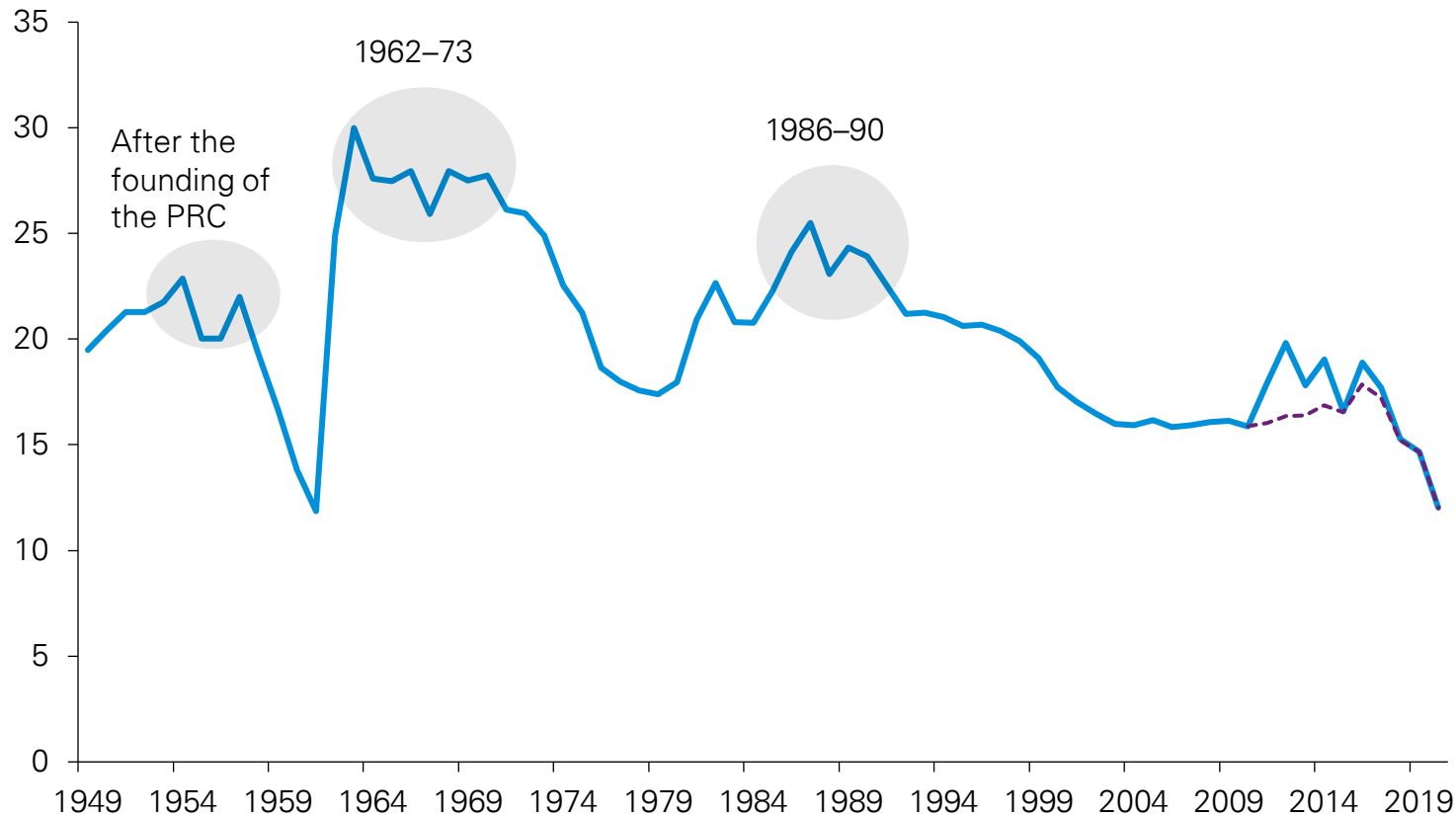
Source: Wind, KPMG analysis





China announced the “three-child” policy to support births and improve the demographic structure

Number of newborns, million person



- On 11 May 2021, China released the results of its 7th Census, which is conducted every 10 years. According to the 7th Census, China’s total population recorded the slowest growth compared with the previous six censuses. The number of newborns fell to 12 million in 2020, almost the lowest level in the entire history of the PRC.
- Meanwhile, the speed of ageing, urbanisation trends, migration flows and education levels are all rising.
- To improve the demographic structure, China announced a “three-child” policy on 31 May and subsequently released measures to encourage people to have more children.
- The census provides important information on China’s demographic trends and has significant implications for business*.

* Please see our report for more analysis: [China’s demographic trends and implications for business—takeaways from China’s 7th Census.](#)

Source: China Statistics Abstract 2021, KPMG analysis

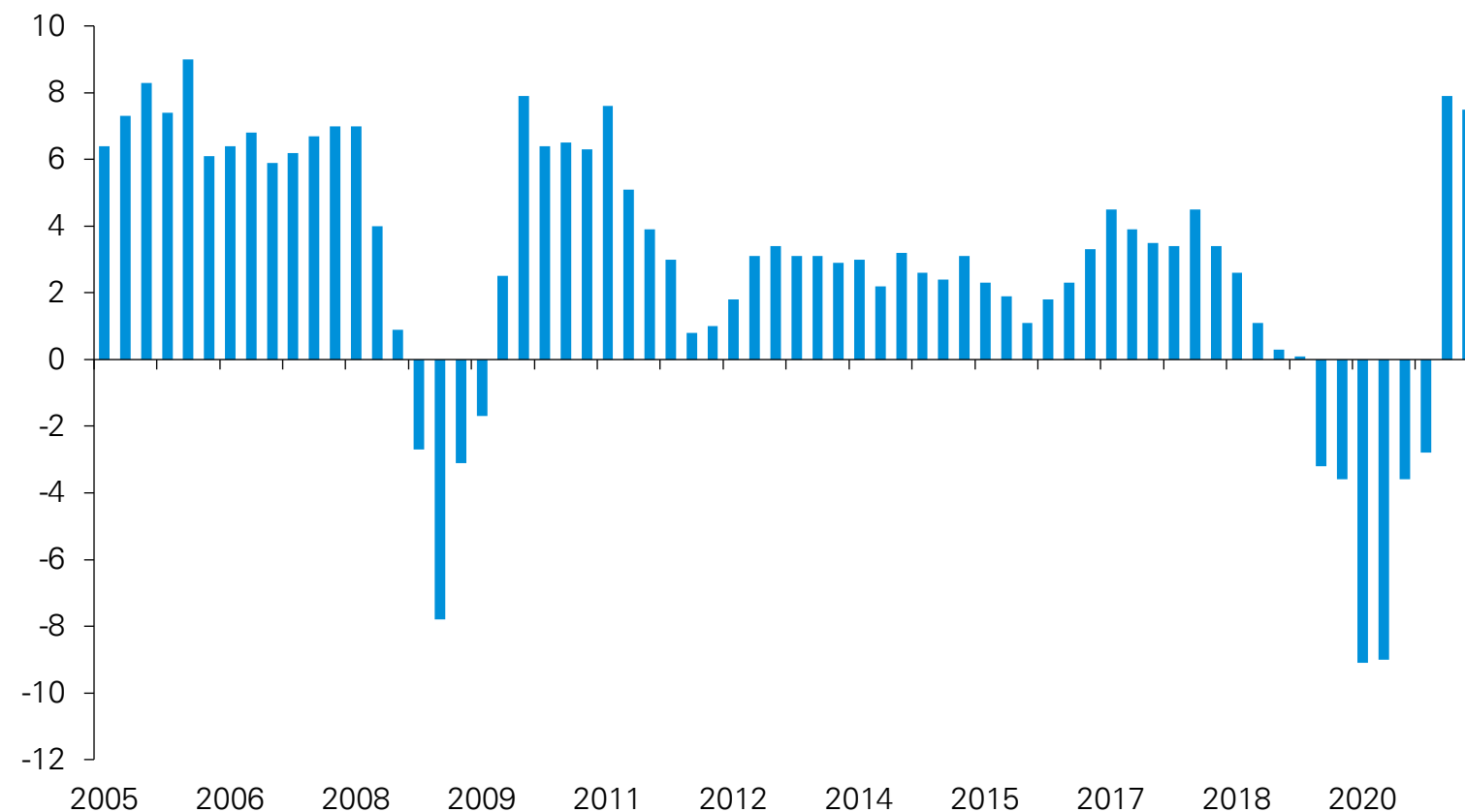
Note: The purple dotted line represents previously released birth data based on each year’s sampling surveys





Hong Kong's economy continues to recover

Hong Kong real GDP growth rate, yoy, %



Source: Wind, KPMG analysis

- Hong Kong's economy is on the path to recovery — the economy grew by 7.5% in Q2, following the rapid growth of 7.9% in Q1. The growth was mainly driven by strong external trade and a lower base in the previous year.
- However, the economic recovery remained uneven in Q2. Exports were still robust while retail, which improved further, still remained below the pre-recession level.
- The labour market showed further improvement as the economy continued to recover. The unemployment rate fell by 0.5 ppt to 5.5% in June. In particular, the unemployment rate of consumption-and tourism-related sectors combined fell by 0.9 ppt to 8.5%.
- Looking ahead, the recovery of the global economy should continue to support the rebound of Hong Kong's exports and economy in H2.



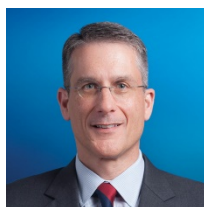
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Publication date: August 2021