China Economic Monitor

Issue: 2021Q4

November 2021

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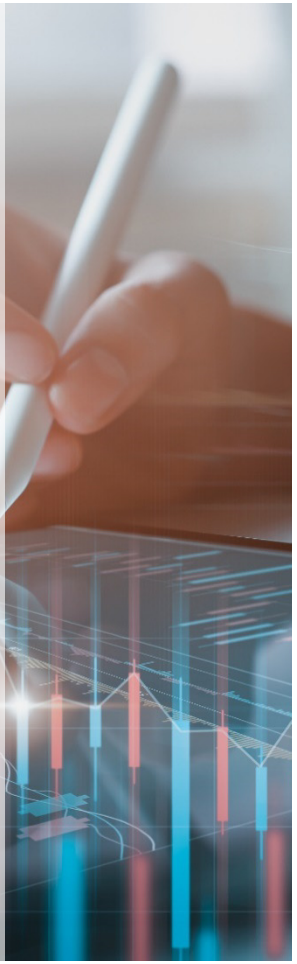
Key takeaways



- China's economy continues its recovery but the pace has slowed. China's GDP grew 4.9% in Q3 year-over-year (yoy), moderating from 7.9% in Q2. Taking the past two years together (2019–21), the annualised average growth rate slowed from 5.5% in Q2 to 4.9% in Q3. In the first three quarters, China's economy grew 9.8%. We expect the Chinese economy to continue to rebound, but the pace will further moderate due to a higher base for comparison, sporadic COVID-19 cases, property market curbs and uncertainty in the global economic environment. Overall, we expect mainland China's GDP to grow 8.2% in 2021 and 5.5% in 2022.

- China's exports remained strong and continued to expand in Q3, due to rising demand from advanced economies and production disruptions in some developing markets due to new waves of pandemic. Exports have been a key driver of China's economic growth since the pandemic. We expect exports to remain robust in the near future, but their contribution to overall growth will likely moderate.

- Manufacturing investment growth rate rose from 7.1% in August to 10% in September. The acceleration is driven by strong corporate profits and robust external demand. However, growth of industrial production slowed to 3.1%, 2.2 ppt lower than that of August, mainly due to power shortages and tightened regulations on carbon emissions.

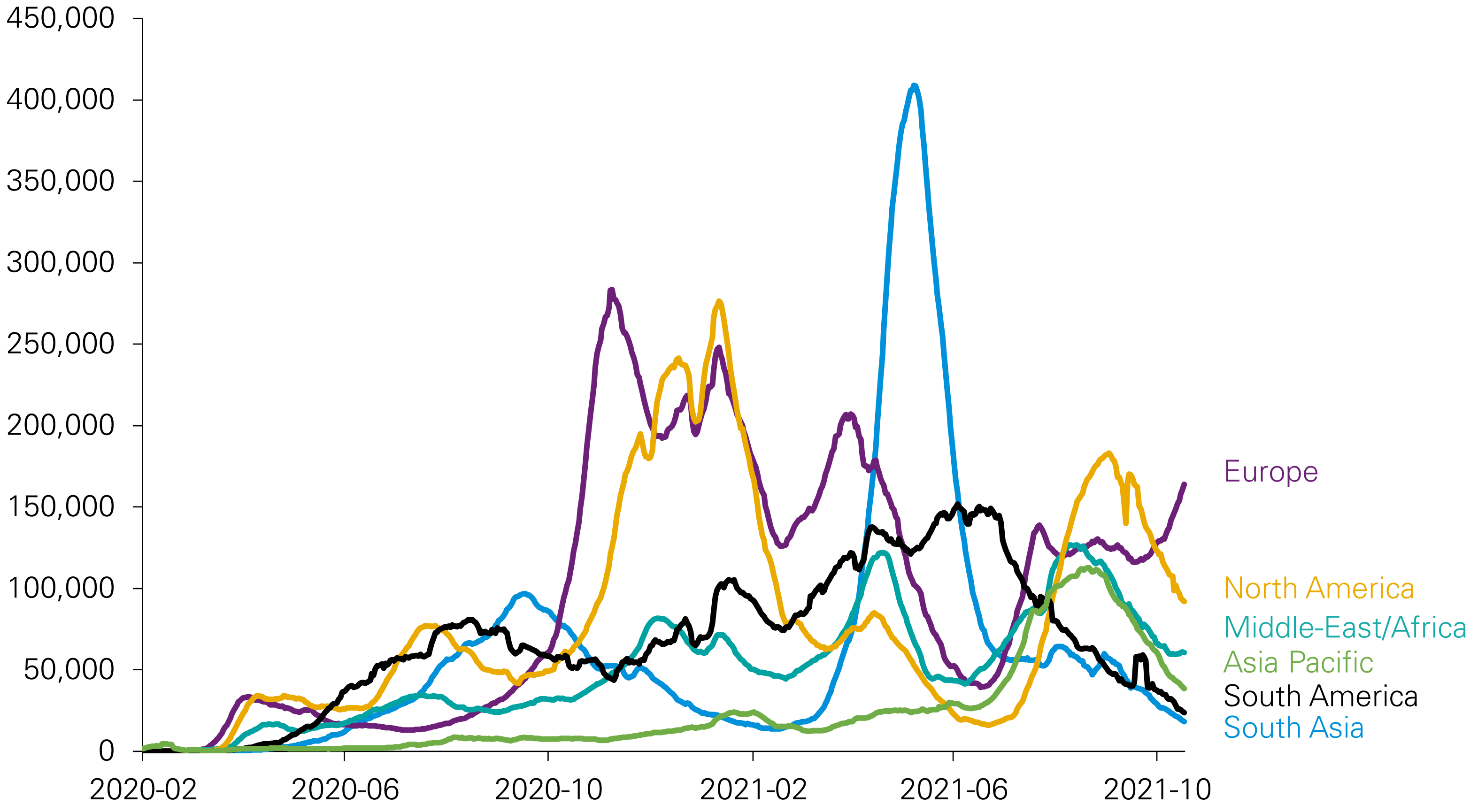
- September retail sales grew 4.4%, up from 2.5% in August. Service-related consumption dropped in August due to new COVID-19 infections and tightened quarantine measures in some areas. The two-year annualised growth rate of consumption is still below pre-pandemic levels. Domestic consumption is expected to be the long-term driver of China's future growth, but its recovery is still subject to pandemic controls and income growth in the near term.

- The producer price index (PPI) jumped from 9.5% in August to 10.7% in September, the highest level in the data's 25-year history. The increase in commodity prices, especially coal, is the main factor behind the spike. The government has taken a combination of measures to increase coal production and reduce price increases. Meanwhile, inflation on the consumer side remains muted, with the consumer price index (CPI) edging up 0.7% in September. The gap between CPI and PPI has increased profit pressure for some downstream companies.

- The central bank has used instruments such as the medium-term lending facility (MLF), open market operations (OMO) and one required reserve ratio (RRR) cut to adjust liquidity levels in the past few months. We expect the central bank to keep the policy rate unchanged, but it may implement another targeted RRR cut to release additional liquidity. The central bank also announced that it will introduce a new monetary tool to support carbon emission reductions.

COVID-19 has caused close to 5 million deaths globally

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

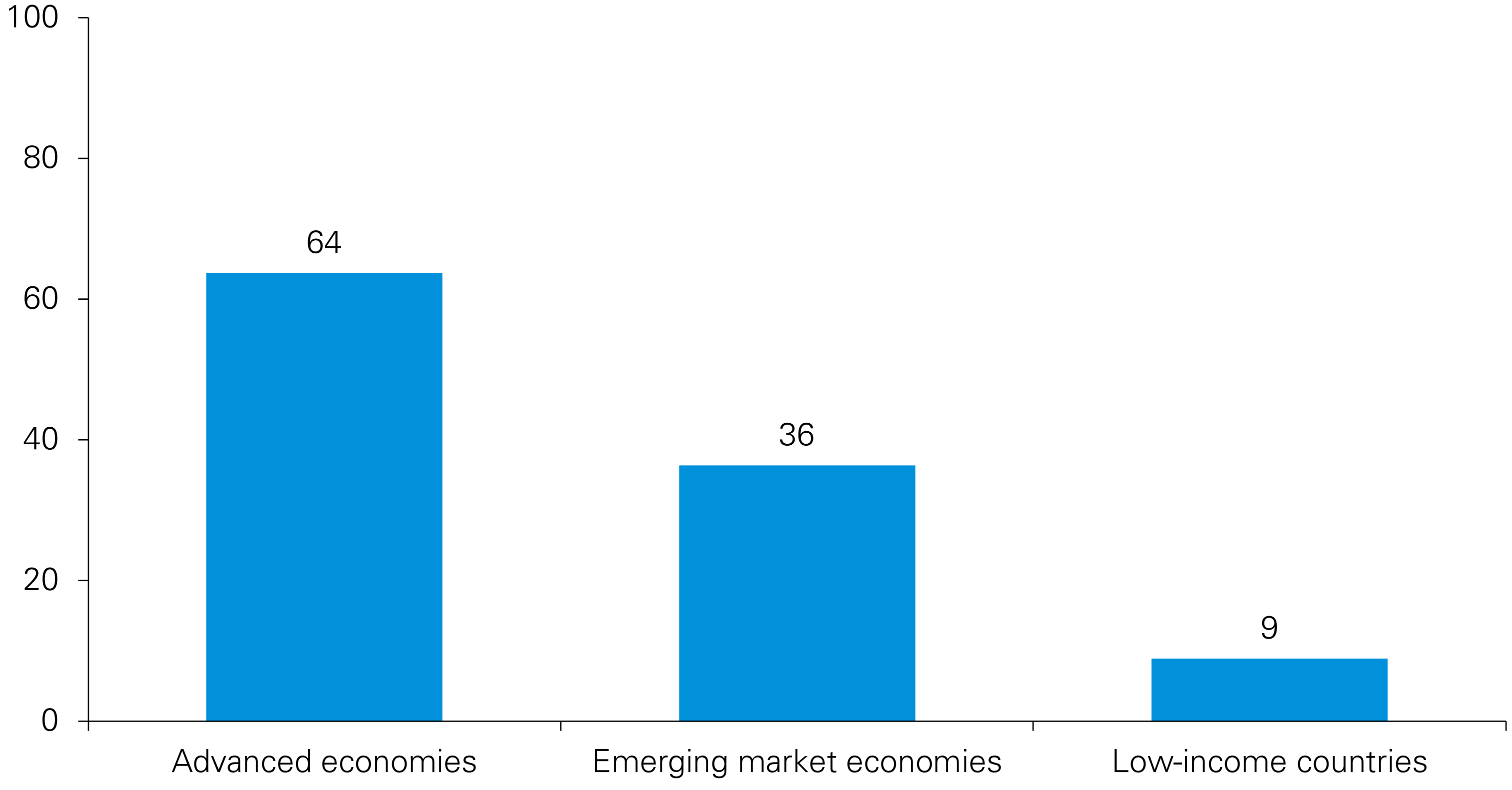


Source: Wind, KPMG analysis. Data through 17 October 2021.

- Confirmed COVID-19 cases reached over 242 million worldwide as of 17 October, including close to 5 million deaths. Due to low vaccination rates in some European countries, new cases have been increasing again in Europe recently.
- New infections in the US have retreated after the spike over the summer, but daily new cases are still around 100k.
- China has also seen a modest resurgence of infections caused by the highly transmissible Delta variant in certain areas. The number of daily new infections has remained low in magnitude, averaging at 45 cases per day in August–October. However, tightened pandemic control measures have also affected the consumption recovery.

Global vaccination rate varies substantially by level of development

Share of population who are fully vaccinated, %

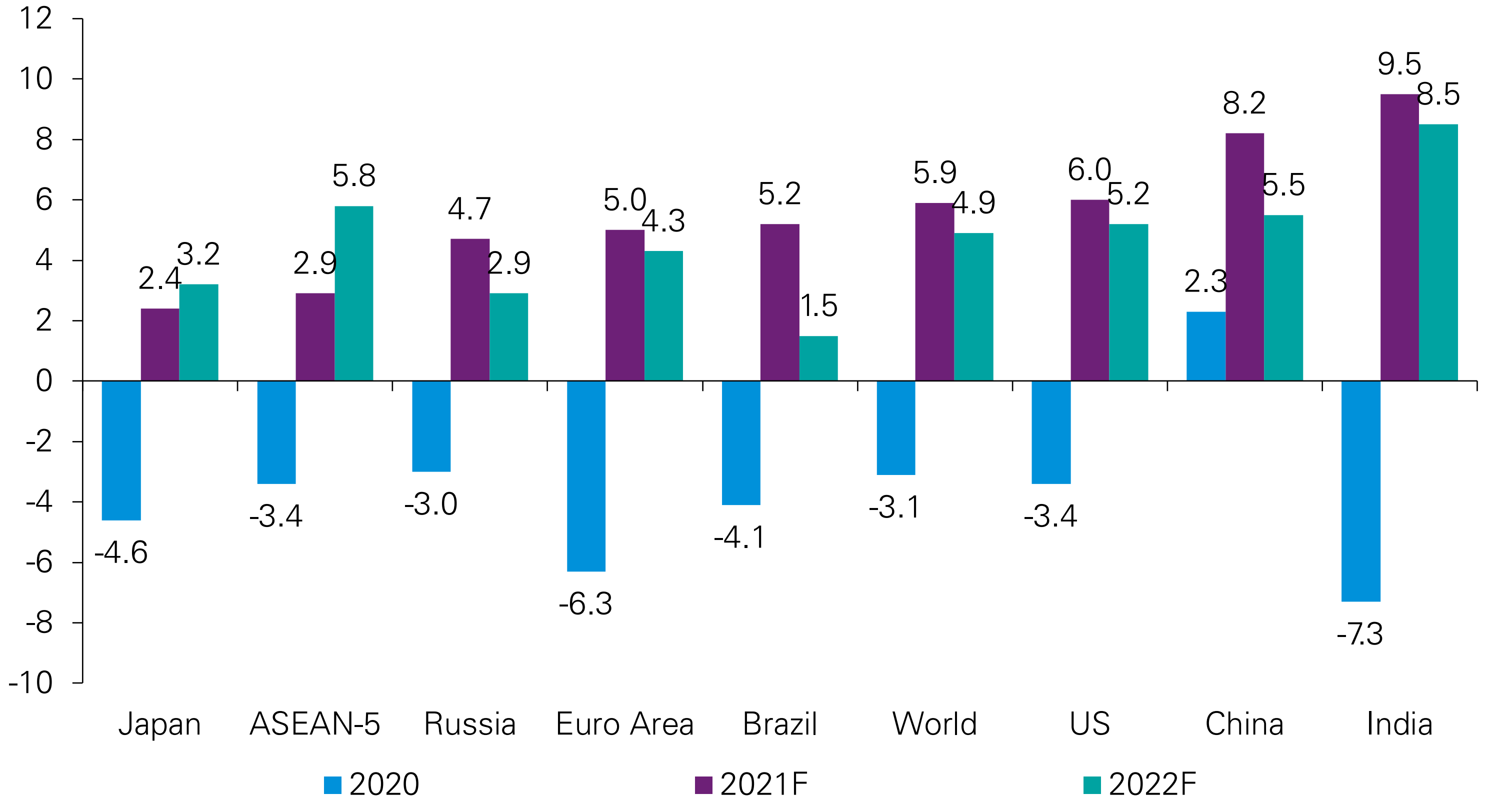


Source: Our World in Data, Data through 17 October 2021. KPMG analysis

- As of 17 October, over 6.6 billion COVID-19 vaccine doses had been administered around the world. A total of 48.1% of the world population has received at least one dose of a COVID-19 vaccine. China ranks at the top globally with over 2.2 billion doses including around 1 billion administered in Q3.
- However, there are large disparities in the share of population who are fully vaccinated by country. Around 64% of the population in advanced economies are fully vaccinated, compared with 36% in emerging market economies and only 9% in low-income countries.
- Global coordinated efforts are needed to ensure more even vaccinations around the world.

The global economic recovery is uneven and still faces many challenges

Real GDP growth and forecast, %

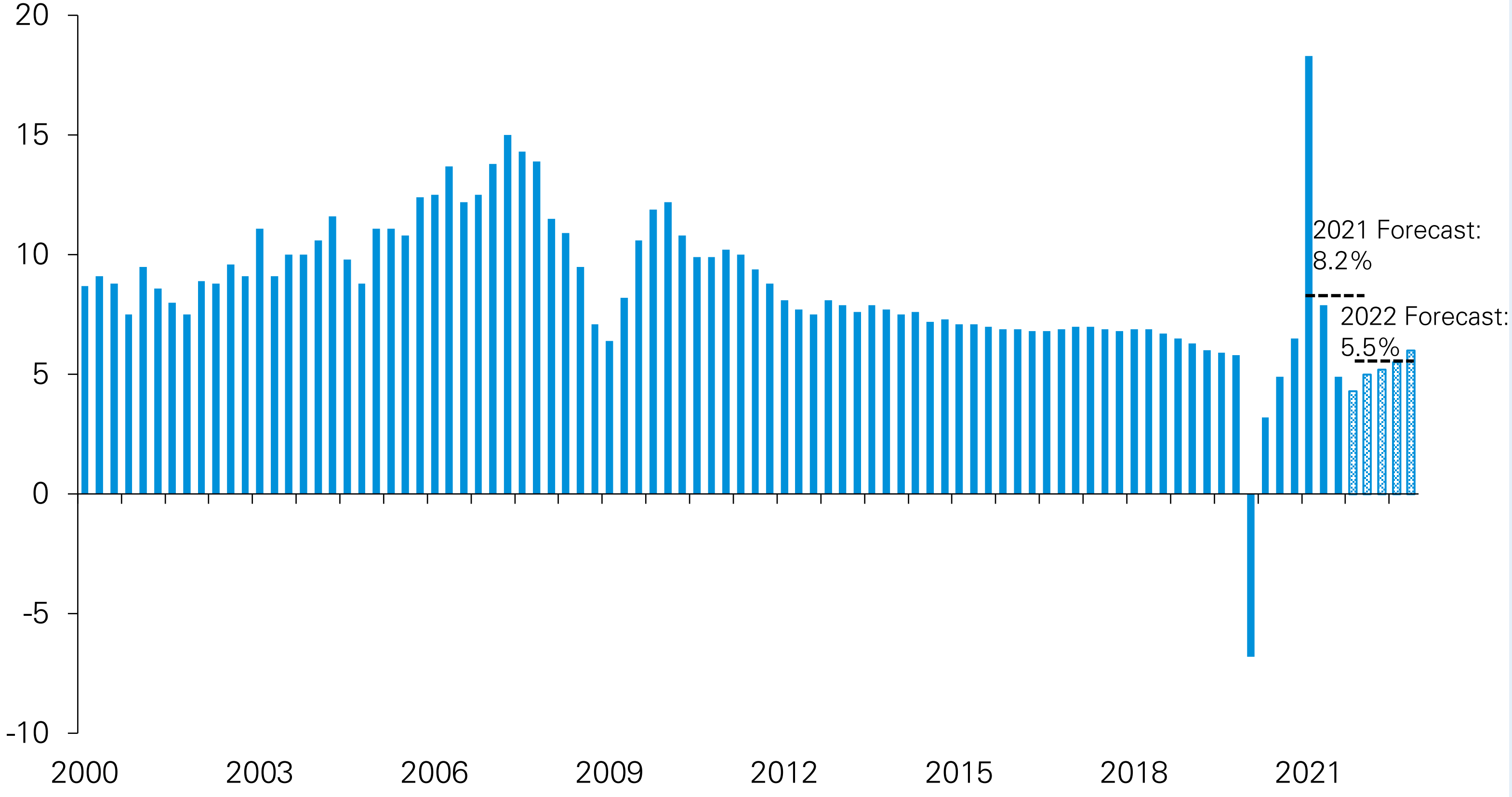


- In the latest update, the IMF revised down its global GDP forecast to 5.9% for 2021, 0.1 ppt lower than the July projection. Its forecast for 2022 remains unchanged at 4.9%.
- Due to supply chain disruptions and a soft consumption recovery in Q3, the economic growth rate of advanced economies was downgraded by 0.4 ppt to 5.2% in 2021. Growth of developing economies was revised up by 0.1 ppt to 6.4% this year, mainly driven by growth in some commodity exporting economies.
- The recovery in developing economies is still facing many challenges. Inflation risks are expected to remain through to mid-2022. Uneven vaccine distribution and tight financial and fiscal conditions also weigh on their economic recovery.

Source: IMF, KPMG analysis.
Note: China's 2021 and 2022 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 moderate

China real GDP growth rate by quarter, yoy, %



Source: Wind, KPMG analysis

- China's GDP grew by 4.9% in Q3, down from the 7.9% pace in Q2 2021. The moderation was due to a higher base, pandemic controls and tightened emission control regulations. Overall, the economy advanced by 9.8% in the first three quarters of 2021.
- Industrial production increased by 3.1% in September, 2.2 ppt lower than that of August. High-tech manufacturing and utilities sectors continued to expand and grew 20.1% and 12%, respectively, during Jan–Sep 2021 – faster than the overall growth of industrial production (11.8%) during the same period.
- Going forward, we expect the Chinese economy to continue to rebound but the pace will moderate. Overall, we forecast mainland China's GDP to grow 8.2% in 2021 and 5.5% in 2022.

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Exports have played a key role in China's economic recovery

Average annualised growth rate of past two years, %

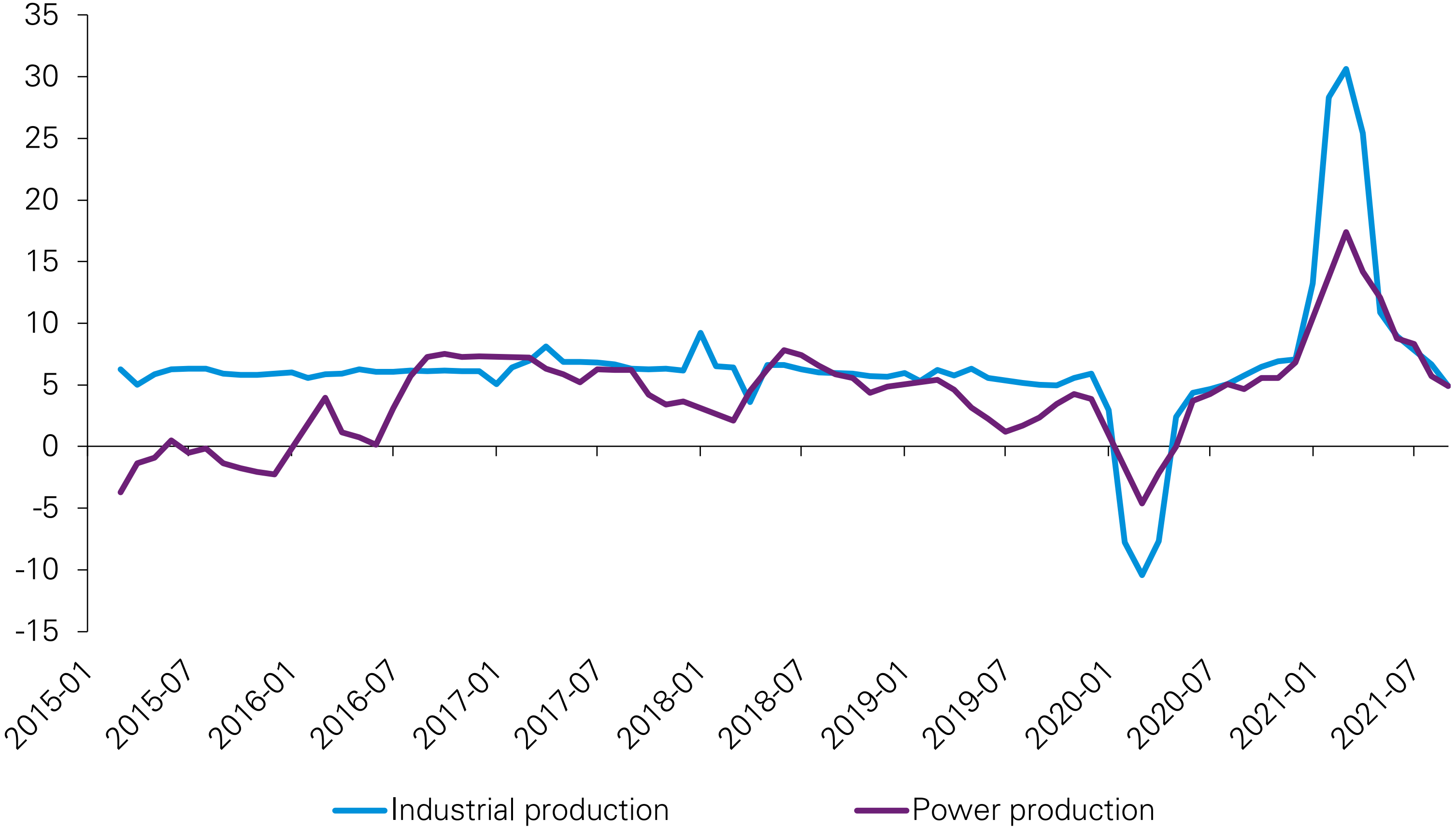
	2017–19 Average	2021Q1	2021Q2	2021Q3	2021Q1–Q3
GDP	6.6%	5.0%	5.5%	4.9%	5.2%
Industrial production	6.2%	6.8%	6.6%	5.3%	6.4%
Retail sales	9.0%	4.1%	4.6%	2.3%	3.9%
Fixed asset investment	6.2%	2.7%	5.6%	3.2%	4.0%
Exports	6.1%	13.4%	14.2%	16.1%	14.6%
Imports	9.8%	11.9%	14.1%	14.3%	13.5%
Income per capita	6.5%	4.5%	5.9%	4.9%	5.1%
Fiscal revenue	5.8%	3.2%	5.2%	4.6%	4.3%
Fiscal spending	8.2%	0.1%	-1.5%	2.3%	0.2%

Source: Wind, KPMG analysis

- To adjust for the base effects, we calculated the average annualised growth rate of the past two years (2019 to 2021) to better gauge the true recovery momentum.
- In the first three quarters, growth rates of exports and imports were significantly higher than pre-pandemic levels. Growth of industrial production slowed down in Q3, but was still above the average level before the pandemic.
- In contrast, growth of retail sales and investment is still significantly below pre-pandemic levels. Fiscal spending was tightened in H1, but returned to growth in Q3 – albeit at a modest pace compared with past averages. We expect fiscal policy to provide some support in Q4 and 2022.

Affected by power shortages, growth of industrial production weakened in September

Year-over- year growth rate, 3mma, %

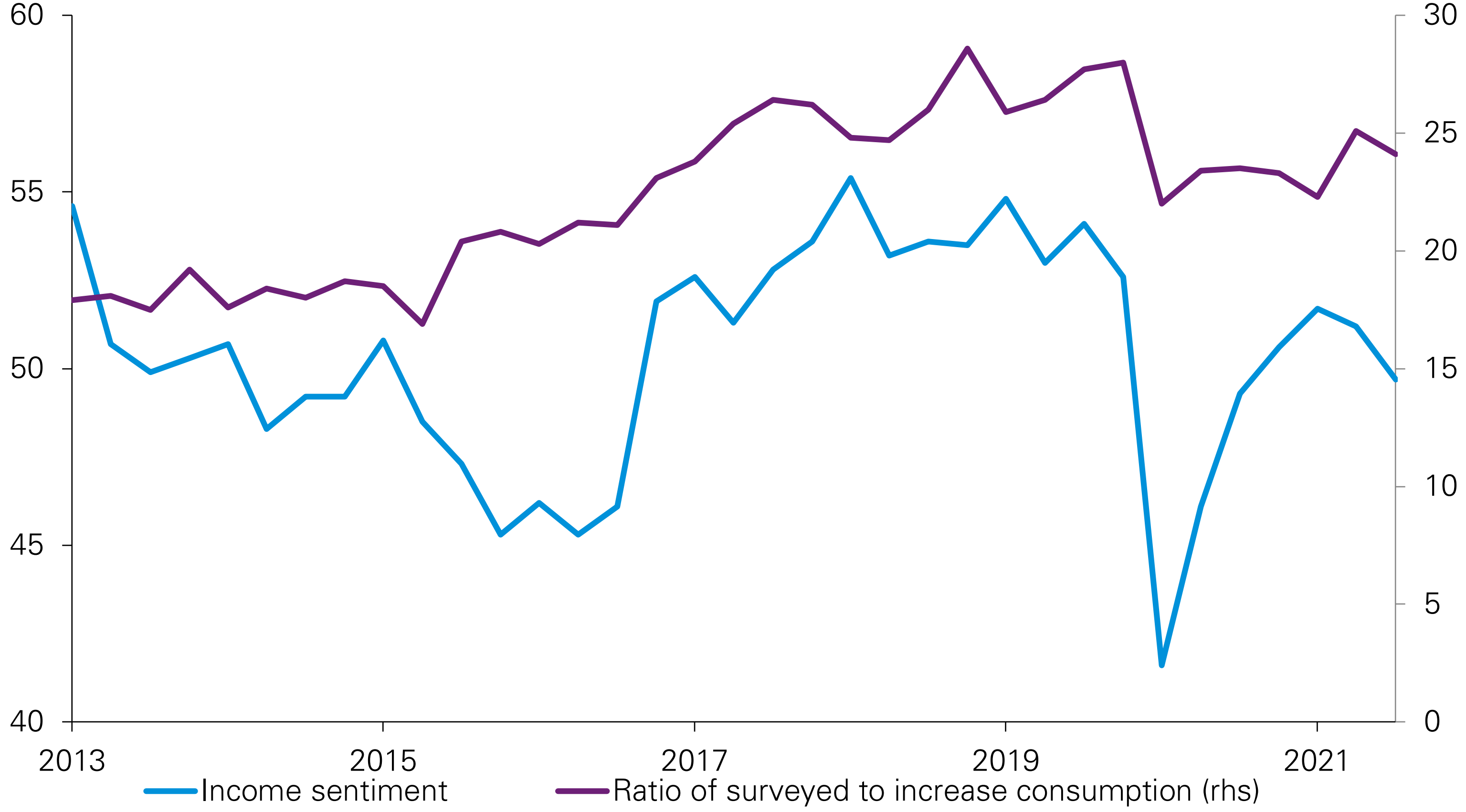


Source: Wind, KPMG analysis

- Industrial production grew 3.1% in September, the lowest growth rate since April 2020, mainly due to power shortages and tightened regulations on carbon emissions.
- Coal-fired power plants account for about 60% of China's total electricity generation. Yet decreasing coal production combined with higher coal prices have led to power shortages in some regions. The government has taken various measures to boost coal supply, cap the coal price increases and allow more flexibility for electricity pricing.
- Vehicle production has also slowed in recent months due to chip shortages. Supply chain disruptions are expected to continue to weigh on China's industrial output in the near future.

Consumers' income sentiment weakened slightly in Q3, putting pressure on consumption growth

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

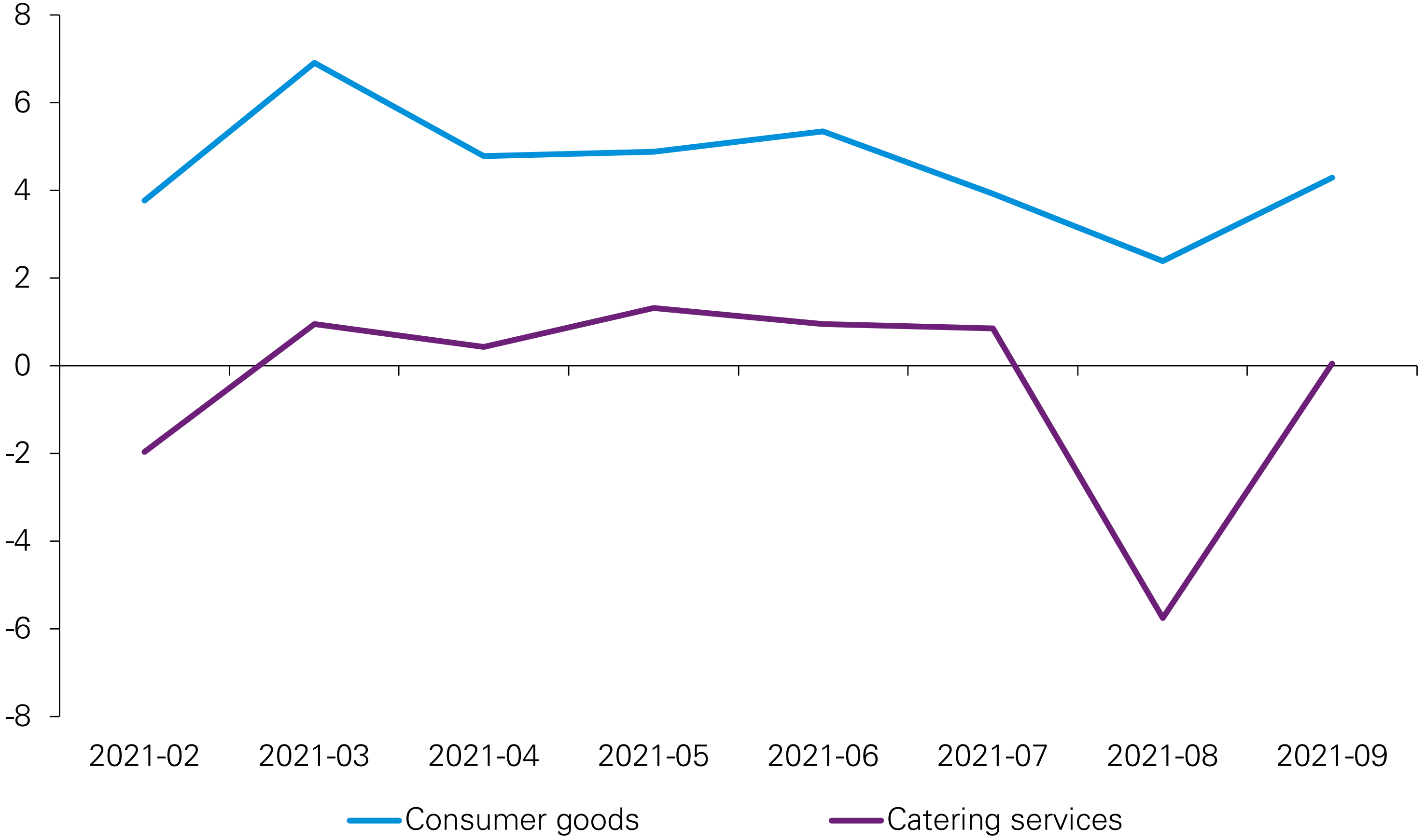


Source: the PBoC, KPMG analysis

- Based on a survey by the People's Bank of China (PBoC), household sentiment for income weakened in Q3 from the previous quarter. As a result, households are still cautious about their consumption. The share of surveyed households that are planning to increase consumption also retreated.
- Meanwhile, the labour market remains stable and is registering a gradual improvement. The surveyed unemployment rate stood at 4.9% in September, 0.5 percentage points lower than a year ago. Urban new job creation came in at 10.45 million in Jan–Sep, representing 95% of the annual target.
- With continued economic recovery, income sentiment should gradually improve and provide some support for future consumption growth.

Service-related consumption fell in August due to new COVID-19 cases but picked up modestly in September

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

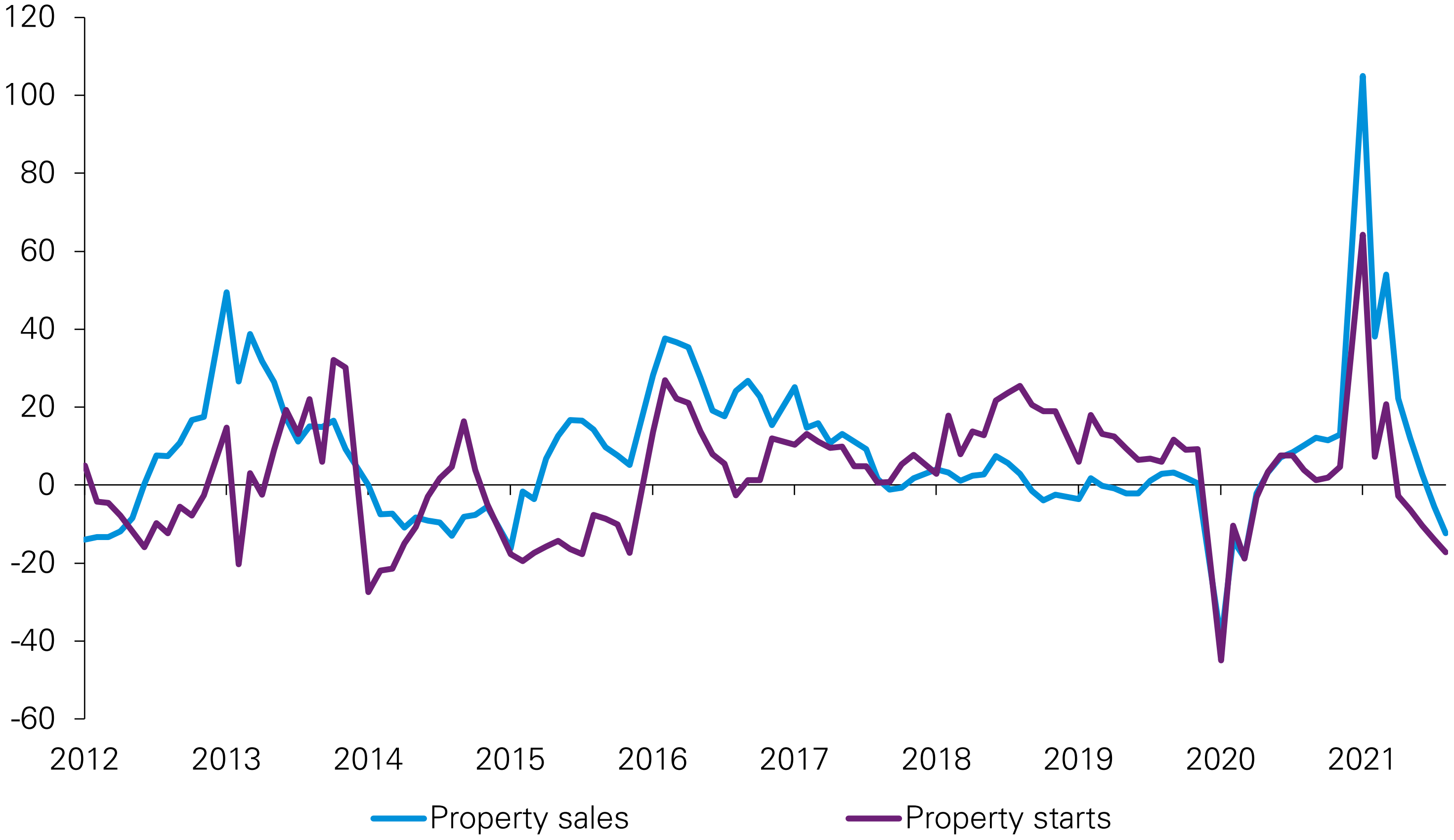


Source: Wind, KPMG analysis

- Service-related consumption, such as catering, dropped in August due to new COVID-19 infections and tightened quarantine measures in some areas. The two-year annualised average growth of catering services declined to -5.8%.
- Growth of catering services and consumer goods rebounded to 0.1% and 4.3%, respectively, in September, due to the relaxing of some quarantine measures. Sales of property-related products such as construction materials and furniture weakened, reflecting slower property sales.
- Consumption is expected to be the long-term driver of China's growth, but its recovery is still subject to pandemic controls and income growth in the near term.

New home starts and sales declined due to continued regulatory tightening

Growth of the property market, yoy, 3mma, %

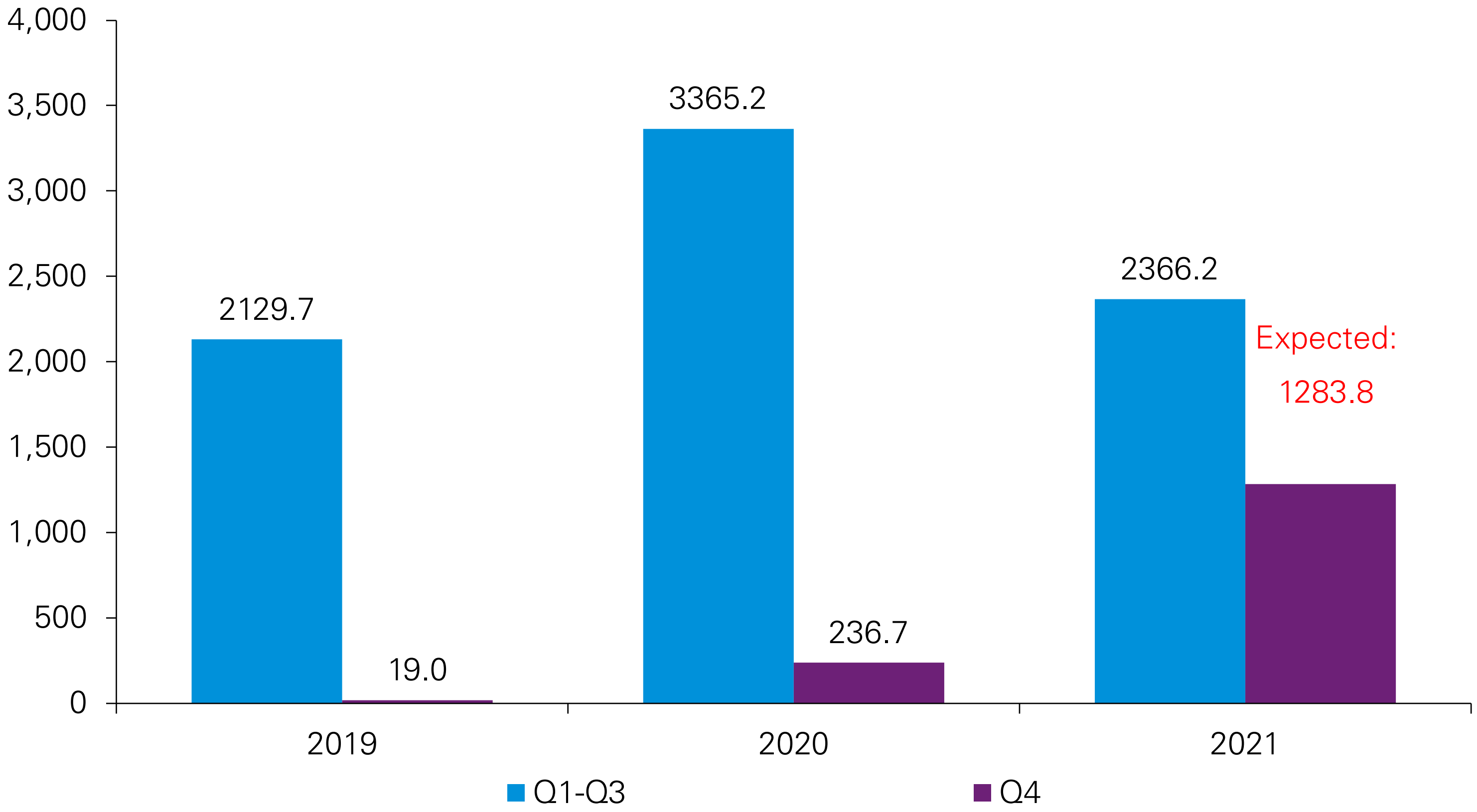


Source: Wind, KPMG analysis

- Growth of property investment continued to moderate and grew 8.8% in the first nine months of 2021, down from 10.8% year-to-date to August.
- Continuously tightening regulations on property and the recent Evergrande issue have weakened housing market sentiment and activities. New property sales declined 13.2% yoy in September, in line with the subdued growth in medium and long-term household loans. New property starts contracted in Q3, declining by 13.5% in September.
- We expect the property sector to continue to face tight funding pressure in the near term.

Local government bond issuance stepped up in Q3 and is expected to further accelerate in Q4, providing some supports to infrastructure investments

New issuance on local government special bonds, RMB billion

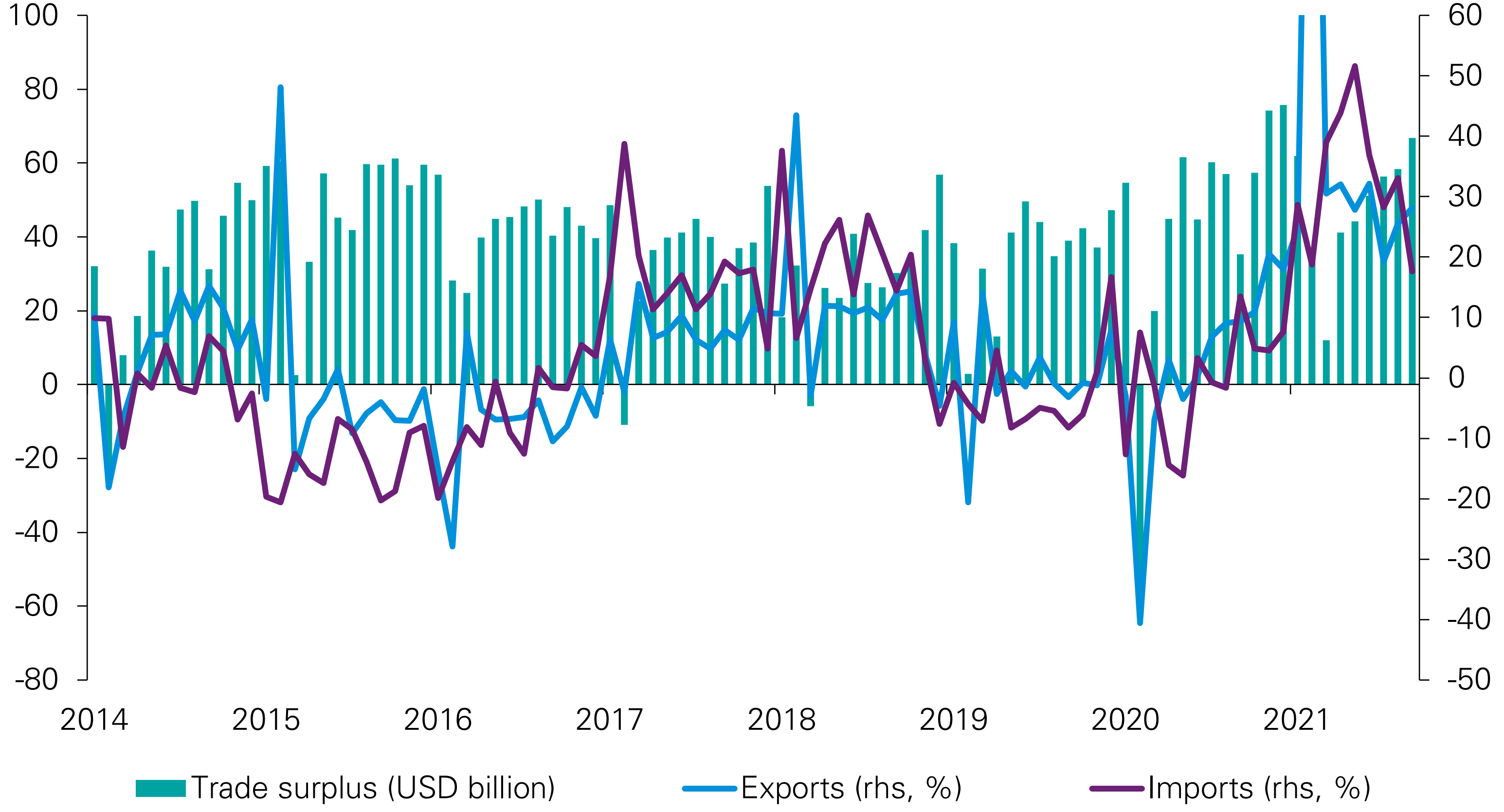


Source: Wind, KPMG analysis

- The government kept a relatively tight stance on fiscal policy in H1, issuing only RMB 1 trillion local government special bonds (LGSB) during the period. This put pressure on local government budgets and infrastructure investments.
- The issuance accelerated in Q3 and totalled RMB 2.4 trillion in the first three quarters of 2021, representing 65% of the annual target. Supported by improved funding conditions, growth of infrastructure investments — which are still in negative territory — improved from -10.5% in July to -6.5% in September.
- To achieve the full-year target of issuing RMB 3.65 trillion LGSB, the government needs to speed up its issuance significantly and offer nearly RMB 1.3 trillion in Q4. This should provide some support to infrastructure investments in the coming months.

China's exports have remained robust but the growth rate will slow due to a higher base

Growth of exports and imports, %

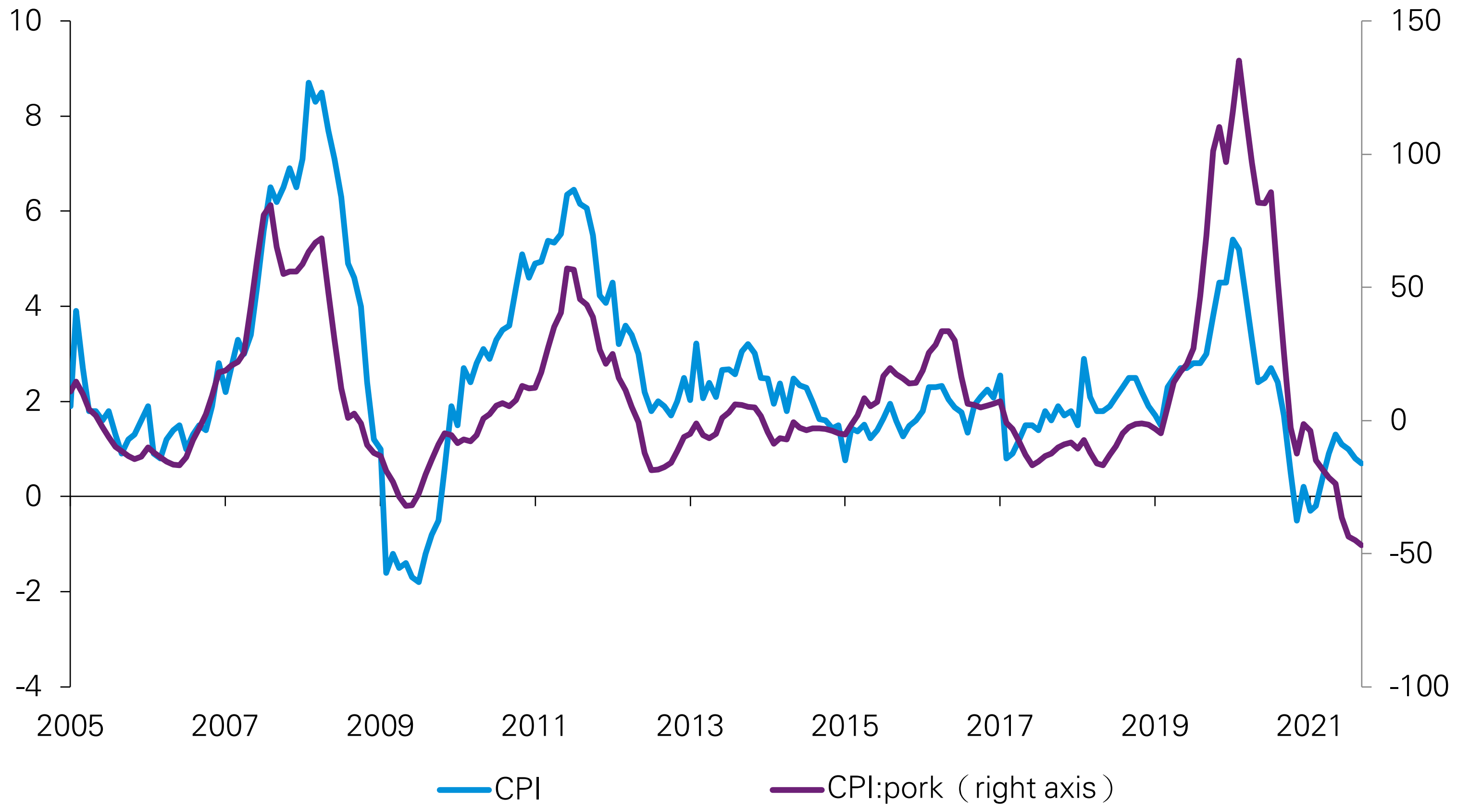


Source: Wind, KPMG analysis

- China's exports remained robust and continued to expand in Q3, mainly driven by rising demand from advanced economies and production disruptions in some developing markets due to new pandemic waves.
- Exports surged by 26% in Q3, pushing the trade surplus to its second highest level on quarterly record. By product, exports of medical supplies and automobiles surged by 108% and 107%, respectively, in Jan–Sep.
- Looking ahead, we expect China's exports to continue to do well but the growth rate will likely slow as the base for comparison is getting higher and demand from advanced economies is shifting more towards services. In addition, shipping disruption and cost burdens may create challenges for exports as well.

Consumer inflation remains soft amid falling pork prices

Consumer price index (CPI) and pork prices, yoy, %

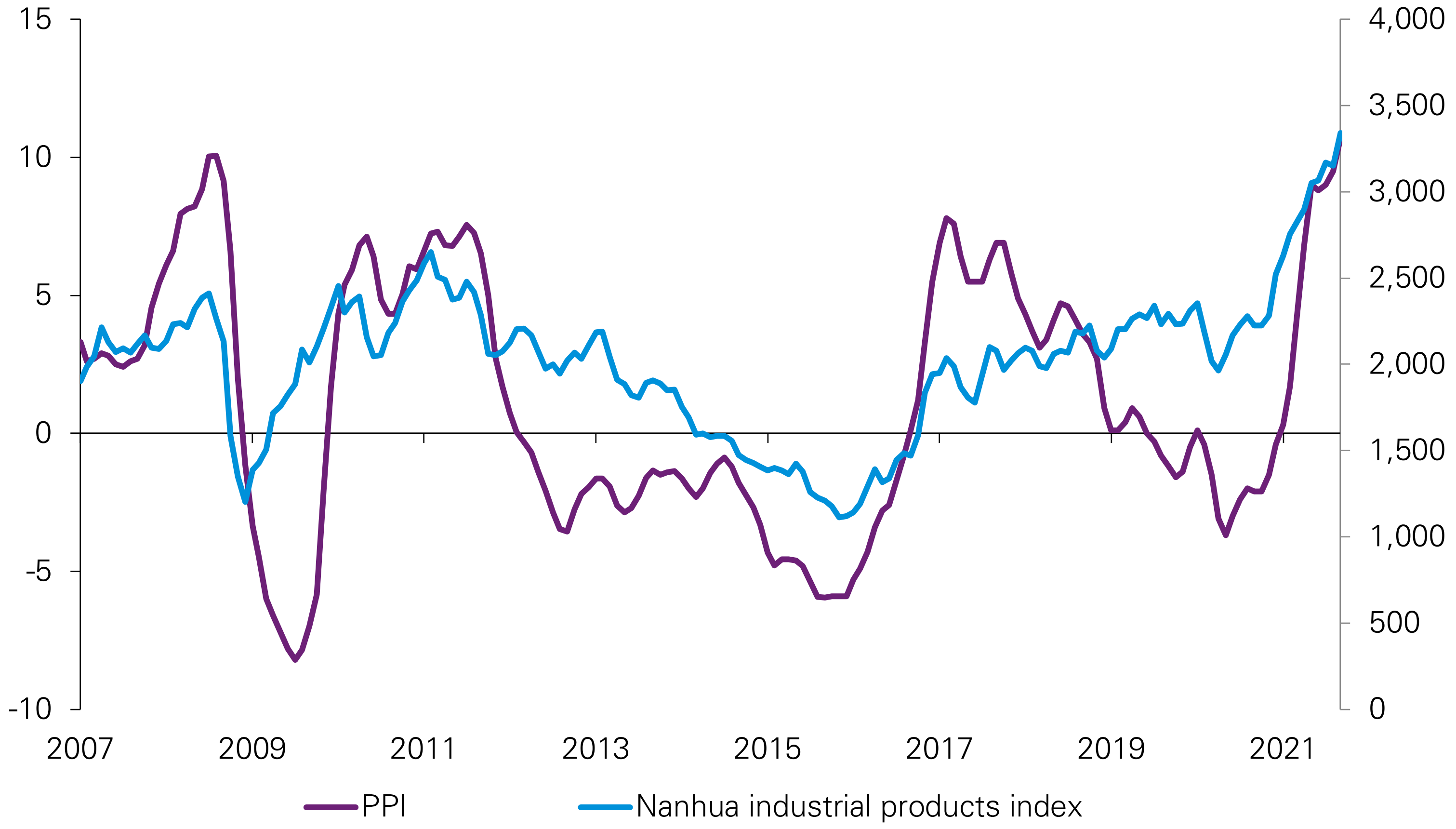


Source: Wind, KPMG analysis

- Prices on the consumer side remain muted, with the consumer price index (CPI) increasing by only 0.7% in September.
- Low consumer inflation is mostly due to falling food prices and a soft demand recovery. Pork prices plunged 46.9% yoy in September, knocking down overall CPI growth by over 1 percentage point
- Looking forward, with fading high base effect, we expect the consumer price to pick up and average 2.3% over 2022.

Producer price inflation hit a record high due to surging commodity prices

Producer price index (PPI) and Nanhua industrial products index, yoy, %

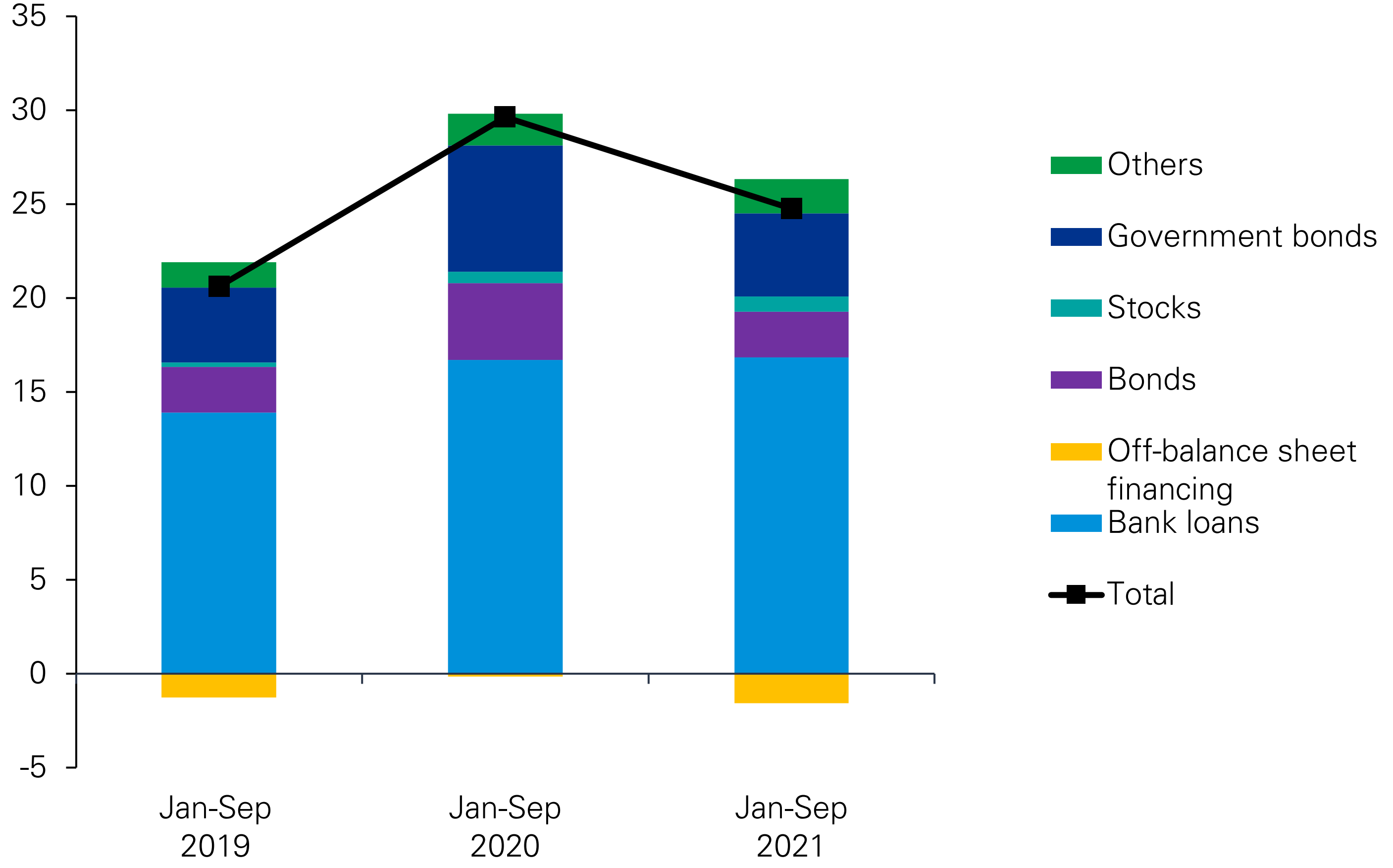


Source: Wind, KPMG analysis

- The producer price index (PPI) jumped from 9.5% in August to 10.7% in September, the highest level in the figure's 25-year history. The increase in commodity prices, especially coal, is the main factor behind the spike.
- The gap between CPI and PPI has put pressure on profits of downstream companies. The government has taken a combination of measures to increase coal production and limit price increases.
- The inflationary pressure on the production side is expected to remain for the rest of the year but should abate in 2022 as supplies further recover.

New total social financing retreated compared with last year, impacted by off-balance sheet financing, corporate and government bond issuances

Change in total social financing, RMB trillion

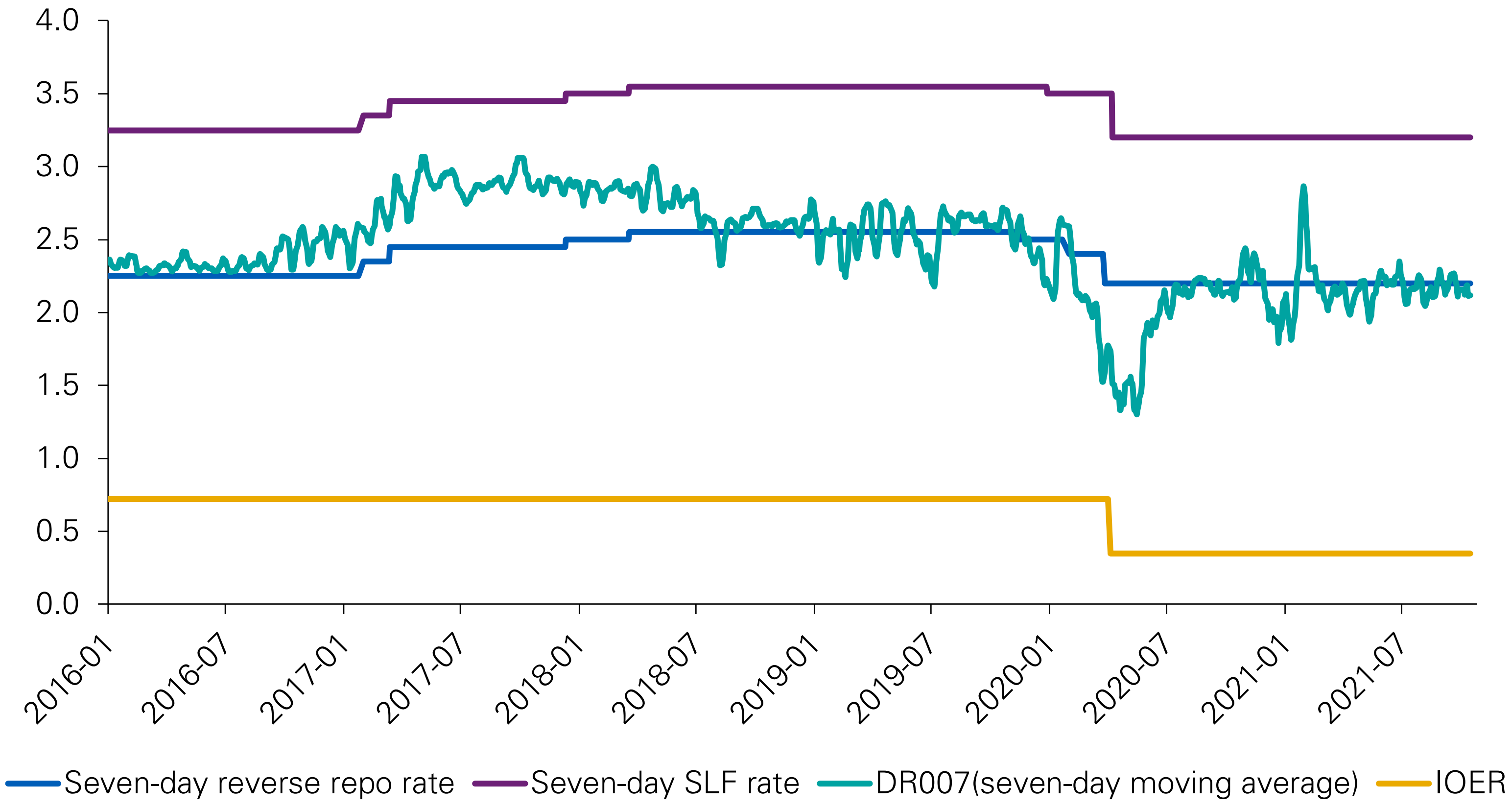


Source: Wind, KPMG analysis

- New total social financing (TSF), a measure of the total liquidity provided by the financial sector to the real economy, increased by RMB 24.8 trillion in Jan–Sep, RMB 4.87 trillion lower compared with the same period last year.
- Bank loans are the main driver for TSF growth, accounting for two-thirds of total new growth. Issuances of corporate and local government bonds both retreated from the last year and off-balance sheet financing continued to decline. Meanwhile, equity financing (e.g. stocks) increased.
- Funding supports for the 'specialised and innovative' SMEs continue to strengthen. Its outstanding loans rose 18.2% yoy in September, 6.3 ppt higher than the growth of overall outstanding loans. The green economy is also expected to attract more funding support in the future.

Market interest rates remain supportive and we expect the central bank to keep policy rates unchanged

Interbank market rate, %

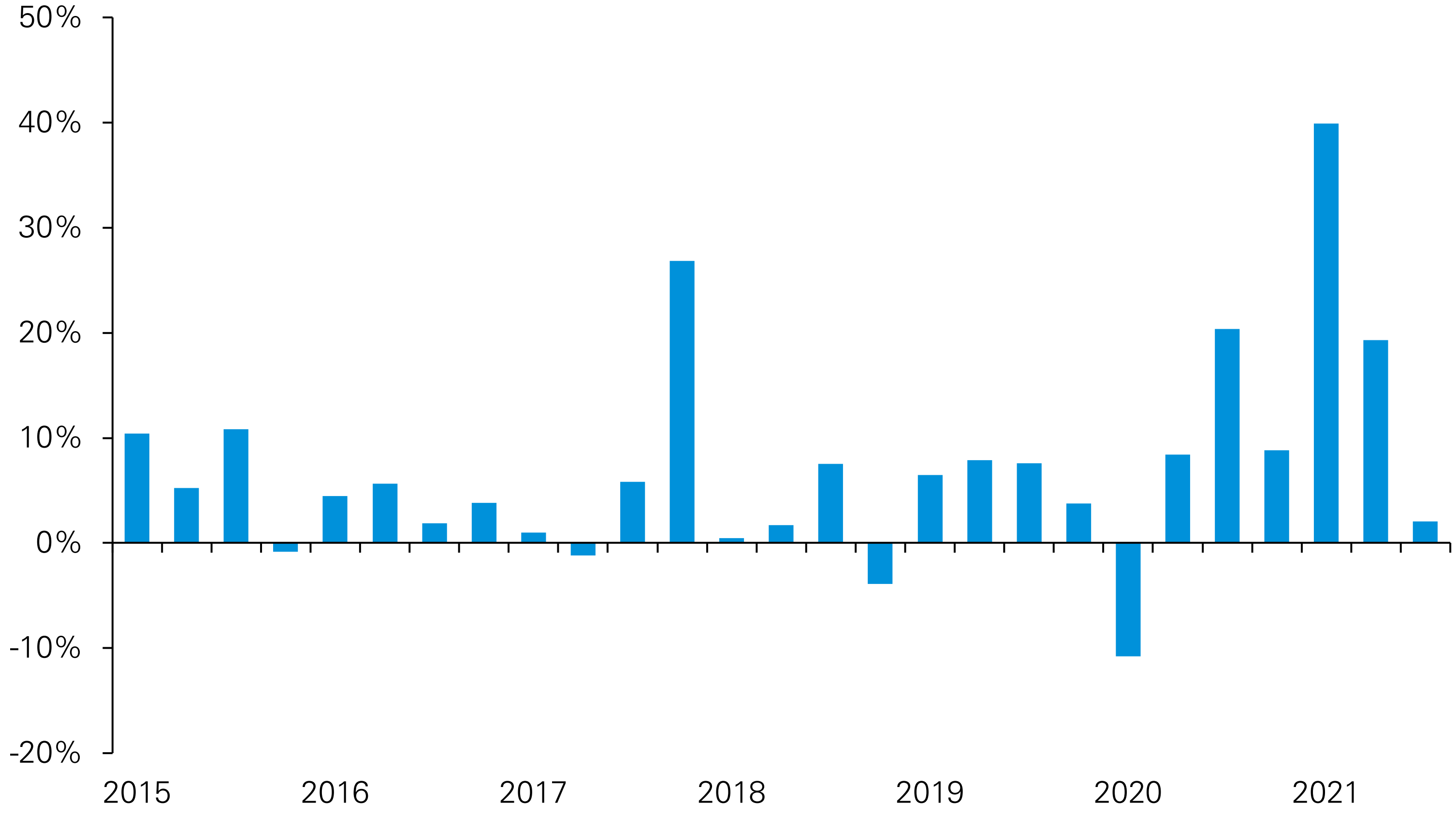


Source: Wind, KPMG analysis. IOER (interest on excess reserve) is the interest rate paid on excess reserves by the central bank.

- DR007, a measure of funding cost for banks, remains stable and averaged 2.18% in September.
- To support the real economy, the central bank increased the relending quota by RMB 300 billion this year to support SMEs. In addition, the interest rate of SME loans fell to 4.89% in September.
- We expect the central bank to keep the policy rate unchanged, but it may implement another targeted RRR cut to increase liquidity. The central bank also announced that it will introduce a new monetary tool to support the reduction of carbon emissions.

Foreign investment into China continues to rise but the pace slowed in Q3 on a high base

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

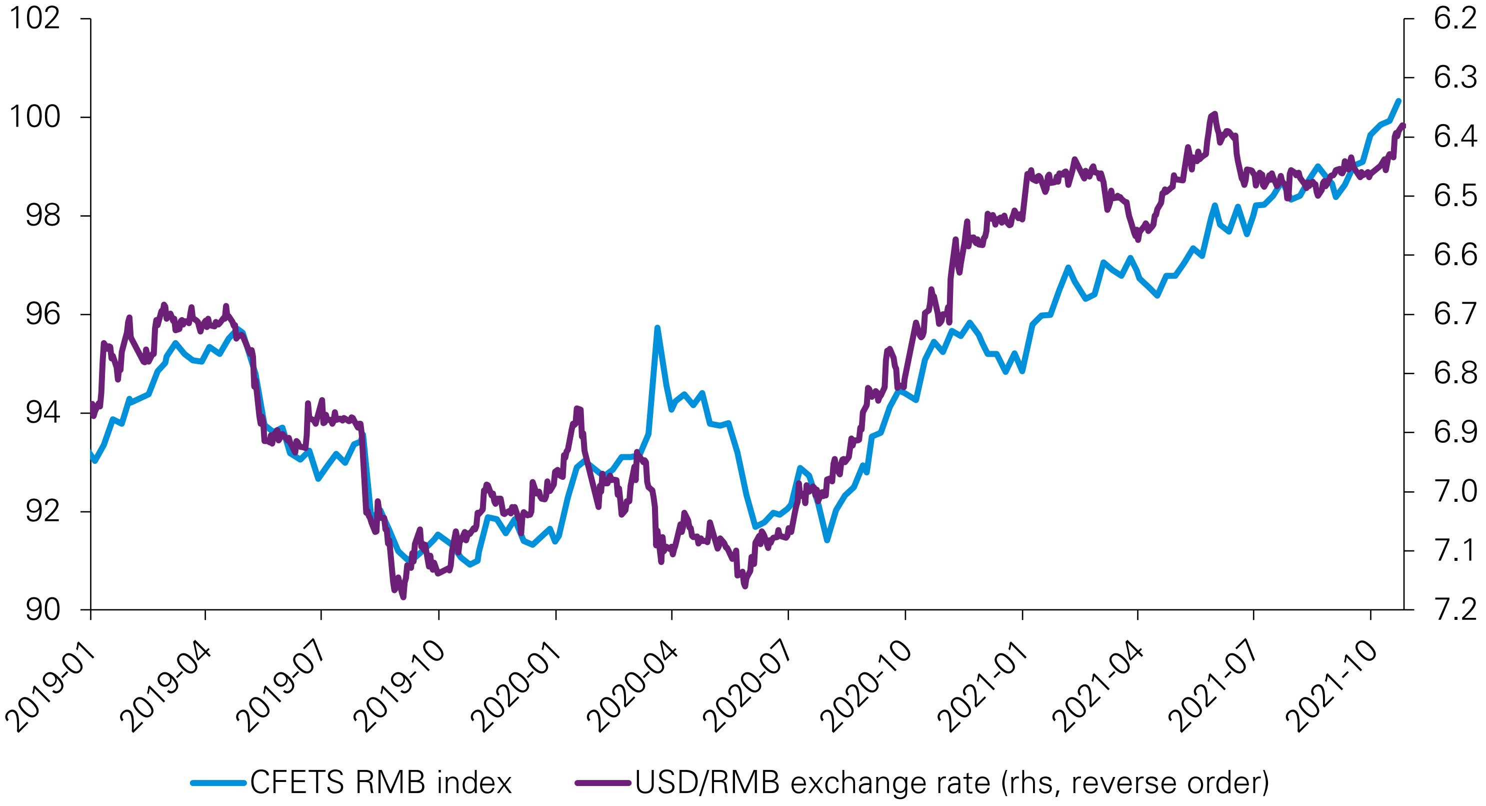


Source: Wind, KPMG analysis

- Growth of foreign direct investment (FDI) into China slowed in Q3 due to a high base comparison, but was still up 2% yoy. Total FDI increased 19.6% yoy to RMB 859.5 billion (USD 129.3 billion) in Jan–Sep 2021, underlining the importance of the China market to MNCs.
- By sector, the share of the service sector in FDI is rising, accounting for 79.7% of total FDI in Jan–Sep. FDI into the high-tech sector increased by 29.1%, of which high-tech service industries increased by 33.4%.
- In terms of countries, investments from the 'Belt and Road' and ASEAN economies increased by 31.9% and 31.4%, respectively.

The RMB exchange rate strengthened on strong exports

CFETS RMB index and USD/RMB exchange rate

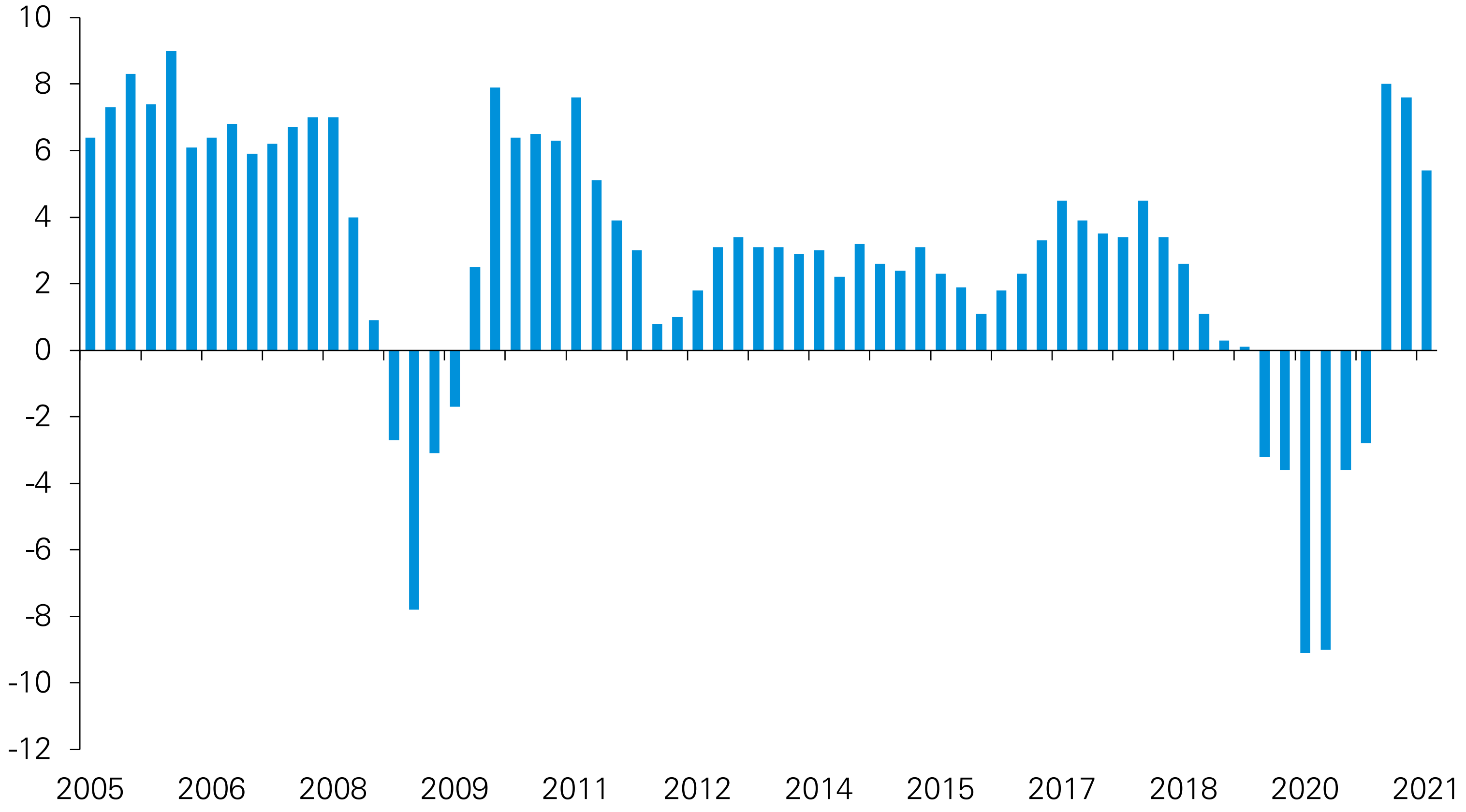


Source: Wind, KPMG analysis

- On the back of China's strong export growth, the CFETS's basket index of the RMB has increased by nearly 10% since the second half of 2020.
- Despite the strengthening of USD in recent months driven by the taper of its quantitative easing, the RMB has appreciated slightly against the USD and traded at 6.38 in late October.
- Looking forward, China's exports should remain robust and provide support for the RMB exchange rate. International investors are also increasing their portfolio investments in Chinese equities and we expect the RMB to remain relatively strong.

Hong Kong's economy continues to recover

Hong Kong real GDP growth rate, yoy, %



Source: Wind, KPMG analysis

- Hong Kong's economic growth moderated in Q3, with the economy growing by 5.4%, following a 7.6% expansion in Q2. The slower growth in Q3 was on account of the high base effect.
- However, the economic recovery remained uneven in Q3. Exports were still robust, while inbound tourism remained muted.
- The labour market showed further improvement as the economy continued to recover. The unemployment rate fell by 0.2 ppt to 4.5% in September. In particular, the unemployment rate of consumption and tourism-related sectors combined fell by 0.2 ppt to 7.2%.
- Looking ahead, the recovery of the global economy, together with policies to boost consumption, should continue to support the rebound of Hong Kong's economy in Q4.

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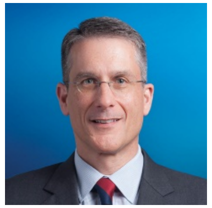

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Publication date: November 2021