China Economic Monitor

Issue: 2022Q1

February 2022

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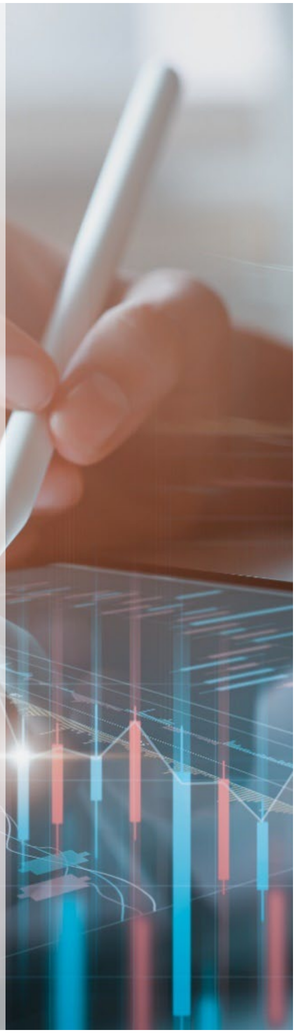
Key takeaways



- China's real GDP grew 4.0% in Q4 year-over-year (yoy), down from 4.9% in Q3, due to a higher base but better than market expectation. The economy expanded by 8.1% for the full year of 2021, after being the only major economy to post positive growth in 2020. In sequential terms, the Q4 growth rate improved to 1.6% from 0.7% in Q3.

- China's 2021 GDP totalled RMB 114 trillion (USD 17.7 trillion). This represents an increase of USD 3 trillion from a year ago, about the same size as the United Kingdom's annual GDP. China's GDP per capita reached USD 12,551, higher than the global average and close to the threshold of high-income economies (current standard by the World Bank stands at USD 12,695). With continued economic growth, China is expected to surpass the mark for high-income economy this year, which will more than double the world's population in the high-income group from 1.2 billion to 2.6 billion.

- Exports remained strong through 2021, growing 23% in Q4 and 30% for the full year. Robust external demand drove up industrial production (up 10% in 2021) and manufacturing investment (up 14% in 2021), a main contributor to the overall growth.

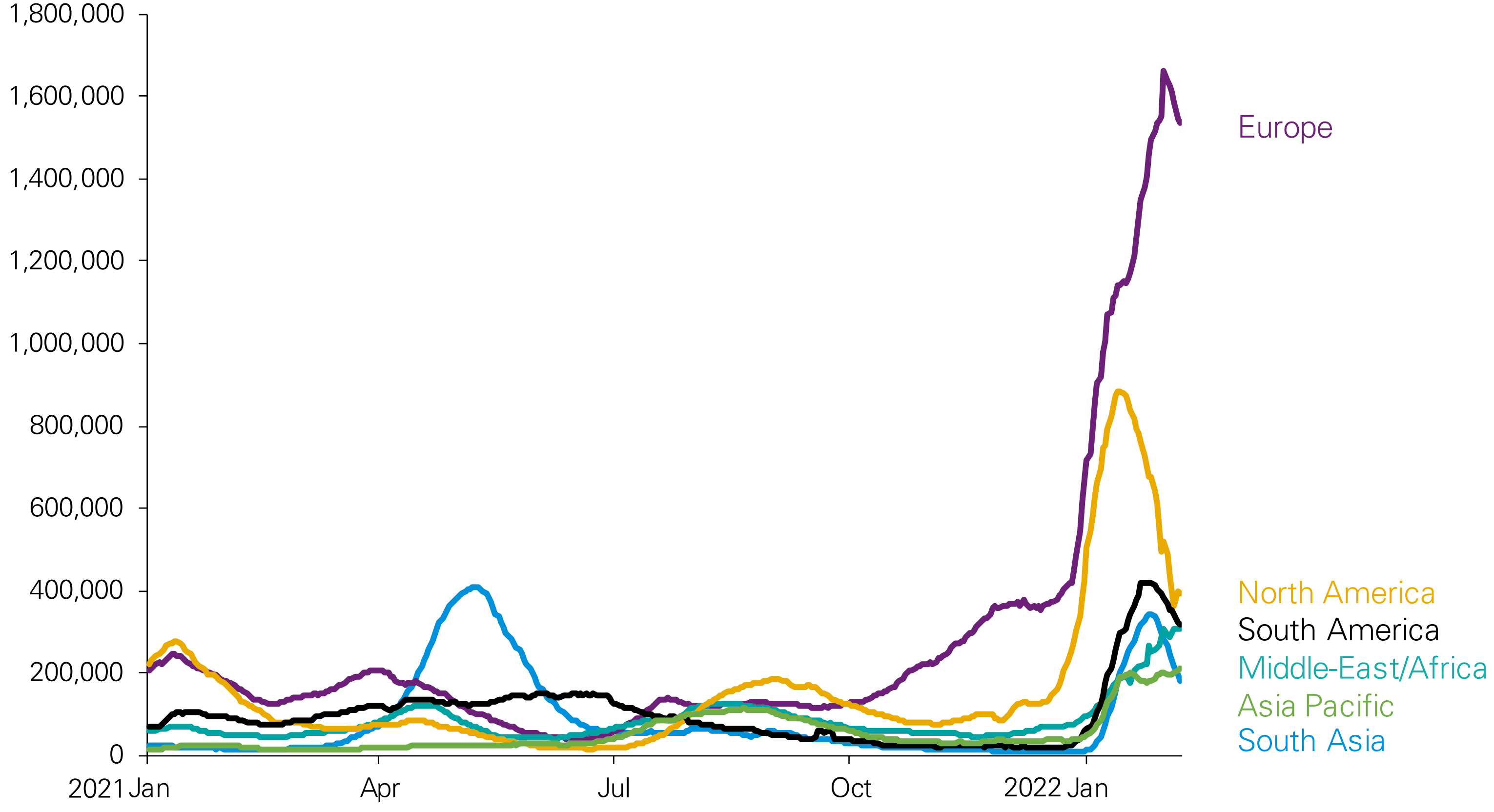
- Domestic consumption remains weak and growth of retail sales growth slowed to 1.7% in December, the slowest pace since August 2020. New COVID-19 cases, especially those with the highly transmissible Omicron variant, have led to tightened quarantine measures in some areas. With a series of major events taking place in 2022 such as the Beijing Winter Olympics, the Two Sessions (National People's Congress starting on 5 March), and the 20th Party Congress, we expect pandemic control measures to remain tight in the near future. The recovery of domestic consumption is likely to be gradual and will be subject to pandemic evolvement.

- The real estate market continues to face pressure. New property sales fell 17% and property starts dropped 29% from a year ago in Q4. The government has applied some marginal easing measures to support the housing market, such as accelerating mortgage approvals and increasing bank loans to the property sector. However, we expect the overall regulatory tone of 'housing is for living in, not for speculation' to remain in place.

- Against increasing headwinds, the government has adopted both fiscal and monetary measures to stabilise growth. On the fiscal side, the State Council pre-approved a RMB1.46 trillion quota for special local government bonds in December, which should help support infrastructure investment in H1. On the monetary side, the People's Bank of China (PBoC) cut the required reserve ratio and reduced the one-year Loan prime rate (LPR) by 5bp in December. It expanded the cut to the MLF and reverse repo rate in January and slashed both one-year and five-year LPR. With significant growth pressure, we expect more supportive measures to be released in the coming months. We expect China's GDP to grow 5.2% in 2022.

The highly transmissible Omicron variant drives global inflections to new highs

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

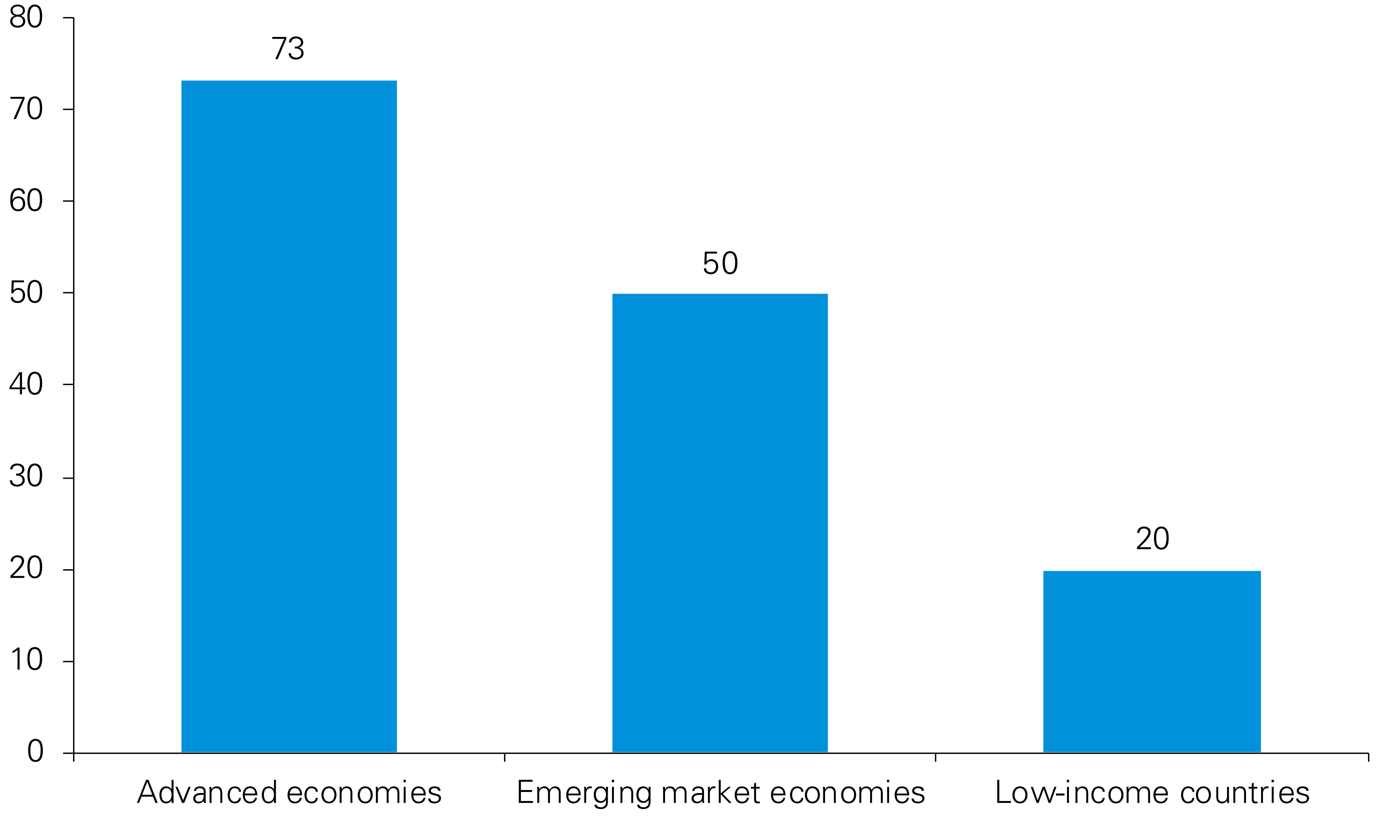


Source: Wind, KPMG analysis. Data through 6 February 2022.

- Confirmed COVID-19 cases reached over 400 million worldwide as of 6 February, resulting in over 5.7 million deaths.
- In late November 2021, a new variant of COVID-19, Omicron, was first discovered in South Africa. It is the fifth variant of concern identified by the WHO and is more transmissible than all previous variants.
- Global daily new infections broke previous records and reached over 3 million in early February 2022. The virus resurgence has brought back travel restrictions in some countries.
- China has also seen new infections caused by the Omicron variant in some areas. Given the high transmissibility of this variant, we expect the government to maintain tight quarantine measures in the near future.

Half of the world's population has received at least two does of vaccines, but there is a significant gap across countries

Share of population who have received at least two does of vaccines, %

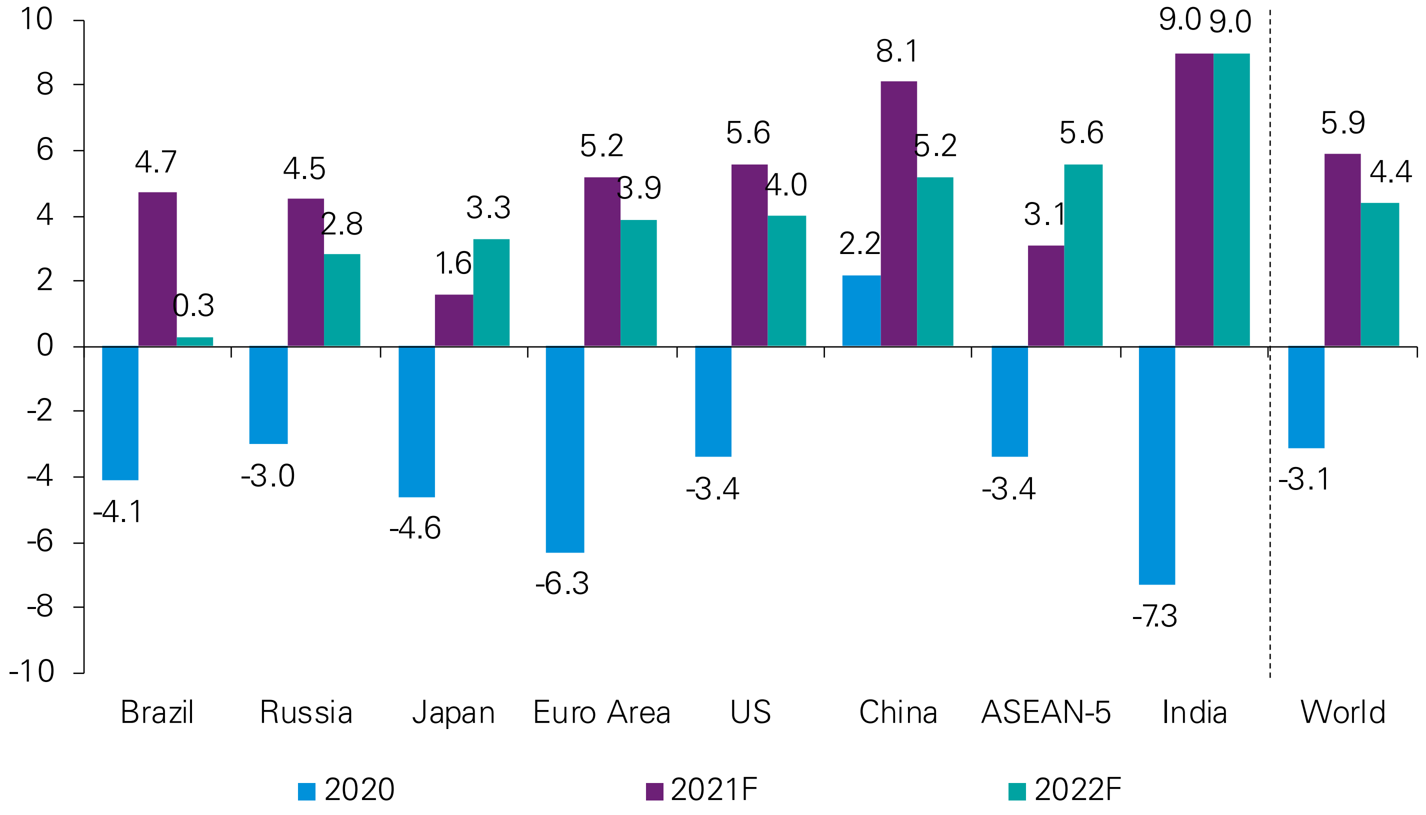


Source: Our World in Data, Data through 16 January 2022. KPMG analysis

- As of 6 February, over 10 billion COVID-19 vaccine doses, including 1.1 billion booster doses, had been administered around the world. A total of 53.5% of the world population has received two doses of a COVID-19 vaccine. China has administered over 3 billion vaccine doses, including nearly 460 million booster shots.
- The vaccine campaign has accelerated in emerging market and developing countries. Around 50% of the population in emerging market economies are fully vaccinated, 14 ppt higher than that in October. However, only 20% of the population in low-income countries are fully vaccinated, significantly below in advanced economies.

The pace of global economic recovery is expected to moderate in 2022

Real GDP growth and forecast, %

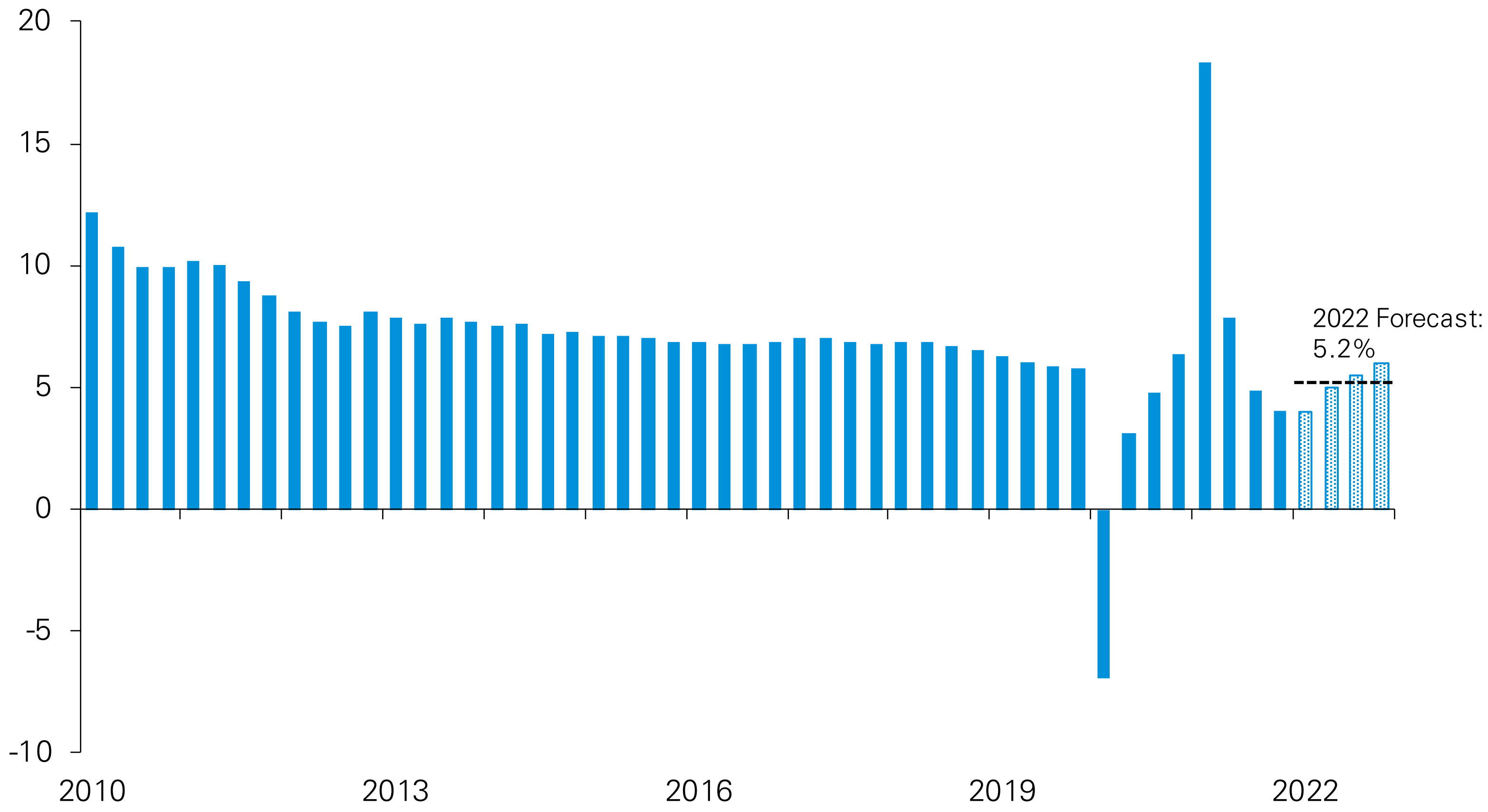


- The global economy is expected to continue to recover in 2022 but the pace will likely be slower. Lingering pandemic spreads, supply chain disruptions and monetary policy normalisation weigh on continued global economic recovery.
- Rising inflation risk has put pressure on central banks to accelerate monetary policy tightening. The US Federal Reserve Bank is expected to raise interest rates four times in 2022 starting in March.
- Meanwhile, recovery of developing economies is facing further multiple challenges, including lower vaccination rates, higher debt levels and tightened financial conditions.

Source: IMF, KPMG analysis.
Note: China's 2022 forecast is by KPMG and the others are based on World Economic Outlook by the IMF (January 2022 edition). ASEAN-5 includes Indonesia, Malaysia, Philippines, Thailand, Vietnam.

China's growth momentum slowed in H2 2021 and more supportive measures are expected to stabilise growth

China's real GDP growth rate by quarter, yoy, %

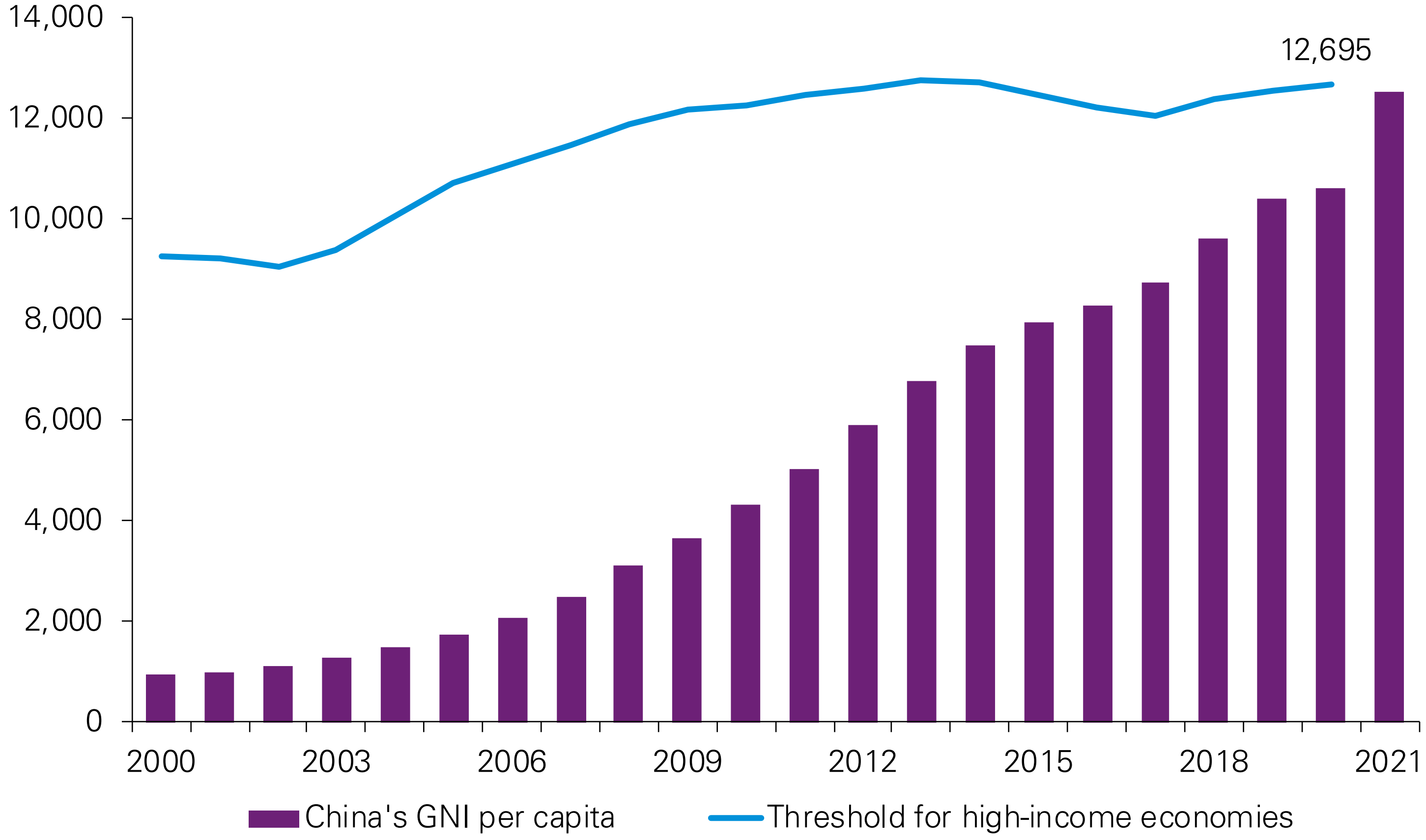


Source: Wind, KPMG analysis

- China's GDP exceeded RMB 114 trillion (USD 17.7 trillion) in 2021. Real GDP grew 8.1% in 2021.
- China's GDP grew by 4.0% in Q4, down from the 4.9% pace in Q3 2021. The moderation was mainly due to a higher base in 2021 and the resurgence of infections in some areas. In sequential terms, the growth rate improved to 1.6% in Q4 from 0.7% in Q3.
- Going forward, the government is expected to roll out supportive measures to stabilise growth. Overall, we forecast mainland China's GDP to grow 5.2% in 2022.

China is a step away from becoming a high-income economy

China's gross national income per capita and threshold for high-income economies, USD



Source: World Bank, KPMG analysis
Note: 2021 data is China's GDP per capita, other data is gross national income (GNI) per capita.

- China's GDP per capita reached USD 12,551, higher than the global average and close to the high-income economy threshold (the World Bank's latest definition was set at USD 12,695 in 2021).
- With continued economic growth, China is expected to surpass the high-income threshold in 2022, which will lift the world's total population in the high-income group from the current 1.2 billion to 2.6 billion.

China's rebound in 2021 was largely driven by external demand, while recovery of domestic demand has remained slow

Two-year average growth rate, %

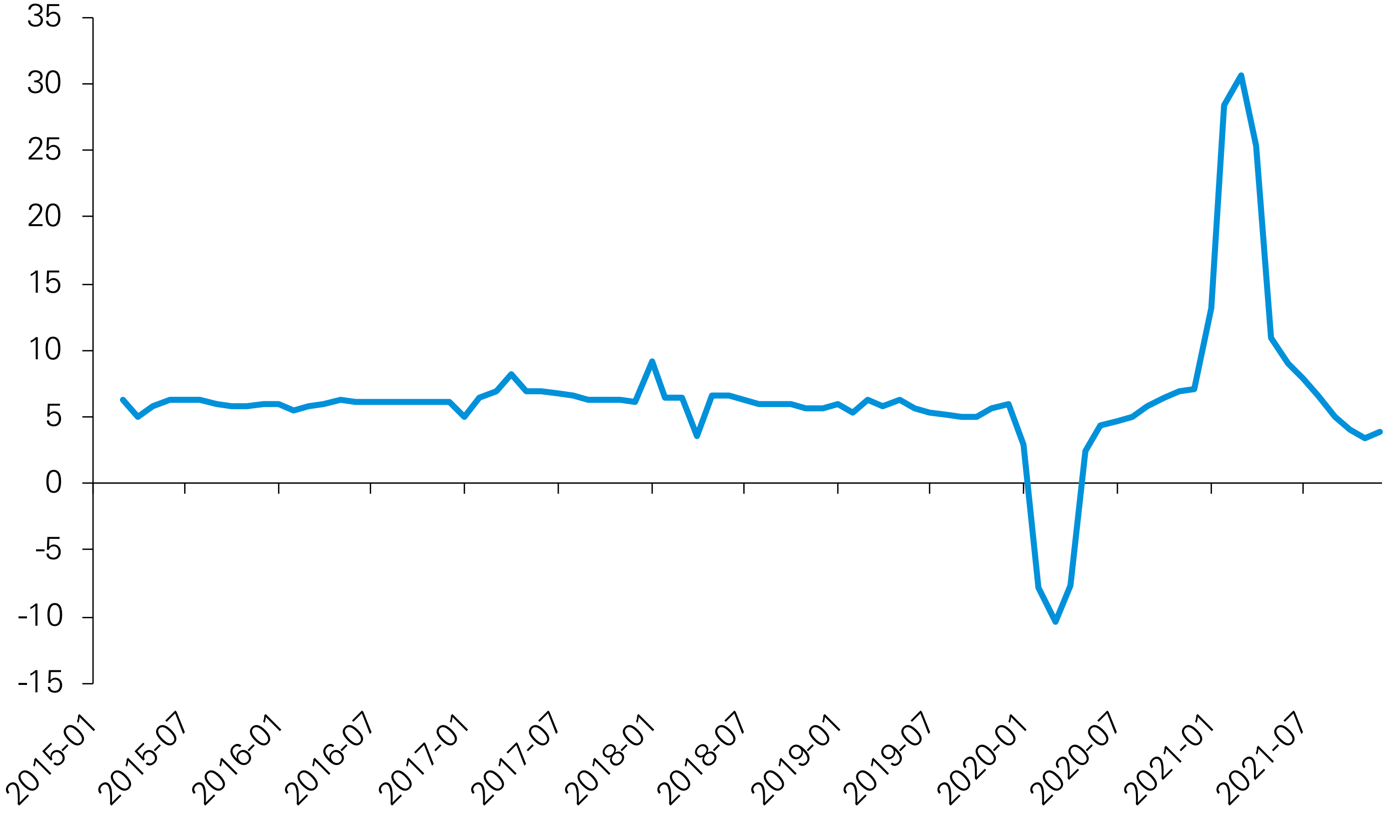
	2017-2019 Average	2021Q1	2021Q2	2021Q3	2021Q4	**2021**
GDP	6.6%	5.0%	5.5%	4.8%	5.2%	**5.1%**
Industrial production	6.2%	6.8%	6.6%	5.3%	5.5%	**6.1%**
Retail Sales	9.0%	4.1%	4.6%	2.3%	3.3%	**4.0%**
Fixed asset investment	6.2%	2.7%	5.6%	3.2%	3.7%	**3.9%**
Exports	6.1%	13.4%	14.2%	16.1%	19.7%	**16.0%**
Imports	9.8%	12.0%	14.2%	14.1%	14.4%	**13.7%**
Income per capita	6.5%	4.5%	5.9%	4.9%	5.1%	**5.1%**
Fiscal revenue	5.8%	3.2%	5.2%	4.6%	-1.5%	**3.1%**
Fiscal expenditure	8.2%	0.1%	-1.5%	2.3%	5.5%	**1.5%**

Source: Wind, KPMG analysis.
Note: 2021's growth rate are two-year average of 2020-2021. GDP, industrial production, and income per capita are in real terms; the rest are in nominal terms.

- To adjust for the base effects, we calculated the average annual growth rate of the past two years to better gauge China's true recovery momentum.
- Exports have been the main driver of China's economic recovery since the pandemic and growth averaged 16% for the past two years, far exceeding its previous pace. External demand also supports industrial production, which has maintained its pre-pandemic growth level.
- In contrast, growth in retail sales and investment is still significantly below the pre-pandemic levels.

Industrial production improved with stabilising power supplies

Growth of industrial production, 3mma, yoy, %

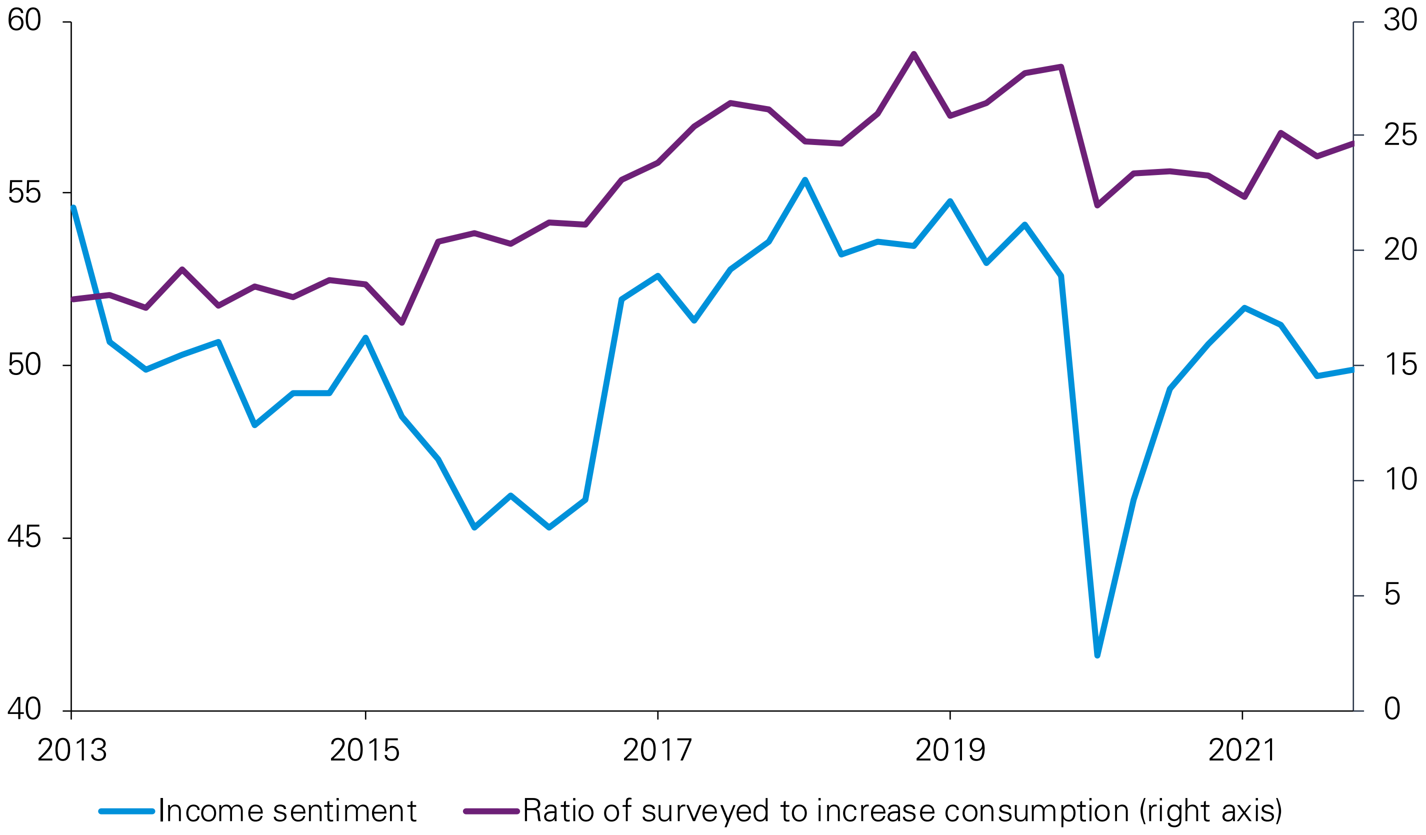


Source: Wind, KPMG analysis

- As the government has taken various measures to boost power supply, such as ramping up coal production and imports, growth in industrial production rebounded to 4.3% in December, 1.2 ppt higher than that of September. The output of industrial production increased by 9.6% in 2021.
- Specifically, the output of high-tech sector performed well above the overall production activity, with an annualised growth of 18.2%. Meanwhile, high energy-consuming sectors, such as cement and aluminium, continued to decline in Q4.
- Vehicle production has improved gradually in recent months with stabilising chip supplies. However, supply chain disruptions will likely remain a constraint for industrial output with continued pandemic control measures.

Household sentiment improved modestly, but remained weak

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

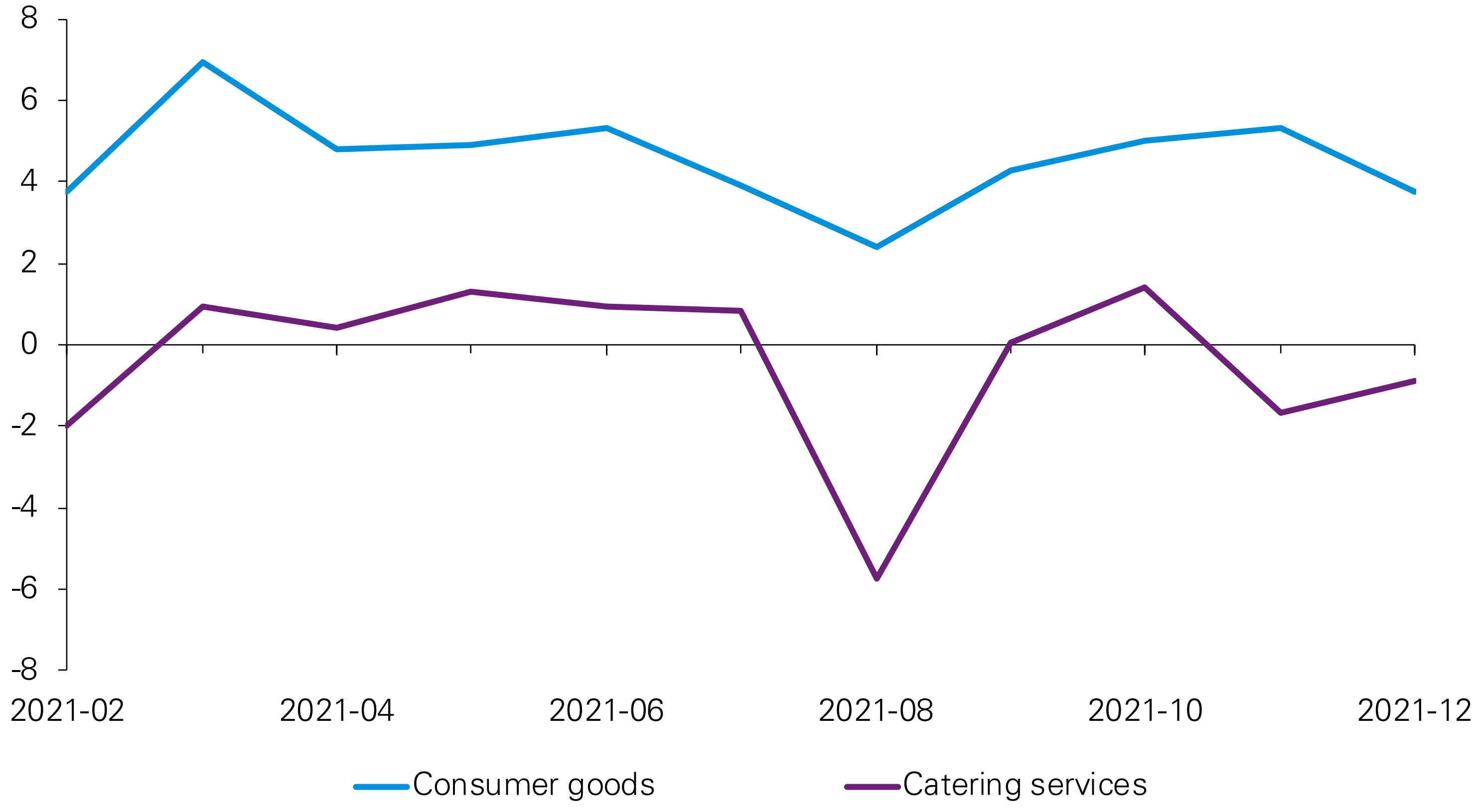


Source: the PBoC, KPMG analysis
Note: Income sentiment is a diffusion index with readings above 50 representing improving sentiment.

- Based on a survey by the People's Bank of China (PBoC), household sentiment for income growth improved slightly in Q4, but remained weak.
- As a result, households are still cautious about consumption. The share of surveyed households that are planning to increase consumption is still below pre-pandemic levels.
- Meanwhile, the labour market is improving, with the urban surveyed unemployment rate at 5.1% in 2021. It was 0.5 percentage points lower than a year ago but better than the government's target of 5.5%.

Service consumption has been more severely impacted by the pandemic

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

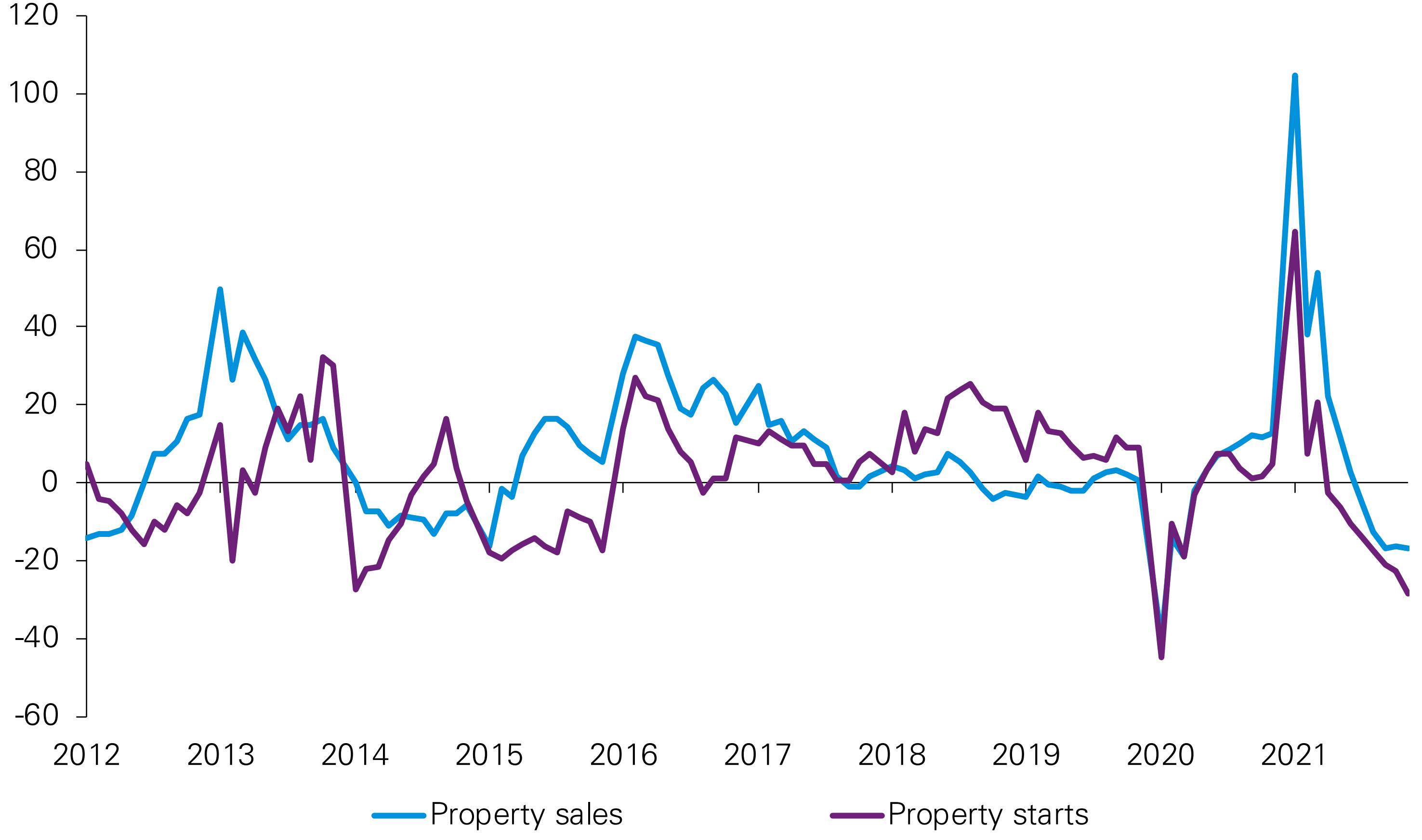


Source: Wind, KPMG analysis

- New outbreaks since December 2021 resulted in tightened quarantine measures in some areas, which put pressure on consumption, especially services-related.
- The two-year annualised average growth of consumer goods dropped to 3.7% in December from 5.3% in November. In particular, catering services fell deeper into negative territory.
- Looking forward, we expect China to continue its dynamic zero-COVID strategy in the near future, as it hosts the Winter Olympic Games and the 20th Party Congress. The recovery in consumption is still subject to pandemic evolvement.

The housing market is facing significant headwinds with falling property sales and starts

Property sales and starts, yoy, 3mma, %

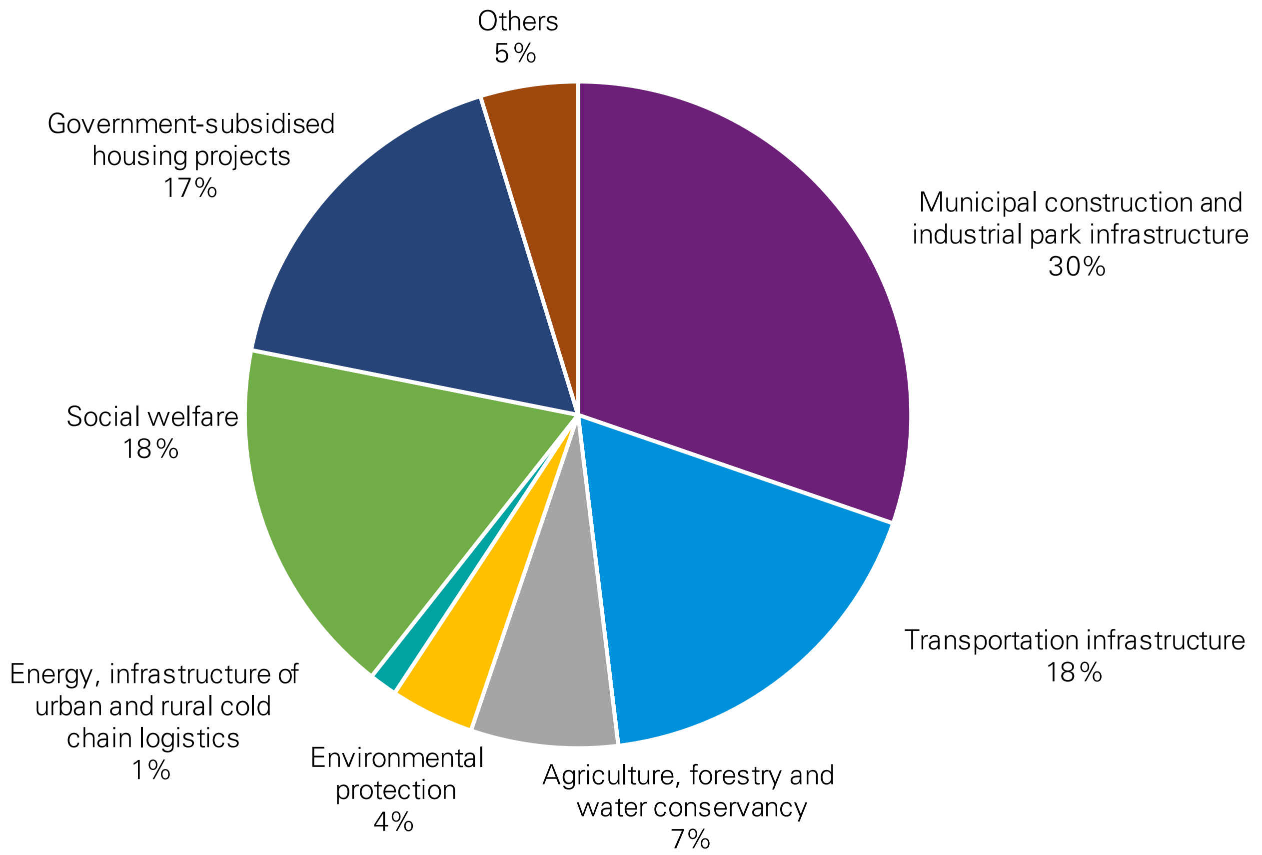


Source: Wind, KPMG analysis

- The property market is slowing down. Property starts fell 11.4% and new property sales were up merely 1.9% in 2021. Land purchases dropped by 25% in Q4, indicating property activity will likely remain weak in the coming months.
- The government has eased housing regulations in some cities to cushion the slowdown, such as relaxing mortgage rates and facilitating mortgage loan disbursement for first-time homebuyers.
- Some marginal easing may be adopted to prevent a sharp decline of the market in 2022, but the overall regulatory tone of 'housing is for living in, not for speculation' is expected to remain in place.

The government has pre-approved a large quota for 2022's local government special bond issuance, which should support infrastructure investment in H1

Share of local government special bond by investment area, January-November 2021, %

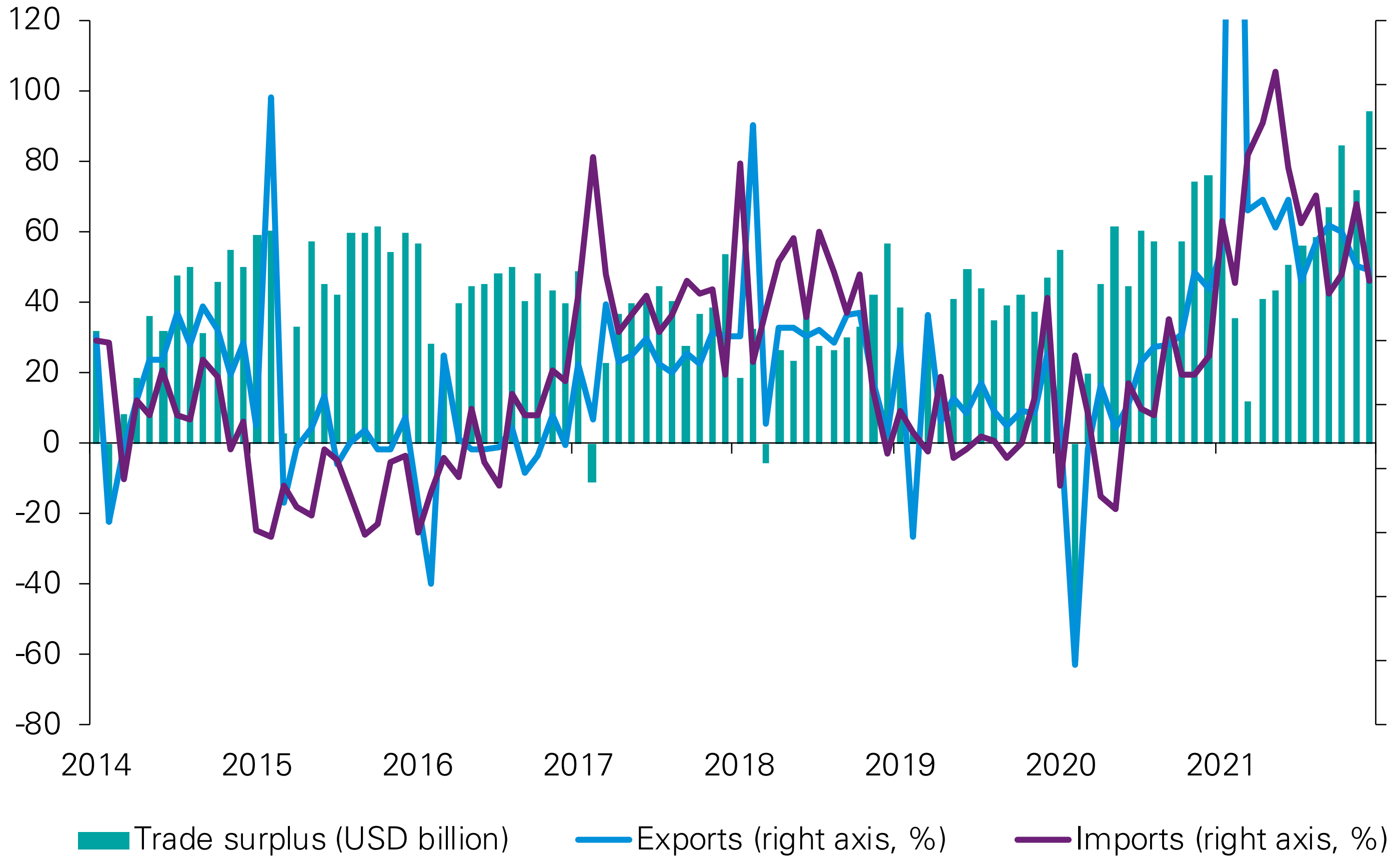


Source: Ministry of Finance, KPMG analysis

- The government stepped up the issuance of local government special bonds (LGSBs) in H2 2021.
- About 60% of LGSBs were targeted at infrastructure projects, including municipal construction and industrial parks, and transportation. With faster government bond issuance and fiscal spending, the decline in infrastructure investments narrowed from -6.5% in September to -0.6% in December.
- To stabilise economic growth, the government has approved a large front-loaded quota for LGSBs of RMB 1.46 trillion. The quota is higher than that approved in 2019 and 2020. This should provide additional support to infrastructure investments in the first half of 2022.

Exports remained strong through 2021, but the growth pace is expected to moderate going forward

Growth of exports and imports, %

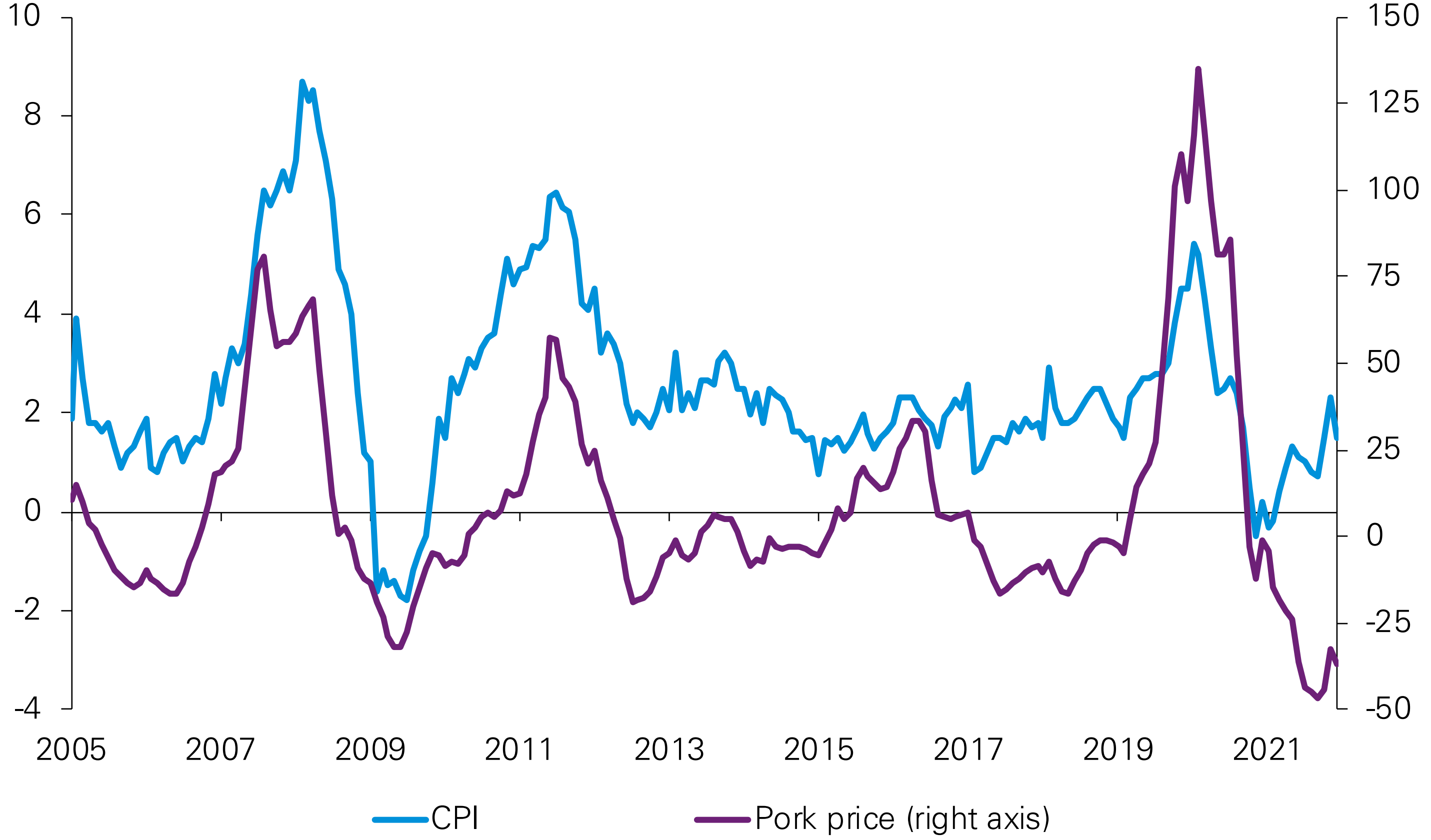


Source: Wind, KPMG analysis

- Thanks to rising demand from advanced economies and production disruptions in some developing markets due to new pandemic waves, China's exports remained robust and stood at USD 3.4 trillion in 2021. Exports surged by 23% in Q4, pushing the quarterly trade surplus to its highest level on record.
- In terms of imports, the growth reached 30.1% in 2021, driven by hikes in commodity prices. China's import prices have been increasing at double digit for nine months. The government also ramped up coal and gas imports to increase energy supplies. The imported volume of coal increased by 44% in Q4.
- Looking ahead, we expect China's exports to continue to do well but the growth rate will likely slow with a higher base and the recovery in advanced economies shifting from goods demand towards services.

Consumer inflation remains subdued thanks to drop in pork prices

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

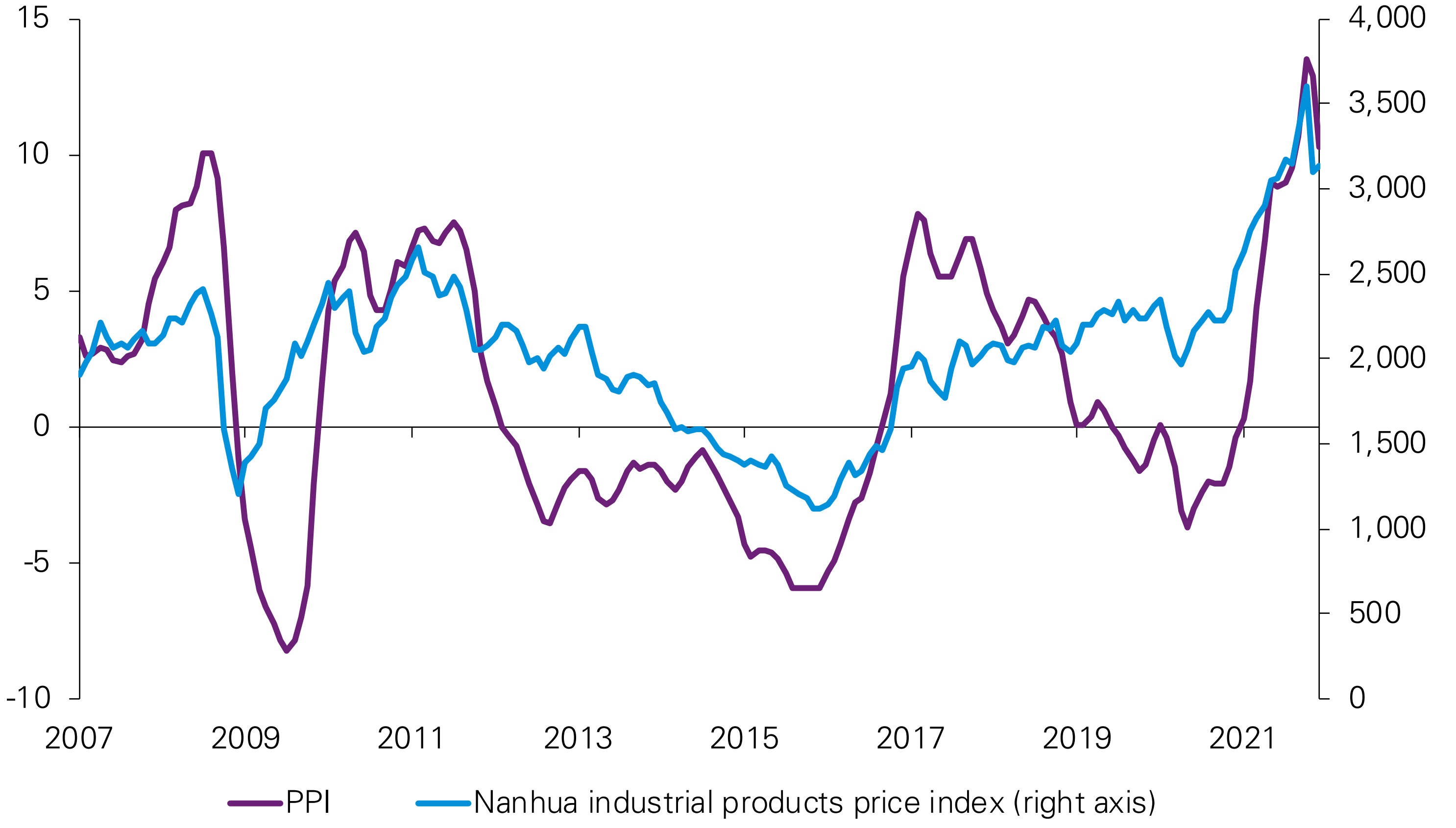


Source: Wind, KPMG analysis

- The consumer price index (CPI) rose 0.9% in 2021, well below the central bank's target of about 3%. Falling pork prices and soft non-food price increase helped to cap CPI growth.
- Looking ahead, we expect China's CPI to rise from 0.9% in 2021 to 2.5% in 2022 owing to last year's low base, consumption recovery, and the spill-over of increases in commodity prices.

Producer price inflation is peaking out as growth of commodity prices retreats

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

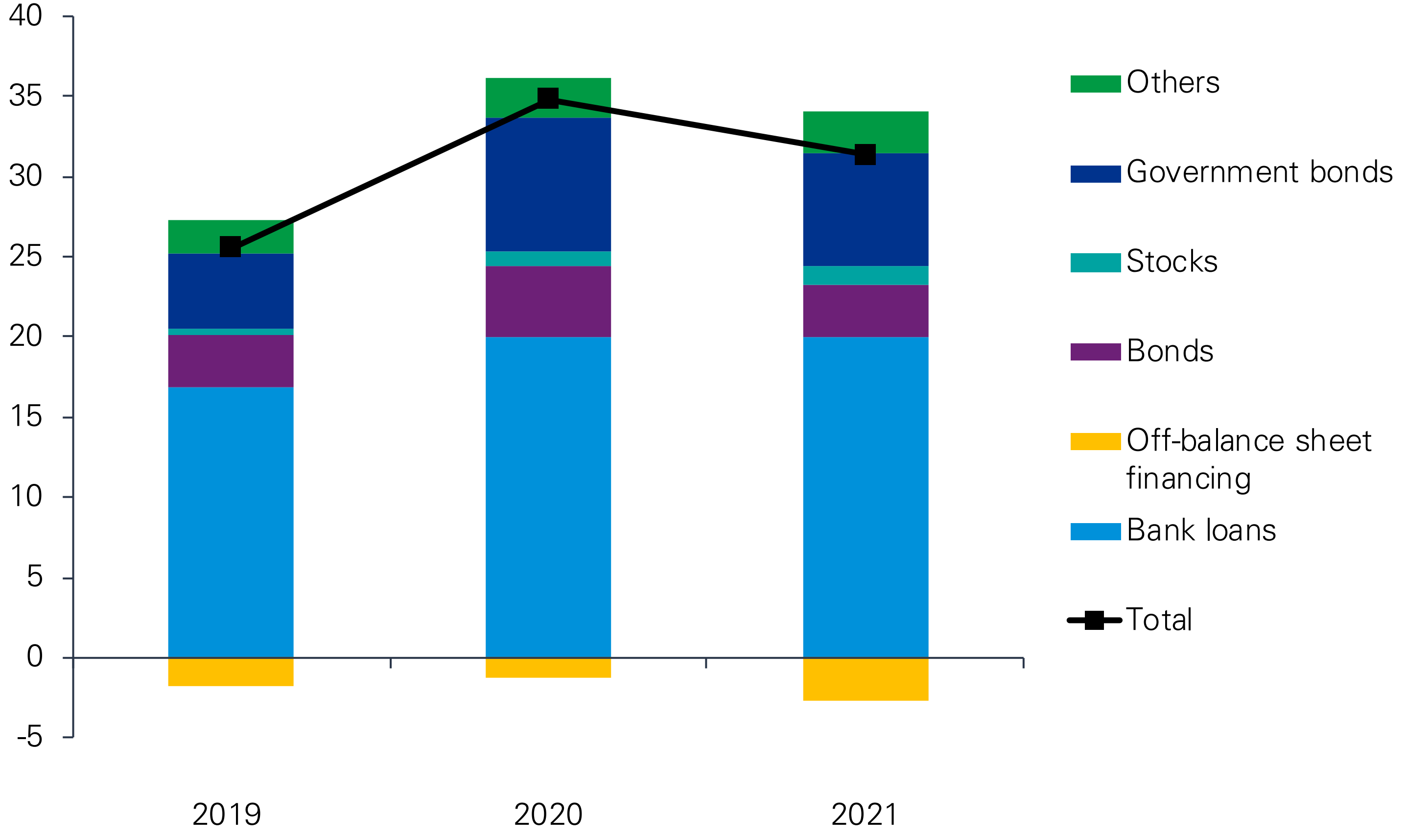


Source: Wind, KPMG analysis

- The government has taken a number of measures to contain rising prices of energy and raw materials. Growth of producer price index (PPI) slowed to 10.3% in December from 12.9% in November. It was the second consecutive drop after reaching a peck in October.
- As the pandemic situations improve and raw material supplies continue to recover, we expect the PPI growth to retreat this year. The gap between CPI and PPI is expected to narrow.

Growth of total social financing slowed, mostly due to a decline in off-balance sheet financing and bond issuances

Change in total social financing, RMB trillion

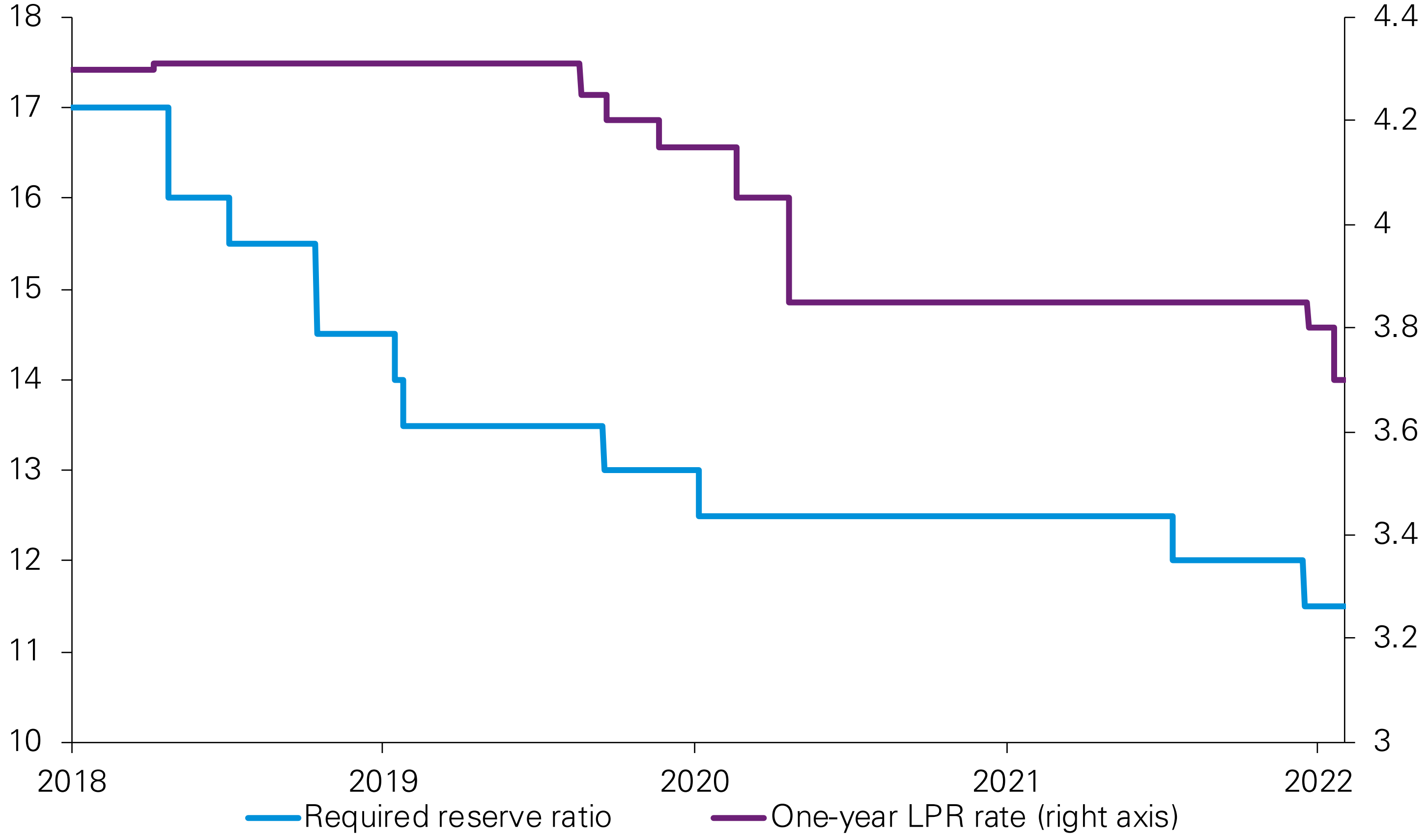


Source: Wind, KPMG analysis

- New total social financing (TSF), a measure of the total liquidity provided by the financial sector to the real economy, increased by RMB 31.4 trillion in 2021, RMB 3.4 trillion lower than the same period last year, but RMB 5.7 trillion higher than in 2019.
- Bank loans are the main driver for TSF growth, accounting for 63.6% 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 support for the green economy continue to strengthen. The central bank launched a new lending facility to support carbon-reduction in November, and it also set up a special relending facility worth RMB 200 billion to support clean coal usage.

The central bank is stepping up support by cutting the required reserve ratio and key policy rates

Required reserve ratio and one-year loan prime rate, %

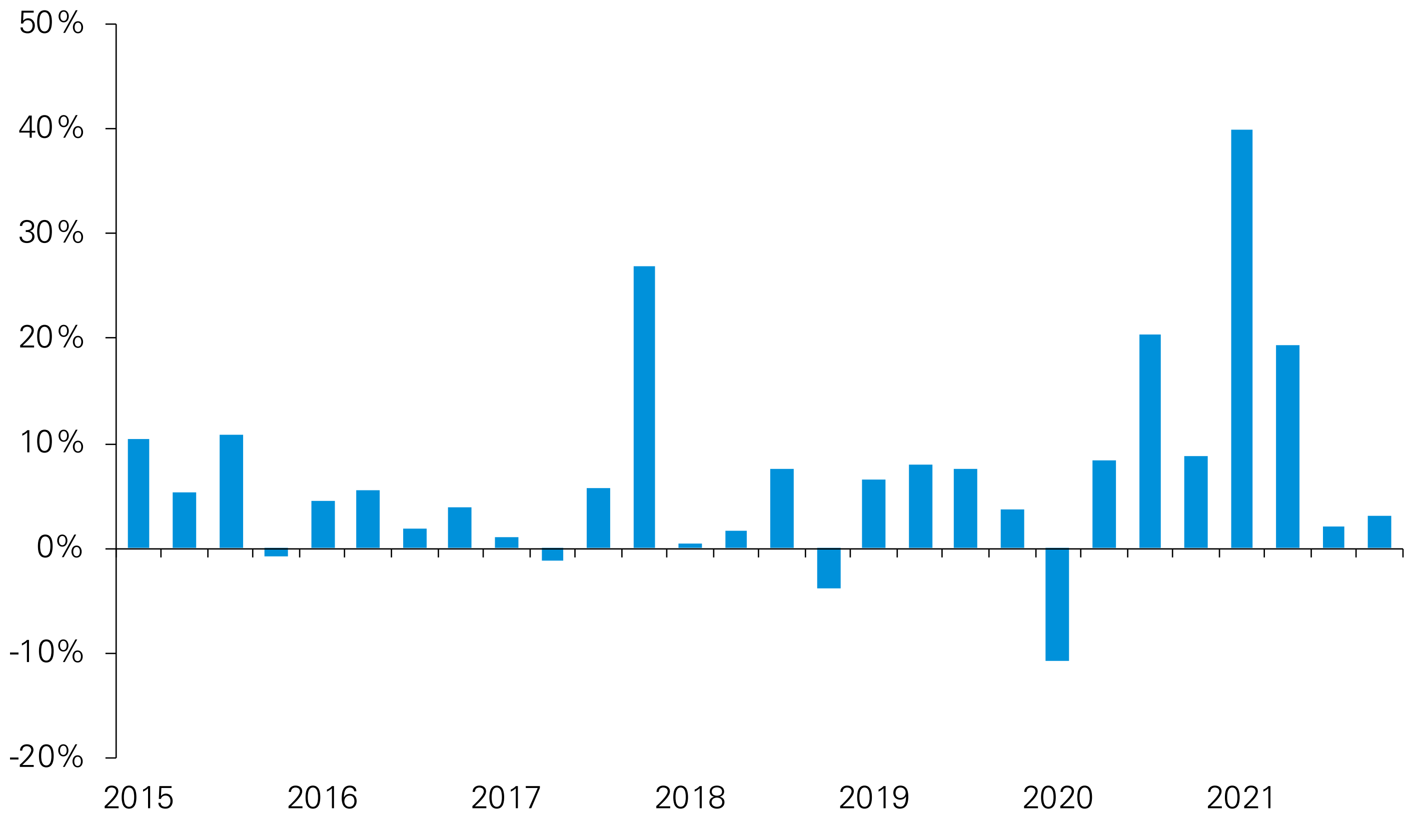


Source: Wind, KPMG analysis.

- The PBoC has accelerated monetary easing to support economic growth. It cut the required reserve ratio and reduced the one-year LPR by 5bp in December.
- In January, it further cut the MLF and reverse repo rate by 10bp each and slashed the LPR for one-year by 10bp and for five-year by 5bp.
- Looking forward, we expect more policy support to stabilise economic growth, as well as further RRR cuts in 2022.

Foreign direct investment remains robust growth

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

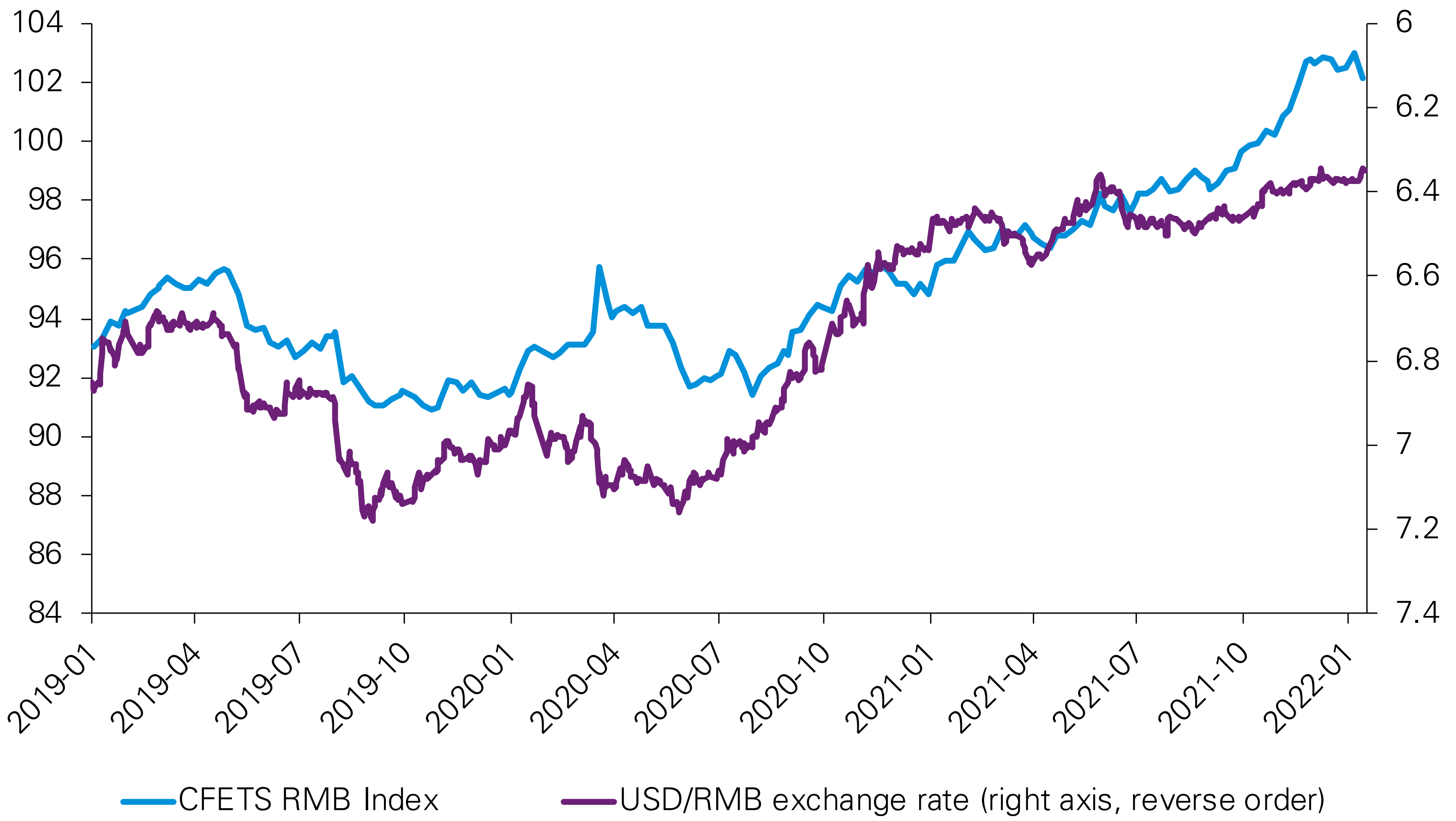


Source: Wind, KPMG analysis

- Growth of foreign direct investment (FDI) into China increased from 2.0% in Q3 to 3.1% in Q4. Total FDI increased 14.9% yoy to RMB 1.15 trillion (USD 173.5 billion) in 2021, underlining the importance of the Chinese market to MNCs.
- The service sector accounted for 78.9% of total FDI in 2021. FDI into the high-tech sector increased by 17.1%, of which high-tech service industries experienced growth of 19.2%.
- The country's large domestic market and strong manufacturing base continue to attract foreign investors, particularly in the wealth management, new energy, and high technology sectors. In addition, China has fully opened up the auto sector to foreign investors as the latest Negative List is trimmed further. We expect China's FDI to remain robust in 2022.

The RMB exchange rate strengthened significantly in 2021 against both the basket currencies and the USD, but is likely to weaken modestly in 2022

CFETS RMB index and USD/RMB exchange rate

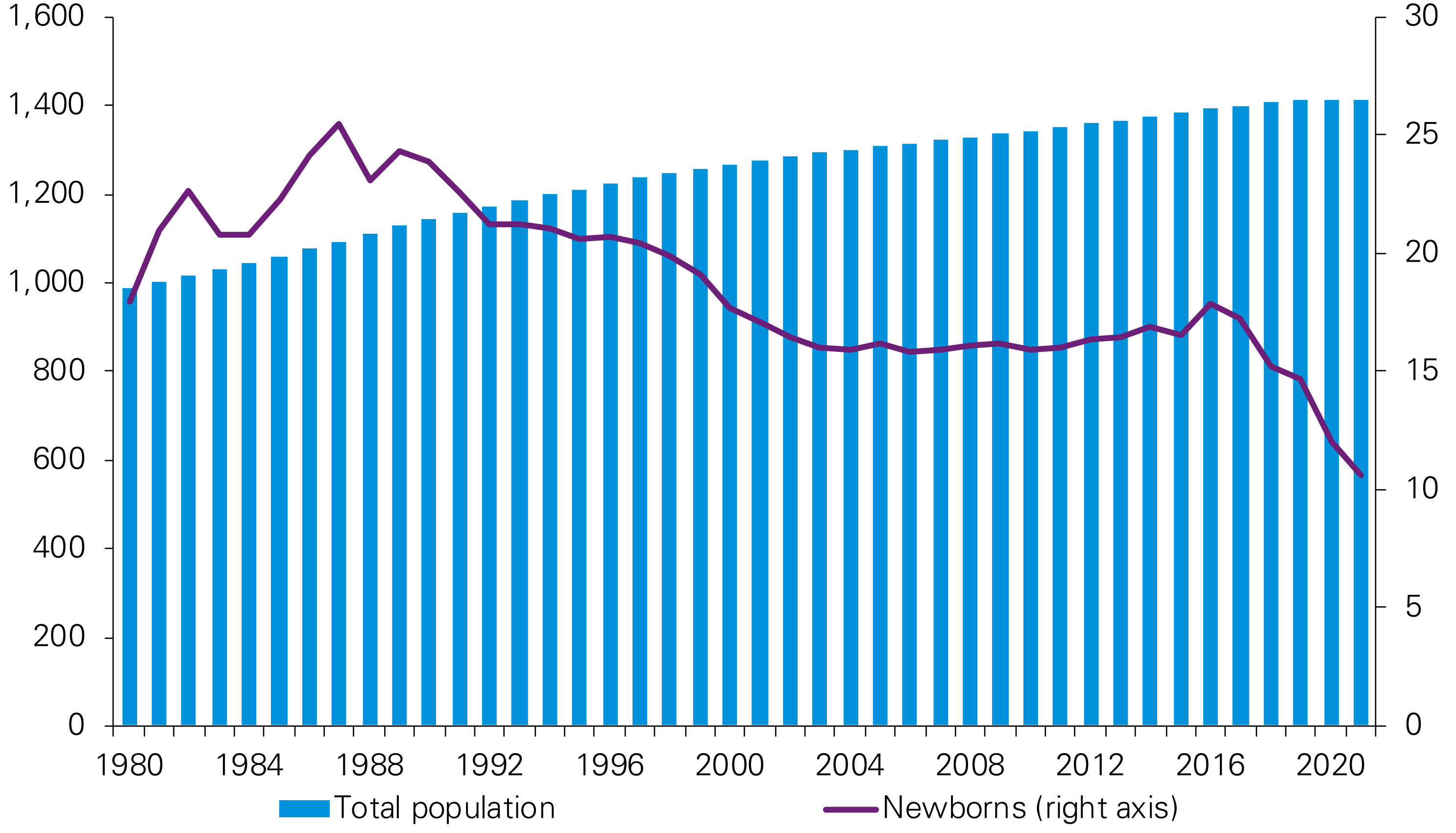


Source: Wind, KPMG analysis

- On the back of China's strong export growth and robust financial capital inflow, the CFETS's basket index of the RMB increased by 8% in 2021.
- Despite the strengthening of the USD due to the US economic recovery and Fed's expected tapering, the RMB also appreciated against the USD by 2.6% in 2021 and traded at 6.35 in mid-January.
- Looking forward, China's export growth will likely slow from a high base. The interest rate differential between the US and China is also expected to narrow, due to Fed's expected tightening and China's interest rate cuts. Thus, the RMB is expected to depreciate slightly against the USD, but should remain relatively strong with China's continued economic growth.

The number of newborns in China fell to a record low

China's total population and number of newborns, million

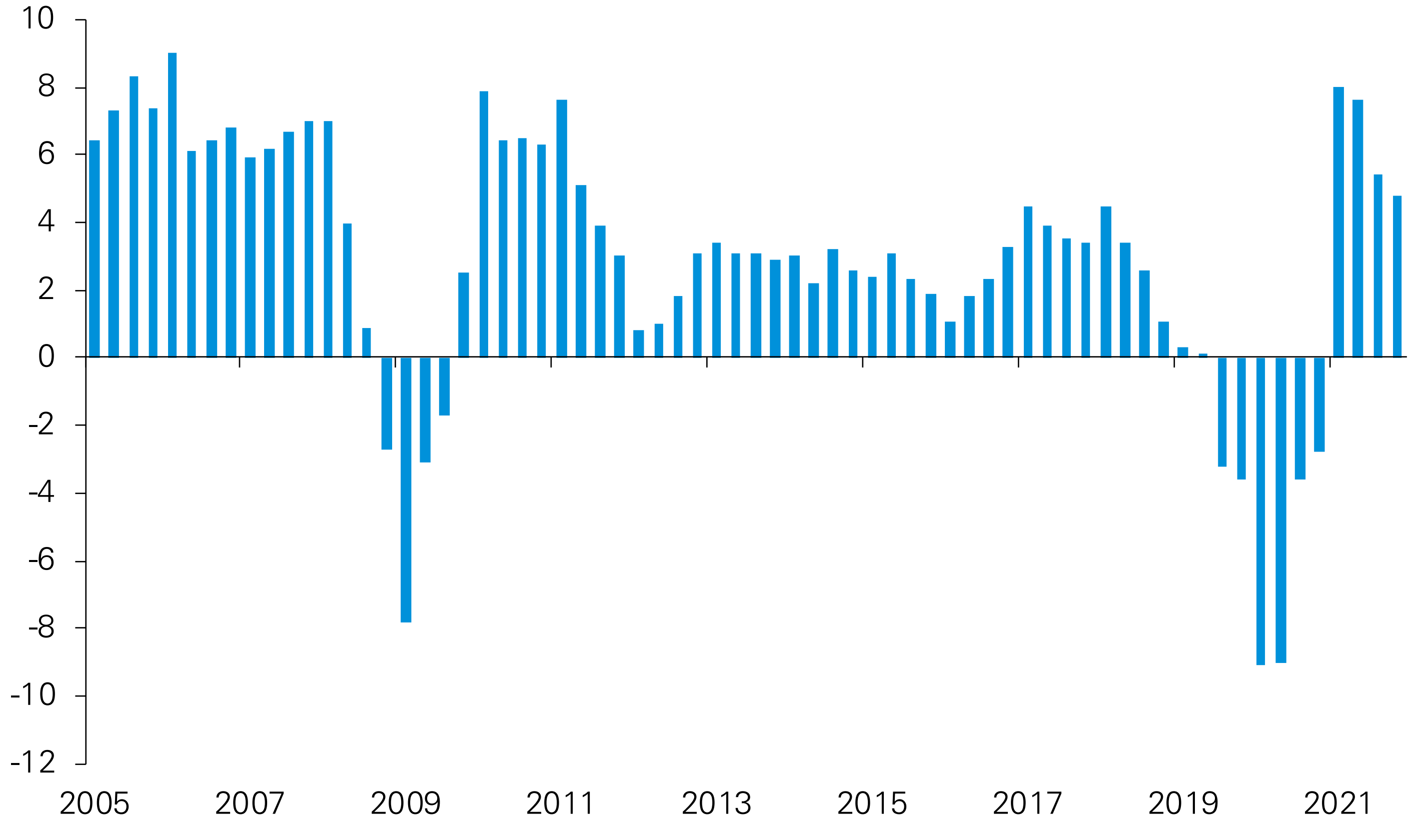


Source: Wind, KPMG analysis

- China's total population grew by 480 thousand in 2021, the smallest increase over the past six decades. Low fertility rate is the main cause of the slow population growth. The number of newborns fell to 10.6 million in 2021, the lowest level on record.
- One reason for the low newborns is the decline in the number of women in childbearing age (21–35) by 3 million in 2021. Having said that, the pandemic has also significantly changed social behaviours worldwide and people may decide to postpone marriages and childbearing. Birth rates in countries such as the US and Japan have also dropped since the pandemic.
- To improve the country's demographic structure, China announced a 'three-child' policy in 2021 and released measures to encourage people to have more children.

Omicron poses new threats to Hong Kong's economic recovery

Hong Kong's real GDP growth rate, yoy, %



Source: Wind, KPMG analysis

- Hong Kong's economy improved in 2021 with a growth of 6.4% for the full year, mainly driven by a higher vaccination rate, strong exports, better retail sales and government stimulus. The labour market continued to improve and the unemployment rate dropped to 3.9% in December, the slowest since the start of pandemic.
- In response to the outbreak of the Omicron variant, the Hong Kong government reintroduced restrictions on travel and social activities. These measures will curb cross-border tourism and business, as well as impact Hong Kong's retail sector. Looking ahead, the surge in Omicron cases will likely weigh on Hong Kong's continued recovery.

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Publication date: February 2022