Takeaways of China's 2022 Two Sessions

Economic Insights

KPMG China

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Summary

The fifth session of the 13th National Committee of the Chinese People's Political Consultative Conference (CPPCC) and the National People's Congress (NPC) (the 'Two Sessions') were successfully held in Beijing during the period from 4–11 March 2022. During the meetings, the government emphasised the importance of stability. As China will hold the 20th National Congress of the Communist Party of China later in 2022, it is particularly important to achieve stable economic growth in the run-up to this landmark event for both the Party and the country as a whole.

The 2022 Government Work Report (the 'Report'), which was released at the start of the Two Sessions, reiterated the government's focus on stabilising growth and called for additional macro-policy support to promote the stable growth of the macroeconomy. Policymakers at the Two Sessions also stressed the importance of structural reforms in areas such as technology innovation, decarbonisation, regional coordination, and higher-level opening-up, with a focus on the following areas:

1. Keeping economic growth within a reasonable range
2. Stabilising growth with supportive macro policies
3. Deepen the innovation-driven development strategy
4. Cultivating strengths in the digital economy
5. Supporting market entities and the labour market and promoting continued recovery in consumption
6. Stimulating infrastructure and manufacturing investment
7. Promoting coordinated regional development
8. Achieving higher-level opening-up
9. Orderly advancing decarbonisation goals, and promoting green and low-carbon development
10. Addressing key risks to balance growth and security
11. Improving people's livelihoods to pursue common prosperity

Table 1: Key targets of the Government Work Report

	Economic indicator	2020 targets	2020 results	2021 targets	2021 results	2022 targets
Economy	Real GDP growth	N/A	2.2%	Over 6%	8.1%	Around 5.5%
	CPI inflation	Around 3.5%	2.5%	Around 3%	0.9%	Around 3%
Employment	New urban employment (million people)	Over 9	11.86	Over 11	12.69	Over 11
	Surveyed urban unemployment rate	Around 6%	5.6%	Around 5.5%	5.1%	Within 5.5%
Monetary policy	Growth of M2 and total social financing (TSF)	Notably higher than 2019	M2: 10.1%; TSF:13.3%	In line with nominal GDP growth	M2: 9%; TSF:10.3%	In line with nominal GDP growth
Fiscal policy	Deficit to GDP ratio	Over 3.6%	6.2%	3.2%	3.8%	2.8%
	Deficit (RMB trillion)	3.76	6.28	3.57	4.38	3.37
	Central government special bond (RMB trillion)	1	1	N/A	N/A	N/A
	Local Government Special Bonds (RMB trillion)	3.75	3.75	3.65	3.65	3.65
	Tax and fee cuts (RMB trillion)	2.5	Over 2.6	Continue cuts	Over 1.1	2.5
Investment	Renovation of old urban residential communities (thousand)	39	40	53	56	Continued
Environment	Reduction in energy use per unit of GDP	N/A	0.1%	Around 3%	2.7%	In line with overall 14th FYP target, keep flexibility

Source: Government Work Report, National Bureau of Statistics, KPMG analysis
Note: The fiscal deficit and deficit ratio exclude funds transferred and surplus funds carried forward

Keeping economic growth within a reasonable range

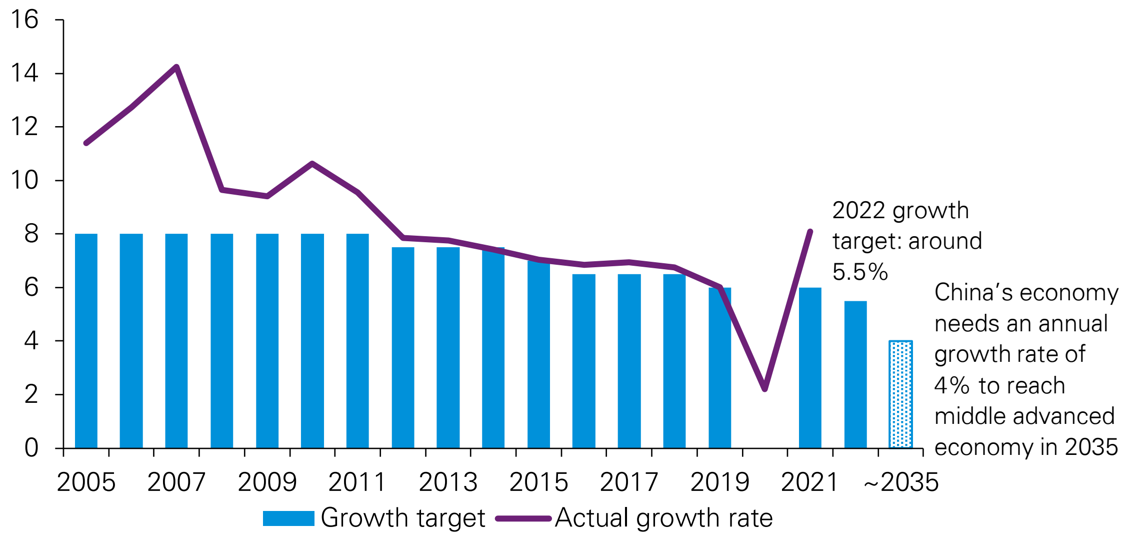
In the Report, China has set an economic growth target of around 5.5% for 2022. The Report follows the guiding principles of the Central Economic Work Conference by prioritising stable growth while also emphasising the importance of ensuring stability on six key fronts and maintaining security in six key areas, improving people's livelihood, maintaining macroeconomic stability, keeping major economic indicators within an appropriate range, and maintaining overall social stability to pave the way for a successful 20th National Party Congress. In addition, the country's 14th Five-Year Plan (14th FYP) has set a goal to raise China's GDP per capita to the level of a moderately advanced economy by 2035. To achieve this goal, KPMG estimates that China will need to maintain an average annual growth of around 4.0% over the next 10 years (Figure 1).

China's GDP in 2021 reached RMB 114 trillion (USD 17.7 trillion), representing an increase of over USD 3 trillion from 2020, which is roughly equivalent to the UK's annual GDP. At the same time, China's economy expanded 8.1% year-on-year in 2021, which was significantly higher than the GDP growth target of more than 6% proposed in the 2021 Government Work Report. Generally, China's economy sustained a continuous recovery in 2021, but the growth rate slowed in the second half of the year.

Given that the International Monetary Fund (IMF) forecasts that the global economy will grow at 3.6% in 2022, with the growth rate of advanced economies posting a growth of only 3.3%, it will be challenging for China to achieve 5.5% growth, particularly with a higher base in the previous year.

As latest data published in Mid-April, China's real GDP grew 4.8% in Q1 year-over-year (yoy), up from 4.0% in Q4 and higher than market expectation. In sequential terms, Q1 GDP grew 1.3% from the previous quarter, lower than the 1.5% pace in Q4. While the highly transmissible Omicron variant has affected many regions in China. The new wave has led to tightened quarantine measures and a few cities has escalated to full lockdowns since mid March, putting pressure on economic growth in Q2.

Figure 1: Target and actual of China's real GDP growth, yoy, %



Source: Wind, KPMG Analysis

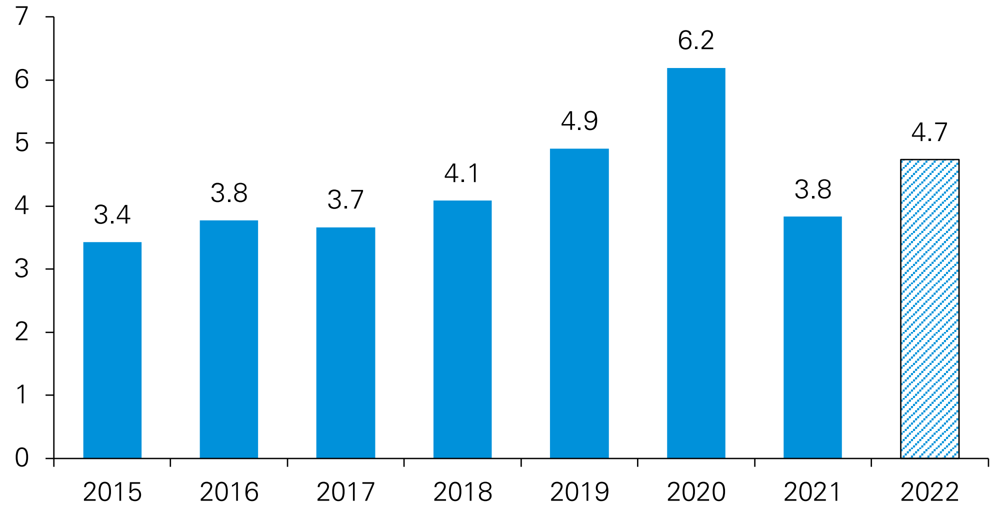
Stabilising growth with supportive macro policies

In line with the guiding principles of the Central Economic Work Conference, the Report calls for more potent macroeconomic policies to maintain economic stability. Specifically, it suggests to intensify cross-cyclical and counter-cyclical adjustments to keep major economic indicators within an appropriate range.

In addition, the Report calls for more proactive fiscal policies in 2022. China has set a target for the deficit-to-GDP ratio at around 2.8%, which is 0.4 percentage points lower than the 2021 ratio of 3.2%. Relatedly, the deficit for 2022 is RMB 200 billion lower than the amount for the previous year. However, after cross-year adjustments, the fiscal expenditure for 2022 will increase by more than RMB 2 trillion year-over-year (y-o-y) to RMB 26.7 trillion, a 8.4% y-o-y increase, which is significantly higher than 2021. This jump is expected to cause the actual deficit-to-GDP ratio (excluding funds transferred and surplus funds carried forward) to increase by nearly 1 percentage point over the 3.8% figure recorded in 2021 (Figure 2). Moreover, revenue generated from China's government-managed funds is expected to reach RMB 15.2 trillion, among which profits handed over by state-owned financial institutions and specialised institutions should amount to RMB 1.65 trillion. On 8 March 2022, the People's Bank of China (PBOC) announced that it will transfer more than RMB 1 trillion (USD 158 billion) in profits to the central government.

In 2022, special bonds issued by local governments will total RMB 3.65 trillion, roughly the same level as in 2021. The expenditures of government-managed funds are expected to reach nearly RMB 14 trillion, a y-o-y increase of 22.3%. At the same time, in order to strengthen the financial resources of local governments, the Report also states that the central government will transfer payments totalling close to RMB 9.8 trillion to local governments, which represents y-o-y growth of 18%, or around RMB 1.5 trillion, and is the largest increase since 2012.

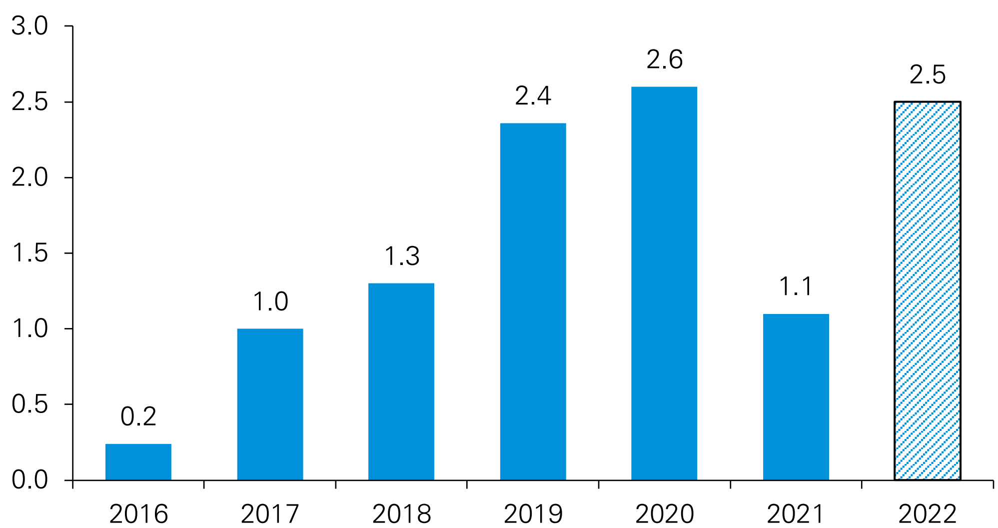
Figure 2: Fiscal deficit ratio in recent years (excluding transferred funds and surplus carried forward), %



Source: Wind, Ministry of Finance, KPMG analysis
Note: 2022 represents the estimated amount

To energise market entities, the government will step up tax and fee reduction initiatives. The Report states that the government will extend tax and fee reduction policies that support manufacturing, micro and small enterprises and self-employed individuals, while also expanding the scale and scope of tax deductions. Moreover, the government will take measures to improve the cash flow of enterprises, promoting consumption and investment. The government plans to issue VAT credit refunds on a large scale in 2022. Priority will be given to micro and small enterprises, which will receive lump-sum refunds for outstanding VAT credits before the end of June, as well as full refunds of newly added credits. Tax refunds and cuts are expected to reach RMB 2.5 trillion in 2022, of which RMB 1.5 trillion will be through refund of value-added tax (VAT) (Figure 3). The tax cut should help enterprises with their cash positions and improve business operations.

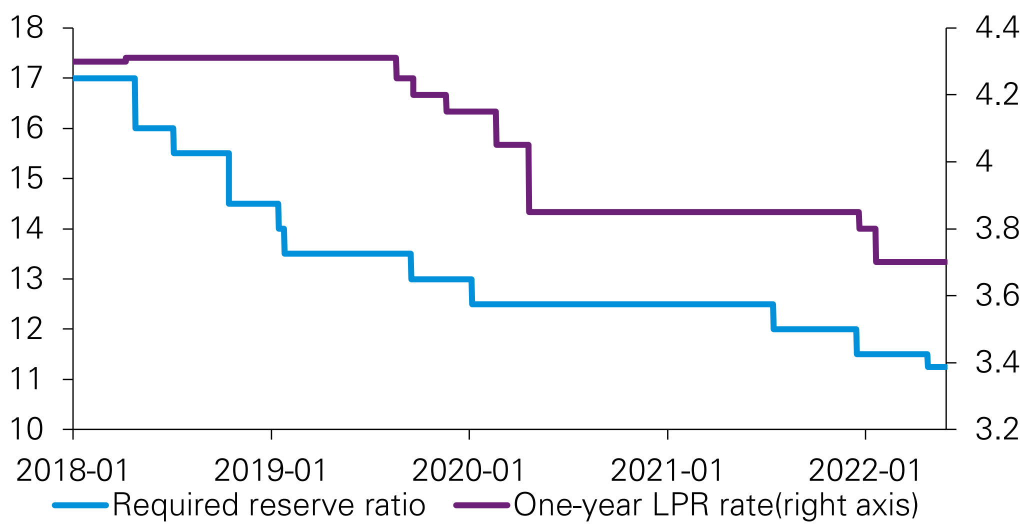
Figure 3: Tax and fee cuts in recent years, RMB trillion



Source: Government Work Report, KPMG analysis
Note: 2022 is the target for the year.

The Report calls for monetary policies that are prudent, flexible and appropriate. In 2022, China will use monetary policy tools to adjust both the amounts and the structure to provide more robust support for the real economy. It will also maintain reasonably ample liquidity, ensure that increases in the money supply and total social financing are generally in line with nominal economic growth, as well as keep the macro leverage ratio generally stable. In terms of the monetary structure, China will continue to encourage financial institutions to increase support for the real economy, in particular in key focus areas such as micro and small businesses, scientific and technological innovation, and green development. The government will also better leverage special relending facilities to support small and micro enterprises, carbon reduction and cleaner and more efficient use of coal. Since the Central Economic Work Conference in December 2021, the PBOC has introduced a series of measures including cutting the reserve requirement ratio (RRR) and interest rates to maintain reasonably ample market liquidity and reduce financing costs for the real economy (Figure 4). These accommodative macro policies will help spur development momentum and mitigate pressures faced by the economy. Meanwhile, the PBOC still has room to make additional RRR and interest rate cuts in the first half of 2022 to improve banks’ ability to provide credit, if needed.

Figure 4: Reserve requirement ratio (RRR) and one-year loan prime rate (LPR), %

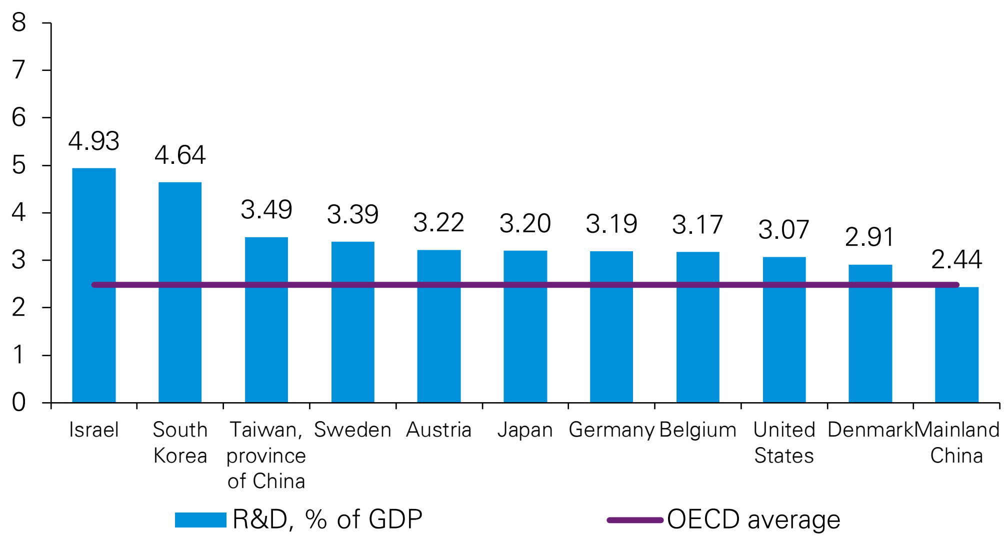


Source: Wind, KPMG Analysis

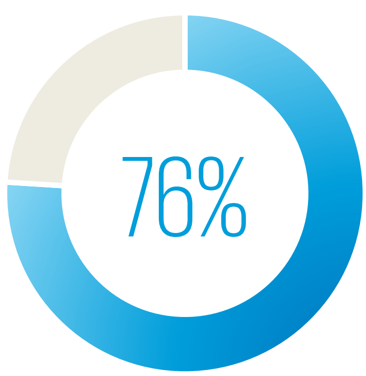
Deepening the innovation-driven development strategy

Innovation has been prioritised during the 14th FYP period, and it represents the core driving force for China's high-quality development. In 2021, China made major strides in scientific and technological innovation, with its comprehensive innovation capability rising to 12th in the world, marking a good start to the 14th FYP period. In 2021, China recorded research and development (R&D) expenses of nearly RMB 2.8 trillion, representing a 14.2% y-o-y increase, which was higher than the target of at least 7% annually set out in the 14th FYP. Meanwhile, R&D expenses as a share of GDP increased by 0.03 percentage points over the previous year, reaching 2.44%, which is close to the average level of 2.47% in Organisation for Economic Co-operation and Development (OECD) countries before the pandemic (Figure 5).

Figure 5: Research and development expenditures as a percentage of GDP, %



Source: OECD, National Bureau of Statistics, KPMG analysis
Note: These figures represent the latest available data from the OECD, along with China's data for 2021



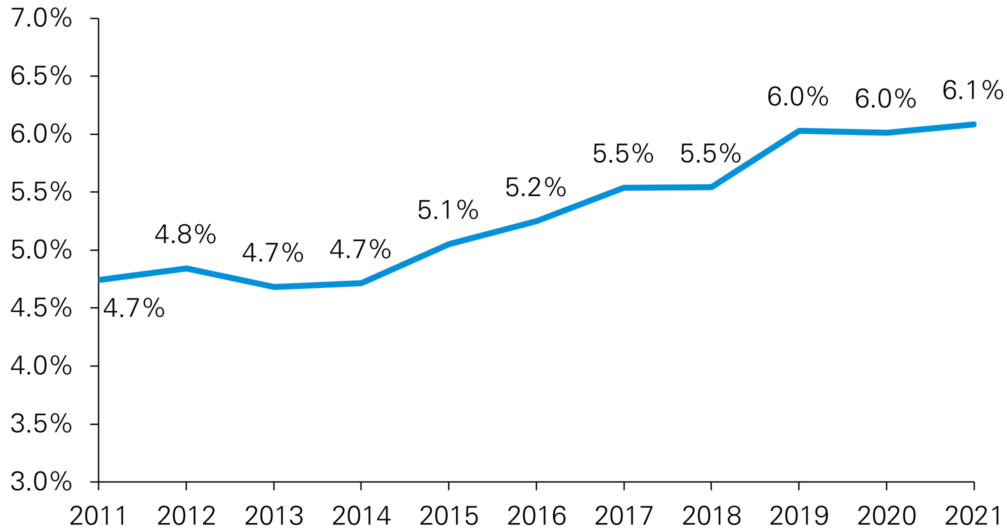
China's research and development expenses in 2021 reached RMB 2.8 trillion, with 76% coming from enterprises

The Report stated that China will continue to implement its innovation-driven development strategy to strengthen the foundation of the real economy. As such, it will continue to promote scientific and technological innovation so as to upgrade industries, eliminate supply bottlenecks, and drive high-quality development through innovation. The country is implementing a 10-year action plan for fundamental research as well as a three-year action plan for reforming its science and technology management system, with the goal of reinforcing the country's strategic science and technology capabilities, further leveraging the strengths of national laboratories and key laboratories, as well as promoting the reform of scientific research institutes. On the other hand, it will also provide stronger incentives to encourage innovation among enterprises, reinforce the principal position of enterprises in the innovation process, as well as promote greater synergy between industry, academia, research and application.

The increase in financial support for innovation has also facilitated the establishment of more high-quality platforms for fundamental scientific research and technological innovation. National laboratories, national engineering research centres, and other scientific and technological innovation institutes are focusing improving technological capabilities in key areas such as information and manufacturing. In addition, there has been progress in breakthrough scientific research, such as the development of an artificial method of synthesising starch from carbon dioxide and the development of coal-to-synthetic oil technology[1]. Fundamental research expenses as a percentage of the country's total R&D expenses increased slightly by 0.1 percentage points (Figure 6). After more than a year of preparation, the Ministry of Science and Technology recently released the 10-Year Plan for Fundamental Research, which focuses on 10 major areas, including scientific and technological planning and fundamental research, as well as strategic science and technology capabilities. In the future, the Chinese government will continue to increase its investment in research and development to strengthen scientific and technological innovation as well as lend more support for economic and social development.

1 The second "Minister's Channel" of the 2022 Two Sessions, March 2022, http://www.gov.cn/zhuanti/2022qglhzb/live/20220308c981672356.html

Figure 6: Fundamental research as a percentage of total R&D spending, %



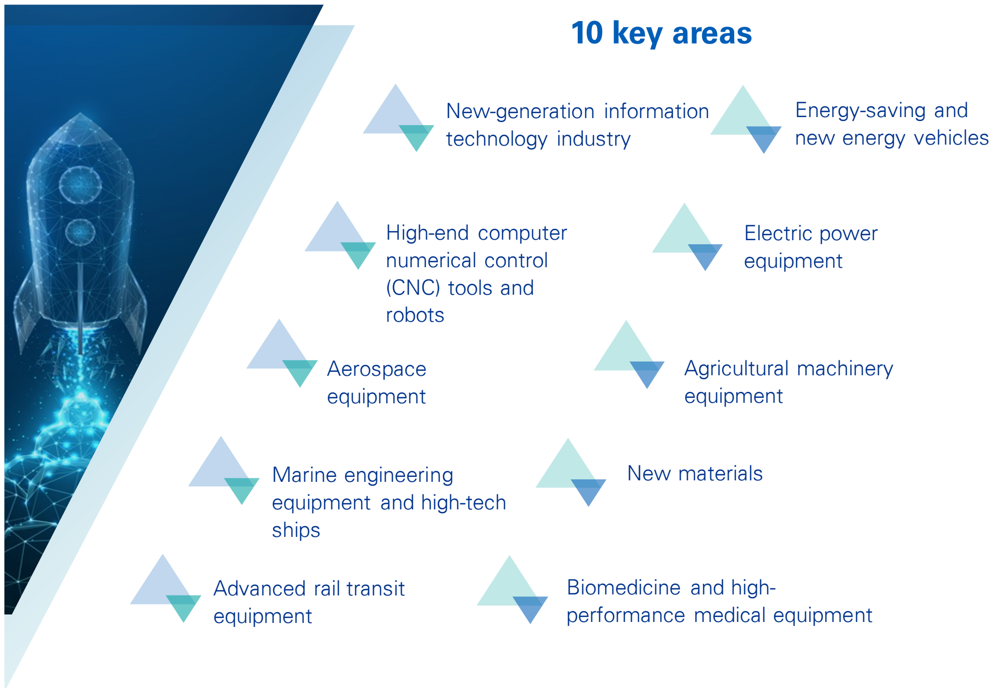
Source: Wind, KPMG Analysis

In 2021, the government enhanced tax incentives for enterprises to invest in R&D. According to statistics from the State Administration of Taxation, 320,000 enterprises enjoyed additional pre-tax deductions of R&D expenses in 2021, with total related tax cuts amounting to RMB 333.3 billion. These incentives helped to further reduce R&D costs for enterprises and enabled R&D investments by leading manufacturing enterprises to grow by 22.6% year-on-year as they more actively pursued innovation. According to the Report, the government will continue to step up its efforts to support enterprises in 2022 by raising tax deduction limit for R&D costs of small and medium-sized sci-tech enterprises from 75% to 100%. It will also grant tax breaks to enterprises that invest in fundamental research; set more favourable tax treatment regarding the depreciation of equipment and tools; and provide preferential corporate income tax rates for new and high-tech enterprises.

Moreover, the government aims to cultivate a batch of 'little giant' enterprises. Xiao Yaqing, China's Minister of Industry and Information Technology, has said that among the more than 48 million enterprises in the country, over 90% are small and medium-sized enterprises[2]. To facilitate the growth of these companies, China aims to cultivate more than 3,000 national-level 'little giant' companies in 2022, and nurture over 50,000 specialised and sophisticated enterprises (Figure 7). With these goals in mind, during the 14th Five Year Plan period (2021-2025), the government has planned to allocate over RMB 10 billion for rewards and subsidies to encourage local governments to improve their supporting policies and public service systems. Further, it established the Beijing Stock Exchange in 2021; and is continuously encouraging more investment in scientific and technological innovation. These measures will support the real economy, and in particular the manufacturing industry, to achieve better and stronger growth, and enhance the stability and competitiveness of the country's industrial and supply chains.

2 The second "Minister's Channel" of the 2022 Two Sessions, March 2022, http://www.gov.cn/zhuanti/2022qglhzb/live/20220308c981672356.html

Figure 7: Key areas of 'little giant' enterprises



Source: KPMG Analysis

Cultivating strengths of the digital economy

The term 'digital economy' has been mentioned many times in Government Work Reports since 2017. According to the 2022 Report, China will continue to encourage the development of the digital economy. To this end, it will strengthen overall planning for the Digital China initiative; build more digital information infrastructure; promote the large-scale application of 5G technology, advance the digitalisation of industries, and build smart cities and digital villages. The country will also accelerate the development of the industrial Internet, build up digital industries and improve the governance of the digital economy.

China's digital economy has made rapid progress in recent years. Since the global pandemic outbreak, the digital economy has played an important role in stimulating domestic demand and keeping employment steady, demonstrating the importance of data as a new factor of production in the country's economic development. In 2021, the Data Security Law and the Personal Information Protection Law were officially released and implemented, providing a legal framework for the healthy development of China's digital economy. In January 2022, the State Council officially released the 14th Five-Year Plan on the Development of the Digital Economy, which proposed 11 key construction initiatives in areas such as digital infrastructure, data factors, digital industrialisation and industrial digitisation. Developing the digital economy is a strategic choice that will enable China to seize opportunities arising from the next generation of technological revolution and other industrial changes. The healthy development of the digital economy will help promote the construction of China's modern economic system and enhance its competitive advantages.

Recently, the National Development and Reform Commission and other government agencies jointly issued the official launch of the 'Eastern Data and Western Computing' project. This project aims to build an integrated national computing power network, comprising data centres, cloud computing resources and big data capabilities, with the goal of encouraging investment in the digital industry.

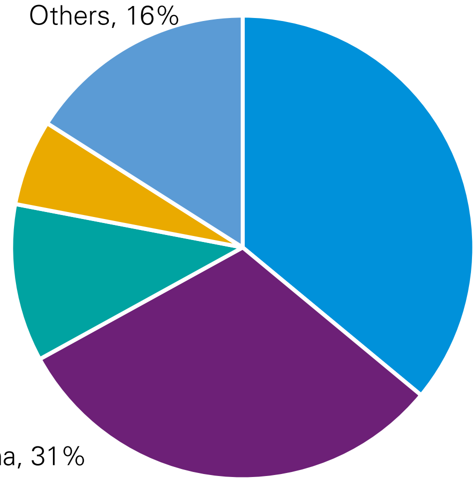
The project will involve the construction of eight national computing hubs and ten national data centre clusters (Figure 8). The eastern hubs will mainly process tasks with higher network requirements, such as those involving the industrial Internet, financial and securities activities, early disaster warnings, telehealth, and video calls and artificial intelligence; while the western hubs will mostly handle back-office processing, offline analysis, and data storage and backup.

Figure 8: China's 'Eastern Data and Western Computing' project

Source: National Development and Reform Commission, KPMG analysis

Computing power is the core driver of productivity in the digital economy era. According to a 2020 assessment report on global computing power, when the computing index increases by 1% on average, the digital economy and GDP expand by 3 ‰ and 1.8 ‰, respectively. In recent years, with the rapid development of digital technology, the scale of China's data computing power has experienced significant growth, reaching a scale of 135 EFlops in 2020, which accounted for 30% of the global total, second only to the US, which comprised 36% (Figure 9). However, increasing shortages of land, energy and other resources in the country's eastern region have limited the development of large-scale data centres there. Owing to the abundant access to sources of land and renewable energy, China's western regions are well-positioned to meet the country's data computing needs. Overall, the project should make resource use more efficient and enhance the overall computing capacity of the country, facilitating the expansion of the digital industry to western regions. The combination of environmental protection and digitalisation will also promote the high-quality development of the Chinese economy.

Figure 9: Distribution of global computing power in 2020, %



Source: China Academy of Information and Communications Technology (CAICT), KPMG analysis

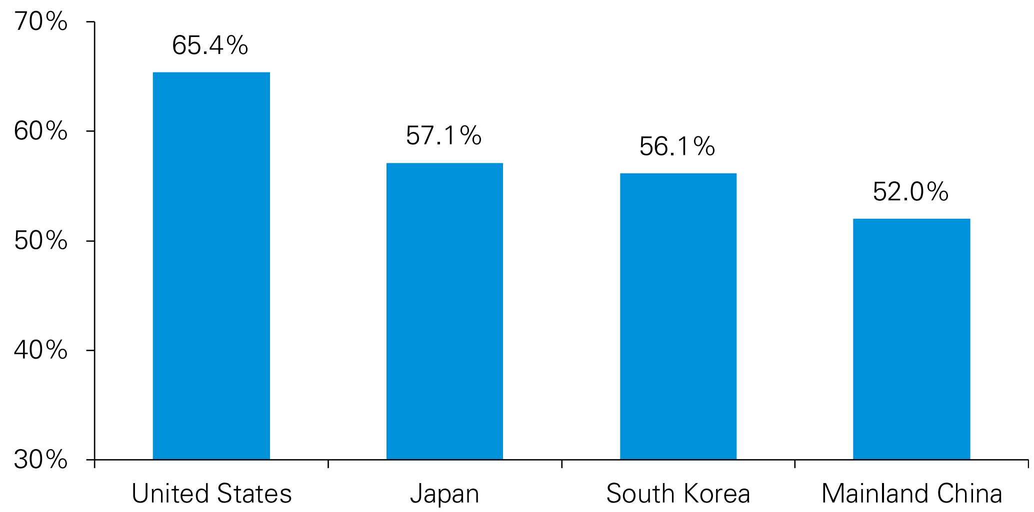
The Report also put forward the goals of improving digital government services; promoting the sharing of government data; further reducing various certification requirements; providing more cross-provincial government services, and achieving more nationwide recognition of electronic licences and certificates. KPMG believes that by deeply integrating digital technology with government decision-making, social governance, urban management and public services, the country can promote the development of a new operating model for governance and raise its overall management efficiency. For more information, please refer to KPMG insights on Digital Intelligent Government series[3].

3 Digital Intelligent Government series (I): Riding on the trend of digital transformation to promote the development of a digital government to optimise management efficiency, KPMG China, February 2022

Supporting market entities and the labour market, and promoting continued recovery in consumption

The Report points out that China will firmly implement its strategy of expanding domestic demand, enabling consumption to play a bigger role in driving the country's economic growth. Upgraded consumer products, green smart consumption and service-oriented consumption such as nursing care and domestic services represent the key paths towards stimulating consumer demand. In terms of initiatives to promote domestic consumption, the Report proposes the following major initiatives: 1) deeply integrating online and offline consumption to foster new forms of consumer spending; 2) supporting the purchase of new-energy vehicles, and encouraging spending on green and smart home appliances in rural areas as well as the replacement of old home appliances; 3) strengthening the construction of facilities for the elderly and child care; 4) upgrading and expanding domestic services; and 5) strengthening county-level commerce and developing e-commerce and express delivery services in rural areas. As the income of Chinese citizens has risen steadily in recent years, they have shifted their focus from goods to services. Currently, service-oriented consumption accounts for more than 50% of the total consumption expenditures of Chinese citizens (Figure 10). However, there is still a gap between this figure and that of advanced economies such as the US, Japan and South Korea. As such, China's consumer services market still has further room for expansion and upgrading.

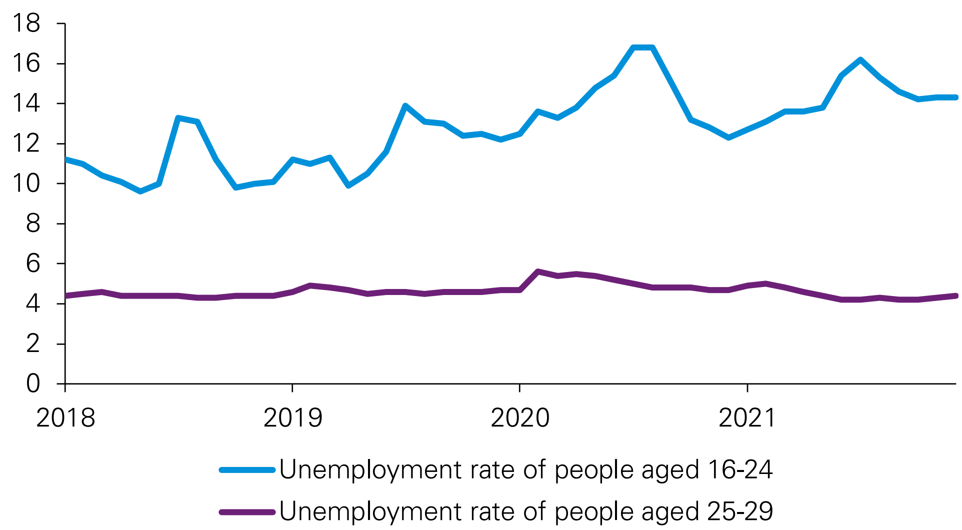
Figure 10: Share of services consumption in total household consumption (2021), %



Source: Wind, KPMG Analysis

Stabilising employment is also an important macroeconomic policy in China, and is critical to ensure healthy growth in consumption. According to the Report, China has set a target of creating over 11 million new urban jobs in 2022, which is same as the 2021 target; however, the target for the urban unemployment rate in 2022 is 'no more than 5.5%', which is slightly higher than the 2021 target of 'around 5.5%', reflecting the central government's commitment to maintaining employment stability. At the same time, in the face of persistent pressure on aggregate job creation and the existence of structural issues in employment, China will strengthen and improve its employment policies in 2022 to promote employment stability, keep the operations of market entities stable, and harness start-up companies to boost employment. According to forecasts, about 16 million people will enter the labour market in 2022, among which 10.76 million will be college graduates, the highest figure on record. Therefore, the employment of young people will be an important focus area going forward (Figure 11).

Figure 11: Surveyed unemployment rate in urban areas, %



Source: Wind, KPMG Analysis

Consumption has faced greater downward pressure since the fourth quarter of 2021. The resurgence of pandemic outbreaks in various regions of the country have led to tightened quarantine measures, putting new pressure on service sectors such as catering, accommodation, and tourism. China will continue to promote COVID-19 booster vaccinations in 2022 and accelerate R&D for vaccines and other specialised medicines.

Stimulating infrastructure and manufacturing investment

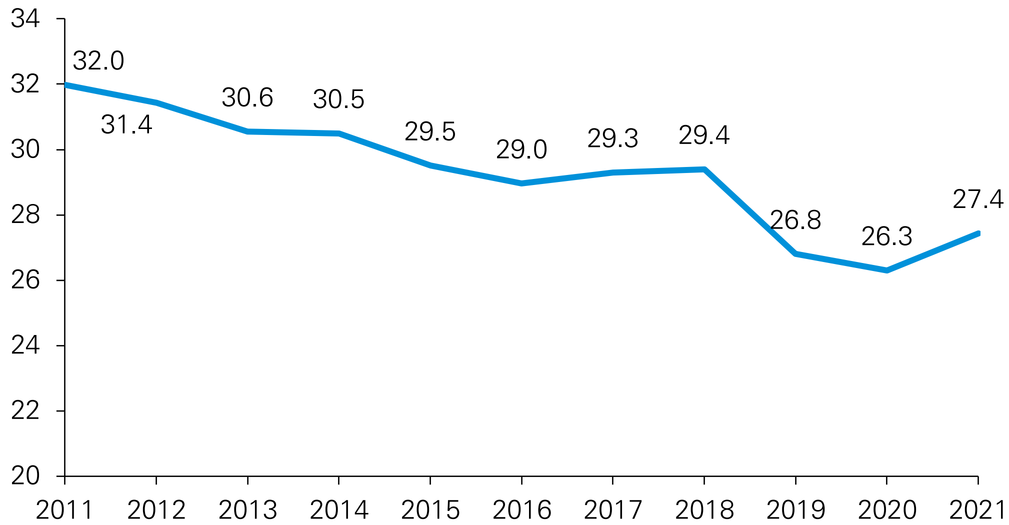
The Report points out that China will expand the scale of investment in the infrastructure and manufacturing sectors to stabilise economic growth. Firstly, China will accelerate the development of advanced manufacturing clusters and launch a national programme to foster clusters of strategic emerging industries. It will also take measures to promote the technological upgrading and transformation of a number of traditional industries, so as to boost the core competitiveness of manufacturing. On the other hand, China will make proactive investments in major infrastructure projects in line with major national strategies in the 14th FYP; strictly ensure that investment funds stay with projects they are allocated to; support follow-up financing for ongoing projects; and begin construction on major projects, including new types of infrastructure and renovations of outdated public facilities. The Report also calls for improvements to relevant supporting policies to encourage the private sector to invest in these projects.

With regard to the development of manufacturing, the 14th FYP calls for strengthening the real economy and ensuring that manufacturing as a share of the economy remains stable. In 2021, the manufacturing sector in China accounted for 27.4% of GDP, representing an increase of 1.2 percentage points compared with 26.2% in 2020 (Figure 12). Meanwhile, policy support has provided the impetus for China's high-tech manufacturing to expand steadily, with investment growing at a rate of over 10% in recent years. Relatedly, 'boosting the core competitiveness of manufacturing' appeared for the first time in the 2022 Government Work Report.

At present, China's manufacturing is transitioning from the middle-low end of the value chain to the middle-high end, and it will continue to play a crucial role in the transformation and upgrading of the country's economy in the future. According to the Report, China will accelerate the development of advanced manufacturing clusters and launch a national programme to foster clusters of strategic emerging industries, which will promote upgrading and innovation in its manufacturing sector. Since the beginning of 2022, local governments have been making targeted investments on transform and upgrade manufacturing operations. In particular, they have been accelerating R&D and production capabilities in high-end electronic devices and other advanced products, harnessing smart manufacturing processes.

In relation to the acceleration in R&D and technology investment in the manufacturing sector, financial institutions are providing more medium and long-term loans to enterprises, and measures are being taken to reduce various taxes and fees, creating a favourable environment for enterprises to continue to increase investments. Going forward, investments that promote green development will also be a focus area. Overall, we expect to see rapid growth in manufacturing investment related to technological innovation and the green transition this year.

Figure 12: Value added of manufacturing sector as a percentage of China's GDP, %



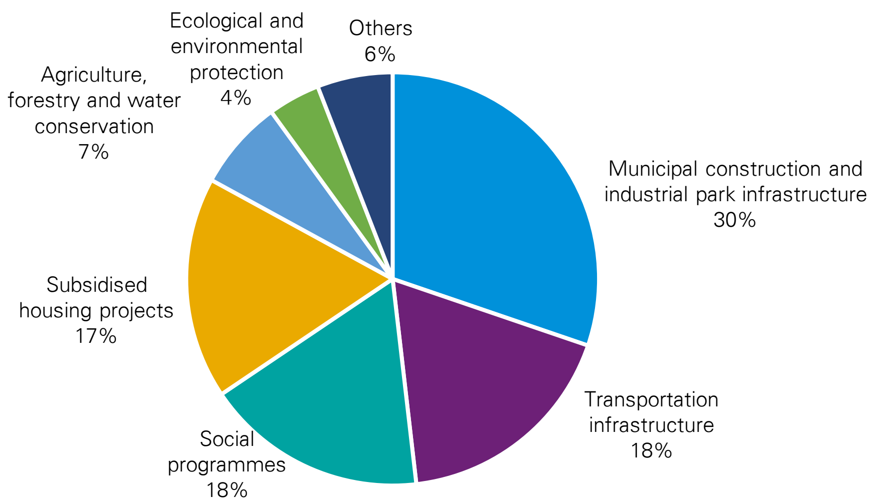
Source: Wind, KPMG Analysis

At the provincial-level Two Sessions meetings held at the beginning of 2022, many local governments indicated they were focusing on 'making proactive investments in major infrastructure projects as appropriate', kicking off a series of major projects in the first quarter of 2022. In this regard, local government special bonds (LGSBs) are being used as a principal source to fund municipal construction, industrial parks, transportation infrastructure, social programmes and subsidised housing projects, with these areas representing over 80% of the total issuance (Figure 13).

In 2022, the issuance of LGSBs is estimated to reach RMB 3.65 trillion, an amount similar to 2021 levels. In addition, a large portion of the RMB 1.2 trillion issued by local governments in the fourth quarter of 2021 has not been used yet and will be carried forward to 2022; therefore, the total amount of LGSBs in 2022 will be higher than that of 2021. Meanwhile, in 2022, the central government will transfer payments totalling close to RMB 9.8 trillion to local governments, representing an increase of around RMB 1.5 trillion over the 2021 budget. These transfers will boost the financial strength of local governments and enable them to expand investment (Figure 14).

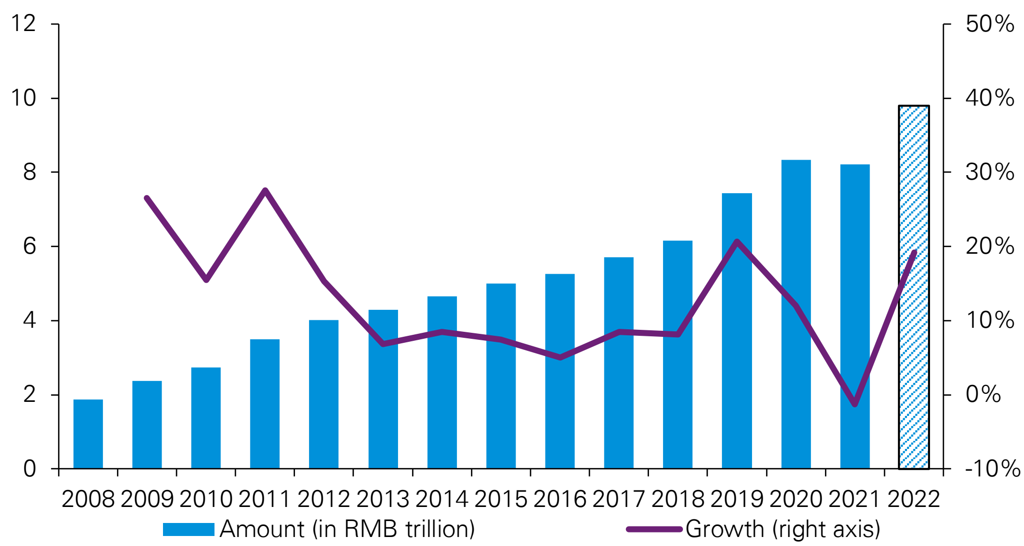
As of 28 February 2022, a total of 29 provinces and cities had issued new LGSBs amounting to RMB 877.5 billion. In addition to traditional infrastructure such as transportation and water conservation projects, the government is also prioritising digital infrastructure initiatives, such as the construction of national hubs for the integrated computing power network and industrial Internet clusters. In addition, since 2020, certain pilot cities have implemented projects to promote the construction and renovation of smart urban infrastructure. Going forward, KPMG expects the government to continue to promote the construction of smart cities to further integrate digital capabilities such as AI and IoT into existing urban infrastructure, which should expand domestic demand and promote stable economic growth.

Figure 13: Distribution of local government special bond by investment area, %



Source: Ministry of Finance, KPMG analysis

Figure 14: Transfer payments from the central government to local governments



Source: Wind, Ministry of Finance, KPMG analysis
Note: 2022 represents the estimated amount

Promoting coordinated regional development

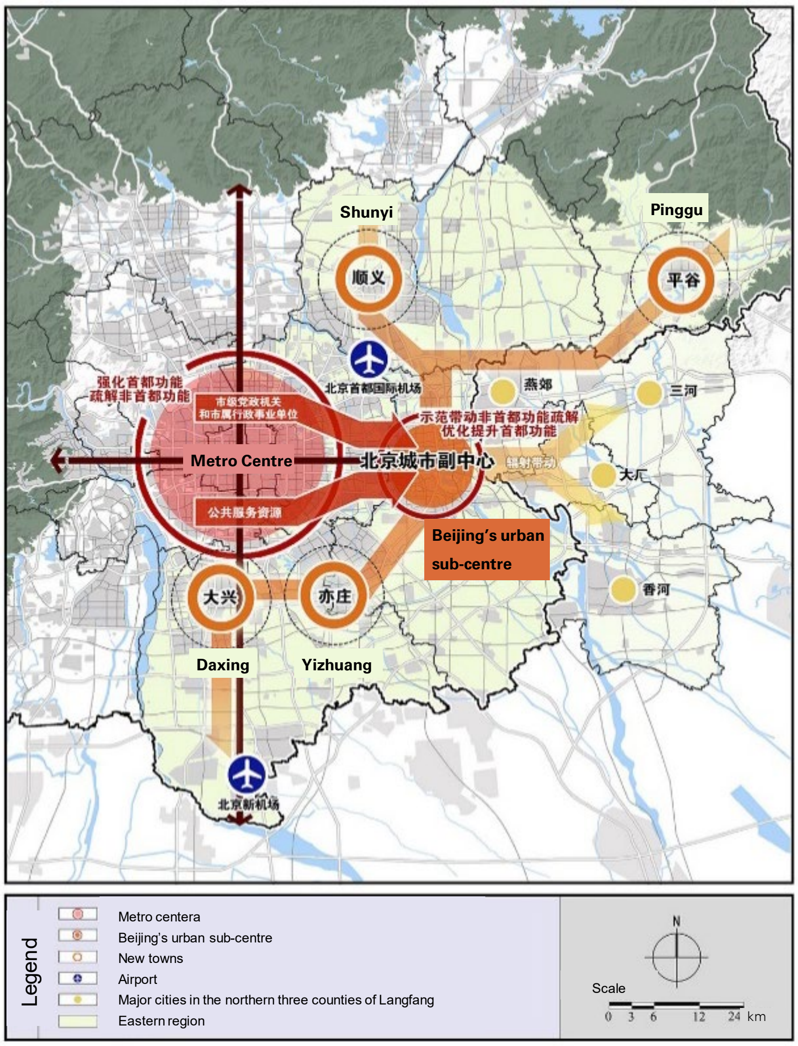
The Report says that China should promote balanced and coordinated development among regions. In 2022, China will fully implement all the major regional development strategies and the strategy for coordinated regional development. Specifically, the Chinese government will promote the coordinated development of the Beijing-Tianjin-Hebei region, the development of the Yangtze Economic Belt, the development of the Guangdong-Hong Kong-Macao Greater Bay Area, the integrated development of the Yangtze River Delta, as well as the ecological conservation and high-quality development in the Yellow River Basin. It will also advance the construction of Xiong'an New Area, and support development of the Beijing Municipal Administrative Centre. Overall, the country will promote balanced and coordinated regional development in its eastern, central, western, and north-eastern regions, expand industrial development across regions, and facilitate regional cooperation.

During the 14th FYP period, the government will promote its major economic strategies: technological innovation; transportation hubs; and environmental protection, across these five major regions. In addition, work reports of some local governments for 2022 have emphasised the development of various competitive industries with regional characteristics such as the construction of high-end manufacturing bases and the development of the green petrochemical industry and the renewable energy industry, as well as the construction of regional transportation networks such as highways, railways and airports.

KPMG believes that more coordinated regional development will better facilitate the flow of goods and services across the country, whilst improving China's ability to allocate public resources, promote coordinated development among different regions, and bring more investment and development opportunities to enterprises.

Moreover, supporting the development of the Beijing Municipal Administrative Centre was included in the Government Work Report for the first time in 2022. In November 2021, the State Council released the Opinions on Supporting the High-quality Development of Beijing's Urban Sub-Centre to facilitate the coordinated development of the Beijing-Tianjin-Hebei region by supporting more functions that are not directly related to Beijing's role as China's capital, as well as talent mobility; enhancing scientific and technological innovation in the area, and promoting the integrated development of Beijing's urban sub-centrein the city's Tongzhou District with three neighbouring counties in Hebei province (Figure 15)[4]. The Opinions will also speed up the construction of a more convenient regional transportation system in the Beijing-Tianjin-Hebei region and promote the establishment of industrial chains in the city's urban sub-centre and surrounding areas. These changes will result in the creation of a more comprehensive urban ecosystem with a better job-housing balance across a larger area, which should help address some of the issues related to overdevelopment in Beijing while making work and life more convenient for residents.

Figure 15: Beijing Municipal Administrative Centres



Source: Beijing Municipal Master Plan (2016–35)

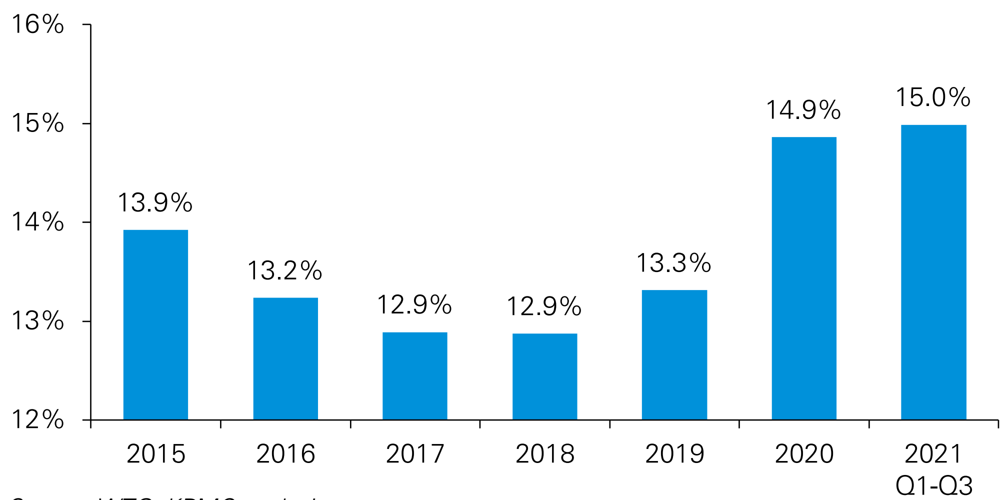
4 http://www.gov.cn/zhengce/content/2021-11/26/content_5653479.htm

Achieving a higher level of opening-up

With respect to foreign trade, the Report emphasises the goal of stabilising trade by adopting a package of measures, including tax and financial policy support; encouraging the development of new forms of foreign trade, and easing international logistic and other supply chain pressures. Specifically, the Report calls for expanding coverage of export credit insurance for micro, small and medium-sized foreign trading companies; strengthening credit support for exports, expediting the process for export rebates, accelerating the development of new models of foreign trade; fully leveraging cross-border e-commerce capabilities, and supporting the establishment of a number of overseas warehouses. China will also explore new ways to develop trade in services (including digital services); implement a negative list for cross-border trade in services; deepen reforms that simplify customs clearance; and accelerate the development of an international logistics services system to help lower costs and raise efficiency in foreign trade.

In 2021, China's export trade maintained rapid growth, with the total import and export volume of trade in goods exceeding USD 6 trillion for the first time, representing a y-o-y increase of 30.0%; meanwhile, the country's trade surplus hit a record high. China's contribution to global exports in the first three quarters of 2021 also reached an all-time high of 15.0% (Figure 16). Given the higher base of comparison in the previous year, China's foreign trade growth will be under pressure in 2022. The government also has a number of reserve measures to stabilise foreign trade through cross-cycle adjustments that can be used to mitigate short-term disturbances to foreign trade that may occur due to the ongoing COVID-19 pandemic and other unexpected events.

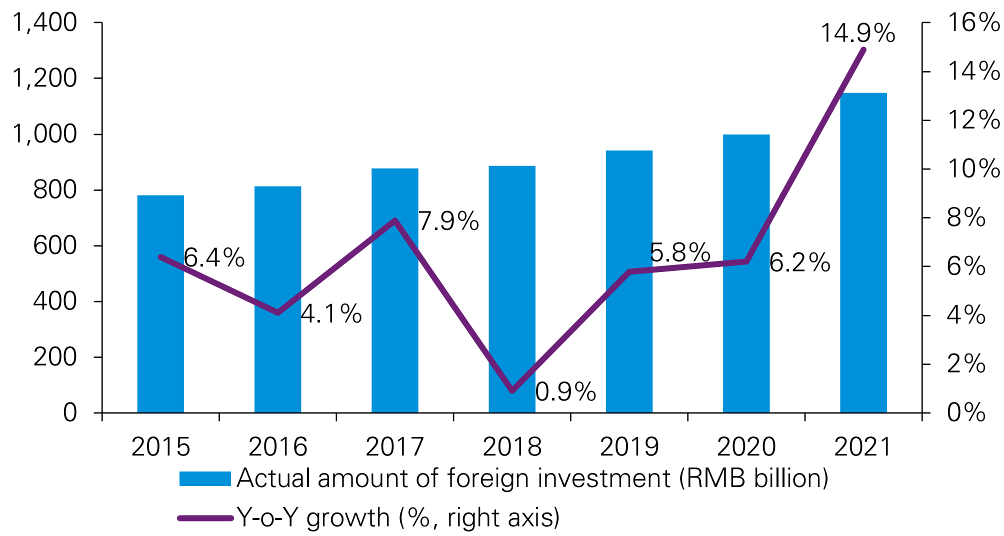
Figure 16: China's share of global merchandise exports, %



Source: WTO, KPMG analysis

With respect to foreign investment, the Report calls for fully implementing the negative list for foreign investment in 2022, improving services that promote foreign investment, and encouraging more foreign investment in medium and high-end manufacturing, R&D, and modern services, as well as in the country's central, western and north-eastern regions. At the same time, China will fully leverage its current pilot free trade zones and the Hainan Free Trade Port, and launch more trial programmes aimed at opening up its service industry, to attract more foreign investment. Since the outbreak of the pandemic, China's foreign investment has maintained steady growth. In 2021, foreign investment in China's non-financial sector exceeded RMB 1 trillion for the first time, hitting RMB 1.15 trillion, which represented a 14.9% y-o-y increase. This was the first time in the past decade that China achieved double-digit foreign investment growth, indicating a significant improvement in the structure and quality of foreign investment (Figure 17). In January 2022, China's foreign investment increased by 11.6% y-o-y, maintaining a double-digit growth rate. For the rest of 2022, China will continue to promote reforms to streamline administrative processes and delegate government powers, improve regulations, upgrade services, and promote fair competition, with the goal of ensuring a level playing field for enterprises of all types and optimising the business environment to attract more foreign investment. According to a recent survey by the American Chamber of Commerce in China, 60% of surveyed companies stated that China remains a 'top three priority investment destination', and 66% of enterprises plan to increase their investments in China in 2022[5].

Figure 17: Foreign direction investment in China (non-financial sector)



Source: Wind, KPMG analysis

5 China Business Climate Survey Report, AmCham China, March 2022, https://www.amchamchina.org/wp-content/uploads/2022/03/AmCham-China-2022-China-Business-Climate-Survey-Report.pdf

China will seize opportunities presented by the Regional Comprehensive Economic Partnership (RCEP), which came into effect on 1 January 2022, to continue to promote free trade and make itself a more attractive destination for foreign investment. In 2021, China applied to join the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP) and the Digital Economy Partnership Agreement (DEPA). To this end, it will continue to negotiate with the parties to these agreements in 2022 and commit itself to aligning with leading international rules and criteria. China will also continue to negotiate free trade agreements with the Gulf Cooperation Council (GCC), Ecuador, Israel, Norway, Japan and South Korea. In addition, it will actively promote the upgrading of China ASEAN Free Trade Area Version 3.0, among other similar agreements.

Orderly advancing decarbonisation goals, and promoting green and low-carbon development

The Report puts forward the goal of continuing to improve the environment and promote green and low-carbon development. China will enhance its efforts to address pollution and reduce emissions while protecting natural ecosystems and promoting greater harmony between humanity and nature. The Report also stresses the importance of a holistic approach towards strengthening environmental governance, taking well-ordered steps to achieve peak carbon emissions and carbon neutrality.

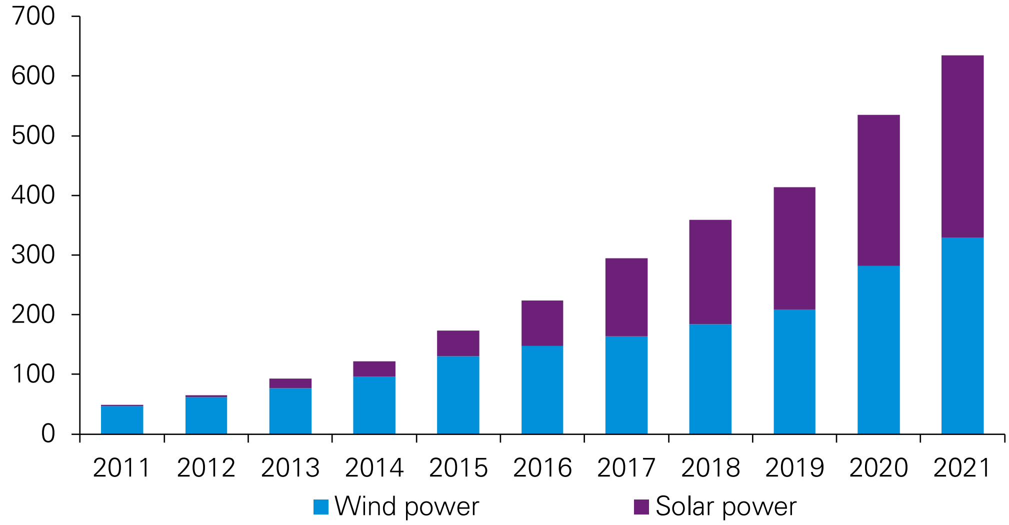
Furthermore, the Report calls for adhering to the principle of 'establishing the new before abolishing the old' by initially focusing on making coal usage cleaner and more efficient, while gradually reducing the use of coal and replacing it with alternative renewable energy source, to accelerate the development of green and low-carbon ways of working and living.

He Lifeng, Chairman of the National Development and Reform Commission, has stated that by promoting the 'dual carbon' initiative, China will create many development and business opportunities, promote the development of emerging industries on a large scale, facilitate the renovation of old communities and improve the living environment in rural and urban areas[6]. The proportion of investments made by China's leading power generation enterprises in renewable energy fields including hydropower, nuclear power, wind power and solar power have grown year by year, with wind power investments encompassing around 50% of investments in the renewable energy sector. Over the past decade, China's installed capacity of wind power has risen from 60 million kilowatts in 2012 to 330 million kilowatts in 2021, making wind power the third biggest source of power after thermal power and hydropower (Figure 18).

Notably, the Report mentions that newly added renewable energy and energy used as raw materials would be excluded from the cap on total energy consumption. In KPMG's view, this change will help to further accelerate China's investment in the renewable energy sector. Increases in the installed capacity of new energy power generation will also result in a rise in new energy consumption during the 14th FYP period. In addition, the acceleration of R&D and promotion and application of green low-carbon technologies will accelerate the transformation of energy-intensive manufacturing enterprises in the iron and steel, non-ferrous metals and chemicals sectors. This transformation will subsequently result in the increased investment in new power and new energy equipment and emissions treatment equipment, among other areas.

6 The First "Minister's Channel" of the 2022 Two Sessions, March 2022, http://www.gov.cn/zhuanti/2022qglhzb/live/20220305c872584589.html

Figure 18: Installed capacity of wind and solar power generation in China, million kilowatts



Source: Wind, KPMG Analysis

As China is still a developing country that is undergoing industrialisation and urbanisation, its demand for energy will continue to grow. In this regard, efforts to reduce carbon emissions should be pursued in line with national economic development and energy security initiatives. In the fourth quarter of 2021, China announced the '1+N' policy framework based on *the Opinions on Completely, Accurately and Comprehensively Implementing the New Development Concept to Properly Carry Out the Work for Carbon Peaking and Carbon Neutrality* and *the Action Plan for Carbon Peaking Before 2030*. This framework will help local governments coordinate their work arrangements and initiatives and develop more robust action plans and policies while also helping enterprises to fully prepare for the transition and develop green, low-carbon and sustainable business models. China will continue to strengthen its carbon reduction efforts in 2022 in a more systematic and organised manner as it pursues high-quality economic development and high-standard environmental protection in a well-coordinated way.

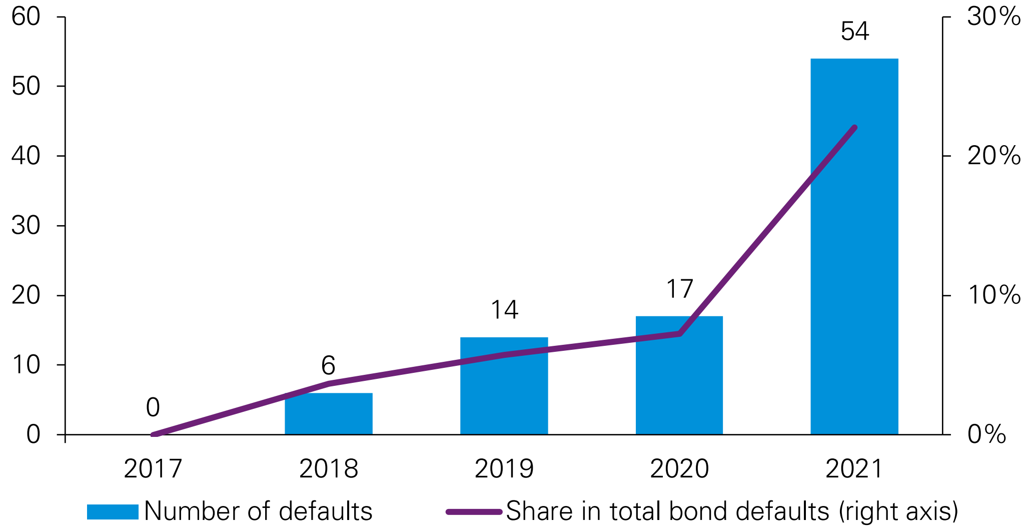
Addressing key risks to balance growth and security

In the current complex external environment, China will strengthen its policies and measures to manage various risks with the aim of maintaining stable economic growth. The Report stresses the importance of safeguarding China's food security and financial markets, as well as the security of industrial and supply chains.

Regarding food security, the Report emphasises the goal of boosting agricultural production and ensuring sufficient supplies of important agricultural products; keeping total grain acreage at a stable level; and maintaining grain output of over 650 million metric tons. The Report highlights the goal of ensuring the total area of farmland in the country remains above the redline of 120 million hectares, and reiterates that using cropland for purposes other than agriculture and grain production is strictly prohibited. Apart from farmland, agricultural technology presents a means to solve food security problems. The Report calls for revitalising the seed industry at a faster pace, and redoubling efforts to develop and apply scientific and technological breakthroughs in agriculture. KPMG expects that during the 14th FYP period, R&D in seed technology and the construction of relevant production sites will receive more government support. It is also expected that support for automation of agricultural machinery and equipment, informatisation of crop cultivation, and development of other smart agriculture technologies will gain steam in the coming year and beyond.

In terms of financial stability, a number of real estate companies experienced liquidity problems in 2021, resulting in more defaults on real estate corporate bonds than in previous years (Figure 19). Against this backdrop, preventing debt defaults in the real estate sector and disposing of the implicit debts of local governments are the key initiatives of financial risk mitigation in 2022. For the first time, the Report proposes establishing a fund to ensure financial stability while adopting market and law-based methods to defuse risks. KPMG believes that the establishment of such a fund, which will use government and sector funds to bail out financial institutions at high risk of default, will resolve risks in a forward-looking and market-oriented manner before they become more prominent, therefore stabilising market expectations. This initiative echoes one of the statements made by the Central Economic Work Conference in December 2021: "Resolving risks requires ample resources, universal cooperation in studying and enacting policies to resolve risks, and enhancement of the mechanism to tackle financial risks".

Figure 19: Number of bond defaults by real estate developers and its share in total corporate defaults



Source: Wind, KPMG Analysis

The Report continues to stress the importance of maintaining the security and stability of industrial and supply chains. Currently, certain factors are still hindering the steady recovery of China's industries and economy. For example, pandemic outbreaks have disrupted some supply chains, leading to increases in the prices of bulk raw materials, disruptions in transportation and increases in costs. Coupled with other changes in the external environment, these factors are inevitably affecting the operation of China's industries and economy. In 2022 and throughout the rest of the 14th FYP period, China will make efforts to enhance the independence and controllability of industrial and supply chains, as well as ensure sufficient supplies of raw materials and key spare parts. In addition, the country will take advantage of its wide range of domestic industries to launch a group of industrial base reengineering projects, and also give full play to the role of large enterprises in supporting micro, small and medium-sized enterprises. Moreover, measures will be taken to further modernise the supply chains of industrial chains with existing advantages.

Improving people's livelihoods to pursue common prosperity

The Report states that the government will continue to make improving people's well-being a policy and investment priority and continue to enhance public services to promote common prosperity for all.

One area the government will focus on to improve people's livelihoods in 2022 is improving the fairness and quality of education. To this end, the government will continue to promote the high-quality, well-balanced development and urban-rural integration of compulsory education, and strengthen targeted training programmes, on-the-job training and salary guarantees for rural teachers. As pointed out by Premier Li Keqiang, government spending on education should not be less than 4% of GDP, and it should be mainly devoted to compulsory education and education in rural areas[7]. Going forward, China will channel more funding to rural and remote areas to promote the development of compulsory education in those regions.

With respect to medical and healthcare services, the Report clearly points out that the government will continue to increase subsidies for basic medical insurance and basic public health services. Currently, on average, about 70% of medical bills of rural and urban non-working residents can get reimbursed, and China will increase these benefits as its capacity grows[8]. Moreover, the Report puts forward new measures for medical insurance, including placing medical insurance funds under stricter oversight, improving the policy for direct settlement of medical expenses incurred outside of a patient's home province, and ensuring the supply of medicines for rare diseases.

With respect to elderly care and childcare, the Report emphasises the goals of working steadily towards national unified management of basic old-age insurance funds for enterprise employees; regulating the development of third-pillar pension plans, improving elderly care in urban and rural areas, and encouraging mutual-assistance elderly care in rural areas to address the challenges associated with the country's ageing population.

On 1 January 2022, the national unified management of basic old-age insurance funds for enterprise employees was put into effect. By the end of 2020, the old-age insurance funds for enterprise employees were managed at the provincial level as opposed to locally, in an effort to successfully address the unequal fiscal burden

7,8 Premier Li Keqiang Meets the Press: Full Transcript of Questions and Answers, 11 March 2022, http://www.gov.cn/zhuanti/2022qglhzb/live/20220311b86021123.html between different regions within provinces. However, as the structural imbalance of funds among different provinces and cities has become increasingly obvious, the funds have been put under the centralised management of the state as of January 2022. Under this model, the balance of funds in more developed provinces and cities can be redirected to provinces and cities with more serious ageing population issues and inadequate financial resources. The government's overarching goal in this regard is to better allocate funds across the entire country in order to ensure that pensions are paid in full and on time in every region.

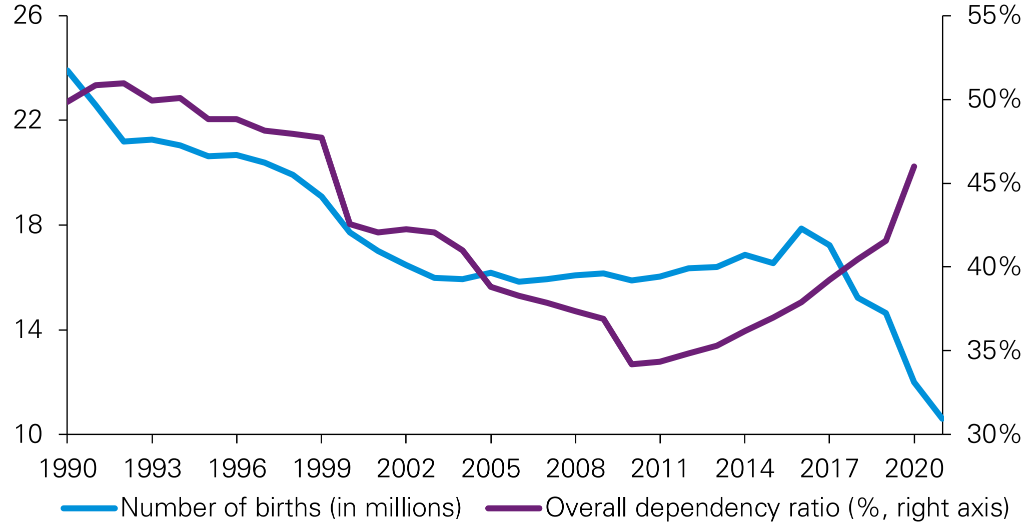
In 2022, China will speed up the construction of the third pillar of its pension system — individual pension plans — includes investments in bank wealth management products, saving deposits, commercial pension plans and public funds. At a press conference on 2 March 2022[9], Guo Shuqing, Chairman of the China Banking and Insurance Regulatory Commission, said, "The pilot project for the pension savings scheme is about to be kicked off, and we are also preparing to launch the commercial pension scheme for low and middle-income groups."

With respect to population demographics, according to statistics from the Seventh National Population Census, China's total fertility rate in 2020 stood at 1.3 births per woman, which was well below the replacement level of 2.1 and fell in the 'low fertility rate' range of below 1.5. In 2021, the number of births continued to drop, declining to 10.62 million. At the same time, the total dependency ratio of the Chinese population (the ratio of the non-working age population to the working age population) rose sharply from 34.2% in 2010 to 46.0% in 2020 (Figure 20), indicating that pressure on the working age population with relation to elderly care and childcare is increasing.

In terms of childcare, the Report stresses that the country plans to improve supporting measures for the three-child policy and develop public-interest childcare services through multiple channels to reduce the burden on families. As of late 2021, many local governments have introduced new policies to promote births, including extending maternity leave, increasing maternity allowances, and encouraging and helping private entities set up childcare institutions — with these policies expected to continue through 2022. Going forward, the government will also promote policy measures that will strengthen women's employment rights and protect rights for children born out of wedlock.

9 http://www.scio.gov.cn/xwfbh/xwbfbh/wqfbh/47673/47957/index.htm

Figure 20: Number of births and dependency ratio in China



Source: Wind, KPMG Analysis

With regards to housing, the Report stresses that China will continue to the existing tone that 'house is for living in, not for speculation'. The government will explore new models for housing development and adopt city-specific measures to facilitate the sound development of the real estate sector. For example, it will continue to encourage both housing rentals and purchases, speed up the development of the long-term rental market, promote the construction of government-subsidised housing and support the commodity housing market so that it can better meet the needs of homebuyers. Meanwhile, real estate tax is not mentioned in the Report. On 16 March 2022, the Ministry of Finance announced that the property tax reform will not be rolled out in 2022[10].

The 2022 Report also calls for 'cracking down hard on the trafficking of women and children and protecting their lawful rights and interests' for the first time. Compared with the 2021 Report, provisions to protect the legitimate rights and interests of women and children are much clearer, indicating the government's strong focus on societal concerns and improving social well-being.

10 http://www.mof.gov.cn/zhengwuxinxi/caizhengxinwen/202203/t20220316_3795716.htm

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