China Economic Monitor

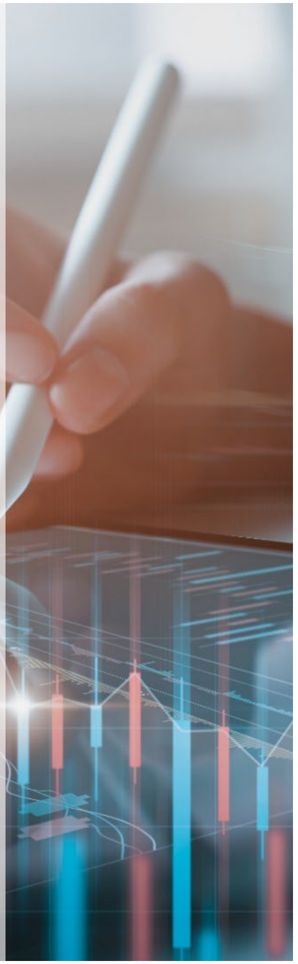
Issue: 2022 Q2

May 2022

kpmg.com/cn

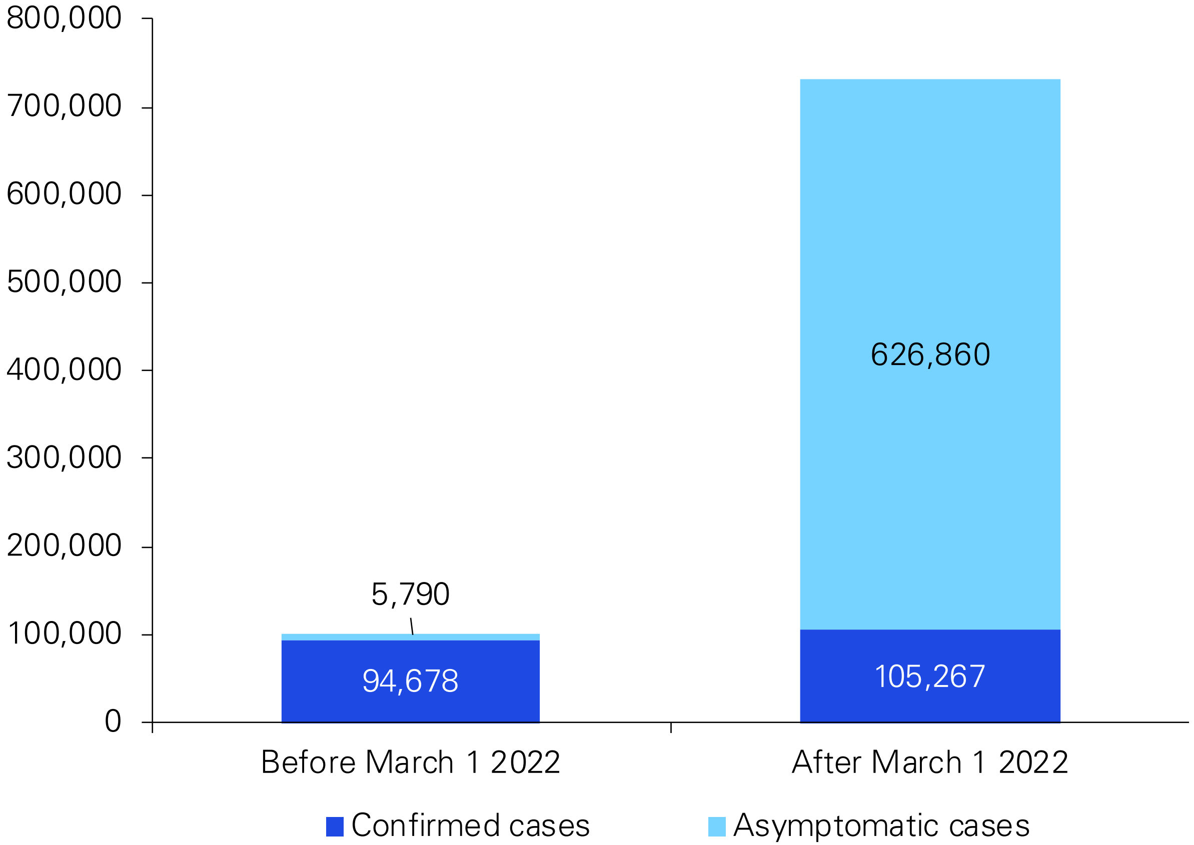
Key takeaways

- China's real GDP grew 4.8% year-over-year (yoy) in Q1, up from 4.0% in Q4 and higher than market expectations. In sequential terms, Q1 GDP grew 1.3% from the previous quarter, lower than the 1.5% pace in Q4.
- The highly transmissible Omicron variant of COVID-19 has affected many regions in China, with the combined number of daily confirmed and asymptomatic cases exceeding previous highs in early 2020. The new wave has led to tightened quarantine measures and a few cities have escalated to full lockdowns since mid-March 2022. There were 41 cities containing risk area(s) in April over 10 days, representing about 21.5% of China's population or 25.7% of GDP. In addition, mobility restrictions have also affected logistics and supply chain operations, putting pressure on economic growth in Q2.
- Industrial production saw solid growth in Q1, and high tech manufacturing and equipment manufacturing continued to outperform the overall growth. However, industrial activity faced challenges from supply chain disruptions due to the spread of the Omicron variant. March industrial capacity utilisation declined from 77.4% in February to 75.8%, while the manufacturing purchasing manager index fell to a contractionary zone in both March and April.
- Domestic consumption remained weak and retail sales declined by 3.5% in March, the first contraction since August 2020. The unemployment rate edged up from 5.5% in February to 5.8% in March. As a result, households will likely remain cautious on spending.
- Manufacturing and infrastructure investments grew strongly, both posting double-digit growth in Q1. However, the real estate market continued to slow down, with new home sales falling 13.8% and investment remaining flat in Q1. Since late last year, some local governments have gradually eased real estate regulations to cushion the slowdown. On 16 March, the Ministry of Finance also announced that the property tax pilot programme will not be implemented this year.
- Against increasing headwinds, the government has introduced both fiscal and monetary measures to support growth. On the fiscal side, the government has issued RMB 1.3 trillion worth of local government special bonds in Q1, which should support infrastructure investment. On the monetary side, the People's Bank of China (PBoC) cut the required reserve ratio (RRR) by 25 basis points (bps) in April, injecting RMB 530 billion liquidity. In addition, the PBoC increased its direct credit supports to SMEs, green investment, tech and senior care through special relending facilities.
- The government set a 5.5% GDP growth target at the annual Two Sessions in March, a target which is facing substantial pressure. We expect more measures to be released in the coming months to support growth.



The latest pandemic wave caused by the Omicron variant has led to rising new infections and tightened mobility restrictions

Cumulated COVID-19 cases in mainland China

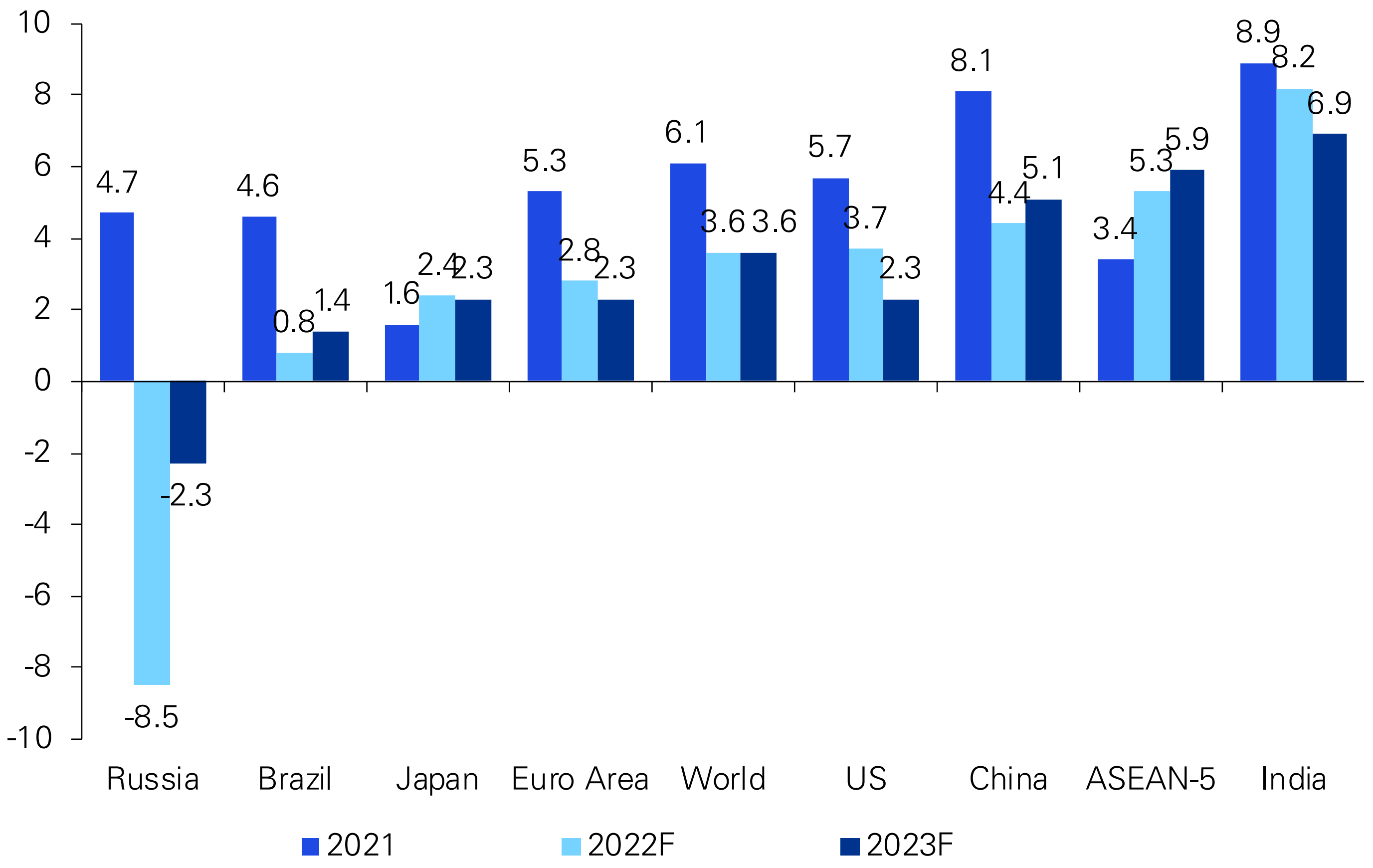


Source: Wind, KPMG analysis. Data through May 4 2022.

- The highly transmissible Omicron variant has affected almost all provinces in China.
- The number of new confirmed cases totalled over 105 thousands in the two months since 1 March, exceeding the total confirmed cases in the previous two years from early 2020. In addition, over 626 thousand asymptomatic cases have also been reported since March.
- The Omicron outbreak has led to tightened quarantine measures in many areas and lockdowns in several cities. There were 41 cities containing risk area(s) in April over 10 days, representing about 21.5% of China's population or 25.7% of GDP. In addition, mobility restrictions have also affected logistics and supply chain operations, putting pressure on economic growth in Q2.

The IMF cut its forecast on global economic growth

Real GDP growth and forecast, %



Source: IMF, KPMG analysis.
Note: ASEAN-5 includes Indonesia, Malaysia, Philippines, Thailand, Vietnam.

- Global economic growth is expected to be moderate in 2022 due to geopolitical tensions, commodity price fluctuations, supply chain disruptions and tightening monetary policy in many countries. In April, the IMF cut its forecast on global economic growth to 3.6% in 2022, 0.8 percentage points lower than its January update.
- As prices of fuel and food have surged rapidly, inflation in advanced economies is expected to stay elevated for longer, and put pressure on central banks to accelerate monetary policy tightening. The Federal Reserve Bank of the US has accelerated interest rate hikes with a 50 bps hike in early May and will start to reduce its balance sheet in June.

The pace of China's economic recovery still varies across sectors

Growth rate of major economic indicators, %

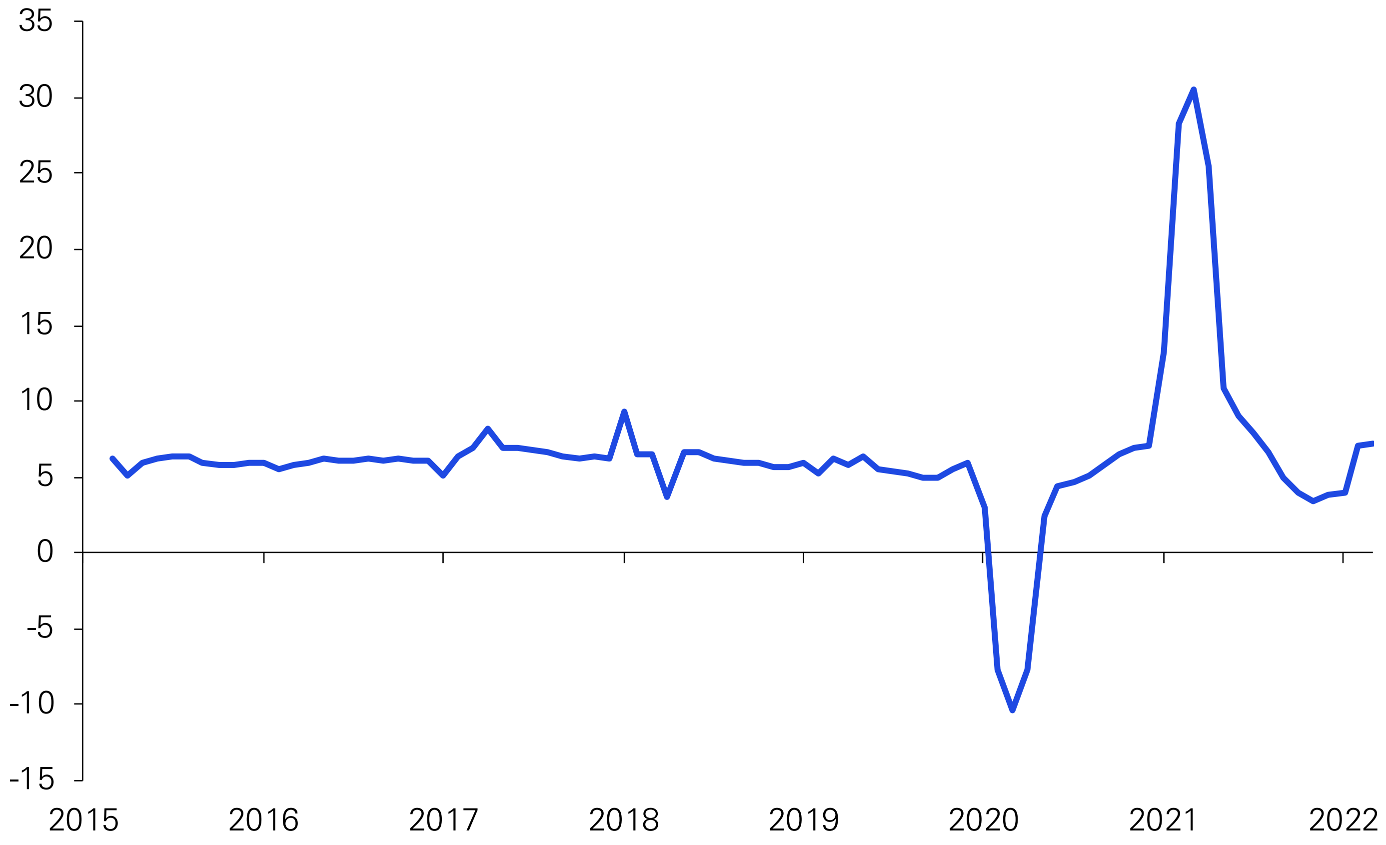
	2017-19 Average	Q1 2020-21 Average	Q2 2020-21 Average	Q3 2020-21 Average	Q4 2020-21 Average	2022 Q1
GDP	6.6%	4.9%	5.5%	4.8%	5.2%	4.8%
Industrial production	6.2%	6.8%	6.6%	5.3%	5.5%	6.5%
Retail Sales	9.0%	3.7%	4.6%	2.3%	3.3%	3.3%
Fixed asset investment	6.2%	2.7%	5.6%	3.2%	3.7%	9.3%
Exports	6.1%	13.4%	14.2%	16.0%	19.7%	15.8%
Imports	9.8%	12.0%	14.2%	14.1%	14.4%	9.6%
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%	8.6%
Fiscal expenditure	8.2%	0.1%	-1.5%	2.3%	5.5%	8.3%

Source: Wind, KPMG analysis
Note: growth of GDP, industrial production, and income per capita is in real terms, while the rest is in nominal terms

- China's GDP grew by 4.8% year-on-year in the first quarter of 2022, higher than market expectation, but down from the two-year average growth of 5.2% in Q4 2021.
- Although the growth of exports slightly moderated in Q1, it remained the main driver of China's recovery. Industrial production also posted strong growth in Q1 but will face challenges from supply chain disruptions going forward.
- Investments in manufacturing and infrastructure rebounded with a rapid growth in Q1.
- In contrast, after a strong rebound in January–February, retail sales contracted 3.5% in March due to the spread of the COVID-19 Omicron variant. Growth in the sector is still significantly below the pre-pandemic levels.

Industrial production improved in Q1

Growth of industrial production, 3mma, yoy, %

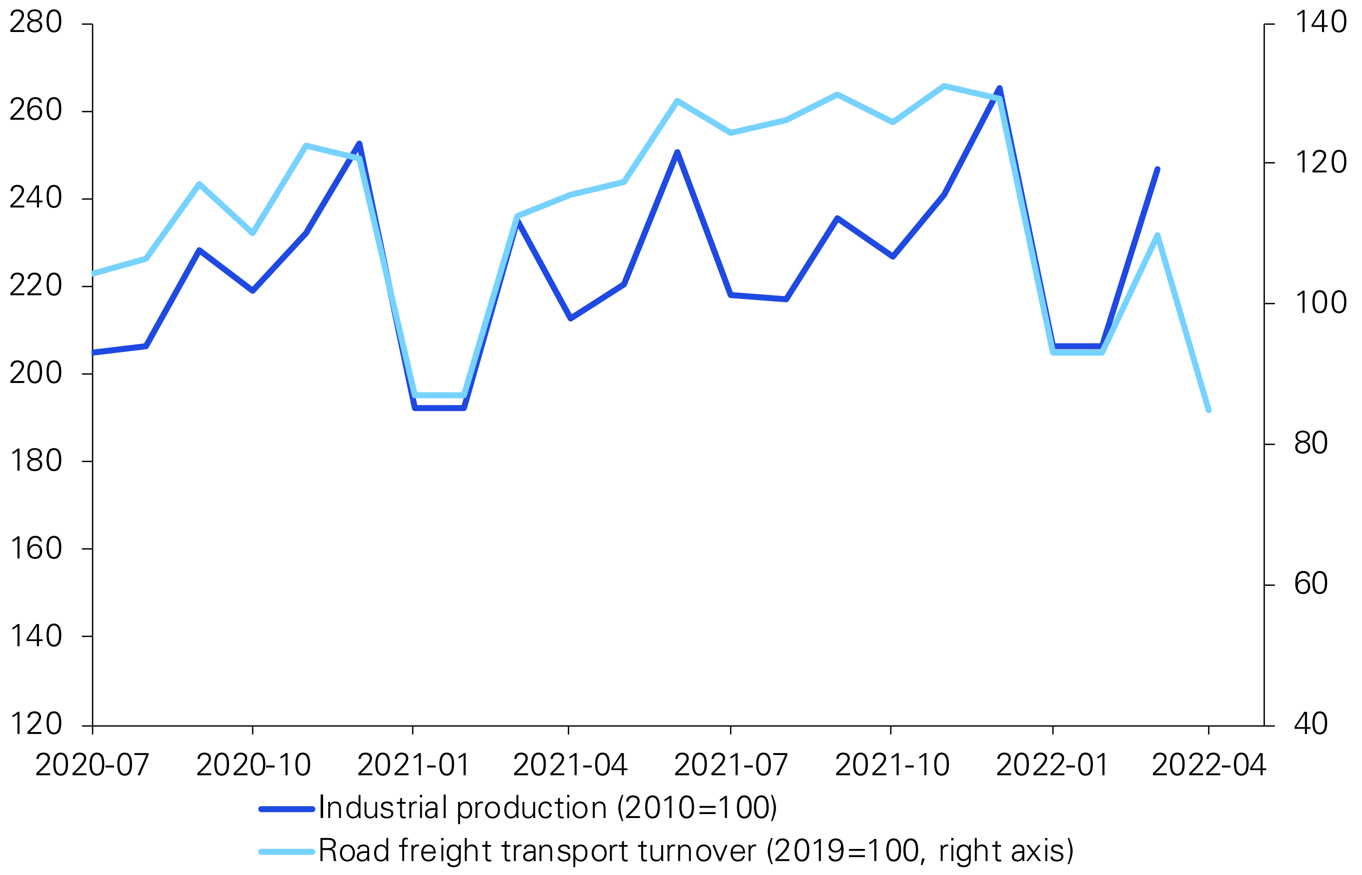


Source: Wind, KPMG analysis

- Industrial production rose by 6.5% in the first quarter, 2.6 percentage points higher than that in Q4 2021.
- The high-tech sector performed well compared with overall activity, growing 14.2% in Q1. Meanwhile, the equipment manufacturing sector rose.by 8.1% with booming external demand.
- As the government has taken various measures to boost the power supply, the mining sector grew by 10.7% in Q1, up from 5.1% in Q4 2021. In addition, the mining and utilities sectors contributed 1.4 percentage points to the growth of industrial production.

Logistics and supply chain disruptions will weigh on industrial production in Q2

Industrial production and road freight transport, index

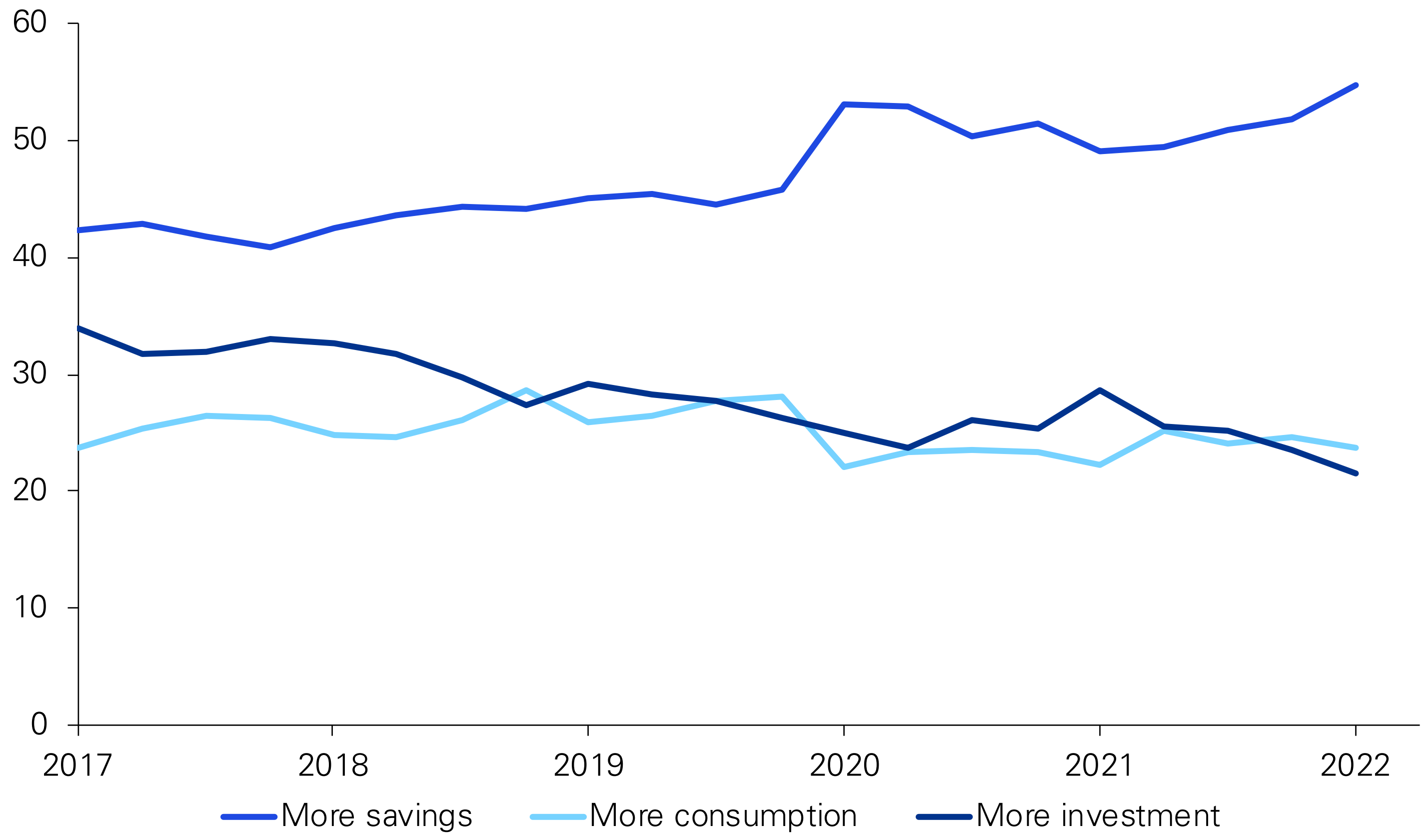


Source: Wind, KPMG analysis
Note: the data in January and February is the average of two months.

- Industrial production is facing challenges amid expansive lockdowns and logistics disruptions, including blocked or closed highways and ports. The index of road freight transport turnover has fallen sharply since late March, dropping 26.6% compared with April 2021.
- The disruptions may weigh on the recovery of industrial production. Some factories suspended their operations due to lack of workers and parts. The industrial capacity utilisation rate declined to 75.8% in March, from 77.4% in February.
- The government has taken many steps to ensure smooth transportation of daily supplies and stabilise supply chains, such as keeping ports and airports running, encouraging closed-loop manufacturing, and issuing nationwide travel permits, etc.

Households plan to increase savings but hold back investment and spending

Share of surveyed households that will either increase savings, consumption or investment

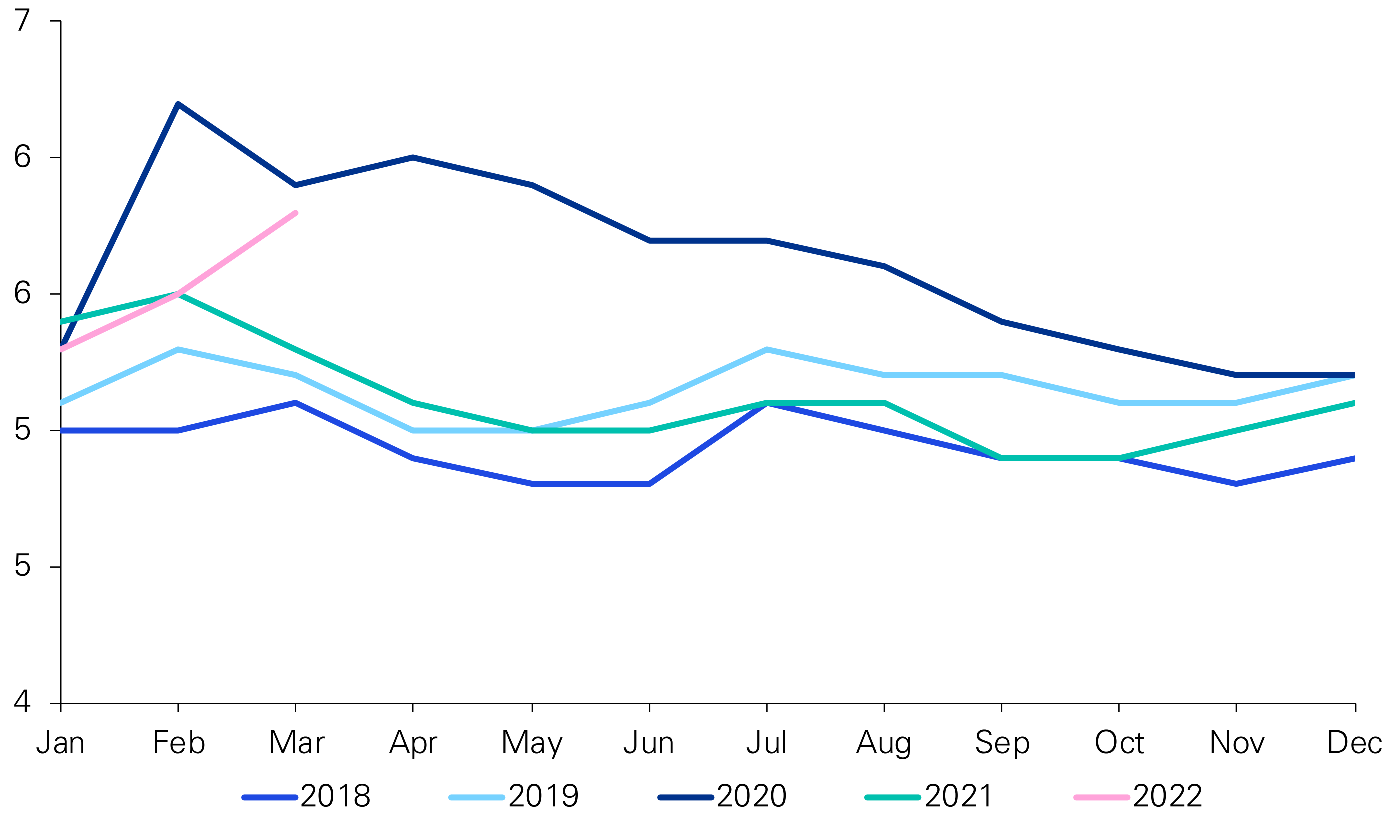


Source: The PBoC, KPMG analysis

- Based on a survey by the PBoC, household sentiment for income growth improved slightly in Q1, but remained weak compared with the same period last year.
- As a result, households are still cautious about consumption and investment. Despite a slightly increase from a year ago, the share of surveyed households that are planning to increase consumption is still below the pre-pandemic levels.
- The share of surveyed households planning to increase investment declined to 21.6%, the lowest level on record.

The urban surveyed unemployment rate increased in March

Labour market, the urban surveyed unemployment rate, %

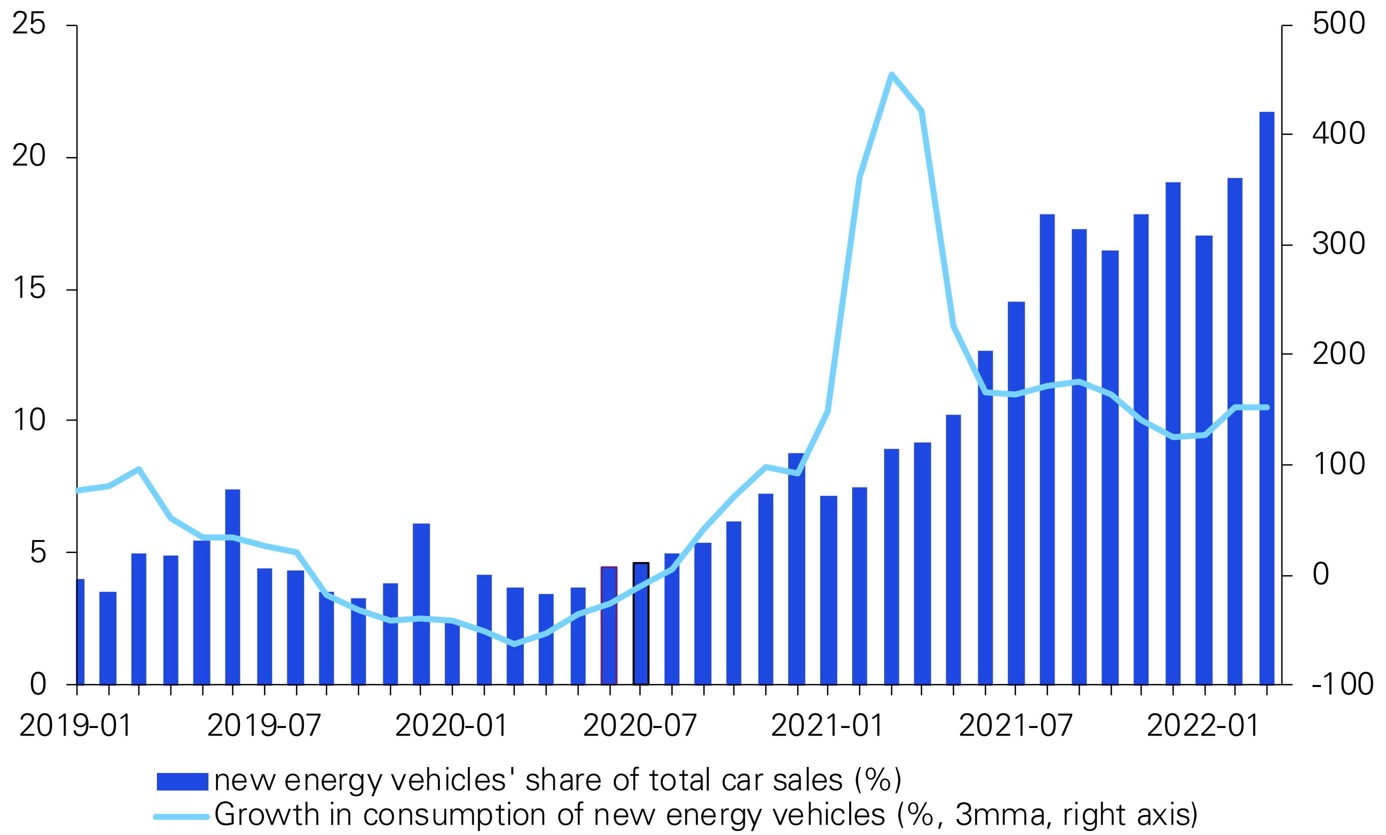


Source: Wind, KPMG analysis

- The urban surveyed unemployment rate increased from 5.5% in February to 5.8% in March. It was only 0.1 percentage point lower than that in March 2020.
- The weak growth momentum may cloud the outlook for the labour market. As over 10 million people are expected to graduate from universities in 2022, providing employment opportunities for young graduates will be important.

New energy vehicles continue to rise and account for over one-fifth of total sales

Growth of consumption on new energy vehicles, and their share of all car sales, %

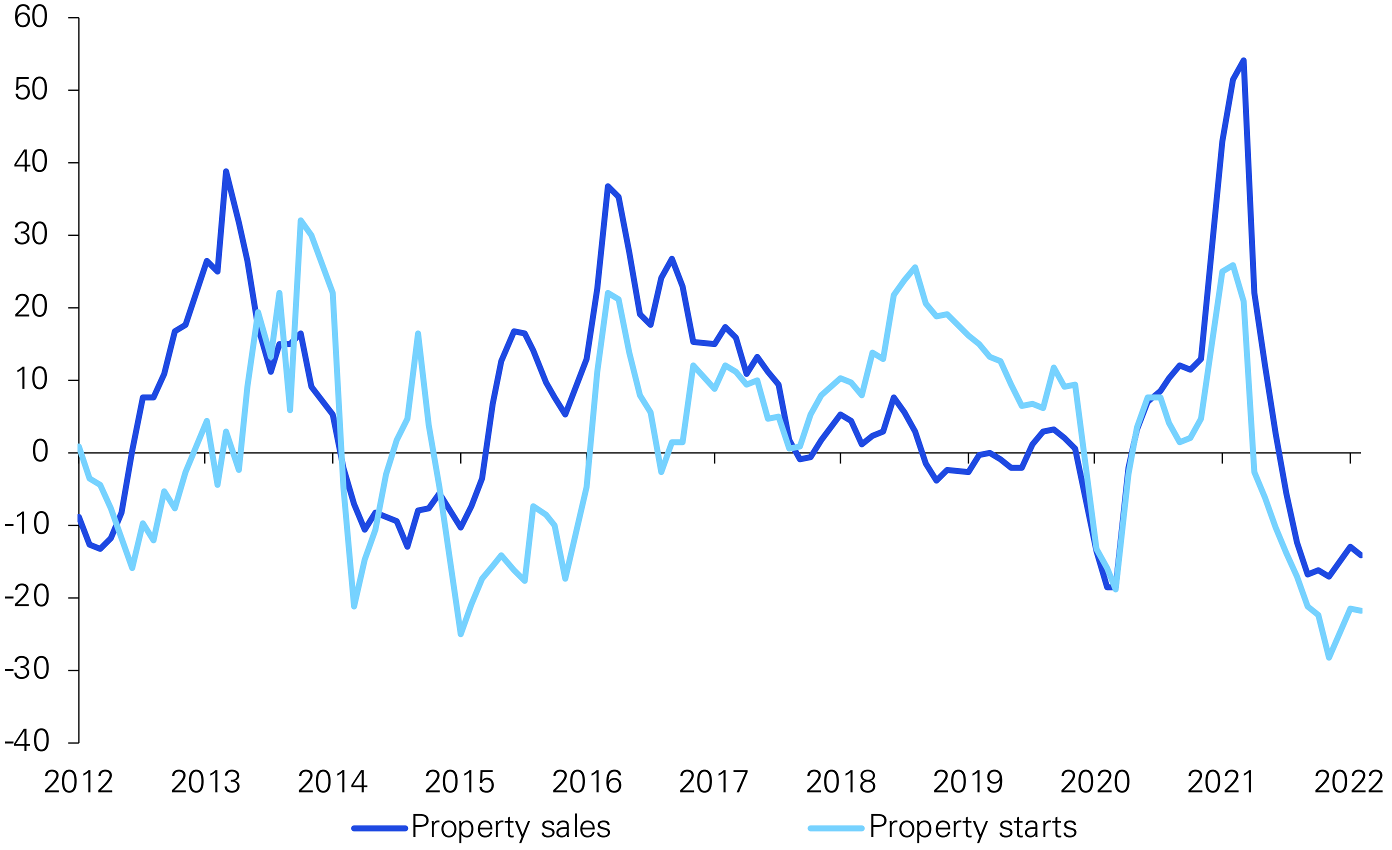


Source: Wind, KPMG analysis

- New energy vehicles continue to see rapid increase, growing 153% yoy in March.
- New energy vehicles accounted for over 20% of total vehicle sales in Q1 2022. In the *New Energy Vehicle Industry Development Plan (2021-2035)* released in November 2020, the government aimed to raise the share of new energy vehicles to 20% by 2025. Thus, this goal has been achieved ahead of schedule.
- Green intelligent home appliances, rural consumer markets and e-commerce are also supported to drive up consumption.

The housing market faces continued pressures with property sales and starts both falling

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

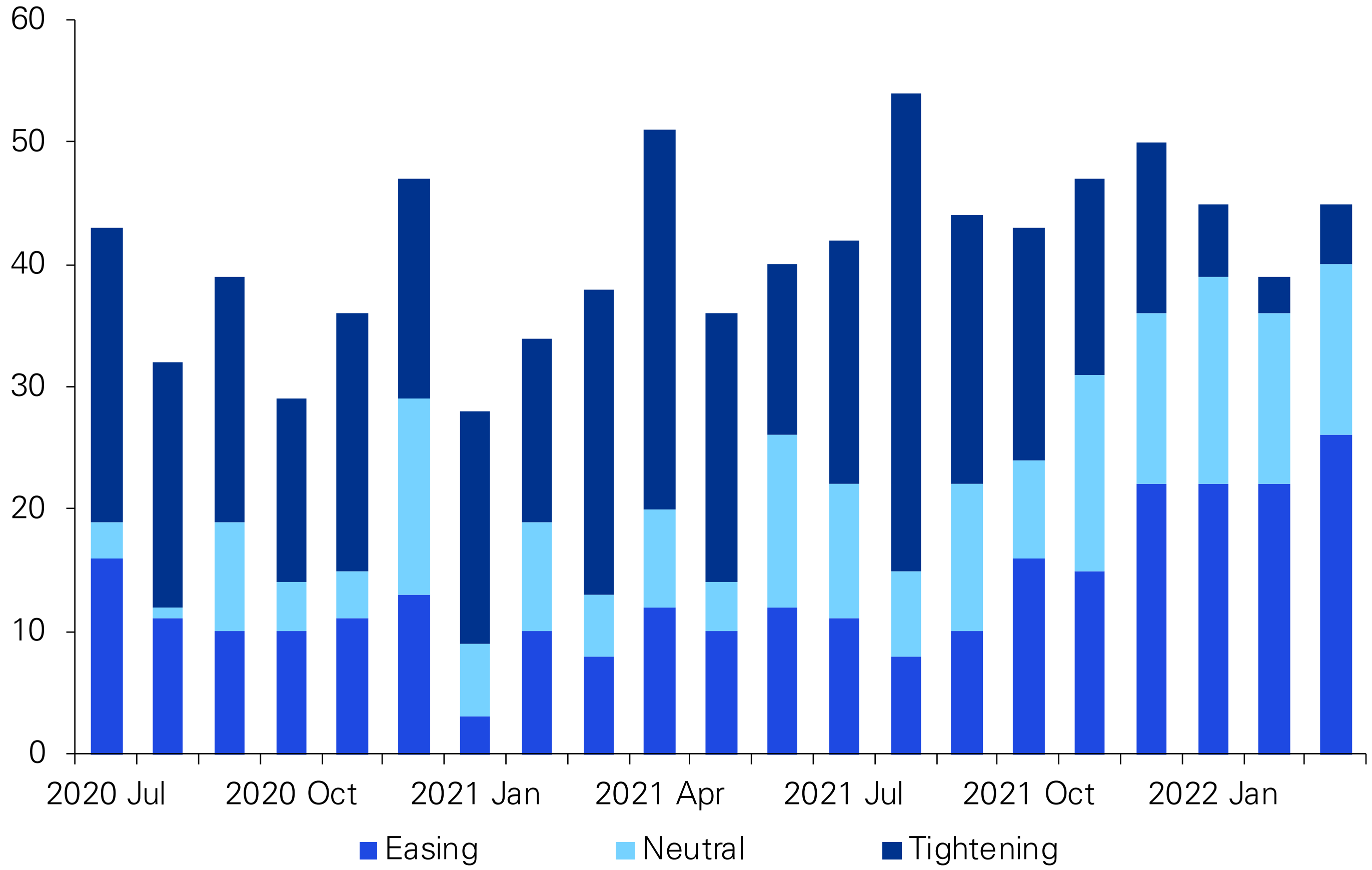


Source: Wind, KPMG analysis

- The real estate market continues to face pressures. Real estate investment rose by 0.7% in the first quarter from a year ago. After a soft rebound in February, new property sales fell 17.7% and property starts dropped 22.2% year on year in March.
- Property developers raised RMB 3.8 trillion yuan of funding in Q1, down 19.6% from a year ago. Meanwhile, land purchases dropped by 42% in Q1, indicating property activity will likely remain weak in the coming months.

More local governments are announcing easing measures on the property market

Number of new real estate policies released by local governments

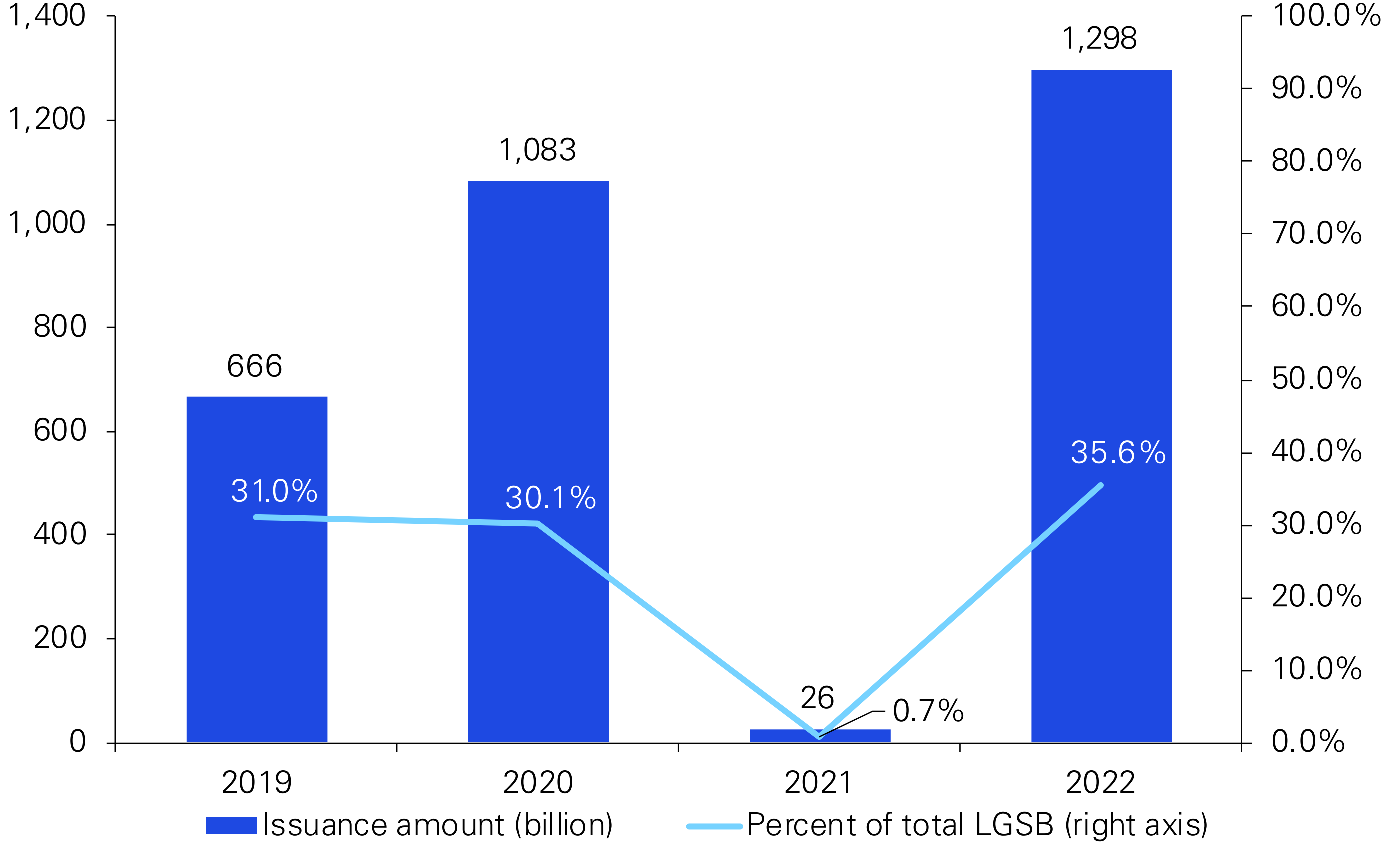


Source: CRIC China, KPMG analysis

- To cushion the slowdown, more local governments are announcing easing policies on the property market. The proportion of easing policies reached 57.8% in March, up from 44% in December 2021. In addition, China's Ministry of Finance also announced on 16 March that the much-watched pilot programme on property tax will be postponed.
- We expect more easing policies may be adopted to prevent a sharp decline in the market in 2022, but the overall regulatory tone of 'housing is for living, not for speculation' will likely remain unchanged.

The issuance of local government special bonds reached a record high in Q1, which should support infrastructure investment

Issuance of local government special bonds in Q1, RMB billion

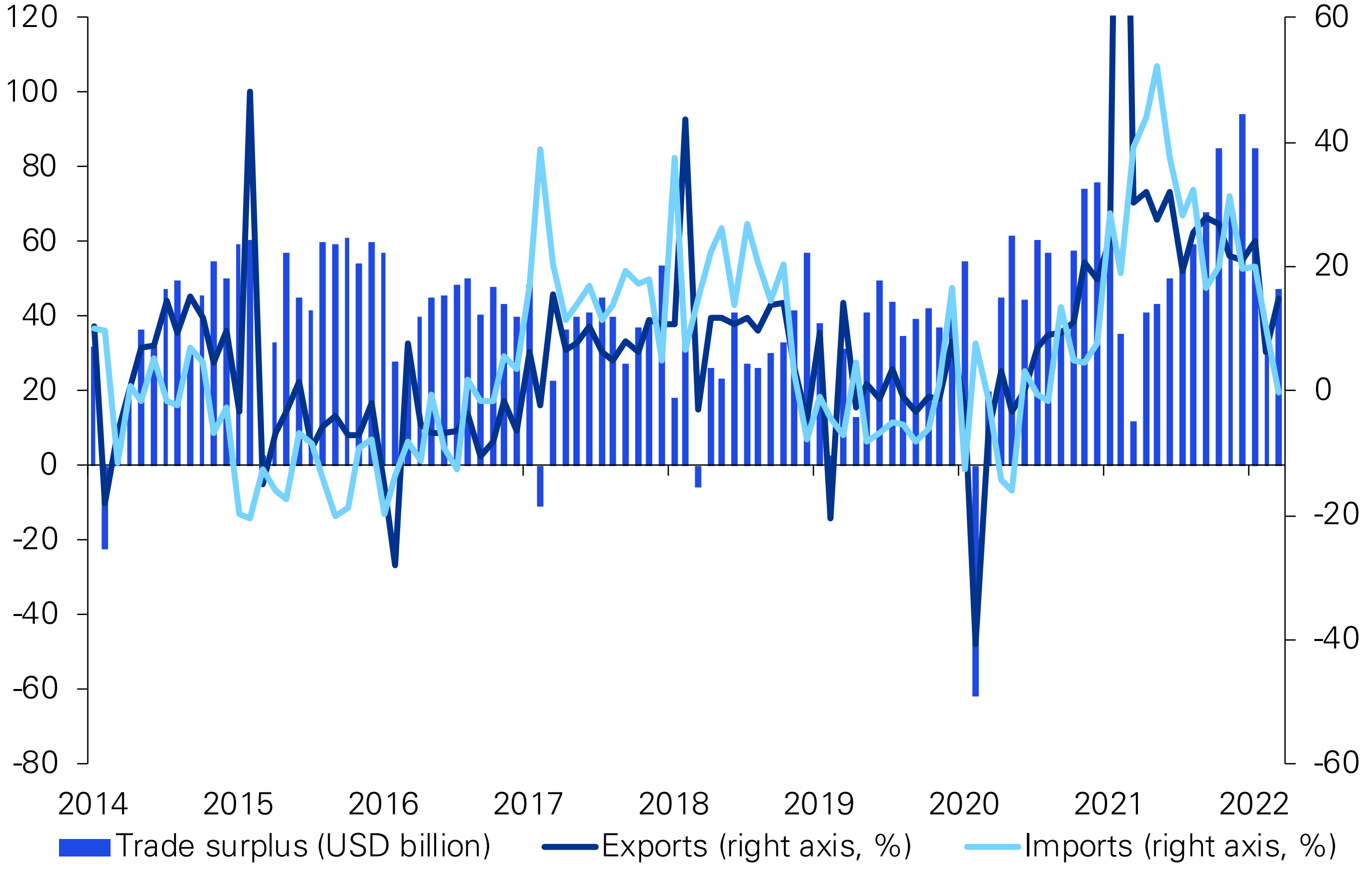


Source: Wind, KPMG analysis

- To stabilise economic growth, the government will increase its fiscal support this year. It plans to issue RMB 3.65 trillion local government special bonds (LGSB), including a front-loaded quota of RMB1.46 trillion in last November.
- As of the end of March, the government has issued new LGSB totalled RMB 1.3 trillion, accounting for 35.6% of its annual quota, much faster than previous years.
- As about 60% of LGSB were targeted on infrastructure projects, an increase in issuance of LGSB drove up the growth of infrastructure investment, which rose by 10.5% in Q1, up from -2.9% in Q4 2021. We expect to see rapid growth in infrastructure investment this year.

Trade remained strong in Q1 but is expected to moderate

Growth of exports and imports, %

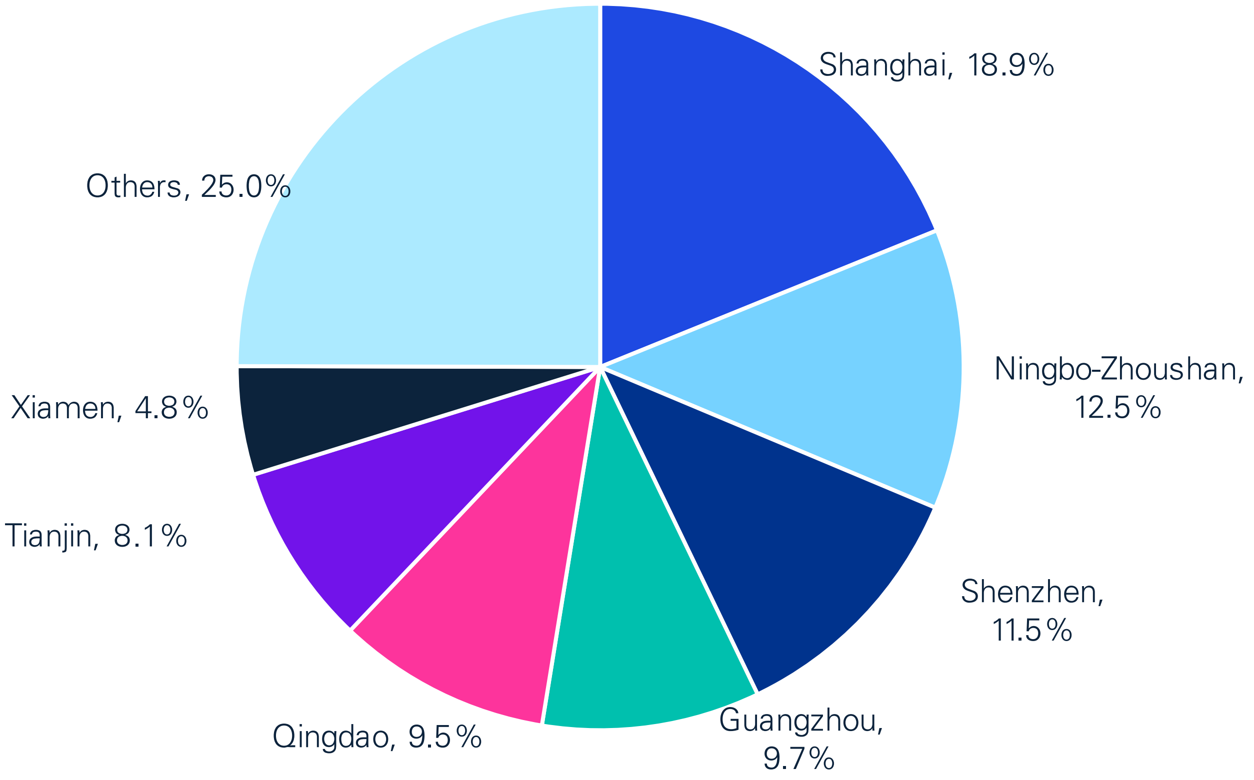


Source: Wind, KPMG analysis

- Export growth in USD terms moderated to 14.7% in March from 16.3% in January–February. The trade surplus was USD 47.4 billion in March, down from the monthly average of USD 58.0 billion in January–February.
- China's imports fell 0.1% in March from 15.5% in January–February, marking the first decline since August 2020. The sharp decline in import growth reflected shrinking domestic demand. Meanwhile, port congestion in the Yangtze River Delta region may have also contributed to the slowdown.

Some of the largest ports in China are facing congestion due to recent pandemic wave

Share of container throughput for the largest coastal ports in China (2021), %

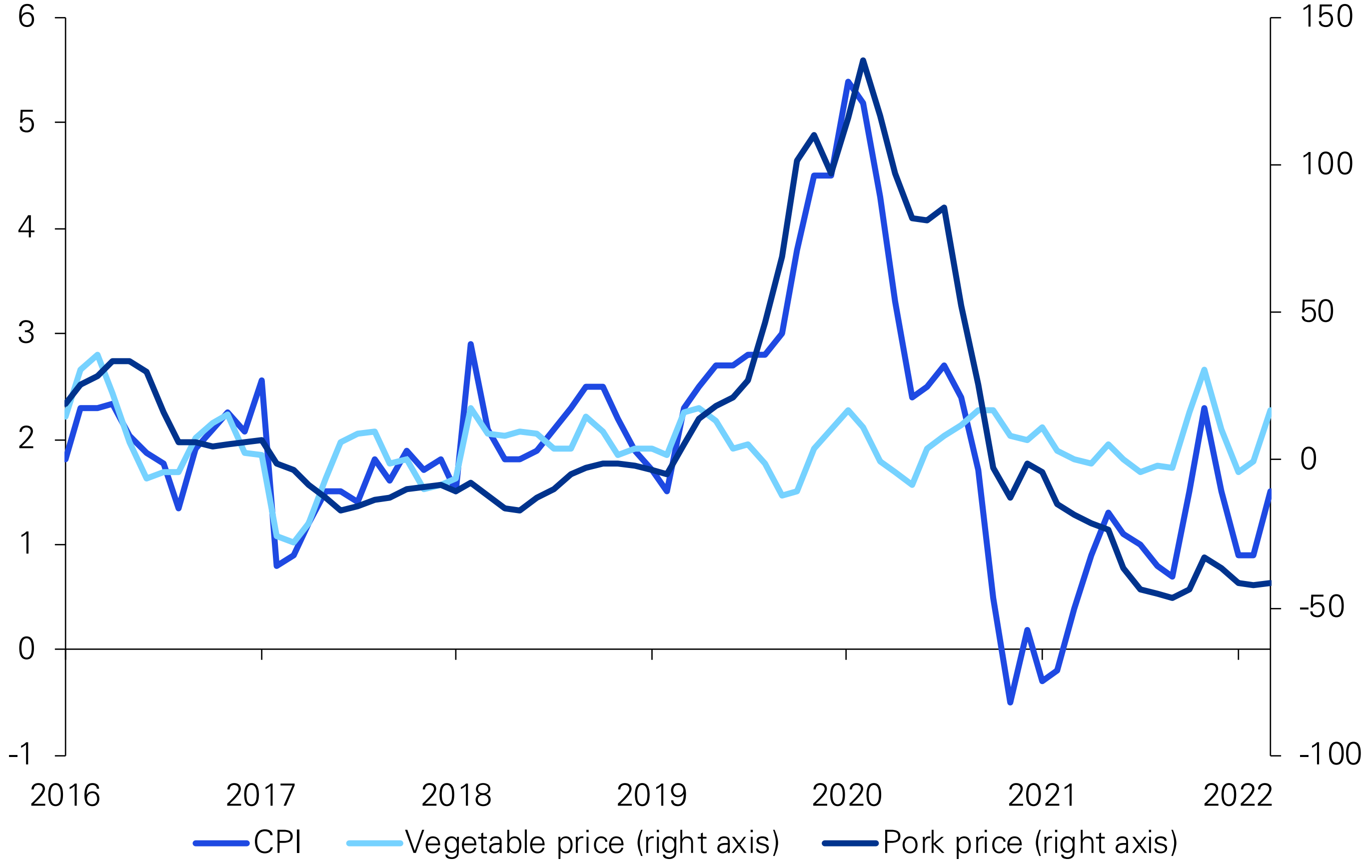


Source: Wind, KPMG analysis

- Container throughput of the Shanghai port exceeded 47 million TEUs in 2021, representing nearly 20% among all major coastal ports in China. Shanghai is followed by Ningbo-Zhoushan port and Shenzhen port.
- Due to strict quarantine measures in the Yangtze River and Pearl River deltas, the efficiency of customs clearance in Shanghai, Ningbo-Zhoushan and Shenzhen ports has significantly decreased.
- The congestion has also expanded to some northern ports (e.g. Tianjin and Qingdao ports) as shipowners divert ships to these ports to avoid dock labour shortages and warehouse closures.

Consumer price inflation remains behaved but will likely see upward pressure due to logistics issues

Consumer price index and vegetable price, yoy, %

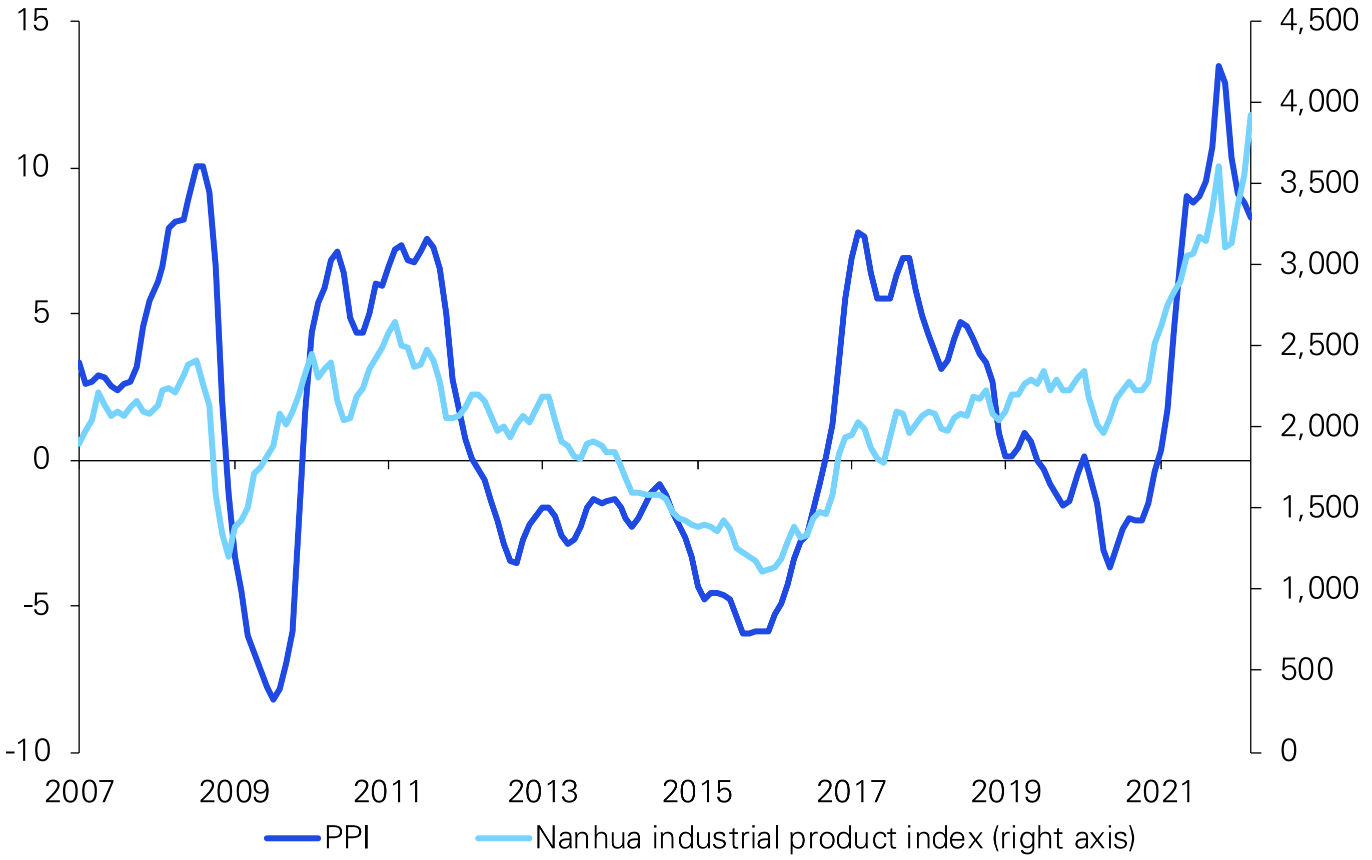


Source: Wind, KPMG analysis

- The consumer price index (CPI) rose to 1.5% in March from 0.9% in February. Vegetable price inflation surged sharply to 17.2% in March from -0.1% in February, mainly due to the increasing mobility restrictions.
- Pork price deflation remained the largest counterpoint to CPI growth, with prices falling by 41.4% in March, compared with a 42.5% decline in February.
- In the non-food categories, boosted by the higher oil prices, transportation-related fuel prices increased 24.1% in March, compared with 23.4% in February.
- Looking ahead, we expect China's CPI to rise further in Q2, owing to last year's low base, the spill-over of commodity price hikes, and residents' continued tendency to stock up on goods while pandemic restrictions continue in many areas.

Growth of producer price inflation is expected to retreat on high base and weakening demand

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

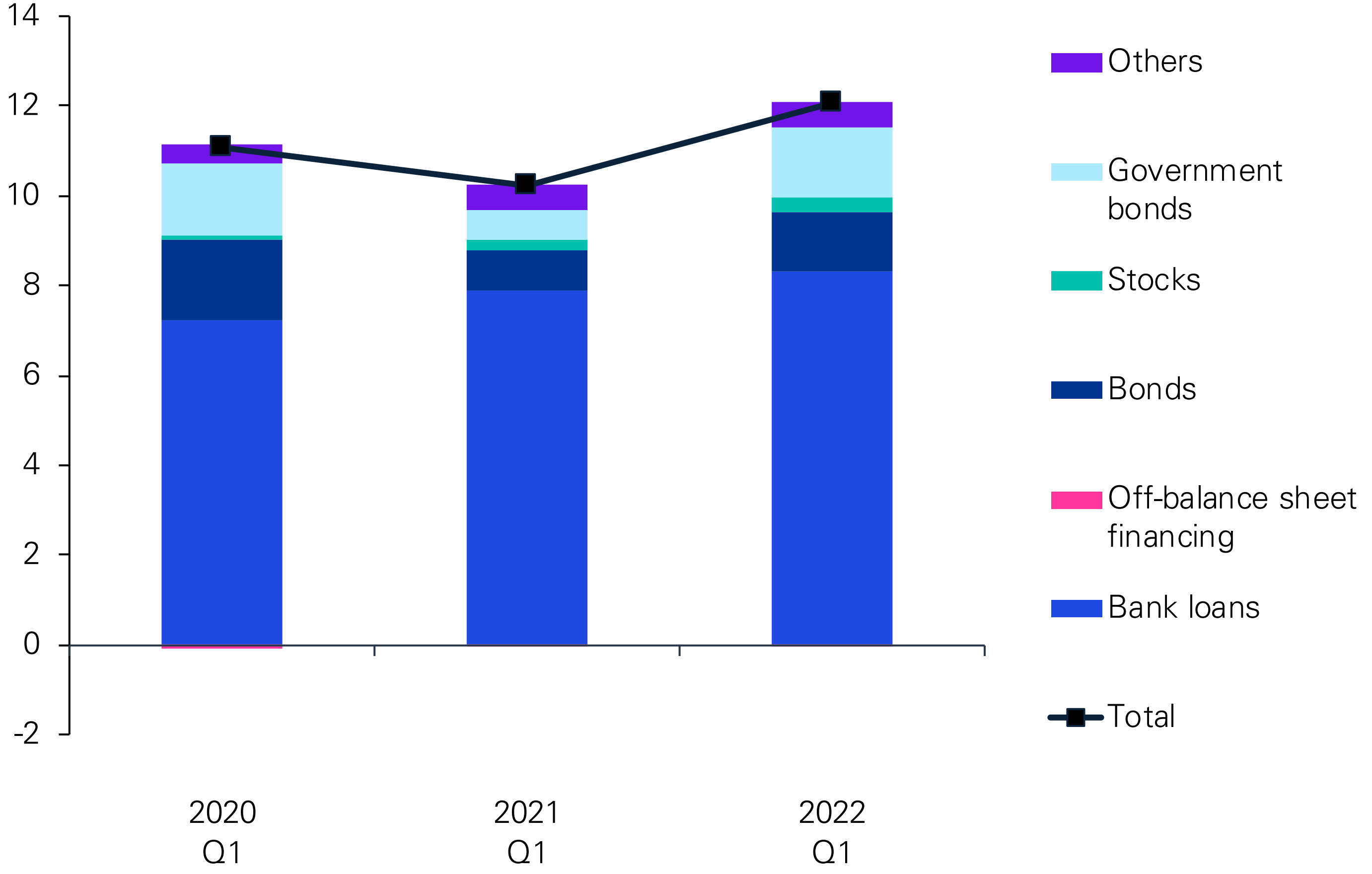


Source: Wind, KPMG analysis

- International commodity prices continued to soar due to ongoing geopolitical conflict, driving up prices of crude oil, non-ferrous metals and other materials.
- China's producer price index (PPI) slowed to 8.3% in March from 8.8% in February, mainly due to current high base.
- Looking ahead, we expect PPI growth to fall further on weak demand and with the current high base. The gap between CPI and PPI is expected to narrow.

Growth of total social financing is mainly driven by bank loans and bond issuances

Change in total social financing, RMB trillion

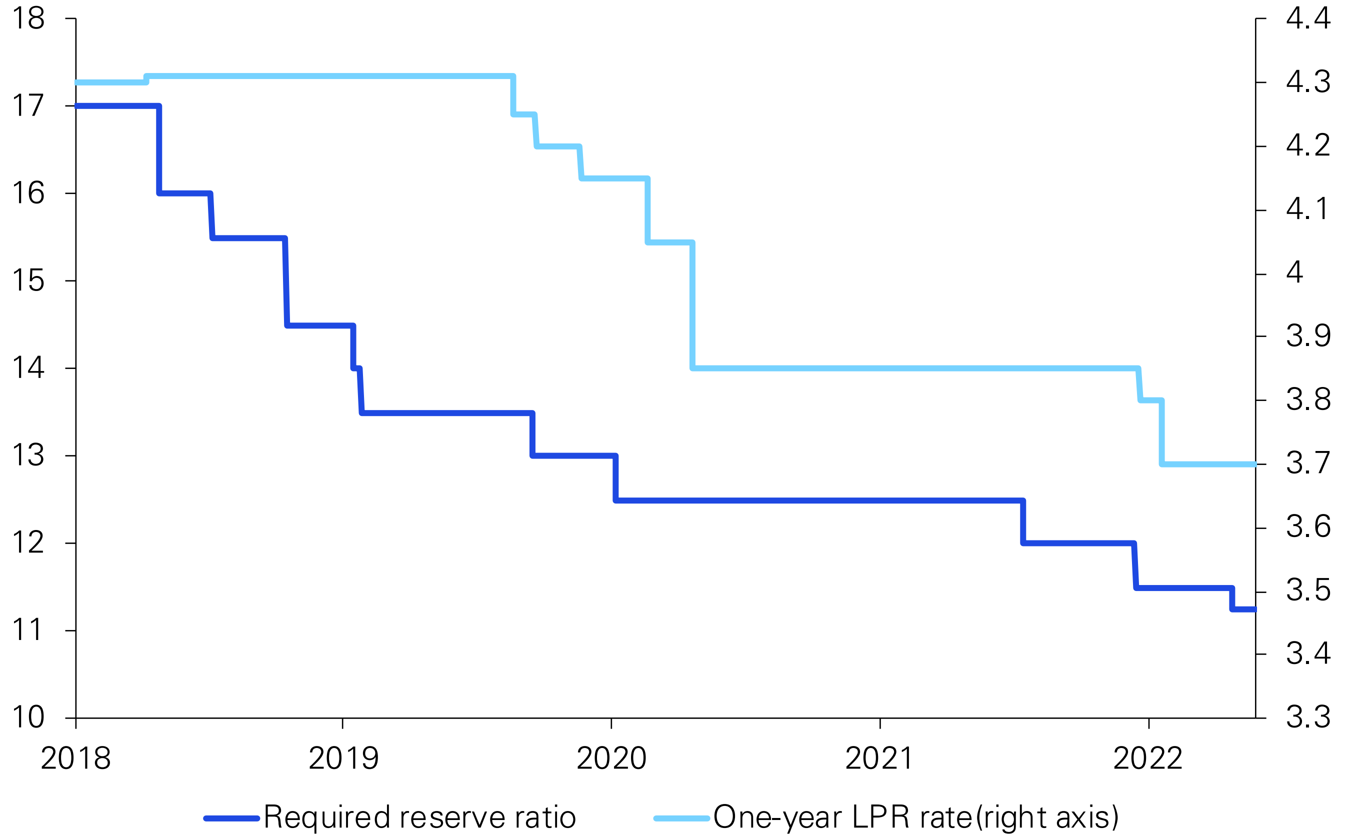


Source: Wind, KPMG analysis

- New total social financing (TSF), a measure of the total liquidity provided by the financial sector to the real economy, increased by RMB 12.1 trillion in Q1, RMB 1.8 trillion higher than the same period last year, and RMB 1.0 trillion higher than in 2020.
- The growth of TSF was mainly driven by bank loans and bond issuances. As Beijing frontloaded bond issuances in H1, government bond issuance rose to RMB 1.6 trillion in Q1, RMB 0.9 trillion higher than that in Q1 2021.
- New bank loans increased to RMB 8.3 trillion in Q1, accounting for 69.1% of total new amounts. The strength in new loans was mainly driven by short-term corporate loans and bill financing. Medium- and long-term loans to both corporates and households retreated.

The central bank cut the required reserve ratio and interest rates to support growth

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

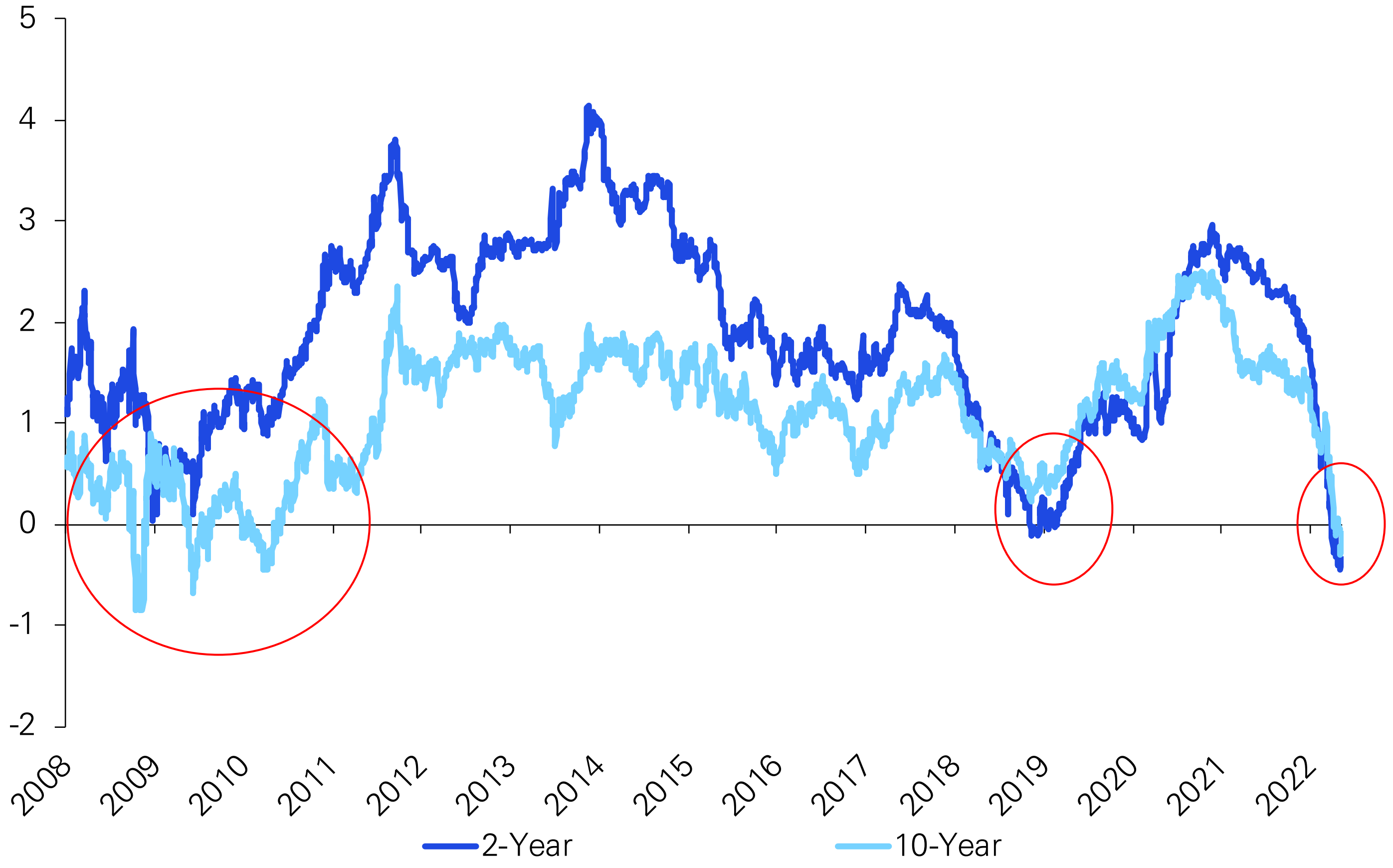


Source: Wind, KPMG analysis.

- In January, the PBoC cut the medium term lending facility rate (MLF) and reverse repo rate by 10 bps each and slashed the one-year loan prime rate (LPR) by 10 bps and five-year LPR by 5 bps in January. Since then, interest rates have remained unchanged through April.
- The central bank cut the required reserve ratio (RRR) by 25 bps in April, providing RMB 530 billion of liquidity. We expect another RRR cut soon to stabilise economic growth.
- The central bank has also increased its direct credit support to SMEs, green investment, tech and elderly care via channels such as special relending facility.

The yield spread between the US-China government bonds has become inverted

Yield spread between China and the US government bonds, %

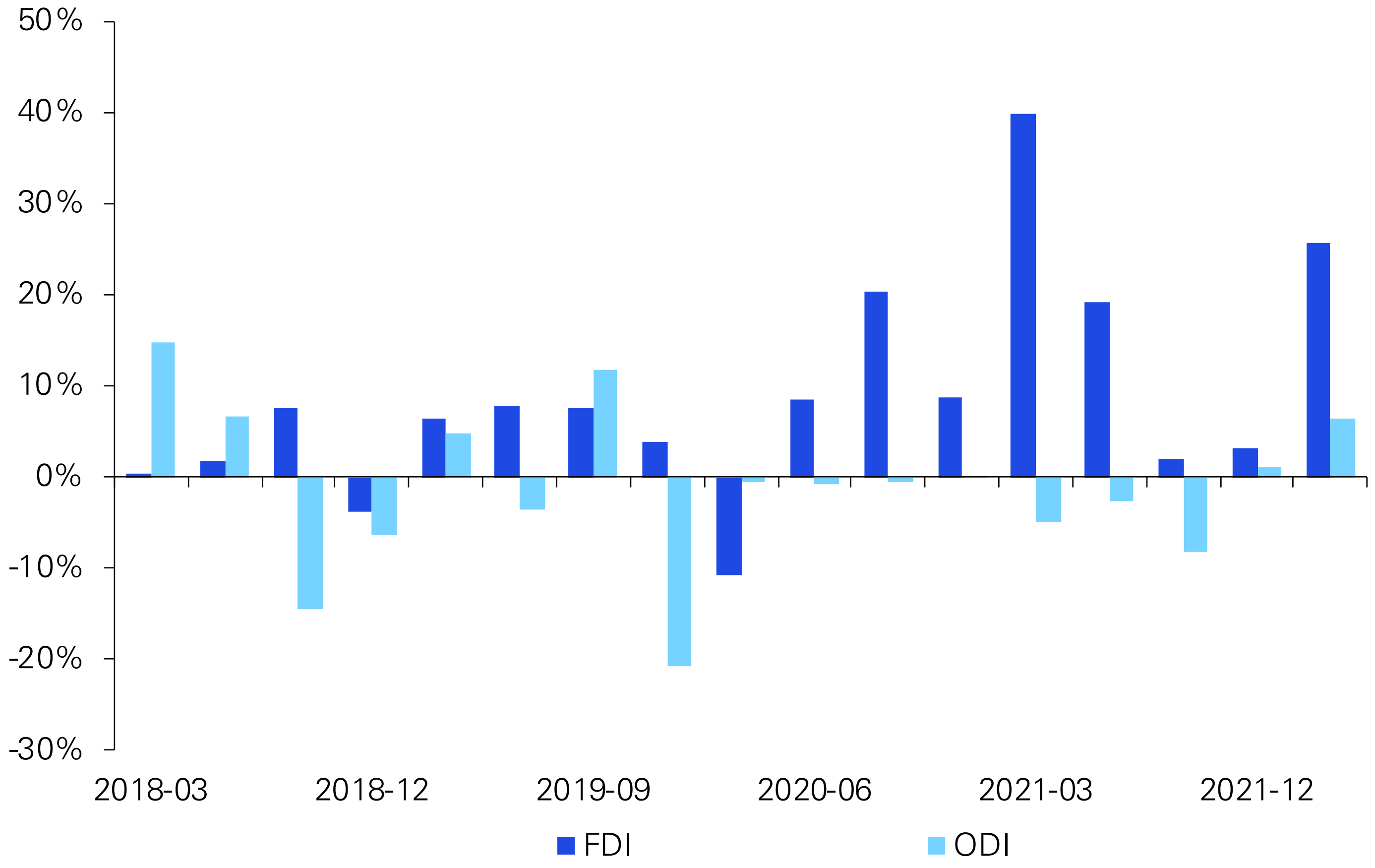


Source: Wind, KPMG analysis.

- The yield on China's 10-year treasury bonds has remained flat at around 2.85%, while US 10-year treasury bond yields jumped over 3% in early May. The spread has become inverted for the first time since 2010.
- The divergence is mainly caused by the different approach to monetary policy by the two countries. While the US Fed is stepping up its monetary tightening, the PBoC, China's central bank, has to take a relatively easing stance to support economic growth.
- RMB bonds held by foreign institutional investors decreased by RMB 66.9 billion and RMB 98.2 billion in February and March, respectively—the first such drops since 2019.

Foreign direct investment remained robust in Q1

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

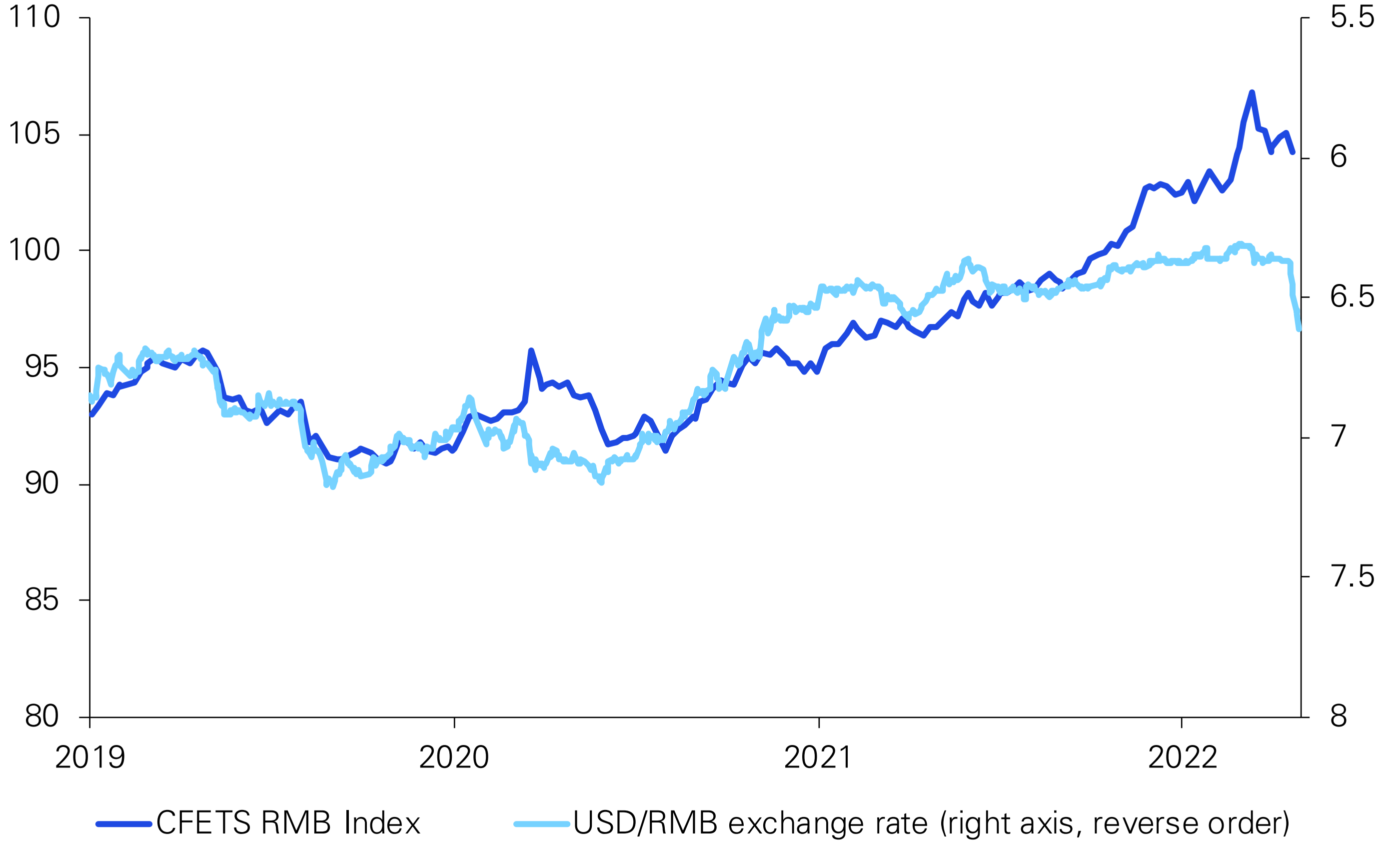


Source: Wind, KPMG analysis

- Growth of foreign direct investment (FDI) in China increased by 25.6% in Q1 to RMB 379.9 billion (USD 59.1 billion), underlining the importance of the Chinese market to MNCs.
- FDI to the high-tech sector increased by 52.9%, of which high-tech service and manufacturing sectors experienced growth of 57.8% and 35.7%, respectively.
- China's outbound direct investment (ODI) has trended upward. Non-financial ODI grew by 6.3% in Q1, and its investments in Belt and Road countries continued to increase.

The RMB exchange rate is facing depreciation pressure

CFETS RMB index and USD/RMB exchange rate

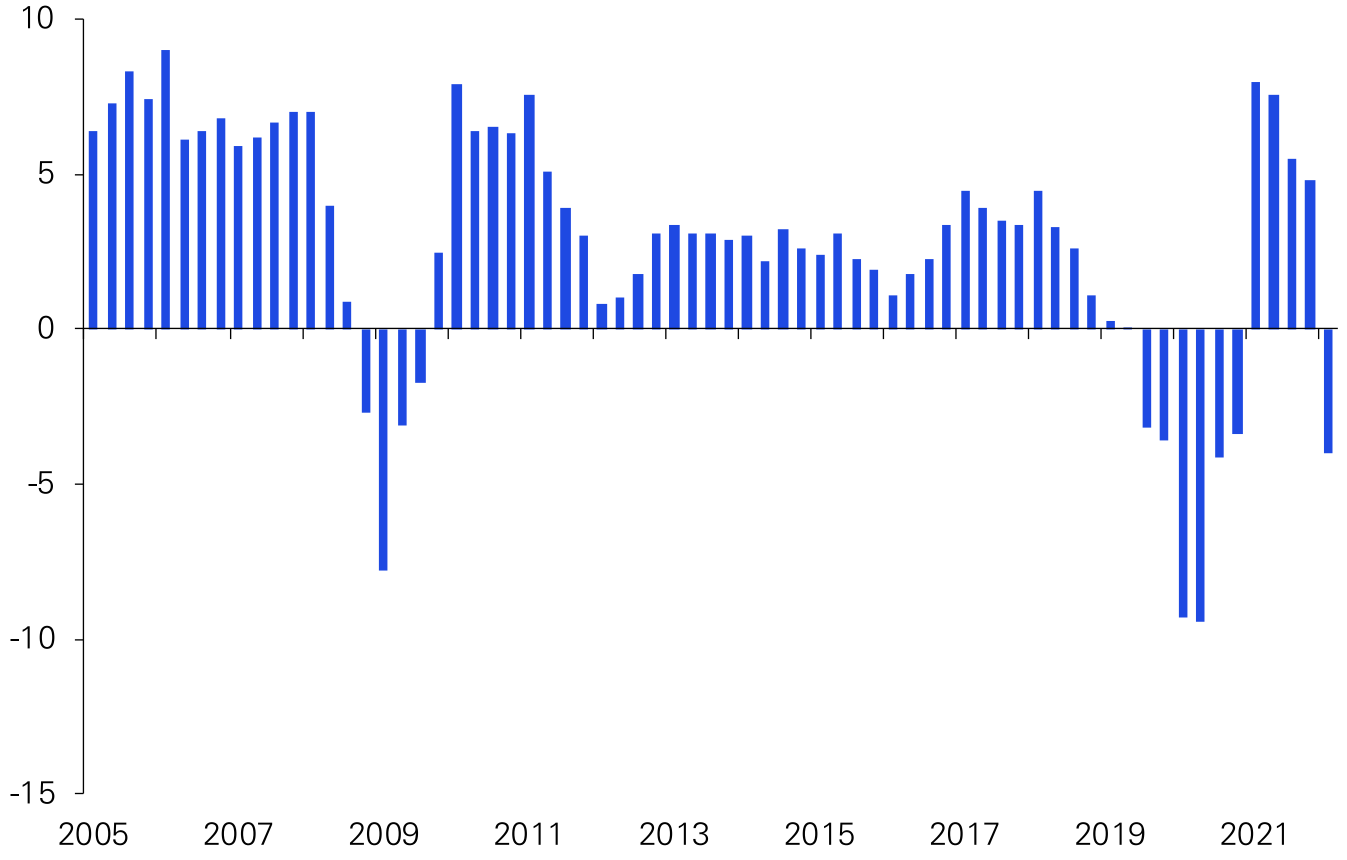


Source: Wind, KPMG analysis

- On the back of China's strong export growth, the CFETS's basket index of the RMB has increased by 2.5% in Q1 2022. As the Fed accelerates its policy rate hikes and is expected to start reducing its balance sheet in June, the USD index has risen 6.5% since the start of the year. Against the backdrop, the RMB has weakened sharply against the USD since mid April.
- Looking forward, China's export growth will likely slow from a high base. The interest rate between the US and China is also expected to narrow, with the Fed accelerating tightening and China adopting an easing stance. As such, the RMB is expected to face depreciation pressure against the USD but should remain relatively stable against the basket of major currencies.

Hong Kong's economy declined in Q1 but it is expected to improve as the pandemic situation stabilises

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



Source: Wind, KPMG analysis

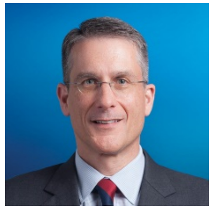
- The Hong Kong (SAR)'s economy contracted by 4.0% in Q1 due to the new wave of pandemic caused by the Omicron variant, dropping from the 4.8% growth in Q4 2021.
- Slowing global demand growth and pandemic-induced disruptions to cross-boundary transportation posed substantial drags to exports. Total goods exports recorded a decline of 8.9% in March. Meanwhile, the labour market continued to struggle with the unemployment climbing to 5.0%, a 0.5% rise from February.
- Looking ahead, the pandemic situation been improving since early March, allowing for the gradual relaxation of social distancing measures. Meanwhile, the government's various support measures should help further bolster Hong Kong's economy in Q2.

Contact us

Raymond Ng
Head of Markets
KPMG China
+86 (10) 85087067
raymond.kk.ng@kpmg.com

Norbert Meyring
Partner
KPMG China
+86 (21) 22122707
norbert.meyring@kpmg.com

Miguel Montoya
Partner
KPMG China
+86 (10) 85084470
miguel.montoya@kpmg.com



Thomas Stanley
COO of Markets
KPMG China
+86 (21) 22123884
thomas.stanley@kpmg.com

Kevin Kang
Chief Economist
KPMG China
+86 (10) 85087198
k.kang@kpmg.com

Research Team: Yuan Zeng, CFA; Yanan Zheng; Qi Shao (Intern); Qiongyu Zhou (Intern)
Design: Zheng Zhu

kpmg.com/cn/socialmedia

Publication date: May 2022