China Economic Monitor

Issue: 2022 Q4

November 2022

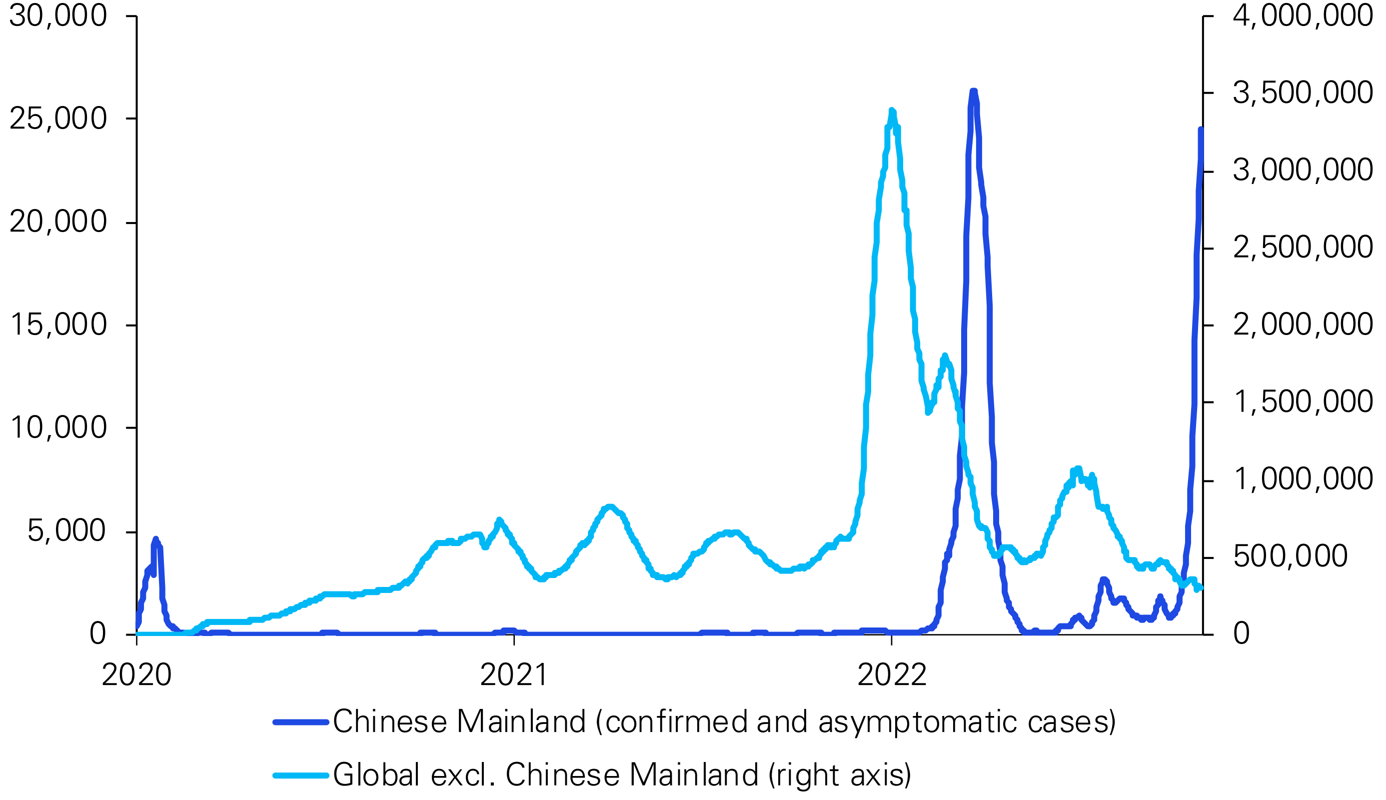
kpmg.com/cn

Key takeaways

- China’s GDP grew 3.0% year-over-year (yoy) in the first nine months of 2022. Q3 GDP grew 3.9%, 3.5 percentage points higher than Q2, better than market expectations. On a quarter-over-quarter basis, the economy grew by 3.9% in Q3, a significant improvement from -2.6% in Q2. The Covid-19 pandemic, slowdown in the real estate market, and ongoing geopolitical challenges continued to affect China's economic growth in Q2. Growth momentum improved in Q3, showing the resilience of the Chinese economy.
- With more policy support and better weather conditions, industrial production saw a rebound in Q3. Industrial production growth improved from 3.8% in July to 6.3% in September. However, the Purchasing Managers' Index (PMI), a leading manufacturing indicator, had been hovering around the 50 threshold and declined to 49.2 in October from 50.1 in September, suggesting a weakening momentum.
- Retail sales growth returned to positive in Q3 after being hard-hit by worsening pandemic conditions in Q2. It rose 3.5% in Q3, beating market expectations. Driven by supply chain improvements, reduced purchase tax, and lower base for comparison, auto sales have shown a strong rebound since June, up 18.2% in Q3. However, service consumption remained anaemic, due to both the ongoing pandemic situation and low consumer confidence.
- The property market faces continued pressure. Real estate investment fell by 12.7% in Q3 from a year ago, 3.6 percentage points lower than that in Q2. Funding constraints have been a key challenge faced by developers, especially those with high leverage ratios. The government has taken actions to stabilise the market. In November, the PBoC and CBIRC jointly issued a package of 16 measures to bolster financing of the property sector. We expect the property market to remain weak in the near term but will gradually stabilize next year.
- The 20th National Congress of the Communist Party of China (CPC) was held in 16-22 October. The Congress outlined focus areas for the country's continued path towards high quality development , with the aim to achieve the goal of becoming a ‘socialist modern power’ by the mid-century. To achieve the goal, we estimate that China’s economy still needs to grow on average 4.5% per annum through 2035. In addition, innovation and national security were emphasised as two key themes for China’s future growth. We expect China’s R&D spending will continue to rise, led by government-guided investment funds.
- China’s National Health Commission (NHC) released a circular in early November 2022, announcing 20 new measures to further optimise the COVID-19 control measures. While the government maintains its ‘Zero Covid Policy’, these measures signal a gradual shift and reopening. We expect more fine-tuning in the next several months to effectively contain the virus while minimising its impact on economic and social development.
- Overall, we expect China’s overall economic policy to remain supportive next year as recovery is still fragile. As such, we expect China’s GDP growth rate to pick up in 2023 from this year’s low level.

Daily infections have surged again in the Chinese Mainland but with few severe cases

COVID-19 daily new cases, seven-day moving average



Source: Wind, KPMG analysis. Data through November 21 2022.

- The omicron variant has surged again this winter. Daily new infections have surpassed 20,000 in mid-November, reaching figures seen in Q2 2022.
- As of 11 November, over 3.4 billion COVID-19 vaccine doses, including 890 million booster doses, had been administered in China, covering 92.5% of total population. For elderly people aged 80 and above, 65.7% were fully vaccinated, including 40% having received booster vaccines.
- Existing data shows vaccination has a clear protective effect against severe illness and death. There were only seven severe cases in China among 80,000-plus new infections since late October 2022.

China announced a set of 20 measures to streamline pandemic control

For Inbound travellers:

- Cancellation of circuit breaker measures for inbound flights and reduction of pre-flight PCR tests to **1** from **2**.
- Allow closed-loop systems to **ease rules** for inbound business executives and sports starts.
- Set cycle threshold (CT) values at **less than 35** to diagnose COVID-19 among new arrivals.
- Reduce quarantine duration for new arrivals from the previous 7 days at central facility plus 3 days under medical observation at home to **5** days centralized isolation and **3** days at home isolation.

For Domestic travellers:

- Quarantine for close contacts will be cut to **5** days at central facility plus **3** days at home, also down from the previous "7+3" scheme.
- **End identification** of close contacts of close contacts.
- People leaving high-risk areas will be subject to **7 days of home quarantine** instead of 7 days in central facility.
- **Remove the "medium" risk category**. The risk areas have been adjusted to the two categories of "high and low."
- Workers in high-risk positions exiting closed-loop operations to **spend 5 days at home**, down from 7 days at home or a central facility
- **Remove mass testing** in most areas, with citywide tests given only when the source of infection is unclear.

- China's National Health Commission (NHC) released a circular in early November, announcing 20 new measures to further optimise the COVID-19 control policy.
- The new measures include steps that will make it easier for overseas travellers to enter the Chinese mainland, such as shortening quarantines and removing the circuit breaker rule, etc.
- The government emphasised that they will stick to 'Zero Covid Policy', but these measures sent a signal of a gradual shift and reopening.
- We expect more fine-tuning in the next couple of months to effectively contain the virus while minimising its impact on economic and social development.

China's economic growth improved in Q3 from the Q2 trough

Growth rate of major economic indicators, %

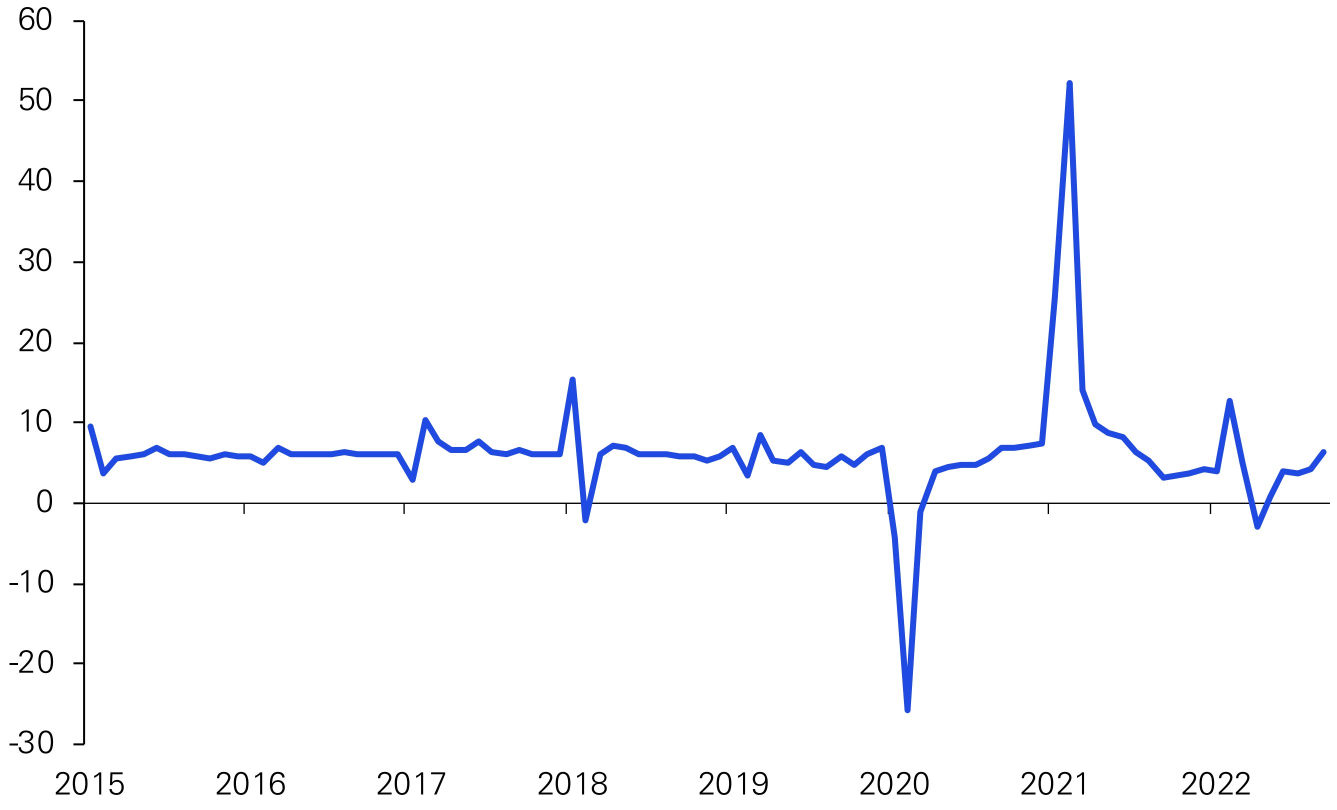
	2017-19 Average	Q1 2020-21 Average	Q2 2020-21 Average	Q3 2020-21 Average	Q4 2020-21 Average	2022Q1	2022Q2	2022Q3
GDP	6.6%	4.9%	5.5%	4.8%	5.2%	4.8%	0.4%	3.9%
Industrial production	6.2%	6.8%	6.6%	5.3%	5.5%	6.5%	0.6%	4.8%
Retail sales	9.0%	4.1%	4.6%	3.0%	4.1%	3.3%	-4.6%	3.5%
Fixed asset investment	6.2%	2.7%	5.4%	3.3%	3.6%	9.3%	4.5%	5.6%
Exports	6.1%	13.4%	14.2%	16.0%	19.7%	15.7%	12.9%	10.1%
Imports	9.8%	12.0%	14.2%	14.1%	14.4%	10.2%	1.7%	0.9%
Income per capita	6.5%	4.5%	5.9%	4.9%	5.1%	5.1%	0.4%	3.6%
Fiscal revenue	5.8%	3.2%	5.2%	4.6%	-1.5%	8.6%	-28.0%	2.2%
Fiscal expenditure	8.2%	0.1%	-1.5%	2.3%	5.5%	8.3%	3.7%	6.7%

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

- China's GDP grew 3.0% year-over-year (yoy) in January-September 2022. Q3 GDP grew 3.9%, 3.5 percentage points higher than Q2, better than market expectations. On a quarter-over-quarter basis, the economy grew by 3.9% in Q3, a significant improvement from -2.6% in Q2.
- Investments in manufacturing and infrastructure rebounded due to policy supports. Retail sales increased from -4.6% in Q2 to 3.5% in Q3. Exports remained resilient in Q3, but growth is expected to moderate in Q4.
- We expect China's macroeconomic policy will maintain accommodative next year and support continued recovery.

Industrial activities rebounded in Q3 2022

Industrial production, yoy, %

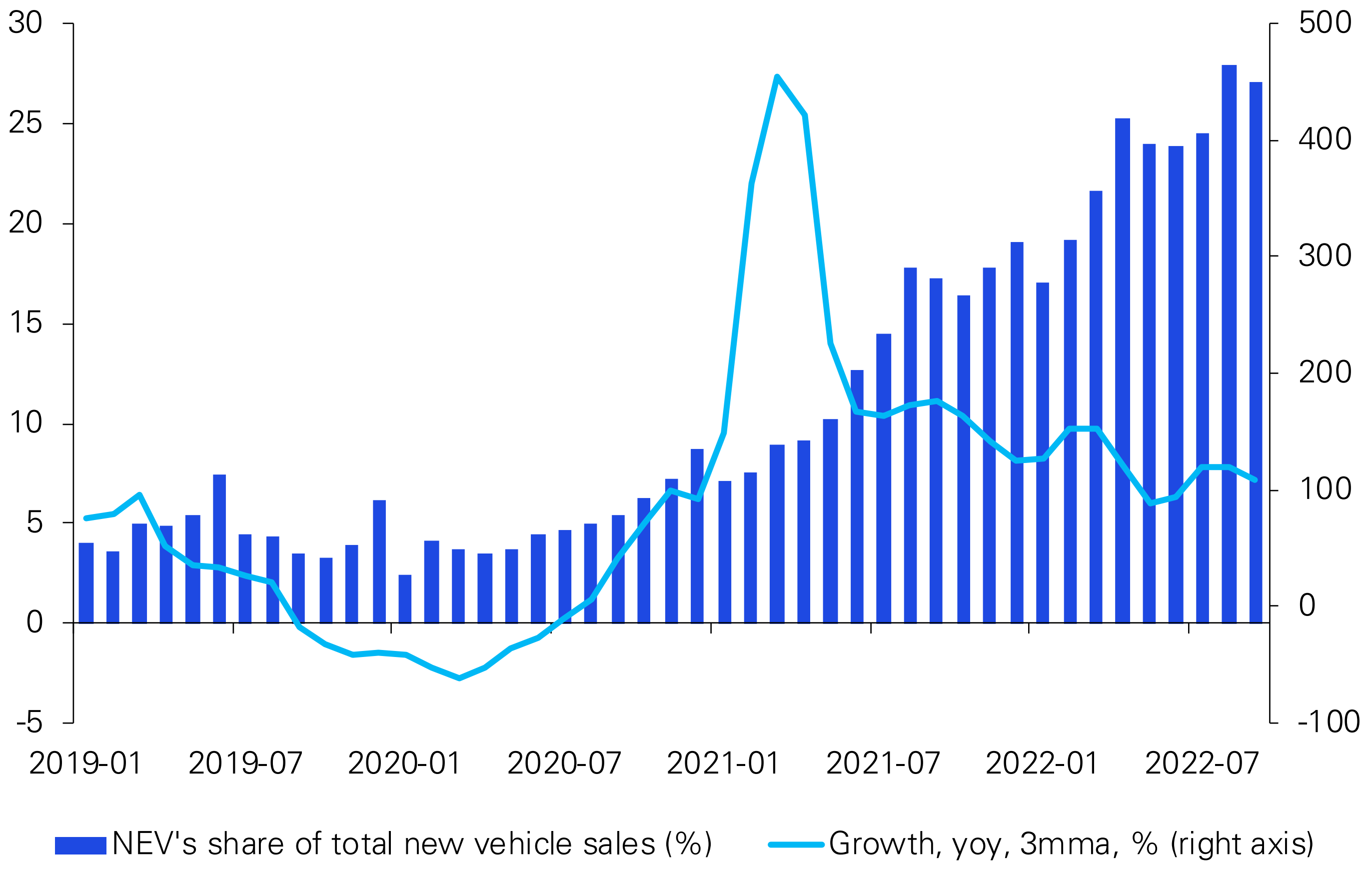


Source: Wind, KPMG analysis.

- With more policy support and better weather conditions, industrial production has shown a rebound in Q3 2022. Industrial production growth improved from 3.8% in July to 6.3% in September.
- Although the Omicron variant continued to spread in the third quarter, transportation and logistics remained stable, helping to boost industrial production.
- In addition, the lower base, robust growth of manufacturing and infrastructure investment, and resilient exports also provide support for the recovery of industrial production.

Sales of new energy vehicles remained strong and accounted for over one quarter of new car sales

Growth of new energy vehicle sales and its share in total new vehicle sales, %

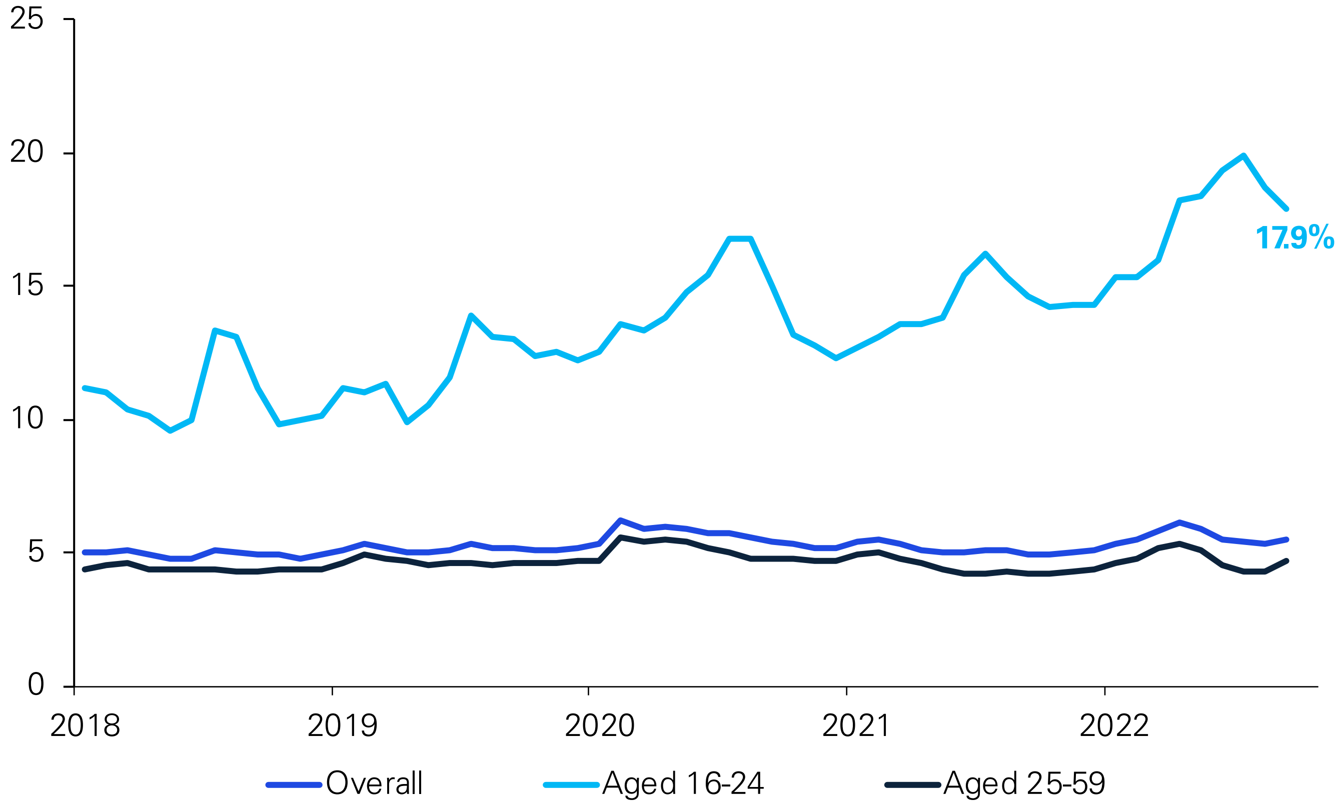


Source: Wind, KPMG analysis.

- Growth of retail sales returned to positive in Q3 after being hard hit by the virus spread in Q2. It rose 3.5% in Q3, higher than market expectations.
- Auto sales have shown a strong rebound since June, up 18.2% in Q3, driven by supply chain improvement, purchase tax reductions, and lower base for comparison.
- The growth rate of new energy vehicles remained at a high level of 100% and above, and its share of total car sales increased to 27% by the end of September.
- Yet, due to both pandemic control measures and low consumer confidence, the recovery of catering service remained anaemic, it fell by 1.7% in September, 10 percentage points lower than that in August.

The labour market remains stable but the youth unemployment rate is still relatively high

Urban surveyed unemployment rate, %

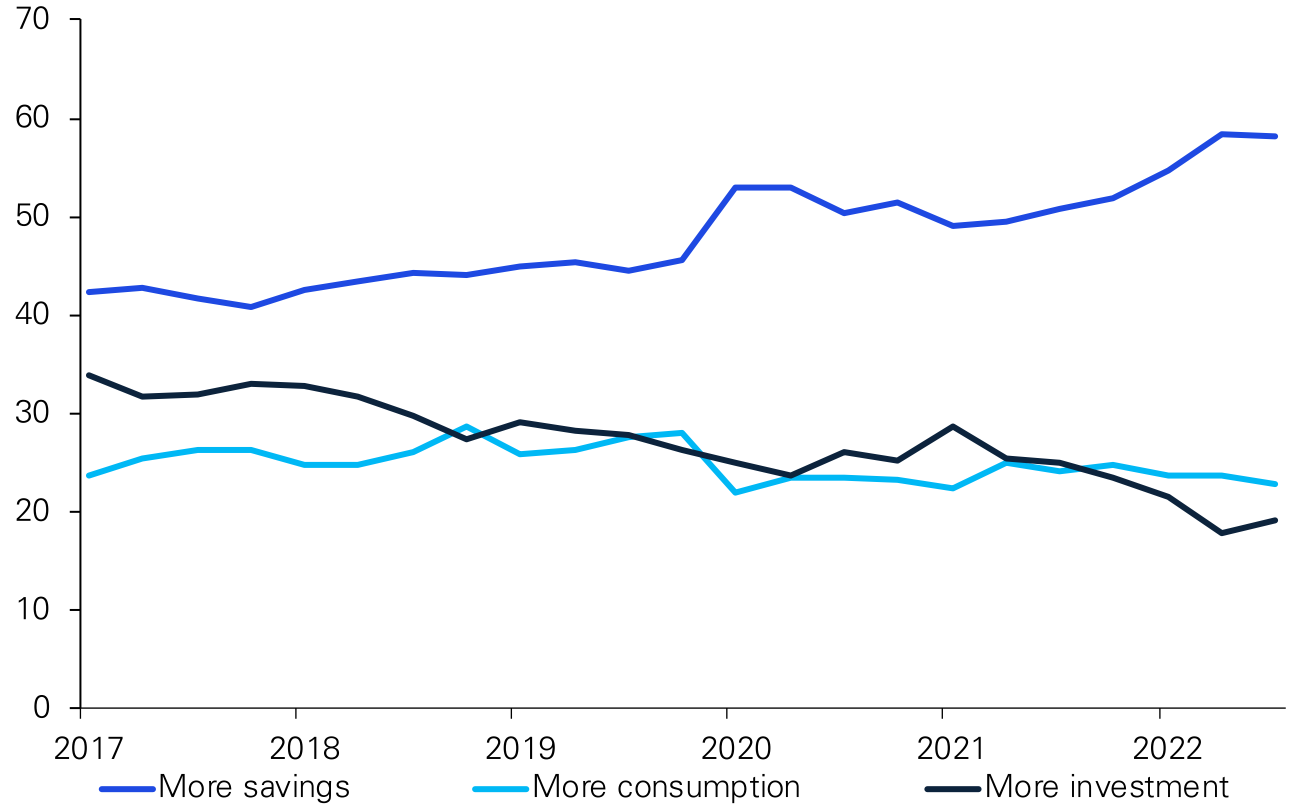


Source: Wind, KPMG analysis

- The urban surveyed unemployment rate declined to 5.3% in August from 6.1% in April, but it grew again in September driven by a rise in the unemployment rate for migrant workers. The unemployment rate of people aged 25–59 stood at 4.7% in September, up from 4.3% in August.
- The unemployment rate of people aged 16–24 slowed down to 17.9% in September, but stayed at a relative historical high. Respective of the current conditions, labour market stability will remain a top priority for the government.

Consumers are more optimistic about income growth, but are still consuming and investing cautiously

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

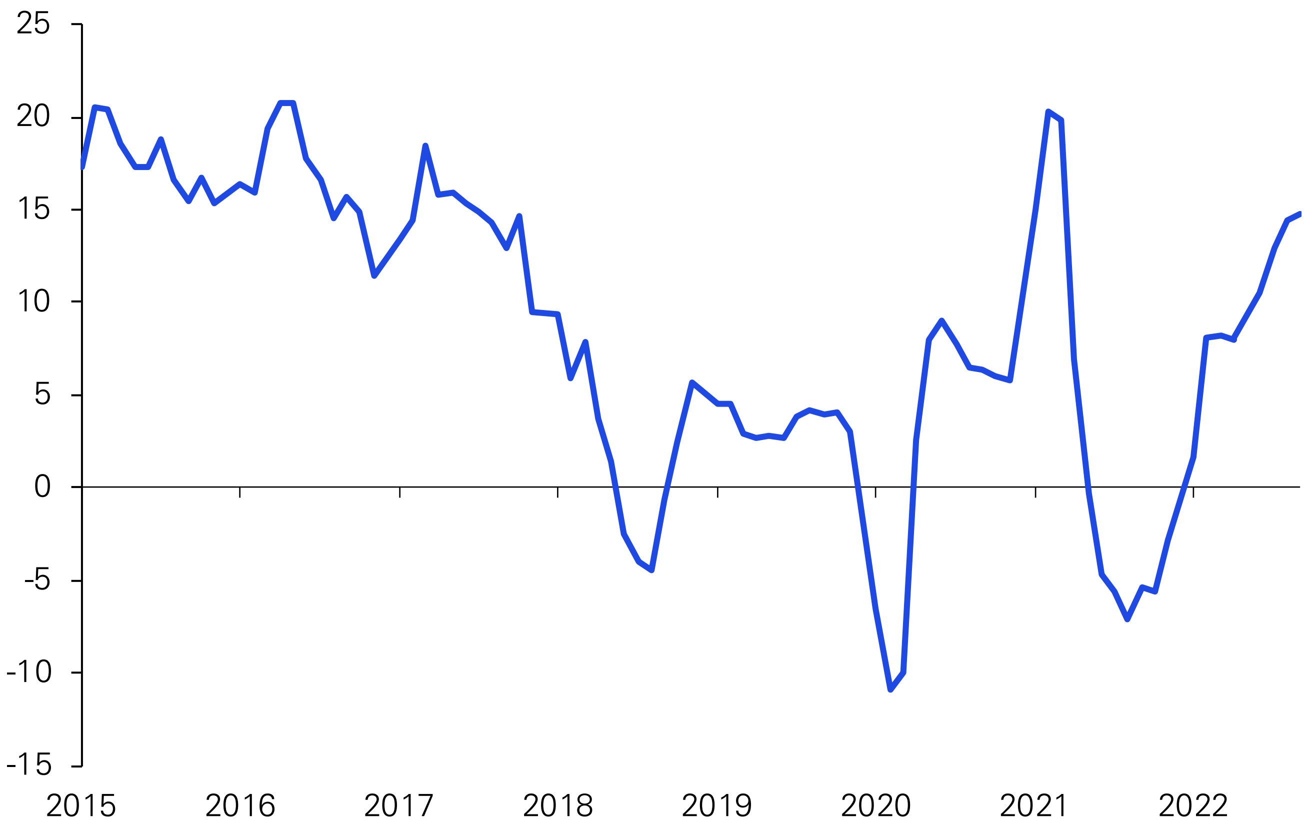


Source: The PBoC, KPMG analysis

- According to a survey by the People's Bank of China (PBoC), household sentiment for income growth returned to 47 in Q3 from 44.5 in Q2.
- Households are still cautious about consumption and investment. The share of surveyed households that are planning to increase investment remained at a relatively low level of 19.1%, while the share of those planning to increase consumption declined to 22.8%, 1 percentage point lower than that in Q2.
- We expect income sentiment to further improve in Q4 and support a gradual recovery of consumption.

Infrastructure investment has become a key driver to support economic growth

Infrastructure investment growth, yoy, 3-month moving average (3mma), %

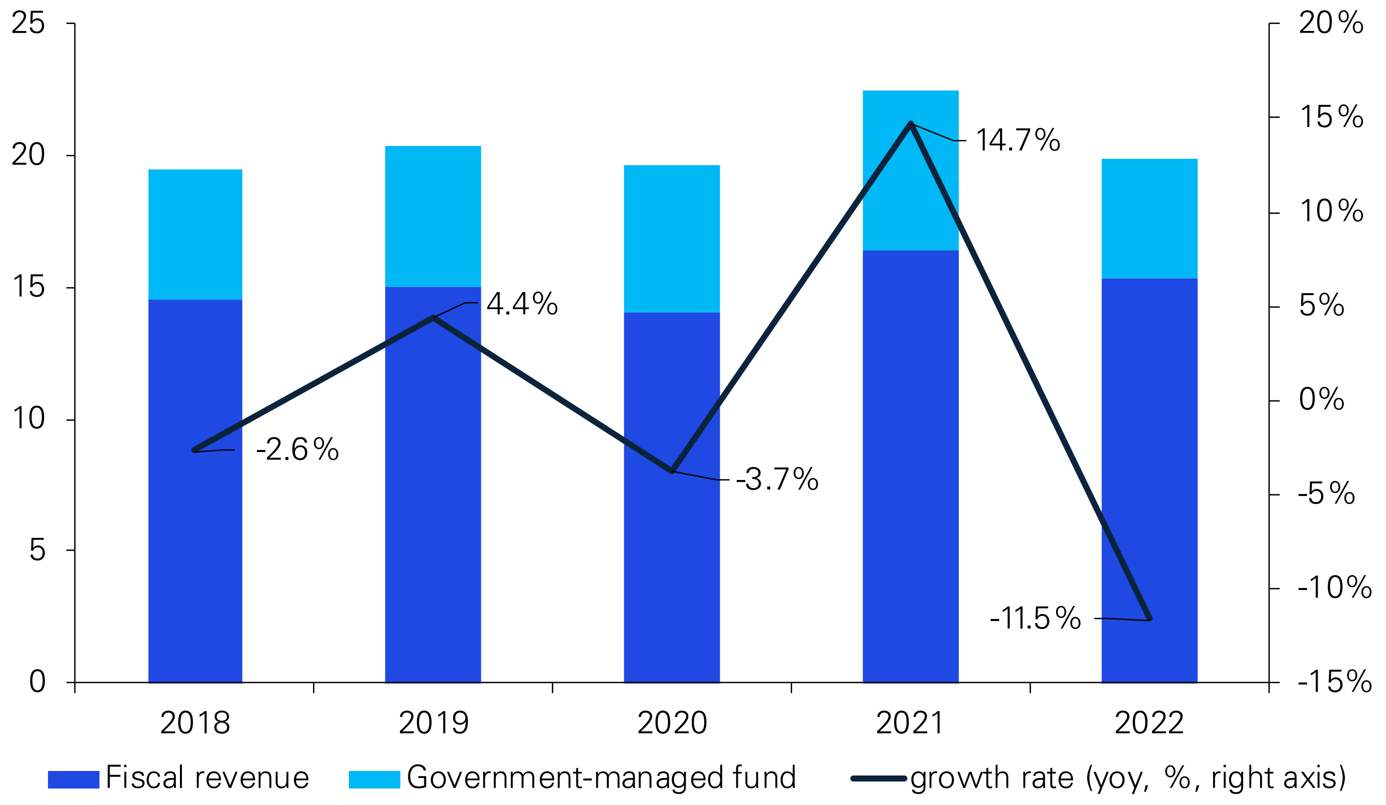


Source: Wind, KPMG analysis

- Infrastructure investment has become a key driver to support economic growth.
- The government accelerated the issuance of local government special bonds (LGSBs), a major funding source for infrastructure investment. In January to September, the government issued a total of RMB 3.54 trillion LGSBs, 97% of the annual quota. By the end of August, the government announced a new RMB 500 billion quota in LGSBs by utilising the remaining balance accumulated from previous years to support local government spending.
- Infrastructure investment rose by 14.6% in Q3. Infrastructure projects such as water conservancy, transportation and urban renovation have been accelerated. We expect infrastructure investment to remain strong in Q4.

Government revenue declined as land sales, a major income for local governments, fell nearly 30%

Jan-Sep government revenue by year, RMB billion

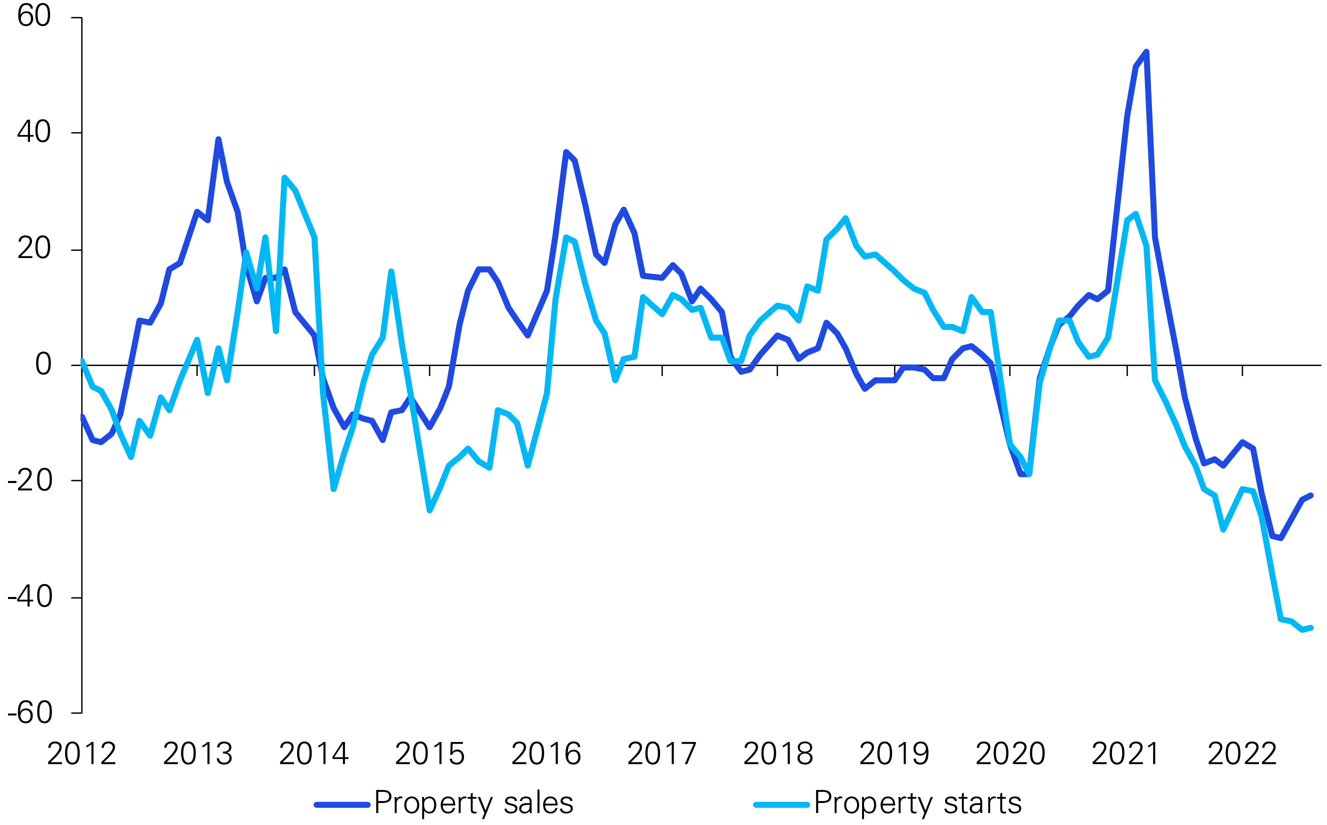


Source: Wind, KPMG analysis

- Due to a large refund of value-added taxes (totalled RMB 2.2 trillion as of end-September), fiscal revenue declined 6.6% in January to September of 2022, far below its annual target of 3.8%.
- The government-managed fund declined by 25% by the end of September. This was mainly due to the sharp drop in local governments' land sales, which fell 28.3%.
- Fiscal revenue and government-managed fund are the two major income sources for the government. The combined revenue dropped 11.5% as of end-September. Weak government revenue may limit the space of additional fiscal support that can be provided by local governments.

The housing market faces continued headwinds

Growth of property starts and new home sales, yoy, 3mma, %

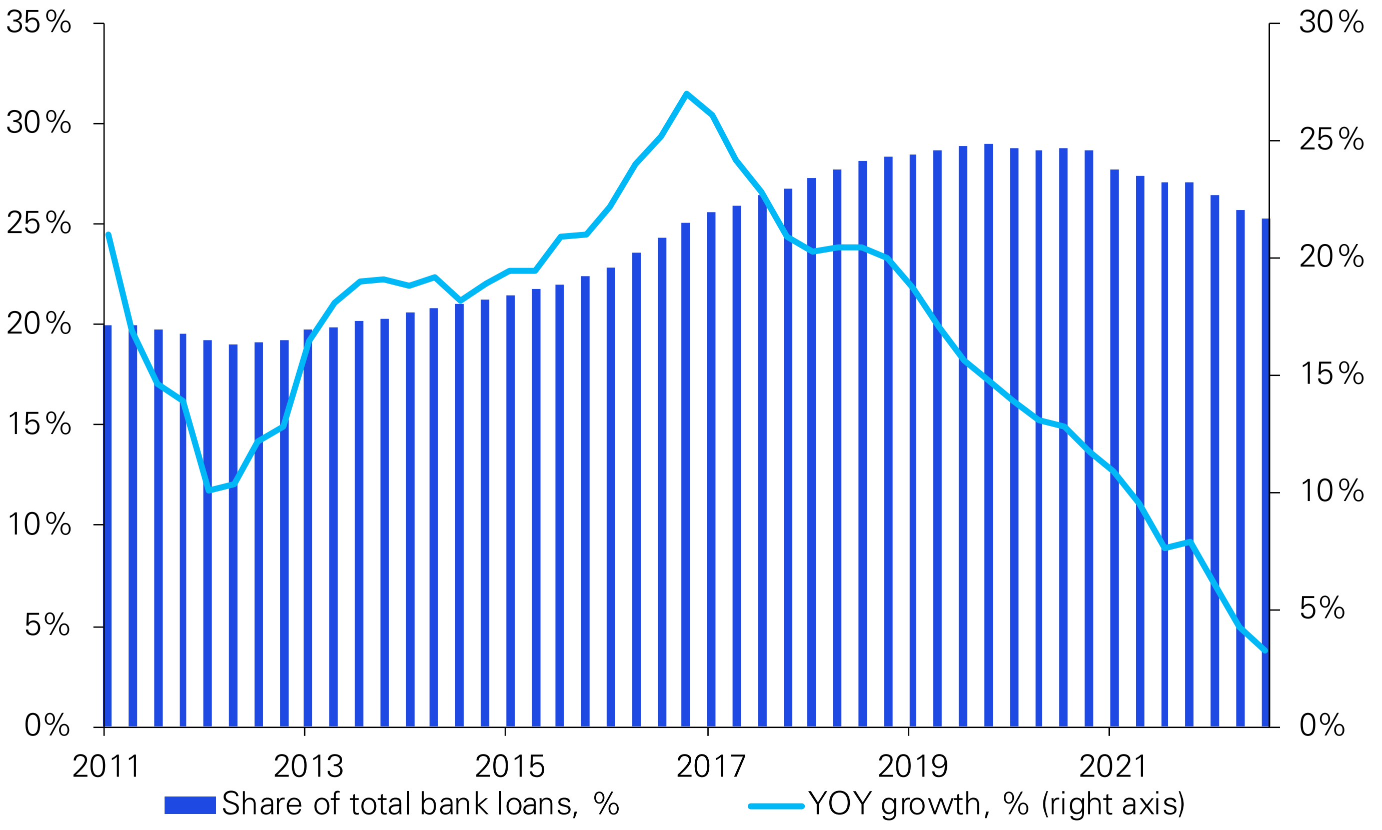


Source: Wind, KPMG analysis

- The real estate market faces continued pressures. Real estate investment fell by12.7% in Q3 from a year ago, 3.6 percentage points lower than that in Q2.
- Housing starts has continued to decline in Q3, while driven by policy supports, property sales improved slightly from -28.9% in July to -16.2% in September.
- To boost property demands, China's central bank has cut mortgage rates for homebuyers in August after the reduction in May. By the end of August, the national average mortgage rate for homebuyers fell by 1 percentage point to 4.39% as compared to the beginning of this year.

Funding constraints have been a key challenge faced by developers

Growth and share of the outstanding bank loans to the real estate sector

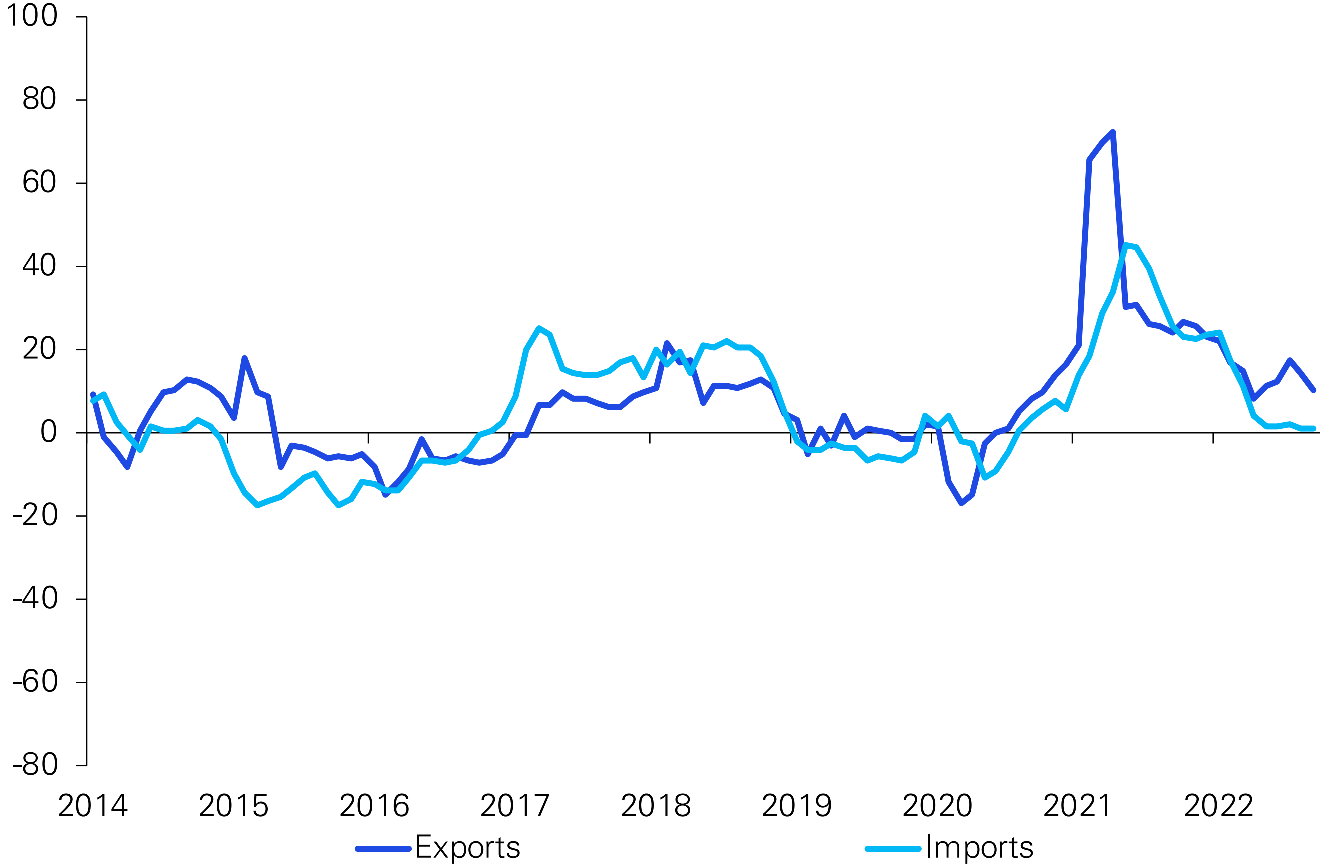


Source: Wind, KPMG analysis

- Funding constraints have been a key challenge faced by developers, especially those with high leverage ratios.
- By the end of September 2022, the growth rate of real estate outstanding loans in financial institutions has dropped to 3.2%, and the share of total outstanding loans declined to 25.3%, the lowest figure since 2017.
- The government has taken actions to stabilise the market. The PBoC and CBIRC jointly issued a package of 16 measures to bolster financing of the property sector. We expect the property market to remain weak in the near term but will gradually stabilise in the coming year.

Export growth is moderating with global demand weakening

Growth of exports and imports, yoy, 3mma, %

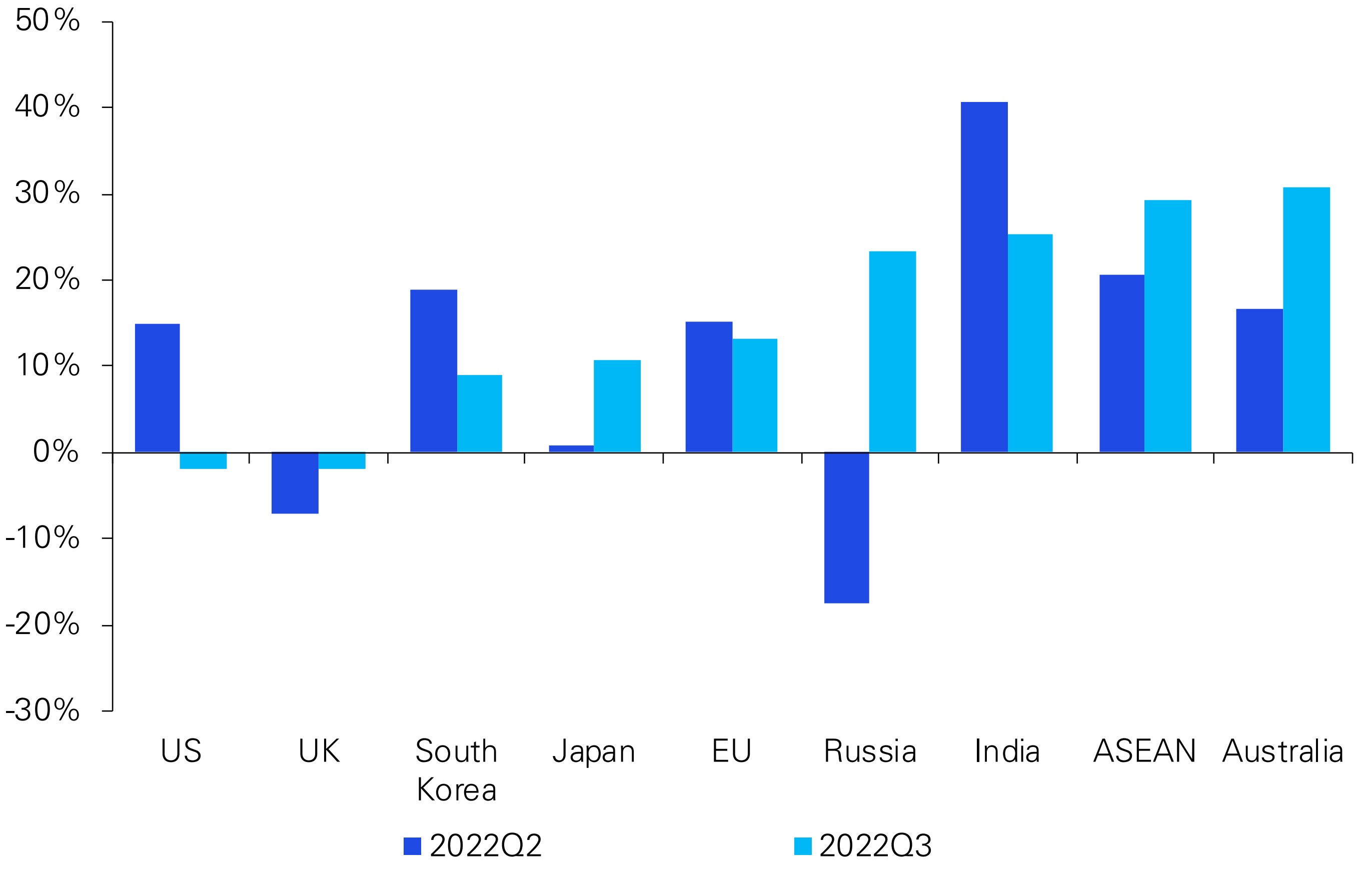


Source: Wind, KPMG analysis

- Export growth in USD terms moderated to 5.7% in September from 7.1% in August, while import growth remained weak and unchanged from August at 0.3%.
- As the risks of global economic recession rise, considerably weighing on global demand. China's exports may face greater downward pressure.

RCEP deepens Sino-ASEAN trade relations

China's export to major economies, yoy, %

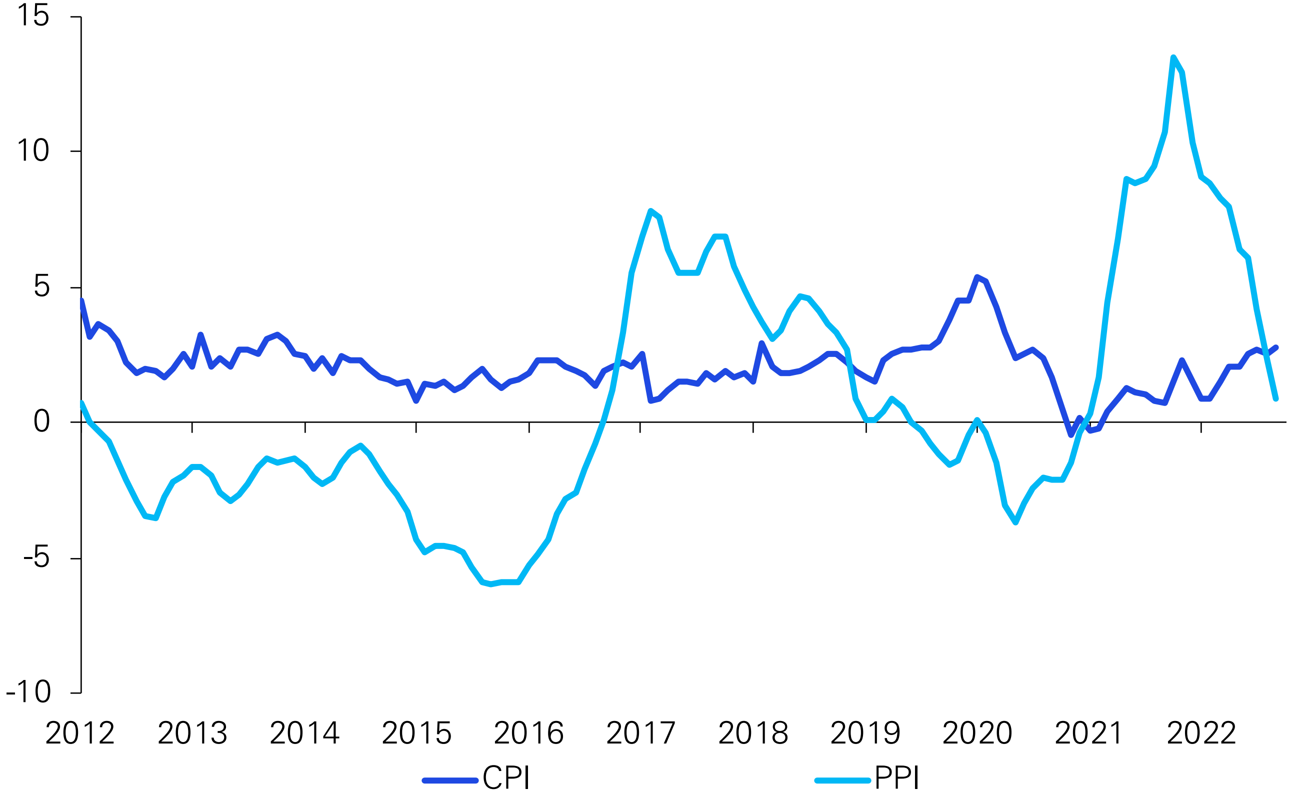


Source: Wind, KPMG analysis

- With demand retreating amid recession risks, China's exports to the US and UK declined in Q3.
- However, as the Regional Comprehensive Economic Partnership (RCEP) has taken effect since the beginning this year, Sino-ASEAN trade relations has continued to deepen. China's exports to ASEAN countries maintained a high growth rate in Q3, becoming a major contribution to China exports.
- Meanwhile, China's exports to Australia and Japan grew faster in Q3.

China's producer price index continued to retreat

China consumer price index(CPI) and producer price index (PPI), yoy, %

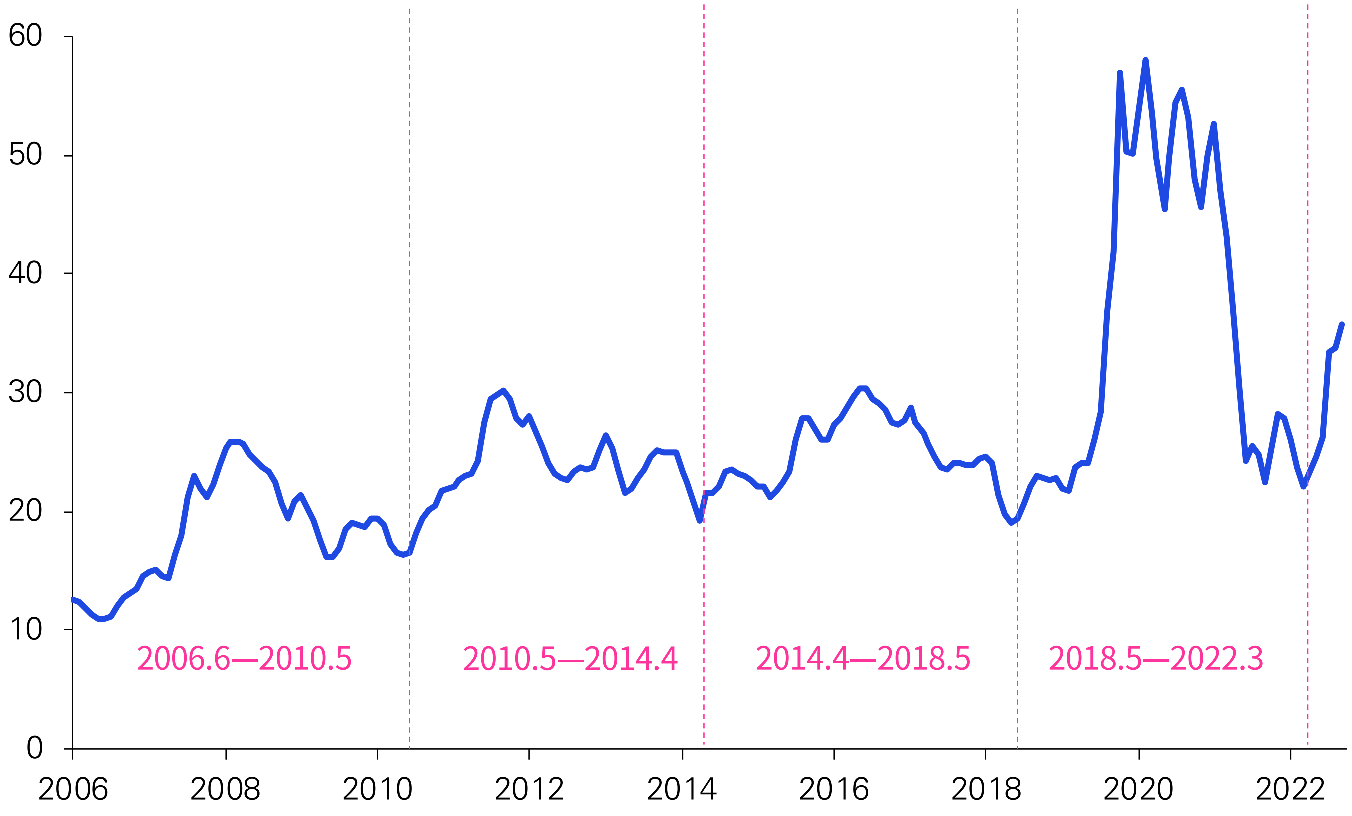


Source: Wind, KPMG analysis

- China's CPI inflation increased to 2.8% in September from 2.5% in August, largely driven by surging pork prices. However, core CPI except food and energy dropped to 0.6% from 0.8% in August due to the weaker overall economy.
- China's PPI inflation fell to 0.9% in September from 2.3% in August. The divergence in PPI between China and western economies suggests China will likely retain a competitive advantage in manufacturing exports.

Pork prices will likely enter a new cycle and face some upward pressure

Pork prices, RMB/kg

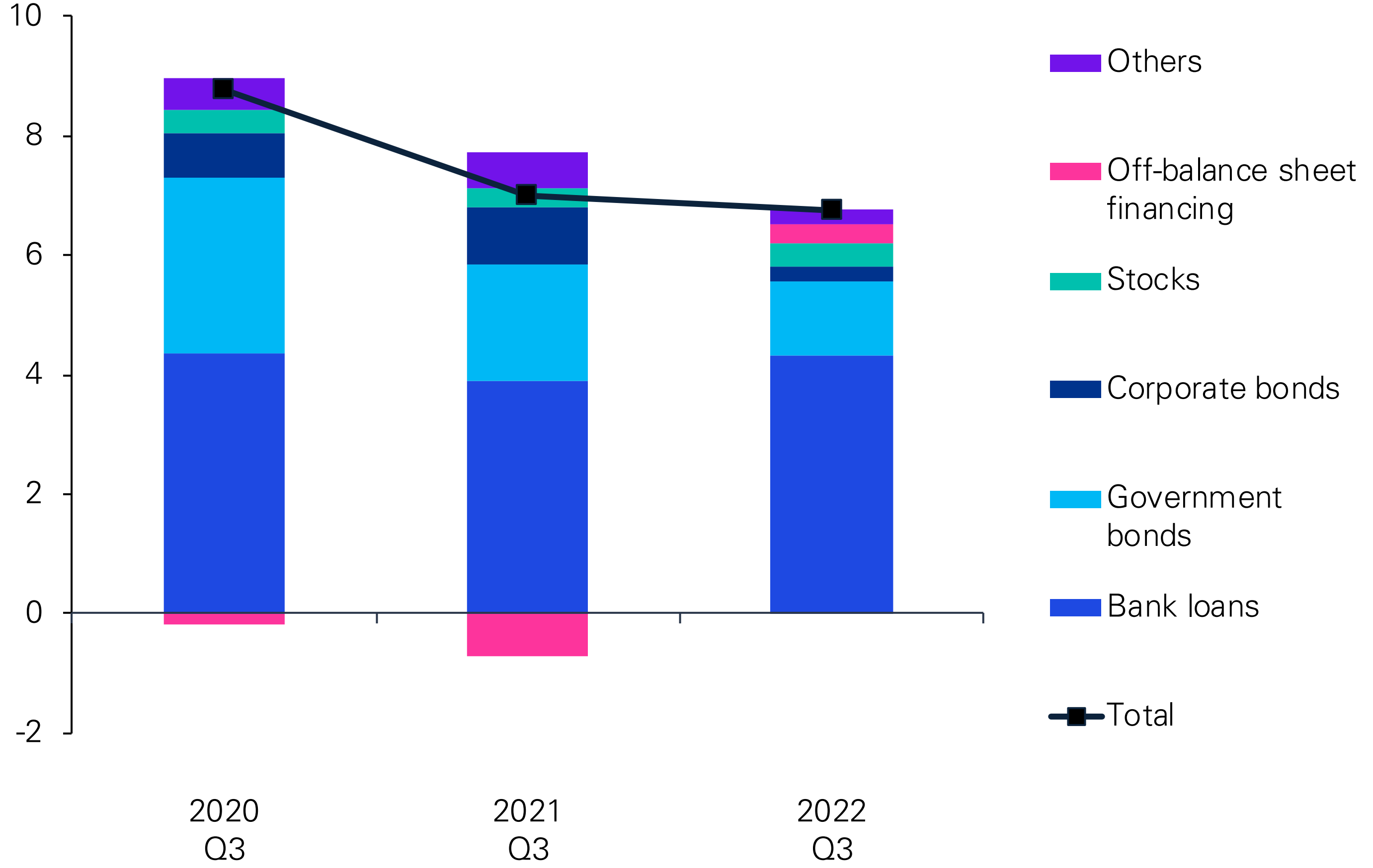


Source: Wind, KPMG analysis

- Pork prices have been rising since April this year. Prices rose to 35.8 yuan/kg at the end of September, an increase of 53.4%, which triggered discussion of a new 'hog cycle'.
- To mitigate pork price increase, the government has released seventh batch of state reserves since September in order to meet the rising Winter demand.
- As domestic pork production capacity returns to normal levels and government continues to accelerate the release of reserves, price increases will likely be more limited for the near future.

Medium- and long-term loans to infrastructure and manufacturing supports total social financing (TSF)

New TSF by sector, RMB trillion

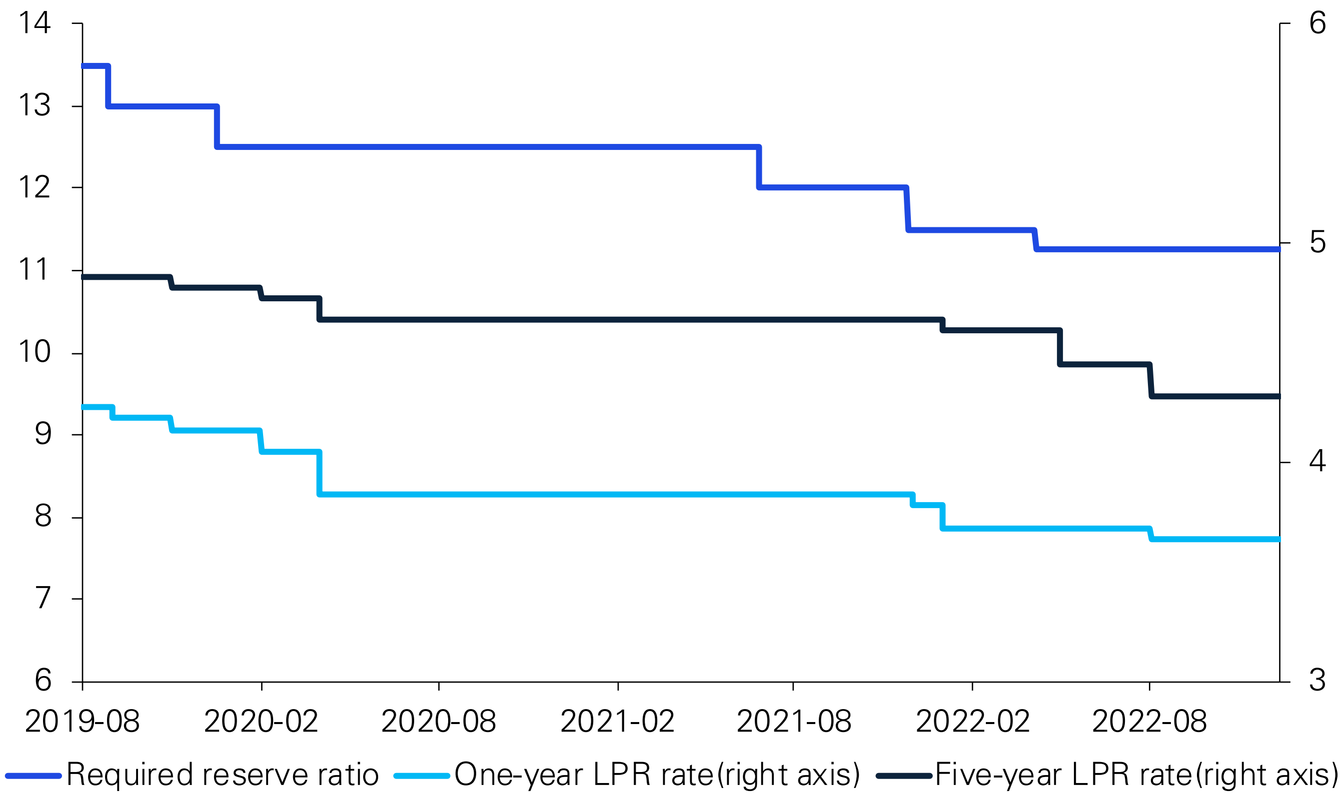


Source: Wind, KPMG analysis

- New TSF, a measure of the total liquidity provided by the financial sector to the real economy, increased by RMB 6.8 trillion in Q3, RMB 0.2 trillion lower than the same period of last year, and RMB 2.0 trillion lower than 2020.
- With the special bonds issuance quota mostly filled in H1 2022, government bonds issuance declined significantly in Q3. Corporate bonds were more constrained by tightened regulatory policies.
- However, new bank loans totalled RMB 4.3 trillion in Q3, an increase of RMB 429 billion from the same period of last year. New medium-to-long term corporate loans were the major contributor, as regulators urged banks to step up long-term lending to sectors such as infrastructure and manufacturing.

China's central bank maintained an accommodative monetary stance to support growth

Required reserve ratio (RRR) and loan prime rate (LPR), %

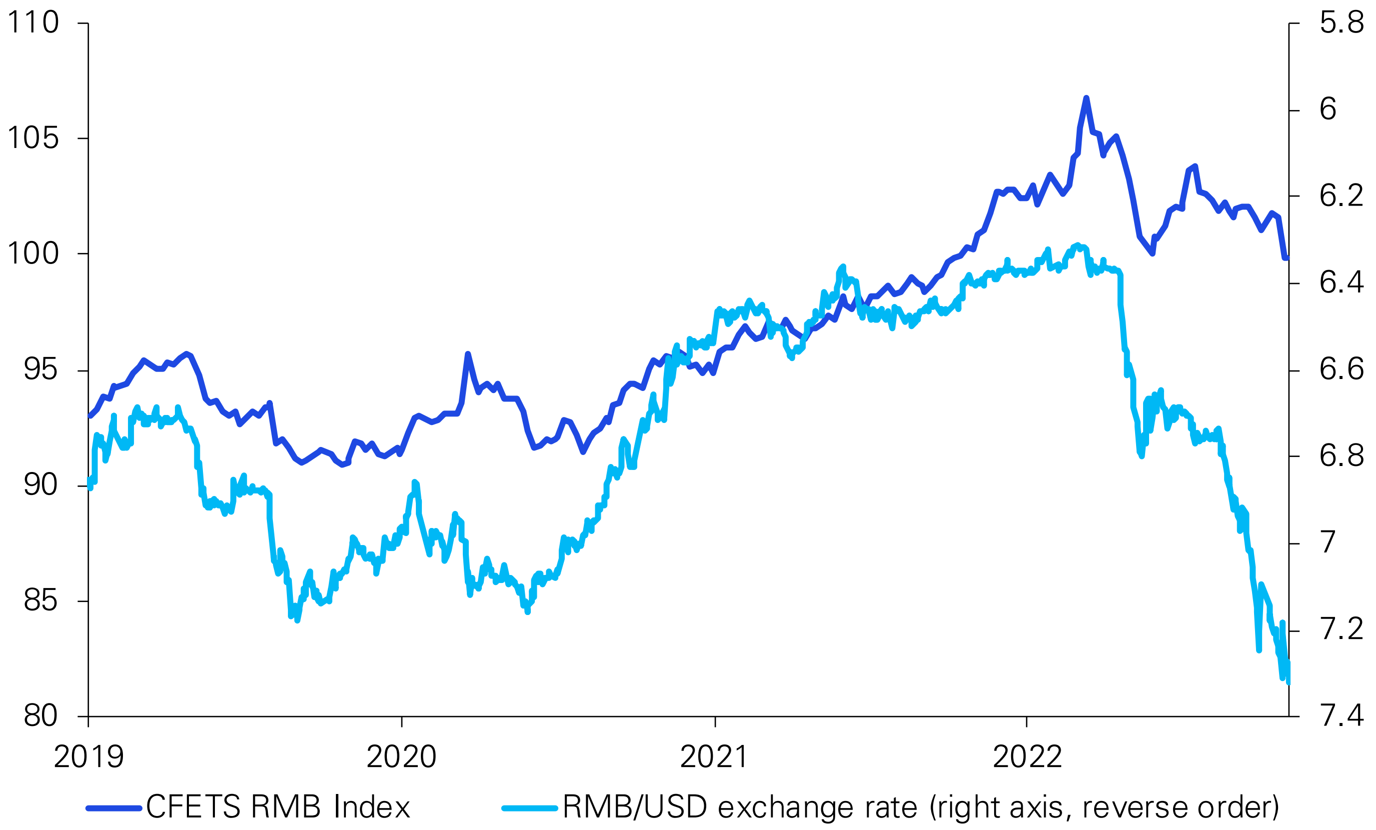


Source: Wind, KPMG analysis.

- Although many central banks around the world have raised interest rates to control inflation, China adopted an easing stance to support economic growth.
- The PBoC trimmed its policy rates again in August, including one medium-term lending facility rate (MLF) cut, the one-year loan prime rate (LPR) and five-year LPR were slashed as well.
- The central bank has also increased its direct credit support to SMEs, green investment, tech and elderly care via channels such as special relending facilities.

The RMB exchange fell against the USD but remained largely resilient against the currency basket

China Foreign Exchange Trade System (CFETS)'s RMB index and RMB/USD exchange rate

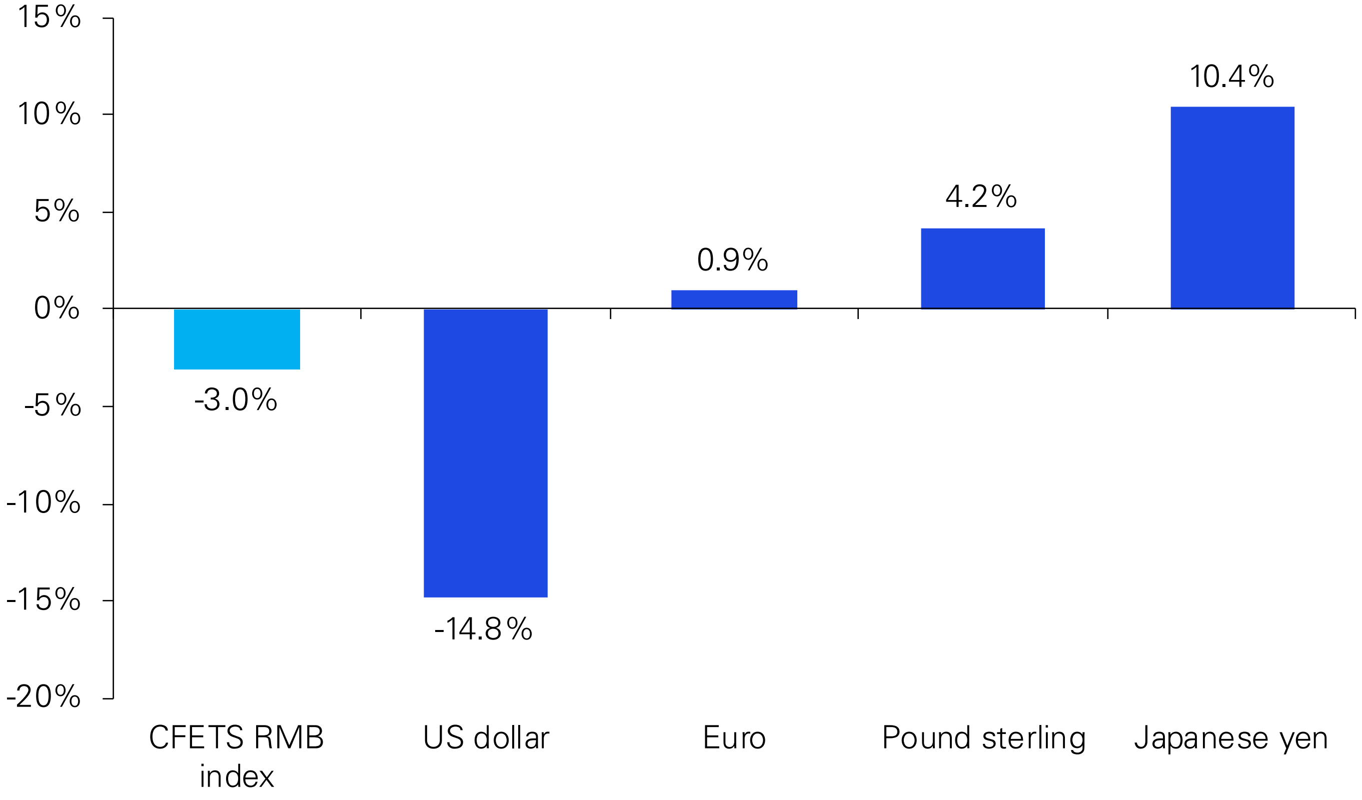


Source: Wind, KPMG analysis

- As the US Federal Reserve accelerated its monetary tightening by raising interest rates and reducing its balance sheet, the USD index has strengthened by 14.9% since late March. While the RMB dropped to 7.32 against USD early November, and has depreciated by 14.7% since the beginning of 2022.
- To stabilise the exchange rate market, the PBoC cut the foreign-exchange reserve requirement ratio and increased foreign exchange risk reserves for purchasing currencies through forward contracts in September.
- Looking ahead, China's expected economic recovery and robust trade surplus should provide support to the RMB exchange rate.

The RMB appreciated against other major currencies outside the USD

The exchange rate of RMB against major currencies in CFETS, %

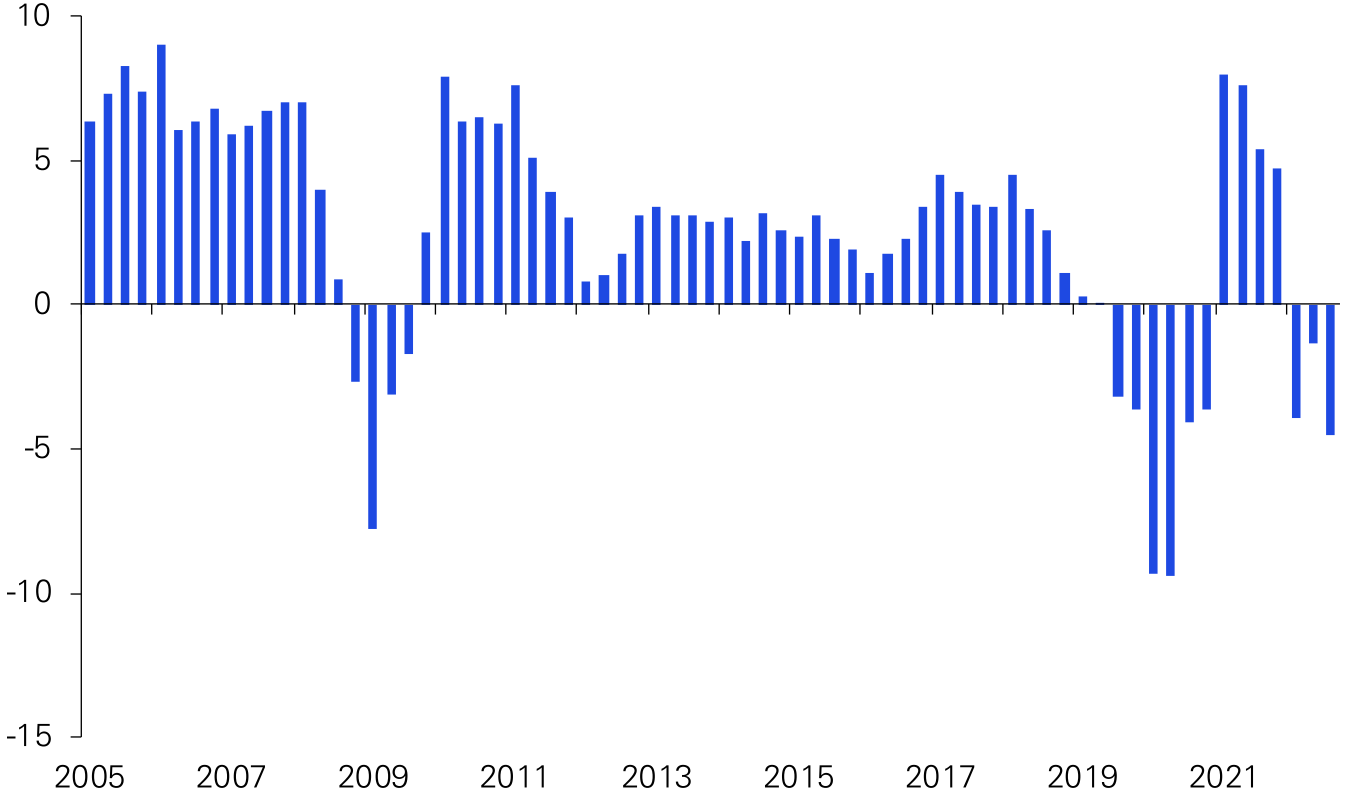


Source: Wind, KPMG analysis

- Although the RMB against the USD has depreciated significantly, the RMB's exchange rate against the basket of major currencies, as measured by CFETS RMB index, has remained relatively stable.
- From 4 January to 3 November 2022, the RMB appreciated by 10.4%, 4.2% and 0.9% against the Japanese yen, the pound and the euro, respectively.

Hong Kong's economy continued to decline on export weakness and rate hikes

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

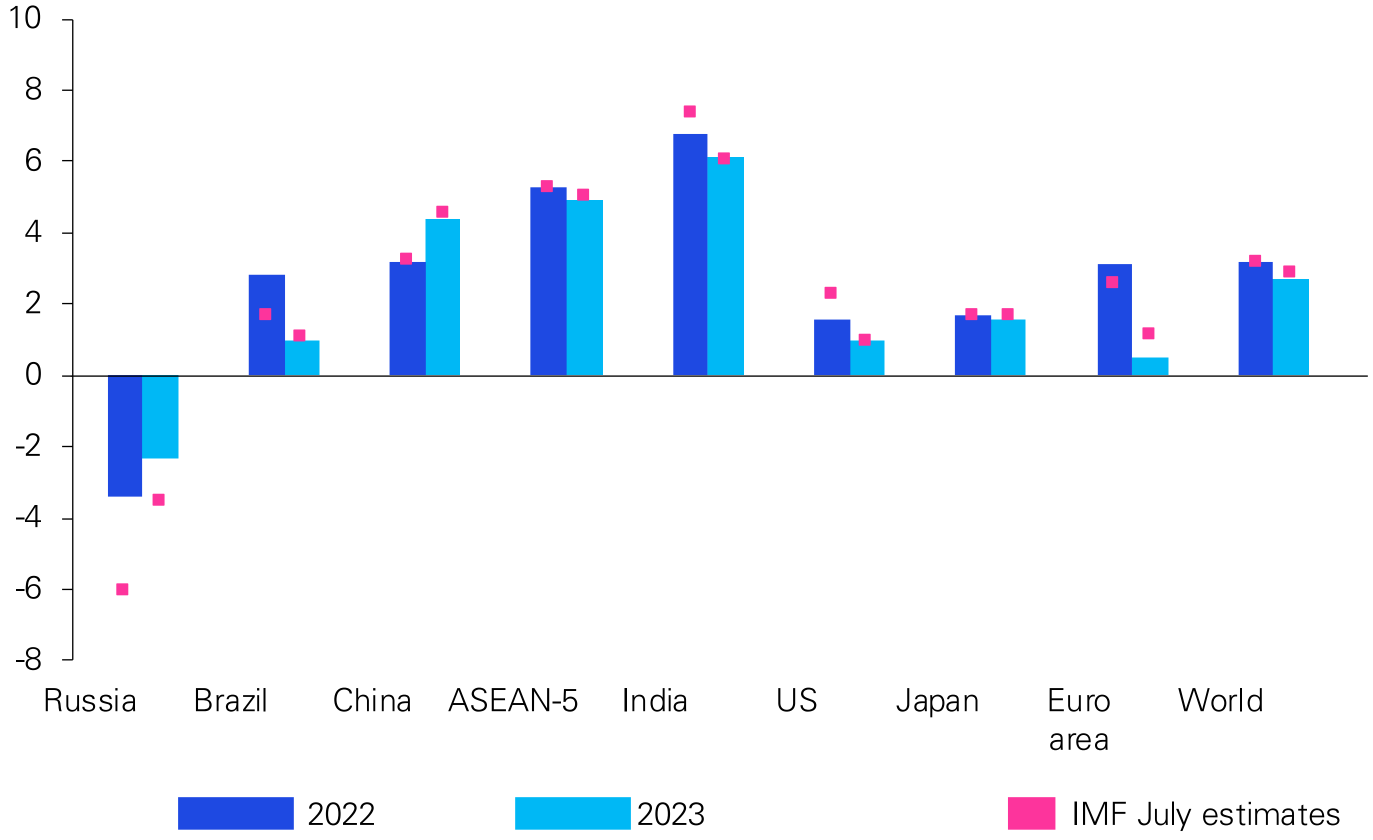


Source: Wind, KPMG analysis

- Hong Kong (SAR)'s economic decline widened in Q3, falling 4.5% in Q3 after decline 1.3% in Q2.
- The decline of GDP was mainly attributable to weak performance in exports. Total goods exports declined 9.1% in September, after falling 14.3% in August. Exports to the Chinese Mainland saw a sharp decline, while exports to US and European Union also fell.
- Improved labour market conditions and government measures continue to support local consumption, while tightened financial conditions partly offset the positive effects. The Hong Kong Monetary Authority has raised interest rates six times following the US Federal Reserve hikes since March 2022.
- Looking ahead, interest rate hikes and the potential for a global economic slowdown may continue to weigh on Hong Kong's economic recovery.

Global growth momentum is expected to slow in 2023

Real GDP growth and forecast, %



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

- The IMF predicted 2022 global economic growth to be 3.2%, and lowered its forecast on 2023 global economic growth to 2.7%, down 0.2 percentage points from its previous July update. It also revised its global inflation forecast to 8.8% in 2022, up 0.5 percentage points from its July update. The IMF forecast for 2023 inflation is 6.5%. Given these estimates, it is apparent that the cost-of-living crisis has become acutely challenging.
- Driven by geopolitical tensions, broadened inflation pressures, and monetary tightening in many economies, The global economy continues to face strong headwinds. It is estimated that one-third of the world's economies will experience, at least, two consecutive quarters of contraction in 2022 and 2023.

Contact us

Michael Jiang
Head of Clients and Markets
KPMG China
+86 (10) 85087077
michael.jiang@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

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

Research Team: Yuan Zeng, CFA; Yanan Zheng
Design: Zheng Zhu

kpmg.com/cn/socialmedia

Publication date: November 2022