China Economic Monitor

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Key takeaways

- China's GDP grew 3.0% in 2022, below the 5.5% growth target set by the government last March. Q4 GDP grew 2.9% year-over-year (yoy), higher than market expectation. Headwinds such as the highly transmissible Omicron variant of COVID-19, slowdown of the real estate market, rapid interest rate hikes by the US Fed, and geopolitical uncertainty weighed on the Chinese economy last year. Meanwhile, despite slower economic growth, the size of China's GDP reached RMB 121 trillion (USD 18 trillion), showcasing China's underlying strengths as a large domestic market.
- When China reversed its zero-COVID policy in early December 2022, the country saw a rapid wave of infections in subsequent weeks. However, the earlier than expected re-opening has also accelerated the country's economic recovery. Using road traffic congestion as an indicator of the pace of the recovery, we estimated, as of mid February 2023, two thirds of the major cities have seen activity rebounded to levels higher than the same period before the pandemic.
- In contrast to many advanced economies, recovery of consumption in China has lagged compared to industrial production and exports. However, we expect consumption to become a key driver for China's growth this year. Consumer spending, especially for services and discretionary, is expected to see a stronger rebound. As an example, holiday spending during the Chinese New Year saw a solid recovery.
- Investment growth last year was primarily driven by manufacturing and infrastructure, up 9.1% and 11.5%, respectively. Looking ahead, we expect investment related to high-end manufacturing and equipment upgrading will continue to see robust growth. Infrastructure investment is expected to remain stable, but fiscal pressure may constrain growth of local government spending.
- The property market saw significant headwinds last year, with real estate investment down 10%, the first annual decline in the data's history. The government has continuously stepped up support measures since 2H 2022. We expect the property market to stabilise this year.
- Growth of exports is slowing due to weakening global demand, which is expected to weigh on the economy this year. Meanwhile, China's export structure is changing. It exported over 3 million vehicles last year and became the world's second largest auto exporter. The trend is expected to continue moving forward.
- Overall, we expect China's economy to grow 5.7% this year. Following the removal of COVID-related restrictions, China is re-focusing on economic growth. The private sector and foreign investments are important contributors to China's innovation, employment, and global competitiveness. We expect the government to increase policy support to boost confidence of private enterprises and MNCs.

China's economic growth slowed last year due to the continued effects of the pandemic

Growth rate of major economic indicators, %

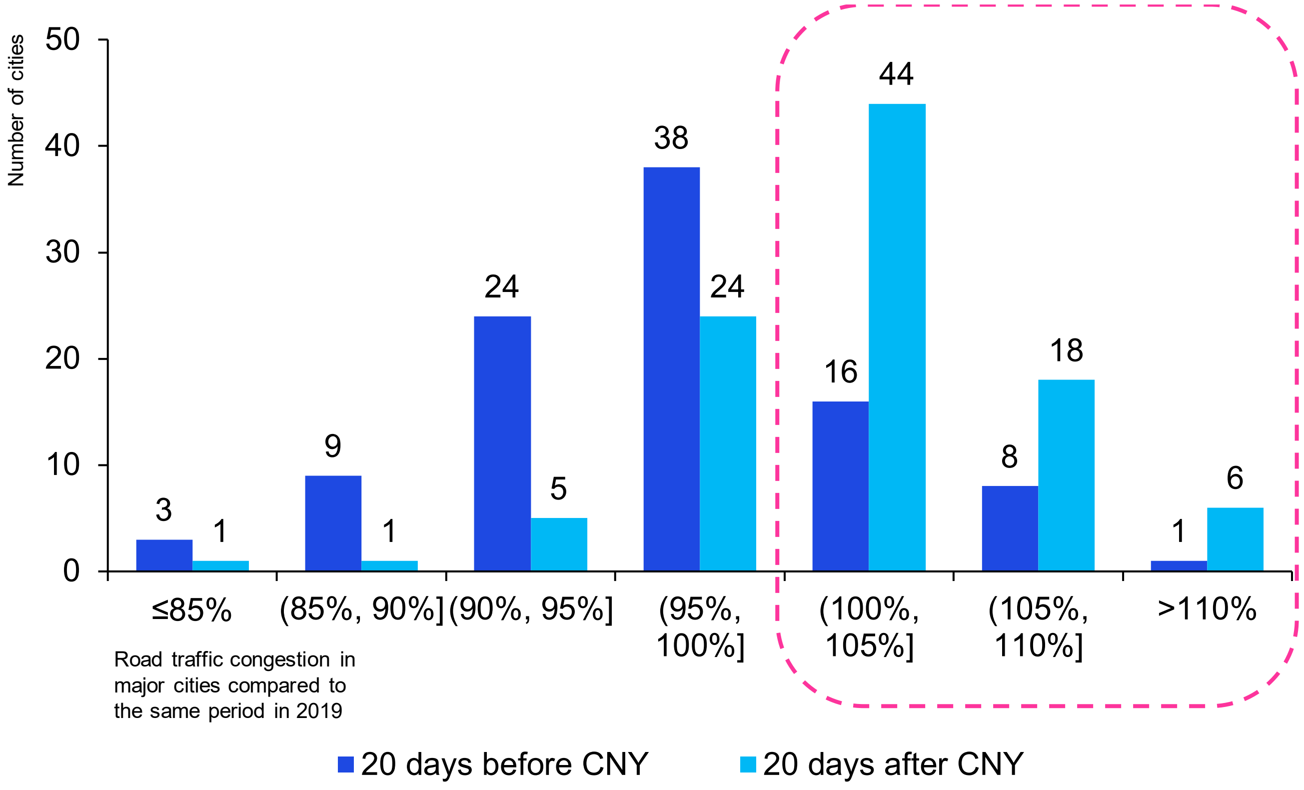
	2017-19 Average	2020	2021	2022
GDP	6.6%	2.2%	8.4%	3.0%
Industrial production	6.2%	2.8%	9.6%	3.6%
Retail sales	9.0%	-3.9%	12.5%	-0.2%
Fixed asset investment	6.2%	2.9%	4.9%	5.1%
Exports	6.1%	3.6%	29.6%	7.0%
Imports	9.8%	-0.6%	30.1%	1.1%
Income per capita	6.5%	2.1%	8.1%	2.9%
Fiscal revenue	5.8%	-3.9%	10.7%	0.6%
Fiscal spending	8.2%	2.8%	0.3%	6.1%

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

- China's GDP grew 3.0% year-over-year (yoy) in 2022. Q4 GDP grew 2.9%, 1 percentage point lower than in Q3 but better than market expectations.
- Investments in high-tech manufacturing and infrastructure rebounded due to policy support. Due to the COVID-19 pandemic and China's strict quarantine measures, consumption had remained weak in 2022, especially in services and discretionary spending.
- Export growth slowed to 7.0% but was still an important driver to overall growth last year.

China's removal of COVID-related restrictions should accelerate its economic recovery

Road traffic congestion in major cities compared to the same period in 2019 in China's 99 largest cities, number of cities

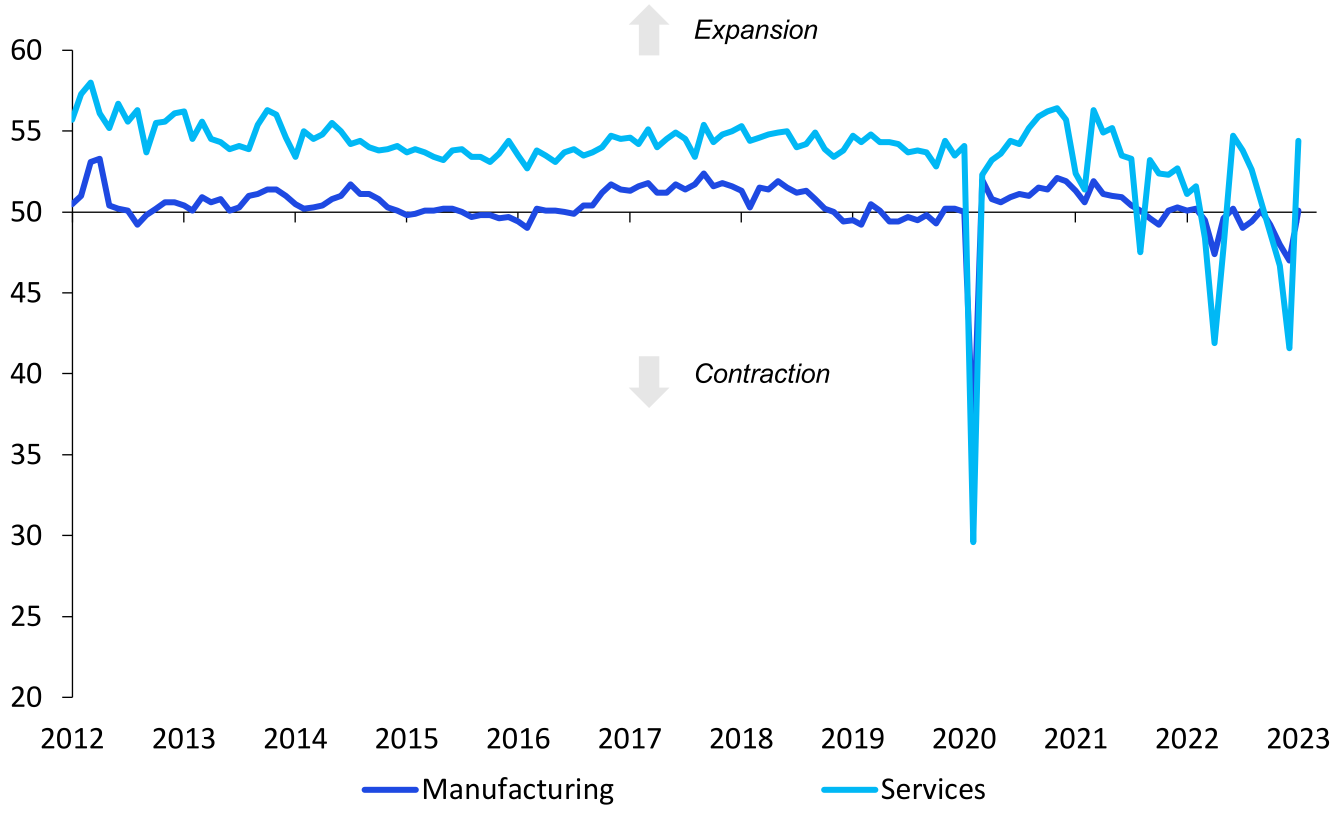


Source: Wind, Gaode, KPMG analysis

- China lifted all quarantine policies in early December 2022. After a rapid exit from the zero-Covid policy, China's economy is quickly rebounding.
- The recovery is reflected in growing road traffic. Twenty days before the Chinese New Year (CNY), 25 out of the 99 largest cities (excl. Hong Kong) saw road traffic more congested than the same period in 2019. The number jumped to 68 cities twenty days after the CNY, indicating a quick normalisation of economic activity.

Industrial production slowed in Q4 2022 but leading indicators suggest a coming rebound

Purchasing Managers' Index (PMI), index



Source: Wind, KPMG analysis

- Industrial production slowed in Q4 2022 due to rising infections and logistics disruptions. Weak property market and subdued exports also dragged down industrial output. National industrial production grew 1.3% in December 2022, the weakest growth since last May.
- The re-opening in December has accelerated China's economic recovery. Manufacturing PMI, a leading indicator of industrial production, returned to the expansionary territory in January 2023 after three months of contraction. Industrial output is expected to recover in the months ahead.
- Meanwhile, service PMI saw an even bigger rebound, jumping 12.8 percentage points in January from the depressed level in December.

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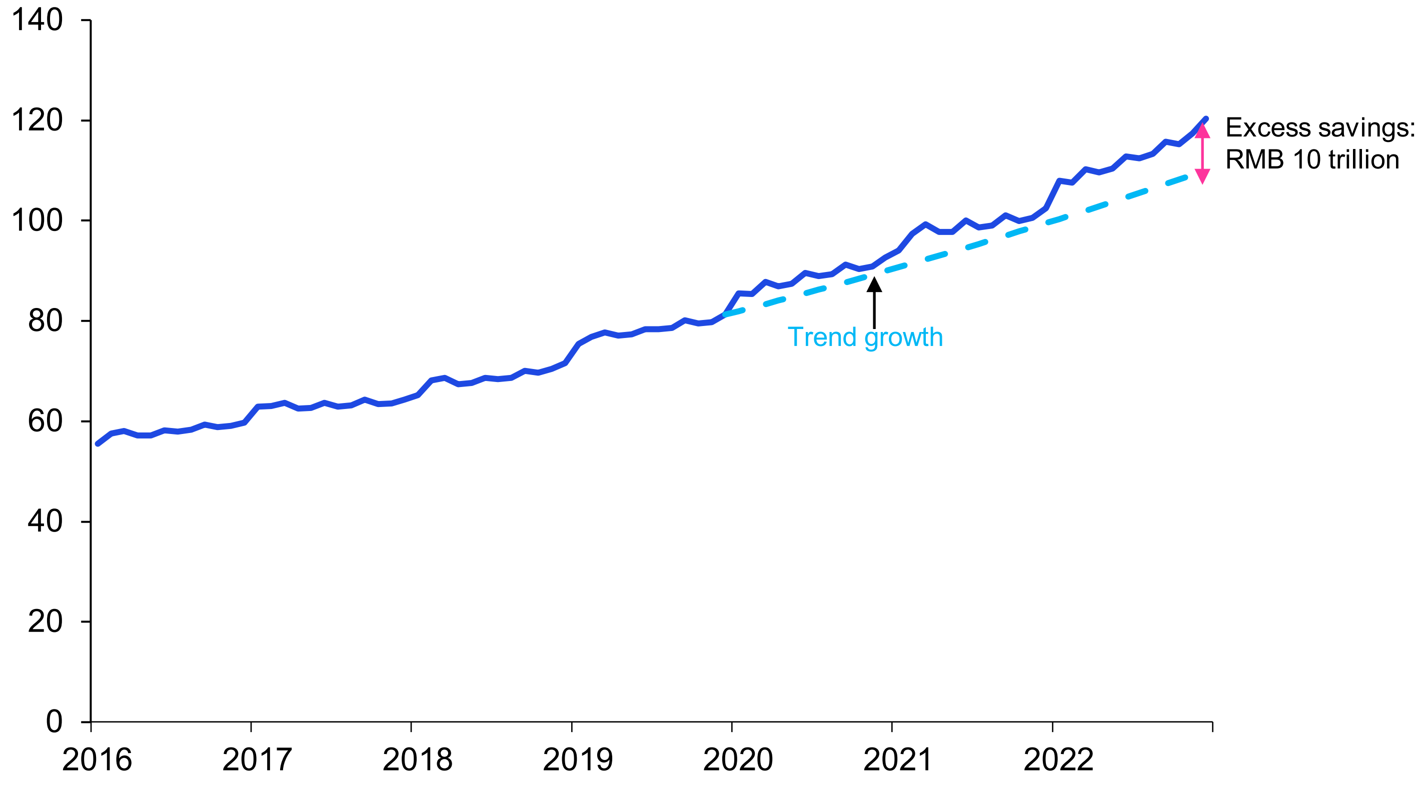
Extra household savings accumulated during the past three years should help consumption to recover after the re-opening

Household bank deposits, RMB trillion

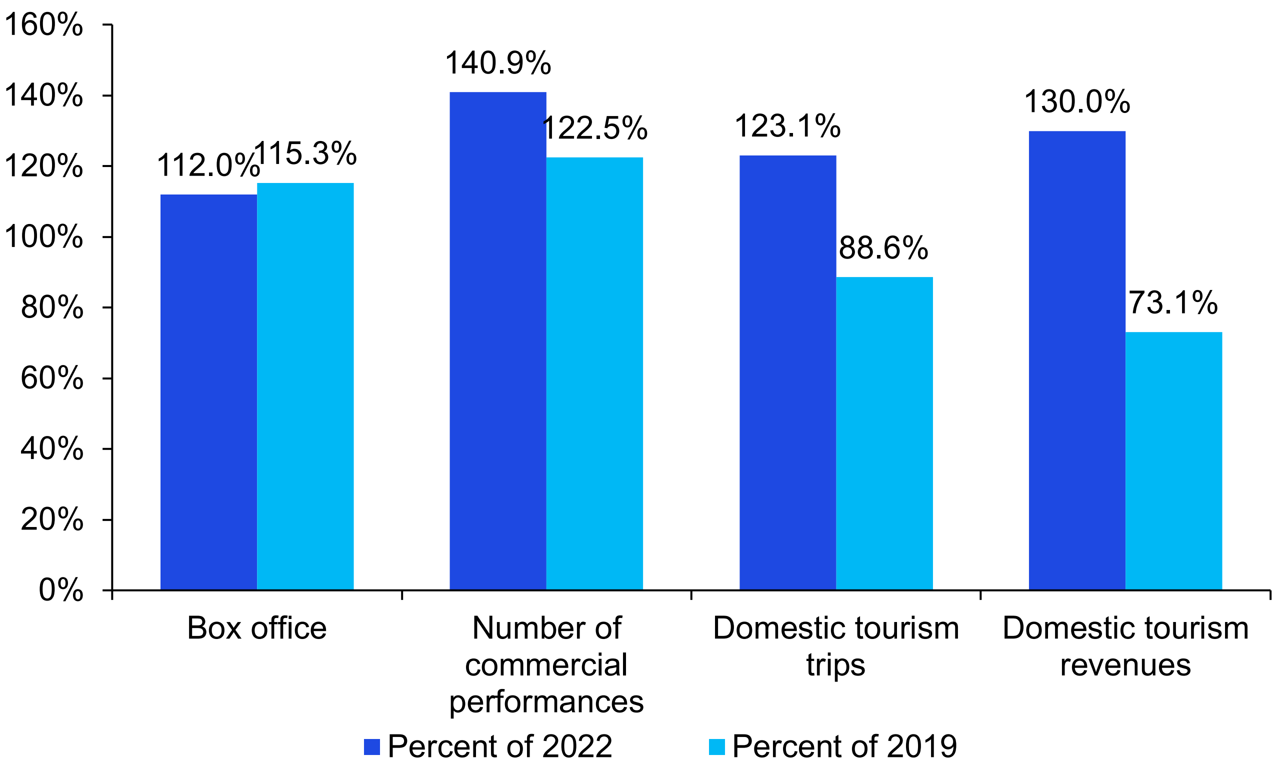


Source: Wind, KPMG analysis

- China's consumption recovery had remained weak in the past three years due to slower household income growth, quarantine measures that limited consumption venues, and increase of precautionary savings. According to a survey by the People's Bank of China (PBoC), the share of households that indicated they would increase savings reached a record high last Q4.
- As a result, the outstanding balance of household deposits jumped by RMB 10 trillion compared to the trend growth. The increase is attributed to various factors and it may take time for household confidence to improve. But if a portion of the extra savings can be released, it should help consumption to recover this year.

Holiday spending during the Chinese New Year saw a solid rebound

Consumption recovery of the 2023 Chinese New Year holiday, %

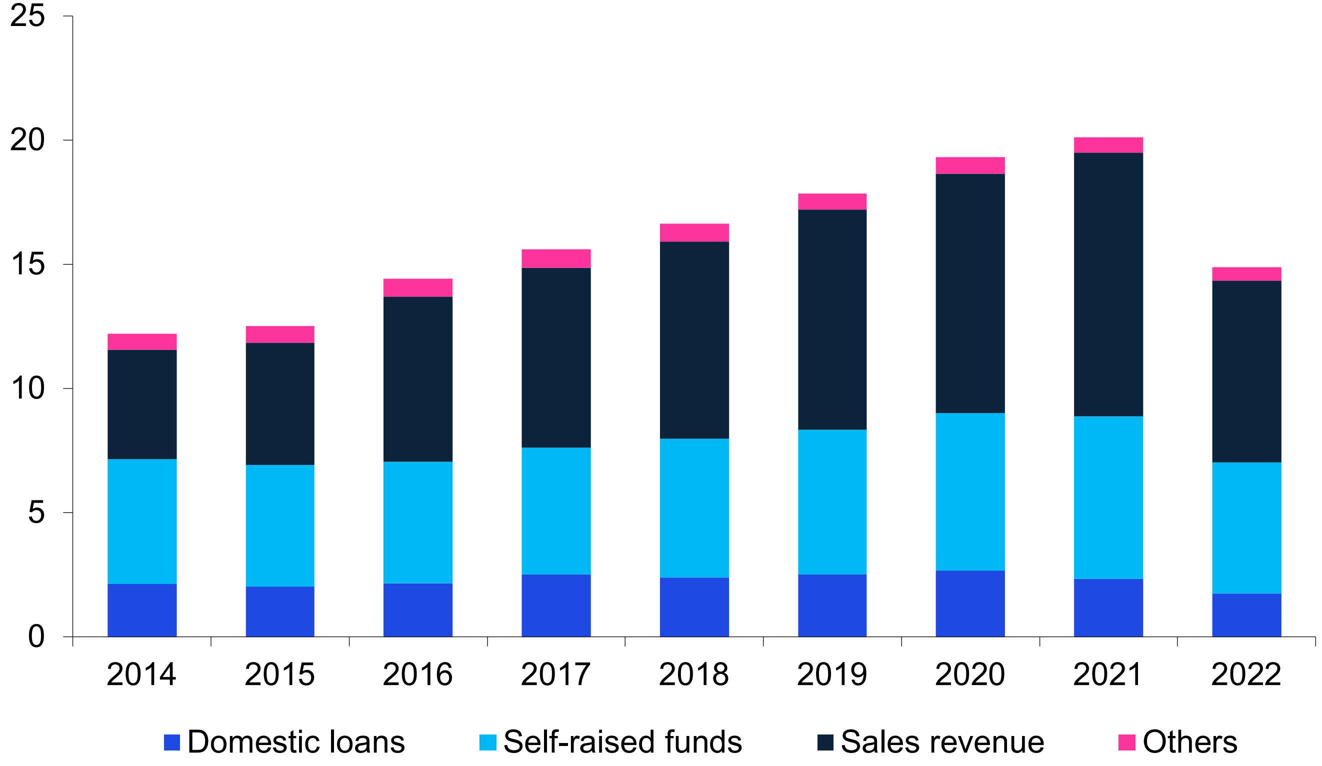


Source: Endata, Ministry of Culture and Tourism, KPMG analysis

- Consumption is expected to be a key driver for China's growth this year. Consumer spending, especially for services and discretionary, is expected to see a stronger rebound.
- Holiday spending during the Chinese New Year saw a solid recovery. Box office totalled over RMB 6.76 billion, the second highest in history. Domestic tourism trips and revenues jumped 23.1% and 30.0% yoy, respectively, recovering to 88.6% and 73.1% of their pre-pandemic levels in 2019.

Liquidity pressure has been a key challenge for property developers

Funding sources of real estate developers, RMB trillion

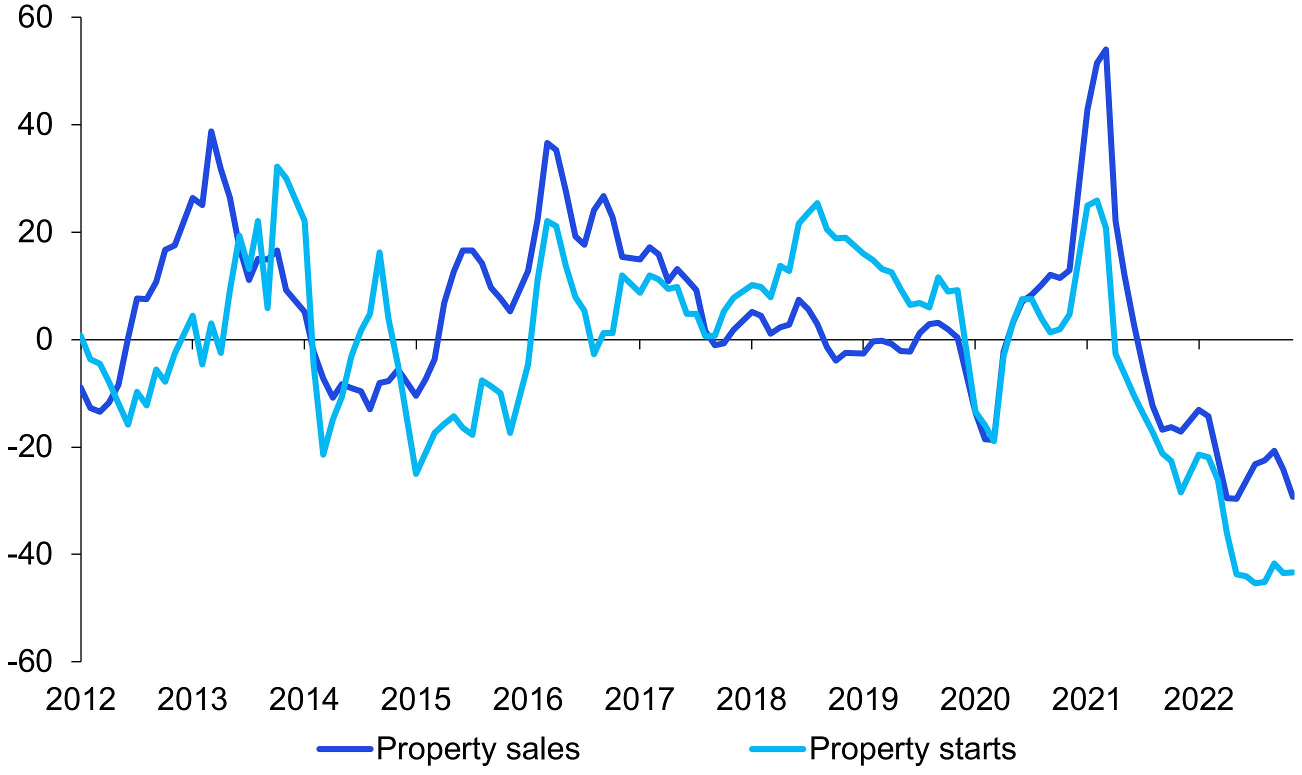


Source: Wind, KPMG analysis

- Liquidity pressure has been a key challenge faced by developers, especially for some private enterprises. Consumer confidence was weak and house sales slumped, dragging down developers' sales revenues.
- Due to stricter regulations, financial institutions also slowed down funding to real estate developers. The growth rate of outstanding loans to the real estate sector declined to 1.2% by the end of 2022, compared to an average growth rate of 20% in 2011-19.

The property market continued to weaken with new home starts and sales falling significantly

Growth of property starts and new home sales, yoy, three-month moving average, %

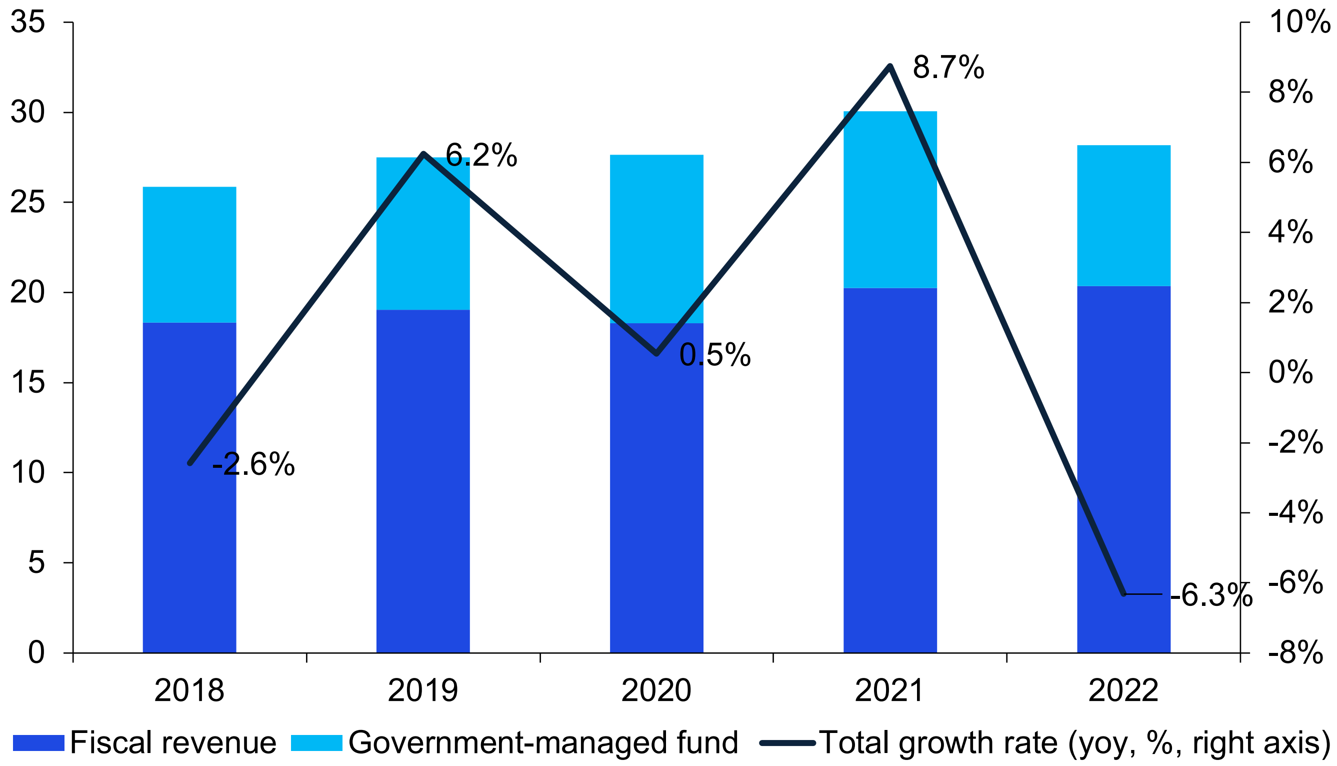


Source: Wind, KPMG analysis

- The real estate market continued to face pressures in 2022. Property starts declined to the lowest level since 2009, and new home sales reached its lowest level since 2015. Real estate investment fell by 10% year-on-year. It was the first annual decline in the data's history, dragging down overall GDP growth by 1.7 percentage points.
- The real estate market plays an important role in the Chinese economy. China has implemented many supportive measures for the property market since 2H 2022. In January 2023, the government scrapped the minimum mortgage rate for first-time homebuyers in cities where housing prices have fallen three months in a row. We expect the property market to stabilise this year.

Government revenue declined as land sales, a major income for local governments, fell sharply in 2022

Government revenues, RMB billion

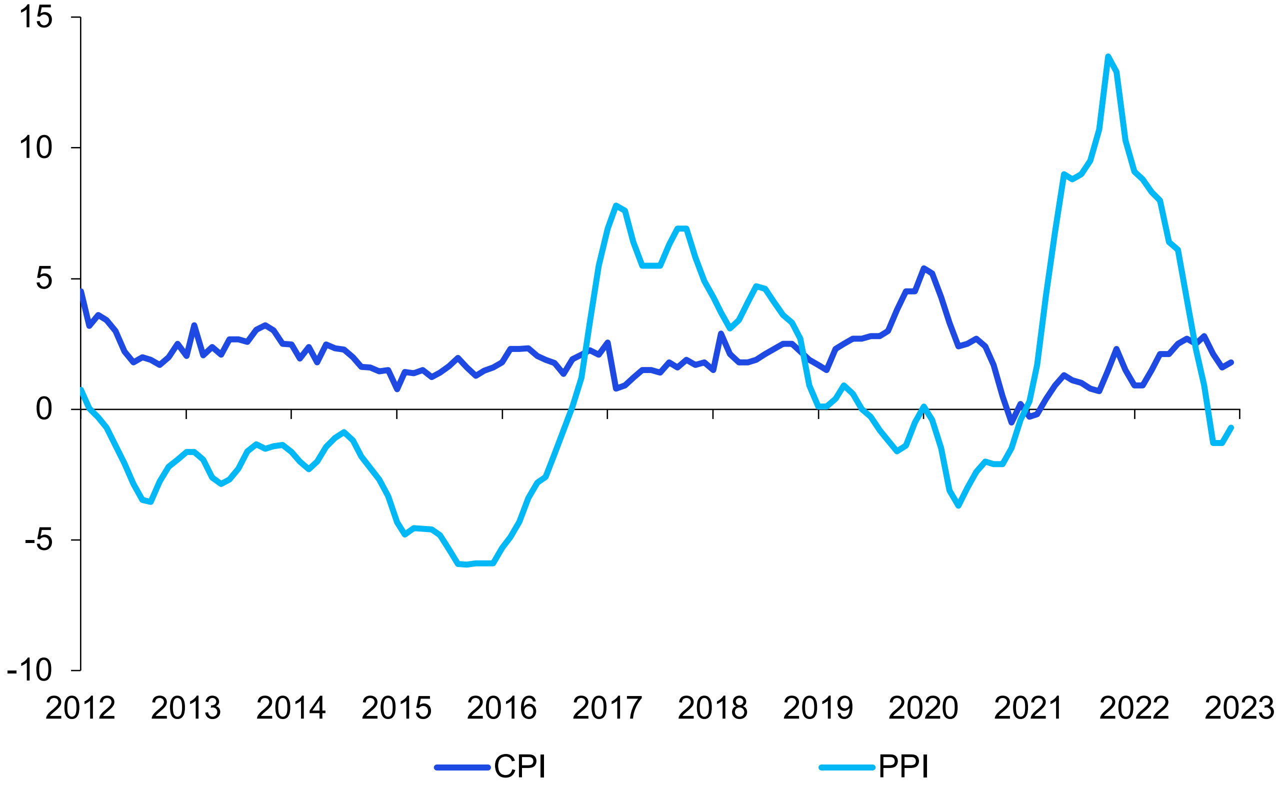


Source: Wind, KPMG analysis

- The sharp decline in land sales weighed on local governments' revenue. Government-managed funds declined by 20.6% for the past year, mainly due to falling land sales which dropped 23.3%.
- In addition, due to a large refund of value-added taxes (totalling RMB 2.4 trillion), fiscal revenue grew 0.6% in 2022, well below the growth rate of 10.7% in 2021.
- Fiscal revenue and government-managed funds are the two major income sources for local governments. The combined revenue from these sources dropped 6.3% in 2022. Weak government revenue may limit the room of additional fiscal support by local governments this year.

Inflation is expected to remain mild

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

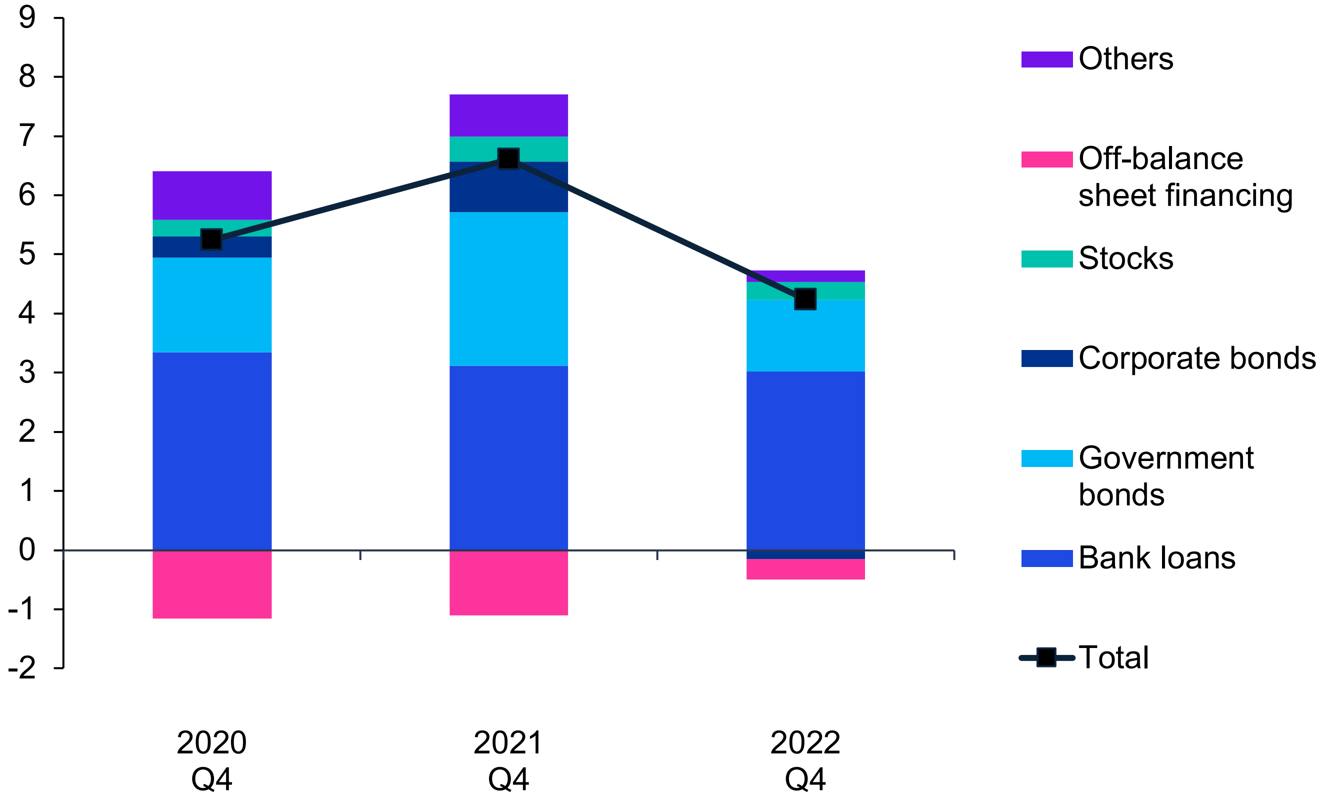


Source: Wind, KPMG analysis

- China's CPI inflation grew by 1.8% in December 2022, up from 1.6% in November 2022, mainly because of the lower base. Core CPI except food and energy grew by 0.7%, slightly up from 0.6% in November due to the weaker consumer demand.
- China's PPI inflation turned negative for three consecutive months and declined by 0.7% in December 2022, reflecting the overall weakening property market and softening global commodity prices.
- Looking ahead, we expect China's CPI will continue to rise gradually as economic activities recover, while PPI may continue to decline due to slowing global demand and a higher base in 2022. We expect CPI inflation to grow 2.4% in 2023.

Medium- and long-term bank loans to infrastructure and manufacturing are the main drivers for total social financing in Q4

Growth of total social financing by sector, RMB trillion

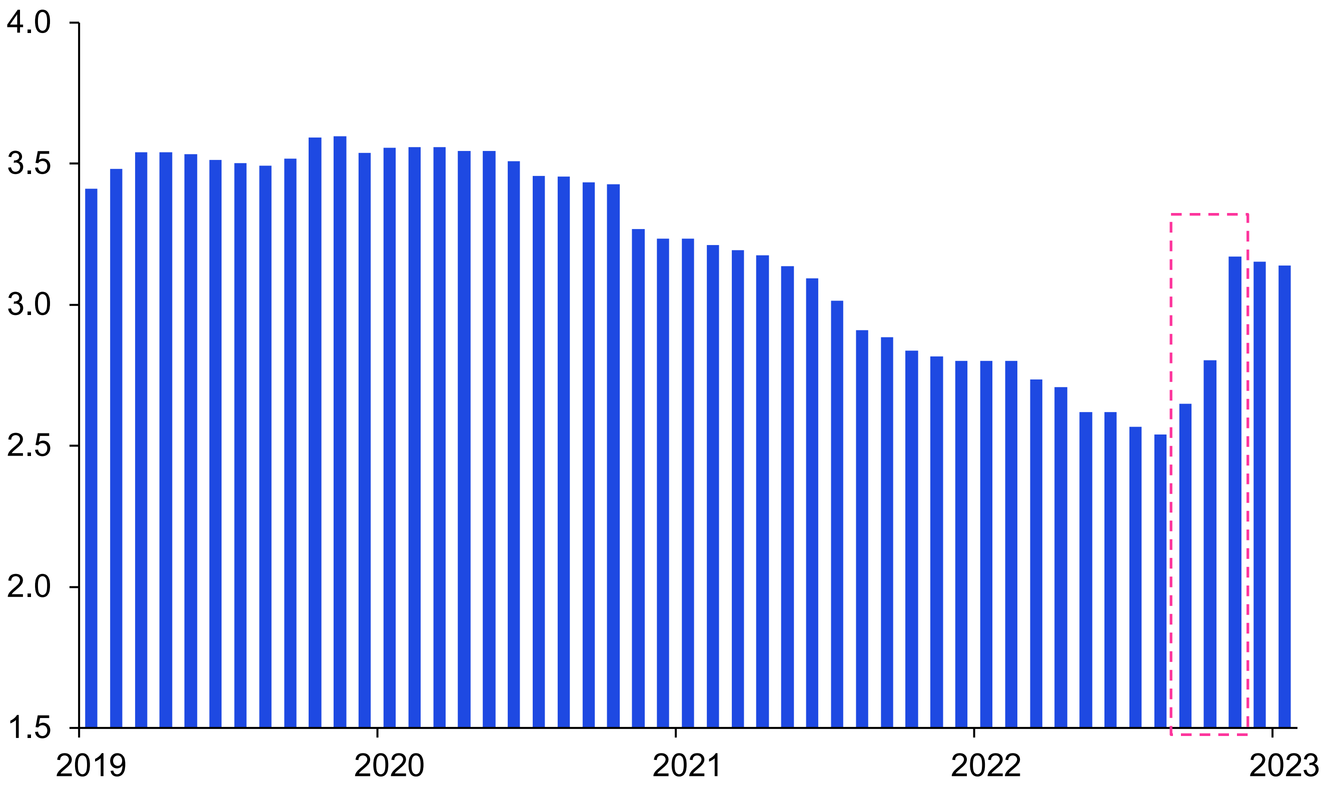


Source: Wind, KPMG analysis

- New total social financing (TSF), a measure of the total liquidity provided by the financial sector to the real economy, increased by RMB 4.2 trillion in Q4 2022, RMB 2.4 trillion lower than the same period of 2021, and RMB 1.0 trillion lower than 2020.
- With the quota of local government special bonds issuance mostly filled in H1 2022, new government bond issuances declined significantly in Q4. Corporate bonds issuance also turned negative due to large redemptions of credit bonds in December 2022.
- As regulators urged banks to increase funding supports to sectors such as infrastructure and manufacturing, new medium and long term corporate loans reached RMB 2.4 trillion in Q4, 1.5 trillion higher than the same period in 2021.

China's central bank is stepping up monetary support to help boost economic growth

Outstanding balance of Pledged Supplementary Lending (PSL), RMB trillion

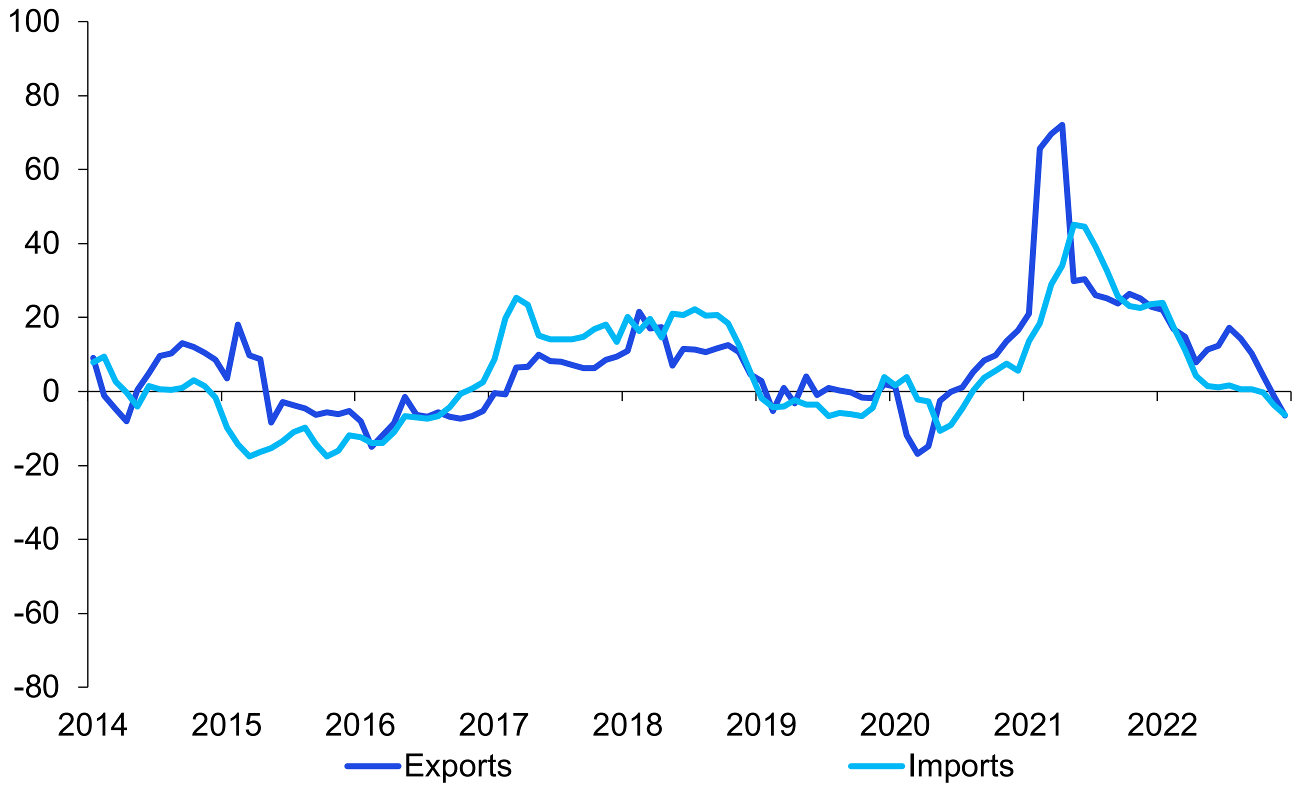


Source: Wind, KPMG analysis

- China has kept an easing monetary stance to stabilise economic growth. The PBoC cut the reserved requirement ratio(RRR) twice and lowered the one-year lending prime rate (LPR) by 15 basis points and the five-year rate by 35 basis points.
- In addition, the PBoC has relaunched its pledged supplementary lending(PSL) in September 2022 to support infrastructure and property investment.
- We expect China to maintain an accommodative monetary policy and continue to make policies more targeted and effective. For example, the country is expanding liquidity and using special relending facilities to increase direct support to SMEs, green investment, technology and senior care.

Export growth is moderating due to weakening global demand

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

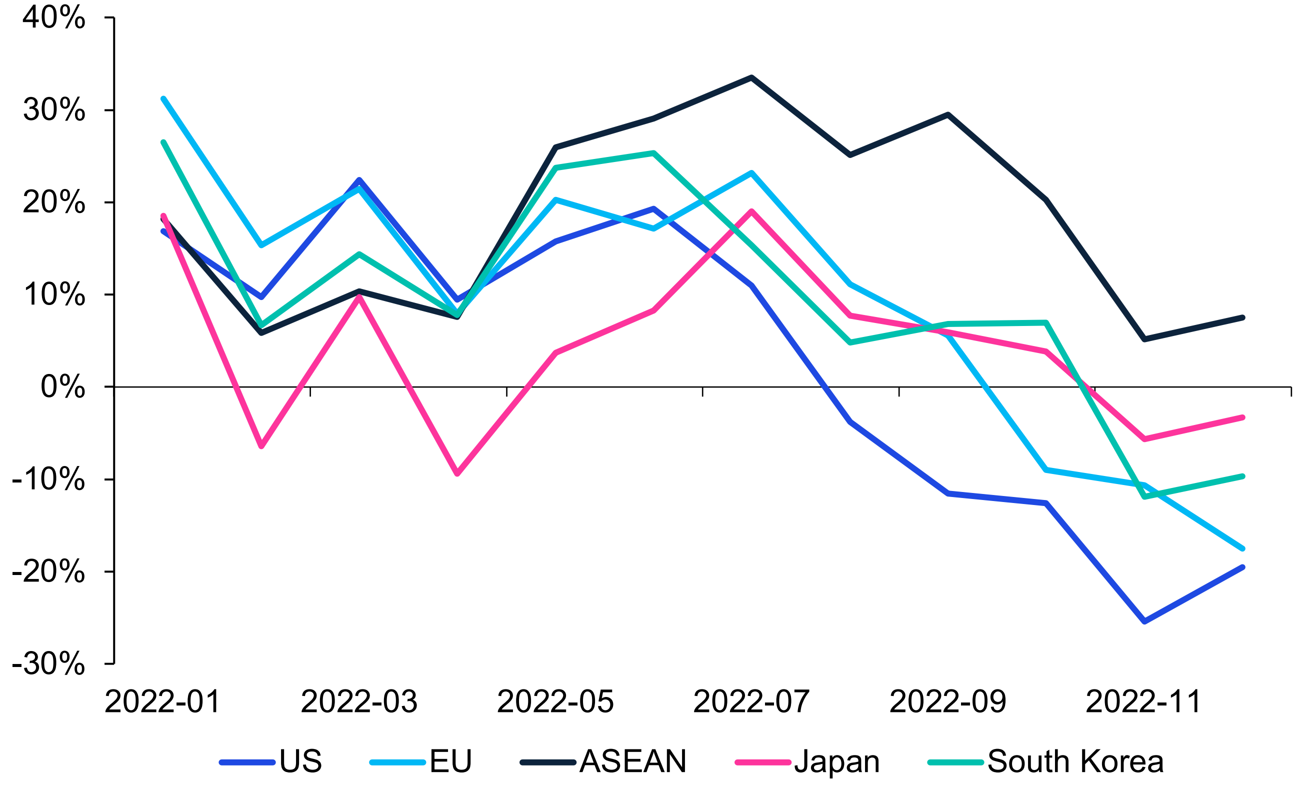


Source: Wind, KPMG analysis

- Strong exports supported China's economy in the last two years. However, the trend has slowed since last Q4 2022 and exports have declined year-over-year for the past three consecutive months.
- Export growth in USD terms fell 9.9% in December 2022 as global demand weakened. Imports fell 7.5% due to soft domestic activity given the ongoing pandemic situation at the time.
- Looking ahead, we expect global economic growth to slow down in 2023, which will weaken external demand and put pressure on China's exports.

RCEP has deepened Sino-ASEAN trade relations

Growth of China's exports to major trading partners, yoy, %

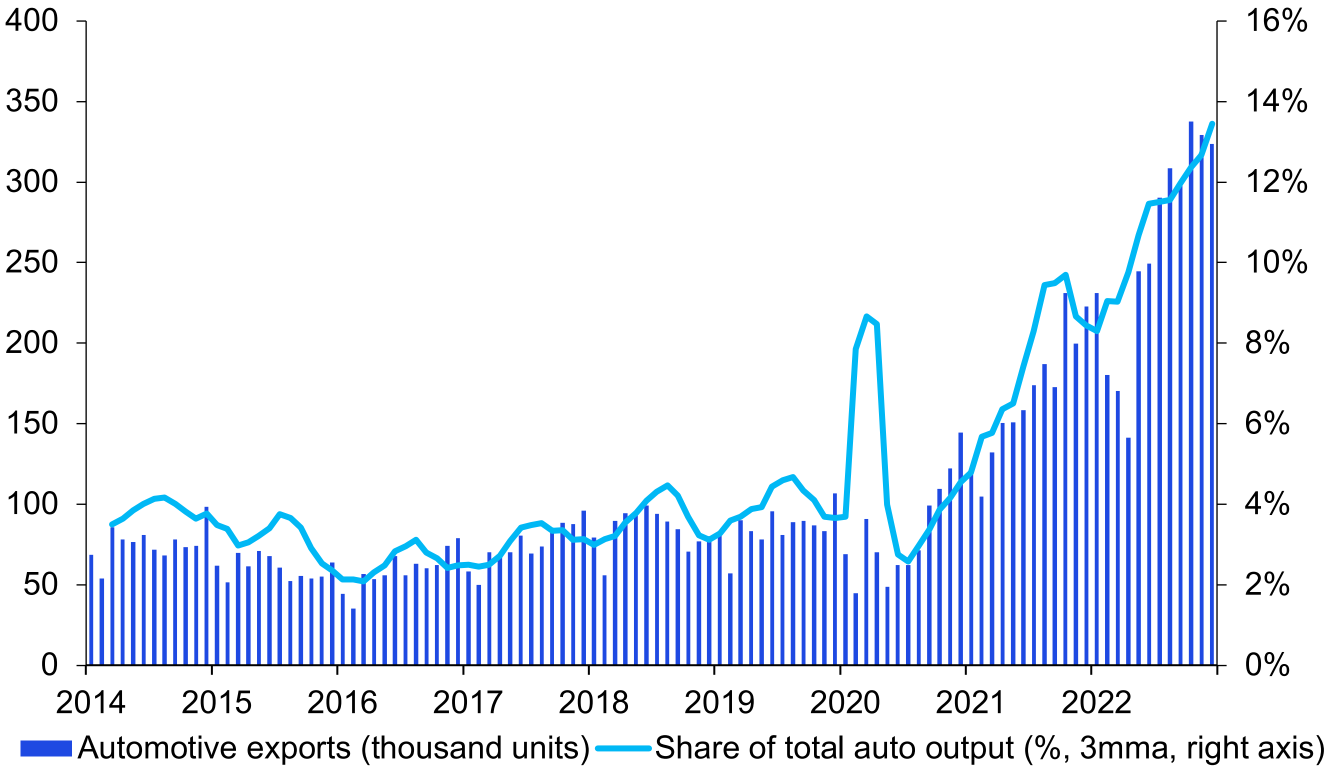


Source: Wind, KPMG analysis

- By region, China's exports to the US and EU have seen negative growth for the past five consecutive months and three consecutive months respectively. Currently, the share of China's exports to the US and EU totalled over 30%, the weaker demands in these economies have weighed on China's exports significantly.
- Export growth to Japan and South Korea has also trended negative since November 2022.
- Meanwhile, due to deepened cooperation through the Regional Comprehensive Economic Partnership (RCEP), China's exports to ASEAN economies maintained strong growth, accounting for 15.8% of total exports in 2022, up 1.4 percentage points from 2021.

China's auto exports have risen rapidly and is expected to remain strong in 2023

China's automotive exports

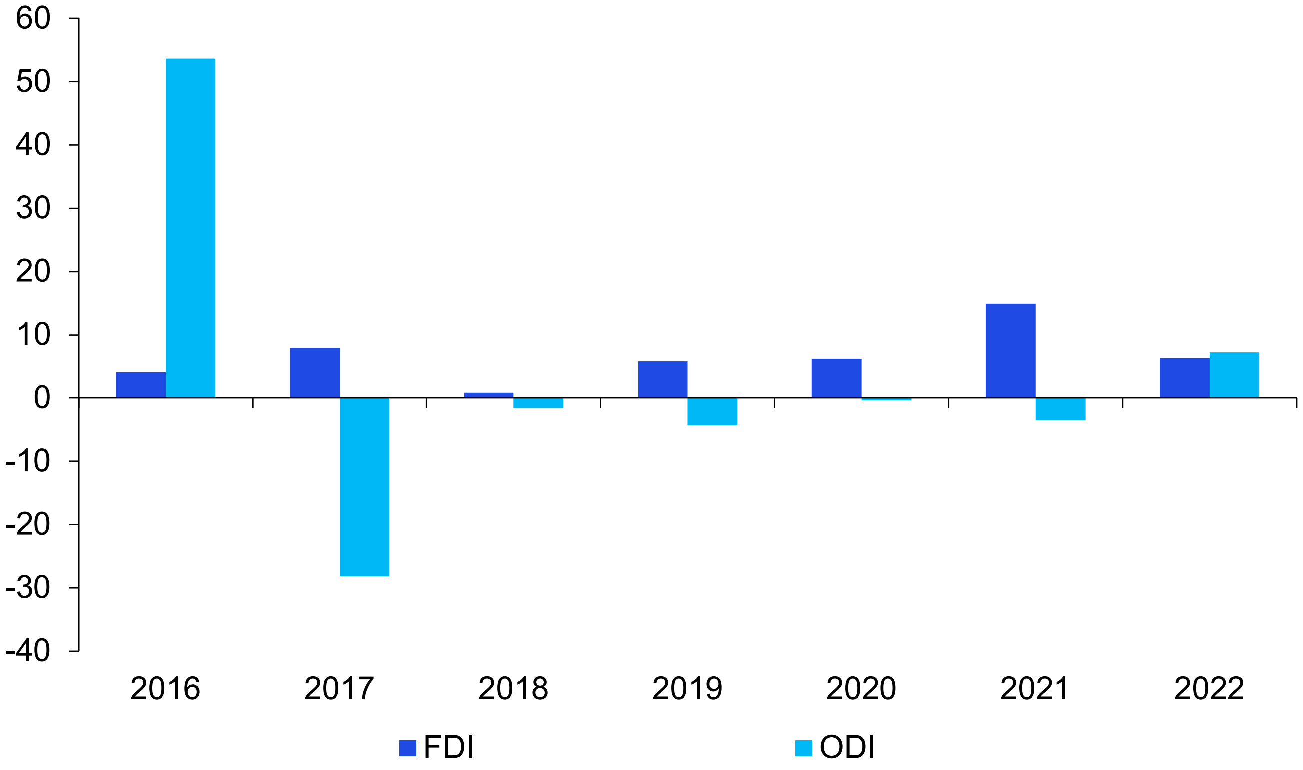


Source: Wind, KPMG analysis

- As China's manufacturing strength continues to grow, its export structure is transforming to include more high-end products, particularly in the automotive sector.
- Driven by robust external demand for new energy vehicles, China's automotive exports reached a record high in 2022, and China became the world's second largest automotive exporter after Germany. Meanwhile, the share of auto exports to total output soared from 3.3% in 2014 to 13.6% in 2022. China's auto exports is expected to remain strong in 2023.

China's outward direct investment is recovering

China's foreign direct investment (FDI) and outbound direct investment (ODI), in RMB terms, yoy, %

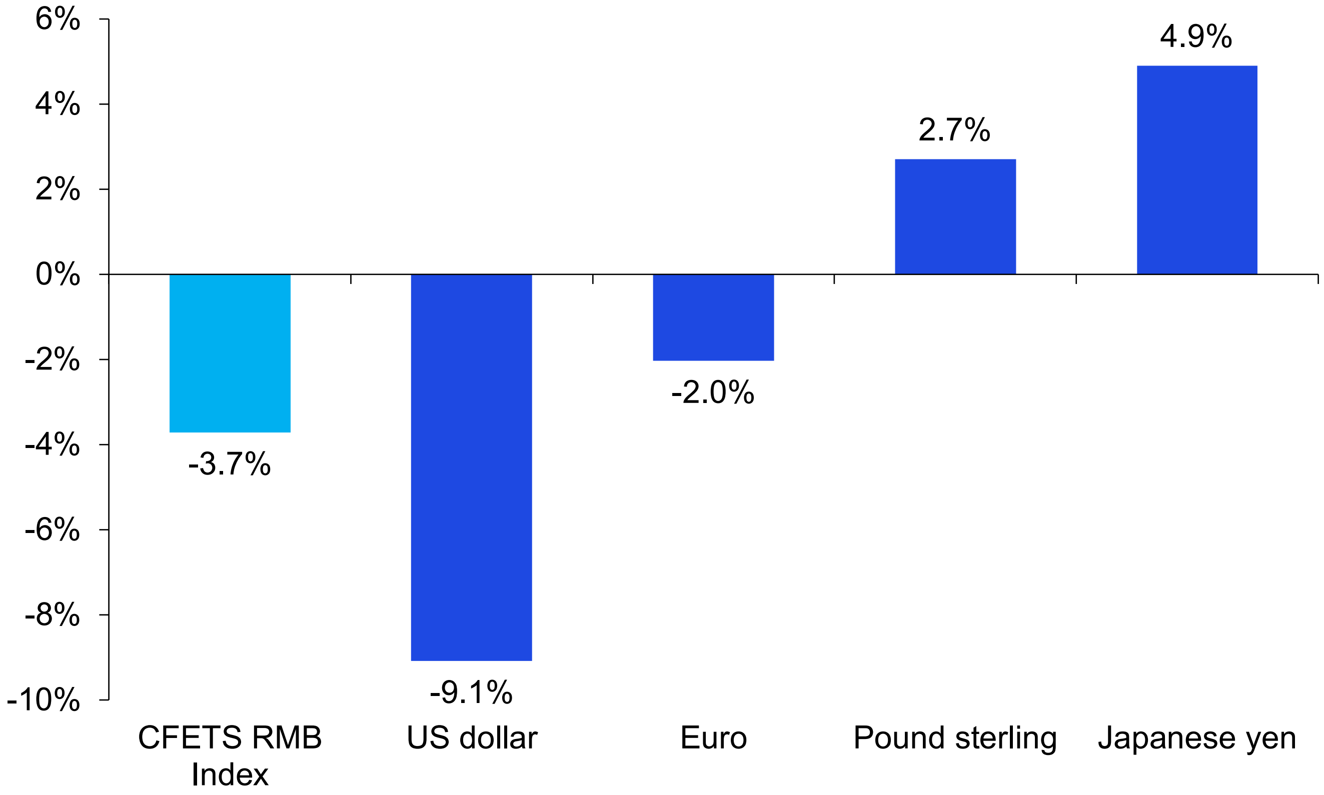


Source: Wind, KPMG analysis

- Growth of FDI into China slowed but was still up 6.3% last year. Meanwhile, manufacturing and high-tech industries continued to attract high levels of foreign investments despite the overall economic slowdown. In particular, FDI from South Korea, Germany and the United Kingdom saw robust growth in 2022.
- ODI from China saw a rebound in 2022, despite the pandemic situation and ongoing geopolitical tensions. Outbound investment in sectors such as wholesale/retail and manufacturing showed rapid growth. Meanwhile, investment and cooperation with "Belt and Road" economies saw steady growth.

The RMB weakened against the dollar and the Euro slightly last year as the US Fed and ECB raised interest rates, but it strengthened against the pound and the Japanese yen

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

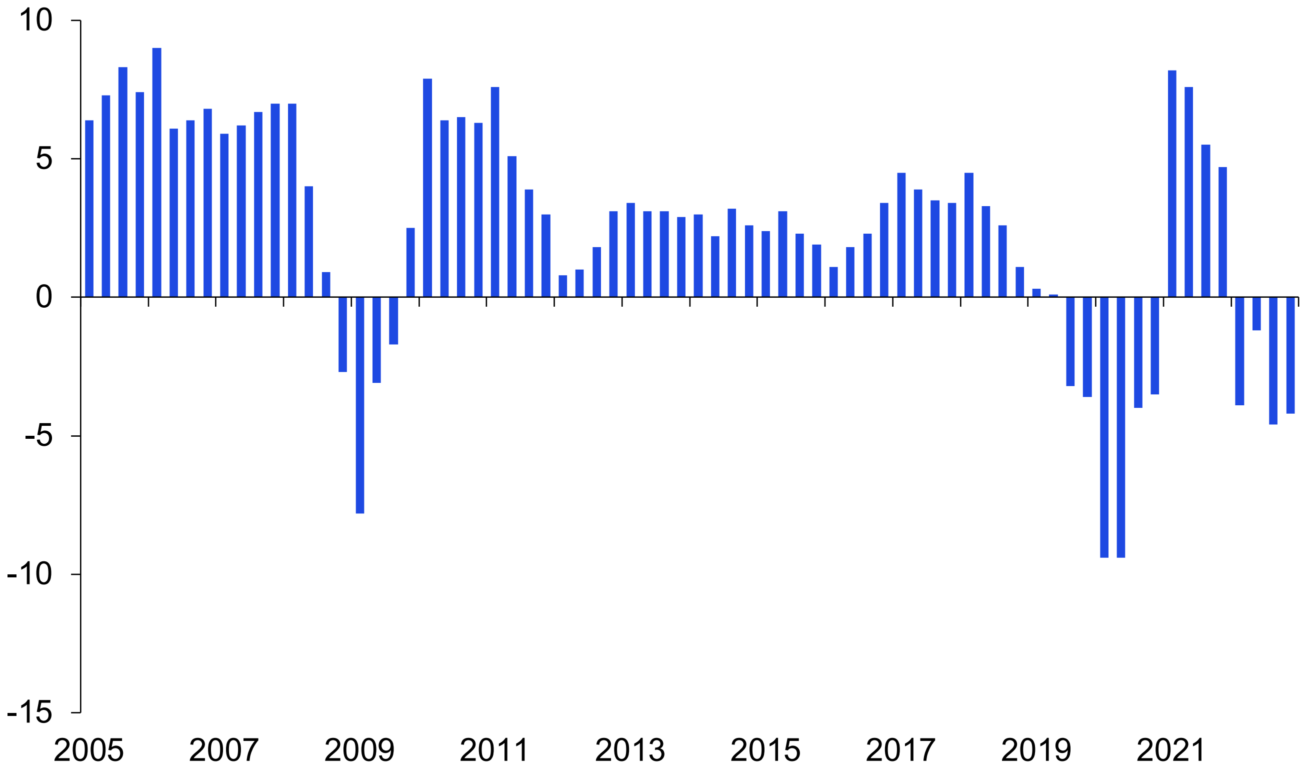


Source: Wind, KPMG analysis

- Although the RMB exchange rate against the USD saw a large depreciation last year, it held relatively well against the basket of major currencies, as measured by CFETS RMB index.
- Despite depreciation against the USD and Euro, the RMB appreciated by 2.7% and 4.9% against the pound and the Japanese yen last year, respectively.
- Looking forward, the US Fed is expected to slow its interest rate hikes, which will reduce pressures on RMB exchange rate and capital outflows. China's economic recovery, China's economic recovery after the re-opening and mild inflation, should support bolster the RMB this year.

Hong Kong's economy is expected to recover as Chinese Mainland cross-border travel resumes

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

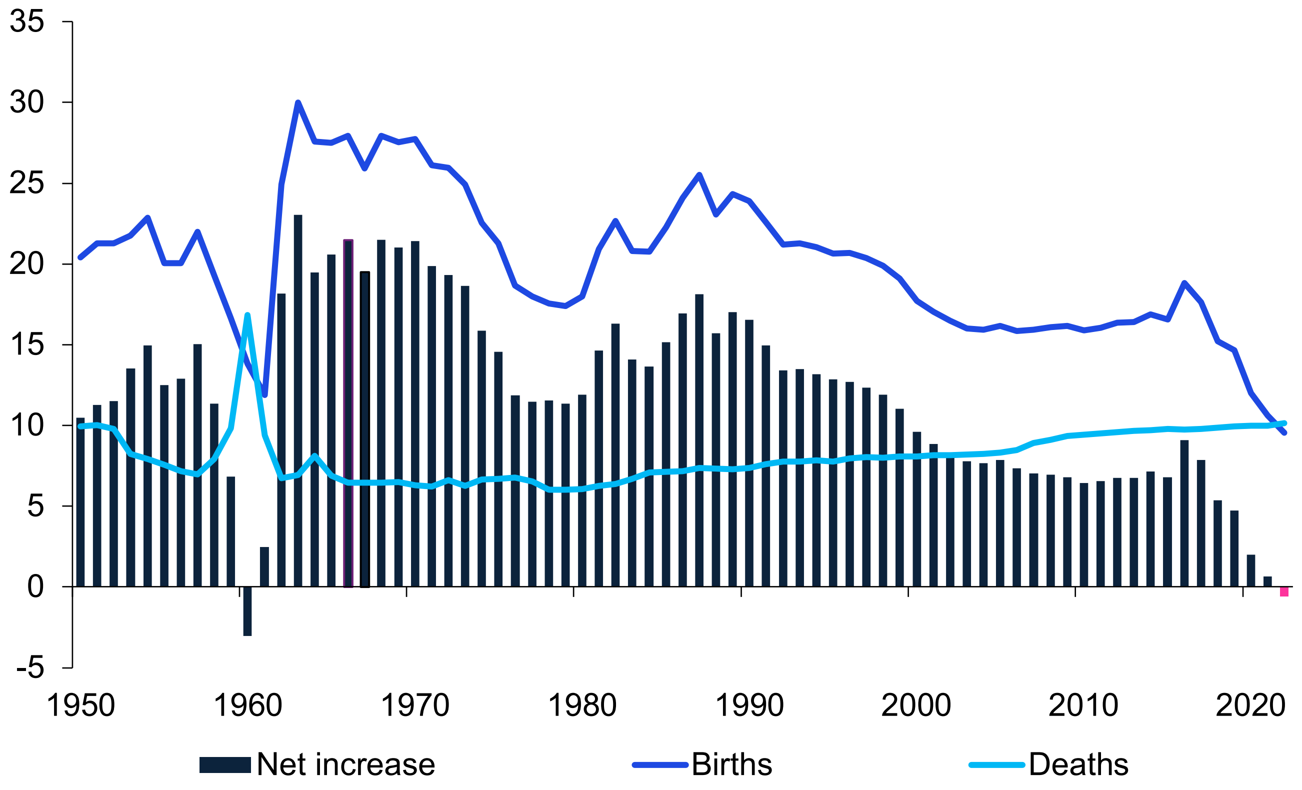


Source: Wind, KPMG analysis

- Hong Kong (SAR)'s economy saw another visible contraction in Q4 2022. Real GDP declined by 4.2% after falling by 4.6% in Q3. For 2022 as a whole, real GDP shrank by 3.5%.
- Hong Kong's GDP decline in Q4 2022 can be attributed to weak exports and depressed levels of visitors as pandemic restrictions continued. Despite this, Hong Kong labour market continued to improve during the same time period.
- Looking ahead, the expected recovery of tourism from the Chinese Mainland should support an acceleration of services consumption. As such, we expect that Hong Kong's economy will return to positive growth in 2023.

China's total population saw its first decline since 1961

China's population growth, million persons



Source: Wind, KPMG analysis

- According to the latest data released by the National Bureau of Statistics, the national population totalled 1.41 billion by the end of 2022, down 850,000 from the previous year. This is the first time that the population has experienced negative growth since 1961.
- A low birth rate is the main reason for the slowdown in population. New births totalled 9.56 million last year, which fell below 10 million for the first time since 1950. In addition, the population continues to age. Those over 65 years old exceeded 209 million, accounting for 14.9% of the country's total population, an increase of 0.7 percentage points from 2021.

Contact us

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

Norbert Meyring
Head of Multinational Clients
KPMG China
+86 (21) 22122707
norbert.meyring@kpmg.com

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

Mark Harrison
Partner
KPMG China
+86 (21) 22123620
mark.harrison@kpmg.com

Shigeru Inanaga
Partner
KPMG China
+86 (755) 25473387
shigeru.inanaga@kpmg.com

Anson Bailey
Partner
KPMG China
+852 29788969
anson.bailey@kpmg.com

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

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

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