China Economic Monitor

Issue: 2023 Q2

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Key takeaways

- China's GDP grew 4.5% year-over-year (yoy) in 2023 Q1, up from 2.9% in Q4 2022 and higher than market expectations. The better-than-expected growth was mainly supported by consumption recovery, export resilience and improving property market.
- With Covid-19 restrictions lifted, retail sales saw a solid recovery in Q1 2023, with service consumption enjoying a particularly strong rebound. Consumer sentiment improved modestly and the share of households indicating more savings dropped slightly in the latest survey (but still high).
- Manufacturing and infrastructure investments were holding up relatively well, growing 7.0% and 8.8% in Q1 2023, respectively. However, momentum has weakened somewhat recently. Looking ahead, investment in high-end manufacturing and equipment upgrading will likely continue to see robust growth.
- The property market is gradually recovering from last year's depressed levels. The year-on-year decline of real estate investment narrowed from -10% in 2022 to -5.8% in Q1 2023. Liquidity pressure remains tight with bank loans down 10% in Q1. The property market is expected to continue the sequential recovery in 2H 2023 but weak land purchases and new starts will likely weigh on the pace of the recovery.
- Exports in Q1 2023 surprised on the upside, highlighting the resilience of China's exports. Despite slowing exports to advanced economies, China's trade with emerging markets continue to rise. China's exports to ASEAN reached USD 56.4 billion in March 2023, a record high. Meanwhile, the structure of China's exports is also changing with rising share of advanced manufacturing products. New energy vehicles (NEVs), solar panels, and lithium battery have become bright spots for China's exports.
- Overall, China's economy is recovering since the removal of pandemic-related restrictions, with demand is gradually improving. However, the recovery is still at an early stage and varies by sector. Improving household and corporate confidence is still the key to unlock faster economic recovery. We maintain our forecast of 5.7% for China's GDP growth in 2023 and expect the economy to grow 5.2% in 2024.

Q1 2023 GDP growth surprised on the positive side, driven by consumption rebound, export resilience and improving property market

Growth rate of major economic indicators, %

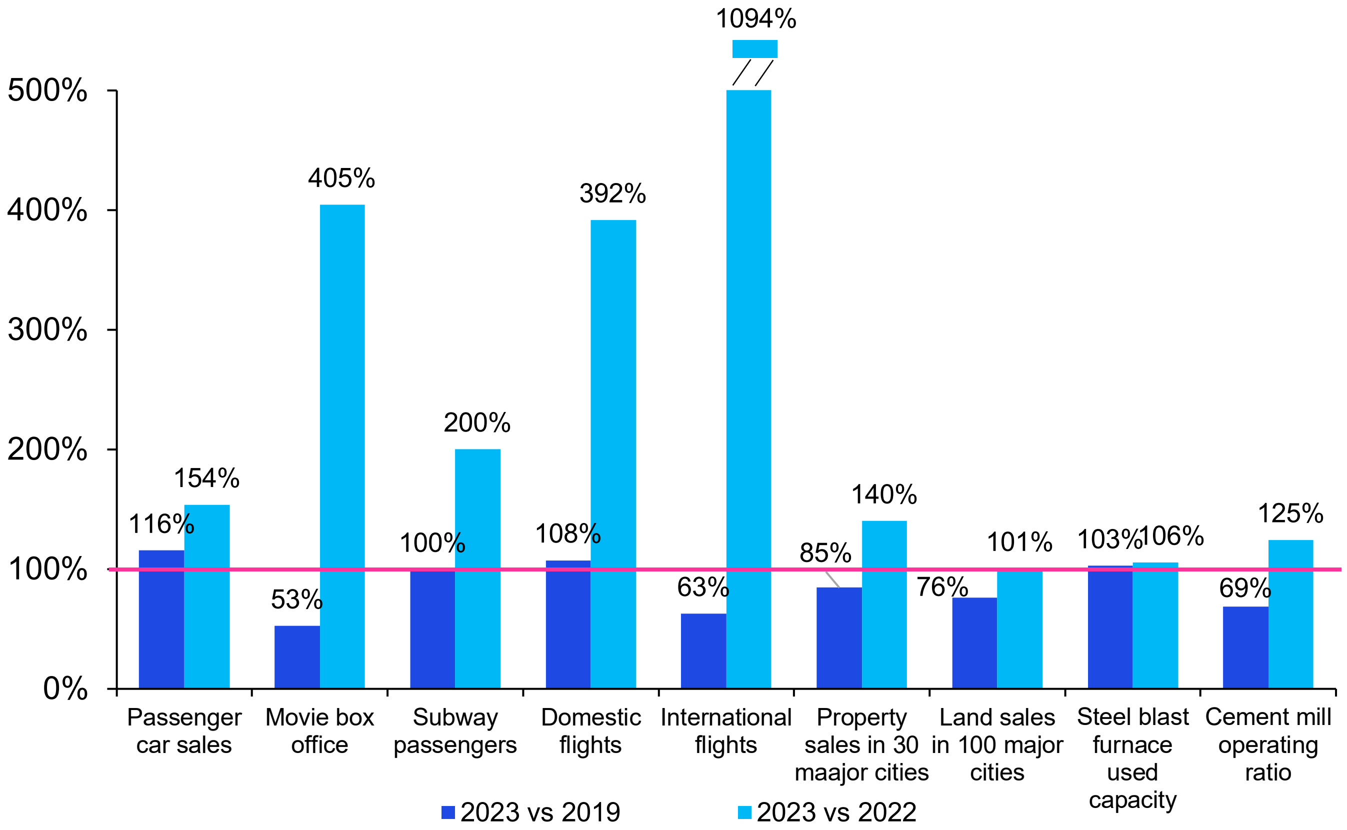
	2017-19 Average	2022Q1	2022Q2	2022Q3	2022Q4	2023Q1
GDP	6.6%	4.8%	0.4%	3.9%	2.9%	4.5%
Industrial Production	6.2%	6.5%	0.6%	4.8%	2.8%	3.0%
Retail Sales	9.0%	3.3%	-4.6%	3.5%	-2.5%	5.8%
Fixed Asset Investment	6.2%	9.3%	4.2%	5.5%	2.9%	5.1%
Exports	6.1%	15.7%	12.9%	10.1%	-6.6%	0.5%
Imports	9.8%	10.2%	1.7%	0.9%	-6.5%	-7.1%
Income per capita	6.5%	5.1%	0.4%	3.6%	2.0%	5.1%
Fiscal revenue	5.8%	8.6%	-28.0%	2.2%	31.2%	0.5%
Fiscal expenditure	8.2%	8.3%	3.7%	6.7%	4.8%	6.8%

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 4.5% year-over-year (yoy) in Q1 2023, up from 2.9% in Q4 2022 and beating market expectations.
- Growth was mostly driven by consumption rebound (especially services), resilient exports, and a gradual recovery of the property market. Investments in high-tech manufacturing and infrastructure were holding up relatively well due to policy support.
- Retail sales growth picked up from 5.0% in Jan-Feb to 10.6% in March. Exports surprised the market by growing 0.5% in Q1 2023. Real estate investment fell 5.8% in Q1 2023 but the contraction narrowed from the 10% decline last year.

Most economic activities see solid rebound from last year, but some are still below pre-pandemic levels

Economic activity in April compared to 2019 and 2022, percent

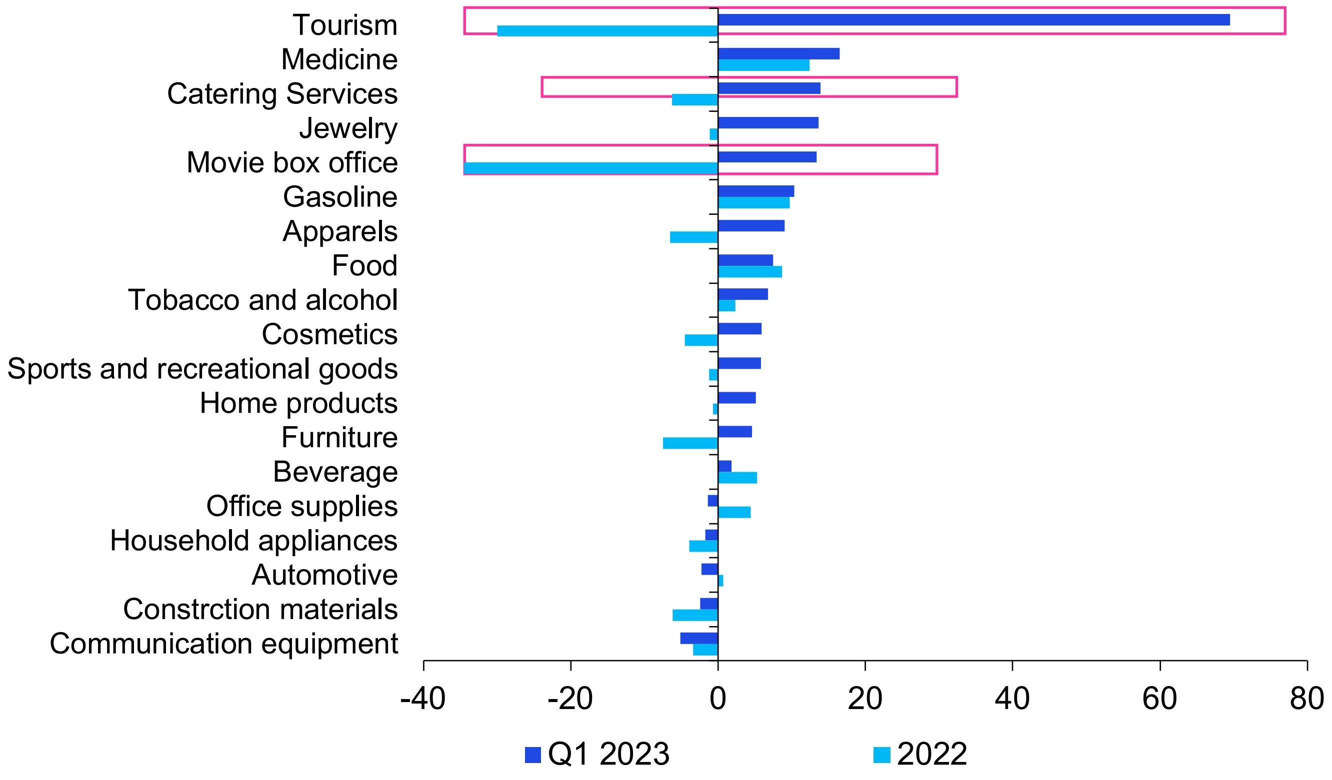


Source: Variflight, Wind, KPMG analysis

- Most economic activities in China were severely affected by the pandemic in 2022 Q2. Although China's economic data has been repaired this year, it is still far from the pre-pandemic levels.
- The pace of recovery has varied across different sectors. Certain consumption areas such as passenger car sales and domestic travels have been repaired.
- On production side, indicators such as steel blast fumace used capacity and cement mill operating ratio has fallen back compare to its recovery in March. Capacity utilisation is still weak, and industrial production momentum has yet to fully recover.

Service consumption is seeing a faster recovery

Growth of retail sales by category, yoy, %

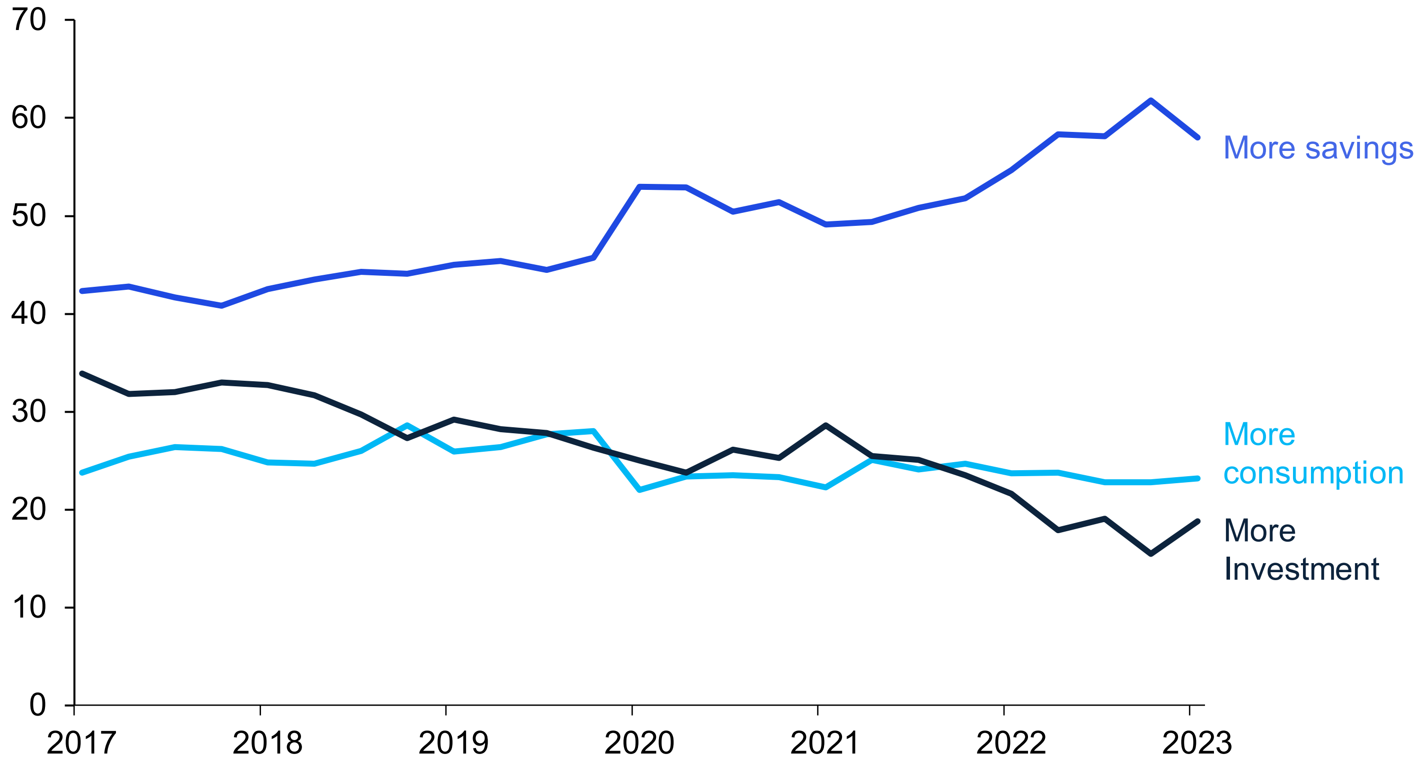


Source: Wind, KPMG analysis. Goods sales data are for above-size retail enterprises

- With COVID-related travel restrictions lifted, retail sales saw a significantly recovery in Q1 2023, especially in the services sector.
- Contact-related consumption including dining, entertainment and travel grew rapidly in Q1 2023, with tourism revenue, catering revenue and movie box office revenue increased by 69.5%, 13.9% and 13.4% respectively.
- In terms of goods sales growth, medicine, jewellery, gasoline and apparels showed a faster growth compared to last year. But household appliances and construction materials continued to slide.

Households' inclination for saving retreated a little bit but remained high

Survey on household's sentiment, %

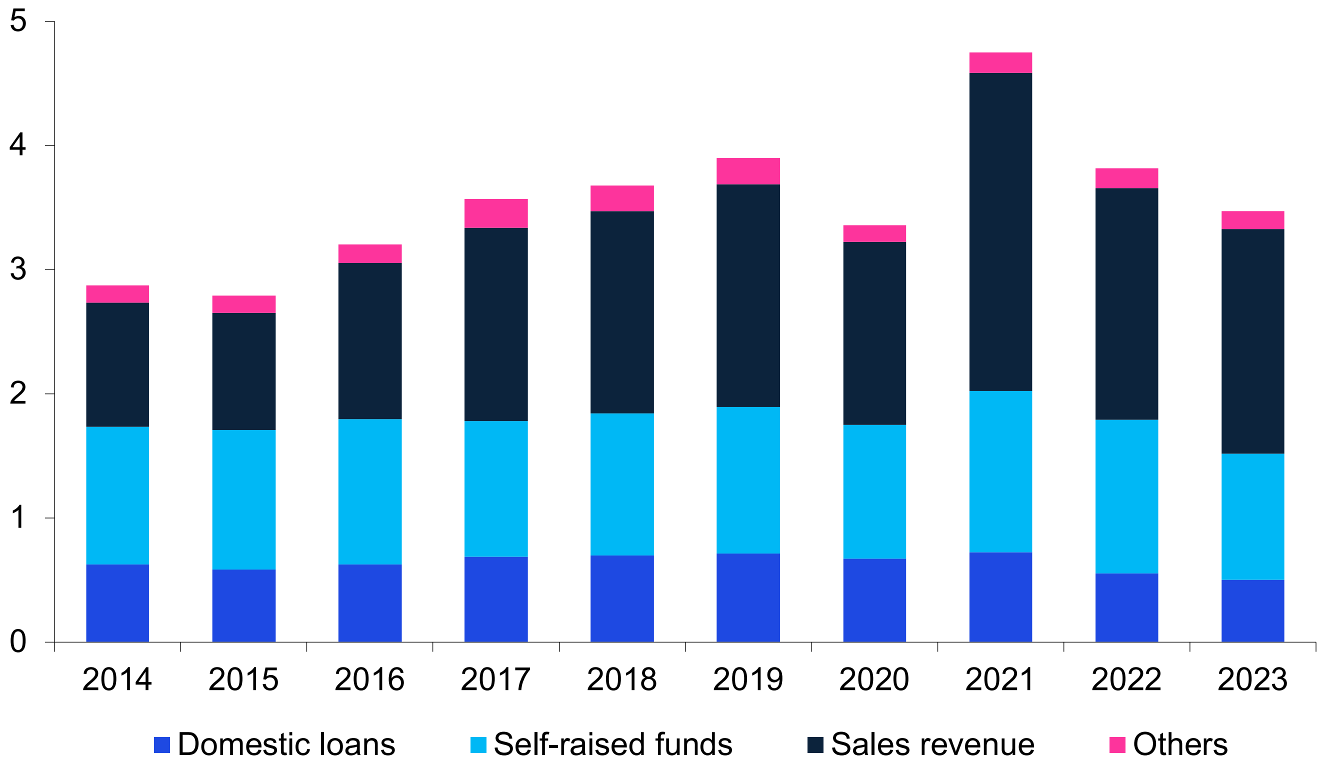


Source: Wind, People's Bank of China, KPMG analysis

- As the economy recovers, consumer sentiment improved modestly. According to a survey by the People's Bank of China (PBoC), the share of households who are planning to increase consumption up to 23.2% in Q1 2023.
- Sentiment among China's savers decreased, with 58.0% of households noting that they will saved more, down 3.8 percentage points from Q4 2022, but the share is still relatively high.
- As the capital market performed well in Q1 2023, 18.8% were inclined to make more investment, a 3.3 percentage points increase.

Liquidity pressure for property developers remained tight

Funding sources of real estate developers in the first quarter each year, RMB trillion

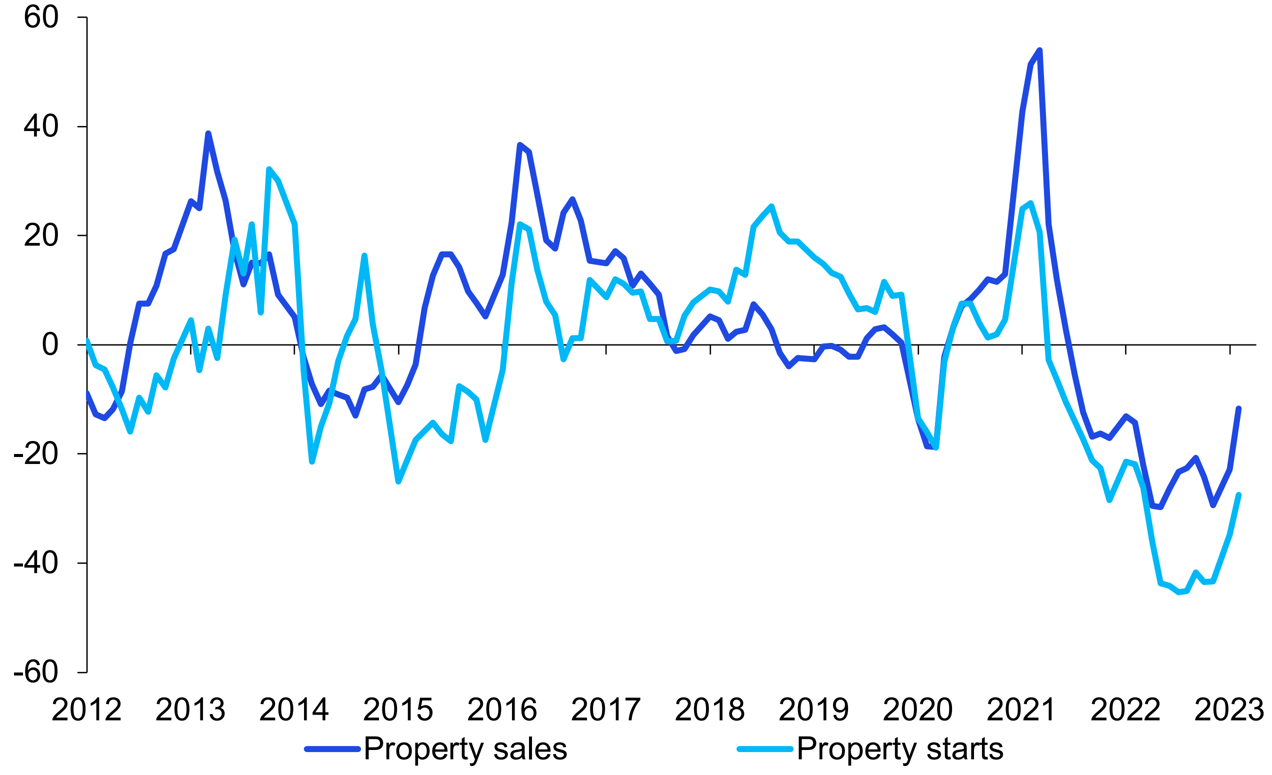


Source: Wind, KPMG analysis

- In Q1 2023, developers raised funding totalled RMB 3.4 trillion, down 9.0% from the same period last year. Liquidity pressure for property developers remained tight, but the decline was narrower than that in 2022 (26%).
- Sales revenue has been still the main source of funding for developers, accounting for 56.3% in Q1 2023. Revenues basically rebounded back to the level of the same period in 2022 as a result of improved housing sales. At the same time, bank loans to developers were down 10% in Q1 2023.
- Driven by the supportive financing policies, developers issued more than RMB 150 billion in bonds domestically in Q1 2023, a year-on-year increase of more than 20%. Confidence in the offshore bond market is also gradually recovering.

New sales and property starts remained weak but improved from last year's depressed levels

Property starts and new home sales, yoy, three-month moving average, %

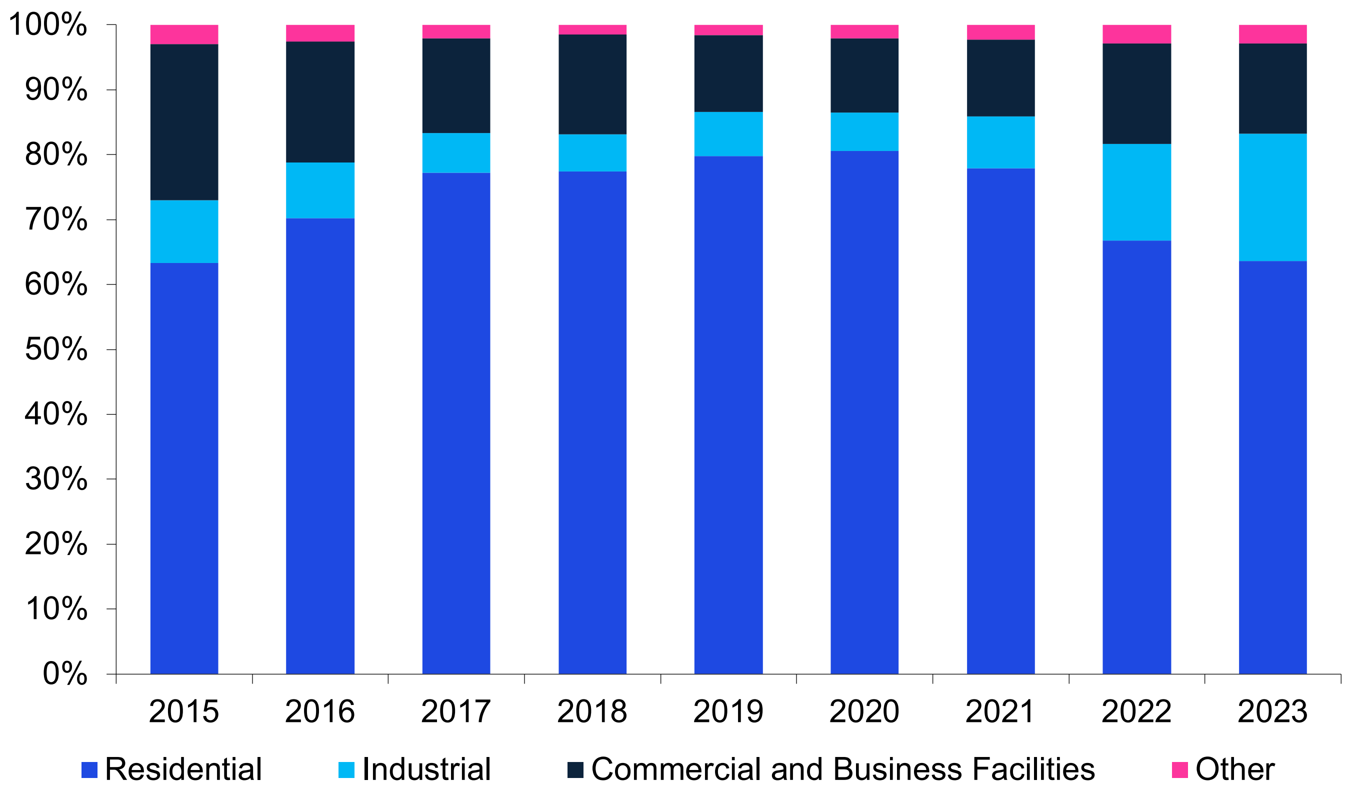


Source: Wind, KPMG analysis

- In Q1 2023, the growth rate of property new starts decreased by 19.2%, but the completed property area increased by 14.7% year-on-year, of which residential completed area increased by 16.8% year-on-year.
- Property sales totalled 300 million square meters in Q1 2023, a 1.8% year-on-year loss, but the pace of decline was slower than late 2022. Monthly growth turned positive in March after a 20-months decline.
- The improvement in property sales was not only due to the release of pent-up demand, but also due to the easing property policies, which lowered the cost of housing purchases.

The share of land sales for industrial purposes increased

Land sales by type in the first quarter each year, %

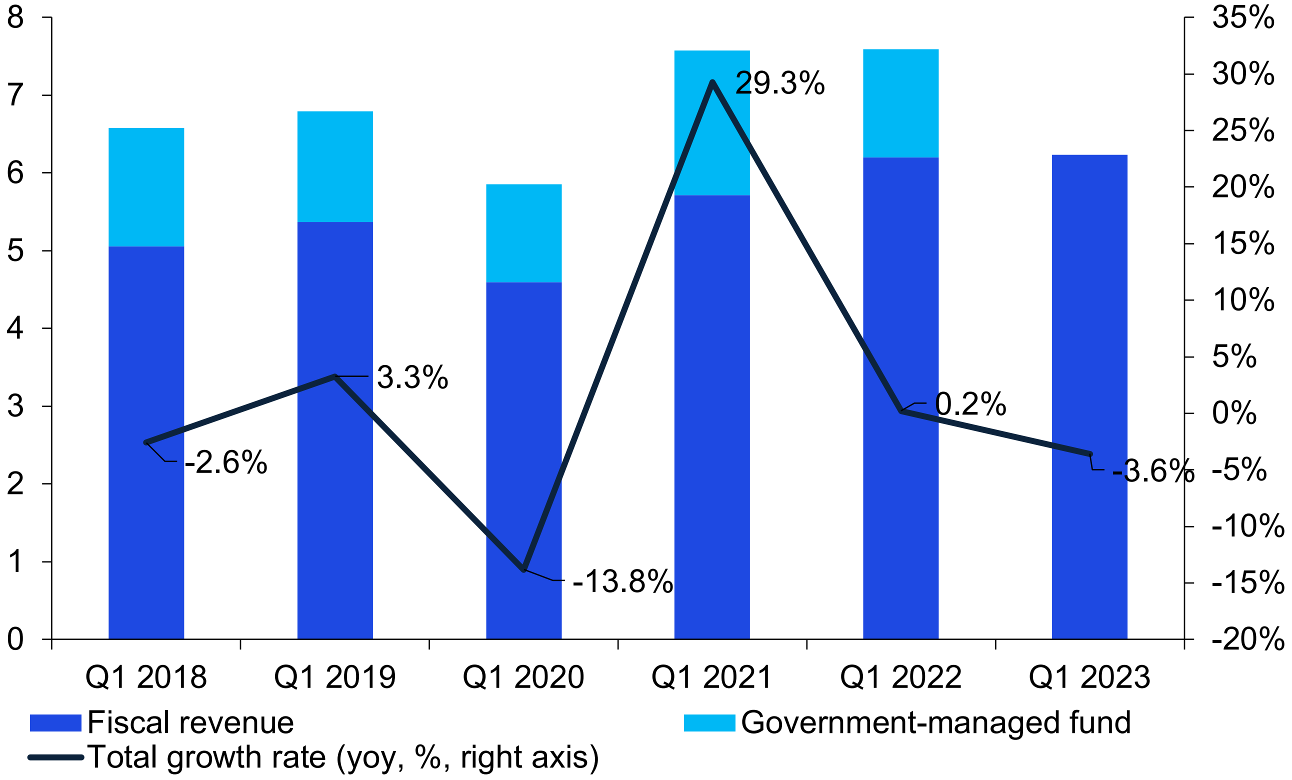


Source: Wind, KPMG analysis

- Land supply were delayed in 2023 Q1 due to policy changes by the Ministry of Natural Resources' new policy, and land transactions have decreased year-on-year.
- Residential land continued to be the dominant transaction type, with a total share of 63.7%. The share of industrial land made up 19.5%, an increase of 4.6 percentage points from the same period of previous year, mainly due to developers' increased interest in regional industrial construction.

Total government revenues dropped in Q1 2023 due to weak tax revenue and government land sales

Government revenues, RMB billion

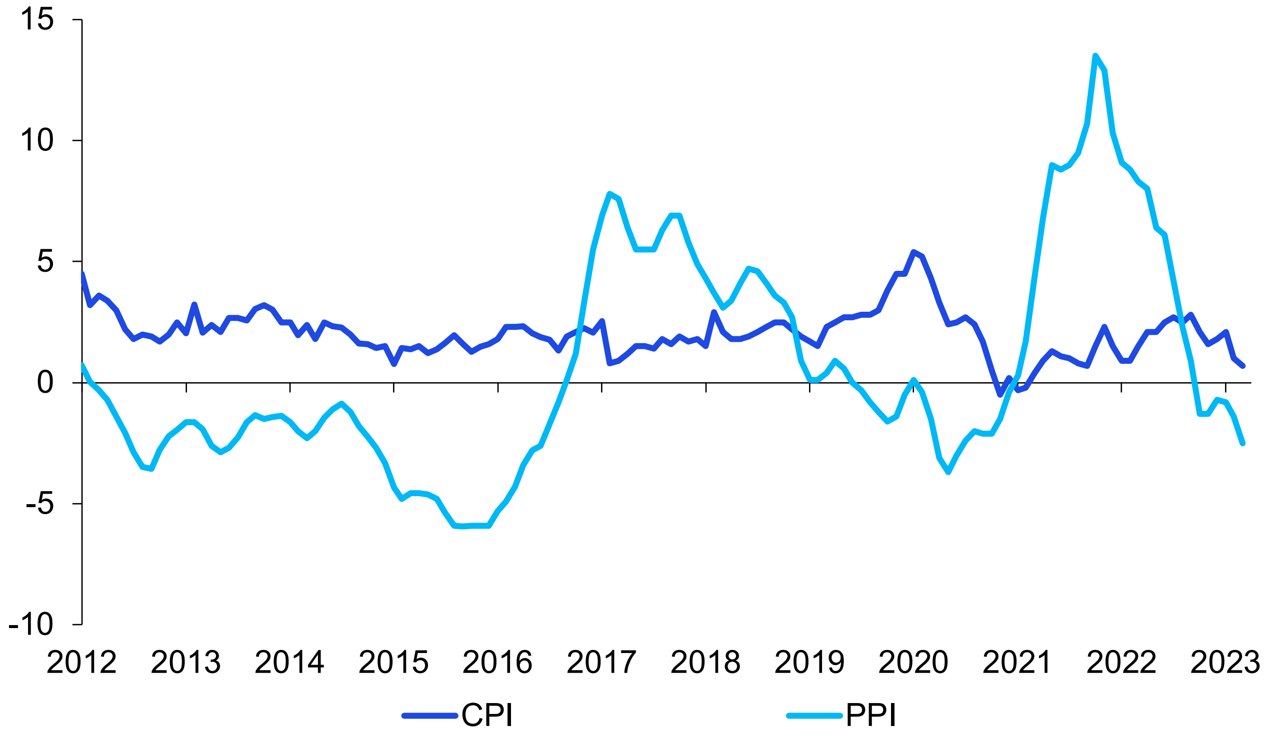


Source: Wind, KPMG analysis

- Q1 2023 public revenue was RMB 6.2 trillion, up 0.5% year-over-year. In terms of structure, tax revenue declines 1.4% year-over-year, while non-tax revenue grew 10.9% year-over-year, including a 32.4% increase in revenue from the use of state-owned assets.
- Thanks to the delayed land auctions and declined land sales, government-managed fund revenue totalled RMB 1.08 trillion for the first quarter of 2023, a 21.8% decrease from the same period in 2022. The revenue from land sales in Q1 2023 was just RMB 872.8 billion, a 27% decrease from the same period in 2022.

Inflation is trending down with producer prices turning negative since Q4 2022

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

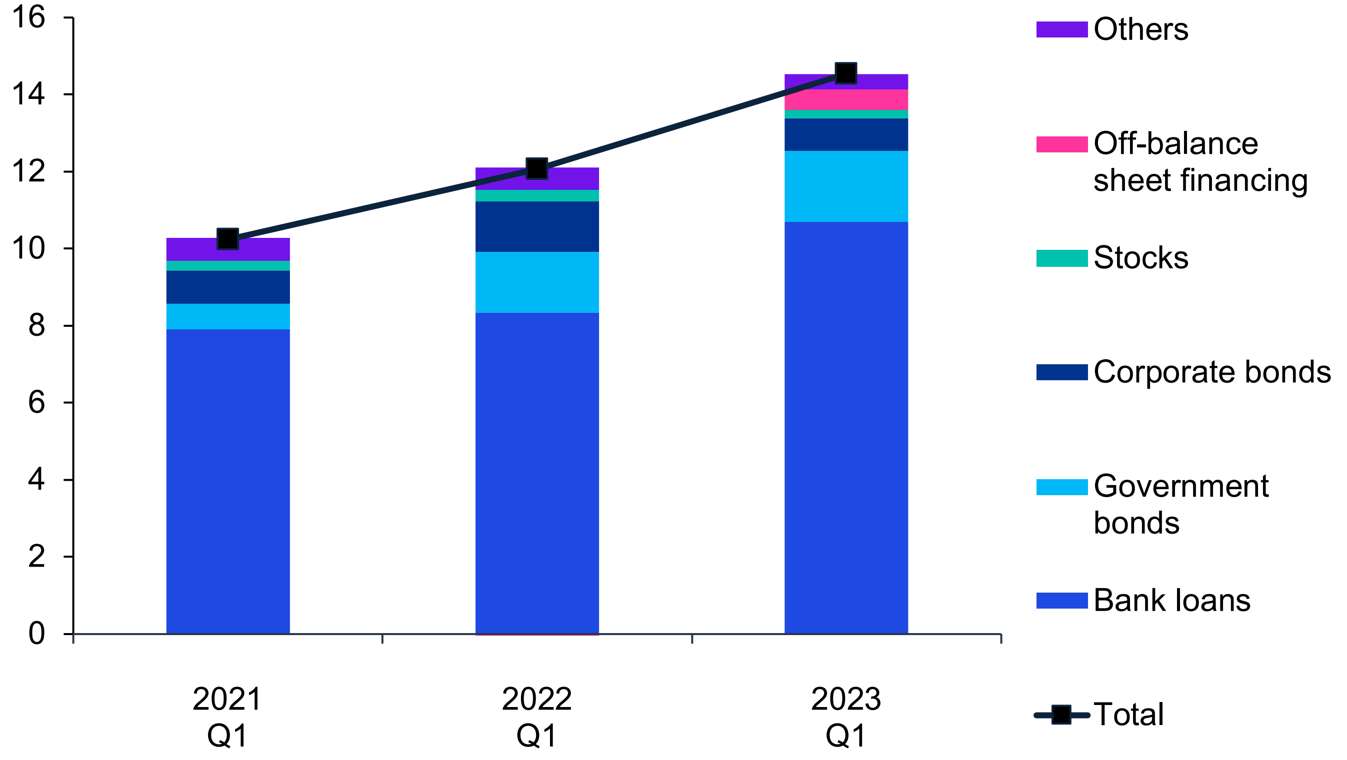


Source: Wind, KPMG analysis

- China's CPI inflation moderated to 0.7% in March 2023, mainly due to soft food prices and year-over-year decline of oil prices (oil prices surged last year due to the ongoing Ukraine situation). Core CPI, excluding food and energy, edged up to 0.8% in Q1, reflecting a weak but continued recovery.
- China's PPI inflation turned negative for six consecutive months and declined by 2.5% in March 2023, reflecting the overall weak property market and soft global commodity prices.
- Looking ahead, we expect China's CPI will continue to rise gradually as economic activities recover, while PPI may decline due to weak global demand and a higher base in 2022.

Bank loans are still the main contributor to total social financing

Growth of total social financing by sector, RMB trillion

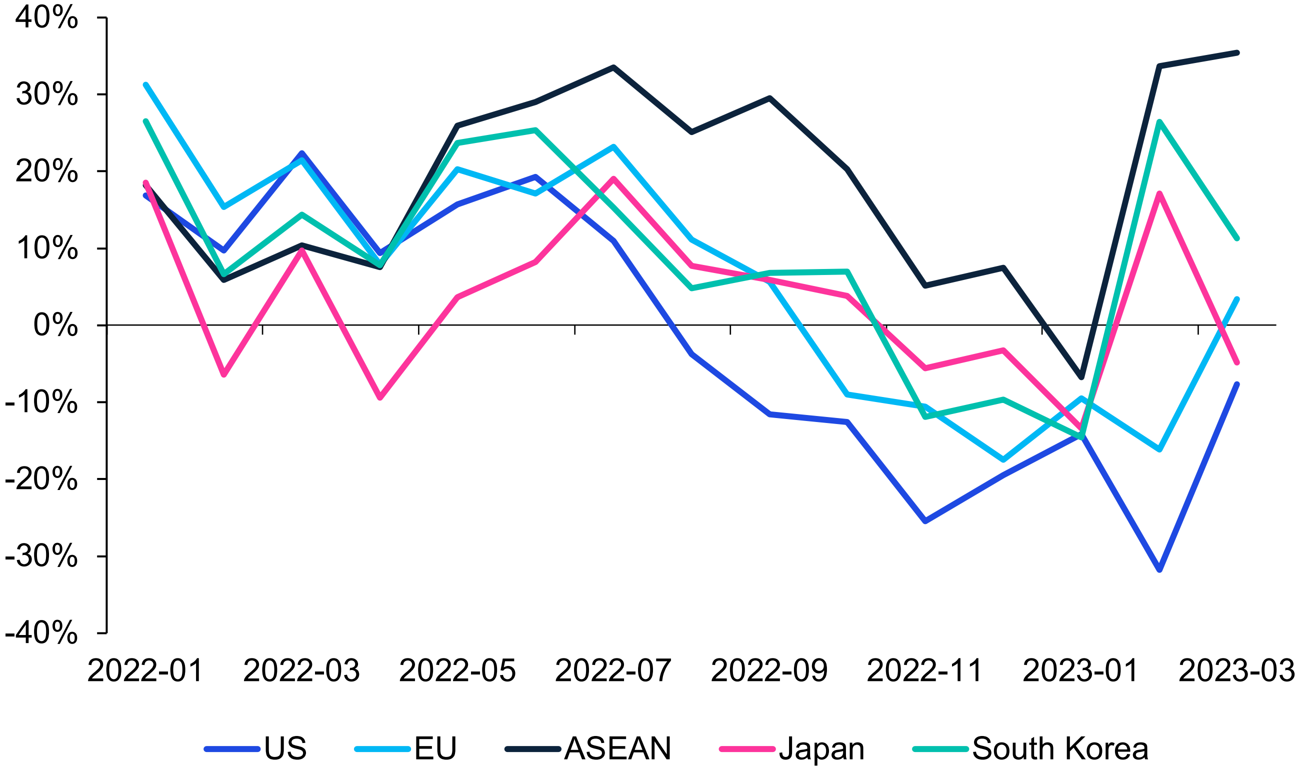


Source: Wind, KPMG analysis

- About RMB 10.7 trillion in new bank loans originated in Q1 2023, up RMB 2.3 billion from Q1 2022, a share of 74% for new total social financing.
- To stabilise economic growth, the government will increase its fiscal support this year. It plans to issue RMB 3.8 trillion local government special bonds (LGSB), including a front-loaded quota over RMB 2 trillion in November 2022. By the end of March 2023, the issuance of LGSB reached RMB 1.83 trillion.
- Corporate bonds issued in Q1 2023 totaled 848 billion, down RMB 465 million from the same period last year.

China's trade with ASEAN have continued to see fast growth, reflecting strengthened regional collaborations

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

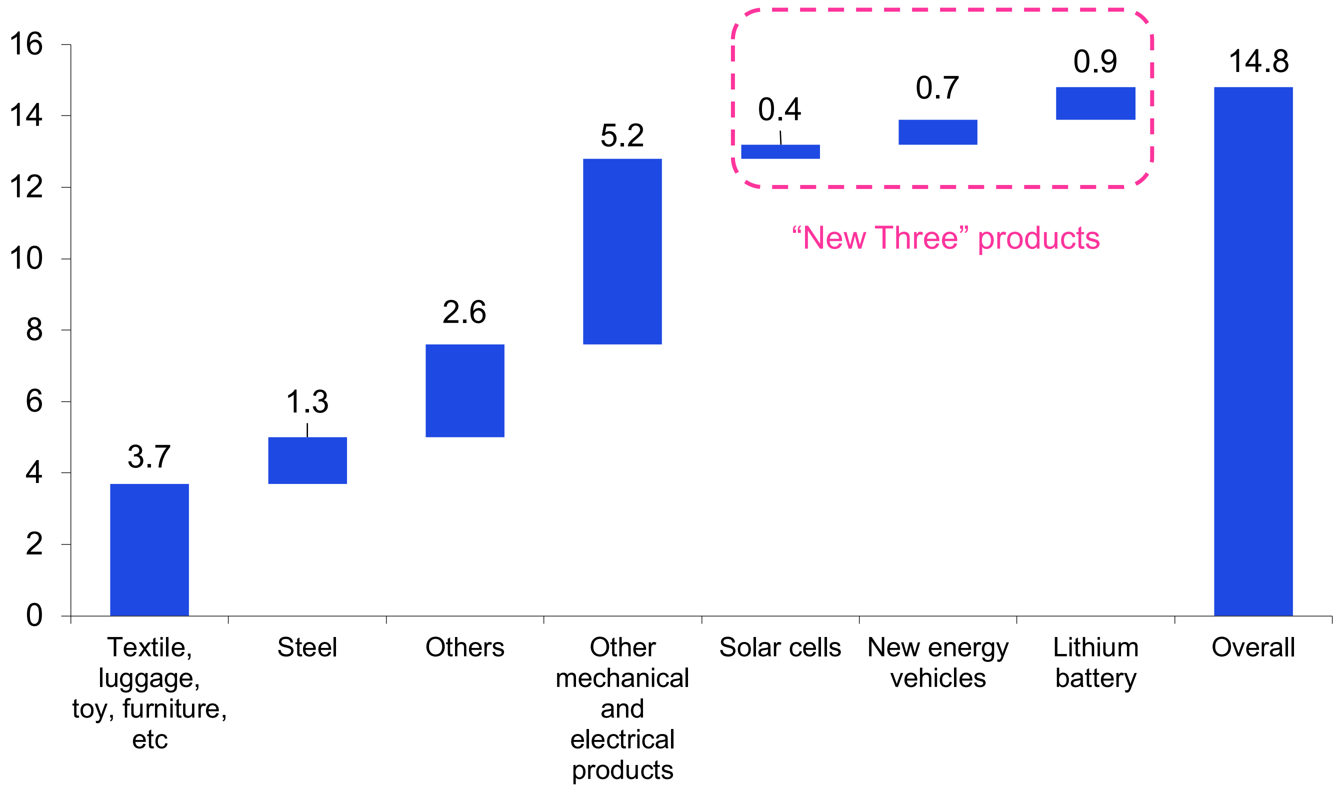


Source: Wind, KPMG analysis

- Despite slowing exports to advanced economies, China's trade with emerging markets continued to rise. China's exports to ASEAN grew 18.6% year-on-year, reaching USD 56.4 billion in March 2023, a record high.
- The rise in exports to ASEAN indicates that some downstream segments of China's supply chain are shifting, which is predicted to both lower the risk of trade tension and promote the upgrading of China's manufacturing.
- In addition, China's exports to Africa, the Middle East, Mexico and India see rapid growth in Q1 2023.
- After five months in negative territory, China's exports to the EU turned positive in March 2023, with a growth rate of 3.4%.

“New Three” products are emerging as new drivers for China's exports

Contribution to March 2023 export growth by category, percentage points

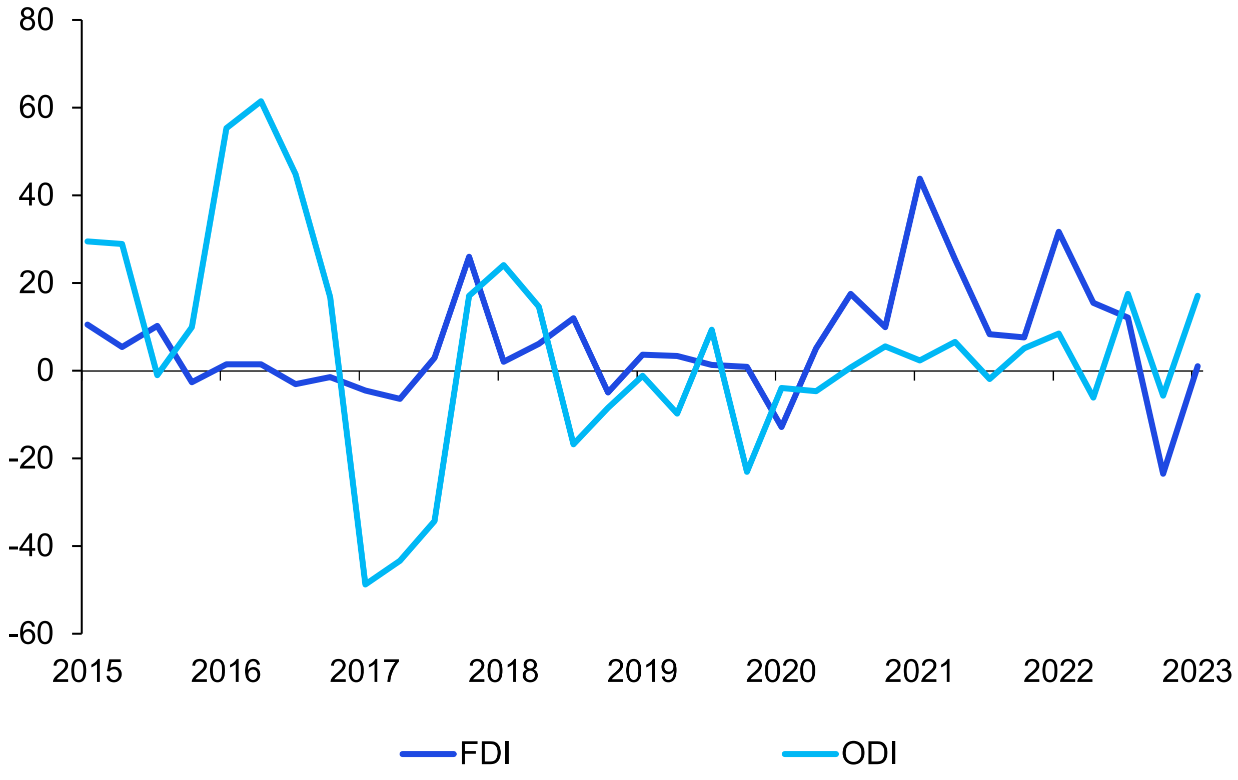


Source: The General Administration of Customs, KPMG analysis

- The share of advanced manufacturing in China’s exports has gradually risen.
- The exports of solar cells, new energy vehicles and lithium batteries totally grew 40% in March 2023, with a year-on-year increase of more than USD 5.6 billion, pulling up the overall export growth rate by 2 percentage points.
- Facilitating policies for green transition, particularly for new energy vehicles, are being actively implemented. We expect that “New Three” products will remain bright spots in 2023.

Foreign investment returned positive in Q1 2023 and outbound investment is trending up

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

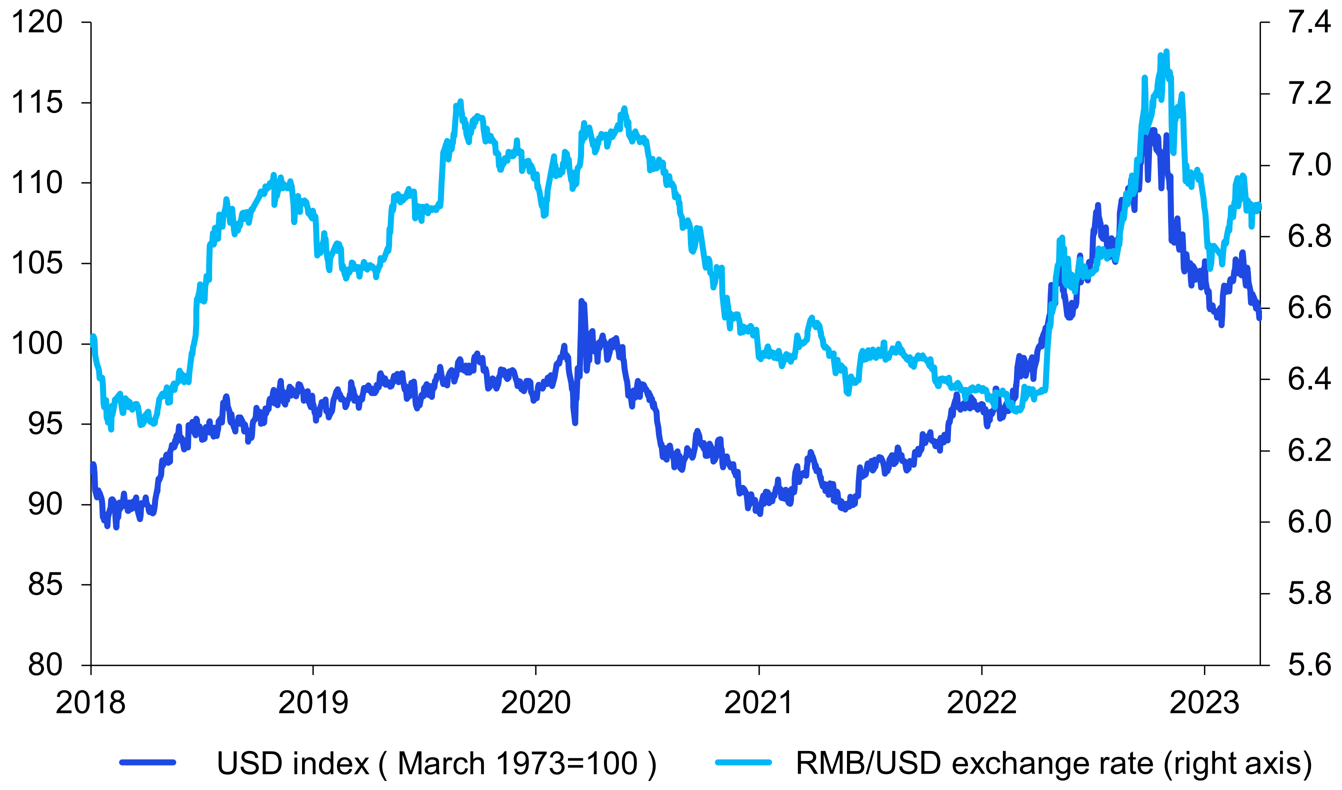


Source: Wind, KPMG analysis

- FDI maintained stable and reached $59.7 billion in Q1, with a year-on-year growth rate of 1.1%.
- Economies such as UK, France, Canada and Germany, expanded their investment in China significantly. FDI in high-tech sector grow up 18% year-on-year, accounting for 38.3% of total FDI, 2 percentage points higher than the end of 2022.
- ODI reached $31.54 billion in Q1, up 17.2% year-over-year, up 10 percentage points from the same period in 2022. Outbound investment in sectors such as wholesale/retail, transportation and manufacturing showed rapid growth. Meanwhile, investment and cooperation with "Belt and Road" economies saw steady growth.

The RMB exchange rate against the USD is expected to remain relatively stable in 2H 2023

USD index and RMB/USD exchange rate

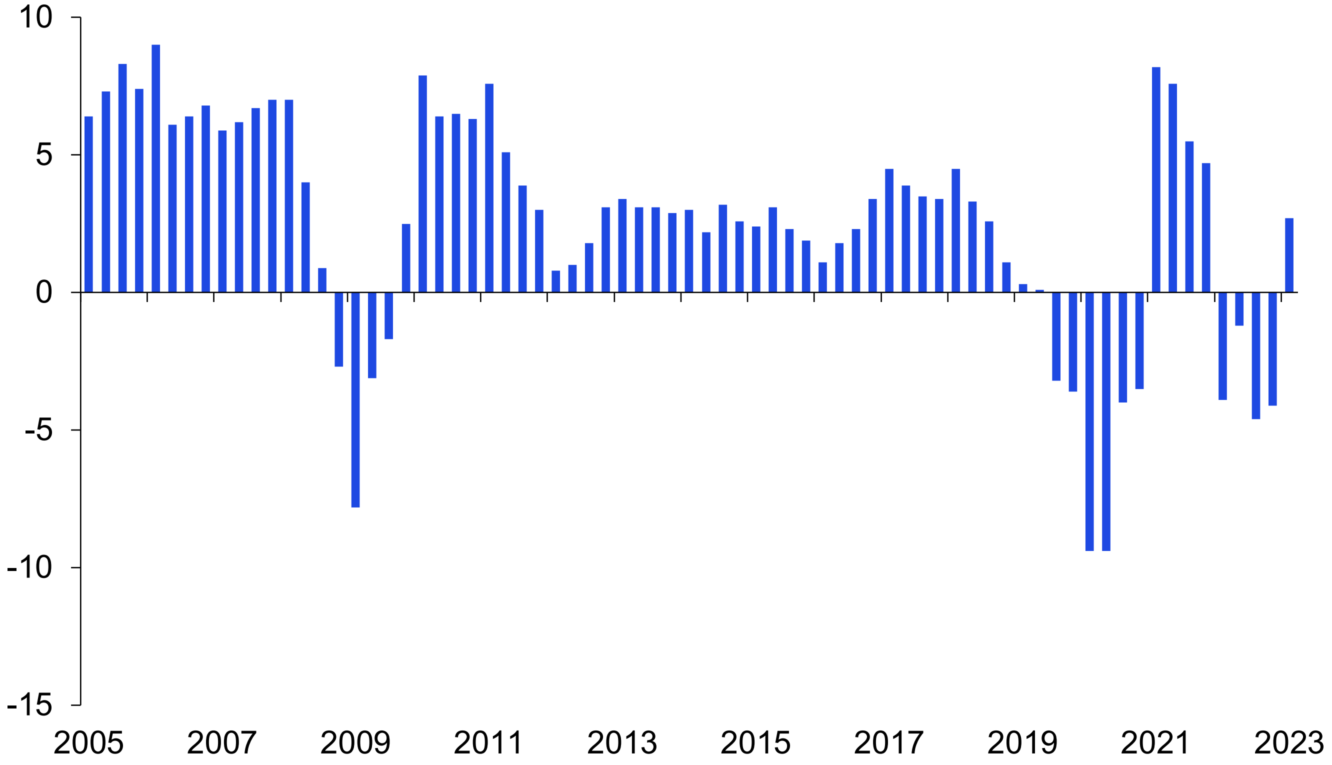


Source: Wind, KPMG analysis

- China's economy rebounded in Q1 2023 as the country's quarantine measures were lifted. With accommodative policies to stabilise economic growth, economic fundamentals are expected to further improve in 2023 .
- The banking crisis in US and Europe brought negative impact on credit and economic environment. A slower pace of Fed rate hikes and weaker US domestic expectations will drive Treasury yields and the USD index down, which would narrow the RMB/USD rate inversion.
- The expectation of stronger economic growth and a trade surplus will support to maintain the RMB exchange rate's resilience.

Hong Kong's economy is expected to recover after the re-opening

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

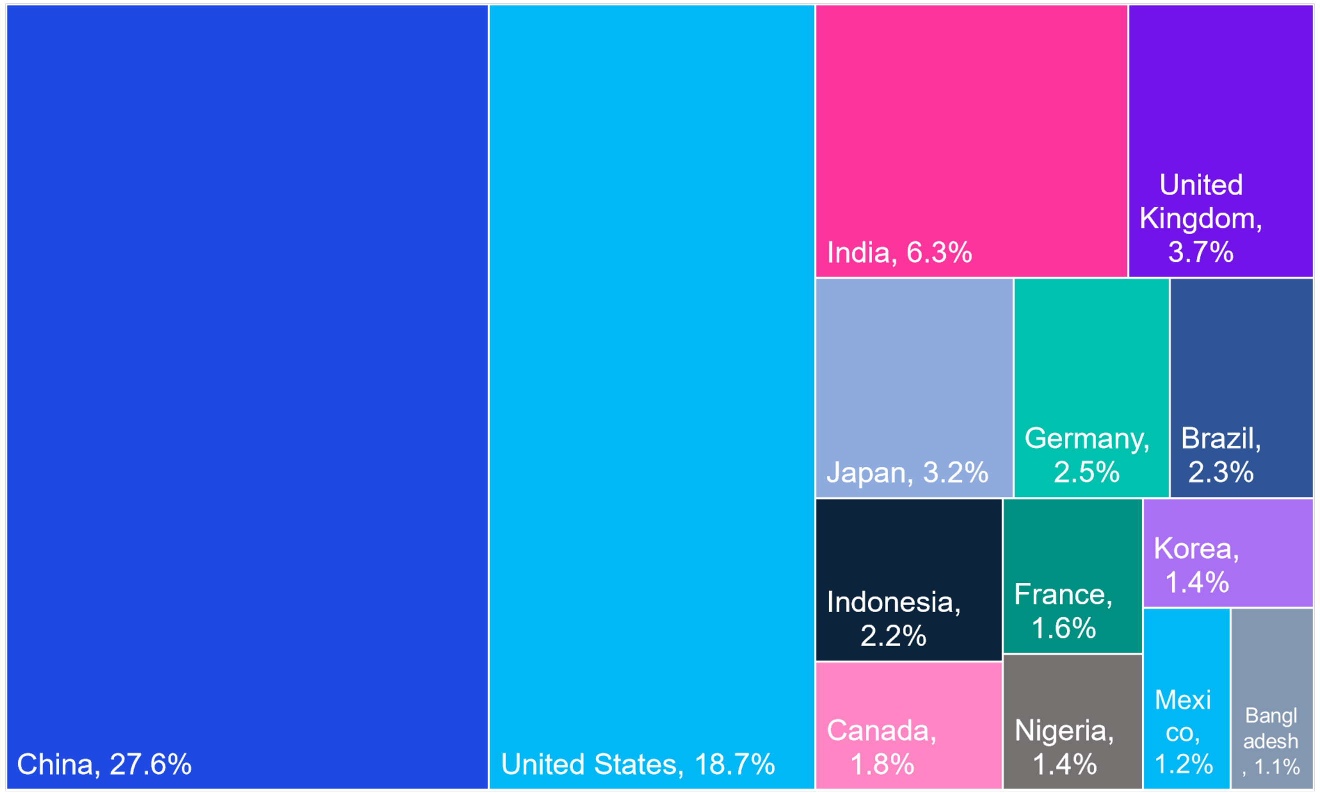


Source: Wind, KPMG analysis

- Hong Kong (SAR)'s economy improved visibly in Q1 2023, driven by strong recovery of inbound tourism and domestic demand. Real GDP resumed growth of 2.7% after contracting by 4.1% in Q4 2022.
- Exports declined further in March 2023, though the pace of decline moderated. The labour market continued to improve alongside the continued revival of domestic activities and inbound tourism.
- Looking ahead, inbound tourism and domestic demand will remain the major drivers of Hong Kong's economic growth this year. On the other hand, slower growth in advanced economies will continue to weigh on Hong Kong's export performance, but the accelerated economic recovery in the Chinese mainland and the removal of restrictions on cross-border truck movement should alleviate part of the pressure.

China is still expected to be the largest contributor to global growth in the next five years

2023-2028 World economy growth contribution, %



Source: IMF, KPMG analysis.
Note: calculation is based on IMF's GDP forecast of each country in nominal USD terms.

- Recent tensions in the banking system are increasing the downside risks to the global economy. The IMF made a 0.1 percentage points reduction to its global growth forecast for 2023, lowering it to 2.8% in its latest report.
- Global inflation has slowed, reflecting a sharp reversal in energy and food prices. Despite this, core inflation has not yet peaked in many countries. Inflation is unlikely to return to target before 2025.
- Nevertheless, positive growth momentum is expected following the reopening of China's economy. Based on our calculations using IMF forecasts, China will contribute 27.6% of global growth over the next five years, totalling more than the contribution of US and India combined. China will be the global economy's largest driver in that period.

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