China Economic Monitor: Policies support steady economic recovery

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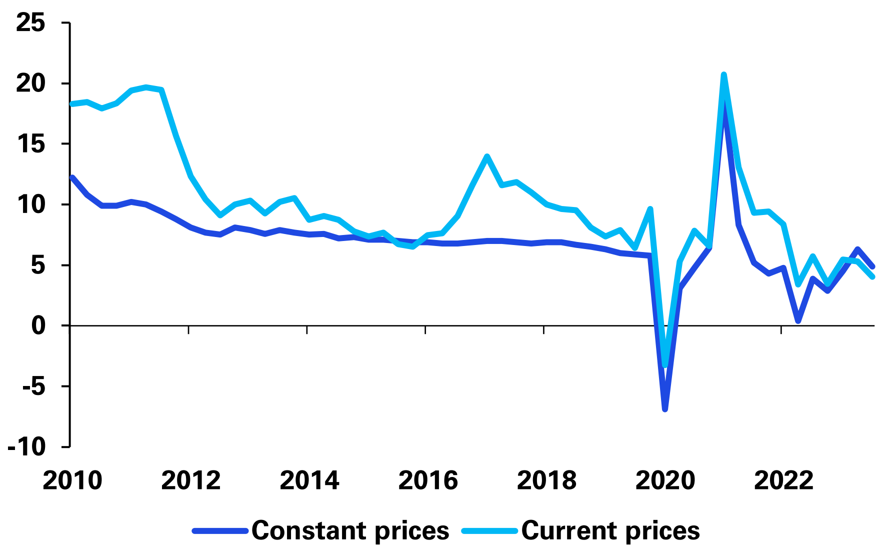
China's GDP grew 4.9% year-on-year in the third quarter, down from 6.3% in the second quarter, mainly due to the rise in the comparison base last year. Excluding the base effect, the average growth rate in 2022-23 in the third quarter was 4.4%, up 1.1 percentage points from the second quarter, exceeding market expectations. On a month-on-month basis, GDP in the third quarter increased by 1.3%, 0.8 percentage points faster than that in the second quarter, and the domestic economy continued to recover, with a significant margin of improvement. GDP in the first three quarters increased by 5.2% year-on-year. This means that, if calculated based on the expected annual target of 5%, only 4.4% growth is needed in the fourth quarter. With the gradual emergence of the effect of the steady growth policy and the low base in the same period last year, it is expected that the annual economic growth target set out in the Government Work Report at the beginning of the year can be successfully reached.

Overall, the period of the greatest downward pressure on the economy in the whole year has passed, and the economy will continue to recover moderately. However, the current economic recovery is still uneven, the momentum of economic recovery is still not strong, the foundation of economic recovery needs to be further consolidated, and the external environment is becoming more complex. Looking ahead, macroeconomic policies are expected to increase support, release the potential of domestic demand, and support steady economic growth. We expect that with the improvement of household income and policy support, the positive effect of consumption on the economy will continue to increase.

Figure 1: GDP growth, % , YoY



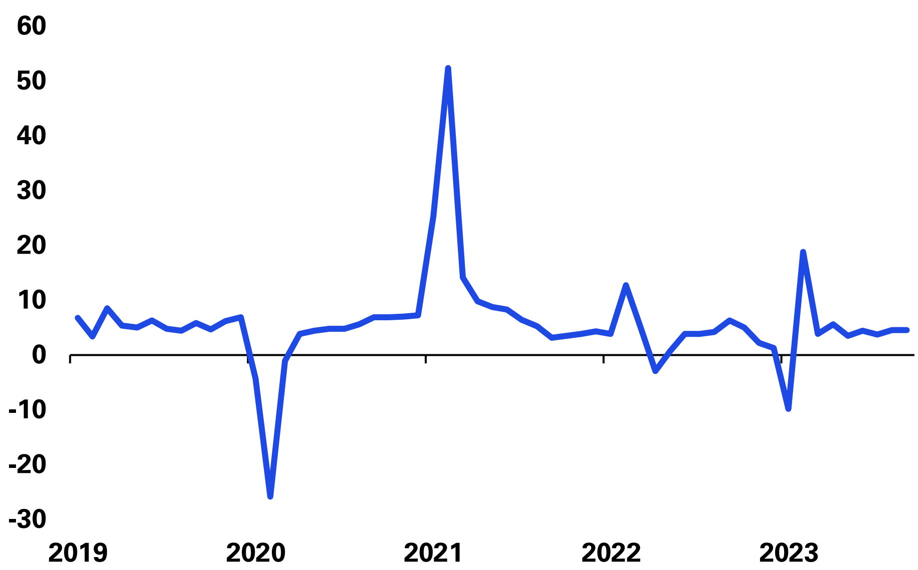
Source: Wind, KPMG analysis

In addition, the momentum of innovation continues to empower economic growth, and the accelerated pace of green transformation will inject new impetus into China's economic development. We expect China's economy to grow 5.2% in 2023.

In terms of industrial production, in the first three quarters, the added value of industrial enterprises above designated size increased by 4.0% year-on-year, 0.2 percentage points faster than that in the first half of the year, of which September increased by 4.5% year-on-year, unchanged from the previous month. However, after excluding the base effect, the average growth rate in two years was 5.4%, 1.1 percentage points higher than that in the previous month. The continuous improvement of demand and prices has promoted the steady recovery of industrial production.

With the gradual narrowing of the decline in PPI, the inventory of finished goods has also begun to bottom out year-on-year, and enterprises have gradually entered the stage of actively replenishing inventory, which forms support for industrial production. However, the recovery of industrial production is still weaker than that of the service industry. In the fourth quarter, with the continuous recovery of demand, the improvement of corporate profits and the low base effect, the growth rate of industrial production is expected to rebound significantly.

Figure 2 Added value of industrial enterprises above a designated size , cumulative YoY,%

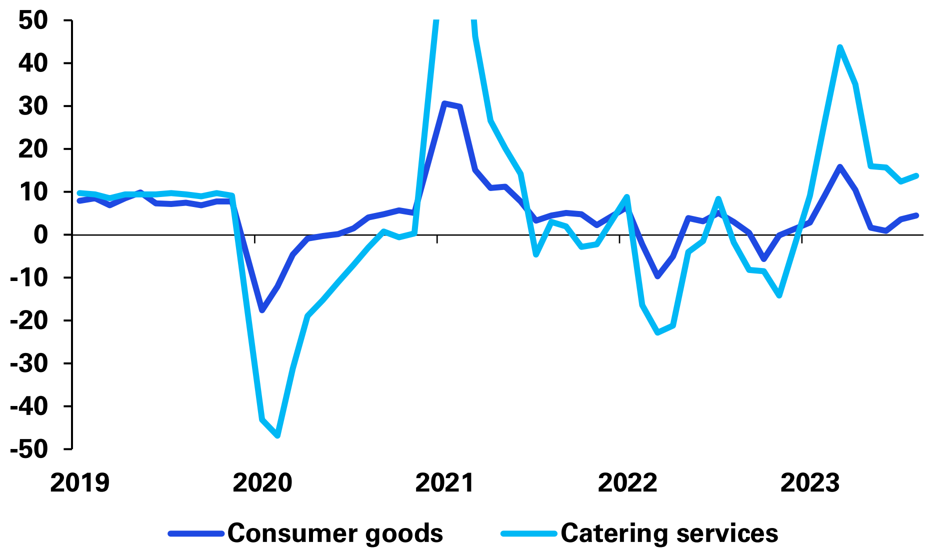


Source: Wind, KPMG analysis

On the demand side, with a series of policies and measures to promote consumption taking effect, the consumption of accommodation, catering, tourism and other services has rebounded significantly, and the basic role of consumption in driving economic growth is more stable. In the first three quarters, consumer expenditure drove economic growth by 4.4 percentage points. Within this, Q3 drove economic growth by 4.6 percentage points. In the first three quarters, retail sales were 34,210.7 billion RMB, a nominal increase of 6.8% over the same period last year.

From the perspective of two-year average growth rate, the average growth rate in the third quarter was 3.9%, 1.1 percentage points faster than that in the second quarter. In August and September, the growth rate of market sales accelerated for two consecutive months, reflecting the further consolidation of the recovery trend of the consumer market. Looking ahead, the recovery of income growth will guarantee the steady growth of consumption in the second half of the year. With the further development of macro policies in supporting the demand for improved housing, new energy vehicles and other bulk consumption areas, consumption is expected to continue to recover.

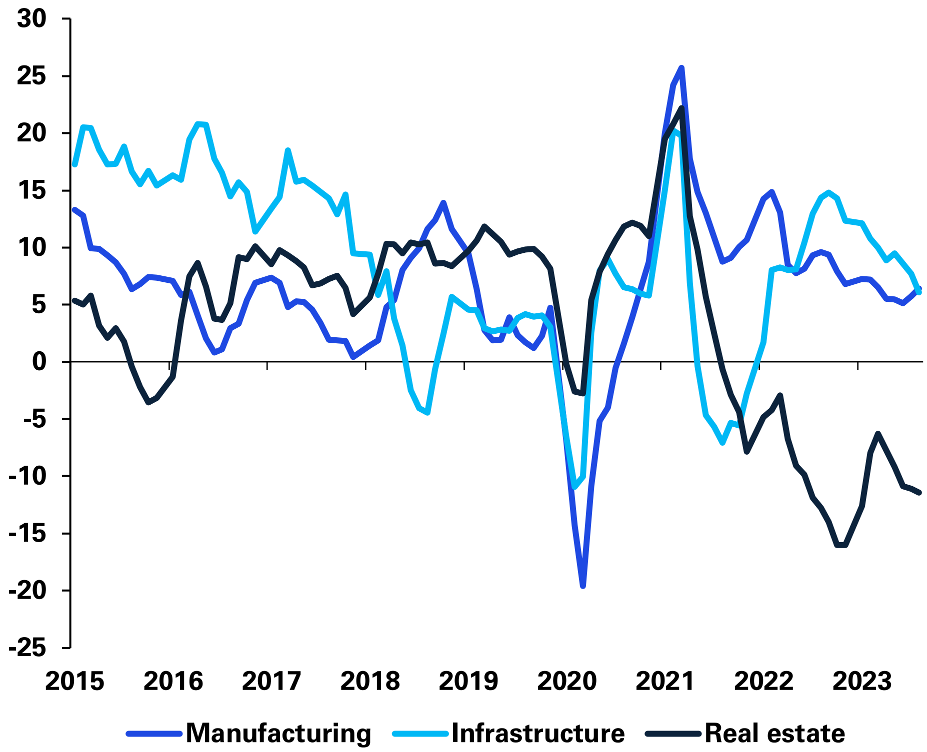
Figure 3 Retail sales, %, YoY



Source: Wind, KPMG analysis

In terms of investment, in the first three quarters, fixed asset investment totalled 3.1% year-on-year, 0.7 percentage points slower than in the first half of the year, and private investment totalled -0.6% year-on-year, 0.1 percentage points narrower than in January-August. It has been in a negative growth range for five consecutive months, and the willingness and ability of private enterprises to invest are still insufficient. Policies are still needed to boost confidence and improve expectations. From the perspective of the internal structure of investment, in September, there was a differentiation pattern that infrastructure and manufacturing support continued to strengthen. However, the effect of a series of real estate support policies introduced since the end of August remained to be seen.

Figure 4 Fixed assets investment by sector, yoy, 3-month moving average ,%

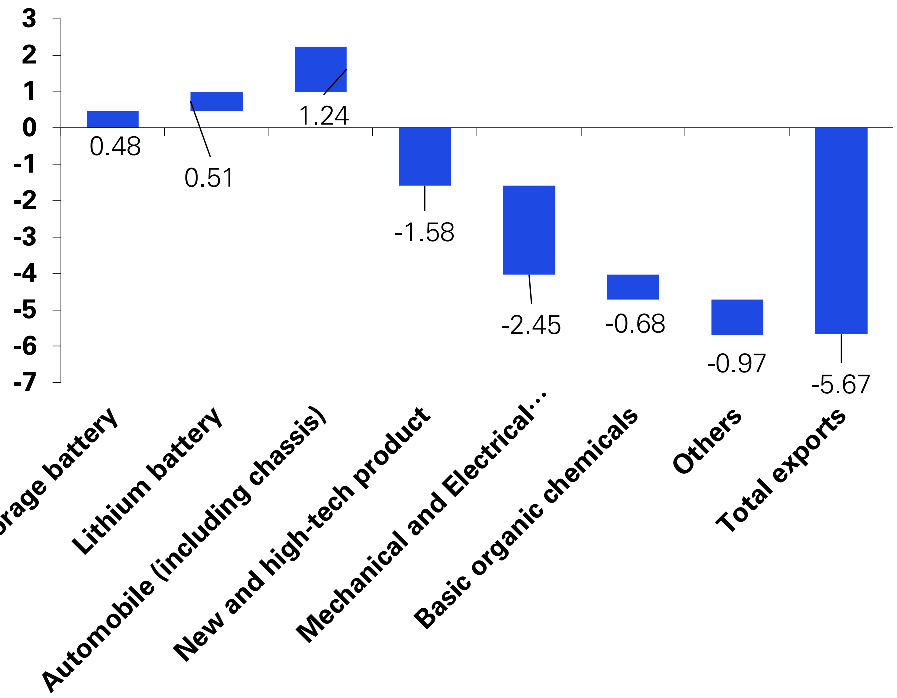


Source: Wind, KPMG analysis

On the export side, China's exports in USD terms fell 5.7% in the first three quarters compared with the same period last year, better than market expectations. In terms of trade structure, the export of power battery products and automotive products was quite bright, especially automobiles, which have become the export growth driver in the first three quarters of China. On the other hand, the decline in the import of mechanical and electrical products, high-tech products and crude oil has narrowed. In terms of trading partners, Russia and the five Central Asian countries experienced the highest growth of China's foreign trade in the first three quarters, but the growth rate of trade with four developed economies in Europe, the United States, Japan and South Korea continued the downward trend this year.

In terms of exchange rate, the overall trend of RMB exchange rate operation in the first three quarters of 2023 showed a rise first and then a decline, mainly affected by the Sino-US trade gap and monetary policy gap. Looking to the future, the policies of “Houses are for living in, not speculation” in the real estate market, the interest rate reduction of the first set of stock housing loans and the loosening of purchase restrictions, as well as the policies of stamp tax reduction and the relaxation of refinancing of housing enterprises in the capital market, will further improve the domestic economic fundamentals and expectations, and support the RMB exchange rate.

Figure 5 Contribution to export growth by category , the first three quarters of 2023, percentage points

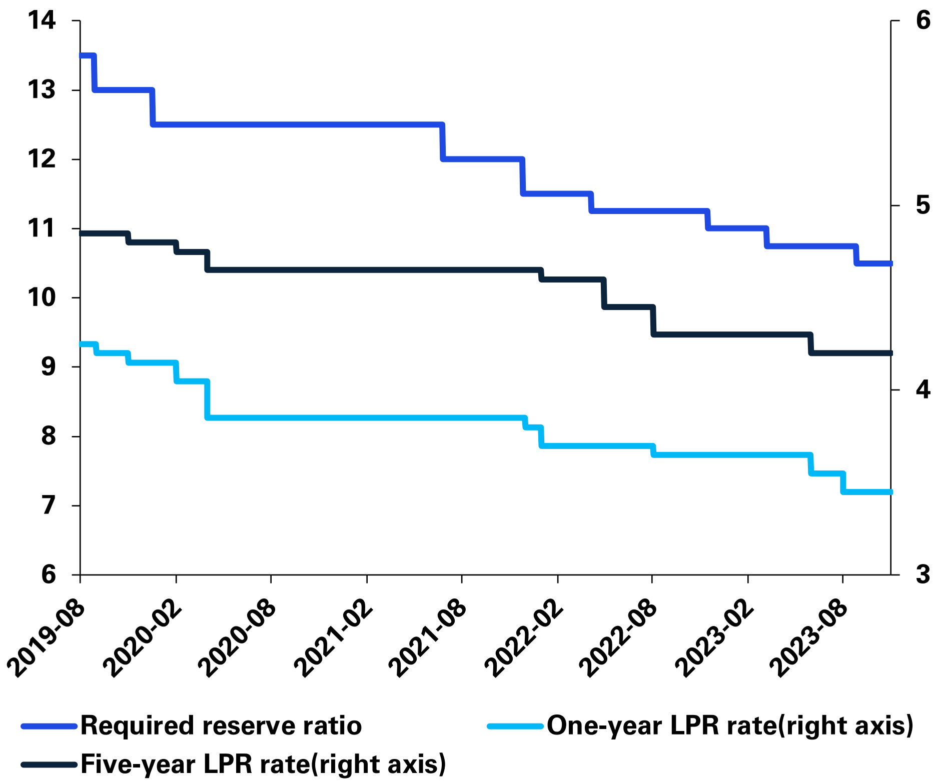


Source: General Administration of Customs, KPMG analysis

In terms of fiscal policy, both fiscal operation revenue and expenditure in the first three quarters were weak. The progress of general public budget revenue and expenditure and government fund budget revenue and expenditure was lower than the same period in 2019. Fiscal policy in the fourth quarter will continue to work to consolidate the trend of economic recovery. On October 24, the Standing Committee of the National People's Congress approved the draft resolution of the State Council on the issuance of additional treasury bonds and the central budget adjustment plan for 2023, which clearly states that the central government will issue an additional 1 trillion RMB of treasury bonds in the fourth quarter of this year. As a special treasury bond management, all of the additional treasury bonds will be issued to local governments through transfer payment arrangements. This year, 500 billion RMB is planned to be used, and 500 billion RMB will be carried forward to next year. The national fiscal deficit will increase from 3.88 trillion RMB to 4.88 trillion RMB, and the deficit ratio is expected to increase from 3% to about 3.8%. In addition, by the end of October, 24 regions across the country had planned to issue special refinancing bonds to alleviate the pressure on local government debt.

In terms of monetary policy, in the first three quarters, China's monetary policy adhered to the principle of stability and steady progress, increased counter-cyclical adjustment, and effectively served the real economy. In terms of total amount, the central bank increased its support for manufacturing, inclusive finance, scientific and technological innovation and green development, and the balance of small loans to support agriculture reached 2.2 trillion RMB in September. In terms of price, in the first three quarters of this year, one-year and five-year LPR decreased by 20 basis points and 10 basis points respectively, promoting the further downward trend of enterprise loan interest rates, while promoting the implementation of the policy of reducing the interest rate of stock first-home mortgages. At the end of September, the weighted average interest rate of stock housing loans was 4.29%. In terms of structure, the growth rates of medium- and long-term loans in manufacturing, infrastructure and inclusive small and micro loans were 38.2%, 15.1% and 24.1% respectively, continuing the high growth trend since this year. In the next stage, the central bank will continue to guide the cost of personal loans and corporate financing to further decline, support the real economy to achieve effective improvement in quality and reasonable growth in quantity, and constantly promote the sustained improvement of economic operation.

Figure 6 Required reserve ratio (RRR) and loan prime rate (LPR), %



Source: Wind, KPMG analysis

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