China Economic Monitor

Issue: 2024 Q3

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Key takeaways

- China's GDP grew 5% year-over-year (YoY) in H1 2024, reaching the target set at the Two Sessions earlier this year. In Q2 2024, the economy grew 4.7%, down from 5.3% in Q1 and lower than market expectations. Extreme weather, adjustments to calculations of the value of the financial industry, and sluggish domestic demand weighed on economic growth.
- The momentum of consumption slowed down with a decline in income growth. The growth of retail sales fell to 2.6% in Q2 2024 from 4.7% in Q1. At its July meeting, the Politburo pointed out that consumption would be the core engine to boost domestic demand. Consumption is expected to recover moderately in H2 2024.
- Manufacturing investments held up relatively well, with a growth rate of 9.3% in Q2 2024. The expansion of equipment renewals is expected to sustain robust growth in manufacturing investment.
- Growth in infrastructure investment dropped slightly to 7.2% in Q2 2024 from 8.8% in Q1. Government investment slowed down due to extreme weather and tightened fiscal spending. With issuances of local government special bonds and extra long-term special treasury bonds speeding up, however, infrastructure investment is expected to remain robust.
- The property market is still struggling with weak sales and sluggish investment. Real estate investment declined by 10.5% in Q2 2024. To further raise housing demand and promote activity in the property market, policies to stabilize home prices and reduce housing inventory will be implemented in H2 2024.
- Thanks to continuous improvement in external demand, exports rose by 3.6% YoY in H1 2024, with robust growth of 5.8% YoY in Q2. China's trade with emerging markets has seen fast growth, reflecting strengthened regional collaborations. Meanwhile, the optimisation of the structure of export commodities continues. Exports are expected to remain resilient through 2024.
- Overall, driven by the implementation of equipment renewal policies and the recovery of external demand, China's GDP growth remained relatively stable in H1 2024. However, it is worth noting that domestic demand is still insufficient. The downturn in prices has had a direct effect on incomes, corporate profits and fiscal revenues, constraining spending. In addition, growing foreign trade tensions may weigh on China's exports. The government is expected to adopt a more accommodative macro policy stance in H2 2024 to facilitate the recovery of economic growth.

China's economic recovery momentum slowed down in Q2

Growth rate of major economic indicators, YoY, %

	2020-23 Average	2023 Q2	2023 Q3	2023 Q4	2024 Q1	2024 Q2
GDP	4.8%	6.3%	4.9%	5.2%	5.3%	4.7%
Industrial production	5.0%	4.5%	4.2%	5.2%	6.1%	5.9%
Retail sales	4.1%	10.7%	4.2%	8.3%	4.7%	2.6%
Fixed asset investment	4.4%	3.1%	1.9%	2.7%	4.5%	3.6%
Exports	9.0%	-4.9%	-9.9%	-1.2%	1.5%	5.8%
Imports	6.4%	-7.0%	-8.5%	0.9%	1.6%	2.5%
Income per capita	4.8%	8.3%	6.1%	6.7%	6.2%	4.2%
Fiscal revenue	4.6%	31.7%	-0.9%	-1.0%	-2.3%	-3.2%
Fiscal expenditures	3.7%	1.0%	4.1%	9.2%	2.9%	1.1%

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

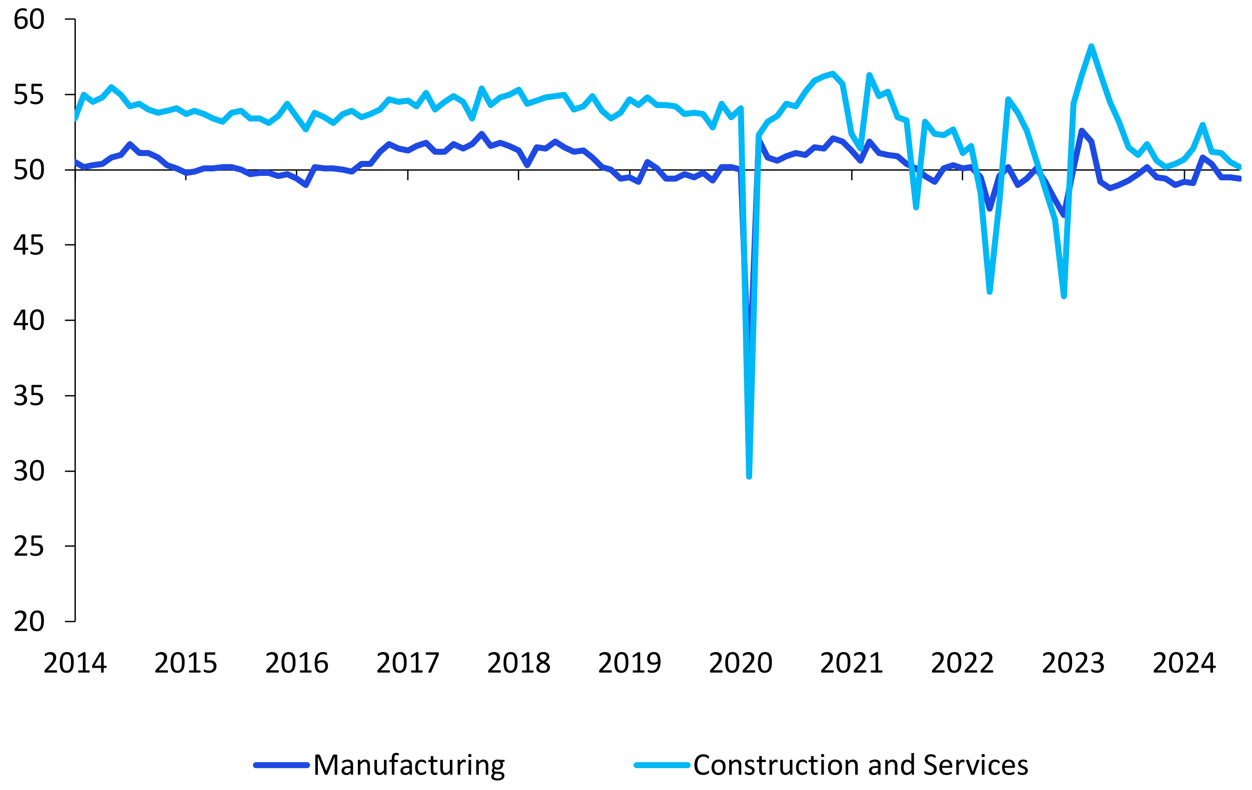
- China's GDP grew 5% year-on-year in H1 2024, reaching the target set at the Two Sessions. However, the growth rate in Q2 dropped to 4.7% in Q2 from 5.3% in Q1, which was lower than expectations. Beyond challenges posed by extreme weather, the slowdown reflected sluggish domestic demand.

- The contribution of consumption to GDP fell from 73.7% in Q1 to 46.5% in Q2. Retail sales growth plummeted to 2.6% in Q2 from 4.7% in Q1 due to weakness in incomes. Fixed asset investment growth dropped to 3.6% in Q2, with activity in the real estate market remaining subdued and infrastructure investment constrained by shortages in fiscal funds.

- Export growth picked up from 1.5% in Q1 to 5.8% in Q2 due to a lower base and robust external demand.

Extreme weather and weak demand still weighed on production side

Manufacturing and non-manufacturing PMI

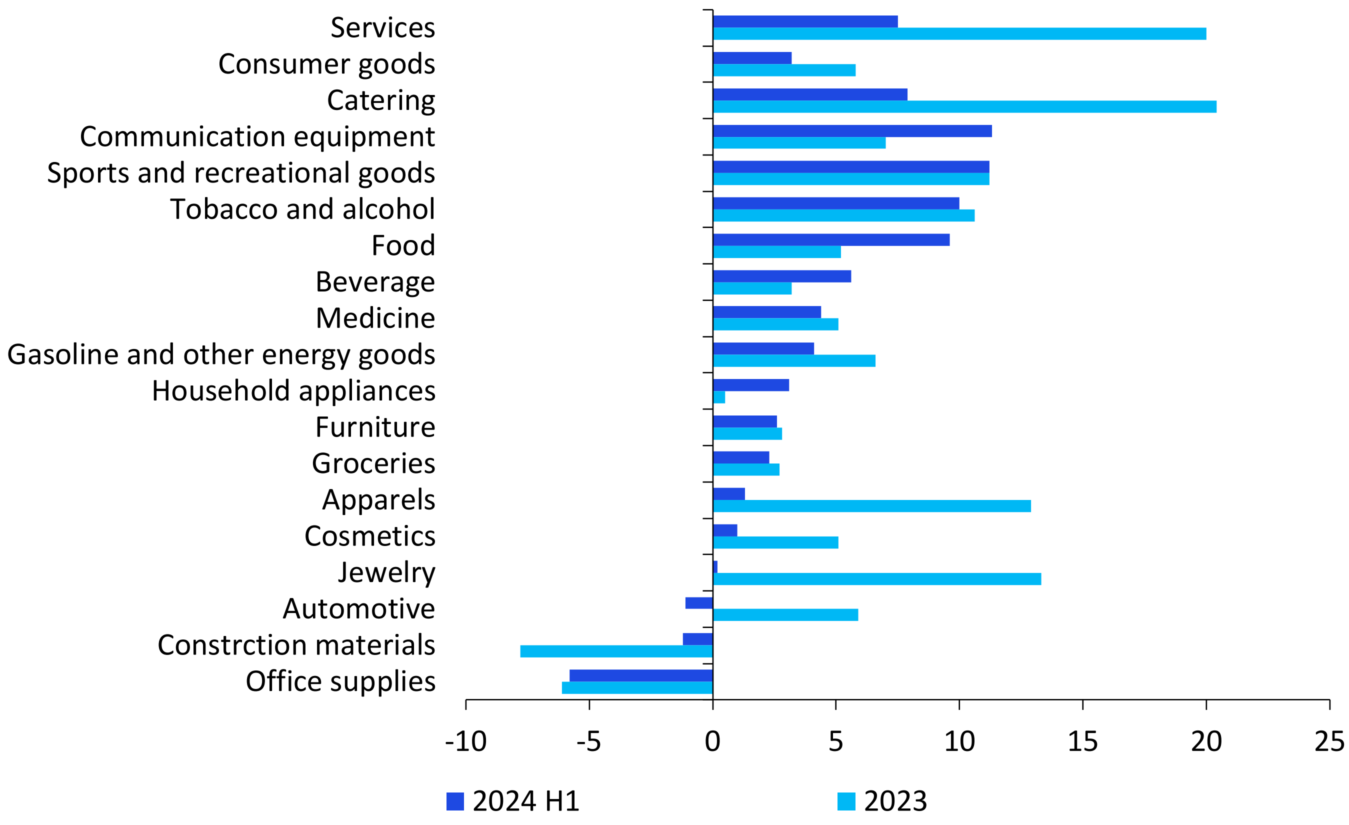


Source: Wind, KPMG analysis

- The manufacturing PMI has been below 50 for the past three months, since April, and fell to 49.4 in July. The divergence between production and demand recovery persisted. The production index dropped 0.5 to 50.1 while the new orders index fell to 49.3 in July, declining below the 50 point mark. A reading under 50 indicates a contraction.
- The non-manufacturing sector also slowed down. Affected by extreme weather, construction activity slowed in July and the Construction PMI dropped 1.1 points to 51.2. With capital markets and the real estate industry still sluggish, the services PMI index dropped to 50, reaching its lowest level for the year.

Consumption slowed as residents' income growth declined

Growth of retail sales by category, YoY, %



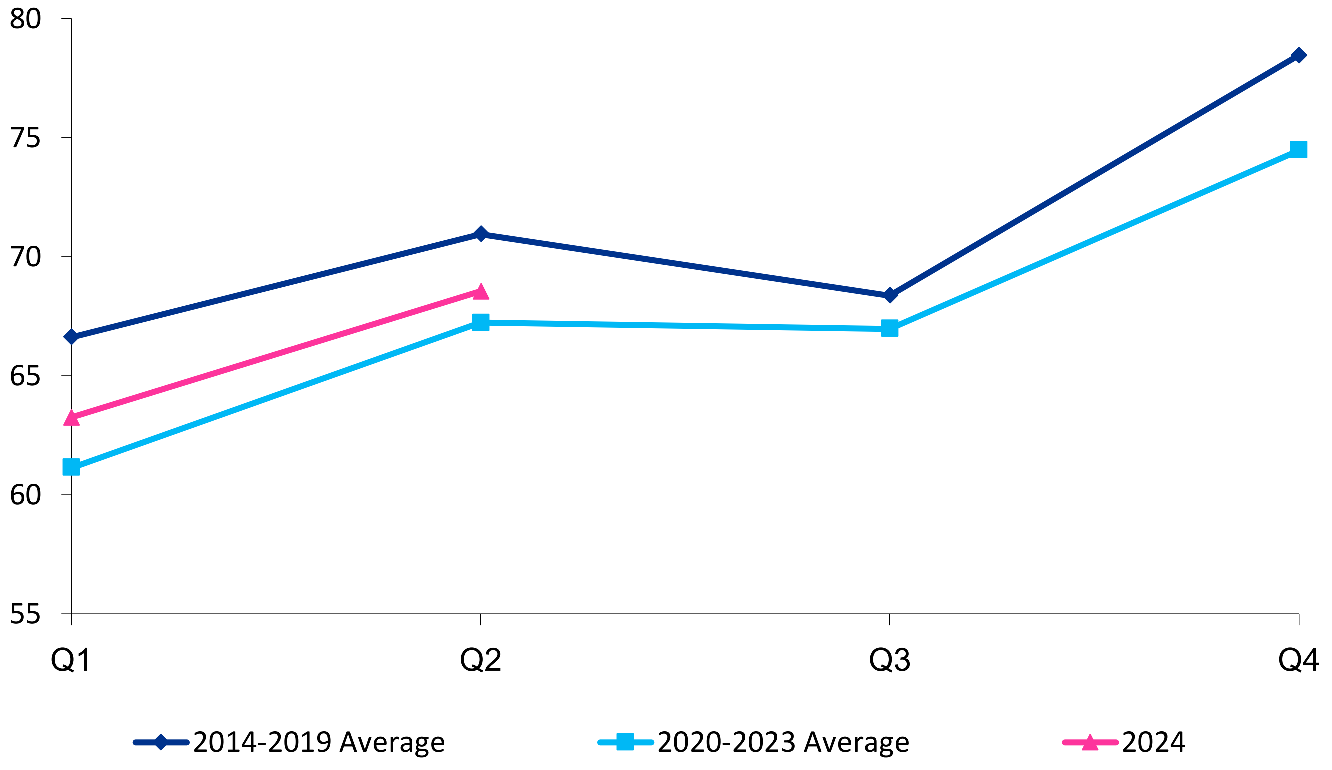
Source: Wind, KPMG analysis. Goods sales data are for above-size retail enterprises

- Consumption has continued a pattern of differentiated recovery since 2023, with services sales increasing 7.5% YoY in H1 2024, 4.3 percentage points higher than goods sales growth. Robust sales of non-discretionary consumer goods and higher-quality goods contributed to consumption. Retail sales of property-related goods improved to varying degrees, driven mainly by relaxed real estate policies and effective trade-in policies of consumer goods.

- The government has identified boosting domestic demand through consumption as a key focus in H2 2024. It sees service consumption as an important lever to expand and upgrade consumption, supporting sectors including culture and tourism, elderly care, housekeeping, childcare, etc.

Consumers showed increased appetite for spending, but faced constraints on purchasing power

Residents' propensity to consume, %



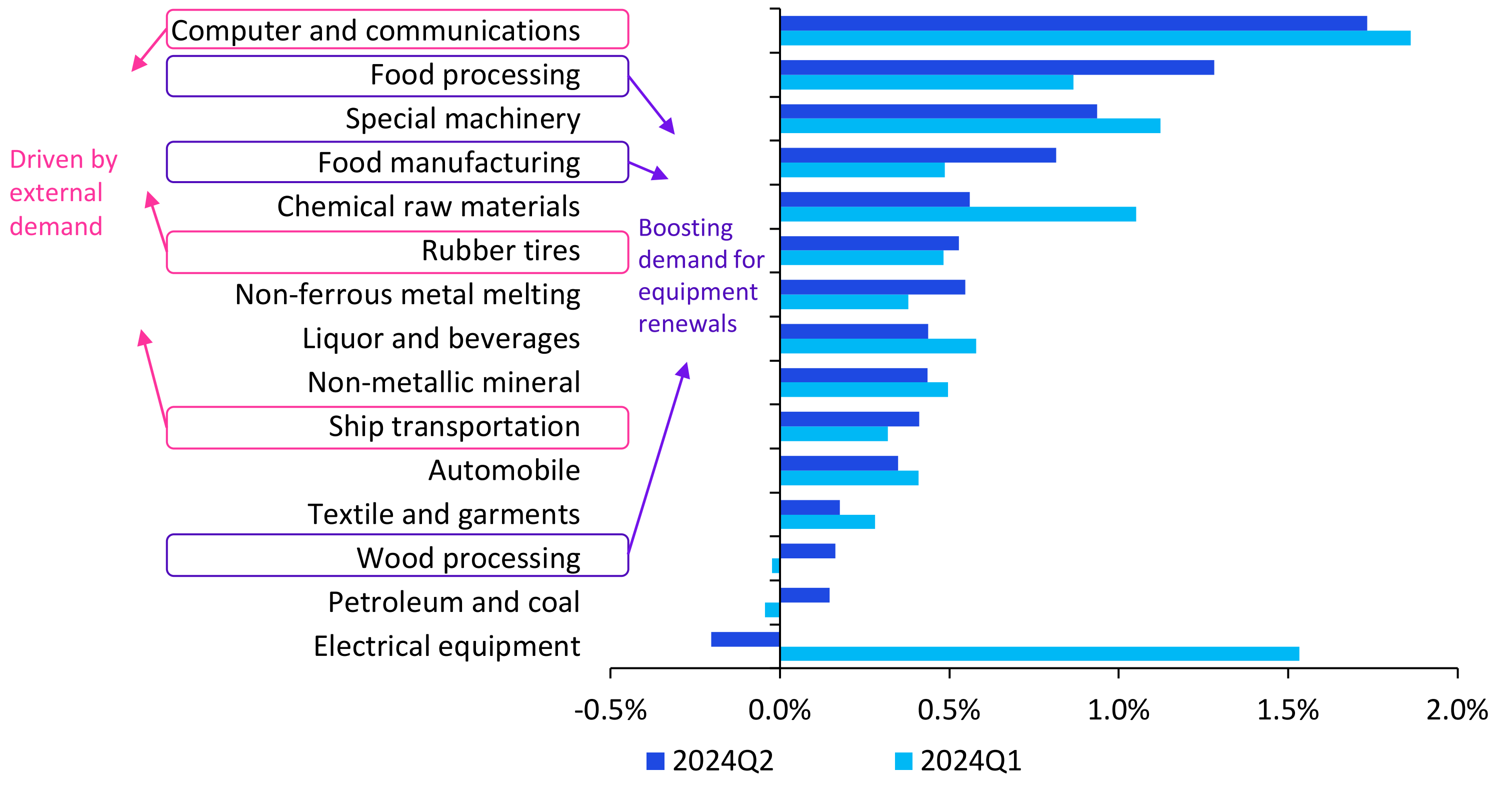
- Residents' consumption propensity rate was 68.5% in Q2 2024, up 1.3 percentage points from the average for the same period in 2020-2023. But it remained below the average of 71.0% for the same period of 2014-2019, indicating room for improvement.
- The slowdown in consumption growth was primarily due to slower income growth, as the per capita disposable income increased by 5.4% YoY in H1 2024. This was 0.8 and 1.1 percentage points lower than in Q1 2024 and H1 2023, respectively.
- Strengthening measures to stabilize employment and raise income will be necessary to support a steady recovery in residents' consumption ability and willingness.

Source: Wind, KPMG analysis

Note: Residents' propensity to consume = nationwide per capita consumption expenditures / nationwide per capita disposable income

Exports and equipment renewals continued driving manufacturing investment

Contributions to manufacturing investment growth by sector, %



Source: Wind, KPMG analysis

- The manufacturing investment growth rate dropped slightly to 9.3% in Q2 from 9.9% in Q1.
- It was the electrical equipment industry that dragged down the manufacturing investment growth rate, as profits in this industry have experienced negative growth for the past 5 months and constrained new investments.
- But driven by the recovery of exports and accelerated implementation of equipment renewal policies, the manufacturing investment growth rate was still 5.4 percentage points higher than the overall growth rate of fixed asset investment. Manufacturing investment continued to play a key role in driving GDP growth in H1 2024.

Both central and local government infrastructure investment slowed down in Q2 2024

Contributions to infrastructure investment growth by sector, %

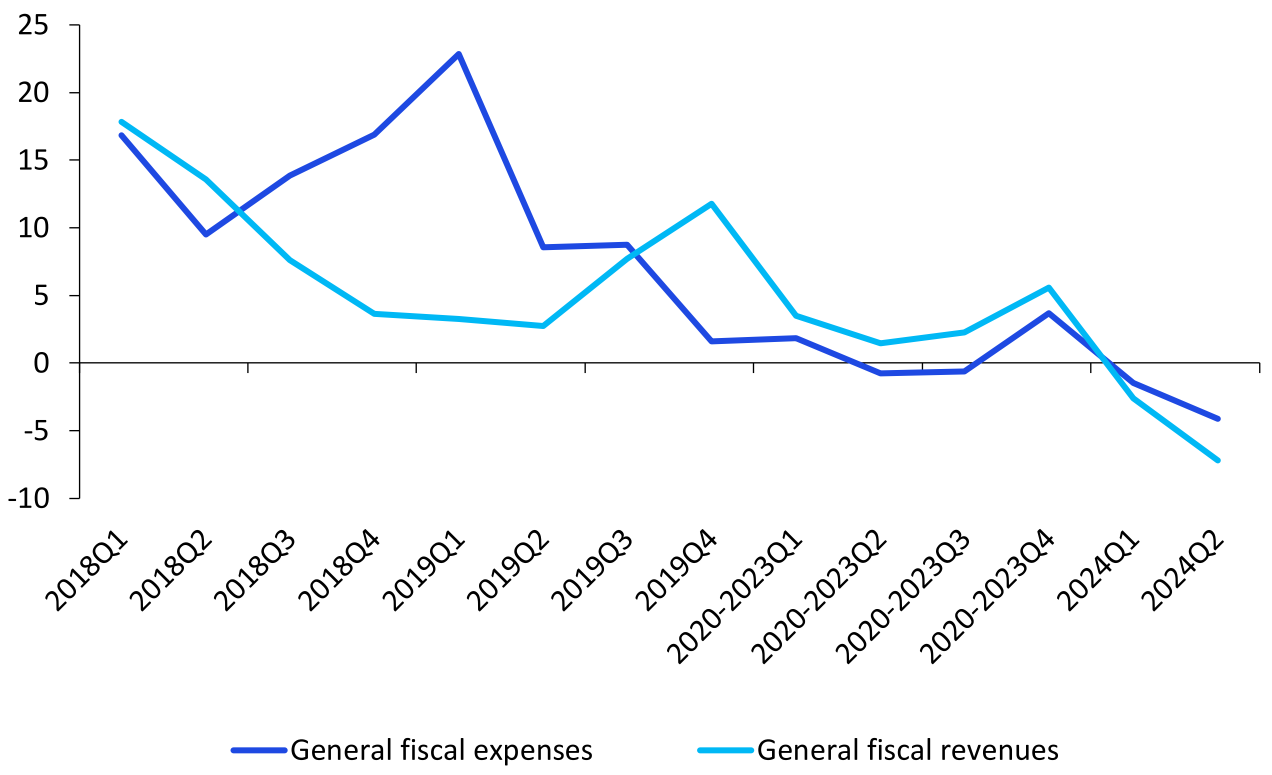
Infrastructure Industry	2024Q1	2024Q2
Infrastructure	*8.8%*	*7.2%*
Electricity, heat, gas, and water production and supply	*5.8%*	*4.7%*
Electricity and heat production and supply	*5.1%*	*4.1%*
Gas production and supply	*0.1%*	*0.0%*
Water production and supply	*0.4%*	*0.3%*
Transportation, warehousing, and postal	*2.8%*	*2.0%*
Railway transportation industry	*0.7%*	*0.6%*
Road transportation industry	*0.9%*	*-0.8%*
Waterway transportation industry	*0.1%*	*0.1%*
Air transportation	*0.3%*	*0.2%*
Pipeline transportation	*-0.1%*	*-0.1%*
Warehousing	*0.4%*	*0.7%*
Water conservancy, environmental and public facility management	*0.1%*	*0.4%*
Water conservancy	*0.9%*	*2.1%*
Ecological protection and environmental management	*-0.1%*	*0.1%*
Public facility management	*-0.8%*	*-1.9%*

Source: Wind, KPMG analysis

- Infrastructure investment growth dropped to 7.2% in Q2 from 8.8% in Q1, and 7.7% in H1, which was lower than the average growth rate seen in 2022-2023.
- Due to extreme weather events and tightened fiscal funding, electricity infrastructure projects led by the central government, road transportation and public facilities management projects led by local governments have all slowed down in this quarter.
- The contribution of these three types of projects to overall infrastructure investment growth fell to 1.5% in Q2, down from 5.2% in Q1.

Weak fiscal revenues constrained government expenditures in Q2 2024

Growth rate of general fiscal revenues and expenses, YoY, %



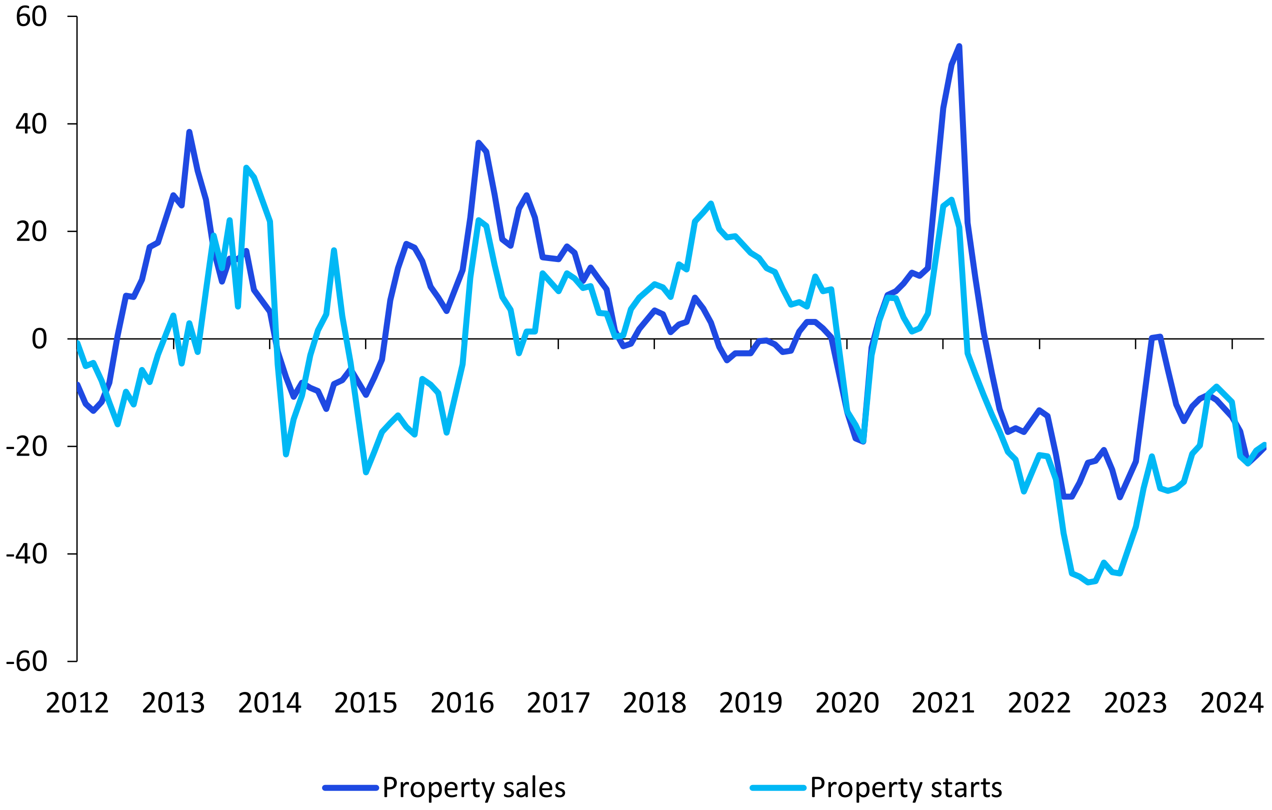
Source: Wind, KPMG analysis

To eliminate epidemic disturbance, growth rate of 4 quarters during 2020-2024 is calculated in CAGS base.

- General fiscal revenue growth dropped to -7.2% YoY in Q2, down from -2.6% in Q1 and -2.8% in H1 2024. Specifically, tax revenue declined by 5.6% and land transfer income dropped by 18.3% in H1.
- With shrinking revenues, the government curbed the expansion of investment, causing the growth rate of general fiscal expenses to fall to -4.1% YoY in Q2, down from -1.5% in Q1. It was well below the 7.9% budgeted growth rate set at the beginning of the year.
- Looking ahead, in addition to accelerating the issuance of local government special bonds in H2 2024, the central government is expected to raise its debt ceiling in 2024 in order to achieve its fiscal budget targets.

The impacts of real estate policies implemented in Q2 were limited

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

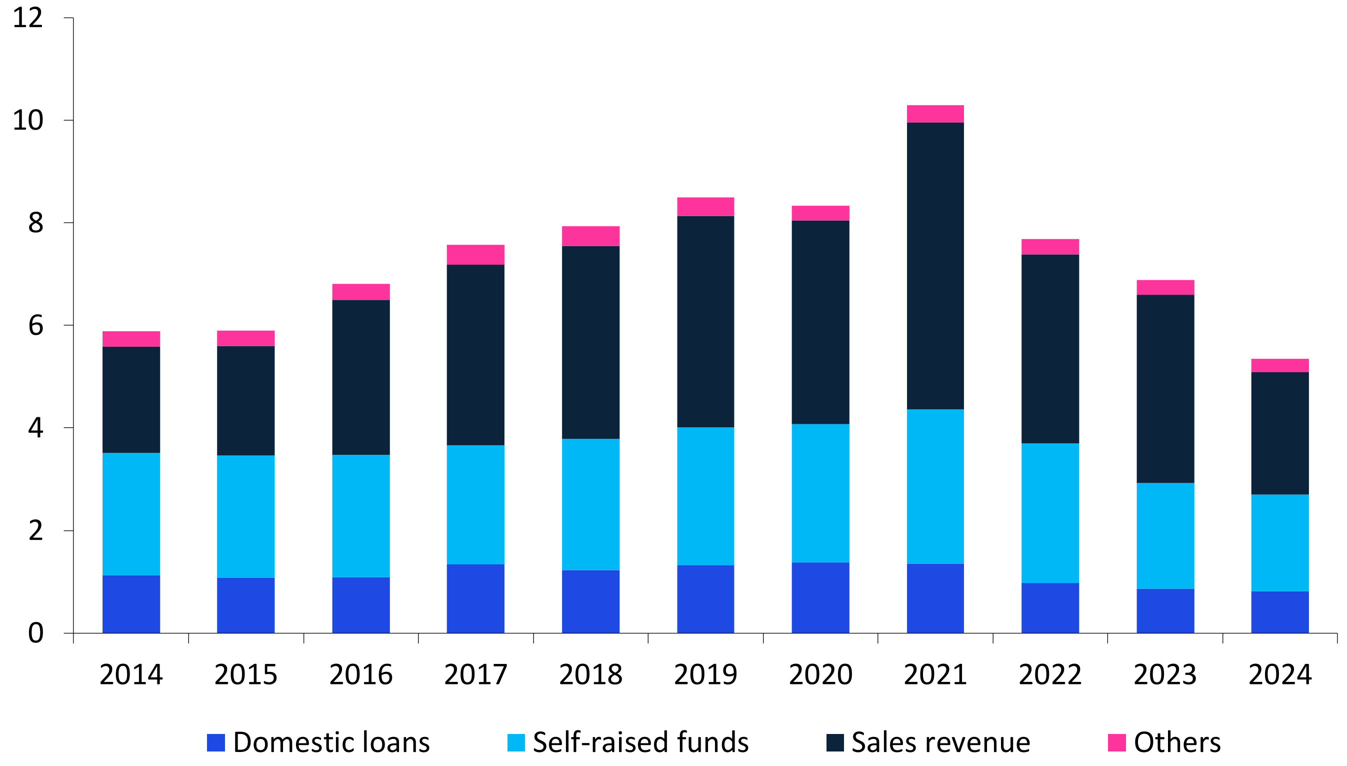


Source: Wind, KPMG analysis

- Led by a series of policies in May to stimulate property demand, property sales appeared stable in Q2, growing by -18.6% in Q2, up from -19.4% in Q1.
- However, property investment growth dropped to -10.5% in Q2 from -9.5% in Q1, reaching historically low quarter-on-quarter momentum.
- The divergent recovery pace of sales and investment in Q2 can be partly explained by extreme weather that disrupted regular construction schedules. More likely was that the limited improvement in sales prompted enterprises to stay cautious about expanding investment.

Liquidity pressure on property developers persisted

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

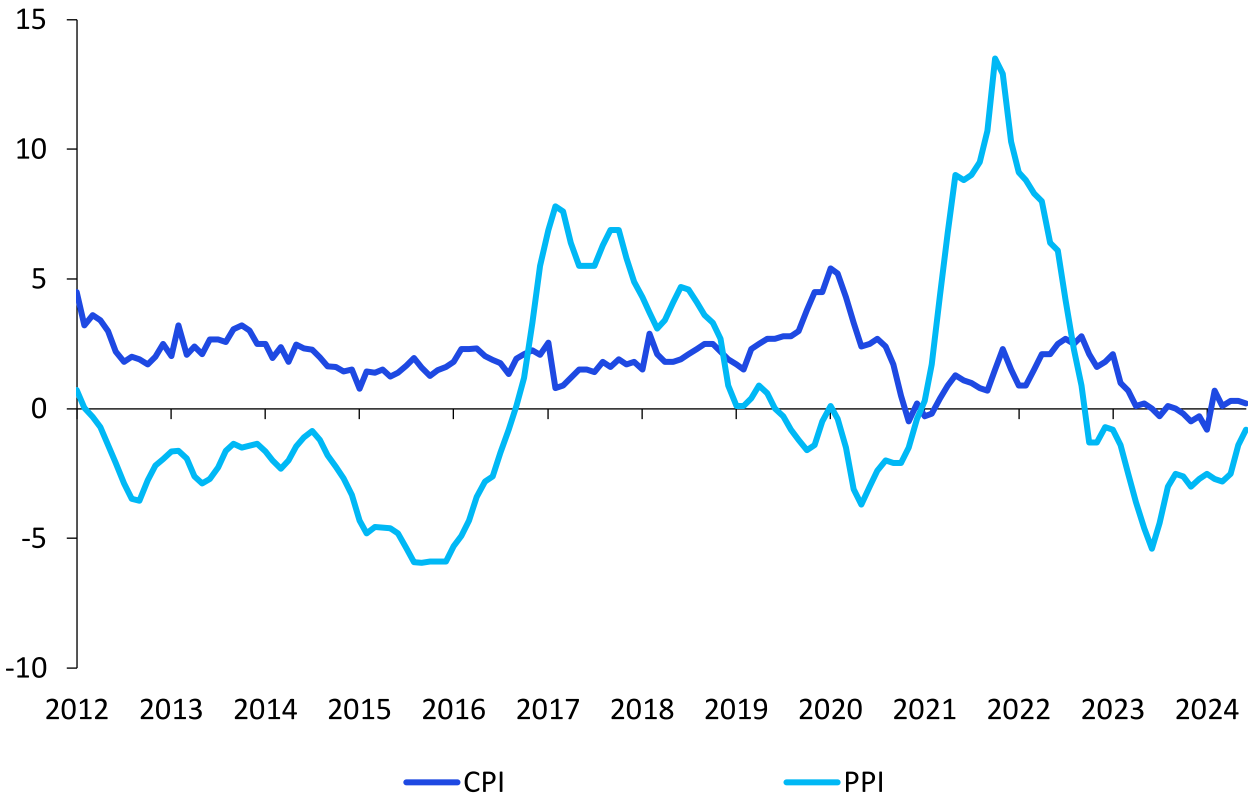


Source: Wind, KPMG analysis

- With sales performance recovering slightly, funding sources growth from property developers picked up to -22.6% in H1 2024, higher than -26.0% in Q1. Both sales revenue and domestic loan growth performed better in Q2 than in Q1.
- While liquidity pressure on property developers eased slightly, overall property funding in H1 remained at historic lows. Property developers chose to remain cautious about investment to prevent cash flow risks.
- To further activate housing demand and boost property developers' willingness to invest, policies to stabilize residents' house price expectations and reduce housing inventory need to be strengthened in H2 2024.

Inflation is expected to pick up moderately

China Consumer Price Index (CPI) and Producer Price Index (PPI), YoY, %

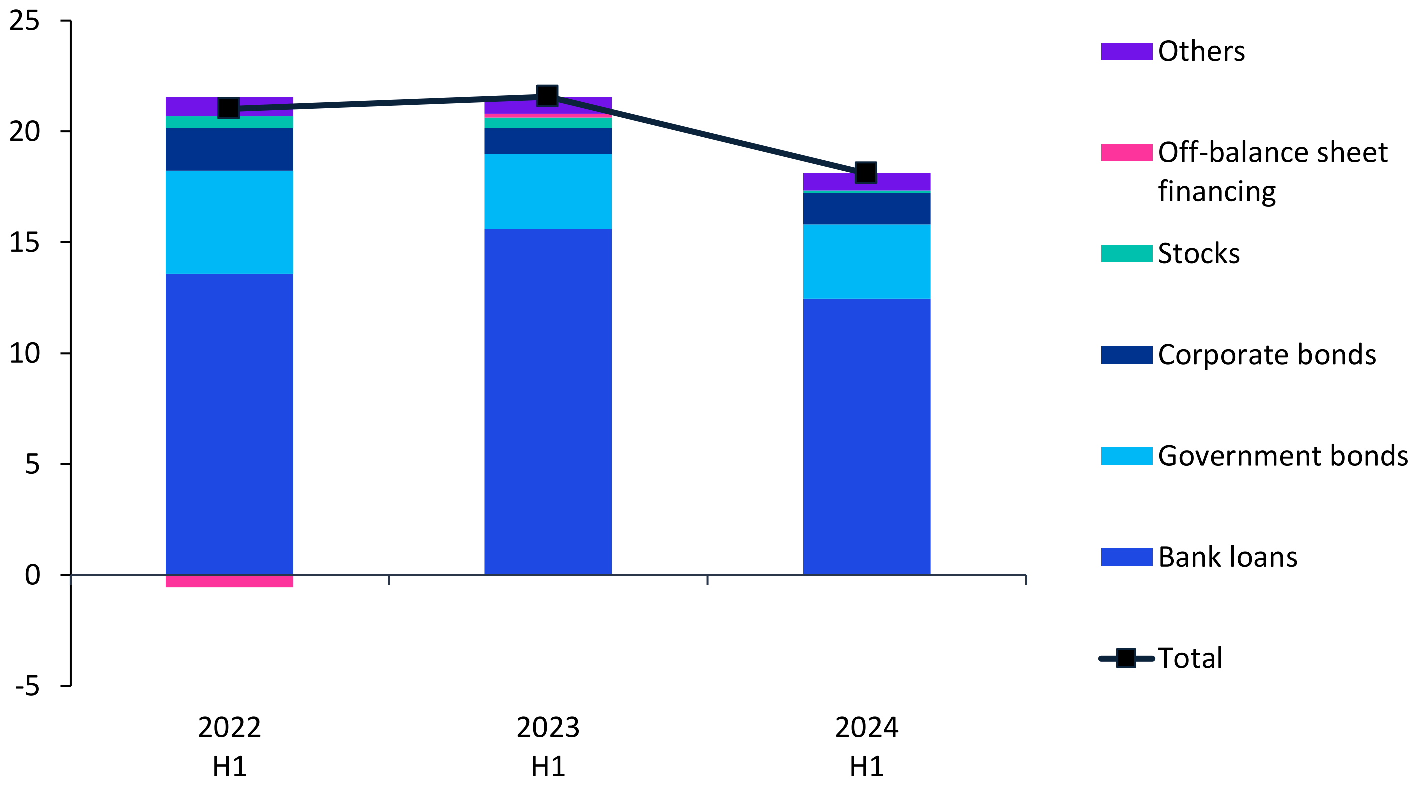


Source: Wind, KPMG analysis

- CPI rose by 0.2% YoY in June 2024, down from 0.3% in May. It was mainly due to the seasonal decline in food prices and the narrowed growth in energy prices.
- Supported by a lower base, the YoY decline in PPI narrowed in June, raising from -1.4% in May to 0.8% in June. However, the PPI continued its month-on-month slide of 0.2%, reflecting the ongoing imbalance between supply and demand facing industrial sectors.
- Looking ahead, CPI and PPI are expected to pick up modestly in H2 2024, buoyed by rebounding demands and the effects of new policies.

Growth of total social financing slowed

Growth of total social financing (TSF) by sector, RMB trillion

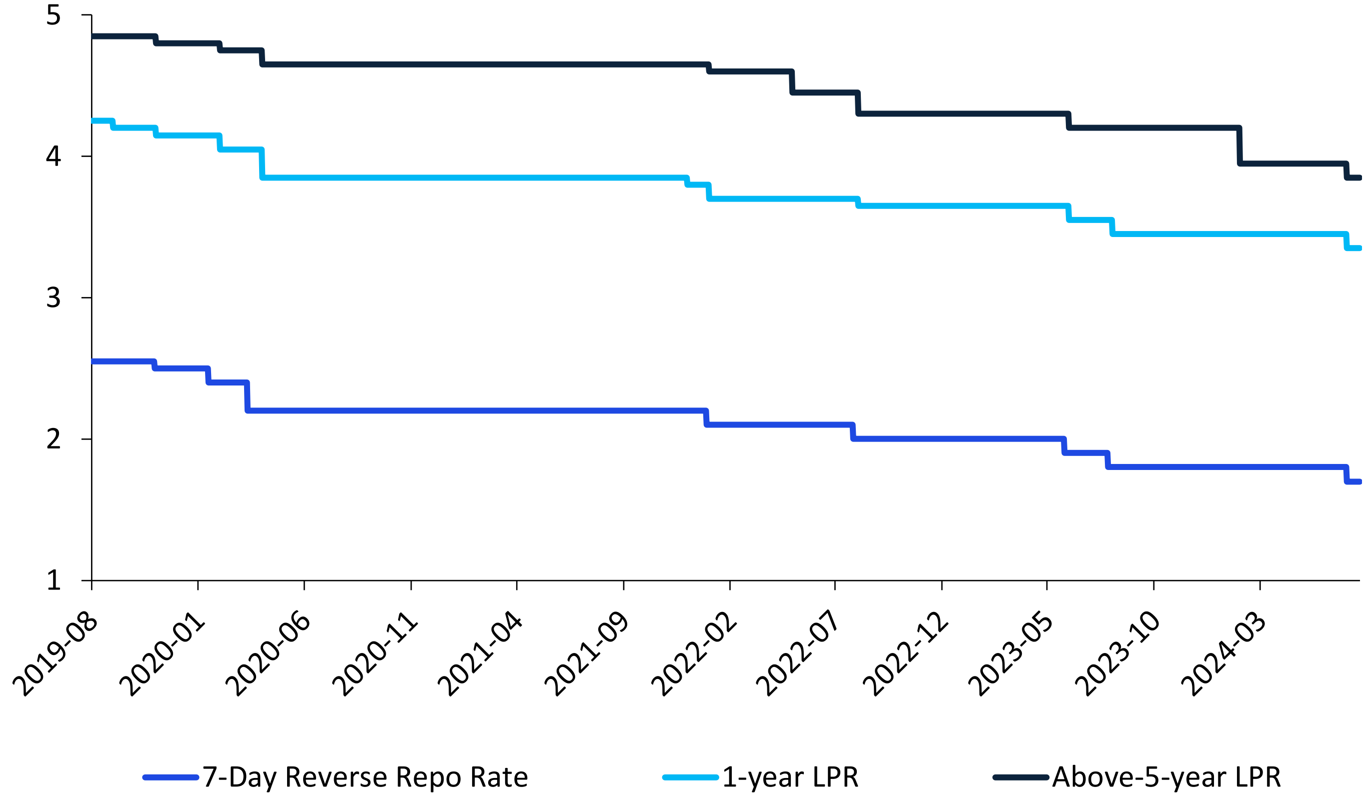


Source: Wind, KPMG analysis

- About RMB 12.5 trillion in new bank loans was issued in H1 2024, a decrease of RMB 3.1 trillion compared to H1 2023. New bank loans in Q2 2024 totalled RMB 3.3 trillion, down RMB 5.8 trillion from Q1 2024, indicating weak credit demand from the real economy amid a slowing momentum of China's economic recovery in Q2.
- As the government accelerated bond issuances in Q2, net financing from government bond issuances rose to RMB 2.0 trillion in Q2, a YoY increase of RMB 431.5 billion.
- Low market interest rates boosted corporate willingness to issue bonds. Net financing from corporate bond issuances rebounded to RMB 1.4 trillion in H1 2024, up RMB 240 billion from H1 2023.

Prudent monetary policies implemented in a targeted manner

7-Day Reserve Repo Rate and Loan Prime Rate (LPR), %

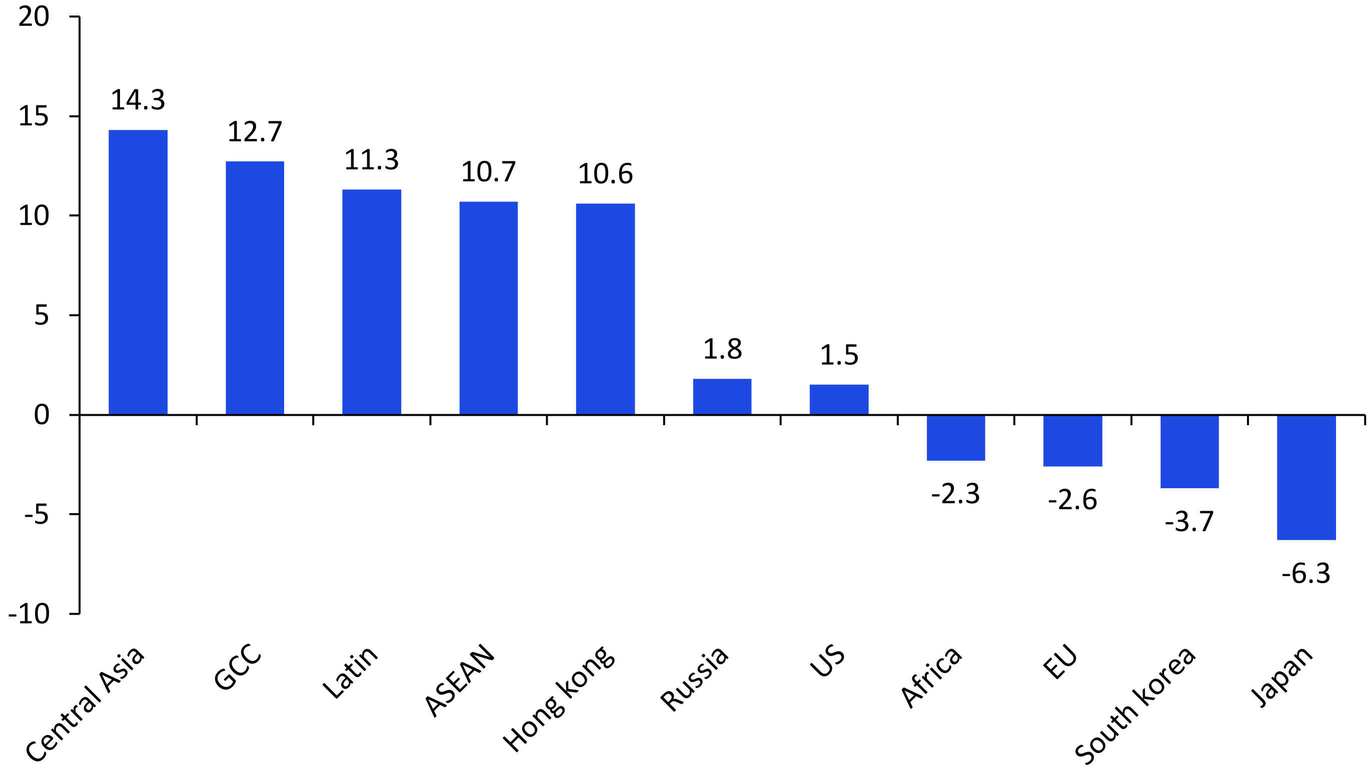


Source: Wind, KPMG analysis

- In response to signs of slowing economic and price recovery momentum, the central bank cut the 7-day reverse repo rate, 1-year and above-5-year loan prime rates by 10 basis points each. This gradual decline in financing costs aimed to convey an accommodative policy signal to markets.
- Further cuts are expected for reserve requirement ratios and other policy rates as financial conditions ease globally. Meanwhile, financial support is intensifying for key sectors such as private small and micro enterprises, technological innovation, digital economy, green development, inclusive finance, and infrastructure construction, promoting industrial upgrading and real estate destocking.

Improvement in external demand drove a steady growth in exports

Growth of China's exports to major trading partners in H1 2024, YoY, %

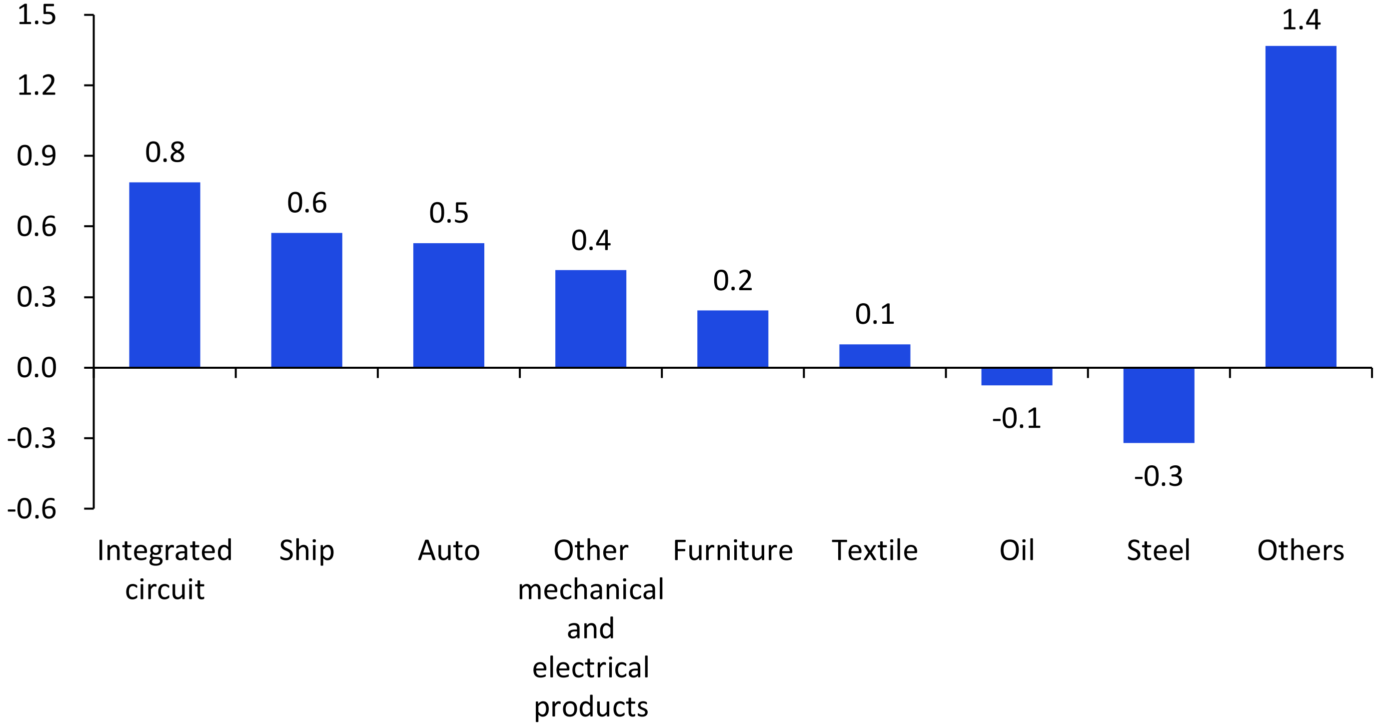


Source: Wind, KPMG analysis

- China's exports rose by 3.6% YoY in H1 2024, with robust growth of 5.8% YoY in Q2, surpassing expectations.
- China's exports to "Belt and Road" economies increased at a rapid rate, exceeding the overall export growth rate during H1 2024.
- ASEAN remained China's largest trading partner, with exports totalling USD 285.5 billion in H1 2024, a 10.7% YoY increase.
- Thanks to a stronger United States economy and lower base in the previous year, China's exports to the United States grew by 1.5% YoY in H1 2024, turning positive from -17.9% H1 2023.

Export commodity structure continued to optimize

Contributions to export growth by category in H1 2024, %

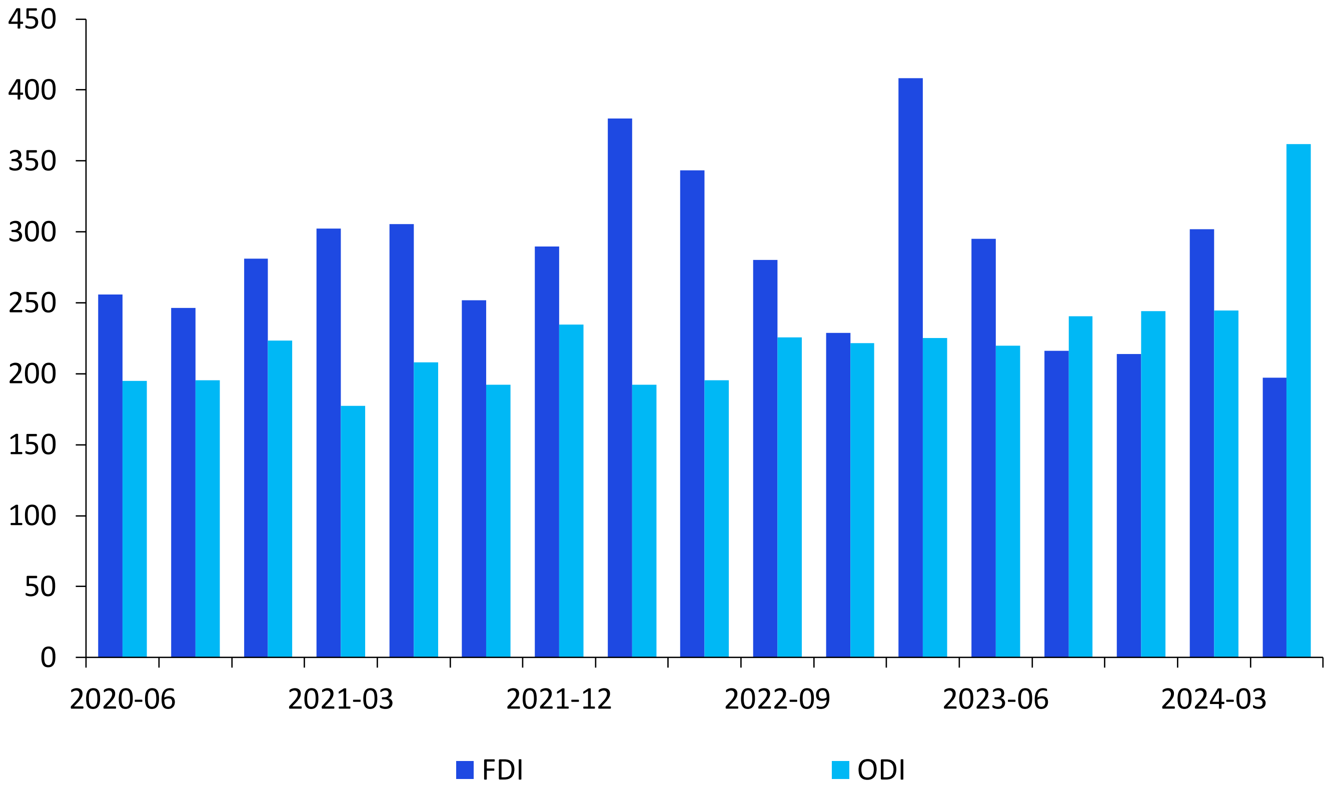


- China's export commodity structure is shifting towards the middle- and high-end sectors along the global value chain. Mechanical and electrical products accounted for 58.9% of exports in H1 2024, contributing 2.3 percentage points to the overall export growth rate. Exports of ships, electric vehicles and household appliances grew by 85.5%, 22.3% and 14.8% respectively.
- As information technology production gradually recovers, exports of integrated circuits increased by 21.6% YoY in H1 2024.
- Labor-intensive product exports, such as furniture and textiles, also showed good momentum.

Source: The General Administration of Customs, KPMG analysis

Outbound investment grew rapidly

China's foreign direct investment (FDI) and outbound direct investment (ODI), RMB billion

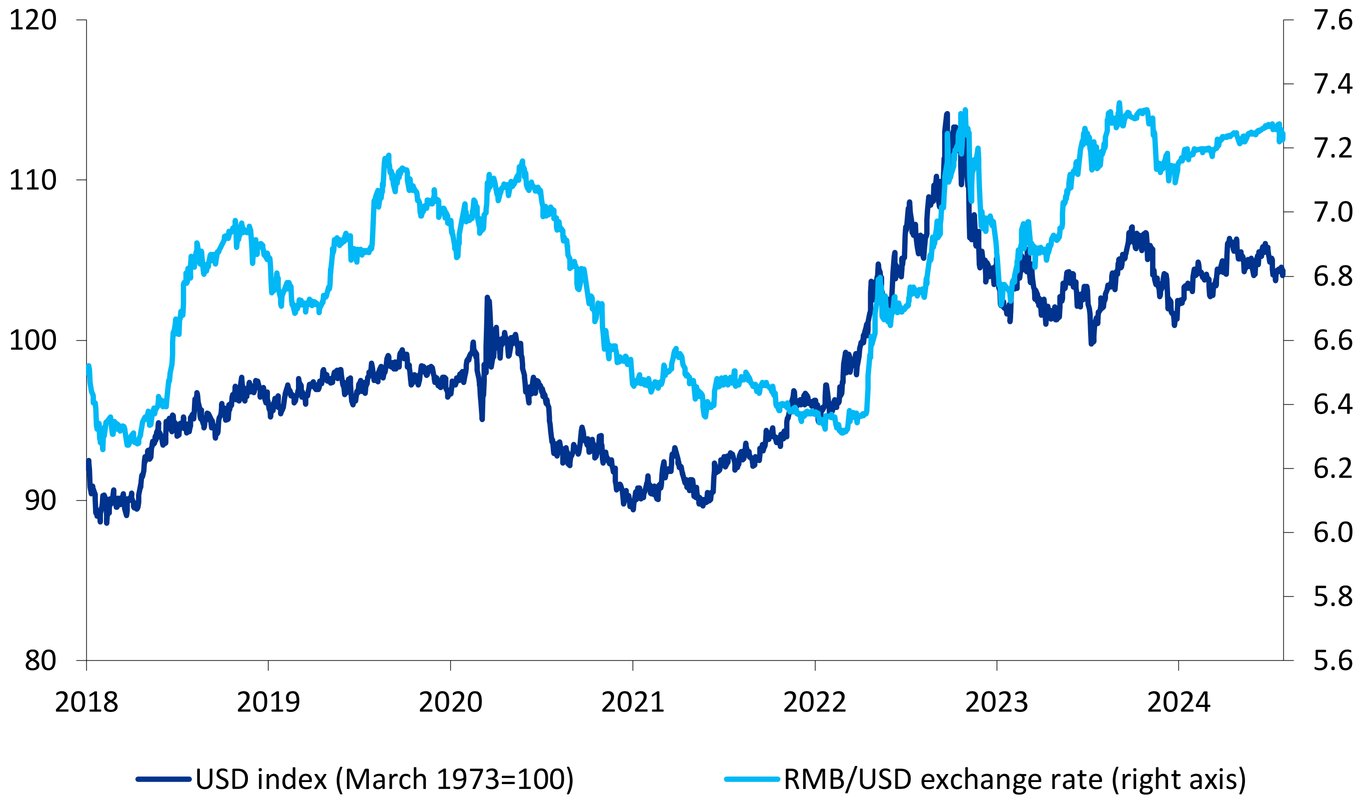


Source: Wind, KPMG analysis

- FDI into China reached RMB 498.9 billion in H1 2024, a YoY decrease of 29.1%. The composition of FDI continued optimizing, with investments into high-tech manufacturing accounting for 12.8% of the total, up 2.4 percentage points from H1 2023. FDI in sectors such as medical equipment, instruments and services showed rapid growth.
- ODI from China reached RMB 606.1 billion in H1 2024, of which non-financial investments totalled RMB 516.0 billion, a YoY increase of 19.5%. Non-financial ODI covered 5,532 enterprises across 152 countries, demonstrating the positive impact of China's "Belt and Road" Initiative on investment and cooperation.

The RMB exchange rate remained stable

USD index and RMB/USD exchange rate

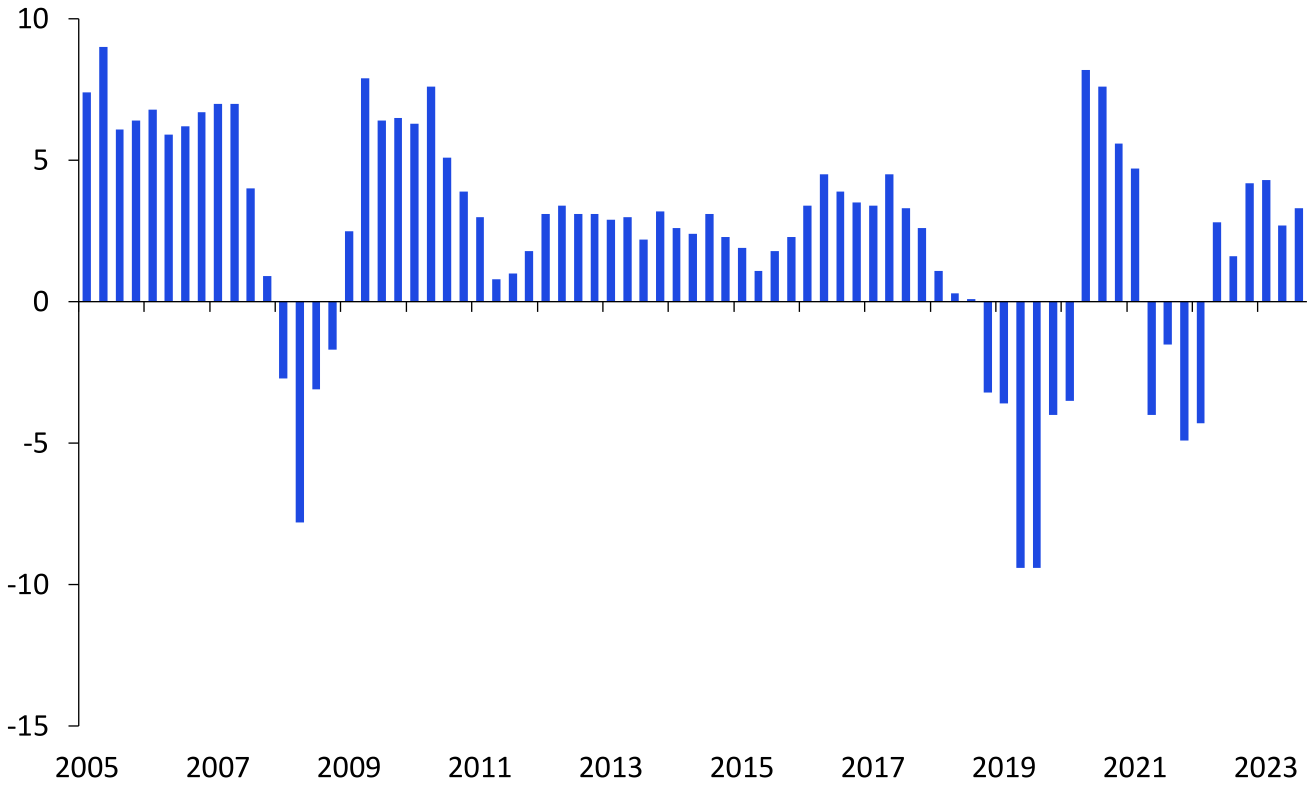


Source: Wind, KPMG analysis

- Amid diverging monetary policies among major economies and tightened global risk aversion, the USD index rose by over 4% in H1 2024, leading the RMB to depreciate by 2.45% against the USD.
- Underpinned by stable domestic economic fundamentals in China, the CFETS RMB exchange rate index rose steadily by 0.26% in Q2 2024.
- As major advanced economies begin cutting policy rates and China's exports recover, the RMB exchange rate is expected to remain stable in the coming months.

Hong Kong's economy is showing stable development

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



Source: Wind, KPMG analysis

- Hong Kong SAR's GDP grew moderately by 3.3% in Q2 2024. The growth of both tourists visiting and private consumption slowed during Q2 due to changing tourist spending patterns. More residents choosing to spend in Mainland China amid the high exchange rate of the Hong Kong dollar, which is pegged to the US dollar.
- Looking ahead, the Hong Kong SAR government is taking proactive measures such as hosting mega events to bolster the economy. Both tourism and private consumption are expected to pick up in H2. However, ongoing geopolitical and trade tensions continue to bring uncertainty to the export sector.

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