China Macroeconomic Developments
2022 Q3

CIMK

November 2022

Executive Summary

After an almost stagnating Q2 2022, China has reached a GDP growth of 3.9% year-on-year in Q3 2022. Those regions that were heavily affected by the pandemic control measures in the last quarter, such as Shanghai and Jilin Province, were able to recover strongly. The original GDP growth target of 5.5% overall is now considered unrealistic by the government and the central bank but has not been adjusted either.

The economy's supply side is mainly responsible for the current recovery in GDP growth. The development in the manufacturing sector, in particular, is substantial, as shown by the increase in the PPI index to 50.1%, the 5.18% growth in industrial production, and the 10.1% growth in the manufacturing sector's investment.

On the demand side, there are slightly positive developments in some areas, but negative developments continue in others. For example, this quarter's retail sales of consumer goods remained practically stagnant. Sales in September grew year on year by 2.5% but declined in comparison to the last quarter by 2.6%. The reasons for the low level of consumer demand are slower income growth and the population's rather negative economic expectations.

Although the export increased by 10.49% year-on-year to RMB 2,191 billion in September 2022, the export growth rate has reduced sharply in recent months, narrowing the trade balance gap.

Despite various government support packages, real estate investment (-8.0%) and commercial property sales (-26.3%) are still declining sharply in the third quarter.

Global recessions in other markets have also led to falling raw material prices in China, resulting in the PPI being at 102.6%, which is below the CPI.

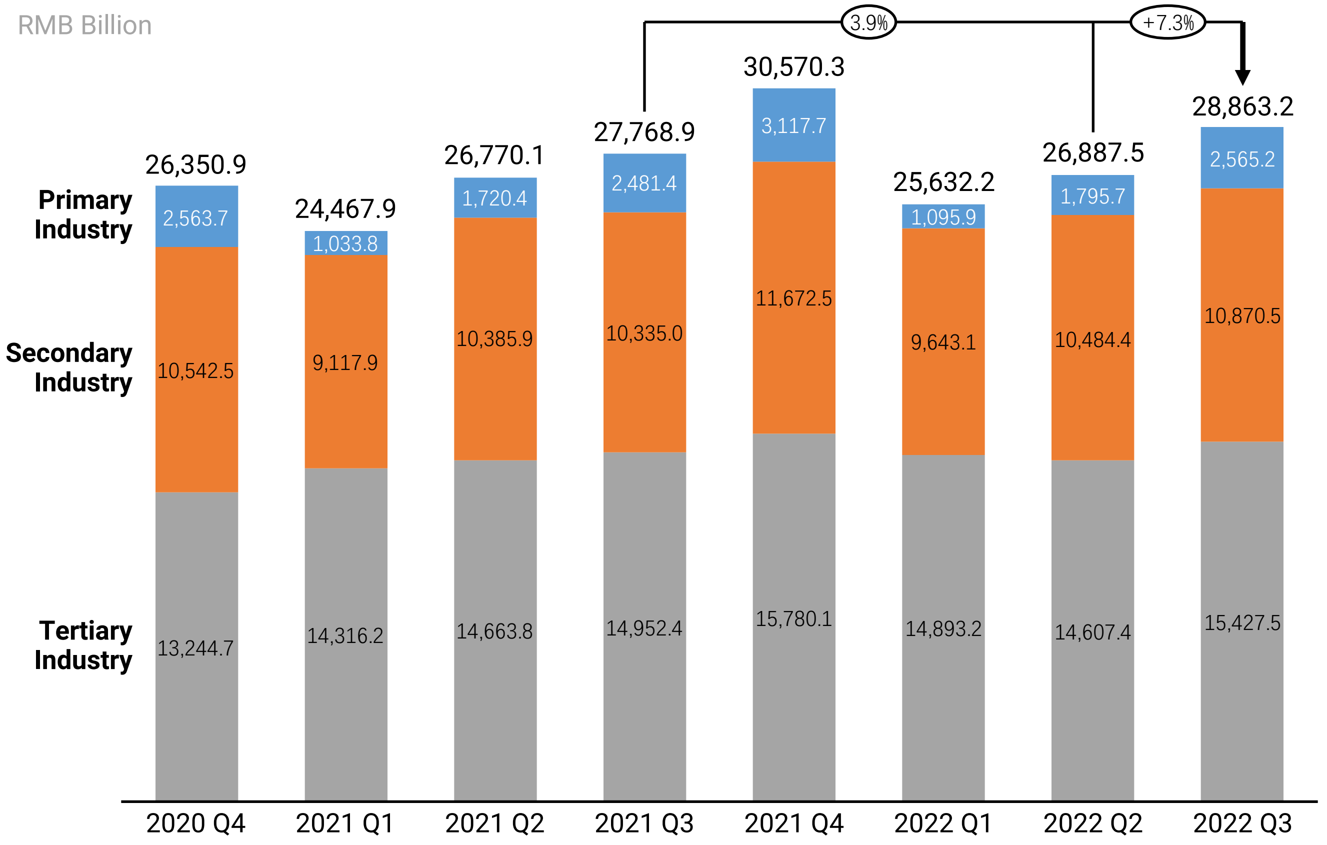
AFRE increased by 10.6% to RMB 340.65 trillion at the end of Q3 2022, an indication that more and more money is flowing into the real economy via loans and government bonds. International financial investors continue to pull out money as, unlike other markets, the 5-year and 1-year policy rates have been cut further. The low-interest rates are helping companies struggling with the pandemic to repay loans, but this has led to a weakening of the RMB against the USD.

The macroeconomic slowdown and COVID containment costs continue to increase local government debt. The increase in debt slows in the third quarter as local government special debt grows by 32.1% YoY and traditional local government debt increases by 6.1% YoY.

The overall unemployment rate increased slightly to 5.5% at the end of Q3 2022 (12.2% YoY), while the youth unemployment rate declined again by 2.7% in September from its peak in July 2022 due to various employment-related government subsidies.

China's economy recovered significantly in the third quarter, with GDP growing 3.9% YoY. However, consumer demand and ongoing real estate sector problems are putting pressure on the economy.

Macroeconomic Trend: China's Quarterly GDP, 2022 - 2022



Source: National Bureau of Statistics

Take Away

- GDP (at constant prices) increased by 3.9% year-on-year in the third quarter of 2022 (7.3% quarter-to-quarter). After the slow growth of 0.4% in the second quarter, the economy experienced a significant upturn
- All three industry types are growing year-on-year, with the secondary industry growing the most at 5.18%. This was mainly due to positive developments on the supply side, e.g., the industrial manufacturing output alone grew strongly by 6.3% year-on-year at the end of the third quarter
- Broken down by category, the strongest growth sectors continued to be electric vehicles (110% year-on-year) and solar energy batteries (33.7%)
- On the demand side, there are slightly positive developments in the areas of export and construction, but also continued problematic developments in the consumption demand and the entire real estate sector. To address this issue, on September 31, the State Council approved new subsidies for the renewal of production facilities, as well as the promotion of automobiles and other large-scale industries
- The GDP in the third quarter is based on 52.4% of consumer spending, 20.2% of the gross investment, and 27.4% of net exports of goods and services
- The original yearly GDP growth target of 5.5% is now no longer considered realistic by the central government and the central bank, but it has not been adjusted either

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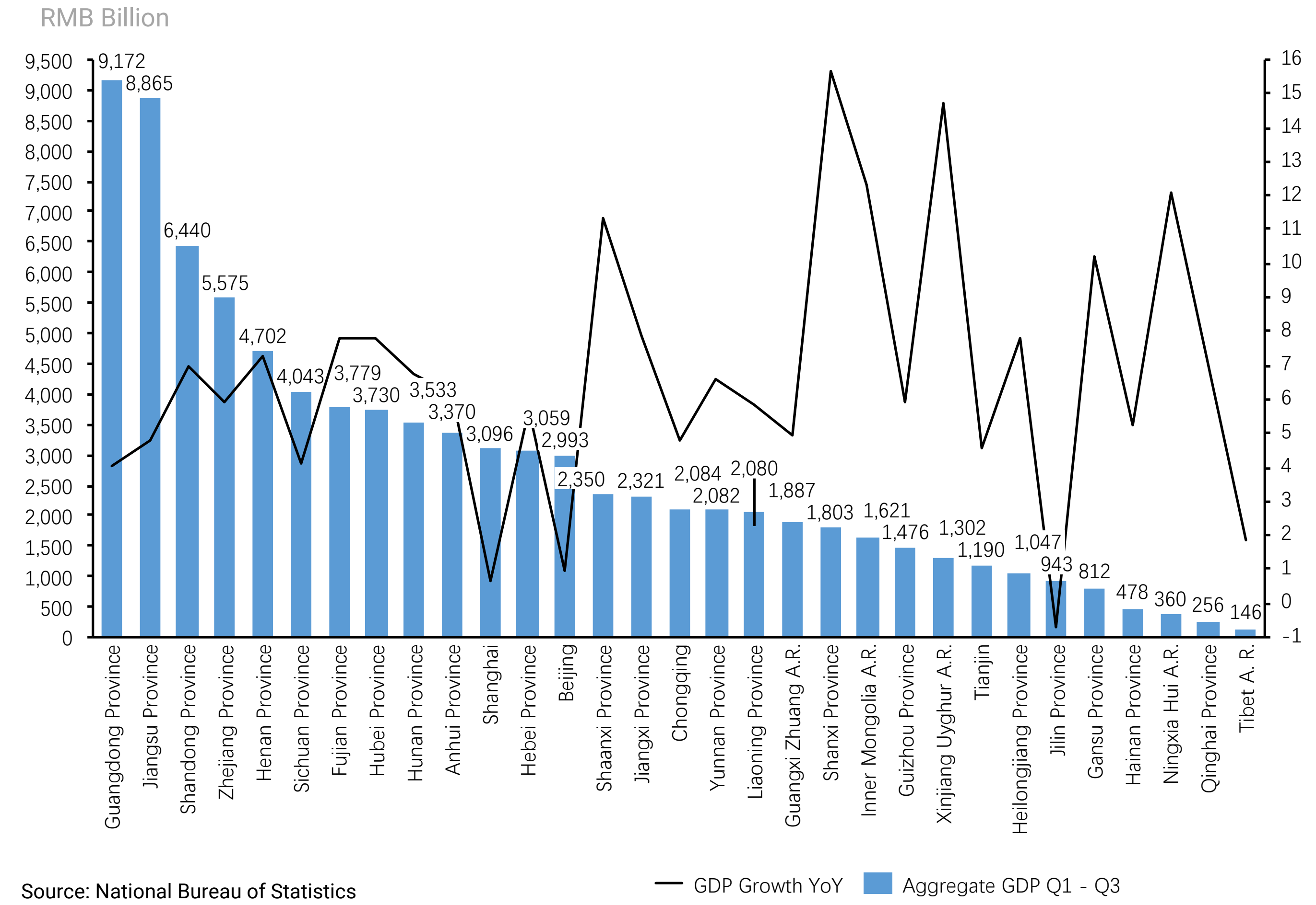
Provinces highly impacted by lockdowns in Q2 recovered strongly in the third quarter. Over-propositional growth can be seen in underdeveloped western provinces.

Macroeconomic Trend: GDP & GDP Growth Rate Q1 - Q3 2022, per Province



Source: National Bureau of Statistics

Take Away

- Guangdong, Jiangsu, and Shandong provinces remain the country's three economic powerhouses, with Guangdong and Jiangsu recording growth of 2.3% and Shandong of 4%
- The highest GDP growth was recorded in the following five provinces: Shanxi Province (15.66%), Xinjiang Uyghur Autonomous Region (14.73%), Inner Mongolia Autonomous Region (12.28%), Ningxia Hui Autonomous Region (12.09%), Shaanxi Province (11.32%)
- In the third quarter, individual provinces and cities continued to be affected by the epidemic prevention measures. Provinces such as Shanghai and Jilin, which were affected by the epidemic in the first half of the year, have recovered strongly, although Jilin has still not achieved positive economic growth
- In the first three quarters, the share of the primary industry was the highest in Hainan at 21.8%. The percentage of value-added in the secondary industry was highest in Shanxi at 51.2%. Beijing had the highest share of value added in the tertiary industry at 84.3%
- In terms of GDP per person in the first three-quarters of all provinces, Beijing maintained its first place with a GDP per person of RMB 136,700, followed by Shanghai with RMB 124,500, Jiangsu with RMB 104,600, and Fujian with RMB 91,000

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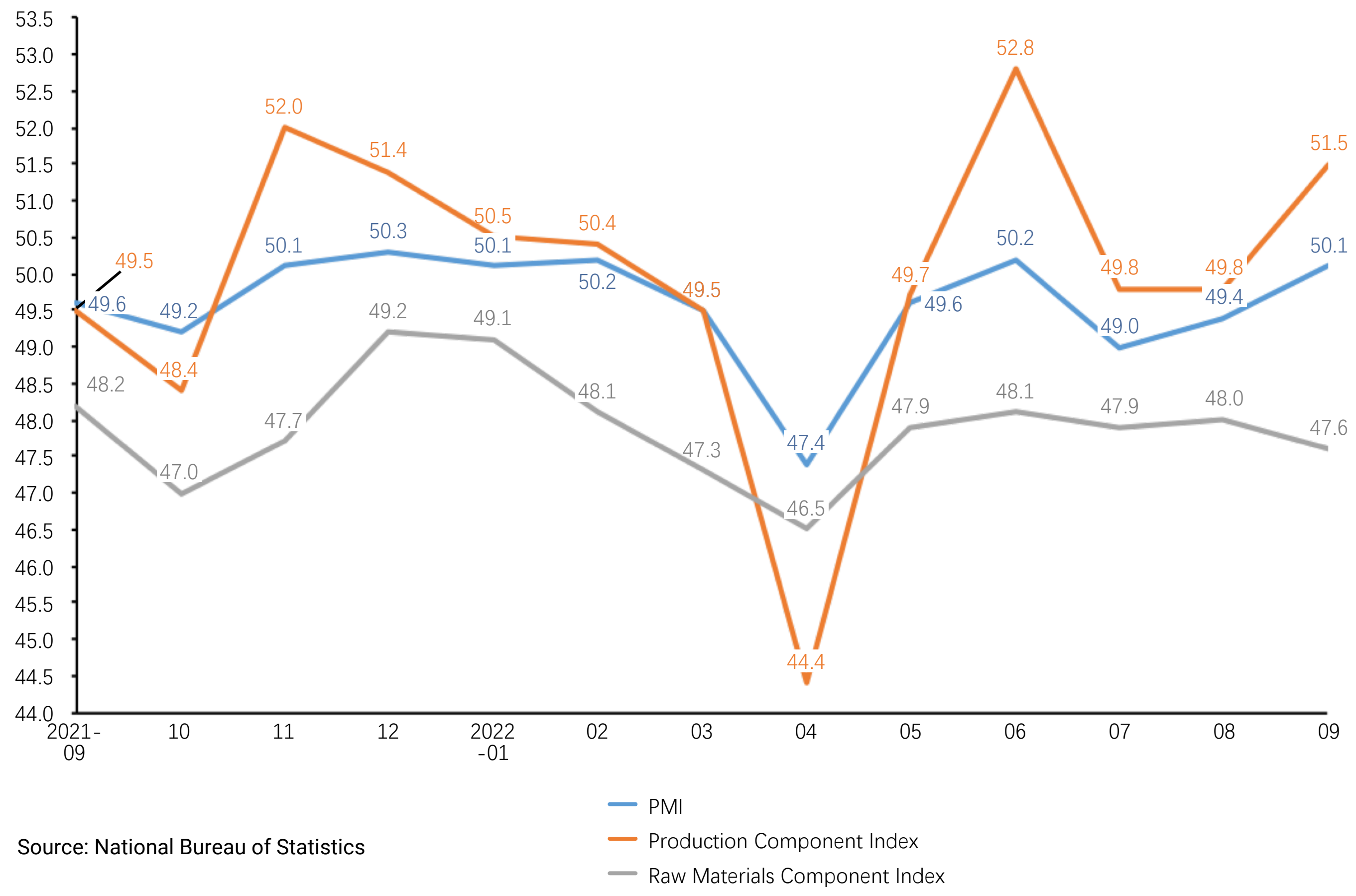
The Purchasing Managers' Index at the end of Q3 is growing by 1.01% YoY and 1.42% MoM. The production index is the primary growth driver for the PMI peak in September.

Macroeconomic Trend: Purchasing Managers' Index, 12 Month



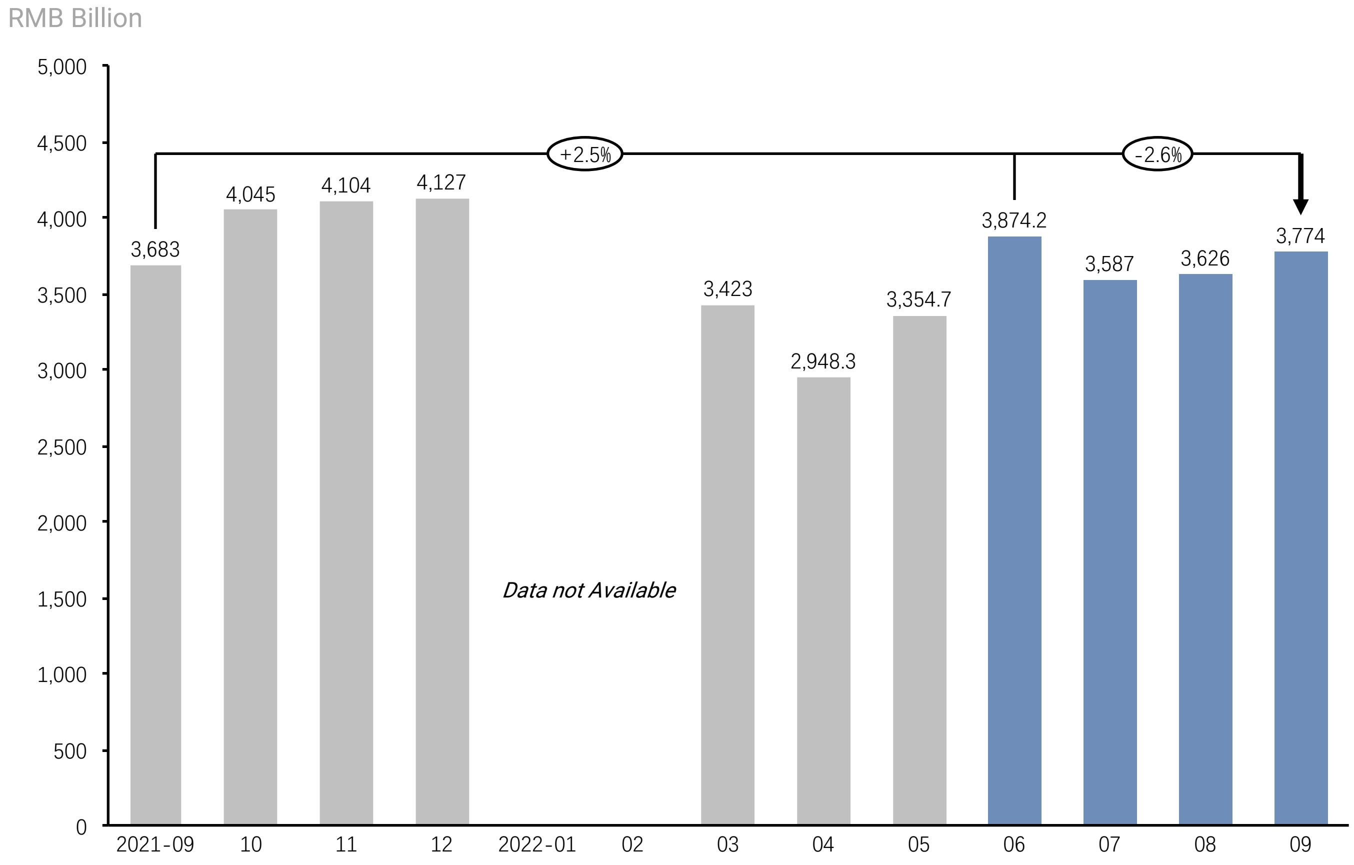
Source: National Bureau of Statistics

Take Away

- The manufacturing purchasing managers' index (PMI) is a composite index calculated by weighting the following five indices: New Orders Index, Production Index, Employee Index, Supplier Lead Time Index, and Raw Materials Inventory Index
- The PMI increased by 1.01% year-on-year. However, compared to the end of the second quarter, it decreased by -0.2%. In September, the PMI crossed the critical value of 50 again, indicating growth and expansion in the manufacturing sector
- The production index shows a positive trend. In contrast, the current order backlog, finished goods inventories, and raw materials index show a rather negative trend
- Investments in the manufacturing sector still increased by 10.1% in the first three quarters despite the current complex economic pressure
- The largest increases were recorded in the advanced technology manufacturing sector, in which investments in the manufacture of electronic and communications equipment increased by 28.8% and in the manufacture of medical equipment by 26.50%

Despite an annual growth in retail sales of consumer goods of 2.5%, it can be seen that consumption demand is rather stagnating.

Macroeconomic Trend： Retail Sales of Consumer Goods, 12 Months



Source: CSMAR (China Stock Market Accounting Research)

Take Away

- Retail sales of consumer goods rose 2.5% year-on-year in September to 3,774 billion (4.1% month-on-month). This is a slowdown compared to the yearly 5.4% growth in August. Regarding price-adjusted retail sales, the growth rate is negative at -0.68%

- The main reasons for the weaker recovery in consumer demand are the slowdown in income growth of the population, the pessimism economic expectations of the population, and a limited consumption area of people, as disease control measures significantly limit offline consumption

- Survey results from the central bank on the population's assessment of future employment and future income have improved but still tend to be negative. The cumulative growth rate of per-person disposable income was 4.3% in the first three quarters

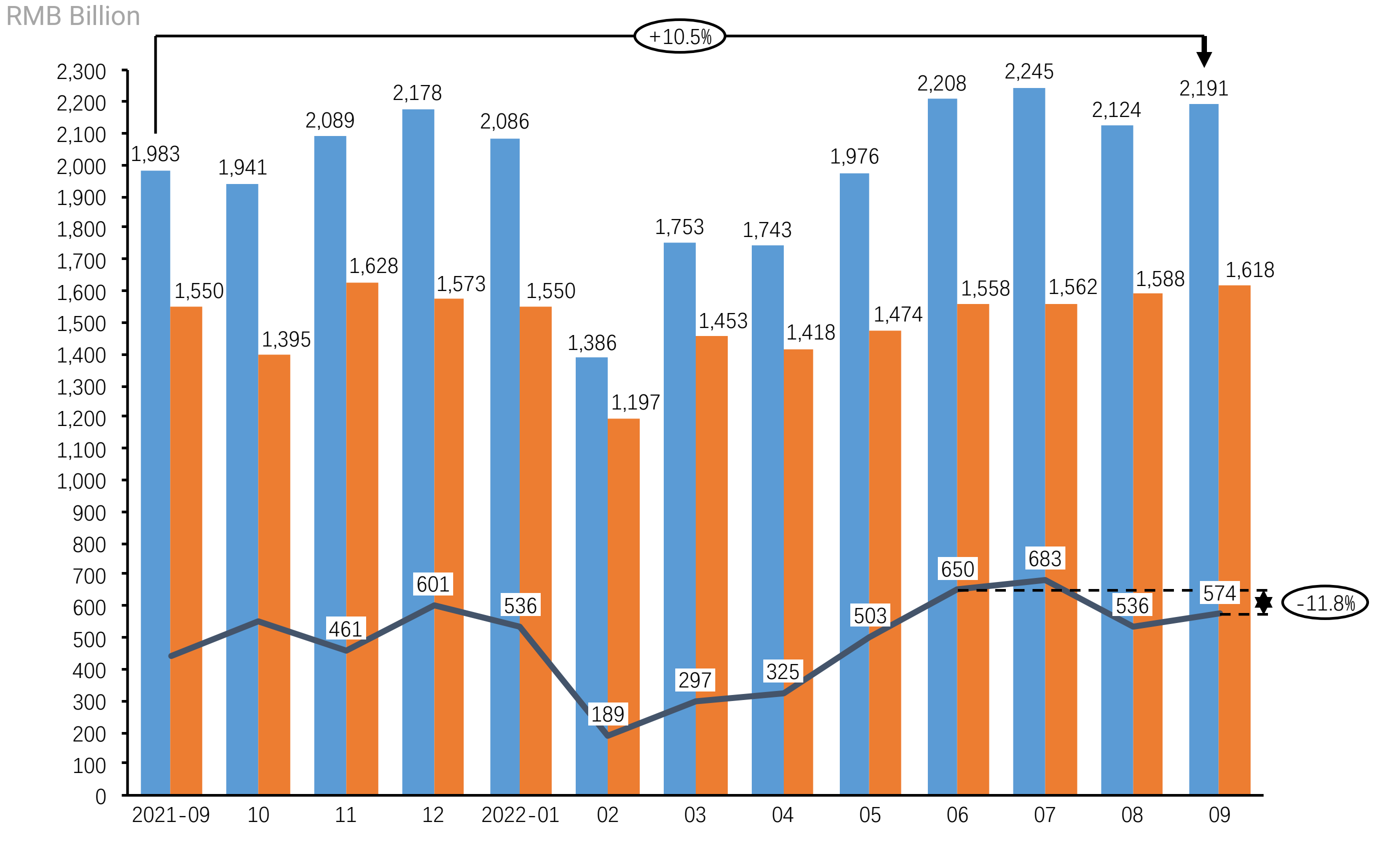
- Consumption is rising for everyday goods such as food and oil, but for many other non-essential product categories, consumption is still weakening

- Online retail sales from January to September increased by 4.0%, reaching RMB 9,588.4 billion, accounting for 25.7 percent of all retail sales of social consumer goods. In this regard, online sales of the food product category led to growth, which increased by 15.6 percent

- Various government support measures have been adopted in this regard; on August 18, it was decided to continue the exemption of NEVs from vehicle tax and to simplify access to consumer loans

Despite the strong initial recovery in exports, export growth fell sharply towards the end of the third quarter. Global recessions hamper exports, while imports remain almost constant.

Macroeconomic Trend： Import and Export Values, 12 Months



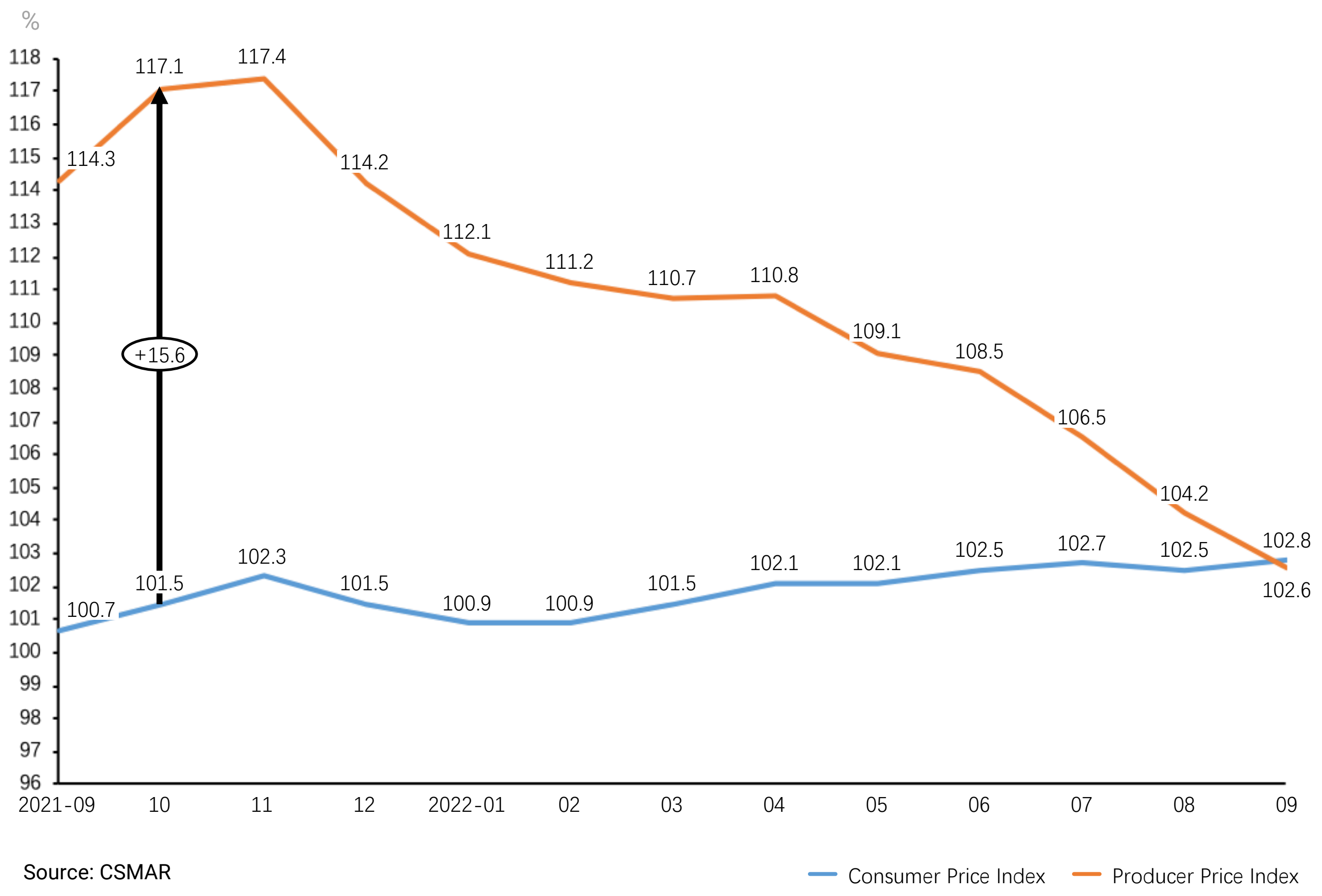
Source: General Administration of Customs

Take Away

- China's exports increased 10.5% year-on-year to RMB 2,191 billion in September 2022 (13.8% price-adjusted), while imports rose 4.2% to RMB 1,618 billion
- Compared with the second quarter, the export value has decreased, and it can be seen that China's export growth is slowing down in the third quarter (8% in July, 7.1% in August, and 5.7% in September). This was mainly due to the decline in exports to major western markets such as the US, Germany, and France
- China's largest trading partner in Q3 2022 remained the ASEAN region, accounting for 15.1% of all imports and exports between January and September. The EU was China's second-largest trading partner, with a total volume of RMB 4.23 trillion, while the US is China's largest export market and third-largest trading partner
- On a year-on-year basis, exports to Germany increased by 9.8% to RMB 581.74 billion in the first nine months, while German imports fell by 5.1% to RMB 554.36 billion
- Mechanical and electrical products accounted for 56.8% of all exports in January-September 2022, up 10.04% from the same period in 2021
- Slowing global economic growth and falling commodity prices are likely to put further pressure on export growth in the near term. Due to the slowdown in global growth and the stabilization of domestic demand, China's trade surplus is expected to narrow further

The consumer price index overtakes the sharply declining producer price index at the end of the third quarter. The cost of manufacturing goods continues to decline due to falling raw material prices.

Macroeconomic Trend: CPI and PPI Index, 12 Months



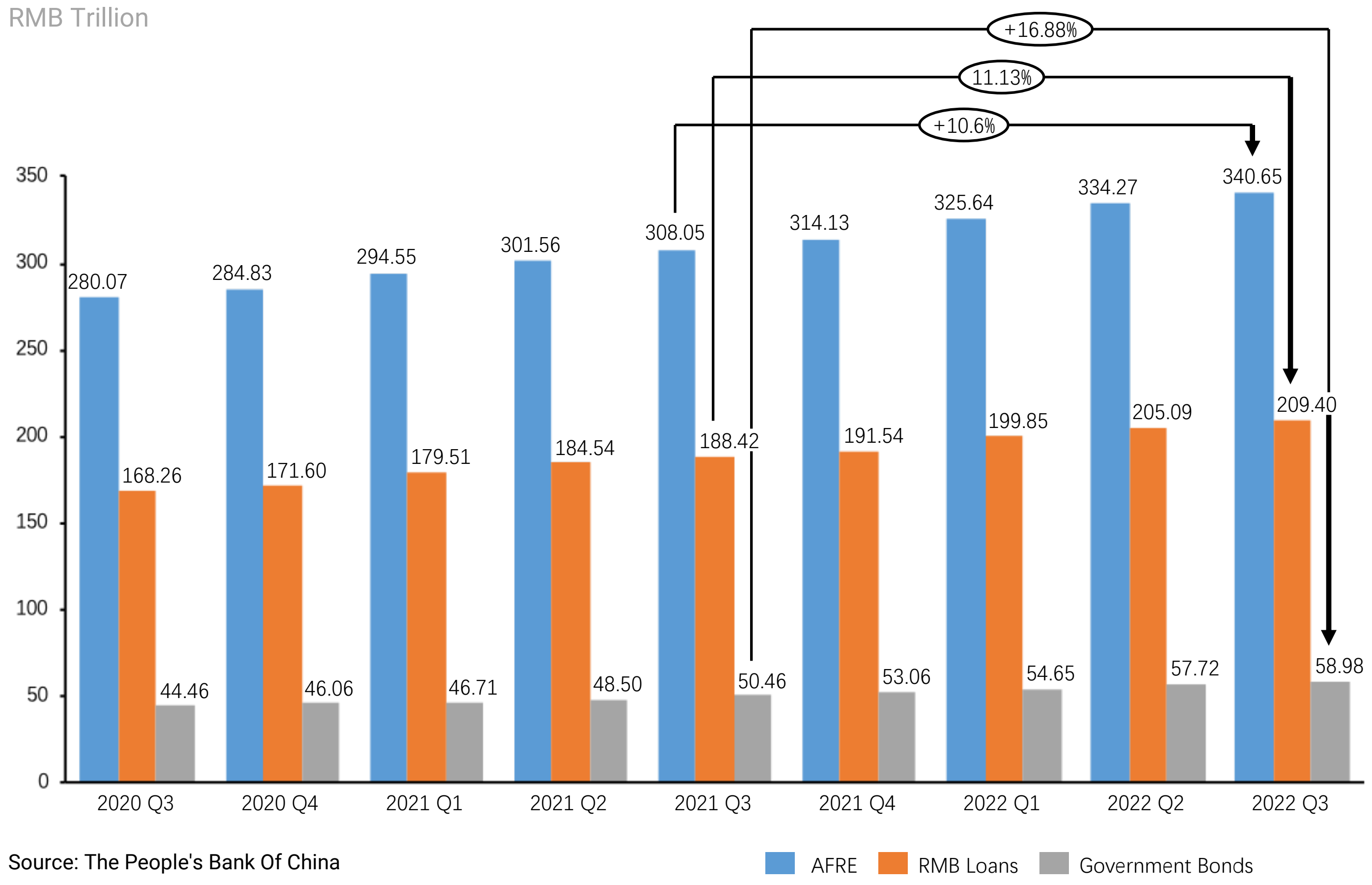
Source: CSMAR

Take Away

- The Producer Price Index (PPI) measures monthly changes in the prices of manufactured goods for the domestic market by comparing the prices of the current month with the prices of the same month of the previous year. The PPI has declined significantly since its peak of 117.1% in October 2021 and is now 102.6% year-over-year in September 2022
- The Consumer Price Index (CPI) is a relative number that reflects the trend and magnitude of annual price changes for consumer goods and services. The CPI has remained nearly constant and is now 102.8% in September 2022, the first time it has been above the PPI index in a long time
- Even as pork prices push food inflation slightly higher, the CPI is not expected to rise because sufficient supply is meeting hesitant consumer demand
- The product price index is expected to fall further due to increasing downward pressure on the global economy, falling raw material prices, and the continued tightening of monetary policy in the major economies
- The divergence between the increase in the consumer price index and the consumer price index will lead to a further widening of the "negative gap"

AFRE is up 16.88% year-on-year, resulting in more capital flowing into the real economy through bank loans and government bonds.

Macroeconomic Trend: Aggregate Financing to the Real Economy, Q3 2020 - 2022



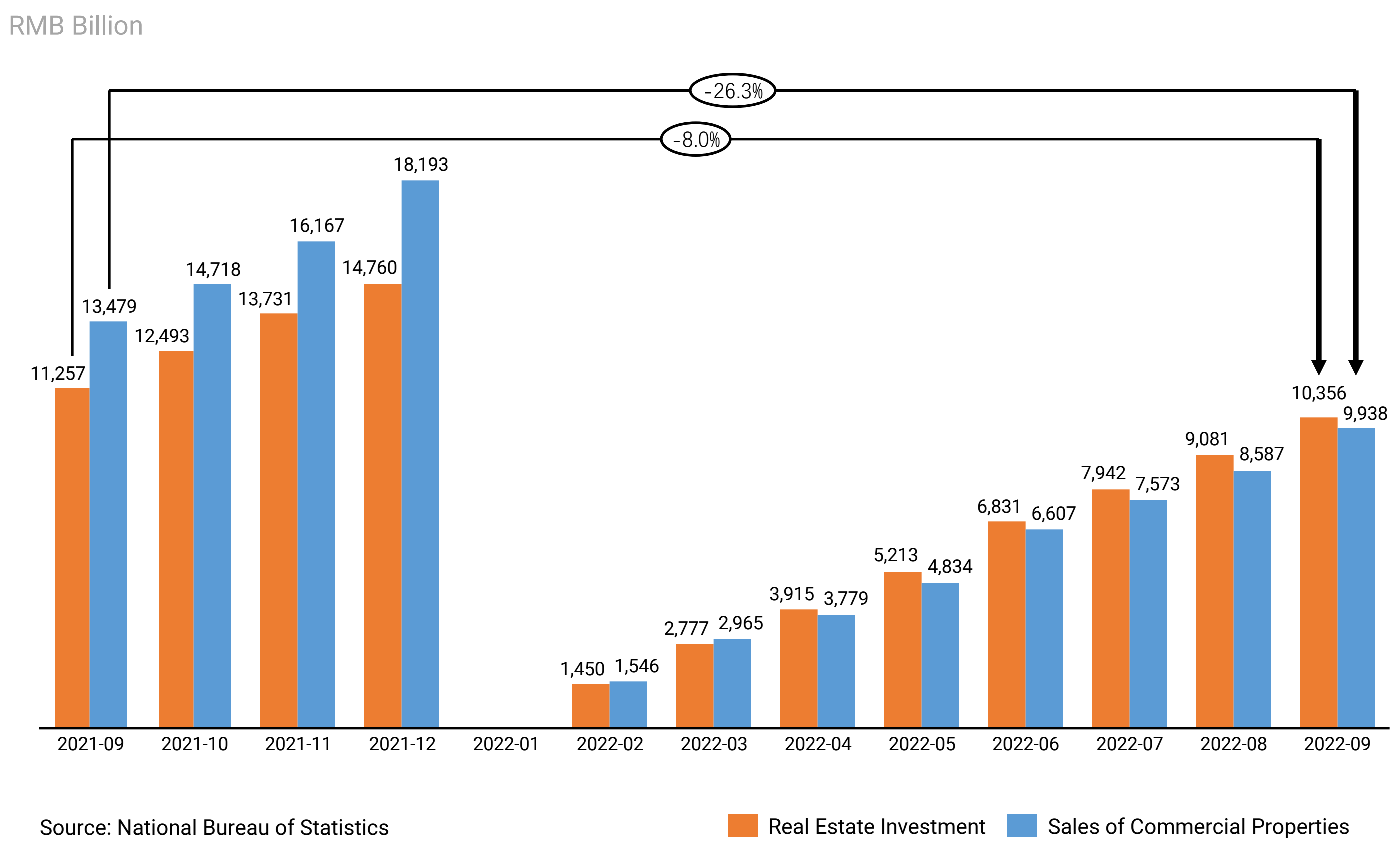
Source: The People's Bank Of China

Take Away

- Aggregate Financing to the Real Economy (AFRE) is a broad measure of China's annual liquidity flow introduced by China's central bank. It indicates how much funding the real economy has received from the financial system
- In this regard, the value of AFRE increased by 10.58% to RMB 340.65 trillion at the end of the third quarter
- This growth comes mainly from RMB loans (+11.1% YoY), outstanding government bonds (+16.9% YoY), and domestic equity of non-financial enterprises (+14 YoY). Over the same period, there were strong declines in foreign currency loans (-7.2% YoY) and trust outstanding loans (-24.8% YoY)
- This is a mixed development, as, on the one hand, the very unsecure trust loans for companies in difficult economic conditions are declining, and banks are granting more regular loans to companies
- In terms of infrastructure investment alone, fiscal support and the use of policy instruments increased by 8.3% year-on-year in the first eight months of the year
- At the same time, it can also be observed that foreign loans continue to decline, further revealing a loss of confidence from foreign investors

Despite various government support packages, real estate investment (-8.0%) and commercial property sales (-26.3%) are still declining sharply in the third quarter.

Macroeconomic Trend: China Real Estate Development Investment, 12 Months



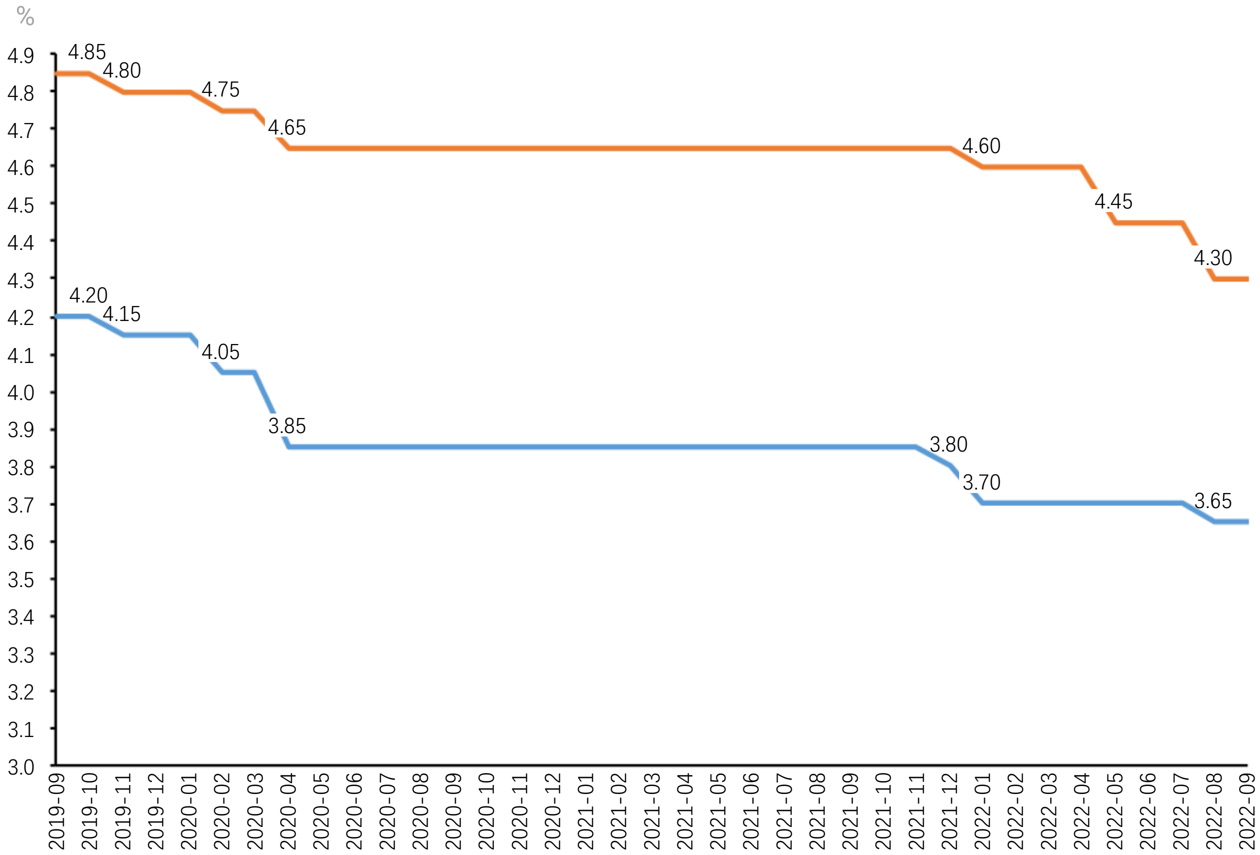
Source: National Bureau of Statistics

Take Away

- The fundamental problems of the real estate sector are a combination of financing problems on the supply side and a demand decline
- Residential property sales and real estate investment fell by 17.9% and 8.0% year-on-year. Commercial property sales fell 26.3% year-on-year to RMB 9,938.0 billion. Only sales of office buildings increased by 3.58%. On a month-on-month basis, real estate investment rises slightly
- Regulations such as the "Three Red Lines" made it difficult for indebted real estate developers to raise new loans, meaning that properties that had been sold in some cases could not be completed
- In response, the People Bank of China has now introduced special credit facilities and lowered the central bank's key interest rate to ensure the construction and delivery of apartments before they are sold
- Another Chinese government support package was launched in August, providing more than RMB 1 trillion in new funds to boost real estate investment and demand and giving local authorities more flexibility to support the property market
- On the demand side, lower income expectations, high youth unemployment, and the expectation that the 20 years of sustained property value appreciation will no longer occur are leading to weak demand

Unlike the other major economies, China continues to lower the central bank rate (5-year LPR 15bp and 1-year LPR 5bp) as inflation is only slowly rising.

Macroeconomic Trend: Central Banks Interest Rate LPR, Last 3 Years



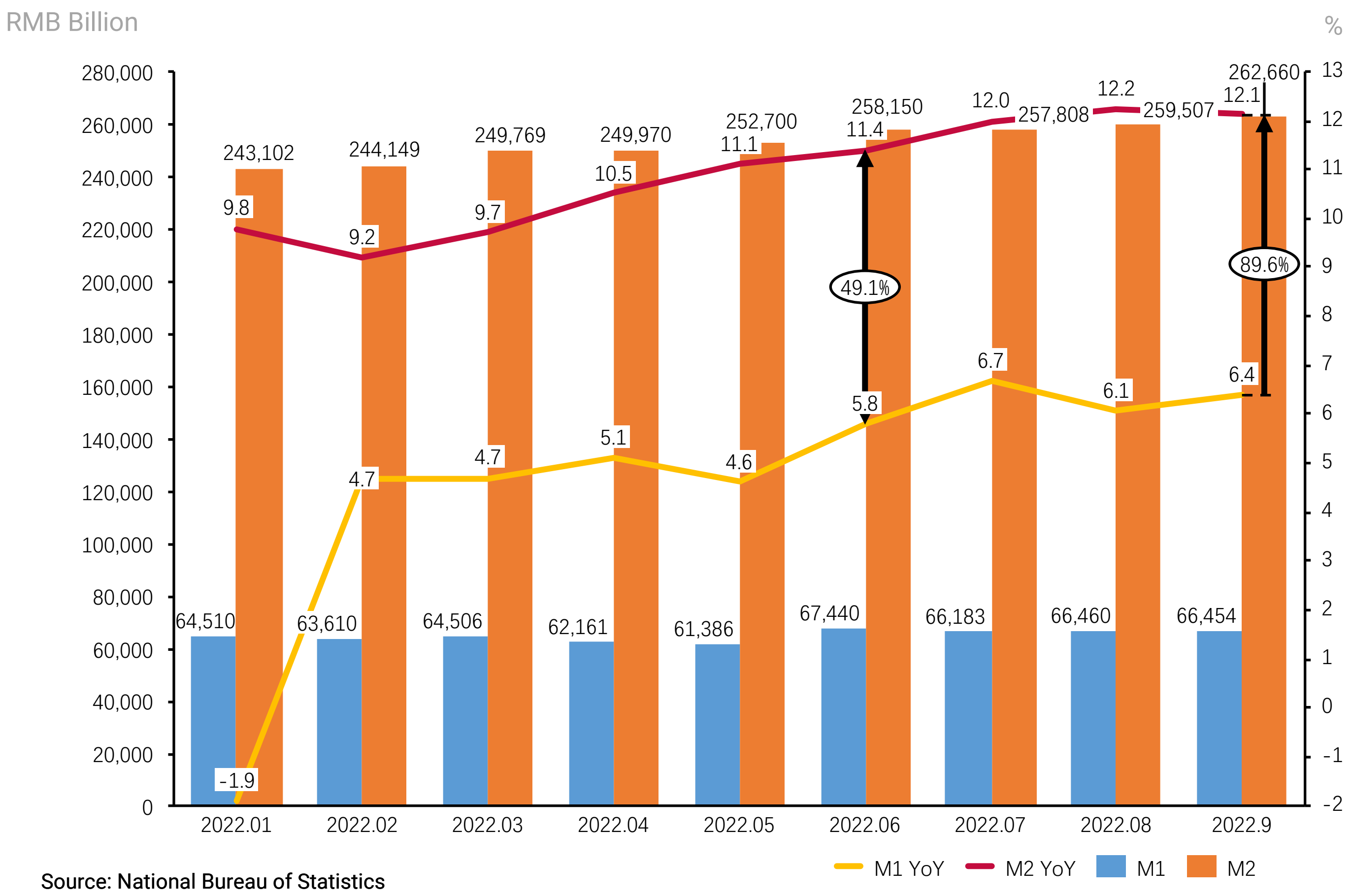
Source: The People's Bank Of China

Take Away

- The LPR rate for 5 years was reduced from 4.45% to 4.3% in August. The LPR rate for one year was cut at the same time from 3.7% to 3.65%
- These rate cuts are possible as inflation rates are still moderate. While inflation is skyrocketing worldwide, the Chinese government has taken active measures to protect supply and stabilize prices in commodity markets such as energy and food in response to imported inflationary pressures from the rise in international commodity prices
- On average, consumer price inflation rose to 2.7% year-on-year in the third quarter from 2.2% in the second quarter. The inflation for food accelerated to 8.8% year-on-year from 2.4%, led by a rebound in pork prices (26% year-on-year). Non-food inflation declined from 2.3% to 1.7% year-on-year
- At the same time, the central bank decided in August to cut the three-year deposit rate of individual commercial banks
- In favor of further interest rate cuts is that it will make it easier for individuals to pay real estate and car mortgages and for SMEs to repay principal and interest on loans that have run into trouble as a result of the lockdown measures
- Against a further cut in interest rates stands the fact that the RMB spot rate was 7.1159 in September, down 6.22% from the end of the second quarter. Rising U.S. interest rates are increasing the pressure on capital outflows from China. The ten-year Chinese government bond closed at 2.68%, down 14 basis points from the end of June

Overall, money supply growth has increased significantly compared with the last quarter. However, the issuance of bonds by local governments and companies has declined.

Macroeconomic Trend: M0, M1 & M2, in 2022



Source: National Bureau of Statistics

Take Away

- M2 money supply increased by 12.1% year-on-year to RMB 262,660 billion and M1 money supply increased by 6.4% to RMB 66,454 billion in the third quarter. Money supply also continues to increase quarter-on-quarter
- In the first three months of the year, RMB 45.82 trillion worth of bonds were issued, which was RMB 1.51 trillion more than a year earlier
- After a sharp increase in the first and second quarters, local government bond issuance slowed significantly in the third quarter. Only bonds valued at RMB 7.54 trillion were issued in the third quarter, down 50.17% year-on-year
- Commercial banks issued RMB 6,280.15 billion worth of subordinated debt, an increase of RMB 1,681.22 billion year-on-year, consistent with the continued increase in commercial banks' capital needs
- Corporate bonds issued amounted to RMB 305.46 billion and RMB 2.3 trillion in the third quarter, down 11.62% and 9.18% year-on-year
- At the end of September, the term spread (yield of 10-year to 1-year government bonds) was 0.85%, 32 basis points higher than at the beginning of the year and two basis points lower than at the end of the second quarter

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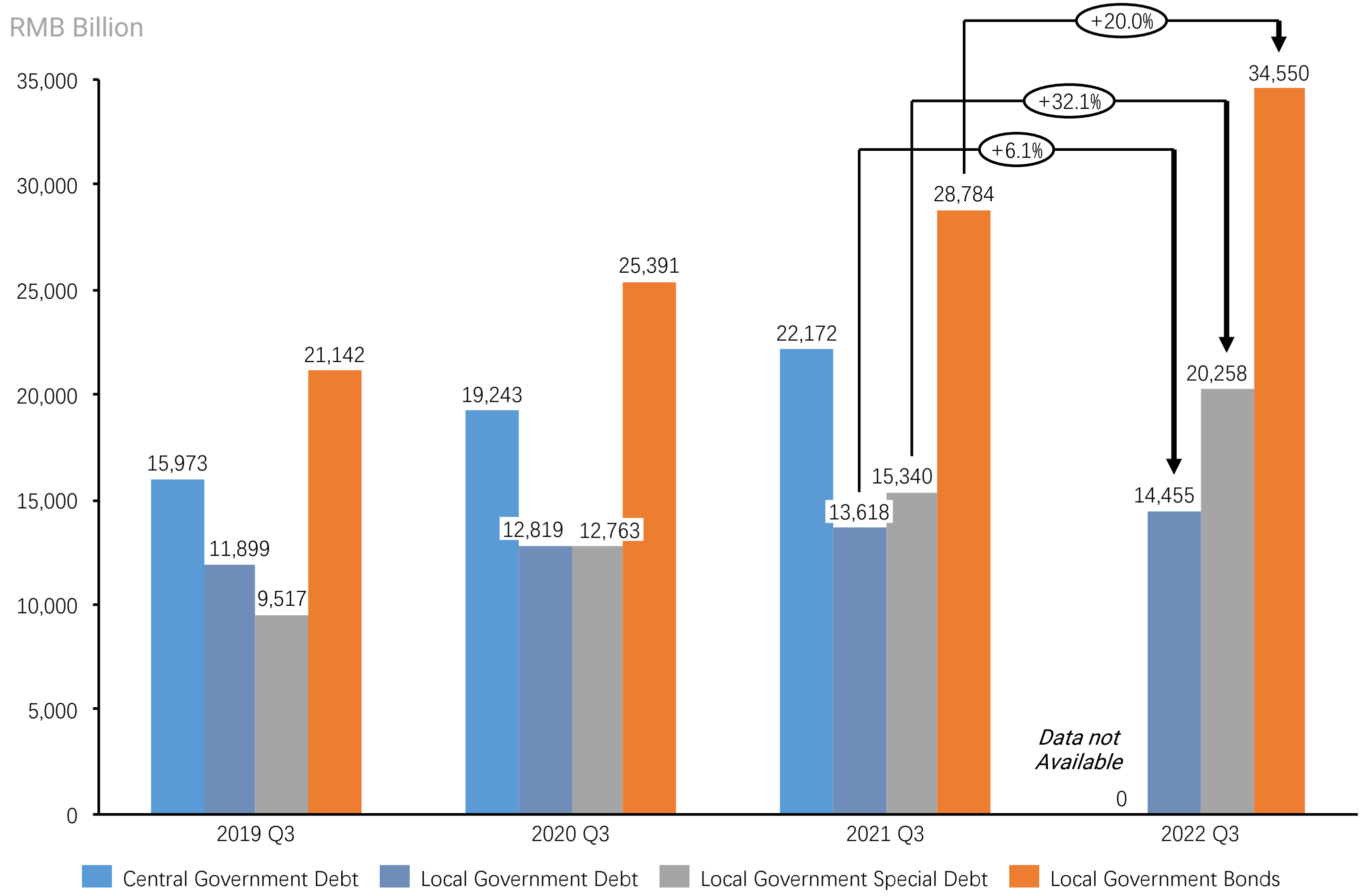
The macroeconomic slowdown and zero COVID-related policies continue to lead to rising local government debt. However, the growth in debt is slowing down in the third quarter.

Macroeconomic Trend: Government Debt, Last 4 Years



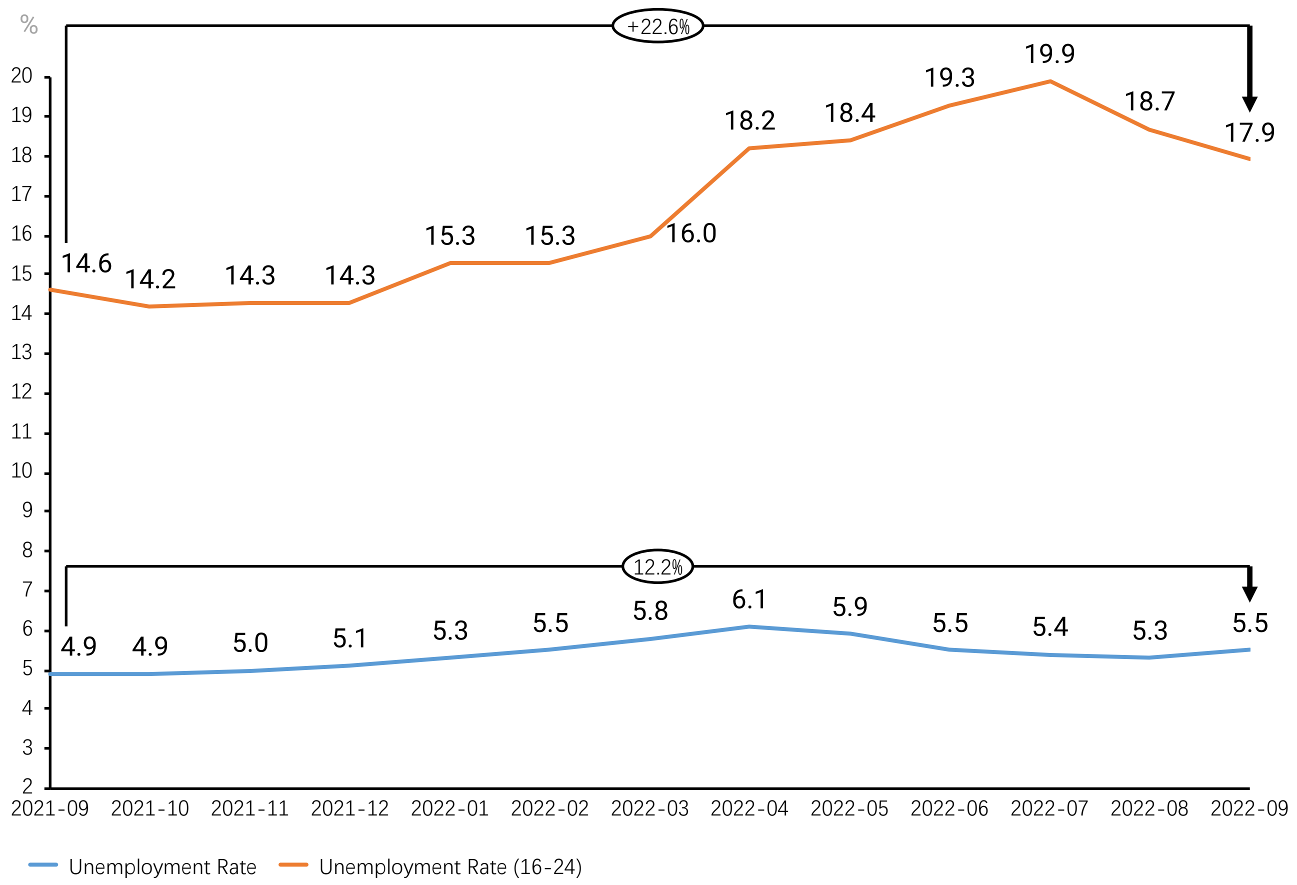
Source: Ministry of Finance of the People's Republic of China

Take Away

- Many different policies and tax relief combined with revenue reductions due to the pandemic control measurements are causing central and local government debt to continue to rise
- If one compares the third quarter of 2022 with the third quarter of 2019 (prior to the COVID pandemic), it can be seen that local government special debt has increased over propositionally at 112.9%. Since a large part of the pandemic-related costs is covered by these special-purpose vehicles, the volume of traditional debt has only increased slightly by 21.5%
- The Q3 2022 central government debt has not yet been published
- In a year-on-year comparison, it can be seen that the acceleration of local government debt has continued by 6.1%. The slowdown in economic growth and the rising costs of pandemic preparedness is causing major problems for many regions, which is why some cities are starting to charge citizens for COVID tests
- On September 24, the State Council decided to increase financial instruments to support the economy by more than RMB 300 billion, while allowing local governments to use loans and other measures on a city-by-city basis

Unemployment remains constant, while youth unemployment has fallen in September by 2% since its peak in July 2022 due to various employment-related government subsidies.

Macroeconomic Trend: Monthly Unemployment Rate, Last 12 Months



Source: CSMAR (China Stock Market Accounting Research)

Take Away

- The overall unemployment rate rose slightly to 5.5% at the end of the third quarter. This is still a year-on-year increase of 12.2% due to negative macroeconomic developments
- On a positive note, the youth unemployment rate has dropped significantly to 17.9% since its peak of 19.9% in July 2022. Despite the positive trend, the youth unemployment rate is 22.60% higher than last year. The reason for the decline in youth unemployment in recent months is increased government support
- Several cities have also introduced personalized and effective own initiatives. For example, Shenzhen has introduced an unemployment insurance reimbursement policy for stable jobs
- The current economic situation with local lockdowns continues to be a major problem for service sectors such as tourism, education, training, and hospitality, which are all important labor markets for young workers
- At the same time, the disposable capital income at the national level is RMB 27,650, representing a nominal growth of 5.3% year-on-year (a price-adjusted real growth of 3.2%). The price-adjusted income per person of the rural population (4.3%) grew faster than that of the urban population (2.3%)
- On July 13, the State Council decided that they will continue to offer social insurance premiums, stable job discounts, and employment subsidies

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