

China Economic Quarterly Q2/Q3 2020

The economy has gradually recovered from the COVID-19 pandemic with 3.2% growth in Q2. It is expected to return to a relatively normal state in Q3.

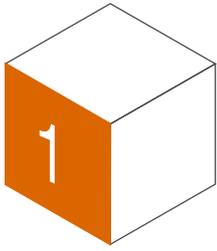
September 2020

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Major economic indicators

Despite the COVID-19 pandemic, China's **economic growth** gradually recovered in the second quarter, and GDP reached 45.66 trillion yuan with 3.2% growth year-on-year in Q2. Nonetheless, GDP still contracted by 1.6% during the first half year, as a result of the 6.8% reduction in growth rate in Q1.

Since the COVID-19 outbreak has basically been controlled in most parts of the country, it is expected that major economic indicators will turn positive in Q3. However, full economic recovery in China will still be challenging to achieve as COVID-19 continues to spread in a few major economies and is not likely to end in Q3 and will possibly even continue in Q4.

In spite of this, the country has achieved 62.7% of its total annual employment goal for the year by creating 5.64 million new job opportunities in the first half of 2020. This is partly due to the fact that government policy has given top priority to stabilising employment. In fact, some state-owned enterprises as well as large private and foreign-owned companies also took the responsibility to retain or add jobs during this difficult period. These are the main reasons why the labour market is still robust regardless of the fragile economy.

In June, the urban surveyed unemployment rate in 31 major cities was 5.8% which is similar to 5.7%, the rate in March, and a bit higher than 5.2% in December 2019. The national unemployment rate in urban areas was 5.7% in June, slightly lower than 5.9% in March. The average working hours of company employees reached 46.8 hours per week in June which was similar to the same period last year.

Furthermore, by the end of June, the number of migrant workers from rural areas reached 178 million, while this number was 182 million during the same period in 2019 and 180 million in 2018. Thus, the unemployment rates of rural migrant workers has also been relatively stable.

While the COVID-19 pandemic persists, serious flooding has also hit a few provinces in Southern China. According to the Ministry of Emergency Management, by the end of the second quarter, over 20 million people were affected. There were 1.76 million emergency resettlements, 12,000 houses collapsed and 89,000 houses were damaged in varying degrees. So far, the flooding has caused around 50 billion yuan in direct economic losses.

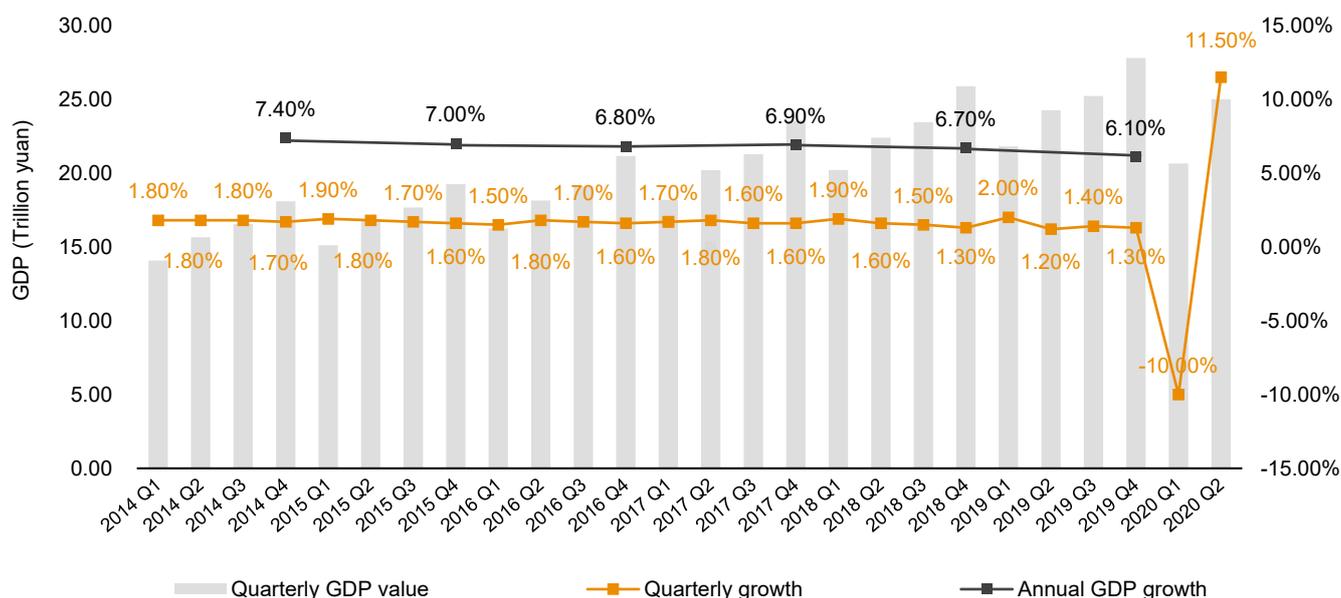


Outside of China, economic conditions are not promising. The IMF has lowered its forecast of global economic growth in 2020 to -4.9% due to the COVID-19 pandemic, which is almost 2% less than the April projection. Nevertheless, the IMF might adjust its forecast again if the situation does not improve in major economies including the US, Brazil and India for example. For many other countries, a subsequent wave of COVID-19 will be the largest threat to economic recovery.

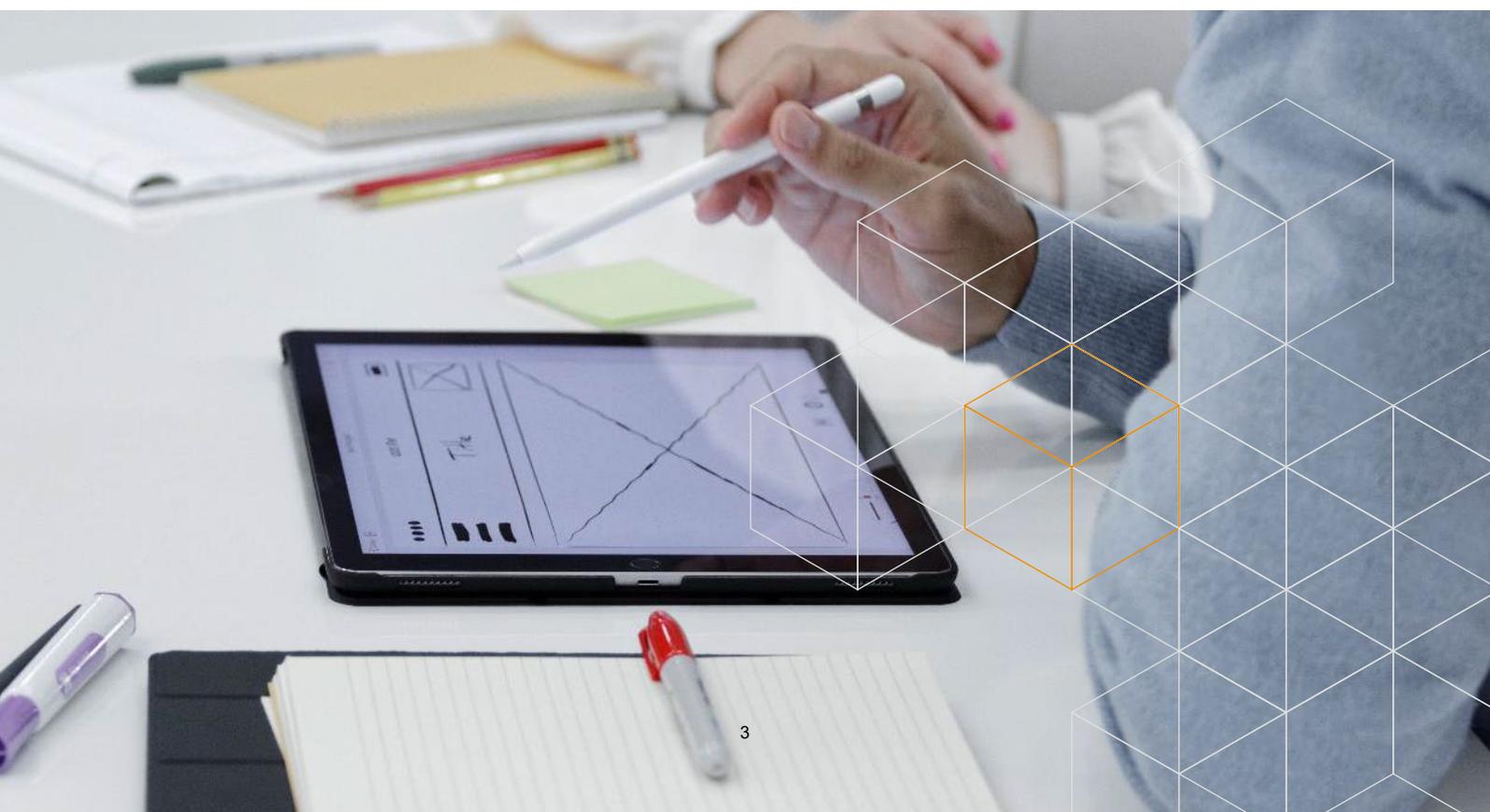
In the process of balancing between controlling COVID-19 and pursuing economic recovery, China's economy is expected to return to a state of relative normalcy in Q3. The economic condition in Q3 will be better than in Q2, despite the sluggish global economy.

China's imports and exports will continue to face weak international market demand in Q3, but domestic consumption will be stronger than in Q2. With strong policy support and stimulus measures, investment will definitely pick up in Q3 and in Q4.

Figure 1: Quarterly GDP values and quarterly and annual GDP growth rate



Source of data: Unless otherwise stated, economic data is from the National Bureau of Statistics, Wind and financial data from the People's Bank of China.



In the first half of the year, the output of the primary, secondary and tertiary industry was 2.60, 17.28 and 25.78 trillion yuan respectively, and the growth rates were 0.9% (-3.2% in Q1), -1.9% (-9.6% in Q1) and -1.6% (-5.2% in Q1) year-on-year. However in Q2, the output of the three sectors increased by 3.3%, 4.7% and 1.9% year-on-year respectively.

As a result, GDP growth in Q2 increased by 3.2%, while it reduced by 1.6% in the first half year.

More specifically in the first half year, the tertiary industry or service sector, accounted for 56.5% of total GDP, while the primary industry and secondary industry accounted for 5.7% and 37.8% of total GDP respectively. Meanwhile in Q2, the primary, secondary and tertiary industry accounted for 6.3%, 39.6% and 54.0% of total GDP respectively.

The recovery of service industry has been slower than the secondary industry. Thus, final consumption expenditure has lowered GDP by 2.9% in the first half year and 2.3% in Q2 year-on-year. Meanwhile, per capita consumption expenditure decreased by 9.3% (12.5% drop in Q1) and total retail sales of consumer goods reduced by 11.4% in the first half year.

Gross capital formation (or gross domestic investment) contributed 1.5% to GDP growth in the first half year and 5% in Q2, as total fixed asset investment declined by 3.1% in the first half year (16.1% decline in Q1).

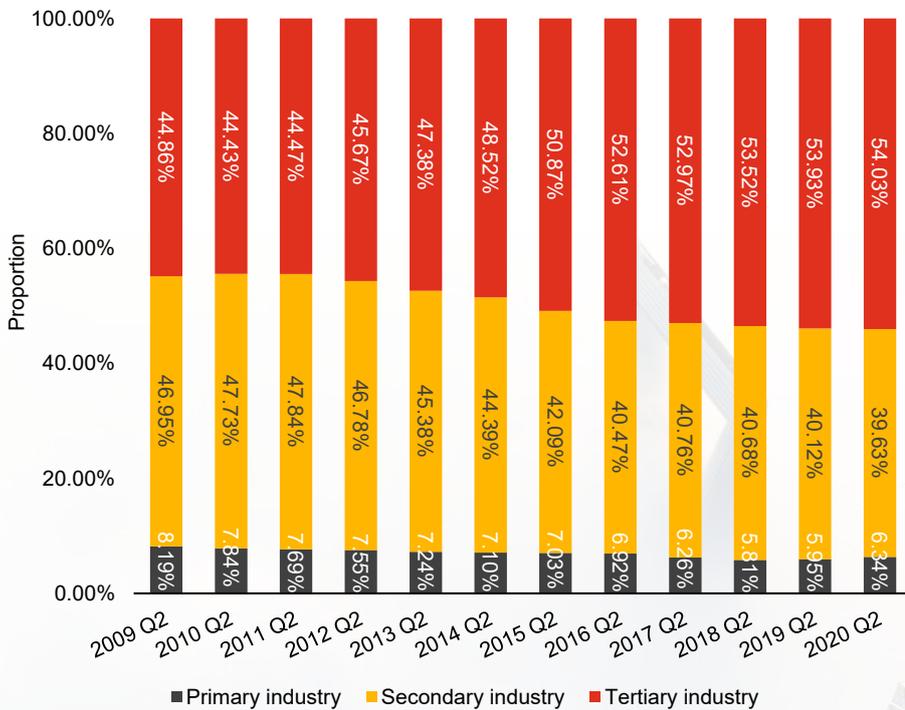
As exports and imports dropped by 3.2% in the first half year (6.4% drop in Q1) year-on-year, the contribution of net exports including both goods and services to total GDP growth was 0.5% (-1.0% in Q1).

Finally, China's economic growth is expected to rely on the domestic market to a greater degree in the second half of the year and will probably continue to do so in the next few years since a "dual circulation" economic model has emerged. As a result of the global economic slowdown due to COVID-19, rising protectionism, as well as increased tensions between China and the US, president Xi Jinping recently called for the creation of a new dual circulation development model. This model promotes taking full advantage of China's huge domestic market while still enabling domestic and foreign markets to work together.

A new development pattern where the domestic market is the mainstay will prioritise the following core aspects of China's economy: continued improvement in the level of the industrial and supply chains, promotion of scientific and technological innovations, speeding up of breakthroughs in core technologies (improving self-reliance), and cultivation of new advantages for future development.

Dual circulation means that the international market will continue to be important for China's future development. However, international and domestic markets will be better connected by exploring and unleashing the potential of domestic demand. China's economic development will be more sustainable when the country makes better use of resources in both domestic and international markets.

Figure 2: GDP composition



Total fixed asset investment reached 28.16 trillion yuan in the first two quarters, declining by 3.1%, which is much better than the 16.1% drop in Q1, year-on-year. With strong government support and fiscal and monetary stimulus measures, total fixed asset investment is expected to return to a normal level of around 5% (similar to 2019) in Q3 and will probably be higher in Q4. In order to achieve the key goals of stabilising employment and ensuring living standards in 2020 while the COVID-19 pandemic continues, China needs to invest an enormous amount in order to maintain economic stability.

More specifically, by ownership, in the first two quarters, private investment accounted for 56.1% of the total (56.8% in Q1 2020, 56.4% in 2019 and 62% in 2018) and dropped by 7.3% (18.8% drop in Q1) year-on-year. This suggests that the recovery of private investment has been slower than that of total investment.

On the other hand, as expected, state-owned investment went up by 2.1% in the first half year (12.8% decline in Q1). In the second half year, state owned investment is likely to grow faster than in the first half.

Furthermore, fixed asset investment from Hong Kong, Macao and Taiwan owned companies increased by 0.6% in the first two quarters (13.0% decline in Q1) year-on-year. Foreign-owned fixed investment increased by 3.9% in the first two quarters (9.0% decline in Q1). This is the highest among all the enterprise categories by type of ownership. It indicates that foreign-owned

enterprises recognise the effective measures China has taken in combatting the COVID-19 pandemic and the decision makers of these companies are confident that the country will achieve economic prosperity in the post pandemic period.

By sectors, fixed asset investment of the primary (0.85 trillion yuan), secondary (8.50 trillion yuan) and tertiary industry (18.83 trillion yuan) increased by 3.8% (13.8% decline in Q1), and contracted by 8.3% (21.9% drop in Q1) and 1.0% (13.5% drop in Q1) year-on-year in first half year respectively.

By industries, the growth of fixed asset investment in the manufacturing sector dropped by 11.7% (25.2% in Q1) year-on-year in the first two quarters. Infrastructure investment (excluding the production and supply of electricity, gas and water) declined by 0.7% (19.7% drop in Q1) during this period.

In Q1, there were several industries that registered a more than 20 to 30% contraction in fixed asset investment, however in the first two quarters, only the manufacturing of textiles and manufacturing of automobiles recorded reductions of 22.4% and 20.9% respectively. Meanwhile, ten industries recorded a contraction of over 10% in fixed asset investment.

A few industries that had positive fixed asset investment growth over the period included: the production and supply of electricity, gas, and water (18.2%), education (10.8%), health and social services (14.0%), manufacturing

of computers, communications and other electronic equipment (9.4%) and farming, forestry, animal husbandry and fishery (5.5%).

Lastly, by geography, fixed asset investment from central China contracted by 11.9% (27.8% drop in Q1), which was still the lowest in the country, given the epicentre of the COVID-19 outbreak, Wuhan city, as well as Hubei province, is located in central China. With support from the central government and large enterprises, there will be more investments coming into Wuhan and Hubei province overall in Q3 and Q4.

Fixed asset investment from western China increased by 1.1% in the first six months (10.8% decline in Q1), while investment from the most developed part of the country, eastern China (mainly the coastal areas), declined by 0.7% (12.3% decline in Q1). Fixed asset investment from the northeast rose by 0.4% (14.2% drop in Q1).

The impact of COVID-19 on China's fixed asset investment will gradually diminish in Q3 and Q4, if the outbreak subsides. There are vast opportunities to invest in China as the world's largest developing country, and fixed asset investment is a key method of stabilising economic development.

Figure 3: Fixed Asset Investment

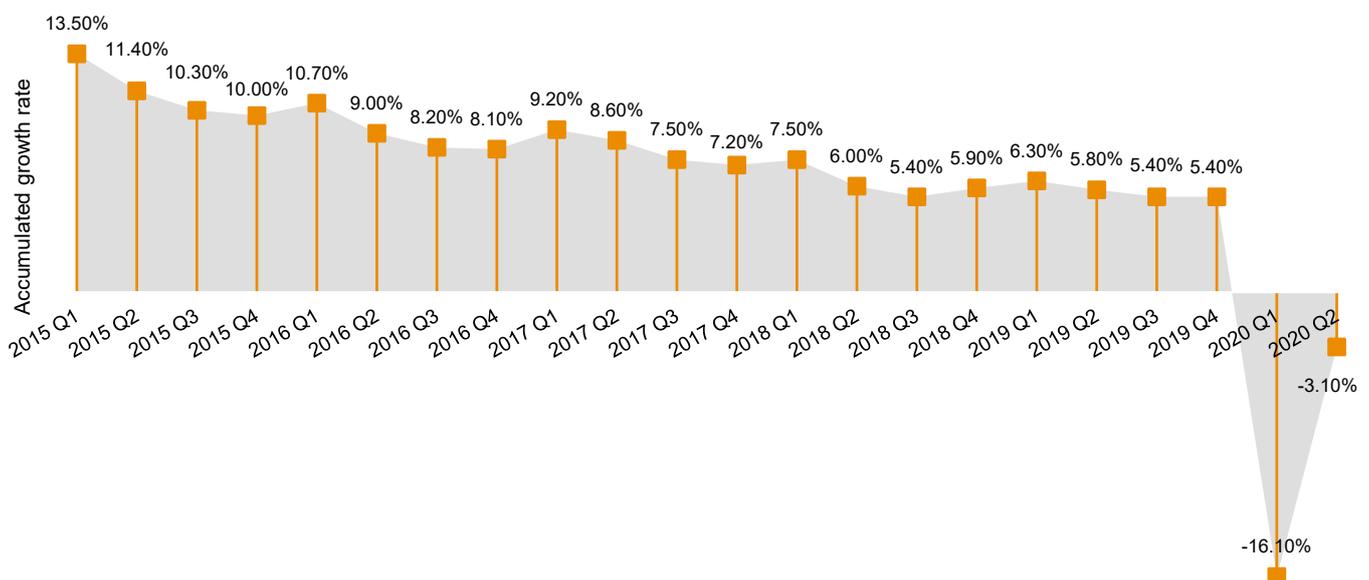
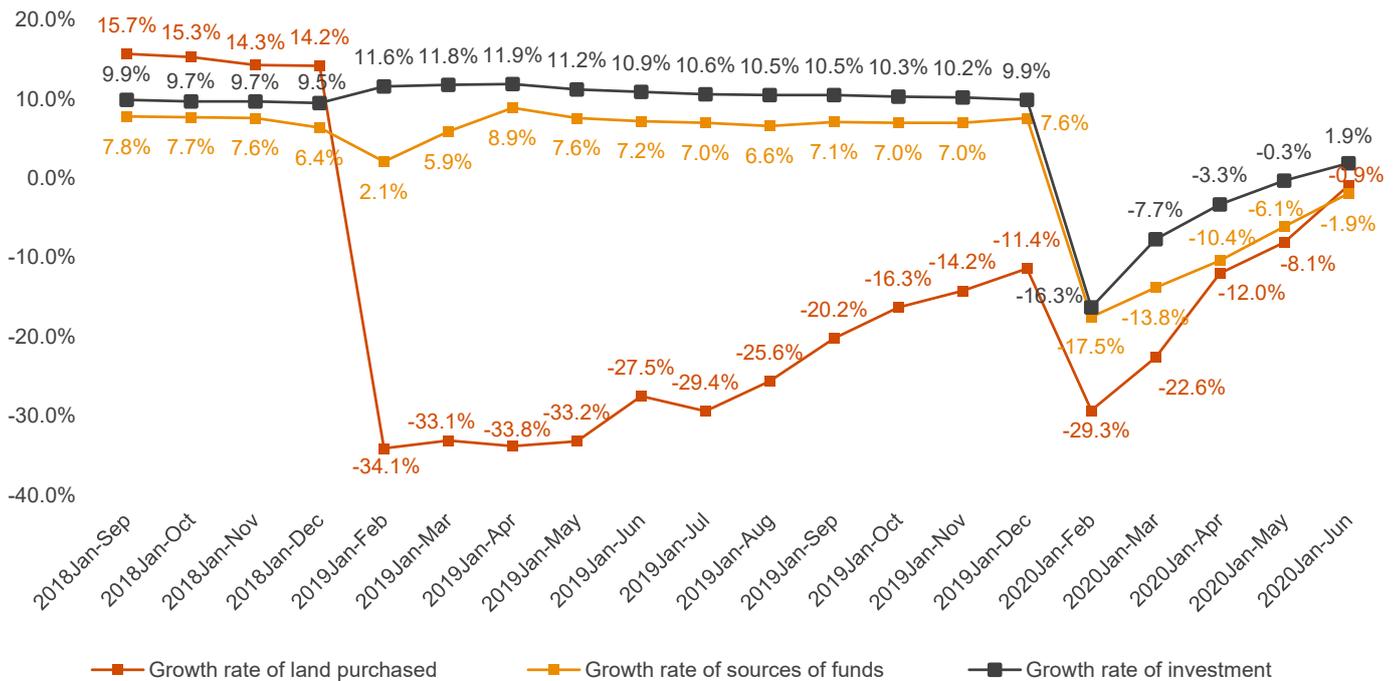


Figure 4: Growth rates in real estate



Total real estate investment increased by 1.9% in the first six months (7.7% drop in Q1) year-on-year and reached 6.28 trillion yuan which accounted for 22.3% of total fixed asset investment in the first two quarters (26% in Q1). This suggests real estate investment contributed slightly less to total fixed asset investment than in the first quarter.

Although macro controls on property investment speculation are not likely to be relaxed in the second half year, total real estate investment is expected to recover in Q3 and Q4. China has to accelerate the speed of urbanisation, particularly given the economy is still facing downward pressure caused by the COVID-19 pandemic. Urbanisation is one of key engines driving domestic growth, and it will certainly create opportunities for the real estate sector. China's urbanisation rate reached around 60% at the end of 2019, so there is still a long way to go to catch up to most advanced countries that have an urbanisation rate of 80%.

The sources of funds for real estate development enterprises recovered in the first half year. The overall growth rate of sources of funds decreased by only 1.9% (13.8% decline in Q1) year-on-year and reached 6.28 trillion yuan. Sources of funds for real estate development will

continue to rise in Q3 and Q4, as monetary and financing policies have been adjusted to support economic growth.

In the first two quarters, besides total real estate investment turning positive, real estate construction continued to moderately expand. Floor space under construction increased by 2.6% year-on-year.

Total land transaction prices increased by 5.9% in the first six months. This indicates that property developers are spending more cash to purchase land and are also confident in future market development.

Most other major performance indicators in the real estate sector were still negative in the first half year, for instance:

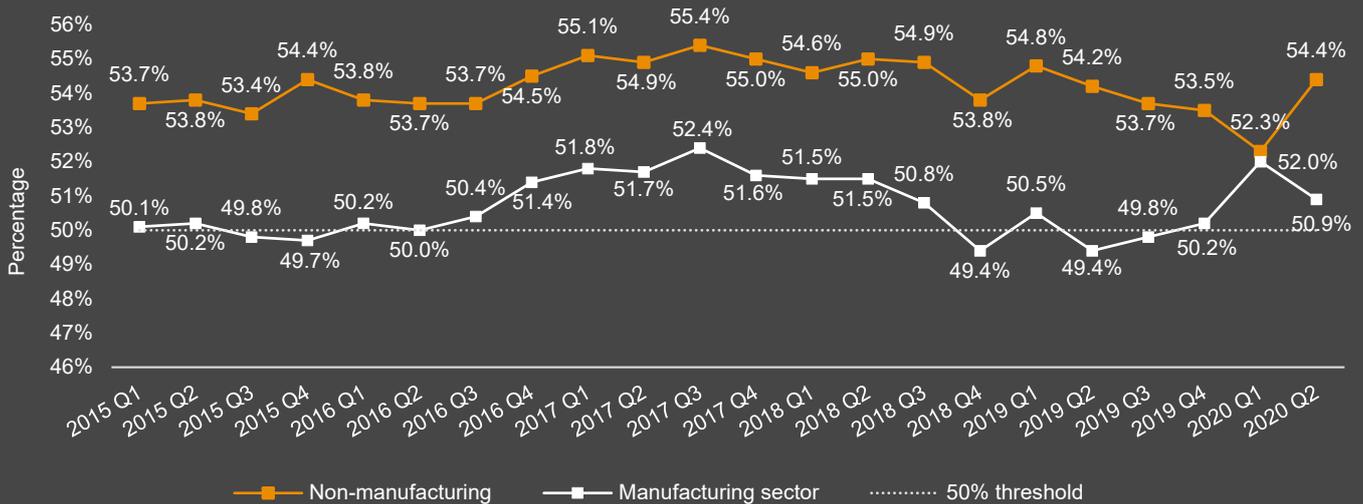
- Floor space of buildings completed (residential, office, and commercial) decreased by 10.5% (15.8% drop in Q1).
- Floor space of buildings just at the start of construction dropped by 7.6% (27.2% drop in Q1).
- The growth rate of land purchased declined by 0.9% (22.6% decline in Q1) after an 11.4% drop in 2019.

- Floor space of properties ready for sale increased by 1.8% (26.3% decline in Q1).
- Total floor space of all properties sold declined by 8.4% (26.3% decline in Q1).

In the first six months, the total sales value of properties reached 6.69 trillion yuan and declined by 5.4% (24.7% drop in Q1).

In spite of the fact that most indicators are still negative, the property market is expected to recover in the third quarter. Thus, the total sales value and total floor space of properties sold are very likely to show positive growth in Q3. Overall, property prices might continue to rise mildly in the second half of 2020.

Figure 5: Purchasing Managers' Index



China's **Purchasing Managers' Index (PMI)** for the manufacturing sector remained above the threshold of 50% in the second quarter. The PMI was 50.8%, 50.6% and 50.9% for in April, May and June respectively. This indicates that the manufacturing industry recovered steadily and fundamentals continued to improve in the second quarter.

For the third quarter 2020, the PMI is expected to remain at a comparatively stable level if COVID-19 can be contained in China as it has been in Q2. At the same time, there are a few uncertainties, such as weak exports caused by the ongoing pandemic, slow recovery of exported-related sectors, and operational difficulties faced by some small enterprises.

Thus, China's PMI for the manufacturing sector is not likely to increase until the COVID-19 outbreak has been contained in most major economies.

The new export orders index was 33.5%, 35.3% and 42.6% in April, May and June respectively. These figures were lower than in the first quarter. This indicates that COVID-19 impacted China's export orders index more in the second quarter than in the first quarter.

The import index declined to 43.9%, 45.3% and 47.0%, for April, May and June, respectively, which is also lower than in the first quarter.

In June, the PMI of large, medium, and small-sized enterprises was 52.1%, 50.2%, and 48.9%, while in March it was 52.6%, 51.5% and 50.9%, respectively. Small-sized

manufacturing enterprises have been more affected than large and medium-sized enterprises by COVID-19. This trend will probably last until Q3 and Q4, unless domestic GDP growth recovers to a similar level as in the past few years.

The production index for April, May and June was 53.7%, 53.2% and 53.9% respectively suggesting production output continues to increase.

On the other hand, while the new order index was above the threshold in the second quarter, it was not as high as in January (51.4%) and March (52.0%). The new order index was 50.2%, 50.9%, 51.4% in April, May and June respectively. The slight increase in June suggests that while demand for new products was not that robust, it still improved during the second quarter.

The raw materials inventory index rose to 49.0% in March, however it declined to 48.2%, 47.3% and 47.6% in April, May and June respectively. This is likely because COVID-19 has had an impact on raw material supply.

The employed person index also dropped from 50.9% in March to 50.2%, 49.4% and 49.1% in April, May and June respectively. This indicates that the employment rate in manufacturing enterprises dropped slightly over this period.

In contrast, the non-manufacturing PMI recovered firmly to reach 53.2%, 53.6% and 54.4% in April, May and June respectively.

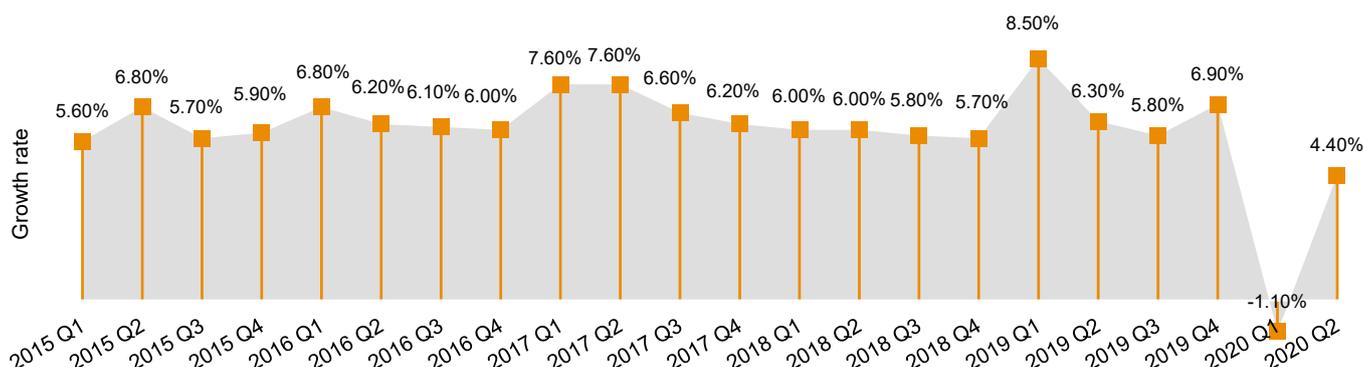
By sectors, the non-manufacturing PMI of the service sector increased to 53.4% in June from 51.8% in March. It returned to a similar level as December of last year when it was 53.1%.

Meanwhile, the non-manufacturing PMI from several sectors were still below the threshold of 50% in June, such as leasing and business services, residential services, as well as culture, sports and entertainment, since large gatherings were still not encouraged in the second quarter.

Furthermore, the new orders index, input price index (similar to the main raw material purchase price index of manufacturing PMI), sales price index and employment index, were 52.7%, 52.9%, 49.5% and 48.7% in June, all slightly higher than the March levels. This suggests that while non-manufacturing PMI is improving, some indexes are still not very robust.

In the third and fourth quarter, the overall non-manufacturing PMI is expected to continue to increase and very few sectors will remain below the threshold of 50%, since restrictions on tourism and gatherings related to culture, sports and entertainment are gradually being lifted.

Figure 6: Industrial Added Values



The growth of **Industrial Added Values** for companies over certain scales contracted by 1.3% year-on-year in real terms in the first two quarters, which is much less than the 8.4% drop in Q1. It increased by 4.4% in Q2 and 4.8% in June. This indicates that industrial production quickly bounced back in the second quarter.

Thus, in Q3 and Q4, the growth of industrial added values is expected to become even more robust.

However, in the first half year, the total profit for all industrial companies over certain scales declined by 12.8% to 2.51 trillion yuan, following the sharp fall of 36.7% in the first quarter.

More specifically in the first two quarters, the majority of sectors still had negative industrial added values, however the amount by which they reduced was much less than in Q1. While around half of the major sectors recorded a more than 10% contraction of industrial added values in the first quarter, the performance of these sectors have improved in Q2, for example:

- manufacturing of non-metal minerals (-2.2% in H1, -13.7% in Q1; 8.9% in 2019);
- manufacturing of fabricated metal products (-3.1% in H1, -15.0% in Q1; 5.8% in 2019)
- manufacturing of railways, shipbuilding, aerospace and other transportation equipment (-3.8% in H1, -13.7% in Q1; 7.4% in 2019);
- manufacturing of electric machinery and equipment (-0.3% in H1, -12.9% in Q1; 10.7% in 2019);

- manufacturing of automobiles (-3.1% in H1, -26% in Q1; 1.8% in 2019);
- processing of food from agricultural products (-4.9% in H1, -11.1% in Q1; 1.9% in 2019);
- manufacturing of textiles (-4.5% in H1, -16.8% in Q1; 1.3% in 2019);
- manufacturing of rubber and plastic products (-4.3% in H1, -16.2% in Q1; 4.8% in 2019);
- manufacturing of general machinery (-2.3% in H1, -17.2% in Q1; 4.3% in 2019);
- manufacturing of special-purpose machinery (2.9% in H1, -13.5% in Q1; 6.9% in 2019).

In the first half year, besides manufacturing of special-purpose machinery, industrial added values of a few sectors rebounded to positive levels including the manufacturing of computers, communications and other electronic equipment (5.7% in H1); manufacturing of high-tech industry (4.5% in H1), manufacturing of medicines (1.8% in H1), manufacturing of ferrous metal smelting and pressing (3.4% in H1), manufacturing and processing of non-ferrous metals (1.0% in H1).

Additionally, according to the China Association of Automobile Manufacturers (CAAM), in the first six months, car output and sales dropped by 16.8% and 16.9% to 10.11 million and 10.25 million year-on-year respectively.

In fact, thanks to strong policy support from both the central and local governments, car output and sales grew in Q2 (rebounding from a contraction in Q1).

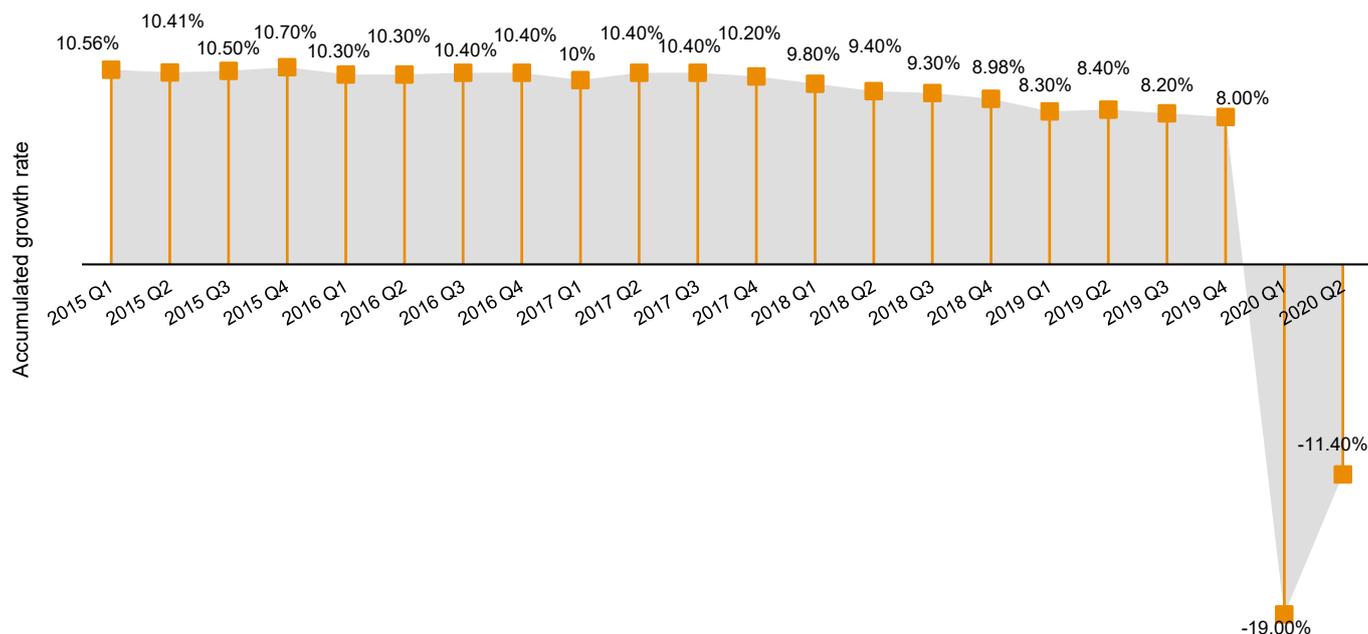
During April, May and June, car output increased by 2.3%, 18.2%, 22.5% year-on-year respectively. During the same period, car sales also increased by 4.4%, 14.5% and 11.6% year-on-year respectively. This outcome was better than market expectations. As the cornerstone of industrial production, the recovery of car output and sales is very encouraging for the whole manufacturing sector.

Additionally, by ownership, profits for all company types continued to contract in the first half year:

- Profits of SOEs dropped by 28.5% to 661 billion yuan (45.5% drop to 223 billion yuan in Q1);
- Profits of foreign-owned enterprises (including Hong Kong, Macao and Taiwan) declined by 8.8% to 649 billion yuan (46.9% drop to 167 billion yuan in Q1);
- Profits of joint-stock enterprises decreased by 13.7% to 1.82 trillion yuan (33% decline to 597 billion yuan in Q1);
- Profits of private companies reduced by 8.4% to 712 billion yuan (29.5% decline to 234 billion yuan in Q1).

As domestic economic growth continued to rebound in Q2, the downward pressure on industrial production has eased significantly. Being the world's largest factory, many sectors of industrial production in China are highly related to global demand. In Q3 and Q4, industrial added values are likely to return to positive levels, however market challenges for manufacturers will not recede until the COVID-19 pandemic subsides.

Figure 7: Retail Sales of Consumer Goods



Total retail sales of consumer goods contracted by 11.4% year-on-year to 17.23 trillion yuan in the first two quarters, which is much better than the 19% reduction in Q1. If automobile sales were excluded, total retail sales would have decreased by 10.9% during this period. In June, the situation improved and sales reduced by only 1.8% (or 2.9% in real terms) year-on-year to 3.35 trillion yuan.

In Q3, total retail sales of consumer goods is expected to return to positive levels with single digit growth, since most social and business activities have returned to normal in Q2 and consumers' confidence will also gradually improve.

As final consumption expenditure serves as the largest contributor to GDP growth on top of investment and net exports, the recovery of total retail sales of consumer goods in the second half year will be critical. Both central and local governments will continue to stimulate consumption.

Ongoing preventative measures in fighting the COVID-19 pandemic still pose a big threat for tourism consumption in Q3, particularly given new cases have emerged again in Xinjiang and in the Northeast. Domestic travel might be affected regardless of the fact that the country reopened cross-province group tourism in July.

In terms of types of consumption, in the first two quarters, catering consumption continued to decline by 32.8% year-on-year and reached 1.46 trillion yuan (44.3% decline in Q1). While in June, catering consumption decreased by 15.2% year-on-year.

Comparatively, similar to Q1, retail sales of physical goods declined by much less than catering consumption. In the first two quarters, it contracted by 8.7% year-on-year to 15.76 trillion yuan (compared to a 15.8% year-on-year reduction in Q1).

At the same time, some positive figures from the retail sector have also emerged. For instance, national online retail sales grew by 7.3% and reached 5.15 trillion yuan (0.8% decline in Q1). Out of which online retail sales of physical goods rose by 14.3% and reached 4.35 trillion yuan accounting for 25.2% of total goods retail sales (23.6% in Q1). This shows how the COVID-19 pandemic has sped up the growth of online retail sales.

Additionally, retail sales of grain, cooking oil, foodstuff, traditional Chinese and western medicines continued to rise in the second quarter. Retail sales of beverages (as a result of the summer season), groceries, and communication equipment, cultural and office supplies, increased by 5.2%, 5.8% and 1.6% in the first half year.

Per capita disposable nominal income rose to 15,666 yuan and increased by 2.4% in the first two quarters. However in real terms, it declined by 1.3% year-on-year, (much less than the 3.9% drop in Q1). More specifically, per capita disposable income was 21,655 yuan and 8,069 yuan for urban and rural residents respectively. This is the reason why the central government has given priority to stabilising employment and ensuring living standards in 2020. Without strong policy support, people's disposable income might fall by much more than the current figure.

By sources of income, per capita salary income increased by 2.5% year-on-year in the first half year. Per capita business income reduced by 5.1% (7.3% decrease in Q1). Meanwhile, asset income and transfer income (including pension, unemployment allowance, etc.) both grew by 4.2% and 8.2% respectively.

As a result of slower GDP growth, and the impact of COVID-19, disposable real income is not likely to rise in Q3 and Q4. Consequently, this will affect consumers' willingness to spend, and stall consumption growth.

Figure 8: Quarterly Balance of Trade



Total imports and exports in the first two quarters were negatively impacted by the COVID-19 pandemic, but were still better than expected. Imports and exports reached 14.24 trillion yuan and contracted by 3.2% year-on-year.

Since the COVID-19 outbreak spread to many countries in Q2, imports and exports were expected to drop much more in Q2 than in Q1. However, trade remained comparatively stable and imports and exports only declined by 0.2% year-on-year and reached 7.67 trillion yuan. More specifically, in the first half year, exports dropped by 3% (4.5% increase in Q2) year-on-year to 7.71 trillion yuan, and imports decreased by 3.3% (5.8% drop in Q2) to 6.53 trillion yuan. In June, imports and exports both increased by 6.2% and 4.3% respectively.

For Q3 and Q4, if China's imports and exports do not decline further, this will meet market expectations. As the COVID-19 pandemic has significantly interrupted global economic growth, the WTO projects that global trade in goods will contract by 13% to 32% in 2020. As the world's largest trading country for goods, China is able to manage well in the domestic market, but it cannot control the international demand.

By geography, according to the General Customs Administration, China is executing the phase one trade agreement between China and the US amidst the COVID-19 pandemic. Thus, China's imports from the US only decreased by 1.5% in the first half year to 396 billion yuan and exports declined by 8.1% to 1.25 trillion yuan year-on-year. As a result, the trade surplus dropped by 10.8% to 852 billion yuan.

In the first two quarters, As a result of Brexit and the fact that the EU was hit by the COVID-19 pandemic more seriously, ASEAN became China's largest trading partner and trade with ASEAN increased by 5.6% year-on-year and reached 2.09 trillion (accounting for 14.7% of China's total international trade). One reason for this is that China's industrial chain has been more closely integrated with ASEAN in recent years, and another is that the COVID-19 outbreak in ASEAN was much more limited than in the EU or the US.

Meanwhile, trade with the EU dropped by 1.8% (10.4% drop in Q1) year-on-year and reached 1.99 trillion yuan in the first half year. This indicates that imports and exports to the EU although impacted by the COVID-19 pandemic, were still relatively stable during this period. China's trade with countries under the Belt and Road Initiative (BRI) slightly decreased by 0.9% and reached 4.2 trillion yuan.

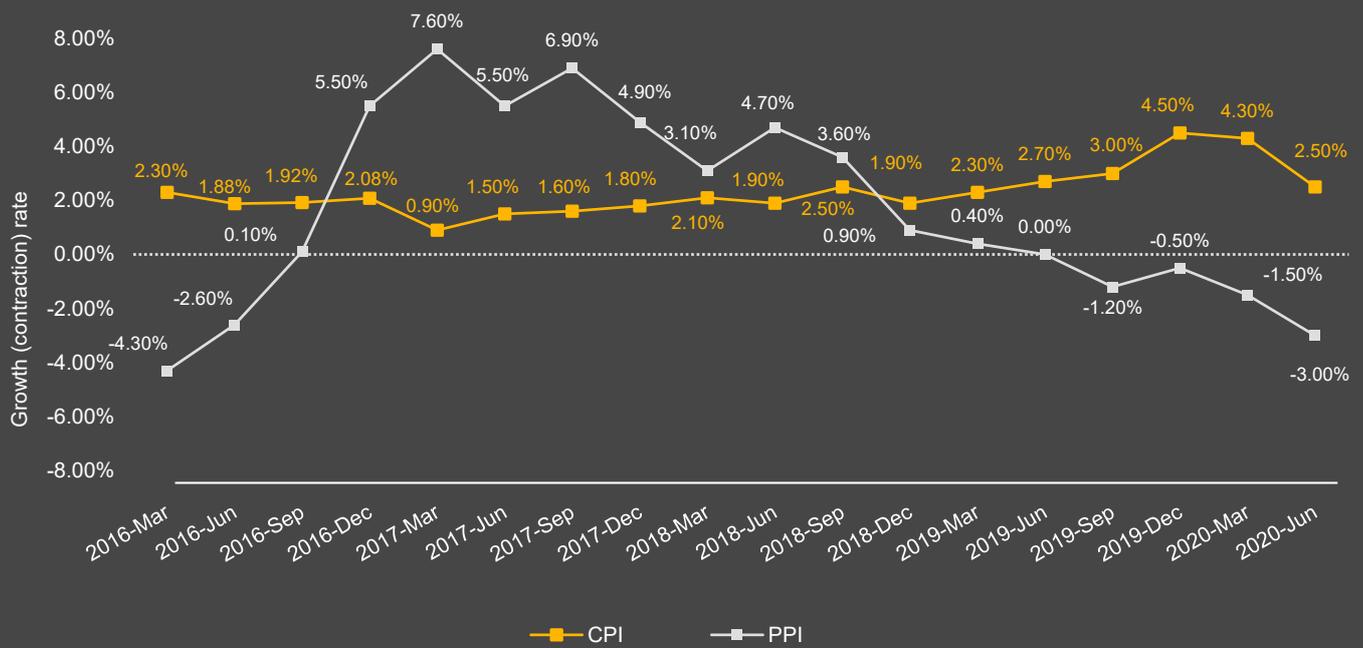
By ownership of trading enterprises, in the first two quarters, exports and imports generated by private enterprises increased by 4.9% year-on-year and continued to be the largest contributor to China's total trade.

More specifically, in the first half year, trade from private enterprises reached 6.42 trillion yuan and accounted for 45.1% of total trade (42.4% in Q1). Of which, exports accounted for 4.14 trillion yuan (53.7% of the total exports) and imports accounted for 2.28 trillion yuan (34.9% of China's total imports). This suggests that private enterprises contributed to more than half of China's exports, and more than one-third of the imports.

Meanwhile, the trade from foreign-owned enterprises and state-owned enterprises were 5.55 trillion and 2.22 trillion yuan, accounting for 39% and 15.6% of total trade, respectively.

The implementation of government policy measures is one of the major reasons why China's trade is comparatively steady. Ensuring stability in terms of food and energy security, stable industrial and supply chains, as well as imports and exports have been top priorities. Thus, in the first half year, imports of commodities and key agricultural products sharply increased. For example, imports of iron ore, crude oil, and coal went up 9.6%, 9.9%, and 12.7% year-on-year respectively. Imports of soybean, pork, and beef also increased by 17.9%, 140%, and 42.9% year-on-year respectively.

Figure 9: Producer Price Index and Consumer Price Index



The Producer Price Index (PPI) for manufactured goods decreased by 1.9% (0.6% drop in Q1) in the first two quarters year-on-year. Meanwhile, the purchasing price index for manufactured goods also declined by 2.6% during this period.

In April, May and June, the PPI for manufactured goods was -3.1%, -3.7% and -3.0% (0%, -0.5% and -1.5% from January to March) year-on-year respectively. As a result of the COVID-19 pandemic, the PPI was much less than in the first quarter of 2020 and than in 2019.

For the second half of the year, the PPI is likely to remain at a low level and probably will still be negative in Q3 and Q4, as demand for industrial products will be weak.

Among all the PPIs for manufactured goods, in the first half year, the price for means of production decreased by 1.9% (4.2% drop in June, 2.4% drop in March) year-on-year. Furthermore, the price of mining and quarrying products declined by 6.0% (10.5% drop in June, 4.0% drop in March) and the price of raw materials dropped 5.9% (8.5% drop in June, 5.2% drop in March).

On the other hand, the PPI for consumer goods increased by 1.0% in the first half year. Out of which, food prices increased by 4.1%, and the prices of all other consumer goods declined.

Nearly all major prices reflected in the purchaser price index went down in the first two quarters year-on-year, except the prices of building materials as well as non-metallic, agricultural and sideline products.

For instance, the prices of fuel and power, non-ferrous metal materials and wires, and chemical raw materials, dropped by 7.7%, 3.7%, 8.0% respectively.

The price of petroleum and natural gas extraction declined by 27% in the first two quarters year-on-year. The price of mining of ferrous metal ores, non-ferrous metal ores and non-metal ores increased by 5.0%, 3.0% and 1.8% respectively, thanks to the recovery in domestic demand.

Growth in the **Consumer Price Index (CPI)** continued to increase in the second quarter, but by less than in the first quarter.

As a result of the continuous recovery of the transportation and logistics sector, and the increase in supply of consumer goods, the CPI increased by 3.8% in the first two quarters year-on-year. This was slightly lower than the CPI growth of 4.9% in Q1. More specifically, the CPI increased by 3.3%, 2.4% and 2.5% in April, May and June, year-on-year respectively.

Food prices continued to rise with 16.2% growth in the first half year, and pushed up the CPI by 3.27%. Among all food prices, meat prices went up by 70.5%, out of which pork price rose by 104.3%, beef prices went up by 20.2%, and lamb prices increased by 11.1% year-on-year. African swine fever virus together with the impact of the COVID-19 pandemic were the main reasons for the sky-high pork prices.

The hike in food prices might last until the second half of the year, since the supply of pork and production capacity has gradually improved.

In addition to food prices, in the first half year, prices of consumer products also increased by 5.6%, prices of education, culture and entertainment went up 2.0%, and the price of healthcare rose by 2.1% year-on-year. On the other hand, the price of clothes, housing, and transportation and communications reduced by 0.1%, 0.1% and 3.2% respectively. The declining prices of fuel for vehicles and communication facilities dragged down the overall price of transportation and communications.



Policy updates

Total aggregate financing to the real economy and bank loans substantially increased in H1.

In order to support domestic economic growth, according to data from the People's Bank of China (PBoC), total aggregate financing to the real economy (AFRE) reached 20.83 trillion yuan during the first half year which was 6.22 trillion yuan more than the same period last year. Total outstanding AFRE reached 271.8 trillion yuan by the end of June, and increased by 12.8% year-on-year.

Total RMB loans to the real economy increased by 2.31 trillion yuan and reached 12.33 trillion yuan, the highest on record. Total outstanding RMB loans to the real economy reached 163.9 trillion yuan and recorded 13.3% year-on-year growth.

While China's GDP contracted by 1.6% during the first half year, the growth of AFRE and RMB loans has been substantial. These are expected to provide sufficient conditions for financing.

As a result of the PBoC promoting direct financing to the real economy, among the items included in the AFRE in the first half year, RMB loans accounted for about 59% of total AFRE, or much less than in the first quarter and the last two years (65% in Q1, 66% in 2019, 76.9% in Q1 2019).

On the other hand, corporate bonds and government bonds accounted for 16% (5.3% more than the same period last year) and 18% (1.4% more than the same period last year) respectively. More specifically, financing of corporate bonds reached 3.33 trillion yuan or increased by 1.76 trillion yuan year-on-year. Financing of government bonds reached 3.79 trillion yuan and increased by 1.33 trillion yuan year-on-year.

Direct financing to the real economy is usually cheaper than offering bank loans. So the large increases in corporate bond financing indicates lower financing costs for companies. During the economic downturn caused by the COVID-19 pandemic, this has been critical for enterprises with high leverage ratios.

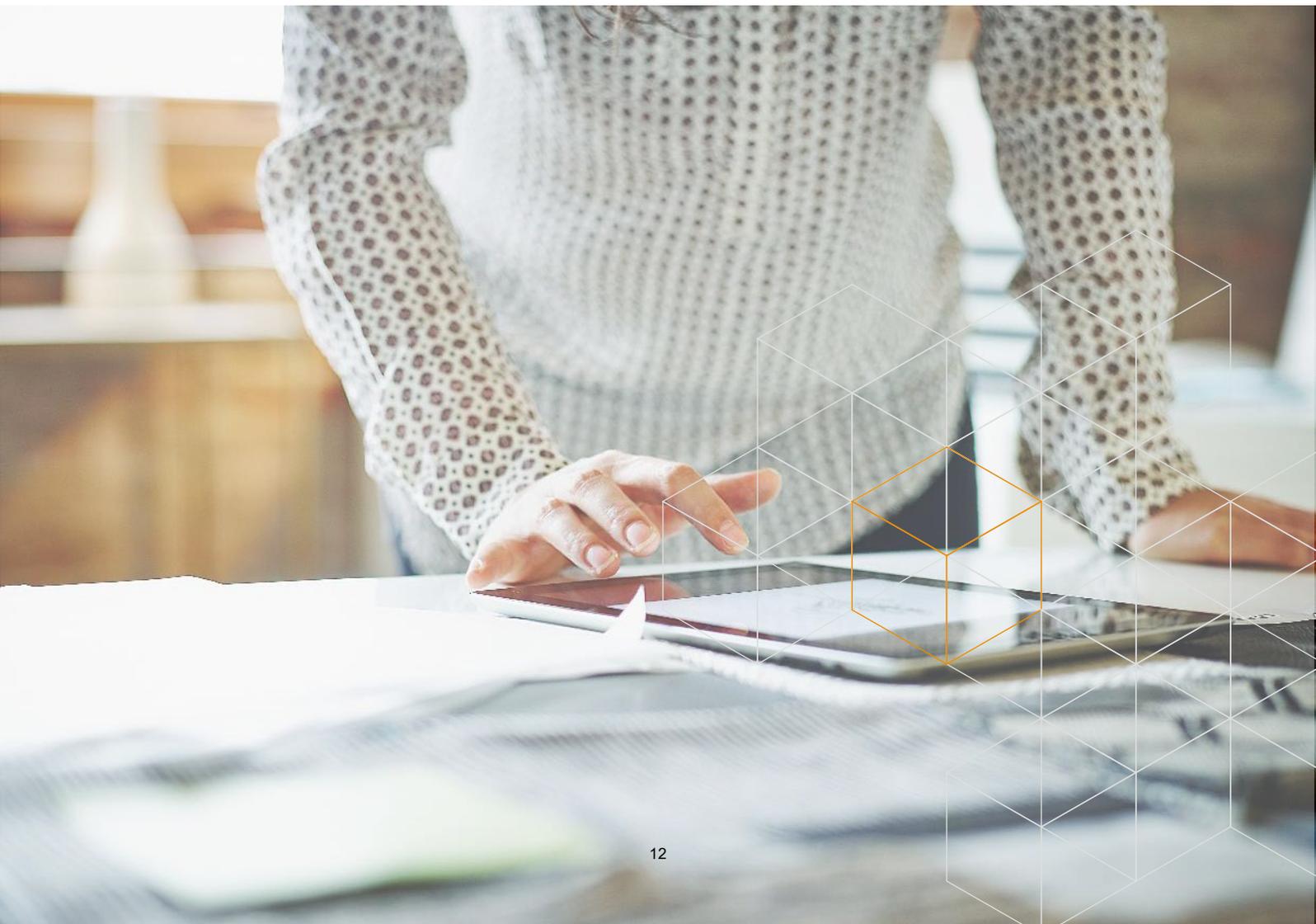
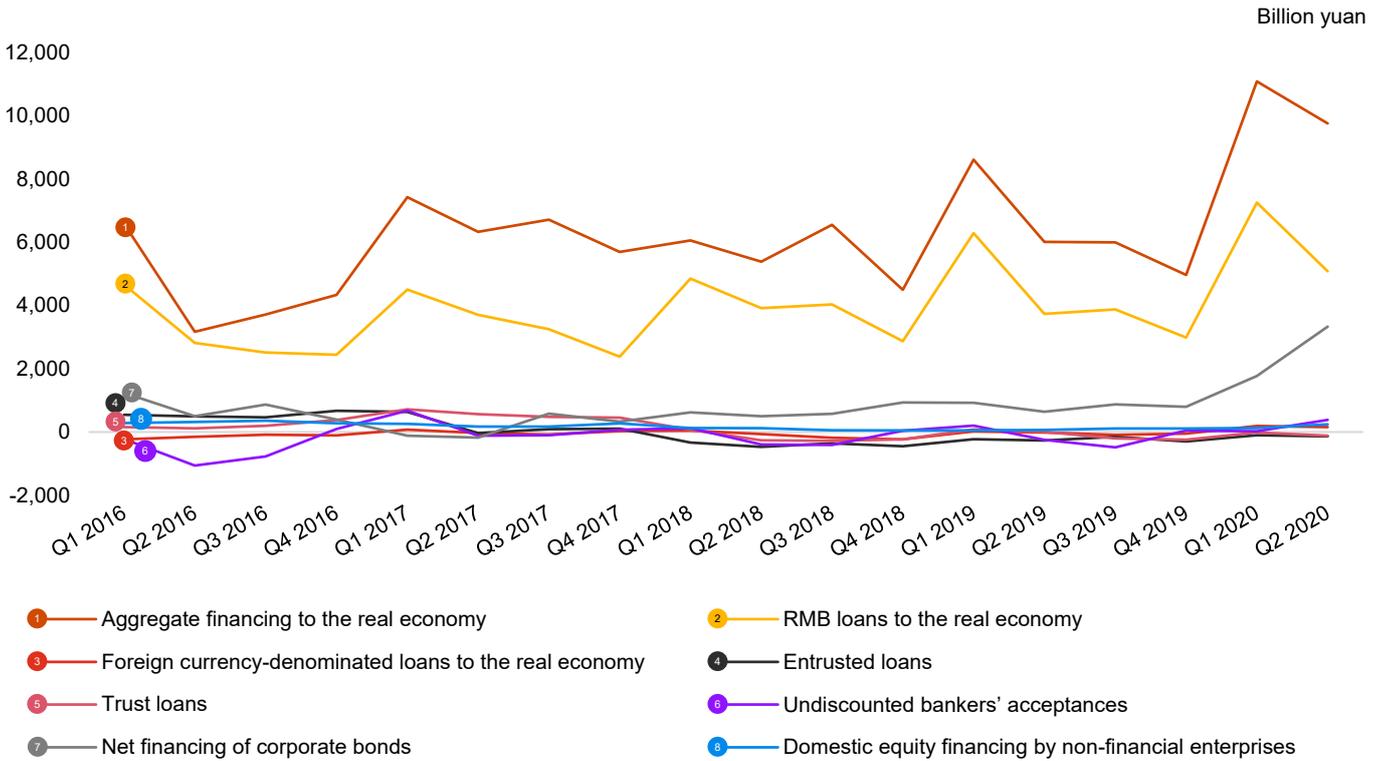


Figure 10: Aggregate financing to the real economy (flows) (Q1 2016 – Q2 2020)



Source: Wind

Thus, in the second half year, corporate bonds, equity financing from the stock market, and other types of direct financing will continue to grow.

Furthermore, the PBoC has continued to support and improve the financing environment for micro, small and medium-sized enterprises (MSME), since this has been the most vulnerable group during the COVID-19 pandemic. As at the end of May, loan balances for micro and small enterprises increased by 25.4% year-on-year to 12.9 trillion yuan, 12.2% higher than the growth of total RMB loans.

Additionally, by sector, bank loans to the manufacturing sector grew rapidly. As at the end of May, medium and long-term loan balances for the manufacturing sector reached 4.28 trillion yuan and increased by 19.6%, the highest increase since February in 2011.

Lastly, to support the real economy, in June the central government asked banks to sacrifice 1.5 trillion yuan in profit to support small enterprises in 2020. According to PBoC, this can be divided into three approaches, namely lowering interest rates with around 930 billion yuan, deferring

principal and interest loan repayments etc. by 230 billion, and reducing bank charges and fees by banks for 320 billion yuan. This type of policy measure has never before been enforced in China. It shows the strong determination from the government to help small companies weather this difficult period.

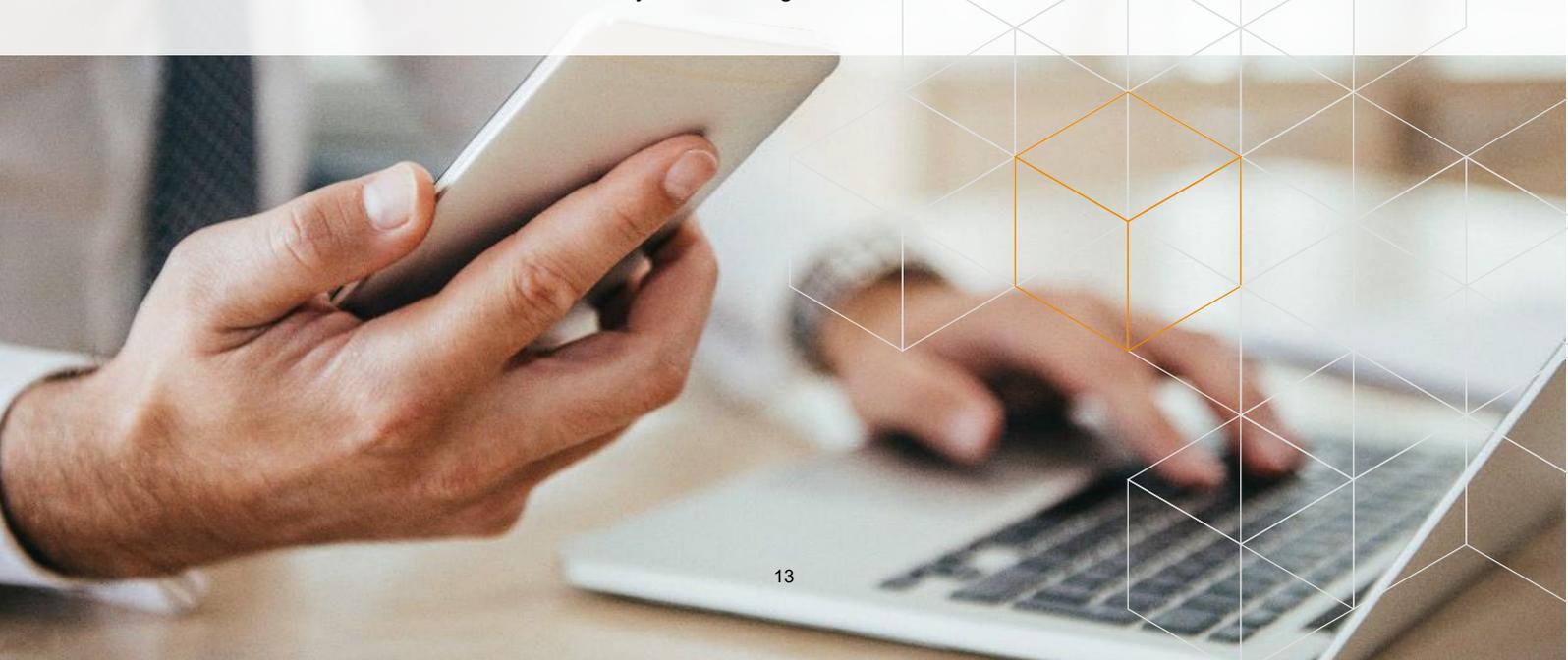
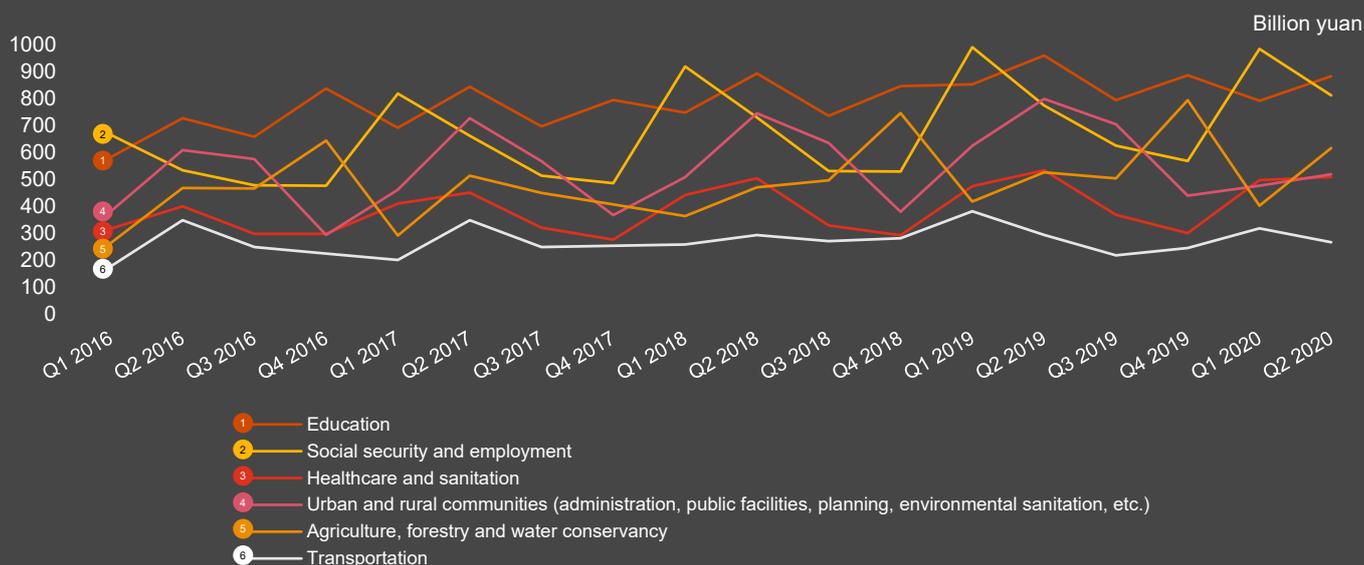


Figure 11: General public budget expenditure (Q1 2016 – Q2 2020)



Source: Wind

Fiscal spending decreased by 5.8% to 11.64 trillion yuan, while fiscal revenue reduced by 10.8% to 9.62 trillion yuan.

As a result of the negative impact of the COVID-19 pandemic on GDP growth, and the measures to cut taxes and fees for enterprises, China's general public budget revenue reduced by 10.8% in the first two quarters year-on-year, which is much less than the 14.3% drop in Q1. Of this, the budget revenue of the central government declined by 14% to 4.43 trillion yuan and the budget revenue of local governments decreased by 11.3% to 5.18 trillion yuan. By category, tax revenue declined by 11.3% to 8.20 trillion and non-tax revenue contracted by 8% to 1.42 trillion yuan.

Economic recovery in the second quarter reversed the drop in China's general public budget revenue and in June it increased by 3.2% year-on-year. Earlier in April and May, general public budget revenue contracted by 15% and 10% respectively.

Moreover, the largest contributor to fiscal revenue, value-added tax, fell by 19.1% in the first half year, which is slightly less than the 23.6% drop in Q1. It accounted for 29.9% of total budget revenue in the first six months of the year.

Budget revenue growth will probably remain positive in the second half year as economic conditions are expected to improve.

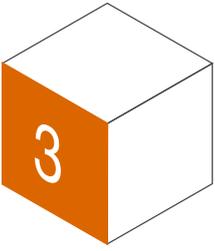
Fiscal spending dropped by 5.8% in the first six months to 11.64 trillion yuan. More specifically, this included central expenditure which was 1.63 trillion yuan (and grew by 3.2%), and local general public budget expenditure which was 10 trillion yuan (and declined by 6.2%). Other major items comprising fiscal expenditure included:

- 1.80 trillion yuan on social security and employment (1.7% in H1, -0.7% in Q1; 9.3% increase in 2019);
- 1.67 trillion yuan on education (-7.6% in H1, -7.1% in Q1; 8.5% increase in 2019);
- 1.02 trillion yuan on agriculture, forestry and water conservancy (7.9% increase in H1 due to flooding, -3.6% in Q1; 6.3% increase in 2019);
- 1.01 billion yuan on healthcare and sanitation (-0.2% in H1, 4.8% in Q1; 10.0% increase in 2019);
- 996 billion yuan on urban and rural communities (administration, public facilities, planning, environmental sanitation, etc.) (-30% in H1, -23.6% in Q1; 16.1% increase in 2019);
- 587 billion yuan on transportation (-13.3% in H1, -16.5% in Q1; 1.2% increase in 2019);

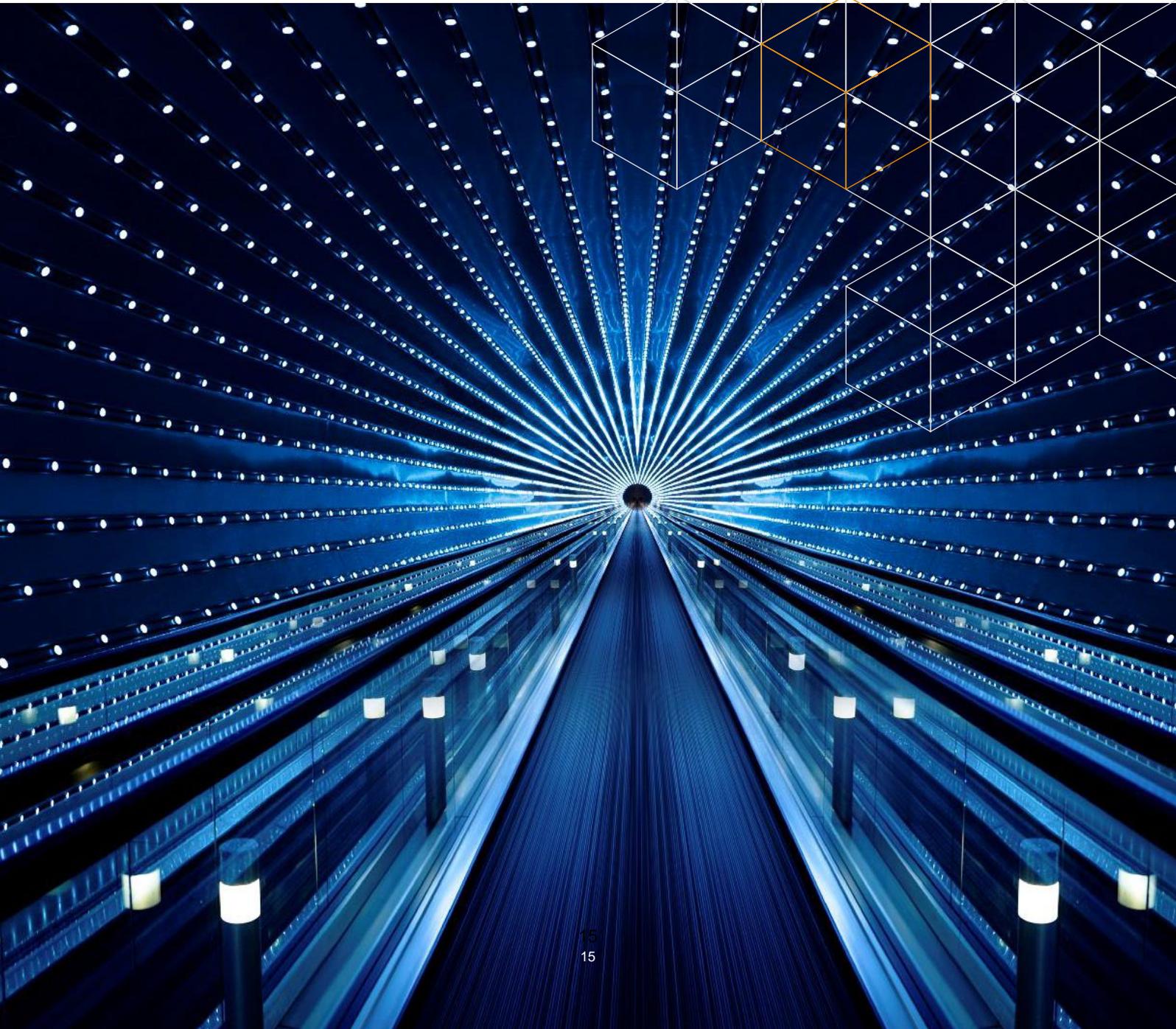
- Expenses for interest payments of debt increased by 9.8% in the first half year to 451 billion yuan. Spending on science and technology declined by 12.2% to 375 billion yuan and spending on energy conservation and environmental protection dropped by 15.4% to 266 billion yuan.

In addition to general public budget revenue, the government funds reached 3.15 trillion yuan in the first half year, decreasing by 1% year-on-year. More specifically, 95% of the government funds was from local governments which reached 2.99 trillion yuan with 0.3% growth. Of which, 2.81 trillion yuan came from the transfer of state-owned land use rights. Overall, 4.52 trillion yuan in government funds was spent in the first half year, an increase of 21.7%, and about 98.6% of this was spent by local governments.

Finally, in order to stabilise economic growth, small and micro enterprises will be provided with tax and fee cuts worth 2.5 trillion yuan as well as tax rebates for exports and preferential tax treatment for expanding automobile consumption, etc. Of the 3.75 trillion yuan quota of special-purpose bonds, 2.29 trillion yuan was delivered. 74.4% more special-purpose bonds were offered in 2020 than in 2019. Roughly 720 billion out of 1 trillion yuan in national special-purpose bonds were issued in the first half year due to the COVID-19 pandemic.



**Hot topic
analysis:** Amidst
COVID-19, what's
next for China's
digital economy?





On 14 July, China's National Development and Reform Commission (NDRC) together with 12 central government departments, released a guideline to support the digital economy. The digital economy has emerged as one of the key forces driving China's economic development in the past few years. Particularly amidst COVID-19, the digital economy played an essential role during city-wide lockdowns. People's lifestyles and work habits as well as business models have been significantly altered and are very likely to stay that way in a post-pandemic era.

COVID-19 has accelerated the fourth industrial revolution or digital revolution. As described a few years ago by Dr. Klaus Schwab, founder and chairman of World Economic Forum, the digital revolution is characterised by "a fusion of technologies that is blurring the lines between the physical, digital, and biological spheres". It is disrupting nearly every industry across various countries at an exponential pace and is transforming production, management and governance systems.

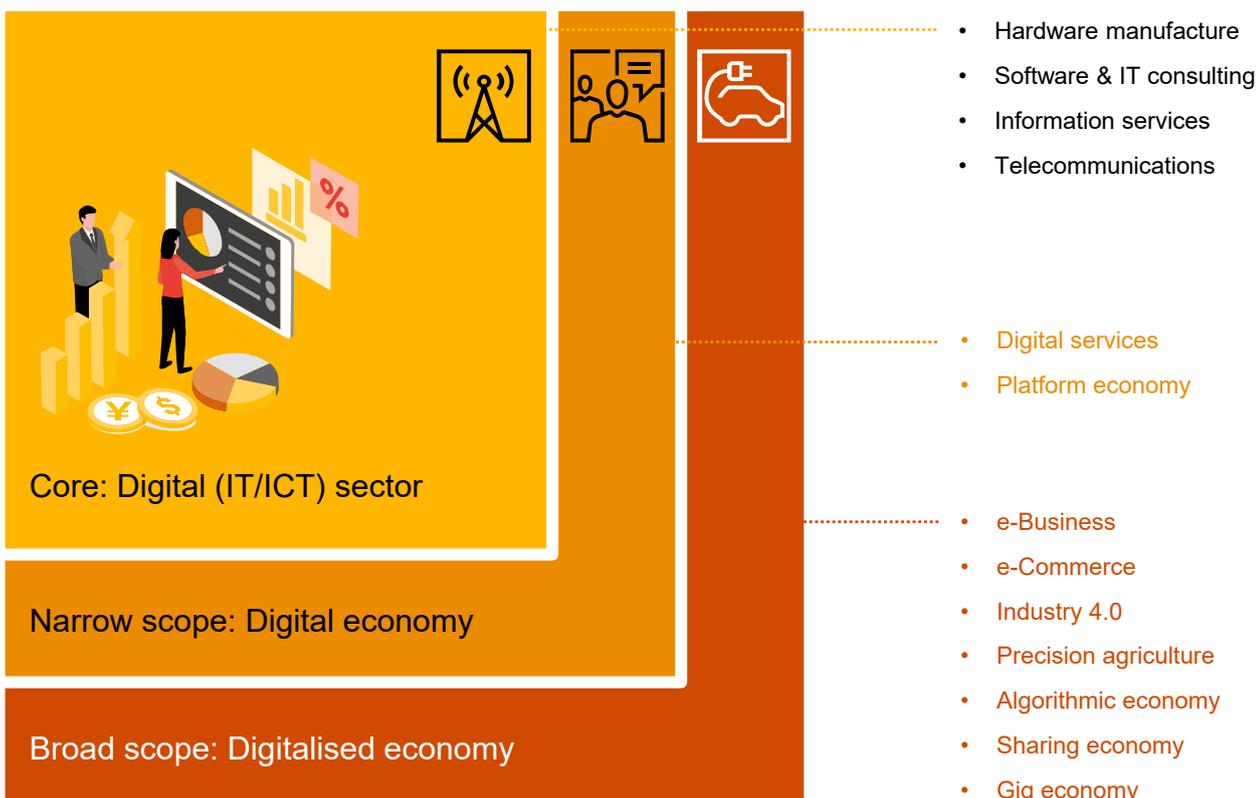
As a developing country, China was far behind in the first industrial revolution (use of steam and waterpower for production) and the second industrial revolution (use of electric power). However, the country's reform and opening up policy over more than four decades has prepared China to become one of the most advanced economies in the current digital revolution. Given the significance of the digital economy in determining long-term prosperity, China is striving to become a global leader in this digital revolution race. So, how has the digital economy impacted China's economy amidst COVID-19, and what's next?

What is the definition and scope of the digital economy?

Since the digital economy, also called the Internet economy, or web economy is still a relatively new concept, the definition and or scope might differ slightly from country to country. According to Digital Economy Report 2019 authored by United Nations Conference on Trade and Development (UNCTAD):

- The core or foundational aspects of digital economy comprise IT/ICT (information technology/information and communications technology). These include fundamental innovations (semiconductors, processors), core technologies (computers, telecommunication devices) and enabling infrastructures (Internet and telecoms networks).
- The narrow scope of digital economy includes products or services that rely on core digital technologies, such as digital services and the platform economy including mobile applications and payment services.
- The broad scope of digital economy contains digitally enabled sectors (new activities or business models that have appeared and are being changed by digital technologies), for example: e-business, e-commerce, Industry 4.0, precision agriculture, algorithmic economy, as well as the sharing economy and gig economy (both can be classified as either narrow or broad scope).

A representation of the digital economy



Source: Digital Economy Report 2019 by UNCTAD based on Bukht and Heeks, 2017

Additionally, when discussing the definition and scope of the digital economy, there are several associated frontier technologies which cannot be ignored. These include:



3D printing



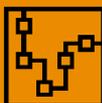
5G mobile broadband



Automation and robotics



Artificial Intelligence (AI)



Blockchain technologies



Cloud computing



Data analytics



Internet of Things (IoT)

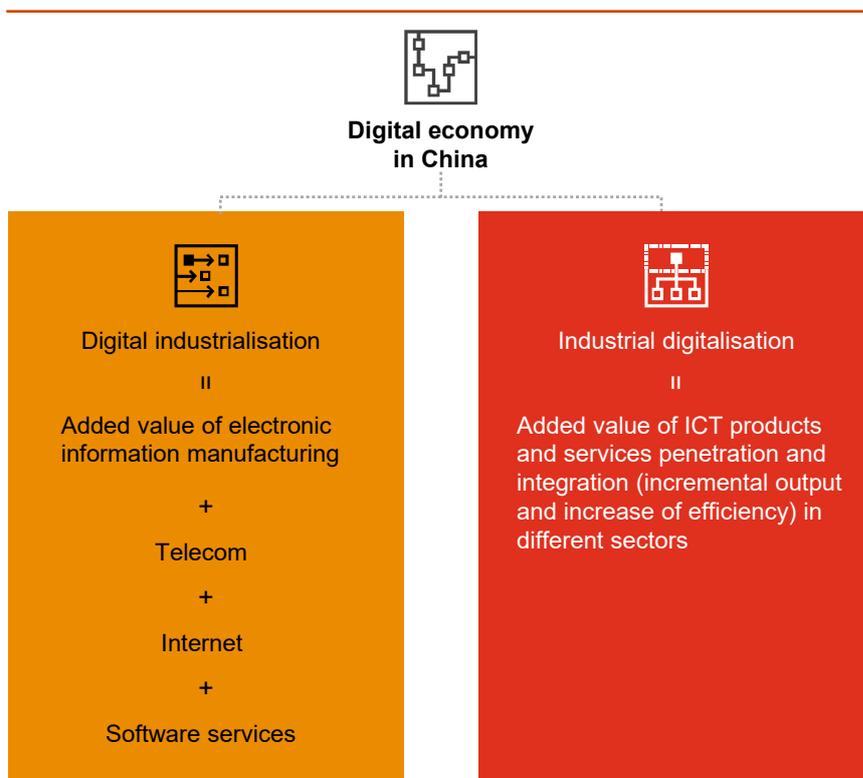


As the UNCTAD Digital Economy Report 2019 has pointed out, the evolution of the digital economy is highly related to progress in these technologies. Moreover, China already leads in terms of adopting some of these technologies. For example, China and the US have 75% of the blockchain technology patents globally and account for 75% of the cloud computing market and 50% of the global spending on IoT.

Regarding the definition and scope of the digital economy in China, it is defined as a combination of data value, digital industrialisation, industrial digitalisation, and digital governance. This definition was determined by the China Academy of Information and Communications Technology (CAICT) which is a research institute directly under the Ministry of Industry and Information Technology (MIIT).

Based on this classification, the CAICT has calculated the size of China's digital economy, including the digital industrialisation and industrial digitalisation aspects. Data value and digital governance are not included because these are very difficult to measure.

Digital industrialisation comprises the added value from electronic information manufacturing, telecom, Internet, and software services. Industrial digitalisation is calculated based on several mathematical models to obtain the added value (incremental output and increase in efficiency) of ICT products and services penetration and integration in different sectors.



Source: CAICT

The four major components of digital economy in China		
Factors of production	Forces of production	Relations of production
<p>Data valuation</p> <ul style="list-style-type: none"> • Collection and aggregation • Affirmative pricing • Marketplace • Security protection 	<p>Digital industrialisation</p> <ul style="list-style-type: none"> • Basic telecom • Electronic information manufacturing • Software and services • Internet <p>Digitalisation of industry</p> <ul style="list-style-type: none"> • Marginal contribution of digitalised agriculture • Marginal contribution of digitalised industry • Marginal contribution of digitalised services 	<p>Digital governance</p> <ul style="list-style-type: none"> • Multi-party participation • Technology and management • Digital public services

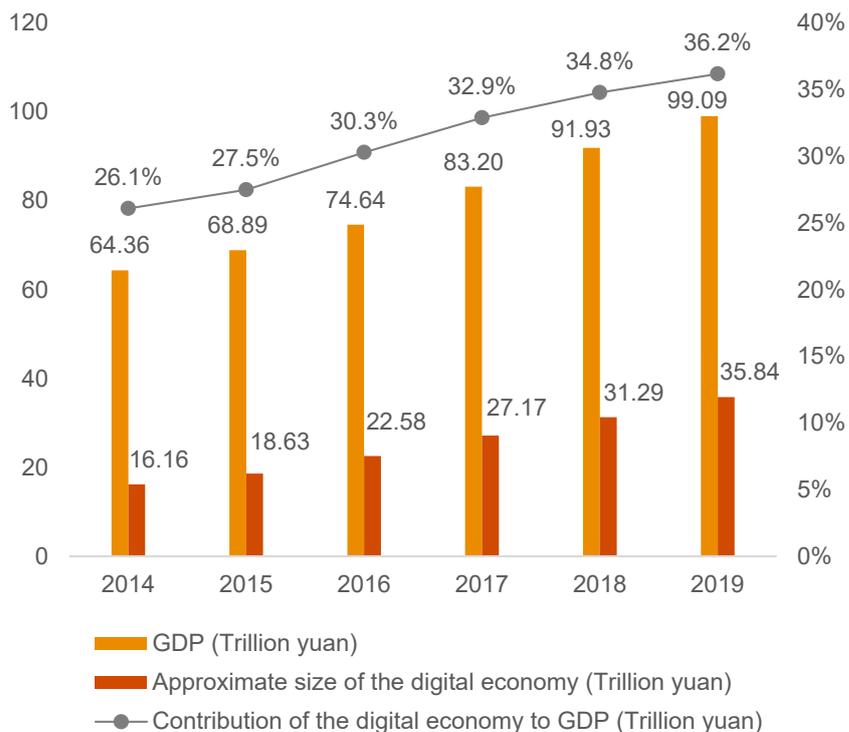
Source: CAICT

The digital economy contributed to more than 60% of China's GDP growth rate in 2019

According to the 2020 White Paper on the Development of China's Digital Economy published by the CAICT, in 2019 the digital economy contributed to around 67.7% of China's GDP growth rate. From 2014 to 2019, the digital economy's contribution to the GDP growth rate on an annual basis has consistently been greater than 50%. Moreover, China's total GDP reached 99 trillion yuan in 2019, and the size of the digital economy was around 35.8 trillion yuan which accounted for about 36% of total GDP. The growth rate of the digital economy was 15.6% in 2019 which was much higher than the GDP growth rate of 6.1% that year.

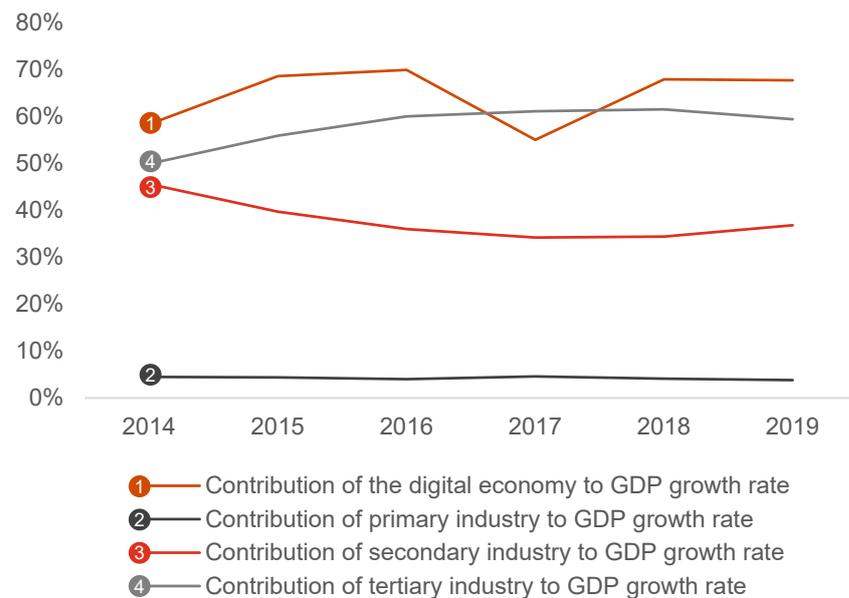
On the other hand, in 2005, the size of the digital economy was merely 2.6 trillion yuan or 14% of total GDP (18 trillion yuan). This means the size of China's digital economy grew by around 1300% over the past 15 years, while the secondary and tertiary industries grew by around 340% and 590% respectively during the same period.

Figure 12: Contribution of the digital economy to GDP in China (2014 – 2019)



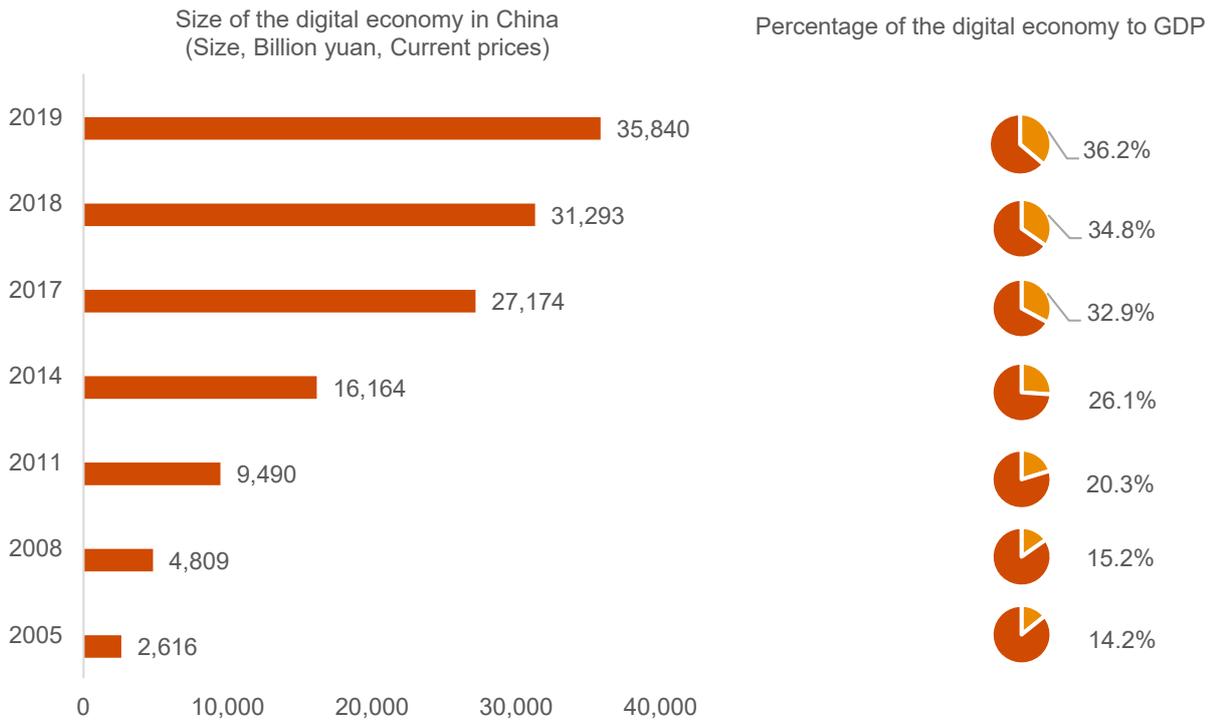
Source: CAICT, Wind

Figure 13: Contribution of the digital economy to GDP growth rate in China (2014 – 2019)



Source: CAICT, Wind

Figure 14: Size of the digital economy in China



Source: CAICT

In 2020, as a result of COVID-19, China's economic growth is expected to be much slower, however the contribution of the digital economy will continue to grow since many lifestyle and business activities have shifted to online or virtual platforms.

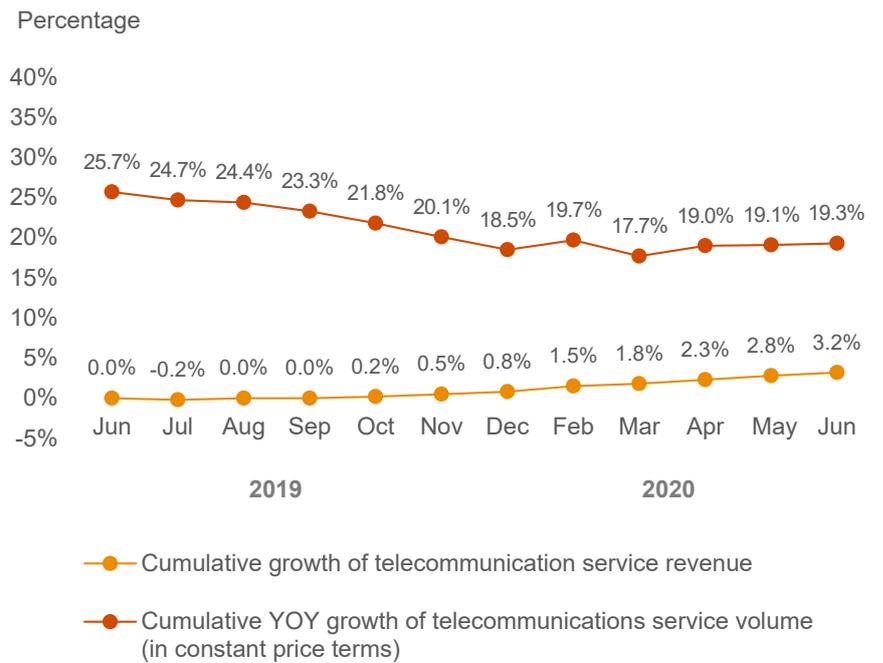


Telecommunications service volume went up by 19.3% in H1

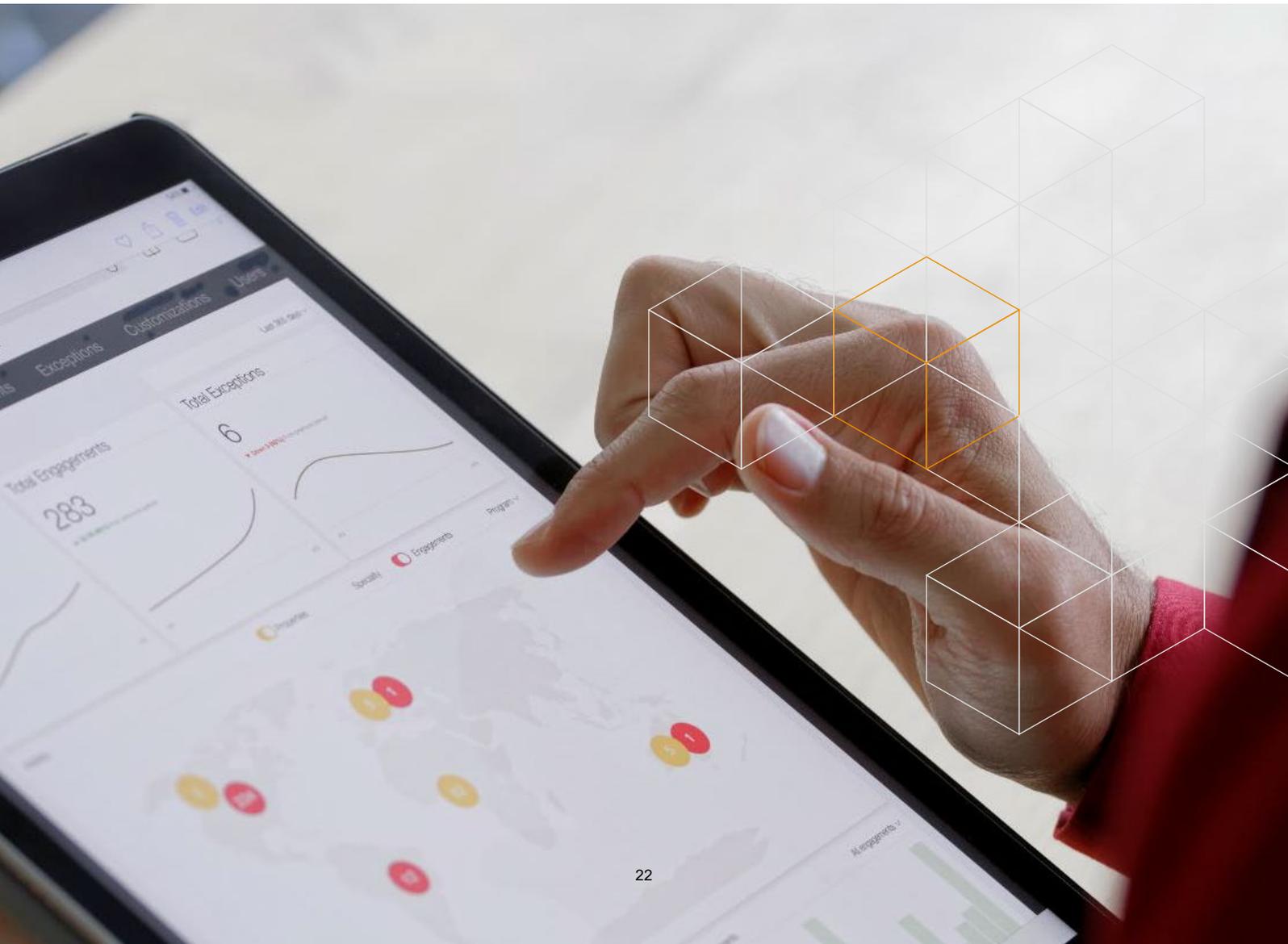
More specifically, despite the impact of COVID-19, based on data from the MIIT, services revenue generated from the telecommunications sector (one of the core aspects of the digital economy), grew by 3.2% and reached 693 billion yuan in the first half of the year 2020.

Besides, telecommunications service volume went up by 19.3% and reached 713 billion (in constant price terms, after adjusting for inflation) yuan during the same period. The growth of service volume was much higher than services revenue, because mobile users were spending more time to watch short videos and etc., meanwhile service fee did not rise simultaneously.

Figure 15: Cumulative growth rate of telecommunication services by revenue and business volume



Source: MIIT



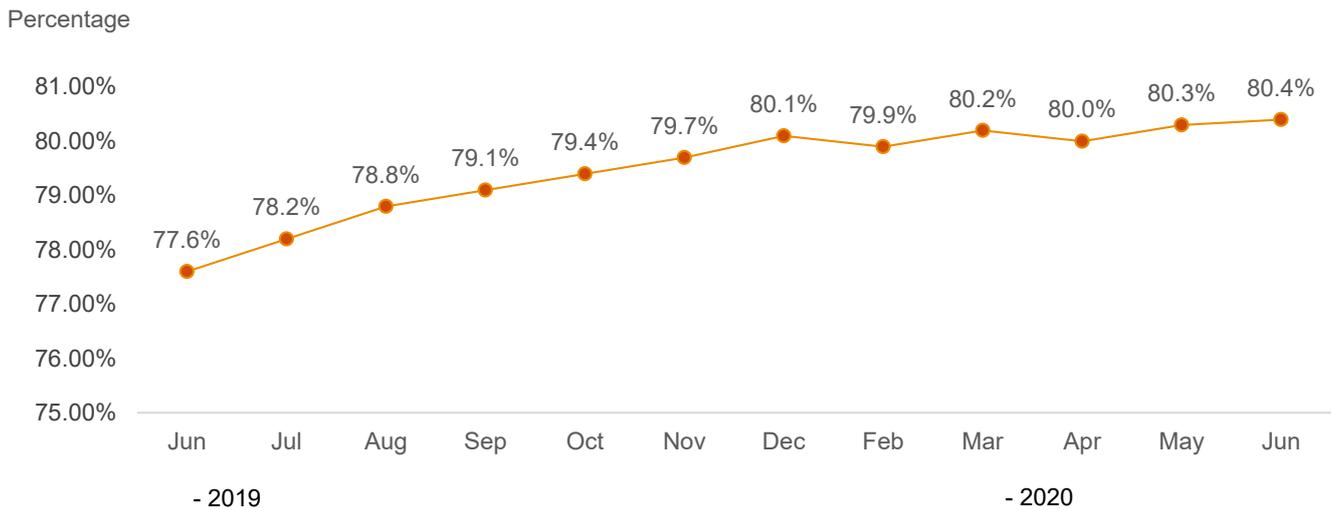
Furthermore, in terms of telecommunications revenue, the mobile business which accounts for 66% of total revenue was affected more seriously and dropped by 0.9% in the first half of the year. Meanwhile, the fixed-line business which accounts for about 34% of the total revenue, increased by 12%.

The data and Internet business (also included both in fixed-line and mobile business) had steady growth and account for 16.7% and 46% of total telecommunications revenue, respectively. They rose by 7.6% and 3.2% in the first half of the year.

Emerging businesses including Internet Protocol television (IPTV), Internet data centres, big data, cloud computing and AI have become new major growth areas for telecom revenue. These businesses account for 13% of the total revenue and their revenue has increased by 23.5% to 90 billion yuan in the first half of the year.

At the end of June 2020, the total number of mobile phone users in China reached 1.6 billion (which is more than the country's total population of around 1.4 billion) and the number increased by 0.6% in the first half of the year. Out of this more than 80% are 4G users and this number has gone up by 4.2% during the same period. It ensures a strong foundation for new mobile applications based on the 4G signal.

Figure 16: Proportion of 4G mobile users at the end of each month (June 2019 - June 2020)



Source: MIIT

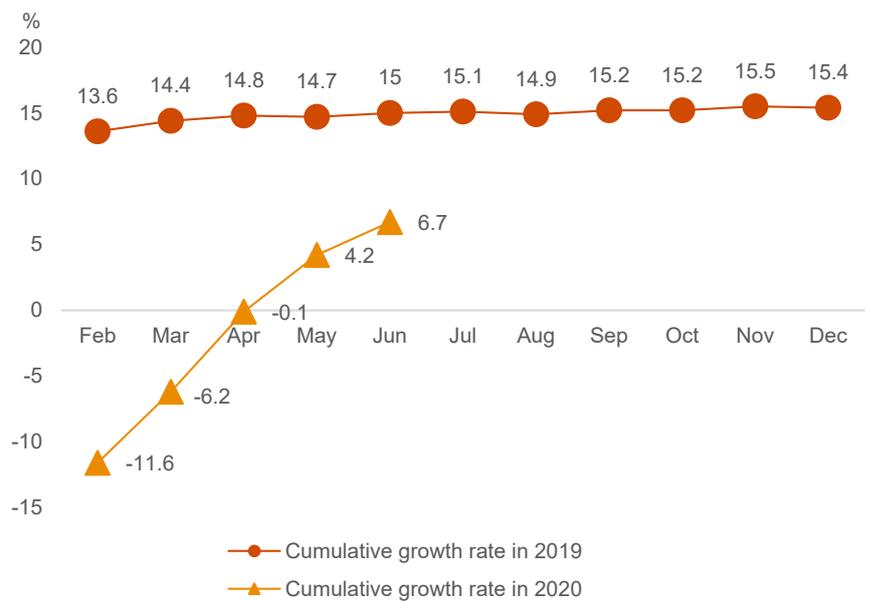


Software revenue reached 3.56 trillion yuan in H1

Revenue generated from the software sector (another core aspect of the digital economy) went up by 6.7% to 3.56 trillion yuan in the first half of the year. Due to COVID-19, the growth rate for the first half of 2020 was 8.3% less than the same period last year, however the growth rate in the second quarter of this year rose by 12.9% compared to the first quarter.

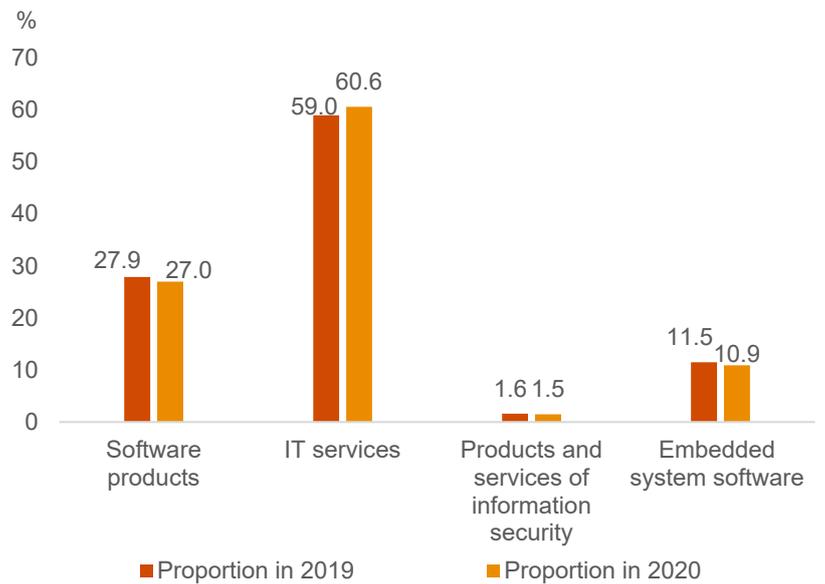
The software sector is comprised of software products (accounting for 27% of the total revenue), IT services (61%), products and services related to information security (1.5%), and embedded system software (10.9%). In the first half year, IT services had the highest growth among the four sub-sectors and grew by 9.5% to reach 2.16 trillion yuan year-on-year. Products and services related to information security declined by 2.6% compared to the same period last year. Software products and embedded system software both grew slightly by 3.3% and 1.5% to reach 962 billion and 389 billion yuan respectively.

Figure 17: Cumulative revenue growth rate of the software business (2019 – H1 2020)



Source: MIIT

Figure 18: Proportion of software industry revenue represented by different sectors (2019 – H1 2020)



Source: MIIT



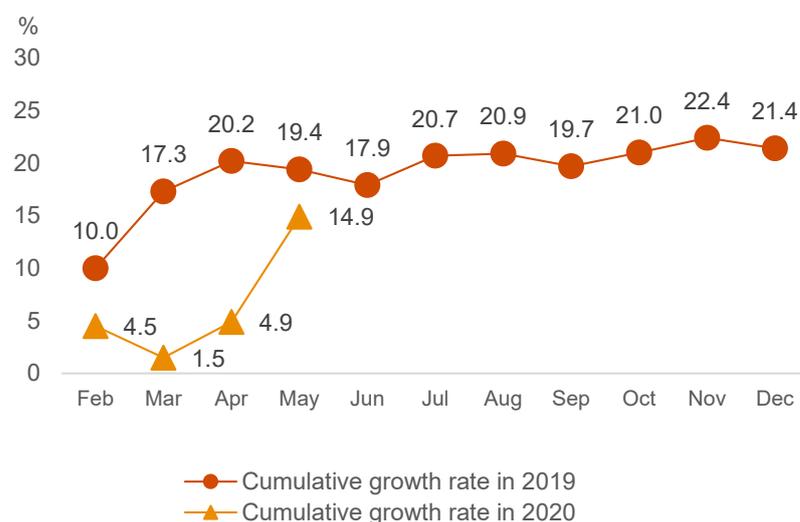
Revenue generated from the Internet sector increased by 14.9% in H1

During the first five months of this year, business revenue generated from the Internet sector (enterprises with value-added telecom business licenses) reached 472 billion yuan and went up by 14.9% year-on-year. This is much higher than the GDP growth rate however revenue growth was 4.5% lower than the same period last year as a result of COVID-19. Profits in the Internet sector also increased by 3.1% to 53 billion yuan from January to May, which is comparatively better than many other industries. As a core aspect of the digital economy, R&D expenses in the Internet sector expanded by 10% to 24 billion yuan during the same period.

In 2019, the business revenue generated from the Internet sector increased by 21.4% and reached 1.21 trillion yuan. Meanwhile profits were 102 billion and R&D expenses were 54 billion yuan, the latter rose by 23.1% which was slightly higher than the growth of business revenue.

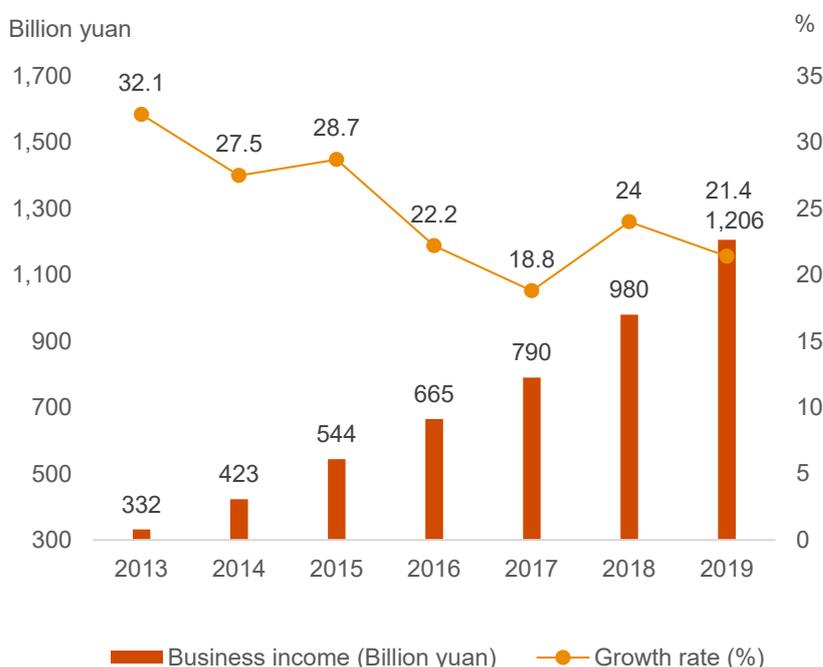
From 2013 to 2019, business revenue generated from the Internet sector grew from 332 billion yuan to 1.21 trillion with the annual growth rate dropping from 32% to 21%. This is one of the reasons why the digital economy has become one of the vital drivers for China's economic development in the past several years.

Figure 19: Cumulative revenue growth of Internet sector (2019 – May 2020)



Source: MIIT

Figure 20: Growth rate of Internet business revenue (2013 – 2019)



Source: MIIT

The digital economy played a vital role in combatting COVID-19 and its rapid growth will continue in the post-pandemic era

The digital economy played a significant role in China during the COVID-19 outbreak as well as the subsequent period when prevention and control measures came into effect. Digital technologies were applied extensively during this period, for example:

- Robots were used to deliver medical supplies which reduced the infection rate among healthcare workers.
- Intelligent image analysis technology improved the speed and accuracy of diagnosis.
- Telemedicine created conditions for medical experts to be consulted remotely.
- Other digital technologies including AI, big data and cloud computing were applied for pandemic mapping as well as crowd and infected individual tracking, etc.

Additionally, during the lockdown period, digital economic activities such as online education, food delivery, retail e-commerce, online entertainment and remote working became an essential part of everyday life.

As a result, the rapid growth of digital economy will continue in the post-pandemic era since people's lifestyles and work habits have changed. On top of this, China has some of the world's largest and most advanced enterprises in the digital sector many of them are heavily invested in related cutting-edge technologies.

In addition, China's government policies have been very supportive in the development of the digital economy. For example, according to professor Xiaojuan Jiang, Dean of the School of Public Policy and Management at Tsinghua University (and former Deputy Secretary-General of the State Council), the current Political Bureau of the Central Committee (China's central leadership) has commissioned four studies on the digital economy covering topics such as national big data strategy, the development of AI, integration and development of new media, as well as the development of blockchain technology.

In the last study, president Xi Jinping stressed that blockchain technology should play a bigger role in building China's strength in cyberspace, developing the digital economy and advancing economic and social development.



In conclusion, the COVID-19 pandemic triggered a crisis in China and across the world. However, the word crisis in Chinese, “weiji”, means both danger and opportunity. In the context of the digital economy, the COVID-19 pandemic is more likely to bring about new opportunities rather than present unforeseen dangers.

According to the CAICT, the digital economy now accounts for 36% of China’s GDP and is expected to account for more than 50% of the country’s GDP by 2030. If this occurs, China will definitely be poised to become one of the global leaders in the digital economy.

On the other hand, the recent tension between China and the US is a big challenge for some of Chinese tech and internet companies whom still rely on American technologies. However,

we should not forget that, during the 1960s, China independently developed its atomic and hydrogen bombs and man-made satellites. China’s economic miracle today is not kindness and sympathy of others, but collective intellect of Chinese people and a large group of competitive enterprises which emerged and rapidly technologically advanced since the opening up and reform.



Online education



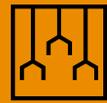
Internet healthcare



Telecommuting



Digital governance



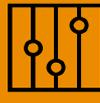
Industrial platforms



Digital transformation of enterprises



Virtual industrial parks and industrial clusters



Intelligent automation (e.g. unmanned distribution)



Gig economy



Sharing economy



Finally, since digital economy will continue to thrive in the coming years, and maybe decades. China’s companies, research institutes, as well as the government will keep investing on key technologies such as 5G mobile broadband, automation and robotics, artificial intelligence etc. Some of digital economic sectors would embrace rapid development in the post-pandemic era. Based on the guidelines to promote the digital economy issued by the NDRC and 12 other central government departments as mentioned in the beginning of this report, the government will continue to support the above ten new sectors (it may not include all sectors, but these are good examples).



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