China Economic Quarterly Q1 2019

The 6.4% growth rate of GDP in Q1 is better than the market expectation, and within the new official target range of 6% to 6.5%.

May 2019
Major economic indicators p1/Policy updates p10/Hot topic analysis p14
I. Major economic indicators

1. GDP increased by 21.34 trillion yuan (equivalent to total GDP for the year 2005)
2. Total fixed asset investment reached 10.19 trillion yuan, expanding by 6.3%
3. Sources of funds were slightly better for property developers
4. PMI was still weak, but rebounded in March
5. Profits of industrial enterprises declined by 3.3%
6. Total retail sales of consumer goods went up by 8.3%
7. Imports and exports decreased by 1.5%
8. PPI continued to fall and CPI was stable

II. Policy updates

1. China’s central bank substantially increased monetary support for the real economy
2. China extended fiscal spending by 15% in Q1, much higher than the past year

III. Hot topic analysis: Will the world’s largest Manufacturer China face a turning point?
For the first quarter in 2019, or the 70th anniversary year of People’s Republic of China, China’s GDP growth has increased 6.4% (6.4% in Q4, 6.5% in Q3, 6.7% in Q2, 6.8% in Q1, 2018) year-on-year, which is same as Q4 of last year, but much better than the market expectation.

As Figure 1 shows, China’s economic growth is entering a slower pace. Policy makers have also noticed this trend and have quickly accepted it. As a result, the central government officially adjusted the GDP growth target range from 6.5% to 6%.

Since the economy was facing much stronger downturn pressure in the last quarter, both monetary and fiscal policies, as well as other reform measures have promptly responded to prevent further drop-off.

Forecasts from some institutes have said that China might achieve more than 6.5% in 2019 after the stronger policy stimulus. But, our observation is that the current policy adjustment is fairly mild, with the aim to meet the official growth target.

Besides, it is not necessary for China to maintain higher growth similar to past years, a lower growth rate is more sustainable.

The total GDP reached 21.34 trillion yuan in Q1 which is 0.4% less than Q1 of 2018, and 0.2% less than last year’s overall growth. But it is about the same as the total GDP for 2005.

After cutting the global economic forecast of 2019 from 3.9% to 3.7% in October of 2018, then from 3.7% to 3.5% in January, the International Monetary Fund (IMF) revised it again from 3.5% to 3.3% earlier in April.

The frequent lowering of forecasts on global economic growth does not happen very often for the IMF. It shows the level of complication and uncertainty in today’s world economy.

Fortunately, China has contributed around 30% of global economic growth in the past few years, and it will continue to be a major force to stabilise the status quo with a slightly lower but stable growth.

In addition to GDP, China’s unemployment rate remained fairly stable in the first quarter. For instance, in March, the urban surveyed unemployment rate in 31 major cities went down by 0.1% to 5.1%.

National average working hours of employees for enterprises was 46.0 hours per week, 1.1 hours more than the previous month.

The economic growth rate for this year is very likely to be lower than 2018, probably within the range of the official target. Nevertheless, sacrificing speed for quality and sustainability is not a bad choice.
In the first quarter, the output of the primary, secondary and tertiary industry was 0.88, 8.23, and 12.23 trillion yuan respectively.

The tertiary industry or service sector, accounting for 57.31% of total GDP, grew by 7.0% year-on-year, while the growth rates for the primary industry (4.11% of total GDP) and secondary industry (38.58% of total GDP) were 2.7% and 6.1% respectively in Q1. Due to a much lower growth rate, the primary industry (mainly agriculture) proportion of total GDP dropped from 7.19% in 2018 to 4.11% in Q1.

For the first quarter, the final consumption expenditure amounted to 65.1% (76.2% in 2018) of total GDP growth. Household final consumption expenditure accounted for 47.7% of the total, 1.4% more than the same period last year.

Meanwhile, gross capital formation (formerly gross domestic investment) contributed about 12.1% (30% in 2018) of total GDP growth, or 28.3% less than the same period last year. This is a substantial shift for economic growth in the first quarter, although total fixed assets had 6.3% growth year-on-year.

Probably as a result of trade tension with the US and the global economic slowdown, the total value of imports and exports in the first quarter increased only by 3.7% (9.7% in 2018) to 7.01 trillion yuan. But, net exports contributed 22.8% to total GDP growth in Q1, which is 42.4% higher than the same period of last year (this figure was negative in Q1 of 2018).

The significance of total fixed asset investment and net exports to China’s economic growth has reversed. However, this trend may not last too long.
Total **fixed asset investment** reached 10.19 trillion yuan, expanding by 6.3% in the first quarter year-on-year, which is slightly better than the previous quarters in 2018.

Policy measures to boost investment and speed up the approval of large projects in Q4 of 2018 generated some good result in the first quarter of this year. In order to avoid economic slowdown by issuing more stimulus, it is expected that total fixed investment will continue to increase in the coming quarters.

More specifically in Q1, private investment accounted for more than 60% of the total, and went up 6.4% in Q1 year-on-year. State owned investment increased by 6.7%, fixed asset investment from Hong Kong, Macao and Taiwan owned companies recovered compared to the previous quarter, but was still very weak at only 2.8%. (it declined 11.5% in 2018).

As a result of opening up more sectors and industries, foreign owned fixed investment increased by 8.7% which was the highest compared to other types of fixed asset investment as mentioned above.

By sectors, fixed asset investment of the primary (0.24 trillion yuan), secondary (3.32 trillion yuan) and tertiary industry (6.62 trillion yuan) went up by 3% (12.9% in 2018), 4.2% (6.2% in 2018) and 7.5% (5.5% in 2018) respectively during the first quarter year-on-year. The service sector outperformed compared to last year’s growth, and the other two sectors had slower progress.

By industries, it is worth mentioning that fixed asset investment of a few sectors had negative growth or growth that turned from negative to positive in Q1 (the majority are still from state controlled industries, but the situation is getting better), such as:

- -8.7% (-4.1% in 2018) in manufacturing of railways, shipbuilding, aerospace and other transportation equipment;
- 0.7% (-6.7% in 2018) in production and supply of electricity, gas and water;
- 11% (-5.1% in 2018) in railway transportation;
- -5.5% (-4.9% in 2018) in management of water resources;
- -3.1% in manufacturing of electrical machinery and equipment;
- -1.0% in manufacturing of automobile due to negative growth of production and sales;
- -17.1% in smelting and pressing of non-ferrous metal;
- -6.7% in processing of food from agricultural products.

Fixed asset investment of manufacturing was strong and grew 9.5% in 2018, but growth became weakened in Q1 to 4.6%.

Infrastructure investment (excluding production and supply of electricity, gas and water) is picking up and increased 4.4% (3.8% in 2018).

For the coming quarter in 2019, it is likely private investment will remain strong and state controlled investment (including infrastructure) would also gradually recover. By sectors, investment from services will be much higher than manufacturing and agriculture.
As a result of monetary policy adjustment and the increase in aggregate financing to the real economy, access to financing in the real estate sector also somehow increased during the first quarter. Total real estate investment increased by 11.8% (9.5% in 2018) and reached 2.4 trillion yuan which accounted for about 23% (19% in 2018) of total fixed asset investment in Q1.

In order to stabilise economic growth, macro control policy for the property market will continue, especially in preventing speculation. However, some policy measures have also restrained reasonable demand in housing. For instance, changing from a smaller apartment to a larger one (even as a sole dwelling) in the major cities has become very difficult in the last few years. Strict policy often works well to achieve certain goals, but the side effects should be considered to sustain market development.

In spite of slightly better access to financing, many other metrics of the property market were not as promising in Q1 year-on-year, for instance:

- Floor space of buildings completed (residential, office and commercial) dropped by 10.8% (7.8% drop in 2018)
- Floor space of commercial housing ready for sale dropped by 9.9% (11% drop in 2018), of which residential housing declined 15.4% (16.8% drop in 2018).
- Total floor space of commercial buildings sold declined by 0.9% (1.3% increase in 2018). To be more specific, floor space of residential buildings decreased by 0.6% (2.2% increase in 2018), office buildings dropped by 11.1% (8.3% drop in 2018).

However, in terms of value, the total sales value of commercial buildings went up by 5.6% (12.2% increase in 2018) or increased by 2.7 trillion yuan in Q1, of which residential housing sales rose by 7.5% (14.7% in 2018). Both office and commercial building sales declined by 13.0% and 2.6% in Q1.

Again, similar to 2018, the prices of residential housing continued to increase in the first quarter, but at a much milder rate than past years.

On the other hand, out of the investment of 2.38 trillion yuan in Q1 in real estate development, 72.5% (70.8% in 2018) is in residential housing, which increased by 17.3% year-on-year.

In 2018 the growth rate of land purchased continued to increase by 14.2%, but it has significantly declined in Q1 this year by 33.1%. This shows weak confidence from developers for the market condition in the future and means housing supply will be reduced.

As mentioned in the beginning of this section, the good news is the slight better financing for the property market.

The overall growth rate of sources of funds increased by 5.9% (6.4% in 2018) and reached 3.89 trillion yuan in Q1. Although, the total growth rate of funds did not improve very much, bank loan growth became positive and went up by 2.5% (4.9% drop in 2018) to 713 billion yuan in Q1.

Foreign funds are a small proportion of the sources of funds for developers, but they sharply rose by 1.1 times to 3.3 billion yuan (35.8% drop in 2018). This is also a result of a new opening up policy and might indicate the confidence of foreign investor in China’s property market. Individual mortgage loans also grew by 9.4% in Q1 year-on-year to 0.96 trillion yuan (0.8% drop in 2018).

Thus, in the coming quarters, the real estate market may face a fairly subdued policy environment.
China’s Purchasing Managers’ Index (PMI) for the manufacturing sector in the past three entered a lower level and then rebounded. The PMI was 49.5%, 49.2% and 50.5% for January, February and March, respectively.

The PMI remained below the threshold of 50% from December to February, after which it went above the threshold in March. This is a reflection of economic slowdown pressure in the last quarter of 2018 which solidified in Q1 in the manufacturing sector.

During the first quarter, the PMI has continued declining since its peak in May of 2018 before the China-US trade dispute took place. It reached the lowest at 49.2% in February. Although, PMI in China went above the threshold of 50% in March, it might not stabilise while the domestic and global economy still face uncertainties and merchandise trade is expected to decline.

Furthermore, as with the previous months in 2018, the new export orders index and import index continued to decline to 47.1% and 48.7% in March respectively.

The PMI of large enterprises stayed at 51.1% in March (50.1% in December 2018) and the PMI of medium enterprises fell just below the threshold at 49.9% (48.4% in December). The small enterprise PMI remained at 49.3% (48.6% in December).

While higher than the last three months of 2018, the PMI of all sizes enterprises was still weak. As usual the PMI of large enterprises is better than small and medium enterprises.

The production index and new order index improved to 52.8% (50.8% in December) and 51.6% (49.7% in December) respectively in March. Without a doubt, overall production and market demand has become stronger.

The raw materials inventory index and employed person index were still below the threshold at 48.4% (47.1% in December) and 47.6% (48.0% in December).

On the other hand, the non-manufacturing PMI still remained at a much higher level than the manufacturing PMI, as the business activity index reached 54.8% (53.8% in December).

The non-manufacturing PMI of the service sector increased to 53.6% in March (52.3% in December).

In March, the index of business activity went up to more than 57% in sectors including railway transport, material handling and warehousing, post service, telecommunications, radio and television, satellite transmission service, services of Internet, software and information technology, financial services, insurance and other financial industries.

Meanwhile, the index of business activity fell to less than 50% (much less in December 2018), in sectors such as accommodation and real estate.

For the coming quarter in 2019, it is hard to say whether or not the manufacturing PMI will remain above 50%. If China and the US reach an agreement in their trade negotiations and global growth stops falling further, then manufacturing PMI will remain above the threshold. Otherwise, at the very least, the non-manufacturing PMI of the service sector is likely to remain at more than 50%.
Similar to the GDP growth rate in Q1, the growth of Industrial Added Values for companies over certain scales went up by 6.5% year-on-year (6.2% in 2018 in real terms). In March, this figure increased by 8.5% compared to the same period in 2018, or 3.2% more than February month-on-month. The reality is much better than expected for the Purchasing Managers’ Index (PMI) for the manufacturing sector as discussed in the previous section.

There were a few sectors that outperformed in Q1.

- Those with more than 10% growth of Industrial Added Values include, manufacturing of nonmetal mineral (11.5%), manufacturing and processing of non-ferrous metals(10.1%), manufacturing of fabricated metal (11.0%), manufacturing of special-purpose machinery(12.6%), manufacturing of railways, shipbuilding, aerospace and other transportation equipment(10.9%), and manufacturing of electric machinery and equipment (11.0%).

On the other hand, as one of the most important indicators for the overall economy, manufacturing of automobiles had negative growth of 10.4% in Q1 and 2.6% in March year-on-year, (the sector had negative growth of 4.2% in 2018 for the first time since 1990).

As a result of the stabilisation in economic downturn pressure, the growth rate of automobiles may not decline further.

Furthermore, total profit for the manufacturing of automobiles declined 25.0% in Q1 year-on-year (4.7% increase in 2018), which was much worse than in 2018.

The total profit for all industrial companies over certain scales declined by 3.3% in Q1, to 1297.2 billion yuan. But the revenue was stable and grew by 7.2% to 24.4 trillion yuan in Q1. Additionally:

- Profit of SOEs dropped 13.4%, profit of foreign owned enterprises (including Hong Kong, Macao and Taiwan) declined 7.9%;
- Profit of joint-stock enterprises (meaning SOEs or companies where the state has no controlling share) went down 1.0%;
- The profit of private companies went up 7.0%, while other types of companies by ownership all made big losses.

Comparatively, in 2018, profits of foreign owned enterprises (for companies over certain scales) increased by 1.9%, and profits of SOEs and private companies went up 12.6% and 11.9% respectively.

Perhaps declining profits is one of the reasons why the VAT rate for manufacturing sector will be reduced from 16% to 13% this year.

With a large number of industrial enterprises having big losses, it was very critical that monetary policy adjustment with increasing aggregate financing to the real economy occurred in Q1. Financial health of companies is vital to economic sustainability.

It is expected that the tough situation of declining profits for industrial enterprises will improve gradually as the economy improves. In fact, March is already much better than February and overall, the total profit for all industrial companies over certain scales had an increase in profit of 13.9% year-on-year.
Total retail sales of consumer goods went up by 8.3% or 6.9% in real terms after deducting the price factor (9.0% in 2018) year-on-year to 9.78 trillion yuan in Q1. The growth of retail sales decelerated in the first quarter compared to 2018. But, the month-on-month growth rate has been improving from November 2018 to March 2019, as it was 8.1%, 8.2%, 8.2%, and 8.7% (January data is not available).

However, in the long term, looking at Figure 7, the growth of total retail sales of consumer goods has gradually slowed down from more than 10% between 2015 to 2017 to slightly more than 9% in 2018.

In terms of types, in Q1, catering consumption went up 9.6% year-on-year. Meanwhile, goods retail sales went up by 8.2%.

Sales of cosmetics went up by 10.9% and home appliances grew by 7.8% year-on-year. Sales of clothes, groceries and foodstuffs (including cooking oil) went up 3.3%, 16.1% and 10.6% respectively in Q1, driven by major holidays such as Lunar New Year took place in February.

More importantly, sales of automobiles decreased 3.4% in Q1 (2.4% drop in 2018) year-on-year. In March, it dropped 4.4% again.

In addition, total online sales reached 2.24 trillion yuan in Q1, growing by 15.3%, but this is much slower than the 2018 growth of 23.9% year-on-year. Online physical goods sales went up 21.0% which accounts for 18.2% (18.4% in 2018) of the total retail sales of consumer goods.

In comparison, the per capita disposable nominal income, reached to 8,492 yuan, and has increased by 8.7% (8.7% in 2018) year-on-year (after adjusting for inflation, 6.8% real growth) in Q1.

More specifically, it was 11,633 and 4,600 yuan for urban and rural residents. Per capita disposable nominal income was 18,704 yuan in Shanghai in Q1 which ranks number one across the country, and followed by Beijing and Zhejiang Province.

On the other hand, per capita consumption expenditure increased by 7.3% (8.4% in 2018) to 5,538 yuan. During the first quarter, the consumption expenditure per capita was as follows (updated for Q1):

- 30.2 (28.4% 2018) for tobacco and food (including liquor); 21.9% (23.4% 2018) for housing;
- 13.2% (13.5% 2018) for transportation and communication;
- 9.9% (11.2% 2018) for education, culture and entertainment;
- 8.4% (8.5% 2018) for healthcare and medical services, and 8.1% (6.5% 2018) for clothing.

Obviously consumption expenditure per capita on tobacco, food and clothing were higher than other items, probably due to Lunar New Year.
Dwindling global economic growth and trade, as well as the trade dispute between China and the US have impacted China’s imports and exports in Q1.

Total imports and exports reached 7.01 trillion yuan, increasing by only 3.7% (9.9% in 2018) over the same period last year. It was slower than total GDP growth of 6.4% in Q1.

Exports went up by 6.7% (7.1% in 2018) year-on-year to 3.77 trillion yuan, and imports grew by 0.3% (12.9% in 2018) year-on-year to 3.24 trillion yuan. The trade surplus went up 75.2% in Q1 to 529.7 billion yuan.

China maintained a steady growth rate in trade with other major trading partners in Q1. For instance, trade with the EU increased by 11.5% (7.9% in 2018) accounted for 15.8% of China’s total trade. Exports and imports with ASEAN went up by 8.1% (11.2% in 2018), and accounted for 13.3% of China’s total trade. Exports and imports with Japan grew slightly by 3.2% and accounted for 7.2% of China’s trade.

China’s trade with countries under the Belt and Road Initiative accounted for 28.6% in Q1 (27.4% in 2018).

Total trade with these countries went up 7.8% (13.3% in 2018) or 4.1% higher than overall trade growth and reached 2 trillion yuan. Obviously, the growth is slowing compared to 2018 since global trade has declined.

More specifically, trade with Russia, Saudi Arabia and Egypt increased by 9.8% (24.4% in 2018), 33.8% (23.2% in 2018) and 18.3% respectively.

Furthermore, in Q1, exports and imports from private enterprises went up 9.9% and accounted for 40.6% (39.7% in 2018) of China’s total trade. Trade by foreign owned enterprises declined 0.7% and the share of China’s total trade was 41.3% (42.6% in 2018), Meanwhile the share of SOEs was 17.7% (17.4% in 2018) and grew by 1%.

Still, foreign owned enterprises account for the largest proportion of China’s total trade, but private companies will soon catch up, probably this year.

Although, China’s total trade in Q1 only grew by 3.7%, in March the growth was 9.6%, much higher than January and February year-on-year. Hopefully, growth will recover in the coming quarters, especially as the market still expects China and the US will reach an agreement of some sort soon.
The **Producer Price Index (PPI)** went up by an average of 0.2% (3.5% in 2018) year-on-year in the first quarter, which is much lower than in 2018. In January, February and March, the PPI increased by 0.1%, 0.1% and 0.4% (0.9%, 2.7% and 3.3% from October to December 2018) year-on-year respectively.

The PPI has gradually declined since August of last year. In June 2018, the PPI reached its peak of 4.7%, then gradually fell to 0.9% at the year end.

The price for means of production rose by 0.3% (4.6% in 2018), which contributed 0.24% to the rise of PPI in March year-on-year.

More specifically, in March, the price of mining and quarrying products rose by 4.2% (8.8% in Q4 2018) and raw materials rose by 0.6% (6.3% in Q4 2018).

Triggered by oil prices, the PPI of extraction of petroleum and natural gas went up 24.3% in 2018, but it returned to normal in Q1 this year and increased by only 1.2% year-on-year.

The PPI of processing of petroleum, coking and nucleus fuel also went up 0.3% in Q1 (16.0% in 2018) and 3.5% in March.

Meanwhile, the price of consumer goods only increased by 0.5% (0.4% in Q3).

For the coming quarters in 2019, raw materials and oil related prices will remain stable or weaken, as demand is lower than expected.

The PPI in China is very likely to stay at a lower level, probably much lower than last year.

Growth in the **consumer price index (CPI)** increased by 1.8% in Q1 and year-on-year, which is slightly lower than Q4 2018.

For March, the CPI grew by 2.3% year-on-year, and it was 1.7% and 1.5% for January and February respectively.

In Q1, thanks to falling oil prices, the price of fuel for transport declined 1.9% (12.6% increase in 2018) year-on-year.

In addition, the price of food rose by 2.2%, of which vegetable prices went up by 6.9% (7.1% increase in 2018) and egg prices dropped 2.1% (12.0% increase in 2018), pork prices went down 1.2% (8.1% drop in 2018).

Meanwhile, the price of healthcare remained at a high level and rose by 4.3% in 2018, but it returned to 2.7% in Q1 year-on-year.

Going forward, we still believe, the CPI in 2019 will probably stay at the current lower level, since energy related prices have cooled down and demand for consumer products will be weak due to slower economic growth.
China’s central bank substantially increased monetary support for the real economy. According to data from the People’s Bank of China, in the first quarter, aggregate financing to the real economy (AFRE) was 8.18 trillion yuan, and substantially went up 2.34 trillion yuan year-on-year. AFRE is the total volume of financing to the real economy, which includes flows of RMB loans, foreign currency-denominated loans, undiscounted bankers’ acceptances, net financing of corporate bonds, domestic equity financing by non-financial enterprises, net financing of local government special bonds etc. Compared to the 5.85 trillion yuan of AFRE in the first quarter of 2018, the growth rate is about 40%.

Among all the items of AFRE in the first quarter, RMB loans accounted for about 76.9% which increased to 6.29 trillion, or 1.44 trillion (around 30%) more than the same period in 2018. Similar to past years, total AFRE, as well as RMB loans in the first quarter often rise sharply by a much larger amount than other quarters, because loan quotas are usually tight during the year end.

Figure 11: Q1 2016 - Q1 2019 aggregate financing to the real economy (flows), RMB bn

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Source: Wind
In 2018, probably as a result of deleveraging and other related policy measures, the total amount of aggregate financing to the real economy was much less than in 2017. Aggregate financing totalled 19.26 trillion yuan in 2018 compared to 22.40 trillion in 2017. Although RMB loans showed minor growth last year, the volume of almost all other financing registered a significant reduction. Perhaps it was one of the reasons for the economic slowdown last year, aggregate financing to the real economy declined by around 14% in 2018 compared to 2017.

Fortunately, these policy measures have been adjusted. As mentioned above, 8.18 trillion yuan of AFRE in the first quarter of this year is much larger than 5.85 trillion yuan in the first quarter of 2018. But compared to 7.21 trillion yuan in the first quarter of 2017, AFRE increased by 13.6%, which is much more moderate.

Nevertheless, aggregate financing flows to the real economy will be much higher in 2019 compared to 2018. The financing conditions for MNCs and private companies are expected to be much better during the year. Consequently, this is positive measure to maintain stable economic growth.

![Figure 12: 2009 - 2018 aggregate financing to the real economy (flows), RMB bn](chart.png)

Source: Wind
China increased fiscal spending by 15% in the first quarter, much higher than the past year.

In addition to stronger monetary measures to uphold economic growth, China’s Ministry of Finance also accelerated fiscal support by increasing spending to 5.86 trillion yuan, which includes 0.69 trillion and 5.17 trillion yuan for central and local general public budget expenditure respectively. The growth rate of fiscal spending was around 15%, or four percentage points higher than the same period in 2018. More specifically, other major expenditure includes:

- 990 billion yuan on social security and employment (7.6% increase);
- 852 billion yuan on education (14% increase);
- 625 billion yuan on urban and rural communities (administration, public facilities, planning, environmental sanitation and etc.) (22.8% increase);
- 475 billion yuan on healthcare and sanitation (9% increase);
- 418 billion yuan on agriculture, forestry and water conservancy (14.6% increase);
- 382 billion yuan on transportation (47.4% increase);
- Spending on science and technology as well as energy conservation and environmental protection went up by 26.5% and 30.6% respectively to 176 and 131 billion yuan.

Source: Wind
However, as a result of tax and fee cutting, as well as slower economic growth, fiscal revenue in the first quarter only increased by 6.2% year-on-year to 5.36 billion yuan.

Furthermore, increasing fiscal spending and cutting taxes will essentially stimulate the economy. For instance, in the first quarter, new tax cuts saved 341 billion yuan for businesses and individuals and such savings will either be directed to investment or be spent by companies or households.
Will the world’s largest manufacturer face a turning point?

In 2018, manufacturing of automobiles in China had negative growth of 4.2% for the first time since 1990. This is an issue because China has the largest automobile market (in terms of sales and production), the second largest economy, and is the world’s largest manufacturer. During the first quarter of this year, manufacturing of automobiles declined 10.4% again, meanwhile, the growth of industrial added values for companies over certain scales went up 6.5%, but during the first two months, profits of industrial added values for companies over certain scales dropped 14.0% and revenues only increased by 3.3%.

Since automobiles are a flagship product for the manufacturing sector and have a strong influence on many other industries, some worry that the slowdown of China’s automobile production might lead to a turning point for the country’s whole manufacturing sector.

If the world’s largest manufacturer, China, faces a turning point, it would be a problem not only for China itself, but also for the global economy. More specifically, China’s secondary industry accounted for 40.65% of total GDP in 2018, of which 87.03% came from manufacturing. In the past few years, China has contributed about 30% to global economic growth.

The manufacturing of automobiles generated 8.34 trillion yuan in terms of company revenue in 2018 which is roughly 8% of China’s total industrial revenue. It was the second largest sector after manufacturing of computers, communications and other electronic equipment with 10.8 trillion in revenue in 2018 and went up by 7.8% in Q1 despite of the trade tension between China and the US.

So, will the slowdown of automobile manufacturing trigger a turning point for the world’s number one factory?
As the world’s largest workshop, by 2017 more than 25% of the global manufactured goods were produced in China according to data from the World Bank. Data from Oxford Economics finds that China’s manufacturing value added is 1.7 times more than the US, 2.8 times more than Japan and 4.4 times more than Germany.

In terms of manufactured goods, China is the only country which produces all the products out of the 39 industrial categories, 191 medium categories and 525 small categories classified by United Nations Industrial Development Organization (UNIDO). According to China’s Ministry of Industry and Information Technology (MIIT), the output of 220 industrial products ranked the first in the world as of 2015.

The significance of China’s manufacturing sector

There is no doubt that the growth in manufacturing in China in the last few decades was one of a few reasons for the rapid development of both the country’s economy as well as the boost to global growth. More specifically, China’s share of global manufacturing gradually increased from only 2.7% in 1990, to 6.0% in 2000, 13.2% in 2007 and most recently to more than 25% in 2017. At the same time, China’s share of global GDP has risen substantially from 1.8% in 1990 to approximately 16% today. The enormous amount of cheap goods China produced was based on its vast domestic demand, on top of supplying the rest of the world.
China’s competitive and low-cost manufacturing sector also helped to make the country the largest trading nation in the world. According to the World Trade Organization (WTO), in 2018, world merchandise exports totalled US$ 19.48 trillion, and went up by 10% from 2017. China’s share of merchandise exports and imports by value was 12.8% and 10.8% of the world’s total in 2018, which ranked number one and number two (after the US). If Hong Kong was included, China would also be the largest importer. In fact, China’s manufacturing value added reached 26.48 trillion yuan or approximately US$ 4 trillion in 2018.

**Figure 15: 2018 global leading merchandise exporters’ volume and shares**

![Chart showing global leading merchandise exporters' volume and shares.](image)

**Figure 16: 2018 global leading merchandise exporters’ annual % change**

![Bar chart showing annual % change in global leading merchandise exporters.](image)

Source: WTO
Thus, there is no doubt that as the world’s factory, China’s manufacturing sector plays a significant role in its growth. At the same time, it also faces challenges.
First, the manufacturing sector is facing slower domestic and global economic growth. It is almost inevitable that China’s economic growth is getting slower as it becomes more industrialised and the advancement gap compared to developed countries narrows. Economic growth over the past year was at the slowest pace since 1990.

For 2019, the Chinese government has lowered the growth target to around 6.5% to 6% which is lower than the previous goal of not less than 6.5%. Global economic growth is also expected to slow down. As a result, with regards to global trade, WTO recently cuts its outlook for 2019 from 3.7% to 2.6%, and merchandise trade volume growth is projected to fall from 3.0% in 2018 to 2.6% this year.

Second, globalisation is under threat. As a result, in the medium and long-term, China’s manufacturing related exports and imports might encounter an uncertain and unstable external environment. In addition, in order to meet domestic demand, many of China’s manufacturing sectors also rely on the international market. While ongoing trade negotiations between China and US have not been concluded yet, it seems another trade dispute between the US and the EU is perhaps in the making. These types of trade frictions are causing damage to businesses around the world, particularly those in manufacturing which require long periods of planning and investment to put up capacity, supply chain, etc..

Third, the growth rates for most of China’s key manufacturing sectors have slid during the past decade. After sorting China’s top 10 largest manufacturing sectors based on the total value added in 2018, and collecting data of year-on-year growth from 2006 to 2018 (all the years that are available from the National Bureau of Statistics), the overall downward trend for these sectors is very clear. The average growth rate of the top 10 largest manufacturing sectors dropped from approximately 20% in 2006 to 6.5% in 2018. During this period, GDP growth also slid from 12.7% to 6.6%.

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**Figure 19: World merchandise trade volume and real GDP growth, 2011 - 2020 annual % change**

![Graph showing world merchandise trade volume and real GDP growth from 2011 to 2020](image)

Source: WTO and UNCTAD
As a result of slower domestic and global GDP growth, the development of China’s manufacturing sector is very likely to stay at the current speed. A few mature and saturated sectors might find it tough to grow further. For instance, according to the MIIT, China’s production of TV sets, computers, and mobile phones accounted around 70%, 90%, and 90% of the global outputs in 2018 respectively. Meanwhile, China’s consumption of personal computers, TV sets, and mobile phones was about 20%, 20% and 27.8% of global consumption.

More specifically, taking manufacturing of mobile phones as an example, developed countries are fairly mature. Among the top 20 countries in terms of the number of mobile phones in use, the size of the country’s population is highly correlated to the total number of mobile phones, regardless of the economic condition of the country. Therefore, unless innovation creates new demand, there is a limit on the total number of mobile phones that can be purchased worldwide.
Obviously, for a few of China’s manufacturing sectors with mature or saturated markets in both developed countries and emerging economies (e.g. mobile phone), there might be a turning point with slower or even negative growth in the future. However, most sectors are likely to maintain a steady development path in line with domestic GDP growth, or at least with global GDP growth.

As mentioned above, taking the automobile sector as an example, China’s manufacturing might face a turning point which could seriously influence many other aspects of the economy. We believe it might be too early to draw this type of conclusion. Here are the reasons why:

- The total number of motor vehicles in China reached 240 million in 2018, which is very close to 270 million and 295 million in the US and EU respectively. But the number of motor vehicles per 1,000 people is still much less than these two regions, this figure was 173 in China, 839 in the US and 543 in the EU. China’s motor vehicles per 1,000 people is also behind major developing countries such as Malaysia (433), Mexico (297), and Brazil (341), while Mexico’s GDP per capita is less than China. Due to the country’s large population, it might be not realistic if motor vehicles per 1,000 people in China matched the US or EU, but the market potential is still huge.
- Furthermore, production and sales of motor vehicles would be slower as economic growth slows down. But as the world’s largest automobile market during the last decade, it is expected that China will remain number one in the market over a long period in the future. The sales of motor vehicles in China is by far higher than any other market. In 2018, it reached 28 million and accounted about one third of global sales. Comparatively vehicles sales were at around 17 million and 15.6 million in the US and EU respectively.
- Additionally, today’s China is much more industrialised than the past, but compared to developed countries, the gap is still huge. For example, China’s urbanisation rate reached about 60% in 2018, based on the National Development and Reform Commission (NDRC). Each one per cent increase of the urbanisation rate means 14 million people moving from rural areas to the cities. The urbanisation rate in developed countries is at about 80%, so China still has 20% to catch up. This would generate enormous business opportunities, particularly for the manufacturing sector.
Lastly, government policy regards manufacturing as a vital part of the economy. Thus, the VAT rate for manufacturing will be reduced from 16% to 13% in 2019. It is very clear that China will continue to support and upgrade the manufacturing sector.

Finally, slower GDP growth in China and worldwide will have an impact on many aspects of the economy and its industries. China’s manufacturing in automobiles is just one of the outcomes. However, as one of the backbones to support sustainable development and uphold vast employment opportunities, the manufacturing sector has played a vital role for the world’s second largest economy. It has historically been critical for economic development, and will continue to perform well, not on speed but on quality in the future.
Author

G. Bin Zhao
Senior Economist
PwC China
+86 (21) 2323 3681
bin.gb.zhao@cn.pwc.com

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