10 Macro Economic Trends in 2022

Economic Insights

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Executive summary

The global economy continued its recovery from the shock of the COVID-19 pandemic in 2021. Thanks to the country's fast and effective measures to control the spread of the pandemic, China was able to restart its economy more quickly than many other jurisdictions. As the only major economy to achieve positive growth in 2020, China continued this growth trend in 2021.

China's economic rebound in 2021 has largely been driven by strong export growth, while the recovery of domestic demand has been lagging. With rising demand from advanced economies and production disruptions in some developing markets due to new waves of pandemic, China's exports have been a key driver of its economic growth since the pandemic, supporting the rebound of industrial production and manufacturing investment. By contrast, the rebound of consumption has been relatively weak, due to the new waves of infections in some areas, slowing property market, and the disruption of global supply chain.

Looking forward, as the pandemic is gradually put under control and the government is tweaking fiscal and monetary policies to make them more flexible and targeted, we expect China's economic to continue to recover and the growth driver to shift more from external to internal in 2022. We expect mainland China's GDP to grow 8.0% in 2021 and 5.2% in 2022.

In particular, we anticipate 10 trends for macro economy next year:

1. The COVID-19 pandemic and quarantine policies will continue to be key factors determining the pace of China's economic recovery
2. Inflation should remain under control, with the gap between CPI and PPI expected to narrow
3. Consumption in China continues to pick up and domestic brands rise in popularity
4. Manufacturing investment, especially in innovative and green sectors, will see rapid growth
5. Real estate regulation is expected to continue but the key policy objective is to stabilize the market and expectations
6. Export growth will likely moderate and trade surplus will narrow
7. Foreign direct investment remains strong, while outbound investment is expected to rebound
8. ESG is becoming a core focus for businesses, and decarbonization regulations are expected to be implemented more systematically
9. Supply chain strategies focus more on resilience and ability to mitigate risks
10. Global economic recovery remains uneven, with widening divergence among economies

A review of 2021

The global economy continued its recovery from the shock of the COVID-19 pandemic in 2021. Thanks to the country’s fast and effective measures to control the spread of the pandemic, China was able to restart its economy more quickly than many other jurisdictions. As the only major economy to achieve positive growth in 2020, China continued this growth trend in 2021. The momentum has largely been driven by strong exports while domestic demand has continued to lag.

Exports have been the main driver of China’s economy since the second half of 2020. In the first three quarters of 2021, China’s exports rose by 32.3%, thanks to strong demand for medical goods, home appliances, machinery and electronics; and also due to the supply chain disruptions in other global manufacturing centres caused by waves of new COVID-19 cases.

Growth of exports and imports were significantly faster than their pre-pandemic levels, according to the average annualised growth rate of past two years (see Table 1). The contribution of net exports of goods and services in the first three quarters of the year was nearly 20% of China’s GDP, a historic high. Booming external demand has accelerated the recovery of the country’s industrial production and investment in the manufacturing sector.

Increasing domestic consumption is a critical part of China’s long-term economic strategy and is a cornerstone of its “Dual Circulation” development model. In 2021, the recovery of China’s consumption remained sluggish. Retail sales of consumer goods in the first three quarters grew at 3.9% on a two-year average annualised rate, lower than the country’s overall economic growth rate and its historical average growth rate (9.0% in 2017-2019). Sporadic but lingering COVID-19 cases and tightening prevention and control measures continued to undermine services consumption; while a slowdown in property market has lowered domestic demand for furniture, home appliances, and construction materials. Chip shortages have also hindered consumption in the domestic auto market.

As China's post-pandemic economic recovery continued in 2021, the country has phased out some of the relief measures introduced in 2020, aiming to normalise its macroeconomic policy. In the first three quarters of 2021, China's two-year average annualised growth rate of fiscal expenditure declined to 0.2%, lower than the historical average. The government's fiscal deficit also fell to RMB 1.5 trillion, a significant decrease from the past two years and a reflection of the country's tightened fiscal policy. Meanwhile, the country's M2 supply and total social financing increased at a much slower pace compared to 2020. Tightened regulations on the real estate sector, after-school tutoring businesses, internet platforms, and energy-intensive enterprises have also slowed investment in infrastructure and real estate, contributing to decelerated economic growth in the second half of 2021.

Looking forward, as the pandemic is gradually put under control and the government is tweaking fiscal and monetary policies to make them more flexible and targeted, we expect China's economic to continue to recover from the effects of pandemic and the country's main growth driver to continue to shift more from external to internal in 2022. We expect mainland China's GDP to grow 8.0% in 2021 and 5.2% in 2022. In this report, we analyse 10 prevalent trends that will shape China's macro economy in the coming year.

Table 1 **Major economic indicators, average annualised growth rate of past two years, %**

	Average growth rate 2017-2019	Q1 2021	Q2 2021	Q3 2021	Q1-Q3 2021
GDP	6.6%	5.0%	5.5%	4.9%	5.2%
Industrial production	6.2%	6.8%	6.6%	5.3%	6.4%
Retail sales	9.0%	4.1%	4.6%	2.3%	3.9%
Fixed asset investment	6.2%	2.7%	5.6%	3.2%	4.0%
Exports	6.1%	13.4%	14.2%	16.1%	14.6%
Imports	9.8%	11.9%	14.1%	14.3%	13.5%
Income per capita	6.5%	4.5%	5.9%	4.9%	5.1%
Fiscal revenue	5.8%	3.2%	5.2%	4.6%	4.3%
Fiscal expenditure	8.2%	0.1%	-1.5%	2.3%	0.2%

Source: Wind; KPMG Analysis
Note: The growth rate in 2021 represents the average growth rate during the period from 2019 to 2021. The growth rates of GDP, industrial production, and income per capita are in real term, and the others are in nominal term.

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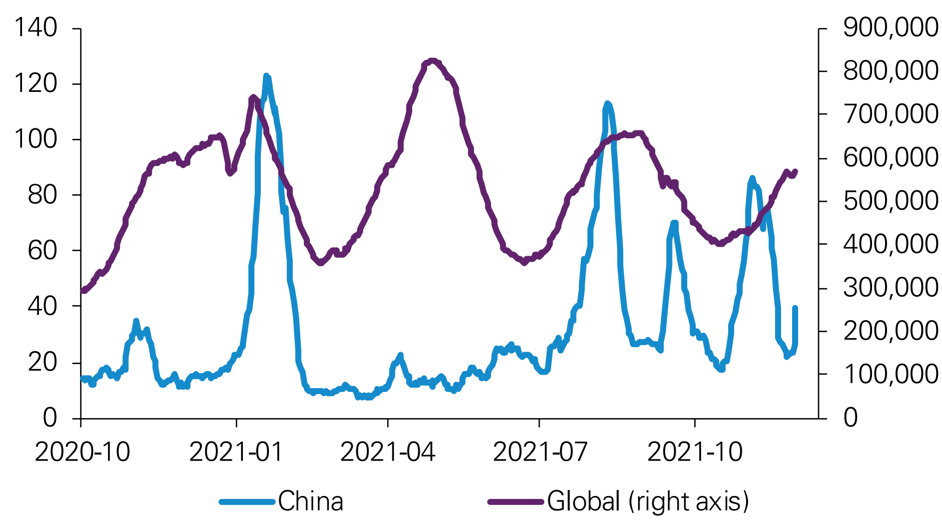
1 The COVID-19 pandemic and quarantine policies will continue to be key factors determining the pace of China's economic recovery

The emergence of the more infectious "Delta" COVID-19 variant since the second quarter of 2021 has led to a rebound of the pandemic. At the end of April 2021, the number of daily confirmed new cases exceeded 800,000 globally, reaching a historical high (see Figure 1). Nevertheless, the acceleration of global vaccine campaigns has reduced the number of critical cases and the disease's mortality rate.

In response to the lingering effects of the pandemic, many countries have adjusted their pandemic control policies. Some of them have steadily relaxed restrictions since mid-2021, adopting a "living with COVID" strategy. These measures have to some extent played a positive role in terms of short-term economic stimulus. However, they have also resulted in waves of new cases in Europe, forcing the Netherlands, Ireland, and some other European countries to consider another round of control measures[1]. These fluctuations in the pandemic have dealt additional blows to some countries' economies. In Asia, one example is Vietnam, which was initially regarded as having effectively contained COVID-19. Its number of daily confirmed new cases soared from less than 100 in May 2021 to over 13,000 by early September 2021 due to relaxed control measures and low vaccination rates, among other factors, dragging down its GDP by 6.2% in Q3, a record decline.

Fig 1 **Daily confirmed new cases, 7-day moving average**



Source: Wind; KPMG Analysis. Data as of 30 November 2021

1 European countries bring back Covid restrictions as cases rise, FT China, 18 November 2021, http://www.ftchinese.com/interactive/53865/?exclusive

In contrast, China has adhered to stringent COVID-19 control measures, which have largely been effective. Despite several outbreaks in January, August, September, and early November 2021, China's number of daily confirmed new cases (7-day moving average) never exceeded 130, a tiny proportion of the global daily totals, which routinely exceed 500,000. Moreover, each round of outbreaks in China has had a lower peak than previous ones. Nonetheless, these minor outbreaks have still caused disruption in some sectors such as retail (see Figure 2).

In 2022, China will host many international sports events, including the 2022 Beijing Winter Olympics in February and the 2022 Asian Games in Hangzhou in September. In addition, the country will also hold the "Two Sessions" in March and the 20th National Congress of the Communist Party of China in the latter half of the year. As these events will require a stable social environment; we expect the government to maintain current anti-pandemic measures well into 2022. However, as the country continues to pursue its "dynamic zero-COVID" goal, local governments will need to ensure that their control measures strike a proper balance between containing the spread of the virus and enabling economic and social development.

In November 2021, a new variant of COVID-19, Omicron, was first discovered in South Africa. Omicron, the fifth variant of concern identified by the WHO, has a higher number of mutations which make it more easily transmissible. As of 3 December 2021, Omicron cases have been found in at least 38 jurisdictions. The continuous mutation of the virus shows the importance of the global effort to fight the pandemic and accelerate vaccination campaigns.

Fig 2 **Confirmed new cases and growth rate of retail sales**

Source: Wind; KPMG Analysis

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2 Inflation should remain under control, with the gap between CPI and PPI expected to narrow

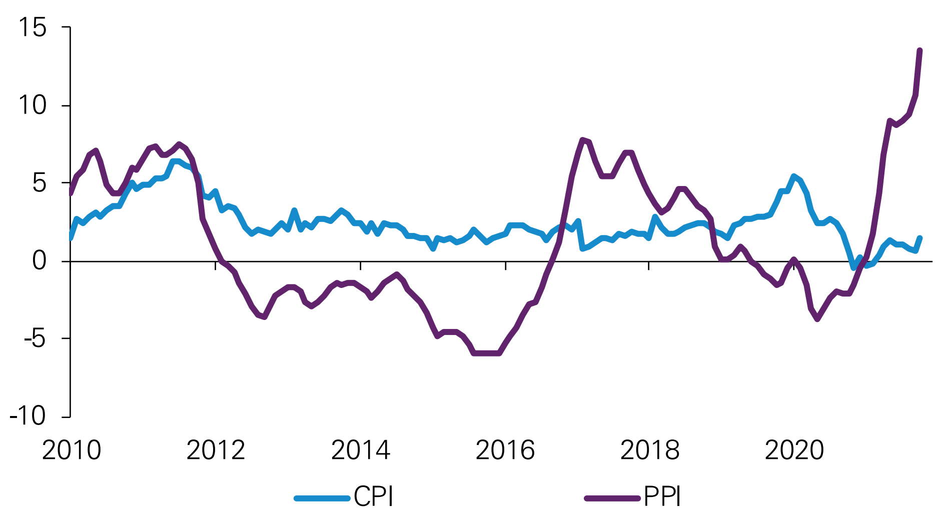
With respect to inflation, China's consumer price index (CPI) and producer price index (PPI) displayed diverging trends in 2021. While CPI remained moderate, PPI rose steadily throughout the year (see Figure 3), further supporting the trend that production has rebounded much faster in China compared to consumption. This widened gap between CPI and PPI has created profit pressure for some middle and downstream companies.

CPI growth slowed due to a slump in food prices, particularly pork prices. In the first 10 months of 2021, the CPI increased by only 0.7%, much lower than the government's target rate of roughly 3%. During the period, pork prices plunged almost 30% year-on-year, dragging down overall CPI growth by nearly 1 percentage point. Core CPI, which excludes food and energy prices, also rose slowly during the year.

Recently, China's pig stocks have declined, and pork prices are expected to stabilise and then increase in the coming year. Looking ahead, we expect China's CPI to rise from 0.9% in 2021 to 2.3% in 2022 owing to this year's low base, continued recovery of consumption, and the transfer of inflationary pressures on the production side to consumers.

Meanwhile, PPI has increased dramatically over the past few months due to the surging price of coal, oil, natural gas, and other commodities. In October, PPI grew by 13.5% year-on-year, a record high. On one hand, demand for energy increased after advanced economies eased COVID-19 containment measures; and expected higher demand for heating during the imminent winter months has led to a short-term energy shortage and rising commodity prices. On the other hand, production

Fig 3 **Consumer price index (CPI) and producer price index (PPI), yoy, %**



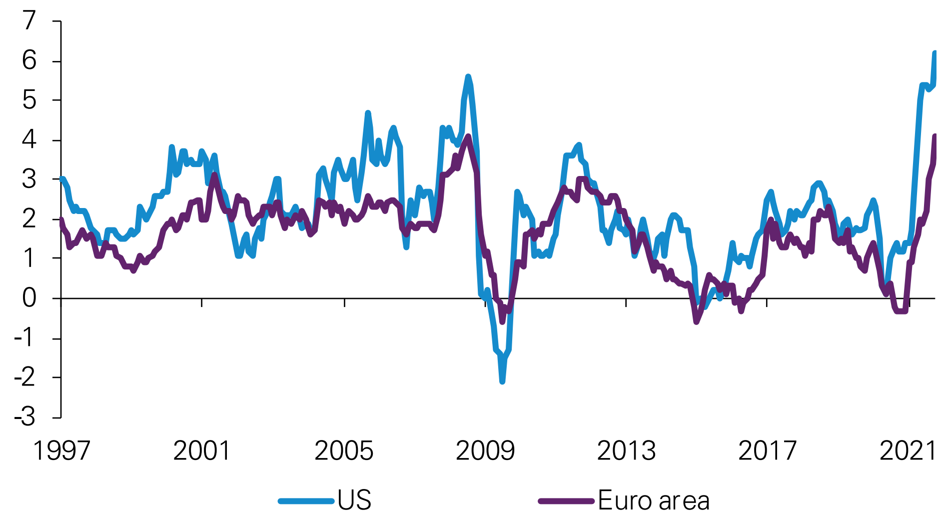
Source: Wind; KPMG Analysis

caps in some segments of the energy sector such as coal have resulted in supply crunches, pushing up prices. As pandemic containment improves and raw material supplies recover further, the gap between supply and demand is expected to narrow. As such, we expect pressure on producer prices to stabilise in 2022.

Overall, we expect domestic inflation in 2022 to be controllable. However, we are closely monitoring global inflation trends and the potential impacts of imported inflation on the Chinese economy. 2021 has seen rapid inflation in Europe, the United States, and other developed economies. The US's CPI surged by 6.2% year-on-year in October, the highest rate since 1990. In addition, the US core CPI is at a 30-year peak. In the same period, the eurozone's CPI grew by 4.1%, reaching the highest rate since 1997 (see Figure 4). US Federal Reserve chairman Jerome Powell removed the word "transitory" in describing the current inflationary trend in his latest speech on 30 November 2021 .

We believe that the new characteristics the US labour market has taken on after the pandemic may have to some extent affected inflationary trends. For example, the US unemployment rate improved from 14.8% in April 2020 when the country was heavily hit by COVID-19 to a moderate 4.6%. On the other hand, however, the US labour participation rate has dropped significantly during the pandemic, and is experiencing a slow recovery. Currently, the US labour force population (which includes the employed and unemployed population) numbers nearly 3 million fewer than in February 2020. In September alone, over 4.43 million people in the country resigned their jobs, a historical record and a phenomenon described by the media as "the Great Resignation"[2]. Wages have been driven up by this tightening in the labour market. In October 2021, the average hourly earnings of nonfarm workers in the US reached nearly USD 31, up 8.6% from last February, representing remarkable growth compared with the historical average. In this context, we are continuing to closely follow the development of global inflation trends and any potential knock-on effects.

Fig 4 **CPI in Euro area and the United States, yoy, %**



Source: Wind; KPMG Analysis

2 "The 'Great Resignation' goes global," Washington Post, 18 October 2021, https://www.washingtonpost.com/world/2021/10/18/labor-great-resignation-global/

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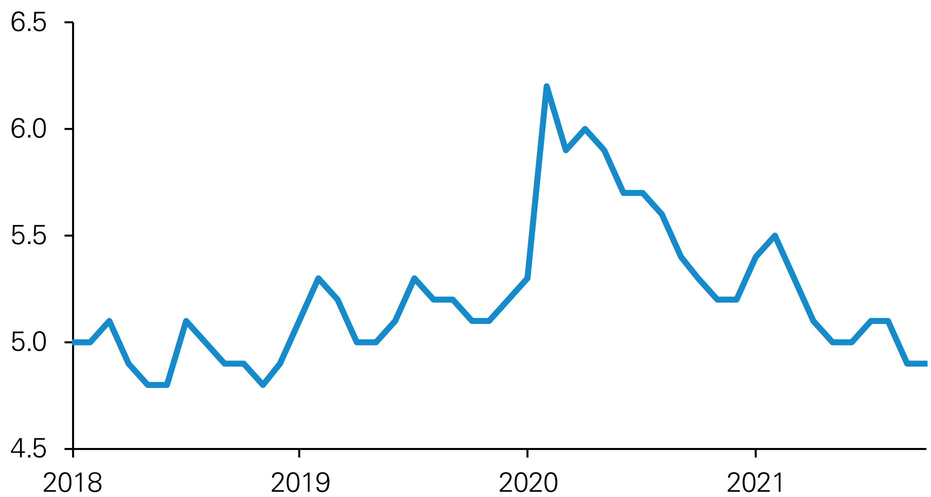
3 Consumption in China continues to pick up and domestic brands rise in popularity

Due to the lingering pandemic and related pandemic control measures, recovery in consumption has been lagging, with services that require physical contact the hardest hit. In addition, residents are now less willing to consumption than the pre-recession level. In the short run, this disruption may continue. However, China will maintain a strong appetite for consumption, particularly with the continuous improvement of the job market.

In the ten months through October 2021, China's new urban employment increased by 11.33 million jobs, with the 2021 target of 11 million new jobs achieved ahead of schedule. A decline in the urban surveyed unemployment rate (see Figure 5) and the steady rise in personal income are providing promising prospects for consumption recovery in 2022. In the medium to long term, China's continued efforts to drive urbanisation, implement common prosperity policies, and expand the coverage of pension, health insurance, and other social welfare programmes will continue to serve as pillars of consumption growth and turn consumption into the main driver of the country's economy.

Fig 5 **China urban surveyed unemployment rate, %**

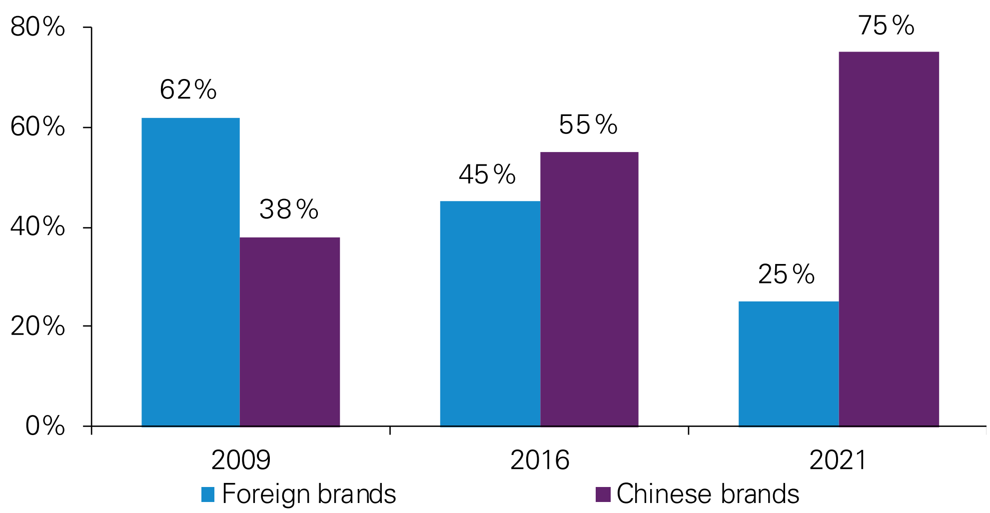


Source: Wind; KPMG Analysis

Against this backdrop, the consumer market has demonstrated several new characteristics, including the rise of so-called "emerging Chinese brands". In China, the quality and size of the consumer market is improving; the country's cultural confidence and lure are growing; Gen Z's position in the consumer market is growing rapidly; and technological innovations are giving birth to new consumption scenarios. In this context, new Chinese consumer brands that feature excellent quality, design, originality, and cost-effectiveness are quickly emerging, further stimulating the growth of the consumer market. Chinese brands had a breakout year in 2019 in particular, with many heralding it as the start of "the era of trendy Chinese products."[3]. The development of Chinese brands across various sectors is drawing increasing attention from domestic consumers.

The number of Chinese consumers interested in Chinese brands is three times the number who are looking for foreign brands (see Figure 6). During this year's "Double 11" shopping festival, sales of Chinese brands exploded, especially in areas such as clothing, cosmetics, and mother and baby care. In conclusion, domestic-branded products are generating more and more excitement among consumers, holding promise to further boost the country's domestic consumption.

Fig 6 Attention on Chinese brands vs. Foreign brands



Source: Big Data Report on Searches for Trendy Chinese Brands by Baidu and the Research Institute of People.cn; KPMG Analysis

3 "New consumption era sees Chinese brands stand out", KPMG China, November 2021
https://home.kpmg/cn/zh/home/insights/2021/11/new-consumption-era-leads-the-rise-of-domestic-products.html

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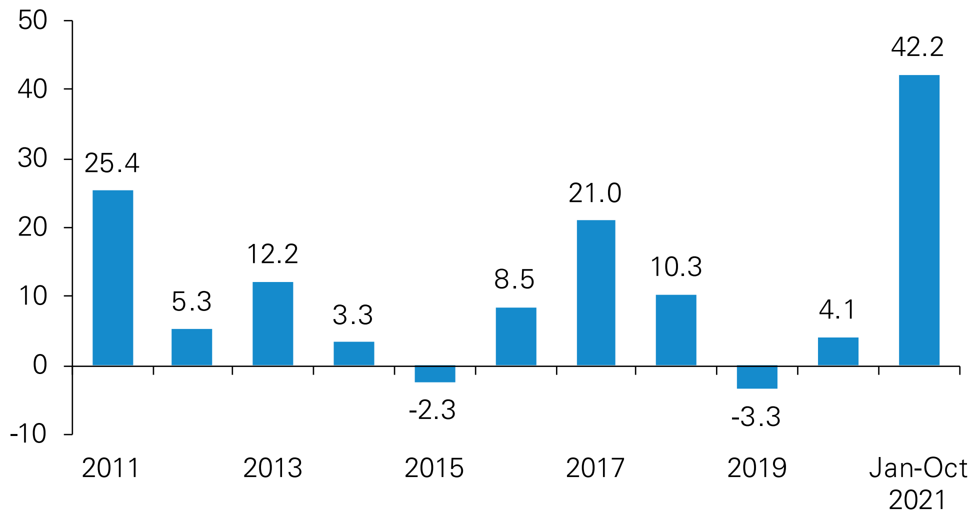
4 Manufacturing investment, especially in innovative and green sectors, will see rapid growth

In 2021, the profits of Chinese industrial enterprises accelerated, driving a parallel increase in manufacturing investments. By the end of October 2021, industrial profits grew by 42.2% year-on-year, significantly higher than pre-pandemic levels (see Figure 7). Meanwhile, China's industrial capacity utilisation reached a high level, which encouraged enterprises to expand their production capacity.

Going forward, manufacturing will continue to serve as a core engine of China's economic transformation. At the same time, manufacturing value as a share of its GDP declined from 32% in 2011 to 26% in 2020. The 14th Five-Year Plan has called for maintaining manufacturing's share of GDP while striving for greener, more intelligent, and higher-end manufacturing, demonstrating the importance that China has attached to upgrade this sector.

Fig 7 Industrial profits growth, yoy, %

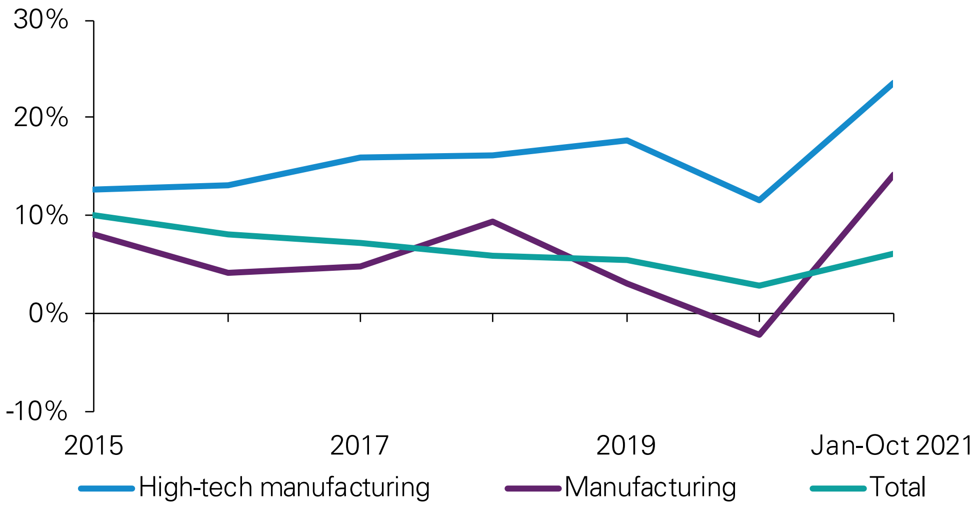


Source: Wind; KPMG Analysis

Meanwhile, financial institutions have been allocating a greater share of medium and long-term loans to manufacturing enterprises, and providing more access to credit to emerging strategic sectors, with the goal of facilitating equipment upgrades and technological transformation of the traditional manufacturing industry. In recent years, China's investment in high-tech manufacturing has been growing at over 10% annually, much faster than the manufacturing sector as a whole (see Figure 8). In addition, the establishment of the Beijing Stock Exchange in 2021 aims to provide better financing opportunities to small and medium-sized enterprises that are professional, specialised, distinctive, and innovative. As a result of these factors, we expect that investments focusing on technological innovation in manufacturing will continue to grow rapidly in coming years.

Investments in green transformation represent another burgeoning area. In November 2021, the People's Bank of China (PBOC) launched new facilities to support enterprises to reduce carbon emissions. Using these instruments, financial institutions can make loans to enterprises to help them reduce carbon emissions and pursue technological development in clean energy, energy conservation and environmental protection, and carbon emissions reduction. The PBOC has also appropriated RMB 200 billion for refinancing that will be used to promote the clean and effective use of coal and facilitate green and low-carbon energy development. In recent years, major power plants in China have concentrated their investments on non-fossil fuel energy sources, including hydropower, nuclear power, and wind power. These investments as a share of overall power project investments have increased from 63% in 2010 to nearly 80%, significantly outpacing investment in thermal power projects. Going forward, we expect enterprises to continue to invest more resources in both technology innovation as well as sustainability.

Fig 8 **Fixed asset investment growth, yoy, %**



Source: Wind; KPMG Analysis

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5 Real estate regulation is expected to continue but the key policy objective is to stabilize the market and expectations

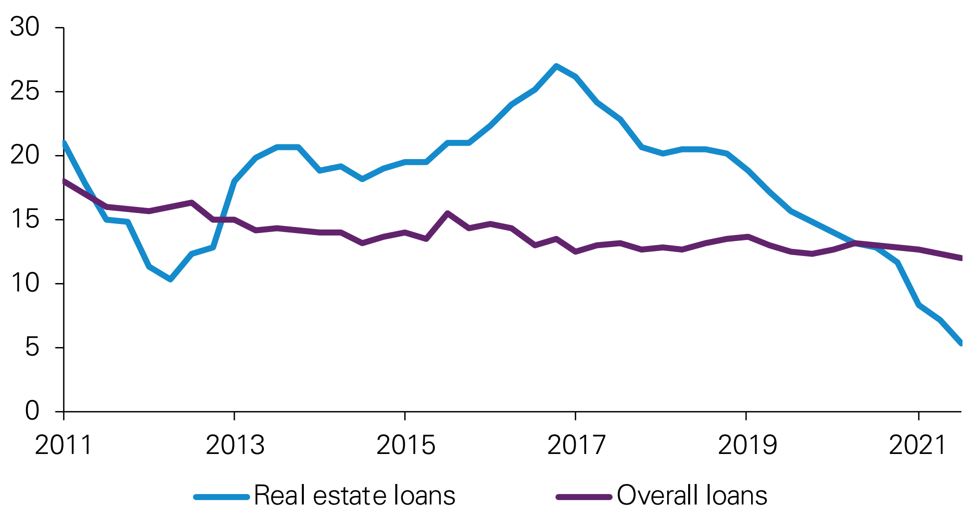
Starting in the latter half of 2020, China implemented a series of tightened regulations for the real estate market, including the "three red lines" policy for asset/liability ratios, the real estate loan concentration management policy, and the "two centralised" land supply policies. These policies represent a comprehensive set of regulations for the property sector covering finance and land supply, among other issues.

From 2013 to 2019, the average annual growth rate of real estate loans exceeded that of total loans by as much as 7%. Since the second quarter of 2020, however, loan issuance has trended in the opposite direction as banks have become conservative in lending to the real estate sector (see Figure 9). At the same time, defaults on real estate bonds have started increasing. From January through October 2021, real estate companies suffered a total of 43 credit bond defaults, 2.5 times the tally in 2020 (17 bonds).

As a result of the increased regulation, real estate sector indicators such as floor area of private housing for which construction has commenced and sales of private housing dropped dramatically in the latter half of 2021. In October 2021, these two indicators slumped by over 30% and 20% respectively. We expect to see these metrics to continue to decline in 2022, with construction and completion stabilising, as overall real estate investment continues to scale back.

Policy adjustments in some local governments in China have had a short-term positive impact on the real estate sector. By the end of October 2021, real estate loans granted by financial institutions during the month had increased by 8.2% year-on-year, and over 90% of personal housing loans were used by borrowers to purchase their first houses. During the same month, loans provided to the rental housing market grew by 61.5% year-on-year.

Fig 9 **Bank loan growth, yoy, %**



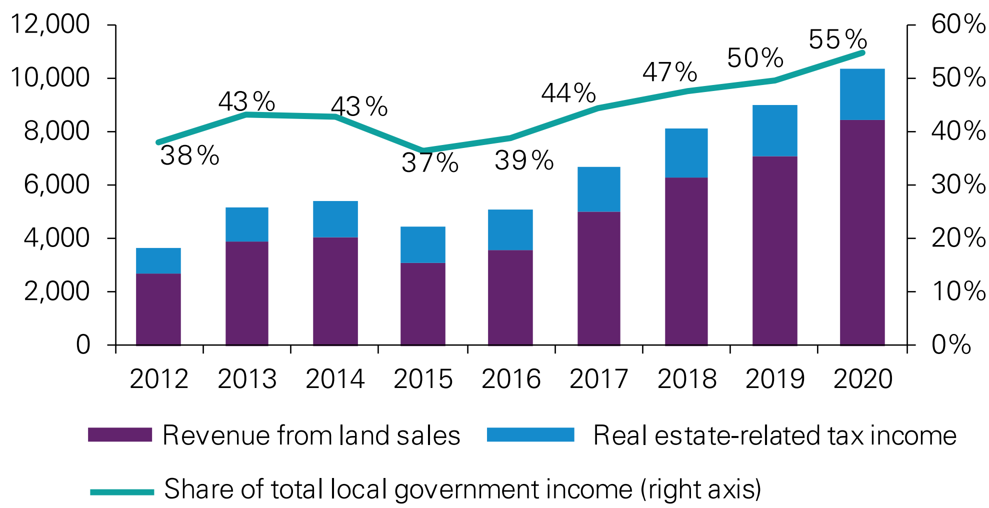
Source: Wind; KPMG Analysis

Despite these figures, we believe real estate market controls will continue to remain stringent in the near future, with only a slim possibility of policy easing. In its recent third-quarter 2021 monetary policy implementation report, the PBOC reiterated that it will "firmly adhere to the philosophy that 'houses are for living in, not for speculation' and insist on not allowing real estate to be used as a short-term economic stimulus"[4].

Overall, the objective of the country's real estate policies is to establish a more effective long-term mechanism for the real estate market to ensure that it remains stable and sustainable. This includes stabilising land prices and housing prices as well as investor expectations. Over the past several decades, China has made great progress in helping to improve living conditions across the country, constructing a tremendous amount of housing. Urban housing area per capita increased from 6.7 m^2 in 1978 to 39.8 m^2 in 2019. In 2020, real estate investments totalled RMB 14 trillion, accounting for 27% of total fixed asset investment, and revenue from the land sales exceeded RMB 8 trillion. This revenue, combined with real estate-related tax income, nearly RMB 2 trillion, accounted for over half of China's local government income in 2020 (see Figure 10).

In October 2021, the National People's Congress (NPC) authorised the State Council to start a 5-year pilot program on property tax in selected cities. We still expect the State Council to announce the city list and the implementation guidelines in the coming months.

Fig 10 **Real estate related income in total local government revenue (before central gov't transfer), RMB billions**



Source: Wind; KPMG Analysis

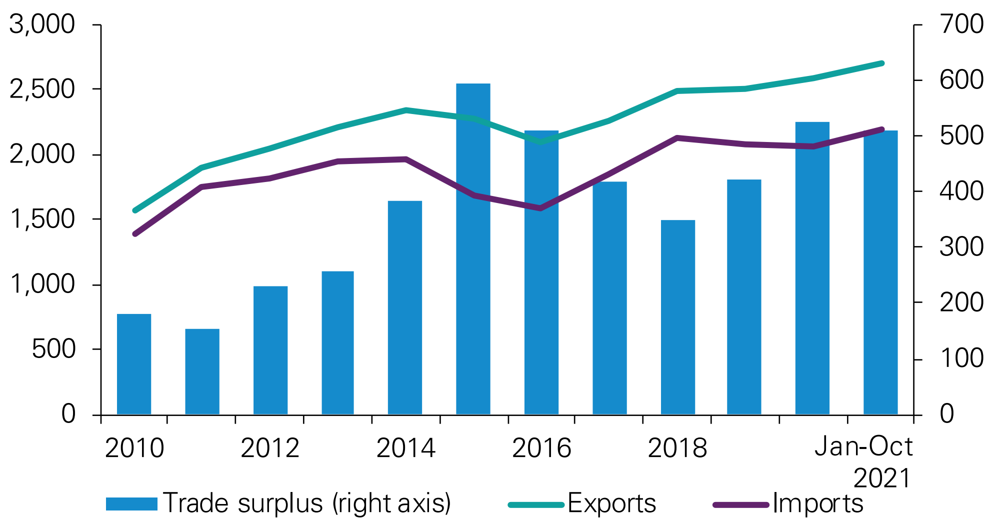
4 China Monetary Policy Implementation Report for Q3 2021, The PBOC, 19 November 2021

6 Export growth will likely moderate and trade surplus will narrow

2021 marks the 20th anniversary of China's accession to the World Trade Organizat ion (WTO). From 2000 through 2020, the global trade of goods nearly doubled, whil e China's exports expanded by more than ninefold. As a result, China's exports as a share of the world's total exports of goods surged from 4% in 2000 to nearly 15% by 2020.

In 2021, China's export trade continued to expand rapidly. Exports in the first 10 mo nths of 2021 already exceeded total exports in 2020, reaching a historical high of U SD 2.7 trillion (see Figure 11). Exported goods mainly included electronics, electrica l, and audio/visual equipment, as well as machinery, which contributed for 24.4% a nd 13.6% of the total export growth respectively (see Figure 12).

Fig 11 **Trade activities, USD billion**



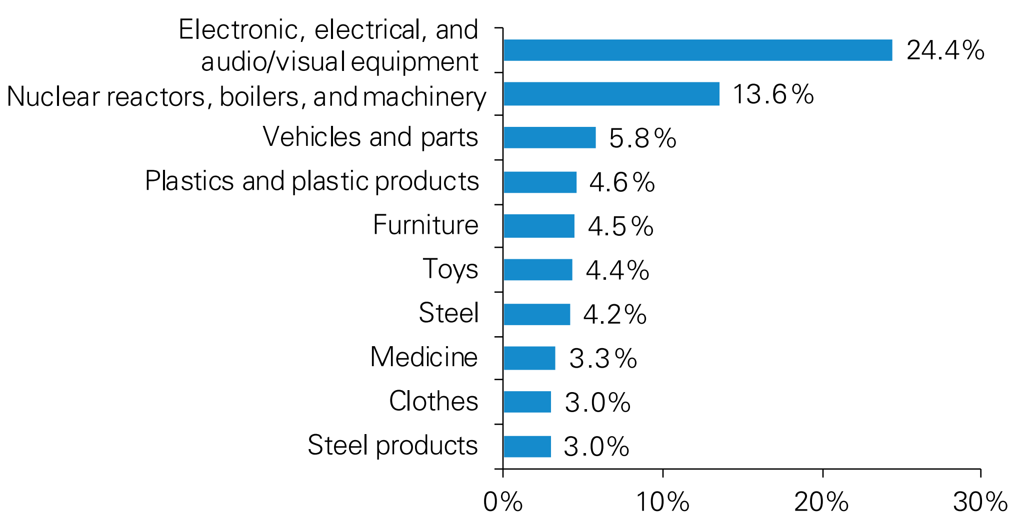
Source: Wind; KPMG Analysis

In 2021, China's exports remained strong due to rising demand from advanced economies and supply chain disruptions in some emerging markets due to new waves of COVID-19 cases. In 2022, we estimate that continued global economic recovery will encourage enterprises to increase their capital expenditures, which will likely boost China's exports of machinery, electrical equipment, electronic products, vehicle parts, etc. However, logistical challenges resulting from a lack of containers, port congestion, and resulting higher freight costs will put pressure on China's exports in the near term. As demand in advanced economies has continued to shift from goods to services, and a higher base effect, we anticipate export growth will moderate in 2022, albeit at a remain robust level.

In terms of imports, we expect China to import more coal and natural gas to address greater energy demands during the autumn and winter months and to mitigate the constraints posed by its "Dual Carbon" target.

The ongoing COVID-19 pandemic is creating challenges for the implementation of the China-US Phase One Economic and Trade Agreement. Our calculations show that by the end of October 2021, China reached 56% of its two-year commitment to import American goods set forth in the agreement. Recently, the two countries have engaged in more dialogue, including a virtual meeting of the two national leaders on 16 November 2021, which may help to further ease economic and trade tensions. As such, we expect imports to continue to ramp up in 2022, and trade surplus will retreat.

Fig 12 **Contributions to China's goods exports, January to October 2021**

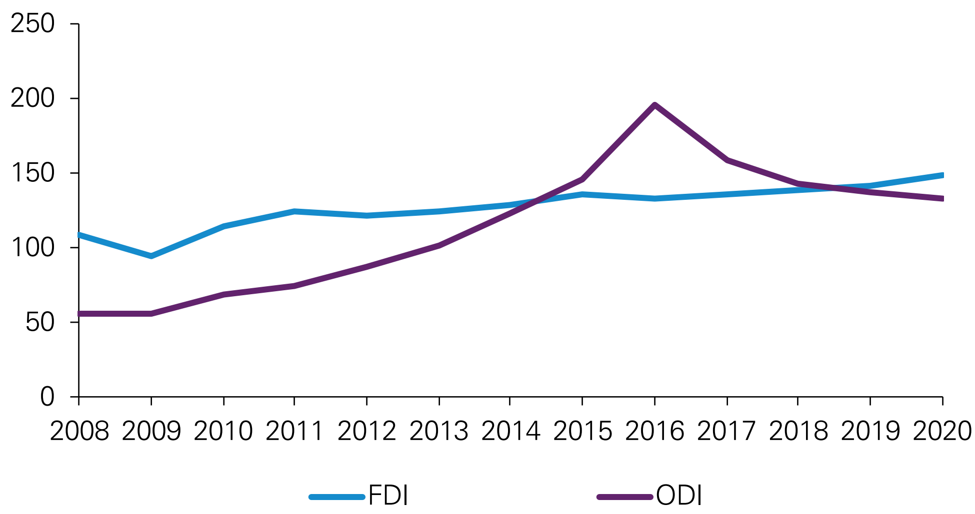


Source: The General Administration of Customs; KPMG Analysis

7 Foreign direct investment remains strong, while outbound investment is expected to rebound

The COVID-19 pandemic has significantly hindered cross-border investment. In 2020, global foreign direct investment (FDI) plummeted by 35%, falling to the lowest amount on record since 2005. In contrast to the global trend, FDI in China increased by 6% during the year, an indication of China's strong appeal to foreign investors (see Figure 13).

Fig 13 China's FDI and ODI, USD billion



Source: UNCTAD; KPMG Analysis

Global FDI has rebound as the global economy normalised, and China's FDI growth has remained robust in 2021. In the first 10 months of the year, non-financial FDI totalled USD 142 billion, representing a year-on-year increase of 23.4%. In recent years, China has opened up wider to the world by introducing favourable policies such as lower market access barriers for investment (see Table 2).

The country's strong economic fundamentals, vast domestic market and well-established industrial sector, infrastructure, and business-friendly environment continue to attract foreign investors, particularly in the wealth management, new energy, and high technology sectors. As such, we expect that China's FDI will remain robust in 2022.

Table 2 China's recent opening-up policies

Time	Policy
November 2021	China established a comprehensive strategic partnership with the Association of Southeast Asian Nations (ASEAN).
September 2021	China applied for CPTPP membership.
September 2021	The CPC Central Committee and State Council issued the General Plan for Building a Guangdong-Macao In-Depth Cooperation Zone in Hengqin and the Plan for Comprehensively Deepening the Reform and Opening-up of the Qianhai Shenzhen-Hong Kong Modern Service Industry Cooperation Zone to establish and improve a more open economic system, with the goal of promoting free trade in services with Hong Kong SAR and Macao SAR and making the financial sector more accessible.
August 2021	The Ministry of Commerce promulgated the Special Administrative Measures (Negative List) for Cross-border Trade in Services in Hainan Free Trade Port (2021 Edition), the country's first negative list for cross-border trade in services.
April 2021	The State Council issued the Official Reply of the State Council regarding Approval for the Comprehensive Pilot Projects to Further Open Up the Service Sector in Tianjin, Shanghai, Hainan, and Chongqing to provide guidelines for these pilot projects.
December 2020	China completed the EU – China Comprehensive Agreement on Investment (CAI) negotiations according to schedule.
November 2020	China officially signed the Regional Comprehensive Economic Partnership (RCEP). On 2 November 2021, six ASEAN member countries—Brunei, Cambodia, Laos, Singapore, Thailand, and Vietnam—and four non-ASEAN member countries—China, Japan, New Zealand, and Australia—officially submitted the Instrument of Approval to the Secretary General of ASEAN to form a quorum and put the agreement into force. RCEP will become effective from 1 January 2022 for these 10 countries as stipulated therein.
September 2020	China rescinded the Qualified Foreign Institutional Investor (QFII) and RMB Qualified Foreign Institutional Investor (RQFII) quotas.
June 2020	The National Development and Reform Commission shortened the Special Administrative Measures (Negative List) for Foreign Investment Access (2020 Edition) from 40 to 33 items.
June 2020	The CPC Central Committee and State Council issued the Overall Plan for the Construction of Hainan Free Trade Port, which will be implemented from June 2021, to put in place a deregulation and facilitation policy centred around a "duty-free" concept.
January 2020	The Foreign Investment Law became effective.

Source: KPMG Analysis

Meanwhile, China's overseas direct investment (ODI) growth has slowed due to strengthened regulation aimed at combating irrational investments. According to statistics from the United Nations Conference on Trade and Development (UNCTAD), China's ODI has moderately declined since its 2016 peak. However, as anti-pandemic efforts continue and the global economy gradually recover, China's ODI has started to trend upward again. Last year, China became the largest provider of ODI for the first time, accounting for over 20% of the global total. During the first nine months of the year, China's non-financial ODI grew by 2.4% year-on-year, and its investments in Belt and Road countries continued to increase. The country has also optimised the structure of its ODI, resulting in investments in the manufacturing sector and high-tech service sectors growing at a much faster rate compared to the overall average.

China has also made progress on a number of economic and trade agreements since 2020. Specifically, the country signed the Regional Comprehensive Economic Partnership (RCEP), completed negotiations on the China-EU Comprehensive Agreement on Investments (CAI), and applied to join the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP). These efforts are aimed at enabling China to more effectively participate in international trade and investment and in the establishment of rules and systems, while also providing mechanisms to facilitate overseas investment. Against this backdrop, we expect China's ODI to see some rebound in 2022.

8 ESG is becoming a core focus for businesses, and decarbonization regulations are expected to be implemented more systematically

In recent years, environmental, social and governance (ESG) issues have drawn more attention across a number of sectors. As such, more and more enterprises are restructuring their business models to make them more sustainable.

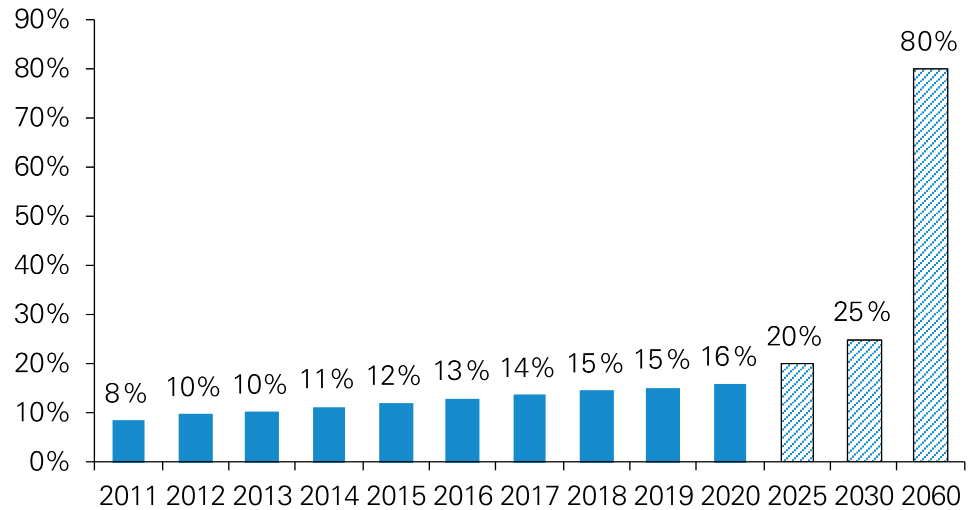
KPMG's *2021 China CEO Outlook* revealed that in the context of a growing focus on ESG, there are increased demands from regulators and investors for more extensive reporting on ESG issues[5]. ESG management can help enterprises reduce compliance risks, gain recognition from employees, and improve their corporate image, enabling enterprises to create long-term value.

China's long-term planning provides for a shift towards green and low-carbon development. The country's carbon emission goals call for the country to reach peak carbon emissions before 2030 and carbon neutrality by 2060. To achieve these goals, it is estimated that China will need to invest over RMB100 trillion in the coming decades, which will in turn present opportunities for businesses across a wide range of sectors.

At the same time, China is still a developing country undergoing industrialisation and urbanisation, and as such, its demand for energy will continue to increase. Therefore, the country should continue to coordinate its national economic development and energy security with decarbonisation objectives in mind. In September 2021, a hike in coal prices due to a tight supply of coal in the domestic market contributed to power outages in some parts of the country, impacting production and people's livelihoods[6]. At the National Energy Committee meeting on 9 October, the government reiterated that the "Dual Carbon" target must be realised in a scientific and systematic manner based on national plans, to avoid unsustainable carbon reduction campaigns enacted by local governments.

5 2021 China CEO Outlook, KPMG China, October 2021
https://home.kpmg/cn/zh/home/insights/2021/10/2021-china-ceo-outlook.html
6 The state council executive meeting, The State council, 9 October 2021,
http://www.gov.cn/premier/2021-10/08/content_5641406.htm

Fig 14 **Share of non-fossil fuel in China's total energy consumption, %**



Source: Wind; *Opinions on Full and Faithful Implementation of the New Development Philosophy for Carbon Dioxide Peaking and Carbon Neutrality*; KPMG Analysis
Note: The proportions for 2025, 2030, and 2060 are estimates.

Recently, the government issued the *Opinions on Full and Faithful Implementation of the New Development Philosophy for Carbon Dioxide Peaking and Carbon Neutrality* and the *Action Plan for Carbon Dioxide Peaking Before 2030* respectively to set up the "1+N" policy system to realise a carbon dioxide emissions peak by 2030 and carbon neutrality by 2060. The *Opinions* set specific phased objectives for 2025, 2030, and 2060, and vowed to increase the proportion of non-fossil fuel consumption to above 80% by 2060 (see Figure 14). The *Action Plan* illustrates green transformation targets and roadmaps for many areas, including energy, industry, transportation, and urban and rural construction (see Table 3).

The issuance of these two policies will enable local governments and authorities to coordinate the planning and implementation of their work and develop more effective action plans and policies. Moreover, they will also guide enterprises in planning and building green, low-carbon, and sustainable business models. As a result, in 2022, we believe that China will further its scientific and systematic approach to carbon emissions reduction.

Table 3 **Major actions in the Action Plan for Carbon Peaking Before 2030**

Action	Description
The action for green and low-carbon energy transition	Promoting coal substitution as well as transformation and upgrading; vigorously developing new energy resources ; developing hydro power according to local conditions ; actively developing nuclear power through a safe and orderly approach; rationally regulating oil and gas consumption; speeding up the development of the new electric power system.
The action for energy saving, carbon emission mitigation and efficiency improvement	Raising capacity for managing energy conservation across the board ; implementing key energy conservation and carbon reduction projects ; advancing better energy saving performance and higher efficiency of major energy consuming equipment; strengthening energy conservation and carbon reduction in new types of infrastructure .
The action for peaking carbon dioxide emissions in industry sector	Promoting green and low-carbon development in the industrial domain ; pushing the steel industry to peak carbon dioxide emissions ; pushing the non-ferrous metals industry to peak carbon dioxide emissions ; pushing the building materials industry to peak carbon dioxide emissions ; pushing the petrochemical industry to peak carbon dioxide emissions ; firmly curbing the irrational expansion of energy-intensive and high-emission projects .
The action for peaking carbon dioxide emissions in urban-rural development area	Promoting green and low-carbon transformation in urban and rural development; accelerating building energy efficiency improvement; accelerating the optimization of building energy consumption structure; promoting a low-carbon transition in rural development and energy consumption.
The action for promoting green and low-carbon transportation	Promoting low-carbon transformation of transportation vehicles and equipment; developing green, high efficiency transportation systems; accelerating construction of green transport infrastructure.
The action for promoting circular economy in carbon mitigation purpose	Pushing industrial parks to develop in a circular manner; strengthening the comprehensive use of bulk solid waste; refining systems for resource recycling; vigorously promoting efforts to reduce and recycle household waste.
The action for advancing green and low-carbon technology innovation	Improving innovation mechanisms and systems ;enhancing innovation capability and personnel training; boosting application-oriented basic research ; accelerating the R&D and wider application of advanced practical technologies.
The action for consolidating and enhancing carbon sink	Consolidating the carbon sequestration capacity of ecosystems; enhancing the carbon sink capacity of ecosystems; strengthening the foundation for ecological system carbon sinks; promoting carbon emissions reduction and carbon sequestration in agriculture and rural areas.
The action for green and low-carbon society	Strengthening publicity and education for ecological civilization; advocating green and low-carbon living patterns; encouraging enterprises to fulfil their social responsibilities; increasing training for cadres .
The action for promoting all regions to peak carbon dioxide emissions hierarchically and orderly	Setting sound, systematic targets; promoting green and low-carbon development according to local conditions; formulating local peaking carbon dioxide emissions plans through coordination between central and local authorities; carrying out pilot projects.

Source: Action Plan for Carbon Peaking Before 2030

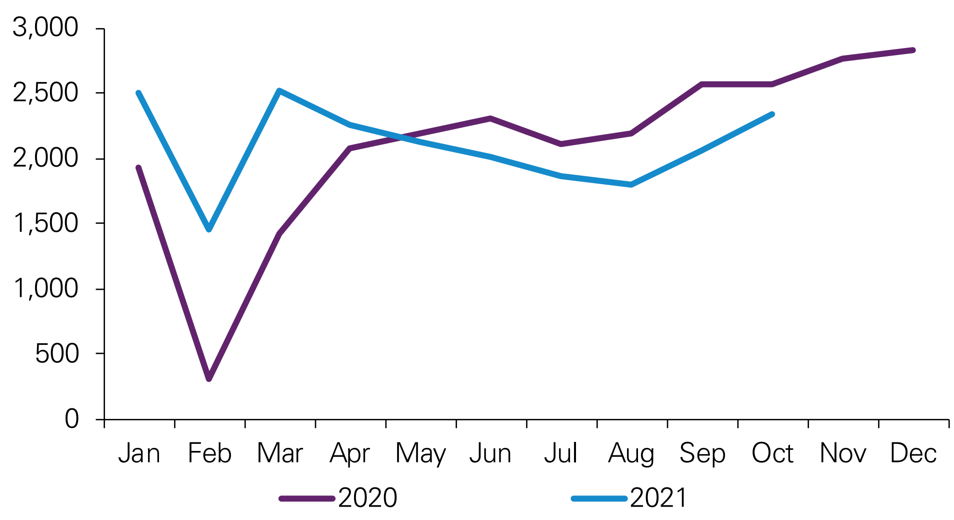
10 Trends

9 Supply chain strategies focus more on resilience and ability to mitigate risks

With the advancement of globalisation, multinational companies have opted towards leaner management of their supply chains to improve cost-effectiveness and enable "just-in-time" (JIT) inventory systems. This may involve using a smaller number of vendors and leverage economies of scale to cut procurement costs and improve management efficiency; shifting production to countries with lower labour costs; and reducing inventory through efficient logistics and transportation.

While this supply chain model can raise the efficiency and profitability of enterprises, it also can subject them to supply disruption risks if key vendors cannot deliver as scheduled due to natural disasters, pandemics, or other external causes. The COVID-19 pandemic is a prime example: anti-pandemic measures have not only prevented the free flow of people but also crippled logistics, imposing great pressure on global industrial chains. The initial impact of the pandemic was particularly significant for sectors that are deeply engaged in the global industrial chain, such as the retail, manufacturing, and automotive sectors, due to the extensive global division of work. For example, COVID-19 outbreaks in Southeast Asia in mid-2021 led to the shortage of auto chips, which hamstrung auto production. As a result, China's auto sales suffered year-on-year declines starting from May 2021 (see Figure 15).

Fig 15 **China's monthly auto sales, thousand units**

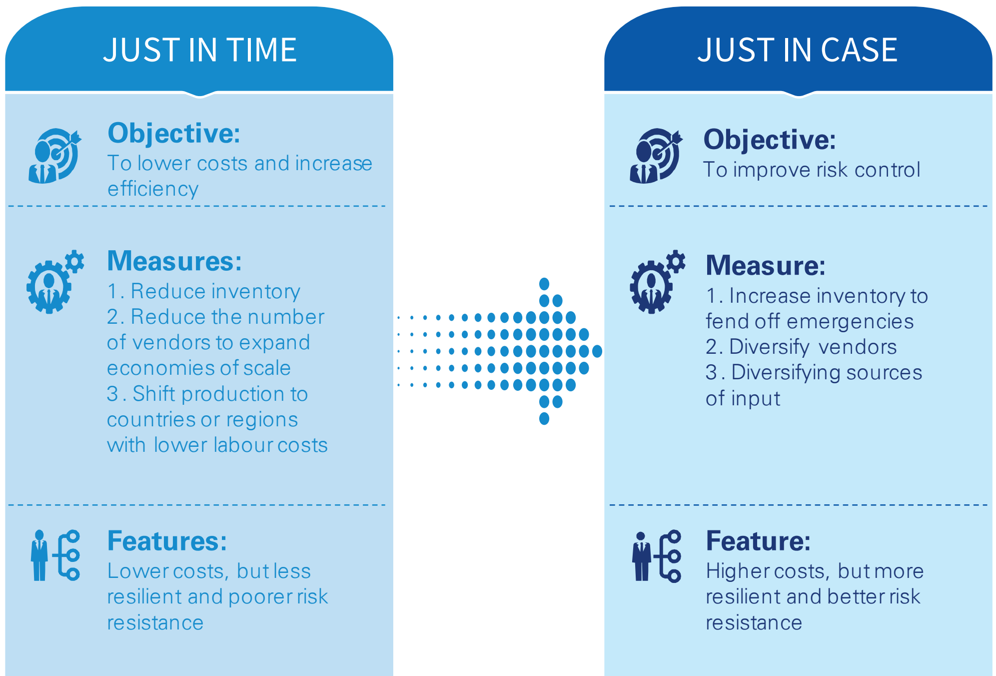


Source: Wind; KPMG Analysis

Following the onset of the pandemic, supply chain constraints, and complex geopolitical environment, enterprises have reflected on the weaknesses in their existing supply chain models. While still trying to keep costs and inventory low, they are now focusing more on the security, stability, resilience, and risk resistance of their supply chains, and emphasising “just-in-case” (JIC) planning to prepare for emergencies before unknown risks arise.

The JIT and JIC models have their own distinct characteristics (see Figure 16), and enterprises should choose which model suits them based on the characteristics of the industries in which they operate. KPMG’s *2021 China CEO Outlook* indicates that China CEOs are planning to implement a range of measures that include closer supply chain monitoring, diversifying their sourcing and engaging in hedging or long-term contracts to stabilise costs to mitigate pressure on their supply chains.

Fig 16 **Comparison of supply chain management philosophies**



Source: KPMG Analysis

For enterprises, supply chains are not only a focus for risk mitigation, but also a critical area for implementing ESG management practices. In addition to improving their own ESG management, enterprises are making efforts to strengthen the governance of other enterprises across their supply chains, with the aim of enhancing ESG compliance and accountability across entire chains.

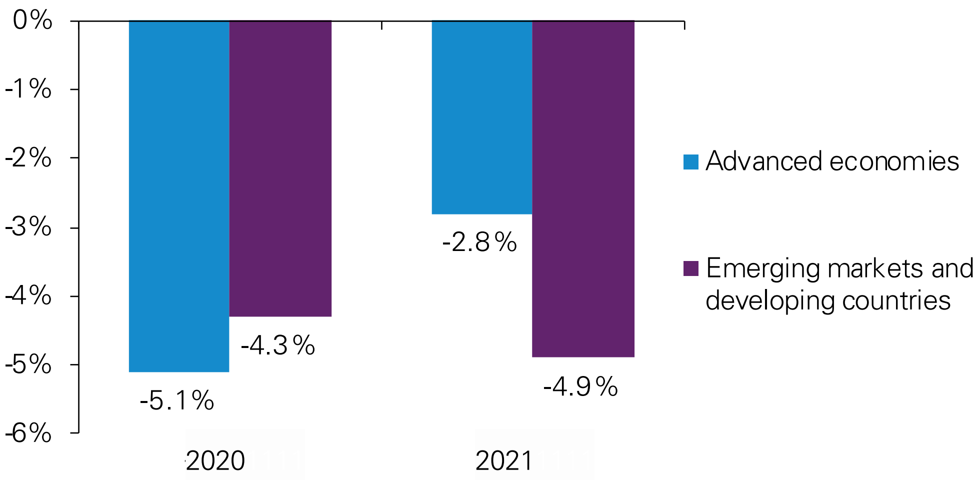
In line with China’s plans to accelerate digital transformation, more and more Chinese enterprises are piloting supply chain digitalisation projects, which combine big data, AI algorithms and other technologies to interconnect information silos in supply chains, draw up more effective production plans, and implement automated management to enable better informed decision-making. They are also speeding up innovation to reduce the impact of supply chain “choke points”.

10 Trends

10 Global economic recovery remains uneven, with widening divergence among economies

The COVID-19 pandemic has greatly impacted the world economy unlike anything that has been seen since the Great Depression of the 1930s. The pandemic is fundamentally different from the global financial crisis in 2008 in terms of the impact it has had among economies in different development stages. The 2008 crisis started when the real estate bubble burst in the US, the impact of which then spread to other economic sectors through the financial system, and subsequently to the rest of the world via interconnected global financial markets and trade systems. However, the 2008 crisis had a more profound impact on advanced economies than on emerging markets and developing countries. According to our calculations, output losses of advanced economies in 2010 relative to pre-crisis trend was 5.1%, while emerging markets and developing countries posted a 4.3% decline (see Figure 17).

Fig 17 **Comparing the impacts of the two global crises on different economies, %**



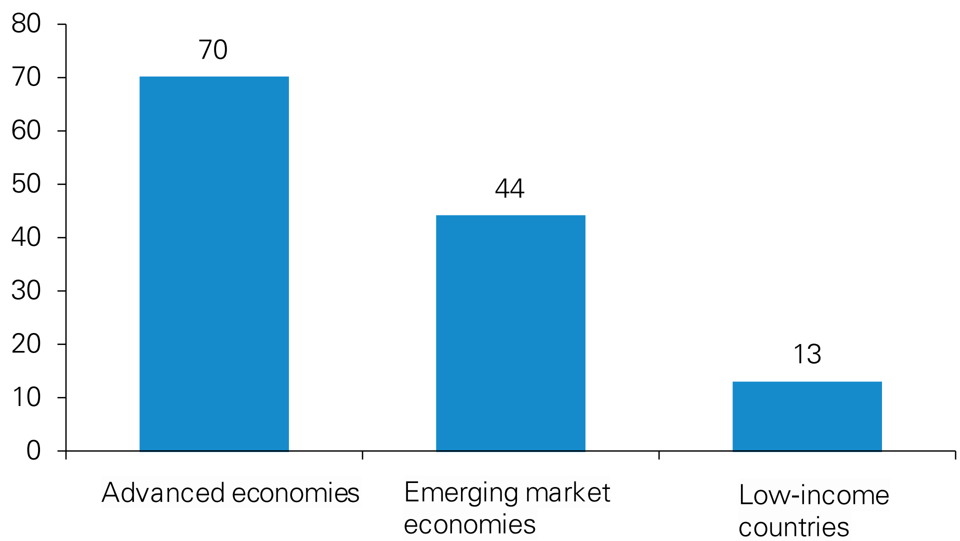
Source: IMF; KPMG Analysis
Note: The short-term impacts, which were estimated by the IMF in October 2021, represent the GDP in 2010 with the pre-crisis trend in April 2008, and the GDP in 2021 with the pre-crisis trend in October 2019.

During the ongoing COVID-19 pandemic, however, emerging markets and developing countries have been hit worse than advanced economies. According to an estimate released by the IMF in October, the output of advanced economies in 2021 may end up being 2.8% lower than pre-pandemic levels, a much more moderate drop than the 4.9% decline estimated for emerging markets and developing countries.

The reason for this gap is obvious: higher vaccination coverage and sufficient financial support in advanced economies. Due to these factors, advanced economies have been able to return to normal faster (see Figure 18). On the other hand, limited resources and poorer vaccination coverage in emerging markets and developing countries caused production and business activities to be more severely disrupted by new waves of COVID-19 cases and the spread of new COVID-19 variants.

As the pandemic is gradually put under control, we expect the global economy to continue to recover, although recovery will be uneven. Large-scale fiscal stimulus and rising demand will make US inflation to maintain higher than expected, possibly remaining elevated until mid-2022. In response, the Federal Reserve has started tapering asset purchases, and it is likely to start raising interest rates from the end of next year; both policies will impact the global economy. Given that the global economy will continue to be characterised by uncertainty in 2022, enterprises will need to continue to carefully consider ongoing global macroeconomic developments in their strategic decision-making.

Fig 18 **Proportion of the population that has received two doses of the vaccine, %**



Source: Our World in Data; KPMG Analysis. Data as of 31 November

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