

# China outlook report

## Second quarter of 2023



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The objective of China’s quarterly report is to provide a comprehensive and summarized overview of the main indicators of the country’s banking sector, as well as the macroeconomic situation at the end of each quarter.

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# 1. International overview

***In 2Q23, the global economy slowed down because of persistent inflation - especially core inflation - and the resulting tightening of monetary policy by major central banks. Growth is expected to be subdued in 2023 and inflation to reach target levels by the end of 2025.***

## Macroeconomic outlook

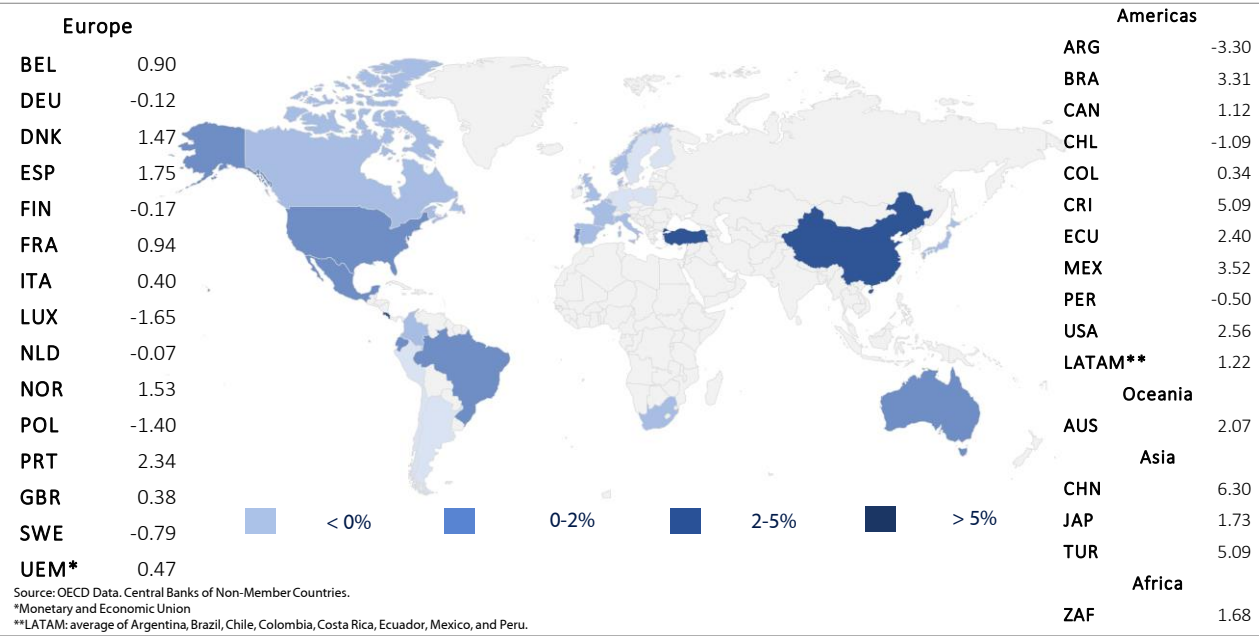
- ▶ During 2Q23, the euro zone registered growth of 0.47%, compared to 1.30% in 1Q23, consolidating the economic stagnation of the area. Of note is the case of Germany, which recorded a decline for the second consecutive quarter and high inflation. The euro zone's average CPI fell to 6.20%, almost 2 p.p. less than in 1Q23 (8.01%), although concerns remain about the persistence of core inflation, while the average unemployment rate declined slightly to 6.4%.
- ▶ Of note in the Americas was the slowdown in the Latam<sup>1</sup> region compared to the previous quarter (1.22% vs. 2.12%), with countries with negative growth rates such as Argentina, Chile and Peru. In contrast, the US continued to stand out, consolidating its growth with a rate of 2.56% (1.62% in 1Q23). Inflation in the US fell to 3.97%, while the Latam<sup>1</sup> average was 20.31% (excluding Argentina (113%), the average was 7.07%). On the continent, unemployment rates were generally stable compared to the previous quarter's reference values.
- ▶ In the Asian region, the reopening of China after the removal of Covid-19 restrictions strengthened economic growth in the region. The growth rate in China was 6.30% (4.50% in 1Q23) and 1.73% in Japan (1.79% in 1Q23).
- ▶ Australia recorded growth of 2.07% (2.27% in 1Q23), continuing its economic slowdown, with a relatively stable unemployment rate of around 3.6% and falling but still high inflation, which closed the second quarter of the year at 6.03%.
- ▶ South Africa, on the other hand, recovered from the decline in its growth rate to 1.68% (compared to 0.18% in the previous quarter), with inflation down at 6.45% and unemployment high at almost 35%.
- ▶ The IMF expects global growth to slow from the recorded 3.5% in 2022 to the 3.0% estimated by the organisation for both 2023 and 2024, in the face of the economic drag from central banks continuing to raise policy rates to combat inflation. Global inflation is projected to fall from 8.7% in 2022 to 6.8% in 2023 and 5.2% in 2024, while core inflation is expected to decline more gradually. Inflation is expected to reach target levels by the end of 2025.
- ▶ ECLAC expects the region's economies to maintain low levels of growth this year and next, affected by a negative global and very complex regional economic outlook, estimating regional average GDP growth of 1.7% in 2023, while for 2024 it projects a slight decline to 1.5%. By sub-region, South America is estimated to grow by 1.2%, Central America and Mexico by 3%.

## Other indicators and main risks

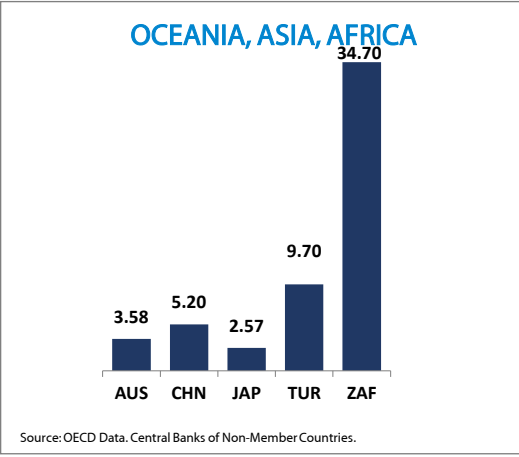
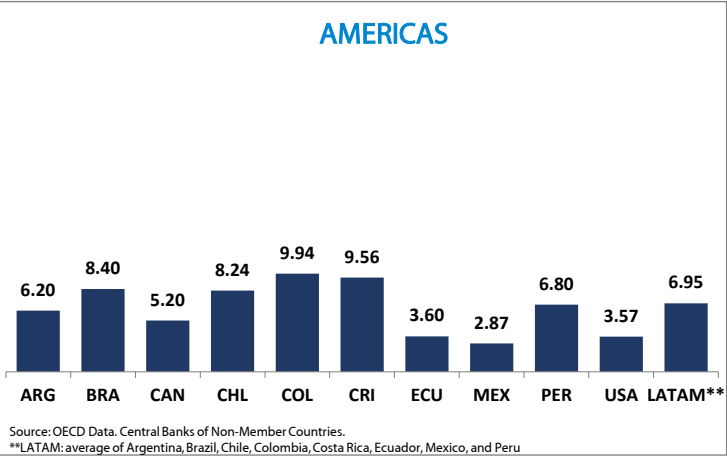
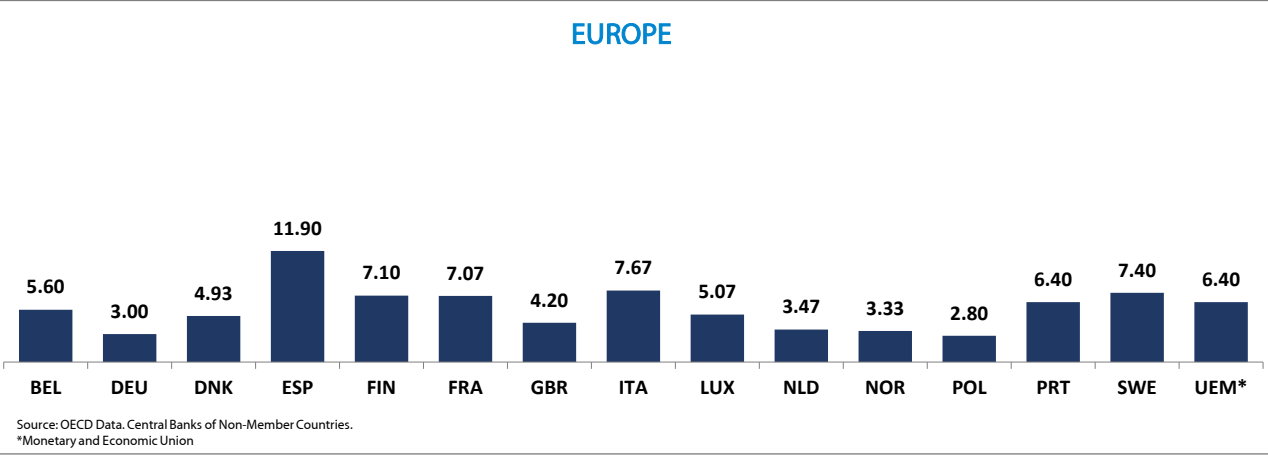
- ▶ The euro consolidated its recovery against the dollar from its decline in 2022. The dollar has become less attractive against the euro because of the interest rate hike cycle of both central banks, the outlook for economic recovery in both regions (expected to be slower in the US) and the government's plan to reduce the US fiscal deficit by raising taxes.
- ▶ The main Latin American currencies also strengthened against the dollar, except for the Argentine peso, whose exchange rate rose from 1Q23 to 239.33 pesos per dollar, a consequence of the region's runaway inflation.
- ▶ The IMF warns that global debt reached 238% of world GDP (+9 p.p. since 2019) and urges governments to take urgent action to reduce long-term debt vulnerabilities and offers specific recommendations for public and private sector debt.

<sup>1</sup> The average for Latam countries is composed from macroeconomic data for the countries of Argentina, Brazil, Chile, Colombia, Costa Rica, Ecuador, Mexico and Peru.

GDP (% , year-on-year growth)

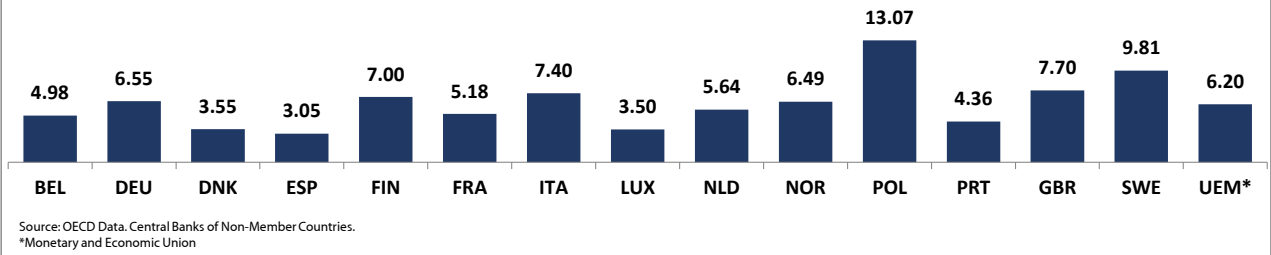


Unemployment rate (%)

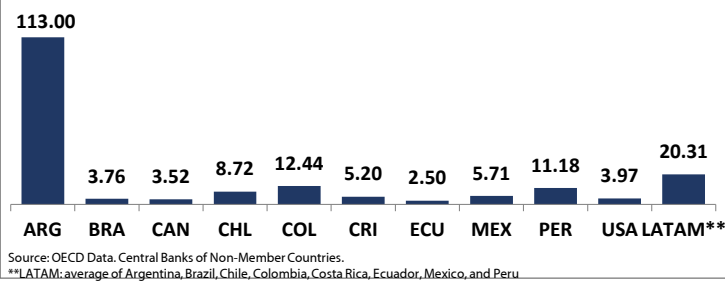


## Inflation rate (%)

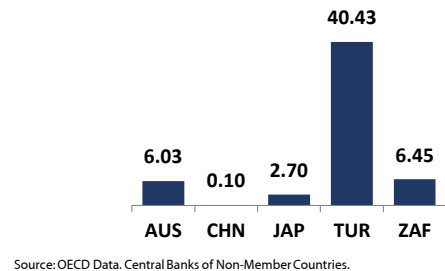
### EUROPE



### AMERICAS



### OCEANIA, ASIA, AFRICA



## Global Ratings and Exchange Rates

### LONG-TERM RATES 2Q23

	MOODY'S	S&P	Fitch
<b>EUROPE</b>			
DEU	Aaa	AAA	AAA
BEL	Aa3	AA	AA-
DNK	Aaa	AAA	AAA
ESP	Baa1	A	A-
FIN	Aa1	AA+	AA+
FRA	Aa2	AA	AA-
ITA	Baa3	BBB	BBB
LUX	Aaa	AAA	AAA
NLD	Aaa	AAA	AAA
NOR	Aaa	AAA	AAA
POL	A2	A-	A-
PRT	Baa2	BBB+	BBB+
GBR	Aa3	AA	AA-
SWE	Aaa	AAA	AAA
<b>AFRICA</b>			
ZAF	Ba2	BB-	BB-
<b>OCEANIA</b>			
AUS	Aaa	AAA	AAA
<b>ASIA</b>			
CHN	A1	A+	A+
JAP	A1	A+	A
TUR	B3	B	B
<b>AMERICAS</b>			
ARG	Ca	CCC-	C
BRA	Ba2	BB-	BB-
CAN	Aaa	AAA	AA+
CHL	A2	A	A-
COL	Baa2	BB+	BB+
CRI	B2	B+	BB-
ECU	Caa3	B-	B-
MEX	Baa2	BBB	BBB-
PER	Baa1	BBB	BBB
USA	Aaa	AA+	AAA

▲ Increased from 1Q23

▼ Decreased from 1Q23

Source: Investing.

### EXCHANGE RATES 2Q23 (\$\*)

EUROPE	2Q22	3Q22	4Q22	1Q23	2Q23	2023
EUR	0.94	1.00	0.97	0.93	0.92	0.92
DKK	7.10	7.59	6.95	6.91	6.85	6.86
NOK	9.85	10.91	9.80	10.27	10.81	10.56
SEK	10.24	11.09	10.45	0.10	10.63	10.35
GBP	1.22	1.12	1.21	0.82	0.80	0.81
PLN	4.48	4.96	4.38	4.36	4.15	4.23
AMERICAS	2Q22	3Q22	4Q22	1Q23	2Q23	2023
ARG	117.95	135.79	176.71	197.70	239.22	219.09
BRL	5.23	5.41	5.29	5.10	4.94	5.00
CLP	928.98	965.90	849.41	805.80	805.20	796.01
COP	4,161.04	4,597.52	4,849.39	4,725.30	4,438.83	4,611.09
PER	3.79	3.99	3.80	3.79	3.66	3.71
MXN	20.13	20.10	19.50	18.38	17.59	17.88
AFRICA	2Q22	3Q22	4Q22	1Q23	2Q23	2023
ZAR	16.27	18.15	17.00	17.76	18.94	18.82
OCEANIA	2Q22	3Q22	4Q22	1Q23	2Q23	2023
AUS	1.45	1.56	1.47	1.47	1.51	1.49
ASIA	2Q22	3Q22	4Q22	1Q23	2Q23	2023
RMB	6.70	7.11	6.90	6.85	7.09	6.93
TRY	16.33	18.21	18.62	18.94	22.09	19.40

Source: Investing, OECD projections, June 2023.

\*The base currency used is the US dollar against each local currency quoted.

## 2. Macroeconomic view

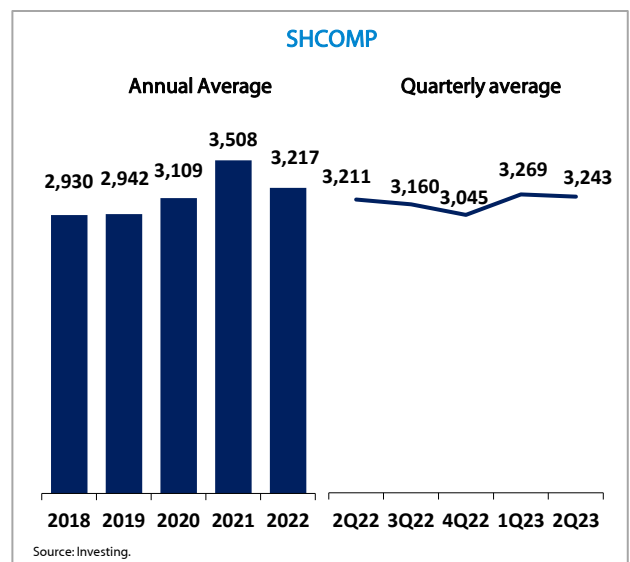
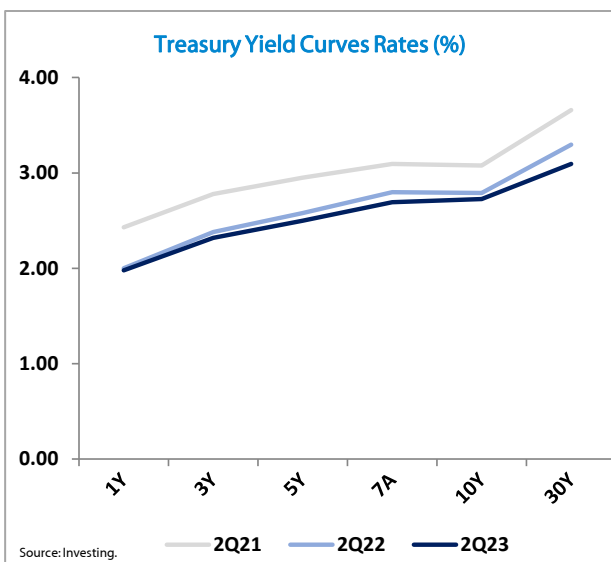
**China's GDP grew more than expected in 2Q23 (6.3%) and the unemployment rate improved slightly. In a context of deflation caused by weak levels of consumption and investment, the Chinese supervisor is betting on stabilising and even lowering interest rates to stimulate the economy and reach the government's growth target (5%).**

Main Macroeconomic Indicators (%)							
INDICATOR	2Q22	3Q22	4Q22	1Q23	2Q23	2023	2024
GDP	0.40	3.90	2.90	4.50	6.30	5.36	5.13
INFLATION							
CPI	2.26	2.65	1.84	1.24	0.10	2.15	2.00
LABOUR MARKET							
UNEMPLOYMENT	5.80	5.50	5.50	5.47	5.20	4.10	3.90
INDICATOR	2018	2019	2020	2021	2022	2023	2024
GDP	6.68	6.15	1.95	8.78	3.00	5.36	5.13
DOMESTIC DEMAND	11.82	8.34	1.68	10.93	-34.75	6.19	5.02
PRIVATE CONSUMPTION	10.43	9.34	0.00	13.34	2.06		
PUBLIC CONSUMPTION	11.91	8.84	4.95	4.86	6.40		
GROSS FIXED CAPITAL FORMATION	13.08	7.26	1.93	11.21	9.39		
NET EXPORTS	-51.61	61.58	121.68	17.98	32.48		
INFLATION							
CPI	2.13	2.90	2.51	0.92	1.96	2.15	2.00
LABOUR MARKET							
UNEMPLOYMENT	3.84	3.63	3.98	3.91	5.58	4.10	3.90
EMPLOYMENT	-0.36	-0.44	-0.51	-0.55	-1.74		

\* The employment variable represents the year-on-year change in employment growth

Source: Organisation for Economic Co-operation and Development (OECD), National Bureau of Statistics of China. Projections OECD and IMF June 2023.

- ▶ In spite of the country registering the highest growth rate of the geographies analysed due to the end of the Covid-19 restrictions, sources such as World Bank Data warn of a possible drop in economic growth in subsequent periods as a result of the significant drop in inflation (almost 0% in 2Q23), which could slow down economic development.
- ▶ The shadow of a possible recession in the real estate sector has led the Asian giant's economy into a situation of deflation that the Chinese authorities intend to reverse by progressively reducing interest rates.
- ▶ All in all, gross domestic product is currently expected to grow at around 5% per year between now and the end of 2023, in line with the government's forecasts, with an unemployment rate of around 4%, better than the previous year, and an inflation rate of around 2%.





### 3. Banking sector

**In the Chinese banking sector, the annual growth rate of deposits decreased to 10.48%, whereas the annual growth rate of total loans increased to 11.01%, and the LTD ratio rose to 82.81%. Regarding the efficiency ratio, it worsened compared to both 2Q22 and 1Q23, while the NPL ratio slightly improved in comparison to 2Q22. As expected, PBoC has lowered the interest rate to 3.55%, which is 0.10 p.p. lower than in 1Q23.**

BANKING SECTOR CONTEXT 2Q23 (%)							
BUSINESS	2Q22	3Q22	4Q22	1Q23	2Q23	Var p.p. 1Q23	Var p.p. 2Q22
LOANS*	10.82	10.73	10.37	11.43	11.01	-0.42	0.20
DEPOSITS*	10.50	10.89	10.83	12.19	10.48	-1.71	-0.02
LTD RATIO	82.41	82.88	82.85	82.33	82.81	0.48	0.40
EFFICIENCY							
EFFICIENCY RATIO	28.85	30.04	33.97	29.05	30.28	1.23	1.43
CREDIT RISK							
NPL RATIO	1.67	1.66	1.63	1.62	1.62	0.00	-0.05
SOLVENCY							
CET 1	10.52	10.64	10.74	10.50	10.28	-0.22	-0.24
LEVERAGE RATIO	6.80	6.84	6.87	6.74	6.63	-0.11	-0.17
LIQUIDITY RATIO	62.27	61.66	62.85	62.97	64.37	1.40	2.10
LCR	146.30	142.68	147.41	149.46	150.86	1.40	4.56
RESULTS							
ROA	0.82	0.75	0.76	0.81	0.75	-0.06	-0.07
ROE	10.10	9.32	9.33	10.32	9.67	-0.65	-0.43
PBoC INTEREST RATE							
INTEREST RATE	3.70	3.65	3.65	3.65	3.55	-0.10	-0.15

\*Note: The values for loans and deposits reflect their year-on-year growth rates.  
Source: China Banking and Insurance Regulatory Commission.

- ▶ During the second quarter of the year, loans year-on-year growth rate increased up to 11.01%, while deposits decreased down to 10.48%. However, loans slightly decreased by 0.42 p.p. compared to 1Q23. Moreover, loans-to-deposits ratio (LTD ratio) increased by 0.40 p.p. and 0.48 p.p. compared to 2Q22 and 1Q23, respectively.
- ▶ The efficiency ratio worsened by 1.43 p.p. compared to 2Q22 and by 1.23 p.p. compared to the previous quarter. The value for this ratio in 2Q23 was 30.28%.
- ▶ Regarding the non-performing loans ratio (NPL ratio), it stayed the same compared to the previous quarter, maintaining 1.62%, which shows a stable trend in management of credit risk.
- ▶ In terms of solvency, during the second quarter of the year, the CET1 ratio worsened by 0.24 p.p., amounting to 10.28%, and the leverage ratio worsened by 0.17 p.p., achieving 6.63%, both compared to 2Q22. On the other hand, liquidity ratio improved by 2.10 p.p. when compared to 2Q22, recording 64.37%. Moreover, the LCR recorded 150.86%, representing an improvement of 4.56 p.p. in contrast with the same quarter of last year.
- ▶ In terms of return rates, ROA ratio of the Chinese banking sector decreased by 0.07 p.p. if compared to the same quarter of the previous year, amounting 0.75%. Regarding the ROE ratio, it also decreased, reducing the ratio by 0.43 p.p. with respect to the same quarter of 2022, reaching a value of 9.67%.
- ▶ The People's Bank of China (PBoC) decreased its interest rate during the second quarter to 3.55%, which meant a decrease of 0.15 p.p. compared to 2Q22 and of 0.10 p.p. compared to 1Q23. This measure was taken to stimulate business confidence and housing demand in order to avoid deflation.



## 4. Glossary

- ▶ **BUSINESS VOLUME:** The turnover volume is the set of activities that generate income for a bank, formed by financing (loans) plus customer resources (deposits).
- ▶ **CET 1:** Common Equity Tier 1 capital is the highest quality of regulatory capital, as it absorbs losses immediately when they occur.
- ▶ **COVERAGE RATIO:** It is a ratio that informs us about the protection that financial entities have against the unpaid loans of their clients. It is represented as the total provisions that the entity has over the total doubtful loans.
- ▶ **CPI:** Consumer Price Index measures the evolution of the average cost of the basket of goods and services representative of household final consumption.
- ▶ **Efficiency Ratio:**  $(\text{Non-interest expense} - \text{amortization of intangible assets}) / (\text{net interest income} + \text{non-interest income})$ .
- ▶ **GDP:** Gross Domestic Product is the total monetary or market value of all the finished goods and services produced within a country's borders in a specific time period.
- ▶ **GM/ATAs:** Gross Margin / Average Total Assets. Gross margin is composed of the set of revenues generated by a financial entity in its activity.
- ▶ **LEVERAGE RATIO:** The Tier 1 leverage ratio measures a bank's core capital relative to its total assets. The numerator consists of the most stable and liquid capital, as well as the most effective at absorbing losses during a financial crisis or recession. The denominator is a bank's total exposures, which include its consolidated assets, derivative exposures and certain off-balance sheet exposures.
- ▶ **LTD ratio:** The loan-to-deposit ratio (LDR) is used to evaluate a bank's liquidity by comparing the total loans of a bank with the total deposits during the same period.
- ▶ **Non-Performing Loans Ratio:** Non-performing loans / net loans and assets.
- ▶ **Non-Performing Loans Coverage Ratio:**  $\text{Loan loss allowance} / \text{non-performing loans}$ .
- ▶ **OECD:** Organization for Economic Co-operation and Development.
- ▶ **Operating Expense:** Total non-interest expense.
- ▶ **p.p.:** percentage points.
- ▶ **Return On Equity (ROE):**  $\text{Net Income} / \text{equity}$ .
- ▶ **Return On Assets (ROA):**  $\text{Net income} / \text{average total assets}$ .
- ▶ **ICBC:** Industrial and Commercial Bank of China
- ▶ **ABC:** Agricultural Bank Of China
- ▶ **BoCom:** Bank of Communications
- ▶ **CMB:** China Merchants Bank

## 5. Appendix

### MACROECONOMIC OVERVIEW

- ▶ National Bureau of Statistics of China:  
<http://www.stats.gov.cn/english/>
- ▶ IMF: <http://www.imf.org/external/index.htm>
- ▶ Standard & Poor's:  
<http://www.standardandpoors.com/>
- ▶ Fitch Ratings:  
<http://www.fitchratings.es/>
- ▶ Moody's:  
<http://www.moody.com/>
- ▶ Organisation for Economic Co-operation and Development, OECD:  
<http://www.oecd.org/home/>

### FINANCIAL SECTOR

- ▶ People's Bank of China:  
<http://www.pbc.gov.cn/english/>

### ACRONYMS

- |                 |                       |                    |                      |                                |
|-----------------|-----------------------|--------------------|----------------------|--------------------------------|
| ▶ DEU - Germany | ▶ LUX - Luxembourg    | ▶ TUR - Turkey     | ▶ ECU - Ecuador      | ▶ ZAF - South Africa           |
| ▶ BEL - Belgium | ▶ NLD - Netherlands   | ▶ ARG - Argentina  | ▶ MEX - Mexico       | ▶ UEM- European Monetary Union |
| ▶ DIN - Denmark | ▶ NOR - Norway        | ▶ BRA - Brazil     | ▶ PER - Peru         |                                |
| ▶ ESP - Spain   | ▶ POL - Poland        | ▶ CAN - Canada     | ▶ USA- United States |                                |
| ▶ FIN - Finland | ▶ PRT - Portugal      | ▶ CHL - Chile      | ▶ AUS - Australia    |                                |
| ▶ FRA - France  | ▶ GBR- United Kingdom | ▶ COL - Colombia   | ▶ CHN - China        |                                |
| ▶ ITA - Italy   | ▶ SUE - Sweden        | ▶ CRI - Costa Rica | ▶ JAP - Japan        |                                |



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