CHINA ECONOMIC UPDATE MARCH 2020

Back in business? China attempts to restart its economy after Covid-19 shutdown

NAB Group Economics

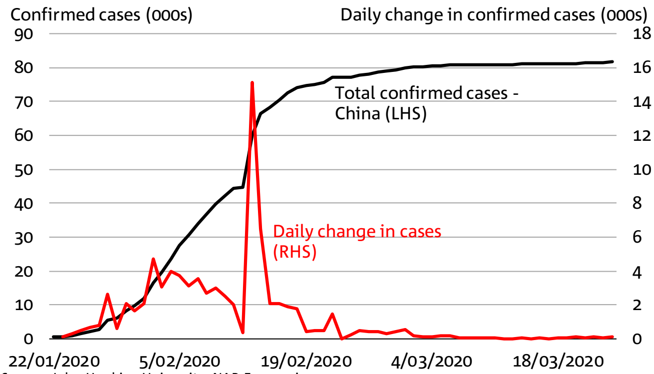
China's economic activity slowed dramatically in early 2020, as measures designed to control the spread of Covid-19 have negatively impacted industrial production, construction and services. Available data appears to suggest that these measures have been successful in slowing the spread, and authorities are now attempting to unwind the constraints and restart activity. That said, it may be some time before China returns to normal activity levels – given the likely slower recovery in confidence and the weaker global economic environment due to the virus spread.

COVID-19 CONTROL HAS HIT CHINA'S ECONOMY

The rapid spread of Covid-19 – initially in China and subsequently around the rest of the world – has led to a rapid slowdown in global economic activity and a deterioration in market expectations. Confirmed cases surged in China, particularly centred around Hubei province, which prompted strong containment measures that impacted the daily lives of residents. Businesses were forced to remain closed following the Chinese new year holiday period, transport was restricted and large numbers of people in affected areas were forced to quarantine.

CHINA'S COVID-19 OUTBREAK

Restrictions have slowed new cases



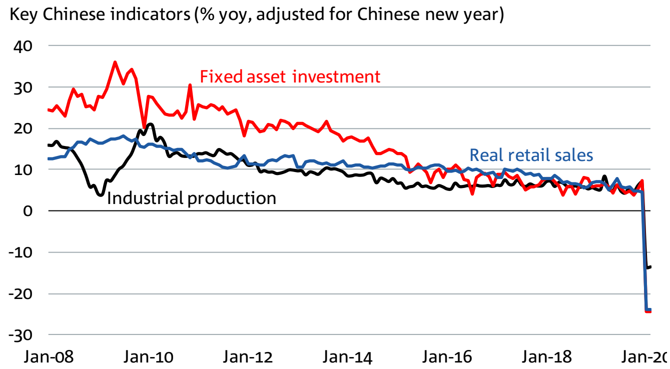
Source: John Hopkins University, NAB Economics

From a public health perspective, these measures appear to have been successful. The number of new confirmed cases slowed from over 1000 a day in mid-February, to generally under 100 a day from 7 March onwards (the exception being 130 cases reported on 22 March). That said, this success came at a heavy economic cost.

China's monthly economic indicators in February were historically weak. Industrial production, investment in fixed assets and retail sales all plunged across January and February – a period where data are typically averaged to account for the variable timing of Chinese new year – recording far weaker outcomes than at any point since the early 1990s (when the time series commenced), including the Global Financial Crisis.

CHINA'S MONTHLY INDICATORS

Unprecedented falls in February



Source: CEIC, NAB Economics

The impact of Covid-19 and the policy efforts to contain its spread has created both supply and demand shocks. On the supply side, the closure and under-utilisation of industrial capacity has limited the flow of goods and services to markets. On the demand side, confirmed and suspected cases of Covid-19 have resulted in Chinese residents being hospitalised or quarantined in their homes, while other residents have favoured isolation, limiting their

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consumption in order to reduce the risk of transmission. There is also a growing external demand shock, as Covid-19 containment measures in Europe, North America and East Asia are generating a large downturn in these regions.

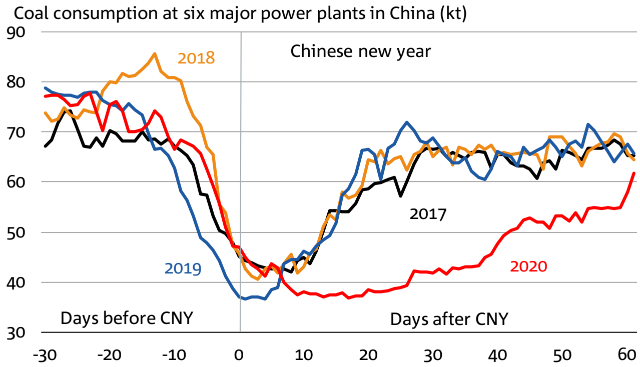
One further constraint has been restrictions on the movement of migrant workers – typically workers from rural regions who move to cities for better employment opportunities. Migrant workers frequently go to their homes for the Chinese new year festivities, before returning to cities. However, various Chinese local authorities have introduced mandatory quarantine periods from returning migrants, while others have barred migrant entry entirely. Reports suggest migrants from Hubei province – at the centre of Covid-19 outbreak – are struggling to find employment, due to fears that they may spread the virus. Estimates by China's transport ministry suggested that in mid-February only around one-third of the 291 million migrant workers had returned, a major constraint to the manufacturing and construction labour force. That said, Nomura suggest that this may have risen to almost 90% by mid-March.

LOOKING FOR SIGNS OF A RECOVERY IN CHINA'S ECONOMIC CONDITIONS

Dated monthly indicators do not provide any indication about the subsequent pace of recovery. The supply side constraints are slowly being unwound as businesses around the country recommence operation. According to the NBS, almost 91% of large and mid-sized enterprises surveyed are expected to resume work by the end of March, compared with almost 79% at 25 February. That said, this does not necessarily translate into a large increase in capacity utilisation. Anecdotal evidence suggests that while many businesses across the country are technically open, they are working well below normal output levels. Indicators such as pollution measures, transport congestion and electricity generation have been well below year ago levels, although there has been an upturn in coal consumption at power plants in recent days.

POWER PLANT COAL CONSUMPTION

Usage finally starting to pick up



Source: CarbonBrief, Capital Economics, NAB Economics

Travel restrictions have largely been removed around the country. The bulk of Hubei province was opened up on 25 March, while Wuhan – the city at the centre of the Covid-19 outbreak – is scheduled to reopen on 8 April.

While authorities are attempting to ease the restrictions on supply, it may take longer for demand side constraints to dissipate. The rapid spread of the virus and the prolonged quarantine period is likely to have a negative impact on consumer confidence, and Chinese consumers may remain cautious for an extended period. Lost income and possible higher rates of unemployment may limit the likely rebound in consumption in the post virus environment. The declines in activity in other parts of the world also mean that export markets will be weak until global activity recovers (although there may be a backlog of orders to fill).

POLICY RESPONSE AND THE ECONOMIC OUTLOOK

Chinese authorities have implemented a wide range of policy measures, intended to limit the negative impact from the containment measures and enable the economy to recover as these restrictions are unwound. That said, given the potential impact on consumer and business confidence, it is unclear how effective these policies will be.

In contrast to the sharp easing in monetary policy in many advanced economies, the People's Bank of China has resisted large cuts to its policy rate, with the Loan Prime Rate only down 10 basis points since the start of the year. That said, the PBoC has cut the Required Reserve Ratio for many eligible banks – aimed at boosting lending to small and medium sized enterprises – and is considering cutting deposit rates to support bank profitability.

Greater emphasis has been placed on fiscal policy – at both the central and local level. A range of measures have been introduced, including infrastructure programs and business support – such as subsidies, liquidity support and tax concessions. Airlines have particularly targeted for support, given the reduced air traffic. There have been estimates that the total value of these measures is around 1% of GDP.

Reflecting the scale of the downturn in the first two months, we expect an unprecedented decline in China's GDP in Q1 – down by 12% yoy (far weaker than any quarter stretching back to the early 1990s). Given the relatively slow recovery in activity measures for March, we expect the rebound in China's economy will be spread across Q2 and Q3. For the full year, we now forecast no growth (compared with our previous forecast of 4.8%).

Due to the weakness in early 2020 (particularly in Q1), the resumption of normal activity in China will result in a rapid acceleration in annual growth in 2021 – now revised up to 10.9% – however it is worth noting that China's economy would be smaller at the end of 2021 in this scenario than had our pre-Covid-19 forecasts eventuated.

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