CHINA ECONOMIC UPDATE APRIL 2020

Shutdown and restart – will China's consumers return to support growth?

NAB Group Economics

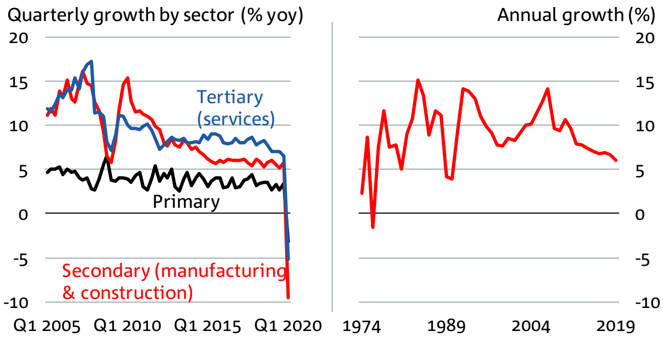
Due to measures designed to control the spread of Covid-19, China's economy slowed significantly in the first quarter of 2020, recording the weakest economic outcome in at least four decades. While there were signs of life in China's industrial sector in March, weakness in consumption – which could last longer than official Covid-19 countermeasures – could be a drag on China's economic recovery in the near term.

CHINA'S MULTI-DECADE DOWNTURN IN Q1

China's latest national accounts data showed that its economy contracted by 6.8% yoy in Q1. This was the first time in the quarterly growth series – which extends back to Q1 1992 – that China recorded negative growth. The last time that China reported negative economic growth in any form was on an annual basis in 1976 – which marked the end of the Cultural Revolution.

QUARTERLY AND ANNUAL GROWTH

Last decline in reported GDP was in 1976

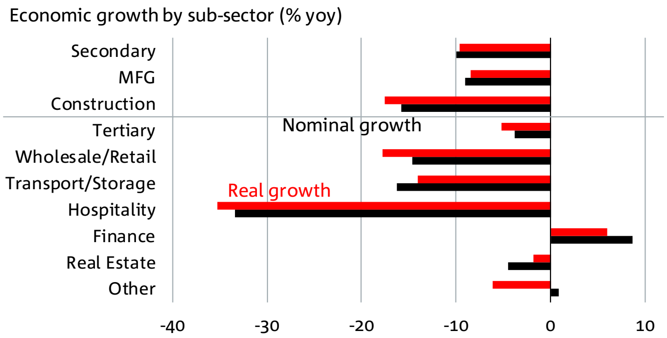


Source: CEIC, NAB Economics

The data showed that the downturn was broad based, with the largest downturn being in the secondary sector (manufacturing and construction) – which fell by 9.6% yoy. In contrast, the primary sector declined by 3.2% yoy and the tertiary sector (which covers services) fell by 5.2% yoy. The relatively small decline in the latter was somewhat surprising, given that a large proportion of services requires close personal contact and data showed a sharp plunge in retail sales – which we estimate fell almost 22% yoy in real terms in Q1.

GROWTH BY SUB-SECTOR

Finance growth limited the fall in services



Source: Refinitiv, NAB Economics

According to subsequently released data, financial intermediation was the only component within the services sector to record real growth in Q1 – increasing by 6.0% yoy. In current price terms, finance overtook the wholesale and retail sector (the previously largest individual category within services), accounting for just over 20% of services activity.

The other large falls by sector were in hospitality – which plunged by 35% yoy – and transport, storage and postal services, which fell by 14% yoy.

THE PARTIAL RECOVERY IN THE INDUSTRIAL SECTOR

Although the quarterly GDP data showed a larger decline for manufacturing than services, this three month average masks a partial recovery in industrial activity in March. According to industrial production data, output plunged by 25% month-on-month in

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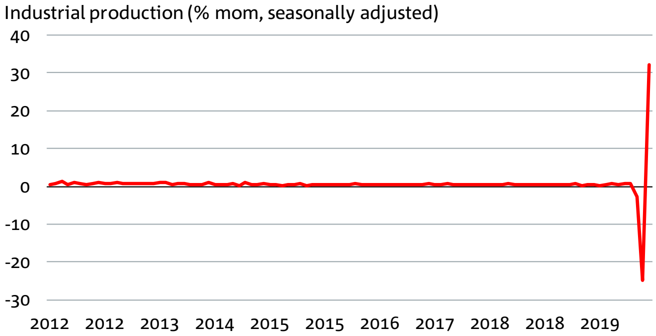
February (on a seasonally adjusted basis), as factory closures restricted supply. However, as these restrictions started to be eased in March, industrial production rose by 32% month-on-month, limiting the declines in Q1 GDP. It is worth noting that the level of output in March 2020 was marginally below that recorded in January, and around 1.1% lower than March 2019.

INDUSTRIAL PRODUCTION

Unprecedented fall and recovery in output

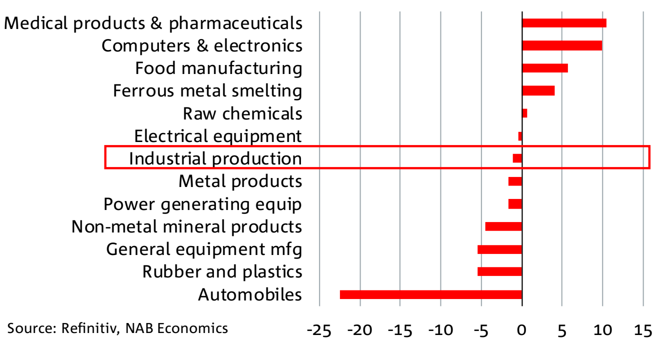


Source: Refinitiv, NAB Economics

However, this high level view masks considerable disparity among individual industries. There were strong increases in production for medical and pharmaceutical products (up by 10.4% yoy in March) as well as computer and electronic products (rising by 9.9% yoy). Food products (up 5.4% yoy) and iron smelting (4.1% yoy) also grew noticeably. In contrast, automobile production plunged – down 22% yoy – while rubber and plastics (-5.5% yoy), general equipment manufacturing (-5.4% yoy) and non-metallic mineral products (which includes cement, ceramics and glass among others) (-4.5% yoy) declined more rapidly than average.

INDUSTRIAL PRODUCTION BY SECTOR

Wide divergence within manufacturing



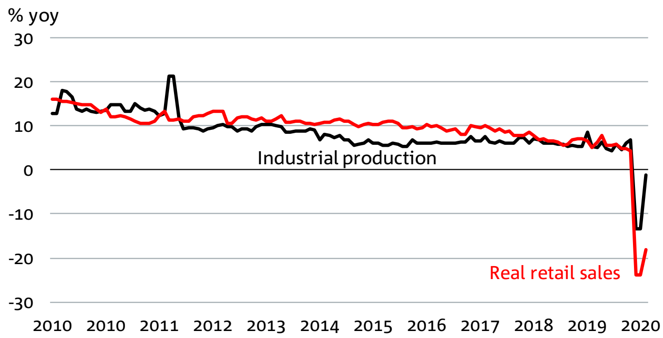
Source: Refinitiv, NAB Economics

CAN CONSUMERS DRIVE THE ECONOMIC RECOVERY?

China's retail sales were extremely weak in Q1 2020 – in part reflecting the impact of various quarantine measures imposed across the country, which differed in duration and conditions. At the peak in mid-February, around 780 million people were subject to travel restrictions, limiting their access to traditional retail outlets (many of which were closed by authorities). However, weakness in retail sales persisted in March, even as many restrictions were wound back – with sales falling by 18% yoy (in real terms), from around 24% yoy across January and February.

SUPPLY VERSUS DEMAND

Industrial recovery but not spending



Source: Refinitiv, NAB Economics

Online retail sales also contracted over the first quarter – down by 0.8% yoy (compared with a 16.5% increase in 2019).

Given this negative consumption profile, and weakness in export markets (as key export markets began to ramp up their own Covid-19 countermeasures), it is likely that this increase in industrial production led to a large increase in inventories. As China's gross domestic product is calculated on a production basis (with no expenditure based estimate provided), there is no ready quarterly measure to confirm this assumption.

Chinese authorities have hoped that the reopening of the country will be associated with a phase of so-called "revenge shopping" – a phrase originally coined for the wave of spending that occurred following the 1976 economic downturn.

That said, there is no guarantee that such a wave will occur. Various household surveys, conducted by universities, consulting firms and investment banks, suggest that a large proportion of Chinese consumers will be more wary in the short term, seeking to save more in preparation for future crises and fearing that their income will be lower this year. A March survey by the Southwestern University of Finance and

Economics found that almost 61% of households believed their income would shrink in 2020, with a quarter of them expecting a significant drop.

There is the risk that the Covid-19 lockdown could result in a psychological shift among consumers – leading to a more conservative attitude towards consumption going forward. While only representative of a segment of the population, a term meaning to cut off trivial things has been trending on Chinese social media. If this trend eventuates on a widespread basis, it would lower economic growth during the recovery from the downturn.

CONCLUSION

The global economic downturn – triggered by measures to address the spread of Covid-19 – means that demand in China's major export markets is likely to be weak in the near term. If domestic consumption is also weak, either due to lower incomes or conservative consumption, this could mean that the recovery in industrial activity is unsustainable – as producer inventories build at considerable cost. This could lead to weaker demand for manufacturing inputs – including a range of Australian commodities – with steel demand (fed in part by Australian iron ore and metallurgical coal) highest in construction, machinery and equipment and automobile manufacturing.

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