

# CHINA ECONOMIC UPDATE MAY 2020



## Diminished demand: Export channels offer little opportunity as China attempts to recover

NAB Group Economics

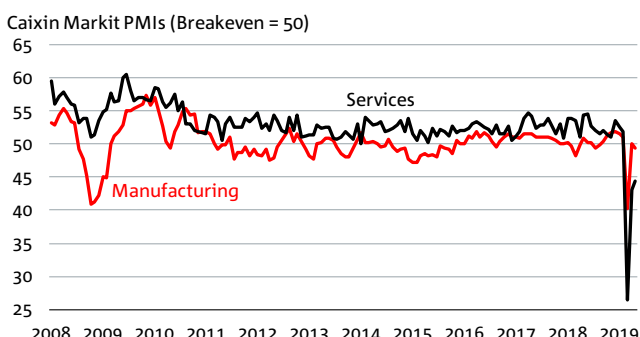
China's economy showed some limited signs of recovery in March, as industrial production partially recovered from the record fall in February. However, early indicators for April suggest that this momentum was not continued. As we noted last month, the increase in industrial supply could struggle to find adequate demand – with consumers in China cautious during the early recovery period from the COVID-19 shutdown, while export markets are constrained by their own measures to limit the COVID-19 spread.

### GLOBAL TRADE OFFERS LITTLE OPPORTUNITY TO MANUFACTURERS

According to official data, there was a rebound in China's industrial sector in March, almost recovering to pre-COVID-19 levels (after a steep plunge in February). That said, China's manufacturing sector has not returned to normal (pre-COVID-19) operations. The Caixin Markit Manufacturing PMI dropped back to 49.4 points in April (suggesting marginally weaker conditions than in March) – while the services measure was even weaker (44.4 points in April). A survey by the China Beige Book noted while 91% of Chinese companies had resumed activity by late April, just 4% of them were at full capacity.

### PMIS SUGGEST ONGOING WEAKNESS

#### Services particularly weak since January



Source: Markit, Refinitiv, NAB Economics

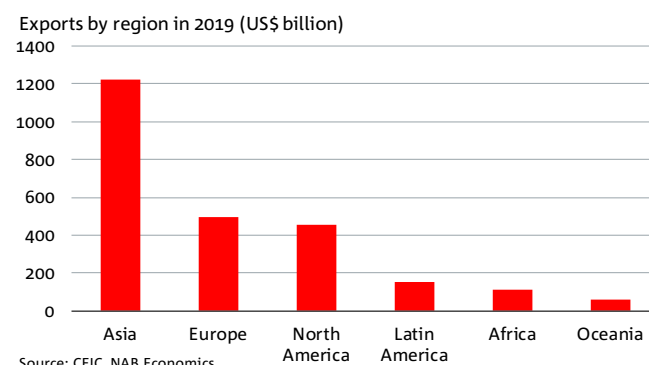
This increase in industrial supply in March did not correspond with a boost in demand, with consumer spending remaining subdued. Analysis of UnionPay credit card data by Xiamen University and the National University of Singapore suggests that

spending slowed in the first two weeks of April (having peaked in late March).

Negative confidence effects are likely to persist for longer than official restrictions on consumers, however the duration of such a period of weakness is inherently uncertain. The overwhelming majority of China's production of goods and services is consumed domestically, with the country's Input-Output tables for 2017 (the most recent available) showing that 46% of China's output was consumed by households or government and a further 37% was accounted for by fixed capital formation and inventory build. Just 17% of China's production was exported in 2017, limiting the potential for manufacturers to offset domestic weakness in demand.

### CHINA'S EXPORTS BY REGION

#### Asia the main destination for exports



Source: CEIC, NAB Economics

While the United States is China's largest individual export market, the Asian region dwarfs North America and Europe as an export destination – accounting for almost 49% of China's exports in 2019. Within this large group, ten key markets in East Asia (Hong Kong, Japan, South Korea, Vietnam, Taiwan,

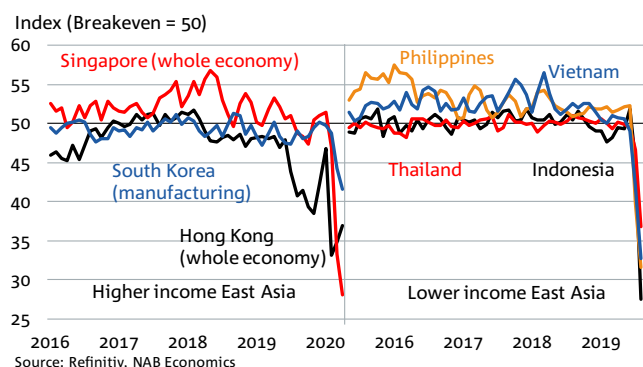
Singapore, Malaysia, Indonesia, Thailand and the Philippines) accounted for 37% of the total – although it is important to note that a sizeable share of exports to Hong Kong are re-exported to other markets in Asia and elsewhere.

In the first three months of 2020, the total value of China’s exports fell by 13.4% yoy to US\$477 billion. The largest falls by region were in exports to North America (down by 25% yoy) and Europe (down by 16.9% yoy), while exports to Asia declined by just 8.5% yoy. In part this may reflect the differing timings and scale of countermeasures introduced in different regions.

## ECONOMIC CONDITIONS IN EAST ASIA REMAIN NEGATIVE

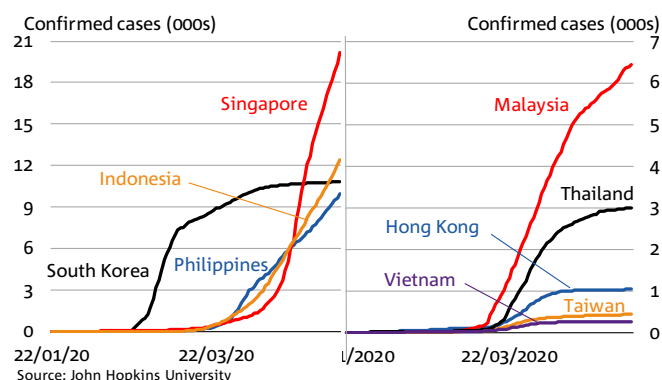
PMI surveys provide more up-to-date indicators of conditions than lagging economic data. PMI surveys for April were widely negative across the region – particularly in Indonesia, Singapore and Malaysia. It is worth noting that there were sharp downturns in survey results for both higher income and lower income economies in the region – highlighting China’s central position in supply chains. The economic impact in the region initially came via these trade channels, but then from these countries implementing their own containment measures to control the spread of COVID-19.

## EAST ASIAN MANUFACTURING PMIS Countermeasures have hit the region



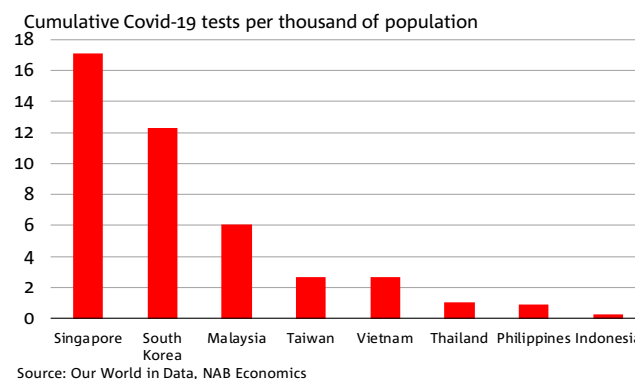
South Korea was one of the first countries outside China to record a COVID-19 outbreak, initially linked to a church in the city of Daegu and a hospital in Cheongdo, before subsequently spreading further. The country was quick to implement travel restrictions, closures of public places and sporting events, encourage heightened hygiene measures and mass testing for the virus, which appears to have slowed the spread after an initial spike in confirmed cases.

## CONFIRMED COVID-19 CASES Mixed trends across East Asia



Both Singapore and Indonesia have overtaken South Korea in the number of confirmed cases, while other countries in the region have fewer. It is worth remembering that population sizes vary considerably and that testing rates have also varied widely – with Singapore and South Korea having a far higher testing rate per capita. This suggests a higher risk of unreported COVID-19 cases in other East Asian economies, which could delay the recovery from the virus and containment-led downturn currently underway.

## TESTING RATES PER CAPITA Singapore and South Korea lead the way



It is far too early to know when the Asian region will be able to return to normal activity. The relatively slow pace of recovery in China – given consumer and business caution – along with the lockdown in Harbin in late April (that highlights the risk of second wave infections) suggests that the recovery from the downturn could be slow.

Further risk, particularly for the lower income East Asian economies, exists in the form of capital outflows. According to estimates by the International Institute of Finance, there was a record outflow from emerging equity markets and the largest outflow since the Global Financial Crisis in debt markets in March 2020. There was a modest recovery in April, however equity inflows were concentrated in China, with other emerging markets continuing to record outflows. Asia accounted for the largest share of the

outflows in March and these threaten to tighten financial conditions across the region, counter to monetary authority attempts to support their individual economies and position them for recovery. This could negatively impact demand for Chinese exports.

## ASIA'S INTERLINKED SUPPLY CHAINS

Widespread factory closures in China from late January through early March impacted the supply of intermediate and finished goods across Asia. Reports highlighted disruptions across a wide range of industrial sectors – including higher value added auto manufacturing in South Korea and lower value added clothing and footwear manufacturing in Cambodia and Vietnam – due to the lack of manufactured inputs from China. Supply chain development over two decades had built a reliance on China for many producers, with a lack of alternative supply from other countries. In 2018, China was the world's second largest importer (behind the United States) and the largest exporter.

These supply chains suffered significant disruption in 2019, as the US-China trade war limited the flow of goods and services between the two countries, with spill over impact into East Asia. The signing of the Phase One trade deal between the two countries in January – prior to the COVID-19 outbreak – had increased hopes of a normalisation to global trade. However, the relationship between the two countries has deteriorated recently. In early May President Trump flagging the re-introduction of tariffs rolled back as part of the trade deal.

Counter-measures to slow the spread of COVID-19 in other East Asian economies are impacting their manufacturing output (according to PMI surveys), which is likely to limit the supply of inputs to China's manufacturing sector in the short term. The duration and scale of this supply constraint – like most other COVID-19 related factors – is uncertain, albeit Chinese manufacturers may be able to find alternative sourcing.

An additional supply side constraint for Chinese manufacturers relates to the current restrictions on global transportation. Various higher value added industries take advantage of foreign engineering expertise, particularly when installing new production lines, with Chinese producers currently unable to access these resources.

## CONCLUSION

Despite the efforts of Chinese authorities to resume normal economic activity, the path to recovery has been constrained by consumer caution and weakness in export markets. Prolonged lockdowns, second waves of infections and hesitant consumers could mean persistent weakness across East Asia – including China – increasing the likelihood of a slower U-shaped recovery, rather than the hoped for faster V-shaped turnaround.

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