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CHINA:
IN SEARCH OF LOST DEMAND

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China's GDP growth collapsed to -6.8% y/y in Q1 2020, down from +6.0% in the previous quarter (see Figure 1). This is the first contraction since quarterly GDP started to be published, in 1992 and worse than consensus expectations (-6.0%), though better than our forecast (-9.0%).

March data suggest the resumption of activity is gradually underway, but should be more difficult for consumer- and trade-related businesses. Industrial production surprised positively, contracting by just -1.1% y/y in March, after -13.5% in January-February. Fixed asset investment contracted by a slower pace as well (-16.1% y/y ytd in March from -24.5%), supported by infrastructure spending. Retail sales disappointed, declining by -15.8% y/y (vs. -20.5% in January-February and consensus at -10%).

Looking forward, the risk of second waves of infections could drag out the recovery. There have been very few new confirmed domestic cases of Covid-19 for about a month, but the risk now comes from imported cases and asymptomatic cases. On 1 April, mobility started to be controlled again in the Jia county in the Henan province (c.600,000 inhabitants). There is anecdotal evidence that confinement measures are being relaxed very prudently (or sometimes even tightened) in some cities.

We now expect Chinese economic activity to fully resume only in June, delayed due to pressures on both domestic and external demand., This is two months later than our previous assessment (see here). High frequency data (see Figures 2 to 4) suggest that production is still 15-20% below usual levels, and it is even lower for consumption (e.g. durable goods spending probably at c.65% of normal levels). The recovery seems to have stalled in April, probably as a result of lower external demand due to confinement in China's trading partners. Social distancing and a hit to disposable income in Q1 should also put a lid on private consumption domestically. While Chinese data generally surprised positively in March, there could be a risk of disappointments in the coming few months.

The recovery of the Chinese economy should become more visible in H2, helped by an accommodative policy stance, particularly on the fiscal side. We expect supportive fiscal measures to account for 6.5% of GDP (see Figure 5) in 2020. Fiscal stimulus is mostly composed of public investment (in infrastructure, health, green policies, technology and other projects) and corporate tax and fees cuts. On the monetary side, the PBOC has injected liquidity worth 2.8% of nominal GDP, with a particular focus on SMEs. We expect further injections worth at least 1% of GDP. Credit conditions should also be eased further for companies, with the loan prime

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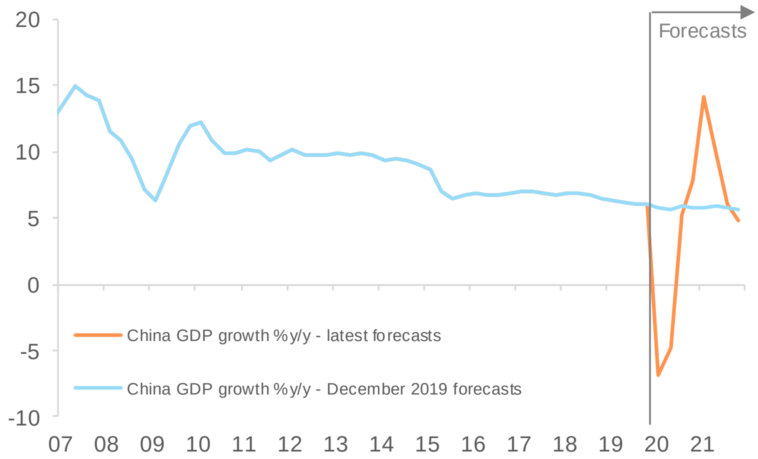
rate lowered by a further 30bp (after 10bp since the beginning of the year).

All in all, we are revising down our forecast for China's GDP growth in 2020 to +1.8%, from +4.0% previously (after +6.1% in 2019). The U-shaped recovery going into 2021 should lead to GDP growth reaching +8.5% in 2021 (up from our previous forecast of +5.8%).

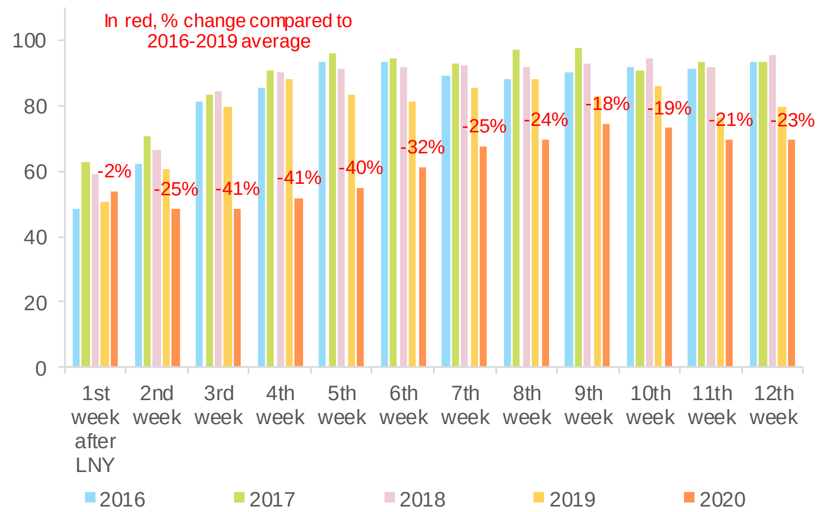
What could go wrong? The main factors that could trigger further downside revisions to our forecasts are 1/ renewed outbreaks of the Covid-19 pandemic (in China and/or in its trading partners), 2/ inefficient policy transmission that does not ease financial conditions for economic actors most in need and 3/ the policy stance not being eased sufficiently or being tightened too early, as Chinese authorities are wary of the country's structural vulnerabilities.

Figure 1 – China GDP growth %y/y, quarterly



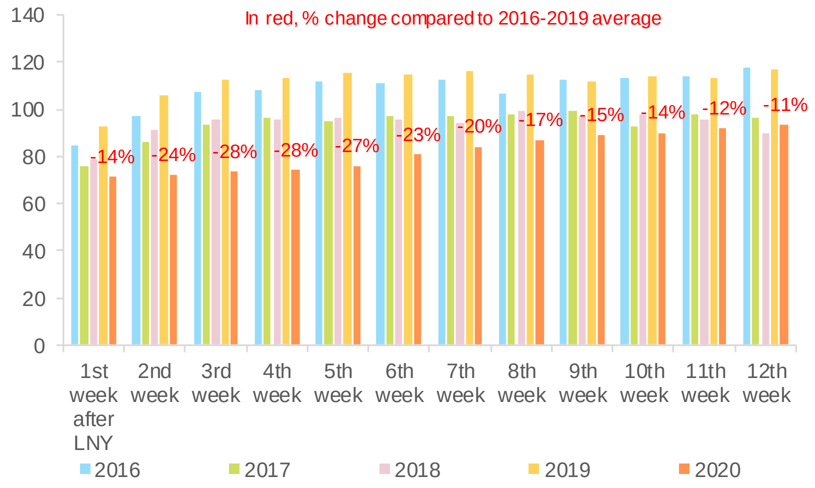
Source: National Bureau of Statistics of China, Euler Hermes, Allianz Research

Figure 2 – China coal consumption at the major power generation groups, base 100 = 30 days before Lunar New Year



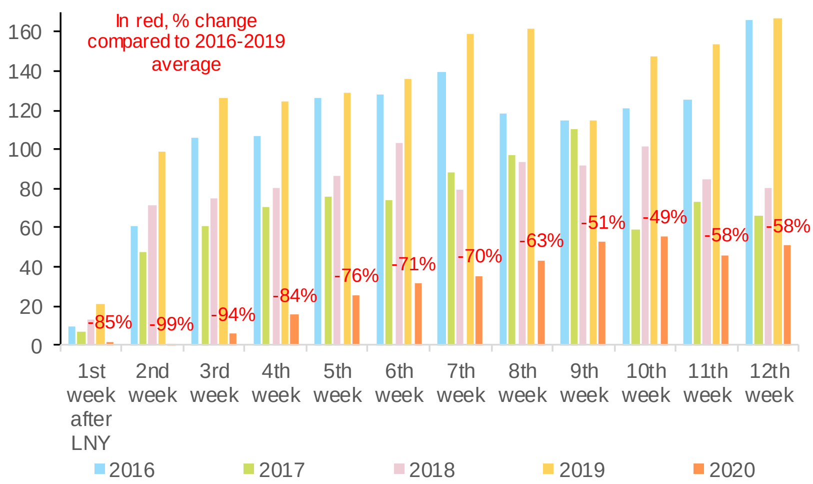
Source: Wind, Euler Hermes, Allianz Research

Figure 3 – China traffic congestion index (100 main cities), base 100 = 30 days before Lunar New Year



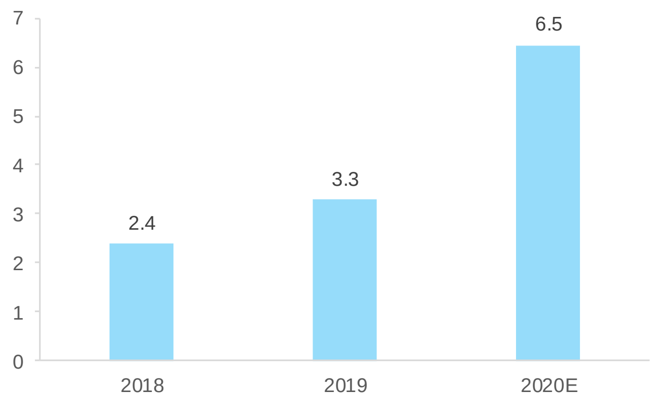
Source: Wind, Euler Hermes, Allianz Research

Figure 4 – China property transaction volume (30 main cities), base 100 = 30 days before Lunar New Year



Source: Wind, Euler Hermes, Allianz Research

Figure 5 – China fiscal stimulus package size (% of GDP)



Source: Euler Hermes, Allianz Research

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