

## China: Covid-19 adds pressure to exports

Domestically-driven growth has been faster than foreign-driven exports and manufacturing. It seems that occasional Covid-19 clusters have not disrupted domestic demand too much. As such, we have revised our PBoC policy forecast to no more rate cuts for the rest of 2020



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### Covid-19 creates hot and cold of the Chinese economy

The Chinese economy shows domestically-driven growth, but an external demand drag.

Domestically, the government has continued to promote more research and development on advanced technology so that it can achieve self-reliance in the most advanced semiconductor chips in the coming years. Most of the growth we see is around this sector.

Some stimulus money has flowed into the real estate market as shown by the increase in land sales fees. Though this is not ideal, it shows that there are still people in good financial shape. They are willing to invest and spend, which at least provides some short-term support for the economy. In the longer-run, this means that Covid-19 has widened the wealth gap in China. As not all the stimulus money has found its way into infrastructure projects, we see little support from infrastructure to economic growth.

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Although there are still some occasional Covid-19 clusters in China, they have quickly been brought under control by semi-lockdown practices. As such, those cluster cases have not disrupted the economy. We see that recovery in consumption continues albeit slowly.

But when it comes to foreign demand-related industries, the economic picture is different. Covid-19 cases have increased overseas, and export orders continued to shrink on a monthly basis in June as shown by the PMI index. This means that China's exports and export-related manufacturing and service activities (e.g port-services) will continue to be under pressure.

The pain point of the economy are small manufacturers, and they usually produce for small exporters. These two groups are expected to face an increased chance of a shutdown. Even though the People's Bank of China set up an innovative re-lending programme for SMEs, they might not be willing to borrow if they can't see orders coming.

## **What we expect from fiscal and monetary policy in 2H20**

The central government will continue to put a lot of focus on stimulating the technology industry in the second half of the year. This is good for long-term growth.

But technology advancement takes time, so this is not a strategy for short-term growth. We expect that infrastructure projects will be increasingly important in supporting the economy in the second half.

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We are sceptical on further broad-based monetary easing. The government has stated that a cut in the required reserve ratio (RRR) could help the economic recovery. But there has been no action from the central bank since the government made that statement. There is a chance that the central bank believes that liquidity is ample, as the front-end of the interest rate curve is already low. The PBoC has cut re-lending rates by 25bp for small firms and the agricultural sector, and made a similar cut in the rediscount rate. These actions are not expected to move the overall interest curve. And therefore further cuts should only be for a targeted purpose.

3M SHIBOR has fallen to around 2% at the end of June (even though liquidity is usually tight at half-year end, the interest rate has not jumped a lot) from 3% at the end of 2019. And it is well known that the PBoC does not like ultra-low interest rates.

As such, we have revised our PBoC policy forecast to no more rate cuts for the rest of 2020.

This may change if there is a large outbreak of Covid-19 in China or a sustained outbreak in the rest of the world that hurts the economy - similar to the situation back in February/March this year.

Our GDP growth forecast remains unchanged at -1.5% for 2020.

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