

China: activity data suggests long recession

China's industrial production, retail sales and fixed asset investment growth only show a slow recovery. With very high unemployment around the world, weak external demand will continue to put pressure on China's manufacturing and export sectors, and therefore jobs



Donald Trump, Xi Jinping. President Donald Trump, right, with China's President Xi Jinping, left

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Data painting a small gradual recovery picture

Overall, this set of data shows only small and gradual improvements in economic activity, which could upset markets as China is seen as the "first out" economy from Covid-19.

The rebound of industrial production in April (+3.9%YoY in April from -1.1% in March) was mainly due to low base effects and some recovery of factory output, especially in industrial robots (+26.6%YoY) and integrated circuits (+29.2%YoY), which should be the result of production for 5G infrastructure as the production of smartphones tanked. It is possible that April was the month that factories began to face export order withdrawals from overseas buyers. This will become more obvious in May as global demand weakens in response to high unemployment in the US, UK and European economies.

Retail sales fell 7.5%YoY, less than March's -15.8%. The good news was that sales of cosmetics grew 3.5%YoY and telecommunications goods grew 12.2%YoY. But this improvement could

change to a slower pace or even revert to a deeper contraction because job security and wage cuts are now in play. These figures could, therefore, represent the unleashing of pent-up demand following the relaxation of the lockdown. Continued strict social distancing resulted in a fall in sales of 27.9%YoY for catering. The unemployment level domestically is high, which will hurt consumption, especially for low-income groups. Sales of clothing fell 18.5%YoY. As Covid-19 begins to subside, retail sales data are highlighting a widening of China's wealth gap.

In the past, China depended on fixed-asset investment to boost the economy in bad times. This time is a bit different. The push for growth is not as hard as in previous crises as there was no jump in investments from contraction to positive growth. Fixed asset investment, which shrank 10.3%YoY YTD in April, came in slightly better than the -16.1% result for March. Most of the investment came from government projects (-6.9%YoY YTD). Private investment experienced a deeper contraction (-13.3%YoY YTD).

But more challenges ahead

There is increasing friction between the US and China. US President Trump has openly contemplated cutting ties with China. Though we cannot be certain what this exactly means in terms of economic and political policies towards China this should be negative for the two economies going forward.

The technology war has not been stopped by Covid-19, and trade war risks seem to be looming again.

Moreover, Covid-19 could be spreading in clusters around the world now that the first round of infection has not been conclusively eradicated.

In general, these imply unemployment levels in major countries remaining very high, and demand from these economies should, therefore, be weaker than during previous crises.

Specifically, this will hurt China's export and manufacturing sectors as well as related sectors such as packaging, freight, port and shipping services. Even if some factories could turn to the domestic market, they may not see demand returning to pre-Covid-19 levels but remaining weak. Factories will lay off more workers, weighing further on domestic consumption.

Expect more proactive policies to stabilise jobs

In the Two Sessions' report due to be announced on 22 May, the Chinese government is expected to reaffirm the "Six-Stability" idea and will put stabilising jobs at the top of the six, which also includes stability in finance, foreign trade, foreign investment, domestic investment, and market expectations,

So far, there are many local subsidies for wages and factories to keep hiring stable. But it is obvious that this is not going to be enough, with our estimate of the unemployment rate rising to 10%. More proactive policies are expected from the Two Sessions.

Forecasts

For the time being, we are keeping our GDP forecast at -3.1 for 2Q20 and -1.5% for the whole of 2020, and USD/CNY at 6.90 by end of 2020.

We may change our forecasts according to developments in the China-US relationship and the Two Sessions policy announcements.

Author

Iris Pang

Chief Economist, Greater China

iris.pang@asia.ing.com