

## China: Terrible GDP contraction means a fat U recovery

China's GDP went into deep contraction in 1Q20, and signs of a recovery in activity are mixed. As long as strict social distancing measures are in place, we think China will struggle to recover quickly



### Economy contraction worse than 1967

GDP contracted 6.8% year-on-year in 1Q20, the last time we saw such a big contraction was back in 1967 when China saw the economy shrink -5.8% during the Cultural Revolution, [according to data from the World Bank](#). The contraction this time is a result of city lockdowns and strict social distancing measures but the comparison provides us with a sense of how big an impact Covid-19 has had.

### Investment was up in March it can't be described as a recovery

Fixed asset investments contracted 16.1%YoY in 1Q20 but rose 6.05%MoM in March.

According to the National Bureau of Statistics, there were many items that experienced a slower contraction in Jan-Mar compared to in Jan-Feb. That means there are signs of some growth in investment in March. But it is still too soon to gauge the effectiveness of stimulus measures on investment.

The central government is now pushing the "New infra" plan, which currently consists of 5G infrastructure, big-data centres, AI, Industrial internet of things, ultra-high voltage connectors and e-vehicle chargers. The contents of the plan are quite fluid and more items have been added to it since January.

But we believe the speed of putting money into projects and turning this into measurable production will take much longer than it would do without social distancing in place. In short, recovery will be a long road.

## Factories were the least affected

Industrial production shrank 8.4%YoY in 1Q20 but shows signs of heading back to recovery in March as the shrinkage narrowed to 1.1%YoY during that month.

Automobiles and related parts were heavily impacted by the lockdown. Automobile production shrank 43%YoY and new energy cars fell 43.9%YoY.

This positive note was mainly a result of the need to fight against Covid-19, e.g. non-woven textiles (masks and protective wear) +6.1%YoY, medicines +4.5%YoY. Other positive notes include the push for the "New Infra" projects by the central government. Computation and telecommunication rose 9.9%YoY and robot production also increased at 12.9%YoY in March.

Exports are expected to be dismal due to the Covid-19 situation in Europe and the US. This could last until June-July.

## Retail sales were the most hit

Retail sales in March fell 15.8%YoY after falling 19.0%YoY in Jan-Feb. Retail sales show some improvement in terms of the variety of spending. It was not just food and medicine as in Jan-Feb, but also telecommunication equipment (+6.5%YoY), which is most likely purchases of smartphones.

But there was still a deep contraction in many retail sales items, e.g. clothing (-34.8%YoY), furniture (-22.7%YoY) and automobiles (-18.4%YoY).

As mentioned earlier, as long as there are strict social distancing measures, the recovery of activity will be very slow, and this will be reflected in consumption.

## Policy expectation

Monetary easing and fiscal stimulus will certainly continue.

We expect a 20bp cut in the 1Y Loan Prime Rate on 20 April. Apart from that, there will be more targeted RRR cuts, which should focus on inclusive finance so that SMEs, which are employers of many workers, can get loans from banks.

Another policy expectation is the combination of monetary and fiscal policy of government guarantee loans for SMEs if banks continue to be reluctant to lend to SMEs.

To further stabilise the jobs market, the central government will push harder on the "New infra" plan, to make sure that the local government special bonds issued so far this year at CNY1.1 trillion

can be put into projects as soon as possible. But the difficulty is still that even getting enough capital, the projects need to run smoothly without strict social distancing measures, which we don't think will be relaxed any time soon.

### **Revision of GDP forecasts**

We have downgraded China' GDP growth further to -3.1%YoY in 2Q20, -0.5%YoY in 3Q20 and 4.5%YoY in 4Q20. 2020 full-year growth is projected at -1.5%.

USD/CNY has been affected by the changes of cases and death tolls of Covid-19 globally. We are revising the yuan to depreciate less than in our previous forecasts to USD/CNY at 7.15, 7.0 and 6.9 by end of 2Q, 3Q and 4Q20, respectively.