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China Economy in 1Q

Simultaneous freefall, unsynchronized recovery

China's GDP shrank 6.8% YoY in 1Q, within market expectation and was better than IMF's forecast of -8% on 15 Apr. After a broad freefall in Jan-Feb, the economy regained some strength in Mar. However, the rebound was unsynchronized and uneven across sectors and industries. While supply recovery was on track, demand may further be inflicted by the adverse feedback loop on employment and income growth. Future trajectory of growth will hinge on domestic consumption recovery as well as pandemic control in global market.

- **Industrial production picked up fast in Mar,** narrowing YoY declined to 1.1% from 15.7% in Jan-Feb. High-tech and high-end manufacturing retrieved pre-pandemic pace of growth in Mar. Automobile output was weak in 1Q20, but is likely to strengthen in 2Q thanks to improving downstream sales in Apr.
- **FAI – rigorous infrastructure, stable real estate and grim manufacturing. 1)** Real estate was the most resilient component of FAI in 1Q (-7.7% YoY) and is likely to maintain stable growth even without massive stimulus. **2)** Infrastructure investment declined 19.7% in 1Q but construction resumed quickly since Mar and we believe growth will pick up faster in 2Q on back of government support. **3)** Manufacturing FAI declined 25.2% in 1Q and future rebound will likely be inflicted by uncertainties in global markets.
- **Consumption recovery remained lackluster.** Retail sales value declined 19.0% YoY in 1Q20 (-20.5% in Jan-Feb, -15.8% in Mar). For most categories of goods and services, YoY decline remained at double-digit rate in Mar and recorded only marginal improvement. Decline in catering even widened in Mar to 46.8% YoY. We think consumption recovery will be shallower than investment primarily because economic downturns weigh on income growth of households and there are consumer behavior shifts after COVID-19.
- **Policy support: targeted + broad.** In terms of investment, we expect policy stimulus to be targeted towards certain industries (high-tech manufacturing, infrastructure, those related to people's livelihood). For consumption, policy support tends to be more broad-based, coming up with subsidies and coupons across the nation and boosting particularly big-ticket items, catering, travel, cultural recreation services, etc. Policy stimulus shall also aim to ensure that SMEs and low-income population are not left behind.
- **Outlook**. In 1Q, it was primarily supply disturbance due to lockdowns that lead to economic downturn. Since 2Q, however, negatives in the demand side have begun to loop in and are likely to sustain. In base case scenario, we forecast GDP to advance 3.0%/6.5%/7.0% in 2Q/3Q/4Q, respectively, which yields annual GDP growth of 2.8%. In the bull case, more rigorous recovery in 2Q-4Q would peg annual growth at 3.5% YoY.

Data Summary

YoY growth (%)	Dec-19	2019A	Jan-Feb 2020	Mar-20	1Q20
Industrial value-added	6.9	5.7	-13.5	-1.1	-8.4
Fixed asset investment, YTD	5.4	5.4	-24.5	-16.1	-16.1
- **Manufacturing FAI**	3.1	3.1	-31.5	-25.2	-25.2
- **Real estate FAI**	9.9	9.9	-16.3	-7.7	-7.7
- **Infrastructure FAI**	3.8	3.8	-31.5	-19.7	-19.7
Retail sales value	8.0	8.0	-20.5	-15.8	-19.0

Source: NBS, CMBIS

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Contents

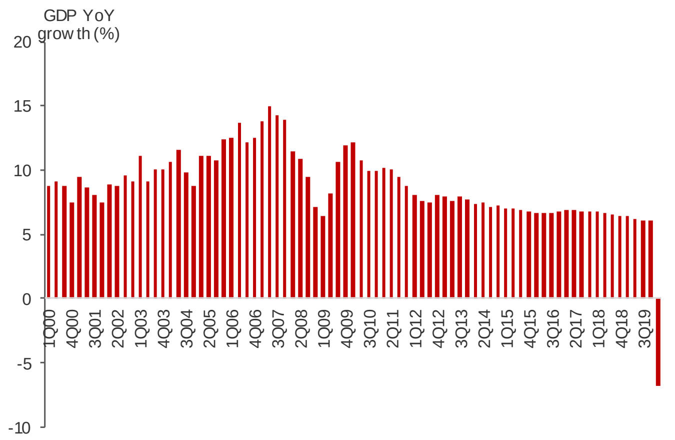
GDP

1Q real GDP declined 6.8%

The unprecedented decline came in largely within market expectation and better than IMF's forecast of -8% in its Apr 15 *World Economic Outlook*. Value-added of the primary/secondary/tertiary sector declined 3.2%/9.6%/5.2%, respectively.

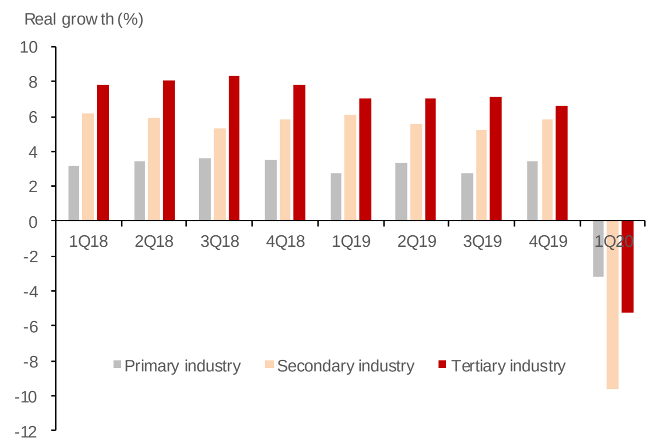
Industry-wise, manufacturing output declined 10.2% YoY in 1Q20 and construction sector output retreated 17.5%. In the service sector, hotel & restaurant suffered the most, posting 35.3% YoY decline in 1Q20, followed by wholesale & retail (-17.8%), transportation & logistics (-14.0%), leasing & business services (-9.4%). The financial and real estate industry posted +6.0%/-6.1% YoY growth, respectively.

Figure 1: China recorded unprecedented 6.8% YoY decline in real GDP growth in 1Q20



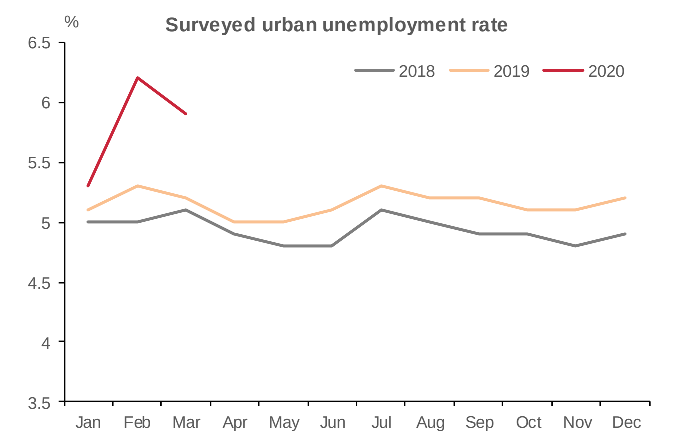
Source: NBS, Wind, CMBIS

Figure 2: Real growth by primary/secondary/tertiary industry



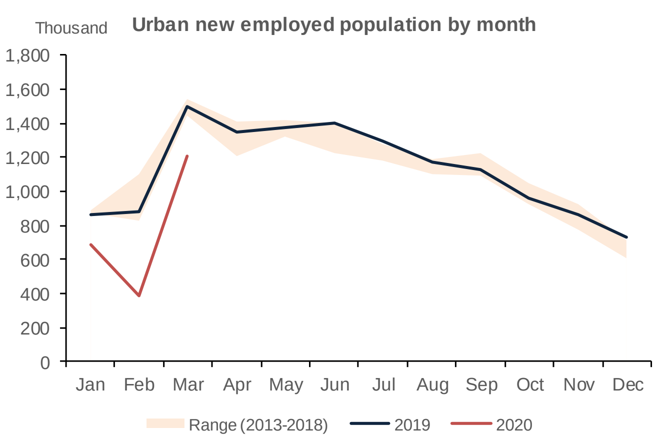
Source: NBS, Wind, CMBIS

Figure 3: Surveyed employment rate was 5.9% in Mar



Source: NBS, Wind, CMBIS

Figure 4: In 1Q, 2.29 million were added to employed population in urban areas



Source: NBS, Wind, CMBIS

Industrial activities picked up faster

Decline narrowed significantly in Mar to 1.1%

Industrial value-added of the above-limit sample declined 8.4% YoY in 1Q. However, rebound was robust in Mar, narrowing YoY decline to 1.1% from 15.7% in Jan-Feb. The three main sectors, mining, manufacturing and utilities supply posted +4.2%/-1.8%/-1.6% YoY growth in Mar, which marked great improvement from -6.5%/-15.7%/-7.1% in Jan-Feb.

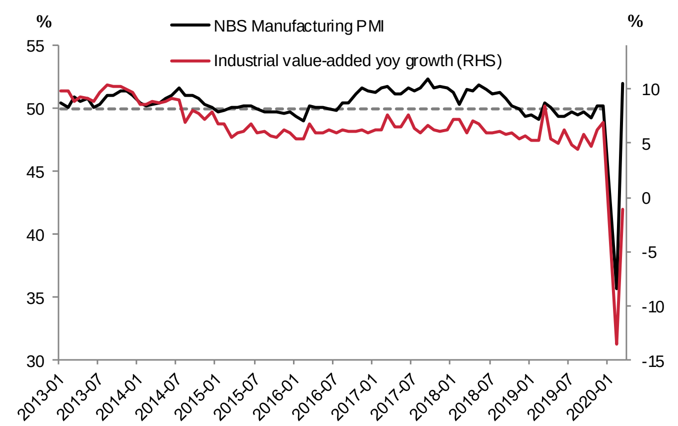
Manufacturing resumption on track

Most high frequency monitors (including coal consumption of six power plants, operating rate of blast furnace, etc.) suggested that work resumption rate has achieved to nearly 90% so far. According to the NBS, work resumption rate had approached 100% for large firms (the above-scale sample) and >80% for medium- and small-sized firms by the end of Mar.

High-tech manufacturing has regained YoY growth of +8.9% in Mar,

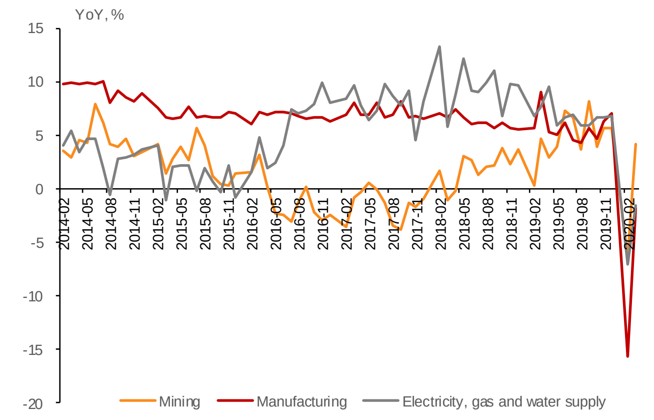
which was comparable to pre-pandemic levels. The pharmaceutical, electronics industries recorded ~10% YoY growth in Mar as production resumed and demand remained strong. Figure 10 exhibited the output of selected high-tech products, which showed that integrated circuits have maintained pretty good growth momentum despite COVID-19. Recovery in the automobile industry, however, remained lackluster in Mar because of weak downstream sales and supply chain disruptions given an indispensable role played by Hubei province.

Figure 5: Decline of Industrial value-added narrowed to 1.8% in Mar from 15.7% in Jan-Feb



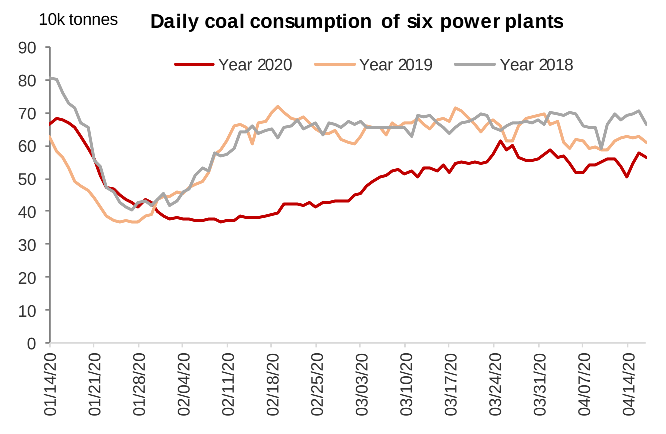
Source: NBS, Wind, CMBIS

Figure 6: Mining/manufacturing/utilities supply all rebounded in Mar



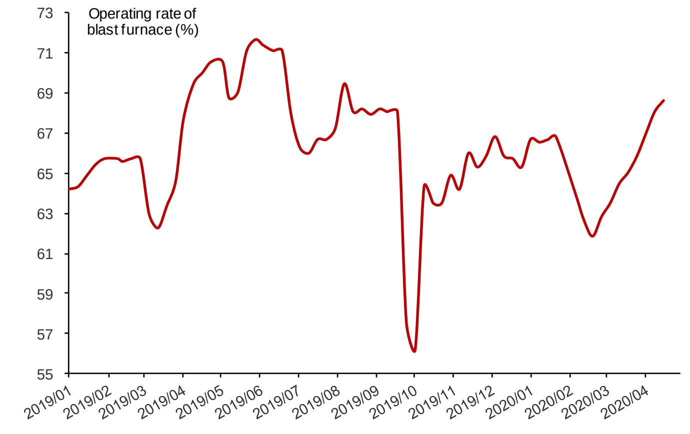
Source: NBS, Wind, CMBIS

Figure 7: Daily coal consumption of power plants reached >90% of 2019 level



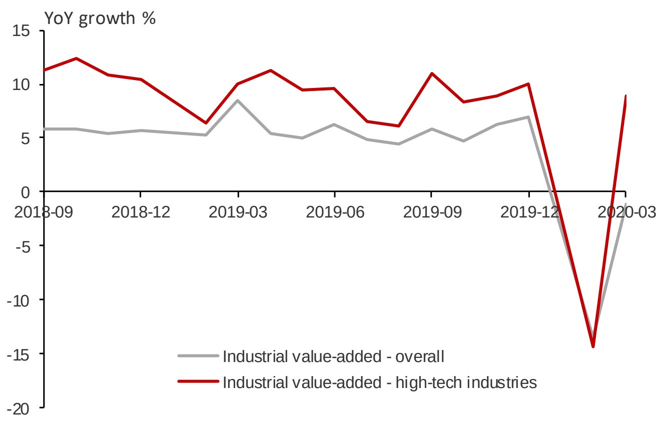
Source: NBS, Wind, CMBIS

Figure 8: Operating rate of blast furnace rose continuously since Mar



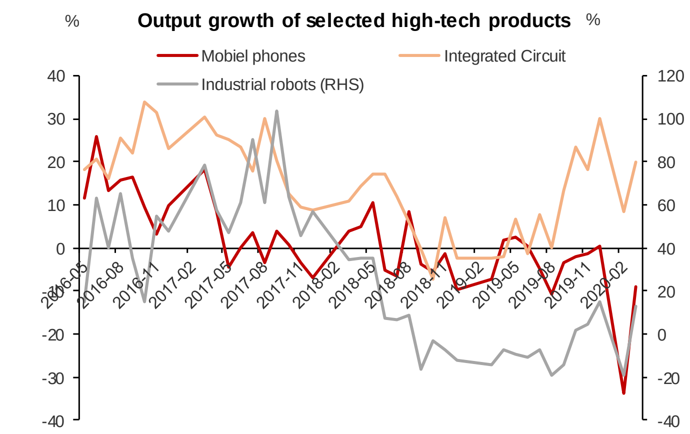
Source: NBS, Wind, CMBIS

Figure 9: High-tech manufacturing has resumed close to pre-pandemic growth in Mar



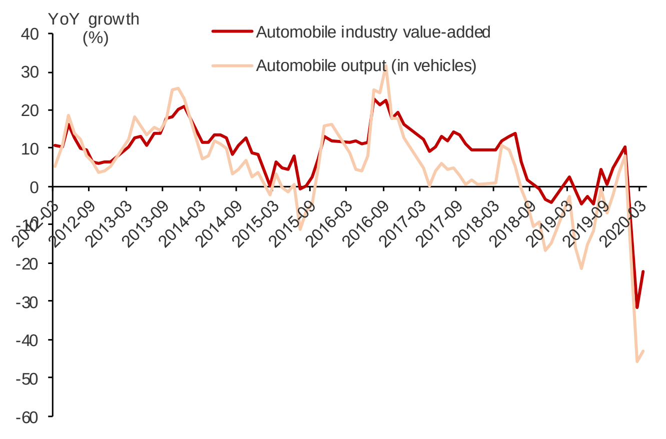
Source: NBS, CMBIS

Figure 10: Output growth of high-tech products – IC maintained strong momentum



Source: NBS, Wind, CMBIS

Figure 11: Automobile industry



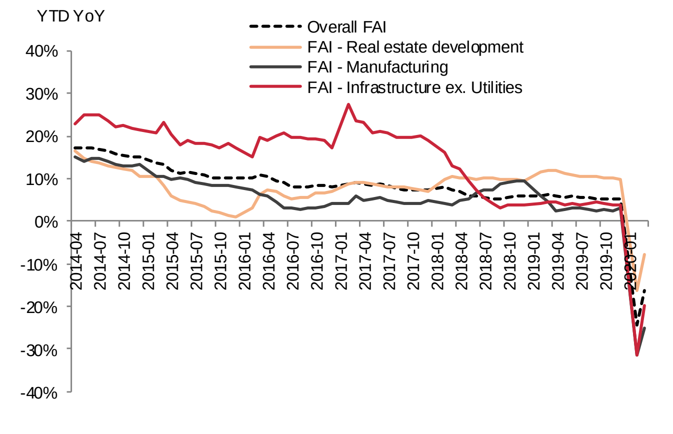
Source: NBS, Wind, CMBIS

FAI – promising infrastructure, resilient real estate, and grim manufacturing

Urban FAI declined 16.1% in 1Q, narrowing 8.4ppt from Jan-Feb

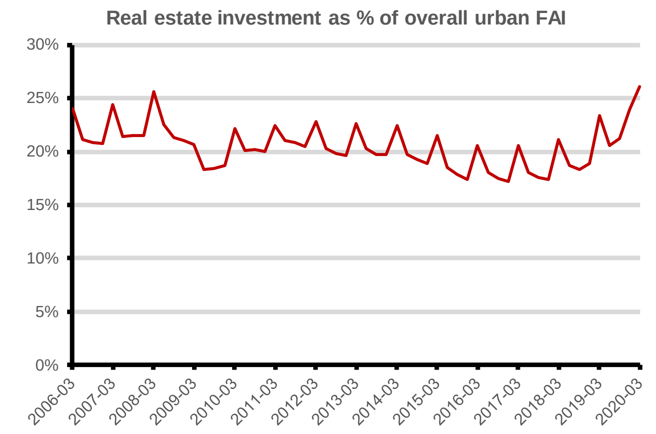
The three primary components all posted improvement in Mar. Real estate investment, in particular, returned to positive growth of +1.1% in Mar, narrowing 1Q decline to 7.7% YoY. Manufacturing FAI declined 25.2% in 1Q (vs. -31.5% in Jan-Feb), infrastructure FAI -19.7% (vs. -30.3% in Jan-Feb).

Figure 12: FAI by three major components



Source: NBS, Wind, CMBIS

Figure 13: Real estate investment accounted for 26.3% of overall urban FAI in 1Q20



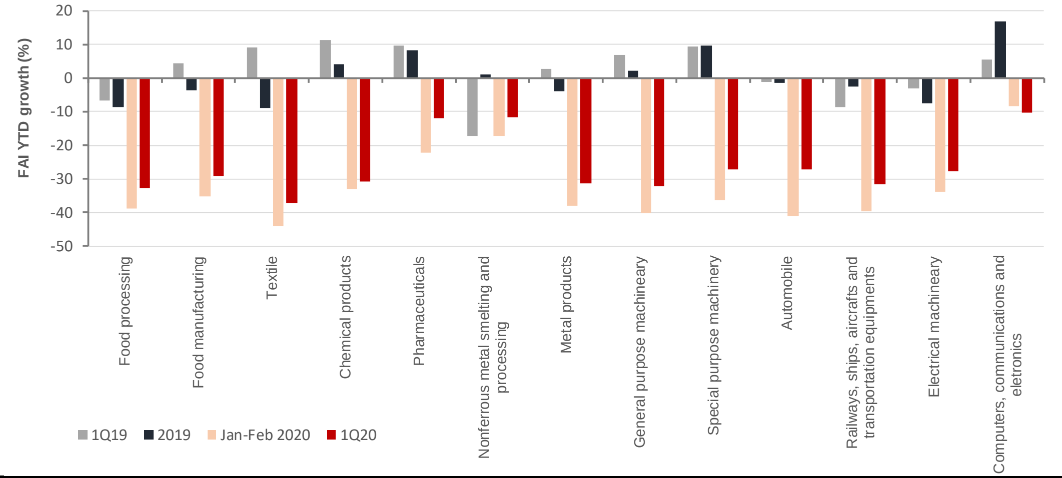
Source: NBS, Wind, CMBIS

Manufacturing investment: outlook remains grim due to export weakness

Manufacturing FAI declined 25.2% in 1Q20 (vs. -31.5% in Jan-Feb). The majority of subindustries narrowed their decline in Mar. Computer, communications and electronic equipment manufacturing was the exception, of which FAI declined 8.3% YoY in Jan-Feb and further enlarged to 10.2% in 1Q20.

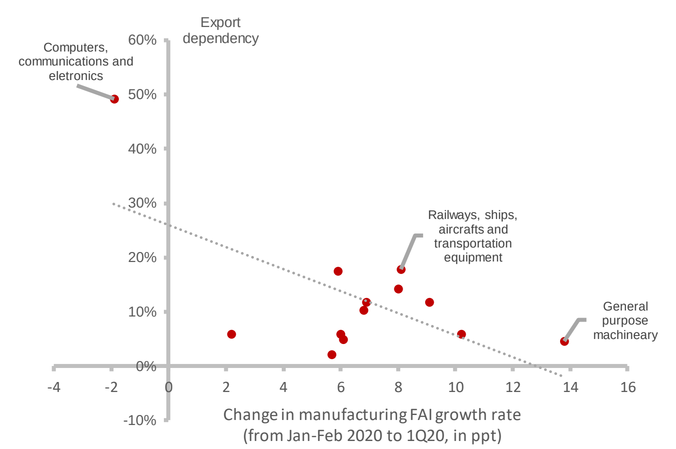
Bleak export could weigh on manufacturing FAI in the near term. We remain cautious on manufacturing FAI outlook in 2Q because of uncertainties in global market, bleak export orders and earnings pressures. Figure 15 plotted each selected subindustry's export dependency, measured by export delivery value as a share of revenue in 2018, against the magnitude of FAI rebound in Mar, measured by change in YTD FAI growth from Jan-Feb to 1Q20 (a positive ppt change would suggest speeding up or narrowing decline). We observe negative correlation between export dependence and manufacturing rebound in Mar, indicating that firms in export-oriented sectors (particularly computers, communications and electronics) are likely to pause making new investments until COVID-19 is better contained in the globe and demand picks up.

Figure 14: Manufacturing FAI growth by industry



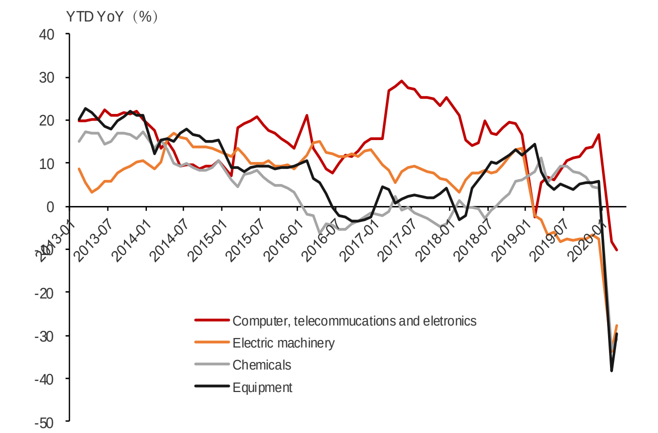
Source: NBS, Wind, CMBIS

Figure 15: More export-dependent industries are likely to experience milder rebound due to uncertainties in overseas markets



Source: NBS, Wind, CMBIS estimates

Figure 16: Manufacturing FAI YTD growth of selected subindustries



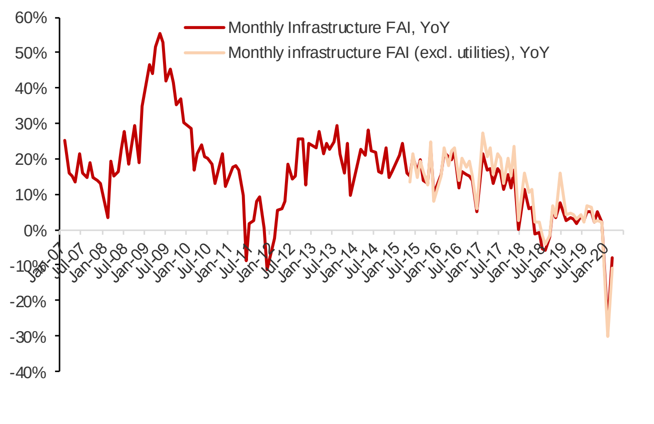
Source: NBS, Wind, CMBIS

Infrastructure investment: expect rigorous rebound

Infrastructure investment posted -19.7% YoY growth in 1Q20, narrowing decline by 11.8ppt from Jan-Feb. After the outbreak of COVID-19, resumption of construction activities lagged behind other industries because previous lockdowns and quarantine requirements had impeded migrant workers from returning to their workplaces. Since mid-Mar, work resumption rate climbed significantly for construction projects. High frequency monitors, such as, construction PMI and excavator usage, all suggested speedy recovery.

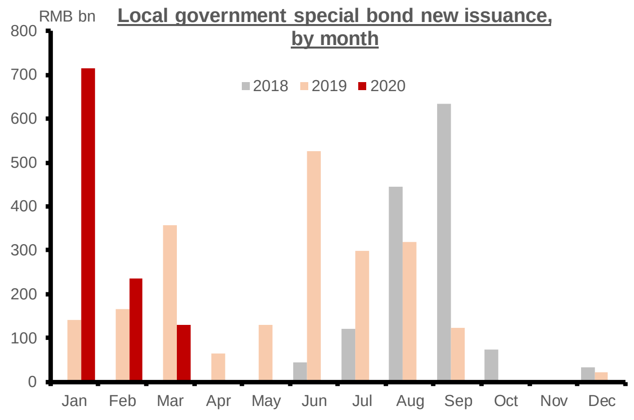
We believe infrastructure investment will stabilize quickly to positive growth on back of massive combined efforts, including fiscal, monetary boost and pushes from the NDRC to expedite project approval and execution. The new infrastructure initiatives, which include not only IT infrastructure layout (5G, datacenters, etc), but also those related to urban development, renovation and new energy, will become an indispensable driving force of infrastructure investment. (For more details please refer to our previous report "New infrastructure in China: What, why, how and where")

Figure 17: Infrastructure FAI growth was -30.3% in Jan-Feb and -11% in Mar



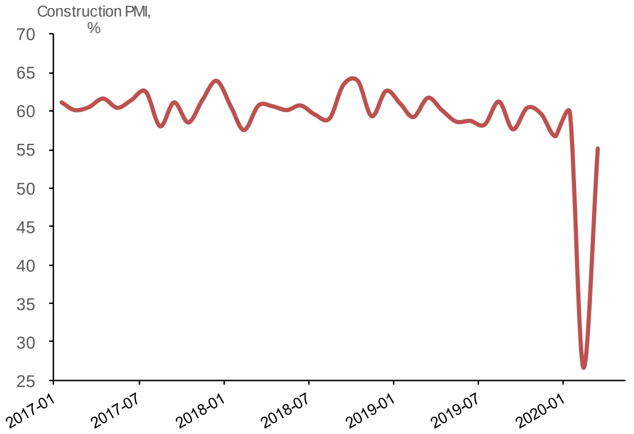
Source: NBS, Wind, CMBIS estimates

Figure 18: Local government special bond issuance amounted to RMB 1.08tn in 1Q20



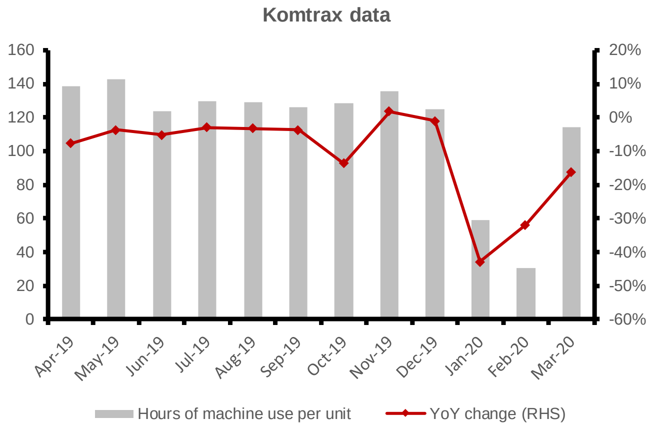
Source: Ministry of Finance, CMBIS

Figure 19: Construction PMI



Source: NBS, Wind, CMBIS

Figure 20: Excavator usage



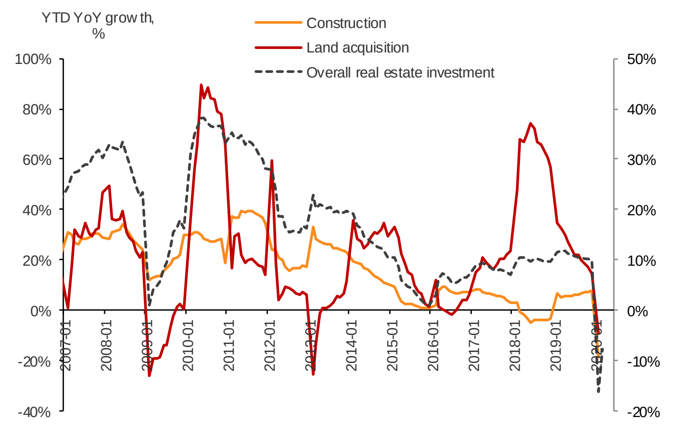
Source: Komatsu, CMBIS

Real estate investment showed resilience relative to other components

Real estate investment was among the most resilient component of FAI, which declined 7.7% in 1Q20 vs. 16.3% in Jan-Feb. Land acquisition expenditures rebounded in Mar, as well as construction expenditures.

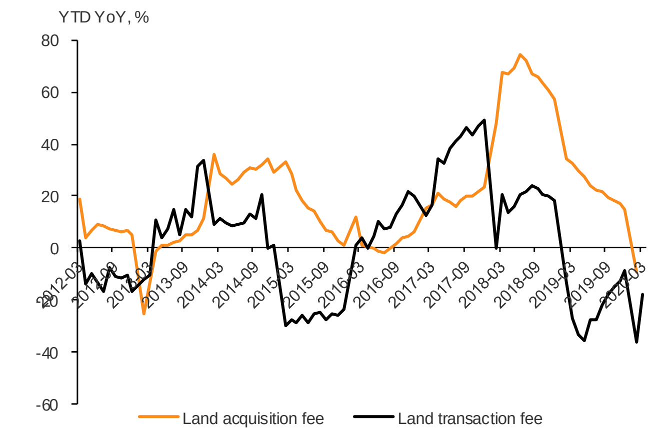
We think the housing market will gradually stabilize and come back to the pace before COVID-19. **We do not expect extra support to boost housing** as the Politburo meeting on 17 Apr reiterated the stance of "Housing should be for living in, not for speculation". **But we do think there is acceptable room for local policy maneuver whenever necessary** to ensure the housing market flows and all related parties (developers and banks) are sound.

Figure 21: Decomposition of real estate investment



Source: NBS, Wind, CMBIS

Figure 22: Land acquisition cost likely rebound



Source: NBS, Wind, CMBIS

Consumption – expect shallower rebound

Retail sales – modest rebound in Mar; catering in mire

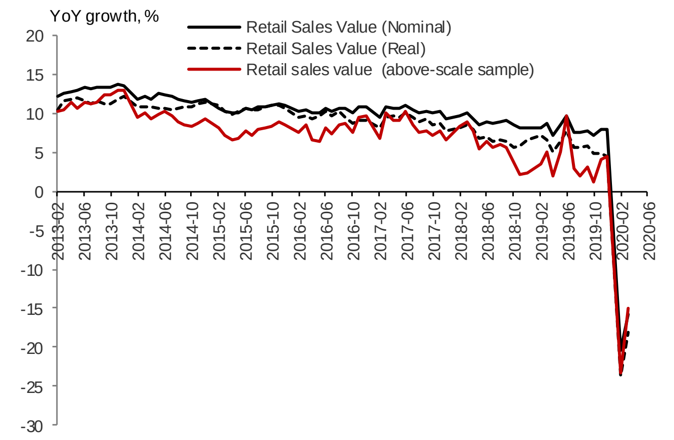
Retail sales value declined 19.0% YoY in 1Q20 (-17.7% ex. Cars and -20.5% for the above-scale sample). Decline in Mar was 15.8%, narrowing modestly by 4.7ppt from that in Jan-Feb. Catering declined 44.3% YoY in 1Q20, and the decline enlarged to 46.8% in Mar from 43.1% in Jan-Feb.

Most categories of goods documented double-digit declines to various extents. Exceptions include durable goods, such as oil, grain and food (+12.6% YoY in 1Q) and beverages (+4.1% YoY in 1Q), as well as medicines (+2.9% YoY in 1Q). Driven by work-from-home demand, office appliances posted +6.1% YoY growth in Mar. Rebound in Mar is more robust in regards to automobiles, building materials & decorations, furniture, etc, but weaker with respect to household appliances.

Consumption recovery faces difficulties

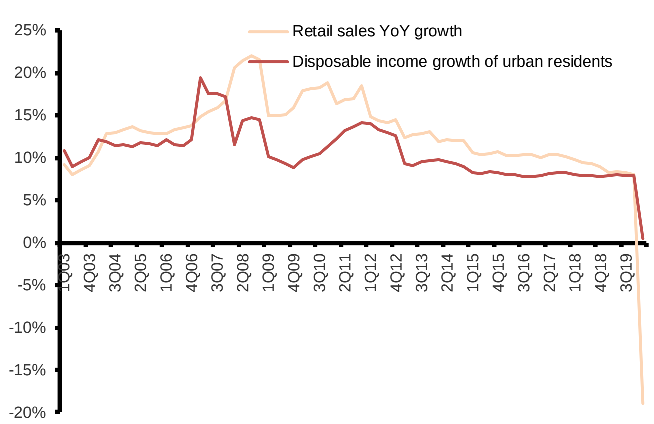
We do not expect "revengeful" expending in a large scale to compensate for previous losses. In fact, the adverse loop of economic downturn has inflicted on income growth, employment and household consumption. Hibernation during the pandemic outbreak has also profoundly changed consumer behavior in a lasting way.

Figure 23: Retail sales value YoY growth



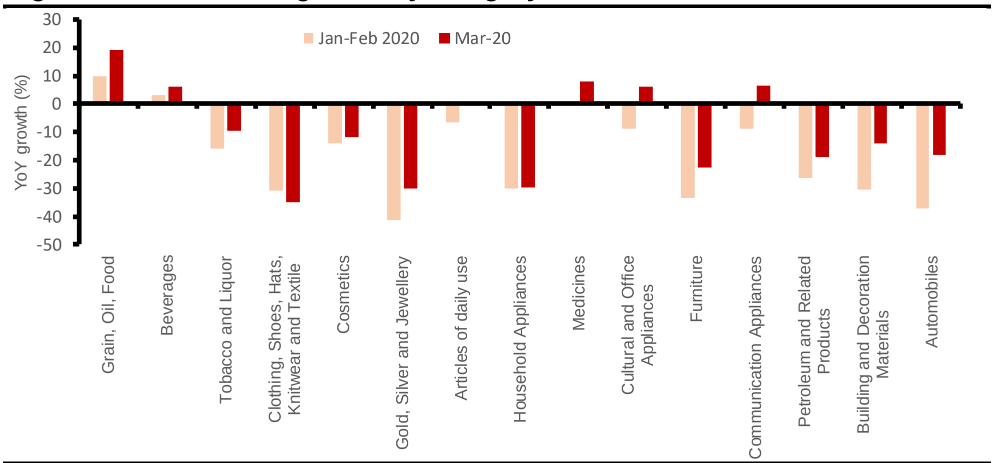
Source: NBS, Wind, CMBIS

Figure 24: Retail sales vs. disposable income



Source: NBS, Wind, CMBIS

Figure 25: Retail sales growth by category, Mar vs. Jan-Feb

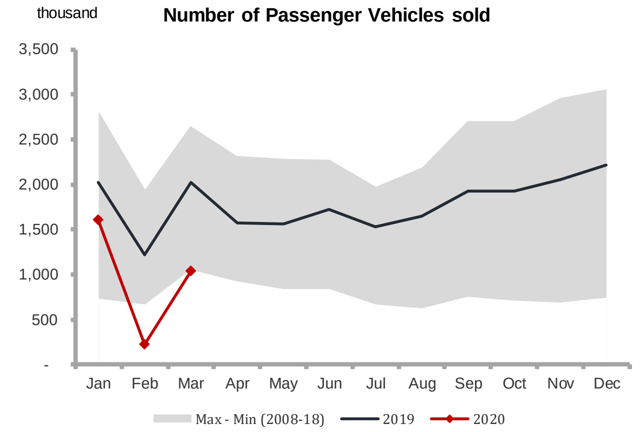


Source: NBS, Wind, CMBIS

Figure 26: Online channels grabbed a larger share of goods sales

Source: NBS, Wind, CMBIS

Figure 27: Sales of cars is showing initial signs of recovery



Source: NBS, Wind, CMBIS

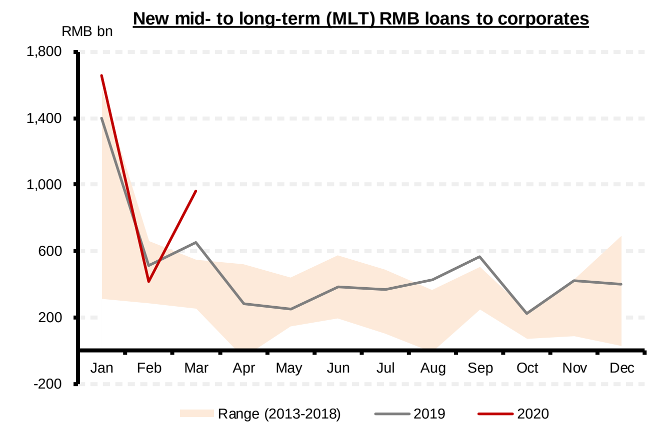
Policy support: targeted + broad

Targeted investment boost and broad-based consumption stimulus

In 2Q and onward, we expect a combination of targeted and broad policy support to revive the economy. In terms of investment, we think support is likely to be very targeted to stimulate both short-run performance and serve long-term purpose without creating extra burdens (asset bubbles, oversupply, inequality, etc). Key areas of focus would be infrastructure in a broader sense, high-tech and high-end manufacturing, and industries related to people’s livelihood (urban renovation, education and elderly care, etc). Policy support will also more intensely target SMEs and low-income population.

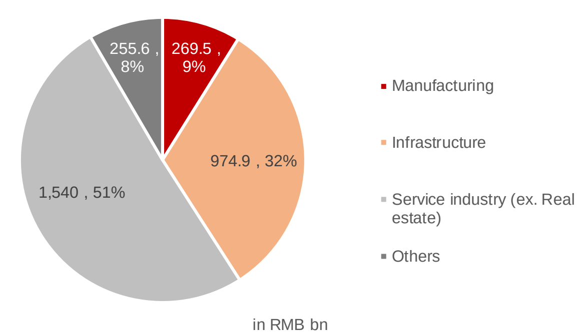
On the other hand, we think consumption stimulus is likely to be broad-based, embracing almost all categories of goods and services and is likely to expand across the nation. Special attention has been paid to big-ticket items, such as cars, household appliances and the most pandemic-stricken industries, such as catering, travel and cultural, sports & recreation activities. People in the low-income bracket should receive more direct and tailored subsidies.

Figure 28: New MLT loans to non-financial corporates amounted to RMB 3.04tn in 1Q20 and RMB 964bn in Mar, exceeding previous years’



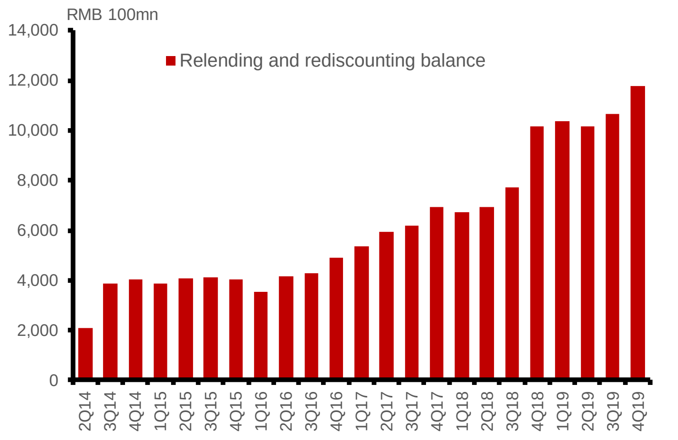
Source: PBoC, Wind, CMBIS

Figure 29: Where did the RMB 3.04tn MLT corporate loans go? 9% manufacturing, 32% infrastructure and 51% service sector (excluding real estate)



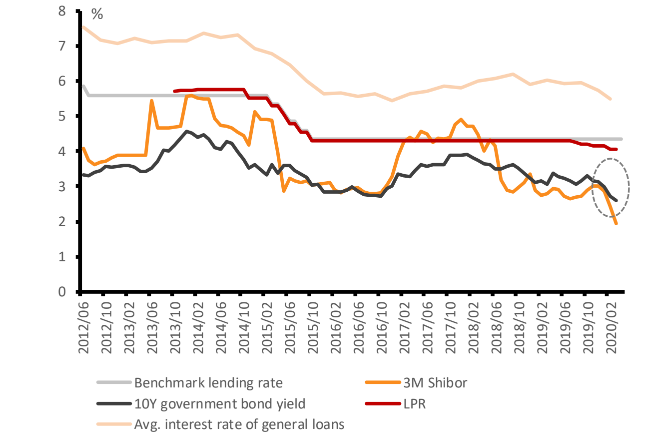
Source: PBoC, CMBIS

Figure 30: Relending & rediscount quota rose by RMB 1.8tn since 2020 primarily to encourage SMEs (YE19 balance was RMB 1.18tn)



Source: PBoC, Wind, CMBIS

Figure 31: PBoC has been making efforts to lower average lending rate of general loans via the market rate guidance mechanism



Source: PBoC, Wind, CMBIS

Monetary policy will focus more on SME support and reducing lending rate

Monetary prescriptions in the rest of the year will focus on 1) encouraging lending to corporates, in particular SMEs, via relending & rediscount programs, RRR cut and backing up small and local banks by some credit loss compensation mechanisms; and 2) reducing lending rate, via rate cut on LPR, MLF and reverse repo operations. Slashing benchmark deposit rate could be an open option in order to incentivize larger banks more directly.

We forecast 1-year/5-year LPR to be cut by 20bp/5bp on 20 Apr, respectively.

Figure 32: Major monetary prescriptions since 2020. So far, the PBoC has injected RMB 3.55tn to boost lending via RRR cut and relending, rediscount programs

Announcement date	Operation	Amount
RRR cut		
1-Jan	Broad RRR cut by 0.5ppt	RMB 800bn
16-Mar	RRR cut for some banks by 0.5-1.0ppt under inclusive finance scheme	RMB 550bn
3-Apr	RRR cut for small and medium banks by 1.0ppt	RMB 400bn
Relending and rediscount		
31-Jan	Special relending for fighting COVID-19	RMB 300bn
26-Feb	Relending and rediscount	RMB 500bn
31-Mar	Relending and rediscount	RMB 1tn
Interest rate cut		
3-Feb	Cut reverse repo rate (7d to 2.4%, 14d to 2.55%)	↓10bp
17-Feb	Cut MLF interest rate	↓10bp to 3.15%
20-Feb	Cut 1-year LPR	↓10bp
30-Mar	Cut reverse repo rate (7d to 2.2%)	↓20bp
3-Apr	Reduced IOER from 0.72% to 0.35% to encourage bank lending	

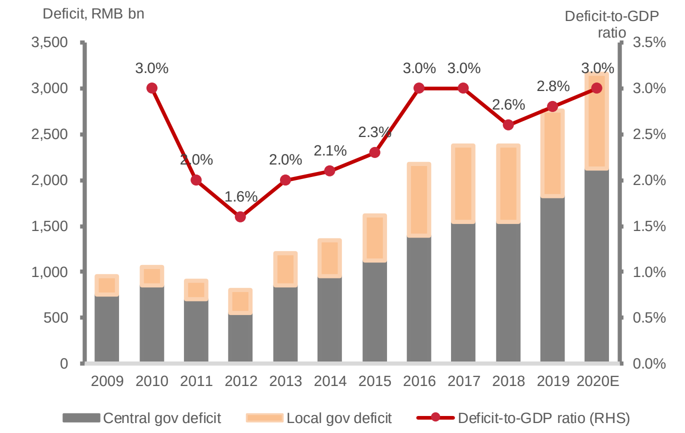
Source: PBoC, CMBIS

Fiscal expansion to step up

What has been done? Tax reductions and fee cuts so far is to save RMB 1.6tn for corporates. Meanwhile, RMB 1.29tn local government special bond has been approved in advance, among which RMB 1.08tn was already issued.

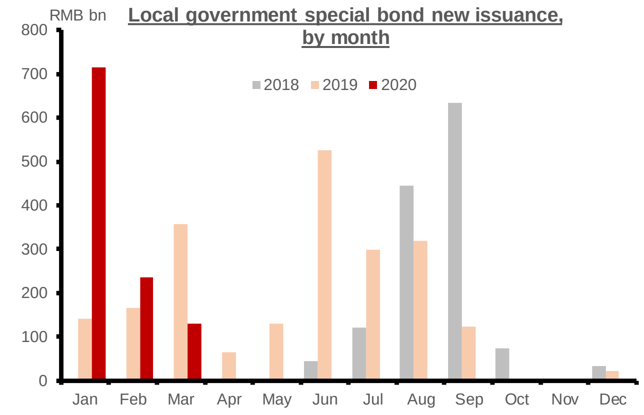
Next steps to anticipate include 1) lifting fiscal deficit ratio (> 3.0% of GDP in 2020); 2) issue special treasury bond; 3) expansion of local government special bond (our estimate is RMB 3.35tn); and 4) promoting efficient use of fiscal resources.

Figure 33: Deficit ratio is likely to be lifted above 3.0% of GDP in 2020



Source: PBoC, Wind, CMBIS

Figure 34: Local government special bond issuance amounted to RMB 1.08tn in 1Q20



Source: PBoC, Wind, CMBIS

Outlook in 2Q

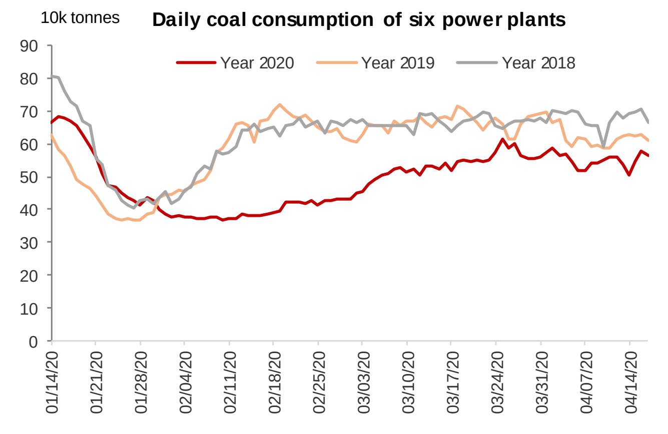
From supply disruption to demand weakness

In 1Q, it was primarily supply disturbance due to lockdowns that lead to economic downturn. Since Apr, however, negatives in the demand side have begun to kick in and are likely to sustain into 2Q.

Domestic market continue to stabilize in 2Q

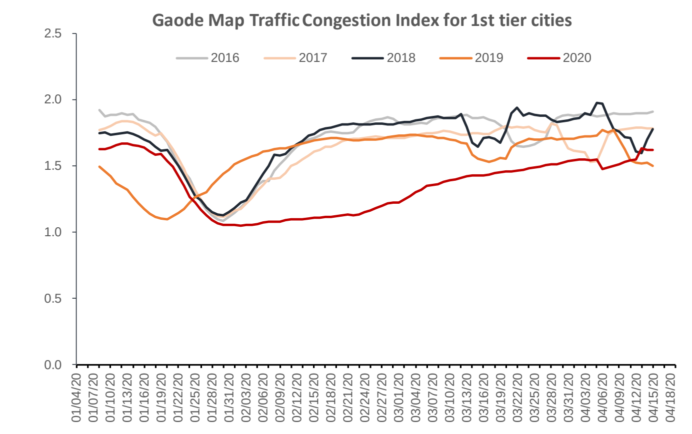
Work resumption progress is on track according to high-frequency monitors of electricity generation and city congestion index.

Figure 35: Daily coal consumption of power plants reached >90% of 2019 level



Source: NBS, Wind, CMBIS

Figure 36: Gaode Map congestion index

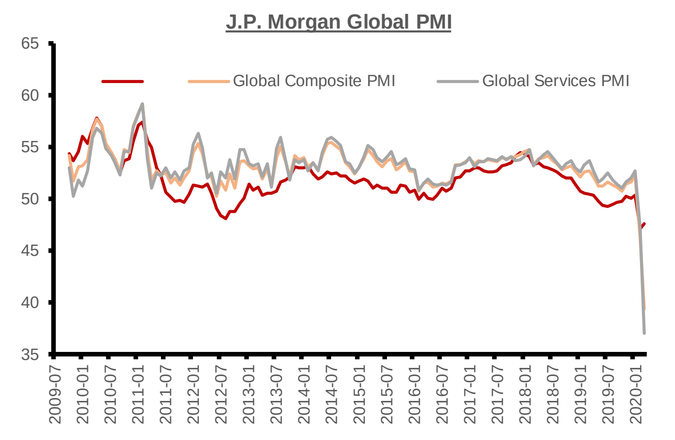


Source: NBS, Wind, CMBIS

Overseas demand may shrank further in Apr and May

Even though major developed countries "open up again" before the onset of May in the best case scenario, it may take some time for the economies to resume normal. China's export industries could face further headwinds in Apr and May.

Figure 37: Global PMI plunged in Mar



Source: Wind, CMBIS

Figure 38: Global PMI by sub-indices

	2019-09	2019-10	2019-11	2019-12	2020-01	2020-02	2020-03
Headline PMI	**49.70**	**49.80**	**50.30**	**50.10**	**50.40**	**47.10**	**47.60**
- Production	50.10	50.30	51.00	50.40	50.80	43.50	45.40
- New orders	49.40	50.00	50.40	50.30	50.80	45.20	43.80
- Input price	51.00	50.40	50.30	51.30	51.80	51.90	50.10
- Employment	49.50	49.20	50.10	49.60	49.80	47.20	47.50
- Output price	50.00	49.70	50.10	51.00	50.60	49.90	48.90

Source: Wind, CMBIS

We forecast annual GDP growth to lie between 2.8% and 3.5% YoY

While the whole economy experienced simultaneous freefall in Jan-Feb, pace of recovery will be unsynchronized. Given uncertainties in global market and the negative supply-demand feedback loop, we think trade and consumption overall are likely to experience sustained difficulties into Apr and May at best.

In our base case scenario, we forecast real GDP to advance 3.0%/6.5%/7.0% in 2Q/3Q/4Q, which implies that we expect economic growth to retrieve pre-pandemic momentum in 3Q. The above quarterly forecasts yield an annual real GDP growth of 2.8%. In the bull case, more rigorous recovery in 2Q-4Q would peg annual growth at 3.5% YoY.

Figure 39: GDP forecast by quarter

Real GDP growth	1Q20A	2Q20E	3Q20E	4Q20E	Annual
Base case	-6.8%	3.0%	6.5%	7.0%	2.8%
Bull case	-6.8%	3.5%	7.5%	8.0%	3.5%

Source: NBS, CMBIS estimates

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