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Domestic Demand Will Lead to Full Economic Recovery in China

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At the start of the year, a sudden novel coronavirus spread rapidly throughout China, bringing a temporary but extremely severe impact on China's economy. It is expected that the GDP growth in the first quarter might shrink by about 10%. However, given the prompt responses in combating the outbreak, as well as accelerated resumption of work and production, revived consumption and investment will drive the economy to fully recover in the second quarter, with faster pace of growth in the second half of the year. China's GDP growth for the whole year is likely to reach 4-5%. Once again, China will lead the global economic recovery, after lifting the global economy out of the financial tsunami in 2009.

1. China's economy is expected to fully recover in Q2

Without doubt, the short-term shock of the coronavirus outbreak to China's economy was unprecedented. In the first two months of the year, industrial production, services indicator, retail sales, fixed-asset investment and exports plunged by 13.5%, 13.0%, 20.5%, 24.5% and 15.9% respectively. In February, the manufacturing PMI was as low as 35.7%, and the electricity consumption dropped by 10.1% year-over-year. Such a decline was never seen since China published GDP statistics. Even if the resumption of production in March progressed smoothly, the GDP growth in the first quarter might shrink by about 10%. While only 20% of the full-year economic output was contributed by the first quarter, the temporary and deep contraction in output will lower the GDP growth by 3.2% for this year. Taking the weakened external demand from the global outbreak into consideration, this once-in-a-century pandemic is estimated to affect China's economic growth by around 4%.

That said, the impact of coronavirus was painful but not devastating. It did not change the economic fundamentals of China's economy. As the outbreak gradually eased in March, the whole nation except Hubei Province started to actively resume work and production with remarkable progress. According to the regional breakdown figures by the Ministry of Commerce in mid-March, there were 19 regions in China, which reported 100% resumption of work rates. And most of them concentrated in the coastal cities with significant economic contributions, such as Zhejiang, Jiangsu, Shanghai, and Shandong. Furthermore, tier 1 cities (Beijing, Shanghai, Guangzhou and Shenzhen) saw a return to traffic jams, evidencing the full recovery of economic activities in these core cities.

Regarding the power generation, recent figures showed that power generation and consumption in China rebounded sharply, the national power generation index on March 17 increased by 10.8% from the end of February and grew by 1% year-over-year, the first growth in daily power generation since the Chinese New Year. And, electricity consumption in the pharmaceutical and electronics industries returned to more than 90% of its normal level, and electricity consumption in the steel, machinery, and textile industries recovered to more than 80%. According to another survey, as of March 25, the national resumption rate of large and medium enterprises reached 96.6%, a jump of

17.7% from the same survey in February. These findings reflected that China's economy has been getting rid of the impact of the outbreak and the production and normal life of society are gradually restored.

At present, the coronavirus outbreak in China has been basically contained with the prevention and control situation continuing to improve. At the global level, the virus is still rapidly spreading with more than 1.3 million infections and more than 75,000 death cases outside China. Both figures were 10 times more than those in China. Experts expected that the global pandemic would remain at its peak level in April. The risks of a second wave outbreak in China should not be underestimated. However, with unparalleled experiences and measures in virus prevention, China has already implemented strict control to avoid imported infections from abroad. In fact, there were only a few imported cases in the past two weeks, showing that China is able to mitigate the risks of large-scale imported infections caused by the severe global outbreak. It would also provide strong support for the economic recovery in the second quarter. It is expected that consumption and investment will be resumed in April to cover the demand accumulated before, and business confidence will gradually stabilize.

Meanwhile, the global demand for medical materials increased substantially. Many countries ordered face marks, protective gears, rapid virus test kits and ventilators from China, which would help drive the recovery and development of China's industrial production and related logistics industries. Taking face masks as an example, which was one of the most important prevention items, there is a large consumption demand not only from the 1.4 billion population in China but also from the 2 billion people across the globe including the US, the Europe, Japan, South Korea, to the Middle East. Face masks have now become the "money printing machine" in the medical kits market. Tens of thousands of corporates in China stepped up production with daily output of masks attaining to 116 million pieces, accounting for more than 80% of the world's production capacity. Also, ventilators are the most important medical equipment. 80% of the ventilator parts in the world are produced in China. Recently, overseas orders for ventilators surged, causing panic buying. The New York State Government of the US made an urgency order of 17,000 ventilators from China to provide rescue treatment, as there were more 100,000 patients with the coronavirus in the state. Similarly, the states of California, Illinois and the federal government have also ordered the same ventilators. Besides, the US specifically exempted China from import tariffs on medical supplies recently, in which more than 100 medical products such as masks and protective gears were covered.

Based on the data from the National Bureau of Statistics, China's PMIs swiftly recovered in March. The manufacturing PMI, non-manufacturing business activity index, and composite PMI output index were 52.0%, 52.3%, and 53.0%, up by 16.3%, 22.7%, and 24.1% respectively from February. Those readings basically returned to the level before the outbreak, indicating that the recent resumption of production and work accelerated significantly. It is expected that China will become the first country in the world to achieve economic recovery.

2. Revived consumption to boost the economic rebound

China's consumer market is sizable with retail sales exceeding 40 trillion yuan in 2019, which has already been the core engine of China's economic development. In the past three years, the contribution rate of consumption to GDP growth averaged 63.9%, boosting China's economic growth by 4.1% per year. Although the outbreak hits consumption hard, it does not change the fact that consumption will remain as the core engine of China's economic growth. Currently, the willingness and ability to spend by the Chinese people are not gone. The consumption demand that has been restrained temporarily will be the leading force in driving the China economy to stabilize and recover quickly:

First, revived consumption will drive growth. Normally, the first two months of the year are the peak season for consumption, but the coronavirus outbreak brought significant shocks to goods consumption and services spending. Retail goods consumption such as automobiles, clothing, gold, jewelry, and daily necessities, as well as services spending such as tourism, hotel, transportation, and cultural entertainment, together experienced a total loss of more than 2.5 trillion yuan of spending. Taking out the part of seasonal spending that cannot be recovered, the National Bureau of Statistics estimated that about 60% of consumer demand delayed or restrained by the outbreak could be covered with an amount reaching to 1.5 trillion yuan. After the outbreak will be fully under control, such demand will be released, leading to a retaliatory growth in the consumer market.

The economic boost from revived consumption is expected to be seen immediately. The 1.5 trillion yuan worth of revived consumption is equivalent to 1.52% of China's aggregate output last year. Its contribution to economic growth can be calculated after excluding the spending for imported goods and overseas services. Based on the data provided by National Commercial Work Conference 2019, imported goods shared 3.4% of China's total retail sales. Assuming a same portion on spending for overseas services, the market power from revived consumption is estimated to lift China's GDP growth by 1.46% this year. The consumption growth from such stimulus is expected to materialize in coming three quarters, especially in the second half of the year.

Second, the policies to encourage spending will bring more consumption demand. To promote consumption, the Government has issued a series of policy measures. For example, in mid-March, 23 departments including the National Development & Reform Commission and the Ministry of Finance jointly launched 19 measures to stimulate domestic consumption. Recently, the Ministry of Commerce is working on measures to promote the consumption of key commodities such as automobiles, furniture, and home appliances, representing a policy shift from purchase restriction to guidance on vehicle usage, and support the local governments to formulate reward policies for spending. Experts estimated that the policy on automobiles alone can bring about 400-800 billion yuan in new car sales. The Central Government also supports local governments to launch pragmatic and effective consumption promotion policies in accordance with their own needs, encourages the introduction of consumer coupons and shopping coupons, and promptly eliminates the practices and regulations of excessive control. Now, 17 provinces and cities announced the issuance of consumer coupons with a total amount of more than 5 billion yuan. This practice is likely to continue. With the continuous policy support to boost spending, it is believed that a strong rebound in household consumption can be seen in future.

Third, a new consumption model is rapidly developing. China's retail and catering companies are accelerating their transformation to actively promote online businesses and develop contactless services such as internet transaction and food delivery, etc. Despite the contraction in broader consumer market, online sales of commercial goods were able to achieve 3.0% growth in the first two months of the year. And its share in the total retail sales reached 21.5%, a significant increase of 5% from the same period in last year. The exponential growth of online consumption and the smart economy opened up new market potential for consumption growth. It is expected that the shift in spending pattern will play an even greater role in driving the rebound in consumption from the second quarter to the second half of this year.

3. Huge potential from new investment

It should be noted that among the three growth drivers of the China economy including consumption, investment and export, investment had the biggest impact from the coronavirus. In the course of reducing the economic damages by the coronavirus, the importance of stable investment growth is once again highlighted, and its potential is huge.

Across all investment areas, infrastructure investment is undoubtedly the most important. In the first two months of the year, China's infrastructure investment contracted by 30.3%, which exceeded the decline in overall investment and became a major source of decline. And, infrastructure investment is indeed one of the areas with the greatest growth potential. Among them, the new infrastructure development (i.e. new infrastructure) represented by 5G networks, data centers, artificial intelligence, industrial network, the Internet of Things, and blockchain, etc. will not only become an important engine for China's new investment and economic recovery, but also a vital force for building a new economy and promoting high-quality development in the future.

Since this year, new infrastructure has been given unprecedented height. It was mentioned in the State Council executive meeting on January 3 and the Politburo meetings on February 21 and March 4. The scope of new infrastructure includes a very wide range. Each project requires massive investment with tremendous boost to economic growth. Taking 5G network as an example, the global 5G industry will receive 3.5 trillion US dollars of investment in the next 15 years, of which 30% will be invested in China and generate 12 trillion US dollars in sales volume. According to industry estimates, last year was the beginning year of China's 5G development with about 80,000 5G base stations planned to be built. But the number of base stations built will rise to 1 million per year from 2020 to 2022, soar further to 2 million per year in the subsequent three years, and finally reach around 8-10 million. Last year, the total investment in 5G base stations by the three major operators in China reached 35 billion yuan. It is expected that the annual investment in the next 5 years will soar to 300-500 billion yuan, ten times higher than in 2019, and the total investment in 5 years will exceed 2 trillion yuan.

Moreover, in order to avoid economic fallout, the Central Government recently issued a series of policies to stabilize investment, in order to make effective use of investment in support of growth, enhance new investment project development, and accelerate development progress. Therefore, the local government's special bond issuance was elevated with new financing at 949.8 billion yuan in the first two months, two times higher than the same period last year. Other measures include reduced or exempted social security contributions by companies, preferential financial services for SMEs, cutting reserve requirement ratios for banks to provide credit support, and lower interest rates on reverse repurchase agreements to reduce borrowing costs. Given these support measures, local governments across the country have intensively announced major investment plans in 2020. Among them, the future investment plans announced by 25 provinces and municipalities are expected to reach a total amount of up to 50 trillion yuan.

Hence, a new wave of investment is imminent and its pace of development is already accelerating. Investment activities are expected to resume normal growth level in the second quarter and speed up in the second half of the year. In the coming nine months, investment growth is likely to reach 7-8% with an additional boost to the whole year GDP growth by 1.06%.

4. The global pandemic remains as the biggest uncertainties

In sum, China’s economy has already started to improve since March, and there is possibility for a full recovery in the second quarter and further acceleration in the second half of the year. Although the coronavirus outbreak was estimated to drag down China’s growth by 4.0%, revived consumption and new investment are expected to add back 2.5% of China’s economy, thus China’s GDP growth for the whole year is forecast at 4-5%. While the growth forecast is far below the potential growth level, China’s economic performance is indeed commendable against the backdrop of low growth or even a possible recession in the global economy due to the coronavirus.

More importantly, China’s economic structure continues to optimize and upgrade amid the coronavirus outbreak. Its new growth engines gather pace to replace the old drivers. And, its momentum towards high-quality development is getting stronger. Hence, these developments will not only allow China to effectively withstand the shocks from “Black Swan” and “Gray Rhino” events but also to inject fresh impetus to the world economy under an international environment with rising uncertainties, and to lead the global economic recovery again, just as China did after the global financial tsunami in 2009.

However, it should also be noted that the current global pandemic is still spreading rapidly. The growth of world economy and trade will be severely affected. The major developed countries like the US and the Europe are experiencing significant impacts from the virus. Their economies may still fall into recession despite the coordinated efforts by their Governments. Though many emerging economies are relatively immune, they are at risk of having a third wave of outbreak. These will bring new challenges to China’s economy. In March, China’s manufacturing PMI rebounded sharply, but the survey found that firms still were operating under a deal of pressure. One of the root causes was the acute shortage of external demand, as the new export order index and import index for the month were only 46.4% and 48.4%, which were still below the normal growth level.

The peak of the global coronavirus outbreak is right in the second quarter. Considering China’s connection to other economies via trade and capital flows, China’s external trade and foreign investment will be affected when the economic conditions abroad are deteriorating. Depending when the global coronavirus outbreak will be brought under control and how long it will last, China’s economy will be affected by to a certain extent. And, it remains as the biggest uncertainties for China’s economy. Nonetheless, domestic consumption has become the major growth engine for China’s economy. The global pandemic will affect the short-term performance of China’s economy, but its long-term prospects is still promising.

主要經濟指標 (Key Economic Indicators)

一. 本地生產總值 GDP	2018	2019	2019/Q3	2019/Q4
總量（億元）GDP($100 Million)	27,355	27,030	6,996	6,738
升幅(%) Change(%)	2.9	-1.2	-2.8	-2.9

二. 對外貿易 External Trade			2020/2	2020/1-2
外貿總值（億元）Total trade($100 Million)				
總出口 Total exports	41,581	40,961	2,386	5,079
進　口 Total imports	47,214	45,714	2,771	5,770
貿易差額 Trade balance	-5,633	-4,753	-386	-691
年增長率(%) YOY Growth(%)				
總出口 Total exports	7.3	-5.6	4.3	-12
進　口 Imports	8.4	-8.1	-0.1	-9.3

三. 消費物價 Consumer Price				
綜合消費物價升幅(%) Change in Composite CPI(%)	2.4	2.9	2.2	1.8

四. 樓宇買賣 Sale & Purchase of Building Units			2020/3	2020/1-3
合約宗數（宗）No. of agreements	79,193	74,804	4,555	12,744
年升幅(%) Change(%)	-5.5	-5.5	-29.1	-25.1

五. 勞動就業 Employment			2019/11-2020/1	2019/12-2020/2
失業人數（萬人）Unemployed(ten thousands)	10.5	12.4	12.2	13.4
失業率(%) Unemployment rate(%)	2.8	3.3	3.4	3.7
就業不足率(%) Underemployment rate(%)	1.1	1.2	1.2	1.5

六. 零售市場 Retail Market			2020/2	2020/1-2
零售額升幅(%) Change in value of total sales(%)	8.8	-11.1	-44.0	-31.8
零售量升幅(%) Change in volume of total sales(%)	7.6	-12.3	-46.7	-33.9

七. 訪港遊客 Visitors				
總人數（萬人次）arrivals (ten thousands)	6,515	5,590	19.9	340.7
年升幅(%) Change(%)	11.4	-14.2	-96.4	-72.5

八. 金融市場 Financial Market			2020/1	2020/2
港幣匯價(US$100=HK$) H.K. Dollar Exchange Rate (US$100 = HK$)	783.6	779.3	776.6	779.3
貨幣供應量升幅(%) change in Money Supply(%)				
M1	-0.4	2.6	3.2	4.7
M2	4.3	2.8	2.3	2.3
M3	4.3	2.7	2.2	2.2
存款升幅(%) Change in deposits(%)				
總存款 Total deposits	5.0	2.9	2.1	1.9
港元存款 In HK$	3.6	2.5	2.5	1.8
外幣存款 In foreign currency	6.4	3.2	1.7	2.0
放款升幅(%) in loans & advances(%)				
總放款 Total loans & advances	4.4	6.7	6.4	6.8
當地放款 use in HK	4.0	7.1	7.0	7.9
海外放款 use outside HK	5.3	5.8	5.2	4.2
貿易有關放款 Trade financing	-7.7	-0.7	-6.5	-3.2
最優惠貸款利率(%) Best lending rate (%)	5.1250	5.0000	5.0000	5.0000
恒生指數 Hang Seng index	25,846	28,189	26,312	26,130