BEYOND THE REAL GDP REBOUND

The economy has been recovering gradually since March, and the rebound in real GDP was strong enough in Q2 2020 to enable it to recover rapidly the ground lost in Q1. Yet the shock triggered by the pandemic and the ensuing lockdown measures has severely weakened some sectors (such as export-oriented industries), some corporates (notably micro-enterprises and SMEs) and some households (especially low-income earners). The central bank has cautiously eased credit conditions and the government has introduced a stimulus plan estimated at about 5 points of GDP for 2020. Public investment in infrastructure projects remains the instrument of choice, but direct support to corporates and households is also expected to boost private demand.

After plummeting during the period of the strictest lockdown in February, economic activity has gradually turned around since March. The contraction in real GDP was unprecedented in Q1 2020, down 9.8% on a quarterly basis (and -6.8% year-on-year) but the rebound in Q2 (+11.5% q/q and +3.2% y/y) was strong enough to completely regain the ground that was lost. On this point, China stands apart from most of the other big economies.

The turnaround observed over the past four months was mainly driven by a V-shaped rebound in industrial production and investment in public infrastructure and real estate. Even so, the economy has been hit be a severe shock that has left numerous scars. Certain sectors, notably those dependent on tourism and international demand, are still a long way from returning to normal. Although only temporary, the loss of corporate sales, jobs and household revenue will continue to strain domestic demand. Meanwhile, export prospects are darkened by the uncertain economic recovery in the developed countries and renewed tensions between China and the United States. Lastly, the risk of new outbreaks of the epidemic is hampering consumer behaviour[1].

Consequently, our short-term growth forecasts face downside risks. Inversely, they are firmly supported by the authorities' stimulus policies. Although the initial support package was relatively moderate, it has been gradually expanded and should keep pace with the economic recovery, even after the first rebound.

A DIFFERENTIATED REBOUND

All economic indicators point to a gradual recovery over the past four months, with industrial production and public investment rebounding more vigorously than private demand and services (chart 1).

On a year-on-year basis, industrial production swung back into positive growth as of April (+3.9% in volume, then +4.4% in May and +4.8% in June). In the first six months of 2020, industrial production was just 1.3% lower than it was in the same period in 2019. The production decline in value terms has been accentuated by producer price deflation (-1.9% y/y on average since the beginning of the year), which has aggravated the deterioration in profits of industrial enterprises (19% lower in January-May 2020 compared to the same period in 2019).

On the demand side, the recovery since March has been bolstered by the rebound in investment, especially in public infrastructure, construction and the real estate sector, which were supported by the authorities' stimulus measures. Investment in the manufacturing sector picked up much more slowly, constrained by the difficult financial situation of enterprises, notably SMEs. Export companies remain being especially cautious.

FORECASTS

	2018	2019	2020e	2021e
Real GDP growth (%)	6.7	6.1	2.5	8.1
Inflation (CPI, year average, %)	2.1	2.9	2.5	2.3
Official budget balance / GDP (%)	-2.6	-2.8	-3.6	-3.0
Central government debt / GDP (%)	16.3	17.0	19.6	20.7
Current account balance / GDP (%)	0.2	1.0	0.3	0.2

TABLE 1 e: ESTIMATES AND FORECAST
SOURCE: BNP PARIBAS GROUP ECONOMIC RESEARCH

SUPPLY-DRIVEN REBOUND, RETAIL SALES LAGGING BEHIND

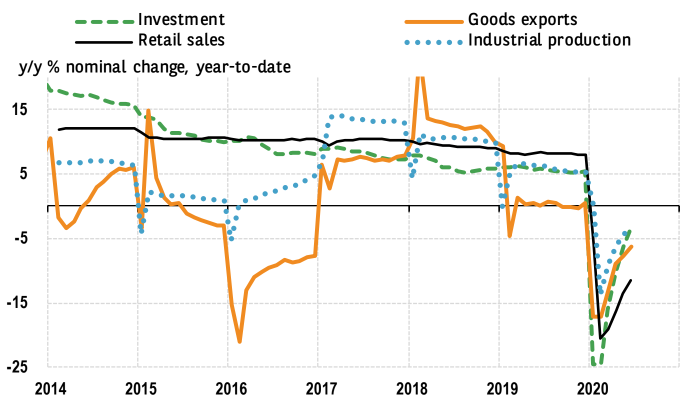
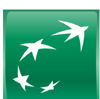


CHART 1 SOURCE: NBS, CUSTOMS

Even though foreign trade data show only a mild decline in merchandise exports over the period March-June (-1.6% y/y on average in USD), after the major disruption in February (-40%), export prospects remain bleak in the short term.

Private consumption has also struggled to recover, undermined by the downturn in the labour market and household revenues. The unemployment rate has held close to 6% since February (vs. 5.2% in 2019) and per capita disposable income declined by nearly 4% y/y in

1 In early June, the outbreak of new Covid-19 cases in Beijing led the authorities to reintroduce lockdown measures in certain districts. Fears have since eased, and official health reports show that the epidemic is currently under control, with a relatively flat curve for new infections over the past two months, and only 58 confirmed cases per 1 million inhabitants (some counties in China have been completely spared).



real terms in Q1 2020. In June, retail sales volumes continued to contract in year-in-year terms (down 2.9%), despite a big rebound in automobile sales (+11.8%). Online sales of goods and services were naturally more dynamic (+16%). The factors that have been straining the recovery in household consumption and exports are expected to persist in the short term, and the authorities are counting primarily on investment-related support measures to stimulate the economy.

FISCAL STIMULUS

The central bank has intervened right from the beginning of the Covid-19 crisis to address the liquidity needs of the financial sector. It has also eased monetary and lending conditions, and then encouraged banks to cover the cash flow needs of their clients and to refinance existing loans to prevent defaults and bankruptcies. Micro-enterprises and small businesses seem to be the main focus of the authorities' concerns. Growth in total social financing accelerated from 10.7% y/y at the end of February to 12.7% at the end of June 2020 and should reach 13% to 14% by year-end 2020. The easing in credit conditions should remain relatively moderate in the end, as the central bank's leeway is much constrained by the excessive debt of the economy.

Stimulating economic growth will depend more on fiscal policy. Measures introduced and/or announced since February aim to help the sectors and companies hit hardest by the epidemic, to boost household revenue (notably by supporting employment), and to stimulate domestic demand. Public investment in infrastructure projects, which is still the government's instrument of choice, has rebounded strongly over the past two months. Direct measures to support corporates, employment and private consumption are expected to be implemented more gradually.

Following the annual session of the National People's Congress in late May, the government released its 2020 budget plan and announced a deficit target of 3.6% of GDP this year, up from 2.8% in 2019. Although this deficit target is historically high, it nonetheless suggests that the recovery plan will be moderate. However, the government's "official" budget largely underestimates the real amplitude of the stimulus, and Chinese fiscal policy in general. Fiscal policy is comprised of several segments, some of which are reported in the official budget, while others can be found in various off-budget accounts, such as the social security fund, funds financed by "special" central government bond issues, the special funds of local governments and the accounts of their financing vehicles. State-owned companies can also participate in stimulus measures. Lastly, transfers can be made between these various accounts over the course of the fiscal year.

In addition to the official deficit target, which is financed through so-called "general" bond issues (about 70% of which are issued by the central government and 30% by local governments), the authorities have announced the amount of "special" bond issues in 2020 to finance the supplemental budget allocated to post-Covid recovery measures. The central government will issue special bonds amounting to a total of CNY 1000 bn (1% of estimated 2020 GDP)[2], and the quota for special bond issues by local governments was increased by CNY 1600 bn to a total of CNY 3750 bn (3.6% of estimated 2020 GDP). Public debt is almost entirely denominated in RMB and issued in the local markets. Central government debt is still moderate and is projected at no more than 20% of GDP in 2020. In contrast, the debt of local government (including their financing vehicles) is high, estimated at about 50% of GDP.

OFFICIAL AND AUGMENTED FISCAL DEFICITS

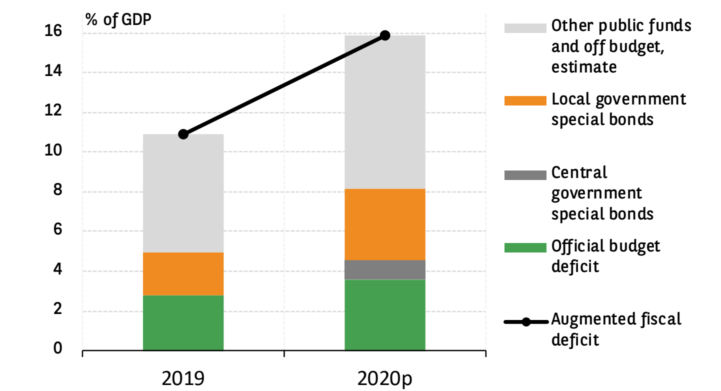


CHART 2 SOURCE: CHINESE GOVERNMENT, BNP PARIBAS

Adding together the official deficit, the funds generated through special bond issues and the estimated amount of off-budget accounts, the "augmented" fiscal deficit comes to 10.9% of GDP in 2019 and is expected to reach 15.9% of GDP in 2020 (chart 2). This increase of about 5 points of GDP gives a more realistic picture of the size of the fiscal stimulus planned by the authorities. They have not specified which amounts will be allocated to the various support measures. We can nonetheless highlight two main kinds of measures: additional investment in infrastructure projects is estimated at about 2% of GDP, and direct support measures for corporates and households are estimated at about 3% of GDP. They notably include social security and tax exemptions and reductions, and an extension in the unemployment insurance system to accelerate benefit payments and cover more migrant workers.

Christine Peltier
christine.peltier@bnpparibas.com

2 The central government issued this type of bonds only twice in the past, in 1998 and in 2007.