# CHINA



## HOUSEHOLDS ARE STILL WORRIED

**The economy continues to recover. Initially driven by a rebound in industrial production and investment, the recovery broadened over the summer months. Exports have rebounded and activity has also picked up in the services sector. Yet it continues to be strained by the timid rebound in household consumption, which is far from returning to normal levels. The unemployment rate began to fall right again after the end of lockdown measures, but this decline has been accompanied by an increase in precarious jobs and large disparities, with the unskilled and young college graduates being particularly hard hit.**

Whereas the economic recovery since March has been initially driven by the rebound in industrial production and investment in public infrastructure and real estate, there has been a more widespread strengthening in activity since the summer. Exports have posted a solid rebound and growth in the services sector has gained momentum. Although private consumption has shown some signs of recovering, households remain very cautious. In the months ahead, whether the economic recovery consolidates will depend largely on the authorities' stimulus policy as well as on export performance and labour market trends.

### A BROADER RECOVERY

Industrial production has continued to strengthen, rising 5.6% year-on-year (y/y) in August in volume terms (+3.6% in value), up from 4.8% in June and July. In the first eight months of 2020, industrial production slightly exceeded the level reached in the same period in 2019 (+0.4%). Activity seems to have returned to normal in a large number of industrial sectors. Yet many corporates still remain severely weakened following the losses reported in Q1 2020. Although profits of industrial enterprises have rebounded over the past four months, they were still 8% lower in January-July 2020 than in the same period in 2019. In the services sector, activity has continued to pick up slowly (+4% y/y in August, vs 3.5% in July and 2.3% in June). After a more drastic downturn than in industry during the Q1 lockdown, the recovery since March has proved to be slower.

On the demand side, the rebound continues to be fuelled by domestic investment. In the first eight months of 2020, investment was only 0.3% below the level reached in the same period in 2019. It remains driven by new projects in public infrastructure and real estate. Manufacturing investment also rebounded in August; yet, in the first eight months of 2020, it was still 8.1% below the level reached in the same period in 2019. In the short term, investment in infrastructure should remain dynamic, bolstered by a still expansionist fiscal policy stance. In contrast, monetary policy is expected to be less supportive, which should contribute to slower growth in real estate investment. In the manufacturing sector, the rebound in investment should gain momentum if corporate profits continue to improve and export performance remains solid. Even so, corporates will probably maintain a cautious approach, due to possible financial difficulties and because uncertainty over the recovery in world demand and US-China tensions continue to strain export prospects.

After declining rather moderately over the period March-June, merchandise exports rebounded by 7.3% y/y (in USD) in July and 9.5% in August (Chart 1). This strong performance is mainly due to high demand for medical devices and equipment and technological goods, as well as to China's advantageous position in the Covid-19 crisis: as the first country to reopen after the lockdown and to start up production, it has been able to respond rapidly to demand from its trading partners as soon as it began to rebound. As a result, China has managed to increase its share of global exports (to about 14% in H1 2020 from 13.3% in 2019). As total import value has declined (volumes have increased but price effects have remained negative), the trade surplus has grown in recent months.

**FORECASTS**

| | 2018 | 2019 | 2020e | 2021e |
|---|---|---|---|---|
| Real GDP growth (%) | 6.7 | 6.1 | 2.5 | 7.5 |
| Inflation (CPI, year average, %) | 2.1 | 2.9 | 2.8 | 2.3 |
| Official budget balance / GDP (%) | -2.6 | -2.8 | -3.6 | -3.0 |
| Central government debt / GDP (%) | 16.3 | 17.0 | 19.6 | 20.8 |
| Current account balance / GDP (%) | 0.2 | 1.0 | 2.0 | 1.6 |
| Total external debt / GDP (%) | 14.3 | 14.3 | 14.1 | 13.5 |
| Forex reserves (USD bn) | 3 073 | 3 108 | 3 168 | 3 208 |
| Forex reserves, in months of imports | 14.5 | 15.0 | 16.6 | 15.4 |
| Exchange rate USDCNY (year end) | 6.9 | 7.0 | 6.8 | 6.6 |

TABLE 1

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

**A STEADY EXPORT REBOUND**

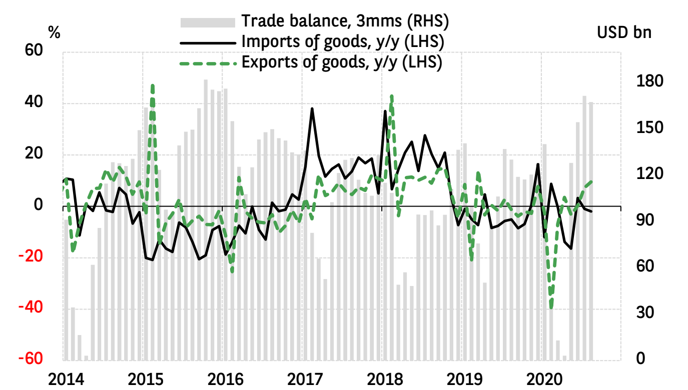


CHART 1

SOURCE: GENERAL ADMINISTRATION OF CUSTOMS

China is far from reaching the level of purchases of US goods stipulated in the Phase 1 trade agreement signed with Washington earlier this year (imports in the first seven months of 2020 would have accounted for a little less than half of the target for the period according to estimates by the Peterson Institute for International Economics), but neither party is presently calling the trade deal into question.

## PRIVATE CONSUMPTION IS STILL RESERVED

Private consumption has shown signs of recovery but still seems far from returning to normal. In value terms, retail sales reported slightly positive growth in August (+0.5% y/y) for the first time this year, but they were still down 1.1% in volume terms. In the first eight months of 2020, retail sales were still well below their 2019 level (-8.6% y/y). E-commerce has continued to make inroads. The amount of online retail sales of goods increased 16% y/y in August, and accounted for 36% of retail sales in H1 2020, vs 25% in 2019. Evidently, households are still worried. Consumer confidence indexes began to recover in July, after plummeting throughout the first half, but they are still holding below 2018-19 levels. This mistrust can be attributed principally to health risks and labour market trends.

## THE CRISIS LEAVES ITS MARK ON THE LABOUR MARKET

The main official unemployment rate (based on people registered at the local employment service agencies) has not increased much, rising from 3.62% in Q4 2019 to 3.84% in Q2 2020 (equivalent to 10.1 million individuals). The unemployment rate estimated by the National Bureau of Statistics (NBS) based on survey data is considered to be more exhaustive; it increased more sharply from 5.3% in December 2019 to 6.2% in February (Chart 2). It has fallen again since March (to 5.6% in August) but remains higher than the pre-crisis unemployment rates.

However, these official unemployment rates largely underestimate the shock that has hit the population. First, the scope of calculation is limited since: 1) it only takes into account the urban labour market, and 2) it excludes a large number of migrant workers who lost their jobs in urban areas during the lockdown, many of whom returned to their rural residence. According to the most common estimates, at least 80 million individuals throughout the country had lost their jobs at the end of February (out of 775 million jobs in 2019, of which 291 million were held by migrant workers).

The labour market began to improve as of March as the unemployment rate fell and migrant workers began to return to urban areas. However, the situation remains very difficult for certain categories of individuals. Average unemployment rates mask high disparities, with the unskilled and recent college graduates being hit hardest. In 2020, 8.7 million young college graduates must enter the labour market, mostly during the summer. As a result, the unemployment rate for the 20-24 age group continued to rise in August according to the NBS (it would be close to 20%). The government is particularly alarmed by this situation and has asked local governments and state-owned enterprises to strongly step up their hiring this year. Lastly, the downturn in the job market is also illustrated by the significant rise in precarious jobs (part-time work, self-employed, online retailers...) which is partially encouraged by the authorities.

As a result of these dynamics, the average disposable income per capita declined by 1.3% y/y in real terms in H1 2020 (the 3.9% contraction in Q1 was followed by a slight rebound in Q2). This trend has resulted from the decline in real wages and the collapse in net business income (for self-employed). The loss of earned income has strained private consumption even more since it has mainly affected low-income households, and has not been offset much by an increase in social welfare benefits. The authorities have introduced a few measures to directly support households, but yet their stimulus plan has focused primarily on programmes to support corporates and public investment.

The improvement in labour market conditions, observed as soon as lockdown restrictions were lifted, could continue in the short term thanks to public-sector construction projects and most importantly if export performance remains strong, thus supporting activity in the manufacturing sector. This is still uncertain, however, as it will depend on external conditions. At a time when the squeeze on household income could continue to be felt for some time to come, the strengthening in China's social welfare system increasingly appears to be necessary to stimulate private consumption in the short and the medium terms.

OFFICIAL UNEMPLOYMENT RATES UNDERESTIMATE THE Q1 SHOCK

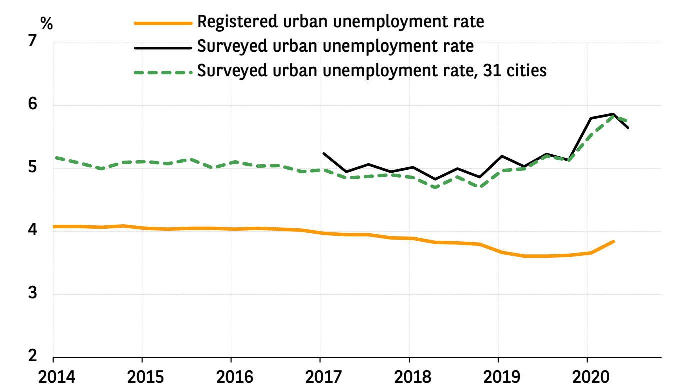


CHART 2 SOURCE: MINISTRY OF HUMAN RESOURCES AND SOCIAL SECURITY, NBS

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