

China Economic Outlook

BBVA Research, Asia

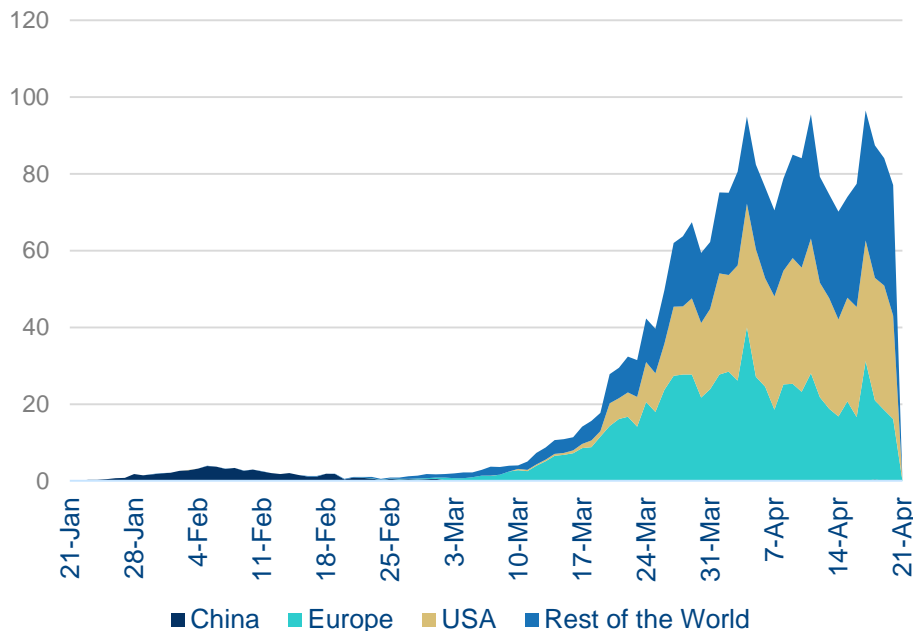
April 2020

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COVID-19 entails a recession for the global economy

In addition to the cost in human lives, the expansion of COVID-19 from east to west entails a recession for the world economy

DAILY CASES OF COVID-19 (*) (THOUSANDS OF PEOPLE)



- COVID-19 has directly affected more than 2 million people since its outbreak in China in mid-January
- In Asia, the initial expansion is currently under control
- In Europe, it has advanced with intensity and is currently in the remission phase
- America is the focus right now, especially USA, where the outbreak seems to have reached a peak

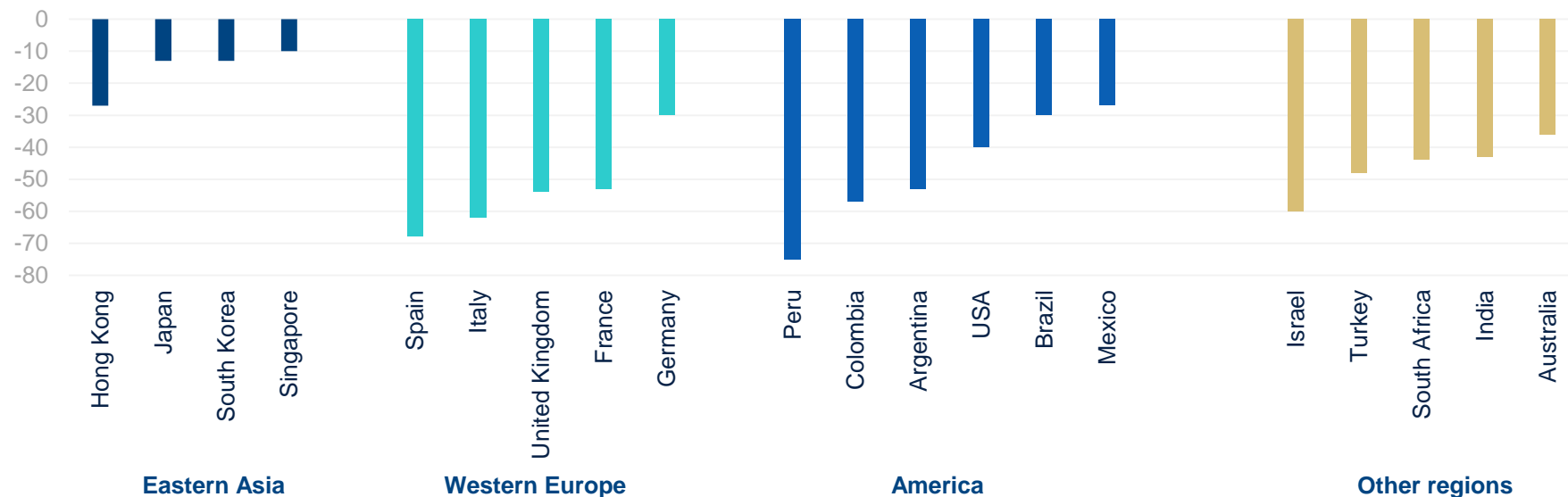
*) Europe includes Italy, Spain, Germany, France and the United Kingdom.

Source: BBVA Research based on data from John Hopkins University.

Confinement measures are helping to control the epidemic, but logically they cause a contraction of economic activity

INDICATOR OF WORK MOBILITY

(% OF VARIATION BETWEEN APRIL 5th AND THE PERIOD FROM JANUARY 3rd TO FEBRUARY 6th)



High uncertainty: we anticipate a deep recession with a rapid but incomplete recovery

Main assumptions of our economic scenario



EXPANSION OF COVID-19

China, Italy and Spain as a benchmark for the evolution of new cases

No new cycles of widespread contagion



CONFINEMENT MEASURES

Around 6 to 8 weeks

Gradual reversal

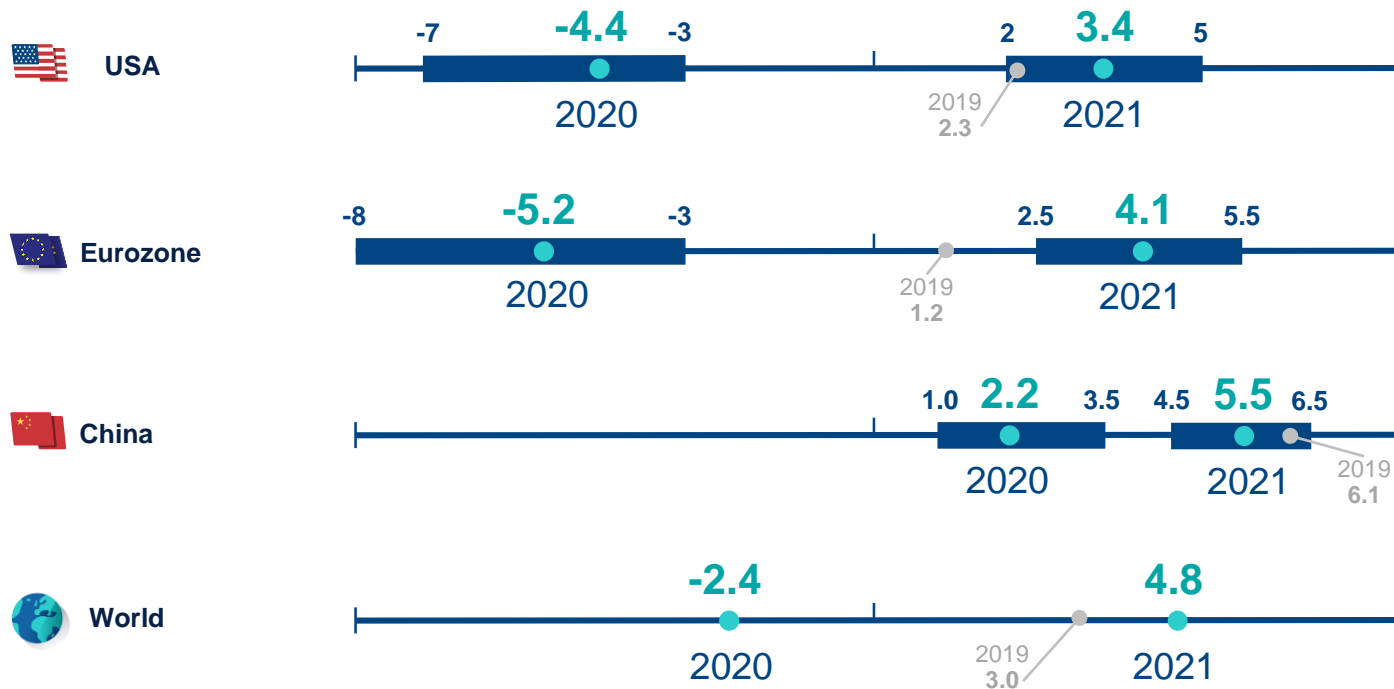


ECONOMIC STIMULUS MEASURES

They will be maintained or amplified

High effectiveness (real and financial)

Growth forecasts: a global recession in 2020, followed by a partial recovery in 2021



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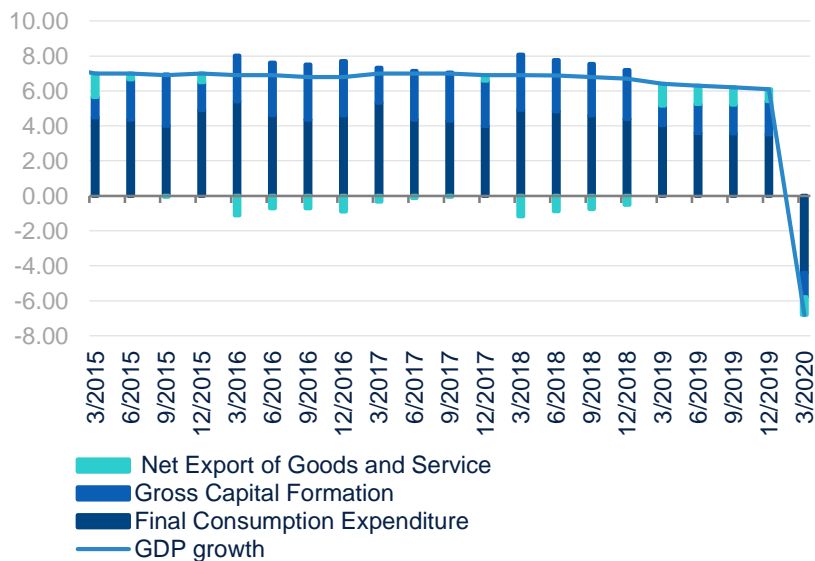
COVID-19 tipped China's growth to historical low

Main messages

- Economic indicators dropped dramatically in Jan-Feb, with a stabilization in March. Still the Q1 growth rate dipped to a historical low since 1992.
- The recovery of supply side is seemingly faster than the demand side, after the lockdown policy gradually phased out.
- Financial markets remained largely stable despite certain valuation correction in lockstep with internal financial markets.

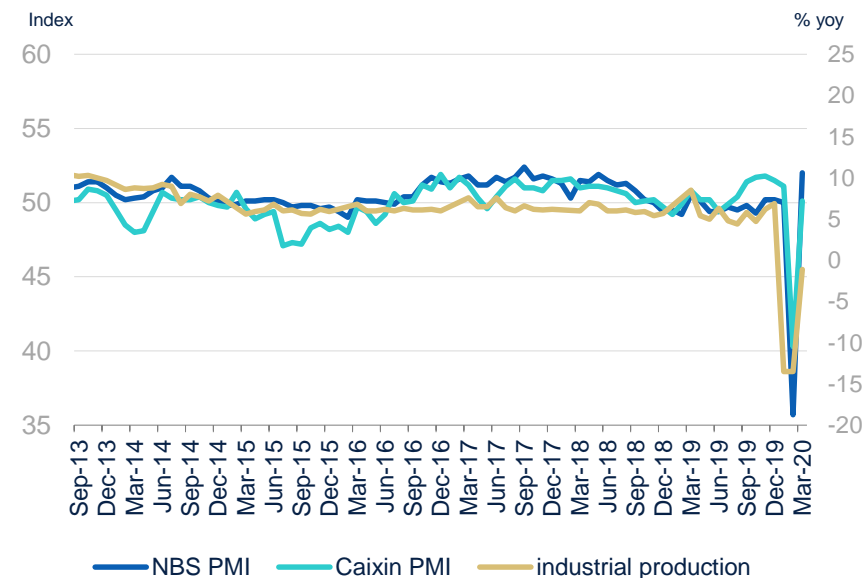
Growth dipped to historical low in Q1 amid COVID-19

GROWTH SLOWED TO -6.8% Y/Y IN Q1 2020 FROM 6% IN Q4 2019, THE LOWEST IN RECORD



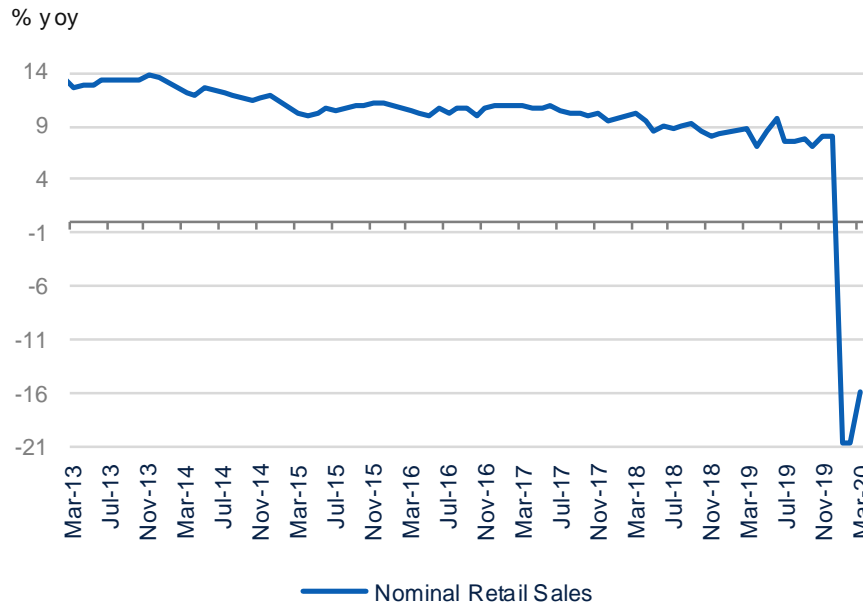
Source: CEIC and BBVA Research

PMIS AND INDUSTRIAL PRODUCTION BOUNCED BACK IN MARCH AS LOCKDOWN POLICY ENDED

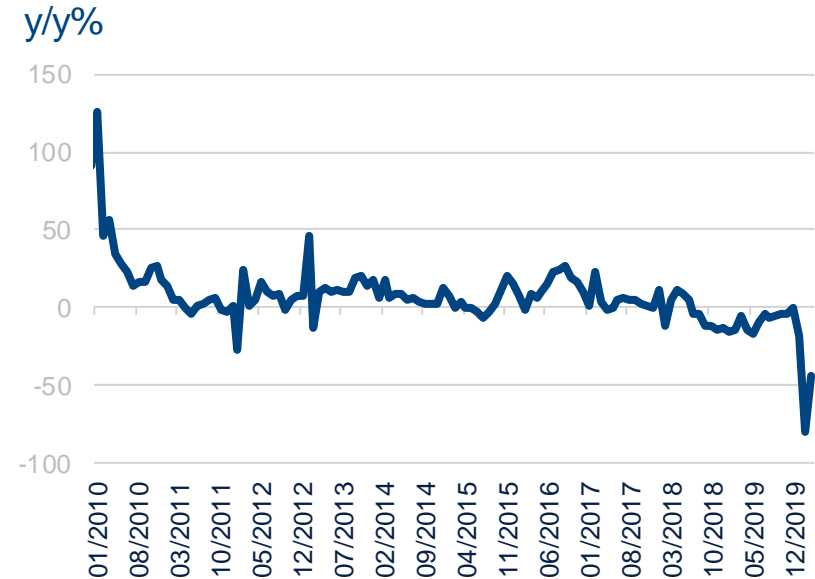


The recovery in demand side lags behind production

RETAIL SALES DIPPED TO -21% IN JAN-FEB AND RECOVERY IN MARCH IS STILL NOT VISIBLE...

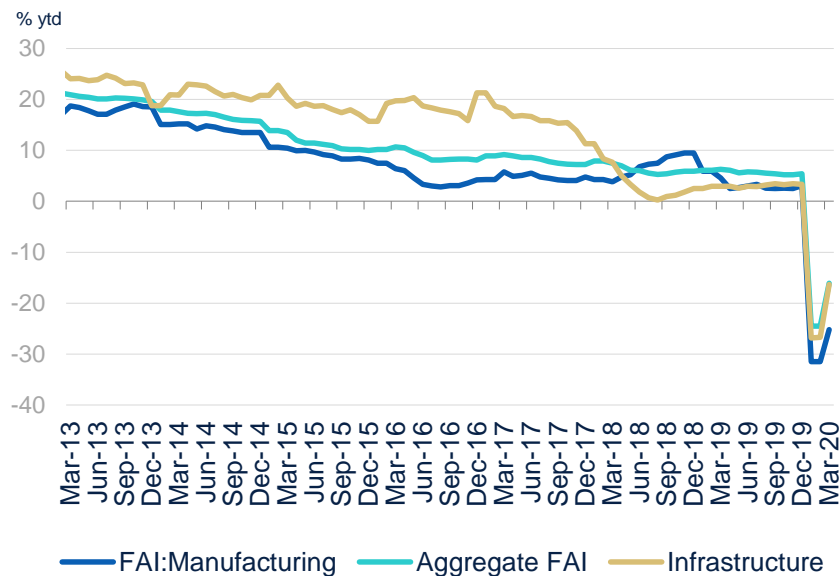


...DUE IN PART TO SLUGGISH AUTO SALES.

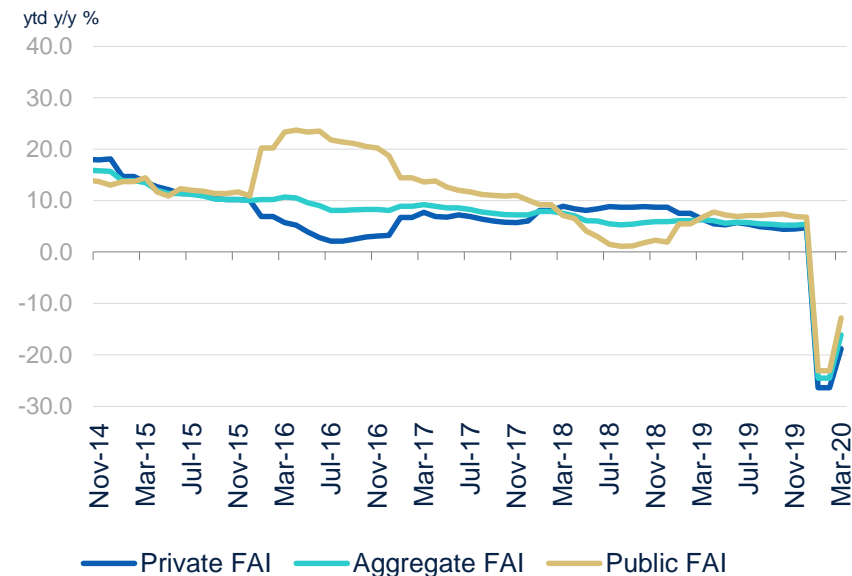


Investment activities were interrupted by lockdown policy

THE AGGREGATE FAI MARGINALLY IMPROVED IN MARCH...

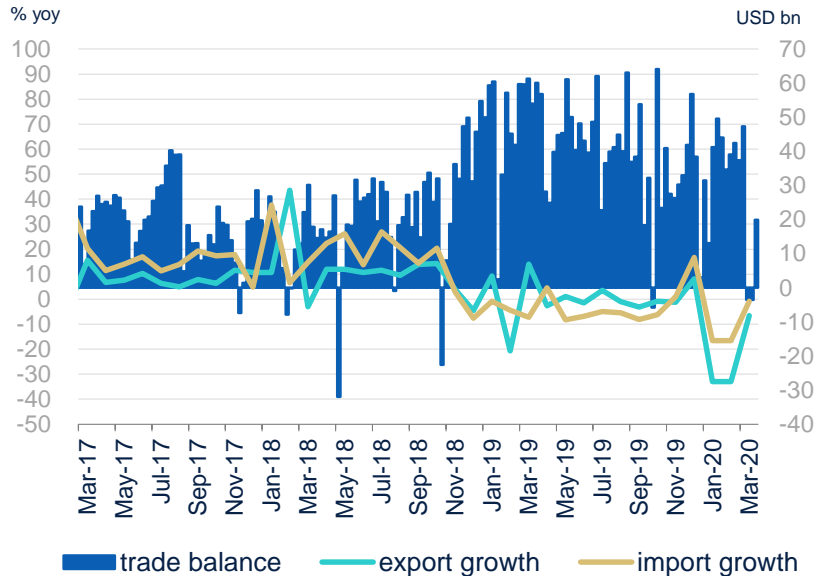


...WITH SYNCHRONIZED PERFORMANCE OF BOTH PUBLIC AND PRIVATE SECTORS

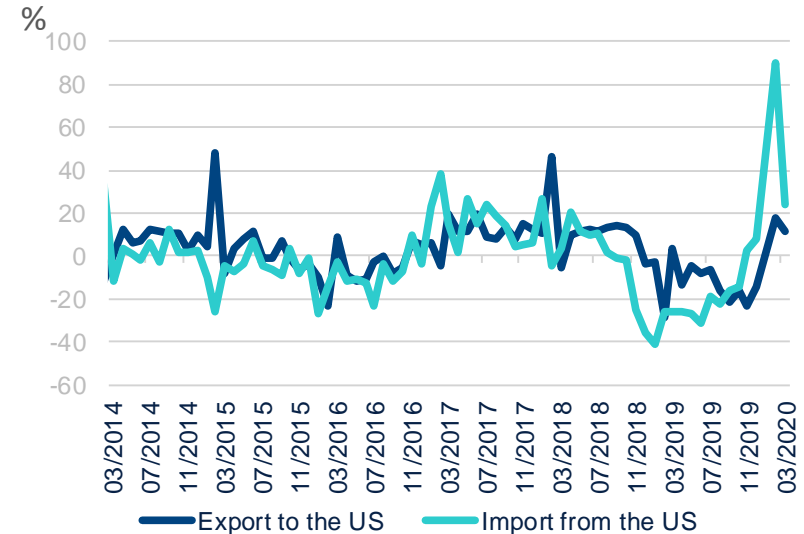


The rebounding trade is set to be short-lived

BOTH EXPORTS AND IMPORTS DECLINED TO NEGATIVE REGION IN JAN-FEB, BUT PICKED UP IN MARCH

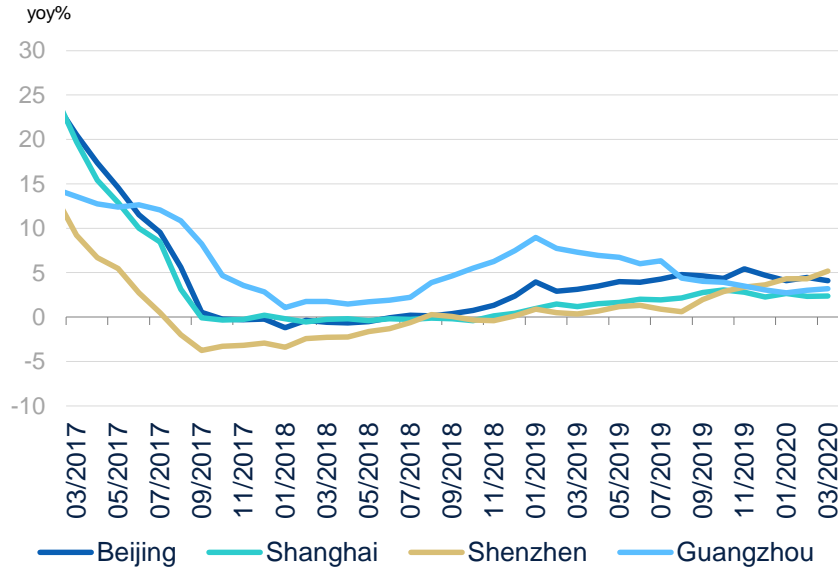


TO FULFILL THE PHASE-ONE DEAL WITH THE US, CHINA'S IMPORTS FROM THE US ROCKETED SIGNIFICANTLY IN Q1

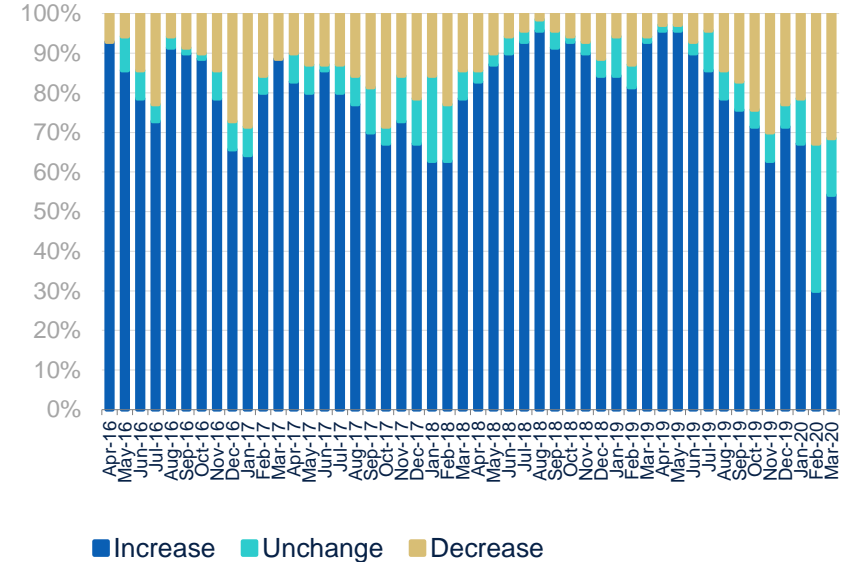


Housing market remains anemic

HOUSING PRICES REMAINED STABLE IN BIG CITIES AS HOUSING SALES RELATED ACTIVITIES STAGNANT IN Q1



THERE ARE SIGNIFICANT DROP OF NUMBER OF CITIES THAT REPORTED HOUSING PRICE INCREASING IN Q1 (M/M GROWTH)

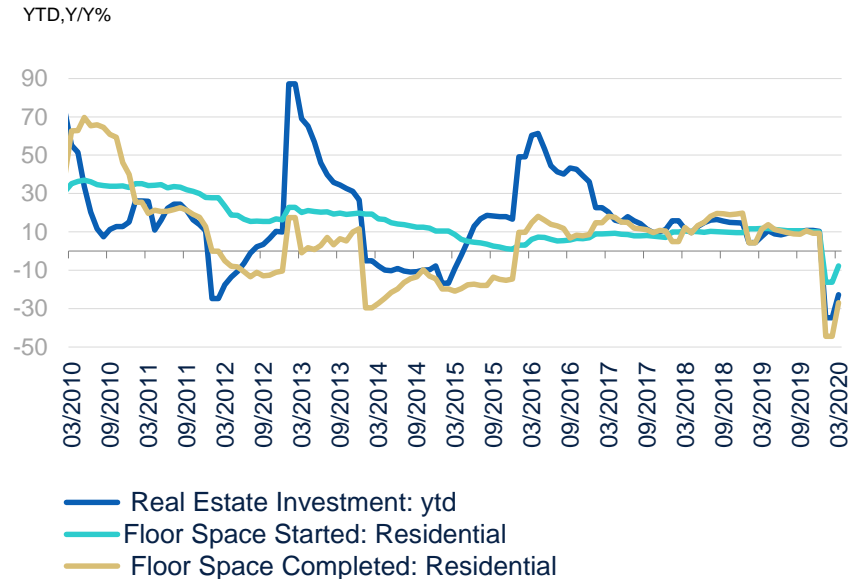


Sluggish property market weighs on real estate investment

THE GROWTH RATE OF RESIDENTIAL BUILDING SOLD DIPPED...

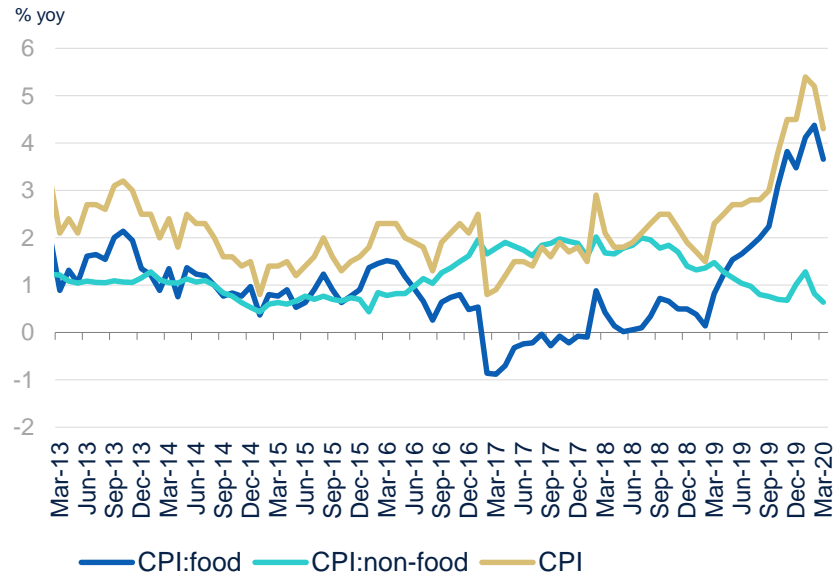


...AS WELL AS REAL ESTATE INVESTMENT

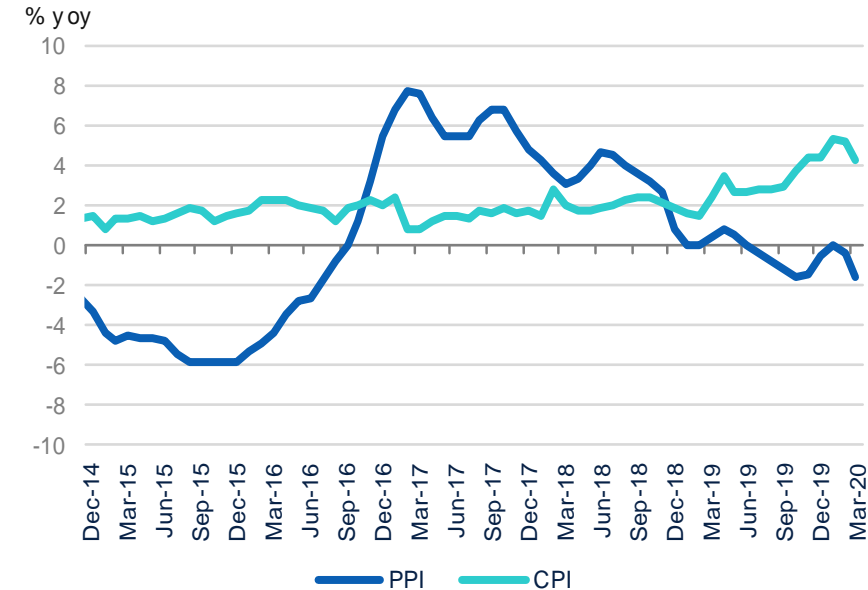


High CPI caused by ASF eased in March amid subdued growth

THE RUN-UP OF FOOD PRICES SLOWED SOMEWHAT IN MARCH DUE TO COVID-19 OUTBREAK

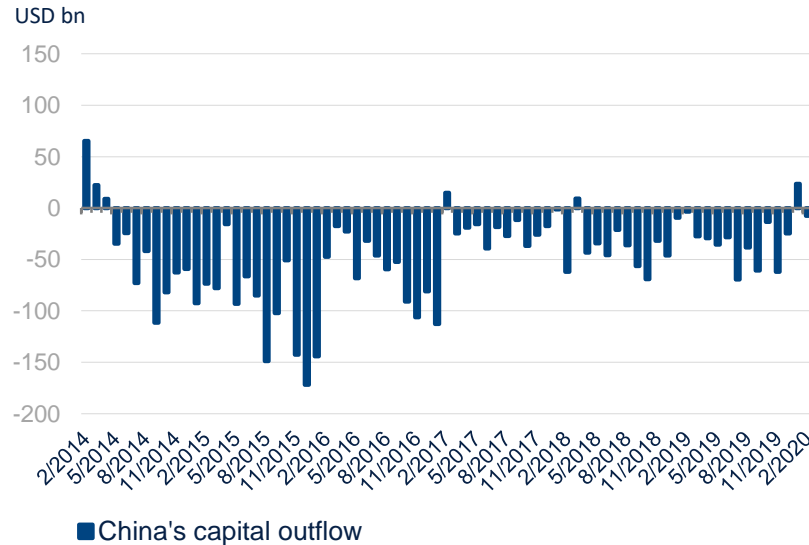


PPI DIPPED TO THE NEGATIVE TERRITORY ON THE BACKDROP OF GLOBAL OIL CRASH

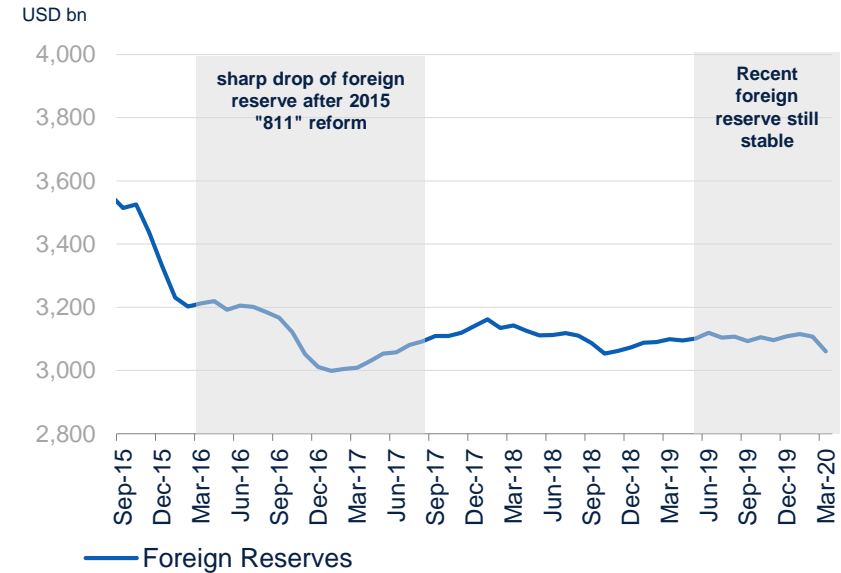


The impact of COVID-19 on China's capital flow and foreign reserve is limited

CAPITAL FLOWS REMAIN MANAGEABLE DUE TO THE AUTHORITIES' CAPITAL CONTROL MEASURES

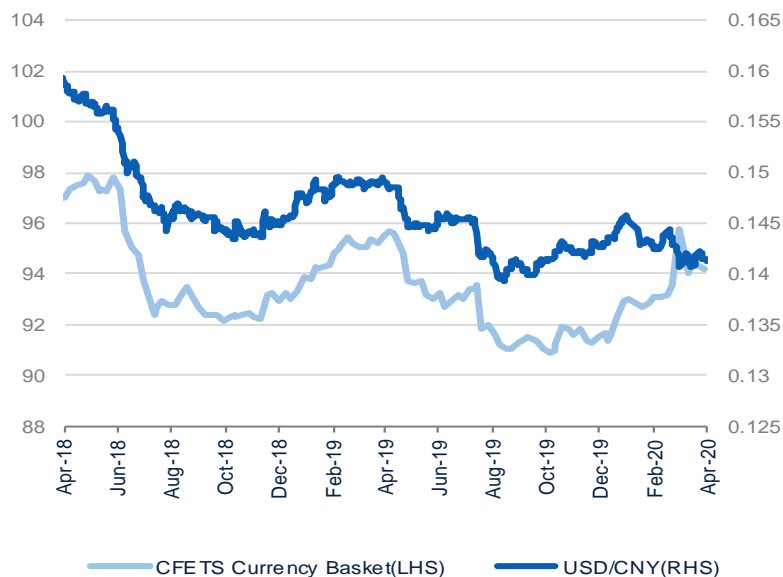


FOREIGN RESERVES STABLE AT THE CURRENT STAGE AND IS EXPECTED TO INCREASE THROUGH THE YEAR

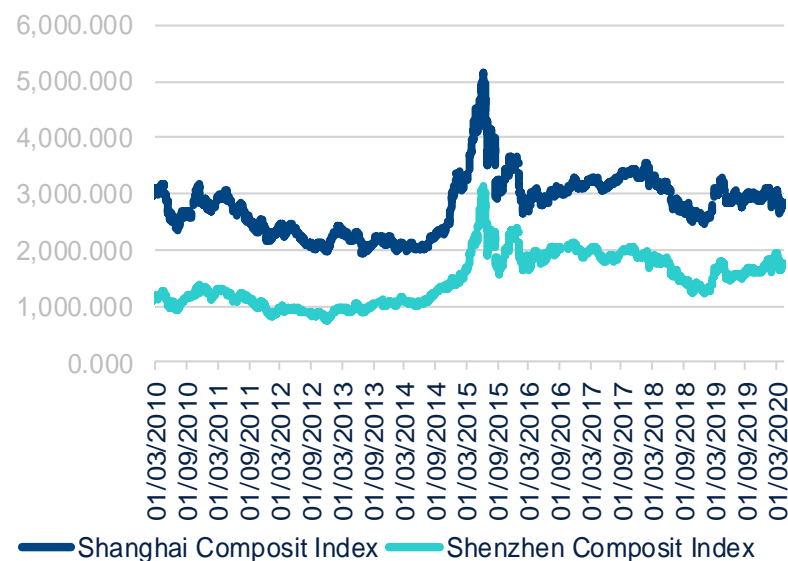


China's financial markets remain largely stable

SLIGHT DEPRECIATION OF RMB...



WITH CERTAIN CORRECTION IN STOCK MARKETS



03

What's in China's policy arsenal to counter global recession?

Main messages

- The current policy mix is to make the fiscal easing play a leading role while monetary policy coordinates.
- It is desirable that fiscal policy will be deployed in a more targeted way. In this respect, the stimulus package is likely to include fiscal tax cut and fee reduction, issuance of special government bond and special local government bond, and support for new infrastructure investment.
- On the monetary front, the liquidity management tools should be used more proactively since the interest rate cuts are constrained by various factors.

What will be China's weapons to counter COVID-19 and global recession?



Fiscal policy: (1) To expand fiscal deficit to GDP ratio



Fiscal policy: (2) To issue special government bond.



Fiscal policy: (3) To expand local government bond quota



Fiscal policy: (4) To support new infrastructure investment



Monetary policy: (1) interest rate cut: including LPR, MLF, benchmark deposit rate, OMO rate.



Monetary policy: (2): RRR cut



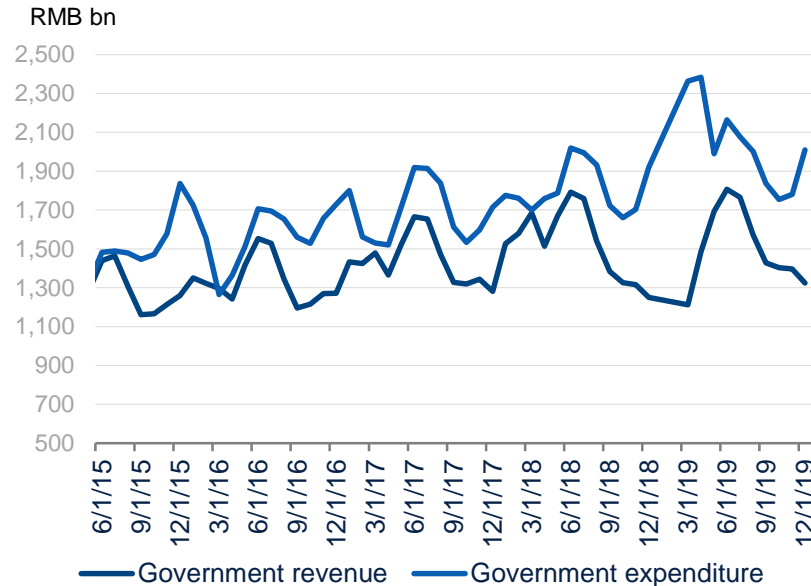
Monetary policy: (3) Liquidity support, such as to delay the debt payment date for household and enterprises.



Monetary policy: (4) Re-lending and Re-discount

Fiscal easing measures are in full swing

THE AUTHORITIES HAVE BEEN CONDUCTING EASING FISCAL MEASURES TO AVERT NEGATIVE GROWTH

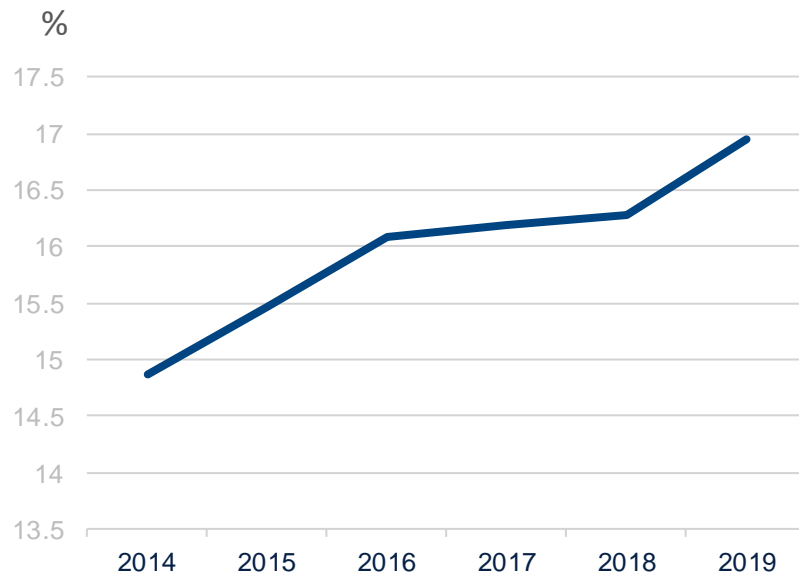


Source: CEIC and BBVA Research

- Proactive fiscal policy this year include:
- Tax cut and fee reductions for affected regions and sectors.
- Expand local government bond issuance; expect to issue RMB 4-5 trillion this year.
- Issuance of special government bond; expect it will be RMB 2 trillion this year.
- Increasing fiscal deficit to GDP ratio: expect from 3% to 4%.
- Support new infrastructure investment.
- We expect the total stimulus of fiscal measures will reach around RMB 4-5 trillion in 2020, equivalent to that of 2008-2009 GFC.

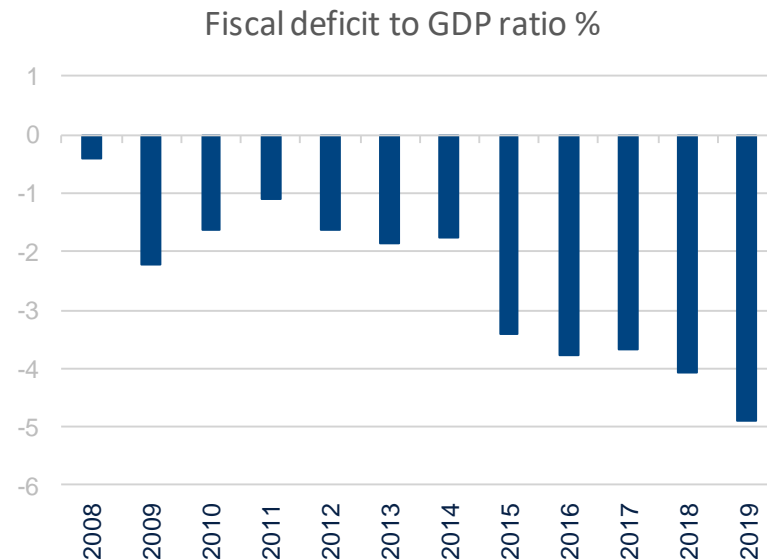
However, the authorities need to take lessons from RMB 4 trillion package in 2008-2009 GFC

CHINESE CENTRAL GOVERNMENT DEBT TO GDP RATIO HAS BEEN INCREASING OVER TIME



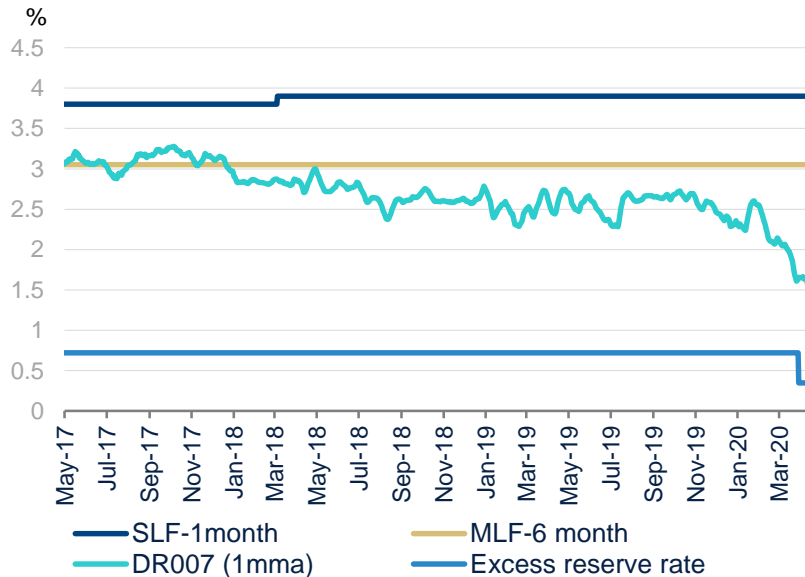
Source: CEIC and BBVA Research

CHINESE AUTHORITIES HAVE ANNOUNCED TO INCREASE THIS YEAR'S FISCAL BUDGET TO GDP RATIO

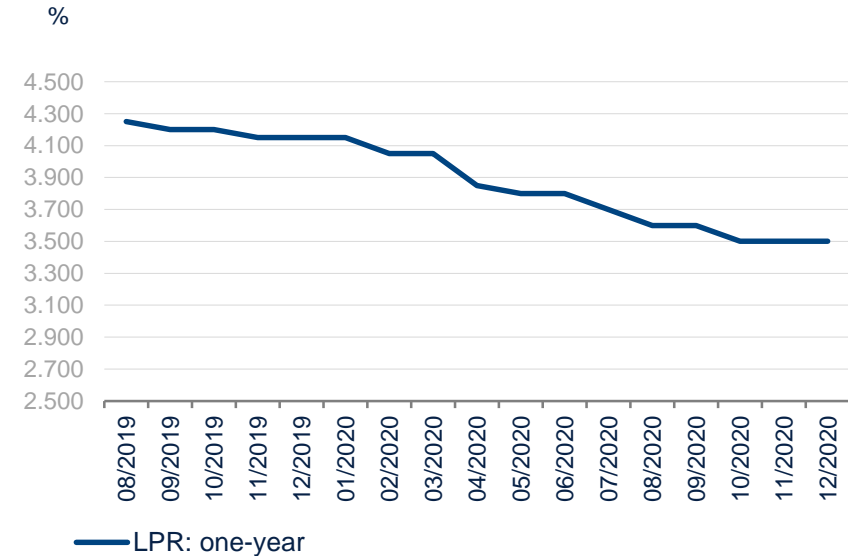


The PBoC cut LPR, MLF and other OMO rates in Q1

THE PBOC IMPLEMENTED EASING MONETARY MEASURES UNDER THE NEW FRAMEWORK OF CORRIDOR SYSTEM; MLF HAS BEEN DECREASING

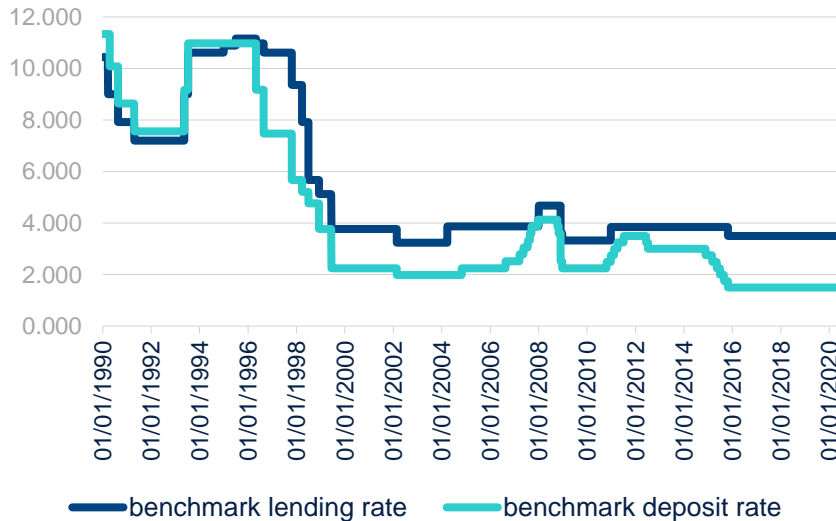


OUR PREDICTION OF LPR: WILL DECLINE ON A MONTHLY BASE, LPR FROM 3.85% NOW TO 3.5% END-2020.

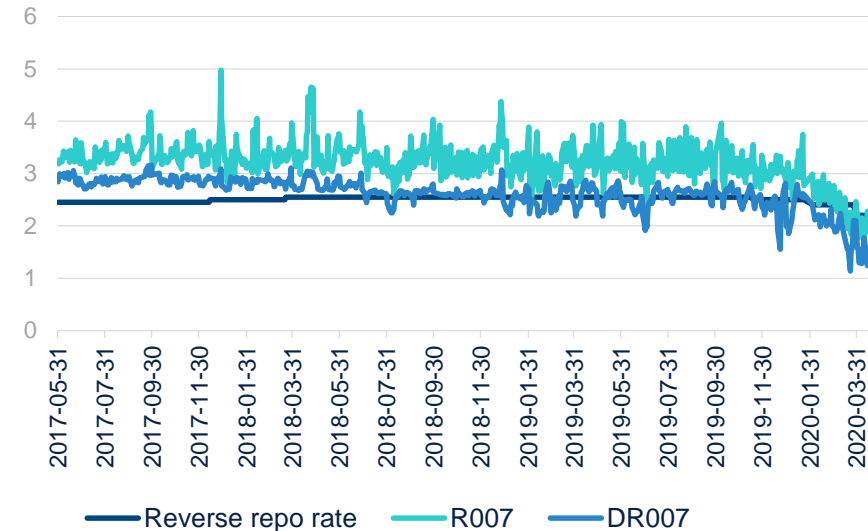


However, room for rate cuts is limited

THE ROOM OF LPR CUT IS LIMITED AS IT WILL SHRINK BANK PROFITS IF BENCHMARK DEPOSIT RATE IS FIXED

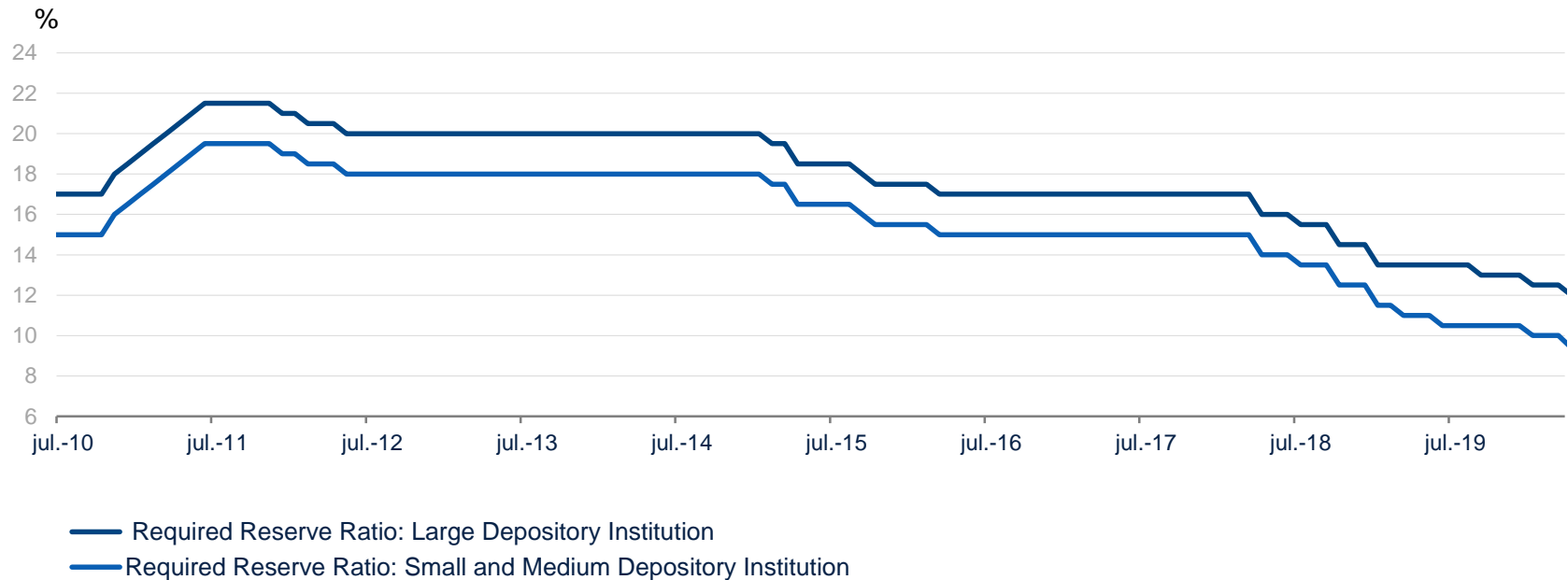


THE 7-DAY REVERSE REPO HIGHER THAN DR007 AND R007, INDICATING INTERBANK MARKET HAS ENOUGH LIQUIDITY (%)



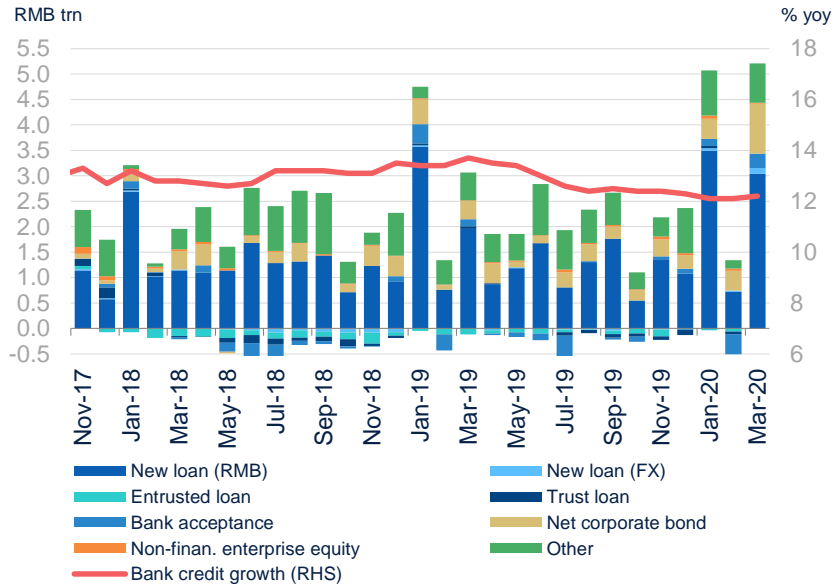
RRR cuts seem more effective

TWO RRR CUTS IN Q1 AND WE EXPECT ANOTHER TWO TO THREE CUTS IN THE REST OF 2020.



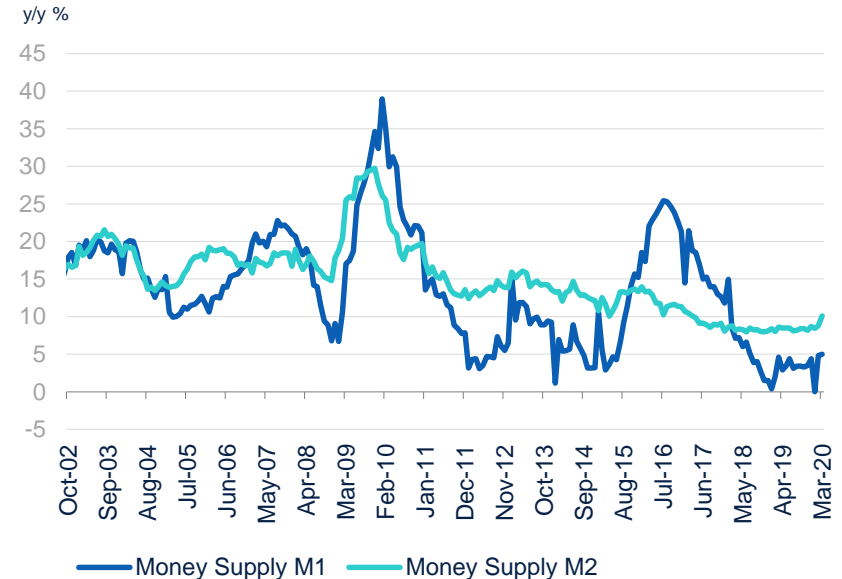
M2 and total social financing are picking up in March

NEW CREDIT SUPPLY INCREASED SIGNIFICANTLY IN MARCH.



Source: CEIC and BBVA Research

M2 GROWTH JUMPED TO 10.1% Y/Y IN MARCH FROM 8.8% IN FEBRUARY.



Source: Wind & BBVA Research

04

Projections

Main messages

- Looking ahead, growth headwinds shift from domestic lockdown policy to subdued external demand as China's major trade partners are struggling to contain the COVID-19 contagion in their domains.
- We forecast GDP growth will pick up to 2% y/y in Q2, while further to 5 % y/y and 7% y/y respectively in Q3 and Q4. Thus, the whole year GDP growth will reach 2.2%.
- Inflation is likely to slow down through the rest of the year due to subdued demand.
- The pandemic's impact on China's Balance of Payment (BOP) is projected to be limited.

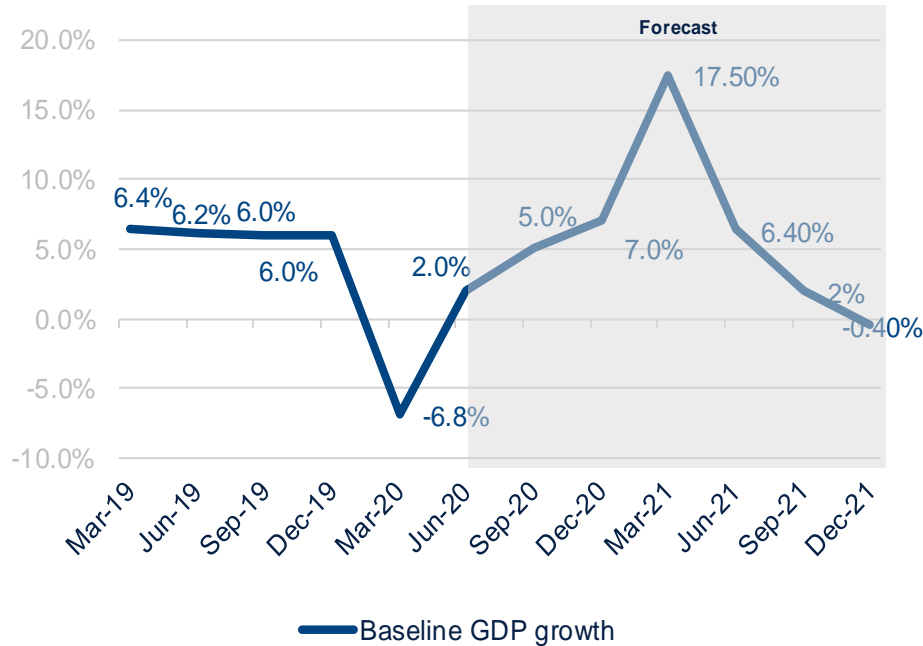
Economic indicators forecasting

BASELINE SCENARIO

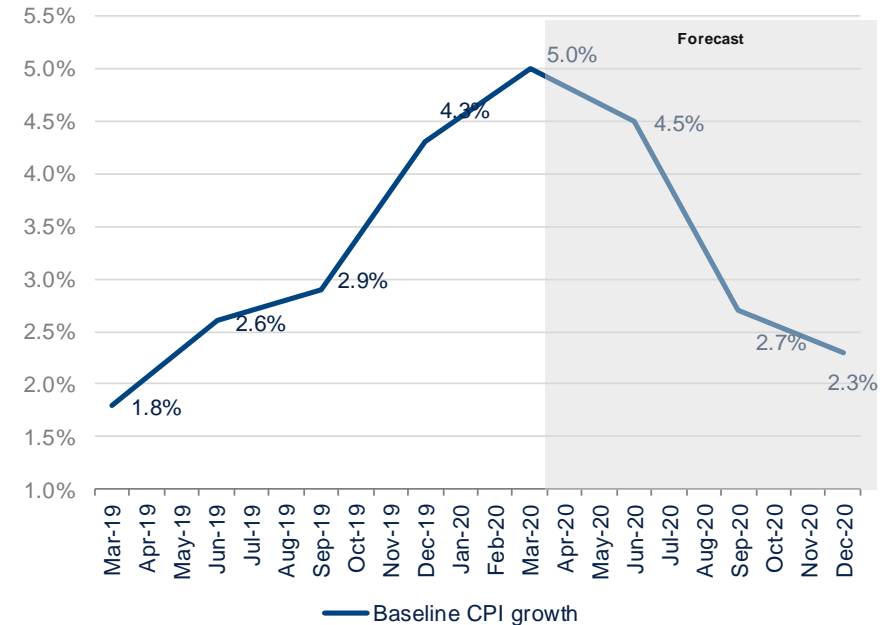
% a/a	2019	2020 (f)	2021 (f)
GDP (%)	6.1	2.2	5.5
CPI (%)	2.9	3.6	2.5
Interest rate (LPR, %)	4.15	3.5	3.5
RMB exchange rate	7	7	6.8
Fiscal deficit to GDP (%)	-4.9	-6	-4.5

Forecast of GDP and CPI: baseline scenario

WE FORECAST GDP GROWTH WILL BE A V-SHAPE IN 2020



CPI WILL CONTINUE TO TREND UP IN 1H 2020 WHILE SLOW DOWN IN 2H 2020 DUE TO HIGH BASE EFFECT.



The impact of COVID-19 on China's Balance-of-Payments is limited (1)

HOW THE COVID-19 OUTBREAK AFFECTS DIFFERENT COMPONENTS OF THE BOP

Components of BOP	Impact in 2020
Goods Trade	Negative
Services Trade	Positive
Primary and Secondary Income	Slightly Positive
Direct Investment	Negative
Portfolio Investment	Positive

The impact of COVID-19 on China's Balance-of-Payments is limited (2): forecasting foreign reserve based on our model for end-2020

(Unit : bn USD)	2018	2019 (f)	2020 (f)
1.Current account	49	141	186
1.1 Goods trade	351	425	310
Goods export	2,487	2,399	2,041
Goods import	2,136	1,974	1,731
1.2 Service trade	-292	-261	-117
1.3 Primary and secondary income	-54	-23	-7
2.Foreign reserve valuation effect	100.1	-62.2	-58.7
3. Domestic FX holding change by household and enterprises	73.0	5.4	16.8
4. Domestic FX holding change by banks	-76.0	13.5	-29.5
5. Cross-border net RMB flow	-22.7	-43.5	-7.8
6. Net FDI	107.0	58.1	37.8
7.Portfolio Flow (including errors and omissions)	-311.2	-23.4	-23.4

Source: CEIC and BBVA Research

**Foreign reserves change= foreign reserves' currency valuation effect +current account balance
+net FDI +net RMB cross-border flow + domestic FX holding change + portfolio flow**