Q1 Data Shows an Unprecedented Contraction in China's Economy - more optimistic outlook for Q2

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Amid gloomy speculation on China's first-quarter economy, the National Bureau of Statistics (NBS) unveiled the Q1 data on April 17, 2020. Although in line with the predictions of many economists, the 6.8% contraction in GDP during the first quarter of 2020 is the first quarterly decline on record at least since the 1992 when the official quarterly GDP records started. All three sectors, the primary, secondary, and service sectors, took a tumble in the past quarter, down by 3.2%, 9.6%, and 5.2%, respectively.

Compared to last year, industrial production, retail sales and fixed asset investment all shrank again in March, albeit less so than in January and February. There are two primary factors responsible for the plunge in China's economy over the beginning of 2020. First, China implemented aggressive actions to combat the spread of COVID-19, which broke out in January. The mandatory home quarantine and economic shutdown deeply hindered domestic demand and production, especially before lockdown orders were eased in March. All economic activities, including household consumption, business investment, and international trade, stagnated due to the coronavirus pandemic response. Since March, responses to the coronavirus pandemic in the rest of the world, particularly in some of China's major trade partners, hit the Chinese economy yet again. Many Chinese manufacturers dependent on imports and exports were heavily disrupted by conditions in global markets.

Industrial production, along with the manufacturing, mining, and utility sectors, fell by 1.1% in March year-on-year. This is less severe than was estimated by a Bloomberg survey, which predicted that China's manufacturing could contract by 6.2% in March. However, included with January and February, industrial production dropped by 8.4% in the first quarter of 2020. Manufacturing took the biggest hit, plummeting 10.2%, followed by utilities (-5.2%) and mining (-1.7%). Even as factories reopen and production resumes on a large scale, this data shows that the economic effects of the Coronavirus response in China are lingering.

Retail sales, a key measurement of consumption, slid by 15.8% in March, year-on-year, following a record decline of 20.5% in January and February. Cumulatively, year-on-year growth of retail sales was -19% in the first quarter, nearly twice as low as the -10% that economists predicted. Restaurants and hotels bore the brunt of the decline, shrinking 35.3% in the first quarter. Retailing and wholesaling decreased by 17.8%. The decline in retail sales slowed as lockdowns in China were gradually lifted in March. Moreover, in March, sales of household staples, such as cereals and oil, food and beverage, and medicine increased. Although E-commerce sales dipped slightly from last year, they played a more significant role in the retail sales sector, increasing their market share by 23.6%.

Fixed asset investment, a gauge of expenditure on items including infrastructure, property, machinery and equipment, fell by 20.5% in January and February, and 16.1% overall in Q1. This is a more severe decline than what economists had forecast (i.e., 15.1%), but at least shows an improving trend since January-February. Infrastructure, manufacturing, and real estate all saw a slump in investment, with drops of 19.7%, 25.2%, and 7.7%, respectively. Investment in sectors that serve to combat the coronavirus health crisis, such as in health and biotechnology, grew against the investment downturn at a modest rate.

According to China's Customs, China's foreign trade reached US$ 941.4 billion in the first quarter of 2020, with a year-on-year decrease rate of 6.4%. Of that, exports decreased by 11.4%, totalling US$ 476.4 billion, and imports fell by 0.7% totalling US$ 465 billion. China's trade surplus in the first quarter fell to US$ 11.4 billion, decreasing 80.6% year-on-year. China's foreign trade volume rebounded in March, decreasing by only 0.8% compared to the 9.5% decline seen in January and February. Exports in March decreased by 3.5%, reaching US$ 183.8 billion, while imports experienced an increase of 2.4% reaching US$ 165.3 billion. Compared to the smaller decrease in imports in the first quarter and even a slight increase in March, the larger decrease in China's exports can be attributed to both supply-side and demand-side factors. As for the supply-side, China's export ability was severely reduced by its quarantine policy and shut down of production. As for demand, the COVID-19 worldwide spread slashed global demand for imports, excluding medical supplies. This could be evidenced by ASEAN[1] (Association of Southeast Asian Nations) replacing the EU (European Union) –– as China's largest trading partner in the first quarter (?). The EU is widely seen as experiencing more difficulties with the pandemic than ASEAN countries.

China's inbound FDI (Foreign Direct Investment) totalled US$ 31.2 billion in the first quarter of 2020, decreasing 12.8% from Q1 2019. March saw FDI of US$ 11.65 billion, a decrease of 14.4%, while FDI decreased by 25.6% in February. However, China's inbound FDI in the high-tech service industry increased by 15.5% in the first quarter. FDI in information service, electronic business service, and professional technical service increased by 28.5%, 62.4% and 95% respectively, which is not unexpected considering the increased demand for online service amid the quarantine measures.

Meanwhile, China's non-financial OFDI (Outbound Foreign Direct Investment) amounted to US$ 24.22 billion in the first quarter, with a decrease rate of 3.9%. The non-financial OFDI reached US$ 8.72 billion in March, while it was US$ 8.1 billion in January and US$ 7.4 billion in February. However, investment in countries along the BRI still increased over the first quarter at a rate of 11.7%. Conversely, 28 countries and regions, including the United States, Europe, Japan and Australia, have implemented new policies enhancing scrutiny on foreign investment since late 2019, imposing additional challenges for China's OFDI growth in 2020.

China's surveyed urban unemployment rate was 5.9% in March, and 6.2% in February. The unemployment rate for 25 to 59-year-old population was 5.4%, compared to 5.6% in February. Meanwhile, the average weekly working hours increased by 4.6 hours to 44.8 hours in March, implying a promising resumption of production in March.

China's CPI (Consumer Price Index) increased by 4.3% in March, less than the 5.2% seen in February. The overall CPI growth rate for the first quarter of 2020 was 4.9%. The decrease in CPI growth can be mainly attributed to the decrease in the growth rate of food prices, especially the price of pork, indicating a stabilization of food supply and expedited logistics. China's Industrial Producer Price Index (PPI) decreased by 0.6% in the first quarter, with a decrease of 1.5% in March alone. The decrease in the Producer Price Index is linked mainly to the large decrease in the price of petroleum. Meanwhile, the Industrial PPI decreased by 0.8% in the first quarter, with the decrease rate in March alone being 1.6%. China's manufacturing PMI (Purchasing Managers' Index) recovered from 35.7% in February to 52% in March, but remained 4.9% lower year-on-year. These figures indicate that the Chinese economy experienced a difficult time in the first quarter of 2020 as the result of the pandemic. However, it is worth noting that both the manufacturing PMI and the non-manufacturing business activity index increased significantly in March, indicating the Chinese economy is recovering.

To help businesses recover from the response to the pandemic, China loosened its fiscal and monetary policy this past quarter. China's total social financing, a broad gauge of credit and liquidity in the economy, rose by 29% to US$1.58 trillion in the first quarter from the previous year. The broad money, or M2, a measure of the money supply, climbed 10.1% to CNY208.09 trillion at the end of March from a year earlier, as new loans surged nearly 30.3% to CNY7.1 trillion, according to data released by the People's Bank of China. China also cut borrowing costs to relieve the financial burdens businesses face in this pandemic. The expansionary monetary policy is expected to continue as the Chinese economy recovers.

This Q1 data confirms China's first economic contraction since the 1970s at the hands of the coronavirus outbreak. With the disease largely under

[1] ASEAN members include Indonesia, Malaysia, Philippines, Singapore, Thailand, Brunei, Laos, Myanmar, Cambodia and Vietnam.

control in China, reopening businesses and resuming production is now the primary item on China's economic agenda, and 99.4% state-owned and 84% of medium & small-sized businesses have already resumed operation.[2] More than 90% of employed workers have reportedly returned to work. China's electricity use, Transportation Service Index (CTSI), and excavator sales in March rose significantly from the first two months of 2020, suggesting a rebound from the historic economic downturn.

March data sheds some light on China's economic recovery and provokes positive projections of China's 2020 economic growth albeit much less optimistic than previously forecasted. Chinese officials said the Chinese economy could show a promising recovery in the second quarter. IMF forecasted a positive growth of 1.2% in China in 2020, despite a contraction of 3% in the global economy. Other projections of China's economic growth this year vary from 1% to 3%. These figures also suggest that an ambitious "V-shape" recovery from coronavirus impact may not happen this time in China, given the severe disruption to the economy in the first quarter and the sluggish global market resulting from the Coronavirus pandemic. As countries reduce economic activity to battle Coronavirus and hamper growth, a global recession is almost inevitable, which may in turn hinder China's recovery. The global economic downturn will have a significant impact on China's overseas supply and demand chain, especially on trade and investment due to the stagflation of its major trade partners.

Besides the global recession, other uncertainties may also challenge China's economic recovery. The dramatic volatility in oil prices further weakened the global economy which has already slowed down by COVID-19. The plunge in oil prices may have multiple impacts on China's recovery. On the one hand, China may benefit from cheap oil prices as the largest oil importer in the world. This could lower the cost of industrial production and business operation, especially benefiting China's manufacturing and transportation sectors and hence stimulating economic recovery. On the other hand, volatility may lead to profit loss for Chinese energy companies and threaten the recovery of the energy sector. Additionally, the US-China trade tensions persist, despite some encouraging signs including the "Phase One Trade Deal" in agricultural purchases and market access.

Facing these uncertainties, it may be too early to predict China's overall economic path in 2020. However, if the global economy indeed falls into a recession, it is unlike China could escape major economic setbacks that would have profound impacts on many of its industrial sectors.

[2] http://www.gov.cn/xinwen/2020-04/17/content_5503281.htm