Ahead of the curve?

15 May 2020

China was the first country to feel the effects of Covid-19, and has been first to relax lockdown. We take a look at what the world can learn.

China specifically, and Asia, in general are interesting for a few reasons. Most obviously it was China that suffered the first wave of coronavirus cases and so offers the first case study for how to contain the virus and how to re-start the economy.

China is also likely to be at the vanguard of any feared second wave of cases. It will also therefore offer the first opportunity for businesses and the authorities to show how they have evolved their practises to be more resilient and active if a second wave of infections hits.

Step by step

At the start of April, the lockdown in Wuhan started to be relaxed, 76 days after restrictions were imposed. The relaxation of rules has been approached regionally – so Beijing and Shanghai reopened schools ahead of Wuhan – and sector by sector. The Government has also recently announced plans to gradually reopen cinemas, museums and other recreational venues.

The process has been carefully managed. Initially, those who had a green clearance code on a smartphone app were free to leave the city, with travel on public transport restricted in a similar way. However, it has not been a quick reopening.

Many restaurants and shops have remained shut. Wuhan's senior schools reopened on 8 May, and then not for all age groups. As well as distancing between desks, thermal scanners were in place, and anyone with a high temperature was not allowed in.

Now, with news of fresh cases in Wuhan, concerns over a second wave following the easing of restrictions seem pertinent.

Consumer confidence

Weeks after restrictions were eased, the streets have remained quieter than normal. Consumers appear wary and seemingly reluctant to venture out and spend.

A recent broker survey of large services firms shows that while 75% to 85% of supply has been restored, demand is only running at 50% to 55% of normal levels. Many companies don't expect full normality at home to return until the second half of the year[1].

This question of demand is significant because while exports remain important for the Chinese economy, (and will therefore feel any drop in international demand caused by lockdowns elsewhere around the globe), they are not as meaningful in terms of growth as they once were. Domestic consumption accounted for 80% of last year's growth, which is why getting consumers back out and spending could be so crucial.

Such is the concern, that billions of yuan in shopping vouchers have been given away to encourage consumers to start spending again.

How long this drop in consumer confidence lasts is something that leaders in the west will be watching with interest.

Further intervention opportunities

Despite consumer caution, the economic data has shown that the reopening is certainly making a difference. Construction and manufacturing activity has been returning. After the shock contraction in the first quarter of the year when GDP shrank 6.8%, China's first year on year quarterly decline since 1976, March and April's monthly data show that activity is picking up.

Nevertheless, the economy still has a long way to go to get back to where it was pre-crisis, putting pressure on the authorities to do more.

However, the authority's dilemma is that they are trying to juggle competing objectives. On the one hand, they want to boost spending and encourage new borrowing to boost

1 https://www.bbc.co.uk/news/business-52305259

growth. On the other hand, they are reluctant to abandon their longer-term goals to reduce debt and risk. There has been a very large increase in debt in China across all sectors, with the stock of debt expanding from 140% of GDP pre-financial crisis to almost 260% of GDP as of Q3 last year.

There have been interventions already. Loan activity is picking up. Data last month showed that bank loan and total social financing growth accelerated, as did M1 and M2 money supply. This signals that the authorities are leaning on its state-owned banks and reducing constraints around shadow bank lending to boost credit creation.

There is scope to do more – and compared to other governments around the world, they have been quite meek so far. The question will be around how much more and where it will be targeted.

The annual National People's Congress, which was initially scheduled for 5 March, will now be held on 22 May. Major legislation, policy initiatives as well as economic targets are unveiled at this event, so this is something that will be watched closely.

Economic scarring

Looking at the experience in China, it is important to remember that suppression measures of some form will remain in place in countries around the world until there is a vaccine or herd immunity. Hospitality businesses may struggle to cover their operating costs with strict social distancing measures in place, which suggests there will be additional job losses once governments start to scale back support for furloughed staff.

Businesses and households will emerge from strict lockdowns cautiously, and investment and consumer spending will not fully snap back. There will also be defaults, which will impact banks' willingness to lend, and result in more job losses. The bottom line is that this crisis will leave the economy with scars.

The Chinese experience has relevance for what the rest of the world can expect from life immediately after lockdown, although it seems as if cultural differences have meaningful implications. Chinese data are notoriously unreliable but even assuming under-reporting, China appears to have restricted cases and mortalities far better than the western world. That is the advantage of an authoritarian system and a largely compliant population.

This is generally true of the developed Asian countries which have also typically taken a cautious approach to lifting lockdown. It means that if we see a meaningful pick up in Asian cases then we should be steeled for even more disruption in Europe and particularly the US, where reopening the economy has been given a higher priority than in other regions.

More recently several western countries have accused China of everything from secrecy to negligence over their management of the virus. President Trump has threatened tariffs once more and so the previously receding threat of a trade war may now be in the ascendancy again.

Neither party would benefit from pushing this issue too far, with their economies pretty well-integrated and dependent upon each other. But facing an election in November and an economic challenge of historical proportions we can expect the US to continue to talk tough.

While markets have rallied significantly from their lows, most remain some distance from this year's highs. We expect them to continue to make progress over the next twelve months, but, amidst coronavirus uncertainty and tense foreign relations, the near-term outlook warrants a slightly more cautiously optimistic stance.