Economic Views – China's Recovery from the COVID-19 Shock

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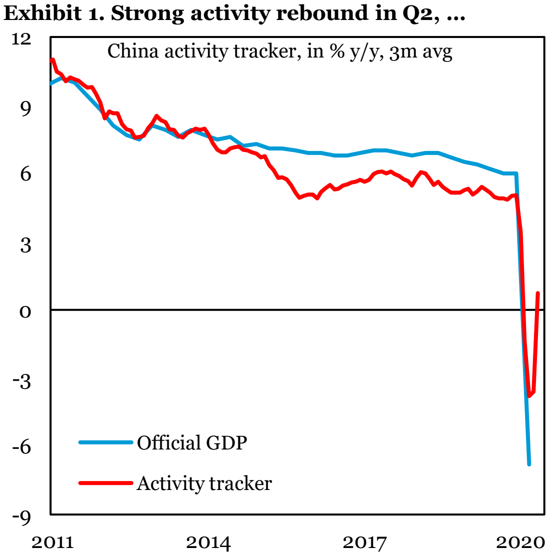
- We look into China's recovery from the COVID-19 shock.
- Our activity tracker points to positive y/y growth in Q2.
- Industry and manufacturing staged a V-shaped recovery, ...
- but retail trade remains weak and looks U-shaped at best.
- Neighboring economies are also struggling to revive retail.

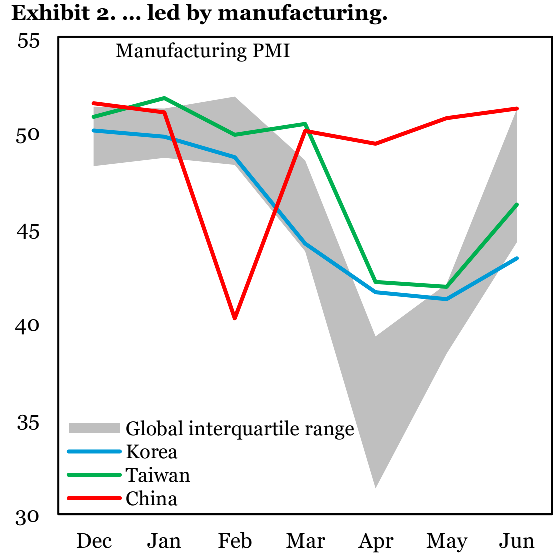
China suffered the most from COVID-19 at a time when the rest of the world still saw the virus as a tail risk. Since then, China has been on the path to normalization, while many other countries struggled to contain the virus. The "first in, first out" nature of China's experience with COVID-19 makes it a useful case study in a fluid environment where the shape of the recovery elsewhere in EM is uncertain. In this note, we gauge China's recovery through the lens of our activity tracker and a range of additional high-frequency indicators. We use Korea and Taiwan, two economies which also took early action to handle COVID-19, as comparators. Our tracking points to a clear V-shaped recovery in China. We think Q2 growth is on track to print above 2% y/y, an impressive rebound from a dismal reading in Q1 (-6.8% y/y). The manufacturing recovery appears complete and exports also normalized, excellent outcomes we have not seen in Korea yet. However, consumption is still heavily disrupted. Retail sales are significantly below pre-COVID-19 levels and look U-shaped at best. On this front, mainland China and Taiwan look very much the same, but Korea outperformed. The pattern is even more pronounced in restaurant sales, where all three economies are struggling. China's experience suggests a strong recovery in industry might be feasible in countries where virus containment measures are effective. Normalization in the retail sector could be an uphill battle, even in countries where the spread of COVID-19 is already well under control. Unfortunately, several major EMs are still far from successful virus containment and are unlikely to see a substantial growth rebound in the second half of the year.

Exhibit 1. Strong activity rebound in Q2, ...



Source: Haver, IIF

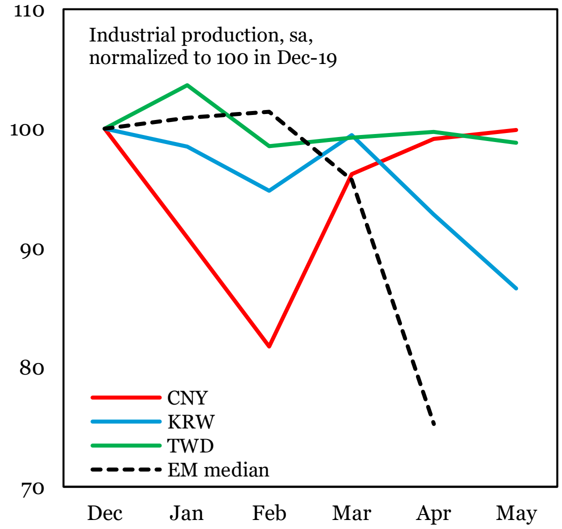
Exhibit 2. ... led by manufacturing.



Source: Haver, IIF

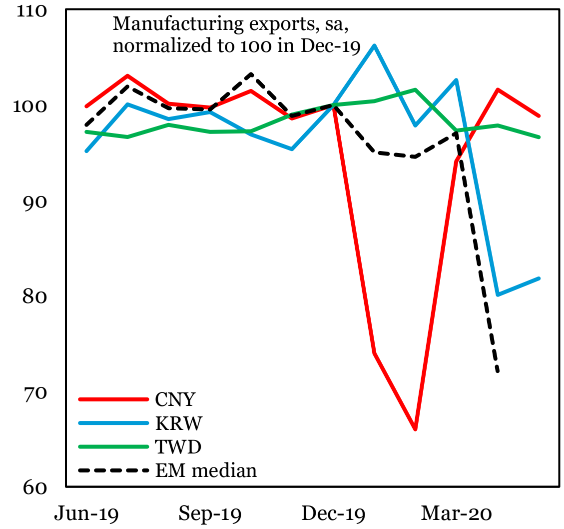
We have often articulated views on China's growth using our activity tracker based on high-frequency indicators. The tracker was especially useful in the 2015-19 period, when official GDP was oddly smooth despite large shocks such as the devaluation scare of 2015. Both official GDP and our tracker contracted sharply in Q1, coinciding with the peak of COVID-19 in the country. How much China's activity improves in Q2 will be an important signal for the global outlook, as most countries lag China by a few months in the COVID-19 infection cycle. Our tracker points to +2.3% y/y growth in April-May (Exhibit 1). The inputs into the tracker are tilted toward industry, which may impart a bit of an upward bias to our estimates as retail is lagging industry in the recovery. Despite this caveat, we are confident that overall activity is staging a V-shaped recovery. Evidence of a strong rebound is abundant in industry. The manufacturing PMI and industrial production paint a clear V-shape (Exhibits 2 and 3). In contrast, Korea and Taiwan, neighboring economies which also took swift and effective action to contain COVID-19, appear to be recovering slower than China. Manufacturing exports collapsed in Q1 but are back to their range in the second half of 2019 despite a sharp global slowdown (Exhibit 4). Whether the upward trend in industry can continue is unclear given exceptionally weak external demand.

Exhibit 3. The recovery is V-shaped, ...



Source: Haver, IIF

Exhibit 4. ... in industry and exports.

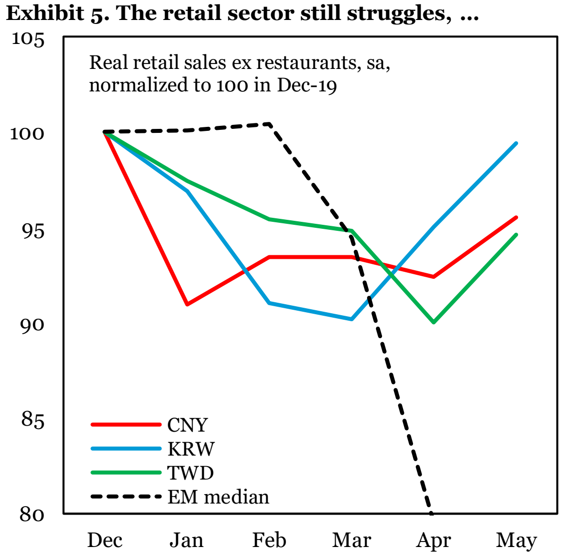


Source: Haver, IIF

The outlook is more challenging in retail than industry. Real retail sales in China are improving but are far from a V-shape (Exhibit 5). Taiwan is in the same position, but Korea outperformed and is close to pre-crisis levels. While the drop is sharp and persistent, it looks moderate relative to other EMs. The retail challenge is especially acute in the restaurant sector, where all three economies are far from normalization (Exhibit 6).

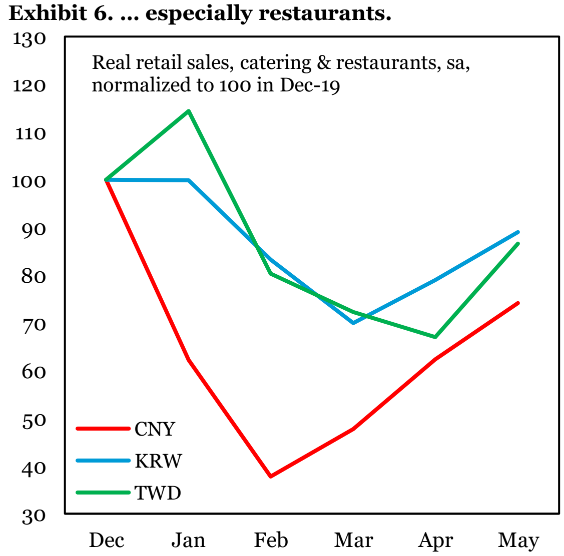
In addition to effective virus control, macroeconomic policy stimulus helped the recovery too. Fiscal stimulus via the central government and local entities could add up to 7-9% of GDP, a substantial figure for EM standards. The turnaround in infrastructure FAI relative to manufacturing suggests that as in the past infrastructure will be a central component of fiscal stimulus. RRR cuts released roughly 1.5% of GDP in liquidity, but in broad terms stimulus is titled to the fiscal side. Reflecting policy stimulus, we expect the broadest credit measure (total social financing) to expand more than 15% this year, on par with the 2016 reading and well above last year when the policy response to the trade war was moderate.

Exhibit 5. The retail sector still struggles, ...



Source: Haver, IIF

Exhibit 6. ... especially restaurants.



Source: Haver, IIF