

The impact of COVID-19 on China's economy

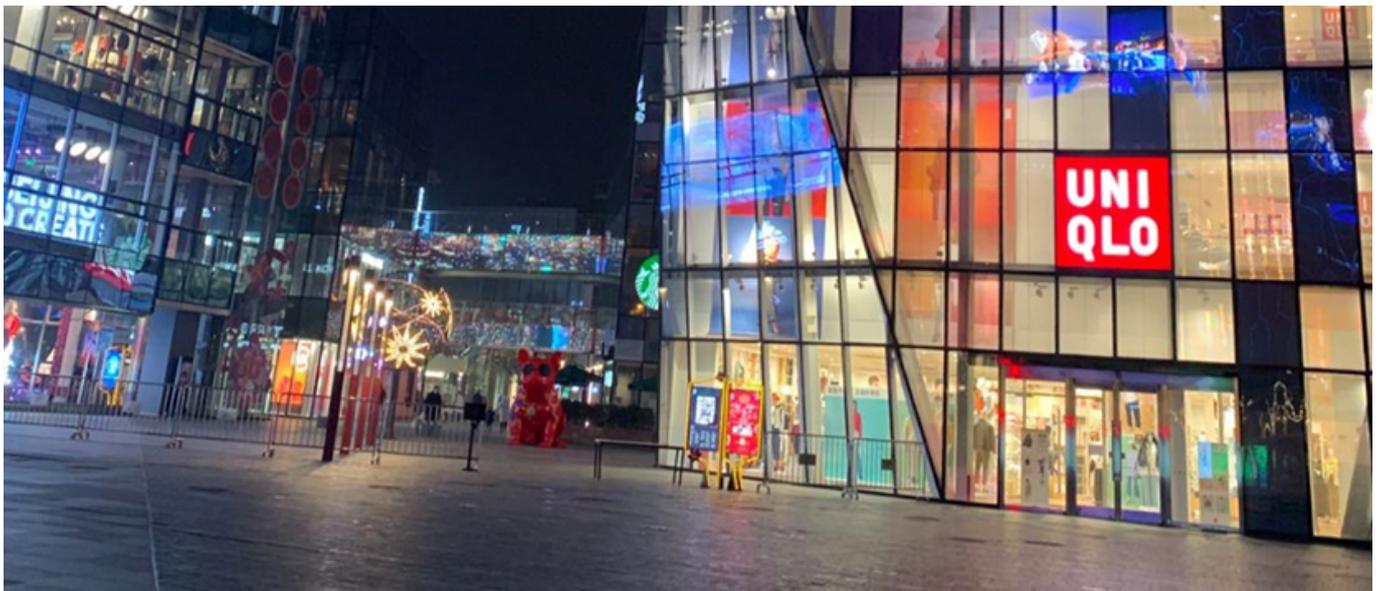
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Novel coronavirus pneumonia (NCP) likely to significantly affect China's economy in 2020

We expect the coronavirus outbreak to have a significant effect on China's economy. On 24 March, Fitch revised its 2020 GDP growth forecast to 2.6% from 4.3% estimated in mid-March. Other notable revisions in the past week include those by Goldman Sachs (3% from 5.5%), S&P (2.9% from 4.8%), Nomura (1.3% from 4.8%) and the EIU (1% from 5.9%).

China's manufacturing PMI was 35.7% in February, according to the National Bureau of Statistics, down 14.3 percentage points from January, well below entrepreneurs' confidence threshold (50%). Moreover, the non-manufacturing business activity index reached 29.6%, a decrease of 24.5% from January. Both manufacturing and non-manufacturing readings have dropped significantly.

The tertiary industry is hit the hardest, but other industries and upgraded supply services should offset this



Empty shops in Tai Koo Li, Beijing's famous shopping centre

The catering industry is large, with annual revenue estimated at around CNY4tn. The industry estimates that the virus outbreak will lead to a CNY500bn revenue loss in 1Q 2020.

The China Cuisine Association (CCA) released a report on the industry's operating conditions and

developing trends during the NCP epidemic: 78% of catering companies had lost all the revenue earned during the period, 9% had lost more than 90%, 7% had lost 70-90%, and only 5% reported losses less than 70%.

The China Real Estate Chamber of Commerce (CRECC) released a “Special Investigation Report on the Shopping Mall Industry during the Epidemic”, indicating that during the Spring Festival of 2020, passenger flow and sales of almost all shopping malls declined sharply. Uniqlo has 750 stores in mainland China, and approximately 280 of these have been closed. H&M China has closed a total of 257 stores in mainland China.

Online retail becomes the new growth engine for the tertiary industry as offline buying recedes

During the outbreak, people stay at home and rely heavily on apps that provide distribution services such as Freshippo, Ding Dong, and Bravo Supermarkets.

During this period, Carrefour’s delivery orders increased by 300% y/y, vegetable orders by 600%, Bravo Supermarkets’ orders by more than six times, and Duodian’s sales by 232.2%.

The outbreak reduces the output value of manufacturing, but overall advantages of manufacturing remain in place

The outbreak has added stress to the job market and weakened consumer demand in general, which in turn affects industrial sectors.



The ChangAn Automobile production line in the Hefei High-tech Zone has resumed operation

At present, Shanghai, Guangdong, Jiangsu, Shandong, Zhejiang, Fujian, Hubei, Chongqing and other provinces and cities have issued notices to postpone the resumption of business for a week longer than the usual Spring Festival holiday. These provinces and cities are also large industrial zones, accounting for about 50% of the country’s total industrial output value. Delaying starting work by a week would significantly reduce industrial economic growth in the first quarter. Manufacturing industries would be greatly affected, and output value may fall by more than 30%.

However, the overall advantages of China’s manufacturing industry remain in place. Its manufacturing system is the most comprehensive in the global market, and its industrial chain, supply chain, service

chain, and value chain the most complete. Most manufacturing industry clusters are still in China. New growth will not occur until the manufacturing industry resumes production on a large scale, which would ultimately depend on whether the epidemic is brought under control.

The fight against the pandemic enters the second half; economic recovery can be expected

As of 31 March, there were 82,640 confirmed cases (95 new cases) in China, with 76,417 cured (192 on 31 March alone). As the number of cured cases surpasses new infections, 318 cities report no new cases and only 19 cities new cases, the outbreak seems to be receding.

The national consumer market's operations have seen positive changes recently, according to data from the Ministry of Commerce, and market sales have bottomed out. In late February, average daily sales of 1,000 retail enterprises monitored by the Ministry of Commerce increased by 5.6% compared to mid-February. This is positive versus negative growth in late January. The automobile sector experienced a marked rebound, with a m/m increase of 14.8%; the communication equipment and home appliances markets reported sales increases of 11.7% and 11.1%, respectively.

In an effort to stimulate the economy, China's central bank effected a targeted reduction in the reserve requirement ratio in mid-March, totalling CNY550bn, based on a 6.13x money multiple (2019); this translates into CNY3tn in total liquidity in theory (2019 nominal GDP was CNY99tn).

Although the outbreak has most likely affected China's economy in the first quarter, its fundamentals and long-term outlook remain the same. As the outbreak is gradually contained, companies across the board would resume operations, steadily reducing the negative effects.

The way forward

Every crisis poses danger and challenges, as well as opportunities. For example, as major economies are likely affected further, bond and loan defaults are likely to rise, as are prices of corresponding CDS. Some sectors – such as energy, retail, restaurants, hotels, tourism, airlines, logistics, offline performance and entertainment – will likely continue to be hit, while others – such as online shopping/ecommerce, online gaming, online food delivery, and healthcare/pharma – are likely to perform strongly. On the macro front, with global central banks taking aggressive measures by beefing up monetary policy stimulus and injecting liquidity, M&A opportunities are likely to emerge as valuations decline, especially for private equity firms with sizeable dry powder.

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To help our clients navigate both the people and business impact of COVID-19, we have created a [dedicated hub](#) containing a variety of topics including our latest thinking, thought leadership content and action oriented guides and best practices.

Sources

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