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Topics What is the outlook of the Chinese economy for 2020 and 2021?

The Chinese economy is recovering at a faster pace than was expected. However, the pace of recovery will likely slow due to inventory adjustments, stagnant external demand and income uncertainty. We expect growth of 1.4% in 2020 and 8.6% in 2021.

■ Economic activity is recovering at a faster pace than expected

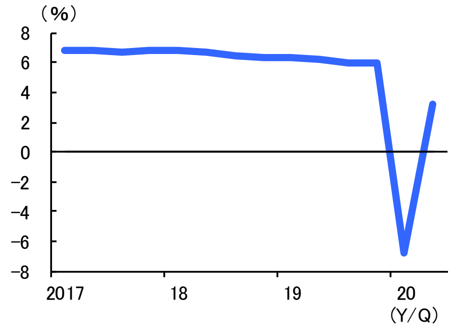
In China, economic activity is on a recovery trend following the peak of the novel coronavirus (COVID-19) outbreak. The real GDP growth rate in the April–June quarter turned positive, increasing 3.2% from the same period last year.

Rapid recovery in supply is currently driving growth. In recent years, as the government's influence on corporate activities has increased, companies have resumed operations in haste in response to the directive from the Chinese government to resume economic activities. As a result, industrial production began to increase as early as April by about 4% year-on-year.

Looking at demand-side statistics, exports have recently rebounded, showing year-on-year growth. This is because demand for medical supplies, such as face masks, as well as information and communication equipment related to remote work and 5G, has increased. Also, orders which were received before the COVID-19 outbreak were shipped.

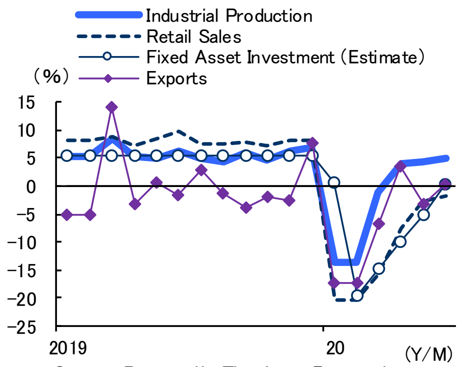
Investments in fixed assets, estimated based on the government's seasonally adjusted figures, turned positive in June from a year earlier. The breakdown shows that real estate development investment and infrastructure investment have expanded remarkably. In March, the government eased real estate price controls, lowered interest rates and instructed banks to extend loans to small and medium-sized enterprises, which resulted in a concentration of funds in the property market. The operating rate of construction equipment recovered to a level higher than the previous year due to the government's request to accelerate infrastructure investment plans and the increased investment in 5G by state-owned enterprises.

<Real GDP Growth Rate (YoY)>



Source: Prepared by The Japan Research Institute, Limited, based on System of National Accounts, National Bureau of Statistics of China

<Major Economic Indicators (YoY)>



Source: Prepared by The Japan Research Institute, Limited, based on Increase in Industrial Production by Enterprises of a Certain Size, Total Retail Sales of Consumer Goods, and China Fixed Asset Investment, National Bureau of Statistics of China, and Trade Statistics, General Administration of Customs

Retail sales are still down on a year-over-year basis, but are picking up. In particular, sales of home appliances and automobiles rebounded sharply. In the past, the Chinese government has strictly restricted the number of gasoline-powered vehicles that can be purchased in an effort to promote the use of electric vehicles. Since March, however, there have been moves across the country to deregulate purchases of gasoline vehicles by providing subsidies for their purchase as a way to stimulate demand. For example, the city of Guangzhou in Guangdong Province will provide a subsidy of 3,000 yuan per vehicle from March 2020 to the end of the year.

The employment situation, which the government considers important, has also improved, mainly driven by the recovery in production. According to the "Rural Migrant Workers Monitoring Survey Report 2019" by the National Bureau of Statistics, the number of migrant workers at the end of 2019 was 174.25 million. Taking into account the Bureau's report of 122.51 million migrant workers as of the end of February, it is estimated that about 50 million migrant workers have lost their jobs due to the spread of COVID-19. The official unemployment rate for February was 6.2%, but considering the number of migrant workers who lost their jobs due to the outbreak of COVID-19 and the number of rural people who didn't have jobs prior to the outbreak, the potential unemployment rate could have temporarily soared to 20%. However, according to a temporary survey conducted by the National Bureau of Statistics at the end of April, the number of migrant workers has recovered to about 90% of the level prior to the COVID-19 outbreak. As a result, it is presumed that about 35 million people have returned to work, and the potential unemployment rate has also declined significantly. The reduction and exemption of social security premiums and the expansion of bank loans to companies have prevented a vicious circle of rapid corporate bankruptcies, worsening employment, and declining consumption.

■ The pace of recovery will slow down

Looking ahead, while the Chinese economy is on a recovery trend under targeted activity restrictions, it is unlikely to continue a V-shaped recovery at the current pace.

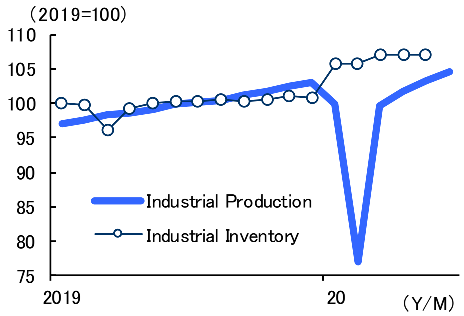
First of all, it is noteworthy that inventory is increasing rapidly because demand cannot keep up with production growth in the manufacturing industry. Major monthly statistics showed that retail sales, investment in fixed assets, and exports in May fell 7.6%, 8.0%, and 1.0%, respectively, from December 2019, while industrial production and inventories in May rose 0.3% and 6.0%, respectively, from December 2019. As inventories that do not meet actual demand have increased significantly, moves to curb production are expected to emerge in the future. In fact, since the beginning of July, coal consumption by the six major power companies has fallen again below the previous year's level. This suggests that the operation rate of plants has been declining.

In addition, exports are expected to fall again due to the global economic slowdown. The manufacturing Purchasing Managers Index (PMI) released by the National Bureau of Statistics shows that new export orders have declined almost as much as when Lehman Brothers collapsed. The DI for new export orders based on the survey conducted by the People's Bank of China, which is equivalent to the Bank of Japan's Tankan Survey, indicates that the situation is even more severe.

Looking at domestic demand, households and companies will not be able to dispel concerns about their incomes, and the resilience of personal consumption and capital investment will be weak. According to the results of a survey on consumption trends by the People's Bank of China, the income outlook DI remains at its lowest level since the statistics began. So far, job cuts and income losses can be avoided, but it is likely that companies will eventually pass on the damage caused by the COVID-19 outbreak to their employees. In addition, private companies are facing funding difficulties and are generally cautious about capital investment.

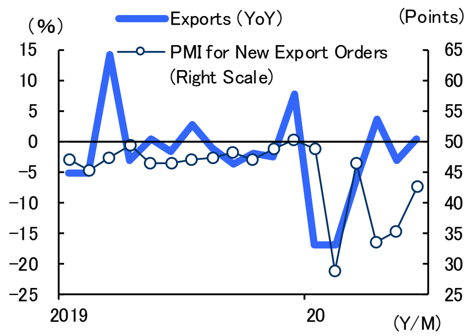
Based on the foregoing, the pace of growth in the second half of the year is expected to slow, with estimated year-on-year growth of +1.4% in 2020, the lowest growth rate in 44 years. Growth for 2021 is expected to be +8.6% year-on-year, slightly boosted by the reaction to the lower level of growth in the preceding year. Of course, growth could decline significantly depending on the spread of COVID-19 in the future.

＜Industrial Production and Inventories＞
(Seasonally Adjusted Figures)



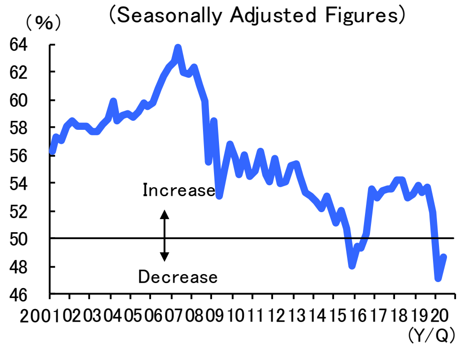
Source: Prepared by The Japan Research Institute, Limited, based on Increase in Industrial Production by Enterprises of a Certain Size, National Bureau of Statistics of China, and Industrial Inventory,

＜Exports and PMI for New Export Orders＞



Source: Prepared by The Japan Research Institute, Limited, based on Trade Statistics, General Administration of Customs, and Manufacturing Purchasing Managers Index, National Bureau of Statistics of China

＜Income Outlook DI＞
(Seasonally Adjusted Figures)



Source: Urban Depositor Survey Report, People's Bank of China
Note: Income outlook DI is calculated based on the following formula: Increase in future income − Decrease +50. The survey was conducted for 20,000 households throughout China. The DI has been seasonally adjusted by The Japan

(Shinichi Seki)

Topics ASEAN and India face a crucial moment

ASEAN and India are suffering from a rapid deterioration in their economies, including sharp rises in unemployment rates. However, this could be a chance to achieve high economic growth in mid-to-long term by the expected structural changes, such as (1) aggressive investments in infrastructure, (2) promotion of production transfers from China, and (3) the development of advanced industries within the countries.

■ Disparities between North and South amid the COVID-19 outbreak

The global economy plunged in Q2 of this year due to the spread of the novel coronavirus (COVID-19), and Asia was no exception. Notably, Southeast/South Asia were severely impacted, and the situation can be described as the North-South gap in Asia. The seriousness of the problem was manifested in the labor market, where unemployment has soared to around 20% in India and the Philippines. In Indonesia, the unemployment rate in February 2020 was 5%, but the government announced on June 22 that it expects the rate to jump to an annual average of 8.1% to 9.2% in 2020. We expect real GDP in Asia for 2020 to contract by 0.6% year-on-year, dropping significantly from +5.1% year-on-year in 2019. While GDP of Northeast Asia (China, Korea, Taiwan and Hong Kong) is expected to grow slightly by 1.0% year-on-year in 2020, that of Southeast and South Asia (ASEAN and India) is expected to decline by 3.1% year-on-year.

<Growth forecasts for Asian economies>

	2018	2019	2020 (F)	2021 (F)
Asia	**6.0**	**5.1**	**−0.6**	**7.0**
Northeast	6.2	5.6	1.0	7.9
China	6.7	6.1	1.4	8.6
Korea	2.7	2.0	−1.8	2.2
Taiwan	2.7	2.7	−1.0	2.9
Hong Kong	3.0	−1.2	−6.6	1.5
Southeast/South	5.8	4.5	−3.1	5.6
ASEAN	5.3	4.8	−1.4	5.7
Thailand	4.2	2.4	−7.0	3.3
Malaysia	4.8	4.3	−1.4	7.7
Indonesia	5.2	5.0	0.1	5.3
Philippines	6.3	6.0	−2.7	6.7
Vietnam	7.1	7.0	3.0	7.4
India (Fiscal year)	6.1	4.2	−4.5	5.6

Source: JRI

The gap between North and South was attributed to the government's response and the existence of benefits from special demand. Based on the bitter experience of SARS in 2003, swift measures were taken in Northeast Asia to curb the infection. On the other hand, many countries in Southeast and South Asia were slow to deal with the spread of COVID-19 due to several problems, such as poor medical infrastructure. These countries introduced severe lockdown measures, following those in Western countries after mid-March.

While many industries were hit hard by the COVID-19 pandemic, sales in some areas increased significantly. Typical examples are medical and high-tech. As for the former, demand for medical products to cope with the outbreak, such as masks, increased, leading to a rapid increase in production mainly in China. The latter is in response to the growing demand for remote working around the world. Demand for personal computers, servers, and semiconductors increased, and Northeast Asia, including China, Taiwan, and South Korea, benefited greatly from the growth.

■ Expectations for moves to turn the crisis into an opportunity in ASEAN and India

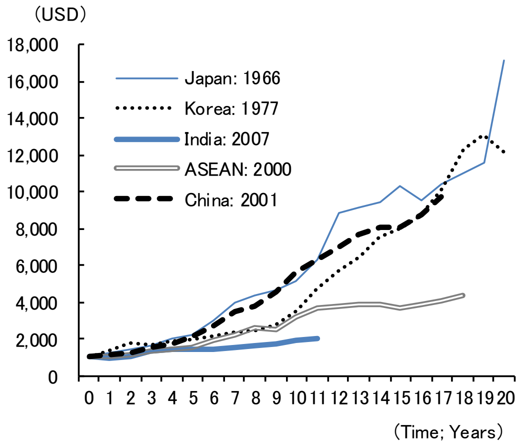
The difference in economic situation between North and South came from the government's response to the COVID-19 outbreak and the existence of benefits from special demand, which has put ASEAN and India in a difficult situation. However, while they may face hardships in the short run, this could be a chance for them to turn a crisis into an opportunity over the next several years. While the spread of COVID-19 brought about economic stagnation, it also highlights (1) the need for fiscal support, (2) the intensification of the conflict between the U.S. and China, and (3) the acceleration of industry's structural changes with IT and digitalization.

Firstly, an opportunity could emerge to promote aggressive investments in infrastructure in ASEAN and India. Infrastructure investment not only support the weakening economy as a stimulus measure, but also could play important role in boosting mid-to-long term economic growth. Secondly, the promotion of production transfers from China is expected to make further progress, and it is possible for ASEAN and India to increase their presence in the supply chain in Asia. Also, ASEAN can be described as a center of competition for the U.S. and China. There is a growing possibility that investment from the U.S. and

China will increase in the future under China's "Belt and Road Initiative" (BRI) and the "Free and Open Indo-Pacific" (FOIP) strategy advocated mainly by the U.S. and Japan.

Finally, expectations for the development of domestic advanced industries (e.g. IT and high-tech sectors) could increase. ASEAN and India have an advantage in the industries, as venture capital investment has grown to the third largest scale following the U.S. and China, and some of the world's most advanced businesses have been already emerging. In the past, ASEAN and India were not able to achieve the expected growth and were unable to enter a period of high growth like China. Looking at GDP per capita on a dollar basis, other mature economies in Asia such as Japan, Korea and China started to accelerate growth in GDP per capita when it exceeded the 1,000 dollars-level, but ASEAN and India are lagging behind. Slow income growth suggests that it is not enough to simply follow the path of development focused on heavy industry, which was experienced by Japan and China. Indeed, China's development was centered on heavy industry until halfway into their growth period, but high-tech industries catching up to advanced countries contributed greatly to China's rapid growth in the 2010s. Given the fact, the development of advanced industries will have great significance.

＜GDP per capita after achieving USD 1,000＞



Source: JRI, based on World Bank
Note: Year = 0 is the year when GDP per capita reached over USD1,000. ASEAN includes Indonesia, Malaysia, Thailand, Philippines and Vietnam.

■ Global monetary easing will also support growth

In addition, the financial environment expected over the next several years could contribute positively to efforts for high growth. With the possibility of large-scale monetary easing in the U.S. expected to continue for a long period of time, it is unlikely that investors will rush to return capital to the U.S.. This could reduce significantly the risk of currency depreciation in Asia and other emerging economies. Even in Asia, where interest rates have fallen sharply due to the outbreak of COVID-19, there is little need to rush for normalization of their policy rates.

Moreover, as ultra-low interest rates emerge not only in the U.S. but also in whole developed countries, the risk appetite for investment increases. There is a high possibility that investment in Asia could accelerate as India, Indonesia, and the Philippines are expected to maintain relatively high growth and high yields in the long-run. Expectations are high for accelerated capital inflows through portfolio investments, as seen in the aftermath of the collapse of Lehman Brothers in 2008, which may provide significant financial support.

However, it is dangerous to evaluate only the positive side of global monetary easing policies. Capital inflows without real economic growth easily reverse after the period of monetary easing ends. In order to prevent the expansion of a financial bubble and the worsening of the debt problem, as well as to preclude a repeat of the Asian Financial Crisis, it is necessary for the government to achieve stable growth in the real economy by promoting structural changes aimed at strengthening economic growth.

(Minoru Nogimori)