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Topics *Novel coronavirus severely impacting the Chinese economy*

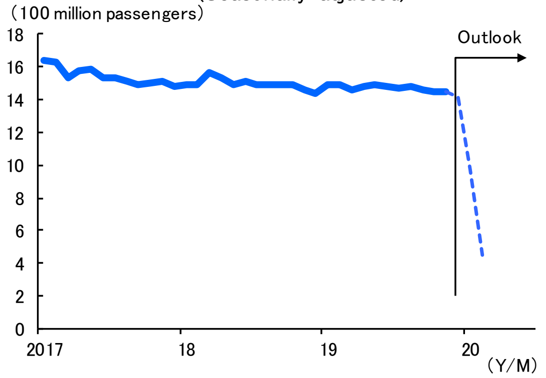
The Chinese economy will be hit hard by the impact of the novel coronavirus. In particular, there are concerns over a decline in personal consumption and a delay in business resumption. Against this backdrop, the Chinese government has come up with a series of economic measures.

■ Concerns over a decline in personal consumption

In China, the economy is slowing down again following the spread of pneumonia caused by the novel coronavirus. Consumers are refraining from traveling or going out, and companies are putting off resuming operations even after the Chinese New Year holiday.

The growth rate for the January-March quarter may not be announced, but it is expected to fall sharply. A particular concern is the decline in personal consumption. According to the Ministry of Transport of the People's Republic of China, the volume of passenger traffic on highways, railways, airplanes, and ships decreased by 35% over the same period last year during the 27 days before and after the Chinese New Year (January 10 to February 5). Passenger traffic thereafter until February 18, when the homecoming rush ends, is expected to drop 70% from a year earlier. This largely reflected the fact that not only did consumers voluntarily refrain from traveling or going out to avoid becoming infected with the novel coronavirus, but central and local governments also imposed traffic and curfew restrictions.

<Volume of Passenger Traffic>
(Seasonally-adjusted)

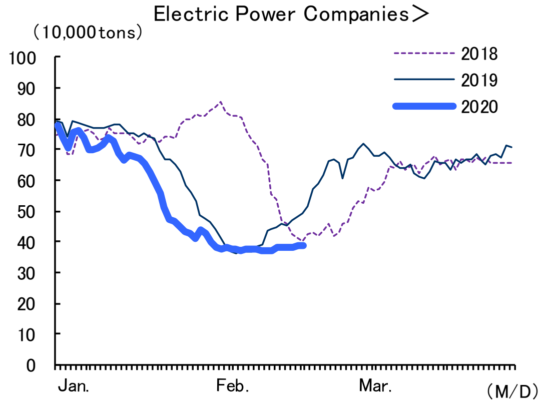


Source: National Bureau of Statistics of China "Passenger Traffic"
Note: Prepared by The Japan Research Institute, Ltd, based on a press conference by the Ministry of Transport

The breakdown of personal consumption will be marked by a decline in service consumption at hotels, restaurants, theme parks and movie theaters. In addition, durable consumer goods such as automobiles and home appliances will inevitably be adversely affected.

For reference, SARS negatively impacted the Chinese economy from March to July 2003. This also had a negative impact on personal consumption. From the January-March quarter to the April-June quarter of 2003, the retail sales year-on-year growth declined from +9.3% to +6.8%, while real GDP year-on-year growth declined from +11.1% to +9.1%. Although industrial production also dropped slightly, fixed asset investment and imports continued to expand steadily.

<Daily Coal Consumption of the Six Largest Electric Power Companies>



Source: Prepared by The Japan Research Institute, Ltd, based on www.cqcoal.com

Service consumption now accounts for a higher percentage of personal consumption compared to when the SARS outbreak occurred. As a result, the decline in personal consumption is expected to be larger this time. The SARS outbreak occurred immediately after China joined the WTO, which was prior to the country being called the "world's factory." At that time, the ratio of capital investment to GDP was lower than it is now, and the impact on the corporate sector was limited. However, this time, depending on the extent of the decline in service consumption, the risk of a major impact on the entire macroeconomy exists.

■ Companies are putting off resuming operations

The economy will also be adversely affected by moves by companies to postpone the resumption of business operations even after the Chinese New Year. It was originally planned that the Chinese New Year holiday would end on January 30 and business activities would resume on January 31. However, due to the spread of the novel coronavirus, the Chinese government extended the holiday until February 2, and local governments in major cities such as Beijing and Shanghai ordered business suspension until the

February 9. The daily coal consumption of the six largest electric power companies during the period between February 1 and February 18 decreased by 10% from the same period the previous year, which indicates greatly decreased production activity. It is highly likely that recovery production will occur in the manufacturing industry after cessation of the novel coronavirus occurs, but it is difficult for the non-manufacturing industry to recover losses due to the extension of the suspension period. As a result, the number of small and medium-sized companies facing financial difficulties will increase.

The novel coronavirus is depressing not only the Chinese economy but also the economies of Japan and other countries and regions. Some Japanese companies have been forced to adjust production due to delays in the resumption of operations in China. The Chinese government's ban on overseas group tours has led to a sharp drop in demand related to inbound tourism in Japan and Thailand, which are popular travel destinations for Chinese consumers.

■ The Chinese government has announced a series of economic measures

If the novel coronavirus threat ends by the end of March, the Chinese economy is expected to return to a growth rate of around 6%.

First, economic measures related to the novel coronavirus will support the economy. On the financial front, for example, the People's Bank of China provided 1.2 trillion yuan in the interbank market on February 3 through open market operations in the reverse repo. Short-term market interest rates were also lowered. The deadline for companies to pay interest was extended, and collateral requirements for corporate loans and issuance requirements for bank debentures were eased.

On the fiscal front, the Chinese government decided to increase the issuance of municipal bonds and accelerate development projects to promote infrastructure investment. In order to support the provision of currently needed services such as home delivery, the government also decided to waive the value-added tax for the sector. For service industries, such as restaurants, accommodations and transportation, where demand has declined significantly, the government extended the expiration date for the carryforward of losses. Moreover, with the aim of securing the provision of medical supplies, the government announced that it would purchase excess production of medical supplies from the manufacturing sector. To support corporate earnings and maintain employment, the government also proposed reducing rent for state-owned real estate and providing employment adjustment subsidies.

In addition, at the Standing Committee of the State Council on February 12, the state government urged local governments to ease excessive traffic regulations. The government's novel coronavirus team expects the outbreak to peak in mid-February. At present, the situation is close to government expectations, and the number of new infections reported has started to decline. If this trend continues, the government is expected to ease traffic and curfew regulations after March.

Based on the above situation, the growth rate for 2020 is expected to be +5.8%, on the assumption that economic activity picks up from the April-June quarter. The growth rate is down 0.3% points from last year’s +6.1%. Of course, if the spread of novel coronavirus infections continues for a long time, the economic downturn will expand, so it is necessary to continue to monitor the situation closely.

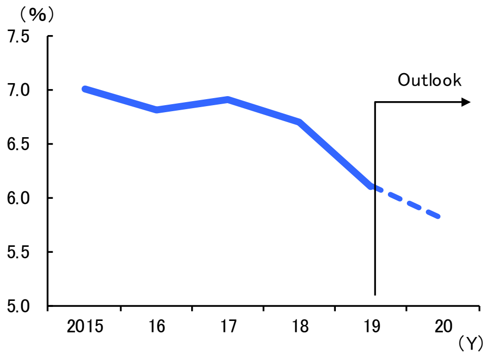
(Shinichi Seki)

＜Major Economic Measures Related to Novel Coronavirus＞
(Based on an Announcement in February 2020)

Monetary Measures	Significantly Expand Funds Supply in the Interbank Market
	Drive Short-term Market Interest Rates Lower
	Extend Interest Payment Deadline for Companies
	Ease the Collateral Requirement for Corporate Loans
	Ease the Conditions for Issuing Bank Debentures
Fiscal Measures	Expand Issuance of Municipal Bonds to Promote Infrastructure Investment
	Exempt Value-added Tax on Home Delivery and Other Services
	Extend the Expiration Date for the Carryforwards of Losses in Restaurant and Lodging Businesses
	The Government Purchases Excess Production from Medical Supply Manufacturers
	Reduce or Exempt Rent for State-owned Real Estate
	Provide Employment Adjustment Subsidies

Source: Prepared by The Japan Research Institute, Ltd, based on the Chinese Government and the People’s Bank of China

＜Real GDP Growth Rate (YoY)＞



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

Topics India aims to achieve both economic recovery and fiscal consolidation

With limited scope for fiscal and monetary policy expansion, India's return to a high-growth path hinges on its ability to accelerate structural reforms.

■ The fiscal 2020 budget proposal remains on a fiscal consolidation path

Since the second half of 2018, the Indian economy has been in a slump against a backdrop of growing credit unrest triggered by defaults at major nonbanks. Since the launch of the 2nd Modi administration in July 2019, the government has launched a series of economic measures, but the economy has remained sluggish. The real GDP growth rate for FY2019 (April 2019 to March 2020) is expected to be the lowest since FY2008, when the collapse of Lehman Brothers occurred.

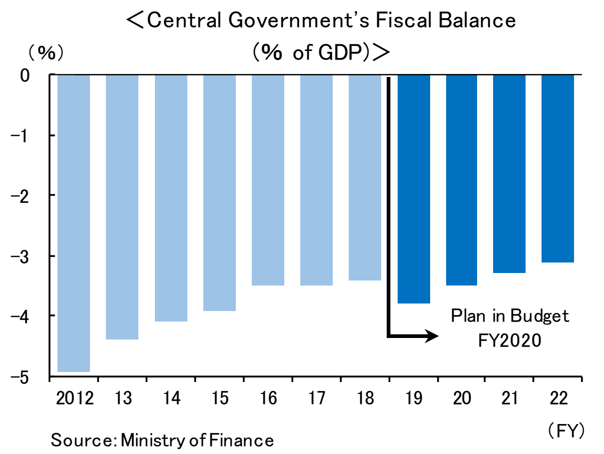
Against this backdrop, the Ministry of Finance announced in early February estimated revenues and expenditures for FY2019 and the FY2020 budget proposal. Due to the economic slowdown and the corporate tax cut announced in September 2019, tax revenue for FY2019 is expected to fall below the initial plan, and the ratio of the central government's fiscal deficit to nominal GDP is expected to increase to 3.8% from 3.4% in the previous year. Expenditures for FY2020 are expected to increase by 12.7% year-on-year due to the expansion of expenditure for economic recovery, exceeding tax revenues (+8.7% year-on-year). However, the budget deficit is expected to fall to 3.5% of nominal GDP due to an increase in non-tax revenues, such as proceeds from the sale of shares held by the government.

■ The government has proposed various economic measures

In its fiscal 2020 budget proposal, the government set the theme of "Ease of Living" and came up with various measures that take into account both households and businesses.

For households, the government announced a cut in the personal income tax rate and an extension of tax breaks on home purchases, while expanding budgets for rural development as well as budgets related to medical services and education.

For businesses, the government also announced an increase in import duties and special purpose taxes on electric vehicles



＜Points regarding the FY2020 Budget Proposal＞

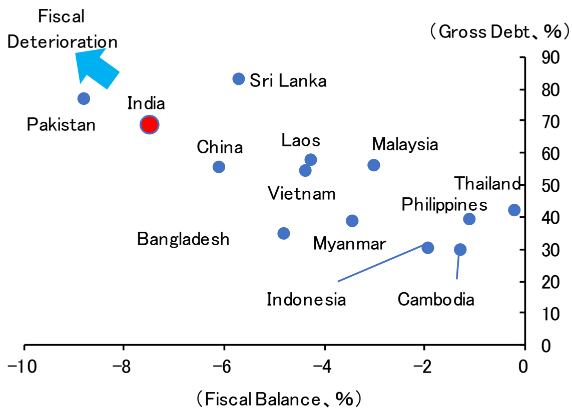
Item	Objective	Contents
Changes in the Taxation System	Promotion of Consumption	Cut in the Personal Income Tax Rate
	Housing Investment Promotion	Extension of Tax Breaks for Home Purchases
	Corporate Support	Elimination of the Dividend Distribution Tax (DDT) on Dividend Payers *From Now on, the Tax will be Payable by the Recipients of Dividends, Who had Previously been Exempt from Taxation.
		Expand the Scope of Startups Eligible for Tax Exemption including the Amount of Sales and the Number of Years since Establishment
	Promotion of the Manufacturing Industry and Import Control	Increase in Tariffs and Special Purpose Taxes on Imports of Electric Vehicles (EVs), Mobile Phone Parts and Medical Equipment
		Lowering the Minimum Replacement Rate for Newly Established Manufacturers after October 2019
	Infrastructure Development	Exemption from Taxation on Investment Income of Infrastructure Projects by Government Investment
Reform of State-owned Enterprise	Privatization	Doubling the Target for Sales of Shares Held by the Government
		Partial Sale of Shares in a State-owned Insurance Company
Other	Improving the Stability of the Financial System	Increase the Amount of Deposits Covered by Deposit Insurance
		Expansion of the Scope of Nonbanks Subject to the SARFAESI Act (Act on the Collection of Claims by Financial Institutions)

Source: Prepared by The Japan Research Institute, Limited based on the Ministry of Finance
Note: Under the new tax system, taxpayers will be able to choose between the current system and the new one because the scope of tax credits for personal income tax will be reduced.

(EVs), mobile phone parts and medical equipment to curb the trade deficit and expand domestic production, while launching measures such as abolishing the dividend payment tax and expanding the scope of startups eligible for tax exemption.

In addition, in order to improve the stability of the financial system, the government increased the amount of deposits subject to the deposit insurance system and expanded the scope of nonbanks subject to the "Securitisation and Reconstruction of Financial Assets and Enforcement of Securities Interest (SARFAESI) Act," which is related to the collection of claims by financial institutions. The budget proposal is scheduled to be adopted around the end of March after deliberation in the parliament.

＜General Government's Fiscal Balance and Gross Debt (2019 IMF's Projection, % of GDP)＞



Source: IMF World Economic Outlook 2019 Oct

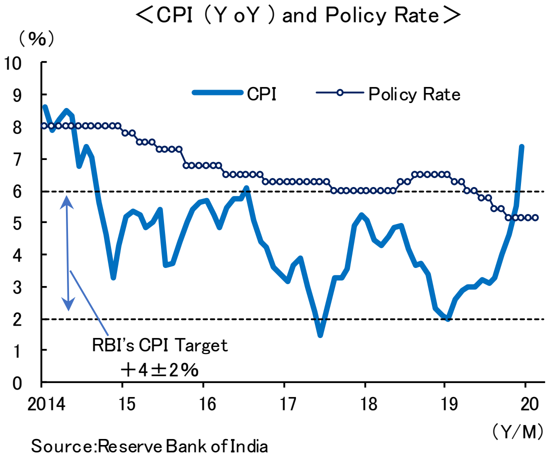
Critics say the budget proposal will have little effect on boosting the economy because (i) the effects of a cut in the personal income tax rate will be limited since tax credits for life insurance and corporate pension payments will not be applied, and (ii) the government did not include measures to reduce the Goods and Services Tax (GST) and a car scrapping policy, as requested by the automobile industry. However, the ratio of the general government's fiscal deficit to nominal GDP, including state governments, is among the worst in Asia, and control of the fiscal deficit is an urgent issue. Therefore, it is inevitable that the budget was formulated with not only economic support but also fiscal consolidation in mind.

■ The room for monetary easing is also declining due to rising prices

While there is little room for fiscal support for the economy, the room for expansion of monetary policy has also decreased due to higher inflation. By following U.S. interest rate cuts, the Reserve Bank of India cut interest rates by a cumulative 1.35% points in 2019. However, since December 2019, the Bank has maintained its policy rate unchanged, as inflation, particularly food prices, has exceeded the upper limit of the inflation target.

The Reserve Bank of India has indicated that it will resume monetary easing amid signs that food inflation is easing, but it is expected to cut interest rates at a moderate pace, closely monitoring trends in crude oil prices and an amount of rainfall during the monsoon period (June to September), which has a significant impact on agricultural production.

＜CPI (YoY) and Policy Rate＞



Source:Reserve Bank of India

In the longer term, there is little room for expansion in both fiscal and monetary policy, and India's return to a high-growth path hinges on its ability to push ahead with structural reforms in various areas, including the economy, finance, and society. From the viewpoint of attracting manufacturers and creating jobs, it is necessary to remove obstacles to the entry of foreign companies into India, such as the difficulty of land acquisition and strict regulations on layoffs, and to accelerate the development of electric power and transportation infrastructure. Furthermore, in order to improve the stability of the financial system, it is important to reform the management of nationalized banks and to enhance the supervisory system for nonbanks by the authorities. For nationalized banks, bank mergers and the injection of public funds have been promoted to strengthen their financial structure, but their profitability remains lower than that of private banks. The government aims to improve management efficiency through the digitization of financial services, but drastic reforms, including privatization and personnel cuts, should be considered.

As subsidies to the electric power and banking sectors have contributed to the expansion of the fiscal deficit in recent years, such reforms are extremely important for fiscal consolidation.

(Shotaro Kumagai)