Market Commentary

March 30, 2020

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China’s official PMIs jumped back into expansionary territory

- **This morning, China’s official NBS manufacturing and non-man. PMIs jumped back into expansionary territory.**
- **While this confirms China’s economy has likely started to bottom out from the Covid-19 crisis, the outlook will depend on three factors:**
  - **The ongoing normalization in production and consumer demand: While production will likely reach normal capacity utilization in mid-April (provided new corona cases remain on low levels) private consumption is still lagging.**
  - **The global recession: We strongly revised down our 2020 global GDP forecasts (to -1%) which will result in weak Chinese exports.**
  - **An additional fiscal package: Last Friday’s politburo meeting fueled expectations that a package will be announced shortly. We expect total stimulus of around 3.5% - 4% of GDP.**
- **In sum, we see China’s growth subdued this year at 2.5%. We stress that this forecast comes with an unusually high degree of uncertainty.**

China’s official NBS PMIs bounced back in March. The manufacturing PMI rose to 52.0, up from 35.7, while the non-manufacturing increased to 52.3 after 29.6 in February. By their very construction, a strong rebound had to be expected. PMI surveys essentially ask whether firm’s businesses have been better or worse compared to the previous month. Therefore, given the upturn in the daily indicators from their very low levels, the increase does not come as a surprise. The return of the PMIs into expansionary territory should not be confused with a return of industrial or service production back to normal. Nevertheless, both indicators came in better than market consensus had anticipated.

The level of production has been the focus of indices constructed from daily indicators. Notwithstanding differences in their components, they point to an overall manufacturing capacity utilization rate at about 70%, still about 5-10 pp below normal (80%). Around 80% of migrant workers have returned to their work places

(Hubei province and city of Wuhan lifted restrictions of late). Under "linear" approximation, the production side is expected to reach "2019 normal" around mid-April. However, the consumption side of the economy looks to lag behind. Consumer activity trackers still shows a much lower level than overall activity. Moreover, PMI total new orders in the non-manufacturing survey were still contracting, at 49.2 (but expanding in manufacturing). And PMI new export orders continued to shrink in non-manufacturing (38.6) and in in manufacturing (46.4).

The data show that China is faced with a double lack in demand, domestic private consumption and international exports. Regarding the latter, the corona virus is expected to lead to a deep global recession. Compared to end of 2019, we revised global growth down by about 4 pp to -1% in 2020. China's export share in GDP is 17%. In the January/February period, China's exports already declined by 17.2% yoy. We now expect this rate to deteriorate severely going forward. Of course, the net impact on GDP will be mitigated by slowing imports. Given that the export manufacturing sector still employs 25-30 mill. workers directly, the labor market will also come under pressure. Moreover, the PMI new export orders are likely to weaken, probably deterring again the overall manufacturing PMI as well. The development could also well threaten manufacturing capacity utilization and lead to some deterioration.

This all speaks in favor for a step up in government support. So far, China has been rather reluctant with extra crisis spending compared to other countries. We attribute that to the experience from the 2008/09 Great Financial Crisis, when China set up a fiscal package of 12.5% of GDP. A large part of current China's debt problems can be traced back to these policy decisions. Therefore, we doubt that China will repeat such a large measure.

Nevertheless, the politburo meeting from last Friday stressed growth targets and therefore resulted in strong expectations of additional measures from the fiscal as well as the monetary side in the near-term. The politburo meeting also discussed the need for issuing special central government bonds. We expect the fiscal impulse between 3.5% and 4% of GDP. A substantial part will go into infrastructure investment which could rise by 10% this year. The official central government fiscal deficit will likely rise to 3.5 of GDP, up from 2.8% in 2019. Other funds will come from a drawdown of reserves and the issue of bonds by CNY 1.5 tr. We see the PBoC to additionally cut the Loan Prime Rate by 30 bps via MLF cuts and additionally cut RRR by 100 bps in 2020. More liquidity measures are also likely. The export sector could see additional support by special refunds (export VAT). Help will be geared towards SMEs. All in, we see China's GDP to slow to about 2.5% in 2020, followed by an overshooting in 2021 due to base effects to close to 8%.

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