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Covid 19 puts unprecedented levels of downward pressure on the Chinese economy

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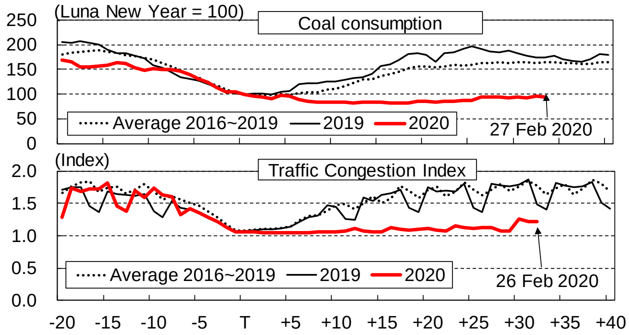
As of 27th February, the number of people who have been infected with Covid 19 in China is 78,497 and the number of deaths is 2,744 (according to the World Health Organisation). The scale of the infection already far exceeds that of SARS (severe acute respiratory syndrome), which spread like wildfire in China and Hong Kong from 2002 to 2003. On 23rd January, the government stopped all aeroplane, rail and bus services leaving Wuhan, Hubei province – the centre of the infection. On 24th, it prohibited domestic group tours nationwide and on 27th it prohibited package and group holidays overseas. There have also been emergency measures imposed across regions; the Lunar New Year holiday period (LNY) was extended until 2nd or 9th February in many areas and it was decided that firms in Hubei province will remain closed until 10th March.

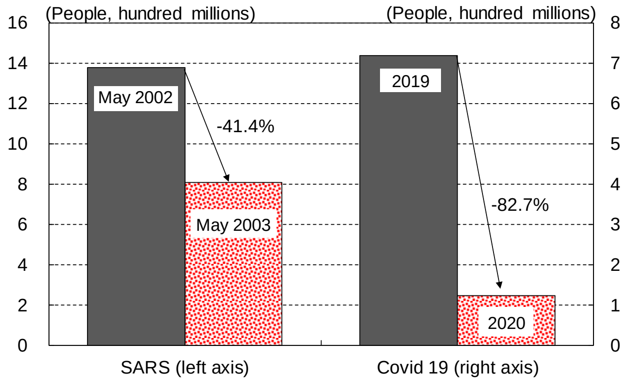
According to statistics which show the current status of economic activities on a daily basis, the volume of coal consumption (average of six large power companies) has fallen by 45.7% YoY as of 27th February (Chart 1). In a typical year, in the period spanning approximately 30 days after the LNY (25th January this year), economic activities have already restarted across the board and coal consumption has risen by 60~80% compared with during the LNY period. However, the current level of coal consumption remains roughly the same as it was during the LNY. Similarly, the Traffic Congestion Index (typical travel time compared with actual travel times) did not increase after the LNY, suggesting a substantial decrease in the quantity of traffic. Furthermore, the total number of travellers between the 16th and 25th days after the LNY (this year 9th to 18th February) fell dramatically by 82.7% YoY. Compared with May 2003, when there was a sharp rise in the number of SARS patients and the number of travellers fell 41.1%, it appears movement is being restricted by a corresponding amount (Chart 2). Based on the above, it is assumed there will be a large-scale stagnation of economic activities and the real GDP growth rate in the January-March 2020 quarter is very likely to fall sharply, far exceeding the small decelerations previously seen.

Chart 1: Coal Consumption of 6 Large Electricity Companies and Traffic Congestion Index (average of Beijing, Shanghai, Guangzhou, Shenzhen, Wuhan)



Note: 1. Traffic Congestion Index is the typical travel time compared to the actual travel time. Subject is city residents
2. T is the Lunar New Year. 25 Jan for 2020
Source Wind Financial Terminal, MUFG Bank Economic Research Office

Chart 2: Chinese Travellers



Note: 1. Total of rail, motorway, ship and aeroplane
2. YoY comparison of travellers during Covid 19 outbreak uses the total of travellers between the 16th and 25th days after the Lunar New Year
Source: Ministry of Transport of the PRoC, MUFG Bank Economic Research Office

The Chinese government is imposing a number of policies which aim to address the spread of infection while also strengthening support for businesses and employment. On the fiscal front, it was decided that revenue generated from logistics of key epidemic prevention supplies, public transport, daily services and postal services will be exempt from value-added tax and that producers will be exempt from registration fees for epidemic prevention medicine and medical equipment at the executive meeting of the State Council on 5th February (Table 1). In addition, on 18th February, the government introduced periodic deductions or exemption from social security fees to support mid-size and small businesses and guaranteed the unemployment insurance fund will be distributed to the unemployed. Furthermore, the Ministry of Finance decided to allow local government to sell RMB 848 billion of bonds early (RMB 558 billion of general bonds, RMB 290 billion of special-purpose bonds – issued to fund infrastructure), a decision it typically makes after the National People's Congress. On the monetary front, officials plan to maintain stability. On 1st February, the People's Bank of China (PBoC) announced it will provide RMB 300 billion to banks for special relending at a favourable interest rate to businesses which produce medical supplies and daily necessities. This interest rate will be capped at 3.15% (the loan prime rate is 4.05%) and the real lending rate for businesses will be less than 1.6% due to additional subsidised interest rates. Furthermore, the PBoC lowered the reverse repo rate on 3rd February – the first day after the LNY period – and injected RMB 1.7 trillion of liquidity in total into markets on 3rd and 4th February. On 17th February, it lowered the 1-year medium-term lending facility (MLF) rate and, on 20th February, it also cut the loan prime rate. The PBoC announced plans on 24th February to soften its approach to its "prudent" monetary policy; it revealed it would support mid-size and small businesses by lowering interest rates as it believes city banks can withstand a rise in bad loans to support businesses who have been badly affected by Covid 19.

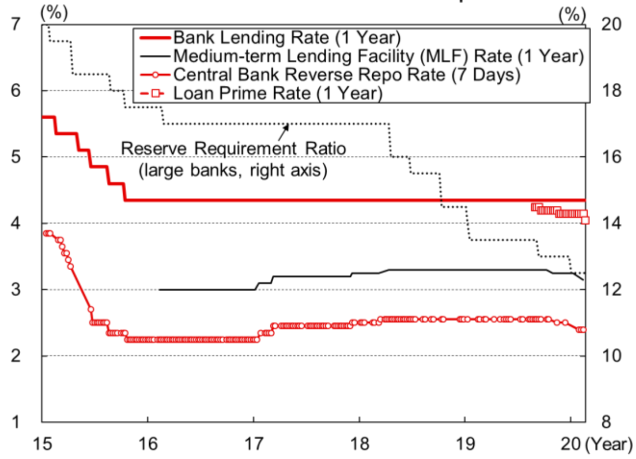
These measures are likely to maintain the operation of businesses related to medicine and daily necessities and lessen issues such as the severe decline in economic activities facing businesses and unemployment to some extent. However, it is still unclear what the scale of the infection will be and when it will end. Considering the fundamental causes of the decrease in economic activity from Covid 19 policies such as blockades in cities and travel restrictions, it is very important to bear in mind that the measures above are unlikely to lead directly to a return of the economic growth rate to typical levels. This year is the final year of the long-term target of doubling real GDP from 2010 to 2020 set at the National Congress in 2012. In order to achieve this target, the Chinese real GDP growth rate must hit a minimum of 5.6% YoY in 2020. If the economy can maintain a growth rate above 4% YoY in the January-March 2020 quarter with a full recovery of production in the April-June quarter onwards, a growth rate of 5.6% for 2020 will be within the realm of possibility. However, there is still much uncertainty about the future and any action taken by the Chinese government will be the focus of a great deal of attention.

Table 1: Chinese Government Policies Addressing the Spread of Covid 19

Fiscal Policies	・One-time pre-tax deduction for equipment procurement of enterprises specialising in key epidemic supplies for production expansion ・Revenue from public transport, daily services and logistics to be exempt from value-added tax ・Exempt registration fees for epidemic prevention medicine and medical equipment producers ・Set aside RMB 66.7 billion for policies to prevent the spread of infection and for bonuses for doctors working on the front line ・Periodic deductions or exemption from social security fees for mid-sized and small businesses ・Guarantee the unemployment insurance fund will be distributed to the unemployed ・Local governments allowed to issue an additional RMB 848 billion of bonds for 2020 debt (general: RMB 558 billion, special-purpose: RMB 290 billion)
Monetary Policies	・Provide RMB 300 billion to banks for special relending at a favourable interest rate to businesses which produce medical supplies and daily necessities. The interest rate capped at 3.15% (LPR at 4.05%) and the real lending rate for businesses will be less than 1.6% due to additional subsidised interest rates ・PBoC injected a total of RMB 1.7 trillion worth of liquidity into the financial sytem in the two days from 3rd to 4th February ・Lowered interest rates: the reverse repo rate on 3rd February, the medium-term lending facility (MLF) on 17th, the loan prime rate (LPR) on 20th ・At a press conerence on 15th February Deputy Governor of the PBoC announced that it would temporarily accept a higher level of bad debt in order to support businesses affected by Covid 19 (plans to maintain "prudent" monetary policy)

Source: State Council of the PRoC, various new reports, MUFG Bank Economic Research Office

Chart 3: Interest Rates and Reserve Requirement Ratio



Source:People's Bank of China, MUFG Bank Economic Research Office

(Translated by Elizabeth Foster)

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