China View

June 2020: The missing consumers

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As a result of multi-year efforts to transform the Chinese economy, it is now highly driven by private consumption and services. The flipside of the new normal is that a shock to consumer confidence will affect economic growth to a much larger extent. Moreover, policymakers now have less control over the economy compared to when it was dominated by public investment and planned production. Fears of a second wave of COVID-19 infections and concerns about prolonged income losses due to high unemployment and a poor social safety net are causing consumers to tighten their belts. The slower-than-expected recovery in consumption and services will likely be the main factor delaying the general growth rebound in China.

Macro: The missing consumers

The Chinese growth recovery is being hampered by consumers' reluctance to spend. Fear of the coronavirus and elevated income insecurity are keeping people at home with their wallets closed. The lack of a social security safety net makes it hard to restore confidence.

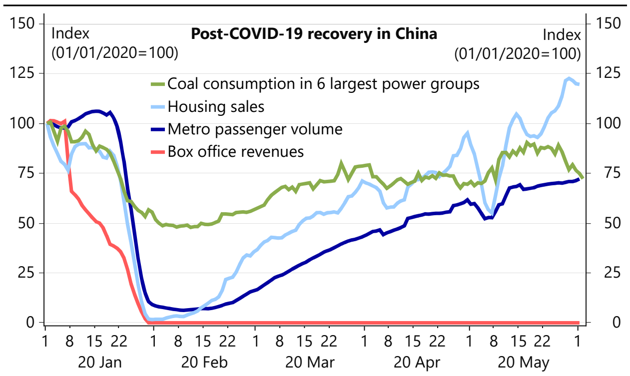
CNY: The Trump slump

Renewed US-China tensions adding to the virus scare and growth challenges are downside risks faced by the CNY versus the USD. On the other hand, the PBoC will likely keep calming the market and providing a cap on USD/CNY.

Nordea's forecasts

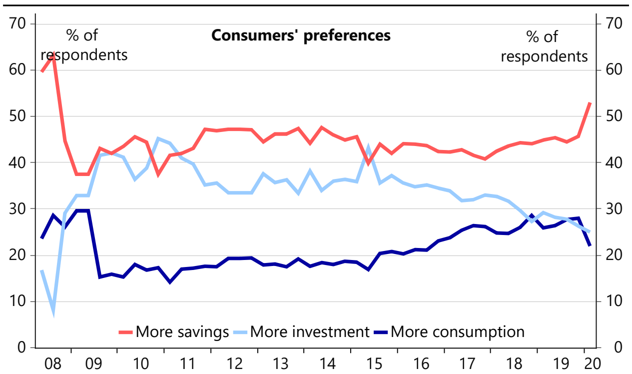
As a result of the slower-than-expected recovery in private consumption and service sector activity, we revise down our GDP forecasts for this and next year to 1% and 8%, respectively. The financial forecasts are unchanged.

THE ROAD TO RECOVERY IN CHINA



Source: Macrobond, Wind, China Metro Association and Nordea

CONSUMERS HAVE TURNED VERY CAUTIOUS



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Lack of demand is a growth challenge for China

It has been three months since China started lifting lockdown restrictions. The challenge faced by the economy is no longer production bottlenecks, but rather insufficient demand. While offices and factories are refilling as people return to work, shopping malls, fitness centres and other leisure service facilities remain largely empty.

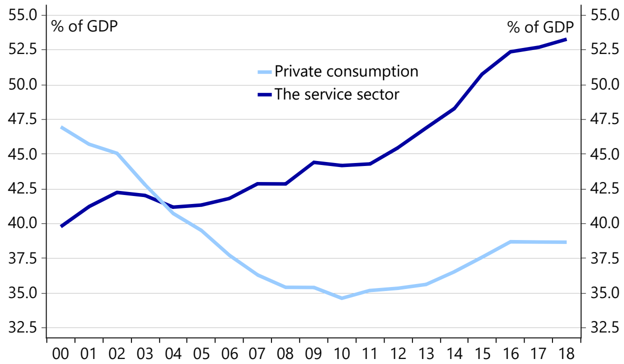
The Chinese economy is highly driven by consumption and the service sector

This is bad news for the Chinese economy, which is now highly driven by the service sector and consumption. Falling spending was mainly responsible for the 6.8% growth contraction in Q1 this year. Cautious consumers will likely make the Chinese recovery slower this time than after previous crises.

The service sector is crucial for employment

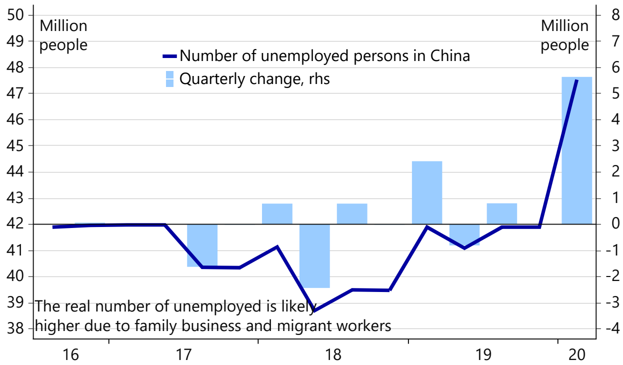
The service sector is important not only for growth, but also for employment. After steadily rising for 40 years, it has become the biggest employer in China, accounting for nearly half of total employment.

THE NEW NORMAL IN THE CHINESE ECONOMY



Source: Macrobond and Nordea

JOBLESS DATA IS POSSIBLY UNDERESTIMATED



Source: Macrobond and Nordea

Official jobless rate is 5.9%

According to the official statistics, the surveyed unemployment rate was 5.9% in Q1, the highest since records began in 2016. That is equivalent to 5.6 million people having lost their jobs in the first quarter of the year.

But the real unemployment rate could be as high as 20%

Still, this number has possibly understated the reality by a wide margin. Most restaurants, shops, and tourist sites, as well as sports, cultural and other facilities, were closed during a large part of Q1. These businesses typically employ on temporary contracts that can easily terminate. Thus, it is not unreasonable to assume that a third of the 360 million people working in the service sector were jobless during Q1. That would push the unemployment rate to 20%, which is comparable to other large countries that underwent lockdowns.

More layoffs on the cards

The near-term outlook is not bright. The expected global recession this year casts a shadow on external demand for Chinese exports. Hence, more layoffs are on the cards.

Large income loss due to lack of social safety net

China's lack of a social safety net means that only a tiny fraction of the jobless are covered by unemployment benefits. The rest will likely suffer a sizable income loss.

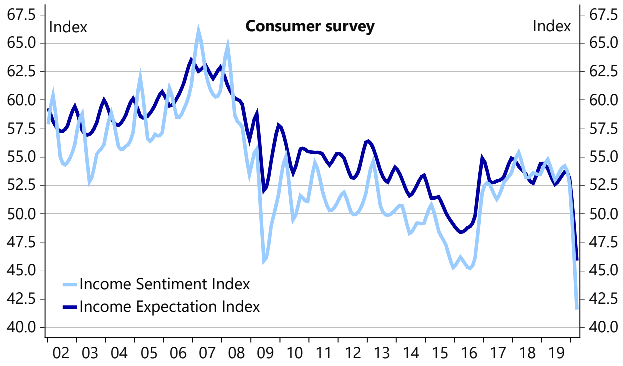
Consumer confidence has collapsed

Against this backdrop, it is not surprising that consumer confidence has tanked recently. Income expectations collapsed to the lowest level in nearly 20 years. For the first time since 2008, the majority of people would rather save than consume or invest.

Income insecurity has a prolonged impact on consumption

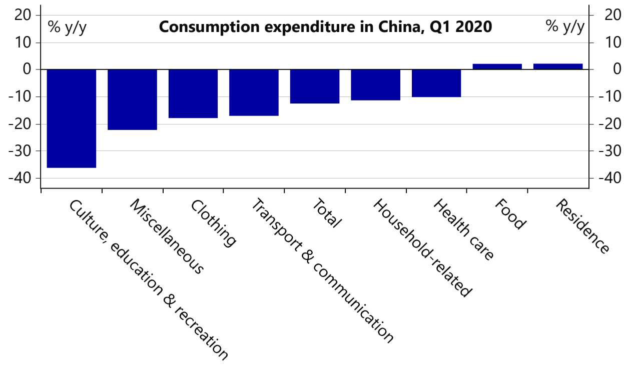
Fear of second-wave infections is keeping shoppers at home for now, but elevated income insecurity is the reason why consumption, especially discretionary spending on culture and recreation, is unlikely to see a meaningful comeback even after a vaccine is available. Consumer skittishness is affecting online sales as well as and offline.

LOWEST CONSUMER CONFIDENCE IN DECADES



Source: Macrobond and Nordea

CHINESE CUT BACK ON DISCRETIONARY SPENDING



Source: Macrobond and Nordea

Travel sector is still struggling for survival

Travel data confirms the bearish view. Despite freedom to move around domestically since March, air passenger volumes remain 40% below the normal level in April. The virus scare does not seem to be the only factor behind this catastrophic number, because traveling by car does not show a much rosier picture. During the Labour Day holiday, domestic tourism fell by 41% compared to the same period last year.

It is harder to stimulate consumption than investment

In light of the challenging growth environment, the Chinese authorities have stepped up policy support. But the flipside of a consumption-driven economy is that Beijing can no longer grow out of a crisis by solely investing in infrastructure. The speed of the recovery depends on how fast consumer confidence can be restored.

Too few migrant workers have unemployment insurance

To make up for lost income, the government has widened unemployment coverage for migrant workers. But that helps only the 20% of the 300 million migrant workers who have unemployment insurance. Those without can apply for a guaranteed minimum income known as dibao, which offers a lower payout than the minimum wage.

Saving jobs is not a priority for struggling small firms

The central government has also exempted value-added taxes, financial costs and social security contributions for small and medium-sized enterprises (SMEs), which account for about 80% of total employment. But the SMEs have been credit-starved for years and might put the extra money to use elsewhere than saving jobs.

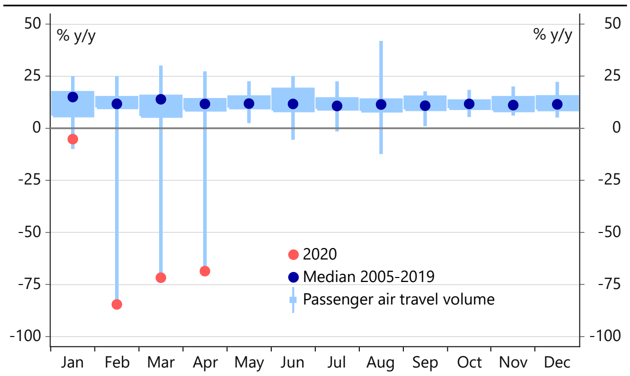
Consumption vouchers have little positive effect

To directly stimulate household spending, 170 city governments have issued consumption vouchers worth a total of CNY 19bn, to be used on everything from food to shopping and different kinds of leisure activities. So far, the realised impacts are smaller than intended. The food and supermarket vouchers are the most popular ones, reflecting consumers' cautiousness on discretionary spending.

Consumption will likely take longer to recover than Beijing hopes for

With a poor social security system and already exhausted public finances, there is only so much the Chinese authorities can do in the short term. The low base of consumption in China, especially on per capita terms, means that while household spending may return to previous levels, it might take longer than Beijing would like.

TRAVEL BUSINESS IS STRUGGLING FOR SURVIVAL



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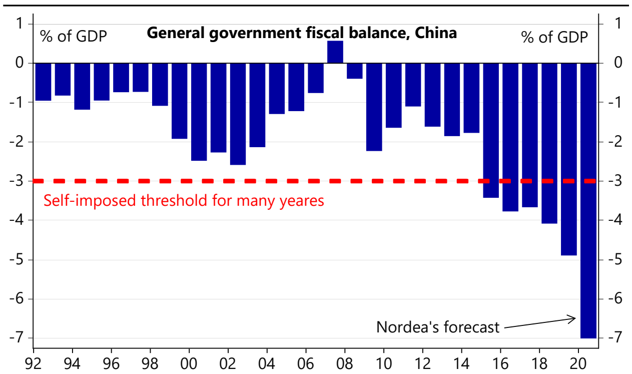
FURTHER EXHAUSTION ON PUBLIC FINANCES



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CNY: The Trump slump

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The CNY took a hit by the renewed US-China tensions

While most EM FX took a breather from the COVID-19 scare in the second half of May and recovered against the USD, the CNY was weakened by the renewed tensions between China and the US.

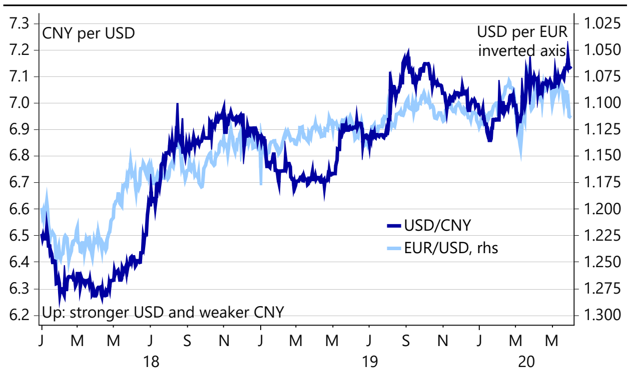
Trump has promised to punish Beijing for its tightened control over Hong Kong

After months of criticising each other for how things were handled during the pandemic, the relationship took a turn for the worse when Trump threatened powerful measures to punish Beijing due to its decision to move ahead with national security legislation on Hong Kong. The move is seen as a way to tighten control over the island.

The trade deal is at risk

Although Trump's toughened rhetoric could be a part of the usual pre-election dance in the US, renewed tensions could jeopardise the phase one trade deal made in January.

WEAK CNY DESPITE POSITIVE MARKET MOMENTUM



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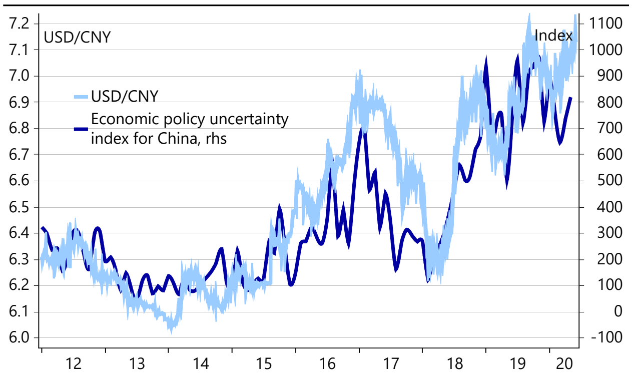
ELEVATED UNCERTAINTY KEEPS USD/CNY HIGH



Source: Macrobond and Nordea

A return of trade frictions could trigger another CNY sell-off

The pandemic is already making the trade deal fragile, as China will struggle to meet the ambitious import demand. A serious comeback of the trade frictions before the pandemic is under control and the economy is on a clear path of recovery could spark another CNY sell-off.

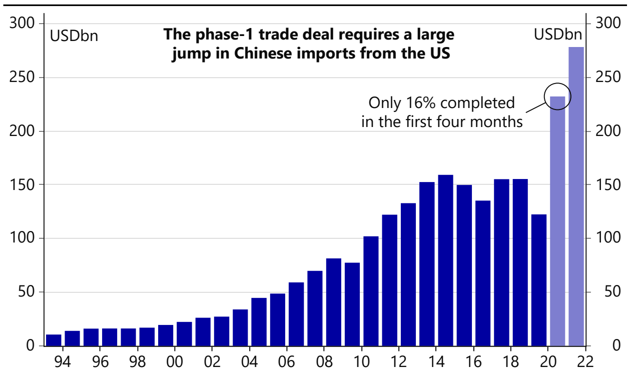
Beijing wants to avoid another trade war but cannot cave

Beijing has its hands full dealing with the economy and is probably not interested in the trade war returning. But its need to show strength domestically as well as globally implies that it will not cave if Trump steps up the pressure.

The PBoC remains the last line of defence for the CNY

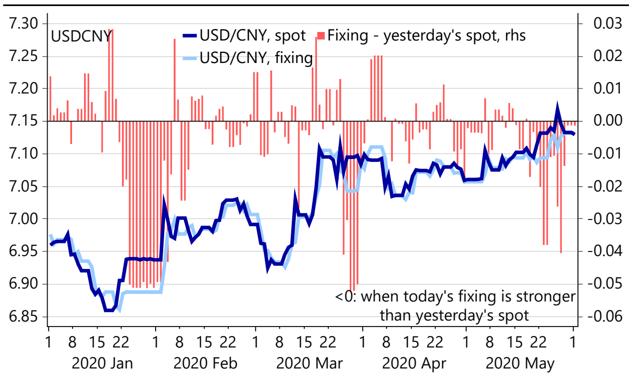
While the cooling relationship with the US poses a large downside risk to the CNY versus the USD, the PBoC, acting like a line of defence for the CNY, is expected to put a cap on USD/CNY. Its efforts to calm the market by setting a stronger fixing rate have already had a positive effect at the beginning of June.

RENEWED US-CHINA TENSION RISKS THE TRADE DEAL



Source: Macrobond and Nordea

THE PBOC REMAINS DEFENSIVE OF THE CNY



Source: Macrobond and Nordea

Nordea's forecasts

MACRO FORECASTS FOR CHINA

	2017	2018	2019	2020E	2021E
Real GDP, % y/y	6.8	6.6	6.1	1.0	8.0
Consumer prices, % y/y	1.8	1.9	4.5	4.3	2.6
Current account, % of GDP	1.6	0.4	1.0	0.5	1.0
Public sector balance, % of GDP	-3.8	-4.7	-6.4	-7.0	-6.5

Source: Nordea estimates and Macrobond

FINANCIAL FORECASTS FOR CHINA

Forecasts	Spot	3M	Mid-2020	End-2020	End-2021
USD/CNY	7.13	7.15	7.10	7.05	7.00
EUR/CNY	7.94	7.65	7.81	8.25	8.19
Policy rate	4.35	4.10	3.60	3.60	3.60

Source: Nordea estimates and Macrobond (spot)

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