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China's first annual contraction in decades

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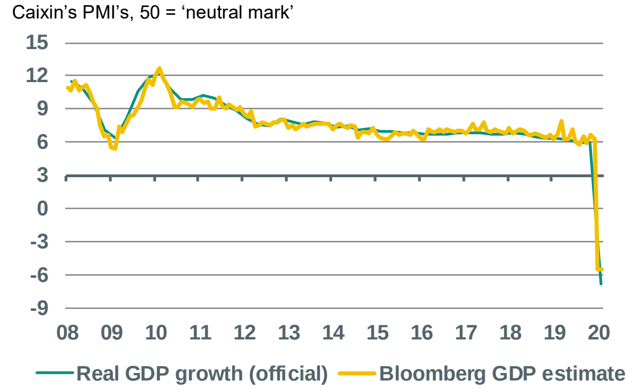
- **China's economy shrinks 6.8% yoy in Q1**
- **March activity data: some improvement, challenges remain**
- **Foreign trade data less weak in March, but headwinds have risen**
- **Policy easing to continue**

1. China's economy shrinks 6.8% yoy in Q1

GDP figures published this morning showed that the Chinese economy contracted for the first time since China started publishing quarterly figures in 1992. Real GDP contracted by 6.8% yoy, and that was even more than consensus expectations including ours. On a quarterly basis, the economy shrank by 9.8% in Q1 We should add that uncertainty regarding the Q1 GDP figure was extremely high and never seen before, with forecasts ranging from +3.5% yoy to -16.0% yoy. This uncertainty does not only fit to the unusual shock China was facing, but may also reflect that Chinese GDP data are often much less volatile than underlying activity data would suggest. In any case, the sharp contraction shows the economics of the major disruptions resulting from the emergency measures taken to stem the spread of Covid-19 such as lockdowns and other (mobility) restrictions. We still expect the Chinese economy to show a rebound in the second quarter as the economy gradually normalises, but the strength of that recovery will be constrained by the collapse in global growth and trade that will hit China's exports and related industrial activity. All in all, downside risks to our 2020 annual growth forecast of 3.0% have risen.

China's PMIs fall to record lows due to corona crisis

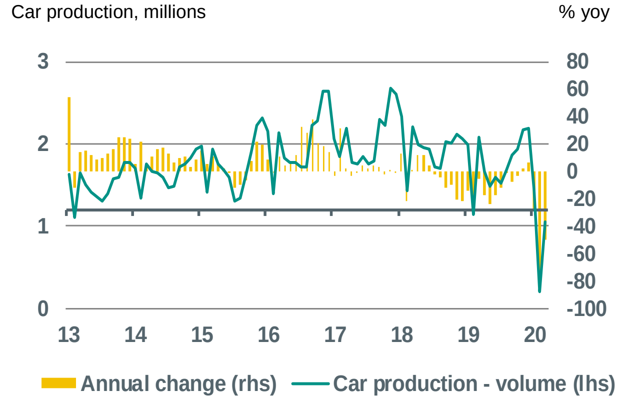


Source: Bloomberg

2. March activity data: some improvement, challenges remain

The monthly activity data for March were published as well. They confirmed at the one hand that the Chinese economy is gradually recovering from the Covid-19 shock, but at the other hand that heavy challenges remain. The sharpest improvement was seen in industrial production. Annual growth was still negative, but at -1.1% yoy less so than the -13.5% seen in Jan/Feb and also than consensus expectation (-6.2%). That partly reflected a fivefold increase in car production compared to February, although remaining sharply negative in annual terms. Meanwhile, fixed investment and retail sales came in still very weak, reflecting the drags to domestic demand stemming from the Covid-19 shock. Annual retail sales growth was still in contraction territory at -15.8% yoy (Jan/Feb: -20.5, consensus: -10%), illustrating that private consumption is still well below pre-corona levels. That partly reflects a rise in unemployment (the official rate has risen from around 5% to 6%) and a drop in consumer confidence. Fixed investment (ex rural) was also still sharply down in annual terms, at -16.1% yoy ytd (Feb: -24.5%, consensus: -15%).

Chinese car production sharply up from February's trough



Source: Thomson Reuters Datastream

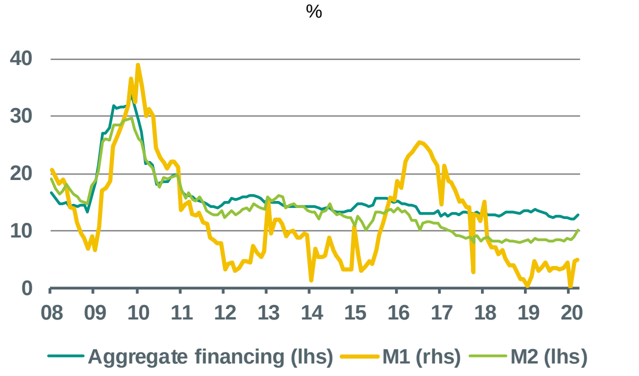
3. Foreign trade data less weak in March, but headwinds have risen
China's foreign trade data that came in earlier this week were not good, but obviously better than the numbers for January-February combined (when lockdowns and other restrictions weighed heavily on activity) and also better than consensus expectations. Exports (in dollar terms) contracted by 6.6% yoy versus -17.2% in Jan/Feb and almost -14% expected. Imports contracted by only 0.9% yoy versus -4% in Jan/Feb and almost 10% expected. It is likely that the improvement of the foreign trade data in March stems from some post-lockdown pent-up flows in foreign trade. That effect may well be less visible in April. Moreover, we expect that headwinds to Chinese exports will rise sharply in Q2, as the spread of Covid-19 beyond China has caused lockdowns around the globe that will lead to a collapse in global GDP and trade growth. That will weigh heavily on external demand for Chinese products. Imports will continue to face drags from subdued domestic demand and from the expected weakness in exports (as parts of Chinese imports are export-related reflecting China's role in global supply chains).

Trade data less weak in March, but headwinds rising

Source: Thomson Reuters Datastream

4. Policy easing to continue
To offset the fall-out from the corona crisis, Beijing continues with gradual monetary and fiscal easing, while also providing targeted support to certain sectors and companies. Over the past weeks, the People's Bank of China (PBoC) has continued with cuts of several policy interest rates. End-March, the 7-day reverse repo rate was cut by 20 bps, to 2.20% (the largest cut in almost five years). Earlier this week, the PBoC cut the policy rate on its one-year medium-term lending facility from 3.15% to 2.95%. Meanwhile, a previously announced targeted 50 bp cut in banks' reserve requirements ratio (RRR) also took effect this week. We expect the central bank to continue with measured interest rate cuts and RRR cuts to offset the impact from the corona crisis, as China still has ample room for conventional monetary easing. On the fiscal front, the authorities had already frontloaded and raised quota for local government bond issuance. The government also announced special tax breaks as well as targeted state support for sectors most hit by the corona crisis. Macroprudential regulation has also been relaxed, as the PBoC and the CBIRC have for instance allowed banks to delay the recognition of bad loans extended to SMEs suffering from the corona crisis. We expect the Chinese authorities to continue with these policies to cushion the blow from the headwinds created by the corona crisis.

Lending growth has picked up a bit



Source: Bloomberg

Key forecasts for the economy of China

	2017	2018	2019e	2020e	2021e
GDP (% yoy)	6,8	6,6	6,1	3,0	6,5
CPI inflation (% yoy)	1,5	1,9	2,9	3,5	2,5
Budget balance (% GDP)	-3,8	-4,2	-4,3	-5,0	-4,5
Government debt (% GDP)	17	15	18	22	25
Current account (% GDP)	1,6	0,4	1,0	0,5	0,5
Gross fixed investment (% GDP)	42,9	43,1	42,1	41,0	39,9
Gross national savings (% GDP)	46,3	45,2	45,1	43,9	42,2
USD/CNY (eop)	6,5	6,9	7,0	7,2	7,2
EUR/CNY (eop)	7,8	7,8	7,8	8,1	8,6

Economic growth, budget balance, current account balance for 2019, 2020 and 2021 are rounded figures

Source: EIU, ABN AMRO Group Economics