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CHINA: IMPACT OF THE PANDEMIC AND ECONOMIC RECOVERY

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ABSTRACT

The favourable course of the pandemic from early March onwards prompted the Chinese government to gradually ease the most stringent measures taken to fight COVID-19 that had been in force since January, relaxing confinements at home and the restrictions on both mobility and the pursuit of economic and business activity. This article describes the main features of the phase of economic recovery in China so far in 2020. These notably include, in first place, the considerable progress already made in the economic recovery in the country as a whole, although it was initially more lagged in Hubei province, where the pandemic originated. Second, people's movements have gradually returned to normal, reaching pre-crisis levels in early October. Third, industrial activity has seen a swift recovery, albeit one partially underpinned by temporary factors, such as supplying the demand of other economies with lockdown measures in force. Moreover, services activity, which requires a high degree of social interaction, still lags. Fourth, as regards spending, the consumption of durable goods has recovered more slowly, while the saving rate has increased, which could be attributable to precautionary motives. Lastly, the pandemic appears to have exerted overall downward pressure on inflation in the country as a whole. Nevertheless, it may not be possible to fully extrapolate the experience of China to other economies, owing to the combination of some specific factors, such as the health strategy pursued and, in the economic sphere, the temporary but notable support of the external sector through manufacturing exports.

Keywords: China, COVID-19, economic policies, recovery.

JEL classification: E60, F41, H12.

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Introduction

The favourable course of the pandemic from early March onwards prompted the Chinese government to gradually ease the most stringent measures taken to fight COVID-19 that had been in force since January, relaxing confinements at home and the restrictions on both mobility and the normal pursuit of economic and business activity. Given the disruption caused to the economy by these lockdown measures, economic activity has been recovering since they began to be eased, as shown by the indicators for Q2 and Q3, with the result that Chinese GDP has already surpassed its pre-pandemic level. Nevertheless, both the contraction of activity in the first few months of the year and its subsequent recovery have displayed geographically heterogeneous profiles, given the higher initial incidence of the disease in Hubei province, and its subsequent spread, on a smaller scale, in the form of localised outbreaks.

This article starts by describing the lockdown measures and goes on to set out the main features of the Chinese economic recovery after the pandemic. In this context, the article also analyses the extent to which the experience of China could serve as a reference for developments in other geographical areas, where the loosening of lockdown measures and fresh outbreaks have hampered the process of economic normalisation.

The easing of lockdown measures

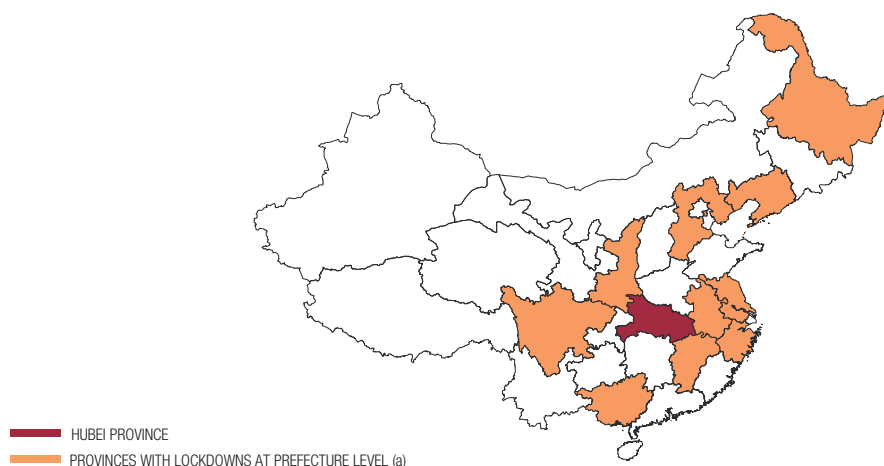
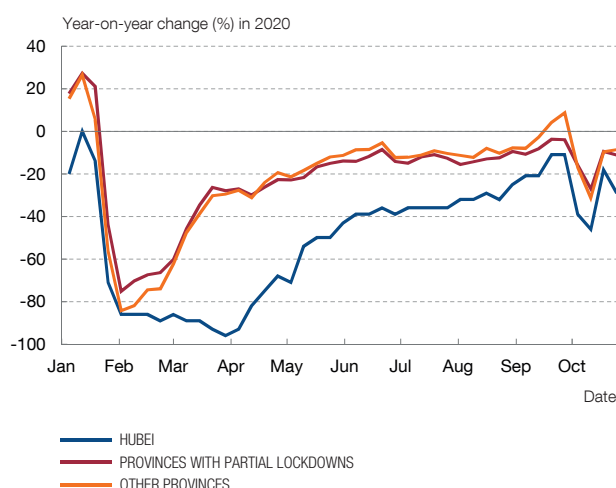
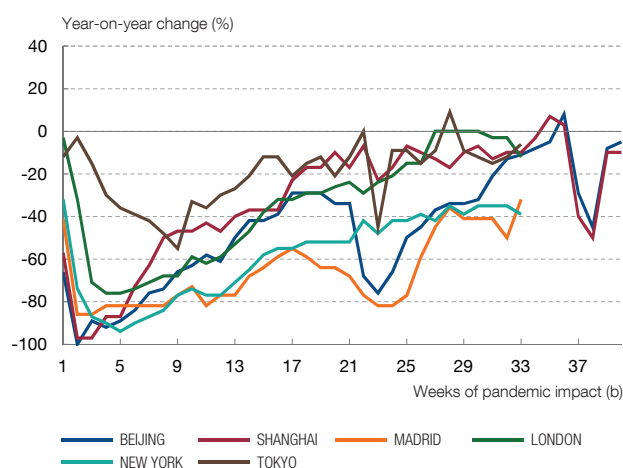
One of the most striking differences with other countries is that in China the strictest lockdown measures were imposed on a small part of the country. Hubei province (capital: Wuhan), where the disease originated and which accounts for around 4% of the country's population and GDP, was quarantined from the rest of China on 23 January, when severe restrictions were also imposed on mobility within the province. Restrictions were introduced in more limited areas, at prefecture or district level,¹ in some neighbouring regions and in regions with contagion hotspots which overall

¹ The administrative divisions in China are, in descending order, provinces, prefectures, districts/counties, municipalities and communities/villages.

Chart 1

LOCKDOWN MEASURES AND MOBILITY IN CHINESE PROVINCES

The Chinese lockdown measures were imposed unevenly across regions. These differences are reflected in the recovery of the mobility indicators.

1 SEVERITY OF THE LOCKDOWN MEASURES IN CHINA**2 TRAFFIC CONGESTION INDICES IN CHINA****3 TRAFFIC CONGESTION INDICES IN MAIN CITIES**

SOURCES: CEIC, TomTom and Banco de España.

a The lockdown was imposed at provincial level for Jiangxi province.

b For the Chinese cities, week 4 of the year (20 January) is taken as the start of the pandemic. For the other cities, week 11 (9 March) is used.



account for around 10% of the country's population and 14% of its GDP (see Chart 1.1). The lockdown measures were at their strictest in the second week of February, when they began to be relaxed somewhat, albeit unevenly. With the exception of Hubei, the government allowed business activity to be resumed between 3 and 10 February (at the discretion of local authorities), following the extended

Chinese New Year holiday period. In Hubei, industry remained shut down until 10 March and lockdown was lifted at the end of that month.²

China's health strategy for containing the pandemic and returning to normal activities has been underpinned by the following elements. First, the early tracing of infections, essentially through mobile devices, combined with extensive human resources facilitating the control of movement. Second, in addition to confinements at district or provincial level, the so-called "closed management" of communities enabled the authorities to limit entries, exits and schedules with a high degree of precision, at building or block level, in the affected zones. Lastly, in the areas with fresh outbreaks, mass free tests have been performed with very little time lag;³ this strategy has been assisted by the domestic capacity to produce medical equipment on a large scale. Moreover, among other health policy measures, in general, temperature controls in public areas have been maintained and individual prevention measures remain in force. Recreational activities involving large gatherings, such as the cinema and sporting events, began to resume in late July, albeit with limitations on capacity. Lastly, to attempt to control cases coming from other geographical areas, the entry of foreign citizens into the country was restricted from 28 March onwards. On 28 September the borders were opened to people holding a residence permit, those with family members in China and those with certain types of visa, although tests upon entry into the country and a 14-day quarantine remain in place. At the cut-off date for this article, the health alert levels have returned to normal in practically all of China, although some small areas were confined at specific points in time during the summer months due to outbreaks.⁴

The translation of the different degrees of provincial lockdown into a reduction in people's mobility in each territory is reflected in some indicators, such as the traffic congestion indicator.⁵ According to this index, both the initial reduction in mobility and its subsequent recovery to pre-pandemic levels are associated with the severity of the measures to contain the health crisis, as shown in a comparison of Hubei province, the other provinces in which lockdown measures were imposed and the rest of China (see Chart 1.2). Nevertheless, even in the areas where explicit measures to restrict mobility have not been imposed, mobility has only reached 2019 levels in early October;⁶ this could be associated with changes in individual behaviour (for

2 Except in Wuhan where, after 11 weeks, lockdown was lifted on 8 April.

3 By way of illustration, on 11 October an outbreak was detected in the city of Qingdao; by 15 October, more than 7 million tests of the population had been carried out.

4 For example, on 13 June, an outbreak originated from one of the largest wholesale markets in Beijing, affecting more than a hundred people. As a result, severe lockdown measures were swiftly reimposed, such as the selective isolation of residential complexes in some districts, the suspension of face-to-face classes and restrictions on movement out of the capital. Most restrictions were lifted again on 5 July, once the outbreak was under control.

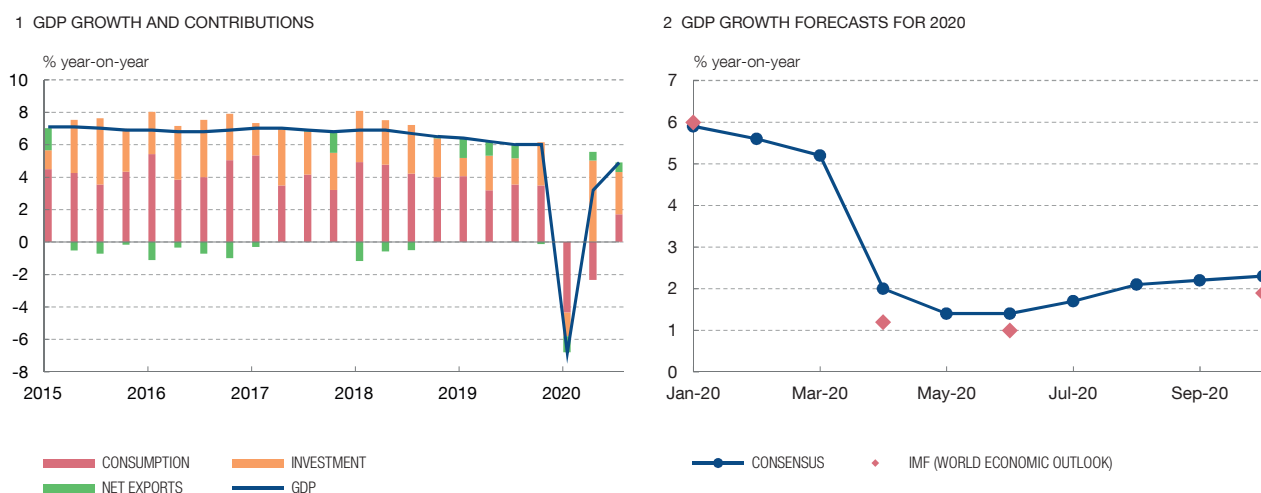
5 This index is compiled by the company TomTom (available at https://www.tomtom.com/en_gb/traffic-index/). Other measures of movement typically used for other countries, such as the indices compiled by Google or Apple, are not available for China.

6 The recent decrease recorded in the data is attributable to the Chinese national festivities during the first two weeks of October (1-8 October).

Chart 2

NATIONAL ACCOUNTS AND GROWTH FORECASTS

Following a historic contraction in 2020 Q1, the Chinese economy showed a marked recovery in Q2, which became firm, albeit at a slower pace, in Q3. The growth forecasts for 2020 were revised downwards up to the middle of the year and have since been revised slightly upwards.



SOURCES: CEIC, Consensus Forecasts and IMF.



example, working from home) to prevent infection and with the public's uncertainty as to the course of the disease during the summer months. In comparative terms, the course of mobility developments in the main Chinese cities (Beijing and Shanghai), after adjusting for the timing of events, is similar to the pattern observed in other leading world cities affected by lockdown measures, although a recent divergence can be observed, owing to the worsening epidemiological situation in other countries (see Chart 1.3).

The economic recovery in China

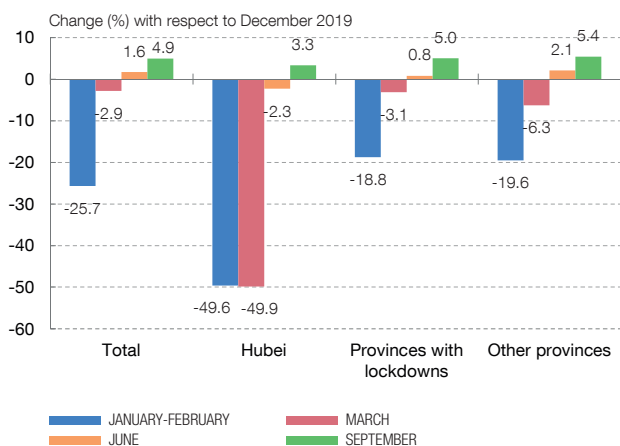
The Chinese economic recovery has already increased GDP to above pre-pandemic levels. While the Chinese economy was significantly impacted by the economic effect of the crisis in 2020 Q1, with GDP shrinking by 10% quarter-on-quarter (falling from 6% to -6.8% year-on-year), the recovery in Q2 was very marked and greater than expected, with GDP posting quarter-on-quarter growth of 11.5% (3.2% year-on-year) and thereby surpassing pre-health crisis levels (see Chart 2.1). In Q3, GDP grew at a more moderate pace of 2.7% quarter-on-quarter (4.9% year-on-year), reflecting reduced momentum in investment, as detailed below. The GDP growth forecast for 2020 was revised substantially downwards up to the middle of the year, but has improved slightly in recent months; as such, growth for 2020 as a whole is

Chart 3

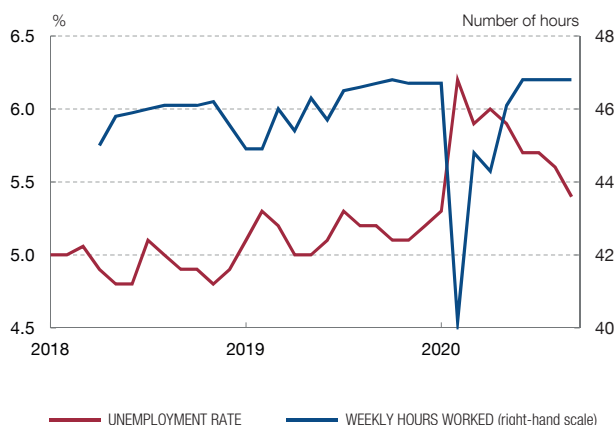
INDUSTRIAL ACTIVITY AND LABOUR MARKET

The recovery of Chinese industry showed high buoyancy in 2020 Q2, which held firm in Q3. In the labour market, the data published present a visible, albeit limited, effect of the pandemic on unemployment.

1 INDUSTRIAL PRODUCTION BY AREA



2 UNEMPLOYMENT AND HOURS WORKED



SOURCES: CEIC and Banco de España.



currently forecast at 2.3%, 3.6 pp below the January projection (see Chart 2.2). For 2021, the January forecast of 5.7% was revised upwards to 7.9% in October.

The heterogeneity of the lockdown measures across provinces and their gradual lifting has been reflected in the dynamics of the Chinese economy.⁷ From the standpoint of production, the recovery in activity has been very visible in industry, which at national level regained its pre-health crisis levels in April, following the sharp contraction in January and February,⁸ although its behaviour varied from one geographical area to another (see Chart 3.1). In Hubei province, where activity came to a complete standstill for six weeks, industrial production experienced a more delayed recovery, starting from April, while areas subject to partial lockdown and the rest of the country performed similarly, with a strong recovery from March and a return to pre-health crisis levels of activity in the following months. In any event, the recovery of industry has reflected some idiosyncratic and, possibly, temporary factors, as detailed below. Turning to the services sector, activity contracted more notably than in industry in February; however, the outlook has since improved swiftly, as illustrated by the Purchasing Managers' Index (PMI) for the sector, which has been in expansionary territory since March.

7 The cross-province heterogeneity also depends on the degree of interconnection of economic activity between provinces, but no data are available in this respect.

8 The activity data for January-February are published jointly to minimise the seasonal distortion caused by the Chinese New Year festivities.

In the labour market, the urban unemployment rate, which stood at 5.3% at the end of 2019, rose to 6.2% in February and has since held on a downward trend, falling to 5.4% in September (see Chart 3.2). Employment, which posted a year-on-year decline of 44% in February, has risen again in Q3. The limited effect of the crisis on employment could, in part, be due to the fact that many firms opted to reduce their employees' working hours rather than resort to dismissals. Thus, the average number of weekly hours worked, which in December 2019 was 46.7, dropped to 40.2 in February and increased again to 46.8 in September. Furthermore, working from home, which has traditionally been limited in China,⁹ appears to have gained prominence in the sectors in which it is feasible.

From an expenditure standpoint, the recovery has been slower in private consumption. Disposable income declined notably in the first half of the year, accompanied by a considerable increase in the saving rate (see Chart 4.1). This could be largely attributable to precautionary motives, as suggested by the fall in consumer confidence regarding future income expectations in the months when the pandemic was at its peak. The figures for Q3 point to a partial reversal of this trend. In this regard, retail sales in the country as a whole in September were still 1.5% below their pre-crisis levels, a phenomenon observed in all provinces, irrespective of the severity of the lockdown measures imposed on them (see Chart 4.2). By type of good, durables contracted sharply up to May, at which point they stabilised, and have improved since the summer. Among durables, car sales are an exception, showing a robust recovery since April (possibly supported by State subsidies), which has continued to date. By distribution channel, the recovery has been uneven, with an increase in e-commerce, which was already widely established in China.

A slower recovery has also been recorded in the consumption of services, with asymmetries across activities, the worst hit being those requiring a higher degree of social interaction. Thus, accommodation and food services and passenger transport are still posting cumulative drops since January of 5% and 33%, respectively (see Chart 4.3); conversely, real estate services have, since June, outstripped the levels of last year. A partial and late recovery has been observed in domestic tourism.¹⁰ For example, during the public holidays in early May, tourism revenues fell by 60% year-on-year, and in the recent national holiday week (1-8 October) these remained 30% below the 2019 figure. In any event, it should be noted that most tourist attractions are currently subject to limitations on capacity.

With respect to investment, the 27% year-on-year decrease recorded in January-February has been in the process of correction since March, at a slower rate in the

9 In 2018, the penetration rate of remote working in China was 0.6%, compared with 19% in the United States and 13.5% in the EU-28.

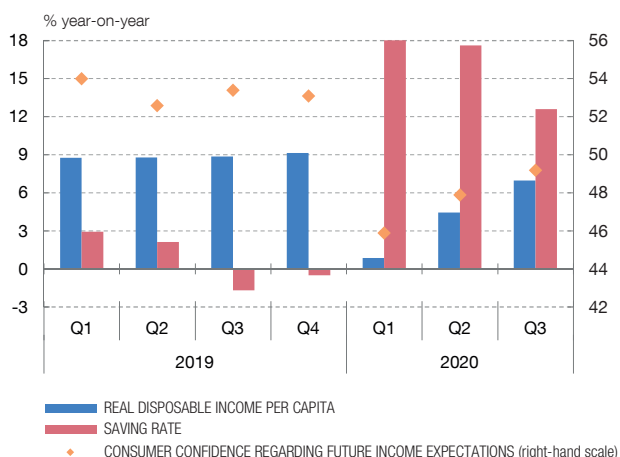
10 In international tourism, the restrictions triggered falls of nearly 100% in inbound and outbound commercial flights, which continued to be the case in August.

Chart 4

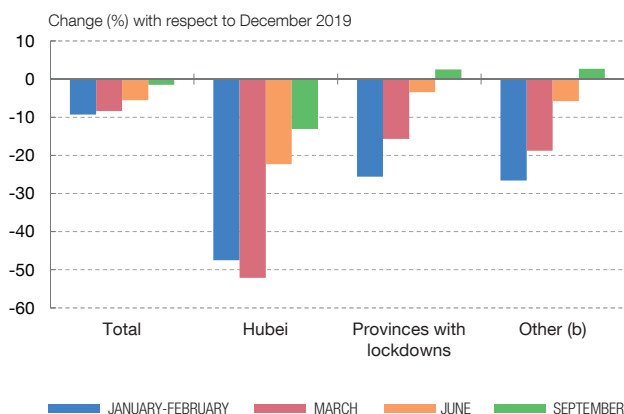
CONSUMPTION, SAVING AND INVESTMENT INDICATORS

The saving rate has increased significantly, which could be attributable to precautionary motives. Sales and services have nearly fully recovered at the end of Q3. Public investment has shown greater momentum, in line with the stimulus measures announced, although the private component has also recovered according to the latest data.

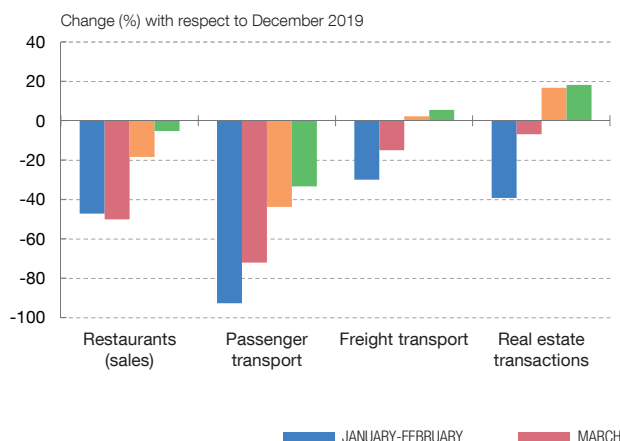
1 DISPOSABLE INCOME AND SAVING RATE



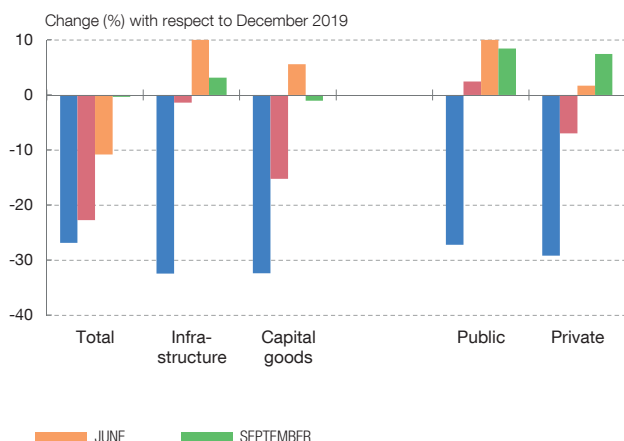
2 RETAIL SALES (a)



3 SERVICES



4 FIXED ASSET INVESTMENT (a)



SOURCES: CEIC and Banco de España.

a The changes in the subcategories and regional aggregates are calculated using year-to-date data.

b Excludes Shanghai and Beijing.



case of capital goods than in that of construction and infrastructure (see Chart 4.4). The initial recovery in investment is largely explained by the pick-up in investment by state-owned enterprises, as part of the stimulus measures implemented by various authorities. At the end of Q3, however, the gap vis-à-vis private investment appears to have narrowed.

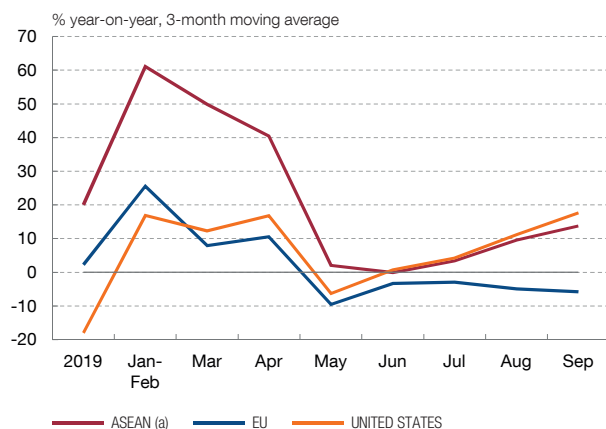
As regards international trade, despite the contraction in world demand at the start of the pandemic's expansion, China's specialisation in manufacturing, in general,

Chart 5

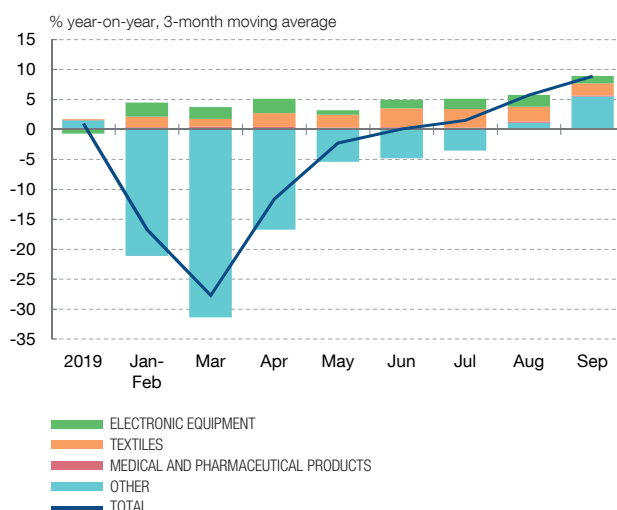
FOREIGN TRADE

The manufacturing power of Chinese industry has enabled it to meet demand for certain products in other economies while they imposed the most severe lockdown measures. In addition to the good aggregate performance of exports, some categories show notable growth as a result of this effect.

1 EXPORTS BY DESTINATION



2 EXPORTS BY TYPE OF GOOD



SOURCES: CEIC and Banco de España.

a ASEAN includes Malaysia, Indonesia, Brunei, Vietnam, Cambodia, Laos, Myanmar, Singapore, Thailand and the Philippines.



and in medical supplies, in particular, entailed that the country was able to supply the demand of many economies that had to limit their activity to contain the spread of the virus. Consequently, export flows improved in 2020, once China's brief factory shut-down period had ended. In February, exports fell by as much as 40% with respect to end-2019, but since July they have exceeded pre-pandemic levels. By geographical area, there was an increase in exports to advanced economies and neighbouring regions, particularly in the first half of the year (see Chart 5.1). By productive sector, there was very significant growth in some components, such as personal protection equipment (included in textile goods) and electronic and communications equipment, given the surge in demand linked to remote working in other economies. However, the latest data suggest that other export products have also improved appreciably (see Chart 5.2). Goods imports have held on an upward trend in the second half of the year, reflecting the recovery in domestic demand, which in May was 17% below its pre-pandemic level.

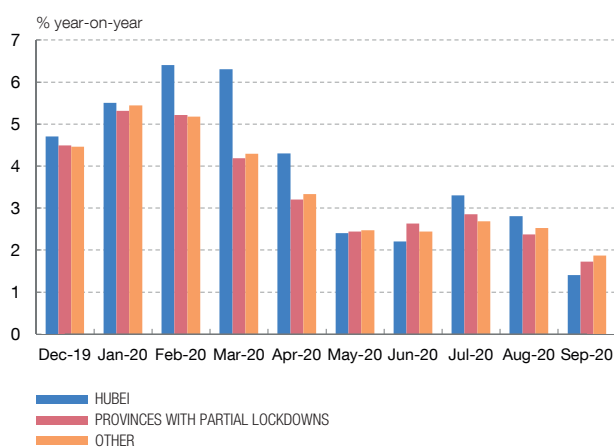
As regards inflation of consumer prices, the negative demand effects arising from the health crisis appear to have prevailed in the country as a whole, although they varied from one geographical area to another, depending on the crisis's impact. Thus, in Hubei, the supply-side factors associated with restrictions on activity appear to have exerted some upward pressure on prices. In this province, inflation stood

Chart 6

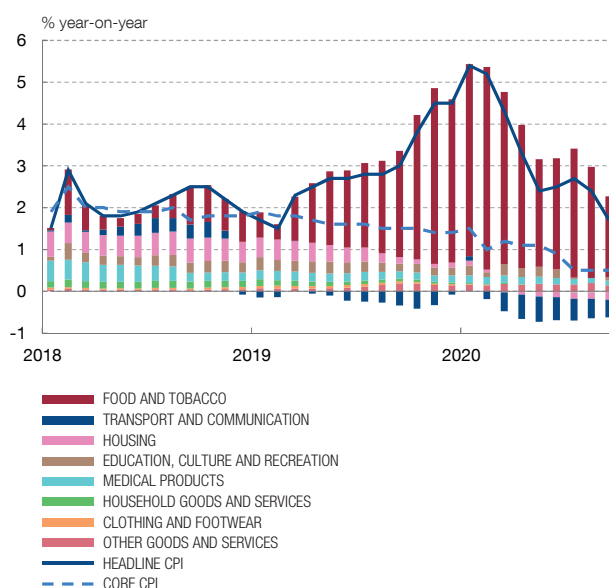
CONSUMER PRICES

The trend in consumer prices during the recovery has been highly affected by the food and fuel components.

1 HEADLINE INFLATION BY REGION



2 HEADLINE INFLATION AND COMPONENTS



SOURCES: CEIC and Banco de España.



above that recorded in the rest of the country until May, owing to supply problems and the disruptions to production resulting from the lockdown measures (see Chart 6.1). In the rest of the country, the trend in prices has chiefly been determined by the moderation of the food component –once the swine fever outbreak had been overcome– and of fuel, which has reversed the upward trend observed since mid-2019. The other CPI items have also suffered the impact of the health crisis, with demand-side factors prevailing. Thus, until mid-2020, the rise in the price of medical supplies and the drop in education, recreation and culture prices were notable. More recently, as the recovery in spending has consolidated and activity in the services sector returned to normal, some of these trends have reversed. Transport and fuel prices have started to rebound, as have those of recreation and culture, albeit with a somewhat greater lag. That said, core inflation has fallen by 0.9 pp since end-2019, to stand at 0.5% year-on-year in September (see Chart 6.2).

In the area of economic policy, it should be mentioned that the Chinese economic recovery has been assisted by a wide range of stimulus measures. On the fiscal side, the stimulus package approved, combining nation-wide and regional measures, accounted for 6% of GDP in 2019¹¹ (see Chart 7.1), more modest than the packages

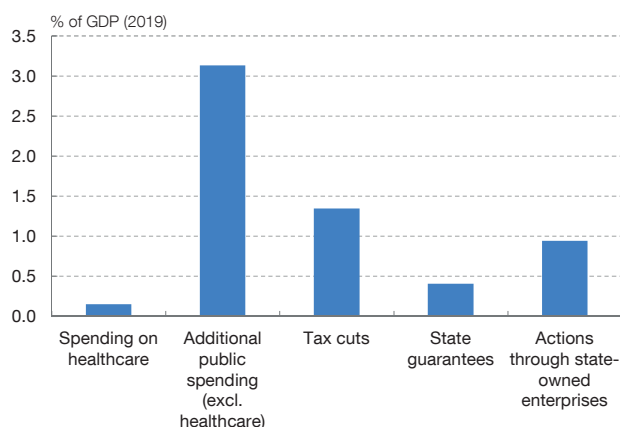
¹¹ This figure does not take into account the bringing forward of certain measures in the 2020 fiscal year, such as the increase in the quota for local government bond issuance, which represents 1.5% of GDP.

Chart 7

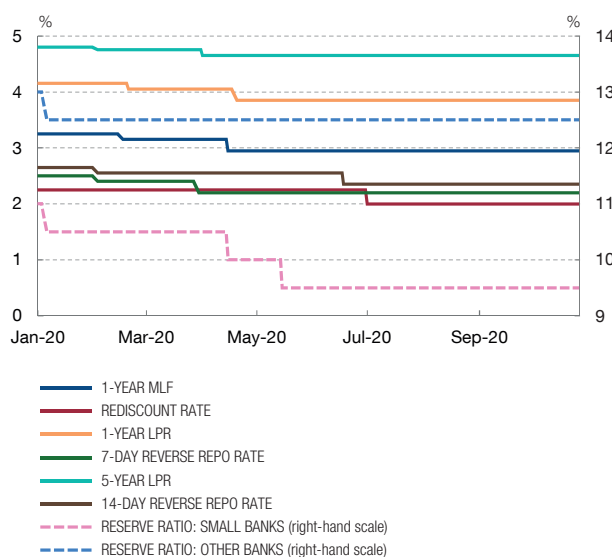
RECOVERY STIMULUS MEASURES

The Chinese authorities have deployed a broad range of measures to combat the harmful effects of the pandemic. In the monetary sphere, the rate cuts and reductions in reserve ratios are noteworthy; among other fiscal measures, the quotas for local government bond issuance to finance infrastructure projects have been increased.

1 FISCAL POLICY MEASURES



2 MONETARY POLICY VARIABLES



SOURCES: CEIC, IMF and Banco de España.



approved in the advanced economies or those deployed during the financial crisis of 2008.¹² Initiatives include greater public spending on healthcare and employment, extended unemployment benefits and subsidies for car purchases. The tax burden on households and firms has been reduced through tax cuts and exemptions from VAT, corporate income tax and social security contributions. Additionally, a State guarantee fund for loans to SMEs has been set up. More indirectly, public corporations (electricity companies, development banks, transport companies) have cut their prices and fees. As for monetary policy, there have been widespread reductions in benchmark rates and reserve ratios (see Chart 7.2), along with liquidity injections and refinancing facilities, the latter representing 2% of GDP, to support lending to SMEs. In the macro and microprudential areas, forbearance on mortgage payments has been introduced and the banking regulator has relaxed the standards for non-performing loans. For now, there has been no significant rise in the NPL ratio.¹³

To conclude, China's economic recovery in the wake of the COVID-19 pandemic has been notable for its speed, without taking into consideration the early incidence of the disease in the country compared to other geographical areas. The Chinese

¹² The fiscal package deployed in 2008 represented, at the time, 13% of GDP.

¹³ In 2020 Q2, the NPL ratio stood at 1.94%, compared with 1.86% in December 2019.

economy has regained its end-2019 levels of activity, although certain asymmetries remain in the path to recovery, such as the reduced buoyancy of some services sectors. Nevertheless, it may not be possible to fully extrapolate the experience of China to other economies, owing to the combination of some specific factors, such as the health strategy pursued, which has so far managed to prevent fresh outbreaks of the disease and, in the economic sphere, the significant temporary factors arising from its productive specialisation in manufacturing, which have contributed to support the recovery through external demand.

29.10.2020.