Economic collapse in April makes stimulus siren call hard to avoid

April's dire econ numbers put to bed the idea that China's 5.5% GDP growth target for this year is reachable. The economy cratered last month as COVID-19 mitigation measures brought economic activity in many parts of the country to a halt.

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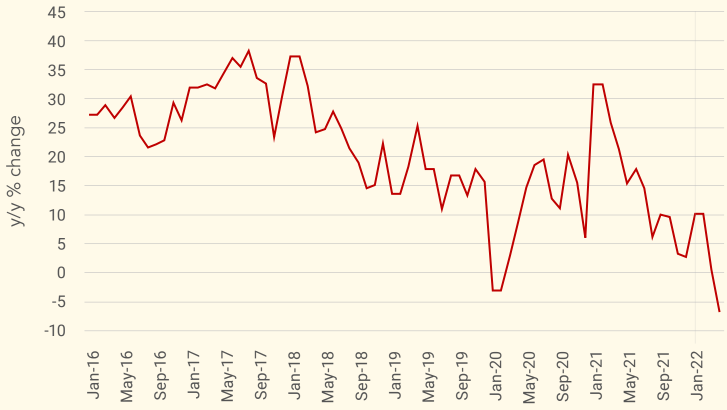
Key takeaways

- Consumer spending plunged; home sales, which had already been falling sharply, saw a further step-down; and manufacturing activity contracted. In the face of this, unemployment spiked, with joblessness among graduates rising to a series high.
- Despite this freefall in economic activity, there was little evidence of government support in the econ numbers. In fact, infrastructure investment growth decelerated last month.
- One obvious barrier to more government support to counter the collapse in economic activity is that stimulus would be rendered largely ineffective by the current COVID-19 control measures. That's not the only issue, though. Another is that officials cannot do much to support growth within the current policy setting.
- Fiscal stimulus, for example, is being held back by the conservative budget position the government adopted for the year. This week's decision to cut mortgage rates falls well short of what is needed to boost housing markets. Stimulus measures to boost consumer spending have been equally miserly.
- It makes sense to hold back on stimulus while vast parts of the country are locked down. Therefore, the urgent task for Chinese officials is to bring the country's COVID-19 outbreaks under control and then move quickly to launch more stimulus.

It was no surprise to most people that China's economy tanked in April. But the scale of the collapse in economic activity was even more significant than markets expected.

Consumer spending fell off a cliff, with retail sales plunging 11.1% y/y – the biggest fall since March 2020. The pullback in spending was not just limited to brick-and-mortar purchases. Online sales of goods and services dropped 6.8% y/y, a record fall [FIG 1].

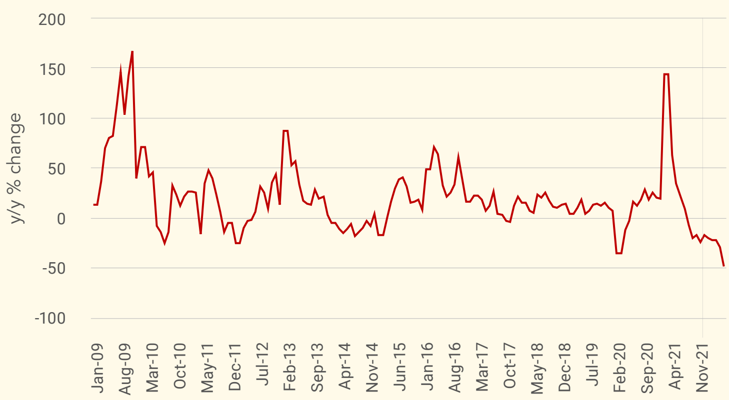
Fig. 1 - Online sales of goods and services



The employment picture also deteriorated. The official unemployment rate rose from 5.8% to 6.1%. In February 2020, at the beginning of the pandemic, it hit 6.2%. The unemployment rate among graduates rose last month to a series high of 18.2% (this data started to be published in January 2018). Unemployment in China's 31 largest cities, at 6.7%, was also at its highest level since June 2013, when this data started.

Home sales, which had already been falling sharply, took a further step down in April. The value of transactions dropped 48.7% y/y [FIG 2]. This fed through into a bigger fall in real estate investment, which dropped 10.1% y/y in April versus a 2.4% y/y contraction in March. This drop in real estate spending reflected the fall in construction last month. Floor space under construction decreased 39.3% y/y; floor space newly started fell 44.2% y/y.

Fig. 2 - Home sales value



Output of building materials consequently remained weak in April, with steel and cement production falling 5.2% and 18.9% y/y, respectively. Broader industrial activity also fell. Industrial value-added output dropped 2.9% y/y in April, the weakest reading since the first two months of 2020. The fall in manufacturing value-added output was even more extreme, dropping 4.6% y/y last month.

Despite this contraction in manufacturing activity, manufacturers' fixed-asset investment (FAI) remained relatively stable. In April, manufacturing FAI growth slowed from 11.9% y/y growth in March, but still expanded 6.4% y/y – faster than the 1.8% y/y increase in overall FAI. However, this looks like an unsustainable source of growth support. The lending data for April shows that the slow-down in economic activity is discouraging firms from taking out loans to fund capital expenditure. Net new corporate loans dropped 23.4% y/y last month. Within this, medium- and long-term loans fell 59.8% y/y.

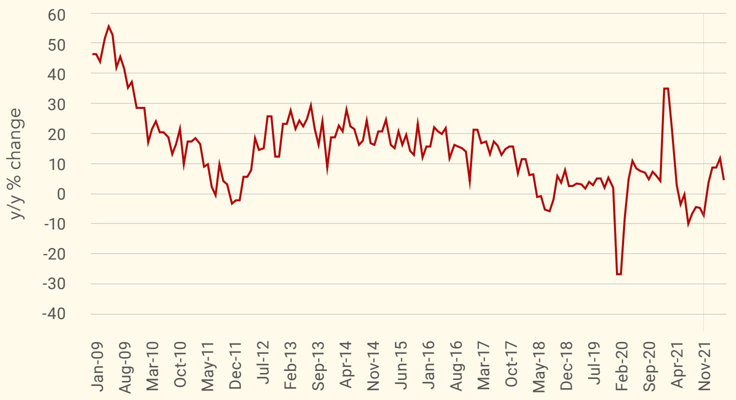
China's economic growth headwinds are not just domestic. In April, export growth fell sharply, slowing to 3.9% y/y from 14.7% in March. More concerningly, the new export orders manufacturing PMI subindex – which tends to lead export shipments by around six months – plunged last month, dropping to 41.6, the lowest since May 2020 [FIG 3].

Fig. 3 - New export orders vs exports

Stimulus is still MIA

Despite this freefall in economic activity, there was little evidence of government support in the April econ numbers. Infrastructure FAI growth slowed from 11.8% y/y in March to 4.3% [FIG 4]. Spending by state-owned enterprises (SOEs) – traditionally a channel for countercyclical investment – also saw weaker growth, slowing to 4.6% y/y from 10.0% in March.

Fig. 4 - Infrastructure FAI



One obvious barrier to more government support to counter the collapse in economic activity is that the current COVID-19 control measures would render stimulus largely ineffective. This likely explains, in part, why infrastructure spending growth decelerated last month. Construction projects have been affected by mobility restrictions, but also the difficulty of sourcing materials, given the logistics problems China has faced.

That's not the only issue, though. The fact is that officials just cannot do much to support growth within the current policy setting.

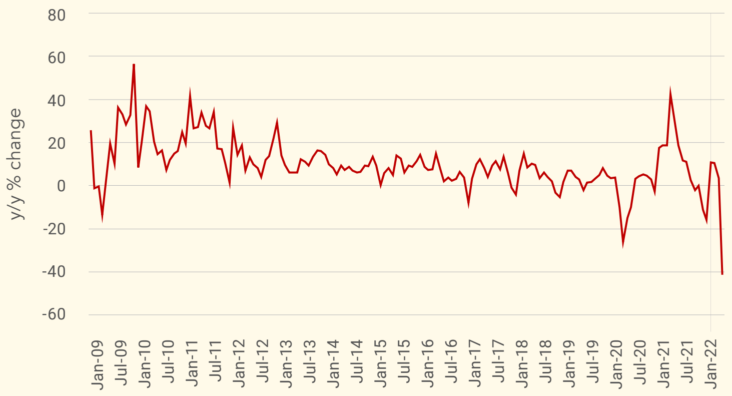
The issue with fiscal stimulus, for example, is not just the difficulty in undertaking construction work at present but also the limited amount of fiscal funding available for such stimulus spending.

The problem is two-fold.

Firstly, funding for stimulatory fiscal expenditure like infrastructure investment has not been overly generous this year. Local government special-purpose bonds (SPBs) are the primary source of fiscal funds for infrastructure projects. However, the issuance quota for this year was set at the same level as last year: RMB 3.65 trillion. Local governments have already utilized 38% of this quota.

Secondly, slower economic growth and lower tax receipts mean that fiscal resources are at risk of being diverted away from areas like infrastructure construction. Fiscal revenue in the general public budget fell 41.3% y/y in April, as tax receipts dropped [FIG 5]. Revenue in the government-managed funds budget – which is used to fund the bulk of government spending on infrastructure – dropped 34.4% y/y last month, due to a 37.8% y/y fall in land sales revenue. This took the year-to-date fall in revenue in this budget to 27.6% y/y, compared with the 0.2% y/y increase in revenue that the government had initially budgeted for. Therefore, it looks increasingly likely that a portion of the funds raised from the issuance of SPBs – which are used to finance the deficit in this budget – will have to be used to make up for this revenue shortfall. These problems are compounded by the fact that more and more fiscal resources are being diverted into funding COVID-19 control measures like testing and quarantine, further reducing the amount of money available to finance growth-boosting efforts.

Fig. 5 - Revenue in the general public budget



Stimulus green light

The policy setting in other areas is also not especially pro-growth. While the banking authorities have reduced the minimum mortgage rate by 20bps, this only applies to first-home buyers. Moreover, this small cut is unlikely to make much difference even for these potential buyers. A good illustration of the scale of the government's challenge in stimulating housing demand is that the outstanding value of mortgages contracted last month, falling by RMB 60.5 billion. One big problem for officials is that there is currently no incentive to purchase property for investment, given the bleak outlook for prices. A 20bp reduction in the cost of mortgages will not change that assessment.

The stimulus measures that have been introduced for households are also fairly measly. Many local authorities have issued consumption vouchers to spur spending, but the scale of this is tiny. Shenzhen, for example, has given away RMB 500 million in coupons and Chengdu RMB 600 million – a drop in the ocean in terms of what's needed.

Therefore, what needs to change is not just COVID-19 control measures, as outbreaks are brought under control, but also the policy setting. The easing of Shanghai's lockdown will help remove some of the supply bottlenecks that have disrupted economic growth and release pent-up demand from locked-down citizens. This, however, will only lead to a short, sequential recovery in economic activity unless it is accompanied by more stimulus.

Currently, it does not make much sense for officials to push harder on the stimulus front, given the constraints on households' and companies' economic activity from COVID-19 control measures. But the roll-back of these controls as outbreaks are reined in will give Beijing the green light to ramp up stimulus.

For China to come anywhere near this year's growth target, therefore, officials need to bring COVID-19 outbreaks under control and then move quickly to launch substantial stimulus.