# China Economy Rebounds in Q2 from COVID-19 Contraction with Uneven Recovery

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The National Bureau of Statistics (NBS) released Q2 Chinese economic data on June 17, 2020, which suggests China's economy has undergone a fairly robust recovery from the COVID-19 damage it received over the first quarter. The Q2 GDP returned to a positive growth of 3.2%, marking a significant improvement from Q1's slump of 6.8%. All three sectors (the primary, secondary, and service) expanded in the second quarter, up 3.3%, 4.7%, 1.9%, respectively, compared to the same period last year.

Major indicators, such as industrial production, service, retail sales, investment, international trade, and FDI attraction all show strong expansion from the first quarter. The financial and labor markets also saw growth compared to Q1, driven by ongoing strong stimulus from Beijing. Industrial production and service output rose by 4.4% and 1.9% year on year, respectively, as compared to a drop of 8.4% and 5.2% in Q1, respectively. Retail sales and fixed-asset investment still showed a dip, albeit both with a slower pace. Industrial production and exports expanded for the third straight month since April. The service sector declined in April but grew for the following two consecutive months. On the other hand, retail sales, a key measurement of consumption, still lagged due to the devastating impact of COVID-19 on restaurants. However, the decline in sales of consumer goods and services is slowing down as the economy recovers from the downturn.

Industrial production grew by 4.8% year-on-year in June, as factories expanded capacity under the control of COVID-19. June's output beat May's 4.4% and marked the strongest monthly rise in 2020 and was in line with the estimate that market analysts had anticipated. The manufacturing sector continued to grow at a pace of 5.1%, slightly lower than the last month. Output of the utility and mining sectors gathered steam and rose by 5.5% and 1.7%, respectively. Combining with April and May, industrial production went up 4.4% year on year in the second quarter. This result suggests a significant improvement from the first quarter when industrial production dropped by 8.4% because of the outbreak of COVID-19 in January. The contraction of industrial production in the first quarter dragged down the growth rate of industrial production in the first half of 2020 to negative 1.3%, although positive growth was seen in the second quarter.

In the second quarter of 2020, retail sales of consumer goods and service declined by 3.9% year on year. In June alone, there was a year-on-year drop of 1.8% in retail sales, or an increase of 1.34% from May 2020. The recovery of China's consumer consumption is much slower than industrial production as this sector was hit the hardest due to COVID-19 and consumer confidence has not fully recovered. Restaurants show the greatest dip, followed by oil and gas sales, and non-essential items (e.g., jewelry, vehicles and furniture). E-commerce continue to outperform in-store retail in June. Online sales, in the first six months, rose by 7.3% year on year as consumers switched to online shopping while being confined at home.

Fixed asset investment dropped by 3.1 % year on year in the first half of 2020, narrowing from 6.3% decline from January to May. More specifically, investment in the primary sector rose by 3.8 % from the same period of 2019, while the secondary and service sectors show a slump of 8.3 % and 1 %, respectively. Investment in high-tech industries increased by 6.3 % in the first half of the year, compared with a 12.1% decline in Q1. Investment from the private sector decreased 7.3 % year on year, although slower than the 18.8% decline in Q1, but still far behind the 2.1% investment increase from SOEs'.

China's total trade volume reached US$ 1,095.7 billion in the second quarter of 2020 with a year-on-year decrease of 0.2%, a considerable improvement from 6.5% drop in the first quarter. The year-on-year change in trade volume was -5.1% in April, -9.3% in May and 1.5% in June, respectively. China's exports grew year-on-year by 3.5% in April, decreased by 3.3% in May and returned to growth by 0.5% in June. Compared with 2019, China's imports slumped 14.2% in April, 16.7% in May and bounced back with a 2.7% increase in June 2020. The positive performance of both exports and imports in June indicated China's recovery in its trade with the rest of the world.

China's inbound FDI totaled US$ 36.7 billion in the second quarter of 2020, increasing 8.4% from the same period last year. In June, China's inbound FDI grew 3.7% to US$ 16.7 billion. Investment from Singapore and the United States experienced a major increase of 7.8% and 6%, respectively. Besides, the high-tech service industries witnessed a remarkable expansion of 19.2% in inward-bound foreign investment, which can be attributed to both the growing reliance on information technologies in Chinese society and workplaces and the Chinese government's endeavour to further develop high-tech service industries.

Meanwhile, China's non-financial OFDI (Outbound Foreign Direct Investment) amounted to US$ 27.3 billion in the second quarter with a year-on-year decrease rate of 15.3% with US$ 11.4 billion in April, US$ 9.2 billion in May and US$ 6.7 billion in June. Among the investment destinations, the ASEAN countries received most of China's FDI investments, with the total amount of US$ 6.2 billion in the first half year of 2020, an astonishing year-on-year increase of 53.1%. Besides, investments in countries along the BRI (the Belt and Road Initiative) also experienced a tremendous climb of 19.4%.

With the resumption of production, the employment situation has improved in the second quarter of 2020. China's surveyed urban unemployment rate was 6% in April, 5.9% in May and 5.7% in June, while the peak of unemployment rate in 2020 was 6.2% in February. Employment in many industries has recovered to levels seen before the pandemic broke out. Additionally, the average weekly working hour has reached 46.8 hours, which was 6.6 hours more than that in February.

However, the unemployment rate in June 2020 was still 0.6% greater than that in June 2019, while the unemployment rate of rural migrants was 0.7% higher than a year ago. These numbers imply that labor-intensive industries and unskilled labours have been disproportionately affected by COVID-19. When breaking down by age groups, statistics show that workers between 16 and 24 years of age experienced a significant increase in unemployment with an increase rate of 0.6% compared to May, 2020 which may be attributed to the increased supply of college graduates. However, the unemployment rate among labourers between 25 and 64 years old was still only 5.2%, which was 0.5% less than the aggregated average.

China's CPI (Consumer Price Index) increased year-on-year by 3.3% in April, 2.4% in May and 2.5% in June, while the CPI growth rate in the first quarter of 2020 was 4.9%. The significant decrease in CPI growth rate was mainly due to the more sufficient food supply which can be attributed to the recovery of transportation and logistics. For the first half of 2020, China's CPI increased year-on-year by 3.8%, among which more than 80% of the increase was generated by the increase in pork prices in the wake of the swine fever epidemic in the national hog population. Besides, it should be noted that the core CPI (excluding prices of food and energy) was stable in the first half year, with a year-on-year growth rate of 1.2%.

China's Industrial Producer Price Index (PPI) decreased year-on-year by 3.1% in April, 3.7% in May and 3% in June, while the PPI decrease rate in the first quarter of 2020 was 0.6%. For the first half year, China's PPI decreased year-on-year by 1.9%. Two factors are likely behind this significant decrease in PPI. Firstly, China's PPI in the same period of 2019 was rather high, which contributed to a larger decrease rate. Secondly, the decrease of China's PPI in the first half year of 2020 was influenced by decreases in prices of petroleum-related industries (reflecting lower global oil prices), which account for approximately 70% of the decrease in China's PPI.

China's manufacturing PMI (Purchasing Managers' Index) was 50.8 in April, 50.6 in May and 50.9 in June,

[1] ASEAN members include Indonesia, Malaysia, Philippines, Singapore, Thailand, Brunei, Laos, Myanmar, Cambodia and Vietnam.

slightly less than that in March (52) but greater than that in January (50) and February (35.7). The non-manufacturing business activity index was 53.2 in April, 53.6 in May and 54.4 in June, experiencing a steady growth from the first quarter, which was 54.1 in January, 29.6 in February and 52.3 in March. The growth was also witnessed in comprehensive PMI. The comprehensive PMI was 53.4 in April, 53.4 in May and 54.2 in June while it was 53 in January, 28.9 in February and 53 in March. The PMI data supports the broad narrative that the Chinese economy is experiencing a recovery from the pandemic in the second quarter.

In the second quarter, China continued to apply expansive fiscal and monetary policies to support the recovery of the real economy. These support policies aim to ensure liquidity at a reasonable and sufficient level. Data from the People's Bank of China show that China's total social financing, a broad gauge of credit and liquidity in the economy increased by 12.8% year on year by the end of June. The broad money, or M2 showed an 11.1% year-on-year increase, pointing to a sufficient money supply in the Chinese market.[1] Loans continued to rise in Q2 and went up by 13% from the same period last year. However, as the economy recovers, China's central bank appears to have begun to pause easing and is turning towards a more neutral monetary policy.

The Q2 data shows clear positive trends for China's economic recovery from COVID-19. China became the first major economy to grow amid the threats of global recession caused by the pandemic. China's industrial capacity in the second quarter is 74.4%, down 2% year on the year, but up 7.1% compared with the first quarter. Except for some service sectors such as hotels and restaurants, most sectors demonstrated positive growth in the second quarter. Agriculture, manufacturing, construction, financial services, real estate, and IT services are even growing at a faster rate than GDP. Investment and exports made positive contributions to GDP growth in the second quarter. Consumption is still a drag to GDP, yet at a lesser degree than the first quarter. High-technology manufacturing and service sectors maintain upward momentum and became a key driver of China's economic recovery in H1.

However, China's Q2 recovery can be seen as uneven, given the significant lag of retail sales data. Retail sales were down 1.8% in June from a year ago, weaker than expectations for a 0.3% increase. The recovery is mainly on the supply-side rather than the demand side, and investment-driven instead of consumption-driven. The sluggish demand recovery suggests weak consumer confidence under which consumption recovery may delayed into the second half of the year. One reason behind the weak demand is declining real personal income in H1 which is 1.3% lower than the first six months in 2019. Expectations regarding personal income is not optimistic either, given the impact of high unemployment rate in the second quarter. This may further limit China's consumption recovery in the 3rd and 4th quarters.

The significant economic improvement that Q2 data has shown lays the foundation of an ongoing positive growth trajectory in the second half of 2020. China expects the economy to continue to grow in the third and fourth quarters, should the pandemic be kept under control and economic policies continue to support the recovery. The most optimistic projection of China's economic growth is over 8% for the second half of 2020, and 4% for the entire year. On the other hand, some economists are more pessimistic about the recovery and expected a 1% annual growth for 2020, given the projected 5% contraction of global economy in 2020. The major challenges that may slow down China's economic recovery include the rising tensions in diplomatic and trade relations with the U.S. and the recently escalating geopolitical conflicts between China and multiple other countries.

[2] Total social financing refers to the ag¬gre¬gate vol¬ume of funds pro¬vided by Chi¬na's do¬mes¬tic fi¬nan¬cial sys¬tem to the real econ¬omy, including non-financial enterprises and households) within a given time¬frame.