

China's Economic Structural Adjustment Encountered Virus Outbreak, Short-term Fluctuation Will Not Affect Long-term Economic Trend

Since around the beginning of 2020, China has encountered a new type of coronavirus pneumonia ("COVID-19"¹) epidemic and it remains unclear when the epidemic will be under control. The transmission speed of COVID-19 is different from that of SARS² in 2003. Because the public transportation is more convenient and the number of migrants in China is huge, it poses a greater challenge to the infection prevention and control of the epidemic and the ability of local health systems in reacting to the public health emergencies. As COVID-19 generally has an incubation period of about 14 days and the symptoms of some infected patients are not significant, there is an unavoidable time lag in the publicly disclosed confirmed and suspected cases. Relying on the currently available statistics to predict the turning point of COVID-19 can be challenging.

The epidemic to some extent reflects certain characteristics of China's political system. As the information delivery takes time, the regions with higher administrative levels are more likely to quickly receive assistance from the central government than those with lower administrative levels. The regions with lower administrative levels usually have fewer resources available to tackle the emergencies and have smaller buffers. In addition, the central government's strong ability to allocate human and other resources in a short period of time has been demonstrated.

The Epidemic Inevitably Has an Impact on the Economy in the Short Term; Credit Divergence Accelerates

China's current economy is more dependent on the tertiary industry³ than 17 years ago when SARS occurred. The outbreak during the Spring Festival has a direct impact on transportation, entertainment, catering, real estate, etc., and indirectly affects the secondary and primary industries. The epidemic needs a large amount of financial and material resources from the central and local governments, which will deplete the fiscal funds. The Chinese economy is facing difficulties to overcome amid its structural adjustment process, while the epidemic has temporarily interrupted the normal operation of social and economic activities, which will also pressure China's GDP growth in the next 6 to 12 months.

Local government financing vehicles ("LGFVs") have generally relied on government support to maintain their normal operation and solvency, while the level of support varies depending on the importance of each LGFV. The outbreak has impaired the fiscal position of governments at various levels. As a result, we expect China's local governments to be more prudent in providing support to LGFVs in order to maximize the effectiveness of their more constrained financial resources. Assessing the credit quality of LGFVs will become more important.

Affected by the epidemic, property development projects across China are facing suspension of construction and sales. This has increased the pressure on property

¹ Coronavirus Disease 2019, WHO

² Severe Acute Respiratory Syndrome, WHO

³ Industries classification please refer to http://www.stats.gov.cn/tjsj/zbjz/201912/t20191202_1713058.html, National Bureau of Statistics

developers' short term liquidity, which may spill over into the financial system. Government policies for property developers can alleviate the impact of the epidemic to a certain extent. However, before such policies take effects, some property developers with intrinsic weakness due to smaller scale or higher liquidity pressure may not be viable during this difficult period. Credit divergence in the Chinese property industry is expected to accelerate as a result of the outbreak.

Regulators Take Multiple Measures to Support Liquidity; Long-term Economic Trend Continues

Although COVID-19 will inevitably have an impact on the economic development in the short term, Chinese regulators have adopted a series of proactive policies to respond, aiming at the financial market and economic stability.

From the perspective of local government fiscal revenue, local governments may try to moderately increase the revenue of government fund income to ease fiscal pressure in the short term in the context of large fiscal expenditure for the epidemic prevention and control. However, the land auction situation is subject to the operation and financial condition of property developers, which are largely influenced by the financing policy for the real estate industry in the coming period. This dynamic situation will pose a challenge to regulators. In the long run, China's overall economic development trend still mainly depends on the economic fundamentals and financial policies. We expect that the long-term economic development will continue steadily advancing.

For more details, please refer to the Chinese report:

《中国经济结构调整偶遇疫情 短期波动不改长期经济发展趋势》

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