Commentary

How China's economic fight against coronavirus will unfold

Patrick Zweifel and Steve Donze

China has plenty of items in its policy toolkit to ease economic pressure from the coronavirus outbreak, but investors should expect the authorities to channel funds into the most vulnerable businesses – a "precision irrigation" approach rather than flood-style stimulus.

The world's second-largest economy can barely begin to count the cost of its public health crisis. Employees have struggled to get back to work after an extended Chinese New Year break, keeping businesses and factories shut. Some cities are still under lockdown as the authorities impose travel restrictions and keep residents indoors.

So it is reasonable to assume that the virus outbreak will deal a severe blow to China's economy. The transport, retail, travel and entertainment sectors, which together make up around 18 per cent of gross domestic product (GDP), will be the hardest hit.

The upshot is that the country is on course to register its first quarterly contraction since 1976, shrinking by 0.2 per cent in the first three months of this year. It will probably continue to struggle for a few months more. But the shock should not last much longer than that. In a repeat of what unfolded during the severe acute respiratory syndrome epidemic in 2003, the recovery is likely to be as sharp as the downturn.

A pumper truck production line at a factory in Zhangjiakou in China's northern Hebei province last month. Last year, China cut household income tax, lowered value-added tax on the manufacturing, construction and transport sectors, and reduced corporate tax in a package equivalent to 1.6 per cent of GDP – and it has room for further stimulus, say the writers. PHOTO: AGENCE FRANCE-PRESSE

One reason that would underpin the speedy recovery is that Beijing is likely to implement coordinated fiscal and monetary stimulus.

Since the start of this month, China has already pumped a net one trillion yuan (S$199 billion) into the banking system: It has also cut interest rates on reverse repurchase agreements in its first bold policy easing since late 2018.

Yet the People's Bank of China has room to ease further: It has been more restrictive than average in recent months than at any point in the last two years. Cutting Chinese banks' reserve requirement ratios by 200 basis points, for instance, would amount to a liquidity injection of US$460 billion (S$643 billion), equivalent to 3 per cent of GDP. We also expect the People's Bank of China to cut the loan prime rate – a new benchmark for pricing existing floating-rate loans – to support virus-affected businesses.

But the support will be measured and targeted – there will be no "flood-irrigation" stimulus, which People's Bank of China governor Yi Gang has been at pains to point out.

In recent days, China cut its one- and five-year benchmark lending rates by 10 and five basis points respectively and lowered the rate on medium-term loans.

China is likely to act on the fiscal front too. Even before the outbreak, the government was already in expansionary mode. As the United States-China trade war escalated, economic growth slowed to 6.1 per cent last year, the weakest in nearly three decades.

Last year alone, Beijing cut household income tax, lowered value-added tax (VAT) on the manufacturing, construction and transport sectors, and reduced corporate tax in a package equivalent to 1.6 per cent of GDP.

Further cuts will come. Even so, China needs to tread a fine line. Its fiscal deficit already stands at 5 per cent of GDP and the authorities are reluctant to see a sharp increase in the level of debt relative to its economic output.

This is why we think Beijing will prefer to give more targeted support this year, such as tax exemptions to certain businesses or VAT cuts for a limited period.

Some of the latest measures by the local authorities in Shanghai and Guangdong province give a flavour of things to come. These policies, designed for small and medium-sized enterprises that are most vulnerable, include reducing office rent, waiving administrative fees, postponing tax filing, subsidising interest payment of new corporate loans and refunding social security contributions.

All of these steps should add up to the economy growing 5.6 per cent this year. This is only 0.3 percentage point lower than we initially forecast and – more importantly – in line with what the ruling Communist Party needs to fulfil its goal of doubling GDP and incomes in the decade to 2020.

With Beijing determined to hit its economic objectives, the monetary and fiscal taps are bound to open. Just do not expect the stimulus to flow into every corner of the economy.

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