

# MACRO OUTLOOK

## Relief Spending Will Drive Recovery, But Won't Last Long

Houze Song

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## 4Q2020 KEY TAKEAWAYS

- Beijing will shift its priority from stimulus to expanding relief efforts through the end of the year, which should have a positive impact on sustaining the ongoing recovery.
- On the back of strong spending on relief measures, struggling segments of the economy such as small and medium enterprises will see further improvements that benefit jobs and domestic consumption.
- The main risk is that relief measures will be prematurely withdrawn, leading to renewed growth weakness in early 2021.

The Chinese economy saw continued recovery during the third quarter, with cumulative GDP growth finally returning to positive territory. Many indicators have shown signs of improvement, including the Purchasing Managers Index (PMI) that has been expansionary through September. This naturally raises the expectation that growth will further accelerate in the fourth quarter.

However, as we previously predicted, Beijing began to withdraw stimulus in 3Q2020, which will sap the recovery momentum in coming months. Both investment and industrial production growth are unlikely to further accelerate in 4Q2020. Instead, after much delay, Beijing will redouble its relief efforts to support sectors such as small and medium enterprises (SMEs).

With the assumption that a resurgence of Covid-19 in China is unlikely, Beijing's prioritization of relief efforts, such as more tax cuts and unemployment assistance, will help equalize the economic recovery. Still, the Chinese economy will continue to struggle to maintain growth momentum because these efforts are unlikely to last much beyond 4Q2020, suggesting the pace of recovery will slow in early 2021.



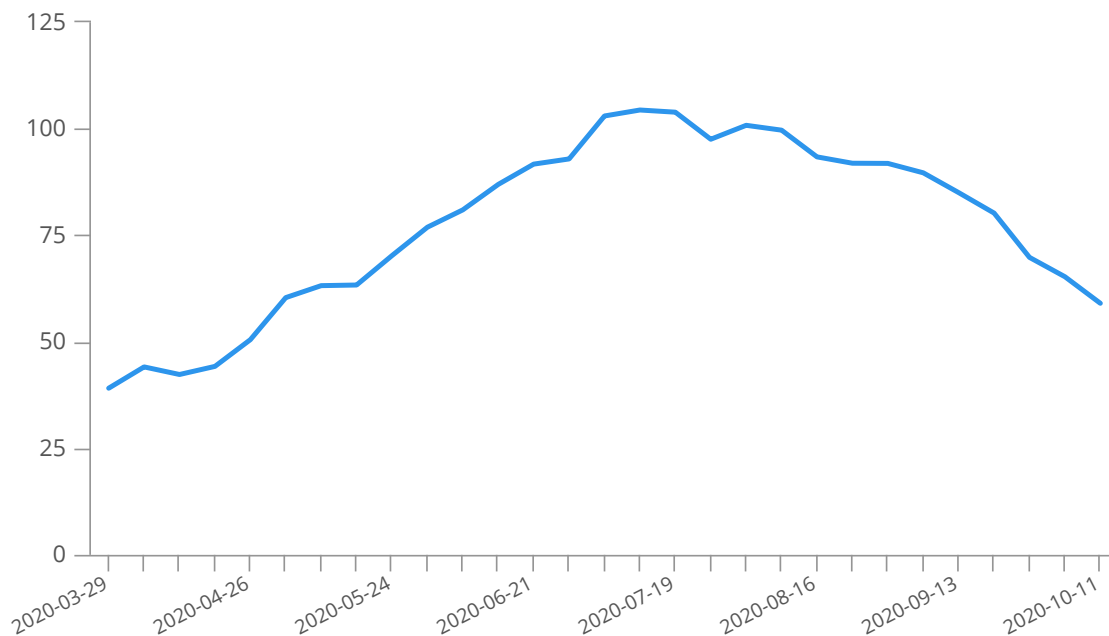
## STIMULUS TAKES BACK SEAT, RELIEF EFFORTS IN DRIVER'S SEAT

Beijing has been winding down stimulus since the third quarter, as our previous [outlook](#) predicted. It is now finally ramping up relief spending in a bid to equalize the economic recovery. The cooling property market and monetary policy actions since early August show how stimulus has petered out.

In response to Beijing setting a debt limit on property firms, these firms are now using apartment sales revenue to pay back debt, rather than acquiring more land as collateral. This type of forced deleveraging has resulted in land sales plummeting in the 100 largest cities, with average weekly sales down more than 40% in September compared to July (see Figure 1).

The deceleration in land sales will drag on growth going forward since that was a big driver of local fiscal spending from May to July, which in turn supported growth in the third quarter. In coming months, the impact of a cooling property sector will spill over into the construction industry. In fact, the future price of steel rebar has already fallen by more than 5% since August.

Figure 1. Land Sales Growth Has Collapsed Since August (in billion yuan)



Note: Data shows 12-week moving average of total residential land sales in the 100 largest cities.

Source: Wind.

Meanwhile, monetary policy is also becoming less accommodative, as the People's Bank of China (PBoC) has signaled that it is tapering stimulus. This is evident when comparing PBoC's June and September policy statements, with the latter dropping "supporting aggregate demand" from the statement's language—a clear signal that headline growth has declined in importance.

Beijing will likely further weaken stimulus in 4Q2020, as it did during the fourth quarter of 2019. At the end of 2019, China was facing pressure from the US-China trade war, but instead of expanding stimulus Beijing chose to reserve ammunition to hedge against future uncertainties.

This time around, there are arguably even more uncertainties, not least of which a potential double-dip of global growth if Covid-19 resurges worldwide. Yet Beijing will likely adopt a similar approach in coming months as it did in 4Q2019, keeping fiscal expenditure lower than the borrowing limit would allow. This means that even as local governments enjoyed >10% land sales revenue growth, a large part of this windfall will not be spent until 2021.

### **Relief Spending Finally Ramping Up...**

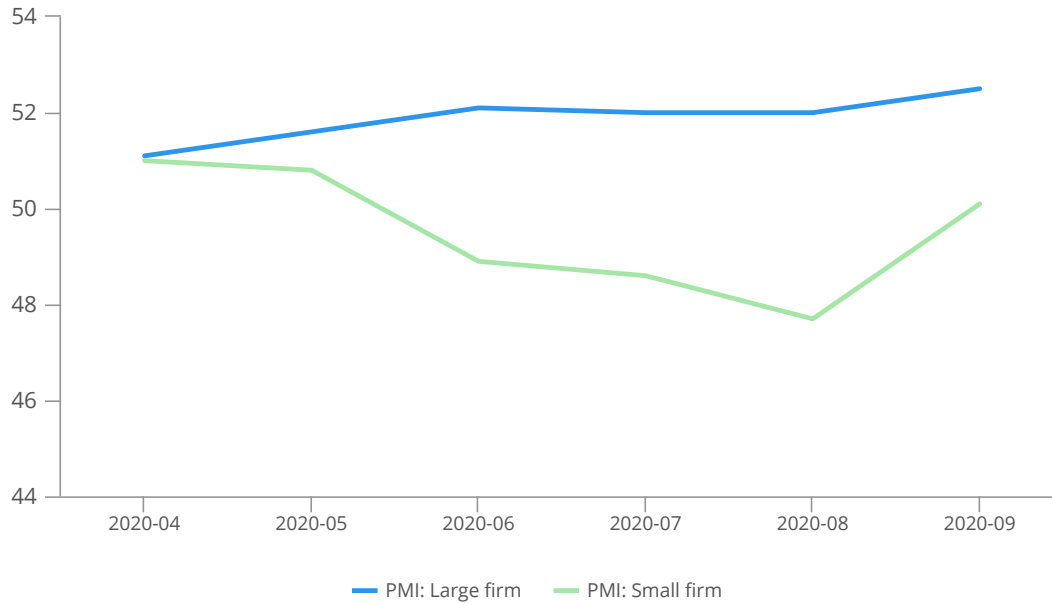
As stimulus gets withdrawn, Beijing is simultaneously deploying its 1.7 trillion yuan (\$250 billion) relief funding, mainly in the form of tax cuts and unemployment assistance. Although this relief package is still relatively modest compared to stimulus in other major economies, it should be sufficient to shore up the recovery for the next few months.

That's because the pace of relief spending has picked up steam since August, even though the funding was approved back in May during the national legislature meeting. Beijing had only spent about 20% of the relief funding from May to July, but then deployed an additional 20% of the funding in August alone.

This acceleration has already led to tangible improvements in the condition of SMEs. For example, in September, SMEs' and large firms' PMI began converging for the first time since April, indicating that small businesses are making better progress in their recovery (see Figure 2).



Figure 2. Gap between Small and Large Firms' PMIs Narrowed in September



Source: National Bureau of Statistics via Wind.

With another 60% of the relief funding to be deployed through the end of the year, that should further support the recovery of SMEs, which will be positive for employment and ultimately benefit consumption. But these effects will have a lag, which means the pace of economic recovery will slow down in coming months. As a result, GDP growth likely peaked in the third quarter.

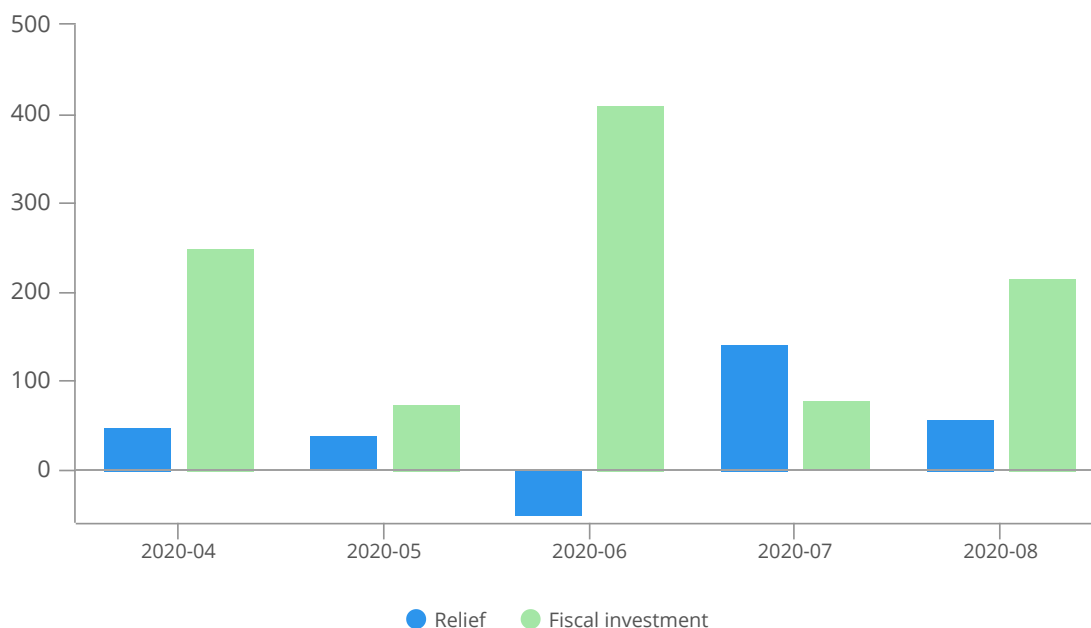
### ...But It Won't Last Long Enough

Relief spending, however, won't last much beyond the remainder of the year. Many local governments were already [struggling financially](#) before the pandemic and now have even less fiscal room to provide sufficient relief support. For example, before the transfer of the \$250 billion relief funding from the central government, total local spending on unemployment assistance rose by just \$12 billion through the end of May, covering less than 1% of the working population.

Now that the central government is meaningfully deploying the relief fund, local governments will have even less incentive to dole out relief spending and instead free ride on this central transfer. Local spending patterns in June showed that this sort of free-riding occurred almost immediately after Beijing announced that it would finance relief spending.

In fact, the collapse of relief spending in June wasn't necessarily the result of a shortage of local funds. Over the second and third quarters, booming land sales and improving tax collection boosted local revenue. Yet instead of spending on relief to small businesses, local governments apparently spent 40% more than in June of 2019 on what they know best: investments (see Figure 3).

Figure 3. Local Governments Are Investing Instead of Spending on Relief Efforts (in billion yuan)



Source: Wind.

Beyond local governments, Beijing is also unlikely to continue relief funding beyond 4Q2020, allowing current measures to expire by early 2021. This is a result of several key constraints on spending at the central level.

For one, Beijing remains a fiscal deficit hawk and seems unwilling to engage in unlimited deficit spending. The central government debt/GDP ratio, for example, was the lowest among major economies before the pandemic and rose by the smallest amount during the pandemic. Moreover, [well aware](#) of local governments' tendency to free ride, Beijing put together a modest size relief package and will likely rein in its future contribution to relief spending.

Second, state banks are still reluctant to lend to small businesses as part of the relief efforts, even under the pressure and admonition of the PBoC. Relief lending does not align with the banks' profit



considerations because struggling small businesses are the highest risk borrowers at the moment. Their ability to pay back their loans is questionable in an economy that remains broadly weak.

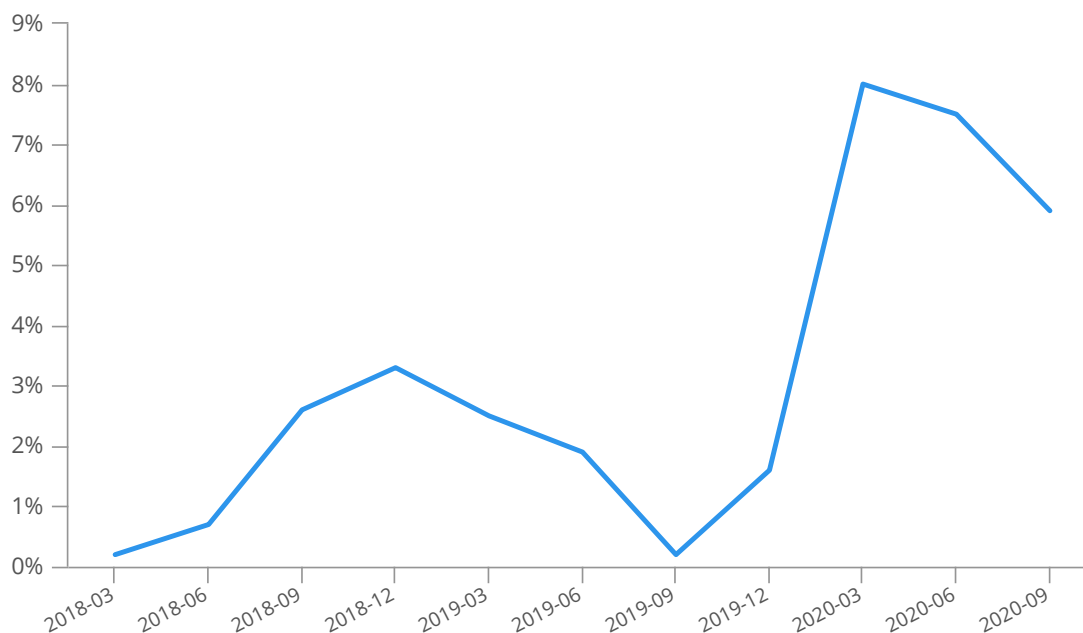
For example, compared to the first three quarters of 2019, the number of SMEs receiving bank lending for the first time fell from 7 million to 4 million through 3Q2020. Moreover, the grace period for \$300 billion of SME loan repayments will expire by early 2021 and is unlikely to be extended, forcing those businesses to make their payments.

## CONTINUED RELIEF SUPPORT NEEDED

Although the employment picture has improved, migrant unemployment is still about 3 percentage points higher than in 2019. Assuming improvement continues at the current pace, it will take at least another six quarters for the labor market to fully recover. Labor market weakness is also showing up in stagnant wage growth. In the most recent quarter, urban wage growth is still 3 percentage points lower compared to the same period in 2019. These factors combined will continue to exert pressure on consumer confidence and domestic demand, evidenced by a household savings rate that remains high relative to the pre-Covid period (see Figure 4).



Figure 4. Chinese Consumers Still Prefer Saving Over Spending



*Note: Data shows year-on-year change in the household savings rate.*

Source: NBS.

With the tapering of broad-based stimulus, the arrival of meaningful relief spending will be the main driver of economic recovery in 4Q2020. This will facilitate the recovery of the job market and SMEs, as gradual improvement continues through the end of the year. Although the fourth quarter will get a needed boost, the risk of a premature withdrawal of relief spending means there is at least a 60% chance that the growth momentum will weaken in early 2021. This could well erase some of the gains in labor market recovery and slow consumption growth throughout next year.