China, What next?

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At the time of writing this article, China has been gripped by the Corona Virus Disease outbreak and the rest of the world, especially Asia, is closely monitoring the outbreak in anticipation of the situation being brought under control.

This article was meant to follow on from my earlier theme on the general rise of commodity prices and the continued rise of China as an economic powerhouse and becoming a net consumer of goods. The hope was that Chinese imports would increase at a far greater rate than exports. The reality is that this narrative may need to be put on hold, hopefully only temporarily. Following the (COVID-19) outbreak, China has needed to increase bank liquidity to prop up the economy and could well allow its currency to weaken to boost the economy.

In the short term, the outbreak will hurt domestic consumption, reduce demand, disrupt supply chains and weaken commodity prices. It could also trigger inflationary price increases in consumer goods.

The Chinese economy will certainly slow drastically in the first quarter of this year. The Lunar New Year holidays have been extended so factories and shops are resuming operations on average two to four weeks later than normal. Even after commercial operations resume, they are likely to be on a reduced scale. Many companies are encouraging their staff to work from home, for instance. It will take time for people to overcome their fear and return to normal working, spending and travel routines.

Tourism, transport and retail sector activities have slowed dramatically all over urban China. For example, daily passenger traffic on China's railways has plunged by more than 70% during the Lunar New Year compared with last year. With so much uncertainty, companies are cutting back on employment, with small and medium enterprises placing workers on unpaid leave, despite government instructions not to do so.

China's footprint in the global economy has expanded massively since the 2003 SARS epidemic. Its share of world GDP today is around 16%, compared with only 4% in 2003, while it consumes more than 10% of total global exports. When China sneezes, the rest of the world will be shaken up a lot more than it was before.

Malaysia, Vietnam, Indonesia and Thailand will be hurt. We will soon see export orders reported in purchasing manager surveys for this month registering sharp declines.

The Chinese economy will bear the brunt of the shock but most of the damage will be limited to the first quarter of the year, assuming that China's policymakers manage the economic consequences well and the virus does not mutate. The rest of Asia will bear some pain as a result, but the hit to growth will be manageable and the region should regain a healthy growth trajectory by the second half of 2020.

We may see that the United States uses this situation to further disrupt the supply chains from China. As a result, more companies may seek to relocate production outside of China because of fears, mistaken or otherwise, that China has a higher risk of epidemiological crises (on top of trade and geopolitical tensions with the US).

I conclude that China will suffer a short-term decline in growth, but at the end of the day this will not reverse the long-term economic progress of China. We pray that fatalities caused by the Coronavirus remain minimal and hope to be able to present a much more positive picture about China and Asia in the next article.