

Hotwiring the Chinese Economy

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The Chinese economy has stalled. The manufacturing PMI for May was an anaemic 50.6, a touch worse than April's 50.8. The PMI is a dispersion index, which means that figures above 50.0 indicate expansion, and figures below 50.0 indicate contraction. So manufacturing growth is only just in positive territory. Trivium's National Business Indicator tells the same story. In the first week of June it had reached 87.8%, compared to 85.3% a month earlier. In particular, new export orders remain very weak as the rest of the world struggles with COVID-19.

The central government had kickstarted economic activity in March by means of a combination of exhortations and threats aimed at the parts of the economy which it can talk to directly – State-owned enterprises (SOEs) and large private companies. It is well aware that it also needs to get small and medium enterprises moving, because they contribute 60% of GDP and over 80% of urban employment.

The obstacle is that China's big banks don't like lending to small businesses. They prefer to lend to large private companies (who own lots of collateral) and to SOEs (because the government will bail them out). Therefore, looser monetary policy, such as lowering interest rates, does not increase the supply of credit to the businesses which really need it. In addition, the banking regulators have spent the last three years de-risking the financial system by shrinking the shadow banks, and they are not letting all their efforts be reversed by an indiscriminate flood of credit.

Nor is the central government going to repeat the 2008 mega-stimulus, which was equivalent to 12% of GDP at the time. This flood of money succeeded in boosting economic activity, but it had several unpleasant side effects:

- Building numerous vanity projects which never made commercial sense, e.g. airports built to service towns which get three flights a day;
- Building numerous substandard projects, such as highways that collapsed;
- Propelling private-sector debt to unprecedented heights; and
- Creating colossal opportunities for corruption, as officials skimmed off commissions and solicited bribes.

Therefore, the government has decided to hotwire the economy, transmitting its stimulus packages through unorthodox channels in the hope that the money will find its way to businesses that need it. For example, central, provincial, and city governments will keep on giving consumers coupons to use at local retailers and restaurants.

Banks have been encouraged to issue bonds whose proceeds are dedicated to loans to small businesses. By end-May, RMB 275bn (\$55bn) worth of bonds had been issued. A special-purpose vehicle has been set up to channel RMB 440bn (\$88bn) to regional banks in order to fund new loans to small businesses or the rollover of existing loans.

The central government will increase its 2020 budget deficit by RMB 1.0 trillion (\$200bn) and has introduced new measures to get the money down to the grassroots. The cash will bypass provincial governments and go directly to city and county governments who are in charge of spending it, subject to strict oversight. The intention is to prevent funds from being diverted to other uses (such as officials' pockets).

The most surprising move was Li Keqiang's off-the-cuff chats with the owners of street stalls and other micro-businesses in a walk around the coastal city of Yantai (population 6.5 million). The Premier asked them how they were trading and whether the local authorities were supporting them. He told them, "The country will only get better once markets, enterprises and individual traders get back on their feet and develop. We will give you our support."

The Premier's remarks spurred China's tech giants into enthusiastic expressions of support for micro-businesses. WeChat offered subsidies, business guidance, and marketing support. Alipay broadened its offers of interest-free online loans. Suning offered free inventory storage in its freezers. JD.com offered inventory sourcing and interest-free loans.

Li Keqiang's attitude came as a painful surprise to city authorities. In recent years, city bosses throughout China have been closing down street vendors on the grounds that they are untidy, unlicensed, unhygienic, and unattractive. Low-level city officials have long supplemented their wages by harassing and shaking down street vendors.

The motivation for the new, capitalist-friendly policy is of course to revive the micro-businesses which were decimated by China's economic lockdown. Premier Li has committed the government to creating nine million urban jobs, and most of these must come from small business. The Chinese Communist Party has already shown that it can control COVID-19 better than the US. If it actually hits its target of nine million jobs, it will have shown that it can do capitalism better than the US.

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