Post-pandemic economic outlook: What to expect?

Alicia Garcia Herrero - Chief Economist, Asia Pacific
alicia.garciaherrero@natixis.com
+852 3900 8680

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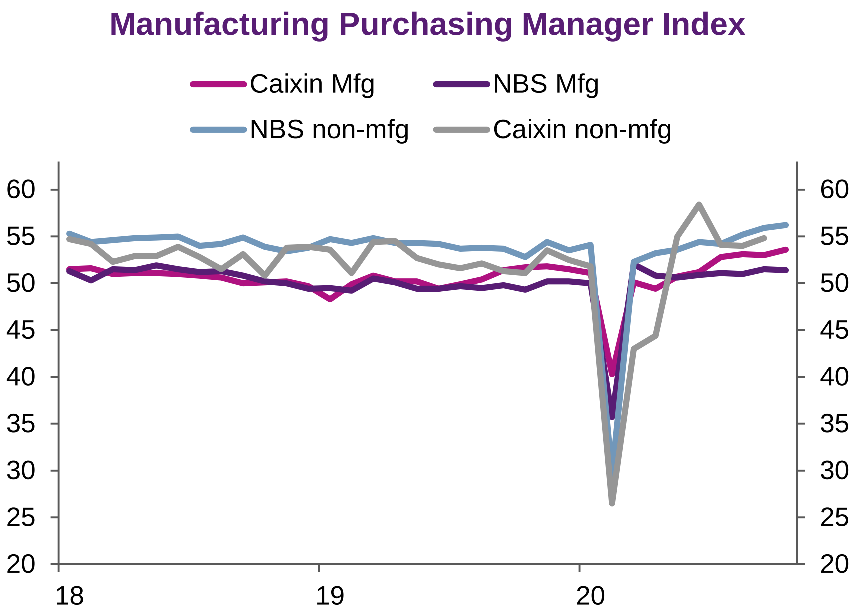
KEY ISSUES

- A QUICK TOUR TO CHINA'S RECOVERY
- STRUCTURAL CHANGES IN A POST-COVID WORLD
- ZOOMING INTO DEGLOBALIZATION
- SOME TAKEAWAYS

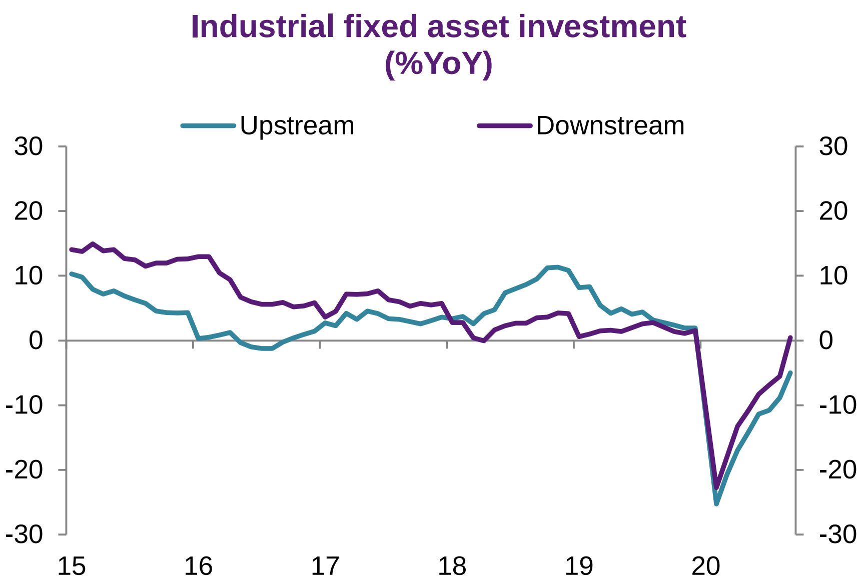
1 A QUICK TOUR TO CHINA'S RECOVERY

The way to economic recovery has been confirmed by PMI data, both on services and manufacturing

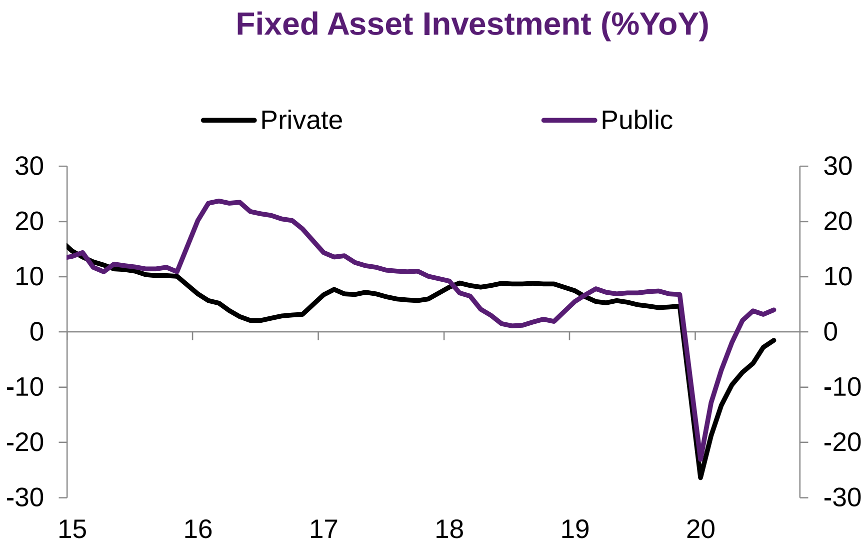


Source: Natixis, Bloomberg

But with some caveats:
1. Fixed asset investment led by the public sector



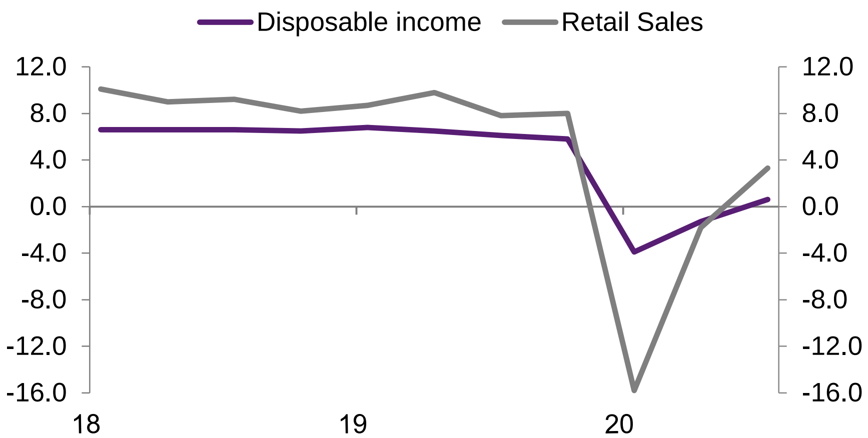
Source: Natixis, CEIC



Source: Natixis, Bloomberg

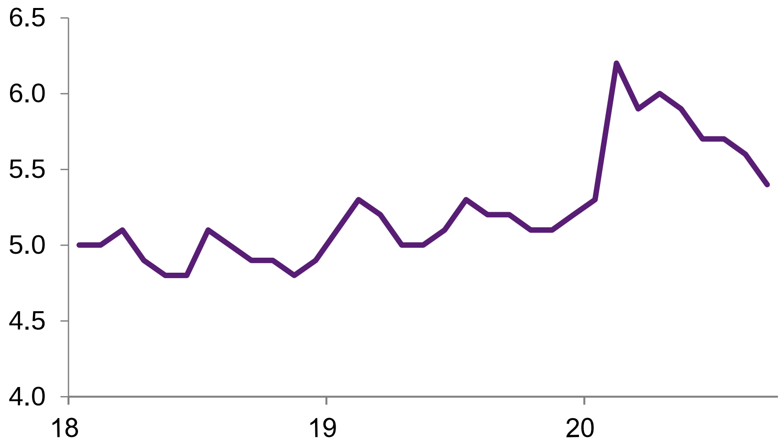
2. Household's disposable income not back to pre-Covid levels so hard to support consumption. Labor market also not back fully

Disposable income and retail sales (%YoY)



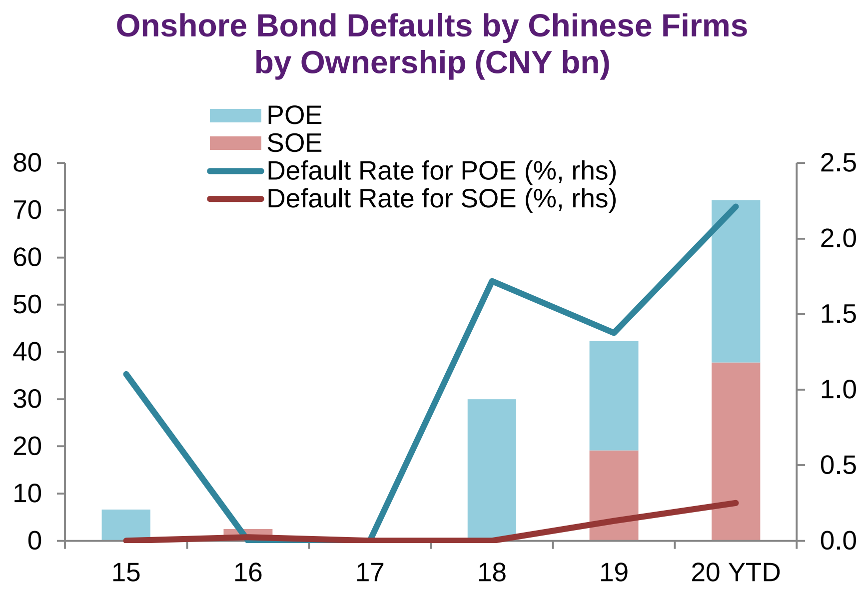
Sources: Natixis, WIND

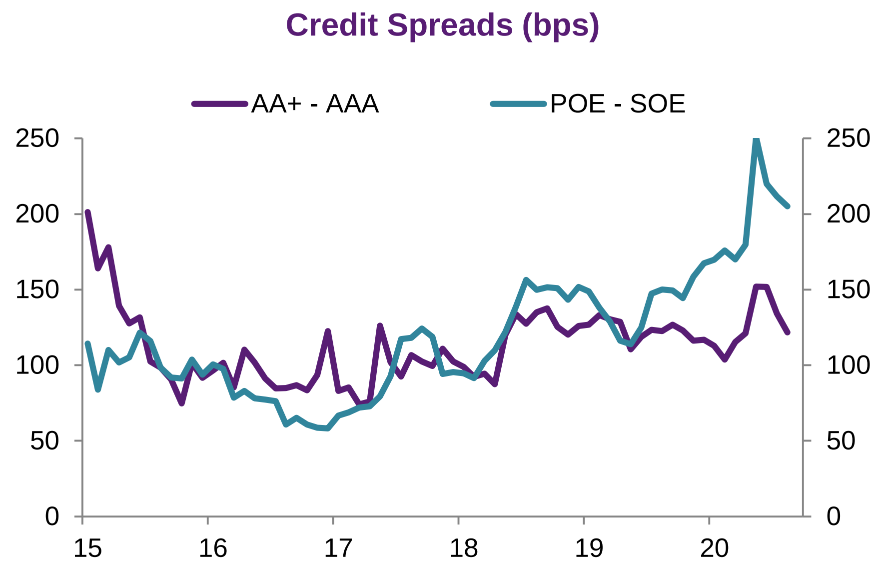
China Urban Unemployment Rate (%)



Sources: Natixis, WIND

3. Financial risk remains elevated: credit risk at local government/local SOE level and private sector



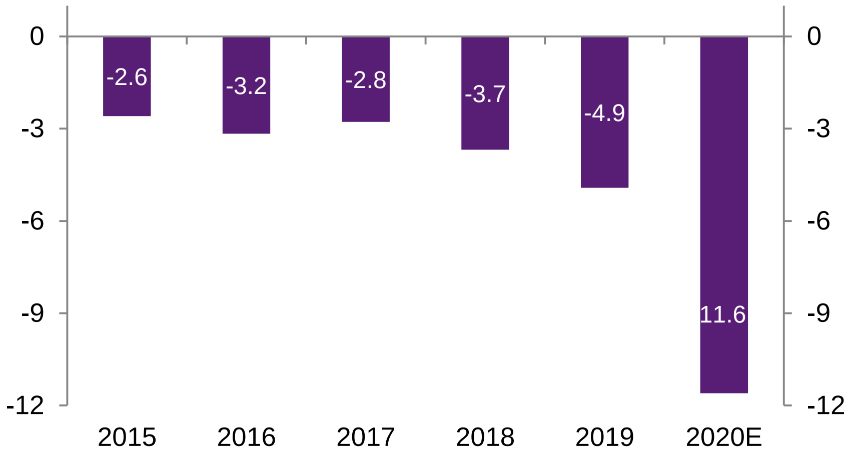


Source: Natixis, Bloomberg

N.B. Included bonds with maturity more than one year. Excluded certificate of deposits.
Source: Natixis, Bloomberg

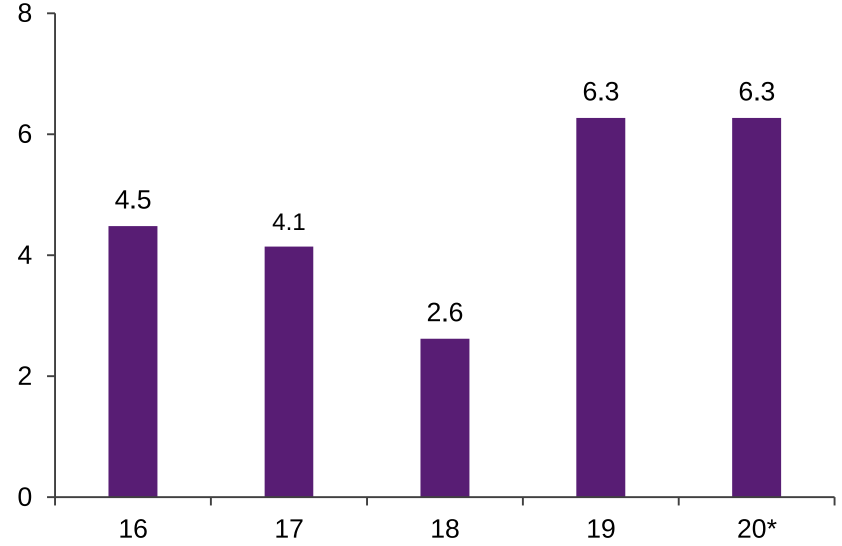
Recovery happening but not organically. Fiscal stimulus is the key. Fiscal deficit has doubled. Local governments finances very stretched

On-balance sheet measure of China's fiscal deficit (% GDP)



Source: Natixis, WIND

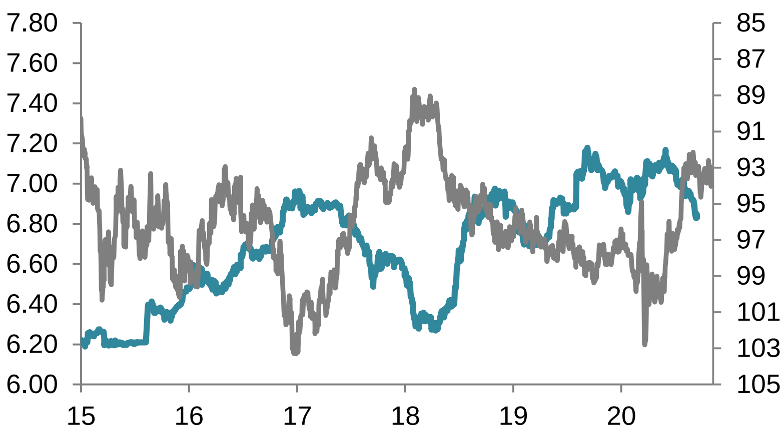
Off-balance sheet deficit: LGFV (% GDP)



Source: Natixis, WIND

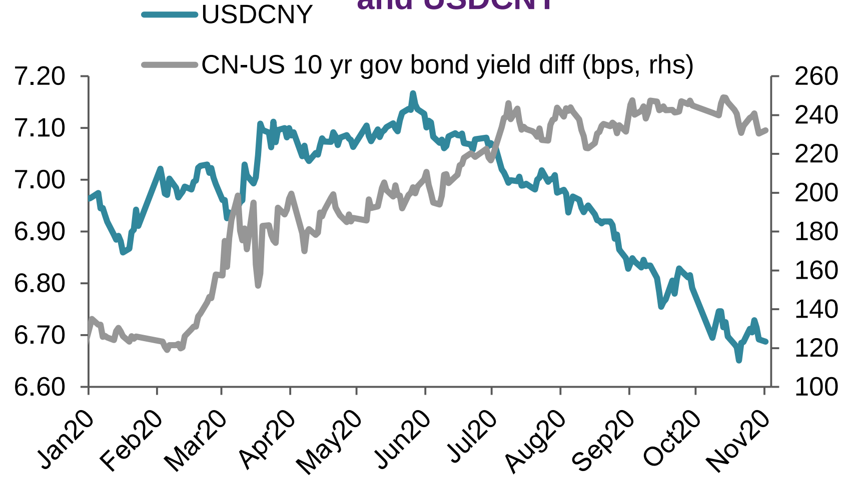
RMB appreciated rapidly given USD weaknesses and yield differential, but moderated recently in the led-up to US election and still hinge on US-China tensions in the medium run. Still, trend seems to have turned again due to PBoC's actions

USDCNY & DXY Index



N.B. As of Nov 2nd, 2020
Source: Bloomberg, Natixis

China-US 10yr gov bond yield differential and USDCNY



N.B. As of Nov 2nd, 2020
Source: Natixis, Bloomberg

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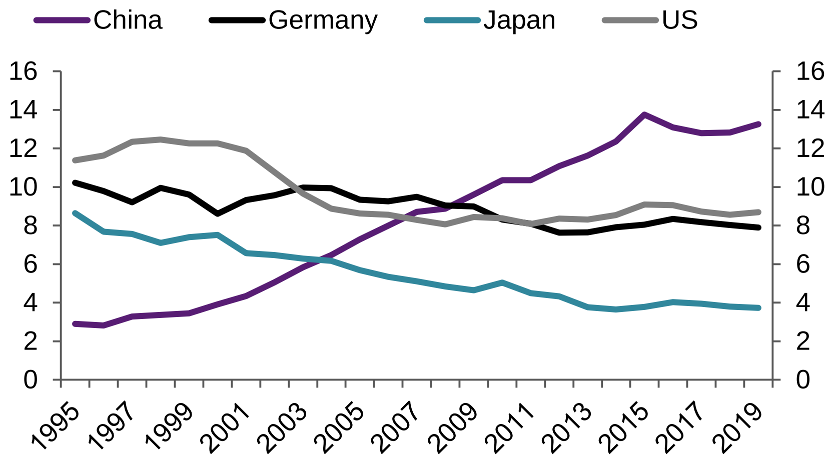
China's exporting capacity show signs of rebounding in 2019

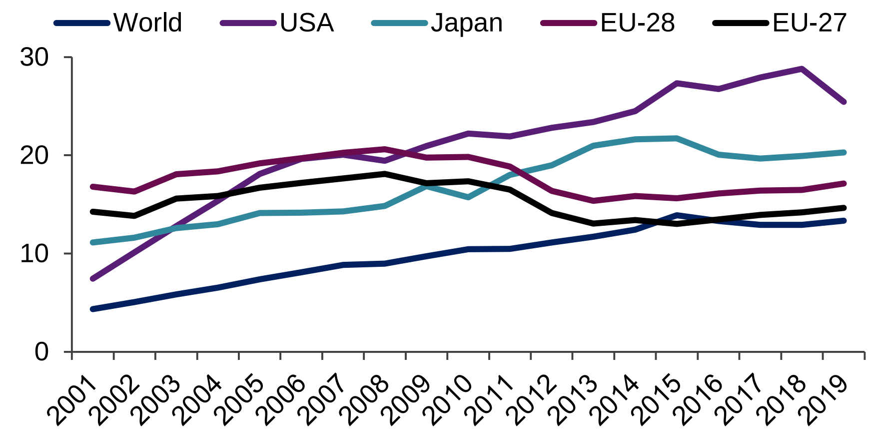
Breaking down by regions, China's exports are seeing a rebound despite the US-China trade war effect.

Share in global exports (%)



Source: Natixis, UNCTAD

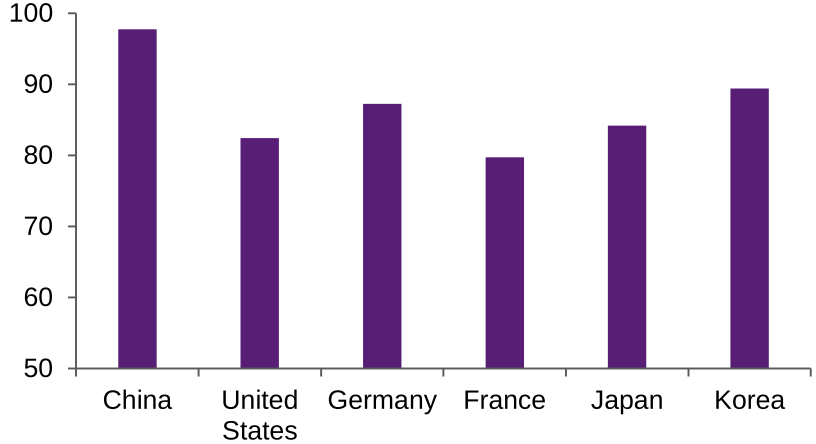
The market share of Chinese exports (%, 2001 to 2019)



Source: Natixis, Trademap

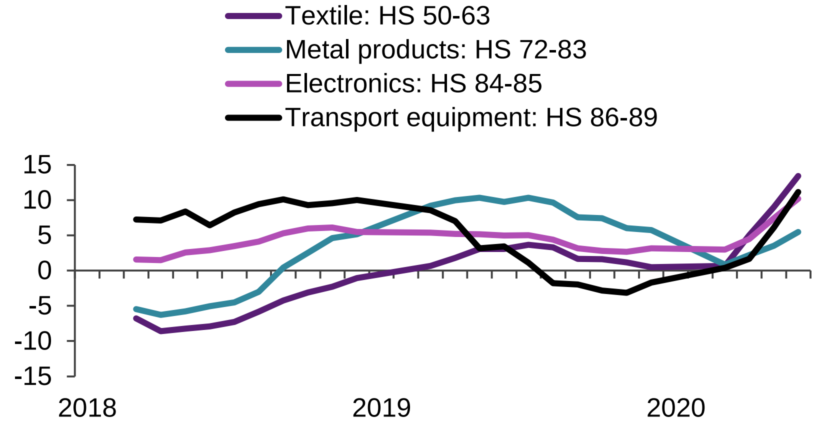
The pandemic strengthened China’s manufacturing position, especially on textiles and electronics

Exports in the first eight months of 2020 (% of the same period in 2019)



Source: Natixis, Bloomberg, CEIC

Export growth rate differential (China minus the average of US/Germany/Japan, 12-month moving average YoY, %)



Source: Natixis, Wind, Trademap.
Note: The data for January and February are set to missing and smoothed to avoid the influence of the Spring Holiday effect.

NATIXIS BEYOND BANKING

2

STRUCTURAL CHANGES IN A POST-COVID WORLD

Towards a square-root recovery in which the problem is not so much the short-run but the medium – due to downward pressure on potential growth

Reasons:

1. Low investment stemming from low interest rates

2. Even higher debt from expansionary policies

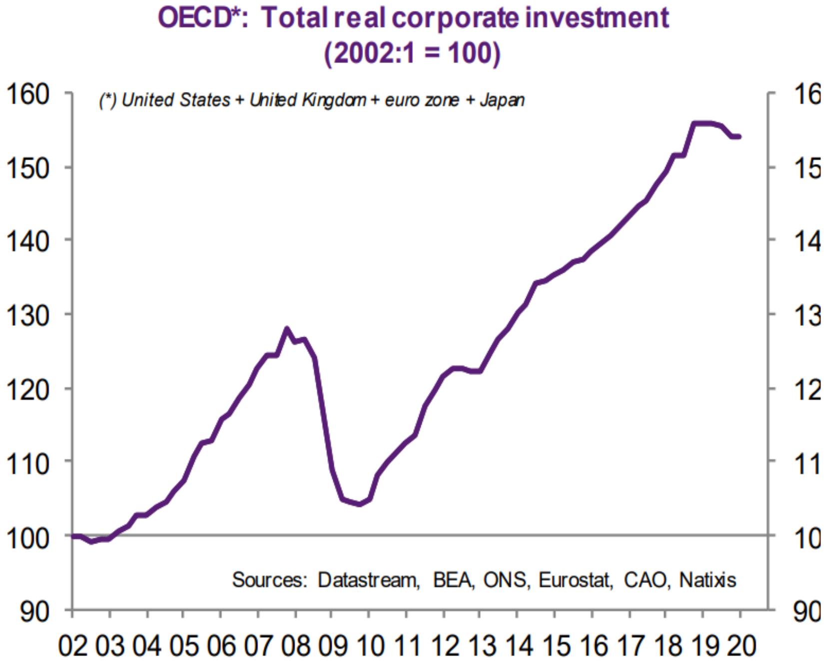
3. Asset price bubbles worsening of income distribution

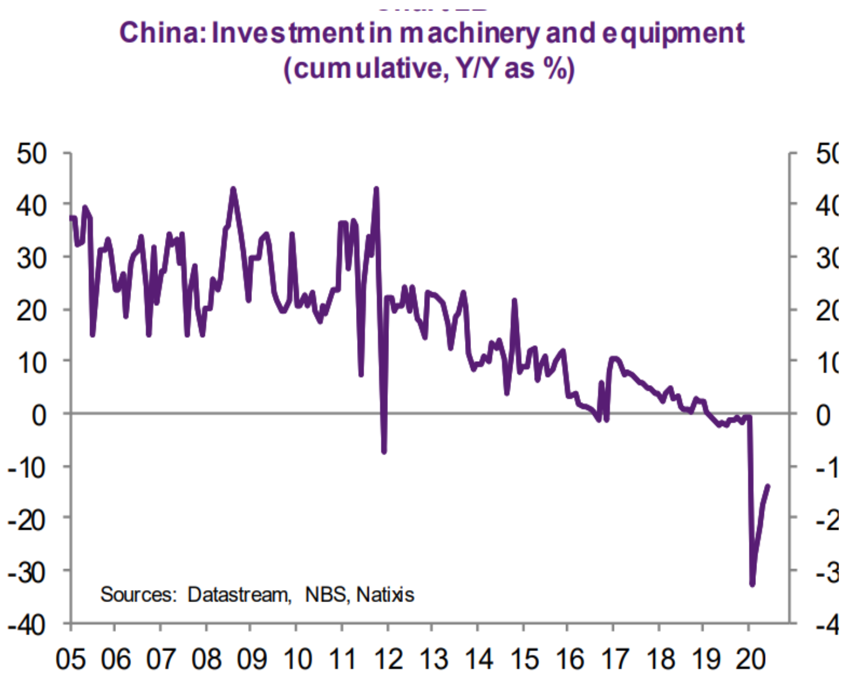
2. State intervention and more zombie companies

3. Loss in human capital

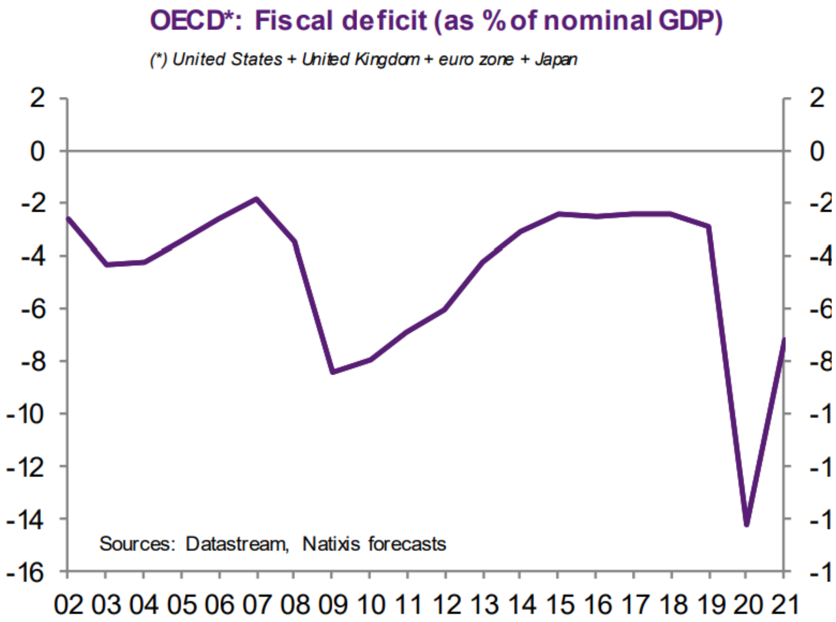
4. Deglobalization

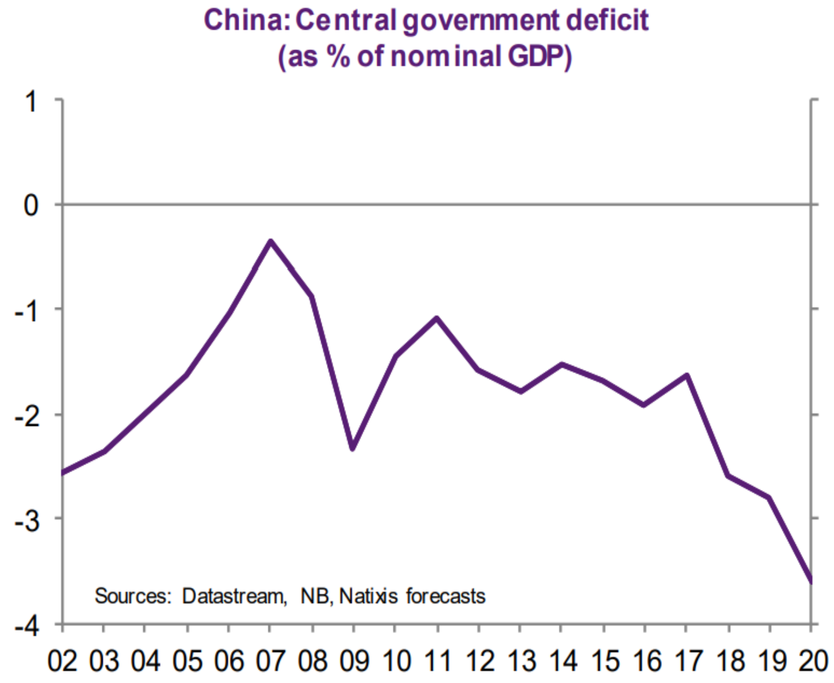
1. Investment coming down globally



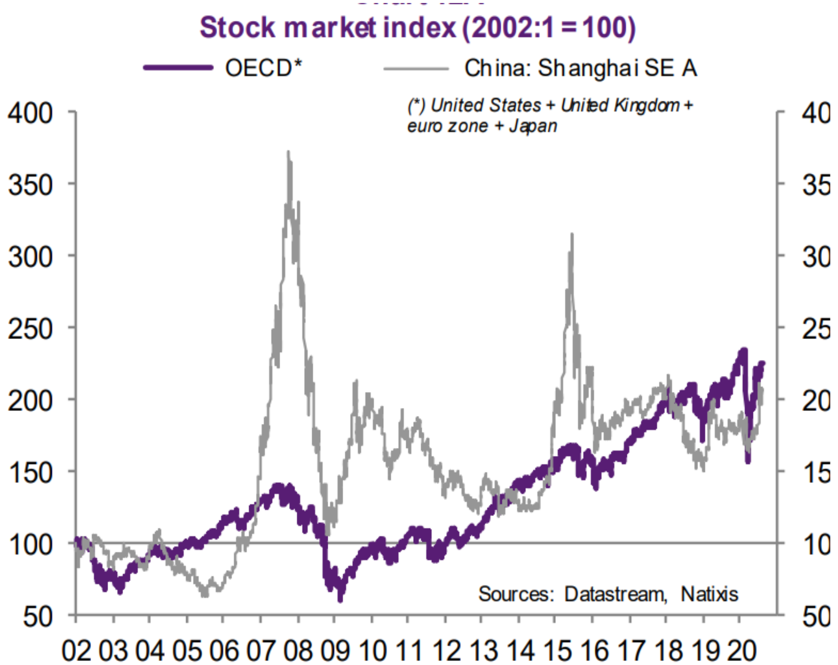


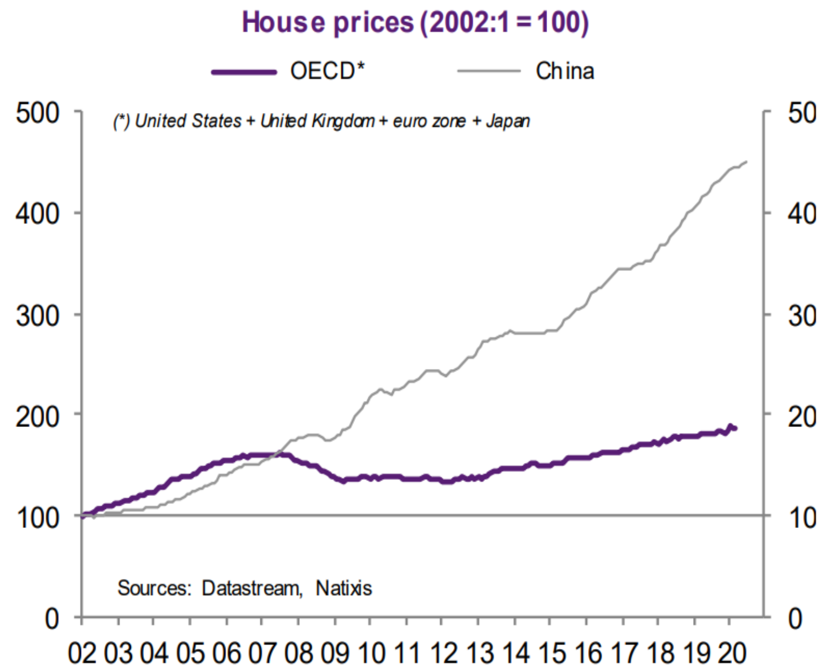
2. Ultra-expansionary policy mix leading to even higher debt





3. Post-COVID consequences globally: Asset price bubbles

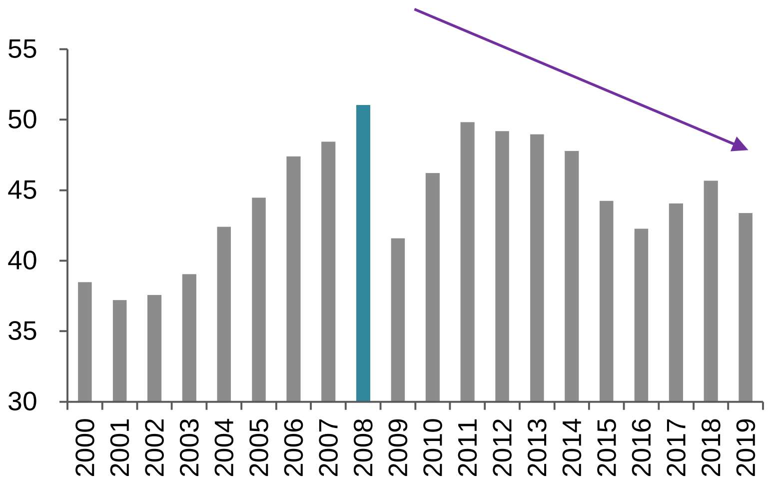




3 ZOOMING INTO DEGLOBALIZATION

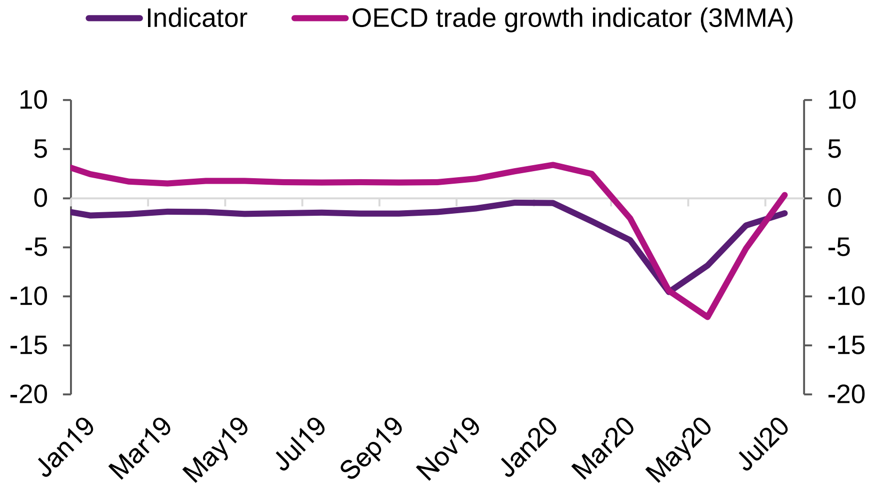
Growth of trade has decelerated since the global financial crisis(GFC) and collapsed recently due to Covid-19 outbreak

Global trade as a share of GDP (%)



Source: UNCTAD, Natixis

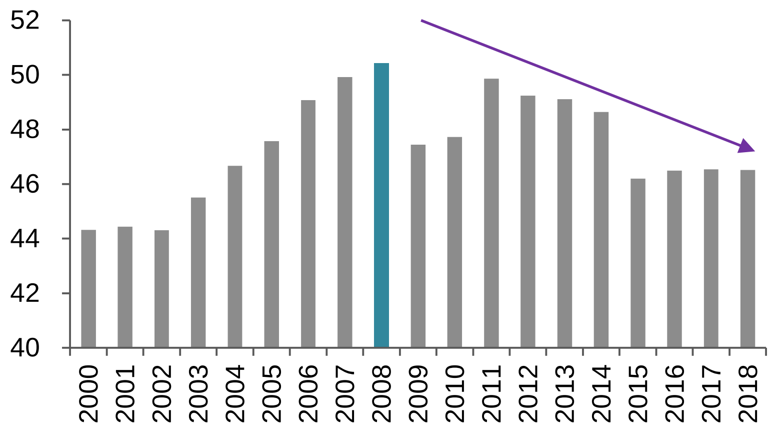
Natixis Global Trade Indicator and global exports (YoY %)



Source: Natixis, OECD

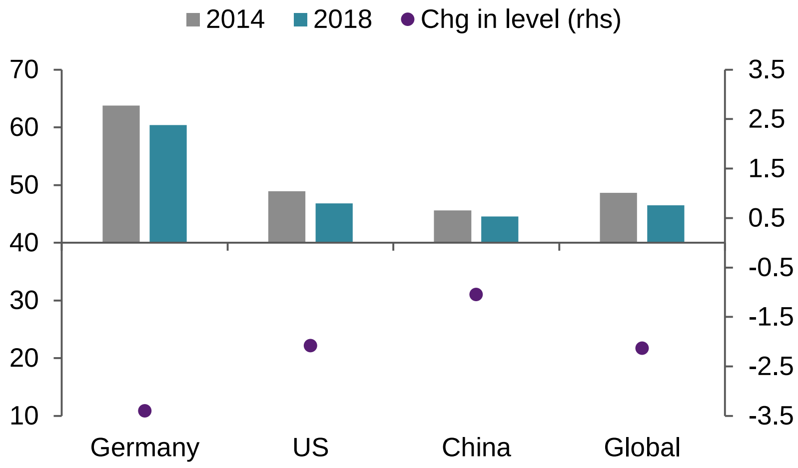
Global value chain (GVC) integration has been declining since the global financial crisis. The decline has been much bigger for Europe (Germany), followed by the US, than for China

World GVC Participation (%)



Source: UNCTAD-Eora database, Natixis
N.B. Results for 2016-2018 are forecasted by UNCTAD-Eora

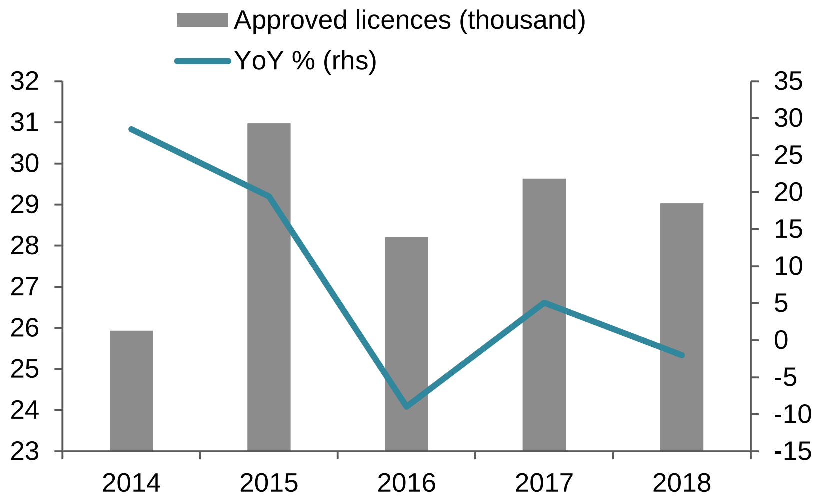
GVC Participation (%)



Source: UNCTAD-Eora database, Natixis
N.B. Results for 2016-2018 are forecasted by UNCTAD-Eora

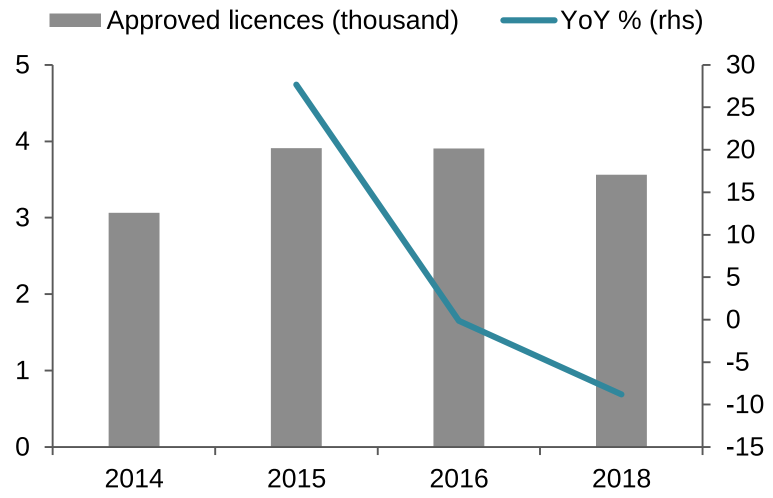
Export controls for sensitive technology have been escalating generally, and even more so between the US and China

Approved licenses for tangible items, software and technology (US)



Source: U.S. Department of Commerce the Bureau of Industry and Security, Natixis

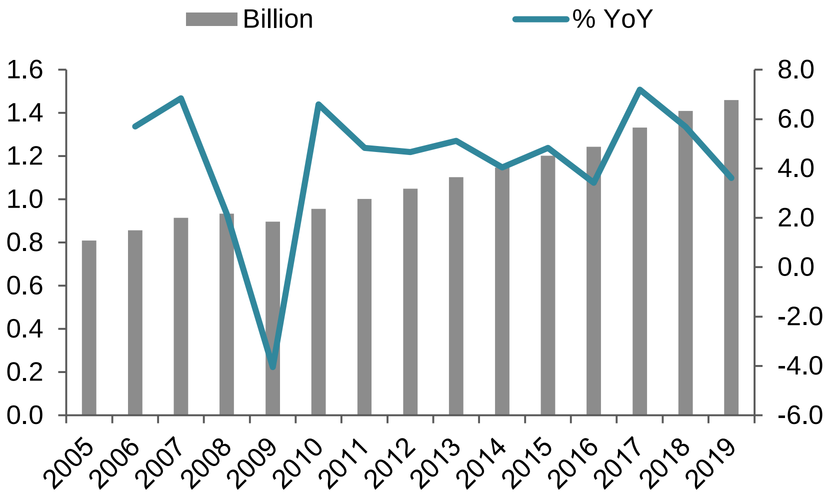
Approved licenses for tangible items, software and technology exported to China from US



Source: U.S. Department of Commerce the Bureau of Industry and Security, Natixis

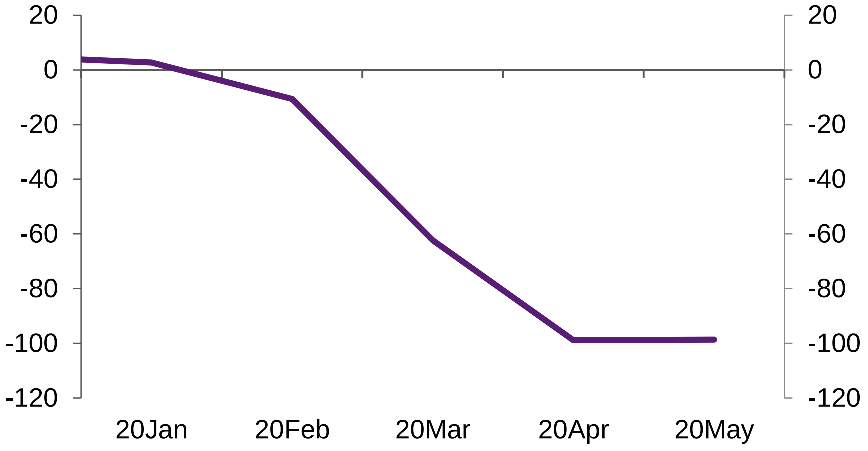
Short-term visitor arrivals have been coming down since 2018 and crushed in 2020 due to mobility restrictions

International tourist arrival



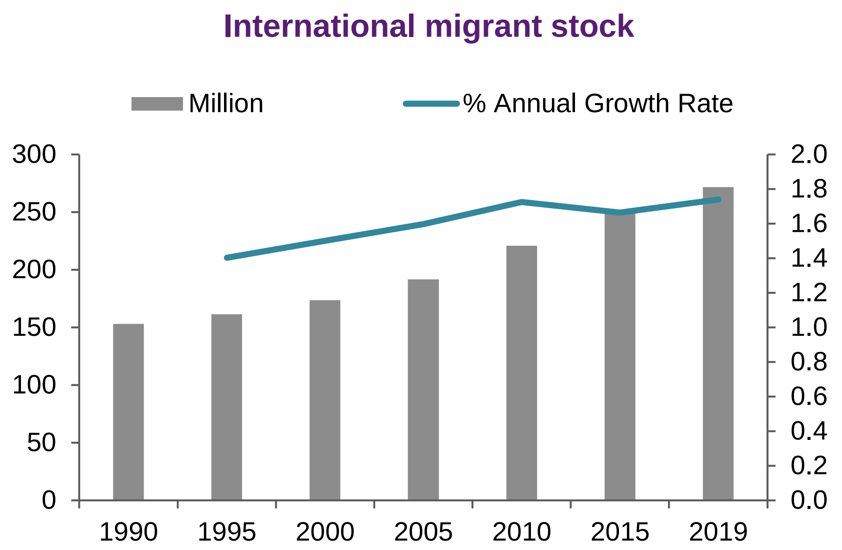
Source: UNWTO, Natixis

International flight passenger (YoY %)



Source: Airports council international, Natixis

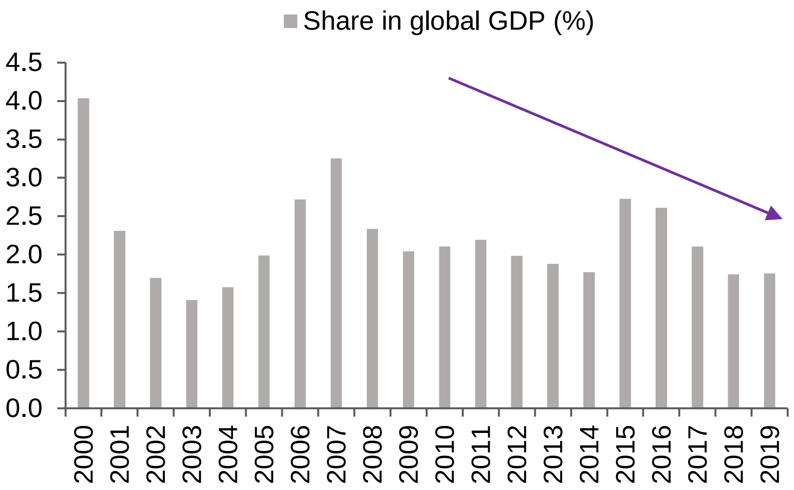
Although the number of international migrant has been rising, the growth is also flattening



Source: UN, Natixis

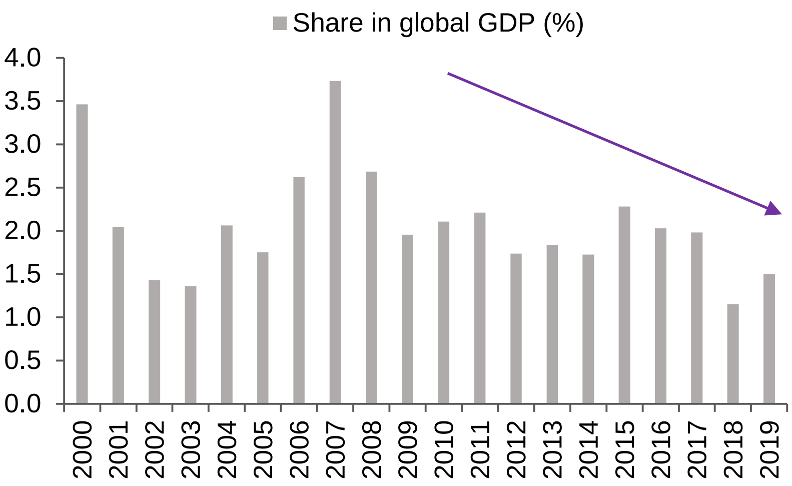
FDI flows have been trending downwards since the GFC. Preliminary data for 2020 points to a collapse in M&A activity

World inward FDI flow



Source: Natixis, UNCTAD

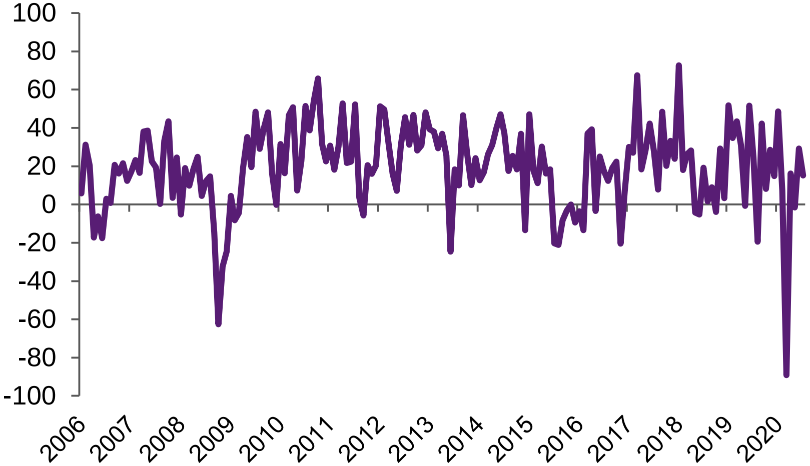
World outward FDI flow



Source: Natixis, UNCTAD

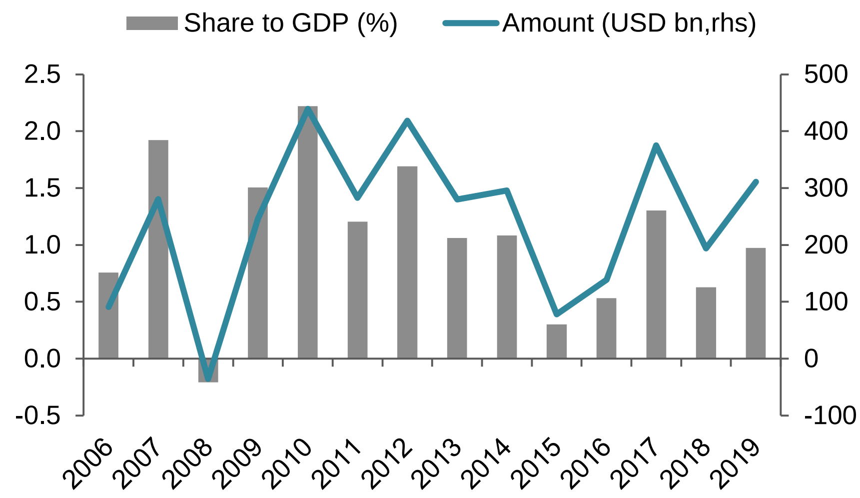
Portfolio flows into emerging economies are rather stagnant in size so basically falling behind the nominal growth of the emerging world. The rebound from the Covid-19 shock has been milder than after the GFC.

Total portfolio flows in Emerging Markets (USD bn)



Source: IIF, Natixis

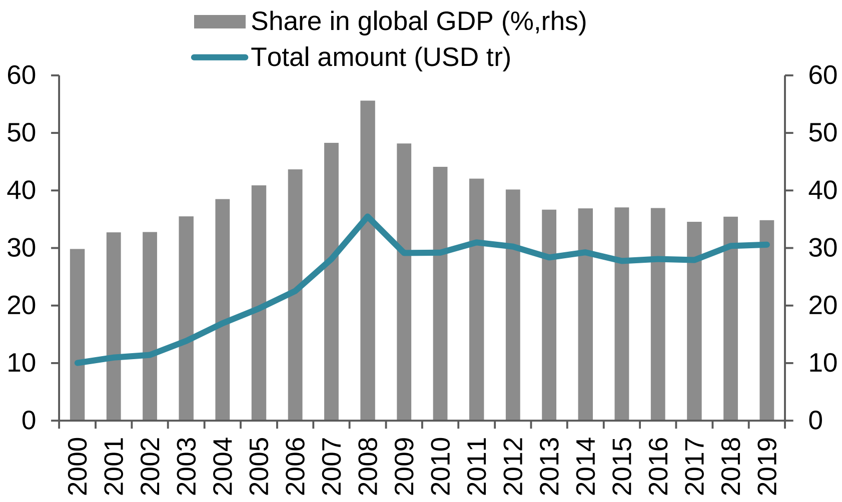
Total portfolio flows in Emerging Markets



Source: IIF, UNCTAD, Natixis

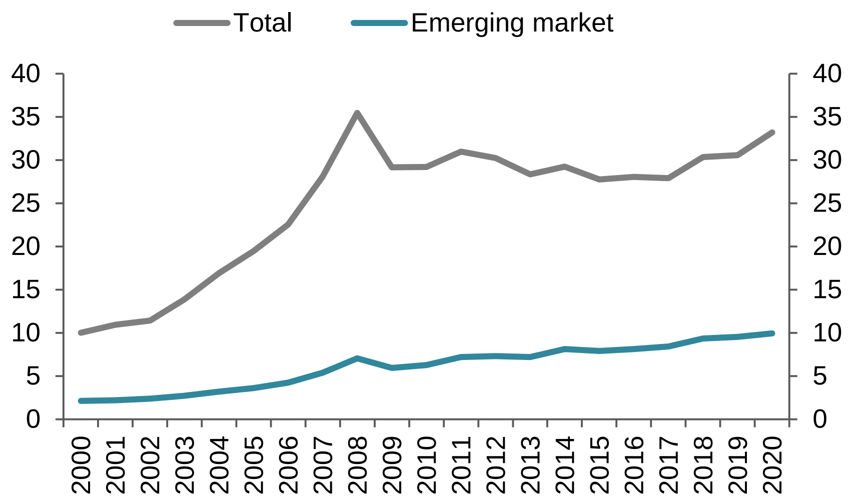
As for cross-border bank lending, it has never come back to pre-GFC levels 2008 although the recovery continues. For emerging markets, there is a net increase.

Global cross-boarder lending, total claims



Source: BIS, UNCTAD, Natixis

Cross-boarder lending, total claims (USD tr)



Source: BIS, Natixis

Relative winners and losers from de-globalization trends

Pros

- Big domestic demand
- Net external creditor
- Abundant domestic savings
- Strong welfare state
- Research oriented

Cons

- Export dependent, especially if integrated in value chain
- Tourism dependent
- Technology dependent

Barring aside geopolitical considerations, China might be a relative winner from Pandemic consequences

- Factors pushing down potential growth are such that the world may look more like China in terms of state intervention, which is bad for the rest of the world.
- In terms of technological upgrade, decoupling – in the context of the ongoing deglobalization – is a problem for China but, at least, it counts with a larger market to exercise self reliance. The key issue is potential technological bottle necks.
- Reducing such bottlenecks will be key as well as tapping the domestic market.
- This explains the dual circulation policy which will probably be key in the design of the 14th Five Year Plan

4 SOME TAKEAWAYS

To sum up

- As the pandemic continues, the global economy is recovering but more slowly than expected and with hesitations
- China is a bright spot but doubts remain, specially in terms of medium term.
- The worst about Covid19 might actually be the medium term in the form of a square root recovery.
- The downward trend in potential growth is coming from many factors but an important one is deglobalization
- Deglobalization is already happening but covid19 will accelerate it as decoupling pushes deglobalization further
- Deglobalization is more of a problem for smaller economies but less for those which manage to rely on their domestic demand and technology.
- This explains a lot of China's recent actions, including the dual circulation strategy.
- In a nutshell, the pandemic is changing the global economy more structurally than we think

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