Notes on China’s economy of my own (2020-8-12)

1. In the early stage of the shock China’s efforts were on containing the virus rather than boosting economy growth. Supply chains were disrupted due to lockdown and demand didn’t drop immediately. There’re other observations:
   1. domestic inflation/headline at the beginning did not drop immediately.
   2. Current account surplus dropped a lot since production was disrupted—impact on exports.
2. It makes sense at the time that monetary policy was loosened to support short-term liquidity trouble. Short term financing was needed to bridge income losses and make sure financial system does not collapse. However the argument at the time was that virus containment was the first priority and fiscal stimulus would only boost growth(it was seen as counter virus-containment).
3. After Apr China did relatively well on containing the virus and production ramped up quickly. However due to uncertainty going forward private sectors were reluctant to spend or investment. Since the virus containment is not the priority anymore it is proper to put fiscal stimulus in place to plug the loss from private sector, especially on investment and consumption.
4. Think it is clear that fiscal stimulus is expected to be deployed in the second half of the year. This is expected to plug in the hole of slowing private sector credit issuance through more gov bond issuance.
5. In response to an anticipated fiscal stimulus, there are 2 things monetary policy can do. **First** is to let the fiscal stimulus to flow through and support growth, and allow growth to overshoot a little bit. The trouble here is housing price. Does the government want to overheat the housing market a little bit and take that error out later? **Second** they can tighten up the money policy and let the fiscal stimulus to crowd out some of the private investment and consumption. This is a rather dangerous path but it will contain the assets price and prevent capital outflow.
6. I think the only trouble now is rates have been drifting up – certain amount of tightening has happened. Actually without this I would expect China’s rates to go higher, but now it looks like in the short term this is unlikely. Rather the longer term rates might go lower vs short rates because of private sector investment is crowded out by the fiscal stimulus – suggesting once the fiscal stimulus is pulling out growth will be slow again.

**IDEA:**

China government credit vs private sector credit growth:

1. If government credit spikes up, short term growth is growth and overheated a little bit. But at the same time private sector credit growth is crowded out(as rates spike up due to more government bond supply). Long term growth disappear. **Flattening.**
2. If government credit doesn’t spike up – monetary policy is massively eased in the short term as growth collapsed. Private sector will growth amid a loosened financial conditions and long end yield should go up. **Steepening**