

SIGNS OF RECOVERY IN CHINA

IMPACT OF COVID-19 ON BUSINESSES

Updated June 2020

While China experienced its disruptions earlier than many other countries, it is also entering the recovery phase sooner than many parts of the world.

HIGHLIGHTS

- **First quarter GDP turns negative**
- **PMI gauges improving**
- **Consumers are waking up**
- **Supply chain challenges evolve**
- **PPE acquisition becomes more complex**

The COVID-19 pandemic has created significant disruptions for companies around the world, including those that do business in China.

We are able to better assess the impact of COVID-19 on China's economy and businesses now that a few months have passed. Their experience may provide a glimpse of what the recovery could look like for other countries.

Below are several key economic highlights and observable trends from the first half of the year:

GROSS DOMESTIC PRODUCT (GDP)

China's first quarter GDP figure, which was released on April 17, registered a negative growth of 6.8%, the country's first negative growth since 1976. The shock to the economy was of course unexpected prior to the pandemic, and, as a result, China has chosen not to set a GDP target for the year 2020, the first time it has not done so since the practice started in 1994.

PURCHASING MANAGERS' INDICES (PMIs)

Various Purchasing Managers' Indices (PMIs) reached historic lows in February, with a strong rebound in March. Jumping ahead to April and May, the PMI gauges have recovered from February lows, and we're now seeing a notable dichotomy between how larger state-owned firms in China are faring compared to smaller private firms.

At a high level, two of the most-watched PMI gauges in China are the official PMI gauge, which is released by China's National Bureau of Statistics and focuses on large state-owned firms, and the Caixin/Markit PMI gauge, which is released by Caixin and focuses on smaller, private companies.



For the months of April and May, the official PMI reported, respectively, 50.8 and 50.6 for manufacturing and 53.6 and 53.2 for non-manufacturing, which includes services and construction. Fifty and above indicates expansion, so the official PMI is indicating solid signs of growth. The Caixin PMI gauges show a different pace of recovery, with contraction in April (49.4 and 44.4 for manufacturing PMI and services PMI, respectively) and a strong rebound in May (50.7 and 55, respectively, as above). This indicates that while larger state-owned firms have bounced back from February's historical low since March — even if not quite back to the same level of activity as pre-COVID-19 — smaller private firms' pace of rebound has differed from that of state-owned firms in the months of March and April, and is now showing a clear sign of rebound in May. With both the official PMI and Caixin PMI indices showing growth in May, there now appears to be momentum gathering for the recovery of both larger and smaller firms in China.



CHANGES IN CONSUMER BEHAVIOR

During the peak of the epidemic in China, consumers were quarantined at home and therefore had to make their purchases online, including for meals and grocery delivery. According to a survey conducted by McKinsey¹ on “Chinese consumer sentiment during the coronavirus crisis,” about 54% of respondents said that during the COVID-19 outbreak, they increased ordering of restaurant delivery services while 18% of the respondents tried the service for the first time. The demand for meal kit and grocery services also increased among more than 75% of the respondents.

Shifts toward online and digital channels in other areas include remote learning, meeting services, online streaming, entertainment, etc. Some of these trends can also be seen in the United States, though China had to adapt before many other countries did as its outbreak occurred earlier. As a result, many companies geared their marketing efforts toward online channels so that they can better reach their customers digitally. This ability was particularly vital for companies during the peak of the quarantine, and it may remain the case post-COVID as well. We’ll see if this shift in consumer behavior and these changes in companies’ marketing strategies during the peak of the outbreak in China will stick even after the outbreak has subsided.

SUPPLY CHAIN AND DEMAND IMPACT

While supply chains in China were severely impacted in February — compounded by the Lunar New Year holiday and quarantine measures — factories and businesses are coming back online. The challenges of lack of workers, reduced production capacity, logistics challenges, etc., that created bottlenecks in February have been resolved.

The challenge is now on the demand side. As countries around the globe grapple with COVID-19, demand for many goods and services from China, with the exception of Personal Protective Equipment (PPEs, further

discussed below), has significantly weakened. On that note, the April export numbers for China were actually good, showing a 3.5% growth year over year and an improvement from March’s decline of 6.6%. However, this was likely due to exporters catching up to their order obligations from the first quarter and not due to strong global demand in April. May export numbers show a decline of 3.3%, reflecting the weakness in overseas demand. More remains to be seen going forward.

On domestic demand, after a very weak February during quarantine, there are signs that consumer spending has been picking up since March based on reports of increased travel bookings and consumer discretionary spending.

During China’s most recent Labor Day holiday weekend from May 1 to May 5, the government was heavily promoting tourism and shopping festivals to boost the economy. There are indications that consumers were indeed traveling and spending. Even though the number of travelers and revenue generated from tourism for the Labor Day holiday are down noticeably from a year ago (down 41% and 60% respectively) according to data² from China’s Ministry of Culture and Tourism, the trend is toward recovery.

In addition, local governments around the country have taken initiatives such as providing consumption coupons to individuals, which can be used at various retail shops, and having local officials go on social media platforms to promote local products to boost their local economy.

How domestic and international demand shapes up in the next few months will weigh on China’s economic momentum for the rest of 2020.

PERSONAL PROTECTIVE EQUIPMENT PROCUREMENT

China manufactures more than 40% of the world’s masks, gloves, face shields, goggles and protective

garments.³ Procurement of this personal protective equipment (PPE) from China has become a focus internationally. Responding to quality issues with certain PPE exports, China's governmental bodies co-released an announcement on March 31 that tightened qualification and documentation requirements on exporters of PPEs. Only exporters with the proper Registration Certificate of Medical Device approved by China's National Drug Administration can export, and a declaration must be made to Chinese customs that the goods meet the relevant standards of the country the product is exported to. China Customs released its own announcement on April 10 that Customs will be carrying out inspections on 11 types of PPE.

Following the policy announcement, there have been reports⁴ of crucial PPE shipments being delayed, and as a result, the government removed the requirement from March 31 that exporters must obtain a registration certificate from the National Medical Products Association before export. Instead they only need to submit a declaration that their PPE meets the quality standards of the importing country. Despite these policy changes, FDA is finding many imported products to be of subpar quality and has restricted⁵ the approved list of manufacturers for import of PPEs. Unfortunately, even with the declaration that exporters are supposed to provide, subpar PPE products can still slip through.

U.S. companies looking to procure PPEs from China should consider utilizing available resources to ensure that proper due diligence can be conducted on suppliers. Various resources are available, such as U.S. commercial services that can help companies vet potential vendors. Other private resources are available such as credit agencies and firms that can conduct supplier due diligence. There is an American Chamber of Commerce Shanghai resource page⁶ dedicated to PPE procurement.



READY TO HELP

Established in 2008, PNC's Shanghai Representative Office (SRO) is available as a resource to PNC clients who are doing business with China or in China. The SRO can provide assistance and guidance on:

- Corporate Establishment
- Market Information
- Obtaining Local Banking Services
- Introductions to Local Resources

Should you have any questions, please contact your PNC International Advisor, or contact: Grace Zhu, Chief Representative, at grace.zhu@pnc.com, and Chris Chen, Representative, at chris.chen@pnc.com, in the PNC Shanghai Representative Office

¹ McKinsey: "Chinese Consumer Sentiment during the Coronavirus Crisis," <https://www.mckinsey.com/business-functions/marketing-and-sales/our-insights/survey-chinese-consumer-sentiment-during-the-coronavirus-crisis>

² Caixin Global: <https://www.caixinglobal.com/2020-05-06/weak-labor-day-spending-shows-tourism-hasnt-recovered-from-covid-19-101550751.html>

³ Peterson Institute of Economics: https://www.piie.com/blogs/trade-and-investment-policy-watch/covid-19-chinas-exports-medical-supplies-provide-ray-hope?mod=article_inline

⁴ Wall Street Journal: <https://www.wsj.com/articles/chinas-export-restrictions-strand-medical-goods-u-s-needs-to-fight-coronavirus-state-department-says-11587031203>

⁵ New York Times: <https://www.nytimes.com/2020/05/07/health/masks-banned-n95-coronavirus.html>

⁶ American Chamber of Commerce Shanghai: <https://www.amcham-shanghai.org/en/article/ppe-procurement-guide-and-contact-list>

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