

Record fall in key China production index

Nick Beams
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The first data to reflect the hit to the Chinese economy of the coronavirus so far this year have come in and they make for sober reading.

China's National Bureau of Statistics (NBS) announced over the weekend that the manufacturing purchasing managers' index (PMI), fell to 35.7 in February, down from 50 in January.

This was an all-time low, below that recorded during the global financial crisis. A PMI of less than 50 indicates a contraction in economic activity.

An export orders sub-index fell to 28.7, down 20 points from the previous month, because of cancelled and delayed orders, according to the NBS.

A related index that tracks purchasing plans in service industries also plunged to a record low of 29.6, indicating major contractions in transport, construction, and consumption spending.

In a note on the latest data, Larry Hu of Macquarie Capital wrote: "Today's PMI data suggest that things are really bad, and the government is willing to report that."

He warned the annualised growth rate for the first quarter could be lower than what has been, at least until now, the "consensus" forecast of 4 percent. The government may even report a contraction for the first three months, the first such event since the Cultural Revolution in 1966.

If such a fall eventuates, it will have a major effect on the world economy because China accounted for around 40 percent of all global growth last year.

Even before the virus outbreak China had recorded a drop in its growth rate to 6.1 percent, the lowest in 30 years, amid expectations that it would decline further in 2020.

In a bid to halt the coronavirus slide, China's president Xi Jinping has told local officials that low-risk areas should "resume full production and normal life," but there is not much sign of this.

While the NBS has announced that medium to large-scale enterprises had recorded a "work resumption rate" of 78.9 percent, the ANZ banking group has said these firms are operating well below their capacity utilisation. Based on migration data, it said the economy was operating at only 20 percent of capacity with just 50 percent of migrant workers back at their jobs.

According to the *Wall Street Journal*, other indications of economic activity, including coal consumption by power stations, and data on home sales and movement at ports "broadly suggest economic activity remains at low levels that are usually seen only during holidays."

Subway activity in eight major cities last Thursday was only one fifth of usual levels. As of the weekend, 12 of China's 31 provinces still had in place emergency-level health provisions that limit travel.

An indication of the global effect of the Chinese contraction is contained in figures from the China Council for the Promotion of International Trade. It has issued a record number of 3325 *force majeure* certificates, giving companies legal protection when they are unable to meet contracts because of circumstances beyond their control.

The certificates, covering contracts worth a combined \$38.5 billion since the beginning of February, include steelworks, electronics companies, car firms and auto parts suppliers.

The effects of the virus are now starting to weigh on the global economy, with the forecast of the International Monetary Fund (IMF) just 10 days ago that it would only bring a reduction of 0.1 percentage points in global growth, now widely declared to be outdated.

The 36-member Organisation for Economic Co-operation and Development is preparing a new interim report which it says will point to "more serious

consequences.”

Capital Economics has cut its forecast for global growth by 0.4 percentage points to 2.5 percent, a level the IMF regards as a recession for the world economy. But it has warned that if the outbreak becomes a global pandemic then world output could fall by 0.5 percent, equivalent to the drop experienced in the global financial crisis.

There are warnings of a “doom loop” when the disruption of supply chains leads to a cut in demand, exacerbating the downturn.

The chief economist at UniCredit, Erik Nielsen, told the *Financial Times* that a global recession in the first half of the year “is suddenly looking like a distinct possibility.”

Italy, the European country most adversely affected by the virus so far and the eurozone’s third-largest economy, has announced a €3.6 billion stimulus package to try to mitigate its effects. This is on top of €900 million worth of measures in the most severely affected regions in the north of the country, announced last week.

Before the outbreak, Italy was already on the brink of a recession, with growth in the first quarter expected to be negative following a contraction in the last three months of 2019. The Prime Minister Giuseppe Conte said the economy needed “shock therapy.”

The European Central Bank has yet to signal its intentions. The ECB president Christine Lagarde has said that the outbreak is not yet at a stage where it would have an effect on inflation, meaning further price falls, that would require a monetary policy response.

With ECB interest rates already in negative territory, there is little further stimulus the central bank could provide and, in any case, further cuts in rates are not going to bring about an increase in production.

The US Fed has indicated that it is ready to cut rates. A statement issued by the Fed last week declared that it was “closely monitoring” developments and would “use our tools and act as appropriate to support the economy.” The issuing of the statement was unusual as the Fed does not generally comment on monetary policy between meetings.

The *Financial Times* reported that in a conference call with reporters, before the statement issued by Fed chairman Jerome Powell, a Treasury official was reluctant to speak about the risks to economic growth

posed by the virus. The official maintained that the most likely outcome was V-shaped, that is, a short-lived downturn followed by a recovery.

This scenario, regarded as “conventional wisdom” little more than a week ago, has since been largely dismissed, with some analysts describing it as “nonsense.”

The opening of Wall Street today is being anxiously awaited with all indications pointing to a continuation of the bloodbath that saw the S&P 500 index fall by 13 percent over the previous seven trading days, wiping off \$3.6 trillion from share market values.



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