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Global Macro Meets Micro | Global

The Road Back From Covid-19: China's Experience - The Road Across for The US

We hosted a call with our China and US economists and consumer sector analysts, focusing on China's experience post the relaxation of social distancing measures and the read-across for the US. This note summarises the key takeaways from the call.

China's experience – what's the read across to the US (Chetan Ahya): China was the first to face the Covid-19 challenge and has also moved to reopen its economy. Several European economies and US states have announced easing of social distancing guidelines from May onwards. As we move towards this phase of a gradual reopening of the economy, we have been keenly watching the developments in China to see which sectors of the economy have normalized faster and which are taking a longer time. From the early experience in China, we see that the production ramp in manufacturing is recovering faster than consumption and that the pace of consumption recovery differs across channels and segments. Considering the importance of consumer spending to the economic recovery, we hosted a call with our economists and consumer analysts to discuss China's experience in the road back from Covid-19 and the read across to the US.

In this report, we summarise the notes from the call, in which the following questions were addressed:

- 1) How has China's manufacturing and services sectors evolved since the outbreak of Covid-19?
- 2) How has China consumer spending patterns evolved since the outbreak?
- 3) When will the US economy bottom out?
- 4) What are the observations in the US online and offline consumer space?
- 5) How does the recovery path in China look like over the next 4 quarters?
- 6) When do we expect the US to reach pre-Covid19 output levels?
- 7) What is the outlook for the Chinese consumer?
- 8) What is the outlook for the US consumer? Will there be structural changes in consumer behavior post Covid-19?

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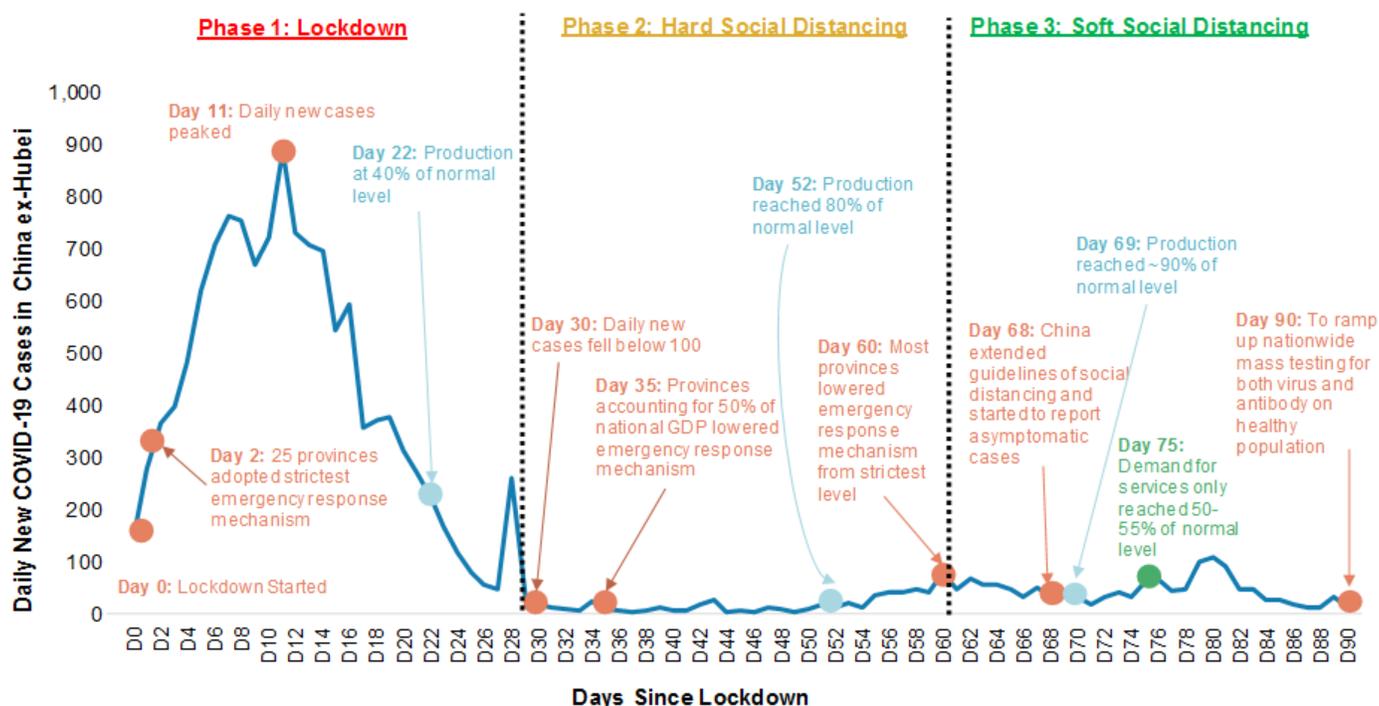
1) How has China’s manufacturing and services sectors evolved since the outbreak of Covid-19? (Robin Xing)

3 stages of social distancing measures: China is currently in the final stage of “soft social distancing” in the fight against COVID-19 (from lockdown in stage 1 in Jan-Feb and hard social distancing in stage 2 in Feb-Mar).

Manufacturing near normal, services still far away: The recovery so far has been led by a bounce back in production. The growth bottleneck has decisively shifted to the demand side, as global growth has weakened and consumption recovery has lagged amid continued social distancing. Production capacity in the industrial sector has almost reached normal levels and supply in the services sector has reached ~80% of normal capacity. However, March data suggest that the rebound in retail sales was much milder than that of industrial production, while the recovery ratio for demand of key discretionary services is even lower. For example, hotel occupancy ratio is still less than half of normal levels due to continued barriers on intercity travel. Furthermore, an expected slump in external demand in 2Q could lead to a double dip in industrial production.

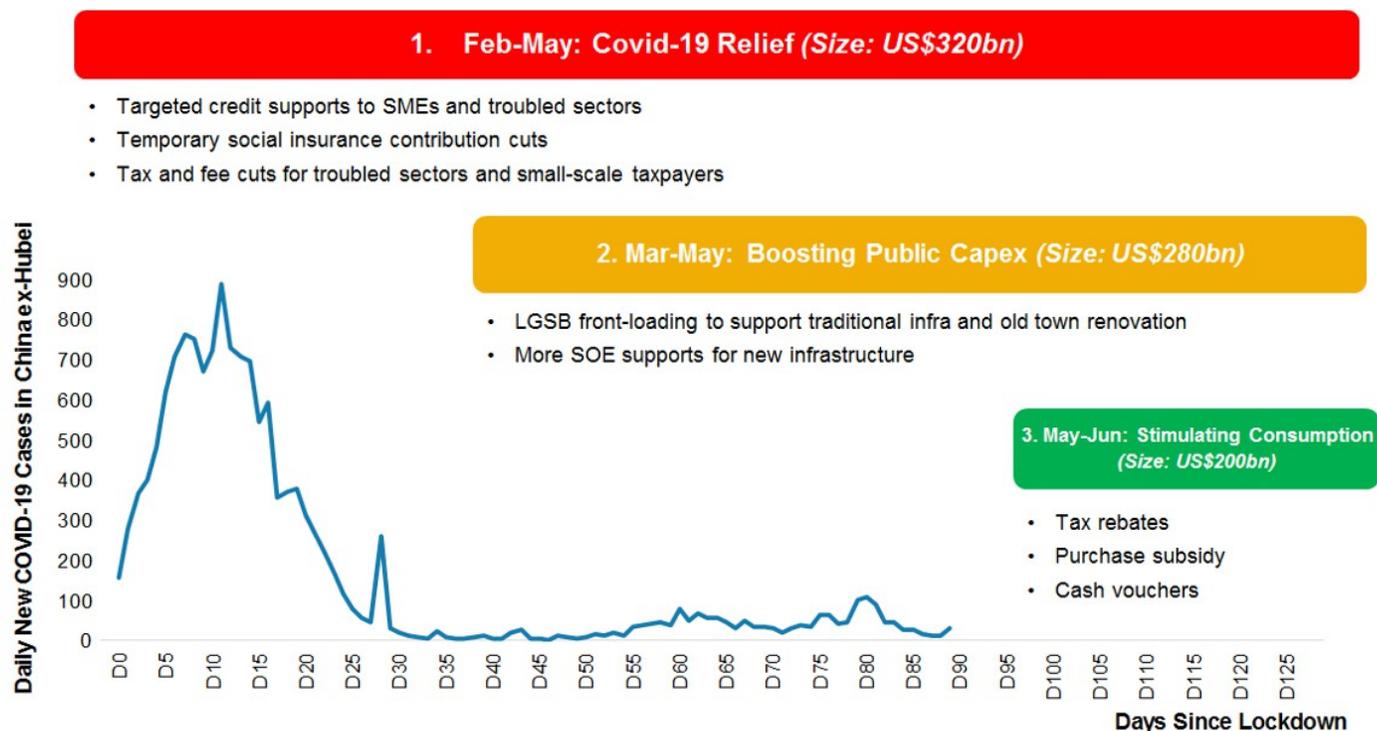
3 phases of policy easing: To address the slowdown in economic activity, policy makers are also easing in 3 phases. The first phase was focused on providing relief to SMEs and affected sectors to minimize the impact on firms and preserve unemployment. In the second phase, policy makers are filling up the gap in overall demand by boosting public investment. In the third phase, we expect the stimulus efforts to turn towards supporting consumer demand, mainly by providing tax rebates, purchase subsidies and cash vouchers.

Exhibit 1: Timeline of Return to Work in China



Source: CEIC, AlphaWise, Morgan Stanley Research

Exhibit 2: Three Phases of Policy Easing



Source: CEIC, Morgan Stanley Research. Note: Including implemented and our expected stimulus

Exhibit 3: Three Stages of Social Distancing, Three Phases in Easing Approach

	Social Distancing	Easing Approach
Stage 1	Lockdown (Jan to Feb): Strictest quarantine measures and travel restrictions, massive production and business suspension	(Feb to May) A US\$320bn relief package mainly focused on targeted credit support to troubled sectors and SMEs, waiver of social insurance contribution, and cut in taxes, aimed at keeping firms afloat and prevent permanent unemployment
Stage 2	Hard social distancing (Feb to Mar): Strict social distancing guidelines, phased production resumption and gradual return of migrant workers	(Mar to May) US\$280bn to boost public investment so as to fill up the gap posed by lagging consumption recovery due to lingering public health concerns
Stage 3	Soft social distancing (Mar onwards): Continued public health rules, normalizing inter-city travel in low-risk regions under a "health code system", and gradual reopening of service sectors	(May to Jun) US\$200bn stimulus on private consumption. If the virus remains under control, we expect nationwide consumption stimulus to be rolled out later in 2Q in the form of tax rebates, purchase subsidies and cash vouchers

Source: Morgan Stanley Research

Exhibit 4: Channel checks show that China's manufacturing activity level have largely normalised

As % of Normal Levels		Relative activity level by end-Feb	Relative activity level by mid-Mar	Relative activity level by end-Mar	Estimated Date of Normalization
Express Delivery (Qianlei Fan)		70%	100%	100%	Mid-March
Auto & Auto Parts (Tim Hsiao)	OEM	50-60%	70-80%	90%+	End March*
	Auto Parts	70%	70-80%	80%+	End March*
	Staples (General F&B)	80-85%	90-100%	~95-100%	Late March
Consumer Goods (Lillian Lou)	Home Appliances	70-80%	90-100%	~95-100%	Late March
	OEM (apparel)	60%	85-90%	~95-100%	Late March
	OEM (Home Appliances)	60-70%	90-100%	~95-100%	Late March
Tech (Yunchen Tsai, Howard Kao)	Notebook	65-75%	75-85%	100%	End March
	Smartphones	50%	80%	90%+	End March*
Property Construction (Elly Chen)		30%	70%	85%	Mid-April
Industrial (Kevin Luo)	Heavy-duty trucks	50%	70%	~95-100%	End March
	Construction Machinery	80%	100%	100%	Mid-March
Basic Materials (Rachel Zhang)	Steel	50%	70%	80%	Mid-April
	Cement	50%	80%	~100%	End March
	Coal	80%	100%	100%	Mid-March
Total		55-75%	75-85%	85-95%	

Note: 20-39% in red, 40-59% in pink, 60-79% in yellow, 80-94% in light green, and 95-100% in dark green

Dates in grey mean already normalized

Source: Companies, Morgan Stanley Research. *Production capacity has normalized but actual production only reached 80-90% of pre-outbreak level due to stalling export and consumption demand

Exhibit 5: Channel checks reveal that operating capacity in China's services sector will normalise by end 2Q, but demand will only normalise by 3Q20

		Operating Capacity vs. Normal Levels			Demand vs. Normal Levels		
		End-March	End-April (E)	Estimated Date of Normalization	End-March	End-April (E)	Estimated Date of Normalization
Infrastructure Construction	Kevin Luo	90%	100%	Mid to Late-Apr	95%	100%	Apr
Property Construction	Elly Chen	85%	100%	Mid to Late-Apr	70%	80%	Mid-May
Property Sales	Elly Chen	90%	100%	Mid-Apr	70%	90%	Mid-May
Auto Sales at Dealers	Shelley Wang/ Jack Yeung	90%	100%	Mid-Apr	60%	80%	Beyond 2020
Airline	Qianlei Fan	70-75%	90%	Jun-Aug	28%	35-40%	Jun-Aug
Rail	Qianlei Fan	95%	100%	Early-Apr	32%	50%	Jun
Shopping Mall	Praveen Choudhary/ Hildy Ling	100%	100%	End-Mar	60%	70%	Oct
In-store Services (such as beauty salon, massage services etc.)	Lillian Lou/ Gary Yu	60-70%	70-75%	2H	~30%	40-50%	2H
Restaurant	Lillian Lou/ Gary Yu	80-90%	90-95%	End-Jun	30-50%	50-80%	End-Jun
Food delivery	Lillian Lou/ Gary Yu	100%	100%	End-Mar	75%	90%	May
Hotels	Praveen Choudhary/ Dan Xu	90%	100%	End-Apr/Early-May	40%	70%	End-Jun/Early-Jul
Tourism	Praveen Choudhary/ Hildy Ling	25%	60%	Jul	25%	40%	Oct
Cinema	Rebecca Xu	0%	5%	Jul	0%	1%	Oct
Medical Services	Sean Wu	~80%	90%	Late-May	70%	80%	Late-May
Offline Education*	Sheng Zhong	0%	10%	Late-May/June	90-100%	90-100%	Mar
Total		75-85%	85-95%	Late-May/June	50-55%	60-65%	3Q20

0-19% in red, 20-39% in pink, 40-59% in orange, 60-79% in yellow, 80-94% in light green, 95-100% in dark green

Dates in grey mean already normalized

Source: Companies, Morgan Stanley Research

2) How has China consumer spending patterns evolved since the outbreak? (Lillian Lou)

Overall retail sales declined by 15.8%Y in March vs a decline of 20.5% Y in Jan-Feb. But there is a clear differentiation between the channels, segments and regions.

Performance by channels:

- **Online** retail spending (which accounts for ~30% of total retail spend) has been less impacted. Online sales of goods grew by more than 10%Y in March vs 3%Y growth in Jan-Feb and total e-commerce growth (including services) grew by 3%Y in March vs a 3% decline in Jan/feb (This compares with a normal rate of growth usually in the high teens to 20%Y).
- **Offline** channels have been impacted to a greater extent. Store openings are now roughly 80-85% on average (but with a wide range of around ~60-70% or ~90/100% for individual retailers). Traffic is currently about ~70% of pre Covid-19 levels.

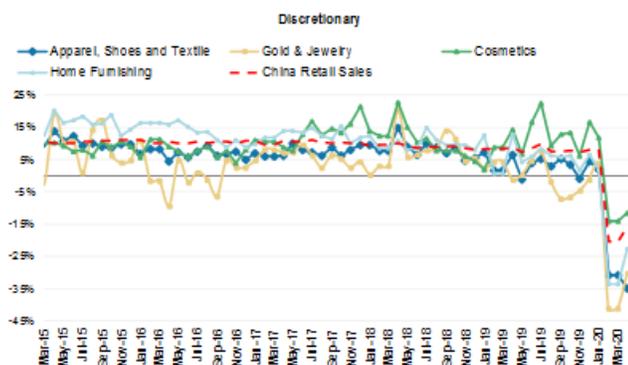
Performance by segment:

- **Groceries:** Supermarkets same store sales growth (SSSG) was strong. Hypermarkets and supermarkets chains grew by single digits to 10% in in 1Q20, stronger than the pre-virus pace of growth.
- **Restaurants:** Overall traffic recovery is about 50-60%, with a wide range for individual restaurants. YUMC mentioned that SSSG is down 20% by mid-to-end March and we think this should further improve in Apr; Leading Chinese restaurant chain Haidilao's traffic flows could returning to 50-70% of normal levels on weekends (weekdays are lower).
- **Shopping malls:** Traffic is better for street stores as compared to shopping malls.
- **Staples:** Relatively stable, currently around 90%ish of normal levels
- **Discretionary:** Recovered to around 50-80% of normal levels (varies by categories)
- **Brands/fashion, cosmetics:** Luxury goods appear to have posted positive growth in early April, likely partially due to some pent-up demand and reshoring of demand due to lack of international travel)
- **Home appliances:** ~50% decline in March and is at ~50% of normal levels

Performance by region:

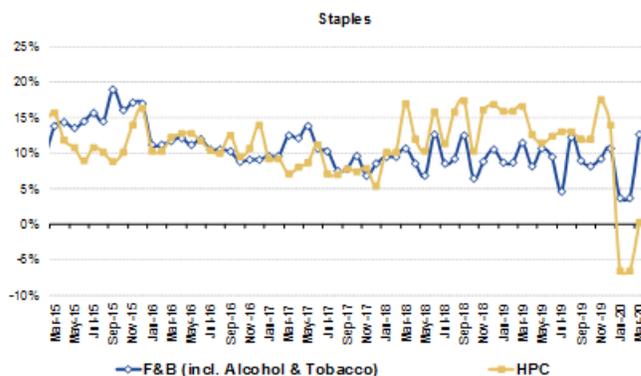
- Better in lower tier cities due to as faster pace of opening up, while Tier 1 cities are still relatively strict in their social distancing measures.

Exhibit 6: Impact of Covid-19 on China Consumer Discretionary



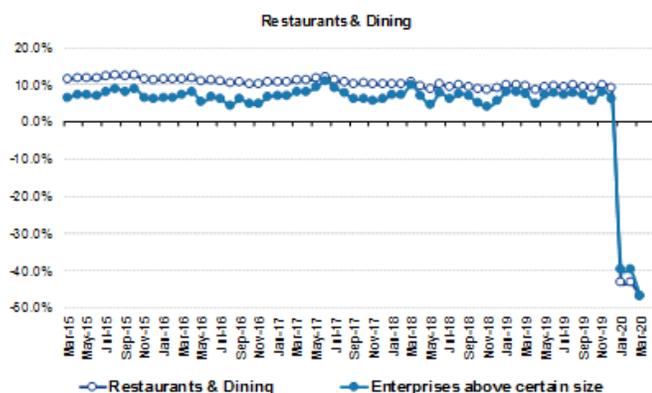
Source: NBS, CEIC, Company Data, Morgan Stanley Research estimates based on the growth ranges that company provides

Exhibit 7: Impact of Covid-19 on China Consumer Staples



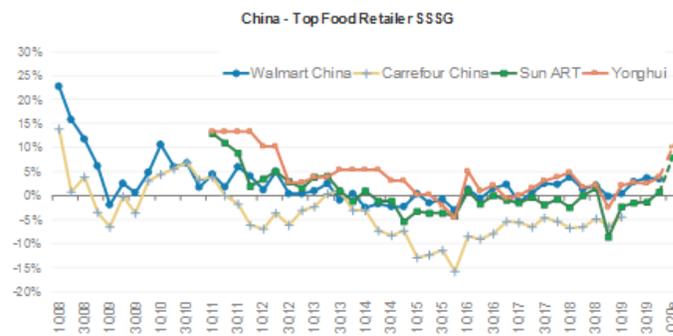
Source: NBS, CEIC, Company Data, Morgan Stanley Research estimates based on the growth ranges that company provides

Exhibit 8: Impact of Covid-19 on China Restaurants and Dining



Source: NBS, CEIC, Company Data, Morgan Stanley Research estimates based on the growth ranges that company provides

Exhibit 9: Impact of Covid-19 on China Top Food Retailers



Source: NBS, CEIC, Company Data, Morgan Stanley Research estimates based on the growth ranges that company provides

Exhibit 10: Recovery Pace by Consumption Categories

Manufacturing Recovery					
As % of Normal Levels	Relative activity level by end-Feb	Relative activity level by mid-Mar	Relative activity level by end-Mar	Estimated Date of Normalization	
Consumer Goods	Staples (General F&B)	80-85%	90-100%	~95%-100%	Late March
	Home Appliance	70-80%	90-100%	~95%-100%	Late March
	OEM (apparel)	60%	85-90%	~95%-100%	Late March
	OEM (Home Appliances)	60-70%	90-100%	~95%-100%	Late March

Service/Consumption Recovery						
	Operating Capacity vs. Normal Levels			Demand vs. Normal Levels		
	End-March	End-April (E)	Estimated Date of Normalization	End-March	End-April (E)	Estimated Date of Normalization
Shopping Mall	100%	100%	End-Mar	60%	70%	Oct
In-store services (such as beauty salon, massage services etc.)	60-70%	70-75%	2H	~30%	40-50%	2H
Restaurant	80-90%	90-95%	End-Jun	30-50%	50%-80%	End-Jun
Food delivery	100%	100%	End-Mar	75%	90%	May
Hotels	90%	100%	End-Apr/Early-May	40%	70%	End-Jun/Early-Jul
Tourism	25%	60%	Jul	25%	40%	Oct
Cinema	0%	5%	Jul	0%	1%	Oct
Average	65-75%	75-85%	End 2Q20/early 3Q20	40-50%	55-65%	3Q20

Source: Company data, Morgan Stanley Research estimates based on the growth ranges that company provides

3) When will the US economy bottom out? (Ellen Zentner)

Currently, we are moving through the bottom in terms of the data flow. Considering that all states are currently effectively closed, it will be a situation that things cannot get worse from here. Looking ahead, there are 5-6 states which could open up in the next week or two and this will contribute to a bounce in the data. In tracking the normalization of consumer spending, we are tracking the dining out category as the key, as it is both largely discretionary and it will provide hints on how confidence consumers will be in the context of the social distancing guidelines. However, as we expect the phased reopening to limit the initial capacity of restaurants, it is likely that we will see an initial bounce but the recovery thereafter will be relatively gradual.

4) What are the observations in the US online and offline consumer space? (Kimberly Greenberger)

Similar to China, there has been a divergent experience across segments:

- **Food retail** was initially up over 100%Y due to consumers stocking up their pantries to prepare for the shelter in place.
- **Groceries** have now slowed into 10-20% growth but remain stronger than usual.
- **Home improvement** have posted positive growth as consumers are now working more on their DIY home projects
- **Farm and hobby** related segments are posting positive growth too.
- **Auto parts** are down 30%Y as there is less driving
- **Electronics:** Best Buy has closed all their stores but sales are down by less than

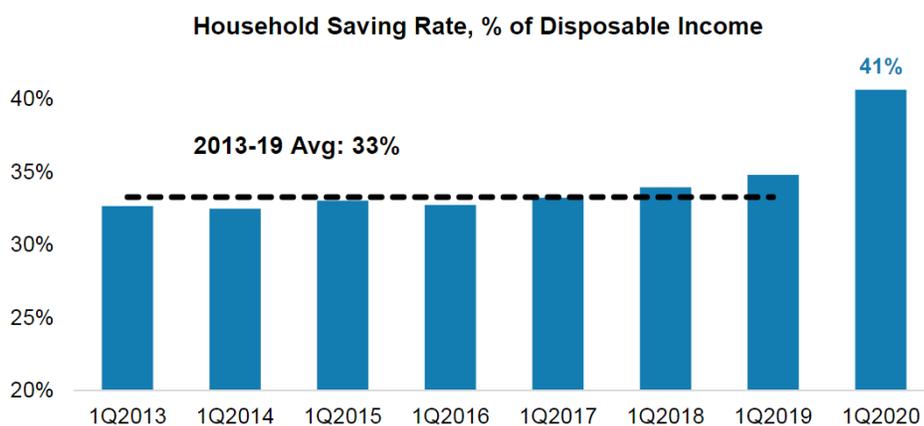
expected at 30%Y, principally due to demand in items related to work from home requirements and video games.

- **Apparel:** Work out gear has showed relative strength but in the Feb-Apr quarter, clothing and accessories are down 50% in March.
- **Restaurants** have already bottomed at a 40%Y decline rate. Limited service restaurants are less impacted due to a great deal of carry outs (posting decline in the high teens to 30%Y), while full service restaurants are down by more in the 50-60%Y range. Fast food remains a bright spot due to drive through sales (which account for 70% of their total) and those have remained open.

5) How does the recovery path in China look like over the next 4 quarters? (Robin Xing)

After the record decline in 1Q20, we expect a gradual recovery to +1.5% Y for 2Q, with support from infrastructure spending but will be held back by weaker exports due to slower global growth and consumption due to prolonged social distancing. We expect the recovery to pick up the pace to a full-fledged one in 4Q20 as consumption picks up in a compensatory fashion. Indeed, consumers would be financially viable to do so, as household saving has significantly increased in 1Q to 41% of disposable income, up from an average of 33% in 2013-19. If household savings move back to those levels in the subsequent quarters, this could amount to a potential boost of 2% of annual household consumption.

Exhibit 11: Household savings surged in 1Q20



Source: CEIC, Morgan Stanley Research

6) When do we expect the US to reach pre-Covid19 output levels? (Ellen Zentner)

Monetary and fiscal policies are already expansionary and should help to provide support to the economy. On the fiscal policy front, the CARES Act has provided support of US\$2.2 trillion and the checks to households and aid for businesses are streaming in. Further support on the fiscal side of up to US\$500bn has been passed by the House, which will take fiscal deficit to 20.5% of GDP in 2020 compared to 4.8% of GDP in 2019. On monetary policy, we expect the Fed to gear its asset purchases toward easing financial conditions and increasing the degree of monetary policy accommodation. A step in this direction will be taken at the April FOMC meeting, where we expect the announcement of a flexible duration \$150bn/month Treasury purchase program. The

Fed will increase the size of its asset holdings by an additional ~65%, or \$4 trillion. Those purchases, paired with the Fed's credit facilities, would bring the Fed's balance sheet to a total size of about \$12 trillion, or roughly 50% of GDP by the end of next year. As regards the recovery, we expect the US economy to reach pre Covid-19 levels in 8 quarters (i.e. 4Q21), which will be a faster pace as compared to the recovery post the GFC.

7) What is the outlook for the Chinese consumer? (Lillian Lou)

The outlook is tied to the relaxation of the social distancing measures. We currently see a steady improvement instead of a sharp recovery, hence the sector will see a U-shaped recovery. The divergent performance across sub-segments will likely persist.

- **Consumer goods** companies expect normalization by the end of June (i.e. moving back towards normal levels of YoY growth in 2H20).
- **Services** especially in the entertainment space will be lagged as night life channels are still closed in tier 1 cities and cinemas remain closed. We expect these channels to fully reopen by the end of June/July, and traffic to normalize in 3Q20.

Overall, the recovery in consumer spending will still be gradual as there will be a drag from the temporary increase in unemployment. For household related consumption, companies are providing discounts and municipal governments are taking actions to support consumption for the lower end segments. In contrast, the luxury and cosmetics segments, which are driven typically by higher income households, will not be as impacted given that their spending power is intact.

8) What is the outlook for the US consumer? Will there be structural changes in consumer behavior post Covid-19? (Kimberley Greenberger)

For the US, we see similar patterns to China on how the recovery will unfold. The outbreak of the virus has been wider in scope in the US. Hence the recovery will be delayed by about 3 months relative to China.

Some US retail discretionary spending stores will open in May but a full reopening is likely only in June. For the May-Jul period, we see a 30-45%Y decline but a material improvement to a 10-15%Y decline in Aug-Oct as people start to return to normal. In the quarter thereafter, the contraction in sales should narrow to 5-10%Y.

In terms of the structural changes, going into the recession, there has been a shift towards online retail spending and we expect that the recession will accelerate the shift towards online spending. For a narrower category of retail, which is general merchandise, apparel and accessories, furniture and other sales (GAFO), there was already a high penetration rate of 40% for online sales. We are skeptical that consumer behavior – in terms of online / offline spending mix – will shift back to what it was in 2019.

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(as of March 31, 2020)

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	COUNT	% OF TOTAL	COUNT	% OF TOTAL IBC	% OF RATING CATEGORY	COUNT	% OF TOTAL OTHER MSC
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Equal-weight/Hold	1437	45%	322	46%	22%	702	48%
Not-Rated/Hold	2	0%	0	0%	0%	2	0%
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TOTAL	3,210		700			1459	

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