China Inside Out

It’s all about jobs

Economics
China

- COVID-19 chaos cuts total urban employment by 6%, or 26m, in 1Q20, the largest contraction in four decades
- More fiscal support for unemployed migrant workers and SMEs is needed to mitigate the risks
- Ramping up broad-based stimulus to restart the job creation engine holds the key to economic recovery in the coming quarters

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The nationwide lockdown and restrictive measures to contain COVID-19 caused an unprecedented economic contraction in 1Q20 in China, with growth contracting by 6.8% y-o-y. Consequentially, the labour market also felt noticeable pressure. Urban employment dropped by 6%, or more than 26m workers, in 1Q20. This is the largest contraction in urban employment in more than four decades, with workers of SMEs (small- and medium-sized enterprises), and self-employed and migrant workers hardest hit.

This, plus even a larger number of people, who are “employed, but not working”, has led to a nearly 4% y-o-y decline (in real terms) in household disposable income in 1Q20, the first income contraction since data starting being recorded in 2002. This will have a lasting knock-on effect on consumption, unless unemployed workers receive, at least, partial compensation and get their jobs back soon. The continued rise in SMEs’ resumption rate in recent weeks helps but is far from enough. We believe Beijing should and will likely play catch-up in increasing financial support for unemployed workers and SMEs, and stimulating domestic demand in the coming months, if not weeks.

Financial relief

Distribute cash grants to rural and low-income families in an ongoing manner to help them ride out the storm and supplement lost income

Extend subsidies to support self-employed workers through fee and rental waivers

Increase credit access for SMEs through expansion of credit guarantees and regulatory ‘carrots and sticks’ to help alleviate cash flow pain

Stimulus to lift domestic demand

Increase infrastructure spending, which can be financed by issuance of special local government bonds, as well as special central government bonds

Further and extended tax cuts through lowering social security contributions for corporations to lower their cost burden

More aggressive monetary easing through lower lending rates and deposit rates to help lower credit costs for corporations, especially SMEs

All about jobs

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COVID-19 chaos cuts more than 26m jobs

The 1Q20 print showed that the economic impact of the COVID-19 lockdown in China was unprecedented. Growth contracted by 6.8% y-o-y, while industrial production fell 8.4% y-o-y, and retail sales fell by 19.0% y-o-y in 1Q20. Inevitably, the labour market also came under pressure due to the unique circumstances. Compared to January 2020, there was a more than 6% decrease in the number of urban employed workers. This would translate into 26.5m displaced workers out of the total number of urban workers of 442.5m (assuming the labour market size was unchanged from December 2019 to January 2020). This stands in contrast to the 8.3m net increase of urban employment in 2019, and would be the first contraction in reported urban employment in more than four decades.

The labour market situation remains severe, and we believe stabilising the job market will remain a key policy goal. In this report, we focus on the most severely affected areas of employment from the impact of COVID-19, namely SMEs, self-employed workers, and migrant labourers, as well as the likely policy responses to support these at-risk groups, help stabilise the labour market, and minimise permanent job losses. This would, in turn, help preserve household income levels and support consumption activity, further aiding the recovery process.

Frictional job losses from SMEs could become permanent losses

The impact on the labour market from COVID-19 is not evenly distributed, and a large proportion of the 26m fall in urban jobs is likely to stem from SMEs. The great majority of SMEs are private businesses. Unlike state-owned enterprises (SOEs), which tend to keep their workforce even under sluggish macro-economic conditions, SMEs are more prone to cutting headcount and more likely to lack unemployment insurance.

According to the Ministry of Industry and Information Technology (MIIT), the resumption rate of SMEs reached only 76% at end-1Q20, compared to 99% for above designated sized industrial enterprises by end-March 2020. Using the total number of urban workers employed by SMEs reported in the latest economic census of 233m, this could translate into 56m workers, who have not yet returned to work. In addition, most SMEs are concentrated in services sectors such as retail trade, catering and accommodation businesses, which have been hit hard by COVID-19. Due to the continuing strict restrictions and people maintaining social distancing, it takes more time for these businesses to recover. Even at the end of 1Q20, the resumption rates remained low relative to other industries. Accommodations and housekeeping businesses, for instance, had resumed operations at only 60% and 40%, respectively, by 26 March, according to the Ministry of Commerce. This means these consumer-facing services sectors might see more people, who have not returned to work, as these businesses remain closed.

However, temporary job losses and underemployment may fail to be fully reflected in official data, as many of these workers are not labelled as "unemployed" with their positions retained but no resumed work or income received. At the end of 1Q20, 18.3% of urban workers were "employed, but not working", or an estimated 80.9m people. Unlike in other economies, mainland China has not implemented a broad-based wage protection scheme, such as the Paycheck Protection Programme in the US or wage subsidy schemes for employers like those in the UK, Singapore, or Hong Kong, which require employers to maintain headcount and pay workers. This means that most of the furloughed workers in mainland China have no source of income. This reality has been partially reflected in the drop in disposable income, where real income fell by 3.9% y-o-y in 1Q20, compared with an increase of 5.8% y-o-y in 2019.

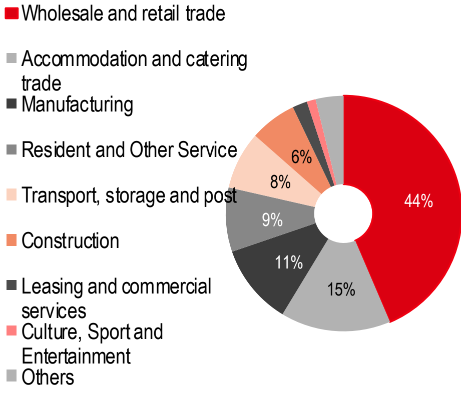
These furloughed workers were partly the result of strict quarantine measures and transportation blocks that were in place initially. Now, most of the supply-side pressures have abated, but the growing headwinds from a slowdown in demand will likely prove to be more challenging. Domestic demand has remained sluggish, with retail sales falling by 15.8% y-o-y in March. Restaurant and catering services were particularly under pressure, as sales fell further, contracting by 47% in March. Without a domestic recovery, prolonged losses in cash flow could spell a worrying amount of bankruptcies of companies, especially of at-risk SMEs. Moreover, there is added pressure from the trade slowdown, which is likely to manifest itself from 2Q20 onwards due to the global economic downturn. As such, the concern is for some of these temporary jobs losses being transformed into permanent job losses.

The truth is, for some of the most affected industries, company exits are already happening. For example, in the film and television industry, the number of companies that cancelled their registration by April 2020 was 80% more than the total number of cancellations in 2019, according to *Economic Daily*. Anecdotal evidence also shows that export-oriented companies are being hit. In Dongguan, which is a key textile exporting hub, there have been numerous factory closures from a slowdown in demand, as cancelled and delayed orders flooded in due to the lockdowns in the US and Europe. Moreover, due to lengthy bankruptcy procedures, as well as delays in the resumption of relevant government departments, the actual number of businesses declaring bankruptcy is likely lagging and could be even greater.

Self-employed workers' pain tends to be more acute

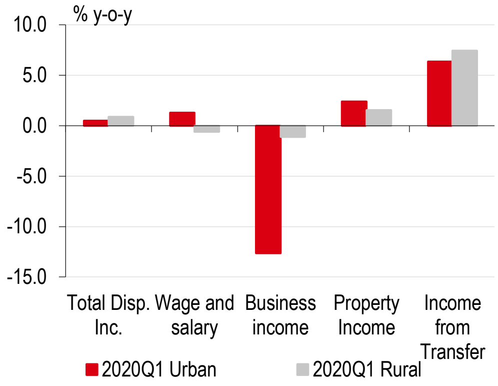
Another important group, who have been disproportionately affected, are self-employed workers. In the latest economic census, the number of self-employed people reached 149m, accounting for 28% of total employment in second and tertiary industries (including urban and rural employment). Most work in hard-hit sectors, including wholesale and retail trade, accommodation and catering businesses, residential services and transportation services (see Chart 1). These individual businesses are normally family-based enterprises, which make them much less able to weather the impact, since once the business is affected, the income of the whole family is lost. Within household disposable income, the largest drop was seen in business income, which mainly reflects the income of self-employed workers (see Chart 2). This means this group has been hit particularly hard.

Chart 1: The bulk of self-employed workers is in retail and catering businesses



Source: 4th Economic Census, HSBC

Chart 2: Net business income fell sharply in 1Q20, in nominal terms



Source: Wind, HSBC

A joint study by Peking University and Ant Financial Services Group estimated the impact on self-employed workers based on Alipay's QR merchant payment system. During the first half of February, the trough of economic activity due to COVID-19 related restriction measures, the number of active self-employed workers decreased by 40.4% and their operating revenues fell by 52.4% as a whole, compared with the same period in 2019 (adjusted for Chinese New Year effects). Based on the estimate of the number of self-employed workers, this translated into 92m people, who were affected.

According to another survey, conducted by the China Enterprise Reform and Development Society (CERDS, a national society approved by the State Council) on 28 March, self-employed workers expect to experience the largest drops in revenue and operating profits (falling by 34.4% y-o-y and 32.8% y-o-y, respectively) in 1H20, followed by private businesses, and then by foreign- and state-owned enterprises; 67.5% of the surveyed self-employed workers noted they were facing a challenging environment compared to an average 48.8% among all surveyed businesses. For self-employed workers, the biggest obstacles lie in rental payments and difficulties in delivering orders.

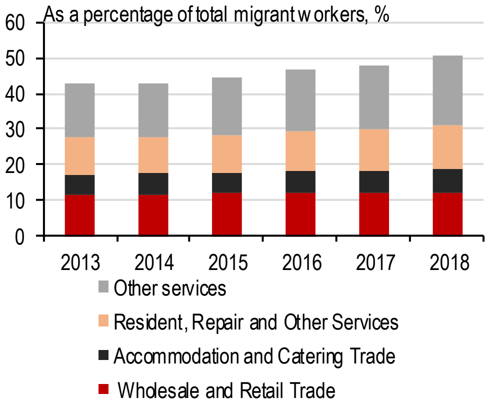
Migrant workers face steep frictional job losses

Migrant workers have faced a significant hit to their employment due to COVID-19. According to the National Bureau of Statistics (NBS), the unemployment rate for rural migrant workers was significantly higher than the average surveyed unemployment rate of 5.9%.

A sharp drop in the number of migrant workers has been seen in 1Q20. Among the 291m migrant workers nationwide, 174m left their rural homes for work, also known as "going out", in 2019. In 1Q20, however, that number dropped to 123m, which means that more than 50m migrant workers are likely displaced now. The reasons are twofold: Firstly, demand for low-skilled labour shrank by a significant amount. In 2018, more than half of all migrant workers were employed in the services sector, with the wholesale and retail trade, accommodation and catering trade, and residential repair and other services taking up more than 30% (see Chart 3). Unfortunately, these are also the same sectors, which are most affected by COVID-19 and containment measures. Even with a lot fewer migrant workers searching for jobs in cities, there are still labour supply pressures as indicated by a 7.9% y-o-y drop of the average income compared to 6.8% growth in 2019 (see Chart 4). Secondly, the lack of transportation and strict restrictions in destination cities has acted as a barrier and dampened migrant workers' willingness to return to cities.

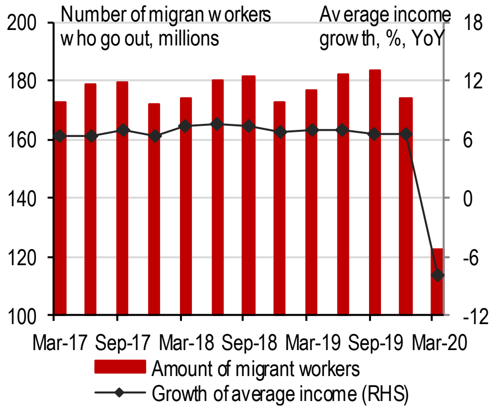
Job losses spell a sharp fall in income for migrant families, which translates into a fall in consumption. While on a per household basis, rural consumption is a little less than half of that urban households, considering the scale of potentially affected rural households, the impact on consumption expenditure remains sizable. And without a speedy recovery of the labour market, these workers and their families are likely to face significant financial difficulties and prolong the sluggish consumption patterns. Meanwhile, in the coming months, an influx of a record number of university and vocational school graduates will be entering the labour market. This could compound the pressures on the labour market. As overall demand for labour falls due to weaker economic conditions, highly specialised labour will likely spill over into the lower skilled labour market as the number of jobs shrink, increasing competition for jobs.

Chart : 3: More than half of all migrant workers are employed in the services sector



Source: Wind, HSBC

Chart 4: Migrant workers, who "go out", fell by 50m, while income shrank by 7.9% y-o-y



Source: Wind, HSBC

More targeted subsidies and broad-based stimulus measures are needed

The pressure on the labour market remains acute. Lost wages from not working or lost jobs have a knock-on effect on consumption, exacerbating the behavioural shifts towards aversions in activity on account of the COVID-19 outbreak. Consumption has already slowed on account of both behavioural shifts to avoid the virus and the restrictions in place, and adding to it are the pressures on the labour market, which have impacted household income. A faster resumption in operations and lifting of restrictions for the services sector can help bring back some more jobs, but we believe propping up domestic demand will remain key, especially as external demand remains dampened in the near term. Without a swift recovery in the broader economy, long-term frictional job losses may become permanent, and lost wages will mean consumption will remain stalled for longer, further delaying any recovery.

For policy makers, the labour market is one of the six key pillars to protect and, in our view, more policy support is still needed to help ease the financial burden of the most at-risk households but also to revive domestic demand and help create jobs. In particular, policies to help low-income workers, especially migrant workers, through direct subsidies and consumption coupons can help them ride out the storm. We believe even more important will be to lift domestic demand through more broad-based support, as well as targeted support, which can help SMEs and self-employed workers to survive and rebound during the recovery process. These policies can help stabilise the labour market and preserve household income levels, which can lift consumption and feed back into stronger economic growth.

Direct and more targeted subsidies to middle- and low-income families
On 21 April, the State Council announced more targeted measures to help people's livelihood. The measures include prioritising low-income worker hiring for the construction of major national projects, an increase in the portion of funding allocated to labour remuneration of these projects from 10% to 15%, as well as allowing for delayed micro-credit payments until the end of the year and job training for low-income households. In addition, low-income urban and rural families not previously included will be able to be included in the coverage of unemployment benefits. By the end of March, a total unemployment insurance benefit of RMB9.3bn has been issued to 2.3m unemployed workers nationwide, with RMB0.41bn in direct grants to 67,000 migrant workers. We believe more can be done to support these workers through the following measures:

Distribute cash grants to rural families in an ongoing manner. The dramatic fall in the number of migrant workers means that, with job losses, the only source of family income is cut off. However, the transitory nature of their jobs in cities prevents them from securing unemployment insurance. This has deprived them of jobless benefits, but this group is the one who need these benefits the most. In light of this, the government should manage direct cash handouts to rural families, not as a one-off, but in an ongoing manner to support them through the current crisis. Multiple instalments can help increase the total amount of cash distributed. In addition, subsidies could be differentiated according to the number of children and elderly people each family supports.

Balance the burden of paying of unemployment benefits by making the central government contribute more. Generally, unemployment benefits are borne by local governments and, with most migrant workers registered in their rural hometowns, this will likely put a fiscal burden on poorer provinces. To help balance this burden, we think the central government should provide more contributions to local governments to help support these measures.

Extend subsidies to and support the operations of self-employed workers. Offer grants to self-employed workers to help with their rental payments, which have topped their list of concerns, during the temporary shutdown. The measures on 21 April also included rental waivers to be granted for three months to tenants of state-own enterprise properties, which will be especially helpful for these self-employed workers. However, a longer time frame should be considered for these subsidies, given the recovery process will likely be more gradual rather than a sharp rebound. Additionally, relaxing the constraints on services businesses, especially retail trade and catering businesses, and allowing for more flexibility in their operations will help them recover quicker.

More aggressive broad-based and targeted stimulus measures to lift demand and create jobs
Equally important for helping to stabilise the labour market will be to lift domestic demand and supporting employers, in particular SMEs. We think stronger fiscal and monetary responses are needed to help reinvigorate domestic demand, especially in the face of an impending trade shock. For fiscal stimulus, further corporate tax cuts as well as extensions of already implemented tax cuts would help lower the cost burden for enterprises. We also expect increased spending on infrastructure projects, which would help lift demand throughout the economy, and these projects will likely be financed by the issuance of special local government bonds (RMB2.3trn have already been announced), as well as by issuance of special central government bonds. At the local level, some cities have issued consumption vouchers to help lift spending, which has fallen by record lows in 1Q20. We think direct payments to households in the form of cash-equivalent subsidies are likely to continue helping boost domestic demand. On the monetary side, further lowering of lending rates and deposit rates will help pass on lower credit costs to businesses.

In addition, more targeted support for SMEs is expected to help alleviate the cost burden and increase access to credit. Also announced during the 21 April State Council meeting were further measures to support SMEs, which account for 80% of urban jobs, and self-employed workers. In addition to the three-month rental waiver for SOE tenants, the provisional coverage ratio for small- and medium-sized banks will be further lowered by 20ppt to help free up more liquidity and increase lending to SMEs. However, we still expect more targeted support for SMEs to help alleviate the cost burden and increase access to credit. We expect that there will be further usage of ‘carrots and sticks’ to incentivise state-own banks to lend to SMEs, as well as more targeted RRR cuts. We also think broader usage of government guarantees can help lower amount of collateral needed, as well as interest rate costs for SMEs.

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