36. CHINA

After a severe slump in the first quarter of 2020 amid a very strict lockdown, economic activity rebounded strongly over the following two quarters. Benefitting from an early and robust control of the pandemic, targeted policy support and a recovery in external demand for China's exports, manufacturing output and investment returned to pre-Covid-19 levels relatively quickly. Despite weaker activity in services, real GDP is expected to grow by some 2% in 2020 and pick up by 7¼% in 2021. However, uncertainty remains high not least because of the US push for trade and tech decoupling.

Severe growth hit was quickly overcome

The COVID-19 outbreak triggered an unprecedented economic downturn as GDP declined by 6.8% (y-o-y) in the first quarter of 2020, reflecting a strict lockdown and a slump in external demand. Yet, health policy measures proved successful in containing the epidemic and production resumed quickly in March/April at a time when the rest of the world was just starting to close down for business. This gave China a head start in the recovery.

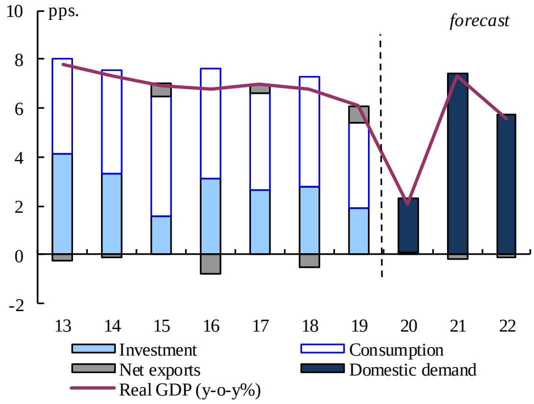
Real GDP rebounded by 3.2% (y-o-y) in the second quarter of 2020, driven by a supportive policy stance, but also by better-than-expected exports growth. Helped initially by stimulus-driven infrastructure investment, industrial production grew by 4.4% (y-o-y) in the second quarter and accelerated to 5.8% in the third quarter. The recovery in the services sector lagged behind due to long lasting social distancing measures and retail sales started growing again relative to 2019 only in August. Investment in fixed assets entered into positive territory in July, driven by infrastructure investment, which rose at a double-digit rate. After a double-digit drop in the first quarter, exports gradually accelerated to about 10% (y-o-y) growth in September.

Overall, economic activity rebounded at a brisk pace driven by industrial production, investment and exports. Real GDP growth firmed up in the third quarter at 4.9% (y-o-y) and became more balanced and broad-based. Yet, the recovery of retail and recreation services has been slower, but it is expected to pick up too as most social distancing measures in the services sector are lifted and domestic travel resumes.

Recovery set to continue and become more balanced

Going forward, growth is expected to gain speed in the fourth quarter and throughout 2021, but the projected rebound still implies some permanent loss of output compared to 2019, particularly in services. Growth is projected to decelerate to 2% in 2020, the lowest growth rate in several decades, and accelerate to 7¼% in 2021, reflecting a strong carry-over effect and a recovery of global growth and external demand.

Graph II.36.1: **China - Real GDP growth and contributions**



All in all, higher unemployment and lower household and corporate incomes are expected to keep consumer demand depressed in 2020, which is likely to rebound more forcefully only in 2021. Despite a better than expected recovery, China's trade volumes are still projected to worsen in 2020 from 2019. The double-digit drop in the first quarter and supply chain disruptions are projected to reduce China's exports of goods and services by more than 3% this year. Imports are forecast to decline by almost 4%, as domestic consumption lags the recovery in 2020. Together with the drop in foreign tourism outflows, China's current account surplus is expected to widen moderately in 2020, while imports will lead the trade rebound as of 2021 and 2022.

Growth is expected to scale back to around 5½% in 2022, as the economy resumes its trend deceleration prior to the COVID-19 outbreak, weighed down by a gradual reduction in productivity and the accumulation of domestic imbalances and debt. This is of particular concern in the corporate sector, where SOEs play an important role.

Targeted policy stimulus has supported the recovery

The macroeconomic policy response to the outbreak has been much smaller and better targeted than the one deployed after the Great Financial Crisis in an effort to avoid exacerbating existing domestic imbalances. The focus has been on supply-side support through targeted stress relief for corporates, rather than on large scale support to incomes and domestic demand directly. Yet, infrastructure investment financed by local governments was a major contributor to the recovery so far. The fiscal support took the form of additional healthcare spending, reduction in taxes and social security contributions for firms, employment or wage subsidies and financial guarantees for SMEs. On the monetary side, liquidity injections were stepped-up together with cuts in reserve requirements for banks while the latter were encouraged to lend more to SMEs, facilitate repayments and increase debt forbearance for all companies. Local authorities provided companies with administrative support to resume production quickly and with adequate health measures in place. Overall, China has planned an extra fiscal stimulus of about 3.5% of GDP in 2020 over 2019.

Unprecedented levels of uncertainty

Although China's growth is likely to be better than expected in 2020, it is still the weakest outcome in decades and projections for 2021 and 2022 remain surrounded by high uncertainty. The main downside risks relate to the trade and tech tensions with the U.S., the possibility of a more protracted global economic downturn and a resurgence of the COVID-19 pandemic. A medium-term risk relates to the unwinding of financial vulnerabilities and the high leverage in the economy, which risks being exacerbated further by the crisis. On the other hand, while the overall policy space has become more limited, China still has some room to implement additional policy support if the economic outlook deteriorates significantly.

Table II.36.1:

Main features of country forecast - CHINA

	2019			Annual percentage change						
	bn CNY	Curr. prices	% GDP	00-16	2017	2018	2019	2020	2021	2022
GDP		99086.5	100.0	9.4	7.0	6.7	6.1	**2.1**	**7.3**	**5.6**
Consumption		55149.5	55.7	-	-	-	-	-	-	-
Gross fixed capital formation		42201.9	42.6	-	-	-	-	-	-	-
of which: equipment				-	-	-	-	-	-	-
Change in stocks as % of GDP				-	-	-	-	-	-	-
Exports (goods and services)		23845.2	24.1	14.7	9.1	4.0	2.3	**-3.6**	**5.5**	**4.3**
Final demand				-	-	-	-	-	-	-
Imports (goods and services)		22364.7	22.6	14.1	7.1	7.9	-2.0	**-3.8**	**7.1**	**5.6**
GNI (GDP deflator)		-	-	-	-	-	-	-	-	-
Contribution to GDP growth :	Domestic demand			-	-	-	-	-	-	-
	Inventories			-	-	-	-	-	-	-
	Net exports			-	-	-	-	-	-	-
Employment				-	-	-	-	-	-	-
Unemployment (a)				4.0	3.9	3.8	3.6	-	-	-
Compensation of employees/head				-	-	-	-	-	-	-
Unit labour costs				-	-	-	-	-	-	-
Real unit labour costs				-	-	-	-	-	-	-
Saving rate of households				-	-	-	-	-	-	-
GDP deflator				3.5	4.2	3.5	1.6	**1.0**	**2.1**	**2.1**
Private consumption deflator				-	-	-	-	-	-	-
Index of consumer prices (c)				2.2	1.6	2.1	2.9	-	-	-
Merchandise trade balance (b)				4.5	3.9	3.2	3.0	**3.2**	**2.7**	**2.5**
Current-account balance (b)				3.9	1.6	0.2	1.0	**1.3**	**0.9**	**0.7**
Net lending(+) or borrowing(-) vis-à-vis ROW (b)				-	-	-	-	-	-	-
General government balance (b)				-	-	-	-	-	-	-
General government gross debt (b)				-	-	-	-	-	-	-

(a) urban unemployment, as % of labour force. (b) as a percentage of GDP. (c) national indicator.