36. CHINA

The COVID-19 outbreak has severely hit the Chinese economy. Available data point to a sharp contraction of economic activity in the first two months of 2020 followed by a gradual recovery, which is, however, expected to be dampened by a slump in external demand. Overall, the Chinese economy is expected to grow by about 1% in 2020 and to pick up by around 8% in 2021 but uncertainty around this forecast is particularly elevated.

Unprecedented hit to an economy already in slowdown

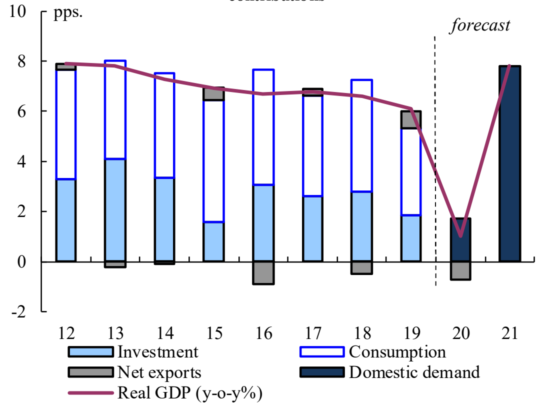
The Chinese economy had been on a decelerating trend already prior to the COVID-19 outbreak. GDP growth slowed to 6.1% last year, amid softer domestic demand and escalation of economic tensions with the US. High frequency indicators at the turn of the year pointed to some tentative signs of stabilisation but the virus outbreak and the related strict public health measures implemented by the Chinese authorities completely reversed this path and resulted in an unprecedented economic downturn. GDP declined by 6.8% year-on-year in the first quarter of 2020, reflecting the severe damage caused by the outbreak.

Available high frequency indicators point to a sharp drop in economic activity in the first two months of 2020 and to a gradual resumption of production in March, as businesses started to reopen and confinement measures were progressively lifted. According to official estimates, the vast majority of businesses have now resumed activity, although capacity utilisation remains below normal levels, in particular in SMEs. Overall, industrial production seems to be recovering much faster than consumer demand. In particular, retail and recreation services remain constrained as a number of health and social distancing measures remain in place.

A gradual and uneven recovery dampened by a slump in external demand

Going forward, the Chinese economy is expected to recover only gradually, with domestic demand weakness compounded by a slump in external demand. Growth is expected to accelerate in the second half of this year and in 2021 but the projected rebound still implies some permanent loss of output compared to the pre-pandemic baseline, as some sectors (in particular services such as travel and tourism) are unlikely to recuperate lost activity. Growth is projected to fall to 1% in 2020, the lowest growth rate in several decades, and to pick up to around 8% in 2021, reflecting in particular a strong carry-over effect, low baseline in 2020 and, to a lesser extent, the macroeconomic policy response to the outbreak. The underlying growth momentum will be weaker than before the crisis as higher unemployment and lower household and corporate incomes are expected to continue dampen consumer demand and investment. In addition, structural factors, such as shrinking working age population, slow productivity growth and high debt levels are expected to act as additional drags on growth in the medium term.

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



The trade outlook for China is also expected to worsen materially. 2019 was already a very weak year in terms of trade performance, with both export and import growth falling sharply. Supply chain disruptions as well as significantly lower demand from the rest of the world due to the COVID-19 outbreak are projected to reduce China's exports massively, by more than 10% this year. Imports are also expected to shrink, reflecting in particular lower outbound tourism. The projected rebound in trade in 2021 is rather subdued by historical standards, as global trade policy uncertainty and still weak external demand are expected to continue to weigh on China's trade outlook.

A targeted and rather cautious policy response

The macroeconomic policy response to the outbreak has been overall more cautious and targeted than the massive fiscal and monetary stimulus deployed during the financial crisis in 2008-09. The Chinese authorities have so far focused on targeted stress relief and liquidity provision. On the monetary side, the Chinese central bank has provided more liquidity to financial markets, banks have been encouraged to provide more lending to SMEs, to extend loan and interest payments for affected enterprises and to raise their tolerance for bad debt. Some key policy rates have been cut but so far to a limited extent.

On the fiscal side, more support has been provided both by central and local governments, in particular in the form of additional healthcare spending, extensions of tax payments, reduction in taxes and social security contributions for firms, employment or wage subsidies and financial guarantees for SMEs. More fiscal and monetary stimulus is likely to be implemented in the course of the year to further support consumption, boost infrastructure investments, stimulate credit growth and achieve the poverty reduction goal. However, available policy space is limited given high public debt burden (in particular at the local government level) and serious financial stability issues.

Unprecedented levels of uncertainty

Both the growth and trade outlooks are subject to extreme uncertainty. In particular, a second outbreak of the virus could occur as factories re-open and activity resumes. This would imply another supply and demand shock and postpone the recovery. Moreover, given the financial vulnerabilities and high indebtedness of the Chinese economy, the supply and demand disruptions together with the sharp financial market reaction globally may trigger severe financial stability problems and deepen the downturn even further. At the same time, upside risks include a possibility of a sharper-than-expected rebound in economic activity when the pandemic subsides as well as more substantial policy support than currently assumed.

Table II.36.1:
Main features of country forecast - CHINA

	2018			Annual percentage change						
	bn CNY Curr. prices	% GDP	00-15	2016	2017	2018	2019	2020	2021
GDP	91928.1	100.0	9.6	6.8	7.0	6.7	**6.1**	**1.0**	**7.8**
Consumption	50613.5	55.1	-	-	-	-	**-**	**-**	**-**
Gross fixed capital formation	39384.8	42.8	-	-	-	-	**-**	**-**	**-**
of which: equipment			-	-	-	-	**-**	**-**	**-**
Change in stocks as % of GDP			-	-	-	-	**-**	**-**	**-**
Exports (goods and services)	18155.6	19.7	15.5	1.1	9.1	4.0	**0.7**	**-10.5**	**5.0**
Final demand			-	-	-	-	**-**	**-**	**-**
Imports (goods and services)	17450.2	19.0	14.7	4.7	7.1	7.9	**-2.3**	**-6.0**	**4.6**
GNI (GDP deflator)	-	-	-	-	-	-	**-**	**-**	**-**
Contribution to GDP growth : Domestic demand			-	-	-	-	**-**	**-**	**-**
Inventories			-	-	-	-	**-**	**-**	**-**
Net exports			-	-	-	-	**-**	**-**	**-**
Employment			-	-	-	-	**-**	**-**	**-**
Unemployment (a)			4.0	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			3.6	1.5	4.2	3.5	**1.6**	**1.7**	**2.1**
Private consumption deflator			-	-	-	-	**-**	**-**	**-**
Index of consumer prices (c)			2.3	2.0	1.6	2.1	**2.9**	**-**	**-**
Merchandise trade balance (b)			4.5	4.4	3.9	2.8	**3.0**	**1.9**	**2.1**
Current-account balance (b)			4.0	1.8	1.6	0.2	**1.0**	**0.6**	**0.8**
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.