36. CHINA

China's economy seems to be slowing, burdened by sluggish private consumption, weaker credit growth and ongoing turmoil in the property sector. In the forecast horizon, China's economy is expected to slowly adjust away from the growth model based on debt-fuelled brick and mortar investment. Policy priorities are changing from maintaining pre-set high levels of growth at all cost to managing China's lengthy list of economic and social imbalances. Short run risks arise in the domestic property, energy and transport sectors, while geopolitical tensions are expected to dominate over the medium term.

Growth slowing down in the second half of 2021

Following record growth in Q1-2021 of 18.3% year on year, the economy grew by 7.9% in the second quarter of the year and more modestly by 4.9% in Q3, reflecting very strong base effects. In the first nine months of 2021, GDP growth was primarily driven by recovering consumption, but has also been supported by investment and net exports. However all three components showed weakening momentum as the year went on. Economic uncertainty due to local outbreaks of COVID-19, followed by strict lockdown measures, and recent electricity shortages are undermining consumer confidence and weighing on households' propensity to spend.

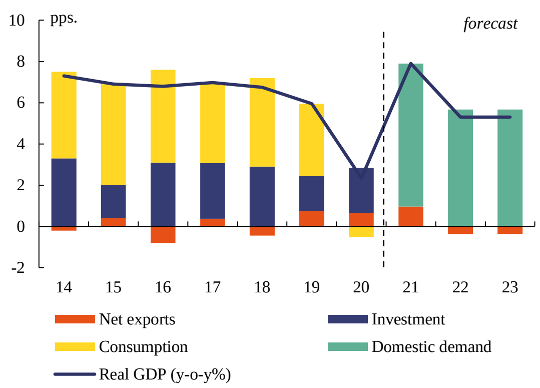
Investment is slowing down as local governments rein in new borrowing for investment purposes, and the real estate sector struggles under tighter financing conditions. Transport and electricity supply bottlenecks, and rising input prices are starting to undermine export performance. While the economy is set to continue losing momentum in the fourth quarter, annual GDP growth is still expected to reach a solid 7.9% in 2021, on the back of an exceptionally strong carry-over effect.

Towards the pre-pandemic growth trend

Growth is expected to moderate to 5.3% in 2022 and 2023, in line with its pre pandemic trend, weighed down by declining productivity growth, an excessively leveraged corporate sector, geopolitical tensions and the increasing policy prioritisation of longer-term economic and social objectives over short-term growth. Household consumption is set to receive support from rising incomes while high vaccination rates should help contain new virus outbursts, despite lower reported efficacy of Chinese vaccines.

Investment growth is projected to remain subdued as both real estate and infrastructure investment start to face strong headwinds. Recent turmoil in the property sector demonstrates the unsustainability of the prevalent business model, based on high leverage and quick turnover. Furthermore, housing demand is likely to moderate, subdued by demographic changes, tighter mortgage financing conditions and exuberant housing prices in higher tier cities. A slowdown in the property sector will impact local government capacity to maintain high infrastructure investment, as property sales account for around one third of their revenue. On the other hand, strategic industries (e.g., semiconductors) will likely benefit from strong government investment support, while access to finance could ease for the previously crowded out, more productive, private investment.

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



Export growth is forecast to moderate in 2022 and 2023 as global consumption patterns shift back from goods to services. At the same time, imports are set to receive support from domestic demand. Overall, the current account surplus is expected to remain sizeable but decline gradually throughout 2022-2023.

Policy focus remains on managing imbalances

China's policy focus recently shifted towards tighter managing of corporate indebtedness, in particular in the property sector, delivering on ambitious climate change targets, stricter regulation of the internet economy, and addressing high wealth disparities in the country. These measures are set to weigh on growth in the short term but could help facilitate rebalancing the economy.

To maintain stability and avoid sharp reversals, monetary authorities will look to maintain ample liquidity in the economy but without backtracking from the stated objectives to maintain credit growth in line with that of the nominal GDP. Fiscal spending will likely remain subdued as local governments face tighter financing conditions.

Multiple downside risks

US-China diplomatic tensions remain a key downside risk for China. The January 2022 deadline of the Phase I trade agreement could lead to an intensification of the trade dispute if the planned round of bilateral talks fails. In all, uncertainty over the future trade and technology relationship is likely to weigh on growth in China over the medium term.

Tighter financing conditions faced by the property sector are contributing to increasing distress in sector's firms with weak liquidity and excessive leverage. If poorly managed, debt defaults and restructurings in the property sector would reverberate through the broader economy, particularly the Chinese banking sector, where small banks tend to have a disproportionally large exposure to property markets.

China's commitment to a "zero-COVID-19" policy could weigh on regional growth. New virus outbreaks would trigger strict social distancing and quarantine measures that could distort further manufacturing supply chains and delay the full resumption of service activities. Furthermore, China is facing both supply and demand-related constraints in electricity markets, largely derived from tight coal supplies, rigid end user power prices and policy pressure to reduce emissions. The resulting shortages in electricity could weigh further on industrial activity, most notably on power-intensive sectors (e.g., steel, chemicals) but extending over a broader range of manufacturing industries.

Table II.36.1:

Main features of country forecast - CHINA

	2020				Annual percentage change					
	bn CNY	Curr. prices	% GDP	02-17	2018	2019	2020	2021	2022	2023
GDP		101598.6	100.0	9.4	6.7	6.0	2.3	**7.9**	**5.3**	**5.3**
Private consumption		38717.6	38.1	-	-	-	-	**-**	**-**	**-**
Public consumption		16981.0	16.7	-	-	-	-	**-**	**-**	**-**
Gross fixed capital formation		43568.3	42.9	-	-	-	-	**-**	**-**	**-**
of which: equipment		-	-	-	-	-	-	**-**	**-**	**-**
Exports (goods and services)		19731.7	19.4	13.8	4.0	0.4	2.2	**13.6**	**2.3**	**3.3**
Imports (goods and services)		17078.7	16.8	12.8	7.3	-3.7	-1.4	**9.1**	**5.3**	**6.3**
GNI (GDP deflator)		-	-	-	-	-	-	**-**	**-**	**-**
Contribution to GDP growth:	Domestic demand			-	-	-	-	**-**	**-**	**-**
	Inventories			-	-	-	-	**-**	**-**	**-**
	Net exports			-	-	-	-	**-**	**-**	**-**
Employment				-	-	-	-	**-**	**-**	**-**
Unemployment rate (a)				4.1	3.8	3.6	4.2	**-**	**-**	**-**
Compensation of employees/head				-	-	-	-	**-**	**-**	**-**
Unit labour costs whole economy				-	-	-	-	**-**	**-**	**-**
Real unit labour costs				-	-	-	-	**-**	**-**	**-**
Saving rate of households				-	-	-	-	**-**	**-**	**-**
GDP deflator				3.7	3.5	1.3	0.6	**3.7**	**2.8**	**2.6**
Consumer price index (c)				2.4	2.1	2.9	2.5	**-**	**-**	**-**
Terms of trade goods (b)				-	-	-	-	**-**	**-**	**-**
Trade balance (goods) (b)				4.4	2.7	2.8	3.5	**3.3**	**2.8**	**2.5**
Current-account balance (b)				4.0	0.2	0.7	1.9	**2.1**	**1.6**	**1.1**
Net lending(+) or borrowing(-) vis-à-vis ROW (b)				-	-	-	-	**-**	**-**	**-**
General government balance (b)				-	-	-	-	**-**	**-**	**-**
Cyclically-adjusted budget balance				-	-	-	-	**-**	**-**	**-**
Structural budget balance				-	-	-	-	**-**	**-**	**-**
General government gross debt (b)				-	-	-	-	**-**	**-**	**-**

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