## CHINA

### Recent developments

Following a sharp contraction in the first quarter China’s economy has started to rebound, but the recovery remains uneven with industrial production and infrastructure investment normalizing much faster than services, consumption and private investment. On the production side, the rebound was led by industry, which expanded 4.7 percent y/y in Q2. In contrast, growth in the service sector remained subdued at 1.9 percent y/y, reflecting remaining restrictions. On the demand side, investment recovered strongly, driven mainly by infrastructure and real estate investment, while manufacturing and private investment continued to contract. Final consumption remained a drag on growth, contributing -2.3 percentage points y/y in Q2. The contribution of net exports to growth turned positive (0.5 pp) in Q2, due to declining imports as well as stronger than expected exports driven by a surge in shipments of medical equipment and electronics.

Labor market impacts have been significant, with rising unemployment and significant labor dislocation. The official surveyed urban unemployment rate jumped from 5.3 percent in January to 6.2 percent in February but has since dropped slightly to 5.6 percent in August. Self-employed workers and those in less secure, informal jobs, particularly migrant workers -which are not counted in the official labor market statistics- were especially hard hit.

Real household disposable income per capita recovered moderately to 2.0 percent y/y in Q2, but income losses, social distancing, elevated unemployment levels and uncertainty continue to weigh on private consumption. Per capita consumer spending continued to contract by 5.6 percent y/y in Q2. Meanwhile, debt levels—already elevated before the crisis—have increased sharply and eroded deleveraging gains made over the past two years. The confluence of a collapse of corporate profits, rising unemployment, and lost income has elevated credit risks in Chinese banks, and asset quality has started to deteriorate. While the nonperforming loan (NPL) ratio of the whole banking system inched up only slightly by 8pp to 1.94 percent between December 2019 and June 2020, the balance sheets of smaller regional banks are particularly vulnerable, due to their higher exposure to unsecured consumer lending and micro and small enterprises (MSEs), as well as weaker capital buffers even before the crisis.

Economic policy measures have cushioned some of the economic and social impacts of the pandemic-induced downturn. The initial policy response aimed to bolster market confidence, relieve near-term cash flow problems, and mitigate more permanent economic damage in the form of bankruptcy, unemployment, and rising NPLs. As lockdown measures were eased, policies shifted toward supporting the recovery with additional fiscal policy measures, amounting to about 5.4 percent of GDP, largely to fund tax relief and public investment.

China’s economy has started to rebound from the COVID-19 induced shock, but the recovery remains uneven. While supply side constraints have largely eased, the recovery of domestic demand and especially private consumption has trailed, reflecting lingering behavioral impacts of the pandemic, labor dislocation and slower growth in household incomes. Growth is projected to slow to 2.0 percent in 2020, dampening the pace of poverty reduction.

### Table 1

<table>
<thead>
<tr>
<th></th>
<th>2019</th>
</tr>
</thead>
<tbody>
<tr>
<td>Population, million</td>
<td>1395.4</td>
</tr>
<tr>
<td>GDP, current US$ billion</td>
<td>14115.8</td>
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<tr>
<td>GDP per capita, current US$</td>
<td>10116.2</td>
</tr>
<tr>
<td>International poverty rate ($19)^a</td>
<td>0.5</td>
</tr>
<tr>
<td>Lower middle-income poverty rate ($3.2)^b</td>
<td>5.4</td>
</tr>
<tr>
<td>Upper middle-income poverty rate ($5.5)^c</td>
<td>23.9</td>
</tr>
<tr>
<td>Gini index^d</td>
<td>38.5</td>
</tr>
<tr>
<td>School enrollment, primary (% gross)^e</td>
<td>100.2</td>
</tr>
<tr>
<td>Life expectancy at birth, years^f</td>
<td>76.7</td>
</tr>
</tbody>
</table>

Source: WDI, Macro Poverty Outlook, and official data.

Notes:
(a) Most recent value (2016), 2011 PPPs.
(b) Most recent estimate (2016), based on grouped data.
(c) WDI for School enrollment (2015); Life expectancy (2016).

### Figure 1

China / Real GDP growth and contributions to real GDP growth

Sources: National Bureau of Statistics; World Bank staff estimates.

### Figure 2

China / Poverty estimates and projections

Sources: World Bank staff estimates using tabulated data from China NBS.
**Outlook**

The baseline forecast envisions a sharp slowdown of growth to 2.0 percent this year, which would mark the slowest expansion since 1976. The baseline assumes that efforts to suppress the virus will broadly succeed, and that localized COVID-19 flareups are effectively contained without causing major disruptions in economic activity. Under this scenario, a sharp contraction in 2020Q1, and a subsequent rebound in 2020Q2, would be followed by a gradual but sustained recovery as aggregate demand progressively normalizes. Under this scenario, poverty reduction is expected to slow down significantly, reflecting labor dislocation, elevated unemployment rate and slower growth in household incomes. Only 9.6 million people are projected to be lifted out of poverty in 2020 (based on $5.50/day 2011 Purchasing Power Parity (PPP)), compared to the pre-pandemic scenario for 2020 where 25 million were projected to be lifted out of poverty. Reflecting in part positive (albeit lower) growth in agriculture for 2020, gains in poverty reduction are expected to come almost exclusively from rural areas.

**Risks and challenges**

Risks to China’s economic outlook remain high. On the downside, recurrent COVID-19 flareups could disrupt economic activity and dampen business and consumer sentiment to a greater extent than assumed in the baseline. In addition, a more significant increase in bankruptcies and corporate distress as well as persistent weakness in private consumption could also lead to a slower recovery and complete halt in poverty reduction. Externally, a more protracted global recession and escalating bilateral tensions between China and key trading partners could also derail the recovery. On the upside, the slowdown could be less severe if domestic and global consumer and investor confidence, boosted by effective policy measures, recover faster than anticipated, and if bilateral economic tensions ease.

The authorities face the complex challenge of ensuring sustained suppression of COVID-19 while allowing economic activity to recover. Public health and pandemic control measures are crucial to reducing the risk of renewed outbreaks. On the economic front, the situation calls for a macroeconomic policy mix aimed at rebuilding confidence and augmenting domestic demand in the short term while supporting the medium-term rebalancing to a greener and more inclusive economy. Monetary and financial sector policies will need to remain flexible ensuring that the flow of credit to the real sector is not impeded, while financial and debt risks are managed carefully. Given the risks of a credit-fueled rebound, fiscal policies will need to play the leading role in supporting the recovery. Specifically, policy makers should aim at closing the gaps in China’s social protection coverage to help protect workers and households and boost private consumption.

Structural policies should focus on enabling the reallocation of resources and facilitating adjustments to post-pandemic economic realities. If corporate distress reflects deeper underlying solvency issues, bankruptcy proceedings may be the appropriate strategy. Intensifying “hukou” (household residency registration system) reform and enhancing access to and portability of social services would strengthen labor mobility. Further opening up could boost investment and accelerate knowledge and technology diffusion, and also help ease lingering geographic tensions.

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**TABLE 2 China / Macro poverty outlook indicators**

<table>
<thead>
<tr>
<th></th>
<th>2017</th>
<th>2018</th>
<th>2019</th>
<th>2020 e</th>
<th>2021 f</th>
<th>2022 f</th>
</tr>
</thead>
<tbody>
<tr>
<td>Real GDP growth, at constant market prices</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>Private Consumption</td>
<td>6.8</td>
<td>6.6</td>
<td>6.1</td>
<td>2.0</td>
<td>7.9</td>
<td>5.2</td>
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<tr>
<td>Government Consumption</td>
<td>6.8</td>
<td>9.5</td>
<td>6.8</td>
<td>-1.0</td>
<td>11.0</td>
<td>6.0</td>
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<tr>
<td>Gross Fixed Capital Investment</td>
<td>10.0</td>
<td>10.4</td>
<td>8.4</td>
<td>9.7</td>
<td>7.2</td>
<td>8.0</td>
</tr>
<tr>
<td>Exports, Goods and Services</td>
<td>4.4</td>
<td>4.8</td>
<td>4.5</td>
<td>1.1</td>
<td>6.5</td>
<td>3.6</td>
</tr>
<tr>
<td>Imports, Goods and Services</td>
<td>9.1</td>
<td>4.0</td>
<td>2.5</td>
<td>-0.5</td>
<td>2.5</td>
<td>2.0</td>
</tr>
<tr>
<td>Real GDP growth, at constant factor prices</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Agriculture</td>
<td>6.8</td>
<td>6.6</td>
<td>6.1</td>
<td>2.0</td>
<td>7.9</td>
<td>5.2</td>
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<tr>
<td>Industry</td>
<td>3.9</td>
<td>3.5</td>
<td>3.3</td>
<td>2.6</td>
<td>3.4</td>
<td>3.3</td>
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<tr>
<td>Services</td>
<td>5.9</td>
<td>5.8</td>
<td>5.5</td>
<td>2.8</td>
<td>6.3</td>
<td>4.7</td>
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<tr>
<td>Inflation (Consumer Price Index)</td>
<td>1.6</td>
<td>2.1</td>
<td>2.9</td>
<td>2.1</td>
<td>2.3</td>
<td>2.3</td>
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<tr>
<td>Current Account Balance (% of GDP)</td>
<td>1.6</td>
<td>0.4</td>
<td>1.1</td>
<td>1.4</td>
<td>1.0</td>
<td>0.9</td>
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<tr>
<td>Net Foreign Direct Investment (% of GDP)</td>
<td>0.2</td>
<td>0.8</td>
<td>0.9</td>
<td>0.5</td>
<td>0.7</td>
<td>0.8</td>
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<tr>
<td>Fiscal Balance (% of GDP)</td>
<td>-3.9</td>
<td>-4.6</td>
<td>-6.4</td>
<td>-11.8</td>
<td>-5.8</td>
<td>-5.4</td>
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<tr>
<td>Debt (% of GDP)</td>
<td>37.2</td>
<td>38.5</td>
<td>41.9</td>
<td>52.4</td>
<td>53.4</td>
<td>55.2</td>
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<tr>
<td>Primary Balance (% of GDP)</td>
<td>-3.2</td>
<td>-3.6</td>
<td>-5.1</td>
<td>-10.7</td>
<td>-4.4</td>
<td>-4.1</td>
</tr>
<tr>
<td>International poverty rate ($1.9 in 2011 PPP)</td>
<td>0.4</td>
<td>0.3</td>
<td>0.3</td>
<td>0.3</td>
<td>0.2</td>
<td>0.2</td>
</tr>
<tr>
<td>Lower middle-income poverty rate ($3.2 in 2011 PPP)</td>
<td>4.5</td>
<td>3.7</td>
<td>3.1</td>
<td>2.8</td>
<td>2.2</td>
<td>1.8</td>
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<tr>
<td>Upper middle-income poverty rate ($5.5 in 2011 PPP)</td>
<td>21.5</td>
<td>19.4</td>
<td>17.5</td>
<td>16.7</td>
<td>14.4</td>
<td>13.0</td>
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</table>


Notes: e = estimate, f = forecast.

(a) The adjusted fiscal balance adds up the public finance budget, the government fund budget, the state capital management fund budget and the social security fund budget.
(b) Last grouped data available to calculate poverty is for 2016 provided by NBS. Projections based on per capita GDP growth estimates, using a neutral distribution assumption with pass through 0.72 to per capita household consumption.