

CHINA

Key conditions and challenges

Recent developments

Table 1	2020
Population, million	1410.9
GDP, current US\$ billion	14722.7
GDP per capita, current US\$	10435.0
International poverty rate (\$ 19) ^a	0.5
Lower middle-income poverty rate (\$3.2) ^a	5.4
Upper middle-income poverty rate (\$5.5) ^a	23.9
Gini index ^b	38.5
School enrollment, primary (% gross) ^c	101.9
Life expectancy at birth, years ^c	76.9
Total GHG Emissions (mtCO2e)	12342.3

Source: WDI, Macro Poverty Outlook, and official data.
 (a) Most recent value (2016), 2011 PPPs.
 (b) Most recent estimate (2016), based on grouped data.
 (c) Most recent WDI value (2019).

Economic growth is projected to reach 8.5 percent in 2021, largely driven by base effects. Poverty is expected to return to the pre-COVID-19 trend amid improving labor market conditions. Near-term risks have shifted to the downside with the key risk being recurring outbreaks led by more transmissible COVID-19 variants which could lead to significant economic disruptions. Over the medium term, China's economy is facing structural headwinds given adverse demographics, tepid productivity growth, and the legacies of excessive borrowing and environmental pollution.

While China managed to quell the country's largest COVID-19 resurgence since the initial outbreak in Wuhan, the outbreak further delayed the recovery in consumption and service activities. Fresh COVID-19 flareups in southeastern Fujian province could risk more significant economic disruptions, despite efforts to suppress the spread of the virus.

With near-term risks clearly on the downside, the authorities will need to stay agile and proactively adjust the level and composition of macroeconomic policy support. While China recently reached its vaccination target of 70 percent of the population by 2021, continued progress toward achieving widespread immunization could lay a foundation for a gradual risk-based relaxation of remaining restrictions.

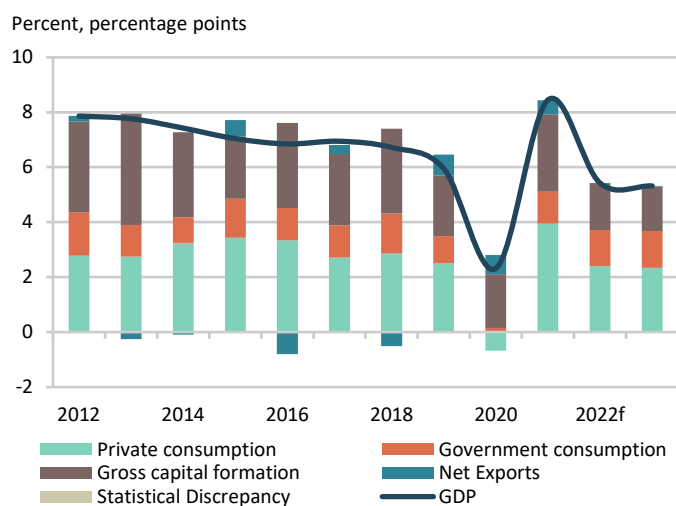
Over the medium term, China's economy is projected to experience a structural slowdown, putting breaks on achieving shared prosperity. Adverse demographics, tepid productivity growth, and the legacies of excessive borrowing and environmental pollution will continue to weigh on growth. Persistent policy uncertainty due to geopolitical and economic tensions could further exacerbate the ongoing structural slowdown and undermine growth prospects.

Economic activity in China continued to normalize in the first half of 2021. Real GDP growth moderated to 7.9 percent y/y in the second quarter from 18.3 percent y/y in the first quarter, as low base effects started to dissipate. On a sequential basis, GDP growth rose to 1.3 percent in the second quarter from 0.4 percent in the first quarter. Meanwhile, labor markets conditions continued to improve, and employment, including those of migrant workers, has fully returned to pre-COVID levels. Headline urban unemployment dropped to 5.0 percent by Q2 2021, the lowest rate since Q3 2019.

During the first half of 2021, both disposable income and household expenditure recovered strongly from the slowdown in 2020, particularly among rural households. Meanwhile, expenditure among urban households grew at a slower rate than incomes (2y/2y growth rates of 6.2 percent vis-à-vis 9.2 percent in the second quarter of 2021). While rural extreme poverty has been effectively eliminated, 16 percent of Chinese were expected to fall below the upper-middle income countries poverty line of \$5.50/day per person (2011 PPP) by 2020, with a third of them residing in urban areas.

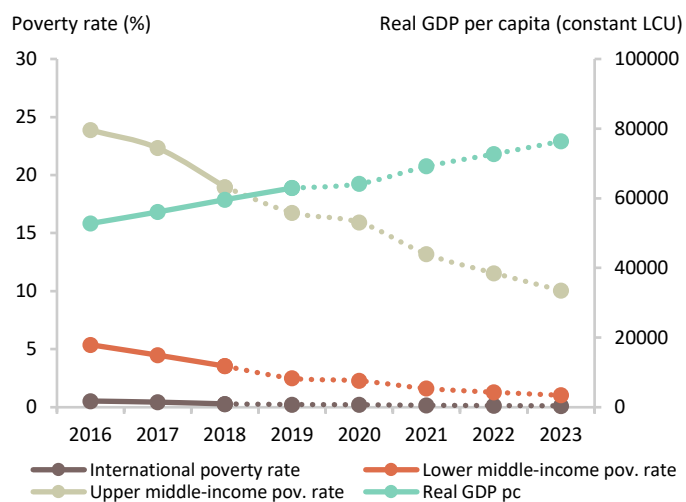
Economic activities have weakened during the third quarter of 2021 reflecting the lagged impact of policy and macroprudential tightening, heavy floods, and the Delta variant outbreak. Growth in both industrial production and fixed

FIGURE 1 China / Real GDP growth and contributions to real GDP growth



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

FIGURE 2 China / Actual and projected poverty rates and real GDP per capita



Source: World Bank. Notes: see Table 2.

asset investment moderated. Retail sales, which have yet to return to the pre-pandemic trend, also decelerated in the third quarter. Meanwhile, export and import growth have remained robust and the surplus in the trade balance remains firmly positive.

The authorities have tightened fiscal policy while keeping monetary policy broadly flexible this year. Public investment in infrastructure has moderated further amid the government's control on local government financing vehicle (LGFV) risks and the slow pace of local government bond issuance. Credit growth has also moderated since end-2020 reflecting weaker growth in bank loans, softer bond financing and shrinking shadow bank activities. To ease liquidity amid weaker economic activity, the PBOC cut the reserve requirement ratio (RRR) by 50 basis points in July but has kept other key benchmark rates on hold for now 16 consecutive months.

Outlook

The baseline forecast envisions a rebound of growth to 8.5 percent in 2021, largely

driven by base effects. Although lingering tighter restrictions and cautious sentiment due to the recent outbreak will weigh on the consumption recovery, its impact is expected to be partly offset by robust foreign demand and moderate policy support in the latter half of the year. On-budget spending and local government special bond issuances are expected to accelerate which should support infrastructure investment during the remainder of the year. GDP growth would stabilize slightly below its earlier trend rate by late 2022, as weaker global demand, the negative impact on activity from fiscal consolidation and deleveraging will weigh on growth and prevent it from returning to its pre-pandemic trajectory.

Given the projected economic growth for 2021, poverty reduction at \$5.50 is expected to return to a pace similar to the one observed prior to COVID-19. Poverty is set to decline rapidly to 13.2 percent in 2021, representing 38 million fewer poor people than in 2020.

Risks to China's growth outlook are tilted towards the downside. The key downside risk relates to recurring widespread outbreaks driven by more transmissible

variants leading to significant disruption in economic activity. Downside risks are further exacerbated by the ongoing wave of regularly tightening which could weigh on confidence in the short-run and stifle innovation and productivity growth over the medium-to-long run. In addition, the COVID-19 shock has brought to the fore weaknesses in corporate, bank and government balance sheets, posing risks to China's growth prospects.

With near-term risks tilted to the downside, the authorities will need to strike a balance between spurring economic activity and containing financial risk. Thanks to ample fiscal space at the central level and a current account surplus, China can provide more fiscal stimulus should downside risks to growth intensify.

The government recently highlighted achieving common prosperity as a key economic objective, reinforcing signals of a possible shift in policy priorities towards tackling income inequality. Over the medium term, policies to tackle high inequality through more progressive taxation and a strengthened social protection system will ensure lasting poverty reduction, a larger middle class and help boost private consumption as a driver of growth.

TABLE 2 China / Macro poverty outlook indicators

(annual percent change unless indicated otherwise)

	2018	2019	2020	2021 e	2022 f	2023 f
Real GDP growth, at constant market prices	6.7	6.0	2.3	8.5	5.4	5.3
Private Consumption	7.5	6.5	-1.7	10.6	6.3	6.1
Government Consumption	9.0	6.0	0.9	7.1	8.1	8.0
Gross Fixed Capital Investment	7.4	5.3	4.7	6.6	4.0	3.9
Exports, Goods and Services	4.0	2.2	1.8	11.2	3.1	3.1
Imports, Goods and Services	7.4	-1.7	-2.0	10.1	3.5	3.5
Real GDP growth, at constant factor prices	6.7	6.0	2.3	8.5	5.4	5.3
Agriculture	3.5	3.1	3.0	3.4	3.3	3.3
Industry	5.8	4.9	2.6	7.3	4.6	4.5
Services	8.0	7.2	2.1	10.1	6.3	6.2
Inflation (Consumer Price Index)	2.1	2.9	2.5	1.1	2.3	2.2
Current Account Balance (% of GDP)	0.2	0.7	1.9	1.8	1.3	0.8
Net Foreign Direct Investment (% of GDP)	0.7	0.4	0.7	0.7	0.9	0.9
Fiscal Balance (% of GDP)^a	-3.3	-4.6	-8.9	-7.6	-7.0	-6.7
Debt (% of GDP)	36.5	38.5	45.4	49.3	53.6	57.4
Primary Balance (% of GDP)	-2.4	-3.6	-7.8	-6.4	-5.7	-5.3
International poverty rate (\$1.9 in 2011 PPP)^{b,c}	0.3	0.2	0.2	0.2	0.1	0.1
Lower middle-income poverty rate (\$3.2 in 2011 PPP)^{b,c}	3.5	2.5	2.3	1.6	1.3	1.0
Upper middle-income poverty rate (\$5.5 in 2011 PPP)^{b,c}	19.0	16.8	15.9	13.2	11.5	10.1
GHG emissions growth (mtCO₂e)	2.6	2.4	1.6	3.2	1.4	1.3
Energy related GHG emissions (% of total)	82.5	82.1	82.1	82.0	81.8	81.7

Source: World Bank, Poverty & Equity and Macroeconomics, Trade & Investment Global Practices. Emissions data sourced from CAIT and OECD.
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 2018 provided by NBS. Actual data: 2018. Nowcast: 2019-2020. Forecast are from 2021 to 2023.

(c) Projections based on per capita GDP growth estimates, using a neutral distribution assumption with pass through 0.85 to per capita household consumption.