



China’s Economy: Current Trends and Issues

China emerged in June 2020 as the first major country to announce a return to economic growth since the outbreak of the COVID-19 pandemic. product (GDP) growth in the second quarter and 4.9% GDP growth in the third quarter of 2020. The International Monetary Fund (IMF) projects China’s economy to grow by 1.9% in 2020. China is still grappling with a slow recovery of domestic demand and its top export markets and has relied on government spending and exports to boost growth. China is facing growing restrictions on its overseas commercial activities and access to foreign technology and pressures for firms to diversify China-based supply chains. Against this backdrop, China’s leadership is deliberating the country’s economic direction and industrial plans for the next 5 to 15 years. See CRS In Focus IF11684, *China’s 14th Five-Year Plan: A First Look*, by Karen M. Sutter and Michael D. Sutherland.

COVID-19 Support Measures to Boost Growth

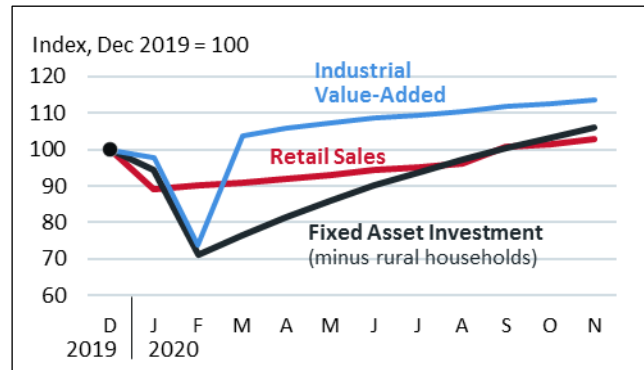
The IMF estimates that China’s announced fiscal measures and financing plans amounted to \$740 billion, or 4.7% of its GDP, as of November 2020. The government increased its budget deficit target to a record high of 3.6% of GDP, up from 2.8% in 2019. Key measures included spending on epidemic control and medical equipment, unemployment insurance, tax relief, and public investment. Between January and November 2020, China’s fixed asset investment grew over the same period in 2019 in e-commerce (32%), pharmaceuticals and medical products (27%), health (26%), computers (20%), and education (14%). China reduced the value-added tax (VAT) rate and introduced VAT exemptions for certain goods and services. China’s central bank extended monetary support with interest rate cuts, eased loan terms, and injected liquidity into banks. Shifting from efforts to reduce debt, the government announced the issuance of \$142.9 billion of special treasury bonds for the first time since 2007; increased the quota for local government special bonds (a source of infrastructure funding); and fast-tracked the issuance of corporate bonds to cover pandemic costs but with potential broader uses. The government says it seeks to control credit risk but the need for additional fiscal and monetary support to boost growth may undermine this goal.

Systemic Economic Challenges

China is grappling with economic challenges that predate the pandemic, including slowing domestic growth, rising labor costs, trade pressures including U.S. tariffs, rising consumer inflation, and rising corporate and government debt levels. In November 2020, China’s Purchasing Manager’s Index was 52.1% and value-added manufacturing was up by 7.7% over November 2019—in a sign of manufacturing expansion. November 2020 retail sales increased 5% over November 2019, but January to November 2020 sales were down 5% over the same period in 2019. The ongoing outbreak of African Swine Flu since 2018 has decimated over half of China’s pork herd and led

to acute shortages. The government initially tapped strategic pork reserves and increased imports from Europe and Brazil, but could not compensate for the drop in imports from the United States since China imposed tariffs in 2018. China has increased U.S. pork imports in 2020. In August 2020, President Xi launched a campaign against food waste, signaling a focus on boosting domestic food supply and agricultural technology, including a focus on seeds. The Communist Party of China (CPC)’s Politburo meeting in April 2020 prioritized strengthening food, energy and supply chain security and stabilizing employment, financial and market operations, and foreign trade and investment.

Figure 1. China’s Industrial Production and Retail Sales (December 2019 to November 2020)



Source: CRS with data from China’s National Bureau of Statistics.

Since 2016, the Chinese government has pursued a deleveraging campaign to reign in bad debt accrued by local governments, commercial banks, and unauthorized “shadow” lending. China’s total debt across sectors—household, corporate, government, and financial sector—could reach 335% of GDP in 2020, according to the International Institute of Finance. China also has an estimated \$90 billion and another \$100 billion in U.S. dollar-denominated debt due in 2020 and 2021, respectively. Onshore, Chinese companies owe an estimated \$694.6 billion in 2020 and \$706 billion in 2021. The deleveraging campaign led to several regional bank bailouts in 2019. While the number of defaults dropped in 2020—likely due to stimulus measures and laxer rules—debt and nonperforming loan challenges persist and could grow if policies push loan forbearance and growth. In late 2020, the government reined in Alibaba’s lending business, signaled it may increase its role in Ant Group, and took control of economically-troubled Hongxin Semiconductor and Honor, Huawei’s smartphone business.

Trade Outlook

China’s trade recovered in the third quarter of 2020, with medical equipment, electronics, and machinery driving growth. In March 2020, China increased VAT export rebates for 1,500 products, including steel, building

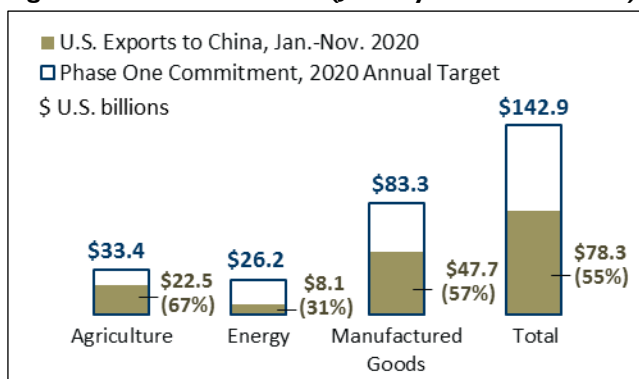
materials, chemicals, and agriculture. In August 2020, China increased its Export-Import Bank's loan exposure cap by \$85.1 billion. China supplies over 50% of global steel and expanded crude steel production by 4.5% between January and September 2020 over the same period in 2019. Production in 2019 was at a high of almost 1 billion tons. In contrast, crude steel production over the same period is down by 17.9% in the EU; 18.2% in North America; 16.5% in India; 19.1% in Japan; and 7.5% in South Korea.

China has been taking steps to stem appreciation of its currency, likely in part to keep exports competitive. China's central bank chairman said that China aims to keep domestic prices and foreign exchange values stable, a goal that could require further market intervention. In December 2020, the Treasury Department kept China on its watch list for currency practices. The January 2020 U.S.-China trade deal has a currency provision—similar to Chapter 33 of the U.S.-Mexico-Canada Agreement—requiring market-determined exchange rates, transparency, and reporting.

Rising costs, U.S. tariffs and technology restrictions, and business uncertainty have driven firms over the past five years to migrate elements of China-based supply chains to other countries, such as Vietnam and Mexico. The COVID-19 pandemic exposed the risks of concentrating certain production in China, likely accelerating this trend. Some governments—such as those of Australia, India, Japan, the UK, and the United States—are calling for secure supply chains and technology alliances among like-minded countries in high-value areas. China is attracting foreign investment in sectors, such as electric vehicles, where it requires a local presence to sell in China, creating some potential counter pressures to offshoring in certain sectors.

China appears to be limiting new market openings in line with its 14th Five-Year Plan priorities (e.g., scientific research; financial, health, and education; and *Made in China 2025* sectors). China arguably is playing geopolitical hardball with trade and has likely violated global rules in imposing ad hoc import restrictions to politically pressure Australia and Canada. In response, Canada abandoned free trade talks with China and Australia filed a World Trade Organization dispute settlement case. In late 2020, China reached a preliminary investment agreement with the European Union and was among 15 Asian countries to sign the Regional Comprehensive Economic Partnership.

Figure 2. Phase One Trade (January-November 2020)



Source: CRS with U.S. export data from the U.S. Census Bureau.

Note: This data does not include China's \$67.8 billion commitment in services imports for 2020.

January 2020 Phase One Trade Deal

The U.S.-China trade deal included a commitment for China to buy \$468 billion over 2 years of U.S. agriculture, energy, goods, and services. To date, China has purchased 55% of its 2020 commitment and some purchases fall below 2017 levels (e.g., coal). China's efforts to diversify sources of agricultural imports—resulting in record imports from countries, such as Argentina and Brazil—may hinder its ability to meet its commitments. When global oil prices collapsed in March 2020, China imported 53.18 million tons of crude oil from non-U.S. sources to replenish its strategic reserves.

Economic Policy Direction

The CPC's 19th Central Committee—a body of 204 senior Party leaders—held its 5th Plenum in October 2020 to deliberate on China's 14th Five-Year Plan (2021-2025) and economic goals out to 2035. China's Central Economic Work Conference reviewed plans in December 2020 ahead of the annual session of the National People's Congress in March 2021. Of potential interest to Congress, Chinese leaders are signaling policies to counter what they describe as new global constraints on China. Early details suggest that China is seeking to leverage the global economy to advance its goals in some ways that could challenge or reshape global rules and counter U.S. interests and policies.

President Xi is reviving a “dual circulation” policy that his predecessor used in the 2009 financial crisis. The term refers to leveraging the dual forces of domestic and global demand, or in other words, developing domestic capacity while pursuing openings in global markets. In 2009, the government used this approach to subsidize increased production in 13 industries while global industry contracted. This generated excess capacity that China then exported. President Xi is advancing a strong state role in the economy and advocating for Chinese leadership in global standards-setting. A digital campaign calls for \$1.4 trillion over five years in 5G, smart cities, and other technology infrastructure, and a push to adopt this approach globally. In September 2020, the CPC Central Committee called for strengthening Party control of the private sector to “build a backbone of private economic actors that are reliable and useful at critical moments.” Chinese leaders are playing up self-reliance and indigenous innovation—long-standing themes in China's policies—while seeking to sustain access to foreign markets and technology. An emphasis on basic research calls for foreign collaboration. A new policy for semiconductors calls for overseas research and production centers. The government is advancing a cryptocurrency to influence global finance and e-commerce and diversify from U.S. dollar financing. China issued an export control law and rules to review foreign investment on national security grounds, potentially to counter U.S. policy actions.

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