



China's Economy: Current Trends and Issues

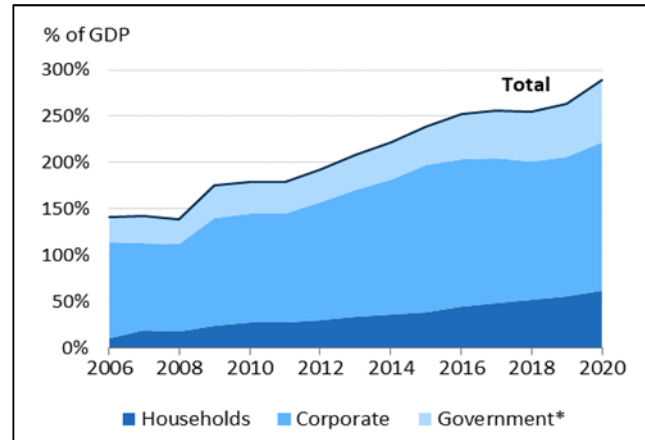
The People's Republic of China (PRC or China) was the first major economy to announce a return to economic growth in June 2020 since the outbreak of the Coronavirus Disease 2019 (COVID-19) pandemic; its economic performance since then has been uneven. Repeated lockdowns under zero-COVID tolerance policies have periodically disrupted manufacturing and transportation. Tightened border controls have curtailed two-way goods and services trade, tourism, and student and business travel. Weak domestic demand and debt pressures, particularly in the property sector, are also constraining growth. In 2021, China relied on government spending and exports to boost economic growth by 8.1%, from a low 2020 base of 2.2% growth. The PRC government targets 5.5% growth for 2022, while the International Monetary Fund (IMF) projects 4.8% growth. Some economists assess China may struggle to meet these targets due to domestic constraints and global economic pressures with Russia's invasion of Ukraine.

Systemic Economic Challenges

China still heavily relies on fixed asset investment and exports for growth. The PRC government faces challenges that predate the pandemic, including slower growth, rising labor costs, trade pressures, consumer inflation, and high levels of corporate and government debt. China's total debt—household, corporate, and government—reached 290% of GDP in 2020 (**Figure 1**), with the majority of debt held by companies. China's property market accounts for almost 30% of GDP, a higher percentage than in most countries, while private consumption accounts for an estimated 37% of GDP, a low share for an economy of China's size and top global trade position. Property is a main source of local government revenue and a key factor in corporate valuations and household net worth, which complicates efforts to reduce debt and address inequality, despite China's leader Xi Jinping's stated goals.

In 2016, the Chinese government initiated a campaign to rein in debt accrued by banks, local governments, and firms. The government restructured several companies and realigned investments in these firms with state goals, established state trusteeship, and transferred assets to state investors. In 2018, Xi pledged to tackle financial risk as one of "three tough battles" facing the government, which included poverty and pollution. The campaign led to several bank bailouts in 2019, but defaults fell in 2020, likely due to the government's pandemic stimulus and relaxation of the rules. In August 2020, the government launched a "three red lines" policy for property developers that sets: (1) a 70% ceiling on liability to asset ratios; (2) a 100% cap on net debt to equity ratio; and (3) a cash requirement to cover short-term liabilities. Several property firms, most notably Evergrande, have since struggled to maintain liquidity. China also imposed new data and security restrictions on firms, arguably fueling volatility in China's technology sector and capital markets.

Figure 1. China's Debt as a Share of GDP



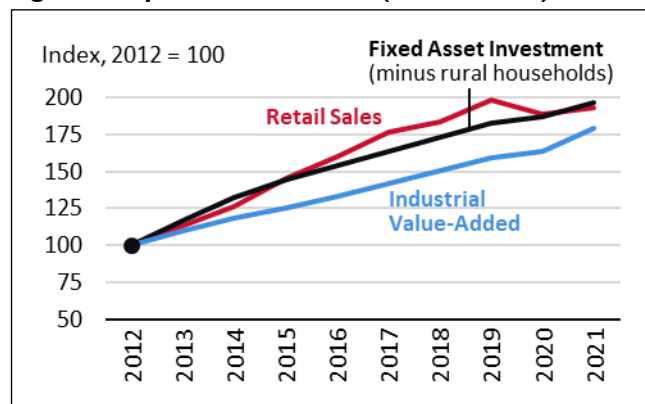
Source: CRS with data from the Bank for International Settlements.

Notes: *Government debt in nominal value. Does not include financial sector debt. Comparable U.S. debt as a share of U.S. GDP was 295.5% in 2020.

Targeted Measures to Boost Growth

The PRC government appears reluctant to further ease fiscal and monetary policies as it seeks to deleverage the property sector and contain market risks. The government is instead using targeted fiscal measures to boost growth, such as value added tax (VAT) rebates for certain exports and tax incentives for research and technology. China faces shortages and rising prices of raw materials, agriculture products, and energy. The government is trying to cap raw materials prices through *de facto* price controls it requires industry associations to set and enforce. In 2021, China's fiscal spending was flat, fixed asset investment grew by 4.9%, and industrial production grew by 9.6%. (**Figure 2**.)

Figure 2. Key Economic Trends (2012 to 2021)



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

A Politburo meeting of senior Communist Party of China (CPC) leaders in December 2021 and the government's work report issued in March 2022 set a "moderate growth"

policy that focuses on stability in employment, finance, trade, foreign investment, domestic investment, and market confidence. This approach involves some monetary loosening, but with strict guidance for banks that aims to moderate lending activity. In July and December 2021, China's central bank, the People's Bank of China, cut the reserve requirement ratio (the amount of money banks are required to hold in reserve as a share of deposits). This freed up an estimated \$190 billion in bank liquidity, but some of the funds are to repay existing loans, limiting their full stimulus effect. In 2022 China also issued \$229 billion in advance quotas for local government special bonds, a key source of infrastructure funding.

Economic Policy Direction

China's 14th Five-Year Plan (FYP) (2021-2025) emphasizes national development priorities in basic research, education, finance, and technology, and calls for \$1.4 trillion in investment over five years in digital infrastructure. Xi is advancing a strong state role in the economy and calling for China's leadership in setting global trade rules and technical standards. China is promoting the extraterritorial scope of its judicial rulings on intellectual property and technology pricing, and its antitrust actions. Since 2020, the government has issued a series of national economic security measures likely to counter U.S. policy actions, including export control and anti-foreign sanctions laws.

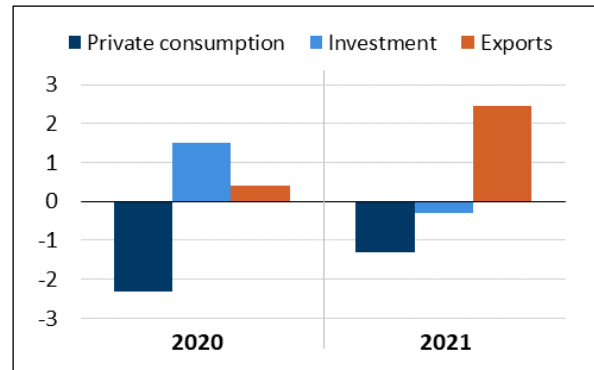
The FYP emphasizes long-standing themes of indigenous innovation, self-reliance, and supply chain security in energy and agriculture (with a focus on biotechnology, genetic resources, and seed technology), while sustaining access to foreign markets, technology, and research. In August 2020, Xi launched a campaign against food waste, signaling concerns about food shortages. The outbreak of the African Swine Flu since 2018, poor harvests, and low yields, have led to shortages of pork, wheat, and soybeans, respectively. China's trade coercion against foreign suppliers, such as Australia, Canada, and the United States, has exacerbated its shortfalls in grain and energy and disrupted global markets as it has ramped up foreign purchases. China's dependence on Ukraine for certain agricultural staples, such as corn, likely further threatens China's supplies. In late 2021, China signed \$30 billion in U.S. liquefied natural gas contracts. It also stepped up large purchases of corn, wheat, and soybean contracts during the same period, including from the United States and Ukraine.

Xi has revived a "dual circulation" policy that China used to address China's economic slowdown during the 2009 financial crisis. Some experts assess the term refers to boosting consumption, but the term is more complex, instead referring to leveraging the dual forces of domestic and global demand, or developing domestic capacity while pursuing openings in global markets. In 2009, China used this approach to subsidize increased production in 13 sectors, while global industry contracted, generating excess capacity that China then exported. China appears to be looking again to trade expansion to drive growth. Its global exports in 2021 rose by 30% over 2020. (Figure 3.) China is also seeking to boost production quality. In May 2021, China eliminated VAT rebates for certain types of steel and lowered import tariffs and raised export tariffs for steel inputs likely to boost prices and promote quality. (The October 2021 EU-U.S. agreement on steel and aluminum

sets new import restrictions based on quality.) China supplies over 50% of global steel; its crude steel production fell by 3% in 2021.

Figure 3. China's Exports Drive Growth

Percentage Point Difference between January 2020 IMF Forecasts and China's Official GDP Data for 2020 and 2021



Source: CRS with data from the IMF.

China's rising costs, COVID-19 restrictions, political crackdowns in Hong Kong, new economic security and data measures, and economic coercion against foreign firms and trading partners are fueling business uncertainty and prompting some foreign firms to diversify production away from China. Russia's invasion of Ukraine increased risk perceptions about China, prompting large capital outflows in March 2022. China is attracting foreign investment in targeted areas (e.g., biotechnology and semiconductors). China has tried to stem appreciation of its currency while advancing a central bank digital currency to influence global finance and diversify from U.S. dollar financing. In December 2021, the Department of the Treasury kept China on its watch list for interventionist currency practices.

Issues for Congress

China's economic constraints could slow certain U.S. exports, sales, and investments while enhancing U.S. leverage as China looks to foreign markets, capital, and technology for growth. Facing shortfalls, China is returning to Australian, Canadian, and U.S. energy and commodity trade. In this climate, Congress might consider whether to:

- Set new terms that advantage the United States vis-a-vis China, including with other countries, to address reciprocity issues; China's statist economic model; PRC state influence in technology, energy, and commodity contracts; and PRC use of trade coercion for commercial and geopolitical gains.
- Evaluate growing U.S. financial flows to China to assess aggregate U.S. exposure, potential risks, and the effects of investments in strategic sectors on U.S. competitiveness.
- Promote private sector investment in the United States and production, technology, research, and financial openings in other markets to diversify and strengthen the U.S. position.

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