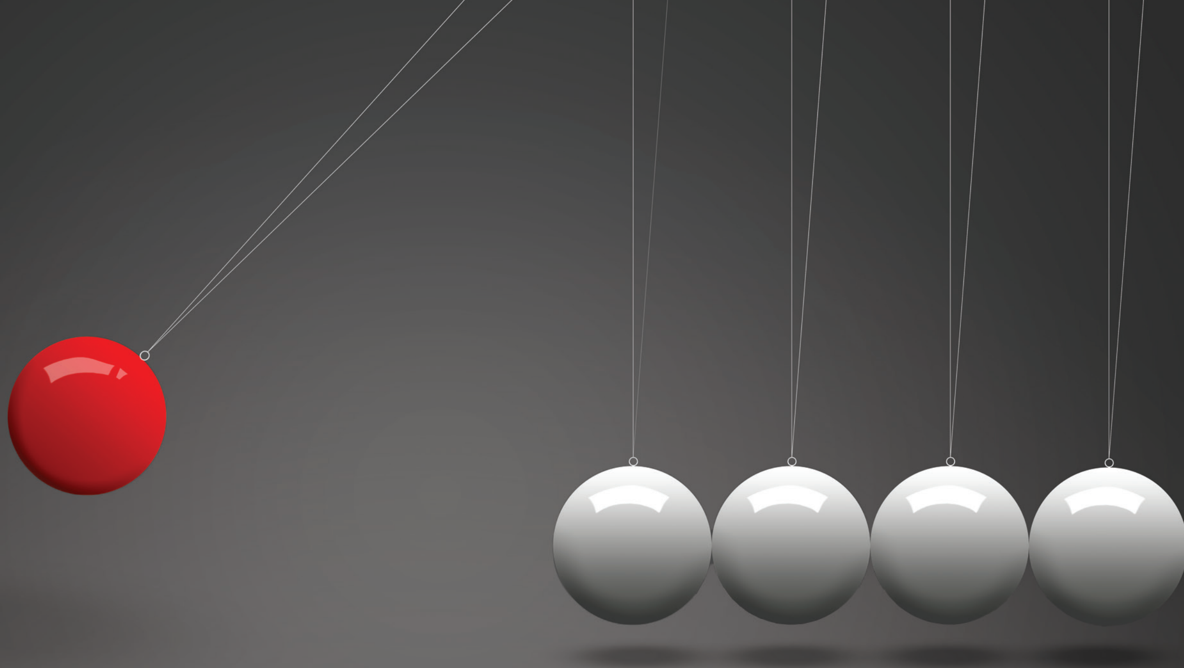

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CHINA ECONOMY FORESIGHTS

HEADING INTO 2021 WITH NEW MOMENTUM AND BOLD GOALS

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Executive Summary

China's economy grew by 2.3% in 2020, ending the pandemic-battered year with a performance that beat most economists' estimates. As the COVID-19 pandemic broke out in Wuhan, the country reacted quickly to the public health crisis, rolling out policies and regulations aimed at pandemic control, economic recovery, and financial easing. These stimulus measures provided ample capital flow to cushion the wide-reaching pandemic impacts across much of China's economy. Despite the economic disruptions, China's economy has shown great resilience through a rapid recovery of factory activities and supply chains, followed by the recovery of exports and domestic consumption.

New economic momentum has emerged from China's economic recovery amid the pandemic. The high-end manufacturing, internet-backed new retail, digitalized services, consumption upgrading, and green economy were the top drivers of recovery in 2020 and will likely continue to drive growth in 2021 and beyond.

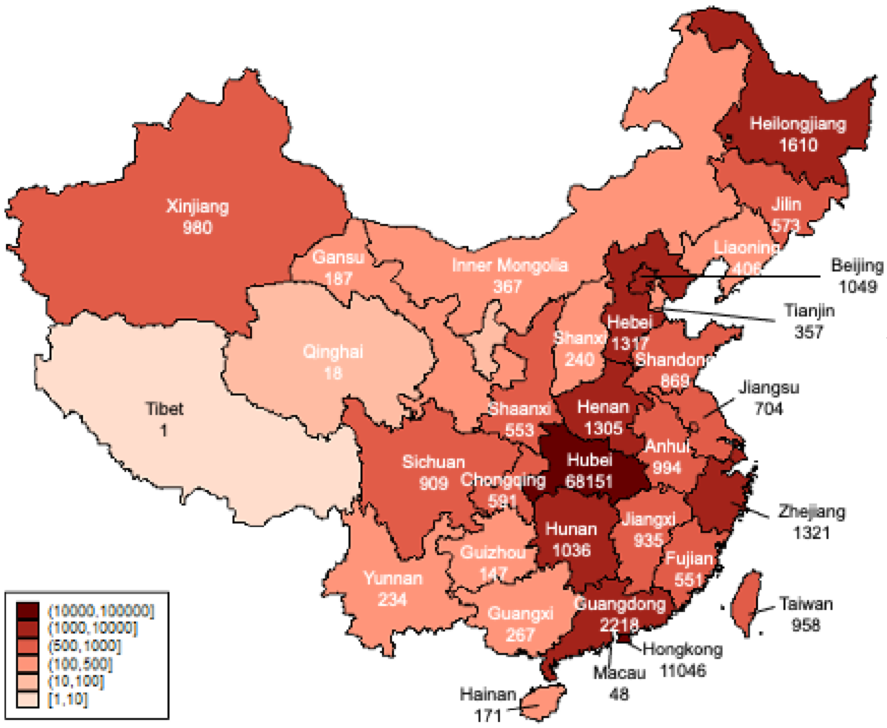
The economic impacts of the pandemic have raised question regarding the global balance of power and in particular the US-China rivalry across trade, high-tech, and geopolitics in general. Despite its economic recovery success, China is bracing for potential challenges to its growth and has been shifting its focus to internal economic drivers. This substantive change in China's macro-economic policy has made economists speculate about how far the world's second-largest economy can go.

China recently announced a conservative GDP growth target of 6% for 2021, below the estimates of most institutional forecasters. This indicates that Chinese policymakers intend to soften the role of a numeric GDP targets. Steady, sustainable, and high-quality growth, rather than absolute growth, have become China's top economic priorities in its new five-year plan.

As of March 2, 2021, China has reported 101,968 cases of COVID-19, with the first reported case detected on December 27, 2019, in Wuhan, the capital city of the province of Hubei, located in central China. Employing strict quarantine measures, China managed to end the first wave of the pandemic by the end of April 2020. Though a second wave emerged around the end of 2020, the reported case numbers were relatively small compared to its first wave. Among all Chinese provinces, Hubei ranked first in total confirmed cases at 68,151, accounting for approximately 67% of confirmed cases nationally, while the other 33% was distributed across the rest of the country. The uneven distribution of cases between Hubei and the rest of China may be attributed to the shutdown of transportation to limit travel in and out of Hubei.

In response to the pandemic, the Chinese government implemented a strict quarantine policy which brought outbreaks under control in only a few months (from January to April 2020), while most of the rest of the world is still struggling. These measures led to the economic contraction of Q1 2020, which was the first instance of negative growth since 1992 when the Chinese government began reporting quarterly GDP figures. Transportation restrictions were also imposed on Wuhan, inhibiting the city's inward and outward travel. Following suit, provinces other than Hubei also implemented their highest-level

TOTAL CONFIRMED CASES



Source: Created by the authors based on data from NetEase virus report.

public health emergency responses. Additionally, health care staff, including doctors and nurses, travelled to Hubei to help fight the pandemic.

Following the strict quarantine and production shutdown, China's economy contracted by 6.8% year-on-year in Q1 2020. The manufacturing sector was hit exceptionally hard, with a year-on-year decline of 9.6%. While production and consumption were both hit by the pandemic, China's consumption took a longer to recover.[1] As COVID-19 grew into a pandemic, global supply and demand were both suppressed. This contraction of international markets enhanced the challenges to China's economic recovery. China's exports were also adversely affected because of decreasing global demand, despite of the growth in foreign demand for medical supplies and working-from-home devises such as laptops and tablets. Additionally, decreasing global supply disrupted China's import of intermediate goods, which brought challenges to China's domestic production. Some observes forecast that this, among other factors, may have advanced China's effort to upgrade its status in global supply chains and innovation, other factors include greater demand in high-tech sectors such as industrial internet[2], artificial intelligence, 5G technologies and online medical and health services.[3]

China's managed to begin its economic recovery in the second quarter of 2020 as China succeeded in bringing the pandemic under control at the end of April 2020. China's overall annual GDP growth reached 2.3% in 2020, making it the only major economy to growth last year. Economic indicators, including industrial production, retail sales, fixed-asset investment, trade and inbound FDI (foreign direct investment) have all undergone steady recovery. Furthermore, the successive decrease of China's unemployment and slower growth of CPI (consumer price index)

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[1] The year-on-year growth of China's industrial production and retail sales in February 2020 were -13.5% and -20.5% respectively. While the industrial production reported a positive year-on-year growth in April 2020 immediately after the pandemic was under control in China, retail sales did not present a positive year-on-year growth August 2020. Over the entire year of 2020, China's industrial production expanded by 2.8% in 2020, but retail sales contracted by -3.9%.

[2] An application of modern internet technology to traditional industrial sectors to make them more automatic and intelligent.

[3] Accelerate innovation to offset the supply chain effects of the pandemic. Xinhua Net. February 22, 2020.

cemented China's recovery in production and supply, which was also reflected in China's PMI (purchasing managers' index), which has remaining above 50% since March 2020.[4]

CHINA'S GDP, YEAR-ON-YEAR GROWTH (%)

Source: Created by authors based on data from China's National Bureau of Statistics

[4] 50% out of the total 100% of PMI is regarded as the prosperity versus depression cut-off point of the economic performance. The economy is on a growth track if PMI exceeds 50%, while otherwise, the economy is in recession.

China's New Economic Trends Amid the Pandemic

NEW RETAIL AND ECOMMERCE[5]

E-commerce has been developing in China for many years. As reported by China's National Bureau of Statistics, the share of online retail sales in China grew from 6.9% in 2013 to 24.3% in 2020. The absolute value of China's online retail sales expanded from RMB 1.2 trillion in 2013 to RMB 7.6 trillion, an almost sevenfold leap. In the year 2020 alone, China's online retail sales expanded by 10.9% even amid a -3.9% contraction of total retail sales. Despite the rapid expansion of online retail, online consumption in the service sector only accounts for about 20% of total online retail. In the post-pandemic era, online consumption of services, such as online medical services and online education, may be the engine of future e-commerce growth in China.

DOMESTIC CONSUMPTION

Despite the contraction in retail sales in 2020 following the outbreak of the pandemic, China intends to increase its reliance on the domestic markets for economic growth. China's export-oriented model has fueled an unprecedented decades long expansion. However, the decreasing global demand caused by the spread of the COVID-19 pandemic reinforced China's ambition to boost domestic consumption. A "dual circulation" strategy, with a focus on "internal circulation", making domestic production and consumption the main drivers of growth, supported by innovation

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[5] New retail refers to the new modes of retail, which applies modern technologies of internet, big data and artificial intelligence to traditional pattern of production, circulation and marketing and combines online service and offline experience.

and upgrades in the economy and "external circulation", was first floated by Chinese President Xi Jinping in May 2020. The new "dual circulation" model aims to reduce China's reliance on foreign markets and to improve its resilience to external shocks. The future growth of China's domestic consumption lies in the combination of offline and online consumption. Online consumption also fits into with China's goal to develop a more digitalized economy.

HIGH-TECH MANUFACTURING SECTORS

In 2020, China's high-tech manufacturing sectors expanded by 7.1% year-on-year, much larger than the year-on-year increase of 3.4% in the aggregate manufacturing sector and 2.8% in total industrial production. Since first announced in 2015, developing high-tech manufacturing sectors has been a key driver of China's economic growth. In the post-pandemic era, the development of high-tech manufacturing sectors will rely more on information technology and digitalization, including artificial intelligence and the internet of things (IoT). Additionally, China will concentrate on upgrading production quality and establishing trustworthy "brands". With the combination of blockchain technology, the internet of things and Q.R. code technology, consumers are able to better track products they purchase, which improves both production standards and consumer confidence. Deploying these technologies will aid both the development of China's high-tech manufacturing sectors and its domestic consumption.

DIGITAL ONLINE SERVICE

In accordance with its ambition to establish a more advanced economy, China absorbed 28.5% more foreign investment in digital online service sectors amid an annual growth of only 4.5%

in total IFDI (Inbound Foreign Direct Investment). Additionally, to fully promote domestic consumption, the Chinese government intends to accelerate investment in digital online service sectors such as remote working services, online healthcare and online education, where demand is yet to be satisfied. The construction of physical facilities comes as a renewed version of China's new infrastructure initiative, which will invest USD $2 trillion over the next five years in projects such as 5G base stations, high-voltage power grids, big data centers, artificial intelligence and industrial internet.[6]

CROSS-BORDER E-COMMERCE AND DIGITAL TRADE

While traditional trade was negatively affected by the pandemic, China's cross-border e-commerce witnessed a year-on-year expansion of 63.3% in the year 2020, with online retail exports exceeding imports. Additionally, China is planning to pay more attention to improve product quality and build trustworthy "brands" so that it can further expand its international market share. Furthermore, digitalization of services trade has accompanied the application of modern digital technology and the increasing demand for remote services, which was especially prominent amid the worldwide spread of COVID-19. As of 2019, digital trade has accounted for over 50% of the world's total services trade. "In the years to come, digital trade will help promote technological sharing and move China upward along the global value chain. In the end, digital trade will be the essential accelerator to establish China's opening up to the outside world as

[6] China's new infrastructure initiative was first unveiled in December 2018 when China set as its priority the development of artificial intelligence, industrial internet and the Internet of Things.

a more developed and comprehensive one." Said Bingnan Wang, the deputy minister of China's Ministry of Commerce.

TRADE WITH BRI AND RCEP COUNTRIES

With China switching to the "dual circulation" model, international trade will gradually be reduced until it is a secondary driver of China's economic growth. This move was partially fomented by the challenges of shrinking global demand caused by the pandemic. However, China still sees opportunities in BRI (The Belt and Road Initiative) and RCEP (The Regional Comprehensive Economic Partnership) countries for trade expansion. China's trade with the BRI countries has been expanding since 2013 and amounted to RMB 9.37 trillion in 2020. The signing of the RCEP in November 2020 provided China with new opportunities. As a member of the RCEP, China will be granted lower tariff rates and be offered a more open regional market in the bloc.

GREEN ECONOMY

The GDP contribution share of China's green economy has been increasing since 2010.[7] The green economy will continue to be a focus of the Chinese government's 14th five-year plan. In the long run, China is planning to peak carbon dioxide emissions before 2030 and reach carbon neutrality by 2060. Despite the progress, China still uses larger amounts of resources for every USD trillion GDP generated compared to other major economies such as the United States and the United Kingdom. Additionally, non-renewable resources such as coal still account for 57.6% of the aggregate consumption of resources in China, which is 4.8 times higher than the United States. To address this issue, China has moved to encourage innovation and improve the ratio of renewable resources used in production. Investments are also encouraged to promote the application of energy-saving products and equipment. Along with production, consumption requires further upgrade toward a green economy as well. Policies such as waste sorting and recycling, expanding public transportation use and promotion of new energy vehicles will continue to reduce consumption driven pollution.

China's Economic Policy Amid & After the Pandemic

Prompt and responsive policies played a substantial role in guiding China's economic recovery in 2020, providing struggling businesses a supportive environment with ample liquidity throughout nearly the whole year. China's major economic policy in 2020 included three key components --the stimulus and relief package, the "dual circulation" strategy, and the demand-side reforms – that reflected the country's varying economic goals at different stages of recovery. The economic stimulus package, lifting China's economy from a recession at the beginning of the pandemic, has laid the foundation of China's expansionary economic policy in 2020 and possibly the post-COVID years. The dual circulation strategy reflected a fundamental change in China's macro-economic policy in response to an evolving

[7] Source from Department of Ecology and Environment of Haitong Securities Institute.

geopolitical environment where China has faced increasing challenges in trade, investment, and international affairs. The demand-side reforms are an analogue of the supply-side reforms, a key component of China's economic policy agenda. The demand-side reform policy is in line with the "dual circulation" strategy, highlighting China's own `super-sized` consumer market. These changes suggest a substantive economic policy shift from the external market to the domestic market and from supply-side regulation to demand-stimulation. This shift will shape China's future economic growth pattern, particularly over the next five years from 2021 to 2025.

Economic policy in China evolved as Beijing's goals changed throughout the pandemic. At the beginning of the COVID-19 outbreak, China rolled out a stimulus package in reaction to the unprecedented economic contraction caused by the pandemic. China's stimulus policy was considered prudent, compared to the U.S.'s unlimited Q.E. (Quantitative Easing) and the record-low interest rate. Drawing on lessons from the stimulus following the global financial crisis of 2008, China has been cautiously averting flood-like stimulus and highlighting financial risk control while injecting massive liquidity into the economy to facilitate recovery. As such, China placed more emphasis on fiscal policy compared to expansionary monetary policy.

Since February 2020, People's Bank of China (PBoC) has taken a conservative stance on monetary tools and kept a cautious rein on interest rates while loosening them only modestly. On the other hand, China vowed bolder moves in proactive fiscal policies to channel funds directly to entities and sectors that had been hardest hit by the pandemic response through tax and fee reduction, direct subsidy, and low-interest loans. Investment and business-oriented fiscal policies targeted small, medium and micro-sized businesses which struggled in acquiring funds from banks.

China's stimulus policies suggest that the country's top priority in economic recovery is on the production side, which noticeably differs from the U.S.'s strong consumption stimulus. The resumption of production and return to work became the priority of China's recovery plan as the COVID-19 outbreak was largely brought under control in late February. This strategy appears to have successfully fueled China's economic recovery in 2020. The resumption of industrial production laid a solid foundation for the recovery of the domestic and global supply chain, leading to a quick bounce back of exports and climbing consumption.

Beyond the effective stimulus policy in response to the pandemic, a fundamental change in China's overall economic policies has emerged. China has started shifting its economic focus towards the internal market. This transition was a prompt reaction to external geopolitical challenges and internal economic changes caused not only by the pandemic but also by problems brought on by skepticism about China's economic growth over the past years. The pandemic-induced economic crisis was a catalyst for the major policy shift towards increasing emphasis on the domestic market and self-reliance in some key sectors. The demand-side reforms, which came under the spotlight recently, are also in line to achieve economic growth through the spurring of consumption.

Given that many Chinese businesses are still in recovery from pandemic-related financial loss, China's political leaders recently vowed not to make a sharp policy turn in 2021 in order to ensure that a continued economic recovery is shored up by persistent, stable and sustainable macro-polices. Fiscal policy will remain active and sustainable while quality and efficiency are the primary objective of government spending. In 2021, the Chinese government is tightening fiscal spending, albeit moderately, for the time being. With fiscal spending reduced, structural regulation and targeted support in key sectors will be policy priority. Medium, small and micro-sized businesses will continue to be supported by preferable tax policies and fee reduction. Policymakers expect to continue to improve employment and living standards through the reallocation of government funds. Monetary policy will likely remain stable, flexible, and targeted with a focus on small businesses finance and risk control in the financial market. At the beginning of this year, PBoC's actions to drain cash from the banking system fueled worries about liquidity tension in 2021. The rise of short-term interest rates and tightening liquidity in February may not necessarily be a signal for monetary tightening, but an attempt to curb market speculation and squeeze bubbles in the financial market.

China's New Geopolitical and Geoeconomic Strategy and How it May Impact the Global Economy

China's evolving economic policy is deeply linked to the changes in its geopolitical position across the world. With the ascent of China's economy as the second largest globally, China's geopolitical and geoeconomic power has changed fundamentally, especially over the past decade. China's foreign policy transformed from keeping a low profile (KLP), or "taoguangyanghui", to striving to achievement (SFA), or "fenfayouwei". Tensions between China and Western economies, especially with the U.S., have been escalating and becoming a focal point of China's foreign relations in recent years. The COVID-19 pandemic has further intensified the US-China conflict. Given the sharp contrast in public health responses and economic restarting, the pandemic also altered China's geostrategic relations with its other major competitors. Amid the pandemic, China and the U.S. have seemingly grown further apart in many respects, including trade globalization, environmental issues, human rights, and political ideology. China-US economic decoupling was a top buzzword in 2020 as the conflicts between the two countries extended from the trade war to technology rivalry and diplomatic tensions. Although a real decoupling, or absolute separation of the Chinese and U.S. economy, is unlikely, China and U.S. tensions will continue and remain a major challenge to China's economic growth over the coming years. Meanwhile, tensions also grew with other trading partners including Canada and Australia, incurring a worsening trade environment with the Western world in general.

With these setbacks, China turned to enhanced multilateralism to develop regional trade and new trade partners to counter the trend of deglobalization. China's effort to strengthen trade relations with countries within the Asia-pacific region and along the BRI was accelerated by the pandemic. In 2020, China saw a significant rise in trade with both ASEAN and the E.U., which surpassed the U.S. to become China's first and second largest trading partners. On the other hand, trade with U.S. and Canada has stagnated since 2019. This is only partially because of the descending diplomatic relations that led to a bilateral trade plunge. The strategic shift of geopolitical and geoeconomic policy underpins China's bid to reshuffle its trading partnerships.

In the post-COVID years, China's trade activities with its top trade partners might be further challenged, indicated by intensifying trade interactions with ASEAN amid the pandemic. The signing of the RCEP and the conclusion of the negotiations for the CAI with the E.U. signal closer trade and investment ties between China and its Asian neighbours and the E.U. Many view this as China's attempt to offset US efforts to restrain China's global expansion. The BRI will remain a significant destination of China's outbound foreign direct investment (OFDI) in 2021, based on a sizeable growth of 18.3% over 2020 even while China's overall OFDI declined by 0.4% year on year. The January-February data also show furtherincreases of investment in the countries along the BRI. Although China has opted for the new "dual circulation" strategy which prioritizes the domestic market, foreign trade is still a key economic driver for China, especially knowledge-intensive service trade which has surged amid the pandemic.

Envisioning New Priorities in China's Future Growth

China's strong economic recovery in 2020 impress the world but also casts doubts on whether growth will continue in the long run. Economists optimistically expected China's GDP to grow at a rate of around 8% in 2021, given that China's economy has been on an upward trajectory since the second quarter of 2020. The "two sessions," China's annual parliamentary meeting, surprisingly announced a conservative GDP growth target of 6% for 2021, which is below the estimation by many institutional forecasters. However, taking the current size of China's economy into consideration, a growth rate of 6% is equivalent to 8% in 2016. Given the uncertainties and challenges the Chinese economy continues to face, the Chinese government is de-emphasizing the role of a numeric economic target in the current and possibly the following years. Steady, sustainable, and high-quality growth, rather growth quantity, is China's top economic priority in the new five-year plan.

While forecasting China's long-term growth pattern is difficult, there are positive economic signals that likely will contribute to sustainable growth in China. Amid the 2020 pandemic, under the pressure of significant changes in China's domestic and overseas economic environment, the Chinese government added major adjustments to the macro policies aimed at supporting "sustainable" and "high-quality" economic growth in the next five years. The "dual-circulation" strategy, designed to boost the domestic market, may help to cement consumption as a driver of China's economy. The new development paradigm envisioned by Chinese leaders may curb the issues that came with China's economic success in the past, such as capitalintensive growth, low-value exports and imported technology. The shift to boosting consumption in China may lead to increased growth since investment and exports have slowed in the past five years. China's new economic plan – the 14th five-year plan, also vows to implement high-level market openness and economic cooperation. More favourable policies are expected to shore up export-related enterprise, especially those that are adapting to innovative trade models empowered by digital technologies.

Overseas investors should also expect improved market openness. Chinese policymakers have announced a further shortening of the negative list that restricts access to specific industries for overseas investment and may also further open the service trade market. China was also reportedly mulling the relaxation of capital controls and allowing its citizens to invest in overseas markets. These all point to an easing financial environment under a two-pronged investment strategy.

Financial risk control is one of the priorities under the relatively loose monetary policy. China had started the deleveraging drive before COVID-19 and resumed it in the second half of 2020 when economic recovery was on track. Economists expected a lower macro-leverage ratio in 2021 and a better balance between economic growth and risk control.

In line with its policy change, China is poised to nurture new growth drivers. The digital economy and green economy are two sectors that have shown tremendous momentum amid the pandemic. The Chinese economy will further move towards digitalization and the promotion of green technology to achieve high-quality and sustainable growth.

At the international level, China appears to be taking a more pragmatic and multilateral approach to foreign policy and continues to expand free trade in targeted regions. In particular, China is focusing on further developing multilateral or regional trade relations with countries mainly located in the Asia-Pacific region.

2021 starts the year of China's transformation from a "high-speed" to a "high-quality" economy, a target set for long-term stable growth over the next two decades, until 2035, when China aims to achieve "socialist modernization". As this occurs, we anticipate several new priorities in China's future economy. First, China's GDP growth in 2021 and the following years may not occur at as high a rate as most economists estimated. China has announced prudent expansion at a target rate of 6% in 2021 in hopes of finding a better balance between economic growth and risk control. Second, science and technology innovation are priorities in China's 2021 agenda and beyond. With significant frictions in this area amid U.S.-China conflicts since 2018, China seems urgent to become self-reliant in select key technologies. To this end, R&D investment will increase at an annual rate of 7% in the next five years. The third potential is the demand-side reforms guided by the "Dual Circulation" strategy. Therein, high-quality supply, new demand, high-end demand, and "rural-urban balanced demand" will be developed to support a comprehensive domestic-demand system. Fourth, the Chinese economy may improve access for overseas investors. Trade and investment with BRI countries, RCEP members, and the E.U. are likely to rise due to the optimism brought about by RCEP and CAI progress. Finally, China is also striving for green and sustainable growth and has set ambitious goals to reduce carbon emissions and expand the clean energy sector.

The pandemic accelerated changes already underway in the world's economy, trade, lifestyle, and most importantly, geopolitics, that appear to give China the opportunity to reshape its internal growth model and the global influence. 2020 brought together both challenges and opportunities for the Chinese economy, sparking a substantive transformation that will not only determine China's future growth trajectory but impact global trade and the global economy. Despite the major challenges such as the US-China tensions and trade decoupling, China's prospects are promising.