KEY POINTS

- The economy of the People's Republic of China (PRC) rebounded fast from the COVID-19 shock. The V-shaped recovery was possible by combining strict virus containment measures with an array of supportive monetary and fiscal policies, while benefiting from strong external demand.

- Though the economic rebound in the PRC was swift, it faced challenges. These include an uneven recovery, rising financial sector vulnerabilities, income inequality, and less emphasis on measures to ensure a green recovery.

- Moving ahead, it is critical to consolidate the economic recovery through policy initiatives that address the highlighted challenges, including efforts to strengthen private consumption and service development, normalize fiscal and monetary policies, and achieve a more inclusive and green recovery.

INTRODUCTION

The outbreak of the coronavirus disease (COVID-19) in Wuhan, People’s Republic of China (PRC), prompted an unprecedented government response to arrest the negative impacts of COVID-19, putting people’s health and welfare first. While effectively containing the spread of the outbreak nationwide, the measures brought the economy of the PRC to a standstill in the first quarter (Q1) of 2020. Strict lockdowns and quarantines disrupted business activities and many enterprises temporarily stopped production. Migrant workers, who account for a sizable share of manufacturing labor, were confined to their provinces unable to return to work. Households scaled back expenditure amid lockdowns and growing health and labor uncertainty.

As a result, the PRC’s gross domestic product (GDP) contracted by 6.8% in Q1 2020, the first decline on record since 1992, and industrial production, retail sales, and investment plunged (Figure 1). The labor market was adversely affected, with the surveyed urban unemployment rate surging to 6.2% in February 2020, a full percentage point higher than at the end of 2019. The cooling in domestic demand was compounded by shorter working hours, further depressing household income.

The sharp economic contraction was followed by a fast rebound driven by industry. Benefiting from changes in global value chains during the pandemic, export orders increased due to high global demand for home office and personal protective equipment, which boosted industrial production, a trend that made the PRC’s economy one of the very few in the world that registered economic growth in 2020 (2.3%).

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The fast recovery also created challenges. The rebound was uneven as industry improved faster than services, and household consumption, dragged by increased precautionary savings, was negative in 2020. The monetary stimulus accentuated vulnerabilities in the financial sector. The impact of the pandemic affected lower-income households disproportionally and the economic recovery fell short of efforts to ensure a green recovery.

This policy brief summarizes the measures and policies that contributed to the PRC’s V-shaped economic recovery, which can serve as valuable information for countries that are fighting the economic shock from the pandemic. The brief will also analyze the abovementioned challenges and provide policy recommendations to address them.

MEASURES AND POLICIES THAT CONTRIBUTED TO THE RECOVERY

This section summarizes (i) the effective pandemic-control strategies adopted by the PRC, such as the targeted lockdowns, strategic reopening policies, and leveraging digital technology; (ii) the monetary and fiscal stimulus measures that spurred the economic recovery; and (iii) the challenges faced by the PRC.

Pandemic-Control, Reopening, and the Role of Technology

Effective pandemic-control strategies. The pandemic-control strategies adopted by the city of Wuhan in late January 2020 restricted the spread of the infectious outbreak nationwide (Figure 2). Efforts included a total city lockdown, mobility restrictions, successful community management, and compulsory quarantines, which effectively contained the infectious outbreak in a few months. In parallel, the PRC increased its testing capacity by scaling up the production of testing kits and reducing the time needed to get the results. The daily testing capacity increased to about 20,000 tests per day from 300 at the beginning of the pandemic, and the time needed for testing reduced from 6 days to a few hours. The approach was replicated nationwide and, by June 2020, cities like Beijing had the capacity to test over a million people per day. The country also accelerated its vaccine development, production, and rollout plans. By June 2021, six vaccines were approved for use, with a capacity to administer over 20 million doses of COVID-19 jabs per day, aiming to fully vaccinate at least 70% of its target population by the end of 2021.

Gradual reopening. Once the number of new COVID-19 infections stabilized in late February 2020, the PRC focused on gradual reopening, allowing essential sectors and low-risk regions to reopen first. Regions were categorized as low-risk, medium-risk, or high-risk based on their exposure to COVID-19. Within them, critical sectors that ensured the supply of functional needs, such as transportation and logistics, were prioritized under strict safety standards. Restrictions on other sectors were gradually lifted based on updated risk assessments and business needs. As a result, in early March 2020, more than 90% of industrial enterprises in 41 cities resumed production, with key industries

![Figure 1: Gross Domestic Product Growth Rate, 2019–2021](image)

Q = quarter, yoy = year-on-year.

![Figure 2: Number of Confirmed COVID-19 Cases](image)

Note: t = 19 January 2020. The numbers added to “t” represent number of days since 19 January 2020.

2 C. Fang, C. Xiyuan, and W. Linlin. 2021. At least 70 pct of China’s target population to be vaccinated by year end. Xinhua. 7 June; and McGill University. COVID-19 Vaccine Tracker.
such as petroleum, telecommunication, power, and transportation operating at 95% of capacity.³

**Technology was key.** Digital technology played a critical role in both the containment of the outbreak and the reopening of the economy. The PRC swiftly developed health QR codes to identify high-risk individuals and trace close contacts of confirmed cases. Differentiated mobility restrictions were imposed for different groups based on their health QR codes. The country also leveraged big data to improve the efficiency of epidemiological investigations and allowed individuals to monitor their own risk levels. Moreover, digital technology was widely used to provide contactless services, such as telemedicine, online education, e-commerce, food delivery, and remote working.

**Policy Actions and Financial Support**
In February 2020, the PRC launched targeted fiscal and monetary stimulus policies to mitigate the adverse impact of COVID-19 on the economy amounting to $2.3 trillion or 16.1% of GDP by the end of May 2021 (Figure 3).⁴ Special policies were deployed to support micro, small, and medium-sized enterprises (MSMEs) to reduce their operational costs—through wider and more affordable access to credit and extended deadlines for qualified loan repayments—and retain employment.

**Fiscal support** to stimulate the economy was multipronged. It consisted of tax cuts and social security contribution exemption, support for infrastructure investment, industry-specific programs, and consumers subsidies. Details are provided below.

(i) **Tax relief and social security contributions exemption.** Tax relief was targeted. For instance, companies involved in the epidemic prevention and control were granted tax incentives. The value-added tax of small-scale taxpayers and vulnerable sectors was exempted or reduced, tax payments of qualified enterprises were deferred, and social security contributions were temporarily waived.⁵ A total of CNY1 trillion in special COVID-19 bonds were issued to strengthen local government finances. Increased public spending and falling revenue due to supportive policies (CNY2.5 trillion cut in taxes and fees,⁶ and CNY1.5 trillion reduction in social insurance contributions)⁷ were effective in fueling the economic rebound, but increased the annual budget deficit by 1.3 percentage points to 6.2% of GDP in 2020.

(ii) **More infrastructure spending.** The quota for new local government special bonds was raised to CNY3.60 trillion in 2020 from CNY2.15 trillion in 2019 to boost public infrastructure development. In May 2020 alone, the issuance of new local government special bonds reached nearly CNY1 trillion, with investments prioritizing building new infrastructure including 5G network, Internet of Things, smart transportation, smart energy, and research facilities.

(iii) **Industry-specific support.** Overall, the industrial sector benefited by service fee reductions, such as lower electricity and internet broadband rates. For industries that were hit hard by the pandemic, specific polices were designed, including incentives for car sales, favorable tax policies for the film industry, fee reductions for shipping and aviation industry, and higher tax rebates for exporters.

(iv) **Consumer subsidies.** The PRC’s plan to boost consumption was more modest than the one adopted to stimulate production, leading to the slower recovery of household consumption. Main initiatives consisted of vouchers to stimulate consumption with over CNY6.5 billion in consumer vouchers distributed by local governments in 42 cities by April 2020 to boost spending and incomes.⁸

**Monetary policy** aimed to expand credit and reduce the financing costs for the real economy. Measures included reduced interest rates, increased non–interest rate instruments, and relaxation of

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⁸ S. Leng. 2020. Coronavirus: China voucher scheme to revive retail hits the buffers, sparking debate about cash payments. 14 May.
selected financial regulations. The approach proved effective in supporting credit growth and mitigating the adverse impact of COVID-19 on the economy. Short-term interbank rates went down and credit to the real economy increased. By the end of 2020, the total social financing outstanding—a broad credit aggregate—expanded by 13.3% compared to 10.7% a year before. The following paragraphs provide more details.

(i) Policy rate cuts. The central bank injected liquidity into the market through open market operations and cut various policy rates to lower financing costs. Examples included (a) reduction in the 1-year medium-term lending facility (MLF) rate by 20 basis points and the targeted MLF rate by 20 points; (b) cut in the 7-day and 14-day reverse repo rates by 30 basis points; (c) rate cuts in the relending facility by 50 basis points and by 25 points in the rediscounting facility; and (d) reserve requirement ratio (RRR) cuts for small- and medium-sized banks (totaling 100 basis points), targeted cuts in the RRR by 50–100 basis points for medium-sized and large banks that meet inclusive financing criteria supporting small enterprises and micro businesses, and an additional 100 points cuts for qualified joint-stock banks (footnote 5).

(ii) Non-interest rate instruments expansion. The central bank expanded non-interest rates instruments to support certain sectors and enterprises. Key measures included (a) widening the use of its relending and rediscount facilities (CNY1.8 trillion) in agricultural business, selected manufacturers, and MSMEs; (b) a new credit support instrument (CNY400 billion), whereby the central bank purchased qualified local banks’ new loans to micro businesses and small enterprises; and (c) a program (CNY40 billion) to subsidize qualified loan repayments (footnote 5).

(iii) Relaxation of financial regulation. The provision coverage requirements for nonperforming loans (NPLs) provision coverage requirements were reduced, and the tolerance for NPLs increased for banks to increase lending despite weaker economic growth. Local governments could use CNY200 billion in proceeds from local government special bonds issuance to recapitalize qualified small- and medium-sized banks. In addition, the transitional period of the 2018 asset management reforms was postponed by a year to the end of 2021.

Challenges
The economic rebound in the PRC was swift but faced challenges. These include an uneven recovery, rising financial sector vulnerabilities, income inequality, and a missed opportunity for a greener recovery.

The recovery was uneven. Investment, industrial output, and exports triggered the recovery in Q2 2020. In contrast, the contraction in consumption and slow rebound in services, two important sources of growth in the economy, slowed down economic growth in 2020. This is partly because of the modest consumption stimulus plan, which accounted for less than 1% of the country’s total COVID-19 policy package and the severe impact of the pandemic on key services, such as accommodation, catering, and transportation, which were hit hard by lockdowns and mobility restrictions (footnote 4).

Financial risks increased. The government call for more infrastructure spending and support for credit expansion, underpinned by increased local government special bonds, led to a higher level of debt. The general government debt increased by 9.7 percentage points up to 67.1% of GDP in 2020. In addition, the relaxation of selected financial regulations (e.g., loosening NPL recognition standards) added risk to the financial sector. According to the central bank’s estimates, the NPL ratio of banks could reach 5.49% by the end of 2021, up from 1.84% at the end of 2020.10

Income inequalities likely widened. The pandemic has likely worsened income inequality as it affected income groups differently, as suggested by the fast recovery of high-end consumption, such as luxury goods and cars.11 High-income groups are likely to work in sectors less affected by COVID-19, e.g., information technology and finance. Also, they could resume work quickly by making use of home office arrangements. In contrast, low-income workers in the hardest-hit sectors, especially migrant workers, faced job losses during lockdowns or lower income growth due to weak domestic demand. For instance, the average income for migrant workers increased by only 2.8% in 2020, much lower than the 7.8% increase a year before.

Environmental challenges persisted. The COVID-19 shock led to a temporary reduction of air pollution and energy consumption with lower greenhouse gas emissions, and fine
particulate matter ($PM_{2.5}$) concentration levels in 168 cities fell by 12% in 2020. However, as the economy rebounded and GDP growth was prioritized, the share of green spending in the PRC’s recovery measures was comparatively low at 12% compared to those of advanced countries such as Canada (75%), Germany (47%), and France (38%).

**POLICY RECOMMENDATIONS**

Moving ahead, it is critical to consolidate the economic recovery by adopting policy initiatives that address the challenges, including efforts to strengthen private consumption and service development, policy normalization, and an inclusive and green recovery. The following policy recommendations are proposed.

**Rebalancing of the Economy**

**Boost household consumption.** The impact and uncertainty brought about by the pandemic increased households’ precautionary savings, pushing national savings to 45.7% of GDP in 2020, from 44.1% a year earlier. While a larger consumption stimulus package can stimulate consumption in the short run, improved social protection is needed to reduce precautionary savings and support household consumption in the long run. Support should be targeted to vulnerable groups, including migrant workers and the unemployed. These policies can include lower social security contribution rates, conditional cash transfers, increased unemployment benefits, job training, and more affordable access to health care.

**Foster service sector development.** The service sector was hit hard by the pandemic, which reduced its contribution to GDP growth from 63.5% in 2019 to 47.3% in 2020. As the sector employed about 48% of the labor force in 2020, the contraction depressed the labor market. Given the importance of services as a source of growth and employment, it is essential to support the sector’s development, in particular with policies and investments focusing on high-value services (i.e., information technology, health care, education, and professional services). In this pursuit, the sector will also benefit from increased productivity, which can be achieved by a greater opening-up and liberalization of the sector that remains highly regulated and suffers from excessive red tape.

**Narrow the income inequality gap.** Besides continued efforts to support the vulnerable, moving toward a more comprehensive personal income tax could make the tax system more progressive and equitable, thus helping reduce income inequality. At the same time, reforms in central–local government relations are needed to address local governments’ fiscal pressures. Such reforms include higher transfers to economically weaker local governments as well as improved local government own-source revenue by granting local governments limited taxation power, e.g., related to a local recurrent property tax.

**Policy Normalization**

**Withdrawal of monetary stimulus.** As the recovery consolidates, the PRC should step back the monetary stimulus while ensuring financial stability. This requires (i) a clearly communicated gradual tightening of monetary policy; (ii) a phased exit of lending targets for banks and moving toward a unified interest-based monetary policy; (iii) tightening of financial regulation and supervision, including stricter NPL recognition standards and strengthened bank capitalization; (iv) selective policy tightening on high-risk sectors, while keeping policy support for MSMEs; and (v) resumption of the financial regulatory reforms that were delayed during the pandemic, including the asset management reform.

**Fine-tuning fiscal policies.** Accelerated fiscal consolidation and more targeted fiscal support will help to absorb the increased debt that followed the stimulus package and increase inclusiveness. Measures could include (i) gradually reducing infrastructure spending financed by local government special bonds and tightening off-budget borrowing; (ii) prioritizing public expenditure toward hard-hit sectors, social protection, and green projects; and (iii) increasing fiscal revenue by making the personal income tax more progressive and rolling out a nationwide recurrent property tax.

**Green and Inclusive Recovery**

**Prioritize inclusive recovery.** The combined health and economic crisis highlighted weakness in the country’s basic systems, including a low public spending on health care (public health care expenditure accounts for 2.9% of GDP in the PRC compared to 6.5% across member countries of the Organisation for Economic Co-operation and Development), inadequate social protection, and the lack of a progressive taxation system, which accentuated inequality during the

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12 Spending is classified as green if it is likely to reduce greenhouse gas emissions, reduce air pollution, and/or strengthen natural capital. Oxford University Centre for the Environment. Global Recovery Observatory (accessed 23 June 2021).

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