Box 4: Rebalancing of the Chinese economy – an overview

Following the ending of the 'zero-Covid' policy late last year, the post-pandemic rebound in the Chinese economy has been much more subdued then initially assumed. Given extensive macro-imbalances, there is now mounting concern that this loss of economic momentum portends a more significant structural adjustment that could weigh on activity for some time.

As the world's second largest economy – with extensive cross-border trade (including in commodities), investment and financial links – China is a key fault-line for the global economy, and the effects of any significant rebalancing could potentially ripple through the global economy. OECD analysis, for instance, shows that a 3 per cent fall in Chinese domestic demand (vs baseline) would reduce global growth by 0.6 percentage points.^

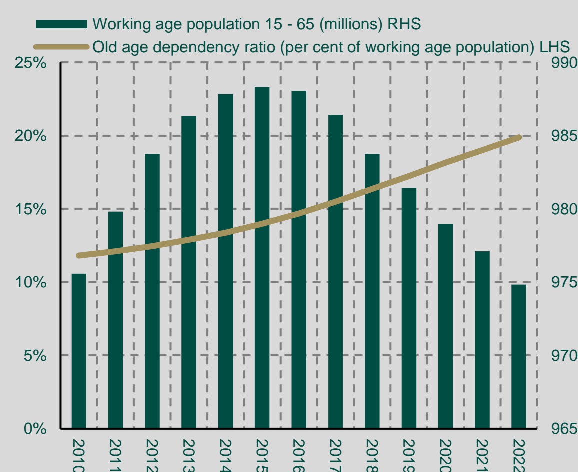
The root cause of macroeconomic imbalances in China is sometimes traced to China's national savings rate. For any economy, the national savings rate is a key variable: it is the amount of disposable income (of households, government and corporates) that remains once current consumption (public and private) has been financed. In the national accounting framework, it is the total amount available to finance domestic investment; any excess of savings over domestic investment is channelled abroad by running a balance of payments surplus and *vice versa*.

Data from the *World Bank* show that the national savings rate in China has been of the order 40-50 per cent for a number of decades;^^ no other high- or middle-income country saves at this rate. Much of these savings originate in the household sector and appear to be largely for precautionary reasons: *inter alia* the absence of a social safety net and high levels of job insecurity. Demographic changes (**figure 9A**) as well as high levels of income inequality also contribute to high levels of household savings.

High levels of Chinese domestic savings were intermediated through the financial system (including through the 'shadow banking' system) to finance high levels of domestic capital formation: the rates of return were sufficiently high for many decades (given the initial, under-developed capital stock). After several decades of rapid, 'catch-up' growth, however, domestic savings in recent years have been absorbed by investment projects subject to decreasing returns.

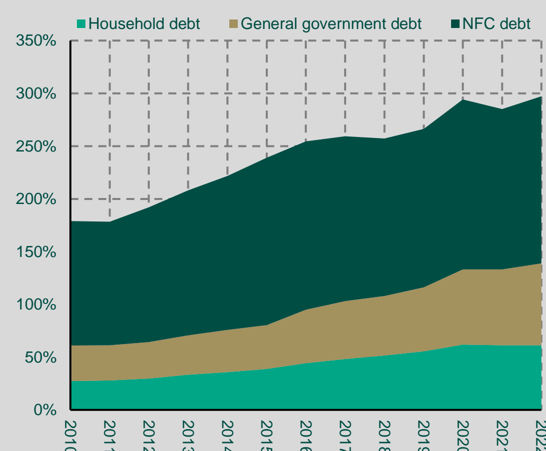
Figure 9: Key structural trends in the Chinese economy

A: Demographic trends in in China



Source: World Bank, 2023

B: Evolution of debt in China



Source: Bank for International Settlements, 2023

In other words, the continued expansion of the Chinese economy over the past decade or so was increasingly reliant on capital spending (investment) rather than current spending (consumption), with a deterioration in investment quality with ever-more concentration in unproductive investment such as real estate and property.

Investment in assets characterised by low rates of return and financed by debt accumulation ultimately leads to a rise in the debt-income ratio (**figure 9B**) and, over the past year or so, evidence of debt stress has emerged – notably in the property-development sector and the local government sector.

The rebalancing of the economy will require a downsizing of the construction sector – a major drag on activity. In order to keep aggregate demand at levels consistent with aggregate supply (in other words to avoid an increase in unemployed workers and capital), it will be – by definition – necessary to either boost consumption (i.e. to lower savings) or to substitute foreign demand for domestic demand (by increasing its external surplus even further).

---

^ OECD interim economic outlook, September 2023, available at: https://www.oecd-ilibrary.org/sites/

^^ See slide 7 in: "The economic and budgetary situation – a stock-take", ESRI Budget Perspectives Conference, 15th June 2023 https://www.gov.ie/pdf/?file=https://assets.gov.ie/