

Ensuring Security, Protecting Livelihoods, and
Seeking Long-Term Development:
A Strategic Analysis of the Economic
Situation During the COVID-19 Pandemic

*Presented by the Institute for National and Global Governance
and the Academic Center for Chinese Economic Practice and Thinking
(ACCEPT) of Tsinghua University*

Pandemic Research Group of the Academic Center for Chinese Economic
Practice and Thinking, Tsinghua University

(Li Daokui, Li Keaobo, Li Bing, Lu Lin, Guo Meixin, Feng Ming,
Xu Xiang, Shi Jinjian, Wu Shuyu, Chen Dapeng, Zhang Chi, Zhang He, Lang Kun)

April 18, 2020

Ensuring Security, Protecting Livelihoods, and Seeking Long-Term Development: A Strategic Analysis of the Economic Situation During the COVID-19 Pandemic

Pandemic Research Group of the Academic Center for Chinese Economic
Practice and Thinking, Tsinghua University

(Li Daokui, Li Keaobo, Li Bing, Lu Lin, Guo Meixin, Feng Ming,
Xu Xiang, Shi Jinjian, Wu Shuyu, Chen Dapeng, Zhang Chi, Zhang He, Lang Kun)

April 18, 2020

As the largest public health event in a century, COVID-19 has had a huge impact on both global production and people's lives. It is expected that this year, the global economy will experience negative growth for the first time since World War II. This report argues that COVID-19 will greatly accelerate major historical processes—long-term shifts in the global environment that would have normally taken ten to twenty years may now be compressed into two or three years, and the external environment may be worse than any period since reform and opening up. The fundamental indicator of the major changes now occurring is the relative decline of the United States and the rise of emerging countries. At present, American society is severely divided by raging social conflicts. The United States is also losing its global influence, shifting from the role of a rule-maker and balancer of global interests to a self-centered and isolationist stance. After the pandemic, the United States is likely to publicly attack China and create obstacles to China's development, thereby covering up its own mistakes in pandemic prevention and control and redirecting domestic discontent. The current globalization pattern will soon end, and as the biggest beneficiary of globalization, China must make comprehensive preparations and design policy responses with the worst-case scenario in mind.

At present, China is still one last step away from crossing the middle-income threshold. In order to cope with future changes, it is necessary to understand the current state of China's economy and craft appropriate responses. This report argues that the Chinese economy is now in the middle and late stages of industrialization, the middle stage of urbanization, the critical period of industrial upgrading, and the deepening period of informatization. Whether the domestic demand potential contained in these four stages can be successfully released will be the key to the steady future growth of China's economy and the accomplishment of its two centenary goals.

Our research institute's report released on February 21 stated that the novel coronavirus is different from SARS, which was possible to completely eliminate in a short period of time. In

contrast, the threat of COVID-19 may be reduced, but it will continue to exist for a long time. Therefore, active resumption of work is the most effective method to ensure a successful “protracted war” against the virus. When the virus had not yet spread abroad on a large scale, it was estimated that the outbreak would be brought under control between the end of the first quarter and the second quarter. Under the assumption that the government would proactively respond to the pandemic, the impact on economic growth was expected to be about -0.17 to -0.36 percent. However, the rapid spread of the virus around the world and the slow response to the pandemic in Europe and the United States have caused large-scale stagnation in the entire world economy, which in turn has severely affected China’s resumption of work, foreign trade, industrial chains, and many other economic factors. Based on the current bleak outlook, our prediction is that without policy stimulus, the annual GDP growth rate will be 1.9%.

Considering the possibility of the rapid deterioration of the international environment in the next two to three years, this report proposes that the core of China’s economic work during this time should focus on three areas. First, ensuring security in key areas such as food, oil, industrial chains, and finance. Second, protecting people’s livelihoods through efforts to ensure the income of low- and middle-income earners, support small and medium-sized enterprises, stabilize employment, and boost automobile consumption. Third, seeking long-term development through a series of market-oriented reforms, including the reform of state-owned enterprises and the reform of the factor market. Domestic demand should also be cultivated and released through the doubling of the middle-income population so as to provide an impetus for the medium and long-term development of the Chinese economy.

This report emphasizes that this year’s economic growth target should not be set too high. If policy is still implemented in accordance with the original growth target despite a global crisis, there will be insufficient policy space to work with in the next two to three years. As the external environment continues to deteriorate through the pandemic, China will still be experiencing the side effects of previous stimulus policies, and thus will be placed in a passive position. Based on this analysis, we recommend doubling the per capita disposable income of urban and rural residents this year. Keeping in mind that the GDP growth target should especially consider the need to ensure employment, we recommend setting the target at 3-4%.

This report will systematically analyze the development and likely conclusion of the pandemic, the impact of the pandemic on finance and the economy on both a domestic and international scale, and give relevant policy recommendations.

Table of Contents

I . The Global Pandemic is Still Accelerating, and the United States and Europe Have Become the Epicenter	5
1.1 Analysis of the Current Pandemic Situations in Key Countries and Regions	7
1.1.1 The United States: New cases have peaked, and the situation is severe.	7
1.1.2 Europe: There have been outbreaks in many areas, and prevention and control have markedly improved.	9
1.1.3 Japan and South Korea: The risk of imported cases is increasing, but the pandemic is controllable overall.	11
1.1.4 South and Southeast Asia: There is insufficient medical care and a sharply rising risk of outbreaks.	13
1.2 Outlook: When and How Will the Pandemic End?	15
1.2.1 Two major uncertainties in the development of the pandemic exist: prevention and control efforts + vaccines and treatments.	15
1.2.2 There are varying prospects for the future of COVID-19 in key countries and regions.	17
II . Analysis of the Global Economy.....	20
2.1 The Status Quo of Finance and the Global Economy	20
2.1.1 World economic growth is weak, and the negative impact of the pandemic is significant.	20
2.1.2 Waves of anti-globalization are rising, and the international outlook is complicated and grim.	23
2.2 Will COVID-19 Lead to a New International Financial Crisis?	25
2.2.1 How should we define a “financial crisis?”	25
2.2.2 Will COVID-19 cause a financial crisis?	27
2.2.3 Potential consequences of global credit expansion	30
2.3 The Impact of COVID-19 on International Trade.....	31
2.3.1 COVID-19 will strengthen the international commodity “tripartite confrontation” trade structure.....	31
2.3.2 The impact of COVID-19 on China's international trade.....	32
III. Analysis of the Domestic Economic Situation.....	34
3.1 China's Current Stage of Economic Development.....	34
3.1.1 China is in the middle and late stages of industrialization.	34
3.1.2 China is in the middle stage of urbanization.	35
3.1.3 China is in the critical period of industrial upgrading.	37
3.1.4 China is in the deepening period of informatization.	39
3.2 2020 Economic Growth Target	40
3.2.1 Our GDP growth forecast without stimulus measures	40
3.2.2 Estimation of policy stimulus measures required under the two growth targets....	40
IV. Response Measures: Ensuring Security, Protecting Livelihoods, and Seeking Long-Term Development.....	41
4.1 Ensuring Security: Protecting the Foundation of China's Economic Development.....	42
4.1.1 Emphasizing food security and guarding against the risk of a sharp rise in	

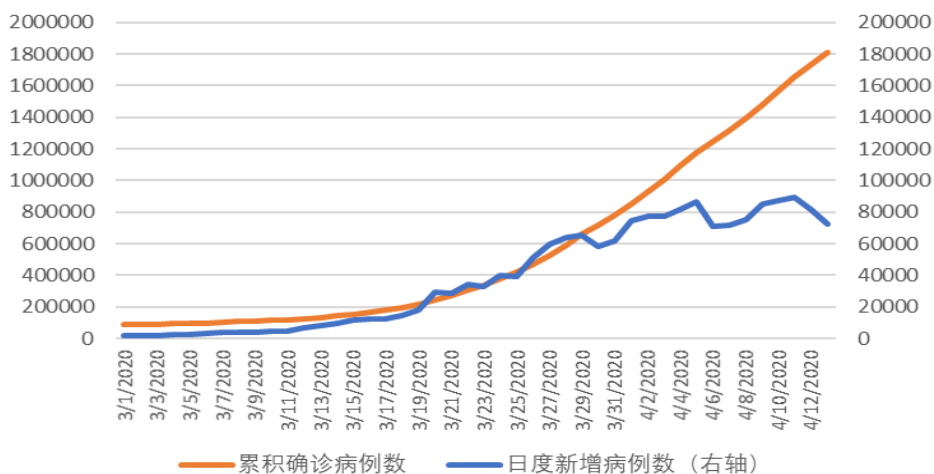
international food prices.....	42
4.1.2 Strengthening oil security, speeding up the construction of oil reserves, and preventing waterway transportation risks	43
4.1.3 Ensuring the security of the East Asian industrial chain and preventing the risk of rupture	43
4.1.4 Safeguarding financial security and promoting two-way openness in finance	45
4.2 Protecting Livelihoods: Stabilizing Employment and Guaranteeing Income Growth	47
4.2.1 Due to COVID-19, China faces increasing pressure on its fiscal balance.	47
4.2.2 Fiscal policy will play a leading role in responding to COVID-19 and promoting economic revitalization.	49
4.2.3 Stimulus policies should be implemented to ensure the livelihood of low- and middle-income groups and the survival of small and medium-sized enterprises so as to avoid excessive government investment.	51
4.2.4 We must reduce policy restraints on the automobile industry and allow it to drive consumption.	54
4.3 Seeking Long-Term Development: Cultivating the Market, Developing Domestic Demand, and Striving to Double the Middle-Income Group	58
4.3.1 We can create great potential for urbanization by reforming the land and household registration systems.....	58
4.3.2 Non-performing assets should be quickly handled and replaced in a highly leveraged environment.	62
4.3.3 We must pragmatically promote the two-way opening of finance and realize the internationalization of the RMB.....	64
4.3.4 We must develop a plan to double the middle-income group and tap medium- and long-term domestic demand.....	66
V. Summary.....	70

I. The Global Pandemic is Still Accelerating, and the United States and Europe Have Become the Epicenter

Compared with SARS, COVID-19 is both more contagious and more difficult to detect. It is highly likely that resurgences of the virus will occur, making pandemic prevention a protracted battle. Humans must adapt to the existence of the virus and actively resume production once the pandemic is basically controlled.

The World Health Organization (WHO) declared the novel coronavirus outbreak a public health emergency of international concern (PHEIC) on January 30 and upgraded it to a “pandemic” on March 11. According to the WHO, as of April 13, cumulative confirmed cases worldwide have exceeded 1.77 million, with more than 110,000 deaths in over 200 countries and regions. On the whole, the global pandemic is at the pinnacle of the outbreak, and the number of daily new cases has shown signs of peaking (as shown in Chart 1).

Chart 1 Global Pandemic Development (March 1 to April 13)



Source: ECDC, <https://ourworldindata.org/coronavirus>

Translation of Chart Text

Orange: Cumulative Confirmed Cases

Blue: Daily New Confirmed Cases

However, the future development of the pandemic is still uncertain, and it will take a long time for cumulative confirmed cases to peak and decline. One uncertain factor is control of the pandemic—whether the current strict quarantine policies of various countries can be sufficiently implemented and how long they can last, and whether international cooperation in pandemic prevention can be effective. The other uncertainty is the development of vaccines and treatments, including both research and development of new drugs and testing of traditional drugs. For now,

due to the highly infectious nature of the novel coronavirus, its long incubation period, the difficulty of identifying potential asymptomatic patients, and the fact that vaccines and treatments are difficult to develop and distribute in the short term, **the pandemic is highly unlikely to disappear soon.** Based on the trend of the global pandemic as a whole, we believe that **the pandemic will most likely last into the next year. The virus will become weaker during the summer and recur in autumn and winter, and with the launch of vaccines and treatments after next spring, it will be gradually alleviated. This outlook emphasizes the importance of coordinating pandemic prevention and control as well as economic and social development. The world will face a protracted war requiring constant adaptation.** On one hand, the prevention and control of the pandemic cannot be won in a single battle. We must be prepared for a protracted war and implement normalized pandemic prevention and control measures. On the other hand, the economy cannot shut down for an extended time, and society cannot maintain social distancing forever. As the pandemic peaks and declines, the global economy will face a great challenge of adaptation—that is, adapting to the characteristics of the pandemic and promoting the comprehensive and orderly restoration of production and daily life against the backdrop of normalized pandemic prevention and control.

Of course, various countries and regions are at different stages of pandemic development, and their individual situations must be addressed accordingly. Since the outbreak of the pandemic in **China**, governments at all levels have taken strong measures such as halting production in enterprises across the country, quarantining residents, and admitting all suspected and confirmed patients to the hospital. So far, China's pandemic prevention and control efforts have made significant progress and the focus is now on preventing imported infections and domestic resurgence. The key is to prevent and control the pandemic while promoting economic and social development, meaning to accelerate the full restoration of production and daily life while executing normalized pandemic prevention and control. Most areas are likely to resume normal business activities and life by the end of April. **South Korea** has also effectively controlled the pandemic through early detection, isolation, and treatment. As long as the risk of imported cases is controlled, the pandemic there will end before summer. **Japan** successfully controlled the spread of the virus in the early stages, but the pandemic has reemerged there since April, and some parts of Japan have now entered a state of emergency. Despite the risks of local transmission and imported cases, Japan's prevention and control policies will be flexibly adjusted according to the development of the pandemic, so the overall risk is controllable. The situation in **Southeast and South Asian** countries is uncertain due to insufficient testing. The dense populations and poor medical conditions of these regions also increase the difficulty of pandemic prevention and control. However, as local measures continue to improve and China's donated supplies are put to use, coupled with good weather there, our judgement is that these countries are also expected to basically prevent and control the pandemic within three months. However, the situation in **the United States and European countries** is not as optimistic as in Asian countries. The pandemic may not be effectively controlled by this summer, and there might be a second wave in autumn and winter. April is a key window for the United States to address the pandemic. COVID-19 has already shown signs of a peak in the US, but there is still great uncertainty about how the situation will develop. This report posits that the number of new cases in the United States has peaked and will gradually decline thereafter, but it will take a significant amount of time for the total number of cases to peak. It will be difficult to bring the pandemic under control before summer, and secondary outbreaks may occur in autumn and winter.

The US may need to rely on vaccines or drugs to control the pandemic. If vaccines and drugs are successfully developed, the COVID-19 outbreak in the US will end in 2021, but otherwise, the pandemic may continue until 2022 or even longer. In Europe, some countries (such as Germany) have already prepared for a protracted war. The official statement of Germany has been to resume work in accordance with a two-year anti-pandemic plan. As we can see, some countries are pinning their hopes on a mild quarantine policy and partial suspension of production to gradually control the pandemic over a relatively long period of time.

1.1 Analysis of the Current Pandemic Situations in Key Countries and Regions

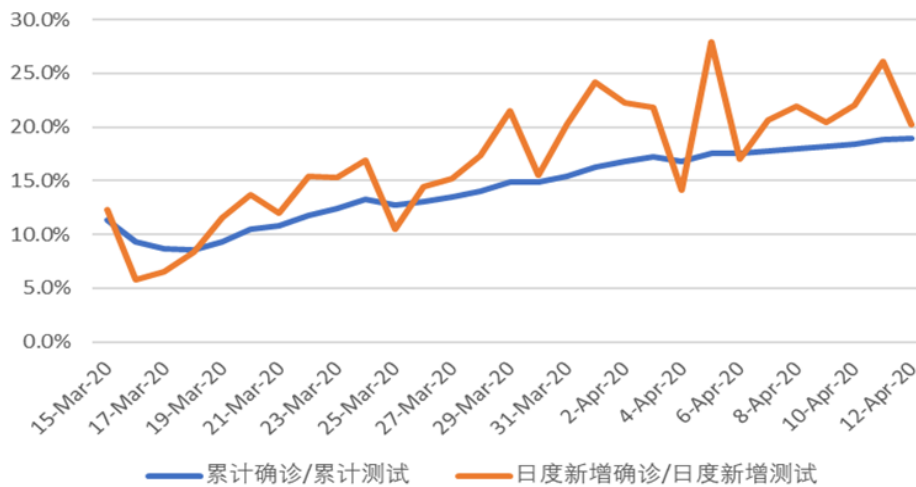
1.1.1 The United States: New cases have peaked, and the situation is severe.

The United States has become the new epicenter of COVID-19. According to data from Johns Hopkins University, as of April 12, there have been more than 560,000 confirmed cases and more than 22,000 deaths in the US—the most in the world for both figures. All 50 states in the United States have entered Major Disaster Status as delineated by the Federal Emergency Management Agency (FEMA). On March 28, the US Centers for Disease Control and Prevention (CDC) issued a “travel warning” for New York, New Jersey, and Connecticut, requesting people to avoid traveling to these areas. **At present, the US pandemic is still severe and has shown signs of a peak.**

Testing capacity has increased and the number of daily new cases has basically stabilized, but the situation varies greatly from state to state. On March 18, the total number of tests in the United States was only 81,000. This number increased to around 200,000 on March 22, over 480,000 on March 26, over 850,000 on March 30, over 1.5 million on April 3, and over 28 million on April 12. With this progress in testing capacity, the number of confirmed cases has also risen sharply, but the number of daily new confirmed cases has basically stabilized in recent days. According to the WHO, from April 8 to April 13, the number of daily new cases in the United States essentially held steady at around 30,000 (the exact figures were 29,510, 31,709, 30,859, 35,386, 31,606, and 31,633 respectively). At the same time, the COVID-19 positivity rate in the United States has also shown signs of peaking. The two indicators of “newly confirmed cases per newly performed tests” and “cumulatively confirmed cases per cumulative tests” have initially shown a stable trend (see Chart 2). The current positivity rate in the United States is at the global average level.¹ However, from a horizontal perspective, the situation varies greatly among states. New York, Washington, California, Louisiana, Pennsylvania, and other states that have been hit hard are currently in possession of a large number of tests. Their number of daily new cases has reached a peak before declining. However, New Jersey and other states in the midst of an outbreak do not have sufficient testing capabilities (as of April 12, the total number of tests was 127,000, of which 62,000 were positive, with a positivity rate of nearly 50%). Some states with less serious outbreaks also have only a small number of tests (as of April 12, there were only 5,571 tests in Wyoming, and in South Dakota, 8,553).

¹ <https://ourworldindata.org/grapher/covid-19-total-confirmed-cases-vs-total-tests-conducted>

Chart 2 The Rate of Positive COVID-19 Tests in the US



Source: <https://ourworldindata.org/grapher/covid-19-total-confirmed-cases-vs-total-tests-conducted>

Translation of Chart Text

Orange: Cumulative Confirmed Cases/Cumulative Tests Blue: Daily New Confirmed Cases/Daily New Tests

The production and supply of key medical materials are gradually increasing, but there may still be shortages. The Trump administration has officially used the Defense Production Act to coordinate the production of critical medical supplies and equipment. The US Food and Drug Administration (FDA) has also issued an “Emergency Use Authorization” for ventilators, allowing similar equipment to be transformed into ventilators for clinical treatment. There are currently approximately 175,000 ventilators available in the US health care system. Before the pandemic, there were approximately 50,000 Intensive Care Units (ICU) in the United States, and the US CDC estimates that this number could go up to 100,000. China’s experience shows that about 20% of confirmed cases will require hospitalization, and about 5% of cases will develop into severe cases. Assuming that the US health care system can devote half of its medical resources to responding to COVID-19 (meaning that all new resources are used for coronavirus patients), the existing ICU beds in the US can handle 50,000 severe cases—corresponding to 1 million confirmed cases—at the same time. In terms of total numbers, this is a feasible task for the US healthcare system. However, due to difficulties in the cross-regional mobilization of medical resources, the health care systems in hard-hit states may struggle. For example, New York fought to obtain ventilators from all over the country during its outbreak, and now it is still barely able to meet the needs of seriously ill patients.² Meanwhile, states with active outbreaks, such as New Jersey, are experiencing a severe

² <https://nypost.com/2020/04/12/de-blasio-says-nyc-has-enough-ventilators-ppe-for-coming-week/>

shortage of critical equipment such as ventilators. As of April 11, there were only 61 ventilators left in New Jersey.³ At the same time, the shortage of professional medical staff should not be overlooked. Equipment can be mass-produced, but professional medical staff cannot be trained in a short period of time. For example, only 7,713 physicians in New York State are licensed to operate a ventilator.⁴

Stricter isolation measures have been implemented, but the flow of people across regions is difficult to control. The US government has issued social distancing policies throughout the whole country, mainly prohibiting people from gathering, closing non-essential public places, etc. These policies are to be followed until the end of April, and are of positive significance for reducing community transmission. Additionally, areas with severe outbreaks have voluntarily extended their social distancing periods. For example, New York City announced that public schools would not be open before the end of June. However, despite these positive measures, the current cross-regional flow of people is not strictly controlled. For example, due to the opposition of the New York State Government, the US Federal Government has failed to impose “lockdowns” in states such as New York where the pandemic has been most severe. Instead, it has only issued travel warnings requiring people to avoid non-essential travel—ineffective for stopping the movement of people and the spread of the virus between states. At the same time, President Trump has refused to implement mandatory quarantine policies at the federal level and instead has allowed states to determine their own prevention and control efforts. As of April 10, eight states—including Utah, Wyoming, and Iowa—have not yet introduced home quarantine policies. In addition, due to privacy protection and other factors, the United States lacks the ability to trace the historical activities of confirmed cases. According to data from the US CDC, the cause of infection in more than 95% of confirmed cases has not been identified. As the pandemic reaches its peak, calls for reopening the economy will gradually increase, social distancing measures will relax, and the states where the pandemic has initially eased cannot rule out the possibility of a rebound.

Generally, the United States is preparing for the future in two ways. On one hand, the US hopes to control the spread of the pandemic through strict measures and successfully control its outbreak before June. On the other hand, the US is preparing for a protracted war and will move forward one step at a time.

1.1.2 Europe: There have been outbreaks in many areas, and prevention and control have markedly improved.

On March 13, the WHO announced that Europe had become the new “epicenter” of the pandemic. In late March, there was an exponential increase in confirmed cases in many European countries, with the most severe outbreaks in Italy, Spain, Germany, and France. Since April, the number of new cases and deaths in many European countries have shown signs of decreasing, but the WHO believes that the pandemic has not yet reliably leveled off in Europe. As of April 11, cumulative confirmed cases in Europe were close to 780,000, and cumulative deaths were around 70,000. Within these figures, a total of 163,027 confirmed cases and 16,606 deaths were in Spain,

³ <https://www.pix11.com/news/coronavirus/latest-coronavirus-updates-in-new-jersey-sunday-april-12-2020>

⁴ <https://nypost.com/2020/03/29/heres-the-next-big-problem-after-new-york-gets-ventilators/>

with a fatality rate of over 10%; a total of 152,271 confirmed cases and 19,468 deaths were in Italy, with a fatality rate close to 13%; a total of 125,452 confirmed cases and 2,871 deaths were in Germany; a total of 93,790 confirmed cases and 13,832 deaths were in France; a total of 79,885 confirmed cases and 9,892 deaths were in the United Kingdom. Meanwhile, the cumulative number of confirmed cases in Turkey, Belgium, Switzerland, the Netherlands, and other countries exceeded 20,000, and the growth rate of confirmed cases remains high.

Chart 3 COVID-19 Data of Select European Countries

Nation	Cumulative Confirmed Cases	New Cases	Deaths
Spain	163027	4754	16606
Italy	152271	4694	19468
Germany	125452	3281	2871
France	93790	3114	13832
The UK	79885	5280	9892
Turkey	52167	5138	1101
Belgium	28018	1351	3346
Switzerland	25107	556	1036
Netherlands	24571	1322	2653
Portugal	15987	515	470
Austria	13806	246	337
Russia	13584	1667	106
Sweden	10151	466	887

Note: The above data is as of 24:00 on April 11th, Beijing time. Countries with a cumulative number of confirmed cases less than 10,000 are not included.

In response to the spread of COVID-19, European countries have gradually strengthened their prevention and control measures. Since Italy announced its border closure on March 10, European countries have gradually closed their borders to restrict the movement of people. In addition, various governments have adopted isolation measures such as halting non-essential commercial activities, issuing stay-at-home orders, closing schools, requesting people to work from home, banning public gatherings, closing public places, shutting down public transportation, and building temporary hospitals. According to publicly released data, we compiled the prevention and control measures adopted by major European countries as shown in Chart 4. Judging from the current news, the European shutdown will essentially last until at least the end of April. For example, Jaguar Land

Rover’s UK plant has announced the suspension of production and is expected to resume work on April 20, but their plans may change according to new developments. Nissan’s UK plant has been closed since mid-March, and there is no plan to reopen in April. BMW’s European plant recently announced that the shutdown is expected to last until April 19. In addition, since late March, many European countries have been improving their prevention and control measures and extending their lockdowns. For example, France extended its nationwide lockdown originally set to end on March 31 to April 15, and recently announced that it would extend the measures once more. The Spanish government will also ask parliament to extend the state of national emergency until April 25, Germany will extend its lockdown until April 19, and the UK’s lockdown measures may last up to six months, according to the Financial Times.

Chart 4 Prevention and Control Measures Adopted by Major European Countries

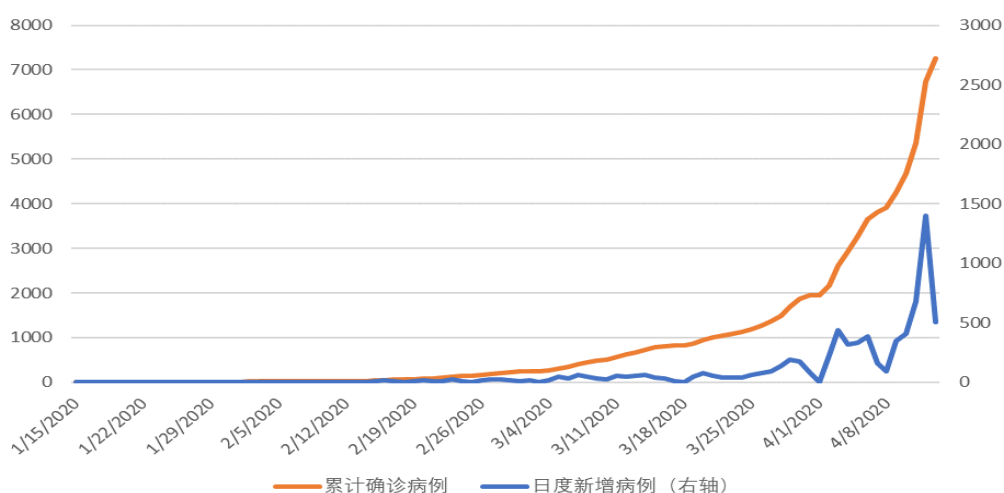
	Closing the border	Closing all non-essential businesses (i.e. restaurants and bars)	Issuing stay-at-home orders	Closing schools and requesting people to work from home	Banning public gatherings (i.e. sports, weddings, funerals, religious services, etc.)	Closing public places (including parks, museums, and art galleries)	Shutting down public transport	Building temporary hospitals
Italy	✓	✓	✓	✓	✓	✓	×	✓
UK	×	✓	✓	✓	✓	✓	partly	✓
Spain	✓	✓	✓	✓	✓	✓	partly	✓
France	✓	✓	✓	✓	✓	✓	×	✓
Germany	✓	✓	✓	✓	✓	✓	×	✓

1.1.3 Japan and South Korea: The risk of imported cases is increasing, but the pandemic is controllable overall.

COVID-19 reached Japan early on, but the number of confirmed cases initially increased slowly. By the end of March, there were less than 2,000 confirmed cases and 62 deaths. However, since April, coronavirus cases in the country have surged. The cumulative number of confirmed cases on April 13 reached 7,255, with 102 deaths. On April 7, Japan declared a one-month state of emergency in seven regions, including Tokyo and Osaka. Local governments in these seven regions were given the authority to implement strict isolation measures such as requiring home quarantine, closing schools, shutting down cinemas and other non-essential public places, requisitioning medical supplies, and controlling food and drug sales via administrative measures. On April 13, the Japanese government announced that there was no reason to extend the state of emergency and that it would not close any cities, but the government urged the public to prepare for a protracted war against the pandemic and practice “maximum vigilance.” The current low number of tests performed in Japan is mainly due to the strict testing conditions required by the Japanese government. For example, asymptomatic and non-high-risk individuals are only allowed to receive testing after their

body temperature has exceeded 37.5 degrees for 4 consecutive days. This requirement is meant to protect the healthcare system from being overwhelmed. According to the expert committee's discussion on March 20, the current focus of Japan's pandemic prevention is to limit gatherings and enhance the capacity of the healthcare system to deal with severely ill patients. Since Japan's tests are limited and its isolation measures are insufficient, patients with mild symptoms may spread the virus. At the same time, Japan has restricted the entry of foreigners, but with increasing numbers of Japanese citizens returning home, the country should be vigilant about the risk of imported cases.⁵

Chart 5 Cumulative Confirmed Cases of COVID-19 and Daily New Cases in Japan (January 15 to April 13)



Source: ECDC, <https://ourworldindata.org/coronavirus>

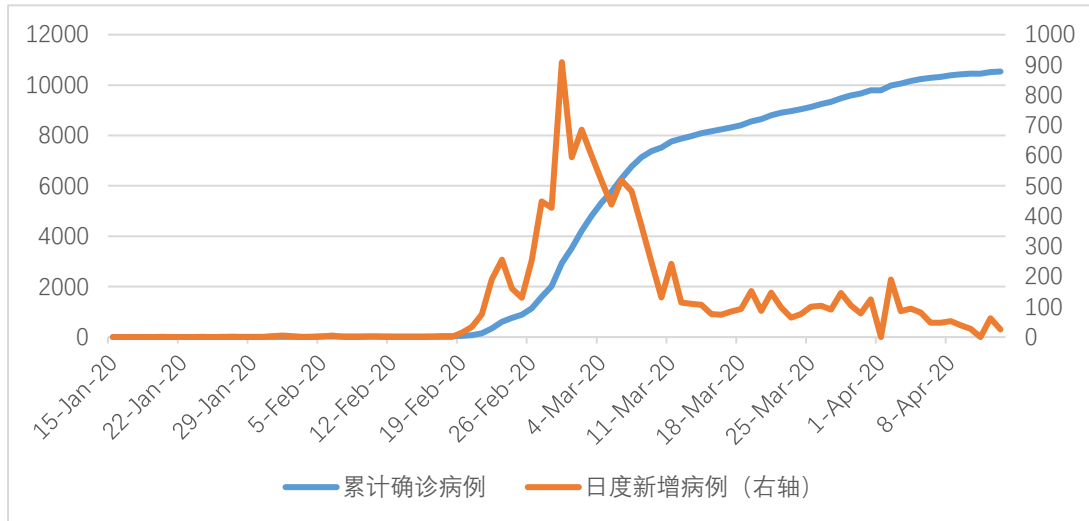
Translation of Chart Text

Orange: Cumulative Confirmed Cases Blue: Daily New Confirmed Cases

In South Korea, a cluster of infections reported on February 18 led to a surge in daily confirmed cases. In ten days, the number of confirmed cases increased from dozens to more than 5,000. However, the South Korean government took timely and decisive measures such as conducting mass testing, thoroughly tracing cases with the help of big data networks, isolating contacts, and banning them from leaving the country. South Korea's universal medical insurance system also ensured that all infected people received high-quality and low-cost treatment. South Korea controlled the spread of its outbreak as quickly as possible while avoiding large-scale shutdowns. Currently, South Korea's daily new infections have been limited to double digits, and the mortality rate has remained within 1%—far lower than the global average of 2.3%.

⁵ <https://www.vox.com/covid-19-coronavirus-explainers/2020/3/28/21196382/japan-coronavirus-cases-covid-19-deaths-quarantine>

Chart 6 Cumulative Confirmed Cases of COVID-19 and Daily New Cases in South Korea (January 15 to April 13)



Source: ECDC, <https://ourworldindata.org/coronavirus>

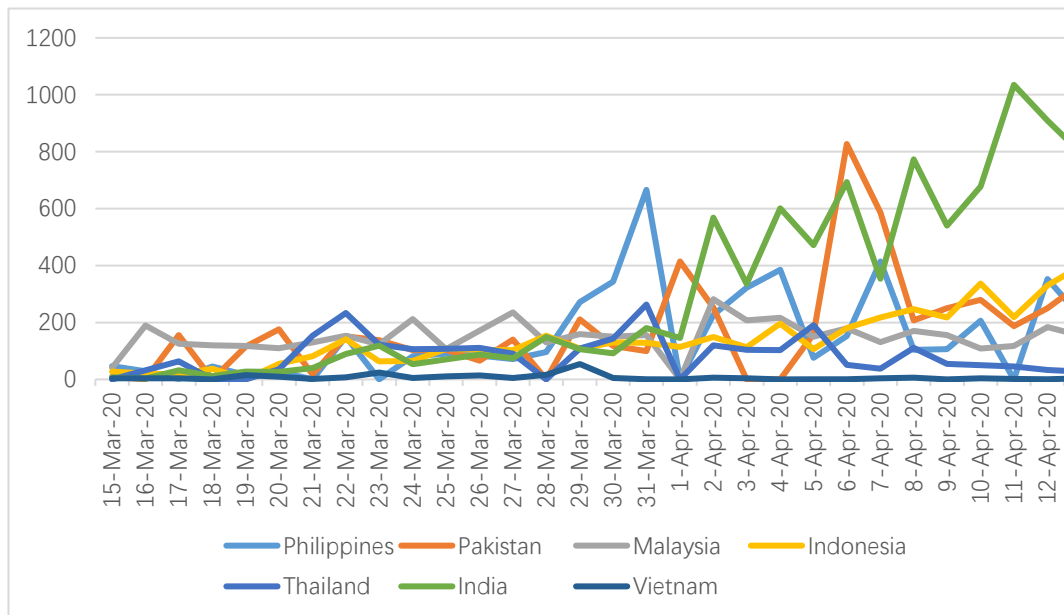
Translation of Chart Text	
Orange: Cumulative Confirmed Cases	Blue: Daily New Confirmed Cases

1.1.4 South and Southeast Asia: There is insufficient medical care and a sharply rising risk of outbreaks.

Besides the previously discussed regions, there is another group of countries worthy of attention: that is, South and Southeast Asian countries with relatively limited healthcare systems and dense populations. Compared with European countries and the US, the cumulative numbers of confirmed cases and deaths in these countries are relatively low. India reported 9,152 confirmed cases—the largest figure among South and Southeast Asian countries (as of April 13). However, our research team is still cautious about the potential for an outbreak and humanitarian crisis in this region. On one hand, countries in South and Southeast Asia have weaker testing capacities, and their fragile health care systems are not capable of supporting large-scale testing. Therefore, many COVID-19 cases may go undiagnosed. Take India, for example. With the recent increase in the accuracy and volume of testing, the number of confirmed cases in India has risen sharply from more than 1,000 at the end of March to nearly 10,000 in mid-April. Even so, the number of people tested only accounts for 0.1 out of 1000 people, which is a far lower rate than that of the United States or Europe, and even of Southeast Asian countries and other developing countries. On the other hand, South and Southeast Asian countries also possess insufficient medical supplies. According to the World Bank, with the exception of Singapore (which boasts the world’s leading healthcare system), the number of doctors per thousand people in most South and Southeast Asian countries is lower than the world average. Indonesia, the most populous country in Southeast Asia, has only one doctor for every 2,650 people. Scarce medical resources make these countries vulnerable to a shortage of medical resources in the middle of a major pandemic, resulting in serious consequences such as

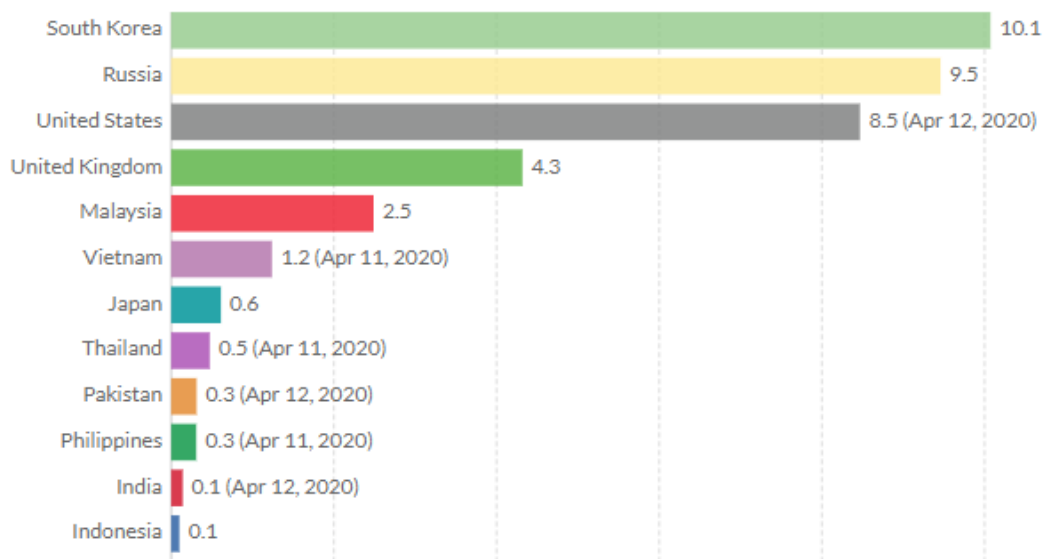
social panic and a rising mortality rate. Fortunately, after the pandemic became severe in mid-March, many Southeast Asian countries upgraded their prevention and control measures. Many of them, including the Philippines and Malaysia, have been locked down to varying degrees with a ban on group activities and gatherings. The hot and humid climate of the region also helps to inhibit virus activity and reduces the probability of cross-infection.

Chart 7 New Cases in Major South and Southeast Asian Countries



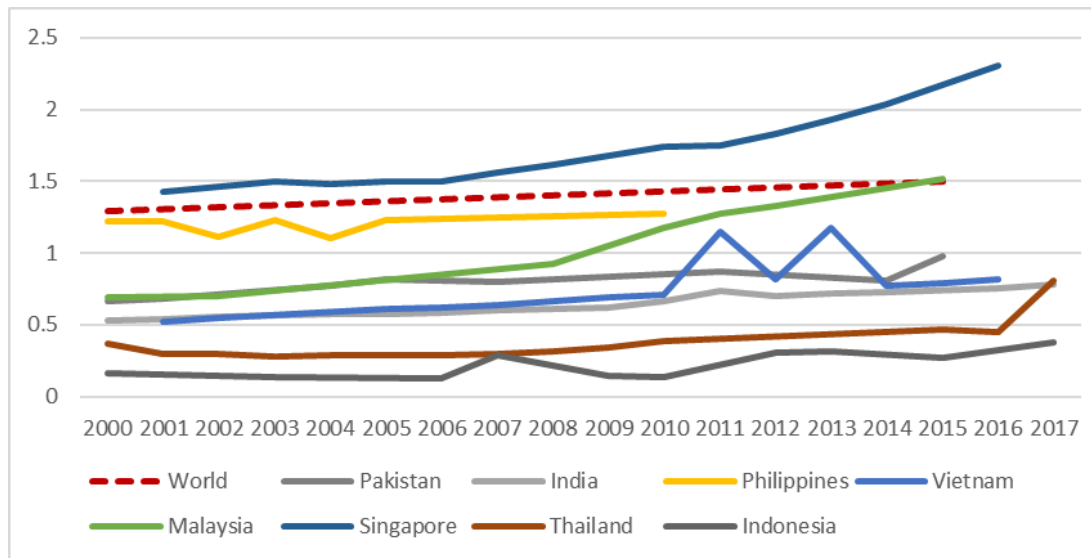
Source: European CDC - Latest situation update worldwide

Chart 8 Number of COVID-19 Tests per Thousand People (as of April 13, 2020)



Source: OurWorld in Data

Chart 9 Number of Doctors per Thousand People in South and Southeast Asian Countries



Source: World Bank WDI Database

1.2 Outlook: When and How Will the Pandemic End?

1.2.1 Two major uncertainties in the development of the pandemic exist: prevention and control efforts + vaccines and treatments.

On the whole, the global pandemic is still ongoing, and its future development is highly uncertain.

The first set of uncertainties relates to control of the pandemic—whether the strict quarantine policies of various countries can be sufficiently implemented and how long they can last, and whether international cooperation in pandemic prevention can be effective. Dr. Zhong Nanshan, who is considered “the Dr. Fauci of China,” predicted that the global pandemic will last at least until June. He also emphasized that for victory to be achieved in the summer, countries must make strong and effective interventions similar to those practiced in China. Zhong also pointed out that since the novel coronavirus is extremely contagious and some patients are asymptomatic, we cannot expect COVID-19 to disappear completely, but we can contain it and minimize its effects on production and our daily lives. China's COVID-19 expert Dr. Zhang Wenhong believes that the low mortality rate of the coronavirus has interfered with the initial judgments of Western countries. Once the strategy of “playing it by ear” led to near chaos, many Western countries turned to active anti-pandemic strategies similar to those of China—that is, “early identification, early isolation, and early treatment.” As long as governments’ responses are active, effective prevention and control of the pandemic can eventually be achieved. We expect that the peak of the pandemic will appear sometime between April and June, and most cases will be well

controlled by summer. However, the virus is likely to come back in autumn and winter and last for 1-2 years.

The second uncertainty is the development of vaccines and treatments, including the research and development of new drugs and the testing of traditional drugs. If effective vaccines or treatments can be developed and mass-produced at a low cost, the pandemic will be easier to control, social panic will dissipate, and countries will be able to refocus their energies toward large-scale vaccinations or treatments along with the steady restoration of social and economic order. However, if an effective vaccination or treatment is not successfully developed, we will have to continue relying on the traditional method of global isolation to “suffocate” the virus. Zhong Nanshan is optimistic about vaccines and believes that one will be available for humans as early as September, while Zhang Wenhong believes that the development and launch of vaccines will require approximately one to three years, with a highly uncertain success rate. Dr. Fauci, the chief technical expert of the US government on the prevention and control of COVID-19, believes that although China and the United States have recently begun the first batch of human trials of the COVID-19 vaccine, it will take at least one or one-and-a-half years before the vaccine is widely distributed. Judging from the progress of existing vaccine and drug research and development projects, this report holds that the probability of vaccines or treatments entering the market in 2020 is low. According to the Milken Institute, as of April 13, there are nearly 200 anti-COVID-19 drugs in development worldwide, including 79 vaccines, 37 antibodies, 18 antiviral drugs, 12 conventional drugs, 4 RNA-related drugs, and 7 cell-related drugs. However, despite the large number of vaccines and treatments under development, most professionals believe that the outcome will be extremely uncertain. For vaccines, both China and the United States have already begun human trials. Among the vaccine research plans that have been announced, the faster-moving projects are expected to start “first phase testing” (testing randomly selected patients) in March 2020 and complete it by the end of the year. Then they will enter the “second phase” (testing a small number of healthy volunteers) and the “third stage” (testing a large number of healthy volunteers). However, none of the projects have announced expected completion dates. It is generally estimated that it will take one year for a vaccine suitable for large-scale use to enter the market. Antibody drugs are generally expected to start their “first phase testing” in the summer of 2020, and the fastest project has already entered second/third phase testing, or is expected to complete the preliminary testing of the second phase in April 2020. As for the testing of existing drugs, the US Food and Drug Administration has formally allowed hydroxychloroquine and azithromycin (two existing low-cost drugs) to be used in clinical trials. There are also a number of different projects testing other drugs (including a project on Lianhua Qingwen Capsules, which Dr. Zhong Nanshan participated in). In sum, it is difficult to reach a robust conclusion now, and a “wonder drug” has not yet emerged.

This report argues that vaccines and treatments cannot play a decisive role in reversing the current trend of the pandemic in the short term, and we must instead rely on strict isolation measures. However, as the pandemic gradually approaches its peak, the United States and European countries may not be able to continue their current strict isolation policies. Once the public’s call for a return to normal economic and social life becomes stronger, these countries may need to dually prevent the pandemic while resuming production.

Given that countries have responded to the pandemic in different ways and that there are many uncertainties in the development of vaccines and treatments, this report assumes that there are three possible conclusions to the pandemic. In the relatively optimistic first scenario, countries around the world will work together to carry out an efficient and coordinated shutdown at the expense of the economy. In this way, the pandemic could be eradicated within three months—just as it was in China—resulting in a summer end date. In the second, more neutral scenario, as predicted by infectious disease experts, the pandemic will reach its peak between April and June. After a weakened spread in the summer, COVID-19 will surge in autumn and winter. In the spring of the coming year, the pandemic will still see a small peak, but as vaccines and treatments are launched a year from now, the virus will be completely contained. In the third, most pessimistic scenario, the development of vaccines and treatments will not be successful. European countries and the US will adopt passive anti-pandemic policies and hope for herd immunity, which will lead to high death tolls as the virus ravages those areas. The pandemic will last for more than two years, and the virus will become less toxic as it continues to mutate and eventually coexist with humans for a long time.

This report believes that the most likely outcome is the second scenario, in which the virus will wane in summer, then come back with a second surge in autumn and winter, and eventually disappear after the launch of vaccines and treatments next spring. This outlook emphasizes the importance of coordinating pandemic prevention and control and economic and social development. The world will face a protracted war requiring constant adaptation. On one hand, the prevention and control of the pandemic cannot be won in a single battle. We must be prepared for a protracted war and implement normalized pandemic prevention and control measures. **On the other hand,** the economy cannot shut down for an extended time, and society cannot maintain social distancing forever. As the pandemic peaks and declines, the global economy will face a great challenge of adaptation—that is, adapting to the characteristics of the pandemic and promoting the comprehensive and orderly restoration of production and daily life against the backdrop of normalized pandemic prevention and control.

However, various countries are at different stages of the pandemic, so generalizations cannot be made when analyzing global trends. This report will take a closer look at the development of the pandemic in specific countries and regions.

1.2.2 There are varying prospects for the future of COVID-19 in key countries and regions.

China's pandemic prevention capabilities have been improving and significant progress has been made. China's focus at this stage is to prevent imported infections and guard against a domestic resurgence. The key is to coordinate pandemic prevention and control with economic and social development, meaning to accelerate the full restoration of production and daily life while executing normalized pandemic prevention and control protocols. Most scholars believe that China's COVID-19 outbreak will be basically under control by the end of April, and normal economic activities and life will resume in most areas.

South Korea has also effectively controlled the pandemic through early detection, early

isolation, and early treatment. Under the condition that the risk of imported cases is controllable, the outbreak will end by summer. **Japan** successfully controlled the spread of the virus in the early stages, but the pandemic has reemerged since April, and some parts of Japan have now entered a state of emergency. Despite the risks of local transmission and imported cases, Japan's prevention and control policies will be flexibly adjusted according to the development of the pandemic, so overall the risk is controllable. The situation in **South and Southeast Asia** is uncertain due to insufficient testing. Although more prevention and control measures have been introduced, limited healthcare resources increase the possibility of outbreaks, putting these areas at risk for becoming the next global epicenter.

The US pandemic is showing signs of a peak, and there is a high probability that the pandemic will last through next year. Ashish Jha, an infectious disease expert at Harvard Medical School, believes that the United States is now facing the dual difficulties of an economic shutdown and a coronavirus outbreak, and has missed the golden period of prevention and control due to its slow response in the early stages. The key to solving the two problems is mass testing in conjunction with strict measures of early detection, early isolation, and early treatment. On March 25, the Institute for Health Metrics and Evaluation (IHME) at the University of Washington issued a forecast that even if existing social distancing measures are maintained, the demand for critical care caused by COVID-19 will exceed the existing capacity of the healthcare system. The US pandemic is predicted to peak in mid-April, and 40,000 to 160,000 people may die from COVID-19 in the United States in the next four months. On March 30, Dr. Fauci, director of the National Institute of Allergy and Infectious Diseases, stated that the total number of deaths caused by COVID-19 in the United States may exceed 100,000. On March 30, President Trump said that the government will do its best to keep the death toll under 100,000. The death rate will peak in the next two weeks (mid-April), and it is expected that the pandemic will be initially controlled by the end of May. In addition, MIT researchers have found that current outbreaks are mainly in cold and dry areas, indicating that the coronavirus may be seasonal.⁶ Dr. Fauci pointed out that as the temperature rises, the coronavirus pandemic in the United States is expected to be significantly alleviated, but the pandemic in southern hemisphere countries (such as South Africa, Australia, New Zealand, and Brazil) may be exacerbated. In the autumn and winter of the northern hemisphere, the pandemic in the United States may come back, and there might be a new peak in early 2021, so vaccine development is extremely urgent.⁷ On the whole, the United States has two main priorities. First, it hopes to curb the spread of the virus through strict measures and to initially control the pandemic before June. Second, it is preparing for the long haul and will play it by ear while waiting for vaccines and treatments. April is a key window for the United States to fight the pandemic. At present, signs of a peak have appeared, but there is still great uncertainty about pandemic prevention and control. **Our judgement is that new cases in the United States have peaked and will gradually decline thereafter, but it will still take a long time for total cases to peak.** It will be difficult for the United States to control the pandemic before summer, and a second wave may occur in autumn and winter, requiring the country to rely on vaccines or treatments. If vaccines and drugs are successfully developed, the pandemic is expected to end in 2021, but otherwise, it may continue

⁶ <https://www.livescience.com/warmer-weather-slow-coronavirus-spread.html>

⁷ <https://www.cnbc.com/2020/03/25/coronavirus-white-house-health-advisor-fauci-says-us-needs-to-be-prepared-for-second-cycle.html>

until 2022 or even beyond that. **This report holds that with the initial control of the pandemic in the United States, the country will reopen its economy in June or even May. The US can learn from China’s strategy of controlling the pandemic while simultaneously ensuring economic and social development, allowing people’s work and home lives to return to normal through normalized prevention and control measures.** Since the US does not experience the same phenomenon of “migrant workers” as China—that is, domestic workers who move from the countryside to cities in order to send remittances home—employees will return to work faster, and it will be less difficult to resume production than in China.

Although the pandemic in Europe is approaching its peak, it is highly probable that the European outbreak will last into the next year. Top British medical experts believe that if social distancing is effective, the pandemic in the UK may peak around Easter (April 12) and then gradually decline. However, even the most optimistic predictions estimate a death toll of at least 20,000 in the UK. German medical experts generally agree that the pandemic will last for a long time (about 2 years), and have warned that it will be difficult to contain the outbreaks before summer. The situation in Europe will be severe from May to June. During this period, even countries like Germany, with abundant medical resources and highly developed medical services, will face pressure from resource constraints. Optimistic French medical experts expect the pandemic in France will be brought under control in the next 4 to 6 weeks, while a pessimistic forecast predicts that the pandemic may last into the fall or even next year. There may be more waves depending on the implementation of lockdown measures and the tracing and monitoring of confirmed cases. The Spanish government has said that the outbreak is approaching its peak, and medical experts expect that the pandemic will begin to decline at the end of May and in early June. The main challenge for Europe is responding to increasing opposition by the public to the current strict prevention and control measures at the expense of “freedom.” European countries also face the challenge of policy coordination, especially because the EU has not yet introduced a unified strict border control plan, resulting in a higher risk of imported cases for countries without an outbreak. **A regional view indicates that Southern Europe, Western Europe, and Central Europe have all seen intense outbreaks.** The virus is spreading extremely quickly in these places and will be impossible to contain at least in the short term, but the situation is expected to improve after the summer peak. **Northern Europe, where the pandemic is relatively less severe, is unlikely to become the new “epicenter” of Europe in the future.** It is more likely that the pandemic there will wane simultaneously with the outbreaks in Southern Europe, Western Europe, and Central Europe, or even earlier. The Northern European countries are far from the epicenter and have not experienced large outbreaks. Countries such as Denmark, Norway, and Finland have also adopted effective lockdown measures, which are expected to be effective at stopping the spread of the virus. In contrast, the Swedish government has not yet taken effective measures. More than 2,000 experts from the country have signed a letter calling on the government to strengthen prevention and control as soon as possible. If the Swedish government can act in a timely manner and tighten its pandemic prevention policy as soon as possible, then the overall risk in Northern Europe will be effectively controlled. **The current situation in Eastern Europe is relatively optimistic except in Russia, which has experienced a major outbreak since April.** The number of confirmed cases in early April increased by nearly six times, mainly because Russia did not effectively prevent the entry of imported infections from Europe. The pandemic in Europe began to spread widely in early March,

but Russia failed to impose restrictions on flights from EU countries until late March. The media has speculated that about one million people entered Russia in late March, and most of them were only quarantined at home without nucleic acid testing. Therefore, the current situation in Russia is not optimistic, and the country may see explosive growth in the future, with the possibility of even becoming the center of the second round of outbreaks in Europe. However, even if the domestic situation deteriorates, Russia's comprehensive national strength, the prevention experiences of other countries, and deeper international cooperation will enable Russia to contain the outbreak gradually as the pandemic in Europe abates. Now that European countries have implemented strict prevention and control measures, residents' awareness of pandemic prevention is increasing, and the international community has offered significant help, the number of new infections is expected to gradually decrease in the short term. The cases that are continuing to arise are mainly a result of those who were previously infected without showing symptoms. **Overall, this report believes that cases in Europe are increasing rapidly, but are approaching their peak. We expect cases to peak before summer, followed by a gradual decline in cases. However, there may be additional outbreaks in the fall, and it will be difficult to completely contain the virus within the year.**

Regarding the resumption of work and production in European companies, it is expected that European countries will reopen their economies as soon as the pandemic is initially controlled. Before that can be achieved, their primary goal at this stage is to curb the pandemic as soon as possible through strict prevention and control measures. **Our prediction is that the European shutdowns will last into May. After the peak, Europe is expected to follow the Chinese model and gradually resume work against the backdrop of strict detection and prevention protocols. Since most employees in Europe are local residents rather than migrant workers, overall it will be less difficult to restart production there than in China.**

II. Analysis of the Global Economy

2.1 The Status Quo of Finance and the Global Economy

2.1.1 World economic growth is weak, and the negative impact of the pandemic is significant.

Even before the coronavirus outbreak, world economic growth was weak and macro financial risks had accumulated against the backdrop of frequent Sino-US trade frictions and geopolitical conflicts.

The performance of the US financial market is completely different from that of the real economy, which implies a crisis. Downward pressure on the US real economy has increased, and we have also seen the negative impacts of Sino-US trade frictions. In 2019, the US GDP grew by 2.3%, which was lower than its growth of 2.9% in 2018 and 2.4% in 2017, and far below the growth target (3%) previously set by the US government. Downward pressure on household consumption

has increased, with quarter-on-quarter annualized rates at 0.78%, 3.03%, 2.12%, and 1.24%, respectively. In December 2019, the US core PCE price index increased by only 1.6% year-on-year, which was lower than the Fed's regulatory target (2%), indicating potentially weak consumption. Fixed asset investment has also shrunk, with quarter-on-quarter annualized rates at 0.56%, -0.25%, -0.14%, and -0.09%, respectively. However, the US financial market has simultaneously been advancing in leaps and bounds, with valuations reaching historical extremes. In 2019, the US S&P 500 index hit a record high, rising 28.3% for the year. During the same time, the price-earnings ratio reached 30.91, which is higher than the level before the 2008 financial crisis (27.55). In addition, the US Treasury yield curve will remain inverted for a long period of time, indicating a risk of recession.

Since the financial crisis in 2008 and the European debt crisis in 2009 and 2010, the structural problems in the European economy have not yet been resolved, and Europe's economic recovery has lacked momentum. Europe's heavy debt and the high burden on the welfare system caused by an aging population have put significant pressure on governments' finances and dragged down economic growth. For example, Italy's international debt accounts for about 135% of GDP. This huge debt-servicing pressure has placed a heavy burden on the government's fiscal policy. At the same time, Italy has the largest aging population in Europe, with spending on pensions accounting for about 16% of GDP. These financial burdens hurt Italy's economic vitality—the country's growth rate in 2019 was only 0.2%. In addition, with regard to the external environment, the continued decline of global manufacturing and the prevalence of trade protectionism have brought arduous challenges on the European economy, which is highly dependent on manufacturing and trade. Since 2019, European manufacturing has continued to weaken, and the Eurozone manufacturing PMI has fallen below the 50.0 no-change mark. Sluggish international trade and frequent frictions with the United States on trade policies have jeopardized the future of European manufacturing. Germany has always been the leader of Europe's developed countries, and its manufacturing industry is world-renowned. In 2019, orders received by the German machinery manufacturing industry decreased by 9% compared with the previous year. Many sub-sectors also saw orders and investments decline. The shrinking manufacturing industry has directly dragged down Germany's economic growth—the growth rate in 2019 was only 0.6%, far lower than the 1.5% growth rate in 2018 and the 2.8% growth rate in 2017.

Major emerging market countries are also struggling to adjust to a more uncertain international environment. Asian countries are still the engines of global economic growth, but due to Sino-US trade frictions, China's overseas markets have been hit hard. As a result, ASEAN and East Asian countries that have close trade relations with China have also had to adjust their positions in the global value chain. Meanwhile, the economic growth of Latin American countries continues to be sluggish. Due to the high uncertainty of policy, private consumption and investment in major Latin American countries such as Brazil and Mexico are very weak. In Argentina, the significant level of foreign debt and a worrying balance of payments cause the financial market to fluctuate frequently as the country faces both internal and external struggles. In the Middle East, countries are also experiencing economic difficulties due to geopolitical crises and oil price fluctuations. With the increase in US sanctions and the sharp drop in oil prices, Iran has had to undertake a difficult and passive project of economic restructuring, vigorously developing its

chemical, steel, and other manufacturing industries to reduce its dependence on oil and achieve self-sufficiency, thereby resolving the economic crisis caused by external forces. According to the report “*World Economic Situation and Prospects 2020*” released by the United Nations (UN) on January 16, 2020, the global economic growth rate in 2019 was 2.3%, the lowest since the 2008 financial crisis.

In such a challenging and risky international environment, the outbreak of the novel coronavirus has undoubtedly pushed the global economy further into recession. The United Nations released its report “*World Economic Situation and Prospects: April 2020 Briefing, No. 136*” on April 1, forecasting the impact of the pandemic on the global economy in 2020 in two scenarios. In the best-case scenario, the UN estimated that the global economy will grow by 1.2% in 2020, and in the worst-case scenario, they predicted that the global economy will tumble, with a growth rate of -0.9%. In comparison, during the 2008 global financial crisis, the 2009 global economic growth rate was -1.7%. Many international financial institutions believe that the impact of COVID-19 on the global economy will be greater than that of the 2008 financial crisis. Bloomberg compiled a database of the forecasts of various financial institutions for the economic growth of major countries around the world as of March 26. Among them, the median (average) of US economic growth forecasts is -1.25% (-2.13%), the median (average) of German economic growth forecasts is -3.25% (-4.02%), the median (average) of Chinese economic growth forecasts is 3.5% (3.29%), and the median (average) of Japan’s economic growth forecasts is -2% (-2.69%). In general, financial institutions predict that major economies, especially those of developed countries such as European countries, the US, and Japan, have a high probability of economic recession in 2020. On March 27, the Organization for Economic Co-operation and Development (OECD) released a forecast report on the impact of COVID-19 on the economic growth of countries around the world, stating that without any supportive economic policies, the first round of direct and negative impacts of the pandemic on major developed countries will reduce country outputs by about 20-25%. That is to say, the implementation of restriction policies each month will cause the annual GDP growth rate to drop by 2%. The International Monetary Fund’s (IMF) latest *World Economic Outlook* in April stated that the global economy will contract by 3% in 2020, indicating far more severe effects than the 2008-2009 financial crisis. However, the IMF also predicts that the impact of the pandemic will gradually ease from the second half of 2020. If the proper measures are put in place, the global economy is expected to rebound significantly in 2021, with a growth rate of 5.8%.

Chart 10 A Summary of Economic Growth Forecasts by Financial Institutions for 18 Major Economies in 2020

Forecasts for:	US	UK	France	Germany	Italy	Canada	Japan	Brazil	Russia
Highest	0.7	1.3	-1.5	-1	-2.2	1.7	-0.8	3	1.8
Median	-1.25	-2.6	-4	-3.75	-5	0.35	-2	0	0.3
Lowest	-9	-7.8	-7.7	-7.4	-10.2	-4	-5	-2.5	-2.7
Average	-2.13	-2.88	-3.82	-4.02	-5.98	-0.64	-2.69	0.29	0.04
IMF Forecast	-5.9	-6.5	-7.2	-7.0	-9.1	-6.2	-5.2	-5.3	-5.5

Forecasts for:	India	China	South Africa	South Korea	Indonesia	Malaysia	Philippines	Taiwan, China	Singapore
Highest	5.2	6.1	1	1.7	4.8	4.3	6.2	1.9	1.4
Median	4.9	3.5	-1.45	0.7	3.15	1.2	2	0.6	-2.8
Lowest	0.5	-3	-2.5	-6.7	-0.6	-5.8	0.6	-5.7	-7.3
Average	3.53	3.29	-1.18	-0.56	2.60	0.17	2.90	-0.07	-2.99
IMF Forecast	1.9	1.2	-5.8	-1.2	0.5	-1.7	0.6	-4.0	-3.5

Data Source: Bloomberg database; calculated by ACCEPT.

2.1.2 Waves of anti-globalization are rising, and the international outlook is complicated and grim.

In the 1990s, when mainstream scholars and policymakers unanimously praised trade and capital liberalization, some Western scholars expressed concern about the potential impact that globalization could have on Western countries. Economists such as Dani Rodrik and Joseph Stiglitz worried that the adjustment of the labor market would not be as timely and effective as predicted in economics textbooks, and a side effect of trade liberalization could be that the manufacturing industries of Western developed countries—particularly low-tech and low value-added ones—would be hit by developing countries, causing social problems such as unemployment and inequality. More than two decades later, this worry has become a reality. Due to the lack of an effective compensation mechanism for low-income groups and the failure of the labor market to make timely and effective adjustments to changes in the global industrial structure, the per capita disposable income of the United Kingdom, the United States, and some other countries has stagnated. Low-income groups, and especially the middle class, have not benefited from globalization, leading to an increase in inequality and social conflict. Additionally, it has been more than ten years since the outbreak of the financial crisis, when Western countries adopted different degrees of quantitative easing policies. The consequences were high debts and fiscal deficits, as well as extremely low policy interest rates. **As a result, the fiscal and monetary policy tools available to these countries**

are scarce in the face of an insufficient economic growth impetus, and the space for adopting large-scale macro stimulus policies once more is limited.

The combination of anti-globalization sentiment and the weak recovery of the global economy has caused populism to prevail in Western countries. Under the influence of right-wing ideology, Western politicians have attacked the current multilateral economic and trade system as well as emerging developing countries in order to redirect domestic discontent. As the largest developing country and beneficiary of globalization, China is now bearing the brunt of Western countries' condemnation. From the Sino-US trade frictions to the technological blockade against China, European and American countries have initiated a wave of anti-globalization and anti-China sentiment. **In this context, the outbreak of COVID-19 has served as the catalyst for another round of more violent anti-China offensives. Western right-wing politicians have blamed China for the global outbreak and its economic and social impact** in an attempt to calm domestic discontent at their governments' improper response to the pandemic. US Secretary of State Mike Pompeo has repeatedly and publicly criticized China and asked the Chinese government to take responsibility for the global impact of the pandemic. Facing a raging pandemic in the UK, members of the British Parliament have also tried to shirk responsibility for their failure to manage the UK outbreak, instead directing anger toward the Chinese people's "unreasonable eating habits" and the Chinese government's "improper response" to the pandemic when it first emerged. **The proposal to withdraw foreign capital from China has been popular for a while.** For example, US White House economic adviser Lawrence Alan Kudlow suggested that the US government should fund the withdrawal of US companies from China and their relocation to the homeland "at any cost." The Ministry of Economy, Trade and Industry of Japan also plans to spend more than 2 billion US dollars to support Japanese companies in efforts to return to their homeland. **In addition to developed countries in Europe and America, some old friends of China from developing countries have also joined the anti-China camp.** The spokesperson of the Ministry of Foreign Affairs of Iran has questioned China's public data on the pandemic, and Brazil triggered a diplomatic crisis with China because of improper remarks by a congressman. These doubts and accusations against China continue to spread. Some people even believe that China should take national responsibility for the outbreak of the pandemic and compensate countries for their losses due to COVID-19. Thousands of Americans joined a lawsuit against China, demanding compensation from the Chinese government for coronavirus-induced losses. A conservative British think tank also suggested in a report that the prime minister should claim compensation worth 351 billion pounds from China for the pandemic. The All India Bar Association (AIBA) and the International Council of Jurists (ICJ) even sued the Chinese government in the UN Human Rights Council, demanding that China pay 20 trillion US dollars for concealing the outbreak, which later became a global pandemic.

In the current complex geopolitical environment, COVID-19 has prompted further adjustments to the global governance structure, which could give rise to various conflicts. **It is the judgement of this report that for many years to come, anti-globalization will gradually become mainstream in the Western world. Anti-Chinese sentiment and attacks on China are likely to become the norm, so China must be prepared to confront growing negative public opinion and**

political pressure. To this end, we propose four suggestions: first, China should actively participate in the global response to the pandemic, particularly focusing on providing assistance to developing countries and underdeveloped countries with relatively poor health care; second, as the world is facing a protracted war requiring constant adaptation, China should steadily promote pandemic prevention and control in conjunction with economic and social development at home while also actively preparing for the possible adjustment of the international industrial chain; third, as production and international economic cooperation resume, China should fully consider international feedback and promote the internationalization of the renminbi in a prudent and pragmatic manner; fourth, opening up and cooperation should still serve as guiding philosophies for the type of world that China wants to help create, and thus China should promote the reform of the multilateral trading system and the further development of the Belt and Road Initiative, which will help narrow the development gap and add lasting impetus to global economic growth.

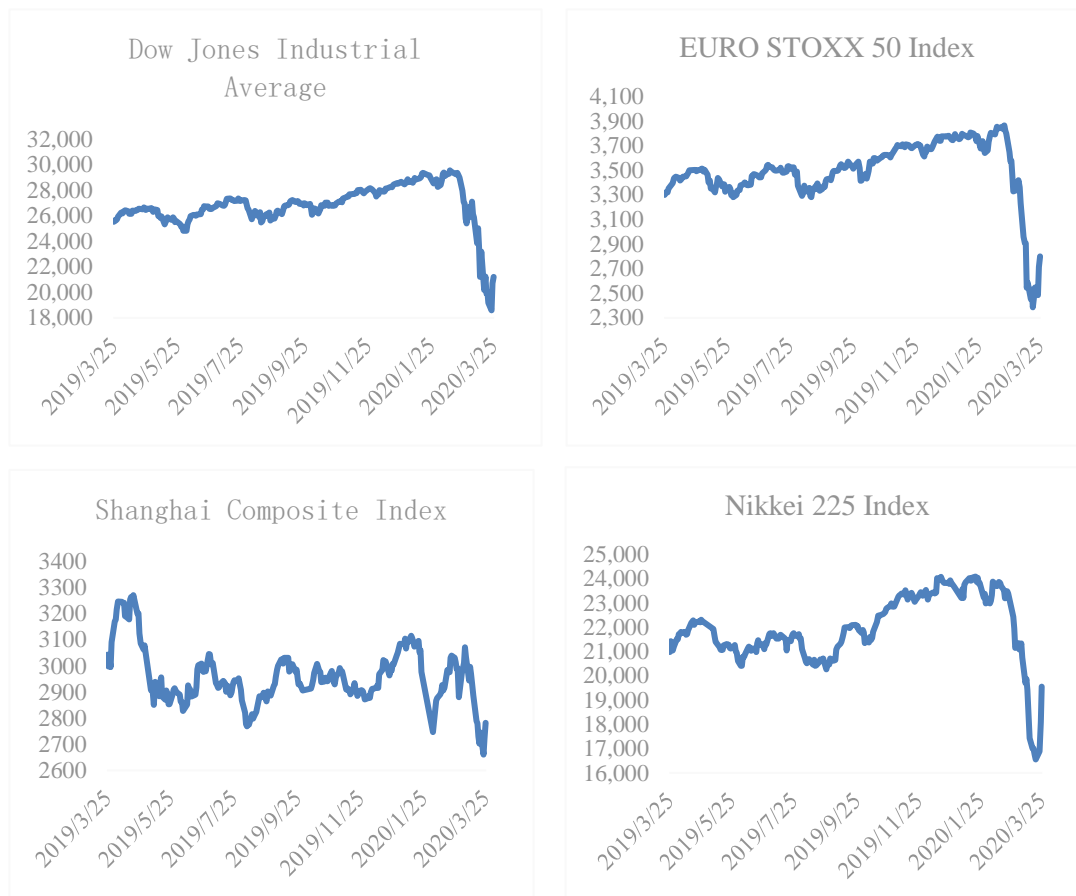
2.2 Will COVID-19 Lead to a New International Financial Crisis?

2.2.1 How should we define a “financial crisis?”

The continuous spread of COVID-19 around the world and its impact on the global financial market have caused the international community to worry about the possibility of a new international financial crisis.

Beginning in March 2020, when Europe and the United States became the second epicenter of the pandemic, the three major US stock indexes plummeted. The S&P 500 index even triggered four circuit breakers in ten trading days, ending the decade-long bull run of the US stock market following the 2008 financial crisis. The sharp fall of US stocks further triggered global financial panic, and the stock markets of many countries recorded their biggest drops in history. On March 12, in addition to the United States, at least 10 countries—including Brazil, Canada, Thailand, the Philippines, and Pakistan—had to implement a circuit breaker. The STOXX Europe 600 index plummeted by 11%, setting the biggest drop in history; Germany's DAX index fell by more than 12%, the biggest one-day decline since 1989; France's CAC-40 index fell by more than 12%, breaking the record for the biggest decline in history; the FTSE Italia index closed at a 17% drop; Spain's IBEX-35 index fell nearly 15%. It is a pity that the policy of aggressive Fed rate cuts (reducing the federal reserve fund rate to 0-0.25%) to stabilize the market has not yet yielded effective results. Meanwhile, the global financial market continues to experience turbulent drops.

Chart 11 Performance of Major Stock Market Indexes in the Past Year



Government bodies, international organizations, and economic circles have put forth differing evaluations on whether COVID-19 has triggered or will trigger an international financial crisis. Christine Lagarde, the President of the European Central Bank, has stated that Europe will face a major economic shock similar to the 2007-2008 financial crisis unless leaders take urgent action against the pandemic. Haruhiko Kuroda, President of the Bank of Japan, emphasized that the impact of the COVID-19 outbreak has been different from that of the 2007-2008 financial crisis. The latter was caused by a bubble in the financial system, while the impact of the pandemic has been more fundamental. Kristalina Georgieva, President of the IMF, stated that losses caused by the pandemic are already incalculable, and the global economy will enter a recession this year even worse than that of 2008. She also stressed that developed economies are generally more capable of coping with the crisis, but many emerging markets and low-income countries will face severe challenges. Professor Roubini of New York University, otherwise known as "Doctor Doom," believes that the economic recession caused by the pandemic will be more serious than the international financial crisis of 2007-2008, the Great Depression of 1929, and even the Second World War. This is because the global economic stagnation caused by the pandemic was absent during these major events. Raghuram Rajan, a former Governor of the Central Bank of India and a professor at the University of Chicago, warned that the global economy still has not completely recovered from the financial crisis of 2007-2008, and that a large-scale default of the government, enterprises, and households could trigger another collapse of the global financial system. Harvard

economics professor Kenneth Rogoff believes that the economic downturn caused by the pandemic is more akin to the severe supply shock caused by the oil crisis in the 1970s. Rogoff's longtime collaborator, Professor Carmen Reinhart of Harvard University's Kennedy School, called for all possible financial and monetary measures—even unconventional ones—to address the economic stagnation caused by the pandemic. According to Stanford University finance professor Darrell Duffie, compared to the environment in which the financial crisis broke out in 2007-2008, the leverage ratio of the banking system is lower and credit is relatively healthy now, which has the potential to significantly reduce the impact of the pandemic on the international financial system. The rapid recovery of China's economy will also be a source of strength which may prevent the global economy from falling into a comprehensive recession. Keyu Jin, a professor at the London School of Economics and Political Science, believes that the world is facing a similar prospect of economic depression as it did in the 1930s. According to Professor Jin, the output of the United States and the world may drop by up to 40%.

In order to better predict the negative impact of the pandemic on the global financial system, we must first define the term “international financial crisis.” According to the International Monetary Fund (IMF), an international financial crisis includes at least some of the following events occurring simultaneously in multiple international financial markets: large changes in asset prices and total credit, the inability of financial intermediaries to provide credit to the real economy, a wide range of balance sheet crises (in the corporate sector, residential sector, financial intermediaries, and sovereign states), and massive government credit support and asset restructuring. Needless to say, most financial crises have historically been caused by a bursting bubble due to a huge expansion of assets and credit. In their research depicting the history of eight centuries of financial crises, Professor Reinhart and Professor Rogoff divided financial crises into two categories: currency and capital account crises, and debt or bank crises. The former often derives from currency devaluation and capital panic outflow, while the latter is caused by credit and asset price bubbles. Reinhart and Rogoff also point out that the outbreak of a financial crisis will often prolong and worsen an economic recession while also leading to a slump in asset prices (including real estate prices).

2.2.2 Will COVID-19 cause a financial crisis?

To answer this question, we must first analyze the following phenomena while using the international financial crisis of 2007-2008 as a reference.

First, judging from the status of global economic fundamentals, the current downward economic pressure is greater than that of the last international financial crisis. Before the outbreak of the 2007-2008 financial crisis, the global GDP growth rate in 2006 was 4.31%, the highest growth rate in nearly two decades since 2001. After the outbreak of the financial crisis in 2007, the global economy was still able to achieve a growth rate of 4.2%, and it was not until 2008 that the growth rate dropped to 1.8%. Now, the economic situation is deteriorating as the global economy begins to show signs of weakness. In 2019, the global GDP growth rate was only 2.9%, and trade disputes between China and the United States further increased the uncertainty within the global economy. The Institute of International Finance (IIF) released a report on March 23 which predicted that the global economy will grow by 1.5% this year. The latest world economic outlook published by the International Monetary Fund (IMF) in April forecast that the global economy will

shrink by 3% in 2020, a more severe drop than that caused by the 2007-2008 financial crisis.

Second, from the perspective of liquidity, it is notable that a liquidity shortage is not the main risk facing the current global financial system. Since the end of 2019, both the US Federal Reserve and the European Central Bank have paid special attention to the liquidity of funds, which has increased sharply in overseas markets. Moreover, the Fed's process of shrinking its balance sheet ended in September 2019, and current assets are approaching the highest level since 2018. In terms of benchmark interest rates, the benchmark interest rate of the European Central Bank has reached zero. The Federal Reserve has also reset the federal benchmark interest rate back to 0-0.25% in response to the pandemic, and the Bank of Japan has announced a policy to maintain the negative interest rate that has been below zero since 2016. In terms of cross-border liquidity, emerging market countries are facing a record-breaking amount of capital outflow. Both the duration and the scale of outflow have exceeded the level of the 2007-2008 international financial crisis. Therefore, in addition to preventing and controlling the pandemic, emerging market countries will need to cope with the pressure on financial markets caused by capital outflow.

Thirdly, from the perspective of sustainability, the disturbance of the pandemic in the real economy and financial markets will last longer than the international financial crisis of 2007-2008. When the 2007-2008 international financial crisis broke out, the catalyst lasted less than a month, from the bankruptcy of Lehman Brothers on September 14, 2008 to the takeover of Kaupthing Bank in Iceland on October 9, 2008. After that, the crisis shifted to the process of governments and central banks rescuing the market and stimulating the economy. From the outbreak of COVID-19 in China in January 2020 to the time of publishing, nearly three months have passed, and still the end of the pandemic appears nowhere in sight. Some scholars have predicted that the pandemic may even last until next year. Even in the most optimistic scenario, the global economy will basically stagnate due to the impact of the pandemic. Normal production activities will not be sustainable until the late second quarter of this year, which will bring continuous negative impacts and uncertainty to the financial market.

Fourth, from a policy perspective, the policies usually used to stabilize the financial market have a limited capacity to alleviate the current situation. The strong response of the financial market to the pandemic was partly because of the low interest rates of major economies and their limited space for further lowering. Furthermore, it is clear that the current state of affairs goes beyond a financial crisis—it is first and foremost a global public health crisis. The role of traditional monetary and fiscal policies in stimulating aggregate demand typically fail in the face of quarantine measures, which cause normal economic activities to stagnate. In addition, considering that the global economy is closely connected by a supply chain network with a stark division of labor, even if one country has basically controlled the pandemic, the lack of supply from other countries and the huge impact on foreign demand will continue to diminish the effects of stabilization policies.

Based on the above analysis, we draw the following four conclusions.

First, what COVID-19 has triggered is not a new international financial crisis, but

rather a financial market panic caused by large-scale economic stagnation due to a global public health crisis. This panic is a spontaneous response of international investors to the economic recession and uncertainty caused by the pandemic rather than the result of structural problems in the financial markets themselves. Therefore, the best way to approach the pandemic is to actively respond so as to promote macroeconomic stability and eliminate panic instead of adopting a traditional aggressive stimulus policy.

Second, before the end of the pandemic, financial market panics and consequential market adjustments will recur repeatedly. Furthermore, this tendency will not be completely eliminated by the stabilization policies adopted by various countries. Reasons for market volatility include not only the development of the pandemic itself and changes to prevention policies, but also the changes to economic stagnation and inflation caused by the pandemic, as well as the fluctuation of financial asset prices and monetary disturbances caused by economic stagnation. One thing to be aware of is that, according to China's experience and the economic and social realities of various countries, a two-month home quarantine is barely achievable for most Western countries. It is likely that large-scale work resumption will occur in the late second quarter. At that time, adjustments in financial markets will also be made in response to further changes in the pandemic outlook and the recovery of the global economy.

Third, the effects of the pandemic on different types of financial markets in different countries have varied significantly. Countries with better pandemic control, more favorable economic development and financial market conditions, more effective maintenance of social production, and sufficient government and central bank ammunition will be relatively less impacted by financial market shocks. On the contrary, countries with more uncertainties in pandemic control, fragile financial markets, overall stagnation of social production, and limited policy tools (especially emerging market countries) will suffer from greater financial disturbances and the possibility of small-scale or regional financial crises. Take the United States as an example: since the 2007-2008 international financial crisis, the scale of corporate bonds has been expanding, reaching 10 trillion US dollars by 2019. July of this year is the centralized payment period for corporate bonds in the United States. If the pandemic situation does not improve significantly and the economy remains sluggish, there will be a large number of corporate bond defaults and those risks may be spread to other financial markets.

Fourth, there are significant differences in the financial impact of the pandemic on enterprises of different sizes. There is no doubt that the financial shock brought about by the pandemic will prompt governments and central banks to adopt large-scale stimulus packages and bailouts, and the biggest beneficiaries of these measures will be large institutions, especially “too big to fail” major enterprises with direct access to all kinds of financial support. On the contrary, small and medium-sized enterprises that are short on cash flow, especially those which do not normally finance through the formal financial system, will face great difficulties.

2.2.3 Potential consequences of global credit expansion

In order to effectively deal with the negative impact of the pandemic, major economies have adopted financial and economic stimulus schemes on the largest scale, with the widest coverage, and with the strongest stimuli since the international financial crisis of 2007-2008 and the European debt crisis of 2009-2011, attempting to hedge the economic downturn caused by economic stagnation and falling demand through comprehensive credit expansion.

After the US Treasury proposed a \$2 trillion economic stimulus bill at the end of March 2020, the Federal Reserve launched another \$2.3 trillion credit program on April 9 in continued support of economic recovery. This money will be used to purchase various financial assets including investment-grade corporate bonds, junk bonds, municipal bonds, and collateralized loan obligations. After a long period of discussions, EU countries finally reached an agreement on an economic stimulus package worth 540 billion euros, providing credit lines through the European stability mechanism (ESM) to guarantee the expenditures of debtor countries under the pressure of the pandemic and increase the loan limit of the European investment bank. On April 6, Japan announced an economic stimulus plan with a total value of 108 trillion yen, the largest in Japan's history. The plan is meant to stabilize the economy through direct cash distribution, deferred payment of taxes and social service costs for enterprises, and interest-free loans for enterprises facing financial difficulties. Through these stimulus schemes, governments are attempting to achieve two important economic goals: 1) to maintain employment and economic operations during the pandemic, and 2) to provide support to help the economy achieve a V-shaped recovery.

In the short term, the credit expansion of governments and central banks will stabilize the economy and pacify the financial markets to a certain extent. The strong recovery of major financial markets in April is a good example. There is no doubt that the common measures in the stimulus plans such as low-interest loans and tax and fee relief can ensure the survival of enterprises, especially SMEs, and have a certain inhibitory effect on the rapid rise of the unemployment rate. However, in the medium to long term, this round of economic stimuli will again inevitably lead to the spread of hot money around the world, which will result in a new round of asset price bubbles, posing serious hidden dangers for the global economy after its recovery.

At the same time, although the US dollar and US Treasury bonds have become hot in the short term due to the hedging function, the huge credit expansion in the US will gradually overdraw on the national credit accumulated by the US dollar over many years. On the other hand, the rapid rise of the US deficit ratio and government debt will also reshape the credit of the US Treasuries in the long run. In fact, the global economy never completely recovered from the financial crisis of 2007-2008. The quantitative easing (QE) policy adopted in response to the financial crisis has led to the continuous expansion of government debt, as well as debt held by enterprises and households. A new round of debt crises for major economies is approaching. At present, the leverage ratio of non-financial enterprises in the United States has reached 75%—the highest level in history. Further credit expansion will only continue to push asset prices up on the premise of insufficient economic growth momentum, which will substantially increase rather than reduce the default risk of all kinds of debts. In fact, negative interest rates will also make it extremely difficult to resume normal economic operations through interest rate hikes and other means after the pandemic is over.

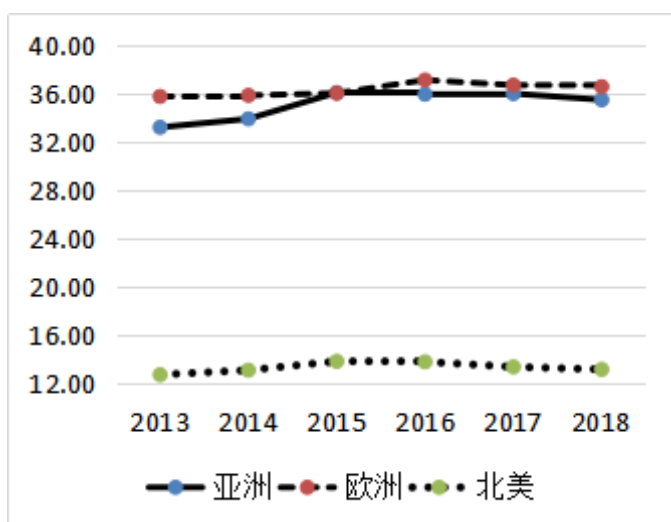
2.3 The Impact of COVID-19 on International Trade

2.3.1 COVID-19 will strengthen the international commodity “tripartite confrontation” trade structure.

From 2000 to 2017, the pattern of international trade changed greatly. Ju Jiandong et al. (2018) concluded that in 2000, the global trade pattern was dominated by the United States as the world trade hub, with two additional small trade centers in Germany (Europe) and Japan (East Asia). By 2017, three relatively stable trade industrial chain regions were formed: Europe, Asia, and North America. Correspondingly, one production and trade hub emerged in each region—Germany in Europe, China in Asia, and the United States in North America.

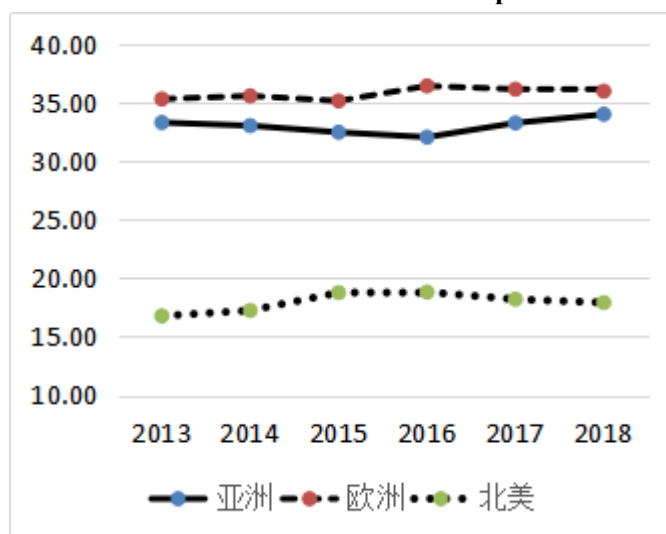
Charts 12 and 13 show the proportions of exports and imports, respectively, of Asia, Europe, and North America in global trade between 2013 and 2018. During these six years, the trade proportions of the three regions in relation to global trade were relatively stable. The imports and exports of Asia and Europe accounted for about 1/3 of world trade, with Europe outpacing Asia by only 1-3%. The export proportion of North America was 12-14%, and its import proportion was slightly higher (16-19%).

Chart 12 The Proportion of Exports from Asia, Europe, and North America in Global Exports



Source: WTO trade database

Chart 13 The Proportion of Imports to Asia, Europe, and North America in Global Imports



Source: WTO trade database

Translation of Chart Text

Blue: Asia Red: Europe Green: North America

From 2013 to 2018, the proportion of internal trade in these three regions was relatively stable, with the highest proportion in Europe, followed by North America and Asia. The proportion of total exports and imports within Europe accounted for about 2/3 of the total exports and imports of Europe, and about 90% of intra-European trade was done by the 28 countries of the European Union. Meanwhile, intra-American trade accounted for 50% of the total trade in North America, and intra-Asian trade accounted for about 48% of total trade in Asia. Germany, the hub of European production and trade, accounted for about 22% of Europe's total exports and 18% of its imports. In contrast, the proportion of US exports and imports in North America was very high, at about 65% of exports and 73% of imports. The average proportion of China's exports to Asia in China's total exports was 50% (China's imports from Asia accounted for 56.28% of China's total imports on average). Among China's exports, those to ASEAN and Europe accounted for about 18% on average and those to North America accounted for 19% on average (18% of which were to the United States).

2.3.2 The impact of COVID-19 on China's international trade

Based on China's imports and exports over the past two months and the current global pandemic, we forecast China's international trade outlook in 2020 under the following two scenarios.

In the first, more optimistic scenario, the United States will initially control the pandemic in early June, and the pandemic in Europe will also peak before summer, with some work and production suspended. As there is no cross-regional labor flow in European countries, once the pandemic is under control, the resumption of work and production will be relatively easy to achieve, especially in Germany, Switzerland, and other countries with good management. In addition, the pandemic in Southeast Asia and South Asia will be basically controlled during the second quarter. We assume that China's exports to the United States, the European Union, East Asia, and South Asia and other regions will drop by 20%, 30%, 10%, and 20%, respectively. In this way, China's annual exports will fall by about 18%.

Under the second, worse scenario, the pandemic in Europe will get out of control, becoming difficult to contain. The pandemic in the United States will also have a second wave in autumn and winter. China's exports to Europe will fall by 80%, its exports to the United States will fall by 50%, its exports to East and South Asia will fall by 10%, and its exports to other regions will fall by 20%. Overall, China's exports are predicted to fall by 33%.

In contrast, during the 2007-2008 financial crisis, global trade shrank and exports fell by 22%. In 2009, China's exports to the United States decreased by about 12.5% (13% for North America as a whole), its exports to the EU fell by 19%, and exports to East Asia dropped by 5%.

According to Wang Zhi, Wei Shangjin, and Zhu Kunfu (2015, Social Sciences in China) and the 2018-OECD-TIVA database, China's domestic added value in exports after 2015 has been about 85%. Based on China's export volume of RMB 17.23 trillion (accounting for 17.44% of GDP) in 2019, if China's exports were to fall by 18-33% this year, then the domestic added value would decrease by 3.1-5.69 trillion yuan, accounting for 3.14-5.75% of China's GDP (98,845.8 billion yuan).

In terms of the service trade, the deficit of tourism accounted for 92% of the total deficit of service trade in 2018. That is to say, outbound tourism is the most important factor generating China's service trade deficit. Since the outbreak of COVID-19, China's overseas tourism trade has been basically zero this year. Taking 2018 as the benchmark, the zero deficit of tourism trade has the potential to increase GDP by about 1.86%.

In the past two years, Sino-US trade relations have experienced ups and downs. Although China and the United States reached a first-stage economic and trade agreement in December last year, trade disputes between the two countries have not yet been completely resolved, and the potential risk of trade friction still exists. With the unemployment rate, income inequality, and the pressure of an economic recession increasing under the pandemic, governments may take more protectionist trade measures, which will intensify the anti-globalization trend. In particular, developed countries may increasingly restrict the trade and technology transfer of high-tech products. China is facing increasing pressure on intellectual property rights and technology transfer.

According to the above analysis, we believe that China's foreign trade should make efforts in the following areas:

(1) All countries need medical supplies to fight against the coronavirus. We should actively restore the mid- and upstream domestic and international logistics of raw materials and components, and increase the production and export of medical products such as masks, ventilators, and so on. (2) The prices of oil and iron ore have fallen due to the pandemic. This is a good time to increase the reserves of oil, iron ore, and various heavy metal ores. China should increase its imports of bulk commodities. (3) China's exports to Asia account for half of its total exports. Additionally, production and trade in East and South Asia have been less affected by the pandemic. Therefore, we should deepen regional trade cooperation in Asia, especially with regard to industrial chain cooperation in East Asia. (4) We should provide loan support to consumer goods export enterprises related to non-medical products to avoid the large-scale bankruptcy of enterprises. Export goods withdrawn for sale in the home market should be allowed, and enterprises should be encouraged to improve the quality of products and open up the domestic market. (5) Negotiations with countries on technology transfer should be carried out in an orderly manner through various ways such as trade and aid for medical products., the goal of mutual benefit, common resistance to the virus, and pursuit of long-term positive economic development. These goals should be clarified, especially in the trade and technology transfer of high-tech products. (6) A series of Sino-foreign trade and investment fairs should be held as soon as possible. Starting from the spring Canton Fair, an online version of fairs should be launched, with relevant government departments providing technical and policy support. At the same time, various network resources should be allotted to facilitate the collection and exchange of information between enterprises in China and foreign countries, match supply and demand resources, eliminate the deficiencies of long-distance business negotiations, and ensure that enterprises can obtain foreign trade orders.

III. Analysis of the Domestic Economic Situation

At present, China is still one step away from crossing the middle-income threshold. In order to cope with future changes, it is necessary to clarify the current stage of China's economy and identify appropriate countermeasures. We believe that China's economy is currently in the middle and late stages of industrialization, the middle stage of urbanization, the critical period of industrial upgrading, and the deepening period of informatization. Whether the domestic demand potential contained in these four stages can be successfully harnessed will be the key to the stable growth of China's economy and the realization of the two centenary goals.

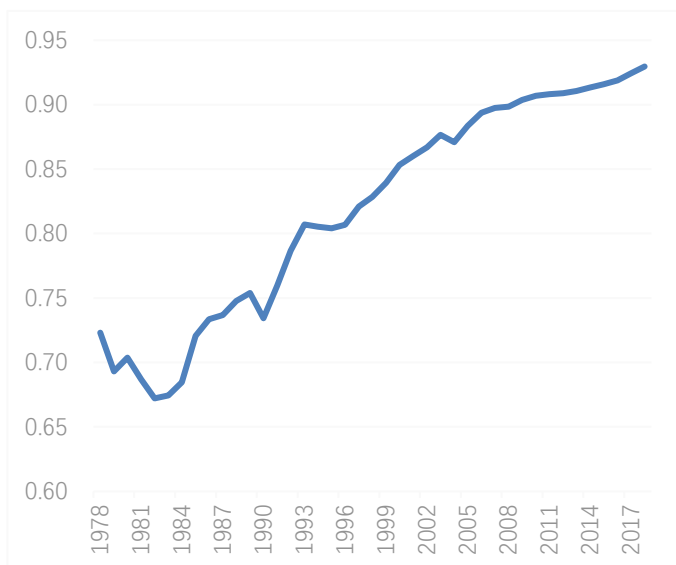
3.1 China's Current Stage of Economic Development

3.1.1 China is in the middle and late stages of industrialization.

In terms of its industrial development stage, China's economy is in the middle and late stages of industrialization. On one hand, looking at the composition structure of added value, the proportion of non-agricultural industries in GDP has reached more than 90%, and agriculture accounts for less than 10%. Although lagging behind the United States (95%) and Japan (98%), this level is roughly equivalent to that of European countries such as Germany and France. China's industrial added value accounted for 33% of GDP in 2018, a significantly higher percentage than the average level of developed countries (22% in the EU, 18% in the US, 29% in Japan). Meanwhile, added value from the service industry accounted for 53% of GDP, lower than the average level of developed countries (66% in the EU, 77% in the US, 69% in Japan). At present, the proportion of industrial added value to GDP has been trending downward, while that of the service industry has been rising rapidly. On the other hand, compared with developed countries, China's industrial sector is still characterized by low capital intensity, low technology content, and low industrial concentration.

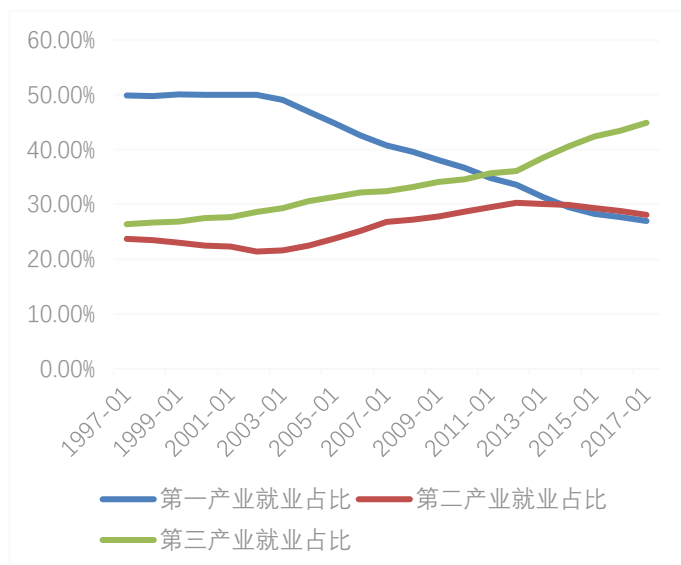
From the perspective of employment structure, China's industrialization still needs further improvement. In 2018, the proportion of non-agricultural employment within the total working population only amounted to 74%. This is not only far below the level of developed countries (more than 95%), but also lower than that of other developing countries such as Brazil and Mexico. For reference, in 2018, the average employment rate of secondary and tertiary industries reached 96% in European countries, 97% in Japan, 98% in the United States, 90% in Brazil, and 87% in Mexico. During the next 15 years, China's major task for economic development will be to gradually promote economic transformation from the middle and late stages of industrialization to the post-industrial period and realize high-quality industrialization. The proportion of the population employed in non-agricultural sectors should further increase and the percentage of agricultural workers should decrease accordingly.

Chart 14 Proportion of Added Value of Secondary and Tertiary Industries



Source: National Bureau of Statistics

Chart 15 Proportion of Employment in Three Industries



Source: National Bureau of statistics

Translation of Chart 15 Text

Blue: Primary Industries

Red: Secondary Industries

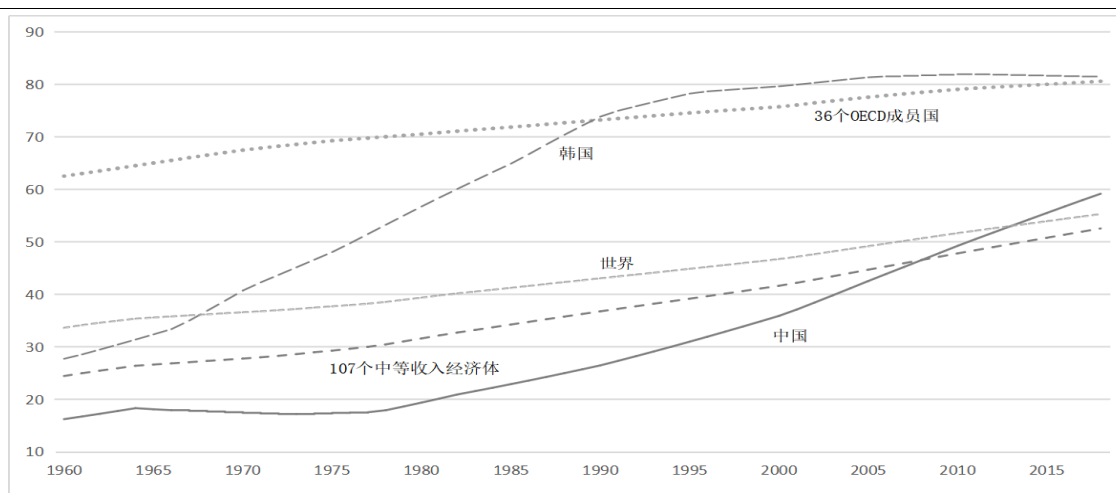
Green: Tertiary Industries

3.1.2 China is in the middle stage of urbanization.

In 2019, China's permanent urban population was 848.43 million, accounting for 60.6% of the total population. Historically, urbanization has been rapidly and consistently improved since the founding of the PRC, especially during the past 40 years of reform and opening up. For reference, the urbanization rate was 10.6% in 1949 and 17.9% by 1978. Seen in the context of international comparison (Chart 16), China's urbanization rate exceeded the average level of middle-income economies⁸ in 2009 and exceeded the world average level in 2014. Furthermore, the gap between China and developed countries has narrowed year by year. The urbanization level in 2018 was roughly equivalent to that of South Korea in the 1980s.

⁸ According to the World Bank's definition, middle-income economies here include countries and regions with a per capita national income between \$996 and \$12,055 in 2017.

Chart 16 Urbanization Rate (Ratio of Urban Population to Total Population, %) of Major Economies in 1960-2018



Source: World Bank

Translation of Chart Text

- Dotted Line: 36 OECD Member Countries
- Dashed Line (longer dashes): South Korea
- Dashed Line (double dashes): World
- Dashed Line (shorter dashes): 107 Middle-Income Economies
- Solid Line: China

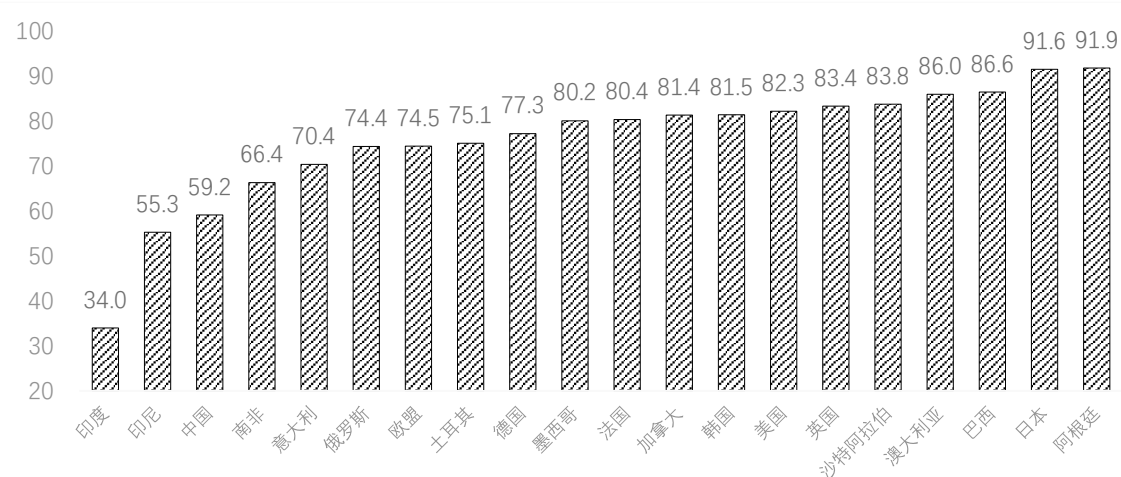
There is still much room for improvement in China's urbanization. Firstly, China still lags behind the 2019 urbanization rate of developed countries—81%. China's urbanization rate is also low in contrast with the average level of G20 countries, and within this group China only outpaces India and Indonesia. Thus, there is still much room for improvement. Secondly, the above-mentioned figures of urban population refer only to all permanent residents living in cities and towns. China's urbanization rate as measured by household registration was only about 44% in 2019. However, there is also a massive non-registered urban population which cannot enjoy the benefits of citizenship and adequate public services such as social security, healthcare, and education. Further efforts must be made to improve the urbanization rate of the registered population. Finally, China's urbanization process is not consistent with its industrialization process. In 2017, the urbanization rate / industrialization rate⁹ ratio was 2.2 in the world, but only 1.4 in China—far lower than that of developed countries such as the United States (4.5) and the United Kingdom (4.7). Compared with the BRICS countries, China's ratio was also lower than Brazil (4.7), Russia (2.4), and South Africa (2.5), and only slightly higher India (1.3).

China's urbanization faces both opportunities and challenges in adjustment and

⁹ The proportion of industrial added value to GDP.

improvement. Along with the process of reform and opening up, urbanization has been one of the most important driving forces of China's economic development. It has played an important role in increasing jobs, raising incomes, reducing the poverty rate, expanding domestic demand, upgrading consumption, adjusting industries, improving productivity, and optimizing the allocation of production factors. As internal migration trends downward, the speed of urbanization will slow each year. While improving the absolute level of urbanization, we must pay more attention to the ensuring that China's urbanization is of the highest quality by addressing problems that have arisen in areas with high urbanization rates, such as traffic congestion, environmental pollution, public health risks, inadequate infrastructure, and insufficient public services and energy supplies.

Chart 17 Urbanization Rate of Economies in 2018 (Proportion of Urban Population in Relation to Total Population, %)



Source: World Bank

Translation of Chart Text

(Left to Right): India, Indonesia, China, South Africa, Italy, Russia, European Union, Turkey, Germany, Mexico, France, Canada, South Korea, United States, United Kingdom, Saudi Arabia, Australia, Brazil, Japan, Argentina

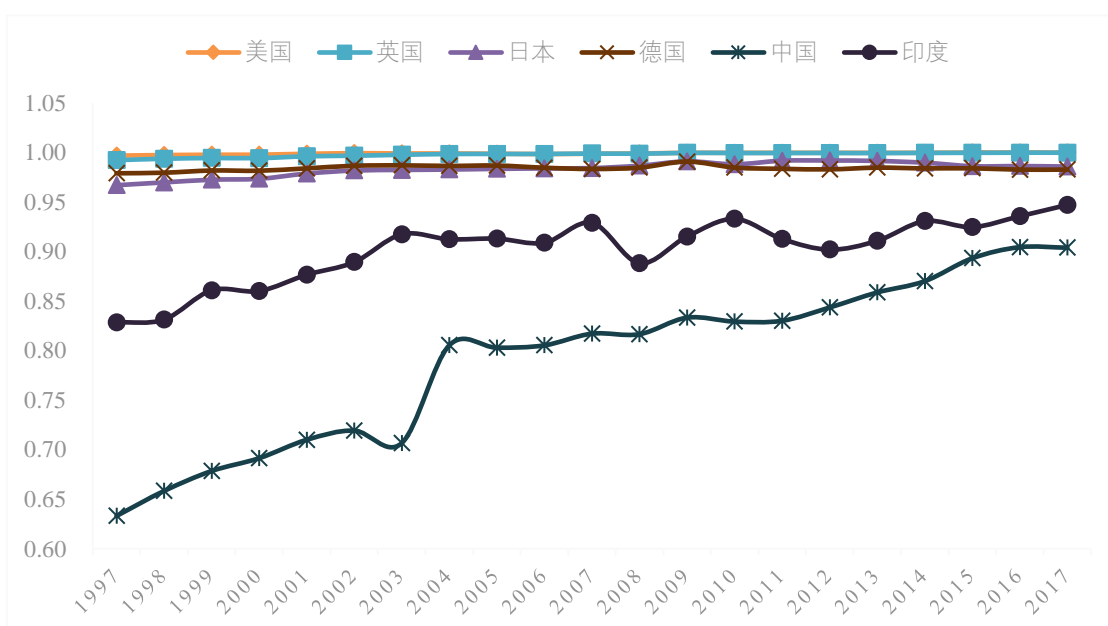
3.1.3 China is in the critical period of industrial upgrading.

Industrial upgrading is the process of raising the industrial sector from the middle and low end of the value chain to the middle and high-end. China is in the critical period of industrial upgrading, and success in this stage is the key to realizing the transformation from high-speed growth to high-quality development. Promoting industrial upgrading through innovation is essential for China to succeed in economic transformation.

Compared with developed countries, there is still much room for adjustment in China's

industrial structure. Since reform and opening up, China's industrial structure has undergone great adjustment: the share of agriculture in GDP declined 20% from 1978 (27.7%) to 2019 (7.1%). At the same time, the service industry has developed rapidly, with its share of GDP increasing from 24.6% in 1978 to 53.9% in 2019. In order to compare the industrial structure of China with that of major developed countries, we calculated the “similarity coefficients of industrial structure” based on the protocol of the United Nations Industrial Development Organization (UNIDO) for China, the United States, the United Kingdom, Japan, Germany, and India from 1997 to 2017. We selected 2017 US data as the benchmark. In our results (Chart 18), is not difficult to see that traditional developed countries have highly similar industrial structures. Compared with these countries, developing countries such as China and India have much room for adjustment in their industrial structure.

Chart 18 Similarity Coefficient of Industrial Structure between China and the United States, Britain, Japan, Germany and India (Based on the Data of the United States in 2017)



Data source: WDI database, Calculated by ACCEPT

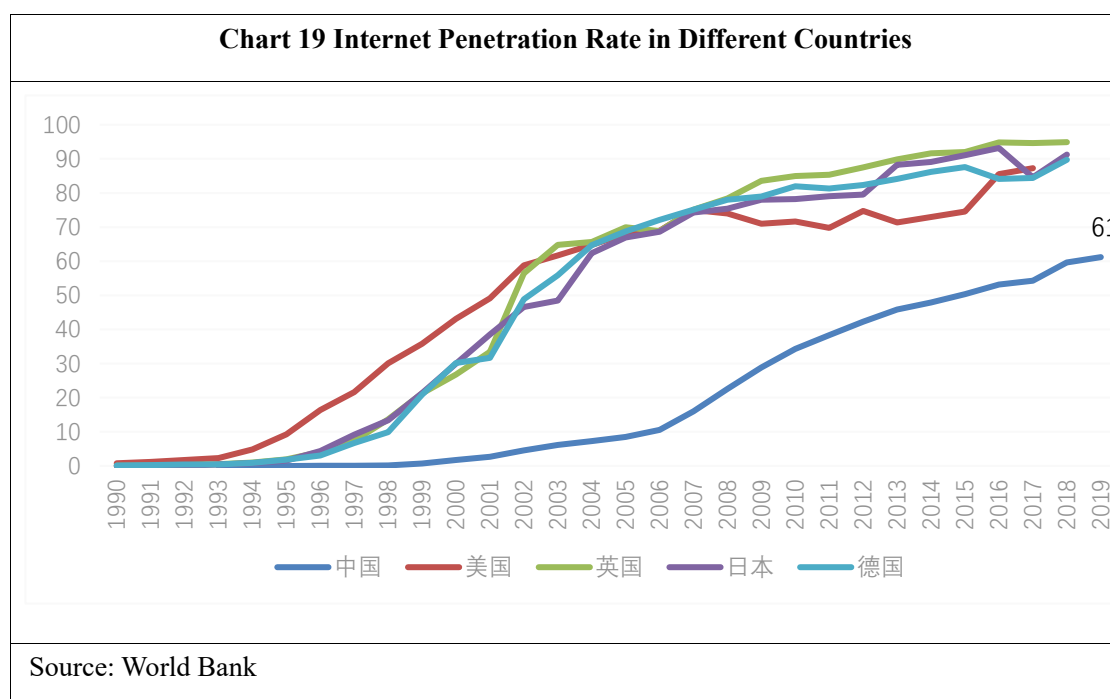
Translation of Chart Text		
Orange Diamond: United States	Blue Square: United Kingdom	Purple Triangle: Japan
Brown "X": Germany	Dark Asterisk: China	Black Circle: India

Following the supply-side reform in 2015, the problem of overcapacity in coal, steel, and other industries in China was been initially solved. **We believe that the key to the next steps in industrial upgrading is the transformation of private enterprises in industries with excessive competition.** China's private economy, especially the private economy in the middle and lower reaches of the industrial chain, is facing difficulties merging and reorganizing due to its low

industrial concentration. Using the elevator industry as an example, at present, national brands occupy about 30% of the market share, among which 10 leading enterprises account for about 15% of the market share, and more than 600 domestic SMEs share the remaining 15%. In countries with mature market economies, similar industries are generally carved up by about 10 large enterprises. The process of moving from the stage of enterprise crowding and excessive competition to the state of high industrial concentration in mature economies will be extremely painful for private entrepreneurs and bankers, but the process of merging and reorganizing is essential for China's continued economic transformation and upgrading. If handled properly, problems encountered along the way can be converted into opportunities for economic growth. If not, they will become a major burden for the financial sector and related industries.

3.1.4 China is in the deepening period of informatization.

After nearly three decades of rapid development, China's informatization has begun to take shape, but it still requires further development. By June 2019, the number of Internet users in China reached 854 million, about 2.9 times the number of Internet users in the United States. The Internet penetration rate also exceeded 60%, reaching 61.2%. However, we should keep in mind that most major developed countries have Internet penetration rates higher than 80% (87.3% in the United States, 94.9% in the UK, 91.3% in Japan and 89.7% in Germany). Thus, China's adoption and popularization of information technology still have room for further improvement.



Translation of Chart Text				
Darker Blue: China	Red: United States	Green: United Kingdom	Purple: Japan	Light Blue: Germany

In addition to the continuous expansion of the overall user scale, the development of China's informatization is also reflected in its digital infrastructure, information technology industry, and digital economy. China has built the world's largest optical fiber and mobile communications network, giving birth to the world's second-largest Internet industry (after the United States). World-class enterprises valued at hundreds of billions of US dollars, such as Alibaba and Tencent, were born here. Big data, cloud computing, artificial intelligence, and other technologies are also becoming increasingly mature. According to China's *Internet Economic Impact Report* (2019), jointly released by the China Center for Internet Economy Research (CCIE) of the Central University of Finance and Economics, ACCEPT of Tsinghua University, and Guangming Online, the direct and indirect contribution of the Internet economy to China's economic growth in 2018 totaled 27.53 trillion RMB, accounting for 28.56% of GDP in that year. As we can see, the Internet economy has become a new driving force for China's economic growth in the new era.

At present, China's informatization is in a critical period of deepening. From this point forward, while expanding in scale, China's information development will also focus more on strategic goals such as core technology breakthroughs, structure optimization, and quality improvement. For example, in the Internet industry, existing unicorn enterprises in China mainly focus on 2C services and business model innovations, while their relatively backward core technology has always been a weak point restricting development. In contrast, unicorn enterprises in the United States focus on 2B services and technological innovation. **The next fundamental step of China's informatization is to master core technologies and create innovations in production based on advantages in 5G and other information technologies such as AI, IoT, the industrial Internet, etc. so as to promote the integration of information technology and the real economy in a deep and sustainable manner.**

3.2 2020 Economic Growth Target

3.2.1 Our GDP growth forecast without stimulus measures

Here, we use the expenditure method to estimate economic activity in the next three quarters. Without policy stimulus, the average growth rate of consumption in the year's last three quarters is expected to rebound to 7%. Let us assume that the investment growth rate is 6% (the average level of the past four years), the import growth rate is 1.6%, and the export growth rates for the last three quarters are -20%, -10%, and 0%, respectively. In this case, **the GDP growth rates in the second, third, and fourth quarters will come out to 2.4%, 4.3%, and 6.2%, respectively. In addition, based on the growth rate in the first quarter (- 6.8%), the annual GDP growth rate will be 1.9%.**

3.2.2 Estimation of policy stimulus measures required under the two growth targets

We now estimate the annual growth rate and the policy stimulus measures needed to achieve the two growth targets: 1) doubling GDP and per capita income, and 2) ensuring

employment.

Goal 1: To successfully double the GDP and per capita income, and to build a moderately prosperous society in all respects. This year is the projected timeframe in which China is expected to achieve its goal of building a moderately prosperous society in all respects. In order to accomplish this goal, there are two instances of “doubling” that must be achieved: 1) to double the real GDP compared with 2010, and 2) to double the per capita disposable income of urban and rural residents. According to our estimations, **in order to double the per capita disposable income of urban and rural residents, the annual per capita disposable income of urban and rural residents must increase by 2.1%.** Assuming that the actual growth rate of per capita disposable income is equal to the actual growth rate of GDP, the actual growth rate of GDP should not be less than 2.1%, **and about 1 trillion yuan in policy stimulus will be required. In order to double real GDP, we must achieve a GDP growth rate of 5.63% for the whole year, requiring about 4.5 trillion yuan in policy stimulus.**

Goal 2: Ensuring employment. Based on data from the past two years, one percentage point of GDP growth is equivalent to about 2-2.2 million new urban employees. This means that in order to create 10 million jobs this year, China requires a GDP growth rate of about 4.5%. **This year, with the introduction of income subsidy policies aimed at protecting the basic livelihoods of middle and low-income people, policies to assist SMEs, flexible employment policies, university enrollment expansion, and so on, employment’s dependence on GDP growth has decreased. We believe that if a 3-4% GDP growth rate can be achieved, employment will be basically stable. The scale of policy stimulus needed to achieve this goal is about 3 trillion yuan.**

We do not believe that this year’s economic growth target should be set too high. Decimated by this once-in-a-century pandemic, the policy space in the next two to three years will be overdrawn if we persist in using the original growth target. As the external environment deteriorates after the pandemic, we will be in a passive situation as we continue to digest the side effects of the early stimulus policy. **Therefore, we propose to focus on doubling the per capita disposable income of urban and rural residents this year and ensuring employment for GDP growth—that is, to set the GDP growth target at 3-4%.**

IV. Response Measures: Ensuring Security, Protecting Livelihoods, and Seeking Long-Term Development

Considering the possibility of the rapid deterioration of the international environment in the next two to three years, the core of China's economic work this year should focus on three main areas. First, ensuring security. Efforts should be made to ensure security in food, oil, industrial chains, and finance so as to prevent problems leading to a retrogression in development. Second,

protecting livelihoods. We must ensure the earnings of low- and middle-income people, support SMEs, stabilize employment, and boost automobile consumption. Third, seeking long-term development. We must promote a series of market-oriented reforms, including state-owned enterprise reform and factor market reform, and focus on cultivating and releasing domestic demand by doubling the middle-income population so as to provide an impetus for China's medium and long-term economic development.

4.1 Ensuring Security: Protecting the Foundation of China's Economic Development

4.1.1 Emphasizing food security and guarding against the risk of a sharp rise in international food prices

During the pandemic, many grain exporters have introduced measures to restrict grain exports. The Food and Agriculture Organization (FAO) of the United Nations has also called upon all countries to take measures to reduce the impact of the pandemic on the food supply chain. Overall, the current impact of the pandemic on China's food security is controllable, mainly due to the following two reasons.

First, China's food supply basically does not rely on foreign imports and is not affected by the export restrictions of other countries. Although China has the largest grain import volume of any country in the world, it is also a “bean-dominant” importer. For example, in 2019 China imported 855.1 billion tons of soybeans, which accounted for more than 70% of China’s total agricultural imports. In terms of the usage of China’s imported grains, most of them are used for processing, such as in edible vegetable oil and protein feed. As an important agricultural product with the potential to stimulate economies through exports, these kinds of grains have not yet faced export restrictions. Even though a small portion of China’s imported food is used to meet different consumer demands (such as Thai fragrant rice, etc.), the impact of imported food on China's food security is generally controllable.

Second, China’s national grain reserves are sufficient to cope with short-term risks. In recent years, China's rice and wheat production have exceeded demand. According to estimations from the China National Grain and Oil Information Center, the surpluses of rice and wheat in 2019 were 14.3 million tons and 14 million tons, respectively, with obvious characteristics of periodic surplus. At present, China's central and local grain reserves are sufficient. The reserve scale of the main production area maintains 3 months’ worth of sales volume, the main sales area retains 6 months’ worth, and the production and marketing areas retain 4.5 months’ worth. Some grains, such as corn and rice, still face the pressure of destocking, which has helped China cope with the short-term risks caused by the pandemic.

However, we must also recognize that **China is the world's largest importer of agricultural products. Since the tradable amount of agricultural products accounts for a relatively low proportion of total global consumption, the global supply fluctuations caused by the pandemic will certainly bring about substantial fluctuations in international agricultural prices.** In this context, we propose introducing supporting policies for agriculture, stabilizing the planting area

used for domestic grain, guaranteeing farmers' incomes from planting, and increasing grain production. We should take this opportunity to gradually adjust and optimize China's grain production structure and reduce our import dependence on some grain varieties. At the same time, we should also strengthen coordination and cooperation in international food security and trade policies, and jointly safeguard global agricultural trade and market order.

4.1.2 Strengthening oil security, speeding up the construction of oil reserves, and preventing waterway transportation risks

We believe that as long as dramatic geopolitical changes do not transpire, China's oil security does not face major threats in the short term. There are two main reasons for this. **First, from the perspective of supply**, oil production is less affected by the pandemic. This is mainly due to the high degree of automation of oil extraction and lower demand for labor. In March 2020, OPEC produced 27.93 million barrels of crude oil per day, a slight increase compared with February. Even in Iran, a country severely affected by COVID-19, oil production did not decline significantly. In addition, the distribution of the world's major oil exporters is scattered, so production changes in select countries have had a limited impact on the industry as a whole. **Second, from the perspective of demand**, the market for international crude oil is becoming a buyer's market. China is also the world's largest crude oil importer—the country imported 506 million tons of crude oil in 2019. Due to the pandemic, the world's demand for crude oil has declined, and the global energy market has transitioned from operating on a shortage to an oversupply. Therefore, in the short term, China's oil security is not under threat.

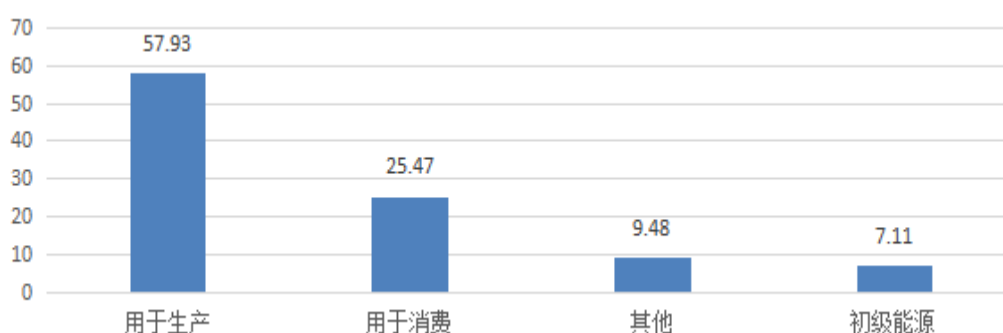
In the long run, however, we must be aware of risks to China's oil supply. China's dependence on imports exceeds 70%, and most of its oil is transported by sea. If there were ever a problem in the Strait of Hormuz or Malacca, China would face an oil supply crisis. **Therefore, we suggest that China should take advantage of the current decline in global energy demand to increase its oil reserves.** At present, China's oil reserves mainly rely on a number of government oil reserve bases, and they are clearly insufficient. It is estimated that China's oil reserve is expected to reach 85 million tons by the end of 2020, which just meets the security standards of a 90-day strategic oil reserve proposed by the International Energy Agency (IEA). These reserves are far less than the amount held by the United States, Japan, and other countries. Therefore, we propose that **China should speed up reforms to the oil reserve mechanism, lift restrictions on commercial oil reserves, and accelerate the pace of related infrastructure construction so as to provide a guarantee for China's long-term oil security.**

4.1.3 Ensuring the security of the East Asian industrial chain and preventing the risk of rupture

The pandemic has not only created the risk of international-to-domestic transmission, but also endangers the industrial chain. According to the UN broad economic category of international trade products, 57.9% of all goods imported by China in 2018 were raw materials and intermediate products serving production (Chart 20). Once the production of related products is affected by the pandemic and begins to stagnate, this will have downstream effects on enterprises in China. Here,

we analyze the potential risks within the international supply chain from two perspectives. **The first is from the perspective of volume, in which we look for products with higher import value. The other is from the perspective of concentration, in which we seek out products with a single import source. From the perspective of volume, integrated circuit products are the upstream products that make up the largest proportion of China's total imports, with the main import sources being Taiwan and South Korea. From the perspective of concentration, imports of rare metals such as cobalt mostly come from a single source, so we should focus on the development of the pandemic in the relevant source countries.**

Chart 20 Composition of China's Imports of Merchandise Goods in 2018



Translation of Chart Text

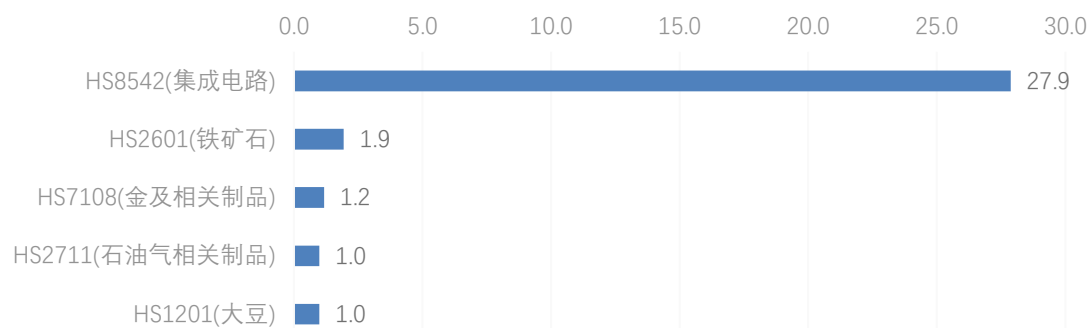
(Left to Right): For Production; For Consumption; Others; Primary Energy Source

Note: The products used for production are those numbered 111, 121, 22, 321, 322, 41, 42, and 521 under the BEC classification. The products used for consumption are the products numbered 112, 122, 522, 61, 62, and 63 under the BEC classification. The products listed as primary energy sources are those numbered 31 under the BEC classification. Other products are those products labeled number 7 under the BEC classification.

Data sources: UN COMTRADE database; World Bank WITS database; calculated by ACCEPT

We now analyze the scale of imported products for production with each 4-digit number under HS classification as a unit, and calculate the proportion of imports in each category within China's total imports in 2018, as shown in Chart 21. Integrated circuit (IC) products (HS8542) make up the largest proportion of China's imports, reaching 27.9% in 2018—14 times that of the second-largest group of imports, iron ore (HS2601). More than 1% of China's imported products also include gold and related substances (HS7108), petroleum gas and related products (HS2711), and soybeans (HS1201). Within the category of integrated circuit products, processors and controllers (HS854231) account for 43.1%, while memory (HS854232) accounts for 38.1%, and the total of these two categories exceeds 80%. As we can see, China's electronic industry is highly dependent on the international industrial chain, and thus we should be alert to the related risks.

Chart 21 Proportion of China's Imported Products for Production in Relation to Total Imports in 2018



Translation of Chart Text

(Top to Bottom): Integrated Circuit; Iron Ore; Gold and Related Products; LPG Related Products; Soybeans

Note: The products used for production are those numbered 111, 121, 22, 321, 322, 41, 42, and 521 under the BEC classification, excluding primary energy (BEC No. 31). The graph shows products that account for 1% or more of imports.

Data sources: UN COMTRADE database; World Bank WITS database; calculated by ACCEPT

East Asia is the most important source of China's IC imports, with Taiwan, China accounting for 36.1%, South Korea accounting for 30.4%, and IC imports from Taiwan, South Korea, Malaysia, and Japan totaling 81.8%. It is clear that **East Asia is the basic upstream market of China's electronic industry. Thus, if East Asia remains stable, the upstream supply of the electronic industry will be basically guaranteed.** However, we should point out that although the proportion of integrated circuit products exported from the United States to China is only 4.5%, the production of chips and other products in different regions relies heavily on relevant US technologies and patents. Therefore, we must be alert **to the risk of US interference in the electronic industry supply chain in East Asia via its advantages in patents and technology.**

4.1.4 Safeguarding financial security and promoting two-way openness in finance

As a sudden exogenous impact, COVID-19 has greatly impacted the stable operation of China's financial market. This impact has materialized in two major ways. First, the panic and uncertainty brought by the pandemic have been reflected in the financial market, causing a large shock in the market within a short timeframe. Second, the negative impact of the pandemic on the real economy will gradually spread further into financial institutions and markets, resulting in local financial market risks and even crisis. This type of impact is long-term and fundamental, with greater potential to impact financial stability.

The impact of the pandemic on the real economy may lead to three major risks and

challenges in China's financial sector, which should be closely monitored. **The first risk is that of declining asset quality coupled with rising non-performing rates.** According to data from the CBIRC, the percentage of non-performing loans in the banking industry had increased by 0.05% at the end of February. In 2019, the loan balance of China's private enterprises exceeded 40 trillion yuan. If 10% of loans from private enterprises evolve into non-performing assets, then non-performing assets will increase by 4 trillion yuan. At the end of 2019, the balance of non-performing assets in the entire banking system was only about 3 trillion yuan, while the provision balance was nearly 6 trillion yuan. **The second risk is that of bond market defaults.** In the first quarter of this year, 40 bonds defaulted, totaling 54.7 billion yuan—a sharp increase of 76.5% compared with 31 billion yuan in the same period of last year. The impact of the pandemic on real enterprises is the key factor aggravating bond defaults. **The third risk is that of stock pledges.** At present, the total number of pledged shares in the A-share market has decreased from about 650 billion in the peak period of 2018 to the current 560 billion shares, and the proportion of pledged shares in the market of total share capital has decreased from about 10% to 8.2% within the same time period. This is still a relatively high level, and the risk of stock pledges is likely to rise due to the impact of the pandemic, which will further delay the recovery of the real economy.

In addition to the fact that the overall performance of China's financial market during the pandemic has been better than that of overseas markets, the advantages of RMB assets are further highlighted. It is worth noting that China's outstanding achievements in the fight against the pandemic have illuminated the lack of governance capacity in Western powers, which have turned to blaming China in an attempt to quell domestic unrest. China's external environment is becoming increasingly complex, posing new challenges to the country's economic and financial security. It is possible that Western countries, represented by the United States in particular, could launch a partial or comprehensive financial war against China. Comparatively speaking, finance is a weak link in China's international competition and communication, so we should take precautions and make advanced preparations for conflict. **We believe that the United States may launch a financial war against China in the following areas:** 1) Using the legal basis of long-arm jurisdiction, the US may crack down on Chinese financial institutions and capital stock companies listed in the United States. The US may also prevent Chinese enterprises from being listed in the United States. Past examples of long-arm jurisdiction in the US include the cases of the Bank of Dandong and the Bank of Kunlun. 2) The United States may continue its past efforts to launch an exchange rate war. In the past, the US has identified China as an "exchange rate manipulator" so as to affect China's exchange rate stability and capital flow, with spillover effects on the financial market and the real economy. 3) The US may use rating agencies such as S&P and Moody's to downgrade China's sovereign and corporate credit ratings, forcing financing costs upward until there is a debt crisis. 4) The United States may use capital to short Chinese currency, the stock market, or the bond market to cause financial turbulence similar to the cases of Thailand and Hong Kong during the Asian financial crisis. 5) The US may try to force China to open its market by a large margin, resulting in excessive liberalization and financialization. 6) The US may consolidate US dollar hegemony through CHIPS of the New York Clearing House, and cut off direct or indirect contact between Chinese

financial institutions and CHIPS, making it impossible for them to conduct cross-border dollar business. A financial war and a trade war are different, and the force of the predicted financial war is expected to be extremely powerful. In addition to reinforcing the strength of financial institutions themselves, we must also enact sufficient plans to stabilize the financial market. This will require sufficient knowledge and preparation regarding the scope, severity, and proper responses to the coming financial war.

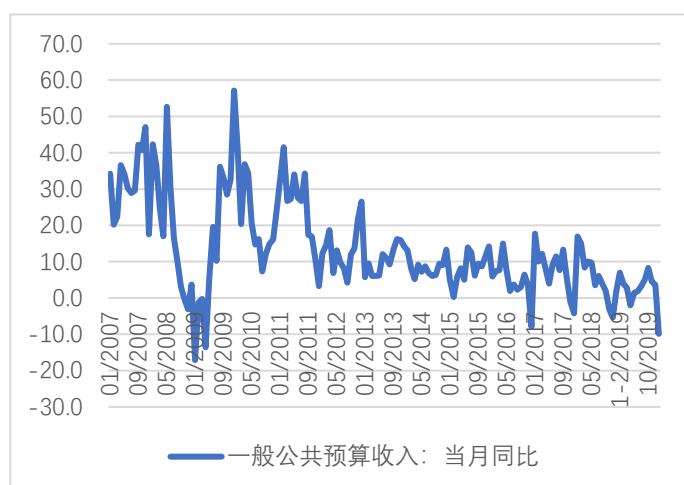
China should thoroughly plan and prepare to launch a multi-pronged response to the potential financial war in order to safeguard financial security. **First, China should accelerate the return of high-quality companies currently listed overseas to the A-shares market.** This is not only a necessary measure to improve the quality of Chinese listed companies, but also an inevitable choice to ensure China's scientific, technological, and financial security. China's high-tech companies listed abroad are potential targets of long-arm supervision by the United States and other countries. Hostile countries may launch investigations or sanctions against Chinese technology companies at any time for any reason, which will seriously affect China's scientific, technological, and financial security. **Second, in the short term, it is necessary to strengthen the control of cross-border capital flow.** This is not contradictory to China's long-term adherence to full convertibility of its capital account, as long as opening is done in a gradual and orderly manner. **Third, China's financial institutions should work hard to improve corporate governance and enhance their core competitiveness.** Financial regulatory authorities should improve their regulatory capacity, reform the regulatory system, and further modernize the financial governance system as well as governance capacity. This will allow China to meet the needs of domestic reform, opening up, and addressing external challenges. **Fourth, China should carry out financial countermeasures when necessary,** such as selling US debt or sanctioning foreign financial institutions in China.

4.2 Protecting Livelihoods: Stabilizing Employment and Guaranteeing Income Growth

4.2.1 Due to COVID-19, China faces increasing pressure on its fiscal balance.

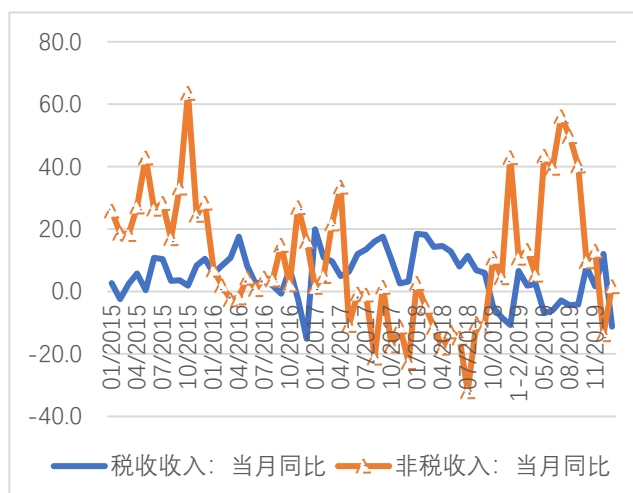
COVID-19 has had a huge effect on the Chinese economy in a short period of time. In terms of finance, according to the latest statistics released on March 24, revenue in China's general public budget fell by 9.9% year-on-year in January-February 2020—the largest drop since the financial crisis in 2008 and a drastic decline compared with the 3.6% increase in December of the previous year. Tax revenue fell 11.2% year-on-year, a sharp drop from the 12.1% growth rate in December of the previous year. Meanwhile, non-tax revenue rose 1.7% year-on-year, which was a significant rebound from the -13.7% growth in December of the previous year.

Chart 22 Year-on-Year Growth Rate of Revenue in China's General Public Budget



Data source: CEIC; calculated by ACCEPT

Chart 23 Year-on-Year Growth Rate of Tax and Non-Tax Revenue



Data source: CEIC; calculated by ACCEPT

Translation of Chart Text

Chart 22 — Blue: General Public Budget Revenue, YoY

Chart 23 — Blue: Tax Revenue, YoY; Orange: Non-Tax Revenue, YoY

In terms of taxation, the significant economic downturn caused by COVID-19 and the aftermath of prior tax and fee reductions resulted in a 19% year-on-year decrease in value-added tax revenue from January to February, a dramatic decrease compared with the drop of 9.4% in December of the previous year. The value-added tax and consumption tax revenue from imported goods also decreased by 25.1% year-on-year, a significant drop compared with the increase of 43.4% in December of the previous year. Meanwhile, deed tax and vehicle purchase tax revenue fell by 15.2% and 32.8% year-on-year, respectively, reflecting the effects of the economic downturn on real estate and vehicle sales. Among all major taxes, personal income tax revenue rose significantly by 14.8% year-on-year from January-February. Due to the bull market from January-February, the stamp duty on securities transactions grew sharply at a year-on-year growth rate of 77.2%.

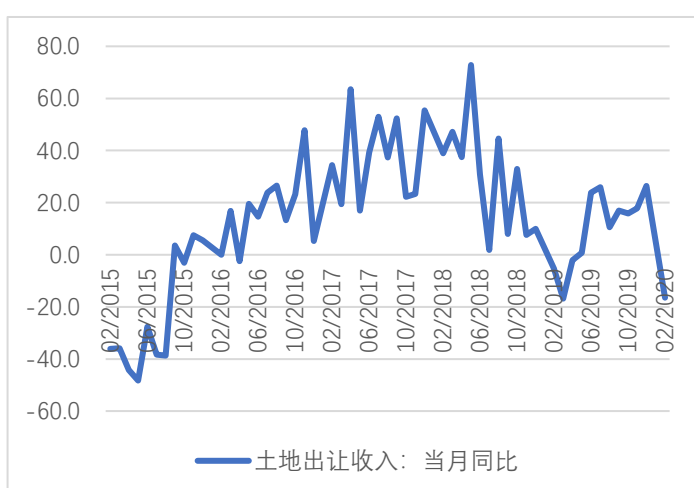
In terms of fiscal expenditures, expenditure in China's general public budgets from January-February decreased by 2.9% year-on-year, a drop of 11.2% compared with December of the previous year. The items with especially significant decreases from the previous year included expenditures in: 1) science and technology (-38.5%), 2) cultural undertakings, tourism, sports, and media (-12.7%), 3) urban and rural community (-20%), and 4) transportation (-25.5%). We also note that during the same time period, health expenditures increased by 22.7% compared with the previous year due to the COVID-19 pandemic.

From January to February, China's land market was severely affected by COVID-19. Income from the transfer of state-owned land-use rights fell by 16.4% year-on-year, a sharp

decrease from the 26.4% growth rate in December of the previous year. Affected by this decrease, the budget revenue and expenditures from central government-managed funds fell by 18.6% and 10.4%, respectively.

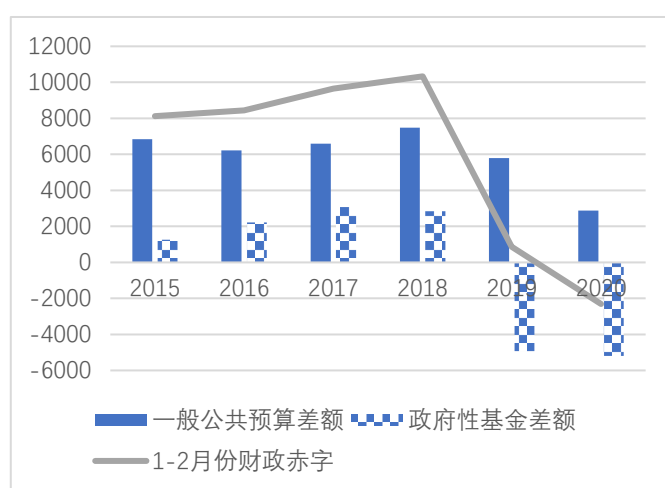
All in all, China reached a 288.2 billion yuan surplus in general public budgets from January to February, a deficit of 519.1 billion yuan in government-managed funds, and a total deficit of 230.9 billion yuan. This is compared with a surplus of 86.6 billion yuan from general public budgets and government-managed funds in the same period last year. **As the impact of the pandemic on the Chinese economy persisted but gradually began to fade after January and February, and the outbreak of COVID-19 overseas began to challenge the Chinese economy from March, the data from January to February does not fully reflect the overall impact of the pandemic. The inevitable reduction in fiscal revenue and the upcoming stimulus policies will put tremendous pressure on this year's fiscal balance. The fiscal space in China is expected to expand significantly in 2020.**

Chart 24 The Growth of Transfers of State-Owned Land-Use Rights Compared with the Previous Year



Data source: CEIC; calculated by ACCEPT

Chart 25 The Fiscal Deficit for January-February 2015-2020



Data source: CEIC; calculated by ACCEPT

Translation of Chart Text

Chart 24 — Blue: Land Transfer Income, YoY

Chart 25 — Solid Blue: General Public Budget Balance; Blue Checkered: Government Fund Balance; Gray: January-February Fiscal Deficit

4.2.2 Fiscal policy will play a leading role in responding to COVID-19 and promoting economic revitalization.

First, **the fiscal deficit rate should be increased appropriately.** According to the *Maastricht Treaty* (or *Treaty on European Union*) in 1991, EU members must maintain a fiscal deficit rate

below the warning level of 3%. It is worth noting that 3% is an integer number intended to encourage EU members to maintain fiscal discipline. It is a soft constraint rather than an internationally recognized, academically proven warning line. In fact, it is commonplace for EU members to have a deficit rate of over 3% and this is also true for other developed economies, such as the United States and Japan. In contrast, China's fiscal position is sound, and the government has abided by more prudent fiscal discipline. The target deficit rate has been maintained within 3% since 1994, and even reached 2.8% in 2019. Challenged by the unprecedented COVID-19 pandemic, China's fiscal deficit in 2020 will be forced to increase in order to match the reduction in taxation and the increase in expenditures brought about by cyclical factors. At the same time, given the probability of more proactive fiscal stimulus policies in the near future, it is pragmatic and necessary to set a deficit higher than the integer number of 3% to compensate for the general public budget gap. If the deficit rate target is raised to 3.5% this year, this will free up about 700-800 billion yuan to enhance people's livelihoods and revitalize the economy in the wake of COVID-19. It is worth noting that the increase in the deficit rate is constrained by factors such as the domestic and international economies, the necessity of national macro-control in China, and fiscal revenue and expenditures. At the same time, the deficit rate plan must be submitted to the National People's Congress for review and approval by the State Council in accordance with legal procedures. Therefore, this year's deficit target is expected to increase in a prudent and limited manner.

Second, special treasury bonds should be issued. Two rounds of special treasury bonds have been issued in China in the past. The first time this occurred was in 1998, when the Ministry of Finance issued 270 billion yuan of special treasury bonds (with a term of 30 years) to replenish capital funds of four Chinese state-owned commercial banks, including the Industrial and Commercial Bank of China (ICBC), the Agricultural Bank of China (ABC), Bank of China (BOC) and China Construction Bank (CCB). This round of bonds played a positive and important role in addressing banks' non-performing assets, dissolving financial systemic risks, and transforming Chinese commercial banks. The second instance was in 2007, when the Ministry of Finance issued 1.55 trillion yuan in special treasury bonds (with terms of 10 and 15 years) to purchase foreign exchange from the People's Bank of China (PBOC) to establish the China Investment Corporation (CIC). Since China's accession to the WTO, there has been a simultaneous current account surplus and capital and financial account surplus, which has allowed China to continuously accumulate foreign exchange reserves for several years. The policy of special treasury bonds established a new mechanism for China's foreign exchange reserve management, and partially helped China relieve the pressure of excessive currency liquidity and deal with an overheated macroeconomy. Since they do not belong to the general public budget deficit and can be issued after approval from the Standing Committee of the National People's Congress, special treasury bonds are a feasible and easy-to-operate policy option. As China faces the gargantuan task of combating COVID-19 and revitalizing the economy, special treasury bonds are a rational and pragmatic choice. The special treasury bonds to be issued this year are being carried out under the special context of the COVID-19 pandemic, and the amount of the bonds is expected to reach more than one trillion yuan.

Third, more local government special bonds should be issued. Local government special

bonds, as capital for major projects, are aimed at leveraging larger-scale credit resources, better supporting the development of major projects under construction, compensating for shortcomings, building more infrastructure, stabilizing investment, and promoting consumption. In 2019, local government special bonds exceeded 2 trillion yuan. Since the beginning of this year, the issuance of special bonds has accelerated significantly. By the end of the first quarter, local government special bonds issued across the country amounted to 1.08 trillion yuan, accounting for 84% of the 1.29 trillion yuan quota issued by the Ministry of Finance. The amount issued in local government special bonds increased by 63% year-on-year, and it is expected that the scheduled issuance will be completed 2.5 months in advance. Based on information released through the conference of the Standing Committee of the Political Bureau of the CPC on March 27, local government special bonds for the whole year of 2020 will be significantly expanded compared to 2019, with an expected amount of 3-4 trillion yuan.

4.2.3 Stimulus policies should be implemented to ensure the livelihood of low- and middle-income groups and the survival of small and medium-sized enterprises so as to avoid excessive government investment.

In response to the pandemic and in order to rejuvenate the economy, China's fiscal policies should be formulated based on two principles. First, people's livelihoods should be given priority, and certain subsidies should be provided to combat COVID-19. There should be a special focus on low-income groups in rural areas and people in areas greatly affected by the pandemic such as Hubei Province. Second, we must also consider long-term development momentum and transform the hardships of the pandemic into an opportunity for a new round of infrastructure revitalization. In this way, we can and contribute to the medium and long-term quality development of the economy and society by increasing investment, employment, and income. In order to promote a more proactive fiscal policy, we raise the following suggestions:

Firstly, we should issue 1.5 trillion yuan in special treasury bonds, with a special focus on the following five areas:

First, we should provide cash subsidies to low- and middle-income groups nationwide. In China's battle against COVID-19, a large number of low- and middle-income families are more vulnerable to unemployment and money shortage. This is not only detrimental to social stability, but also creates obstacles to building a moderately prosperous society in all respects and combating poverty. In order to ensure that low- and middle-income families are able to meet their basic needs and improve their consumption capacity in difficult times, we recommend that the central government directly issue one-off cash subsidies to low- and middle-income groups through special treasury bonds. This will reflect that China is committed to prioritizing the needs of its people and overcoming difficulties in trying times.

Second, we should make special cash transfer payments to Hubei Province and other pandemic-stricken places in China. Hubei Province and other areas severely hit by COVID-19 will take some time to regain social and economic normalcy and begin to invest regularly in capital. Hubei Province has brought about positive externalities through its great sacrifices and contributions

to the prevention and control of COVID-19 in China. In the next two years, the Chinese central government should increase transfer payments to Hubei Province in order to help safeguard people's livelihoods and support the economic and social recovery of Hubei Province and other epidemic-stricken places. Part of the funds should be used to make cash transfer payments or issue consumption vouchers to individuals and families in the affected areas.

Third, more capital should be injected into the China Development Bank (CDB) or used as equity to establish additional special infrastructure investment and financing banks or funds. The COVID-19 pandemic has revealed China's infrastructure shortcomings in healthcare, public health, and other fields. China also has additional shortcomings when it comes to student admissions in primary and secondary schools for the urbanizing population, housing security for migrant workers, renovation of aging residential areas, branch railways, general aviation airports, medical care and public health facilities, municipal infrastructure, national land development, urban and rural garbage disposal, and more. Once the pandemic is over, we propose that China start a new round of infrastructure revitalization with an initial focus on medical care and public health, created around the holistic goal of protecting people's livelihoods.

Fourth, the capital in the commercial banks should be supplemented. COVID-19 has dealt a direct blow to the enterprises and residents. However, it will also inevitably affect the balance sheets of commercial banks. We expect that the non-performing asset ratio of banks will rise in the near future. At the same time, the banking industry will play a leading role as China intensifies its counter-cyclical regulation and policies. Therefore, we must inject capital into banks so as to enhance their lending capacity and their ability to tackle non-performing assets.

Fifth, fiscal policies should support small- and micro-enterprises. Due to the pandemic and weak external demand, employment prospects in China are currently not very promising. Stabilizing employment should be prioritized in terms of China's "six stabilizations" policy and should be the primary starting point of current macroeconomic policies. Small and micro-enterprises play a major role in creating jobs and are more vulnerable to the effects of COVID-19. At present, it is particularly necessary to provide assistance to small and micro-enterprises that have been severely affected by the pandemic and help them retain as many jobs as possible. Specific policies we recommend include loan interest discounts, loan guarantees, unemployment relief, social security subsidies, and supply chain funds.

Specifically, we propose the following: **(1) The 1.12 trillion yuan of newly issued special treasury bonds should be used as one-off cash subsidies for low- and middle-income groups nationwide.** In 2019, the incomes of all Chinese residents were categorized into five groups. The per capita disposable income of the low-income group, the lower-middle-income group, and the middle-income group were 7,380 yuan, 15,777 yuan, and 25,035 yuan, respectively. If the monthly per capita disposable income of each group is taken as the reference standard for this subsidy, around 1.12 trillion yuan is needed to carry out this policy. **(2) An additional subsidy of 150 billion yuan should be provided to people in pandemic-stricken areas, like Hubei Province.** In 2019, the per capita disposable incomes of urban and rural residents in Hubei Province were 37,601 yuan and

16,391 yuan, respectively. If the monthly per capita disposable income of urban and rural residents in Hubei Province is used as the reference standard for subsidies, roughly a total of 150 billion yuan is necessary to carry out this policy. Based on comprehensive calculations, the two cash subsidies provided to low- and middle-income groups nationwide and the people of Hubei would total at about 1.27 trillion yuan. **(3) The remaining portion of the newly issued special treasury bonds, about 230 billion yuan, should be used as supplementary capital for the CDB and other commercial banks.** At the same time, the China Development Bank should be in charge of issuing a greater amount of the CDB bonds. As policy financial bonds, CDB bonds are based on the national credit rating. CDB bonds are categorized as commercial activity and are not included in the government budget, so they are more flexible. Also, they have clear uses and are mainly used to support environmental governance, urban infrastructure development, and other undertakings. As they are clearly based on assets operation, CDB bonds can effectively prevent and control risks and stabilize social expectations. As previously mentioned, the newly issued the CDB bonds can be used to initiate a new round of infrastructure revitalization to prioritize the development of people's livelihoods and facilitate the mid- to long-term high-quality development of China's economy and society. Since CDB bonds are mainly targeted at domestic financial institutions, it is possible to arrange more general government bonds to be issued to foreign investors, which can also effectively promote the internationalization of the Renminbi.

In summary, we propose that China should issue a total of 1.5 trillion yuan in special treasury bonds this year, accounting for about 1.5% of GDP. Within these bonds, cash subsidies for residents will reach 1.27 trillion yuan, accounting for about 1.3% of GDP. As of the end of 2019, China's government debt ratio was 38.5%, and the overall government debt risk was controllable. Therefore, the issuance of 1.5 trillion yuan in special treasury bonds this year falls within the controllable capacity of the Chinese government.

Secondly, the transfer of state-owned capital can be used to offset the reduction in social insurance premiums. In order to respond to COVID-19 and reduce the burden on enterprises, especially small and medium-sized enterprises, the Ministry of Finance and other authorities have issued a series of policies, including some to reduce corporate social insurance premiums. It is estimated that the reduction in social insurance premiums alone will reduce the burden on enterprises by more than 1 trillion yuan throughout the year. Considering that the financial pressure this year is relatively high, **we propose a transfer of state-owned capital to offset the reduction in social insurance premiums so as to avoid the deficit of social security funds being moved into the general public budget and covered by the fiscal subsidies of the Chinese government.** **In the medium and long term, we also recommend that China should speed up the transformation of state-owned enterprises, revitalize state-owned assets, increase the rate of return on state-owned assets, and use the appreciation of state-owned assets to provide fiscal financing, so as to avoid increasing government leverage.** ACCEPT has made specific calculations in previous reports which indicate that the Chinese government can propose specific reform measures for the current state-owned assets that have reached 210 trillion yuan, and increase the current rate of return on state-owned assets from 2% to 3% within three years. According to our

estimates, this has the potential to result in an investment return of nearly 2 trillion yuan, equivalent to one-tenth of fiscal revenue in 2019. This will greatly enhance China's financial strength and provide a solid foundation for further tax cuts and profit concessions. At the same time, the Chinese government can provide 20 trillion yuan of state-owned assets to effectively transform the mixed ownership system, so as to enhance the economic vitality of relevant economic entities and create considerable fiscal revenue for the Chinese nation. According to our estimates, if one-fifth of the transfer of assets can obtain a cash return, the cash return will be about 4 trillion yuan, equivalent to nearly four times the personal income tax revenue in 2019. This will greatly enhance China's financial strength and lay a solid foundation for further reducing taxes and fees.

4.2.4 We must reduce policy restraints on the automobile industry and allow it to drive consumption.

As it becomes clear that the COVID-19 pandemic will last long into the future, we can be sure that its negative impact on consumption will be long-term as well. Sectors that require a large number of consumers, like the catering, hotel, and tourism industries, are likely to be the last to restore normal production and operations. In order to realize economic growth and ensure employment stability, China must stabilize consumption while maintaining investment. To this end, automobile consumption has the potential to serve as an effective driving force. The automobile industry has experienced negative growth in the past two years, but according to our estimates, **if vehicle sales can be replenished to their 2017 levels, the annual GDP growth rate will increase by 0.8%, which is enough to completely offset the negative impact of the catering, hotel, and transportation industries on GDP in the first half of 2020.**

In the past two years, China's automobile consumption has been restrained due to government policies, causing a large amount of demand to remain unmet. With the outbreak of COVID-19, Chinese families' demand for vehicles has become inelastic. Promoting vehicle consumption can boost the Chinese economy, fight against COVID-19, and improve security and convenience in travel. Thus, the automobile industry has the potential to become the core driver of the economy this year.

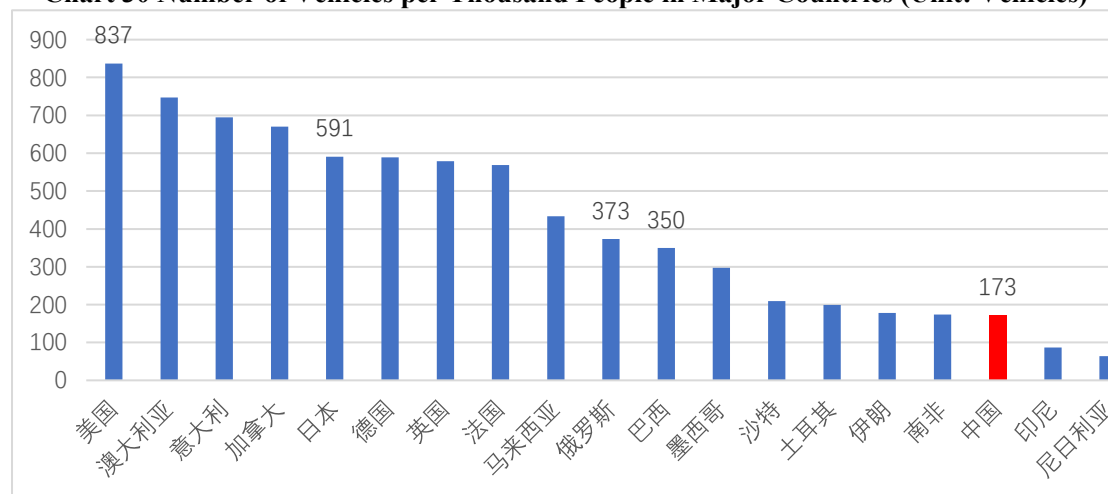
We divide the growth rate of retail sales of consumer goods into two parts: the growth rate of consumer goods other than automobiles has been basically stable in recent years (except for the sharp decline in the first quarter of 2020 due to COVID-19), while vehicle consumption has demonstrated negative growth in the long term. Since July 2018, China's automobile sales have maintained negative growth for 19 consecutive months. Vehicle sales in 2019 totaled 25.77 million, among which there were 21.44 million passenger vehicles—much lower than the 23.71 million in 2018 and 24.72 million in 2017. In 2019, the year-on-year growth rate of vehicle sales was -8.2%. As automobile consumption accounted for more than 10% of total retail sales of consumer goods, **the decline in automobile consumption decreased both the growth rate of total retail sales of consumer goods in 2019 by about 0.85% and the GDP growth rate by about 0.4%.**

There are three main reasons behind the continued decline in this round of vehicle sales: First, the preferential automobile purchase tax policy satisfied people's demands for vehicles in advance,

but that policy was withdrawn in 2018. The policy brought about rapid growth in automobile sales and also had an overdraft effect on automobile consumption for years down the line. Therefore, since 2018, when the preferential automobile purchase tax policy was completely withdrawn, the demand for vehicles has been significantly suppressed. Second, over the past two years, macroeconomic downward pressure has increased, economic growth has continued to decline, and residents' income growth has slowed significantly. Thus, Chinese residents have lowered their expectations for the future and delayed their automobile purchases, as vehicles are optional items. Third, the early transformation from China-V Vehicle Standards to China-VI Vehicle Standards has aggravated the wait-and-see attitude of residents and forced people to delay their purchase and consumption of vehicles. In particular, as some regions have stated that in the short interim between China-V Vehicle Standards and China-VI Vehicle Standards, China-VI vehicles are in short supply while there is a surplus of China-V vehicles. Although consumers want to buy the discounted China-V vehicles, they are unwilling to accept them for fear that the China-V models will be denied license plates, will become unfashionable, and will have a quickly depreciating residual value. As a result, automobile sales have declined dramatically.

At present, China has a total of 240 million automobiles, with 173 vehicles per 1,000 people. This is significantly lower than the rates of 837 in the United States, 591 in Japan, 579 in Germany, 373 in Russia, 350 in Brazil, and 297 in Mexico. China's ratio of cars to 1,000 people is only comparable with that of South Africa—174. Generally speaking, vehicle consumption is closely related to economic development. However, China's per capita GDP is roughly equal to Brazil's and Mexico's, but significantly higher than South Africa's. Therefore, as China's per capita GDP continues to rise and China eventually becomes a high-income country, there is significant space for the number of vehicles per capita in China to increase. In the 15 years between the accomplishment of a moderately prosperous society in 2020 and the realization of socialism in 2035, even if the number of vehicles per 1,000 people reaches the conservative estimate of 350 (with a family of three owning one vehicle on average), the number of vehicles in China can be doubled.

Chart 30 Number of Vehicles per Thousand People in Major Countries (Unit: Vehicles)



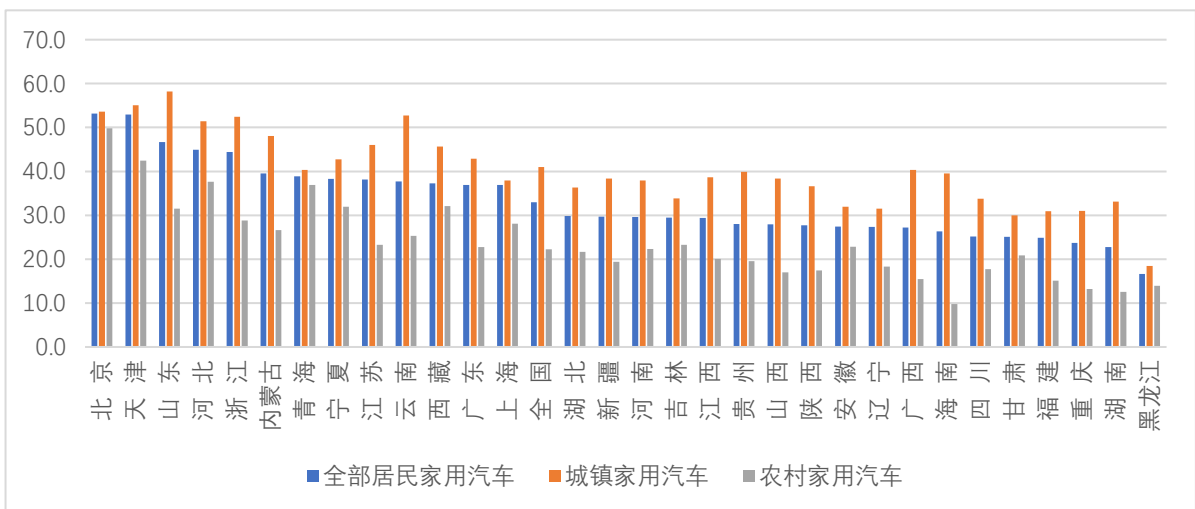
Data source: World Bank

Translation of Chart Text

(Left to Right): United States, Australia, Italy, Canada, Japan, Germany, United Kingdom, France, Malaysia, Russia, Brazil, Mexico, Saudi Arabia, Turkey, Iran, South Africa, China, Indonesia, Nigeria

Moreover, due to the unbalanced economic development between urban and rural areas and between different regions of China, there are obvious differences in the number of vehicles owned by each family between urban and rural areas as well as between different provinces and cities. In provinces, counties, towns, and rural areas with fewer vehicles, local residents are still willing to buy them. As China is still urbanizing and residents' incomes are increasing, these areas have huge potential for vehicle consumption. According to data from the *China Statistical Yearbook*, the average number of vehicles per 100 households in 2018 for the whole nation was 33. In urban areas, this figure was 41, and in rural areas, the figure was halved at 22.3. In terms of different provinces and cities, residents in Beijing and Tianjin had more than 50 cars per 100 households at the end of 2018, while residents in Heilongjiang Province, Hunan Province, Chongqing City, Sichuan Province, Fujian Province, Gansu Province, Hainan Province, Guangxi Province, Liaoning Province, Anhui Province, Shaanxi Province, Shanxi Province, Guizhou Province, Jiangxi Province, Jilin Province, Henan Province, Xinjiang Autonomous Region, and other provinces and cities all had less than 30 vehicles per 100 households, which is lower than the national level. In these provinces and cities, two-thirds of households do not own vehicles yet. As we can see, in the long run, China's vehicle consumer market still has an immense amount of potential still waiting to be tapped.

Chart 31 Average Number of Vehicles Owned by Rural and Urban Residents per 100 Households at the End of 2018 (Unit: Vehicles)



Data source: China Statistical Yearbook

Translation of Chart Text

Key — Blue: Household Vehicles of the Entire Population Orange: Household Vehicles of the Urban Population
Gray: Household Vehicles of the Rural Population

Horizontal Axis (Left to Right) — Beijing, Tianjin, Shandong, Hebei, Inner Mongolia, Qinghai, Ningxia, Jiangsu, Yunnan, Tibet, Guangdong, Shanghai, Entire Country, Hubei, Xinjiang, Henan, Jilin, Jiangxi, Guizhou, Shanxi, Shaanxi, Anhui, Liaoning, Guangxi, Hainan, Sichuan, Gansu, Fujian, Chongqing, Hunan, Heilongjiang

Domestic residents' vehicle purchasing needs have not been fully satisfied. With appropriate stimulus policies, there is still great potential to significantly increase vehicle consumption. Policies created in response to the 2008 financial crisis have been very effective, such as the vehicle purchase tax reduction policy and subsidies for home appliance purchases in the countryside. Passenger car sales in China increased at a rate of 43% in 2009 and 2010 on average, and after the announcement of tax cuts in 2015, the growth rate of passenger car sales also rose to 14.9% in 2016. Vehicle sales have become an important driver for consumption growth.

As long as the Chinese government formulates reasonable stimulus policies, we expect vehicle consumption to become the main driver for consumption growth in 2020. Therefore, we propose the following: **First, we recommend that the State Environmental Protection Administration (SEPA) put forth a unified standard and a plan for phasing out some outdated vehicles, which were manufactured based on inadequate emission standards.** We should appropriately delay the policy of phasing out China-V vehicles so as to boost consumer confidence. In the future, urban air quality will be improved by gradually improving the quality of oil products and encouraging consumers to purchase new vehicles. **Second, in places with license plate restrictions, we recommend that local governments allow the owners of existing license plates to lease them for a fee under the precondition that the total number of license plates must remain unchanged.** In this way, preexisting idle license plates can be transferred, the stock can be revitalized, and young peoples' demand for vehicles can be met. **Third, we recommend the resumption of the vehicle purchase tax reduction and exemption policy. Furthermore, we suggest gradually delegating the regulation power of the vehicle purchase tax to local governments so as to increase their enthusiasm.** In 2019, the total revenue from the vehicle purchase tax in China was 349.8 billion yuan. This money was managed by the central government, which did not provide any incentive for the involvement of local governments. Moving forward, we recommend transferring the regulation of this tax to local governments in order to mobilize them to increase vehicle sales. **Fourth, we recommend that China utilize the opportunity provided by COVID-19 to mobilize domestically-manufactured vehicles to establish themselves in the global market while also bringing in spare parts suppliers from abroad.** COVID-19 has brought great uncertainty to the global supply chain. Due to the pandemic, many parts and components manufacturers and most vehicle companies in Europe have announced the suspension or partial suspension of production, affecting the supply of imported vehicles. In this context, Chinese vehicle companies have an opportunity to increase production and exports to meet the needs of overseas

markets. On the other hand, vehicle production involves tens of thousands of spare parts, and COVID-19 has also caused companies in the vehicle supply chain to stop production. This cut in supply also directly threatens China's vehicle and spare parts production. Therefore, we recommend that China formulate policies to attract some key spare parts and components manufactures—some of which were previously unwilling to operate in China—to set up factories in China and improve the country's industrial competitiveness.

4.3 Seeking Long-Term Development: Cultivating the Market, Developing Domestic Demand, and Striving to Double the Middle-Income Group

4.3.1 We can create great potential for urbanization by reforming the land and household registration systems.

Urbanization is the most critical driving force for China's long-term economic growth, and the real estate market still has huge potential. China should further deepen its urbanization, appropriately increase the supply of land for real estate construction, and maintain stable development of the real estate market. In 2019, China's urban population accounted for 60.6% of the total population, a significant increase from less than 20% at the beginning of reform and opening up. However, nearly 40% of China's population still lives in rural areas. In the future, 150-200 million people will migrate to cities and purchase houses, which will continue to create potential demand for the real estate market, and will require a matching supply of real estate properties and services. Although China's per capita housing area reached 39 square meters at the end of 2018,¹⁰ the complete housing rate¹¹ in urban areas still requires growth. The demand for demolishing old buildings and constructing new buildings is still high, and a large number of houses still require upgrading. This includes the renovation of old residential communities and further urban renewal. People in different communities across cities and regions have different living preferences. When we consider the demand for improved housing, it is clear that China's demand for new housing will continue to grow.

In terms of land supply, most land in the first- and second-tier cities is currently used for industrial development. There is a low supply of residential land, which cannot satisfy the Chinese population's migration needs. The country's current real estate regulation policy focuses on demand-side purchase restrictions. While successfully restricting the purchasing demand for housing in first- and second-tier cities, this policy has not fundamentally solved the problem of housing shortages. Long-term purchase restrictions have made it difficult for some residents to meet their housing needs, but the direct removal of purchase restrictions without increasing the land supply will further push up housing prices. China's urbanization is still developing gradually, and in the future, a large amount of land will be required to continue developing the real estate market and satisfying the

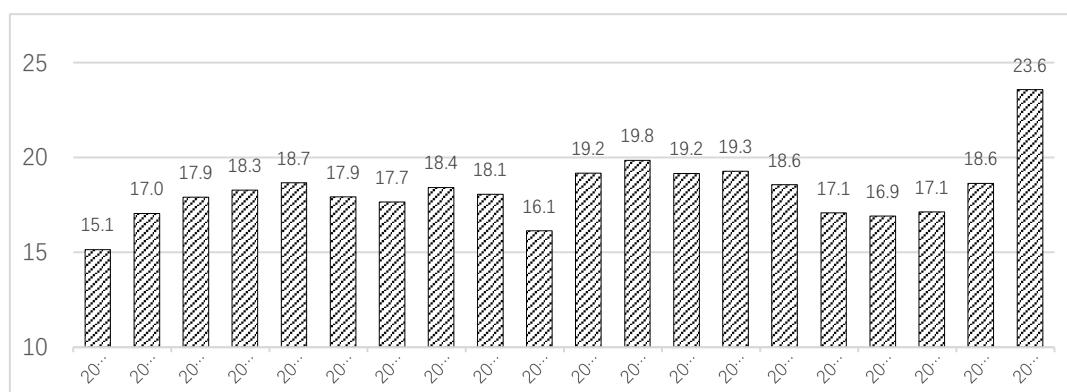
¹⁰ "The Continuous and Rapid Development of the Construction Industry and Significantly Improved Urban and Rural Landscape: The Tenth Report on the Economic and Social Development Achievements of the 70th Anniversary of the Founding of New China," *National Bureau of Statistics*.

¹¹ Here, a "complete house" refers to a living space that can meet all of a resident's needs, including a kitchen, living area, bedroom, and bathroom with toilet and bath/shower. The "complete housing rate" is calculated as the percent of complete housing residential building area out of the entire actual residential construction area.

housing needs of the new urban residents. Furthermore, urban planning must be further transformed. To satisfy other land use needs, we recommend that China appropriately increase the supply of land for real estate construction to meet the rigid demand of urbanization, to meet people’s growing demand for quality housing, and to stabilize land prices. By stabilizing land prices, steadying housing prices and expectations, and avoiding speculation in affordable housing, China can maintain long-term stable and sound development of the real estate market.

Investment in real estate has continued to increase in recent years, and has become an important part of stimulating fixed asset investment and economic growth. Since 2000, China’s real estate market has achieved rapid development—investment in real estate development increased from 498.4 billion yuan in 2000 to 13,219.4 billion yuan in 2019. As the second most important category of fixed asset investments in the whole country,¹² investment in real estate development accounts for a basically stable proportion of overall fixed asset investments, from 15.1% in 2000 to 23.6% in 2019 (as shown in Chart 26), with an average annual proportion of 18.2%. Investment in real estate development has made a relatively stable contribution to the growth of total fixed asset investments from 2001 to 2019, with an average of 28.9%.

Chart 26 Investment in Real Estate Development as a Proportion of Total Fixed Asset Investment in China: 2000-2019 (%)

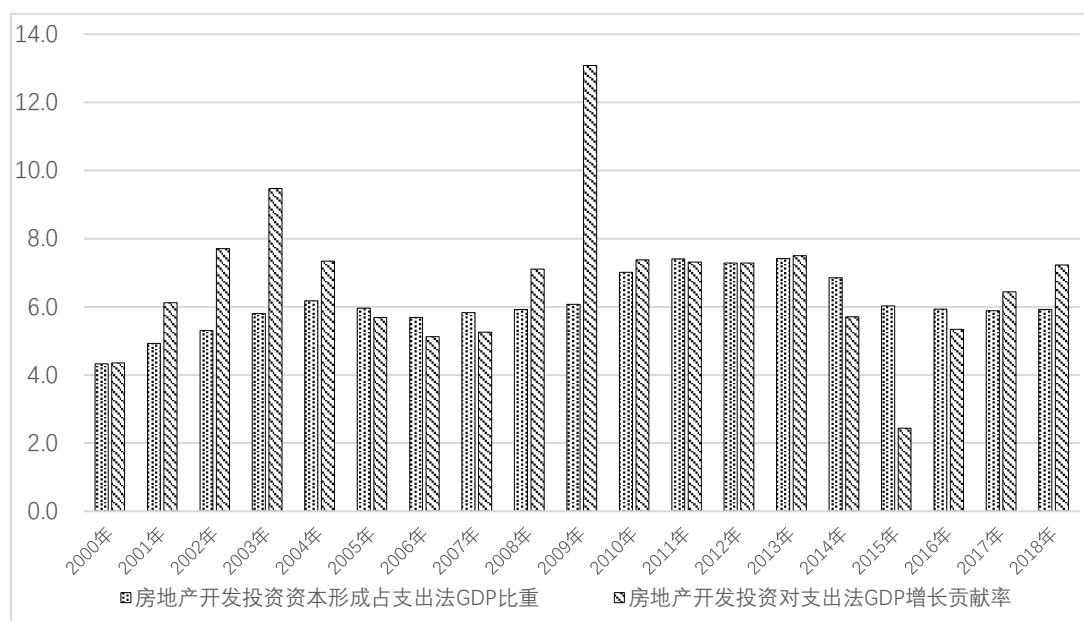


Data source: National Bureau of Statistics; calculated by ACCEPT

After deducting land purchase fees, investment in real estate development accounted for an average of 15% of total fixed capital investments from 2000 to 2018. Based on the average ratio of gross capital formation, which accounted for 40.4% of the GDP by expenditure method in the same period, it can be calculated that the gross capital formation by real estate development investment accounted for a relatively stable ratio of GDP—6.1% on average, as shown in Chart 27. The contribution rate of investment in real estate development to GDP growth was 6.7% on average from 2000 to 2018.

¹² The other two fields are construction project investments of 5 million yuan and above and fixed asset investments of rural households.

Chart 27 The Proportion and Growth Contribution Rate (%) of Real Estate Development Investment in China's GDP: 2000-2019



Data source: National Bureau of Statistics; calculated by ACCEPT

Translation of Chart Text

Dots: Proportion of real estate development investment in China's GDP

Stripes: Contribution rate of real estate development investment to China's GDP growth

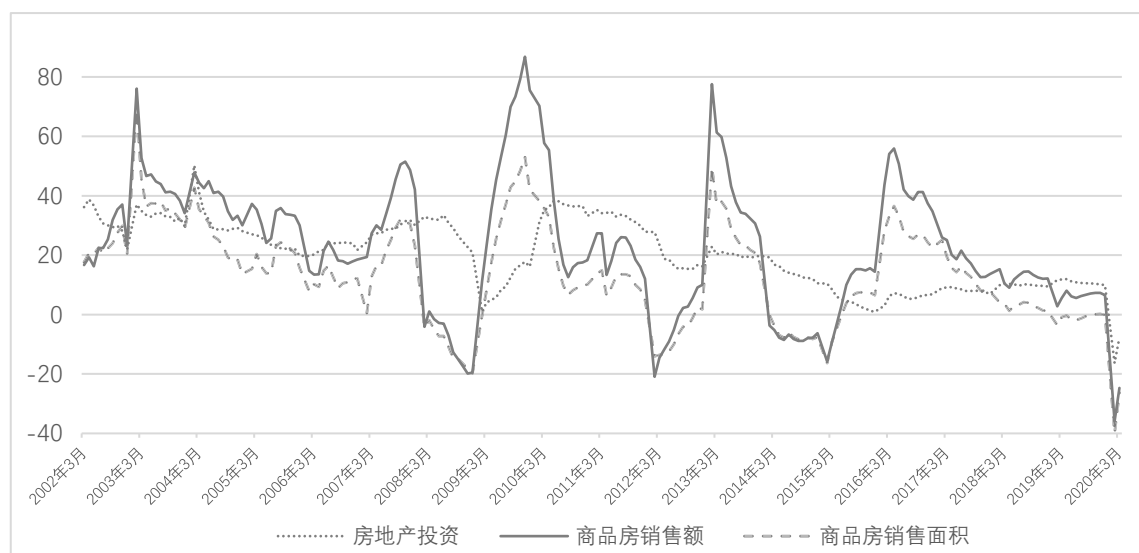
The added value of the real estate industry increased from 404.09 billion yuan in 2000 to 6963.1 billion yuan in 2019. The average annual growth rate at comparable prices for this time period is 8%, which is 1% lower than the average annual growth rate of GDP compared with the same period of last year. The proportion of real estate's added value to GDP increased from 4.1% in 2000 to 7.0% in 2019. Based on our calculations, after deducting price factors, the contribution rate of real estate's added value to economic growth averaged 2.8% from 2000 to 2018.

Although COVID-19 has brought about short-term fluctuations in the real estate market, the market will recover gradually as the pandemic is brought under control in China. From January to March 2020, national investment in real estate development was 216.3 billion yuan (a drop of 7.7% YoY), the area of sold commercial housing was 21.78 million square meters (a drop of 26.3% YoY), and the sales volume of commercial housing reached 2.036.5 billion yuan (a drop of 24.7% YoY). In addition, China's Real Estate Climate Index (CEIC) was 98.18 in March, an increase of 0.78 points from February. From Chart 28, we can see that China experienced the lowest growth rate of its real estate market over the past 20 years in January-February. Although the real estate industry continued to experience negative growth in March, the rate of decline visibly slowed. As the pandemic spread to all provinces and regions across China, sales offices and construction sites everywhere shut down, severely shrinking the real estate market. COVID-19 has been more

detrimental to the real estate market than SARS in 2003. During SARS, although the growth rate of investment and sales in the real estate market declined, the total investment and sales continued to rise. One reason for this was that China was still rapidly developing its economy after joining the WTO during this time. Only some regions such as Beijing and Guangdong were harmed, and thanks to subsequent policy stimulus and demand recovery, damage to the real estate market was limited.

Overall, we believe that the negative impact of COVID-19 on the real estate market will only be short-term, and will not change the long-term development trajectory. As the pandemic weakens, the real estate market will regain its growth. The release of rigid demand and the market demand for upgraded housing has just been postponed, not canceled. The lockdowns and home quarantines necessitated by COVID-19 have also increased Chinese families' requirements for the quality and size of their houses. Correspondingly, demand for housing ownership and improvement is expected to increase significantly, as is the attractiveness of first-tier cities and China's developed eastern coast. As China has basically brought COVID-19 under control, the real estate markets in various regions are rapidly recovering, investment and sales of real estate have rebounded, and new adaptations, such as online housing viewing, are gradually emerging. As of April 1, 2020, China has a total of 186,600 housing and municipal infrastructure projects under construction, and staff for 158,700 housing and municipal infrastructure projects have resumed work (a rate of 85.06%). Among these projects, those in 16 provinces have reached a work resumption rate of 90% or more. The work resumption rate of sales offices nationwide is 92.73%, even reaching 95% in 15 provinces.

Chart 28 The Year-on-Year Growth Rate of Real Estate Investment and Sales from March 2002 to March 2020 (%)



Data source: National Bureau of Statistics

Translation of Chart Text		
Dots: Real Estate Investment	Solid Line: Commercial Housing Sales Income	Dashes: Commercial Housing Sales

4.3.2 Non-performing assets should be quickly handled and replaced in a highly leveraged environment.

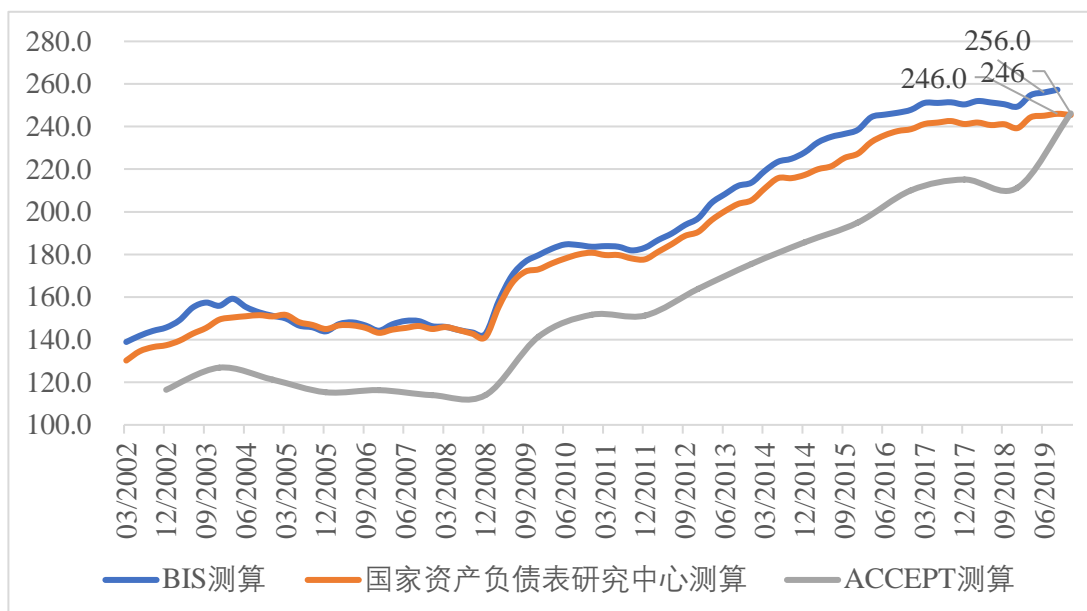
Over the past two years, the rapid increase in China's leverage ratio has been effectively controlled. **In 2019, China witnessed only a slight increase in its macro leverage ratio and achieved a transition from deleveraging to leverage stability.** According to estimates by the Research Center for National Balance Sheet, the leverage ratio of China's real economy (including the government, non-financial enterprises, and residents) in the third quarter of 2019 was 245.4%, an increase of 6.1% from 239.3% at the end of 2018. At the same time, we conducted a unified estimation of the debt balance in China's non-financial sector based on social financing data and constructed China's macro leverage ratio series based on this. According to our calculations, China's leverage ratio was 246% at the end of 2019, an increase of 35% compared with the leverage ratio at the end of 2018.

Leverage will increase this year due to the proactive fiscal and monetary policies implemented by the Chinese government. However, due to the foundation laid by the previous resolution of financial risks, we believe that the increase in leverage should be handled reasonably, keeping the total amount of leverage within the proper range. There are three internal reasons behind China's recent increase in leverage. First, recent developments in China's real estate market and the deepening development of the financial sector have enabled many physical assets, such as land and houses, to be used as collateral for banks' credit funds. To a certain extent, the leverage ratios of the residential sector and non-financial corporate sector have been raised. Second, since 2008, local governments have increased their investments in infrastructure construction. According to relevant estimates, the implicit liabilities of local governments have reached 30 trillion yuan. Those liabilities are rooted in the credit funds of banks and have also contributed to the increase in the leverage ratio. Third, the low proportion of equity financing in China's financing structure and the long-term high national savings rate have resulted in a large amount of investment being transformed into debt, which has increased the leverage ratio in China.

At the same time, we believe that the most important issue at present is to achieve leverage replacement in a highly leveraged environment, increase good leverage, remove bad leverage, and deal with non-performing assets, especially the implicit debt risks of local governments. In terms of the current Chinese economy, during the transition from rapid growth to high-quality growth, the key issue is to deal with bad debts leftover from previous rapid growth. To achieve high-quality development in its financial system, China must be more committed to resolving non-performing assets. At present, non-performing assets mainly include corporate and local debts. The corporate debts have been dealt with in a sound manner in many provinces, which have established asset management companies to resolve corporate non-performing loans. This leaves the remaining problem of how to resolve existing local government debt. In response, China has gradually formed a set of local government-led and bank credit-driven infrastructure development models. This model has played an active role since reform and opening up, enabling China to rise as a global infrastructure power and develop rapidly for many years. At the same time, we should also be soberly aware that local government-led infrastructure investment in China has always lacked

unified, efficient, and feasible analysis and management operations, effective restraint mechanisms, clear accountability, and transparency. There are also a series of problems in cost-benefit analysis, such as formality and difficulties in supervision and accountability. Furthermore, we must emphasize that bond financing cannot satisfy capital needs for infrastructure investment. Rather, local governments tend to take advantage of the large amount of bank credit resources at their disposal and issue a considerable amount of financing in the form of LGFV bonds based on local financing platforms. As government-led projects are characterized by implicit guarantee, infrastructure projects have given small and medium-sized enterprises access to a large number of loans, and in the process have also formed implicit liabilities estimated at 30 trillion yuan. These implicit liabilities come from the banking system, and in the long run, they may cause a prominent risk to China's economy. Whether this risk can be effectively prevented and resolved is an issue of great consequence to society at large.

Chart 29 China's Macro Leverage Ratio



Data source: CEIC database and BIS database

Translation of Chart Text		
Blue: BIS calculation	Orange: Research Center for National Balance Sheet calculation	Gray: ACCEPT calculation

To resolve local government debt, China can make efforts from two key areas. **First, we must speed up the resolution of local government debt stocks.** Non-performing debt should be stripped from local governments and undertaken by the central government as soon as possible. We must prevent the financing and refinancing of local governments from continuing to occupy valuable bank credit resources. In this way, we can effectively alleviate the problems of many enterprises, especially the financing pressure on small and medium-sized enterprises. **Second, we must restrict**

the financing behavior of local governments and adopt innovative methods to accelerate the reform of investment and financing in the infrastructure sector. We recommend empowering the CDB or a new nationwide infrastructure investment and financing company to uniformly manage the planning, financing, construction, and supervision of new infrastructure projects in the new round of infrastructure investment. To accomplish this, personnel can be transferred from the National Development and Reform Commission (NDRC), the Ministry of Finance, the National Audit Office (NAO), and other relevant departments. According to the operation methods of the World Bank and other international development institutions, this company should conduct market-based cost-benefit analyses on infrastructure projects of local governments across China, issue bonds or organize social capital to finance the projects, and exercise the rights of investors to supervise and hold projects accountable. At the same time, we also suggest that these debts should not be included in the national budget. Instead, they should be issued separately by the Ministry of Finance to avoid misunderstandings in the market. As these debts will form corresponding assets, they are not government debts or treasury bonds in the ordinary sense.

4.3.3 We must pragmatically promote the two-way opening of finance and realize the internationalization of the RMB.

It must be recognized that the current level of China's financial opening up is still extremely low and clearly lags behind the opening up of the real economy. Foreign enterprises hold less than 4% of shares in China's stock market, less than 3% in the bond market, and less than 2% in the Chinese banking sector. The renminbi accounts for less than 2% of global reserve assets. If China wants to become an economic power and attain quality development, the country must unswervingly follow a policy of financial opening up. There is still a long way to go before two-way opening up can be realized. China still lacks some experience in the extremely secretive, professional, and complex finance sector. In the context of the current complicated and hostile external environment, we must promote two-way financial opening up at a moderate speed while ensuring safety.

According to predictions by international organizations and market institutions, the global economy will face an inevitable recession in 2020. Thanks to China's successful efforts against the pandemic, it may become the only country to achieve positive growth among the world's major economies this year. The effective recovery of the real economy has laid a solid foundation for China to become the first to stabilize its financial market. If this advantage is fully utilized, China's financial difficulties may be transformed into three major opportunities for development:

First, China's financial market may become one of the best choices for global asset allocation. The spread of COVID-19 is accelerating around the world. The top five European economies, including Germany, France, the United Kingdom, Italy, and Spain, have been the most affected. The United Kingdom, which has the least number of confirmed cases out of the five countries, has over 100,000 confirmed cases. Meanwhile, the United States has become the most severely affected country in the world with a total of more than 650,000 confirmed cases. Some other countries have even begun preparing for the long-term presence of COVID-19 in society. The rampage of the pandemic has caused extreme panic and huge shocks in the global financial market.

The US stock market saw four circuit breakers within two weeks, and the prices of major financial assets fell sharply. In response to the impact of COVID-19, countries have introduced massive stimulus policies, including zero or even negative interest rates and various quantitative easing policies. Meanwhile, China's financial market has shown itself to be more resilient and risk resistant. Additionally, China has maintained reasonable positive interest rates and has ample room for monetary policies. At the same time, the supply-side restructuring of the real economy and the financial sector over the past few years have effectively controlled the surge in the macro leverage ratio. The valuation of China's financial assets is relatively low, allowing asset allocation to bring about safety and stability. These factors have gradually highlighted the advantages of Chinese financial assets and allowed Chinese financial assets to become one of the best choices for global financial asset allocation.

Second, China's financial reform and opening up may accelerate. The impact of COVID-19 and China's response to it have revealed many problems in China's governance system and capabilities, including shortcomings in the financial sector. The fundamental purpose of finance is to serve the real economy, but the current financial market in China has not satisfactorily met either the investment needs of residents or the financing needs of enterprises. Due to the pandemic, the financing needs of small and medium-sized enterprises and private enterprises have increased in urgency, and the demand for direct financing has strengthened. Due to the decline of the real economy, salaries have decreased, which has caused residents to rely more on financial property income. This has emphasized the demand for diversified, multi-level, and intelligent financial services. In addition, China has a top high savings rate, and COVID-19 has brought both great pressure and great motivation to the reform and two-way opening of the financial sector. Now, the financial sector has an opportunity to improve its governance and capabilities in order to better utilize the advantages of huge savings to meet the financing needs of the corporate and financial sectors. Indeed, financial reform and opening up have accelerated. With the implementation of the new *Securities Law* on March 1, the registration system will be gradually extended to the entire market, and a number of additional opening up measures will also be expedited.

Third, the process of RMB internationalization is expected to speed up. The Renminbi exchange rate experienced short-term depreciation pressure due to the panic and risk accompanying the pandemic—it fell from around 6.9 before COVID-19 to around 7.1 at the most severe point of the pandemic. In contrast, the US Dollar exchange rate rose sharply in response to the increased panic and risk aversion in global financial markets, tightened liquidity in corporate and residential sectors, and increased demand for cash. However, as China has adopted effective control measures against the pandemic, the country's economic and financial situation has improved significantly, which will cause the RMB exchange rate to gradually stabilize. As China's economy continues to improve while COVID-19 worsens in the United States and Europe, the safety, robustness, and profitability of Renminbi assets will be further highlighted in international settlement, trading, and investment. In the future, demand for Renminbi assets in international settlement, trading, investment, reserves, etc. will further increase. The currently depreciating exchange rate of the Renminbi may experience positive growth in the future, which is expected to accelerate the process

of Renminbi internationalization. According to the latest statistics from the Society for Worldwide Interbank Financial Telecommunication (SWIFT), the Renminbi's share in the international payment market rose sharply from 1.65% in January to 2.11%, a record high for the second half of the year. The Renminbi has also increased by one rank in the international payment market, now at fifth. It is clear from these events that the pace of RMB internationalization has accelerated.

We recommend that China make full use of the favorable opportunities resulting from its successful pandemic prevention and control to subtly promote the internationalization of the Renminbi. COVID-19 has been a huge test for China's economy and financial sector, but the country's high standards, strict requirements, and large expenditures on pandemic prevention and control have made it the first economy to emerge from the pandemic. At present, China's COVID-19 outbreak has been brought under control, and the resumption of work and production has accelerated. Overall, China's financial market is resilient and has favorable conditions to promote the internationalization of the Renminbi: first, there is strong support for the short-term recovery of the real economy and a long-term upward trajectory; second, the macro leverage ratio is generally stable and controllable, and China's national savings rate is the best in the world; third, despite the impact of the pandemic, China's financial market has become more resilient and less volatile, RMB-denominated assets are more stable and safe, and their rate of return is higher; fourth, in recent years, China's two-way opening of the financial sector has improved, creating a favorable policy environment for Renminbi internationalization. Furthermore, as COVID-19 continues to spread, the downward trend in the financial market will be difficult to reverse, locking in zero interest rates and negative interest rates for the foreseeable future. Together, these factors can provide a favorable environment to expedite the internationalization of the RMB. The Chinese government and financial regulatory authorities should use this opportunity to create more favorable conditions for Renminbi settlement, trading, investment, reserves, etc., accelerate the development of the international financial hubs of Shanghai and Shenzhen, and enhance the global competitiveness and voice of China's financial sector.

4.3.4 We must develop a plan to double the middle-income group and tap medium- and long-term domestic demand.

China has a middle-income population of 400 million and a lower-income population of 1 billion. Both of these groups have needs that are far from being met. In the case of the middle-income group, these needs include medical care, education, vehicles, and housing. Such needs are complex and have been strongly affected by externalities, and thus there are many policy restrictions in these areas. In order to satisfy the needs of the 400 million middle-income residents, and in doing so to lay the groundwork for a well-off society with an improved standard of living, the Chinese government must cultivate the market more actively and accelerate the modernization of its governance capabilities. As for the 1 billion lower-income residents, winning the battle against poverty, we should plan to lift another 400 million people into the middle-income group within the next three Five Year Plans—effectively doubling the middle-income group during this time. We predict that this strategy will drive up GDP growth by at least 0.7%-0.75% each year, and will provide an impetus for high-quality development of the Chinese economy.

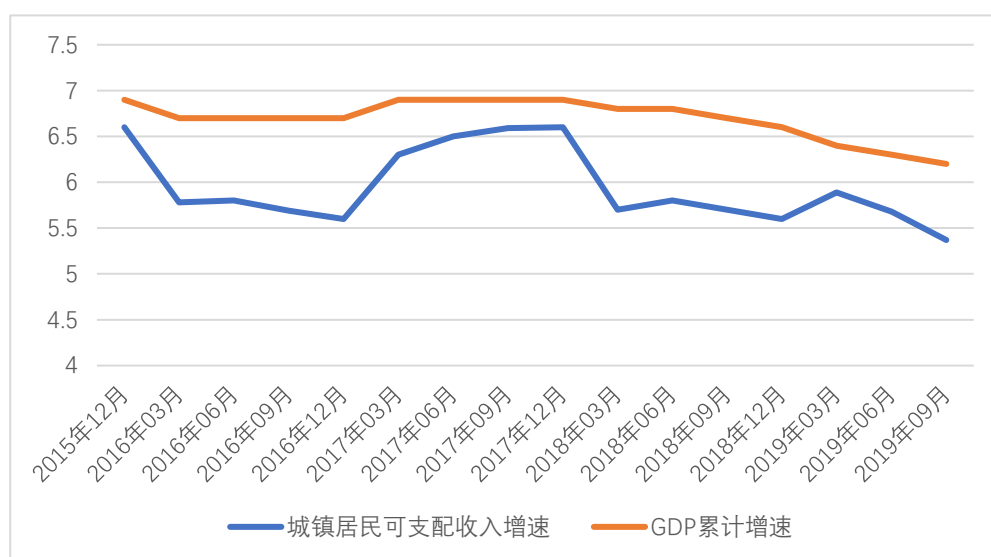
China enjoys a large market and thus has great potential for domestic demand as well as huge reserves of human capital and human resources, which will surely enable the country to overcome various risks and challenges. Since 2008, China's household consumption has passed the U-shaped turning point, and its contribution to the country's economic growth has continued to increase. This is due to a continuous increase in residents' income—especially the disposable income of the middle-income group—and a series of structural transformations in residents' consumption and savings behavior. In order to further enhance the long-term growth potential of China's economy and accelerate high-quality development, China should fully release consumption and investment demand in the medium- and long-term through continuous expansion of its middle-income group and market cultivation, thereby promoting supply-side upgrading and realizing a virtuous cycle and a complementary dynamic between supply and demand.

In 2018, the size of China's middle-income group surpassed 400 million for the first time, making up about 31% of China's total population and about 35% of the global middle-income group. Although these landmarks were monumental in themselves, China must push further toward the goal of doubling the middle-income group. This will be especially difficult considering that China is the world's most populous country, and thus will require the government to enact prudent policies. If the middle-income group can be successfully doubled, China's middle-income group will account for about 60% of its total population, which is roughly the proportion of the middle-income groups in most developed economies with an "olive-shaped" distribution pattern. By this time, social distribution will have greatly improved and China's income gap will have significantly narrowed. One important way to continue expanding China's middle-income group is to maintain a relatively high rate of income growth. The graph below shows the average annual growth rate of the disposable income of Chinese residents. We can see that the growth rate of the disposable income of Chinese urban residents slows down, which basically conforms to the decline in the GDP growth rate. The growth rate of the disposable income of Chinese urban residents was reduced to a level of about 5.4% by September 2019. If China's economic growth rate continues to decline, the growth rate of residents' disposable income may fall below 5%, which is not conducive to the further expansion of China's middle-income group and the long-term sustainable and stable development of the Chinese economy.

In order to achieve China's economic development goal of nurturing markets and increasing demand, the first order of business is to continue expanding the middle-income group. China has made outstanding achievements since reform and opening up 41 years ago. Through rapid economic growth and continuously increasing incomes, China has managed to lift the world's largest population out of poverty. It is worth noting that China still suffers from a dual economy problem, as the barriers between urban and rural areas have not been completely eliminated. The income gap between urban and rural residents calculated based on the disposable income of urban residents and the net income of rural residents has remained at around 2.7 since 2014. Among China's current population of 1.4 billion, excluding the 400 million people with the highest income, the remaining 1 billion people have an annual per capita income that is equivalent to that of the entire population of China 20 years ago. The marginal propensity to consume for these 1 billion people is significantly

higher than that of the 400 million people in the middle- and high-income groups. Thus, raising the income of the 1 billion lower-income people in China will enable us to tap domestic demand and help achieve the three goals of stable growth, improving livelihoods, and structural readjustment. **To this end, after completing the targeted poverty alleviation, the next goal should be the expansion of the middle-income group. This group's increase in income will lay a solid foundation for the further release of domestic demand and the improvement of market mechanisms.**

Chart 32 Disposable Income Growth Rate and GDP Quarterly Growth Rate (Cumulative)



Data source: National Bureau of Statistics

Translation of Chart Text

Blue: Disposable Income Growth Rate of Urban Residents Orange: GDP Growth Rate
 Note: On the horizontal axis, 年 = year and 月 = month.

In order to achieve China's economic development goal of nurturing markets and increasing demand, the first order of business is to continue expanding the middle-income group. China has made outstanding achievements since reform and opening up 41 years ago. Through rapid economic growth and continuously increasing incomes, China has managed to lift the world's largest population out of poverty. It is worth noting that China still suffers from a dual economy problem, as the barriers between urban and rural areas have not been completely eliminated. The income gap between urban and rural residents calculated based on the disposable income of urban residents and the net income of rural residents has remained at around 2.7 since 2014. Among China's current population of 1.4 billion, excluding the 400 million people with the highest income, the remaining 1 billion people have an annual per capita income that is equivalent to that of the entire population of China 20 years ago. The marginal propensity to consume for these 1 billion people is significantly higher than that of the 400 million people in the middle- and high-income groups. Thus, raising the

income of the 1 billion lower-income people in China will enable us to tap domestic demand and help achieve the three goals of stable growth, improving livelihoods, and structural readjustment. **To this end, after completing the targeted poverty alleviation, the next goal should be the expansion of the middle-income group. This group's increase in income will lay a solid foundation for the further release of domestic demand and the improvement of market mechanisms.**

On the premise of maintaining relatively high disposable income growth, continuously increasing the ratio of consumption to disposable income can promote the sustainable release of domestic demand in the Chinese economy. According to a series of studies by Li Daokui and Chen Shi (2011) and Li Daokui, Xu Xiang, et al. (2015), in terms of the contribution rate of Chinese household consumption to economic growth, an increase in residents' disposable income makes a higher contribution than an increase in the ratio of residents' consumption to disposable income. The reason behind China's high household savings rate and low ratio of consumption to income lies in the suppression of the demand side and the imperfection of the corresponding market system. In addition to the flawed development of the consumer market, need greatly exceeds supply in terms of medical care, health, education, housing, etc., causing risk-averse individuals to actively choose relatively low consumption levels in order to cope with possible expenses related to severe illness, their children's education, housing upgrade needs, and even retirement needs. These issues are illustrated in the domestic demand analysis of this report. **The high savings rate of Chinese residents is generated passively rather than actively to a certain extent. Therefore, we can encourage individuals to increase their consumption rate spontaneously through market cultivation, thereby promoting supply-side upgrades and effectively eliminating overcapacity.**

The doubling of the middle-income group will boost the consumption of Chinese citizens, accelerate the effective release of domestic demand, and spur significant improvements in the economic structure. Let's take the consumption of two durable goods, vehicles and air conditioners, as an example. At present, the number of vehicles owned by the Chinese residents has reached 250 million (as of the end of June 2019), and the number of vehicles per 1,000 people is 179, exceeding the world average of 170 vehicles per 1,000 people. The average number of air conditioners per household is about 100 units per 100 households, with 65.2 units per 100 households in rural areas and 132 units per 100 households in urban areas (as of the end of 2018). According to the average income standard of the middle-income group used by the National Bureau of Statistics (100,000-500,000 yuan per household per year), we assume that the number of vehicles and air-conditioners increases proportionally with an increase in income according to our previous estimates on the doubled middle-income group (the actual per capita income will increase by 4% per year, and the number of middle-incomers will be doubled in five years). In this process, the annual total number of vehicles will increase by about 23 million (the number of vehicles per 1,000 people will increase by about 16.5 each year), and the number of air conditioners per 100 households will increase by about 6.6-9.3 units per year. Most of these increases will originate from the increase in consumption brought about by the new middle-incomers. The increase in the number of vehicles and air conditioners has the potential to boost China's GDP growth by about 0.45-0.5% annually.

The increase in housing demand brought about by the doubling of the middle-income group will bring about a surge in domestic demand. This increase in housing demand will be a result of three main trends. The first trend is the new urban housing demand brought about by urbanization. The second is the demand for updated housing brought about by income increases. According to our previous predictions, among the 400 million people who are expected to rise to the middle-income group, 74.2% are rural residents and 25.8% are urban residents. Therefore, the resulting housing demand will mainly be concentrated in demand for houses in urban areas due to urbanization. We predict that with the doubling of the middle-income group, China's annual new housing demand will be about 8.89 million units. According to the per capita housing area of 39 square meters proposed by the National Bureau of Statistics,¹³ as of the end of 2018, the annual new housing demand was about 1.04 billion square meters. Based on the above forecast, we can roughly calculate that the new housing demand brought about by doubling the middle-income group has the potential to boost China's GDP growth by about 0.25% annually.

V. Summary

Over the past 41 years since reform and opening up, and especially after China's ascension to the WTO in 2001, China has deeply integrated itself into the global division of labor. Through the process of economic globalization, we have actively learned advanced foreign technologies and expanded into the vast international market. These opportunities have undoubtedly helped China achieve rapid growth and promote the development of its economy and society. However, the COVID-19 pandemic will greatly accelerate major historical processes—long-term shifts in the global environment that would have normally taken ten to twenty years may now be compressed into two or three years, and the external environment may be worse than any period since reform and opening up. The forces of anti-globalization, unilateralism, trade protectionism, and nationalism will rapidly gain strength. In response, we must adjust our path of economic development.

The Chinese economy is currently in the middle and late stages of industrialization, the middle stage of urbanization, the critical period of industrial upgrading, and the deepening period of informatization. The current economic slowdown will only be an intermittent period of economic transformation. It does not signal a long-term overall decline in the Chinese economy. The changing international and domestic situations require China to actively explore new markets and independently develop core technologies from this point forward. On one hand, we must firmly promote a higher level of opening up to the outside world in the new era, increase our trading partners, and especially focus on maintaining our partnerships in East Asia as we continue to study and observe the international situation. More importantly, we should focus on cultivating and building the domestic market, strive to double the middle-income population, manage complex

¹³ In their report: "The Continuous and Rapid Development of the Construction Industry and Significantly Improved Urban and Rural Landscape- The Tenth Report on the Economic and Social Development Achievements of the 70th Anniversary of the Founding of New China"

demand, and tap long-term consumer demand.

Considering the possibility of rapid deterioration in the international environment over the next two to three years, we believe that China should focus on three economic goals during this time. First, China should ensure security through efforts to increase and protect financial security, supply chain security, energy security, technological security, and food security. Second, China should protect the livelihoods of its people. Efforts should be made to guard the income of low- and middle-income earners, support small and medium-sized enterprises, and stabilize employment. Third, China must enact a plan for long-term development. A series of market-oriented reforms should be promoted, including the reform of state-owned enterprises and the factor market. China must commit to cultivating and releasing domestic demand by doubling the middle-income group and providing an impetus for the medium- and long-term development of the Chinese economy.

In terms of this year's economic growth target, we caution that it should not be set too high. Due to the current unprecedented pandemic, if we continue to implement policy in accordance with the original growth target, the policy space for the next two to three years will be overdrawn. As the external environment continues to deteriorate through the pandemic, China will still be experiencing the side effects of previous stimulus policies, and thus will be placed in a passive position. We recommend that this year China should prioritize employment in GDP growth and strive to double the per capita disposable income of urban and rural residents. As such, we recommend a GDP growth target of 3-4%.