Reviving Demand, Regaining Momentum

Special Focus: Economic Mobility and China's Emerging Middle Class

WORLD BANK GROUP

China Economic Update - December 2024

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Table of Contents

Figures

Table

Box

List of Abbreviations

ASEAN	Association of Southeast Asian Nations
bps	Basis Points
CAR	Capital Adequacy Ratio
CEU	China Economic Update
CFPS	China Family Panel Survey
CHIP	Chinese Household Income Project Series
CHN	China
CO2	Carbon Dioxide
CPI	Consumer Price Index
DRC	Development Research Center of the State Council
EAP	East Asia and Pacific
ECA	Europe and Central Asia
EMDEs	Emerging Market and Developing Economies
FDI	Foreign Direct Investment
GDP	Gross Domestic Product
H1	First Half Year
H2	Second Half Year
IDN	Indonesia
IIF	Institute of International Finance
IT	Information Technology
LAO	Lao PDR
LAC	Latin America and the Caribbean
LGFV	Local Government Financing Vehicle
MMR	Myanmar
MNA	Middle East and North Africa
MNG	Mongolia
MOF	Ministry of Finance
MOFCOM	Ministry of Commerce
MYS	Malaysia
NBS	National Bureau of Statistics
NIM	Net Interest Margin
NFRA	National Financial Regulatory Administration
NPL	Non-Performing Loan
PBC	People’s Bank of China
PFB	Public Finance Budget
PHL	Philippines
PIP	The Poverty and Inequality Platform
PPI	Producer Price Index
PPP	Purchasing Power Parity
pp	Percentage Point

Q1	First Quarter
Q2	Second Quarter
Q3	Third Quarter
Q4	Fourth Quarter
RMB	Renminbi
RRR	Reserve Requirement Ratio
SAFE	State Administration of Foreign Exchange
SAS	South Asian Sea
SML	Special Mention Loan
SOE	State-Owned Enterprise
SSA	Sub-Saharan Africa
THA	Thailand
US/USA	United States / United States of America
USD	US Dollar
VAT	Value-Added Tax
VNM	Vietnam
y/y	Year-on-Year
ytd	Year-to-Date
3mma	Three-Month Moving Average

Executive Summary

China's GDP growth has moderated since the second quarter of 2024, owing to subdued domestic demand. The property sector remains the key drag on economic activity, with real estate investment contracting by 11.5 percent y/y in real terms in July-November, even as manufacturing investment grew by 9.6 percent and infrastructure investment by 11.4 percent. Consumption growth has also weakened, as pent-up demand for services has started to fade. Falling property prices and sluggish income growth have also weighed on consumer confidence. Retail sales growth, at 2.8 percent y/y in July-November, was about half of its 2019 growth rate. Subdued domestic demand is reflected in persistently low inflation, with average core CPI inflation at only 0.3 percent y/y in July-November. Despite these headwinds, China has maintained a robust growth rate of 4.8 percent in the first three quarters of 2024.

The government has responded to the domestic demand slowdown with incremental policy stimulus, balancing short-term growth support with longer term derisking objectives. While monetary policy has been eased, its impact has been constrained by subdued credit demand. Despite lower downpayment ratios and mortgage rates, state-financed purchase of housing inventories, and liquidity support to developers, the property sector remains weak in the face of dampened housing demand. A RMB 300 billion (0.2 percent of GDP) consumer trade-in and equipment upgrade scheme has provided a boost to consumption and investment, but the impact is expected to be relatively moderate and short-lived. A RMB 10 trillion (8 percent of GDP) program to swap local government off-budget debt for lower-cost on-budget financing over five years is expected to improve transparency and reduce the risk of default on off-budget debt in the short term but is not designed to release significant stimulus.

China Economic Outlook	***2021***	***2022***	***2023***	***2024f***	***2025f***	***2026f***
Real GDP growth (%)	8.4	3.0	5.2	4.9	4.5	4.0
Consumer price index (% change, average)	0.9	2.0	0.2	0.4	1.1	1.6
Current account balance (% of GDP)	2.0	2.5	1.4	1.6	0.9	0.2
Consolidated fiscal balance (% of GDP)*	-4.0	-6.3	-5.8	-6.0	-6.2	-5.8

Source: World Bank.

Note: f = forecast (baseline). * World Bank staff estimates.

To account for the effect of recent policy easing and near-term export strength, the growth forecasts for 2024 and 2025 are revised up by 0.1 and 0.4 percentage points, respectively, compared to the projections in the June 2024 *China Economic Update*. Growth is projected at 4.9 percent in 2024 and 4.5 percent in 2025. Policy support for the property sector is expected to provide a modest boost to housing demand and to help lower high inventory levels, but a turnaround in the sector is not anticipated until late 2025. Slower household income growth and the negative wealth effect from lower home prices are expected to weigh on consumption into 2025. Elevated uncertainty and reduced profitability will temper manufacturing investment, while public spending will support infrastructure investment. Weak domestic demand is projected to keep consumer price inflation low at 0.4 percent in 2024, before modestly rising to 1.1 percent in 2025.

The outlook is subject to domestic and external risks. Domestically, a more persistent downturn in the property sector could further temper investment and local government revenues. Tighter local government financing, in turn, could lead to under-execution of fiscal policies, dampening growth. Globally, heightened uncertainty around trade poses risks to China's exports. Following recent guidance from policymakers, there are upside risks to the 2025 growth forecast. Higher-than-expected fiscal spending, especially if financed by the central government, could lift growth above baseline expectations. Decisive policy action to stabilize the property sector, including through the restructuring of struggling property developers, could lead to an earlier-than-anticipated pick up in real estate activity.

While providing near-term support to aggregate demand, conventional stimulus measures will not be sufficient to reinvigorate growth. China's growth slowdown is partly driven by structural factors, such as structurally low consumption, high property developer and local government debt, and an aging population. Addressing these challenges requires structural reforms to address vulnerabilities and sustain growth. Key priorities include (i) fostering domestic demand by strengthening social safety nets, redirecting fiscal resources to social spending, and promoting market-oriented reforms to encourage private sector investment; (ii) supporting a sustainable property sector recovery by addressing shortcomings in the property financing mechanism and resolving the sector's debt overhang; and (iii) managing local government financial risks through reform in the fiscal framework and medium-term subnational fiscal consolidation. Recent policy announcements have stressed the need to address some of these structural challenges by rebalancing fiscal spending towards supporting social welfare and consumption while implementing reforms to increase the fiscal capacity of local governments, but specific details are not yet available.

Special Focus: Economic Mobility and China's Emerging Middle Class

China has achieved dramatic success in improving the living standards of its population. With 800 million people lifted out of poverty in the past 40 years, China alone accounts for three-fourths of the global success on poverty reduction during this period. Translating its success in poverty reduction into similar success in bringing about continuous improvements in the living conditions of its population is one of the key challenges facing China today. The context in which China must confront this challenge, however, is vastly different from the one that prevailed during its economic transformation over the last four decades. Growth has slowed, inequality has plateaued but remains high, and the population is rapidly aging.

Many who exited poverty succeeded in moving up the economic ladder into the *secure middle class,* which grew from 9.8 percent of the population to 32.1 percent between 2010 and 2021. No other region of the world witnessed a faster increase in the share of the *secure middle-class* population than China. While the prospects of upward mobility into the secure middle class remained brighter in urban areas, the share of the secure middle class in rural areas rose from 13.7 percent to 26.2 percent, suggesting a greater sharing of prosperity during this period.

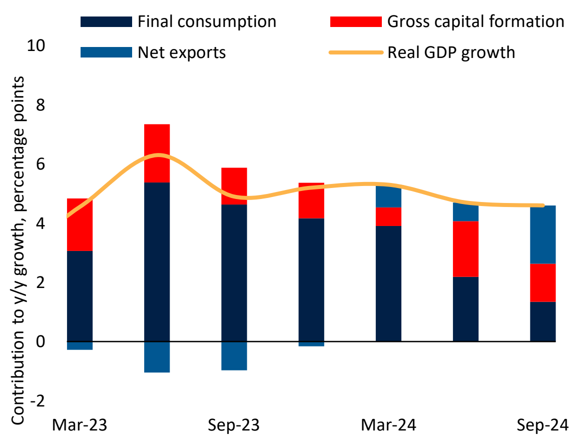
Yet, a sizeable majority of the population is not yet economically secure. First, 17 percent of the population is *low-income* (using US$6.85/day (2017 PPP), a higher benchmark used by the World Bank to compare progress across upper-middle income countries). Second, 38.2 percent is in the *vulnerable middle* class – the segment of the population that is above the US$6.85/day line, but not on a firm economic footing to be free of the risk of falling below it.

Expanding opportunities for everyone to move up the economic ladder is important for China's goal of achieving common prosperity. Equal opportunities for social mobility can also support growth – especially in countries at the cusp of high-income transition – by boosting human capital investments and preventing misallocation of talent. The special focus points to three key policy directions. First, education is likely to play a greater role in determining prospects for upward economic mobility than it has in the past. Making quality education affordable to all and closing the gaps between rural and urban areas in terms of attainment is an important way of boosting upward mobility. Second, the country has made great efforts to provide better financial protection to households through a series of health reforms, but insurance provided through the resident's system provides very limited financial cover. Helping households better manage health shocks is one way to protect and consolidate economic gains. Finally, in addition to efforts to boost productivity of workers, stronger social protection against a broader set of potential vulnerabilities, particularly in monetary forms, could help allay economic anxieties, particularly of those in the low-income and vulnerable middle class. Stronger safety nets can also have efficiency benefits when greater risk taking by economically secure households drives enterprise and entrepreneurship.

The *China Economic Update* at a glance

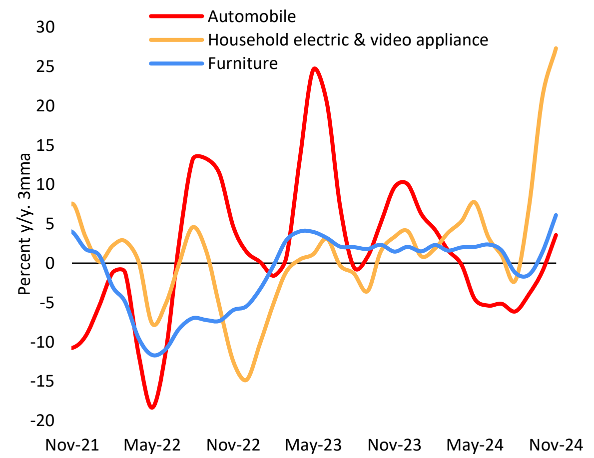
Domestic demand has weakened since Q2…

A. GDP demand components



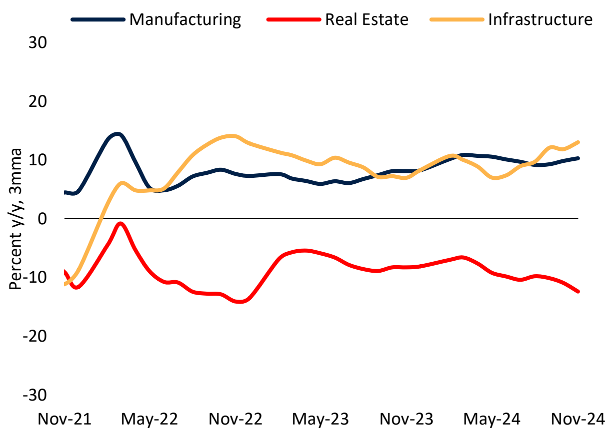
… but recent policy measures have resulted in some improvement in consumption…

B. Retail sales growth



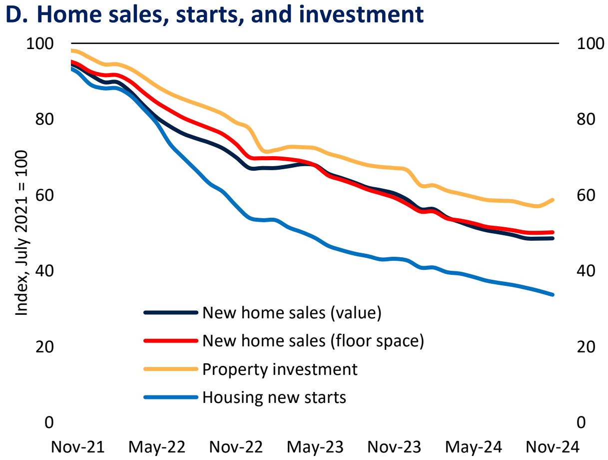
… and acceleration in infrastructure investment.

C. Fixed asset investment by sector



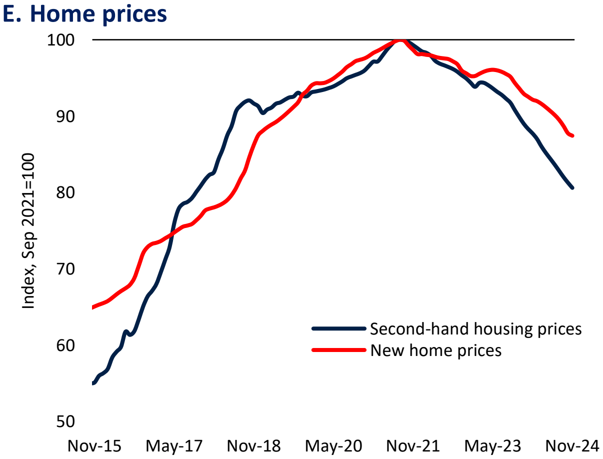
The deep contraction of the property sector continues to weigh on growth, …

D. Home sales, starts, and investment



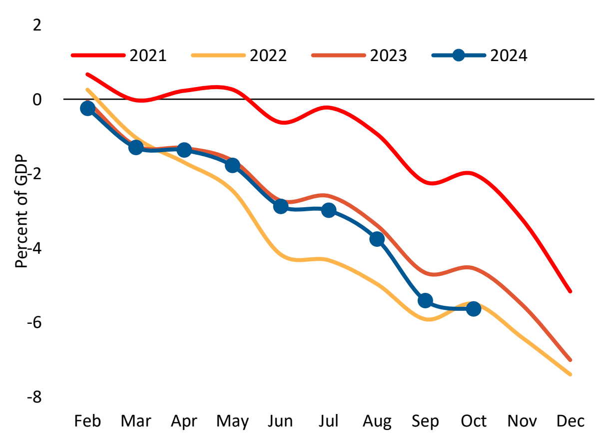
… with home prices falling deeper in the secondary housing market from their peaks in mid-2021.

E. Home prices



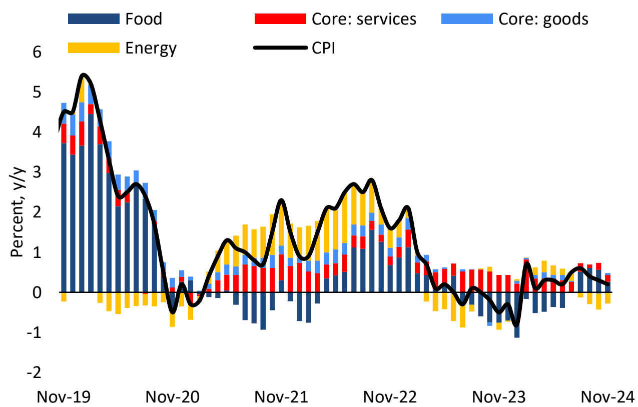
Fiscal policy has also recently turned more supportive.

F. Consolidated fiscal deficits



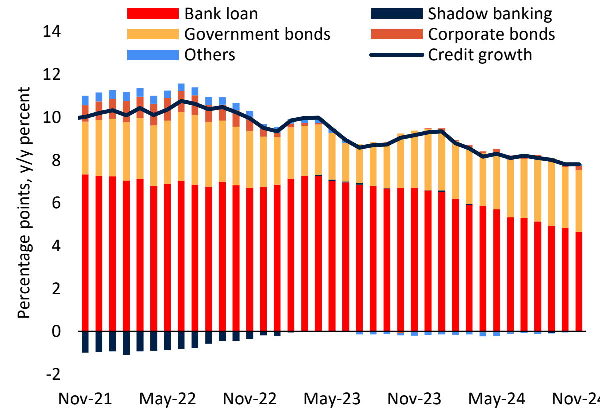
Despite monetary easing, headline inflation remained persistently low ….

G. Headline CPI inflation



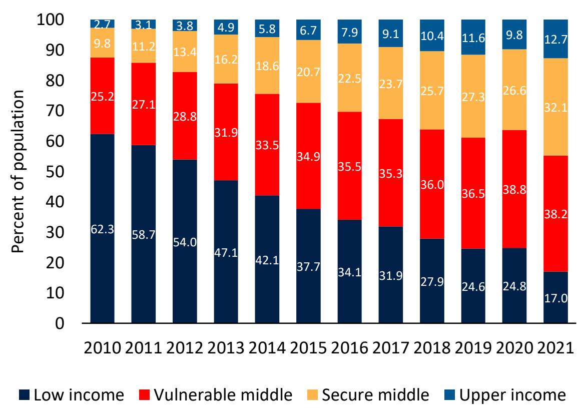
… while household and corporate credit growth continued to slow.

H. Credit growth



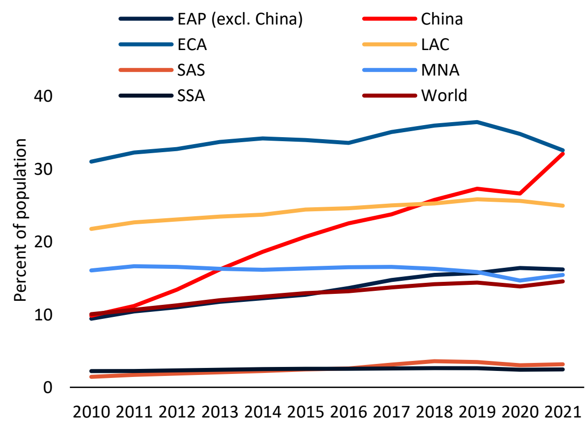
China's economically secure middle class has expanded, …

I. Population in different economic classes, 2010-2021



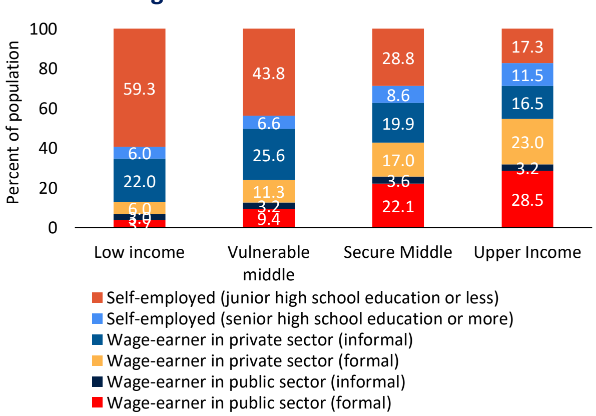
… accounting for over three-fourths of the middle class in developing EAP.

J. Share of the secure middle class to population



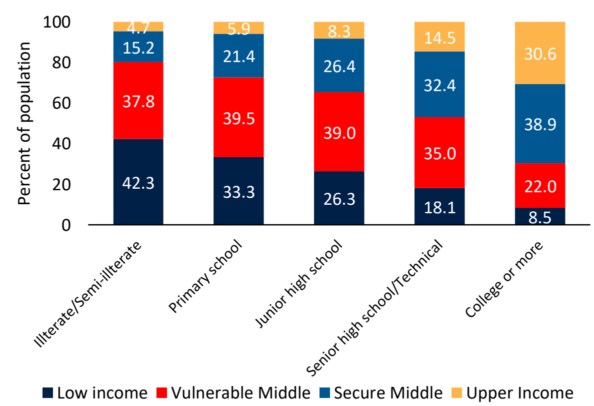
Wage-earning class accounts for the largest share of the secure-middle and upper middle income class.

K. Share of wage-earners in income classes



Higher education was ticket to upward mobility, but not the only one

L. Education achievements in income classes



Source: NBS, PBC, WIND, MOF, Montalva and Tiwari (forthcoming), Kwah, Montalva and Tiwari (forthcoming), 2018 China Family Panel Studies, World Bank staff estimates.

I. Recent Economic Developments

Growth momentum has slowed under domestic demand constraints

China's growth has moderated since the second quarter of 2024 due to subdued domestic demand. Growth decelerated from 5.3 percent year-on-year (y/y) in Q1 to 4.7 percent in Q2 and further to 4.6 percent in Q3 (Figure 1A). The growth contribution of final consumption declined from 2.1 percentage points (pp) in Q2 to 1.3 pp in Q3, amid lackluster consumer confidence. The deep but necessary adjustment in the property sector remains the key drag on investment and GDP growth. Robust net exports on the back of strong external demand supported China's growth, contributing 2.0 pp to growth. Despite the headwinds from the property sector and consumer sentiment, China has maintained a robust growth rate of 4.8 percent in the first three quarters of 2024.

Consumer confidence and spending have remained weak amid falling property prices and sluggish income growth. Low spending on consumer discretionary items has weighed on retail sales which grew by 2.8 percent y/y in real terms in July-November, about half of its 2019 average growth rate. The reluctance of households to make big-ticket purchases reflects weak confidence related to the negative wealth effect from declining home prices, slower income growth, and uncertain employment prospects. Nominal household disposable income growth decelerated from 6.3 percent y/y in 2023 to an average of 4.7 percent in Q2 and Q3 2024, driven by weaker wage growth and the collapse in income from property (Figure 1B).[1]

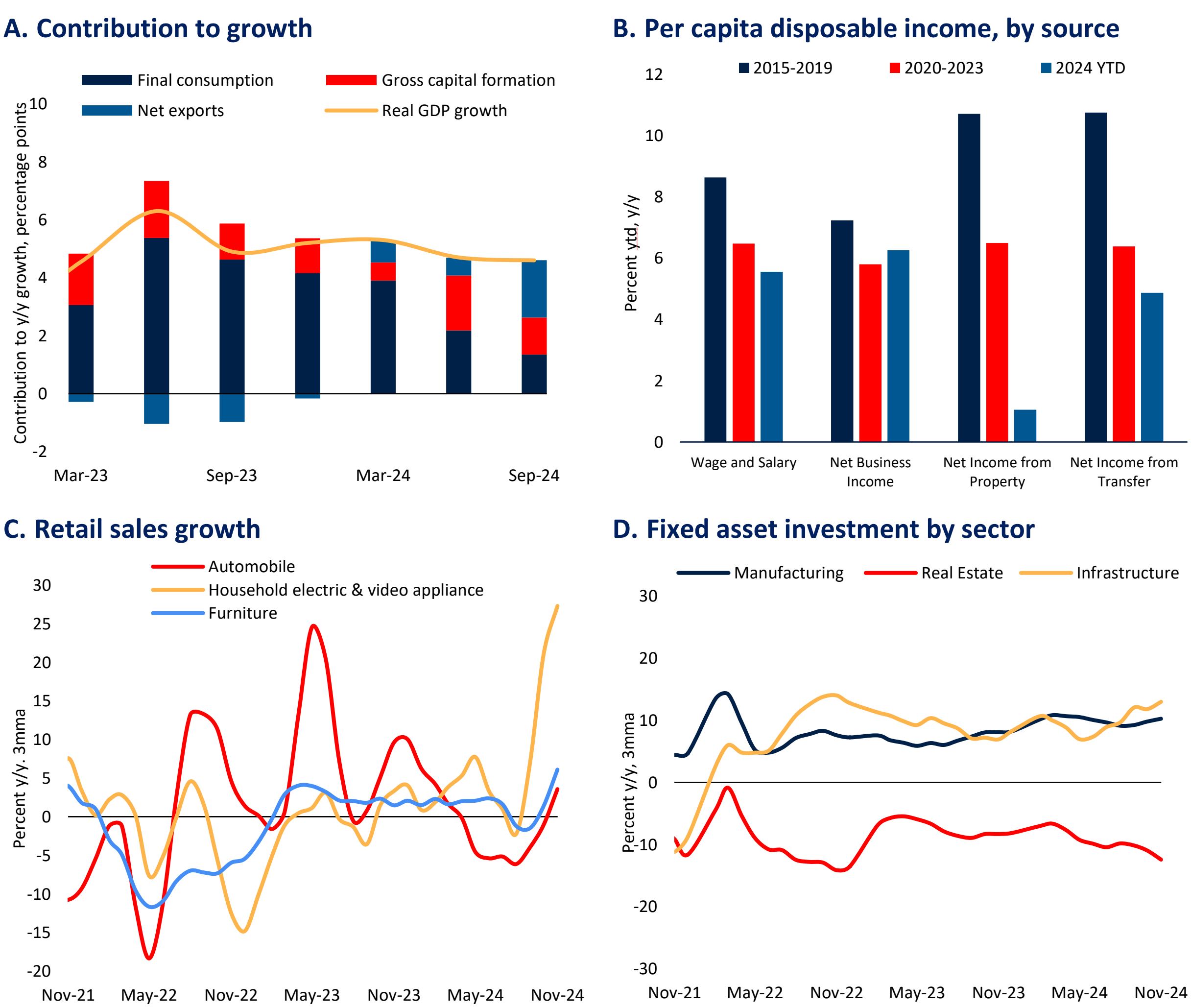
Manufacturing and infrastructure investment have remained robust, partially offsetting the contraction in real estate investment. Robust external demand, alongside policy incentives for equipment upgrades and targeted support to priority sectors, underpinned the resilience in manufacturing investment, which expanded by 9.6 percent y/y in July-November.[2] Efforts to improve the execution of the fiscal budget helped accelerate infrastructure investment in the third quarter. In contrast, real estate investment continued to contract by 11.5 percent y/y in July-November, despite additional stimulus measures to support housing demand and provide liquidity to property developers. Weak housing demand and debt distress among property developers continued to weigh heavily on the sector, limiting the effectiveness of policy support.

Recent high-frequency data revealed some policy-driven improvement in domestic demand. Retail sales of household appliances, furniture, and automobiles have rebounded since

[1] For a detailed analysis of urban wage trends, refer to Box 1.
[2] World Bank staff estimate real fixed asset investments by deflating nominal fixed asset investments using the GDP deflator.

September, benefitting from the RMB 150 billion (0.1 percent of GDP) consumer trade-in program (Figure 1C). A RMB 150 billion equipment upgrade program for firms has supported manufacturing investment growth. Infrastructure investment rose by 13.0 percent y/y in September-November, supported in part by the acceleration in local government special bond issuance (Figure 1D).

Figure 1. Domestic demand has remained weak, but policy measures have recently supported growth in some sectors of the economy



Source: China NBS, World Bank staff estimates.

Note: Figure C shows real retail sales growth deflated using CPI inflation. In Figure D, infrastructure sector includes transport, storage and postal service, water conservancy, environment and utility management, and electricity, gas and water production and supply.

Box 1. Divergent urban wage growth: A multi-dimensional analysis

The labor market in urban China reveals pronounced wage disparities, reflecting uneven post-pandemic trends among sectors, income groups, and city tiers.

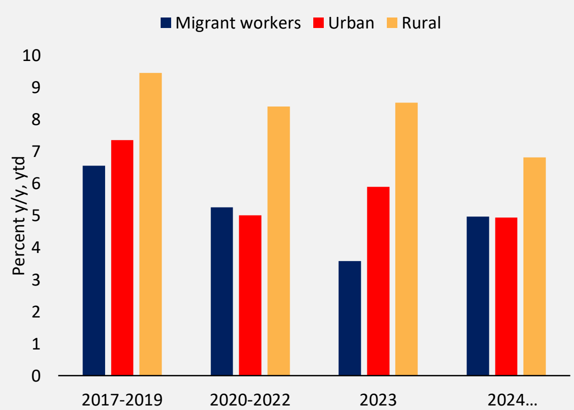
Nominal wage growth has slowed, especially for high-wage executive employees and low-wage migrant workers. The slowdown was pronounced for migrant workers in 2023, with income growth at 3.6 percent y/y, significantly below the urban household average of 5.9 percent (Figure 2A). Although the income growth of migrant workers recovered to 5.0 percent in the first three quarters of 2024, it remained below the pre-pandemic level of 6.6 percent. The high wage group—executive employees—also saw their earnings fall below pre-pandemic trends (Figure 2B).[3] In contrast, non-executive employees' wages have largely recovered to pre-pandemic trajectories, although the pace of growth this year shows signs of moderation. Wage disparity within listed companies narrowed, with salary ratios decreasing from 8.8 to 8.5.[4]

Nominal wage growth has slowed across most sectors compared to pre-pandemic trends, but some high-paying sectors have experienced large declines. Wages in the property sector declined by -7.8 percent y/y and in finance by -6.1 percent y/y in 2023, due to the cost-cutting measures amid the market downturn, as well as annual salary caps of financial workers. In contrast, wages in the manufacturing sector outperformed, rising by 5.5 percent, as robust investments and solid industrial activity boosted demand for labor and resulted in higher wages (Figure 2C).

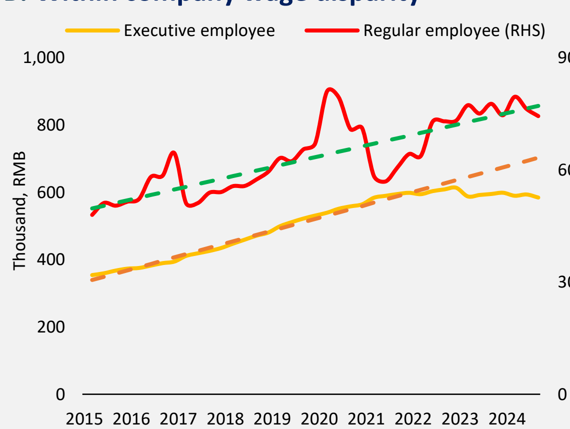
Nominal wage growth divergence across city tiers partly explains the uneven consumption recovery. Wage growth has been higher in low-tier cities compared to high-tier cities in the post pandemic period, where high-wage jobs face slower growth or wage cuts. This geographic disparity is reflected in consumption patterns, with retail sales growth stronger in low-tier cities than in high-tier cities after the reopening (Figure 2D).

Figure 2. Wage disparity in urban labor market

A. Nominal wage growth

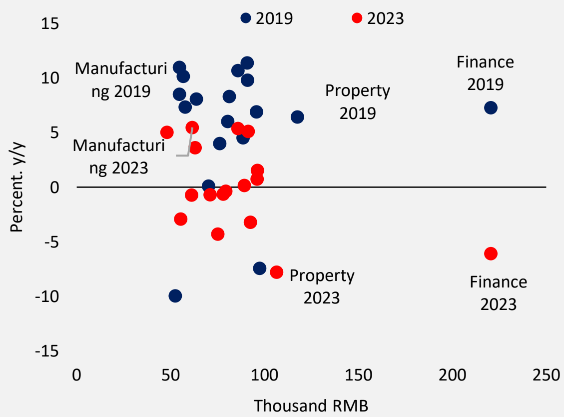


B. Within company wage disparity

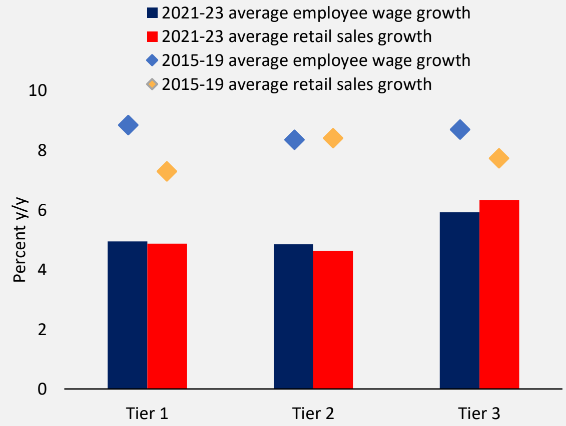


[3] Regression analysis indicates that the decline is primarily attributable to reduced firm revenues and profits, and other firm-specific factors.
[4] Following the approaches of Faleye et al. (2013) and Banker et al. (2016), the firm's internal income disparities were measured using the salary ratio of average executive income to average non-executive employee income.

C. Wage level and growth, by sector



D. Wage and retail sales growth, by tier city



Source: NBS, Wind, World Bank staff estimates.
Note: In Figures B, C, and D, the wage data is derived from employee compensation data of domestic listed companies, which may be subject to sample bias as it primarily reflects the higher income levels of urban wage earners. On average, employees and executive employees of listed firm earned over four and ten times of urban household, respectively. In Figure B, the wages are seasonally adjusted, and the 2024 wages for executive employees are projected.

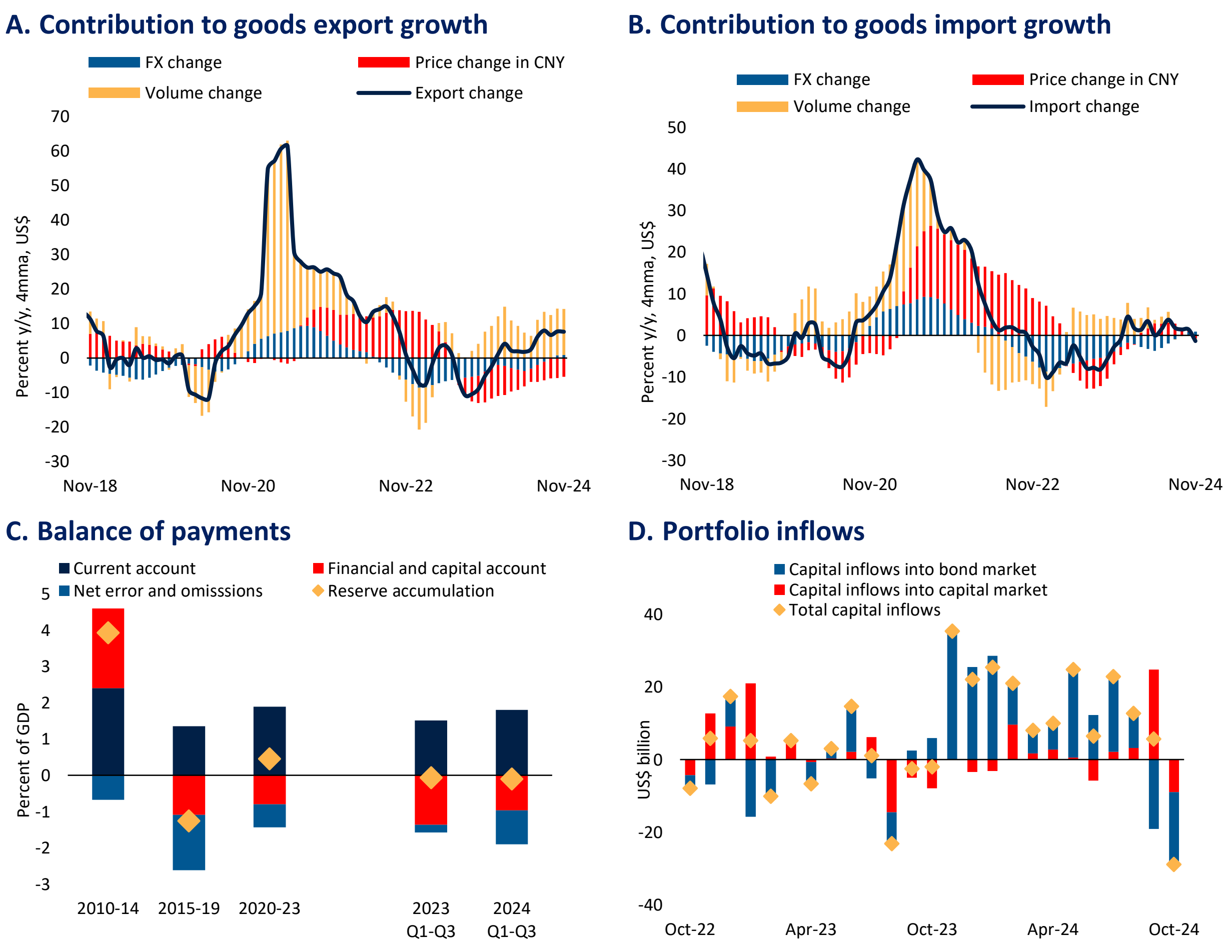
A growing current account surplus has been offset by capital outflows

Robust growth in merchandise exports this year has been driven by a cyclical rebound in external demand, declining export prices, and real exchange rate depreciation. Merchandise exports increased by 5.4 percent y/y in the first eleven months of this year, reversing a 4.7-percent decline in 2023. This recovery was driven by higher demand from both advanced economies and EMDEs, particularly ASEAN members and Brazil, alongside declining export prices and real exchange rate depreciation earlier in the year (Figure 3A). By product category, the increase in exports was broad-based, though medium-tech machinery and high-tech IT products performed better.

Although imports improved this year, growth remained low on the back of weak domestic demand. Following a 5.5-percent contraction in 2023, merchandise imports rose by 1.2 percent y/y in the first eleven months of the year (Figure 3B). Subdued domestic household demand and the downturn in the property sector have adversely affected the demand for consumer goods and construction materials. In contrast, robust industrial activity and strong exports have contributed to strong imports of high-tech products and intermediate inputs, likely driven by the global tech upcycle.

A resurgence in tourism, transport, and intellectual property payments drove up trade in services. Services exports rose by 16.6 percent y/y in the first ten months of 2024, supported by a recovery in inbound tourism. Tourist arrivals have returned to pre-pandemic levels, aided by the easing of visa requirements for some countries and easier access to domestic electronic payment systems for foreign travelers. Transport services also increased on the back of robust goods trade. Meanwhile, services imports grew by 13.2 percent y/y over the same period, fueled by the continued revival of outbound travel, as well as rising payments for intellectual property rights. However, despite the recovery, outbound travel remains below pre-pandemic levels, partly due to subdued consumer confidence.

Figure 3. Trade surplus remained robust but was offset by substantial capital outflows



Source: China Customs, SAFE, MOFCOM, IIF, Haver, CEIC, World Bank staff estimates.
Note: Figure C shows preliminary data for the balance of payments in Q3 2024.

A rising current account surplus has been more than offset by large capital outflows[5] driven by domestic and international factors. Robust exports combined with subdued imports contributed to an increase in the current account surplus to 1.8 percent of GDP in the first three quarters of

[5] Capital outflows include recorded transactions in the financial account and unrecorded flows, often reflected in net errors and omissions.

2024, up from 1.5 percent in the same period last year (Figure 3C). However, the widening current account surplus was outweighed by larger net capital outflows, resulting in a loss of foreign exchange reserves of USD 32 billion as of September 2024. While foreign direct investment (FDI) inflows have been muted amid higher global trade policy uncertainty, outbound direct investment has remained robust. Incremental policy stimulus in China since September provided a short-lived boost to the equity market, attracting foreign equity investment (Figure 3D). However, this momentum in portfolio inflows has faltered since October, highlighting renewed concerns over domestic economic challenges and trade policy risks abroad.

The property sector remains a key drag despite some positive signs in top tier cities

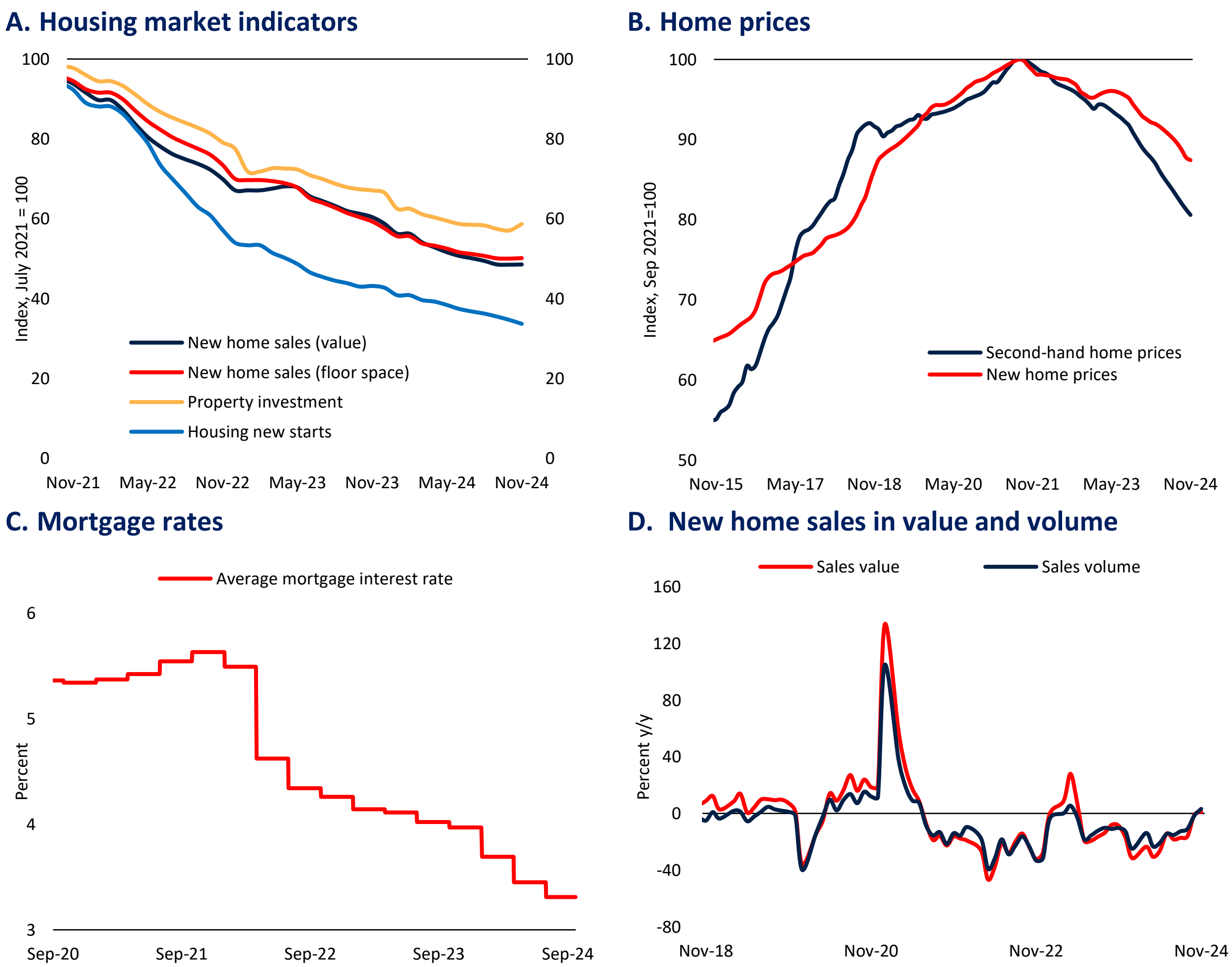
Property sector activity continues to decline, reflecting persistent weakness in housing demand and liquidity constraints of property developers. By November, new home sales in the primary market for 70 cities had declined by 51.5 percent in value and 49.9 percent in volume terms compared to their peak levels in July 2021 (Figure 4A). Home prices had fallen by 12.6 percent in the primary market and 19.4 percent in the secondary market from their respective highs in 2021 (Figure 4B). Weak housing demand, alongside persistent liquidity constraints of highly indebted developers, has led to a continued contraction of real estate investment. In the first eleven months of 2024, housing new starts and completions declined on average by 22.3 and 25.5 percent y/y, respectively.

Property markets in top-tier cities have seen some improvement in housing demand, following intensified easing measures, though a broad and sustained recovery remains out of reach. Since September, the authorities have introduced a new round of easing measures, aiming to accelerate the rebalancing of housing supply and demand. Measures to prop up household demand include a cut in mortgages rates, lower downpayment ratios for second home purchases, and reductions in value-added taxes on housing transactions (Figure 4C). These easing measures and relaxed purchase restrictions have boosted property transactions recently, likely reflecting release of pent-up demand (Figure 4D). However, in lower-tier cities, where the supply-demand imbalance is more pronounced, property markets have remained weak.

Meanwhile, the effectiveness of policies to reduce housing inventory and alleviate liquidity pressures on developers has been limited by inadequate incentives. Local governments have been permitted to use proceeds from special bonds to purchase back idle land and completed homes to convert into affordable housing. Additionally, state-owned enterprises can now access the existing RMB 300 billion relending facility of the People’s Bank of China to refinance the full principal of loans used to purchase housing inventories to convert into social housing (up from

60 percent previously). On the supply side, the credit line under the “whitelist program” for creditworthy developers to complete pre-sold but unfinished homes was doubled to RMB 4.0 trillion. Nevertheless, low returns on social housing and high risk aversion of commercial banks have limited the impact of these measures. The utilization rate of the relending facility was only 5.3 percent in September, and just RMB 155 billion were disbursed under the original RMB 2 trillion whitelist program in the first quarter, based on the latest publicly available data.

Figure 4. The home market remains depressed, despite some recent improvements in tier-1 cities



Source: PBC, NBS, WIND, World Bank staff estimates.

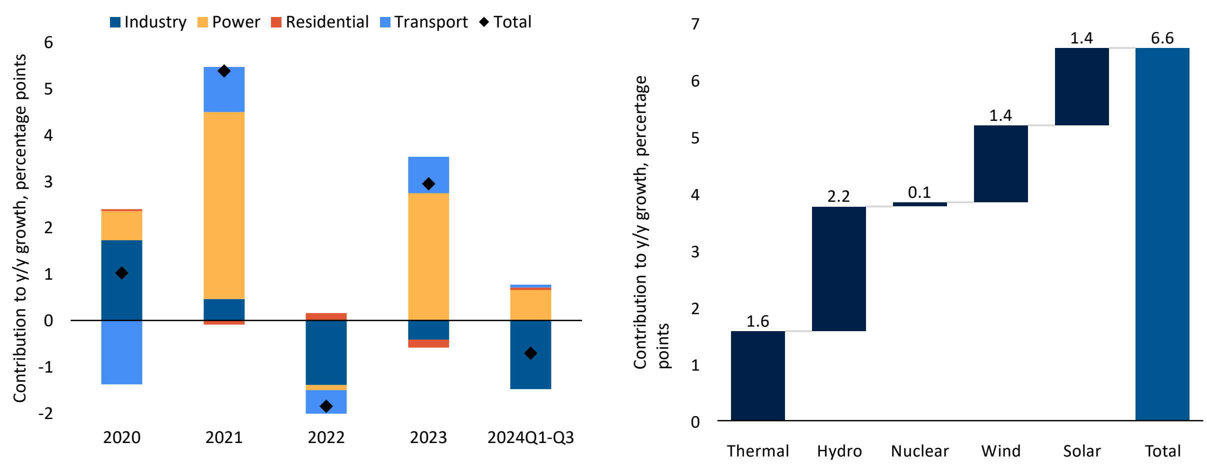
Carbon emissions have decreased amid the construction sector downturn

Carbon emissions declined in the first three quarters, due to reduced output in construction-related industries. China’s carbon dioxide (CO_2) emissions are estimated to have declined by 0.7 percent y/y in the first three quarters of 2024, despite GDP and electricity production expanding by 4.8 and 6.6 percent y/y, respectively, over the same period (Figure 5A). Reduced output in carbon-intensive construction-related sectors, particularly steel and cement, was the main reason for lower carbon emissions. This fall in industrial emissions offset a moderate rise in power sector emissions. Although wind and solar electricity generation increased by 15.4 and 41.1 percent y/y in the first three quarters, with low-carbon sources meeting 76 percent of additional electricity demand, this was insufficient to meet surging electricity demand during the summer heatwaves. Thermal electricity generation increased to fill the gap (Figure 5B).

Figure 5. Carbon emission fell as declining industrial emissions offset moderately increasing power sector emissions

A. Contribution to carbon emission growth, by sector

B. Contribution to electricity generation growth in the first three quarters, by source



Source: Carbon monitor, NBS, World Bank staff estimates.

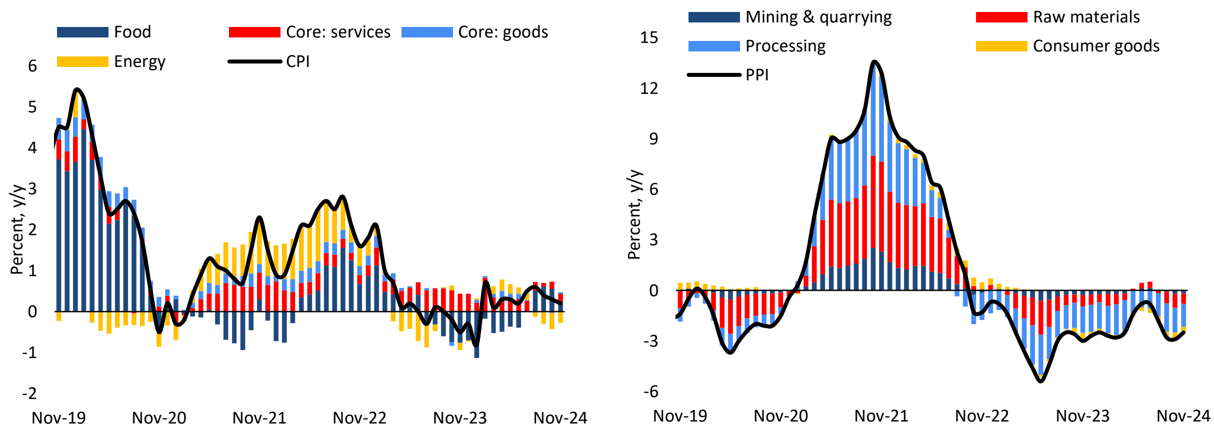
Weak demand is reflected in persistently low inflation

Consumer price inflation has remained very low due to sluggish domestic demand. China's headline inflation edged up slightly to 0.4 percent y/y in July-November, from 0.1 percent in the first half of 2024, driven by a transitory spike in food prices caused by extreme weather that hindered the production of fresh produce (Figure 6A). The uptick in food prices offset the decline in energy prices due to lower global oil prices. Service price inflation also eased, as the boost from pent-up travel demand faded. Excluding the volatile food and energy prices, core inflation remained tepid at 0.3 percent y/y in July-November, down from 0.7 percent in the first half of 2024.

The property sector downturn and muted consumer demand are also reflected in persistent producer price deflation. By November, producer prices had contracted for the 26th consecutive month, declining by 2.2 percent y/y in July-November, extending the contraction of 2.1 percent y/y in the first half of 2024 (Figure 6B). Although recent declines in commodity prices, particularly crude oil, have lowered producer prices in upstream sectors, the primary drag remains weak demand for ferrous metal and non-metal mineral sectors, driven by the property sector downturn. Additionally, weak consumer demand has exerted downward pressure on prices in downstream consumer sectors such as clothing and durable goods.

Figure 6. Deflationary pressure has persisted

A. CPI inflation decomposition **B. PPI inflation decomposition**



Source: NBS, World Bank staff estimates.

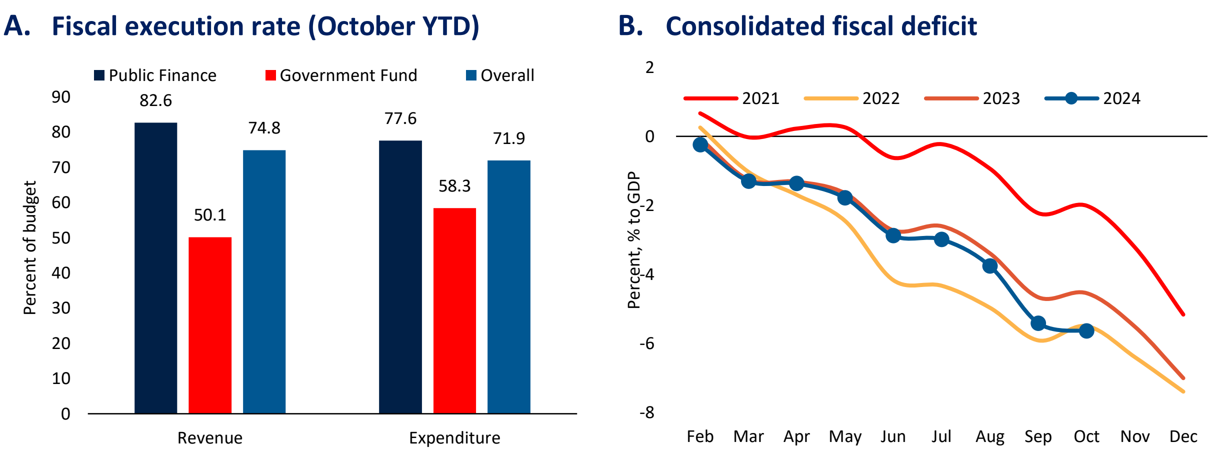
Fiscal policy faces financing and implementation challenges at the local level

Fiscal revenue contracted due to weak domestic activity and a sluggish property sector. China's consolidated fiscal revenue contracted by 4.7 percent y/y in the first ten months of 2024. Soft domestic demand drove the decline in domestic value-added tax collection, while the property sector correction led to a nearly 23-percent fall in land lease revenues – a crucial revenue source for local governments. Meanwhile, non-tax revenues such as fees, fines, and proceeds from state-owned assets sales, rose notably by 15.3 percent y/y, helping to offset some of the revenue loss faced by local governments.

Fiscal policy has become less tight but faces financing and implementation hurdles at the local level. The recent acceleration in government bond issuances has provided a boost to public infrastructure spending, resulting in a 1.0 percent y/y expansion in consolidated fiscal expenditure in the first ten months of 2024. However, budget implementation remains a key challenge for local governments due to financing constraints and a shortage of viable projects. The execution rate for capital expenditures reached only 58.3 percent of the budget target as of October, compared to 77.6 percent for current expenditures (Figure 7A). With the recent improvement in project implementation, the consolidated fiscal deficit rose to 5.6 percent in the first ten months of 2024, from 4.6 percent in the same period last year (Figure 7B).

Recognizing growing financial risks at the local level, the authorities announced a debt swap program to bring off-budget debt of local governments onto their balance sheets. RMB 10 trillion (8 percent of GDP) in hidden local government debt will be swapped for lower-cost on-budget financing over five years. In addition, local governments will repay RMB 2 trillion of off-budget debt used to finance shantytown renovation due from 2029 onwards. The program will improve transparency and reduce the risk of default on off-budget debt in the short term, though a sustainable reduction in the local government debt overhang would require subnational fiscal consolidation over the medium and long term.

Figure 7. A low execution rate is a challenge for the implementation of fiscal support



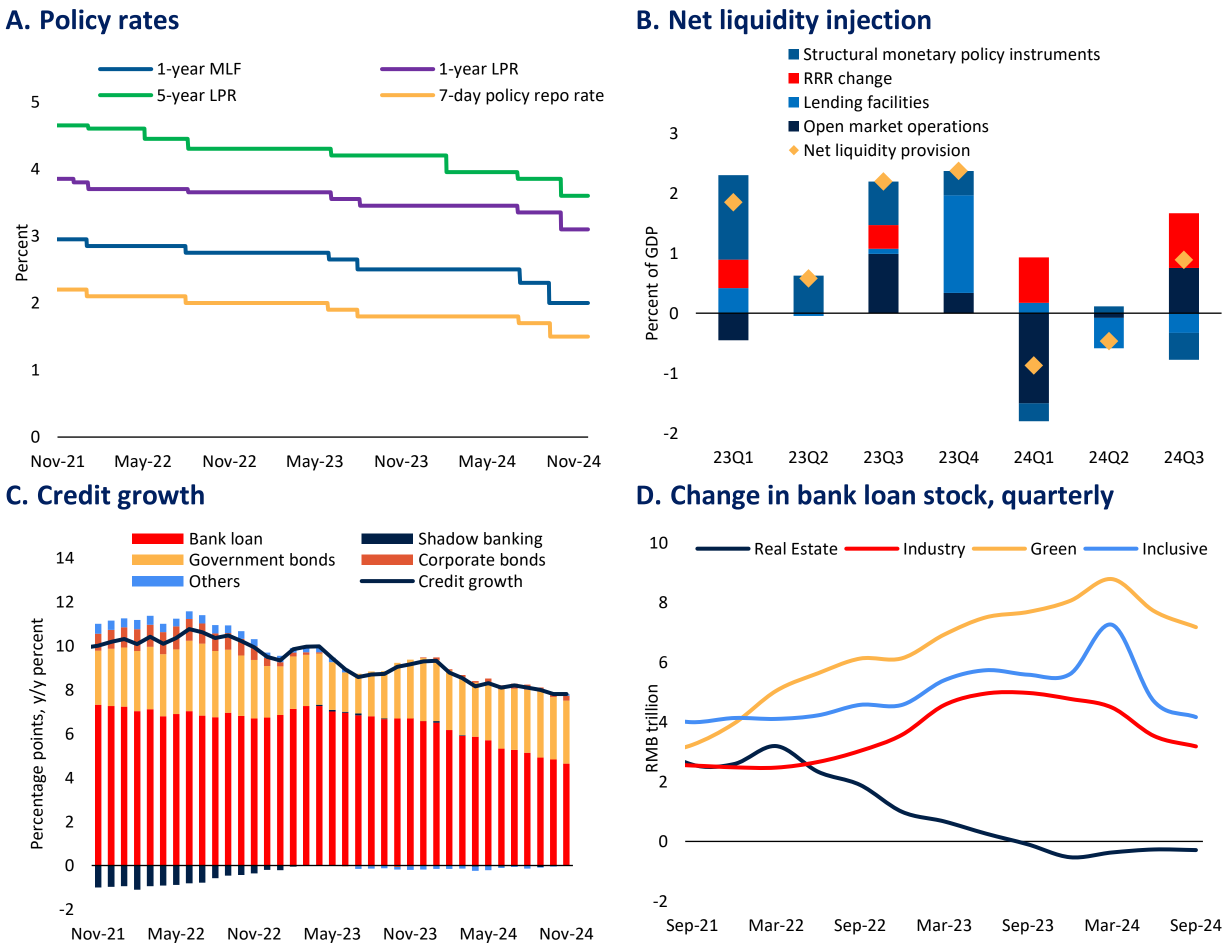
Source: MOF, NBS, World Bank staff estimates.

Note: China's budget system consists of (i) the Public Finance Budget (PFB) which includes tax and non-tax revenues, current expenditures, and a portion of capital expenditures; (ii) the Government Fund Budget which reflects mainly land-lease revenues of local governments and expenditures for specific infrastructure and social projects; (iii) the Social Security Fund Budget which records social insurance contributions and disbursements; and (iv) the SOE Fund Budget which is the state-owned assets operation budget. The consolidated budget balance refers to the sum of (i), (ii), (iii) and (iv) minus net withdrawals from the government's stabilization fund. Data on (iii) and (iv) are only reported at annual frequency. In the PFB, local government revenues exclude transfers from the central budget, and central government expenditures exclude transfers to local governments.

The impact of monetary easing has been constrained by weak credit demand

China's central bank unveiled extensive monetary policy support in September. The People's Bank of China (PBC) lowered the 7-day reverse repo rate by 20-basis points (bps) and the 1-year medium-term lending facility rate by 30 bps in the third quarter (Figure 8A). The 1-year and 5-year loan prime rates, benchmarks for short-term lending and mortgages, were reduced alongside a corresponding cut in deposit rates to maintain stable net interest margins for banks. Banks' reserve requirement ratio was also lowered by 50 bps. These measures collectively reduced financing costs and injected liquidity equivalent to 0.9 percent of GDP in the third quarter (Figure 8B). A new PBC relending facility to support equity share buybacks helped fuel a rally in the stock market. The latest policy package followed the U.S. Federal Reserve's September interest rate cut, enabling the PBC to lower interest rates without significantly pressuring the exchange rate.

Figure 8. The effectiveness of the expansionary monetary measures might be constrained by the subdued credit demand



Source: PBC, NBS, WIND, World Bank staff estimates.

However, the effectiveness of the expansionary measures might be constrained by subdued credit demand. Growth in credit to the non-financial sector slowed to 7.8 percent y/y in November, due to decelerating loan growth (Figure 8C). This decline in loan growth reflected weak corporate and households credit demand amid property-sector challenges and subdued sentiment. Corporate credit demand weakened across sectors, including in green industries and for micro and small enterprises for which the PBC provides targeted credit support (Figure 8D). In the household sector, deleveraging, sluggish mortgage demand, and subdued short-term credit needs for consumption contributed to slower credit growth.

The banking sector remains well capitalized, though profitability has fallen

Bank asset growth has decelerated to 7.3 percent by the end of the third quarter of 2024, a decline of 2.4 pp compared to the same period last year. This growth slowdown may reflect a combination of softer credit demand and more cautious lending approaches by banks. Concurrently, the system-wide non-performing loan (NPL) to total loans ratio slightly decreased to 1.6 percent in the first three quarters of 2024 (Figure 9A), amid an ongoing decrease in the property sector's outstanding loans. The NPL ratio for loans to property developers also fell to an estimated 4.0 percent, where non-performing developer loans make up 0.2 percent of total loans outstanding. The sector-wide loan-loss provision ratio was kept at a high level of 209 percent.

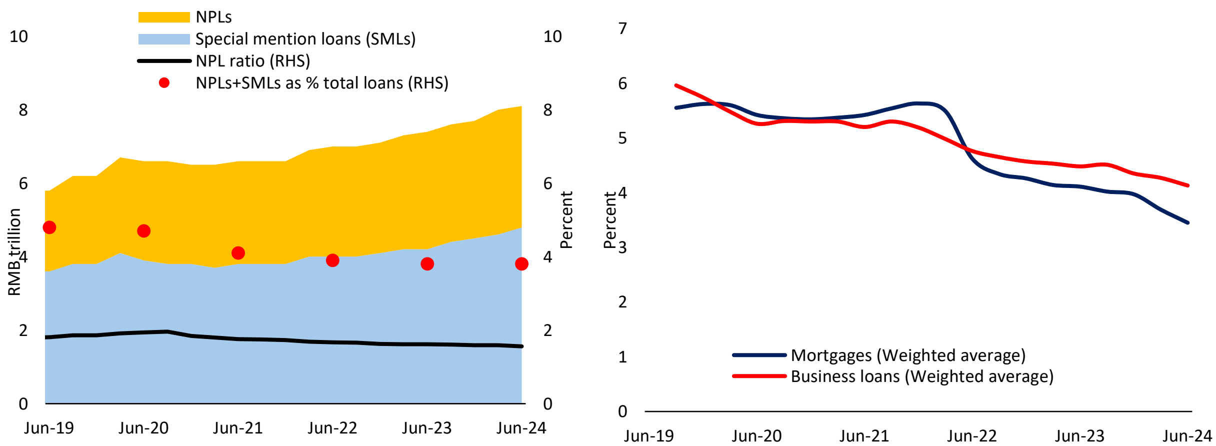
The aggregate bank net interest margin (NIM) remains under pressure from declining asset yields in the short and medium term. The banking sector's aggregate NIM was 1.5 percent in June, compared to 1.7 percent in 2023. The reduced NIM is attributed to declining asset yields—a consequence of multiple interest rate cuts—coupled with relatively high funding costs, particularly for fixed-term deposits. The NIM is at risk of declining further in the last two months of 2024 when banks comply with the recent policy to align the interest rate on existing mortgages with the lower rates on new mortgages (Figure 9B). This effect is partially mitigated by the recent reduction in the banks' reserve requirement ratio by the PBC, as well as the lowering of deposit rates by commercial banks. The compressed NIM continues to exert pressure on banks' profitability. Although still positive, the banking sector's net profit growth in the first half of the year fell by 2 pp compared to the same period last year.

Even as the banking sector has, so far, maintained adequate capital buffers, the government plans to inject new equity into large state-owned banks. The banking sector's overall capital adequacy ratio (CAR) was 15.5 percent as of June 2024, 10 bps higher than in March. The increase in capital adequacy has been partially caused by the slowdown in the growth of risk-weighted assets that has offset slower growth of retained earnings. System's capital adequacy is expected to improve in 2025 by RMB 1 trillion (US$140 billion) capital injection into China's six large state-owned banks by the Ministry of Finance. As banks' profit growth weakens, the capital injection will boost their capital base and enhance their ability to meet future credit demand.

While the banking sector remains broadly well-capitalized, some small banks are experiencing pressures, leading to an increase in mergers. The authorities continue to prioritize consolidation as the primary strategy for the resolution of distressed rural commercial banks, with efforts being accelerated in 2024. In the first three quarters, 261 small rural banks were either merged into larger institutions or scheduled to be, reflecting intensified consolidation efforts aimed at preserving overall financial stability. Meanwhile, the risk of contagion from the failure of small banks to the broader banking system is mitigated by the small size of institutions designated as 'high risk' by the central bank, which account for less than 2 percent of total bank assets.

Figure 9. NPL ratio marginally improved in the first half of 2024, while loan rates fell in supportive monetary conditions

A. Non-performing loans **B. Loan rates**



Source: PBC, NFRA, World Bank staff estimates.

II. Outlook, Risks, and Policy Implications

Outlook

Global growth is expected to remain tepid in 2025 and 2026, at a pace notably below the pre-pandemic average (World Bank, 2024a). The outlook reflects a variety of headwinds including mounting global trade frictions and broader policy uncertainty, the lagged effects of monetary tightening, and moderate consumption growth in the context of receding savings buffers. Globally, investment growth is also expected to remain subdued, constrained by elevated real interest rates and policy uncertainty amid heightened geopolitical tensions. Having rebounded over the course of 2024, global trade growth is expected to firm a little further next year, in tandem with an anticipated growth pickup in some key economies, and remain broadly steady in 2026. However, amid prevalent protectionist measures, global trade growth is expected to fall short of pre-pandemic averages.

China's GDP growth is projected at 4.9 percent in 2024, slowing to 4.5 percent in 2025. This reflects a 0.1 and 0.4 pp upward revision of the growth forecast for 2024 and 2025, respectively, compared to the June 2024 *China Economic Update (CEU)*, to account for the effect of recent policy easing and near-term export strength (Table 1 and Box 2). Slower household income growth and the negative wealth effect from lower home prices are expected to weigh on consumption into 2025. Policy support for the property sector is expected to provide a modest boost to housing demand and to help lower high inventory levels, but a turnaround in the property sector is not anticipated until late 2025. Elevated uncertainty and reduced profitability will temper manufacturing investment, while public spending will support infrastructure investment. Weak domestic demand is projected to keep consumer price inflation low at 0.4 percent in 2024, before modestly rising to 1.1 percent in 2025.

The pace of poverty reduction assessed at the US$6.85/day per person threshold (2017 PPP)—the poverty line used by the World Bank for upper middle-income countries—slowed in 2024 and is expected to decelerate further. Rural extreme poverty, following the national definition of US$ 2.3/day per person in 2017 purchasing power parity (PPP), has effectively been eliminated. In 2024, about 12 percent of the population, or 176 million people, is estimated to have consumption levels below US$6.85/day per person, a higher living standard benchmark used by the World Bank to compare progress across countries (Figure 10A). Based on this higher benchmark, 23 million people were lifted out of poverty in 2024, compared with 26 million in 2023 (Figure 10B). The pace of poverty reduction at this line is expected to decelerate further to 20 and 17 million in 2025 and 2026, due largely to the slower economic growth projected for these years.

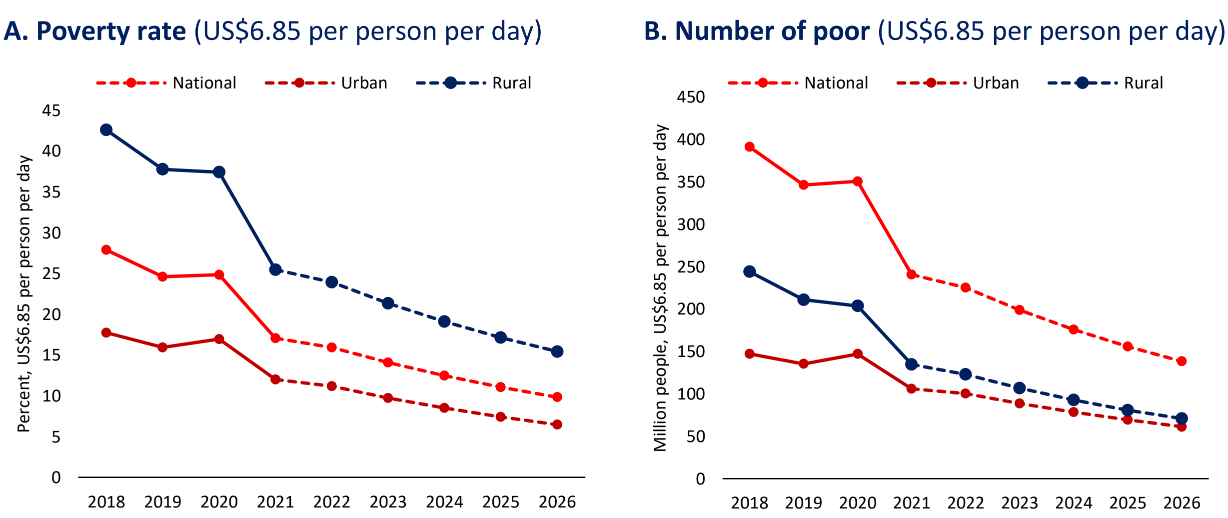
Table 1. China selected economic indicators, 2021-2026

Annual percent change unless indicated otherwise	2021	2022	2023	2024f	2025f	2026f
Real GDP growth, at constant market prices	8.4	3.0	5.2	4.9	4.5	4.0
Private Consumption	11.7	1.1	8.6	5.3	5.2	5.4
Government Consumption	3.3	4.6	6.7	2.7	3.1	3.2
Gross Fixed Capital Formation	3.1	3.2	4.9	3.4	3.6	3.6
Exports, Goods and Services	18.4	-2.5	1.6	7.2	4.1	2.0
Imports, Goods and Services	10.3	-5.6	6.1	2.4	2.3	2.7
Real GDP growth, at constant factor prices	8.4	3.0	5.2	4.9	4.5	4.0
Agriculture	7.1	4.2	4.0	3.3	3.1	3.0
Industry	8.7	2.6	4.7	5.4	4.3	3.2
Services	8.5	3.0	5.8	4.7	4.7	4.8
Inflation (Consumer price index)	0.9	2.0	0.2	0.4	1.1	1.6
Current account balance (% of GDP)	2.0	2.5	1.4	1.6	0.9	0.2
Net foreign direct investment, Inflow (% of GDP)	0.9	-0.1	-0.8	-1.1	-1.0	-1.0
Consolidated fiscal balance (% of GDP)*	-4.0	-6.3	-5.8	-6.0	-6.2	-5.8
Government debt (% of GDP)	46.9	50.6	54.1	57.8	63.4	68.0
Primary balance (% of GDP)	-3.0	-5.2	-4.8	-5.0	-5.2	-4.7

Source: World Bank.

Note: f = forecast (baseline). * World Bank staff estimates.

Figure 10. Poverty reduction will continue, albeit slower than in previous years



Source: World Bank staff estimates using tabulated data from NBS and World Bank's GDP growth projections.
Note: Last grouped data available to calculate poverty is for 2021. Projections based on per capita GDP growth estimates, using a neutral distribution assumption with pass-through 0.85 to per capita household consumption.

Box 2. Recent economic policy measures and guidance

China's policymakers have announced counter-cyclical measures to support domestic demand. In the second half of 2024, the People's Bank of China eased monetary policy by lowering policy rates and banks' reserve requirement ratios (RRR) and introducing a long-term reverse repo facility and liquidity support to the stock market. Fiscal measures have included a RMB 150 billion (0.1 percent of GDP) consumer durables trade-in program and a RMB 150 billion equipment upgrade program for businesses. To support the property sector, the authorities lowered minimum down payment ratios, reduced mortgage rates, extended public support for purchases of existing housing inventory, expanded the "whitelist" of real estate developers that can receive liquidity to complete unfinished housing projects, and offered cash subsidies for housing renovation in certain urban areas. Local governments were allowed to issue special bonds to finance the purchase of unused land and unsold homes to convert into affordable housing (Table 2).

Table 2. Main policy measures and their expected impacts

	Measure	Expected impact	Time of announcement
Monetary and financial	Further policy rate and RRR cuts	Increase market liquidity and lower borrowing costs, though impact may be limited by risk aversion and weak credit demand.	September and October 2024
	Long-term outright reverse repurchase tool		October 2024
	Liquidity facilities to support stock market		September 2024
Fiscal	Consumer trade-in and equipment upgrade programs	Raise demand for consumer durables and capital goods. The World Bank estimates the growth impact at about 20 basis points in 2024, using a fiscal multiplier of 0.9 (World Bank, 2022a).	Rolled out in March and funding increased in August 2024
	RMB 10.0 trillion debt swap program over 2024-28	Improve transparency and reduce the risk of default on off-budget debt in the short term but not designed to release significant stimulus	November 2024
	Planned issuance of special central government bonds to replenish the capital of state banks	Improve the banking system's capital adequacy	October 2024
Property sector	Lower minimum down payment ratio, reduced mortgage rates, and reduced applicable tax rates of deed tax and real estate-related VAT	Support housing demand, but impact could be dampened by weak confidence	September and November 2024
	Increase ceiling of PBC relending facility to 100 percent of the principal of eligible loans to support purchases of housing inventory by SOEs	Support housing inventory destocking, but low returns on social housing[6] could limit the incentives of local SOEs to tap the facility	September 2024
	Expansion of "whitelist" of real estate projects which can receive bank financing to more than RMB 4 trillion by end-2024	Support completion of presold but unfinished homes. Risk aversion of commercial banks could be limiting demand for this facility	October 2024

[6] World Bank estimates suggest that the average rental yield for public housing is about 1.0 percent for tier-1 and tier-2 cities, based on the rental price of public rental housing and the property price per square meter published by the China Real Estate Information Website (accessed through CEIC) with a sample of 19 tier-1 and tier-2 cities.

	Subsidies for urban residents to move to 1 million new homes	Moderate support for housing inventory destocking	October 2024
	Local government can use special bonds to purchase unused land and existing homes to convert into affordable housing	Support housing inventory destocking. Moderate impact is expected due to the low returns on social housing[7]	October 2024

These measures have offset some of the near-term weakness in domestic demand but details of the size and composition of fiscal support for 2025 are yet to be announced. To support growth next year, the authorities have committed to a more proactive fiscal policy stance that features a higher budget deficit, a higher local government special purpose bond quota, and new issuance of special treasury bonds, alongside a looser monetary policy stance. The size and composition of next year's fiscal stimulus will be announced with the release of the 2025 Budget, likely in March 2025.

Policymakers have also announced several long-term measures to complement the counter-cyclical support, with specific details expected to be announced in the coming months. Policymakers have pledged to improve the fiscal spending structure to support social welfare and consumption and implement fiscal and tax systems reforms to provide more financial resources to local governments. However, greater detail of the specific policy measures is necessary to bolster household and business confidence. To defuse financial risk and improve transparency of local government debt, a RMB 10 trillion (8 percent of GDP) debt swap program has been introduced to swap off-budget debt with lower-cost on-budget bonds over the next five years.

Risks

Risks to China's outlook—both domestic and external—are tilted to the downside. Domestically, a more persistent downturn in the property sector could further temper investment and local government revenues. Tighter local government financing, in turn, could lead to under-execution of fiscal policies that would hinder growth. Further softening of labor market conditions due to lower enterprise profitability and reduced hiring could weigh on consumption. Globally, heightened uncertainty around trade poses risks to China's exports. Following recent guidance from policymakers, there are upside risks to the 2025 growth forecast. Higher-than-expected fiscal spending, especially if a larger share is financed by the central government, could lift growth above baseline expectations. Decisive policy action to stabilize the property sector, including through the restructuring of struggling property developers, could lead to an earlier-than-anticipated pick up in real estate activity.

[7] The interest rate on new special local government bonds with a maturity of 5 to 10 years is about 2.0 percent, lower than the above-mentioned estimate of 1.0 percent for the average rental yield for public housing in tier-1 and 2 cities.

Policy implications

China's economic outlook underscores the importance of providing targeted short-term support to stimulate growth, while avoiding measures that could exacerbate existing structural imbalances. Short-term policy interventions could be aligned with longer-term objectives such as promoting greener growth and rebalancing the economy toward higher consumption. Communicating specific policy measures with transparency and credible forward guidance are crucial to reassuring markets, rebuilding consumer confidence, and supporting a balanced and sustainable economic recovery.

Furthermore, structural reforms are essential to address key vulnerabilities and safeguard long-term growth. While the monetary, fiscal, and property sector measures are expected to provide a moderate and temporary boost to domestic demand, conventional stimulus will not be sufficient to sustain higher growth. China's growth slowdown is partly driven by long-term factors such as structurally low consumption, high property developer and local government debt, and an aging population. Thus, short-term macroeconomic policy support needs to be accompanied by structural reforms.

A sustained increase in domestic demand growth will depend on reforms both to increase reliance on consumption and to improve the business enabling environment. Long-term improvements in the social safety net could reduce China's persistently high household savings rate (38 percent of disposable income) and boost consumption (World Bank, 2023). Given diminishing returns to investment in traditional infrastructure, fiscal resources could be redirected toward social spending. Recent guidance from policymakers indicated commitment to rebalance fiscal spending to support social welfare and consumption, but specific details are not yet available. Reforms to lower barriers to market entry, address distortions in factor markets, and reduce regulatory uncertainty could help restore business confidence and private sector investment, generating jobs and lifting household income growth (World Bank, 2023).

To help restore homebuyer confidence, the authorities could implement measures to address shortcomings in the property financing mechanism. The inability of property developers to complete homes that have been sold through advance sales has hurt confidence in the pre-sale system. Advanced deposits made by retail property buyers expose them to risks of developers which the buyers are often unable to assess, creating consumer protection concerns. There are several potential solutions. Advanced deposits could be banned, with developers raising all their funding from professional investors who can better evaluate risks. Alternatively, advanced deposits could be restricted to a small portion of the property price and a small share of the developer's total borrowing, thus reducing home buyers' financial risk exposure. A dedicated public-private guarantee facility, akin to deposit insurance, could provide stronger protection of advanced deposits. These reforms would enhance consumer protection and encourage more sustainable developer financing practices, rebuilding trust in the housing market.

Furthermore, a sustained recovery in the property sector would require a reduction of the sector's debt overhang. With structurally lower housing demand in the future (World Bank, 2023), property developers face weaker revenue growth prospects, limiting their capacity to service debt. A more active use of the insolvency framework could facilitate the orderly exit of unviable developers, while debt restructuring would enable viable developers to complete stalled projects and deliver homes and potentially attract new capital to the sector. Additionally, dedicated asset management companies could bring industry expertise to bear on the disposal of troubled assets held by developers or banks. An efficient and expedited debt resolution would allow credit to be redirected for more productive uses.

Turning to the issue of high local government debt, a durable solution would require reforms to the fiscal framework to complement the debt swap program. While the debt swap program will not necessarily reduce the overall (on-budget and off-budget) debt burden of local governments, it will enhance transparency regarding contingent liabilities and reduce interest expense, lowering local government refinancing risks. It may also allow for maturity extensions, easing short-term liquidity constraints. However, without complementary reforms to the fiscal framework over the medium term, there is a risk of further build-up of local government financial vulnerabilities. Lessons from China's 2015 local debt swap program suggest that LGFVs could increase off-budget borrowing after the debt swap. The growth of LGFV debt, adjusted for the effects of the debt swap, surged by 35 and 22 percent y/y, respectively, in 2015 and 2016.

Subnational fiscal consolidation over the medium term could contribute to a sustainable reduction in local government financial risks. Loal government balance sheets could be repaired via corporate restructuring and sales of viable assets of LGFVs and, where needed, greater use of insolvency frameworks. Furthermore, the introduction of local taxes and adequate block grants would reduce local governments' reliance on land lease revenue and off-budget liabilities to finance investment. Recent guidance from policymakers indicated intent to implement fiscal and tax reforms to increase the financial resources of local governments, but specific details are not yet available. The central government could increase the unconditional transfers and make them predictable, allowing transferred revenues to be viewed as part of local governments' disposable revenues. Introducing local taxes such as a recurrent property tax (at an appropriate time in the future when the property market has stabilized) and granting local governments some discretion to levy taxes, within a specified rate range, on certain bases such as VAT and personal income tax could further strengthen their revenue capacity.

III. Special Focus: Economic Mobility and China's Emerging Middle Class

Building on past success to tackle the next challenge

China has achieved dramatic success in improving the living standards of its population. With almost 800 million people lifted out of poverty in the past 40 years, China alone accounts for three-fourths of the global success in reducing poverty during this period. Chinese citizens today are more prosperous, live longer and healthier lives, and enjoy a better quality of life relative to those in earlier generations.

Translating its success in poverty reduction into similar success in fostering upward economic mobility is one of the key challenges facing China today. Upward economic mobility is about sustained improvements in the welfare of all citizens. This will require growth, without which living standards will stagnate. But equal opportunities for greater economic and social mobility can in turn can also support growth. Equalizing these opportunities can boost the quantity and quality of human capital and foster more optimal allocation of talent. This can facilitate the infusion of available technologies in the economy *and* accelerate innovation to extend technological frontiers, enhancing the country's growth potential (World Bank, 2024b).

The context in which China must confront this challenge, however, is different from the one that prevailed during its economic transformation over the last four decades. First, inequality, which rose through much of the rapid expansionary phase, has plateaued but remains high for the country's level of development. Second, China's growth model too is undergoing a double-pivot: a shift from export-led, labor-intensive manufacturing to domestic demand- and innovation-driven industry and services; and the other a transition from a heavily coal dependent economy to a sustainable, carbon-neutral, and more resource-efficient one. Third, China's population is aging rapidly which could further dampen growth momentum.

This special focus examines economic mobility in China during the period between 2010 and 2021. It uncovers trends, profiles, and some underlying drivers of mobility, drawing from the analysis some policy lessons going forward.

Measuring economic mobility

The mobility concept used is intra-generational mobility—the improvement in the welfare of individuals and households within a lifetime or a single generation. In particular, mobility is defined as movement across four discrete economic classes: low-income, vulnerable middle, secure middle, and upper income. The US$6.85/day (2017 PPP) cutoff is used to define the *low-income* population. This threshold is used by the World bank as a reference to compare progress across countries. Based on that, a higher threshold of US$13/day (2017 PPP) is used to distinguish those who are not *low-income* but are at a sufficiently high risk (>10 percent) of slipping into it. This group is labeled the *vulnerable middle*. Finally, an even higher threshold of US$25/day is used to divide those above the *vulnerable middle* category into the *secure middle class* (US$13 - US$25/day) and the *upper income class* (>US$25/day).[8]

Mobility trends and profiles

The period between 2010 to 2021 saw robust growth in consumption and household living standards, and this boosted the upward mobility of Chinese citizens. During this period, the *low-income* share of the population declined from 62.3 percent to 17.0 percent (Figure 11). Correspondingly, the size of the economically *secure middle class* increased from 9.8 percent to 32.1 percent, while the share of the upper income group increased from 2.7 to 12.7 percent of the population.

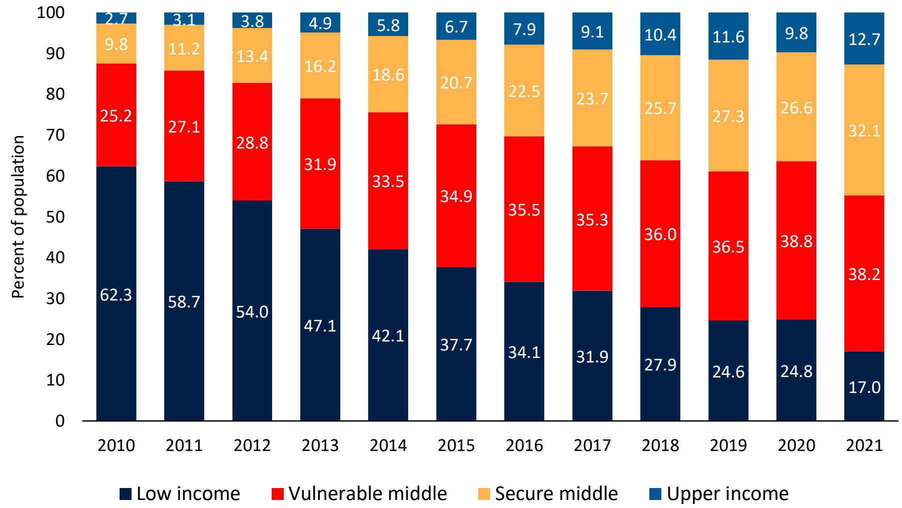
Yet, a sizeable majority of the population is not yet economically secure. 17 percent of the population is still *low-income*, while 38.2 percent is in the *vulnerable middle* class – the segment of the population that is above the US$6.85/day line but not on a firm enough economic footing to be free of the risk of falling below that line in the future.

The expansion of the secure middle class in China is noteworthy also from a global perspective. The slight decline in 2020 notwithstanding, China witnessed the fastest increase in the share of the secure middle class population compared to any other region of the world (Figure 12A). Among emerging markets and developing economies in 2021, only the Europe and Central Asia region had a slightly larger share of population in the secure middle class than China. Given China's large population, the size of its middle class is quite large in a regional and global context. China accounts for 78 percent of the secure middle class in the East Asia and the Pacific region (Figure 12B). The size of China's secure middle class would make it the third most populous country in the world.

[8] The thresholds are derived using the "vulnerability-to-poverty" approach suggested by Lopez-Calva and Ortiz-Juarez (2014) and the method in Chaudhuri (2003) to approximate intertemporal variability in welfare from cross-sectional variation across households. Several rounds of data from the China Family Panel Studies (CFPS), a representative survey of household socio-economic conditions conducted by Peking University, are used to derive the thresholds using these methods. Thresholds are calibrated so that shares in each economic class match between CFPS data and the synthetic consumption distribution derived from grouped (ventile) data for urban and rural areas made available to the World Bank by the National Bureau of Statistics of China. See World Bank PIP webpage and Montalva and Tiwari (forthcoming) for details about the methodology to derive this synthetic distribution.

Figure 11. China's economically secure middle class has expanded to 32.1 percent of the population

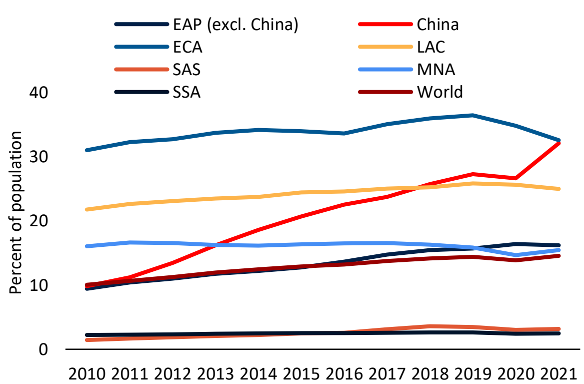
(% of population in different economic classes, 2010-2021)



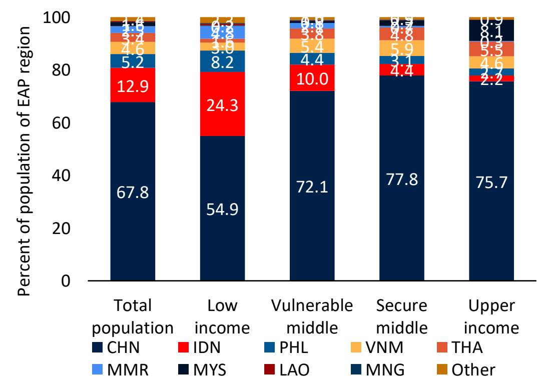
Source: Montalva and Tiwari (forthcoming).
Note: The underlying data is the synthetic consumption distribution derived from grouped (ventile) data made available by the NBS for urban and rural areas separately (see: World Bank PIP webpage for details on the methodology used).

Figure 12. China's secure middle class accounts for over three-fourths of the middle class in developing EAP

A. China's secure middle-class growth in a global perspective



B. Country Contributions to Population by Income Class in the EAP Region (2018)



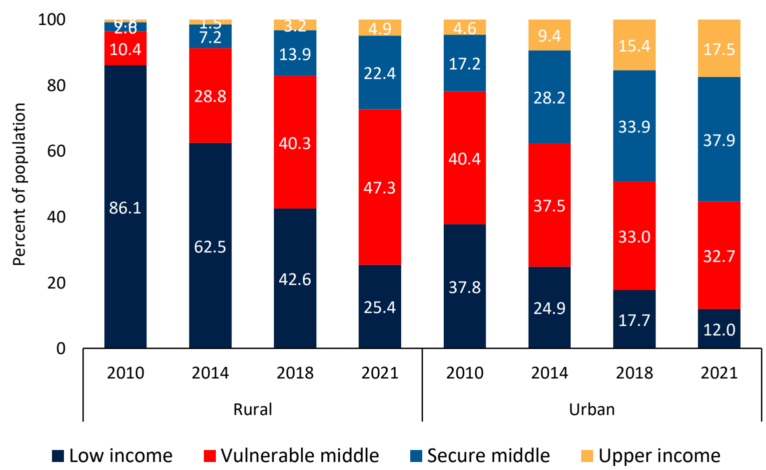
Source: The numbers for China are from Montalva and Tiwari (forthcoming). The numbers for other countries in the EAP are derived using comparable methodology in Kwah, Montalva and Tiwari (forthcoming), a regional piece on the same topic.
Note: Countries included in the figure in the right panel are: China, Indonesia, Philippines, Vietnam, Thailand, Myanmar, Malaysia, Lao PDR, Mongolia and the "Other" category, which aggregates populations from Cambodia, Fiji, the Federated States of Micronesia, Kiribati, the Marshall Islands, Nauru, Papua New Guinea, Solomon Islands, Timor-Leste, Tonga, Tuvalu, Vanuatu, and Samoa. For countries lacking survey data in 2018, interpolated and

extrapolated estimates were used. For Cambodia, for which poverty rates are censored, the average income class shares for the region were imputed.

Both urban and rural areas experienced a sharp decline in the share of low-income population during the 2010-2021 period. The low-income share declined from 86.1 percent in 2010 to 25.4 percent in 2021 in rural areas and from 37.8 percent to around 12 percent in urban areas (Figure 13). Even though the relative reduction was similar in both areas (around 70 percent), rural areas experienced a larger absolute reduction of 61 pp relative to 26 pp in urban areas.[9] Urban areas started from a much lower base of low-income population so the scope for reduction was more limited. But the scale of absolute reduction in rural areas also reflects the concerted push China has made in boosting rural incomes to eliminate extreme poverty and close rural-urban income gaps. These efforts included measures to boost agricultural productivity, improve the skills of rural workers, and strengthen connectivity to job opportunities in the rest of the country (World Bank, 2022b).

Figure 13. Mobility across urban and rural areas

(% of population in different economic classes, 2010-2021)



Source: Montalva and Tiwari (forthcoming).

Note: The underlying data is the synthetic consumption distribution derived from grouped (ventile) data made available by the NBS for urban and rural areas separately (see: World Bank PIP webpage for details on the methodology used).

[9] An important caveat needs to be noted here. The 2013 comparability break in the household survey may particularly affect comparisons over time for urban and rural areas as the change in sampling frame involved using actual residence instead of hukou to determine location. Readers are cautioned to keep this caveat in mind while interpreting the findings, noting of course, that the conclusions are broadly similar, qualitatively, when analyzing the period 2014-2020.

Urban areas are more prosperous than rural areas in China, though there are signs that prosperity is getting better shared across space. In 2010, urban areas accounted for 30 percent of China's low-income population. This increased to 44 percent in 2021. Urban China accounted for 86.3 percent of China's secure middle-class population in 2010; this decreased to 73.8 percent in 2021. This means that prosperity was less concentrated in urban areas in 2021 than it was in 2010.[10]

Higher education has been a ticket to the secure middle class. Education is closely related to prospects of upward economic mobility in China. Better educated individuals are more likely to be found in the upper rungs of the economic ladder, while those with little to no education are more likely to remain in the lower rungs. Those with college education or above have the highest likelihood of belonging either to the secure middle class or upper income groups (70 percent). This likelihood declines progressively for those with lower education levels (Figure 14A). Among the illiterate or semi-literate group, which accounts for 27 percent of the population aged 25-64, the probability of belonging to either the secure middle class or the high-income group is just 19.9 percent. Conversely, every 4 in 5 individuals with education at the primary or lower level are likely to be in the low-income group or in the vulnerable middle.

However, education was not the only ticket to upward mobility. Many people entered the secure middle class and beyond with education attainment below high school. This is consistent with the kinds of opportunities that were created by China's growth process. Workers with limited formal education not only became more productive farmers (with stronger links to markets and technologies), but they were also able to find work on assembly lines, factory floors, and construction sites as China's export-oriented growth generated these low-skilled jobs in large quantities. An industrialization strategy which harnessed cheap labor that was available in abundance meant that higher education was not a necessary condition for upward mobility.

Employees working for wages and salaries account for close to 63 percent of China's secure middle class, which suggests that these jobs are important pathways for upward mobility. 62.6 percent of those in the secure middle class and 71.2 percent of the upper income class belong to the salaried or wage-earning group (Figure 14B). In comparison, the majority (65.3 percent) of those in the low-income group are self-employed. Looking specifically at public sector jobs, the contrast is even starker: 31.7 percent of those in the upper income classes are in some form of public sector employment whereas for the low-income group, public sector employees account

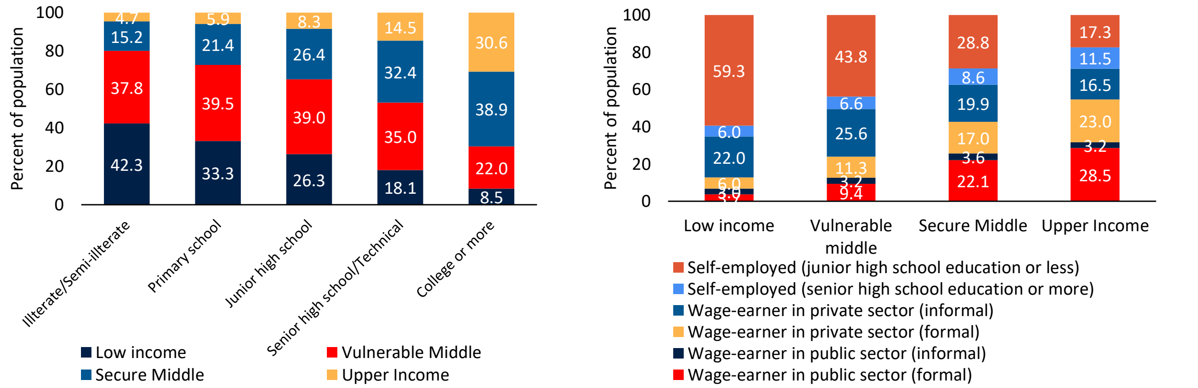
[10] The share of the urban population itself increased over the decade from 49.2 percent to 61.2 percent. Rural to urban migration accounted for some of this growth while some could have been due to administrative reclassification of rural areas which started getting absorbed into growing cities. To the extent that it was the poorest families from rural areas that were moving to urban areas, or that the reclassified rural areas were poorer relative to other rural areas in the country, these compositional changes could have also played a part in lowering the concentration of prosperity in urban areas (relative to rural areas).

for just 6.7 percent of the total.[11] Self-employed workers, on the other hand, are much more likely to be in the low-income or vulnerable-middle categories.

Figure 14. Mobility prospects by education and job-type in 2018

A. Higher education was ticket to upward mobility, but not the only one

B. Wage-earning class accounts for the largest share of the secure-middle and upper income class



Source: Montalva and Tiwari (forthcoming). The profiles are based on data from the 2018 round of the China Family Panel Studies (CFPS).

Note: For education, the sample includes individuals aged 25 to 64. The marginal distribution of education is as follows: 16 percent illiterate or semi-literature, 18 percent with primary school, 32 percent with junior high school, 17 percent with senior high school or technical education and 17 percent with college or more. For job type, the sample is further restricted to 25–64-year-olds who are working. Public sector employees include those who work directly for the government, party or people's organizations, state-owned enterprises, collectively owned public institutions etc., while private sector employees include those working for private enterprises (domestic or foreign) as well as individual or family-owned businesses. Workers having any type of insurance (health, unemployment, work injury, or maternity) or contributing to the pension system through the contributory system are considered formal.

Economic mobility is intricately linked to mobility across space. China's economic transformation has gone hand in hand with an equally dramatic spatial transformation, with the urban population increasing nearly four-fold from 200 million in 1980 to 900 million in 2020. Even though China's *hukou* (household registration) system limited migrants' access to key public benefits such as social security, health care, and education in their place of employment (tying them instead to their place of birth), the urban-rural wage differentials were large enough to offset the cost of migration. Migrants who could capitalize on these new job opportunities in urban and coastal areas were able to earn higher incomes than they would in their villages, and their remittances not only helped their own families climb up the economic ladder but, by

[11] Public sector employees include those who work directly for the government, party or people's organizations, state-owned enterprises, collectively owned public institutions etc. while private sector employees include those working for private enterprises (domestic or foreign) as well as individual or family-owned businesses.

indirectly invigorating the local economies, helped their entire villages (World Bank and DRC, 2022).[12]

Results show that migrants do distinctly better than those who stay behind. Among the various types of migrants in urban areas, migrants who successfully convert to local hukou or migrate with urban hukou from another urban area have, on average, better mobility prospects than the urban locals.[13] Those who move to cities with another urban hukou (urban-to-urban migrants) are likely those who can afford to move, and migration allows them to take advantage of better economic opportunities than they have in their places of birth. Migrants who are able to convert to local hukou are likely long-term migrants or workers with higher education for whom hukou restrictions were relaxed in some cities. In contrast, urban migrants with rural hukou have the worst upward mobility prospects among all urban residents, though they have better odds of being in the secure-middle or upper-income classes relative to those who remain in rural areas.

Future pathways to upward mobility?

Going forward, education is likely to play a greater role in determining prospects for upward economic mobility than it did in the past. While formal or higher education might not have been a prerequisite to get on the economic escalators going up in the past, the same will not be the case in the future. The pattern of economic transformation China witnessed in the past was such that many farmers, factory floor workers, construction hands, and small-scale entrepreneurs were able to benefit from what were essentially *in situ* improvements in productivity largely through learning-by-doing. However, as the economy becomes more reliant on high-value services and on knowledge and innovation, the specialized skills that come from higher education, as well as general skills such as critical thinking and reasoning, adaptability, communication, and collaboration, are likely to be much more in demand.

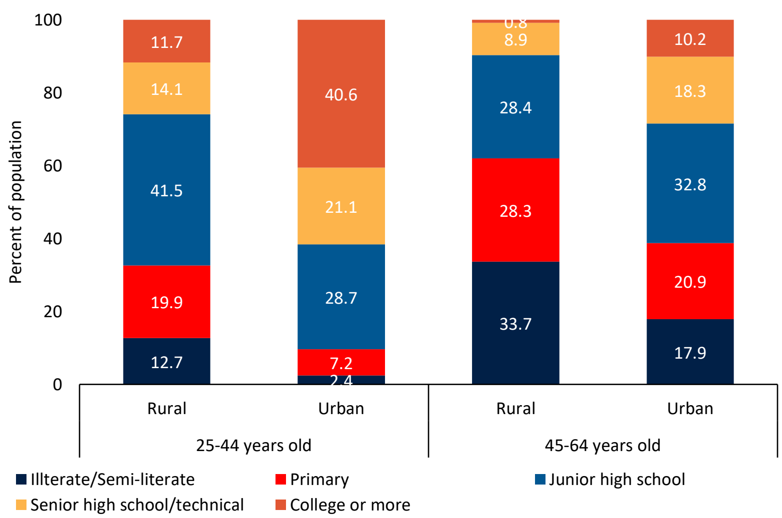
Against this changing labor market landscape, low educational attainment, particularly the gap between rural and urban areas, could deprive large segments of the population from the opportunities to move up. According to the 2018 round of the China Family Panel Studies (CFPS) survey, high school attainment among working-age adults (25-65 years old) was 28.9 percent.

[12] Du, Park and Wang (2005) document that per capita incomes of households with migrants exceed per capita income of households without migrants by as much as 13.1 percent. There is also evidence on migration earnings having a spillover benefit for village economies, potentially by increasing demand for non-agricultural commodities. de Brauw and Giles (2018) find that between 1995 and 2002, a percentage point increase in village out-migration was associated with a 10 percent increase in consumption by poor households.

[13] Migrants in urban areas who have converted to local hukou are identified as those whose birth county is different from county of residence but hukou corresponds to the county of residence. Migrants who have an urban hukou different from their county of residence are inferred to have migrated from other urban areas (urban-urban migrants). Those whose birth county and hukou correspond to the county of residence are considered locals to that area.

This is a lower attainment rate than in today's high income countries (78 percent), high income countries at the time they graduated to high income status (72 percent), and countries that are middle-income now (36 percent) (Li et al 2017). Concerted efforts from the government, including doubling the amount spent on education over the decade leading up to 2018, are helping close this gap. Attainment rates among younger cohorts (25-44 years old) are distinctly better (46.2 percent) than those of older ones (21.6 percent). However, the rural-urban gaps persist. Among the younger cohorts (25-44 years old) in the labor force, 41 percent of workers in urban areas are college educated, while over 70 percent in rural areas still have attainment levels below high school (Figure 15).[14] Closing these attainment gaps across urban and rural areas could increase the number of future workers with completed high school or college education by 34 million.

Figure 15. Younger cohorts are better educated than older ones, but the urban rural gap is still quite large



Source: Montalva and Tiwari (forthcoming) using data from CFPS (2018).
Note: Educational attainment among adults aged 25-64.

Health shocks are a source of economic vulnerability for households and likely an important impediment to upward mobility. Of all respondents between the ages of 16 and 65 in the CFPS, 12.8 self-reported being in poor health. More than double that proportion, 26.5 percent of the same population, reported being in poorer health in comparison to the year before. Around 8.4 percent of the population reported experiencing some physical discomfort or illness within the last two weeks of being interviewed. Finally, the incidence of poor health is higher in rural areas more generally than in urban areas. Workers in formal white-collar jobs may have provisions for medical leave in their contracts, whereas for those who do not work in this type of jobs, a health shock may lead directly to loss in earnings. Even when entire livelihoods of families are not in

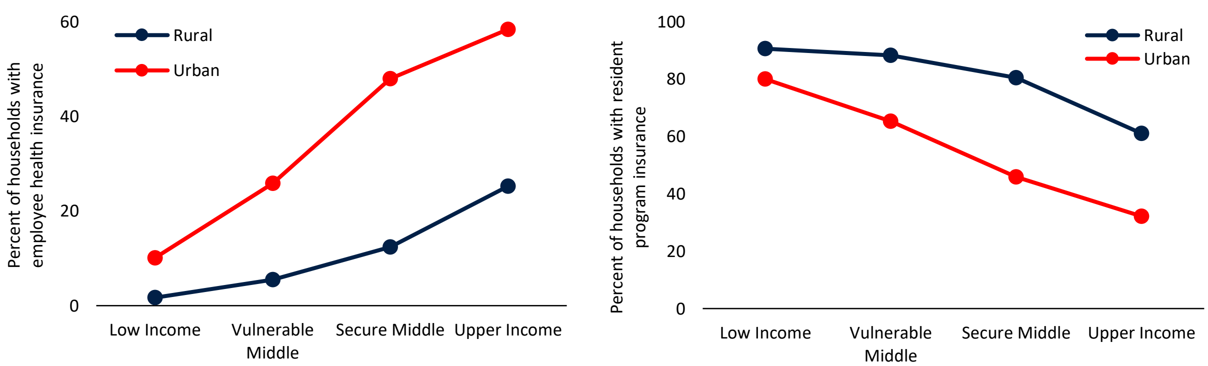
[14] The difference in the quality of education is likely to further accentuate the urban-rural differences. Rozelle and Hell (2020).

jeopardy, health shocks to family members may represent sizeable budgetary shocks to the household if the cost of the medical care required has to be borne out of pocket.

The government has strengthened financial protection against health shocks in the past two decades. Data from the CFPS (2018) shows that around 90 percent of the population is covered by some type of health insurance, either public or private.[15] Health insurance provided by the urban employee program is more prevalent among those who live in urban areas, have formal employment, and are relatively prosperous. For example, almost 60 percent of those who are in the upper-income group in urban areas have access to health coverage through the urban employee program. In contrast, among the low-income in urban areas coverage under this scheme is around 10 percent (Figure 16 A and B). The subsidized resident medical insurance program has bridged this gap by providing insurance to those not covered by the employee program. Around 90 percent of those in the low-income group in rural areas and almost 80 percent of the low-income group in urban areas depend on the financial protection provided by the resident program. In rural areas, over half of those even in the secure middle class and the upper-income groups rely on the resident program.

Figure 16. Expansion of the resident program has helped boost health insurance coverage to near universal levels

A. Urban employee Health Insurance **B. Health Insurance through the Resident Program**



Source: Authors' calculations using data from CFPS (2018)

There are sizeable differences in the level of benefits between the urban employee and resident health insurance schemes. Under the resident program, deductibles and co-payments are higher, coverage for in-patient services is only 50 percent of the total cost, reimbursement rates on outpatient care are significantly lower, and reimbursement from insurance funds (as opposed to out-of-pocket expenditures) are capped such that, in case of critical illness, families would have to pay most of the cost themselves (Yip et al., 2023). Although people living below the *Dibao* line are eligible for medical assistance under the Targeted Anti-Poverty Campaign,

[15] Recent data from the National Healthcare Security Administration, the social health insurance agency, reports coverage rate over 95 percent in 2024.

many in the low-income group (as defined here) are well above the *Dibao* thresholds and as such subject to substantial financial hardship on account of health shocks related to illness and accidents (Yip et al., 2023).[16] Among low-income families in urban areas, the difference in the budget share allocated to health expenditure between families with a household head enrolled in the employee program and those not in the employee program is around 4 percentage points. As there are few rural households in the low-income group with access to the employee program, a statistically robust comparison is difficult, but for all three of the remaining groups (vulnerable-middle, secure-middle, and upper-income), health expenditure shares are higher for those in the resident program than for those in the urban employee scheme and above what the World Health Organization considers catastrophic health expenditures.[17]

The high rate of precautionary savings among Chinese households suggests that existing social programs may not be providing adequate protection against shocks. China already provides many types of benefits to its poorest citizens. Evidence shows that when accounting for what households themselves pay into the fiscal system in the form of taxes, social security contributions, and user fees to access some of the education and health benefits, these benefits are also clearly progressive – i.e., delivering the greatest value to the poorest households (Lugo et al, 2024). However, an overwhelmingly large part of the benefit is delivered to the poorest segments is in the form of publicly provided education and health services. Not counting these "in-kind" benefits (households cannot monetize these) and focusing only on the balance of fiscal elements that are cash or cash-like, the net benefits are slightly less progressive across the distribution and positive only for households in the bottom two deciles of the distribution. This implies that accounting for the taxes paid and contributions made into the social security system, the China's current package of social protection provides a net positive value only to some of the poorest households. The high rate of precautionary savings among Chinese households is a potential manifestation of a collective, albeit private, effort to maintain financial security and economic buffers in the face of limited publicly provided protection against anticipated (e.g., children's education, retirement) and unanticipated (e.g., health, employment) shocks.

Policy directions

As China attempts to consolidate its progress on poverty reduction and realize its goal of achieving common prosperity for all, expanding economic opportunities for everyone to move up the economic ladder and ensuring adequate support to address economic vulnerability of

[16] *Dibao*, also known as the Minimum Living Standards Guarantee Program, is China's flagship cash transfer program.
[17] Yip et al. (2023) use the CHIP data in their calculations and report incidence of catastrophic health expenditures using the 25 percent and 10 percent threshold to be 4.7 percent and 21.7 percent respectively. That is, 21.7 percent of households in China in 2018 (using their estimates from the CHIP data) had health expenditures accounting for over 10 percent of their overall budget. The numbers obtained from the analysis of the data from CFPS is similar. This is much larger than the global average for the same thresholds which were 3.8 percent and 13.2 percent respectively according to the Global Monitoring Report on Financial Protection in Health.

households are two important fronts to push on. The analysis conducted in the report points specifically to four areas: education, health, social protection, and hukou restrictions.

Closing gaps in educational attainment across urban and rural areas and between children of migrant workers will be crucial to provide opportunities for upward mobility. The large gaps in education outcomes between urban and rural areas, and between children of migrant workers and the rest imply significant forgone human capital formation. The expanded technical/vocational education stream has provided an important pathway for many students who do not necessarily want to take the academic track. But while some pilots have been successful, the overall quality of these programs is low (Rozelle and Hell, 2020). Improving quality of early childhood education, supporting disadvantaged children who may need remedial attention through the basic education system, widening means-tested bursaries and, over time, abolishing fees up to the tertiary level are some ways to close the gaps and improve the quality of China's future workforce (Rozelle and Hell, 2020). Some of the efforts will require spending more. China has more than doubled its spending on education over the last 15 years, but at around 3.6 percent of GDP in 2018, its spending is still lower than the average amount upper-middle income countries spend on education (4.5 percent of GDP).

To reduce household vulnerability to health shocks, policies could be directed at lowering costs and reducing disparities between the two social insurance schemes. Many households in the low income and vulnerable middle segments are reliant on insurance provided through the subsidized resident program. The financial protection provided through this program is limited as many cost elements are excluded. This exposes many households to the risk of catastrophic health expenditure. Furthermore, the employee scheme and the resident scheme are run in parallel. Consolidating them fully with parity in benefits will be a key step toward universal health coverage, as well as lower insurance risk owing to polling risk at the national level. To achieve this, China may need to increase fiscal spending on health and tackle inefficiencies associated with a hospital-centered delivery system by incentivizing providers at all levels to deliver cost-effective and results oriented care and strengthening gate-keeper functions.

Expanding coverage and generosity of social protection programs would help boost economic security of its population. China's strong performance on delivering upward economic mobility has been built on the back of a robust job creation over several decades. For its current level of development, a stronger social protection would be an important way to reduce vulnerabilities. There are several ways of doing this. First, there is ample room to expand both coverage and generosity of programs, especially cash-based assistance. Currently while around 14 percent of households are covered with some type of social assistance program, the country's flagship cash transfer program Dibao only covers 4 percent of the population. This is modest in comparison to 17.6 percent of the population in typical upper-middle income countries and primarily covers families whose members are unable to work due to age or disabilities. Second, pensions will become a key vehicle for the provision of social security to its aging population. However, those enrolled in the resident scheme must make do with benefits that are significantly less generous (a tenth of the benefit of the urban employee scheme, on average). Closing the gaps in pension coverage and raising benefit levels for retirees under the resident schemes can help reduce economic anxieties. Third, the temporary expansion of the unemployment insurance scheme to include rural migrants in cities during the pandemic could be made permanent.

Reforming the hukou system and providing migrant workers similar access to public services as native residents would support greater mobility of workers and enhance upward economic mobility. China's hukou system has played an important role in helping the country manage the complex spatial transformation that accompanied its economic transformation.[18] Gradual reform to this system is critical for a more efficient spatial allocation of human capital and for the fulfillment of the upward mobility aspirations of millions that are still in low-income or vulnerable middle categories. The urgency for reform is recognized by policymakers. The resolution passed in the Third Plenum included several measures to decouple access to social security and other services from hukou registration. For example, rural migrants to urban areas will now be able to access social security benefits and compulsory education for their children in the places where they work. Announced measures also included the pooling of health insurance funds at the prefectural level to provincial levels. These are all moves in the right direction but still short of what would be a centrally led effort of a full liberalization of the hukou system.

[18] It has been noted, for example, that China has avoided the "common ills of urbanization such as urban poverty, unemployment and squalor" (World Bank and DRC, 2014).

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