China’s Post COVID-19 Economy and the “Dual Circulation” Strategy

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On the economy, four quick points:

I. Policymakers are in a post-COVID frame of mind

II. August data was solid, but markets and businesses are overly sanguine about the trajectory

III. Monetary policy is now firmly in neutral

IV. Officials are actively planning for stress in the banking sector
The COVID-19 era in China is effectively over

• This week saw the first domestically transmitted cases in eight weeks

• Life has largely normalized, even if consumption hasn’t

• Very diligent in preventing second wave – via national testing buildout and investment in vaccines (research and production)
Economic recovery looking increasingly solid, but not super durable

- Retail sales, fixed asset investment, and industrial output all improved in August (most recent data) and beat forecasts
- Still, consumer spending is nowhere near full strength
- Supply-demand mismatch persists
- Fiscal cliff is looming
Monetary policy is now firmly in neutral

- Interbank rates are back to pre-pandemic levels
- Liquidity injections are smaller, less frequent
- Crackdown on structured deposits also hurts bank funding
- Still, very limited room for outright tightening
Officials are actively prepping for a looming surge in NPLs

• Current policies are delaying a reckoning
• Guo Shuqing has been clear that NPLs will surge in H2 and 2021
• Disposals could be an issue
On dual circulation, four quick points:

I. MNCs and investors need to begin to understand China’s key new economic policy framework – the “dual circulation” strategy

II. For now, it seems like a nebulous Chinese policy phrase, but it reminds us a lot of “Supply-Side Structural Reform” (SSSR), which had a profound impact on the economy and economic management over the past five years

III. The policy has been espoused by the Politburo and is the brainchild of Liu He – just like SSSR

IV. Even marginal shifts in China’s economic approach could reshape the global economy in fundamental ways
Meet the new policy framework – dual circulation

- Introduced by the Politburo in May 2020
- The brainchild of Vice Premier Liu He (pictured right) – appears similar in nature to SSSR
- It’s all about shoring up supply chains in China, while reducing exposure to external demand (more on that later)
- Many details are yet to come, but the policy is starting to shape up
Key goals of dual circulation, as articulated by economist Yu Yongding

• Ensure higher levels of food and energy self-sufficiency
• Reverse the policy trend of prioritizing the service sector over manufacturing
• Localize key supply chains within or close to China
• Keep foreign companies in China by treating them fairly
• Reduce external demand as a driver of economic growth by further boosting domestic demand
The policy could fundamentally reshape the global economy

- **Our outstanding questions:**
  - Is this the end of Chinese mercantilism?
  - What will this mean for global trade flows in the medium term?
  - What will this mean for supply chains in the medium term?
  - Is this China’s plan for decoupling?
Why “Duel Circulation”?  
The underlying messaging from Party theorists point to grave and enduring concerns about globalization and geopolitics

Complex, Unstable, and Uncertain
“At present, peace and development are still the main global trends, but globalization is facing countercurrents, trade protectionism is on the rise, the Covid-19 crisis continues to grow, and the world’s political and economic situation is becoming more complex, unstable, and uncertain. The complex and profound changes in the international environment require us to speed up the construction of a new duel circulation development pattern.”

-- Wang Changlin, Dean, Chinese Academy of Macroeconomics

Supply Chain Security
“Industrial chains and supply chains are the core of constructing the dual circulation system. Talking about dual circulation outside the supply chain and industrial chain is like a tree without roots and water without a source... When risks appear in international ‘circulation’ China’s ‘internal circulation’ can also operate safely, thereby improving the resilience, stability, and safety of China’s industrial supply chain.”

-- Huang Hanquan, NDRC

A Response to US “Bullying”
“Trying to deflect the Trump administration’s trade protectionism and technology blockade, the new Chinese policy aims to set up a global economic and technological innovation center, rivaling that of the US... The Trump administration has recently ratcheted up its attacks on Chinese technology giants including Huawei, Bytedance and Tencent, to blunt China’s technological rise. Perhaps the "dual circulation" policy may prove to be a useful weapon in quashing the US government's bullying.”

-- Global Times editorial
Final Thoughts: China Pivots to the Future

“We are witness a paradigm change in both China’s diagnosis of the long-term trends in the external environment and the corresponding reforms and restructurings they need to make to adjust and thrive. “Since many problems we face are long- and medium-term, resolving such problems is like fighting a protracted war.”

- Xinhua, August 8, 2020

“In the eyes of the subjugationists the enemy are supermen and we Chinese are worthless, while in the eyes of the theorists of quick victory we Chinese are supermen and the enemy are worthless. Both are wrong. We take a different view; the War of Resistance Against Japan is a protracted war, and the final victory will be China’s. These are our conclusions.”


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All the major fault lines travel in the same direction as Beijing’s diagnosis. From expansive views of national security to worries about national security risks stemming from global integration, Beijing has consistently been “ahead of the curve.”

Very little will change in Beijing’s diagnosis with a new US administration. Tempo, pace, and tactics will change, but Beijing has firmly stepped into a new era, one that will last for a generation of policy, politics, and foreign policy. We all must adjust accordingly.
About Trivium China

We are a strategic advisory firm that works with companies, investors, and government entities to better understand China.

We provide:

- Macroeconomic and industry research
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