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The global economy is facing mounting challenges amidst the largest energy market shock since the 1970s and the cost-of-living crisis for many households from rising inflation pressures. The OECD Economic Outlook, Volume 2022 Issue 2 highlights the unusually imbalanced and fragile outlook, the significant downside risks associated with energy market developments and rising financial vulnerabilities as interest rates are raised, and the associated policy challenges. Well-designed and timely policy actions are required to maintain economic stability, enhance energy security and strengthen the prospects for future growth.

This issue includes a general assessment of the macroeconomic situation, and a chapter summarising developments and providing projections for each individual country. Coverage is provided for all OECD members as well as for selected partner economies.

Simply put, in many crucial economic sectors, China is producing far more output than it, or foreign markets, can sustainably absorb. As a result, the Chinese economy runs the risk of getting caught in a doom loop of falling prices, insolvency, factory closures, and, ultimately, job losses. Shrinking profits have forced producers to further increase output and more heavily discount their wares in order to generate cash to service their debts. Moreover, as factories are forced to close and industries consolidate, the firms left standing are not necessarily the most efficient or most profitable. Rather, the survivors tend to be those with the best access to government subsidies and cheap financing.

Despite vehement denials by Beijing, Chinese industrial policy has for decades led to recurring cycles of overcapacity. At home, factories in government-designated priority sectors of the economy routinely sell products below cost in order to satisfy local and national political goals. And Beijing has regularly raised production targets for many goods, even when current levels already exceed demand. Partly, this stems from a long tradition of economic planning that has given enormous emphasis to industrial production and infrastructure development while virtually ignoring household consumption. This oversight does not stem from ignorance or miscalculation; rather, it reflects the Chinese Communist Party''s long-standing economic vision.

To craft a better approach, Western leaders and policymakers would do well to understand the deeper forces driving China''s overcapacity and make sure that their own policies are not making it worse. Rather than seeking to further isolate China, the West should take steps to keep Beijing firmly within the global trading system, using the incentives of the global market to steer China toward more balanced growth and less heavy-handed industrial policies. In the absence of such a strategy, the West could face a China that is increasingly unrestrained by international economic ties and prepared to double down on its state-led production strategy, even at the risk of harming the global economy and stunting its own prosperity.

When Beijing"s economic planners do talk about consumption, they tend to do so in relation to industrial aims. In its brief discussion of the subject, the current five-year plan states that consumption should be steered specifically toward goods that align with Beijing"s industrial priorities: automobiles, electronics, digital products, and smart appliances. Analogously, although China"s vibrant e-commerce sector might suggest a plethora of consumer choices, in reality, major platforms such as Alibaba, Pinduoduo, and Shein compete fiercely to sell the same commoditized products. In other words, the illusion of consumer choice masks a domestic market that is overwhelmingly shaped by the state"s industrial priorities rather than by individual preferences.

A larger problem with China"s reliance on local government to implement industrial policy is that it causes cities and regions across the country to compete in the same sectors rather than complement each other or play to their own strengths. Thus, for more than two decades, Chinese provinces--from Xinjiang in the west to Shanghai in the east, from Heilongjiang in the north to Hainan in the south--have, with very little coordination between them, established factories in the same government-designated priority industries, driven by provincial and local officials" efforts to outperform their peers. Inevitably, this domestic competition has led to overcapacity and high levels of debt, even in industries in which China has gained global market dominance.

On paper, the program seems impressive. China is now second only to the United States in AI investment. But the quality of actual AI research, especially in the field of generative AI, has been hindered by government censorship and a lack of indigenous intellectual property. In fact, many of the Chinese AI startups that have taken advantage of the strong government support are producing products that still fundamentally rely on models and hardware developed in the West. Similar to its initiatives in other emerging industries, Beijing risks wasting enormous capital on redundant investments that emphasize economies of scale rather than deep-rooted innovation.