

# Chinese Economic Development Trends

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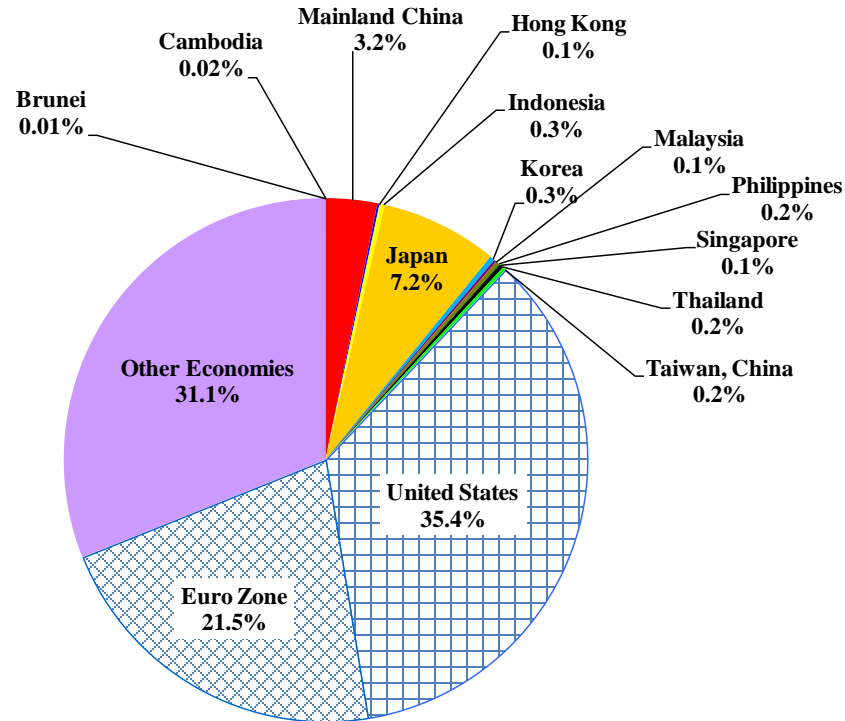
# Outline

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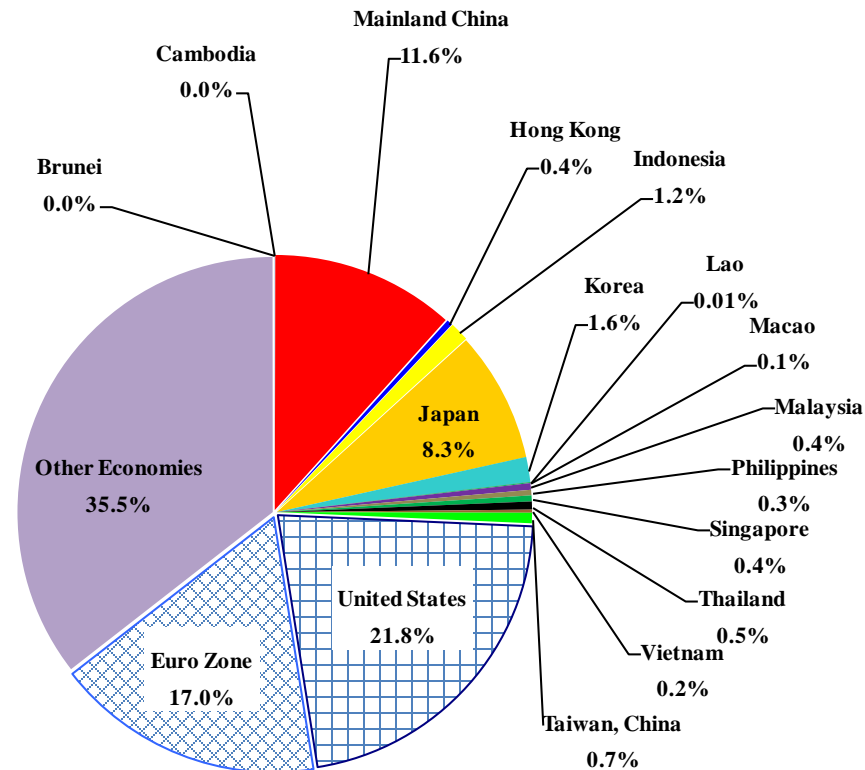
- ◆ Introduction
- ◆ The Chinese Economy in the Global Context
- ◆ The Macroeconomic Outlook
- ◆ Sources of Sustainable Growth of Aggregate Demand
- ◆ Projections of the Future
- ◆ Concluding Remarks

# The Distribution of World GDP, 1970 and 2012, US\$

The Distribution of World GDP in 1970



The Distribution of World GDP in 2012



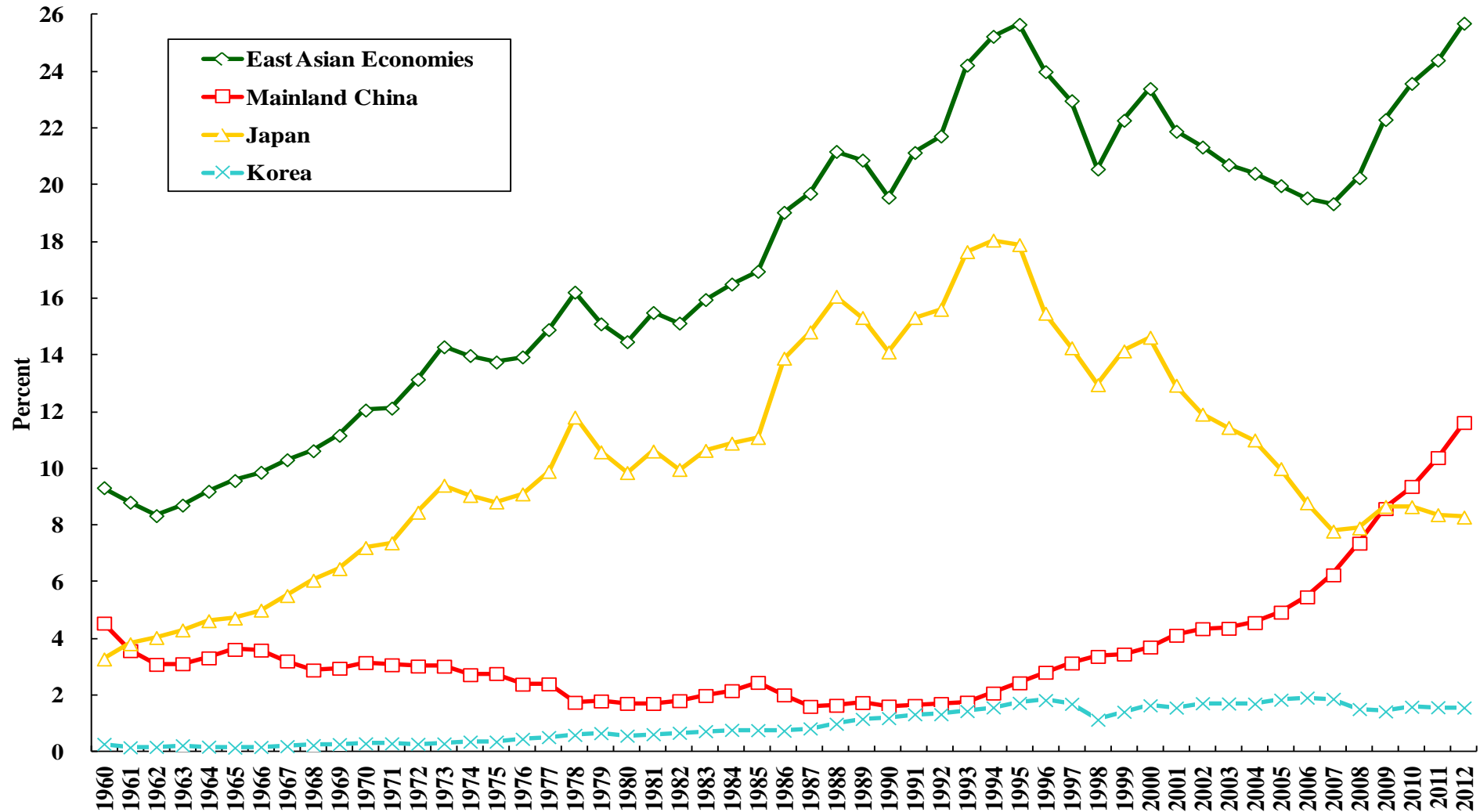
# The Chinese Economy in the Global Context: GDP

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- ◆ The East Asian (defined as the 10 Association of Southeast Asian Nations (ASEAN) + 3 (China, Japan and the Republic of Korea) share of World GDP rose from just above 10% in 1970 to approximately 25% in 2012.
- ◆ The Japanese share of World GDP declined from a peak of 18% in the mid-1990s to 8% in 2012.
- ◆ The (Mainland) Chinese share of World GDP rose from 3% in 1970 and only 4% in 2000 to over 11% in 2012.

# The Shares of East Asia, China, Japan and South Korea in World GDP, 1960-present

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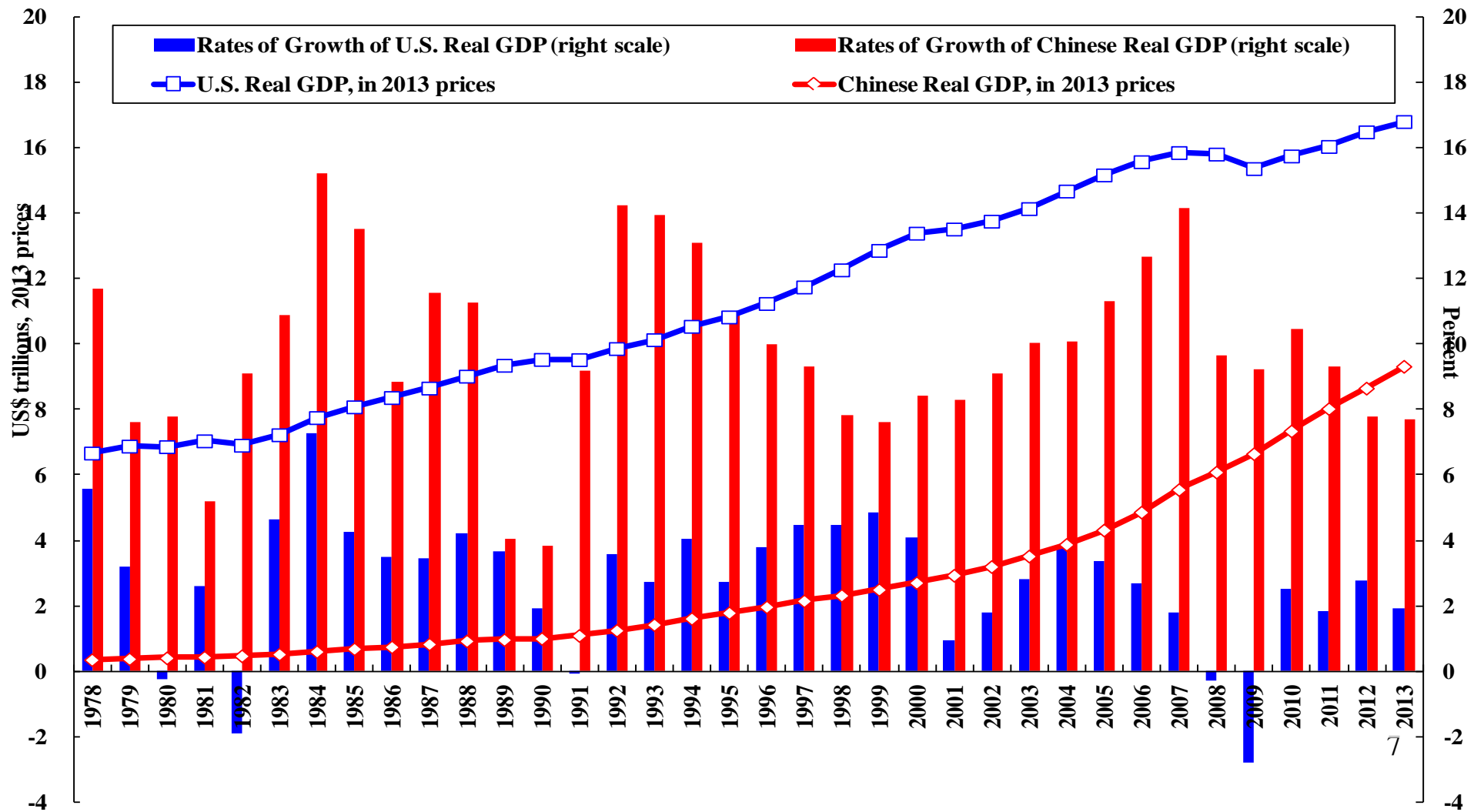
# The Chinese Economy in the Global Context: GDP

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- ◆ China has made tremendous progress in its economic development since it began its economic reform and opened to the World in 1978. China is currently the fastest growing economy in the World—averaging 9.8% per annum over the past 36 years. It is historically unprecedented for an economy to grow at such a high rate over such a long period of time.
- ◆ Between 1978 and 2013, Chinese real GDP grew more than 26 times, from US\$356.5 billion to US\$9.32 trillion (in 2013 prices), overtaking Japan and becoming the second largest economy in the World, after the U.S., in 2010.
- ◆ By comparison, the U.S. GDP (approx. US\$16.8 trillion) was less than 2 times Chinese GDP in 2013.

# Actual Real GDPs and Their Annual Rates of Growth: China & the U.S. (2013 US\$)

The Real GDP and Its Annual Rates of Growth of China and the U.S.  
(trillion 2013 US\$)



# The Chinese Economy in the Global Context: GDP per Capita

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- ◆ Despite its rapid growth, in terms of its real GDP per capita, China is still a developing economy.
- ◆ Between 1978 and 2013, Chinese real GDP per capita grew 18.5 times, from US\$370 to US\$6,850.5 (in 2013 prices).
- ◆ By comparison, the U.S. GDP per capita of approximately US\$53,086, was 7.7 times Chinese GDP per capita in 2013.



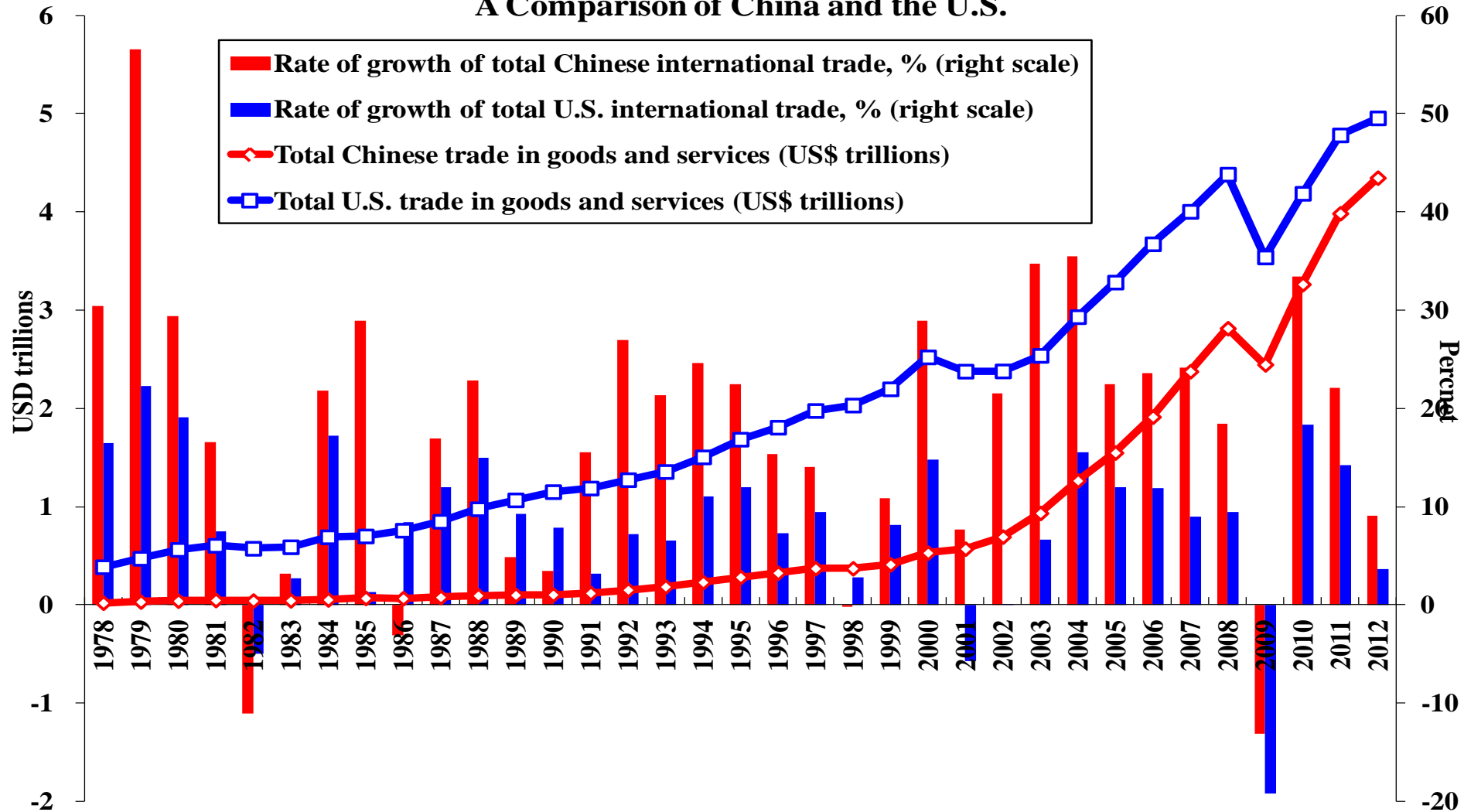
# The Chinese Economy in the Global Context: International Trade

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- ◆ Chinese international trade has grown very rapidly, especially after it acceded to the World Trade Organisation (WTO) in 2001.
- ◆ China has also grown into the second largest trading nation in the World in terms of the total value of international trade in goods and services (US\$4.61 trillion in 2013), just after the U.S. (US\$5.02 trillion).
- ◆ While China is the largest exporting nation in terms of goods and services (US\$ 2.425 trillion in 2013), followed by the U.S. (US\$2.271 trillion), the U.S. is the largest importing nation in terms of goods and services (US\$2.75 trillion), followed by China (US\$2.19 trillion). China is also the largest exporting nation in terms of goods alone, followed by the U.S. The U.S. is the largest exporting as well as importing nation in terms of services, followed by respectively the United Kingdom and Germany.

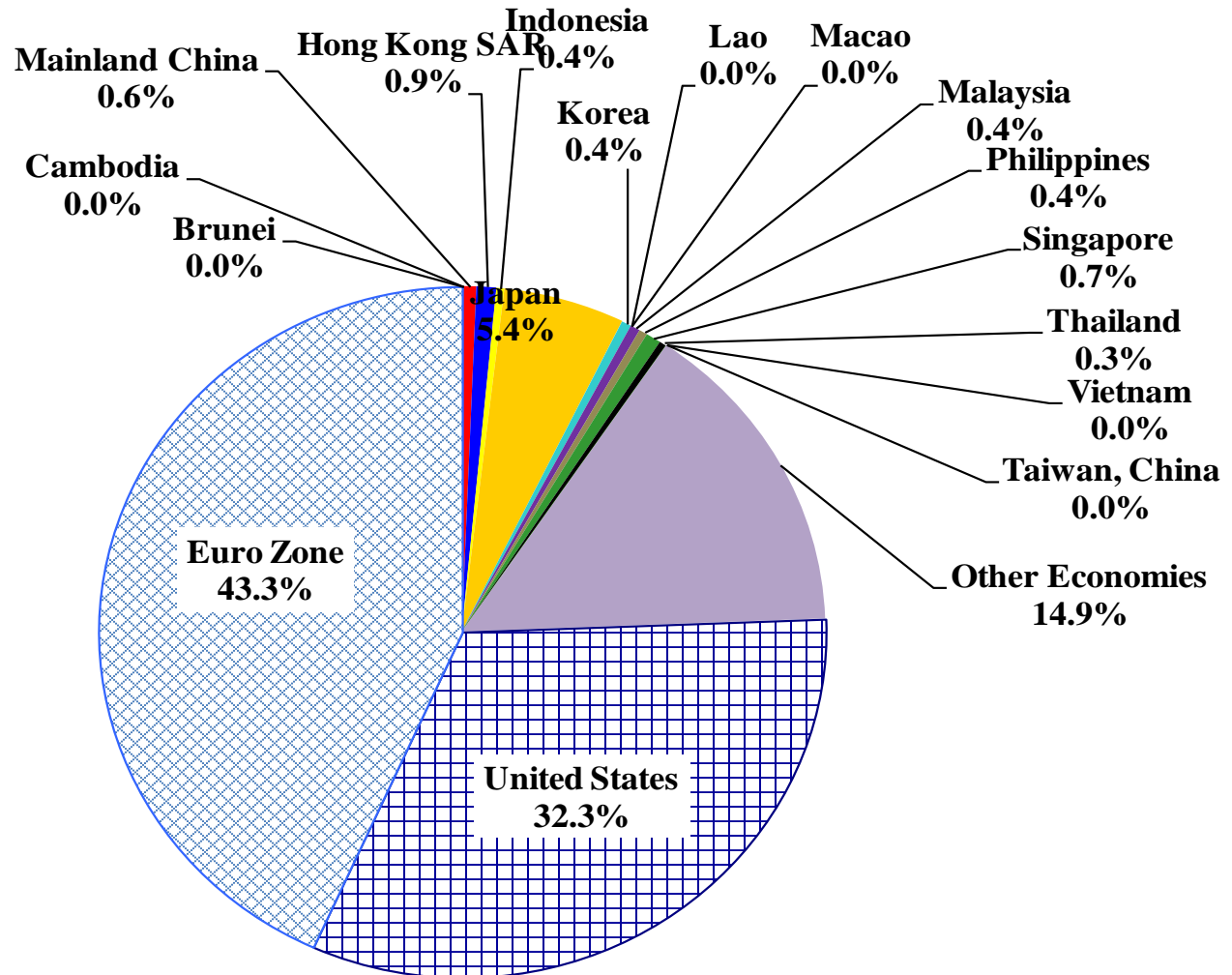
# International Trade & Its Rate of Growth: A Comparison of China and the U.S.

The Value of International Trade and Its Rate of Growth:  
A Comparison of China and the U.S.



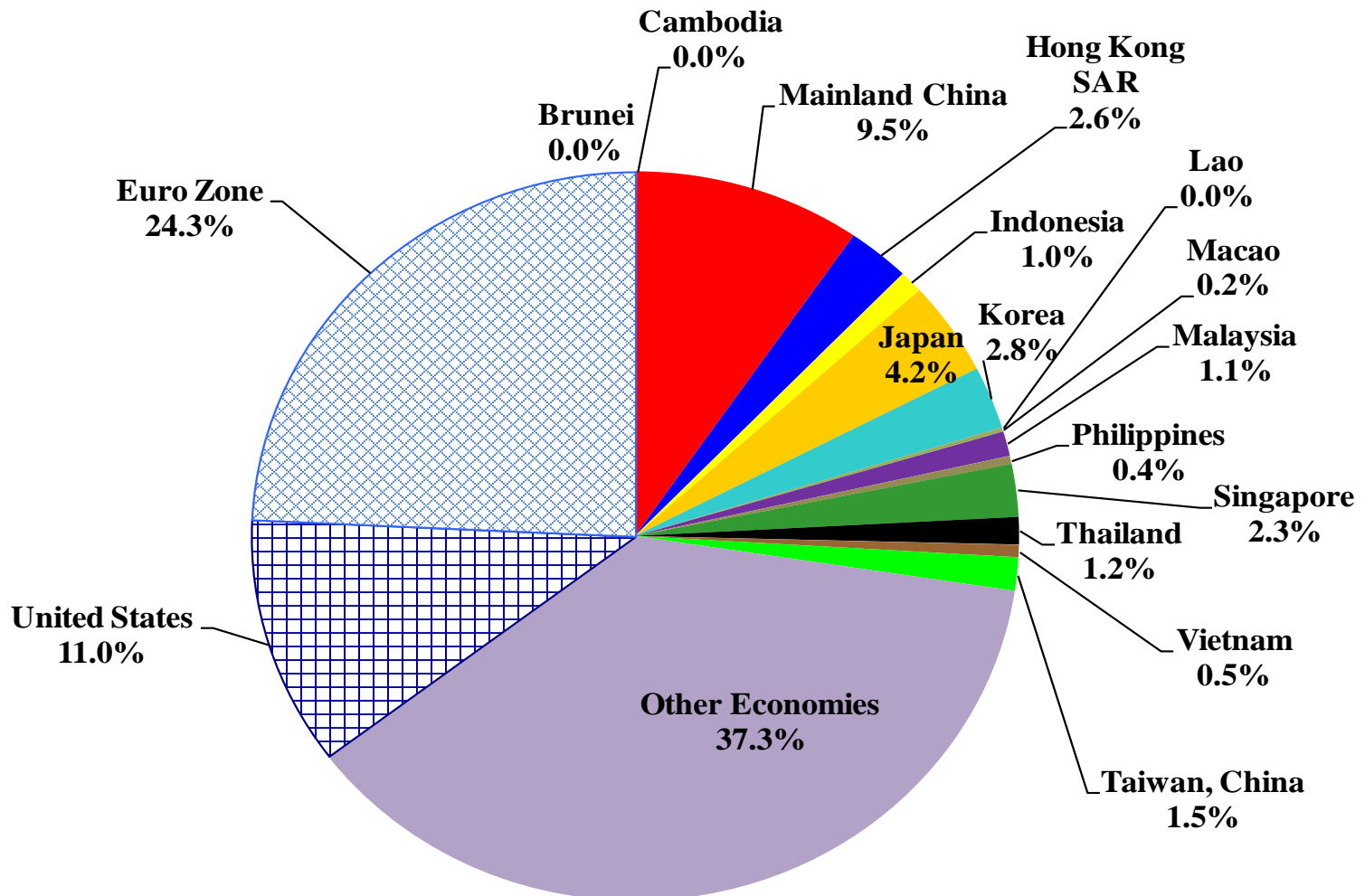
# The Distribution of Total International Trade in Goods and Services, 1970

The Distribution of Total International Trade in Goods and Services in 1970



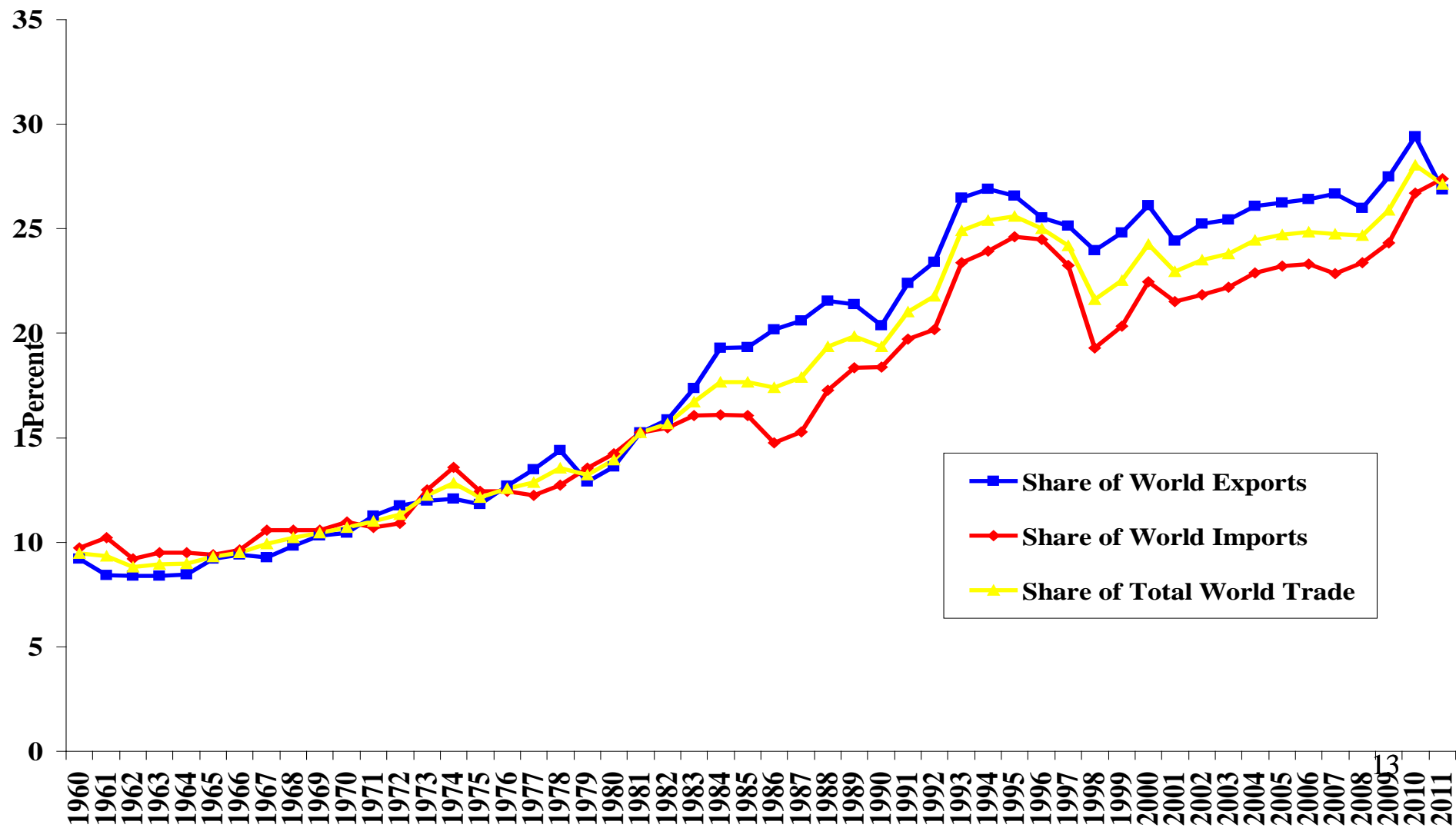
# The Distribution of Total International Trade in Goods and Services, 2012

The Distribution of Total International Trade in Goods and Services in 2012



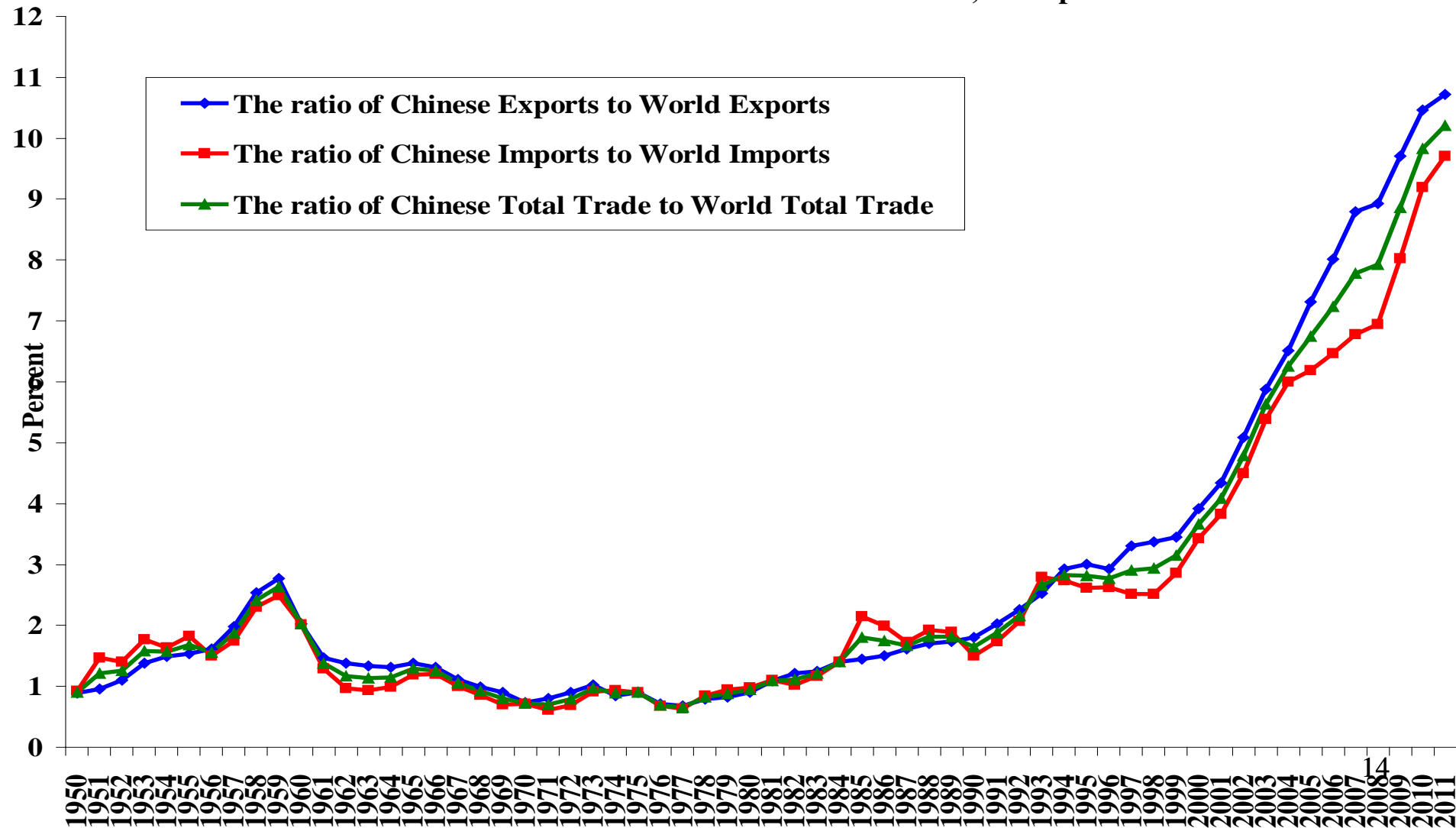
# The Rising Share of East Asian Trade in Total World Trade, 1960-present

The Rising Share of East Asian Trade in Total World Trade, 1960-present



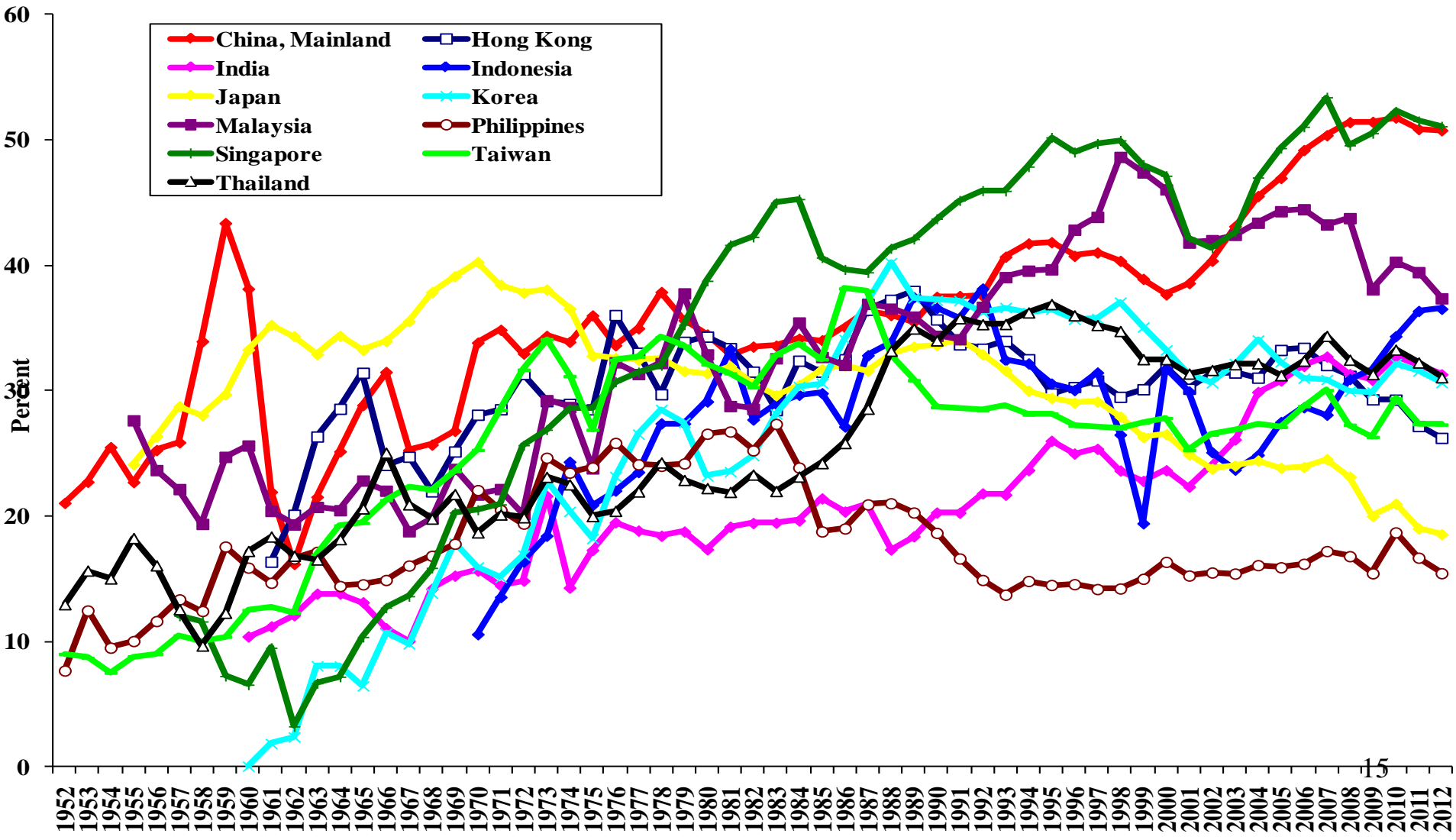
# The Share of China in Total World Trade, 1950-present

The Share of Chinese Trade in Total World Trade, 1950-present



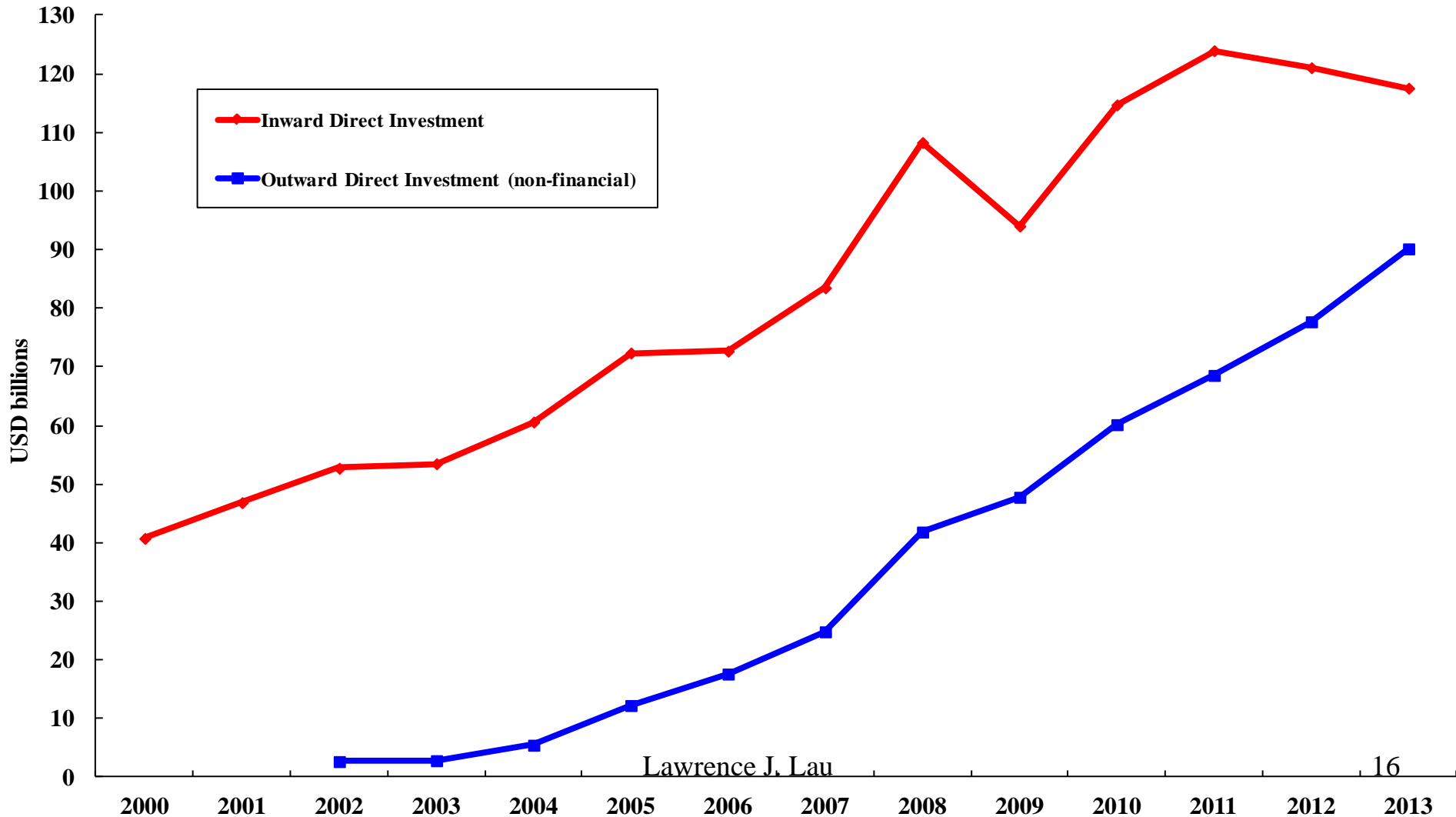
# Saving Rates of Selected Asian Economies (1952-present)

Savings Rates of Selected East Asian Economies



# Chinese Inbound and Outbound Foreign Direct Investment, in US\$ Billions

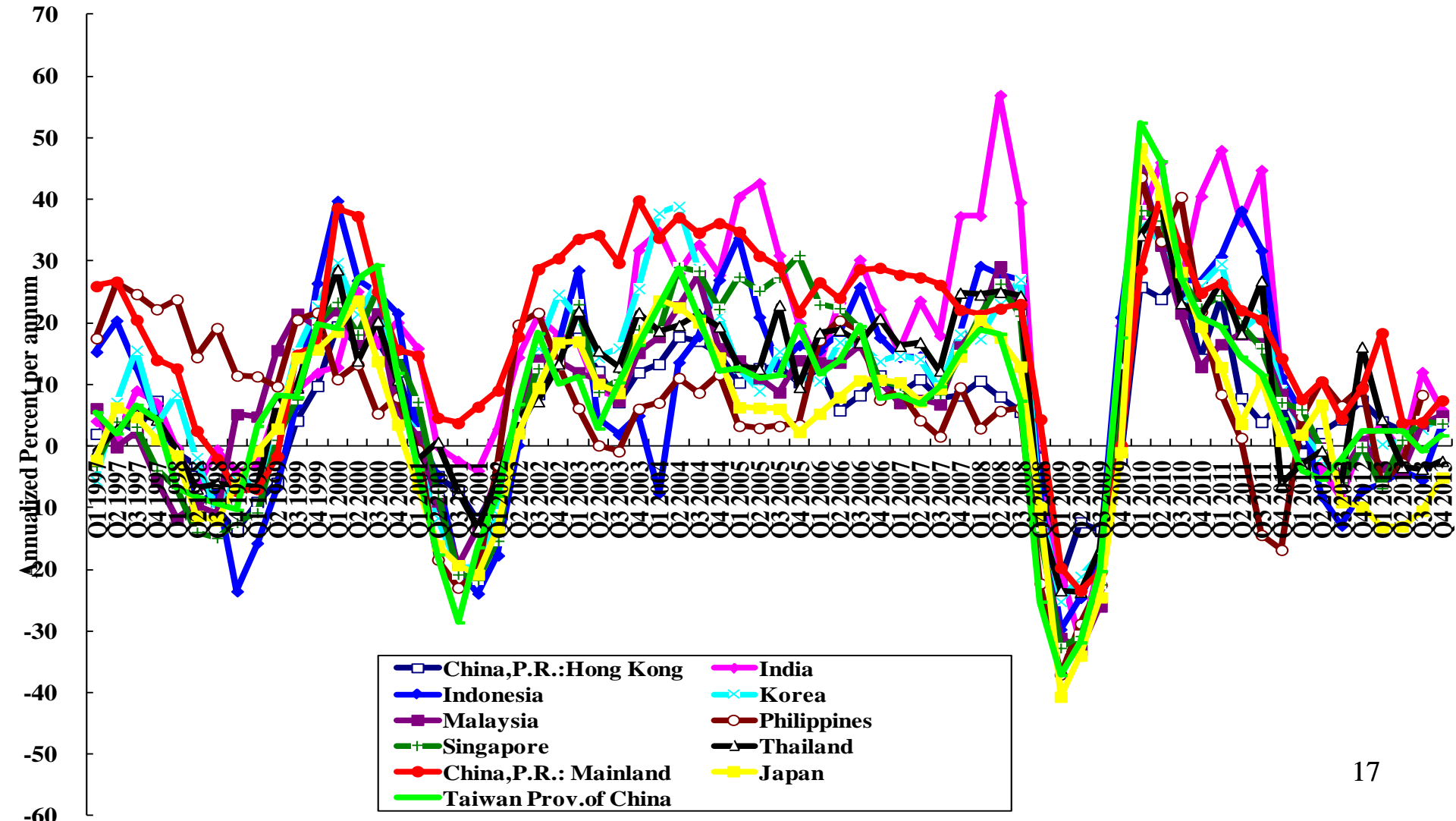
Chinese Inward and Outward Direct Investment, in USD billions





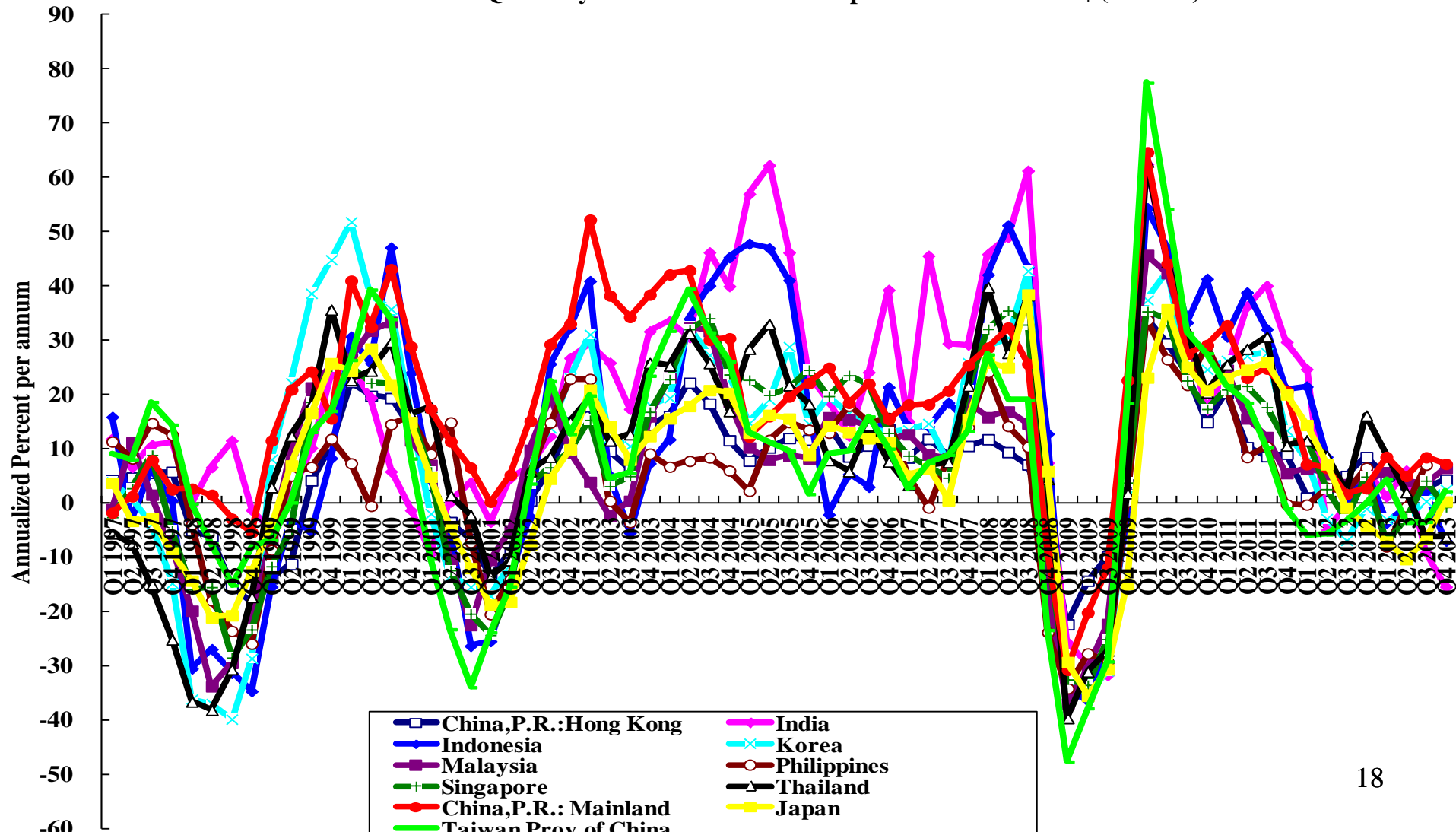
# Quarterly Rates of Growth of Exports of Goods: Selected East Asian Economies

Year-over-Year Quarterly Rates of Growth of Exports of Goods in US\$ (Percent)



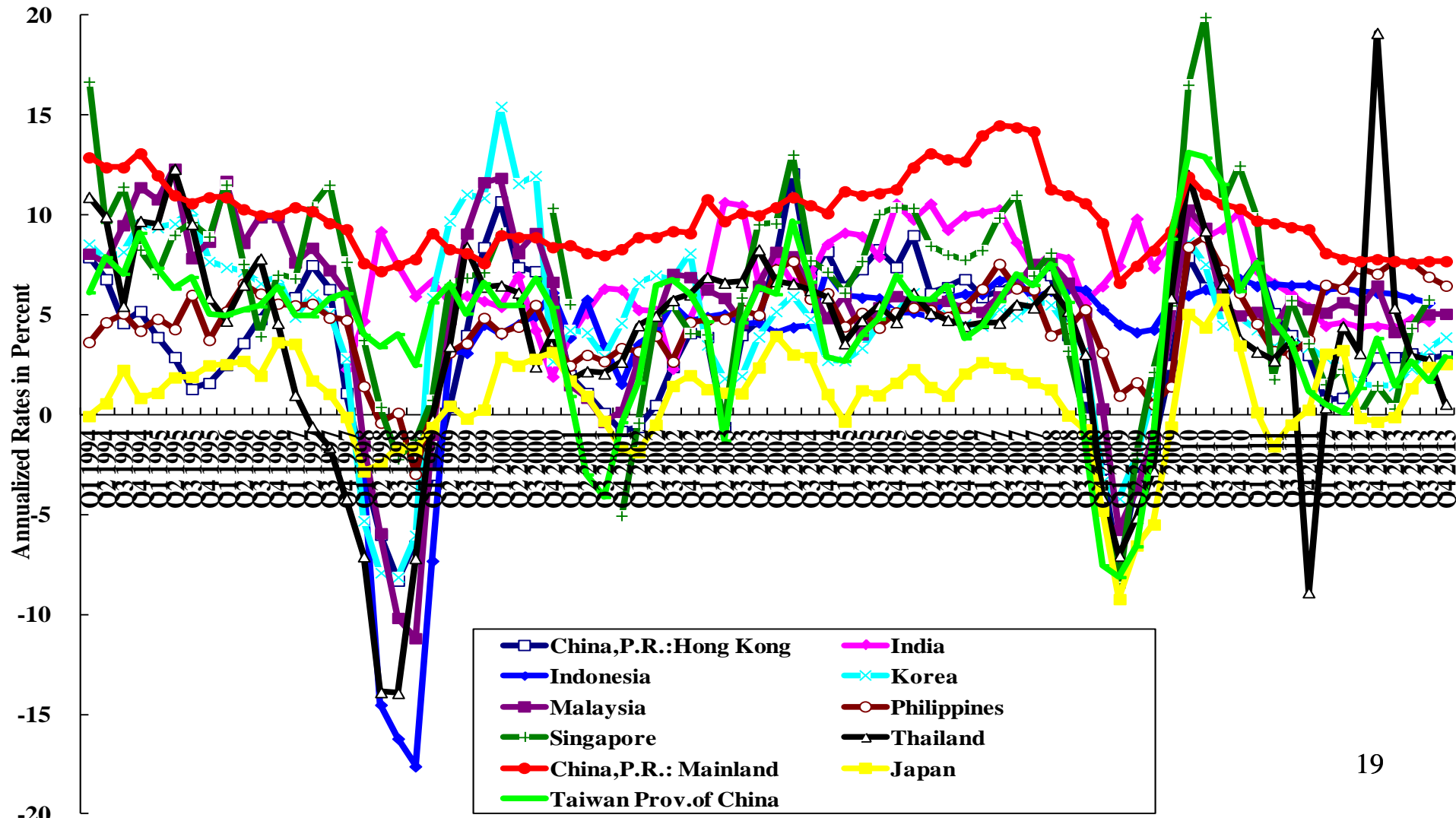
# Quarterly Rates of Growth of Imports of Goods: Selected East Asian Economies

Year-over-Year Quarterly Rates of Growth of Imports of Goods in US\$ (Percent)



# Quarterly Rates of Growth of Real GDP, Y-o-Y: Selected East Asian Economies

Quarterly Rates of Growth of Real GDP, Year-over-Year, Selected East Asian Economies



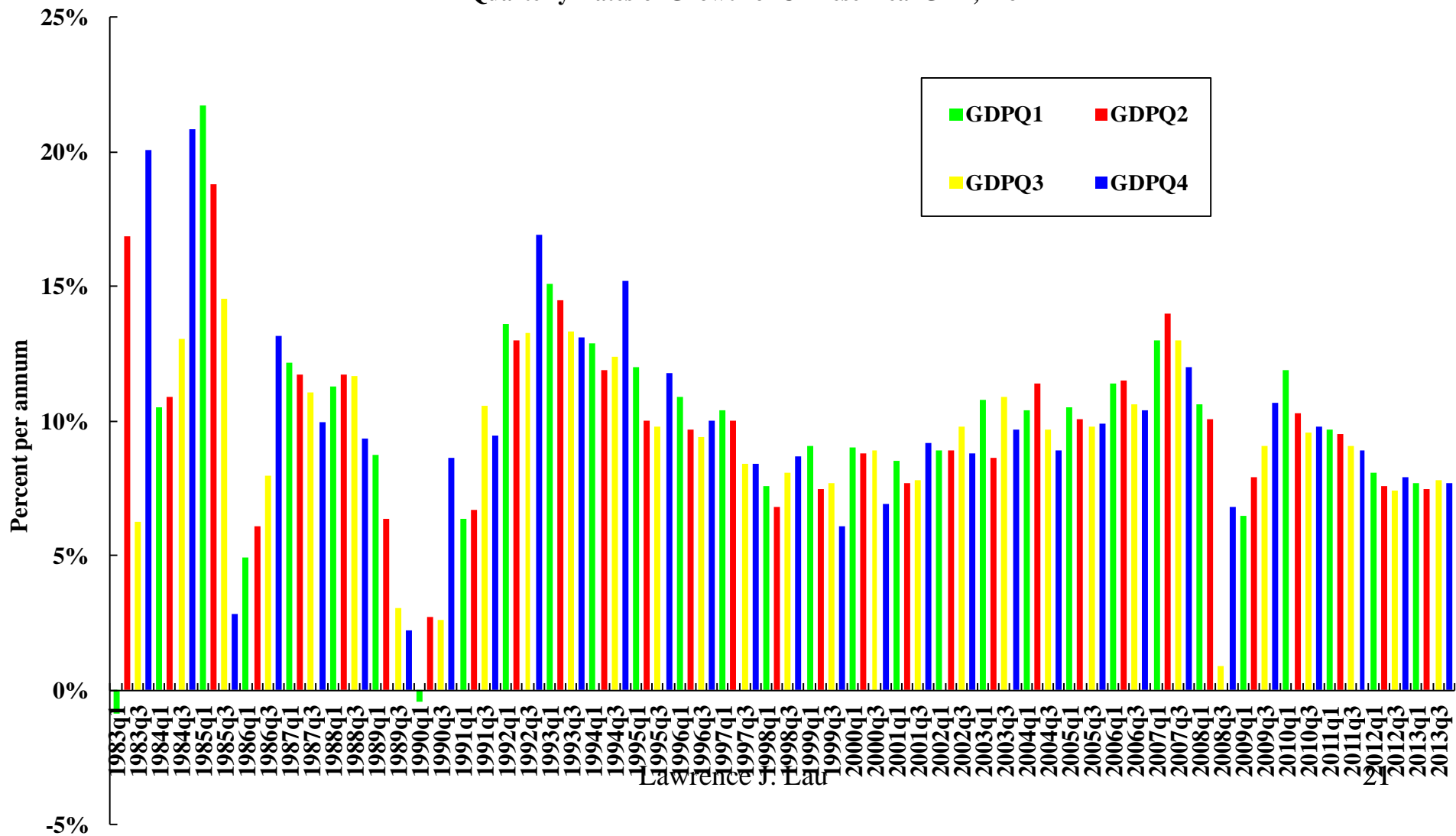
# The Macroeconomic Outlook: GDP

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- ◆ The Chinese economy grew 9.2% in 2009, 10.4% in 2010, 9.3 % in 2011, 7.7% in 2012 and 2013 even as the European and U.S. economies remained in recession.
- ◆ In 2013Q3, the rate of growth of real GDP was 7.8%, Y-o-Y, and in 2013Q4, 7.7%, Y-o-Y. The rate has stabilised between 7% and 8%.
- ◆ The target growth rate of the Chinese economy for 2014 is around 7.5%.
- ◆ The official target average growth rate for the Twelfth Five-Year Plan (2011-2015) period is a relatively modest 7%. A real rate of growth of over 7% per annum is definitely achievable for 2014.

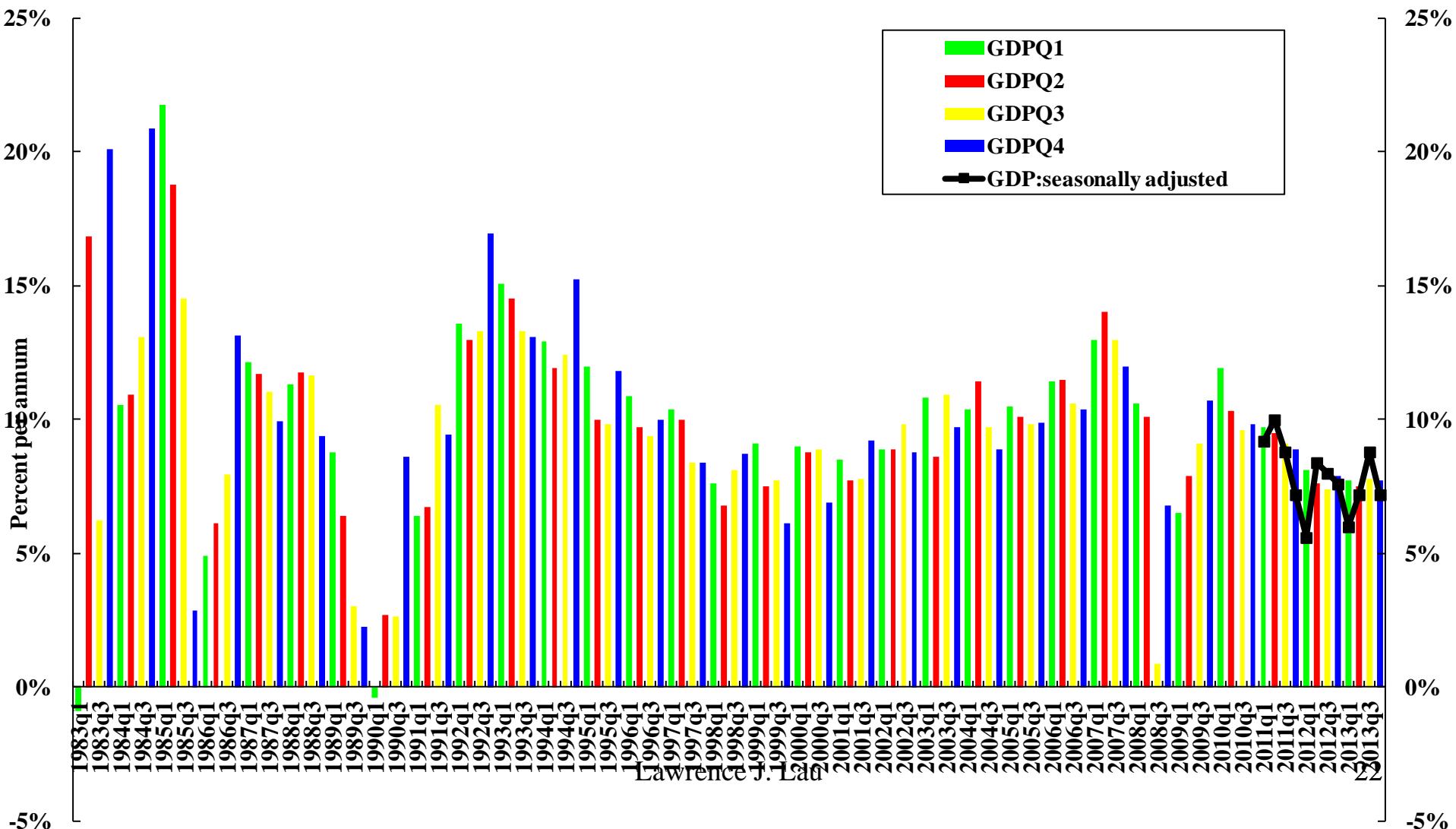
# Quarterly Rates of Growth of Chinese Real GDP, Y-o-Y

Quarterly Rates of Growth of Chinese Real GDP, Y-o-Y



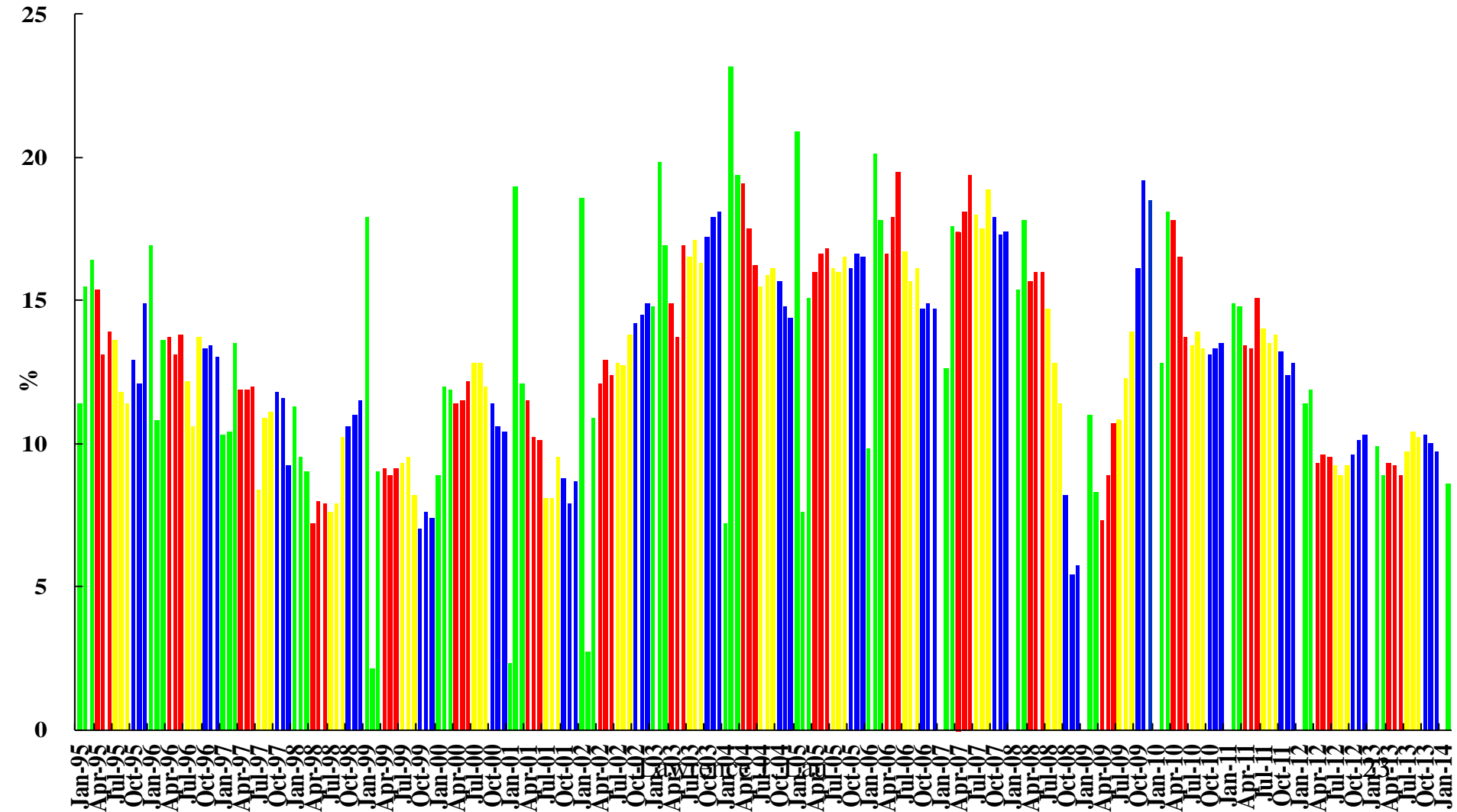
# Quarterly Rates of Growth of Chinese Real GDP, Y-o-Y and Seasonally Adjusted

Quarterly Rates of Growth of Chinese Real GDP, Y-o-Y and Seasonally Adjusted



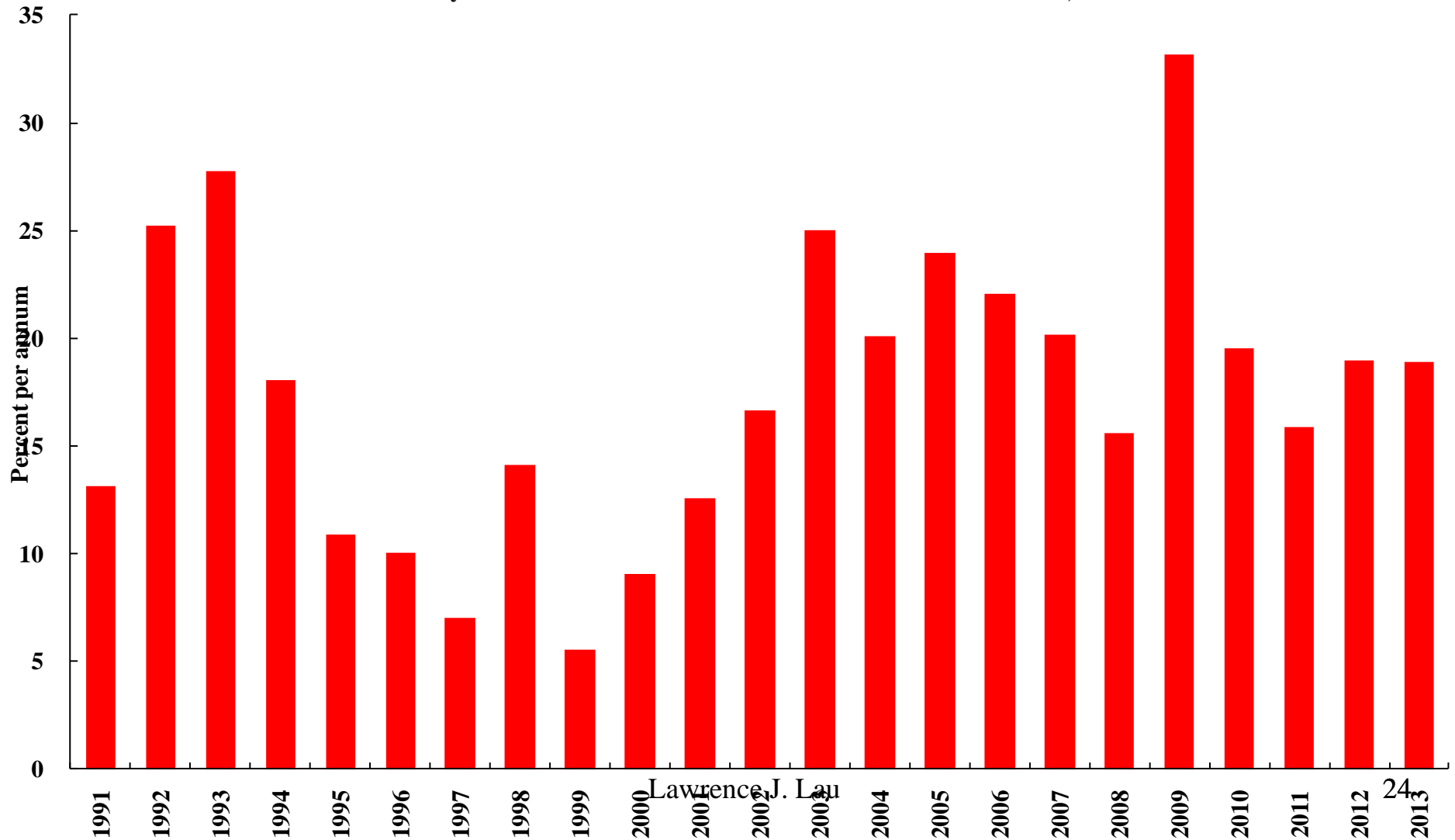
# Monthly Rates of Growth of Real Value-added of the Industrial Sector, Y-o-Y

Monthly Rates of Growth of Real Value-Added of the Industrial Sector, Year-over-Year



# Annual Rates of Growth of Chinese Real Fixed Assets Investment, Y-O-Y

Annually Rates of Growth of Chinese Real Fixed Assets Investment, Y-O-Y





# The Metaphor of the “Wild Geese Flying Pattern”

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- ◆ The metaphor of the "wild-geese-flying pattern" of East Asian economic development over time, introduced by Professor Kaname Akamatsu (1962), suggests that industrialisation will spread from economy to economy within East Asia as the initially fast-growing economies, beginning with Japan, run out of surplus labour and face labour shortages, rising real wage rates, and quota restrictions on their exports.
- ◆ Thus, East Asian industrialisation spread from Japan to first Hong Kong, and then Taiwan, and then South Korea, and then Southeast Asia (Thailand, Malaysia, Indonesia), and then to Guangdong, Shanghai, Jiangsu and Zhejiang in Mainland China. During this industrial migration, the large trading firms such as Mitsubishi, Mitsui, Marubeni and Sumitomo of Japan and Li and Fung of Hong Kong played an important role as financiers, intermediaries, quality assurers, and managers of logistics and supply chains.

# The Metaphor of the “Wild Geese Flying Pattern”

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- ◆ This metaphor actually applies not only to East Asia but also to China itself. Within China, industrialisation first started in the coastal provinces, regions and municipalities. It has begun to migrate and spread to other provinces, regions and municipalities in the interior—to Chongqing, Henan, Hunan, Jiangxi, Shaanxi and Sichuan. As the coastal provinces, regions and municipalities slow down in their economic growth, the central and western provinces, regions and municipalities will take their turn as the fastest growing areas in China. China as a whole will be able to maintain a relatively high rate of growth for many years to come.



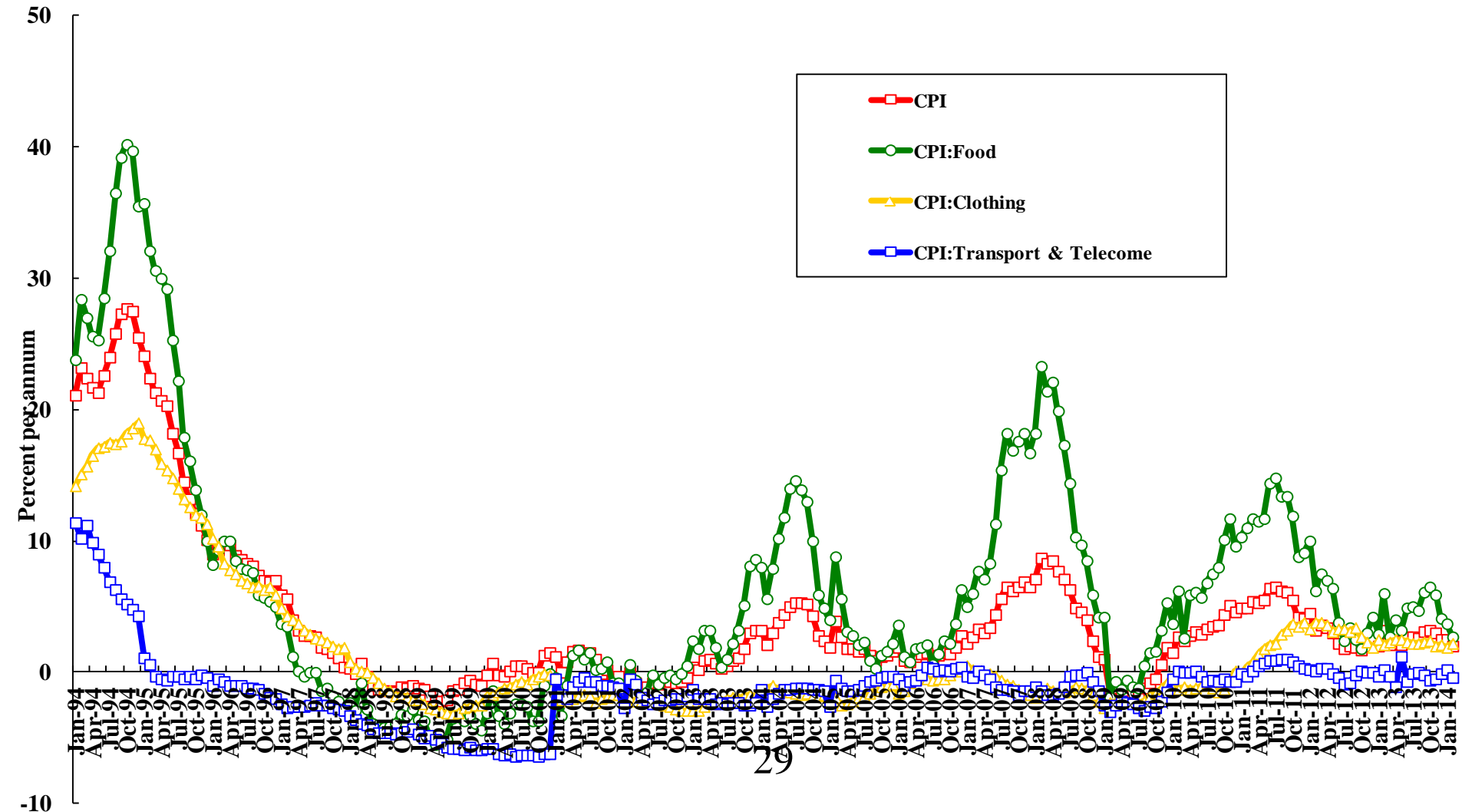
# The Macroeconomic Outlook: Inflation

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- ◆ For 2012 as a whole, the rate of inflation was 2.6%, down from 5.4% in 2011.
- ◆ For 2013 as a whole, the rate of inflation was also 2.6%.
- ◆ For 2014, the monthly rates of inflation as measured by the CPI year-over-year were 2.5% and 2% for January and February. There was little indication that inflation would rise significantly in the near term, especially given the excess production capacity in many industries such as steel, cement, plate glass, etc., and favourable agricultural harvests.
- ◆ The government target for 2014 is to keep the rate of inflation below 3.5%, which appears quite feasible at this time.

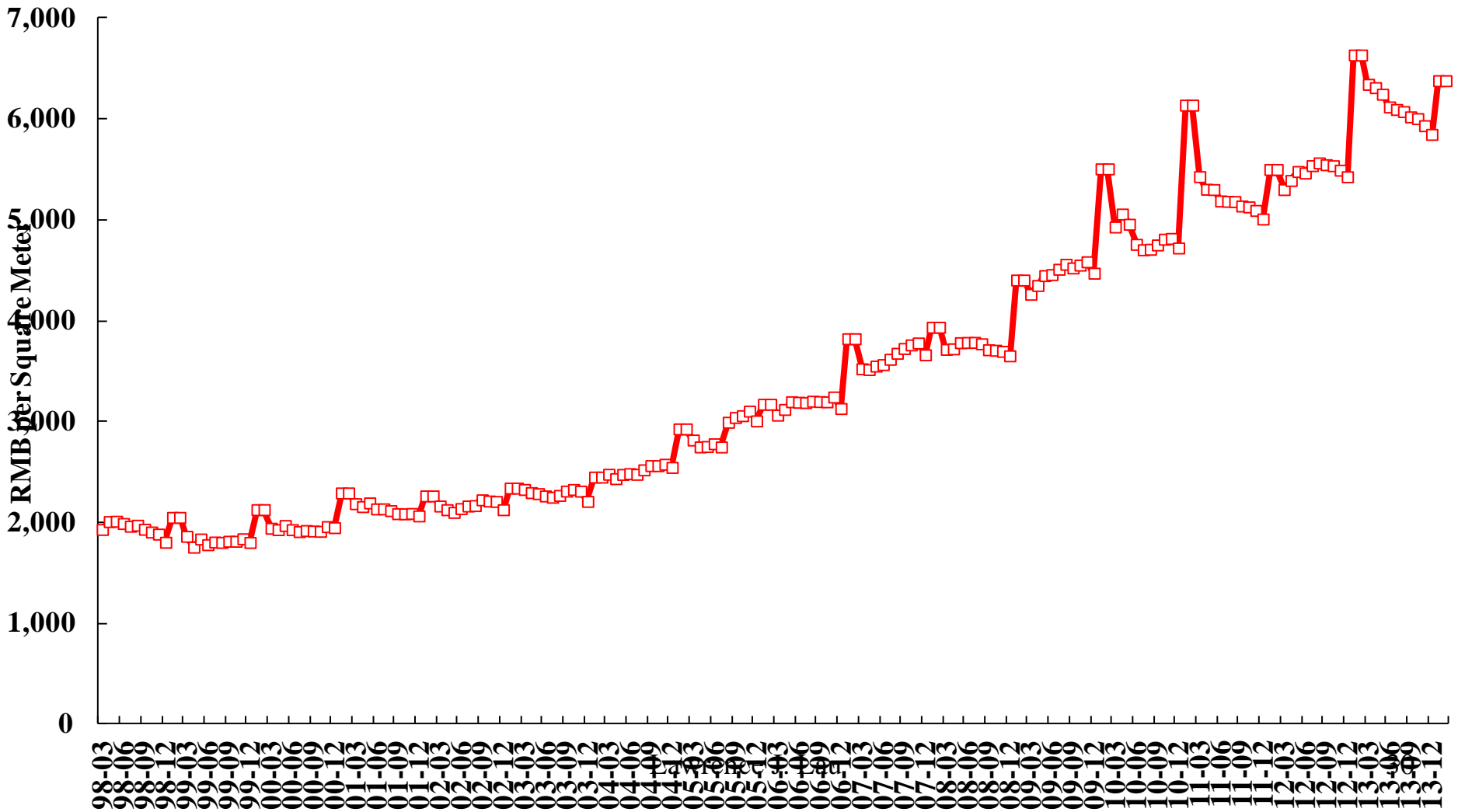
# Monthly Rates of Change of the Consumer Price Index (CPI), Y-o-Y

Monthly Rates of Change of Consumer Price Index and Its Components since 1994, Y-o-Y



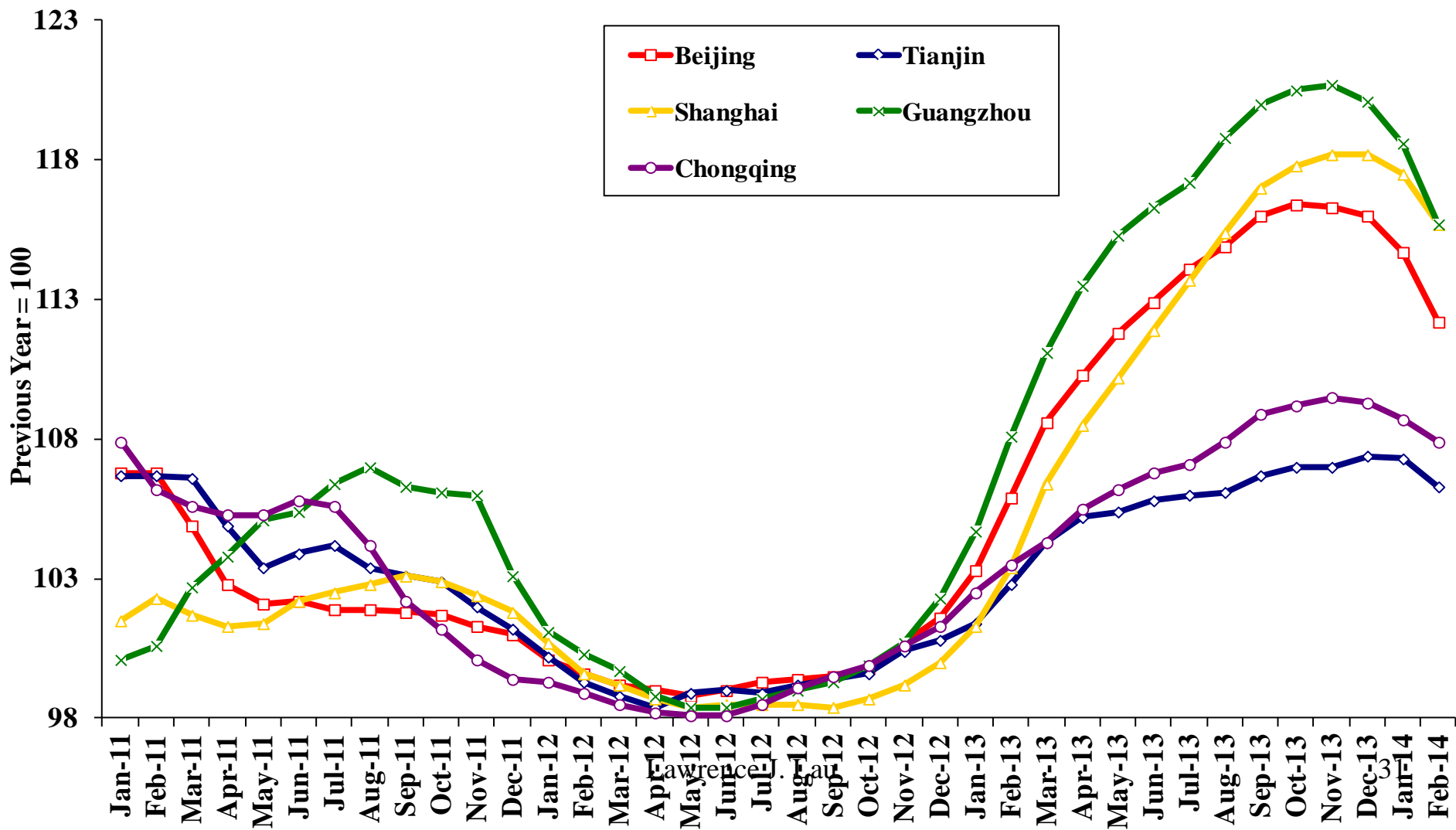
# Average Housing Price in China, Yuan/Square Meter since March 1998

Average Housing Price in China, RMB per Square Meter



# Price Index of New Residential Units, Selected Cities, Y-o-Y, since 2011

Price Index of New Residential Units, Selected Cities, Year-over-Year



# The Macroeconomic Outlook: Shadow Banking

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- ◆ “Shadow banking” has become more common in Mainland China in the last couple of years. Shadow banking arises in response to various restrictions on bank lending and other requirements: total quota on the value of loans outstanding and its rate of increase, capital requirements, leverage ratios, reserve requirements, etc. The fundamental idea of “shadow banking” is to move both “deposits” and “loans” off the bank’s balance sheet and hence reduce the size of its total assets and liabilities through various devices, circumventing all the requirements and restrictions such as capital requirements, reserve requirements, leverage ratio requirements as well as loan quotas.



# The Macroeconomic Outlook: Shadow Banking

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- ◆ “Deposits” can be moved off a bank’s balance sheet but retained under the bank’s control through the use of various wealth management products and trust products. This also allows a higher “interest rate” to be paid to the “depositors”.
- ◆ Through these wealth management and trust accounts and with the assistance of trust companies the funds can be “lent” to various enterprises. The “borrowers” will have to pay higher interest rates than regular bank loans and additional fees to the bank as well as other intermediaries in the credit supply chain.

# The Macroeconomic Outlook: Shadow Banking

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- ◆ Shadow banking has advantages for every one except possibly for the shareholders of the banks and for the regulator. The net result, however, is a significantly lower actual capital ratio and a significantly higher actual leverage, increasing the risks to the financial sector.

# The Macroeconomic Outlook: Shadow Banking

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- ◆ There is also the problem of maturity mis-match: wealth management products are typically short-term, and loans are typically of longer duration. Moreover, there is also reliance on interbank lending, which is also short-term in nature. Thus, a serious problem may arise when the wealth management accounts fail to roll over a “loan” and interbank liquidity is insufficient to cover the shortfall. But Chinese commercial banks in general have not paid too much attention to this potential problem of maturity mis-match, counting on the central bank to bail them out if and when it becomes necessary.

# The Macroeconomic Outlook: Shadow Banking

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- ◆ The proportion of financing accounted for by conventional bank loans was over 90 percent 10 years ago but has since fallen to below 50%. Shadow banking probably accounts for 17-20 trillion Yuan worth of “loans”, approximately 30% of GDP, still considerably lower than the percentage in other major developed economies. But the commercial banks are involved in 60% of the shadow banking activities in China, much more than the commercial banks in other countries and regions.
- ◆ To the extent that the commercial banks are involved, this means that the implicit hidden liabilities of the commercial banks and hence their leverage ratios are much higher than are represented on their balance sheets.

# The Macroeconomic Outlook: Shadow Banking

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- ◆ The problem is that the commercial banks are ultimately responsible for these “shadow loans”, which are initially off-balance-sheet but if the “borrowers” default, they will have to be taken back onto the balance sheet, forcing recognition of large losses similar to what happened to Enron and to the major commercial banks in 2006-07 when they had to take back on to their balance sheets the losses of their sub-prime mortgage loan special purpose vehicles.
- ◆ Shadow banking can pose huge risks to the financial system because of the potential of over-leveraging. Moreover, there is unlikely to be sufficient provision against non-performing “shadow loans”. The Chinese regulators are aware of these problems and have been taking steps to control and restrict shadow banking.

# The Macroeconomic Outlook: Local Government Debt

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- ◆ Concern has also been expressed on the local government debt in Mainland China. The total value has increased significantly especially since 2008Q4.
- ◆ A 2011 report by the National Audit Office estimated that total local government debt in 2010 at 10.7 trillion Yuan (\$1.74 trillion), or 27% of the then GDP. Between 2010 and 2012, the total local debt level probably increased by another 10-15%, with the proportion of the GDP remaining approximately the same. At the moment, only 1% of the local government loans is reported to be non-performing.
- ◆ It is unlikely that all of the local government debt would become non-performing. Even if half of the local government debt eventually becomes non-performing, part of it would likely be assumed by the central government, which will still have a relatively low public debt to GDP ratio of approximately 40% compared to 150% for the U.S. and 250% for Japan.

# The Macroeconomic Outlook: Local Government Debt

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- ◆ Total central government public debt may be estimated at between 15 and 20 trillion Yuan; total local government debt, may be estimated at approximately 20 trillion Yuan. Private household debt may be estimated at 16 trillion Yuan and enterprise debt at around 70 trillion Yuan. To put all of these figures into perspective, the GDP in 2013 was 57 trillion Yuan.
- ◆ However, the debt levels should not cause worries. The debt to GDP level is lower than all the developed economies. In addition, China has a high national saving rate. Its public debt is almost exclusively denominated in Renminbi and held mostly by Chinese nationals. The Government deficit is low and the rate of growth of government revenue has been higher than the rate of growth of GDP.

# Sources of Sustainable Growth of Aggregate Demand

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- ◆ The Chinese economy is not supply-constrained but demand-constrained—there is excess capacity in almost all of the manufacturing sectors—steel, cement, glass, etc.; and as long as there is adequate aggregate demand, the aggregate supply will be there to meet the demand. Thus, the Chinese GDP is primarily determined by aggregate demand.
- ◆ Chinese exports, or net exports, is unlikely to grow very fast in the future, partly because of its already very large market shares in many internationally traded manufactured goods, and partly because the rise in Chinese real wage rates and the appreciation of the Renminbi since 2005 have made Chinese labor-intensive goods no longer that competitive.



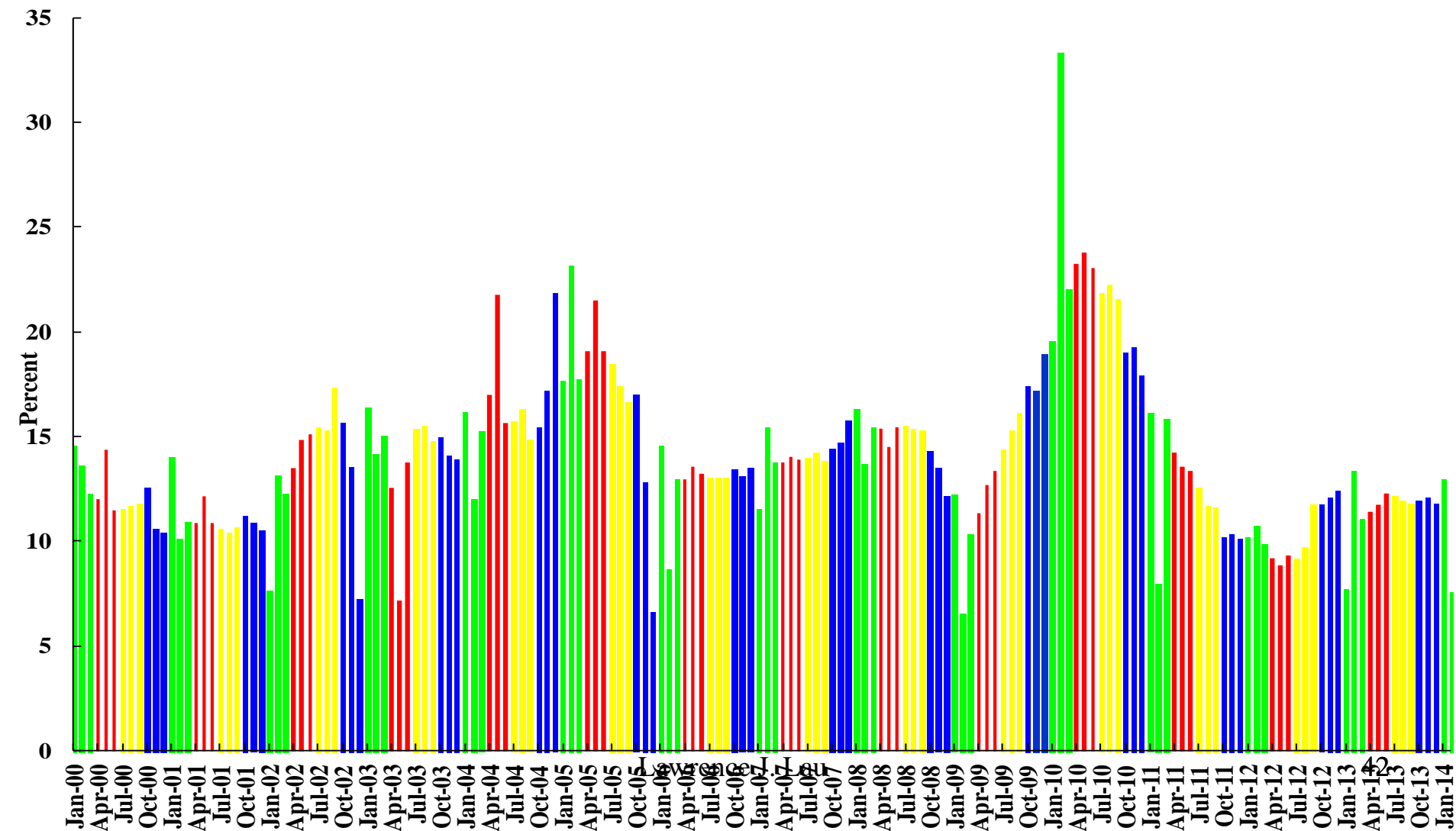
# Sources of Sustainable Growth of Aggregate Demand

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- ◆ Chinese household consumption is sometimes viewed as a potential sustainable source of growth of Chinese domestic aggregate demand.
- ◆ Chinese household consumption has actually been growing quite rapidly, as indicated by the double-digit monthly year-over-year rates of growth of real retail sales since the first quarter of 2009. The rates of growth of real retail sales declined in 2011 but have since risen again and exceeded the rates of growth of real GDP and real household income significantly.

# Monthly Rates of Growth of Chinese Real Retail Sales, Y-o-Y

Monthly Rates of Growth of Chinese Real Retail Sales since 2000, Year-over-Year



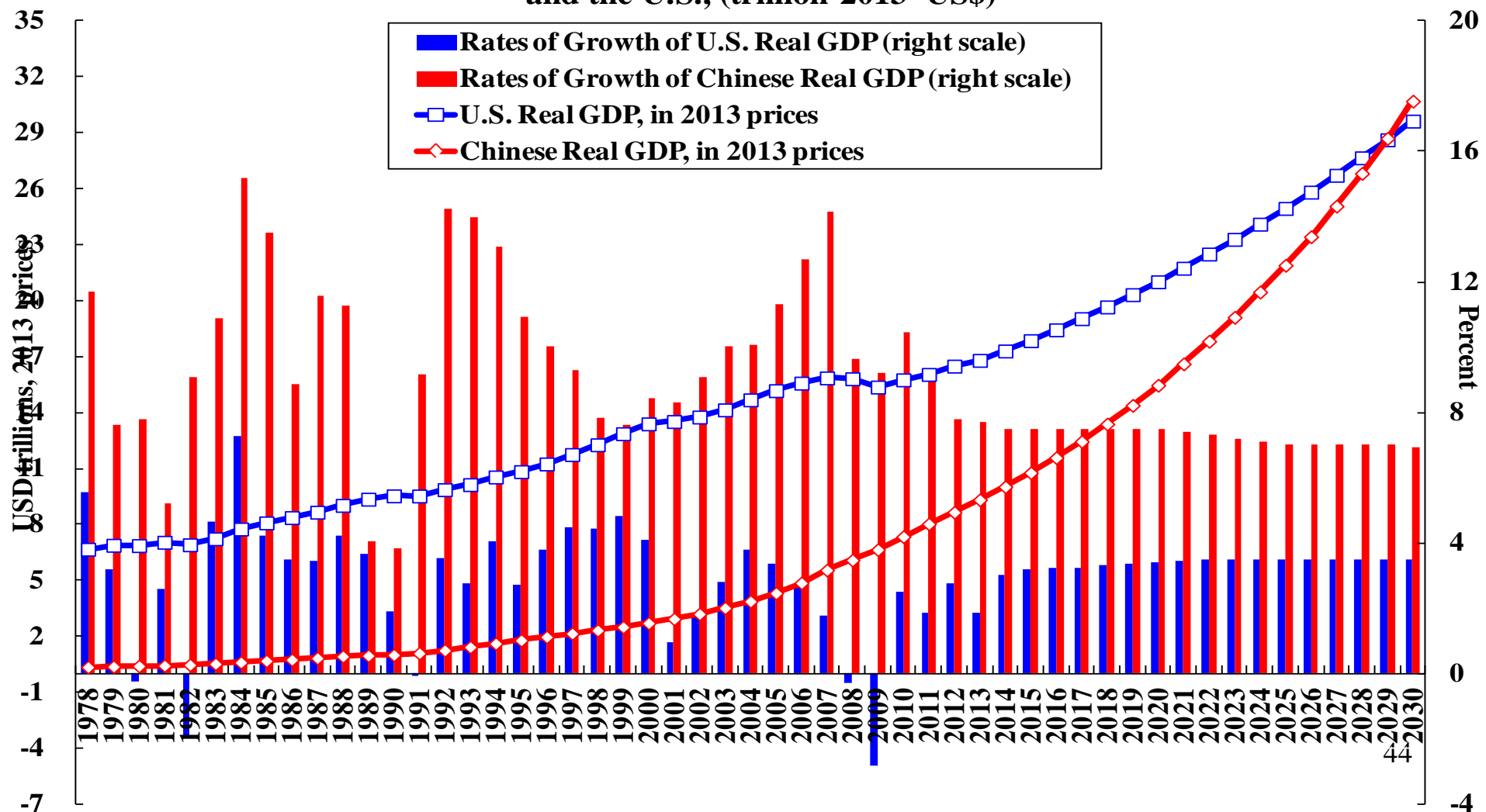
# Projections of the Future

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- ◆ It is projected that the Chinese and the U.S. economies will grow at average annual real rates of approximately 7.3% and 3.3% respectively between 2013 and 2030. Chinese real GDP is projected to catch up to U.S. real GDP in approximately 15 years' time--around 2029, at which time both Chinese and U.S. real GDP will exceed US\$28 trillion (in 2013 prices). This is more than three times the Chinese GDP and not quite two times the U.S. GDP in 2013. By then, China and the U.S. will each account for approximately 15% of World GDP.

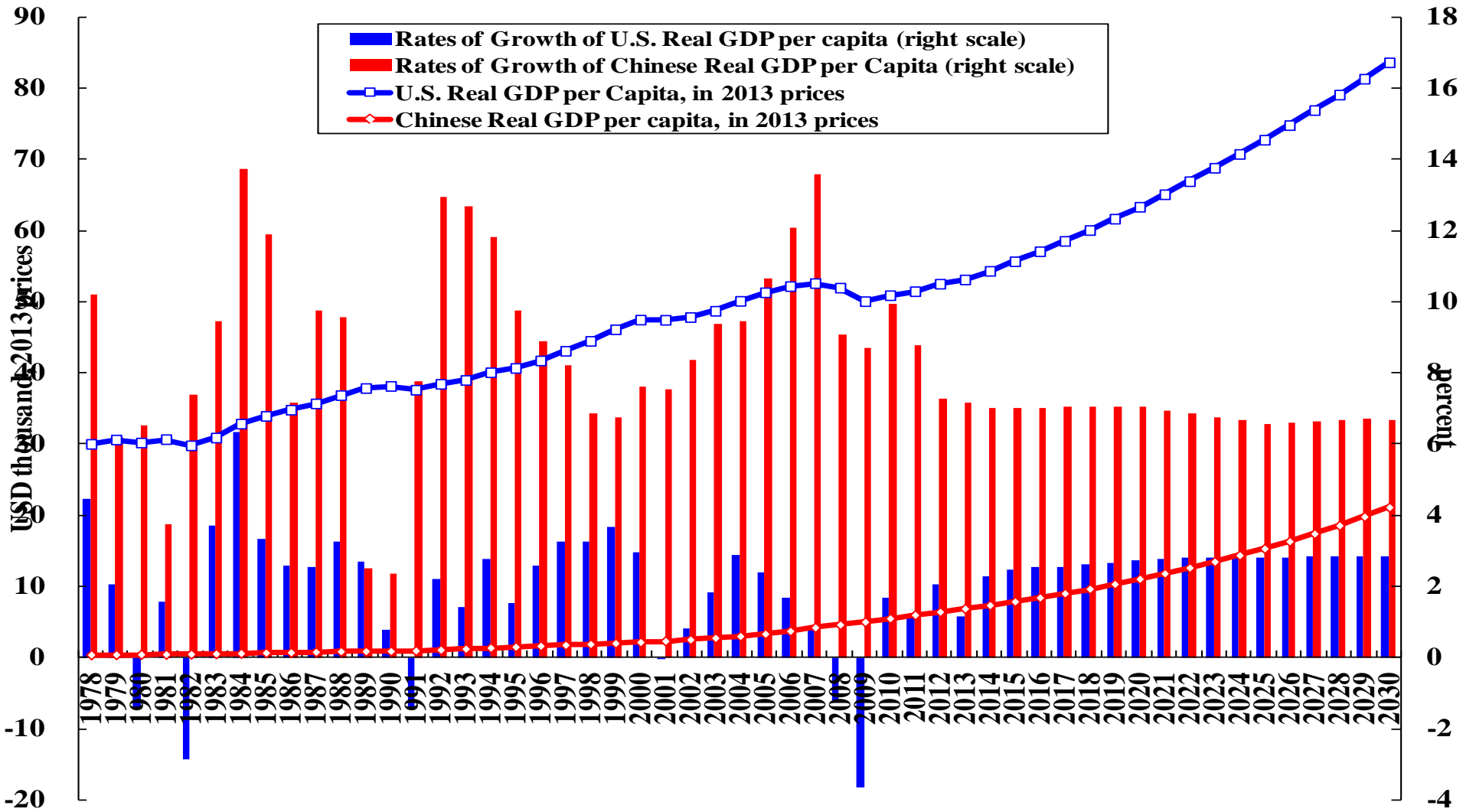
# Actual and Projected Real GDPs and Their Annual Rates of Growth: China & the U.S.

Actual and Projected Real GDPs and their Annual Rates of Growth of China and the U.S., (trillion 2013 US\$)



# Actual and Projected Real GDP per Capita's and their Annual Rates of Growth

Actual and Projected Real GDP per Capita and their Annual Rates of Growth of China and the U.S., (thousand, 2013 US\$)



# Concluding Remarks

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- ◆ The centre of gravity of the global economy has been gradually shifting to East and South Asia from North America and Europe. The centre of gravity of the East Asian economy has been gradually shifting to China from Japan.
- ◆ The Chinese economy is partially de-coupled from the developed economies of North America and Europe.
- ◆ On the basis of its strong economic fundamentals, China should be able to continue to grow at an average annual rate of at least 7% for the next couple of decades, more or less independently of what happens in the rest of the World.

# Concluding Remarks

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- ◆ Chinese economic growth will be marginally, but not critically, affected by a large decline in its exports, as demonstrated by its experience in the past several years as well as during the 1997-1998 East Asian currency crisis. Thus, it will be able to survive even prolonged economic recessions in the European and U.S. economies.
- ◆ China is a large continental country like the United States and will similarly develop into a largely internal-demand driven economy. International trade and international investment will not have a decisive impact on the Chinese economy in the future. Eventually, Chinese exports as a percent of its GDP should be relatively low, in the teens.

# Concluding Remarks

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- ◆ The long-term sustainable sources of Chinese aggregate demand will all be internal: urbanisation (building new cities), public infrastructure, mass-transit systems, household and public consumption, residential housing, investment in education and health care, environmental protection and preservation, energy conservation and renewable energy, and the green economy.
- ◆ Chinese household consumption will rise, as GDP per capita and wage rate rise and the social safety net is gradually perfected. But the national saving rate may remain high for a long time.



# Concluding Remarks

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- ◆ The Chinese economy will remain investment-led for a while—including infrastructural investment, investment in urbanisation and in agricultural mechanisation, and investment in the supply of public goods (for example, clean air, clean water, clean earth, education and health care).
- ◆ The provision of public goods such as education, health care, clean environment, by the government can greatly increase the welfare of the average people. It is also an effective means for redistribution, narrowing the degree of actual inequality in the consumption of services.