

Reshaping China's Economy and Capital Markets

Lawrence J. Lau

Ralph and Claire Landau Professor of Economics, The Chinese Univ. of Hong Kong
and
Kwoh-Ting Li Professor in Economic Development, Emeritus, Stanford University

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Tel: +852 3943 1611; Fax: +852 2603 5230

Email: lawrence@lawrencejlau.hk; WebPages: www.igef.cuhk.edu.hk/ljl

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Outline

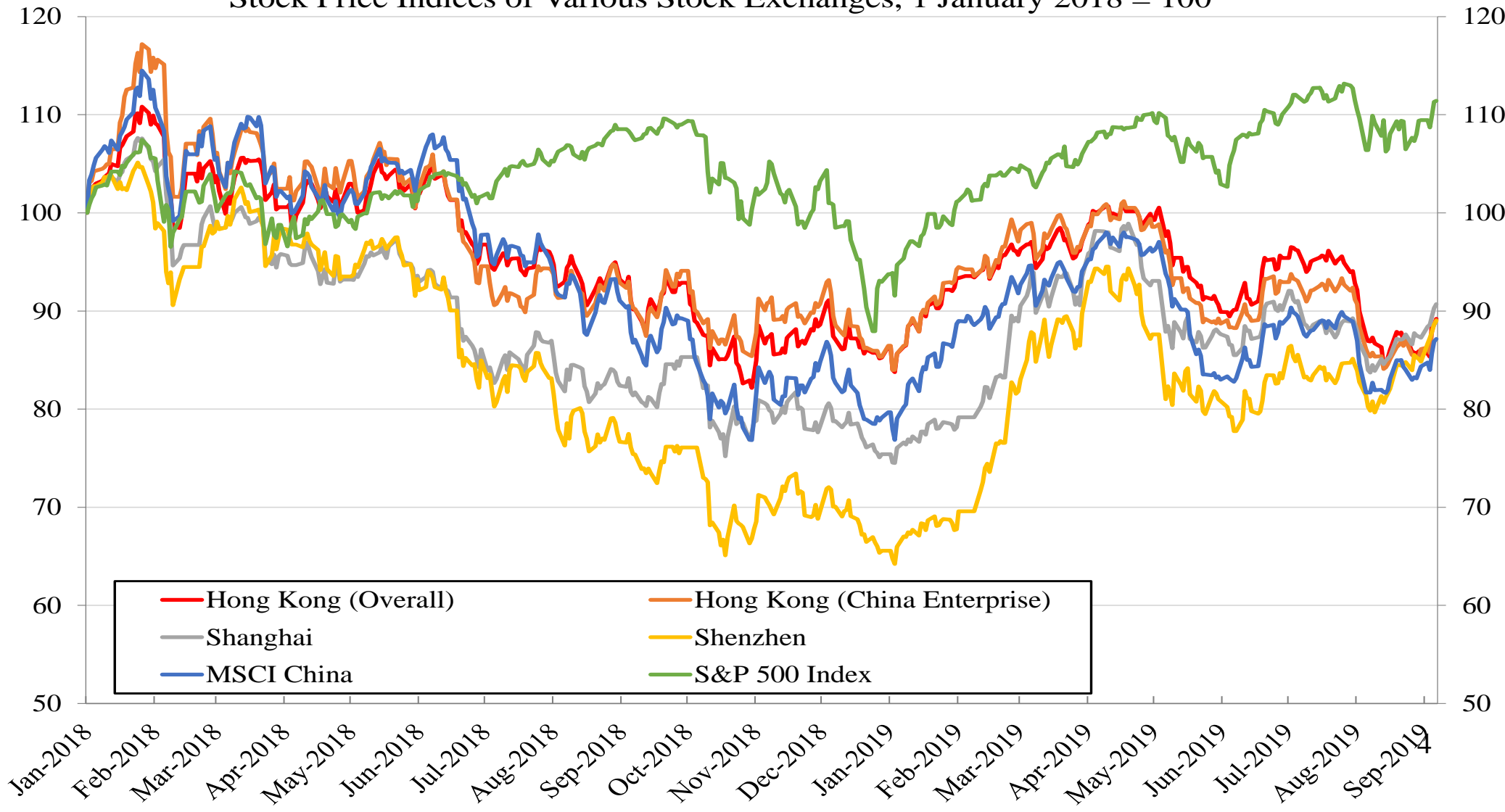
- ◆ Introduction
- ◆ The Impacts of the China-U.S. Trade War
- ◆ Projections of the Future
- ◆ Chinese Economic Policy Options
 - ◆ Increasing Domestic Aggregate Demand
 - ◆ Mobilising Domestic Savings
 - ◆ The Three Zeroes Strategy
 - ◆ Promoting Innovation

Introduction

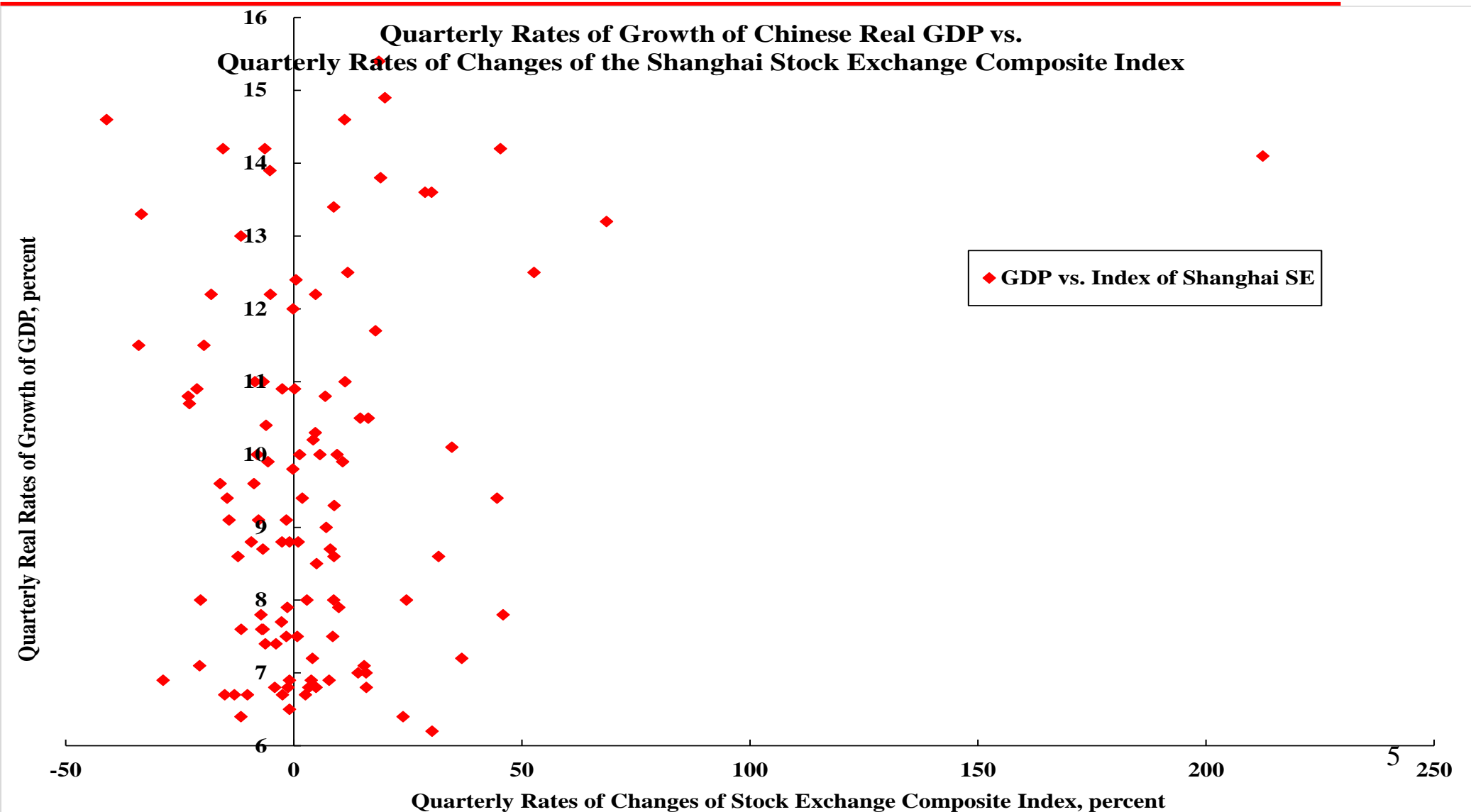
- ◆ The impacts of the trade war on the Chinese economy are manageable.
- ◆ The Chinese economy will continue to grow around 6% for the next couple of decades.
- ◆ Chinese economic policy options.

The Chinese, Hong Kong and U.S. Stock Market Indexes, 2018M1 to Date

Stock Price Indices of Various Stock Exchanges, 1 January 2018 = 100

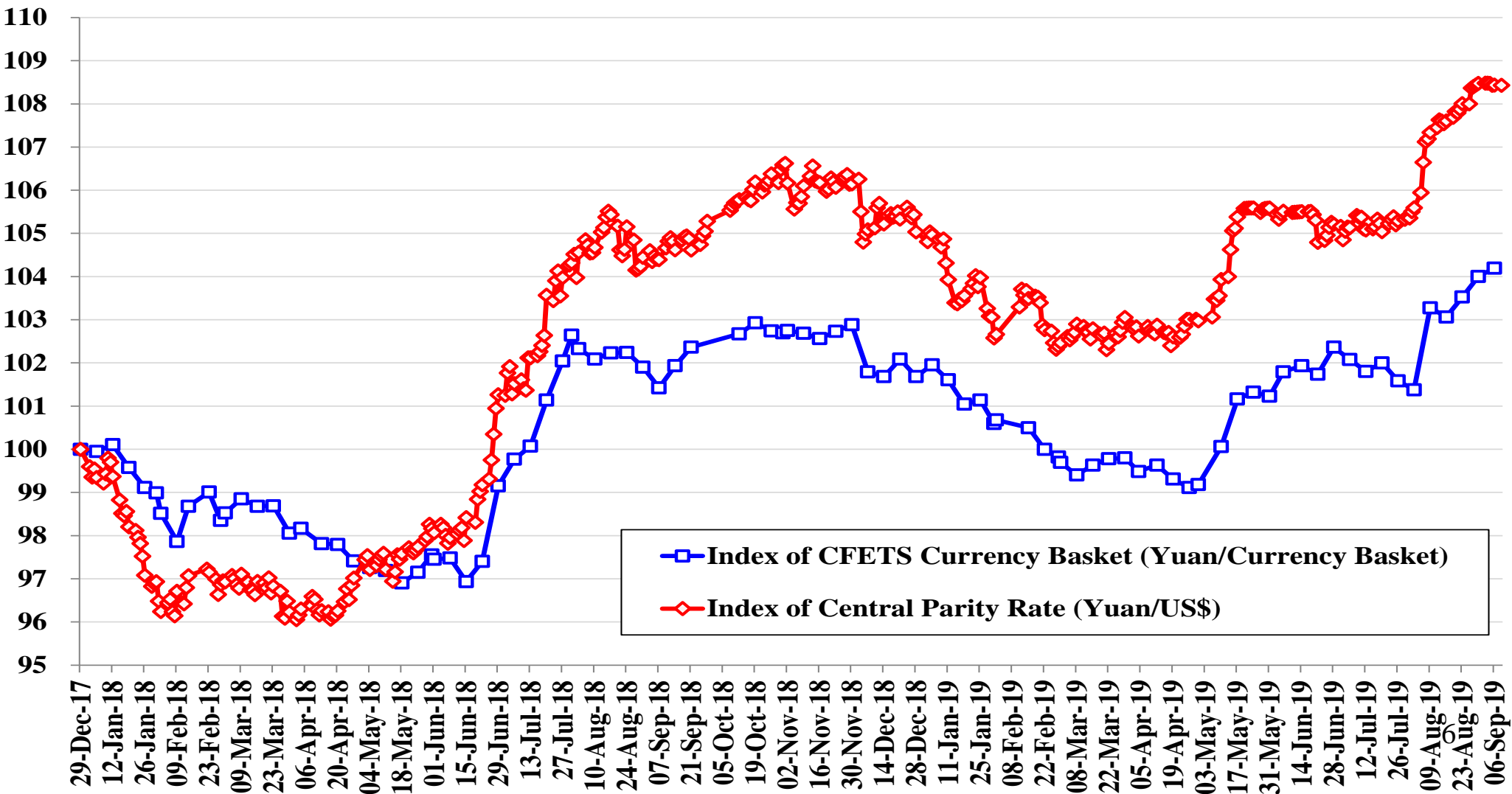


The Quarterly Rates of Growth of Chinese Real GDP versus the Chinese Stock Price Index

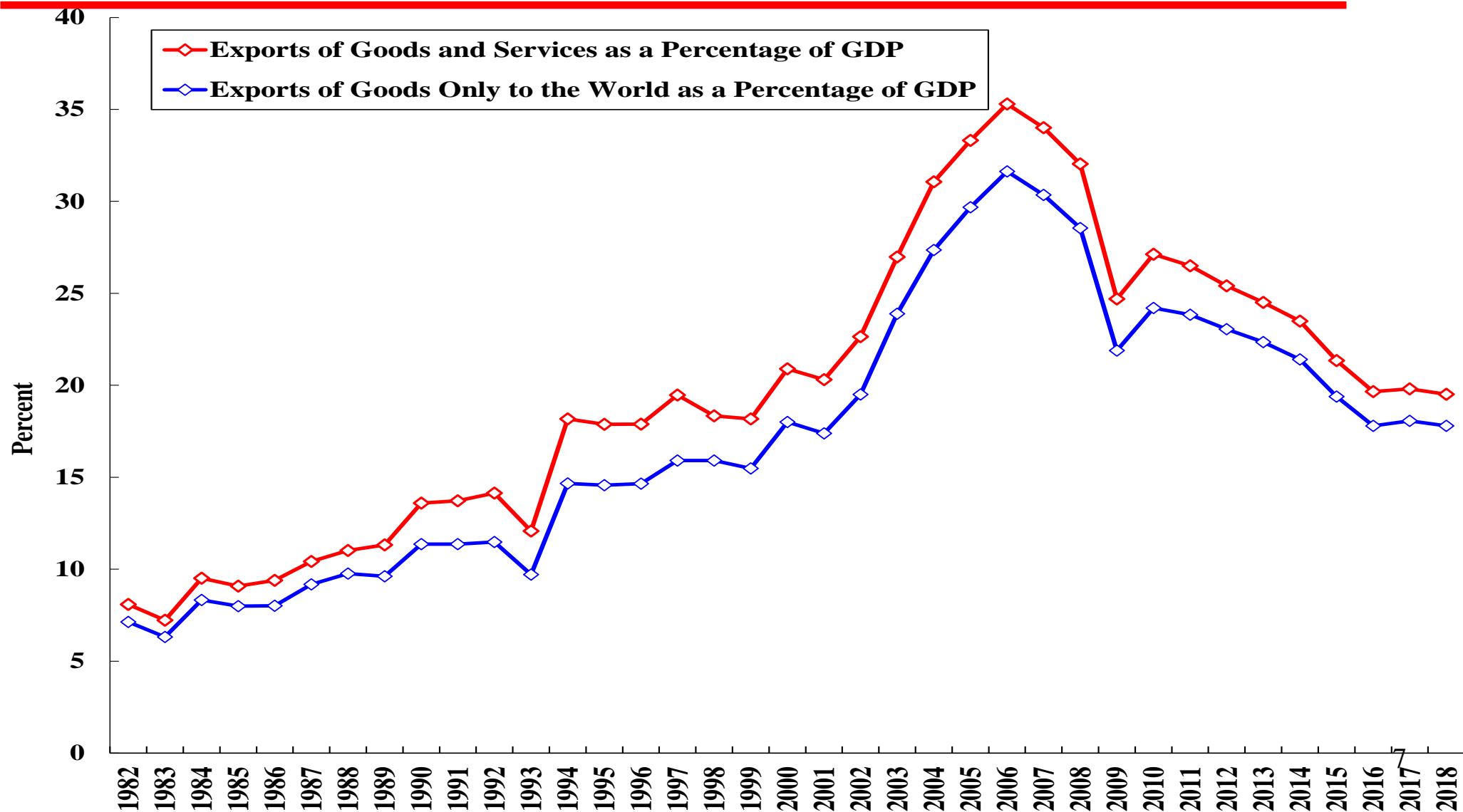


The RMB Central Parity Exchange Rate and the CFETS Index, 29/12/2017 to the Present

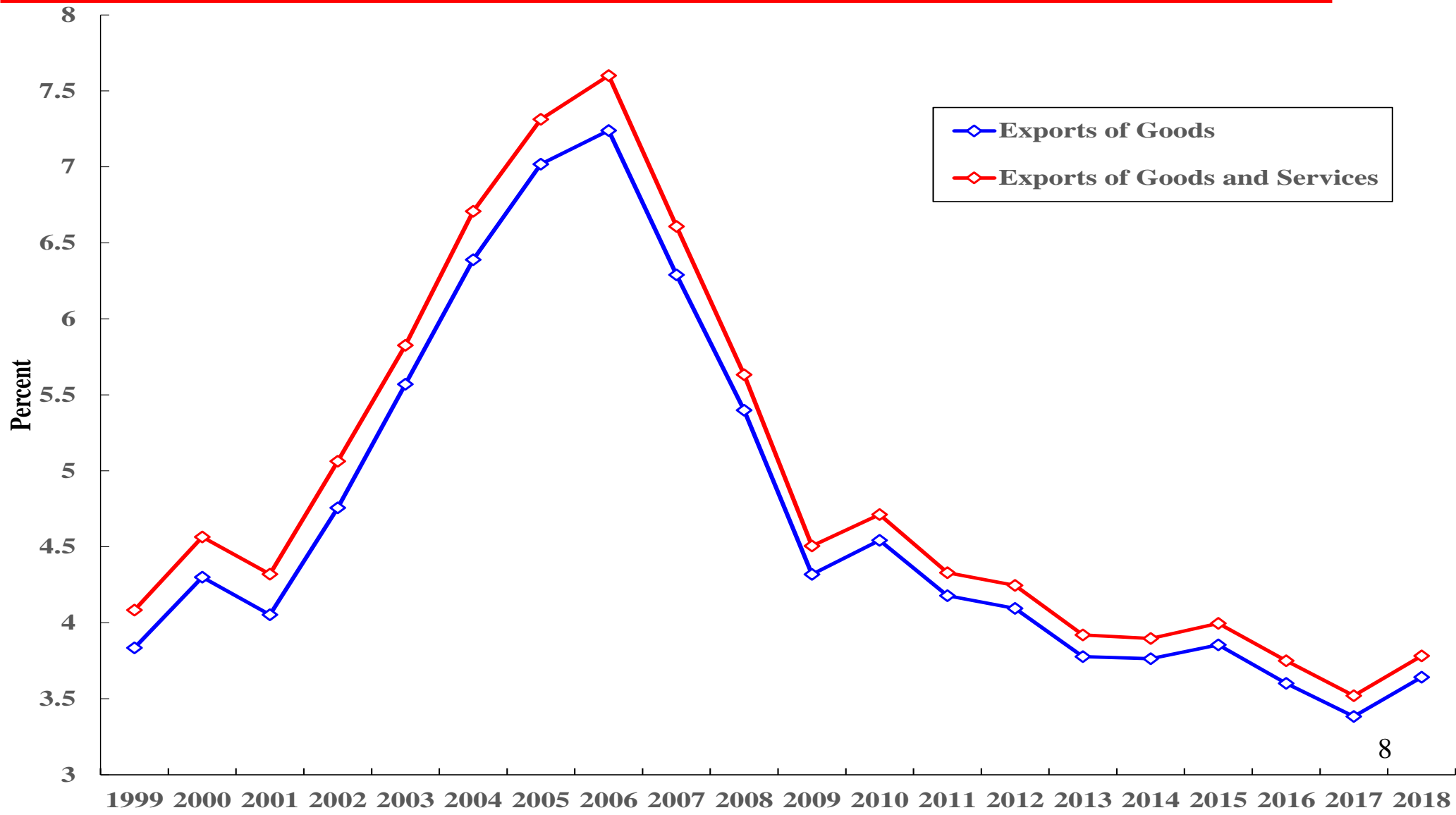
The Central Parity Rate and the CFETS Index, 29 Dec. 2017 = 100



Chinese Exports of Goods and Services and Goods Only as a Percent of Chinese GDP



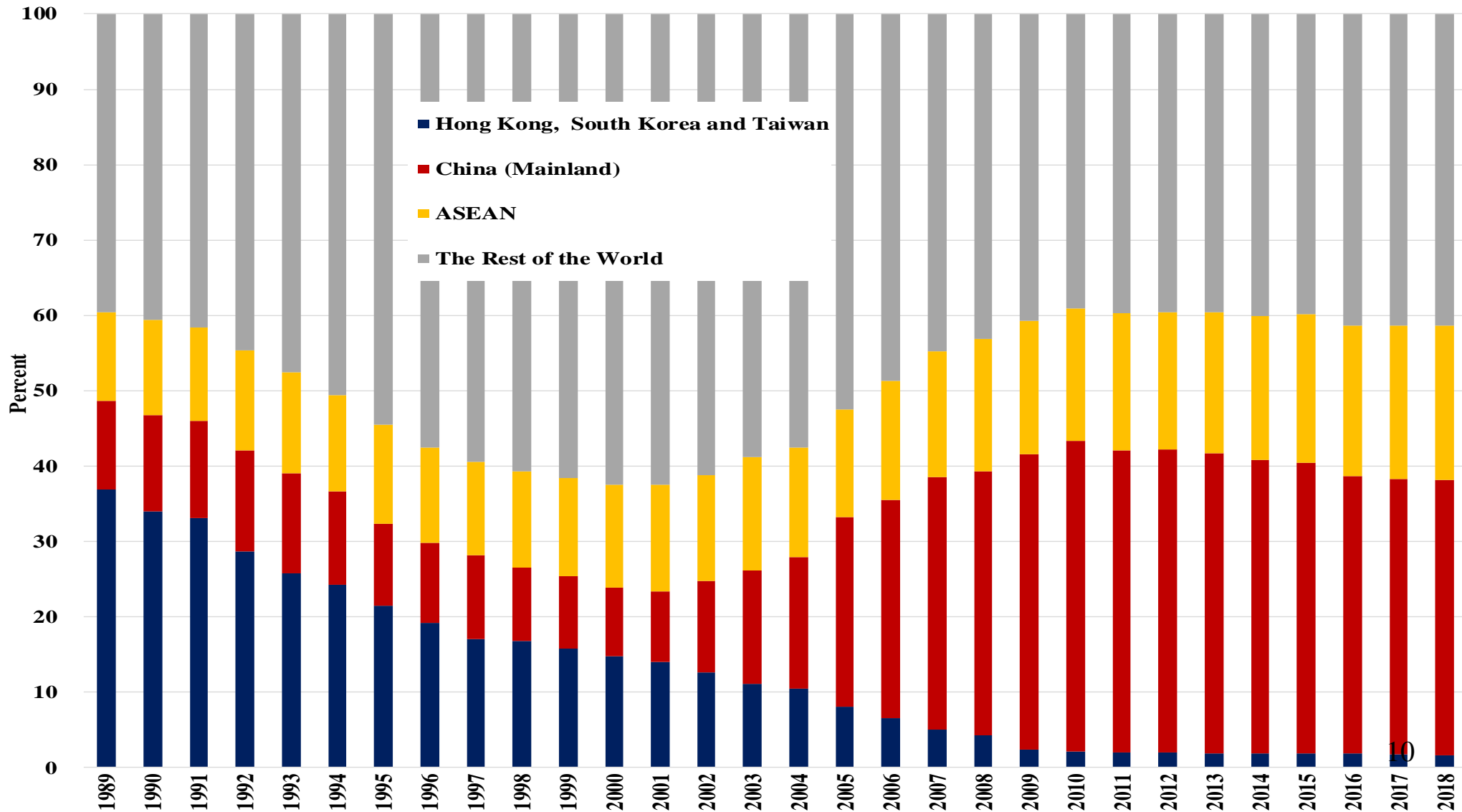
Chinese Exports of Goods and Services and Goods to the U.S. as Percent of Chinese GDP



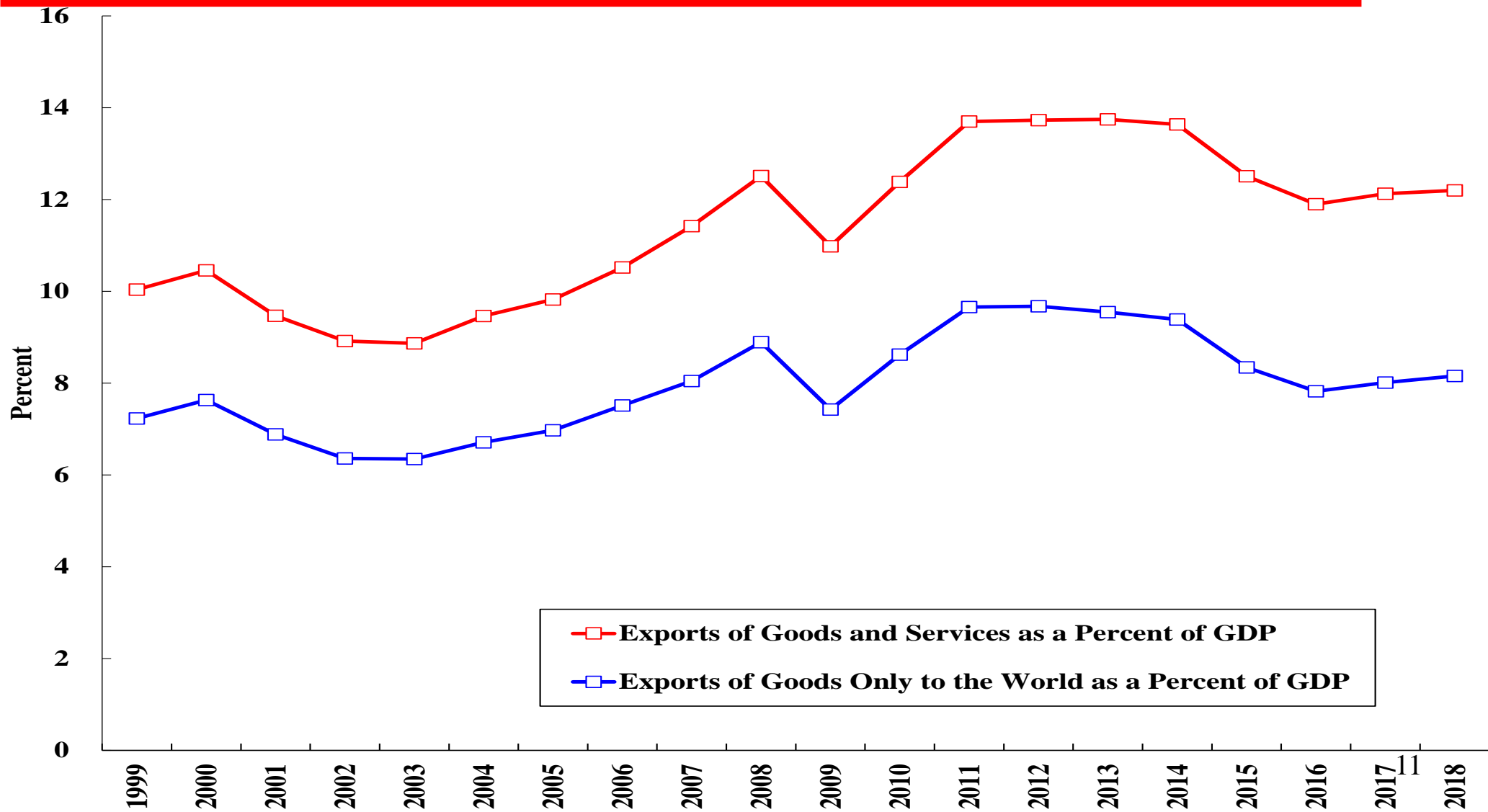
Real Impacts on the Chinese Economy

- ◆ The direct domestic value-added content of Chinese exports to the U.S. is less than 25%. Thus, the maximum loss in Chinese GDP, assuming that half of the exports to the U.S. is completely halted, in the first instance, may be estimated at 0.45% ($3.6\%/2 \times 0.25$), a manageable level, especially for an economy growing at an average annual real rate of 6.6 percent and with a per capita GDP of US\$9,410 in 2018.
- ◆ However, the reduction of exports leads to a reduction in the demands for domestic inputs used in their production, which in turn leads to a second-round reduction in the demand for domestic inputs used in the production of the domestic inputs. With the indirect, that is, second-, third-, fourth- and higher-round effects of the reduction of Chinese exports kicking in, the total domestic value-added affected will eventually increase to 66 percent cumulatively. This implies ultimately a maximum total loss in Chinese GDP of 1.19% ($(3.6\%/2 \times 0.66)$). In absolute terms, this amounts to US\$156 billion in 2018 prices.
- ◆ If all of Chinese exports of goods to the U.S. are halted because of the prohibitive tariffs, the maximum total loss in Chinese GDP would be 2.4%, still tolerable. These losses are all estimated assuming that nothing is done in response to the imposition and increases of U.S. tariffs.

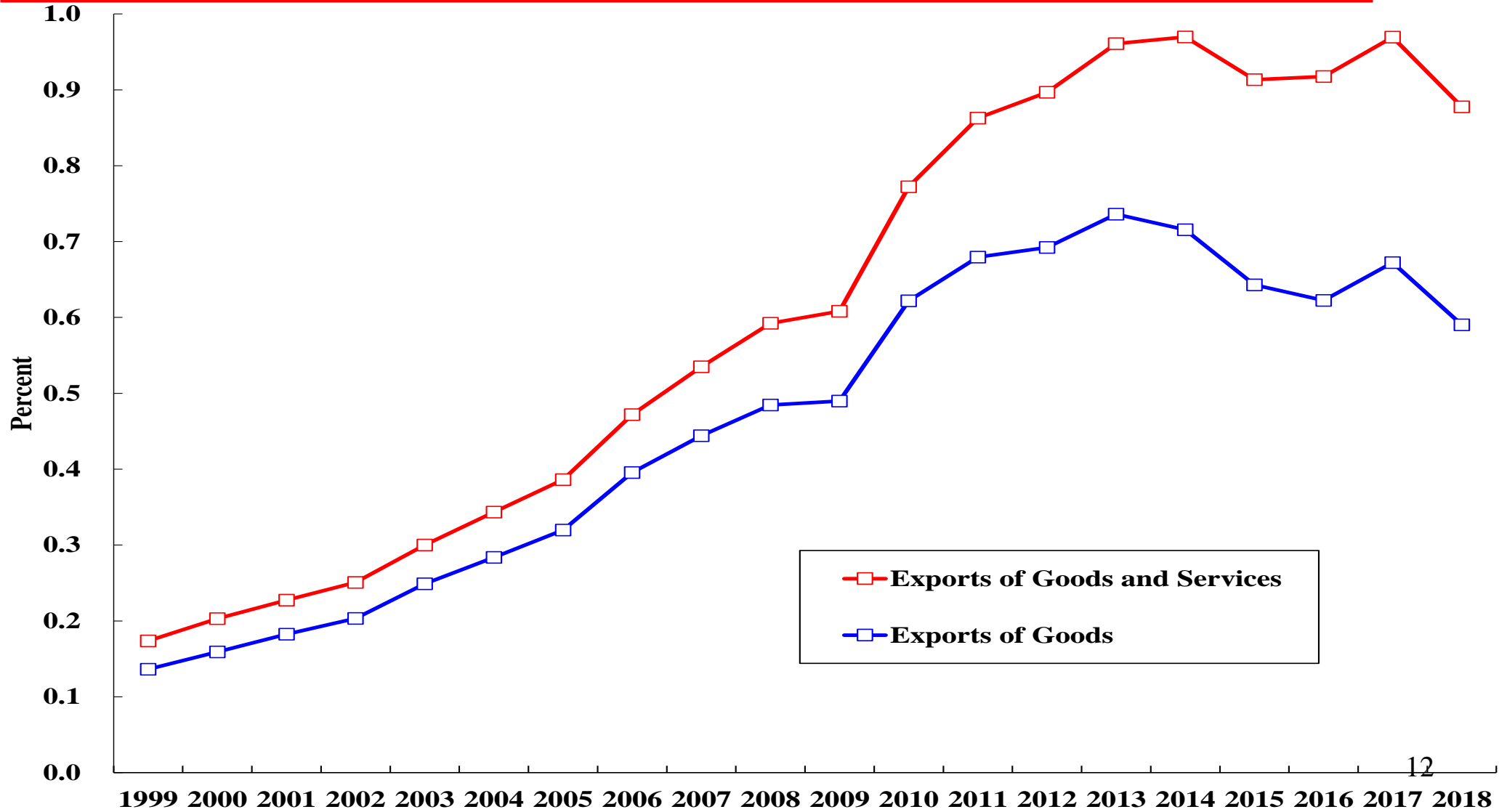
The Distribution of U.S. Apparel Imports by Countries and Regions of Origin



U.S. Exports of Goods and Services and Goods Only as Percent of U.S. GDP



U.S. Exports of Goods and Services and Goods Only to China as Percent of U.S. GDP



Real Impacts on the U. S. Economy

- ◆ The direct domestic value-added content of U.S. exports of goods to China may be estimated to be 50.8%. Thus, the maximum loss in the U.S., assuming that all of its exports to China is completely halted by the tariffs, may be estimated in the first instance at 0.29% ($0.58\% \times 0.508$), less than the initial impact on Chinese GDP of 0.45%, based on the assumption that half of Chinese exports of goods to the U.S. will be halted.
- ◆ With the indirect, that is, second-, third-, fourth- and higher-round effects of the reduction of U.S. exports of goods kicking in, the total domestic value-added affected increases to 88.7% cumulatively. This implies ultimately a total loss in U.S. GDP of 0.51% ($0.58\% \times 0.887$), assuming that all of U.S. exports to China will be halted.
- ◆ In absolute terms, this amounts to US\$104.6 billion (0.51×20.5 trillion) in 2018 prices, much less than the estimated potential Chinese loss in terms of GDP of US\$312 billion assuming all Chinese exports are halted.
- ◆ Thus, in both absolute and relative terms, the Chinese losses in real GDP will be much higher than those of the U.S.

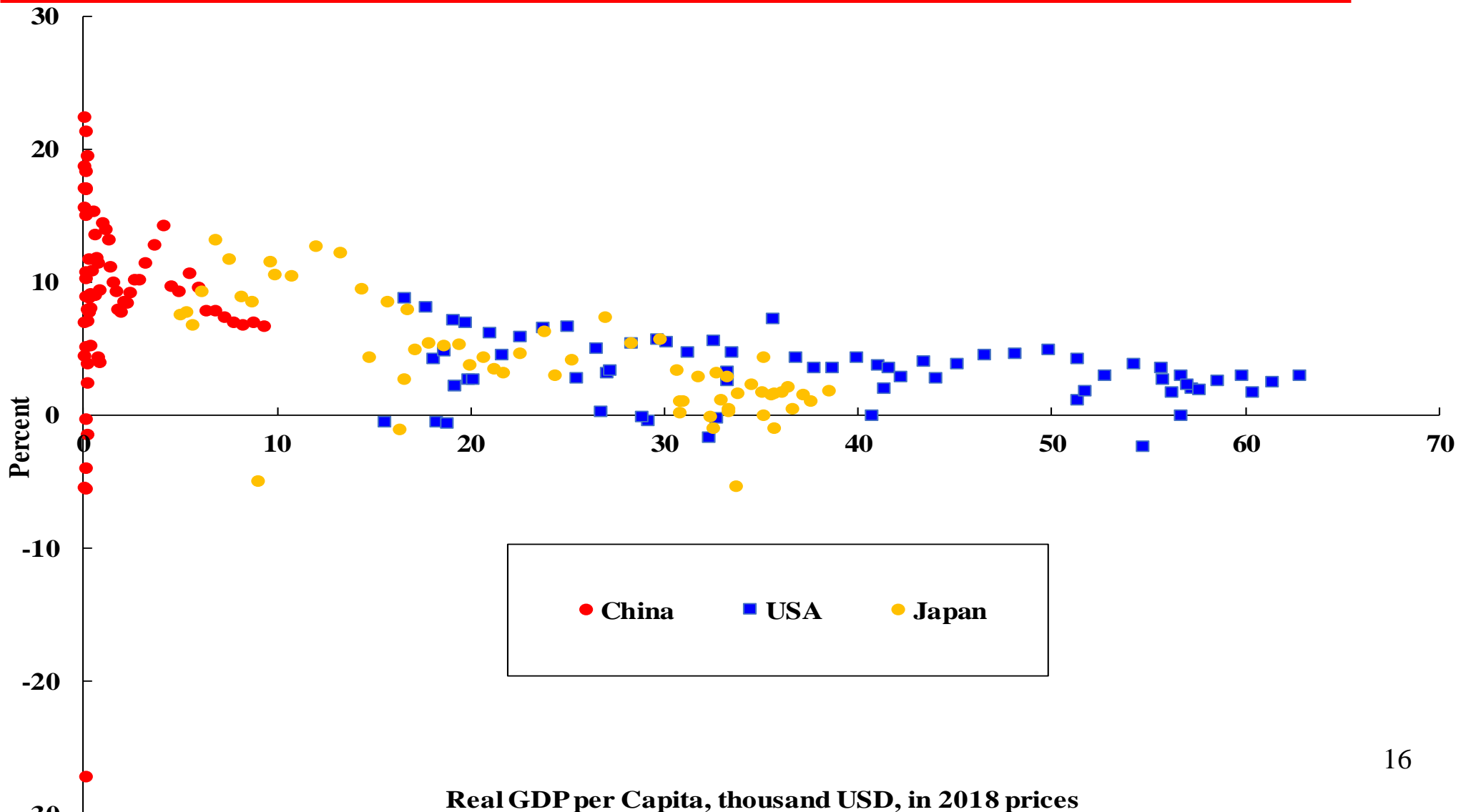
Economic and Technological Competition

- ◆ In terms of aggregate GDP, China went from only one-fifth of the U.S. GDP in 2000 to two-thirds in 2017, taking only 17 years (64.1% in 2018 because of exchange rate changes). It is only a matter of time that the Chinese GDP will catch up with the U.S. GDP, probably in the early 2030s. However, in terms of GDP per capita, China is still way behind, with US\$9,410 compared to almost US\$62,609 for the U.S. in 2018. My own projections suggest that it will probably take until the end of the 21st Century before Chinese GDP per capita approaches the U.S. level.
- ◆ In terms of the number of nuclear-armed warheads, according to the New York Times, the U.S. is estimated to have more than 6,000 such warheads, compared to less than 300 for China. The difference is even more striking in per capita terms. This is not a competition that China should wish to join. However, a race to find an effective cure for cancer or Alzheimer's disease would be worthwhile for both countries and in fact for the entire mankind.

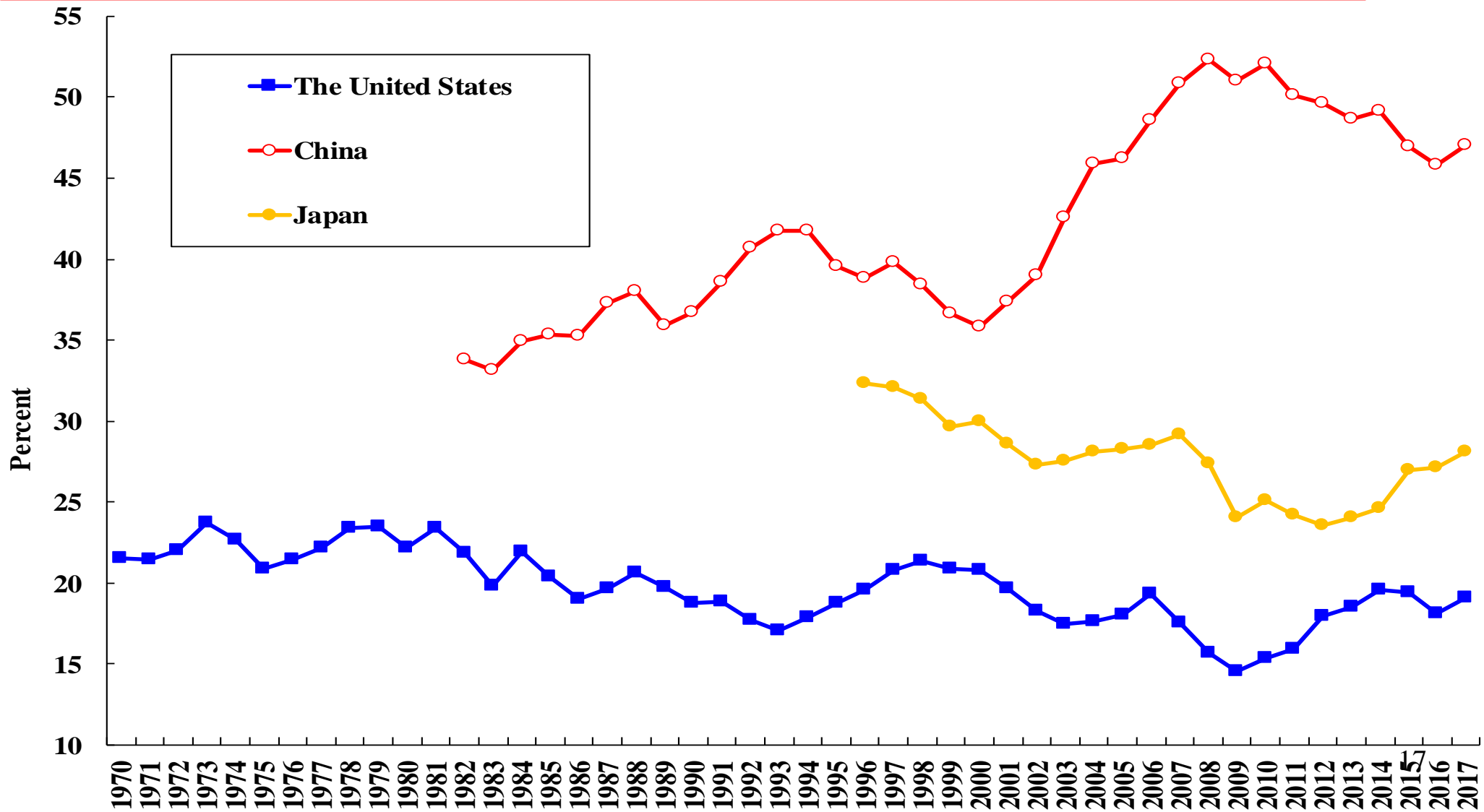
Long-Term Forecasts of the Chinese and the U.S. Economies

- ◆ It is assumed that the Chinese economy will continue to grow around 6% per annum for a few more years, declining gradually to between 5% and 6%, and that the U.S. economy will grow at an average rate of 3% per annum between now and 2050.
- ◆ In 2018, the Chinese economy grew 6.6%. In 2019H1, Chinese real GDP grew at an annualised rate of 6.3%. The target range of the Chinese rate of growth for 2019 is between 6% and 6.5%. The Chinese economy is on course.
- ◆ The U.S. economy grew 2.9% in 2018, close to its long-run average of 3%. The rates of growth of 2019Q1 and 2019Q2 were respectively 3.1% and 2.1%. Both the U.S. Federal Reserve Board and the U.S. Congressional Budget Office expect 2.3% growth for 2019.
- ◆ It may be thought that the Chinese economy will be unable to sustain an average annual rate of growth of between 5% and 6% for such a long time. Past experience shows that the rate of growth of an economy declines as its real GDP per capita rises. But given the still relatively low level of real GDP per capita in China, and the low level of its capital per unit labor, such a rate of growth should still be possible for at least several decades (see the following charts in which the experiences of China, Japan and the U.S. are compared.)

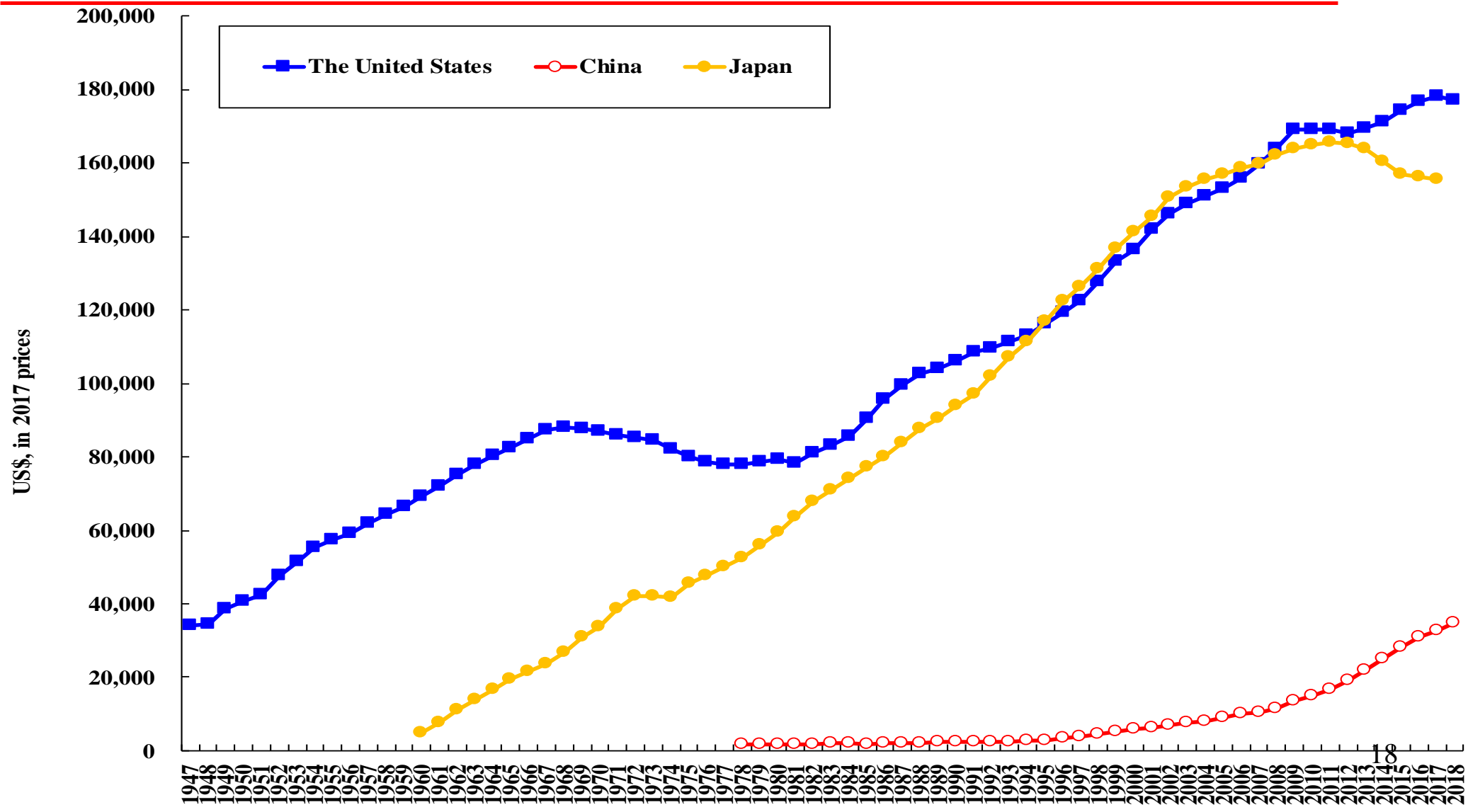
Growth Rate vs. Level of Real GDP per Capita (2018 tril. US\$): China, Japan and the U.S.



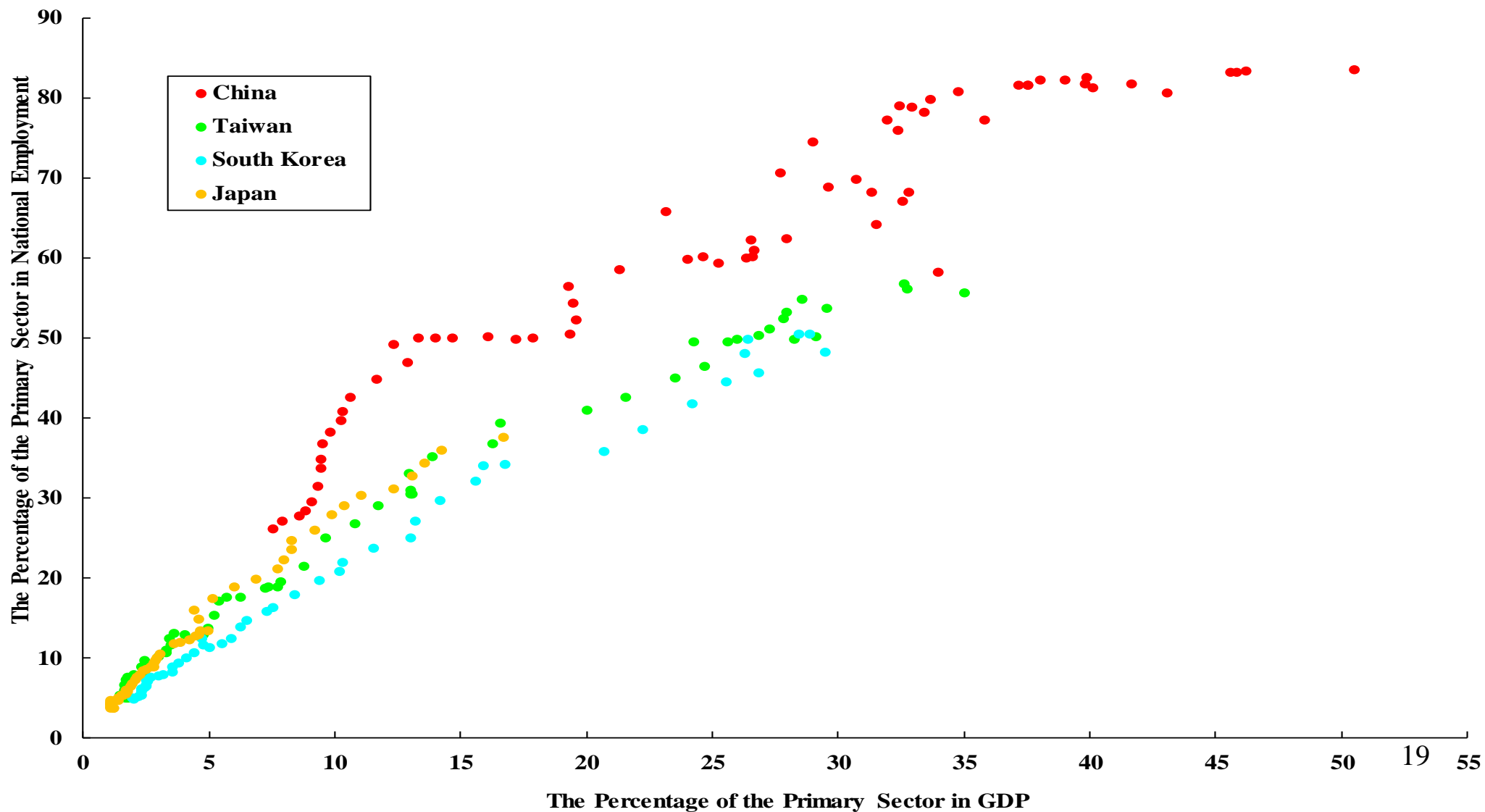
Comparison of National Savings Rates: China, Japan and the U.S.



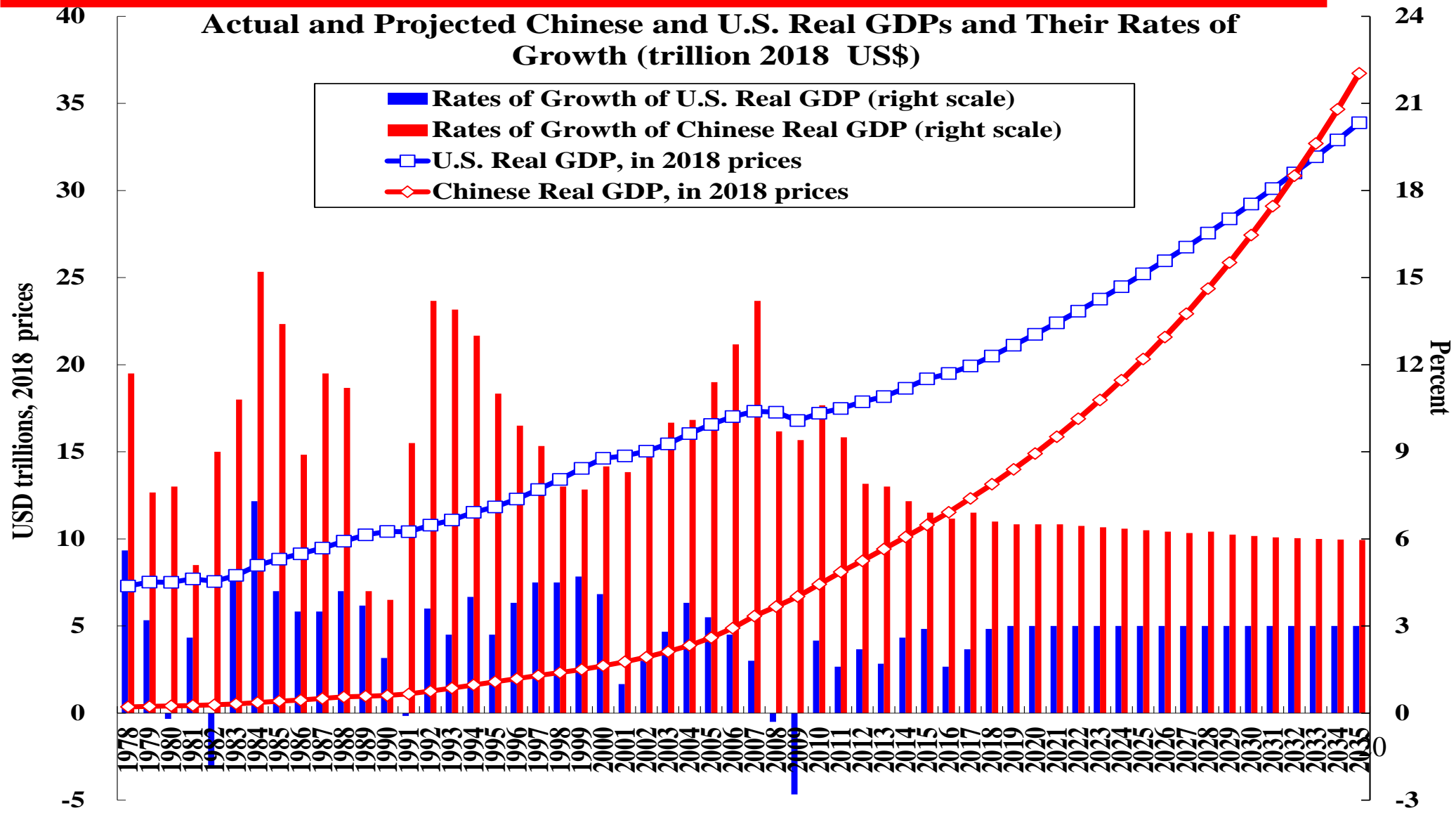
Comparison of Capital-Labour Ratios: China, Japan and the U.S.



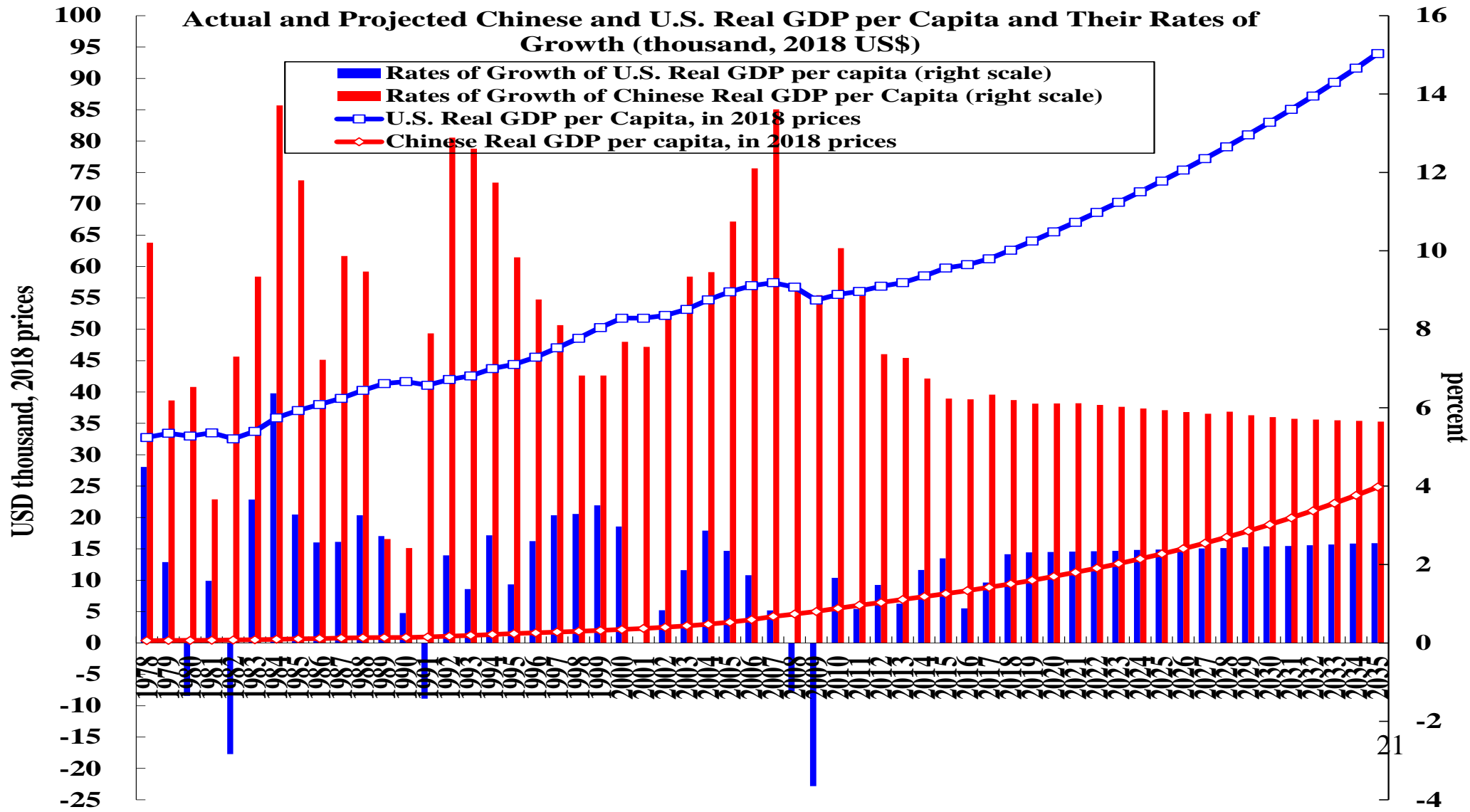
Scatter Diagram between the Shares of Employment and GDP of the Primary Sector



Actual and Projected Levels and Growth Rates of Chinese and U.S. Real GDP (2018 tril. US\$)



Actual and Projected Chinese and U.S. Real GDP/Capita and Their Annual Rates of Growth (1,000 2018 US\$ & %)



Increasing Domestic Aggregate Demand

- ◆ Basic infrastructure projects such as 5G base stations, high-speed railroads and urban mass-transit systems. Additional investments in public goods provisions such as environmental preservation, protection and restoration, education, health care and elderly care.
- ◆ The oil-and-gas pipeline network will allow the markets to play a more decisive role; the same is true of the national electricity grid and the future 5G network of base stations.

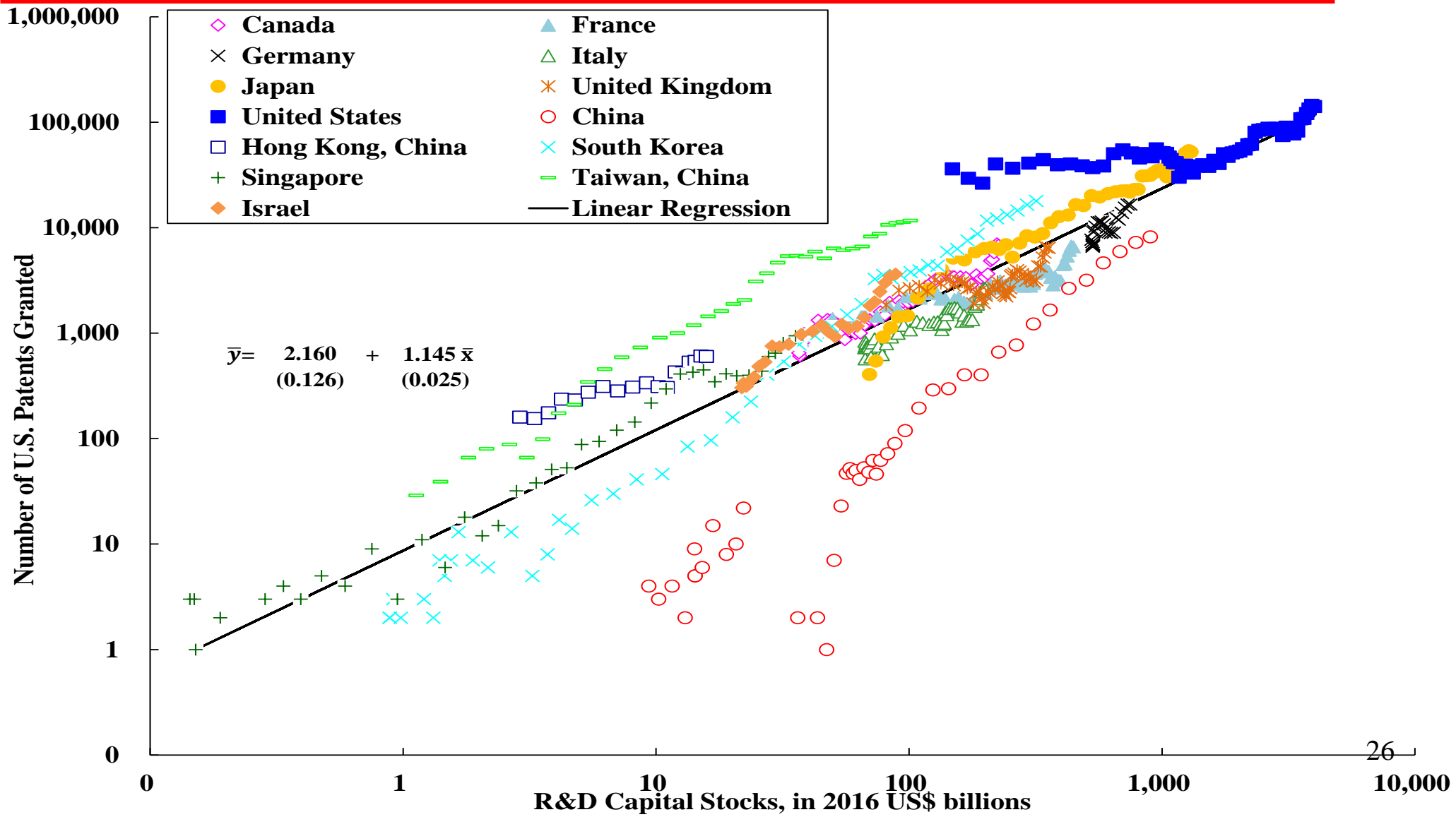
Mobilising Domestic Savings by Making Equity Investment More Attractive

- ◆ Encouragement of the substitution of equity for debt
- ◆ Making cash dividends deductible to corporations
- ◆ SOEs required to pay cash dividends
- ◆ International board for foreign multinational corporations

The Three Zeroes Strategy

- ◆ Zero tariffs, zero non-tariff barriers and zero subsidies
- ◆ On a reciprocal basis
- ◆ National treatment for all enterprises
- ◆ Transformation from the world's factory to the world's market
- ◆ Maintaining competitiveness through upgrading

U.S. Patents Granted and R&D Capital Stocks: G-7 Countries, 4 EANIEs, China & Israel



Basic Research Expenditure as a Share of Total R&D Expenditure: China, Japan and the U.S.

Basic Research Expenditure as a Percentage of Gross Expenditure on R&D

