The Prospects for the Chinese Economy

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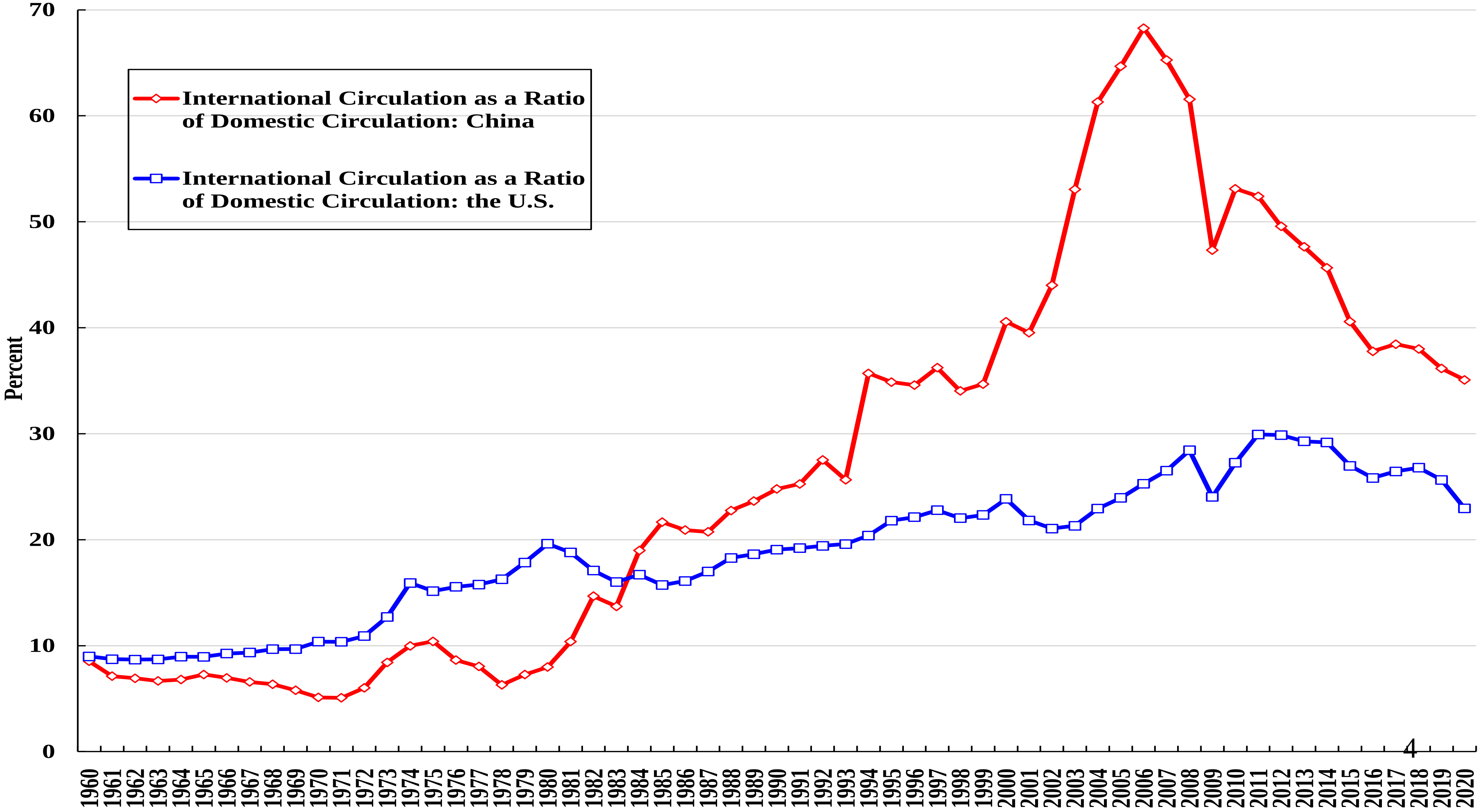
Underlying Trends

- The Dual-Circulation Economic Development Strategy
- The Peaking of Carbon Emissions by 2030 and the Achievement of Carbon Neutrality by 2060
- The Common Prosperity
- The China-U.S. Competition as the New Normal

The Dual-Circulation Economic Development Strategy

- As President XI Jinping announced some time ago, China will pursue a dual-circulation development strategy. There is a domestic circulation and an international circulation, but with the domestic circulation playing the primary role, which is to be expected for large continental economies like China (and also the U.S.). However, the dual circulations complement each other.
- The Chinese economy is no longer export-driven. It aims to have balanced international trade. It will be domestic demand-driven--household consumption, investment and public goods consumption.
- The adoption of a dual circulation strategy by China is evidence of its recognition that total self-sufficiency is not a viable alternative and of its continuing commitment to an open economy and to economic globalisation.
- The Chinese ratio of international circulation to domestic circulation was below 10 percent before 1981, when it began to rise and reached a peak of almost 70 percent in 2006, but declined to 35 percent by 2020. The U.S. ratio was around 20 percent between 1980 and 2000 and rose to a peak of 30 percent in 2011, but declined to 23 percent in 2020. It is expected that the ratios for both countries will be declining some more over time and eventually reach similar levels.

International Circulation as a Ratio of Domestic Circulation: China and the U.S. (%)



The Peaking of Carbon Emissions by 2030 and the Achievement of Carbon Neutrality by 2060

- President XI Jinping also committed China to peak its carbon emissions by 2030 and to achieve carbon neutrality by 2060.
- These objectives will be achieved through
  - growth of electric vehicles
  - A network of high-speed trains substituting for airplanes
  - Massive expansion of renewable energy, such as including hydro, massive solar and wind power farms, and nuclear fusion as sources of electricity generation, replacing the fossil fuels
  - Ultra-high-voltage long-distance transmission of electricity
  - Large-scale re-forestation

Common Prosperity

- The "Common Prosperity" promoted by President XI Jinping should not be equated with simple re-distribution. It genuinely means giving other people who have not gotten rich yet an opportunity to get rich. The establishment of the new Beijing Stock Exchange is an indication that the private sector consisting mostly of small and medium enterprises will be allowed to grow and prosper.
- The promotion of equity finance can reduce the reliance on debt finance and hence the overall level of leverage in the economy, helping to ensure economic and financial stability.
- Eventually, China can use even more stock exchanges, for example in Chongqing and Tianjin.

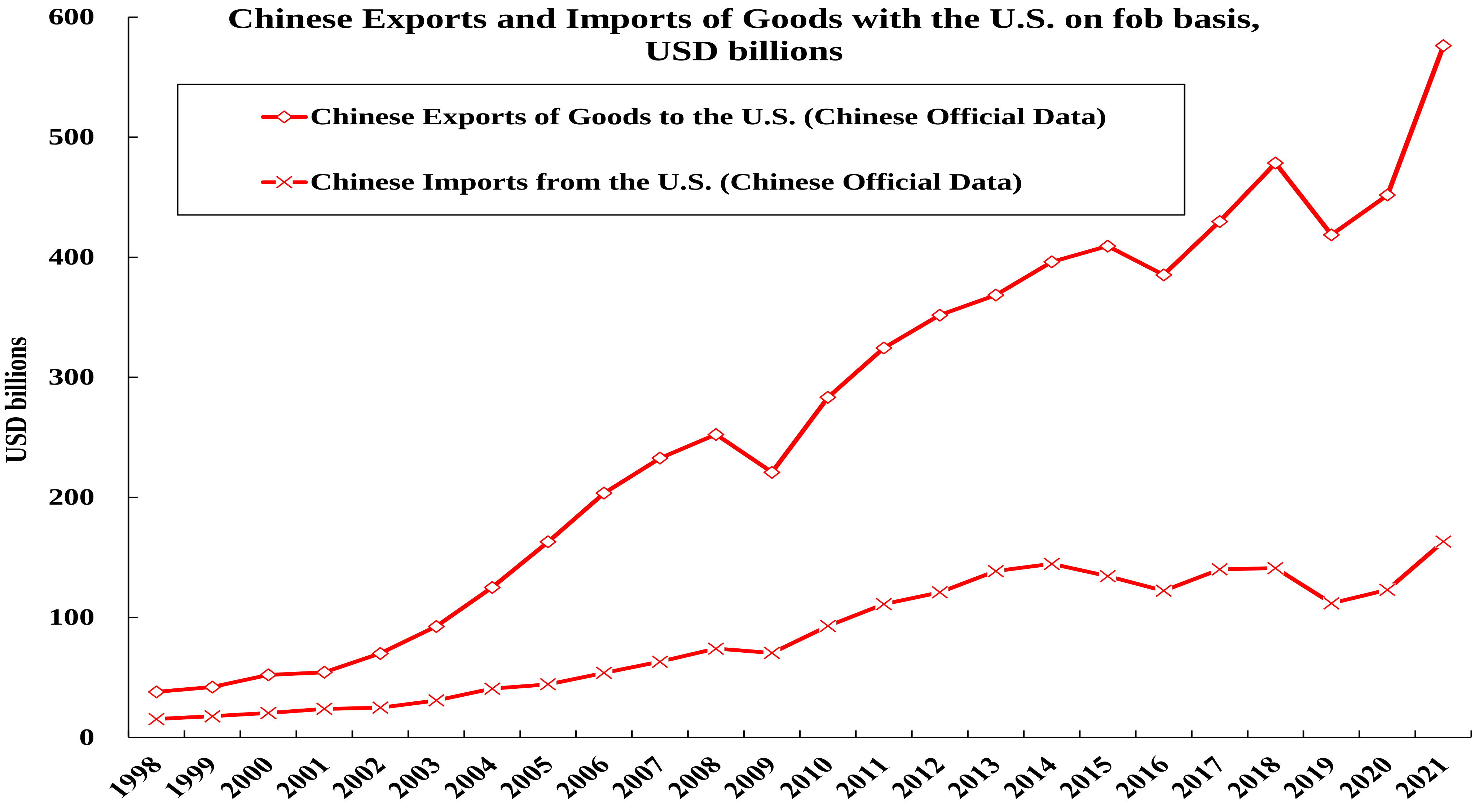
The China-U.S. Competition as the New Normal

- The strategic competition between China and the U.S. is likely to be the new normal for the next decade or so. National security is often a convenient excuse for the U.S. to impose unilateral sanctions on China. China actually poses no threat, military or otherwise, to the existence and continued prosperity of the U.S.
- However, it can potentially cause a problem for the maintenance of global hegemony by the U.S., because, as Noam Chomsky, a professor at MIT, once pointed out, to the effect that China is one of the very few countries that can actually say no to the U.S. As the global hegemon, the U.S. cannot allow any country to say no to it and get away with it, because it will encourage other countries to also say no, and fairly soon its global hegemony is no more.
- The (bi-partisan) military-industrial complex in the U.S., first identified by the late U.S. President Dwight Eisenhower in 1961, is intent on continuing to be the global hegemon and will use any and all means necessary to prevent China's rise, until it is finally convinced that the effort is a futile one without incurring unacceptably high costs to the U.S.
- That is why China-U.S. competition is likely to be the new normal for the next decade or so. Things will eventually get better, but it will take a while.

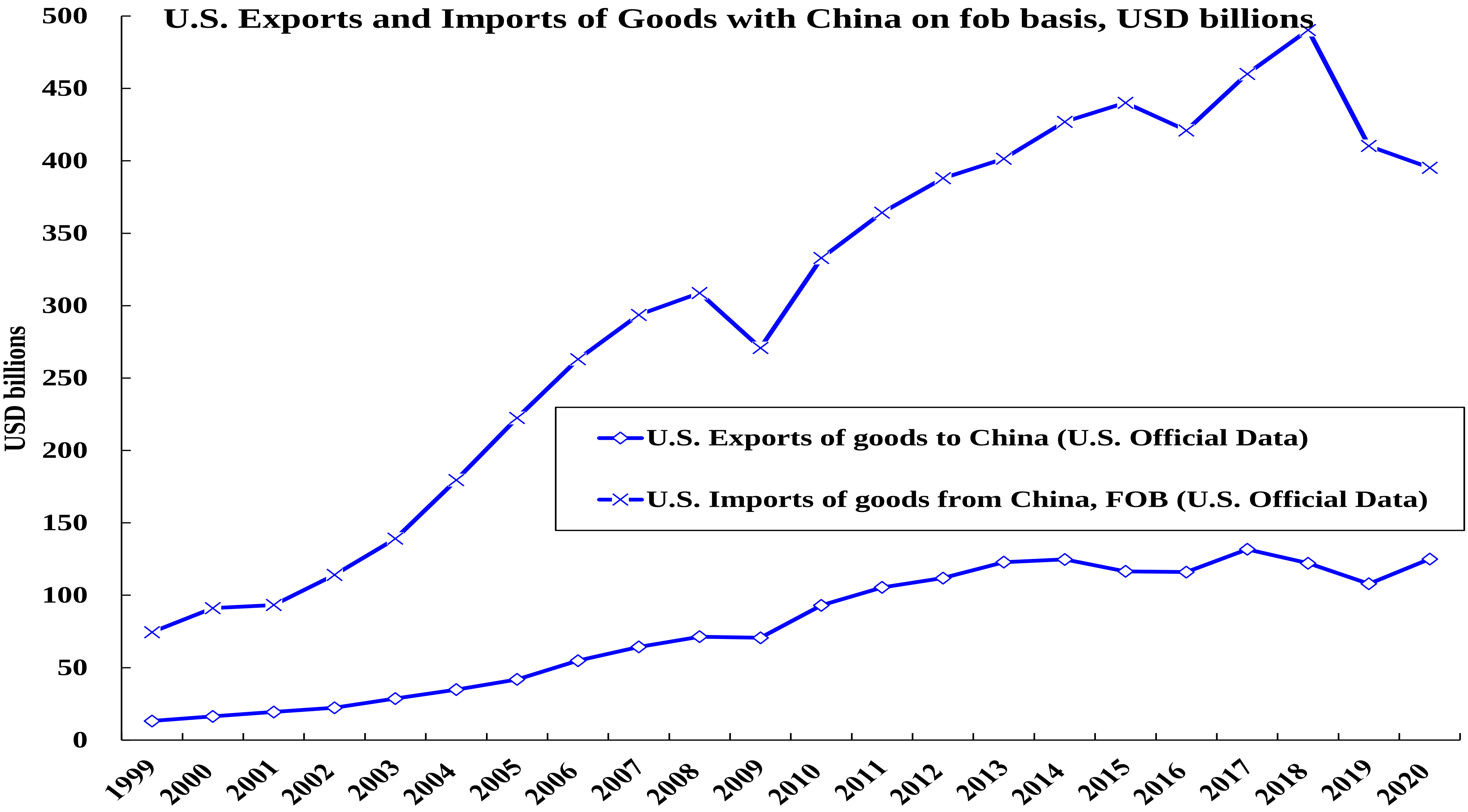
The China-U.S. Competition as the New Normal

- Thus, the China-U.S. trade war will not end any time soon. The U.S. is likely to use all the available means, legal or illegal, ethical or unethical, at its disposal to prevent China's rise.
- Nevertheless, even though mutual tariffs have remained in place, trade in goods between China and the U.S. reached a new high of US$755.6 billion in 2021, according to Chinese Customs, an increase of 28.7% over 2020 and higher than the US$620 billion before the start of the trade war.
- U.S. data, which are available only up to 2020, show a significant decline between 2018 and 2020.

Chinese Exports and Imports of Goods with the U.S. on FOB Basis, US$ billions



U.S. Exports and Imports of Goods with China on FOB Basis, US$ billions



The China-U.S. Competition as the New Normal

- However, China-U.S. strategic competition is not likely to result in a hot war between China and the U.S., because the casualties and losses will be enormous on both sides. There will be no winners. If even the former Soviet Union and the U.S. did not go to war in the last Century, it is highly unlikely that China and the U.S. will go to war.
- However, in order to maintain peace, China must have a minimal effective deterrent against a first strike.

The China-U.S. Competition as the New Normal

- De-coupling of the two economies to a certain extent is inevitable, but there has been some experience with partial de-coupling. After the 2008 Global Financial Crisis, China and East Asia continued to grow while the U.S. and the West stagnated. So, it has proven possible for the Chinese economy to grow without the West growing.
- Moreover, while the artificial de-coupling of the global supply chains will cause some transitional problems in both economies, it encourages the search for a second source. Once a second source is developed or found, export controls are no longer useful, and will likely be discontinued.
- The U.S. Dollar domination of worldwide invoicing, clearing and settlement will also decline gradually with the greater use of own-currencies for such purposes, as, for example, between China and Russia, and between China and Indonesia.

The China-U.S. Competition as the New Normal

- The problem of capital control is the regulation of the volatile short-term capital inflows and outflows, not the long-term flows. Every country should welcome long-term capital inflows, but short-term capital inflows and outflows do not bring any benefit to either the originating or the recipient countries.
- The use of the digital currency, with its distributed ledger (block-chain) feature, at both the retail and the wholesale levels, can greatly simplify capital control by distinguishing between short-term and long-term capital flows.
- China will have the largest pool of savings in the world. Chinese investors need to diversify away from China. The trading of China Depositary Receipts (CDRs) of foreign, including U.S., firms on Chinese stock exchanges can allow a transitional period for Chinese investors to invest in foreign firms without the full lifting of capital controls.

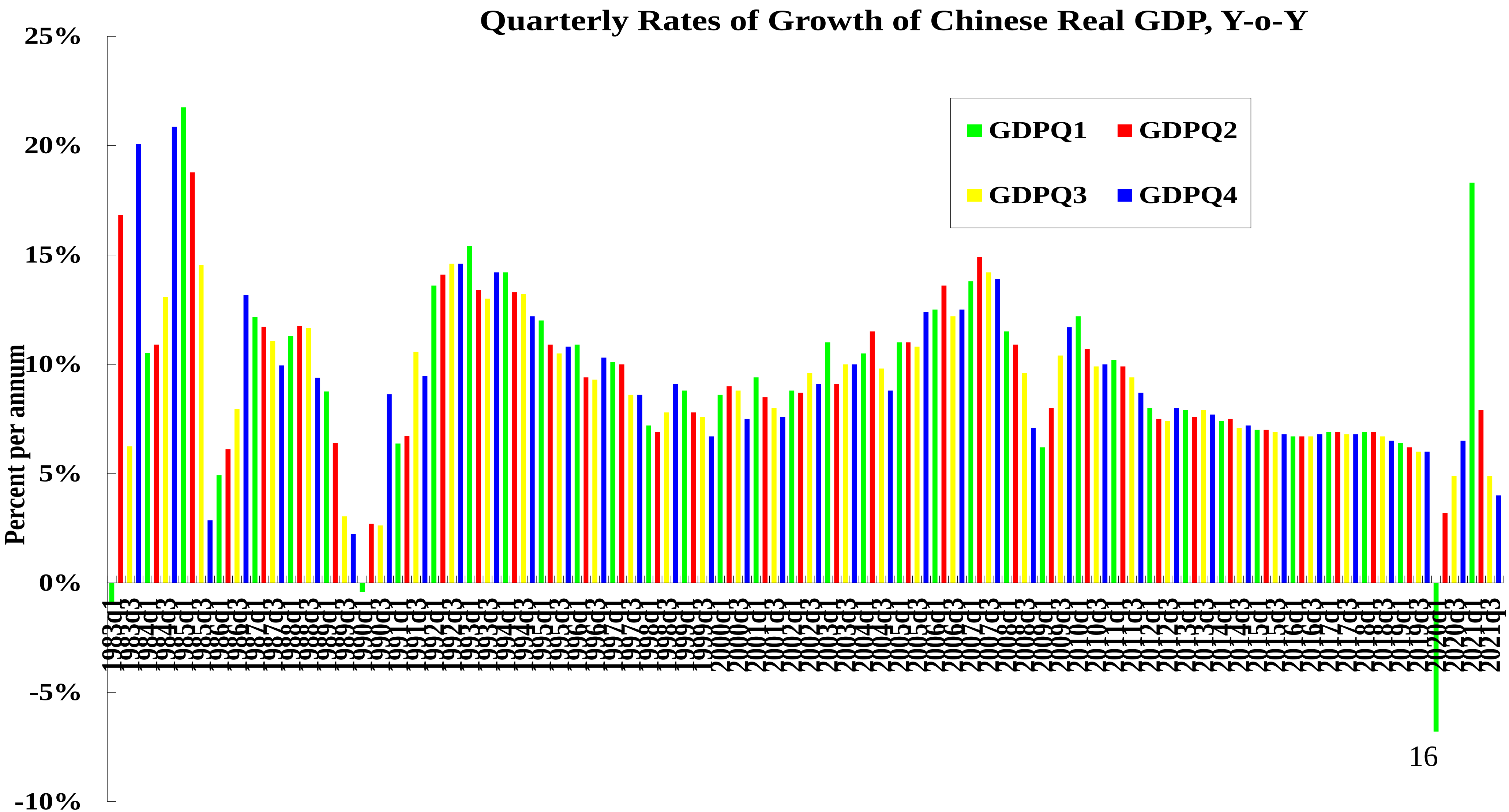
Actual and Projected Rates of Growth of Real GDP (% p.a.)

ACTUAL AND PROJECTED RATES OF GROWTH OF REAL GDP (% p.a.)					
The World	2019	2020	2021	2022	2023
IMF (2110)		-3.1	5.9	4.9	3.3
WORLD BANK (2201)	2.6	-3.4	5.5	4.1	3.2
China (Mainland)					
IMF (2110)		2.3	8.0	5.6	
WORLD BANK (2201)	6.0	2.2	8.0	5.1	5.3
The U.S.					
IMF (2110)		-4.5	5.2	4.5	
WORLD BANK (2201)	2.3	-4.6	5.0	3.8	2.3

Near-Term Performance

- The rate of growth of Chinese real GDP in 2021 is 8.1%, a significant recovery from the 2.2% of 2020.
- The four quarterly year-over-year rates of growth of Chinese real GDP in 2021 are respectively 18.3%, 7.9%, 4.9% and 4.4%.
- For 2022, the general expectation is that the non-mandatory target rate of growth of Chinese real GDP may be set between 5% and 6%.
- The IMF and World Bank projected rates of growth are 5.6% and 5.1% respectively.

Quarterly Rates of Growth of Chinese Real GDP, Y-o-Y (% p.a.)



Near-Term Performance

- The rate of growth of U.S, real GDP year-over-year in the first-three quarters of 2021 is 5.0%, even though the quarterly year-over-year rate of growth has declined from 6.3% in Q1 and 6.7% in Q2 to 2.1% in Q3.
- Even if there is no growth in Q4, the annual rate of growth would have been a very respectable 3.8%. To achieve an annual rate of growth of 4.5%, the Q4 year-over-year rate of growth only has to be 3.0%, which should prove feasible.
- For 2022, the general expectation is that the U.S. economy will be able to grow at a rate of around 4%.
- The IMF and World Bank projected rates of growth are 4.5% and 3.8% respectively.

Near-Term Performance: Some Lingering Questions

- (1) Will the COVID-19 epidemic retard Chinese economic growth? There may be some negative, but not overly significant, effect. The maximum damage is no more than 1 percentage point.
- (2) Can tariffs on Chinese exports hurt the Chinese economy? The evidence from the past few years, during which Chinese exports faced heavy U.S. tariffs, suggests that the negative impact is small.
- (3) Can export controls on U.S. high-technology products slow the Chinese economy down? Yes, it can, to a certain extent. But for really essential national projects, such as the construction of super-computers, China has the capability of producing all of the chips required domestically, but probably not at a commercially viable scale. However, cost per se is not an important consideration for such projects.

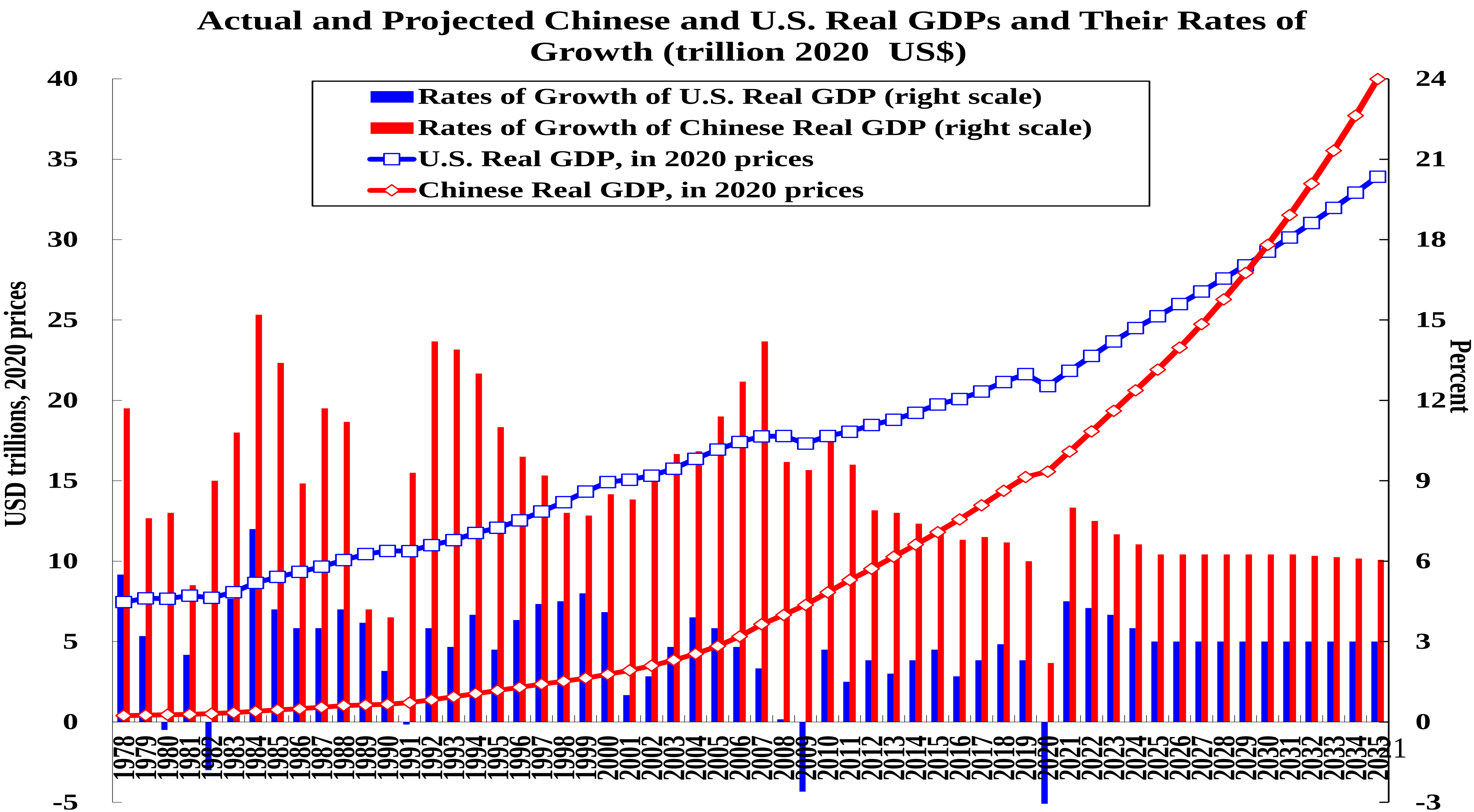
Near-Term Performance: Some Lingering Questions

- (4) Will a financial crisis be caused by the debts of over-extended real estate developers? The currently available evidence suggests that the problem is entirely manageable.
- (5) Can a massive failure of the real estate developers drag down the construction, including building materials, sector, which is a major part of the Chinese economy? There will be a negative impact. However, investment in residential housing can be supported by not only owner-occupied housing but also by rental housing. There can be an equilibrium between renting and owning in expanding cities, as in some European countries. The ultimate total housing demand is the same whether it is more rental or ownership.

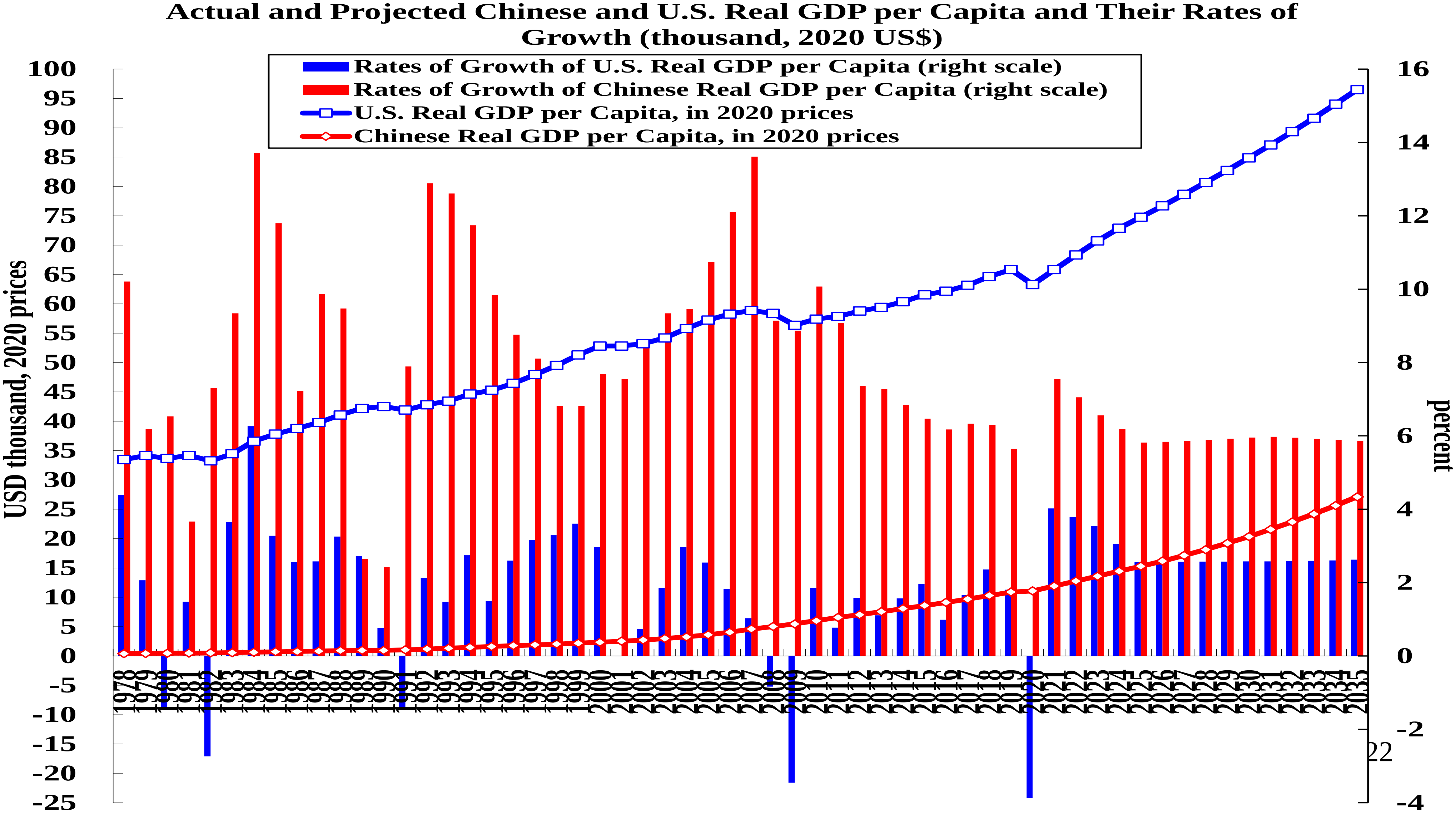
Long-Term Forecasts

- Beyond 2022, the Chinese economy will be able to grow at an average annual rate of approximately 6% for at least another decade. The U.S. economy will be able to grow at an average annual rate of 3%, as it has been doing in recent decades.
- Our long-term forecasts suggest that Chinese real GDP will surpass U.S. real GDP in 2030, with US$29.67 trillion to US$29.26 trillion (in 2020 prices).
- Our long-term forecasts also suggest that Chinese real GDP per capita will still be significantly below the U.S. real GDP per capita in 2030, with US$27.1 thousands to US$96.5 thousands (in 2020 prices), or less than 30 percent.

Comparison of Chinese and U.S. Real GDPs, 2020 US$, 1978-the Present



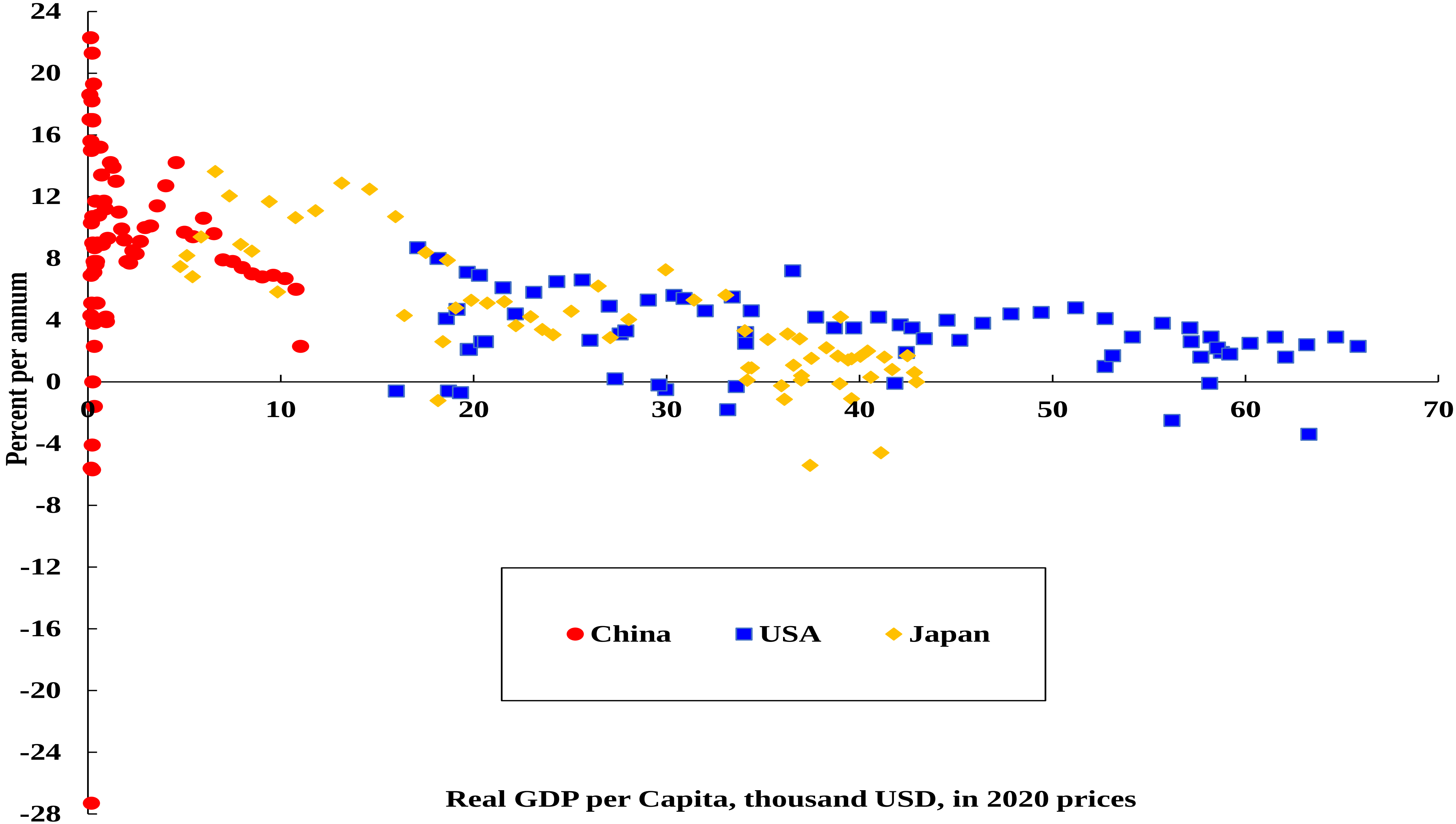
Comparison of Chinese and U.S. Real GDPs per Capita, 2020 US$, 1978-Present



Long-Term Forecasts

- It is true that the Chinese economy cannot continue to grow at close to 10% per annum indefinitely, as it did between 1978 and 2018. In fact, It is an empirical regularity that as the real GDP per capita of an economy grows, the real rate of growth of the economy will decline. This is demonstrated in the following chart in which the real rates of economic growth of China, Japan and the U.S. are plotted against their respective real GDPs per capita. As expected, there is a negative relationship.
- However, we note that China is currently still in the range of real GDP per capita that permitted high rates of growth for both Japan and the U.S. Perhaps when Chinese real GDP per capita reaches US$30,000 in 2020 prices the Chinese real rate of economic growth will decline to below 5%.

Rate of Growth of GDP vs. Level of Real GDP per Capita: China, Japan and the U.S.



Concluding Remarks

- Without economic globalisation and accession to the World Trade Organisation in 2000, the Chinese economy would not be where it is today.
- The long-term prospects of the Chinese economy are on the whole excellent. However, it will be domestic demand-driven rather than export-driven. Technical progress, or growth in total factor productivity, will also become an important source of economic growth.
- It is essential for the Chinese economy to maintain openness. Self-reliance should not be equated to total self-sufficiency. We should always remember it is dual circulation and not mono-circulation.