

GERGELY SALÁT

A MEDIUM-TERM OUTLOOK FOR THE CHINESE ECONOMY

A KÍNAI GAZDASÁG KÖZÉPTÁVÚ KILÁTÁSAI



MKI POLICY BRIEF

Summary: In 2023, the Chinese economy exhibited mixed results, with analysts correspondingly divided between two extremes regarding the future of the Chinese economy. One viewpoint suggests that China will continue its rapid growth and will soon surpass the United States, while analysts of the opposite opinion argue that China is vulnerable and could collapse at any moment. The assessments are also influenced by propaganda, making clarity even more challenging. This analysis examines the reserves of the Chinese economy, the growth factors and opportunities that are still available, and how they affect the medium-term prospects of the country. Extensive and intensive growth factors, significant governmental leeway, the resilience and flexibility of the society, the central role of innovation, and the peculiarities of the Chinese economy indicate that China can continue to grow in the coming decade. However, the pace of expansion might decelerate further.

Keywords: China, Chinese economy

Összefoglalás: A 2023-as évben a kínai gazdaság vegyes eredményeket produkált, s ennek megfelelően az elemzők két véglet között mozognak a kínai gazdaság jövőjével kapcsolatban. Az egyik véglet szerint Kína folytatja gyors növekedését, s hamarosan megelőzi az Egyesült Államokat, míg a másik szélsőséges vélemény szerint Kína sérülékeny, és bármelyik pillanatban összeomolhat. Az értékeléseket a propagandaszempontok is befolyásolják, ami még nehezebbé teszi a tisztánlátást. A jelen elemzés azt vizsgálja, hogy a kínai gazdaság milyen tartalékokkal rendelkezik, milyen növekedési tényezők és lehetőségek állnak még rendelkezésére, és ezek milyen hatással vannak az ország középtávú kilátásaira. Az extenzív és intenzív növekedési tényezők, a jelentős kormányzati mozgástér, a társadalom tűrőképessége és rugalmassága, az innováció központi szerepe és a kínai gazdaság sajátosságai abba az irányba mutatnak, hogy az elkövetkező évtizedben Kína tovább növekedhet, ugyanakkor a bővülés üteme tovább lassulhat.

Kulcsszavak: Kína, kínai gazdaság

Introduction

In 2023, assessments of the state and prospects of the Chinese economy fluctuated between two extremes. When at the very end of 2022, China [lifted](#) its zero-COVID policy and the restrictions that came with it after almost three years, many analysts expected that, as in other parts of the world, there would be a bounce-back, with the population [catching up](#) on its deferred consumption and companies finally making new investments, and as a result, the Chinese economy would return to its pre-pandemic growth path. The data for the [first quarter of 2023](#) - notably a GDP growth of 4.5% - showed that this

rebound had already begun, and the forecasts based on them were very optimistic. However, the [second-quarter](#) data were a major disappointment, with GDP growing by 6.3% year-on-year, a particularly poor result given that the 2022 base was extremely low due to the closure of major cities (such as Shanghai) last spring. In the second quarter, growth was only 0.8% compared to the first. At the time, many experts and institutions lowered their growth forecasts for this year, calling for [reforms](#) and coming up with a wide range of disaster scenarios. The [third-quarter](#) data already pointed to a positive turnaround, with a growth of 4.9% beating analysts' expectations and making the [official annual target of "around 5%"](#) realistic. Other data (including exports, consumption, investment, etc.) have been similarly volatile over the year, and the overall picture is mixed. This has triggered the usual speculation regarding the growth prospects of the Chinese economy, and opinions are influenced not only by analysts' different attitudes but also by the fact that the issue has become politicised, with forecasts regarding the future of the Chinese economy now being used as a tool for political propaganda and influence by all parties concerned.

Scenarios

In this politicised space, two extreme views on the future of the Chinese economy tend to emerge. The first is that the economy of the East Asian giant is unstoppable. Despite small blips such as the current one, China's growth rate will remain well above the world average for the foreseeable future, and it will soon [outgrow](#) the United States and [achieve](#) an economic hegemony that will make it possible for it to occupy a dominant position in [all spheres of](#) life (military, diplomacy, culture, etc.), similarly to the position the US has at present (or at least there is a real chance for this, which is why the members of the US alliance system must do everything in their capacity to stop this growth and contain China). The view at the other extreme is that China is a giant [on feet of clay](#), which could collapse at any time. The Chinese growth [bubble](#) will burst sooner or later, and the country will be mired in its own problems and possibly even collapse. The best-known exponent of the latter view is the American analyst Gordon G. Chang, who [in his](#) 2001 [book](#) *The Coming Collapse of China* predicted that China would fall apart in 2011, and when that did not happen, he pushed the date to 2012, and when that did not happen either, he began to [state](#) (now without a deadline) that China would sooner or later have a revolution that would sweep away the Communist Party. More subtle versions of this view, for example [about being trapped](#) in the [middle-income](#) trap, appear every time adverse data are published on the Chinese economy, with many drawing conclusions from quarterly figures.

There is a particular contradiction in mainstream Western thinking regarding forecasting. On the one hand, [political action](#) is largely based on the assumption of China's unstoppable development, which is why the US has declared a trade war and a technological blockade against Beijing and is trying to organise China's neighbours into an anti-China alliance, even naming Beijing as the number one challenger in [its national security strategy](#). The anti-China policy of the US, which enjoys bipartisan support, is also followed with varying degrees of enthusiasm by its allies. Even those who are less enthusiastic (e.g. Europe's [more realistic](#) leaders and the economic leaders interested in good relations with China) do not question the basic premise that China

is set for further significant growth and should be reckoned with as an increasingly powerful world power. At the same time, the Western press and various analyses from the intersection of politics and research almost constantly report on China's economic [difficulties](#), its [insolvable problems](#), and its expected [stagnation](#). This is both a sign of wishful thinking and a kind of self-fulfilling prophecy because if the outside world believes that the Chinese economic miracle is over - or that it will soon be over - and that it is therefore not worth investing in it or thinking about long-term cooperation, this in itself will harm China's prospects. The contradiction of why, if China is being crushed, or at least globally denigrated by its own problems, it should be the number one threat, is not addressed.

According to the problem-focused estimates, the negative news for 2023 (including the *de facto* bankruptcy of major [property developers](#) (Evergrande, Country Garden), in addition to the disastrous second quarter figures) is already a sign that the [structural problems](#) that have been swept under the carpet are beginning to have an impact. An [ageing](#) society is leading to a [shrinking](#) active population, there is a huge oversupply of [real estate](#) due to imprudent development (which could lead to a bursting of the [property bubble](#)), public sector debt (especially that of local government) is [skyrocketing](#), and public [consumption](#) and [investment](#) is low. The Xi Jinping administration [subordinates](#) everything to politics, [restricting](#) the high-tech companies that drive the Chinese economy, putting less efficient state-owned firms [in the place](#) of the private sector, and stifling innovation and development through party rule. On top of this, the Western technology blockade and other sanctions have begun to take [effect](#), Chinese firms using imported microchips and other sensitive components are in a crisis, and technological development has stalled. The lessons that can be drawn from data carefully culled from the wealth of information available are corroborated for the wider public by colourful reports in the Western press. These present stories that are easy to understand and fit the dominant narrative: the country is full of uninhabited [ghost towns](#), Chinese middle-class people [queue up](#) in Hong Kong banks with bags full of hundred-dollar bills to keep their savings safe, workers in factories [are protesting](#), Alibaba's innovative founder Jack Ma is [being persecuted](#), etc.

Chinese propaganda, on the other hand, [naturally](#) focuses on the [positive](#), trying to minimize or gloss over the negative and emphasizing the country's ability to deal with its problems. This narrative reaches the countries of the Global South, but it is virtually absent from the Western mainstream press, where an almost exclusively negative view of China's prospects is dominant.

The reality, of course, is somewhere between the two extremes. The Chinese economy is indeed facing serious problems: the real estate sector is in crisis, debt levels are unsustainable, demographic indicators are poor, overall productivity is low, and the list of negative factors goes on. At the same time, it is worthwhile to be sober and try to separate the momentary from the long-term trends and rather than focusing on the elements that fit our narrative, concentrate on those that are likely to be important. Of course, this objective approach is [present](#) among the Western economists and [analysts](#) working [for the](#) economic and financial [organisations of the world](#). Their forecasts [are accessible](#), but less so in the media, where sensationalist disaster predictions tend to dominate. It is therefore worth examining the opportunities the Chinese economy has, highlighting those factors - often obscured by the 'fog of geopolitics' - that are worth paying attention to rather than quarterly data. This is what I attempt to do below, without, of course, claiming to be exhaustive.

Considerations for assessing the outlook of the Chinese economy

First, it is a fact that Chinese economic growth **slowed** down considerably in the 2010s, from double-digit growth in the 2000s to around 6% by the end of the 2010s. However, this is a perfectly **natural** process. Growth from a low base can be very fast for a while, but once a certain level is reached, lower growth becomes normal. This has happened in other countries that were once fast-growing. It seems almost certain that the period of double-digit growth in China is over once and for all, and even the most optimistic Chinese analysts do not expect it to return. Slower growth is not evidence of some catastrophe or bad decisions but **of a general** economic law. The Chinese themselves have been expecting this, and talking about accepting the **new normal** has been common.

Second, slower growth does not mean that China has fallen (or will fall) into the middle-income trap. The examples of other East Asian countries show that this **can be avoided**: in the decade after reaching a “middle income” of USD 10,000 GDP per capita, Japan grew by an average of 4% per year, South Korea by 5.5% per year, and China can match this. China reached the USD 10,000 per capita level in 2019, and although 2020 saw a growth **decline** (2.2%) due to the COVID-19 pandemic, the country has already bounced back with an 8.1% growth rate in 2021. The year 2022 ended with another near bottom (3%), but for 2023 the government expects growth of around 5%, and the latest data suggest that this is **sustainable**. The pandemic years behind us make it difficult to see clearly, but for the time being it does not appear that China has stagnated after reaching the USD 10,000 level.

Third, the fact that China has not even exhausted its reserves of extensive growth improves the growth outlook. 36% of the population or 500 million people still live in **rural areas**. Agriculture does not need such a large labour force, so it is expected that in the next decade, a few hundred million more people will move to **urban** areas, where they will switch from low-productivity agriculture to higher-productivity industry or services. If nothing else, this process alone would sustain a considerable rate of growth. This will also **offset** the much-touted demographic decline until roughly the middle of the 2030s, with **urbanisation** outpacing ageing. Thus, the impact of the latter will be less pronounced in the medium term. Although China’s population has only been declining since last year, the proportion of the working-age population in the total population has been **falling** year on year for a decade, and while this has played a role in slowing economic growth, it has not caused a disaster.

Fourth, what makes the forecasts most uncertain is the impact of **innovation**. China is in the unique position of having development based on both extensive and intensive factors, and the government intends that as the former exhausts, the **latter** should take over as the economic **engine**. The Chinese government and society are turning to scientific and technological progress with almost religious devotion, reminiscent of the public mood in the West or the Soviet Union decades ago, and the scepticism and fear that this implies is absent. Twenty years **ago**, China spent 1.1% of its GDP on R&D; **today** it spends over 2.5%, and as GDP itself has increased several times over, this means exponential growth. China spends the second largest amount on R&D in the world after the US, and the difference between the two countries is not significant (in **2022**, the US spent USD 679 billion, while China spent USD 551 billion). Research results are

quickly incorporated into the economy in China, and in some areas (high-speed rail, 5G networks, e-commerce, fintech, etc.) China is the absolute world leader. Innovation is expected to continue to [contribute](#) an increasing amount to economic growth. If the performance of the so-called “old economy” (heavy industry, construction, coal mines, etc.) declines while the [weight](#) of the “new economy” (high-tech, services, etc.) [increases](#), this may lead to moderate economic growth in the short term, but the shift towards the “new economy” will offer significant growth potential in the long term. Therefore, in the case of China, national GDP figures often mask more than they reveal.

Fifth, debt is often cited as a major problem for the Chinese economy. The total debt of the various players [exceeded](#) 280% of the GDP in the third quarter of 2023, which is a bad figure indeed. However, the external debt of the country is [only](#) around 14% of its GDP, meaning that the players in the Chinese economy are borrowing from each other. In addition, most of the loans are taken out by local governments and state-owned enterprises from state financial institutions, so the huge debt burden is largely made up of Chinese state actors owing money to [each other](#). Therefore, the debt level could be significantly reduced through administrative intervention, but this is not something that is being pursued at the moment, as debt is both an important measure of the performance of a company or local government as well as an orientation force. Writing off debt would send the wrong message. However, there is a lot of room for manoeuvre here, too, and the debt-to-GDP ratio in China should not be compared with that of other countries because of the specific structure of the debt.

Sixth, the Chinese state has the tools at its disposal to make administrative changes that can give a further boost to growth. For example, the flow of rural people into cities has been [restricted](#) by legal means since the 1950s, and while people can move freely around the country, it is not possible to settle, become a city resident, or buy property without meeting many strict criteria. [Lifting](#) these restrictions would solve the problem of the oversupply of real estate, as it would be possible to bring tens of millions of new buyers into the market at the stroke of a pen. (This will not happen overnight due to the risk of overburdening the urban infrastructure, but [changes](#) are slowly taking place). Many China-sceptic foreign analysts do not reckon that the Chinese state operates differently from the West and has much more room for manoeuvre to take the necessary steps.

Seventh, the high tolerance of the Chinese society has traditionally contributed to the government’s wide room for manoeuvre. It is often suggested that if economic growth were to stagnate or a major crisis were to [break out](#), China [would experience](#) a “revolution of rising [expectations](#)”. A frustrated population would not accept it if the rapid growth that has been the norm for decades were to come to an end. However, historical evidence shows that the Chinese can endure very serious hardship and only in extreme cases will they challenge power. The Chinese system has survived many crises, and there is [no](#) evidence so far that its survival is threatened.

Prospects

All of the above factors point to the fact that the Chinese economy is not yet at risk of stagnation or a near-stagnation slowdown. Of course, growth in China is not linear, there will be better and worse times (we are currently in a worse period), but the

coexistence of extensive and intensive growth factors and buffers, the government's wide room for manoeuvre, the emphasis on innovation and other factors should allow for continued relatively rapid (albeit gradually slowing) growth for at least another decade. In practical terms, this means that GDP per capita could grow to USD 20,000 by 2030, and China could catch up with the US in terms of economic size by around 2035. By then, however, there is a good chance that growth will have fallen to the level of the US, as urbanisation will no longer be able to compensate for the demographic decline, and an era could begin in which the two superpowers are neck and neck, with neither significantly outpacing the other.

This is, of course, if, in Xi Jinping's words, neither a "black swan" (an unforeseen and low-probability event with extreme consequences) nor a "grey rhino" (a known and obvious high-impact threat that is ignored) disrupts global processes. The main lesson of recent years is that such events can happen at any time.

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