

China Economic Update

by NAB Group Economics

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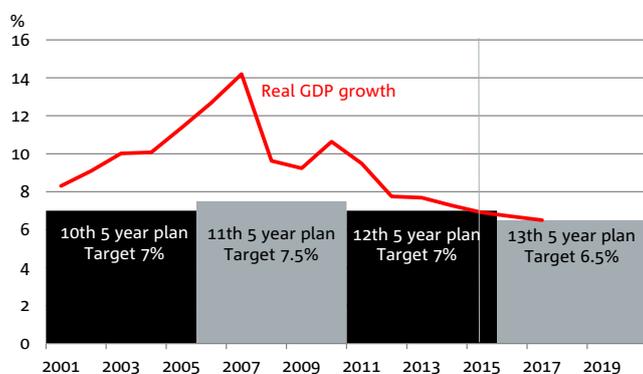
China signals weaker growth but population pressures add downside risk

China's main leaders met in late October, holding the fifth plenary session of the 18th Communist Party Central Committee (or Fifth Plenum). The meeting will go some way towards shaping the 13th Five-Year Plan – the guide for China's economy and policy objectives between 2016 and 2020. The full details of the plan will be released following the National People's Congress in March, however the communique following the Fifth Plenum has signalled a few key measures.

Latest plan signals (slightly) slower economic growth

A key component of the previous (12th) Five-Year Plan is expected to carry over to the latest one – namely the goal of doubling the size of China's economy between 2010 and 2020 – which was reaffirmed in the Fifth Plenum communique. Based on our forecast for growth in 2015 at 6.9%, achieving this target would require an average annual growth rate of just over 6.5% over the five year period.

Slowing economic trends bring growth closer to target than under previous five-year plans



Source: CEIC, NAB Economics

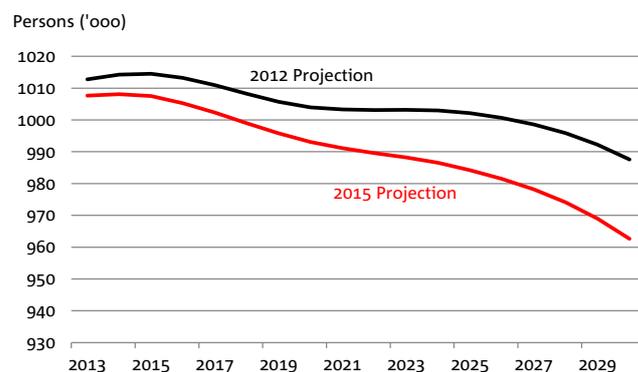
While the Fifth Plenum documents did not specifically state a target rate of growth, President Xi stated that an annual growth of 6.5% would be required for China to "build a moderately prosperous society" by 2020 (compared with a target of 7.0% over the course of the 12th Five-Year Plan).

The Fifth Plenum communique also emphasises the importance of transitioning China's growth model – focussing on domestic consumption, services and strategic innovation. That said, several observers have noted that there was less emphasis on reform in this document when compared with 2013's Third Plenum – raising some concerns around the Government's appetite for reform (particularly following June's share market bubble burst).

In some respects, the direction of the move is more significant than the figure – which appears almost implausibly high – although it points to further slowing in

China's economy. In part this reflects a reduction in the potential growth of China's economy due to population trends. The 2015 edition of the UN population projections paints a more negative picture than the 2012 edition – with China's working age population set to fall more rapidly over the next few decades.

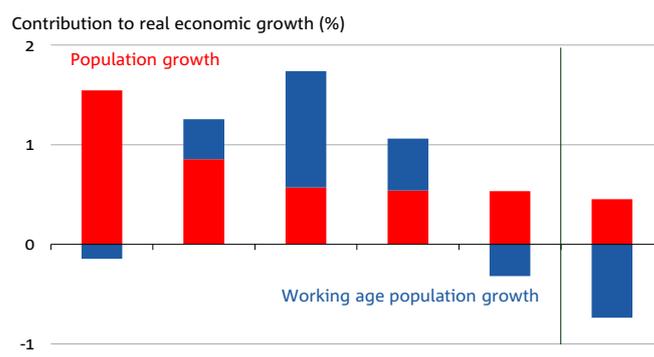
The latest UN population projections point to a more rapid decline in China's working age population



Source: UN population database, NAB Economics

Over the period of the 13th Five-Year plan, the impact of China's shrinking working age population will shave around 0.7% a year from economic growth (compared with -0.3% in the five years to 2010 and a contribution of 0.5% in the five years to 2005) – meaning that productivity gains will become increasingly important to underpin growth.

The shrinking working age population will increasingly constrain China's economic growth



Source: CEIC, UN population database, NAB Economics

Under NAB's forecasts, China's economic growth is expected to slow from 6.7% in 2016 to the Five-Year Plan target of 6.5% in 2017. With further demographic pressures, reaching the target growth rate over the period is likely to be challenging – meaning that the significance of the lower target in the 13th Plan may be largely symbolic.

The end of the One Child Policy is unlikely to have a major impact on the demographic trends

The looming working age population pressures may have contributed to the removal of China's deeply unpopular One Child Policy. Introduced in 1979, the policy contributed to the current demographic trends, although it did not solely cause them – as birth rates were already declining across the 1970s. The policy has been revised numerous times across the past few decades – most recently in 2013 – when couples where one partner was an only child were permitted to have more than one child. Relatively few couples sought a second child following this policy relaxation – extra births were estimated in the tens of thousands in 2014, rather than numbers in the millions that may have been hoped.

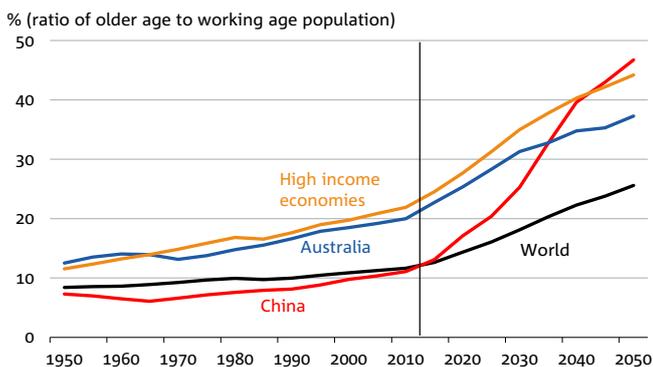
The latest change (once it is ratified at the National People's Congress and implemented as law) will effectively create a two-child policy – China's Family Planning Authority expects around 90 million couples could be impacted by the change – but this will not necessarily trigger a baby boom in China, with many demographers arguing that single child families have become a cultural norm. The Shanghai Academy of Social Science argues that this change may only result in a baby boost (only a modest increase in the birth rate), citing cost and societal pressures as significant constraints.

Even if the policy change resulted in a significant change in birth rates, it will take a long for this policy to impact the working age population – 2030 at the earliest (allowing for 15 year olds born this year to enter the workforce) and later for more highly educated workers (critical for the productivity gains necessary to sustain China's economic growth).

Shifting the older age burden back to the state

An inevitable impact of China's demographic trends is an increase in the older age dependency ratio – the ratio of the retired population to those of working age. In 2015, China's older age dependency ratio is around the global average, and well below the trends of higher income economies. That said, the declining working age population and ageing trend will see the older age dependency ratio rise significantly over the next few decades – exceeding the level of Australia before 2040.

China's older age dependency ratio set to climb over coming decades – increasing the burden on workers



Source: UN population database, NAB Economics

The Fifth Plenum communique announced that China's Government will provide guaranteed state funded social security for its older aged population. At present, social security coverage is highly disparate – with some receiving employer funded schemes, others from local governments while some receive nothing at all – often exacerbating existing income inequality. Chinese government employees receive a guaranteed pension which can be as high as 95% of their salary, whereas private sector workers receive closer to 40%, with the added burden of an 8% salary contribution to a retirement fund – often referred to as the 'dual track' system (The Diplomat).

While the full details of the proposal are limited – including how the scheme will be funded – the proposed changes will create a more uniform system for China's workers – with the People's Daily announcing that the Government will use state-owned capital to augment existing social security funds.

In addition, China's Ministry of Human Resources and Social Security has proposed a gradual increase in the retirement age over time – noting that at present the average retirement age is below 55 years – with the Ministry highlighting the risk of China getting old before it gets wealthy.

Conclusions

In line with our forecasts for slowing economic growth, the target rate of 6.5% a year to 2020 looks to be far more challenging than the previous targets of China's five year plans – given the negative impact of China's demographic trends. That said, the main significance of the lower target (when compared with the 12th plan) may be largely symbolic – in line with the political rhetoric of the 'new normal' of slower growth from 2014.

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