

# CHINA ECONOMIC UPDATE DECEMBER 2018



Turning 40: Charting the rise of China since reform and opening up

NAB Group Economics

Mid-December marks the fortieth anniversary of a critical change in China's economy. The Third Plenum in 1978 saw China's economic planning change course, transforming the country over four decades from a small, closed and still heavily agrarian society to a global powerhouse – and in the process, fundamentally changing the shape of the global economy and international relations as well.

## DENG CHANGES COURSE, SHIFTING INDUSTRY PATTERNS

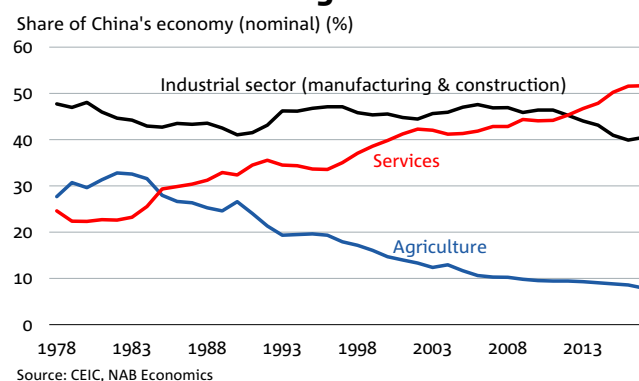
In December 1978, China's Communist Party held the Third Plenary Session of the 11th Central Committee – which saw the rise to power of Deng Xiaoping as paramount leader and the official start of the program of “reform and opening up” (although it is worth noting that some key reforms had already commenced under Deng's predecessor Hua Guofeng).

Some of the key changes included agricultural reforms (which drastically improved output), along with market based reforms, including the introduction of private sector firms in the industrial sector, opening the economy to international trade and foreign investment and the creation of Special Economic Zones (which have been key engines for growth over recent decades). These reforms fundamentally transformed the shape of China's economy.

In 1978, agriculture accounted for over a quarter of China's economy, and this share rose slightly in the next few years as reforms boosted output from the sector. However, the rapid growth in the industrial and services sectors saw agriculture's share drop away from the early 1980s onwards – down to 8% of GDP in 2017.

## CHINA'S ECONOMY BY INDUSTRY

### Services now the largest sector

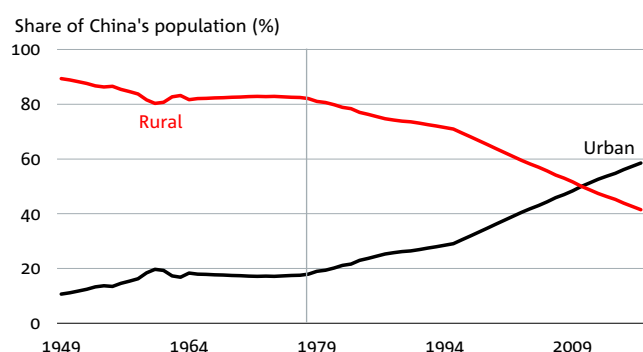


Given China's dominant role in global manufacturing, it is perhaps surprising that the industrial sector has a smaller share of China's economy today than in the late 1970s – having lost share across much of the 1980s, gained share back in the 1990s (as the country rapidly industrialised, becoming the centre of global manufacturing) before declining once again from 2011 onwards.

This largely reflects the spectacular growth of the services sector. Services accounted for less than a quarter of China's economy in 1978, as opposed to over half of the economy in 2017. While in part this reflects the modernisation of China's economy more recently – as it moves away from an investment based model of growth towards one based on domestic consumption – it also reflects the incredible urbanisation of China's economy over this forty year period. The mass migration of people from rural areas to cities (one of the largest movements in human history) created enormous demand for services in these centres. In 1978, less than 20% of China's population lived in cities, but this share rose to almost 60% in 2017.

## POPULATION PROFILE BY LOCATION

### Urbanisation driven by mass migration

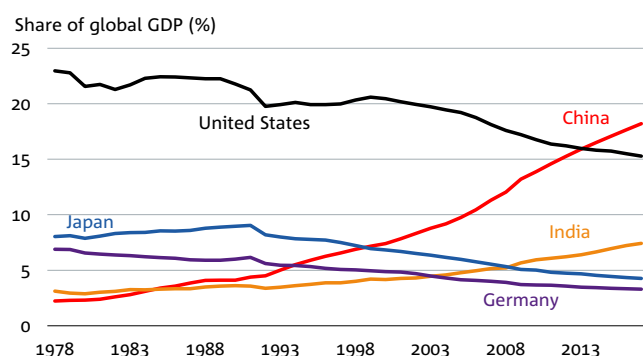


Source: CEIC, NAB Economics

## THEN AND NOW – HOW CHINA’S ECONOMY HAS CHANGED?

Despite having the world’s largest population in 1978 (at around 22% of the global total), China was a very small economy. Ranked thirteenth overall, it accounted for around 2.0% of the global economy, dwarfed by advanced economies such as the United States, Germany, France and Italy, as well as the then Soviet Union.

## CHINA NOW THE LARGEST ECONOMY... China overtook the US in 2014



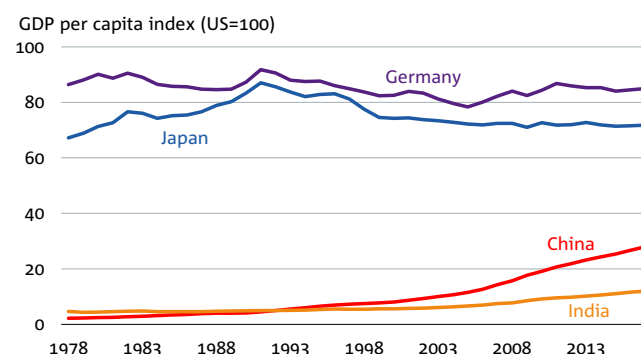
Source: IMF, The Conference Board (pre-1980), NAB Economics

China’s One Child Policy started in 1979 – which further slowed an already declining birth rate – meaning that China’s share of the global population has slowed significantly over the past forty years, to less than 19% in 2017. The slowing birth rate also provided China with a boost to growth via the “demographic dividend” as the working aged population’s share of the total expanded – from around 58% of the total in 1978 through to a peak of almost 74% in 2010. Since this time, the share has declined – as the population as started to age – with the demographic profile switching from a “dividend” to a “burden”.

Today, China is the world’s largest economy (based on purchasing power parity), accounting for just over

18% of the global total. Its share of global population is relatively similar which means that on a per capita basis, China is close to the global average (having been extremely poor prior to the 1978 reforms). This highlights the fact that China is only part way through its long term economic development, as it still lags well behind other countries, such as Japan and South Korea, that followed a similar model. Whether it can achieve such a longer term target (given the demographic pressures it will face in coming years) is far from clear.

## ...BUT SMALL IN PER CAPITA TERMS China still lags advanced economies

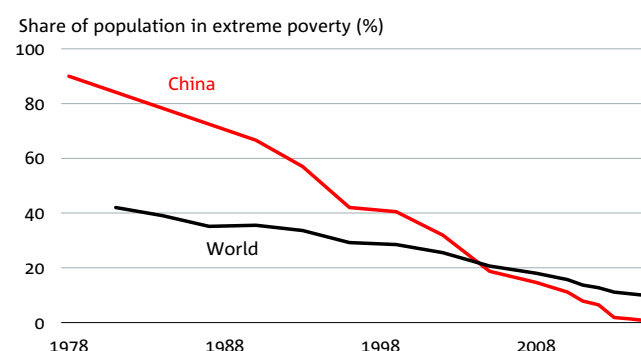


Source: IMF, The Conference Board (pre-1980), NAB Economics

The strong increase in per capita income has improved China’s living standards enormously. According to the World Bank, around 90% of China’s population were living in extreme poverty in 1978 – with an income of less than US\$1.90 a day (on a purchasing power parity basis in 2011 prices). This rate has steadily declined since this time, falling below 1% in 2015. Other poverty measures have also fallen sharply over the past few decades.

## CHINA’S DECLINE IN POVERTY

### Dramatic improvement over past 40 years



Source: World Bank, NAB Economics

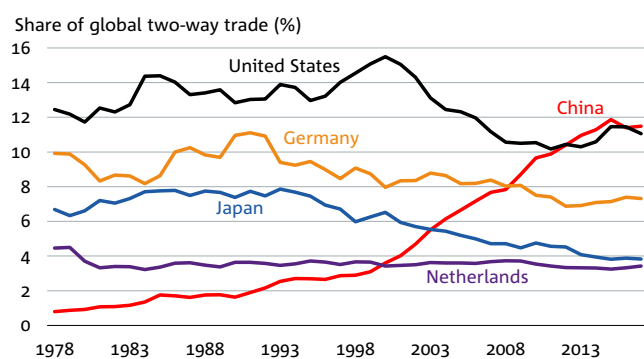
## CHINA HAS BECOME A MAJOR FORCE IN TRADE

As China rapidly industrialised, global markets were essential for its manufactured goods. The early stages of its growth model relied on financial repression – which provided a pool of low cost funds to support investment but limited domestic consumption. The incredible growth in China’s trade provided a key platform for its economic development, but also created political tensions – culminating more recently in the trade dispute with the United States.

In 1978, China accounted for just 0.8% of global two-way trade (exports and imports combined), however this share has grown strongly, particularly following China’s entry into the World Trade Organization in 2001. China became the world’s largest exporter and second largest importer in 2009.

## GLOBAL TRADE

### China has rapidly become a major force



## CONCLUSIONS

A range of policies implemented over the past forty years have contributed to the development of China’s economy over this period. That said, the reform and opening up program marks a clear starting point for this development – there is little doubt that China’s economy would not be as large today had it continued its isolation from the rest of the globe.

Although China is now a large global economy, its still low per capita income highlights the long way it has to go in terms of economic development. It remains to be seen whether China can overcome longer term policy and demographic constraints to reach advanced economy levels.

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