China's (Rough) Economic Trajectory to 2050

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Key Points

- Since the Chinese economy has matured and the policy trend is established, long-term forecasting should be more accurate. It's still imprecise, of course, and vulnerable to any sharp domestic change.
- The COVID-19 pandemic and recovery interrupted an economic slowdown that began in 2011 and will resume in 2024–25. China will still outperform in the 2020s, but its trajectory will be unmistakable by the end of the decade.
- The 2030s will be worse. Aging will be the principal reason, augmented by a large debt burden and (unless lifted) self-imposed constraints on innovation. In the 2040s, these factors will effectively bring growth to a halt.

Normally, a country's short-term economic outlook is clearer than its long-term outlook. As of early spring 2023, however, there are many questions about China's short-term outlook. How sharp and durable will the rebound be from lifting the "zero-COVID" policy? Can Chinese consumers actually lead growth? Will the new government of Xi Jinping loyalists allow even a bit of pro-market reform? Answering these questions is guesswork, notwithstanding the many people constantly guessing.

China's long-term outlook is actually more sure, as its economy is far less dynamic than it was 15 years ago. There's a dispute over whether it could have stayed dynamic for longer, but in any case, loss of dynamism has at least one benefit: It makes forecasting more accurate. While predicting in 1979 how the People's Republic of China (PRC) would look in 2004 would have been extremely difficult, predicting today how the PRC will look in 2048 is far easier. This also sidesteps the issue of data quality, as a generation of weakness is impossible to hide.

The base case: After the post-COVID surge fades in 2024, China will return to the slowdown path it walked in the 2010s. By the 2030s, it will be old before it can reasonably be considered rich. In the 2040s, it will keep getting older and stop getting at all richer. This may seem a bearish view; it's not. The bear case moves stagnation closer, while the bull case puts it off for longer. The PRC's fundamentals, featuring but not limited to demography, ensure stagnation, then decline.

There is certainly potential variation in performance, chiefly from domestic economic policy. A quick return to pro-property rights and pro-competition reform would make the PRC much more prosperous. There appears to be no chance at all of this happening while General Secretary Xi remains a Mao Zedong–like figure. He intends to remain so for as long as possible, and there is no guarantee his eventual successor will change the policy set. Those continuing to advertise China's economic future may be counting on the country producing technological breakthroughs, but Xi's own decisions make this unlikely.[1]

Ways to Be Wrong

Delineating specific phases of China's economic trajectory guarantees mistakes. It's not just that one can err about when outperformance in gross domestic product (GDP) ends. It's also that shifting from global outperformance to in-line performance to underperformance is gradual and initially ambiguous rather than stark. And global performance itself can shift. Here, decades of the PRC's competitive success against a changing set of industrial peers will ultimately give way to being outpaced for a sustained period by a set of peers (whoever these are). This just assumes the existence of some comparatively successful economies, somewhere.

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The biggest variable is possible pro-market reform. Better economic organization can sustain growth for longer, despite weak fundamentals. Sharper rural land rights would boost rural productivity, income, and consumption, addressing longstanding weaknesses. Allowing more (genuine) corporate competition would accomplish similar things in cities. Reform would give the PRC a larger, more prosperous economy than it otherwise would have, starting from the time of implementation and continuing until any significant recentralization.

Fresh on the heels of Xi's second coronation at the 2022 Communist Party Congress (CPC) and 2023 National People's Congress, it's almost impossible to imagine pro-market reform this decade. The 2032 CPC, when Xi is 79, seems like the first notable opportunity, and even then, there's hardly a guarantee. China at that point will be considerably older, more indebted, and possibly even more centralized with regard to innovation. Reform would still help, but it would be helping a slower, weaker economy.

For a large economy, international factors are less important. Cyclical fluctuations in major partners only matter for a year or two. Substantial de-globalization, if it occurred, would matter more. While any de-globalization may be partly caused by the PRC, it involves a number of disparate international factors that are hard to fully describe, much less anticipate. To simplify, domestic pro-market reform should be viewed as a major bullish shock to the base case, de-globalization as a smaller bearish shock.

A final way to be wrong would be if Chinese technology development charges to the rescue. This is improbable. To shift the PRC from in-line performance to outperformance or from underperformance to in-line performance, innovation must be superior to competitors' for long enough to have a persistent economic effect. As evidenced by Japan's stagnation, merely being an innovator for several important technologies is not enough. Either the advantage in those technologies must be sustained or innovation must be spread widely across industries and time.

The PRC is not organized to do this, and the failure is conscious. While the party would like broad, sustained technological advantage, private property rights have been made vulnerable and competition with state enterprises is anathema. Artificial intelligence, for instance, is highly appealing if under state control, but it is a foreign threat if not. Xi spent three years attacking his own private sector, essentially for being too successful.[2] These are not prime conditions for innovation even if resource mobilization is impressive. When China bulls talk about a technological revolution, what Xi hears first is "revolution."

2011–28: Current Slowdown

The PRC's economy began to slow after the initial effects of the 2009 credit binge wore off, and it continued to do so throughout the 2010s. The main problem at that time was debt. Debt represents unproductive use of past capital causing unproductive use of present and future capital in the form of excess interest payments. This amount exploded in 2009–10 and has continued to rise since.[3] It, however, is no crisis in the making. Chinese debt is largely self-funded, erasing external risk. Domestic risk is also minimal, because the financial system is noncommercial in nature, and parties do not have the option of withholding credit and freezing the economy.

COVID-19 introduced a new phase, in two ways. Its obvious effect was to create volatility in growth that even the stability-obsessed National Bureau of Statistics did not hide. Looking forward, growth should sharply accelerate throughout 2023 and into early 2024. By mid-2024, though, it will return to the pre-COVID path. GDP will drop below a 5 percent annualized pace late in 2024 and resume its deceleration from there. Another, less pronounced blip could occur if stimulus is used to grease the wheels for the 2027 CPC, but any such boost will be temporary and vanish by early 2029.

The second shift heralded by COVID-19 was from primarily capital constraints to primarily labor constraints. The most important factor starting in 2024 and lasting for at least a generation is aging. This is receiving a great deal of attention, clouded by PRC population data being flawed at least since interprovincial migration surged in the mid-1990s. The party's stability obsession is and will be an incentive to hide deterioration. But the medium-term economic impact will be impossible to hide, and it will ensure true GDP growth falls below 4 percent (and eventually further).[4] A large silver lining: Aging reduces the scale of necessary job creation, making slower growth less threatening.

After the 2023–24 acceleration, therefore, China will return to fairly orderly economic deceleration. The looming end of outperformance will not in itself pressure decision-making in Beijing in 2025–26 or for several years after. The world's second largest national economy will still be growing faster than the first (the US) or the third (Japan) or the biggest supranational entity (the EU). The point is merely that China will not sweep past America to become the global economic leader. (That it might may be a more common belief outside the PRC.)

Beijing began conveniently de-emphasizing GDP as early as 2013, as growth prospects faded. The shift was illustrated in the passive economic response to the pandemic. New national goals may include sector or regional economic supremacy. Regionally, data on the Belt and Road Initiative show it no longer has (or never had) truly global pretenses.[5] Among large developed markets, relations with Australia and the US, at least, have changed. New priorities for China's relationships will emerge over the next several years. These will of course be interactive, with partner behavior mattering. But China will up its game in courting those it values most.

By sector, the PRC's attempts at forward identification of rapidly growing industries may be de-emphasized or modified to some extent. Some sectors seen as valuable pre-pandemic will fall by the wayside, as is usual with the five-year plans, and a slowing economy makes it infeasible to have as many genuine priorities as before. The replacement approach may feature pursuing vital roles in supply chains identified as valuable after they begin to mature. Xi pointed to this in internal speeches starting in 2020.[6]

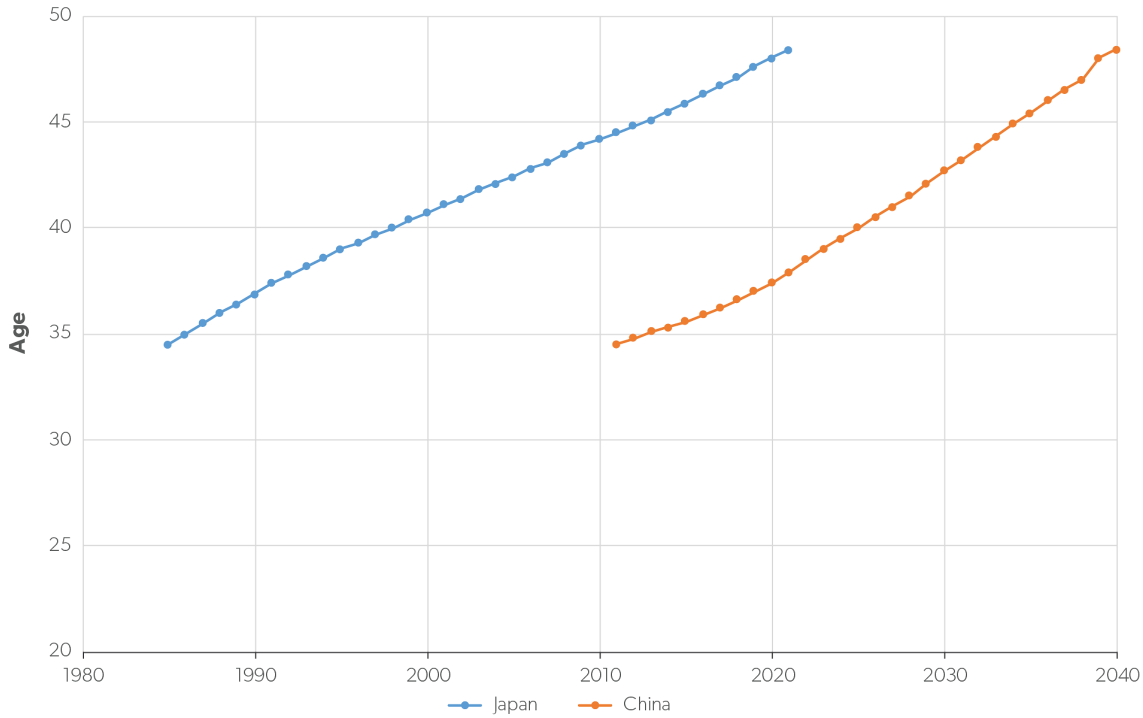
It's almost certainly the case that, as fast growth for job creation is slowly abandoned, the PRC's economic goals will become harder to verify. Barring a threat to Xi, the impetus for dramatic, sharply defined steps will not appear until late this decade, if then.

2029–42: Rich-Country Growth, Still at Middle Income

There's a general consensus that China will return to its pre-COVID gradual slowdown. The consensus collapses regarding how far the slowdown will progress. The bullish view has a floor below which China will not go—say, 3 percent GDP growth.[7] This is not how things work. Economies are not guaranteed to grow because they have previously grown for a long period. Objective conditions say Chinese growth is headed toward zero. On the way there, the pace will resemble that of much richer countries.

After any stimulus associated with the 2027 CPC, forecasting for the ensuing five years will clarify the onset of a new era. The economic trajectory may not initially look much different than 2026, but it will already be quite different

Figure 1. Median Age, Japan vs. China



Source: United Nations, Population Division, Median Age of Population, https://population.un.org/dataportal/data/indicators/67/locations/156,392/start/1970/end/2053/table/pivotbylocation.

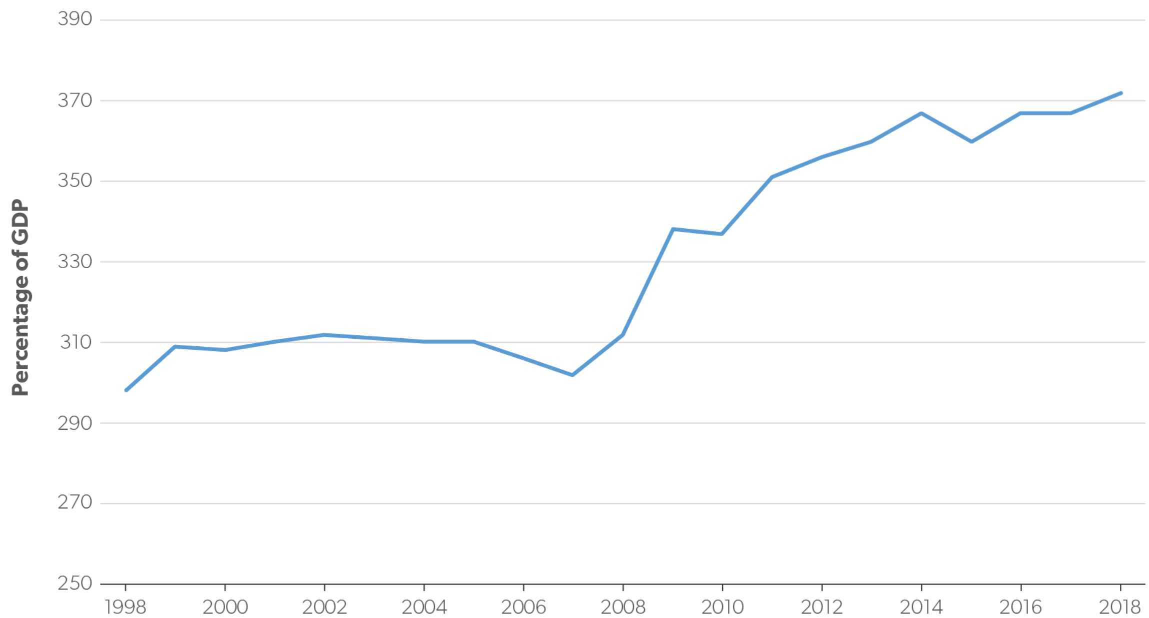
than 2019. The most apt comparison may be early 21st-century Japan (Figures 1 and 2). Note that for Figure 2, in the third quarter of 2022, China's outstanding credit was 296 percent of GDP (up from 142 percent in 2002). China's aging will accelerate briefly, then deteriorate more slowly. At period end, median age will be near Japan's 20 years earlier. The size of the debt burden is more amenable to policy, but on current trends, the PRC's debt will be similar to Japan's in the late 2010s (that is, pre-COVID). Beijing will try to follow Tokyo's path in substituting innovation for labor and capital and will join Japan in falling short.[8] Barring reform, limited resources will also constrain growth.

The result is that true GDP growth will start this period below 4 percent annually[9] and end it as frictional—below 1.5 percent annually and possibly near zero. Domestic wealth accumulation will be faster than GDP growth in some years. Without pro-market reform, though, it will also stall, in part due to money leaving the country.[10] The per capita numbers will be better, because population will shrink the entire time, but they will not be good enough to genuinely pull the PRC out of middle-income status. This is because the PRC's GDP per capita is approximately twice its own reported personal income, where the latter in 2022 was less than 10 percent of the most comparable American figure.[11] In short, China gets old before it gets rich.[12]

Below the topline, the PRC's size and capacity for effective incentives will still draw large-scale international economic activity; the change is activity will now also exit at similar scale due to weak fundamentals, slow growth, and still-poor (barring a shift) policy. This will manifest internally in flat aggregate output, with high variance by industry. Oversupply will ease in previous mainstays, such as building materials and ship construction.

Externally, China's powerful dampening effect on global consumer inflation, especially in electronics, will fade away as exports contract modestly. Substantial net de-globalization could worsen

Figure 2. Japan, Credit to the Nonfinancial Sector



Source: Bank for International Settlements, Credit to the Non-Financial Sector, February 27, 2023, https://www.bis.org/statistics/totcredit.htm?m=2669.

that deterioration and even cause outright decline in domestic output. Contrary to claims about China raising global growth because it's above the global average, a falling trade surplus could be a contribution to GDP growth outside the PRC.

Use of traditional commodities—for example, oil, gas, coal, iron, copper, bauxite, soy, and wheat—will remain large but first stall, then contract. Talk of the Chinese yuan replacing the dollar will be shown to be poorly grounded. The yuan can still become a true global currency in this period, but only with reform, and it cannot become the reserve currency. If the US does not defend the dollar's status, there will be no reserve currency, and the yuan could be used by a sizable bloc.

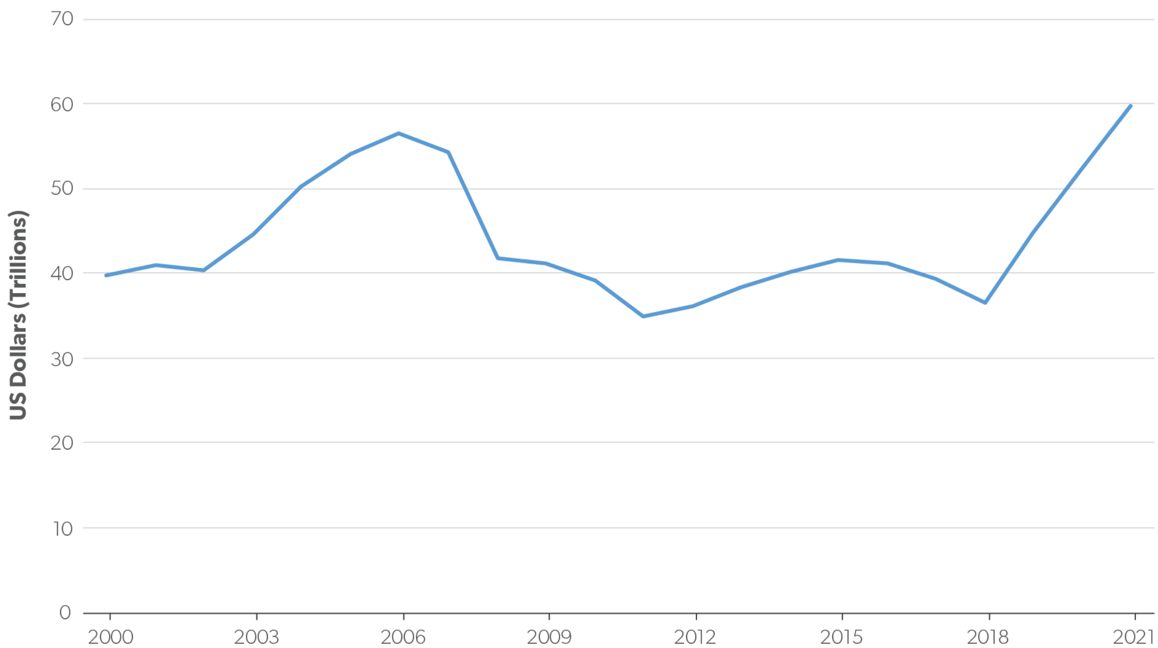
While the period after the 2027 CPC represents an important and multifaceted shift, it is not sudden nor, at the outset, any sort of calamity. Xi may become increasingly frustrated by falling short of personal and national greatness, but there is no curtain dropping by the 2032 CPC. By the end of the 2030s, though, China's relative economic capabilities will have unmistakably ebbed. While military capabilities lag economic ones, they will be either facing indefinite resource scarcity or also fading. At that point, variability in global developments will become less important, because the dominant factor for the PRC will have become its own decline.

2043 and Beyond: Heat Death

That's the good news. Absent reform or a profound reversal of demographic contraction, Chinese growth will be near zero in the 2040s. This will persist indefinitely; there is no sign of any future reacceleration. Unless births quickly rise—for example due to exit from "zero-COVID"—labor force contraction from the 2015 peak will breach 150 million people in the 2040s. Excessive debt accumulation at middle income will have the same weighing-down effect as on any country; there will be no miraculous China exception.

Without reforms that spur competition and enhance property rights, innovation will not outperform sufficiently to sustain growth in an economy the size of the PRC's. Even technology theft and coercion will have a more limited value, since

Figure 3. Sino-American Wealth Gap



Source: Credit Suisse Research Institute, *Global Wealth Report 2022: Leading Perspectives to Navigate the Future*, 2022, https://www.credit-suisse.com/about-us/en/reports-research/global-wealth-report.html.

there will be degradation in the ability to then scale up production using the acquired intellectual property. Beijing will focus on a smaller number of sectors, likely with clear military applications.

Years of intensifying Chinese weakness and the opportunities thus made available will help breed international competitors. Net production shift out of China could be sizable, partly reversing what occurred in 1993–2019. Directly related will be a substantial deterioration in external performance. Aggregate exports will fall, as will inbound investment both for the sake of operating locally and for export. The PRC's dominant role in global commodities trade will gradually unwind (leaving energy, metals, and food exporters vulnerable). This translates to fewer economic partners and a regional focus or two replacing its previous global focus. Far from becoming the reserve currency, the yuan will have a notably smaller role than the euro.

This trajectory will of course seem too negative for some. The refrain "China always solves its problems" is still common. But it stopped being accurate in 2009 when the PRC responded to an externally imposed problem—the global crisis—with a frenzy of financial leveraging that it has yet to correct. It stopped being accurate when the party failed to recognize in a timely fashion the need to reverse the One-Child Policy. And it stopped being accurate with the rejection of pro-market reform under Hu Jintao and continuing, for as far as the eye can see, under Xi.

What About the US?

China descending from outperformance to, eventually, enduring underperformance merely requires some set of economic competitors to be more successful. But one competitor is most important—the US. And Chinese weakness says nothing about American strength. The US has its own economic challenges, also featuring debt and demography. While these are less extensive than the PRC's, the quality of policymaking in the two countries could either widen the gap in America's favor or erase it.[13]

Projecting one country's economic performance for a generation inevitably involves errors; projecting two is that much more fraught. A basic comparison may be instructive. In 2022, the gap between American and Chinese GDP was more than $7 trillion.[14] This gap will continue to narrow through most, if not all, of the 2020s, but only by small amounts annually. It's likely to remain above $4 trillion by 2029. Much of the 2030s will see years where the gap does not shrink. Then it will widen in the 2040s. China will probably never quite catch the US in GDP.

There's at least one caveat: exchange rates. The yuan will probably weaken against the dollar, ensuring American advantage in GDP measured in dollars. If it strengthens, or in the individual years it strengthens, the gap will narrow quickly. The role of exchange rates is the justification for use of purchasing power parity (PPP), a GDP adjustment that boosts China. But application of PPP has multiple, serious flaws. Conceptually, it stems from open markets, which the PRC does not have for capital. Empirically, it is difficult to measure, to the point of absurdity when requiring a price adjustment for all of China compared to all of America.[15] Contemporary PPP adjustments can be dubious; forecasting using PPP borders on pointless.

A third way to compare economic size is national wealth. American wealth is measured by the Federal Reserve, with no official equivalent for the PRC. Credit Suisse provides unofficial data, compiled for dozens of countries since 2000 and close to Fed numbers for the US. (See Figure 3). Here the absolute size of the American advantage began to expand in 2012, to hit $60 trillion in 2021. Without reform, China will not be able to create nearly enough wealth to close this gap, which should remain above $35 trillion and start to expand consistently at some point in the 2030s.

All this presumes at least a mediocre performance for the American economy out to 2050. The US has a long track record of economic success, but the time horizon here is long enough and the conditions are present for an extended period of weakness. It's entirely possible that both the top two economies fade. If the US can maintain the moderate pace of the past 40 years for the next 25, China will only briefly be a true peer, if it becomes one at all.

About the Author

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Notes

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