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China Economy: World's Second Largest

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Summary

- 1. Official figures confirm that China is the second largest economy in the world in nominal US dollar terms. China has been the second largest in purchasing power parity (PPP) terms for some time. But officials and commentators alike have been stressing that China remains a developing country (and this will continue to shape China's foreign policy) and faces significant challenges in maintaining rapid growth in the longer-term.**

Detail

- 2.** The release of official Japanese second quarter data on 16 August confirms what had been widely assumed - that China's economy has surpassed Japan's to become the second largest in the world. In dollar terms Japan's economy was \$1.288 trillion in the second quarter, China's was \$1.337 trillion. Japan's fall to third place occurred despite the strengthening yen, as second quarter growth was much slower than expected - at 0.4% on an annualised quarter-on-quarter basis. Data shows that China's economy was in fact larger than Japan's in the fourth quarter of last year, but seasonal factors were at play (growth tends to be back-loaded in the year) - and Japan's economy regained the No.2 slot in the first quarter of this year. But this time round China seems certain to hold on to the No.2 slot, with growth expected to be around 9-10% this year. [comment: given that China's GDP figures are widely believed to understate the 'true' size of the economy, in reality China's economy likely surpassed Japan's earlier than the second quarter this year].
- 3.** China's rapid economic growth since the 'reform and opening up' process began in 1978 has led to a meteoric rise up the global GDP rankings. In 2005 China's GDP was around the same size as the UK's - this year it is expected to be twice as big. But the gap between No.1 and No.2 remains large. At the end of 2009 China's GDP was around \$5 trillion, compared to the US's \$14 trillion (and combined EU GDP of over \$16 trillion). But many analysts predict China will become the world's largest economy in the next 20-30 years (though surveys suggest a minority of people in China subscribe to this idea).

Comment

4. Most officials and commentators have cautioned against gloating at China's latest step up the global GDP rankings and have instead sought to dampen both domestic expectations of continued rapid growth and international expectations on China to assume a greater role in world affairs. Vice Governor Yi Gang of the central bank recently pointed out in an interview with the state media that despite China's meteoric rise up the global GDP rankings per capita GDP remained relatively low, at around \$3600 (IMF ranks China 98th in the world in GDP per capita terms, World Bank 103rd). If China could maintain 7-8% annual growth rates this decade that would be a strong performance, Yi said. But he pointed out that the rate of growth was bound to slow over time, not least as a matter of simple arithmetic. According to Yi the biggest challenge facing the authorities was maintaining relatively rapid growth rates, given a higher base and longer-term constraints to growth (he highlighted environmental factors, but demographics are also likely to slow growth in the long-term).
5. In seeking to manage global expectations on China to play a greater role in world affairs, an op-ed in the English language China Daily in early August argued that "although China may be rated as an economic giant it is far from being a superpower". China's 'developing country' status would continue to determine its foreign policy. The article pointed out that Chinese exports were still dependent on the processing trade (less than 20% of Chinese exports were domestic brands), 150 million Chinese still lived on \$1 or less a day, research and development only accounted for 1.62% of GDP (low compared to developed countries), per capita government expenditure on education was just \$50 a year, and the United Nations Human Development Index (HDI) ranked China 92nd in the world. But as the Foreign Secretary said on his recent trip to China, "a big house is still big, even if it is made of small bricks".
6. The release on 16 August of the results of a recent joint China-Japan study on relations between the two countries seems to have been timed deliberately to coincide with the economic data. The results (published in an article entitled "Chinese bullish on Japan's future economic growth") showed that 40% of Chinese students felt Japan would be a 'mid-level country with very strong influence' in 2050 - whereas the most popular response in Japan itself was that Japan would be a 'mid-level country without influence'. The results of the survey also showed that the Chinese viewed the relationship with Japan more positively than they did last year - 75% of the Chinese public were 'satisfied' with the relationship and 60% had high hopes for the future (only 40% of Japanese felt the same way). And this year's survey was the first time that the 'Nanjing Massacre' wasn't listed as the first thing that came to Chinese minds when thinking about Japan - it was superseded by 'electrical appliances'. Another op-ed on 16 August argued the poll results demonstrated that although

historical events remained important, more Chinese were willing to look to the future of bilateral ties. But this was nuanced with the remark that "as long as Japan keeps rightist sentiments at bay, there will be a much greater space for relations between the two countries to grow". In that vein, the Japanese Cabinet's decision not to visit the Yasukuni Shrine on 15 August (65th anniversary of Japan's surrender in World War II) has been widely welcomed in China.

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