An Era in Which China Once Again Learns from Japan

Financial Times cites the Citi report and "argues that Japan in the post-property bubble era and China are strikingly similar." Photo shows real estate development in a city in southern China.
Photo: Captain Hook/PIXTA

Nishimura Gota, Columnist, Toyo Keizai Inc.

Foreign observers have begun to point out similarities between the Japanese and Chinese economies. How should we understand the current state of the Chinese economy? What is the issue of "Japanification" that is ongoing in China?

China in a state of intoxication

There was a time when it was said that selling the land on the inside of the Yamanote Line that circles central Tokyo would earn you enough to buy the whole of the United States. This tends to come up as an illustration of what the bubble economy was like in the late 1980s. In retrospect, it makes little sense, and even at the time, there were many who felt it strange. Even so, it is hard to resist when there is some kind of inertia at work in society as a whole.

Nearly 40 years later, China is now likewise intoxicated. According to a February 2023 report by Citigroup Inc. (hereinafter "Citi"), China's property market had reached $65 trillion as of 2020. This is more than the combined property markets of not only the United States but also the EU and Japan. Incidentally, in terms of nominal GDP, China had about $18 trillion in 2021, less than half of the total of about $45 trillion in Japan, Europe, and the United States.

The Japanese bubble occurred during a decline in the potential growth rate and a widening divergence between the real economy and the financial system. Now, China's growth rate is also entering a phase of significant decline.

At the National People's Congress (NPC, equivalent to the Japanese Diet), which commenced on March 13, 2023, the target real economic growth rate was set at a record low of "around 5%." In the previous year, the target was set at around 5.5%, but it fell short of 3.0%. President Xi Jinping's insistence on the "Zero-COVID Policy" to thoroughly contain the spread of COVID-19 infections and locking down Shanghai, the city with the largest economy, acted to suppress it.

Given the low performance of the previous year, there are high expectations that this year's target of "around 5%" is achievable. The Chinese government abolished the Zero-COVID Policy in one go after December 2022 and shifted to a "with Corona" policy. China having successfully weathered the great migration season of the Spring Festival (Chinese New Year), the IMF raised its 2023 growth forecast from 4.4% to 5.2% on January 30.

However, there is no doubt that expectations for growth in the Chinese economy have declined significantly. China has maintained an average annual economic growth rate of 9.9% for 30 years since the Reform and Opening-up began in 1978. No one expects that era will come again. At a press conference on March 13, Premier Li Qiang, who was officially inaugurated at the NPC, said, "It will not be easy to achieve growth of around 5%, and further efforts will be needed."

Prior to the NPC, on February 26, the electronic edition of the British financial newspaper the *Financial Times* (FT) published an opinion article titled "China's economy is looking at a new wave of Japanification." It cites the aforementioned Citi report and argues that Japan in the post-property bubble era and China are strikingly similar.

The commonalities listed in the Citi report are: "(1) an economic growth model driven by fixed asset investment, (2) a reliance on indirect financing (most of the credit is supplied by commercial banks), (3) economic challenges from the United States after becoming the world's second largest economy, (4) divergence between the real economy and the financial system (which encouraged the real estate bubble), (5) the presence of large shadow banks amplifying real estate risk, and (6) declining housing demand and structural problems due to an aging population that are obstructing economic growth." Shadow banks are lending institutions outside the jurisdiction of banking supervisory authorities. A typical example in the case of modern China is the "local government financing vehicle" (LGFV) established by local governments to conduct infrastructure investments and such, while bubble-era Japan had specialized housing loan companies, so-called "jusen" companies.

All of these sound familiar to Japanese people. You could say that this observation brilliantly highlights a certain cross-section of the Chinese economy. Professor Michael Pettis, Guanghua School of Management at Peking University, responded to the FT report by tweeting, "The China-Japan comparisons have come thick and fast in the past two years, as similarities become increasingly clear, but to those who were thinking of China's development model within its historical context, it was obvious well over a decade ago."

"Japanification" as an ongoing issue

"Japanification" is a word frequently featured in financial media around the world. After the Global Financial Crisis (GFC), this concept came into the spotlight as Western economies were predicted to continue to experience prolonged low growth, low inflation, and low interest rates.

Its definition varies from person to person. Some people simply refer to long-term economic stagnation like that in Japan as "Japanification," while others say that it is "a state of economic stagnation and deflation that cannot be overcome even if a low interest rate policy is maintained for a long time."

Of course, the reasons for such a situation vary from country to country, but they have in common that they were triggered by a decline in working-age population (15–64) or in working-age population as a ratio of the total population. When the working-age population ratio, which makes up the bulk of workers and may be termed the "working generation," is high, personal consumption increases. On the other hand, since there are few elderly people, social security costs are suppressed, which is advantageous for economic growth. This is called the population bonus.

During the population bonus period, demand for housing grows significantly on the back of high savings. The problem is that the momentum will continue even after the population bonus period is over. Such a turning point came around 1990 in Japan and around 2005 in the United States. After that, a divergence between the asset market and the real economy, that is, a bubble expansion, has happened in many countries. In the case of China, the working-age population is thought to have peaked in 2011. Ten years later, the danger of a real estate bubble bursting is growing.

Now, China's "Japanification" is in focus again, probably because the total population has started to decline just like the working-age population has. The total population of China at the end of 2022, as announced in January 2023, was 1 billion 411.75 million. That is 850,000 fewer than in 2021.

If population change turns negative, it also means that the population will age. China's population is aging fast, partly due to the influence of the one-child policy. Internationally, people aged 65 and over are counted as elderly, but the Chinese definition is people over 60 years old. According to the latest estimates by the Chinese government, more than 30% of the population will be over 60 years old around 2035. That means the arrival of a Japan-like super aged society. "Japanification," which was previously talked about as a "possibility," has come to be discussed as an ongoing issue.

China's sharp reaction

It is probably because this is such a delicate time that the Chinese authorities have reacted sharply to the FT report.

The spokesperson for this was the *Global Times*, which the Chinese government frequently uses when probing public opinion. The English-language electronic edition of the *Global Times* published a lengthy review titled "Western attacks won't shake stability of China's real estate sector" the day after the FT article.

The article says that "[...] some from the West are still trying to play up the potential long-term risks confronting the Chinese economy by finding fault within its real estate sector," dismissing the FT's point by saying that it "exposes their ignorance."

The *Global Times* acknowledges that there are certain similarities between Japan of the 1980s and the 1990s and China today. It says, "Indeed, there may be some areas of similarity between Japan in its property bubble era and the current Chinese property market, such as an aging population and massive bank credit that has supported real estate expansion. But that doesn't necessarily mean China will follow in Japan's footsteps, as the differences between the two are more obvious than some superficial similarities."

In particular, it said that China is going through a process of urbanization. China's urbanization rate (the ratio of urban residents to total population) reached 65.22% as of the end of 2022. Compared to developed countries that have about 80%, China's urbanization still has room for further development. The article says that many small and medium-sized cities in China are currently accelerating the construction of infrastructure, which will have a significant effect on stabilizing the real estate market.

"Urbanization" has long been the driving force behind China's economic development. The urbanization rate, which was only 7% when the new Chinese state was created in 1949, soared after the start of the Reform and Opening-up policy. In 2011, it exceeded 50% for the first time.

Big cities like Beijing, Shanghai, Guangzhou, and Shenzhen that are referred to as "Tier 1" cities already have permanent populations that have reached their limits. As such, the Xi Jinping administration has continued its policy of guiding rural residents to Tier 3 and Tier 4 regional cities.

Cai Fang, vice president of the Chinese Academy of Social Sciences, the Chinese government's think tank, has said that a breakthrough in supply will come when more rural residents are able to work in urban areas and engage in more productive industries. China's agricultural employment rate in 2021 was 23%. If this is lowered to around 3%, which is the average level in developed countries, nearly 300 million new workers can be used for productive jobs in cities.

Of course, in order to do this, certain conditions on the receiving end must be met. The current urbanization rate is 65%, but only 40% actually possess urban household registration. If a huge number of migrant workers and their families can receive adequate services such as social security and education, a huge middle-income group will be created and consumption will be stimulated. Cai says they should make it easier to get urban household registration and encourage further relocation from rural areas to cities. In response, the Chinese government aims to create around 12 million new jobs in urban areas this year, more than in 2022. In fiscal 2022, the number of people expected to graduate from university reached 10.76 million, topping the 10 million mark for the first time. The number of graduates in 2023 is expected to increase by another 820,000 to 11.58 million. Expanding employment in urban areas will be essential for both productivity improvement and social stability.

In terms of population aging, raising the retirement age is an urgent issue. In China today, the retirement age for men is 60, but women in executive positions retire and start to receive pensions at 55 while other women do so at 50. Since the birthrate peaked in 1963, the baby boomers are now reaching retirement age, with 40 million people becoming elderly by 2021–2025.

Already, social security costs have risen dramatically. In 2012, when Xi Jinping became the General Secretary of the Communist Party, it was 2 trillion yuan, but it had increased to 5.3 trillion yuan by 2021. This is 21.6% of the country's expenditures. "It will not be long before they reach the level of Japan, where 30% of expenditures are social security-related expenditures, perhaps eventually making it necessary to raise funds through government bonds" (Katayama Yuki, Researcher, NLI Research Institute).

In some cases, local governments have been forced to cut medical insurance benefits due to financial difficulties. Earlier this year, it was reported that protests against this were taking place in Wuhan and Dalian.

The clear and present danger

The impact of population decline is also a "clear and present danger" in terms of business. The real estate market is being hit directly. The population of 30–34-year-olds, who make up the core of homebuyers, will decline by more than 30% over the next 10 years, according to UN estimates. When it comes to actual demand, there is no way that current prices can be maintained in the first place.

In 2022, the sale price of new condominiums fell for the first time in 14 years. Moreover, the floor area of condominium sales nationwide declined by 26.8% from the previous year, the largest decrease ever.

One reason for this is the Chinese attempt to eliminate the real estate bubble, what may be termed the

Chinese version of "Soryo-kisei" (restrictions on the total loan volume of real estate lending set by the Japanese Ministry of Finance in 1990)," which was initiated under the Xi Jinping administration's slogan "housing is for living in, not speculation."

In Beijing and Shanghai, the average annual income multiple for buying an apartment was close to that of bubble era's Tokyo and Osaka. Since mid-2020, the Xi Jinping administration has introduced a series of regulations for real estate developers to limit funding based on their financial situation. The main target is private enterprises. "The government has had state-owned enterprises buy out private real estate developers, with the Chinese business community thinking that it intends to reduce the number of companies from the current 60,000 to less than 10,000" (head of a local subsidiary of a Japanese manufacturer). It is said that they have aimed to reorganize the industry in view of the real estate recession caused by the population decline, but this has been very untimely.

With successive interruptions in condominium development due to developers facing deteriorating cash flow, there has been a growing tendency since July 2023 to refuse to repay mortgages. Policies to financially support developers were announced in November of this year, after the conclusion of the 20th National Congress of the Chinese Communist Party. Still, in reality, it seems difficult for private companies to raise funds, so real estate investment has continued to decline year-on-year this year.

The decline in real estate prices will also hit local governments, which have been making ends meet by selling off land ownership. In 2022, land sales revenue was 6.7 trillion yuan, down 23% from the previous year. In January–February this year, it fell to minus 29%, and the situation is only getting worse. Since the GFC in 2008, China's local governments have continued to implement economic stimulus measures reminiscent of Japan by repeatedly investing in infrastructure with debt. This arrangement has reached its limit.

New trends in opinions about Japan

Expanding domestic demand is the top priority of the Chinese government's economic policy this year, but it will be difficult to restore consumption in earnest when there is great uncertainty about the future. If the government is serious about leverage, it should engage in income redistribution through asset taxation, but it has yet to go beyond mere sloganeering.

If so, the only choice is to support the economy by constructing infrastructure with low investment efficiency through debt. That will follow the path that Japan took.

By the time economic relations between China and Japan began in earnest in the 1980s, the high growth of the Japanese economy had already ended, shifting to medium growth. Japanese politicians, bureaucrats, and businessmen generously passed on the lessons of Japan's high growth to China.

China's behavior since surpassing Japan in GDP in 2010 seems to reflect the idea that there is nothing to learn from Japan. However, for China, which is expected to soon become a super aged society comparable to Japan, there is no doubt that the time has come to learn from Japan once more. Xi Jinping's ally and anti-corruption activist Wang Qishan, former Vice President, issued instructions to "study the history of Japan's finances" when the Xi Jinping administration was created in 2012. This suggests that the leadership is afraid of a "Japanification."

The same is true of ordinary citizens. With themes like "unrelated society," "bankruptcy after retirement," and "women's poverty," recent years have seen the Chinese publishing industry producing a series of non-fiction translations that highlight the negative aspects of Japanese society. However, this should not be seen as a manifestation of anti-Japanese sentiment.

Liu Ning, a Beijing-based writer who is familiar with publishing in China, explains that "There is a new tendency to view Japan more objectively, and readers are not only citing it as an easy way to criticize the situation in China but are also really trying to understand the good and bad points of Japan." As the number of people who have visited Japan increases, more and more people are looking at Japanese society as a reality connected to East Asia.

One thing that should not be mistaken is that even if the Chinese economy is "Japanified," it does not necessarily mean that Chinese companies will be weakened. As the growth of the home market has begun to slow, Chinese companies are finally becoming more geared toward overseas expansion. Japanese companies need to prepare for fierce competition with Chinese companies, especially manufacturers, in the global market.

China, an economic powerhouse that has been a rising dragon, is facing a major turning point. Although it follows a similar path to Japan, there are many elements that make prediction difficult, such as differences in relations with the United States and capital controls. It is necessary to keep an eye on these trends without letting our guard down.

Translated from "Tokushu 1 Gyakushu no Nihonkeizai:Chugoku ga Futatabi Nihon ni Manabu Jidai (Special Edition1 The Japanese Economy Strikes Back: An Era in Which China Once Again Learns from Japan)*,"* Voice*, May 2023, pp. 76-83. (Courtesy of PHP Institute)* [July 2023]

NISHIMURA Gota
Columnist, Toyo Keizai Inc.

Born in 1969. He joined Toyo Keizai Inc. in 1992. He has been editor-in-chief of *Weekly Toyo Keizai* twice from October 2016 to the end of 2018 and from October 2020 to March 2022. He is now a columnist for the company. From 2004 to 2005, he was a visiting fellow at the Institute of Japanese Studies of the Chinese Academy of Social Sciences in Beijing. His publication is *Bei Chu Keizai Senso* (US-China Economic War) (Toyo Keizai Inc.).
