ALBERTA FINANCE
Office of Budget and Management
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Economic Spotlight

CHINA'S ECONOMIC RISE & ALBERTA'S TRADE WITH CHINA

Highlights

- China's economy has undergone a remarkable transformation over the past quarter century. With real economic growth averaging 9.5% annually over this period, China has become the world's second largest economy, and the third largest in terms of international trade.

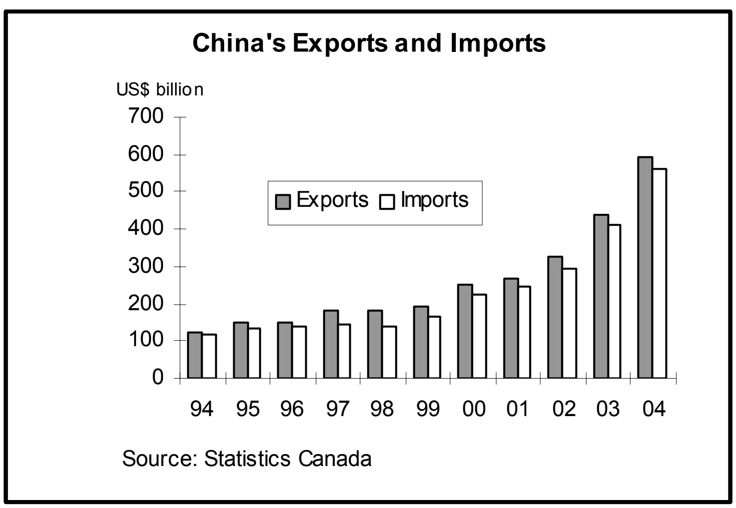
- Low-cost labour has been a key factor driving China's expansion, encouraging rapid growth in investment, particularly in manufacturing. Manufacturing sector growth has led an export boom that has seen a quadrupling of China's exports over the past decade. In 2004, China surpassed Japan as the world's third largest exporter, with exports totaling $593 billion.

- China's export growth has been accompanied by rapidly rising Chinese demand for raw materials and industrial inputs. In 2004, China absorbed 20% of global copper output and 27% of world steel output, and was responsible for 40% of the growth in global oil demand.

- While Alberta's trade with China remains small in relative terms (accounting for only 2.1% of Alberta's exports), the recent growth in Alberta-China trade has been exceptionally rapid. In 2004, Alberta's exports to China jumped by 85%, enabling China to surpass Japan as the province's second largest export market.

China's Transition to a Global Economic Power

In 1978, China began transforming its Soviet-style centrally planned economy into a more market-oriented system, ushering in a more than quarter-century of uninterrupted economic growth. Since 1980, China's real economic growth has averaged 9.5% per year, more than three times the comparable growth rates of both Canada (2.8%) and the United States (3.1%). On a purchasing power basis, China has become the world's second-largest economy, up from a tenth place global ranking in 1980. However, measured in U.S dollars, China is the seventh largest world economy. From 2002 to 2004, China's economic growth has accounted for one-third of the total increase in global economic output.

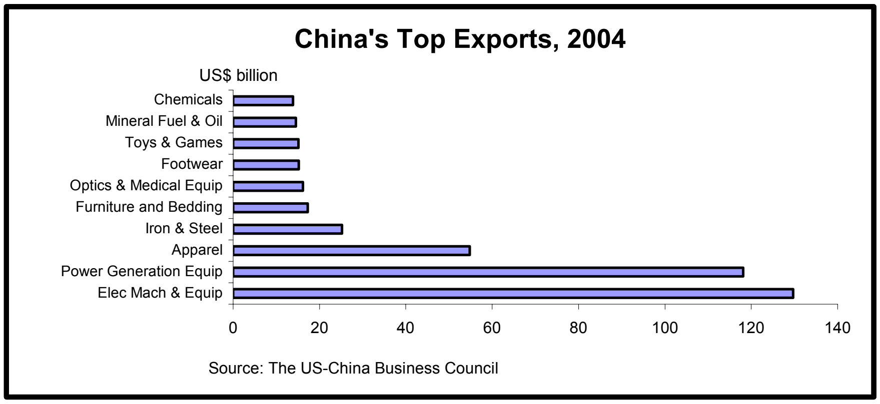


China's rapid growth has been fuelled by investment and exports, as cheap and abundant labour initially enabled China to gain a foothold in global marketplace, providing manufacturers of basic goods with a low-cost production environment. According to the World Bank, China's per capita income was US$1,100 in 2003, less than 3% of the U.S. per capita income of $37,870. This labour advantage continues to be the driver behind China's economy, with economic growth coming primarily from investment (42.3% of GDP in 2003) and exports. Domestic and foreign investors are continuing to further develop China's manufacturing sector, expanding it beyond basic manufactured goods into considerably more hi-tech and durable goods. For example, China now produces about 70% of the world's photocopiers and 45% of the world's microwaves.

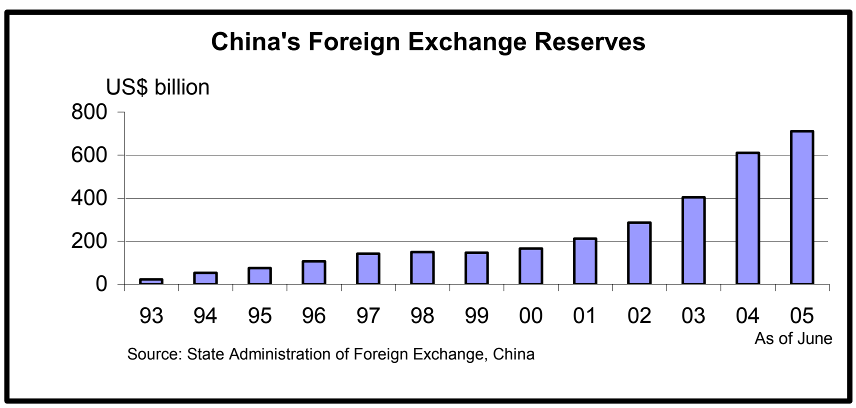
Rapid Growth in Investment and Trade

Foreign direct investment inflows in China increased to US$60.6 billion in 2004 from US$7.3 billion in 1990. High levels of foreign investment raised China's stocks of foreign investment to US$500 billion in 2003 from only US$25 billion in 1990. The U.S. and the EU accounted for 20% of direct foreign investment in China, as majority of investment came from Asian countries.

Strong growth in investment has helped China to achieve rapid export growth over the past decade. In 2004, China accounted for 6.5% of global exports, becoming the third largest exporter behind Germany and the United States. The value of Chinese exports has more than quadrupled, rising from $121 billion in 1994 to $593 billion last year. Major export destinations are the United States, Hong Kong, Japan, South Korea, and Germany. China is best known for its exports of toys, apparels, and other consumer goods, but in recent years, the country is becoming a large exporter of electrical machinery and equipment and power generation equipment. China's imports are dominated by capital goods, rather than just raw materials. Mineral fuel and oil were the third highest, behind electrical machinery and equipment and power generation equipment. China was a big importer of iron and steel products but the gap has narrowed substantially as China's exports of iron and steel products increased by 96% in 2004. Nonetheless, on a global level, China was the world's second largest oil consumer and used an estimated 27% and 20% of the world's steel and copper output respectively.



In 2005, China's economy is benefiting from the elimination of textile quotas. Exports of textiles were up over 60% in the United States and Europe in the first quarter of this year. The surge in textiles exports increased concerns over the yuan-U.S. dollar peg. Recently, China devalued the yuan by 2.2%, much less than the 10% depreciation expected by most analysts. At this point, China is the second largest holder of U.S. dollars and the high saving rates in China and rising trade surplus is allowing China to increase its holding of U.S. dollars at a rapid rate. China's foreign exchange reserves stood at US$711 billion at the end of June 2005, mostly in U.S. Treasury notes.



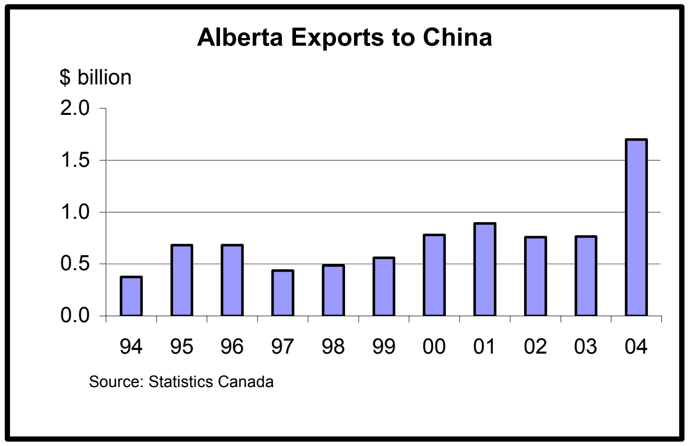
Looming Consumer Market

China's rapid economic growth has supported healthy growth in personal incomes, although income levels remain quite low. In 2003, China's per capita income was US$1,100. There is a large gap between urban and rural incomes; urban income more than three times higher than per capita rural income. Personal expenditures represented just over 55% of the economy, about 10 percentage points lower than its share in major industrialized countries. As a result, savings are high in China. Gross domestic savings (business, government and consumers) are 47% of GDP in China, compared to 26% in Japan, 25% in Canada and 13%- 14% in the United States and the United Kingdom. China should increases its domestic expenditures, which will allow the country to rely more on the domestic economy, increasing imports and dampening growth in exports. The lower trade surplus is likely to alleviate some of the trade imbalances that China has with other countries, particularly with the United States.

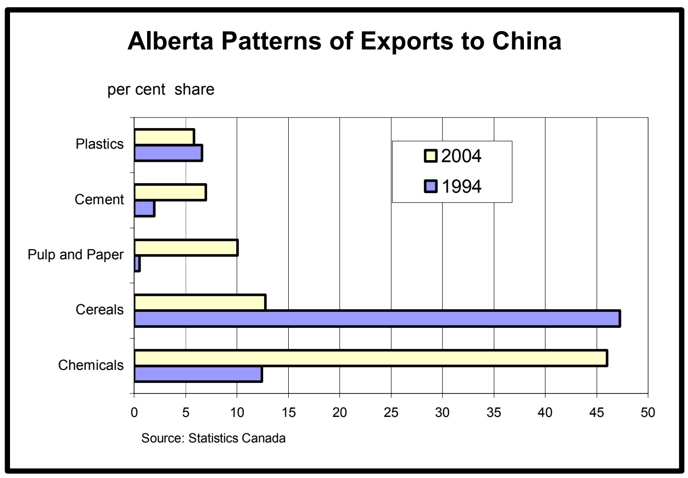
Despite China's remarkable growth, there are several issues that will need to be addressed. Some of these problems include: overheated sectors of the economy, which, if not properly addressed, may result in a hard rather than soft economic landing; a shaky banking system, thought to be holding a considerable portion of bad loans; a currency that needs to be further re-evaluated, especially given recent global pressure; and, finally, the growing disparity between rural and urban incomes, which could potentially be a source for political upheaval within the country.

A Growing Export Market for Alberta

The relative importance of Alberta's exports markets continues to change with the changing global economy. Alberta's merchandise exports to the United States, China, and Mexico have steadily increased since 1994, while exports to the once strong markets of Japan and South Korea have steadily declined. Exports to China averaged annual growth of 14.4% over the 1994-2004 period, second only to Mexico (16.7%), which enabled China to overtake Japan as Alberta's second largest export market in 2004. However, even as Alberta's second largest export market, China's 2.1% share of Alberta's total merchandise exports at Can$1.7 billion, is dwarfed by the US's 89.0% share, which has grown from 79.4% in 1994.



Over the past decade, China shifted the makeup of the portfolio of products exported by Alberta. In 1994, cereals comprised 47.3% of Alberta's exports to China. However, with China's rapid transformation into a major manufacturer, cereals share of trade has dropped to 12.8% in 2004 as industrial products such as organic and inorganic chemicals, and pulp and paper, have made significant gains over the 1994 to 2004 period.



As China continues to expand its exports through the use of its low cost manufacturing advantage, prospects are highly favourable for continued strong growth in Alberta's trade with China. Alberta can continue to work at helping China meet their immense import demands. This will require Alberta to continue to look ahead, identifying new trade opportunities where the competitive advantages and abundant resources of Alberta can be utilized.