China 2035

China will be a Eurasia super power. Neighboring countries will face difficulties

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Abstract

1. Experts are concerned about China’s future being thrown into political and social confusion in the 2020’s. China will have room for autonomous economic expansion with government’s fiscal support in the next decade, but inland China which receives the most fiscal support or promotes various projects, will face a middle income trap in the middle of the 2020’s. After the middle of the 2020’s, baby boomers born during the Cultural Revolution will start to retire, and a labor shortage will be serious year by year. On the other hand, conflicts and competition between China and the U.S. will become more acute due to the fact that China’s nominal GDP will overtake that of the U.S. Reconciliation among China, the U.S. and the surrounding countries will be much significant issue for the global economy and politics.

2. The excess debt, an immature security and bond market, FX reform and globalization are key issues. June 2015’s stock plunge has accelerated financial reforms. And the adoption of a SDR calculated currency has become a new motivation for FX reform. The Renminbi will be one of the major international currencies in the future. But the next ten years will be a crucial period for financial reforms. Stability of the economy and credibility of financial markets are the two major concerns for advancing or limiting reforms.

3. Oil demand in the last 5 years expanded faster than the 12th 5 year plan. In the 13th 5 year plan, it is also expected to grow faster. In 2035, in the current policy environment, oil demand will be 0.84 billion tons, 1.6 times larger than in 2015. But oil demand may be suppressed under stricter energy and national security policies. And oil imports will be more diversified using pipelines.
   China’s oil demand will be a factor of rising oil prices, but future energy saving policies and activities will reduce the pressure on oil price rises.

4. From September 22th to 28th, Xi Jinping visits the U.S.as China’s president for the first time. Amid so many differences and conflicts, both presidents have to seek, at least show the determination to hold on to the architecture for mutual trust and on improving relationship between the two giants of the world. On the other hand, the U.S.-China relationship in the mid and long-term, amid closer economic volumes and more influence from the political cycles in each country, will go back and forth between cooperation and competition.

5. While the Chinese economic rise is becoming clearer, the framework for policy cooperation is becoming the important issue between the U.S. and China.
   China’s imports value will overtake the U.S.’s imports value by the middle of the 2020’s. The U.S. will

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seek to welcome China to be a friendly economic partner. Economic conflicts will decrease gradually, due to a declining a trade deficit in the country's GDP.

Seeing the recent lose in mutual trust between the two, it will take a long time for the U.S. to accept China's rise as a claim for restructuring of the international order after WWII.

6. In 2015, the goals of China's economic diplomatic activities seemed to be: "Separation of politics and economics", reinforcement of new geopolitical strategies due to the need for promoting economic reforms and strengthening its economic growth. Amid rising uncertainties in territorial and sovereignty disputes, China is trying to be seen as a peaceful power which is contributing to maintain the current international order. But China is also seen as a challenger to this order through founding the AIIB, and advocating the One Belt One Road.

   In the long run, China's responsibility for the world economy and burden in economic diplomacy are becoming larger and larger through its rising presence in Asian Pacific or Eurasia. China's cooperative participation in existing international frameworks such as G20, WTO, and its maintaining a risk averse posture are important. These can be seen as ways to measure the risks of China's rise.

7. Building better economic relationships and reducing economic conflicts with neighboring counties and improving China's economic structure will be the keys to China's economic rise. In addition, deepening talks and cooperation with foreign countries on non-economic issues will be necessary because the challenges that China faces in the areas of both economic reforms and non-economic reforms will remain in the next 20 years.

   The U.S. is pragmatically seeking a balance between engagement with China and containment. It is also necessary for Japan not only to deal with its difference and mistrust with China but also to continue looking for areas of cooperation with China.

Ⅰ. Macro forecast – Chinese economy next twenty years

ⅰ) Experts' view. Concern over political and social confusion in the 2020's

China is in a transition period from a high growth era which has continued some 30 years to a lower growth era. On the other hand, there has already been new trends such as" Made in China 2025 ", "Free Trade Zone ", "One belt, One road Initiative (Some experts suggest that it should called" Many belt, Many road"), "Asia Infrastructure Investment Bank (AIIB)". Regarding a transition period, the high-speed growth period has past, there are two types of concerns known as "Can China keep current political regime?" and "Will China export its confusion?" And regarding new trends, there are also two uncertain ones, "Can China keep and succeed with its economic and political reforms?" and "Will China, as a global giant, contribute to maintaining the current international order (at least its framework)? ".

Many experts make statements such as these: "China can keep relatively stable growth for a while, but economic and social inequality will not be easy to be improved in slower growth"; "Due to immature and underdeveloped social systems except Communist party, political and social stability is not easy to be kept";" China putting its priority on domestic issues especially things of current regime, China's contribution to international order will not be expected enough". In other words, they are concerned that: an economic slowdown will cause social and political difficulties, and a hegemonic challenge to current international order will be strengthened.

On the other hand, in China, there is enough room for city and infrastructure development, new industries promotion, improvement in productivity and progress for globalization. These will support China's economic growth for a while. After the middle of the 2020's, due to demographic changes such as a decrease in population and the internal migration of populations, the space in cites and infrastructure development will shrink rapidly. China will have to expand its economic growth by further improvements in production, deregulation and globalization. Meanwhile, inland China which currently leads in economic growth is already dependant on investment from the central and local governments. In this area, even if improvement in production and deregulation will be strengthened, a downward shift in economic growth will not be able to be avoided. The GDP growth rate in the last half of the 2020's and the 2030's will be much less certain.

ii) What will be the risks? Social unrest in the short-term, fiscal and financial unrest in the mid-term and international conflicts in the long-term

The major global economic players, the U.S., EU, Japan, China, ASEAN5(Malaysia, Thailand, Indonesia, Philippine and Vietnam), and India, represent more than 70% of world GDP, I forecasted these economies through 2035 referring to IMF and United Nations data (Figure1,2,3). And I reviewed the opportunities and risks for China through changes in its economic growth and structure.

I forecasted 6 major economies with standard scenarios. For China, I forecasted three scenarios: i) China will continue reforms and achieve not fast but steady growth (a standard scenario, this seems to be very similar to the scenario of the Chinese government); ii) China will really succeed reforms, the real GDP growth rate will be pushed up by 0.5% point a year from a standard to an optimistic scenario; iii) China will delay or fail in its reforms, the GDP growth rate will be pushed down by 0.5% point a year from a standard scenario to a pessimistic scenario.

According to the standard scenario, the GDP growth rate will be more than +5% per year in the 2020's, and more than +4% per year in the 2030's. <u>China's nominal GDP will surpass that of the U.S. in the last half of the 2020's, and China's nominal GDP will reach 46 trillion dollars (quadruple that of 2015). This is 7 times that of Japan, 5 times that of ASEAN, and 4 times that of India. The nominal GDP per capita will be some 8,000 dollars in China by 2015, some 16,000 dollars by 2025 and some 32,000 dollars by 2035. In 2035, this 32,000 dollar figure will be 1/3 of that of the U.S. (present 1/7), 3/5 of that of Japan (present 1/4).</u>

In 2025, the nominal GDP per capita in advanced coastal areas will be above 20,000 dollars. On the other hand, in developing inland areas, it will not have reached 10,000 dollars and overcoming "the Middle Income Trap" will be a real challenge. Even now, although the investment/GDP ratio reached 66% in inland areas in 2013, a shift from an investment driven economy to a consumption driven economy will be a much more serious challenge. In the future, China will maintain its current surplus, and its fiscal and financial measures can be continued as well.

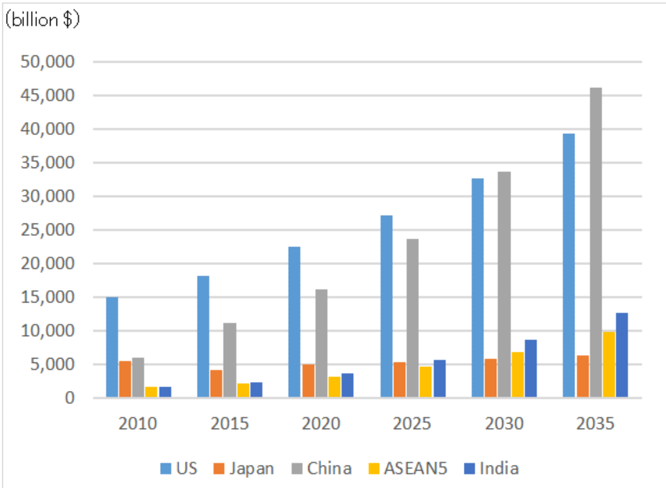
Regarding international relationships, the fear to China will increase as well as expectation to China, but China will have to make progress with economic reforms and adapt to an era of a decreasing labor force, the fear will be only a potential one. <u>According to this forecast, the military budget of China will be some 40% of that of the U.S. in 2025, and accumulated weapon and military equipment (in nominal dollar terms) will reach some 30%.</u>

In 2035, the coastal area will be well developed as an entrance to China and will be collection of several major Asian megalopolises. On the other hand, focusing on the inland areas, less dependence on public projects and more independence in economic development will be serious subjects. Furthermore, from the end of the 2020's, baby boomers born in the Cultural Revolution will be retiring. The support for inland areas and the increasing social welfare budgets will be a big burden. So China's financial and financial related reforms such as more effective investment of foreign exchange reserves, better investment environments, development of sound financial markets, and globalization of Renminbi will all be more needed. Financial reforms of the next 10 years ending in 2025 will be a milestone for the decade after that.

Regarding international relationships, China will overtake the U.S. in terms of nominal GDP and will reach more than 50% of the U.S. in terms of military budget and accumulated weapon and military equipment(in nominal dollar terms). Conflicts between China and the U.S. will be more serious. The U.S. will lead the world with its democracy and experience as a developed country. On the other hand, China will strengthen its leadership with pragmatism, the experience of a developing country, and grass roots exchanges with surrounding Eurasia countries. Whether China will corporate with the U.S. or compete with it, all depend on the effort of both countries and the surrounding countries.

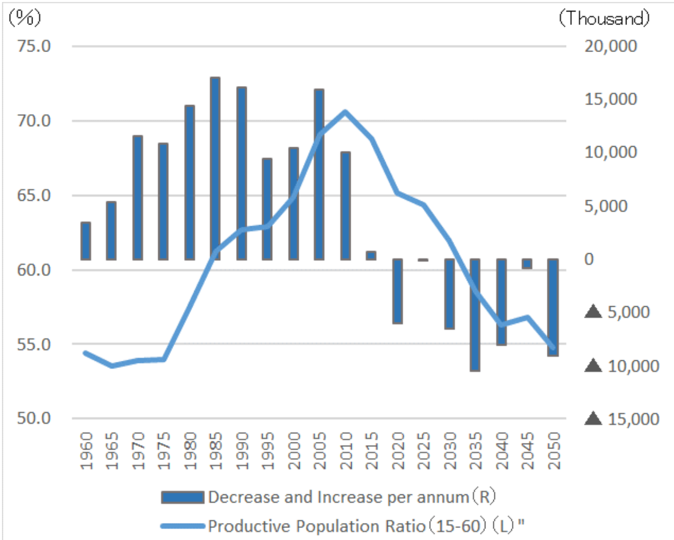
In an optimistic scenario, higher economic growth and stronger Renminbi, the nominal GDP of China will be 1.3 times that of the U.S. in 2035. On the other hand, in a pessimistic scenario, lower economic growth and a lower CPI and weaker Renminbi, nominal GDP will be 0.8 times that of the U.S. And overall, this optimistic scenario is a little less optimistic than the forecasts I made before. This is due to weaker domestic and foreign demand and weaker deflation pressure in the whole world.

Figure1 Nominal GDP in Major Countries/Areas



(source) Marubeni Research Institute

Figure2 Productive Population of China



(source) United Nations(midium)

Figure3 Points of the Forecast

U.S.	Real GDP growth 2016-20 will be +2.4% per year, that of 2021-35 will be +2.0% per year
EU	Real GDP growth 2016-20 will be +1.9% per year, that of 2021-35 will be +1.9% per year, USD/EUR will continue fluctuating around the current level
Japan	Real GDP growth 2016-20 will be +0.7% per year, that of 2021-35 will be +0.7% per year, JPN/USD will continue being in slightly weak posture
China	Real GDP growth 2016-20 will be +6.2% per year, that of 2021-25 will be +5.5% per year, that of 2026-30 will be +4.8% per year, that of 2031-35 will be +4.0% per year, RMB/USD will gradually appreciate. Growth rate of government revenue will be slightly more than the nominal GDP growth rate, and the milirary budget per GDP will be unchanged (except off budget military expenditure that is 0.7 times on budget military expenditure (Reported by the Depertment of Defence of the U.S.)
ASEAN5	Real GDP growth 2016-20 will be +5.5% per year, after that it will be +5.0%, +5.0%, +4.5% per year each five years. Mild inflation and somewhat weak exchange rates will continue
India	Real GDP growth 2016-20 will be +7.6% per year, after that it will be +7.0%, +7.0%, +6.0% per year each five years. Mild inflation and volatile exchange rate will continue

(Source) Marubeni Research Institute

Ⅱ.Financial situation and foreign exchange rate

i) Financial risks and current focus

The stock price adjustment in June 2015 re-announced the existence of financial risks in the Chinese mid and long-term economic progress (Figure 4). So far, some crucial problems have been pointed out in China's financial development: i) many local governments and state owned enterprises have accumulated debt with remarkably low real interest rates compared to nominal GDP growth rate; ii) private and individual companies, which are difficult to raise funds from banks, have piled on high interest rate debts through the non-banking sector, so called shadow banking; iii) a low quality stock and debt market has produced a low quality financial sector as a whole, which includes for example, scarce institutional investors, a listed companies' capital structure that are mostly owned by parent companies, lack of transparency of information, less developed market interest rates, and others; iv) delay of reforms of exchange rates and capital accounts.

The stock market upsurge by June 2015 were started by monetary easing and easing regulations, and the market plunged then due to tightening regulations and an expansion in the gap between the real economy and stock market fever. In the adjustment process, authorities progressed: i) introduction of deposit insurance system, ii) repeal of loan/deposit ratio for banks, iii) deregulation for CD issuance to non-financial institutions, iv) permission for stock investments of pension funds and raising upper limits of investment for insurance companies, v) re-deregulating marginal transactions, vi) cutting stock transaction fees and others. They can promote more sound banking systems and relatively sound stock market reforms. Distortion in price mechanisms are encouraged by several price keeping operations; such as i) requirements of purchase of investment trusts by stock brokerage firms and government funds, and requirements of repurchase of stocks by state owned companies, ii) guidance forbidding sell-offs for 6 months to board members of listed companies and major stock holders, iii) PBOC's price keeping measures by supplying liquidity, and iv) supervision and policing of stock transactions by public regulators.

ii) Renminbi reform

In terms of Renminbi reform, the Chinese government promoted the Renminbi inclusion in the SDR for economic and financial internationalization in 2015. For promoting this, the Chinese authorities refrained from leading the Renminbi sharp depreciation despite a concern over a growing deterioration of export competitiveness. About Renminbi inclusion in the SDR, the U.S., that competed with China about trade frictions and future economic hegemony, insisted that "The Renminbi still remains undervalued", " Capital account liberalization is not enough" and others. And the U.S. had not seemed to accept the inclusion of the Renminbi in the SDR until at least President Xi's visit to the U.S.. The U.S. had not been also prepared and had been afraid that the Renminbi internationalization in aspects of China's re-thinking about foreign reserve policy, which meant the reallocation of foreign assets formed mainly of the U.S. treasury. On the other hand, the IMF whose managing director is from Europa reported that the Renminbi not to be underestimated. And it showed positive attitude toward Renminbi inclusion in the SDR (the end of November the IMF decided to include Renminbi in the SDR).

According to ” At a Glance: Renminbi Internationalization-The Pace Quickens” (Standard Chartered Bank, June 2015), the principles for Renminbi liberalization of Chinese government are i) mid-term stability of the currency, ii) control of short-term speculative fluctuations, iii) relatively liberalized capital flow. Chinese authorities seems to promote Renminbi liberalization for several reasons: trade settlements have already expanded to around 20% of China's trade (Figure 5), there has been deregulation of outward FDI, inward and outward capital investments, and rules for issuance of foreign bonds, with prudent judgements seeing the stability of the Renminbi and the need for internationalization of China's economy.

Figure4 Stock Price (Shanghai)

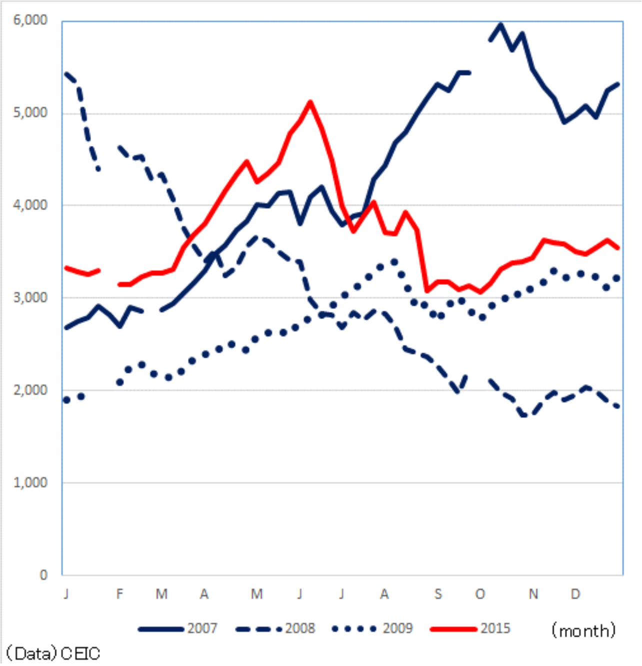
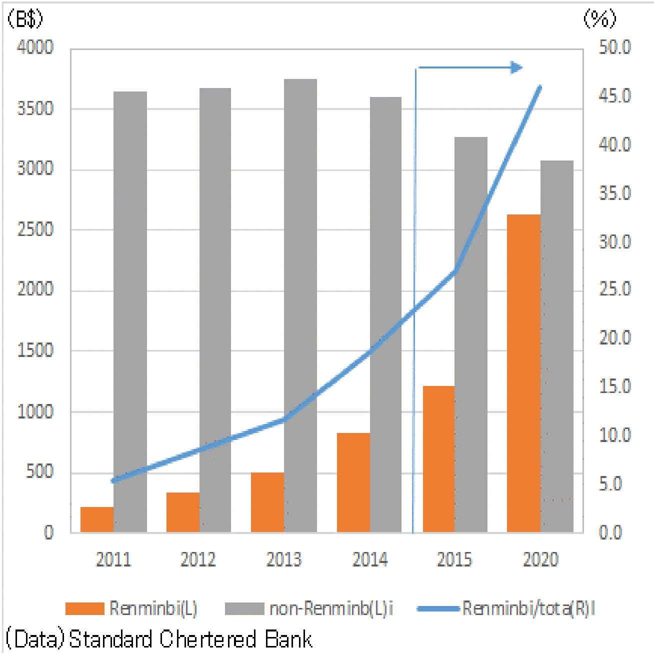


Figure 5 Renminbi Trade settlement



iii) Mid and long-term forecast

For the financial reforms in the next 20 years, the first 10 years will be a crucially important period, because further financial development will be needed for economic development and globalization as the world second biggest economy. If China will not devote all its time to the financial reform until 20 years from now, when it is a high possibility for China's nominal GDP to overtake that of the US, China's financial stability and its economic stability can be damaged seriously.

As a main scenario, stock and bond market reforms will progress within these next 10 years. And as it continues its internationalization, progressing with stability, the Renminbi will be practically one of the major international currencies. Though its current account will be able to maintain a surplus, budget deficits will be easy to expand to support local government and improving personal income gaps. And since central and local government bonds will be mainly issued in the domestic bond market, and a strong Renminbi will continue to be national interest for maintaining high purchasing power, Chinese authorities will not take on a weak Renminbi policy. But due to an economic slowdown, the temptation for Renminbi depreciation will increase more easily. If China's nominal GDP will become 7 times that of Japan and 5 times that of ASEAN, China's monetary policy and financial situation will be two of the most influential factors for Asian financial markets and economies.

On the other hand, in one risk scenario, if there is increasing government intervention into financial activities, financial reforms will be delayed further. This can come about from the central government's supporting economic growth, postponing local governments' or related vehicles' debts, or supporting stock or real estate prices. China is going to expand consumer loans to stimulate consumption and online shopping, consumer debt problems can also be a factor in the future. And this delay will not only slow down Renminbi's internationalization but also raise the temptation of Renminbi's depreciation. Although in the main scenario, a moderating strong Renminbi can be assumed over the long period, in the risk scenario, Renminbi will depreciate. In that case, if the surrounding countries were to take the same currency policy, which might be called a competitive devaluation of currencies, the overall Asian financial and economic situations will be unstable. Chinese authority will not select an extremely weak Renminbi policy in order to avoid inflation and maintain purchasing power.

In conclusion, China will promote further financial reforms in order to be an economic and financial giant. It will avoid exchange rate cuts. But an economic slowdown will cause an expansion of budget deficits and intervene in the economy, and this will be a headwind for financial reforms. The speed and depth of financial reforms seems to depend on efforts not over the long-term but the short-term. Government's attitude towards economic growth and the market economy should be watched clearly for the present.

III.Oil demand in the next two decades may much less than expected

i) Demand:More than expected in the mid-term, Less than expected in the long-term due to economic slowdown and introduction of energy saving measures and technologies

China's oil consumption, which was 224 million ton in 2000, 6.3% of world consumption, doubled to 520 million ton in 2014, 12.4% of world consumption. In view of this additional amount of consumption, world demand increased by 629 million tons from 2000 to 2014, and China was responsible for 47% of this increase. So China drove world oil consumption and trade in the 2000's (Figure 6).

Looking at the correlation between oil consumption and real GDP growth, the average annual growth in oil consumption was +6.2% per year from 2000 to 2014, and the real GDP was ＋9.8％ per year in the same period. This means that the elasticity of oil consumption was 0.63（＋6.2%／＋9.8%）. In the same period, the average growth rate of world oil consumption was ＋1.2％ per year, and that of real GDP growth rate was＋3.8％ per year, then the elasticity of world oil consumption was 0.31. This shows that China expanded its oil consumption not only because of high economic growth but also because of high levels of oil consumption. And major drivers of the oil intensive economy were an expanding demand both in transportation activities and in chemical materials for industrial activities. Two thirds of China's oil consumption is the form of processed oil. Half of all processed oil is used as diesel oil mainly for commercial vehicles, and one third of processed oil is consumed as gasoline mainly for passenger vehicles. And only one third of oil consumption is for industrial use. From an historical view, 2001 to 2005 was an historical period for Chinese oil consumption, because it recorded the highest growth in oil consumption. China joined the WTO to be the world's factory, localizing and nationalizing materials and parts, and to be a world market, opening retail and logistics industries, which multiplied oil demand. After 2005, while despite manufacturing and distribution bases appeared to have matured, China's elasticity and growth rate of oil consumption were much higher than the world average. Currently, a correction of industrial production and a plunge in transportation is reducing oil consumption. And an oil saving movement is also pushing down oil consumption.

In my forecast, stimulus measures may accelerate oil consumption through expanding demand for construction materials and transportation fuels in the short term, but it will dull in the long term (Figure 7). Needless to say, it is due to an economic slowdown and lower elasticity of oil consumption. Major factors of lower elasticity are: <u>i) ① the shift of energy components from fossil fuels such as oil and coal to gas and renewable energies will be progressed (oil/total energy use will be from 19.0％ in 2010 to 16％ in 2015 and to 13％ in 2020 as planned), ② improvements of car fuel efficiency will continue (the fuel efficiency standard from 7.38ℓ/100km in 2012 to 6.9ℓ/km in 2015 and to 5.0ℓ/km in 2020 as planned) and new standard will be widespread in the 2020's, ii) motivation for car ownership will be weakened by urbanization and by a spread of public transportation (the ratio of urbanization goes up to 60% in 2020, and to 70% in 2030), iii) nationalization of high value added products in the chemical industry will come to a peak in the 2020's and there will be little room remaining to introduce new capacity.</u>

ii) Forecast of oil demand: 840 million tons in 2035 under the current policy framework. However it will be reduced by the request from national energy and security

Under the trends listed in the previous paragraph, China's oil consumption in 2035 will be as follows. As additional assumptions, I set these: i) car registration in 2035 will be 400 million, penetration ratio will be around 30% (penetration ratio of urban households will be around 50%, that of rural households will be around 100%. NDRC forecasted similar results), ii) the growth rate of the chemical industry has relatively high correlation with that of all industry, there will be limits on the ability of the chemical industry to export its products, iii) contribution of e-commerce to transportation will be limited, because delivery for e-commerce is done by regular transport lines. These assumption as a whole are optimistic for the forecast of oil consumption (for China, this means inefficient and excess consumption of oil).

<u>Oil consumption in 2015 will be 510 million tons (early estimate). It will be 680 million tons, 770 million tons and 840 million tons in each of 2020, 2030, 2035 (Figure 8). Major reason is the increase in the number of cars.</u>

On the other hand, the Chinese government has 200 million tons of domestic production and less than 60% dependency on imports (this means that import amount to be 300 million tons). So the forecast of 840 million tons (import amount be 600 million tons) in 2035 seems hard to accept. The Chinese government will introduced further oil saving measures, like the restriction of car ownership in urban areas, reinforcement of fuel efficiency standards and a shift to electric cars.

In conclusion, while China's oil consumption will expand at some speed due to consumption stimulus measures, technological difficulties for electric cars, promotion of the chemical industries, accumulation of oil reserves and others in the mid-term, oil consumption it will decrease through government lead in the long-term.

iii) Trade：China's long-term strategy is diversifying origin of imports and increasing contracts and development using pipelines

So far, China is importing as much as 60% of its total oil demand. China imports 50 % of it from the Middle-East, 20% from Africa and 10% from America (Figure 9). Dependency on the Middle-East represents only one-third of China's oil supply, it can be said that China relatively succeeded with its diversification of oil imports (Japan's dependency on the Middle-East is 80%). China originally imported oil only for making up for the shortage of domestic products and procured oil from spot markets. At present, China has been expanding off-shore oil developments and increasing imports through pipelines from Russia and Central Asia to increasing diversification of the origin of imports, less dependency on marine transport and promoting boarder areas of development. Cross border pipelines currently being operated or constructed are: i) North-west (Xinjiang)- Kazakhstan, ii) North-east (Daqing)-Far east Russia, iii) South-west (Kunming)-Myanmar, iv) North-west (Xinjiang)- Pakistan/Iran. This diversification strategy will contribute to a stronger bargaining power and more influence with neighboring countries, and to various alternative routes to the Straits of Malacca/South China Sea. Regardless of how much oil China will procure from Eurasia, it will also contribute to China's diplomatic relationships and national security. Oil price plunges in the last half of 2014 will reduce oil's strategic meaning for China, however China's oil imports will keep increasing to some extent in the long-term and a further increase its diversification. Because of various risks such as terrorism and public security, concern over the expanding oil imports from Central Asia, South Asia and the Middle-East is mentioned here.

iv) Oil Prices：China will contribute to oil price rises in the long-term. But this depends on additional energy saving policies

January 2016, oil prices dropped under $30/ b. This was the first time since 2004. This was caused by reasons, expanding production in the US, Saudi Arabia and Iran, increasing commodity market's concerns over outflow of money by predictions of the FED's interest rates increases and a sluggish Chinese economy. This drop was accompanied by world currency and stock market tumbles, a resulting in a vicious circle at the present. Within 2016, oil price will hover under $50/b. It is uncertain whether this will trace a moderate recovery. On the other hand, there is a possibility that China's oil imports may double in the long-term, and oil prices may be forced up. However as I mentioned above, the Chinese government will not accept a higher dependency on imported oil from the view point of environmental aspects and national security. Under their current energy policies, the dependency of imported oil will be 70% in 2020. As a result, the Chinese government will revise its objectives in the next 5 year plan or the plan after that, to reduce oil consumption further.

So forecasting China's influence on world oil prices is difficult, since China's economic slump will continue in the very short term, while China's expanding domestic demand will increase in the mid and long-term. But upward pressures will all decrease gradually in the 2020's due to political and social reasons.

Figure 6 Statistics for oil

	2000 (00/95)	2005 (05/00)	2010 (10/05)	2014 (14/10)	2014 /2000
World GDP(annual, %)	3.3	3.9	3.9	3.6	3.8
World oil consumption(mt)	3,582	3,919	4,042	4,211	-
(annual, %)	1.7	1.8	0.6	1.0	1.2
China GDP(annual , %)	8.6	9.8	11.2	8.0	9.8
China oil consumption(mt)	224	327	438	520	-
(annual, %)	7.0	7.8	6.0	4.4	6.2
China oil /World oil(share%)	6.3	8.3	10.8	12.4	-
World oil consumption(mt)	291	337	122	169	629
China oil consumption(mt)	64	103	111	83	296
China oil/world oil(share%)	22.0	30.4	90.6	48.7	47.0
World oil elasticity to GDP	0.52	0.46	0.16	0.29	0.31
China oil elasticity to GDP	0.81	0.80	0.54	0.55	0.63

(Data) BP, Marubeni Research Institute

Figure 7 Mid-term plan

		2010	2015		2020	
Primary energy use	100mtce	32.5	40.0	+4.3%/y	48.0	+3.7%/y
of coal	100mtce	22.1	26.0	+3.3%/y	29.8	+2.7%/y
	share%	68.0	65.0		under62.0%	
of oil	100mtce	6.2	6.4～7.3	+0.8%/y	6.2～7.6	same level
	100mt	4.3	4.5～5.1	～+3.3%/y	4.3～5.3	same level
	share%	19.0	16.1		under13.0%	
Dependency of imports			61%以下		under62%	
National saving/imports	day		30 d		90d	
of natural gas	100mtce	1.4	3.0	+16.0%/y	4.8	+9.9%/y
	share%	4.4	7.5		over10.0%	
of non-fossil energy	100mtce	2.8	4.6	+10.3%/y	7.2	+9.6%/y
	share%	8.6	11.4		15.0	
Primary energy product	100mtce	29.7	36.6	+4.3%/y	42.0	+4.3%/y
of oil	100mt	2.0	2.0		2.0	
Primary energy imports	100mtce		6.4			
Energy use/GDP	tce/10000yuan	0.81	0.61	▲16%		
Self sufficient of energy	%		85.1		85.0	
CO2 emmition/unit				▲17%		

*Chinese government noted oil consumption uncleary, i) it calculate from non-oil figures, ii) from planed oil production and dependency of imports. i) shows lower case, ii) shows higher case. In the ii) case, primary energy use is push up 100 mt in 2020

(Data)Energy Development 12th 5 year plan(2011～15) and others

Figure 8 Forecast (Under current policies)

		2015	2020	2025	2030	2035
Car registration	1000	164,818	255,000	315,000	360,000	400,000
average growth	%	16.1%	9%	4%	3%	2%
Car sales	1000	23,844	29,000	32,000	34,000	36,000
average growth	%	5.7%	4%	2%	1%	1%
Penetration ratio	%	12%	18%	23%	26%	30%
Car transportation (passenger)	2000=100	325	390	430	470	500
average growth	%	8%	4%	2%	2%	1%
Car transportation(cargo	2000=100	435	560	630	680	710
average growth	%	8%	5%	2%	2%	1%
Oil consumption	100mt	509	681	769	816	835
average growth	%	3.5%	6%	2%	1%	0%

*Car registration is registration(-1)+Car sales－elimination. In 2035, car penetration in urban household is assumed around 50, rural household around 100, share of commercial car is assumed around 20%.

(Data) Marubeni Reserch Institute

Figure 9 Major import countries

(%、%point)

		2008	2014	difference
region	Mid-east	50.1	52.1	2.0
	Central and south America	7.2	10.8	3.7
	Africa	30.2	22.1	▲ 8.1
country	Saudi Arabia	20.3	16.1	▲ 4.2
	Iran	11.9	8.9	▲ 3.0
	Oman	8.2	9.6	1.5
	Russia	6.5	10.7	4.2
	Kuwait	3.3	3.4	0.1
	Kazakfstan	3.2	1.8	▲ 1.3
	UAE	2.6	3.8	1.2
	Iemen	2.3	0.8	▲ 1.5
	iraq	1.0	9.3	8.2
	Qatar	0.5	0.1	▲ 0.4
other	Pipe line	9.7	12.6	-
	Pipe line in the furure	-	21.5	-

*Pipe line:Russia, Kazakfstan. Pipe line to iran is planned

(Data) Customs

Ⅳ.U.S.-China relationship: Xi's state visit to the U.S.

i) Xi's state visit to the U.S.～Confirm the framework for discussions to avoid serious conflicts

Regarding the relationship between the U.S. and China so far in the 21st century, when we focus on the economic aspects, both countries have had a relatively good relationship as a whole. For China, joining the WTO has provided a broad policy package for economic reforms, which has led to the changes from a processing and assembly type industrial base to a full-set type of one. The U.S. has also provided various opportunities for China's industrial base to diversify and to stimulate domestic demand. For example, the U.S. has not only provided external pressure but also provided the export market for electric-electronic equipment and miscellaneous goods, introduced new business opportunities and knowhow. On the other hand, the U.S. has gotten broad opportunities to access Chinese markets. The U.S. companies in automobile, aircraft, securities, insurance, logistics, software, energy, environment and others have gotten some kinds of special treatment or access in China. In addition, these days, the expectation of more direct contributions to the U.S. economy by China has been increasing through direct Chinese investment, enterprise partnerships and grass roots contributions such as immigration preference because of investments in the U.S., and overseas students.

However, the U.S.-China economic relationships, it is much better than political one. There are more than a few things to be hard to compromise on or to compete with each other: a handling the word "Great partners", the evaluation of China's market economy status, the assessment of the Renminbi reforms and internationalization, the negotiation for the Bilateral Investment Treaty (BIT), the progress for protecting intellectual rights, the conflict of anti-dumping measures and others. In 2015, the founding of the Asia Infrastructure Investment Bank (AIIB), the adaptation of the Renminbi to calculating Special Drawing Rights (SDR), and the detection of a big cyber espionage case have all become conflicts.

While China's official view of the U.S. is consistent, the U.S. view on China depends on a person's viewpoint. However, even in the U.S., there is a broad consensus that dialogue and engagement with China has to continue. The thing which should also be paid attention to in the dialogue between the two is that they should talk about shall not be limited, but shall encompass more global issues such as the Middle-East and Africa. At a regular meeting, started as U.S.-China Strategic Economic Dialogue (SED) since 2006, which has continued as the U.S.-China Strategic and Economic Dialogue (S&ED) , several tens to more than a hundred subjects have been discussed each time. The dialogue by the two has become more and more important for international politics and economy, because holding the dialogue itself has become a factor of world stability, and because some kinds of agreements come to be expected.

During Xi's state visit to the U.S. from September 22nd to 28th, his visit to Washington DC from 24th to 25th attracted the most attention (Figure10). Before his visit, high officials visited each country and prepared for the formal visit. For the U.S., this visit was for i) improvement engagement by explaining the U.S.'s political and economic powerhouse and its rationality of current international order, and ii) maintain and expand economic cooperation. For China, it was for i) improving its recognition as a major country, ii) obtaining some cooperation for economic reforms, and iii) softening various conflicts.

The points of these are i) confirmation of importance of U.S.-China relationship and of constructing mutual trust, ii) recognition of the differences between the two, iii) increase their cooperation through viable individual projects, and iv) confirmation of the importance of dialogue.

In the formal meeting talks on Thursday night and Friday morning of Xi's visit, some agreements were reached between President Obama and Xi, and at the joint press conference in the Rose Garden in White House, they announced their common understanding on the way forward and accepted that more needed to be done. Obama had three main points: i) South China Sea and cyber security, ii) human rights and the environment, and iii) development cooperation and human exchanges. On the other hand, Xi had four main points: i) bilateral cooperation, especially in the economy such as BIT, fiscal and monetary policy, and AIIB, ii) cooperation for cyber security, and iii) confidence building, and iv) cooperation on North Korea and others (Figure 11).

Seeing Obama and Xi's announcement, both seemed to confirm the importance of bilateral relationship and recognizing their differences (South China Sea and cyber security). The differences seem to be so big, however it cannot be said that there was little fruit from these meetings.

ii) The U.S-China relationship in the long term. What will happen when China overtake the U.S economy

China's nominal GDP will overtake the U.S. in the last half of the 2020's. And the U.S. military budget will remain superior, but the difference between the two will be much smaller than that of today, especially in the West Pacific. Both the U.S. and China have similar political and economic problems, such as income differences and minorities. The U.S., however, has more experience and knowhow in how to operate a big country than China has. China has many challenges economic reforms, rural developments, improvement of local governments and corporate debt, dealing with aging society, stabilizing policies and others. It will not be affordable for China to challenge current international order, in other words, China will stay behind the U.S. at least for another 20 years.

One question that should be paid attention is "How does the U.S. and China see each other?" So far the U.S.'s view on China is moving toward "competitive" from "cooperative" due to the national security problems and the start of the next president race. On the other hand, China's view of the U.S. is also moving toward "competitive" because of some kind of domestic political needs. This situation seems as though it will continue at least by the last half of 2016. In the mid and long-term, the U.S.'s view will be primarily influenced by the business cycle and the presidential race, and China's view will be mostly influenced by domestic tensions during the economic reforms and the regime change. So the next five years will be a period to be watched, due to China's accelerating reforms. And the second half of the 2020's will also be time to be watched, due to China's nominal GDP becoming to equal the U.S. GDP, Another factor then will be China's decreasing population.

Figure 10 Schedule for Xi's visit

Date	Who/What	Topic
5/17	Kerry, Secretary of states, visited Beijing	general
6/11	Fan Changlong,Vice Chairman of the Central Military Commission, visited the U.S.	national security, military
6/23-24	Strategic and Economic Dialogue	Economic cooperation
8/27	China, military exercise at East China Sea	
8/20-28	China-Russia, joint military exercise at Japan Sea	
8/28-29	Rice, National Security Advicer,visited Beijing	general
9/9	Brian Deese, Senior Adviser, visited Beijing	climate change
9/9-12	Meng Jianzhu, Special Envoy, visited the U.S.	national security, cyber
9/22-25	President Xi, State visit	
22-23	Seattle (Boeing, Microsoft,etc)	
24-25	Washington DC (Formal meeting)	
9/26-28	President Xi, New York (Event at UN HQ)	

(sourse) various news source

Figure 11 Joint Press Conference

	Obama		Xi Jinping
Basic relation	The United States welcomes the rise of a China that is peaceful, stable, prosperous, and a responsible player in global affairs.	Basic relation	I appreciate President Obama's reaffirmation to me that the United States welcomes the rise of a peaceful, stable and prosperous China. It supports China to play a bigger role in the international arena.
Economy	We agreed to step up our work toward a high-standard bilateral investment treaty-(omit)-.President Xi discussed his commitment to accelerate market reforms, avoid devaluing China's currency,and have China play a greater role in upholding the rules-based system that underpins the global economy	Major country relationship	China is firmly committed to the path of peaceful development. It is committed to growing friendship and cooperative relations with all countries in the world. To work with the United States to build the new model of major-country relationship without conflict, without confrontation, with mutual respect and win-win cooperation is a priority in China's foreign policy.
Cyber	I can announce that our two countries have reached a common understanding on the way forward. We've agreed that neither the U.S. or the Chinese government will conduct or knowingly support cyber-enabled theft of intellectual property, including trade secrets or other confidential business information for commercial advantage.	Economy	We have agreed to vigorously push forward the bilateral investment treaty negotiation, --(omit)-- We will expand mutually beneficial cooperation in energy, environmental protection, science and technology, aviation, infrastructure, agriculture, health and other areas.--(omit)-- For the United States to recognize China's market economy status and ease export control on civilian high-tech items, it will help expand the mutually beneficial cooperation between the two countries.
Climate Change	I'm pleased that we're building on last year's climate commitments. Last month, I issued our Clean Power Plan to help reduce America's carbon emissions.	International Economy	We have also had in-depth discussion on the current international, economic, and financial situation.
Military channels	We agreed to new channels of communication to reduce the risks of miscalculations between our militaries. --(omit)-- We did have candid discussions on the East and South China Seas, and I reiterated the right of all countries to freedom of navigation and overflight and to unimpeded commerce. --(omit)--And I encouraged a resolution between claimants in these areas. We are not a claimant; we just want to make sure that the rules of the road are upheld.	RMB	I appreciate the U.S. supporting including the RMB into the IMF Special Drawing Rights when certain standards of the IMF are met.
		Military	We have truly affirmed the new progress made in the confidence-building mechanisms between the two militaries. --(omit)-- We are committed to maintaining peace and stability in the South China Sea, managing differences and disputes through dialogue, --(omit)--and exploring ways to achieve mutual benefit through cooperation.
Internatioal security	We've agreed to do more to promote international security.	Cyber	We should strengthen dialogue and cooperation. Confrontation and friction are not made by choice for both sides.
Human rights	I again affirmed America's unwavering support for the human rights and fundamental freedoms of all people, including freedom of assembly and expression, freedom of the press and freedom of religion.	Human rights	Democracy and human rights are the common pursuit of mankind. At the same time, we must recognize that countries have different historical processes and realities--(omit)--
Human exchange	We're taking more steps to expand the connections between our two peoples..	Climate Change	We have agreed to expand bilateral practical cooperation, --(omit)-- to push the Paris climate change conference to produce important progress.

(source) White House

V. U.S.-China economic relationship: China overtakes the U.S. as import market

i) Economic relationship between the U.S. and China: China's economic rise will be more clear. Building and maintaining the framework of economic policy cooperation will be the important issue

Regarding the economic relationship between the U.S. and China, the U.S. market and its cooperation with China have contributed to China's industrial reforms and have expanded China's domestic demand by providing huge market and leading China to be a market economy (joining the WTO, liberalization of the Renminbi, Bilateral Investment Treaty, and others) for a long time..

However, China is going to contribute to the U.S. economy by providing huge amounts of FDI, service imports and immigrants, all of which the U.S. needs. China has been replying to requests from the U.S. And through the U.S.- China relationship is becoming more cooperative than competitive because of diplomatic activities. This includes the Regional Comprehensive Economic Partnership (RCEP) , "One belt, One Road", in places of negotiations for trade and intellectual property friction. So far, it is becoming more and more important to build frameworks and dialogues for economic cooperation between the U.S. and China, as they are facing in opposite directions in terms of economic policies. While the U.S. moves to tighten monetary policy, China goes toward loosening it, which is strengthening the uncertainty in world financial markets.

On 5th, October, an agreement was reached in principle on major issues in TPP after 5 and a half years of negotiations. Regarding Trans Pacific Partnership (TPP), it is said the U.S. and Japan will wall off China in general. President Obama said that the U.S. will not allow China to take the lead in the 21st century economic rules. Nevertheless the real meaning of TPP is recognized as not walling off China but engaging in and cooperating with China. It can be said that the U.S. is looking to see how it can recognize China's economic rise.

ii) The U.S-China trade: China's imports will overtake that of the U.S. in the middle of the 2020's. China will be needed more

Trade is the most important factor for the U.S-China economic relationship at the present. The amount of U.S.-China trade reached 500 billion dollars in 2014. Gao Hu-cheng, China's minister of commerce in a newspaper interview, suggested that it will be more than 1 trillion dollars by 2024.

① Main scenario of the forecast

The real GDP growth rate in the U.S. will continue around +2% per year through the first half of 2030's, and that of China will slow to +4% per year also through the first half of 2030's. And I propose the following possible scenario.

In regards to the U.S.,

i) Exports to GDP (nominal export/nominal GDP) will moderately rise to 11% from 9% at the present (Figure12).

ii) The major upside factors are 1) expanding oil and natural gas exports with commodity price rises in the long-term, 2) accelerating high-tech exports such as aircraft and industrial machines. The elasticity of exports to GDP will remain stable at the level of 2010-15.

iii) Imports to GDP (nominal import/nominal GDP) will remain around 13% at the present level in the long-term.

iv) Trade deficits per GDP will decrease below 2% until 2035 from about 4% at the present (the result of i),ii)). The trade deficit value will increase in the short-term but will turn into decreases over the long-term.

v) Exports to China to total exports of the U.S. will rise to around 10% by 2035 from around 7% at the present. China's structure of imports will shift to more toward high added value items.

In regards to China,

i) Exports to GDP (nominal export/nominal GDP) will decrease from around 20% at the present to below 15% by 2035. The major reasons for this are: i) a decline in this ratio has continued since Renminbi reforms started, ii) a shift of labor intensive industries to foreign countries. The elasticity of exports to GDP, decreasing at the present, will somewhat recover.

ii) Imports to GDP (nominal import/nominal GDP) will also decrease from just below 16% to around 14% by 2035. Though a larger purchasing power will promote an increase in import, the ratio will decrease because of lower investments per GDP, the improvement of efficiency of energy/natural resources consumption, and the shift to service based economy.

iii) The trade surplus per GDP will decrease from above 5% at the present to around 1% through 2035(the result of i),ii)).Its value will increase until the middle of the 2020's, and decrease moderately toward the 2030's.

iv) Exports to the U.S. to total China exports will decrease from 17% at the present to below 15% through 2035. China's exports will be diversified more, shifting from the developed countries to the developing countries.

About other foreign economies, Japan and ASEAN will depend more on exports, being stimulated by China's expanding domestic demand and the effects of TPP and RCEP. India also will increasing depend on export due to leadership in the Pan-Indian Ocean trade.

Looking at the world economy, the U.S. is become the only champion in the 2010's. The Euro zone, China, and emerging countries have seen their growth momentum weaken. This contains slowdown and adjustments prevent maintaining them from stable economic growth and steady trade expansion. Especially in emerging markets, a strong dollar and weak emerging currencies leads to a repatriation of U.S. dollar and a plunge in commodity prices, all of which are reducing emerging countries' purchasing power and financial stability. The negative impacts of normalization of U.S. monetary policy and China's economic slowdown will gradually decrease, and the world economy and trade will return to the trajectory of expansion in the mid-term (2 to 5 years). However trade growth will be difficult to grow faster than it did at the beginning of the 2000's, due to demographic and major countries slowdowns.

② Result of the forecast

World exports (Imports) will grow by +4.7% per year until 2025 (export value will be 28 trillion dollars in 2025, as compared with 18 trillion dollars in 2015) and by +5.2% per year for the ten years until 2035(47 trillion dollars in 2035) (Figure 13). U.S. exports will increase by around +5.2% per year until 2025 (their value will reach 2.7 trillion dollars, up from 1.6 trillion dollars in 2015), and by +4.8% per year for the following 10 years 2025 (4.3 trillion dollars in 2035) (Figure 14). China's export will expand by about +6.2% per year until 2025 (its value will reach 4.3 trillion dollars up from 2.3 trillion dollars in 2015), and by about +4.8% per year until 2035 (6.8 trillion dollars). The share of U.S. exports in world trade will be almost unchanged around 9%. Looking at China, its export will rise moderately to 15% in 2035 from 13% at the present.

Referring to import, U.S. imports market will grow by around +3.6% per year in next decade to 2025 (3.5 trillion dollars up from 2.4 trillion dollars in 2015), and by +3.5% per year in the 10 years after the next decade (5.0 trillion dollars in 2035). China's imports will increase by +7.3% per year until 2025 (3.6 trillion dollars up from 1.7 trillion dollars in 2015) by +6.0% per year until 2035 (6.4 trillion dollars). U.S.'s imports share in world imports will slide to a level of +10% in 2035 from around 13% in 2015. On the other hand, China's imports share in world imports will continue rising to around 13% in 2035 from below 10% in 2015.

During this period, trade between the U.S. and China will expand from about 500 billion dollars in 2015 to 900 billion dollars in 2025, to 1.4 trillion dollars in 2035 (Figure 15). About the trade balance, China enjoys a 300 billion dollar surplus from the U.S at the present; this surplus will expand to 400 billion dollars in 2025, and to 500 billion dollars in 2035. However of the U.S.'s trade deficit per GDP with China and China's trade surplus per GDP with the U.S.,will both decrease steadily.

Meanwhile, the TPP agreement countries' GDP in nominal terms, due to the U.S.'s contribution, is larger than RCEP negotiating countries' GDP at the present (China is promoting RCEP seeking a central role), the share of TPP countries to world GDP reaching 36% against 29% of that of RCEP countries. However, the GDP of RCEP countries will overtake that of TPP in the future, unless TPP will expand (at the end of October, South Korea and Indonesia announced their joining TPP).

In terms of trade, RCEP countries' exports has already overtaken that of TPP, with RCEP recording 28% of world exports against TPP is 24% at the present. RCEP will expand this lead toward 2035 by increasing intra-Asian trade.

iii) Implication for world economic order and the U.S. view

① China will overtake the U.S. in terms of global supply chain and consumption market in the middle of the 2020's

In the middle of the 2020's, the U.S. will keep its No.1 position in nominal GDP and import. On the other hand, China will be No.1 in nominal GDP, exports and imports in the middle of the 2020's (PPP GDP is going to overtake that of the U.S. at the present). TPP, in which the U.S. leads, is larger than RCEP in nominal GDP, but RCEP has already overtaken TPP in terms of trade. While the U.S. and Japan, two leaders of TPP, are the countries where domestic demand is leading their economies, and TPP countries depend less on trade, China and other Asian countries forming RCEP are building a close supply chain which China exists at the center of it. This means that RCEP countries depend more on trade. Due to rising labor costs and outflow of assembling factories, China's dependency on exports can easily decrease. And due to becoming a more consumption driven economy and a more efficient economy, its dependency on imports is going to decrease. However, China will keep its position as a center of supply chains, because the economies of scale in material industries and machine manufacturing industries cannot be easily transferred from China, and further expansion of world trade will need China' s supply chains of core materials and parts.

Through the success of the TPP agreement, the U.S. and Japan have until now gotten a superior position in making trade and investment rules. Some industries and factories such as light electronical equipment, automobile parts and cloth can move from China to TPP agreement countries such as Vietnam. China may lose its some superior position. But we should never forget that we cannot build supply chains without China and we cannot make rules to exclude China. What the U.S. and Japan, particularly the U.S can do is to make rules which every country can set up as ideal goals. The U.S. will be expected to be more of a promoter in both making rules and securing China's agreement to them which are acceptable globally and prevent from building rules which are not acceptable.

② Trade frictions between the U.S. and China will be diminishing

Trade deficits with China will continue to increase over the long-term. However, because trade deficits per GDP will decline steadily, the trade frictions between the U.S. and China will also diminish gradually. And four factors can be said to contribute to diminishing the frictions: i) a number of key items will swell further: an employment inducement effect in the U.S. from China will be made much bigger by China's service trade deficit, FDI to the U.S. (according to Rhodium Group, 14 billion dollars at the present); immigrants, students and tourists from China will increase (2 million accumulated immigrants or 100 thousand immigrants per year buying 25 billion dollar of residence per year, 270 thousand students spending 22 billion dollars per year, and 220 thousand tourists spending 24 billion dollars per year(11 thousand dollars per person a year)) , ii) the current frictions do not come from key manufacturing industries such as automobiles or aircraft: Half of the trade deficit with the U.S.is from manufactured goods such as cloth, shoes and toys; and a large part of the trade deficit comes from intra-company trade, particularly in the electronics industry. The value added of non-China brand smartphones made in China is estimated at less than 10%, but the U.S. contributes more than 50% of the value added. iii) partnerships between the U.S. major companies and China's major companies are strengthening recently, iv) dialogues such as S&ED and a joint belief that economic frictions and uncertainties should not be allowed to increase in the global economy, also bring in success one.

③ It may take a long time for the U.S. to accept China' s economic rise as a factor in restructuring the international economic order after WWII. This dilemma may cause some unforeseeable risks

The biggest risks for the global economy which I have found through this forecast are these: a diminishing trend in the

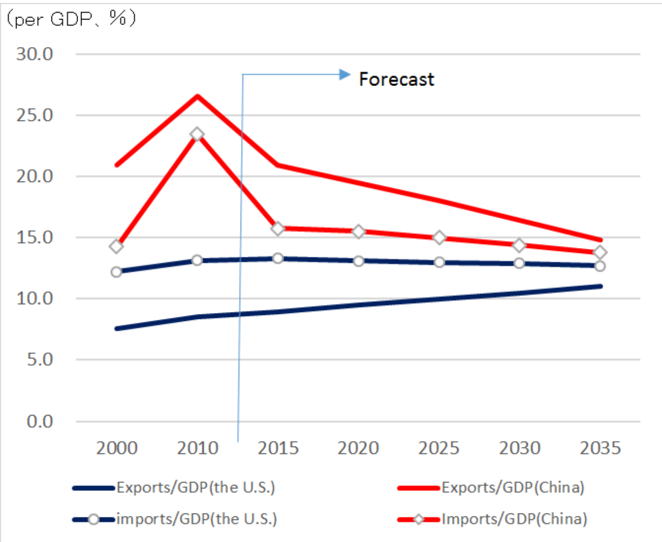
U.S.'s trade or current deficit per GDP, and a declining trend in China's trade or current surplus per GDP as these two economic power work through the next decades. This means: the global money supply, following the U.S. trade deficit and the global flow of funds following the China's trade surplus, are easily to be short, unless a much more reliable global liquidity supply source or supply system is built. This may lead to the instability of non-major currencies and economies. In addition, a gap in the direction of economic policies between the U.S. and China may enlarge volatility and uncertainty in the global economy.

The U.S. monetary policy is decided by domestic issues such as employment and prices. September 2015, FOMC postponed raising interest rates with an unusual comment referring to China's economic uncertainties. In the back ground, there was a relatively big correction in global stocks and on foreign exchange markets from June to August in 2015, and there was a request at G20 that the U.S. take more care in preventing its monetary policy from influencing the global economy. But the U.S. monetary policy's uncertain posture towards the global economy has not become clear. If the U.S. lowers its ability to supply global money as a key currency country, or loses its will to benefit to the global economy by expanding its trade deficit, there will be no entity of last resort or global economic leader. China would then be more expected to be the new entity of last resort or global economic leader. But it has a lot of issues itself; economic reforms such as economic globalization of the Renminbi, or decreasing trade surplus. Thus it may not have enough room to be the global economic leader. The 2020's may become the era of two economic powers, but each of them may not have enough ability to support the global economy. Though economic cooperation of the U.S. and China is much easier than their national security or military cooperation, the economic order after WWII will still have to struggle adapt to a new situation with no strong economic leader like the U.S. was in the cold war era. Harmonizing the differences between the two and balancing cooperation and competition between the two; these are beyond economic diplomacy.

iv) A Risk Scenario

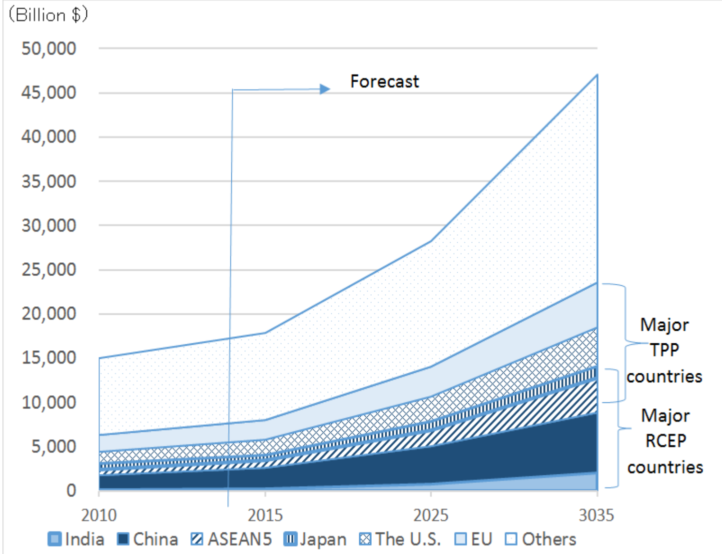
If China's dependency on imports continues to decrease dramatically (China's imports in the first nine months of 2015 was minus 15% yoy), the global economy will face severe deflationary pressure. The share of China's imports, as a % of world imports of major commodities, is so high that a sudden decline in these imports would destroy emerging economies; the vicious circle of trade deficits or currency depreciations in emerging economies would create a financial crisis. So, at the present, short-term stabilizing measures, particularly trade stimulating and finance stabilizing measures, become more important than long-term measures. Careless workarounds for economic risks easily generate other risks. We are going to face a big dilemma (Figure 16).

Figure 12 Trade/GDP



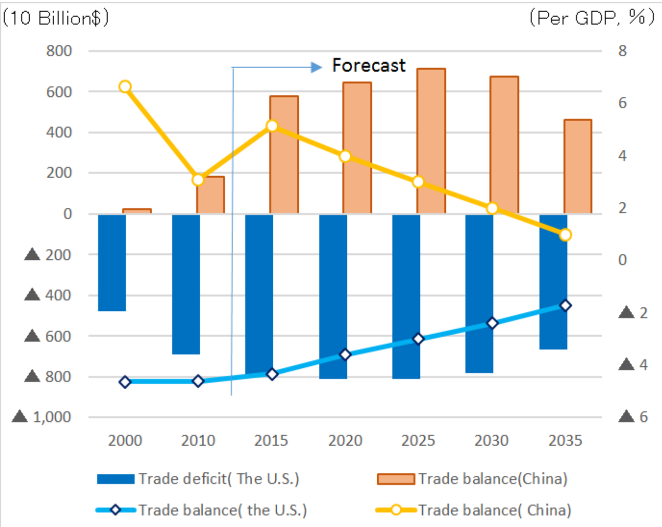
(note) the figure of 2015 is the forecast by 2014 and first half of 2015 data
(source) Marubeni Research Insititute

Figure 13 World Trade (exports)



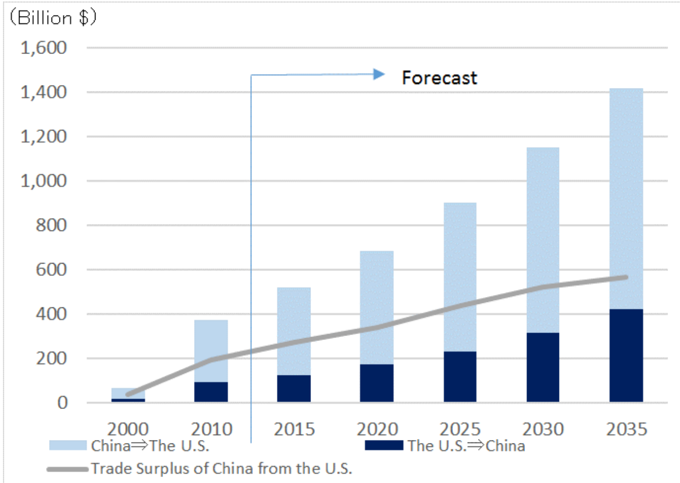
(note) ASEAN 5:Thailand,Malaysia,Indonesia,Philippines,Vietnam
(Source)Marubeni.Research Insitute

Figure 14 Trade balance of the U.S. and China



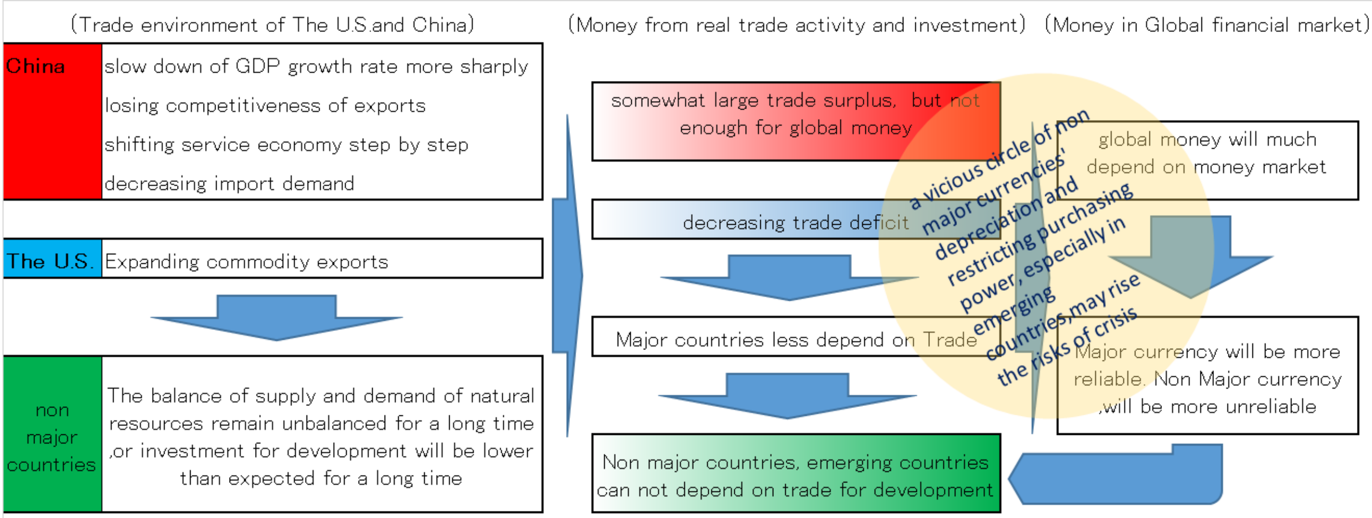
(source)Marubeni.Research Institute

Figure 15 Trade between the U.S and China



(note) The U.S.⇒China estimated by the U.S.statistics, China⇒The U.S.by Chinese statistics.
(source)Marubeni.Research Institute

Figure 16 The mechanism of risk scenario



(souece) Marubeni Research Institute

VI.Economic diplomacy: Starting challenges for new international order?

i) Economic diplomatic activities in 2015

After the establishment of the Xi Jinping administration, China is accelerating new economic diplomacy, which has set up several new tools and goals, such as "Neighborhood diplomacy", "One Belt One Road", " a New Model of Major Power Relationship(with the U.S.)", "Asia for Asians", "Asia-Pacific Dream" : all of these concepts came out of the following gatherings: Work Forum on Neighborhood Diplomacy on October 2013, the 4th summit of the Conference on International and Confidence-building measures in Asia (CICA) on May 2014, the Asia Pacific Economic Cooperation (APEC) on November 2014, and others.

In 2015, President Xi and Premier Li deployed more energetic diplomatic actions in major countries. In the first half of the year, these two top Chinese leaders met with the leaders of Russia, India, Brazil and Indonesia. And in the second half of the year, President Xi made the first official visit to the U.S. before the Chinese National Day. After that, Xi and Li met with or made official visits to almost all major countries in Europe, such as Great Britain, France, and Germany; in East Asian countries, such as Japan, Korea and Taiwan; and with Southeast Asian countries, such as Vietnam, Singapore, the Philippines and Malaysia. In 2016, regarding Middle-East uncertainty, China joined peace talks in Afghanistan and President Xi visited Iran, Saudi Arabia and Egypt.

Characteristics of diplomatic actions before the Chinese National Day can be said that higher priority and emergency issues were focused on. For example, focus was placed on the following: getting support for AIIB and One Belt One Road, which would strengthen ties with major developing countries; maintaining and confirming a relationship with the U.S, the South China Sea situation and cyber security have caused the tension between the two countries. On the other hand, after the Chinese National day, Chinese diplomacy were turned toward more structural issues such as strengthening relationships with European countries which expect to become bases of off-shore Renminbi markets and to conclude various trade and investment cooperation with China, to improve relationships with Asian countries in which territory and sovereignty disputes have risen.

As a whole, it can be said that China has intended to separate economic diplomacy from political diplomacy and to place more emphasis on geopolitics (As far as international politics is concerned, it is said that China's diplomacy is changing into great power diplomacy). In terms of separating economy diplomacy from political diplomacy, China seems to have put aside political issues that are difficult to cope with, and to have brought forward economic issues which can easily emphasize mutual cooperation. About territory and sovereignty disputes, though there was no compromise between China and its opponents, however, both sides have agreed to build mechanisms for avoiding escalations of disputes, and to seek opportunities for mutual understanding. In terms of geopolitics, through building infrastructures and participating in regional cooperation frameworks, China has strengthened its mutual ties with neighboring countries. In the past, China's neighboring countries were referred as border countries, but as China proposes new concepts such as AIIB and One Belt One Road, the meaning of neighboring countries has been taking a more of a Pan-Eurasia meaning.

In its open door policy, China had focused on domestic development for a long time, and China had emphasized maintaining a low profile, called "Hide and Bide" as well. This was China's reality. On the other hand, since the end of 2014, it has been said that President Xi has been shifting its diplomacy into a more active one such as "Great power diplomacy", and "Being active". This kind of shift is becoming an underlying concern for the current international order, especially for East and Southeast Asian countries. However, looking carefully at China's economic diplomacy since 2015, China has been becoming active but has maintained its pragmatic posture and its principle.

China's current economic diplomacy is still based on China's economic reality. China needs to reform its economic structure and to keep its solid economic growth respectively. On the other hand, China still needs stability both inside and outside the country. I think that there are mainly five things, which we should pay attention to in economic diplomacy, all of which would become at the moment new risks for the global economy and the economic order (Figure 17).

First, China's new institutions and frameworks themselves would cause new kinds of conflicts. For instance, the founding of AIIB became a divisive issue, separating the developed countries into two camps in the first half of 2015. And a New Model of Major Power Relationship proposed by China has not been accepted by the U.S. and has caused the U.S. to be embarrassed. These conflicts may not necessarily be said to be actual problems, because a sound arrangement and competition may occur in some cases. But, on the other hand, unforeseen misunderstandings and mistrust often occur between countries.

Second, some Chinese concepts of economic diplomacy would come in conflict with those of developed countries. While the economic cooperation of developed countries includes some demands for recipients to adopt some western style democratic reforms, China's economic cooperation is based on non-intervention into recipients' internal affairs. Demands are for China and other donor countries to adopt common concepts on these disputed issues in order for economic cooperation to continue without creating new problems.

Third, One Belt One Road would create inefficient infrastructure projects in the long run.

Fourth, there is concern about the sustainability of separating economic diplomacy and political diplomacy on a practical level. This is in reference to Russia, Central Asia, and South Asia, whose political continuity and social stability are unclear in the long term. China's economic diplomacy would face new problems in the future. This is a big challenge not only for China but also for the " Pan-Eurasia" countries.

Fifth, China would have to clear further its political attitude to Middle-East as one of global leaders. It would not be allowed a free ride on this issue, nor be allowed to avoid a proactive contribution to peace-building in the region.

ii) Economic diplomacy toward 2035

① Basic conditions

Thinking about China's economic diplomacy over the next twenty years, it will be conclude on 4 levels. The first level is the U.S. which will exist as a leading super power. The second is the neighboring East and Southeast Asian countries which will have continued relatively solid economic growth. The third consists of the other neighboring countries such as Russia, Central Asia, and South Asia. The last is "Others" such as Europe, the Middle-East, Africa and Latin America.

And one important thing when we foresee China's economic diplomacy is that China is going to build new economic orders mainly along frontiers. China's center of economic diplomacy is shifting from trade and inbound foreign direct investment with developed countries, where is not bordered, into trade and outbound investments with neighboring countries. In other words, China's economic diplomacy is going to include two spheres (the old relationships with developed countries and new relationships with neighboring countries covering Eurasia) and going to include two directions (old inbound investments and new outbound investments). This will expand the Chinese influence on the international economic order and systems. This should not necessarily be denied, but it will impose more responsibilities and more burdens on China. Under the Chinese economic slowdown, China have to share these responsibilities with the countries on each level in relative ways. If China will take a hegemonic economic diplomacy path, it will not be easy to sustain this approach.

Comparing each other's economic conditions, it can be summarized as follows.

China will expand its economy while there is a huge risk of a plunge in economic growth in the last half of the 2010's and there will be a further shift lower in economic growth in the last half of the 2020's. China's nominal GDP in US dollars will overtake that of the U.S. at the end of the 2020's. The risk of a sudden devaluation of the Renminbi will be relatively smaller than that of other emerging currencies under a progressively internationalized Renminbi. And China's dependence on foreign trade will be gradually lowered by economic structural changes and a relatively strong Renminbi. So China will be one of the most influential players in foreign direct investments and foreign aid. However, even if the Chinese economy develops in a bigger and better way, it will continue to be difficult for China to transfer its development philosophy and model (e.g. a one-party administration, an economic growth oriented strategy, a full set type industrial structure) to the neighboring countries, which . China will be able to be No.1 in varying degrees, but it won't mean that the Chinese economic diplomacy can be conducted easily.

The U.S. will keep growing moderately. The sheer volume of economic activity will be overtaken by China, but the quality of its economy such as personal income levels, and the innovativeness of industry and finance won't catch up with the U.S. . The political and economic systems of the U.S. is more universal than those of China. This U.S. superiority won't diminish within the next two decades.

Japan will continue to experience lower economic growth and find it will more difficult to stand alone. Japan will need to expand foreign trade and investment. Building various kinds of alliances and partnerships without discrimination will be more crucial for its survival.

Southeast Asia and India will maintain relatively high economic growth. However their economic volumes will be far smaller than those of China. So, they are going to have to strengthen their political and economic ties inside and outside the region, through the ASEAN Economic Community (AEC), the Trans Pacific Partnership (TPP) and alliances with the U.S., in order to maintain equal partnerships with China. Within the next twenty years, physical and institutional connectivity will progress under the ASEAN 2025, the Free Trade Area of the Asia-Pacific (FTAAP). Some countries such as Myanmar and Cambodia will become more democratic. The international position of Southeast Asia and India will improve further, being helped by the Japanese strategy for Asia and the U.S. pivot as well.

Russia, Central Asia and South Asia would grow relatively moderately. Because since a transitions from long-term dictatorial administrations, severe religious tensions, and ethnic problems will all contribute to the continuing risks of political and economic uncertainty, the diplomatic posture can't be predictable in the long run.

② Economic diplomacy in the future

China's goal of economic diplomacy in the next twenty years will be engaging its neighboring counties and connecting with Eurasia and the world by leading with a new economic framework and new institutions such as OBOR (Figure 18) and AIIB, while maintaining a relatively stable relationship with the developed countries. What becomes a tool for economic diplomacy is the cooperation through development of transportation, trade, and finance and creation of systems. In other words, the promotion of virtuous economic and political circles which by improving the economic growth of neighboring countries, also improves China's economic growth. This can be said to be able to reverse a vicious circle in which acceleration in investments and plunge in commodity prices, which has been seen in recent years.

On the other hand, there is concern in the international community that China's rise in this way would increase its say and pressure on the existing international order, especially in terms of territory and sovereignty. However, it would be difficult for China to be self-centered since China's high growth era is now finished, with many significant economic and social problems remaining. China's enterprises and financial institutions will take more time to mature to supply money globally. Neighboring countries which will become partners for a breakthrough in new economic developments will continue to have underlying political risks for a long time.

Under these circumstances, China's economic diplomacy, moving in its best direction for improving the global economy, should be accepted by many countries (policy cooperation to be accepted universally) and to reduce political and social uncertainties in Eurasia. And China should contribute to the framework of the global economy such as G20, WTO and other international institution, the framework of Asian regional economy such as ASEAN+3, ASEAN+6 and APEC, and the framework of regional developing countries such as BRICS, and Shanghai Cooperation Organization (SCO). But within the next twenty years, it will remain uncertain whether the best direction won’t be derailed. Chinese economic diplomacy has to be seen with prudent attitude.

Figure 17 Major risks in neighboring countries and areas

	Risks
Japan	・Territorial disputes and historical problems become worse again
Southeast Asia	・The richer Southeast Asian countries become, the more democratic countries they become. Some counties may review their current relationships with China ・Territorial disputes become worse
South Asia	・China-Pakistan cooperation often creates frictions between Pakistan and India. Investments for China-Pakistan transportations would become new factors of terrorism in the region ・Some countries would not achieve and maintain sustainable growth ・The Middle-East countries’ uncertainty would reduce stability in South Asia ・Confricts between China and India would increase in their power games
Russia	・If relationships with Western countries improve or President Putin resigns, Russia would change its relationship with China
Central Asia	・It is uncertain whether Central Asia countries, which includes some dictatorial countris, would maintain their positive attitutde toward China ・Terrorism and anti-China mood would occur through religious accidents in China ・The infrastructure developments in low population density areas would destroy sound development in the long run ・Some governments would not achieve and maintain sustainable growth ・The Middle-East counrties’ uncertainty would reduce stability in Central Asia

(Source) Marubeni. Research Institute

Figure 18 One Belt One Road Projects

(Source) http://www.merics.org/merics-analysen/china-mapping/seidenstrassen-initiative.html

VII. Conclusion

Implications of each chapter are as follows;

Primarily, there is an optimistic scenario that China's nominal GDP in dollar terms will be at the 30 trillion dollar level and overtake the U.S.'s GDP in the late 2020's. The real GDP growth rate will slow to the 3% level in the first half of the 2030's. However, for achieving this scenario, the success of economic reforms, especially financial reforms, is needed. Financial reforms include not only the recent completed liberalization of interest rates but also promoting reliable and innovative financial institutions and markets, the relaxing of capital controls, and the globalization of the Renminbi. Unless China's financial fundamentals are stabilized, it will become difficult for China to overtake the U.S. GDP because of the rising risks of a serious credit crunch or the Renminbi's depreciation. Accumulating current surplus and increasing outward investments will help with the Chinese economic and financial stability and globalization. But standing in the way of financial reforms will be financial pressures, such as increasing fiscal deficits caused by a declining labor force and an increasingly aging society, huge remaining debts of SOEs and local governments, and saturated local government investments. If the Chinese economic and financial reforms come to a dead end within this the next five to ten years, a pessimistic scenario will become real.

Incidentally, the U.S. will maintain its military lead over China during the next twenty years. However, in the limited Western Pacific, the military forces of the U.S. and China will come into a balance in the last half of the 2020's. The military tension between the U.S. and China will easily increase in the next five years when increases in the military budget of China will be much greater than that of the U.S..

Secondly, although China's energy consumption, especially oil, will continue to increase due mainly to the spread of automobiles, the overall growth of energy consumption will radically decelerate. In the 2000's oil and commodity prices rose, and, China's rapid industrialization, urbanization and motorization contributed to increased energy consumption. On the other hand, in the 2020's, these three factors will no longer make such a contribution. In addition, the substitution of energy saving products, a shift to renewable energy sources and a diversification of energy imports by construction of the Eurasia pipelines, will save more energy. China's influence on world energy demands will decrease.

Thirdly, China's dependence on external trade will be gradually lower reflecting a reduction in fixed investments and a shift to a service economy. Though trade and current surplus will remain as absolutely large amounts, these surplus per GDP will become lower and lower. The U.S.'s dependency on external trade will remain almost at current level over the long term, due to the available expansion of energy and commodity exports. And the U.S.'s trade and current deficits per GDP will gradually decrease. During the economic shift in the relationship between the U.S. and China, that is, the shift from trade in goods to trade in services or foreign investments, frictions will become less severe not only between the U.S. and China but also between China and the rest of the world.

Fourthly, in the situation such I mentioned above, both the U.S. and China will explore cooperative relationships rather than competitive relationships. In 2015, the U.S. become more guarded in its relationship with China, because of China's challenges to the current international order, such as the foundation of the Asia Infrastructure Investment Bank (AIIB) and the "reclamation" works in South China Sea. Nevertheless, for the U.S.-China related problems are not urgent issues to be immediately dealt with through the use of military power or economic sanctions. For the U.S., Russia and the Middle-East, which are unstable with economic decelerations and increases in terrorism, present more urgent issues. On the other hand, for China, it is more necessary to make progress in economic reforms. And China may represent a peculiar approach toward the current international order, but would seek to avoid confrontation with the U.S.. In the next twenty years, it will be pragmatic for the U.S. to set its priorities on the international politics of Russia and the Middle-East rather than on Asia even if China's rise will be a potential threat for the U.S. and its allies. And it will be rather realistic for China to follow the current international order led by the U.S. As a result both countries will seek cooperation with one another.

Lastly, it is hard to predict if China's diplomatic efforts will be a success or a failure. From the Chinese diplomatic activities in 2015, we can see that China tried to stabilize its relations with other countries, in line with three approaches: separating political and economic affairs, focusing on geopolitics and understanding and accepting reality as it exists. But, it is uncertain whether AIIB or One Belt, One Road, which may contribute to stabilizing both China and its partner countries' economies in the short time, will contribute to political and social developments and the stability of partner countries. In fact, China's foreign economic aids in infrastructures and mining development are often judged to bring about new problems. Many neighboring countries have difficult issues such as dictatorial regimes, transitional problems, rational problems, and others. Both good mutual interactions and bad interactions may influence one another.

And the important things for anyone building relationships with China are as follows;

i) China will have a large production base and a large purchasing power. The large production base includes not only manufacturing but also service to be a center of global value chains. Economic globalization will proceed to some extent mainly in state own enterprises and banks. But economic reforms as an upgrade of the industrial structure, an adaption to geometric changes, an optimization of energy structures and others, will not be finished during the next twenty years. Maintaining Reform and Open-door policies will remain as the best path for China. Deepening and improving international economic relations by the ASEAN Economic Community (AEC) and the Trans-Pacific Partnership (TPP) will help China continue as well.

Also, it should be said that there is much uncertainty about the effects of One Belt, One Road which is expected to vitalize trade and investment on the Eurasian continent by connecting railways and roads in the next twenty years. Because the stability in Russia, Central Asia, and the Middle-East is vulnerable, and these areas need more industrialization. On the other hand, we can expect deeper connectivity between China and Europe, and between China and other East Asian countries. Regarding the connectivity between China and Europe, though the direct impacts from railways and roads for expanding international trade would be limited, fewer political frictions and greater expectations for economic profits will all strengthen the investments and relationships. Regarding the connectivity between China and East Asia, though political conflicts would be negative factors, building close supply chains, vitalization of business by overseas Chinese, increasing overseas travels and others would all help deepen this connectivity. In fact, the globalization of Renminbi can be clearly seen in the Indo-China Peninsula, and East Asia is becoming the center of the globalization.

ii) For Chinese diplomatic and military progress, it is better for China to have more dialogues and expand broader cooperation with the U.S. and other countries. This is true because: i) there are large gaps in how China and developed countries perceive each other's political systems. For example, China has a doctrine of non- interference in the affairs of other countries, ii) there are frictions with neighboring countries in territories and waters, iii) there are large political uncertainties in neighboring countries (Russia, Central Asia, the Middle-East), and a second best path to avert problems would be to build a mechanism to avoid various risks mentioned above.

iii) At the present, the U.S. is seeking realistic ways to maintain stable relations by encouraging China to think highly of the current international order, the rule of law, democracy, governance and others, also by containing China through the pivot to Asia. It would be better to think that the U.S.would encourage China to be more democratic only when China has become much more stable. Military exchanges, energy cooperation in climate change and nuclear power, and understanding of One Belt, One Road all seem to represent the U.S.'s will to realistically engage China in the U.S.'s global strategy.

Regarding the U.S.'s global strategy or its China strategy, it is said that the U.S. does not have actually definite strategies and goals. Recently, an argument about a hegemonic competition, it is called Thusydides Trap, involving the U.S.as a present super power and China as a new super power, and presents an argument about the Chinese changes in diplomatic attitude to be more proactive as a challenge toward the current international order, has become popular in academic circles. And dissatisfaction is growing among both the U.S. Republicans and the Democrats to a relative decline in the U.S. national power and President Obama's diplomacy. As a result, I think that the next President will deploy a stronger posture vis-a-vis China.

iv) Under the circumstances mentioned above, I think that Japan will have to have mainly two attitudes in its international communications with China. Primarily, Japan will continue to face and deal with large differences between their country and China. Also, Japan must continue to seek various area of cooperation with China. Looking back on Japan-China relations since the restoration of diplomatic ties in 1972, Japan had improved the relations by being a mediator between western developed countries and China by the end of last Century.

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