

# China Economic Spotlight

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Economics - China

## Slowing population: How worrying is it?

- ◆ Population growth has slowed to a record low and the labour force is shrinking
- ◆ But a smarter workforce is replacing retirees, while faster urbanization helps to lift labour productivity
- ◆ We expect growth in human capital to gain momentum in the years ahead, which is conducive to long-term economic growth

The census results are in, and the population is still growing, though at a slower pace. But many are concerned about the population peaking in size soon and the impact of a smaller labour force on China's longer-term growth. Indeed, the latest data shows the population is aging fast and the labour force is shrinking. But these concerns are overblown, in our view, as a smarter and more productive labour force is replacing the retirees. We believe human capital will continue to grow strongly over the next decade or so as previous investment into education pays off. Combined with a faster pace of urbanization, this should more than offset the negative impact on economic growth from a shrinking labour force. We expect China's potential growth to stay above 6.5% in the years ahead.

### Population is slowing and aging, but concerns about the negative impact on economic growth are overblown...

The headline results showed China's population increased to 1.41bn people in 2020, a 72m increase from the last census in 2010. The compound annual growth rate was 0.5% for the last decade, which was the slowest pace since the census has been recorded. The data also confirms that the population is aging fast. The share of the population over 65 years old saw the largest increase, as the ratio rose by 4.6ppt, while those between 60 and 64 saw the ratio increase by 0.8ppt from 2010.

Meanwhile, new births also stalled. In 2020, the birth rate fell to 0.85%, the lowest on record, though this was most likely an outlier year due to the COVID-19 shock as the previous years saw modest growth rates averaging roughly 1.2% in the period from 2010 to 2019. Nonetheless, even excluding 2020, the birth rate has shown a noticeable decline in pace, which also puts pressure on the population growth.

As more people age and retire and the birth rate slows, this in turn means that the working age population is shrinking. The working age population (see footnote on page 2) fell to 879m, down 37m from 2010, or a CAGR decline of 0.3%. While the declining working age population has made many investors concerned about the shrinking labour force and its negative impact on China's longer-term growth, this is overblown, in our view.

*This is an abridged version of a report by the same title published on 12-May-21. Please contact your HSBC representative or email [AskResearch@hsbc.com](mailto:AskResearch@hsbc.com) for more information.*

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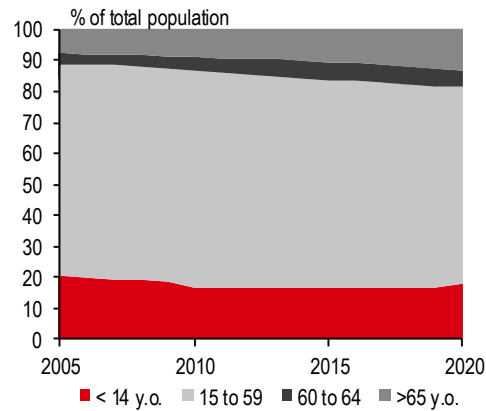
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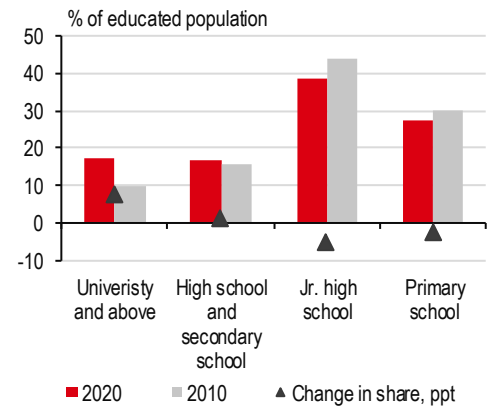
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**Chart 1. An aging population**



Source: CEIC, HSBC

**Chart 2. Education levels have increased**

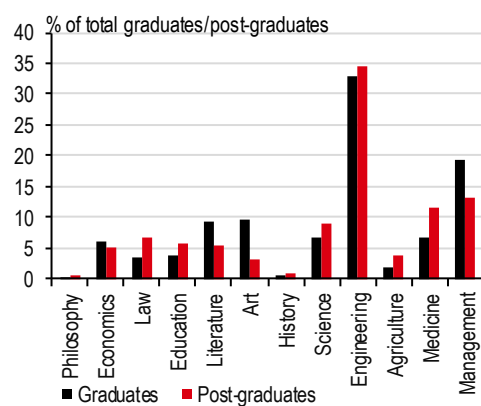


Source: CEIC, HSBC

**...because it is being replaced by a smarter work force**

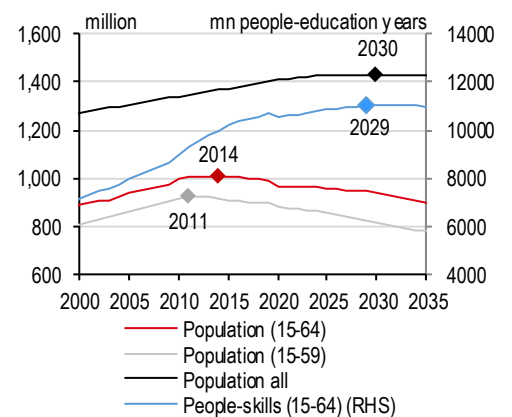
Most importantly, a smarter and more productive labour force is replacing the exiting retirees. In 2020, there were over 218m people who had a university or higher level of education. This is a 73% increase from 2010, and shows the rapid gains in education levels of the population. The share of the educated population with a university or higher level education saw the sharpest increase, rising by 7.2ppt to 17% over the last decade. Meanwhile, the shares of primary and junior high levels of education declined, showing a clear upgrading in education levels. We estimate that for every two retirees that have less than eight years of education, they are being replaced by 1.9 new graduates who have over 12 years of schooling. Moreover, university and post-graduate students are choosing to specialize in more technical fields with over 40% concentrated in science, technology, engineering, and maths (STEM). This should in turn support China's drive for increased technological development.

**Chart 3. Over 40% of students in university and postgraduate are in STEM**



Source: Wind, HSBC, Data is from 2018. University graduates in this chart do not include vocational school graduates

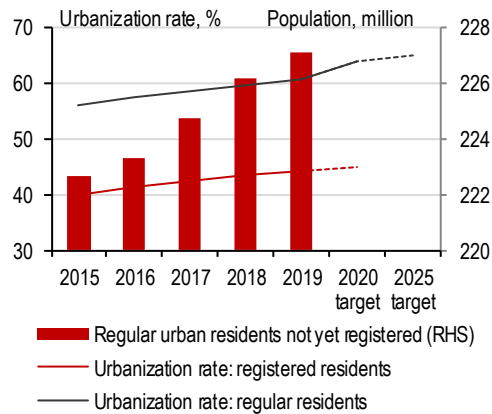
**Chart 4. Human capital will still grow over the next decade**



Source: CEIC, NPC, Barro—Lee, UN, HSBC; For working age population, we define as aged 15 to 64<sup>1</sup>. Marker denotes peak year. Projections are from 2020 onward.

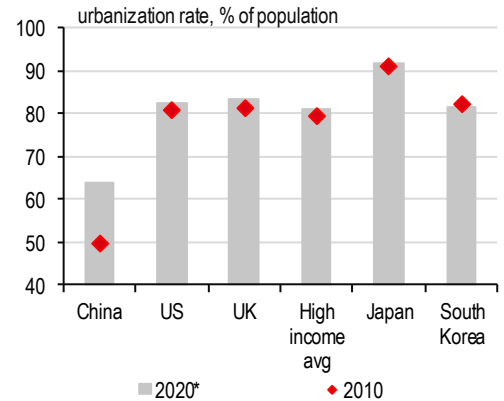
<sup>1</sup> While the retirement age is officially 60 years old, we expand the demographic to 64 as this age group is generally still able to work and due to data limitations as the expanded demographic group allows for a longer time series analysis. The 14<sup>th</sup> Five Year Plan also mentioned that there will be a gradual increase in the retirement age in the coming years, which is likely to expand to this age group.

**Chart 5. Urbanization has accelerated**



Source: Wind, NBS, HSBC; Dash line denotes target.

**Chart 6. China's urbanization rate still falls behind other developed economies**



Source: World Bank, NBS, HSBC; Urbanization rate for 2020 is for China, for other countries, data is for 2019.

We believe the smarter workforce can more than offset the shrinking size of the labour force. In fact, once adjusted by education, we find that human capital growth is still positive and likely to continue to grow over the next decade, and is not likely to peak until 2029 (see blue line in Chart 4). This is one year faster than our previous estimate of 2030 as the census data showed a slightly larger decline than anticipated in the working age population.

Aside from education, there are also other drivers that would support human capital development. Improvements in health care coverage and health care breakthroughs can improve labour quality, while increased labour market protections and social security coverage would also benefit more productive and satisfied workers.

**Urbanization accelerates**

One key factor driving China's labour productivity growth has been urbanization. As rural workers move to urban centres, they gain more skillsets, higher paying jobs, and can contribute to a more productive area of the economy. The urbanization trend has in fact accelerated. The population census showed the urbanization rate reached 63.9%, close to the 14<sup>th</sup> Five Year Plan's target of 65% by 2025. In our view, while this puts China closer to its target, this does not necessarily mean that the pace of urbanization will slow. Urbanization will likely be a continued trend as there is still more than enough capacity for China to continue to urbanize. China's urbanization rate lags behind other developed economies as the average urbanization rate of high-income economies is above 80%.

We estimate that if China continues to urbanize at a pace of 5ppt of the population over the next five years (which has historically been the target in prior FYs), this means roughly 70m more urban workers and would help to boost labour capacity by 3.5%. Continued focus on hukou reforms and land rights reforms could help to continue to lift the urbanization rate. Meanwhile, a renewed focus on the industrial sector in the 14<sup>th</sup> FYP also means that migrant workers are likely to gravitate towards higher-productivity sectors as opposed to lower-skilled services sectors. This would also help to allow China to unleash its productivity potential.

**Human capital matters more**

Putting this altogether, we think the drivers for human capital development are still going to be strong in the coming years. While the working age population is shrinking, this is likely to be more than offset by a smarter and more-productive labour force. In terms of longer-term economic growth, we believe human capital will still be a contributing factor, and will help to keep potential growth elevated and above 6.5% in the coming years.

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