PRUDENTIAL **INSIGHTS**

PRUDENTIAL
INVESTMENT MANAGERS

David Knee
Chief Investment Officer

AUGUST 2019

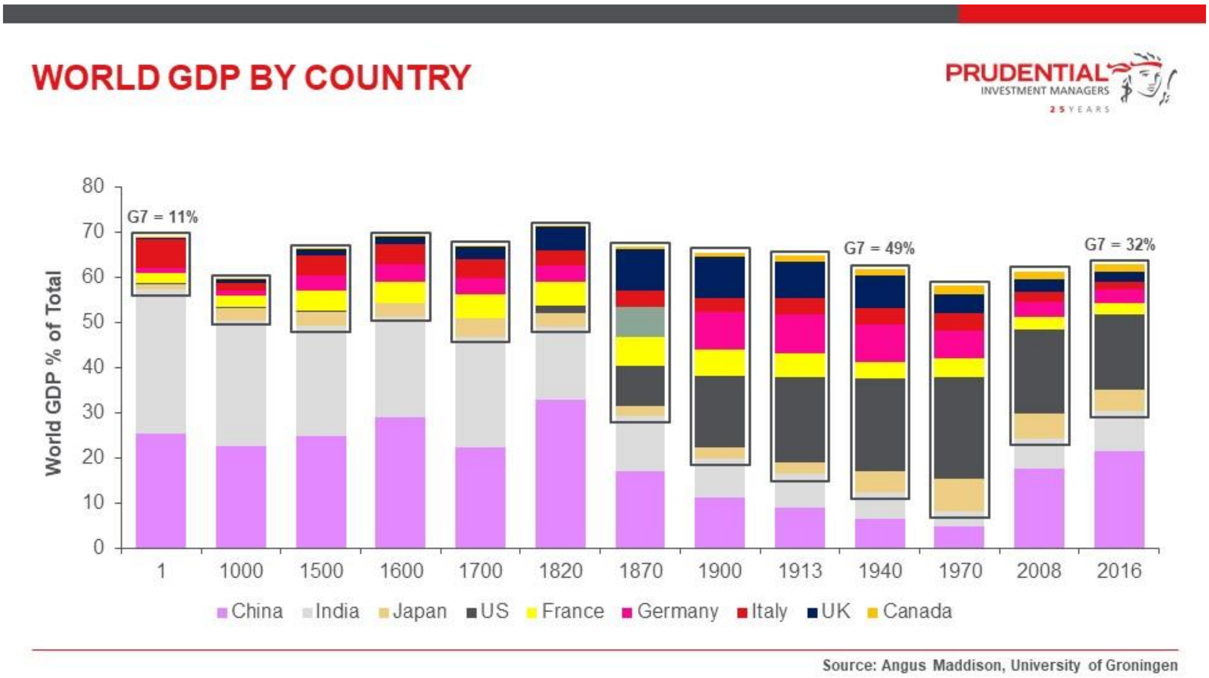
The East's economic power is moving forward to the past

ARTICLE SUMMARY

A reminder that China and India accounted for over 50% of the global economy for more than 1,800 years.

By David Knee, CIO, and Lynn Bolin, Head of Communications, at Prudential Investment Managers.

Much attention has been focused on the rapid rise of Chinese and Indian economic power in the past decade or so, challenging the dominance of the global economy by the West (and particularly the US). As of 2016, China's and India's economies accounted for over 30% of the total global economy. This is roughly equal to all of the G7 countries combined (the US, Japan, UK, France, Germany, Italy and Canada), as the graph shows.



But is what we might think of as a relatively new development really just a gradual return to the status quo that lasted over 1,800 years of world history? From ancient history, the relatively large populations of the regions now known as China and the Indian subcontinent meant that they would necessarily make up an important part of global output. In fact, looking at the graph, from the year 1 through 1820 the two together accounted for over 50% of total world GDP, as the pink and grey blocks illustrate.

For China, what had been one of the world's leading civilisations and trading regions, united under various emperors, started to decline through increasing isolationism and internal strains, together with external pressures from the West and Russia as they tried to gain access to Chinese markets. China's loss in the First Opium War of 1839 showed that they could not match the military power of the West, which led to rising Western influence (particularly British), further external clashes and internal uprisings, and culminated in the Republican Revolution that brought down the empire in 1911. After the two World Wars and the founding of the People's Republic of China in 1949, the final blow was the Cultural Revolution under Mao Zedong from 1966-76. This caused a huge famine, impoverished millions, and brought the country to its knees. It was only when reforms began in 1978 that China was able to get back on the path to economic growth.

The Indian subcontinent followed a similar road, managing to thrive through intensive trade and urban development to account for about 25%-30% of the global economy from the year 1 through 1700. By that point the Mughal Empire had reunited under one ruler and it was recognised as the largest economic and manufacturing power in the world. It was under the governance of the British East India Company for a century (1757-1858) that its economic might started to wane, and under subsequent British colonial rule from 1858-1947 it de-industrialised even further. Following independence after World War II, various Indian governments had trouble implementing successful growth policies, but eventually economic development gathered pace such that today it is one of the world's fastest-growing economies, and the seventh largest.

So as recently as 1970, China and India together were almost insignificant in the world economy, representing only about 5% of total GDP as the graph illustrates. Since then both countries have grown rapidly relative to the G7 Western economies, and now find themselves once again major contributors to global trade and output. They are only likely to grow in importance as well, given that they both have much open road ahead of them on their development paths. This should see their GDP per capita rise as well. So going forward, could the shape of the global economy gradually return to the past? Might China and India again grow to contribute 50% of world GDP in the coming decades?

This would presumably represent a tremendous shift in political and economic power from the West to the East, and along with it higher global tensions as Western (developed) countries struggled to preserve the old status quo. Going by other countries' traditional development paths, we would see higher national wealth and rising inequality in China and India, which their governments might respond to by creating a social safety net. With some form of social security funding in place, the Chinese and Indian people might then move away from their traditional focus on high savings (to provide for their old age and inter-generational transfers) to become much more consumer-oriented societies. In turn, these giant consumer markets with their increasing demand for goods and services could provide lucrative outlets for the more advanced economies, helping offset some of the negative impact from their aging populations.

Such a development path would mean that the potential for long-term global growth is still strong, although this will undoubtedly come in cycles. Perhaps by 2050 the global economy will have come full circle, such that China and India become the world’s largest markets that everyone wants to penetrate (as they were before 1820), while the US is the exporter needing foreign markets for more growth.

For more information, feel free to contact our Client Services Team on 0860 105 775 or email us at query@prudential.co.za.