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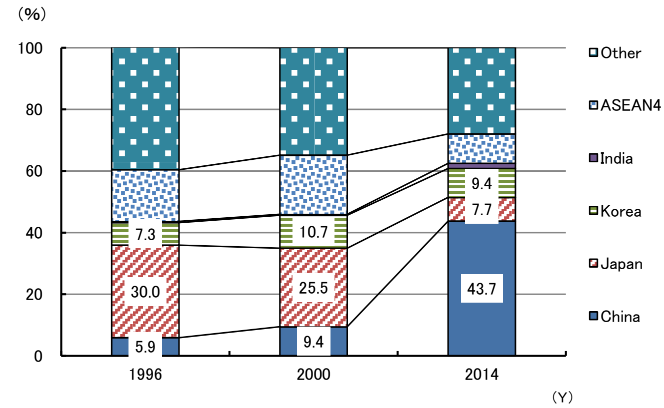
Topics Rapidly increasing Chinese value added exports

China's value added exports have surpassed those of Japan, and are contributing to the expansion of trade within the East Asian region. In order to secure a major position within the East Asian global value chain, it will be necessary for China to join TPP.

■ Japan overtaken in exports of high-tech goods?

According to the Asian Economic Integration Report issued by the Asian Development Bank (ADB) at the end of 2015, China had overtaken both Japan and Korea in the exports of high-tech goods. China's share of the exports of high-tech goods in Asia rose from just 9.4% in 2000 to 43.7% by 2014. Meanwhile, Korea's high-tech goods export growth in the same period was in a very small margin, from 7.3% to 9.4%, while that of Japan fell drastically from 30.0% to 7.7%.

＜Share in Asia' s High Technology Manufactured Goods Exports ＞



Note: High-technology industries include aircraft and spacecraft; pharmaceuticals; office machinery; telecommuncations equipment; and medical and precision equipment. ASEAN means Indonesia, Malaysia, phillipines and Thailand.
Source: ADB, *Asian Economic Integration Report 2015*

While the report is indeed shocking, as ADB points out, the export figures are based on customs cleared statistics, and the figures given above do not necessarily mean that China's technological prowess has improved to that extent. High-tech goods produced in China contain many intermediate goods, such as parts and components made overseas. Customs cleared statistics also count those as Chinese exports, so China's actual strength is over-estimated. In fact, Chinese value added of the product price of smartphones and tablets is only around 6% to 7%.

China has long been called "the world's factory". However, many of the industrial products exported from China are produced via the global value chain (GVC), which includes Japan, Korea and ASEAN. These goods, having been finally assembled in China, rather than being called "Made in China", should more correctly be called "Made in Asia". Furthermore, though they are called "high-tech goods", the reality is that almost all of them are computers and electronic and optical equipment.

■ The fall of the value added ratio due to the development of GVC

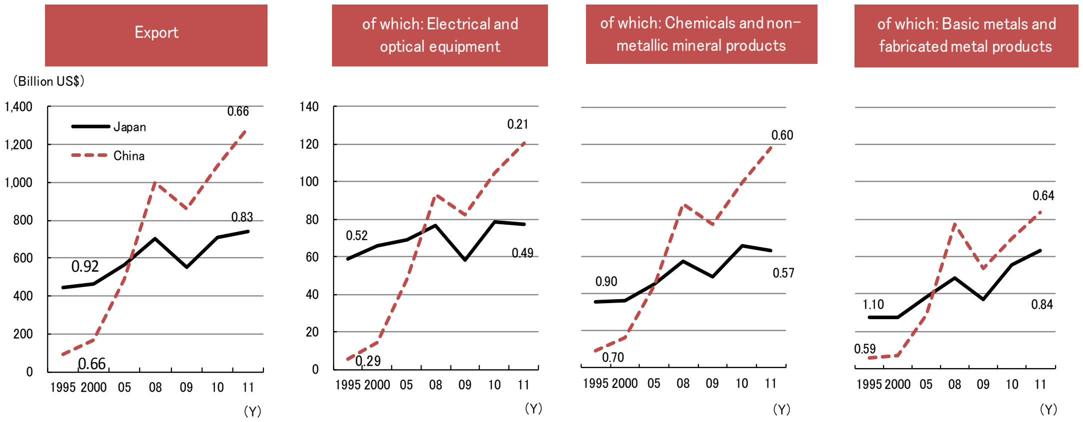
With the development of GVC, trade in intermediate goods, such as parts and components and the like, has increased by leaps and bounds. This has meant that it has become much more difficult to have a clear understanding of the competitive strength of individual countries from customs cleared basis trade statistics alone. In order to shed more light on the ever more complicated GVC, the Organisation for Economic Co-operation and Development (OECD), in cooperation with bodies such as the World Trade Organization (WTO), is developing sets of statistics on Trade in Value Added (TiVA). This TiVA is a set of trade statistics that is prepared by linking the industrial input-output tables of major countries on a global scale, and its main feature is that it provides trade statistics on a value added basis.

Value added based trade statistics make it clear which industries in which countries provide the value added of finished products, so in terms of value added based exports, only domestically produced value added are counted as a country's value added exports. Because the figures do not include value added that is produced in other countries, the value added based export value of a country will be lower than its gross export value. China's gross export value for 2011 was $2.0 trillion, whereas its value added based export value was $1.3 billion. If the value added ratio is taken as the latter divided by the former, China's value added ratio is 0.66, falling to 0.39 for the manufacturing industry. The trend observed in developing economies is that, the greater the extent of the development of GVC among the manufacturing industries of a country, the lower its value added ratio tends to be.

■ China's value added exports ahead of Japan's

In research into East Asia's GVC, China is seen as a site of final assembly, so its value added basis export worth is lower than its gross basis export worth. In other words, it has come to be considered that China's value added ratio is low and, as described above in the example of smartphones, that its industrial competitiveness is not necessarily all that strong. Also, while GVC is highly developed in East Asia, intra-regional demand is low and many exports are still reliant on European and US markets, and the region has not yet reached the stage of having fully developed self-cyclical growth. However, a renewed investigation of the long term trends of value added trade reveals that a situation is appearing that does not fit with that theory.

＜Amount of Value Added Export and Value Added Ratio＞



Note: Figures are Value Added Ratio in 1995 and 2011.
Source: OECD, *Trade in Value Added (TiVA)-October*

In the first place, the rapid growth in China's exports has not been on a gross basis but a value added basis. China's value added exports were at a level of 20% of those of Japan in 1995, but by 2011 had grown to 1.7 times those of Japan. This reversal of Japanese – Chinese positions is also occurring among products where Japan has many value added exports, such as electrical and optical equipment, chemical and non-metal products, and basic metals and metal products. While the value added ratio among electrical and optical equipment is still low, there is an increasing number of mid to low end smartphone parts and components that can be sourced locally, and the value added ratio is expected to take an upward turn. Envisaging high end smartphones and then applying this low value added ratio across all industries leads to a mistaken understanding of China's real strength.

In addition, East Asia has become a region of final demand, in place of the US. East Asia's intra-regional value added exports were worth $589.7 billion in 2009, more than the value of exports to NAFTA ($577.2 billion), and the share is growing all the time. 40% of intra-regional exports are to China, surpassing the 30% destined for Japan. In East Asia there are no FTAs (free trade agreements) that cover an entire region, such as NAFTA does. Nevertheless, the formation of a self-cyclical trade structure is being caused by the dramatic strengthening of China's role as a destination of final demand, and by the skillful development of GVC in order to take full advantage of that fact.

The beginning of China's economic development was in the implementation of export-oriented industrialization policies through the aggressive introduction of foreign capital. To the solid industrial clusters that were formed in this way were added cheap labor costs and an overwhelming market scale, allowing China to occupy a vital position in East Asia's GVC, and its economy to continue to grow. However, it is expected that East Asia's trade environment will be changed by the emergence of TPP (Trans-Pacific Economic Partnership) and AEC (ASEAN Economic Community), and that there will be accelerated movement towards GVC reorganization, not only among Japanese companies, but also among Chinese, Korean and Taiwanese firms. On the other hand, meanwhile, as labor costs soar and the economic future remains uncertain, China's attractiveness as an investment target is declining. And even some in government are beginning to take a more favorable view of TPP, which had been criticized as a "China economic containment network". It may be argued that, in order for China to continue to occupy a major position in East Asia's GVC and to achieve further economic development, it will need to consider TPP participation positively.

(Yuji Miura)

Hong Kong *Policy interest rate is raised despite signs of frailty in domestic demand*

■ Retail sales continue to fall below previous year's figures

Hong Kong's economic slowdown is continuing. November's retail sales growth (price basis) was -7.8%, compared to the same period in the previous year, with the breadth of deceleration increasing from the previous month (-3.0%, similarly). In terms of individual items, sales of durable consumer goods were -7.0%, due to a recoil from the surge in sales of new smartphone models in the previous year, and sales of jewelry slumped massively -20.6%, due to the declining numbers of tourists from mainland China.

In addition, an examination of the numbers of visitors from outside of the region shows that while the number of visitors from countries other than mainland China increased by 8.1% in November, the number of visitors from mainland China was down by 15.5%, falling well below the previous year's number. Visitors from mainland China account for about 80%, the vast majority, of the total number of tourists to Hong Kong, and jewelry and other retail sales and service exports are feeling a very negative impact due to the decline in the number of visitors from main land China.

Further, it is becoming increasingly more difficult to expect consumption to be boosted by the asset effect. Following the major deceleration in China's economy since the summer, Hong Kong, which has a close economic relationship with China, has seen share prices stagnate and real estate price growth begin to slow, and there are concerns that consumer sentiment will deteriorate.

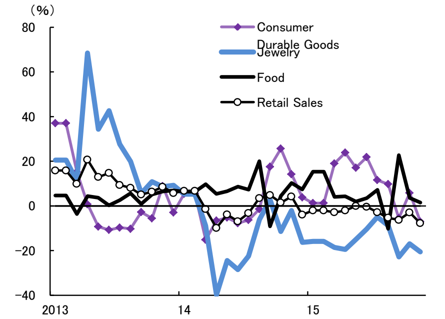
Also, with regard to external demand, November's export growth was -3.5% (customs cleared basis, US dollar denominated) and import growth -8.0%, both continuing to stagnate. In terms of individual countries and regions, exports to the EU had positive growth and the margin of decline in exports to ASEAN contracted, but exports to China, which account for 50% of the total, have slumped.

■ First policy interest rate hike since June, 2006

After the US policy interest rate was raised on December 16, 2015, Hong Kong's Monetary Authority raised the Base Rate of the Discount Window, which had been at 0.5% since January, 2009, by 0.25% points to 0.75%. The Hong Kong dollar is pegged to the US dollar and financial policy moves in tandem with that of the US, so the expectation is that, in the future, Hong Kong's policy interest rate will be raised when US interest rates go up. Given the fact that the likelihood of higher US interest rates had already been factored in, and that the interest rate hike was a modest one, it looks likely that a serious deterioration in consumer and corporate sentiment due to a rapid adjustment in real estate prices and higher lending rates can be avoided. However, there is evidence of a slump in both domestic and foreign demand and, to the extent that the employment and income environments are not necessarily rock solid, it will be necessary to keep an eye on the pace of US interest rate increases in the months ahead.

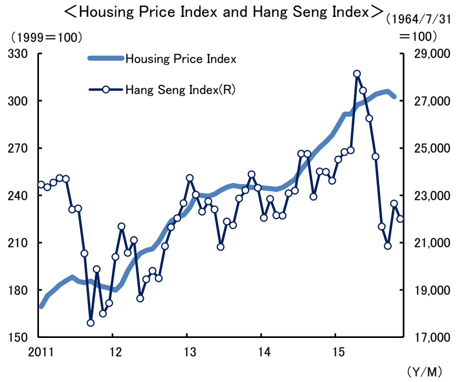
(Kentaro Matsuda)

<Retail Sales Index（YoY）>



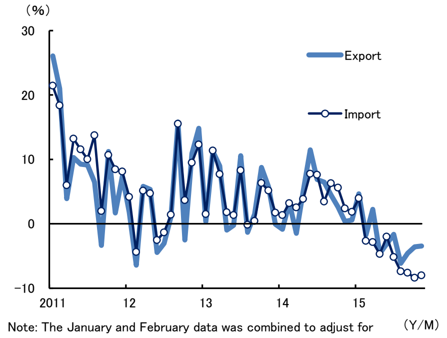
Note: The January and February data were averaged to adjust for the impact of the Lunar New Year
Source: Census and Statistics Department

<Housing Price Index and Hang Seng Index>



Source: Statistics Department, Rating and Valuation Department

<Export and Import（YoY）>



Note: The January and February data was combined to adjust for the impact of the Lunar New Year
Source: Census and Statistics Department

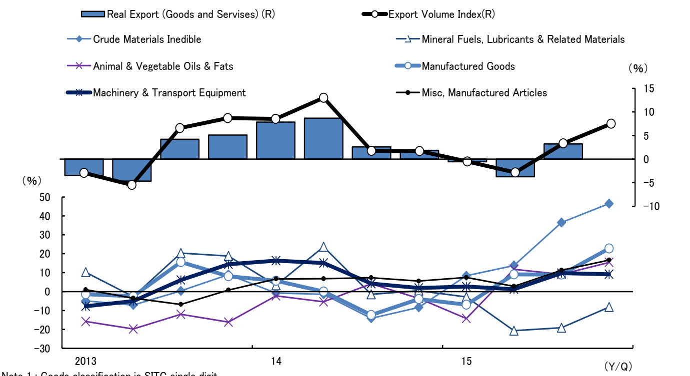
Malaysia Economic recovery expected to take some time

■ Exports improve, but domestic demand remains poor

Export momentum has been accelerating recently. The export volume index, which has a high level of conjunction with GDP real exports (goods and services), grew 7.5% in the period October to November, 2015, compared to the same period in the previous year, growing at a faster pace than the July to September quarter (5.3%, similarly). In terms of export goods, there were big increases in categories like "crude materials inedible" such as natural rubber, textiles and metal ores, (up 46.7%, compared to the same period in the previous year), "manufactured goods" such as leather goods, paper goods and metal products (22.8%, similarly), "miscellaneous manufactured articles" such as furniture, cameras, precision equipment, (16.7%), "animal and vegetable oils and fats" such as palm oil (15.4%), and "machinery and transport equipment" such as general machinery, electrical machinery and automobiles and the like (9.2%). The recovery in resources demand, as a result of the implementation of economic leveraging measures in China, and Christmas shopping season exports to the advanced nations, appears to have supported export growth.

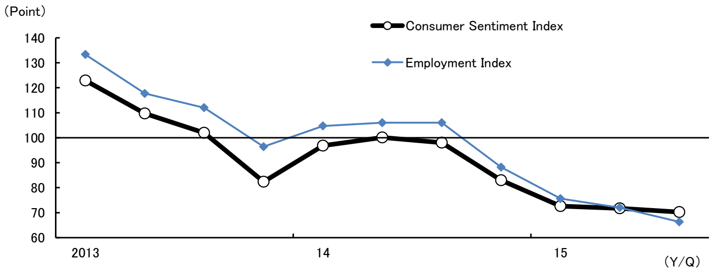
On the other hand, domestic demand lacks vigor. The consumer sentiment index, which indicates whether people are feeling optimistic or pessimistic about consumption, continues to be well below the 100 point mark due to the deterioration of the employment situation and the introduction of the goods and services tax (GST) in April, 2015. In the corporate sector, construction related production indices for October, 2015, improved to 5.1% growth compared to the same period in the previous year, but the pace of recovery has been slow.

<Export Volume Index and Real Export (Goods and Services) (YoY)>



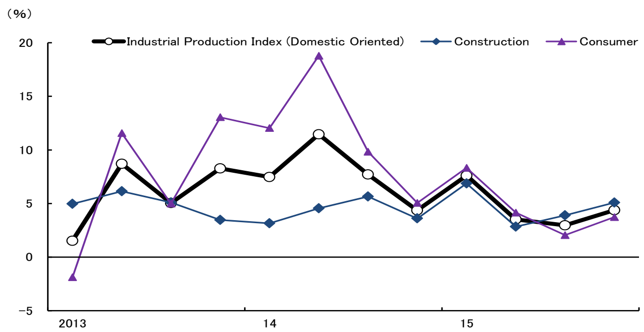
Note 1 : Goods classification is SITC single digit.
Note 2 : The value of 15/4Q is October and November.
Source : Department of Statistics, Bank Negara Malaysia, CEIC

<Consumer Sentiment Index and Employment Index>



Note : When the index exceeds (falls below) 100 points, people are optimistic (pessimistic) about consumption, are positive (negative) about employment conditions.
Source : MIER

<Industrial Production Index (Domestic Oriented) (YoY)>



Note : The Value of 15/4Q is Octorber.
Source : Bank Negara Malaysia, CEIC

■ Expectations of export driven economic recovery are faint

In terms of the outlook for the foreseeable future, with regard to foreign demand, in addition to re-emergence of concerns since the start of 2016 that the economy of China, which accounts for about 10% of Malaysia's exports, will quickly run out of steam and decelerate, the pace of recovery among other global economies is expected to be very modest at best, and there is little hope that exports can perform as a driver of economic recovery.

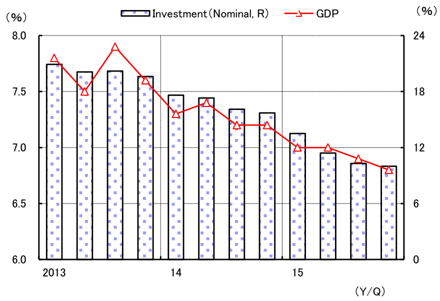
In addition, with regard to domestic demand, in addition to expectations that the effects of the recoil deceleration in response to the rush demand that followed the introduction of GST will continue until the January to March quarter, 2016, amidst uncertainty over the future of the economy, it is thought likely that firms will continue to be hesitant about full scale plant and equipment investment. Given the foregoing, it should be considered that it will take some time before Malaysia's economy is ready to recover.

(Yuta Tsukada)

China 2015 economic growth rate 6.9%

■ Economic growth rate 6.8%, year on year, in Q4, 2015

China's real GDP growth rate for the October to December quarter, 2015, was 6.8%, compared to the same period in the previous year, slightly down (0.1% points) from the July to September quarter. This brought the growth rate for the whole year 2015 to 6.9%, compared to the previous year, the lowest level since 1990 (3.9%, similarly), but a significant drop below the government's target of around 7.0% was avoided.



Note: Nominal investment figures are year-to-date.
Source: National Bureau of Statistics

In terms of individual demand items, the poor performance of investments was noticeable. Fixed asset investment growth in 2015 (excluding rural households) was 10.0%, compared to the previous year, with the nominal growth rate the lowest in 11 years, since comparison by the same standards became available. Judging from the fact that a succession of economic countermeasures have been implemented, such as lowering the policy interest rate and accelerating the implementation of priority projects, signs of improvement are beginning to appear, but the growth rate for the whole year trended downwards.

Consumption has stayed strong. Nominal retail turnover in 2015 was 10.7% up on the previous year, and though the growth rate slowed in comparison to 2014's results, on a month by month basis the growth rate accelerated slightly in the latter half of the year, compared to the first half. In addition to policy factors such as the raising of the minimum wage level and the introduction of a tax reduction on small automobiles (until the end of 2016), the fact that the service industry has developed and has been able to stimulate consumer purchasing motivation through the introduction of products and services that satisfy market needs is also considered a contributory factor.

External demand is facing a serious slump, and has been unable to meet the government's target of increasing by around 6.0%, year on year, in terms of trade value. Though export growth in December was on the road to recovery at -1.4%, compared to the same month in the previous year, the growth rate has continued to fall below the previous year's levels on a month by month basis since July. Annual export worth in 2015 was -2.8%, compared to the previous year, and the first negative growth in six years. Imports also have been improving since bottoming out in 2015, but have been unable to buck the trend of decline, with growth rates falling below the previous year's levels for 14 consecutive months, for example, against a backdrop of sluggish domestic production. For the whole year, growth was -14.4%, compared to the previous year, a bigger negative growth margin than even that of 2009 (-11.2%, year on year), which was caused by the Lehman shock.

■ Aggressive intervention measures are a double-edged sword for structural reform

The Xi Jinping administration, based on the fact that the economic slowdown has not been too drastic, is getting ready to apply the same stance of advancing structural reform in its economic management in 2016 also. However, in terms of individual policies, the priority will be on calming the current situation, and measures are being adopted that will make the realization of reform difficult. The stock market stabilization measures of early January, 2016, may be said to be an example.

From January 1, 2016, a circuit breaker system (in which trading is temporarily suspended in the event of extreme market volatility) was introduced into China's stock market. However, the system was triggered several times in succession after major share price falls from the first day of trading (January 4), prompting the authorities to announce the suspension of the system after just four days. Also, measures to restrict share sales by major shareholders, introduced in July, 2015, and due to be lifted on January 8, were extended, with some relaxations made. While these measures may be praised as being a swift response in order to calm the current situation, the frequent use of heavy handed intervention runs the risk of increasing government involvement and of hindering structural reform that makes use of market mechanisms. In order to achieve the kinds of reforms that are necessary for the sustainable development of the Chinese economy, the Xi administration has the tough job of limiting and even reducing market intervention, all the while keeping an eye on the health of the economy.

(Junya Sano)