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Topics *Chinese perspective on achievements of US-China Dialogue*

For China, the main achievement of the US-China Comprehensive Economic Dialogue may be said to be the very fact that talks with the Trump administration have finally started. It is highly likely that China will continue to take steps to expand imports of US products.

■ General assessment of the 1st round of the US-China Comprehensive Economic Dialogue

The general view of the first round of the US-China Comprehensive Economic Dialogue held in Washington this July is that it failed to deliver, due to the fact that 1) the post Dialogue joint press conference was cancelled, 2) despite an early agreement (in May) to a “100-day economic plan”, there has been no significant progress towards correcting trade imbalances, and 3) in spite of negotiations on issues other than trade imbalance, there have been no concrete results.

In particular, the US side, taking advantage of the summit meeting held in April, had softened its posture towards China with regard to economic matters, in hopes of winning China’s cooperation in dealing with geopolitical risks, such as the North Korean nuclear and missile issues. In spite of this, there was no improvement in geopolitical risk issues, and with only limited measures designed to expand US exports to China, there are many who rate the latest US-China Comprehensive Economic Dialogue as poor.

■ Certain results from the Chinese perspective

Nevertheless, from the Chinese side, given that there had been about three months of negotiation in the run up to the US-China Comprehensive Economic Dialogue, it may be viewed that, to a certain extent, some results were achieved. The three most important of these are as follows.

First, the framework for suppressing the triggering of the Trump administration’s protectionist trade policy measures has begun to function.

Based on the results of the latest round of talks, the likelihood of the Trump administration implementing hard-line policies, such as high tariff policies, has grown slightly stronger. However, if hard-line policies were to be introduced by the US while the Chinese are emphasizing the continuation of the dialogue, there would be even greater criticism of the US, at home and abroad. In that case, it is thought possible that the Chinese could also switch their stance, leading to an intensification of retaliatory measures. Such a development would likely have the effect of cooling not only the Chinese economy but the US economy as well, and it seems that the US will probably have to tread warily with regard to implementing hard-line policies. In other words, the realization and future continuation of the US-China Comprehensive Economic Dialogue is expected to have the effect of suppressing the triggering of sanctions against China, which can be viewed as a beneficial development for China.

＜Achievement that China Gained in Dialogue＞

Achievement	Attention Point
Start and Continue Economic Dialogue with Trump Administration	・The effect of suppressing triggering of measures against sanctions against China by the Trump Administration
Trade	・While China will allow the resumption of imports of US beef, the United States will work urgently on making rules for importing Chinese processed chicken
	・With regard to the export of liquefied natural gas to China, the United States can admit it under the same conditions as other countries
Belt and Road Initiative	・The US side recognized the importance of the plan by China and dispatched a delegation to the 1st International Forum held from 14 to 15 May

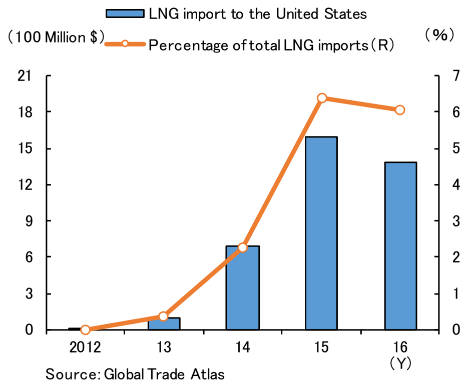
Source: Chinese Government, US Department of Commerce
Note: Including achievements from summit in April to the 1st US-China Comprehensive Economic Dialogue.

Second, while keeping trade concessions to a minimum, there have also been some positive results for the Chinese economy. Focusing on agricultural produce, China has agreed to resume imports of US beef, though this had already been agreed upon with the Obama administration. At the same time, the US has agreed to advance its preparatons for accepting the import of Chinese processed poultry meat. Even including the lifting of the embargo on imports of US rice, which was reported after the latest Dialogue had ended, it may be said that the concessions have not been made unilaterally by the Chinese side.

Additionally, with the agreement to relax restrictions on imports of US produced LNG (liquefied natural gas) to the same degree as other countries, imports of LNG from the US are expected to grow. Given that the diversification of importers lessens the risk of a suppply interruption and increases price bargaining power, the agreement may be said to have benefits for the Chinese side.

Third, it demonstrated a softening of the US government's stance towards China's Belt and Road initiative. The US has, thus far, continued to display a non-cooperative attitude towards the Belt and Road initiative proposed by China, such as refusing to participate in the Asian Infrastructure Investment Bank and failing to show clear approval. However, in the initial agreement to the "100-day economic plan", the US expressed an understanding of the importance of the Belt and Road initiative, and announced that it would be sending a delegation to the Belt and Road International Forum. In fact, a delegation from the US government did attend the forum in May, impressing the change in position. The fact that the US has displayed the stance of being "at least not opposed" has brightened the prospects for the realization of China's Belt and Road initiative. The softening of the US attitude towards the initiative is a big step forward for the Xi Jinping government, given that the initiative is a central part of its foreign economic strategy.

<China's LNG import to the United States>



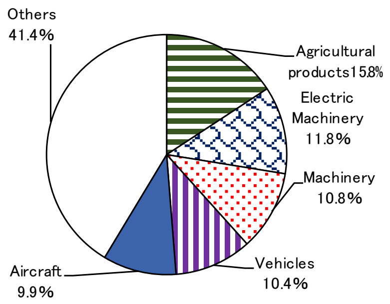
Source: Global Trade Atlas
Note: LNG is HS code 2711.

■ Focusing on import expansion in order to avoid US trade friction

In the future, it is highly likely that there will be further US-China Comprehensive Economic Dialogue, including pre and post negotiations behind closed doors on primarily global economic issues. In that event, it is expected that China will meet US requests for remedies to pending issues, such as excess production capacity and the renminbi exchange rate, with a mixture of fierce objection and positive initiatives.

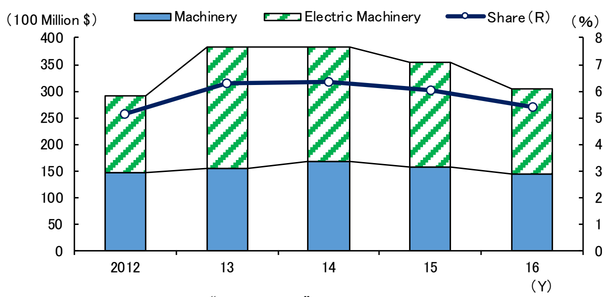
With regard to the issue of trade imbalance in particular, which is the biggest focal point, it is envisaged that China will continue to make greater efforts to expand its imports of US goods, in order to avoid breakdowns in negotiations and the all-out triggering of US sanctions against China. In terms of individual Chinese imports from the US, agricultural products and aircraft occupy a large share. Every time trade friction with the US becomes an issue, China has responded by making mass purchases of these items, and before and after the latest US-China Comprehensive Economic Dialogue the purchase of Boeing aircraft and the buying of US rice were agreed upon. In the future also, such conciliatory measures towards the US will likely be used with careful timing.

<China's import to the US (By Item, 2016)>



Source: Customs Statistics
Note1: Agricultural products are HS codes 1 to 24 (excluding category 3) aggregates.
Note2: Vehicles are HS code category 87

<China's import to the US (Machinery, Electric Machinery)>



Source: United Nations "UN Comtrade"
Note: Share accounts for imports of Chinese machinery and electrical machinery percentage of the United States.

Should these measures prove insufficient, it is possible that the Chinese side will assert more strongly that the relaxation of restrictions on exports of mainly high-tech products into China will lead to an expansion of US exports to China. Given that the US share of imports of general machinery and electrical equipment into China is falling, and that the argument is persuasive, it may be expected to have the effect of contributing to the sophistication of Chinese industry. At the Communist Party's National Congress, slated for this autumn, the Xi Jinping administration is expected to touch upon foreign economic relations also, and in doing so will likely present policies that support the continuation of dialogue with the US. However, depending on the attitude of the Trump administration, there is no guarantee that this premise will not collapse, and it will be important to keep an eye on US-China developments related to trade imbalance, free of any preconceptions.

(Junya Sano)

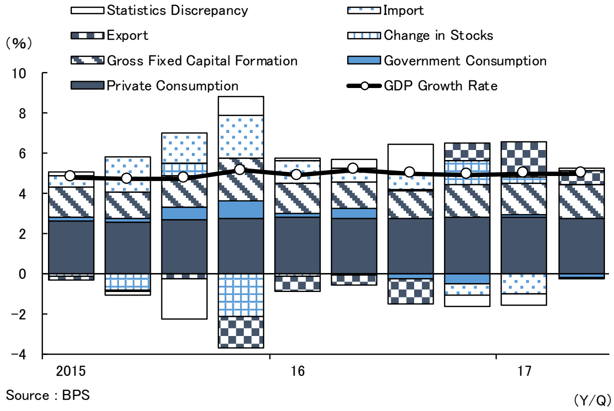
Indonesia 5.0% growth in Q2, 2017

■ Recovery at gentle pace moving forward

Although Indonesia's current economy is growing steadily, the pace of recovery is lacking in strength.

Indonesia's real GDP grew 5.0%, compared to the same period in the previous year (the same hereinafter) in the April to July quarter of 2017, basically unchanged from the January to March quarter. The economy was underpinned by growth in investments and private consumption. Investments grew at 5.4%, encouraged by progress in the government's infrastructure development projects and market entry by foreign firms, picking up speed from the previous quarter (4.8%). Also, although the rising inflation rate had a suppressing effect on private sector consumption, consumer sentiment improved as a result of the recovering tone of the economy, and consumption maintained growth in the 5% range.

<Real GDP Growth and Contribution by Expenditures(YoY)>



Source : BPS

On the other hand, a decline in government consumption and slowing exports were a hindrance to economic growth. In addition to curbs on expenditure due to insufficient tax revenues, government consumption was also affected by a recoil from the previous year's increases. As regards exports, the Lebaran holiday, marking the end of Ramadan, fell in June this year, causing a reduction in the number of working days, and a pause in the sudden rally in export growth that had continued since mid 2016, with the result that the pace of export growth was blunted.

Looking towards the latter half of the year, the economy is expected to post a modest paced recovery. In terms of domestic demand, as the inflation rate falls gradually, it is thought that the momentum of private consumption will gradually strengthen, and that expenditure expansion measures introduced with the suppplementary budget will encourage growth in government spending, so that growth in domestic demand will begin to accelerate again over the latter half of the year. Also, as regards investment growth, the progress of infrastructure development will likely have a booster effect. Meanwhile, the expectation is that export growth too will benefit from an increase in pace, as the global economy trends towards recovery.

■ 15th economic policy package launched

As the economy continues to grow steadily, the Indonesian government is also working on policies aimed at achieving stable growth over the mid to long term. On June 15, 2017, the government announced its 15th economic policy package since the first one in September, 2015. The policies are aimed at improving the country's logistics industry and contain reduced investment handling charges for the port industry, easier procedures for the return of container storage guarantee fees, and the strengthening of the Single Window authority, providing one-stop services for export, import and port procedures. To the extent that Indonesia's underdeveloped logistics infrastructure and inadequate and unclear logistics services had been regarded as factors that were hindering foreign companies in their attempts to do business in Indonesia, this latest initiative may be considered an appropriate action for the purpose of attracting foreign companies.

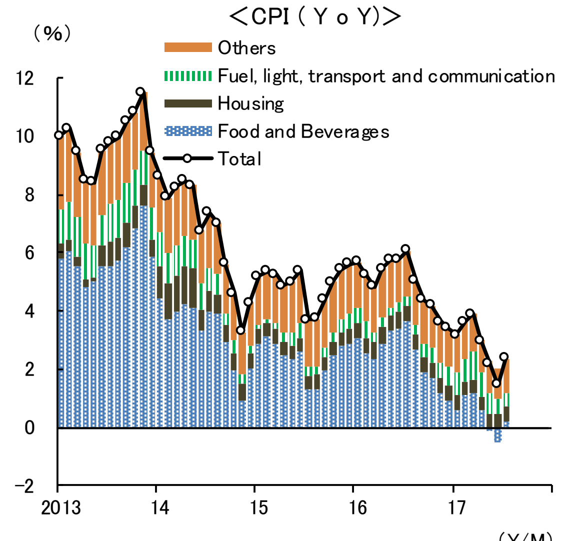
Since its inauguration in October of 2014, the Joko administration has tackled a fair number of reforms, such as the abolition of fuel subsidies, and since September of 2015, over a period of slightly less than two years, has launched an intermittent series of economic policy packages. While these activities will contribute to the future growth of Indonesia's economy, it has often been pointed out that, though the government has implemented amendments of laws and ministerial ordinances and such, changes and relaxations of regulations are not being fully implemented by officials in the field. In the latter half of the Joko administration's term of office, the focus of attention will be on whether the reforms that have been announced in such quick succession thus far have actually been implemented, which will affect the pace of growth of the economy in the future.

(Yuta Tsukada)

India Central Bank lowers policy interest rate

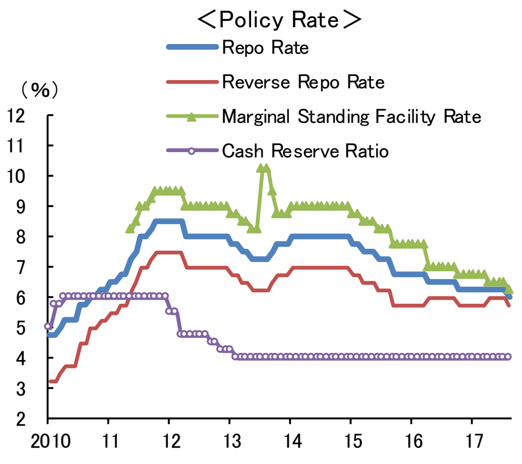
■ Policy interest rate (repo rate) at lowest level since November, 2010

The Indian economy appears to be picking up, against the backdrop of the weakening of the adverse effects of the demonetization of high denomination notes in November of 2016, and a rally in exports. It was under these circumstances that the Goods and Services Tax (GST), said to be the biggest indirect tax reform since India's independence, was introduced on July 1. While the introduction of GST will involve companies in a burden of labor and cost in the short term as they install IT systems to cope with the new system and their tax officers gain proficiency, the integrating of a range of indirect taxes into one GST will greatly improve convenience for taxpayers. Also, it is anticipated that changes to tax return and refund timing, and to the taxation system on cross-state product sales and inventory movements, will promote reviews of corporate cash flow strategies and supply chain systems.



Source: Central Statistics Office

As to how the introduction of GST will have an impact on consumer prices, the basic GST tax rate is split into four levels, 5%, 12%, 18% and 28%, so that the impact on sales prices will vary significantly from item to item. Some services that had been taxed at 15% before the introduction of GST will now be taxed at 18%, which will increase upward pressure on prices, but basic groceries, such as rice, wheat, vegetables and fruit, will still be exempt from taxation, while other food products will now be taxed at a lower rate. Therefore, the short term impact of the new tax rates on consumer prices overall will be largely neutral. In addition, the introduction of GST will make it easier to supply products across different states, and is expected to bcome a factor in lowering the inflation rate in the mid term.



Source: Reserve Bank of India

Looking at how consumer prices have performed before and after the introduction of GST, the growth rate of food prices turned negative in June, causing the inflation rate to come in at a very low 1.5%, compared to the same period in the previous year, under the lower limit of Central Bank's inflation target (4±2%). In July, after GST had been introduced, the inflation rate grew to 2.4%, similarly, gaining on the previous month, but still at a low level. Under these circumstances, with the rupee continuing to perform strongly against the dollar, and expectations that an average rainfall in the monsoon season (June to September) will mean that, from a supply perspective, inflationary pressure on food products will be limited, Central Bank lowered its policy interest rate (repo rate) in early August by 0.25% points, for the first time in ten months. Looking ahead, while inflationary pressure will increase as the economy picks up, expectations of additional US interest rate hikes will cause continued downward pressure on emerging economy currencies, so that it will still be difficult to expect any sudden further interest rate cuts. As a result, any booster effect on durable goods consumption and investments as a result of monetary easing will likely be limted at best.

(Shotaro Kumagai)

China *Economy slowing gently*

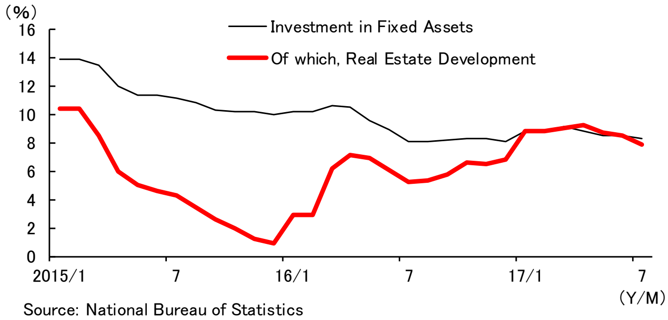
■ Economy continuing to recover, but pace of growth slowing

China’s economy has continued to recover, driven by domestic demand, since mid 2016. However, the most recent indices show a slowing of the pace of growth, mainly i n trade and direct investments, and suggest something of a lull in the momentum of economic recovery.

July’s exports grew at 7.2%, compared to the same period in the previous year, maintaining a five consecutive month run of positive year on year growth, though the growth rate stayed at its lowest level. In terms of individual countries and regions, in addition to a falling growth rate overall in exports to the industrialized economies, the sudden spurt in exports to Brazil and India also eased, with the result that the export growth rate overall was supressed. Imports have maintained a high growth rate against the backdrop of expanding domestic demand, but July’s growth was 11.0%, compared to the same period in the previous year, the lowest level since the start of 2017.

FDI (foreign direct investment), both inward and outward, continues to grow negatively, year on year. Direct investment in China (excluding money-related) in the period January to June grew negatively at -5.4%, compared to the same period in the previous year. Though investments from Japan and some other countries changed to positive growth, direct investment from Europe and the US declined sharply, and the impact was telling. The government is currently taking steps to speed up the process of opening up markets to foreign participation, such as revising the Catalogue for the Guidance of Foreign Investment Industries, but the expectation is that it will take a little more time before the results appear and direct investment in China turns to positive growth.

＜Investment in Fixed Assets (Excluding Rural Households)＞



Source: National Bureau of Statistics
Note: Figures are year-to-date. The growth rate in January was not announced. Therefore, this graph used the growth rate in January-February compared to the previous period.

Meanwhile, outward direct investment from China (excluding money-related) stalled at -45.8%, similarly, worth $48.19 billion. As pointed out by the Ministry of Commerce, this may be explained in part by 1) an improvement in China’s domestic economy, and 2) a deterioraton in the investment climate, including a review of investment attraction policies. However, the main reason behind the decline is believed to have been the tightening of restrictions on outward direct investment, with the aim of curbing capital outflow.

The loss of momentum in domestic demand was comparatively slight, and performance was solid overall. In response to the keynote of improvement in incomes and employment, July’s nominal retail sales grew 10.4%, compared to the same period in the previous year (down 0.6% points compared with June actual), maintaining a pace of expansion of over 10%. The pace of investment growth dipped once more, with gross fixed asset investments (excluding rural households) in the January to July period growing 8.3%, compared to the same period in the previous year. Infrastructure related investments continue to grow strongly, but this is because tighter controls by the authorities have suppressed growth in real estate development investments.

■ Recent tightening measures are a forerunner of post party congress economic management

Looking ahead to how the economy will perform towards the end of the year, one of the key points is what kind of economic management will be adopted after the party convention. Given that the power base of the Xi Jinping administration has consolidated greatly recently, the possibility is strong that policies will be advanced which reflect President Xi’s intent. For this reason, measures to try to calm the economic overheating that is currently underway also have significance as the vanguard of the economic management of the 2nd Xi administration. It will be important to pay close attention to the fine tuning of policy management so that the economy does not stall due to an excess of tightening.

(Junya Sano)