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Topics *Four factors prompting the opening up of the Chinese market*

China's market liberalization measures are not simply aimed at mitigating intensified U.S.-China trade friction. Reinforcement of competitiveness of China's key industries, expansion in consumption and enhancement of external presence are also significant factors that prompt market opening.

■ Market opening as a measure to mitigate U.S.-China trade friction

During his keynote speech at the opening ceremony of the Boao Forum for Asia (BFA) held in April, Chinese President Xi Jinping announced the following four measures to open up the country's markets: i) easing of market access restrictions; ii) development of an attractive investment environment; iii) reinforcement of intellectual property protection; and iv) expansion of imports . Around the time of the BFA, a series of initiatives in line with the opening up policy were announced and implemented.

Xi's administration has been promoting the opening up policy, which will increase imports and direct investment into China, the main purpose of which is to mitigate U.S.-China trade tensions.

The Trump administration has criticized the lack of access to Chinese markets and insufficiency in intellectual property protection and urged China to rectify the situation promptly by exerting pressure through increasing tariffs on some imports from China, among other measures.

Against such actions, the Chinese government has rejected the Trump administration's demands and shown a stance of retaliation against U.S. tariffs with trade sanctions on U.S. products.

However, if only hardline stances are taken, the U.S.-China trade dispute will continue to intensify, which will result in a decline in China's exports and ultimately an economic slowdown. Moreover, while China's trade surplus has been decreasing since 2016, surplus has been increasing when looking at trade with the United States alone. Therefore, it was necessary for China to take some demands from the U.S. side and implement measures to rectify trade imbalance quickly.

＜Opening-up Policy Announced in April＞

Policy	Major Initiatives
Easing of Market-Access Restrictions	･Announcement of the timing for easing restrictions on foreign ownership caps in banking, securities and insurance fields as well as relevant regulations (on the securities field)
	･Announcement of the timing to repeal restrictions on foreign ownership caps related to automobiles, aircrafts and vessels (by the end of 2018-2022)
Development of Attractive Investment Environment	･Announcement of the schedule to simplify application and registration procedures for foreign enterprises (March 2018)
Reinforcement of Intellectual Property Protection	･Competent authorities integrated into the State Intellectual Property Office (SIPO)
Expansion of Imports	･Reduction of import tariffs on 187 items including cosmetics and paper diapers (December 1, 2017)
	･Commencement of solicitation for participation in the first China International Importer Expo (CIIE 2018) and associated PR activities

Source :News of the Communist Party of China, the National Development and Reform Commission, and the Ministry of Commerce

■ Also aiming at reinforcement of industrial competitiveness and expansion of consumption

However, China's opening up policy has not been solely prompted by such negative reasons. The main features of this policy are positive aspects, such as the promotion of economic structural reforms and cooperative diplomatic relations. Specifically, there are the following three aspects.

First is the reinforcement of industrial competitiveness.

If markets are opened up under the circumstances of low level of industrial competitiveness, it is likely that foreign enterprises will take market shares away from local Chinese companies and many of them will not be able to survive. However, such risk will be reduced if appropriate procedures are taken by giving priority to market liberalization focusing on industries where the competitiveness gap with foreign enterprises is small. Furthermore, China's industrial competitiveness will be boosted if state-owned businesses and private companies compete with foreign enterprises in a broad range of fields such as prices, technology and services following China's market opening.

It is apparent that this is the Chinese government's intention in its plan to repeal foreign ownership caps related to the automobile industry.

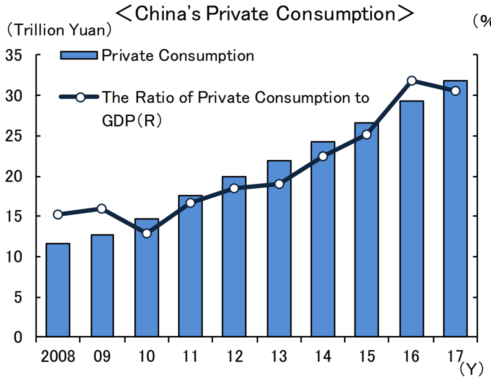
＜Liberalization Schedule of Automobile Market＞

Type	Time to Repeal (Year)
New Energy Vehicles	2018
Commercial Vehicle	2020
Passenger Vehicle	2022

Source: National Development and Reform Commission
Note: New energy vehicles are electric vehicles, fuel cell users, and plug-in hybrid vehicles.

In mid-April, the National Development and Reform Commission (NDRC) announced a policy on how to promote market access to the manufacturing industry and the revision of negative lists. According to NDRC's policy, foreign ownership caps on makers of new energy vehicles will be removed by the end of this year, while commercial vehicle manufacturers will be freed from restrictions in 2020 and passenger vehicle manufacturers in 2022. Restrictions on makers of new energy vehicles will be repealed earlier than manufacturers of gasoline-fueled vehicles because the competition gap related to new energy vehicles between foreign manufacturers and Chinese manufacturers is small. Another factor behind this is that the Chinese government has positioned new energy vehicles as a key driver of industrial revitalization towards the reduction of air pollution and promoting energy saving. If aimed solely at easing U.S.-China trade friction, the removal of foreign ownership restrictions on manufacturers of gasoline-fueled vehicles could have been prioritized as it is an area where U.S. automakers have competitiveness and the importance of gasoline-fueled vehicles has declined in industrial policies.

＜China's Private Consumption＞



Source: National Bureau of Statistics, CEIC

The second aspect is the expansion of consumption.

The ratio of private consumption to GDP has been increasing in recent years, indicating that the driving force of the Chinese economy has shifted from investment to consumption. In light of the fact that the ratio of consumption has remained low compared with developed countries, the Chinese economy is likely to continue to be driven by consumption in the future. Meanwhile, China has faced a problem of increasing demand which cannot be solely covered by Chinese products. For example, Chinese consumers purchase a large volume of cosmetics, disposal diapers, toilet seats and the like as souvenirs of overseas trips. Given such circumstances, various measures have been implemented one after another in a way to expand the imports of consumables, including the reduction of tariffs on imports and the alleviation of non-tariff barriers.

The third aspect is the improvement of the national image.

Contrary to the Trump administration's protectionist trade policy, language and conduct based on excessive "America First" nationalism, Xi's administration has been pushing forward with the liberalization of trade, investment and international cooperation since 2017. Furthermore, China has been presenting its market opening to the world by utilizing international conferences such as the FBA. A series of such efforts will help to improve China's national image, changing negative views such as market entry barriers for foreign enterprises are high and the protection of intellectual property rights has not been prioritized. It is also expected to contribute to increasing support for China and advantageously engaging in trade negotiations with the United States.

■ Opening up policy is likely to be continued

As for the future outlook, Xi's administration is likely to further accelerate its opening up policy and the liberalization of Chinese markets will continue to advance. While no specific progress was observed as a result of the U.S.-China negotiations held in early May and difficult negotiations are likely to continue in the future, we expect that the United States and China will eventually compromise with each other and trade frictions will be eased. In such a scenario, the necessity to promote market opening will be diminished as a means to mitigate trade disputes with the United States. Nonetheless, Xi's administration has set a national goal of becoming a country which will drive the world in developing the international economic order by mid-century. With the aim of achieving this goal, the Chinese government mostly likely believes that promoting the opening up of Chinese markets regardless of the results of bilateral negotiations and the revision of global strategy by the United States will help China to attain support from the world and move closer to become a global leader replacing the United States. Reinforcement of industrial competitiveness and the expansion of consumption will also continue to serve as driving forces in promoting the opening up policy.

There is a possibility that China's external liberalization policy will be reviewed if the economy sharply decelerates. However, if China's growth slows down gradually in accordance with the soft-landing scenario predicted by the Chinese Government, China's market opening is likely to continue in the future.

(Junya Sano)

Korea Exports reaching a plateau

■ Positive growth achieved in January–March 2018 for the first time in two quarters

The real GDP growth rate for January–March 2018 increased 1.1% on a quarter-on-quarter basis, maintaining a high growth rate due partially to the reaction to the negative growth recorded in the previous quarter.

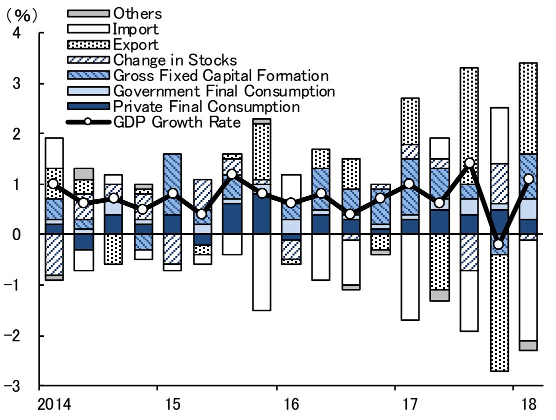
Looking at the contribution by demand component, exports significantly jumped by 1.8% points. This is attributable mainly to the reaction to the previous quarter which recorded a low level of contribution due to Chuseok, or the Mid-Autumn Festival in South Korea (long holidays in October).

The gross fixed capital formation also drove the growth rate by 0.9% points. In addition to an increase in capital investment related to semiconductors, construction-related investment increased due to a rush in demand for housing starts ahead of a hike in capital gains tax in April that will target owners of multiple houses. Government consumption also contributed more at 0.4%, owing to institutional factors such as an expansion in the scope of application of health insurance.

Meanwhile, contributions from consumer spending remained low at 0.3% points. Despite consumption demand related to the Pyeongchang Olympic and Paralympic Winter Games, consumer spending seems to have been negatively affected by the fact that people refrained from going out due a cold wave, while the personal income climate deteriorated as a result of an increase in the unemployment rate.

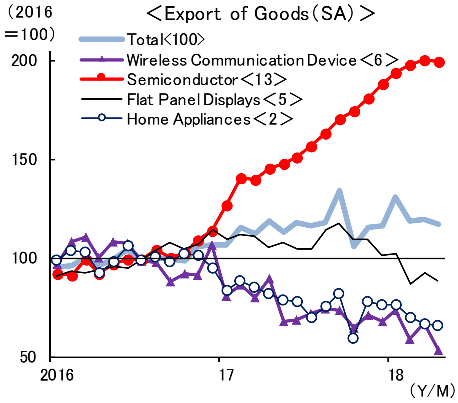
While it is difficult to analyze the trend as the GDP growth rate for the last three quarters fluctuated significantly, the average growth rate for the last three quarters is 0.8%, from which we can conclude that economic recovery has been solid.

＜GDP Growth Rate and Contributions by Expendeitures＞



Source : Bank of Korea, Economic Statistics System

＜Export of Goods (SA)＞



Source : Ministry of Trade, Industry and Energy
Note : Inside ＜＞ of legend is share in Export of goods

■ Growth led by exports reached a turning point

As explained above, while a high growth rate was achieved for the January–March period, overall exports of goods which had led growth have reached a plateau since the latter half of 2017. This primarily reflected a slowdown in increasing exports of semiconductors, which had surged since the beginning of 2017, in addition to a decline in exports across a broad range of items including smartphones, LCD panels and household appliances due to the appreciation of the won among other factors. As for the future outlook, downward pressure on exports will weaken as the appreciation of the won came to a pause at the beginning of 2018. Meanwhile, the export climate for semiconductors which have a large share in exports will likely remain severe for the foreseeable future given negative factors such as global smartphone demand reaching a plateau and the rise of Chinese semiconductor manufacturers. Under such circumstances, the stagnant situation surrounding the recovery in exports of goods will likely continue for the time being.

Meanwhile, there are some positive signs for the export of services. Although the number of Chinese tourists visiting South Korea had dropped sharply since March 2017 due to China's retaliatory measures against the THAAD (Terminal High-Altitude Area Defense) deployment to South Korea by the United States, the number increased on a year-on-year basis for the first time in 13 months in March 2018. If the number of Chinese tourists continues to recover as a result of the improvement in relationship with China in the future, it can exert a positive influence on the economy. However, as services make up merely over 10% of overall exports, there will be limited effects in boosting exports of goods and services on the whole.

(Michinori Naruse)

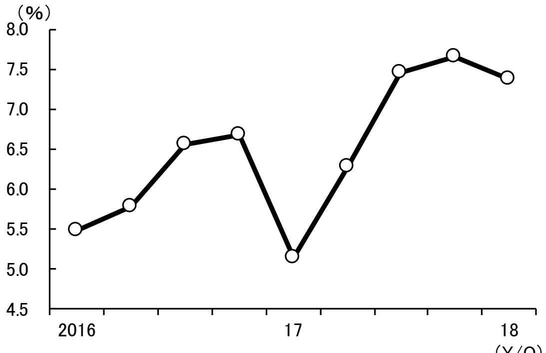
Vietnam *While the economy remains solid, attention must be paid to the effect of restrictions on car imports*

■ 7.4% growth in January–March 2018

Even in 2018, the Vietnamese economy has remained robust.

Vietnam's GDP growth in January–March 2018 recorded 7.4%, compared to the same period in the previous year, a slight decline from 7.7%, similarly, scored in October–December 2017, which indicated that the high pace of economic growth has continued.

＜Real GDP Growth (YoY)＞



Source : GSO, CEIC

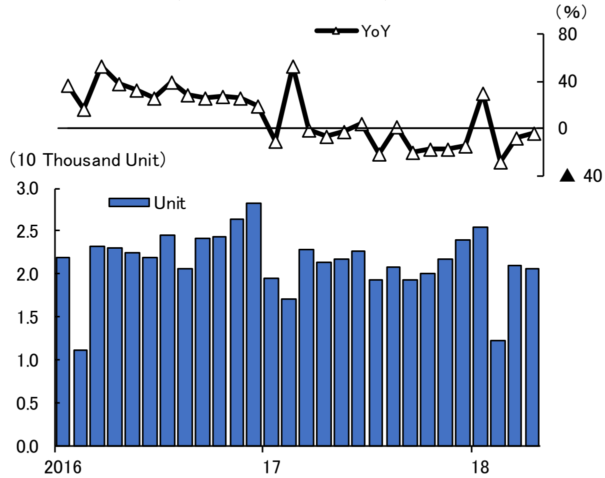
Looking closely at the breakdown by demand items, we can see that the economy was underpinned by private consumption. While the inflation rate hovered at a relatively low level around 3%, consumption was boosted by an improvement in employment and income environment on the back of the rebound in corporate earnings and a hike in the minimum wage. In addition, exports remained strong. Dollar-denominated nominal exports for the January–March period surged by 25.1%, compared to the same period in the previous year, against the backdrop of the recovery in the global economy and operation of new factory by South Korean electric and electronic components manufacture in Vietnam.

Even after April, retail and service sales in real terms for the January–April period grew by 8.5%, compared to the same period in the previous year, exceeding the growth rate of the previous year (7.0%, similarly). Dollar-denominated nominal exports in April turned out to be 5.0% year-on-year, continuing on a growth trend even though slowing.

■ Effects of import regulations on finished vehicles which are likely to be prolonged

In terms of the future outlook of the Vietnamese economy as of 2018, a higher level of growth is expected to continue, driven by the expansion of exports reflecting the rebound in the global economy as well as a low inflation rate and an improvement in the employment and income environment.

＜Motor Vehicle Sales＞



Source : VAMA, CEIC

However, attention must be paid to a risk of prolonged stagnation of automobile sales in the domestic market as a result of the new car import regulations.

Initially, automobile sales were predicted to significantly increase in 2018 due to the removal of tariffs within the ASEAN region. With the aim of protecting Vietnamese manufactures, however, the Vietnamese government imposed non-tariff barriers on the imports of finished vehicles starting in January 2018, including requirements for importers to submit permits issued by the government of the country from which the vehicles are imported and to conduct safety inspections by import vessel and vehicle type. Furthermore, the Vietnamese government initially did not approve permits issued in Thailand and Indonesia, where Japanese automobile manufacturers have their export bases, for reasons that such permits do not satisfy the requirements as permit forms. As a result, imports of finished vehicles have stagnated, and automobile sales have remained lower than the previous year's level since the beginning of 2018.

Since the automobile industry cannot be developed over night, the increase in supply restrictions through non-tariff barriers will likely heighten the downside risk for the economy. It is anticipated that the Vietnamese government will implement trade and industry development policies from a flexible and long-term perspective.

(Yuta Tsukada)

China Aiming to avoid economic slowdown through fine-tuning of policies

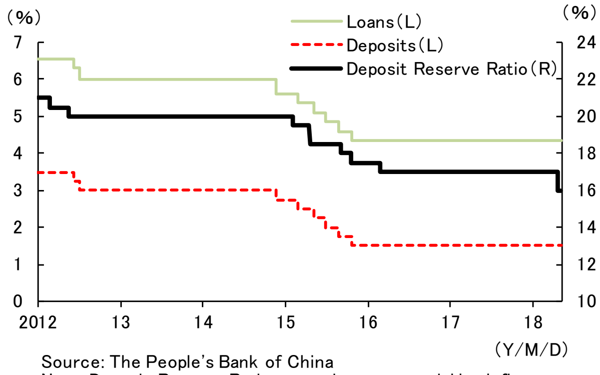
■ Lowering of the deposit reserve ratio

While the Chinese economy has remained stable, signs of a slowdown are apparent in some indicators. While China's manufacturing PMI (Purchasing Managers' Index) in April stood at 51.4 exceeding the 50-point mark that separates growth from contraction for the 21st consecutive month, the index has been falling after peaking in Septemb er 2017. Indicators related to new orders have been sluggish in particular.

There has been a sense of uncertainty concerning trading activities, which previously had been robust. U.S. dollar-denominated exports in April increased by 12.9% year-on-year, recording positive growth for the first time in two months. The growth of exports also accelerated, with an increase of 21.5% year-on-year. Despite su ch circumstance, fears about an economic downturn have been increasing against the backdrop of intensifying trade disputes with the United States.

In light of such changes, the government has been strengthening its economic measures in an effort to prevent an economic slowdown in advance. One such measure is the lowering of the deposit reserve ratio by major commercial banks on April 25. However, the Chinese government has not commenced full-fledged monetary easing yet. The People's Bank of China (central bank) demanded of other banks that capital increase as a result of the reduction of the deposit reserve ratio be allocated to not only the expansion of loans to small- and medium-sized enterprises, but also the repayment of borrowings from the central bank (medium-term lending facilities). This indicates that this move of lowering the deposit reserve ratio was not aimed at boosting the economy.

＜Base Interest Rate(1 Year), Deposit Reserve Ratio＞



Source: The People's Bank of China
Note: Deposit Reserve Ratio are major commercial bank figures.

＜Meeting of the Political Bureau of the CPC Central Committee Held on April 23＞

Confirmation Item	Key Points
Current Recognition on Economic Conditions	・Economic indicators for the January-March period remained stable overall, indicating that the economy continued moving towards recovery
	・With structural factors inhibiting sustainable economic growth remaining, uncertainties surrounding the global economy and political situation have increased
Economic Management for Achieving Annual Targets	・Will maintain economic management with a focus on sustainable expansion of domestic demand
	・Reinforcement of "supply-side structural reforms" and promotion of "reforms and opening up"

Source: News of the Communist Party of China

■ Basic policy on economic management has been maintained

At the meeting of the Political Bureau of the Communist Party of China (CPC) Central Committee held on April 23, China's economic management for 2018 was discussed and it was confirmed that various reform measures will be implemented, including "supply-side structural reforms" with due consideration so as not to undermine economic stability. While the basic policy on economic management was maintained overall, the following two changes were made.

The first change is related to concerns over the current economic situation. In the statement, the global economy and political situation were described as "increasingly intertwined and complex," indicating fears that an increasingly uncertain external environment may become a downward risk for the economy. It has become standard to express an intention to steadily execute domestic policies in preparation for various downward risks surrounding the global economy as the economic management policy. However, it seems that concerns over the global economy were further heightened in light of the uncertain outlook reflecting the hardline trade demands presented by the Trump administration.

The second change is a clear statement on the "sustainable expansion of domestic demand." This statement is a clear determination towards securing stable growth led by domestic demand amid increasing concerns over a decline in external demand. In fact, the State Council (central government) announced tax reduction measures primarily for mitigating corporate burdens two days after this meeting.

Xi's administration is expected to aim for both sustainable growth and structural reforms for the time being through fine-tuning policies. While flexible economic management is anticipated under strong leadership, the situation will continue to call for vigilance given various downward risks surround both the domestic and global economies.

(Junya Sano)