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Topics *China's economic slowdown halted*

China's economic slowdown has been brought to a stop, thanks to the government switching to a policy stance emphasizing economic growth and adjusting its deleveraging policy in the latter half of last year. The effects of these economic measures are expected to pull the growth rate out of its slump in the April-June quarter.

■ Infrastructure investment boosting the economy

China's real GDP growth rate for the January-March 2019 quarter was up 6.4% year-on-year, essentially level with the previous quarter. It thus appears that the economic slowdown ongoing since last year has been halted. Below is a perspective on China's economic future in terms of the factors that will push the economy down and those that will pump it up.

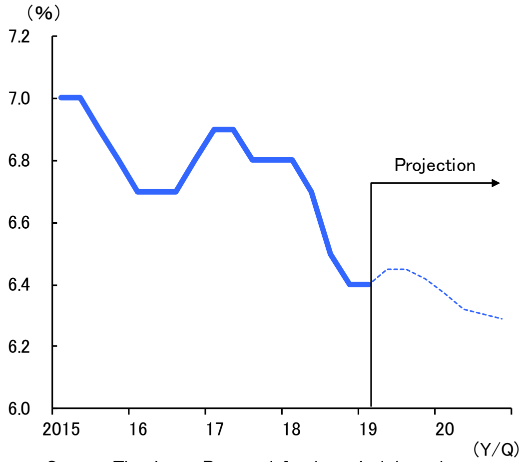
Three factors can be seen putting downward pressure on the economy: higher import tariffs imposed by the US, an increasing sense of stagnation in the global economy, and the repercussions of overinvestment in the manufacturing industry.

First, the Trump administration in the US, citing infringements of intellectual property rights as justification, imposed punitive tariffs on Chinese products in three phases: the first in July of last year ($34 billion), the second in August (about $16 billion), and the third in September (about $200 billion). The consequence has been a substantial drop-off in Chinese exports to the US.

Exports to destinations other than the US are also losing momentum, undermined by a growing stagnation in production activities in emerging countries, the European Union (EU) and elsewhere.

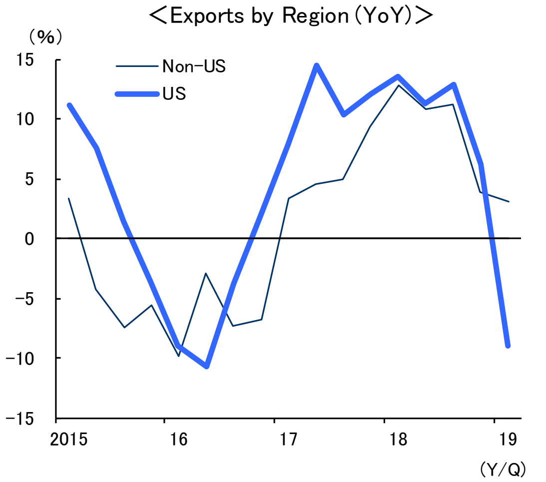
Also weighing down on the economy is a slowdown in capital investment. The capital investment made in large-scale computerization and in the automation of manufacturing processes over the past few years has resulted in overcapacity in high-tech and in manufacturing as a whole. Bad timing, government deleveraging (constraining credit and debt), and intensifying US-China trade frictions have all combined to make companies concerned about worsening returns on investment more cautious about investment.

＜Real GDP Growth Rate (YoY)＞



Source: The Japan Research Institute, Ltd. based on data from the National Bureau of Statistics

＜Exports by Region (YoY)＞



Source: General Administration of Customs "Trade Statistics"

On the other hand, one major factor bolstering the economy is the government's switch to a policy stance emphasizing economic growth. From the end of 2017, the government earnestly pursued a deleveraging policy for the sake of structural adjustments, strengthening financial regulation and oversight of banks by, for instance, instructing them to reduce off-balance-sheet transactions ("shadow banking"). This has indeed reduced shadow banking but, with local governments facing cash flow difficulties, infrastructure investment has dampened markedly.

The unexpectedly steep plunge in investing drove the government out of a sense of crisis to shelf the structural adjustments it had viewed as a priority and rethink its deleveraging policy in the latter half of 2018.

On the financial front, the government redirected its efforts toward easing financial regulation and oversight, setting out to ease credit by, for example, guiding short-term interest rates lower, and extending the deadline for banks to reduce their off-balance-sheet transactions. In the fiscal arena, the government has accelerated infrastructure improvements to create demand, and asked local governments to expand their own infrastructure investment.

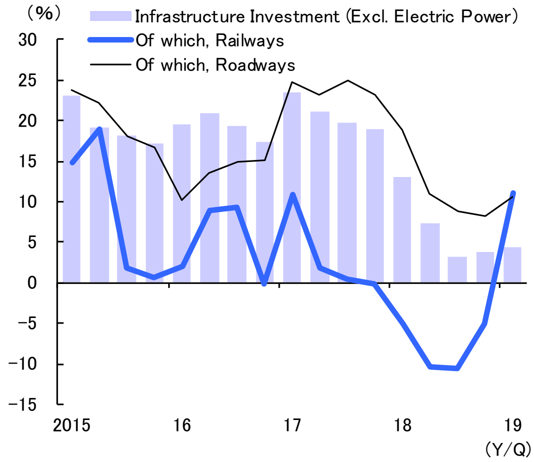
This put a halt to the contraction in shadow banking, and signs of renewed expansion are now appearing. Coupled with increased bank financing for Local Government Financing Vehicles responsible for local infrastructure improvements, infrastructure investment has bottomed out, with the recovery in rail traffic being particularly notable.

■ Economic recovery anticipated in April-June quarter

Looking ahead, the growth rate for the April-June quarter is expected to see somewhat of a recovery, the result of a variety of concrete measures having been introduced since the start of this year. The effectiveness of such measures as expanded lending, corporate tax cuts, reductions in the social security burden (totaling approximately 2 trillion yuan), frontloaded issuance of local government bonds, tax cuts for individuals, and subsidies for automobiles and household appliances in underpinning the economy has gradually become apparent.

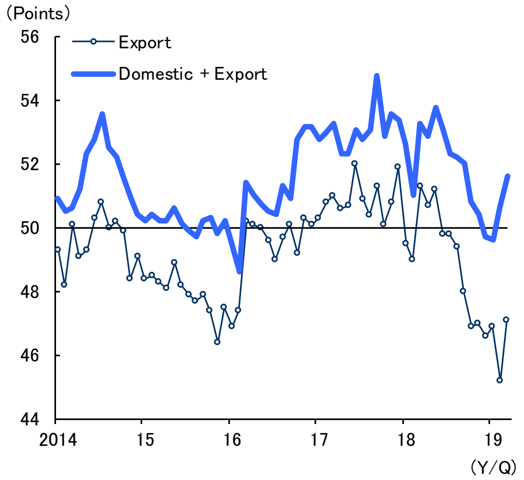
The Purchasing Managers' Index (PMI) (domestic and export orders), a leading economic indicator, has exceeded the 50-mark, which separates growth from contraction, for the second consecutive month as of March. Although overseas demand remains sluggish, domestic demand continues to show signs of a rapid recovery. Share prices have rebounded about 30% since the end of last year. This rally in share prices, together with tax cuts, has also spurred a bounceback in sales of full-sized automobiles with engine capacities of over 2,500cc that are popular among high-income earners.

<Infrastructure Investment>
(Cumulative Year-start, YoY)



Source: National Bureau of Statistics of China "China Fixed Asset Investment"

<Purchasing Managers' Index (PMI)>



Sources: National Bureau of Statistics of China, China Federation of Logistics & Purchasing, "China Manufacturing Purchasing Managers Index"

A look at demand by commodity shows that exports will likely continue to weigh down the economy, even as investment and consumption prop it up. The government's economic policies are expected to have particularly significant effects on infrastructure investment, real estate development investment, and expanded production in the manufacturing industry. The full-year growth rate for 2019 is forecast to be 6.4%, fitting well within the government's target range (6.0%-6.5%).

However, these economic measures were only taken after setting structural reform aside. This has given rise to concerns that, as collateral effects, local finances will worsen and the problems of excess production capacity and excess debt will become more serious. Once it is certain that an economic slowdown has been averted, the Chinese government will likely shift its attention within the year from economic growth back to structural adjustments, making it highly probable that it will turn to constraining investment and shadow banking. Consequently, a sustainable V-shaped economic recovery similar to that achieved after the Lehman Shock is unlikely, and the economy will likely begin decelerating once more next year.

(Shinichi Seki)

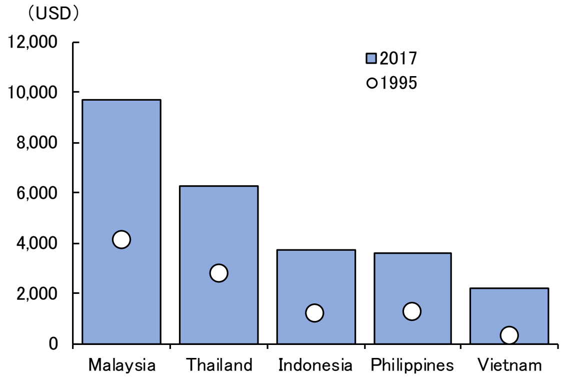
Topics *Malaysia's economic policy management at a crossroads*

Having achieved growth through steady economic policy steered by a distinctive developmental dictatorship, Malaysia has been pursuing increasingly populist policies in recent years. Future growth will depend on whether Anwar, being eyed as the next prime minister, can rebuild a Malaysian-style developmental dictatorship.

■ Sitting on the verge of joining the high-income countries

Malaysia's economic success stands out conspicuously among the ASEAN5 (Indonesia, Malaysia, Philippines, Thailand and Vietnam), and its per capita GNI, only $4,132 in 1995, reached $9,684 in 2017. This has put Malaysia on the verge of becoming the only high-income country (per capita GNI of $12,055) among the ASEAN5.

< Per Capita GNI in ASEAN5 >



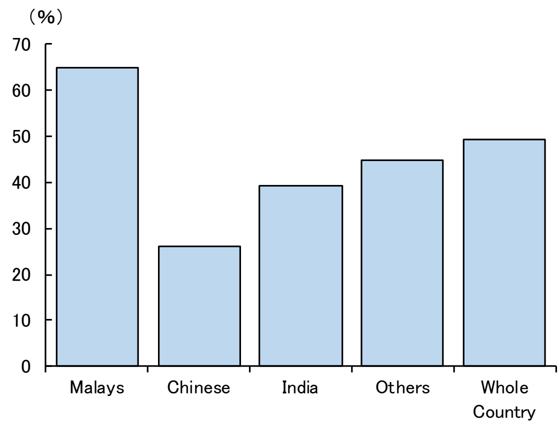
Source : Unaited Nations

Credit for this goes entirely to the effective management of economic policies demonstrated heretofore. During the Asian currency crisis, for instance, Malaysia quickly put its economy back on track to strong growth by imposing low interest rates, increasing public spending, and placing controls on international capital transfer, thereby avoiding IMF intervention. When the country ran up against the limitations of export-driven growth, it made the transition to domestic demand-driven growth by opening up the service sector to foreign capital, improving IT infrastructure, and enhancing workers' skills.

■ The backdrop of a Malaysian-style developmental dictatorship

A key factor in the success of Malaysia's economic policy management was its distinctive developmental dictatorship that pursued long-term approaches. Dictatorship in the name of economic development was not unique to Malaysia, though, and indeed much of the post-World War II development in Asia's emerging countries stemmed from developmental dictatorships. Among the ASEAN5, the Suharto regime in Indonesia and the Marcos regime in the Philippines were clear examples of such systems.

< Poverty Rate by Ethnicity in Malaysia (1970) >



Source : Prime Minister's Office of Malaysia

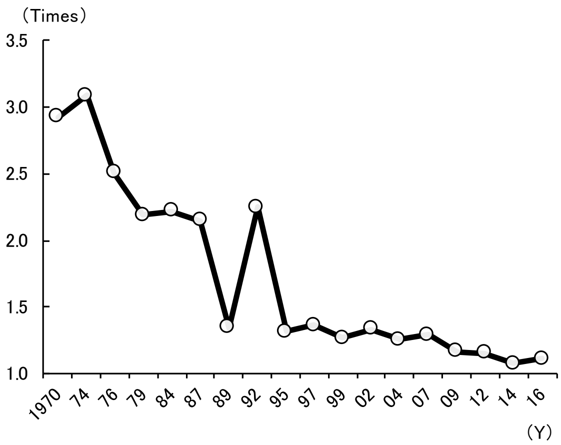
One major feature distinguishing Indonesia and the Philippines on the one hand and Malaysia on the other is the political philosophy imbued in their developmental dictatorships. The developmental dictatorships in Indonesia and the Philippines, if anything, implemented policies from short-term perspectives. The development dictatorships in these countries relied heavily on their leaders' charisma, and the principal aims of the leaders running these regimes were keeping the regime in power and retaining their status as leaders. Leaders thus increasingly began to pander to their publics through such populist policies as subsidies, and policies designed to promote industry were often heavily influenced by the reactions of the regime's supporters. Corruption also tended to be chronic, giving rise to influence peddling vis-à-vis relatives to ensure regime stability over the long term.

Contrarily, Malaysia's developmental dictatorship adopted long-term perspectives because its power rested on the values of the entire populace to keep disparities between the haves and the have-nots from sparking ethnic conflict. Although constituting 70% of the population since the founding of the country, Malays were quite frequently impoverished, while disproportionate numbers of Chinese and other non-Malay minorities enjoyed relative affluence. In fact, poverty rates by ethnicity in 1970 show a rate for Malays that is more than double that for Chinese. Consequently, large-scale sectarian violence broke out in 1969 that threatened to bring the country to its knees. Holding in common the view that reducing the disparities between ethnic groups was essential to the country's development, the people of Malaysia as a whole demanded that the government make this its utmost priority. Given this mandate, the government began to incorporate the idea of rectifying ethnic disparities into its considerations for all policies. Through this course of events, the Malaysia government adhered to a style of proposing long-term policies and then steadily and patiently realizing them with the aim of resolving future disparity issues. As a result, Malaysia's economic policies were steadily and properly managed over the long term and were relatively unwavering compared to those of neighboring countries.

■ The loss of a shared vision among the populace

From around 2013, however, Malaysia's economic policy began showing signs of instability despite this sound management. Broadly speaking, the Malaysian government's policies in recent years have turned toward chasing short-term profits, and have come to resemble those formerly in place in Indonesia and the Philippines.

＜ Income Gap Between Ethnicity ＞



Source : Departmnet of Statistics Malaysia
Note : Non-Malays / Malays

The second Najib administration that began in 2013 made a sudden turn away from the fair and impartial poverty reduction measures of the first administration and toward a handout policy favoring its Malay support base, giving rise to suspicions of corruption surrounding the prime minister himself by the end of this administration. The successor Mahathir administration still in office has given priority to tax breaks for urban residents, its support base, and has begun placing greater emphasis in its industrial policy on manufacturing, as if to recreate the experience of successful development achieved by attracting foreign manufacturers

One factor underlying this destabilization is the loss of a shared vision for the country as a whole in preventing open ethnic conflict. The income disparity between Malays and non-Malays was for the most part statistically eliminated earlier in the 2010s and, realizing this, members of the public began demanding the government implement policies advantageous to their own particular interests. With its noble cause of rectifying ethnic disparities now gone, the government rapidly became inclined toward handout policies to gain greater support and toward policies that sought to restore past glory by emphasizing manufacturing.

■ The Malaysian-style developmental dictatorship expected to be reinstated by Anwar as the next prime minister hopeful

Malaysia had thus been known at one time for its sound economic policy management, but it has since become heavily tainted with populism over the past five years or so. In light of the experiences of countries in Southern Europe and South America, a bleak future awaits states that veer increasingly toward populism. Should Malaysia continue to go down the populist path, it might find future economic development extremely challenging.

To put the country back on a steady course to economic growth, Malaysia needs to return to a paradigm in which, as before, the nation as a whole shares a vision of the country's future and the government implements policies from a long-term perspective in pursuit of this vision. There seems little possibility at the moment that Prime Minister Mahathir, who possesses great charisma and currently enjoys a good reputation both inside and outside the country, will ditch his current policies to achieve this drastic transformation. Accordingly, hopes for such a change lie with Anwar, who clashed with the prime minister over responses to the Asian currency crisis and stepped down from the earlier Mahathir administration but who has again teamed up with Mahathir and has come to be viewed as the strong favorite to become the next prime minister.

(Yuta Tsukada)