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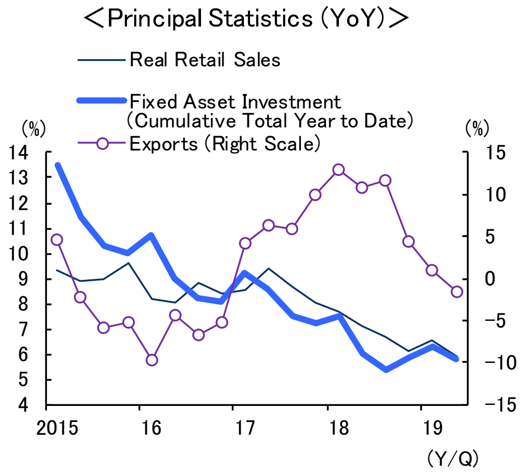
Topics *What are the prospects of the Chinese economy in 2019 and 2020?*

China's economy has been slowing down against the backdrop of the investment control measures in place until last year and the raising of tariffs by the United States. While the trade conflict between the United States and China will continue to weigh on the Chinese economy in the future, economic downturn is likely to be avoided thanks to the economic measures being implemented by the government.

■ The progress in economic recovery has been slow

Economic slowdown has continued in China. Fixed asset investment started to slow down again recently due to the remaining effects of the investment control measures in place until last year. Retail sales have also been sluggish due mainly to the stagnant performance of the automobile market. The momentum of exports has been diminished against the backdrop of the raising of tariffs by the United States.



Source: The Japan Research Institute, Ltd. based on "Trade Statistics" by the General Administration of Customs, "Total Retail Sales of Consumer Goods," "Consumer Price Index" and "China Fixed Asset Investment" by the National Bureau of Statistics

The two pillars of the investment control measures were the tightening of financial regulations targeting banks and the reinforcement of supervision on fiscal expenditures by local governments. While the rapid expansion of credit supply and liabilities came to a halt as a result of the reduction of off-balance transactions by banks (so-called shadow banking) and the review of unregulated infrastructure investment, a number of infrastructure development projects such as those for subways, airports and highways were also suspended.

In particular, local economies have been suffering the most. Although economic growth in Guangdong, Jiangsu and Zhejiang, which are less dependent on infrastructure investment, has declined only slightly, economic growth in Inner Mongolia, Jilin, Tianjin and Chongqing, which are more dependent on infrastructure investment, has remained bleak after declining to a level around half of that in 2016.

Such sluggish local economies have been weighing on private consumption. Looking at automobile sales, while the sales of Japanese vehicles with higher market shares in major cities along coastal regions have been robust, sales of Chinese brand vehicles with higher market shares in small and medium-size cities in the inland areas declined significantly from the previous year. Meanwhile, sales of U.S. brand vehicles have been sluggish amid tension in the relationship between the United States and China.

Momentum in exports has been diminished as well. The Trump administration of the United States raised tariffs on $50.0 billion worth of Chinese goods to 25% in July and August 2018 and raised tariffs on $200.0 billion worth of Chinese goods to 10% in September 2018. As a result, exports to the United States, which account for 20% of China's total exports, have been decreasing on a year-on-year basis since the end of last year. Furthermore, exports to other regions have also stagnated. This reflects economic downturn in Asia and the EU due to the delay in recovery of global IT demand and uncertainties arising from the Brexit problem.

Of course, there have been some positive signs. Thanks to the economic measures by the government, railroad investment as well as demand for telecommunications equipment such as smartphones have been expanding. However, positive effects for boosting the economy have not emerged in a straightforward way as the negative impact of the investment control measures has remained stronger than anticipated.

■ Economic slowdown will be avoided, underpinned by policies

As for future prospects, China's economic growth rate will likely pick up soon as the government has already taken full-fledged measures to stimulate the economy.

Firstly, as the government has relaxed its investment control measures, infrastructure investment will likely pick up in the latter half of this year. On fiscal policy, the government shifted toward monetary easing including the lowering of the deposit reserve ratio. In addition to extending the deadline for banks to reduce off-balance transactions, the government demanded banks to respond to financing demand for local government financing vehicles (LGFVs) which are in charge of local infrastructure development projects, thus shifting gears toward relaxing financial regulation and supervision.

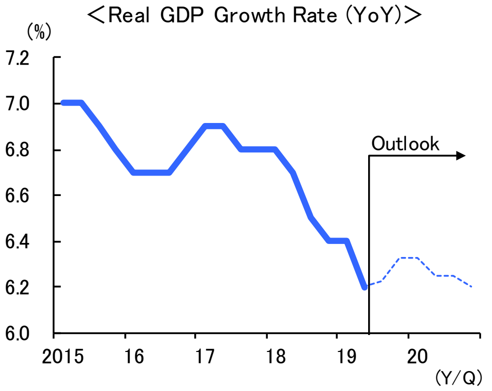
On the financial aspects, the government has accelerated its efforts related to the development of railroads among others with the aim of creating demand. The government has also notified local governments to push forward with infrastructure development by issuing municipal bonds. It looks like the difficulties surrounding funding by local governments will be eased thanks to the expansion of underwriting of municipal bonds by financial institutions in the future.

Fixed asset investment by the private sector will also likely rebound on the back of investment promotion measures by the government. The Chinese government decided to reduce corporate income tax on the integrated circuit (IC) and software industries this spring. Local governments including Chongqing municipal government have promised subsidies for industries. As we just discussed, the Chinese government has taken full-fledged measures for the domestic production of high-tech products. As a result of the effects of these investment stimulus measures, signs of recovery in fixed asset investment by the private sector are currently being seen.

Automobile sales are also anticipated to pick up on the back of the recovery of local economies and sales boosting measures. As an example of additional stimulus measures for automobile sales, the National Development and Reform Commission (NDRC) prohibited the introduction of new restrictions on the issuing of new license plates for passenger vehicles, which are aimed at protecting the environment and alleviating traffic congestion, and Guangdong has eased existing restrictions on new license plates. Annual automobile sales are expected to decrease by 6 percent year-on-year to 26.5 million in 2019 and increase by 4 percent year-on-year to 27.5 million in 2020. Given the fact that the added value of the automobile industry accounts for approximately 2 percent of China's GDP, China's GDP will be pushed down by 0.12 percentage points due to the bad performance of the automobile industry in 2019 but will be pushed up by 0.08 percentage points due to the moderate performance of the automobile industry in 2020.

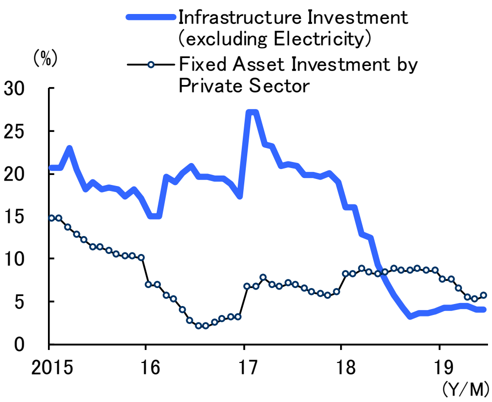
As discussed above, while the U.S.-China trade frictions will continue to weigh on the Chinese economy, an economic downturn will likely be avoided with the nation's real GDP anticipated to grow by 6.3 percent both in 2019 and 2020 under the policy measures of the government which will pursue stable growth with determined commitment.

<Real GDP Growth Rate (YoY)>



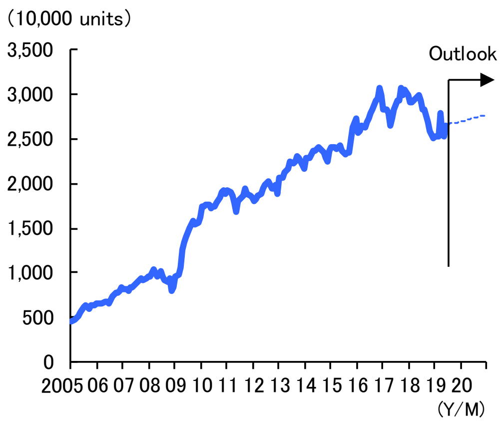
Source: The Japan Research Institute, Ltd. based on "National Accounts Statistics" by the National Bureau of Statistics

<Infrastructure Investment and Fixed Asset Investment by Private Sector>
(Cumulative total year to date, YoY)



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

<Automobile Sales (SAAR)>



Source: The Japan Research Institute, Ltd. based on data from the China Association of Automobile Manufacturers (CAAM)

(Shinichi Seki)

Topics *The Asian economy is likely to slow down in the future*

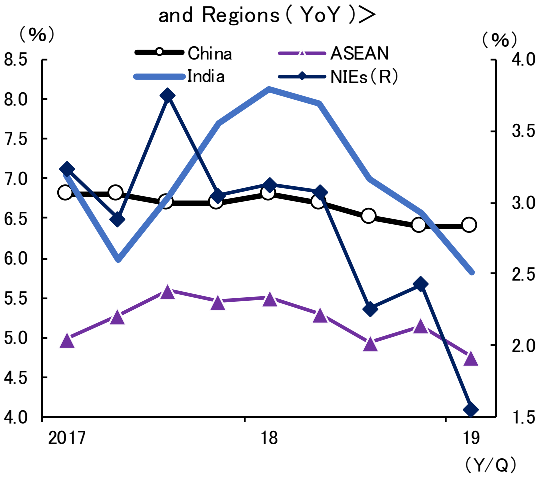
The economies of Asian emerging nations and regions, which had remained resilient, turned to a declining trend since the latter half of 2018. As for future prospects, the overall Asian economy will likely remain on a downward trajectory on the whole due to the prolonged conflicts between the United States and China and the slowdown of infrastructure investment.

■ The Asian economy has turned to a downward trend

The Asian economy, which had remained resilient on the whole, has turned to a declining trend since the second half of 2018.

The following three points can be pointed out as contributing factors.

＜Real GDP Growth in Asian Emerging Nations and Regions (YoY)＞



Source : Government Statistics, CEIC
Note : The regional GDP growth is calculated by weighted average of each nations' and regions' real GDP growth in dollar-denominated nominal GDP (backward four-quarter moving average).

The first point is sluggish exports. While there have been several factors including the U.S.-China trade conflicts, the slowdown of IT demand, in particular, had a major impact among them. The global semiconductor market has cooled down rapidly since the latter half of 2018 as the spread of smartphones ran its course and investment in data centers leveled off. Since exports of electronic equipment and parts account for approximately 20 percent of nominal exports of Asian emerging nations and regions, the cooling down of the market put significant downward pressure on exports. The second point is slowdown of investment. China's fixed asset investment rapidly decreased as the government reinforced its deleveraging policy last year in order to rectify the excess liability problem. In addition, Korean companies, mainly large-scale enterprises, refrained from investing due to excess investment, as a result of investment stimulus measures implemented in the past few years. Furthermore, in ASEAN-5 countries and India, the tighter financial environment such as rate hikes following the United States suppressed investment activities by the private sector. The third point is weak consumption. In NIEs and ASEAN-5 countries, consumption was sluggish reflecting the deterioration of income conditions for workers in the relevant sectors due to a decline in exports and a drop in prices of primary products in addition to the negative impact of rate hikes. Meanwhile, in India, buoyant consumption slowed down as pent-up demand ran its course which was a reaction to economic turmoil caused by policies implemented in 2016 and 2017.

■ Both upside and downside factors will affect future economic prospects

In predicting future prospects for the Asian economy, it is necessary to consider three factors that could affect the economy both in upside and downside directions.

The first downward factor is sluggish exports. Retaliatory tariff hikes between the United States and China, which started in July 2018, have rapidly put downward pressure on not only China's exports to the United States but also exports from NIEs, ASEAN-5 countries and India to China through global supply chains. Amid prolonged conflicts between the United States and China, there is little hope for a rapid recovery of exports. Furthermore, the Trump administration of the United States announced that the U.S. government will exclude India from the scope of the Generalized System of Preferences (GSP) program at the end of May. As exports to the United States account for 15% of India's total exports, this measure will become a significant negative factor for India's exports in the future. The second factor is stagnant demand for semiconductors. In mid-May 2019, the United States initiated sanctions which in principle prohibited China's leading telecommunications equipment manufacturer from exporting products from the United States as well as the supply of overseas products that contain 25 percent or more of products of U.S. companies to this Chinese manufacturer. As a result of these sanctions, sales of smartphones by this manufacturer are anticipated to decrease by 40 million units. This is equivalent to 2 percent of global mobile phone shipment for 2018. As a result, this will likely put downward pressure on the Asian economy after the second half of 2019 through the supply chain of the electronic parts industry in East Asia. The third factor is the slowdown of infrastructure investment. In the past few years, the expansion of infrastructure development played a leading role in driving the economies of ASEAN-5 countries. However, this driving force has begun to appear overshadowed by insufficient funds. In fact, all of the ASEAN-5 countries nations suffer from fiscal deficits. The government debt of Vietnam and Malaysia has remained at a level exceeding the average of emerging countries. For this reason, it will be difficult to significantly increase the budget for infrastructure development by further expanding the fiscal deficit.

＜Real GDP Growth Rate and Forecast in Asia＞

(%)

	CY2017 (Actual)	CY2018 (Actual)	CY2019 (Forecast)	CY2020 (Forecast)
Asia	6.4	6.1	5.9	6.0
China	6.8	6.6	6.3	6.3
Asia (Except China)	5.8	5.5	5.4	5.6
NIEs	3.2	2.7	2.2	2.4
South Korea	3.2	2.7	2.3	2.4
Taiwan	3.1	2.6	2.1	2.2
Hong Kong	3.8	3.0	2.1	2.6
ASEAN5	5.4	5.2	5.1	5.2
Indonesia	5.1	5.2	5.2	5.3
Malaysia	5.9	4.7	4.7	4.7
Philippines	6.7	6.2	6.2	6.5
Thailand	4.0	4.1	3.4	3.6
Vietnam	6.8	7.1	6.7	6.7
India (FY)	7.2	6.8	6.8	7.0

Source : Government Statistics, IMF, CEIC

On the other hand, there are three upward factors. The first upward factor is the U.S.-China conflicts having positive effects on Asian emerging nations and regions other than China by “profiting while others fight.” Currently, a considerable number of companies have been shifting their bases for exporting to the United States from China to surrounding Asian countries in order to avoid the impact of tariff hikes. It is predicted that the transfer of production bases to ASEAN-5 countries and India will gain speed in the future. This is attributable to the fact that labor costs in ASEAN-5 countries and India are lower than in China and they are promising as a consumption market of final goods amid the rise of a middle class who are eager to spend. The second factor is the realization of positive effects of lower rates. Since the beginning of 2019, central banks of many Asian emerging nations have turned to lowering interest rates. Since it is predicted that the Unites States will most likely shift toward rate cuts in the future, the risk of a rapid devaluation in currency has been substantially reduced. In addition, with a limited upside potential for resource prices due to global economic slowdown, there will be less risk of an increase in inflation. For this reason, it is likely that central banks will continue to reinforce their monetary easing stance in the future. The third factor is an expansion of semiconductor demand over the medium term in line with the progress of global digitalization. As described earlier, while the smartphone market will remain stagnant for the time being, the usage applications of semiconductors have expanded into a wide range of fields. In particular, since full-scale investment toward the shift to the 5G communication standard is expected to start all around the world this year, an increase in semiconductor demand for base stations as well as an expansion of data center development in line with an increase in communications traffic will likely continue over the medium term. These movements are anticipated to underpin the economies of Asian emerging countries and regions through the supply chain of the electronic parts industry which is currently being redeveloped.

■ The Asian economy will remain resilient despite the declining trend anticipated in the future

Looking at the future prospects of the Asian economy based on the foregoing, it is anticipated that the overall downward trend will continue. However, unilateral slowdown will likely be avoided as the aforementioned three upside factors will be realized gradually. Nevertheless, the pace of growth will vary slightly among countries and regions. The economies of ASEAN-5 countries and India are forecast to start to pick up after bottoming out as they reap profits out of the U.S.-China conflicts through alternative exports and the transfer of production bases as well as due to the positive effects of a decrease in interest rates. While China will be directly impacted by the negative effects of the U.S.-China disputes, a significant downturn will likely be avoided as the government will take full-scale fiscal and monetary measures to underpin the economy. Meanwhile, although NIEs will likely move out of the worst period as IT demand bottoms out, the pace of growth is expected to remain at the level of potential growth rate with the perception of excess capacity lingering persistently.

(Yuta Tsukada)