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Topics The effects of China's economic stimulus measures ································1
Topics Moon’s income-led growth policy is now in a critical phase ·················3

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Topics The effects of China's economic stimulus measures

The effects of the Chinese government's economic stimulus measures are expected to be seen in infrastructure investment, automobile sales and private investment. However, the government plans to lower its economic growth target, and measures to stimulate domestic demand are likely to be small.

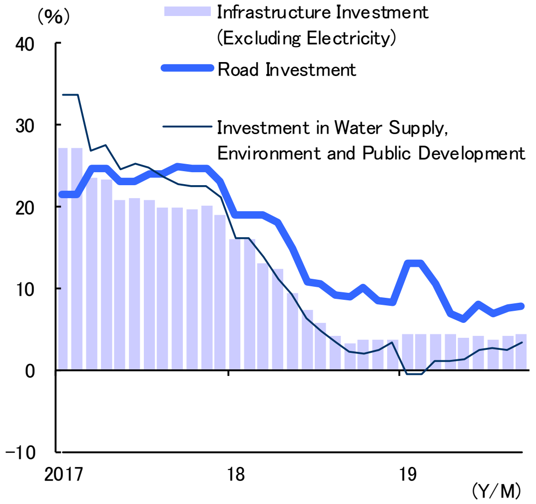
■ Infrastructure investment has bottomed out

In China, the government has taken a series of pump-priming measures amid a continuing economic slowdown. The effects of past policies are expected to manifest in the following three areas.

The first is infrastructure investment. While the government's policy of curbing investment until the first half of last year stopped the rapid expansion of credit and debt, many infrastructure projects such as subways, airports and expressways have been suspended. In the second half of last year, however, the reins on investment restraint were relaxed, allowing some projects to resume and infrastructure investment to bottom out.

Since the beginning of this year, the issuance limit of local government bonds has been raised, and financial institutions have been actively underwriting local government bonds. In September, the Chinese government requested that funds be steadily used, and local governments were required to allocate all funds to their projects by the end of October. The government also decided to announce the issuance of local government bonds in 2020, which is earlier than scheduled. As a result, local government bonds for next year are expected to be issued in the October-December period of this year, which is expected to contribute to the recovery of infrastructure investment.

<Infrastructure Investment (YTD, YoY)>



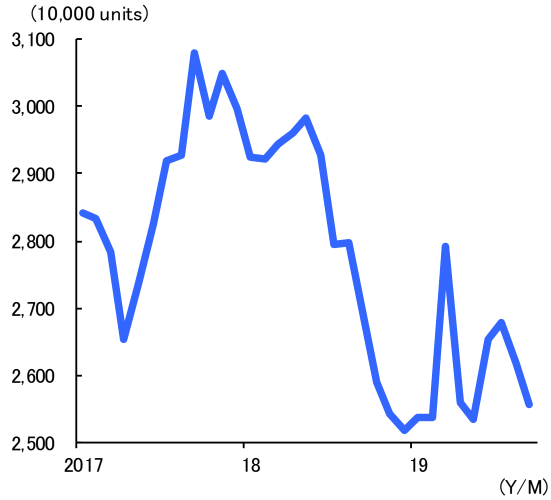
Source: "China Fixed Asset Investment" by the National Bureau of Statistics

■ Automobile sales and private investment have also stopped falling

The second is automobile sales. Although automobile sales declined sharply in the second half of last year, they stopped declining since the beginning of this year. In particular, sales of compact cars with engine displacements of 1,600 cc or less, which are popular in rural areas, have recovered.

The negative impact on sales due to new exhaust regulations, which began on July 1, was not as severe as had been feared. Rather, the stabilization of local economies through economic stimulus measures has led to a halt in the decline in automobile demand.

<Automobile Sales >
(Annualized Figures after Seasonal Adjustment)



Source: "Operational Status of Automobile Manufacturers" by the China Association of Automobile Manufacturers (CAAM)

Looking ahead, automobile sales are expected to pick up moderately, driven by a recovery in local economies and measures to boost sales. In September, Guiyang, Guizhou Province, which is enjoying a boom in the IT industry, including big data and AI, decided to lift restrictions on car purchases ahead of other cities, citing improvement in environmental problems and easing traffic jams. It is expected that the easing and removal of purchase regulations in other cities will likely contribute to the recovery of automobile sales.

The third is private fixed asset investment. In recent years, private investment has been sluggish, reflecting a reaction to the sharp rise in investment since 2016, growing trade friction between the United States and China, and deteriorating corporate profits.

However, the decline in profits in the corporate sector has come to a halt, and the government and authorities have announced several measures to promote investment. Specifically, the government has decided to reduce or exempt corporate income taxes on the semiconductor integrated circuit and software industries from this spring. Local governments have also introduced industrial subsidies.

In September, the People's Bank of China also lowered its reserve requirement ratio for the first time in eight months and lowered its loan prime rate for the second consecutive month. It also called for expanding loans to small and midsize enterprises and manufacturers. As a result, fixed asset investment by manufacturers of information and communications equipment is already recovering.

＜Private Fixed Asset Investment (YTD, YoY)＞

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

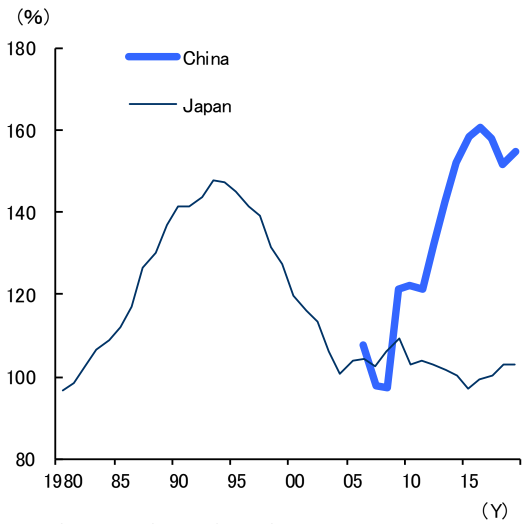
Based on the aforementioned three points, the economic slowdown is expected to stop by the end of this year and the growth rate is expected to remain in the 6% range.

■ The Chinese government remains reluctant to take large-scale economic measures

The Chinese government, however, has been reluctant to implement large-scale economic stimulus measures such as those implemented after the collapse of Lehman Brothers. They seem to be concerned about the risk that large-scale economic stimulus measures will aggravate excess capacity and debt.

China's corporate debt as a percentage of the GDP rose sharply until 2016, and the debt level has already exceeded that of Japan during the bubble economy. As companies have invested not only in plant and equipment but also in high-risk financial assets, their debts have ballooned. Another factor is that local governments have used special purpose companies called local government financing vehicles (LGFVs) to raise funds to invest in infrastructure and real estate development.

＜Ratio of Non-financial Corporate Debt to GDP＞



Source: BIS Total Credit Statistics
Note: The latest data is as of March 31, 2019.

Therefore, the government is strengthening risk management. Looking at fundraising by local governments as an example, while restricting funding from LGFVs—which are difficult for the state government to control—the Chinese government has eased funding through the issuance of local government bonds and has flexibly controlled the issuance limit and issuance standards. This indicates that the government has no intention of increasing infrastructure investment at the expense of risk management.

In addition, the expansion of the service industry has made it possible to ensure stable employment even without a real GDP growth rate of more than 6.5%. The employment of migrant workers is also diversifying from factory workers to lunch delivery services using smartphones.

The Chinese government is thus poised to lower its economic growth target, and its measures to stimulate domestic demand are likely to be small.

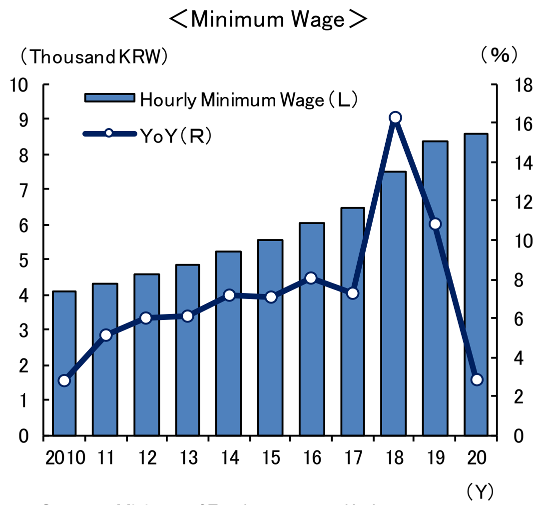
(Shinichi Seki)

Topics Moon's income-led growth policy is now in a critical phase

The Moon administration gave up its promise to raise the minimum wage to 10,000 won per hour in 2020, citing side effects such as rising unemployment. The government plans to increase income by expanding fiscal spending, raising concerns about the fiscal deficit.

■ The Moon administration is likely to significantly fail to meet its minimum wage pledge

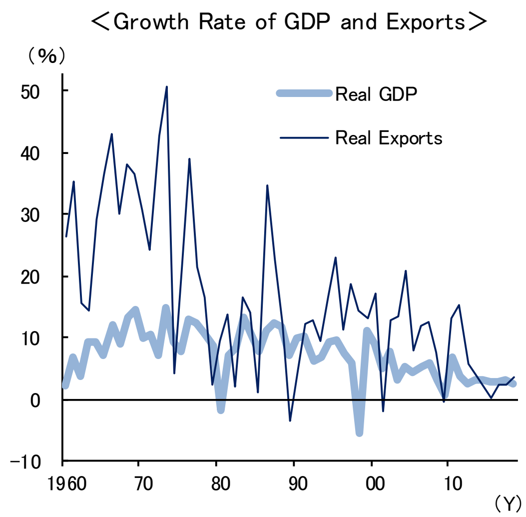
The administration of South Korean President Moon Jae-in, which was inaugurated in May 2017, has set "income-led growth" as its most important economic policy, aiming at economic growth by creating a virtuous circle based on an increase in household income. Above all, the main promise was to raise the minimum wage to 10,000 won per hour (equivalent to approximately 1,000 yen) by 2020. In fact, the minimum wage increased 16.4% in 2018 and 10.9% in 2019, a double-digit increase for two consecutive years. However, the minimum wage is expected to reach 8,590 won, far below the promised level, as the rate of increase is expected to be reduced to 2.9% in 2020. Under these circumstances, the economic policies of the Moon administration are increasingly viewed with harshness in South Korea.



Source : Ministry of Employment and Labor

■ What was behind the proposal on income-led growth?

The Moon administration's income-led growth strategy can be attributed to the stagnation of export-led growth, which drove the South Korean economy in the past. South Korea has developed its economy by promoting export industries since the Park Chung-hee administration, which was established in a military coup d'état in 1961. In fact, until the early 2010s, the growth rate of exports greatly exceeded that of the GDP, and the South Korean economy was driven by typical export-led growth. Since the mid-2010s, however, the growth rate of South Korean exports has slowed considerably due to a slowdown in the growth of the Chinese economy, which is a major export destination, and the development of in-house production of parts and other products in China in response to China's policy of industrial advancement. In addition, under the export-led growth model, wealth was concentrated only in export-oriented conglomerates, and the employment and income conditions did not improve as expected from a macro perspective. In addition, the dissatisfaction of the people grew due to the wage gap between large enterprises and small and midsized enterprises as well as the poverty of the elderly. As a result, Moon Jae-in, who advocated a policy of increasing income, especially among low-income people, won the support of voters.



Source : Bank of Korea

The income-led growth policy not only raises the minimum wage, but also supports income by expanding public sector employment, increasing basic pensions and unemployment allowances, and creating child allowances. However, since these fiscal expenditures were financed by raising the corporate tax rate from 22% to 25% in 2018, companies eventually came to bear all the financial resources distributed to households, including the increase in the minimum wage.

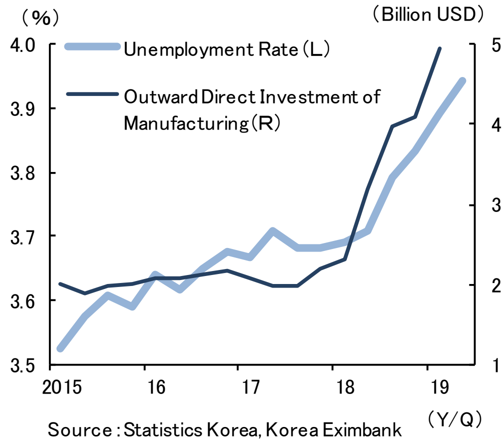
■ Side effects have become apparent

As a result of implementing policies that impose heavy burdens on companies, major side effects have emerged. First of all, the manufacturing industry is moving away from South Korea. In recent years, many companies have chosen production bases that are advantageous to them without being bound by national borders. Consequently, the manufacturing industry has accelerated moves to relocate production overseas in fear of rising labor and tax costs in South Korea. Outward direct investment by South Korean manufacturers has surged since 2018.

Next, the number of jobs in the retail and wholesale industries and the hotel and restaurant industries decreased. These industries were strongly affected by the increase in minimum wages due to their high dependence on low-wage labor. Faced with an increase in labor costs, small business operators voluntarily worked long hours by dismissing part-time workers, shortening their business hours, and were forced out of business. In South Korea, there are many cases in which people who cannot work for companies start small businesses such as retailing or foodservice, and self-employed people account for about one-fourth of the employed people, so the increase in the minimum wage, which has brought them to this predicament, caused a great backlash.

Thus, the income-led growth policy, which imposed a burden on companies, resulted in a decrease in production and an increase in unemployment, contrary to the original intention.

＜Unemployment Rate and Outward Direct Investment of Manufacturing＞

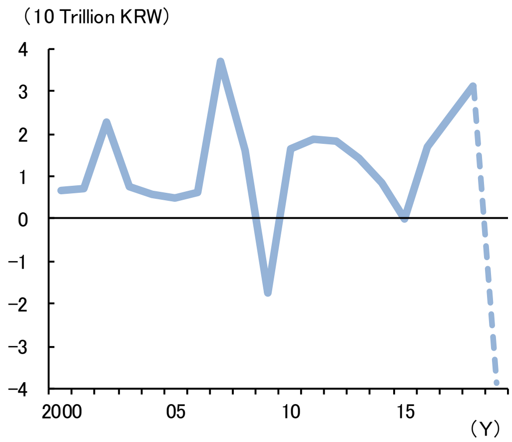


Source : Statistics Korea, Korea Eximbank
Note : 4-Quarter Moving Average

■ There are concerns about an increase in the fiscal deficit

In response to these side effects, the Moon administration was forced to slow down the pace of minimum wage increases. However, the Moon administration has never withdrawn its policy stance of "income-led growth." It intends to pursue income growth by focusing on "pork-barrel" fiscal spending, such as expanding public sector employment and increasing benefits for low-income earners. Such a change in the course of the Moon administration's policies could undermine fiscal discipline in South Korea, which has so far maintained sound fiscal management. In the wake of the Asian currency crisis in 1997, South Korea has been striving to restore its fiscal health and has secured a fiscal surplus, except in crisis situations such as the collapse of Lehman Brothers. However, the budget deficit in the first half of 2019 was 38 trillion won. In the long run, the rapid aging of society is likely to increase the pressure on fiscal spending. Under these circumstances, if various benefits are expanded without discussing the appropriate form of burden and how to link it to a positive cycle, the fiscal deficit in South Korea will increase at an accelerated pace, increasing the risk of destabilizing various markets. The Moon administration's income-led growth policy has entered a crucial stage.

＜Fiscal Balance＞



Source : Ministry of Economy and Finance
Note : 2019 (dotted line) is January−June

(Michinori Naruse)