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Asian economy generally remains firm despite continued bipolarization

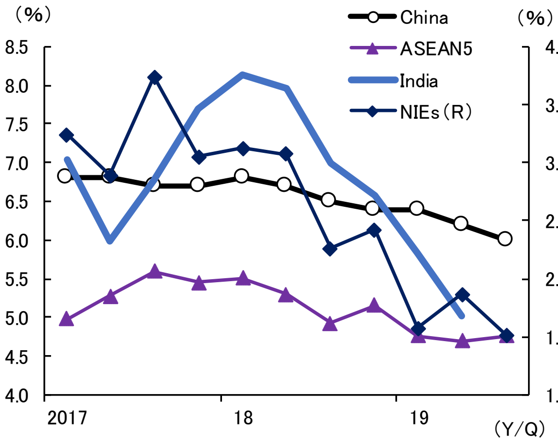
The Asian economy will likely remain firm overall, despite polarization among the ASEAN5 countries and India, which are recovering thanks to benefitting from the trade conflict between the United States and China among other factors, and China and the NIEs, which are suffering from the negative effects of the economic sanctions by the United States and the sluggish world economy.

1. Asian economies generally decelerated in the second half of 2019

Asian economies generally continued to slow down in the second half of 2019. However, looking more closely, the situation has been polarized among countries and regions.

First, the economy continued to decelerate in China as well as in South Korea and Hong Kong among the NIEs (Korea, Taiwan and Hong Kong), and Indonesia, Malaysia and Thailand among ASEAN5 countries (Indonesia, Malaysia, Philippines, Thailand, and Vietnam) and India. China's real GDP growth rate in the July-September quarter of 2019 increased 6.0% from the same period last year, the lowest level since the statistics became available in 1992, partly because of a decline in exports to the United States due to the trade conflict between the United States and China. The other countries and regions mentioned above have also experienced downward pressure on their exports due to the global economic slowdown caused by the U.S.-China conflict and other factors, as well as other country-specific factors negatively affecting their growth. In South Korea, exports of goods and services declined sharply due to sluggish IT demand and worsening relations between Japan and South Korea. In Hong Kong, the economy deteriorated significantly as the conflict between pro-democracy and pro-Chinese factions has led to a decline in the number of tourists. In Indonesia, foreign investment was suspended in an attempt to gauge policy after the new government took office. In Malaysia, resource prices fell, and in Thailand, the baht appreciated. These factors weighed on economic growth in each of these countries. Meanwhile, in India, the economic slowdown has been continuing due to the high interest rates on loans reflecting credit uncertainty in the financial sector and the end of the pent-up demand stemming from the economic turmoil triggered by the policies implemented in 2016 and 2017.

<Real GDP Growth in Asian Emerging Countries and Regions>



Source : Government Statistics, CEIC
Note : The growth rate of ASEAN5 and NIEs are calculated by weighting the growth rate of each country and region using the nominal GDP in dollars (backward quarterly moving average).

On the other hand, the economies of Taiwan, the Philippines, and Vietnam are relatively firm. Taiwan and Vietnam have benefitted from the U.S.-China conflict, which will be discussed later. In fact, in the January-September period of 2019, Taiwan and Vietnam's exports to the United States surged by 21.3% and 34.8%, respectively. As a result, in the July-September quarter of 2019, Taiwan's real GDP grew by 2.9%, the highest in five quarters, while Vietnam's growth rate remained high at 7.3%. The situation in the Philippines, however, is different. The Philippine economy decelerated sharply in the first half of 2019 due to the suspension of new public works projects, caused mainly by the delay in the approval of the fiscal 2019 budget. Since then, the Philippine government has focused on the normalization of budget execution, and the real GDP growth rate in the July-September quarter of 2019 was 6.2%, the first recovery in three quarters.

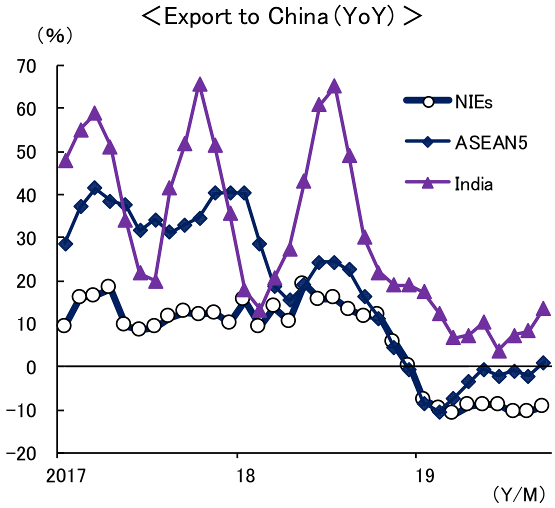
2. There are three key factors which will influence the Asian economy from 2020 onward

In forecasting the Asian economy from 2020 onward, the following three points are noteworthy: (1) the impact of the US-China trade conflict, (2) IT demand, and (3) monetary policies.

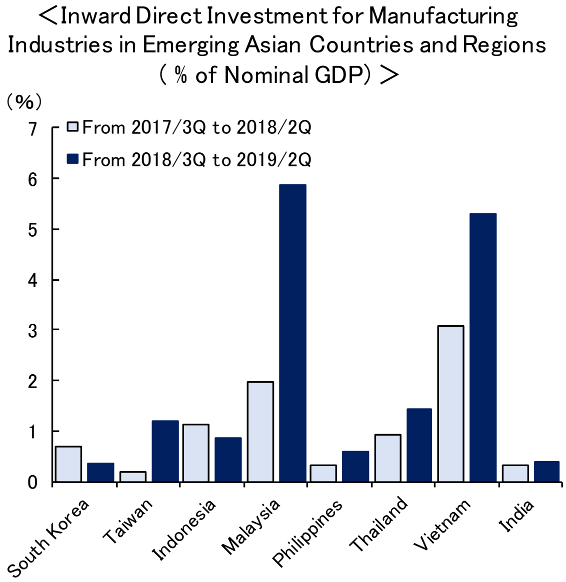
(1) Impact of the US-China trade conflict

Since the autumn of 2019, there have been views that a cease-fire between the United States and China may occur, including concessions in the U.S.-China trade talks. However, given the depth of the dispute over technology transfer and other issues, the confrontation between the two countries will inevitably continue for a long time. Therefore, the U.S.-China conflict will likely continue to have both positive and negative effects on the Asian economy.

On the negative side, it can be pointed out that China's exports to the United States have declined as a result of tariff hikes and other factors, that the Chinese economy has slowed as a result, and that exports to China from emerging Asian countries have declined throughout the supply chains. In fact, exports to the United States by China, as well as exports to China by NIEs, ASEAN5 countries and India remained sluggish in 2019.



Source: Government Statistics, CEIC
Note : Backward 3 months moving average



Source : Government Statistics, CEIC
Note : Approved base

On the other hand, the confrontation between the United States and China is bringing about two positive effects to some emerging Asian economies through the reconstruction of supply chains. The first is to replace China's exports to the United States, and the second is to shift production from China to NIEs, ASEAN5 countries and India, which are progressing due to structural changes. China's labor costs have risen sharply as a result of economic development in the past, but production shifts from China are expected to pick up in earnest as the U.S.-China trade conflict is expected to continue for a long time. These trends have already begun to emerge. In the January-September period of 2019, China's share of U.S. imports shrank by 3.4% points from 2017, while Vietnam's share increased by 0.6% points and Taiwan's and India's by 0.3% points respectively. In Vietnam, Malaysia, Taiwan and other countries, inward FDI by the manufacturing sector on an authorization basis, which is a leading indicator of the shift of production, for the period between July 2018 and June 2019 greatly exceeded that during the preceding one year period.

These effects are expected to become more evident in the future. However, the degree of positive and negative impacts may vary by country and region. In China, downward pressure on the overall economy is expected to remain strong. On the contrary, in countries like Vietnam, an increase in investment due to the shift of production and subsequent increase in exports, in addition to short-term substitute exports, are expected to significantly boost the economy in the medium term.

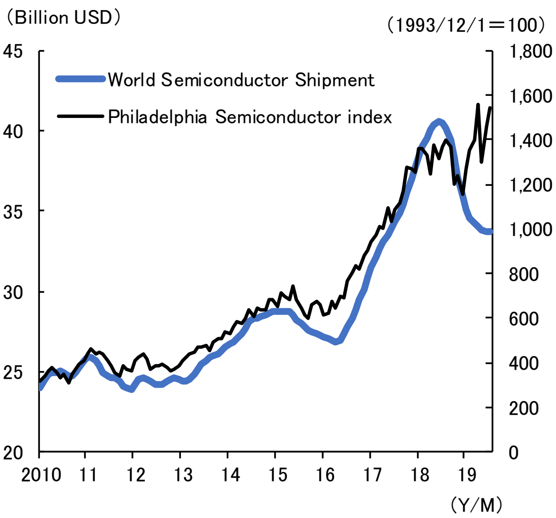
(2) Trend of IT demand

The IT demand trend, the so-called silicon cycle, have influenced the export trends of many emerging Asian countries and regions through supply chains in Asia related to electronic components and devices. World semiconductor shipment value, which shows the trend of world semiconductor demand, showed a sharp increase from 2016 to the end of 2017, which was called the "super cycle," but from the beginning of 2018, it decreased significantly due to the leveling off of smartphone diffusion in China and the pause in data center construction. As a result, exports of electronic components and devices by South Korea and other Asian countries and regions faced a strong setback in 2019.

Looking ahead, however, demand for semiconductors is expected to recover from bottoming out. It is highly likely that demand for semiconductors for base stations will increase as 5G communications networks around the world start to be built in earnest from 2020 onward, and that data center construction, which had been paused for a while, will recover in line with an increase in communications traffic. Memory prices, which had been falling recently, are also on the rise, and inventory adjustments are believed to have progressed. In fact, the Philadelphia Semiconductor Index, which is a leading indicator for the semiconductor market, has been breaking new records intermittently.

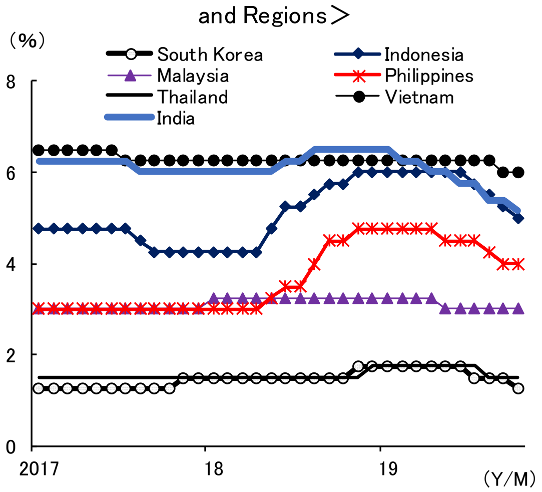
However, it is too early to predict a sharp recovery in semiconductor demand at the pace indicated by the Philadelphia Semiconductor Index. Considering that the May 2019 U.S. sanctions against a major Chinese electronic component manufacturer have forced countries around the world to review their 5G telecommunications network development plans, it cannot be denied that the Philadelphia Semiconductor Index has overstated expectations for 5G. Actual semiconductor demand is expected to pick up only moderately.

＜World Semiconductor Shipment and Philadelphia Semiconductor Index＞



Source : WSTS、Bloomberg L.P.
Note : World Semiconductor Shipment data is Trend Value.

＜Policy Rate in Asian Emerging Countries and Regions＞



Source : Central Bank Statistics

(3) Monetary policies

Up until around the end of 2018, monetary policies in emerging economies in Asia tended to tighten in order to "normalize" significant monetary easing, but from the beginning of 2019, monetary policies shifted to an easing stance across the board. In fact, during the January-October period, India cut its policy interest rate by a cumulative 1.4 percentage points, and NIEs and the ASEAN5 countries and regions also cut interest rates intermittently. This was due to the rise of expectations for interest rate cuts in the United States since the end of 2018, the decline in resource prices, which reduced currency depreciation and inflationary pressures, and the significant slowdown in the pace of economic growth in each country and region.

Even in 2020 and beyond, accommodative monetary policy stances are expected to be maintained in many emerging Asian countries and regions for both domestic and international reasons. First, domestic factors include the fiscal deterioration of each country. Fiscal balances in emerging economies in Asia are consistently in the red, except for South Korea and Hong Kong, and the outstanding amount of government debt (ratio to nominal GDP) in Malaysia and India exceeds the average of emerging economies. As a result, many emerging economies in Asia lack the capacity to mobilize fiscal resources and have no choice but to rely on monetary easing to shore up their economies. As for external factors, the global economy will continue to lack strength against the backdrop of the prolonged U.S.-China trade conflict, and exports from emerging Asian countries and regions are not expected to increase significantly, although there is an increase in exports due to alternative exports and production transfers. Therefore, emerging economies in Asia are expected to continue seeking further monetary easing to stimulate domestic demand.

However, given the expected cessation of interest rate cuts in the United States and the risk of emerging trade friction with the United States in emerging Asian countries other than China, it is unlikely that emerging Asian economies will implement rapid and bold interest rate cuts. The pace of interest rate cuts in the future will remain moderate, taking into account the international situation and developments in financial markets.

3. The outlook remains firm overall, but bipolarization will likely continue

Looking at the outlook for the Asian economy from 2020 onward based on the above, we can see, first of all, that a bipolarization is likely to continue between countries and regions.

ASEAN5 countries and India are expected to recover moderately. In addition to benefiting from the U.S.-China rivalry, emerging positive effects of interest rate cuts and government stimulus measures, as well as the weakening of downward pressure in 2019, will boost the economies of the ASEAN5 countries and India, resulting in economic growth of 5.1% in both 2020 and 2021, 7.0% in 2020 and 7.1% in 2021, respectively.

On the other hand, China will be forced into a slowdown. Although the government's economic stimulus effect is expected to gradually emerge, China's economic growth is expected to slow moderately to 6.1% in 2020 and 5.9% in 2021, as downward pressure on the economy from the U.S.-China trade conflict and excess debt problems prevails. Among NIEs, Taiwan's economy will likely be underpinned by the shift of production from China, in addition to a recovery in IT demand. However, given the weak global economy, the recovery in exports will not be enough to significantly drive the economy. As a result, NIEs' growth rates for 2020 and 2021 are predicted to be 2.1% and 1.8%, respectively, continuing at around the 2% level.

Based on the above, the economic outlook for the Asian region as a whole is likely to remain firm, with growth of 5.8% in both 2020 and 2021.

(Yuta Tsukada)

＜Real GDP Growth Forecast in Asian Emerging Countries and Regions＞

(%)

	CY2018 (Actual)	CY2019 (Prospect)	CY2020 (Forecast)	CY2021 (Forecast)
Asia	6.1	5.6	5.8	5.8
China	6.6	6.2	6.1	5.9
Asia (exclude China)	5.6	4.9	5.5	5.6
NIEs	2.8	1.6	2.1	1.8
South Korea	2.7	1.9	2.3	1.9
Taiwan	2.6	2.6	2.7	2.0
Hong Kong	3.0	−1.0	0.3	1.3
ASEAN5	5.2	4.8	5.1	5.1
Indonesia	5.2	5.0	5.2	5.3
Malaysia	4.7	4.5	4.7	4.8
Philippines	6.2	5.9	6.4	6.4
Thailand	4.1	2.6	3.0	3.1
Vietnam	7.1	7.1	6.7	6.6
India(April to March)	6.8	6.0	7.0	7.1

Source : IMF, Governement Statistics

Note1 : GDP figures in Asia, NIEs, ASEAN5 and Asia (exclude China) are calculated by PPP.

Note2 : In calculating Asia and Asia (exclude China), we use India GDP growth which is the calender year basis.

NIEs The growth will pick up as external demand recovers

■ 2020 will be a period of temporary stability

We expect the real GDP of the NIEs (Korea, Taiwan and Hong Kong) to grow by 1.6% in 2019, a significant slowdown from the growth of 2.8% in 2018. This is largely due to the stagnation in IT demand toward the first half of 2019 and the ongoing adjustment phase in the semiconductor industry. In addition, the growth rate of China's economy, the largest trading partner for the NIEs, continued to slow, marking a record low of 6.0% year-on-year growth in the July-September quarter. As trade friction between the United States and China escalated, trade stagnated due to tariff hikes, and investment came to a standstill due to increased uncertainty, which also curbed the economic growth.

At present, however, this external environment is improving, and the economies of the NIEs are stabilizing. First, although the pace of semiconductor demand varies from product to product, it has improved overall. Indeed, in recent months, the ratio of inventories to shipments of semiconductors in major semiconductor producing countries including South Korea, Taiwan, Japan and the United States has fallen, indicating that the adjustment phase is coming to an end. We believe the preparation for 5G systems is gradually contributing to overall demand for semiconductors, and expect this trend to gain momentum toward 2020. In China, there have been some signs of growth rates stabilizing thanks to economic stimulus measures, and the slowdown in growth is expected to come to a halt once around the middle of 2020. On the issue of trade friction between the United States and China, although many media outlets reporting the difficult situation, the two countries have been engaged in fierce bargaining over the issue. In the run-up to the U.S. presidential election in November 2020, President Trump wants to avoid a negative impact on the economy, so it is difficult to predict that trade friction between the United States and China will intensify over the next one year.

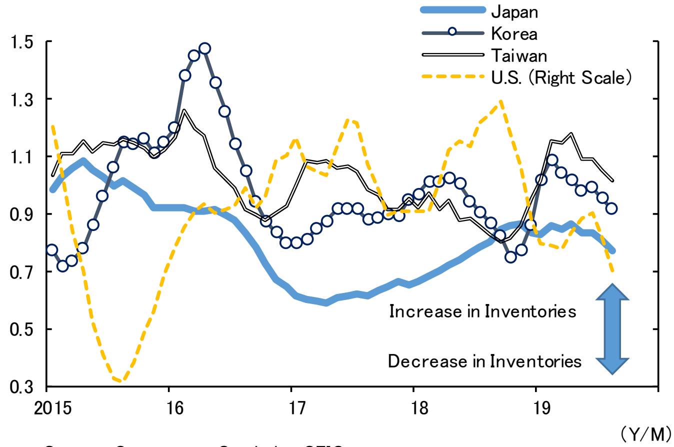
＜Real GDP Growth Rate and Forecast of NIEs＞

(%)

	2016 (Actual)	2017 (Actual)	2018 (Actual)	2019 (Forecast)	2020 (Forecast)	2021 (Forecast)
NIEs	2.4	3.2	2.8	1.6	2.1	1.8
Korea	2.9	3.2	2.7	1.9	2.3	1.9
Taiwan	1.5	3.1	2.6	2.6	2.7	2.0
Hong Kong	2.2	3.8	3.0	−1.0	0.3	1.3

Source: Prepared by The Japan Research Institute, Limited based on Government Statistics Central Banks and IMF

＜Inventory/Shipments Ratio for Semiconductors and Other Electronic Components＞



Source: Government Statistics, CEIC
Note: Inventory/shipments ratio is calculated by the dividing inventory index by the shipment index. 3-month moving average.

On the other hand, it is unlikely that these moves toward improvement in economic conditions will accelerate rapidly. In particular, U.S.-China relations are expected to remain unpredictable over the medium to long term. In this sense, 2020 will be a period of temporary economic stability for the NIEs. The NIEs' economic growth rate in 2020 is expected to accelerate to 2.1% over the previous year as it is likely led by external demand, and then decelerate to 1.8% in 2021.

(Minoru Nogimori)

ASEAN The economies will pick up moderately from 2020 onward

■ The economies ofASEAN5 countries slowed in 2019

The real GDP growth rate of ASEAN5 countries (Indonesia, Malaysia, Philippines, Thailand and Vietnam) in 2019 is expected to have decelerated to 4.8% over the previous year. With the effectuation of the CPTPP (Comprehensive and Progressive Agreement for Trans-Pacific Partnership), alternative exports to the United States and the shift of production from China, Vietnam alone maintained high growth, while other countries saw sluggish growth, mainly in exports, due to the global economic slowdown stemming from the U.S.-China conflict and a pause in IT demand. Declines in resource prices also depressed the economies of Indonesia and Malaysia. In addition, the economic situation in each country was hampered by factors such as the suspension of foreign investment in Indonesia in an attempt to gauge the policies of the second Joko administration and the suspension of new public works projects due to the delay in the passage of the Philippine budget.

＜Real GDP Growth Forecast in ASEAN5＞

(%)

	CY2016 (Actual)	CY2017 (Actual)	CY2018 (Actual)	CY2019 (Forecast)	CY2020 (Forecast)	CY2021 (Forecast)
ASEAN5	5.0	5.3	5.2	4.8	5.1	5.1
Indonesia	5.0	5.1	5.2	5.0	5.2	5.3
Malaysia	4.5	5.7	4.7	4.5	4.7	4.8
Philippines	6.9	6.7	6.2	5.9	6.4	6.4
Thailand	3.4	4.0	4.1	2.6	3.0	3.1
Vietnam	6.2	6.8	7.1	7.1	6.7	6.6

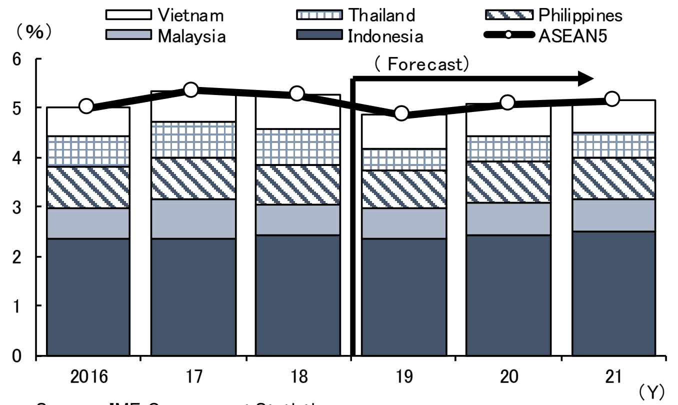
Source : IMF, Governement Statistics
Note : ASEAN5 is the weight average value.

■ Looking ahead, both domestic and external demand expected to remain firm

The economies of ASEAN5 countries are expected to pick up in 2020 and 2021.

First, external demand is expected to underpin overall exports as the global economy continues to firm, and exports of electronic components, which had been sluggish, are expected to expand on the back of the full-fledged introduction of the 5G system. In addition, the start of operations at production bases transferred from China in the wake of the U.S.-China conflict will contribute to an increase in exports from Vietnam and other ASEAN5 countries. Although the global economy remains firm, a strong recovery is unlikely due to the continued confrontation between the United States and China, so it should be noted that exports from ASEAN5 countries will not increase significantly.

＜RealGDP Growth Rate and Contribution by Countries of ASEAN5＞



Source : IMF, Government Statistics

On the other hand, the aforementioned country-specific negative factors for domestic demand will pass. In addition, the ASEAN5 countries have been reducing their interest rates since mid-2019, and the monetary policy of the ASEAN5 countries as a whole is likely to remain accommodative during the forecast period. Therefore, it is expected that the effects of interest rate cuts will gradually spread from 2020 onward, stimulating consumption of durable goods and private investment. In addition, as the confrontation between the United States and China will likely be prolonged, moves to shift production from China to ASEAN5 countries are expected to continue, although there may be differences between countries, and this will contribute to a significant increase in demand in the region.

In light of the above, the growth rate of the ASEAN5 countries in 2020 and 2021 is expected to remain firm at 5.1%, respectively, over the previous year.

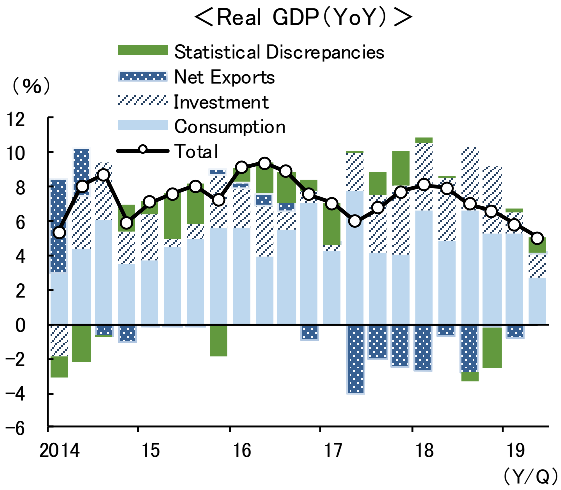
(Yuta Tsukada)

India Growth is expected to pick up in fiscal 2020

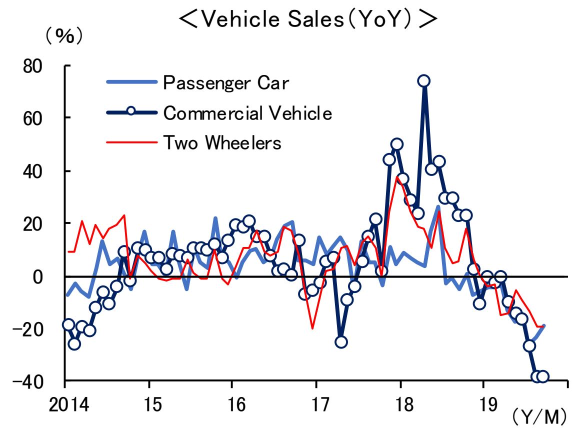
■ Growth rate in fiscal 2019 is expected to be 6.0% over the previous year

In India, a general election was held in April-May 2019 for theLok Sabha (the lower house), which was regarded as the judgment of the people on the Modi administration. As a result, the Indian People's Party, led by Prime Minister Narendra Modi, won a majority of seats on its own, following the previous election, a positive evaluation of the various economic reforms symbolized by the introduction of the GST (Goods and Services Tax) aimed at simplifying the tax system.

On the other hand, the economy is slowing down. As confusion stemming from the abolition of large denomination bills in November 2016 and the introduction of the GST in July 2017 subsided, real GDP increased by 8.2% year-on-year in the April-June 2018 quarter then slowed for five consecutive quarters, declining to 5.0% year-on-year in the April-June 2019 quarter, the lowest growth in five years. The recent economic slowdown has been greatly affected by sluggish automobile sales, which have continued to show double-digit year-on-year declines. The factors behind this include (1) financial institutions' tightening of lending attitudes and high interest rates triggered by a series of defaults by major nonbanks, (2) uncertainty over whether BS6-incompatible vehicles will be able to continue to be used after the introduction of stricter emissions standards “BS6 (Bharat Stage 6)” to be applied from April 2020, and (3) increases in insurance premiums for compulsory coverage and high fuel prices.



Source: Ministry of Statistics and Program Implementation

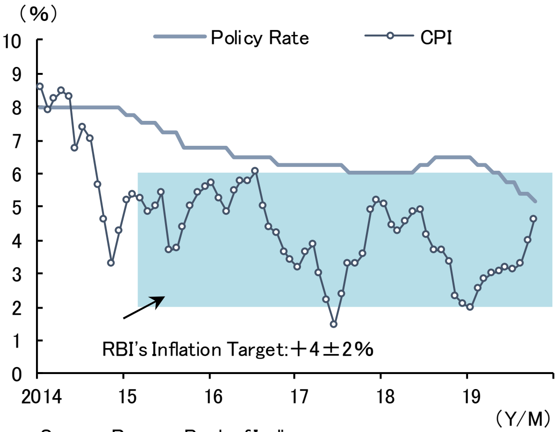


Source: Society of Indian Automobile Manufacturers

In response to this situation, the second Modi administration has launched a series of economic measures since July to boost the economy. On the financial front, the government announced a plan to inject public funds into state-run banks to ease the credit crunch, and in October, it was made mandatory for banks' lending rates for individuals and small- and medium-sized enterprises to be linked to the policy interest rate and the short-term government bond rate. On the tax front, it scrapped a proposal to increase capital gain tax and cut the standard corporate tax rate to 22% from 30%. In order to revive automobile sales, the government attempted to alleviate consumer concerns by declaring that vehicles purchased before the introduction of BS6 would be able to continue to be used even after the introduction of BS6. In addition, the government has come up with measures including postponing the timing of the planned increase in vehicle registration fees, raising the depreciation rate of vehicles purchased by March 2020, and promoting the replacement of vehicles by public agencies. In the future, car dealers are expected to launch a campaign to slash prices to get rid of BS6-incompatible cars. As a result of the package of measures, the economy is expected to pick up in the second half of this fiscal year, mainly through automobile sales. Real GDP in fiscal 2019 (April 2019 to March 2020) is expected to grow by 6.0% year-on-year, a significant slowdown from the previous year (6.8% year-on-year) and the lowest growth since fiscal 2012, mainly due to the low growth in the first half of this fiscal year.

In terms of monetary policy, the Reserve Bank of India cut interest rates by a cumulative total of 1.35 percentage points from the beginning of 2019 to October 2019, in reaction to the slowdown in the domestic economy and a cut in interest rates in the United States. Following the additional rate cut by the United States at the end of October, the possibility of an additional rate cut in December has increased, but the Bank is expected to keep its policy interest rate unchanged thereafter in line with that of the United States.

<CPI(YoY) and Policy Rate>

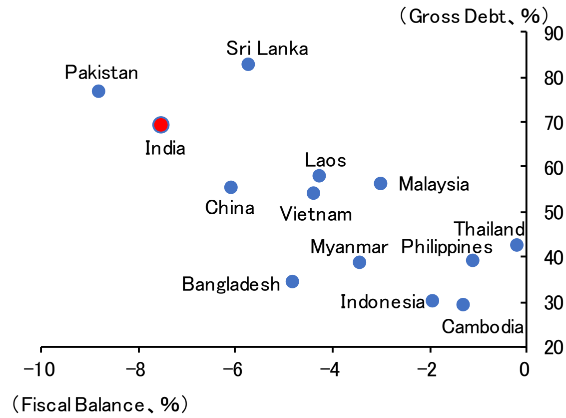


Source:Reserve Bank of India

■ The growth rate in fiscal 2020 is expected to increase by 7.0% from the previous year

Looking ahead to the Indian economy in fiscal 2020, while factors such as the diffusion of consumer durables and the advance of urbanization accompanying an increase in per capita income are expected to underpin growth in the medium term, the growth rate is likely to recover to 7.0% over the previous year, reflecting the effects of the economic reforms and economic stimulus measures implemented thus far. However, as the ratio of the fiscal deficit to nominal GDP increases to about 7% due to a decrease in tax revenues caused by the economic slowdown and the corporate tax cut, the fiscal 2020 budget is expected to be restrained in consideration of fiscal soundness. In addition, as automobile sales are expected to continue to fluctuate due to changes in automobile-related systems, such as emissions regulations, the economy is likely to be somewhat unstable. Specifically, automobile sales are expected to weaken from April 2020 due to a price hike associated with the introduction of BS6 and a reaction to the rush demand before the introduction of BS6. On the other hand, the government is considering making it mandatory to scrap vehicles that are older than a certain number of years in order to protect the environment and support automobile sales. In this regard, if bold tax incentives are introduced for replacement vehicles, demand for automobiles will increase temporarily, but then fall sharply after that.

<General Government Fiscal Balance and Gross Debt to GDP (2019 Projection)>



Source:IMF "World Economic Outlook 2019 Oct"

Regarding monetary policy, although it will be difficult to cut interest rates at the same pace as in the past as the United States stops cutting interest rates. The Reserve Bank of India, however, is expected to maintain its accommodative monetary policy stance until the recovery of the economy is clarified. The Bank will seek further rate cuts while watching the weather during the monsoon period (June-September), which affects food prices, as well as the trend in crude oil prices.

As for politics, attention will be focused on whether the ruling coalition will win a majority of seats in the upper house, where legislators are elected through state legislatures, and whether the "twist" between the upper house and lower house will be dissolved. During the first Modi administration, the limited number of seats for the ruling coalition in the upper house made little progress in reforms such as the Land Acquisition Act and labor-related legislation, which hampered manufacturing investment and job creation in India. If the ruling coalition gains a majority of seats in the upper house, momentum for further economic reforms to promote investment in India may grow.

(Shotaro Kumagai)

China Growth is expected to slow to 6.1% year-on-year in 2020

■ Investment curbs and U.S.-China trade friction depressed the economy

In China, the real GDP growth rate in the July-September quarter of 2019 increased by 6.0% from the same period of the previous year, declining for two consecutive quarters, which indicates a continuing economic slowdown.

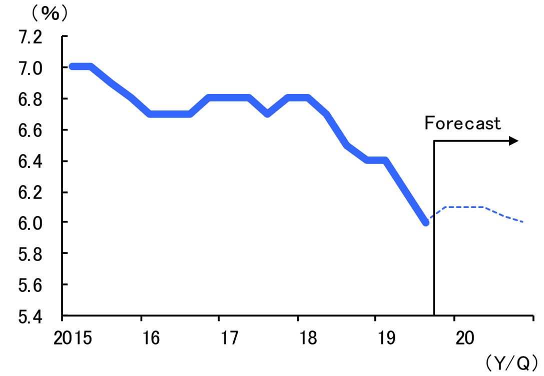
Broadly speaking, the Chinese economy is in a period of seeking stability in the excess capacity and debt adjustment phase, and until last year, the Chinese government had taken measures to curb investment in order to encourage such adjustment. As a result, the pace of credit expansion slowed particularly in shadow banking, while local governments and private companies faced funding difficulties, which cooled local economies, which are vulnerable to changes in infrastructure investment.

In addition, escalating trade friction between the United States and China further depressed the economy. Since the Trump administration raised tariffs on most Chinese products, the value of exports of such products to the United States has fallen by approximately 20% and the total value of exports to the United States has fallen by more than 10%. This negative impact is mainly seen in coastal areas such as Guangdong, Jiangsu and Zhejiang provinces. In these regions, however, the economy is not so bad because the driving force of infrastructure investment is small and the service industry is expanding rapidly.

Moreover, growing uncertainty stemming from the trade friction between the United States and China also pushed down capital investment by private companies and household consumption. Since around 2016, private companies, mainly in the manufacturing industry, have been increasing capital investment in computerization and manufacturing process automation. However, as mentioned earlier, local economies have stalled and the risk of a decline in exports to the United States has increased, and thus companies concerned about the deterioration of profitability have become cautious about new investment. Imports of wristwatches and wine also fell, as consumers refrained from consuming expensive goods due to growing concerns about the future. In addition, Chinese consumers are refraining from buying U.S.-brand cars and smartphones due to the deterioration of U.S.-China relations.

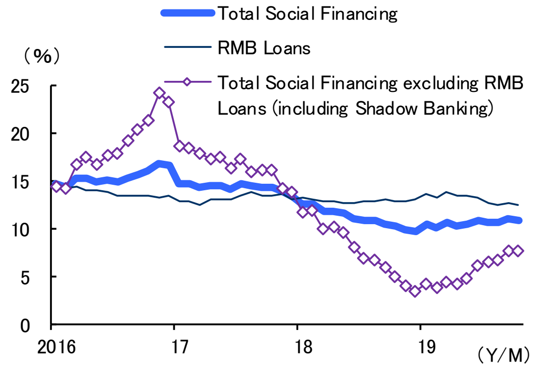
However, the impact of trade friction between the United States and China on the economy has not been as severe as initially feared. Initially, China's exports to the United States and its GDP were expected to fall sharply, but it appears to be more difficult than expected for U.S. companies to switch suppliers from China to other countries. In coastal areas such as

＜Real GDP Growth Rate (YoY)＞



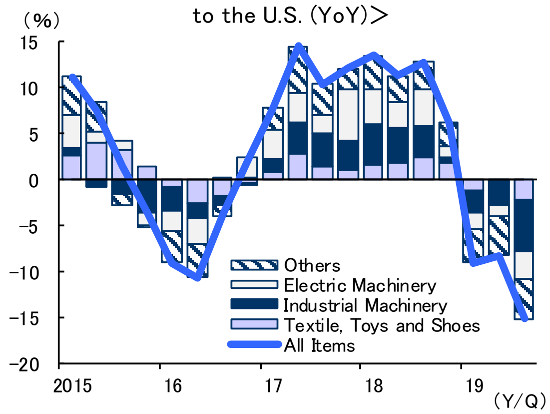
Source: Prepared by The Japan Research Institute, Limited based on "System of National Accounts" by the National Bureau of Statistics of China

＜Total Social Financing (YoY)＞



Source: Prepared by The Japan Research Institute, Limited based on "Statistics on Volume of Social Financing" by the People's Bank of China

＜Breakdown of Contribution to Exports to the U.S. (YoY)＞



Source: Prepared by The Japan Research Institute, Limited based on "Trade Statistics" by the General Administration of Customs

Guangdong and Jiangsu provinces, substantial industrial clusters have been formed, and these groups of companies can meet the quality and delivery requirements of companies in developed countries. It will take years to form a similar industrial agglomeration in other countries.

■ Effects of economic stimulus measures will appear

Looking ahead, further economic slowdown is likely to be averted through policy support. Although the package of economic stimulus measures already announced is small, there are signs that the economy is bottoming out.

First, infrastructure investment is recovering, albeit slowly. Local governments' funding conditions have improved thanks to an increase in the issuance limit of local government bonds and the active underwriting of local government bonds by financial institutions.

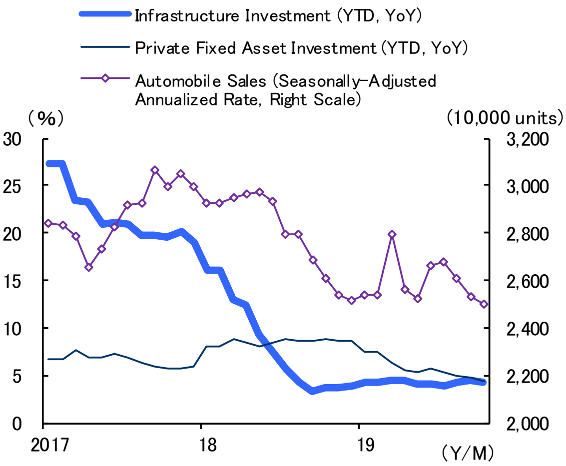
Infrastructure investment is expected to pick up in the future. In September, the central government asked local governments to ensure the steady use of funds procured, and by the end of October, local governments were required to allocate funds procured to projects without leaving any funds. The early issuance of local government bonds in 2020 will also contribute to the recovery of infrastructure investment.

Second, tax cuts and subsidies for high-tech manufacturers and the issuance of 5G licenses have boosted fixed asset investment in the computer, telecommunications and other equipment and business oriented machinery manufacturing industries, as well as in leasing and corporate services industries. In the future, the effects of these expanded investments are expected to spread to related industries. Private fixed asset investment is anticipated to bottom out sooner or later, partly because the government has asked financial institutions to extend loans to private companies.

Third, although automobile production has stalled since the second half of last year, it has stopped declining. The decline reflected a completion of inventory adjustments and the bottoming out of small car sales. Local economies are stabilizing thanks to economic stimulus measures, and sales of compact cars, which are popular in rural areas, are picking up moderately. The negative impact of the new emissions regulations, which began in July, on sales was not as great as had been feared. Automobile sales are expected to pick up in the future as local economies recover and license plate regulations are eased.

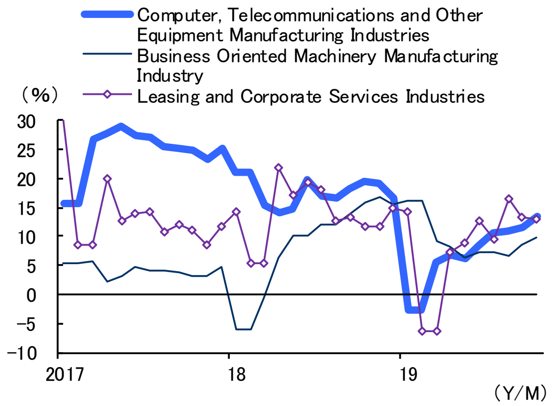
Production of computers, telecommunications equipment, other electronic equipment and general-purpose machinery is also showing signs of

＜Infrastructure Investment, Private Investment and Automobile Sales＞



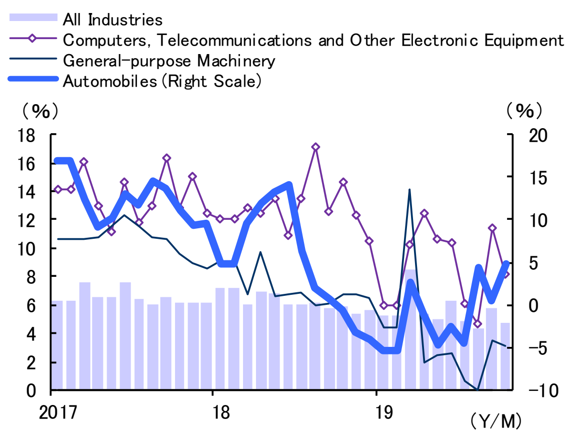
Source: National Bureau of Statistics, China Association of Automobile Manufacturers (CAAM)
Note: Seasonally-adjusted annualized rate for automobile sales is prepared by The Japan Research Institute, Limited.

＜Fixed Asset Investment by Industry (YTD, YoY)＞



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

＜Industrial Production (YoY)＞



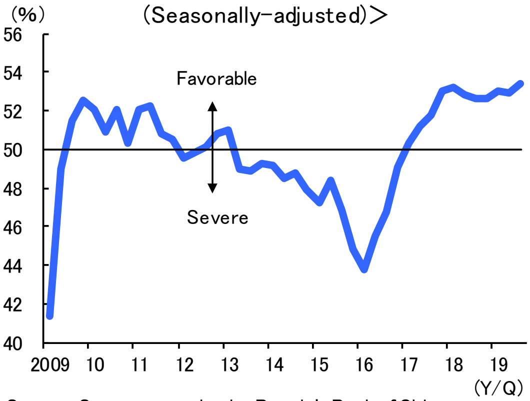
Source: "Industrial Production Index" by the National Bureau of Statistics recovery. It is also encouraging that the decline in orders from overseas manufacturers has come to a halt on the back of a recovery in IT demand and the realization of the effects of economic stimulus measures in each country.

■ Overall situation will continue to lack strong sense of recovery

Against this backdrop, the Chinese government seems to have decided that it is not necessary to take drastic economic measures at this stage. In addition to the above factors, the expansion of the service industry and the problem of excessive debt have also had a significant impact on the gradual policy stance of the Chinese government.

The expansion of the service industry has made it possible to ensure the stability of the employment and income environment, even without maintaining a real GDP growth rate of 6.5% or above as in the past. For example, although the economic growth rate has declined, per capita nominal disposable income has maintained a high annual growth rate of around 8%. The diffusion index (DI) for the outlook of employment situation released by the People's Bank of China remains high (see the chart on the right). Job offers for migrant workers are also diversifying from jobs at factories to lunch delivery services using smartphones.

<DI for Outlook of Employment Situation (Seasonally-adjusted)>



Source: Survey report by the People's Bank of China
Note: The DI for Outlook of Employment Situation is calculated by adding 50 to the results of "the future employment situation will be favorable" minus "the future employment situation will be severe." The survey covered 20,000 households nationwide and the DI has been available since 2009. Seasonally-adjusted by The Japan Research Institute, Limited.

The Chinese government is also concerned about the risk that large-scale economic stimulus measures will aggravate excess capacity and debt. China's corporate debt balance as a percentage of 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. In addition, local governments have used special purpose companies called local government financing vehicles (LGFVs) to raise funds recklessly to invest in infrastructure and real estate development. Therefore, the government is strengthening risk management.

Looking at fundraising by local governments as an example, while restricting funding from LGFVs, the Chinese government has been promoting 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. Therefore, the pace of recovery in infrastructure investment is likely to be slow.

It is also unlikely that automobile sales will recover strongly. This is because the recovery of local economies and the relaxation of license plate regulations are both expected to be modest. In Guiyang City, Guizhou Province, where the IT industry, such as big data and AI, is flourishing, there has been a move to ease or abolish license plate regulations. In major cities such as Beijing and Shanghai, however, it is unlikely that the regulations will be eased or abolished because environmental problems and traffic congestion remain as major problems.

In addition, uncertainty about the future of Chinese companies has not been dispelled amid concerns over U.S. trade policy. Even if President Trump withdraws some of the retaliatory tariffs on Chinese goods to avoid a slowdown in the U.S. economy ahead of the presidential election scheduled in November 2020, it is possible that the United States will impose additional tariffs again after the election.

The world economy also remains uncertain. If the weakening of manufacturing activities in each country leads to a reduction in income and consumption, Chinese exports will be further adversely affected.

As discussed above, the continued trade friction between the United States and China and the Chinese government's cautious attitude toward large-scale economic stimulus measures are likely to make the Chinese economy less powerful. The real GDP growth rate is expected to decline slightly to 6.2% year-on-year in 2019 and 6.1% year-on-year in 2020.

(Shinichi Seki)