Asia Perspective Economic Update Report

Quarter 4, 2018

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2018 Summary

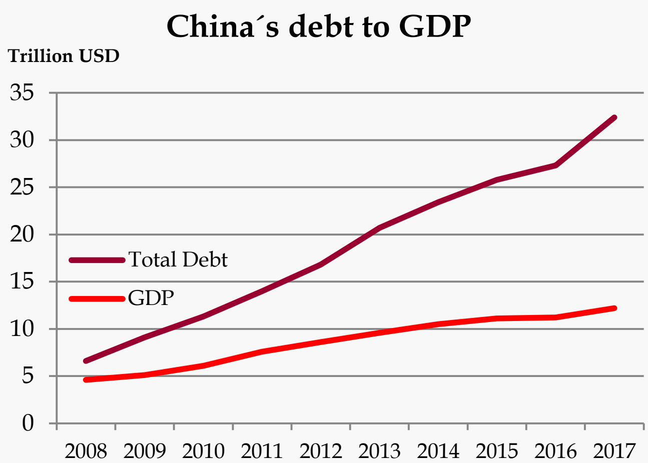
The year started with big ambitions to re-accelerate growth and mitigate the growing financial risk of debt. Instead, the entire year was dominated by the US-China trade war. The trade conflict has hit both countries hard, and in December 2018 manufacturing PMI in China fell below the 50-mark for the first time since the summer of 2016, indicating a contraction of China´s manufacturing sector.

According to other indicators such as the Business Activity Index, however, a recovery was noted in the last month of 2018, driven by an increased activity in the service sector. The index increased to 53.9, its highest level in half a year. During the end of the fourth quarter there was a general increase in orders in both the service and manufacturing sectors despite exports orders decreasing. This is an optimistic indication of a very robust domestic demand.

The Service industry, including such diverse businesses as financial services and transportation, have been steadily increasing their share of the Chinese economy and now constitute just above half of the total economic value of the country. Manufacturing and agriculture constitute around 40% and 10% respectively.

For the economy as a whole, the fourth quarter GDP growth reached the expected level of 6.4%. Many expect the next half years´s growth to fall under 6%, however, which would put it at the lowest level since quarterly reports started to be released in 1992.

China has seen steady growth ever since the big global recession of 2008, but the growth has been heavily fuelled by debt. Total debt has by now increased five-fold since 2008, and constitute 253% of GDP – one of the highest debt rates in the world. This growing financial risk is very clear for Beijing, but plans to tackle the increasing debt-mountain have been partly thwarted by the trade war. Even so, the budget deficit in 2018 was decreased for the first time in six years, and public spending has been considerably more conservative. Infrastructure investments for example, a potent indicator of government spending, fell to a growth rate of just 7.3%, compared to 21.1% in 2017.



The Year of the Trade war

The end of 2018 finally brought an early Christmas gift in the form of a truce between the US and China. Hopes are now high for the parties to reach a final agreement before the 90-day ceasefire expire. We look back at the year of the trade war to understand how it all started.

The first salvo in the conflict was fired by the American side in February by the introduction of a 30% tariff on washing machines and solar panels. This prompted a formal Chinese complaint to the WTO. The following month, the US also introduced tariffs on all imports of steel and aluminum. This time, the tariffs provoked an almost immediate retaliation from the Chinese side that responded by introducing tariffs on 128 US imports, mainly from the food and agricultural sectors.

A further escalation occurred in July as the US activated section 301 under the Trade Act in order to introduce punitive tariffs on $34 billion worth of Chinese imports, quoting Chinese violations of intellectual property and trade practices. This was soon countered by corresponding tariffs from Beijing. Following this, another $16 billion worth of trade was covered by tariffs in August, and China again responded in kind.

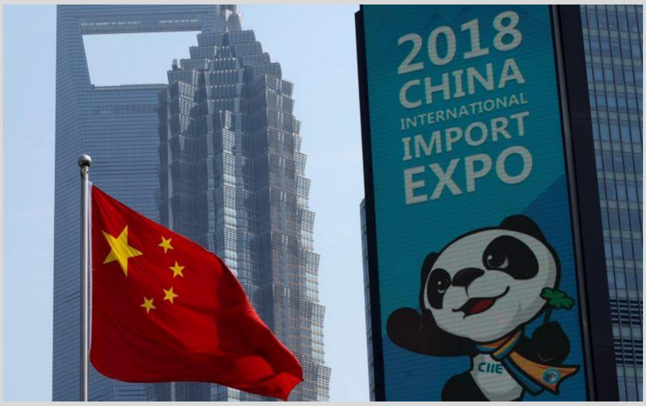
Following failed talks to resolve the crisis during late August, new tariffs were again added by first the US and then by China on $200 billion and $60 billion worth of imports respectively. Talks scheduled for September and November were subsequently canceled, reportedly by the Chinese side.

By the time the two parties finally sat down again during the G20 summit in December, new US tariffs had been slapped on $250 billion worth of imports from China, and Beijing had raised retaliatory tariffs on $110 billion worth of US imports. The US tariffs are broad and cover everything from consumer products and construction materials to electronic equipment and automotive parts. 44 Chinese companies claimed to pose a national security risk have also been subject to specific restrictions. From the Chinese side tariffs also cover a wide spectra of products, but have been particularly focused on food and agriculture and most notably soybeans. Many believe that this has been purposefully aimed at undermining President Trump´s rural support base.

The current truce states that no new tariffs will be raised for 90 days, and postpones an planned additional round of American tariffs on $200 billion of Chinese imports . The parties are now in intense talks to hopefully resolve the deadlock before March.

Xi and the Import Expo

The much-hyped China International Import Expo (CIIE) was the first of it kind when it was inaugurated with a lavish opening ceremony in Shanghai during on November 5th. Contrary to the many previous expos in China, this one was focused on China as an export market instead of as a supply market, and companies from all around the world came to showcase their products to potential Chinese customers.



The Expo was a tactical opportunity for China to flex its economical muscles amidst the increasing trade conflict with the US, and for strengthening its trade ties with the rest of the world. While the world´s eyes and ears were pointing in its direction, President Xi took the opportunity to promise reduced trade barriers between China and its partners, and made a few policy announcements regarding the direction of the economy:

Promoting domestic consumption
China will take effective policy steps to increase residents' disposable income and promote mainly medium and high-end consumption.

Further tax reduction
Following large scale tax cuts during 2018, China continues to be committed to further reduce and simplify tax across the entire economy.

Improved access for foreign investment
Increased foreign access is promised to the financial-, service-, agricultural-, mining-, and manufacturing sectors. China will also specifically relax restrictions on the proportion of foreign capital shares in the education sector.

Protecting foreign investment
New legal protection and increased transparency is promised for foreign investments, as well as a national-level consolidation of the regulation.

IPR protection
China will improve the quality and efficiency of intellectual property right legislation, enforce fair implementation of the law, and significantly increase the cost of breaching.

Advance multilateral free trade agreements
China is willing to accelerate negotiations for a trade deal with the EU as well as for establishing a free trade area together with Japan and Korea.

ASIA PERSPECTIVE

About Asia Perspective

Asia Perspective has established itself as a trusted partner and service provider on the East Asian and South East Asian markets.

We have decades of business experience in the regions, and we have supported businesses from a multitude of industries in reaching their goals and visions. Thanks to our reputed advice and practical support, we can proudly count many leading global companies amongst our returning clients.

We are clearly specialized in providing the services that are needed by foreign enterprises operating in Asia – whether it is relating to market entry and growth, to the supply side or to the operations and organization in the region. Our approach has always been to offer realizable advise and hands-on support – more often than not supporting our clients in the actual implementation of our recommendations. By doing this we are ensuring sustainable added value for our clients. The efficiency of our hands-on approach is best demonstrated in our enduring relationships with the many former clients who now look to us as trusted partners.

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