The outlook for Asia

Our expectations for 2019

A presentation by The Economist Intelligence Unit

October 2019

Nick Marro
Global Trade Lead
Coverage: Global Trade; China, Taiwan, Macau
Twitter: @nickm4rro

Table of contents

1. The US-China trade war

Setting the stage

Tariffs, tariffs and more tariffs

Duties have been placed on roughly US$360bn worth of bilateral trade

Major tariff actions:

- Tariffs on intermediate goods since mid-2018, at rates ranging from 5%-25%
    - US$250bn of Chinese imports into the US
    - US$110bn of US imports into China
- More US tariffs on September 1st; 15% on US$125bn
- Further tariffs of 15% on US$175bn in late December
- Next round of tariffs: cover finished consumer goods. Most important for Taiwan

Date	Amount	Tariff duty
July 6th, 2018	US$34bn	25%
August 23rd, 2018	US$16bn	25%
September 24th, 2018	US$200bn (US)/ US$60bn (China)	5%-10%
June 15th, 2019 (US); June 1st, 2019 (China)	US$200bn (US)/ US$60bn (China)	5-25% (China); 25% (US)
September 1st, 2019	US$125bn (US)	15%
December 15th, 2019 (proposed)	US$175bn (US)	15%

The US-China "mini-deal"

More talk than substance

Image source: AFP

Trade negotiations in October led to another pause

- "Three phase" deal
- First phase: China to increase its purchases of US farm products, strengthen its intellectual property protection, liberalise its financial services sector; US to refrain from minor tariff hike (from 25% to 30%, on US$250bn-worth of goods, on October 15th)
- Second and third phase: US and China to focus on resolving "structural issues" in their relationship

However…

- No written agreement (potentially will get one at APEC)
- Existing tariffs remain in place
- China potentially pushing back?

2. What happens next?

We do not expect resolution by end-2019

What happens next?

Can the current truce last?

Image source: South China Morning Post; AFP

The next important event will be at APEC in November

- US has indicated that it might try and establish a meeting between Trump and Xi on the side-lines
  - This could result in a “first phase” deal being formally signed
  - However, we expect China to continue to resist US demands on structural issues; i.e., “phase two” and “phase three”
- The US will have an incentive to back-down, however; tariffs are now becoming much more economically disruptive. This could have political consequences for Mr Trump.
- Meetings between the presidents have previously helped calm the dispute
- Any de-escalation will come from the US, not China

The Economist INTELLIGENCE UNIT

Will this de-escalate US-China trade hostilities?

The trade war will increasingly spill over into other areas

Economic friction will persist elsewhere

- ➢ Current tariffs (on US$360bn) will be maintained until after the US 2020 presidential election
- ➢ Trump will frame the trade war as part of his presidential campaign
- ➢ Positive chance that duties could be withdrawn earlier owing to economic pressure; already starting to see aspects of this start to happen

New battlegrounds for the trade war:

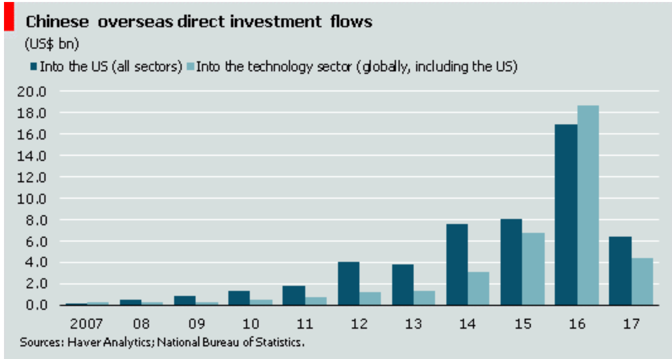
- Technology (Huawei, Sugon, Hikvision, etc.)
- Finance (de-listing of Chinese companies; US financial sanctions)
- Investment, national security

Image source: AFP

The Economist INTELLIGENCE UNIT

Other retaliatory options

Both sides may seek to enact pressure outside of tariffs



- ➢ The trade war will intensify in other areas, regardless of what happens with tariffs
- ➢ Companies from third countries will increasingly be caught between regulatory frameworks
- ➢ Consequences of this: supply chain and digital isolation may hurt Chinese innovation in the long-run

Other strategies?

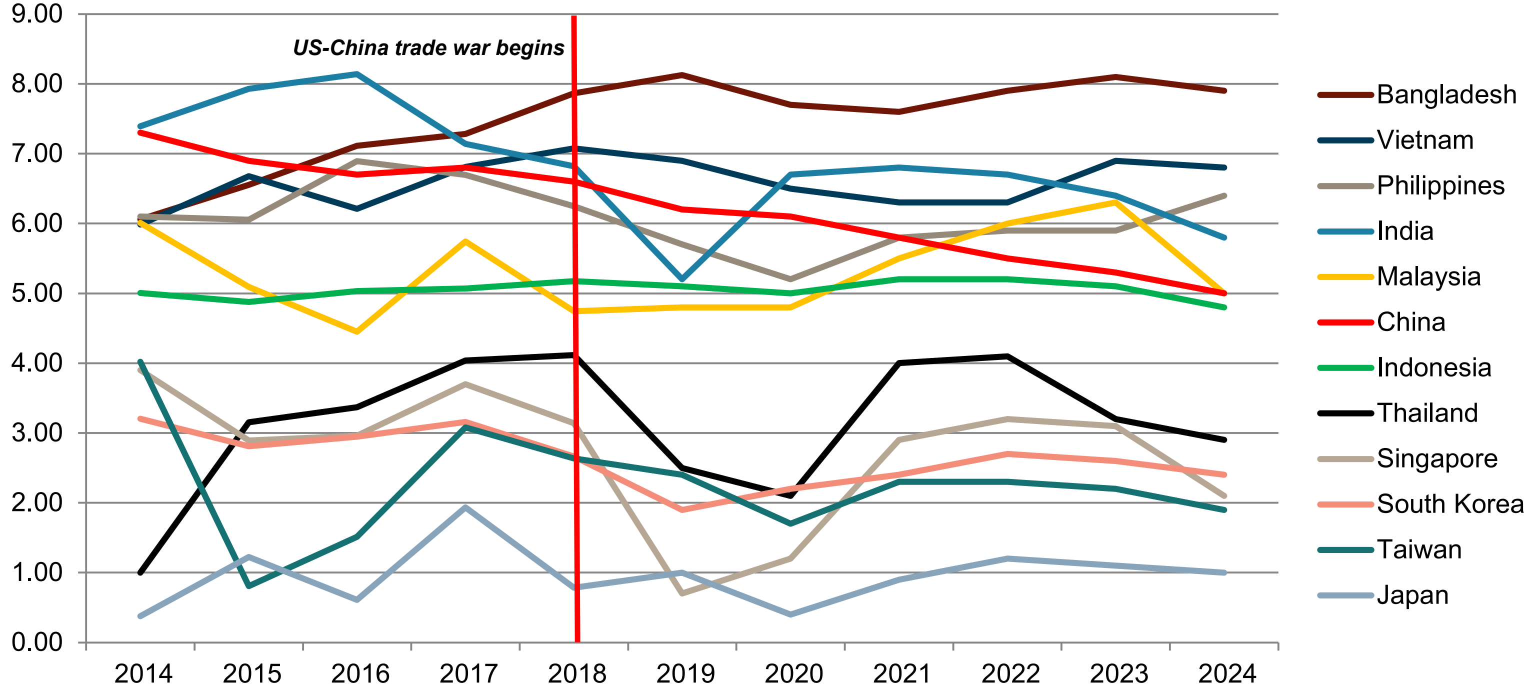
- ➢ China weaponising the renminbi
- ➢ China dumping US Treasuries
- ➢ The US restricting the access of Chinese financial institutions to US dollar denominated financing; consequences for Belt and Road

3. The outlook for Asia

What does this mean for the region?

The picture looks mixed

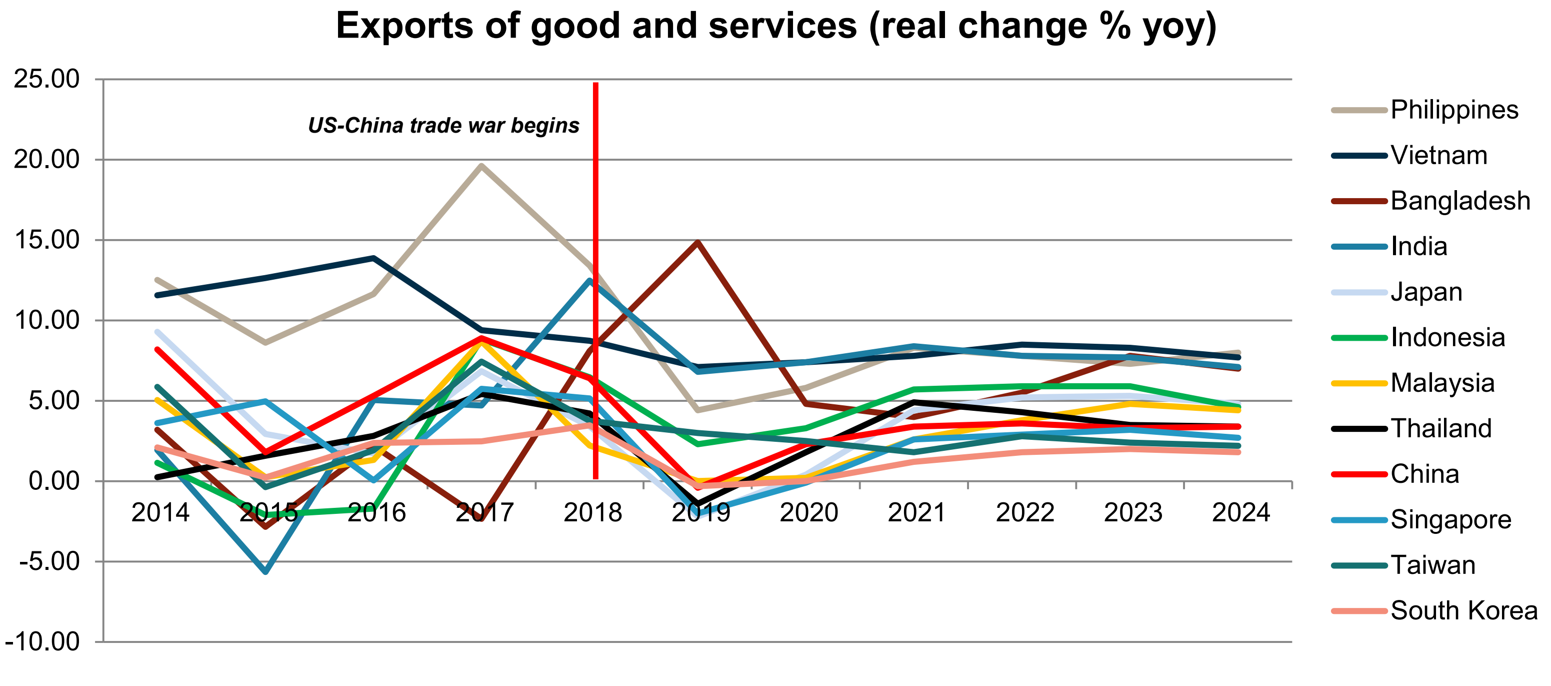
Growth, on average, will remain generally buoyant through 2024



Source: The Economist Intelligence Unit.

The picture looks mixed

Exports of goods and services will remain under pressure



Source: The Economist Intelligence Unit.

Economic outlook for China

GDP growth will continue to slow through 2019-21

	2019	2020	2021
Real GDP (% change)	6.2	6.1	5.8
Consumer price index (% change)	2.7	3.1	2.7
Exports of goods and services (% change)	- 0.4	2.3	3.4
Broad money supply, M2 (% change)	8.6	9.2	8.1
Rmb:US$ exchange-rate (av)	6.95	7.23	7.05
Current account balance/GDP ratio (%)	1.4	0.8	0.3

Reforms and policies to watch:

- Monetary policy loosening to support growth
- Increasing reliance on infrastructure growth and consumption stimulus policies (e.g. automotive)
- Currency stabilisation policies
- Trade rebound in 2020 as Chinese exporters diversify away from the US; although high risks to this forecast

Source: The Economist Intelligence Unit.

Policies and events to watch:

- Chinese economic slowdown
- Emerging trade dispute between Japan and South Korea
- Expected economics demand rebound from late 2019 onwards
- Trade war investment incentives across major ASEAN economies
- Supply chain diversification supporting export growth; signs of this already happening
- Looser monetary policy reducing trade financing costs
- Global trade recovery in 2020 driven by emerging markets
- US protectionism elsewhere (e.g., Vietnam)
- Relatively weak business environments

4. Trade war opportunities and challenges
How can Taiwanese investors benefit?

Up for grabs: Asia's trade war investment plans

South and South-east Asia is racing to attract investment affected by the trade war

India

- *Cut its corporate tax rate to 22%; tax relief for new manufacturing companies; tax rate down to 15%*
- *Focus on developing more initiatives for electronics, automotive, textiles*

BOTTOM LINE:

Investment must help the country reach its own policy goals

Indonesia

- *Government Regulation No. 45/2019;*
- *Larger foreign investment programme tied to infrastructure development*

Thailand

- *September relocation package*
- *Tax incentives, but with certain conditions*

Malaysia

- *Establish the National Committee on Investment I*
- *Aims to streamline and reduce investment approval timeline, particularly targeting trade war-affected industries*

A policy deep-dive

What's on offer?

Thailand relocation package

- *Corporate income tax (CIT) rate is at 20%; higher than Singapore and Taiwan (17%) but lower than Malaysia (standard 24%); equal with Vietnam (20%)*

The Thailand Plus incentive package includes:

- *50% corporate tax reduction for five years, but applicants need to apply by 2020*
- *Tax deductions on investment in automation, but also training for advanced technology and skills development*
- *However, requires an investment of at least Bt$1bn (US$32.1m) by 2021; but no geographic restriction*
- *These policies on top of existing corporate income tax exemption (of up to 13 years) under the Eastern Economic Corridor plan, with 50% tax reduction for five years*
- *Thailand also rushing to finish Thailand-EU FTA; plans to participate in CPTPP, with decision likely by end-2019*

Indonesian relocation package

- *CIT is at 25%; relatively high for the region, same level as India, but lower than the Philippines (30%) and Sri Lanka (28%)*

Government Regulation No. 45/2019 includes:

- *300% tax reduction for domestic taxpayers that conduct qualified R&D activities; needs to be aimed at invention, innovation, technology development or technology transfer*
- *200% tax reduction for skills training activities, including internship programmes and other human resources development*
- *Net income reduction (of up to 60%) of total investment used for new investments or business expansions in labor-intensive industries*
- *Larger foreign investment programme tied to infrastructure development; part of the trade war, but not driven by it*

India investment opportunities

- *CIT is at 22%, reduced from 30%; India is now more regionally competitive, especially in comparison to some ASEAN nations*

No dedicated relocation package. However:

- *The recent tax cut has also been extended to new manufacturing companies (who start operations after October 1st 2019, but before March 31st 2023); new rate has been reduced to 15% from 25% previously*
- *Indian ministers are reportedly drafting up a larger plan aimed at trade war relocation, targeting industries such as electronics, automotives and textiles*
- *Like Indonesia, this is also not being solely driven by the trade war; is also aimed at broader policies aimed at encouraging economic growth*
- *Difficult business environment may blunt opportunities; will return to this topic later*

Source: The Economist Intelligence Unit.

What about the long-term?

Positioning for the future

Asia's winners and losers in the trade war

Countries that will: come out ahead

- Vietnam (ICT, garments)
- Malaysia (ICT, auto parts)
- Thailand (auto parts)
- Bangladesh (garments)

Countries that will experience disruption in the short-to-medium term

- Singapore
- Taiwan
- South Korea
- Japan

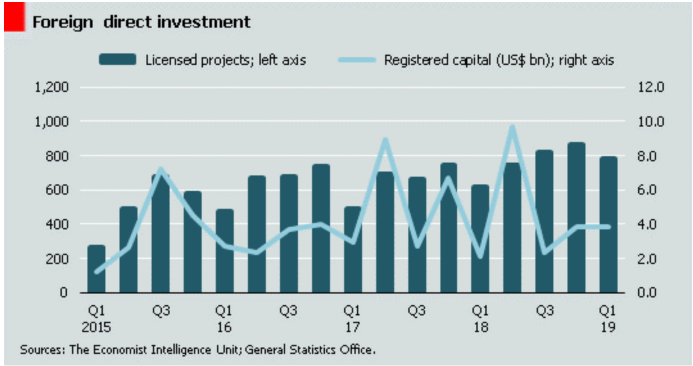
What about the others?

- Indonesia, Philippines, Laos, India?

Vietnam is already pulling ahead

One clear winner of the trade war

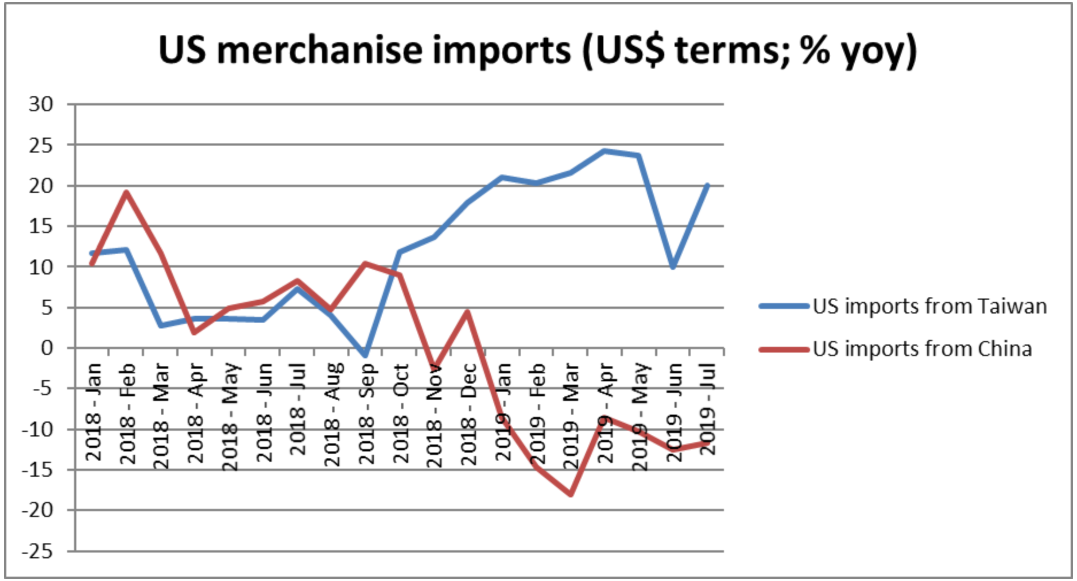
- **Surge in inbound FDI**
  - No strong need for a policy plan; already attractive
  - Up by 38.7% yoy in Jan-May 2019; well established destinations
  - Driven by China (ex HK); likely reflecting supply chain shifts
- **Not as rosy at it seems**
  - Issues with trans-shipments
  - Reports of infrastructure capacity being strained



Signs that Taiwan is also benefitting

Uneven advantages along the supply chain

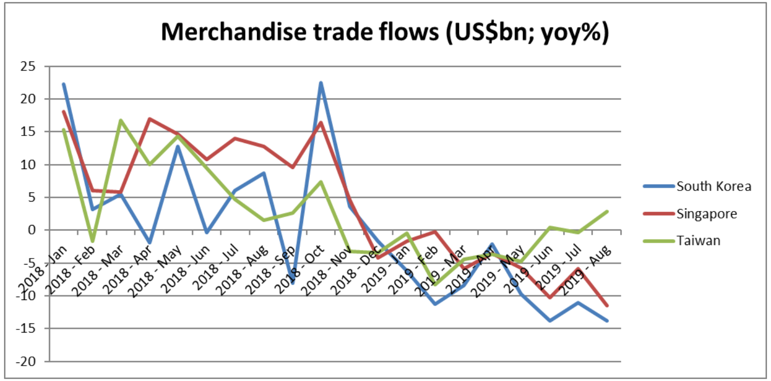
- **Import substitution bringing benefits**
  - Shipments to the US outstripping shipments to China and ASEAN
  - Some equipment or critical devices are being shipped directly to the US for assembly
- **The emerging electronics rebound should continue this trend**
  - However, slower US economic growth in 2020 should put a cap on this growth

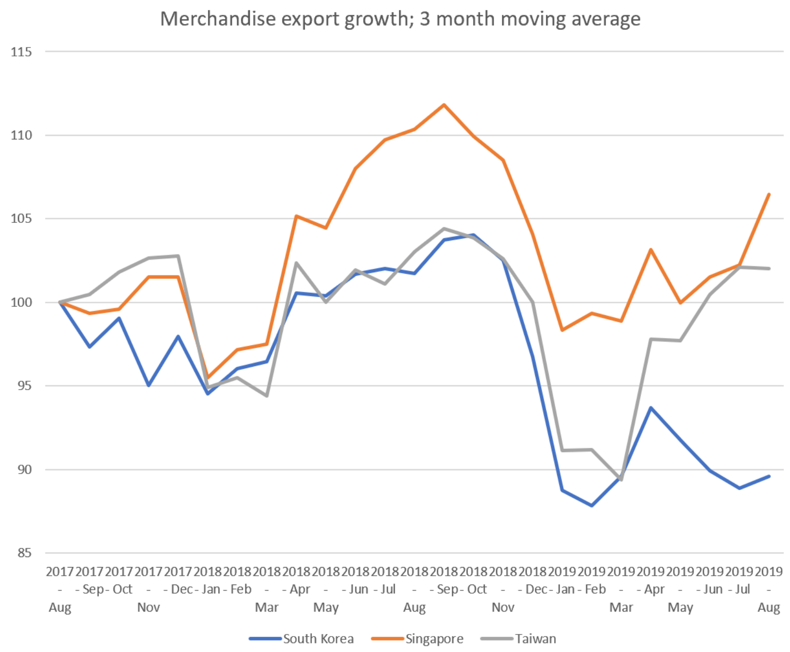


The Asian electronics supply chain is changing

Uneven advantages along the supply chain

- **Manufacturing re-shoring plan**
  - Latest investment data show muted effect; but should materialise more strongly later in 2020/21
- **Taiwan's competitiveness vis-à-vis is improving**
- **US-China tech tensions as an opportunity**
  - Short-term pain; long-term gain





Source: The Economist Intelligence Unit.

The business environment in Asia

Constrains in talent and infrastructure will limit investment opportunities

The business environment in Asia is very uneven

- ➢ Singapore tops The EIU's global and regional rankings; but the environment is pricey.
- ➢ Malaysia, Thailand and Indonesia are the only emerging markets that make the top 10 of our Asia regional rankings
- ➢ South Asia has strong economic potential, but there are severe business environment issues. In addition, operational risk – such as infrastructure quality, but also security and political corruption – might deter investment

Regional business environment rankings (2020-24 period)	
Singapore	1
New Zealand	2
Australia	3
Hong Kong	4
Taiwan	5
Japan	6
Malaysia	7
South Korea	8
Thailand	9
Indonesia	10
Vietnam	11
China	12
Philippines	13
India	14
Sri Lanka	15
Bangladesh	16
Pakistan	17

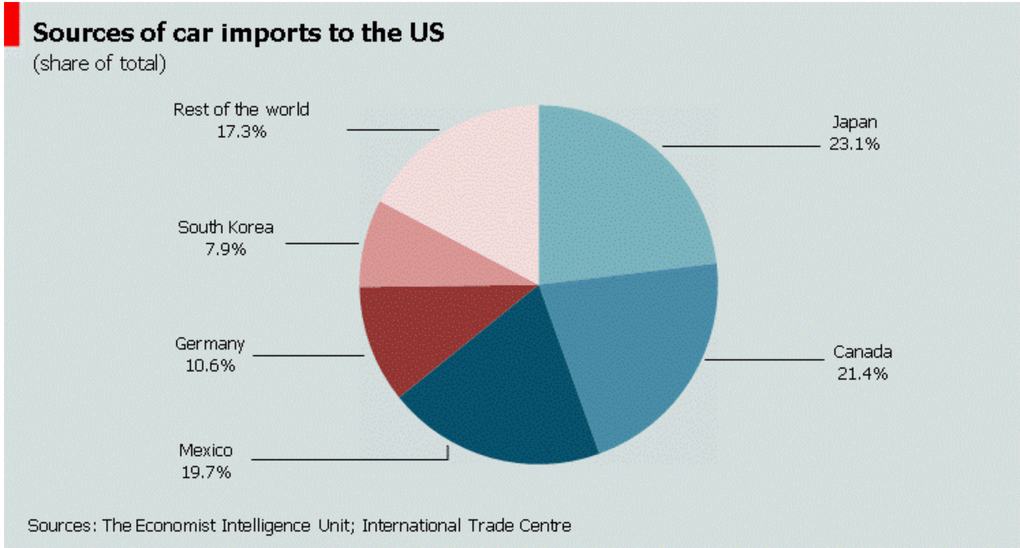
Source: The Economist Intelligence Unit.

The horizon is full of challenges

The US-China trade war is worsening protectionist sentiment

Major tariff actions:

- **Auto 232:** US tariffs on imports of finished autos and auto parts
  - **Japan, Thailand, Malaysia**
  - South Korea (exempt)
  - Pain for China, but not much more
- **China telecom ban**
  - Huawei, Hikvision, Megvii, etc.
  - Potential ban on all telco products
  - Disruption for supply chains & the 5G rollout
- **EU-US, US-India, US-ASEAN trade relations**
  - US is now looking at other markets
  - US-India under strain with GSP
  - Vietnam trade surplus, currency
  - Risk to global trade demand



The global trade story is also under pressure from slowing external demand

Slowdown in electronics has been particularly painful

Big impact on business and consumer sentiment

Nick Marro
Global Trade Lead
Coverage: Global Trade; China, Taiwan, Macau
Twitter: @nickm4rro