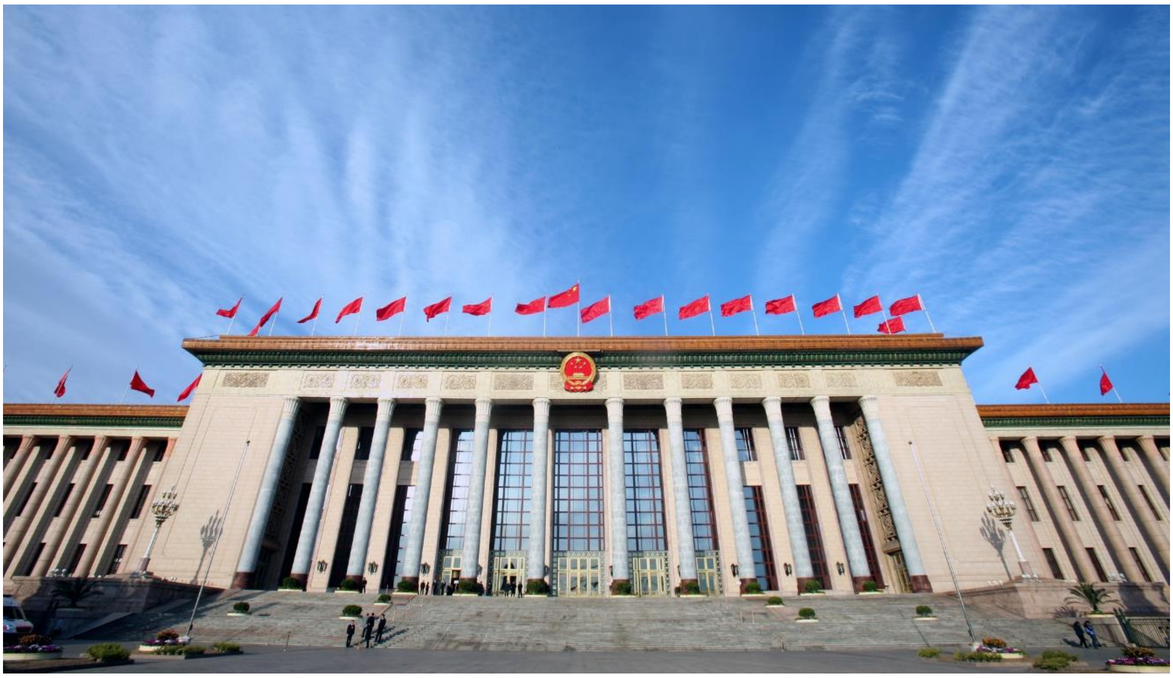
NOTE

SCB Economic Intelligence Center

China Cuts 2019 GDP Growth Target to 6.0-6.5%,

Focusing on All-Round Economic Stimulus and Trade Negotiation with the US

April 2, 2019

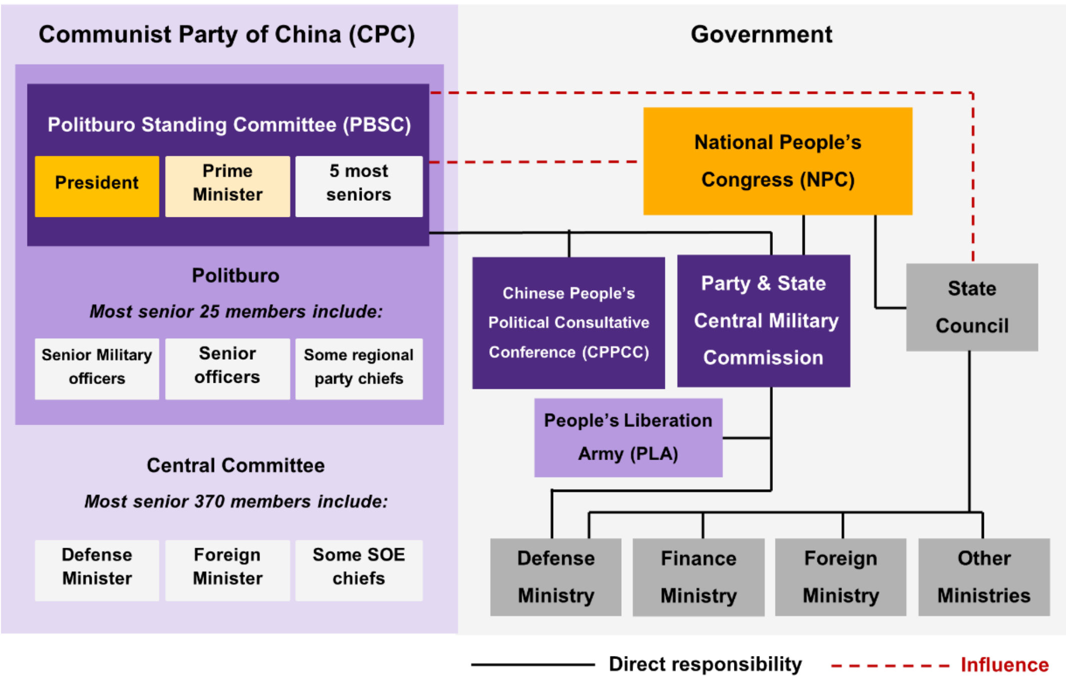


Ending the Two Sessions 2019, China announced that it is lowering its economic growth target to 6.0-6.5%, the slowest in nearly 30 years. From internal economic restructuring to the risks and challenges from external forces that are increasingly serious and complex, China is redirecting and loosening its fiscal and monetary policies in 2019 to sustain the economic slowdown and to effectively boost economic growth as well as moving forward in constructive trade negotiations with the US to reach an agreement between the two countries. EIC believes that China could avoid a hard landing by swiftly and continuously implementing their economic policies with the help of various fiscal and financial tools. No matter which direction the Chinese economy is moving towards, both the world and Thailand's economies would be affected through trade, investments and tourism.

What is the “Two Sessions”?

Two Sessions 2019 is the most important meeting on the Chinese political calendar. Starting with the Chinese People’s Political Consultative Conference (CPPCC) on March 3, 2019 followed by the National People’s Congress (NPC) on March 5, 2019 and concluded on March 15, 2019. This particular “Two Sessions” is of distinct interest because, in addition to the report and evaluation of the government’s performance of the past year, the international arena has been paying special attention to the direction of China’s economy as well as its economic and social growth target along with its announcement of 2019 policies and strategies for the upcoming future. (Figure 1)

Figure 1: The National People’s Congress (NPC) is tasked to establish economic and social policies aligned with the strategies of the communist party.

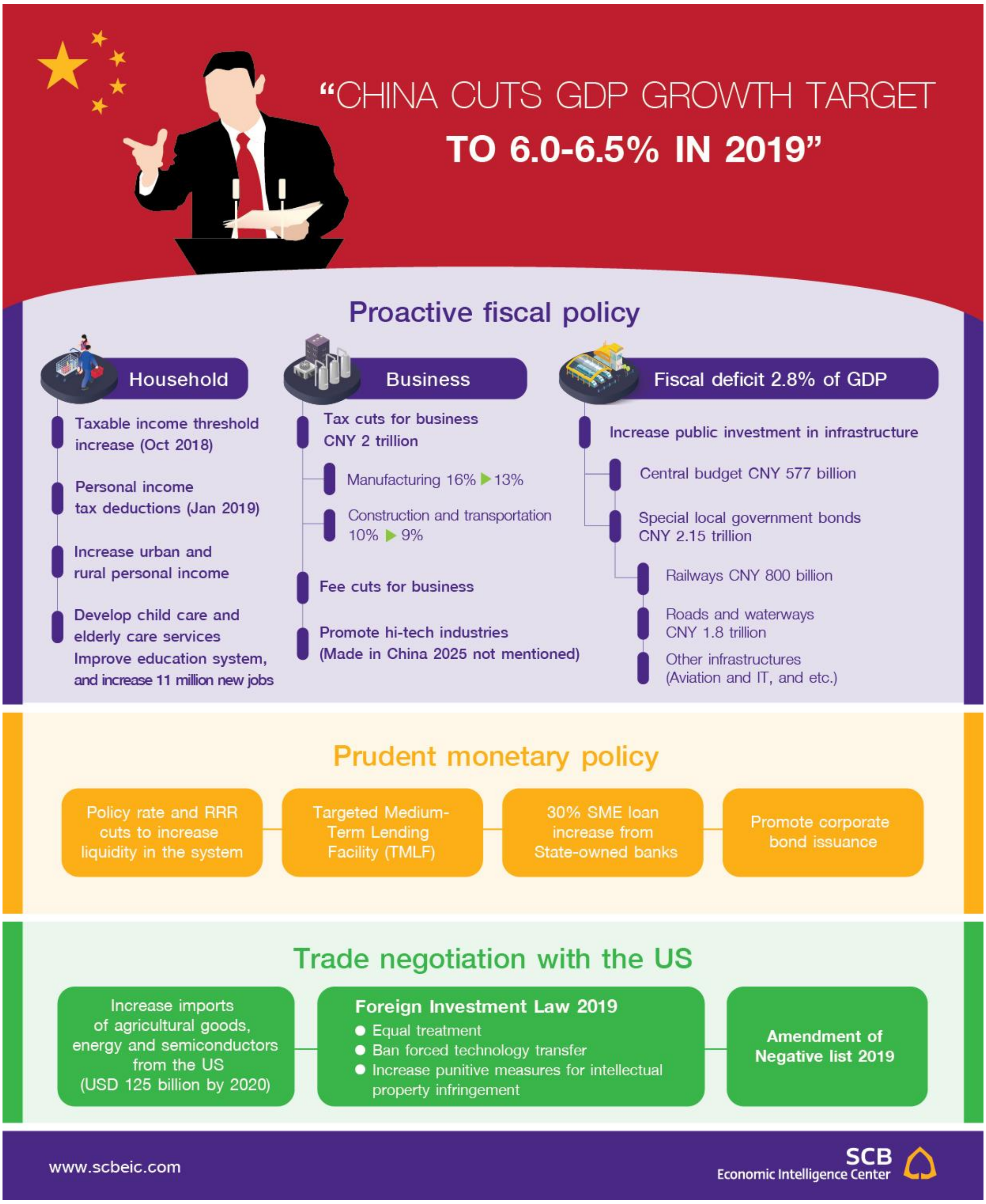


Source: The Economist *Who really holds the power in China?*

China’s Economic Target and Policy Directions in 2019

Premier Li Keqiang admitted at the beginning of the first day of the National People’s Congress’ meeting that China’s economy is facing volatility and external challenges; the slowdown of the world’s economy, the complex global financial conditions, and the trade war with the US, including the country’s three critical battles, namely; risks in the financial sector, poverty, and pollution causing continuous slowdown in China’s economy in 2018, and that China’s economic growth in 2019 will greatly affect the world’s economy as well.

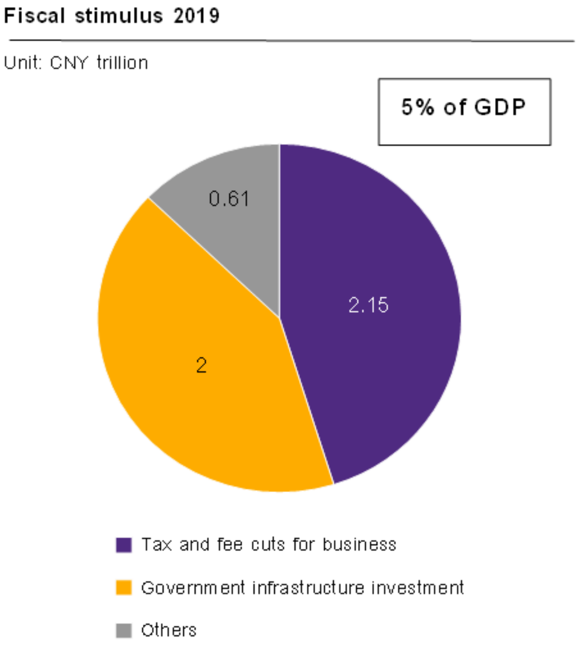
Amidst domestic and international risks, Premier Li Keqiang announced lowering China's growth target to 6.0-6.5% in 2019, as expected by economists around the world, with the implementation of proactive fiscal policy and prudent monetary policy in order to; maintain economic growth as targeted, promote high-quality economic development, and create stability within the financial sector as well as pushing China to become an economy driven by domestic consumption and innovation alongside moving forward with trade and investment reformation to end conflict with the US.



Fiscal Policy: China announced a comprehensive economic stimulus package by increasing public investment, supporting the business sector, and improving the overall people's standard of living with the total spending of CNY 5 trillion. (Figure 2)

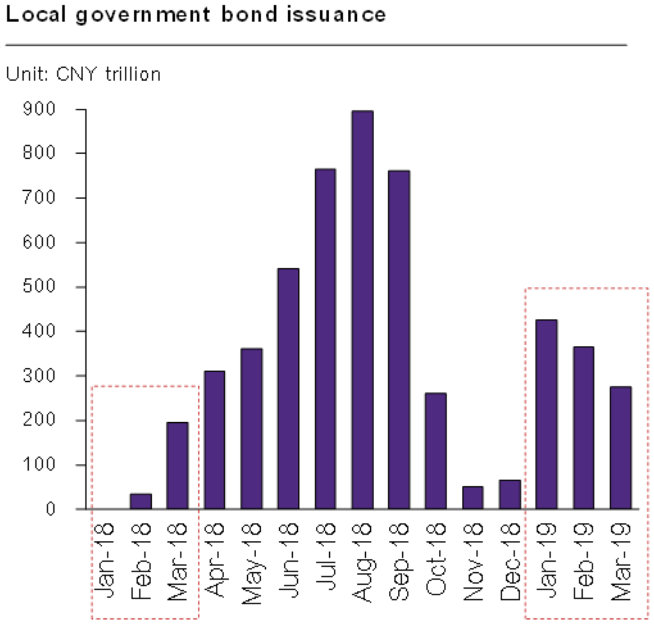
China targets a fiscal deficit of 2.8% of the GDP in 2019 to increase infrastructure investment spending. A CNY-2.76 -trillion fiscal deficit is only marginally greater than the number in 2018, however, if off-budget public spending is included, the fiscal deficit could rise by approximately 1% of the GDP in 2019. The increased public spending is concentrated on infrastructure investment separated into; the central government budget at CNY 577 billion (a 7.5%YOY increase) and the issuance of CNY 2.15 trillion of special local government bonds (a 60%YOY increase). Major investment projects include; the construction of CNY 800 billion in railways, e.g. the Sichuan-Tibet route, and the construction of roads and waterways valued at CNY 1.8 trillion as well as the construction of transportation systems and other amenities for inter-city transportation, civil and commercial aviation systems and IT infrastructure systems. The local government has already issued over CNY 1 trillion worth of bonds in the first quarter of 2019. (Figure 3)

Figure 2: 2019 fiscal stimulus package worth CNY 5 trillion or 5% of the GDP



Source: Data from Euler Hermes, Allianz Research

Figure 3: The local governments have issued new bonds worth over CNY 1 trillion in the first quarter of 2019.



Source: Data from the People's Bank of China as of March 20, 2019

China actively supports business sector by cutting taxes and expenses at a total cost of CNY 2 trillion in order to promote the manufacturing industry and the development of small and medium enterprises (SMEs). The Chinese government has reduced tax burdens to businesses across industries by lowering the value-added tax (VAT) for the manufacturing sector from 16% to 13% and for construction and transportation industries from 10% to 9%, while keeping VAT stable at 6% for the services sector but, instead, implementing tax deductions for service providers. The measures will be implemented on April 1, 2019 (Table 1). The government also focuses on supporting small and medium enterprises (SMEs) by exempting value-added tax for SMEs with taxable income of less that CNY 100,000 per month; previously VAT was exempted for taxable income of less than CNY 30,000 per month. Corporate tax is reduced to 5% for companies with taxable income not exceeding CNY 1 million per year and 10% for companies with taxable income of more than CNY 1 million but not exceeding CNY 3 million per year, from the maximum of 20%. As for financial burden reduction, the Government is reducing employers' social security contribution from 19-20% to 16% but will continue to maintain the benefits given to employees. The Government not only will ease financial burden but will also promote and support businesses by improving environment to facilitate business activities, among other things, reforming public utility monopoly systems including energy, oil, natural gass and train industries to be more market driven.

Table 1: Examples of goods and services with VAT reduction in 2019

16% → 13%	10% → 9%	6%
Goods Sales or import of goods (except for other goods listed in 9% bracket) **Services** Tangible property nance/business leasing services	**Goods** • Agricultural goods for farming and household consumption • Water, natural gas, and petroleum for household consumption • Building and structure of real estate **Services** • Trafc and transit services • Postal and telecoms services • Construction services	**Services** • Financial services • Reserch and technology services • Information technology services • Logistics auxiliary services • Authentication and consulting services • Radio and television services • Buisness support services • Life services - Food, beverage, and accomodation services - Education and medical services - Travel and entertainment services

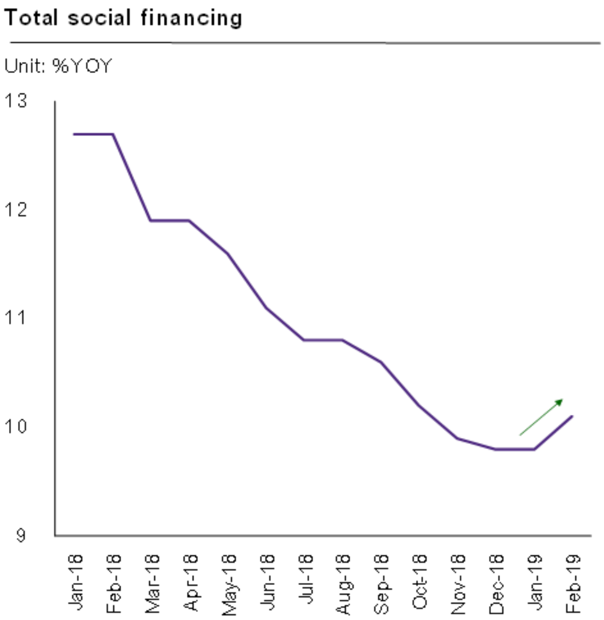
Source: Data from China Briefing: *Vat Rates in China Lowered – 2019 Work Report Announcement*

China to issue support measures to stimulate consumption and elevate people's quality of life. As an extension of the amendment of individual income tax to increase the minimum taxable income from CNY 3,500 per month to CNY 5,000 per month in October 2018 and additional tax deductibles for expenses regarding education, health, elderly care and housing in January 2019, the Government plans to issue more measures to raise the income of citizens both in the urban and rural areas. The two key measures are; 1) development of tourism industry to be the community's main source of income and 2) promoting domestic car purchases. Concurrently, the Government plans to raise the people's quality of life throughout the country by ensuring access to quality products and services, particularly, for the care of elderly to accommodate the needs for care of over 250 million elderly today with the likelihood to increase in the near future, along with child care services from infants to primary school students to ensure the quality of future human resources. Moreover, the Government aims to increase over 11 million employment opportunities in 2019 coupled with a heighten quality for vocational trainings to solve the problem of skilled and sustainable labor shortage.

Monetary Policy: The People's Bank of China adopts a looser monetary policy to support economic activities alongside with strict debt control.

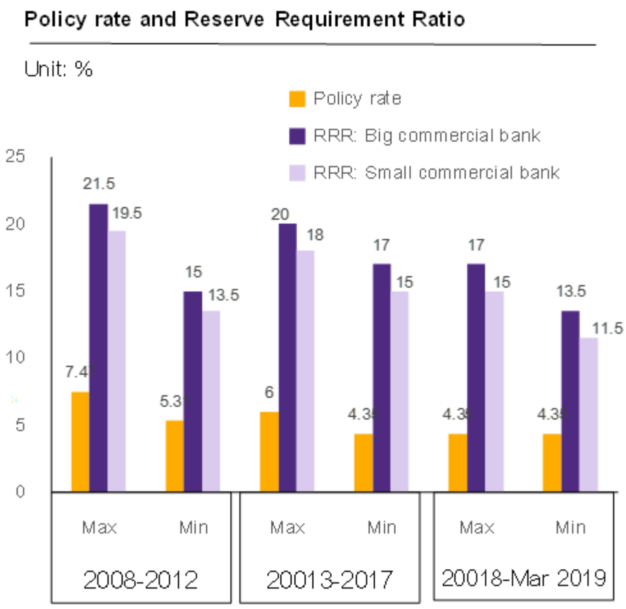
The PBOC will continue to maintain stability within the financial sector, in particular, the control of debt of shadow banking and inefficient businesses, while using necessary measures to increase the expansion of credit within the system in accordance with economic growth. As a result of such measures, total social financing expanded in February 2019 after the slowdown throughout the year of 2018 (Figure 4). It is expected that the PBOC would reduce the market interest rates in 2019 and has the propensity to further reduce the Reserve Requirement Ratio (RRR), which currently at 13.5% for large commercial banks and 11.5% for small commercial banks (Figure 5). This would increase liquidity in the banking sector to promote loans being given out to the business sector. Especially, SMEs will receive direct backing from state-owned banks with the aim for a 30% increase in loans. At the same time, the PBOC announced that it will be using Targeted Medium-Term Lending Facility as another tool to increase liquidity to the business sector and SMEs with a one-year interest rate at 3.15%, lower than the rate on the medium-term lending facility at 3.30%. Additionally, the PBOC also has measures to promote issuance of debentures to be the other source of funding for the business sector.

Figure 4: China's total social financing accelerated in February 2019 after a continuous slowdown in 2018.



Source: Data from the People's Bank of China

Figure 5: Policy interest rate and RRR are tools of PBOC to increase liquidity within the system.



Source: Data from Euler Hermes, Allianz Research

Trade Negotiation with the US: China moves forward to reform trade and investment practices to express intentions in negotiating with the US.

China compromises its stance and agrees to increase imports from the US. In the trade negotiation held at the end of February, the US maintained the tariff on Chinese products valued at USD 200 billion at 10% whilst indefinitely postponing further trade agreements. Categories of products China agreed to increase purchase from the US include agricultural products, i.e. soy, corn and rice valued at USD 30 billion and energy products i.e. crude oil and liquid natural gas. Moreover, it is expected that China may consider increasing imports of semiconductor from the US which worth a total of USD 33 billion. The increased value of US goods imports may be as much as USD 125 billion by the year 2020.[1]

The new investment law not only helps increase foreign participation in Chinese business, it also serves as an important step in the trade negotiations with the US. The new foreign investment law has been revised to improve business conditions of foreign investors in China, particularly in major chapters which include 1) Fair treatment of foreign businesses in China beginning at the start of the business, acquiring business licenses, access to raw materials, business operations, and relations with the government sector. 2) Banning of forced technology transfer and 3) increased punitive measures for intellectual property infringement. This new investment laws will be effective starting January 2020, with the expectation that China will issue additional laws in regard to business as well as reducing restricted businesses for foreign investors in its Negative List in 2019 to liberate businesses in both manufacturing and service sectors. Additionally, foreign investors might be able to be involved in procurement for the government. However, the challenge for China is the ability to enforce such laws in order to restructure businesses in the country so as to be in accordance with requests of the US and international standards.

The "Made in China 2025" strategy disappeared but the policy to promote high-tech industry remains. China's goal in becoming the world leader of technology under the strategy of "Made in China 2025" is severely criticized by the US as the domestic technology industry is clearly being supported by the Chinese government, a fact which the US deemed unfair to foreign businesses. Therefore, Premier Li Keqiang avoided speaking of "Made in China 2025" directly at the 2019 Policy Speech, however, he reaffirmed that China would strengthen its manufacturing industry as well as support the high-tech industry, e.g. new-age information technology, high-end tools, biopharmaceutical products and alternative energy vehicles with the same goal as "Made in China 2025" in mind, precisely, "Buy China".

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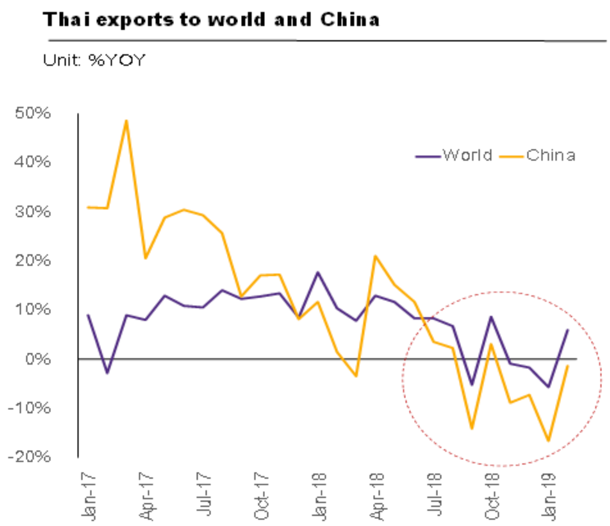
[1]Wei, Tilton, Philips, and Taylor, *Which econoies could lose from a China-US purchase agreement?,* Goldman Sachs, March 11, 2019

Implications to World and Thai Economies

The slowdown in the Chinese economy, the second largest economy in the world, will affect the global economy in three major channels, namely; exports, investments and tourism.

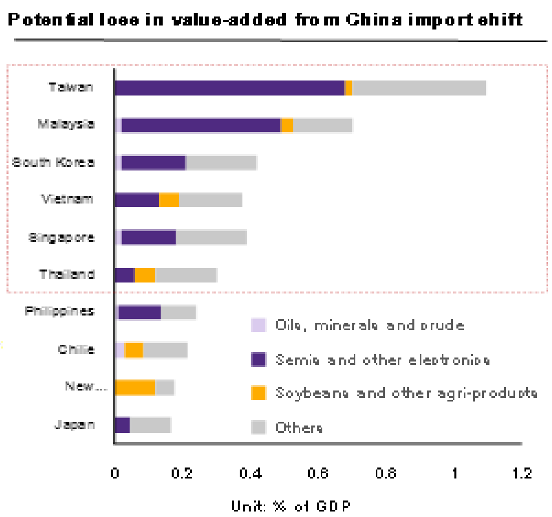
1) **Exports:** China is the no. 1 export market in may countries around the world. The US and Singapore exports to China shrunked while the European Union and philipines exports to China also severely dwindled in 2018. Thailand's exports to China diminished so critically at 14%YOY in September 2018 until February 2019 compared to a double-digit increase in 2017 (Figure 6). This signifies the supply chain linkages between China and Thailand and other countries that have already been affecte by the US-China trade war starting from the late 2018, which is believed to cause severe impact to exports and economies of countries in the region. Taiwan, Malaysia, South Korea, and Thailand, which are China's major suppliers of industrial raw materials and intermediate products, for instance electronics equipments, will be severely affected from China's own economic slow-down and the global supply chain reformation, in which China agrees to shift imports from the US.

Figure 6: Thailand's export to China continues shrinking since September 2018.



Source: EIC analysis based on data from the CEIC

Figure 7: Taiwan, South Korean, ASEAN including Thailand will be severely affected by China's increased imports from the US.



Source: Data from the Goldman Sachs Investment Research

1) **Investments :** Investments from China could increase both directly and indirectly - the Chinese government promoting Chinese companies to invest in foreign countries under the Belt and Road Initiatives (BRI) which results in higher investment from China in some member countries of the ASEAN for instance the Phillipines and the CLMV countries. Main investments include energy and high-speed rail infrastructures. In the future, it is expected that China's investment under the BRI scheme would expand to the European Union as well, discerned by an increasing support of the member countries towards this scheme. In addition, the US-China trade war could pressure businesses to move their production bases out of China to avoid higher import tariffs from the US, especially for product categories the US is targeting. Thailand has the potential to become the new production base with the dexterity to expand different industries including machinery and electronical manufacturing industries and the services. There are multinational companies who have already annouced the possibility of investment relocation from China to Thailand, companies include; Delta Electronics Power (Dongguan) and Merry Electronics, manufactuerers from Taiwan with approximate investment of USD 10 and 100 million respectively, as well as Toshiba Machinery (Shanghai), a Japanese machinery manufacturer. Additionally, Chinese investors began investing in Thailand's targeted industries, for instance, the automobile and car battery manufacturing industries, in the third quarter of 2018 – meaning Chinese investment in Thailand is still growing at the rate of 13.4%YOY in 2018 and this is expected to further expand in 2019. However, Thailand faces competition in attracting foreign companies, who wish to move their production bases out of China, especially with other members of ASEAN, namely, Malaysia who is more technologically advanced or Cambodia whose labor cost is lower. And especially Vietnam who has an advantage over Thailand in the terms of enpansive trade agreements such as CPTPP and free trade with the European Union (Table 2).

2) **Chinese Tourists:** In 2018 the number of Chinese tourists touched 150 million globally, that is an increase of 14.7% YOY - and the Chinese tourists spent as much as USD 1.2 billion. In 2019 and the foreseeable future, it is expected that more Chinese tourists will travel the world as currently, only 10% of the Chinese population holds passports. With an increasing number of middle class Chinese population, Thailand and other countries in Asia that are popular tourist destinations for China will benefit from this. However, Thailand's risk is its high reliance on Chinese tourists with proportion of approximately 30% of all foreign tourists, along with other countries with high proportioins of Chinese tourists. If the Chinese economy slows beyond expected and if the government limits international travel of its population, this will negatively impact the countries relying on Chinese tourists.

Table 2: Multinational Companies announced investment relocation out of China

Country	Company	Nationality	Industry/product	Detail
Thailand	Panasonic	Japan	Car electronics (stereos)	-
	Toshiba Machine Co. (Shanghai)	Japan	US-bound Plastic molding machines	Move to Japan or Thailand in October 2019
	Merry Electronics Co.	Taiwan	Headphones for Bose Corp.	Shifted part of its processes to Rayong, Thailand in 2018 (USD 100 million)
	Daikin Industries	Japan	Compressors	-
	Delta electronics power (Dongguan)	Taiwan	Electronics and electric parts for smartphones	Expand investment (USD 10 million) to Thailand, replacing the current production in Southern China
Cambodia	Steve Madden Ltd.	US	Handbags and shoes	Plan to double the production to 30% by 2019
	Vera Bradley	US	Luggage and handbags	Plan to shift production away from China to Cambodia and Vietnam
	Trek Bicycle	US	Bicycle	Plan to move production of at least 200,000 bicycles from China to Cambodia in 2019 (A&J factory)
	Kent International	US	Bicycle	Plan to move a large share of production from China to Cambodia in early 2019 and begin shipping in September 2019
Vietnam	Tapestry Inc.	US	Handbags	Expand its production in Vietnam
	Sintai	China	Furniture	Shift 20% of production to Vietnam
	Man Wah Holdings	Hong Kong	Furniture	Acquire new plant in Vietnam in November 2018
	Zhejiang Hailide New Material	China	Polyester	Invested in the new plan in Vietnam
	Second Generation (BeBop and Gypsies & Moondust Lables)	US	Junior wears	Shift part of production to Vietnam
	Yokowo	Japan	Automotive antenna components	Relocate all production to Vietnam in 2019
	HL Corp.	China	Bike parts	Shift part of production to Vietnam
	Hon Hai Precision (Foxconn Technology Group)	Taiwan	iPhone assembly	Acquired land in Vietnam industrial park in January 2019
	GoerTek	China	Wireless earphones for Apple	Shift part of production to Vietnam
	Key Tronic	US	Electronics products	Invest in the new plant in Vietnam and anticipate to open the factory in July 2019
Malaysia	Panasonic Corp.	US	Electronics products	Shift production from the US to consignment production and export from Malaysia
	Kayamatics	Hong Kong	Internet of Thinfs devices	Plan to set up production lines in Kuala Lumpur and Penang in Malaysia

EIC believes that Chinese economy will be able to maintain its targeted growth and avoid hard landing in 2019. Since the implementation of economic policies from the Chinese central government is swift and continuous, as reflected by the increased issuance of special local government bonds in mid 2018 and beginning 2019 and the accelerated total social financing in February 2019 along with China's flexibility in having policy space using various fiscal and financial tools. The important economic stimulus measures of 2019 are the acceleration of the public infrastructure investments and the reduction of taxes and expenses for the business sector, valued at CNY 5 trillion – only 5% of 2019's GDP, still lower than the economic stimulus package of 2008-2009 at 12.5% of GDP. At the same time, policy interest rate remains stable at 4.35%. These reflect that China still has the option to use a variety of fiscal and financial tools to boost the economy should the economy shrink more than expected. The major traction factor, however, is the trade war between the US and China. The increase of the US import tariffs of 10%-25% on Chinese products with a total value of USD 250 billion in 2018 has clear impact on China's exports – a shrinkage of 4.6%YOY and 21.2%YOY in December 2018 and February 2019, respectively. As well as the industry's most promising manufacturing sector reflected by the Purchasing Managers' Index and New Export Orders index, which have fell below their benchmark level of 50 since the forth quarter of 2018. However, considering from a different perspective, trade negotiations with the US might be that factor pushing China's internal economic structure reformation, especially the shift of an export-based economy to a consumption-based economy. Therefore, the world is paying close attention to China's economy in 2019 since the impacts would affect the economy of the world, regions and countries including Thailand through linkages in the supply chain with China, Chinese international investments, and Chinese tourists.

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