12 March 2019

ECONOMIC REPORT | China Economy

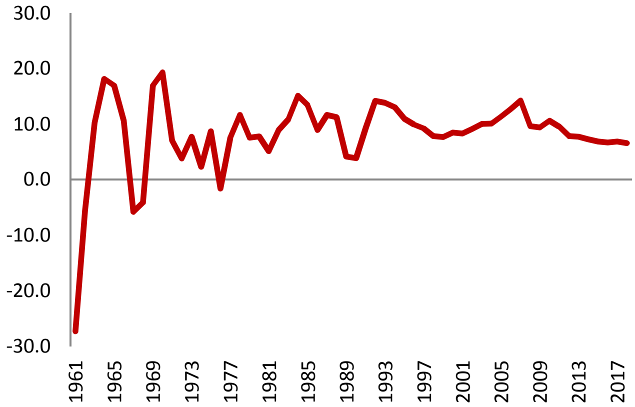
Quantifying Impacts of China Slowdown on Malaysia's Trade Performance

- *Trivial slowdown in China amid trade tension. As trade talks with the US still ongoing, the Chinese government trims down its GDP growth target to 6.0-6.5% in 2019. Last year China hits 6.6%, lowest ever recorded since 1990. The slowdown is mainly due to protectionist trade policy of the US and global uncertainties.*
- *Global growth to decline -0.15%. Based on our estimate, global economy is predicted to contract by -0.15% if China slowdown by -1%. In addition, Asian economies namely Taiwan, Hong Kong, Malaysia, South Korea and Singapore are expected to be impacted the most, in the range between -0.15%-0.08%.*
- *Malaysia affected by -0.11%. In the event of China's economy slowdown by -1%, Malaysian economy is predicted to fall by -0.11%. Consequently, production of electronic & optical, basic metals and electrical machinery are among the major industries affected.*

Trivial slowdown in China amid trade tension. As trade talks with the US still ongoing, the Chinese government trims down its GDP growth target to 6.0-6.5% in 2019. Last year China hits 6.6%, lowest ever recorded since 1990. The slowdown is mainly due to protectionist trade policy of the US and global uncertainties. Henceforth, China's Premier Li Keqiang announced stimulus package during the opening of annual meeting of its parliament. The government sets higher budget deficit at 2.8% of GDP in 2019 (2.6% in 2018). Cut in taxes & fees for companies and increase in infrastructure spending are among the key fiscal boosters.

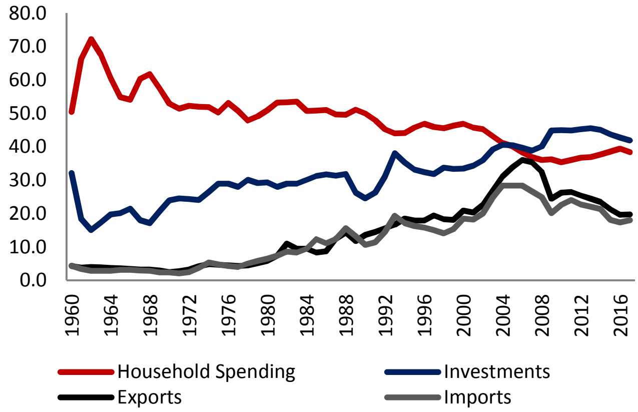
China remains in transition period. Referring to the 18th National Congress of the Communist Party of China in 2012, the Chinese government unveiled its policies of shifting its economic focuses from exports & manufacturing to consumption & services-led model. Particularly after GFC'09, we notice there are structural changes in the economy as exports share to GDP is trending down whereas household spending is crawling up. For instance in 2007, exports constituted about 35.4% while household spending at 36.9%. After 10 years, exports share reduced to 19.8% and local expenditure inched up to 38.4%. Moving forward, China's economic strengths would derive from domestic demand and less dependence on external front when household spending share surpasses 50% level. We opine strong domestic demand in China may minimize the effects of trade war especially in the event of no deal with the US.

Chart 1: China GDP Growth (YoY%)



Source: CEIC, MIDFR

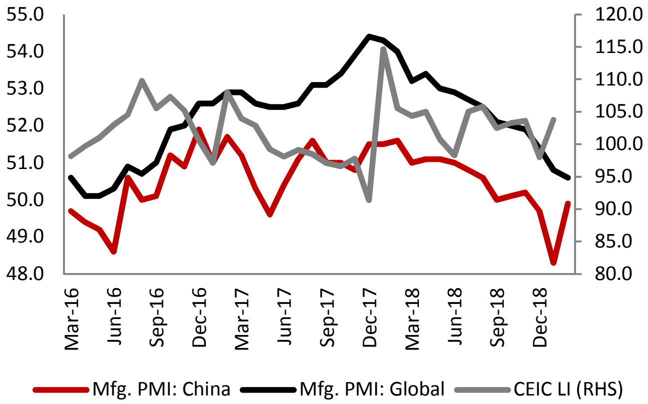
Chart 2: GDP Share by Expenditure Component (%)



Source: CEIC, MIDFR

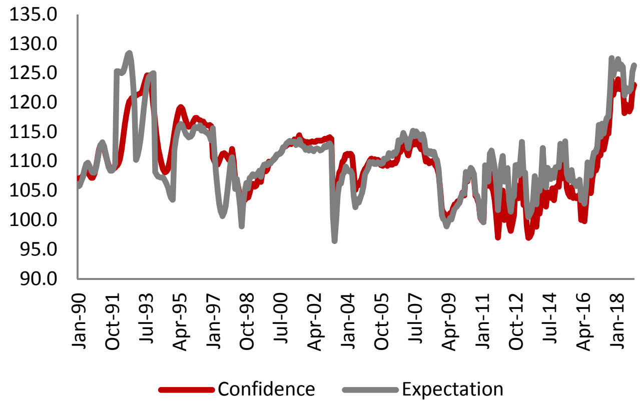
Business confidence downhill, consumer sentiment uphill. The protectionist trade policy by Trump-led administration has resulted in China's business confidences namely manufacturing PMI and CEIC Leading Indicator to point downward since early 2018. Uncertainties on trade war heighten in Nov-18 as China and the US agreed on trade truce and working towards a deal. On a flip side, optimism among Chinese optimism is gaining momentum as the index hits average 121.1 points in 2018, highest in 24-years. Apart from China's consumption-led strategy, jobless rate hits bottom at 3.8% in 4Q18 and low inflationary pressure support consumer spending in China last year.

Chart 3: Business Confidence (Points)



Source: CEIC, MIDFR

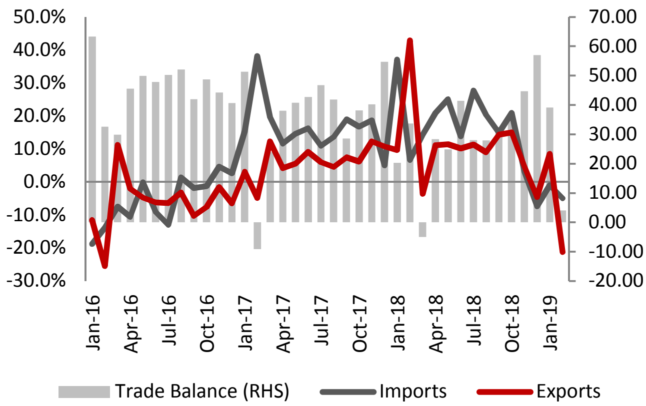
Chart 4: Consumer Confidence (%)



Source: CEIC, MIDFR

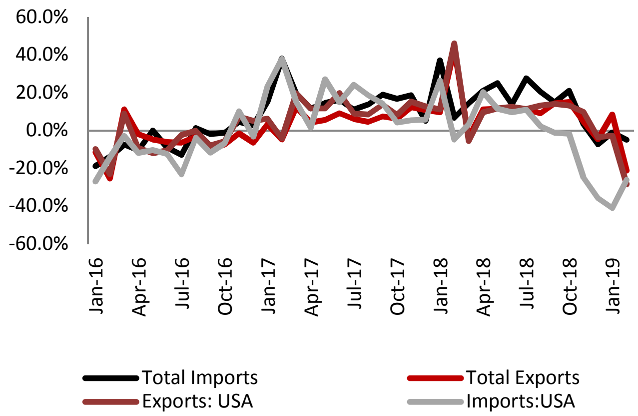
Trade deal uncertainties hurt exports. China's trade surplus narrowed sharply to USD4.1B in Feb-19 (Feb-18: USD32.3B) and missing market expectation of USD26.4B gain. The lowest trade surplus since a deficit in Mar-18 was due to exports fell more than imports. Exports plunged -20.7%yoy, far worse than market forecast of a -4.8% drop and the largest decline since Feb-16 driven by low sales of aluminum, steel products and rare earths. Similarly, imports fell -5.2%yoy also worse than market estimates of a 1.4% decline. Purchases of soybean fell -17.8%yoy and tumbled -39.5%mom amid higher tariff imposed on shipments from the US. In regards to trade surplus with the US, it narrowed sharply to USD14.7B (Jan-19: USD27.3B). Slowing business in Feb-19 could be due to Chinese New Year holiday. Even after accounting for the seasonal effects, the latest figures still portray weaknesses in the economy, signaling lower growth ahead. China and the US failed to reach an agreement by March 1 deadline given for the 90-day truce. Instead, it was extended, as negotiations are progressive. While a reversal in the US tariffs would provide a boost to China's exports, it is not sufficient to offset the broader external headwinds. Moving forward, its exports outlook remains gloomy.

Chart 5: External Trade Performance (USDb vs YoY%)



Source: CEIC, MIDFR

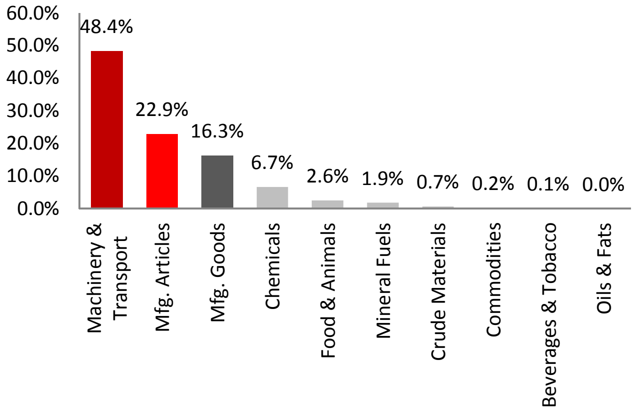
Chart 6: China-USA Trade Performance (YoY%)



Source: CEIC, MIDFR

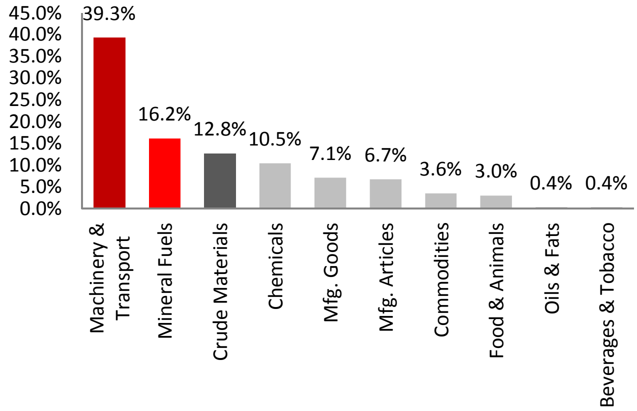
Manufacturing activities dominate external trade market. In 2018, 48.4% of the total exports were contributed by machinery & transport equipment especially electrical machinery. Also, both miscellaneous manufactured articles such as apparel & clothing accessories and manufactured goods particularly textile & manufactured metals contributed 22.9% and 16.3% respectively. As for the imports, China purchases on machinery & equipment is the most followed by mineral fuels particularly petroleum at 16.2% and crude materials, specifically metalliferous ores & scraps at 12.8%. By product, China's major trade surplus contributors are manufacturing articles, machinery & transport equipment and manufactured goods.

Chart 7: China Exports Share by Product 2018 (%)



Source: CEIC, MIDFR

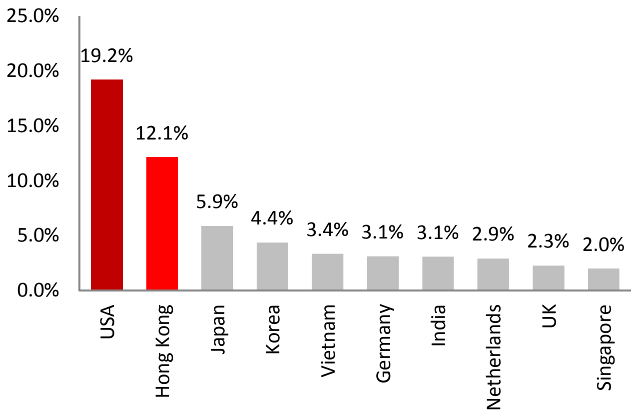
Chart 8: China Imports Share by Product 2018 (%)



Source: CEIC, MIDFR

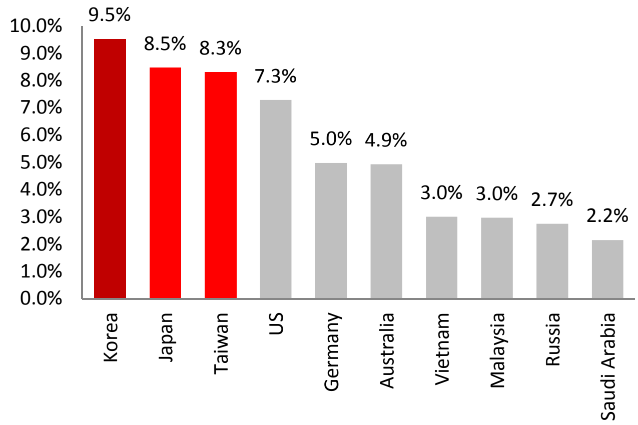
Malaysia within China's radar. Among the top ten imports destination for China, Malaysia is ranked 8th last year. The top three are South Korea, Japan and Taiwan. By region, in 2018 ASEAN and EU have 12.6% and 12.8% share of imports respectively. As for exports, the US remains the major export destination, 19.2% of total exports. ASEAN and EU contributed 12.9% and 16.5% respectively in 2018. Securing a deal with the US is critical for China's external trade performance due to its presence as the major exports partner. On the other hand, growing domestic demand in China is expected to translate into higher imports growth and indirectly affects Malaysia positively.

Chart 9: China Exports Share by Country 2018 (%)



Source: CEIC, MIDFR

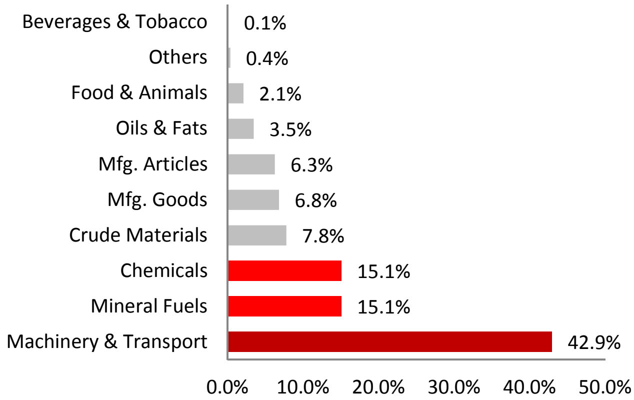
Chart 10: China Imports Share by Country 2018 (%)



Source: CEIC, MIDFR

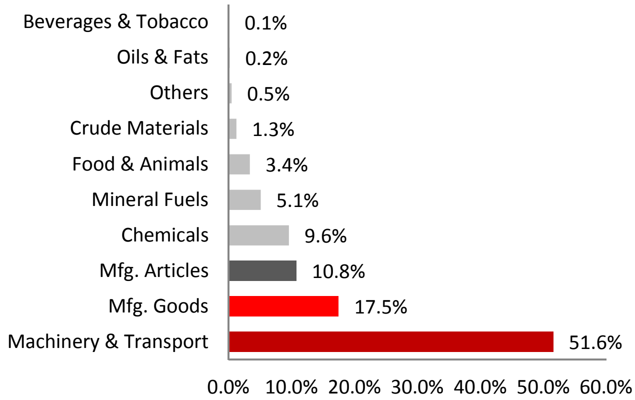
Malaysia-China trade. By country, China is the second largest exports partner for Malaysia. Almost 14% of Malaysian outbound shipments went to China last year. Exports of machinery & transport, mineral fuels and chemicals are among the major products. However, Malaysia has been running trade deficit with China since GFC'09. In 2018, Malaysia registered trade deficit of RM36bn with China. We notice there were four products that Malaysia had net exports with China namely mineral fuels, crude materials, oils & fats and chemicals last year. In essence, Malaysia still has competitive advantage on commodity-based products over China.

Chart 11: Malaysia Exports to China 2018 (Share %)



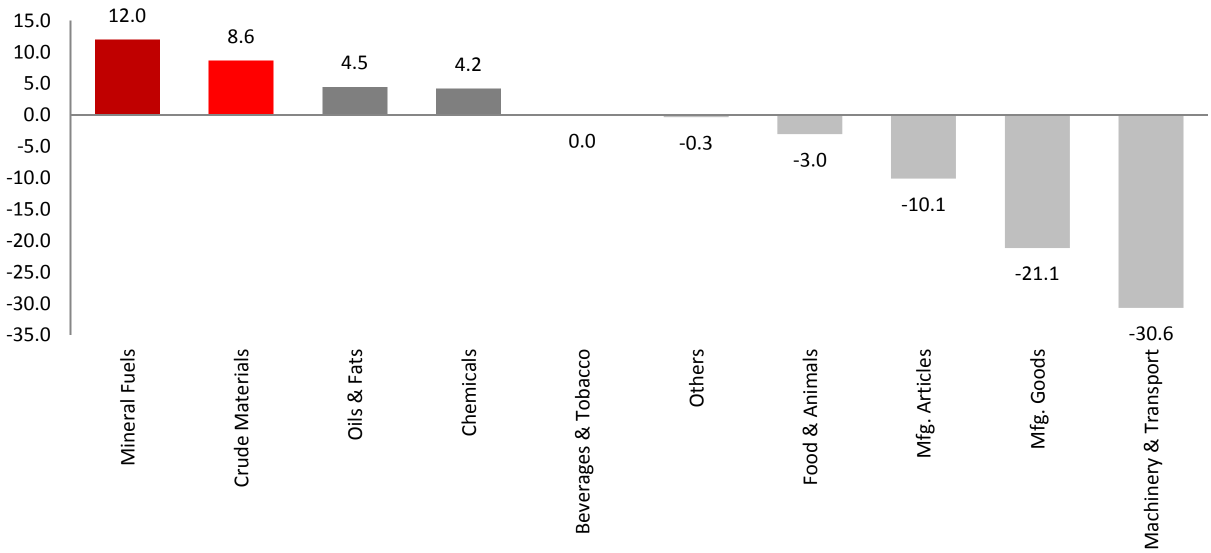
Source: CEIC, MIDFR

Chart 12: Malaysia Imports from China 2018 (Share %)



Source: CEIC, MIDFR

Chart 13: Malaysia's Trade Balance with China 2018 (MYR bn)

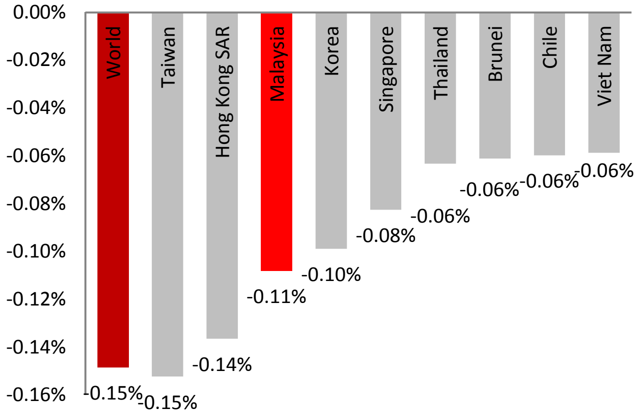


Source: CEIC, MIDFR

Global growth to decline -0.15%. Based on our estimate, global economy is predicted to contract by -0.15% if China slowdown by -1%. In addition, Asian economies namely Taiwan, Hong Kong, Malaysia, South Korea and Singapore are expected to be impacted the most, in the range between -0.15%-0.08%. These economies are affected due to high dependence on China especially on external trade. For instance, Taiwan, South Korea, Malaysia and Vietnam were listed in China's top ten imports partners in 2018.

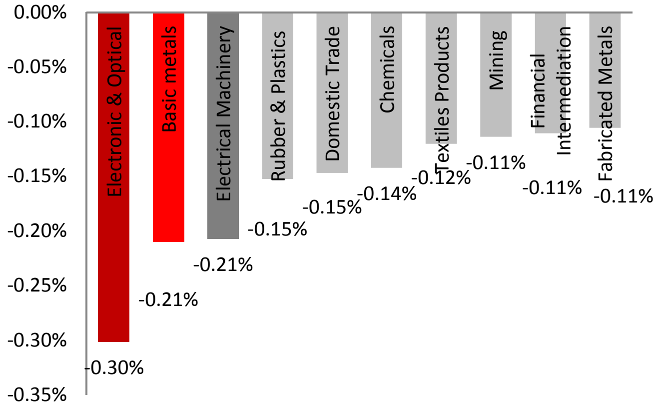
Malaysia affected by -0.11%. In the event of China's economy slowdown by -1%, Malaysian economy is predicted to fall by -0.11%. Consequently, production of electronic & optical, basic metals and electrical machinery are among the major industries affected. Looking ahead, we opine China to remain on expansionary path this year despite of having a trade deal or not. Recent stimulus packages and steady domestic demand would support the economic growth and may reduce the effects of trade war with the US.

Chart 14: Global Impacts as China Slowdown by -1%



Source: OECD, MIDFR

Chart 15: Sectoral Impacts on Malaysia (%)



Source: OECD, MIDFR

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