

China Factor, ASEAN Business Cycle Synchronization, the U.S.-China Trade War

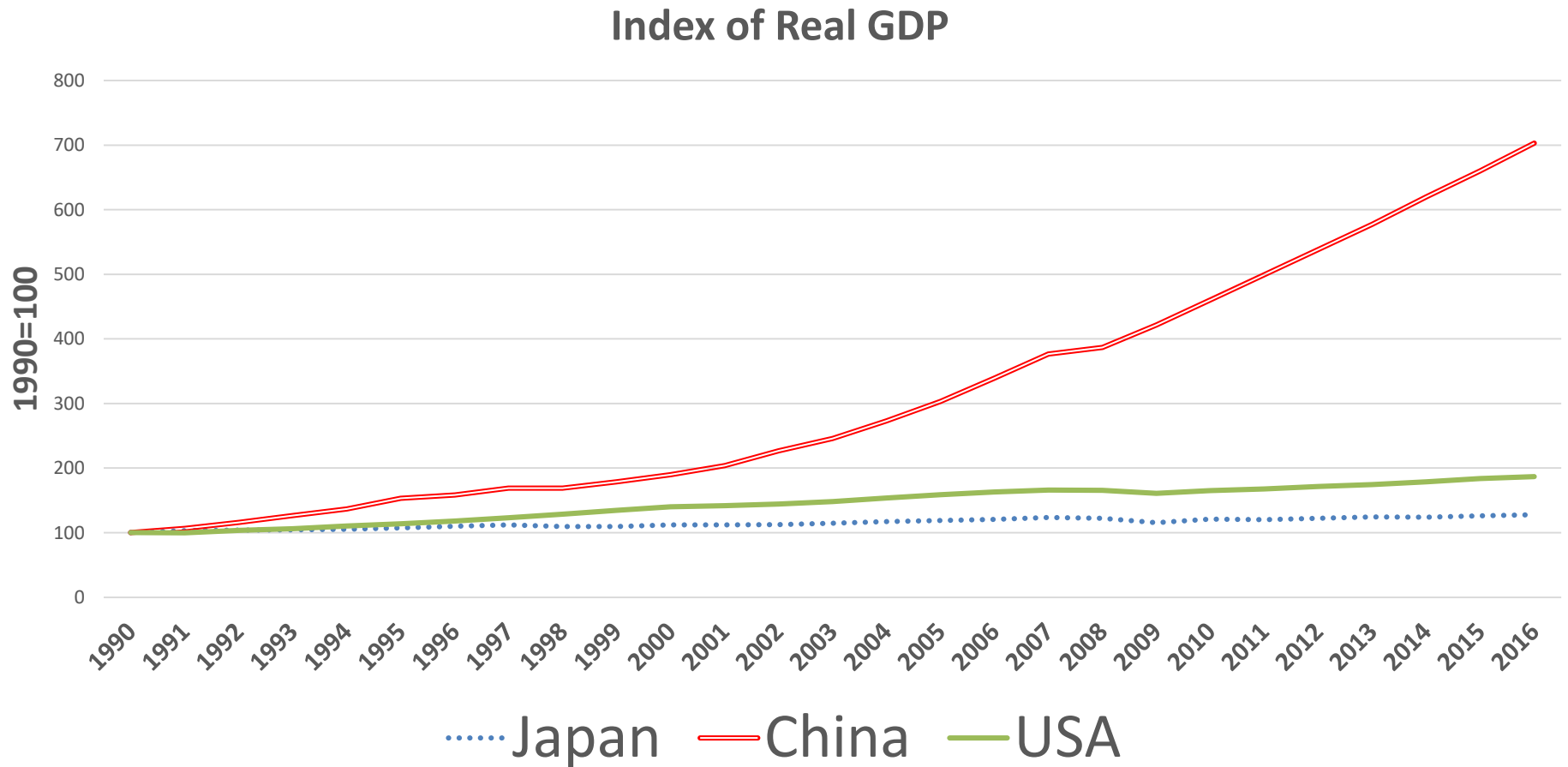
Bhanupong
Lecture 21

***How important is the China factor to the Thai economy?
Direct and indirect impacts of the U.S.-China Trade War***

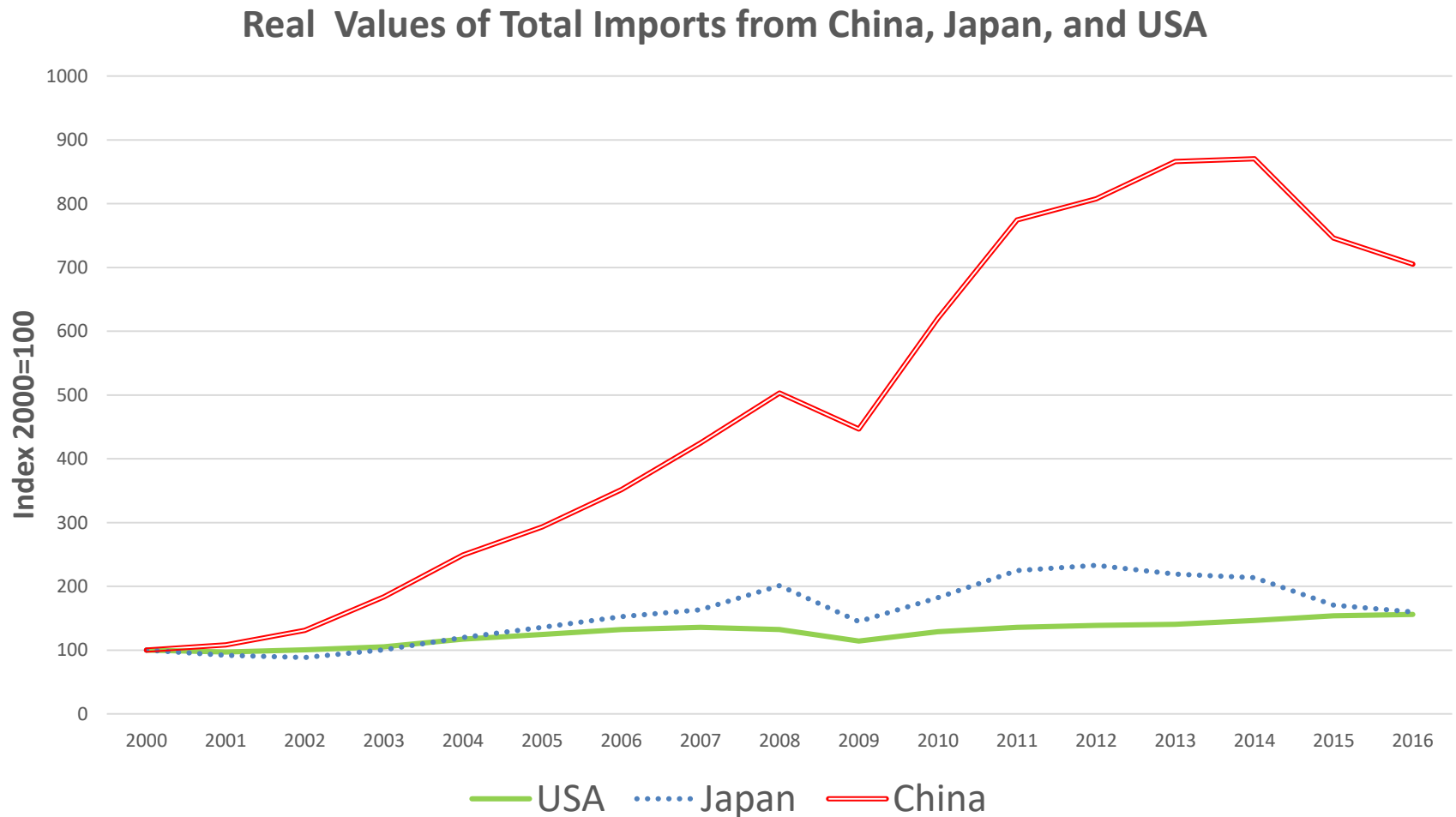
Main themes

1. China factor
2. ASEAN Business Cycle Synchronization
3. Current account disequilibrium:
investment-saving gap
4. The U.S.-China Trade War

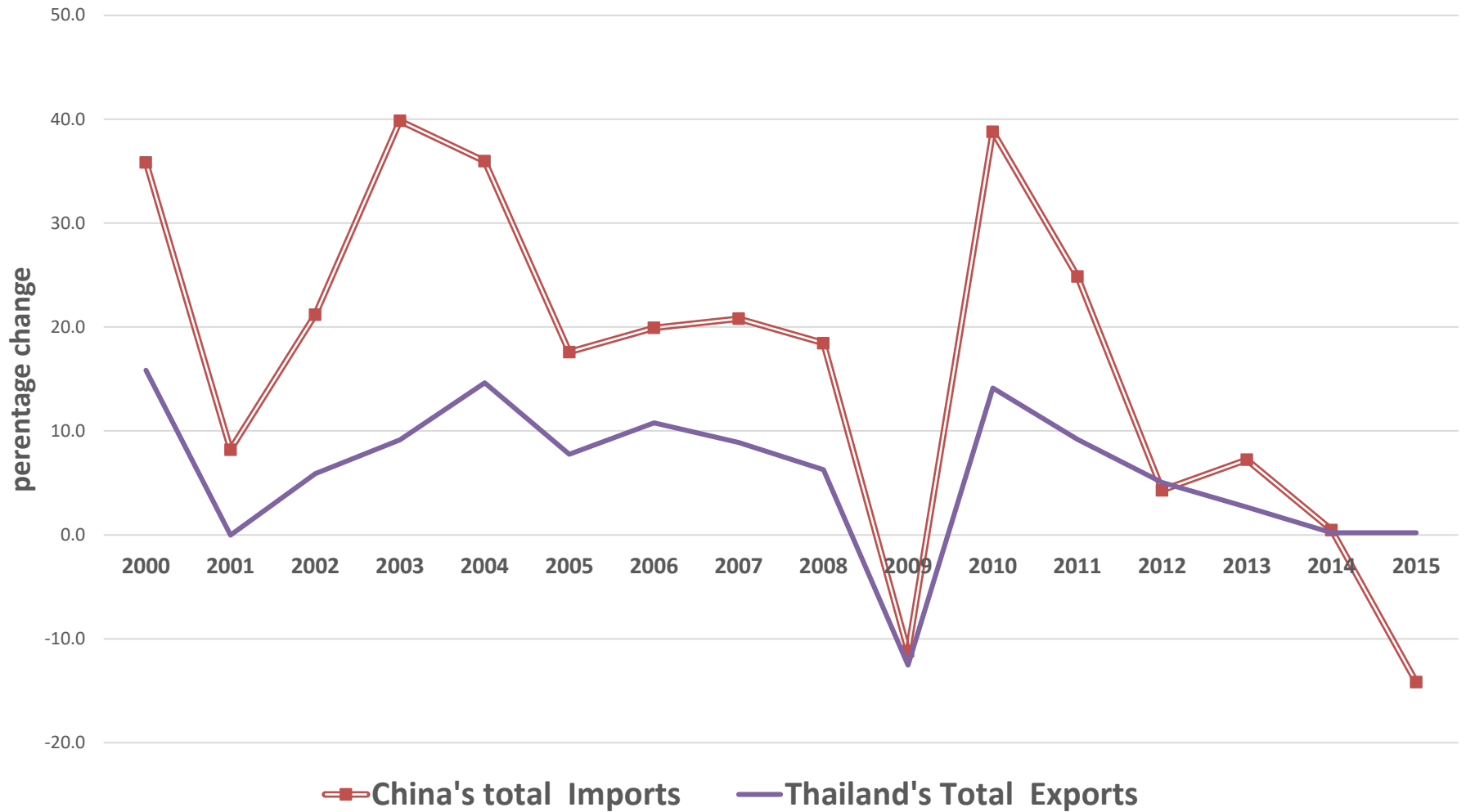
1. China Rising



Imports from the three largest economies



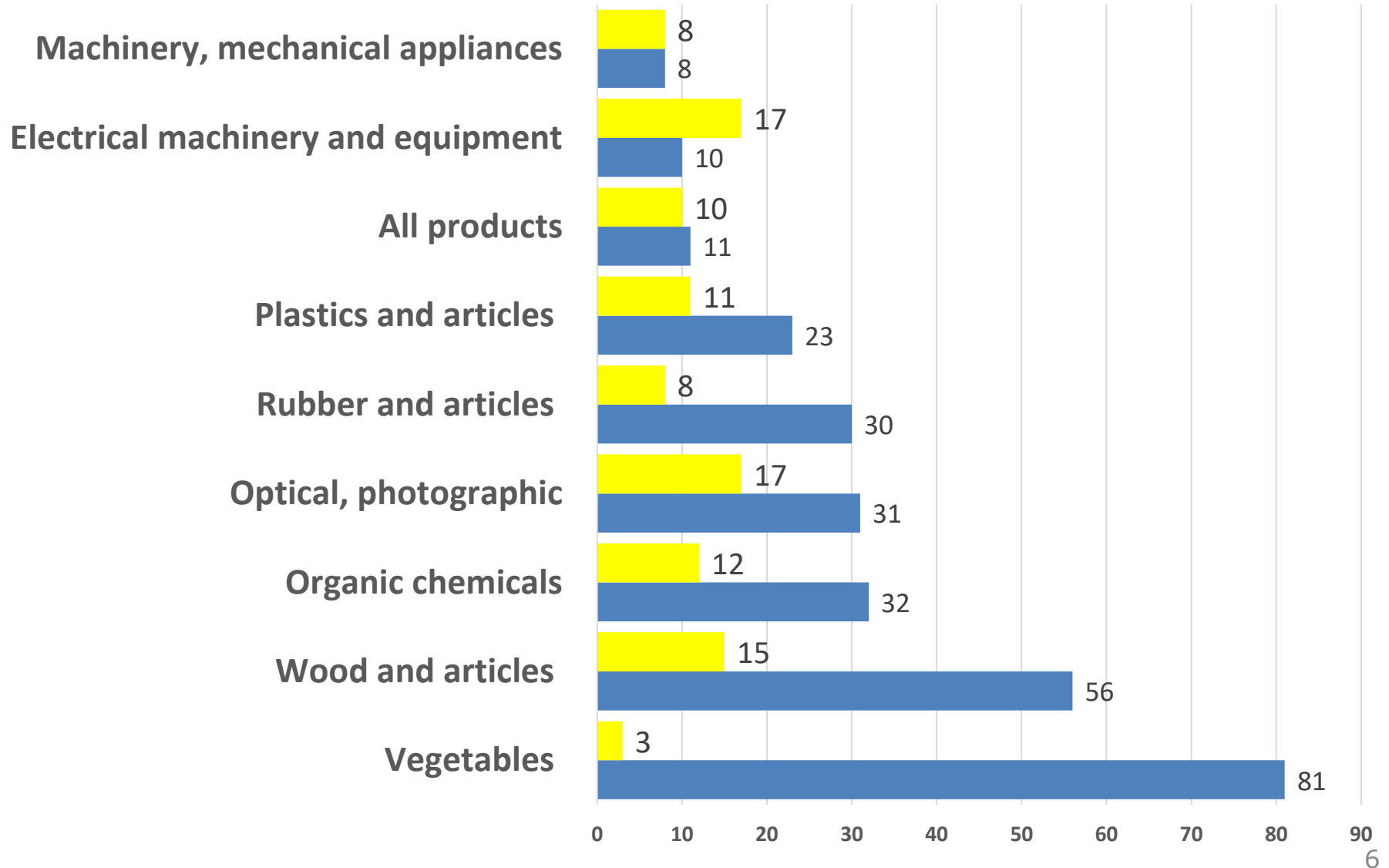
China's influence on Thailand's exports



China's influence on Thailand's exports: 2016

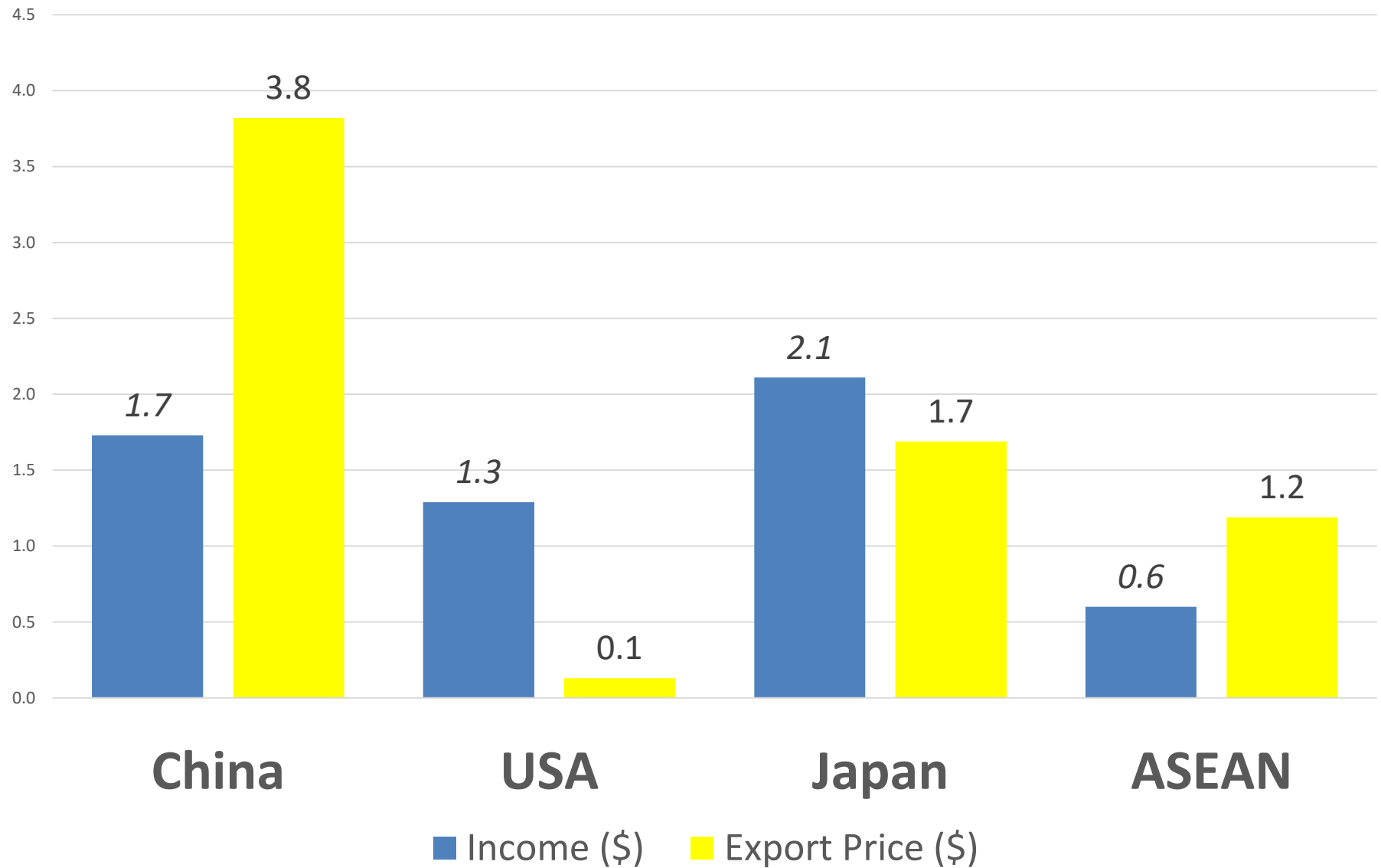
Share of Thailand's exports in China's total Imports

Share of Thailand's exports to China in Thailand's total exports

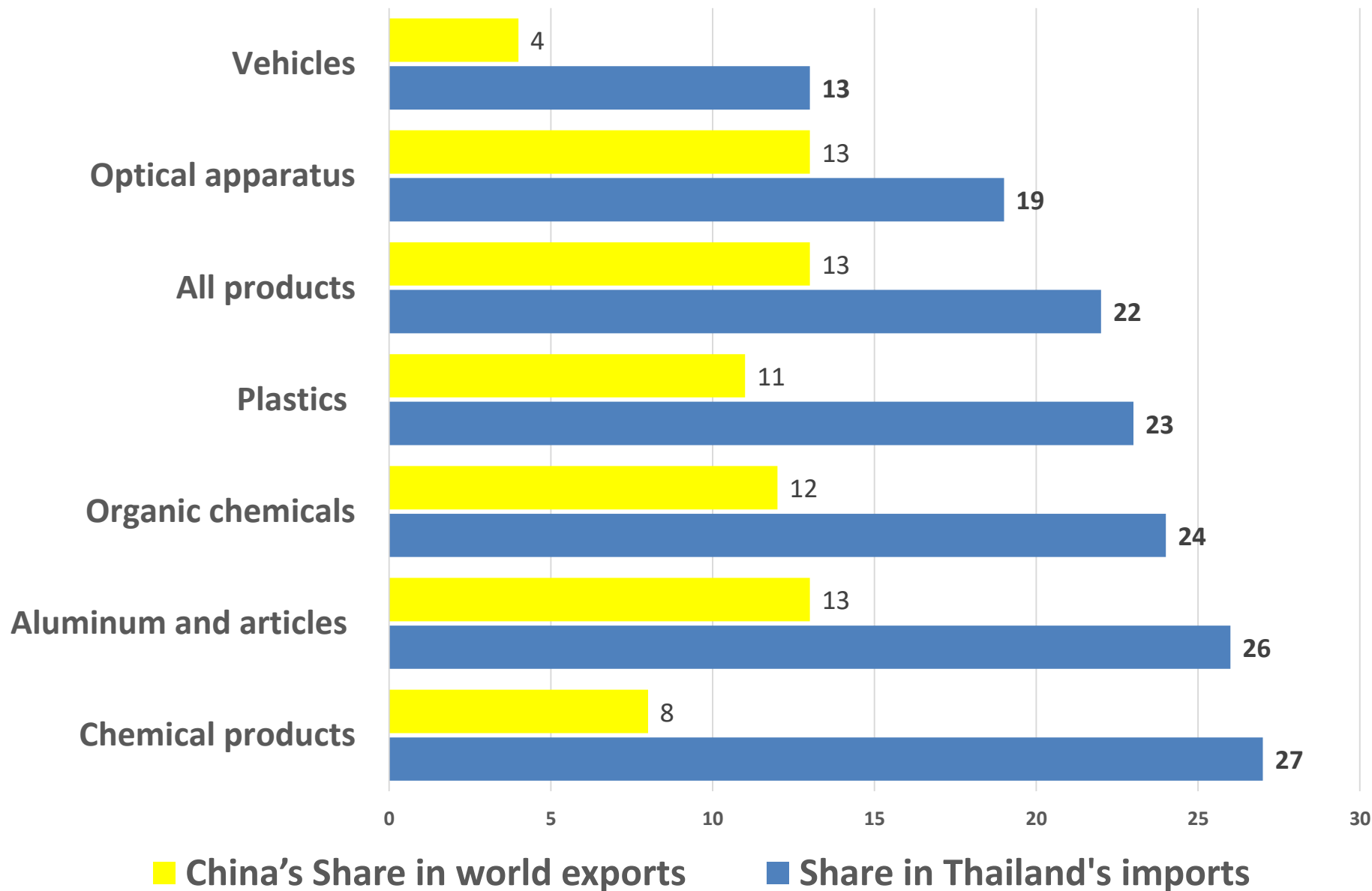


Thailand's *exports value* elasticities

Source: FMOLS (2003-2016)

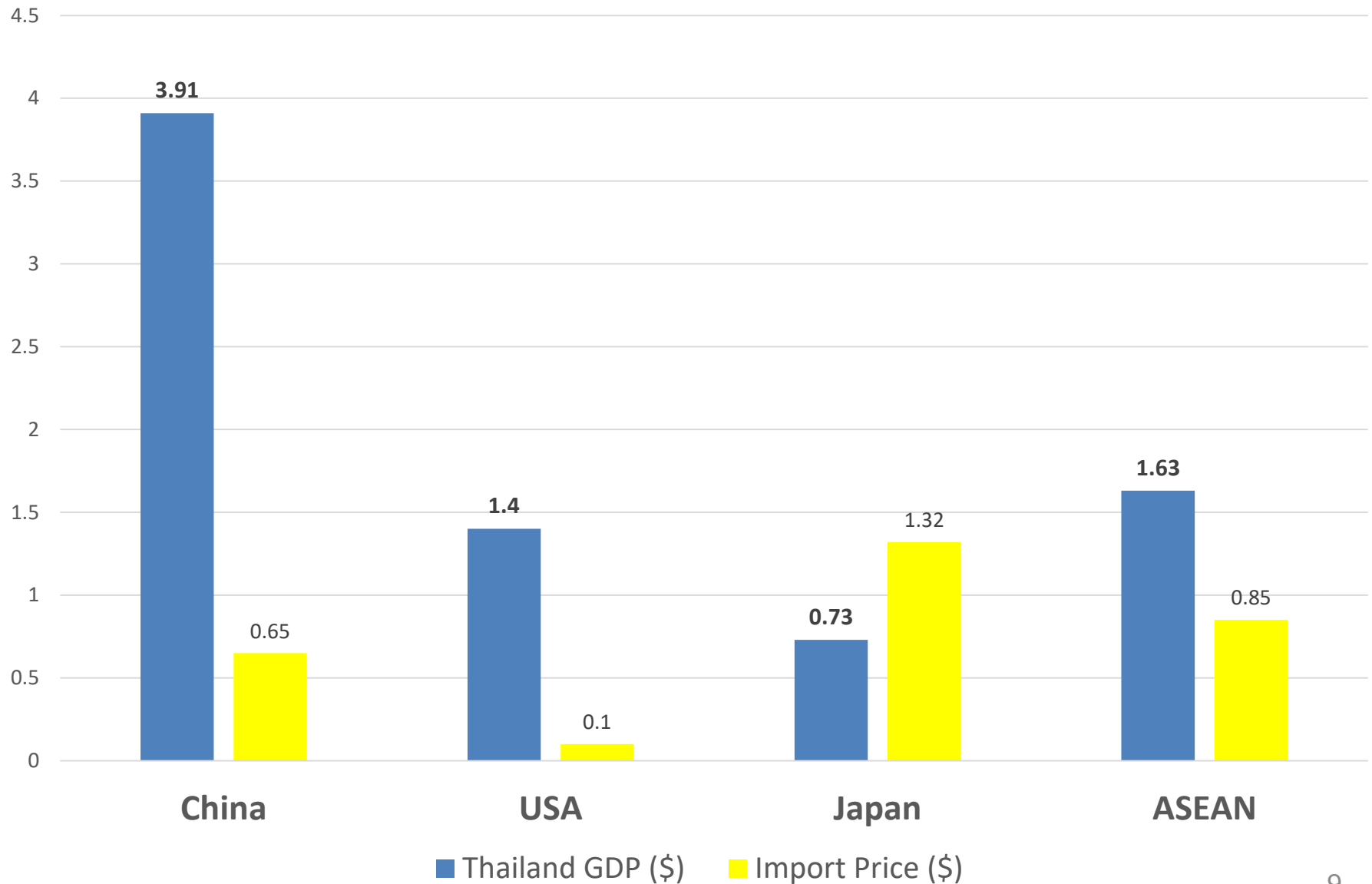


China's influence on Thailand's imports: 2016



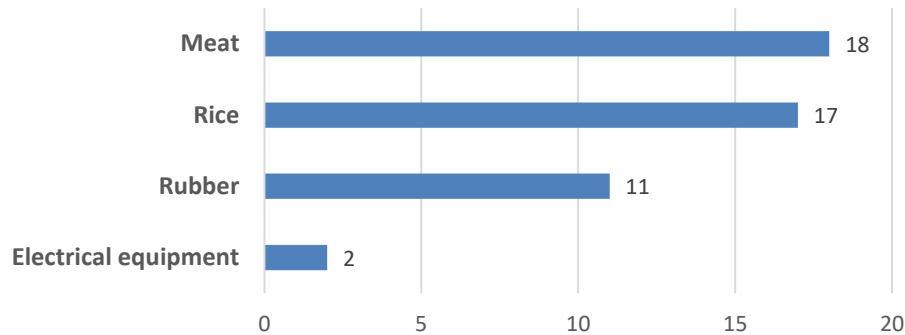
Thailand's *import value elasticities*: 2002-2016

Source: FMOLS estimates

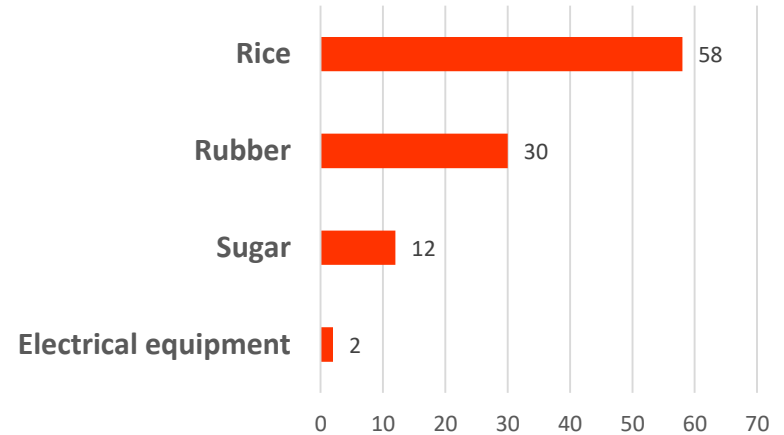


Thailand's market access

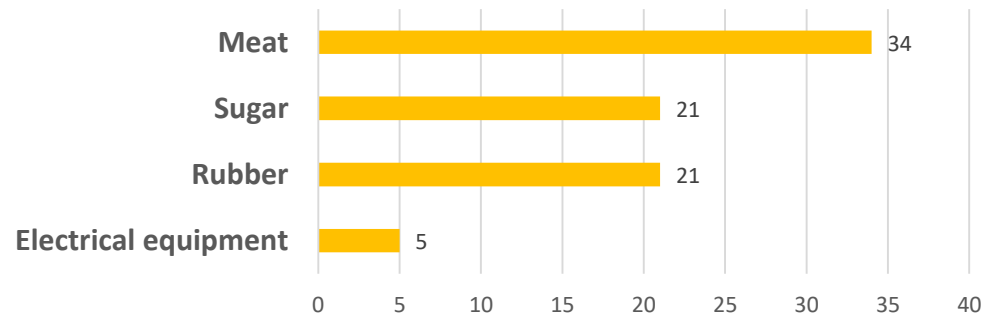
U.S. markets' import penetration
(% total import values)



Chinese markets' Import penetration

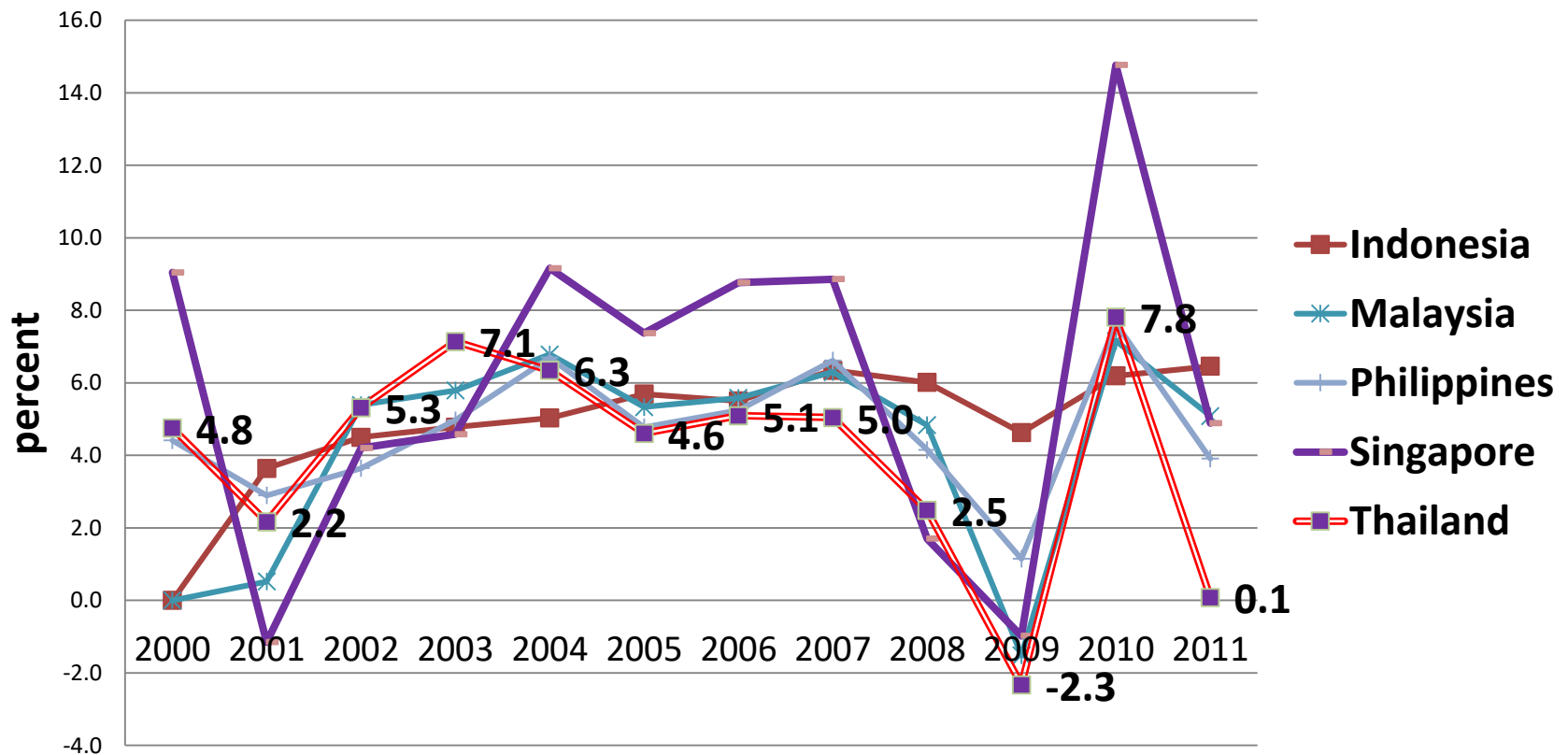


Japanese markets' import penetration



2. ASEAN Business Synchronization

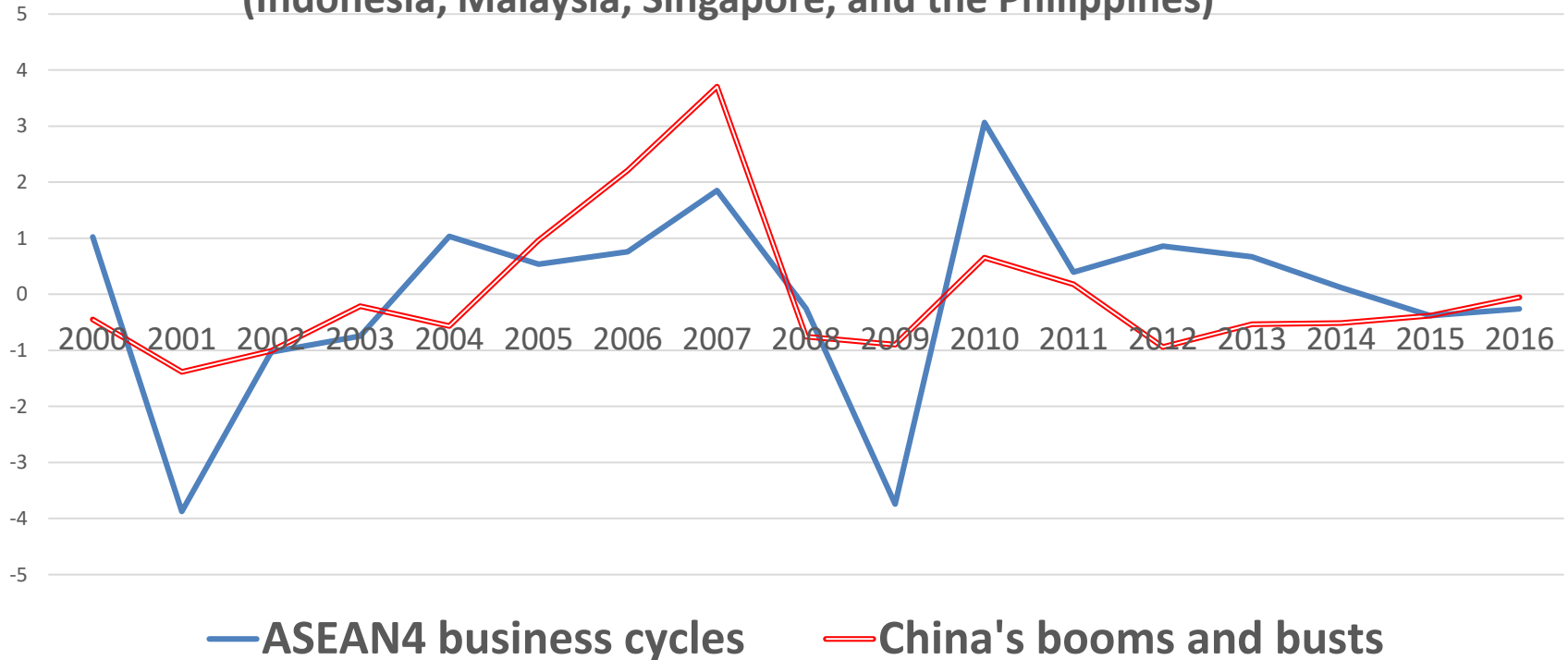
GDP Growth: ASEAN 5



China and ASEAN-4 Business Cycle

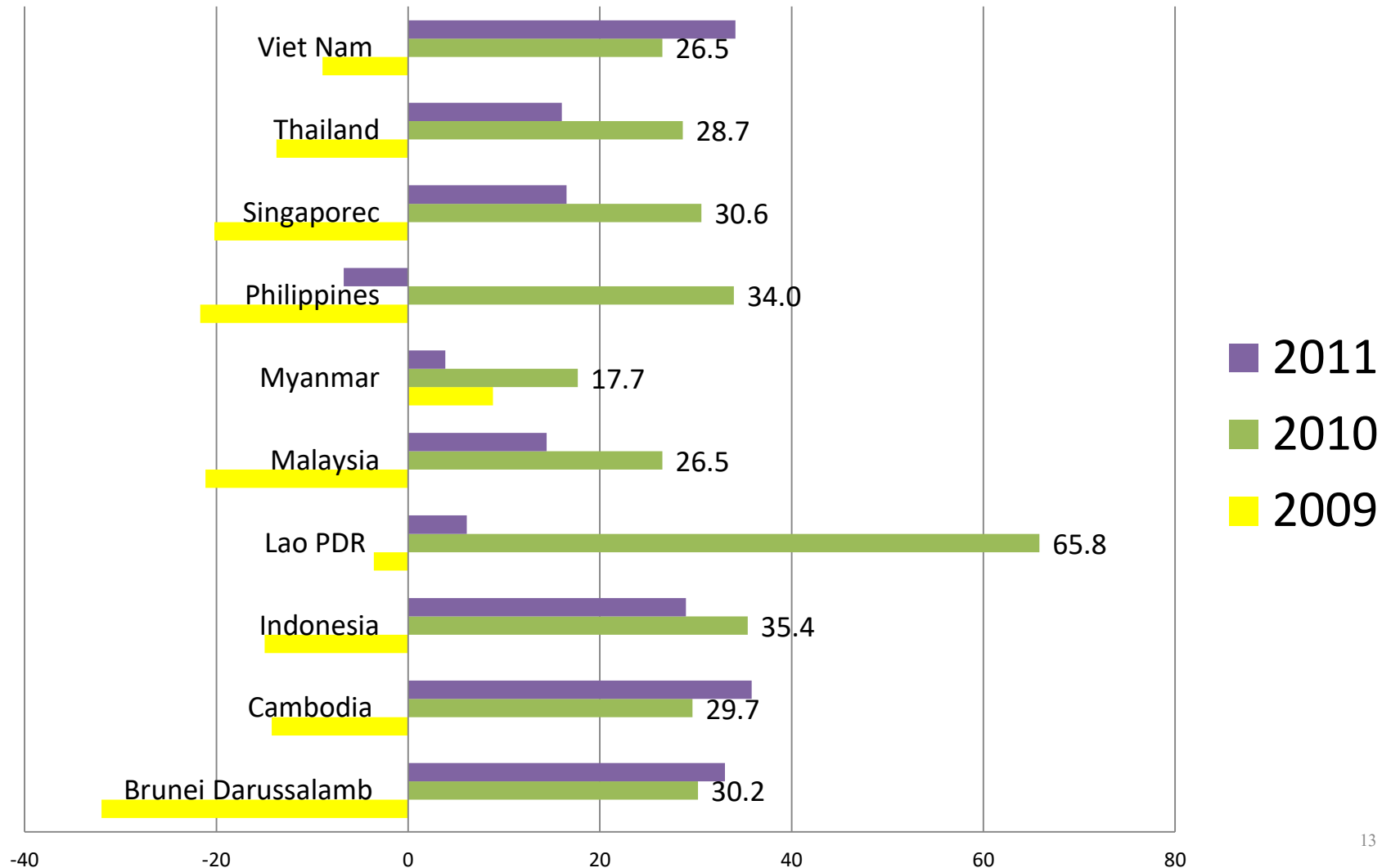
Business Cycles in China and ASEAN-4*

(Deviation from trend growth path)
(Indonesia, Malaysia, Singapore, and the Philippines)

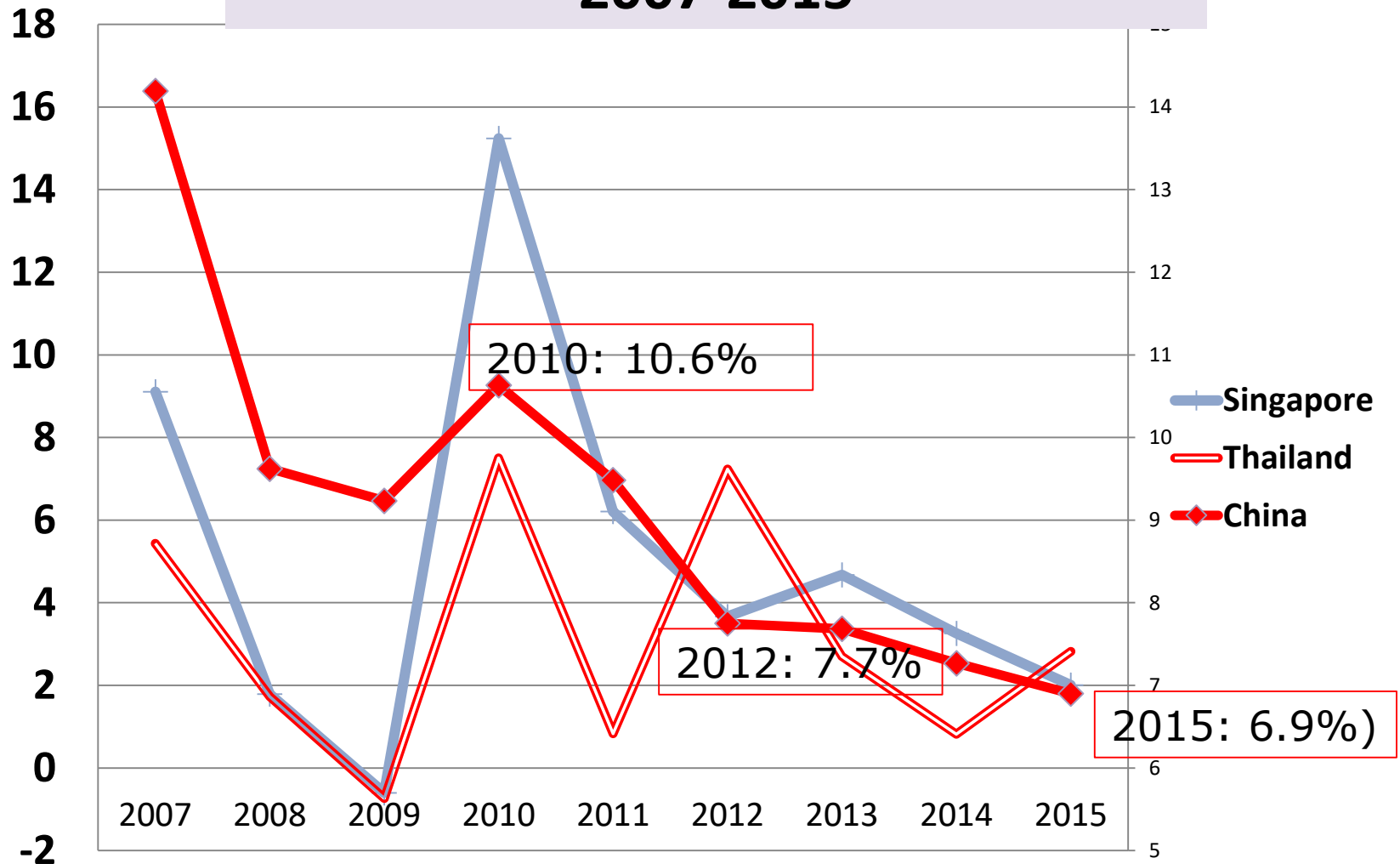


What did ASEAN Exports have in common after the GFC?

Impact of GFC on Exports (% growth)

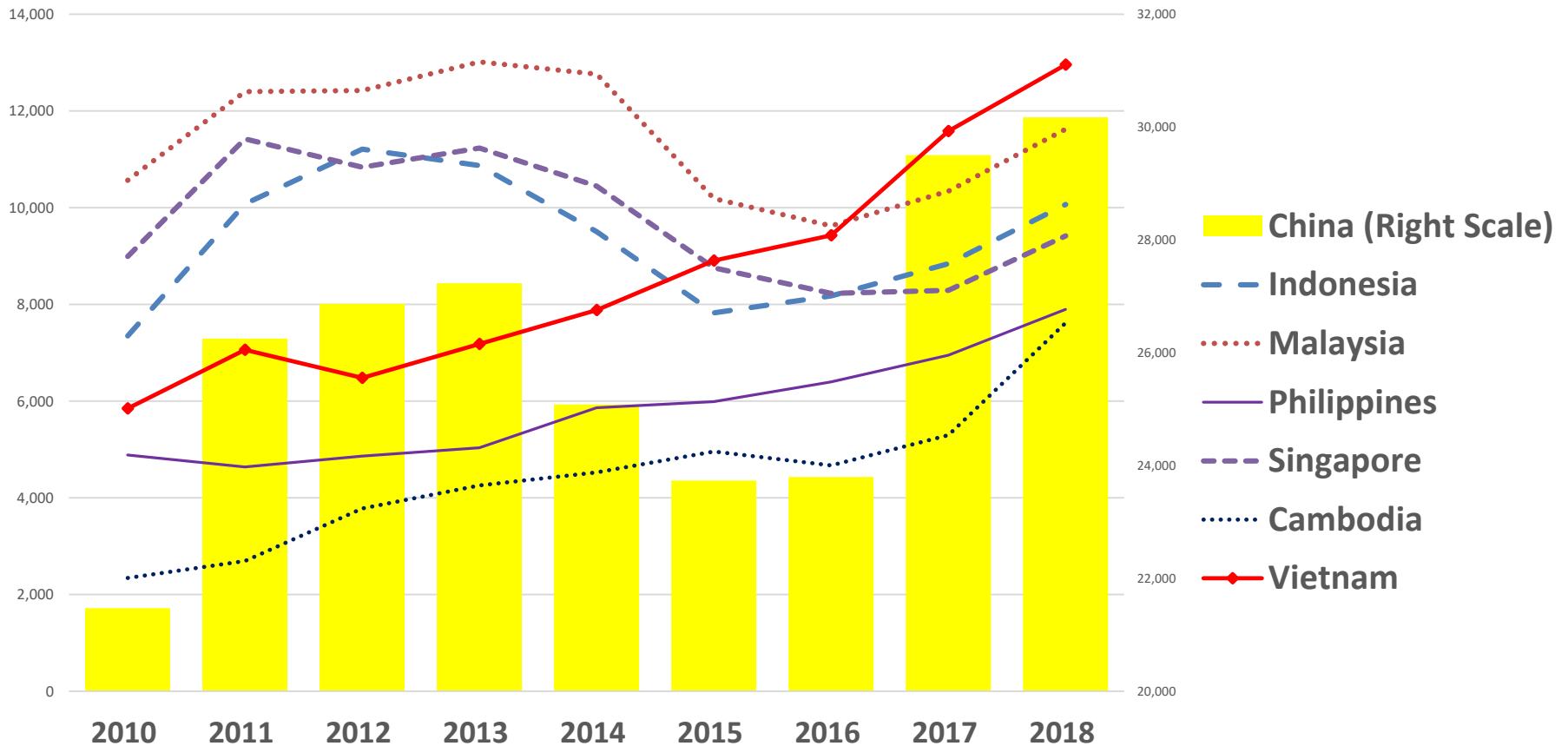


GDP growth in China, Singapore, and Thailand 2007-2015



Thailand's exports synchronize with China's business Cycle

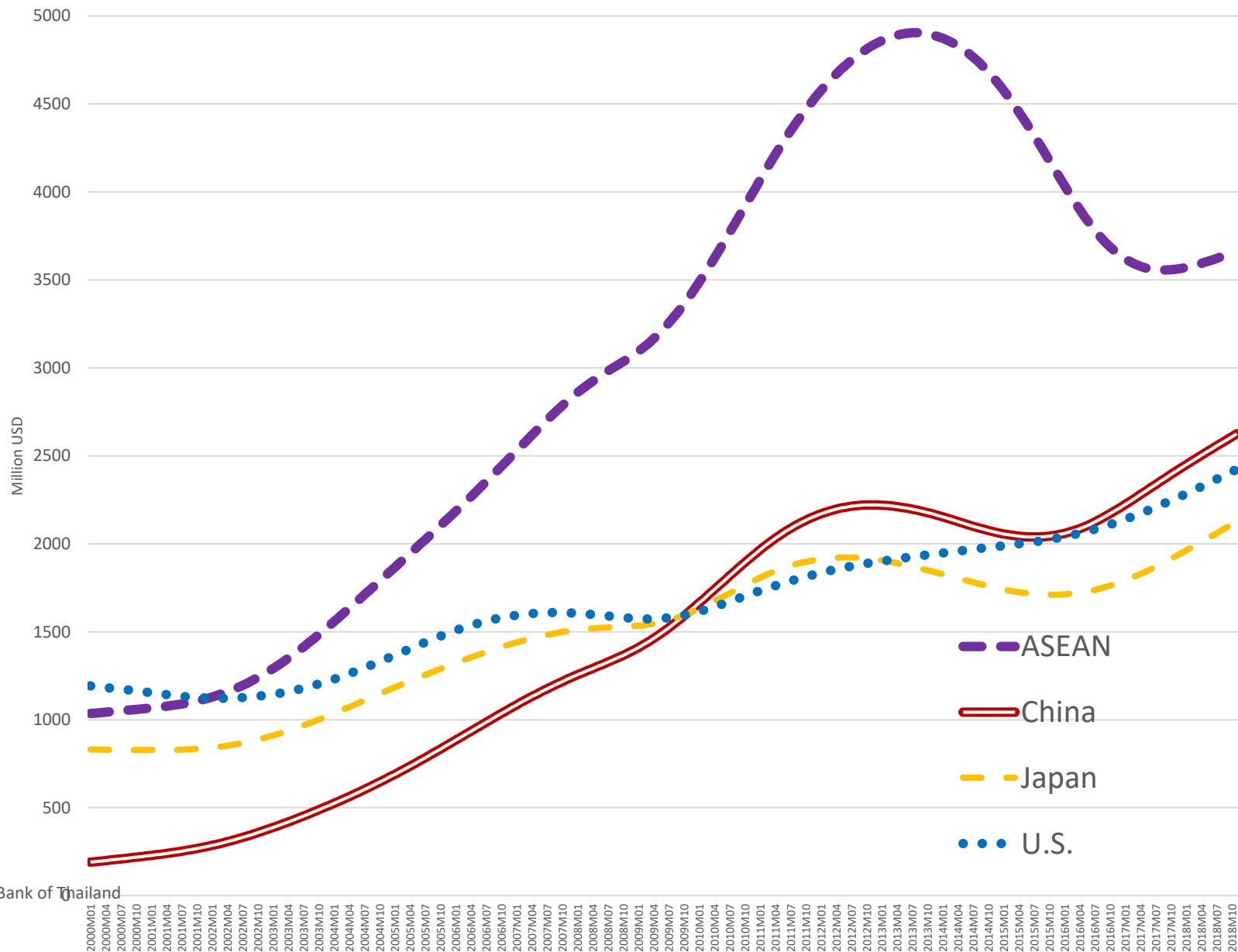
Thailand's exports to China and ASEAN (million USD)



Source: Bank of Thailand

Trends of Thailand's exports to major markets

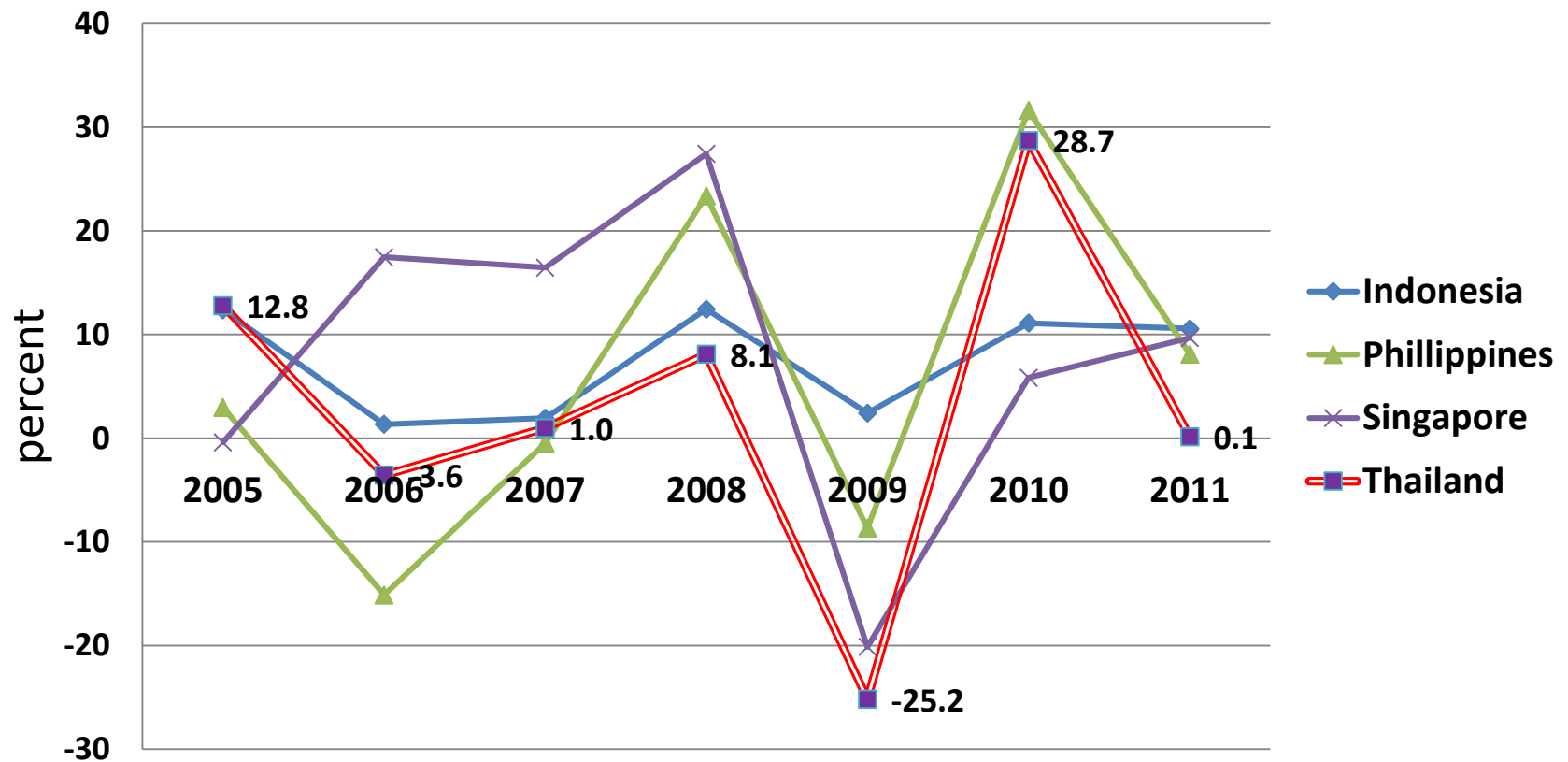
The importance of ASEAN markets



Source: Bank of Thailand

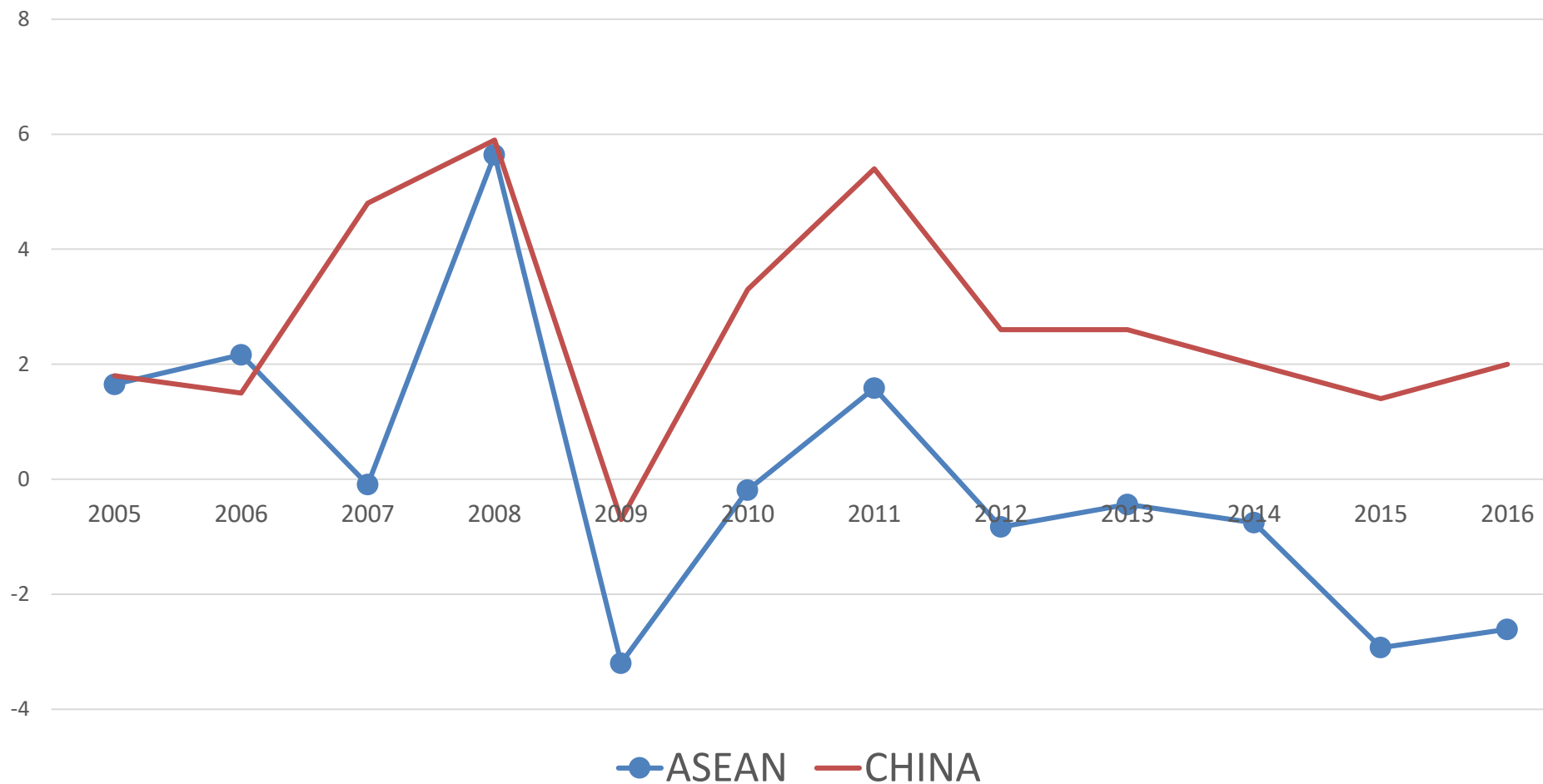
ASEAN Investment synchronization

Gross Domestic Investment



China and ASEAN *Inflation Synchronization* (Principal Component of CPI inflation)

Source: ADB Key Indicators

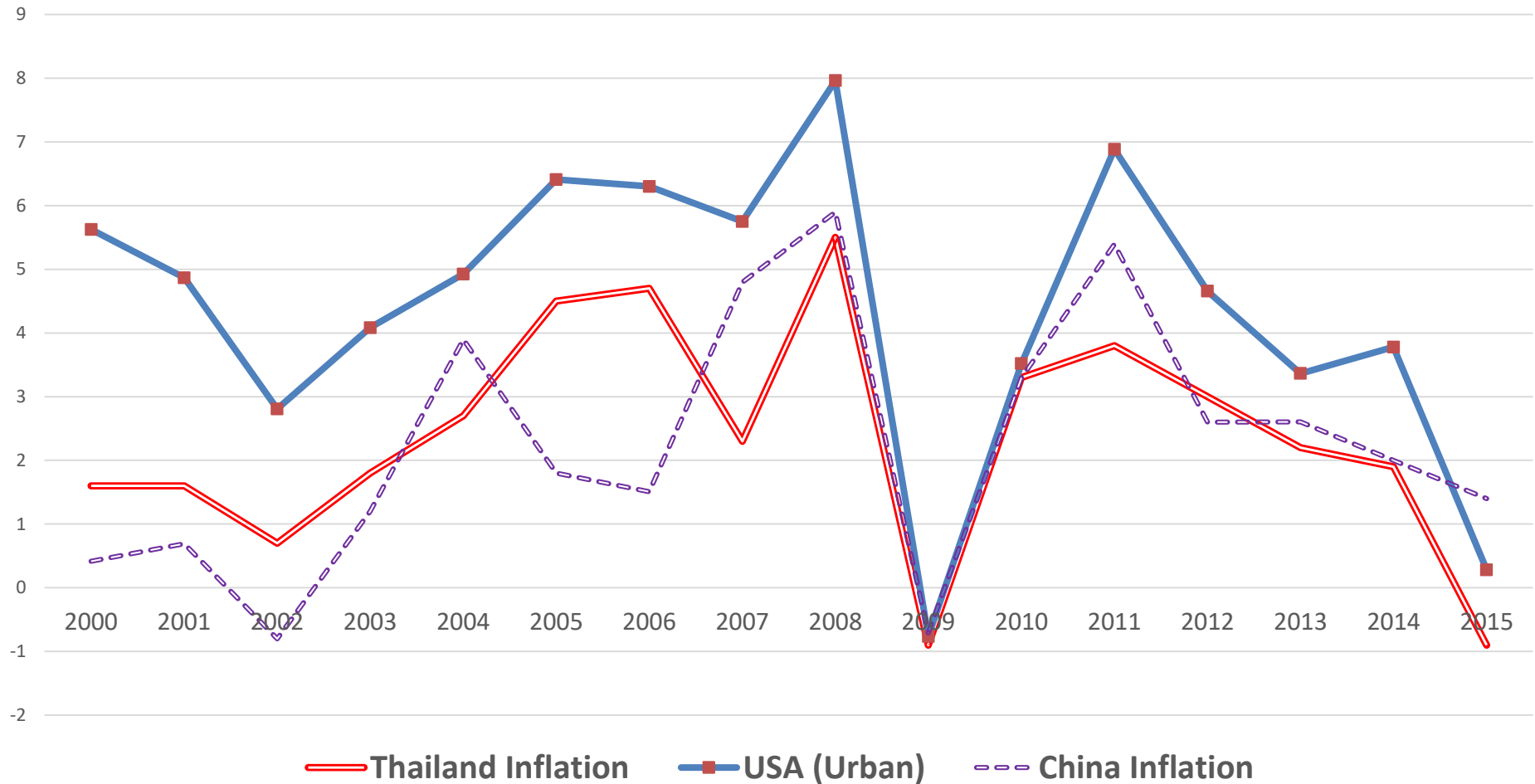


The ASEAN business cycle and China's slowdown

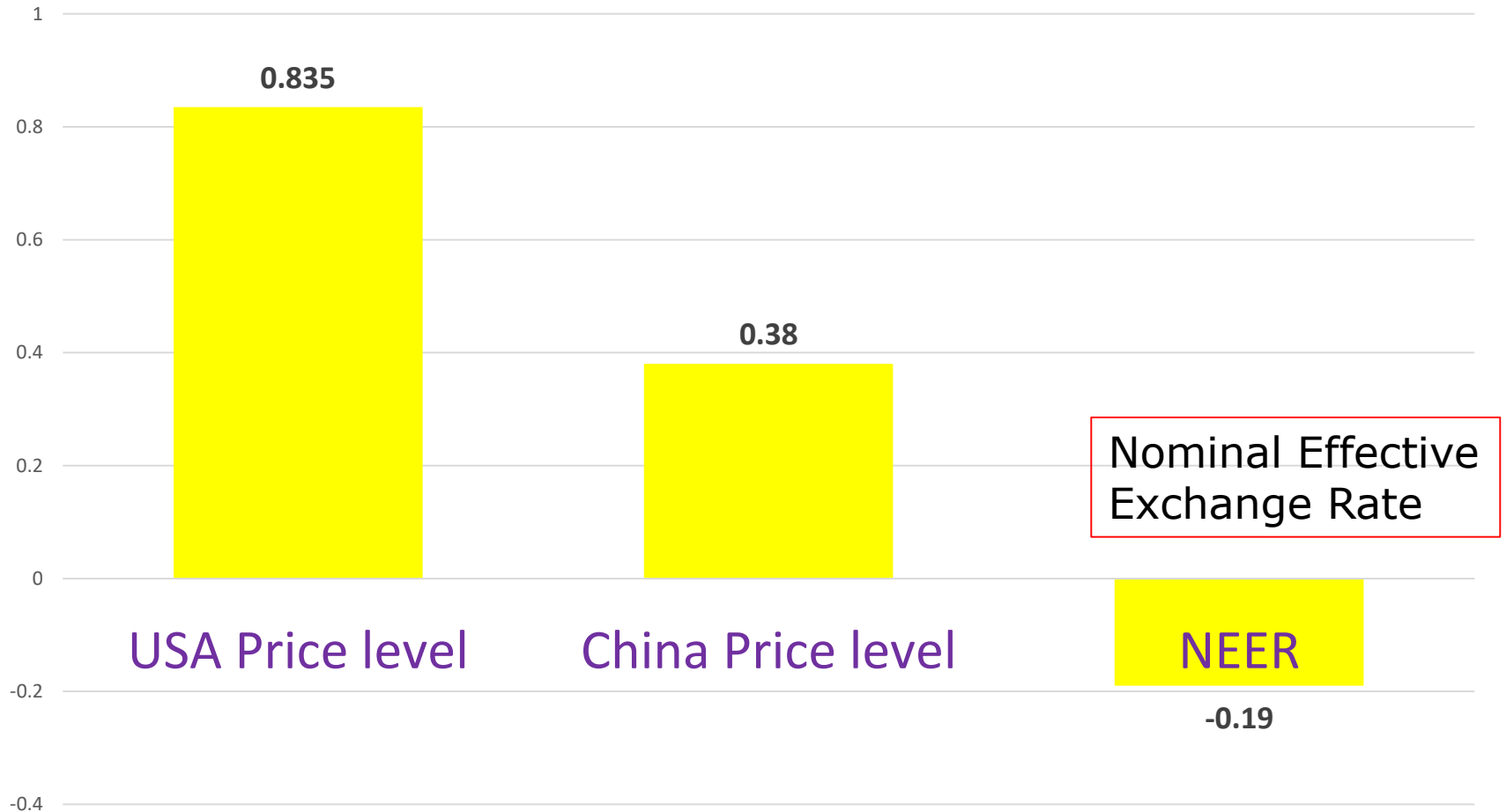
Bhanupong Nidhiprabha

The economies in the Association of Southeast Asian Nations (ASEAN) have been integrated through increasing trade relations intensified by tariff reductions and increasing openness to foreign direct investment. Rising volume of networks trade has deepened interconnectedness between ASEAN and China, a recent growth locomotive in the world. ASEAN business cycle is shaped by volatile China's trade volume. As China's expansion slows down, adverse consequences on ASEAN economies have become more pronounced. The extent of the damage depends on each member of ASEAN's trade exposure and China dependency. This paper identifies the most vulnerable ASEAN economies to China's business cycle. The slowing down of the Chinese economy would undoubtedly result in a decline in long-term growth of some ASEAN economies, unless appropriate policy responses can be implemented.

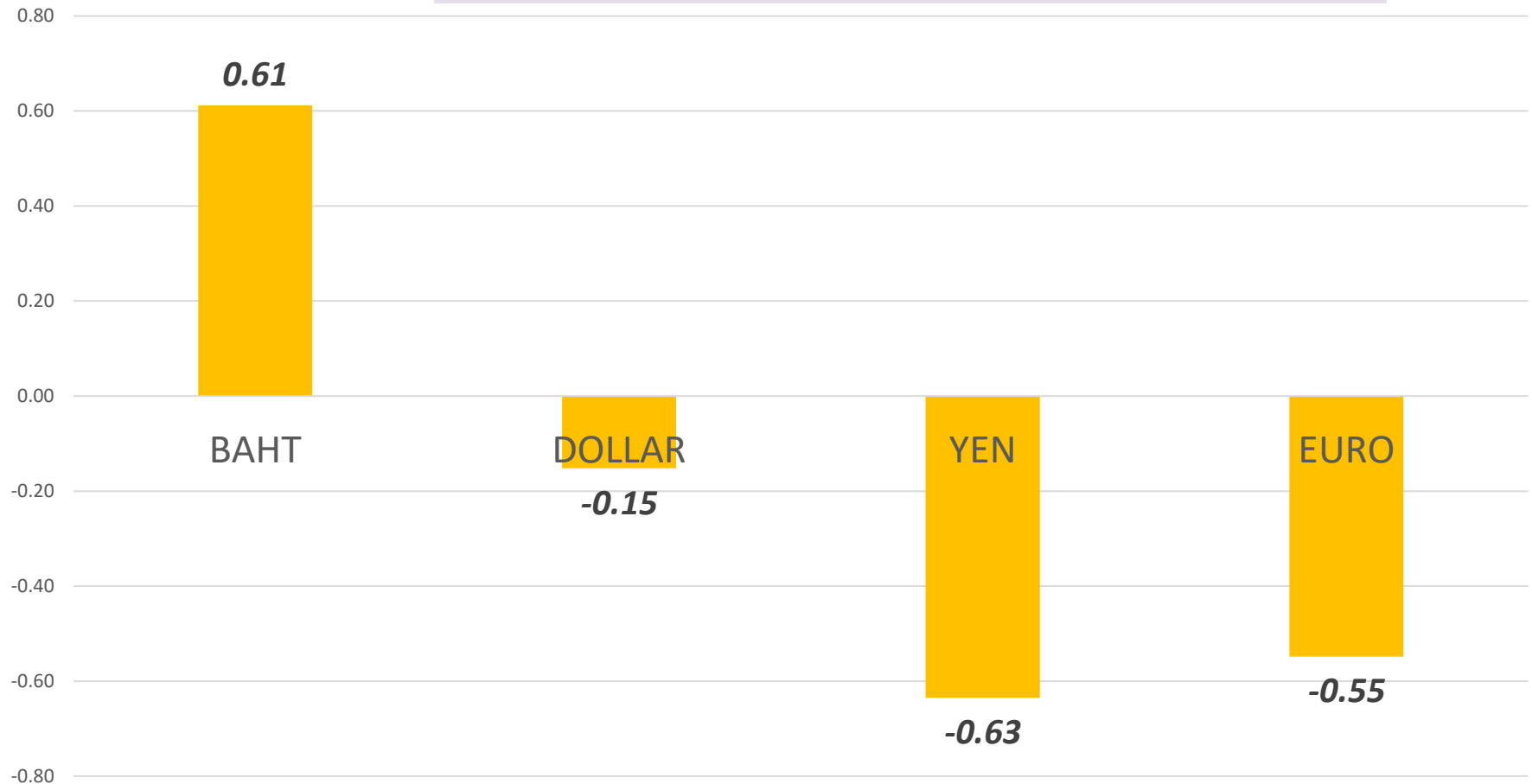
Influences of the Two Major Trading Partners on Thailand's inflation



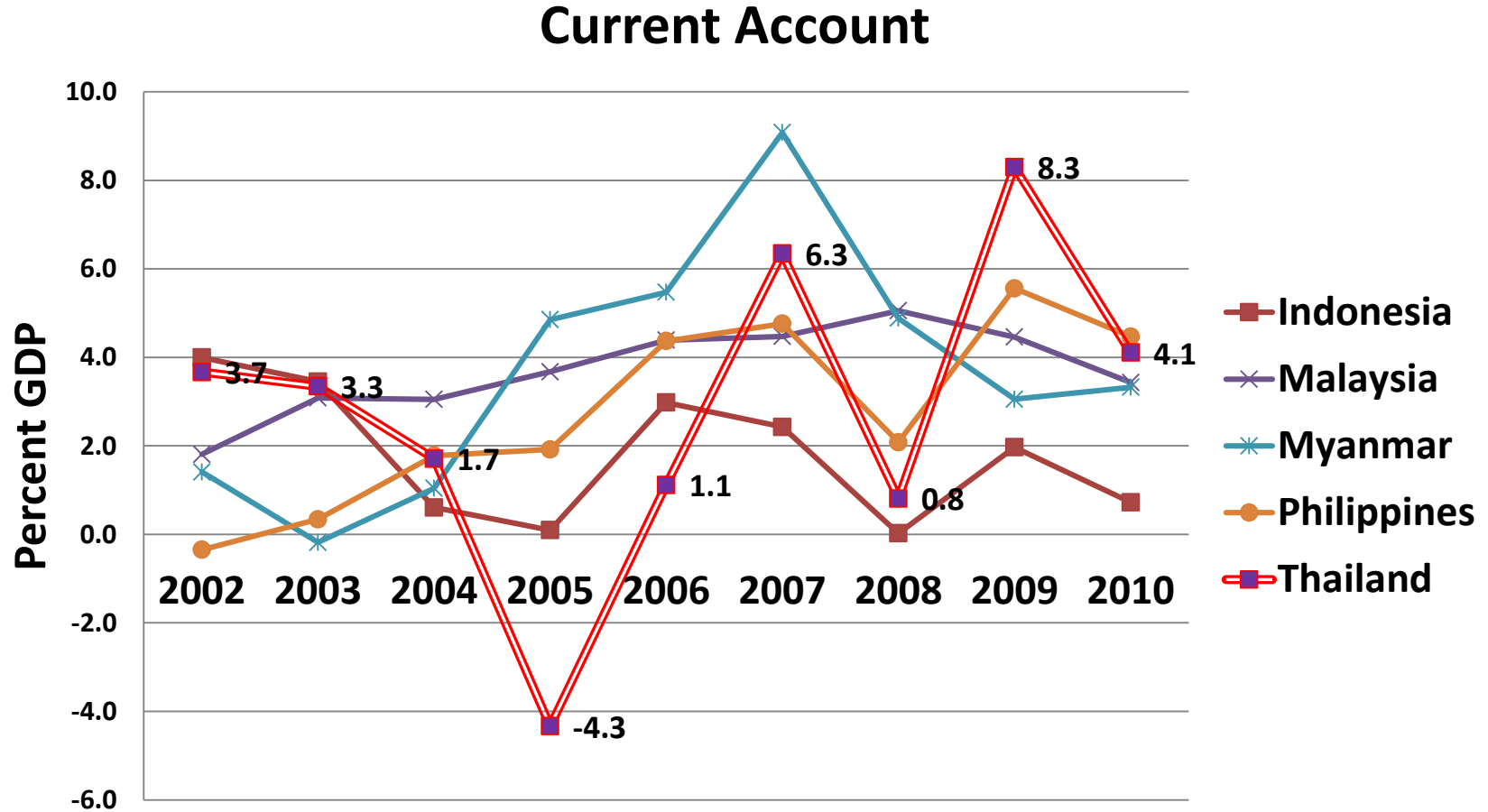
Thailand's Consumer Price Elasticities
Source: Estimated coefficients obtained from Canonical
Cointegrating Regression
(Jan 1994 -May 2017)



Correlates of the **renminbi**
Real Broad Effective Exchange Rates
(Jan 2000-July 2017)



Current account: another common macro variables



Strong growth leads to current account deficit

3. Explaining CA Deficit : Investment-Saving Gap

Saving and Output growth

- $S_t = \alpha + \beta Y_t$

(implied by Keynes' absolute income theory of consumption)

- $(S/Y)_t = \alpha/Y_t + \beta$ (s=saving rate=S/Y)

$$s = \alpha / [(1+g)Y_{t-1}] + \beta \quad (g=\text{output growth})$$

$$\text{Since } \alpha < 0, \quad \partial s / \partial g > 0$$

- There is a positive impact of growth on saving rate.
- High saving rate is driven by high economic growth and vice versa (higher savings generate more investible funds)

I/Y depends on S/Y

Current account deficit: Absorption (A) approach

- $M-X = (I - S) + (G - T)$ *The twin deficits*
- $M-X$ can be thought of as foreign savings (capital inflows) used to finance investment gap and budget deficit
- $Y = C + I + G + (X-M) = A + (X-M)$
- $(X-M) = Y - A$
- $(M-X) = A - Y$

When A exceeds Y , current account turns deficit.

Absorption (A) approach

- To reduce trade deficit, domestic absorption (**A**) must be curtailed, if Y cannot be raised.
- However, the absorption approach **ignores** the price effect (i.e., exchange rate)
- Define net exports as: $NX = X - M$
- $NX = 0$ at the trade balance equilibrium when $X = M$.

Determinants of net exports

$$NX = X(Y_f, \frac{eP_f}{P}) - M(\frac{eP_f}{P}, Y)$$

$$\text{Real exchange rate} = \frac{eP_f}{P}$$

$$e = \text{Baht} / \$$$

$$P_f = \text{Foreign price}$$

$$Y_f = \text{Foreign income}$$

Balance of Payments: Current Account and Capital Account (Financial Account)

$$BP = NX(Y, Y_f, \frac{eP_f}{P}) + CF(i - i_f - \frac{\Delta e}{e})$$

$\frac{\Delta e}{e}$ = expected depreciation

What are other determinants of CF?

Output growth, capital account openness, financial sector depth
Business environment (ICRG rating on investment risk) VIX,

Determinants of current account balances

- Growth (affecting savings and investment)
- Real interest rates
- Capital inflows (FDI, portfolio investment)
- Inflation
- Exchange rates
- Fiscal imbalance (Twin Deficits Hypothesis)
- *These determinants are intricately related.*

Growth, financial resource, and current account deficit

- Higher expected growth generates higher demand for credit required by investors to expand their plants.
- Higher growth increases permanent income and raises saving deposits.
- If loan growth outpaces deposit growth, interest rates tend to rise.

Why does strong growth lead to current account deficit?

- Output growth leads to strong demand for imports of raw materials and capital goods.
- If growth is not export-driven, growth can lead to deficit current account.
- On the other hand, weak economic growth is related current account surplus.

A conventional growth strategy

- Growth is the first priority, in particular export growth.
- Capital inflows propel private investment.
- Exchange rate appreciation may be postponed as much as possible.
- Exchange rate competitive (though unrealistic) exchange rates to drive exports.

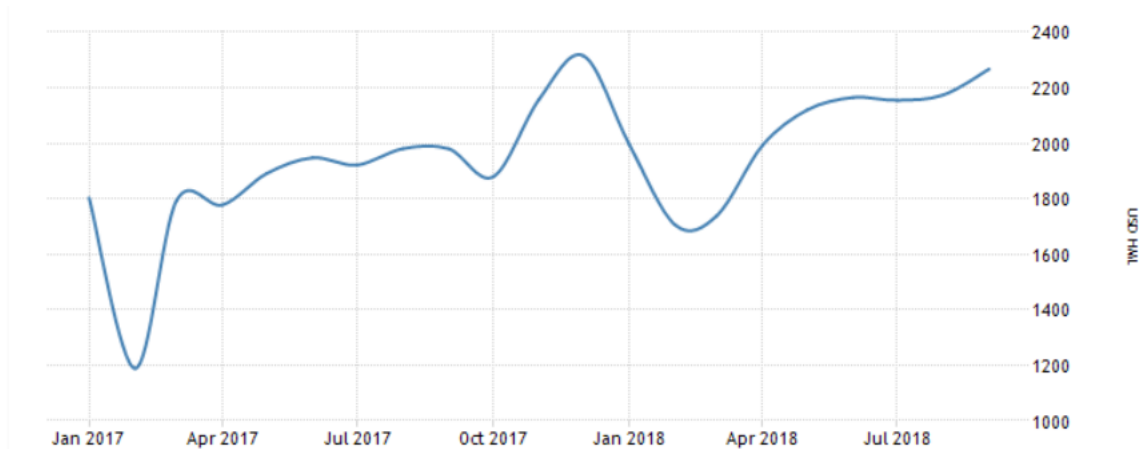
Growth engines downed

- During period of growth acceleration, private consumption and investment play a leading role.
- During growth slowdown, with the absence of fiscal stimulus, net exports are the **only** growth driver.
- But during the period 2014-2016, with weak consumption and investment demand, unfavorable world trade conditions, fiscal policy remain the only option to the Thai government.

Growth engines downed

- Compared to favorable external markets conditions and competitive exchange rates in 2007, next exports led the recovery in 2007
- Unlike the recovery of exports after 2010, the revival of exports did not happen, thanks to China's slowdown after 2015.
- The short rebound of Thailand's exports in 2018 can be attributed to China's trade volume growth, which might slow down as the impact of the trade war has come into full force started from the last quarter of 2018.

China Exports: Jan 2017-Sep 2018



Exports from China increased by 14.5 percent year-on-year to USD 226.69 billion in September 2018, after a 9.8% rise in July, beating market consensus of 8.9%.

It was the fastest growth in outbound shipments since February, due to strengthening global demand and despite intense trade tensions with the US.

Global rebalancing: It started with the huge trade deficit between the US and China

- When the issue of global rebalancing first emerged, it was focused squarely on the trade imbalance between **China and the United States**.
- However, the global economic turbulence of 2009-2010, and the subsequent economic fragility and uncertainty enveloping much of **the global economy** today, has begun to underscore how broad this issue really is.

Global rebalancing

- China has taken steps to contribute to possible rebalancing.
- China's currency has ***appreciated*** by over 30 percent against the US Dollar since 2005.
- And it has experienced some decline in its trade surplus in recent years.
- Nevertheless, the consumption share of GDP in China is still low (and even declined according to recent statistics).

Global rebalancing

- Further, the US still has a current account deficit amounting to about 3.1 percent of GDP.
- In 2011, the US maintained a trade deficit with at least 91 countries, most of which are in the developing world.
- Thailand is one of those countries on the watch list of the US government.

For global rebalancing between the two countries

$$(M - X) = (I - S) + (G - T)$$

For the U.S. to cut down trade deficit with China, private and public saving must rise: lower domestic consumption, the US government must tax more and spend less (Lower absorption)

For China to cut down trade surplus with the U.S., private and public saving must fall: higher domestic consumption (Higher absorption)

The Chinese government's actions

- The government has started to tackle several ingrained problems.
- After a long period of **overproduction** of steel and coal, a campaign to close unused capacity restrained output and pushed up prices.
- To **reduce** the **property overhang**, local governments bought millions of unsold homes from developers and gave them to poorer citizens.

Maturing Chinese Economy

- Growth is bound to slow over time as China gets richer, but structural changes are also making growth more stable.
- Thanks in part to a falling working-age population, which peaked in 2011.
- This, in turn, is rebalancing the economy.
- Excessive reliance on investment is giving way to **consumption**.
- And heavy industry is giving way to **services**, which now account for more than half of GDP, up from a third two decades ago.

4. U.S.-China Trade War Tariffs , 2018

A game of chicken

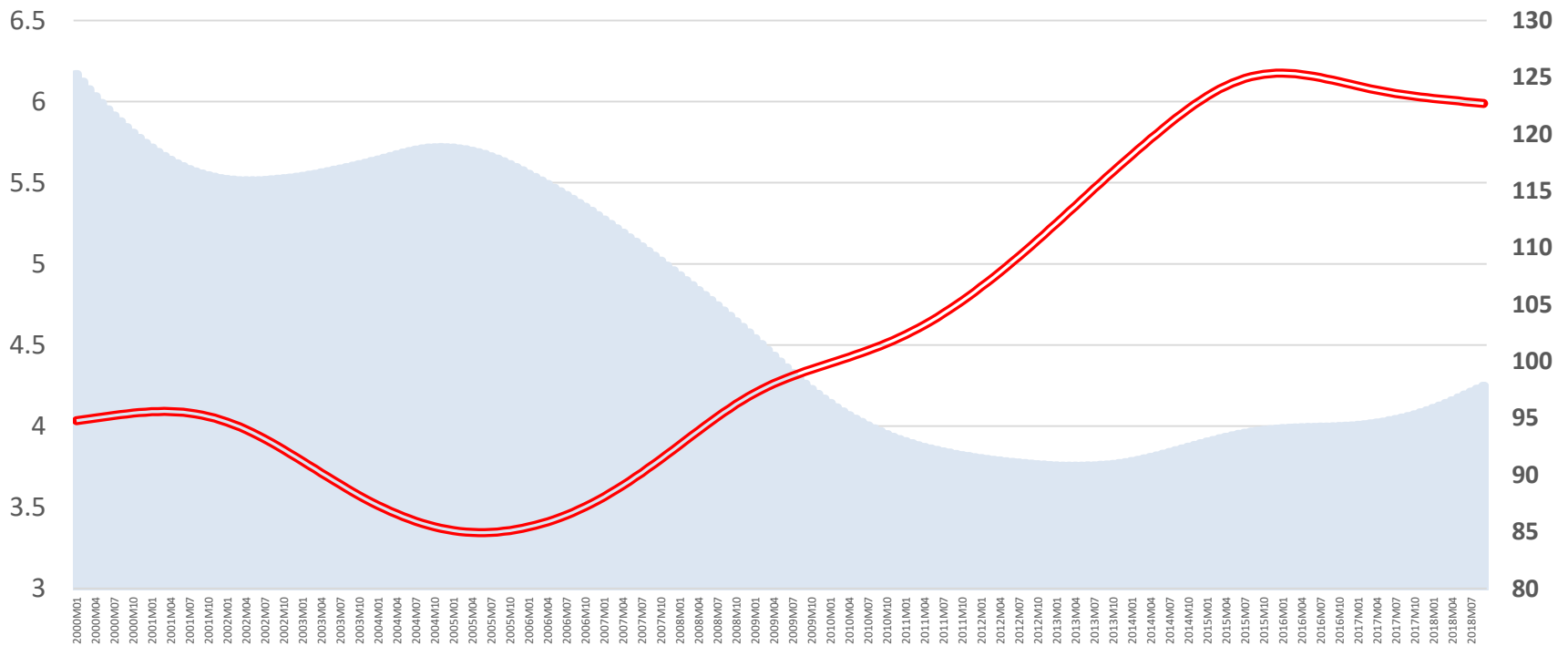
Table 1: Key Dates in U.S.-China 2018 Tariff Implementation under Section 301 Case

EFFECTIVE DATE	ACTION	TARIFF DETAILS
ROUND 1: JULY 6, 2018	U.S. imposes 25% tariff on \$34 billion in Chinese imports	Includes products identified as containing "industrially significant technology"
	China imposes 25% tariff on \$34 billion in U.S. imports	Includes agricultural goods, autos and auto parts, and aquatic products
ROUND 2: AUGUST 23, 2018	U.S. imposes 25% tariff on \$16 billion in Chinese imports	Includes products identified as benefiting from Chinese industrial policies including 'Made in China 2025'
	China imposes 25% tariff on \$16 billion in U.S. imports	Includes chemical products, medical equipment, and energy products
ROUND 3: SEPTEMBER 24, 2018	U.S. imposes 10% tariff on \$200 billion in Chinese imports	Wide range of goods including tobacco, chemicals, small manufactures
	China imposes 5-10% tariffs on \$60 billion in U.S. imports	Includes agricultural, food, chemical, textile, metal, and electrical equipment products
ROUND 4: TO BE DETERMINED	U.S. threatened to raise the 10% tariff on \$200 billion in Chinese imports to 25% if no agreement reached	Includes same product list at Round 3.

Source: U.S. Trade Representative's Office, Ministry of Commerce.

The U.S. trade deficit with China

Trends of the U.S. trade deficit and Renminbi REER



Source: Federal Reserve Bank

U.S. Trade Deficit

Renminbi REER

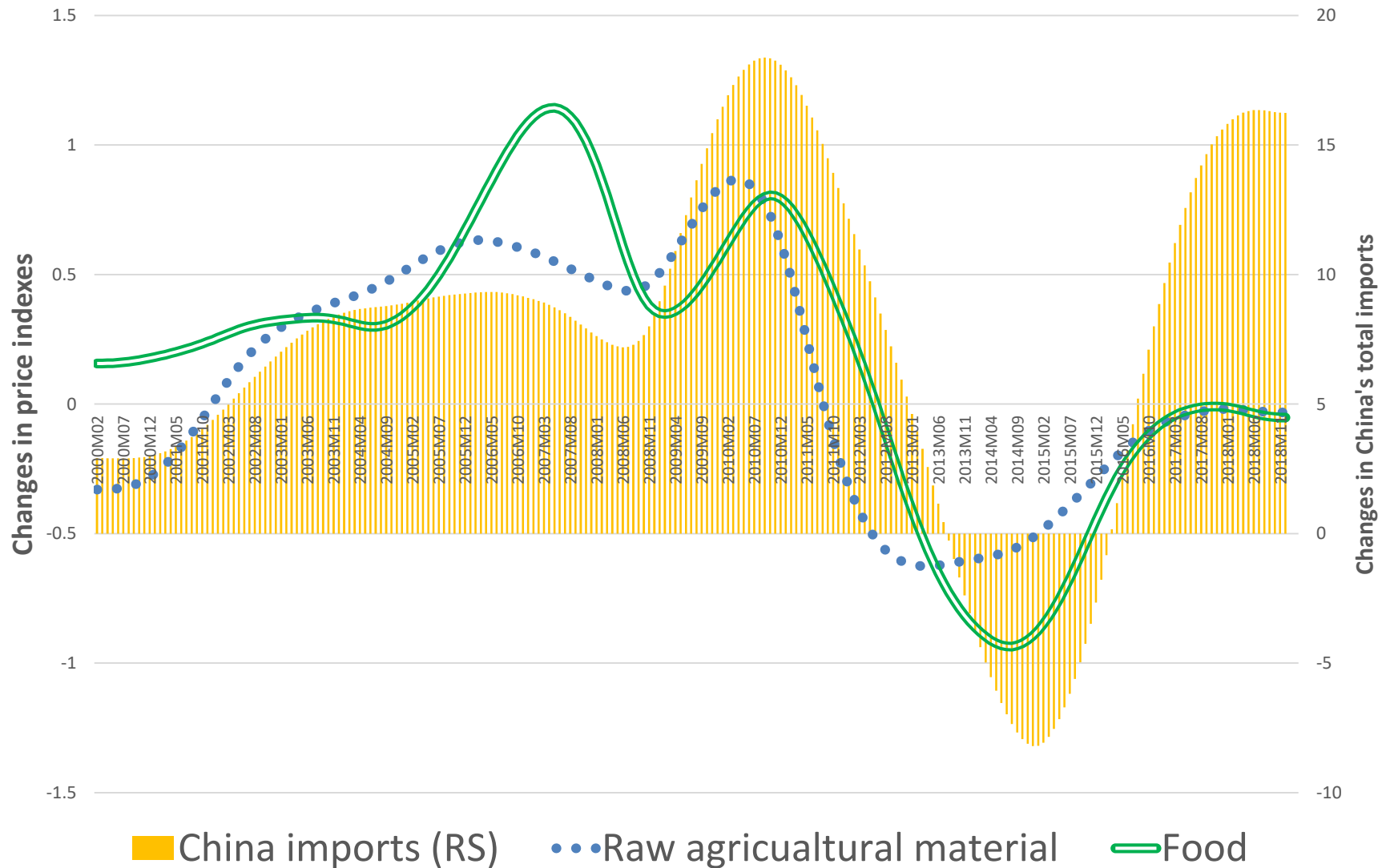
In nominal time, growth was above 10%



The Trade Conflict and China's strategy

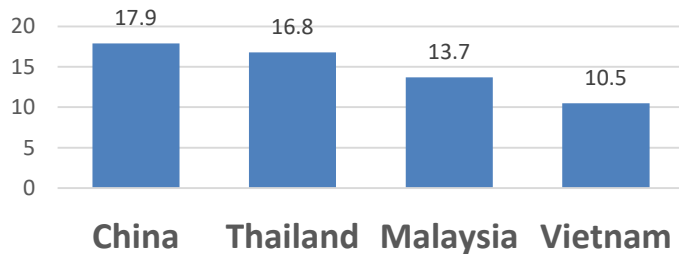
- The conflict with Washington has prompted Chinese leaders to step up a marathon effort to encourage *self-sustaining growth driven by domestic consumption and reduce reliance on exports and investment*.
- Beijing has cut tariffs, promised to lift curbs on foreign ownership of auto producers and taken other steps to rev up growth.
- But leaders have refused to scrap plans such as "Made in China 2025," which calls for state-led creation of Chinese champions in robotics and other technologies.

Changes in trends of commodity price indexes and China's total imports

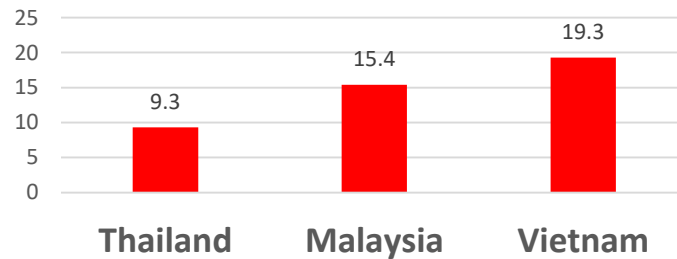


Market exposures to shocks in exports of electrical machinery and equipment (% total exports in each country)

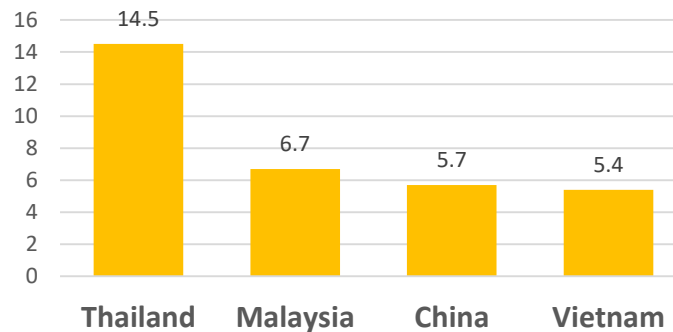
Exposure to the U.S. market



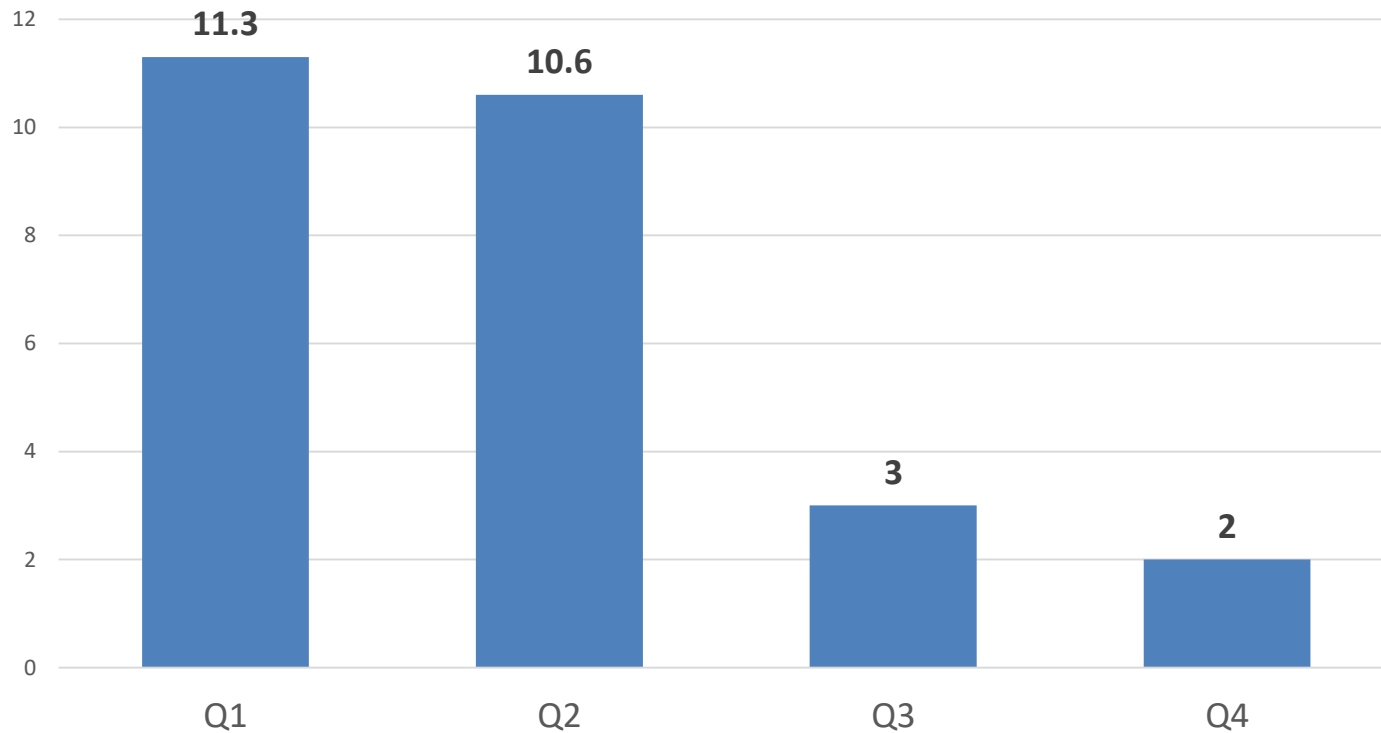
Export exposure to the Chinese market



Exposure to the Japanese market

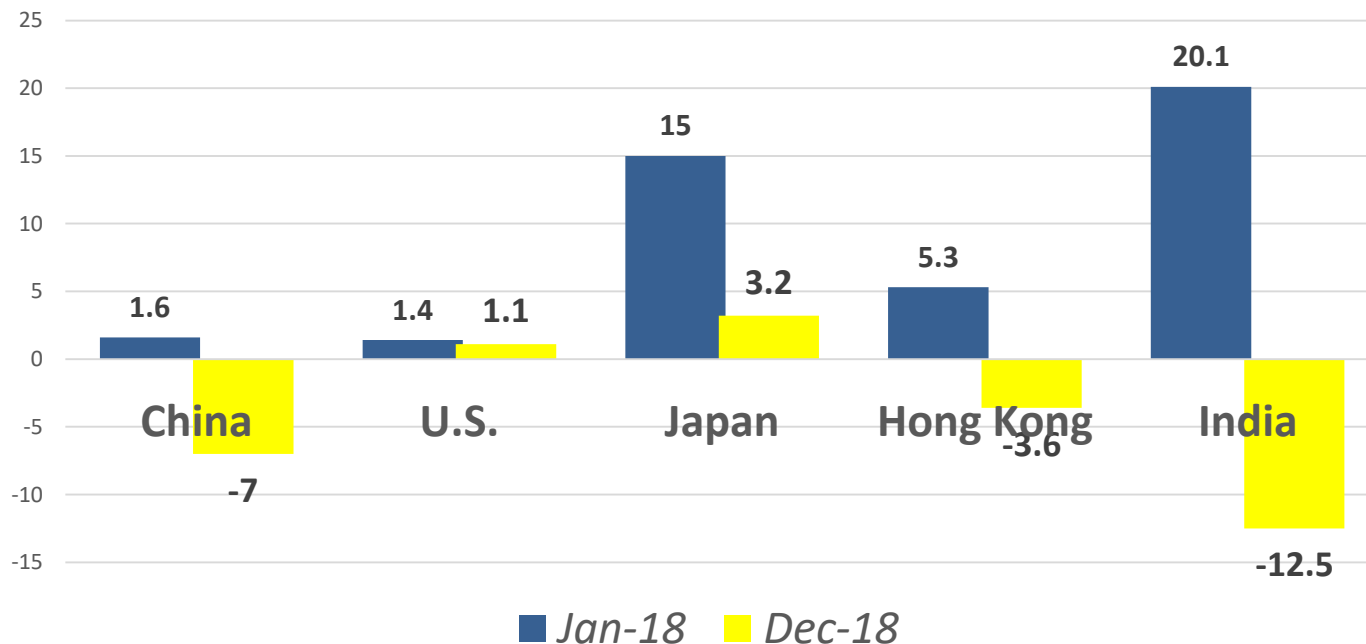


Thailand's export growth in 2018: 6.7 % (Quarter-on-quarter growth)



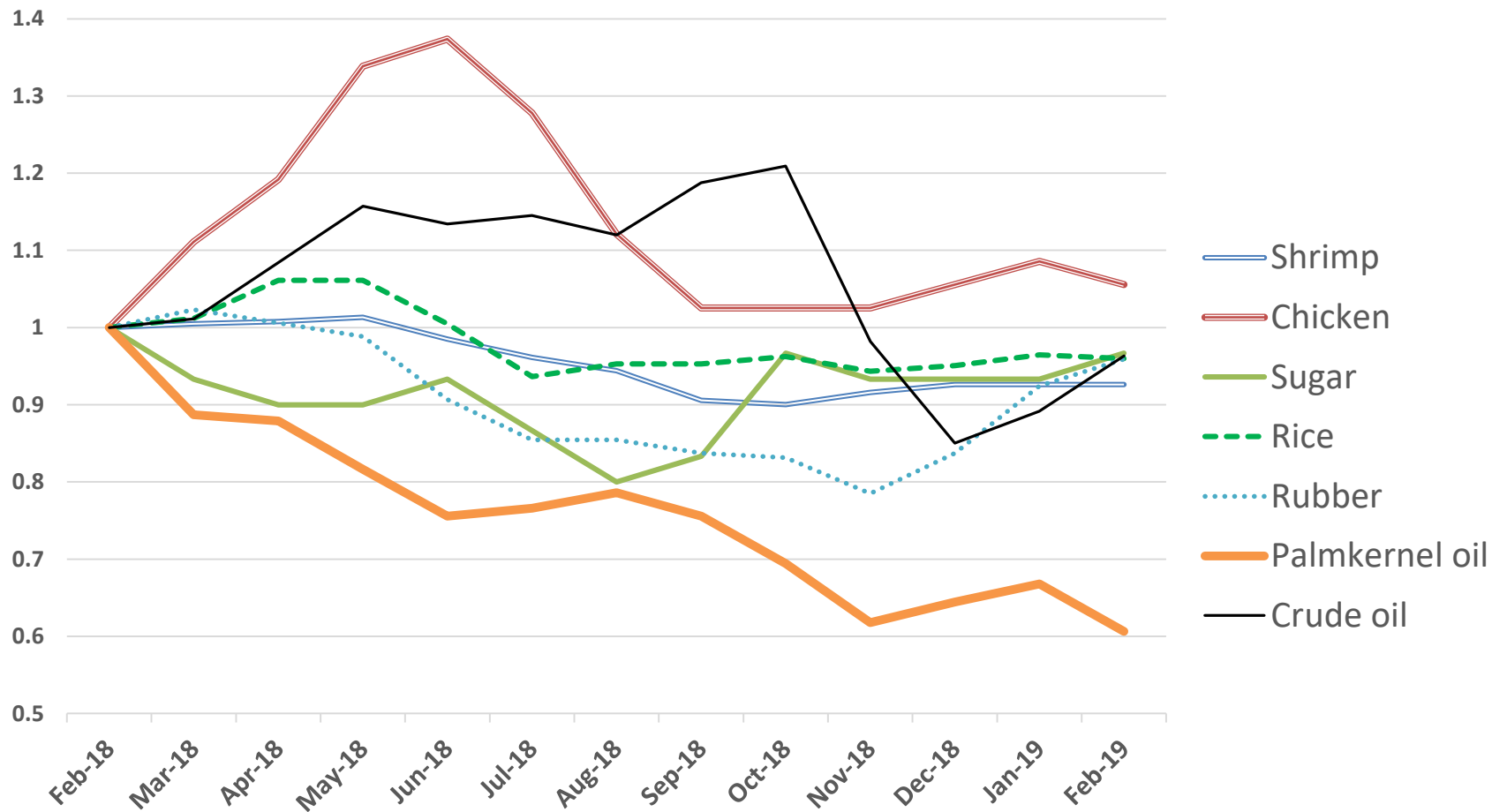
Thailand's export growth in 2018

Beginning and year-end growth rates (year-on-year)



Declining world commodity prices

January 2018=100



Source: Mudi Index

Palm oil is a close substitute to soybeans

Impacts of the trade war

- A full-blown trade war between the U.S. and China would immediately generate a negative impact on Thailand's output growth.
- The adverse effect will be long-lasting. The impulse response functions indicate that the reduction in the U.S. imports from China causes greater output losses for Thailand than when China retaliates the US by imposing import restrictions.
- The quantitative simulation results from the model indicate that the country which imposes trade barriers to other trading partners would be less well-off due to reducing output growth effect.

The Trump tariffs

- Some of the Trump tariffs could remain even after the conclusion of the trade deal between the U.S. and China (Ratchet effect)
- The chicken tax of 25% on light trucks imposed in 1964 still remains until today and it has shielded the U.S. car manufacturers from imports of one-ton pickup trucks from Thailand.
- The slowdown in the U.S. economy delays the Fed's interest normalization policy, causing capital inflows and appreciation of regional currencies

Indirect impact of the trade war

- The trade war dampens consumer confidence and depress investor sentiment, exacerbating the slowdown of the global growth
- If stock markets falls because of the bad news from trade disputes, the wealth effect would further reduce private spending.
- Due to a significant slowdown in China growth, commodity prices fall, decelerates the speed of poverty reduction and complicates income distribution issues.

Conclusions

- The indirect impact of the Trump tariffs is on the global slowdown, particularly in Thailand's major trading partners.
- The negative effect on output is stronger than the diversion effect that might occur from substitution and diversion effects.
- Thailand's GDP responds positively to output expansion in the US, China, and Japan.
- The negative impact on GDP will be higher if we incorporate the negative impact of global growth deceleration on consumer confidence and investor sentiment on aggregate spending.

Concluding remarks

- The policy implication is that stimulus policy packages of these large economies can ameliorate the contractionary effect of the trade war.
- Unless these economies sustain high growth, other countries in the region will also experience growth slowdown.
- Since ASEAN economies have a different degree of vulnerability to trade shocks, the relative contractional impact of the trade war would hinge on the individual country's international trade exposure as well as domestic policy responses.