Country trade view China

[Trends in global trade]

General Markets Analysis – July 2016

Summary

After accelerating from 8.5% in the 1990s to an average growth rate of 11.5% in the 2000s , economic growth in China currently hovers around 6.5%, a pace ING believes China can sustain through the current decade.

China's economy is slowly rebalancing towards more consumption-driven growth, at the expense of exports. We expect the share of investment in the economy to decline as well, provided the over-investment in manufacturing established during the 2009-10 credit boom, is reversed. There are concerning signals that multinationals, such as Dutch enterprises, are increasingly hesitant to do business in China. Fear of cyber theft, intellectual property rights laws and unequal treatment of domestic and foreign firms by the Chinese government are among their concerns.

The slowdown in the value of exports and especially imports in 2015 was, to a large extent, due to falling commodity prices, but a decline in volume growth in the second half of last year also contributed. Manufacturing weakness exerted downward pressure on Chinese exports and imports (commodities and intermediate products). Spending growth outside of China slowed. In China itself, the housing correction and slowdown in infrastructure investment growth cooled spending.

There is a structural element to the slowdown in China's trade growth as well. Foreign suppliers of intermediate goods are increasingly being replaced by Chinese suppliers. Along with the existing overcapacity within the Chinese manufacturing industry, it is becoming clear that Chinese supply is driving out part of the supply from other countries. Imports from Korea seem to have been hit by this (graph on page 7).

ING forecasts a gradual trade recovery in the years to come, after the 2015 contraction. Exports are expected to recover within a year. For imports, it may take nearly three years to reach the 2014 level, according to our forecasts (see graph). Although the estimated growth rate of goods imports exceeds that of exports, exports are still growing faster by value. This is because, in absolute figures, the value of exports exceeds the value of imports. Consequently, the goods trade surplus will continue to expand in coming years.

Despite a deficit in services trade, the total trade surplus will continue to expand as well, in our view.

It should be said, however, that the slowdown in trade growth during the first months of this year, subjects this forecast recovery in US$ trade values to the risk of being pushed out in time.

Related to the long period of trade and current account surpluses, China has accumulated sizeable foreign currency reserves worth over USD3.19tr as of May 2016. However, in 2015, reserves declined 17.5%. Total (public and private) Chinese debt is estimated at the equivalent of USD25tr, or 237% of GDP in 2015), of which, according to official sources, external debt was USD1.4tr.

Chinese trade in goods (US$ bn)

About International Trade Analysis at ING

ING International Trade Analysis aims to help ING's (inter)national clients develop their knowledge and capabilities for doing business across borders and contribute to the public debate on internationalisation. We do this by providing insights on current and future trends in the business climate of countries and in international trade developments worldwide.

Economic profile

Economy

Expectations	2016	2017	2018
GDP growth (Real; %)	6.5	6.5	6.5
GDP nominal (USDbn)	11,383.0	12,263.4	13,338.2
GDP per capita (USD)	8,239.9	8,833.3	9,599.9
Exchange rate, CNY/USD	6.54	6.50	-
Inflation (%)	2.0	1.4	1.0
GDP composition by sector	**1990**	**2000**	**2015**
Agriculture (%)	27.0	15.0	9.5
Industry (%)	41.0	45.5	42.9
Services (%)	32.0	39.5	47.6

Population

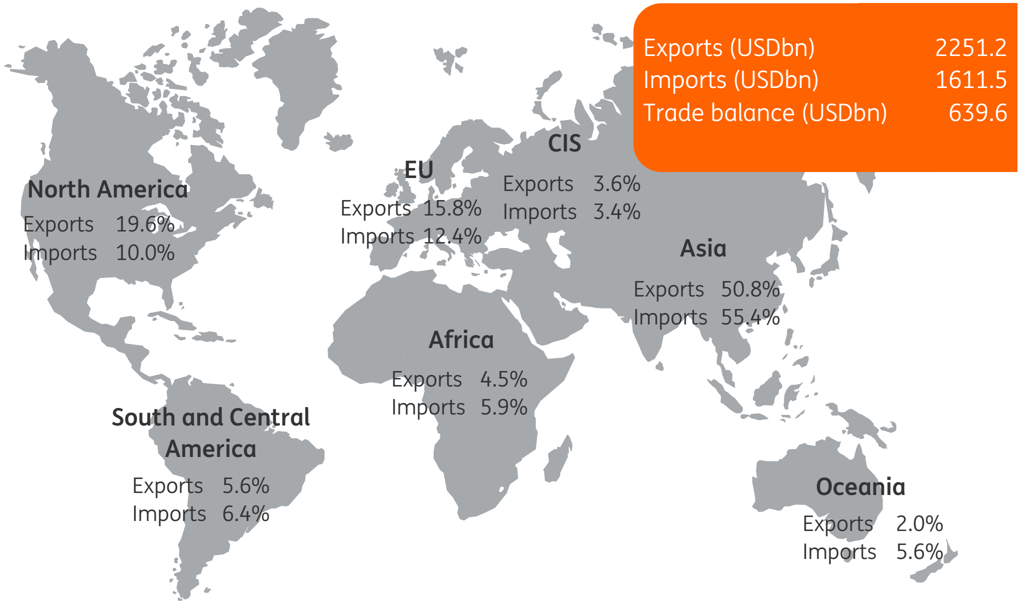
	2015
Population (m)	1,367.49
Unemployment rate (average; %)	4.2
65 years and over (as a % of total population)	10.0

Other indicators

	2014	2015
Competitiveness rank – World Economic Forum	28/140	28/140
Ease of doing business rank – World Bank	83/189	84/189
Exports as a % of GDP	21.6	19.9
Credit rating		
S&P		AA– Neg.
Moody's		Aa3 - Neg.
Fitch		A+ Stable

China trade profile: composition (USDbn), destination of Chinese exports and origins of imported goods (% of total), 2014

Product group	Exports	Imports
Office, telecom & electrical equipment	$920.8	$353.2
Other manufactured goods	$601.1	$197.8
Fuels	$22.6	$207.9
Textiles	$243.6	$28.8
Industrial machinery	$172.2	$124.3
Chemicals	$115.6	$162.2
Ores & metals	$27.3	$186.2
Road vehicles & transport equipment	$56.2	$119.6
Basic food	$44.5	$86.4
Agriculture & raw materials	$7.0	$43.3
Pharmaceuticals	$12.0	$17.8
Beverages & tobacco	$2.6	$3.8
Other products	$25.7	$80.1



Sources: ING, IMF World Economic Outlook, UNCTAD, Trading Economics, national sources

Product group amounts in USDbn, and for the 32 partner countries distinguished

China's economic environment

Transformation of the Asian dragon

After an acceleration in China's economic growth rates to 11.5% in the 2000s, growth has slowed to 6.5% currently, a pace ING believes China can sustain through this decade.

The economy is gradually shifting from export-led growth towards consumption-driven growth, further altering contributions made by the agricultural, industrial and service sectors to GDP. While the first two are expected to decline in importance, the last one is expected to increase its share.

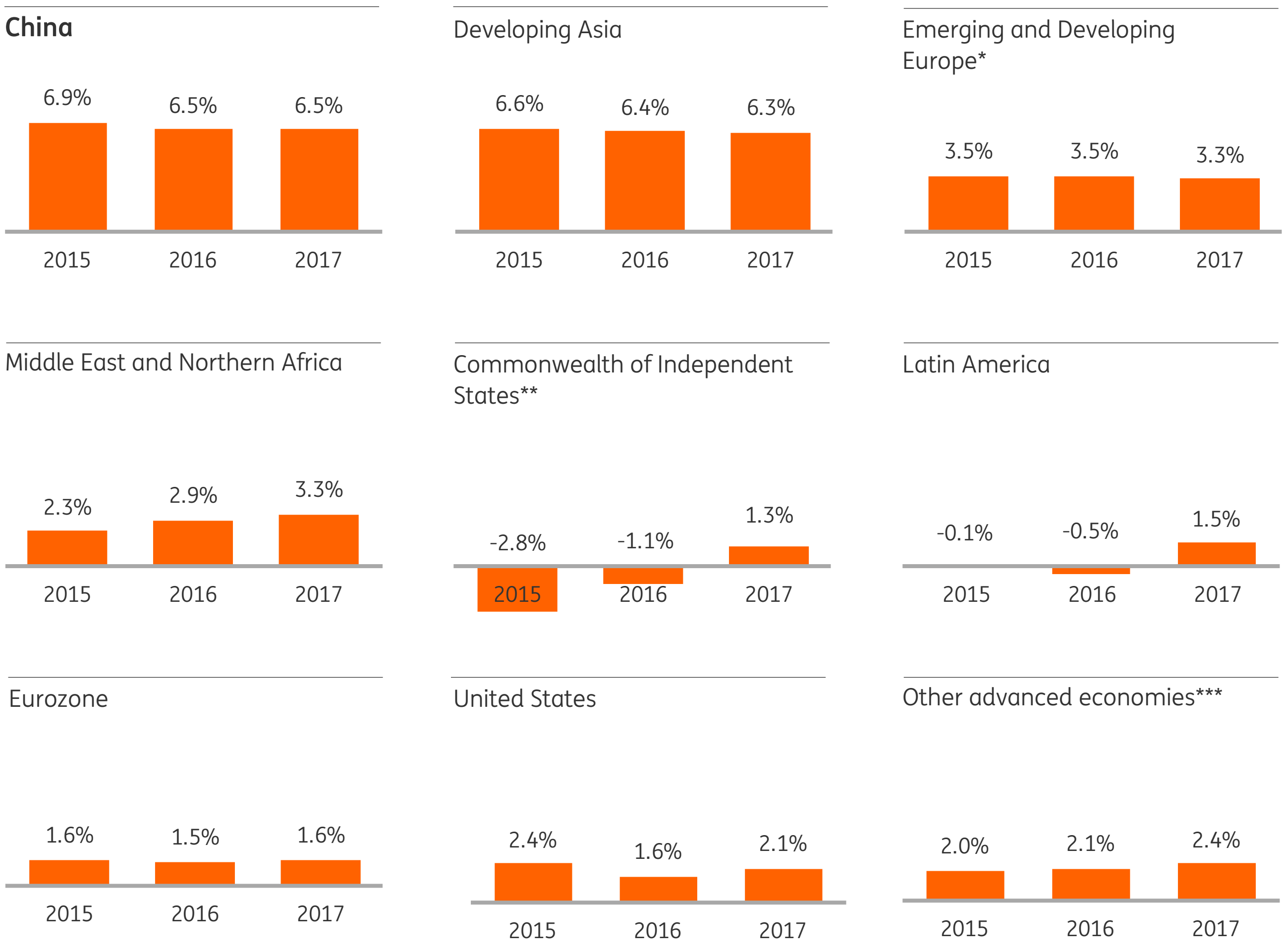
The Chinese government has recently implemented numerous reforms and investment programmes. For instance, supply-side policies were introduced to curtail the persistent over-supply and excess labour in some Chinese state-owned companies (eg, coal and steel producers). ING, therefore, believes that the over-investment in manufacturing, which occurred during the 2009-10 credit boom, will reverse.

In the wake of a fast-aging population and shrinking work force, the one-child policy has been abolished. In 2000, only 6.7% of the total population was over 65 years, while as of 2014 it was 9.7% (much higher than in other countries in emerging Asia, such as in India (5.5%).

Demand-side programmes, too, have been implemented. These range from expansionary monetary policy to targeted fiscal policies that aim to increase investments in high-tech/ green sectors.

China has currency reserves worth USD3.19tr (May 2016). However, reserves declined 17.5% last year. Public and private debt equates to USD25tr, or 237% of 2015 GDP. Of this, according to official sources, external debt made up USD1.4tr. Much of this is corporate debt. Chinese authorities address the issue by pushing acquisitions of debt-loaded zombie corporations by healthier corporations.

Expected real GDP growth



*Albania, Bulgaria, Croatia, Hungary, Lithuania, Macedonia, Montenegro, Poland, Romania, Serbia and Turkey

**Azerbaijan, Armenia, Belarus, Georgia, Kazakhstan, Kyrgyzstan, Moldova, Russia, Tajikistan, Turkmenistan, Uzbekistan and Ukraine

***Australia, Czech Republic, Denmark, Hong Kong SAR, Iceland, Israel, Korea, New Zealand, Norway, San Marino, Singapore, Sweden, Switzerland and Taiwan.

Source: ING Forecasts – May 2016, IMF World Economic Outlook – April 2016

Trade forecasts

Trade will recover gradually

According to the latest figures published by UNCTAD, China experienced negative growth in nominal exports and imports, of –2.9% and –14.2%, respectively, in 2015.

There are several cyclical reasons for the sluggish 2015 performance in terms of value. First, plunging oil prices caused a decline. Second, growth in spending in the rest of the world slowed, causing manufacturing weakness to exert downward pressure on trade in volume terms. Third, China's housing market faced a correction and the infrastructure investment growth slowdown cooled spending.

Further, persistent overcapacity within Chinese manufacturing industry led to excess supply of Chinese goods, such as office, telecom & electronics supplies, in the domestic market. Hence, similar goods were imported less from counties like Korea.

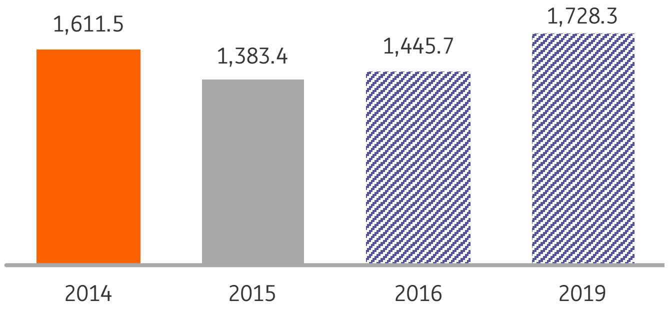
Structural factors also play a role. Chinese manufacturers are increasingly using domestic suppliers, and the economy is shifting towards more consumption-driven growth. Both trends reduce imports. As a result, China's import ratio (imports/GDP) has been declining since 2006. Although part of this is a result of prices of traded goods trailing the price level of GDP, it reflects the structural shift taking place within the economy.

ING predicts a gradual recovery of growth in the value of goods imported and exported. The cautious oil price recovery will drive Chinese import values somewhat higher in the coming years and also translates into higher prices for export products.

For 2016-19, export and import values of goods are expected to grow by a respective 4.8% and 5.7% annually. It should be noted that these forecasts are subject to downward revision, due to the slowdown of trade in the first few months of 2016.

Though China runs an increasing services trade deficit, the total trade balance is in surplus. The deficit is more than offset by a still-growing trade surplus in goods, which is expected to continue to expand in the years to come.

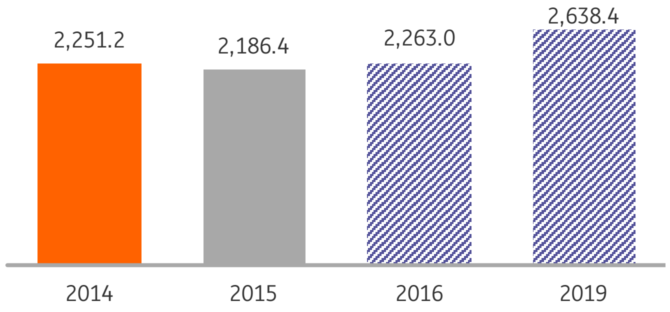
Total imports of goods, USDbn



China's imports of goods	
World ranking, 2014	2
Average expected nominal growth rate, 2016-19 (USD)*	5.7%

*Calculated as a compound annual growth rate (CAGR)
Source: UNCTAD Data, ING forecasts

Total exports of goods, USDbn



China's exports of goods	
World Ranking, 2014	1
Average expected nominal growth rate, 2016-19 (USD)*	4.8%

*Calculated as Compound Annual Growth Rate (CAGR)
Source: UNCTAD Data, ING Forecasts

Imports by product group

Mixed outlook Chinese import demand

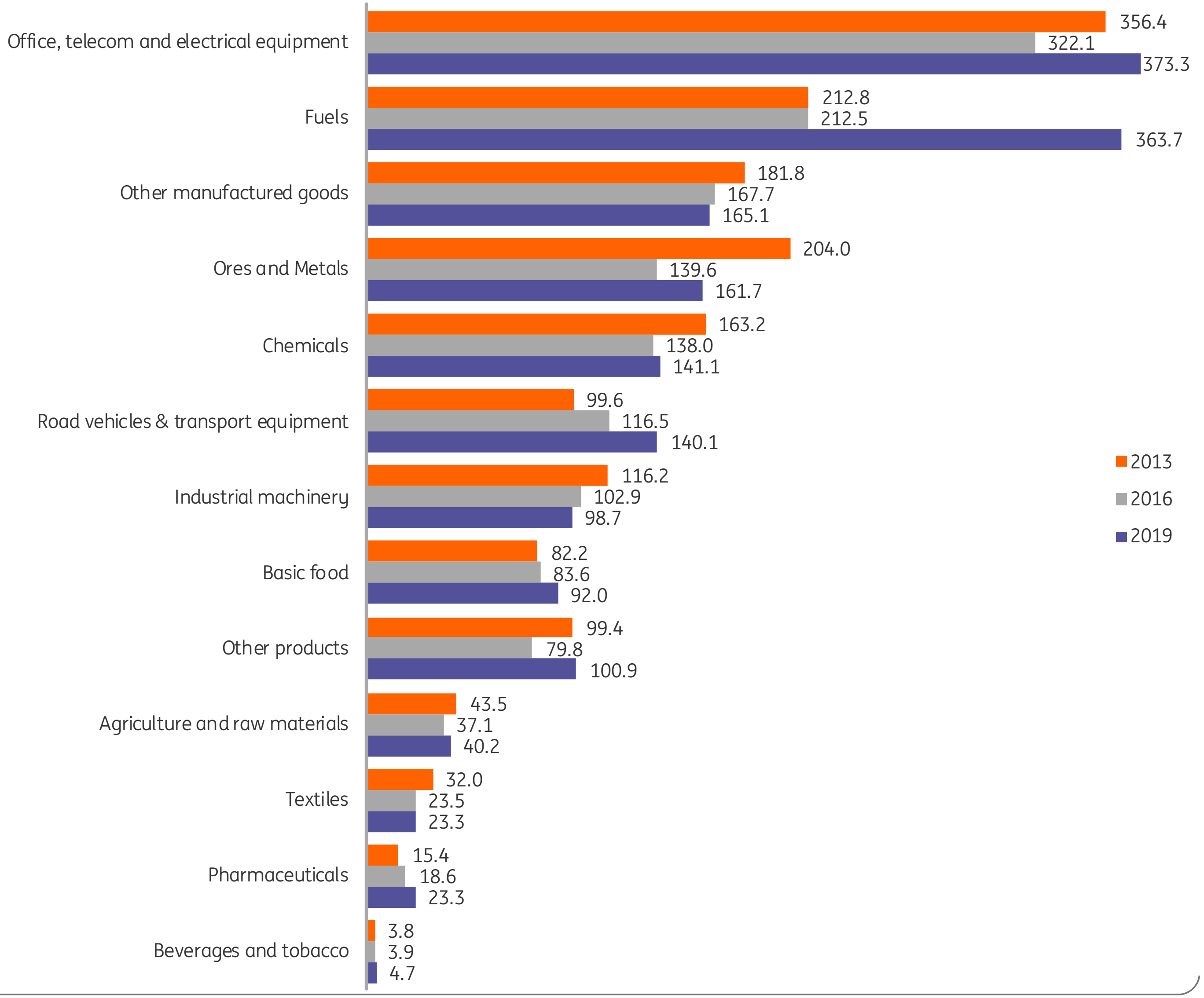
For 2013-15, many product groups show a decline in turnover of exports to China. Declines have been strongest for ores & metals, textiles and chemicals, with annual growth rates of -11.9%, -9.8%, and -5.4%, respectively. Exceptions to the contractions are road vehicles & transport equipment (+5.4%) and pharmaceuticals (+6.6%).

Remarkably, the value of fuel imports did not decline, despite a sharp decline in the oil price. Hence, imports in terms of volumes have continued to increase. As well as a forecast increase in the oil price, a continued increase in volumes is another reason for the expected increase in the value of fuel imports in the period up to 2019 (annual growth of 19.6%).

Also, for other product categories, ING forecasts higher import growth for 2016-19. The highest increases are expected in pharmaceuticals (+7.7%), beverages & tobacco (+7.1%) and road vehicles & transport equipment (+6.3%). The strong rise across these categories is in line with China's shift from an export-driven (intermediate-goods-importing) economy towards a final-goods-consuming economy.

The forecast of an ongoing contraction of imported industrial machinery is also in line with the rebalancing of the economy away from (industrial) exports.

Imports by product groups, 2013-19 (rankings based on 2016 levels; USDbn)



Imports by origin

United States expected to become the main source of Chinese imports

By 2019, the US is expected to overtake Korea as the main supplier of Chinese imports. Korea is expected to drop to third place behind Taiwan, and in front of Iraq.

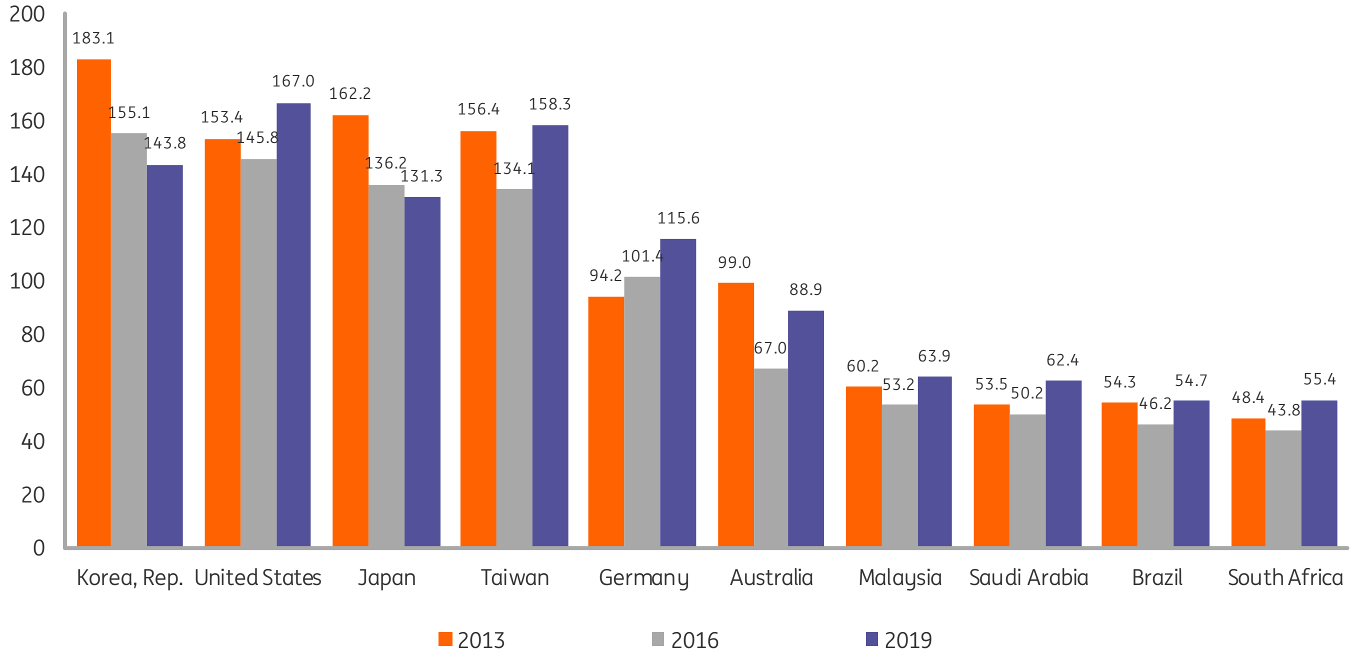
The rebalancing of the Chinese economy is the driving force behind the rise of the US as the future main external supplier to China, in place of Korea.

Korea's manufacturing goods, on the other hand, are similar to Chinese goods and suffer from the tendency to substitute foreign intermediate goods with domestic ones. Also, the excess capacity of Chinese firms appears to flood domestic markets, driving out Korean products. On top of this, rising Korean labour costs have made Korean goods less competitive. In addition, recent reports suggest that a fear of cyber theft is making foreign manufacturers of telecom and other IT-related products less eager to sell in the Chinese market.

The US is primarily a producer of final goods. Hence, as China's economy transforms, demand for American final goods (such as road vehicles & transport equipment and office, telecom & electrical equipment) increases. ING forecasts that, within product groups in which Chinese imports from Korea decline, imports from the US will grow.

China's main bilateral import flows, at product level in 2016, are likely to be Taiwanese and Korean office, telecom & electrical equipment. Apart from final goods, Korea and Taiwan are two of China's most important suppliers of intermediate goods. As stated previously, Iraq is forecast to become China's fourth-largest import partner by 2019. This is due to the forecast sharp increase in bilateral fuel imports over 2016-19.

Main origins of imports, 2013-19 (rankings based on 2016 levels; USDbn)



Top 5 largest import flows by product group and country of origin (USDbn)

China					
Product group	Origin	2013	2016	2019	CAGR* 2016 -19 (%)
Office, telecom and electrical equipment	Taiwan	91.2	84.1	115.4	11.1
Office, telecom and electrical equipment	Korea, Rep. of	81.3	74.8	74.9	0.0
Ores and metals	Australia	67.3	44.2	64.3	13.3
Fuels	Saudi Arabia	43.3	39.8	49.6	7.6
Fuels	Iraq	18.0	38.5	141.3	54.2

Sources: IMF World Economic Outlook, UNCTAD, national statistical services, rating agencies, ING

*Compound average growth rate

Exports by product group

Chinese exports continue to grow

China's top 3 export groups (office, telecom & electrical equipment, other manufactured goods and textiles) represent 80% of total exports. Despite the rebalancing of the economy, the value of the top 3 exports reflects that China is still the world's leading exporter of manufactured goods.

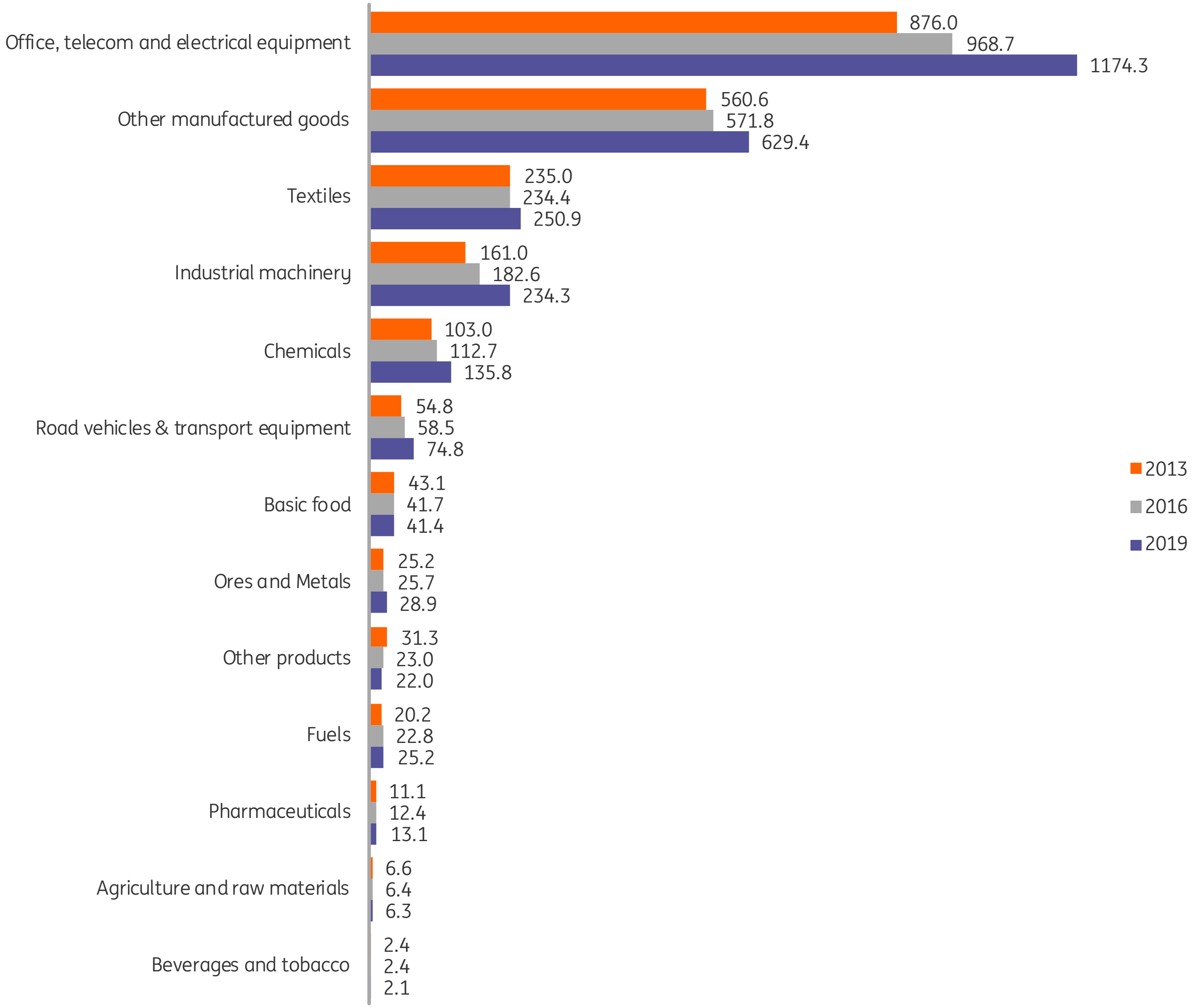
Despite the contraction in 2015, exports expanded over 2013-15. In exports by product group, a similar trend can be observed. Hence, contrary to imports, exports showed a net increase in value.

ING anticipates that exports will grow gradually during 2016-19, but less than forecast GDP growth, reflecting a continuation of the shift towards less export-driven growth. In part, this increase will be the effect of higher prices, reflecting higher forecast prices for inputs like commodities. China's largest export product group, being office, telecom & electrical equipment (+6.6%), is due to remain the predominant group. This product group is forecast to represent 45% of China's total exports in 2019, vs 42% in 2013. The increase of this and other export groups coincides with the rise of large Chinese (electronics) manufacturers, such as Lenovo and Huawei.

The highest annual increases in exports are expected for industrial machinery (8.7%), road vehicles & transport equipment (8.5%) and chemicals (6.4%). Declines are due in: beverages & tobacco (4.0%) and agriculture & raw mat. (0.9%).

Interestingly, despite rising production costs in China and the subsequent relocation of some of the textile production to other countries (eg, Vietnam), Chinese textile exports are forecast to increase. It points to industrial upgrading by Chinese textile producers, from basic textile production to more advanced production, thereby moving up the value chain. This is in line with the fact that the strong rise of exports is primarily to countries with relatively high quality standards like the US, France, Italy and Spain.

Exports by product groups, 2013-19 (rankings based on 2016 levels; USDbn)



Exports by destination

US remains at the top, India on way up

With China's top 10 export partners, exports to all destinations (except Korea) are forecast to rise during 2016–19. The United States is, and will remain, China's undisputed top export destination.

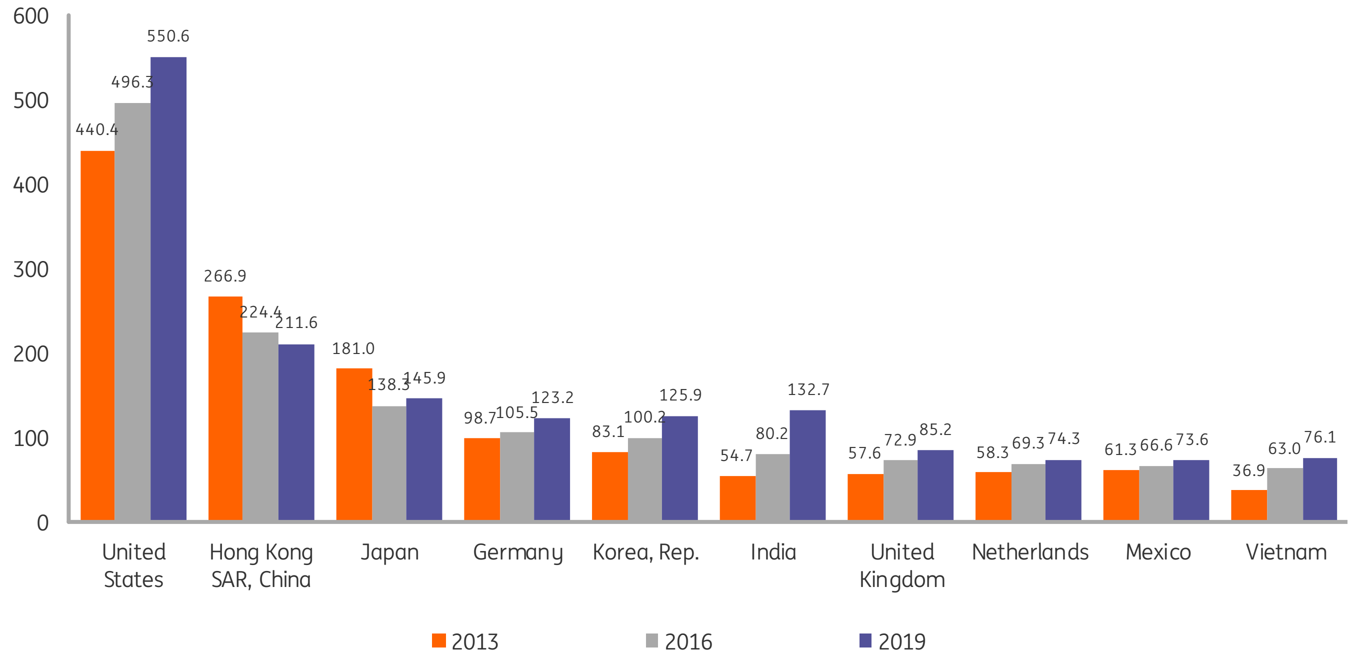
Exports to India show the fastest growth, however. Compared to 2013, Chinese exports to fast-growing India are estimated to more than double by 2019.

Official Chinese export figures suggest that exports to Hong Kong have increased rapidly. However, it is possible that China inflates official export data to conceal capital outflows.

ING forecasts that by 2019, exports to China's second-largest export destination, Hong Kong, will have been reduced. Hong Kong used to be China's gateway to the rest of the world. However, some Chinese mainland ports are now larger than that of Hong Kong. Whereas shipment volumes of such Chinese ports have been increasing, Hong Kong's shipment volumes have been decreasing (Worldshipping.org).

Of the top 5 largest bilateral export flows by product group, 4 out of 5 belong to the office, telecom & electrical equipment group. This is not very surprising, as office, telecom & electrical equipment represent over 40% of Chinese exports by value. A strong increase in demand for this product group is expected to come from Germany and the United States, where demand for Chinese office, telecom & electrical equipment is increasing by 11.7% and 6.2% per annum, respectively, on average.

Main destinations of exports, 2013-19 (rankings based on 2016 levels; USDbn)



Top 5 largest export flows by product group and country of destination (USDbn)

China					
Product group	Destination	2013	2016	2019	CAGR* 2016-19 (%)
Office, telecom and electrical equipment	United States	188.8	224.6	268.7	6.2
Other manufactured goods	United States	139.4	145.6	137.5	-1.9
Office, telecom and electrical equipment	Hong Kong	154.2	145.0	149.2	1.0
Office, telecom and electrical equipment	Japan	68.0	57.6	63.4	3.2
Office, telecom and electrical equipment	Germany	41.1	49.7	69.2	11.7

Sources: IMF World Economic Outlook, UNCTAD, national statistical services, rating agencies, ING

*Compound average growth rate

To find out more, please contact:

Marco Loonstra
International Trade Analysis
marco.loonstra@ing.nl

Raoul Leering
Head of International Trade Analysis
raoul.leering@ing.nl
+31 6 1330 3944

Tim Condon
Chief Economist Asia
tim.condon@asia.ing.com
+65 6263 6020

Robert Gunther
Sr. Communications & PR manager
robert.gunther@ing.nl
+31 6 5025 7879

Arjen Boukema
Sr. Communications & PR manager
arjen.boukema@ing.nl
+31 6 3064 8709