ASIA PERSPECTIVE

Insights: Quarter 2, 2020

China Economic Update Report

This Issue:

China's Economic Performance in Q2
Rising Tensions between China and Australia
China's New Digital Currency

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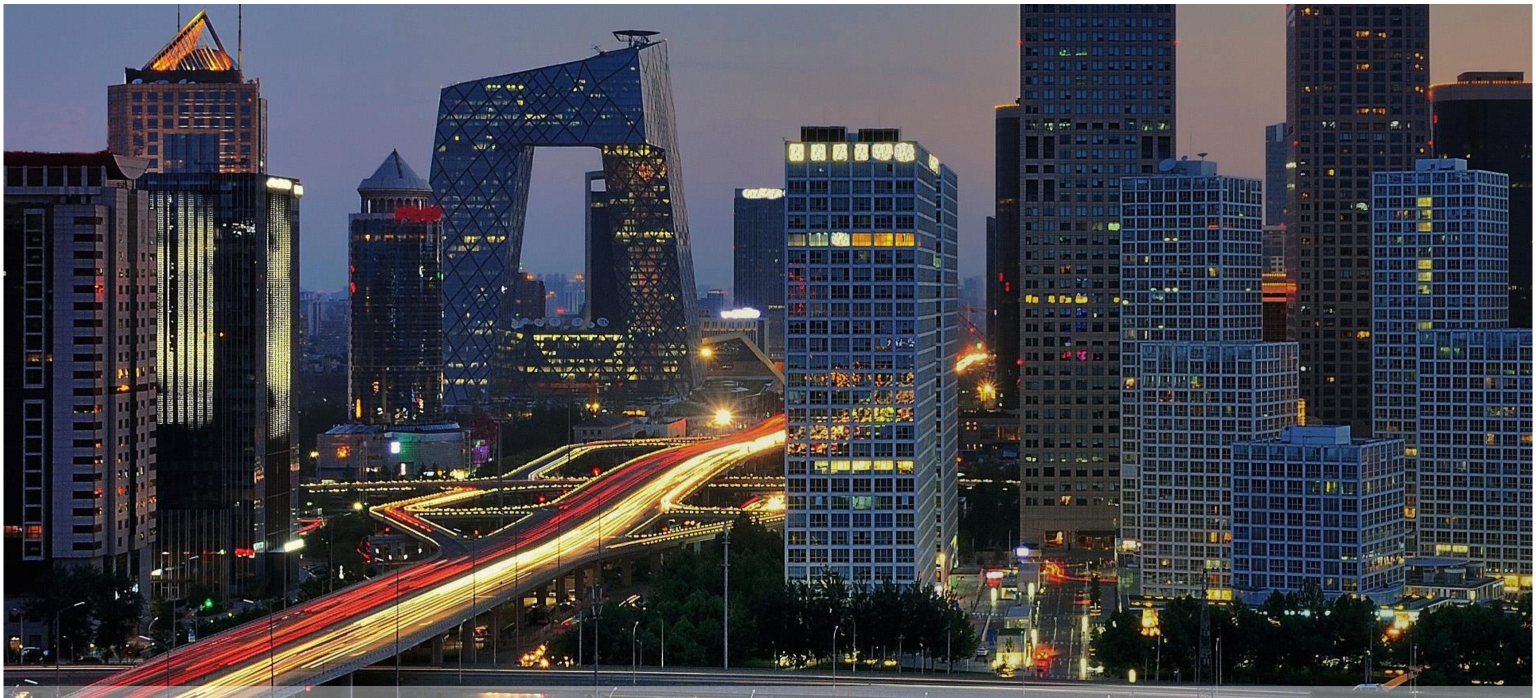


China's economy shows signs of recovery as the GDP grew 3.2% in Q2

After the GDP contraction of 6.8% in the first quarter of 2020, China has strived to become the first major economy to achieve positive economic growth amid the COVID-19 pandemic, and succeeding.

China's GDP grew by 3.2% (YoY) during April - June, exceeding the market consensus of a 2.5% expansion. The surge in infrastructure, cross-provincial travel, and industrial production are believed to be the main dynamics for this quick recovery. As virus control measures are gradually eased, and most of the economic activities back on track, China's GDP growth is expected to recover by around 5% in the last half of 2020.

China's service sector bounced back strongly in May as strict control measures were eased. The Caixin China General Manufacturing PMI has gone up from 49.4 to 51.2 in the second quarter, while the MoM retail sales increased 1.34% in June.

Despite all positive signs, there are obstacles to overcome before China can fully recover, such as external demands. Global demand accounts for 17% of China's economy, and its decreasing trend due to lockdowns and limited business activities is expected to cause severe damage to China's economy, regardless of the positive rise in domestic demand.

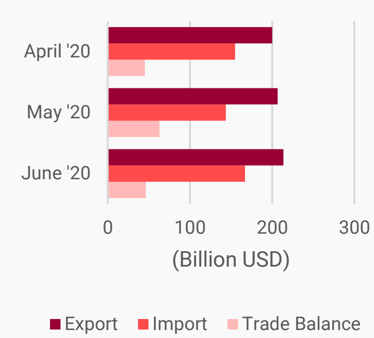
In May, China recorded the largest trade surplus since 1981

In April, China's export unexpectedly rose by 3.5% (YoY) while imports fell by 14.2% (YoY) due to deteriorating domestic demand and lower commodity prices. As a result, China's trade surplus widened to 45.34 billion USD, far beyond market expectations of a 9.7 billion surplus USD.

However, in May the surplus rose further, hitting 62.93 billion USD, marking China's largest monthly trade surplus since 1981, as exports dropped 3.3% while imports plunged 16.7% (YoY).

June saw the trade surplus going down to 46.42 billion USD as both exports and imports went up by 0.5% and 2.7% (YoY) respectively.

Trade balance of China in Q2 2020

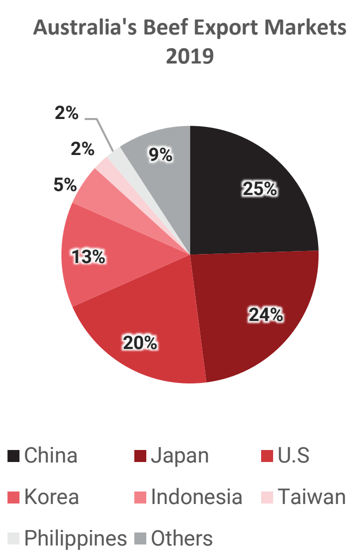


Rising Trade Tensions Between China and Australia

Relations between China and Australia were severely deteriorated in the second quarter as Australia added to growing pressure on China over its handling of the coronavirus, questioning and demanding an international inquiry into the virus' origins.

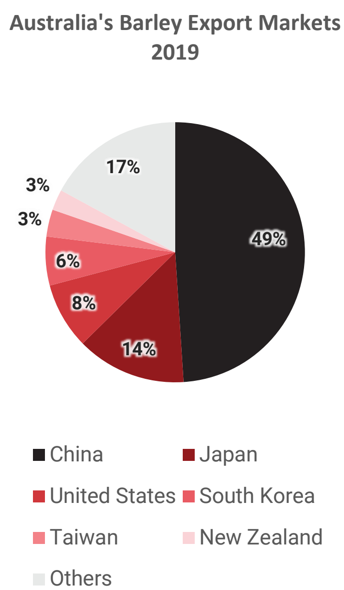
During this time, China has taken economic actions against Australia as a retaliation strategy, which negatively affected trade relations between the two countries. Specifically, China prohibited beef imports from four of Australia's largest meat processors and announced anti-dumping duties of 80.5% on Australian barley imports. Moreover, China is also considering more economic actions aiming at other Australian imports, including wine, dairy and fruit.

Since China is, by far, the largest trading partner of Australia, its recent movements have severely hit Australia's exports, especially agricultural commodities. The suspension of four big abattoirs instantly caused the total frozen and chilled beef exports from Australia to China to fall 30% between May and June. Thousands of jobs related to these meat processing facilities, and Australian farmers whose beef is used, were significantly affected.



Source: Meat and Livestock Australia, 2020

For Australia's barley exports, the situation is even worse. China is the biggest importer of Australian barley, which accounts for around 50% of the country's annual barley trade. Therefore, the new tariffs will completely halt shipments of barley to China, causing a total loss of at least 500 million AUD to the Australian grain industry.



Source: Trading Economics, 2020

On the other hand, the impact on China was really small as there are many alternatives to beef and barley imports across the world. Moreover, it is possible that China's restrictions on Australian beef and barley is a part of its plan to increase imports of these two agricultural products from the U.S to fulfill its commitments amid rising pressure from Washington over the phase one trade deal.

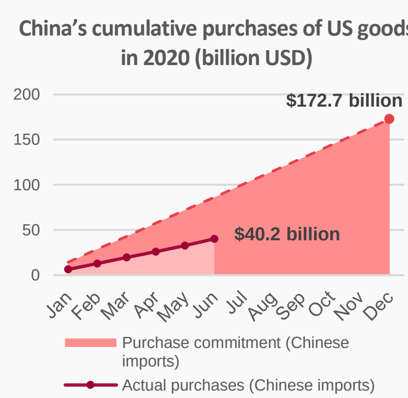
In response to China's actions against Australian beef, the Australian government is working hard together with industry leaders and relevant authorities to seek for solutions that would allow businesses to resume to normal operations as soon as possible. Meanwhile, the Australian government is trying to convince the Chinese government to drop the tariffs on barley imports, and instead work out a solution together with the Australian farming sector and industry. However, if no breakthrough is made anytime soon, it is possible that Australia will request the dispute to be resolved through the World Trade Organization.

China struggles to reach Phase One Deal targets amid growing tensions with the US

The Phase One Deal, a partial truce for the 18-month trade war between the US and China, came into effect mid-February this year. The deal requires China to increase its purchases by 200 billion USD (compared to baseline 2017) of agricultural and manufactured products as well as energy and services from the US over the next two years. In return, the US will relax its tariffs on 370 billion USD worth of Chinese imports.

However, since the Coronavirus outbreak occurred in China and became a global pandemic, the US President has accused China for mishandling the epidemic and threatened to terminate the deal if China does not meet the purchase commitment.

Although China has increased its purchases of US goods, records show that it is still falling behind the pace needed to meet the first-year goal of 172.7 billion USD (or an increase of 76.7 billion USD).



Source: Peterson Institute for International Economics.

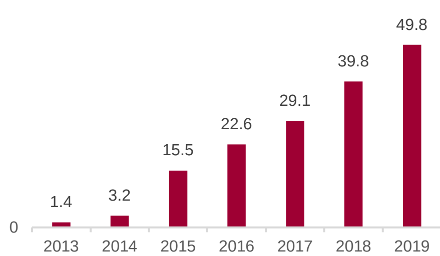
In June, Chinese purchases only reached 47% of their target, meaning they are far behind on the 2020 goal. The biggest contributor was manufactured goods, which accounted for 75.3% of China's purchases from the US in June.

China Introduces New Digital Currency

In April 2020, China introduced a pilot program for the official digital version of its currency – eRMB – set to be the first digital currency operated by a major economy. The Chinese authorities are testing it in four cities and looking forward to a bigger test at the future sites of Beijing Winter Olympics 2022.

Mobile payments, heavily dominated by AliPay and Wechat Pay, are widespread across China. With both platforms offering QR-code solutions as a payment, it is both easier and more efficient to shop with a smartphone instead of cash or credit card. At the start of 2019, China had a 35.2% penetration rate of mobile payments, with the average annual spend per user being 1,163 USD. In comparison, the US and the UK have an average annual user spend of nearly 3,000 USD and 2,500 USD respectively, but their penetration rates are as low as 8.8% and 6.6%. The total transaction volume of mobile payments in China has expanded rapidly in the past years, increasing 36 times, to 50 trillion USD Yuan, between 2013 and 2019.

Mobile payment transaction volume in China 2013 – 2019 (trillion USD)



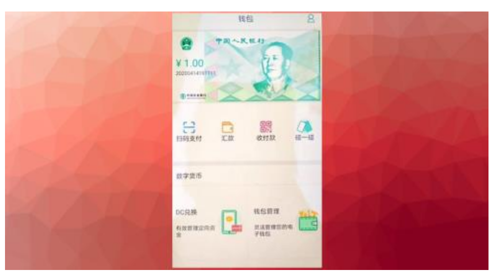
Source: Annual transaction value of mobile payments in China, China Central Bank.

However, these third-party payment platforms do not replace the existing currency. The platforms are accounts connected to the big banks of China, where transactions are made at a certain cost. Transaction data from these platforms is scattered, meaning that the Central Bank is unable to monitor the cash flow in real time.

To gain better control, the Chinese government launched a project in 2014 to develop a national digital currency, which are now being tested throughout different Chinese cities. Unlike cryptocurrencies such as Bitcoins and Ether, China's digital currency follows traditional monetary policies and rules under the central Chinese government. If successful, the digital currency can allow the government to better understand the economy, forecast economic slowdowns, reduce transaction costs and act towards illegal transactions.

From the user's perspective, there will not be a significant difference between using this new digital currency and using the current payment platforms, but from the government's perspective, this will be a big leap in financial and social control.

The pilot program was rolled out in four cities, namely Shenzhen, Suzhou, Chengdu, and Xiong'an. Starting from May, some government employees and public servants receive their salaries in eRMB. As an incentive to try the new currency, people in Suzhou are being offered cheaper transportation if its paid by the new currency, and in Xiong'an, you can enjoy food and retail shopping to a subsidized price.



A screenshot of China's digital currency app

In addition to improving the Chinese government's control over the financial system, the digital currency also shows an ambition to enhance China's influence in the global economy. Due to the digital currency's high mobility, it may be possible in the future to easily make transactions across borders with China's digital currency without going through the currently widespread dollar-based payment systems.

India bans 59 Chinese apps, including Tiktok and WeChat

Last June, the Indian government publicly released a list of 59 banned Chinese apps, including Tiktok, WeChat and Weibo. The bans were introduced after information surfaced about misuse and transmission of user data to servers outside the country, which pose as a huge threat to the national security and defense of India. The movement was also considered as the latest escalation of tensions between India and China after the border clashes in the Himalayas.

China has expressed strong concerns about the ban, which could hurt expansion plans and cost millions of Chinese jobs. Moreover, as India is viewed as a major growth market for internet companies, such as ByteDance, the ban on Chinese apps could jeopardize China's ambition to dominate global tech. If the ban remains in place, Chinese app developers risk losing out on India's booming digital advertising market, which is forecasted to grow by 26% to 3.7 billion USD this year. India's movement may even set a precedent for other countries looking to regulate or ban Chinese tech firms. Shortly after India announced the ban on Chinese apps, the U.S and Japan have raised similar concerns and considered censorship or complete ban on a Chinese app – Tiktok.

While the decision to ban Chinese apps help to ease the pressure from Indians calling for revenge for the border clash, it hurts many Indian enterprises and individuals whose businesses depend on these apps. However, the ban also offered a great opportunity to grow market shares for local tech companies whose rivals have been forced to leave the game.

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