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Shifting sands: changes in trade and investment in an uncertain world

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Overview

Unparalleled economic disruption, a resurgence in COVID-19 cases and heightened trade tensions are stealing newspaper headlines but also mask fundamental developments in trade and investment. In this piece, we examine some of the latest market trends that are taking place in Asia and globally against a backdrop of increased economic uncertainty and geopolitical tension.

The Asian Century

The rise of Asia remains undisputed and will continue to power global GDP growth going forward. A brief glance shows unparalleled milestones[1]:

- 50% of world GDP is expected to be Asian by 2024, and drive 40% of the world's consumption
- 21 of the top 30 largest cities are now in Asia
- From 2000 to 2019, China increased its GDP from just over US$1trillion to US$14 trillion

While 2021 will see some rebound in western economies as they emerge from COVID, this economic growth is likely to be lacklustre compared with mid and long-term growth rates in Asia.

[1] Financial Times; McKinsey

Trend 1: Increasingly dynamic investment activity *within* Asia

Deeper global integration and trade look set to stall in the coming years, with total world foreign direct investment ("FDI") outflow already at its lowest in 2019. The WTO forecast world trade to further decline between 13% and 32% in 2020 due to COVID.

Asia has shifted from trading with the West to trading with itself, with 60% of trade now being within Asia according to McKinsey, facilitating increased regional growth. These trends are supported by:

- Geographic proximity, shared historical ties and increasing regional economic and political forums
- While China continues to play a prominent role, Southeast Asia is increasingly in the spotlight given rapid urbanisation and industrialisation, a large and relatively young population and the increased use of digital technology

But even taking China by itself, there are notable trends:

Chinese strengthening of domestic markets:

- Chinese exports as a share of its GDP have fallen from 31% in 2008 to just 17% in 2019[1], heavily driven by increased domestic consumer demand, spending and disposable income
- The "Made-in-China 2025" plan has as its goal the surpassing of the United States in areas such as advanced manufacturing and software technologies. China no longer is dependent solely on Western technology imports; increasingly it is a leader in robotics, AI, telecommunications, and other cutting-edge solutions
- Outbound Chinese investment into the USA is facing enormous headwinds:
  - The Committee on Foreign Investment in the United States (CFIUS) had already cast a pall across inbound Chinese transactions given its unpredictability and opacity
  - With recent interventions from TikTok to WeChat, the stage is set for further retrenchment of Chinese investment into the USA

[1] World Trade Organisation

Trend 2: Economic clustering and partial global decoupling

Increased trade tensions are forcing multinationals ("MNCs") to reconsider their foreign investment decisions and locations. Three key drivers affect the target of where MNCs invest:

- Avoidance of trade barriers and tariffs - Investment in countries insulated from economic disruptions
- Low cost competitive advantages - As China matures, its cost advantage is eroding leading to production being located elsewhere and second source locations outside of the country, sometimes called China+1
- Local presence to serve local markets - Increasingly China is viewed as a market in its own right as opposed to a hub for cheap production for export

On the first trend, we increasingly see transactions motivated or impacted by trade barriers and distortions. Across the world, trade protectionism is on the rise, driven by populist sentiment and backlash against the effects of globalisation. The 25% tariffs placed on >US$200bn of Chinese goods by the US has heavily impacted exports from China leading to significant trade distortions. This distortion accelerates an existing trend as China's global product export market share declined 3% between 2018-2019[1]. As a result, MNCs are looking to invest in countries that escape the tariff net while at the same time providing low cost and strategic access to world markets.

The second trend is exemplified by the eight-fold rise in Chinese average blue-collar wages from 2004 to 2019[2] and implementation of automation in production. Increasingly, locations in Southeast Asia and South Asia look appealing from a cost perspective such as Vietnam and India, and in some cases enjoy the added benefit of country risk diversification and tariff mitigation.

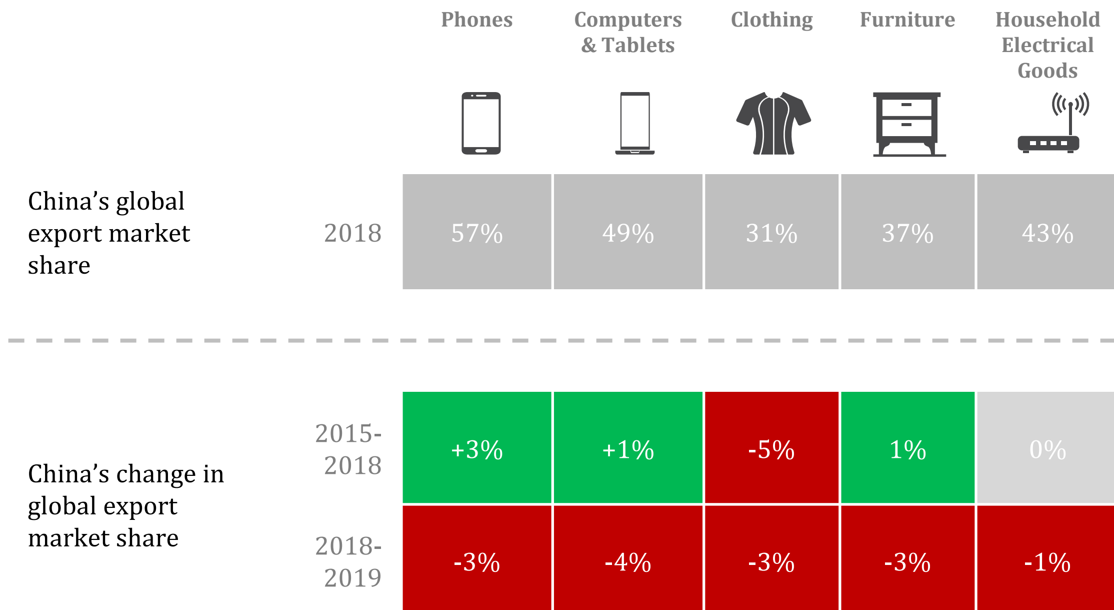
[1] Baker McKenzie
[2] CNBC

Trend 2: Economic clustering and partial global decoupling

A few examples of the strategic diversification from Chinese manufacturing:

- Late 2019, Samsung ended mobile phone production in China whilst opening manufacturing and R&D facilities in Vietnam
- Quanta Computer, the world's largest notebook contract manufacturer, has shifted production of servers out of China into Taiwan and the US
- COVID has exposed over-reliance on China in certain key areas such active pharmaceutical ingredient ("API") for antibiotics as China produces 80% and 90% of the global supply. There exists the potential for a shift in global sourcing

Decreasing product export market shares as supply chains move beyond China
Source: Baker McKenzie, adapted by Financial Times



		Phones	Computers & Tablets	Clothing	Furniture	Household Electrical Goods
China's global export market share	2018	57%	49%	31%	37%	43%
China's change in global export market share	2015-2018	+3%	+1%	-5%	1%	0%
	2018-2019	-3%	-4%	-3%	-3%	-1%

Trend 2: Economic clustering and partial global decoupling

One country that has benefited from a China + 1 strategy is Vietnam:

- Labour costs are at US$2.73 per hour, which is c. 50% less than China
- It holds advantages in low tech manufacturing (e.g. hub for the furniture, textile and footwear industries)
- Of the US$31bn in US imports that shifted from China to other Asian low-cost countries, 46% was absorbed by Vietnam

The last trend we look at in this insight is China as destination market rather than a location for cheap production. While this trend may appear self-evident, the urgency and complications associated with this reality are increasing. Led by western luxury brands, auto OEMs and technology giants over the past 20 years, western companies are increasingly looking to carve out a market in an ever-competitive domestic landscape in China. Harmonising brand image and product appeal to local tastes has become ever more challenging as native brands and products compete across a broader and more comprehensive price range and offering.

Conclusion

The past twenty years have seen debate over economic integration versus regional decoupling between the West and Asia. Increasingly a hybrid approach is apparent with regional trade and integration succeeding while global trade talks have faltered or stalled.

As America retrenches before the election in November 2020 and the European Union looks to address its ever-closer union, China's economy continues to mature, stimulating greater investment activity in its near abroad.

In these unpredictable times, with rapidly shifting trends, having a global financial advisor with a strong understanding of regional markets is essential. BDA Partners is uniquely positioned with its nine offices globally of which seven are in Asia, allowing unparalleled access and insight. We look forward to helping you make sense of these changes and to help you navigate through uncharted waters.

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