World Economic Trends II
<The 2018 Autumn/Winter Report>

- 'Sophistication of China`s Exports and U.S.-China Trade Tension -
  (Summary)

March 2019
Cabinet Office
Government of Japan
Contents

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About “World Economic Trends”
This report, published semi-annually since 2002, surveys and analyses the trend of the world economy. This is the 34th issue.
Chapter 1  U.S.-China trade tension and China’s higher value-added economy (i)

1. Quantitative expansion of Chinese economy

(1) Share of major countries and regions in global GDP
China’s share expanded sharply after joining WTO. At present, the U.S. and China account for about 40% of global GDP.

- Global GDP was $34 trillion in 2001 (year when China joined WTO)
- Global GDP was $80 trillion in 2017

(2) Share of countries and regions in U.S. imports
China has expanded its share to the same level of Japan in the middle of the 1980s.

2. Efforts to improve the quality of Chinese economy

(3) R&D spending in major countries and regions
China’s R&D spending continues to increase, approaching that of U.S.

(4) Relationship between R&D spending and GDP per capita in major countries and regions
China expands R&D spending faster than growth in GDP per capita.

(Note) Adapted from “World Economic Outlook, October 2018” by IMF.
(Note) Adapted from “World Economic Outlook, October 2018” by IMF.
(Note) Adapted from OECD Stat.
## Chapter 1  U.S.-China trade tension and China’s higher value-added economy (ii)

### 3. Background of U.S.-China trade tension

#### (1) Additional tariff measures by U.S. and China

<table>
<thead>
<tr>
<th>Date for imposing additional tariffs (final list release date)</th>
<th>What to do (against China)</th>
<th>Example of items subject to tariffs</th>
</tr>
</thead>
<tbody>
<tr>
<td>Jul 6, 2018 (Jun 15, 2018)</td>
<td>Additional 25% tariffs on $34 billion worth of goods</td>
<td>Industrial machines, Electronic parts</td>
</tr>
<tr>
<td>Sep 24, 2018 (Sep 18, 2018)</td>
<td>Additional 10% tariffs on $200 billion worth of goods (*)</td>
<td>Food products, Furniture</td>
</tr>
<tr>
<td>The date is undecided</td>
<td>Additional 25% tariffs on $257 billion worth of goods (**)</td>
<td>-</td>
</tr>
</tbody>
</table>

*What to do*

- Against China: Additional 25% tariffs on $34 billion worth of goods, Additional 25% tariffs on $16 billion worth of goods, Additional 10% tariffs on $200 billion worth of goods (*), Additional 25% tariffs on $257 billion worth of goods (**).

*Example of items subject to tariffs*


#### (2) Status of US-China trade talks

- Dec 1, 2018 US-China Summit: Regarding the additional tariff measures worth $200 billion (as the 3rd round of a series of measures), the U.S. decided to leave tariffs unchanged at 10% after Jan 1, 2019.
- Jan 2019 Ministerial and vice-ministerial level meeting was held.
- Feb 2019 Ministerial and vice-ministerial level meeting was held.

### 4. Scale of economy brought by U.S.-China trade tension

#### (3) Share of the U.S. and China’s exports in respective GDP

- Effects of exports are relatively great in China.
- U.S. exports of $1.5 trillion (Ratio to GDP, 7.9%)
- China’s exports of $2.3 trillion (Ratio to GDP, 18.8%)

#### (4) Share of the U.S. and China’s imports in respective GDP

- Effects of imports are relatively great in U.S.
- U.S. imports of $2.3 trillion (Ratio to GDP, 12.0%)
- China’s imports of $1.8 trillion (Ratio to GDP, 15.3%)

Chapter 1  U.S.-China trade tension and China’s higher value-added economy (iii)

5. Effects on Chinese financial and capital markets

(1) Renminbi exchange rate

- Oct 15, 2015: Requiring financial institutions handling foreign currency forward contracts (involving foreign currency-buying and yuan-selling) to deposit a reserve (foreign exchange risk reserve)
- Sept 11, 2017: Stopping requiring financial institutions to deposit a reserve
- Aug 11-13, 2015: Lowering RMB central parity rate
- May 2017: Introducing “counter-cyclical factors”
- Aug 24, 2018: Re-introducing “counter-cyclical factors”
- Jan 2018: Stopping “counter-cyclical factors”
- Aug 6, 2018: Requiring financial institutions to deposit a reserve

The renminbi depreciated significantly around mid 2018, mainly due to implementation of additional tariff measures by U.S. and China.

(2) Foreign reserves

- Foreign reserves decreased significantly when the stock prices fell in 2015, but remain stable in the current phase.

(3) Global manufacturing business confidence

Declining trend in both developed and emerging markets since the beginning of 2018.

(4) Global manufacturing new export orders

Sharp drop due to intensifying U.S.-China trade tension. Lower than the breakpoint of 50 in both developed and emerging markets.
Chapter 1  U.S.-China trade tension and China’s higher value-added economy (iv)

7. More burden on American producers and consumers

(1) U.S. Exports to China (by product)

- Mainly soybeans and cars on which China has imposed additional tariff measures have significantly reduced export growth.

(2) Amount of increase in U.S. tariff revenue

- Significant effects of additional tariff measures against imports from China on the increase in tariff revenue.

(3) China’s exports by destination

- Decline in overall export growth, mainly in exports to U.S. since Nov 2018.

(4) China’s imports by destination

- Decline in overall import growth, mainly in imports from U.S. since Nov 2018.
9. Structural changes in China's exports and imports

(1) China's exports by production stage

The share of consumption goods decreased, while the shares of intermediate goods and capital goods increased.

(2) China's imports by production stage

The shares of consumption goods and raw materials increased while the shares of intermediate goods and capital goods decreased.

10. China's higher value added exports (i)

(3) Trends in global gross exports and value added exports

Global value chain (GVC) development lost momentum after the global financial crisis.

(4) Share of value added exports in gross exports

In China, the share of domestic value added in exports rose (dependency on overseas imports in producing exports declined) after the global financial crisis.
11. China’s higher value added exports (ii)

(1) Share of domestic value added in U.S. and China’s exports

Shares of domestic value added in automobile and semi-conductor exports from U.S. are on a downward trend. Share of domestic value added in computer exports from China is on an upward trend.

(2) Income elasticity of U.S. and China’s exports

Income elasticity of China’s exports is on an upward trend reflecting its higher value-added exports. China’s export structure is more subject to sluggish external demand than that of U.S.

12. China’s higher value added exports (iii)

(3) GVC participation rate of U.S.

Mostly “forward participation” in the past, but gradual increase in “backward participation” has been observed.

(4) GVC participation rate of China

Along with the increasing share of domestic value added in exports, “forward participation” has been expanding.
Chapter 1  U.S.-China trade tension and China’s higher value-added economy (vii)

13. Effects through supply chains (i)

(1) Foreign value added in U.S. exports: share by country and region

Increasing dependency on imports from China.

(2) Foreign value added in China’s exports: share by country and region

Decreasing dependency on imports from developed countries. Strengthening GVC ties with ASEAN.

4. Effects through supply chains (ii)

(3) Ratio of value added in semi-conductors, etc. exported from U.S. by country

China’s share of value added in U.S. export of semi-conductors, etc. is on an upward trend.

(4) Ratio of value added in computers exported from China by country

U.S. share of the value added in China’s computer exports is on a downward trend.
Chapter 2  Economic Trends in Major Regions (World economy)

The world economy has been recovering moderately on the whole. With increasing uncertainty on economic policies, the growth pace in 2019 is expected to be a little slower than that in 2018. Crude oil prices have been on an upward trend in 2019 mainly due to coordinated production cut after a significant drop in 2018.

1. Characteristics in current economic conditions

(1) Global real economic growth rate

The economy recovered more moderately in 2018 than in 2017.

(2) Global industrial production and Economic Policy Uncertainty Index

Growth in industrial production peaked out in the beginning of 2019. Economic Policy Uncertainty Index hit a record high level.

2. Outlook for world economic growth and crude oil prices

(3) Outlook for world economic growth

The world economic growth rate in 2019 is expected to fall slightly compared with 2018.

(4) Crude oil prices

Significant drop in autumn 2018. Upward trend in 2019 mainly due to coordinated production cut.

Jan 1, OPEC members and non-member states expanded coordinated production cut (agreed upon on Dec 7)

Jul 1, OPEC members and non-member states eased coordinated production cut (agreed upon on Jun 23)

Nov 5, the U.S. re-imposed full-scale economic sanctions on Iran
Chapter 2  Economic Trends in Major Regions (U.S. economy)

The U.S. economy has been continuing its long-term economic recovery for more than nine and a half years since the global financial crisis, with the employment situation improving continuously. FRB raised interest rates four times in 2018. The effect of the partial government shutdown on the economy will be limited in full-year 2019.

1. Current state of U.S. economy

(1) Real economic growth rate

- Robust private consumption and business fixed investment supported high growth.

<table>
<thead>
<tr>
<th>Quarter</th>
<th>MoM change in employment (MoM, in 10 thousand people)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2018</td>
<td>-4</td>
</tr>
<tr>
<td>2019</td>
<td>-2</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Year</th>
<th>Real economic growth rate (QoQ annualized rate, %)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2015</td>
<td>1</td>
</tr>
<tr>
<td>2016</td>
<td>2</td>
</tr>
<tr>
<td>2017</td>
<td>3</td>
</tr>
<tr>
<td>2018</td>
<td>4</td>
</tr>
</tbody>
</table>

(Quarter) Q3  (Year) 2018

(Notes) Adapted from U.S. Department of Commerce.

(2) Labor market

- Increase in employment and downward trend in unemployment.

<table>
<thead>
<tr>
<th>Year</th>
<th>Unemployment rate (right scale)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2018</td>
<td>3.5</td>
</tr>
<tr>
<td>2019</td>
<td>3</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Year</th>
<th>MoM change in employment (MoM, in 10 thousand people)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2018</td>
<td>1</td>
</tr>
<tr>
<td>2019</td>
<td>2</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Year</th>
<th>Increase in employment and downward trend in unemployment.</th>
</tr>
</thead>
<tbody>
<tr>
<td>2018</td>
<td>-90</td>
</tr>
<tr>
<td>2019</td>
<td>-60</td>
</tr>
</tbody>
</table>

(Notes) 1. Adapted from U.S. Department of Labor.
2. Nonfarm employment.

(3) Policy interest rates

- From Dec 20, 2018 onwards FF target rate (upper limit of 2.50%)

<table>
<thead>
<tr>
<th>Month</th>
<th>FF target rate (upper limit of 2.50%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2004</td>
<td>4</td>
</tr>
<tr>
<td>2005</td>
<td>5</td>
</tr>
<tr>
<td>2006</td>
<td>6</td>
</tr>
<tr>
<td>2007</td>
<td>7</td>
</tr>
<tr>
<td>2008</td>
<td>8</td>
</tr>
</tbody>
</table>

(Year) 2004 05 06 07 08 09 10 11 12 13 14 15 16 17 18 19

(Notes) 1. Adapted from FRB.
2. Policy Interest rate is FF (Federal Funds) target rate.
3. FF rate has been incremented or decremented by 0.25% points since Dec 2008.
4. In January, FOMC also made another statement that it would review its balance sheet normalization program.

(4) Effect of the partial government shutdown on real economic growth rate

- The effect of the partial government shutdown on real GDP in full-year 2019 will be minus 0.02%.

<table>
<thead>
<tr>
<th>Quarter</th>
<th>Outlook on growth rate without considering the effect of the partial government shutdown (Baseline prediction) (QoQ annualized rate, %)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Q4 19</td>
<td>3.5</td>
</tr>
</tbody>
</table>

(Quarter) Q4 19

2. The period of the partial government shutdown was 35 days from Dec 22, 2018 to Jan 25, 2019.
3. The effect of the partial government shutdown includes delay in expenditure for the purchase of goods and service by the federal government, but does not include indirect effects due to failure of businesses to obtain authorization from the federal government, for instance.
Chapter 2  Economic Trends in Major Regions (Asian economy)

The Chinese economy has slowed down moderately. This is because growth in infrastructure investment has fallen due to effects caused by efforts to reduce debt, and growth in consumption has somewhat fallen since autumn in 2018. Against the background of the slowdown of the Chinese economy, growth in exports to China has fallen in Asian countries.

1. Slowdown of Chinese economy

(1) China’s real economic growth rate

Growth rate in 2018 fell gradually.

(2) Fixed asset investment

Growth in infrastructure-related investment, which had fallen significantly in early 2018, began to bottom out around the autumn.

2. Slowdown of Chinese economy and its spillover effects

(3) Consumption

Growth in consumption has been on a downward trend.

(4) Exports to China from Korea, Taiwan, and Thailand

Slowdown of Chinese economy had spillover effects on Asian countries.
Chapter 2  Economic Trends in Major Regions (European economy (i))

The Eurozone economic growth rate fell as the economy of Germany had remained at a standstill since the latter half of 2018, due to temporary factors including a slowdown in the pace of expansion in external demand and the introduction of WLTP. Uncertainty over Brexit weighed down capital investment, resulting in weaker recovery.

1. Trends in European economy

(1) Real economic growth rates in major European countries

The Eurozone economy has recovered moderately, with weaknesses seen in some countries like Germany. The UK economic recovery has been weak.

(2) Unemployment rates in major European countries

The rate has been generally on a downward trend since 2013.

(3) Manufacturing production in Germany

Signs of improvement have appeared recently despite a drop in production mainly of road transport vehicles in 2H of 2018.

(4) UK Business fixed investment

Business investment has been declining for 4 consecutive quarters due to uncertainty related to Brexit.

The share of road transport vehicles, etc. in manufacturing industry is 17.7% (2015).

1. (QoQ annualized rate, %)
2. (Quarter) Adapted from Eurostat, the Federal Statistical Office and Office for National Statistics.
3. Business investment has been declining for 4 consecutive quarters due to uncertainty related to Brexit.
4. Signs of improvement have appeared recently despite a drop in production mainly of road transport vehicles in 2H of 2018.

(Notes) Adapted from Eurostat, the Federal Statistical Office and Office for National Statistics.

Note: WLTP (Worldwide harmonized Light vehicles Test Procedure) is a globally harmonised test procedure for measuring CO2 emissions and fuel consumption from cars and vans in conditions close to actual running.
Chapter 2  Economic Trends in Major Regions (European economy (ii))

In Germany and UK, the number of immigrants has been increasing with the tight labor supply-and-demand situation continuing. Increased political and policy uncertainty in Italy, including an ongoing conflict with EU over Italy’s expansionary budget plan, has caused the financing environment to deteriorate, showing Italy has entered into a recession.

3. Utilization of immigrants in Germany and UK

<table>
<thead>
<tr>
<th>Year</th>
<th>Share of working age population in the total population (%)</th>
<th>Share of immigrant workers in total employment (right scale)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1992</td>
<td>65</td>
<td>16.1</td>
</tr>
<tr>
<td>1995</td>
<td>67</td>
<td></td>
</tr>
<tr>
<td>1998</td>
<td>69</td>
<td></td>
</tr>
<tr>
<td>2001</td>
<td>70</td>
<td></td>
</tr>
<tr>
<td>2004</td>
<td>71</td>
<td></td>
</tr>
<tr>
<td>2007</td>
<td>72</td>
<td></td>
</tr>
<tr>
<td>2010</td>
<td>73</td>
<td></td>
</tr>
<tr>
<td>2013</td>
<td>74</td>
<td></td>
</tr>
<tr>
<td>2016</td>
<td>75</td>
<td></td>
</tr>
<tr>
<td>2017</td>
<td>76</td>
<td></td>
</tr>
</tbody>
</table>

(Notes) 1. Adapted from World Bank, Federal Statistical Office.
2. The working age population is defined as those aged 15 to 64.
3. 1% point on the left longitudinal axis shows about 827 thousand people, while 2% points on the right longitudinal axis show about 883 thousand people.
4. Immigrants are defined as those who have moved to live in the territory of the current Federal Republic of Germany since 1949 (See text for details).

(2) Net immigration to UK

<table>
<thead>
<tr>
<th>Month</th>
<th>Overall</th>
<th>Non-EU</th>
</tr>
</thead>
<tbody>
<tr>
<td>2010</td>
<td></td>
<td></td>
</tr>
<tr>
<td>11</td>
<td></td>
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<tr>
<td>12</td>
<td></td>
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<tr>
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<td>17</td>
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<td></td>
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<tr>
<td>18</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

(Notes) 1. Adapted from Office for National Statistics.
2. Figures for 2018 are provisional.
3. Number of net increases in the past year until the time of publication (by quarter).
4. Immigrants are those who are defined by UN (as those who move to countries other than that of their usual residence for a period of at least 12 months).

4. Weaknesses in Italy

(3) Italy’s real economic growth rate

<table>
<thead>
<tr>
<th>Year</th>
<th>(YoY, %)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2007</td>
<td>-6</td>
</tr>
<tr>
<td>2008</td>
<td>2</td>
</tr>
<tr>
<td>2009</td>
<td>1</td>
</tr>
<tr>
<td>2010</td>
<td>0</td>
</tr>
<tr>
<td>2011</td>
<td>1</td>
</tr>
<tr>
<td>2012</td>
<td>2</td>
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<tr>
<td>2013</td>
<td>3</td>
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<td>2014</td>
<td>3</td>
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<td>2015</td>
<td>3</td>
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<td>2016</td>
<td>3</td>
</tr>
<tr>
<td>2017</td>
<td>3</td>
</tr>
<tr>
<td>2018</td>
<td>3</td>
</tr>
</tbody>
</table>

(Notes) 1. Adapted from World Bank, Federal Statistical Office.
2. Figures for 2018 are provisional.
3. Number of net increases in the past year until the time of publication (by quarter).
4. Immigrants are defined as those who have moved to live in the territory of the current Federal Republic of Germany since 1949 (See text for details).

(4) Italy’s fiscal risk premium

<table>
<thead>
<tr>
<th>Year</th>
<th>(Quarter)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2018</td>
<td>Q1</td>
</tr>
<tr>
<td>2018</td>
<td>Q2</td>
</tr>
<tr>
<td>2018</td>
<td>Q3</td>
</tr>
<tr>
<td>2018</td>
<td>Q4</td>
</tr>
</tbody>
</table>

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