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
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

(Note) Adapted from “World Economic Outlook, October 2018” by IMF.

(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.

U.S. $10.6 trillion 31%
China $1.3 trillion 4%
Japan $4.3 trillion 13%
EU $9.0 trillion 27%
Emerging (excluding China) $5.7 trillion 17%
Others $2.6 trillion 8%

Emerging (excluding China) $19.7 trillion 25%
U.S. $19.5 trillion 24%
China $12.0 trillion 15%
Japan $4.9 trillion 6%
EU $17.3 trillion 22%
Others $6.6 trillion 8%

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

(3) R&D spending in major countries and regions

China’s R&D spending continues to increase, approaching that of U.S.

(Note) Adapted from OECD Stat.

(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) 1. Adapted from “World Economic Outlook Database October 2018” by IMF and from OECD Stat.
2. Based on figures of OECD member countries, China, Taiwan, Singapore, Russia, Argentina, Romania, and South Africa.
3. Ratio of R&D spending to GDP is based on figures of Singapore in 2014, those of New Zealand, Republic of South Africa, and Swiss in 2015, those of China in 1995 to 2016, and those of other countries and regions in 2016.
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 (Jul 10, 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>

(Notes) 1.* The tariffs were to be raised to 25% at Jan 1, 2019 as of Sept 24, 2018. As a result of the US-China Summit held on Dec 1, 2018, the tariff hike was postponed to Mar 1, 2019, and further postponed based on the progress of trade talks (the deadline was not published as of Mar 1, 2019).

2.** In Sep 18, 2018 President Trump announced that the U.S. would impose additional 25% tariffs on $257 billion worth of goods if China should invoke countermeasures.

(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
- Both governments agreed to make effort to conclude negotiations within 90 days
- If they don’t reach an agreement, the U.S. will raise the 3rd round of tariffs to 25%

Jan 2019 Ministerial and vice-ministerial level meeting was held

Feb 2019 Ministerial and vice-ministerial level meeting was held

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

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

U.S. GDP of $19.5 trillion China’s GDP of $12.0 trillion


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

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

U.S. GDP of $19.5 trillion China’s GDP of $12.0 trillion

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”

Jan 2018: Stopping “counter-cyclical factors”

Aug 24, 2018: Re-introducing “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.
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.

(Notes) 1. Adapted from U.S. Department of Commerce.
2. On a customs basis, nominally/not seasonally adjusted.

(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.

(Reference) YoY comparison in total tariff revenue

(Notes) 1. Adapted from U.S. Department of Treasury, and Department of Commerce.
2. Amount of increase in tariff revenue due to additional tariff measures is estimated by Cabinet Office based on statistic item numbers designated and published as items subject to additional tariff measures.

8. Effects of U.S.-China trade tension on China’s exports and imports

(3) China’s exports by destination

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

(Note) Adapted from General Administration of Customs of the People’s Republic of China.

(4) China’s imports by destination

Decline in overall import growth, mainly in imports from U.S. since Nov 2018.

(Note) Adapted from General Administration of Customs of the People’s Republic of China.
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.

- Jul 1, OPEC members and non-member states expanded coordinated production cut (agreed upon on Dec 7)
- Aug 7, the U.S. re-imposed some of the economic sanctions on Iran
- Nov 5, the U.S. re-imposed full-scale economic sanctions on Iran

(Note) Adapted from "World Economic Outlook update, January 2019" by IMF.
Figures for 2018, 2019, and 2020 are all predicted.
The U.S. economy has been continuing its long-term economic recovery for more than nine and 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.

Government expenditure
Inventory investment
Business fixed investment
Private consumption
Housing investment
Net export

(Quarter)
Q3
(Year)
2015 16 17 18

(QoQ annualized rate, %)

Real economic growth rate

(Year)

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

2. Movements in U.S. policy

(2) Labor market

Increase in employment and downward trend in unemployment.

MoM change in employment
304 thousand people in Jan 2019

Unemployment rate
4.0% in Jan 2019

(Year)
2004 05 06 07 08 09 10 11 12 13 14 15 16 17 18 19
(%) 11 10 9 8 7 6 5 4 3

(MoM, in 10 thousand people)

(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%)

The FOMC said in its January statement that it would be patient in adjusting interest rates in the future.

(Year)
2004 05 06 07 08 09 10 11 12 13 14 15 16 17 18 19
(Month) 0 1 2 3 4 5 6

(%) 6 5 4 3 2 1 0

(Notes) 1. Adapted from FRB.
2. Policy Interest rate is FF (Federal Funds) target rate.
FF rate has been incremented or decremented by 0.25% points since Dec 2008.
3. 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%.

Outlook on growth rate in consideration of the effect of the partial government shutdown
Outlook on growth rate without considering the effect of the partial government shutdown (Baseline prediction)

(QoQ annualized rate, %)

(Quarter)
Q4 Q1 Q2 Q3 Q4
2018
2019
1.0 1.5 2.0 2.5 3.0 3.5

(Notes) 1. Adapted from "The Budget and Economic Outlook: 2019 to 2029 (Jan 28, 2018)" and "The Effects of the Partial Shutdown Ending in January 2019 (Jan 28, 2019)" created by the Congressional Budget Office (CBO).
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.

2. Weaknesses in German and UK economies

(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.
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

(1) Working age population and immigrants in Germany

Immigrant workers have partially offset the decrease in labor force population.

(2) Net immigration to UK

UK’s referendum on Brexit held in June 2016 has reduced the number of immigrants from EU.

4. Weaknesses in Italy

(3) Italy’s real economic growth rate

(4) Italy’s fiscal risk premium

The risk premium has been widened since June 2018 due to concerns over fiscal management.

(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 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).

(Note) Adapted from World Bank, Federal Statistical Office.

(Note) Adapted from Office for National Statistics.

(Note) 1. Adapted from Office for National Statistics.
2. Figures for 2018 are provisional.
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(New administration in Italy)

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