

With the rise in US-China trade friction, more Chinese companies shift production to Southeast Asia

SHOHEI TAKASE
ECONOMIC RESEARCH OFFICE

MUFG Bank, Ltd.
A member of MUFG, a global financial group

18 NOVEMBER 2019

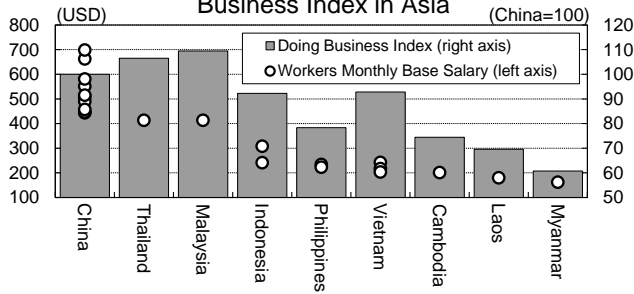
(ORIGINAL JAPANESE VERSION RELEASED ON 1 NOVEMBER 2019)

China has long remained as the world's largest production base taking advantage of cheap labour, however its relative dominance as a production base is being threatened by peers in Asia owing to a substantial increase in labour costs on the back of a tight labour supply and demand and a rapid increase in minimum wages due to the government's income growth policy since mid-2000. In fact, comparing the workers base salary in major Asian economies, wages in Southeast Asian countries are lower than ones in major cities in China which indicates Southeast Asian economies have an advantage in terms of labour costs (see chart 1). Moreover, the World Bank's Doing Business Index (see note) shows that Thailand and Malaysia ranked higher than China. Bearing these in mind, it can be said that both foreign capital companies and the Chinese companies were already in a situation where they had no choice but to consider shifting production in China to overseas. It was when the additional burdens were placed on Chinese exports to the US in the form of tariffs and sanctions due to an intensifying US-China trade friction, and since the second half of last year it is not uncommon for the companies particularly in export goods production to shift their production base from China to Southeast Asia region.

Note: The World Bank's "Doing Business Index" ranks the countries/regions on the ease of doing business in 10 areas such as "Starting a business" and "Getting electricity". "Wages" is not included in the 10 areas.

It will take some time for this trend of shifting production base to be reflected in statistics as it usually requires construction of equipment, however signs of the trend can already be seen in some Chinese companies. Looking at Chinese FDI into Thailand, Malaysia and Vietnam which have relatively high dependence on exports in major ASEAN countries, FDI in Vietnam has increased substantially since the middle of last year (see chart 2). Going forward, it is likely that the Chinese companies will increase investment in other Asian countries and it is also possible that foreign capital companies will follow the trend. The US-China trade talks have reportedly reached a partial agreement for now, yet there seems to be lingering concerns about the additional tariffs to be imposed hence an upward trend in FDI will be maintained. It is considered to be extremely challenging to reach a full agreement as the underlying conflicts between the two countries seem to be the national security and tech hegemony. Other Asian countries also started to adopt the measures such as reducing corporate tax to attract foreign investment. Looking ahead, it is important, from the perspective of watching Asian economies, to keep an eye on the development of shifting production base by companies from China to Southeast Asia.

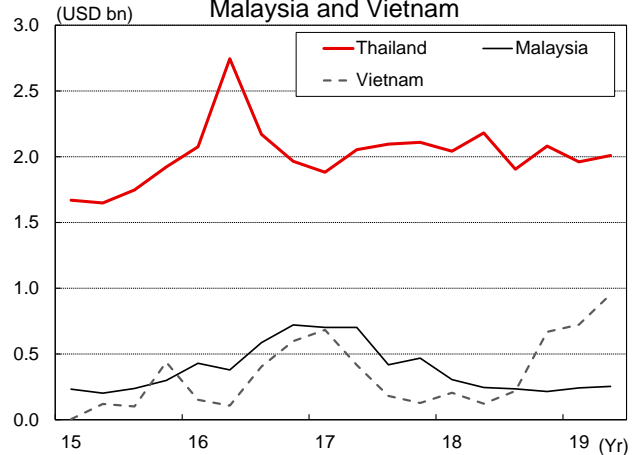
Chart 1: Workers Base Salary and Doing Business Index in Asia (China=100)



Note: 1. "Workers Monthly Base Salary" is a comparative survey with Japanese companies in major global cities conducted in the period between December 2018 and January 2019.
 2. The World Bank's "Doing Business Index" ranks 190 countries and regions on the ease of doing business in 10 areas such as "Getting electricity", "Dealing with construction permits" and "Resolving insolvency".

Source: World Bank, MUFG Bank Economic Research Office

Chart 2: Chinese FDI into Thailand, Malaysia and Vietnam



Source: Individual country statistics, MUFG Bank Economic Research Office

(Translated by Makiko Stokes)

For further details, please contact the Economic Research Office, MUFG Bank

Managing Director, Rei Tsuruta Tel: +81-(0)3-3240-3204

Written by Shohei Takase<shiyouhei_takase@mufg.jp>

This report is intended for information purposes only and shall not be construed as solicitation to take any action such as purchasing/selling/investing financial market products. In taking any action, each reader is requested to act on the basis of his or her own judgment. This report is based on information believed to be reliable, but we do not guarantee its accuracy. The contents of the report may be revised without advance notice. Also, this report is a literary work protected by the copyright act. No part of this report may be reproduced in any form without express statement of its source. This report is also available for viewing online.