'Ill wind' of US-China trade war boosts south-east Asia

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"As companies flee China, it is the countries that make up the Association of Southeast Asian Nations who are proving the largest beneficiaries."

Sally Macdonald

The US-China trade war has helped to create an unprecedented opportunity for countries in south-east Asia, believes Sally Macdonald, Head of Asian Equities for Marlborough Fund Managers. Here she explains why.

The world has focused on the US-China trade war with increasing intensity since late 2018 and although during the G20 meeting in Japan, Presidents Trump and Xi agreed to resume talks, punitive tariffs remain in place.

When tensions initially escalated, most manufacturers thought that the two sides would find common ground and higher tariffs would never be imposed.

Then, as the first 10% actually hit, panic set in and companies scrambled to re-route products, or strike deals with customers and distributors to split the hit between them and leave end-consumers least impacted. Few believed that the shift to 25% tariff increases would ever really materialise, but when January came with no resolution, manufacturers based in China began to act.

The trend to relocate from China had already been underway for some time. Beijing's Made in China 2025 policy had been trying to shift the country's manufacturers up the value chain, by raising wages and lessening tax breaks for low-end products.

Many companies were also becoming ever more uncomfortable with the degree of surveillance to which they and their staff are now subjected. So, when the need arose to have anything but 'Made in China' on their labels, companies began to act, increasing their existing overseas capacity - though this may have backfired for some with bases in Mexico - or leaving entirely.

As companies flee China, it is the countries that make up the Association of Southeast Asian Nations (ASEAN) who are proving the largest beneficiaries. Producers of low-end goods are seeking out Vietnam, Myanmar, Indonesia, Laos and Cambodia, whilst those focused on higher-value products are moving to Malaysia and Thailand.

The benefits are not only an avoidance of the negative impacts of US-China trade tensions. By moving into ASEAN, Chinese companies regain the ability to export to countries like Korea and India, which, to avoid dumping, restrict the inflow of Chinese goods.

Indonesia and Vietnam

In Indonesia, industrial estate management company Puradelta Lestari has seen enquiries from Chinese customers rise 150% this year over 2018 numbers. Meanwhile in Vietnam, the number of new foreign direct investment projects reported by the General Statistical Office of Vietnam rose 82% year on year in May 2019, after rises in January, February and March of 147%, 93% and 80% respectively (there is no data for April).

We have spent a considerable amount of time trying to disentangle this apparent exodus from China from other underlying industry trends, talking to companies not only in the recipient countries, but also other foreign businesses with facilities in China, who are relocating.

We have also looked closely at the data. Despite the surge in foreign investment projects in Vietnam, the data shows that Japanese and Korean investment in the country has actually fallen by 27% and 28% respectively year-to-date, year on year, and this is in line with that of other nations. On that basis, we are confident that the surge in foreign investment is primarily driven by Chinese relocation.

Unprecedented opportunity

The trend will be tough for the great manufacturing hubs of southern China, but it represents an unprecedented opportunity for the recipient countries.

In Thailand, where the government has been constructing a massive new infrastructure corridor on the eastern seaboard, we have been tracking the moves there for some time, as we visit our holdings in industrial estate companies. But even we have been surprised by the strength of demand. Industrial estate developers Amata and WHA Corp are reporting huge increases in sales negotiated (up 117% on the previous year for Amata), with emphasis on the auto, plastics, chemical and consumer sectors.

After a few years of internal disruption, in which the Thai economy has trodden water, the new influx could be the catalyst needed to kick-start a new economic cycle. The new factory demand has not yet showed up clearly in direct investment data, but real estate activity is starting to rise and data from the purchasing manager surveys have been improving since September last year.

In Myanmar, manufacturing confidence surveys have rocketed from a deep contraction to strong expansion and the opening of a new border link with Thailand looks set to support this trend still further.

While the agreement between presidents Trump and Xi to resume talks has been widely welcomed, it comes only after both leaders have demonstrated their readiness to throw unguided trade missiles. Investing in Chinese exporters in such circumstances is a very tricky business, but while the ill wind of this trade war continues, it is gradually blowing the nations of south-east Asia some good.

A version of this article was first published by Investment Week.

The views expressed are for general information purposes only and should not be construed as investment advice. Sally Macdonald is Investment Manager of the Marlborough Far East Growth Fund, which holds some or all of the stocks mentioned.

Marlborough House, 59 Chorley New Road, Bolton, BL1 4QP

Intermediary Support: 0808 145 2502

Email: enquiries@marlboroughfunds.com

Website: www.marlboroughfunds.com

Marlborough
Fund Managers