Good MornING Asia - 11 April 2019

Keeping with their developed market counterparts, the balance of the central bank policy risks in Asia is shifting toward easing

In this bundle

ASEAN Morning Bytes

General market tone: Wait and see. Investors will likely stay defensive and monitor geopolitical developments ahead of China trade data later in the week

EM Space: Brexit deadline pushed back, trade talks continue

- **General Asia:** Keeping with their developed market counterparts, the balance of the central bank policy risks in Asia is shifting toward easing. The Fed minutes confirmed the shift to dovish policy bias and the US CPI data reinforced the same. The ECB President Draghi also maintained his dovish rhetoric, though the central bank had no details of new TLTRO. EU leaders offered an extension to the Brexit deadline to 31 October, though it could be potentially more destabilizing for the UK.
- **Malaysia:** February industrial production data is due today. A sharp fall in exports underlines our forecast of 1% YoY fall in IP as against the consensus of 2.2% growth (prior 3.2% growth). The combined January-February growth will have a good sense of 1Q19 GDP growth. Our forecast of a slowdown in GDP growth to 4.2% YoY in 1Q19 from 4.7% in 4Q18 remains on track. And so is our view of the Bank Negara Malaysia cutting its overnight policy rate by 25bp to 3.00% at the next meeting on 7 May.
- **Philippines:** The Philippines reports trade data for the month of February with market players expecting further struggles from the export side while imports are seen to have expanded at a moderate pace. The trade balance is also forecasted to remain in a

substantial deficit which should continue to validate our fundamental view for PHP weakening bias in the coming months.

What to look out for: China trade data

- Philippine trade (11 April)
- Malaysia industrial production (11 April)
- US PPI (11 April)
- Singapore GDP (12 April)
- China trade (12 April)
- US consumer sentiment (12 April)

Article | 10 April 2019 China

China's foreign investment law may end up hindering 5G tech development

The new Chinese foreign investment law has caught a lot of positive attention. But there is one clause that could turn international political risks into...

Source: Shutterstock

The benefits of the foreign investment law

Last month, China passed a new foreign investment law, which in principle means that foreign companies will receive the same treatment as their Chinese counterparts. The law will come into effect on 1 January 2020, and we think this is an attempt at appeasing the US during the ongoing trade negotiations.

So far, most media reports have focused on the benefits of the law which in theory should help foreign firms operating in China protect business secrets from 'forced' sharing requests from local governments. Another advantage is that foreign companies will have the same market entry, exit and operation standards as local Chinese companies.

However, there is a sector 'blacklist' for sectors that aren't open for foreign investment. For example, there is a complete ban on investing in fishing, gene research, religious education, news media, and television broadcasting. Additionally, only partial investment is allowed in oil and gas exploitation, nuclear power, airlines, airport operation, and public health, among other sectors.

But there is a clause that increases political risks

The law includes a clause that protects Chinese companies operating or investing in foreign countries. It says that if any country or region imposes discriminatory measures against China, then China can take similar retaliatory actions. At first glance, this might seem irrelevant for foreign companies operating in China, but it really isn't.

For example, Huawei and ZTE are two of the biggest producers of 5G components in China and also export their products to the US and Europe. Both companies were sanctioned by the US during the trade talks. If Huawei's and ZTE's 5G products cannot be exported abroad, this could be interpreted as discrimination against Chinese products, and then China may retaliate.

Therefore, we see this political risk increasingly having the potential to turn into a business risk.

The trade war is really a tech war

The foreign investment law confirms our view that the trade war targets not only goods trade but also how China grows its technology sector and that this is really a technology war.

China and the US are now discussing cybersecurity and cloud computing in their trade negotiation and how these negotiations pan out will largely affect how Chinese firms will be treated when they sell high-tech products in the U.S.

As the US continues to advocate banning the use of China made 5G products, the enforcement of the foreign investment law could become a real risk to the progress of building a 5G network globally and to China's Made in China 2025 agenda.

Article | 10 April 2019 China

China: Relaxing residency restrictions positive for ageing economy

China has announced a new policy to relax some of the existing residency restrictions (hukou). In the long term, this will release a "new"...

A busy road in Shanghai

New policy: Relaxing residency restrictions

Under China's residency system, citizens born in a rural city can only enjoy social benefits in that city alone. These benefits include education for children and family medical services. Even if citizens move to an urban city for work, the residency restrictions (hukou), in most cases, cannot be lifted, and hence these citizens can't enjoy the same social benefits.

The hukou policy has been relaxed slightly for a few years but there has been no significant reform. That's about to change.

On 8 April 2019, the government announced a new policy to remove the hukou restrictions in some cities.

No flood of labour in mega cities

The policy will remove residency restrictions completely for cities with a population of between one to three million (including citizens moved from rural cities). It will also relax some residency restrictions for cities with a population of three to five million.

Following the definition set by the government, cities with a population of one to five million are considered "big", five to 10 million "very big" and over 10 million are "mega" cities.

With these population sizes in mind, we note that these cities are not the first-tier cities (i.e. not Beijing, Shanghai, Guangzhou and Shenzhen) and aren't even the second-tier cities. As a reference, Shanghai's population is 24 million. A city with a population of three million would be Qinhuangdao City, located in Hebei province.

The big cities have common characteristics; they are either manufacturing hubs with factories or are famous for cultural and scenic tourism. These characteristics make them potentially attractive to workers from rural areas.

The idea is to give social benefits to people in the cities where they work without flooding first-tier mega cities with extra workers.

A new workforce for mid-size cities

We believe that with this new policy, there will be more rural citizens moving to the big cities where they can enjoy more social benefits. This could create a new workforce for the manufacturing and tourism industry.

It's also positive for the ageing population. With better social benefits, younger people from rural cities can raise children in the places they live and work. This could encourage younger couples to raise more than one child, as living costs will fall.

> *"On 8 April 2019, the government announced a new policy to remove the 'hukou' restrictions in some cities....This is positive for the ageing population. "*

This will lead to an upgrade of mega-cities

The policy could also encourage rural labour currently working in mega-cities to move to the big cities where they can get social benefits. Factories could then potentially relocate to chase the labour supply. This happened around 10 years ago when some factories in Shenzhen (then a low-end factory hub) moved to the inner area of the Mainland, and some moved to south-east Asia.

We believe that this policy is an attempt to repeat the Shenzhen story by relocating low- to mid-end factories in larger cities to mid-size cities. This would free up land in the larger cities to cater to higher value-add companies.

Short-term challenges

There are at least two short-term challenges.

1. The success of the policy relies on how many jobs are immediately available in the big cities that remove the residency restrictions. If factory relocations from larger cities to mid-size

cities are slow then the policy impact will also be slow.

2. Housing prices and rentals in those cities will rise when more citizens move from the rural areas to the cities. The higher rental costs will offset some of the benefits created by the policy, making the policy less attractive.

Residency reform to continue

We recognise that this is a meaningful milestone in reforming the residency restriction (hukou) system. If successful, the policy will bring the rural workforce to manufacturing and tourism industries in the big cities, which goes some way to addressing the ageing workforce. But the reform progress is slow, this policy only relaxes residency requirements for cities with a population of between one to five million. There is still a long way to go before the hukou system is removed nationwide allowing full labour mobility within the country.