



Matthews Asia Perspective

Will Vietnam and Thailand Benefit From U.S.–China Trade War?



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We recently traveled to Vietnam and Thailand to assess the potential production relocation activity related to the U.S.–China tariff war. We came away with the impression that Vietnam is seeing a rising tide of enquiries regarding either contract manufacturing for China-based companies or outright relocation. That said, many of these relocations represent minor changes. We heard repeatedly about the difficulty in finding the necessary scale and supply chain depth outside of China.

In many instances, this relocation activity predated the current tariff war, driven by rising costs in China and less-convenient inland locations. Vietnam's attractive tax privileges, when combined with extra tariffs on Chinese products, are helping to clinch the deal for some manufacturers. Furniture, travel goods, electronic components, auto parts, seafood and processed agricultural products are among the industries that are seeing either increased contract manufacturing or relocation from China.

Typical timelines for production relocation operations varied from 1 to 1.5 years depending on whether rental factories or greenfield sites were used. These relocations underscore the long-term trend of companies such as Samsung, Intel, Nike and Adidas moving their production facilities to Vietnam, and have helped Vietnam attract twice as much foreign direct investment (FDI) compared to countries in the Association of Southeast Asian Nations (ASEAN) excluding Singapore (as a percentage of GDP). The investment inflows have supported the explosive growth of Vietnam's exports, which have quadrupled over the past decade from approximately US\$50 billion to over US\$200 billion today, with the latest developments likely to continue the trend.

Bottlenecks remain, however: 1) lack of available manufacturing capacity (for contract manufacturing orders); 2) a tight skilled-labor market (despite a good supply of math- and science-proficient high school graduates) and high labor turnover that push up training and development costs; 3) tight land supply and rapidly rising prices for industrial real estate and factory rentals; and 4) lack of depth in the local supply chain (goods and services).

Several sources also mentioned a technology-related law that made it difficult for second-hand machinery and equipment to be imported, but it appears that Vietnamese authorities are increasingly showing more leniency in accommodating the FDI relocation.

As an aside, the U.S.-led Indo–Pacific Agreement, ratified in July 2018, was discussed repeatedly as a new U.S. Marshall Plan-style pivot in Asia to counter the influence of China's Belt and Road project.

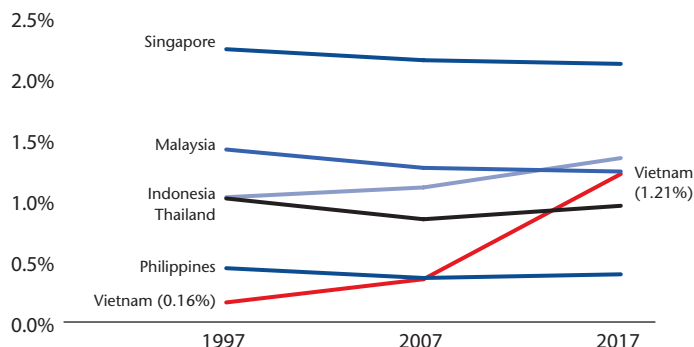
Few Signs of Production Relocation in Thailand

In Thailand, there has been little evidence yet of production relocation activity, with most of the FDI inflows thus far centered around the Eastern Economic Corridor initiative on the Eastern Seaboard, and concentrated primarily in heavy chemical industries, autos and auto parts. In addition, Thailand's revamped industry-based investment privileges make it difficult to attract FDI driven by production relocation, much of which is in mid-level electronics components and auto sector-related areas that do not benefit from official investment promotion. Production diversion (using available spare capacity elsewhere) seems more prevalent, with electronic component manufacturing services (EMS) operators noting a strong rise in enquiries from China-based companies.

A shift in supply chains and manufacturing to Vietnam, followed by Thailand and Malaysia (as two other countries in Southeast Asia with relatively deep supply chains) seems poised to accelerate incremental FDI flows to Southeast Asia. We expect it to also boost investment and increase exports, following nearly two decades in

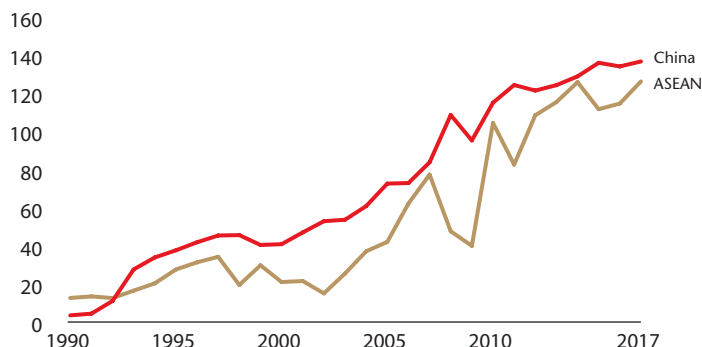
which the focus was on China. This trend is unlikely to change even if a U.S.–China trade deal is struck as multinational corporations will want to diversify their production risk. Consumption should also benefit from increased manufacturing activity, as jobs are created and incomes rise.

Figure 1. ASEAN Share of World Exports (%)



Source: United Nations Conference on Trade and Development

Figure 2. Inward FDI: China and ASEAN (US\$B)



Source: United Nations Conference on Trade and Development

As of November 30, 2018, accounts managed by Matthews Asia held positions in Samsung Electronics Co., Ltd. As of November 30, 2018, accounts managed by Matthews Asia did not hold positions in Intel Corp., Nike Inc., or Adidas AG.

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