FinanceAsia

Print Close

Frontier markets: winners from China's slowdown

By Thomas Hugger | 13 September 2016

China’s economic slowdown is bad news for some but it can be a real positive for Asia’s frontier economies.

China’s economy is starting to lose steam. That is the story of the moment. But China’s slowdown is a consequence of its past successes. It has achieved eye-catching economic growth, impressive wage growth and the creation of companies that are now regarded as global champions.

It should come as no surprise that China is undergoing changes.

After the second world war, Japan became the manufacturing hub of the world. I remember the early 1970s when Japanese cars started to flow into Europe and some people greeted them with scepticism. But a company like Toyota quickly became one of the most prominent global manufacturers.

In time, Japan moved up the value chain. Manufacturing moved to Hong Kong, to South Korea, to Taiwan, and after that to South America and Eastern Europe. It is now China that is seen as the manufacturing hub of the world, but we all know this will not last. It never does.

This does not mean China will suffer the same problems that Japan has suffered. This is an argument that some people make, but GDP per capita is still much lower in China than it was in Japan at the point of its transition — and the sheer scale of the Chinese economy makes it a very different proposition.

But China will need to change from an export led economy to a domestic driven economy. That change will reap significant benefits for Asia’s frontier markets.

Change of the guard

Let us take a clear example. Guangdong province hosts tens of thousands of factories. It is the manufacturing hub of the world. But in the last few years, the average salary in Guangdong province has doubled and the Renminbi has appreciated compared with the price 3 years ago. That has led to a major loss of competitive advantage.

Manufacturing companies all too often operate on razor-thin margins. They cannot continue to produce their goods in Guangdong. But nor can they simply move to Asia’s other emerging economies. The average monthly minimum wage in Guangzhou was $283 in 2015. That is around the level workers earned in Thailand, Malaysia and the Philippines.

“In the last few years, the average salary in Guangdong province has doubled”

In the Asian frontier markets, average monthly minimum wages are much lower. In Vietnam the range is currently between $115-168, in Bangladesh and Myanmar it was $68 and $67 respectively for workers in the garment industry.

This cheap labour force has already driven some companies to move manufacturing out of China. We have seen that already with the movement of textile factories to Bangladesh, shoe factories to Cambodia, and light manufacturing and mid- to high-tech manufacturing to Vietnam. But this is a shift that is only going to get stronger.

Vietnam stands to benefit in particular from this move. It is a signatory of the Trans-Pacific Partnership (TPP) — China is not, and nor is Hong Kong. If Donald Trump wins the next US election, we can forget about TPP. But if Hillary Clinton wins, she looks likely to try to pass the bill, which she helped to draft when she was Secretary of State.

That will be great news for Vietnam, and will help the country attract ever more tech manufacturing and textile industry. The country is often billed as ‘the next China’. The TPP would help make that a reality.

The slowdown in China is going to lead to some major changes in the global economy. Asian emerging markets — many of which rely on export demand from the country — look likely to suffer. But for countries like Bangladesh, Cambodia, Laos, Myanmar and Vietnam, the slowdown will bring some clear benefits.

In the years to come, these economies will make their own transitions. They will move up the value chain, face higher wages, and be forced to adapt to their own changes. But to get there, they will enjoy their status as the manufacturing centres of the world for years to come.

China has had its turn as the hub. It is now time for the Asian frontier markets to take centre stage.

Thomas Hugger is the founder of Asia Frontier Capital, a long-only fund specialising in frontier markets in the region. He was formerly managing partner at Leopard Capital, and has been investing in frontier markets since 1993.