# CHINA ECONOMIC UPDATE OCTOBER 2020

COVID-19 put the brakes on already stalling foreign investment

NAB Group Economics

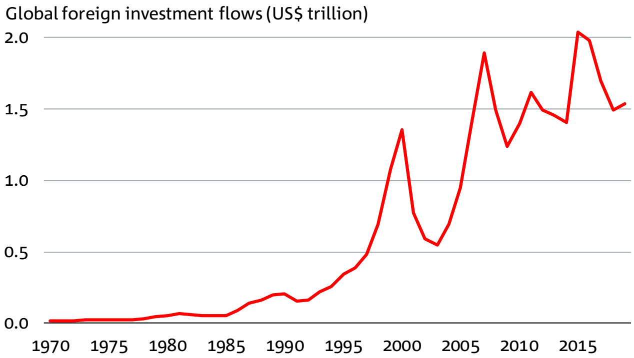
The disruptions to global economic activity that resulted from the COVID-19 pandemic have negatively impacted foreign direct investment, including China's investment abroad. China's foreign investment surged over the past few decades, with its focus changing as the country has developed, however global political tensions – particularly with the United States – slowed FDI prior to COVID-19 and could remain a constraint in years to come.

## THE CHANGING SHAPE OF GLOBAL FOREIGN INVESTMENT

From a global perspective, foreign direct investment flows have been highly cyclical – typically accelerating during economic booms and plunging following downturns. Peaks in recent decades were in 2000 (prior to recession in the European Union and United States), 2007 (prior to the GFC) and 2015 (ahead of a downturn triggered by fears around China's economy).

## INVESTMENT WEAKER SINCE 2015

### US and China key drivers of the decline



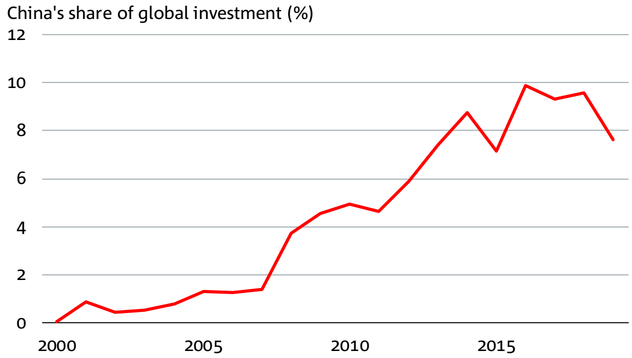
Source: UNCTAD, NAB Economics

Global foreign direct investment flows into all countries totalled around US$2 trillion in 2015 before retreating in subsequent years. A range of factors have influenced this declining trend, including tax incentives implemented in the United States in 2017 designed to encourage US multinational firms to repatriate earnings from abroad, as well as a slowdown in outflows from China. In 2019, global foreign direct investment flows totalled US$1.5 trillion.

China's share of global foreign investment remained relatively modest until 2007 – at around 1.2% of the total – before rising to almost 10% in 2016. This increase in share was due to both a steady increase in the value of China's foreign investment as well as the drop off in investment from a number of major economies due to the impact of Global Financial Crisis and subsequent recessions.

## CHINA'S SHARE OF GLOBAL INVESTMENT

### China became a key player since the GFC



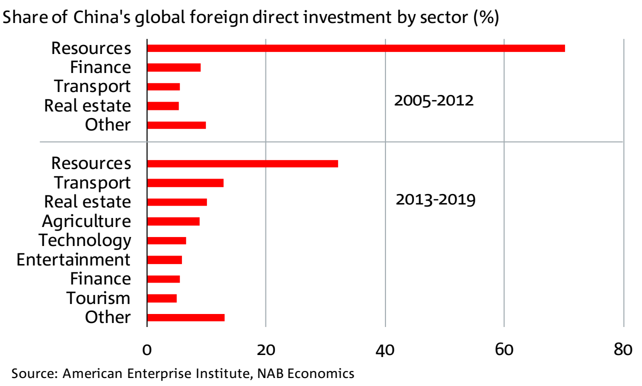
Source: UNCTAD, NAB Economics

Over this period, there was a significant shift in the focus of China's investment by sector. Data from the American Enterprise Institute (AEI) shows that prior to 2012, investment was largely focused on resources (energy and minerals), to guarantee the supply of these materials to China's rapidly expanding industrial sector. In the period from 2005 and 2012, just over 70% of China's foreign investment was directed towards these sectors. While this sector continued to receive a large share of investment from 2012 through 2019, there was also substantial investment in areas such as transport, real estate, agriculture and technology.

Date **October 2020** | Author **Gerard Burg** – Senior Economist – International

# CHANGE IN CHINA'S INVESTMENT FOCUS

## Resources less dominant in recent years

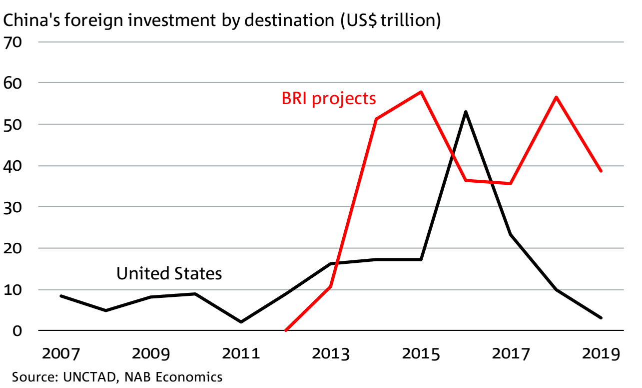



The slowdown in China's investment since its peak reflected both domestic policies to control capital flight – due to concerns around financial market liquidity and currency stability from late 2015 through 2016 – as well as measures in target countries (particularly the United States) to restrict Chinese investment. In August 2017, the State Council restricted foreign investment by Chinese firms in certain segments (such as real estate, hotels, entertainment, sports clubs and so-called "outdated" industries). More recently, China's investment in the US was limited by stricter regulatory oversight and negative sentiment as a result of the trade war between the two countries – with loss of intellectual property, particularly in technology sectors, a critical concern of US authorities.

The impact of these various measures is evident in the AEI data – which shows a steep drop-off in Chinese investment into the United States – from US$23 billion in 2017 to US$10 billion in 2018 and just US$3 billion in 2019. In contrast, investment in Belt and Road Initiative projects (none of which has occurred in the US) also declined in 2019 but remained above levels recorded in 2016 and 2017.

# INVESTMENT IN THE US HAS DROPPED

## BRI projects still relatively strong




China's foreign direct investment slowed over a number of years ahead of COVID-19, however the impact of the virus domestically and internationally stalled investment in the first half of 2020. AEI data showed investment of US$10.8 billion over this period (compared with US$35.3 billion in the same period in 2019). Overall it was the smallest total recorded in the first half of a year since 2007. Stronger economic growth in the second half of the year could support an increase in investment over this period and into 2021, however regulatory restrictions remain in place – with the Trump Administration prohibiting US firms from transacting with various Chinese technology firms, and the potential for other countries to implement restrictions.

# CONCLUSIONS

The UN Conference on Trade and Development forecast global foreign direct investment flows will decline by 40% in 2020, which would result in total investment falling below US$1 trillion for the first time since 2005. The organisation anticipates further falls in 2021 – in the range of 5% to 10% – before starting to recover in 2022, however they note the high degree of uncertainty around this outlook, in part due to the unknown duration of the pandemic.

They highlight that the COVID-19 pandemic has generated shocks to both the supply of and demand for foreign investment, as well as impacting government policies – the latter having a considerable potential to constrain Chinese investment.

A key driver of the expected pickup in investment flows in 2022 is the restructuring of global supply chains. In part this may be required to develop greater resilience – with the fragility of supply chains highlighted during the early stages of the pandemic – but also efforts develop non-Chinese industrial capacity to avoid growing trade barriers.

# CONTACT THE AUTHOR

Gerard Burg

Senior Economist – International

Gerard.Burg@nab.com.au

+61 477 723 768

# Group Economics

Alan Oster
Group Chief Economist
+(61 3) 8634 2927

Jacqui Brand
Personal Assistant
+(61 3) 8634 2181

Dean Pearson
Head of Economics
+(61 3) 8634 2331

John Sharma
Economist
+(61 3) 8634 4514

## Australian Economics and Commodities

Gareth Spence
Senior Economist – Australia
+(61 4) 36 606 175

Phin Ziebell
Senior Economist – Agribusiness
+(61 4) 75 940 662

## Behavioural & Industry Economics

Robert De Iure
Senior Economist – Behavioural & Industry Economics
+(61 3) 8634 4611

Brien McDonald
Senior Economist – Behavioural & Industry Economics
+(61 3) 8634 3837

Steven Wu
Economist – Behavioural & Industry Economics
+(613) 9208 2929

## International Economics

Tony Kelly
Senior Economist
+(61 0) 477 746 237

Gerard Burg
Senior Economist – International
+(61 0) 477 723 768

# Global Markets Research

Ivan Colhoun
Global Head of Research
+(61 2) 9237 1836