TRANSFORMATION OF GLOBAL SUPPLY CHAINS IN THE WAKE OF THE US-CHINA TRADE WAR

EAC investigated manufacturing opportunities and indicators in South East Asia

The ongoing trade war between China and the United States continues to impact global supply chains. In Q1 2019, imports to the U.S. from China have declined around 14% YOY, with tariffs of up to 25% putting pressure on manufacturers in China. Shrinking margins and unpredictable trade relations are forcing companies to consider new strategies to avoid tariffs, including moving part of their production facilities out of China. Short-term solutions to avoid tariffs include temporarily moving production back to a company’s home country. But with no end in sight for the trade war, companies are starting to look for more long-term solutions such as building up production capacity in third-party countries.

**EAC China Relocation Index 2019 - Opportunities for manufacturing in South East Asia**

A recent industry survey shows that 80% of US respondents are considering shifting their supply chains away from China. European companies are significantly less affected, currently only 6% are moving relevant production out of China. The majority (68%) of European companies is still monitoring the situation according to a study by the European Chamber. This is in line with EAC’s observation that most European companies do not plan to abandon their China facilities as a result of the trade war. Instead they are planning to diversify their operations by adding another location in Asia, also known as a “China plus One” strategy. For companies considering investing outside of China, South East Asian countries are an attractive destination due to their proximity to China and low labor costs. EAC looked at recent trends in international trade as well as country- and industry-specific indicators to analyze which industries are most likely to transform their supply chains and where companies are expected to go.
Vietnam is the most attractive country for companies in the electronics sector, closely followed by Malaysia. Due to the complexity of electronic products, companies are mainly focusing on shifting the assembly of products, with tooling and development remaining in China. As a result, Northern Vietnam emerges as a potential new hub near the electronic manufacturing center in Southern China. Apple is reportedly considering moving up to 30% of its production out of China and has started trial production of its AirPod headphones in Vietnam.

**Which markets are likely to see an influx of investment in the wake of the US-China trade war?**

China is currently the largest exporter of textiles in the world, with products accounting for 11% of Chinese exports to the US. Vietnam and Indonesia are the most likely destinations for textile companies, with existing infrastructure and industry-specific expertise attracting investors. Price-sensitive customers and low product complexity further increase the likelihood of a shift out of China. One example is the American shoe manufacturer Brooks Shoes, a subsidiary of Warren Buffett’s conglomerate Berkshire Hathaway. The company is forced to move its factories out of China because tariffs cannot be passed on to their American customers. Around 8,000 jobs will be shifted from China to Vietnam until the end of 2019.

This shift of supply chains from China to South East Asia is part of a larger trend, with companies pushed out of China due to rising wages and an aging workforce. However, China has long moved above cheap, low-skilled manufacturing and offers other advantages such as a well-developed infrastructure and expertise in automation. While the trade war is increasingly shifting the business case in favor of relocating production to low-cost countries, companies need to carefully consider the risks of moving out of China. Productivity in South East Asia remains low compared to China and infrastructure is already at capacity with congested roads and ports as a result of the rapid influx of companies.

**China reacts by easing restriction on foreign companies**

To prevent a potential exodus from China, the Chinese government recently confirmed its commitment to easing restrictions on foreign companies. During the World Economic Forum in Dalian at the beginning of July, Chinese Premier Li Keqiang announced plans to reduce tariffs, protect intellectual property and liberalize the manufacturing
sector. Chinese officials are also discussing a test project at the Shanghai Free trade Zone with lowered import taxes and streamlined processes. Companies who so far had limited exposure to China could now take advantage of an improved regulatory environment by making a strategic move to China.

Conclusion

The US-China trade war accelerates the ongoing global shift of diversifying supply chains. Companies hope to limit exposure to trade conflicts while benefitting from cost-saving opportunities in South East Asian countries. While China will likely play a central role in global manufacturing for the foreseeable future, an increasing number of companies opening factories elsewhere could lead to a chain reaction and a permanent transformation of global supply chains. EAC can help your company to navigate these complex changes and to identify strategic manufacturing locations in China and South East Asia.

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