JPMorgan Chase Bank, N.A., Hong Kong
Carol Wei Liao (852) 2800-2801
carol.w.liao@jpmorgan.com

JPMorgan Chase Bank, N.A., Singapore Branch
Benjamin Shatil (65) 6882-2311
benjamin.shatil@jpmorgan.com

JPMorgan Chase Bank, N.A., Hong Kong
Shaoyu Guo (852) 2800-2163
shaoyu.guo@jpmchase.com

J.P.Morgan

Economic Research Note

China's tourism outflows step up

- **China's outbound tourist flows have accelerated rapidly…**
- **…driven in part by disguised capital outflow but now contained by capital controls**
- **These flows have become important sources of current account (CA) surpluses for several Asian economies**
- **Tourism-related outflow likely will stabilize as a share of GDP, limiting scope for wide CA deficits in China**

China's current account (CA) surplus has narrowed sharply over the past decade, from nearly 10% of GDP in 2007 to just 0.4% last year. It could turn into a small deficit as early as this year if the US-China tariff war escalates further. While historically the goods trade balance drove the overall narrowing—a trend that weak exports could exacerbate as trade tensions escalate—China's widening deficit in services is an increasingly important factor. The persistent widening of the services deficit, in turn, reflects the rapid rise in outbound tourism from China.

The number of Chinese tourists traveling abroad grew at a double-digit pace almost every year from 2000 to 2015. While growth has slowed over the past few years, the number of outbound tourists remains high, and their per capita spending was almost double the world average as of 2018. The loosening of the correlation between tourist expenditures and tourist numbers in recent years suggests that a portion of flows classified as tourism payments may in fact represent disguised capital outflows, particularly around the sharp CNY depreciation in 2015-2016. The tightening of capital controls since then, though, has successfully clamped down on such outflows.

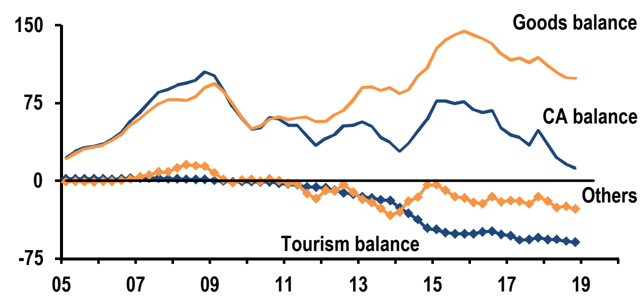
China's tourism-related outflows have by and large become Asia's inflows, with China accounting for over a fifth of all arrivals in the rest of Asia, and China-derived tourism receipts supporting regional current account surpluses to varying degrees across Japan, Korea, and several ASEAN economies. Chinese tourist spending appears comparatively insensitive to exchange rate fluctuations and arrivals are less seasonal than their North American or European counterparts, suggesting a relatively stable contribution from China to regional current accounts, absent exogenous shocks.

While we expect the number tourists from China to continue rising, we think spending per capita may have peaked, putting a brake on surging tourism-related outflows. If we are correct, China's tourism deficit (as a share of GDP) should remain stable, limiting any further widening in the current account services deficit. And, if US tariffs prove to be a one-off shock and trade flows adjust after a couple of quarters, the trade balance also could stabilize. In addition, China's saving rate remains one of the highest in the world. Thus, while China's current account could turn into a small deficit as early as this year if tariffs rise further, a sustained widening deficit is unlikely in the medium term.

China's growing outbound tourism…

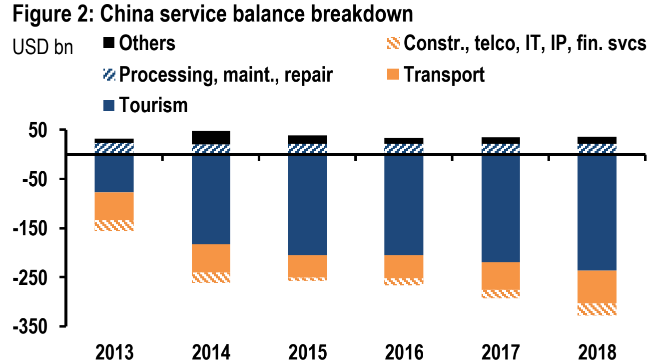
China registered a services trade deficit of almost US$300 billion (or 2.2% of GDP) last year, largely offsetting the goods trade surplus of just under US$400 billion. With the size of the service deficit now comparable to the goods balance, the trend in service trade is increasingly important in determining China's overall external position. While China's invisibles (services and income) deficit has been widening steadily since 2010—largely on account of tourism flows—it has showed signs of stabilization lately (Figure 1).

Figure 1: China current account composition
USD bn, 4qma



Source: SAFE, J.P. Morgan

Figure 2: China service balance breakdown
USD bn



Source: SAFE, J.P. Morgan

Within services trade, tourism is the largest component. The tourism deficit reached US$237bn in 2018, or 1.7% of GDP, accounting for 81% of China's total service deficit (Figure 2). Outbound travel accounts for about 54% of China's service imports, reaching US$277bn in 2018, up from just US$13bn

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Benjamin Shatil (65) 6882-2311
benjamin.shatil@jpmorgan.com

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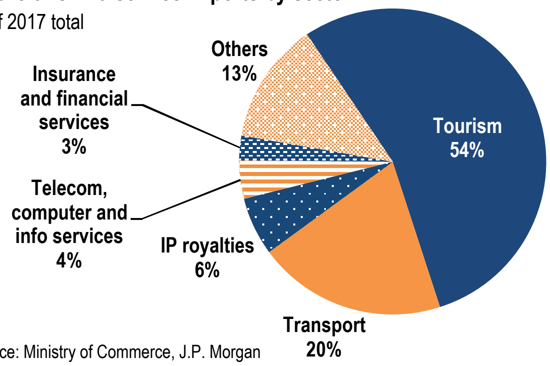
Shaoyu Guo (852) 2800-2163
shaoyu.guo@jpmchase.com

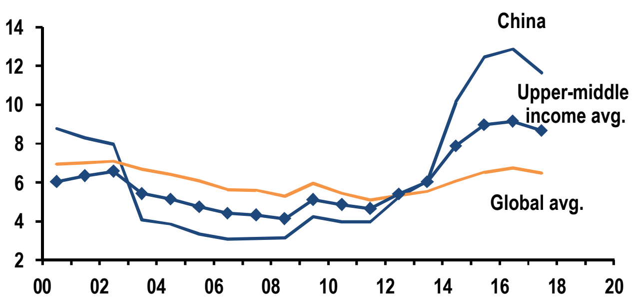
in 2000. The share of travel expenses in China's total imports has climbed rapidly, significantly exceeding global and upper-middle-income country averages (Figures 3 and 4).

Figure 3: China service imports by sector
% of 2017 total



Source: Ministry of Commerce, J.P. Morgan

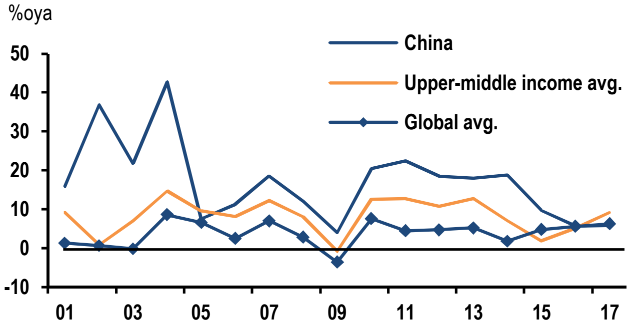
Figure 4: Tourism expenditure as share of total imports
% share



Source: World Bank, J.P. Morgan

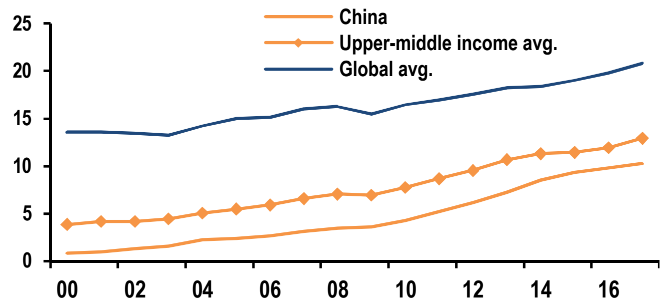
The number of Chinese tourists traveling abroad had registered double-digit annual growth between 2000 and 2015 (except for a short dip in 2009 around the global financial crisis), well above the world average (Figure 5). The growth rate has eased notably since then, converging to the global average. While the number of outbound tourists as a percentage of China's total population has been rising steadily, it is still lower than that of the upper-middle-income country (UMC) and world averages (Figure 6).

Figure 5: Tourist departure growth
%oya



Source: World Bank-WDI, J.P. Morgan

Figure 6: Outbound tourists
% share of population

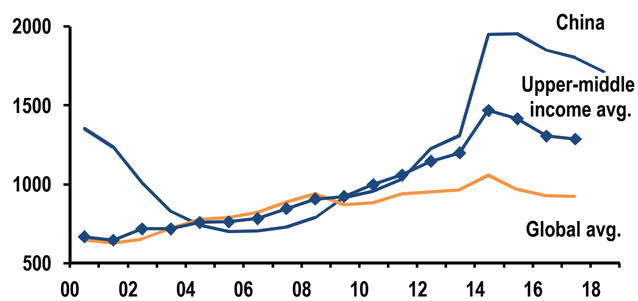


Source: World Bank-WDI, J.P. Morgan

…partly reflects hidden capital outflows…

Not only have outbound tourists surged in number, but their expenditure per capita has increased rapidly (Figure 7). It had been growing broadly in line with the UMC average tourist spending before it surged nearly 50%oya in 2014 by, and remained elevated in 2015 peaking at US$1,953.9. Average spending has contracted since 2016, but still was double the world average in 2018.

Figure 7: International tourism, expenditure per capita
USD



Source: World Bank, J.P. Morgan

The surge of China's travel imports in recent years may also reflect disguised capital outflows. As China's financial account remains tightly controlled, households have limited channels to move assets overseas. Indeed, China's tourism spending has grown much faster than the number of outbound tourists, especially around the capital flight episode of 2015-2016 (Figure 8), in contrast to the trend for the rest of the world (Figure 9).

Part of the surge in tourism spending reflected financial market developments: bank cards and third-party payment systems overseas have greatly facilitated overseas travel spending, which has been included in official BOP statistics since 2014. But the SAFE 2015 BOP report noted an unusual surge in bank card withdrawals overseas and since then China has tightened regulations on overseas card spending. With new rules on cash withdrawals in place, cash withdrawals as per-

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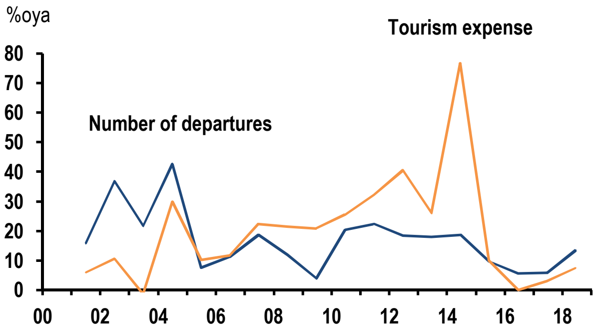
JPMorgan Chase Bank, N.A., Hong Kong
Shaoyu Guo (852) 2800-2163
shaoyu.guo@jpmchase.com

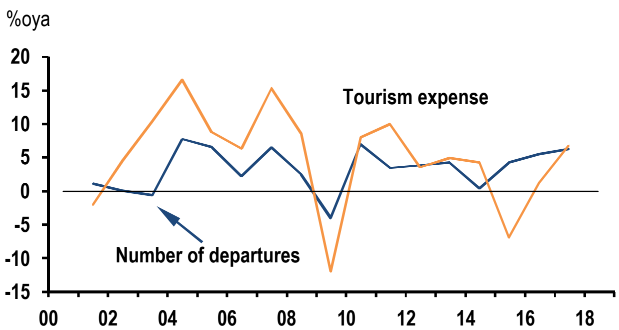
centage of card spending overseas fell from 21% in September to 13% in December 2015.

Figure 8: Chinese tourism flows



Source: World Bank, J.P. Morgan

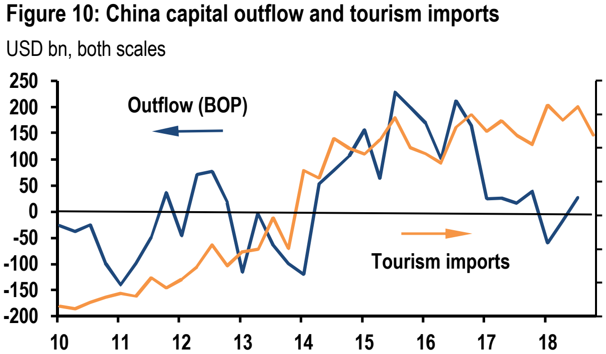
Figure 9: World ex. China tourism flows



Source: World Bank, J.P. Morgan

Tourism imports also appeared highly correlated with BOP capital outflows (Figure 10) around 2015-2016. Since late 2016, shifting economic fundamentals and tightened capital controls have contained capital outflows, and tourism import growth also moderated. Indeed, despite sharp CNY depreciation in 3Q18, per capita tourism outflows were unchanged, suggesting that capital controls helped prevent capital flight.

Figure 10: China capital outflow and tourism imports

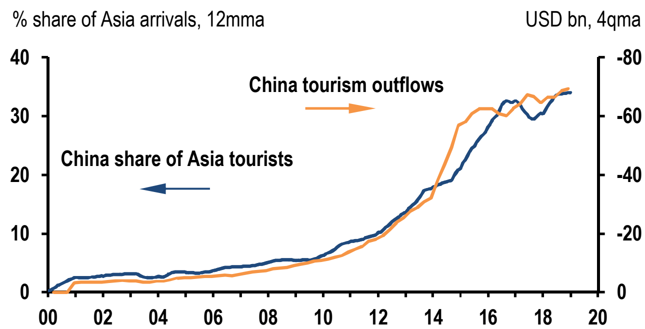


Source: SAFE, J.P. Morgan

…supporting regional external surpluses

China's tourism-related outflows have by and large become Asia's inflows, with China accounting for over a fifth of all tourist arrivals in the rest of EM Asia and Japan (Figure 11).

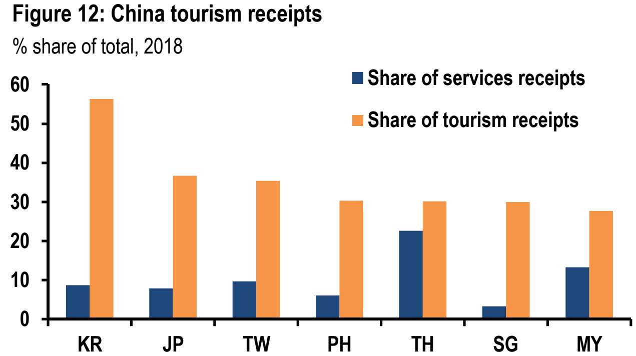
Figure 11: China tourists to Asia and tourism outflows



Source: National statistics authorities, J.P. Morgan

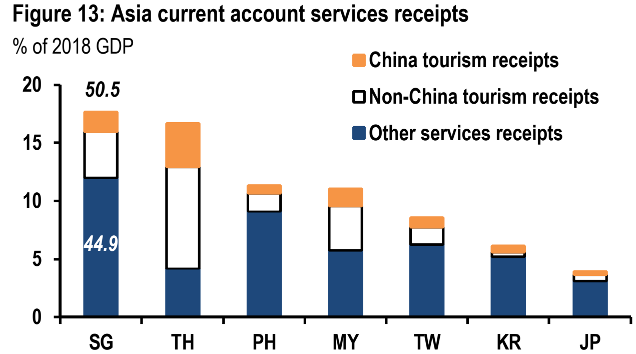
China accounts for an even higher share of Asia's total tourism revenues. Using average per capita tourist expenditure data, which suggest that Chinese tourists spend more than the average visitor as discussed above, we estimate that China accounts for around one-third of tourism revenues across much of the region (Figure 12). In some ASEAN economies—particularly Thailand—Chinese tourism inflows have become an important driver of the overall services balance, supporting the overall current account surplus (Figure 13).

Figure 12: China tourism receipts



Source: National statistics authorities, J.P. Morgan estimates

Figure 13: Asia current account services receipts



Source: National statistics authorities, J.P. Morgan estimates

JPMorgan Chase Bank, N.A., Hong Kong
Carol Wei Liao (852) 2800-2801
carol.w.liao@jpmorgan.com
JPMorgan Chase Bank, N.A., Singapore Branch
Benjamin Shatil (65) 6882-2311
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shaoyu.guo@jpmchase.com

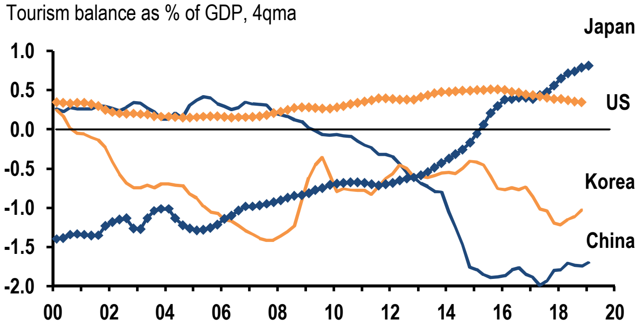
China's tourist spending appears comparatively insensitive to exchange rate fluctuations, and tourist arrivals from China are less seasonal than their North American or European counterparts. As a result, Chinese tourists' contribution to regional current accounts appears relatively stable, absent exogenous shocks. In some economies—most notably Thailand and Japan—this has fueled a steady rise in the net tourism balance.

Expecting stable growth in China's tourism outflows

The number of Chinese outbound tourists likely will continue to rise steadily instead of rapidly, as the percentage of the population traveling abroad per year approaches the UMC average (10.3% for China vs. 12.9% average for UMC in 2017). Meanwhile, per-capita travel expenses appear to have peaked, and have tapering off from a near-US$2,000 high in 2015, partly due to tightened capital controls, but also driven by the upgrading of domestic industry and economic rebalancing. This could put a brake on any further widening in the tourism deficit. Indeed, China's tourism deficit as a percentage of GDP has been roughly stable since 2015 (Figure 14).

Figure 14: Global net tourism receipts

Tourism balance as % of GDP, 4qma



Source: National sources, J.P. Morgan

We expect the number of outbound tourists to continue growing as the share of the population that has traveled abroad is still low, but the moderating per-capita spending could ease tourism import growth. In an extreme scenario where sharp CNY depreciation revived capital outflow pressure, the reduced purchasing power and tighter capital controls should be able to prevent a renewed surge of tourism expenditures.

Overall, we think China's tourism deficit as a percentage of GDP will stabilize in the next few years. Since US tariffs are likely to be a one-off shock trade flows should adjust in a few quarters and the trade balance stabilize after that adjustment. In the risk scenario of a full-blown trade war with a further tariff hike later this year, China's current account could fall into a small deficit as early this year, driven by a reduced goods trade surplus and a stable services deficit relative to GDP.

While tourism outflows as a share of China's GDP likely will level off in coming years, these flows will nevertheless continue to represent a large nominal dollar inflow elsewhere in the region, supporting regional external balances. Assuming China's tourism-related outflows grow in line with nominal GDP, these dollar flows could rise around 8%oya per year, faster than export growth for most economies, and thus services balances could become an increasingly important driver of regional current account surpluses.

This dynamic could have important implications for the overall balance of payments and exchange rate drivers for several economies in EM Asia, given that China's tourism spending tends to be neither cyclical nor seasonal—in sharp contrast to the drivers of exports and the goods trade balance. The relation between currency valuations and tourism inflows may also be more tenuous: whereas expensive or uncompetitive exchange rates can prompt export and import adjustments in the goods balance, tourism flows appear relatively price inelastic. In Thailand, for example, China-related tourism inflows have surged despite the THB appreciating almost 25% against the CNY from the low in 2015. This has allowed for persistent balance of payments surpluses and FX appreciation—a trend which could extend to other EM Asia economies, albeit to lesser degrees, over the medium term.

JPMorgan Chase Bank, N.A., Hong Kong
Carol Wei Liao (852) 2800-2801
carol.w.liao@jpmorgan.com
JPMorgan Chase Bank, N.A., Singapore Branch
Benjamin Shatil (65) 6882-2311
benjamin.shatil@jpmorgan.com

JPMorgan Chase Bank, N.A., Hong Kong
Shaoyu Guo (852) 2800-2163
shaoyu.guo@jpmchase.com

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