

# ASIA MONTHLY

## January 2021

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## **Topics** *China aims to double national income with its "dual circulation" strategy*

China aims to double its national income by 2035 by employing a "dual circulation" growth strategy. This strategy emphasizes three points: (i) domestic demand-led growth; (ii) strengthening self-sufficiency; and (iii) increasing the world's dependence on China.

### ■ **China's medium- and long-term goals were set at the Fifth Plenary Session**

The Fifth Plenary Session of the Central Committee of the Communist Party of China (CPC) was held in October as an important meeting to show the direction of China's medium- to long-term policies. The discussion held in the Fifth Plenary Session was summarized as "Proposals on the 14th Five-Year Plan and Long-Range Objectives Through the Year 2035" (hereinafter, the "Proposal"). It was published on November 3 and consists of 20,000 Chinese characters and 15 chapters with 60 sections.

At the same time, an explanation of the Proposal by President Xi Jinping was made public on November 3. In his explanation, President Xi highlighted the following seven points as important issues for policy management during the period between 2021 and 2035: (i) ensuring high quality growth; (ii) building a new economic development model based on "dual circulation"; (iii) becoming a high-income country by 2025 and doubling GDP or per capita income by 2035; (iv) reducing poverty and income disparity; (v) strengthening national security and defense; (vi) reinforcing the leadership of the Communist Party; and (vii) declaring the achievement of a "moderately prosperous society" in the year of the 100th anniversary of the CPC (2021).

Ensuring high-quality growth listed in (i) above can be seen as a message to shift toward "moderate growth" that does not create imbalances. The Chinese government has described the transition of the Chinese economy from a high growth rate to a medium-to-high growth rate using the phrase, "new normal." Such medium-to-high speed growth indicates growth at about 7%. If the government continues to aim to achieve medium-to-high speed growth in the future, it could widen the imbalance in various fields. This appears to be the reason why the government chose to use the phrase "ensuring high-quality growth."

In order to achieve the target of becoming a high-income country by 2025 listed in (iii) above, it is necessary to increase per capita GDP in U.S. dollars by at least 4.5% annually on average. High income countries have a per capita GDP of approximately 13,000 dollars or more. China's per capita GDP in 2019 was 10,278 dollars. If China's annual average growth rate over the next five years is +4.5% or more, its per capita GDP could reach 13,000 dollars by 2025. As a reference, China's average annual growth rate of per capita GDP over the last five years was +6.1%.

With regard to the long-term target of doubling GDP or per capita income by 2035, it is unclear whether the target is set on a dollar basis, yuan basis, real basis or nominal basis. However, in order for China to become a country with a per capita GDP of 20,000 dollars, it will be necessary to maintain an annual average growth rate of more than 4.5% over the next 15 years.

This long-term goal is an ambitious one. In China, the population will start to decline around 2030, while the problem of excessive debt and nonperforming loans is another cause for concern that could hamper achievement of the target.

### ■ **"Dual circulation" growth strategy has been set to achieve the targets**

Attention has been focused on "dual circulation" listed in (ii) above as a strategy for medium- to long-term economic growth. The Proposal indicated that dual circulation would be implemented to expand trade and inward and outward investment while boosting domestic demand through various policies.

According to President Xi's explanation on November 3, dual circulation is not only a strategy for economic growth but also a strategy for international cooperation and competition. Smooth circulation of the domestic economy will enable China to attract foreign resources (capital and human resources), meet domestic needs, raise technology levels, participate in international economic cooperation and form new advantages in international competition.

However, this explanation is not sufficient to clarify what exactly the new development model is and what kind of policies should be emphasized in the growth strategy.

### ■ **Emphasis on domestic demand-led growth**

Despite the foregoing, if we look at President Xi's statement at the following internal meeting, we can better understand dual circulation and medium- to long-term policy management directions. Specifically,

let's look at President Xi's statement at the meeting of the Central Financial and Economic Affairs Commission held on April 10. The statement entitled "Serious issues concerning the national strategy for medium- to long-term economic and social development" was posted in the November 2020 issue of *Qiushi*, a political theory periodical published by the Central Committee of the CPC, and was also released on the government website on October 31 immediately after the Fifth Plenary Session.

According to the statement, the government aims to create a new development model that promotes both domestic and international cycles with a focus on the domestic general cycle. China has grown up with a development model called "international general circulation." However, as anti-globalization movements have emerged in recent years, expansion of domestic demand has become more essential for long-term economic development.

It is also noteworthy that President Xi placed consumption as an important driving force in the statement. Currently, China has the world's largest middle-class population, numbering about 400 million, and further expansion of this middle class is set as an important policy goal. To this end, the statement indicated that the government should review income distribution, establish a compensation system that is commensurate with the degree of contribution in knowledge, technology and management skills, and expand human capital investment. In this way, the Xi Jinping administration is aiming for domestic demand-led growth centered on expanding consumption.

The statement also indicated that the government would increase the urban population as well as the urbanization rate, which currently stands at 61%. Notably, however, megacities with a population density of 10 million or more and super large cities with a population density of 5 million or more are exceptions. In addition, the quality of people's lives will be improved through the development of healthy, safe and convenient communities. The statement indicated that demand for childcare, nursing care, housekeeping, education and medical services is expected to grow sharply. In other words, urbanization is positioned as a powerful policy to expand consumption. Some say China's rural surplus labor has reached its limit and has passed the "Lewis turning point" but the Xi Jinping administration still sees plenty of surplus labor in rural areas.

■ **The government aims to strengthen self-sufficiency and increase the world's dependence on China**

In addition, the statement indicated that China would enhance its own technology to boost self-sufficiency and increase the world's dependence on China. The Proposal listed challenges in a wide range of areas, including industry, monetary policy, fiscal policy, administrative structure, social policy, diplomacy, and defense, and positioned innovation as the core of new nation-building. Based on the recognition that innovative science and technology will support the development of the nation, the Proposal calls for strong top-down national projects such as artificial intelligence (AI), quantum cryptography, and semiconductors.

President Xi's statement goes even further. It was clearly stated that China would promote import substitution by improving technology. One of the aims is to reinforce weaknesses and to ensure normal production in the event of an emergency.

Another aim is to enhance China's strengths. The government aims to continue to develop and demonstrate China's competitive edge in fields such as high-speed railways, power generation, new energy (EV, etc.) and telecommunications by refining its core technologies. The statement also indicated that the government aims to increase dependence on China in the global supply chain and thereby develop a strong counterattack and deterrence against foreign countries that would discontinue the supply of goods. This can be interpreted as remarks that take into account prolonged confrontation between the United States and China.

In light of the above, the Xi Jinping administration will likely place importance on (i) domestic demand-led growth, (ii) enhanced self-sufficiency, and (iii) increased world dependence on China in terms of dual circulation and China's medium- to long-term policy management that has attracted much attention.

(Shinichi Seki)

**Topics** Supply chain restructuring will likely continue due to U.S.-China conflicts

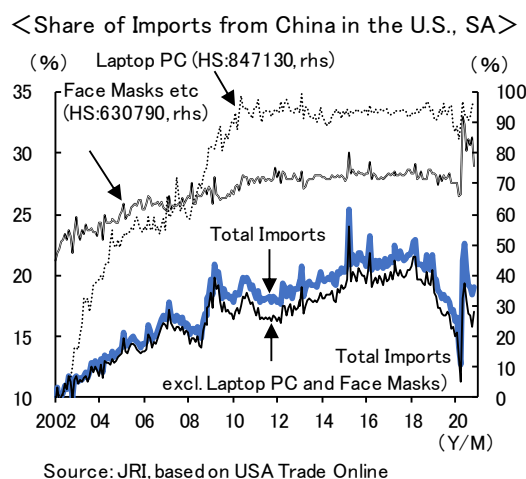
The United States' dependence on imports from China has increased, but this is only a temporary boost due to special demand related to COVID-19. The continuation of tariffs on Chinese goods would encourage foreign companies in China to relocate their production bases to other parts of Asia.

■ **The rebound in China's exports to the United States is temporary**

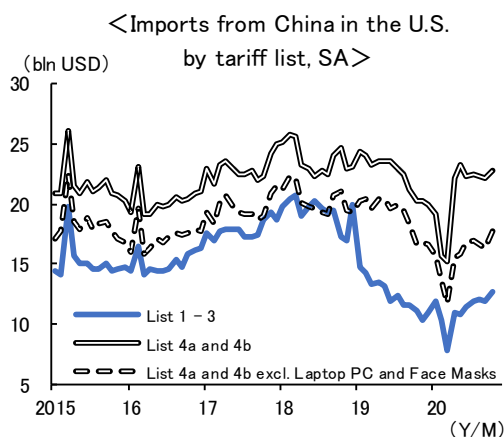
In October 2020, U.S. imports were flat compared to the same month last year, but imports from China increased by 11.7% year-on-year, showing that the import dependence on China has been increasing recently. However, given that (i) special demand related to COVID-19 will gradually decline, and (ii) the United States will maintain tariffs on Chinese goods imposed by the Trump administration, these moves are expected to be temporary.

In the wake of the COVID-19 pandemic, a sharp increase in demand for IT-related products and medical products was seen; however, in all other areas, U.S. imports from China have stayed at a low level. In fact, China's share of U.S. imports has returned to the 2018 level (approximately 20%) before the imposition of tariffs, while the share of imports has remained low at around 16% when excluding imports of face masks to prevent the spread of COVID-19 and laptop PCs, which saw a surge in demand as a result of an increase in telework. The rapid increase in imports from China was due to China's ability to supply products to the rest of the world in a short period of time amid supply problems in the early stages of the COVID-19 outbreak. China's share of U.S. imports increased rapidly not only for face masks (the share of U.S. imports from China increased from 72% in 2019 to 85% on average during the period between January and October 2020) but also for medical products such as felt and nonwoven clothing (increased from 54% to 77%) and thermometers (increased from 36% to 71%). Also, in the United States, some goods had already been dominated by Chinese production, and an increase in demand for laptop PCs boosted production even further in China. This type of special demand does not seem to be sustainable, and demand is expected to gradually decline in the future.

In addition, tariffs imposed by the Trump administration are expected to weigh on imports from China. On December 2, U.S. President-elect Joe Biden announced that he would not immediately abolish tariffs that had been introduced as sanctions. Under the Trump administration from 2017, confrontation with China intensified, and the United States has announced additional tariffs in four stages. In stage 1, 25% additional tariffs were imposed on approximately USD34 billion of goods annually (from July 2018); in stage 2, 25% additional tariffs were imposed on about USD16 billion of goods (from August 2018); in stage 3, 10% additional tariffs were imposed on about USD200 billion of goods (10% tariffs were imposed from September 2018, which was increased to 25% from May 2019); and in stage 4a, 15% additional tariffs were imposed on about USD120 billion of goods (15% tariffs were imposed from September 2019, which was decreased to 7.5% from February 2020). Face masks, which are included in the scope of stage 4a tariffs, were designated as tariff exempt items, while laptop PCs are included in the scope of stage 4b tariffs on about USD160 billion of goods, which had been decided to be suspended as a result of the U.S.-China agreement in January 2020.



Source: JRI, based on USA Trade Online



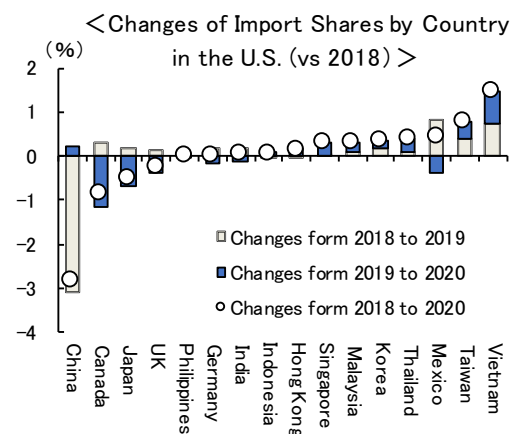
Source: JRI, based on USA Trade Online

Looking at imports from China by tariff list, imports of goods subject to 25% additional tariffs (stage 1 through stage 3) have slumped significantly. Even after the change of government in the United States, it is unlikely that the U.S.-China conflict will ease, and strong calls for correction of imbalances in trade will likely remain across different political parties. It will be difficult for the new president to decide to ease or abolish the tariffs, and the United States will likely continue to exert downward pressure on imports from China.

**■ Asia will remain as a strong candidate destination for production transfer**

Against the backdrop of continuing tariffs on exports from China imposed by the United States, many companies are expected to continue reviewing their supply chains by transferring their production bases in China to other regions. In fact, import shares in trade statistics of the United States indicate that production transfers will continue, as shown by the significant increase in Vietnam’s share not only during the period between 2018 and 2019 but also during the period through 2020.

Looking at items that have contributed significantly to the decrease in U.S. imports from China, many countries and regions with increased share of US imports are in Asia. This indicates that Asian countries are leading candidates in the transfer of production bases away from China. Vietnam in particular has been expanding its share for a wide range of items, including furniture, toys and electronics. On the other



Source: JRI, based on USA Trade Online  
Note: Average of Jan–Oct for 2020.

hand, while Taiwan and South Korea are highly competitive in the field of high-technology items such as processing equipment including CPUs and SSDs (storage media using semiconductor memory), Malaysia is also expanding its share. Malaysia has been successfully attracting a large number of semiconductor companies in Penang and has the potential to increase its presence in the high-tech field in the future.

A series of tariff hikes on Chinese goods since 2018 and the suspension of distribution in China during the early stages of the COVID-19 outbreak in 2020 have encouraged many countries to shift away from their dependence on China. Although imports from China recently increased significantly in the United States and the dependence of the U.S. economy on China has also increased, this trend is only temporary, with no change in the movement toward the shift away from dependence on China. Looking at developments to date, Asian countries and regions, particularly Vietnam, will likely continue to benefit from this movement. At the same time, there are concerns that tensions in the high-tech sector, such as the Huawei ban, may intensify further. If high-tech supply chain realignment accelerates, Malaysia, in addition to Taiwan and South Korea, could demonstrate the advantage in this field.

< Ranking of Import Share Changes by Product in the U.S. >

Imports from China in the U.S.: Top 10 Products of Negative Contributions to Imports in 2018 Jan – Oct 2020 (HS-digit)	Top 5 countries where expand their shares in U.S. imports				
	1	2	3	4	5
1 Communication apparatus excl. phones	Vietnam	Taiwan	Thailand	Israel	Czech Republic
2 Phones for Cellular Ntwks	Vietnam	India	Indonesia	Singapore	United Kingdom
3 Parts for Machines	Taiwan	Korea, South	Vietnam	Mexico	Malaysia
4 Digital Processing Units	Taiwan	Poland	Germany	Malaysia	Netherlands
5 SSD	Korea, South	Taiwan	Malaysia	Mexico	Philippines
6 Reception Apparatus for TV	Mexico	Vietnam	Taiwan	Poland	Hungary
7 Seats with Wooden Frames	Vietnam	Malaysia	Cambodia	Thailand	Mexico
8 Container Bags	Cambodia	Vietnam	Burma	Indonesia	Philippines
9 Static Converters	Vietnam	India	Thailand	Spain	Mexico
10 Wheeled Toys	Vietnam	Indonesia	Czech Republic	Thailand	Taiwan

Source: JRI, based on USA Trade Online

(Minoru Nogimori)