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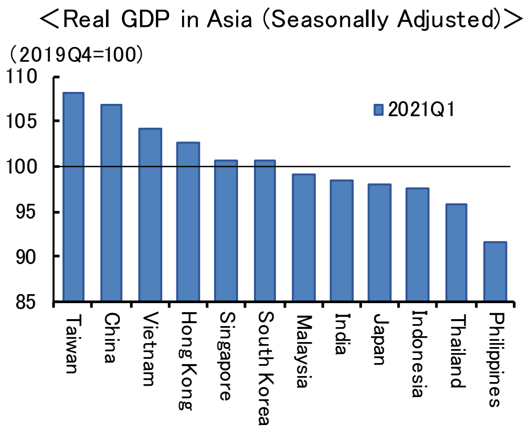
Asia: The Asian economy is moving toward the post-COVID-19 era

In Asia, economic recovery has remained robust in countries such as Taiwan and Vietnam, whose economies are export-led. The Philippines, Indonesia and India, which have been slow to recover, are showing signs of catching up, but normalization of U.S. monetary policy may hamper their progress.

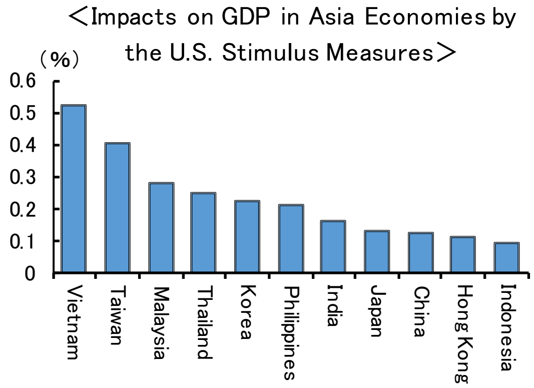
1. Economic recovery has accelerated in countries and regions led by exports

While the Asian economy has continued to recover, the pace of recovery varies among countries and regions. China managed to curb the spread of COVID-19 from an early stage and is on a recovery track. Taiwan and Vietnam, whose exports to China and IT-related exports have greatly increased, are also recovering rapidly. Following in the footsteps of these countries are Hong Kong, Singapore, and South Korea, and economic activity in countries and regions with high external demand ratios has returned to pre-COVID-19 levels. On the other hand, Southeast Asian countries such as the Philippines, Thailand and Indonesia are lagging behind. These countries are more affected by weak domestic demand than by increased exports. Although Thailand has a high ratio of goods exports, it is also highly dependent on demand related to inbound tourism, and the lack of a return of foreign tourists has been a major factor behind the economic downturn.



Source: JRI, based on CEIC

Looking ahead, the Asian economy is expected to continue to recover, led by external demand due to the following three factors. First, China's robust recovery will continue. While the government is expected to take steps to curb investment, personal consumption is expected to show further recovery. With the establishment of a system to contain the virus as soon as possible, China's vaccination rate has already reached 94.3% (cumulative number of vaccinations per population as of July 7), and the possibility of a downturn in the economy due to restrictions on activity is greatly decreasing. As a result, Asian countries are likely to continue expanding their exports to China.



Source: JRI based on OECD and various media reports
Note: After estimating economic impacts on the U.S. by the USD 1.9trn American Rescue Plan, we calculated impacts on Asia economies through exports to the U.S. by using data of "Trade in Value Added (TiVA)" and income elasticity of the U.S. imports.

Second, the IT boom, which has grown to the point where supply and demand for semiconductors is tight, will continue. Demand related to medical products, which enjoyed special demand following the outbreak of the COVID-19 pandemic, has slowed, as shipments of nonwoven masks have peaked out. Demand related to IT, on the other hand, is expected to remain firm, including demand related to telework.

Third, exports from Asia to the United States are expected to increase upon the approval of an additional $1.9 trillion economic stimulus package (American Rescue Plan Act of 2021) in March. Additional economic measures, including individual benefits of up to 1,400 dollars per person and additional unemployment insurance, are expected to boost personal consumption. This will likely boost the U.S. economy by around 2%, and an increase in exports to the United States could boost Asian economies as well.

In this way, the pace of recovery is expected to increase in export-led countries and regions thanks to the economic recovery of the United States, in addition to the continuation of China's economic recovery and special IT demand. In 2021, the growth rate of Asia as a whole is expected to rebound to + 8.0% year on year, from + 1.9% in 2020. In particular, China, Taiwan, and Vietnam are expected to achieve high growth. On the other hand, in terms of domestic demand, many countries other than China have been slow in their vaccine rollout, and they will not likely overcome the downtrend trend. In the Philippines, Indonesia, and India, where domestic demand ratios are high, the pace of recovery will be slow and a full-scale recovery is not anticipated until after 2022.

＜Growth Forecasts for Asian Economies＞

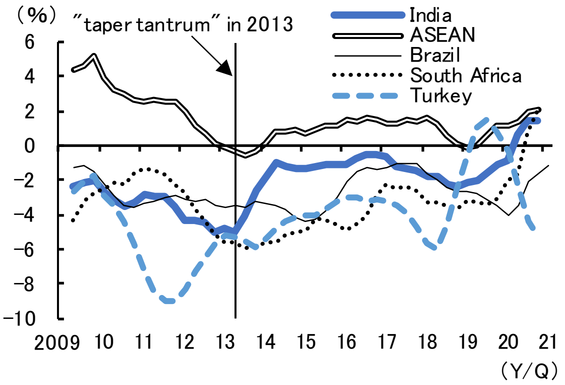
	2019	2020	2021 (F)	2022 (F)
Asia	**5.4**	**1.9**	**8.0**	**4.8**
China	6.0	2.3	9.0	5.1
Korea	2.2	▲ 0.9	3.9	2.2
Taiwan	3.0	3.1	5.5	2.2
Hong Kong	▲ 1.7	▲ 6.1	5.9	2.2
ASEAN	4.8	▲ 3.6	4.4	5.3
Thailand	5.0	▲ 2.1	4.3	5.5
Malaysia	4.4	▲ 5.6	5.9	5.9
Indonesia	6.1	▲ 9.6	4.8	5.2
Philippines	2.3	▲ 6.1	1.8	3.5
Vietnam	7.0	2.9	6.9	6.9
India (Fiscal year)	4.0	▲ 7.3	9.0	6.9

Source: JRI

2. The Stability of Asian finance and the economy will be tested in the post-COVID-19 era

The normalization of monetary policy in the United States could dampen moves toward a full-fledged recovery by 2022. In May 2013, the U.S. Federal Reserve's indication of a reduction in quantitative easing accelerated capital outflows in emerging economies, causing turmoil in those markets (taper tantrum). At that time, India and Indonesia, along with Turkey, South Africa, and Brazil, were called the "Fragile Five," and suffered a rapid depreciation of their currencies, which resulted in a severe economic downturn. Currently, the exchange market in Asia is generally stable, supported by a significant improvement in the current account balance. According to the IMF's assessment of the adequacy of foreign exchange reserves, Turkey, South Africa and some other countries are expected to continue to face shortages of foreign exchange reserves, while most Asian countries and regions were assessed to have no problems.

＜Current Account Balance in Emerging Economies (% of GDP)＞



Source: JRI, based on CEIC
Note: 4-quarter backward moving averages.

However, there is a great deal of uncertainty about the future. In the United States, the recovery trend is clear, and discussions about the Fed’s tapering of asset purchases may move ahead of expectations. In Asian countries and regions, if domestic demand recovers rapidly due to the progress of COVID-19 vaccinations, foreign currency may flow out due to the deterioration of the current account balance as a result of the rapid increase in imports and their currencies may fall. The IMF expects that the current account balances of India, Indonesia and the Philippines will worsen in 2021. Furthermore, in the wake of the COVID-19 pandemic, fiscal and monetary policies were actively implemented in Asian countries and regions. As a result, the fiscal balance of many countries is expected to deteriorate significantly. Indonesia has temporarily abolished the fiscal discipline rules that limit its fiscal deficit to 3% of GDP and has been allowing direct underwriting of government bonds by the central bank. A large proportion of Indonesia’s government bonds is held by foreign investors, and their interest rates tend to rise in reaction to growing fiscal risks. In the Philippines, inflation has risen above the central bank's target, while policy interest rates remain at record lows. This could lead to devaluation of the Philippines’ currency, resulting in a vicious circle of further inflation.

As described above, factors such as 1) the accelerated normalization of U.S. monetary policy, 2) the re-expansion of current account deficits in emerging Asian countries, and 3) excessive fiscal and monetary easing in emerging Asian countries may cause market turmoil. In particular, in the Philippines, in addition to Indonesia and India, which are part of the Fragile Five, downward pressure on currencies may increase, which would make the path to full recovery even more challenging.

＜Indicators Assessing Currency Market's Stability＞

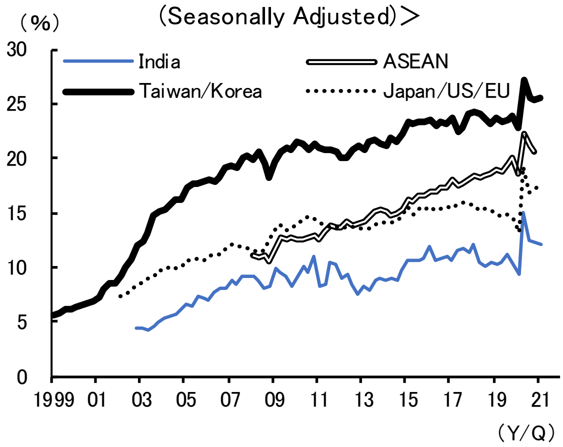
	Current Account Balance (% of GDP)			Fiscal Balance (% of GDP)		Inflation (2021Q1、% y-y)		ARA Metric (%)	
	2013	2020	2021 (IMF forecast)	2013	2021 (IMF forecast)		Inflation target (%)	End-2012	End-2020
Turkey	▲ 5.8	▲ 5.1	▲ 3.4	▲ 1.5	▲ 5.7	16.1	5.0	98.0	74.7
Indonesia	▲ 3.2	▲ 0.4	▲ 1.3	▲ 2.2	▲ 6.1	1.5	2～4	90.1	121.4
India	▲ 2.7	1.3	▲ 1.2	▲ 7.0	▲ 10.0	5.0	2～6	142.9	197.2
Brazil	▲ 3.2	▲ 0.9	▲ 0.6	▲ 3.0	▲ 8.3	6.1	3.75	158.8	160.8
South Africa	▲ 5.8	2.2	▲ 0.4	▲ 4.3	▲ 10.6	3.8	3～6	78.7	74.4
Philippines	4.0	3.6	▲ 0.4	0.2	▲ 7.4	4.5	2～4	256.2	233.8
Thailand	▲ 2.1	3.2	0.5	0.5	▲ 4.9	0.9	1～3	225.7	241.4
China	1.5	1.9	1.6	▲ 0.8	▲ 9.6	0.4	3.5	157.1	74.6
Mexico	▲ 2.5	2.5	1.8	▲ 3.7	▲ 3.4	4.8	2～4	122.9	128.4
Argentina	▲ 2.1	0.8	2.3	▲ 3.3		43.4		69.6	90.3
Vietnam	3.6	5.5	2.4	▲ 6.0	▲ 4.7	1.3	4.0		
Malaysia	3.4	4.4	3.8	▲ 3.5	▲ 4.4	1.5		105.7	118.1
Russia	1.5	2.3	3.9	▲ 1.2	▲ 0.8	5.6	4.0	163.6	360.7
Korea	5.6	4.6	4.2	0.6	▲ 2.9	1.7	2.0	112.5	99.0
Taiwan	9.7	14.0	14.5	▲ 3.2	▲ 2.8	1.4			

Source: JRI, based on IMF and CEIC
Note: ARA Metric(Assessing Reserve Adeqacy Metric) is a ratio of an actual reserve to a compositeof reserves adecency indicaotors based on exports, broad money, short-term debt and other liabilities, assessing the appropriate level of FX reserves. The metric for many countries assumes floating exchange rates, but for China assumes a fixed exchange rate(In case of floating rates in China, the metric rose to 129.9%). Data at end-2014 is used for Argentina instead of end-2012.

3. There are growing concerns over the growth of the Asian economy brought about by China

Attention should also be paid to the fact that strong dependence on the Chinese economy, which is also one of the reasons behind the prediction of the overall strength of the Asian economy, could be a risk factor. China's presence in Asia has been further enhanced partly due to its rapid recovery from the COVID-19 pandemic. In particular, the ratio of trade to China increased significantly in the second half of 2020, and remained at a high level in 2021. In addition, the Regional Comprehensive Economic Partnership (RCEP), the first regional trade agreement in which China is a participant, is expected to enter into force as early as the end of 2021, possibly further boosting trade with China. In particular, India's boycott of the agreement could increase China's influence. China's outward FDI in the countries along the Belt and Road Initiative (BRI), which is believed to include large

＜Share of Total Trade with China (Seasonally Adjusted)＞

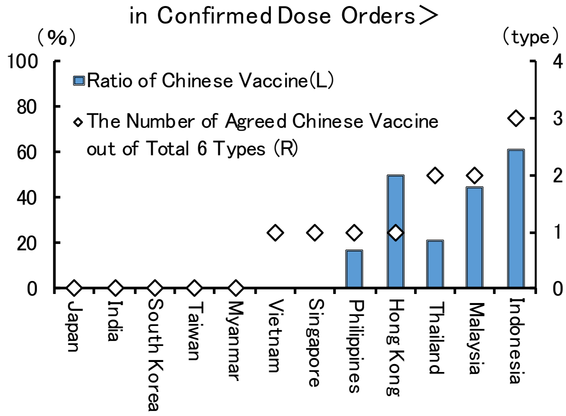


Source: JRI, based on CEIC
Note: Total Trade = Exports + Imports

amounts of investment in Asia, increased by 14.0% year on year in the January-April 2021 quarter, indicating that China is also supporting the Asian economy in terms of investment.

In addition, China has been active in its vaccine diplomacy, and the share of Chinese-made vaccines is increasing, particularly in Southeast Asia. In the past, developed countries were busy dealing with their own problems, and China was quick to start helping to curb infections in the Asian region, particularly in Southeast Asia, which contributed to China's growing presence.

＜Asia: Share of Chinese Vaccine in Confirmed Dose Orders＞



Source: Duke Global Health Innovation Center
Note: As of 11 June. Ratios are calculated by available numbers as some countries have unknown procurements. Chinese vaccines include 6 types of vaccines, Sinovac, Sinopharm, CanSino, Biologics, Anhui Zhifei Longcom, Chinese Academy of Medical Sciences, Sinopharm (Wuhan).

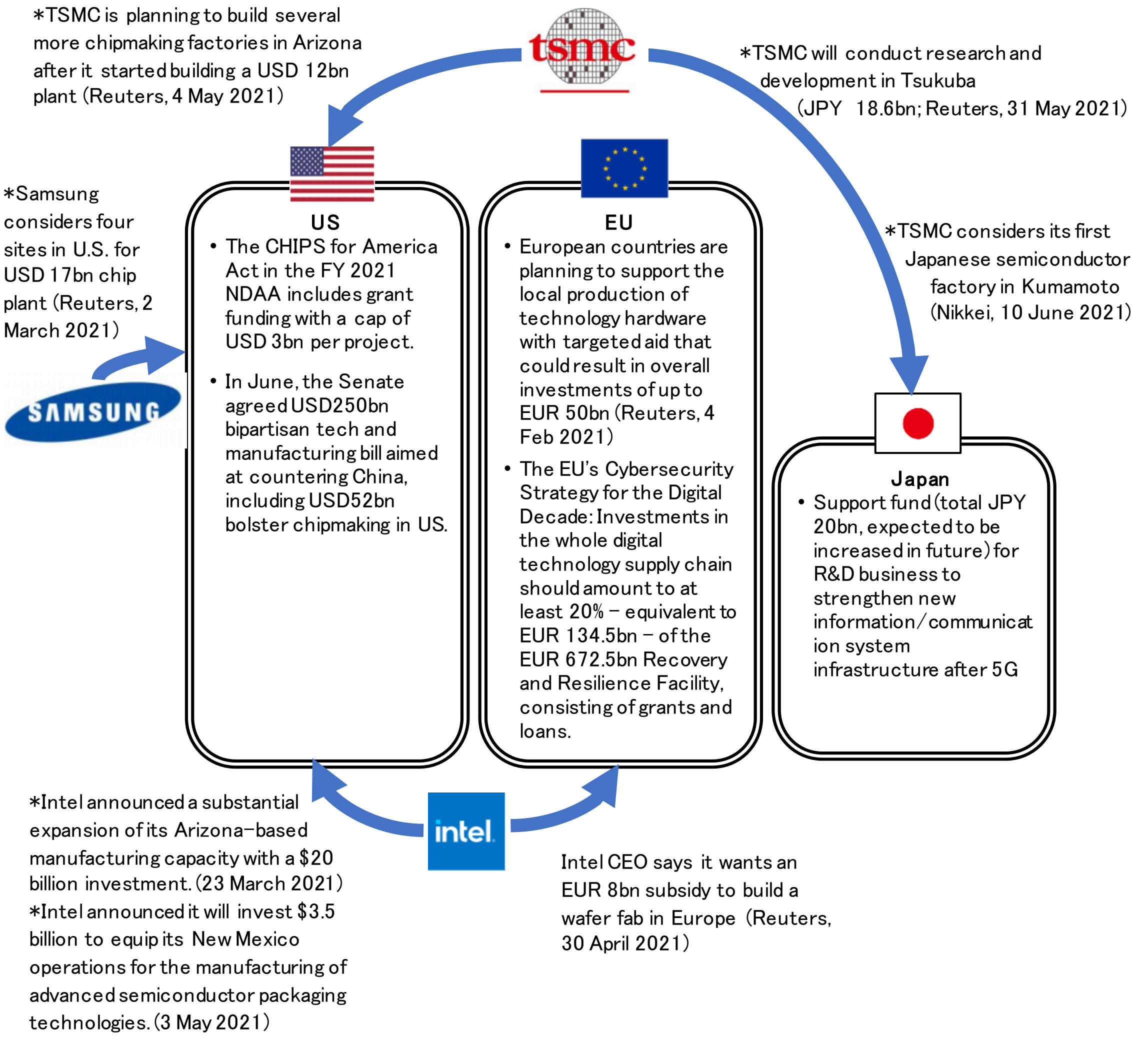
However, Western pressure on China has steadily increased. Given the many political and diplomatic problems that have arisen, it can be said that increasing Asian countries' dependence on the Chinese economy has many potential downsides. On the human rights front, apparel makers in Japan, the United States and Europe faced mounting criticism over the use of cotton produced in the Uighur Autonomous Region. The impact on Asian companies excluding Japan is still limited, but risks pertaining to business with China are increasing.

In addition, the United States and Europe are increasingly wary of supply chains centering on China from the viewpoint of security. In particular, at a hearing of the U.S. Senate Committee on Armed Services held on March 9, Admiral Davidson, Commander of United States Indo-Pacific Command (USINDOPACOM), stated that the threat is manifest that China could attempt to take control of Taiwan in the next six years. This comment raised awareness of the geopolitical risk surrounding Taiwan. European and American authorities are taking active moves to attract the semiconductor industry back to their own countries and regions, and three of the world's largest semiconductor manufacturers (Taiwan's TSMC, the US's Intel, and South Korea's Samsung) have started to consider building factories in the United States and Europe in response. If many of the production functions of the semiconductor industry are transferred to Europe and the United States, there will be a great impact on peripheral industries. Mexico and Eastern European countries, which are close to the United States and Europe, respectively, will be candidates for the relocation of related industries, which will be a major headwind for supply chains across Asia.

Thus, the pattern of economic recovery in Asia, which depends on China, contains risks. In Asia, India is expected to become a superpower in the future, and ASEAN is seen as the world’s next factory after China, although their presence significantly lags behind China. In order for Asia to continue stable development over the medium to long term, it is necessary for the Indian and ASEAN economies to regain momentum and become a balanced economic bloc that does not rely excessively on the Chinese economy.

(Minoru Nogimori)

＜Major Countries' Policies to Attract Semiconductor Industry and Recent Actions of Major Chip Makers＞



Source: JRI based on METI and various media reports

NIEs The export-led recovery and risks in the high-tech sector

■ The economy is expected to grow by +4.6% in 2021, supported by strong IT-related demand and recovery in Chinese consumption

While economic activity has been held back by the spread of COVID-19, the economy of NIEs (South Korea, Taiwan, and Hong Kong) has remained relatively robust and is recovering at a faster pace than those of other Asian countries such as ASEAN nations and India. In particular, the rapid growth in IT-related demand for telework due to COVID-19 has contributed greatly to the increase in exports from Taiwan and South Korea. In addition, China, NIEs' largest trading partner, has become the first country in the world to achieve recovery from the pandemic. Although service exports remain sluggish due the restrictions on travel, the recovery in exports of goods to China has been supporting NIEs economy.

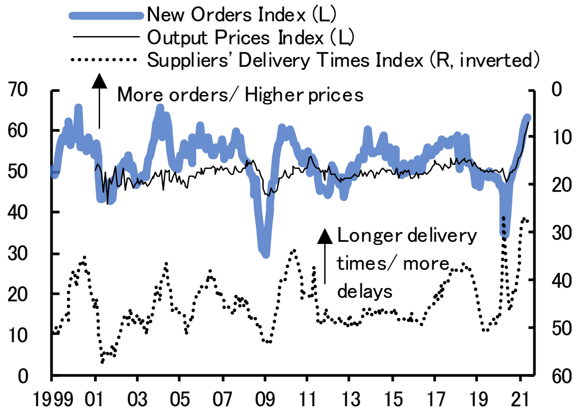
＜GDP Growth Forecasts for NIEs＞

(%)

	2017	2018	2019	2020	2021 (F)	2022 (F)
NIEs	3.3	2.9	2.0	−0.2	4.6	2.2
Korea	3.2	2.9	2.2	−0.9	3.9	2.2
Taiwan	3.3	2.8	3.0	3.1	5.5	2.2
Hong Kong	3.8	2.8	−1.7	−6.1	5.9	2.2

Source:JRI, based on Government Statistics

＜Global Electronics PMI＞



Source: JRI, based on IHS Markit

In the second half of 2021, strong IT-related demand and the recovery of the Chinese economy will continue to boost the economy, and the GDP growth rate of NIEs is expected to increase by 4.6% year on year for the whole of 2021. In addition to PCs for telework, demand for mobile phones is expected to increase, as the introduction of 5G has been picking up speed. In addition, IT demand is expected to remain strong, as demand for systems such as remote control and automatic operation is also strong. In fact, in the Global Electronics PMI in May, the index of new orders rose to 66.3, while the decline in the Supplier Delivery Time Index (an index of less than 50 indicates prolonged delivery times) and the rise in the Product Price Index indicate unprecedented tight supply and demand conditions. In addition, as economic activity in China has normalized, Chinese consumption has become particularly strong, and NIEs countries and regions will likely further benefit from this in trade and other areas. COVID-19 vaccination rates (the percentage of people who have received at least one dose as of June 13) were 3.4% in Taiwan, 23.1% in South Korea and 23.2% in Hong Kong. The pace of vaccine rollout in these countries has not increased compared with the United States and Europe due to problems such as sluggish vaccination rates due to delays in securing vaccines as well as refusal of vaccinations. However, vaccination rates are expected to gradually increase in the second half of the year, which will likely become a factor underpinning domestic demand.

Meanwhile, in the high-tech sector, including semiconductors, intensifying U.S.-China rivalry and supply shortages could place downward pressure on the economy. The United States' stance toward China has not changed, and regulations on companies with ties to Chinese companies may be tightened from the viewpoint of human rights and security. In particular, emphasis has been placed on high-tech fields, such as those related to IT, as a security issue, and if sanctions are tightened, China as well as NIEs will be adversely affected. In addition, the semiconductor supply shortage has become a serious problem worldwide. This will result in increased profits in the semiconductor industry through higher prices, but will adversely affect other industries that use semiconductors such as electronic products and automobiles.

(Minoru Nogimori)

ASEAN5 The ASEAN economy will be led by Vietnam in 2021

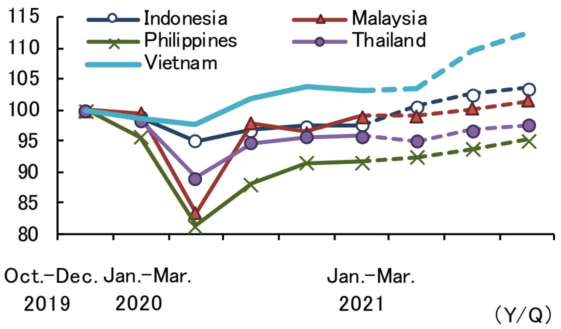
■ ASEAN's economy will pick up in 2021, but it remains unclear when the spread of COVID-19 will be contained

The real GDP growth rate of the ASEAN5 (Indonesia, Malaysia, Philippines, Thailand, and Vietnam) in the January-March quarter of 2021 was 0.9% lower than the same period last year. By country, many countries posted negative growth due to activity restrictions, while Vietnam, which has relatively loose restrictions on activity and a high export ratio, maintained positive growth compared to the same period last year on the back of the recovery of the world economy.

Since April, ASEAN countries have seen a new spike in COVID-19 infections. In the April-June quarter, domestic demand is expected to be depressed due to activity restrictions, and the pace of recovery in overall economic activity is expected to slow in many countries. Meanwhile, the world economy, led by the United States, is recovering, and increased exports are expected to support each country's economy. In Vietnam, although operations were suspended at some plants due to activity restrictions implemented since May, the industrial production index in the same month remained at the same high level as in April, with only a slight impact on the overall economy. In ASEAN as a whole, the impact of activity restrictions on manufacturing operations is considered to be limited.

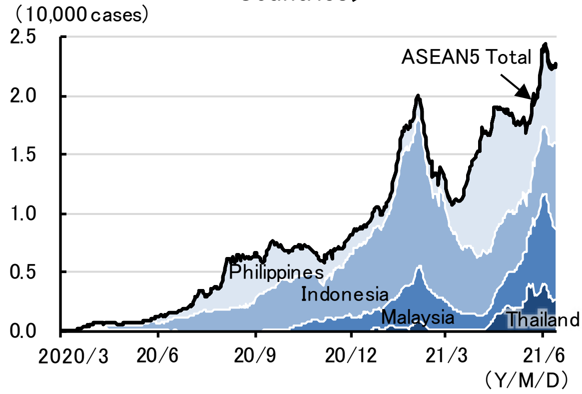
In the second half of 2021, ASEAN's economy is expected to pick up both in external and domestic demand. Strong exports are expected to improve corporate profits, and capital investment will likely increase as monetary easing continues. Continued expansion of infrastructure investment in many countries will also boost the economy. Furthermore, if the spread of COVID-19 infections settles down along with progress in vaccination rollout, restrictions on activities will be eased, and government measures to stimulate demand will also be effective, leading to recovery in personal consumption. Overall, ASEAN's real GDP is expected to increase by 4.4% year-on-year in 2021 and by 5.3% year-on-year in 2022.

<<Real GDP Levels of ASEAN Countries (Seasonably-adjusted)>



Source: Prepared by The Japan Research Institute, Limited based on statistics from each country
Note: Figures after the April-June 2021 period are based on forecasts by The Japan Research Institute, Limited.

<Number of New COVID-19 Cases in ASEAN Countries>



Source: Prepared by The Japan Research Institute, Limited based on CEIC

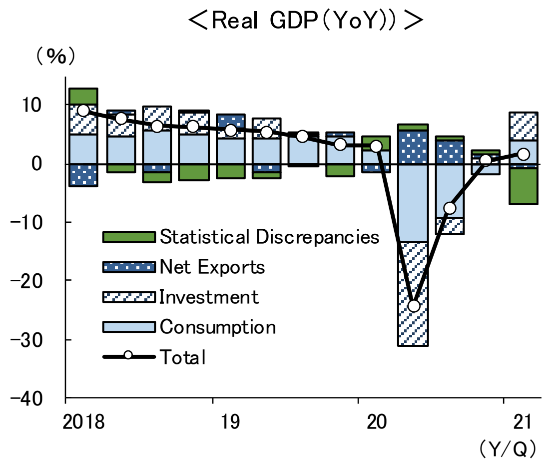
Risks pertaining to the main scenario include a delay in vaccination rollout and rapid capital outflows. As of June 10, the highest vaccination rate (the percentage of people who have received at least one dose) among ASEAN countries is only 12.7%, in Malaysia. If the vaccination rollout does not progress, the spread of the virus will not be contained and restrictions on activities may be strengthened again. In addition, if the fear over the normalization of U.S. monetary policy increases, there is a risk that capital will rapidly flow out of ASEAN countries. In the face of such a situation, there is a high risk that fiscal and monetary policies will be tightened in each country in order to curb capital outflows, which will likely place significant downward pressure on the economy.

(Mitsuhiro Matsumoto)

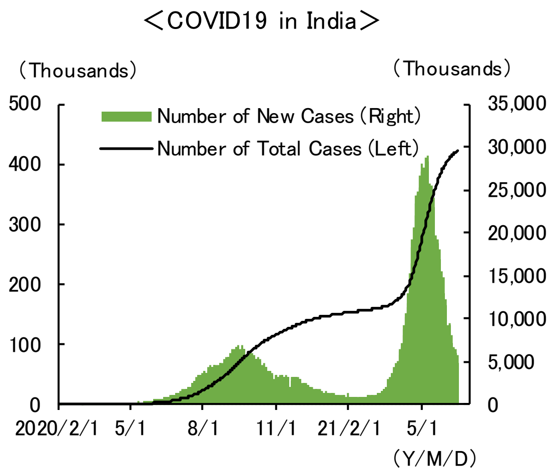
India The worst of the outbreak is over, but downside risks remain

■ The economy has been deteriorating since April due to a massive COVID-19 surge

India's economy continued to recover from mid-2020 through early spring 2021 following a gradual easing of lockdown measures to curb COVID-19 infections. In the April-June 2020 period, India's real GDP declined by 24.4% from the same period of the previous year, the largest drop in history, and then rapidly recovered to + 1.6% year on year in the January-March 2021 period.



Source: Ministry of Statistics and Programme Implementation



Source:WHO

However, following India's massive COVID-19 surge since mid-March 2021, the country's economy has once again deteriorated. The daily number of new COVID-19 cases exceeded 400,000 in early May, causing a medical breakdown due to shortages of hospital beds, medical supplies, oxygen and ventilators. As it became difficult to provide adequate medical services to critically ill patients, the number of deaths per day, which had remained in the 100 range until early March, surged to more than 4,000 in early May. In view of the lack of a PCR testing system in rural areas and confusion in medical practice, the actual number of COVID-19 patients and deaths may be substantially higher than the government's official announcement.

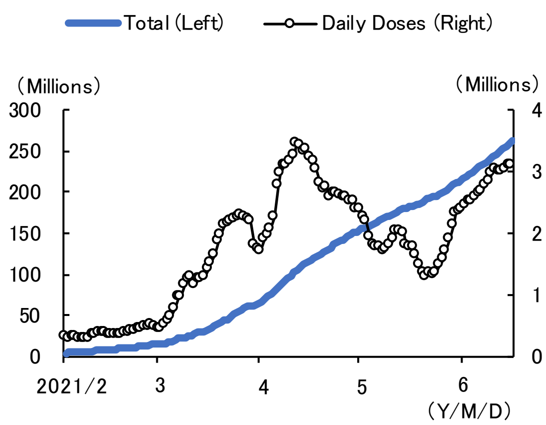
Amid this situation, in an effort to avoid further spread of the virus, the government has once again introduced severe restrictions on activities, including restrictions on gatherings, restrictions on outings, reduced operating hours for restaurants and entertainment facilities, and the obligation to carry a certificate stating negative COVID-19 test results when traveling across states. As a result, the number of people, mainly in commercial areas, declined rapidly, and activities in the service industry, such as face-to-face services, stagnated. In the manufacturing industry, operating requirements have been tightened except for factories that produce daily necessities and products for export. In addition, the conversion of industrial oxygen to medical oxygen forced the shutdown of factories that require oxygen, such as metal welding. As a result, the Purchasing Managers' Index (PMI) composite index for May 2021 stood at 48, falling below the 50 threshold for the first time in nine months. Some indicators, such as automobile sales, accelerated year on year despite the recent COVID-19 surge, but this was due to a reaction to last year's sharp economic downturn caused by the severe lockdown measures, not to any strength in the current level of automobile sales.

More severe restrictions on activities have worsened the economy, but they have succeeded in curbing the spread of the virus, which is their primary objective. The number of new COVID-19 cases per day in mid-June fell to around 70,000, less than one-fifth of the peak level, due to factors such as a decrease in the number of outings and an increase in people's awareness of infection prevention. In states where the outbreak is starting to subside, restrictions on activity have been gradually eased, including allowing longer business hours for commercial facilities, higher office attendance limits, and fewer restrictions on event gatherings such as weddings and funerals.

■ The economic recovery trend is expected to strengthen after 2022

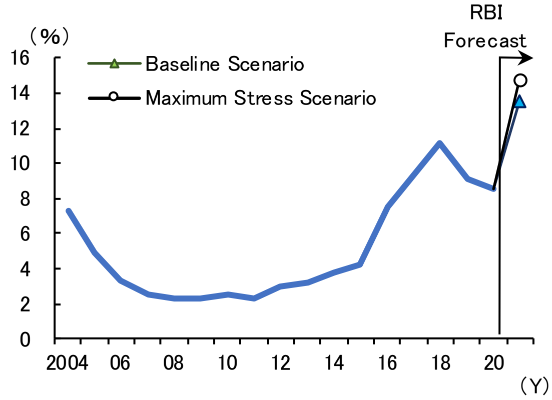
In light of the government's efforts to reduce the spread of the virus and to ease restrictions on activities once again after mid-May, the economic downturn caused by the massive COVID-19 surge in early spring is expected to be temporary and the Indian economy will likely return to a recovery track in the second half of the year. Given India's vulnerable medical system, however, it is likely that the government will continue to restrict activities for the time being in order to prevent a resurgence of infections. In fact, the state of Maharashtra, which has begun to ease lockdown measures ahead of other states, has introduced activity restrictions based on the rates of positive COVID-19 test results, bed utilization and ventilator use, and severe restrictions on activities continue to be imposed in areas of the state with vulnerable health systems. Therefore, the initial pace of economic recovery is likely to be moderate.

＜COVID-19 Vaccination in India＞



Source:Ministry of Health and Family Welfare

＜Commercial Bank's NPA＞



Source: Reserve Bank of India "Financial Stability Report January 2021"

The timing of full-scale relaxation of restrictions will depend on the vaccination trend for people aged 18 and older. Although the government aims to increase the vaccination rate to 5 million doses per day in the next few months, the actual vaccination rate slowed down toward the end of May due to confusion in medical facilities caused by the massive COVID-19 surge and voluntary restraint on outings. In order for the majority of people aged 18 years or older to complete their second vaccinations and achieve a state close to herd immunity, the cumulative number of vaccinations must reach approximately 1 billion doses. Given the current vaccination pace and government targets, this is expected to be achieved between October 2021 and March 2022. The path to economic recovery will not become certain until India's vaccination rates reach this level, there is a clear decline in the number of new cases, a downward trend in severity and fatality rates occurs, and restrictions on activities are significantly relaxed. The real GDP growth rate for FY2021 (April 2021 to March 2022) and FY2022 is expected to be +9.0% and +6.9% year on year, respectively. While the growth rate for FY2021 is expected to be high, it will likely slow through FY2022 due to the reaction from the previous year.

Based on the following, however, it should be assumed that the downside risk will continue to be high. First, the risk of resurgence of COVID-19 through further viral mutations, in addition to the risk of instability in the financial system due to an increase in the ratio of nonperforming loans held by commercial banks remains extremely high. Although the temporary special measures helped to avoid a rise in the NPA ratio of commercial banks during FY2020 despite the substantial deterioration in the economy, the Reserve Bank of India projects that the NPA ratio will increase to more than 10% for the current fiscal year. Furthermore, given that the general government's budget deficit exceeds 10% of nominal GDP, the fiscal expansion has limited capacity to prop up the economy. As the inflation rate is slowing, there is room for monetary easing to some extent, but on the whole, there are no great expectations regarding policy responses, which should be noted as a downside risk.

(Shotaro Kumagai)

China 2021 will see higher growth at a rate of +9.0%

■ The economic recovery is expected to continue

China's real GDP for the January-March 2021 period grew sharply from the same period last year on the rebound from the previous year's decline, but was +2.4% on an annualized quarter-on-quarter change basis, down from the preceding quarter (+13.4% on an annualized quarter-on-quarter change basis). This is due to government restrictions on the movement of people around the Spring Festival holidays in response to an increase in the number of new COVID-19 cases. The decline in the number of outings placed downward pressure on the economy, mainly on service consumption such as food services and other spending.

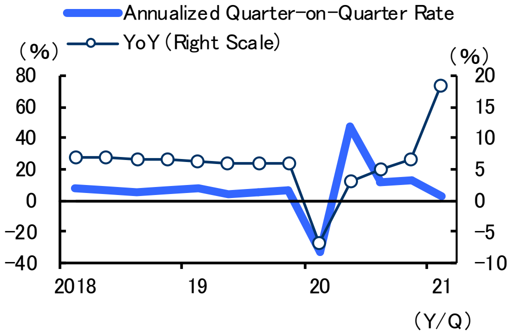
Since the spring, however, the Chinese economy has regained strength. As the number of new COVID-19 cases has remained low in most areas, the number of people on the street has recovered to almost the same level as before the COVID-19 outbreak thanks to the removal of restrictions on the movement of people. As a result, retail sales in May increased by 12.4% year on year, of which expenditure on goods increased by 10.9% year on year and food services sales increased by 26.6% year on year. Looking at these levels, expenditure on goods is growing steadily, while service spending is also returning to the increasing trend witnessed prior to the COVID-19 outbreak.

As an exception, in May, the city of Guangzhou reintroduced severe restrictions on the movement of people in response to an increase in the number of new COVID-19 cases. However, since the population of Guangzhou is only about 1% of the national population, the impact of the restrictions on the overall economy is small.

The government's measures to stimulate consumption are also encouraging consumer spending. Although the shortage of semiconductors is a cause for concern, automobile sales have remained high, with annualized vehicle sales of 27 million units, on the back of purchase subsidies and improvements in the employment and income environment. In particular, because electric vehicles (EVs) have been heavily subsidized from the perspective of green recovery, the overall share of EVs at present is 8%, a significant increase from 4% before the COVID-19 outbreak.

Investment in fixed assets also continued to rise sharply. Fixed asset investment in the

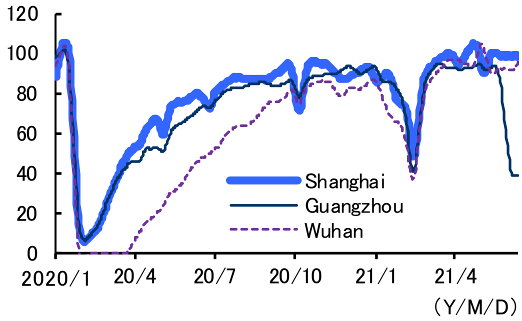
＜Real GDP＞



Source: Prepared by The Japan Research Institute, Limited based on "System of National Accounts" by the National Bureau of Statistics of China

＜Number of Subway Passengers (HP Filter)＞

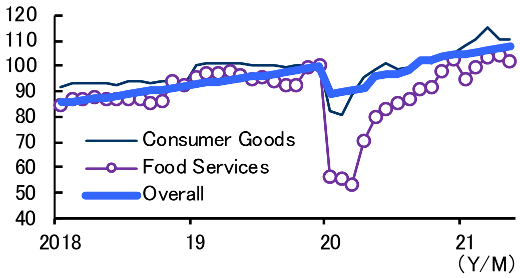
(First half of January 2020 = 100)



Source: Prepared by The Japan Research Institute, Limited based on "Subway Passenger Volume" by Wind Database

＜Retail Sales (Seasonally-adjusted)＞

(December 2019=100)



Source: Prepared by The Japan Research Institute, Limited based on "Total Retail Sales of Consumer Goods" by the National Bureau of Statistics of China
Note: Overall figures are compiled based on seasonally-adjusted month-over-month data. Others are compiled based on original series.

January-May 2021 period was up 15.4% from the same period last year, and up 8.5% from the same period in 2019, which was prior to the COVID-19 outbreak. As the capacity utilization rate has recovered to a level exceeding that prior to the COVID-19 outbreak, private companies' appetite for capital investment is strong, and imports of capital goods and the amount of machine tool orders received by Japan have continued to increase significantly.

Exports are also expanding, albeit with fluctuations, as the global economy recovers. Dollar-denominated exports rose 27.9% in May from a year earlier. In particular, exports of telecommunications equipment such as computers and mobile phones have remained at a high level.

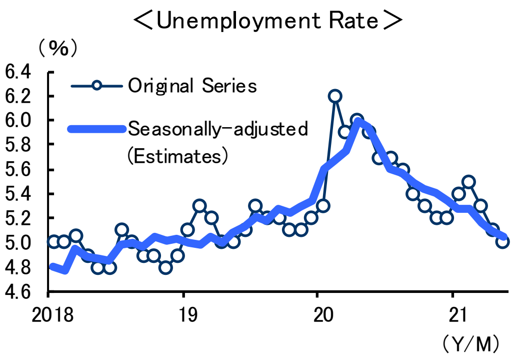
■ Growth in line with the potential growth rate will likely continue

Looking ahead, the Chinese economy is expected to recover steadily. First, personal consumption is anticipated to increase further due to the following three factors.

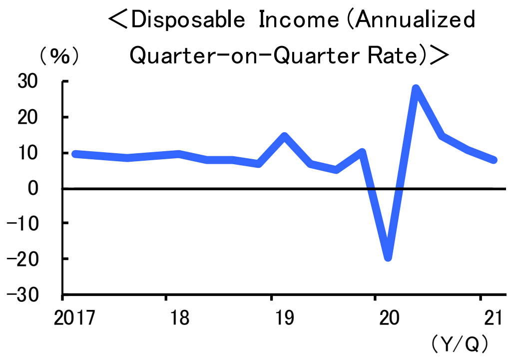
The first is improvement in the employment and income environment. In May, the unemployment rate fell to 5.0%, similar to the level prior to the COVID-19 outbreak, following a recovery in production and policy support. The employment outlook DI is above the threshold of 50, indicating a favorable employment outlook. The rise in disposable income has also returned to its pre-coronavirus pace.

The second factor is the rise of so-called "revenge consumption" in earnest. According to a survey of 20,000 households nationwide conducted by the People's Bank of China, the percentage of respondents who said they had increased their savings during the January-March 2021 period remained higher than before the COVID-19 outbreak, and it is highly likely that the accumulated savings will be shifted toward consumption. As for the pandemic, the Chinese government has already established a system to contain the spread of COVID-19 at an early stage, even if new cases arise. Therefore, as the number of vaccinations further increases from the current total of 900 million doses (as of June 16), it is expected that revenge consumption will begin in earnest.

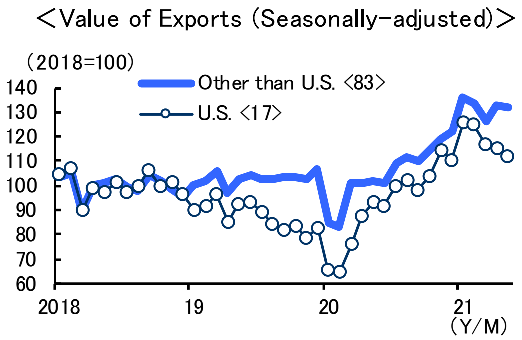
The third factor is the government's policy of stimulating consumption. The Chinese government aims to boost sales of new energy vehicles, including electric and plug-in hybrid vehicles, to 20% of new vehicle sales by 2025. Given that new energy vehicles accounted for only 5% of all vehicles sold in 2020, additional measures are likely to be taken to support their spread. Subsidies for the purchase of home appliances and furniture will also be expanded.



Source: Prepared by The Japan Research Institute, Limited based on "China Urban Survey Unemployment Rate" by the National Bureau of Statistics of China



Source: Prepared by The Japan Research Institute, Limited based on "Per Capital Disposable Income of Chinese Residents" by the National Bureau of Statistics of China
Note: Per capita, nominal basis.



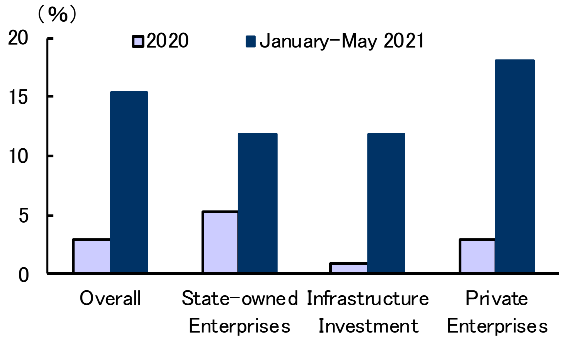
Source: Prepared by The Japan Research Institute, Limited based on "Trade Statistics" by the General Administration of Customs
Note: Numbers in < > indicate share in 2020. The figures are in dollars.

In addition to consumption, exports are expected to continue to expand. Global demand for goods will likely recover thanks to the progress in vaccine rollout and economic measures. Moreover, although the value of the yuan has been rising since the second half of last year, downward pressure on exports is not a cause for concern because Chinese exports cannot be immediately replaced by those of other countries.

On the other hand, investment in fixed assets is expected to slow down due to the government's measures to restrain investment. Since the latter half of 2017, the Chinese government has placed the following three issues as the key issues in its economic policy: financial risk reduction, poverty alleviation, and environmental issues. With regard to financial risk reduction, various measures have been taken to resolve the problem of excessive investment and debt, including reduction in the size of shadow banking, strengthening of risk management by financial institutions, and administrative guidance for companies to reduce debt. In the first half of last year, the government took a temporary stance of promoting investment in order to restore economic activity affected by the COVID-19 pandemic at an early stage. However, since the latter half of last year, when it succeeded in bringing COVID-19 under control and a remarkable recovery in the economy started to be seen, the government has gradually returned to its restrictive management ways.

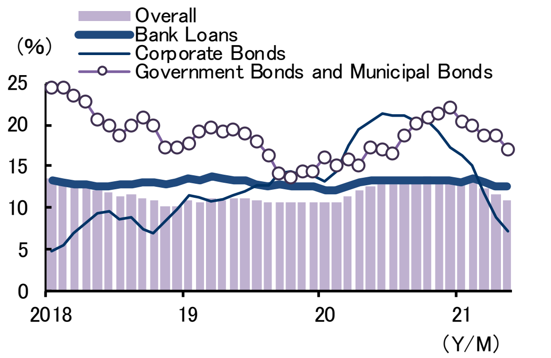
As a result, investment in fixed assets by state-owned enterprises has been controlled to lower growth than that by private enterprises. Funding by state-owned enterprises through the issuance of corporate bonds increased sharply in the first half of last year, but slowed in the second half of the year as the government allowed state-owned enterprises to default on corporate bonds.

<Fixed Asset Investment (YoY)>



Source: "National Fixed Asset Investment" by the National Bureau of Statistics of China

<Outstanding Total Social Financing (YoY)>



Source: "Statistics on Volume of Social Financing" by the People's Bank of China

The trend of infrastructure investment is similar to that of investment in fixed assets by state-owned enterprises. Last year, the government allowed local governments to issue more municipal bonds to secure funds for infrastructure investment. However, the issuance of municipal bonds has settled down recently.

Investment in real estate development is also expected to slow down. Land acquisitions by real estate developers have already dropped to pre-coronavirus levels as a result of government measures to curb overheating. In the past, the real estate market witnessed a bubble, as land acquisition by real estate developers rapidly increased as a result of monetary easing in response to the economic downturn caused by the pandemic, and real estate prices soared. As a result, the government is taking measures to curb overheating of the real estate market from both the supply and demand sides. In particular, supply control measures, such as tightening the funding conditions of real estate developers, are being implemented more stringently than demand control measures (such as restrictions on housing purchases and on the total amount of housing loans).

Private fixed asset investment, on the other hand, is likely to continue to recover as the capacity utilization rate improves. As a result, fixed asset investment as a whole is expected to slow down only slightly.

Thus, while the growth in fixed asset investment will remain moderate, continued growth in personal consumption will likely shift the Chinese economy toward consumption-led growth. The real growth rate for 2021 is expected to be +9.0% year on year, with a higher increase due to the reaction from the previous year. Meanwhile, the real growth rate for 2022 is expected to be +5.1% year on year, the same level as the potential growth rate, due to policy guidance that takes into account the balance between consumption and investment.

■ China’s economy could see an upward or downward swing depending on policy

The risks to the main scenario described above are bidirectional. Given that the CPC is scheduled to hold a congress in 2022, when President Xi Jinping is expected to remain in power, the government will likely change its stance to promoting investment going forward, which will boost the economy.

On the other hand, the possibility cannot be denied that the government's policy of curbing investment will excessively cool down the economy. In fact, the government's measures to curb shadow banking slowed the economy in 2018.

In addition, since the inauguration of President Biden, the deepening confrontation between developed countries and China with regard to more fundamental problems, such as the Taiwan issue and human rights issues, in diplomatic fora such as G7 has heightened potential risks, which need to be closely monitored.

(Shinichi Seki)