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Topics *The Xi Jinping rushes to realize “common prosperity”*

The Xi Jinping administration has elevated “common prosperity (gongtong fuyu)” as a challenge after achieving “moderate prosperity (xiaokang).” China’s common prosperity is becoming a reality through encouraging donations and charitable activities. However, it will be difficult to achieve it without fundamental institutional reforms.

■ The focus is shifting from “moderate prosperity” to “common prosperity”

In July 2021, on the occasion of the 100th anniversary of the founding of the Communist Party of China, General Secretary Xi Jinping declared that China had achieved “moderate prosperity (xiaokang)”. Moderate prosperity was advocated by Deng Xiaoping, who laid the foundation for today’s China through his reforms and ‘opening-up’ policies. Since the 16th Communist Party Congress in 2002, it has been a top priority for successive administrations to achieve. Xi Jinping cemented his name in history as the leader who fulfilled China’s long-standing ambition.

What has been presented as China’s next goal after achieving moderate prosperity is “common prosperity (gongtong fuyu)” for all people. In the latter part of Deng Xiaoping’s “Get Rich first,” initiative, which involves allowing some people to “get rich first,” there is a phrase stating, “those who have become rich will help others later on.” Common prosperity can be said to be an attempt to enhance social stability and the sustainability of economic development (and in turn, the credibility of the Communist Party) by correcting distortions caused by rapid economic development, such as income disparity.

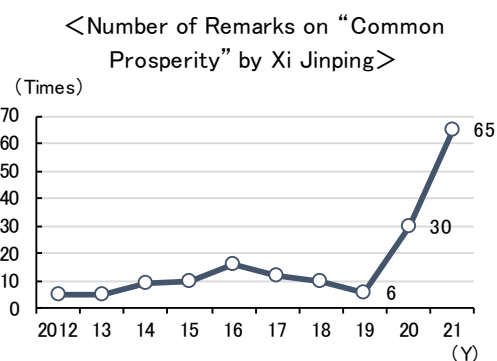
According to Bloomberg, Xi Jinping referred to the phrase “common prosperity” 65 times during the period between the beginning of 2021 and August 2021, far more than the 30 times in 2020. On the other hand, the Gini coefficient, which indicates the degree of income disparity, stood at 0.465 in 2019, almost unchanged from 2015. The coefficient presents a value between 0 and 1, with larger values indicating greater disparity. China has one of the worst income disparities in the world. Rectification of this is the first step toward the realization of common prosperity.

■ Strengthening of conspicuous tertiary distribution has been highlighted

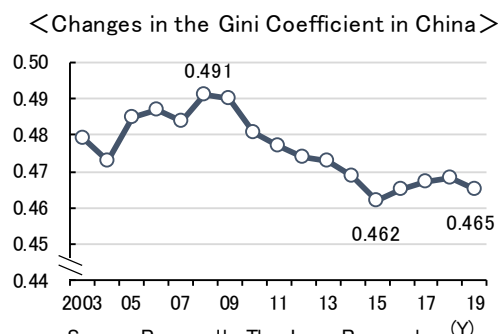
At a meeting of the CPC Central Committee for Financial and Economic Affairs held in August 2021, General Secretary Xi Jinping once again showed a strong desire for common prosperity. As wealth is transferred from the wealthy, the number of China’s middle-class consumers is expected to increase, leading to a shift to a consumer-driven economy in which personal consumption leads economic growth. Social stability is also anticipated to increase.

According to the committee, income distribution includes 1) primary distribution based on market principles such as salary as compensation for labor, 2) secondary distribution that rectifies the primary distribution bias through tax, social security and fiscal spending, and 3) tertiary distribution that transfers the wealth of the wealthy through donations and charitable activities. A notable move has been seen for tertiary distribution toward achieving common prosperity.

Coastal metropolises that have benefited from the reform and opening-up policies as well as industries such as real estate, education, and IT are assumed to be the entities that make donations and engage in charitable activities in tertiary distribution. The aforementioned three industries were chosen because: housing loans and education costs are putting pressure on households, online games have a negative



Source: Prepared by The Japan Research Institute, Limited based on Bloomberg materials
Note: The figure for 2021 is based on the totals up to mid-August.



Source: Prepared by The Japan Research Institute, Limited based on the National Bureau of Statistics of China and the International Monetary Fund (IMF)

impact on children, and improvement of the treatment of gig workers who take one-off jobs such as driving, and delivery work has become a social problem. The Committee has pointed out that common prosperity would entail “some pain” in the short term, and added that the development logic of these industries would change significantly and their contribution to growth would decline.

In fact, the environment surrounding the real estate, education and IT industries is changing. Big tech companies are setting up 100-billion-yuan funds to contribute to common prosperity. Although it is not a matter of donation or charity, the nonprofit status of cram schools and the setting of an upper limit for the selling price of second-hand houses can be regarded as policies that are in line with common prosperity.

■ Common prosperity is difficult to achieve without fundamental institutional reforms

In its 14th Five-Year Plan (2021-2025), the Xi Jinping administration said, “We will do our best and make efforts to continuously enhance the happiness and security of the people.” Since common prosperity is a policy goal that embodies this ideal, it is not discussed critically by domestic media. However, it is unclear whether achieving common prosperity would actually enhance people’s happiness and security.

One problem, for example, is that it is doubtful whether tertiary distribution can contribute to narrowing the income disparity gap. According to a survey on household assets conducted by the People’s Bank of China in 2019, the 1st quintile of the lowest 20% households with the least amount of assets held had an average of 410,000 yuan in assets, while the 5th quintile of the top 20% households had an average of 10.02 million yuan in assets, which amounts to a 24-fold difference between the two. This is much higher than the difference in disposable income among cities (5.9 times).

Housing accounts for 70% of assets held by households, and the home ownership rate is as high as 96%. This suggests that the wealth gap in China has been exacerbated by wealth capitalization using housing ownership as collateral to purchase new housing. This disparity cannot be corrected through donations or charitable activities, but real estate taxes and inheritance taxes, which are levied on the ownership and inheritance of assets, are effective. The real estate tax was mentioned in the 14th Five-Year Plan, and the Ministry of Finance has indicated its willingness to introduce it. However, given that five years have already passed since preparations for drafting were said to have been completed, it is difficult to be optimistic about early introduction of the tax.

Another problem is that tertiary distribution may induce a slowdown in growth. If the policy becomes more arbitrary, such as pressing specific companies or industries to make donations or engage in charitable activities, or imposing regulations that fundamentally change their profit structure, the amount of money flowing into the target companies or industries will decrease. The three industries of real estate, education, and information technology have grown rapidly, driven by private companies, accounting for 13.9% of GDP in 2018, up 3.8% from 2004. Strengthening tertiary distribution may diminish this boost.

In China, it is predicted that the medical services industry, whose high medical fees have been viewed as a problem, will be added to the aforementioned three industries. If the medical services industry is included, the percentage will rise to 16.1% of GDP, and if the construction industry, which is closely related to the real estate industry, is included as well, the percentage will reach 23.2% of GDP. The Xi Jinping administration appears to be prepared for the pain generated by the process leading to common prosperity, but if this causes wariness not only among domestic investors but foreign investors as well, the Chinese economy will experience more downward pressure than expected.

There is no doubt that there is a rising number of Chinese people who feel their quality of life is not increasing as much as their income level due to the burden of real estate, education and medical expenses. However, it was the Chinese government itself that created a system that only wealthy people could access. Common prosperity should be realized not through donations or charitable activities, but through the drastic reform of systems related to taxes, land, education, medical care, and social security, by creating a system in which the middle class can feel improvement in their quality of life.

(Yuji Miura)

<Disparity Between Owned Assets and Disposable Income (2019)>

| Tier | Assets | | Disposable Income (Cities) | |
|--------------|-------------|-----------|----------------------------|-----------|
| | 10,000 yuan | Share (%) | 10,000 yuan | Share (%) |
| 1st quintile | 41 | 2.6 | 15,549 | 6.9 |
| 2nd quintile | 99 | 6.2 | 26,784 | 11.9 |
| 3rd quintile | 164 | 10.3 | 37,876 | 16.8 |
| 4th quintile | 282 | 17.8 | 52,907 | 23.5 |
| 5th quintile | 1,002 | 63.0 | 91,683 | 40.8 |

Source: Prepared by The Japan Research Institute, Limited based on local media reports

Topics *Supply chain turmoil spreads from ASEAN amid the pandemic*

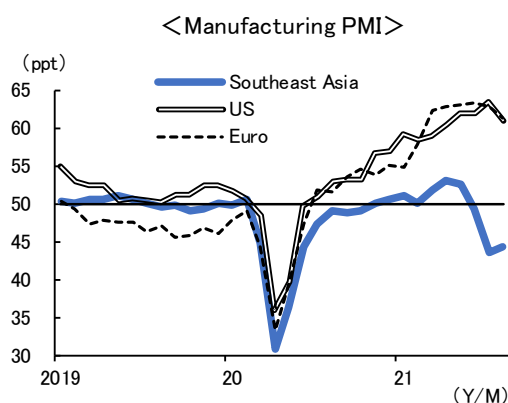
In Southeast Asia, where vaccination rates have stagnated, strict restrictions on activities continue to put downward pressure on the economy. It is necessary to pay close attention to the impact on supply chains, as delivery delays have been caused by restrictions on plant operations, mainly in Vietnam.

■ Strict restrictions on activities continue in Southeast Asia

Since the middle of this year, the economies of Southeast Asian countries have been in a severe slump due to stricter restrictions on economic activities. Southeast Asia's manufacturing industry saw a sharp decline in manufacturing PMI after June, and the index in August fell sharply below the 50 thresholds for all countries in the region. This was contrary to the U.S. and Europe, where the economy has been strong. In addition to the downward pressure on consumer spending and domestic demand, activity restrictions due to COVID-19 have had notable negative effects on production activities in the manufacturing industry such as strict restrictions on plant operations in Southeast Asia.

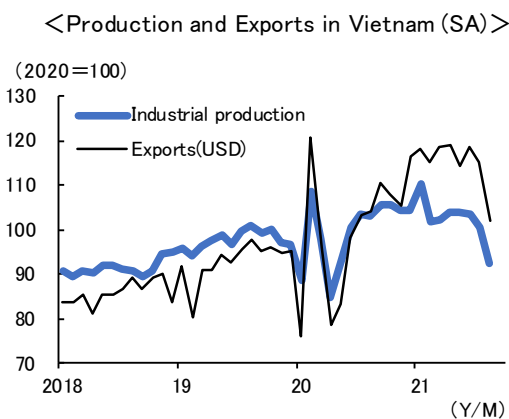
Behind the continued strict restrictions on economic activities in Southeast Asia is the slow pace of vaccine rollout due to delays in securing vaccines. Excluding Malaysia (53.3%), vaccination rates as of September 13 were 5.7% in Vietnam, 15.4% in Indonesia, 15.6% in the Philippines and 17.7% in Thailand, well below the global average of 30.1%. At present, the situation is improving with the increase in the provision of vaccines by developed countries, but it is not easy to rapidly expand the vaccination program due to various problems such as the requirement for refrigerated vaccine transportation, vaccine storage, and medical preparation for vaccinations. The average number of new cases between September 1 and 15 (number of new cases per one million population) was 19,336 (178) in the Philippines, 12,371 (127) in Vietnam, and 19,072 (579) in Malaysia, showing a rise in new infections. While the average number of new cases between September 1 and 15 (number of new cases per one million population) was 5,891 (22) in Indonesia and 14,374 (206) in Thailand, which has been on a declining trend, vaccination rates are still low and activity restrictions have been eased only modestly in these countries. The economies of Southeast Asian countries are expected to remain sluggish for the rest of the year due to the effects of ongoing activity restrictions.

In particular, the Vietnamese economy is in an extremely difficult situation as a result of severe restrictions on activities. Vietnam's Industrial Production Index in August was down 10.0% from a year earlier, recording a further decline from July (down 2.7% from a year earlier), due to the suspension of operations at many plants, owing to very strict operating conditions (employees in manufacturing industries are not allowed to commute from residential areas, and labor, food, and housing must be consolidated within the plant.). Exports in August declined 1.7% year on year (up 11.9% year on year in July) due to supply constraints. By product type, decreases in exports of footwear (down 39% year on year), wooden products (down 30% year on year), and apparel and textile products (down 11% year on year) pushed down overall exports.



Source: JRI, based on IHS Markit

Note: Data for Southeast Asia is a weighted average of Indonesia, Malaysia, Philippines, Thailand and Vietnam by PPP based GDP.



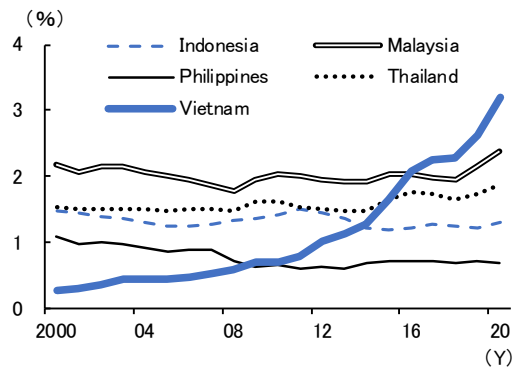
Source: JRI, based on CEIC

In recent years, the "China Plus One" strategy has been promoted in developed countries to disperse overseas manufacturing bases from China, and Vietnam had emerged as the most promising country for production transfers. However, the recent deterioration in the Vietnamese economy has cast a shadow over this trend. In Southeast Asian countries other than Vietnam, economic stagnation is continuing and their presence in the supply chain is not increasing. In fact, China's exports in August increased by 25.1% year on year, up from 18.9% year on year in the previous month. It has been pointed out that this could have been because operation rates of production lines in China increased in place of plants in Southeast Asia.

There have been ripple effects on the supply chain from activity restrictions, impacting Japanese companies; what Japanese companies should watch out for

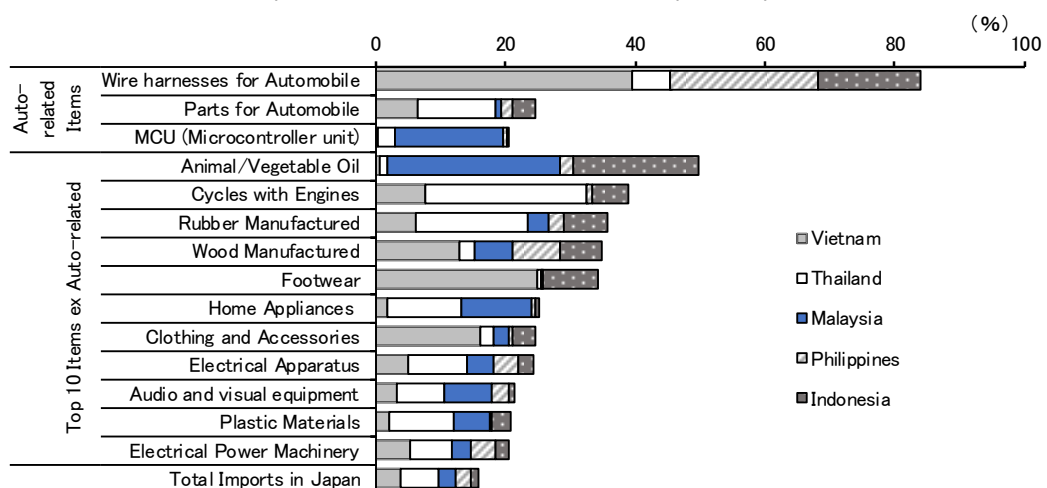
Stricter restrictions on activities in Southeast Asia, especially restrictions on plant operations, have curtailed production in the region's manufacturing industries and disrupted the entire supply chain. In particular, it has become a serious problem in the automobile industry, and there are insufficient supplies of wire harnesses (cables for automobiles) and microcontrollers (semiconductors for automobiles). Japan depends on Vietnam for the import of wire harnesses. In general, wire harnesses are susceptible to activity restrictions as they require a great deal of manpower in the process of bundling wires. Supply shortages are expected to continue for the time being, given that strict restrictions in Ho Chi Minh have been extended to the end of September. In Malaysia also, production of semiconductors is concentrated. Suspension of operations in the country has had a major impact on the global automobile industry due to a shortage of microcontrollers, adding to the global shortage of semiconductors that has continued since the beginning of the year. The vaccine rollout is progressing in Malaysia, including Penang, where production bases are located. It is expected that the plants will resume operations sooner or later. However, it may take time to restore sufficient supply capacity amid a situation where demand requires full plant operations at an early stage.

< Share of Imports from Southeast Asia in US, EU, China and Japan >



Source: JRI, based on CEIC

< Ratios of Import Goods from Southeast Asia in Japan's Imports (2020) >



Source: JRI, based on Trade statistics of Japan

Note: Wire harnesses (Import HS code 854430010) and MCU (Microcontroller unit, HS854231032) are picked up from 9-digit statistical code lists, and other data are included in MOF's Principal Commodity code lists

Japan is highly dependent on Thailand for imports on many goods, as well as imports of footwear and clothing from Vietnam. There have been reports that sales of frozen foods made in Thailand will be halted in Japan after mid-September due to an outbreak of COVID-19 at a poultry processing plant in Thailand. Thailand has been relaxing its restrictions on eating and drinking in its restaurants since September, but in 29 provinces designated as “maximum and strict controlled areas (Dark Red zones),” including Bangkok, night-time curfews and working from home measures continue to be imposed.

Japanese companies need to be wary not only of the impact on the automobile industry caused by restrictions on plant operations in Vietnam and Malaysia, but also of the risk that future restrictions in Thailand will have an impact on a number of industries.

(Minoru Nogimori)