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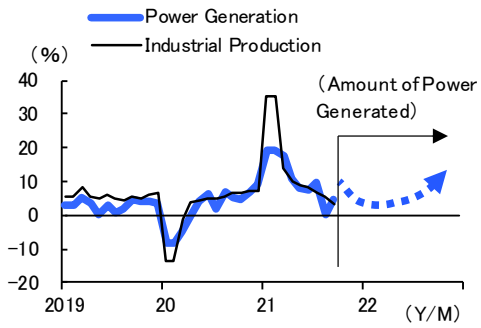
# Topics *Power shortages hamper China's economy*

In China, electricity shortages have been a drag on the economy. The main causes are shortages of coal and rising prices. The electricity and coal shortages are expected to be resolved after the beginning of the year, but until then, they will remain a drag on manufacturing production.

## ■ Production in manufacturing has declined due to power shortages

In China, local governments have taken steps to curb electricity supply. The power supply restriction started in the spring in a number of areas such as Guangdong Province, and spread to 20 areas from among 31 provinces, cities and autonomous regions, including Beijing and Shanghai, by the summer. Since the start of this year, power generation continued to increase by about 10% from the same month of the previous year, but growth rapidly slowed down in August to +0.8% year on year and remained at a low level in September at +4.9% year on year.

<Power Generation and Industrial Production (YoY)>




Source: Prepared by The Japan Research Institute, Limited based on "Increase in Added Value of Industries Above Designated Size" by the National Bureau of Statistics of China

The amount of power generated is usually determined passively by the amount of power used, such as the amount produced by the manufacturing industry. However, in China, restrictions on the amount of power generated have restrained the amount produced by the manufacturing industry. Industrial production in September increased 3.1% from the same month last year, which was the lowest growth since March 2020, and the real growth rate in the July-September quarter was 4.9% higher than the same period last year, a sharp drop from 7.9% in the previous quarter. This slowdown in manufacturing production is in contrast to the turnaround in the non-manufacturing sector, which saw operating activity pick up as activity restrictions were eased due to a decline in the number of new COVID-19 cases. Many manufacturers received notification of planned power outages and adjusted plant operations. In some cases, power was cut off without prior notice.

Local subsidiaries of Japanese companies were also affected by the power supply restrictions in China. According to a JETRO survey of Japanese companies in Guangdong Province, the majority of respondents said their operations had been restricted for long stretches, from 8:00 a.m. to 11:00 p.m., for most of the week. Companies that manufacture automobiles, electric machinery, electronic components, plastic products, and metal products are said to have suffered power supply restrictions. Some local governments have informed Japanese companies that the restrictions will remain in place until the end of October, with many local people expecting the restrictions to remain in place until at least that time.

In addition to manufacturers, individuals, non-manufacturers, and the public sector were also subject to certain restrictions with regard to electricity supply. According to the state-owned Xinhua News Agency, some city water heaters, elevators, and traffic lights were shut down due to power supply restrictions by local governments.

## ■ Coal shortages and soaring coal prices are behind the problem

The main cause of this situation is the shortage of coal and the resulting rise in coal prices. According to the China Coal, Transport & Distribution Association (CCTD), inventories of domestic coal companies at the end of August were 48 million tons, down 29.0% from a year earlier; coal inventories of thermal power plants were 100 million tons, down 25.7% year on year; and coal inventories of major ports were 52.26 million tons, down 24.2% year on year. The price of CCTD Qinhuangdao thermal coal (5,500 kcal), a leading coal price indicator for power generation, increased by 91.7% year on year at the end of September.

As the government continues to liberalize the electricity market, power companies have been allowed to add 10% to the standard electricity price since 2020. In fact, price hikes have started in 2021. However, the sharp rise in the price of coal, which is used as a raw material, has made a number of electric power companies unprofitable. Under such circumstances, it is believed that local governments have no choice

but to allow electric power companies under their control to adjust production levels.

There are three factors behind China's coal shortage: The first is government control of coal production. The government has shut down coal mines in areas such as the Inner Mongolia Autonomous Region, Shanxi and Shaanxi, citing strengthened safety standards, environmental measures and cases of corruption. According to the National Bureau of Statistics, coal production in 2020 increased by 0.9% from the previous year to 3.84 billion tons, and from January to September 2021, production increased by 3.7% from the previous year, achieving low growth. According to the China National Coal Association (CNCA), there were about 4,700 coal mines nationwide as of the end of 2020, but the government has called for a reduction to about 4,000 by 2025.

The second factor behind China's coal shortage is the government's curbing of coal imports. As a result of the Chinese government's unofficial ban on the import of Australian coal due to its opposition to the Australian government's request to investigate the origin of COVID-19, the volume of coal imports from Australia fell from 55.88 million tons in the January-June 2020 period to zero in the January-June 2021 period. On the other hand, imports from Indonesia, which ranked first in terms of import volume by country for three consecutive years, remained unchanged, going from 84.28 million tons to 85.05 million tons for the same period. Imports from the United States, South Africa, and Colombia increased from less than 1 million tons to 3.87 million tons, 3.44 million tons, and 2.5 million tons, respectively, for the same periods. However, these increases did not offset the decrease in imports from Australia, and China's total coal imports from the world declined significantly from 170 million tons to 140 million tons for the same periods.

The third factor behind China's coal shortage is the expansion of domestic demand for coal. In 2020, China's economic growth rate was the only one positive among major countries. As a result of the government's early easing of activity restrictions and promotion of infrastructure investment and capital investment by state-owned enterprises, as well as a significant increase in exports centering on information and communications equipment and medical supplies, major coal consumers such as electric power companies and the steel industry have significantly increased production levels and raw material procurement.

## ■ The government is rushing to ensure a stable supply of electricity and coal

Against this backdrop, the government has launched a series of measures to address the electricity and coal shortage. The first is the release of national coal reserves. From January to July 2021, the government released more than 5 million tons of national coal reserves to the market on four occasions. As of July 2021, China's national stockpiling base is believed to have about 40 million tons of coal in stock.

Restrictions on coal production were also eased. In August 2021, the government resumed production at 15 coal mines, with a combined capacity of 43.5 million tons per year, by postponing their expiration by one year. By approving the use of land in coal mines in Ordos, Inner Mongolia, where production had been halted due to inadequate land procedures, the government resumed production at 38 coal mines, with a total capacity of 66.7 million tons per year. The combined capacity of the 53 sites will total 3% of China's coal production last year. In September and October 2021, the government allowed production at an additional 153 coal mines, with a total production capacity of 220 million tons per year. The authorities expect that this will increase coal production for the October-December 2021 period by 55 million tons.

In addition, the government is supporting electric power companies and coal companies through the expansion of loans. Financial authorities have asked financial institutions to extend loans to electric power and coal companies. While coal import prices surged 89.5% in September from a year earlier, coal imports jumped 76.1% year on year to 32.88 million tons thanks to the policy support.

As a result of these measures, coal stocks at thermal power plants in the eight major provinces reached 19.25 million tons on October 8, an increase of 2 million tons from September 20, indicating a rebound in coal stocks.

At the same time, the government is trying to curb electricity demand by allowing increases in electricity prices to a certain extent. In October, the government allowed power companies to raise their electricity prices by 20% above base prices, with higher prices possible for industries that consume more energy. The government has announced that it will prioritize the supply of electricity to households, the public sector, and companies with low electricity consumption, while at the same time curbing the production activities of companies with high electricity consumption. In addition, the government has taken measures such as supporting renewable energy projects and expanding electricity procurement from Russia.

Although concerns remain, such as current low coal stocks and rising demand for electricity and coal in the winter, the government's assistance is expected to help eliminate power and coal shortages forecast for early next year. Until then, however, it is highly likely that power and coal shortages will continue to be a deterrent to manufacturing production.

**(Shinichi Seki)**

# Topics *How do we see the impact of rising resource prices on ASEAN?*

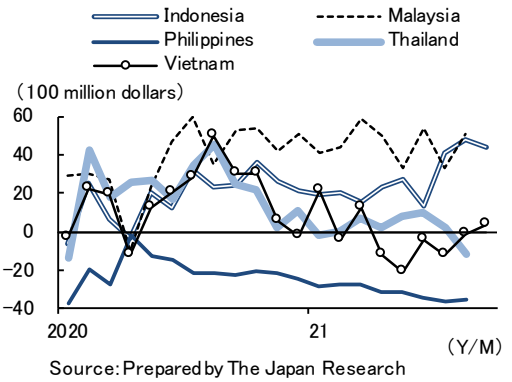
Soaring resource prices will cause a decline in currency values and acceleration of inflation in countries other than Indonesia and Malaysia, which are resource exporting countries. In particular, the Philippines and Thailand may face increased pressure to raise interest rates, which may delay their economic recovery.

## ■ Some countries benefit from rising resource prices, while others do not

Prices of natural resources, including crude oil, natural gas and coal, have remained high. In October, the WTI crude oil futures price reached 80 dollars per barrel, its highest level in about seven years since October 2014, and spot prices of LNG in Asia and Australian thermal coal set new records. Supply and demand may remain tight through the winter, when demand for heating increases, and the price of natural resources is likely to remain high.

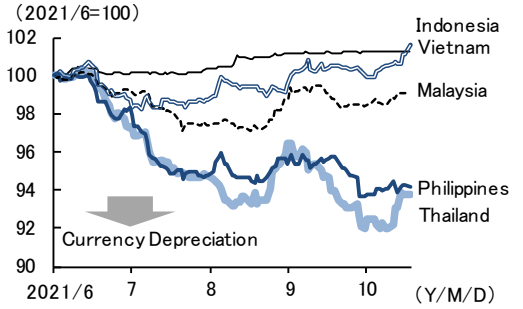
The impact of rising resource prices is not uniform across the five ASEAN countries (Indonesia, Thailand, Philippines, Malaysia, and Vietnam), but is split depending on whether or not the countries are net exporters of resources. Net resource exporters Malaysia (trade balance of mineral fuels in 2020: +1.1% of GDP) and Indonesia (+0.9% of GDP) are expected to benefit significantly, with the increase in resource exports likely to boost their economies and stabilize their nations' finances. On the other hand, net resource importers such as Thailand (-4.5% of GDP), Vietnam (-3.8% of GDP) and the Philippines (-2.0% of GDP) face severe conditions. As the trade balance deteriorates due to an increase in resource imports, the cost burden on firms and households increases. In fact, Malaysia and Indonesia have recently maintained a high trade surplus, while Thailand, Vietnam, and the Philippines have experienced a worsening trade balance.

<Trade Balance (Monthly)>




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

<Exchange Rate of Southeast Asian Currencies Against the U.S. Dollar>




Source: Prepared by The Japan Research Institute, Limited based on CEIC
Note: U.S. dollar/currency of each country as of June 2021 was indexed as 100.

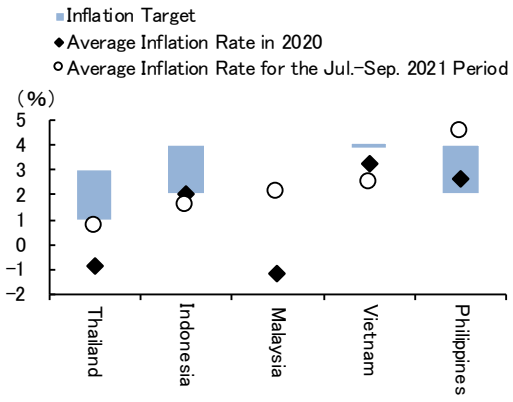
Rising resource prices also affect exchange rates through changes in the trade balance. The Vietnamese dong, which is subject to strict regulations such as restrictions on currency use outside the country, has been little affected. However, since this summer, the Indonesian rupiah has risen slightly against the dollar, while the Thai baht and Philippine peso have declined significantly. When considering the impact on exchange rates, it is necessary to look not only at the trade balance but also various flows of funds. In Thailand, expansion of the service balance deficit since the April-June 2020 period due to the slump in the tourism industry also affected depreciation of the currency. Against a backdrop of rising resource prices, the trade balance is expected to fluctuate widely for the time being, which will likely affect the currencies of each country.

Furthermore, tapering is likely to begin as early as in November in the United States. Such moves toward the normalization of U.S. monetary policy will exert significant downward pressure on emerging currencies, including those in Asia. The Philippines and Thailand, whose currencies have recently weakened, may need to raise interest rates to avoid further downward pressure on their currencies.

## ■ The Philippines and Thailand need to be wary of further delays in economic recovery

The effects of high resource prices vary greatly from country to country in terms of trade, but they are likely to be negative on households in general due to an increase in costs. The share of energy and electricity in the consumer price index (CPI) of ASEAN counties is highest in Thailand at 12.4%, followed by Malaysia at 11.7%, the Philippines at 9.5% and Indonesia at 5.8%. In many ASEAN countries, CPI growth has accelerated from the 2020 level, and in the Philippines in particular, the CPI for the July-September 2021 period was 4.56% higher than the same period last year, exceeding the central bank's upper target range of 4%. In addition to the rise in crop prices due to heavy rain in July, the CPI has recently been boosted by the rise in utility expenses due to soaring energy costs. In Thailand, the government cut electricity and water rates from June to the end of August, thereby mitigating the effects of high crude oil prices, but in September, the CPI rose to +1.68% from -0.02% in August due to the end of the price cut and higher transportation costs.

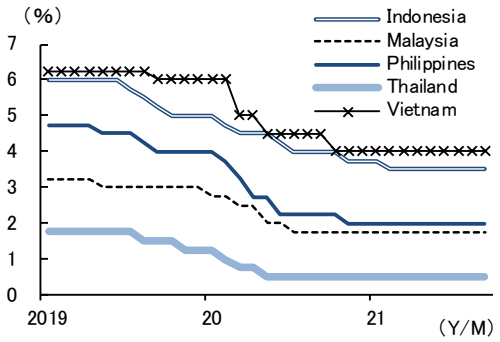
＜Inflation Rates and Inflation Targets＞




Source: Prepared by The Japan Research Institute, Limited based on CEIC
Note: The inflation targets are based on those set by the central banks. However, the inflation target for Vietnam is based on that set by the government.

Malaysia and Indonesia, on the other hand, have fuel subsidy programs in place, and the impact of rising resource prices may have little impact on inflation. Year-on-year CPI growth in Malaysia jumped to +4.68% through April 2021 in reaction to the sharp decline seen in the previous year, but dropped to +2.0% in August 2021 due to the impact of the economic downturn in the summer and the prices of regular gasoline and diesel fuel remaining unchanged through the fuel subsidy system. In Vietnam, although transport costs have risen, the effects of rising resource prices have been negated, with the core inflation rate excluding food and energy having significantly slowed due to the economic downturn caused by strict activity restrictions.

＜Policy Interest Rates in ASEAN＞




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

As described above, with the exception of Malaysia and Indonesia, which have fuel subsidies in place, rising resource prices are expected to have a major impact on inflation. ASEAN countries have been taking monetary easing measures to cope with the COVID-19 pandemic, but the acceleration of inflation due to high resource prices could be a turning point. In particular, the Philippines and Thailand are likely to raise interest rates at an early date, taking into account the risk of currency depreciation mentioned earlier. For the time being, ASEAN countries that experienced weak economic recovery from the COVID-19 pandemic are faced with the challenge of the normalization of U.S. monetary policy. Under such circumstances, the Philippines and Thailand in particular may be forced to tighten their monetary policy in the face of strong downward pressure on their currencies and accelerating inflation, raising the risk of further delays in economic recovery.

**(Mitsuhiro Matsumoto)**