ASIA MONTHLY

January 2022

株式会社 日本総合研究所

https://www.jri.co.jp/en/reports/asia/

This report is the revised English version of the January 2022 issue of the original Japanese version (published 27th Dec.).

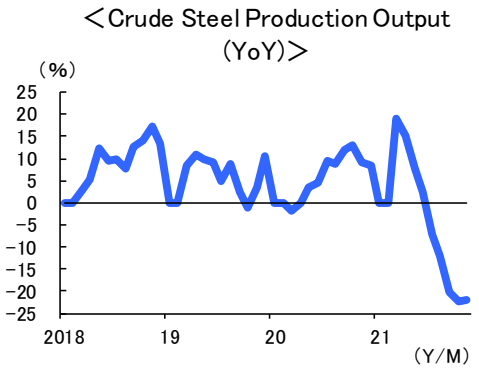
Topics China's steel production may increase around spring

The main reason for China's reduction in steel production is believed to be weakening demand for steel products in the construction and automobile industries. For the time being, the steel industry will continue to cut production to adjust inventories, but it is expected to increase production around spring, reflecting a recovery in demand.

■ Crude steel production has decreased significantly

Steel production in China continues to decline. Crude steel production in November 2021 was down 22.0% from the same month of the previous year, marking the fifth consecutive month of year-on-year declines. It has generally been pointed out that the Chinese government emphasized decarbonization policies and urged the steel industry to reduce production.

In a speech at the United Nations General Assembly in September 2020, Chinese President Xi Jinping declared that China would aim to achieve a peak in carbon dioxide emissions by 2030 and carbon neutrality by 2060. To achieve these decarbonization targets toward 2030 and 2060, Xiao Yaqing, Minister of Industry and Information Technology, called on the steel industry to reduce crude steel production in 2021 from 2020 levels at the Work Conference held at the end of 2020.



Source: "Output of Major Industrial Products" by the National Bureau of Statistics of China
Note: Figures for January and February are based on the total of these months.

In April 2021, the National Development and Reform Commission (NDRC) and the Ministry of Industry and Information Technology renewed their requests for production cuts, and in June, local governments in Jiangsu, Anhui, and Jiangxi provinces issued written requests to the steel industry for production cuts.

Since the latter half of June, the steel industry has announced a series of schedules aimed at halting production, mainly by state-owned enterprises. For example, Wuhan Iron and Steel Corporation, a unit of the Baowu Steel Group, China's largest steel producer, said it would maintain its blast furnaces for 150 days starting June 29. Major steel companies such as Hesteel Group and Ansteel Group also announced a production cut schedule in June.

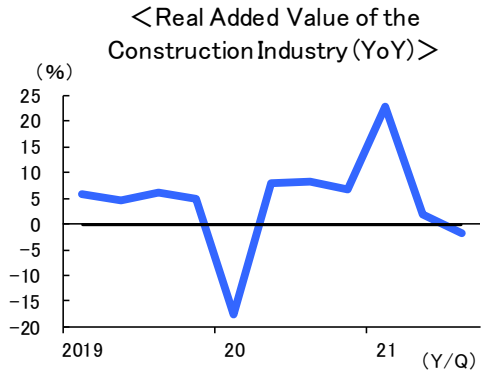
However, based on various data, even if the Chinese government did not order a reduction in crude steel production, the Chinese steel industry would have been forced to significantly reduce production anyway due to weakening demand.

■ Lower demand for steel products has led to higher inventory levels

In China, construction accounts for a large share of steel demand. According to the "2021 China and the national steel demand forecast results research report" by the China Metallurgical Industry Planning and Research Institute, 58.5% of China's steel consumption in 2020 was for construction, 16.1% for machinery, 5.4% for automobiles, and 20.0% for other purposes.

Demand for steel for construction has weakened rapidly since the spring of 2021 due to a slump in the construction industry. According to GDP statistics, the real value added of the construction industry slowed down from +6% year on year in the latter half of 2020 to +1.8% year on year in the April-June period of 2021, and turned negative to -1.8% year on year in the July-September 2021 period.

This was due to the Chinese government's measures to curb investment. As the Chinese economy recovered from the COVID-19 pandemic in 2020, the Chinese government curbed the issuance of municipal bonds to finance infrastructure investment, as well as credit to



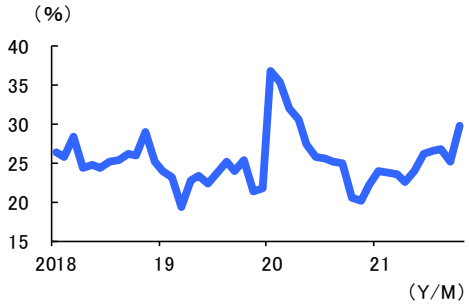
Source: "System of National Accounts" by the National Bureau of Statistics of China

local governments through schemes such as bank financial products to prevent the spread of hidden debt. As a result, investment in infrastructure, such as railways and roads, began to slow in the spring of 2021, and fell far below the level of the previous year in the summer.

In addition, the so-called "three red lines" introduced in the summer of 2020, which were aimed at tightening funding conditions for real estate development companies, combined with the decline in housing demand, caused major real estate development companies such as Evergrande Group to face a management crisis, and weakened real estate development investment throughout the economy.

Demand for steel for automobiles also declined. Automobile sales in China remained above 27 million units on an annualized basis from the latter half of 2020 to April 2021, but fell sharply to 23 million units in September 2021 due to a shortage of semiconductors and other components.

<Inventory Levels of Steel Products (Seasonally Adjusted)>



Source: Prepared by The Japan Research Institute, Limited based on the China Iron and Steel Association
Note 1: Inventory level = Inventories of steel products / Shipments of steel products
Note 2: Values of major and mid-size steel companies

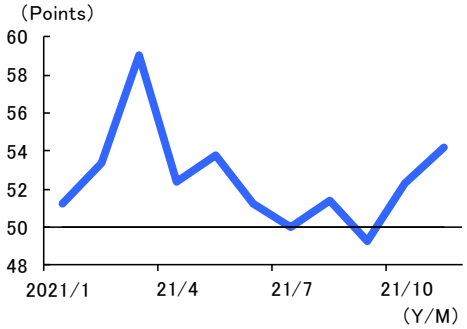
As demand for steel for construction and automobiles weakened, steel shipments by major and mid-size steel companies fell faster than steel production, and inventory levels rose from 22.6% in April 2021 to 29.9% in October 2021.

■ Production cuts will continue for the time being, but thereafter, production will increase due to increased investment

Looking ahead at China's steel industry in 2022, production cuts are expected to continue for the time being to adjust inventories. In October, the Ministry of Industry and Information Technology and the Ministry of Ecology and the Environment asked steel companies in Beijing, Tianjin, Hebei and surrounding areas to reduce production (from November 15, 2021 to March 15, 2022). This appears to be a measure that considers the need for inventory adjustment.

However, steel companies are likely to increase production soon due to a recovery in demand for steel for construction. In the summer of 2021, the Chinese government gradually shifted to an economy-oriented policy stance and began to ease measures to curb investment, as private capital investment had weakened and employment conditions showed signs of deteriorating. Specifically, the government ordered the acceleration of infrastructure investment and began to ease conditions for real estate development companies to raise funds as well as measures to curtail housing demand.

<PMI New Orders Index of the Construction Industry>



Source: "Non-manufacturing Business Activity Index" by the National Bureau of Statistics of China

The construction industry is expected to recover as infrastructure investment picks up, although there will still be pressure to adjust real estate development investment. In fact, there have been signs of a recovery in business conditions, with the PMI New Orders Index for the construction industry in November 2021 exceeding the threshold of 50 for two consecutive months.

Demand for steel for automobiles is also expected to recover moderately. Automobile sales rose to 25 million units on an annualized basis in November 2021 as the semiconductor shortage eased.

As mentioned above, the reason for the reduction in steel production is the weakening demand for steel products for construction and automobiles, and it is not appropriate to attribute this to environmental measures alone. For the time being, steel companies will continue to reduce production due to inventory adjustments, but they are expected to increase production around spring as the construction and automobile industries recover.

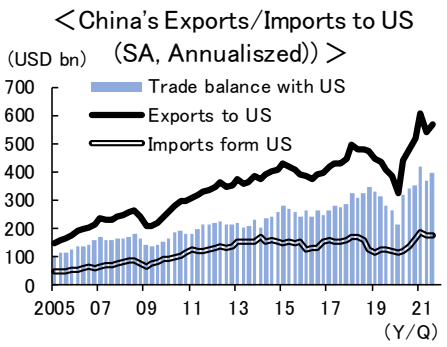
(Shinichi Seki)

Topics Rebuilding U.S. supply chain and its impacts on emerging Asia

The focus of U.S. policy toward China has shifted from trade to economic security. Friend-shoring, an initiative to strengthen the U.S. supply chain, could open up new opportunities for emerging Asia.

■ The focus of the U.S.-China confrontation has shifted from trade to economic security

China's trade surplus with the United States (trade deficit with China for the United States) was 357.9 billion U.S. dollars in the January-November 2021 period, up 24.6% from the same period of the previous year, and is continuing to expand. Before the outbreak of the COVID-19 pandemic, trade tensions between the United States and China intensified under the Trump administration, and China's exports to the United States slumped due to tough trade sanctions imposed by the United States, including tariff hikes. China-Plus-One, a management strategy in which companies diversify their overseas bases away from China, accelerated and benefited emerging Asian countries selected as new production bases in 2019. Since the COVID-19 outbreak, however, China's exports to the United States have been on the rise.



Source: JRI based on CEIC

Note: Unlike the China trade data, the US trade data shows a narrowing of US's trade deficit with China. However, this is because the US data is distorted by errors in reports to customs (see FEDS Notes, June 21 2021, https://doi.org/10.17016/2380-7172.2927)

Although U.S. exports to China were expected to increase as a result of the Phase One agreement (China aims to increase the imports of goods and services from the United States by 200 billion U.S. dollars from 2017 levels), which is scheduled to expire at the end of 2021, only around 60% of the target is expected to be achieved according to the Peterson Institute for International Economics (PIIE). In a telephone conversation on October 8, 2021 between U.S. Trade Representative Katherine Tai and Chinese Vice Premier Liu He, it was confirmed that talks on the agreement would continue, but it is highly likely that the focus of discussions will shift to the Phase Two agreement, which covers China's subsidies to domestic industries. In addition, the United States announced that it would resume the exemption of tariffs imposed on imports from China in October as a measure to reduce the burden of purchasing imported goods amid accelerating inflation in the United States. In this way, the United States' exports to China have not increased, and downward pressure on imports from China through punitive tariffs has been eased; no progress has been made in correcting the trade imbalance. Nevertheless, the trade war between China and the United States is in a lull.

However, it would be premature to assume that the U.S.-China conflict is now coming to an end. This is because the Biden administration's policy toward China has shifted from correcting trade imbalances to responding to economic security risks. For example, the United States, mindful of its confrontation with China, is accelerating its review of supply chains for products that are important from an economic security perspective. In June 2021, it released a report aimed at strengthening supply chains (results of studies in four fields: semiconductors, batteries, rare earths, and pharmaceuticals).

■ Friend-shoring is a key to strengthening supply networks

The United States aims to boost supply capacity in key industries such as semiconductors by attracting companies as a way to strengthen its supply chain. Taiwan's TSMC and South Korea's Samsung Electronics have already announced plans to build plants in the United States (TSMC announced in May 2020 a plan to build a plant worth 12 billion U.S. dollars in Arizona, and Samsung Electronics announced in November 2021 a plan to build a plant worth 17 billion U.S. dollars in Texas). However, since the United States had in the past accelerated the overseas transfer of production bases (offshoring) for many industries, it is not easy to move them back to the domestic market (reshoring) against such a trend from the viewpoint of economic efficiency, including cost. In fact, an enormous amount of financial support will be required to attract semiconductor companies, and the field that attracts them will be limited to advanced technology. The aforementioned report suggests "friend-shoring" as a policy of strengthening the supply chain not only through domestic production but also through the United States' relationships

＜Programme for Development of Semiconductors Manufacturing in India (Published on 15 Dec)＞

USD 10 billion approved for development of semiconductors and display manufacturing ecosystem in India – Government of India has committed support of total USD 30 billion to position India as global hub for electronics manufacturing with semiconductors as the foundational building block.	
Target	Government supports
At least two greenfield Semiconductor Fabs	Fiscal support of up to 50% of project cost
Atleast 15units of Compound Semiconductors and Semiconductor Packaging	Fiscal support of 30% of capital expenditure
100 domestic companies of semiconductor design	Up to 50% of eligible expenditure, incentive of 6% – 4% on net sales

Source: Website of India government (https://pib.gov.in/PressReleasePage.aspx?PRID=1781723)

with its allies and friends.

At the Quad (Quadrilateral Security Dialogue) summit in September 2021, the leaders of Japan, the United States, Australia and India confirmed that they would cooperate in building semiconductor supply chains. India is expected to expand its semiconductor industry in line with U.S. policy, as evidenced by the announcement on December 15, 2021 of a subsidy plan to attract semiconductor companies worth 10 billion U.S. dollars. In addition, the United States and Malaysia will conclude an agreement by early 2022 to ensure transparency, resilience, and safety in the semiconductor supply chain. Malaysia has also become a key part of U.S. supply chain reinforcement, with U.S. semiconductor giant Intel announcing on December 16, 2021 that it will invest 7 billion U.S. dollars over the next 10 years. In addition to semiconductors, the aforementioned report examines other important industries in detail. For EV batteries, Indonesia has been mentioned as having abundant reserves of nickel, which is a raw material for EV batteries, and for pharmaceuticals, India has been mentioned as important production bases.

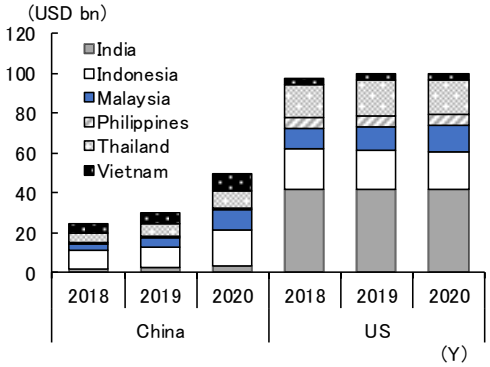
■ The U.S.-China conflict brings about new opportunities and challenges for emerging Asia

As described above, the U.S. government has shifted its policy focus on China from trade to economic security, and has adopted friend-shoring as a new strategy to strengthen supply chains. Against this backdrop, new opportunities are expected to form in emerging Asian countries, such as the development of key industries related to economic security in the region, supported by the United States.

However, emerging Asian countries have strengthened their economic ties with China in recent years, and a significant tilt toward the United States could pose a problem in terms of deteriorating relations with China. In fact, direct investment by the United States in major emerging Asian countries (India and ASEAN-5 countries) in 2020 was 99.62 billion U.S. dollars, up slightly from the previous year (99.57 billion U.S. dollars), while that by China was 49.5 billion U.S. dollars, up sharply from the previous year (30.27 billion U.S. dollars). The United States has ruled out a return to the Trans-Pacific Partnership (TPP), and aims to build a new economic partnership framework in 2022. In this context, the United States intends to strengthen its relationships with its allies and friends to strengthen its coalition against China.

Friend-shoring offers emerging Asian countries an opportunity to develop their industries, but it also raises the risk of creating friction with China, whose economic ties are growing. Emerging Asian countries will have to balance their position with the United States and China, and governments will be forced to walk a fine line.

<FDI to Asia from China and US>



Source: JRI based on IMF(CDIS)

(Minoru Nogimori)