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<i>Topics</i>	<i>China's Dominance in Critical Minerals</i>	<i>1</i>
<i>Topics</i>	<i>ASEAN Economic Recovery Hinging on Inbound Tourism</i>	<i>3</i>



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Topics *China's Dominance in Critical Minerals*

China holds an overwhelming share in critical minerals essential for digitalization and green initiatives, while developed countries seek to reduce their dependency on China. These tensions warrant attention due to the potential adverse effects on the economies of various countries.

■ China's dominance in the supply of critical minerals

Active discussions have been addressing economic security issues. Since 2020, disruptions in trade due to the COVID-19 pandemic and Russia's invasion of Ukraine have heightened the awareness of the need to reconstruct manufacturing supply chains. The discussions on economic security cover a wide range of critical resources, including industrial products like semiconductors, batteries, robots, and pharmaceuticals, as well as energy resources such as LNG. Among these, rare earths and rare metals like lithium, collectively defined as critical minerals, hold significance for 'digitalization' due to their use in high-tech products. Additionally, such critical minerals find applications in electric vehicles (EVs) and renewable energy-related equipment like batteries and high-performance turbine generators for wind power, making them essential for 'green initiatives.' While the priority for securing supply chains for each commodity varies from country to country due to differences in industrial structures, it is noteworthy that many countries consider critical minerals as their foremost priority.

Critical minerals are potentially mineable in various countries and regions worldwide. However, the concentration of refining and processing in China offers a significant advantage in the critical minerals supply chain to China. Three key factors underlie China's growing share in refining and processing such minerals.

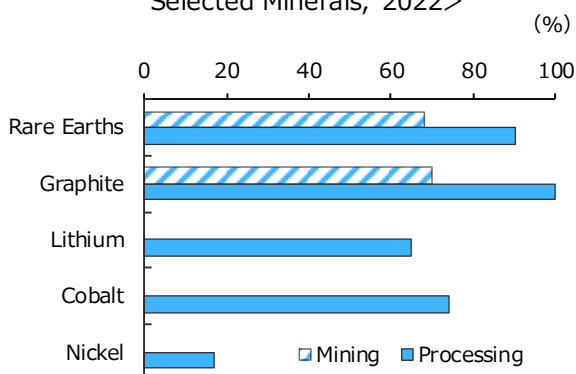
Firstly, there is the advantage of cost. Refining and processing involve generating harmful substances and a substantial environmental burden, especially when purifying ore. Many rare earth ores contain radioactive materials, leading to the generation of radioactive waste during the refining process. In China, lower labor costs compared to developed countries, coupled with less stringent environmental regulations, contribute to a lower comprehensive processing cost.

Secondly, there is proactive investment in resource-rich emerging countries. China has deployed its 'Belt and Road Initiative' to mineral resource countries, channeling significant funds into resource development investments. For instance, China has focused on cobalt mining development in the Democratic Republic of the Congo, actively expanding its procurement network for mineral resources. Additionally, China has intensified its investments in nickel refining facilities in Indonesia.

Thirdly, there is a comprehensive safeguarding of the critical mineral industry, notably in the case of rare earths. The Chinese government has long recognized the strategic significance of rare earths and implemented export quota systems in the 1990s. Additionally, they have progressively enhanced trade regulations for rare earths, including raising export tariffs.

Movements to protect the critical mineral industry have gained momentum in recent times. In 2021, the Chinese government released draft Regulations on Rare Earth Management and signaled its intention to reinforce regulations on rare earths with this new legislation. Additionally, starting in August 2023, the Chinese government initiated export controls on gallium and germanium, both indispensable for manufacturing electronic components such as semiconductors, LEDs, and solar cells. Furthermore, there is a potential for the expansion of regulations to encompass other critical minerals like lithium and graphite. The Chinese government has been actively advancing strategic actions concerning pivotal critical minerals for economic security, steadily enhancing its supremacy in the mineral resource supply chain.

<China's Share of Mining/Processing of Selected Minerals, 2022>



Source: JRI based on IEA

■ Developed countries heighten vigilance and accelerate supply chain restructuring

Developed countries rely heavily on China for the procurement of critical minerals. Recently, with digitalization and green initiatives becoming top priorities, the demand for critical minerals has steadily risen, intensifying concerns about the current dependence on China. In 2010, amid worsening Japan-China relations after the Senkaku Islands fishing boat collision incident, China implemented export restrictions on rare earths destined for Japan. In light of this, Japan aimed to diversify its sourcing regions by increasing imports from countries like Vietnam. Furthermore, Japan pursued the development of alternative technologies to decrease the reliance on rare earths, resulting in a temporary decrease in the import ratio from China to below 40%. Nevertheless, it has now exceeded 50% again as the utilization of rare earths in various products has increased, illustrating the challenge of seeking to reduce dependence on China.

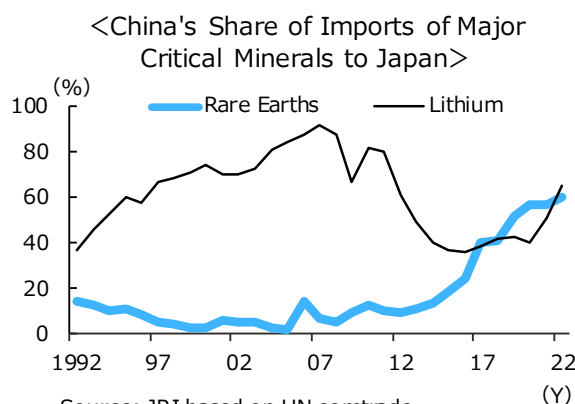
In light of these past experiences, developed countries, including Japan, have embarked on supply chain restructuring for critical minerals, supported by more robust policy measures. In Japan, the government introduced the 'Policy for Ensuring Stable Supply of Critical Minerals' in January 2023, clearly delineating the specific initiatives and goals including financial support. The government has allocated a budget totaling 215.8 billion yen, which includes (1) investment projects by the Japan Organization for Metals and Energy Security (JOGMEC) and (2) subsidy programs related to mineral resources under the Economic Security Promotion Act. In November 2021, the United States enacted the Infrastructure Investment and Jobs Act, allocating a \$2.8 billion grant for projects to enhance domestic EV battery production and support the production of minerals such as lithium and nickel. In addition, the 'Inflation Reduction Act,' passed in August 2022, excluded EVs equipped with batteries containing critical minerals of Chinese origin from subsidy eligibility and introduced tax reductions for domestic production of critical minerals. In the EU, the 'European Critical Raw Materials Act' was unveiled in March 2023 to domestically process at least 40% of the annual consumption of critical minerals and mine 10% by 2030. To achieve this target, simplifying business permitting procedures has been identified as a concrete step, along with the possibility of offering subsidies.

■ The rebuilding of critical mineral supply chains could escalate tensions between China and developed countries

In the context of economic 'de-risking' aimed at reducing dependence on China, a pursuit led by developed countries, there has been significant progress in the semiconductor sector, and a similar trend is expected to gain momentum in critical mineral-related sectors. Today, Japan, the United States, and Europe have each initiated financial support on the scale of trillions of yen for the semiconductor industry. In contrast, subsidies for the mineral resource sector are relatively small. Moreover, putting into practice refining and processing in developed countries with strict environmental standards presents cost-related challenges. Reducing reliance on China for critical mineral acquisition proves to be a formidable task.

Amid such a situation, developed countries will likely accelerate the restructuring of supply chains for critical minerals as digitalization and green initiatives continue to advance. In addition to inward-looking subsidies such as the relocation of production facilities, strict trade restrictions may come into effect targeting China, as in the semiconductor sector, further intensifying the conflict between China and developed countries and possibly inflicting adverse effects on the economies of each country. Unlike semiconductors, China holds a large share of the market for critical minerals, suggesting that countermeasures against China could have little impact on its economy in the short term. However, a restructuring of supply chains would reduce China's function as the "world's factory" and depress its medium- to long-range growth potential.

(Minoru Nogimori)



Topics ASEAN Economic Recovery Hinging on Inbound Tourism

In ASEAN countries, the resurgence of inbound tourism is driving economic growth. Nevertheless, there is an increasing sense of uncertainty stemming from factors such as (1) a slowdown in the recovery of tourists from countries other than China, (2) a decline in the purchasing power of Chinese tourists, and (3) worsening diplomatic relations with China.

■ Boost in tourism offsets sluggish goods exports

In ASEAN, exports of goods have been sluggish, and the manufacturing sector continues to struggle. In particular, the production of high-tech devices has been lackluster. During the COVID-19 pandemic, there was a surge in demand for 'stay-at-home' electronics like computers and gaming consoles due to increased indoor activities. However, as the pandemic abated, demand plummeted rapidly. Demand for high-tech equipment had already seen a front-loaded increase, and combined with the effects of the subsequent global price increases, demand for goods has been sluggish since last summer. Exports of electronic equipment and components, among others, have significantly declined in countries like Malaysia and Vietnam, where they constitute a substantial portion of exports.

In contrast to the weak demand for goods, the demand for services has been strong; particularly the rapid rebound of inbound tourism is offsetting the decline in goods exports in various countries. In ASEAN, authorities have gradually relaxed entry restrictions implemented in response to the COVID-19 pandemic since spring 2022, leading to an influx of foreign tourists. Consequently, service sector industries such as retail, wholesale, and food and accommodation in ASEAN have seen a resilient recovery. As of 2019, the share of spending by foreign tourists in the tourism sectors of the five leading ASEAN emerging countries (Indonesia, Thailand, the Philippines, Malaysia, Vietnam) was notably high at 46.6%, in contrast to the global average of 28.3%. Additionally, many ASEAN countries demonstrate a higher-than-average ratio of the tourism industry within their overall employment figures (Philippines: 22.7%, Thailand: 21.8%, Malaysia: 15.1%), exceeding the global average of 10.6%. In this way, ASEAN enjoys strong economic traction from inbound tourism demand, thus creating a virtuous cycle mechanism that expands domestic demand by improving employment and income circumstances.

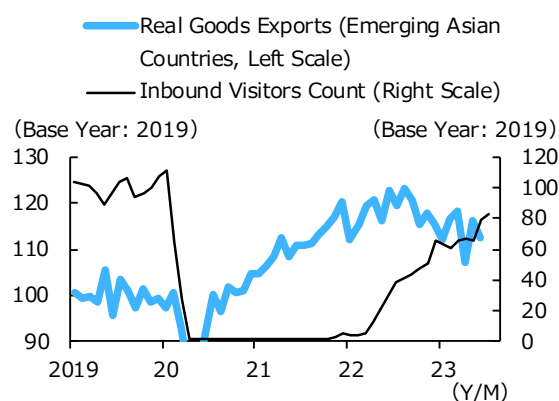
For the time being, the growing number of foreign tourists, supported by individual country policies, will likely bolster the overall ASEAN economy. Thailand, as an example, has opted to exempt Chinese tourists from visas starting in September. Furthermore, even the Philippines, which had experienced a delayed recovery in inbound tourism demand, is expected to align with the recovery trends seen in other countries. The Philippines had not implemented electronic visas until July 2023, requiring proof of vaccination upon entry, which contributed to a delayed reception of tourists compared to other Southeast Asian countries that had already lifted entry restrictions. These measures have placed significant limitations on the reception of Chinese tourists, resulting in a slower growth rate for Chinese tourists to the Philippines, which stood at 23.3% of the 2019 average as of July, compared to the other countries (average of Indonesia, Thailand, the Philippines and Vietnam: 42.8%). The Philippines mostly lifted these entry restrictions in August 2023 and implemented an electronic visa service for Chinese tourists.

■ Inbound tourism demand facing downward risks

As such, the current state of the ASEAN economy heavily relies on inbound tourism demand. However, as noted below, the downward risks to inbound tourism demand are increasing, heightening concerns that the ASEAN economy could suddenly lose one of its essential foundations.

Firstly, the recovery in the number of non-Chinese tourists has plateaued. With the easing of entry

<Overseas Demand in Southeast Asia>



Source: Created by JRI based on CEIC data

restrictions for tourists from ASEAN countries, Europe, and the United States in the spring of 2022, non-Chinese tourist numbers rebounded ahead of others. That said, the number of tourists from outside China has already reached 85% of its pre-COVID level, leaving little room for further recovery.

Secondly, the purchasing power of Chinese tourists has declined. In China, with the

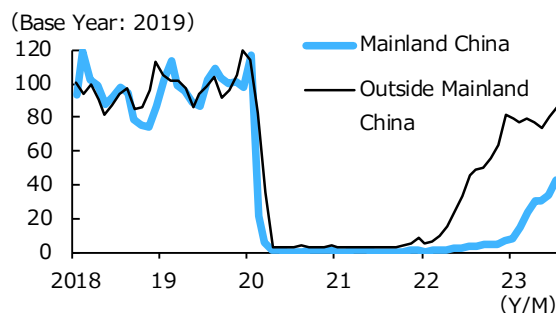
conclusion of the Zero-COVID policy at the end of 2022 and the resumption of group travel to ASEAN countries (Indonesia, Malaysia, the Philippines, Thailand, Vietnam) in February-March 2023, Chinese tourists to ASEAN have rapidly increased, offsetting the sluggish growth of non-Chinese tourists. However, the economy is cooling down in China amid factors such as real estate market adjustments. Income conditions are deteriorating, particularly within the younger demographic experiencing increasing unemployment rates. In addition, the People's Bank of China has been intensifying its efforts to implement accommodative monetary policies to stimulate economic growth. As a result, the Renminbi has depreciated, particularly against the US dollar, reaching its lowest level since 2007. Such economic malaise and currency depreciation have reduced China's purchasing power, which may result in fewer tourists from China and decrease in their travel spending or, even if there is an increase, a smaller positive impact on the ASEAN economy than in the past.

Thirdly, diplomatic relations with China are deteriorating. Some ASEAN countries have territorial disputes with China. In August 2023, the Chinese government published a 'standard map' that depicted regions disputed with neighboring countries as Chinese territory, leading to protests from the Philippines, Vietnam, and Malaysia. In the past, when relations with China soured in countries like South Korea and Taiwan, the Chinese government took measures such as restricting travel to those regions. It remains possible that the Chinese government may take similar actions with ASEAN countries with which it has territorial disputes.

The prospects for inbound tourism demand, once a strong driver of the ASEAN economy, do not necessarily look optimistic, and given the risk that such demand could dry up to become a downward pressure on the economy, ASEAN countries face the challenge of managing their economies to avoid excessive dependence on inbound tourism demand.

(Tomoki Kumazawa)

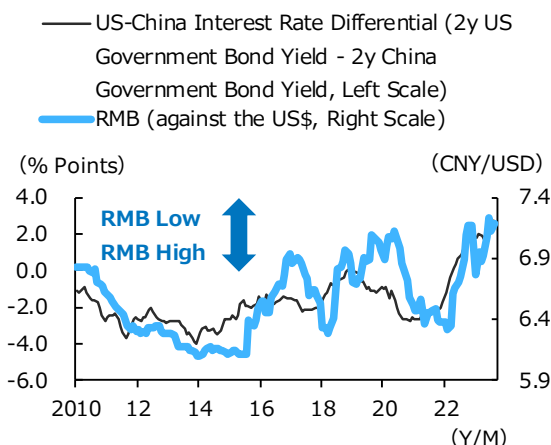
<Inbound Tourists Trend in ASEAN>



Source: Created by JRI based on CEIC data

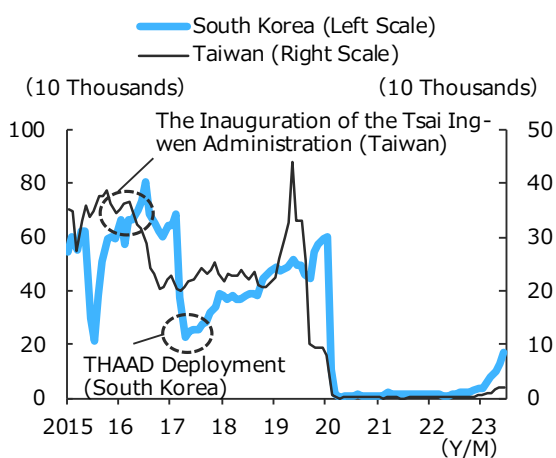
Note: ASEAN is the total of Indonesia, the Philippines, Thailand, and Vietnam.

<RMB & US-China Interest Rate Differentials>



Source: Created by JRI based on CEIC data

<Inbound Chinese Tourists to South Korea and Taiwan>



Source: Created by JRI based on CEIC data

Note: Both figures after adjustment for seasonality and Spring Festival factors