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<i>Topics</i>	<i>Will "new productive forces" drive China's economy?.....</i>	<i>1</i>
<i>Topics</i>	<i>U.S.-India economic relations under the Trump administration.....</i>	<i>3</i>



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Topics Will "new productive forces" drive China's economy?

The Xi Jinping administration has positioned three industries, including electric vehicles (EVs), as "new productive forces" (sometimes called "new quality productive forces") for driving the economy forward. However, contrary to expectations, the three industries' exports have stalled, and the problem of overcapacity is expected to become an even more serious.

■ Why "new productive forces?"

The Xi Jinping administration has declared "new productive forces" a fresh driver of the Chinese economy and begun to emphasize the promotion of these industries. What are the "new productive forces?" The "Resolution on Further Deepening Reform Comprehensively to Advance Chinese Modernization," adopted at the Third Plenary Session of the 20th Central Committee of the Communist Party of China (Third Plenum) in July 2024, mentioned a wide range of fields: next-generation information technology, artificial intelligence, aviation and aerospace, new energy, new materials, high-end equipment, biomedicine, and quantum technology.

Among them, there are three areas, all the new energy field, where China already boasts an overwhelming presence in the global marketplace: EVs, lithium-ion batteries, and solar power generation. General Secretary Xi Jinping said in his 2024 New Year's message that these three industries are "new testimony to China's manufacturing prowess," asserting that the momentum of China's innovation and economic development is not slowing down. And at the Central Economic Work Conference held at the end of 2024, driving the development of "new productive forces" was identified as the second key task for 2025 after "boosting consumption."

The reasons for the emphasis on "new productive forces" are that demand for new energy is expected to increase in order to curb greenhouse gas emissions, and that the deterioration of relations with the U.S. has made the Chinese government starkly aware of the vulnerability of manufacturing supply chains. Advanced semiconductors provide a clear illustration of this. According to the U.S. Semiconductor Industry Association (SIA), in 2023 China possessed 37% of the world's production capacity for legacy semiconductors (transistor feature size of 28 nm or more), but only 3% of that for advanced semiconductors (10 nm or less). This is because the country is unable to procure state-of-the-art extreme ultraviolet (EUV) lithography equipment, which is indispensable for the manufacture of advanced semiconductors, due to U.S. government restrictions. This has brought home to the Xi Jinping administration the fact that the development of industries that depend on foreign countries for core technologies can be constrained by deteriorations in foreign relations.

■ Supply chains are almost completely domestic

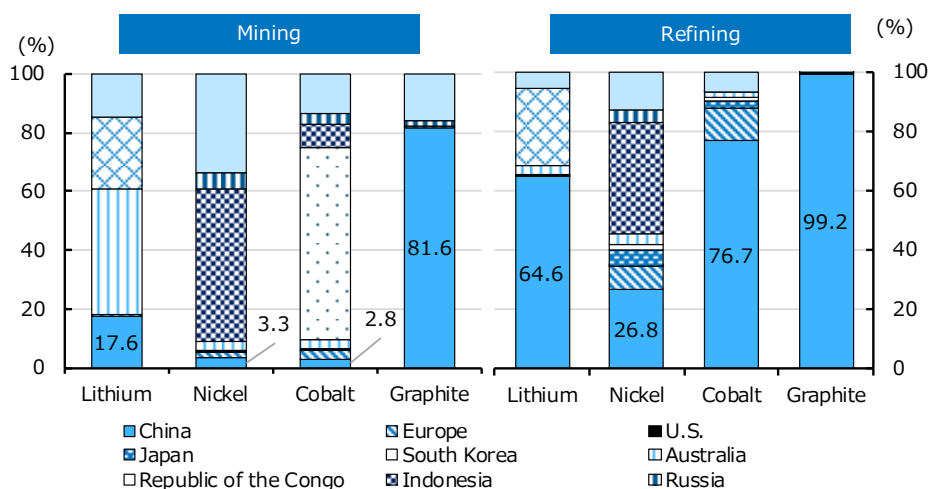
China is the world leader in the three industries, and the scale of production has reached levels unrivaled by other countries. In 2023, China accounted for 60% of global EV production, 80% of lithium-ion battery production, and 80% of solar panel production. Considering that China's share of world GDP is only 17%, these figures show how concentrated the three industries are in China.

The country's strength in the three industries stems not only from its massive output, but also from the fact that the supply chains supporting the industries are almost completely domestic to China. As an example, a look at China's share of mining and refining of the rare metals used in lithium-ion batteries reveals that China is the world's biggest refiner of all of them except nickel, though for mining, it depends on other countries for most of them except graphite.

In addition, since high-value-added processes such as planning, development, sales, and maintenance are performed domestically, another characteristic of the three industries is that China's share of the total value added is exceedingly large. This can be clearly seen in comparisons with PCs or smartphones. China is the world's largest producer of both these products, but it relies on imports for the core components and exports the finished devices to the world under OEM arrangements. In other words, China only handles low-value-added manufacturing and assembly processes, so China's share of total value added for these products is low, and raising it is also difficult.

In the case of the three industries, though, Chinese companies handle planning and development, and having developed their own core technologies, they sell the products worldwide under their own brands. The upshot is that since China performs high-value-added processes, its share of the added value is naturally high. This means that the growth of the three industries is unlikely to be hindered by U.S. export curbs, which have shackled China's semiconductor sector.

<Countries/Territories' Shares of Mining and Refining of Rare Metals Used in Lithium-ion Batteries (2023)>



Source: Prepared by JRI based on data from the International Energy Agency (IEA)

■ Exports are sluggish, and overcapacity is becoming more serious

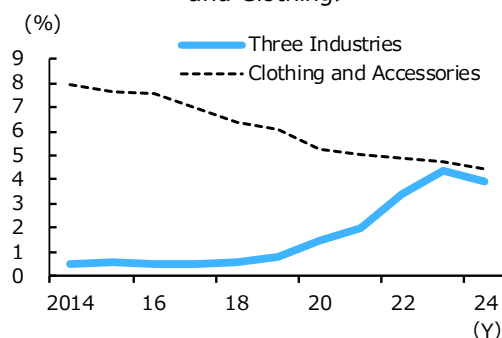
The three industries appear to be sufficiently equipped to drive the Chinese economy forward. However, exports have been lackluster recently. Combined exports of EVs, lithium-ion batteries, and photovoltaic products in January-November 2024 fell 8.5% year over year (YoY) to \$127.2 billion, and accounted for only 3.8% of total exports and less than the 4.5% export share held by clothing and accessories, which are traditional export goods. Moreover, their share of total exports has declined from 4.4% in 2023.

A background factor behind this drop is that in May 2024, the U.S. government designated exports of photovoltaic products from four Southeast Asian countries, including Vietnam, as "circumventing exports" by Chinese companies, and revoked their tariff exemption. As a result, exports of photovoltaic products in January-November 2024 were just \$28.6 billion, down 30.9% YoY. In 2025, with the addition of the European Commission's tariff hike for Chinese-made EVs, the three industries' exports are expected to stagnate further.

Since excess capacity is a serious problem in all three industries, China is likely to focus on exports to emerging countries in Southeast Asia and elsewhere. However, due to the limited access to the large markets of the West, hopes that the three industries will drive the Chinese economy forward will probably be dashed. In fact, the excess capacity problem is expected to become even more serious due to the stagnation of exports.

(Yuji Miura)

<Shares of Exports of Three Industries and Clothing>



Source: Prepared by JRI based on data from CEIC

Note: Figures for 2024 are for January-November.

Topics U.S.-India economic relations under the Trump administration

As the U.S.-China rivalry intensifies, the U.S. is trying to strengthen its economic ties with India, but the protectionist tilt on both sides and the inadequacy of the business environment in India could prove an obstacle.

■ The basic policy of the U.S. toward India will not change

The question of how the second Trump administration will affect different countries has been generating a lot of interest. However, the impact of this change of government on the general direction for economic relations with India, which has been steadily raising its global profile in both the economic and political spheres, is expected to be limited. The reason is that there will be no change in the view, held by the previous administration, that it is important for the U.S. to strengthen its relationship with India, which shares the same security concerns about China, as the U.S.-China confrontation heats up. And India, meanwhile, remains committed to maintaining a good relationship with the U.S., a key partner in terms of trade, investment, and aid.

The two countries are expected to seek to expand economic ties in priority sectors such as electronics, digital, and clean energy, in line with the policies set out in the Comprehensive Global Strategic Partnership agreed in 2020 and at the iCET (U.S.-India Initiative on Critical and Emerging Technology) meetings held in 2023-24.

For the foreseeable future, mobile phones are likely to continue to be a driving force in India's expansion of exports to the U.S. Although India's mobile phone exports to the U.S. have skyrocketed over the past few years (right figure), the U.S. still imports about 50% of its mobile phones from China, leaving plenty of room for India to replace China's exports to the U.S. Mr. Trump has long pledged to revoke China's most-favored-nation status, and is currently vowing to gradually halt imports of essential goods from China. This has led to major EMS (electronic manufacturing services) companies shifting production to India in anticipation of a deterioration in the environment for Chinese exports to the U.S.

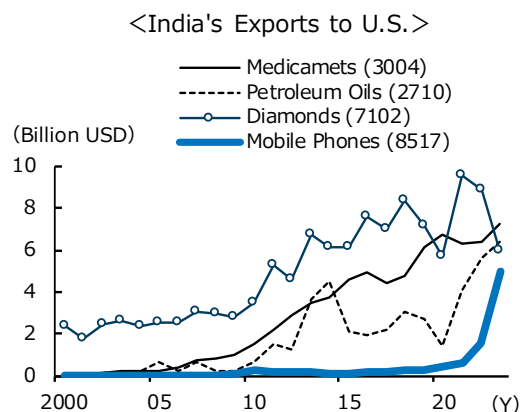
Similar developments could spread to electronics products such as PCs, tablets, and storage batteries, for which the value of U.S. imports is high and for which the U.S. is heavily dependent on China, as well to solar panels, exports of which from Southeast Asia have been labeled as circumventing exports originating from China. India is also highly reliant on China for imports of these goods, prompting the Indian government to position them as important products that should be manufactured domestically.

Developments with PCs and tablets, of which the U.S. is a big importer, clearly demonstrate this trend, with companies such as HP and Dell of the U.S., ASUS of Taiwan, and Lenovo of China planning to expand production in India. In November 2023, the Indian government approved about 30 companies, including these firms, as eligible for its PLI (Production Linked Incentive) schemes, which provide subsidies to companies based on how much they increase production value compared to the base year. It is also reported to be planning to introduce import curbs on IT equipment in the near future in order to promote the switch from imports to domestic production of the PCs and tablets used in the country. As with mobile phones, attention is focused on whether the combination of subsidies for domestic production and stricter import regulations will accelerate domestic production.

■ Constraints on the expansion of U.S.-India economic relations

Although the U.S. and India are aiming in more or less the same direction, attention needs to be paid to the possibility that the following two factors will constrain the development of bilateral economic relations:

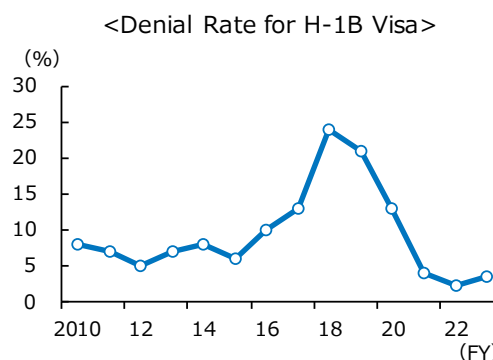
The first limiting factor is U.S. protectionism. As mentioned above, tighter restrictions on imports to the U.S. from China will encourage a shift in production to countries/territories other than China. However, Mr. Trump has indicated that he will also raise tariffs by at least 10% on all imports from countries/territories



Source: Prepared by JRI based on United Nations
Note: Figures in parentheses are 4-digits HS codes.

other than China, and a decline in U.S. purchasing power due to rising import costs will put downward pressure on exports to the U.S. from other countries, including India. In addition, given that during the first Trump administration the U.S. and India raised tariffs on each other's goods and filed complaints about these mutual tariff hikes with the WTO (World Trade Organization), and that the U.S. trade deficit with India, which was one of the causes of the U.S.-India trade clash at that time, has been growing, the possibility that a fresh trade battle between the U.S. and India will arise as a result of U.S. tariff hikes cannot be ruled out.

Furthermore, a tightening of U.S. immigration restrictions will also constrain the expansion of U.S.-India economic ties, especially in the digital arena. Besides cracking down harder on illegal immigrants, Mr. Trump has also conveyed alarm about expansion in the acceptance of legal immigrants and permanent residents, and may take measures such as significantly raising visa application fees and tightening screening requirements. India would be particularly impacted by changes in the issuance of the H-1B visas for highly skilled human resources, as Indians currently make up about 80% of recipients of these visas. Looking back on the trend with the issuance of these visas under the first Trump administration, the percentage of applications rejected soared through 2018 (right figure), quashing the rise in the number of highly skilled Indians working in the U.S.



Source: Prepared by JRI based on National Foundation for American Policy

The second limiting factor is the lack of a well-developed business environment in India. India is a promising market with solid growth potential over the medium to long term, but at the same time, it has various problems.

In the electronics industry, which is attracting attention, both tangible and intangible infrastructure are still in the process of being developed. The focus is on electricity, water, and human resources, which are indispensable for the sustainable development of the sector. Regarding electricity, even in the industrial parks of states with relatively well-developed power infrastructure, sudden outages and sudden voltage drops occur frequently, and this inadequacy in electricity infrastructure hampers the development of industries such as semiconductors that require "high-quality" power. As for water, the high cost of producing the "ultrapure water" required for semiconductor product cleaning due to the pollution of rivers and groundwater and the risk of experiencing serious water shortages in the future are issues that have yet to be fully addressed. With respect to human resources, compounding the limited numbers of skilled electronics personnel are several obstacles to smooth worker mobility between sectors and across state boundaries: 1) the application of strict rules on dismissing workers to factories over a certain size, 2) the obligation in some states to hire people from within the state, and 3) complex labor laws that differ from state to state.

In addition, factors such as the maintenance of strict restrictions on foreign investment in the retail and e-commerce sectors, which are designed to protect Indian micro-retailers, and the slow development of systems for intellectual property rights systems, could constrain U.S. investment in the service sector and in R&D (research and development) in India, and contribute to a re-ignition of confrontation on trade between the U.S. and India in the future.

Against this backdrop, if global companies decide to make active use of ASEAN countries, which have more favorable business environments than India and are part of the ASEAN-China Free Trade Area, as bases for exports to the U.S. to replace those in China, the benefits to India from supply chain restructuring will be limited.

(Shotaro Kumagai)