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Topics China's government subsidies and corporate growth

The Chinese government is increasing subsidies to companies, with an emphasis on specific industries such as semiconductors. However, looking at various studies and data, it is unclear whether government subsidies are effective in helping firms grow.

■ Government subsidies for listed companies are increasing

Chinese government subsidies are on the rise. Under Chinese accounting standards, government subsidies are defined as cash or other assets received by companies from the government at no cost. They are provided directly to enterprises by the central government and local governments. The total amount of government subsidies received by all the companies listed on the three stock exchanges of Shanghai, Shenzhen, and Beijing increased from 125.9 billion yuan in 2010 to 240.6 billion yuan in 2023. Government subsidies as a percentage of GDP also rose slightly from 0.18% to 0.19% over the same period.

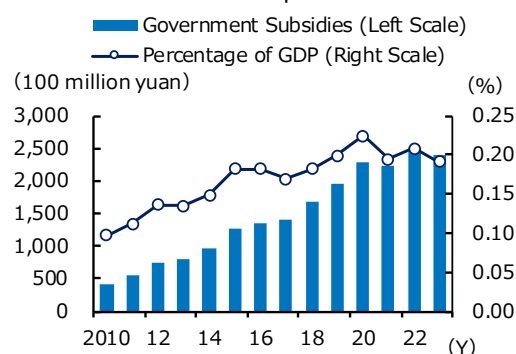
In China, subsidies have long been used to plug losses at state-owned enterprises (SOEs) in the steel, oil, and power sectors, to safeguard employment and keep prices stable. But in recent years, the central government and local governments have been heavily allocating subsidies to specific industries that are expected to grow, such as semiconductors. From 2010 to 2023, government subsidies for 4,425 companies in all industries, excluding ones founded or listed in 2016 or later, totaled 1,604 billion yuan, equivalent to about 0.35% of their net sales. Relative to other sectors, the ratio of government subsidies to net sales of the 34 listed semiconductor companies was remarkably high, standing at 2.32%. In contrast, for listed companies in the general machinery, chemicals, automobile, and electrical machinery sectors, the figures over the same period were of 0.82%, 0.71%, 0.68%, and 0.64%, respectively.

Given the domestic situation in China, with problems such as population decline, over-investment and excessive debt, gone are the days when it was possible to accelerate growth simply by deploying labor and capital in large quantities. For this reason, by focusing on the promotion of strategically designated specific industries and supporting the growth of companies that operate in them, the government wants to develop these sectors as new engines of economic growth. It also needs to deal with more international issues such as the U.S.-China rivalry and global warming. Therefore, reducing import dependence in strategic industries such as semiconductors and renewable energy has become increasingly important for national security and economic stability.

■ Subsidies for the steel industry and other SOEs are being cut

In contrast, subsidies to the steel industry are surprisingly low. The ratio of government subsidies to net sales of the 31 listed steel companies was just 0.21% in the period from 2015 to 2023. Furthermore, whereas

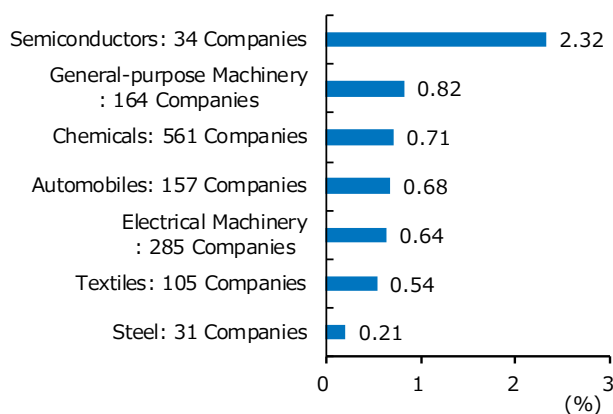
<Government Subsidies for Chinese Listed Companies>



Sources: Prepared by JRI based on financial data from each company and Wind

Note: As of 2023, there were 5,346 listed companies.

<Ratio of Government Subsidies to Net Sales in Major Industries (2015-23) >



Sources: Prepared by JRI based on financial data from each company and Wind

SOEs received 63.5% of total government subsidies for all listed companies in 2015, this figure had fallen to 45.1% by 2023.

This drop can be attributed to the central government and local governments moving to deal with the problem of excessive debt. In the steel industry, the central government has led efforts to reduce overcapacity and debt, and restricted annual crude steel production and production capacity expansion to promote decarbonization. Additionally, local governments, faced with their own deteriorating finances, have been forced to cut subsidies aimed at covering losses by SOEs in recent years. With real-estate prices continuing to fall and home sales sluggish, income from the transfer of land use rights, which used to make up 30% of local government revenue, has declined by 40% from 8.4 trillion yuan in 2020 to 4.9 trillion yuan in 2024.

■ The effectiveness of government subsidies is questionable

Taking China's semiconductor industry as an example, an examination of the factors behind the growth of the sector and the companies that operate in it reveals that while market expansion has undoubtedly been a major driver, it is unclear how big a role government investment funds and government subsidies have played.

The net sales of the 34 listed semiconductor companies increased 3.9-fold from 52.2 billion yuan in 2015 to 205.9 billion yuan in 2023, mainly due to the expansion of the market. During this period, China's semiconductor market saw huge growth, driven by advancements in PC and smartphone functionality as well as the proliferation of cloud services and artificial intelligence (AI). According to World Semiconductor Trade Statistics (WSTS), the size of China's semiconductor market increased 2.0-fold in RMB terms, from \$98.6 billion (614 billion yuan) in 2015 to \$180.3 billion (1,211.8 billion yuan) in 2022.

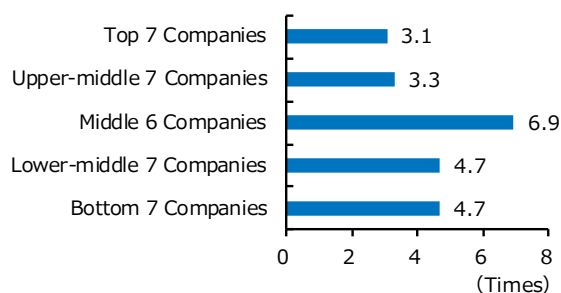
While some view government investment funds and subsidies as having been a major factor in the growth of China's semiconductor industry, others have argued that the sizes of the government investment funds and their effect on corporate growth have been overestimated. Tomoo Marukawa, a professor at the University of Tokyo, argues in his book *China's Industrial Policy: The Search for Leadership* that the actual capital held and the investments made by the China Integrated Circuit Industry Investment Fund and the investment funds of local governments are much lower than initially targeted. The reason he gives is that the government has found it more difficult than anticipated to select excellent companies that can be expected to deliver investment returns. Furthermore, a study analyzing microdata conducted by Kobe University professor Kai Kajitani and two others found that while equity investment in companies by government investment funds has a significant effect on the firms' fixed assets and personnel headcounts, its impact on their net sales, labor productivity, R&D, and debt-to-equity ratios is insignificant.

In addition, an examination of the financial data of the listed semiconductor companies indicates that those lavished with government subsidies actually tend to grow at a slightly slower pace than others. Specifically, when the 34 listed semiconductor firms are divided into five groups according to their ranking in terms of the ratio of government subsidies to net sales, the firms in the top group saw their sales increase 3.1 times on average from 2015 to 2023, while the figures for the upper-middle group, middle group, low-middle group, and bottom group were 3.3 times, 6.9 times, 4.7 times, and 4.7 times, respectively. So, there does not appear to be a direct link between the amount of government subsidies a company receives and its business performance.

Government subsidies have undeniably increased the number of companies newly entering specific sectors, and given a lift to provincial areas by, for example, leading to the establishment of new local industries. However, as mentioned above, with public finances being squeezed more than ever before, more effective and efficient ways of providing support may be required to produce growth companies going forward.

(Shinichi Seki)

<Increases in Net Sales of Groups of Semiconductor Companies (2015-23) >



Sources: Prepared by JRI based on financial data from 34 companies and Wind

Note: The companies were divided into five groups according to their ranking in terms of the ratio of government subsidies to net sales.

Topics *India at risk of being indirectly impacted by Trump tariffs*

The negative impact on the Indian economy of the ramifications for trade caused by the Trump administration's tariffs looks likely to be limited overall. However, given the growing uncertainty about the future, attention needs to be paid to the way financial market disruptions could increase downward pressure on domestic demand.

■ Damage from the impact of tariffs on exports could be limited

The Trump administration in the U.S. views its trade deficit with India as a problem, and is calling for an expansion in U.S. exports to India and for India to reduce its tariffs on American goods. At a meeting between U.S. and Indian leaders on February 13, the two countries agreed to start talks aimed at concluding a trade agreement to correct their trade imbalance by the end of the year. But there remains a great deal of uncertainty surrounding U.S. tariff policy. Among the tariff policies introduced by the Trump administration so far, two have significant implications for India:

The first is higher duties on specific products such as steel, aluminum, automobiles, semiconductors, and pharmaceuticals. The tariff hikes on steel and aluminum have already been implemented, but India's exports of these products to the U.S. are small. Those on pharmaceuticals and semiconductors are still under consideration, but as these are India's top exports to the U.S., there is a growing sense of alarm about higher duties being imposed on them.

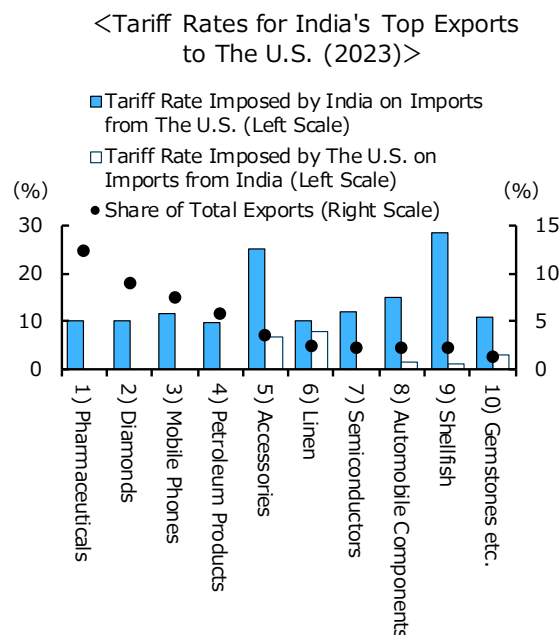
The second is "reciprocal tariffs." The U.S. has announced the introduction of "reciprocal tariffs", i.e. subjecting trading partners to the same tariff rates that they apply to imports from the U.S. India charges a trade-weighted average tariff of 12.1% on American goods, which is much higher than the 2.4% trade-weighted average tariff charged by the U.S. on imports from India. So, it is possible that the introduction of reciprocal tariffs will see higher duties across the board on Indian exports to the U.S.

While the Trump tariffs will hit India's exporting industries, the impact on the broader economy is expected to be limited overall. There are three reasons for this.

The first is that structurally, India's economy is driven by domestic demand, and its degree of dependence on exports is low. In FY2023, exports represented 21.8% of India's GDP, significantly lower than the ASEAN5 average of 48.0%. Assuming the U.S. imposes a 25% tariff on imports from India of the five aforementioned products and a 12.1% reciprocal tariff on other items, it is estimated that India's exports to the U.S. would fall by about \$10 billion, but this would only depress India's real GDP by about 0.3 percentage points.

The second mitigating factor is that India has shown a conciliatory attitude towards the U.S. To avert a sharp increase in tariffs, the Indian government has already embarked on efforts to improve the trade imbalance; its FY2025 budget, announced in February, included tariff reductions on imports of motorcycles and bourbon. According to media reports, it is also considering reducing duties on automobile imports, after President Trump criticized India's high tariffs on cars in his address to Congress in March. In addition, at the aforementioned summit in February, India agreed to increase purchases of energy and defense equipment from the U.S. While there is no denying the possibility that the U.S. will impose reciprocal tariffs on India, India's cooperative stance is expected to avert a significant increase in duties.

The third reason is that the Trump administration is focused on the IT business. If the U.S. IT sector



Sources: Prepared by JRI based on data from the U.S. Department of Commerce and WITS
 Note: Tariff rates are simple averages for each product category. Based on 4-digit HS codes.

thrives, exports from India to the U.S. in the areas of IT and Business Process Outsourcing (BPO) will increase, which can be expected to boost the economy. Indian IT companies have taken advantage of the H-1B visa, a temporary visa allowing professionals to work in the U.S., to send numerous IT engineers there, and developed their IT/BPO businesses in ways that span the two countries. After Mr. Trump's re-election, there were concerns that requirements for H-1B visa issuance would be tightened. But recently, there seems to be less risk of that happening. Elon Musk, now a close adviser to the president, has insisted that H-1B visas are essential to maintaining the competitiveness of U.S. technology companies. The Trump Administration is therefore actually more likely to pursue deregulation to energize the IT business. President Trump has already rescinded the executive order on AI safety issued by his predecessor, Joe Biden, and has also announced the withdrawal of the U.S. from the international digital taxation framework. This emphasis on IT is expected to be maintained going forward, and should help India expand its IT/BPO exports. This would offset any decline in goods exports due to tariffs.

■ Caution required concerning financial market turbulence

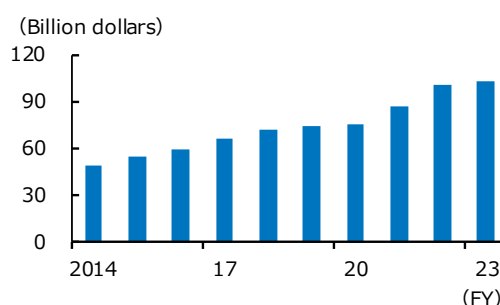
While the trade impact of Trump tariffs on the Indian economy is likely to be limited, the risk of financial market disruption and a downturn in the Indian economy warrants attention. Already, against the backdrop of the uncertainty surrounding the Trump Administration's tariffs, capital outflows from the Indian stock market are accelerating, with the benchmark Sensex index falling to a low of about 11% off the peak registered in September 2024. In addition, the view that the duties will cause U.S. inflation to spike is becoming increasingly widespread. U.S. interest rates have risen, adding fuel to the depreciation of the rupee. As a result of intermittent rupee-buying and dollar-selling interventions by the Reserve Bank of India (the country's central bank), India's foreign exchange reserves, excluding gold, have declined by about \$74 billion from their peak at the end of September 2024. This drop is more than India's average monthly imports. Given that room for additional dollar-selling is limited, if the rupee depreciates further in the future, the Reserve Bank of India will be forced to raise interest rates to defend the currency. This is likely to depress domestic demand.

<Main Products Subject to Indian Tariff Reductions>

Product Subject to Reduction		Tariff Rate (Before)	Tariff Rate (After)
Implemented	Motorcycles (Small)	50%	40%
	Motorcycles (Large)	50%	30%
	Rocket/Satellite Components	5%	0%
	Bourbon	100%	50%
Under Consideration	Automobiles	125%	-
	Chemicals	12%	-
	Pharmaceuticals	10%	-
	Agricultural Products	37%	-

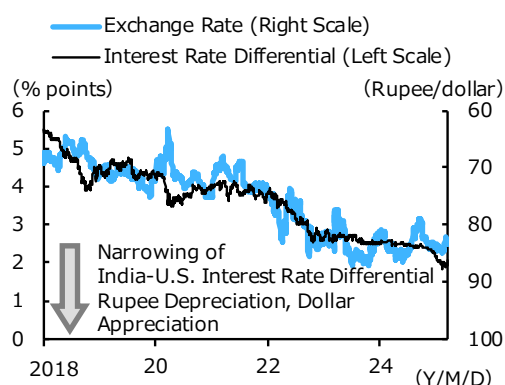
Sources: Prepared by JRI based on information from the Indian Ministry of Finance, WITS, and various media reports
Note: Tariff rates are those applied to imports from countries with

<India's IT/BPO Exports to The U.S.>



Source: Prepared by JRI based on data from the Reserve Bank of India
Note: Figures until FY2021 include Canada.

<Interest Rate Differential between Indian and U.S. Two-year Government Bonds and Rupee/dollar Exchange Rate>



Source: Prepared by JRI based on data from Bloomberg L.P.

India also has financial vulnerabilities, as it runs a current account deficit and is a debtor nation. If rupee depreciation widens the current account deficit, it could lead to a vicious cycle of continued currency decline. The outcome could be financial instability as a result of factors such as a heavier external debt repayment burden.

(Tomohiro Hosoi)