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<i>Topics</i>	<i>Can China eliminate its overcapacity?</i>	<i>1</i>
<i>Topics</i>	<i>Southeast Asia's accelerating population aging and birthrate decline</i>	<i>3</i>



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Topics *Can China eliminate its overcapacity?*

In China, ex-factory prices (the prices of goods at the point of shipment from manufacturers) have been falling due to overproduction dragging down corporate earnings at a rate not seen in recent years. The Xi Jinping administration has set out a policy of overhauling the relationship between companies and local governments to resolve this problem.

■ Price war strain

At the "Summer Davos" conference in Tianjin in June 2025, Chinese Premier Li Qiang said that China's economy was recovering despite rising uncertainty provoked by protectionist policies and expressed optimism about the economic outlook for 2025 and beyond. The start of tariff negotiations with the Trump administration helped alleviate anxiety about the future of the Chinese economy, albeit temporarily.

During bilateral talks in Geneva in May 2025, the Chinese government's threat to impose curbs on rare earth exports allowed it to win concessions from the Trump administration. More specifically, the U.S.'s reciprocal tariff on imports from China, which had risen to 125%, was reduced to the original 34%. The implementation of 24% of that was also paused for 90 days.

But what level will the Trump administration's China tariffs eventually settle at? Whatever happens, the Chinese economy will be significantly impacted. Yet this is not the only problem. Within China, ex-factory prices have been falling due to overproduction, causing corporate earnings in the mining and industrial sector to deteriorate at a pace unseen in recent years. This is an economic problem on par with the Trump tariffs.

The issue has also started to be hotly debated inside China since EV giant BYD cut prices by as much as 34% at the end of May 2025. Repeated price reductions have long been a fixture in China's EV sector, so the cuts were not exactly unusual. Nonetheless, they attracted a lot of attention as they were considered likely to seriously damage not only BYD, which initiated the price war, but also the entire EV industry.

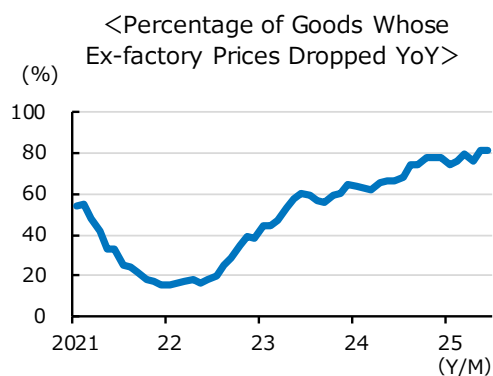
BYD's share price plummeted 20% within just a week of the price cuts being announced. Instead of viewing the price war as a market-driven process of "survival of the fittest", leaving only highly competitive companies in business, the market saw it as a "race to the bottom"; a futile competition with no winners. The Xi Jinping administration has described this type of competition as "involutionary" (i.e. self-defeating and excessive). It sees it as a problem that could lead to an increase in unemployment, a rise in non-performing loans at banks, and the curtailment of R&D investment, which would reduce competitiveness.

■ More companies are operating at a loss

So why is the current price war considered a race to the bottom? The answer lies in the fact that there is no clear end in sight given local governments, wary of unemployment rising if companies collapse, continue to support local firms financially. This phenomenon is thought to be occurring in a wide range of sectors, not just the EV sector. The National Bureau of Statistics of China, which publishes the ex-factory prices of 174 products in the mining and industrial sectors every month, found in June 2025 that the prices of 81.0% of products were lower than a year earlier. This share was the highest since the data started being collected in 2014.

The price war is weighing on corporate earnings. According to China's National Bureau of Statistics, 158,111 firms, or 30.4% of the 519,513 companies above a certain size in the mining and industrial sectors, were operating at a loss in May 2025. Following on from 2024, this is the second time that the percentage of companies operating in the red in the five months from January to May exceeded 30%. This situation without recent precedent is a first since the end of the 1990s, when exports declined due to the impact of the Asian currency crisis and unemployment increased due to the restructuring of state-owned enterprises.

The recent price cutting has clearly reached its limit given has hurt not only BYD, but also the EV



Source: JRI based on data from CEIC

Note: Shows the percentage of goods for which prices in the month concerned were lower than a year earlier. The number of goods for which data is gathered varies for each month, but is around 170.

industry as a whole – including component manufacturers. It has become evident that many EV-makers are covering their price cuts by delaying payments to the suppliers who provide them with parts. The current liabilities, i.e., accounts payable and notes payable, of China's leading listed automobile manufacturers reached a record high of 960.9 billion yuan at the end of March 2025, up 15.1% year over year. Meanwhile, the accounts payable turnover period averaged 182 days, far higher than the average of 47 days in Japan's manufacturing sector. The rising number of companies operating in the red in the mining and industrial sectors suggests that the problem is not limited to the EV sector but extends across a wide range of industries.

■ Overhauling the relationships between local government and companies

To remedy the problem of major automakers using their dominant positions to delay paying their suppliers, the Chinese government has set a payment deadline of 60 days, starting in June 2025. One after another, automakers announced that they would abide by the rule, but it is uncertain whether this will bring an end to the price war and improve corporate earnings.

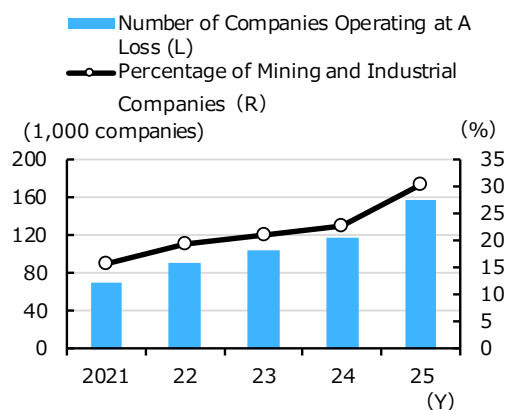
The underlying cause of the price war is overproduction, which has resulted in supply greatly exceeding demand. This problem is particularly prominent in three industries: EVs, automotive lithium-ion batteries, and solar power generation. Behind the phenomenon lies a distinctive Chinese approach to fostering emerging industries. This involves the central government designating certain sectors as emerging industries to prioritize and rapidly expanding the markets for their products by lavishing them with subsidies and other forms of support. Meanwhile, local governments keen to revitalize regional economies take stakes in startups and provide them with tax breaks, attracting massive amounts of additional investment from other investors.

With rates of return from real-estate and infrastructure investment declining, emerging industries that the central government has stated it is prioritizing make suitable investment targets for local governments. These industries are therefore perceived as triggers for local economic revitalization. Indeed, the city of Hefei, the capital of Anhui Province, has successfully attracted factories from domestic and foreign EV manufacturers and emerged as a hub for the EV industry as a result. It has now become a "trillion-yuan city," i.e., a city with a GDP of over one trillion yuan. Dubbed the "Hefei model," this has encouraged many local governments to join in the competition to attract EV manufacturers.

The growing number of companies in the mining and industrial sectors operating in the red indicates a growing need to overhaul the relationship between local government and companies. At the Central Financial Work Conference in July, General Secretary Xi Jinping made two key points. First, investment promotion measures would be standardized, making local governments no longer able to offer bespoke preferential treatment to companies. Second, the degree of contribution to "high-quality development," meaning high-quality economic development, would be added to the factors taken into account when evaluating local government officials. This can be seen as progress in advancing existing policies requiring both local governments and companies to exercise self-restraint. Still, it needs to be borne in mind that success could be elusive, as the former is expected to invite resistance from local governments while the latter is something that has already been talked about for years.

(Yuji Miura)

<Number and Percentage of Companies in The Mining and Industrial Sectors Operating at A Loss>



Source: JRI based on data from CEIC

Note: Figures for 2025 are for May.

Topics Southeast Asia's accelerating population aging and birthrate decline

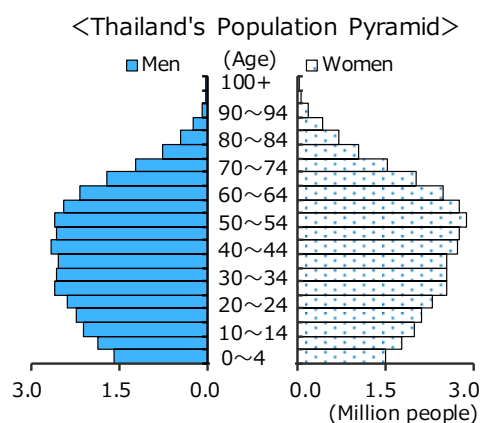
A rapid shift to population aging and low birthrates is currently underway in Southeast Asian countries. With preparations for aging populations inadequate, concern is mounting that economic growth momentum will weaken and fiscal burdens will increase going forward.

■ Falling birthrates and aging populations in Southeast Asia

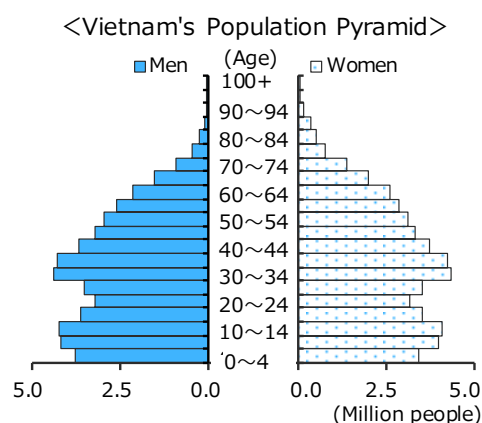
Southeast Asian countries are becoming increasingly important as production bases as manufacturers seek to take advantage of their abundant and inexpensive labor. Notably, supply chain restructuring amid protracted U.S.-China confrontation has been raising the profiles of countries like Vietnam and Thailand as targets for direct investment by global companies.

However, a look at recent demographic trends reveals that the problem of declining birthrates and aging populations is gradually reaching these nations as well. Thailand's population pyramid for 2023 was close to the "vase shape," symbolic of a shrinking pool of young people, with the lower part of the pyramid indented. Even in Vietnam, elderly people over 65 years old already account for 8.6% of the total population, meaning that the country has become an "aging society."

According to median estimates from the United Nations, the amount of time it will take for the proportion of the population over 65 years of age to double from 7% to 14% is estimated to be 18 years in Thailand and 17 years in Vietnam. Thus, birthrates are falling and populations aging even faster than in China and Japan.



Source: JRI based on data from CEIC



Source: JRI based on data from CEIC

<Old-age Dependency Ratios in the ASEAN5>

	Old-age Dependency Ratio (2023, %)	Year in Which The Old-age Dependency Ratio Surpassed 7% (a)	Year in Which The Old-age Dependency Ratio Surpassed 14% (b)	Doubling Period (b-a)
ASEAN5	7.9	2020	2042	22
Thailand	14.7	2004	2022	18
Vietnam	8.6	2019	2036	17
Indonesia	7.0	2023	2047	24
Philippines	5.3	2031	2059	28
Malaysia	7.5	2022	2045	23
Japan	29.6	1970	1994	24
China	14.3	2000	2023	23

Source: JRI based on data from the United Nations

■ The merits and demerits of population control measures

The factors underlying the trends include longer average lifespans because of advances in medicine and the long-term impact of past population control policies.

Both Thailand and Vietnam have a history of aggressive population control measures, as their leaders were concerned about food shortages and poverty arising from population growth. Starting in the early 1970s, Thailand encouraged the use of contraception and tried to curb its birthrate through a "family planning program." Similarly, Vietnam introduced a "two-child policy" at the end of the 1980s, limiting the number of children per household to a maximum of two and regulating childbearing age and the spacing of births. The rules were applied particularly stringently to Communist Party members and civil servants; in some cases, violators were subject to administrative sanctions such as fines, demotions, and dismissals. As a result, the birthrate fell before the population had started aging. This increased the number of working age people as a proportion of the total population, giving the country a "population dividend" period that supported economic growth as it was developing.

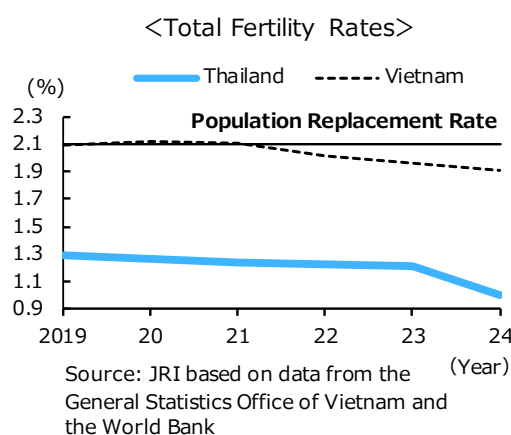
In recent years, the effects of rapid economic growth and urbanization have been compounded by factors including rising education costs, later marriage, and the diversification of lifestyles. This has caused falling birthrates to become even more pronounced. A decrease in the total fertility rate (TFR) in Thailand has been widely acknowledged for some time, but the same thing is now also happening in Vietnam. In 2024, the country's TFR hit a record low of 1.91, remaining below the population replacement level (2.1) for the third consecutive year. Birthrate decline is particularly pronounced in urban areas – in Ho Chi Minh City it has dropped to around 1.4, a level classed as an "ultra-low fertility rate" (less than 1.5). Against this backdrop, the Vietnamese government effectively abolished its long-standing two-child policy in June this year.

With a declining birthrate and an aging population, labor costs will inevitably rise in the future as the working-age population shrinks. There is mounting concern about profits being put under pressure in labor-intensive industries where low costs have long served as a competitive weapon. To cope with such structural changes, Southeast Asian countries are working to make their industries more advanced and high value added, but they are facing challenges such as lack of investment in R&D, shortages of highly skilled human resources, and lagging infrastructure development. They should urgently create systems and environments that help maintain and improve their international competitiveness.

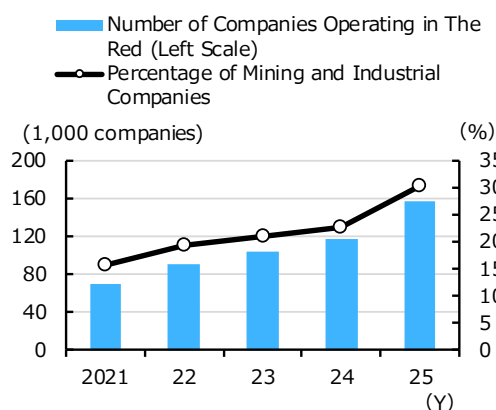
■ Significant challenges given limited capacity to respond to population aging

Given these circumstances, it is also concerning that Southeast Asian countries are still in the process of economic development and their social security systems remain inadequate. In 2024, the gross national income (GNI) per capita was only about \$8,000 in Thailand and around \$4,700 in Vietnam. Yet when the old-age dependency ratio in Japan and the U.S. reached 14%, their per-capita GNI was over \$30,000, so there is still a massive gap. The structural problem of "getting old before getting rich" further complicates social and economic responses in Southeast Asian countries.

There is also the problem of elderly people not having sufficient incomes due to relatively low mandatory retirement ages in Southeast Asian countries and less than half of working populations being covered by public pensions. There are also shortages of nursing care personnel and hospital beds per 1,000 people,



<Number and Percentage of Companies in The Mining and Industrial Sectors Operating at A Loss>



meaning higher social security spending in areas such as medical care and nursing care looks unavoidable as these countries age. This will mean higher taxes and social insurance premiums, which will increase the financial burden on households and pose a risk to future economic growth. With some countries in the region already seeing fiscal deficits widen, concern over fiscal sustainability is likely to further intensify if debt expands amid population aging and tax revenue falls due to slowing growth. The situation needs to be monitored closely.

(Wu Zijing)