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Topics *The "China Shock 2.0" and the need for a strategic response*

The strength of China's manufacturing industry has now entered a new stage of "competitiveness through advanced technology" rather than "low-cost manufacturing." Given economic and security risks, countries need to respond strategically with industrial policies and other measures.

■ What is the "China Shock 2.0"?

On July 14, 2025, The New York Times published an article entitled "We Warned About the First China Shock - The Next One Will Be Worse," by professors David Autor and Gordon Hanson, in which they employ the term the "China Shock 2.0." First, they discuss the "China Shock 1.0," a term they coined in 2016, describing it as the period from the 1990s to the 2000s when cheap Chinese products flooded the U.S. market, causing a decline in U.S. manufacturing and a significant drop in employment. President Trump's "MAGA" (Make America Great Again) movement has taken issue with the emaciation of manufacturing in the so-called "Rust Belt" (an ailing industrial zone stretching from the East to the Midwest) due to international trade – the idea of the China Shock 1.0 supports this view.

Still, U.S. manufacturing decline should have stopped being a major problem for U.S.-China relations once China's supply of low-wage labor reached its limit. Indeed, labor-intensive industries are already shifting to other emerging countries, such as Vietnam. However, China has in recent years begun to take the lead in aviation, AI, telecommunications, microprocessors, robotics, nuclear power and fusion, quantum computing, biotech and pharma, solar power, batteries, and other fields in which the U.S. had led for many years. According to a survey by the Australian Strategic Policy Institute (ASPI) ("ASPI's two-decade Critical Technology Tracker: The rewards of long-term research investment", August 28, 2024), the U.S. was the top-ranked country for research in seven of 64 advanced technology fields in 2019-23 (2003-07: 60 fields), while China was number one in 57 fields (2003-07: 3 fields). China is enjoying rapid growth not only in industries affecting the economic sphere, i.e. ones providing high-value-added products and high-wage employment, but also industries affecting the geopolitical and military spheres. In other words, the impact on the U.S. of Chinese economic expansion has shifted from the China Shock 1.0, a decline in manufacturing due to cheap imports and an accompanying drop in employment, to the China Shock 2.0, which poses security and geopolitical risks alongside having economic ramifications.

■ Four proposals

China's manufacturing industry grew with the help of multinational companies in the 1990s and 2000s, but China's new growth model is now characterized by the government leading industrial investment and creating its own ecosystems to support innovation. Autor and Hanson, like many economists before them, had a negative view of industrial policy based on government intervention. However, they now say that they "no longer think that," and that China should be countered with China-style industrial policy. Under the Trump administration, the U.S. has been actively raising tariffs to protect industry, but the authors argue that this alone cannot make the U.S. an attractive place for manufacturing, particularly in advanced technological fields. As an alternative, they propose the following four measures.

The first is stronger external cooperation. This has two facets. One is that the U.S. should cooperate with partners such as the EU and Japan that face similar problems. Rather than impose tariffs, it should conclude trade agreements with them. The other is that the U.S. should actively attract investment by Chinese companies. Enticing competitive rivals will invite criticism, but the authors emphasize that excluding all of them would reduce the competitiveness of domestic industries. Except in areas that would pose national security problems, they contend that it is necessary to accept Chinese companies and then try to catch up with them technologically.

The second is more active state-led investment. The government should take risks and invest, particularly in key technologies, to encourage the creation of new industries in the same way that China has done. One example they cite is "Operation Warp Speed," which saw the U.S.

government aggressively pursue vaccine development during the COVID-19 pandemic. They also advocate the establishment of independent strategic investment institutions – like the Federal Reserve, but for innovation rather than interest rates.

The third is emphasis on policy continuity. The Trump administration has drastically altered the multilateral cooperation and environment-focused policies of the Biden administration. The authors argue that U.S. failure to implement key policies consistently is a problem, and efforts should be made to ensure long-term investment in semiconductors and rare earths is not hindered.

Finally, the fourth is preventing the impact of job losses from spreading. Non-China factors, such as the proliferation of AI, will always pose the risk of changes in industrial structure and accompanying changes in the labor market. Loss of employment leads not only to economic but also political turmoil, so the authors stress the importance of developing a safety net for the labor market. They also recommend government-led efforts to foster new industries as a way to contribute to this.

■ The U.S. IRA sets a precedent for strategic response

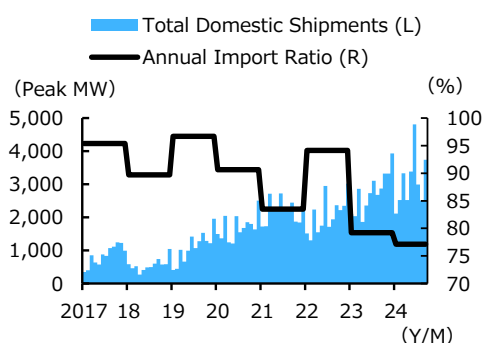
In the U.S., some policies in line with the above proposals had already been implemented. The Inflation Reduction Act (IRA), which took effect in August 2022 under the Biden administration, represented a strategic policy of strongly promoting domestic production, centered on environmental-related manufactured goods, under the leadership of the government. Solar modules are a prime example of successful expansion of domestic production with IRA support. Since 2023, shipments have increased significantly, while the proportion imported has declined. Many of the companies that contributed to this success were solar panel manufacturers that received investment from Chinese companies. So, as Autor and Hanson point out, it is worth noting that policy goals have been achieved by also accepting investment from Chinese companies that are ahead of the U.S. technologically. The IRA can be credited with contributing to the expansion of domestic manufacturing because it implemented Autor and

<Four Policy Proposals for the U.S. in Response to the China Shock 2.0 >

(1) Strengthening International Coordination
• The United States, the EU, Japan and other countries should share their concerns over trade with China and pursue cooperation through free trade agreements and multilateral frameworks. • Actively attracting Chinese investment, including the establishment of production facilities in the U.S., can contribute to enhancing domestic industrial competitiveness.
(2) Expanding State-Led Investment by “China Style”
• The government should select strategically vital sectors—such as drones, advanced semiconductors, nuclear fusion, quantum technology, and biotechnology—and make large-scale, state- • The U.S. government should manage public venture funds to support emerging industries.
(3) Ensuring Policy Continuity and Long-Term Investment
• The U.S. must choose battles it can win (e.g., semiconductors) and those it cannot afford to lose (e.g., rare earths), and sustain long-term investments in these sectors.
(4) Preventing the Social Impact of Job Losses

Source: JRI based on David Autor and Gordon Hanson, “We Warned About the First China Shock. The Next One Will Be Worse,” New York Times (July 14, 2025)

<US Solar Modules Shipments>



Source: JRI based on EIA

Note: Data has only been published up to September 2024 (the import ratio for 2024 is the average from January to September).

Hanson's first and second proposals. However, as is well known, the third proposal has basically been rejected by the Trump administration. This is expected to greatly undermine the impact of the IRA going forward.

In Japan too, there has been state-led investment, mainly in semiconductors, as well as moves toward multilateral cooperation in areas such as critical minerals, so there has been progress in making a strategic response like that proposed by Autor and Hanson. However, to ensure that long-term policy support measures in areas such as semiconductors are not affected by changes in the administration and policy shifts, it will also be necessary to advance legislation for ensuring policy continuity. It is also vital to establish a receptive environment that encourages efforts to attract investment from Chinese companies while appropriately managing national security risks.

(Minoru Nogimori)

Topics Structural changes in the Indian smartphone market

For a long time, the expansion of India's smartphone market was driven by growing domestic shipments, but in recent years, higher handset selling prices and increasing export volume have been the main factors behind market expansion.

Domestic shipments have remained flat since the start of the 2020s

India is becoming a greater presence in the global smartphone market in terms of both production and sales, but two structural changes have occurred in the 2020s.

The first is a change in the driving forces behind the expansion of the domestic market. In the 2010s, smartphone sales soared against the backdrop of 1) people replacing their feature phones (commonly known as flip phones) with smartphones, 2) the proliferation of cheap smartphones made in China, and 3) the expansion of the middle class. These events led to market growth; domestic smartphone shipments increased from about six million units in 2010 to about 150 million units at the end of the 2010s.

However, shipments stopped rising in the 2020s. One reason for this was the economy deteriorating significantly for a short period in the early 2020s due to the COVID-19 pandemic. Another was that smartphones had already become widespread.

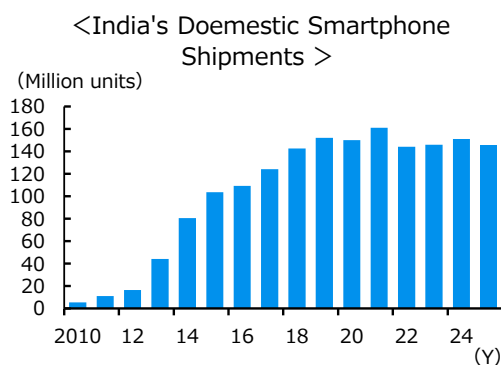
The percentage of Indian households owning smartphones has now reached about 90% in urban areas and 80% in rural areas. At first glance, there seems to be limited room for any further increase in the penetration rate. But in reality, many households own a single smartphone shared by the whole family, and rates of individual ownership remain low. In rural areas, the rate of individual mobile phone ownership, including feature phones, is about 60%. Considering that India's population is increasing by more than 10 million people every year and more than 50 million conventional phones are still shipped every year, there still seems to be significant room for an increase in the number of smartphones sold.

Nevertheless, growth in domestic shipments is sluggish. This is because per-handset selling prices have risen rapidly due to soaring raw material prices and improved device performance. The average selling price of smartphones, which had been around \$150 in the late 2010s, had reached the \$270 level as of 2025. This is a key reason for the market's continued expansion despite sluggish sales.

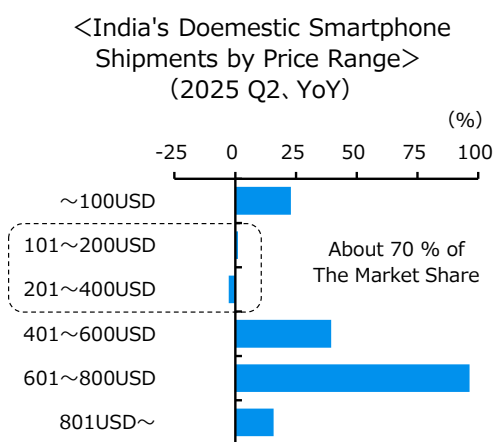
In addition, while shipments of handsets with a selling price of \$101 to \$400, which account for about 70% of the domestic market, have been slowing, shipments of 5G (fifth-generation mobile communication system)-enabled devices with a selling price of \$401 to \$800 have increased sharply. One reason for the rising average selling prices appears to be the middle class upgrading to more advanced models, amid rising wages and financial assets.

In contrast, people in the low-income population, whose incomes and assets are limited, may prefer cheap feature phones over smartphones, and could be prioritizing purchasing home appliances, such as air conditioners, refrigerators, and washing machines, which have lower household ownership rates than mobile phones.

As solid economic growth continues across the macro spectrum, trends in the domestic smartphone market differ greatly depending on income level, which suggests that income and asset disparities are widening.



Sources: JRI based on various media reports
Note: The original data is from IDC. The 2025 value is the midpoint of IDC's forecast range.



Source: JRI based on IDC

■ Increased dependence on external demand

The second change is growing reliance on external demand. Until recently, most of the smartphones produced in India were sold on the domestic market, but in the 2020s, exports, mainly to Western countries, began to surge. A background factor was the Indian government launching a volley of subsidy policies with an eye to developing the country's manufacturing industry. This included the PLI (Production Linked Incentive) scheme, which provides subsidies to companies based on how much they increase sales compared to a base year, as well as subsidies targeting the electronics sector.

Amid intensifying U.S.-China tensions, major companies engaged in the contract manufacturing of smartphones that have high market shares in developed countries, such as Apple's iPhone series and Samsung's Galaxy series, took advantage of the PLI scheme to rapidly expand production in India. As a result, exports as a share of total sales (the sum of domestic smartphone sales and exports) increased from about 10% in 2020 to just under 40% in 2024. Since the inauguration of the second Trump administration, moves to shift the production of smartphones destined for the U.S. from China to India have been accelerating. Exports as a share of total sales may reach around 50% in 2025.

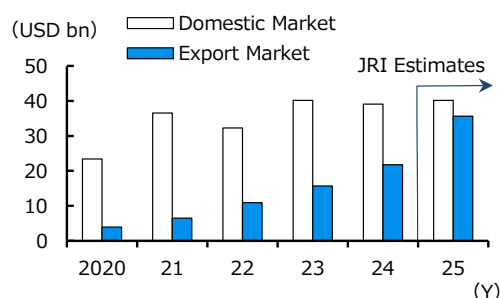
The outlook for India's smartphone exports will largely depend on how the U.S., the largest export destination, revises its trade policies for each country and territory. At present, smartphones are not subject to U.S. reciprocal tariffs, but President Trump has hinted that they may be covered by a new sectoral tariff regime based on investigations related to national security, and a drop in exports to the U.S. is inevitable if high tariff rates are applied to smartphones.

Given these circumstances, to mitigate the risk of export decline due to U.S. policy changes, India is expected to focus on expanding exports of high-end smartphones for the Japanese, EU, and U.K. markets, as well as feature phones and cheap smartphones for the African market. It will also aim to increase the value-added ratio (the share of the selling price added as value in India) by attracting investment in the semiconductor and battery industries.

Further smartphone export growth will have positive effects on the Indian economy such as improving exchange rate and price stability by narrowing the trade deficit. But at the same time, it is necessary to recognize that the Indian economy, particularly its electronics industry, may become more susceptible to the impact of global economic fluctuations than before.

(Shotaro Kumagai)

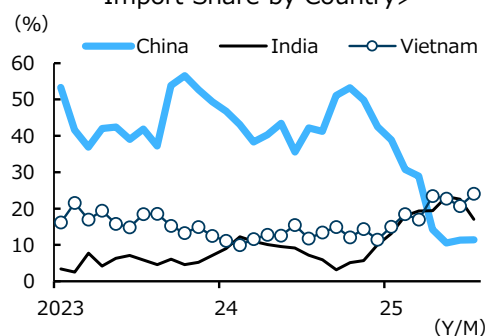
<India's Smartphone Market Size>



Sources: JRI based on IDC, United Nations, Ministry of Commerce and Industry

Note: The domestic market is calculated by multiplying domestic shipment volume by average sales price. The domestic market for 2025 is based on IDC's annual shipment volume forecast (median) and the average sales price for the April-June 2025 period, while the export market is calculated based on exports from January-July 2025 compared to the previous year and actual figures for 2024. Exports are for items included in HS8517 (including feature phones, etc.).

<U.S.'s Mobile Phone (HS 8517) Import Share by Country>



Source: JRI based on United Nations