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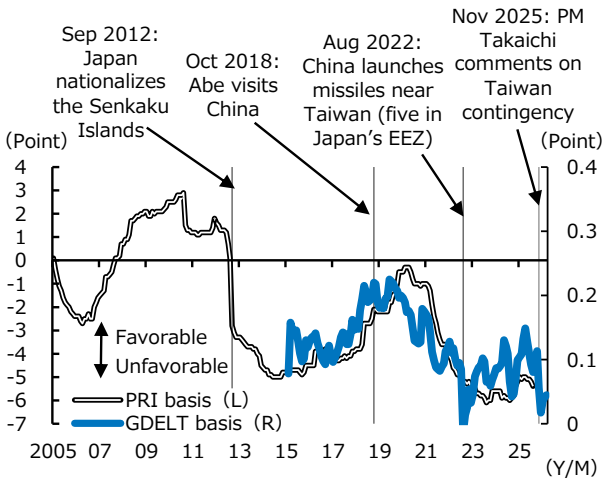
Topics *Japan-China political relations and implications for supply chain*

With the relationship between Japan and China worsening, this report examines the extent of deterioration and its economic impact. Despite concerns about effects on manufacturing supply chains, an immediate, severe impact is unlikely, and in the short term, measures such as building up inventory would be an effective response for Japan.

■ Tracking Japan-China relations through data

Media reports on the deterioration in Japan-China relations are increasing. The Chinese government's objection to remarks made by Prime Minister Takaichi in November 2025 regarding a potential Taiwan contingency has received particular attention, but it is difficult to gauge the true severity of the situation, e.g., the degree of deterioration, from media coverage alone. To gain a more objective picture, I will examine indicators that quantify prominent international news stories and events to visualize the state of Japan-China relations.

<Japan-China Political Relations Index>

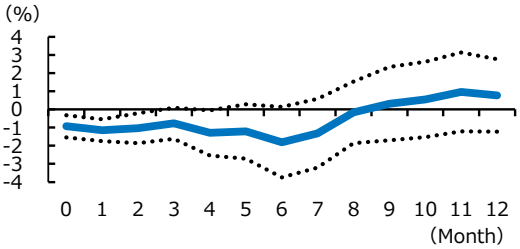


Source: JRI based on Tsinghua University, The GDELT Project, and Ferrara and Saadaoui [2025]. "Measuring Geoeconomics," Revue d'économie financiere

Several indicators exist for tracking improvement or deterioration in relations between countries, but for the purpose of monitoring Japan-China relations specifically, the Political Relationship Index (PRI) produced by the Institute of International Relations at Tsinghua University is considered the most useful. It is a monthly indicator constructed from the classification of positive and negative diplomatic events reported in the People's Daily, the Chinese Ministry of Foreign Affairs website, and other official sources. Looking at the Japan-China relationship, a gradual deterioration can be seen through August 2025, the most recent data point available.

Complementing this indicator, the GDELT (Global Database of Events, Language and Tone), which is published on a daily basis, albeit for a shorter timeframe, is also useful for assessing recent developments. Like the PRI, it is compiled based on a large volume of media information, and combining the two enhances analytical accuracy. China's level of vigilance toward Japan, as gleaned from the GDELT (the data in the figure has been converted into an index reflecting event categories and their intensity), indicates deterioration, and the PRI suggests that the relations are at quite a poor level by the standards of the past 20 years. Over the past five years, however, the relationship has hardly changed. There has been fluctuation, but with no clear directional trend, so the situation is different from the sharp deterioration triggered by the Senkaku Islands dispute in 2012.

<Impact of a 1-point Deterioration in Japan-China PRI on Industrial Production>



Source: JRI based on various statistics
Note: This estimates a resposse of Japan's Industrial Production Index (log-level) to shock to Japan-China PRI, using Japan's Consumer Price Index (log-level) and the 10-year Japanese government bond yield as control variables with six-month lags. Dotted lines indicate the 90% confidence interval.

■ Historical patterns suggest that adverse effects will spread gradually

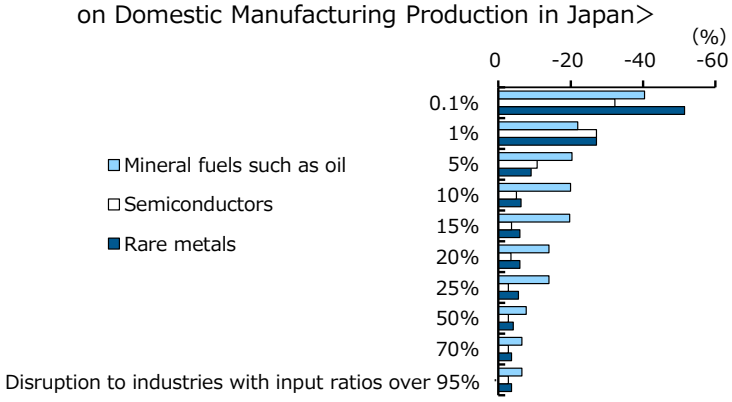
What kind of impact will this deterioration in relations have on the Japanese economy? At present, effects are already being felt in the service sector, due especially to a significant decline in the number of Chinese tourists visiting Japan, but no obvious negative impact on the manufacturing sector has been observed as yet. That said, manufacturing is viewed as heavily dependent on China, for procurement of components and materials, for

example, so concerns about the outlook are intensifying as the relationship worsens. Since November 2025, the PRI is likely to have declined by around one point, and estimates using the Local Projections, now widely used in causal inference analysis, indicate that a one-point deterioration in the PRI gradually weighs on the Industrial Production Index, starting immediately, with a downward effect of as much as −1.8% in the seventh month. This pattern suggests that even as Japan-China tensions rise, adverse effects on manufacturing activity do not appear instantaneously, but rather there is a gradual deterioration.

■ Rare metals account for a low share of inputs in most industries

Media reports have highlighted the Japanese manufacturing sector's heavy dependence on China for materials procurement, with the tightening of Chinese export controls on critical materials such as rare earths targeting Japan cited as a major concern. Indeed, if deteriorating relations were to result in a complete cutoff of supplies of rare metals, including rare earths, the consequences would probably be severe, with the aforementioned estimated impact of roughly −2% on production likely to be exceeded. The gap between this cutoff scenario and that estimate reflects the fact that a total disruption of supply (where virtually all companies would find their procurement of these goods cut to zero) has never occurred before. Unlike mineral resources such as oil and natural gas, the absolute quantities of rare earths and semiconductors used in any given manufactured product are not large. Looking at the most granular categories in input-output tables, rare metals (i.e., non-ferrous metals excluding copper, zinc, and aluminum) account for a low share of production input volume across most industries, suggesting that many sectors could maintain output levels through emergency measures such as drawing down inventories or securing circumventing/substitute procurement sources. Estimates indicate that if a rare metal supply cutoff only affected industries where the metals account for a large share of inputs, the impact would be limited. However, if it extended to sectors that use only small amounts, Japanese domestic manufacturing output could be dealt a devastating blow, with output falling by as much as 51%. A similar pattern is observed for semiconductors, which also differ in character from mineral fuels such as crude oil, relatively large volumes of which are required (though unlike rare metals, dependence on China for supplies of semiconductors or mineral fuels is not high).

<Impact of Disruption in the Supply of Key Resources on Domestic Manufacturing Production in Japan>



Source: JRI based on the Ministry of Internal Affairs and Communications "Input-Output Table (2020)"

■ Monitoring and preparing for ever-changing risks are key

Although Japan-China relations are deteriorating, the economic impact, particularly on manufacturing, remains limited at this point. In areas that are heavily dependent on China for supply, such as rare metals, including rare earths, the risk of supplies being cut off has come under the spotlight as the relations worsen. However, if supplies can be secured to a reasonable degree through inventory build-up as well as procurement of circumventing imports and substitute goods through multilateral cooperation, a dramatic adverse impact on overall production activity is probably avoidable. On the other hand, media coverage stressing the importance of reducing dependence on China through large-scale supply chain restructuring, such as the development of rare earth resources off the island of Minami-Torishima, has been prominent, but such development will obviously take a long time and so does not constitute a short-term solution. Large-scale restructuring should be pursued as a long-term strategy, with careful planning while assessing sustainability, including cost implications. Of course, the risk of further deterioration in Japan-China relations dealing a serious blow to Japan's economy cannot be ruled out. It will be important to closely monitor such ever-changing risks carefully using visualization indices or similar tools, and also for the government to exercise leadership in driving medium- to long-term supply chain restructuring as preparation for the possibility of risk materialization.

(Minoru Nogimori)

Topics *Upgrading of Asia's export structure has stalled*

In Asian countries other than China, export competitiveness in high-value-added intermediate goods is failing to increase. Since the relocation of intermediate goods production is expected to take considerable time, there is a risk of stagnation in industrial upgrading in Asian nations

■ The transfer of production from China to other Asian countries is centered on final goods

With U.S.-China animosity intensifying, production is being relocated away from China. Estimates indicate that from 2017, when Donald Trump began his first term as U.S. president, through 2025, the total value of production transferred from China to other countries/territories amounted to $209.3 billion (approximately 30 trillion yen). Around 70% of that amount went to other Asian economies (Taiwan, South Korea, India, and the ASEAN5), with Vietnam (33.0%), India (12.6%), and Thailand (8.9%) standing out as the leading destinations.

Since electronic devices accounted for 60% of the total amount transferred, Asian countries/territories can be viewed as having strengthened their export competitiveness in electronic devices through production transfers from China. However, 80% of the transfer value in electronic devices comprised final electronic products such as notebook PCs, smartphones, and routers, with electronic components accounting for only 20%. In this way, the transfer of production from China to other Asian economies is centered on final goods, with only limited relocation of intermediate goods production.

<Top Ten Product Categories for Production Transfer from China (2017→25) >

HS Code	Product Category	Amount Transferred ($100 million)
847130	Notebook PCs	286
851713	Smartphones	209
851762	Routers	174
847330	Components (Computers)	93
852351	Solid-state Non-volatile Storage Devices	43
847150	Other Computers	40
940161	Upholstered Chairs	29
950450	Game Consoles	29
950300	Wheeled Toys	28
850440	Static Converters	23
Total Amount Transferred		2,093
Total Amount for Electronic Devices		1,194
Total Amount for Final Electronic Products		972
Total Amount for Electronic Components		223

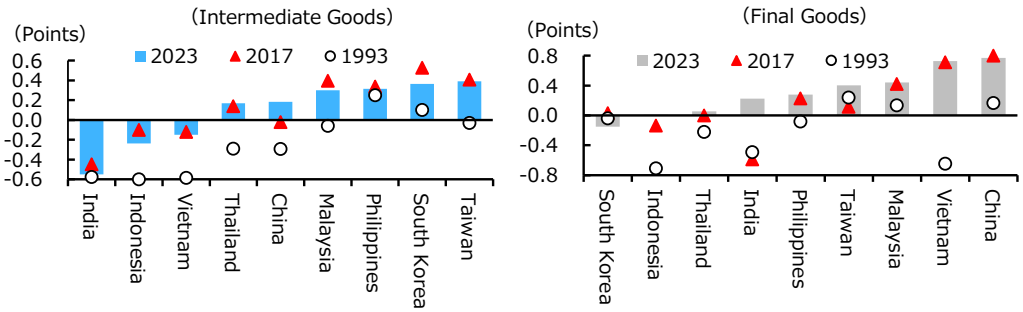
Source: Prepared by JRI based on data from U.S. Department of Commerce
Note: Some data for 2017 were estimates. For electronic devices, the amount transferred is the total for product categories in HS codes 8470, 8471, 8473, and 85. For electronic components, 16 major product categories were selected.

■ The export competitiveness of Asian countries in intermediate goods is failing to increase

Asian countries have expanded their presence in global supply chains for electronic devices, but because the transfer of electronic component production has been small in scale, their export competitiveness in intermediate goods has remained stagnant. An examination of trade specialization coefficients, which are measures of the degree of export competitiveness, reveals that for almost all countries/territories except China, the coefficient for intermediate goods for electronic devices has fallen since 2017, indicating that export competitiveness has declined. This stands in contrast to what has happened with final goods, where the coefficients have continued to rise since 2017. India, in particular, has seen its coefficient for final goods improve markedly, and move into positive territory, since 2017. This can be attributed to the relocation of smartphone assembly to India. However, India's coefficient for intermediate goods remains deep in negative territory, reflecting a growing dependence on imports. Vietnam exhibits a similar pattern. Vietnam has become a destination for production transfers across a wide range of electronic products, centered on notebook PC and router assembly processes.

China, meanwhile, has steadily increased its specialization coefficient for intermediate goods, strengthening its export competitiveness in electronic components. As demand has grown across Asian countries for the components needed to assemble finished products, China's position as the supply hub for

<Trade Specialization Coefficients for Electronic Devices>



Source: Prepared by JRI based on data from RIETI-TID
Note: Trade specialization coefficient = (exports - imports) / (exports + imports).
Closer to +1: more export specialized, closer to -1: more import specialized. Figures are for electrical machinery.

these components has been reinforced. Chinese exports of electronic components to elsewhere in Asia reached $254.4 billion (approximately 40 trillion yen) in 2025, more than triple the figure recorded in 2017 ($75 billion). Furthermore, their share of China's total exports to Asia expanded by over 10 percentage points from 17.3% in 2017 to 28.0% in 2025.

Within China's export figures, semiconductors (devices and integrated circuits) are by far the largest category, accounting for 40% of the total. This category includes logic and memory chips, which are essential for the production of a wide range of products such as computers and mobile phones, and the exports go to Vietnam and various other countries/territories. The second-largest export category is components (for mobile phones, etc.), which include parts destined for communications devices such as smartphones and routers. Exports to India, the primary destination for smartphone production transfers, and to Vietnam and Thailand, which have been increasingly targeted for router production relocation, are particularly significant.

<Exports of Electronic Components from China to Asia>
(2025)

HS Code	Product Category	Amount Exported ($100 million)
8541 8542	Semiconductors (Devices/ICs)	1,106
8517	Components (Telephones, etc.)	335
8524	Flat Panel Displays (FPDs)	222
8507	Storage Batteries	164
8473	Components (Computers)	158
8534	Printed Circuit Boards	131
8504	Transformers	130
8529	Components (broadcasting devices, etc.)	117
8536	Fuses, etc. (Low Voltage)	74
8518	Microphones	48
8532	Capacitors	29
8523	Disks and Other Memory Devices	14
8533	Electrical Resistors	7
8535	Fuses, etc. (High Voltage)	6
8522	Components (Audiovisual Recording Devices)	2
8540	Thermionic Tubes, etc.	Less than 1
Total		2,544

Source: Prepared by JRI based on data from General Administration of Customs of the People's Republic of China
Note: The figure for HS code 8517 is the total for 851771 and 851779.

■ The transfer of intermediate goods production will be gradual and limited

The key question going forward is whether production of intermediate goods will shift from China to other Asian economies, and particularly to lower-income ASEAN member states and India. In general, intermediate goods are more technology-intensive than final goods, and if higher-level technologies and

skills flow in through the transfer of intermediate goods production capacity, this can be expected to drive industrial upgrading and income growth in those countries/territories.

However, the bar for relocating intermediate goods production is higher than for final goods. Compared to the assembly of finished electronic products, the manufacture of electronic components, which are precision instruments, requires more advanced production technology and superior quality management capabilities, as well as more skilled workforce needed to deliver them. China has built itself into an industrial cluster in the electronic components sector over many years, and as a result, it possesses strong and comprehensive competitiveness across technology, quality, human resources, and price. This can be seen in the fact that China is the world's top exporter of electronic components, and that its share expanded by five percentage points between 2017 and 2023. In contrast, it is only in a limited range of product categories that ASEAN countries and India possess the technological foundations and industrial clusters that would make substituting for Chinese production feasible.

<Global Shares of Electronic Component Exports>

(%)

2017		2023	
China	17.9	China	22.4
South Korea	12.8	Taiwan	12.1
Taiwan	10.4	South Korea	9.6
Japan	7.8	Malaysia	6.3
Malaysia	7.6	Japan	6.1
U.S.	7.0	Germany	5.1
Germany	5.4	U.S.	5.0
Singapore	4.5	Singapore	3.9
Philippines	2.8	Vietnam	3.2
Other	23.7	Other	26.2

Source: Prepared by JRI based on data from RIETI-TID

For this reason, even if intermediate goods production does shift to Asian countries going forward, the pace will be gradual, and the shift will likely be confined to specific areas where industrial clusters already exist outside China, such as back-end semiconductor processes and smartphone components. The destination countries are also expected to be limited to ones where electronics industry clusters are relatively well established, such as Vietnam and Malaysia. As the transfer of high-value-added processes becomes concentrated in specific countries, Asia's industrial upgrading will lack breadth, and the pace of productivity improvement is likely to diverge across nations. Notably, if industrial clusters in intermediate goods fail to develop in populous countries such as India and Indonesia, the growth momentum of Asia as a whole could be undermined, raising the risk of many countries being snared in the "middle-income trap."

(Tomohiro Hosoi)