

# ASIA MONTHLY

## January 2020

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## Topics *Decoupling between the United States and China*

U.S.-China trade negotiations have reached “agreement of the first stage.” However, there are still concerns about the decoupling of the world into U.S. and Chinese camps as a result of a renewed conflict. How far will decoupling really go?

### ■ Elimination of Chinese telecommunications equipment has not spread

U.S. President Trump has said he will not impose the fourth round of punitive tariffs that were scheduled to be imposed on China on December 15. If the “agreement of the first stage” is signed early next year, the tariff rate imposed in September will be lowered from 15% to 7.5%. China did not disclose specific figures, but the United States said it received a promise from China that it would increase its imports from the United States by \$200 billion over the next two years in return.

While it can be assumed that the series of retaliatory tariff hikes have come to a halt, the risk of a flare-up of the conflict between the United States and China has not disappeared. U.S. public sentiment toward China worsened sharply in 2019, according to a Pew Research Center poll. On the other hand, the Chinese government is steadily promoting “Made in China 2025,” and the amount available to the government’s guidance funds, which financially support emerging industries, has exceeded 4 trillion yuan. It is premature to think that the latest agreement will bring the U.S.-China conflict to an end.

Companies that export finished products and parts from their Chinese production bases to the United States are expected to continue to shift their production bases to other countries in the future on the assumption of a prolonged conflict. A more serious problem is the decoupling of the world into competing United States and China camps due to a flare-up of conflicts. The main members of the U.S. camp will be developed countries, mainly allies, and those of the China camp will be emerging and developing countries with close ties to China. Multinational companies face serious problems if decoupling occurs because it will be very expensive to build an independent supply chain on both sides.

However, decoupling as in the Cold War era between the United States and the Soviet Union is not likely to occur easily, the U.S.’s dependence on China, which is the “world’s factory” has increased more than expected as a result of the progress of globalization, and China’s clout as leader of emerging and developing countries is expected to gradually weaken.

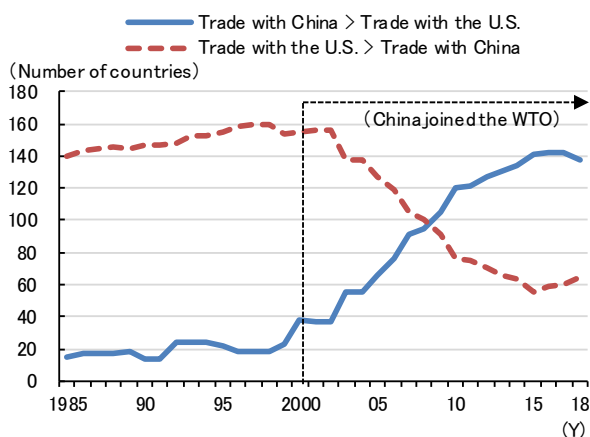
### ■ China has been deepening its relations with emerging and developing countries

One example of a strong dependence on China is that the U.S. government’s drive to eliminate Chinese telecommunications equipment has not spread widely. In November 2018, U.S. President Trump began pressuring his allies not to use Chinese telecommunications equipment on the grounds that it posed a security risk, but little progress has been made. Chinese telecommunications equipment, which is superior in both performance and price, is already in use around the world, and the cost to eliminate it in Europe is estimated at up to 55 billion euros.

On the other hand, China is solidifying its position as the leader of emerging and developing countries. International Monetary Fund (IMF) trade statistics show that the number of countries whose trade with China exceeds that with the United States has increased rapidly since China joined the World Trade Organization (WTO). Behind General Secretary Xi Jinping’s call for a change in global governance at the 19th National Congress of the Communist Party of China under the banner of “Common destiny of mankind” lies his strong pride in having strengthened ties with emerging and developing countries and solidified his position as a leader.

The strengthening of China’s relations with emerging and developing countries can be said to be the result of efforts by the public and

<Comparison of World Trade with China and the U.S.>



Source: Prepared by The Japan Research Institute, Limited based on materials by IMF and DOT

private sectors working together. According to the University of William and Mary in the United States, China's external public assistance from 2000 to 2014 totaled \$354.3 billion, which is comparable to the 394.6 billion provided by the United States. Moreover, China provided \$36.3 billion in export credit in 2017, far more than Japan's \$2 billion and the U.S.' \$200 million.

China's leadership is gaining recognition, albeit slowly. According to an international Gallup poll of 138 countries, 34% of respondents (median) rated China's leadership highly in 2018, up 3% from the previous year. On the other hand, the percentage of people who value the leadership of the United States declined by 18% from the previous year to 30% in 2017, due to the backlash against the Trump administration's "America First" policy and remained low at 31% in 2018. As a result, the evaluation of China has exceeded that of the United States for two consecutive years.

**■ Can China be a leader?**

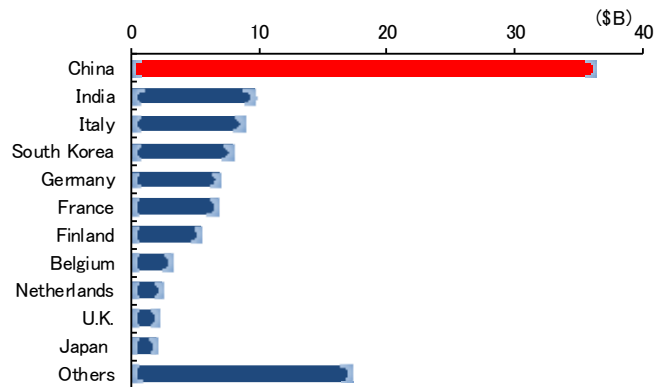
However, it will become increasingly difficult for China to maintain its centripetal force as a leader of emerging and developing countries. The problem is that the trade deficit with China is growing in many countries as relations with China deepen. Dividing each country's trade deficit with China by GDP yields the "depth" of the deficit. Of the 188 countries with effective data in 2018, 124 countries (66.0% of the total) had trade deficits with China of more than 1% of GDP in 2018, up significantly from 36 countries (20.3% of the total) in 2001. This contrasts with trade with the United States, where countries with trade deficits of 1% or more of GDP have been stable at around 30%.

The huge trade deficit with China is reflected in most countries' overall trade deficits. Developing countries with weak export industries and insufficient domestic savings have deficits in the service and income balance, and the trade deficit is a factor that affects the current account deficit. If the current account deficit continues, it will not only lead to an increase in foreign debt but also risk a depreciation of the currency due to capital outflow. The trade deficit with China is a problem that cannot be overlooked by any country.

In developing countries, this current account deficit has been offset by inflows of capital from China, such as direct investment and export credit, but this pattern is likely to become increasingly irrelevant. This is because China's foreign exchange reserves are expected to decrease as its current account surplus shrinks. In November 2019, the IMF predicted that China's current account would show a deficit in 2022. The Chinese government is tightening regulations on foreign currency control, and its plan to increase the number of "pro-China" countries by freely distributing abundant foreign currency is reaching its limit.

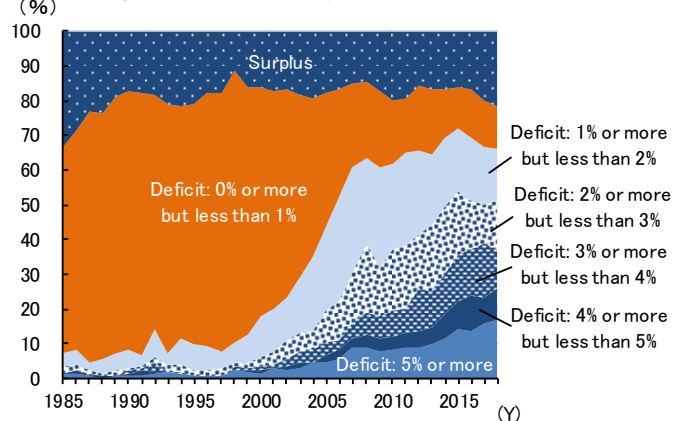
While the United States is unable to exclude China from its global supply chain, China does not have the clout to compete with the United States, so it is more realistic to assume that decoupling will be slow. As a result, many countries will likely be forced to engage in balanced diplomacy that takes into account both the United States and China, and multinational companies that do a lot of business with China will be compelled to engage in activities that are conscious of U.S. government regulations, such as entity lists.

<Export Credit Provided by Each Country (2017)>



Source: Prepared by The Japan Research Institute, Limited based on materials by the Export-Import Bank of the United States

<Depth of Each Country's Trade Deficit with China>



Source: Prepared by The Japan Research Institute, Limited based on materials by IMF, DOT and WEO

(Yuji Miura)

**Topics**    *The semiconductor market has shown signs of recovery led by 5G*

The semiconductor industry, whose major production bases are located in Asia, is showing signs of bottoming out. However, it is necessary to pay attention to the risk that the supply-demand balance will collapse, as there may be excessive expectations for 5G demand.

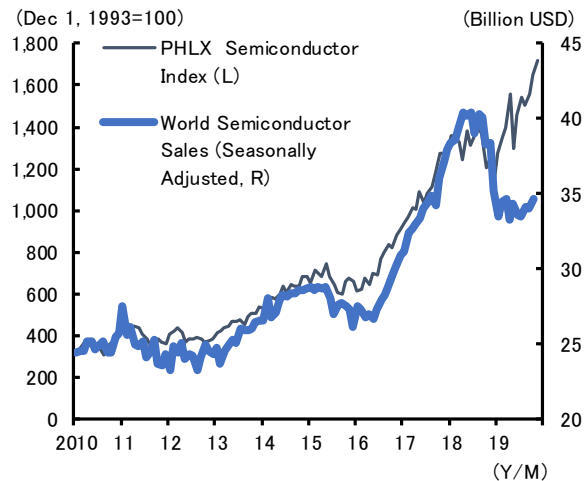
■ **Stock prices indicate a recovery in the semiconductor market**

The value of global semiconductor shipment (dollar basis) decreased by 9.6% in October compared to the same month of the previous year, showing a smaller decline than the 14.4% in September compared to the same month of the previous year. The slump in IT-related demand up to the first half of 2019 had been one of the reasons for the downward pressure on the Asian economy, particularly in Taiwan and South Korea, but the semiconductor market appears to be bottoming out. In addition, the PHLX Semiconductor Index (SOX), a major indicator for the semiconductor market, rose strongly, raising the prospects of the semiconductor market. While stock price movements depend on expectations and the circumstances of individual companies, the rise in the index indicates that semiconductor shipments will pick up in the future, judging from the high correlation in the past.

However, the pace of recovery in demand for semiconductors has varied by product. The demand for memory such as NAND flash and DRAM is still weak. This is largely due to sluggish investment in data centers (facilities with servers and telecommunications equipment), which rapidly increased due to a boom around 2017. In fact, the production adjustment of semiconductor memory, which is important for investment as a device for information recording, continues. Exports of electronic components in November (USD basis) by South Korea, whose share of memory in semiconductor exports is high (72%), continued to sharply decrease by 30.8% compared to the same month of the previous year. Since memory sales account for more than 30% of total semiconductor sales, the product's poor performance is a major obstacle to a turnaround in shipments. The widening gap between the PHLX Semiconductor Index and the actual value of semiconductor shipments reflects the fact that the index does not include the two South Korean memory makers that hold the top and second largest shares in the memory market.

On the other hand, demand for non-memory products including other integrated circuits, has been boosted by investments in 5G base stations and the commencement of sales of 5G-compatible smartphones, in addition to the absence of serious production adjustments, contributing to the overall market recovery. Indeed, Taiwan's electronic component exports (USD basis), in which non-memory accounts for 89% of its semiconductor exports, were robust in November 2019, recording 10.1%

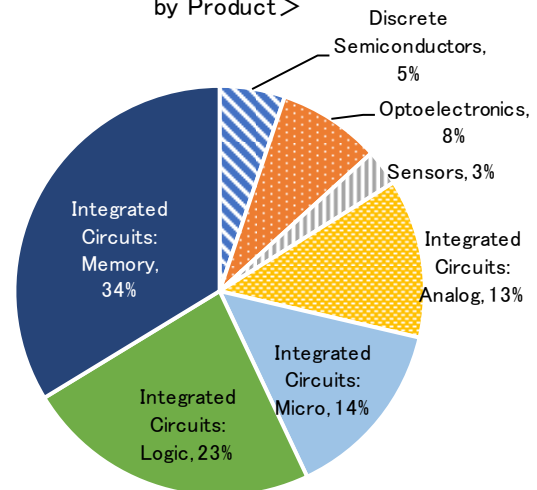
<World semiconductor sales and stock price>



Source: WSTS, Bloomberg L.P.

Note: The PHLX semiconductor index is a capitalization-weighted index composed of 30 U.S. listed semiconductor companies.

<Share of World Semiconductor Sales in 2018 by Product>



Source: WSTS

year-on-year growth.

■ **Semiconductor manufacturers have been actively making 5G-related capital investment**

The surge in demand for 5G is reflected in aggressive capital spending by semiconductor makers. Indeed, the world's largest semiconductor foundry in Taiwan raised the amount of capital investment for 2019. Sale of North American semiconductor manufacturing equipment (USD basis) were up 3.9% in October from a year earlier, marking the first growth since November 2018. While sales of Japanese semiconductor manufacturing equipment (USD basis) were down 5.9% in October from a year earlier, the decrease rate has narrowed significantly. In July 2019, Semiconductor Equipment and Materials International (SEMI) estimated that global sales of semiconductor manufacturing equipment would decrease by 18.4% year-on-year in 2019 and increase by 11.6% year-on-year in 2020.

As the PHLX Semiconductor Index includes manufacturing equipment companies, the more than 50% growth in stock prices of those companies since the beginning of 2019 has contributed significantly to the surge in overall growth of the index.

■ **There are concerns about excessive capital investment**

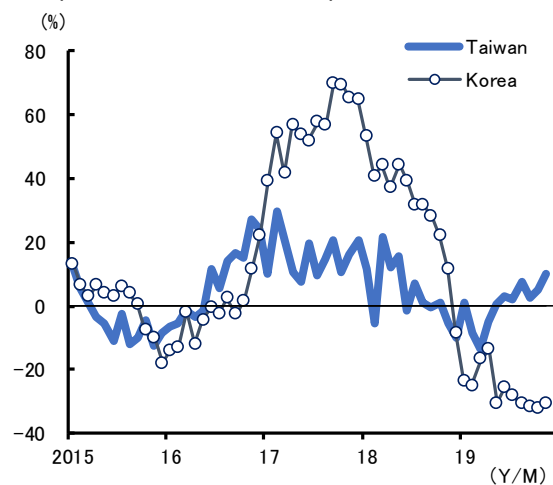
However, given this situation where capital investment is taking a lead, it is feared that excessive expectations are being generated for 5G-related semiconductor demand. The original 5G features of “high speed and large capacity,” “low delay” and “connection with multiple terminals” are emphasized in fields such as automated operation, telemedicine, and remote supports for nursing care. However, it will take some time before innovative services that fully utilize these 5G technologies are launched. Although infrastructure development for 5G is progressing, such as base stations, there are few practical 5G products other than smartphones at this stage. Shipments of 5G-compatible smartphones are also expected to increase in 2020, but there is a risk that demand may decline due to overpriced specifications. Although the market is anticipated to expand in the medium term, it may not grow as quickly as the market investors expect.

As the PHLX Semiconductor Index shows, the semiconductor market is expected to recover going forward driven by 5G demand-led demand, including memory whose demand has been sluggish. However, there are lingering concerns that the prospect of an increase in demand for 5G-related semiconductors may be premature. Although a recovery in semiconductor demand is expected to push up the Asian economy in 2020, excessive expectations should not be placed on the recovery. Attention should be paid to the risk that the supply-demand balance will collapse and negative factors will be passed on to the Asian economy.

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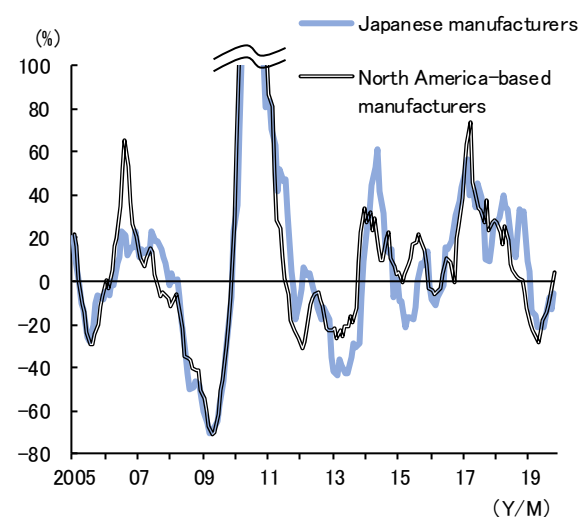
(Nogimori Minoru)

<Exports of Electronic Components (USD, YoY)>



Source : Korea Customs, Taiwan Ministry of Finance

<Semiconductor Equipments Sales (USD, YoY)>



Source : SEAJ, SEMI

Note : Backward 3 months moving average. Combined sales of semiconductor equipments from U.S. and Japan accounts for ~75% of global total sales in 2018.