ASIA MONTHLY

July 2024

http://www.jri.co.jp/english/periodical/asia/

This report is the revised English version of the July 2024 issue of the original Japanese version (published 28th June.).

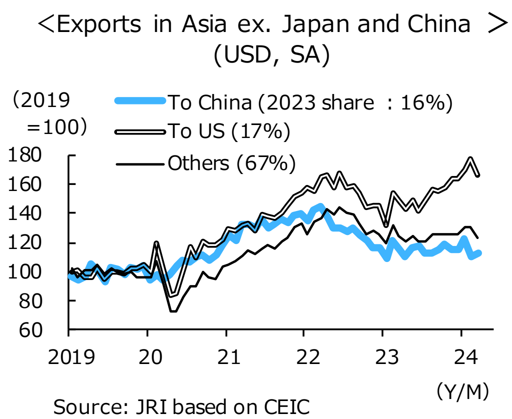
Asia: Headwinds for China but tailwinds for other Asian economies

While the Chinese economy is expected to slow in the second half of the year, other Asian economies should continue to perform well as they reap the benefits of the relocation of production facilities. However, if Mr. Trump regains the U.S. presidency, there is a possibility that the Asian economy as a whole will deteriorate.

1. Economic recovery will continue in 2024 with the exception of China

(1) IT-related trade will be the main driver of exports of both goods and services

Asian economies have picked up overall. Real GDP growth (seasonally adjusted) for the January-March quarter of 2024 was positive across the board on a quarter-over-quarter (QoQ) basis. As a general picture, factors such as high interest rates have pushed down domestic demand, but strong external demand has offset the downward pressure. Demand for IT-related products is recovering worldwide. In particular, exports to the U.S., where demand is strong, are driving the Asian economy as a whole. South Korea and Taiwan have been major beneficiaries and are the propulsive force behind the recovery. In ASEAN countries and India, IT-related demand is also the driver. In China, the economy was strong in the first half of 2024, as domestic tourism and spending on eating out rebounded, mainly during the Chinese New Year period, from the slump that occurred during the COVID pandemic. Furthermore, exports of new-energy products such as electric vehicles (EVs) increased significantly, which provided support to the economy.

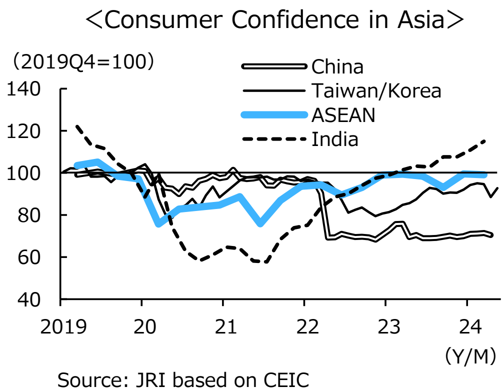


Source: JRI based on CEIC

(2) China's economy is expected to deteriorate as other Asian economies demonstrate resilience

In the second half of 2024, there will probably be a disparity in economic performance between China and other Asian economies. The pick-up in China's economy is expected to be temporary, and the recovery is likely to slow going forward due to sluggish domestic demand resulting from further deterioration in the housing market and stagnant consumer sentiment . In the West, growing criticism of overproduction/overcapacity in China has led to countermeasures such as higher tariffs on Chinese exports, so the rise in external demand is expected to lose steam.

Although the slowdown in the Chinese economy will exert downward pressure on the Asian economy as a whole, three other factors are predicted to allow the recovery of other Asian economies to continue: 1) a further surge in IT-related demand, 2) an increase in investment due to the relocation of production from China, and 3) the initiation of reductions in policy interest rates.



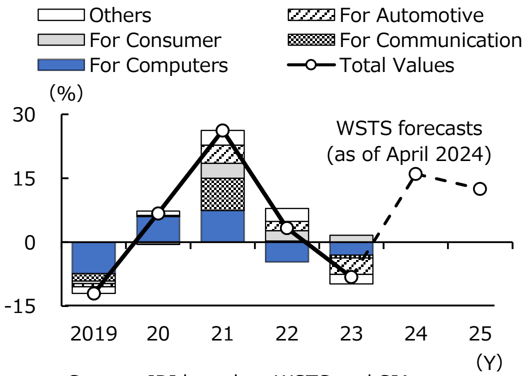
Source: JRI based on CEIC
Note: Taiwan/Korea and ASEAN (Indonesia, Thailand and Malaysia) are simple averages of figures for each country/region.

First, IT-related demand should remain strong. According to WSTS (World Semiconductor Trade Statistics), semiconductor sales are expected to increase significantly through 2025, reversing the -8.2% year-over-year (YoY) decline recorded in 2023. A background factor has been the rapid growth of the AI-related high-tech sector. In recent years, major U.S. cloud providers have enjoyed a growth spurt, and their services offer not only data storage and computer processing, but also AI functions, and demand for such services has skyrocketed, especially from the corporate sector. In addition, this increase in IT-related demand has had a positive impact on the demand for services in the IT and BPO (business process outsourcing) sectors. Besides call center operations, IT support and other services are expanding in English-speaking countries in Asia, such as India and the Philippines, and this is boosting service exports, especially to the U.S., from other Asian economies.

Second, there have been increasing moves to transfer production from China to other Asian economies. Notably, since the spring of this year, developed countries have been intensifying their confrontational stance toward China. For example, they have been severely criticizing China's overproduction, and it is expected that moves to reduce dependence on China and restructure supply chains will accelerate further in the future. The inflow of funds into China through direct investment and portfolio investment has been declining sharply, and this is likely to give a boost to ASEAN countries and India as investment cash is redirected toward these economies in earnest.

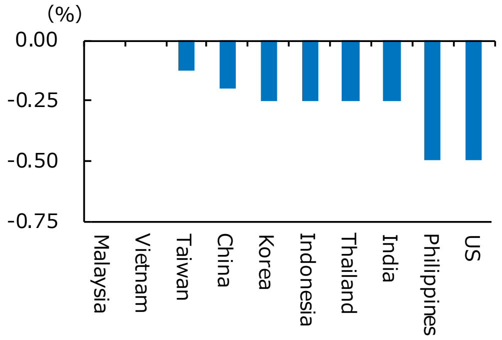
Third, monetary easing will provide an economic uplift. In Asia, with the exception of China, inflation had remained high and downward pressure on consumption had been strong until recently, but inflation rates have clearly been trending downtrend of late. From 2022, other Asian economies had been raising their policy rates continuously, following the U.S. lead, but they are expected to shift to an accommodative stance in the second half of 2024. By the end of 2024, Taiwan, Korea, Indonesia, Thailand, and India are projected to have cut their rates once, and China and the Philippines are projected to have cut their rates twice. Such monetary easing should stimulate domestic demand, which is sluggish in most of the countries/territories. Given these factors, the growth rate of Asia as a whole in 2024 is expected to be +5.3% YoY, which is slightly lower than in 2023, but still constitutes steady growth as it is higher than the pre-pandemic level of +5.0% in 2019. Looking at each country/territory, a disparity in economic performance between China and other Asian economies is forecast to arise. China's growth is expected to slow from the previous year and fall below the government's target of +5%. On the other hand, Taiwan and Korea should see significant increases in their growth rates to +3.6% and +2.7%, respectively, mainly due to the rebound in exports. Of the ASEAN countries, Vietnam, Thailand, and Malaysia, which are highly dependent on exports, are expected to see higher growth rates, while growth in Indonesia and the Philippines should quicken in 2025 when the effects of interest rate cuts will be felt. India is expected to maintain brisk growth in 2024, at a pace of +7.8%.

<Semiconductor Sales (YoY)>



Source: JRI based on WSTS and SIA

<Forecasts: Changes in Policy Rates>
(End-2024 vs Actual in May 2024)



Source: JRI

<Asia Economic Forecasts>

(%)

	2022	2023	2024 F	2025 F
Asia	**4.2**	**5.4**	**5.3**	**4.9**
Northeast Asia	2.8	4.7	4.5	4.1
China	3.0	5.2	4.7	4.4
Korea	2.6	1.4	2.7	2.3
Taiwan	2.6	1.3	3.6	2.4
Hong Kong	-3.7	3.3	2.8	2.4
ASEAN 5	6.0	4.5	5.0	5.0
Indonesia	5.3	5.0	5.0	5.2
Malyasia	8.9	3.6	4.5	4.2
Philippines	7.6	5.5	6.0	6.2
Thailand	2.5	1.9	2.9	2.8
Vietnam	8.1	5.0	6.5	6.5
India (FY)	7.0	8.2	7.8	7.0

Source: JRI based on various statistics

2. Trump risk: Tailwinds but potential pitfalls for other Asian economies

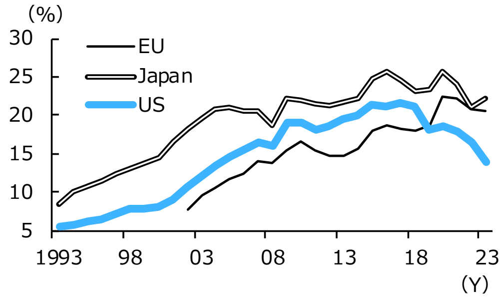
(1) Tariff hikes to hurt China but benefit other Asian economies

In developed countries, there are growing moves to reduce dependence on China and to reorganize supply chains as a means of doing this. As a result, China's share of imports is declining. China's share is falling especially fast in the U.S., where imports from Vietnam, Taiwan, and India are increasing as they replace Chinese goods/services. In 2024, criticism of China's overproduction of new-energy products such as EVs has intensified, and curbs on Chinese products have been strengthened, with tariffs being hiked, for example. In the U.S., in particular, moves to reduce reliance on China keep on accelerating.

The U.S. presidential election is coming up in November, and attention is focused on whether incumbent Joe Biden will retain the presidency or whether Mr. Trump will regain it. Regardless of who wins, the hardline stance against China will continue, and there will probably be no significant change in direction. However, if Mr. Trump proves victorious, the U.S. government's tough line on China is expected to become even tougher. Mr. Trump has vowed to adopt radical policies such as abolishing China's most-favored-nation status and imposing 100% tariffs on cars produced in Mexico by Chinese automakers and 60% (or more) tariffs on all goods imported from China.

If the tariff hikes that Mr. Trump has pledged are implemented, the Chinese economy will suffer enormous consequences. Estimating the economic impact, the measure would likely reduce China's real GDP by 1.1%, larger than the negative impact on U.S. real GDP of -0.5% and on average global real GDP of -0.3%. As a result, China's share of U.S. imports would plummet from 21.5% in 2015 to around 10% in 2025. On the other hand, in other Asian economies, positive effects would be seen through export circumvention or substitution, as well as the relocation of production facilities from China. The tariff hikes would boost Vietnam's real GDP by 1.4% and also have a small positive impact on the Taiwanese and Indian economies. In response to the recent U.S.-China confrontation, multinational companies have tended to focus on other Asian economies as alternative production locations. Already, imports from North America ex. U.S. and other Asian economies are accounting for a gradually increasing share of U.S. imports. Even if President Biden stays in the Oval Office, the headwinds for China and the tailwinds for

<China's Share of Imports from Japan, the US and Europe>



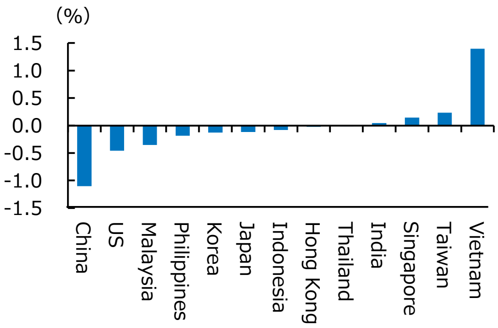
Source: JRI based on CEIC and US Department of Commerce

<Trump's Claims in the Media>

Sanctions against China	(1) Imposition of tariffs exceeding 60% on imports from China
	(2) Elimination of China's Most Favoured Nation (MFN) treatment
	(3) Impose 100% tariffs on autos made in Mexico by Chinese manufacturers
Other (Mainly Negative Effects on the Rest of Asia)	(4) Introduce 10% tariff on all US imports
	(5) Emphasis on the USMCA, which substituted NAFTA
	(6) Withdrawal from IPEF
	(7) Reduce or scrap the Inflation Reduction Act (IRA)

Source: JRI based on various media reports

<GDP Impacts of Trump Tariffs>



Source: JRI based on WIOD and other sources
Note: Estimated impacts include effects of policies (1) and (4) in the table above.

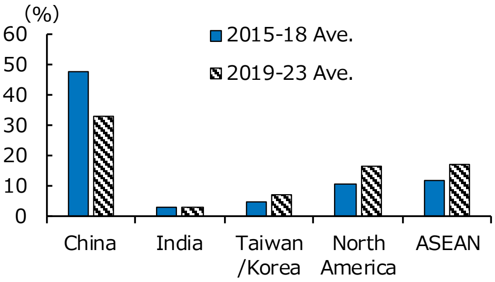
other Asian economies will likely keep blowing, but this trend is expected to intensify substantially if Mr. Trump implements his radical agenda.

(2) Deterioration in other Asian economies is also a risk

However, given that he advocates an "America First" approach, Mr. Trump will not necessarily continue to direct the brunt of his criticism toward China alone. He has criticized the Indo-Pacific Economic Framework (IPEF), an initiative for strengthening relations with friendly countries promoted by the Biden administration. He has called it "TPP2," and argued that it will hurt U.S. manufacturing and agriculture. An excessive tilt toward protectionism by Mr. Trump could lead to economic stagnation and dependence on China in other Asian economies, which could exacerbate the negative economic consequences of the U.S.-China rivalry.

First, there is the risk that the trade imbalance between the U.S. and other Asian economies could be viewed as a problem. Mr. Trump regards the U.S. trade deficit as a key issue, and the widening deficit has already shifted to countries/territories other than China. In the ASEAN countries, in particular, currency depreciation against the U.S. dollar and the expansion of trade surpluses with the U.S. have progressed more than during the previous Trump administration. In the U.S. Treasury Department's semi-annual foreign exchange report, Japan, China, Taiwan, Singapore, Malaysia, and Vietnam comprise the Asian presence on the Monitoring List, on the grounds of trade imbalances and track records of foreign exchange market intervention. The imposition of higher tariffs on them as punishment for trade surpluses and currency manipulation could harm their economies.

<US Trade Deficit with Asia>
(Share of Total Trade Deficit)



Source: JRI based on US Department of Commerce

Next, unintended increases in their dependence on China could intensify friction with the U.S. If the U.S. neglects its relations with friendly countries in the manner described above, there is a risk of the widening trade imbalance being seen as a problem and other Asian economies being subjected to penalties, which could result in an unintended increase in reliance on China in other Asian economies. In addition, it is not only developed-country companies with a China presence that are seeking export bases outside China and looking to make investments in other Asian economies. Chinese firms that do business with the U.S. are also making similar moves. Already, an increasing number of Chinese companies are using other Asian economies as a launchpad for exporting to the U.S. indirectly, in a bid to avoid the negative impact of tariff hikes on exports from China. And for other Asian economies, especially ASEAN states, the scale of this investment is such that its positive implications for their economic growth cannot be ignored.

Developed countries are expected to actively increase their support for Asia's emerging economies and to pursue mutual economic growth, but many of Mr. Trump's policies are about unilaterally strengthening U.S. protectionism, which reduces the likelihood of economic resources being allocated to lead the development of emerging nations. Furthermore, Mr. Trump has shown antipathy toward renewable energy and indicated that the Inflation Reduction Act (IRA), which is important for promoting decarbonization, may be watered down or repealed. The Just Energy Transition Partnership (JETP), which supports investment in renewable energy-related infrastructure by developed countries such as Japan and the U.S., will be implemented in Indonesia (announced in November 2022) and Vietnam (announced in December 2022), but a Trump presidency raises the likelihood of assistance measures such as this being emasculated and the U.S.'s efforts hitherto to build stronger economic ties with other Asian economies ending in failure.

Therefore, it must be noted that if Mr. Trump is re-elected, there is a risk that the Chinese economy will face a further economic downturn, and at the same time, there is a risk that other Asian economies will face headwinds that outweigh the benefits they will reap from supply chain restructuring.

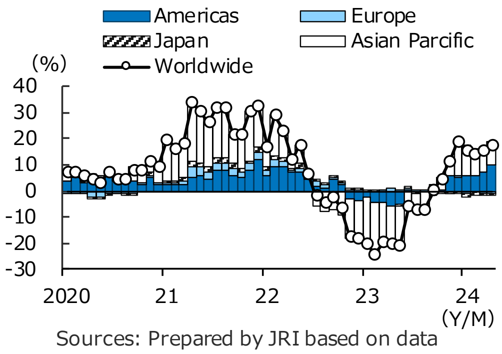
(Minoru Nogimori)

NIEs Growth is accelerating as IT-related demand recovers

■ A goods export-driven economic recovery was seen in the first half of 2024

The real GDP growth rate of the NIEs (Korea, Taiwan, and Hong Kong) in the January-March quarter of 2024 was +4.2% YoY, up from +3.8% in the previous quarter. Both Korea and Taiwan emerged from stagnation in 2023 and are now clearly on the recovery track. Exports of semiconductors and other IT-related products have been particularly strong, driving economic growth. According to WSTS (World Semiconductor Market Statistics), global semiconductor sales growth has been positive compared to the same month of the previous year since the end of December, and in April the sales growth rate jumped to +17.3% YoY. In Hong Kong, meanwhile, an expansion of trade contributed to economic growth. In China, exports of EVs and other products have increased significantly, and Hong Kong has benefited as a transit hub for this trade.

<Total Semiconductor Revenues (YoY)>



Sources: Prepared by JRI based on data from WSTS

Going forward, the economies of the NIEs are expected to remain firm on the whole. Their economic growth rate is projected to be +3.0% YoY for the full year of 2024, up from the previous year (+1.5% YoY). The outlook for Taiwan and Korea is bright, with both looking set to maintain their robust economic recoveries. Against a backdrop of increased demand for products for generative AI and data centers, higher exports of semiconductors and other IT-related goods are expected to provide a tailwind for their economies. This upward phase of the silicon cycle will likely continue for a while, so their economies should remain in a recovery phase through 2025.

<NIEs (Korea, Taiwan, Hong Kong) Growth Rate Forecasts>

(%)

	2020	2021	2022	2023	2024 F	2025 F
NIEs	0.0	5.3	2.0	1.5	3.0	2.4
Korea	-0.7	4.3	2.6	1.4	2.7	2.3
Taiwan	3.4	6.6	2.6	1.3	3.6	2.4
Hong Kong	-6.5	6.5	-3.7	3.3	2.8	2.4

Sources: Prepared by JRI based on data from national statistical bureaus, central banks, and the IMF

The recovery in exports will likely spill over into domestic demand. Benefiting from strong external demand, unemployment rates in Korea and Taiwan have continued to decline, and the employment situation has improved. Furthermore, as inflationary pressures subside, households' purchasing power is expected to rebound, thereby bolstering personal consumption. Korea and Taiwan have followed the U.S. in raising their policy rates since 2022, but are projected to start cutting rates before the end of 2024. Such monetary easing should also boost domestic demand. Nevertheless, it is anticipated that exports in Hong Kong will decelerate in accordance with the deceleration of the economy of mainland China, with which Hong Kong has close economic relations. Consequently, the Hong Kong economy is likely to experience a loss of momentum.

The economies of the NIEs are thus expected to perform well, overall, though further instability on the political front poses a risk. In Korea, there are concerns about the escalating tensions with North Korea. In Taiwan, attention needs to be paid to the intensifying confrontation between the ruling and opposition parties since the inauguration of the new administration, as well as the possibility of a further straining of tensions with mainland China. And on Hong Kong, the tightening of the Chinese government's grip on the territory could accelerate the exodus of foreign companies and undermine Hong Kong's status as an international financial center. Although none of these risks are likely to lead to serious consequences immediately, if concerns about potential consequences rise, economic activity will cool and the chance of recession will increase.

(Wu Zijing)

ASEAN5 *Supply chain restructuring drives economic recovery*

■ An export recovery will provide a tailwind in 2024

The real GDP growth rate of the ASEAN5 (Indonesia, Malaysia, the Philippines, Thailand, and Vietnam) in the January-March quarter of 2024 (simple average: +4.45% YoY, +4.39% in the previous quarter) increased slightly. Overall, the economies of each country have stayed on the recovery track, and the overall trend has been driven by brisk exports, including inbound demand.

<ASEAN5 Growth Rate Outlook>

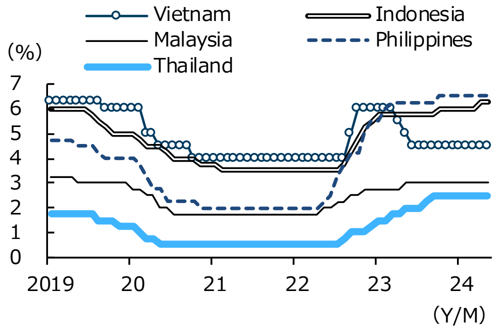
(%)

	2021	2022	2023	2024 F	2025 F
ASEAN 5	3.4	6.0	4.5	5.0	5.0
Indonesia	3.7	5.3	5.0	5.0	5.2
Malaysia	3.3	8.9	3.6	4.5	4.2
Philippines	5.7	7.6	5.5	6.0	6.2
Thailand	1.6	2.5	1.9	2.9	2.8
Vietnam	2.6	8.1	5.0	6.5	6.5

Sources: Prepared by JRI based on data from national statistical bureaus. central banks. and the IMF

The economic recovery is expected to continue on the whole in the second half of the year, with real GDP growth in the ASEAN5 set to accelerate to +5.0% YoY for the full year of 2024, up from +4.5% YoY in the previous year. Although the momentum of service exports appears likely to weaken due to sluggish growth in numbers of Chinese tourists, an increase in goods exports against the backdrop of a recovery in IT demand is expected to provide a fresh driver for the ASEAN5 economies. The relocation of production facilities to the ASEAN zone as part of the supply chain reorganization trend should also provide a structural boost to exports.

<ASEAN5 Policy Rate>



Source: Prepared by JRI based on data from CEIC

In some of the countries, high interest rates have put increasing downward pressure on domestic demand, but this situation will be mitigated if the U.S. cuts interest rates and they follow suit. By the end of 2024, Indonesia and Thailand are projected to have cut their rates once, and the Philippines is projected to have cut its rates twice.

The U.S. presidential election scheduled for November is expected to be a contest between former President Donald Trump of the Republican Party and President Biden of the Democratic Party. Regardless of who becomes president, the hardline stance toward China will not change, and Western countries are expected to continue to move away from dependence on China, a process that involves the restructuring of supply chains. ASEAN countries stand to benefit from U.S. policy toward China, as it is likely to lead to increases in their production and exports.

However, it must be noted that if Mr. Trump regains the U.S. presidency, there may also be negative implications for ASEAN economies. Mr. Trump, who advocates an "America First" approach, is not necessarily friendly toward countries other than China, raising the risk that ASEAN countries will also experience increased friction with the U.S. over trade. The structure of U.S. trade has changed significantly, with China's share of the U.S. trade plummeting and ASEAN's share rapidly expanding. There is a danger that Mr. Trump, who has pressed for a correction of trade imbalances, will adopt a hardline stance on this issue. In fact, in 2020, then-President Mr. Trump took issue with the U.S. trade deficit with Vietnam. In the U.S. Treasury Department's semi-annual foreign exchange report, of Asian countries, China, Taiwan, Singapore, Malaysia, and Vietnam are already on the Monitoring List for currency manipulation, on the grounds of trade imbalances and track records of foreign exchange market intervention. If a country is recognized as a currency manipulator, it is likely to become subject to punitive tariffs, so ASEAN countries could find their economies under immense pressure.

(Minoru Nogimori)
(Kazushi Morita)

India High growth is continuing but reforms are needed

■ The IT-related services sector is recovering resiliently

India's real GDP growth in the January-March quarter was +7.8% YoY, recording high growth after +8.6% YoY in the previous quarter. By demand component, export growth accelerated to +8.1% YoY from the previous quarter (+3.4% YoY). Breaking this down, although goods exports were sluggish, exports of services increased significantly. One of the reasons for the expansion of trade in the service sector was that India has large numbers of personnel and IT experts who can converse in English, and orders related to IT and BPO (business process outsourcing), such as for call center functions and administrative operations, have been coming in from all over the world. The recent expansion of the IT sector has provided a tailwind, and among service exports, IT and BPO-related exports have soared.

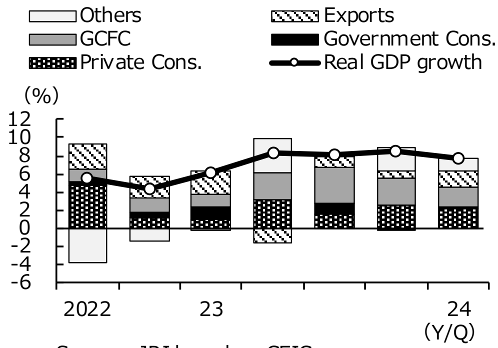
On the domestic demand front, personal consumption increased by 4.0% (+4.0% YoY in the previous quarter) and fixed capital formation by 6.5% (+9.7% YoY in the previous quarter), so relatively rapid growth was maintained. The unemployment rate in urban areas is 6.7%, lower than before the COVID pandemic (7.9% at the end of 2019), and the improvement in the employment situation is supporting consumption.

■ Recovery will be centered on services going forward, with monetary easing providing a tailwind

The economy is expected to continue expanding through the second half of the year, with the service sector as the main driver. Global IT-related businesses are growing, and the Indian economy should benefit from outsourced services. In addition, digitalization is progressing rapidly in fields such as public infrastructure, and businesses using this infrastructure are expected to expand.

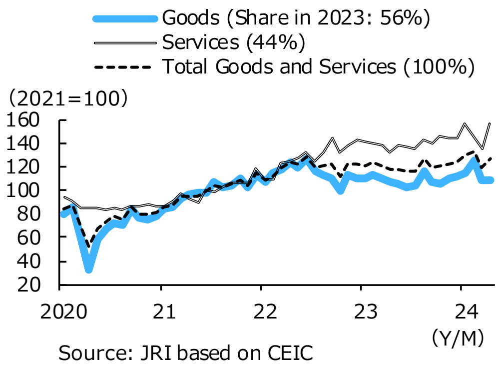
The boost to domestic demand that monetary easing will deliver should also help to support the economic recovery. The consumer price index (CPI) for May was up 4.7% YoY (core: +3.1% YoY), below the upper limit (6%) of the inflation target, which is 4% (±2%), for the ninth consecutive month. At the June 7 meeting of the Monetary Policy Committee of the Reserve Bank of India (RBI), it was decided to leave interest rates unchanged for the eighth consecutive meeting, though two of the six committee members argued for a rate cut. With the U.S. Federal Reserve looking increasingly likely to cut rates later this year, the downward pressure on the rupee should recede sooner or later, and the RBI is expected to cut rates by 0.25% around the end of the year.

<Real GDP Growth Rate >
(year-on-year)



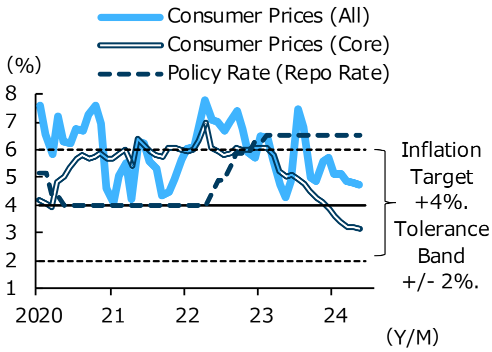
Source: JRI based on CEIC

<Exports of Goods and Services>
(Nominal, USD)



Source: JRI based on CEIC

<Inflation and Policy Rates>

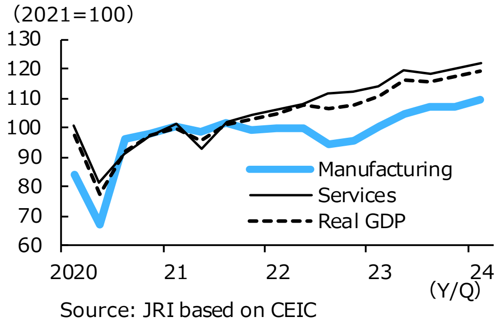


Source: JRI based on CEIC

■ Developing the manufacturing sector presents a challenge and potential political instability poses a risk

Since 2014, under the slogan "Make in India," the Indian government has been trying to develop the country's manufacturing sector, yet manufacturing growth remains sluggish. Breaking GDP down by industry, the service sector has grown by 21.8% since 2021, while manufacturing growth has been just 9.9%, and the momentum gap has widened since the pandemic. In addition, although the inflow of funds into India for the purpose of investing in securities such as stocks and bonds has been increasing recently, the inflow from direct investment, for the construction of production facilities, for example, remains on a downward trajectory.

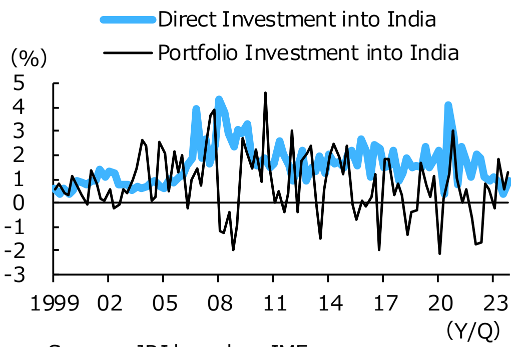
<Real GDP by Industry (SA)>



Source: JRI based on CEIC

As with other Asian countries, such as ASEAN member states, there is no doubt that the West's moves to reduce its dependence on China have benefited India. The share of processed goods (machinery, electronics, and transportation equipment) in India's exports to the U.S. has more than doubled from 11.2% in 2017 to 25.1%. A major factor in this has been Apple's shifting of smartphone manufacturing to India. However, if smartphones are excluded, the share has hardly expanded at all, so certain industries aside, it can be said that the production relocation trend has not given the Indian economy much of a boost so far.

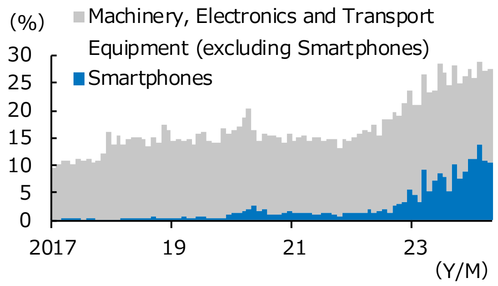
<Inward Investment in India>
(% of GDP, BOP, Flow)



Source: JRI based on IMF

India's economy is currently doing well, but to sustain high growth over the medium to long term, revitalization of the manufacturing sector is imperative. Expectations for India's manufacturing sector are high, and according to a survey of Japanese companies conducted in FY2023 by the Japan Bank for International Cooperation (JBIC), India tops the list of "promising countries for overseas business over the mid-term (next three years)," coming out ahead of China for the second consecutive year. But to meet these expectations, further reforms will be needed in areas such as the labor market and infrastructure.

<Processed Goods in India's
Exports to the US>



Source : JRI based on US Department of Commerce

Political trends also warrant attention as a risk to the Indian economy. On June 4, votes were counted for India's Lok Sabha (lower house) general election, and the results, which were declared the same day, saw the ruling coalition, the National Alliance for Democracy (NDA), secure a majority with 293 seats. Prime Minister Narendra Modi's government has thus entered its third term, and it has been announced that key ministers such as Foreign Minister Jaishankar and Defense Minister Singh will remain in their posts. However, Prime Minister Modi's Bharatiya Janata Party (BJP) has failed to secure a majority on its own, making it difficult to continue the strong, top-down style of administration seen until now. If the manufacturing sector fails to grow due to a stalling of reforms as a result of the weakening in leadership, high growth may not be sustainable.

(Minoru Nogimori)

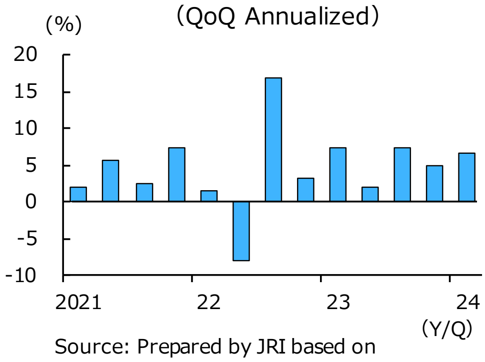
China Slowdown will continue due to substantial downside risks

■ The rebound seen in the first half of 2024 will be temporary

In the first half of 2024, China's economy picked up at the beginning of the year, but the pace of growth subsequently slowed.

The real GDP growth rate for the January-March quarter was an annualized 6.6% QoQ, accelerating from 4.9% the previous quarter. The main reasons for this were an increase in demand due to the consecutive holidays over the Chinese New Year period and a pick-up in domestic demand due to the effects of policy measures. Since the end of last year, the downward trend in external demand has also come to a halt, which has helped boost the growth rate.

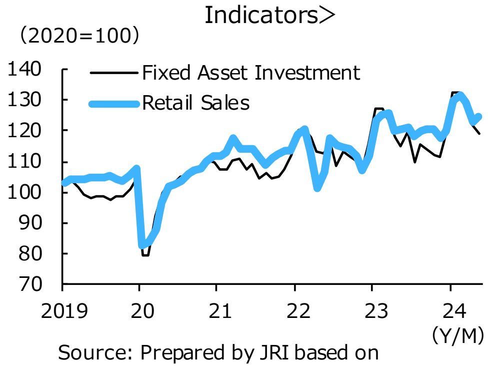
<Real GDP Growth Rate> (QoQ Annualized)



Source: Prepared by JRI based on data from CEIC

Looking at each demand component, personal consumption boomed, thanks chiefly to more people eating out and traveling within the country as Chinese New Year-related consumption returned in the wake of the COVID pandemic, and retail sales (seasonally adjusted) also increased . As for fixed asset investment (seasonally adjusted), funds procured through the issuance of additional government bonds to help stimulate the economy seem to have been directed into infrastructure development in rural areas, leading to a rise in public investment.

<Consumption/Investment-Related Indicators>



Source: Prepared by JRI based on data from CEIC

Regarding exports, an increase in overseas demand for relatively low-priced products such as automobiles, particularly EVs, drove an overall pick-up in exports from the end of last year.

However, since the spring, a slackening in domestic demand has held the economy back, causing growth to slow. First of all, the surge in personal consumption during the Chinese New Year period did not last long. Against a backdrop of consumers wanting to save money and the severe employment and income situation, retail sales have been on a downward slide since peaking in February, and the sense that the recovery in consumption has run out of steam is getting stronger. Fixed asset investment is also sluggish. The expansion in fiscal spending has paused, and the pace of increase in infrastructure investment has slowed. Furthermore, the real-estate slump is deepening again, with property investment falling even more steeply than before.

On the other hand, exports remain on an upward trajectory. Categories such as automobiles are continuing to see rising exports. As for destinations, while exports to Japan and Europe are dropping, those bound for the ASEAN zone are on the rise.

■ The effects of stimulus measures will be limited and the economy will continue to slow in the second half of 2024

Looking ahead, the economy looks set to continue to slow in the second half of the year, with real GDP growth expected to be 4.7% YoY for the full year of 2024, lower than both the previous year's (5.2% YoY) and the government's target (around 5.0% YoY). There are three reasons for this: 1) low consumer confidence, 2) export headwinds, and 3) excess real-estate inventory. Specifically, this is what is expected to happen:

Concerning the first reason, low consumer confidence, the Consumer Confidence Index shows that consumer sentiment has remained significantly depressed even since the abandonment of the zero-COVID policy, and there are still no signs of recovery. In a survey of urban depositors conducted by the People's Bank of China, only 23.4% of all respondents said they would "consume more" in the January-March quarter of 2024, indicating that the remaining over 70% of households intend to refrain from active consumption.

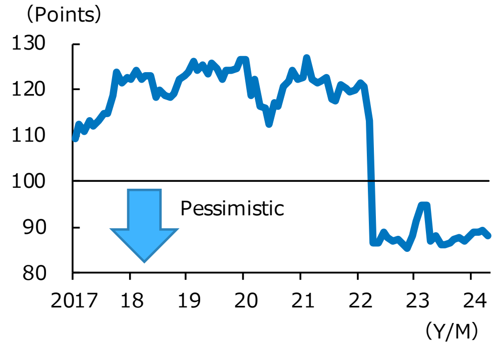
This continuation of low consumer confidence reflects the harsh employment and income environment. In particular, the fact that many young people are having trouble finding employment is presenting an obstacle to a recovery in personal consumption. In April 2024, the unemployment rate for young people aged 16-24 remained high at 14.7%. This is a stand-out level in comparison with other countries.

As for the second reason, a detailed look at the export situation reveals that overseas sales of lithium-ion batteries, EVs, and solar cells, known as the "new three," have increased rapidly in recent years, driving overall exports. In response, Western developed countries have slammed China's efforts to boost exports of these and other goods as market competition-distorting "dumping," and begun to take countermeasures such as imposing punitive tariffs. The U.S. will raise import duties on goods including the new three from August, while the EU has decided to impose provisional additional tariffs of up to 38.1% on Chinese-made EVs from July. As Western developed countries beef up restrictions on imports of Chinese goods, Chinese export growth is likely to falter.

And about the third reason, an examination of the real-estate slump shows that housing sales remained lackluster. Coming into 2024, local governments have been trying to improve the situation with one new measure after another, such as easing restrictions on the purchase of housing, but the effect has been small and has not led to a recovery in sales. As a result, prospective buyers remain convinced that prices will continue to fall, and a vicious cycle has arisen in which drops in housing prices trigger further declines in housing demand. Housing inventory thus keeps on rising, and according to the Yiju Research Institute, the average number of months housing spends in inventory (the area of housing inventory divided by the area of recently sold housing) in 100 cities nationwide as of the end of 2023 is 22.4 months, which is way above the appropriate level of 12-14 months. This situation cannot be expected to improve overnight, making the likelihood of a recovery in real-estate development investment small.

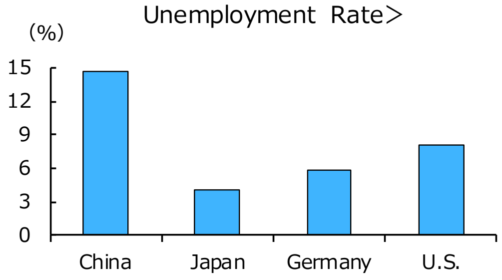
In response to the economic slowdown and the deterioration of the real-estate market, the government has taken various measures. To stimulate the economy, the government has taken steps since this spring to encourage firms to upgrade their facilities with fresh capital expenditures and to entice households to replace items such as cars with new ones.

<Consumer Confidence Index>



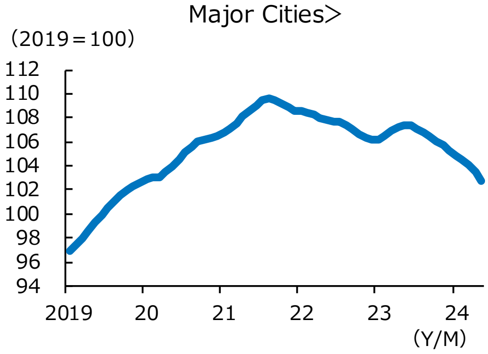
Source: Prepared by JRI based on data from CEIC

<Youth (16-24 years) Unemployment Rate>



Source: Prepared by JRI based on data from CEIC
Note: Data is for ages 15-24 in the case of Japan and Germany. Data for countries other than China is seasonally adjusted.

<Prices of New Homes in 70 Major Cities>



Source: Prepared by JRI based on data from CEIC

However, the stimulus effect on the economy is likely to be limited because of the following two problems:

The first is that private-sector companies have little appetite to invest. A background factor behind this is that the Chinese government has been tightening business regulations and pursuing industrial policies that emphasize state-owned enterprises. Since 2023, the Chinese government has taken measures such as easing barriers to entry and providing financial support for private-sector companies, yet the recovery in private-sector investment remains weak.

The second is that the scale of the stimulus measures is small. For example, it was announced that total government subsidies for purchasing new cars to replace old ones in 2024 will be RMB11.2 billion. This is less than 0.01% of GDP in 2023, so there is little reason to believe that it will be effective.

In addition, as a measure to tackle the real-estate slump, the government in May announced a raft of measures such as buying up housing inventory and scrapping the floor on mortgage interest rates. However, due to the inadequacy of the scale of financial support for housing purchases (RMB500 billion) and the high probability that the purchase prices will be set low, a significant reduction in housing inventory and resulting improvement in the cash-flow situation of real-estate developers is unlikely.

<Measures to Tackle Real-estate Slump (2024)>

Area	Key Measures
Purchasing Restrictions	・Relaxation of restrictions on purchases in large cities
Housing Inventory	・Limits on sale of land use rights
	・Purchase of housing inventory
	・Financial support for housing purchases from the People's Bank of China and major financial institutions
Demand Stimulation	・Scrapping of mortgage interest rate floor and reduction of downpayment percentage

Source: Prepared by JRI based on data from the People's Bank of China and others

■ There is a risk of economic collapse

As detailed above, the slowdown in China's economy is expected to continue for some time. Furthermore, attention needs to be paid to the fact that the possibility of the economy collapsing cannot be ruled out, and much will depend on which of the following two risk scenarios plays out:

The first is that the real-estate slump becomes much more serious. If this happens, the government may indicate that it is committed to staving off, at all costs, a situation in which the entire financial system becomes dysfunctional, but may also allow some real-estate companies to fail. However, it is also possible that concerns about the creditworthiness of certain firms may spread to other companies in the form of a chain reaction, resulting in a situation in which the government is unable to wield effective control. In such a case, domestic and overseas financial markets will be plunged into turmoil, with a high probability of the economy also being subject to huge downward pressure.

The second is that the U.S. exerts even greater pressure on China. Even now, the U.S. is still China's third largest export buyer after ASEAN and the EU. If the U.S. significantly raises tariffs on exports from China either in the run-up to the presidential election, as a means of attracting votes, or as the result of a more hardline stance being adopted after the election, there will be a substantial drop in China's exports to the U.S. In addition, if the China-U.S. relationship continues to deteriorate, not only foreign companies operating in China, but also Chinese companies, may accelerate moves to shift their production facilities outside China.

As the above highlights, the Chinese economy is encumbered with numerous risk factors both at home and abroad, and depending on what happens, full-scale domestic demand stimulus measures funded by additional fiscal spending could be required. This is another reason that eyes are focused on the CCP Central Politburo meeting in late July. In most years, this meeting features a readout of policy for economic administration in the second half of the year, which reflects key indicators for the period from April to June, so there is a possibility of some new measures being announced.

Conversely, if no major economic measures are announced at the meeting, the economy will likely continue to decelerate in the second half of the year. If that is the case, disillusionment among domestic and foreign investors about the Chinese economy will mount, and headwinds from financial markets, such as drops in stock prices and a weakening of the renminbi, can be expected to intensify, which will further depress the economy.

(Junya Sano)