Economic Research Department 23 November 2023

Economic QuickView

China's Economy: An Inseparable Role in Global Supply Chain with Ample Potential

- China remains the centre of the global supply chain despite an increasingly challenging and complex global trade environment.
- A new form of regional supply chain is emerging with shift of final assembly to ASEAN, which allows China to focus on high value-added manufacturing.
- China's vast and efficient manufacturing ecosystem with competitive infrastructure and skilled labour supply makes it hard to be replaced.
- The success in technological upgrades and increasingly popular homegrown brands solidified China's leading role in the global market.
- The catch-up potential from the inland regions will generate new growth momentum, with stronger regional and city cluster development.
- China's economy is poised to see ample growth potential in the next decade, heading to double its GDP by 2035.

China Continues to Keep a Strong Position in Global Trade

Global trade has become more challenging and complex. While there were rising anti-dumping duties and non-trade barriers in early 2010s, it was until 2018 that the then-US President Donald Trump's massive tariff measures against its trading partners elevated protectionism as one of the major risks faced by the global economy, causing huge uncertainties for cross-border trade and investment. Subsequently, the Covid-19 pandemic caused prolonged disruptions in critical supplies. This led to a re-think of global supply chain strategy, with diversification and security gaining importance. Besides, ongoing military conflicts in Europe and Middle East triggered higher uncertainty in supply chain activity and commodity trade. Although global trade has become more challenging and complex, China is proving resilient in maintaining its leading position as a global manufacturing hub.

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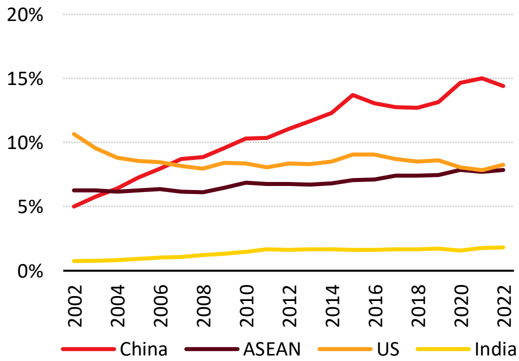
China remains the centre of the global supply chain. Even with a challenging geopolitical and economic landscape, China maintains a strong foothold in global trade, ranking top with 14.4% of global export share in 2022 and serving as the largest trading partner with over 140 economies. Meanwhile, other Asian economies have seen notable export growth, but their scales are still small. For example, ASEAN and India shared 7.9% and 1.8% of global export in 2022, respectively.

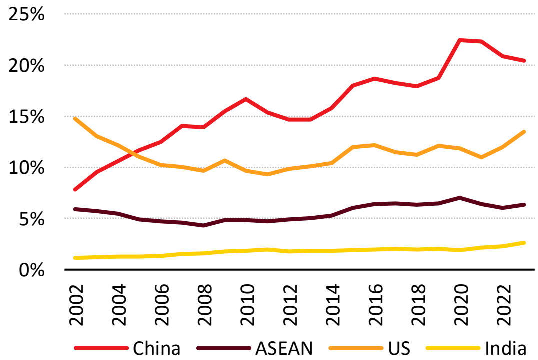
Among the advanced economies, demand for Chinese merchandise goods has stayed robust. In the US market, China continues to serve as a major source for US imports, accounting for 9.7% of total US imports in 2022, albeit down from 12.1% in 2018 due to the trade war. In the European market, China's trade ties with the EU get closer, accouting for 20.4% of total EU imports in 2022, up from 17.9% in 2018. It suggests that global "de-risking" is hardly feasible and realistic.

Share of World Merchandise Exports



Source: CEIC

Share of EU Imports

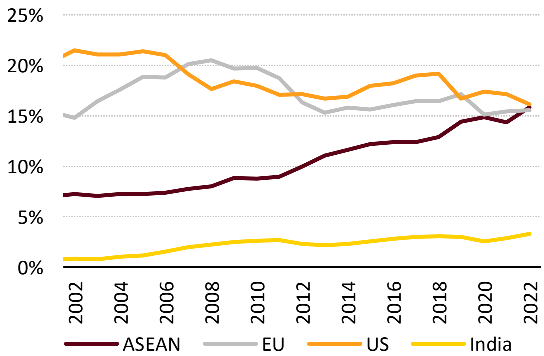


Source: CEIC

A new form of regional supply chain is emerging. Trade tariffs have further sped up a reshuffling of Asia's production network, which only re-directs Chinese exports and builds closer cooperation among Asian economies. Analysed by China's major export destinations, the share of exports to US showed a steady decline from 19.2% in 2018 to 16.1% in 2022, while the share of exports to ASEAN rose from 12.9% in 2018 to 15.8% in 2022. China's export share to India also reported a rise.

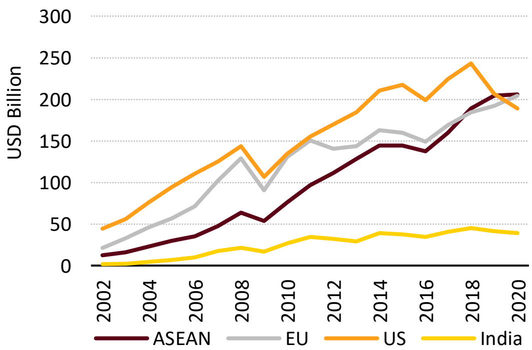
Analysed by China's major export product types, exports of intermediate goods from China to the ASEAN have surged to above USD 200 billion level, outpacing that to the US. Export share of intermediate goods to India also showed a modest rise. An increase in regional trade between China and other Asian economies, accompanied by rising trade of intermediate goods, probably reflected a shift of final assembly work from China to other Asian economies, as China is moving away from low value-added labour-intentive production. This shift allows China to move up the value chain and focus on higher value-added activities.

Share of China Export Destination



Source: CEIC

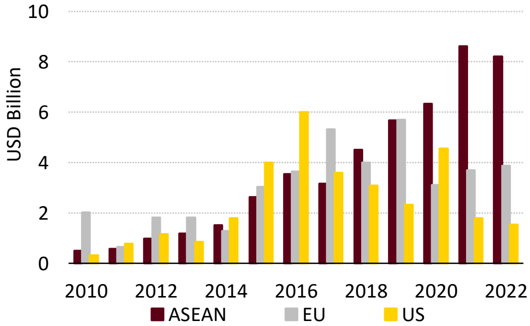
Intermediate Goods Exports from China



Source: OECD

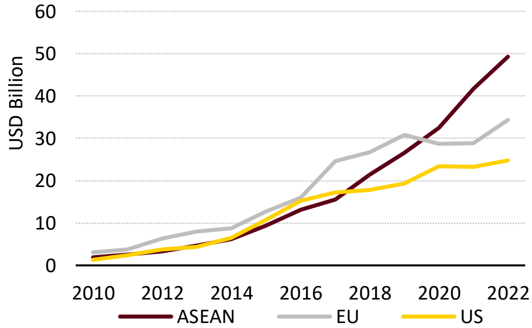
Chinese firms are stepping up manufacturing investment in ASEAN. In addition to trade, China's direct investment into ASEAN manifests the efforts of Chinese firms to develop an integrated production network in Asia. Over the years, Chinese firms has steadily increased manufacturing investment in ASEAN. The stocks of Chinese manufacturing investment in ASEAN surpassed that of the US in 2018 and that of the EU in 2020. This closer regional investment and cooperation does not only allow Chinese firms to yield cost advantages in other Asian markets but also cement their resilience with a diversified supply chain against any potential protectionist measures and escalations of geopolitical tensions.

Outward Direct Investment in Manufacturing Sector by China (Outflows)



Source: CEIC

Outward Direct Investment in Manufacturing Sector by China (Stock)



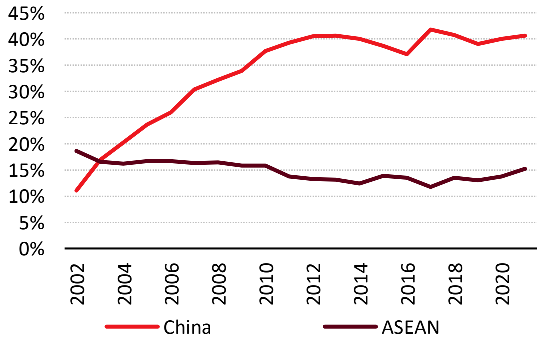
Source: CEIC

China's Competitiveness Makes It Hard to be Replaced

China has increasingly gained a competitive edge in high-end manufacturing and large-scale production. Over the past decade, China has secured a stable global export share at around 40% in electronic data processing equipment, whereas ASEAN's corresponding share only stayed at around 15%. Most notably, over half of the US phone imports are still coming from China, despite the massive tariff measures. Furthermore, China's global export share in machinery also rose from 20% in 2018 to 24% in 2021. These data indicated a substantial global lead of Chinese high-end manufacturing products.

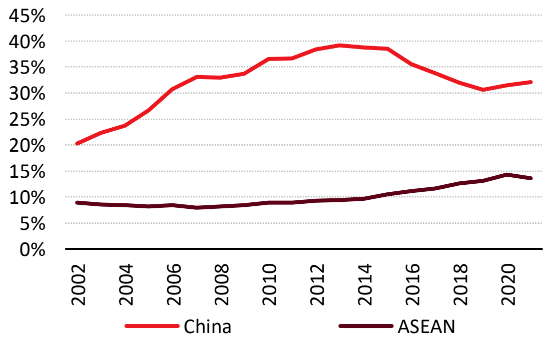
There are capacity constraints in other Asian economies to expand production rapidly. For instance, China's global export share in clothing remained high at 32% in 2022, albeit down from nearly 40% in 2013. In the same period, ASEAN's global export share in clothing gradually picked up from 9.4% to 13.6%. China's vast manufacturing ecosystem with supplies from raw materials to various increasingly important intermediate parts has allowed its manufacturers to deliver stable quality in massive scale, which is hard to be copied by others.

Share of World Exports - Electronic Data Processing Equipment



Source: World Trade Organisation

Share of World Exports - Clothing



Source: World Trade Organisation

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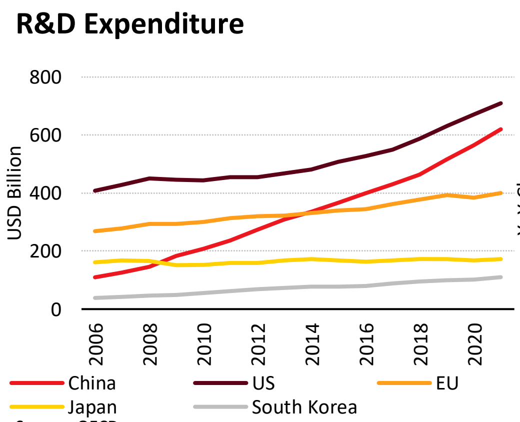
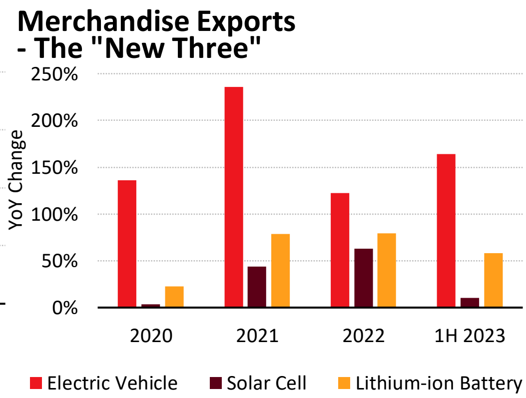
China's innovation and technology investment is bearing fruit. China has pursued high quality growth over the years, with a strong focus on developing strategic emerging industries. Strong government support and a huge domestic market have attracted significant investment into innovation and technology sectors. Since early 2000s, China's R&D expenditure has exceeded most major economies and continued to rise. These have fostered the development of several new leaders in exports and manufacturing sectors.

Specifically, China-made electric vehicles (EV), solar cells and lithium-ion batteries have witnessed a sturdy rise in global demand, with their exports growing at 164%, 10% and 58% year-on-year, respectively, in 1H 2023. Among these strategic emerging industries, China's EV battery technology is leading the world, with Chinese battery makers accounting for over 60% of the global market share. China's top domestic EV battery maker, CATL, has partnership with famous foreign carmakers such as BMW, Volkswagen, Mercedes-Benz, etc. This reflected China is now in the centre of global EV supply chain, and its success in technological upgrades.



Source: OECD



Source: CEIC

Homegrown Chinese brands are gaining popularity in global marketplace. Amid rising labour costs and a rapidly evolving external environment, Chinese entrepreneurs have successfully captured the global mass market by offering affordable, value for money, and good quality products. At present, numerous Chinese brands have flourished in a wide range of industries.

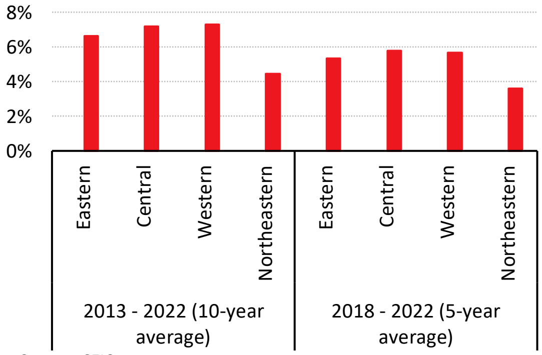
In the electric vehicle (EV) market, China's BYD is on track to overtake US's Tesla as the world's biggest EV maker (by measure of fully electric vehicles). In Q3 2023, BYD's fully EV sales rose to 431,603 units, while Tesla sold 435,059 cars. In the smartphone market, Chinese brands have gained significant traction, particularly in Asian emerging markets. In Q1 – Q3 2023, top Chinese phone makers (namely Xiaomi, Oppo & Vivo) had a combined global market share of 32%, compared to 18% for US's Apple and 21% for South Korea's Samsung.

China's infrastructure and skilled labour supply have laid solid foundations for future's upgrade. Many emerging markets are still experiencing significant shortfall in infrastructure investment, making them difficult to meet the global production demand. For example, the transport infrastructure in Vietnam and India is less developed than that in China. The total port throughput in Vietnam and India is only equivalent to 7.0% and 7.6% of China's ports in 2021. Moreover, the supply of skilled labour in China matches with the needs in high-end manufacturing, with 19.0% of the working-age population have advanced education (tertiary education to doctoral level) in 2020, higher than 12.5% and 11.7% in Vietnam and India, respectively.

The catch-up from the inland (namely, central and western) regions will generate new growth momentum. For years, the Mainland authorities have supported urbanisation, infrastructure investment, industrial transformation and upgrade in the inland regions, fuelling a faster GDP growth in the central and western regions than that of the eastern region. To narrow economic imbalances, increase productivity growth and unlock development potential in the inland regions, various favourable policies and strategic plans are implemented to foster regional and city cluster development in the inland regions.

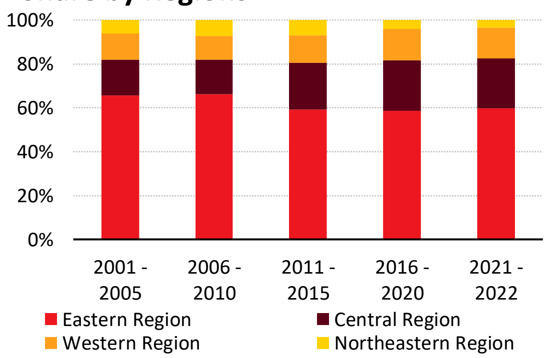
Furthermore, lower costs (labour, land, energy, tax, etc.) attract more industrial enterprises to shift their manufacturing activity from the coastal regions to the inland regions, resulting in a rising share of industrial establishments in the central region (from 16% during 2001 – 2010 to 22% during 2011 – 2020). After decade-long development, industrial clusters are emerging to lift the inland regions' growth potential. Among them, Guizhou stands out as a remarkable front-runner in big data industry. Being one of the most undeveloped regions in the past, Guizhou has transitioned itself into a hub of data centres, with the share of the digital economy accounting for 37% of Guizhou GDP in 2022. Strong growth led to a significant progress in poverty alleviation, with over 9 million of impoverished residents in Guizhou escaping poverty in the past decade.

Regional GDP Growth



Source: CEIC

Number of Industrial Enterprises - Share by Regions



Source: CEIC

*Note:
- Eastern region: Beijing, Tianjin, Hebei, Shanghai, Jiangsu, Zhejiang, Fujian, Shandong, Guangdong, Hainan
- Central region: Shanxi, Anhui, Jiangxi, Henan, Hubei, Hunan
- Western region: Inner Mongolia, Guangxi, Chongqing, Sichuan, Guizhou, Yunnan, Xizang, Shaanxi, Gansu, Qinghai, Ningxia, Xinjiang
- Northeastern region: Liaoning, Jilin and Heilongjiang

In the next decade, China is poised to see ample growth potential. Overall, strong manufacturing prowess, ascending technological capacity, along with rising Chinese brands and a closer integration of regional production network are likely to maintain China's leading position in global trade. Within the nation, a continued rise of middle-class and further development of the inland regions will bolster a steady and sustained growth momentum ahead. China is on its track to double its economic size from 2020 level by 2035.

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