

Chapter 2

THE ECONOMIES OF JAPAN AND KANSAI: RECENT DEVELOPMENTS AND OUTLOOK

Section 1

THE IMPACT OF THE CHINESE ECONOMY: THROUGH DATA OBSERVATION

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1. The Current State of the Chinese Economy

(1) China's Economy Continues to Be in a Recession

China's economy has been in recession since the Corona pandemic, despite the massive economic stimulus taken to boost the economy. Below we review the current economic trends in China based on several indicators.

Figure 2-1-1 shows the evolution of China's industrial production index from January 2017 to May 2024. This is also evident in the sentiment index (Purchasing Manager's Index) shown in Figure 2-1-2.

The current stagnation of the Chinese economy has already been explained in detail in Asia Pacific Institute of Research (2022) (2023)¹⁾. However, as the impact of the Chinese economic slowdown on the Kansai economy has not been sufficiently examined²⁾, in Section 1, we pay particular attention to trends in exports from the Kansai region to China, and carefully examine recent changes in these exports. In addition, we confirm that China's excess production is manifesting in the form of export drives. We also examine the sustainability of the recession in China by introducing the results of an existing questionnaire survey on the current status of Japanese companies operating in China.

1) The Cabinet Office (2023) also provides a comprehensive and detailed outlook.

2) Chapter 2 Column A quantitatively examines the impact of the decline in exports to China on the prefectures in the Kansai region.

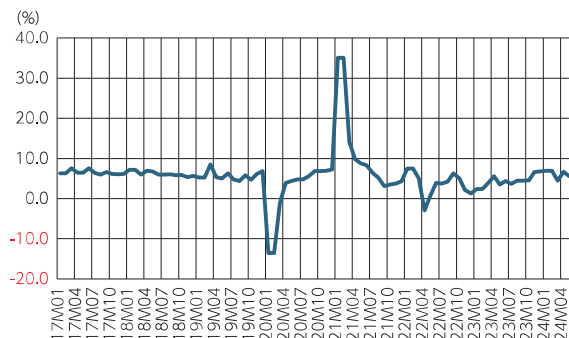


Figure 2-1-1

China's industrial production index: YoY: Jan 2017 - May 2024

Source: Prepared by the author from CEIC

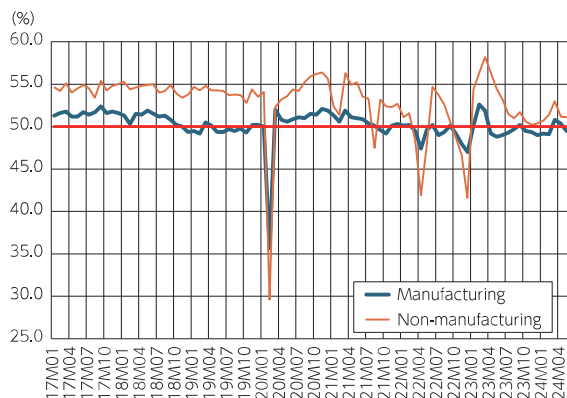


Figure 2-1-2

Purchasing Manager's Index (PMI): Manufacturing and non-manufacturing: Jan 2017 - May 2024

Source: Prepared by the author from CEIC

2. Trends in Chinese Exports

(1) Changes Since the 1990s

In China, which had sustained high growth in the 2000s, a slowdown in growth began to become apparent in the latter half of the 2010s. In these circumstances, how are Japanese exports to China changing over the medium to long term? Below, we first look at the transition of exports to China.

Figure 2-1-3 shows the change in exports to China in the Kansai and Kanto regions from 1988 to 2023. This can be attributed to the fact that China began

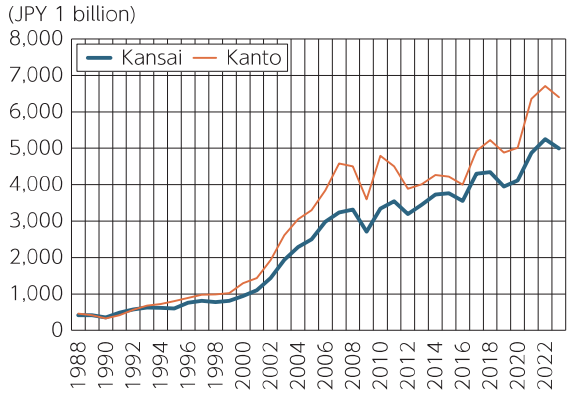


Figure 2-1-3 Changes in exports to China from Kansai and Kanto: 1988-2023

Source: Ministry of Finance, "Trade Statistics"

to expand its trade on a global scale after joining the World Trade Organization (WTO) in 2001. However, the global financial crisis triggered by the collapse of Lehman Brothers in 2008 began to slow export growth, and although there were some signs of recovery from 2017 to 2018, it slowed again from 2018 to 2020³⁾. With the economic stimulus following the Corona pandemic in 2020, exports grew from 2021 to 2022, but then began to decline from 2023 in both the Kansai and Kanto regions.

As described above, since the 2010s, exports to China from the Kansai and Kanto regions have shown a recovery in the short term, but the growth rate has slowed or declined in the medium to long term. This clearly differs from the rapid expansion seen in the 2000s.

(2) Medium- to Long-Term Trends in the Exports of Capital Goods and Intermediate Goods

Here is a breakdown of the export items in the Kansai and Kanto regions.

As can be seen from Table 2-1-1, the share of electrical equipment in Kansai is more than 30% from 2015 to 2023, with a particularly high rate for semiconductors and other electronic components⁴⁾. Kansai's exports have an intermediate goods supply type of export structure⁵⁾.

3) The slowdown in this period is explained in detail in Asia Pacific Institute of Research (2019).

4) Table 2-1-1 is also found in Chapter 1 Section 6.

5) This point is also shown in Asia Pacific Institute of Research (2019).

As Table 2-1-2 shows, the share of general machinery is high in the Kanto region, and the rate of semiconductor production equipment, in particular, has increased significantly from 2015 to 2023. On the other hand, the rate of semiconductors and other electronic components is about 4%, which is considerably lower than that of the Kansai region. Therefore, it can be seen that Kanto's exports have a capital goods supply type of export structure with general

Table 2-1-1

Top 3 export products to China by category: Kansai: 2015 and 2023

Ranking in 2023	Principal Commodity Code	Articles	Export value and share in 2015 (JPY 1 billion, %)		Export value and share in 2023 (JPY 1 billion, %)	
1	'703'	Electrical Machinery	1,364.0	36.2	1,557.3	31.2
	'70323'	Semiconductors, etc.	610.9	16.2	740.9	14.8
	'70303'	Electrical Apparatus	115.6	3.1	204.0	4.1
	'70329'	Condenser	80.5	2.1	136.4	2.7
2	'701'	Machinery	525.6	14.0	1,057.8	21.2
	'70131'	Semicon Machinery, etc.	73.6	2.0	341.8	6.9
	'70101'	Power Generating Machine	31.0	0.8	68.3	1.4
	'70125'	Pump and Centrifuges	35.4	0.9	66.7	1.3
3	'515'	Plastic Materials	205.5	5.5	380.0	7.6
	'51505'	Polyethylene	5.3	0.1	11.4	0.2
	'51503'	Polyvinyl Preparation	11.8	0.3	7.0	0.1
	'51507'	Polystyrene	2.6	0.1	6.1	0.1
Total exports to China			3,764.9	100.0	4,989.8	100.0

Source: Ministry of Finance, "Trade Statistics"

Table 2-1-2

Top 3 export products to China by category: Kanto: 2015 and 2023

Ranking in 2023	Principal Commodity Code	Articles	Export value and share in 2015 (JPY 1 billion, %)		Export value and share in 2023 (JPY 1 billion, %)	
1	'701'	Machinery	918.3	21.8	1,764.1	27.6
	'70131'	Semicon Machinery, etc.	125.5	3.0	754.0	11.8
	'70101'	Power Generating Machine	109.5	2.6	144.3	2.3
	'70125'	Pump and Centrifuges	77.3	1.8	116.8	1.8
2	'703'	Electrical Machinery	974.2	23.1	1,357.0	21.2
	'70323'	Semiconductors, etc.	185.4	4.4	302.8	4.7
	'70327'	Electrical Measuring	107.9	2.6	228.0	3.6
	'70303'	Electrical Apparatus	242.5	5.7	225.9	3.5
3	'901'	Re-export goods	346.9	8.2	630.6	9.9
	Total exports to China		4,219.7	100.0	6,401.5	100.0

Source: Ministry of Finance, "Trade Statistics"

machinery at the core.

Here, it is important that the downturn in the Chinese economy is closely related to trends in private-sector capital investment.

As shown in [Figure 2-1-4](#), private fixed assets in China have been declining since the late 2010s. This is largely due to the disposal of excess machinery and equipment, as well as the curtailment of private-sector facilities in line with structural reforms. Although some recovery was seen from 2017 to 2018, private-sector investment again slowly declined from 2019 and became significantly negative during the Corona pandemic in 2020. Accompanied by economic stimulus to counter the recession, private investment increased rapidly in 2021, but the growth rate has been declining ever since.

These changes must have affected exports of capital goods (e.g. machinery and equipment) from Japan to China. [Figure 2-1-5](#) shows that since the mid-2000s, the growth of capital goods exports from the Kansai region has been slower than that of the Kanto region, and that exports of general machinery to China have been relatively strong in the Kanto region. In the mid-2010s, when the growth of private capital investment in China was slowing down, the growth of capital goods exports to China was sluggish in both Kanto and Kansai. On the other hand, both regions have been on an increasing trend since 2017, but Kanto's exports have begun to decline since 2022. We can see that China's capital stock adjustment has had a relatively stronger impact on exports of capital goods in the Kanto region than in Kansai.

Next, let's look at exports of intermediate goods to China.

As [Figure 2-1-6](#) shows, Kansai's exports of intermediate goods have been on an increasing trend since the 1990s. However, a closer look reveals a decline

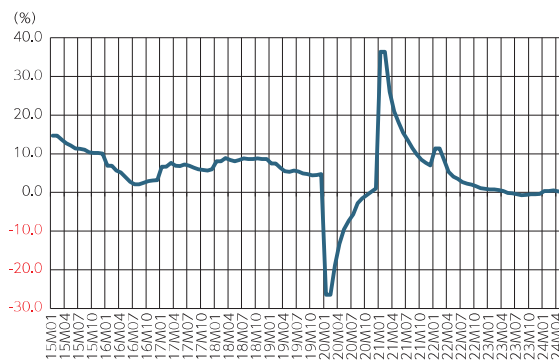


Figure 2-1-4

Cumulative growth rate of private fixed asset investment in China:
Jan 2015 - May 2024

Source: Prepared by the author from the National Bureau of Statistics of China and CEIC

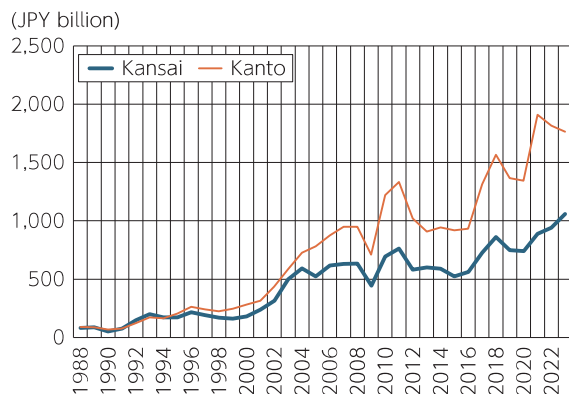


Figure 2-1-5

Changes in machinery exports to China: Kansai and Kanto: 1988-2023

Source: Ministry of Finance, "Trade Statistics"

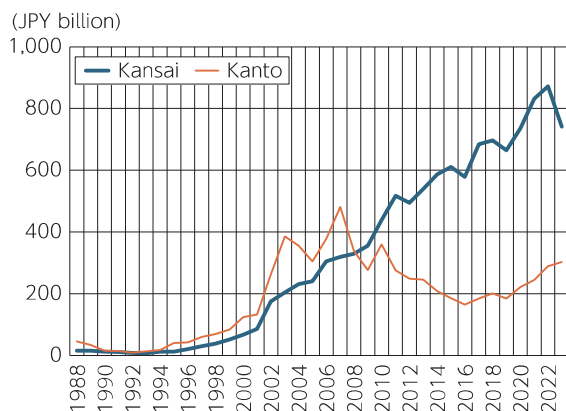


Figure 2-1-6

Changes in the export of semiconductors, etc. to China: Kansai and Kanto: 1988-2023

Source: Ministry of Finance, "Trade Statistics"

from 2018 to 2019 and another decline after 2022. The question of whether or not the current change is a short-term phenomenon is important because it is related to the current economic situation in China. On the other hand, exports of intermediate goods from the Kanto region have been sluggish since the global financial crisis of 2008, and as of 2022, the value of Kanto exports is about one-fourth that of the Kansai region, clearly indicating the relative advantage of the Kansai region in intermediate goods exports to China. In 2023, there was no significant decline in Kanto's exports of intermediate goods to China.

(3) Short-Term Trends in the Exports of Capital Goods and Intermediate Goods

Next, to confirm the impact on China of the current economic slowdown in exports of capital goods and intermediate goods, we look at short-term fluctuations since 2017.

As shown in Figure 2-1-7, exports of capital goods have been sluggish since early 2021 in both the Kanto and Kansai regions. In the Kanto region, however, they began to increase from the beginning of 2024.⁶⁾ As shown in Figure 2-1-8, exports of intermediate goods to China, especially from the Kansai region, show a declining trend from mid-2022.⁷⁾

As pointed out by Asia Pacific Institute of Research (2019), since 2018, trade friction with the United States has been showing signs of intensifying in China, and China's global supply chain had begun to unravel. In other words, as China's exports to the U.S. declined, domestic production of electrical equipment (e.g. smartphones) fell rapidly, resulting in sluggish demand for intermediate goods

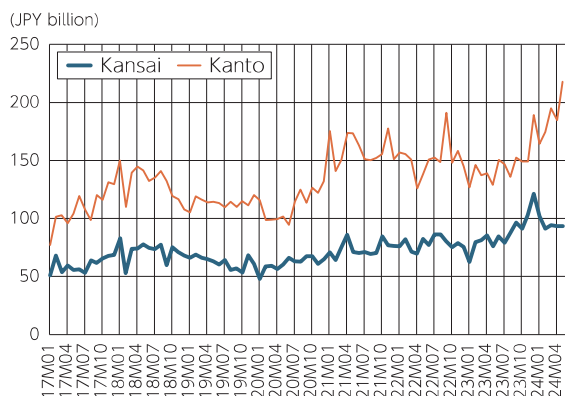


Figure 2-1-7

Changes in machinery exports to China: Kansai and Kanto:
Jan 2017 - May 2024

Source: Ministry of Finance, "Trade Statistics"

- 6) Since Figure 2-1-7 only shows annual data through 2023, we were not able to confirm the current trend from January to May 2024. The recent increase in exports of general machinery is largely due to the remarkable growth in exports of semiconductor electronic manufacturing equipment (7013101). This is due to the fact that semiconductor consumption in China is increasing in favor of domestic production against the backdrop of U.S. restrictions on China, and demand for semiconductor production equipment is expanding.
- 7) Similar to the exports of capital goods in the Kanto region, exports of intermediate goods in the Kansai region have begun to increase from 2024, but it is not yet clear whether or not this trend is sustainable.

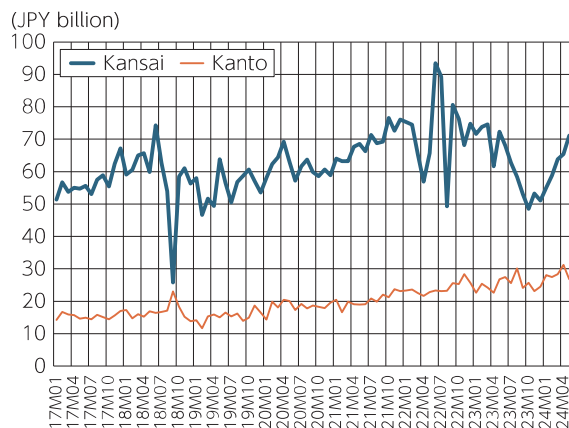


Figure 2-1-8

Changes in exports of semiconductors, etc. to China: Kansai and Kanto: Jan 2017 - May 2024

Source: Ministry of Finance, "Trade Statistics"

(semiconductors), a production factor, and as a result, intermediate goods exports from Kansai to China were stagnant.

As confirmed by China's industrial production index and sentiment-based business confidence index, China's economic trends were gradually becoming apparent from 2021. Based on these macroeconomic conditions in China, exports of intermediate goods in the Kansai region have clearly shown a downward trend since mid-2022, and the value of exports at the end of 2023 had fallen to the level of the beginning of 2017.

As discussed above, the Kansai region has large transactions with China in intermediate goods, particularly semiconductors and other electronic components. The prolonged stagnation of the Chinese economy and the persistence of trade friction with the United States are likely to have a considerable impact on the Kansai economy.

3. Economic Stagnation and the Export Drive Potential

(1) The Current State of Excess Production

China's economy continues to stagnate due to a severe lack of demand, as a result of the decline in consumption and slump in real estate prices following the Corona pandemic. In these circumstances, how have production levels been changing?

Figures 2-1-9 and 2-1-10 show the trends in production capacity, actual production, and excess production (production capacity minus actual production)

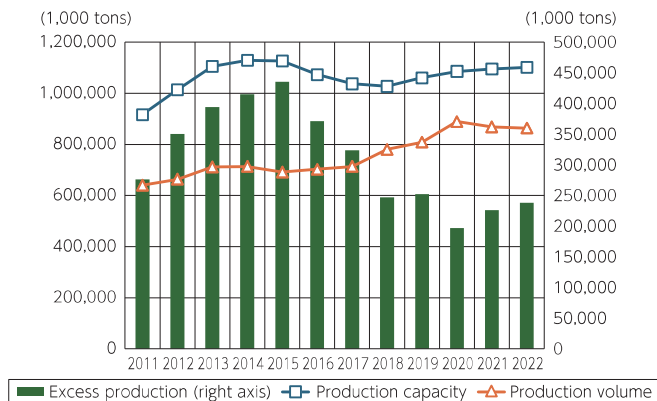


Figure 2-1-9

Changes in excess production of crude steel: 2011 - 22

Source: Prepared by the author from the National Bureau of Statistics of China and CEIC

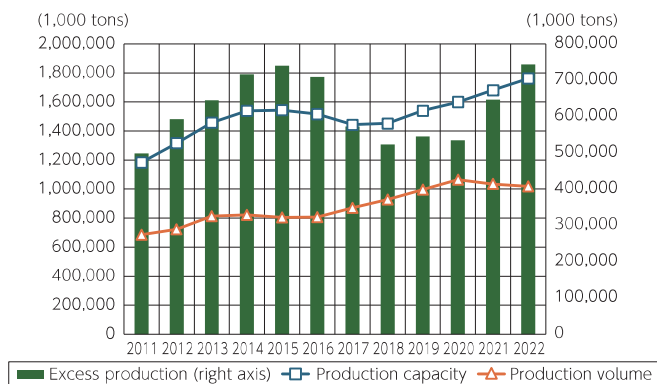


Figure 2-1-10

Changes in excess production of steel products: 2011 - 22

Source: Prepared by the author from the National Bureau of Statistics of China and CEIC

of crude steel and steel products from 2011 to 2022.

Crude steel and steel product production capacity grew from 2011 to 2015. This is largely due to the large-scale economic stimulus measures taken in response to the global financial crisis triggered by the collapse of Lehman Brothers in 2008, particularly with respect to infrastructure facilities. This stimulus package led to a rapid increase in demand for steel and other materials. Reflecting this situation, steel-related production capacity also expanded. In general, when demand in a sector in China grows rapidly, the local government,

in particular, expands investment by providing various subsidies. Such moves tend to be generally larger than the level of demand and can create a situation of excess production.⁸⁾

As shown in Figures 2-1-9 and 2-1-10, excess production increased for both crude steel and steel products from 2011 to 2015. However, this situation has been gradually resolved through capacity adjustments since 2016. However, through the economic stimulus taken in the late 2010s to deal with the recession and the Corona pandemic economic expansion starting in 2020, production capacity is again beginning to expand. Based on the background of stagnant demand after 2020, excess production is expanding as well.

(2) Excess Production and Export Drive

Excess production reflects a lack of domestic demand (consumption and capital investment), which ultimately takes the form of inventories and external demand. When inventories are unintentional, they do not generate immediate profits for the firm. Therefore, a practical solution to the problem of excess production is to seek overseas export sales channels for the excess production.

Generally, during a period of recession in the domestic economy, the demand for overseas sales channels is sought and export pressure increases, a condition known as an “export drive”⁹⁾.

As shown in Figure 2-1-11, excess production and exports have generally followed the same trend, suggesting that an export drive is likely occurring in the steel industry.

In general, under conditions of an export drive, firms will try to increase their overseas sales even at the cost of reducing export prices. In other words, an export drive is a phenomenon of exporting deflation, also known as “deflationary exports.”

As Figure 2-1-12 shows, the export price index has been declining in tandem with the increase in steel exports since 2022, indicating deflationary exports. The important point here is that deflationary exports from China will have no small impact on the global steel market, since China’s crude steel

8) This point is also indicated in Miura (2024).

9) Asako et al. (1993) and Hamaguchi (1990a) (1990b) are the most comprehensive studies on export drives in Japan. Asako et al. (1993) confirm the strong possibility that an “export drive” occurred as a short-term factor in export fluctuations from Japan’s period of rapid economic growth through the 1980s. As pointed out by the Economic Planning Agency (1993), Japan’s export behavior has changed since the 1990s due to the expansion of overseas production bases, and the occurrence of export drive is said to be decreasing.

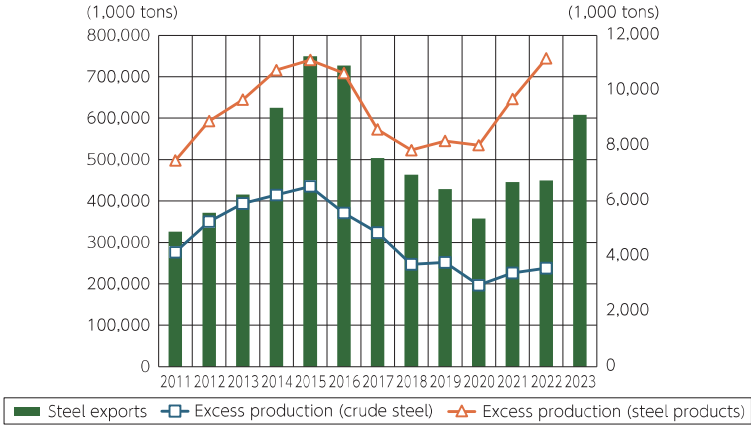


Figure 2-1-11

Changes in excess production of crude steel and steel products and steel exports: 2011 - 23

Source: Prepared by the author from the National Bureau of Statistics of China and CEIC

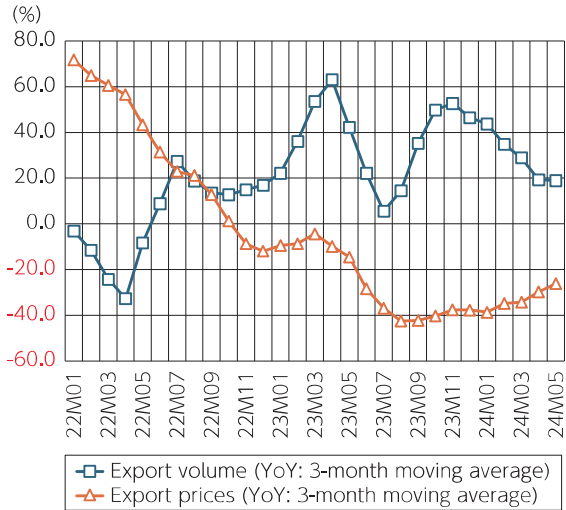


Figure 2-1-12

Volume and export prices of steel products: YoY: Jan 2022 - May 2024

Source: Prepared by the author from the National Bureau of Statistics of China and CEIC

production accounts for about 60% of the world's total.¹⁰⁾

It is also important that steel is not the only industry in China that is in a state of excess production. Examples include electric vehicles (EVs), solar cells, and lithium-ion batteries. These are promising industries and are referred to by the Chinese government as “new quality productive forces.” And even in these industries, deflationary exports are on the rise.¹¹⁾

This situation means that inexpensive Chinese products are dominating the global market, creating a new phenomenon of trade friction. For example, the U.S. and Europe are preparing responses that may include various trade restrictions, and China's economic slowdown is resulting in a further rise in global protectionism.

4. The Current State of Japanese Companies in China

(1) Overview of the “FY2023 Survey on Business Conditions of Japanese Affiliated Companies”

As discussed earlier, the Chinese economy has been in a clear economic slump since around 2021, and we have confirmed from the data that this has had no small impact on exports from Japan. On the other hand, it is difficult to grasp the actual situation of Japanese companies operating in China due to data limitations.

In the following, we examine the current status of Japanese companies operating in China using the existing survey. The two survey investigations are JETRO's “FY2023 Survey on Business Conditions of Japanese Affiliated Companies” and the Japanese Chamber Commerce and Industry in China's the third “Survey of Business Conditions and Perceptions of the Business Environment.” The former survey is representative of trends among Japanese companies operating overseas and is conducted once a year. The latter has been conducted every quarter since October 2023, and provides a better understanding of the current situation.

First, an overview of the results of JETRO's “FY2023 Survey on Business Conditions of Japanese Affiliated Companies” is summarized.

As shown in Figure 2-1-13, the proportion of profitable firms in China as a

10) For example, Nikkei (2024a) points out the impact of deflating steel exports from China on the East Asian steel market. Nikkei (2024b) notes that in response to inexpensive steel products from China, the Japanese are stepping up measures to prevent them from entering their home markets.

11) For example, the price decline for solar cells in the first quarter of 2024 was about 44%, while the decline for lithium-ion batteries was about 30% (see Tsukioka (2024) Charts 3 and 4).

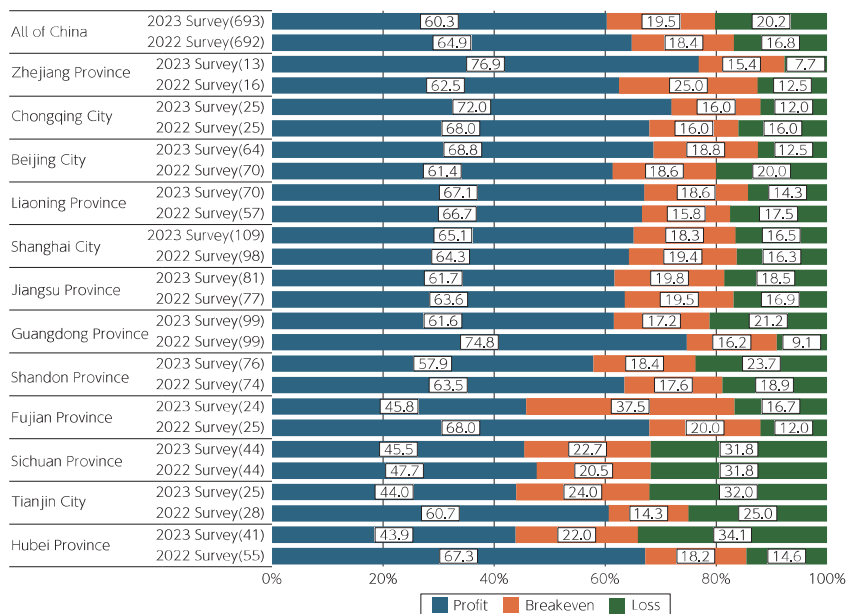


Figure 2-1-13 Operating profit forecast by Chinese province/city for 2023

Source: Adapted from JETRO's "Survey on Business Conditions of Japanese Affiliated Companies: China"

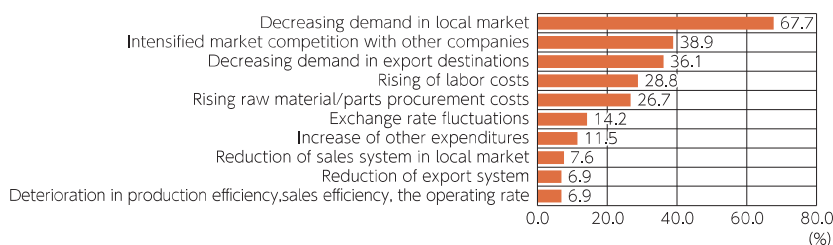


Figure 2-1-14 Reasons for decreased operating profit forecast for 2023 (multiple responses)

Source: Adapted from JETRO's "Survey on Business Conditions of Japanese Affiliated Companies: China"

whole was 60.3%, down 4.6 percentage points from 64.9% in FY2022.

As Figure 2-1-14 indicates, the biggest reason for the deterioration in business performance was "declining demand in the local market," accounting for about 70% of the total. This result clearly shows that the decline in sales due to the economic slowdown has had a direct impact on the performance of Japanese firms.

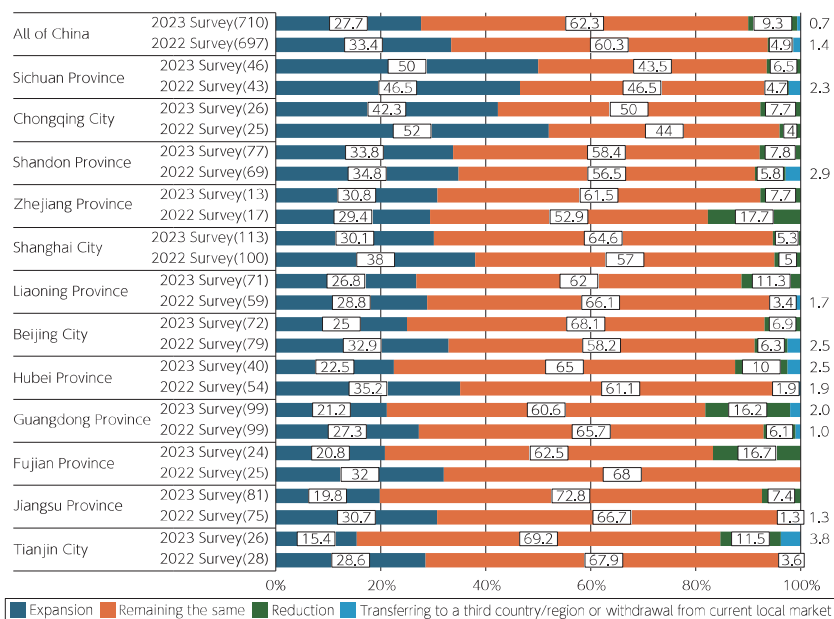


Figure 2-1-15

Future business development by Chinese province/city and company size: YoY

Source: Adapted from JETRO's "Survey on Business Conditions of Japanese Affiliated Companies: China"

Figure 2-1-15 shows that the rate of respondents who answered “expansion” as the direction of business development over the next 1-2 years was 27.7% for China as a whole, a decrease of approximately 6 percentage points from 33.4% in FY2022. On the other hand, the percentage of respondents who answered “maintain the status quo” increased by 2 percentage points YoY, while the percentage of those who answered “downsize” increased by 4.4 percentage points YoY. Faced with declining demand in the market, local firms’ aggressive stance has somewhat receded.

(2) The Third “Survey of Business Conditions and Perceptions of the Business Environment” by the Japanese Chamber Commerce and Industry in China

Next, a summary of the results of the survey conducted by the Japanese Chamber Commerce and Industry in China is presented.

First, as Figure 2-1-16 shows, about 20% of all Chinese respondents answered that business confidence (sales trends) “improved” or “slightly improved” in the first quarter of 2024. This is a decrease of 7 percentage points

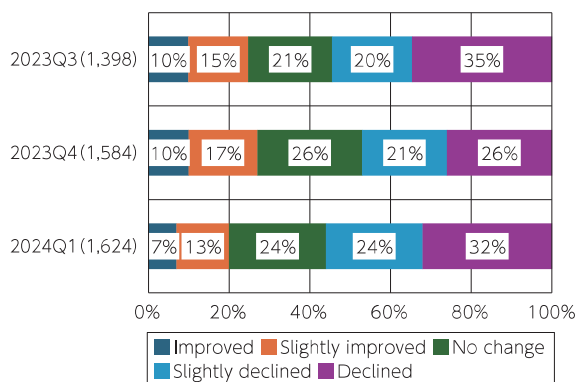


Figure 2-1-16

Business sentiment: Changes in sales: Q3 2023 – Q1 2024

Source: Adapted from the Japanese Chamber Commerce and Industry in China's the third "Survey of Business Conditions and Perceptions of the Business Environment"

from the previous survey (Q4 2023). On the other hand, the rate of respondents who answered that business confidence “declined” increased by 6%, clearly indicating that the percentage of respondents who are pessimistic about the current business sentiment is increasing.

Next, we examine trends in sales price levels in the manufacturing sector as a sign of business confidence. As shown in Figure 2-1-17, the current situation differs by industry.

In the steel and automobile industries, where export drives are increasing, the total rates of “Slightly declined” and “declined” in the first quarter of 2024 increased compared to the previous quarter (Q4 2023). On the other hand, there was no significant decrease in the electrical machinery and chemical industries.

Thus, the perception of the current state of sales prices in the manufacturing industry depends on the industry.

Finally, let's look at future investment trends. As Figure 2-1-18 shows, the rate of respondents who answered “same amount as the previous year” in the first quarter of 2024 was 40%, almost unchanged from the fourth quarter of 2023.

There was no change in the rate of respondents who answered that they would “reduce the amount of investment from the previous year. The results of the questionnaire suggest that Japanese companies in China have not significantly changed their mindset regarding investment decisions based on a medium- to long-term perspective, even though they are currently facing economic stagnation and declining sales.

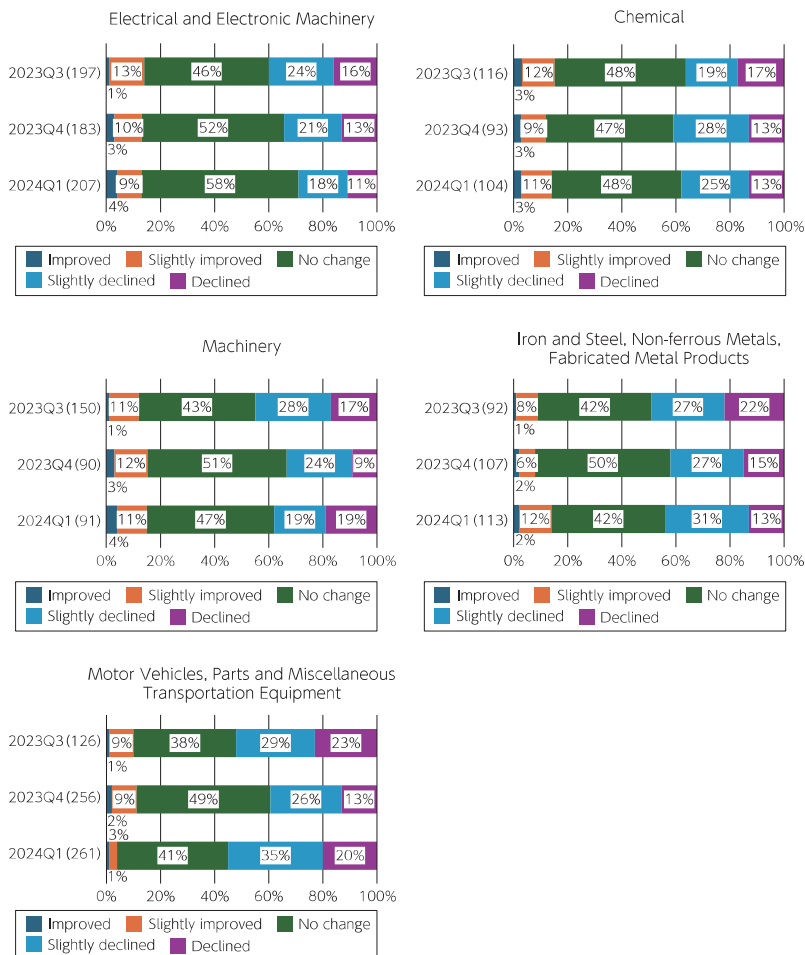


Figure 2-1-17

Business sentiment: Changes in sales price levels: Q3 2023 - Q1 2024

Source: Adapted from the Japanese Chamber Commerce and Industry in China's the third "Survey of Business Conditions and Perceptions of the Business Environment"

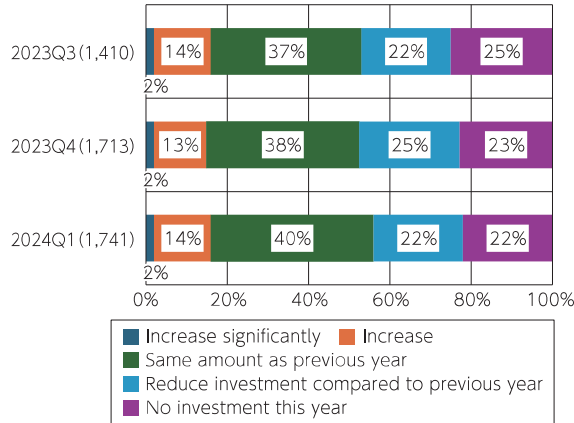


Figure 2-1-18 Forecast of investment amount in 2024

Source: Adapted from the Japanese Chamber Commerce and Industry in China's the third "Survey of Business Conditions and Perceptions of the Business Environment"

5. Summary

In Section 1, we looked at the impact of the recent economic slowdown in China on the Japanese economy, particularly in the Kansai region, mainly from the perspective of trade transactions. In the Kansai region, the production of electrical equipment, including semiconductors and other electronic components, has been an important driving force in the region's economic growth. Therefore, the possibility of a sustained decline in exports of these intermediate goods to China would be a cause for concern.

In addition, the expansion of China's export drive is having ripple effects throughout the world and is likely to exacerbate trade friction even more than it did in the late 2010s, and should be watched closely.

As confirmed by existing surveys, business confidence in China has been deteriorating. However, at present, the decline in local sales prices in China is uneven across industries, and the outlook for future investment has not yet reached the point of a bold reduction in investment. It is thus necessary to calmly judge whether and to what extent the current economic stagnation will be prolonged.

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