

Will the Chinese Supply Chain Shine in the Year of the Tiger?

In the Chinese zodiac, 2022 is the “Year of the Tiger”. In Chinese customs, the tiger is “the King of all animals” and is used as the icon of power and dignity. The tiger has characteristics of being strong, determined, powerful, energetic, and never giving in. Therefore, the Chinese expect the “Year of the Tiger” to have a strong economic outcome. CCA would like to discuss what factors to consider in the Chinese supply chain environment at the beginning of the year.



Source: Zodiac Stamp from China Post for 2022

CCA Newsletter Feb 28, 2022

The CCA Newsletter is summary of articles about the Asia Business environment. This issue is "Will the Chinese Supply Chain Shine in the Year of the Tiger?". Please follow-us on [Linkedin](#) for more.

About China Centric Associates

Since 2003, China Centric has assisted 250+ companies and 30+ Private Equity firms to develop and execute customized regional business strategies in China and Asia. We provide Consulting and Project Management, Outsourced Supply Chain Management and Hosted Facility and Administration.

Learn more at www.chinacentric.com

Your input is valuable to us

China Centric Associates always welcome your contribution of the [questions and feedback](#) to the subject of this newsletter. You are also welcomed to raise [specific topics](#) that you are interested. Our team members will make response to your request in quickest manner.





Staying the Course through the Stormy Sea - 2021 China Export Result

2021 was a very challenging year globally. The Covid-19 pandemic still continues after two years without a foreseeable end. Although many nations developed and launched adaptation strategies, new threats continue to surface and obstruct the possibility of getting back to normal life. China, being the world’s factory, has had many supply chain issues including increasing overseas freight forwarding costs, power crunch, lockdowns according to China’s Covid-Zero Policy, chip shortages, crises from Evergrande default, etc. Nevertheless, China’s total annual exports reached 3.364 Trillion USD in 2021 (a 30% increase from 2.59 Trillion in 2020); of which 576 Billion USD was exported to US ((a 27.5% increase of 452 Billion in 2020). Source General Administrations of Customs China announcement on January 14, 2022). Source General Administrations of Customs China announcement on January 14, 2022).

The total Import/Export performance in 2021 was not a bad year, the expectation of switching the supply base from China to other countries was not as common as expected because many countries had been locked down due to the Covid-19 outbreak and many factories were closed. This created an impact on raw material supplies affected by logistic issues. However, since more and more countries adopted

the philosophy of “Coexist with Coronavirus”, the tables may be turning.

Journey to the New Continent in 2022 – Additional Factors Impact China Supply Chain

Chinese planners are struggling with the nation’s GDP growth momentum slowing down in the last few years. China enjoyed 10% or higher annual GDP growth for more than 30 years since the “Open Door Policy” in 1978. The growth rate lowered to 7-8% from 2012 and further dipped to 6% after 2016. The average GDP growth rate for 2020 and 2021 was only 5.1%. Analysts forecast that China’s 2022 GDP growth may be a “low 5%”. Even so, maintaining 5% GDP growth is a challenging goal.

In addition to commonly mentioned Supply Chain ecology, such as The Sino-US trade relationship, low (China) domestic consuming power, population growth shrinkages, etc., CCA believes the following situations will have a significant impact on China’s supply chain environment:

- Lower import tariffs
- RCEP benefits
- Falling Consumer Index
- PPI-CPI Scissors Gap

Nearly 1,000 Products Import Tariffs Lowered

Since 2022 start, China temporarily lowered 954 product import tariffs including: cancer treatment drugs; products related to Beijing Winter Olympics Games; select lower carbon emission auto parts, etc. In a Finance Ministry Press Conference, it was stated that “The above changes are made to safeguard the stability and security of domestic industrial and supply chain and support the economy’s cross-cyclical stable operation and long-term good momentum.”

In addition, the Chinese authority also indicated that there will be tariff rate adjustments for different products under the RCEP agreement. A more tariff relaxed environment will help China’s supply chain be more competitive because many import products are exported again after value is added within China.

Kicking Off of RCEP and Benefits

The Regional Comprehensive Economic Partnership (RCEP) is composed of countries who are members of the Association of Southeast Asian Nations as well as China, Japan, South Korea, Australia, and New Zealand with the ultimate goal of eliminating tariffs on more than 90% of goods among the member countries. The RCEP came into effect on New Year’s Day 2022.

This agreement is the most extensive free trade agreement in the world (exceeding the United States, Mexico, and Canada’s Free Trade Agreement (USMCA), or the trade volume between member states of the European Union Common Market). RCEP member countries will cover nearly one-third of the world’s GDP (26.2 trillion USD) and population.

With the RCEP in place, China-made products (including foreign-invested companies) can have better penetration to other member countries and have the ability to share part of the added value

process in these countries to be re-import back to China for final integration.

After the RCEP comes into effect, China will actively lead the agreement, which is expected since China has always been the first or second-largest trading partner of most member states in the mechanism. The RCEP will also be the very first time that China, Japan, and South Korea are within the same boundary of regional trade agreement/treaty, which may enhance the bi-territories trade tide between these countries.

Chinese researchers believe China will provide more global goods and services to the market and consumers through the RCEP: “Attract overseas consumption and effectively improve the supply system’s response to domestic demand. Adaptability, activate the huge potential of consumption.” They also comment that RCEP can promote the integration of industrial and supply chains in the region externally, attract foreign investment and talents to continue to develop in China, and promote the transformation and upgrade of China’s manufacturing industry.

Consumer Price Index Fell Back from 15-month High

China's annual inflation (CPI) rate fell to 1.5% (YOY) in December 2021 from a 15-month high of 2.3% (YOY) a month earlier. The total annual result is a CPI increase of 0.9% against 2020, which is much lower than the 3% expected at the beginning of the year. The positive side of these lower annual figures shows that the Chinese economy has strong flexibility, and the state government has very steady control of supply prices. However, the low total figure has rapidly dropped indicating that consumer buying desire has fallen off or suddenly froze. The situation has further worsened by the PPI rising in the last few months simultaneously.

PPI-CPI Scissors Gap Range Narrowed from Double Digits

PPI-CPI Scissors Gap is known as the differences between Producer Price Index (PPI) and Consumer Price Index (CPI) increases. In October 2021, PPI-CPI Scissors Gap reached a historical high of 12%. The monthly gap dropped back to 8.8% in December because of the state authority's continuous efforts. The annual figures of PPI and CPI are 8.1% and 0.9% respectively for 2021.

High PPI increment indicates that the manufacturers are under pressure of increasing the ex-factory price because of increasing critical costs such as raw materials and power utility. On the other side, low CPI growth indicates consumers have less willingness to pay more for products. Large PPI-CPI Scissors Gap indicates that manufacturers need to cut their margin rather than price increase because of less bargaining power in a slow market environment.

In China, the raw materials, commodities, and power utility are controlled by the state-owned enterprises or conglomerations. The manufacturers of the semi-finished goods and final products are mainly SMEs and micro companies. This makes the manufacturers having less bargaining power in raw materials, commodities, and power utility prices. At the end, the manufacturers need to either sacrifice their profits or reduce investment. Both will affect the sustainability of the manufacturers in long run. In the extreme manner, SMEs and micro companies may have to shut down their operations because of the lack of confidence in future profitability. This is why the authorities are looking seriously in the situation and considering interfering with the market.

China published a report issued by State Council stating that the expected annual CPI growth for 2022 will grow to 2.5% and PPI growth will be suppressed to 5%. However, due to the impacts of price increases, the growth of PPI in the first quarter would

still be considered high, while the predicted PPI growth will be down in the 2nd quarter.

CCA Observation and Conclusion

Some of the factors discussed above are not final and still dynamically changing. It is unclear how smooth trade will be since all the member countries of the RCEP just started to open their borders for trade. Similarly, it is difficult to predict how well the Chinese authorities can control the CPI and PPI as planned or expected. CCA will continue to monitor the supply environment and provide updates as we progress through 2022. whenever appropriate.