Future Watch Report

The future of global supply chains: Asia and the World

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Agenda

- Executive summary
- Chapter 1: The current state of supply chains and relevant players in Asia
- Chapter 2: Factors driving changes in supply chains
- Chapter 3: The EU and Asia’s approach to the US-China conflict
- Chapter 4: Future scenarios for global supply chains
- Chapter 5: The Impact on Finnish Businesses
- Appendix: global and Asia Pacific overviews

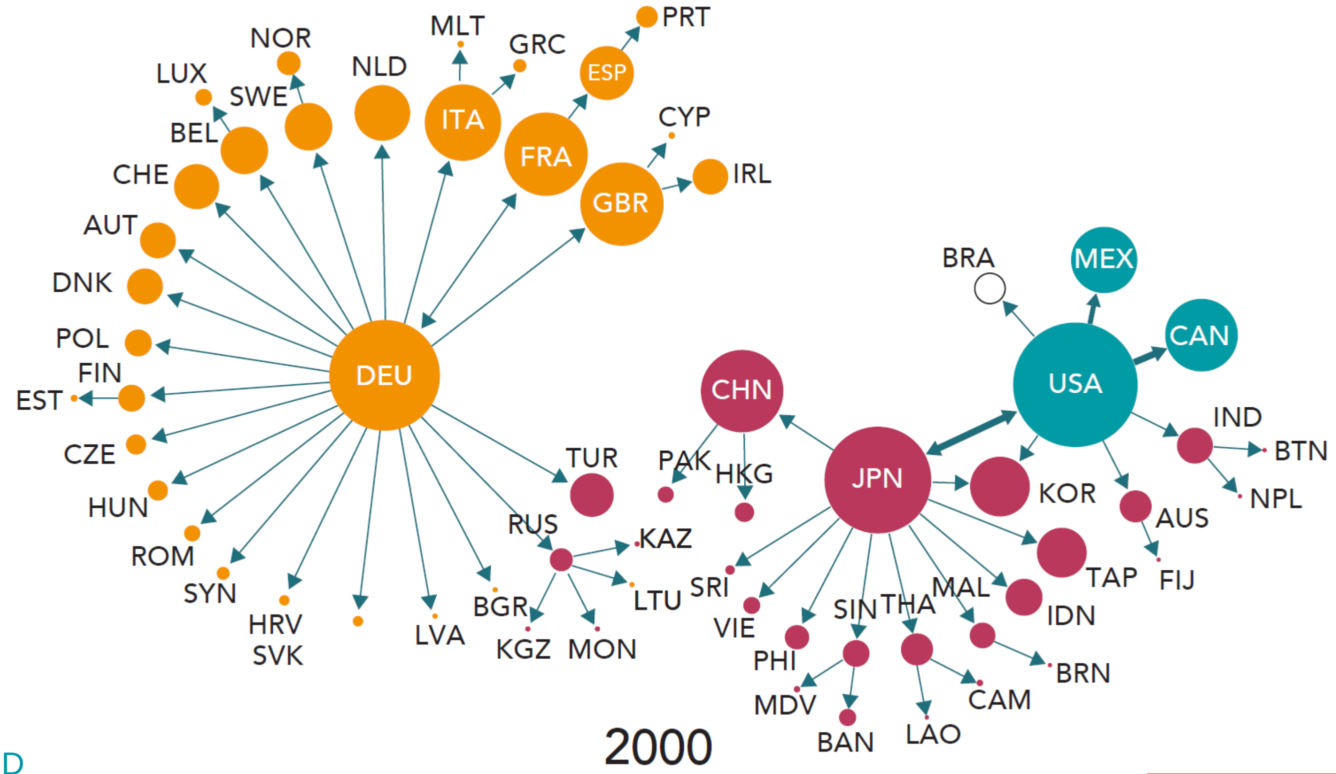
Executive Summary

- International supply chains were transformed from a set of regional systems in 2000 to a China-centred global system by the mid-2010s. In Asia, China is dominant both in size as well as the central hub. Japan and South Korea act as supporting hubs. Vietnam and Malaysia are the rising stars.
- Among the factors driving changes in global supply chains are the rise in production costs in China, automation, geopolitics and natural disasters.
- International views on China are deteriorating. European countries are becoming cohesive in demanding reciprocity in economic ties with China. The “Quad” is raising its profile as the bulwark against China. South-East Asian countries are attempting to remain neutral.
- For the future of supply chain, continued globalisation, bifurcation and localisation are the main scenarios.
- The deteriorating relationship between China and the West presents both opportunities and challenges for Finland. By remaining neutral, Finnish companies may retain access to both markets. Challenges may arise if the EU strengthen restrictions on dual-use technology. The rising tide of data sovereignty may hamper collaboration between Finnish and Chinese software businesses.

Chapter 1: The current state of supply chains and the relevant players

Global trade chain: how the world is connected

Till 2000, Japan and the US were the regional hubs in the Asia-Pacific region

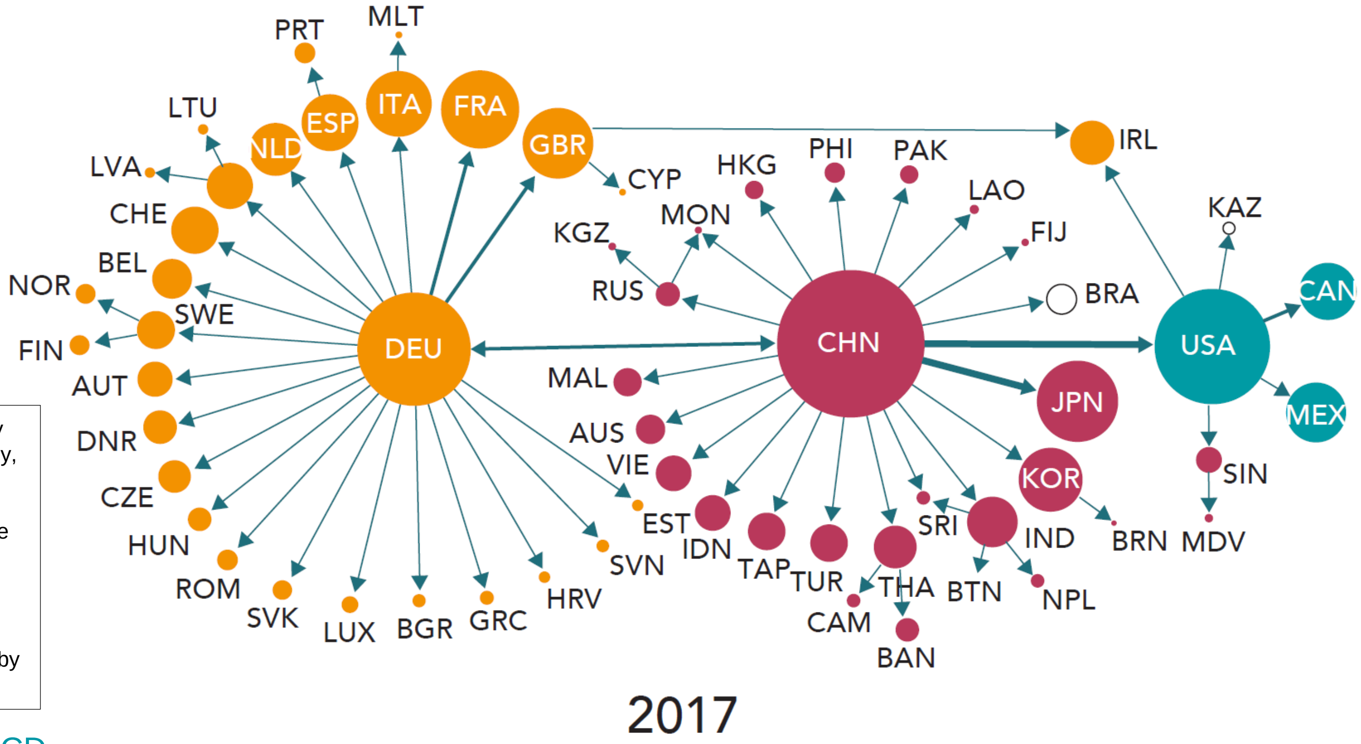


Source: OECD

Note: The origin of each arrow is the biggest trading partner **(in value added terms)** for the country that the arrow points to.

Global trade chain: how the world is connected

By 2017, China has become the global and the regional hub



Note: The country that links Germany, Latvia and Lithuania in the chart is likely to be Poland although we are yet to confirm it with the authors of the original research by OECD.

Source: OECD

Note: The origin of each arrow is the biggest trading partner **(in value added terms)** for the country that the arrow points to.

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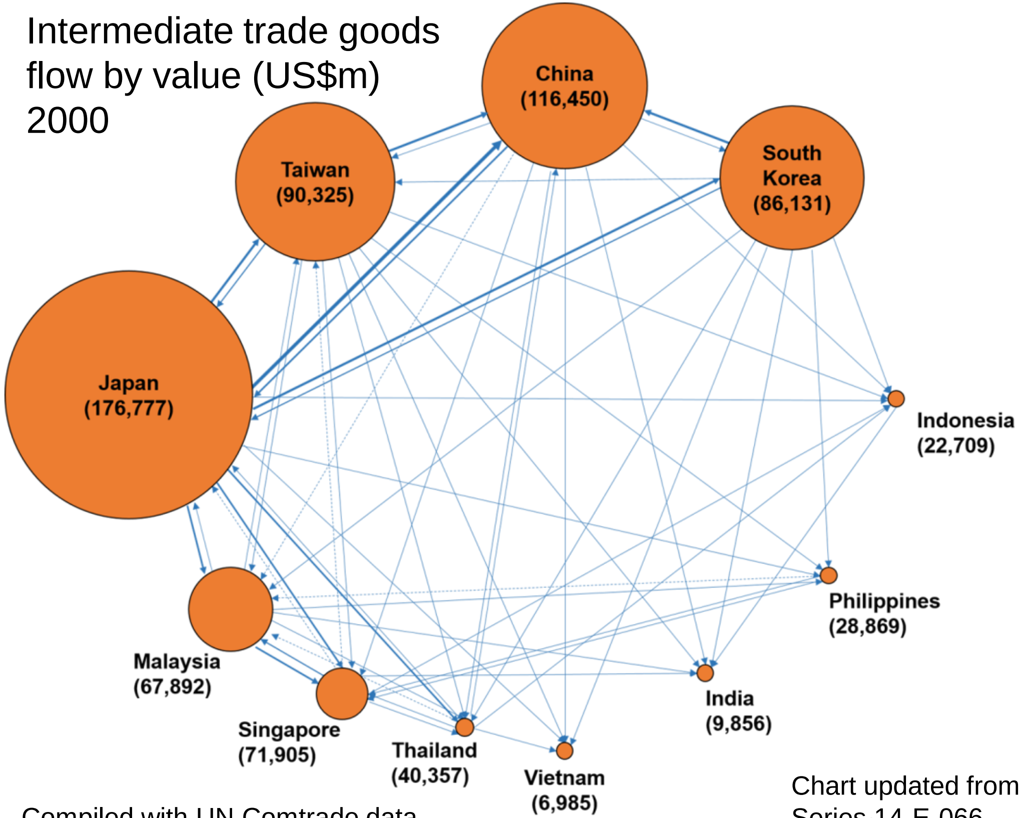
Supply Chain in Asia in 2000

East Asia and South-East Asia trade hubs linked by Japan

Intermediate trade goods flow by value (US$m) 2000



Compiled with UN Comtrade data
Intermediate Trade goods: BEC Classification 22, 42, 53

2000 Trade Flows:

Trade hub of comprising of China, Japan and Korea in East Asia

South-East Asia trade hub of Singapore and Malaysia

Japan acts as the bridge between East Asia and South-East Asia

Note:

- Solid lines are flows where trade value is >5% of the country's trade flow, representing a major trade partner and link
- Width of lines represent value of trade (Thicker lines = Higher value of goods flow)
- Arrowhead denotes direction of trade flow
- Dotted lines represent trade value of ~5%
- Trade flows that are less than 2% are not represented

Chart updated from RIETI Discussion Paper Series 14-E-066,
Authors: Fujita Masahisa, Hamaguchi Nobuaki

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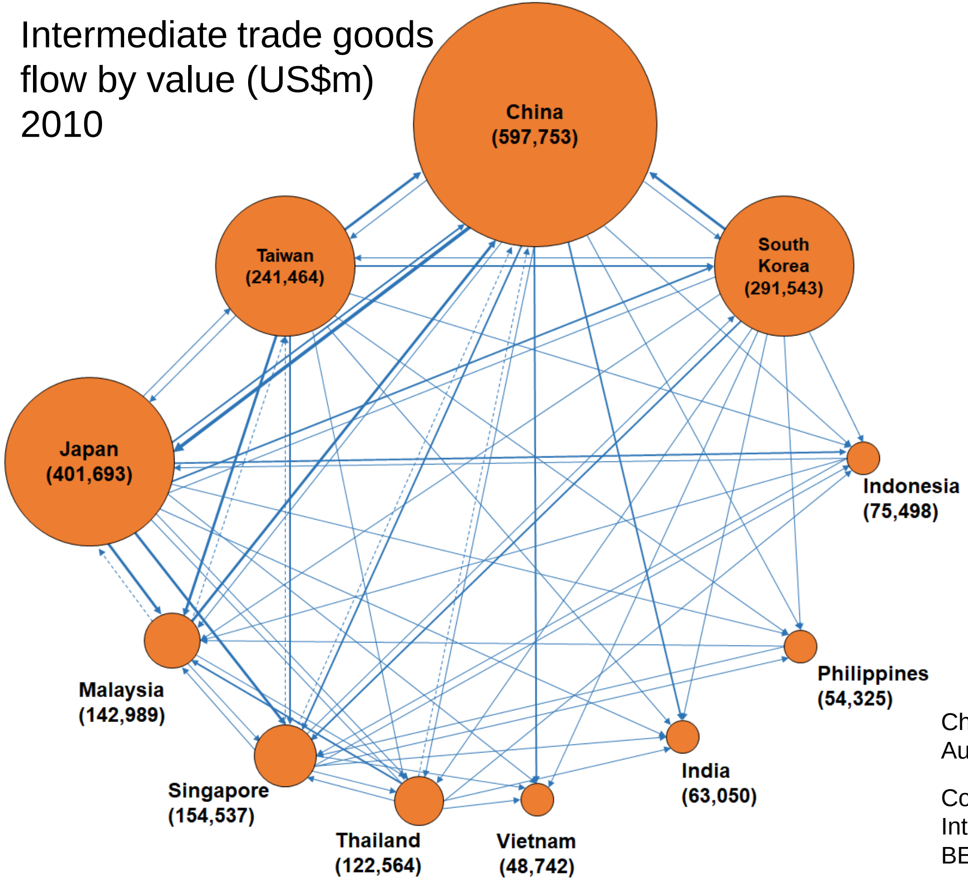
Supply Chain in Asia in 2010

Diversified SEA trade, and Chinese expansion into South East Asia

Intermediate trade goods flow by value (US$m) 2010



2010 Trade Flows:

East Asia trade hub grows, and China swells be the clear dominant player for Asia

China starts to form links directly with South-East Asia and India

Diversified inter-SEA trade as SEA nations form many linkages within the region with each other

Chart updated from RIETI Discussion Paper Series 14-E-066, Authors: Fujita Masahisa, Hamaguchi Nobuaki

Compiled with UN Comtrade data
Intermediate Trade goods:
BEC Classification 22, 42, 53

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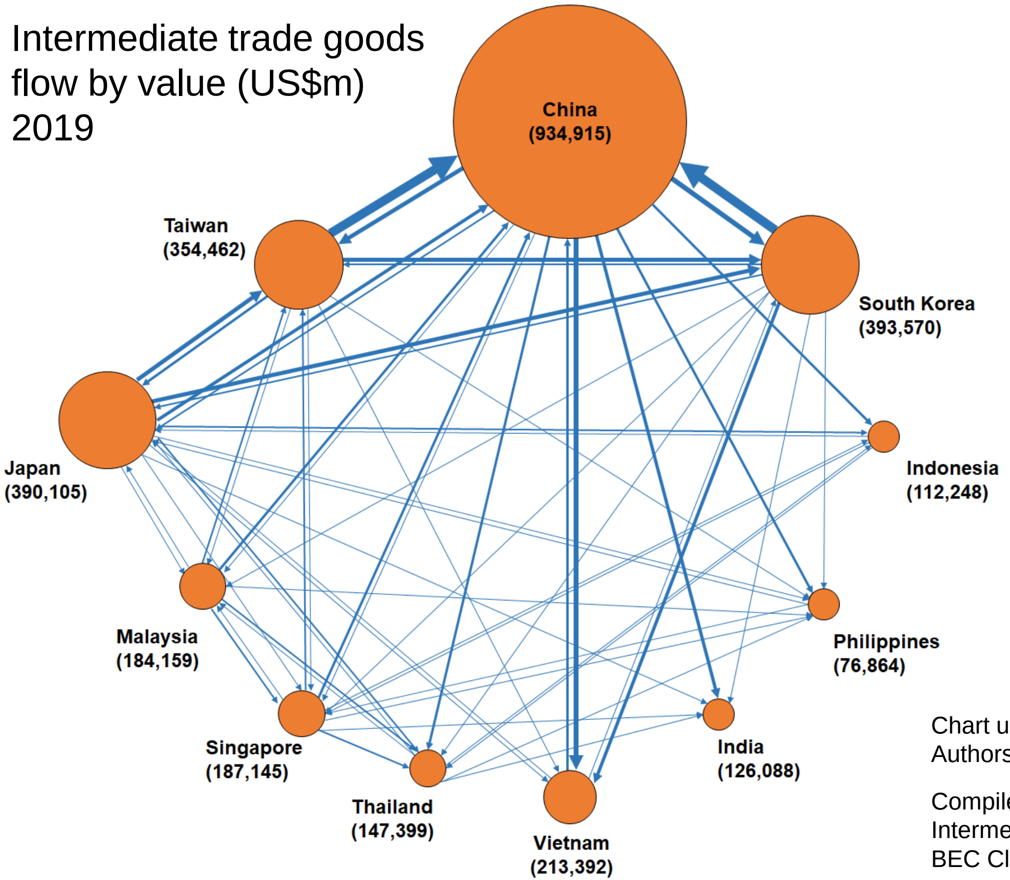
Asian Supply Chain (2019)

China solidify its links to SEA to solidify hub and spoke system in Asia

Intermediate trade goods flow by value (US$m) 2019



2019 Trade Flows:

South Korea eclipses Japan as 2nd largest hub

Vietnam becomes an important supply-chain player in the region

India lags behind Vietnam

Important new South Korea-Vietnam link

As bilateral trade between SEA and China grows, inter-SEA trade linkages declines in relative importance

Chart updated from RIETI Discussion Paper Series 14-E-066, Authors: Fujita Masahisa, Hamaguchi Nobuaki

Compiled with UN Comtrade data
Intermediate Trade goods:
BEC Classification 22, 42, 53

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China's goal: maintain its role as a global supply hub

Worsening ties with the West threaten decoupling and risk bifurcation

China, already the central player in the global supply chain, will be hard to dislodge

CHINA: COUNTRY FACTSHEET	
Population:	1.4bn
Population growth:	0.30%
GDP (PPP$):	24.1trn
GDP per head (US$ at PPP):	17,250
Exports (US$):	2.45trn Partners: US (16.7%), HK (11.1%), Japan (5.7%), South Korea (4.4%)
Primary exports:	Telecommunications equipment (14.6%), Electrical machinery (13.7%), Office machines (8.9%), Clothing & apparel (6.4%)
Imports (US$):	2.03trn Partners: South Korea (8.4%), Taiwan (8.4%), Japan (8.2%), US (5.9%)
Primary imports:	Electrical machinery (25.2%), Petroleum & petroleum products (16.2%), Metalliferous ores & scrap (8.3%), Professional instruments (4.3%)

Investments continue to drive Chinese manufacturing:
Industrial and investment activity expanded by 6.9% in September 2020, led by growth in electrical machinery and equipment, and automobiles manufacturing

Chasing self-sufficiency and domestic innovation:
The 14th Five-Year Plan placed importance on advancing Chinese technological capabilities, owing to US restrictions on critical tech exports

National security:
Foreign competition in the ICT sector will be limited by protectionist policies under the guise of national security. Integration between tech developed domestically and abroad will be disrupted

Spheres of digital influence:
China risks digital isolation with a separate standards ecosystem, potentially presenting a waning of globalisation

Note: Import / export values are 2020 est., primary imports / exports and partners are based on 2019 data, Source: EIU

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India: an alternative for China in the long term

In the short-term, weak infrastructure makes the country an unappealing location

A diverse business landscape, skilled workforce and huge domestic market

INDIA: COUNTRY FACTSHEET	
Population:	1.4bn
Population growth:	1.00%
GDP (PPP$):	8.7trn
GDP per head (US$ at PPP):	6,300
Exports (US$):	277bn Partners: US (16.4%), UAE (9.1%), China (5.2%), Hong Kong (3.6%)
Primary exports:	Engineering goods (24.2%), Gems & jewellery (14.6%), Petroleum & petroleum products (12.8%), Agriculture (10.4%)
Imports (US$):	383bn Partners: China (13.6%), US (6.9%), UAE (6.0%), Saudi Arabia (5.4%)
Primary imports:	Petroleum & petroleum products (24.9%), Electronic goods (10.4%), Gold & sliver (8.3%), Machinery (8.1%)

Tensions with China:
Foreign policy and trade related challenges lie ahead

Sectoral advantages:
India has the world's third-largest Pharma industry by volume, 13th largest by value. It provides 62% of global vaccine supply, and is the largest supplier of generic drugs to the global manufacturing industry

Challenges:
Poor infrastructure and complex government regulations (some variance between central and state jurisdictions)

Upsides:
Skilled workforce, growing middle class

New fiscal stimulus:
US$35.2bn package aims to attract FDI and job creation

Note: Import / export values are 2020 est., primary imports / exports and partners are based on 2019 data, Source: EIU

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Indonesia: great potential, yet unfulfilled

Underdeveloped infrastructure hampers productivity and efficiency of supply chain

Annual forecast average growth 5.8% after the pandemic is below potential of economy

INDONESIA: COUNTRY FACTSHEET	
Population:	267m
Population growth:	0.90%
GDP (PPP$):	3.3trn
GDP per head (US$ at PPP):	12,220
Exports (US$):	148bn Partners: China (16.6%), US (10.5%), Japan (9.5%), Singapore (7.7%)
Primary exports:	Manufactured goods (73.5%), Mining products (20.3%), Agricultural products (4.3%), Unclassified exports (1.9%)
Imports (US$):	137bn Partners: China (26.2%), Singapore (10.1%), Japan (9.1%), Thailand (5.5%)
Primary imports:	Raw or auxiliary materials (65.4%), Capital goods (16.7%), Consumer goods (16.7%), Unclassified imports (1.2%)

Omnibus reform not as good as it looks:
Many of the new rules, including openness to foreign, have yet to be finalised by central and local governments and will face pushbacks in implementation

Corruption and thick bureaucracy impede effective governance and policymaking, creating a poor business environment

Fragmented politics:
Major provinces defied a government circular on freezing the minimum wage, raising wages by 2-5%, although Western Java, an industrial powerhouse, complied

Ongoing infrastructure developments delayed:
Construction of a high-speed railway, seaports, toll roads and coastal barriers are delayed as funds are diverted to fighting the pandemic

Note: Import / export values are 2020 est., primary imports / exports and partners are based on 2019 data, Source: EIU

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Vietnam: a winner from the diversification drive

The government to focus on economic liberalisation, incentivising FDI

Omnidirectional foreign policy will see deepening ties with the US and other regional powers

VIETNAM: COUNTRY FACTSHEET	
Population:	97.3m
Population growth:	0.90%
GDP (PPP$):	1.1trn
GDP per head (US$ at PPP):	10,800
Exports (US$):	275bn Partners: US (23.6%), China (16.0%), Japan (7.8%), South Korea (7.6%)
Primary exports:	Telephones & mobile phones (19.9%), Textiles & garments (12.3%), Computers & electronics (13.8%), Footwear (6.8%)
Imports (US$):	252bn Partners: China (30.3%), South Korea (18.9%), Japan (7.8%), Taiwan (6.1%)
Primary imports:	Computers & electronic parts (22.3%), Machinery, equipment & tools (15.0%), Telephones & mobile phones parts (6.5%), Fabrics (5.1%)

Gains in share of international production
Foreign-invested production of electronics, machinery and footwear will benefit from rising labour costs and polarisation in China

Reliance on labour to increase:
Expansion in export-oriented manufacturing. However, this will remain highly labour intensive, limiting growth in value added to exports. Lack of upstream and downstream industrial linkages

Recession avoided:
3.1% GDP growth reported, despite most regional economies going into the red. Real GDP growth will normalise in 2021-23 owing to a reliance on external demand

Note: Import / export values are 2020 est., primary imports / exports and partners are based on 2019 data, Source: EIU

Malaysia: an appealing relocation candidate

Political risk high with change in government on the horizon

Some stability with the 12th Malaysia Plan (2021-25) to be implemented

MALAYSIA: COUNTRY FACTSHEET	
Population:	32.4m
Population growth:	1.30%
GDP (PPP$):	871bn
GDP per head (US$ at PPP):	26,920
Exports (US$):	206bn Partners: China (14.1%), Singapore (13.9%), US (9.7%), HK (6.7%)
Primary exports:	Machinery & transport equipment (42.3%), Mineral fuels (13.4%), Manufactured goods (9.3%), Chemicals (8.9%)
Imports (US$):	177bn Partners: China (20.7%), Singapore (10.5%), US (8.1%), Japan (7.5%)
Primary imports:	Machinery & transport equipment (38.6%), Mineral fuels (11.4%), Manufactured goods (10.1%), Chemicals (11.0%)

Political instability:
The next election (not due until 2023, but may be called early) is likely to deliver Malaysia's third transition of power in less than three years, hampering effective governance

A good alternative:
The country is an attractive potential production location for diversification from China

Existing supply chain hubs in Penang and Kuala Lumpur are drawing FDI to the electronics and semiconductor sectors. Malaysia is the third-largest auto manufacturer in South-East Asia

Diversification:
The 12th Malaysia Plan will bring about less reliance on oil & gas, and promote domestic tourism and a reform of a government aid programme, the BSH

Note: Import / export values are 2020 est., primary imports / exports and partners are based on 2019 data, Source: EIU

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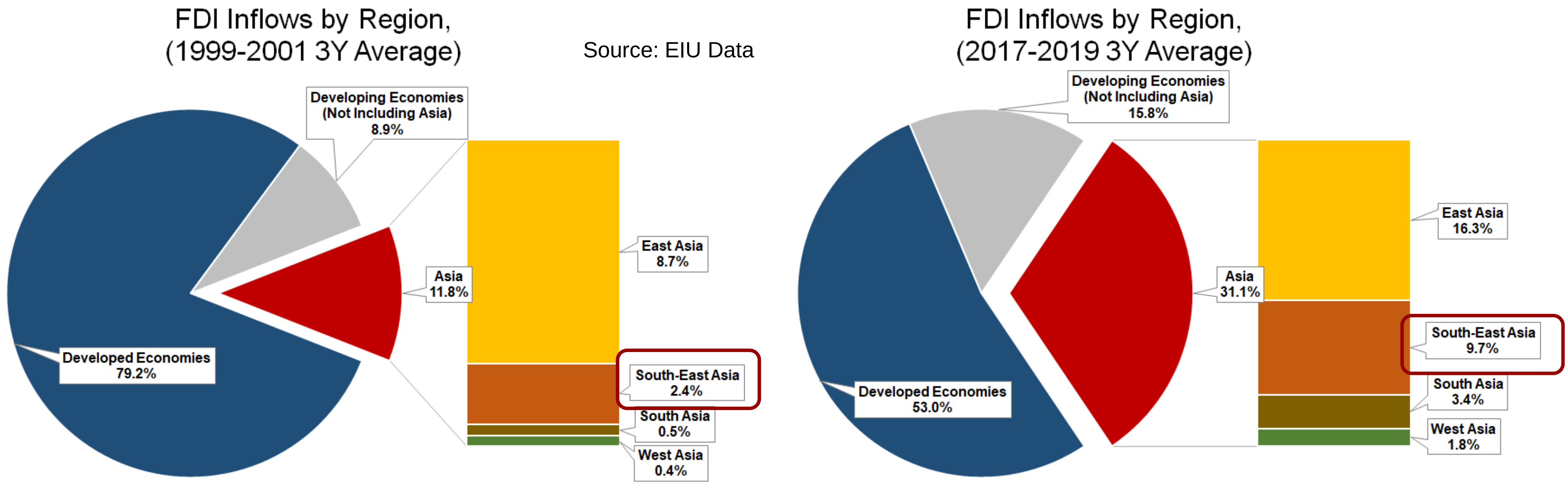
Emerging Asia receiving lion's share of global FDI

Importance of South-East Asia has risen over 20 years

Source: EIU Data



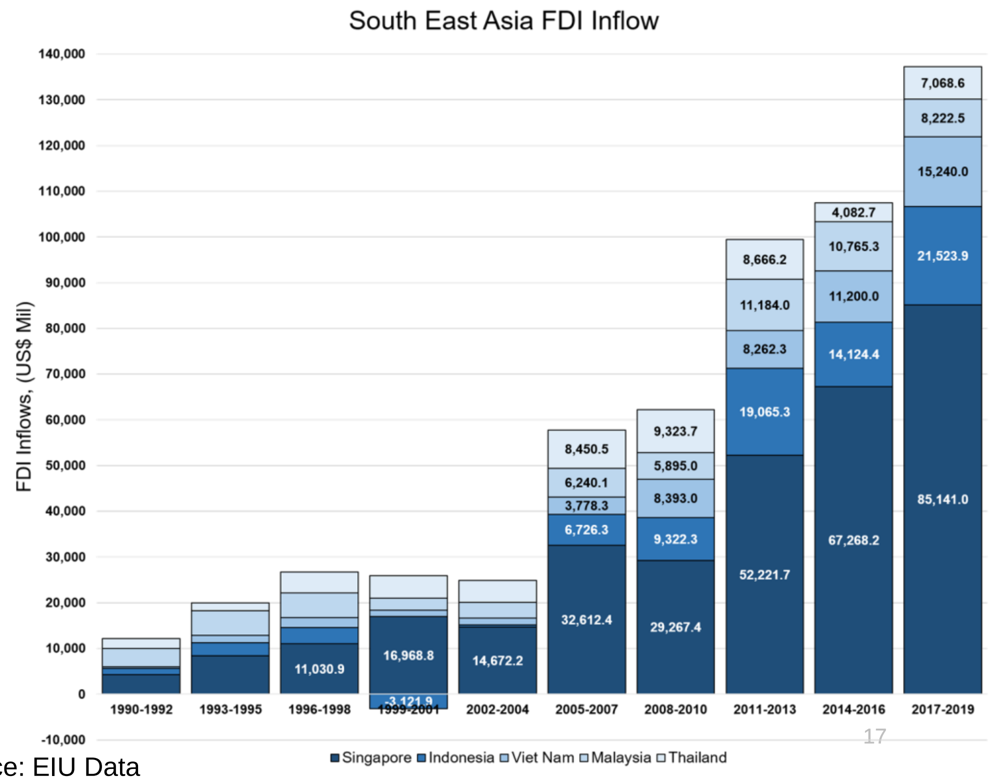
Note on Asia country groupings:
East Asia: China, Hong Kong, Macao, South Korea, North Korea, Mongolia, Taiwan
South-East Asia: Brunei, Cambodia, Indonesia, Laos, Malaysia, Myanmar, Philippines, Singapore, Thailand, Timor-Leste, Vietnam
South Asia: Afghanistan, Bangladesh, Bhutan, India, Iran, Maldives, Nepal, Pakistan, Sri Lanka
West Asia: Bahrain, Iraq, Jordan, Kuwait, Lebanon, Oman, Qatar, Saudi Arabia, Palestine, Syrah, Turkey, UAE, Yemen

Source: UNCATD

How does Covid-19 affect FDI flows?

Uncertainty from pandemic and weak prospects stifle investments

High upfront costs and a narrow window for exit add to risk and unwillingness to invest



Source: EIU Data

Assessing the damage:
The worst-hit industries are also those that serve as essential vehicles for FDI (such as airlines, retail and hospitality)

Opportunities:
Digital service providers see demand rising as containment measures continue.

Pharma, biotech and medical manufacturers benefit from the global demand surge for PPE

Risks:
Lack of capacity for service providers.
Medical industry closed off from foreign investors, and regulation increased

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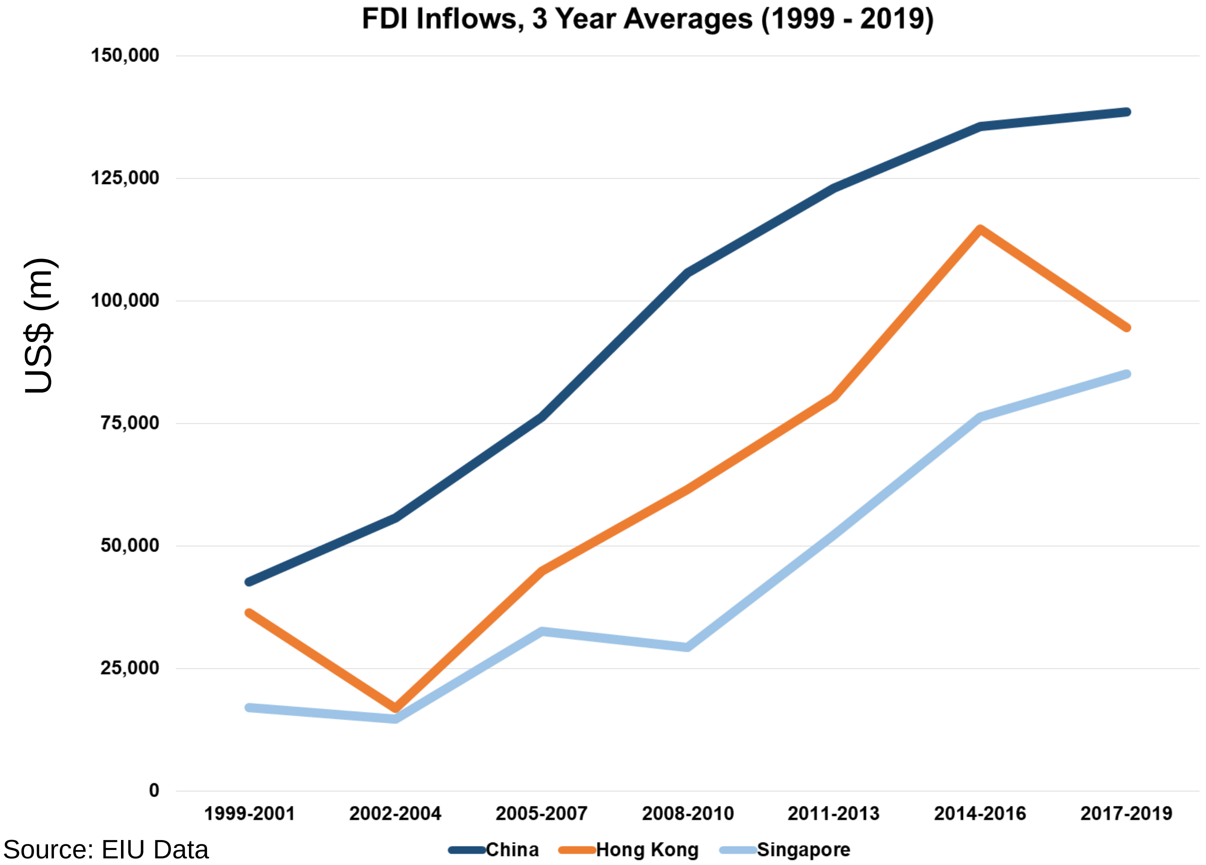
FDI inflows to Asia's developed-market economies

FDI growth slows in China and Singapore, and shrinks in Hong Kong



Source: EIU Data

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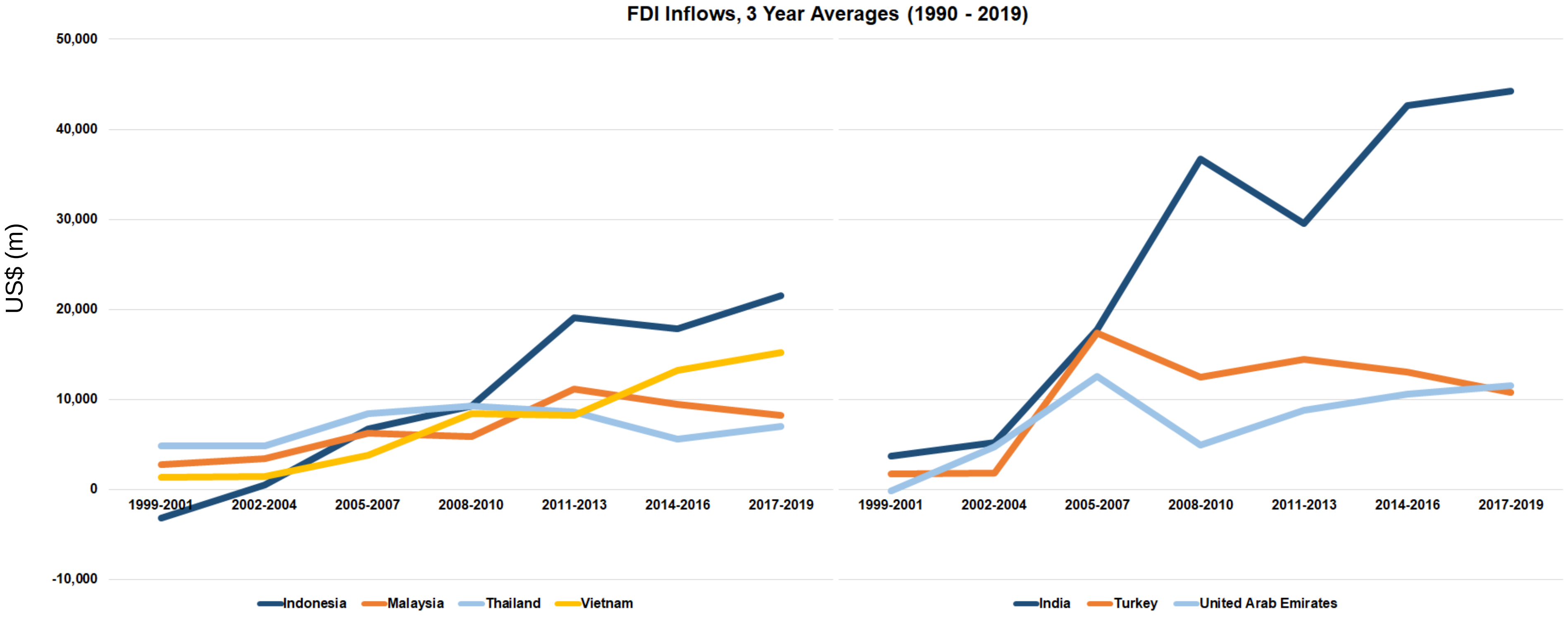
FDI inflows to Asia's emerging-market economies

India, Indonesia and Vietnam see the bulk of FDI, investments continue to grow



Source: EIU Data

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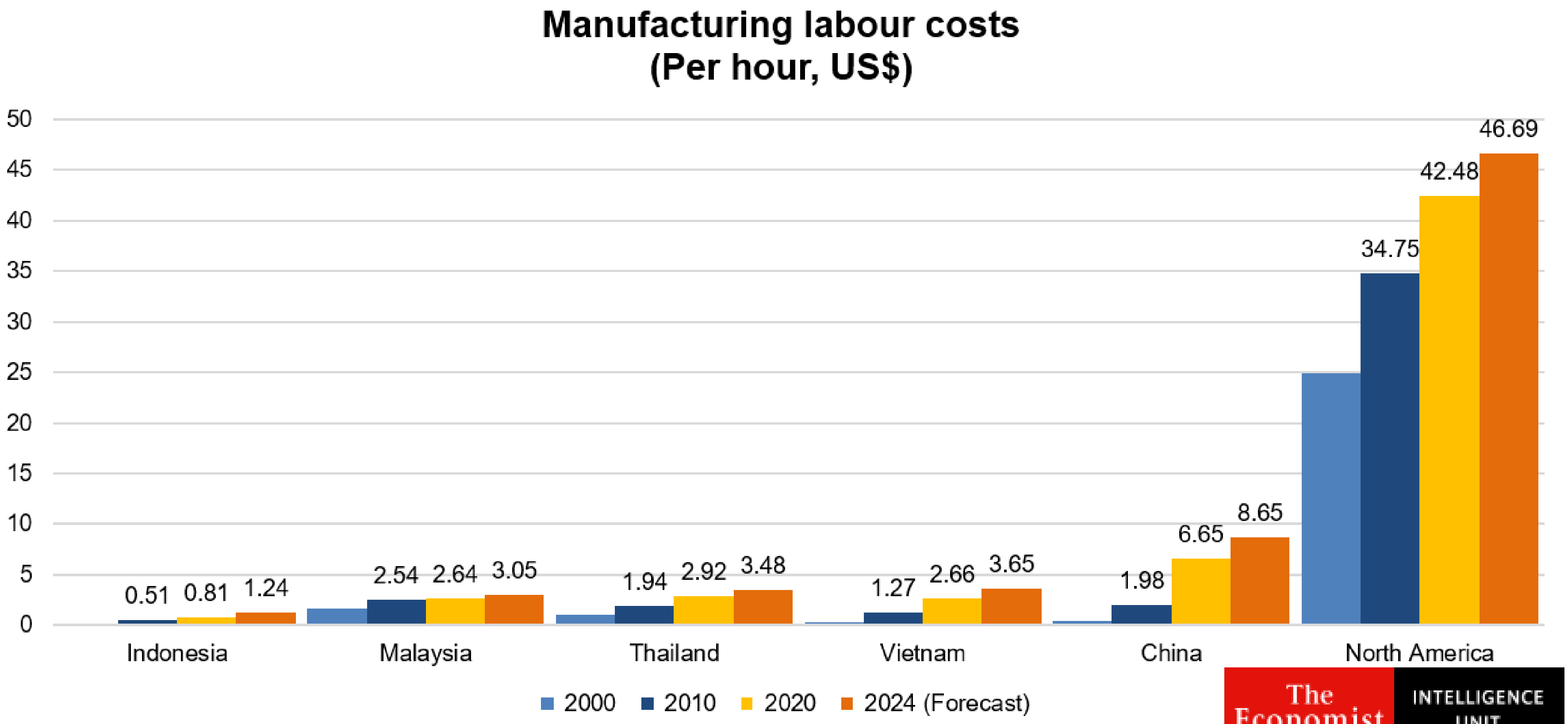
Chapter 2: Changes in supply chains

2.1: Rising production costs in China and The Rise of Automation

The rising cost of production in China

Labour costs in emerging Asia are lower than in China



Source: EIU Data

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Trade and supply-chain diversification

Malaysia, Thailand, Vietnam and Indonesia are lower cost alternatives to China

But investment shifts are unlikely to take hold for another 2-3 years due to Covid-19

Some Asian economies will benefit more quickly from supply chain shifts than others

(score out of 10 in The EIU's Business Environment Rankings)

	Political effectiveness	FDI policy	Foreign trade & exchange controls	Labour market	Infrastructure	Technological readiness	Average
Singapore	9.4	10	10	7.1	8.8	9.7	8.58
Taiwan	7.8	8.2	8.2	7.1	7.5	9.4	7.88
South Korea	8.1	6.9	8.2	6.1	7.8	9.4	7.63
Japan	8.1	6.4	7.8	6.9	8.3	9.4	7.37
Malaysia	6.1	7.3	8.2	6.8	6.5	7.8	7.19
Thailand	5.5	6.9	8.2	6.5	5.8	6.3	6.74
China	4.9	6	6.4	6.2	6.8	7.5	6.3
Vietnam	4.9	6	7.8	6.3	4.5	5.5	6.15
Indonesia	4.5	5.1	7.3	5.3	4.5	5.2	5.95
India	4.5	6	6.4	5.5	5.5	6.3	5.89
Philippines	3.6	6	7.8	6.2	4.3	5.8	5.87
Bangladesh	4.2	5.1	6.4	5.7	4.5	3.5	5.23
Sri Lanka	3.9	6	6	6.2	4.5	4.9	5.08
Pakistan	3.9	6	5.5	5.7	5	3.5	4.94

Note. Scores cover the forecast period of 2021-25.

Source: The Economist Intelligence Unit, Business Environment Rankings.

Turning away from China:
Distribution firms are identifying cost inefficiencies and re-negotiating on contracts as decoupling from China continues

Emerging ASEAN countries with good labour market and infrastructure are better positioned to receive diversification flows from China

Long-term goals of supply chains:
Digitalisation, and focusing on national and regional production to improve self-reliance and security

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Asian winners of the US-China trade war

ASEAN nations will benefit from relocation of supply facilities from China

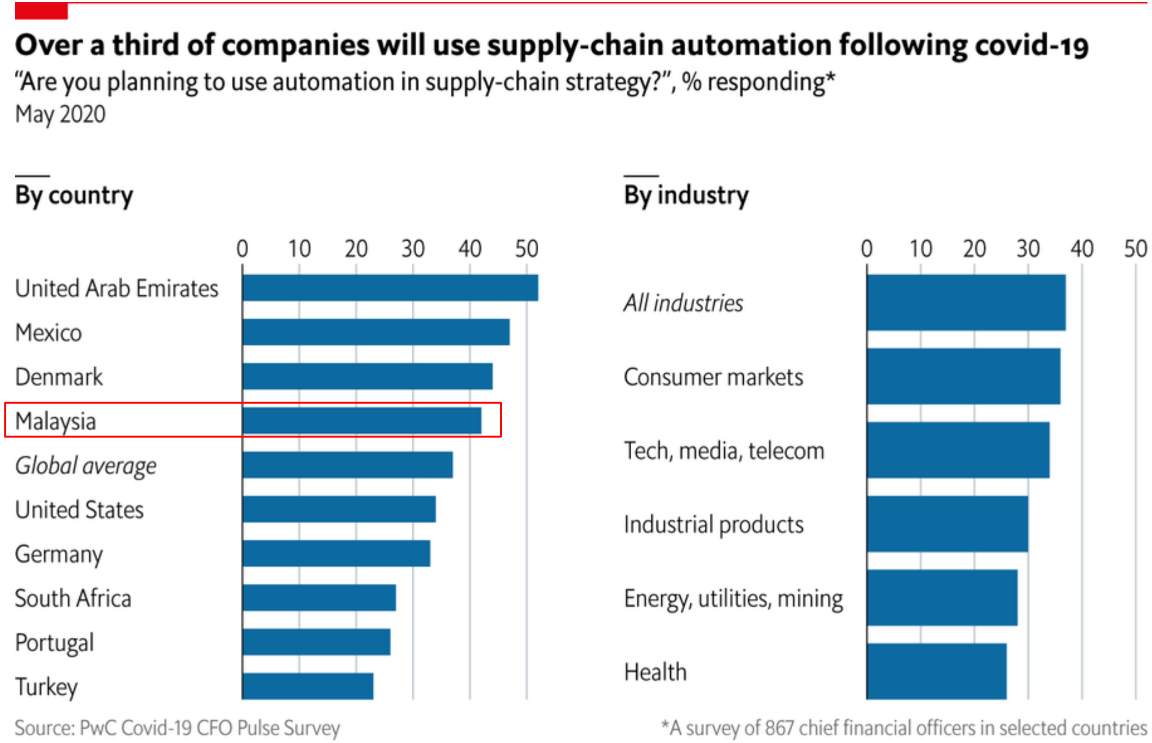
	Strong benefits	Mild benefits	Disruption
Information and communications technology	Taiwan	India	Japan
	Vietnam	Indonesia	Singapore
		Thailand	South Korea
		Malaysia	
		Philippines	
Automotive	Thailand	India	Japan
	Malaysia	Indonesia	South Korea
		Philippines	Taiwan
		Vietnam	Singapore

Source: EIU Country Reports

The next wave of tech adoption in supply chains

Enthusiasm for tech has increased amid Covid-driven disruption

Expect to see more sensor-laden factories, autonomous robotics and digitalisation of workflow



Covid-19 as an accelerator of digitalisation:
A survey of 825 business executives* worldwide saw 82% of organisations increase IoT investment

Driven by AI:
Fully connected data networks and AI unleashes the value of collected data, allowing for more accurate and timely forecasts and pattern detection

Security and data privacy concerns:
Adoption held back by concerns, but less so in consumer goods and retail

*Survey Source: The IOT Business Index 2020 by EIU

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2.2: The US-China conflict

A timeline of the US-China Conflict

2000-20

2000-01: US-China Relations Act of 2000 **normalises trade relations** and paves the way for China to join the WTO

2007-08: China **increases military spending**, by an average of 15% a year from 1990-2005. China becomes the **largest US foreign creditor** at ~US$600bn

2010: China becomes the **world's second-largest economy,** valued at US$1.33trn, overtaking Japan. (It is set to overtake the US by 2027.)

2011: The US secretary of state, Hillary Clinton, outlines a **US pivot to Asia**, calling for increased US presence in the APAC region **to counter China's growing clout.**

2012: Rising trade tension as the **US trade deficit with China reaches US$295.5bn.** The US accuses China of trade violations as **China sets export restrictions on rare earth metals.** Xi Jinping rises to the presidency.

2013: China begins **construction of artificial islands in the South China Sea,** with a total area of close to 3,000 acres; clashes between Chinese fishing boats and other claimant countries increase.
2015: US warns China to **halt land reclamation activities.**

2017: Donald Trump affirms the **One China Policy**, and hosts Mr Xi at Mar-a-Lago

2018: The US-China trade war escalates, as **Mike Pence signals a hard-line approach** on China. Canada arrests Huawei's CFO, signifying the **spill-over of politics into the corporate sphere.**

2020: 'Phase One' trade deal signed, but tensions rise over pandemic origins. **Mike Pompeo says that engagement with China has failed**

Source: [Council on Foreign Relations]

Biden's China policy will be a mix of Trump's and Obama's

Fewer wild punches, and an embracing of allies to enlist them to take on China

Biden has vowed to be "tough on China", shedding the mindset of the Obama administration

Amalgamated China policy:
The Biden administration will combine a Trumpian wariness of China with caution in handling strategic matters

Obstacles:
Mr Biden will be constrained by a Congress that has become more hostile to China

The Republican Senate may restrict Mr Biden's office appointments (mostly Obama-era veterans from traditional school of foreign policy that places trust in alliances, treaties and multilateral institutions)

CPTPP:
Mr Biden will want the US to re-join, but China also intends to secure a spot, complicating US entry

How 2021 US policy outlook has changed

A comparison of presidencies

A Joe Biden presidency

- Economic recovery strategy based on higher government spending on: healthcare, education and childcare, state/local government budgets, SME lending, infrastructure investment and a shift to a low-carbon economy.
- Tax code revisions will provide some of this funding, but the fiscal deficit will stay wide.
- Trade relations with foreign partners (USMCA, EU) will relax, improving clarity.
- US-China rivalry deepens and increasingly shifts to high-tech industries, investment, finance, with greater focus on human rights.

A Donald Trump presidency

- Economic recovery strategy based on lifting constraints on the private sector (energy and environmental regulation, and a formal payroll tax cut) and boosting lending to SMEs.
- Economic recovery predicated on fast access to a vaccine, and corporate-led spending (both seem unlikely to deliver desired results).
- Further substantial tax reform is unlikely, given Congressional divisions and skinny tax code.
- Trade relations remain tense worldwide, especially with China. US-China rivalry deepens and diversifies, but trade tariffs also remain.

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Biden may ease trade restrictions (ex-China)

Some protectionist elements will remain, but move to embrace trade with allies

Likely to seek “confrontation without conflict”, and attempt to work with democratic US allies

America under Trump (2017-21)

- “America First” policies that sought to revise trade deals, protect struggling US industries and reduce trade deficits
- Withdrew US from TPP talks in 2017
- Engaged in trade war with China
- Leveraged auto tariffs to sign deals with partners (Japan, South Korea)
- Trade talks ongoing with EU, but stalled in 2020

America under Biden (2021-25)

- No wholesale return to Obama-era embrace of free trade
- Clear move to re-engage with trade partners and ease tariff threats (EU, Asia ex-China)
- Crafting new trade deals is not the top priority:
  - EU - obstacles in DST, agriculture
  - CPTPP - Biden open to re-joining, but with reforms
  - Maintain pressure on China (with a focus on IP and trade practices)

US-China tensions will persist under Biden

Conflict is over long-term economic dominance, and across various spheres

Isolationist Trump policies may be swapped for revived engagement with allies under Biden

America under Trump (2017- 21)

- Initial focus on narrowing US goods trade deficit with China
- Trade tariffs imposed under Section 232 (National Security) and Section 301 (Trade Violation)
- Rivalry has begun to shift away from trade toward tech, investment and finance
- Export bans (Huawei)
- Entity-specific sanctions (HR) and investment restrictions

America under Biden (2021-25)

- Maintain a confrontational stance toward China, but with different tools and tone
- May drop some tariffs (non-tech sectors, finished consumer goods)
- Use investment, incentives and procurement (rather than tariffs) to boost US firms
- Seek engagement on shared issues such as pandemic management and climate change
- Increased focus on IP protection, countering China's BRI influence through US Indo-Pacific Strategy, tech dominance and HR

A wary China will attempt to ease US tensions

A full reset of relations is unlikely, as the US needs to maintain leverage

Do not expect a quick unwinding of export controls and investment curbs

Trade barriers enacted by Mr Trump will remain largely intact
Mr Biden's agenda is to bring manufacturing back to America, along with "Buy America" rules to support domestic markets

But some leeway will be given
The Biden White House sees trade tariffs as destructive, and recognises the risk of using the dollar to restrain China

Tech-divide spills over to politics
Divide between techno-democracies versus techno-authoritarian bloc led by China as Congress demands sanctions over China's activities

Olive branches
Some co-operation between the US and China on global issues like climate change and Covid-19 treatments can be expected

The great decoupling

Wrenching Chinese and American corporate worlds apart would hurt everyone

Flows of Chinese FDI and venture capital into America have declined as restrictions rise

The Economist

*Source: The Trump administration wants a US-China commercial split article by The Economist, estimate given by Deutsche Bank

China hawks lead the way: Executive order for unwinding all commercial relations with ByteDance and WeChat in US marks escalation in US-China economic war

Impact of decoupling: America's tech giants, many of which rely heavily on Chinese demand, as well as on Chinese supply chains will be hardest hit

Lost revenues in China, the expense of relocating factories out the country and compliance with diverging Chinese and American standards could cost global technology firms **$3.5trn*** over the next five years

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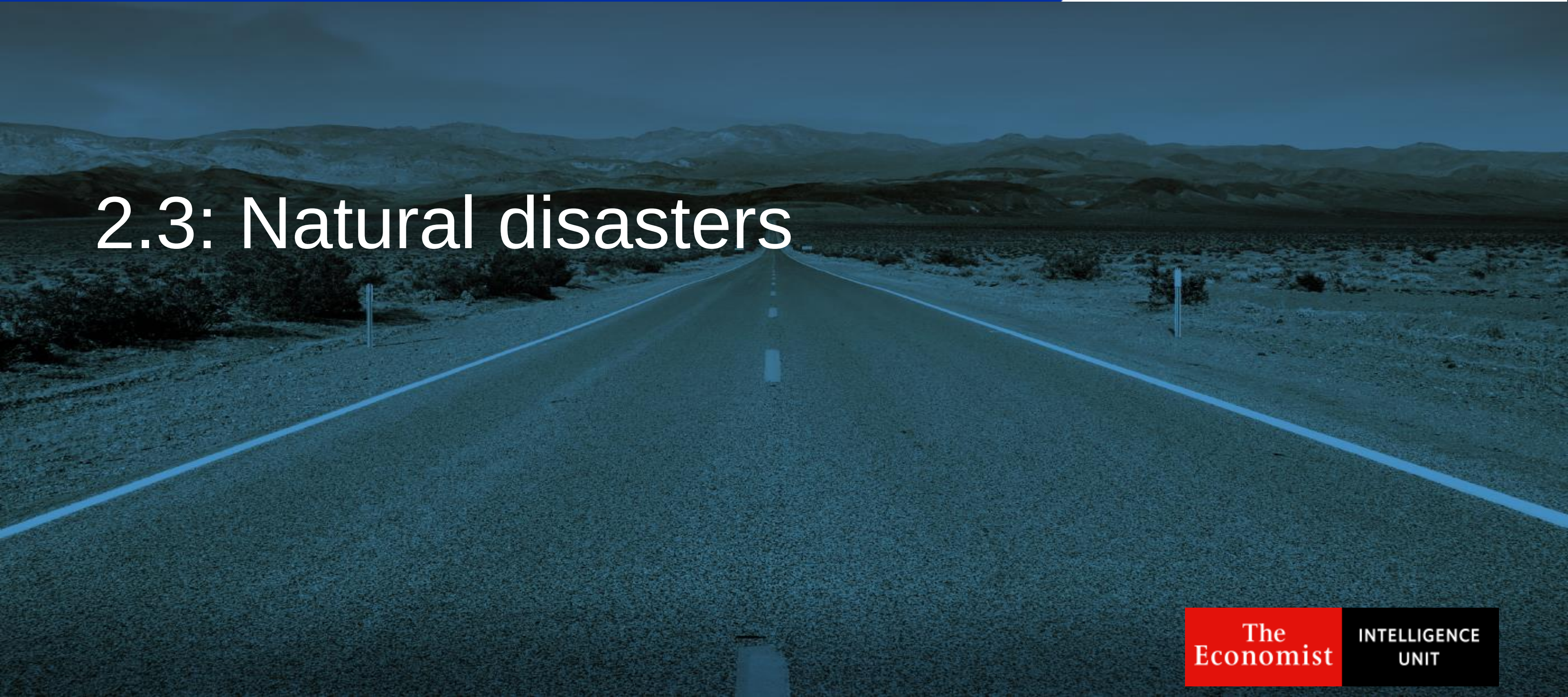
2.3: Natural disasters



Risk management against natural disasters

Supply chains reliant on just-in-time practices are especially vulnerable

Rising severity and frequency of disasters will weigh heavier on investment decisions

Case examples:
Tōhoku earthquake (2011) - US$210bn in costs* as auto manufacturers Toyota, General Motors and Nissan had to shut down facilities outside of Japan, as they were unable to ship or receive needed parts from disrupted local assembly plants

Hurricane Maria (2018) - Puerto Rico faced economic collapse and population migration after supply chains serving their two biggest industries, pharmaceuticals and medical devices, suffered heavy damage

80% of CEOs & CFOs are not fully prepared**
CEOs and CFOs believe such incidents to be out of their control, although 76% recognise that their firms have significant exposure to climate risk

Mitigation:
Diversification away from disaster-prone areas, or source from multiple factories around the region

Reliance on global supply chain can be risky when ports and infrastructure are damaged, although there are more sourcing options

*Source: Thomasnet.com ,

** 2020 CEO / CFO Climate Risk Survey by FM Global

Team FINLAND

Chapter 3: Different approaches from EU and Asia on the US-China conflict

The Economist INTELLIGENCE UNIT

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3.1: The EU's Approach to the US-China conflict

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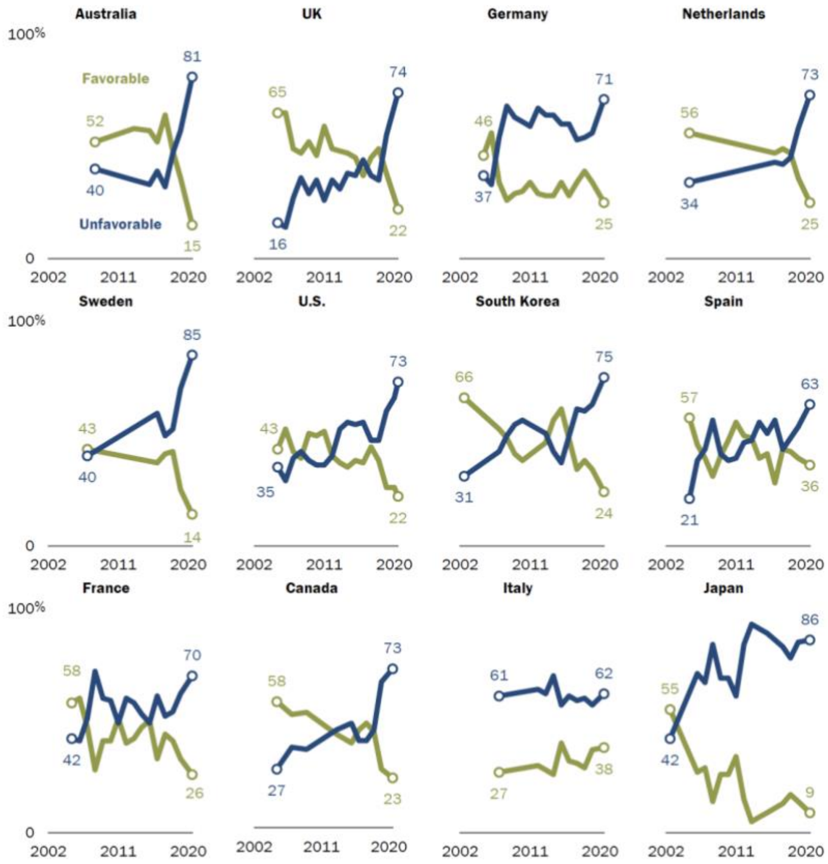
Increasingly negative evaluations of China across advanced economies

% who have a(n) __ view of China



Note: Belgium and Denmark not surveyed prior to 2020. In Italy, 2020 data from telephone surveys; prior data from face-to-face surveys. Those who did not answer are not shown.
Source: Summer 2020 Global Attitudes survey. Q8b.
"Unfavorable Views of China Reach Historic Highs in Many Countries"

PEW RESEARCH CENTER

Europe's "Sinatra Doctrine"

The EU wants to go its own way

EU has to develop an independent position on China to avoid being caught between US-China

Sharp deterioration in EU-China relationship:
Concerns over supply chain vulnerabilities, market access for EU investments and potential security risks from Huawei add to increasing negative sentiment

EU-China Leipzig summit ditched:
EU's 27 leaders were supposed to band together across from President Xi but Covid-19 has pushed back the summit indefinitely

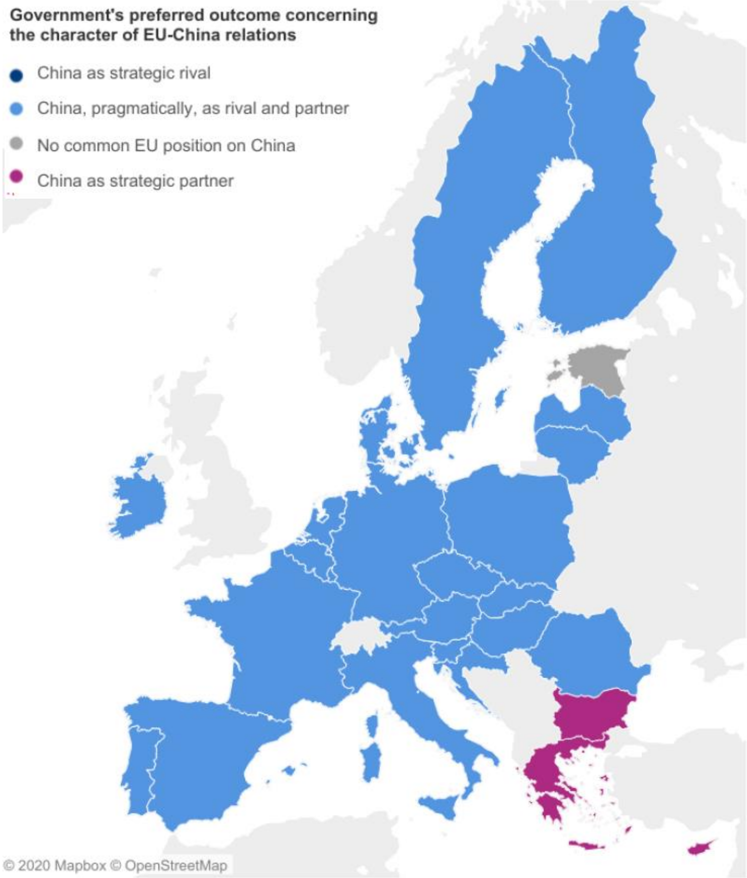
EU will aim to balance ties with US and China
EU will align with US on political and security issues, while preserving active engagement with China in areas of mutual interest
(trade and investment, WTO reform and climate change)

EU aims for diversification to other international partners, rather than US "decoupling"

Source: Unfavourable Views of China Reach Historic Highs in Many Countries report by Pew Research Centre

China consensus: Europe is growing wary

Convergence of EU states' assessment that China poses a challenge to Europe



Concern over lack of reciprocity in Sino-European economic relationship and China's assertiveness

Not adequately equipped to tackle Chinese challenges:
EU member states view China pragmatically as a partner, but also as a rival – there is agreement that EU needs to restrict Chinese investments in strategic sectors and create institutional structures to improve the EU's capacity to act

General agreement in most member states:
EU members show cohesiveness on China policy, allowing longer-term planning and unlikely reversals in the current trend

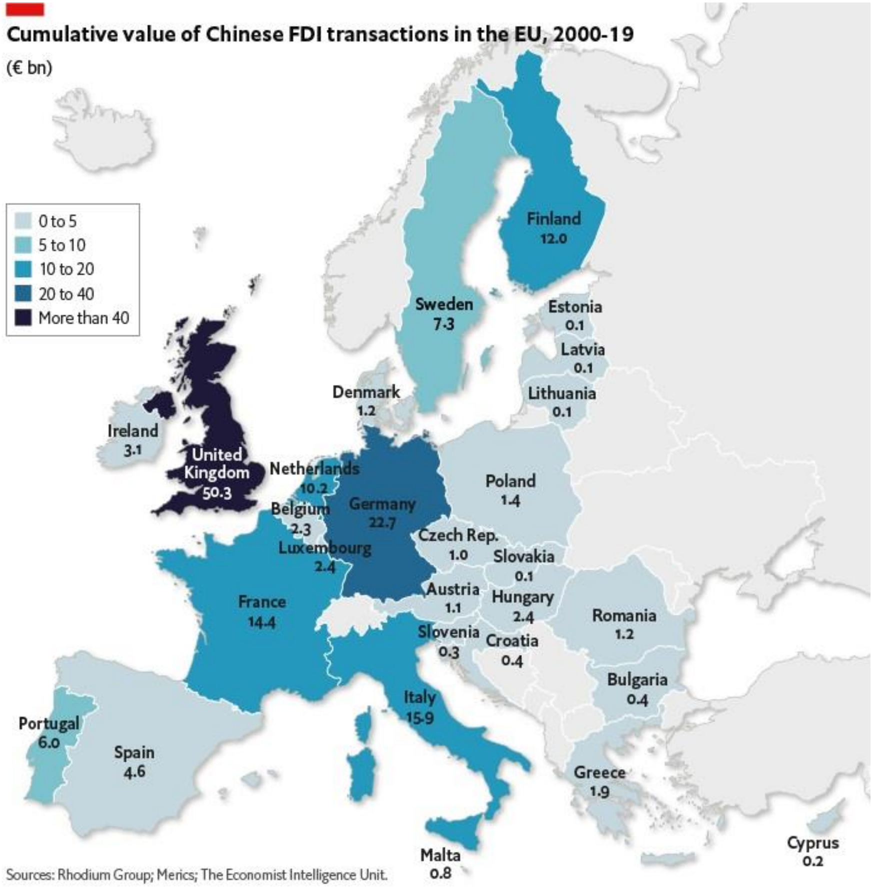
Likely EU policy changes:
A reassessment of the EU's normative approach to human rights in Hong Kong, and creation of a mechanism to encourage member states to engage with and shape a cohesive EU policy on China

Continued negotiations for Comprehensive Agreement on Investment to strengthen legal basis for economic interactions with China, and to provide all European companies with greater access to the Chinese market

Source: European Council on Foreign Relations report

Economic imbalance between the EU and China

The EU seeks to rebalance trade through stronger ties with third-party countries



FTAs and security partnerships provide a counter-balance to China

Uneven playing field:
Most Eastern European countries received little Chinese investment, despite co-operation agreements

China's strong Covid recovery means that the EU has to use market power more assertively to engage in geo-economic confrontation

Diversified approach to China:
Poland looks to the US as a key ally against Chinese economic threat

France focuses on building and maintaining Indo-Pacific trade relations

Spain is wary of China's growing influence in Latin America

Pulling in all directions:
Member states worry that Germany may shape the EU's China policy to their economic interests as China's largest trade partner

Source: Europe brief: western Europe's stance on China hardens report by EIU

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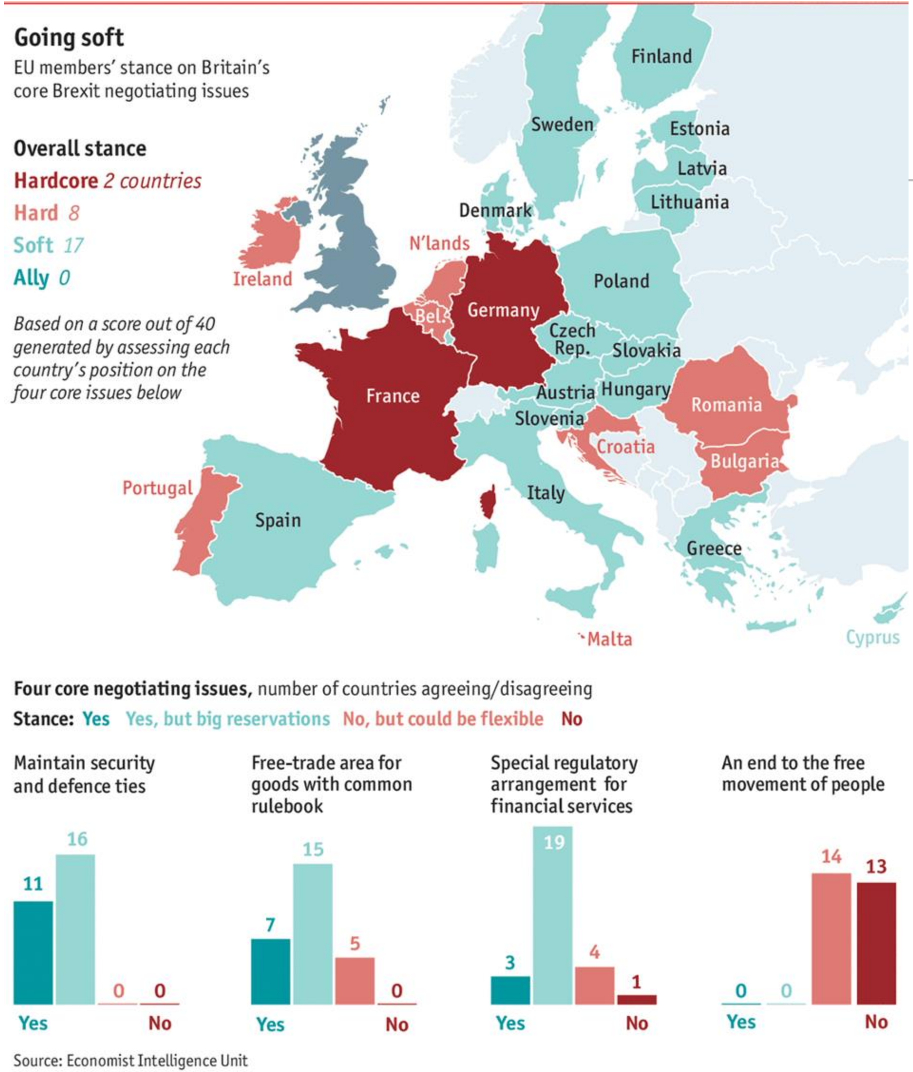

Brexit: disruption, not collapse

ASEAN stands to gain from EU-UK diversification

Coherent economic policy only in 2021
Short-termist approach by the UK government on making critical decisions for the "levelling up" agenda raises uncertainty for businesses

Disruption in key sectors, even with a compromised deal
Trade frictions and increased compliance costs will cause disruption for industries such as agriculture and manufacturing

Impact on ASEAN
Loss in trade between UK and EU will be redirected to ASEAN, especially to emerging markets where FTA negotiations are already underway

Source: [What to expect from a no-deal Brexit](#) article by The Economist

Team Finland

3.2: Asia’s approach to the US-China conflict

The Economist Intelligence Unit

Vietnam: pragmatism amid conflict

Territorial disputes in the South China Sea will continue to strain ties with China

Security ties with the US will deepen as a counterbalance to China's regional influence

Long-stemming grievances with China:
The Sino-Vietnamese war of 1979 and subsequent international isolation as a result of Chinese foreign policy

Modern conflicts over territorial claims and resource exploitation in the South China Sea and the upstream damming of the Mekong River

US relations:
The leading source of FDI and largest export market, joint members of TPP agreement to boost trade, and a shared interest in maintaining the current order in ASEAN

The US is wary of alleged currency manipulation, after Vietnam broke the US Treasury's three threshold criteria, and will move to enact modest tariffs on low-to-middle value added exports

Hanoi's strategy:
Separate political and economic aspects of relationship to not negatively affect overall bilateral relationship.

Increasing uncertainty as US world dominance wanes, leading to US-China co-operation at the compromise of Vietnamese national interests

Source: Security Outlook of the Asia Pacific Countries and Its Implications for the Defense Sector, NIDS Joint Research Series No.16, Chapter 8 by Tran Truong Thuy

Malaysia: hedge against uncertainties, not countries

Weaker ASEAN states have no control over power shifts, and will stay neutral

Aligning with either side will raise risks linked to autonomy, foreign interference and alienation

Single direction policies unlikely:
Partnering with a single ally as a means of balancing against another foe will incur strategic, economic, and political costs that outweigh any potential security benefits

Selective deference and collaboration:
Malaysia continues to hedge in a light manner, pursuing mutually counteracting measures without overplaying magnitude of threat or support with the US or China
E.g.: Downplaying of aggressive Chinese territorial claims over Malaysia's James Shoal in the South China Sea

Improving military relations with US, but stopping short of allowing US troops to station on Malaysian bases

Opportunity costs:
Maintaining equidistance with major powers will enable smaller states to preserve manoeuvrability, but completely neutral hands often come out empty

Former Malaysian prime minister, Mahathir Mohamad:
"We can hope for the best and prepare for the worst by working with our ASEAN neighbours to cushion the impact of superpower collision. We have to enhance our collaboration."

Source: Malaysia Between the United States and China: What do Weaker States Hedge Against?
Research paper by Cheng-Chwee Kuik, Universiti Kebangsaan Malaysia

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Thailand, Laos and Myanmar: Chinese enclaves?

Outpouring of Chinese investment and workers welcomed by authoritarian states

China is one of the biggest investors in South-East Asian countries through the BRI

Special economic zones (SEZs):
Poorer governments will still court Chinese money, hoping that it will kickstart their economies and improve their infrastructure.

Incentives like faster permitting, reduced tax and duties, and looser controls on movement of goods and capital improve ease of doing business draws businesses to these countries

Who benefits?
Chinese companies in SEZs import labour and materials from China, resulting in little benefit for the host country.

Legislative and governance structures underpinning SEZs are skewed towards the interests of investors and against locals

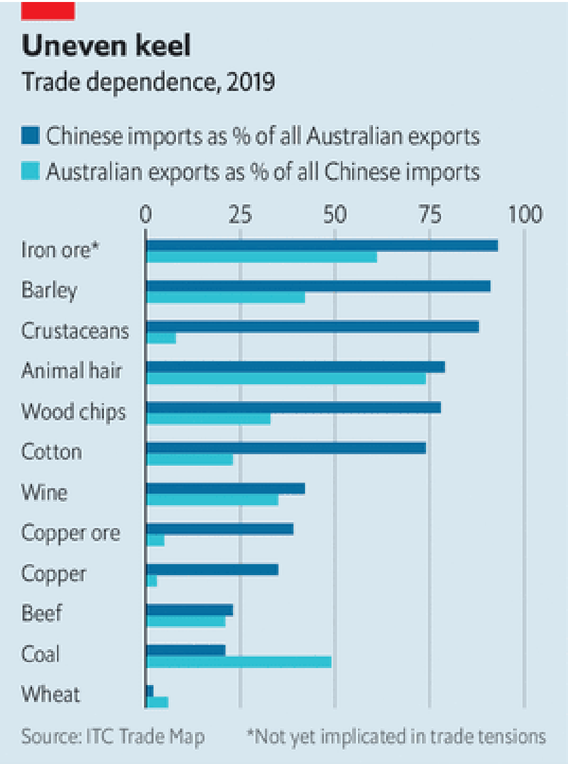
Rising public dissent against encroaching Chinese influence will easily be quelled by authoritarian governments

Source: South-East Asia is sprouting Chinese enclaves, article by The Economist

Australia: Trade conflict with China intensifies

China curbs more imports of Australian goods as row enters sixth month

Tariffs of 80% on Australian barley imports were followed by restrictions on beef and wine



The Economist

"China, we think in this case, has made errors of fact and law. We're going to use whatever avenues are available to us, and I would firmly hope that we will see resolution of any appeals well within the next five years"
Simon Birmingham, the Australian trade minister

Underlying hostilities:
Australia as the largest Western ally in the pacific has repeatedly called China out for their activities, keeping Chinese ambitions in check around the region

Trade conflict has both economic and political drivers:
China's tariffs against Australia could be leverage to gain market economy status, as well as favourable deals
China may be pulling Chinese agriculture importers away from Australia and to the US to meet the US$37bn quota that agreed on as part of US-China trade deal

Over-reliance?
A third of Australian exports go to China, too big a market for exporters to replace swiftly, but 94% of Australian businesses* are in favour of reducing this reliance

*Source: Lowy Institute Poll 2020

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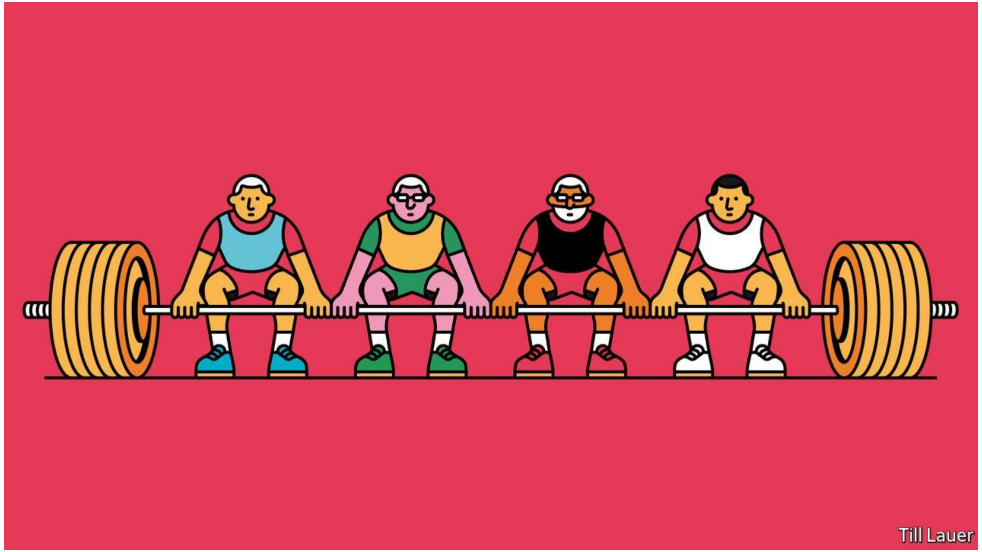
An Indo-Pacific club builds heft

The "Quad" is not an alliance, but is shaping an increasingly confident course

America, Australia, India and Japan have all seen relationships with China deteriorate



Source: An Indo-Pacific club builds heft article by The Economist

Defence ties:
Navies came together for the second phase of India's annual "Malabar" exercises after a 13-year Australian absence

America and India have signed agreements on logistical support, encrypted communications and the exchange of geospatial intelligence, such as secret maps, and Australia and Japan have agreed to a defence pact

Criticism:
"Free and open Indo-Pacific" papers over big differences between the two halves of that vast region

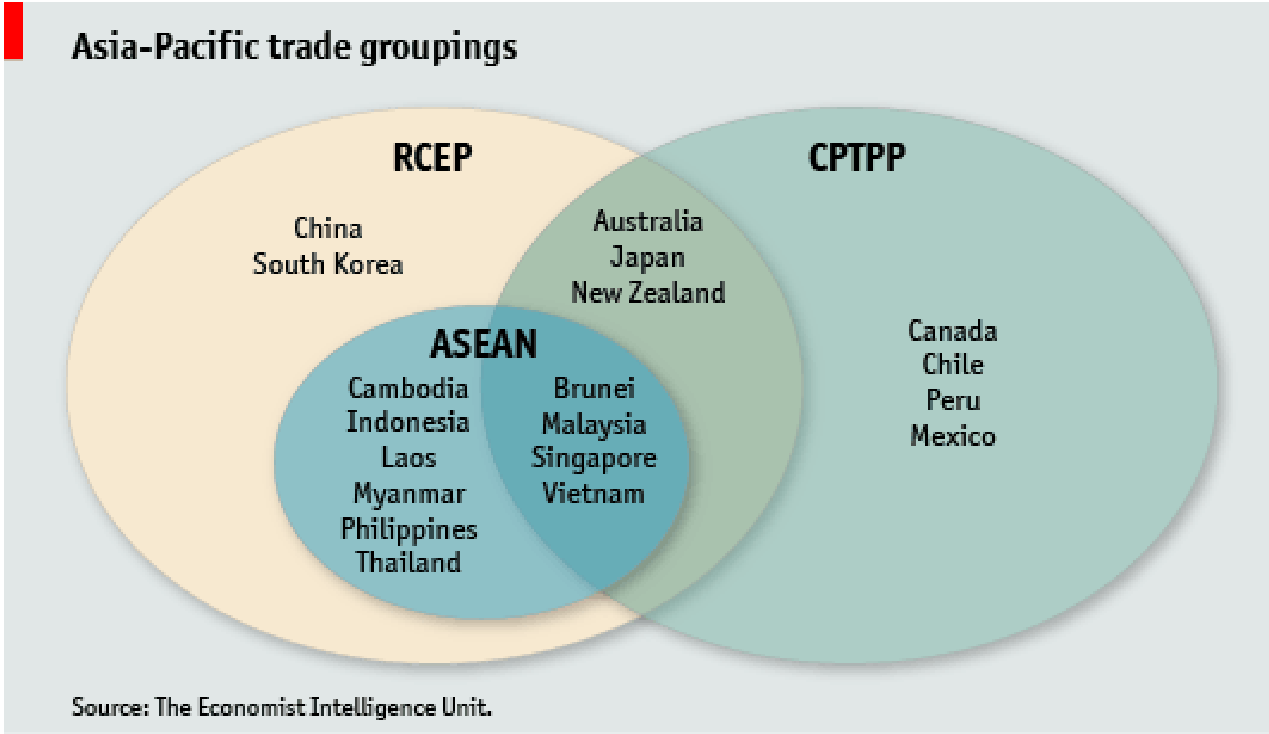
A compact bloc, rather than a sprawling multilateral organisation, capable of broadening agenda

Chapter 4: Potential scenarios for future supply chains

Scenario 1: continued globalisation

APAC leaders signed the RCEP, the world's largest FTA, on November 15th

The agreement is a big win for ASEAN, which led the RCEP, as well as a small win for China



Less ambitious:
Limited coverage of services. High import duties maintained on "politically sensitive" products such as agriculture for Japan

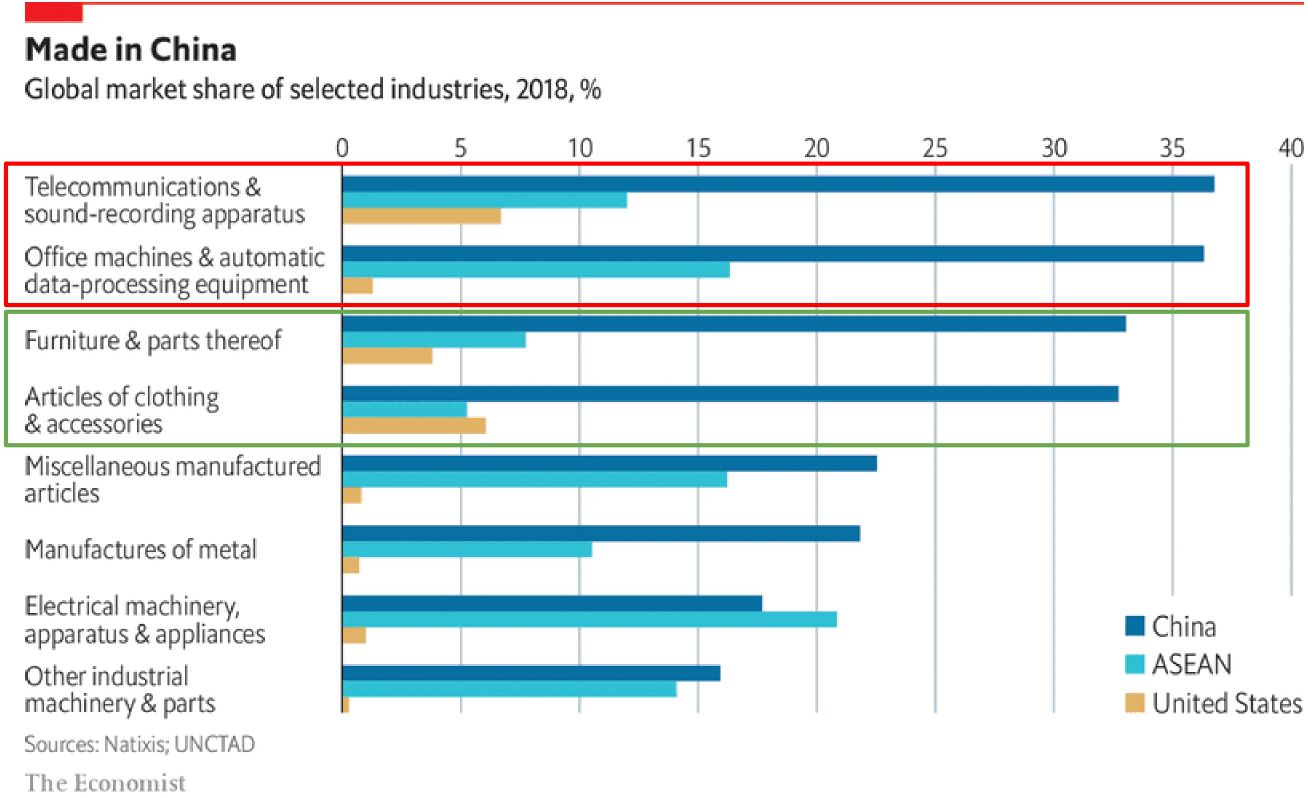
Benefit for ASEAN:
Harmonising disparate rules-of-origin provisions in ASEAN's existing FTAs, allowing easier regional sourcing

China's commitment to trade liberalisation:
The RCEP is China's first plurilateral trade agreement

Source: Warm RCEPtion - Article by The Economist

The Economist INTELLIGENCE UNIT

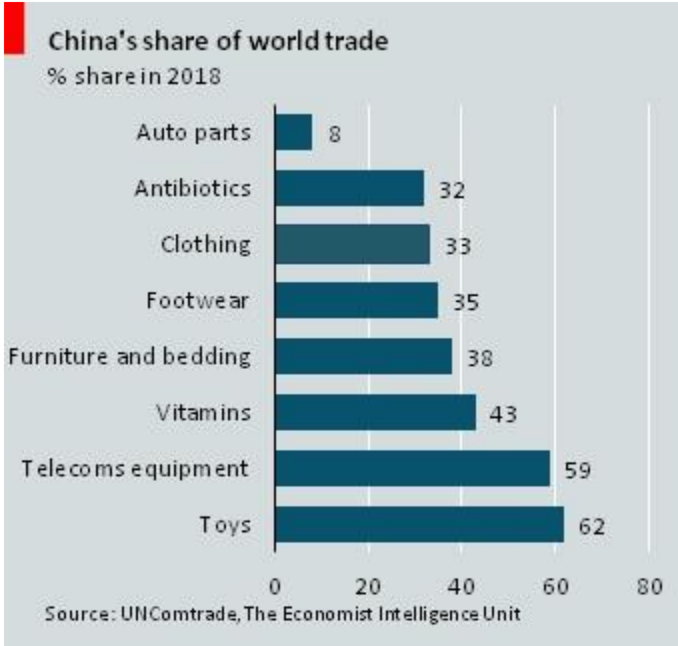
For non-strategic goods, globalisation will continue

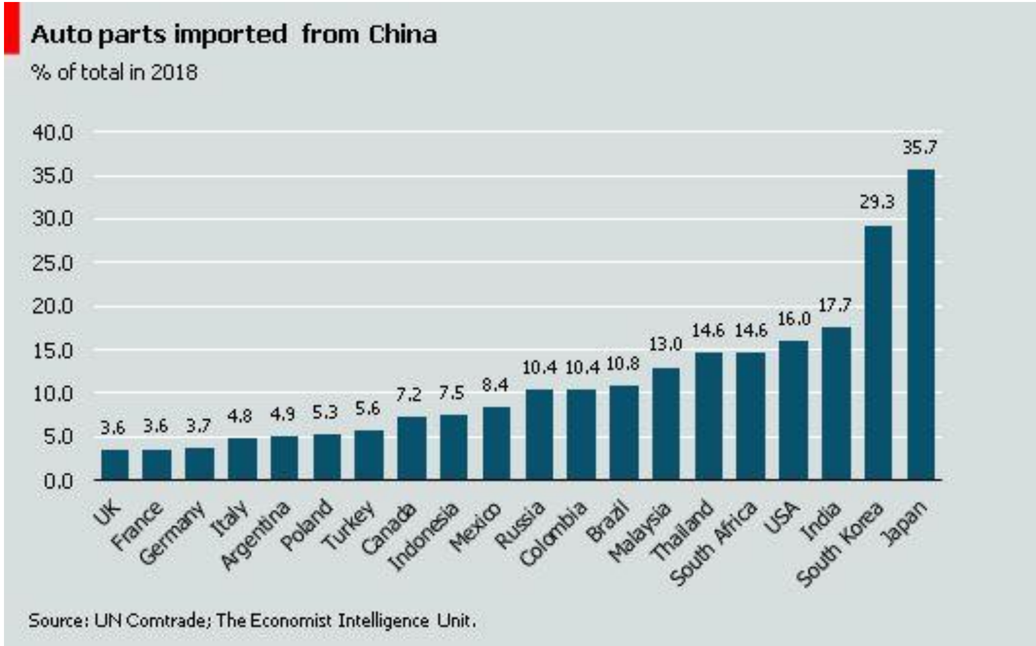


Cost-efficiency:
Production of the bulk of consumer goods (clothes, footwear and toys) will remain in China

Scenario 1: continued globalisation

Even for strategic industries, it will be near impossible to dislodge China





Source: Coronavirus: the impact on global supply chains report by EIU

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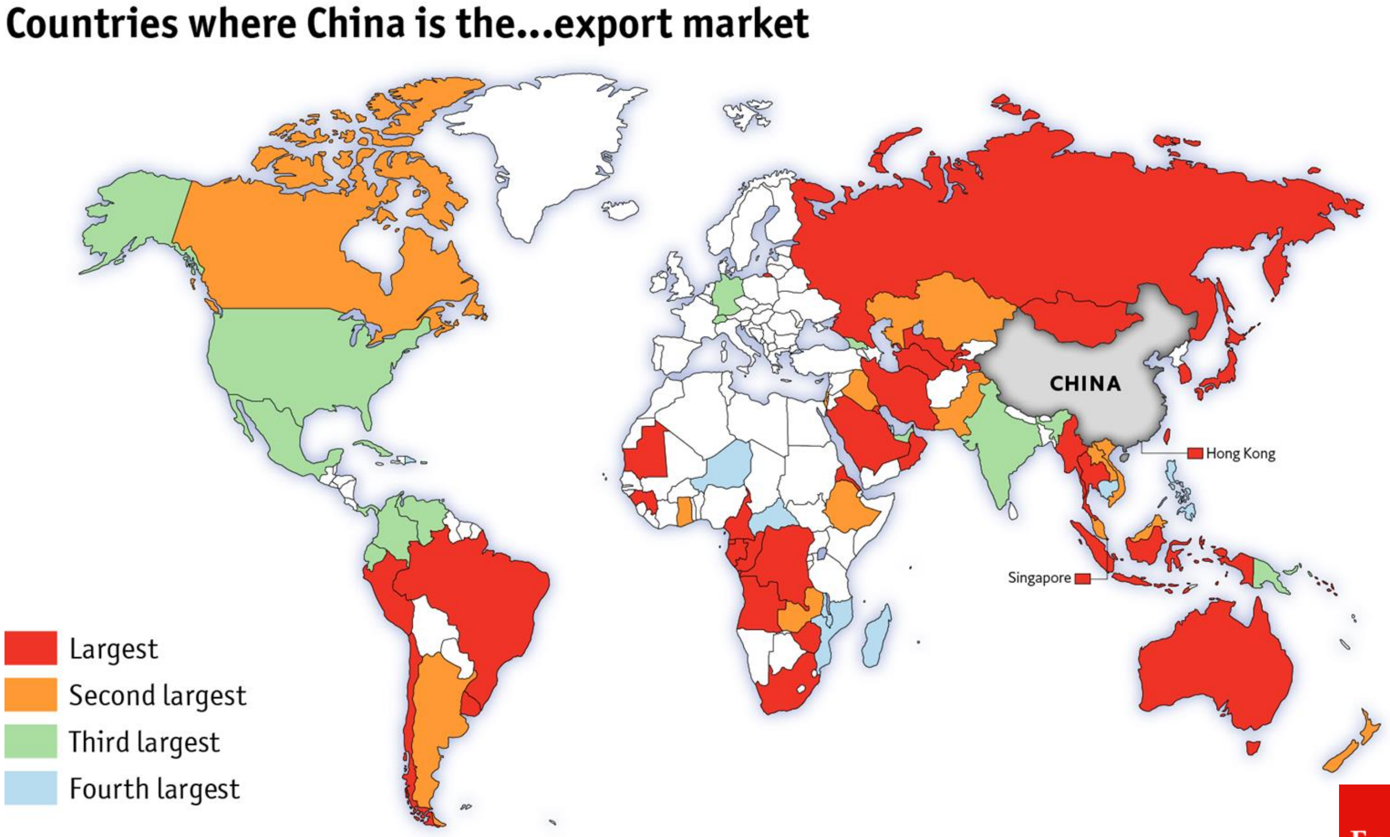
China is within top 3 trade partners with vast majority of the world

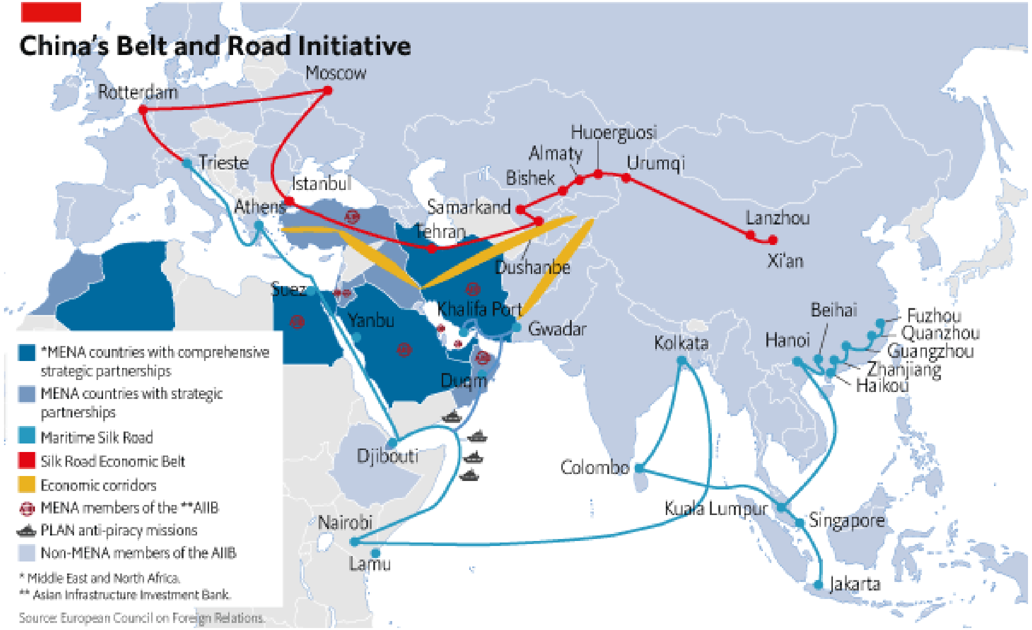


Source: EIU

Shortening and de-risking of supply chains

A shift to domestic production aims to curb countries' over-reliance on China

The Belt and Road Initiative connects nations to the global trade market—but at what cost?



BRI as a tool: Several Asian countries are key staging posts for the Belt and Road Initiative (BRI), which makes decoupling difficult—if not impossible—to reverse

Investments and development are major positives for nations with poor existing infrastructure

The Economist INTELLIGENCE UNIT

Scenario 2: bifurcation

The US and China reduce their dependence on each other

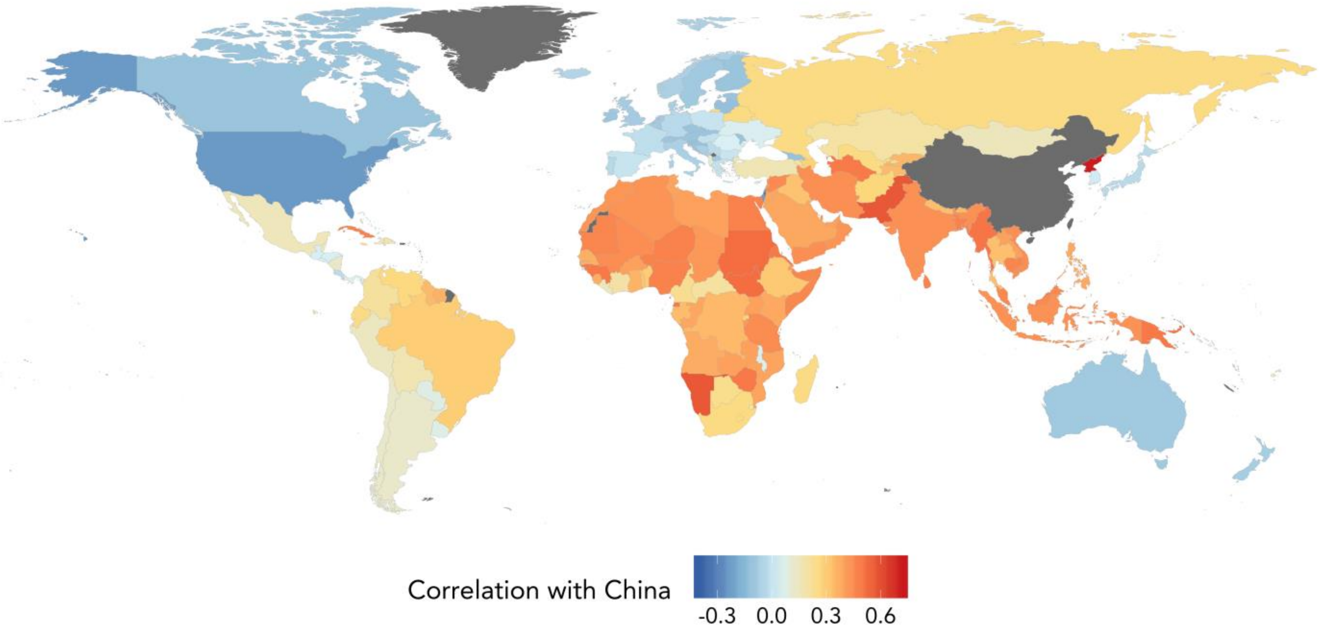
Bifurcation:
Strategic industries (telecoms, tech hardware, pharma) will split into pro-Western and pro-China camps and form separate supply chains

Source: [Uncertainty grows for international start-ups as US-China decoupling becomes a reality]

Scenario 2: bifurcation

US and China are pulling the world apart

United Nations General Assembly Resolutions, Voting Patterns Compared to China's



Note: Data from Voeten (2013). China (the PRC) became a UN member in 1971. All absences ignored. Yes/Abstention/No treated as ordered categorical variables. "Correlation" computed as the Spearman statistic with range [-1, 1]. Unweighted Euclidean distance yields a similar result. Gray areas are non-UN members or China. Chart by Yiqin Fu.

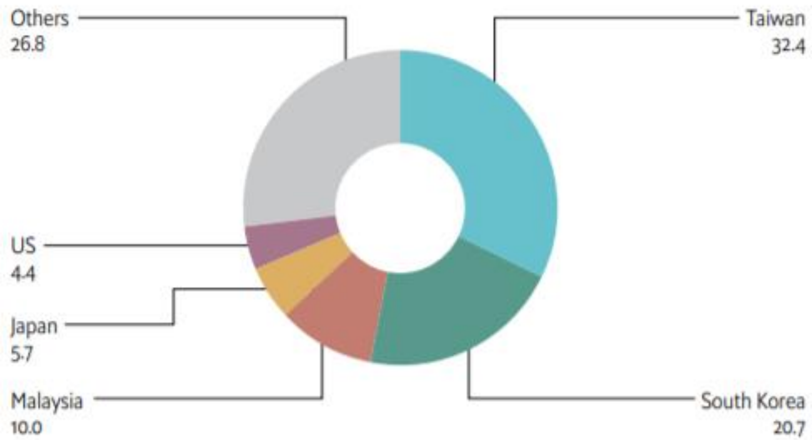
Source: [The United Nations: Who Votes with China vs the US]

Scenario 2: bifurcation

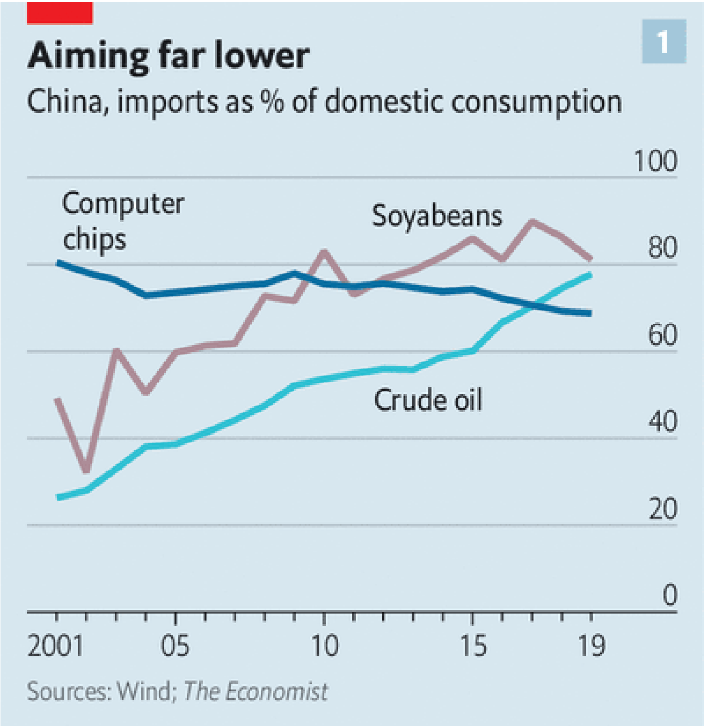
China remains dependant on the US for critical IT parts

Taiwan and South Korea are the main chip exporters to China

(China's imports by supplier; % of total value of integrated circuit shipments)



Sources: ITC Trade Map; The Economist Intelligence Unit.



The Economist

China's "chokeholds" – ICs, energy shipments, financial services

Dual circulation - protectionism

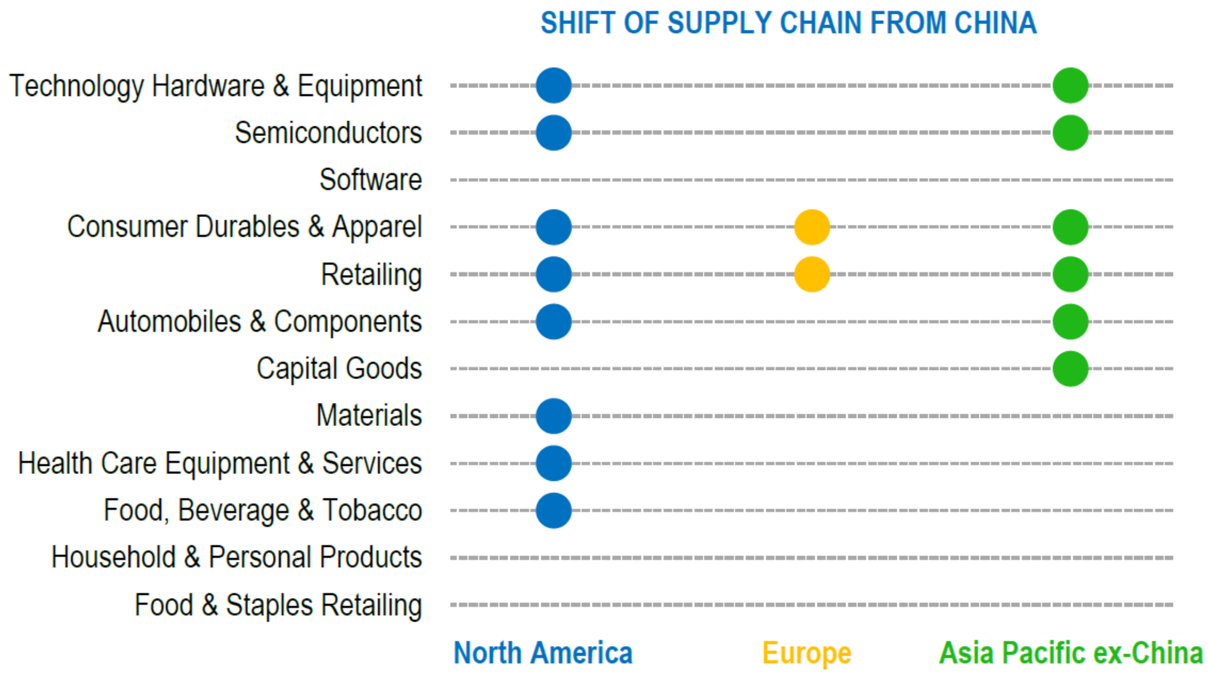
Source: [China's "dual-circulation" strategy means relying less on foreigners](), article by The Economist

The Economist INTELLIGENCE UNIT

Scenario 2: supply Chains move out of China...

US ahead of EU firms in relocating away from China

Figure 6: North American companies are ahead of their Asia Pacific (ex-China) and European counterparts in moving their supply chains out of China



Survey methodology:
Bank of America surveyed all of their fundamental equity analysts (covering more than 3,000 companies globally) to gauge the dependence of listed companies on other countries or regions in terms of revenue, costs, supply chain and technology

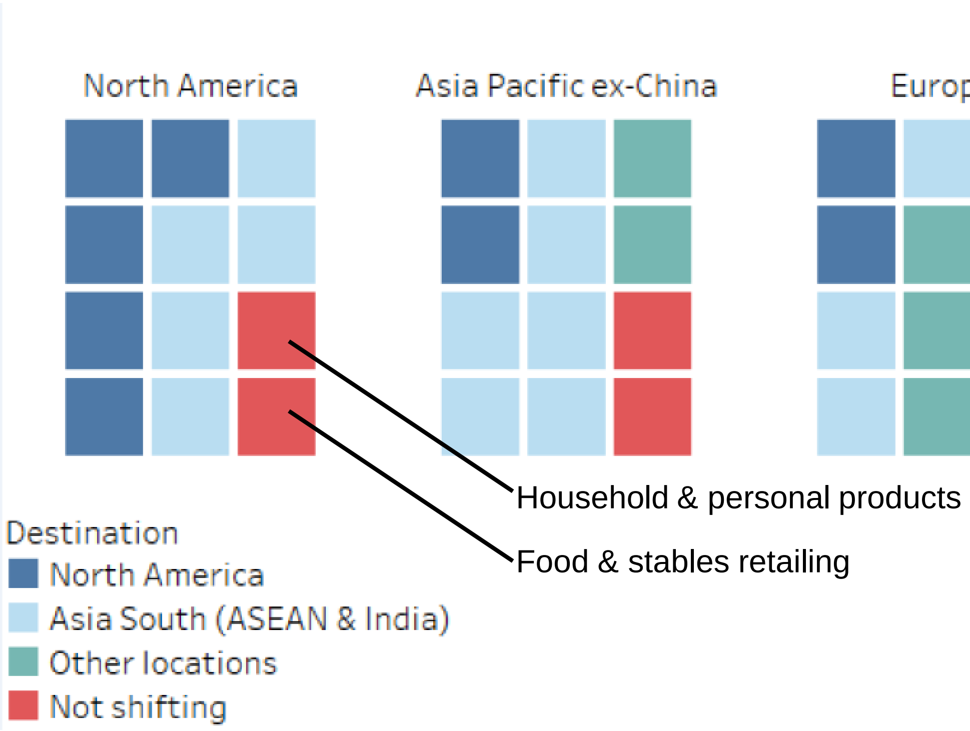
Findings:
Two-thirds of global sectors in US and half in APAC (excluding China) have either implemented or announced plans to relocate at least a portion of their supply chains out of China; 83% of sectors in the EU are staying put in China, with minor shifts

Source: Tectonic shifts in global supply chains report by Bank of America

…and come homeward, closer to consumers

A decentralised world, with supply chains shifting back to within regional borders

Figure 7: Companies are inclined to move their supply chains to Asia South and North America



Squares represent each of 12 sectors:

Tech hardware and equipment
Semiconductors
Software
Consumer durables and apparel
Retailing
Automobiles and components
Capital goods
Materials
Healthcare equipment and services
Food, beverages and tobacco
Household and personal products
Food and staples retailing

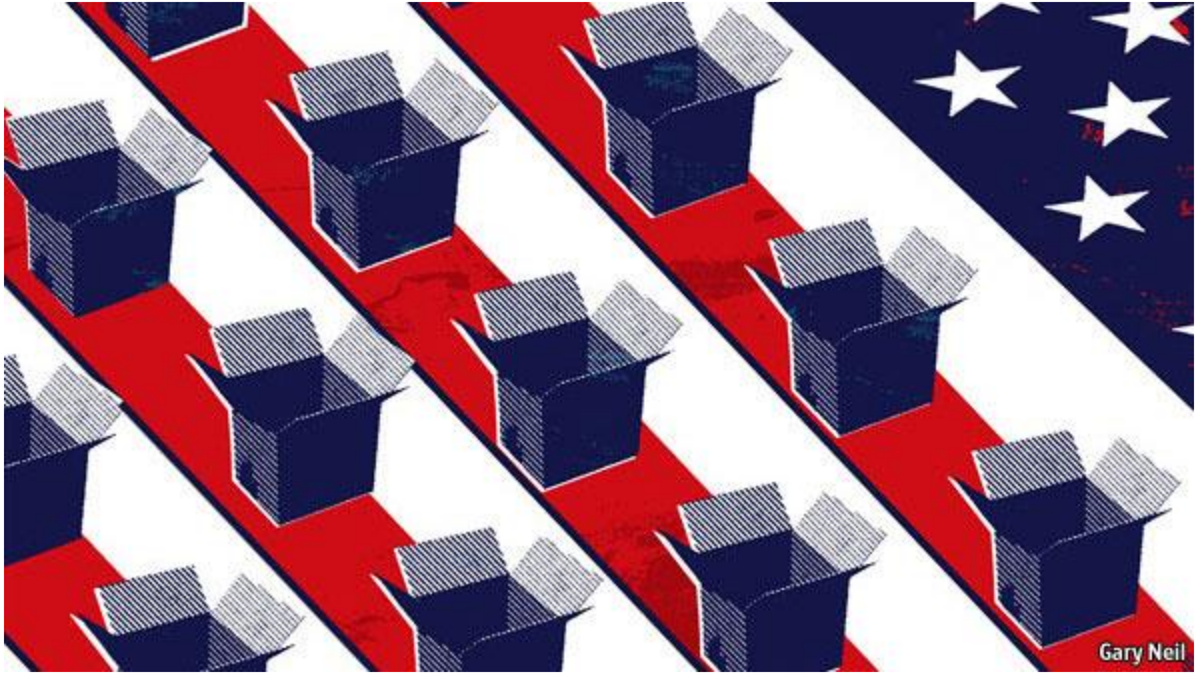
Source: BofA Global Research

Source: Tectonic shifts in global supply chains report by Bank of America

The Economist INTELLIGENCE UNIT

Scenario 3: localisation and reshoring

Suppliers seek closer production venues to consumers



Reshoring:
In order to avoid supply disruption from natural disasters, and shield themselves from geopolitical risks, suppliers are relocating production closer to their consumers

Localisation:
Sustainability issues are a driver for localisation

Scenario 3: localisation and reshoring

Governments are erecting borders for data

Source: Governments are erecting borders for data article by The Economist

EU: The GDPR allows personal data to leave the EU only if firms have appropriate safeguards in place or if the destination country has “an adequate level of protection”
The EU is also discussing the creation of a single market for data, as it already has for goods

India:
India blocks payment information from leaving the country and may soon require that certain types of personal data never leave the country

Russia:
Russia requires that data be processed and stored on servers within its territory

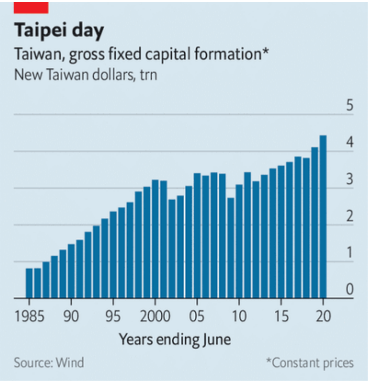
China:
China blocks most international data flows

The Economist INTELLIGENCE UNIT

Scenario 3: localisation and reshoring

Case example: Taiwan is welcoming back firms that had decamped to China

Taiwan has been a been a beneficiary of tensions between China and America



Shifting home:

Taiwanese manufacturers pull out of China amidst growing threat of not being able to export made-in-China chips to the West, and to avoid trade tariffs

Returning firms include Giant, a bicycle producer, Long Chen, a paper company, Compal and Quanta Computer, both computer manufacturers

Investments in factories and other fixed assets in Taiwan reached an all-time high last year of over NT$4trn* (US$140bn), with Hwa Ya Technology Park in Taoyuan expanding to accommodate returning tech companies

The Economist

Surge in investments has clear limits:

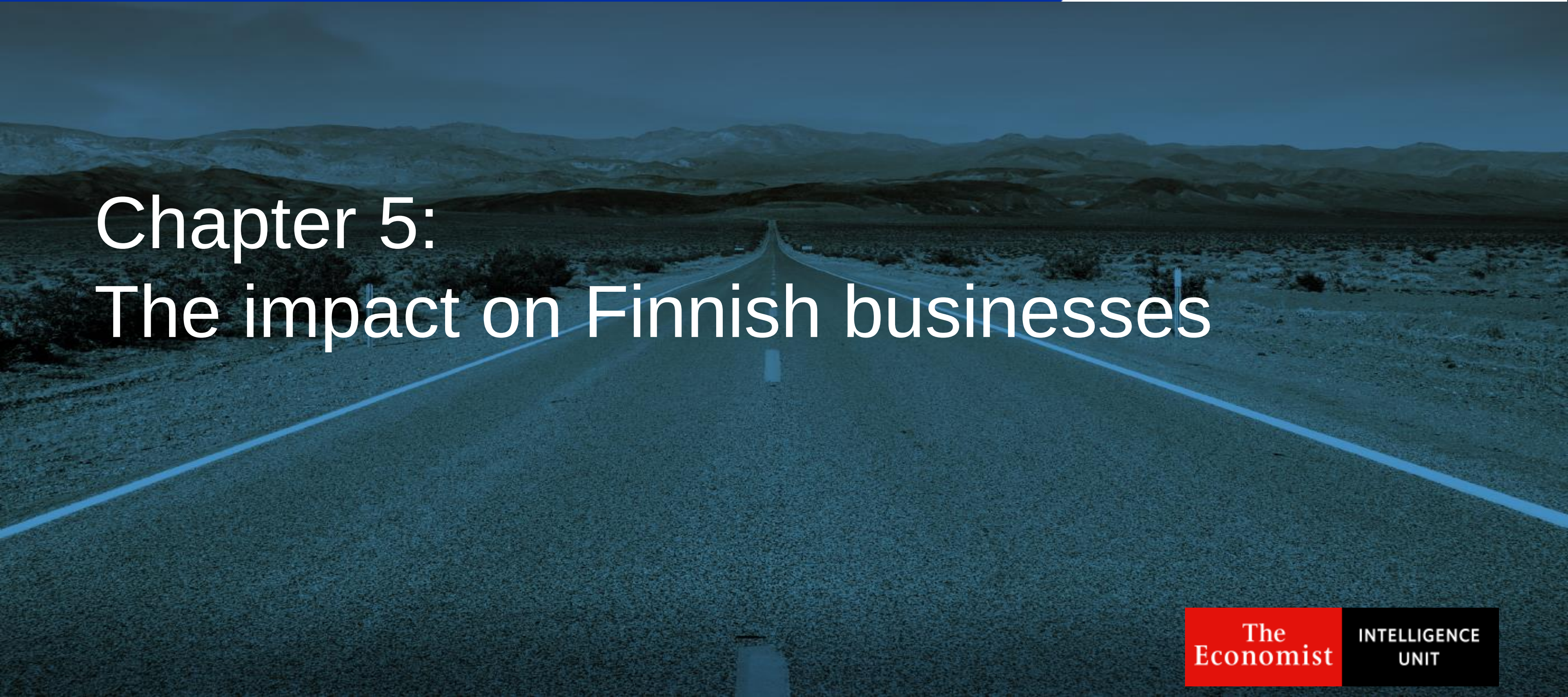
President Tsai's "five shortages" – finite supply of land, water, power, workers and talent can only support so many companies

Risk that some US-China tariff roll backs will fizzle momentum

Taiwan still reliant on China, with 40% of exports going to China and HK but China needs Taiwanese products as much as Taiwanese firms need the Chinese market

Source: [Covid-19 has ravaged economies all over the world—but not Taiwan's](#)article by The Economist

The Economist INTELLIGENCE UNIT

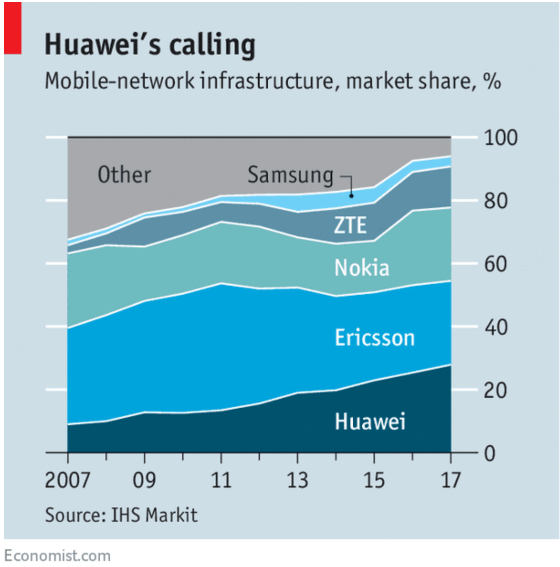


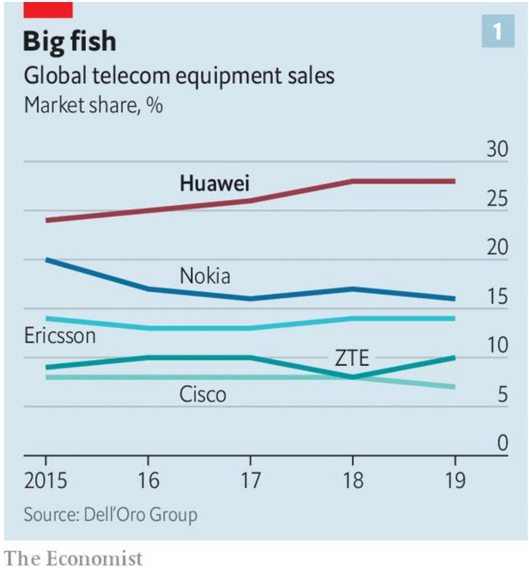
Chapter 5:
The impact on Finnish businesses

Nokia stands to gain from telecoms bifurcation

EU and UK bans on Huawei's 5G hardware will create opportunities for Nokia

Risks emanate from both sides with telecoms labelled a strategic industry





Made in the EU, for the EU:
"High-risk" Chinese vendors like Huawei are being dropped in favour of EU brands. This will benefit Nokia, as shown by a 5G deal with BT, making it BT's largest infrastructure partner

Intensified competition:
Ericsson and Samsung are competitors with Nokia in the 5G fight.
OpenRAN, an open-source architecture and network virtualisation technology in development could cut reliance on brand-specific hardware.

Chinese retaliation:
China's has threatened export controls to prevent Nokia from sending made-in-China products to other countries if Huawei bans continue

Finnish-Chinese health technology may be blocked

As the EU pursues “healthcare sovereignty”, bans on medtech transfers may occur

Healthcare also labelled as a strategic industry, and will see increased regulation worldwide

Ongoing tech and software scrutiny:
Privacy concerns over Chinese apps that collect user data have raised eyebrows and led to bans in the US. The EU may follow suit, threatening any gains from co-operation between Finland and China in the medtech sphere

Medtech investments in China may be vulnerable:
As EU-China friction intensifies, Finnish health technology interests in China may be exposed to risks from both sides—EU sanctions aim to curb reliance on China and limits on technology transfer, while Chinese restrictions rise in retaliation to the EU’s ongoing bans

Finland faces risks from the EU as well

China-Finland is a “model relationship” for Beijing, but the EU may clamp down

Export controls will be a new front for the China conflict

EU to increase restrictions on tech exports
Tech that is considered “dual-use” under the Wassenaar Arrangement can be blocked for export; expect more of such blockages to occur on tech and software

Modernisation of EU export controls has expanded to include surveillance tools, as well as impose more restrictions. Finnish exports to China may be at risk if regulations continue to stiffen

A repeat of Russian sanctions?
Reciprocal sanctions between EU and China could have the same effect on Finland as the EU - Russian sanctions in 2016 - resulting in shutting out of China as a trade partner for Finland whilst counter-sanctions from China will hurt Finnish companies as well

Source: Commission welcomes agreement on the modernisation of EU export controls

Covid-19 will mean big changes for business

Get used to it. We don't expect a vaccine until late 2021

Firms will have to live with distancing measures for at least two years, and these will be periodically tightened alongside any further waves of infection

Space it out: Automation and e-business will accelerate; high-contact business will adapt to personal spacing, and remote working will continue to impact tech spending and office space.

Masked crusaders: Masks and other PPE will be normalised, demand will grow, and the health context will be key for employee retention.

Mental preparation: Employees will need new skills, especially in relation to tech and automation.

Resilience: Just-in-time supply chains will be re-optimised to account for risk.

Surveillance: Achieving a balance will be difficult: governments will demand data-sharing and tracking, employees will want to feel safe, but customers might raise privacy concerns.

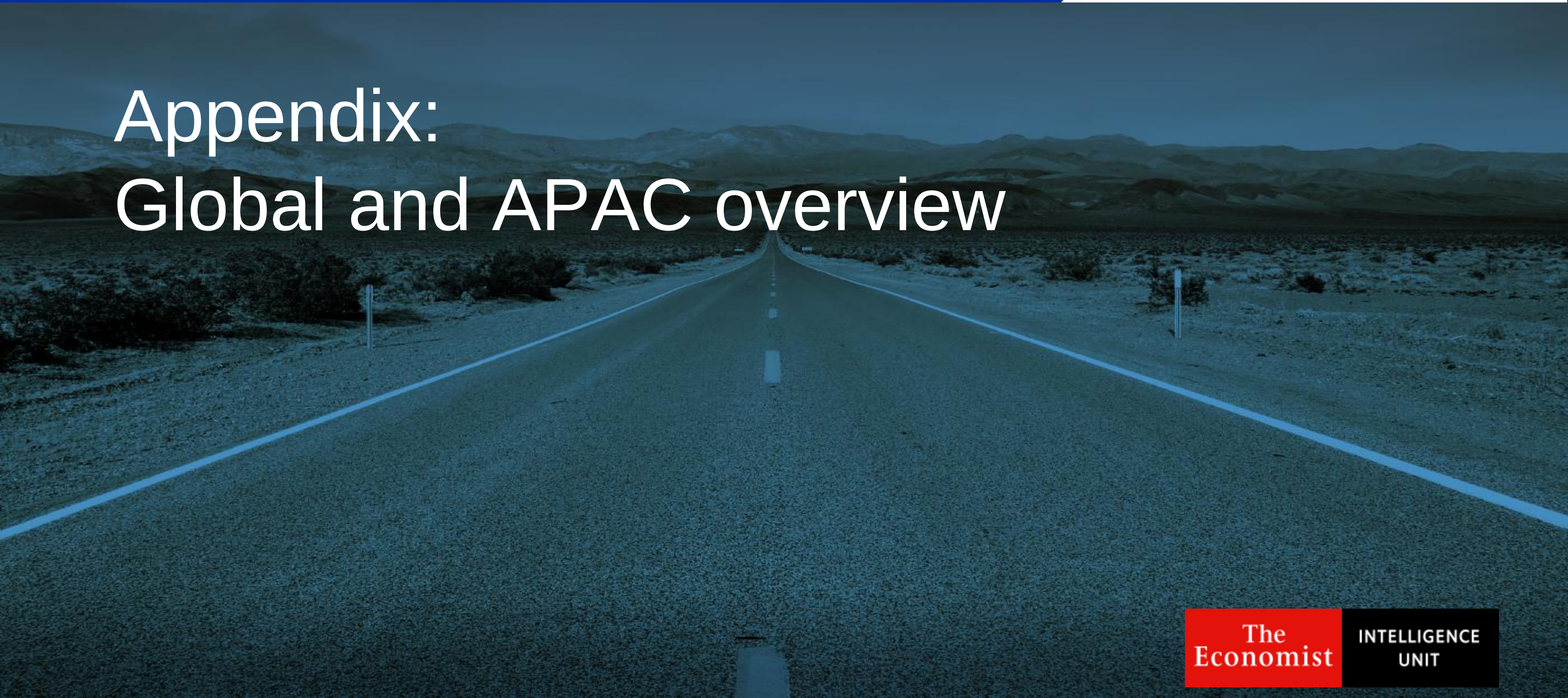
Liquidity is king: Cashflow recession, credit lines and government financing will be key to survival for many.

The payback: With so much government money going to firms, the state will take—and the public will expect—more control.

Return to normal: This will happen first in small cities and remote regions.

Team FINLAND

Appendix:
Global and APAC overview



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Buckle up for (even more) uncertainty

Downturn will be deep

The downturn in 2020 will be deep, and worse than during the global financial crisis; risk extends into 2021

Despite growth in 2021, global output will only return to pre-covid levels from 2022 onwards, with some countries taking longer

Impact on consumer and business sentiment will be especially prolonged

Uncertainty is high

Second waves of infections spreads across developed nations, destabilising any recovery progress

Biden’s new policy directions for US and grappling with a Rep. Senate

Worst-case scenario: sovereign debt crises lead to second recession

Existing trends accelerate

Rise of nationalism; “revenge of the state”

Questions around privacy and tech to track pandemic

US-China trade war had started decoupling—coronavirus will accelerate it

Fragmentation of traditional, Western-led global order accelerates

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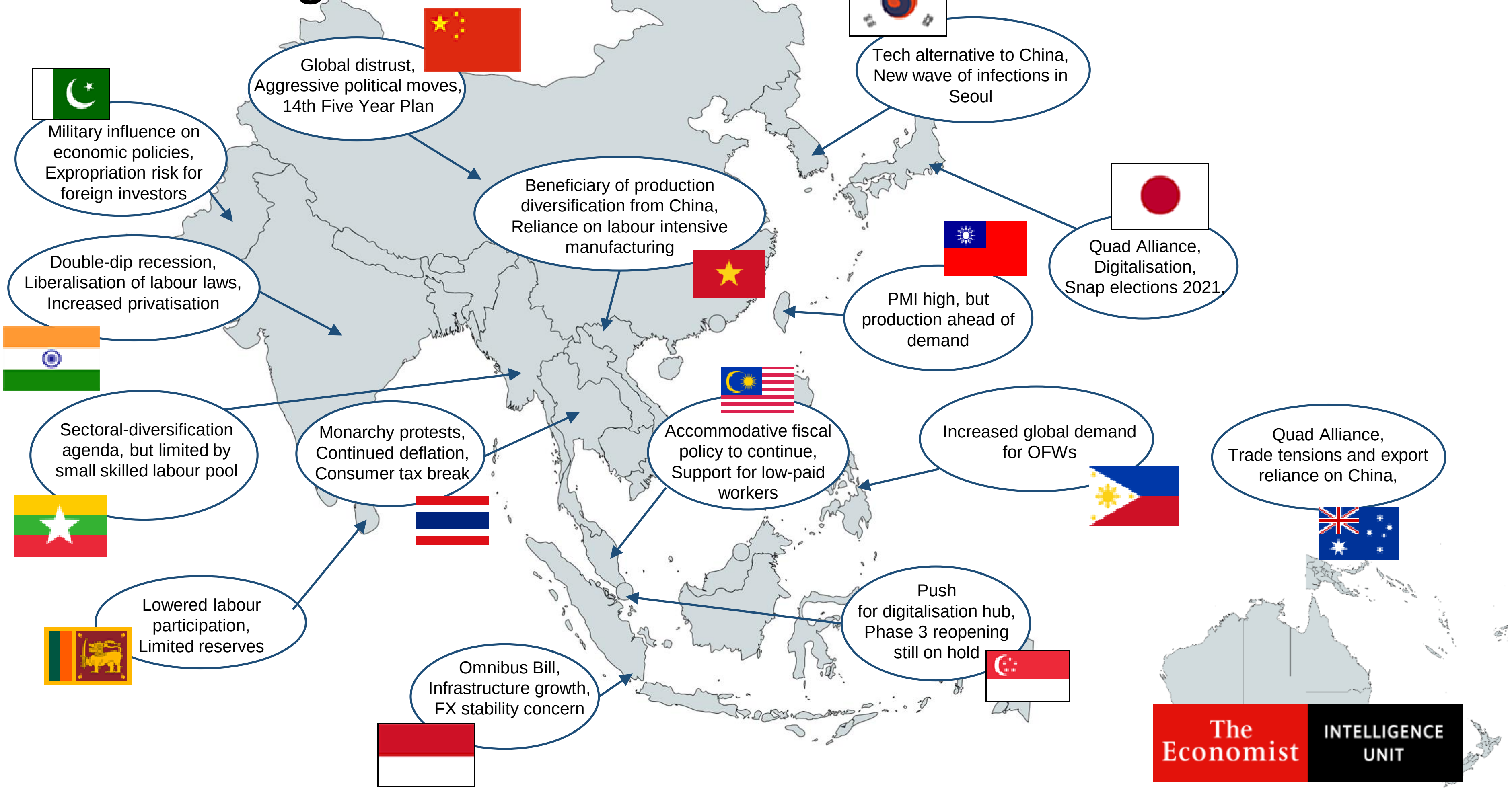
Source: EIU Global Reports

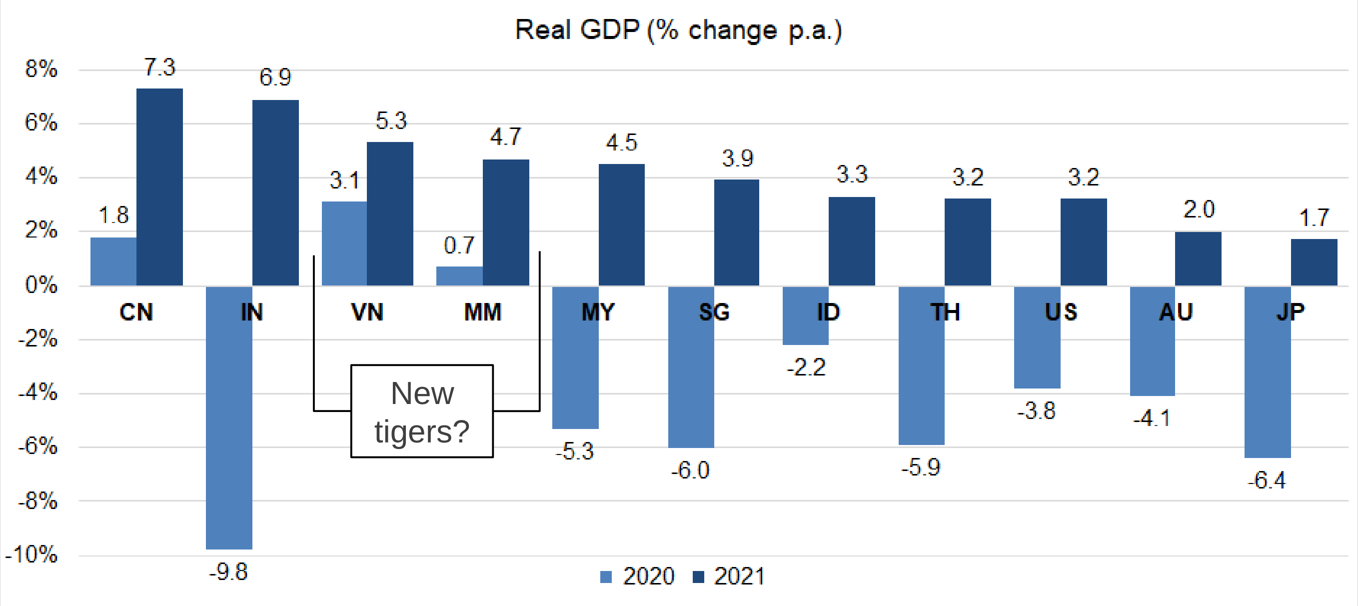
APAC at a glance



APAC economies have different growth drivers

Rapid urbanisation, high saving rates and investment to support overall growth

New Tigers vs. Aging Tigers?



Growth to continue:
Asia will remain the world's fastest growing region in 2020-24

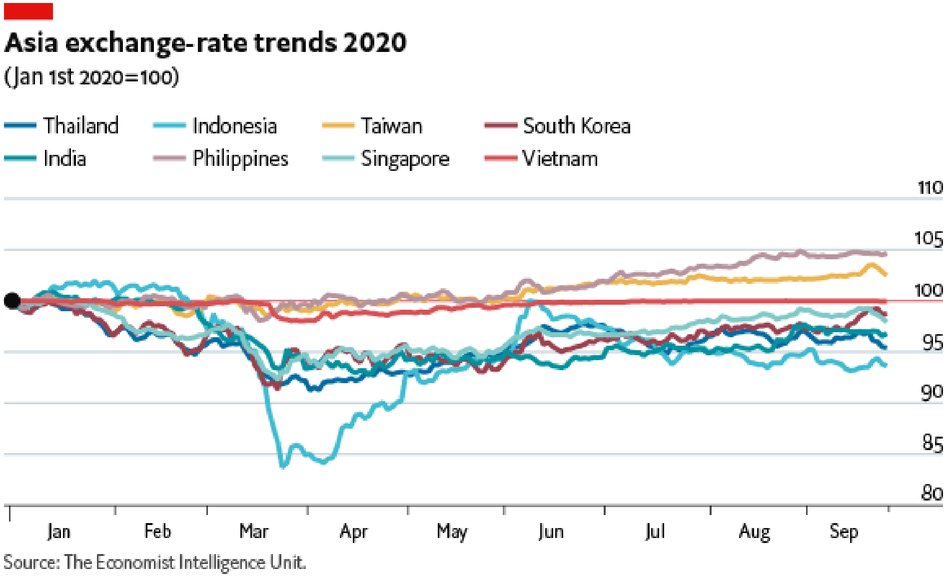
Source of growth:
Varies between consumption and investment

New tigers:
Myanmar, Vietnam and Cambodia will continue to record strong growth rates due to low wage costs

Asian currencies strengthening amid US weakness

Apart from Indonesia’s rupiah, Asian currencies will continue to gain on the dollar

Optimistic sentiment in currency markets is reflected by a retreat from safe-haven assets



Stronger economic performance:
Buoyancy of Asian currencies reflects the region’s stronger performance relative to the global economy.

Highly active central banks:
Currencies have not been allowed to appreciate to pre-pandemic levels as sell-offs continue.
Foreign reserve accumulation accelerates as imports rise.

Leading the pack:
Vietnam, South Korea and Taiwan, where Covid-19 outbreaks were contained, are likely to escape recession and be strong performers in 2021.

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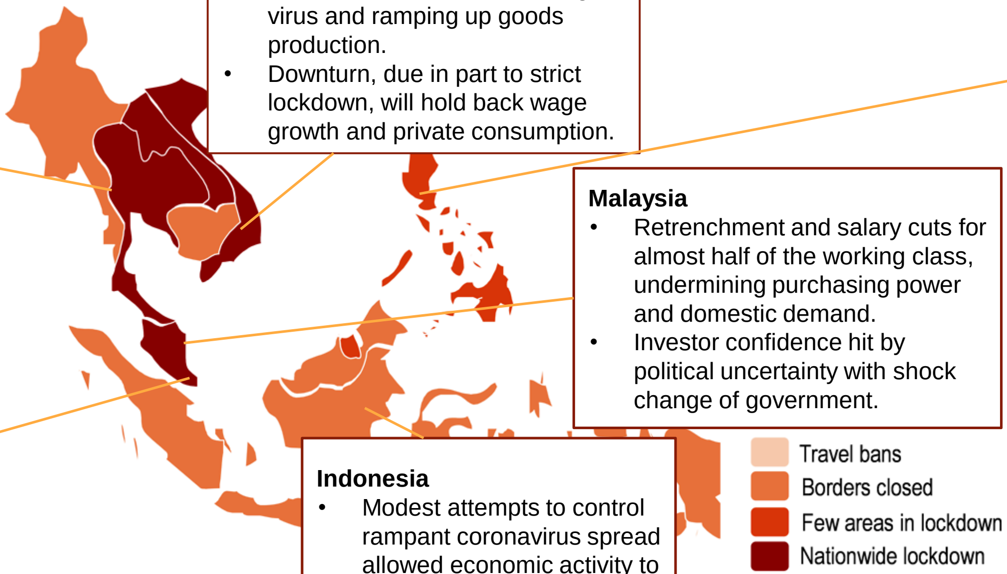
Corona restrictions vary across ASEAN markets

Recovery speed will depend on pandemic measures and domestic economy

Thailand
- Increasingly volatile political climate amid the coronavirus-induced recession.
- Tourism sector set to remain in a prolonged slump.

Vietnam
- Relative success in containing virus and ramping up goods production.
- Downturn, due in part to strict lockdown, will hold back wage growth and private consumption.

Philippines
- Long and robust quarantine measures have taken their toll.
- Severe slumps in manufacturing, construction and transportation, as well as trade, investment and household consumption.



Malaysia
- Retrenchment and salary cuts for almost half of the working class, undermining purchasing power and domestic demand.
- Investor confidence hit by political uncertainty with shock change of government.

Singapore
- Construction and services slow down owing to border restrictions and social-distancing measures.
- Lower export and local demand will weigh on economic recovery.

Indonesia
- Modest attempts to control rampant coronavirus spread allowed economic activity to normalise, but consumer spending remains subdued.
- Omnibus Law and tax incentives to improve the investment environment.

Source: OECD, EIU Country Reports

ASEAN business risk comparison

Assessment based on opportunities and risks facing businesses

Country	Overall business risk
Singapore	13
Brunei	29
Malaysia	32
Thailand	42
Vietnam	48
Indonesia	49
Philippines	52
Laos	58
Cambodia	59
Myanmar	61

Risk Scores

0 - Low risk

100 - High risk

Pandemic policies: Severe economic impact from Covid-19, especially for emerging countries with weaker healthcare systems. Staggered trajectories will make regional recovery difficult.

Reshoring: Countries to boost self-reliance amid global restrictions on movement of people and capital. Protectionism will rise to placate political tensions. Although regional FTAs will help, exports will be disrupted.

Vietnam the sweet spot: Vietnam offers a low-cost regional alternative to China for export-oriented manufacturing. FTAs with the EU and South Korea, along with participation in the CPTPP, will drive growth and an easier business environment.

Source: EIU Risk Briefing Data

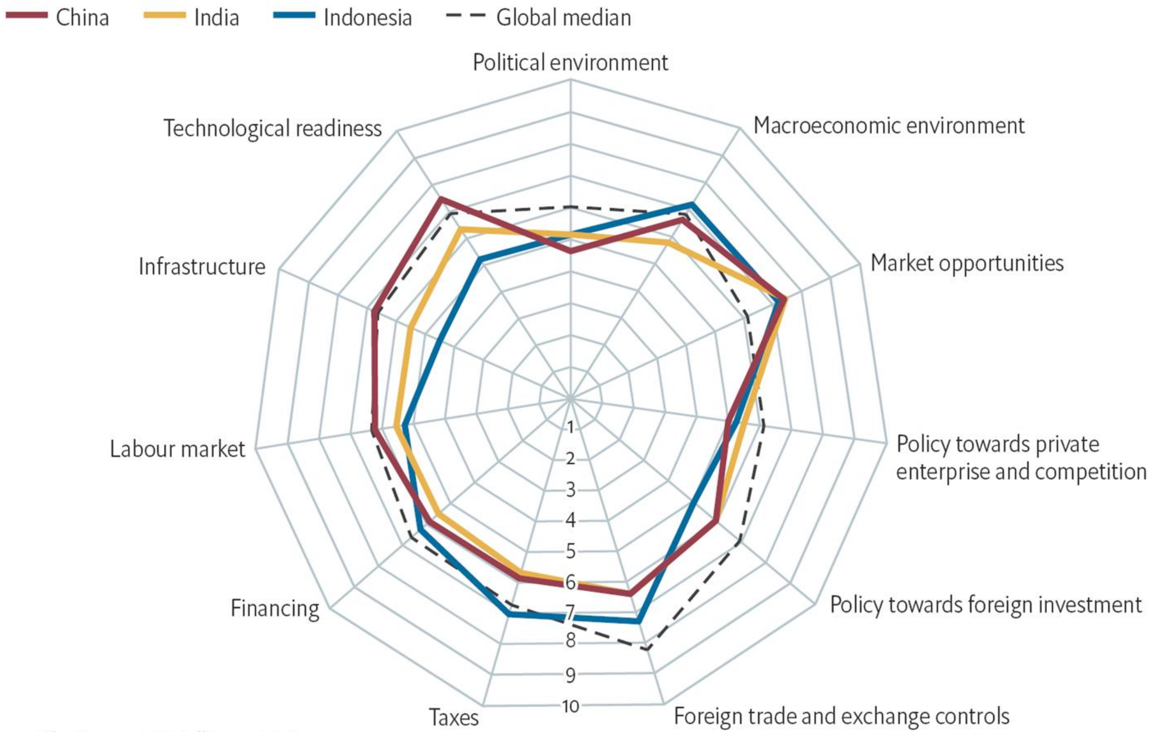
The Economist INTELLIGENCE UNIT

What Asia's self-sufficiency drive means for you

Foreign businesses and investors must pivot and align with local governments

China, India and Indonesia score highly for market opportunities

(Business environment rankings by country, 2021-25; 10 = most favourable)



Source: The Economist Intelligence Unit.

Localisation is paramount!

Add value to the local economy:

Companies will have to demonstrate how they contribute to the local economy to stay

Localisation:

Key to responding well to fluid local market dynamics

Opportunities for growth:

Increase expenditure on local R&D, and delegate more resources to local offices, but beware of reputational concerns

Government Aid:

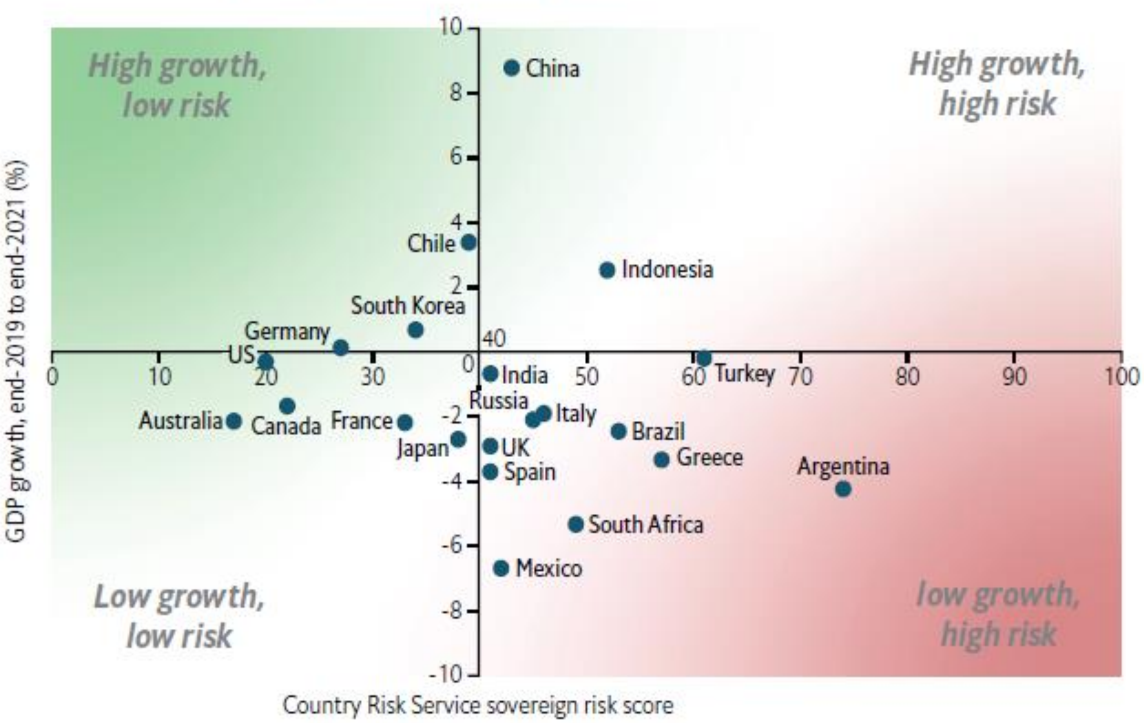
Align with government healthcare policies to receive fiscal incentives, and adopt an effective PR strategy

The Economist INTELLIGENCE UNIT

Investing post-covid: Prepare for a bipolar world

The investment landscape has probably changed for good

Economic recovery prospects and sovereign risk



Notes. Sovereign risk score ranges from 0 (minimum risk) to 100 (maximum risk). A score of 40 corresponds to the boundary between a BBB and BB rating.

Source: The Economist Intelligence Unit.

Investment strategies need to consider the gap between the real economy and the financial economy, and the risks if this delicate balance is disrupted

- Monetary stimulus will begin to tighten in 2021, but asset prices will remain decoupled from economic data
- Watch for a backlash and political risk
- Prepare for a bipolar world

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