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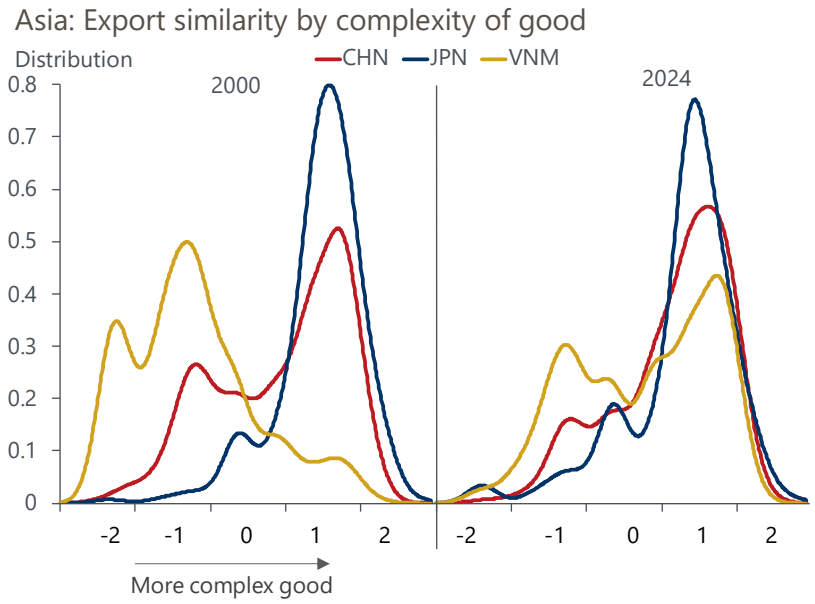
Research Briefing | Asia Pacific

China's export transition reorders regional supply chains

- **China's emerging roles as both a critical intermediate goods supplier to global supply chains and a dominant producer of high value-added goods will remain the key forces sustaining its large current account surplus, far more so than the eventual direction of US tariffs.**
- **The regional implications are varied. Emerging Asian economies are capturing mid-tech assembly niches left behind by Chinese manufacturers. In return, increased Chinese investment in these economies is helping improve local production capabilities, even if the employment dividends are uneven, according to our top-down analyses.**
- **Advanced Asia faces sharper competition and a disinflationary squeeze as China's export profile shifts to mirror theirs. Japan, Korea, and Taiwan now compete with China in parts of the semiconductor value chain, electric vehicles, and precision machinery. As export overlap deepens, production gains are giving way to margin pressure and employment risks.**
- **In response, regional governments are deploying industrial policy to manage the asymmetric nature of their economic relationship with China, balancing rising competitive pressure against continued dependence on Chinese demand, inputs, and investment.**
- **For most emerging Asian economies, the strategy has been to welcome Chinese capital inflows while shielding domestic industries. In contrast, advanced Asian economies are responding by intensifying innovation drives, strengthening strategic partnerships, and diversifying supply chains.**

Chart 1: China's export profile is increasingly mirroring Japan's



Sources: Oxford Economics, TradePrism

Asia's supply chains are navigating China's industrial and export transition

China's ongoing export transition, combined with the widening US tariff wedge between Chinese goods and those from the rest of Asia, is accelerating the outward push of its lower-margin manufacturing

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towards emerging Asia. Increasingly, Chinese producers are relocating assembly and basic processing to emerging Asian economies through direct investment in local factories or by embedding themselves as critical input suppliers to regional manufacturers. This reconfiguration is deepening regional supply chain linkages.

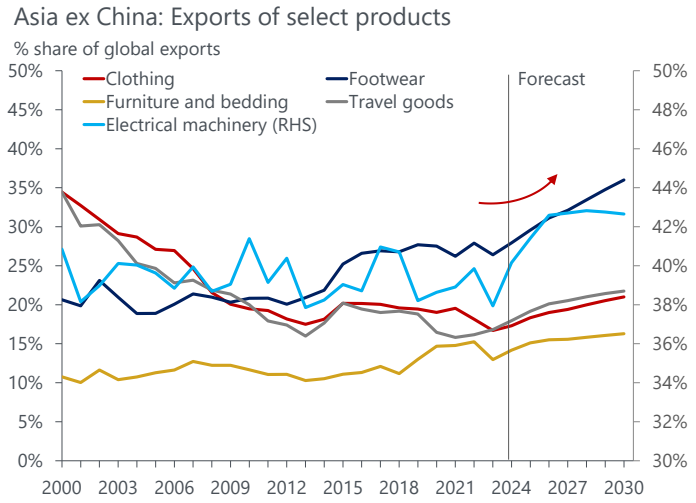
At the same time, another structural shift – this one secular to US tariff policy – is also underway: China's climb up the technological ladder is bringing it into more direct competition with Japan, Korea, and Taiwan in high-value industries. The economy's vast industrial clusters, deflationary cost base, and undervalued currency are allowing mainland firms to compete aggressively in sectors once dominated by its advanced neighbours.

These twin dynamics – Chinese offshoring of low-value production and a domestic upscaling into high-tech industries – are leading to varied government responses as they seek to safeguard domestic industries, preserve competitive advantages, and capture new opportunities from China's investments.

Emerging Asia: Filling the gaps China leaves behind

As Chinese firms become more self-sufficient and technologically advanced, emerging Asian manufacturers are finding room to specialise in mid- and lower-tier production that China leaves behind. The Oxford Economics' TradePrism forecasts to 2035 suggest a clearer hierarchy will emerge within regional supply chains over the next decade (**Chart 2**). China sits at the top, specialising in high-tech capital goods, electric vehicles, and green manufacturing. Middle-income economies such as Malaysia, Vietnam, and Thailand occupy the middle tier in assembly and mid-tech electronics. Meanwhile, lower-income economies such as Cambodia and Bangladesh focus on labour-intensive goods (see our industry team's recent Revealed Comparative Advantage (RCA) analysis).

Chart 2: Some Asian economies will shift their export specialization



Sources: Oxford Economics, TradePrism

However, this stratification masks still-deep interdependence. Much of Asia's manufacturing still relies on Chinese machinery, components, and materials as inputs to local production. With investment flows typically following trade flows, Chinese firms are not only supplying these inputs but also investing directly in regional production (**Chart 3**), such as CATL's battery investments in Indonesia or BYD's new EV facility in Thailand.

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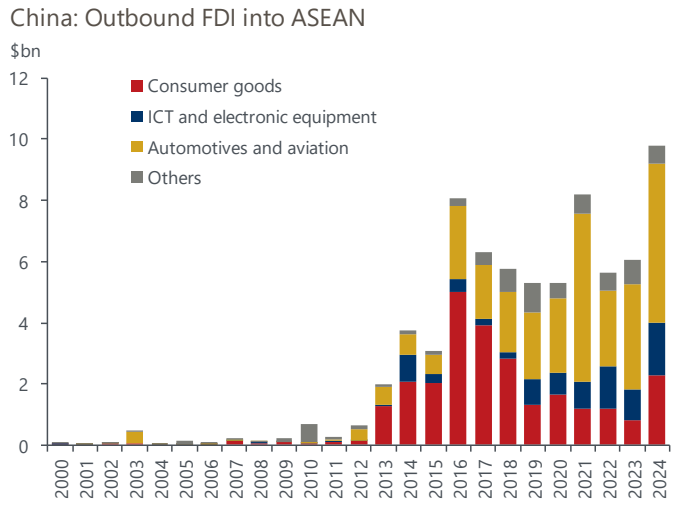
Chart 3: Chinese investments into ASEAN have centred on automotives and mid-tier electronics

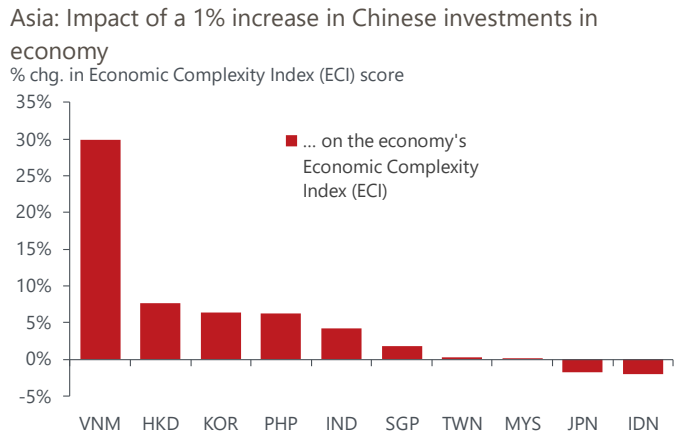


Sources: Oxford Economics, RHG CBM

The economic implications for recipient economies are ambiguous. On the one hand, rising Chinese investment has often accelerated technology transfer and raised production sophistication in recipient economies. On the other, job-creation effects are typically modest (**Chart 4** and **Chart 5**). Here, we examine the historical effects of Chinese FDI on Asian recipient economies' Economic Complexity Index (ECI) – a proxy for technological sophistication – while controlling for global and domestic demand. We regress manufacturing employment and ECIs on Chinese foreign investments by destination, interacted with country-specific indicators.

Vietnam and Thailand stand out in our analysis. Data since 2002 suggest that Chinese capital has deepened technological capabilities in electronics, solar cells, textiles, and machinery, fostering domestic knowledge spillovers despite uneven labour market benefits. However, we caveat that the lack of obvious job gains might not necessarily mean that Chinese investments don't improve domestic labour conditions in recipient economies. For instance, mid-tech job gains in favour of low value-added roles could imply beneficial labour force upskilling.

Chart 4: Recipient economies' economic innovation and industrial productivity tend to improve



Source: Oxford Economics

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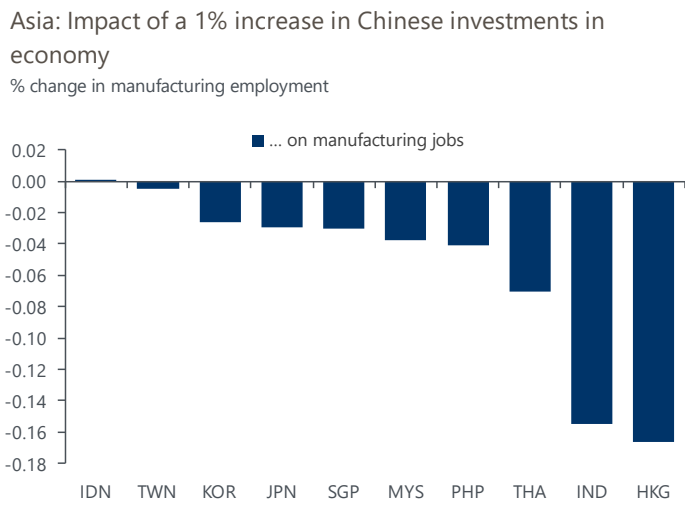
Chart 5: The number of jobs doesn't necessarily increase as a result of Chinese investment



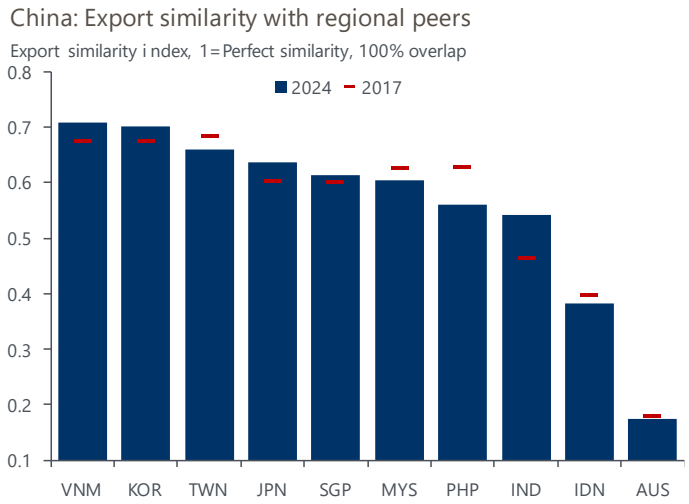
Source: Oxford Economics

Advanced Asia: Competing at the frontier

For advanced Asian exporters – Japan, Korea, and Taiwan – China's ascent into higher value-added sectors presents a sharper competitive challenge.

As mainland China's production processes increase in sophistication, their export mix increasingly overlaps with that of their Northeast Asian peers (**Chart 6**). Furthermore, today's macro backdrop in China – more acute deflation, a weaker renminbi, and targeted state and industrial subsidies – further tilts competitiveness in China's favour, making the relocation of higher-value manufacturing out from China less compelling than it was five years ago.

Chart 6: China's export structure is increasingly mirroring advanced Asia's



Sources: Oxford Economics, Trademap

Competitive pressures are already evident. China now accounts for more than one-third of global chip assembly and testing, while its semiconductor imports from Korea continue to fall. In EVs and batteries, national champions such as BYD, NIO, and CATL have captured sizeable global market shares, squeezing traditional producers across Japan and Korea.

The economic implications of increased direct competition with China's exporters are mixed. We show that a one-standard-deviation rise in export similarity with China is initially associated with higher employment as firms intuitively scale up to compete (potentially bringing about increased initial production capacities in the region). However, this gain typically reverses within four years, giving way to job losses and price

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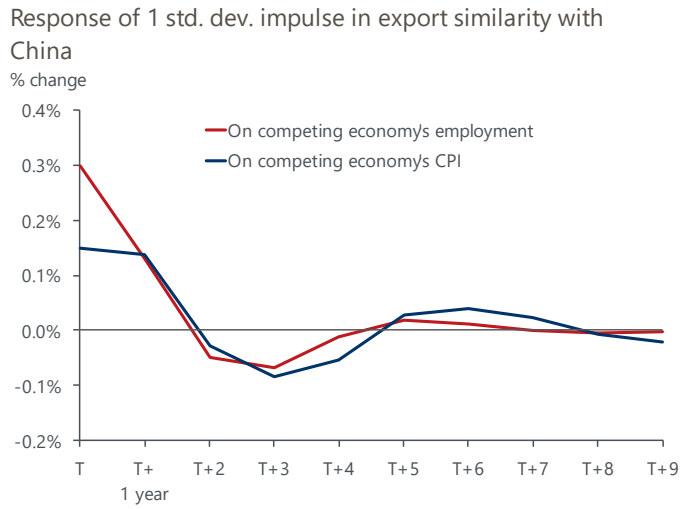
softness (**Chart 7**). The disinflationary impact is more or less consistent with academic estimates showing a roughly 0.6ppts downward pressure in regional prices following a 1ppt downward shock to Chinese export price inflation.

Chart 7: Increased export competition with China tends to be disinflationary, driving down employment



Source: Oxford Economics

While the empirical results are intuitive, we think that they are likely to still understate headwinds across advanced Asia. Importantly, for these economies, historical offsets from China's import demand are now much smaller. The foreign value-added share of China's own exports has declined from 19% in the mid-2000s to about 14% today. As a result, stronger Chinese exports no longer translate into the same import boost (for intermediate goods) from Japan, Korea, or Taiwan, magnifying the net competitive drag.

Policy responses: Managing the transition

Governments across Asia are responding to China's export transition with a mix of industrial policy, investment incentives, and technology partnerships.

In emerging Asia, the priority is to capture new investment inflows – much of this from China – while upgrading domestic capabilities. Thailand has launched generous EV and battery incentives. Malaysia and Vietnam are positioning as regional electronics and EV hubs through various tax and infrastructure support. India has strengthened labour force training and manufacturing incentives for semiconductor production.

Advanced Asia is doubling down on innovation and strategic alliances. Japan is expanding semiconductor and precision machinery investment under its Chip Act and joint US–EU ventures. Korean automakers are shifting toward premium EVs and US-based production to benefit from Inflation Reduction Act incentives. Taiwan's TSMC and Foxconn are diversifying their global footprint to retain technological leadership.

What to watch out for

Several policy and legal developments could shape the near-term outlook on trade flows in the region:

- **US-China negotiations and IEEPA tariff rulings:** A potential deal on fentanyl could cut Chinese tariffs by up to 20ppts, narrowing China's cost disadvantage and partially reversing relocation trends. Beijing's critical-mineral export controls remain a key bargaining chip. At the same time, a Supreme Court ruling limiting tariff powers under the International Emergency Economic Powers Act could remove roughly 30ppts of China's tariff burden, though alternative executive powers could preserve similar measures.
- **Transshipment penalties:** Washington's proposed 40% tariff on goods routed through low-tariff economies could either dampen or accelerate diversification, depending on how rules of origin and Chinese content are enforced.

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- **China's own controls:** Beijing's tightening over outbound capital, technology transfer, and critical-mineral exports – alongside selective retaliation – may temporarily slow diversification momentum.

Overall, these policy shifts underscore that Asia's supply-chain realignment is being driven less by cost competitiveness and more by geopolitics and China's industrial strategy. Tariffs, US court rulings, and export controls may cause short-term reversals, but the long-term direction is clear: China's central role in regional production networks will deepen. For the rest of Asia, governments will have to continue their efforts in cushioning the risks of this dominance while leveraging it to accelerate their own industrial upgrading.

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