

Regional Analysis China

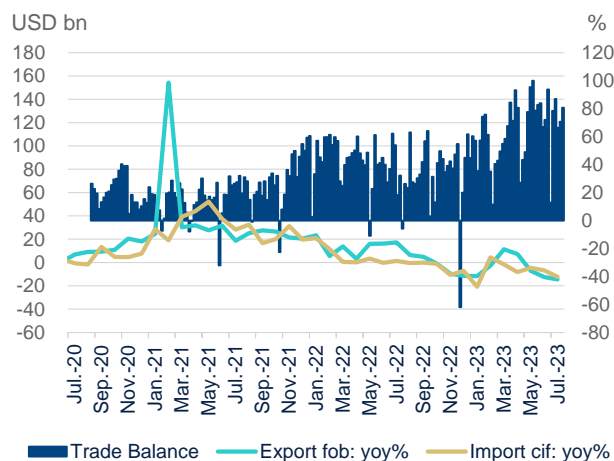
# China | Structural change of China’s international trade: “forced” imports substitution industrialization

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China’s stunning exports used to be the main growth engine during 2020-2022 Covid-19 pandemic time thanks to China’s “zero Covid” policy. The manufacturing sector of China was operated in full gear to meet global demands when the rest of the world is grappling with the virus.

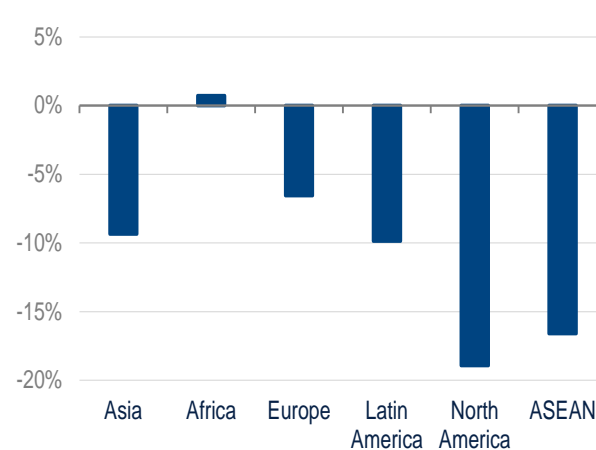
However, the situation changed dramatically in the post-pandemic era, as the advanced economies entered into growth slowdown due to the aggressive central bank interest rate hikes to curb historical high inflation. Under the weak external demand, China’s exports growth dipped to -14.5% in July and -8.8% in August. On the other hand, imports growth also decelerated significantly to -7.3% in August (-12.4% in July) amid sluggish domestic demand and weak household and enterprises sentiments. (Figure 1 and 2)

Figure 1. EXPORT AND IMPORT GROWTH DECLINED SHARPT IN POST-PANDEMIC ERA



Source: CEIC and BBVA Research

Figure 2. CHINA’S EXPORTS TO ALMOST ALL REGIONS DECLINED RECENTLY



Source: BBVA Research and CEIC

On top of the aggregate export and import figures, when we dig out the composition of exports and imports data deeper, it is not difficult to find that China is experiencing significant structural changes of both exports and imports sectors.

Briefly speaking, Chinese economy is experiencing “forced” import substitution industrialization (ISI):

- (i) China is transferring from importing final goods with technology content from advanced economies to importing raw materials and conducting high-end manufacturing domestically for technology self-sufficiency purpose and then to export them to the economies;

- (ii) China is also experiencing the transformation from exporting lower-end manufacturing goods to high-end manufacturing goods. The technology contents of Chinese exports have also been rising over time, chief among them, the most stunning performance is EV exports while traditional low-end exports, such as textile, has been declining and these lower-end manufacturing products have been gradually relocated to other regions in southeast Asia, India and Latam etc. amid global value chain relocation.

The so-called Import substitution industrialization (ISI) is a trade and economic policy that originally advocates replacing foreign imports with domestic production. It is based on the premise that a country should attempt to reduce its foreign dependency through the local production of industrialized products. ISI policies have been enacted by developing countries with the intention of producing development and self-sufficiency by the creation of an internal market. The term primarily refers to 20th-century development economics policies, but it has been advocated since the 18th century by economists such as Friedrich List and Alexander Hamilton.

Unlike the original implication of Import substitution industrialization (ISI), China's ongoing Import substitution industrialization has its new version and it comes against several global factors, chief among them are the background of US-China trade war and technology war, ever-rising geopolitics as well as the weak external demand in the post-pandemic era.

Here are quite a number of evidences of China's forced Import substitution industrialization (ISI) based on the recent trade data outturns, we summarize four of them as below:

**First, the recent import data show that China continues to import large amount of commodities and agricultural products, but import much less high-tech intermediate goods** (such as semiconductors, unicircuit, machine tool, LCD display module etc.) **and high-tech final goods** (such as automobile and electronic products) which experienced double-digit decline. This pattern is found not only by value but also by volume. (Figure 1 and 2)

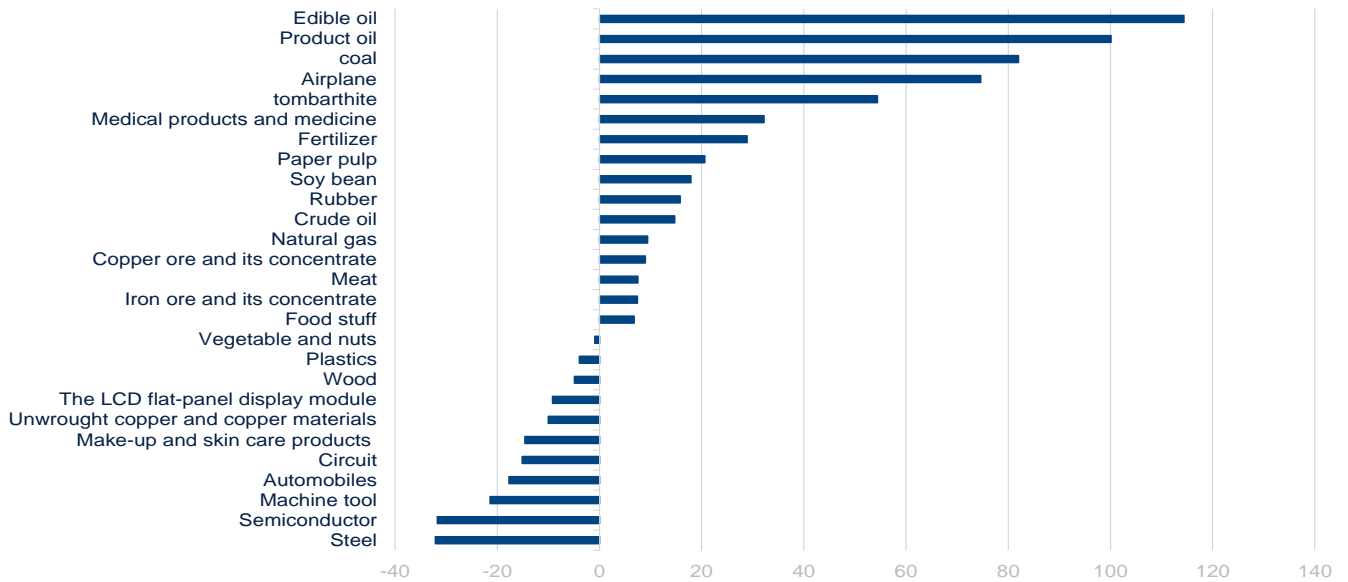
The main reason for the above import structural change is the US "de-coupling" (or "de-risk" the recent more fashionable and moderate political term) strategy. As the US banned the exports of high-tech final products, high-tech intermediate goods and advanced technology to China, China has started to develop these technologies all himself as well as to try to produce these high-tech intermediate and final goods domestically under "technology self-sufficiency" national strategy.

**Second, another feature of China's forced Import substitution industrialization (ISI) is that China started to import more of raw materials (such as agricultural goods, copper ore and concentrate etc.) and commodities but less of refined commodities** (such as copper products and unwrought copper, steel, plastics, rubber etc.). It seems like China has explored its own capacity to refine these raw commodities domestically instead of directly importing refined commodities. (Figure 3-5)

This phenomenon is particularly obvious in copper imports. For instance, China has imported more copper ore and concentrates while much less of unwrought copper and copper products. The other obvious example is oil: while China's crude oil imports remained high at 14.7% by volume, China also exports product oil significantly to other countries (42.6% by volume)

One direct explanation is due to the launch of some large clean copper refining projects in February and also in Q2 2023, releasing large capacity for copper refining domestically. Some commodity reports indeed summarize these new green refining projects launched in 1H 2023. (Table 1) Second, due to the geopolitical reason, China is willing to expand its strategic energy reserve in face of uncertainties of China-US conflicts in the future.

Figure 3 CHINA'S IMPORTS GROWTH: BY SECTOR AND BY VALUE (% y/y)



Source: General Administration of Customs of People's Republic of China

Figure 4 CHINA'S IMPORTS GROWTH: BY SECTOR AND BY VOLUME (% y/y)



Source: General Administration of Customs of People's Republic of China

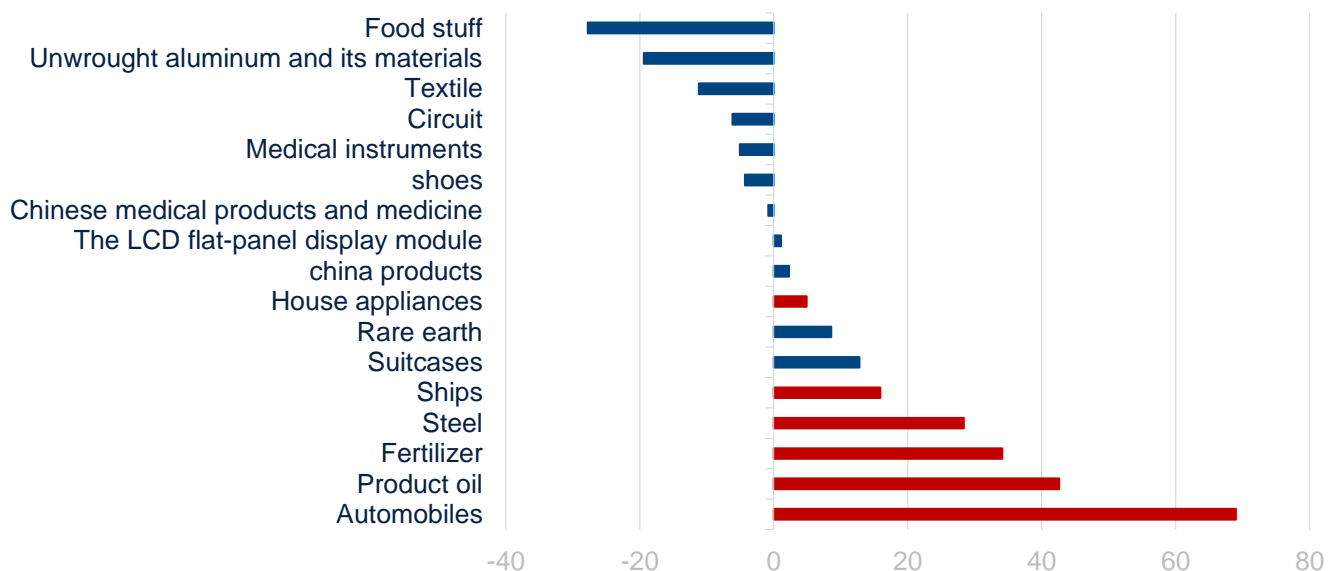
Table 1 **SUMMARY OF NEW GREEN PROJECTS OF COPPER REFINING**

Company name	Newly developed refining capacity (10 thousand tons)	raw materials	Lauch time
Daye Nonferrous Metals Group	40	copper concentrates	14-Feb-23
Guo Run Copper. (Shandong Yantai)	8	copper concentrates	Q2 2023
Baiyin Nonferrous Group Co.	20	copper concentrates	Jun-23
Zhongtiaoshan Non-ferrous Metals Group Co.,	18	copper concentrates	Oct-23
Jiangxi Copper Company Limited	10	copper concentrates	1H 2023
<b>Sum</b>	<b>96</b>		

Source: BBVA Research and summary of commodity research reports

Third, China has started to export more high-tech related products to different geographics, in particular, the most stunning performance is China’s Electronic Vehicles (EV) exports which takes a large share in global EV trade even in the background of weak external demand. That means, the domestic technology contents of Chinese exports have been rising over time. (Figure 5)

Figure 5 **CHINA’S EXPORTS GROWTH: BY SECTOR AND BY VOLUME (% y/y)**



Source: Source: General Administration of Customs of People’s Republic of China

Fourth, under the framework of value chain relocation outside of China and “China+1” strategy applied by multinational firms, the lower-end manufacturing exports from China is significantly declining while high-

**end exports is ramping up, indicating higher-end enterprises still chooses China for manufacturing** due to China's special advantages. That means, in the future, China will transfer from low-end world factory to high-end world factory going forward. See our previous [Economic watch: China | De-Sinicization of Global Value Chain after COVID-19](#) (Figure 5)

In sum, the ongoing structural change of China's exports and imports indicate that China is experiencing the transformation of trade and manufacturing upgrading. In particular, China is transferring from importing high-end final goods from advanced economies to importing raw materials and conducting high-end manufacturing domestically for technology self-sufficiency purpose and then to export them to other regions; in addition, China is experiencing the transformation from exporting lower-end manufacturing goods to high-end manufacturing goods. The technology contents of Chinese exports have been rising over time, the most stunning performance is EV exports while traditional low-end exports has been declining and these lower-end manufacturing products have been gradually relocated to other regions in southeast Asia, India and Latam amid global value chain relocation wave.

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