Global Research

Special Report

Shop Talk – What GBA clients think

- Our annual survey of manufacturers operating in China's Greater Bay Area (GBA) shows a recovery across orders, sales, hiring, wages and capex in 2021. Larger manufacturers are operating closer to pre-COVID levels and look set to outperform smaller respondents.
- Beyond the expected y/y improvements in performance metrics, our survey also shows lingering labour-market slack and weak appetite for investing in key innovations. Respondents are less eager to move their capacity overseas.
- That said, diversification looks set to remain a strong driver of factory relocation; we see ASEAN capturing a greater share of global investment and exports over time.
- Respondents expressed greater confidence in the long-term GBA outlook; we see the GBA benefiting from a broad range of drivers, a sizeable population and strong policy support.

Issuer of Report Standard Chartered Bank (HK) Limited

Important disclosures and analyst certifications can be found in the Disclosures Appendix

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Our clients have something positive to say

We conducted our first annual manufacturing survey 12 years ago to assess China's vulnerability to a worsening labour shortage and rising wages. In more recent years, the survey's focus has shifted to tracking the rise of the Greater Bay Area (GBA), given China's aspiration to create the world's largest city cluster by linking Guangdong, Hong Kong and Macau. The GBA is a microcosm of China's fast-transforming manufacturing landscape, as well as its innovation drive, emerging consumerism, financial opening, and the effectiveness of policy support. As such, looking through the GBA lens allows us to understand China better. This year's survey provides additional valuable insights into how fast and far the GBA has emerged from last year's COVID shock.

Some recoveries are faster than others

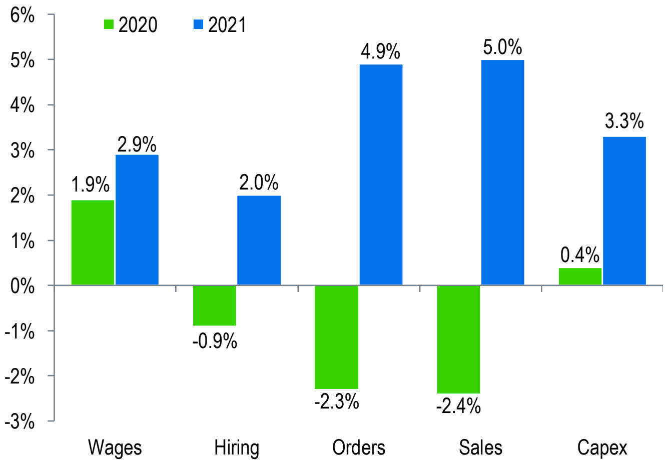
Orders and sales lead the GBA's post-COVID comeback

Our respondents expect the survey's five key performance metrics – orders, sales, hiring, wages and capex – to improve from last year, mirroring the nationwide trend of a steady post-COVID recovery (Figure 1). Orders and sales are expected to rebound the most, by an average of 4.9% and 5.0%, respectively, this year; this is unsurprising following contractions of more than 2% last year. Last year's 0.4% increase in capex suggested that many companies needed to increase investment again amid a strong order recovery and supply shortages as the H1-2020 COVID setback was largely reversed. This looks likely to carry over into 2021, with the average expected capex increase at 3.3%. Respondents are also back in hiring mode after a pause in 2020 (+2.0% from -0.9% prior), while wage growth is also expected to reaccelerate (to +2.9% from +1.9% prior).

Larger manufacturers are operating closer to pre-COVID levels and look set to outperform smaller respondents in 2021. The divergence in responses across the wide range of industries seems less pronounced than in previous years; that said, semiconductor manufacturers do appear keener to move capacity overseas. Regardless of size and industry, our clients' top concern is a COVID resurgence, and they have turned more upbeat on the market outlook for China and the rest of Asia. A majority of them expect USD-CNY to end 2021 between 6.30 and 6.70.

Figure 1: Business performance metrics rebounding

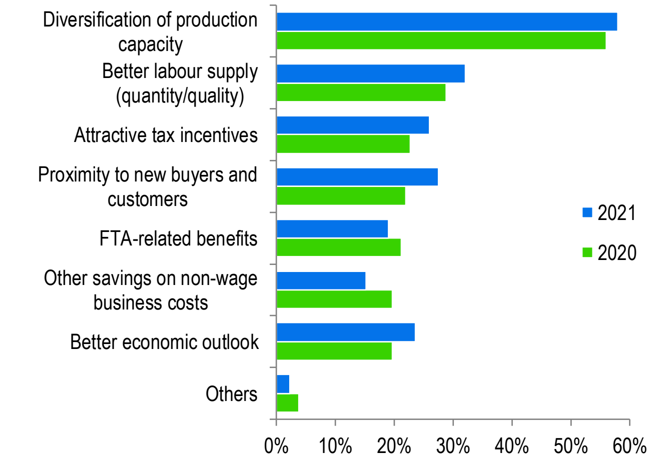
Average actual (2020) and expected (2021) change, %



Source: Standard Chartered Research

Figure 2: Non-wage advantages of relocating factories

% of respondents



Source: Standard Chartered Research

Labour-market tightness, appetite for technology upgrading, and the push to relocate factories may take longer to return to pre-COVID levels

The more in-depth survey questions, however, reflect more measured improvements in business activity and confidence. In particular:

- **Lingering labour-market slack:** Despite expectations of re-accelerated hiring, more respondents are finding it easier to hire staff than a year ago; the 2.9% average increase in wages this year is also still below the pre-COVID pace. This indicates lingering labour-market slack, which means less urgency for manufacturers to relocate factories and/or pursue industrial upgrading.

- **Weak appetite for key innovations:** Despite clear plans to increase capex and a preference for automation to save costs, respondents (especially smaller manufacturers) do not plan to make significant progress on key innovations such as robotics and artificial intelligence this year. Smaller manufacturers see the uncertain economic and business outlook as the biggest hurdle to industrial upgrading, while larger respondents selected 'too costly to implement' and 'need more strategic thinking' as their top concerns.

- **Less keen to relocate:** Respondents appear less keen to move factories overseas than they were a year ago. In addition to weaker labour pressures, China's faster recovery is likely incentivising manufacturers to stay onshore; recent COVID resurgences in some potential relocation destinations may have also played a role. Despite this lack of urgency to relocate, our survey shows that the structural case for diversification remains strong.

Diversification to drive more investment to ASEAN

ASEAN should continue to benefit from GBA manufacturers' diversification needs over time

Vietnam is again our clients' most favoured relocation destination, followed by Cambodia and Bangladesh. For many years, ASEAN economies have benefited as investment has been diverted away from China due to rising costs; ASEAN also offers new market potential, attractive tax incentives and FTA-related benefits. However, companies are now citing the diversification of production capacity as their primary reason to relocate away from China (Figure 2). Our survey also shows that respondents with existing production in ASEAN are seeing an increase in orders diverted from China (c.32%) to their ASEAN operations, up from only 17% in 2020; more than 30% said they planned to add more capacity in ASEAN due to the US-China trade war and COVID-19. 45% of those who have invested in ASEAN said they are satisfied with their move. We expect ASEAN to capture an increasing share of global investment and exports over time.

GBA as a concept seems to be growing on manufacturers

Respondents are more upbeat towards the long-term outlook of the GBA and its impact on their business

In addition to seeing their businesses recover from COVID, more respondents expressed long-term confidence in the GBA than a year ago. A majority (66%) see the GBA presenting new business opportunities a few years down the road, up from 58% a year ago; this could reflect manufacturers' growing familiarity with the GBA, as many of our surveyed companies have probably operated in the region for a long time. The swift post-COVID reopening of factories in the region also showcases its reliability as a primary production base for companies keen to tap onshore China demand. We believe the GBA will be able to live up to clients' lofty expectations thanks to its broad range of growth drivers beyond manufacturing: a sizeable (and still-growing) population; strong policy support, including a commitment to more R&D-related spending to drive innovation; and accelerated financial opening and Renminbi internationalisation, which should promote further cross-border integration with Hong Kong.

GBA survey – 2021

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Insights into the GBA's post-pandemic recovery

What's recovering, and what's not

Over 220 manufacturers told us their views on what has improved since the post-COVID recovery started, and what has yet to improve

We recently conducted our annual client survey for a 12th straight year in 2021, between mid-March and mid-May, with over 220 manufacturers answering questions related to their current operations and business outlook. The surveyed companies are mostly headquartered in Hong Kong, Taiwan or mainland China, and all have operations in the Greater Bay Area (GBA). Our survey respondents are among the more successful firms in the region, having survived a decade-long labour shortage and wage inflation, and in more recent years, a global slowdown. The strong profiles of our survey's participating corporates usually lend the survey results a positive tilt, and this year is no exception, as they have weathered escalating trade headwinds and a global pandemic outbreak in the past year.

In addition to providing valuable insights into how fast and far the GBA has emerged from the COVID shock, these corporates' leading presence in the region makes them key to assessing the outlook for labour-market conditions, factory relocations out of China, industrial upgrading and the effectiveness of policy support.

There are four parts to our survey findings; we list the key takeaways below.

How the recovery is shaping up ***(page 7)*****:** Respondents expect improvements across the five key performance metrics – orders, sales, hiring, wages and capex – from last year, mirroring the nation-wide steady post-COVID recovery trend. Larger manufacturers are operating closer to pre-COVID levels and look to outperform smaller respondents in 2021. Respondents are still most concerned about a COVID resurgence and more upbeat towards China and the rest of Asia in terms of market outlook, although rising costs and supply challenges would garner more votes if the survey were conducted today, in our view. 37% of respondents expect USD-CNY to end 2021 within the 6.50-6.70 range, with another 29% estimating 6.30-6.50.

Labour and wages ***(page 11)***: Respondents expect wages to rise by an average 2.9% in 2021 after edging up 1.9% in 2020 (which exceeded the expected 0.2% decline, based on last year's survey). However, this is still below the pre-COVID wage increase trend, with more respondents continuing to find it less difficult to hire staff than a year ago; this, along with only 19% respondents seeing a persistent labour shortage, suggests lingering job-market slack despite the y/y improvement. This labour-market slack supports the authorities' decision to remain focused on job creation this year, in our view. A majority 54% of respondents see wages accounting for 20-30% of their total cost base.

Factory relocation ***(page 14)*****:** Respondents appear less keen to move factories overseas than a year ago, partly given the easing labour shortage and manageable wage pressure, and possibly rising concerns over a COVID resurgence in potential relocation destinations. That said, we see several structural reasons to relocate in the medium to long run. 58% of respondents cite diversification of production capacity as their top driver of relocation overseas, with Vietnam still the most favoured destination, followed by Cambodia and Bangladesh.

Industrial upgrading ***(page 17)*****:** Manufacturers plan to increase capex by an average 3.3% in 2021, with automation remaining a top strategy for tackling wage pressure. However, respondents do not plan to make significant progress on key innovations such as robotics and artificial intelligence this year. Beyond 2021, 54% maintain a long-term target of industrial upgrading, but this is still below the 2019 pre-COVID level of 63%, indicating another area of business where recovery remains slow, with an uncertain economic/business outlook cited as the biggest hurdle.

How is the recovery shaping up?

Speed versus breadth through the survey lens

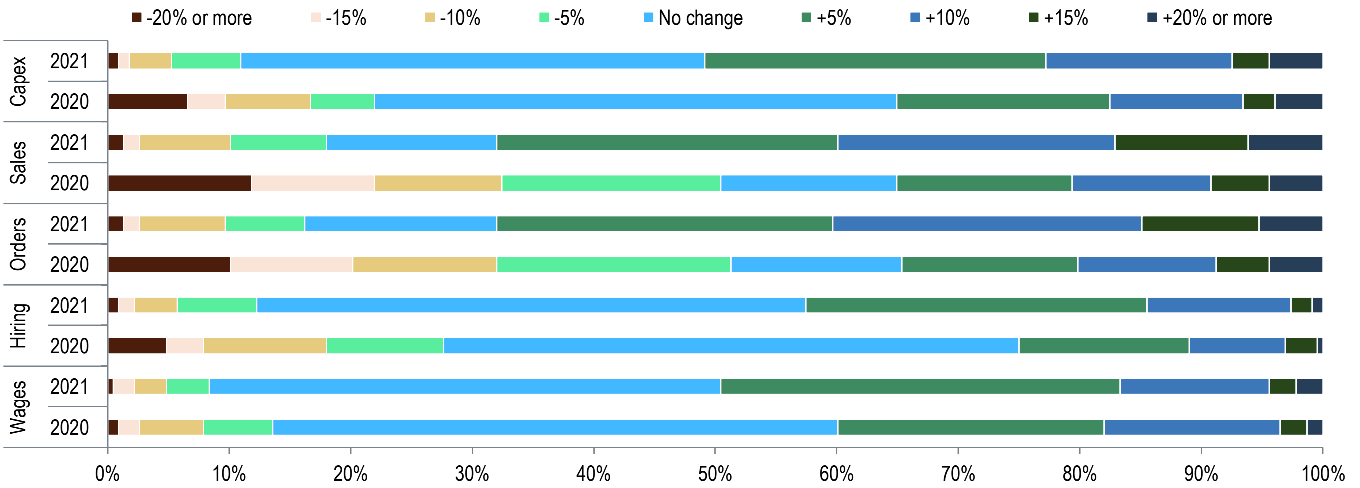
Key business performance metrics echo the narrative of a swift nationwide post-COVID recovery

We asked our clients how their businesses performed in 2020 and what they expect for 2021 (Figure 3). They confirmed that a recovery is well underway. In this report, we seek deeper insights by investigating the breadth of the improvement so far, and whether this momentum can be sustained for the rest of 2021 and beyond.

Orders: 68% of respondents expect orders to rise by an average 9.5% in 2021, against only 16% expecting an average fall of 9.2%. This is an evident turnaround from actual 2020 performance. 51% reported fewer orders in 2020 (an average drop of 11.1%) versus 35% reporting an actual average rise of 9.8%. We think this may have been worse if not for the quick containment of the domestic COVID crisis, which allowed a swift factory reopening to capture the subsequent local and global demand recovery.

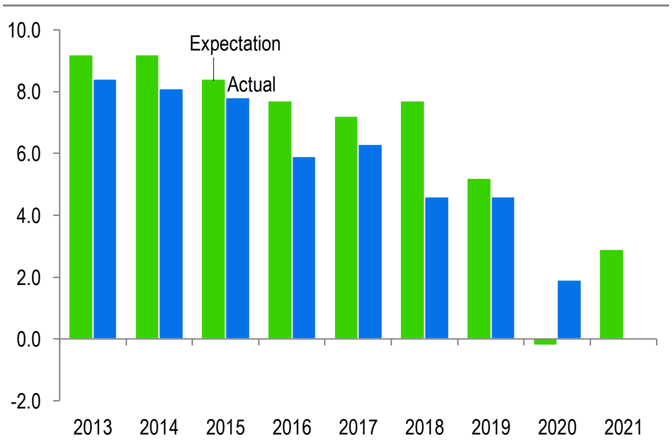
Sales: Similar to orders, 68% of respondents expect sales to rise by an average 9.6% in 2021, while 18% see an average decrease of 8.9%. 50% reported worse sales in 2020 (an average drop of 11.6%), materially more than 35% who reported an improvement (an average 9.9% increase).

Figure 3: How did the following metrics change in 2020, and what are your expectations for them in 2021?
% of respondents



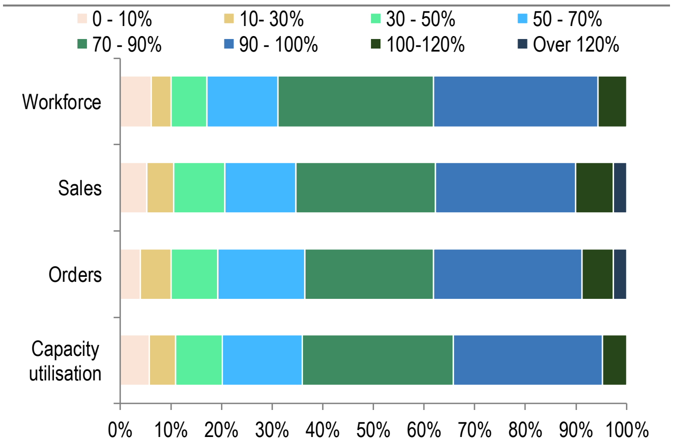
Source: Standard Chartered Research

Figure 4: Wage expectations rebounding
Surveyed wage increase, expectation vs actual



Source: Standard Chartered Research

Figure 5: Where do the following metrics currently stand compared with pre-COVID levels? *(% of responses)*



Source: Standard Chartered Research

Hiring: Respondents are back in hiring mode after a pause in 2020, likely on a combination of recovering capacity utilisation and improving business prospects. 43% of respondents expect more hiring this year, with only 12% stating they would hire less. This expansion bias contrasts with last year, with only 25% reporting an actual increase in headcount, while 28% reported a contraction. On average, hiring is expected to rise 2.0% in 2021, versus an actual 0.9% decline in 2020.

Wages: Respondents expect wages to increase by an average 2.9% in 2021, versus more modest but still-positive growth of 1.9% last year. Only 14% respondents lowered wages in 2020, while 40% still hiked wages or were willing to hike; this metric improved to 50% expecting to increase hiring (in this year's survey), versus only 8% expecting less hiring this year. Nonetheless, the expected 2.9% average wage increase this year is low compared with pre-COVID levels: 2018 and 2019 each had actual average wage hikes of 4.6%, based on prior surveys (Figure 4). This implies further room for improvement once economic activity (especially overseas) normalises and international travel resumes.

Capex: Interestingly, more companies increased their capital expenditure (35%) than those reporting a decrease (22%) last year, by an overall average 0.4%. We think this is because many companies needed to add investment again after the H1-2020 COVID setback was largely reversed due to the subsequent strong order recovery and the supply shortage. Respondents broadly expect capex to pick up in 2021: 51% see capex rising while 11% expect a decrease, with the average expected capex increase at 3.3%.

On track to returning to 'normal'

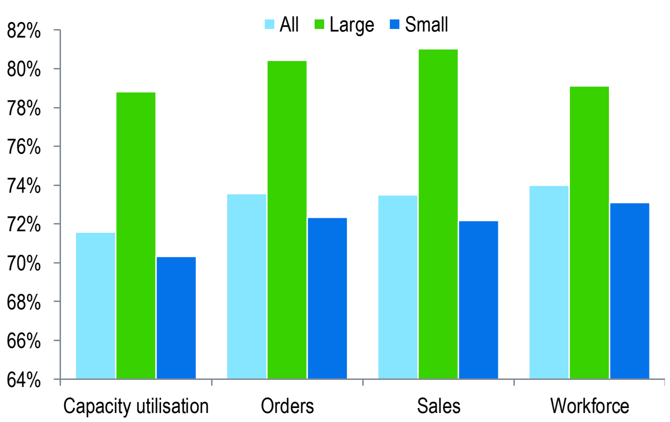
15-20% of respondents are still operating at 50% or below their pre-COVID levels

We asked respondents where they currently stand compared to normal (pre-COVID) operational levels. 60-70% said they are currently operating at 70% or more of pre-COVID levels on all four business metrics: capacity utilisation, sales, orders and workforce strength (Figure 5). The survey results show that 15-20% of companies surveyed are still operating at 50% or below pre-COVID levels on all four metrics. However, more companies are performing at above 100% on orders (8.8%) and sales (10.1%) than on capacity utilisation (4.8%) and workforce (5.7%). We think this is understandable, given that additional orders and sales can be met by maximising capacity, but expanding capacity and workforce numbers in a short period could be more challenging.

Figure 6: Larger companies showing more resilience
Average actual (2020) and expected (2021) change

Source: Standard Chartered Research

Figure 7: Larger respondents closer to returning to normal levels *(% of pre-COVID levels)*



Source: Standard Chartered Research

Interestingly, in a separate quarterly survey that informs our GBA Business Confidence Index (GBAI), we asked a similar question about operational levels versus pre-COVID – we asked this in our *Q2-2020* and *Q4-2020* quarterly surveys. While we acknowledge that our quarterly and annual surveys are not directly comparable given their different sample populations, the results of our GBAI quarterly survey also reflected a swift post-COVID normalisation of business operations. In Q2-2020, 31% reported capacity utilisation at 50% of pre-COVID levels or below; 34% reported new orders at 50% or below. In Q4-2020, the corresponding numbers had dropped to 13% and 12%, respectively.

These quarterly survey responses differ from the equivalent response of c.15-20% (reporting operational levels 50% or below pre-COVID levels) in our latest annual survey. Based on our previous quarterly GBAI surveys, we believe the variance is because the quarterly survey sample includes respondents from more resilient non-manufacturing industries such as 'financial services' and 'innovation and technology, and more respondents from mainland GBA cities, which recovered faster than their Hong Kong-based counterparts (who comprise the majority of our annual survey).

Size matters when it comes to resilience

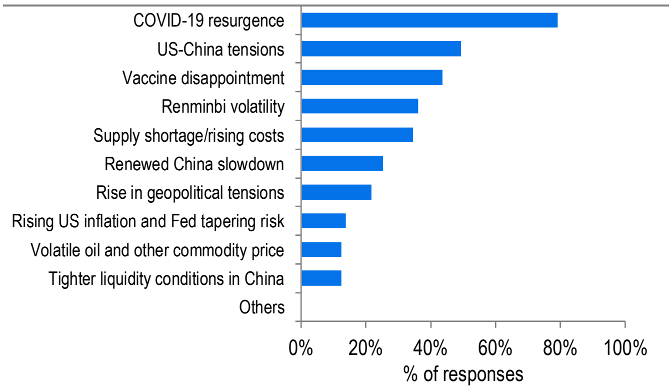
Larger manufacturers are performing better in the post-pandemic recovery

A further breakdown of the abovementioned metrics shows that larger companies (mostly based outside Hong Kong and which account for only c.15% of our 220+ respondents) performed better on average last year and are more optimistic on this year's outlook than smaller companies (which represent a majority of our annual survey sample and are largely Hong Kong-based, with a smaller number based in mainland China); see Figure 6.

This difference is most evident in the orders, sales and hiring metrics, which showed an average decline last year for smaller companies, while larger ones continued to expand. This year too, larger companies look to continue to grow more than 2x the pace of smaller companies on the three metrics. In contrast, in terms of capex, both groups registered average 0.4% growth in 2020, implying similarly weak appetite for adding investment during the COVID crisis; the two groups have started to diverge on capex expectations this year, however. Larger companies have also hiked wages more than smaller ones throughout last year's downturn, and the same applies to expectations for this year's upturn.

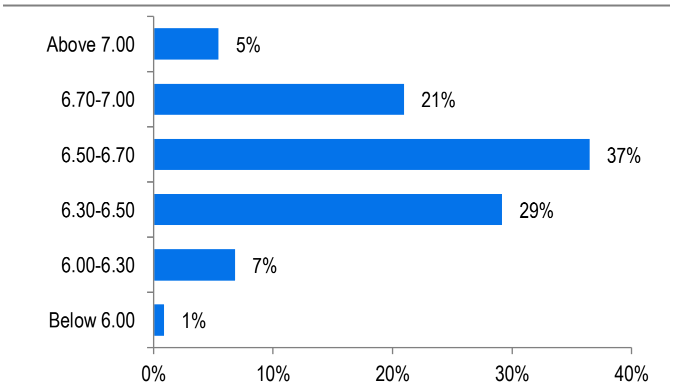
Compared with pre-COVID levels, larger companies are operating at higher levels than smaller ones on average, with a difference of more than 8ppt across capacity utilisation, orders and sales, and more than 6ppt in workforce size (Figure 7).

Figure 8: What are your biggest concerns for 2021?
% of responses



Source: Standard Chartered Research

Figure 9: Where do you see USD-CNY at the end of 2021?
% of responses



Source: Standard Chartered Research

COVID still tops the list of challenges

Unsurprisingly, 79% of respondents said 'COVID-19 resurgence' posed one of the biggest challenges to their business in 2021 (Figure 8). This, together with 43% citing 'vaccine disappointment', highlights the importance of China accelerating its pace of vaccination for the rest of the year. Failing this, GBA manufacturers may be unable to continue to benefit from (1) orders diverted from other manufacturing hubs in the short term, and (2) a sustained services-sector recovery and eventual reopening of international travel on reaching herd immunity in the long term, especially given the US and euro area are on track to achieve herd immunity in H2, which could give these economies a bigger boost after China's early sprint to a post-COVID recovery in the past year.

Almost half of our respondents also named 'US-China tensions' as one of their top challenges, a reminder that clashes between the two economic superpowers look unlikely to dissipate following a change in the US administration. The Biden administration continues to view China as a competitor (in terms of trade, economic size, military strength, geopolitics and ideology), but also as a needed partner in addressing common challenges such as global warming. We are of the view that a multilateral US approach should increase predictability and reduce collision risks.

CNY expectations far from one-way

Respondents' CNY expectations reflect some uncertainty on potential US tapering after the currency's extended rise in the past year

'Renminbi volatility' has been a recurring top business challenge for our survey respondents over the years, and it ranks even higher this year (in fourth place at 36%), likely evidenced by the currency's volatility during the survey period. After rising persistently by 10% against the USD from June 2020-February 2021, the Chinese yuan (CNY) weakened 1.3% in March with the emergence of the 'reflation trade' and a temporary USD boost due to the UST yield rise. The CNY regained this lost ground and continued to appreciate by 3.1% in April and May. Recent policy action from China's authorities continues to indicate a strong preference for less abrasive methods (counter-cyclical measures such as hiking banks' reserve ratio for FX deposits, over direct intervention) to prevent one-sided CNY appreciation, but instead allowing the market to play a greater role in determining the right FX level.

37% of respondents expect USD-CNY to end 2021 within 6.50-6.70, followed by 29% expecting 6.30-6.50 (Figure 9). On the more extreme spectrum, more respondents (26%) see USD-CNY ending this year above 6.70, versus 8% estimating below 6.30. The larger CNY depreciation tail risk likely reflects concerns over US tapering or an overdue correction in the CNY given its sharp 11% rise versus the USD since Q2-2020.

From growth to inflation concerns

Rising costs likely to rank higher on respondents' list of concerns if the survey were to be repeated today

China features heavily on the list of business challenges due to the country's sheer size, making it too important a production base or consumer market for manufacturers. However, in terms of business prospects, our respondents are most upbeat on China versus other markets. Among companies with actual operations in China, 65% held a positive view on the country, far above ASEAN (43%), rest of Asia (37%), the US (34%) and Europe (30%); see Figure 10. In terms of negative economic outlook, expectations diverged more evidently between Asia and other regions: 8% and 12% held negative views towards China and ASEAN, versus 29% and 30% towards the US and Europe, respectively. That said, we believe the gap between Asia and developed markets has narrowed notably since the survey given the swifter and broader vaccine rollout in developed markets, which has boosted their growth prospects by reducing the tail risk of renewed lockdowns leading to a recession.

Similarly, if the survey were conducted today, a greater number of respondents might have cited 'supply shortage/rising costs' as one of their top challenges, whereas during the survey, this concern ranked fifth in the list (35% citing it as a challenge). China's PPI, which returned to positive y/y growth in January, surged to 9.0% y/y in May, reflecting the accelerating pass-through of surging commodity costs to manufacturing prices YTD. We expect the seasonally adjusted (SA) PPI to trend higher through Q1-2022, driven partly by an asymmetric recovery in global demand and supply. While the strong demand backdrop may help companies, especially bigger ones with more pricing power, to pass on higher costs to buyers, this factor may continue to pressure margins and create uncertainty on the policy front.

We do not expect China to change its approach to maintain "prudent" and "flexible" monetary policy. As such, we see little urgency on the policy side to change the reserve requirement ratio (RRR) and policy interest rates, but rather a preference to guide total social financing (TSF) growth lower to 10-11% in 2021 from above 13% in 2020 to stabilise the macro leverage ratio (which rose to 281% of GDP at end-2020 from 256% in 2019). 33% of respondents said borrowing money is harder now compared with the same time last year, versus 14% who said borrowing was easier now (Figure 11). This is an improvement from the previous year's survey, when almost 50% said borrowing was difficult; that said, any further improvement in credit access is likely to be more targeted, given the policy focus on boosting lending to SMEs and micro enterprises while cooling lending to sectors like real estate.

Labour and wages

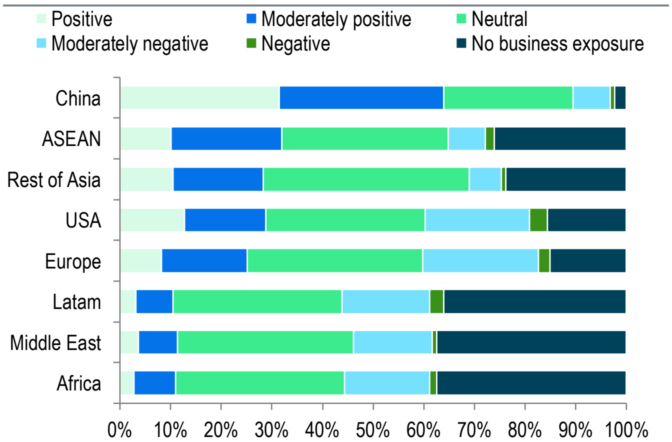
Job creation key to sustaining growth

China sets an easy 'above 11mn' job creation target this year

For a second straight year, China has de-emphasised the GDP target for 2021, setting it at a conservative 6% despite the very favourable base-effect boost. The focus of this year's National People's Congress (NPC) was on ensuring the quality of growth and supporting employment. Our survey findings on hiring and wage increases appear to support the current policy goals, with respondents seeing modest improvements in labour-market conditions this year, reflected in higher average expected wage changes as well as a perceived reduction in market slack. This implies that China's job creation target of "above 11mn" in 2021 should be easily achievable, given 11.86mn jobs were created even in 2020 during the crisis, significantly exceeding the 9mn target (which had been lowered in view of COVID disruptions).

Figure 10: Which other countries/regions do you do business with; what are your views on them in 2021?

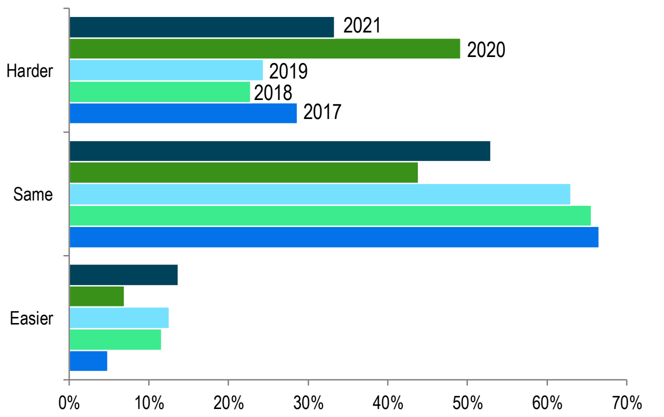
% of respondents



Source: Standard Chartered Research

Figure 11: How easy is it to borrow money compared with a year ago?

% of respondents



Source: Standard Chartered Research

Wages rising in nominal and real terms

Rebounding inflation may cap otherwise substantial real wage gains

The 2020 job market in China was not as bad as originally expected. In last year's survey, respondents expected wages to fall marginally by an average 0.2%, versus an actual average increase of 1.9%, based on this year's survey (Figure 4). This year, we see a 11ppt increase in respondents expecting wages to rise 5%, mostly at the expense of those choosing the 'no change', 'down 5%' and 'down 10%', which were down 4.4ppt, 2.2ppt and 2.6ppt, respectively, from last year's actual numbers (Figure 12).

This points to average expectations of a 2.9% wage hike in 2021, which is still modest versus pre-COVID levels, leaving room for a potential upside surprise. On the face of it, wages may improve more strongly in real terms, given our estimate of annual CPI inflation easing to 1.5% in 2021 from 2.5% last year. That said, CPI inflation may have already bottomed out in late 2020/early 2021, and is rebounding swiftly, especially if we exclude the drag from declining pork prices. We see monthly CPI inflation averaging 2.9% in Q4, having already risen to 1.3% y/y as of May.

Less job market slack, but a slack nonetheless

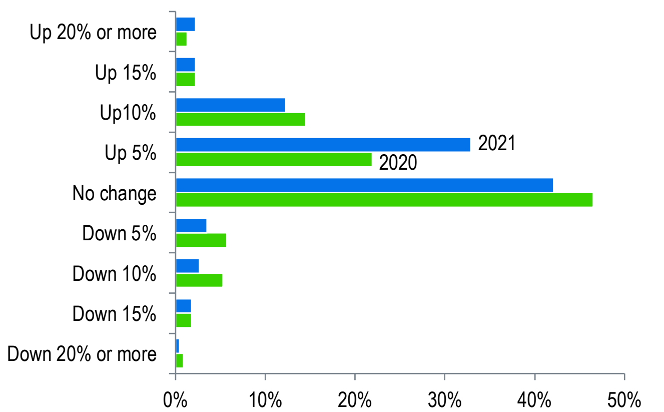
Only 12% said hiring has become more difficult than a year ago

33% of respondents said finding workers this year is less difficult compared with the same time last year (versus 43% in last year's survey), indicating that a swift post-COVID recovery has helped to marginally reduce labour-market slack. 12% reported more difficulty in hiring, similar to 14% a year ago (Figure 13). Larger manufacturers generally see less slack in the market now, with a net change of 13ppt (those reporting 'less difficult' minus 'more difficult') versus 21ppt for smaller ones.

When asked to describe the current labour-market conditions in their respective industries, respondents echoed the finding that the labour market is seeing less slack but is far from returning to tight conditions. 19% see a persistent labour shortage versus 16% a year ago, albeit still a minority and below the 23% pre-crisis level in 2019 (Figure 14). Another 35% see a 'reduced labour market shortage', up from 25% prior, mainly at the expense of those reporting 'no longer difficult to find workers' (down to 34% from 39% in 2020) and 'excess worker supply' (to 10% from 18% prior). And in line with earlier findings, fewer large manufacturers (28%) see either no difficulty in finding workers or have excess staff, compared with smaller companies (46%).

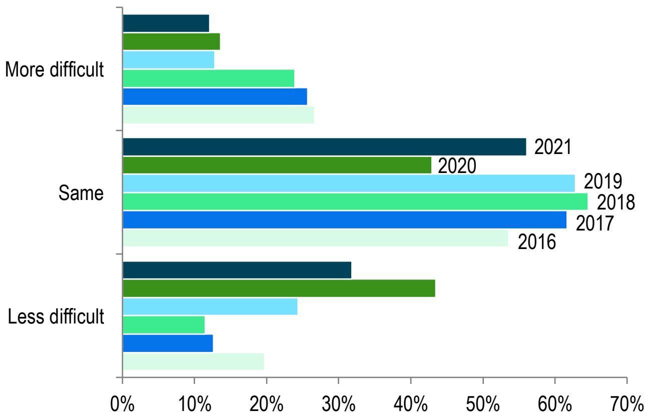
Figure 12: Wages to rise 2.9% in 2021 vs 1.9% in 2020

Actual and expected wage increase, % of respondents



Source: Standard Chartered Research

Figure 13: Is it more difficult for you to find workers this year than at the same time last year? *(% of respondents)*



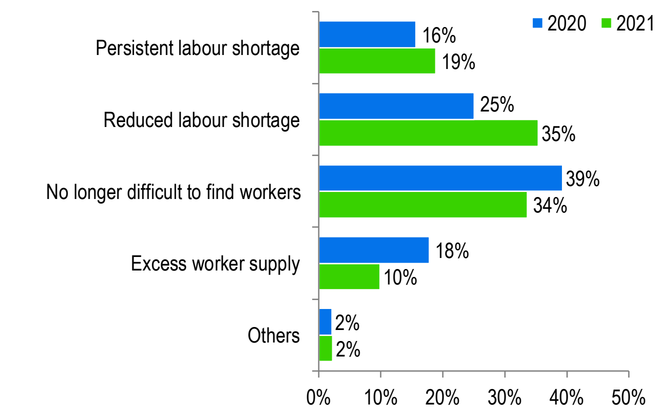
Source: Standard Chartered Research

Policy support still has a foot on the gas pedal

The ongoing need to preserve jobs and support enterprises as the economy continues to recover implies there should be little urgency for policy change in China. For two straight years now, Guangdong province has deployed expansive measures to cut taxes and reduce fees, including 'anti-epidemic' initiatives such as delaying social insurance fee payments, benefiting over 3mn enterprises by a total amount of CNY 197bn. Many such social insurance payment reduction/relief windows have been extended to at least end-2021. The province has said it will continue to support SME financing, promote vocational training and assist job seekers. This confirms that government support may remain indirect in nature rather than direct, i.e., by subsidising wages.

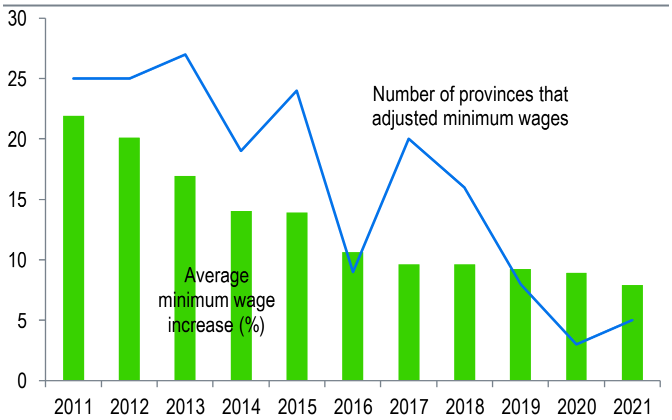
The pressure to create jobs and relieve companies also explains why only five provinces have hiked the minimum wage so far this year (despite building on a very low base of three provinces in 2020) and by an average of only 8% (Figure 15). Since 2016, the provinces have been allowed to hike minimum wages once every two to three years (from at least once every two years). Based on this, seven provinces that are due for a minimum wage hike this year have not hiked yet, reflecting flexibility in policy implementation. Shenzhen and Guangdong, which both last hiked minimum wages in 2018, would likely welcome this extra breathing room next year if their economic recovery disappoints or remains tepid.

Figure 14: How would you best describe the current labour market situation of your industry?
% of responses



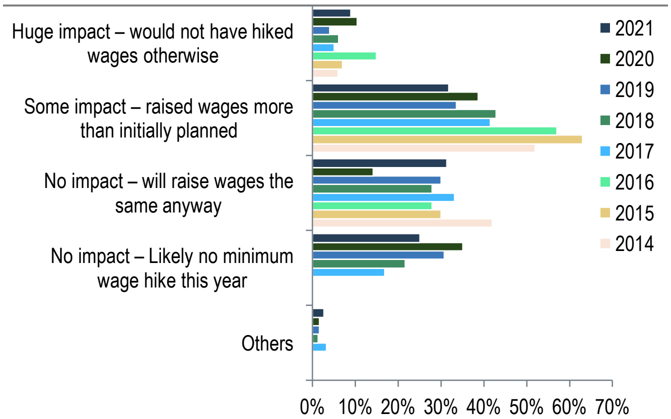
Source: Standard Chartered Research

Figure 15: 5 provinces hiked minimum wages so far this year, by an average 8.0% *(number of provinces; average % of minimum wage increase)*



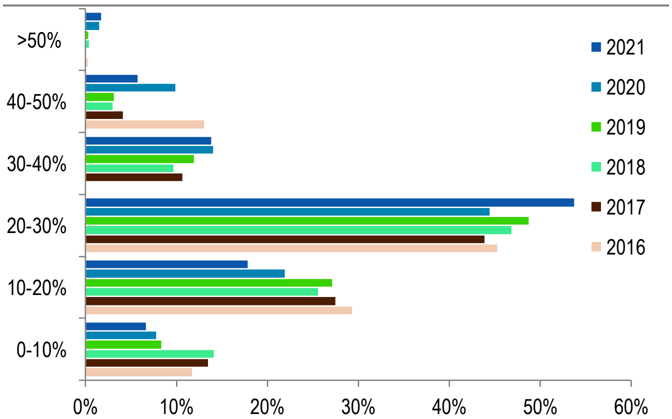
Source: Standard Chartered Research

Figure 16: Impact of minimum wage hikes
% of respondents



Source: Standard Chartered Research

Figure 17: What share of your total costs are wages?
% of respondents, this and previous survey



Source: Standard Chartered Research

In any case, our survey shows that companies' ability to handle higher minimum wage hikes has improved in the past year: the share of respondents seeing some or a substantial impact from higher minimum wages fell to 41% from 49% a year ago (Figure 16). Those seeing 'no impact' on their wage decision, and seeing minimum wage hikes as unlikely this year, also fell to 25% from 35%; instead, more respondents (31% from 14% prior) selected 'no impact' from minimum wage hikes because they plan to raise wages anyway. Building on this, as per prior surveys, we also asked respondents how important wages are as part of their total costs.

Impact of wages on overall costs

Wages, while accounting for a material portion of manufacturers' cost base, may not be their biggest profit margin concern

54% of respondents said wages accounted for 20-30% of their cost base – the highest (and the first majority) in recent years – at the expense of other brackets (Figure 17). This convergence towards 20-30% is interesting, with those moving up from the 0-20% brackets possibly playing catch-up in wage adjustments after being interrupted by COVID last year, and those moving down from the 30%+ brackets possibly seeing stronger expansion in non-wage costs as orders return and commodity prices rebound, as reflected in the recent PPI inflation surge. Moreover, larger manufacturers comprise a higher proportion of our survey respondents (34%), with wages accounting for 20% of less of their costs, making them generally less vulnerable to wage pressures compared to smaller manufacturers (23%).

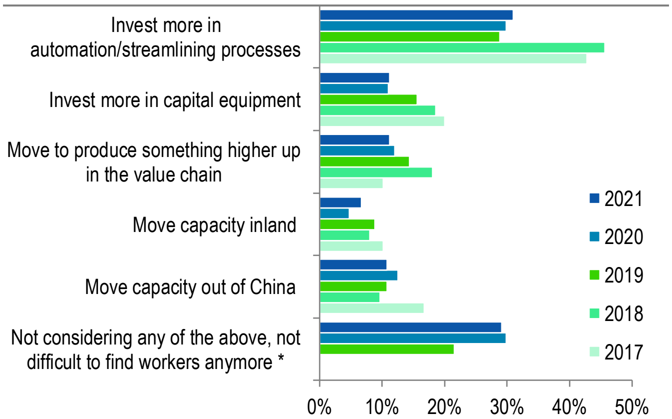
Factory relocation

A little less keen to relocate factories overseas

The improvement in the job market appears to be too slow to increase GBA companies' urgency to explore strategies for a labour shortage. 29% chose no action, similar to 30% a year ago (Figure 18). Of the remaining 71%, those choosing automation rose marginally to 31% from just under 30% last year, extending the lead of 'automation' over 'invest more in capital equipment' (11.2%) and 'produce things higher up the value chain' (11.2%). Those choosing to relocate factories as their top strategy remained steady at 17.5% from 17.3% prior. However, there was an evident shift towards those looking to move inland (up to 6.7% from 4.7% prior) versus overseas (10.8% from 12.6%). This marks a reversal from last year, when talks of relocating offshore were more common due to the need for diversification amid lingering US-China tensions and COVID disruptions.

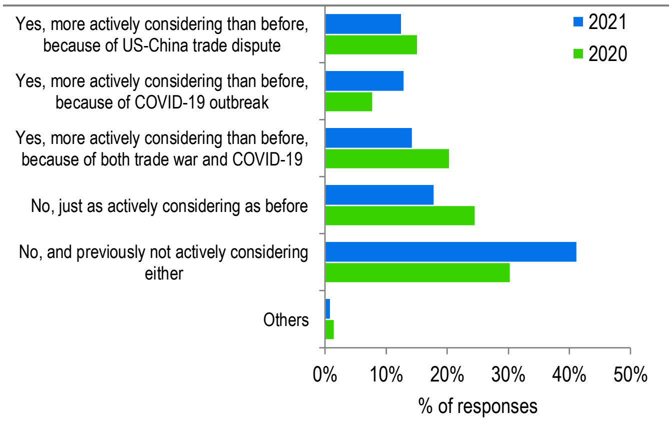
Figure 18: What do you consider to be the most feasible response to labour shortages?

% of respondents, this and past surveys



* new option this year; Source: Standard Chartered Research

Figure 19: Has the US-China trade dispute / COVID-19 outbreak made you more actively consider moving capacity outside China? *(% of responses)*



Source: Standard Chartered Research

China's success in containing COVID relative to regional economies likely discouraged factory relocation overseas in the short term

We believe many manufacturers operating in China still face a high concentration risk and have a structural need to diversify supply chains to other locations. That said, the urgency of making such moves or accelerating their timeline has faded since our last survey, as China's effectiveness in containing COVID cases, the speedy reopening of its factories and its strong economic recovery made the country the most reliable location for manufacturing operations, especially with many regional relocation destinations struggling to control the pandemic. In particular, manufacturers that could tap domestic demand may have been incentivised to maintain production onshore; this also partly explains the rise in respondents choosing to move inland.

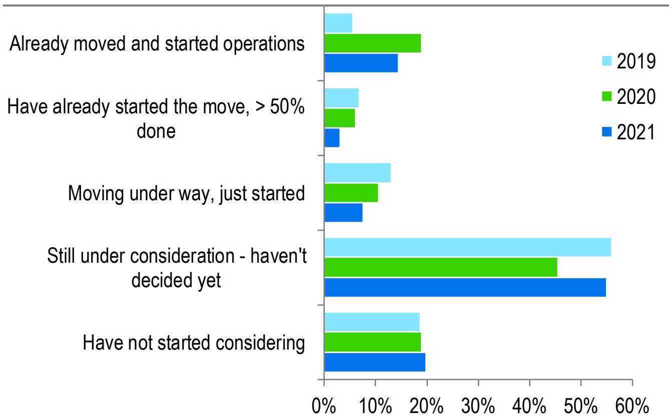
Unsurprisingly, there was an 11ppt rise (to 41% from 30% last year) in companies not considering moving capacity overseas due to US-China trade tensions and/or COVID-19, and who said they were not considering moving anyway (Figure 19). The proportion of companies that are more actively considering moving capacity offshore than before due to COVID rose to 13% from 7.9% prior, but the improvement was more than offset by the drop in companies citing other combinations of reasons for relocation. If we add to this another 18% who are not swayed by the trade war or COVID but still actively considering relocating overseas, we could say that a majority of 58% (albeit less than 68% a year ago) are still considering 'going out' (relocating).

Larger companies appear even less eager to relocate production than smaller ones: only 28% said they are considering moving capacity overseas due to US-China trade tensions and/or COVID-19, versus 42% for smaller manufacturers. As a strategy to deal with the labour shortage, none of the large manufacturers chose to move inland; instead, over half (53%) chose automation and streamlining processes, and 16% chose investing in capital equipment (likely given their better economies of scale).

Manufacturers in no rush to start new relocation projects

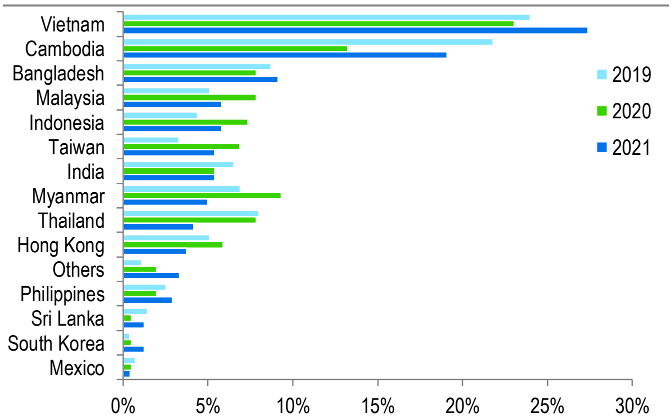
Among the 58% that are considering or planning to actively consider moving overseas, 15% have already moved and started operations, down from 19% a year ago, but still higher than 6% in 2019 (Figure 20). Another 3% (6% prior) are more than halfway through the relocation process and 8% (11% prior) said they have just started moving. These responses, along with those choosing 'still under consideration' rebounding to 55% from 45% prior, reflects little urgency to put relocation plans into action, while prior projects have carried on and those that have started or completed relocation projects are not rushing to start new ones. We see a 1ppt uptick from last year for those who have not yet started considering moving (20%).

Figure 20: What stage of moving are you at?
% of respondents



Source: Standard Chartered Research

Figure 21: If you plan to move capacity out of China, to where? *(% of responses)*



Source: Standard Chartered Research

As with our previous surveys, it is worth stressing that the actual proportion of manufacturers who already have operations overseas could be much higher than stated above, given how long factories have been facing labour and other challenges; they simply may not need to relocate more than they already have, likely perceiving themselves as diversified enough to handle trade headwinds and/or COVID disruptions, and deciding to focus more on industrial upgrading for now.

Vietnam is once again the top choice for relocation

The list of preferred overseas relocation destinations becomes more top-heavy this year

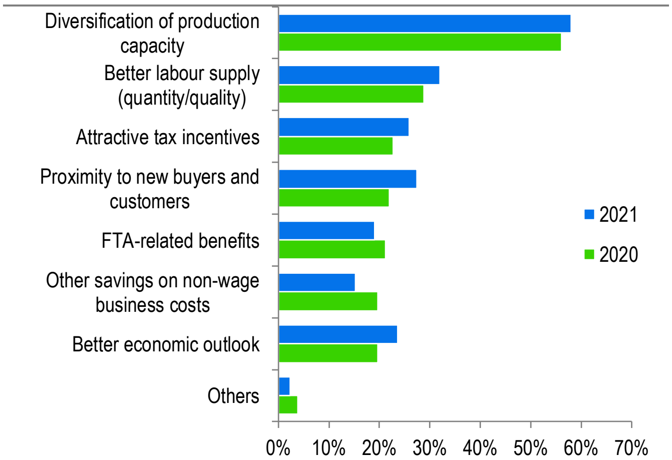
In terms of preferred destinations, those that would consider moving overseas continued to favour Vietnam, as in prior years (Figure 21). Notably, three of the top four preferred destinations in prior years (Vietnam, Cambodia, and Bangladesh) gained even more votes this time, making the list more top-heavy. Myanmar dropped from its prior top three spot to eighth place, probably due to political concerns; Malaysia, Indonesia, Taiwan, Thailand and Hong Kong all saw a drop in percentage of votes. Looking at the top choices, the results may indicate that those considering relocating from China are mostly low-end producers in sectors such as textiles and garments, commodities, and electronics packaging and assembly. The exception to this result is Vietnam, which is favoured by a wider range of industries; Taiwan, Malaysia, India and the Philippines also in general attracted a higher proportion of interest from electronics manufacturers.

With wage savings now a less pressing factor driving the choice to relocate overseas given the lingering job market slack in the GBA region, the next big consideration cited for choosing a destination was gaining a diversification advantage in production capacity. 58% of respondents picked production diversification as a key non-wage benefit from relocation, a modest increase from 56% a year ago (Figure 22). There were also marginal increases in votes from last year for factors such as labour quality and quantity, attractive tax incentives, proximity to potential buyers and economic outlook. Interestingly, 'FTA-related benefits' was the only option picked by fewer respondents this time.

Our survey shows that expected average cost savings from moving capacity overseas (18.3%) ranks the highest among strategies to deal with a labour shortage, widening its cost advantage over 'investing more in capital equipment' (16.5%), 'moving the product up the value chain' (15.0%), and 'moving capacity inland' (16.0%) compared with a year ago (Figure 24). This supports the view that relocating capacity offshore still has

Figure 22: Non-wage advantages of relocating factories

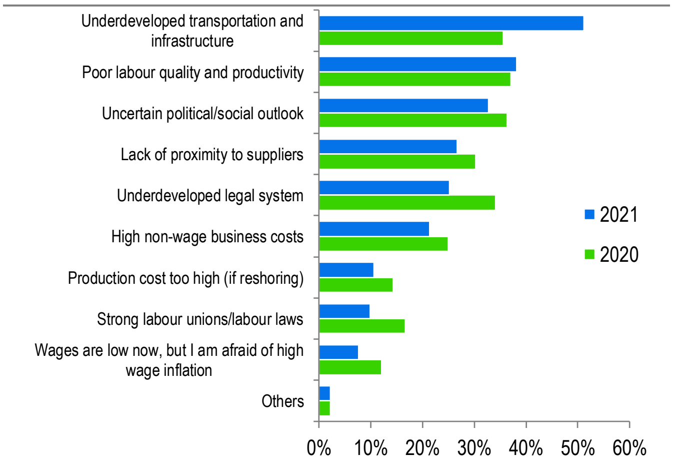
% of responses



Source: Standard Chartered Research

Figure 23: Concerns about relocating factories overseas

% of responses



Source: Standard Chartered Research

its merits, notwithstanding the greater hesitancy to move in the short term. 'Automation' was cited as offering the least cost saving (12.7%); however, cost saving is only one of many reasons for improving productivity, with a bigger reason likely being the strong policy push towards innovation and industrial upgrading.

Finally, plenty of hurdles still need to be overcome before manufacturers can reap the benefits of moving capacity overseas (Figure 23). Among the top concerns was 'underdeveloped transport and infrastructure' (51%), which regained the top spot from 'poor labour quality and productivity' (38%) and 'uncertain political/social outlook' (33%). 'Underdeveloped legal systems', 'high non-wage business costs' and 'lack of proximity to suppliers' rounded up the top six, a long list serving as a reminder that the exodus of production from China, whether for cost or diversification purposes, is likely to be a gradual process. In the meantime, manufacturers need to keep upgrading to stay competitive, which in turn fuels the GBA's innovation drive.

Industrial upgrading

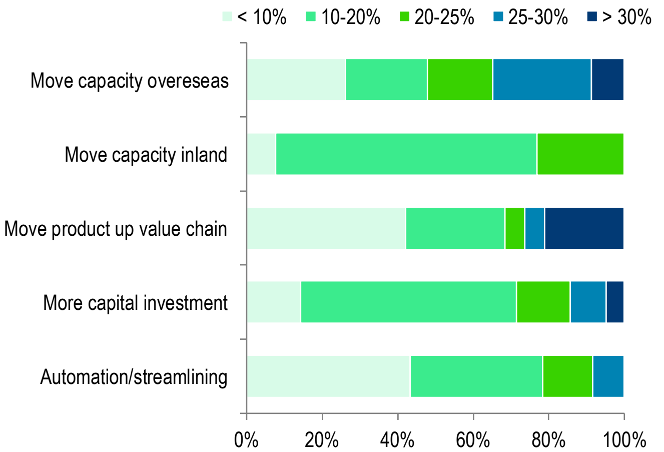
Manufacturing investment is picking up…

Capex making a comeback after lagging infrastructure and real estate investment recovery for much of 2020

Official data shows that after being most disrupted by COVID last year, manufacturing investment (+23.8% y/y in 4M-2021 after contracting 2.2% in 2020) is catching up to investment in infrastructure (+18.4% vs +0.9%) and real estate (+21.6% vs +7.0%). Our survey findings support this view: 51% of respondents see a rise in capex this year, while 11% expect a fall; this translates into an expected average capex increase of 3.3% this year, versus an actual 0.4% rise in 2020 (Figure 3). The survey respondents also said they prefer investing more towards tackling labour challenges and boosting productivity. This is in addition to 31% choosing 'automation' and 'streamlining processes' as the main ways to tackle wage pressure. Companies that are choosing to 'invest more in capital equipment' and 'move to produce something higher up the value chain' remain material segments, at 11% each (Figure 18).

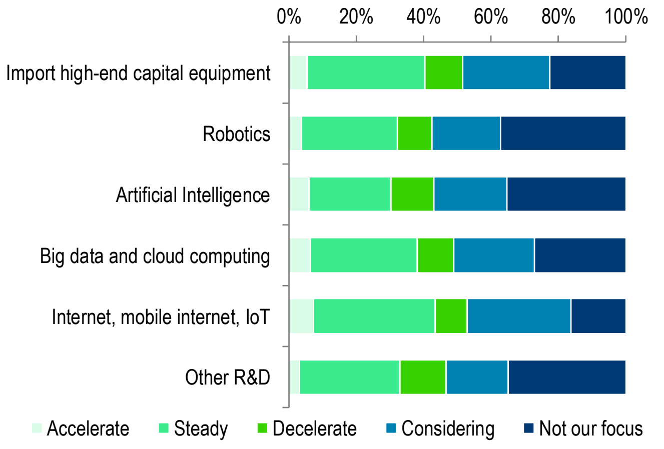
We maintain our view that labour shortages and wage pressure – persistent issues even pre-COVID – will return once COVID disruptions fade. These cost pressures will likely force behavioural changes at a micro level, including more investment towards improving the cost structure, productivity and competitiveness.

Figure 24: How much would your preferred way to tackle labour shortage save you on costs? *(% of respondents)*



Source: Standard Chartered Research

Figure 25: What are your plans for industrial upgrading in 2021? *(% of respondents)*



Source: Standard Chartered Research

More respondents see slower rather than faster technology upgrading this year

… but appetite for innovation remains weak

An improved investment appetite looks unlikely to be enough to immediately boost the GBA region's innovation and technology development drive, however. When asked about their 2021 technology investment plans, respondents choosing 'deceleration' exceeded those picking 'acceleration' for a second straight year, this time by an average 6ppt across all upgrading initiatives (Figure 25). 'Robotics', 'artificial intelligence' and 'importing high-end capital equipment' posted the largest negative net decreases of 6.8ppt, 6.8ppt and 5.9ppt, respectively; 'big data and cloud computing' and 'internet, mobile internet and IoT' were only marginally better, at -4.5ppt and -2.3ppt, respectively. This is despite China's push towards greater self-reliance in terms of technology and innovation and establishing a more complete manufacturing ecosystem, which we believe to be a part of the 'dual circulation' strategy cited in its 14th Five Year Plan (FYP) in response to potentially persistent US-China tensions and the GBA's ongoing transformation, with high-end manufacturing attracting skilled talent and boosting the region's population.

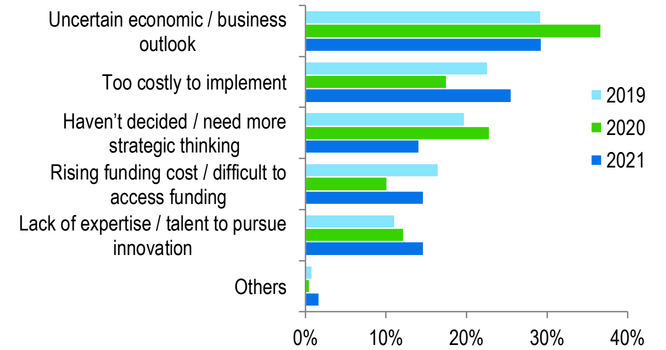
This deceleration bias towards technology upgrading in 2021 among our survey respondents was most evident among smaller companies. Meanwhile, despite their smaller proportion in the sample, respondents of larger companies reported positive net increases (more expect an acceleration than deceleration) in investment in 'robotics', 'artificial intelligence' and 'internet, mobile internet and IoT'. Larger manufacturers also generally showed a higher involvement in all key areas of innovation industrial upgrading (as measured by a higher percentage of those responding accelerate, steady or decelerate in Figure 25).

These findings echo the survey responses on the biggest hurdles to industrial upgrading in 2021: smaller manufacturers ranked an uncertain economic and business outlook at the top, while larger respondents ranked it third, behind 'too costly to implement' and 'haven't decided/need more strategic thinking' as top concerns, suggesting that larger companies have recovered better than smaller ones from COVID disruptions (Figure 26).

More companies need to return to having an upgrading plan

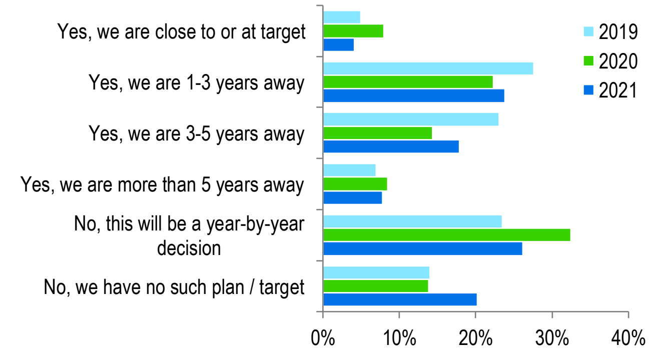
Given their more favourable recovery from COVID, larger manufacturers appear to be better able to plan for industrial upgrading. Almost 70% of respondents from larger companies said they have a long-term upgrading target, of which 60% said they are 1-3 years from reaching their target. This contrasts with smaller manufacturers: 51% have upgrading targets, with responses on time to targets more evenly spread between 1-3 years and 3-5 years. Across all respondents, 54% have an upgrading target, almost the same as last year's 53%, indicating no recovery yet to the 2019 pre-COVID level of 63% (Figure 27).

Figure 26: What are the biggest hurdles to your industrial upgrading? *(% of responses)*



Source: Standard Chartered Research

Figure 27: Do you have a long-term target for industrial upgrading? *(% of respondents)*



Source: Standard Chartered Research

An industry deep dive

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A deeper dive into industry-wide preferences

Less divergence in responses than in the past

Semiconductor manufacturers are recovering rapidly

As in previous years' surveys, we dig deeper into the factors driving our clients' preferences, analysing the responses from an industry perspective. A majority of our respondents are from non-semiconductor sectors, predominantly involved in the manufacture of textile and apparel, rubber and plastics. Respondents also include manufacturers involved in metals, chemicals and pharmaceuticals, wood, paper and printing products. Semiconductor manufacturers are involved across the semiconductor value chain, from component manufacturing to fabrication, packaging assembly and equipment manufacturing.

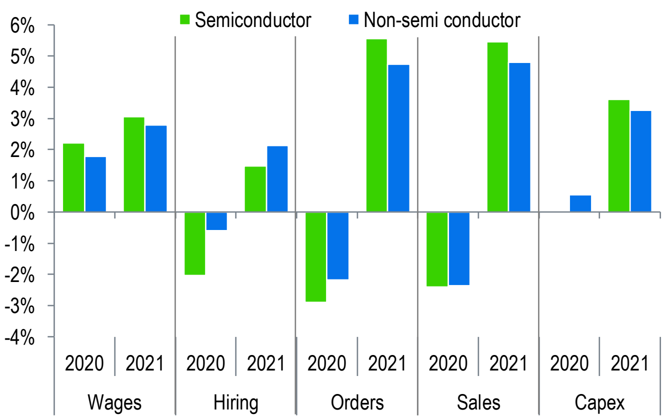
Despite the wide range of industries covered, we noted more similar responses from both semiconductor and non-semiconductor companies than in our previous surveys, perhaps because they faced largely the same external pressures during the pandemic. While there are fewer differences in their responses, the variation is nonetheless significant to assess their individual performances so far this year and their potential growth trajectories.

A little further to go for full normalisation

Semiconductor manufacturers are operating at around 70% of pre-COVID capacity levels

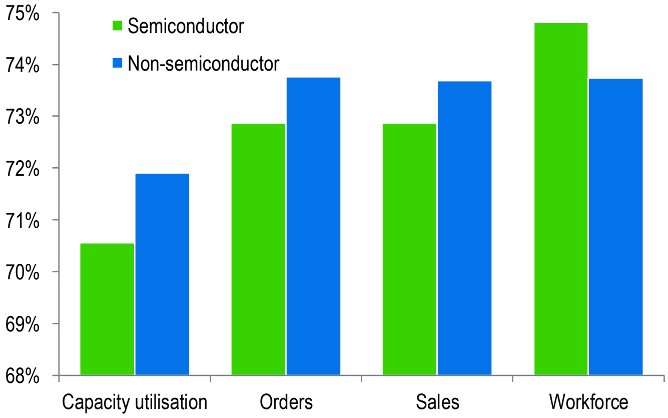
Non-semiconductor manufacturers are currently operating closer to pre-COVID levels, with average capacity utilisation at 72%, while orders and sales back to 74% of levels before the pandemic. Comparatively, semiconductor manufacturers are at slightly lower levels of 70.5% on capacity utilisation, and 73% on orders and sales against pre-COVID levels. Semiconductor companies have seen a quicker worker return rate, with their workforce back to 75% pre-COVID levels, versus a marginally lower 73.7% for non-semiconductor manufacturers.

Figure 28: Semiconductor manufacturers are expected to be better off *(average actual, 2020; expected change, 2021)*



Source: Standard Chartered Research

Figure 29: Non-semiconductor manufacturers are closer to pre-COVID levels of activity *(% of pre-COVID levels)*



Source: Standard Chartered Research

Wages as a share of total costs is highest for semiconductor fabrication companies, followed by non-semiconductor manufacturers

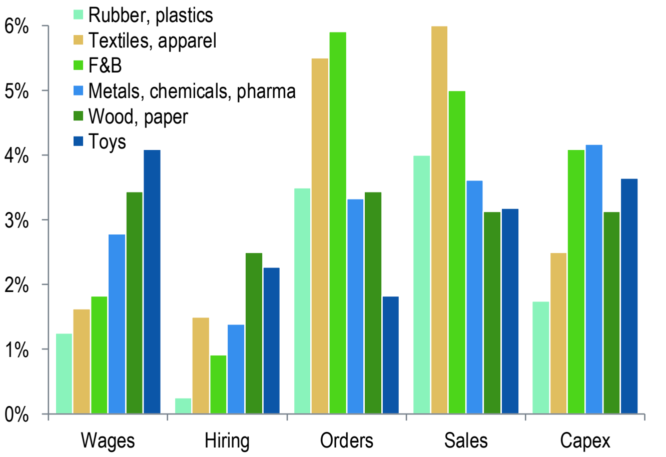
Wages are rising, now comprising a larger share of total costs

Wages as a share of total costs have risen significantly during the pandemic, to c.25% this year from c.22.5% in 2019. Wage costs tend to be sticky – respondents saw only small declines in wage costs in previous surveys conducted before the pandemic. As such, wages may remain moderately elevated near-term. Our respondents also expect an average 2.9% wage increase this year, compared to the actual 1.9% increase in 2020, likely keeping wages a significant share of total costs, albeit not rising rapidly enough to be a concern.

Notably, wages now make up about a third of total costs for semiconductor fabrication companies, substantially higher than c.20% before 2019. One reason for their greater share of wages in total costs may be increased automation in higher-end fabrication and a greater share of more skilled and higher-paid workers. These manufacturers reported flat wages in 2020 and see wages remaining flat in 2021, suggesting that employed workers are already at higher wage levels. Wages comprise 21.4% of total costs of semiconductor component manufacturers (the lowest ratio among the industry groups in our sample). They saw the largest increase in wages (3.9%) last year and also expect the strongest wage increase (4.3%) this year. This is well above the average wage hike of 1.9% in 2020 and average expected 2.9% increase in 2021.

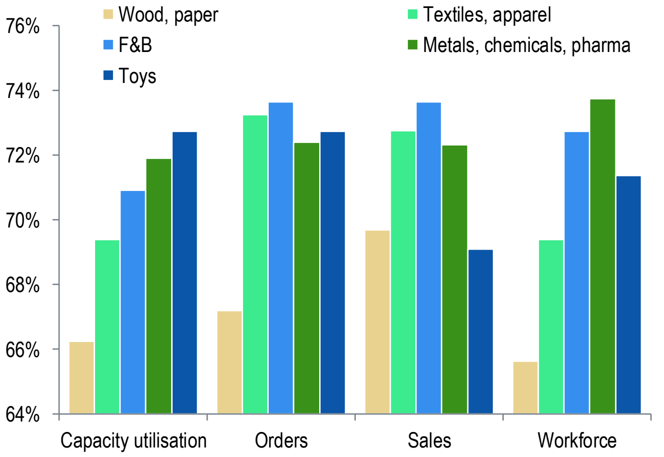
Wages make up over 25% of total costs of non-semiconductor manufacturers, the second-highest share after semiconductor fabrication companies. Textile and toy manufacturers reported among the highest shares, at 27.1% and 32.3%, respectively. Toy manufacturers experienced a sharp wage increase of 5.9% in 2020, and they expect a 4.1% increase in 2021. Given the structurally high weighting of wages in toy makers' overall costs, these wage hikes imply close to a 2% increase in their overall costs in 2020, and a potential 1.4% increase in 2021.

Figure 30: Among non-semis, textiles and F&B expect the biggest demand pick-up in 2021 *(average expected change, 2021)*



Source: Standard Chartered Research

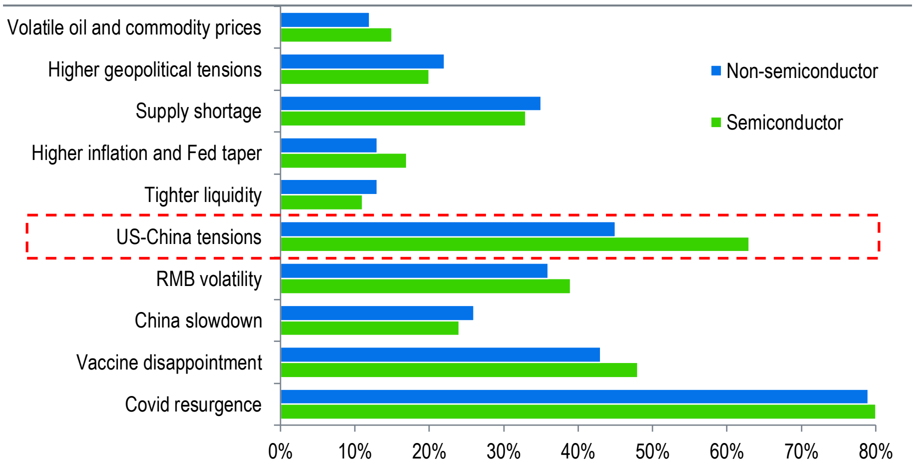
Figure 31: Among non-semis, rubber manufacturers are hurt the most; metals, chemicals, toys are closer to normal activity levels *(% of pre-COVID levels)*



Source: Standard Chartered Research

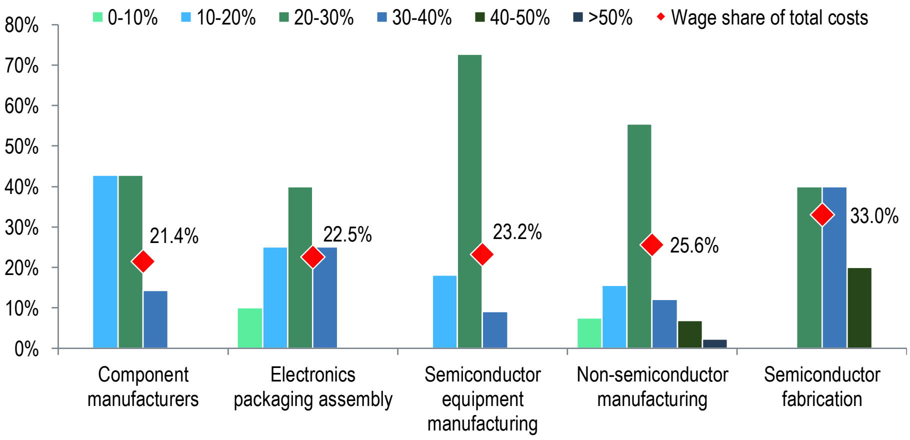
US-China tensions are a much bigger worry for semiconductor manufacturers

Figure 32: Semiconductor manufacturers generally more concerned about US-China tensions
% of total responses



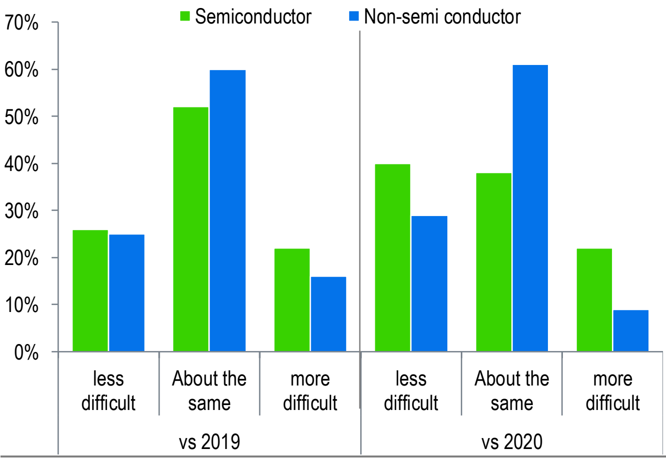
Source: Standard Chartered Research

Figure 33: Wages make up about a quarter of all costs, slightly higher for non-semiconductor manufacturers; *% of total responses*



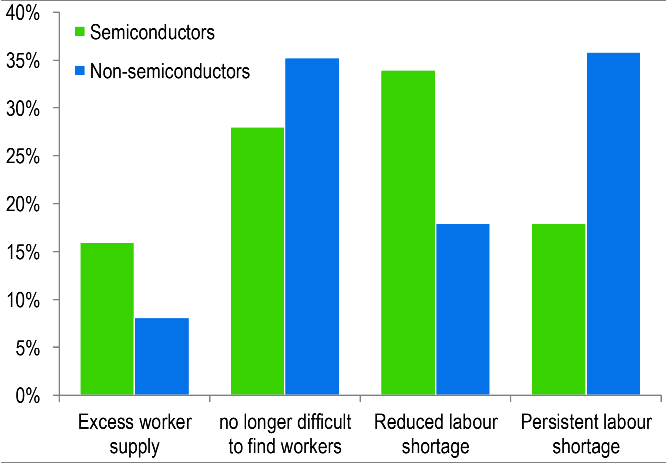
Source: Standard Chartered Research

Figure 34: Finding good workers is mostly not a concern now, compared to 2019 and 2020; *% of total*



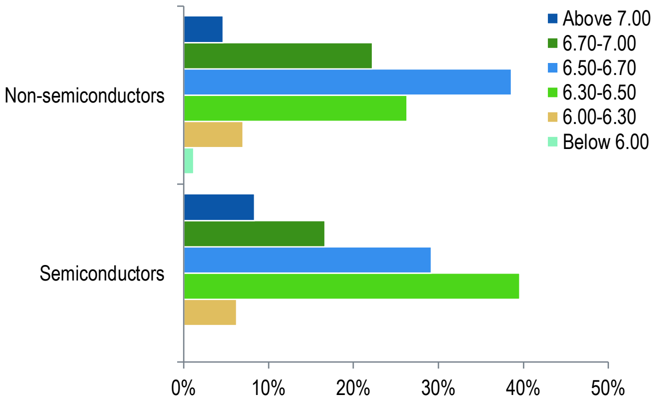
Source: Standard Chartered Research

Figure 35: A larger share of non-semiconductor manufacturers see labour shortage; *% of total*



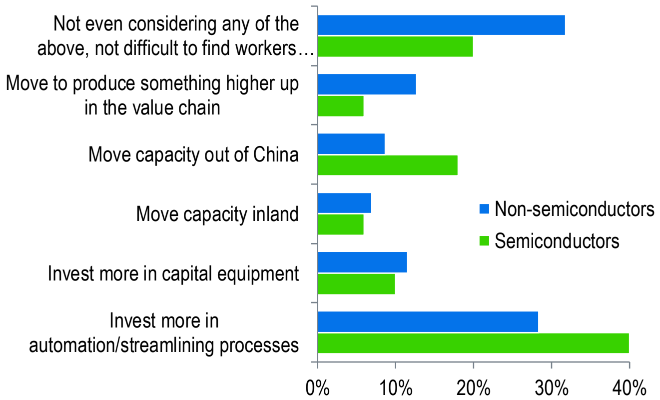
Source: Standard Chartered Research

Figure 36: Non-semiconductor manufacturers expect a slightly weaker CNY in 2021; *% of responses*



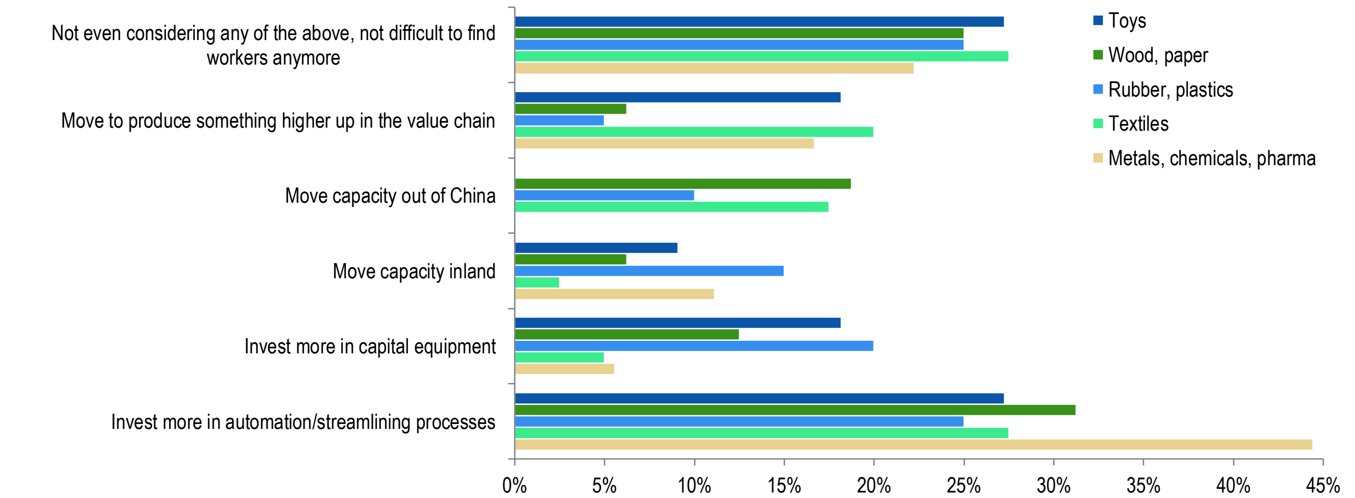
Source: Standard Chartered Research

Figure 37: More semiconductor manufacturers want to invest in automation, move capacity out; *% of total*



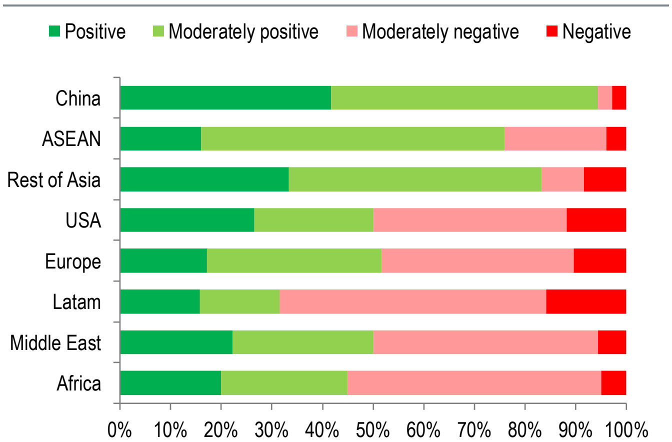
Source: Standard Chartered Research

Figure 38: Automation is the most popular choice, but labour shortage is less of a concern now; fewer manufacturers are keen on moving out of China *(% of respondents answering 'How will you respond to labour shortages?')*



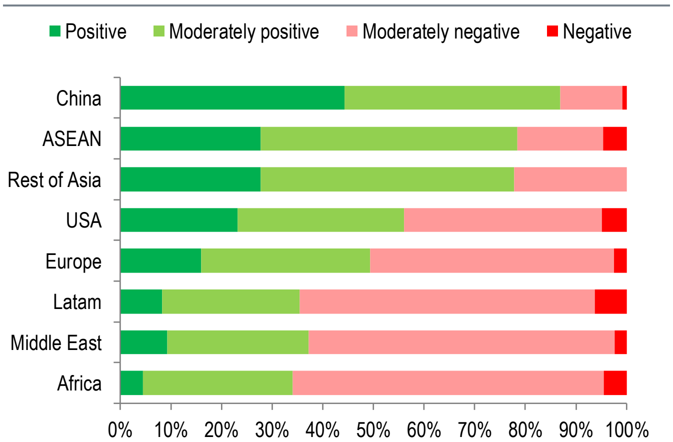
Source: Standard Chartered Research

Figure 39: Which other countries/regions do you do business with; what are your views on them in 2021?
% of respondents with non-neutral views, in semiconductor manufacturing



Source: Standard Chartered Research

Figure 40: Which other countries/regions do you do business with; what are your views on them in 2021?
% of respondents with non-neutral views, in non-semiconductor manufacturing



Source: Standard Chartered Research

Semiconductor manufacturers have a more positive growth outlook

Most of our respondents, both semiconductor and non-semiconductor manufacturers, are optimistic about China's growth outlook. However, they differ on their growth outlook for the rest of the world (i.e., non-Asia), with non-semiconductor manufacturers generally expressing more pessimism. While non-semiconductor manufacturers broadly hold neutral opinions on the growth outlook outside Asia, about two-thirds of the rest see softer growth in Africa, the Middle East and Latam this year. Both semiconductor and non-semiconductor manufacturers are optimistic about the outlook for Asia, with semiconductor companies showing more optimism.

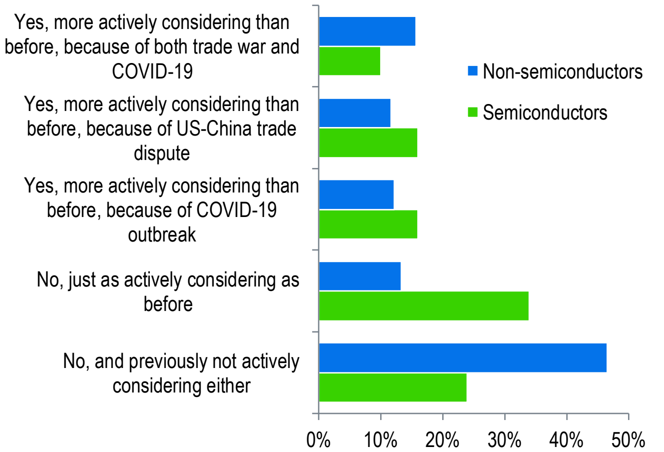
Semiconductor manufacturers more keen to relocate capacity

42% of semiconductor manufacturers said they are more actively considering moving capacity overseas than before

Overall, the urgency to move manufacturing capacity outside China has not changed substantially on account of the pandemic. Over 40% of our respondents said they have not considered relocating production out of China due to the pandemic or US-China trade tensions, a higher proportion than in previous surveys (see the *'GBA survey – 2021'* section). Meanwhile, only a little more than a quarter of all our respondents have actively considered moving out due to the pandemic – these were predominantly semiconductor manufacturers. More than a third of semiconductor manufacturers responded that they had considered relocating even before the pandemic. 42% have started more actively considering moving overseas either due to the pandemic or US-China trade tensions. Meanwhile, close to 50% of non-semiconductor manufacturers have not considered moving out and are not looking to do so.

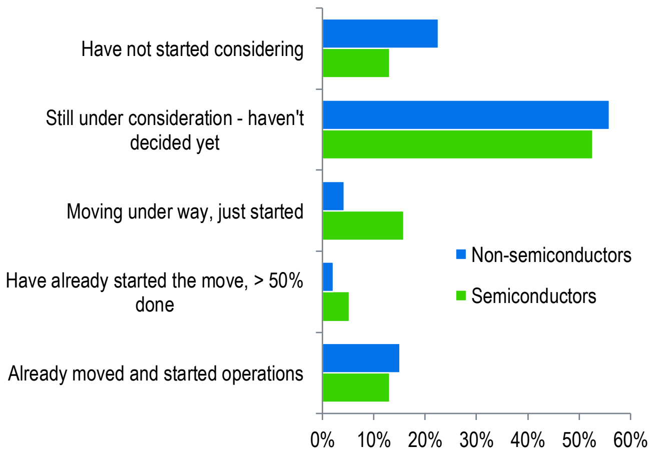
However, there generally appears to be no urgency to move production capacity out of China. A majority of both semiconductor and non-semiconductor manufacturers said the decision to move out was still under consideration and pending a final decision. Of those choosing to move overseas, semiconductor manufacturers have made more progress. Over a third of have already started the move overseas and 13% have begun overseas operations. Only 20% of non-semiconductor manufacturers have started their move overseas, but a majority of them have already started operations.

Figure 41: Has the US-China trade dispute / COVID-19 outbreak made you more actively consider moving capacity outside China? *% of total*



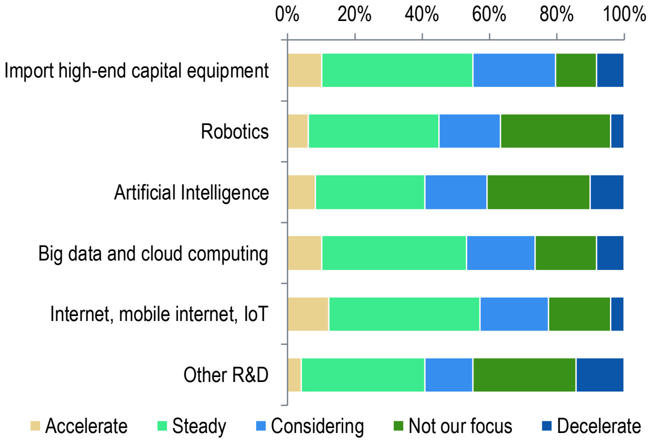
Source: Standard Chartered Research

Figure 42: There is no urgency to move production capacity yet, but semiconductor manufacturers have made more progress; *% of total*



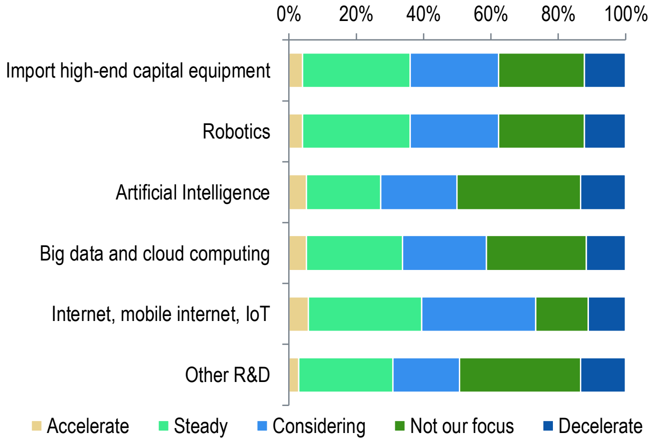
Source: Standard Chartered Research

Figure 43: What are your plans for industrial upgrading in 2021? *(% of semiconductor manufacturing respondents)*



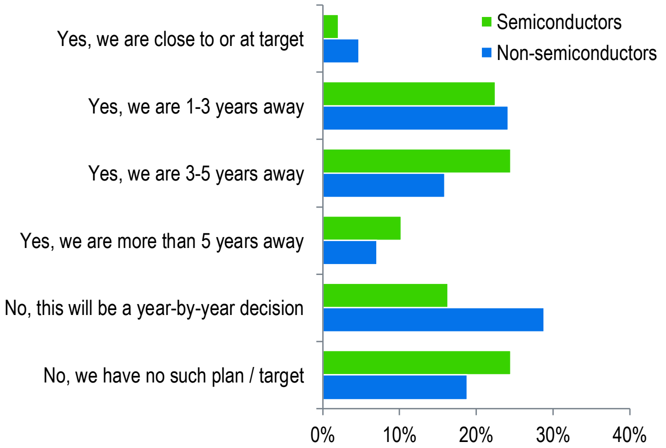
Source: Standard Chartered Research

Figure 44: What are your plans for industrial upgrading in 2021? *(% of non-semiconductor manufacturing respondents)*



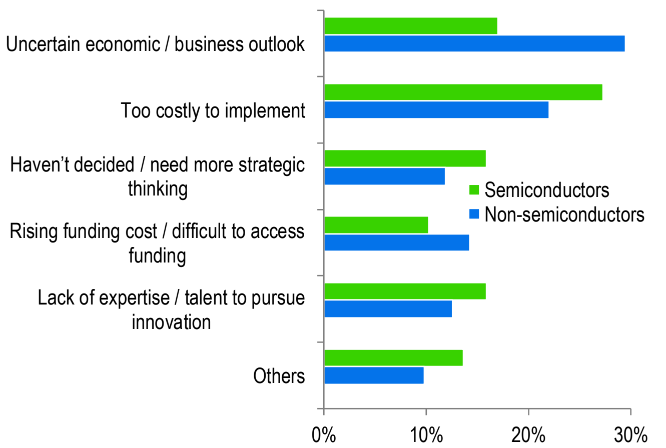
Source: Standard Chartered Research

Figure 45: Do you have a long-term target for industrial upgrading? *(% of responses)*



Source: Standard Chartered Research

Figure 46: What are the biggest hurdles to your industrial upgrading? *(% of respondents)*



Source: Standard Chartered Research

Wage growth, 2020 actual versus 2021 expectations

% of respondents; blue shading indicates faster expected growth vs 2020, green shading indicates slower expected growth

Figure 47: Component manufacturing

	2021				
2020	Down by 15%	No change	Up by 5%	Up by 10%	Up by 20% (or more)
Down by 5%			7%		
No change		43%		14%	
Up by 5%		7%			
Up by 10%				7%	7%
Up by 15%	7%				
Up by 20% (or more)					7%

Source: Standard Chartered Research

Figure 48: Electronics packaging assembly

	2021							
2020	Down by 15%	Down by 10%	Down by 5%	No change	Up by 5%	Up by 10%	Up by 15%	Up by 20% (or more)
Down by 10%	4%	4%		4%				
No change			8%	13%	17%	8%		
Up by 5%					21%	8%		
Up by 10%				4%			4%	
Up by 20% (or more)								4%

Source: Standard Chartered Research

Figure 49: Semiconductor fabrication

	2021			
2020	Down by 15%	No change	Up by 5%	Up by 10%
Down by 15%	20%			
No change		40%		
Up by 5%			20%	
Up by 10%				20%

Source: Standard Chartered Research

Figure 50: Semiconductor manufacturing equipment

	2021				
2020	Down by 10%	Down by 5%	No change	Up by 5%	Up by 10%
Down by 5%				9%	
No change	9%	9%	27%	9%	
Up by 5%			9%	9%	9%
Up by 10%					9%

Source: Standard Chartered Research

Figure 51: Non-electronics

	2021								
2020	Down by 20% (or more)	Down by 15%	Down by 10%	Down by 5%	No change	Up by 5%	Up by 10%	Up by 15%	Up by 20% (or more)
Down by 20% (or more)					1%		1%		
Down by 15%					2%				
Down by 10%			1%	1%	2%	1%	1%		
Down by 5%			1%	1%	3%	2%	1%		
No change		1%		1%	30%	13%	1%		
Up by 5%			1%		7%	13%	1%		1%
Up by 10%	1%		1%		1%	7%	5%	1%	
Up by 15%							1%	1%	1%
Up by 20% (or more)								1%	

Source: Standard Chartered Research

The future of the GBA

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Living up to lofty expectations

Emerging stronger from COVID

The GBA as a manufacturing powerhouse has become more important post-COVID

In the previous sections of this report, we looked at how manufacturers performed and what their expectations are. Now we turn to the implications for the region's ongoing transformation. Last year, we had pointed out that what makes the Greater Bay Area (GBA) unique and competitive could also exacerbate the impact of COVID-19 on the region, at least in the short term. For one, being export-oriented, the region is prone to headwinds from a global recession and supply chain disruptions, Two, it has among the country's largest migrant worker populations and highest population density, which could complicate containing the pandemic. Lastly, the region's significant positive driver of cross-border integration across Guangdong, Hong Kong and Macau could face setbacks from extensive and prolonged travel bans.

Despite such concerns, the GBA has weathered the COVID disruptions fairly well, in our view. The region's ability to contain the spread of COVID-19 allowed a speedy factory reopening and normalisation of supply chains. Its successful response to the pandemic has likely reinforced the GBA as a reliable and important production base for manufacturers. China's swifter economic recovery compared to other major markets may also have strengthened the GBA's long-standing proposition as a primary production base for companies keen to tap onshore demand.

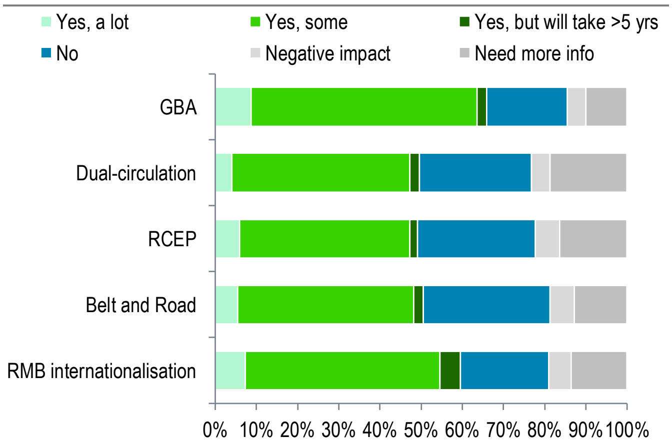
Respondents have become more optimistic long-term

Our positive view on the region's prospects appears to be confirmed by our survey results this year, with more respondents expressing long-term confidence in the region's opportunities (Figure 52). In terms of presenting new business opportunities, a majority 66% cited the GBA this year (up from 58% a year ago), widening the region's lead over Renminbi internationalisation (60%), the Belt and Road initiative (50%), the 'dual circulation' strategy under the 14th Five-Year Plan (FYP; 50%), and the Regional Comprehensive Economic Partnership (RCEP; 49%).

GBA as a concept seems to be growing on manufacturers

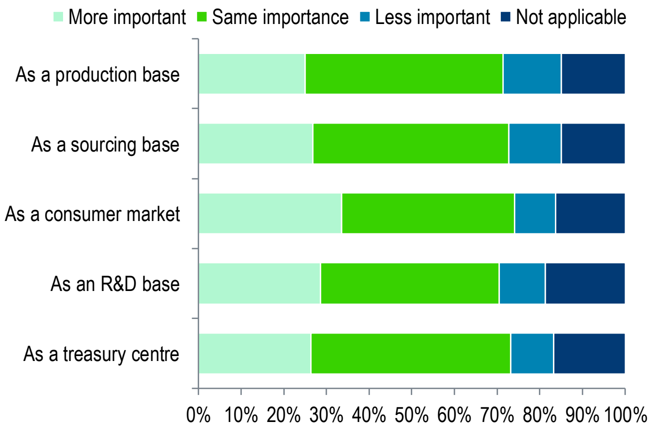
Manufacturers' growing familiarity with the GBA has likely provided it with an edge over other business opportunities, as many of our respondents have probably operated in the region for a long time. This year's survey recorded the fewest respondents selecting

Figure 52: Which of these drivers present new opportunities to your business in the next 3-5 years?
% of respondents



Source: Standard Chartered Research

Figure 53: How will the GBA market's importance to your business group change in the following areas?
% of respondents



Source: Standard Chartered Research

'GBA' when asked if they 'need more information' (10%), compared to previous surveys. This growing confidence is supported by the authorities' active rollout of policies to support the region's development in recent years. By comparison, China's 'dual-circulation' strategy recorded the highest proportion (19%) of respondents saying they need to know more. That said, the dual circulation strategy is a newer initiative and was only mentioned for the first time at the May 2020 Politburo meeting. As shown in Figure 54, a majority (58%) of respondents said they were 'not sure' and 'needed more information' when asked whether the 14th FYP and 'dual circulation' strategy could help address their stated hurdles to industrial upgrading (see our discussion on *industrial upgrading* in the GBA Survey – 2021 section).

A stronger proposition across multiple functions

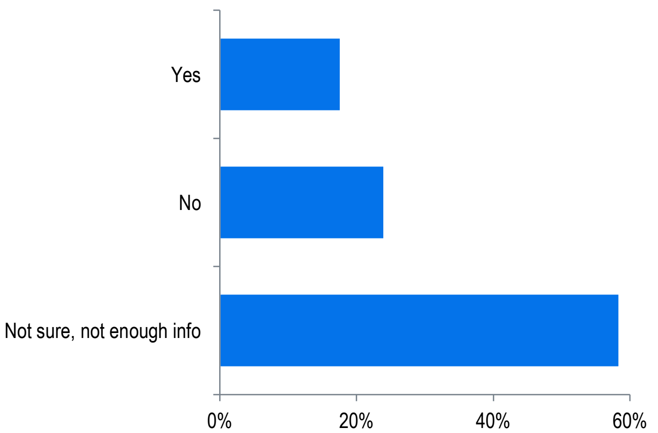
GBA is being seen as increasingly important to respondents' business, especially as a consumer market

Respondents also said outright that the GBA was becoming more important to them. 34% said the GBA would become a more important consumer market for their business, more than double last year's respondents saying the same (16%). Netting out those opting for GBA being 'less important', this year's responses represent a 24ppt net positive increase (versus -3.7ppt last year). This sizeable net positive response for the GBA as a consumer market was the highest across the five key business functions (Figure 53). 29% picked 'more important' (from 12% prior), representing a net increase of 18ppt (vs -10ppt prior), when asked about the GBA as an R&D base. Similar big y/y jumps were seen across the GBA's function as a base for production, sourcing and treasury centre. These upward-trending responses may indicate that companies have been reminded in the past year of the ways in which the GBA may not lose out to other production bases, despite their still-evident structural need to diversify overseas to reduce risks related to ongoing US-China tensions and supply chain concentration.

Maintaining an edge over China's other economic zones

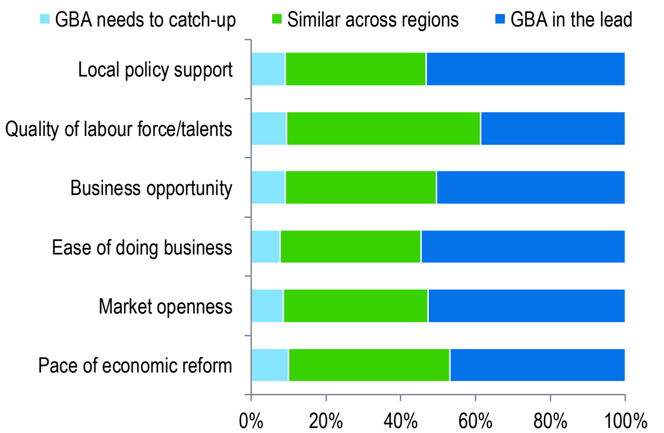
The GBA also enjoys an edge over other economic zones in China, in our view. Most of our respondents believe the GBA has established a clear lead over other economic zones in China in terms of economic reform pace, market openness, ease of doing business and business opportunity; a greater number voted for 'GBA in the lead' than those voting for 'similar across regions' (Figure 55). The GBA's edge in terms of 'quality of labour force and the talent pool' appears relatively less prominent; yet almost 40% responded favourably, versus only 10% saying the GBA needed to catch up with other

Figure 54: Do you expect the 14th FYP and the dual-circulation strategy to help address cited hurdles for industrial upgrading? *(% of respondents)*



Source: Standard Chartered Research

Figure 55: How do you compare the GBA's prospects with those of other economic zones*?
% of respondents



* Yangtze River Delta, Beijing-Tianjin-Hebei, Chengdu-Chongqing; Source: Standard Chartered Research

economic zones, which is comparable to the results in other areas of competitiveness. We believe that concerns over the GBA's labour quality and availability reflect the GBA's strong demand for high-end talent (rather than representing a complaint about the lack of the standard of available talent), which is necessary to support the region's long-term aspirations to advanced manufacturing, innovation, and modern services.

But are respondents walking the walk?

Well, yes and no. We asked our survey respondents where they currently operate in the GBA, and what their plans for each city are for 2021. Focusing on just those respondents that already have operations in a particular city, more plan to reduce rather than expand their size of operations (this applies to all 11 GBA cities), although a majority are still looking to keep things unchanged (Figure 56).

However, if we include those that do not currently have a presence in a city but plan to expand there in 2021, 10 of 11 GBA cities (except Macau) see a net positive change (up by an average 4ppt) this year. And by this same measure but in absolute terms, Zhaoqing and Foshan see the biggest expected net gains in 2021, probably thanks to their lower base (fewer manufacturers already having a presence there, giving them more room to grow); this is followed by the core cities of Shenzhen, Guangzhou and Hong Kong.

Revisiting the propositions for a megacity cluster

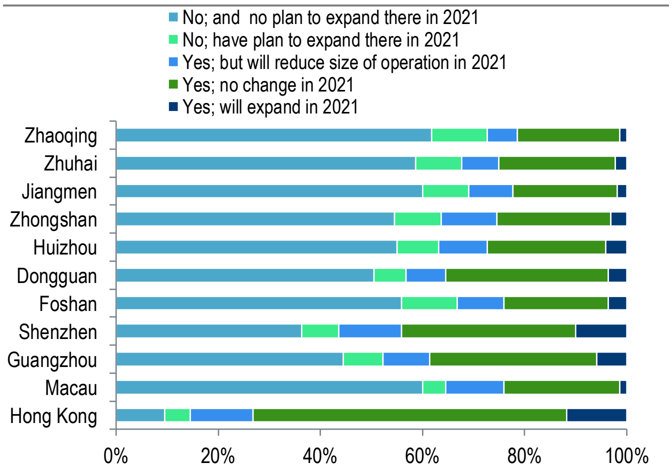
We believe China's lofty expectations (especially in the medium-to-long term) for the GBA are still justified. We provide below an update on three main reasons for our optimism: the GBA's broad-based growth drivers, high population growth, and strong policy support.

(1) The GBA represents more than just manufacturing

The GBA is also a leading innovation hub, a pioneer is financial opening, and an emerging consumer market

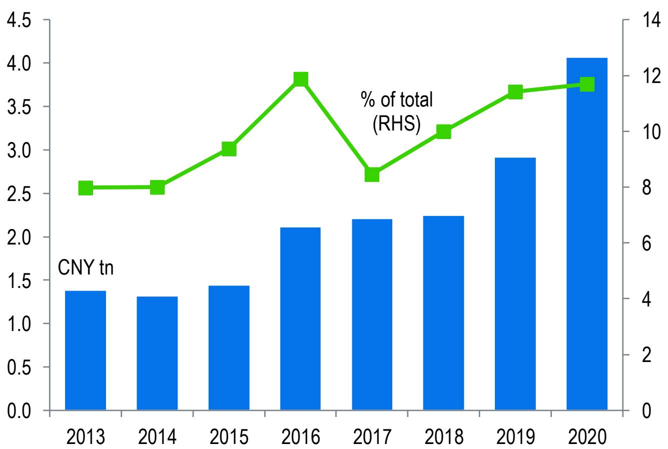
Historically, the GBA (previously known as the Pearl River Delta region) made its name for being China's (if not the world's) manufacturing powerhouse. This is reflected in the region's strong post-COVID recovery so far, as it is driven predominantly by strong industrial production and export orders. However, the GBA represents more than just manufacturing prowess. Using Guangdong as a proxy, in addition to accounting for over 28% of China's total exports and 12% of industrial production, the GBA is also China's leading innovation base, contributing 38% of high-tech new product sales and

Figure 56: Where do you currently operate, and do you expect that to change in 2021? *(% of respondents)*



Source: Standard Chartered Research

Figure 57: Ramping up credit support during tough economic times *(Guangdong's total social financing)*



Source: Wind, Standard Chartered Research

49% of patents nationwide (Figures 58 and 59). Furthermore, the GBA, whose core cities are already among the country's most wealthy and financially savvy, is spearheading China's financial opening and transformation into a more services-oriented economy. Financing resources are also being channelled to such growth areas; unsurprisingly, Guangdong is China's largest province in terms of total social financing (TSF; the country's broadest measure of credit creation). Its share of national TSF has been high through past downturns, reflecting the province's importance in driving overall growth during troubled times (Figure 57).

About a year ago, we collaborated with the Hong Kong Trade Development Council (HKTDC) to devise a way to track the GBA's multi-faceted evolution in the coming years; we jointly launched the *Standard Chartered GBA Business Confidence Index* (GBAI). The GBAI is based on information drawn from quarterly surveys of over 1,000 companies operating in the GBA – half representing the manufacturing and trading sector, and the rest representing a balanced mix of services industries. The index offers a unique and timely look at the business and credit outlook across cities and industries in the GBA. *Our most recent Q2-2021 GBAI report released in April* foresaw a further acceleration in growth for the quarter; however, a breakdown of the index provides even more important takeaways, in our view.

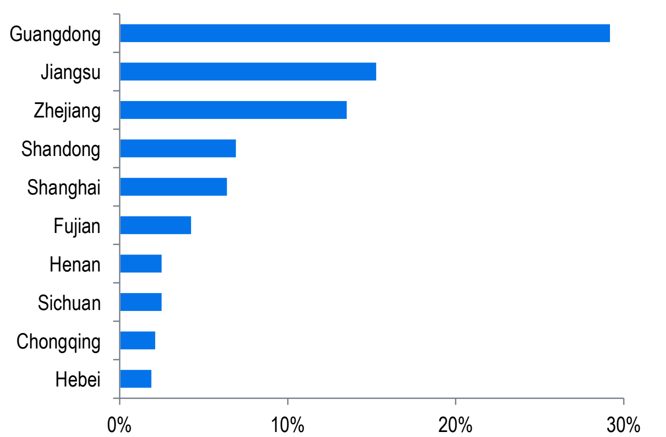
GBA retailers are starting to catch up to other services sectors, such as IT and financial services

An industry breakdown of our GBAI confirmed that the IT and financial services sectors were resilient in the early months of the region's post-COVID rebound, before the manufacturing and trading sectors took over as the largest recovery driver. More recently, the performance of the 'retail and wholesale' sector has exceeded that of the IT and financial services sectors, indicating that retail and wholesale is playing catch-up, reflecting the broadening of China's services-sector recovery. A city breakdown shows Shenzhen and Guangzhou as being the outperformers, as they were best positioned within the GBA to enjoy the favourable combination of a vaccine-driven export recovery and a broader services-sector rebound. By comparison, however, while Hong Kong has shown signs of bottoming out, the city has remained a clear underperformer for four straight quarters.

(2) Stronger-than-expected population growth

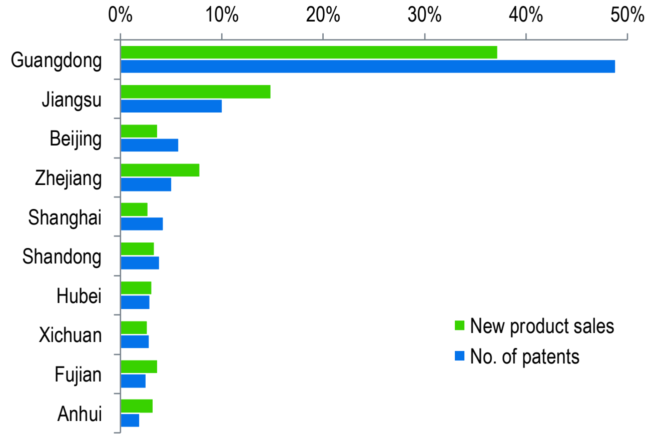
Another key reason for our long-term optimism towards the GBA is its massive size advantage. Based on our survey respondents' feedback, we know that high-end talent has robust demand within the region. Notwithstanding stagnant growth in the working

Figure 58: Guangdong's disproportionally large export sector *(Top 10 province by exports, % of 2020 total)*



Source: CEIC, Standard Chartered Research

Figure 59: Guangdong maintains the lead in innovation
High-tech industry, % of 2019 national total



Source: Wind, Standard Chartered Research population due to China's ageing demographics, the trend of the rural population moving to megacity clusters such as the GBA is likely to continue as people seek better job opportunities and living standards. Moreover, we believe the region's diverse growth drivers, ability to garner strong policy support, and opportunities stemming from a deepening integration between the GBA cities should boost its ability to attract high-end talent via a 'siphoning effect'. This means that the GBA's innovation drive, industrial upgrading trend, higher wages and favourable residential policies should make it competitive in job creation, creating a 'siphoning in' effect for not just rural workers, but also high-end talent from other major Chinese cities.

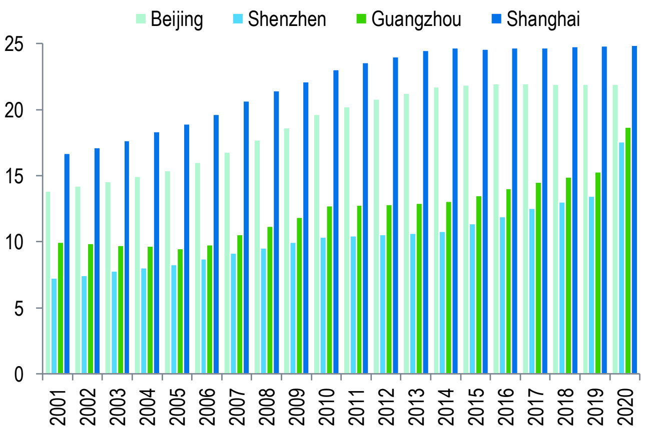
Shenzhen and Guangzhou's populations have been underestimated

Furthermore, China's official 2020 decennial census (conducted once per decade) offers a more positive outlook for the GBA's demographics. As per sample counts conducted over 2015-19, Shenzhen and Guangzhou's residential populations grew by 2.7mn and 2.2mn, to 15.3mn and 13.4mn as of 2019, respectively. Meanwhile, as per the 2020 decennial census, Shenzhen's population stood at 18.7mn in 2020 and Guangzhou's at 17.6mn. These sharp y/y population increases from 2019 levels point to significant undercounting at the sample population census level (Figure 60). We are unlikely to see such sharp adjustments in actual population numbers again in the coming years given the infrequency of the full census. Still, these statistical adjustments show the potential for significant underestimation of actual population numbers. The population data further serves to show the contrast between GBA cities' more dynamic population growth and stagnant growth in other major cities such as Beijing and Shanghai, which each added c.0.2mn from 2015-20.

Indeed, such strong population growth in the GBA's major cities may have policy and social ramifications. For example, Shenzhen recently announced adjustments to its talent attraction policies, and other GBA cities are looking to follow suit, as per media reports. As per the announcement, starting September 2021, newly qualified graduates (Bachelor's degree holders) and postgraduates looking to settle in Shenzhen will no longer be eligible for a one-off rental and living subsidy. Shenzhen is also raising the 'hukou' threshold (i.e., the educational threshold for people seeking a residency permit) and tightening the requirements for obtaining a permit through marriage.

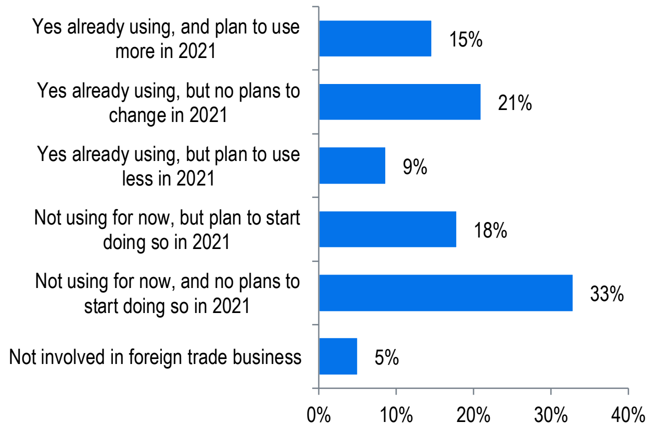
Such policy moves to slow population growth are part of the authorities' balancing act of attracting the right talent to support an industrial transformation while avoiding overstretching public resources and fuelling property speculation. We expect an

Figure 60: Evident population rise in Shenzhen and Guangzhou *(Population, usual residence, mn persons)*



Source: CEIC, Standard Chartered Research

Figure 61: What is your usage of and plan for Renminbi in international trade settlement? *(% of responses)*



Source: Standard Chartered Research

inevitable slowdown in the GBA's population growth because of such policy tightening measures, which may not be negative if they support sustainable growth long-term.

This is also where the 'bay area' concept comes in, where clustering generates massive infrastructure needs. Infrastructure spending is key to make a sprawling project such as the GBA manageable in the long run, in our view. For example, more efficient transportation links are needed for the adequate dispersion of residential zones while maintaining acceptable commute times. This, together with speedier customs, higher data connectivity and the mutual recognition of public services and professional qualifications across the 11 GBA cities, will likely drive the region's population to c.100mn by 2035 (our projection) from 70+mn currently.

(3) Policy support remains strong

Innovation and financial opening are getting more of a policy boost

The promotion of industrial upgrading, intra-regional collaboration and the acceleration of infrastructural connectivity – all of which require strong policy support – are seen as key means to achieving the GBA's long-term goals. On the innovation front, Shenzhen recently announced that during the 2021-25 FYP period, 5% of GDP will be allocated to investment in R&D to support innovation and breakthroughs in core technologies. This equates to at least CNY 700bn of spending over the FYP, based on last year's nominal GDP. The investment focus is likely to be on artificial intelligence, 6G, quantum technology, driverless vehicles, intelligent networks and other 'frontier areas', as per media reports.

In terms of intra-GBA collaboration and connectivity, while the pandemic has presented a major hindrance to physical cross-border travel and contact, the region still made significant headway on the financial-services front. Just over a year ago, China's top financial regulators (the PBoC, SAFE, CBIRC and CSRC) made the high-profile joint announcement of the so-called "26 measures" to support the GBA's development. Since then, financial regulators on the provincial and city levels have followed up with their own implementation plans, expanding the original 26 policies into actionable financial measures, headlined by the upcoming launch of the Wealth Management Connect scheme (which allows cross-border investment in wealth management products distributed by banks in the GBA).

The scheme counts towards the "more than 90%" implementation rate of the "26 measures" that Guangdong's financial authorities recently claimed to have achieved, according to media reports. Other achievements mentioned include the opening of the Guangzhou Futures Exchange, which has plans to develop carbon emissions derivative products; the launch of the multi-currency cross-border cash pooling pilot scheme by Shenzhen; and the continued expansion of trade and investment facilitation programmes, benefiting over 1,000 eligible Guangdong enterprises.

Our tracker for Renminbi internationalisation indicates a reacceleration over the past year

The combination of a renewed policy push, strong CNY performance, China's robust export recovery and ample global liquidity has also fuelled a reacceleration in Renminbi internationalisation, as reflected in the increase in *our proprietary Standard Chartered Renminbi Globalisation Index (RGI)* for nine straight months until March 2021, surpassing previous September 2015 peak. In particular, we see GBA manufacturers leading the way in again taking up Renminbi trade settlement, which has recovered to c.15% of China's total goods trade, but remains well below the 2015 peak of over 30%, implying plenty of room to grow (we discuss this further in the next paragraph). At the same time, the recent strong CNY appreciation should also make the relaxation of outbound capital flows a more attractive proposition for the mainland authorities. Hong Kong is likely to be the main beneficiary of such a relaxation, which would cement its role as China's financial window to the rest of the world, and its dominance as the Renminbi's biggest offshore centre.

Our latest GBA manufacturing survey shows that a majority 55% of our respondents see Renminbi internationalisation presenting at least some new opportunities within the next five years (Figure 52). We also asked respondents about their plans for Renminbi usage in international trade settlement this year (Figure 61). 44% respondents said they were already using Renminbi trade settlement. Within that, around one-third expect to increase usage in 2021, while another 47% said they expect no change. Another 18% of total respondents are currently not using Renminbi invoicing for international trade, but plan to start doing so in 2021. All this supports our view that GBA manufacturers will lead the return of Renminbi invoicing.

ASEAN – Benefiting from diversification

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ASEAN – More reasons to invest in the region

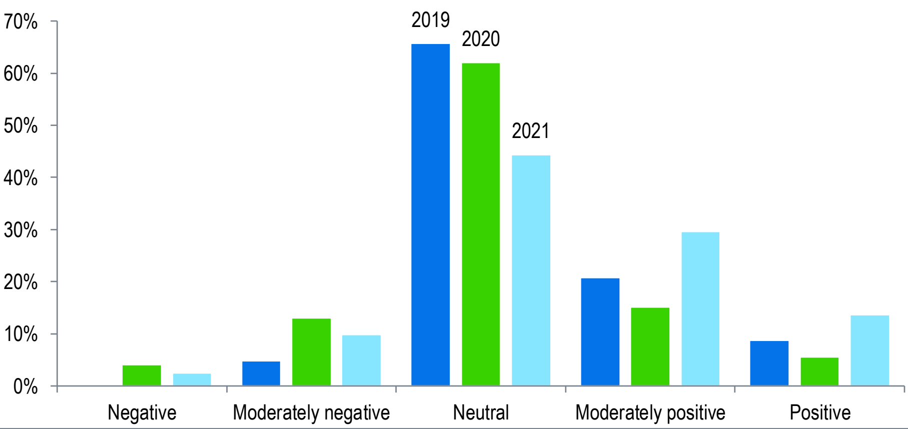
The pandemic remains a near-term challenge

Our latest GBA survey responses to questions on the region's near-term outlook for 2021 were markedly more confident than year-ahead expectations last year, when our survey was conducted in the thick of the COVID-19 crisis. This renewed optimism is unsurprising, as the economic data has been generally improving globally, with vaccination programmes being rolled out. About 43.6% of respondents said they are moderately positive to positive on the region's prospects this year (Figure 62). They even appear more confident about the 2021 outlook compared to 2019, likely due to the negative impact of the US-China trade war in 2019.

ASEAN's 2021 growth outlook improves, but the region needs to accelerate its vaccination rollout

Figure 62: What is your view on ASEAN for 2021?

% of total responses



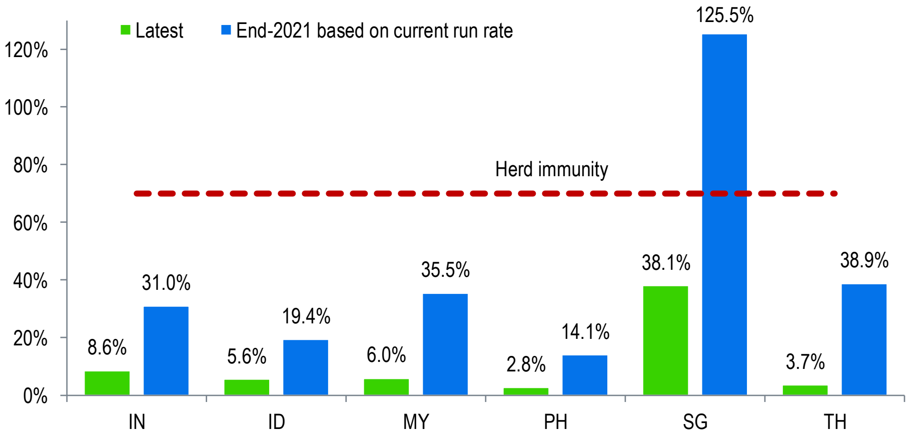
Source: Standard Chartered Research

However, ASEAN continues to lag its developed market counterparts on vaccination progress. At the time of writing this report, several economies in the region are battling another COVID resurgence. With the exception of Singapore, the inoculation rate has been slow for the broader region, with most economies having vaccinated less than 10% of their populations as of early June. Based on the current vaccination rates, only Singapore appears set to reach herd immunity by year-end. Encouragingly, however, various local media reports are pointing towards an acceleration in vaccination pace across the rest of the region in Q3-2021.

The pace of vaccinations is widely expected to pick up in the coming months

Figure 63: Vaccination rollout has been slow in the region

% of population, assuming two doses required for full vaccination

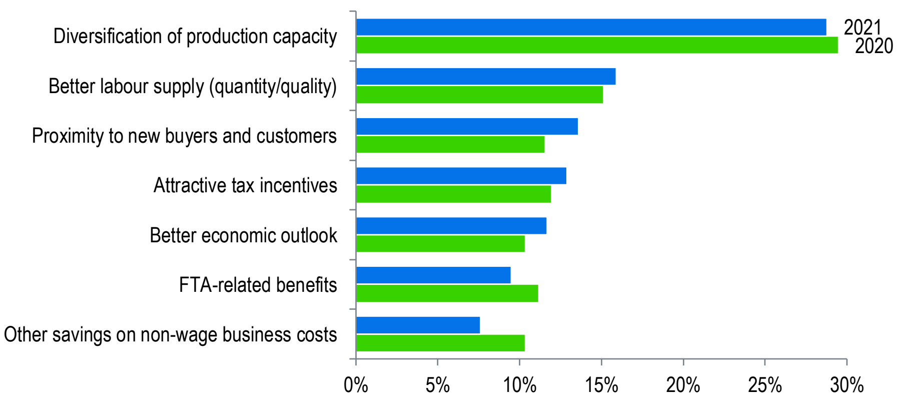


Source: OWID, Standard Chartered Research

Diversification objective driving investment to ASEAN

Manufacturers in the region have been negatively affected by major events in recent years, including the US-China trade war in 2018-19 and COVID-19 since 2020. Before this, ASEAN was benefiting from investment diverted away from China to the region due to rising costs in China, particularly hiring costs as labour supply had tightened. Other factors drawing investors included new market potential, attractive tax incentives by pro-growth governments in the region and FTA-related benefits. Companies are now citing diversification of production capacity as a primary reason to relocate out of China (Figure 64). **This is especially relevant for companies manufacturing in China but supplying elsewhere, especially to the US**.

Figure 64: What are the non-wage advantages of moving to your selected destination?
% of total responses

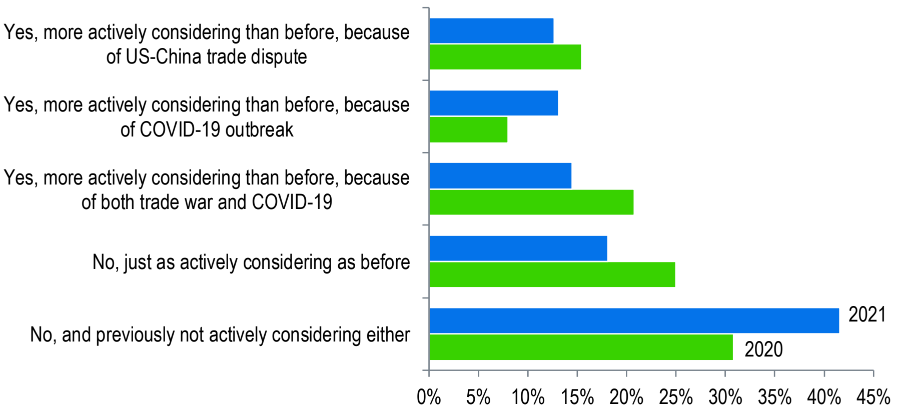


Source: Standard Chartered Research

Will US-China competition broaden?

The Biden administration has maintained a policy of firm pressure on China, and is further looking to collaborate with its traditional allies to broaden the challenge to China. This stance raises the question whether more of China's export destinations may be affected going forward. We believe this potentially broader challenge to China may bolster companies' incentive to diversify production in the coming years. In this event, ASEAN should benefit. However, China-based companies servicing domestic demand may have less reason to move out, explaining why a significant proportion of our survey respondents are not considering relocation.

Figure 65: Has the US-China trade dispute/COVID-19 outbreak made you more actively consider moving capacity outside of China? *% of total respondents*



Source: Standard Chartered Research

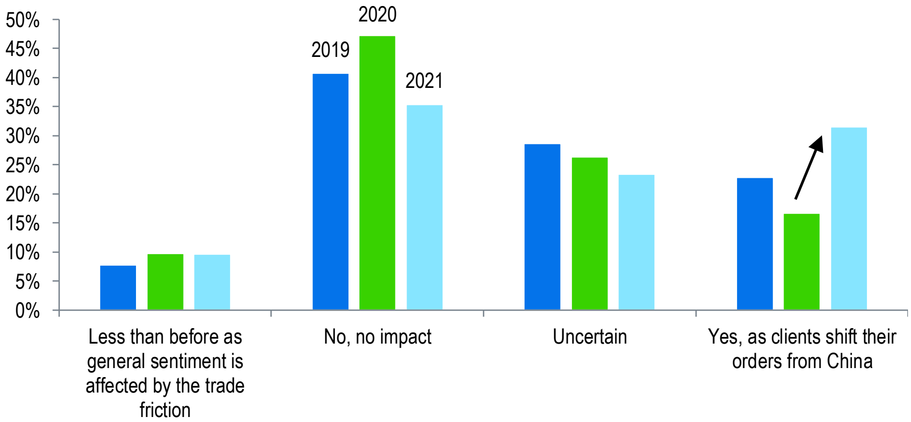
A need to increase capacity

ASEAN operations are attracting more orders diverted from China

Our 2021 survey showed that respondents with existing production in ASEAN are seeing an increase in orders diverted from China (c.31.5%) to their ASEAN operations, compared to only 16.7% in 2020. The 2021 figure is even higher than in 2019, when the US-China trade war may have driven affected companies to seek alternative production sources. Similarly, at a macro trade level, ASEAN exporters are gaining more market share in key major economies (see section '*Progressively capturing market share*').

Figure 66: Have you seen more orders for your business in ASEAN due to the China-focused tariffs from the US?

% of total responses



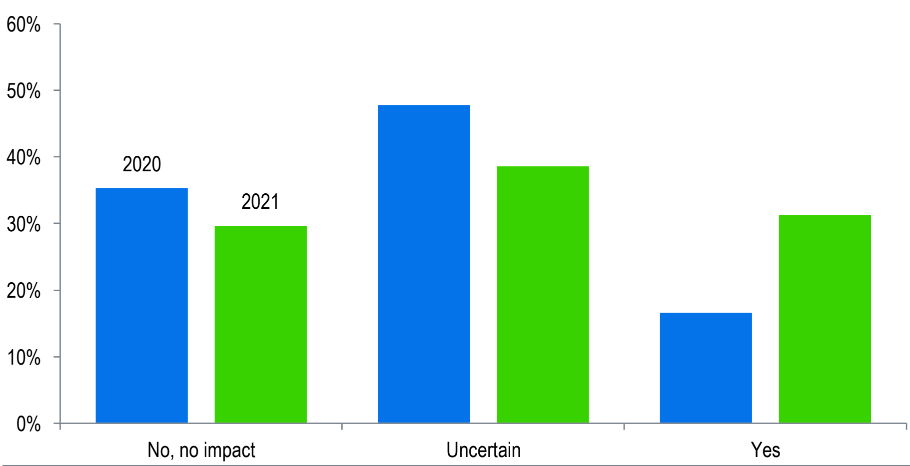
Source: Standard Chartered Research

Respondents appear more confident increasing capacity in ASEAN in 2021 partly driven by the post-pandemic recovery

The clear trends of diverted investment from China and increased client orders are driving more manufacturers to increase operational capacity in ASEAN, in our view. Companies now have three primary considerations for increasing production capabilities in ASEAN: efficiency (cost-related issues), diversification (reducing operational risk by lowering geographic concentration of production capacity) and geopolitics (to be able to navigate a potential increase in US-China rivalry).

Figure 67: Will you be adding more capacity in ASEAN given the US-China trade war and COVID-19?

% of total responses



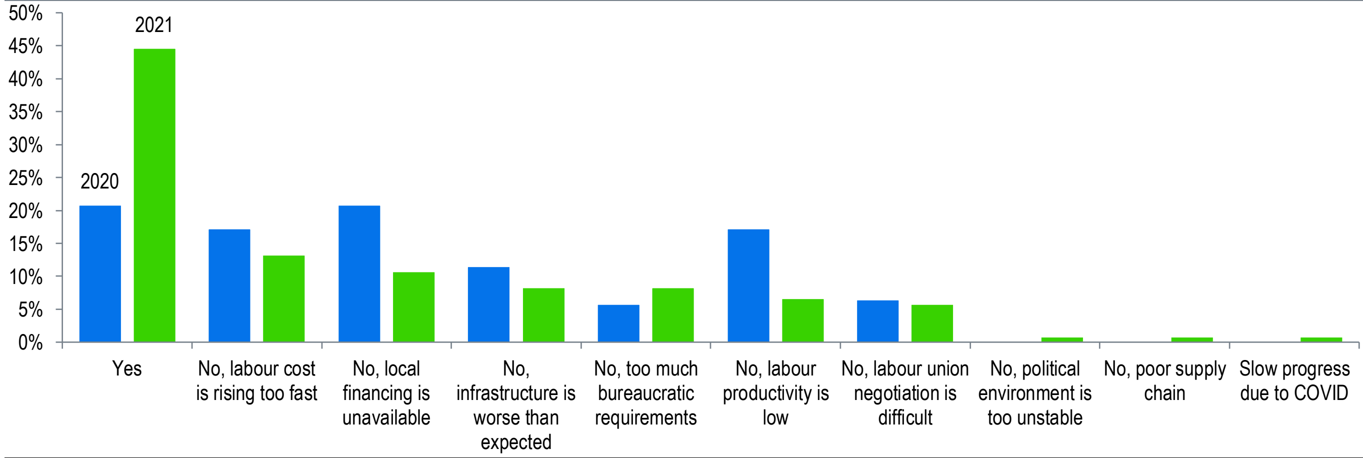
Source: Standard Chartered Research

According to the survey responses, manufacturers who have invested in ASEAN appear to be more satisfied with their move this year (45%) compared to last year's survey (21%), perhaps partly due to an improved economic outlook as the pandemic is gradually receding. Most of the negative responses showed a decline, although concerns over bureaucratic requirements in the region increased slightly.

Concerns over low labour productivity have declined, which is a key improvement, as that has been a typical issue for investors moving into the region. This change is particularly important in this survey, which includes more basic manufacturing companies.

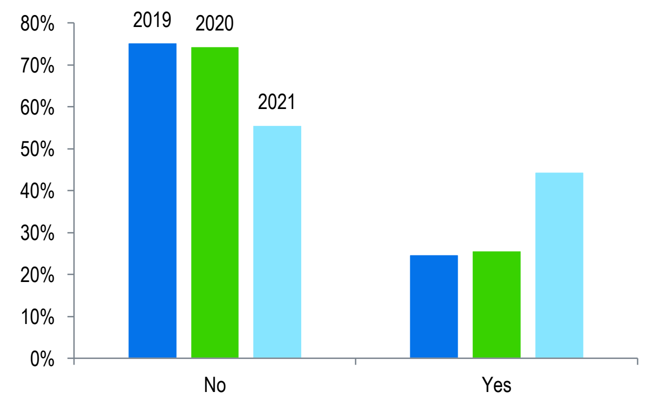
It is also encouraging to see the increased adoption of FTAs in ASEAN by companies in this year's survey, compared to 2019 and 2020. ASEAN is the world's most open region in terms of trade. By region, ASEAN has five bilateral FTAs with six partners (China, Australia, New Zealand, India, Korea and Japan). In addition, the conclusion of the Regional Comprehensive Economic Partnership (RCEP; expected to be ratified in 2022) should reinforce the integration of the region and its bilateral FTA partners. However, we see further scope to increase FTA utilisation, based on the survey results.

Figure 68: Are you satisfied with your investments in ASEAN?
% of total respondents



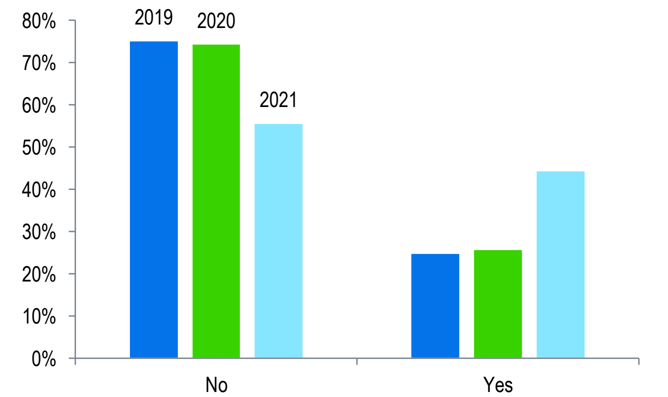
Source: Standard Chartered Research

Figure 69: Do you benefit from FTAs in ASEAN?
% of total responses



Source: Standard Chartered Research

Figure 70: Is ASEAN sufficiently integrated for your business strategy; *% of total responses*



Source: Standard Chartered Research

Top three favoured investment destinations

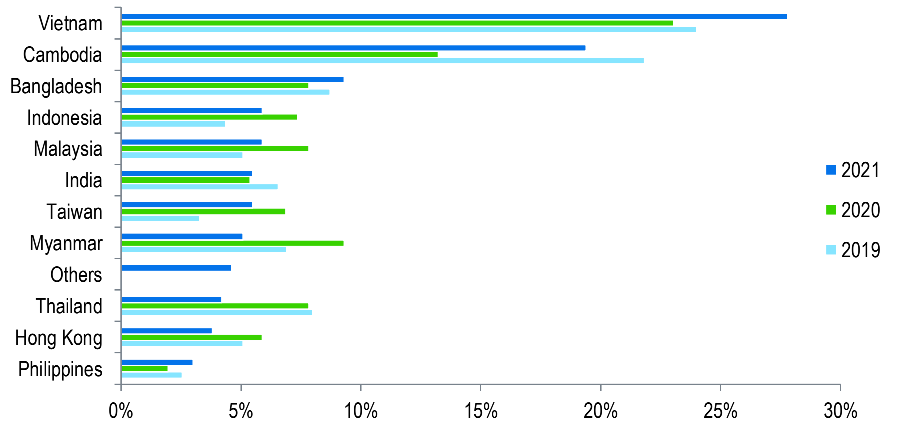
In our annual GBA survey, we asked participants where they would move their production capacity if they considered moving out of China. The favourite destinations have been consistent over the years, namely Vietnam, Cambodia and Bangladesh.

However, this does not imply other countries are less attractive, in our view. Rather, the survey outcome may be a result of sample bias, given a large portion of our surveyed companies operate in more basic manufacturing segments. About 75% are in non-electronics-related manufacturing; 23% (the highest proportion within non-electronics-related sectors) in textiles and apparel; and 11% in rubber, plastics and non-metallic product manufacturing. Within electronics-related manufacturing, c.47% operate in electronics packaging assembly.

Vietnam, Cambodia and Bangladesh remain top investment destinations

Figure 71: If you plan to move capacity out of China, where would you choose?

% of total respondents

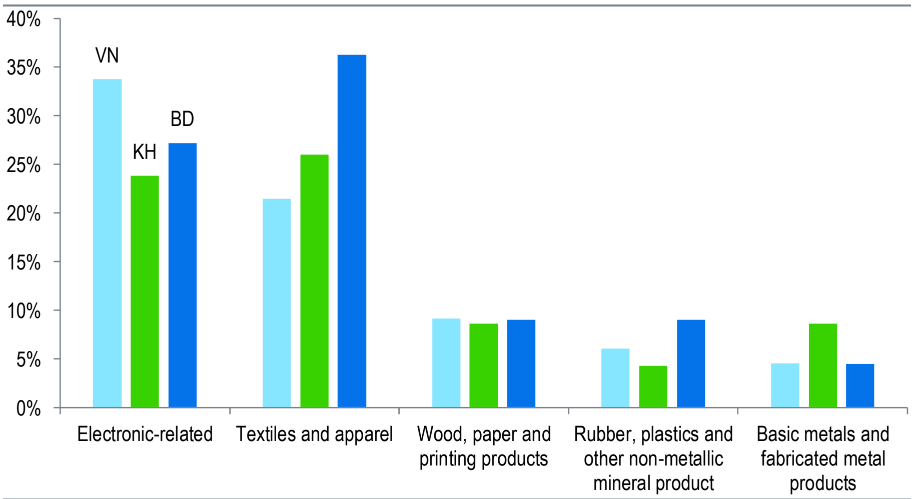


Source: Standard Chartered Research

In Figure 72, we show which sectors the respondents who chose to invest in Vietnam, Cambodia and Bangladesh operate in. Textile-related manufacturers showed a preference for Bangladesh and Cambodia, while Vietnam attracted greater interest from electronics-related manufacturers.

Figure 72: Electronics and textile-related manufacturing stand out

% of respondent sectors who chose VN, KH and BD as investment choices



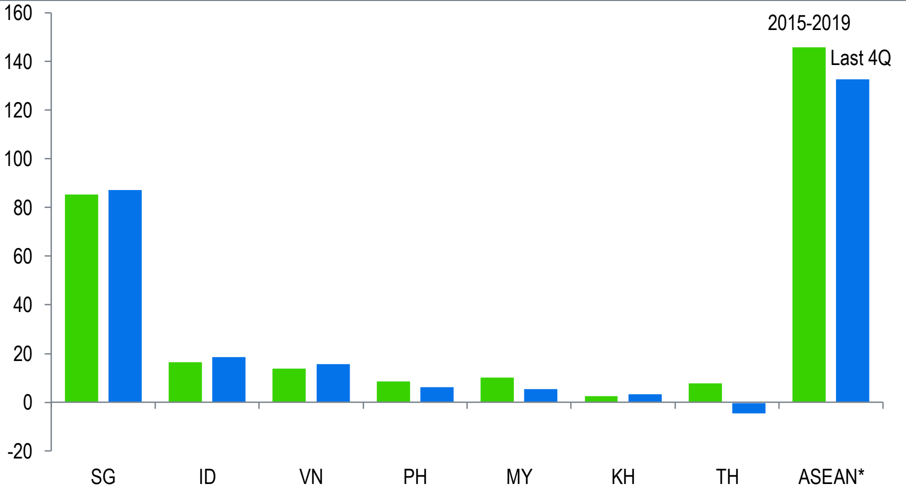
Source: Standard Chartered Research

Progressively capturing market share

The latest balance-of-payments data shows that FDI in ASEAN was (expectedly) hit in H1-2020 due to the pandemic, but recovered strongly in H2-2020. However, FDI may have still declined c.9% in 2020 compared with average annual FDI from 2015-19. Only Singapore, Indonesia and Vietnam attracted higher FDI last year than their annual averages over 2015-19 (Figure 73).

Figure 73: Investment in ASEAN has largely held up despite the pandemic

Annual average; USD bn

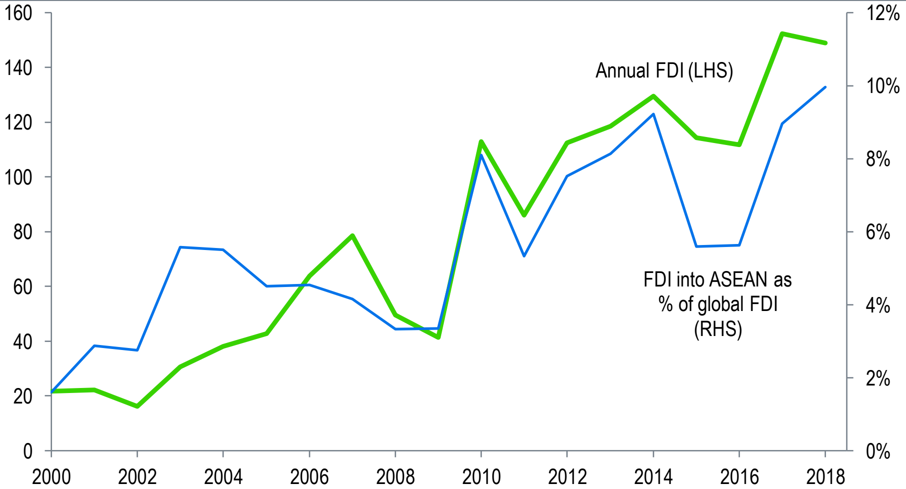


* ASEAN here include SG, ID, VN, PH, MY, KH and TH; Source: CEIC, Standard Chartered Research

Importantly, the region continues to draw a rising share of global FDI – about 10%, according to the 2020 World Investment Report. We think this reflects growing investor interest in the region, despite the fact that its GDP comprises only c.3% of global GDP. Key FDI investors in the region remain the US (15% of total FDI), Japan (13%), China (including Hong Kong; 12.6%) and Europe (9.7%), based on 2019 data from the ASEAN Secretariat.

Figure 74: ASEAN continues to grab global investment share

USD bn (LHS); % of global FDI (RHS)



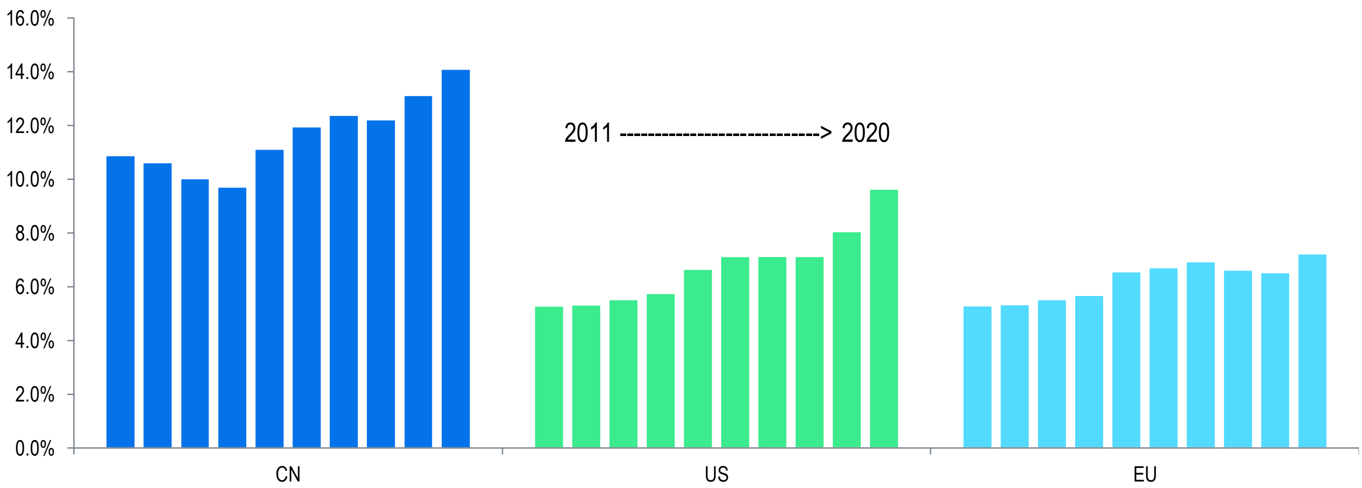
Source: UNCTAD, Standard Chartered Research

Given the increasing investment trend and supply-chain movements across the region due to various major factors discussed earlier, ASEAN's share of exports to major economies (i.e., the US, China and euro area) has risen steadily in the past decade. Within ASEAN, Vietnam's performance has been outstanding, consistently increasing its share of the region's exports to the three major economies in the past few years. Malaysia and Singapore's exports have also taken larger shares of imports by the three major economies.

As more companies relocate production and bolster their regional supply chains, we expect ASEAN to continue to take an increasing share of the global export pie. The region still offers attractive attributes, including pro-growth policies, regional stability, growing domestic markets, and a still-competitive cost base. It continues to drive its integration with the global economy via trade agreements, and additionally, the changing global geopolitical winds should keep the region on course to becoming a larger exporter in the coming years.

Figure 75: ASEAN has increased its share of major economies' imports

ASEAN's share of CN, US and EU total imports, 2011 to 2020



Source: UNCOMTRADE, Standard Chartered Research

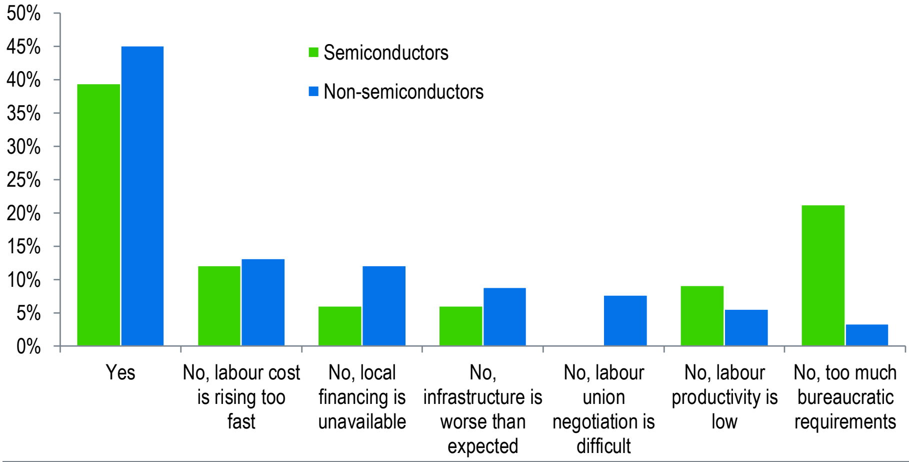
A closer look at the survey responses by industry

Semiconductor sector respondents are keener to add capacity in ASEAN due to the US-China trade war and COVID

Manufacturers appear to be generally satisfied with their investments in ASEAN, with non-semiconductor companies slightly more satisfied than semiconductor companies. The survey responses show an increase in concern over bureaucratic requirements in the region among companies not satisfied with their investments. This concern was cited most by semiconductor manufacturers (one in five), and by less than 5% of non-semiconductor manufacturers. Semiconductor companies are also more concerned about low labour productivity in the region.

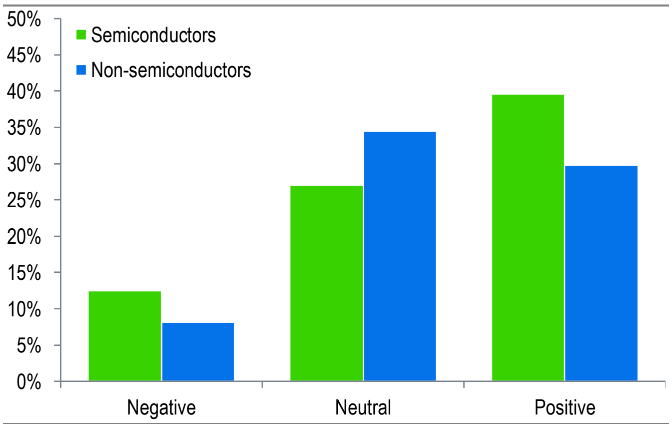
Nonetheless, semiconductor manufacturers appear more keen to diversify their production capacity to ASEAN to mitigate US-China trade tensions and due to COVID-19. Over 42% are looking to add more capacity in ASEAN, versus only 27% of non-semiconductor manufacturers looking to do so. A substantial number of our surveyed semiconductor manufacturers (36%) have seen a positive impact on orders in their ASEAN operations due to increased US tariffs on China. That said, respondents overall said the deterioration in business sentiment due to trade frictions had affected their business negatively (37% of non-semiconductor manufacturers and 30% of semiconductor manufacturers saw ASEAN orders decline for this reason).

Figure 76: Are you satisfied with your investments in ASEAN?
% of responses



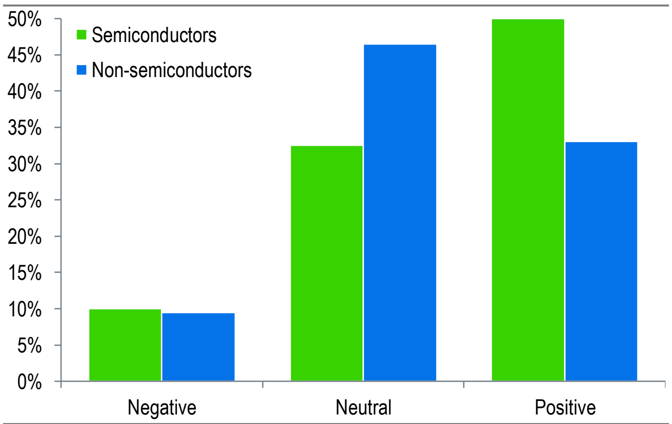
Source: Standard Chartered Research

Figure 77: Semiconductor manufacturers are polarised on ASEAN, non-semiconductors more positive; *% of total*



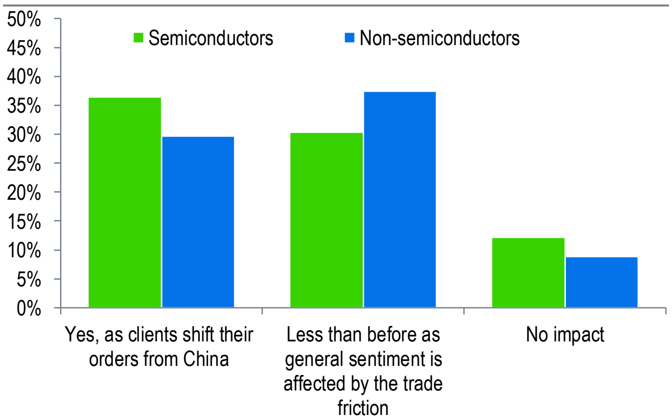
Source: Standard Chartered Research

Figure 78: Semiconductor manufacturers are more optimistic on the rest of Asia*; % of total*



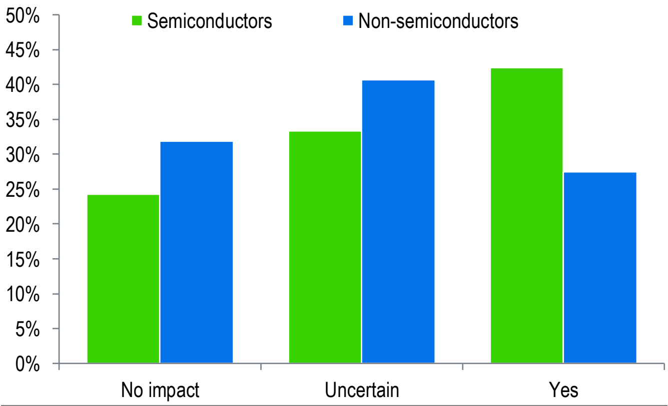
Source: Standard Chartered Research

Figure 79: Have you seen more orders in ASEAN due to China-focused tariffs from the US?*; % of total*



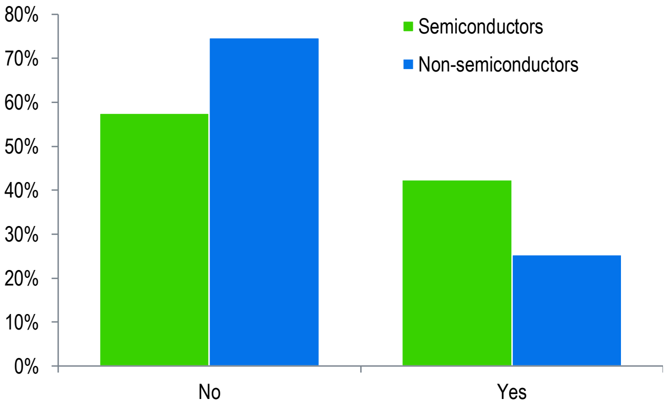
Source: Standard Chartered Research

Figure 80: Will you be adding more capacity in ASEAN given the US-China trade war and COVID-19?*; % of total*



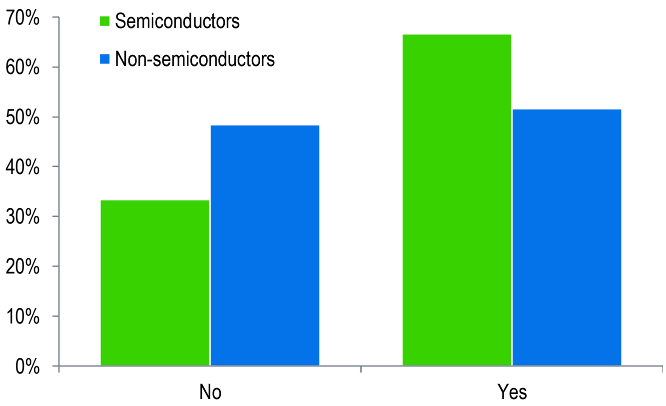
Source: Standard Chartered Research

Figure 81: Do you have difficulty finding workers this year, compared with last year?; *% of total*



Source: Standard Chartered Research

Figure 82: Are wages rising as a share of your total production/operation costs?; *% of total*



Source: Standard Chartered Research

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