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# CHINA WATCH

**An Analysis of the Asia-Pacific Situation and Outlook**

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# **An Analysis of the Asia-Pacific Situation and Outlook**

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## **1. The Pandemic and the Prospects for Asia's Economic Recovery**

The Asian economy maintained strong recovery momentum in 2021, and relevant international organizations are forecasting that Asia will be the fastest growing region in the world. This is because the countries of Asia have achieved results in epidemic prevention and control, while European and American countries' supply chains were damaged due to an out-of-control pandemic, which has objectively promoted Asian exports. Of course, the fast growth in Asia is also related to the low growth base in 2020. Looking ahead, the Asian economy will still maintain a relatively high growth rate in 2022, but the growth rate will show a downward trend.

Two factors are worth paying attention to when evaluating the prospects for Asian economic growth: one is the reversed positions of the epidemic prevention process in Asia as opposed to Europe and the Americas, and the other is the reversed positions of macroeconomic policies in Asia as opposed to Europe and the United States.

When dealing with the novel coronavirus pandemic of the past two years, the countries of Asia have approached epidemic prevention in a way that differed from their counterparts in Europe and the Americas, and achieved good results. Since the start of 2022, the epidemic prevention policies of most European and American countries have begun to relax, and barring unforeseen circumstances, they will lift restrictions in the first half of 2022. In contrast, the vast majority of Asian countries, including Japan, South Korea, China, and the countries of Southeast Asia, will not be easing restrictions in the short term. As soon as the countries of Europe and the

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<sup>1</sup> From [www.cssn.cn](http://www.cssn.cn); posted 13:40, 1 March 2022

Americas relax their pandemic restrictions, they will be able to swiftly repair their damaged supply chains. Considering that the end consumer markets for Asian exports are mainly Europe and the United States, this will have a very obvious impact on the Asian economy.

In the past few years, loose monetary policy has been the global trend, but in 2021, the inflation rate in the developed countries in Europe and the Americas rose sharply, to the point that people are beginning to worry that this combination of high inflation and low growth may devolve into a new round of “stagflation.” In response, the major central banks in Europe and the United States are certain to choose to raise interest rates and take quantitative tightening measures in 2022. By contrast, the inflation rate in Asian economies is generally low, though economic growth is faced with uncertainties brought about by the pandemic. The possibility of them adopting a contractionary monetary policy is very small, and some countries will even choose an expansionary fiscal and monetary policy. Such differences in monetary policy may lead to a reversal in the direction of international capital flows, which in turn would lead to fluctuations in exchange rates. At the same time, in the past few years, Asian countries have accumulated very large-scale debt. Once interest rates in Europe and the United States increase, the debt burden of Asian countries will also increase.

These two reversals between Asia on the one hand and Europe and the United States on the other will pose hidden dangers for the sustainable recovery of the Asian economy in 2022 and even beyond. Therefore, we can expect that the Asian economy will remain the locomotive of global growth, but we cannot ignore the hidden dangers behind the growth momentum.

## **2. The Impact of the Indo-Pacific Strategy Begins to Show**

The American Indo-Pacific strategy is the biggest variable affecting the pattern and security of the Asian region. Two events of 2021 deserve attention: one was the emergence of AUKUS (a trilateral security agreement between the United States, United Kingdom, and Australia), and the other was the first “Global Summit for Democracy” hosted by the United States.

From the positioning of AUKUS, one can see that it will constitute the inner circle of the US Indo-Pacific strategy, while the Quadrilateral Security Dialogue (QUAD, made up of the US, Japan, India, and Australia) will constitute its second circle and the future QUAD+ will be its third circle. The outermost layer will be the democratic alliance system around the world. In other words, the membership of the Indo-Pacific strategy is not limited to the geographical Indo-Pacific countries.

Whether the Indo-Pacific strategy can achieve its intended goals will depend on the scale of its allies. In “The Indo-Pacific Strategy of the United States,” released on February 11, 2022, these goals include: advancing a free and open Indo-Pacific, connecting with allies within and outside the Indo-Pacific, advancing prosperity in the Indo-Pacific, enhancing security in the Indo-Pacific, and building regional resilience against “21<sup>st</sup>-century transnational threats.” These goals boil down to containing China. Although the “Indo-Pacific Strategy of the United States” lists as many as ten action plans to achieve these goals, the most fundamental issue is how many countries are willing and able to participate in the future. US officials have made it clear that the next step will be to focus on expanding the number of players in the Indo-Pacific strategy.

Over the past year, under the QUAD framework, all-round cooperation has been achieved not only in the area of economics but also in the political and security areas. Meanwhile, the four countries have also been cooperating at the bilateral level. For example, on November 17, 2021, the United States and Japan announced the establishment of a new trade partnership to promote cooperation on labor, the environment, and digital trade issues; they also emphasized “third-country concerns.” On January 7, 2022, the US-Japan Security Consultative Committee (2+2) meeting issued a joint statement pointing directly at China. On January 6, 2022, Japan and Australia signed the Reciprocal Access Agreement (RAA) on the joint training and disaster response of the Japan Self-Defense Forces and Australian Army; this is the first agreement in which Japan has allowed non-US foreign troops to appear in Japan since the US-Japan Treaty of Mutual Cooperation and Security was signed in 1960. Both sides consider it an epoch-making agreement that will bring their security cooperation to a new level.

The second factor affecting the realization of the expected goals of the Indo-Pacific strategy is closely related to the first, i.e., whether the “Indo-Pacific Economic Framework” (IPEF) can become an economic cooperation platform for the Indo-Pacific strategy. According to reports, the United States will officially announce the specific content of the framework in the next few weeks. In a sense, the IPEF will affect the willingness of developing countries in the region to participate in the Indo-Pacific strategy.

We believe that the most important factor in the attractiveness of the IPEF will be whether the United States is willing to open up its domestic market in order to build an economic cooperation platform similar to the original Trans-Pacific Partnership (TPP). At present, the domestic political resistance in the United States is rather large. Therefore, we remain cautiously optimistic about IPEF’s impact.

### **3. The Reshaping and “De-Sinicization” of Global Value Chains in Asia in the Post-Pandemic Era**

The reshaping of global value chains is reflected first in their shortening, and secondly in their layout—moving closer to final consumer markets. That is, they are being regionalized or localized. As far as Asia is concerned, there are both economic and political reasons for promoting the reshaping of global value chains in this region. In particular, China-US relations are having a direct impact on the value chains’ reshaping.

In early 2021, after Biden took office, he proposed an assessment of the United States’ global supply chains and emphasized, “We shouldn’t have to rely on a foreign country—especially one that doesn’t share our interests or our values.” This means that the direction for reshaping the United States’ supply chains in the future will be to exclude China. Compared with the Trump administration, the Biden administration is shifting from “comprehensive decoupling” to “selective decoupling” from China—that is, decoupling from China in high-tech fields and fields related to national economy and people’s livelihoods, while continuing to cooperate with China in other fields. This is consistent with subsequent statements of the US Trade Representative Katherine Tai.

In addition, China's "dual circulation" strategy is also promoting the reshaping of global value chains in the region.

Considering that the relative lack of an end consumer market in Asia will be difficult to change in the short term, it is possible that two parallel regional value chains may form: those leading to the end consumer markets of Europe and the US, and those leading to the end consumer market in China. It should be pointed out that it would be impossible to completely isolate the two sets of regional value chains from each other, and that most countries will still participate in them at the same time.

As we enter the post-pandemic period, the reshaping of global value chains is having a dual impact on China. On the one hand, their layout is becoming more and more localized. China's promotion of a new pattern of development and expansion of its domestic consumer demand will provide the world an increasingly large consumer market, thereby attracting international capital and expanded investment in China, so that China will become a "safe haven" for global capital. On the other hand, the United States and other Western countries' "selective decoupling" with China will be reflected in a "de-Sinification" in their reshaped value chains. Therefore, the claims in Chinese economic circles about the "safe haven" and "de-Sinification" may be valid. This is a new challenge we will be facing in the future.

Translated by Thomas E. Smith