

# Greater Bay Area Insight

## Upgrading the industrial base – three questions

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- ◆ “New quality productive forces” is the latest economic buzzword in mainland China; we think the GBA stands to benefit
- ◆ We look at why high-end manufacturing is changing and how it can advance further, helped by financial backing from HK...
- ◆ ...and how policy support can create better synergies through regional integration across the GBA

### The GBA – at the forefront of change

Since the high profile Two Sessions meeting in March, all the policy talk has been about “new quality productive forces” and modernizing the country’s industrial base. Given Guangdong’s status as mainland China’s manufacturing powerhouse, we expect the Greater Bay Area (GBA) to benefit. Against this high-tech backdrop, we address three questions – how the region’s manufacturing sector is changing, what can make it evolve further, and what are the best policies for future growth?

- ◆ **The future of the manufacturing sector.** Guangdong Province remains the country’s largest manufacturing base for electronic goods like smartphones and computers. However, growth has slowed and this sector is highly export dependent, so there is an urgent need to develop strategically important industries. We think the province’s manufacturing future lies in new economic sectors like new energy vehicles (NEVs), integrated circuits, and optoelectronic devices. Production in all three grew rapidly last year.
- ◆ **What will drive this change.** In a word, money. Manufacturing loans in the province rose 24.4% y-o-y in 2023, led by bank lending to advanced manufacturing (up 37%) and high-tech manufacturing (up 35%). Guangdong has also rolled out tax benefits to encourage R&D investment. Technological advances need backing from the capital market and the GBA has a clear advantage here – Hong Kong’s status as an international financial centre.
- ◆ **Policy support – integration, co-operation, human capital.** 1) Businesses in the GBA should be able to benefit from improving the flow of people, data, and capital, especially for technology-driven projects. The EU’s best practices in this area could be a good reference for the GBA. 2) A joint task force of GBA local governments is discussing a “one-stop shop” for business registration to improve co-operation and support foreign direct investment. 3) A huge shortfall of skilled manufacturing workers is forecasted by 2025, according to the Ministry of Industry and Information Technology. The government is making efforts to reform the college curriculum and provide tailored vocational training.

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## Section 1: Fostering “new quality productive forces”

**Policymakers have stressed the importance of modernizing the country's industrial base**

### Sectors like new energy vehicles (NEVs) are growing rapidly

In recent months, policymakers have stressed the importance of modernizing the country's industrial base and developing “new quality productive forces”. For example, the central government has released a series of initiatives to upgrade industrial equipment and facilitate the digital transformation of traditional industries. We think these policies will further enhance the prospects of the GBA. Since the beginning of the 14<sup>th</sup> Five Year Plan (2021-25), it has redoubled efforts to expand high-tech and advanced manufacturing, a key aspect of driving the GBA's high-quality economic transition.

To put this into perspective, Guangdong's overall industrial value-added reached RMB4.13 trillion in 2023, 10.3% of the national total. The province has a robust, broad industrial base, covering 40 of the country's 41 major industrial categories. This makes it an ideal test centre for industrial modernization. The high-growth and high value-added sectors have both flourished over the past decade – for example, the share of high-tech manufacturing in Guangdong's industry value-added rose from about 20% in 2000 to 32% in 2022.

**The production of electronics rose only 3.6% y-o-y in 2023**

Hampered by slower external and domestic demand, value-added in Guangdong's manufacturing sector increased just 4% y-o-y in 2023, much slower than the 9.5% expansion of the overall industrial sector. For instance, the production of electronics (computers, cell phones and other electronic equipment) rose only 3.6% y-o-y in 2023, weighing on the overall performance of the manufacturing sector. This is one of the most important manufacturing sub-sectors in Guangdong, representing 23% of the total industrial value-added and 51% of total exports. But at the same time, new economic sectors expanded strongly in 2023: production of new energy vehicles (NEVs), integrated circuits (IC) and optoelectronic devices grew 83.3%, 23.8% and 17.9% y-o-y, respectively. Meanwhile, the combined exports of NEVs, lithium-ion batteries, and solar cells – now widely referred to as the “new three” products – jumped 33.7% y-o-y in 2023.

This provides encouraging evidence of Guangdong's steady progress in high-quality growth. But how is the GBA's manufacturing sector changing, what can make it evolve further, and what policies would be most conducive for Guangdong's future growth? This report sets out to answer these questions.

**Table 1. Sub-sectors of Guangdong's high-tech and advanced manufacturing (2022)**

High-tech manufacturing sectors	Number of enterprises	% of total industrial value-added	Advanced manufacturing	Number of enterprises	% of total industrial value-added
1 Electronic and Communication Equipment	9,488	24.9	1 Advanced Electronic and Communication Equipment	6,832	21.4
2 Computers and Office Equipment	1,510	2.3	2 Advanced Equipment	11,304	17.9
3 Medical Equipment, Instruments and Meters	1,602	2.2	3 Advanced Light Textiles	12,501	7.1
4 Medicines	628	2.2	4 Petrochemical Manufacturing	3,218	5.3
5 Aircraft and Spacecraft	30	0.1	5 New Materials	8,221	4.5
6 Information Chemical Products	13	0.0	6 Biological Medicines and Advanced Medical Equipment	1,345	2.8
<b>Total high-tech Manufacturing</b>	<b>13,271</b>	<b>31.6</b>	<b>Total Advanced Manufacturing</b>	<b>41,624</b>	<b>55.0</b>

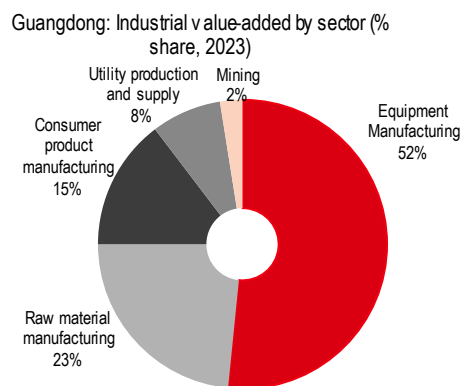
Source: Guangdong Statistics Year Book (2023), HSBC

## How the GBA's manufacturing sector is changing...

**Guangdong has long been the country's largest manufacturing base for electronic products ...**

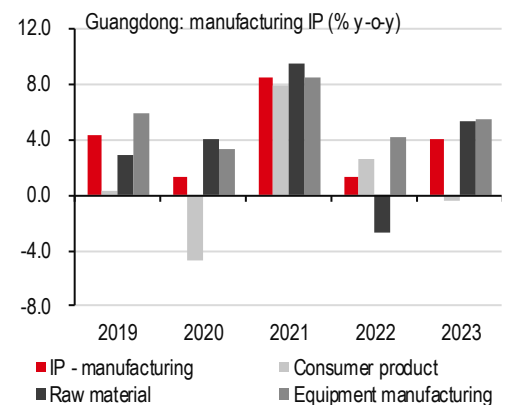
Guangdong's manufacturing industry has three major categories – equipment, raw materials, and consumer products. Together, they constitute 90% of Guangdong's overall industrial value-added (Chart 1). After years of development, some sectors have become pillar industries in the province. For instance, the manufacturing of electronic goods, a key component of Guangdong's high-tech and advanced manufacturing sector, reached nearly RMB1 trillion in size (industrial value-added) as of 2023, constituting 23% of the province's overall industrial value-added. To put this into perspective, Guangdong has long been the country's largest manufacturing base for electronic products like cell phones and computers – it produced about 650m smartphones and more than 80m computers in 2023, equivalent to 41% and 24% of the national total, respectively.

**Chart 1. Equipment manufacturing leads the way...**



Source: Guangdong Statistics Year Book (2023), HSBC

**Chart 2. ... recording growth over the past few years**



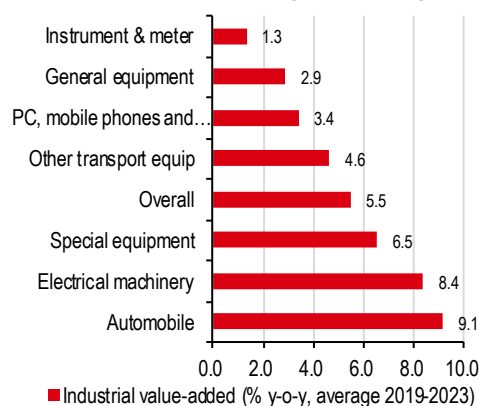
Source: Wind, HSBC

Drilling down into the details, beneath the seemingly steady manufacturing growth of the past few years, Guangdong has been undergoing an industrial transformation. The change started in the labour-intensive sector, mostly in the lower-end consumer goods. Industrial production in this category recorded only limited growth over 2019-23 except for 2021 (Chart 2), with seven out of 12 sub-sectors contracting. Many factors contributed to the lacklustre performance, including but not limited to, supply chain relocation driven by efforts to avoid punitive tariffs, increasing local labour costs, and rising competition from other markets.

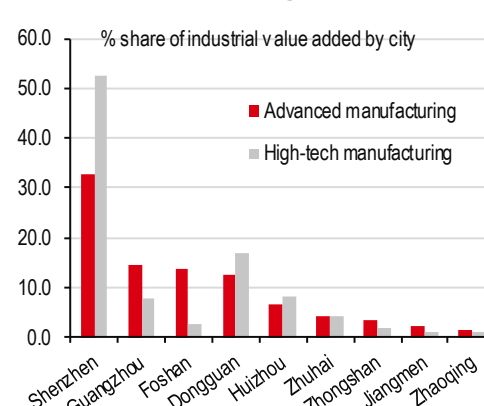
**... but the new economic sectors have expanded rapidly**

Over the same period, Guangdong's largest manufacturing sub-category – equipment – maintained solid growth (Chart 2). While electronic products have grown by an average of only 3.4% annually since 2019, the new economic sectors have expanded rapidly. For instance, industrial value-added for the auto sector maintained annual growth above 9% (Chart 3), with most of the expansion happening over the past two years (32%). We think these new growth drivers can reshape Guangdong's manufacturing landscape in the years ahead.

Raw material manufacturing is also changing. Guangdong still has more than 3,000 petrochemical companies, with annual production growth rate stabilizing at 4-5%. Several cities, including Huizhou and Guangzhou, have meaningful exposure to the petrochemical industry. Instead of moving out of Guangdong, the companies within this sector are putting more emphasis on the green transformation by ramping up green investments. Another key sub-sector in this category – pharmaceutical manufacturing, also a new economy sector – has also expanded quickly in Guangdong, growing by an average of 9% over the past three years, although it is still relatively small in terms of the overall industrial base (Table 1).

**Chart 3. The growth rate in the GBA's equipment manufacturing has diverged**


Source: Wind, HSBC

**Chart 4. Distribution of high-tech and advanced manufacturing across the GBA**


Source: Wind, HSBC

## ...and how can it evolve further

### Ample room for improvement

Although Guangdong's manufacturing sector has been steadily moving towards high value-added sectors, there is still ample room for improvement.

- ◆ As shown in Table 1, high-tech manufacturing is concentrated in the production of electronic goods, which is highly sensitive to external demand. Amid the reconfiguring of global supply chains, Guangdong needs to gear up efforts to develop strategically important industries<sup>1</sup> which are generally more tech-intensive and, in turn, build a resilient supply chain for the high-tech sector.
- ◆ Although new economy sectors are growing rapidly, they are still too small to offset the slowdown in traditional sectors. In 2023, Guangdong's exports of NEVs and lithium battery together reached RMB138bn, equivalent to just 2.6% of overall exports.
- ◆ Intense competition among Chinese manufacturers has led to lower prices, a trend which has also spilled over into external markets. Thin profit margins are challenging manufacturers to invest to innovate.
- ◆ The pace of manufacturing upgrading and technology advancement has been very uneven within the GBA and remains concentrated in Shenzhen (Chart 4).

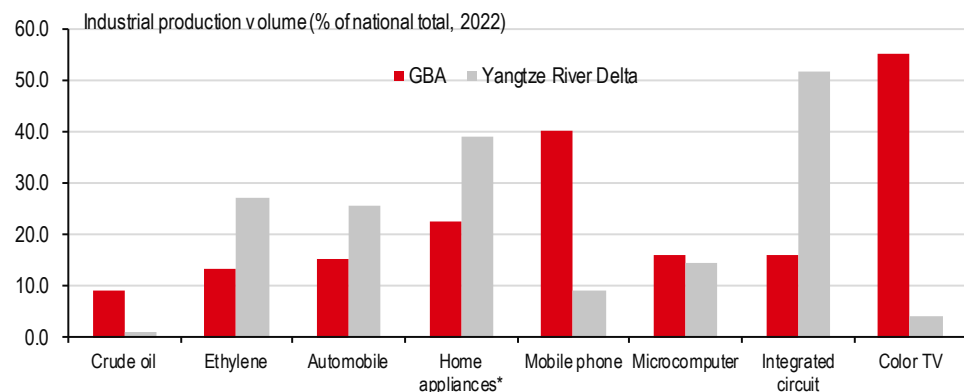
Since the start of the 14<sup>th</sup> Five-Year Plan, Guangdong has put more emphasis on developing the high-end manufacturing sector. One of the key targets is to build a more comprehensive and stronger supply chain in the GBA. If we compare mainland China's two largest manufacturing clusters – the GBA and Yangtze River Delta region (YRD), which includes Shanghai, Jiangsu, Zhejiang and Anhui – the GBA plays a dominant role in making consumer electronic products, but more than 50% of the country's chipsets are produced in the YRD (Chart 5). While different regions have different competitive advantages, Guangdong province clearly wants to develop more strategically important industries.

<sup>1</sup> In June 2020, Guangdong's provincial government issued guidelines for developing 10 strategic pillar industries (e.g. next-generation electronic information, green petrochemicals, automobiles, etc.) and 10 strategic emerging industries (e.g. semiconductors and integrated circuit, advanced equipment manufacturing, intelligent robots etc.) in the province. The goal is to cultivate the development of a number of industrial clusters that have global competitiveness and set an example for high-quality industrial development by 2025.

We see several reasons to support our optimism about the pace of industrial modernization in Guangdong:

- ◆ Backed by policy support, manufacturing loans in the province rose 24.4% y-o-y in 2023 and bank lending to advanced manufacturing and high-tech manufacturing were up 37.4% and 35.8%, respectively (Southcn.com, 26 January). Strong credit support to the manufacturing sector, led by government policy initiatives, is expected to keep capex strong.
- ◆ Guangdong has rolled out tax benefits to encourage R&D investment, benefiting manufacturing companies the most (Guangdong government website, 21 February). This should help more manufacturers embrace automation, digitalization and green upgrades.
- ◆ Advances in technological development need backing from the capital market. Here, the GBA has a clear advantage – Hong Kong’s status as an international financial centre. Despite recent challenges, Hong Kong can play an important part in connecting the GBA’s industrial ambitions with the necessary capital, given its role as a global financial hub with a robust regulatory framework, vast pool of international capital, sophisticated services sector, and strong legal system and respect for intellectual property rights.

**Chart 5. Key manufacturing products of the Greater Bay Area and Yangtze River Delta**



Source: Guangdong Statistics Year Book (2023), HSBC

## How further policy support can speed the GBA’s transformation

As Guangdong strives to solidify its status as manufacturing powerhouse, the province has set ambitious targets. We think policymakers and regional enterprises could push the boundaries on several fronts:

- ◆ **Integration:** In recent years, regional integration has made significant progress due to improved transport networks. Greater efficiency can be achieved if “soft connectivity” – flows of people, data, and capital – can be further streamlined. Enterprises in the GBA region should be able to benefit from strengthening connections, especially when it comes to technology-driven projects. The European Union’s best practices in this area could be a good reference for the GBA.

- ◆ **Co-operation:** Details about how the concept of the GBA can be implemented should be fleshed out so that local governments and businesses can jointly explore opportunities in the domestic and overseas markets. After the National People's Congress in March, the central government further stepped up opening up policies, fully liberalizing FDI in the manufacturing sector (gov.cn, 28 February). A joint task force of GBA local governments is discussing ideas such as a "one-stop shop" for business registration to provide a single point of access for information and administrative procedures. This could go a long way to making the GBA more attractive, productive, and efficient.
- ◆ **Human capital:** A guide to developing manufacturing talent released by multiple departments, including the Ministry of Industry and Information Technology, forecasts a shortfall of around 30m skilled workers in 10 critical manufacturing sectors by 2025. The government is making efforts to reform the college curriculum and provide tailored vocational training to grow the talent needed. Meanwhile, providing better social benefits (e.g. affordable housing) would also help to retain skilled labour.

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