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MARKET INSIGHT

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CHINA/US - TOWARDS A NEW PARADIGM IN THE RELATIONS BETWEEN THE TWO SUPERPOWERS?

Over the past few weeks, much has been written about the various protectionist measures announced by Donald Trump. Further to the import taxes on solar panels and washing machines, duties on steel and aluminium[1] have also been announced. On 22 March, President Trump signed a presidential memorandum targeting China's "economic aggression" under article 301 of the 1974 trade law, introducing punitive measures on USD 60 billion of imports from China, i.e. approximately 12% of the USD 506 billion Chinese imports to the US in 2017. The US administration has justified these measures as compensation for alleged violations of intellectual property. Washington has notably accused the co-enterprise system imposed by Beijing on American companies. In exchange for access to the Chinese market, US companies are obliged to share part of their technological knowhow with local partners. The US administration has 15 days after the signature of the memorandum to present the official list of products and tariffs concerned, followed by a 30-day period during which US industrial groups can state any objections.

Confirming the protectionist stance adopted by the US administration, President Trump has also tasked the United States Trade Representative Robert Lighthizer to use WTO litigation processes to attack China's discriminatory licensing practices. Lastly, Donald Trump has asked the US Treasury to draw up investment restrictions within 60 days aiming to prevent companies controlled by China from acquiring sensitive American tech firms and groups in other strategic sectors[2]. In other terms the US administration is relying on the Committee on Foreign Investment in the United States (CFIUS) to block takeover bids on US companies, as demonstrated by the recent blocking of the hostile bid on Qualcomm by the Singapore-based group Broadcom.

These punitive measures, which are the first to directly target China, demonstrate a shift in paradigm in China-US relations. Under Donald Trump, the underlying tone between the two superpowers that has prevailed for decades is now becoming more frontal and conflictual. Although he previously avoided accusing China of being a currency manipulator, the US president has now opted for another angle of attack, reproving China for its economic aggression and more precisely intellectual property theft and unfair competition. In order to drive the point home, tariffs are likely to target products covered by the Made in China 2025 programme, which is an ambitious industrial policy designed to boost the Chinese manufacturing sector. Donald Trump has also specified that the recent measures were the first in a long series to come. In addition to creating obstacles for trade and investments with China, President Trump has launched several provocations on the diplomatic front, notably with regard to Taiwan by signing on 16 March a law enabling US officials to visit Taiwan[3].

President Xi Jinping has until now refrained from responding to the multiple verbal attacks launched by the US administration. Pursuing this same policy, China has urged the US to negotiate towards an agreed settlement within the 30 days prior to the recently-announced tariffs being applied. Beijing has affirmed that it does not wish to escalate trade tensions, but on the contrary wishes to negotiate and therefore appears to be promoting free trade. The Chinese authorities have nonetheless said that they are ready to face a possible trade war. China has also retaliated against the steel and aluminium customs tariffs by applying taxes on over 120 imported American products worth a total amount of USD 3 billion. Although the Chinese have yet to respond to the taxes applied to the USD 60 billion of imports, some USD 15 billion - 25 billion of US exports towards China could be hit according to some estimates[4].

The much-publicised protectionist measures recently announced primarily serve President Trump's political interests. On the international front, the threat of import tariffs provides him with significant leverage over certain bilateral negotiations underway. In short, he has adopted a carrot-and-stick approach. This is notably the case with Canada and Mexico, which are likely to be exempted from steel and aluminium taxes in exchange for concessions in the renegotiation of the NAFTA agreement. Backed by his talents as a negotiator, Donald Trump appears to be counting on the announcement effect of the punitive measures in order to force his partners to join the negotiation table where he enjoys a certain advantage. This is a negotiation technique that many observers describe as negotiating with "a gun to the head". The planned measures by the US president against China are likely to lead to the negotiation of a bilateral settlement, with the aim of reducing by USD 100 billion the trade deficit with China. Beijing and Washington have allegedly already begun behind-the-scene trade talks after Steven Mnuchin and Robert Lighthizer sent a letter to Liu He demanding that China implements measures facilitating US imports.

On the home front, the US administration has denounced the deepening trade deficit with the Asian giant that it has accused of unfair trade practices. At the end of 2017, the US trade deficit was USD 566 billion, its highest level since 2008. The bilateral deficit with China reached an all-time high at USD 375 billion. This situation has led to negative macroeconomic repercussions such as heavier debt and the loss of competitive edge. A bipartisan consensus also reigns in Washington, in the belief that it is now necessary to act on the trade deficit. The punitive measures against China are allowing President Trump to win support within the Democrat camp. This is the case of Senator Chuck Schumer for example, leader of the Democrats in the Senate. For Donald Trump, who is facing mid-term elections in November 2018 and the potential loss of a majority in Congress by the Republicans, support from part of the opposition is a windfall. Meanwhile, Donald Trump has demonstrated that he has lived up to his electoral promises by defending America against what his partisans have been calling the "trade war" waged by China against the US for the past several decades.

China and the US nevertheless remain extremely interdependent. Economically, China remains the leading creditor for the US and the American treasury will have heavy financing needs over the next two years. As for the Chinese, their priority is to resorb the excesses of their economy in an orderly manner. To do so, they require a buoyant global economic environment. Although the impact of the first wave of tariffs announced by the US and China on economic growth will likely remain muted, there is nonetheless a relatively high risk of escalation towards a full-blown trade war. Trade and investment ties between China and the US are deeply integrated in the global supply chain and a trade war between the two countries would therefore have an impact on companies and consumers in other countries. This risk is fast becoming one of the major preoccupations among investors regarding the outlook for the next few months, potentially triggering episodes of stress and possibly leading to a bear market cycle.

It is nonetheless likely at this stage that Donald Trump, who is no novice in terms of negotiation, is brandishing the threat of protectionism and a trade war mainly in order to force his opponents' hand during future negotiations. The US administration's primary objective appears to be reducing the considerable bilateral commercial deficit with China, rather than entering into a global trade war that economists unanimously agree would have a negative impact globally. If by acting in this way Donald Trump can strengthen his electoral base and score points ahead of the mid-term elections, this will be the cherry on the cake. Lastly, the ultimate stakes in the rivalry between the two superpowers is to obtain greater global influence on the political, economic and technological level. This still requires the Chinese government to refrain from calling his bluff by escalating protectionist measures. Let us not forget that Xi Jinping, the strongman of China who has just been appointed president for life, could also lose patience.

[1] Although these measures do not solely concern China, the exemptions granted to many countries since the initial announcement imply that China is the real target of these measures.

[2] Including IT, robotics and automation, the aerospace industry, maritime equipment, rail roads, renewable energies, electrical equipment, farming equipment, new materials, biotechnologies, medical equipment

[3] The One China policy at the heart of the relations between the two countries is not being called into question, however.

[4] Source: Bank of America Merrill Lynch

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«The US president has now opted for another angle of attack, reproving China for its economic aggression.»