

April's monthly - China (pls don't click)

Title: China: tough on trade game

Paragraph for front page:

Trade protection actions imposed by the US may not be too damaging for China. We expect some loss of employment in manufacturing but this may be shifted to the service sector and result in higher prices of some imported goods. More, trade protection actions will lead to changes in global production and trade, given today's globalized, complex supply chain.

China's sends a strong message to US

The Ministry of Commerce of China has announced a concrete list of items imported from the US to face import tariffs on 23rd March. Nuts and fruits, wine, modified ethanol, American ginseng and steel pipes, would all face a 15% import tariff. Pork related items and scrapped aluminium would face a 25% import tariff. These items' export value in total was close to US\$3billion in 2017.

Complicated: Is it this economics or politics?

We need to ask (or answer) the question, "is all this protectionism an economic or a political issue?"

That would make a significant difference to the outcome. If it is the latter, it could get even more complicated. Wang Qishan, now the vice president of China, takes the lead on China-US relationship and Taiwan matters.

Though it is not a well known fact, the vice president also has an unlimited tenure after the Two Sessions. Wang's strength is to solve tough issues, e.g. leading anti-corruption campaign. We believe Wang is going to be tough again.

China clearly signals it will retaliate

Compared to US plans to put a tariff on US\$60billion of imports from China announced on 22nd March, the US\$3billion plan in China looks small. But it has big implications.

First, China indicates clearly that it can retaliate.

Second, the retaliation starts with tariffs on major export items from the US to China, namely: vegetable products, pork and scrap metal.

Third, China's embassy in the US has stated that China will fight these tariffs strongly. That implies that China's reaction to US trade tariffs need not end at the list announced on 23 March, and could be expanded to include stopping US companies from operating in China.

Retaliation could continue

Any further reaction by China will depend on how US reacts.

Let's assume the US targets the largest chunk of China exports to the US - machinery and electrical products.

Then China could react similarly by imposing tariffs on the largest chunk of US exports to China (either machinery and mechanical products or transport equipment). We believe that China will choose transport equipment, because if there were import tariffs on China's exports of machinery and electronic products to the US, then those imports from the US would also shrink (there is a complicated two-way supply chain in this sector). Taking this into account, the largest remaining import sector from the US is transport equipment.

Implications are complex

Would Chinese employment be hurt if US companies manufacturing in China decided to move their production lines out of China? Yes. But this is not likely to happen overnight. Additionally, displaced workers could choose other jobs, likely in the service sector that is booming in China and has low skill requirements.

For transport equipment imports into China, there are always substitutes from Europe and elsewhere. The overall impact on China may be predominantly through rising prices of these substitutes - this is likely to be considerably less than the US tariffs, however.

Not expect yuan devaluation

China would be reluctant to devalue yuan to get more exports. Simply that this will hurt trade relationship beyond US. As the impact of yuan devaluation is more far fetch we believe that this is like the last bullet for China.

There are alternatives

There are so many alternatives in a globalized world when it comes to decision-making that we are very likely to have left out something critical in our analysis. And this is the point we would like to make - there are choices.