# China: More retaliation on the way

With trade tensions with the US only set to increase, we expect the People's Bank of China to allow the yuan to depreciate to 7.00 by the end of this year

## Trade war looks set to be long and increasingly complicated

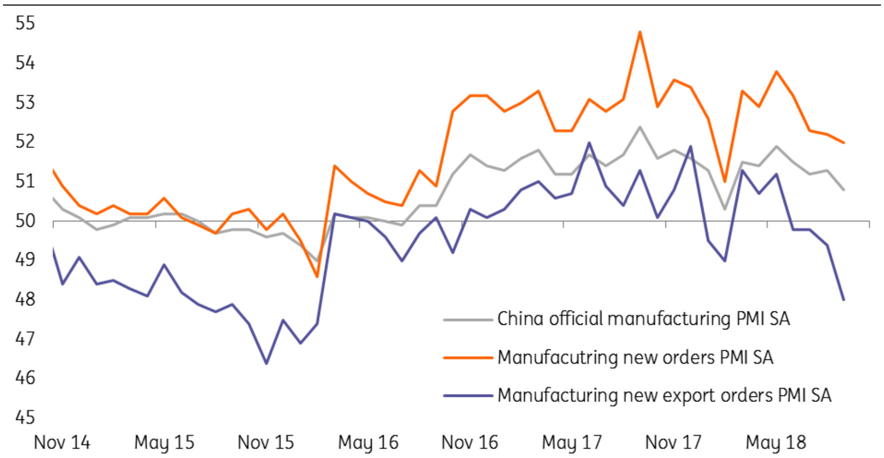
On 18th September, China announced fresh tariffs on a list of $60 billion worth of US goods. The tariff rates are set between 5 to 10%, which is lower than the 5 to 25% that was proposed previously, following a US decision to initially limit tariffs to 10% on its list of $200 billion worth of goods. However, these lower tariffs are only set to last until the end of 2018, and if the US increases the rate to 25% in 2019, as it has suggested, we expect China to follow suit – as it initially suggested back at the start of August.

> *Given that China imports less from the US than it exports, there is only so much China can do quantitatively. So the focus is now increasing on China's qualitative retaliations*

This so far includes the reinstatement of a 2013 WTO dispute and lowering import taxes on various goods - a move designed to weaken the competitiveness of US companies in China. This decision will benefit other countries' exports to China, while US imports suffer from the additional tariffs and this is a situation is similar to that of US automobiles, which face higher tariffs in China than imported cars from other economies.

But the trade war doesn't end with tariffs. Geopolitical tensions in the South China Sea escalate at a time where China will not return to the negotiation table until after the US mid-term elections. The new trilateral trade bloc of US, Mexico and Canada (USMCA), will include a clause that allows any member to veto trade agreements between China and other members. With negotiations between China and the US delayed, the trade war is set to be a long and increasingly complicated process, which undoubtedly will continue into 2019.

## PMIs show China still holding up domestically despite fall in export orders



Source: ING, Bloomberg

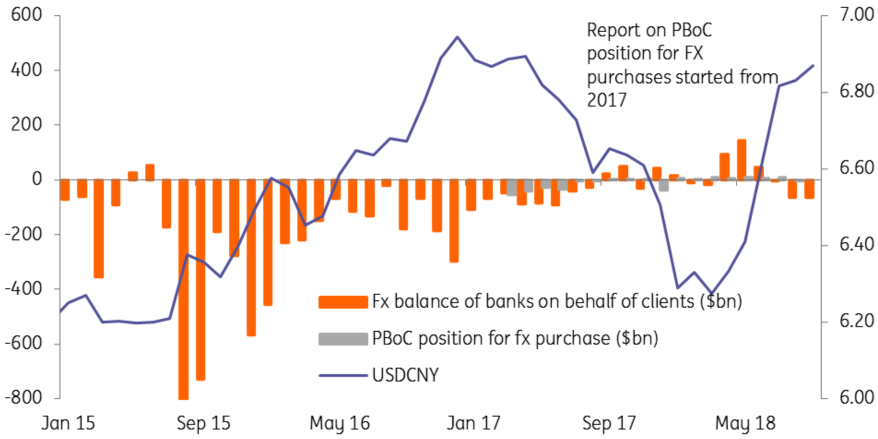
## Fiscal stimulus should help economic activity in the months ahead

Fiscal stimulus in China has started quietly as various local governments are starting infrastructure projects, and support from these economic activities should be seen in the months ahead. For now, industrial profits and PMIs, as shown in the chart above, point to a slowdown in export activity, while domestic demand still appears to be holding up.

We don't believe that further yuan depreciation will trigger massive capital outflows as there were inflows into the onshore asset markets to offset regular outflows, and the cross-border regulator (SAFE) has closed illegal loops of outflows. The figure shows that conversion from yuan to foreign currencies has been low compared to the 2015 level.

We expect the People's Bank of China to allow the yuan to depreciate to 7.0 by the end of this year (Spot rate was 6.88 at the time of writing this note).

## We believe that USDCNY is heading towards 7.0 by end 2018




Source: Bloomberg, ING

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