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China's Xi speaks, Trump reacts

Tensions over a US-China trade war are far from over. On 28 Maybefore the US announced possible tariffs on Chinese imports and a control list on investments and exports to China- President Xi Jinping made a high-level speech about the need for China to be self-reliant on high-tech products



The timing of President Xi's speech plays an important role in forthcoming trade negotiations

President Xi Jinping's speech on 28 May emphasises building a self-sustained high-tech industry. We think the speech plays an important role in the China-US trade war.

- First, the speech was made by President Xi himself, suggesting the objective of building a self-reliant high-tech economy is concrete with a high chance of success given Xi's power of execution.
- Second, the timing of the speech is significant. It was given before the US administration announced a list of tariffs on Chinese goods (on 15 June) and a list of investment and export controls on high-tech products into China (before 30 June).

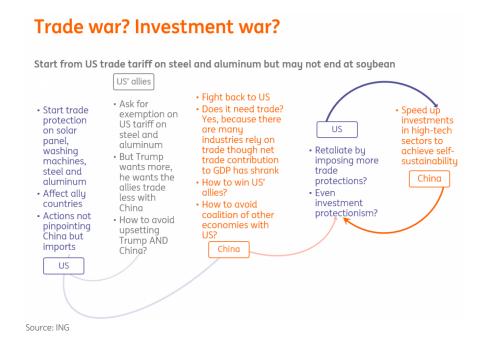
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US reaction to Xi's speech

President Xi's speech likely hit a nerve in the US administration. We expect the US to try to interrupt China's Made in China 2025 plan by imposing controls, especially through investments and exports of high-tech goods and services to China.

Xi would have known that the US would react to his speech. We believe, therefore, that China is prepared to put sizeable investments into the high-tech sector to achieve its target so it doesn't need to depend on US tech products. Still, it's impossible to yield any positive results from these investments before the end of June.

The forthcoming announcements of the two lists by the US administration are crucial to future trade and investments of China and the US. The Trump administration's latest move suggests that its claim of putting the trade war "on hold" after the latest round of negotiations is not binding.



China could lower tariffs to the rest of the world, as well as to the US

As a buffer to trade tension, China may import more consumer goods by lowering tariffs for the rest of the world, in addition to the US. These may include health-related products, baby products and cosmetics, which are sought after by Chinese tourists when they shop abroad. Though the value of these goods would not change the trade of goods' deficit situation of some economies with China it would at least calm trade tensions.

However, from China's current account point of view, this may not create a big change. The Chinese will likely spend more money at home on domestic imports rather than shopping overseas, so it could be that some imports of services move to imports of goods. Though the pie of imports of consumer goods would become bigger with a growing middle class, this growth would likely be gradual.

We should be aware that it is difficult for China to give in more than this, especially as this is about

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China-US bilateral trade, which is still under negotiation.

China investment will focus on high-tech R&D and talent pool

This is not the first time that President Xi has emphasised that China needs its own technology to survive in the future. The government is aiming to achieve more self-sustained technology by 2020.

This is an aggressive and challenging target. But it is not impossible because China is on a strong growth path, which makes it easier to spare more investment for a particular objective that the government believes is vital to its future growth. Inevitably, before there is any positive result from these investments, China's debt, particularly government debt, will grow.

President Xi's speech also emphasises that China will achieve its goal by growing its talent pool in the high-tech sector. We expect that talent from around the world will be attracted by this opportunity. However, this is not without challenges. The rest of the world may not be willing to export its talent to China. We believe that another war is coming, a war for talent.

Investment will be the new growth driver

Investment growth driven by the high-tech sector is likely to increase before any change in tariffs slows down Chinese export growth.

But trade tensions will delay business investment decisions and could disrupt the future supply chain of the semiconductor industry, which will partially offset the contribution of investment growth to GDP.

Given that China will invest more in high-tech, the job market should be stable and support current growth in consumption.

The combined effect means that our China GPD forecasts of 6.8% in 2018 still holds, although the forecast has an upside risk from fast and sizeable investments in high-tech sectors.

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