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The US imposes tariffs on China while China takes a cautious approach to domestic and foreign policy

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Real GDP growth in the April-June quarter was 6.7% YoY, decelerating slightly from the previous quarter (6.8% YoY), yet maintaining robust growth which exceeded the government's target of GDP growth between 6.7% YoY to 6.9% YoY for twelve consecutive quarters (Table 1). However, monthly indicators show a noticeable slowdown in investment due to a tightening of shadow banking regulations focused on deleveraging (trimming excess debt). Exports remained in double figures, but with the undeniable possibility that this was due to a rush before the US imposes tariffs, this means there are many concerns about the future of China's economy.

In June, both China and the US announced a list of products worth USD 50 billion each, against which they will apply 25% tariffs. On 6th July, the US government imposed tariffs on USD 34 billions' worth of the goods previously listed, resulting in the Chinese government retaliating with their own tariffs, matching the US' in terms of scale. Furthermore, the US government published an additional list of goods worth USD 200 billion (10% tariff) on 10th July. In June, the Chinese government declared that it would respond with unwavering resistance, using "comprehensive measures which combine quantity and quality"; however, it has only given a statement saying it will take countermeasures as of yet. Chinese imports from the US came to just USD 153.9 billion in 2017 and if the Chinese government were to combine quantity and quality, it would have to take provocative action: a high tariff on around USD 100 billion of imports from the US. Therefore, as it expands its policies to open up markets, China appears to want to encourage a position of "protecting the free trading system and opposing US protectionism" in line with other countries, such as the EU, and to avoid an escalation of the situation.

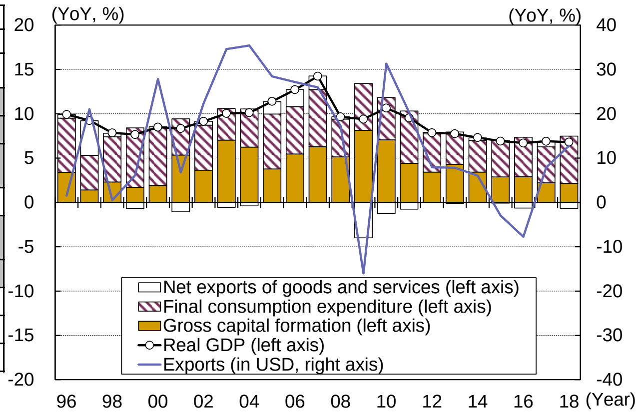
That being said, it appears that trade friction looks as though it will worsen in future, surpassing the "normalcy bias" that, ultimately, a fruitless trade war will be avoided. As it did after the global financial crisis, it seems the Chinese government is compensating for a downturn in exports by stimulating domestic demand, and is strengthening its aim to maintain stable economic growth (Chart 1). However, the government is paying close attention to this situation so that an unruly increase of investment and debt does not re-emerge. When it lowered the reserve requirement ratio on two occasions this year, it set conditions for the use of the extra funds which had been released as a result. In addition, when the government shifted from a policy of freezing the construction of subways to one of promoting it in July, it took steps to raise the minimum requirements for local governments for which construction plays a key role. This covers the size of their economy, their budget revenue and population. In contrast with after the global financial crisis, it seems the government will continue to take cautious and detailed action concerning support for the economy as well as deleveraging, while also being poised to face a prolonged, psychological war with the US.

Table 1: Main Economic Indicators (China)

	2018				
	Feb	Mar	Apr	May	Jun
Real GDP (YoY, %)	6.8		6.7		
Exports (YoY, %)	23.9	-2.8	12.3	12.3	11.2
Imports (YoY, %)	21.9	14.5	21.7	26.0	14.1
Fixed Assets Investment (YTD, YoY, %)	7.9	7.5	7.0	6.1	6.0
Retail Sales (YoY, %)	9.7	10.1	9.4	8.5	9.0
Industrial Production (YoY, %)	7.2	6.0	7.0	6.8	6.0
Manufacturing PMI	50.3	51.5	51.4	51.9	51.5
Non-manufacturing PMI	54.4	54.6	54.8	54.9	55.0
CPI (YoY, %)	2.9	2.1	1.8	1.8	1.9
PPI (YoY, %)	3.7	3.1	3.4	4.1	4.7

Note: 1) Manufacturing PMI and Non-manufacturing PMI are from China National Bureau of Statistics.
2) Shadowed portion indicates lower growth rates or decline in indicators from previous months.
3) February values of "Exports", "Imports", "Fixed Asset Investment", "Retail Sales", "Industrial Production" are cumulative values in January - February.
Source: National Bureau of Statistics of China, MUFG Bank Economic Research Office

Chart 1: China's GDP and Exports



Note: Value for 2018 uses data from January to June 2018
Source: National Bureau of Statistics of China, General Administration of Customs, MUFG Bank Economic Research Office

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