Preparation for worsening tension with the US incorporating hard and moderate lines

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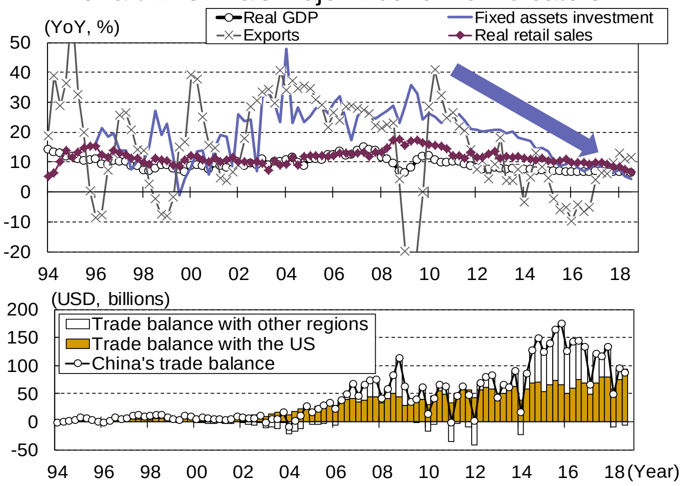
At a meeting between US and China's leaders on 1st December, both countries reached a provisional agreement to temporarily shelve an escalation of additional tariffs. In other words, the US will postpone raising the rate of its tariffs on USD 200 billions' worth of Chinese imports (10%→25%) from the start of 2019 until the 2nd March. In addition, China will stop additional tariffs against imports of US automobiles from January to March. During this time, the US and China will carry out negotiations across five areas, such as forced technology transfers and intellectual property infringements, for a limited period of 90 days.

When it comes to their stance taken during negotiations, the US continues to take a tough approach, stating that it will raise the rate of its tariffs in the event that a conclusion cannot be reached. On the other hand, the Chinese government has frequently made statements suggesting that progress is being made in negotiations and has taken a prominently conciliatory stance, such as increasing imports from the US and deviating from its policy guidelines for local governments regarding its long-term growth strategy, Made in China 2025, which has become a point of contention between the two countries. Looking back at the path taken by the Chinese economy, up until the 2000s, it appears that growth was driven by two main engines: investment and exports. However, both these have slowed since the 2010s owing to factors such as over-investment issues and a rise in domestic personnel costs. It seems China has entered a phase where it must change the structure of its investment-and-export-reliant economic model (Chart 1). As the friction with the US has occurred during this important phase for China, it appears that this conciliatory stance by China is an attempt to encourage a soft landing for its relationship with the US.

During China's annual Central Economic Work Conference (where the economic policies for the following year are decided) which took place from 19th to 21st December, seven major policies for next year were raised, starting with driving forward high quality developments in the manufacturing sector and promoting the establishment of a powerful domestic market. These policies, along with increasing the difficulty of access to US markets and advanced technology, suggest that China is trying to find new opportunities by turning to its own market and technology. In preparation for a prolonged period of tension with the US and the resulting economic damage, the central government and local governments are also continuing to enhance policies for stimulating investment in areas such as infrastructure, as well as policies which offer financial support for private enterprises which already struggle to raise capital and which have a high dependency on exports (Table 1). Alongside these policies, China is expected to achieve a "self-realised rebirth" (President Xi Jinping) in the mid- to long-term, as well as maintain solid economic growth in the short term. Nevertheless, it is important to keep an eye out for a postponement of structural reforms and a resurfacing of issues caused by excess investment.

Chart 1: China's Major Economic Indicators



Source: National Bureau of Statistics, MUFG Bank Economic Research Office

Table 1: Local Governments' Major Policies to Support Private Enterprises

Shandong	Defer tax payments for 3 months for private enterprises facing difficulties in paying, raise banks' credit line for small and medium-sized enterprises (SMEs, RMB 1 million to RMB 5 million)
Hebei	Raise banks' credit line for SMEs (RMB 1 million to RMB 5 million), announce a plan to promote the use of uncollateralized loans for high quality SMEs
Anhui	Establish a relief fund of RMB 10 billion for private enterprises, support private enterprises which have potential
Beijing	Set aside a relief fund of RMB 35 billion to solve private enterprises' financial difficulties
Shenzhen	Establish a stable development fund for private companies, lower social insurance premiums, expand the lending risk
Chongqing	Lower social insurance premiums, cut corporate income tax, offer financing with low interest rates for small and micro enterprises who are experiencing temporary hardship, give financial incentives to newly-listed companies
Guangdong	Lower social insurance premiums

Source: Chinese government, various, MUFG Bank Economic Research Office

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