

China and the US engage in a bilateral meeting as China prepares for prolonged conflict with the US

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Since the end of last year, the effects of US tariffs on imported Chinese goods have started to take shape. Exports to the US are lower than last year and are pushing down the growth of overall exports, and there is an apparent deceleration of industrial production and investment (Table 1). In addition, on 15th June, the US Trump administration raised the tariffs (from 10% to 25%) it had placed on USD 200 billions' worth of Chinese imported goods in the third round of tariffs announced in May. The US also pushed forwards with the matter of imposing tariffs on its remaining imports of Chinese goods (fourth round), holding a public hearing about the issue from 17th to 25th June. This has culminated in increased pressure on China by the US. At the G20 summit at the end of June, there was a meeting between the US and China's leaders, yet it is difficult to be optimistic about the future given that there appears to still be significant differences between the two countries' opinions and negotiations in the past have concluded in an increase in the scale of tariffs imposed.

As the US steps up its offensive, China repeatedly alludes to restricting exports of rare earth – of which it has abundant supplies – to the US as a diversion. However, trade embargoes encourage the use of alternative goods and the general view is that it is not the best policy in the mid to long term as it may lower China's competitiveness. Rather than developing such retaliatory measures, it appears that China's government is instead solidifying its position in preparation for a drawn-out conflict with the US. Part of this seems to be scaling down its measures to stimulate consumption, which were announced in June. This includes removing short-term measures, such as easing regulations for new vehicle registrations and subsidies for eco-friendly household electrical appliances, which were included in the Discussion Draft published in April. Therefore, China still has some remaining capacity to prepare for further worsening of its economy. On the other hand, it is bolstering measures to avoid instability in its financial system. At the end of May, financial regulators placed a small bank in Inner Mongolia under administration, taking this kind of step for the first time in 20 years. Regulators then introduced a credit risk hedging tool for certificates of deposit targeting small and medium-sized banks (SMB), which are finding it difficult to provide financing in the interbank market. Previously, SMBs were dependent on the interbank market for financing, which led to a surge in lending (Chart 1). This issue is being addressed and it is possible that this move by regulators will mark the start of a period of restructuring of SMBs. That being said, China's largest long-term measures are structural reforms, which include the correction of the principle

of priority given to state-owned enterprises, in order to establish a system that maximizes its economic efficiency and technological strength. It is important to maintain a close eye on these reforms and action by the Xi Jinping administration, particularly since they coincide with demands from the US.

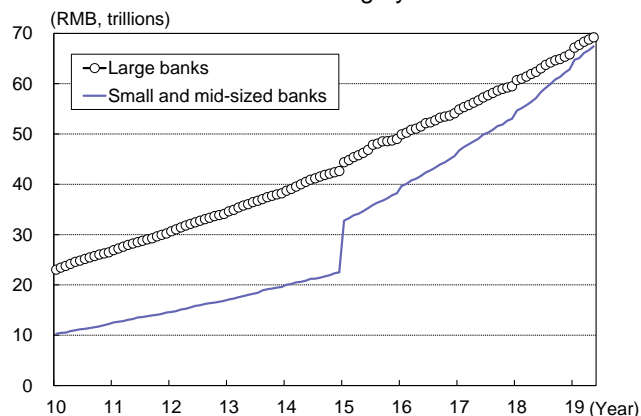
Table 1: Main Economic Indicators (China)

	2019				
	Jan	Feb	Mar	Apr	May
Real GDP (YoY, %)	6.4			n.a.	
Exports (YoY, %)	-4.6	13.8	-2.7	1.1	
Imports (YoY, %)	-2.9	-7.8	4.0	-8.5	
Fixed Assets Investment (YTD, YoY, %)	6.1	6.3	6.1	5.6	
Retail Sales (YoY, %)	8.2	8.7	7.2	8.6	
Industrial Production (YoY, %)	5.3	8.5	5.4	5.0	
Manufacturing PMI	49.5	49.2	50.5	50.1	49.4
Non-manufacturing PMI	54.7	54.3	54.8	54.3	54.3
CPI (YoY, %)	1.7	1.5	2.3	2.5	2.7
PPI (YoY, %)	0.1	0.1	0.4	0.9	0.6

Note: 1) Manufacturing PMI and Non-manufacturing PMI
 2) Shadowed portion indicates lower growth rates or decline in indicators from previous months.

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

Chart 1: Amount of Lending by Chinese Banks



Note: Due to a statistical change, the range covered by "small and mid-sized" banks" increased in 2015

Source: People's Bank of China, MUFG Bank Economic Research Office

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