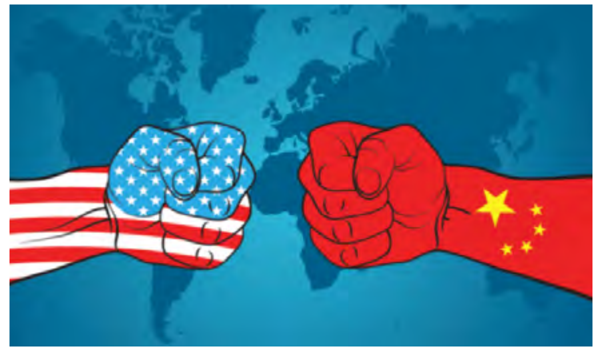
imposed higher tariff, which is something that China is capable of doing. Second, crisis management consciousness is crucial to preventing potential risks from developing into full-fledged crises. China needs to negotiate and defuse tensions where possible to avoid a completely hostile situation. Third, China-US trade only accounts for just 16-17% percent of global trade, and trade with Europe, another 16-17%. China also has the option to develop trade relations with emerging countries, including countries in Latin America, Middle East and Africa.

China's core concern is still development. China welcomes foreign investment not just for the sake of attracting capital, but also creating jobs and bringing in advanced technologies and management. We observe how foreign-funded businesses operate and learn their experience in management. This is not stealing, as this kind of knowledge or expertise is universally shared. It is a common practice among all countries to model on existing products and come up with similar products on their own, not just in China. China is committed to staying open and will not shut its door for foreign businesses even though its own businesses are denied entry into a foreign country.

Globalization will not stop

Globalization was started by American capital and multinationals in the first place. American workers did not take it seriously at the beginning, but globalization has indeed spurred the development of China. As farmers leave villages to work in cities, China has seen a steady increase in per capita income, fast development of technologies and larger exports. Naturally, discontent in the US rises as local workers lose jobs to their foreign counterparts. In a sense, reversals and relapses in the process of globalization are inevitable. It is therefore important to anticipate challenges and be prepared.

However, globalization will not stop. Multinationals from developed countries now continue to promote globalization as they are still establishing their presence across the world today to maximize their gains. Two new forces have also joined to promote globalization nowadays, one being low-income countries which have discovered the benefits of attracting foreign investments for their own development from the experience of China and India, the other being middle-income countries like China.



China, as a middle-income country, needs globalization in the process of bringing in foreign capital and encouraging its businesses to go global. Going global is a must for China in view of its domestic excess of capital. Despite a moderate level of income in China, the high savings rate has resulted in a huge amount of capital, which will lead to overcapacity if invested within the country. Many Chinese businesses have also come to realize the importance of seizing the opportunity to develop abroad as China restructures its economy, thus starting to allocate global resources.

Despite opposing voices, globalization will continue in the long run. It is natural that the US wants to get some of its businesses back to accommodate the interest of domestic workers, as all governments wish to see more investment within their own borders. While there are many reasonable ways to do this - reducing interest rate in particular - fighting a trade war, however, is a bit of reversal of globalization.

Fan Gang, President of CDI

China Shall Actively Respond to Sino-US Trade Frictions

The current trade frictions between China and the United States have not yet escalated to a trade war, although both sides are "preparing" for one. There are several iss ues that should be looked at properly.

With increasing anxiety over China's economic rise and change in world economic landscape, United States now intends to contain China's development by targeting intellectual property and imposing restrictions on high-tech exports in the name of "reducing trade deficits".

Two issues need to be made clear regarding Sino-US trade imbalances.

First, before being assembled in China, 90% of parts are not produced in China, but are rather imported from other Asian countries as part of the production chain. In other words, much of China's trade deficit will end up as trade surplus with the US.

Second, at certain points nearly 60% of exports are derived from multinational corporations in China. Some products were produced by American multinational corporations in China and exported to United States, in which case China's profits were rather low. American consumers have benefited from high-quality and reasonably priced products made in China. The US has also enjoyed a relatively low inflation rate. The US government, however, has failed to properly examine this issue, only focused on the impact of China's rise on the US instead.

Since China is part of the global production chain, in the long run the trade war will certainly have negative effects on China and the US as well as other countries that are part of the production chain.

China's biggest interest is sustained development. As a late starter, China should be fully aware of the difficulties during development despite fast economic growth over the past 40 years. To maintain sustainable growth, China needs to keep long-term interests in mind and minimize external disturbances through rational counter measures

Fan Gang, President of CDI

Based in Shenzhen and founded in 1989, China Development Institute (CDI) is a non-governmental think tank that develops solutions to public policy challenges through broad-scope and in-depth research to help advance China's reform and opening-up. Based on rigorous research and objective analysis, CDI is committed to providing prospective, innovative and pragmatic reports for governments at different levels in China and corporations at home and abroad. In December 2015, CDI was designated as one of top 25 national leading think tanks in a pilot project of central government which is aimed at promoting the building of new-type think tanks with Chinese characteristics.

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Topic >

U.S.-China Trade Tension

Insights >

Globalization Will Not Be Stopped by Trade War

Eventually, China and the United States will need to sit down at the negotiating table to solve trade frictions.

China Shall Actively Respond to Sino-US Trade Frictions

Impelled by the anxieties over China's economic rise, United States has initiated a series of actions towards China, including the trade war and possibly with investment and intellectual property as targets. China shall actively respond to these actions with long-term development interests in mind.

News >

Fan Gang Talks about Sino-US Trade Tension, Opening Up and Chinese Macro Economy

Any country needs to react on the trade friction or trade war. In the regard of trade deficit, President Trump is not focusing on trade related issues. He is targeting intellectual property rights, China's high-tech industry, "Made in China 2025" development strategy which are really about growth, development and emergence of China.

In the long-term, Sino-US trade tension definitely will cause negative impact for both America and China, as well as other countries since China is part of the supply chain.

We need to understand that the long-term interest is to enjoy long-term continuous and sustainable growth. In time people will get used to China's growth. Now they are not used to it yet.

In terms of further opening up of China, it is a fundamental interest. We have been opening up in the past 40 years. As a result, we became stronger, and more used to international market, its risks, fluctuations, and sometimes crisis. As we are more sophisticated in dealing with these risks, we can open further. And as we grow up we need to take responsibilities for human kind and global community. Further opening implies a lot of tasks at hand, for example, composition of new policy; then afterwards people need to adapt to the new institution. It's not easy but it's time.

As to Chinese macroeconomic development trend in the near future, we should know that there is risk in the economy at any given time. We are already at the bottom, part of, not a V curve, but rather a L curve. Now we are on the horizontal line at the bottom, which is not long, but we still have some distance to go. In other words, we are in the process of bumping at the bottom and cannot immediately bounce back to high growth. This cycle is a normal process. Hopefully we can use this opportunity to fix our problems, e.g. overcapacity and financial risk, in order to have better growth in the next stage of economic development.

Exit from the Integrated World May Be Costly

Chinese economic growth was stable in Q1. GDP was up 6.8% y/y, flat on Q4. Industrial output was up 6.8% y/y, and up 0.6 pps from Q4.

Investment rose 7.5% y/y in Q1, up 1.7 pps from the lowest growth rate of 2017. However, the price-adjusted investment growth rate rose only 1.2% y/y. Assuredly, private investment recovered strongly, and rose 8.9% y/y, up 4.7 pps from Q3, reaching its highest rate since 2016. In Q1, real estate investment grew 10.4% y/y, up 6.3 pps from Q4 - its highest growth rate since 2015.

Retail sales of consumption goods were up 9.8% y/y in Q1 in nominal terms, and 8.1% y/y in real terms. Although both figures were only slightly lower than in Q4, these were among lowest growth rates since 2004.

Prices are declining, amid tightening monetary policy. CPI was up 2.1% y/y in March, down 0.1 pps from January-February. In March, producer price growth continued to fall rapidly. The ex-factory price index of industrial output was up 3.1% y/y, down 0.6 pps from February. This is the fifth consecutive decline. PPI was up 3.7% y/y, down 0.7 pps from February. Monetary policy is still tightening, and financial regulation is stricter, intended to reduce financial risk. In March, M1 rose 7.1% y/y, down 4.7 pps from the end of 2017, and down 11.7 pps from last March.

Though exports were up 14.1% y/y in Q1, up 4.9 pps from Q4 and up 8.5 pps from Q3, and imports were up 18.9% y/y, China and the United States are in a trade war. On March 22nd, U.S. President Donald J. Trump signed a memorandum to apply tariffs of $50 billion on Chinese goods. In a quick response, China raised its tariffs on 128 U.S. products, with implementation beginning on April 2nd. Both countries indicated that they plan to hike tariffs on the other's exports far more.

The U.S.-China trade war may be short-lived. We believe that the United States has more to lose. The exit of U.S. firms from the Chinese outsourcing labor market will give its competitors a greater advantage in improving their balance sheets, and consequently in profit, R&D expenditure and TFP -- and in the end, more wins. Take the U.S.'s Apple vs. South Korea's Samsung, for example. China's large state capacity, as seen from the state sector's sizable share of the economy and better government budget situation, will make growth both feasible and stable, as greater state capacity means better macro management ability. Too, the share of exports in Chinese GDP growth has declined steadily over the years.

Trade War Truce Resolves Growth Uncertainties

Growth data was mixed in April. The value added for industrial firms was up 7% y/y, up 0.2 pps from Q1 and up 0.8 pps from Q4 2017. Fixed asset investment was up 6.1% y/y, down 1.4 pps from Q1, although still higher than in Q3 2017. Specifically, private investment was up 7.5% y/y, down 1.4 pps from Q1, and state investment was up 5.4% y/y, down 1.7 pps from Q1.

Retail sales of social consumption goods climbed 9.4% y/y in April in nominal terms, down 0.4 pps from Q1. The real growth rate rose 7.9% y/y, down 0.2 pps from Q1. In April, exports were up 12.9% y/y, 1.2 pps lower than in Q1, though still high. The seasonally adjusted import growth rate is around 17% y/y. The fact that import growth exceeded export growth will help reduce global imbalance and sustain growth.

CPI was up 1.8% y/y in April, after falling for two consecutive months. We expect CPI this year will be like the trend in 2014, growing at stable rates. The fluctuation interval is between 1% and 2.5% y/y. Producer prices continue their slower growth trend, after growing powerfully for almost two years. The ex-factory price of industrial goods was up 3.4% y/y, and down -0.2% m/m. PPI rose 3.7% y/y, and fell -0.3% m/m.

Monetary policy is still tightening. At the end of April, M1 was up 7.2% y/y, and up just slightly -- by 0.1 pps -- from March. RMB savings deposits from non-financial enterprises were up 6.1% y/y, and up 0.8 pps from March. Both indices were mainly

affected by large reductions last month, rather than signaling monetary policy loosening.

After high-level trade talks in Washington, the United States and China announced on May 21st that they would put their tariff increase threats on hold. This is very much consistent with our forecast last month that the trade war would be short-lived. We expect China to import more from the United States, as in the past, mostly in agriculture, high tech and services. This will reduce uncertainties in the global economy, and may boost investor confidence, as signaled the day after the announcement, when the S&P 500 rose 0.8%. Although the agreement would reduce China's net exports, the impact on GDP would be negligible, as the trade share of GDP is much smaller than it once was. Use of imported high tech as capital goods in industries will certainly boost Chinese firms' productivity. We view cooperation between China and the United States as a win-win solution for both countries, and for the world.

Fan Gang, President of CDI

Insights >

Globalization Will Not Be Stopped by Trade War

Trump would sooner or later impose trade sanctions on China, but no one had expected such a big move. China's exports to the United States amounts to over 400 billion U.S. dollars, while Trump is now seeking to impose tariffs on up to $60 billion of Chinese imports. Such a big move on

trade shows that the United States treats China as its primary rival in trade. The action also illustrates that such superpower like United States can be brutal sometimes, adopting measures without any evidence or reasonable analysis and ignore rulings by the WTO.

American consumers will be the victims of trade war between the US and China. The trade war will also harm China as the consumer product prices could rise. It is necessary for China to consider the price elasticity of demand when deciding how much to export. Generally speaking, the trade war will impact on United States as much as China. There is the fear that if you want to fight this trade war and I do not fight back, you would probably be even less reasonable tomorrow. Thus, China will certainly take countermeasures.

Keep a level head in face of US-China trade war

As a rising middle-income country, China needs to be prepared for the possible suspicion, antagonism and even aversion from others. These reactions must be taken care of proactively but also with a cool head. This is not the first time for China to meet with oppositions from other countries, nor will it be the last. China shall keep a level head in face of the cacophony of voices as it rises.

Those who in the past believed the China's growth depended on low-end manufacturing have now discovered that China is able to innovate and has even become a leader in certain high-tech industries. The western world now feels threatened as China becomes a stronger competitor. And the trade war is highly interconnected with the rise of rise since Trump has declared that the trade sanctions on China are to protect US interests.

China has worked hard for its own success. Chinese have lower per capita income but are increasingly capable of innovation. Most exporters in China are private companies not subsidized by the government. There are many foreign-funded products and services among Chinese exports as well, for example, products that are manufactured in China by American businesses, which also count as Chinese exports to the US when calculating the US trade deficit with China.

Structural conflicts exist in Sino-US trade

The Sino-US trade frictions is not simply caused by trade deficit but more fundamental structural challenges existing in the two kinds of economies. Initially, the US alleged that the deficit due to China's low foreign exchange rate. However, trade deficit has persisted after China raised RMB's exchange rate against the US dollar. Even after US conducted the 301 Investigation against China, trade deficit still stayed on the same level.

China is not only highly competitive in a wide range of industries and also benefits from low cost and high efficiency in many fields. Even though, the competitivity in high-tech industries still needs to improve. Structural problems exist in Sino-US trade in the sense that China is not allowed to import the desired products as it exports its products to the US.

Stand up to US-China trade war

First, China needs to have reciprocal countermeasures. China will probably raise tariffs in response to the