

China's playing the long game, and is making key moves to hedge against Trump's tariffs

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Eighteen months into the trade battle with Trump, China has come to terms that it's fighting a forever war as conflicts have spread well beyond trade.

China is preparing for a battle that could be as long as the U.S.-Japan trade war in the 1980s that lasted more than a decade, according to Yi Xiong, China economist at Deutsche Bank.

"We think China is neither aiming to quickly reach a trade deal, nor trying to hit back at the U.S. as hard as it can," Xiong said in a note Wednesday. "China's current strategy likely has a long time horizon embedded in it. The time horizon may also go beyond the life cycle of the current U.S. administration."

While China will remain open to further negotiations, it's less likely to make concessions given its effort to diversify its supply chain, the economist said.

China is accelerating efforts in other countries to reduce its reliance on the U.S. The official newspaper of the Chinese Communist Party, the People's Daily, on Sunday published several articles about China's improving cooperation with other countries including Thailand, Japan, South Korea and **Latin America**.

The country is also strengthening its domestic market. The State Council on Tuesday outlined 20 measures to support consumption, including applying new technologies to promote the circulation of products, improving infrastructure of commercial streets and accelerating the development of chain convenience stores, according to state-run media Xinhua.

Hu Xijin, editor of a tabloid under the People's Daily, highlighted the move in a Tuesday tweet, saying it's "more and more difficult for the U.S. to press China to make concessions." Hu is widely followed by **Wall Street** for his insight on the trade war.

"China - U.S. relationship [is] at new low level," Donald Straszheim, head of Evercore ISI's China Research, said in a note. "Both sides still have 'red lines' which are incompatible," including tech transfer, wider market access, currency and enforcement mechanism, he said.

Smaller and targeted tariffs

When Trump abruptly ended the trade truce earlier this month by announcing a 10% tariff on \$300 billion of Chinese goods, China retaliated with smaller tariffs ranging from 5% to 10% on \$75 billion in U.S. goods. That is because the goal is not to maximize damage, but to "disincentivize further U.S. tariffs," Xiong said.

"China will still respond to US tariffs, but with smaller and targeted measures," he said. "For the same reason, China is likely reluctant to take non-trade actions against the U.S., such as punishing U.S. business interests in China."

In fact, China has been welcoming U.S. businesses. Costco just had a grand opening of its Shanghai location on Tuesday. Tesla's "gigafactory" in Shanghai is also being built in "top speed," a Xinhua article said Wednesday.

Far beyond trade

In the past year, the trade war has morphed into a technology war and tariffs appear to have become a tool for Trump to gain leverage on other issues including currency manipulation and agriculture buying.

"Frictions between the US and China have gone far beyond trade, reducing China's potential gains in a trade deal," Xiong said. "If China had hoped before that resolving the trade war could help improve overall U.S.-China relations, that hope is largely gone."

Earlier this year, the Trump administration blacklisted Chinese telecom giant Huawei for national security concerns, halting its ability to purchase U.S.-made chips. Trump also claimed China failed to buy U.S. farm goods "in large quantities" as it had promised.

White House trade advisor Navarro said earlier this month that there are still many structural issues the U.S. needs to settle with China before a deal can be reached. These issues include cyber intrusion into U.S. business networks, forced technology transfer, intellectual property theft and currency manipulation, he said.

"We do not expect a significant trade deal in calendar 2019," Straszheim said. "Remember a deal is not a deal until every paragraph is agreed."