Walsh Advisors, LLC

June 30, 2019

US and China 2019: It is not simply a trade conflict, but a clarion call to the West to take action.

On June 5-7 the annual financial markets symposium on China and the US jointly sponsored by the Harvard Law School Program on International Financial Systems (PIFS) and the China Development Research Foundation (CDRF) of the State Council was held in Washington, DC. This was the sixteenth such symposium although none of the previous symposia were held at such a challenging time for Sino-US relations as under the current Trump-Xi trade disputes. (I believe the over-used "war" metaphor is neither definitive nor helpful.

Clearly the trade dispute was an overhang on the discussions at the Symposium however since most of the participants from both China and the US knew each other well from previous symposia the prevailing atmosphere was one of pleasant cooperation and collaboration. The general consensus of the group was that both Presidents Donald Trump and Xi Jinping were each separately creating and magnifying the disruption around the trade issue for what they each perceive to be their respective domestic political advantage. The group also generally agreed that this was a seriously incorrect perception by each of the two presidents.

a multiplicity of issues makes the US-China situation very complicated. China is adapting to new levels (lower) of growth than it has had for the past two decades

There have been a number of reversals in the data set that were not surprising but represent major management challenges, in particular to the PBOC.

In large part due to trade effects, sluggish new orders recently brought the Manufacturing PMI below 50 (49.4) and the PBOC reported a surge in interbank borrowing as the China interbank rate hit a new high for 2019. Loan defaults are increasing and the PBOC is planning further interest rate liberalization while continuing to defend the offshore RMB ("CNH)"

It is a difficult balancing act for the PBOC which last month took over a problem bank and cut reserve requirements to provide liquidity for small and medium size banks.

Headlines around the world demonstrate selective preoccupation with trade (not "investment" and the overall Sino-US relationship. Sadly, these fixations miss the fundamental geopolitical paradigm shift that already is largely underway. Different than any other time in history with the possible exception of the seven century dominance of Venice over (what then was) world trade, the new world order (now in gestation) will not be based on political or religious ideology.

IT WILL BE DRIVEN BY THE PERVASIVEMERCHANTILE IMPACT OF THE SECOND-LARGEST ECONOMY IN THE WORLD. Perhaps more-importantly it will have mitigated much of the motivation of nation states to align themselves with the United States for military security and protection; key exigencies of the Post World War II and Cold War eras, now relegated to legacy issues. The military blocs of the past such as NATO, SEATO, Warsaw Pact and others will devolve into what ENODO Economics, the macroeconomic and political forecasting firm, refers to as "spheres of influence.

Under the circumstances it is imperative that the US reverses its haphazard course takes a broader and more accurate view of Sino-US relations before it is too late, and it soon will be.

While CFIUS tried to rattle its cardboard sword over Chinese acquisitions of US tech firms which never reached a level of materiality, both the GOP and the Democrats did a bum"s rush on US hegemony in Asia, in what was essentially a bipartisan surrender of the US position achieved over the last century.

Trade issues notwithstanding, the principal drivers of the financial markets of China at this time are the recent rise of a mass affluent subset of the Chinese middle class and the ambitious undertakings of the Belt and Road initiative to better integrate the markets and economies of South Asia. These factors are affecting capital flows in China as never before. The wealthy middle class is a development of the last fifteen to twenty years and China never has managed a project on the scale of "belt and road" since the government managed and funded "Great Leap Forward" of the 1950s long before any elements of capitalism were tolerated in the economy. As a result, Chinese financial institutions are scrambling to satisfy new investment strategy and product demands on both the buy and the sell sides of their markets, creating opportunities for US firms to advise indigenous Chinese firms on their business strategies and to present cross-border strategic partnership M&A opportunities.

At the recent 2019 G20 Meeting in Osaka the main event was the widely anticipated meeting of Presidents Trump and Xi on the sidelines. Many had high expectations of results from this highly publicized rendezvous but these were unrealistic expectations. The meeting did no further damage to US-China relations but neither was there a substantive improvement in Sino-US relations as a result of the meeting.

As host of the first G20 meeting to be held in Japan Prime Minister Abe wanted it to be a landmark session but that is likely to escape him. His proposal to expand the WTO rules to include trade in data as well as goods and other services appears to be dead on arrival with the WTO essentially on life support and data protection and global technology standards having become two centerpieces of US – China policy disagreement.

China now is three years into two separate initiatives to enhance Chinese technology, far beyond the extraterritorial reach of CIFIUS, and apparently also beyond the limit of comprehension of the Trump Administration .China “experts”.

“Made in China 2025 seeks to improve Chinese competitiveness in higher tech sectors across a wide range of manufacturing industries. Specifically, China has a target level of 40% domestic content of ‘core” technologies by next year and will raise that to 70% by 2025.

On the sell side, the “belt and road” initiative is an effort to orchestrate trade and investment flows within South Asia and with the rest of the world without the organizational impediments and overhead of bureaucratic legislative and executive branches.

As the US has abdicated its position of leadership in Asia, TPP, scorned by the short-sightedness of both US political parties has now been supplanted by Belt and Road.

While the us conjures up spurious external trade and investment threats to its sovereignty and Europe is preoccupied with the complicated dissolution of BREXIT, a vestigial structure with origins in the European Coal and Steel Community (ECSC) of six decade ago, both the Chinese and Japanese are focused on the future, seeking to enhance domestic technology content in their key industries and do so with sustainably achievable goals in the short run. For China these goals are 2020 and 2025.

Japan has incorporated the goal of achieving significant economic growth from fintech and med tech into the current statement of Abenomics, the successful economic policy since 2012. It can only be seen as a failure of our political leadership (both parties) to comment and make the American people aware of this.

In football (Americans would say “soccer”, the critical element is the passing game and the crucial part of that is to pass the ball where the would-be receiver “will be” and not where they are before the pass. In like manner, as the US engages President Xi and Prime Minister Abe in so-called “trade talks” we need to anticipate and deal in a forward time zone. Of necessity our discussions need to be based on 2025 and beyond. They cannot be anchored to the Uruguay Round (1995) and certainly not before that.