China's measured response lifts hopes

Despite markets' knee-jerk reaction to Trump's tariffs, there is optimism among analysts that a trade war can be avoided

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The threat of a trade war between the United States and China sent a cold chill through global equity markets, but many analysts are optimistic that a compromise will be reached in the coming weeks.

On March 22, US President Donald Trump ordered the US Trade Representative (USTR) Robert Lighthizer to prepare concrete action targeting China, including raising trade tariffs.

The tariffs would initially have an impact on $60 billion worth of Chinese imports.

This follows a so-called Section 301 investigation by the USTR into policies and practices pursued by China that it claims constitute "intellectual property (IP) theft" and "forced technology transfer".

Trump also ordered the Treasury Secretary to explore restrictions on Chinese investment in the US.

Lighthizer told the Senate Finance Committee that the industries he will recommend for tariffs are mainly those that China identifies in its Made in China 2025 plan as areas in which it wants to become a global leader.

These are: New advanced information technology, automated machine tools and robotics, aerospace and aeronautics equipment, maritime equipment and high-tech shipping, new-energy vehicles and equipment, modern rail transport equipment, agricultural equipment, new materials, biopharma and advanced medical products.

The move sent a wave of panic across global equity markets, which was compounded when China said it had prepared retaliatory tariffs on 128 US products worth about $3 billion against US tariff hikes on steel and aluminum.

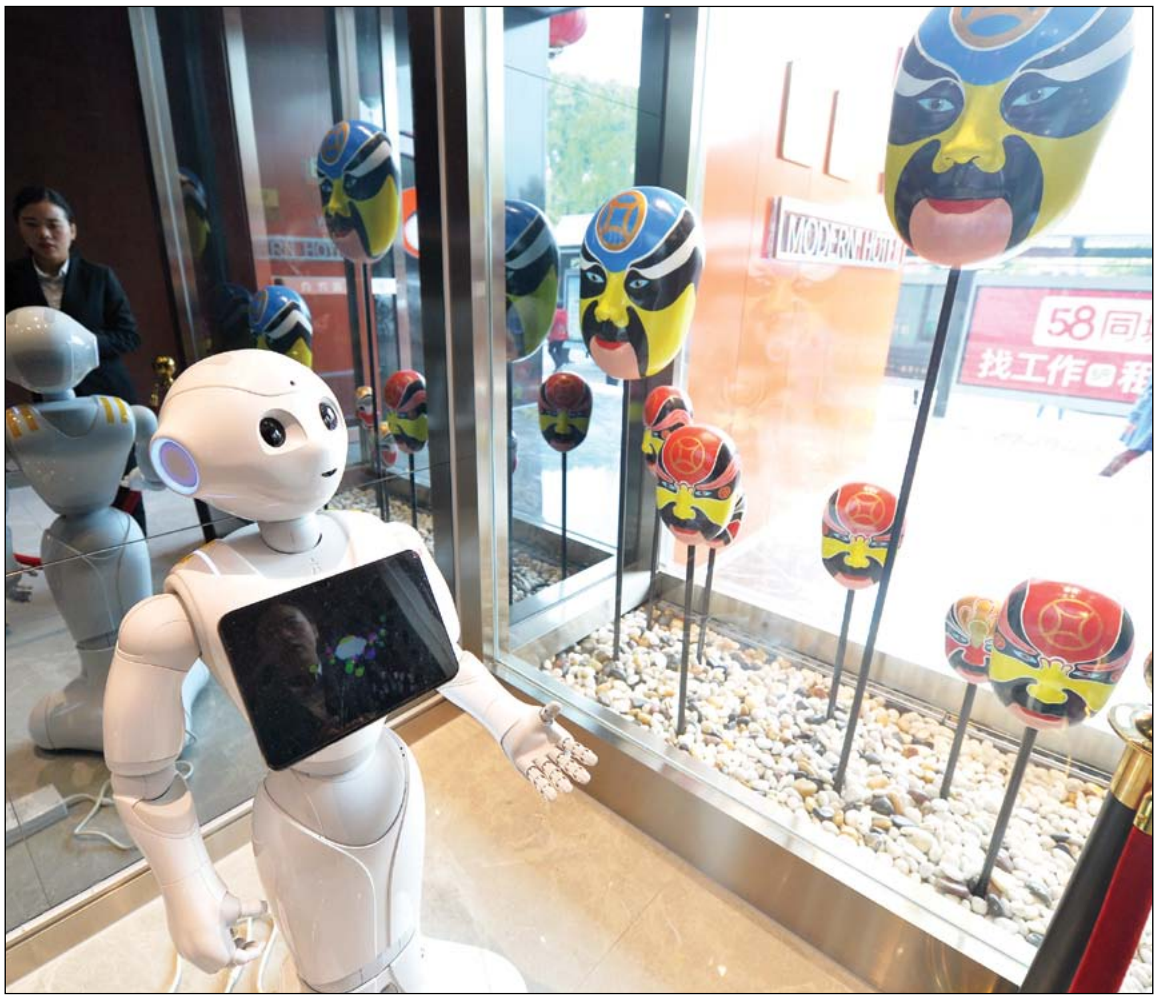
Asian markets were particularly hard hit, with billions of dollars being wiped off the value of stocks.

A lot of selling was a knee-jerk reaction to Trump's tariff announcement and a great deal of foreign media speculation that a trade war was looming.

If the US does go ahead with the tariffs, it would only have an impact on about one-eighth of China's total exports to the United States, or 2.6 percent of total Chinese exports.

Even though equity markets have recovered since the announcement, uncertainty still hangs in the air.

The US tariffs were set to take effect on May 1. However, they may not be imposed until early June, administration officials said on March 29, and analysts said public consultations and potential tariff revisions buy time for negotiations to forestall them.



An intelligent robot serves customers at a hotel in Chengdu, Southwest China's Sichuan province, on March 21. The United States plans to impose tariffs on products, such as robotics, where China has made progress. IMAGINECHINA

It comes in the wake of 25 percent and 10 percent tariffs on steel and aluminum imports announced by the US earlier in March.

Already the US administration has given the European Union, along with Australia, Argentina, Brazil, Canada, Mexico and South Korea, a temporary exemption until May 1, while talks continue.

Professor Ying Zhu, director of the Australian Centre for Asian Business at the University of South Australia, said "a lot of talking is going on behind the scenes right now to strike some sort of compromise".

"No one wants a trade war because there are no winners," he told *China Daily Asia Weekly*. "Both sides have a month to get something in place.

"I expect you might see China take more from the US, such as gas, and it might free up restrictions on US multinationals operating in China. That's my guess anyway," Zhu said.

"The point is, no one knows for sure what will happen or whether a compromise that will satisfy both sides will be reached or not.

"As I have already said … no one wants a trade war."

China's economic transformation has been based on globalization and free trade. The decision to open the country up to the outside world in the 1970s has benefited millions of its citizens and lifted millions more out of poverty.

In his address to the 19th National Congress of the Communist Party of China in October, President Xi Jinping said: "China will support multilateral trade regimes and work to facilitate the establishment of free trade areas and build an open world economy."

Louis Kuijs, head of Asia economics at Oxford Economics, said that because China is the largest exporter to the US, the bilateral goods trade deficit with China is by far the largest.

He estimated that it stood at around $375 billion at the end of last year based on US data. At the same time, he noted that China has now become a key hub in global trade.

"While the global supply chains for many products end in China, substantial value is added to them in other economies," he said in a briefing note on March 20.

"That is an important reason why US-China trade friction will cause collateral damage, especially in other Asian economies."

Kuijs added that in value-added terms, the US bilateral trade deficit with China was only $239 billion last year, some 36 percent lower than the headline number.

"Nonetheless, such nuances get lost in the political debate," he said.

The fact that much of what China exports to the US has considerable input by US companies in the supply chain, it "constrains the range of Chinese exports at risk of major US trade restrictions", Kuijs added.

China on the other hand imports a great deal of agricultural products from the US.

Taimur Baig, chief economist with DBS Group Research, and DBS economist Irvin Seah said in a briefing on March 23 that China will likely adopt a "two-pronged approach" with the US.

"Negotiation through diplomacy, alongside promises to import more auto, planes, and natural gas from the US," they said.

"In fact, it has already been reported that China is planning to reduce tariffs for automobiles and other consumer products imported from the US.

"Simultaneously, Beijing will likely impose tariffs on soybeans grown in farm states that voted for Trump, such as Arkansas, Indiana, Iowa, Missouri, Nebraska, North Dakota, Ohio, and South Dakota."

They said, however, that it is not in China's interest to escalate tensions.

"The country's 'mercantilist' approach will not change overnight, given its heavy reliance on trade. If the US wants a reduction in its bilateral trade deficit by $100 billion, China is likely to meet the goal halfway or perhaps even more," they said.

Goldman Sachs economists Andrew Tilton and Jonathan Sequeira said in a note on March 24 that the reaction from China to Trump's tariffs had been "measured".

Should the US tariffs go through, they said, the impact on China is likely to be modest at well under half a percentage point of GDP.

Leon Perera, CEO of Spire Research and Consulting, said it is clear that China "will not take US tariff hikes sitting down".

"However, they do want to de-escalate, as seen in Premier Li (Keqiang's) recent speech announcing plans to tighten IP protection and liberalize rules on foreign investment," he said.

Perera said if Trump's plan for a tariff hike goes through, China will retaliate but with a measured response that seeks to de-escalate the tit-for-tat.

"The most likely scenario is a limited series of tit-for-tat tariffs that will not escalate into a full-blown trade war," he said.

"There is little support within the US establishment and even the president's own Republican Party for an all-out trade war with China."

Sacha Tihanyi, deputy head of emerging markets strategy with TD Securities, said China's decision to level retaliatory sanctions on the US was expected.

"China has provided a number of important signals for markets," Tihanyi told *China Daily Asia Weekly*.

"The contained response tells us that China is focused on ensuring that escalation risk is minimized.

"The decision to leave several key industries untouched also suggests that China perceives a substantial risk of further iterations or tit-for-tat responses and realizes the need to preserve negotiating leverage that poses a credible threat to counter future US moves."

This then begs the question as to where China may interpret the ultimate endgame for the US administration in its trade complaint, and what they see the US' ultimate goals to be, said Tihanyi.

"We believe that China is recognizing a change in the 'order' in which the US has dealt with it in recent years (or the past administration), and acknowledging that the US' actions not only reflect issues of pure economics or trade, but also those that are geostrategic in nature.

"How it interprets the endgame and constraints posed by each US goal will be key in shaping how it proceeds in future responses. This will be crucial for markets."