Global economic risks: China, Trade and the Dollar

Tony Nash, November 2018
Top risks

• China slowdown
  • Every country in Asia is China’s largest trading partner
  • Chinese debt
  • Trade war
  • Potential for social unrest (income/aspirations)
  • RMB internationalization
  • Belt and Road Initiative / Funds, failures and debt overload

• Rethinking multilateralism
  • Trade: WTO – What is “free trade”? Circumvention vs compliance.
  • Finance: G8/G20 vs G66 & China-led organizations
  • UN: China’s increasing presence (risk or opprt?)

• Western baby boomer meltdown
  • Nationalism, political polarization and political giving (US)
  • Pensions, debt and taxes
  • Japan, China & Korea (Malaysia, Thailand, Singapore)?

• Dollar dominance
  • For how long? What competitors – EUR, CNY, crypto? Does the US want this dominance?
  • Impact on commodities? EM currencies/debt?

• Automation
  • Regionalization vs globalization / segmented supply chains (Vernon’s product life cycle theory?)
  • Jobs impact – professional, skilled and unskilled
  • Impact on conflict / algorithmic war / mechanical casualties

• AI, Privacy, Individualism
  • What is AI? Is everything algorithmic?
  • Does privacy exist? Individual, corporate, government. Convenience, cost, surrender?
  • Collective vs individual cultures – How does AI form culture? Do cultures resist? Soft(ware) power projection.
Synchronized tightening? PMI slowdown all around

China’s Purchasing Managers’ Index (PMI)

Over 50 = Expansion
Under 50 = Contraction

Source: Ifo, Eurostat, Macrobond Financial, Danske Bank
Before we look at China: What is your China bias?
China: Rising power, changing methods

China is already the world’s largest trading nation & largest military spender in Asia, but domestic infra spend has slowed dramatically.
Social change: Does China understand itself?

Young Chinese studying overseas are often thought to have a unique perspective on China. But the more China reporting and research I consume, the less confident I feel about my own understanding. It’s almost certainly the case that I know more about the U.S. than my home country.

Social credit scores

Runner-up

China’s investment in AI is big, but still well behind the US

<table>
<thead>
<tr>
<th>Size of financing received by AI firms 01 2012 to Q2 2016 (US$)</th>
<th>Total number of AI companies around the world</th>
</tr>
</thead>
<tbody>
<tr>
<td>US 17.9b</td>
<td>US 2,105</td>
</tr>
<tr>
<td>2.6b China</td>
<td>China 709</td>
</tr>
<tr>
<td>800m Britain</td>
<td>Britain 246</td>
</tr>
<tr>
<td>640m Canada</td>
<td>India 233</td>
</tr>
<tr>
<td>639m Germany</td>
<td>Canada 228</td>
</tr>
<tr>
<td>400m Israel</td>
<td>Israel 173</td>
</tr>
<tr>
<td>300m Japan</td>
<td>Germany 160</td>
</tr>
<tr>
<td>280m France</td>
<td>France 136</td>
</tr>
<tr>
<td>250m Spain</td>
<td>Spain 132</td>
</tr>
<tr>
<td>210m Switzerland</td>
<td>Switzerland 183</td>
</tr>
</tbody>
</table>

Source: South China Morning Post
China is overly dependent on consumer credit & SOE debt, which are slowing fast.
China’s not winning the trade war

Sales of Chinese passenger cars 2018, usually a good gauge of asset markets, especially property.

Shanghai Composite Index

2,651.51

Last Updated: Nov 21, 2018 3:29 p.m. CST

22% YTD
Who is paying for the trade war? or

![Graph showing average consumer price increase in percentage points for US consumers/firms](image)

*Average consumer price increase in percentage points for US consumers/firms*

After an increase in US import tariffs by 25 percentage points; 702 HS92 4-digit product categories

- **Investment goods**
- **Consumer goods**
- **Mixed goods**
- **Intermediate goods**

<table>
<thead>
<tr>
<th>Category</th>
<th>Average increase (in percentage points) in US consumer prices</th>
</tr>
</thead>
<tbody>
<tr>
<td>Investment goods</td>
<td>1</td>
</tr>
<tr>
<td>Consumer goods</td>
<td>5</td>
</tr>
<tr>
<td>Mixed goods</td>
<td>4</td>
</tr>
<tr>
<td>Intermediate goods</td>
<td>5</td>
</tr>
</tbody>
</table>

Source: Authors’ calculations © ifo institute

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Just in the last 24 hours had a Chinese exporter friend say he is moving to Vietnam to get around the trade issues, and another who is a technician at an American tech company manufacturing here say they’ve moved all production that is geared toward the US to Bangkok.

5:37 PM - 12 Oct 2018

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@doumenzi · Oct 10
Seems like everyone in China is staying an extra week in Thailand or Hainan—no business to come back to.
The biggest loser: If the US is successful, who would import China’s deflation?

Japan imports from China down $20bn/yr since 2012

EU imports from China up $40bn/yr since 2012
A move to trade regionalization?  

China is most exposed in computer assembly, but has clear advantages in mobile/wireless equipment.
Belt & Road Initiative: Beyond the Central Asia vision

China aims to build a global infrastructure network
“Belt and Road” infrastructure projects, planned and completed (March 2017)

- Hungary
- Pakistan
- Indonesia
- Thailand
- Malaysia
- Greece
- Zimbabwe
- Kenya
- Etc

Filling an $8trn hole $100bn at a time

Major sources of Asian infrastructure funding include the following:

• BRI - CIC ($200bn) + AIIB ($100bn) + BRICS Bank ($100bn) + Silk Road Fund ($40bn) + CEB+ CDB; One Belt One Road ($6trn impact / CAAS-NDRC)
• Asian Development Bank has $53bn in equity and $99bn of loans outstanding
• India = ~$150bn for domestic road, port infrastructure, waterways and rail.
• Japan infrastructure investment fund: $110bn over 5 years
  • AAGC (Asia Africa Growth Corridor) – Japan, India, African nations

China wants to do it their way: Transparency, monitoring, anti-corruption, etc
Is Xi’s vision being realized? Maybe….

2017 ODI fell: Non-financial ODI to countries involved in the Belt and Road Initiative has been encouraged. ODI in those countries totalled 14.4 billion U.S. dollars, 12 percent of the total, up from 8.5 percent in 2016.
http://www.xinhuanet.com/english/2018-01/16/c_136900334.htm

White elephants: Inside China’s US$1 billion port in Sri Lanka where ships don't want to stop

Cancelled high-profile projects: Indonesia set to abandon infrastructure schemes worth $19bn by 2019 if sufficient progress isn’t made
• $6bn specific to BRI Jakarta-Bandung HSR
• Regulatory hurdles
• Disbursement of funds from China (CDB), 75% of project funds

Corruption and tax evasion by key BRI players: EU suspects tax fraud at China’s ‘gateway to Europe’ as state-owned shipping firm Cosco faces mounting opposition abroad

Strong dollar takes a pause, then resumes strength in 19

Volatility is back. And we expect disordered markets through the end of the year.
October 18, 2018
Issue No. 62

Equity markets took an interesting turn over the past week. We’ve been saying for months that Complete Intelligence expected a bit of turbulence in September/October and we were right. Some of this is due to the return of 1.4bn Chinese from their Golden Week holiday only to realize that things aren’t as rosy as many once thought. China is not immune to Trade War fallout as China’s September manufacturers data showed.
Major currency weakness into the new year

Bonus: CNY strength on very strong stimulus
Precious metals continue their decline in H1 18 on dollar strength and EM weakness
Chinese industrial metals mixed on stimulus to impact exports and real estate
Summary

- Structural changes in China – with trade, economics and politics – underscore uncertainty
- China’s major global initiative – the Belt & Road Initiative – has failed to gain momentum. Will it die or will expectations tone down?
- Dollar appreciation continues, with impacts on major currencies, EMs, commodities