DANIEL'S TOUR OF CHINA

September 2018

HAWKSMOOR
FUND MANAGERS

1. CHINA'S TRADE WAR WITH THE US

Despite the recent news emanating from the US confirming that a much larger set of Chinese goods will be subject to import tariffs - $200bn vs original $50bn and moving to 25% tax in January from the current 10% - it was received quite well in China. This is probably because the uncertainty has been cleared and now investors and analysts are more able to calculate the impact and consider how the Chinese government might retaliate.

In simple terms, a 25% tax on goods of $200bn (effectively everything the US imports from China) would dent the gross domestic product (GDP) by 50bps per annum, although the weakness in the Renminbi does offset the hit somewhat.

Will reducing cheap imports 'Make America Great Again'?

The consensus among the people I met was that this trade war will be protracted and not something either side is prepared to negotiate. Although it can be attributed to Trump, he has cross party support so it is more about the US vs China fight for global supremacy. So although Trump became more vocal in the run up to the mid-term elections, the fact that the Democrats have taken control of the House will not have any impact on this. In any case, most people I met thought **this is a fight that the US will ultimately lose.** Trump has promised his voters a better life through his Make America Great Again plan by attacking cheap imports - but there is no chance that the US can produce goods at the same price as Asia.

"The average wage in the manufacturing sector in the US is $22 an hour. In China it is $3 and the Chinese are delighted, as just a few years ago it was $1 an hour."

Therefore it won't be long before the US population has to decide whether to take a massive pay cut or pay more for stuff that used to be made in China.

Economic protectionism

The basic premise of the attack on China is to remind them of the promises made upon joining the World Trade Organisation (WTO) in 2001, such as opening up their economy to foreign investment. There are many examples of Chinese companies investing in the US by acquiring businesses or taking market share from US companies.

"For example, Unionpay is taking share off Visa and Mastercard in the US, yet Visa and Mastercard are not allowed into China. Trump is simply saying enough is enough."

AGENDA

24th September - Hong Kong

- Head of Moody's China
- Moody's Asia Property
- Kaisa Group Holdings (Property Developer)
- BNP Paribas top ranked China strategist
- Agile Group (Property Developer)
- Gleneagles Hospital (Private Hospital)
- Head of Moody's South East Asia
- Deutsche Chief Economist
- Deutsche Asia Chief Economist

25th September - Shenzen

- Shenzhen Investment Holdings (State Owned Property Developer)
- Shenzen Investment Holdings' new science park
- Huawei headquarters and innovation centre (technology company)
- SF Holdings distribution centre (logistics company)

26th September - Shanghai

- Fosun International (conglomerate)
- Greenland Holding Group (State Owned Property company)
- Shui On Properties (Property Developer)
- Xintiandi – new mixed use retail/ dining centre developed by Shui On
- Yingde Gas (industrial gas producer, owned by private equity)

27th September - Beijing

- Metallurgical Group (State Owned Steel producer)
- Aluminium Corporation of China (State Owned Aluminium producer)
- Orient Advisers (State Owned Asset Management Co.)

28th September - Beijing

- Bank of China (State Owned Bank)
- Lenovo campus and technology centre

China is standing firm and has promised to employ appropriate measures to deal with any impact although one person I met thought additional stimulus would be dangerous, **given it has just dipped into a current account deficit for the first time in 20 years and its debt to GDP is rising - although at 40% it is much lower than most economies.**

To reduce its reliance on US trade, it has been making friends with other countries in regions such as Africa, Europe and the rest of Asia in recent years and will step up those efforts. China's Belt and Road Initiative is an obvious example of this (more about that in part 5). What's more, President Xi can blame the US for a slowdown rather than his own policies, which will be a welcome relief at a time when his popularity is alleged to be waning. Generally China doesn't give the impression of being too concerned about this subject and has publicly stated it has sufficient tools to deal with any associated issues.

Impact on businesses

In terms of company feedback, most people I met were sanguine about the impact of the trade war on their businesses. The state-owned enterprises answered the question with just the facts on how much of their product is exported to the US and in most cases it was very low, if not zero, followed by a curt comment that **they do not give opinion on government policy**. Lenovo probably had the highest exposure at around 20% of their sales but they have contingency measures in place including shifting production to their existing plants in Brazil and Mexico, and the US where they still have operations from their acquisition of Motorola in 2016 and IBM's PC and Server businesses over recent years.

Huawei, which has just 1% of sales going to America, saw its bonds derate on the tariffs news as the market lazily thought "tech company = high exposure." It is likely that the next few months will show a slowdown of GDP and some corporate earnings as a result of the trade war, but it is important to consider it alongside the deliberate policy of slowing the property market and the natural fall in the GDP growth rate – China cannot grow at 8% a year and will gradually trend towards 3% over the next 10 years in line with more mature economies.

"However, this won't stop many commentators using this as evidence in their bear case for the Chinese market."