

China Weekly Letter

A US-China trade deal is moving closer

- Report of ‘unprecedented proposal’ from China as new talks kick off in Beijing.
- Profit growth falls sharply on weak economy, more monetary stimulus is coming.
- EU’s Jean-Claude Juncker says calling China ‘rival’ is a compliment at meeting with Xi Jinping.

Signs of progress, but deal more important than timing

An insight *Reuters* story reported that China has made unprecedented proposals on technological transfer, citing unnamed US officials: ‘If you looked at the texts a month ago compared to today, we have moved forward in all areas...they’re talking about technology transfer in a way that they’ve never wanted to talk about before’. A new round of high-level talks started in Beijing on Thursday. On the timing of a deal, Donald Trump’s economic adviser Larry Kudlow said yesterday that ‘This is not time-dependent...If it takes a few more weeks, or if it takes months, so be it. We have to get a great deal’.

US chief negotiator Robert Lighthizer gave some interesting insights in an *interview* with NPR. On stopping forced technology transfer, he said ‘They’re committed to do this, but it’s going to be a question of whether they can get all the layers of government, I think, to follow through’. On whether China would be willing to make structural changes, Lighthizer said, ‘I think you have to start with the proposition that there are people in China who believe that reform is a good idea. And you have to believe that those people are at a very senior level’. Lighthizer also stressed that what the US is asking for is not anti-Chinese and added ‘**In fact, the reformers would say it’s pro-Chinese. It will help their economy, not hurt their economy.**’

This seems to be in line with Premier Li Keqiang’s speech at the Boao Forum (‘Asia’s Davos’). Li emphasised that ‘**No forced technology transfer shall be imposed on foreign investment. We will be true to our words.**’ Li also stressed intentions to open up further for investments in Chinese services, such as telecommunications, medicare, education, transport and infrastructure. For more on his speech, see *SCMP* 28 March.

Comment: The Reuters story indicates we are moving closer to a deal but that a deal is made is more important than its exact timing. The key hurdles regard enforcement and whether or not US tariffs are removed immediately. We expect to see a compromise, with tariffs being removed on some goods but not all. We see a 50% probability that the high-level talks in the next two weeks pave the way for a ‘signing meeting’ between Xi and Trump in late April. We see a low probability of a no-deal outcome, as Trump wants a deal ahead of the coming election campaign.

Lighthizer’s comments underline that there is a genuine wish to reform at the top level in China, because it is the only way to deliver on the ‘Chinese Dream’ and become a prosperous society by 2049. The obstacle for reform is mostly at the local government level, where vested interests block reform. The Chinese LSE professor Keyu Jin has called the trade war a ‘strategic gift’ to China, because it creates the outside pressure that the leaders need for reforms to be pushed through (see a short interview with *SCMP* [here](#)). This was also the case when China reformed to become a member of WTO.

Selected China Research

A tour of the global economy (in one chart pack), 26 March (follow link to China section on page 3)

Flash Comment China – Q1 was weak but leading indicators still point to a bottom, 14 March.

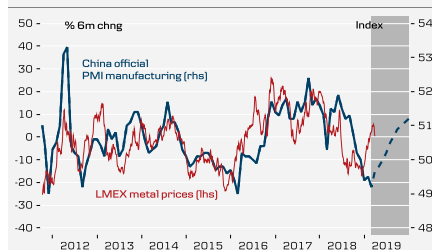
China Leading Indicators – First signs of a bottom, 7 February

US-China Trade – A deal in sight – look out for Xi-Trump meeting(s), 1 February

China Outlook – Short term pain, long term gain, 13 December 2018

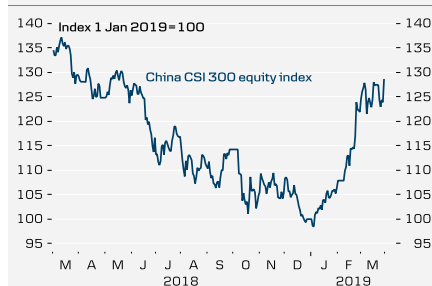
[Link to all China research including previous China Weekly Letters](#)

Look out for March PMI next week – we expect to see an increase



Source: Macrobond Financial, Bloomberg

Chinese stocks end the week on a strong note amid higher volatility



Source: Macrobond Financial, Bloomberg

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Big fall in profit growth, room for more stimulus

Chinese profit growth fell by 14% y/y in January and February. This is a very weak reading and much more so than suggested by most other data.

Comment: While we expected negative profit growth in Q1, the fall was far bigger than we looked for. Our model for profits based on producer prices and PMI manufacturing points to profit growth more in the area of -5%. We believe we will see a rebound in the March data: profits tend to correlate with commodity prices and we have seen higher prices for both metals and oil this year, which should underpin profits in coming months. We also expect further monetary easing to add to the stimulus and thus support activity.

Li Keqiang mentioned in his Boao speech that daily electricity consumption has been growing at a double-digit pace in March. The data has not been released but if this is true, it would underpin the picture of higher activity. Look out for PMI data next week for confirmation of this. Stock markets closed the week on a strong note and reached a new cycle high. **We look for higher equities on a six-month horizon driven by a trade deal and recovery.**

Juncker says designating China a 'rival' is a compliment

The EU toned down its critical voice on China significantly at a joint summit with Chinese President Xi and French President Emmanuel Macron, German chancellor Angela Merkel and EU President Juncker. On referring to China as a 'systemic rival' in a recent EU Commission strategy paper, Juncker said that the description was a 'compliment' describing shared ambitions.

The four leaders found common ground on working for a multilateral world order and trade system and in a surprisingly positive tone, Merkel said that *'we, as Europeans, want to play an active part' in the Belt and Road Initiative and added 'we are seeing the project as a good visualisation of interaction, interrelation and interdependence'*. In a rebuke to Washington, Macron said that *'I don't believe in the efficiency of confrontational postures, but in a demanding spirit of co-operation'*. However, the EU leaders also stressed the need for reciprocity and Merkel said the EU is still wrangling over that a bit. EU leaders also made clear that the EU is opposed to any attempt to divide Europe and that it should be consulted on major matters regarding individual countries. Xi described the new world order as one where *'we are marching forward side by side and we should not become suspicious. We should not always be looking behind our backs'*.

During Xi's trip, Italy became the first G7 country to sign up to the Belt and Road Initiative (see *SCMP*, 23 March). In France, Xi's visit also came with a new Airbus order of 300 new planes on top of a range of other business deals with France.

Comment: Xi could hardly have hoped for a better outcome of the trip to Europe. While Xi is facing a very confrontational stance in the US, he is dealing with a Europe that is more critical but also still favouring a path of engagement. One of China's main state media *People's Daily* wrote 'Xi's fruitful visits boost partnership with Europe'.

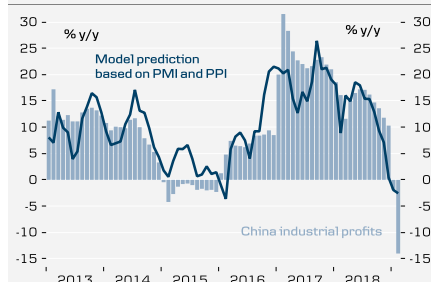
Other selected China news of the week

FT had an interesting article on 'Asia's century' (see *Financial Times*, 26 March).

China's private education industry is booming (see *SCMP*, 25 March).

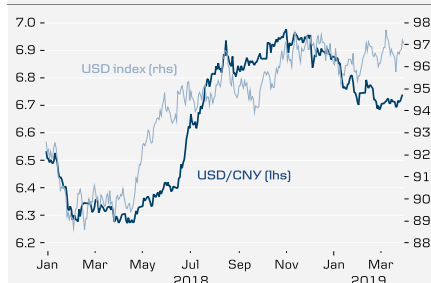
Chinese tech firms promote young staff (see *Reuters*, 25 March).

Fall in industrial profits much weaker than model prediction



Source: Macrobond Financial, Bloomberg

USD/CNY a bit higher this week on broad-based USD strength



Source: Macrobond Financial, Bloomberg

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