

Trading with China: risks and rewards

Baker McKenzie Trade Day 2018

181011 Stockholm
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Is China “the bull in the China shop”?



Xi Jinping – The core and the eternal leader



Communist Party of China (CPC)

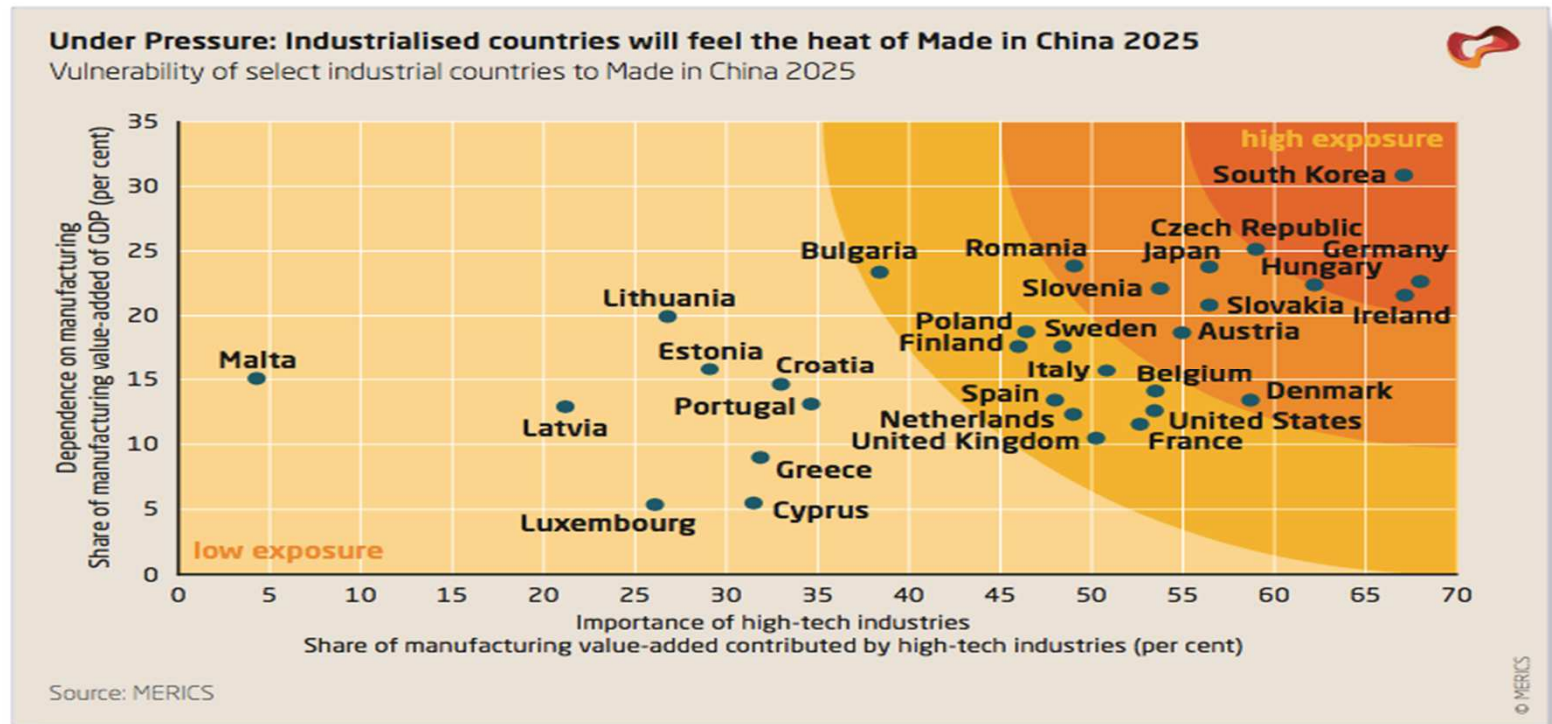
- Rule the country, maintain social stability
- "Socialism with Chinese characteristics for a new era"
- Growth and prosperity to the people, uphold socialist and communist values
- Owner, Arbitor, Consolidator of the economy



13th 5-Year Plan 2016-2020

- Sustainable growth – "The New Normal" – "Around" 6,5 %
- Doubling GDP to 2020 (from 2010) avoid "The Middle Income Trap"
- Quality, productivity, efficiency, risk control, debt reduction, supply side reforms
- SOE reforms while encouraging entrepreneurs and innovation
- "Belt and Road Initiative" (BRI), Asian Infrastructure Investment Bank (AIIB), NDB
- The Environmental Challenge: Paris Agreement, investments in renewables, strict environmental inspections
- Urbanization, Hukou-reforms, Xiong'an New Area osv
- Poverty reduction, social insurance and pension systems, healthcare
- Digitalization, AI, "social credit system", IoT, Robotisation, Automatisations, "Made in China 2025"
- Internationalization of RMB
- Further opening of capital markets: Stock Connect, Bond Connect, Panda Bonds, Green Bonds, MSCI EM-inclusion (first steps taken this year)

Made in China 2025 – global impact



Paradigm shift in governance of the economy

Old Paradigm

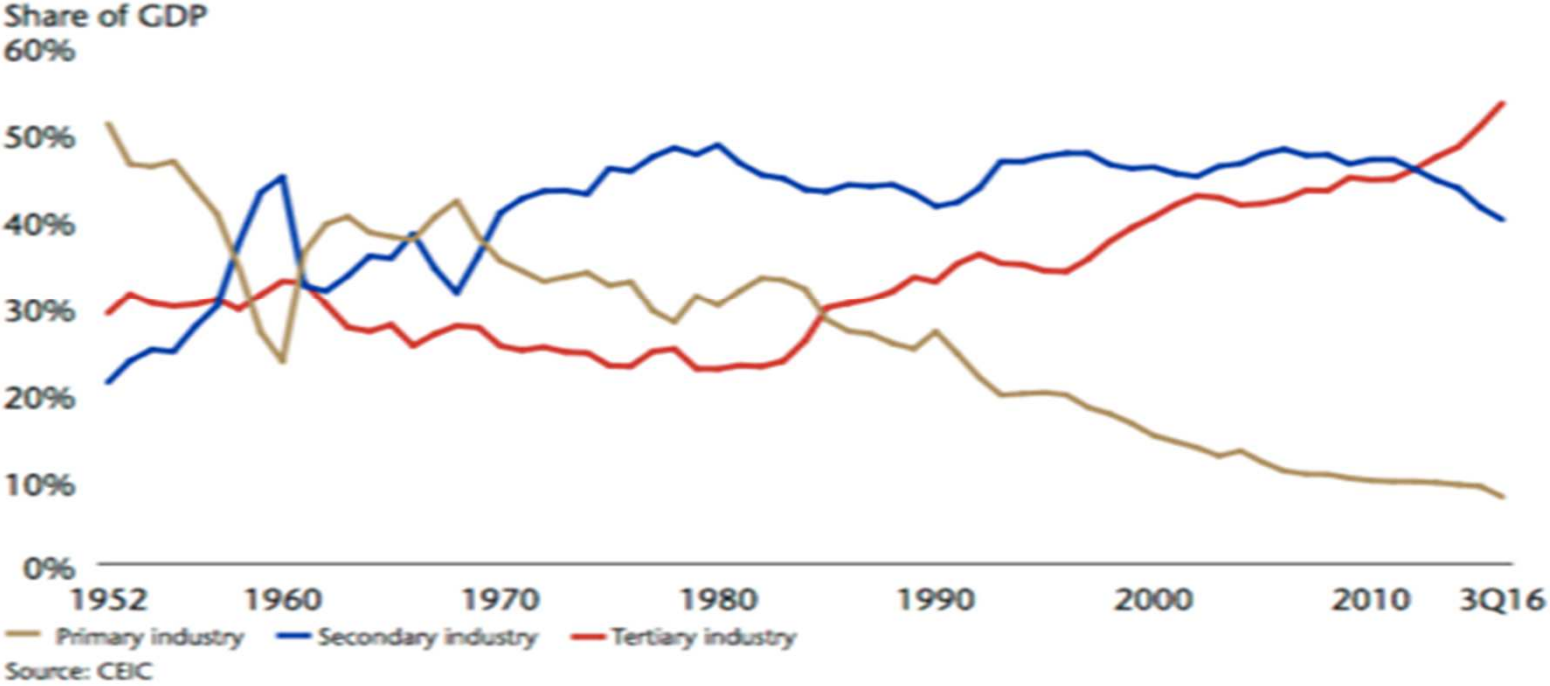
- Central Control
- State Capitalism
- Fixed Assets Investments
- Export Driven
- Volume
- Growth at any price

New Paradigm

- Set regulatory frameworks
- Market Economy
- Consumption led growth
- Domestic and organic
- Quality
- Sustainable growth

Services and consumption drive GDP-growth

Figure 2. GDP BY PRODUCTION APPROACH



The growing middle class



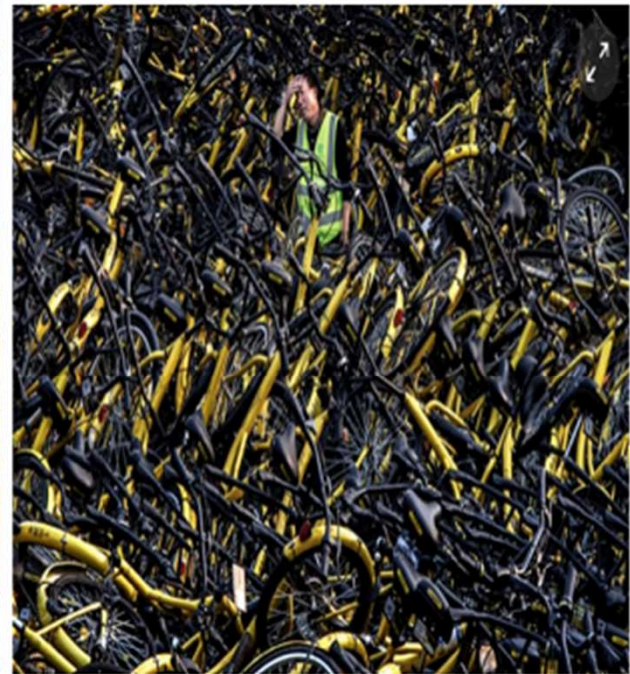
“Singles Day” 11/11 2017



Supply-side reforms: dealing with overcapacity



Thousands of share bikes laid to rest in the south-eastern Chinese city of Xiamen. Photograph: Chen Zixiang for the Guardian

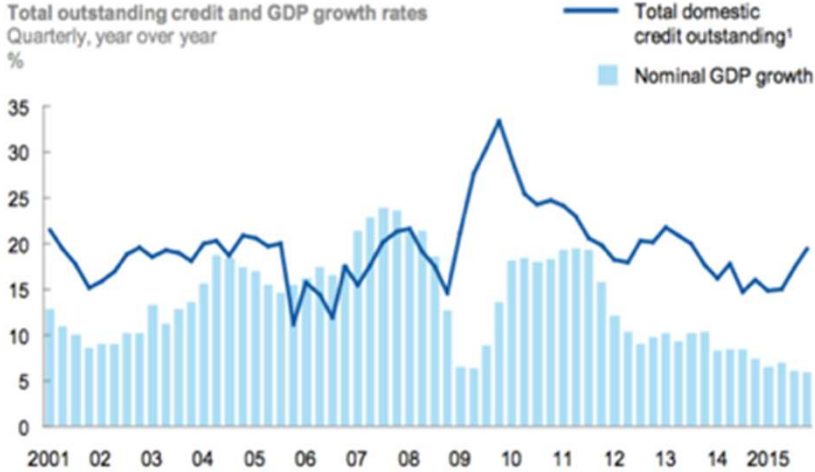


A mechanic from bike share company Ofo stands amongst damaged bicycles needing repair in Beijing. Photograph: Kevin Frayer/Getty Images

Credit growth, debt levels and now risk controls

Exhibit E1

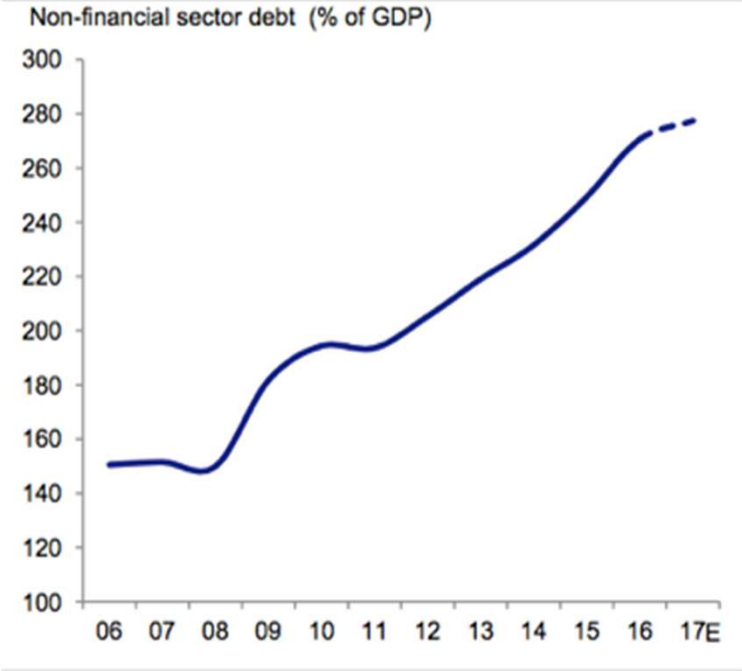
Under the investment-led model, China's credit growth far exceeds GDP



1 Includes total social financing, non-loan bank claims on non-banking financial institutions and on corporations and households, and banks' net claims on government (a portion of the claims data is available only starting in 2005). This measurement includes all outstanding credit in the real economy but excludes interbank credit.

SOURCE: McKinsey Global Institute Debt & Deleveraging database; CEIC; Emerging Advisors Group; McKinsey Global Institute analysis

Figure 1: China's debt kept rising as a share of GDP

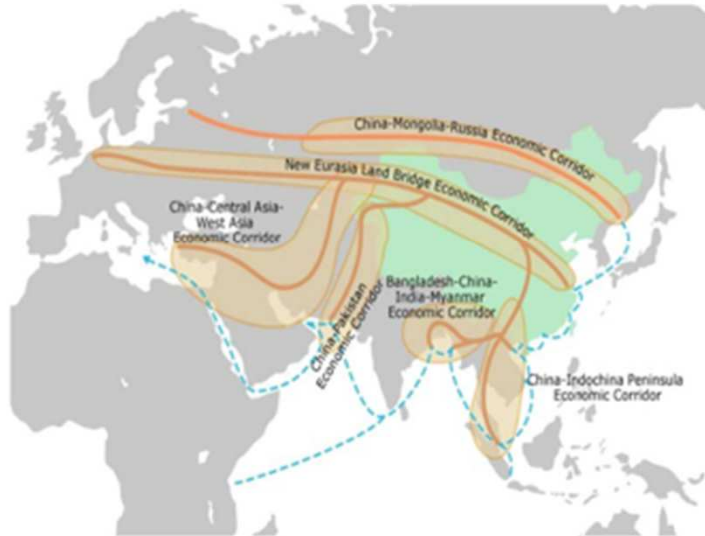


Source: CEIC, UBS estimates

“Belt & Road Initiative” (BRI) & AIIB

Figure 1: Roadmap for the Belt and Road Initiative

The Belt and Road Initiative: Six Economic Corridors Spanning Asia, Europe and Africa



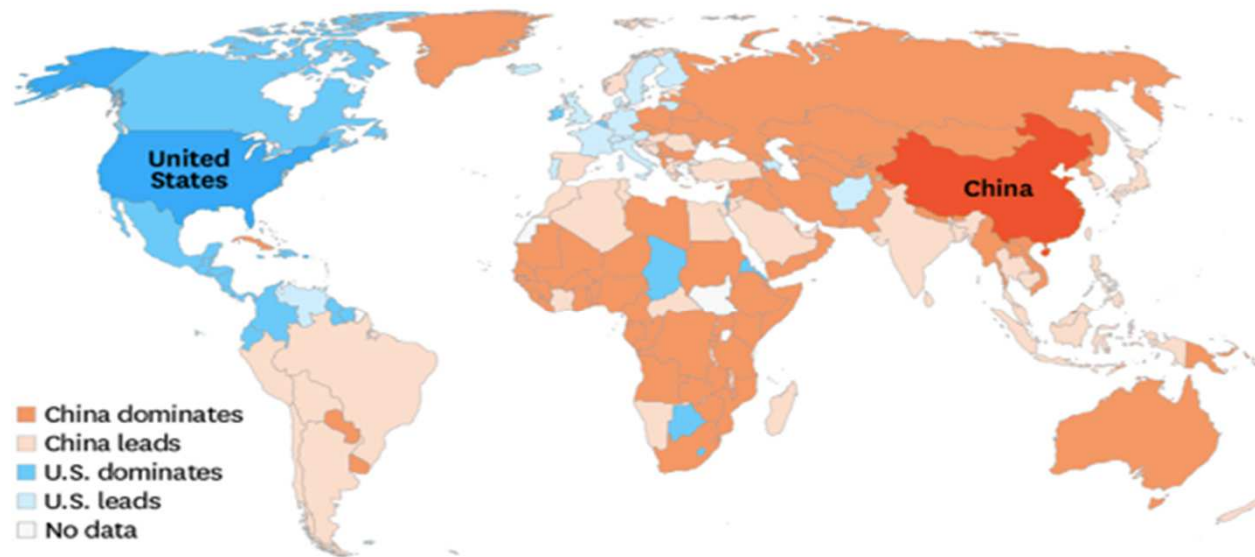
Source: HKTDC Research, <http://china-trade-research.hktdc.com/business-news/article/One-Belt-One-Road/The-Belt-and-Road-Initiative/obor/en/1/1X000000/1X0A36B7.htm>



Asian Infrastructure Investment Bank (AIIB) president Jin Liqun attends the opening ceremony of the first annual meeting of AIIB in Beijing, China, June 25, 2016. REUTERS/Jason Lee.

The world's largest trading nation

U.S. vs. China in Global Merchandise Trade: Who Leads Where?

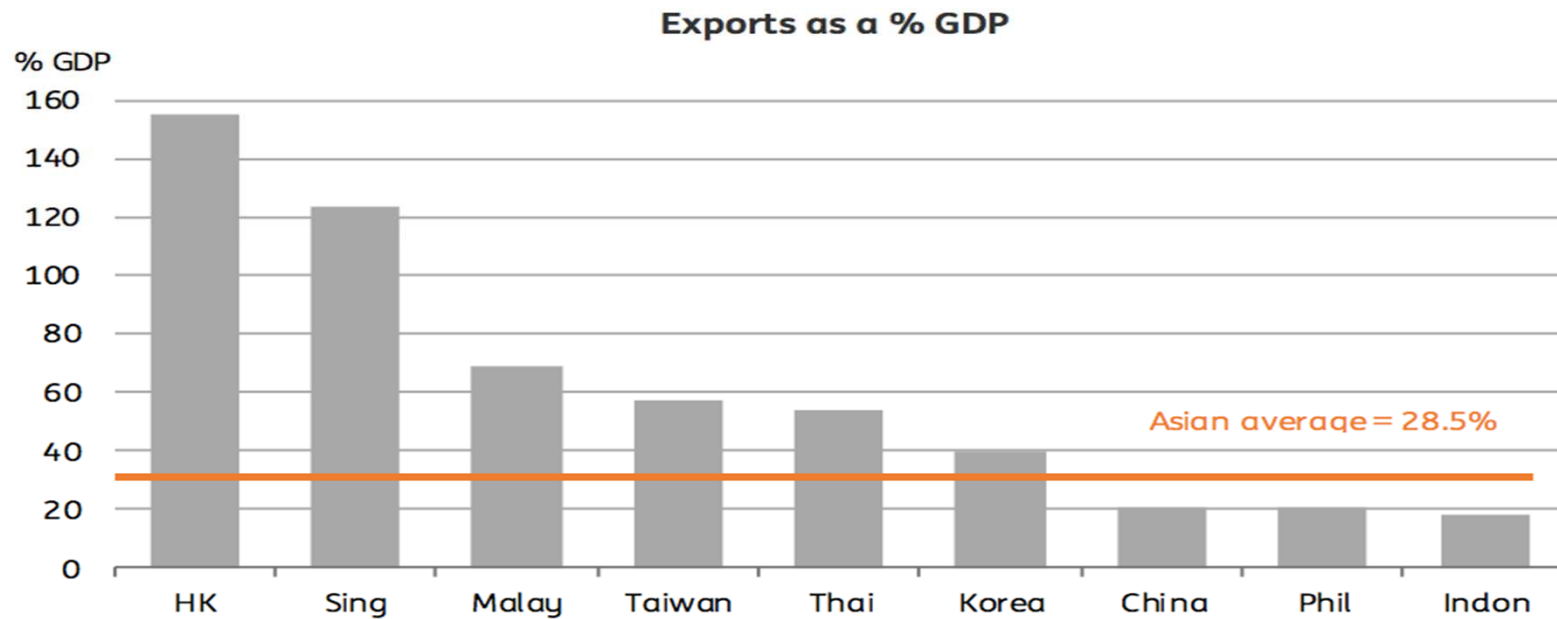


NOTE "CHINA DOMINATES" REFERS TO CHINA HAVING MORE THAN TWICE AS MUCH TRADE AS THE U.S. WITH A THIRD COUNTRY; "CHINA LEADS" REFERS TO CHINA HAVING BETWEEN ONE TO TWO TIMES AS MUCH TRADE AS THE U.S., AND SO ON. SOURCE PANKAJ GHEMAWAT, BASED ON 2015 OR MOST RECENT AVAILABLE DATA FROM IMF DIRECTION OF TRADE STATISTICS AND UN COMTRADE DATABASES

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China decreasing export dependency

Tariffs and growth – also depends on export dependency



The evolving trade war or frictions

The “World” Trade War



● US

● Everyone else on the receiving end

The combatants in this global trade war are centred on 3 main regions:

1. North America
2. EU
3. Asia (China, but also Korea, Japan)
4. Add in Turkey and Iran, (Brazil, Argentina, exempted tariffs but quotas on steel, Aluminium exports)

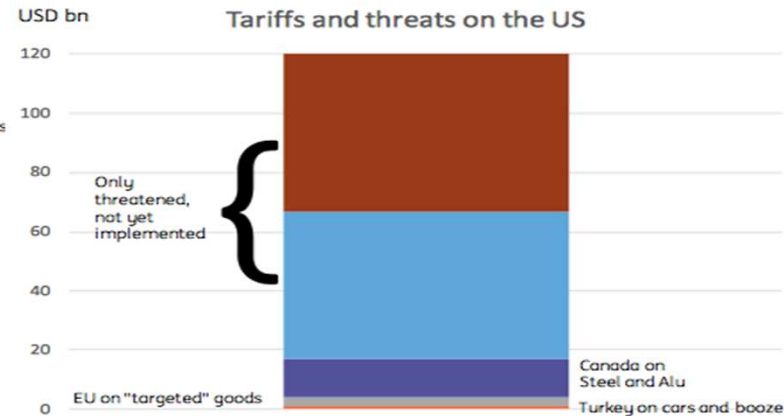
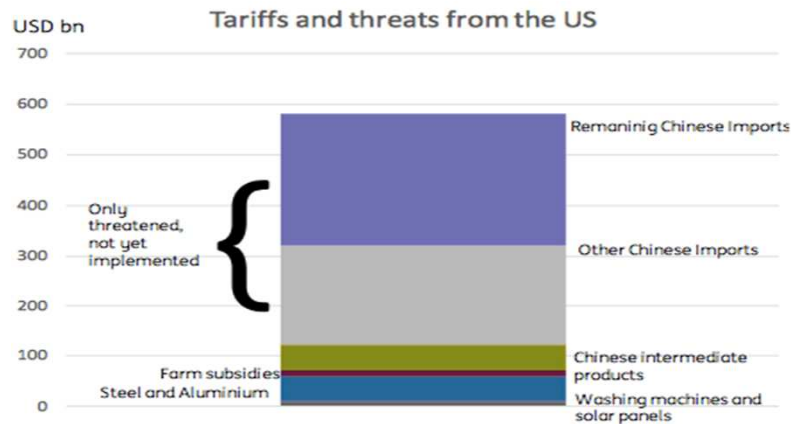
There are four main “battles” in this war (see next slides...)

Tariffs, tariffs, tariffs



Tariffs, tariffs, tariffs

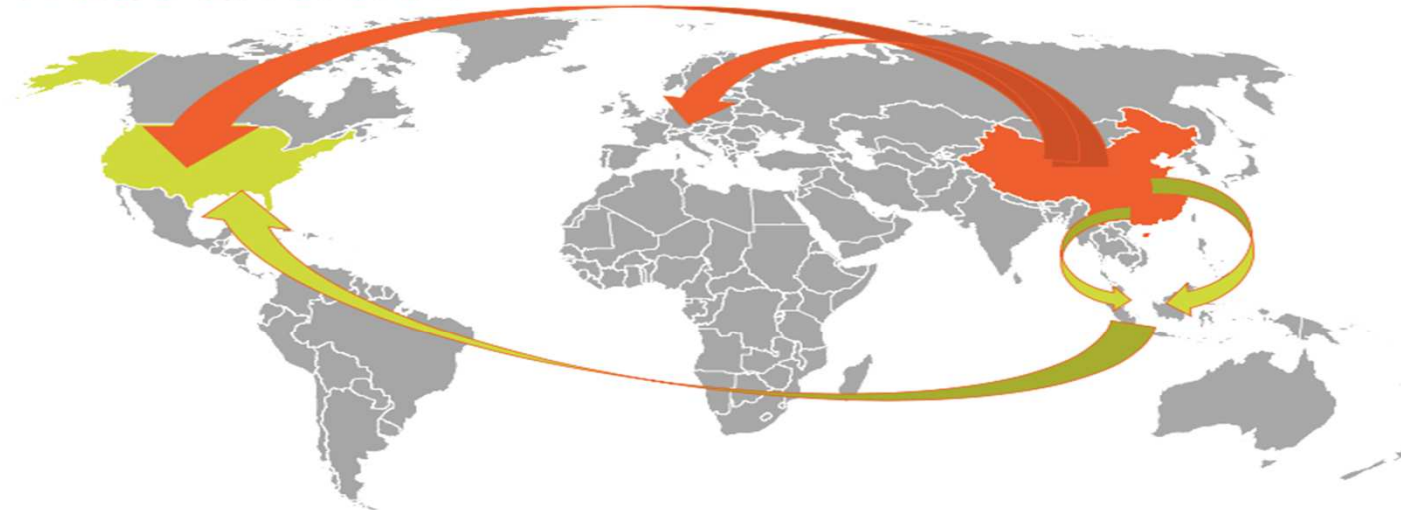
The Scale of the Tariffs



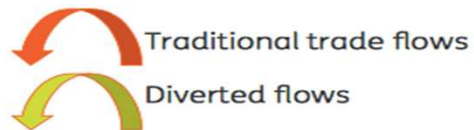
- So far, the trade war is pretty one sided.
- Actual tariffs implemented amount to only about USD \$165bn of trade at tariff rates of between 10% and 25% (excludes the \$200bn Section 301 tariffs)
- Threatened tariffs not yet implemented amount to a further USD\$340bn (plus up to \$200bn of the section 301), at similar tariff rates...
- ... for a total of about USD \$700bn. For comparison, Global GDP is about USD\$80tr so tariffs equivalent to <1% global GDP.

Tariffs creating new trade patterns

Trade diversion



We typically think of China as an exporter of finished goods and intermediate products to the US and to Europe



But as tariffs bite, US trade flows are likely to be diverted

1. To nearby Asian economies (squeeze local production?)
2. To traditional destinations, but indirectly (Asian shipping could benefit) – could “near-China” economies benefit... Vietnam?

How will China-US relations develop?



China-US relations

- USA sees China as a competitor, not only in trade but also in geopolitics, a new "Cold War" in the making?
- Toughening stance on China by Trump and his administration
- CFIUS evolved into the tougher FIRRMA
- China still not given "Market Economy Status" by WTO due to resistance from USA and EU
- NAFTA evolved into USMCA
- Will China retaliate on USA by flashing its "black belt in bureaucracy"?
- China implements deregulations and opening up to foreign participation in different sectors: financial sector, automotive, shipbuilding etc
- Lowering import duties on a wide scale
- China International Import Expo, Shanghai in November 2018

Sweden – China and why Sweden is interesting

- Sweden one of very few EU with a trade surplus (and growing) on China
- Sweden one of the largest recipients of Chinese direct investments into the EU in 2018
- Open economy, free trade tradition
- No or little government interference, in contrast to larger European countries (might change if EU introduces screening of Chinese investments)
- Sweden perceived as a world leading innovation nation – there is a lot to learn!
- Sectors: Technology, life science, healthcare, gaming, consumer brands, machinery, shipping, cleantech, fintech, social security and welfare systems etc

Always remember the "Laundry List"!

- Understand the priorities of the Communist Party of China, today and tomorrow
- Do we know the rules and regulations that apply?
- Pros and Cons for us? SWOT analysis!
- Optimal way to work with China given our existing resources?
- Do we have sufficient financial and personnel resources?
- Be mindful of the different levels of income and development in different parts of China
- No reason to rush through agreements – "the devil is in the details"
- Do you know your Chinese client/counterpart?
- The importance of always getting paid!
- Deals can be done in both good and bad times, what matters is that you understand the risk and can handle it satisfactorily.
- China impresses on a macro level, confuses on a micro level
- Work with China in a multi-dimensional way 1) direct 2) via Hong Kong, Taiwan, Syd Korea, Japan or elsewhere 3) with Chinese companies outside of China