MERICS CHINA UPDATE

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METRIX

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30 million USD is the minimum net-worth of an ultra-rich person. Globally, over 250,000 people belong to the "ultra-high net-worth" category. Over 10,000 people within this privileged group reside in Hong Kong today. A new report by Wealth-X explains the drastic increase of 31 percent compared to the last year with the significant increase of property values. Hong Kong has officially surpassed New York City as the city with the highest number of ultra-rich residents. Among the world's wealthiest cities are Tokyo, Los Angeles, London, and Paris.

TOPIC OF THE WEEK: US-China trade war

US-China trade war escalates to dangerous level

The trade war between the United States and China has escalated to a new level. On September 17, US President Donald Trump announced his decision to impose 10 percent punitive tariffs on Chinese imports worth 200 billion USD. Adding this to the previous round of tariffs, roughly half of Chinese imports are affected by the higher tariffs. China retaliated by announcing tariff hikes by 5 and 10 percent on 60 billion USD worth of US products. The new tariffs on both sides will go into effect on September 24.

Policymakers, economists and entrepreneurs around the world fear that the US-China trade conflict could be the beginning of a downward spiral for the world economy, but certainly for the two opponents. Japanese government representatives called on the United States and China to resolve their dispute. Alibaba's president Jack Ma warned of a protracted trade war that could last up to 20 years.

A near-term solution seems off the table. There is no face-saving way for China to enter into negotiations after the Trump administration had offered new talks as late as last week and then gone through with its initial threat. Commentary in Chinese media described the US move as an attempt to thwart China’s rise and as an attack on the global economic order.

Unlike during the first round of the trade dispute, China was not able to response in kind to the US measures. Chinese imports from the United States only amounted to 130 billion USD in 2017. China’s two rounds of tariff hikes on US products this year already cover more than 80 percent of all US imports.

But China has other ways to hurt the United States. Chinese holdings of US Treasuries fell to a six-month low in July. As the world’s biggest holder of US bonds, bills and notes, China is the United States’ biggest creditor. The Chinese Ministry of Commerce had filed a complaint against the US tariff hikes with the World Trade Organization, which it renewed on September 17. China could also respond by weakening its currency to help Chinese exporters. But its prime minister Li Keqiang took that option off the table. On September 19, he told the World Economic Forum in Tianjin that China had not intervened in the exchange rate of the yuan to cope with trade tensions – an implicit rejection of Trump’s allegations that Beijing manipulates its currency.

Many economists argue that the United States is already hurting its own interests with the trade war. US consumers have to expect rising prices for Chinese imports or switch to buying more expensive domestic alternatives. Manufacturers that rely on intermediary products from China will be at a competitive disadvantage on the US and the global market. At the same time, US companies operating in China will have to expect stronger non-tariff barriers – ranging from discrimination in public tenders and stricter controls by Chinese authorities to public boycotts of their products.

Max J. Zenglein, senior economist at MERICS:

"The timing of the higher tariffs on Chinese products is very bad for China. The Chinese government is currently tackling a range of problems from a high debt burden to industrial overcapacities and environmental degradation. The last thing it needs right now is a global economic slowdown. China may be less dependent on exports than 10 years ago, but the tariffs are putting substantial pressure on its economy."

CHINA AND THE WORLD

China closes ranks with Russia amid tensions with United States

Beijing has expanded its already close military cooperation with Moscow and is moving to strengthen economic ties with Russia amid the worsening trade conflict with the United States. This September, China's first-ever participation in one of Russia's largest annual military exercises coincided with China's president Xi Jinping attending the Russian-led Eastern Economic Forum for the first time.

The frequency and intensity of Chinese-Russian joint military exercises has increased over the past 15 years, but China's participation in this year's "Vostok" drills brought the cooperation to a new scale. With 300,000 soldiers, 1,000 planes, 36,000 tanks, armored vehicles and other cars, and 80 ships, this year's Vostok was the largest exercise since 1981 (when Russia was still part of the Soviet Union). China contributed 3,200 soldiers, 30 planes and helicopters.

Unlike other regional neighbors, Xi had previously skipped the Eastern Economic Forum but might now be using it to signal to the United States that he has other options. At the summit in Vladivostok, Alibaba announced a 2 billion USD deal with mail.ru to set up a joint venture ("AliExpress Russia") for communication, social media, gaming and shopping.

So far, Russia has not made it into the group of China's top ten trading partners. The focus so far has been on energy deals. Russia is now a major source of China's oil supply (but it took two decades to get there) and is set to become a major supplier of its gas by the early 2020s. In the wake of the tariff war with the United States, US agricultural imports to China are set to become more expensive, potentially creating an opening for Russian exporters.

Pakistan's new government sows doubts about BRI commitment

The China-Pakistan Economic Corridor is often touted as the flagship project of China's Belt and Road Initiative (BRI), and it enjoyed the full support of the former Pakistani government. However, a close economic advisor to the new prime minister Imran Khan has now openly criticized Chinese investments in Pakistan, shortly after the visit of Chinese foreign minister Wang Yi. In an interview with the Financial Times, Abdul Razak Dawood complained that the previous government had agreed to "unfair contracts." He recommended to postpone all projects for at least one year and to wait five years with the establishment of the economic corridor. Meanwhile, Dawood retracted his statements and the Ministry of Commerce dismissed the article.

Khan's election had caused unease among the proponents of the China-Pakistan Economic Corridor. He had strongly spoken out against what he described as a lack of transparency and corruption in connection with the project.

On the day of the interview, Pakistan's government informed its Chinese partners that it intended to open the economic corridor for investments from third countries. Considering the headwind China is facing in other countries it wants to recruit for the BRI, analysts see the developments in Pakistan as a positive sign for an increasing openness on the Chinese side to incorporate the needs of its partners.

Pakistan received the highest amount of Chinese investments and loans to finance BRI projects worldwide. All in all, the funding for finished projects and projects under construction adds up to 15 billion USD.

MERICS analysis: The BRI in Pakistan: China's flagship economic corridor. China Mapping by Thomas Eder and Jacob Mardell.

Venezuela begs for financial support from China

Venezuela's president Nicolas Maduro visited Beijing from September 13 to 16 in an apparent attempt to secure financing for his crisis-ridden country. During his visit, China National Petroleum Corporation (CNPC) announced the acquisition of a further 9.9 percent equity in its joint venture with Venezuelan state oil company PDVSA, bringing its share to almost 50 percent. (China also agreed to farm into a further bloc in the Orinoco Belt. Maduro and Chinese president Xi Jinping also signed a Memorandum of Understanding announcing Venezuela's participation in China's Belt and Road Initiative (BRI), representing a further milestone in China's recent push to include Latin America in the BRI.

The overall success of Maduro's mission remains unclear. Beijing has not confirmed Venezuelan reports prior to Maduro's trip that China had agreed to a new 5 billion USD loan for the country. Neither had it commented on earlier reports this July that China Development Bank would provide 250 million USD to boost oil production.

Venezuela is in a deep financial and economic crisis. China – which currently holds 23 billion USD of Venezuelan debt – is the country's largest foreign creditor. Beijing must balance the risk of major financial losses against the potential benefits of access to Venezuela's economy and resources – and influence in the region.

Venezuela holds the world's largest oil and gas reserves. However, the country has been hit by the fall of oil prices and a dramatic decline in oil output resulting from chronic under-investment and corruption under Chavismo. China has also imported other resources from Venezuela, notably iron ore and coltan (highly valuable for smart phone manufacturing), and undertaken numerous major infrastructure projects. It has also exported large quantities of PRC-manufactured goods, among them arms and technology for social and political control.

In recent years, Beijing has sought to restrict further exposure to Venezuelan debt, and any return to major lending by Beijing would likely include significant concessions by Caracas. In the context of wider debates on Beijing's alleged 'debt-trap diplomacy', it has been speculated that China may seek ownership of a port or similar infrastructure in Venezuela.

News in brief

- Australian maritime exercise: PLA navy participates for first time
- Abe plans to visit China: Japanese prime minister meets Xi Jinping at Eastern Economic Forum
- South China Sea: Japanese submarine participates in naval drill
- China-backed trade pact: Singapore's PM doubts that RCEP will be finalized this year

POLITICS, SOCIETY AND MEDIA

State Council reorganizes priorities of health and technology administration

The State Council has announced changes to the internal structures of seven ministries and nine other government agencies. The planned changes in the cabinet-level agencies dealing with public health and technology reflect the Chinese government's shifting priorities on these issues. The announcements build on the comprehensive restructuring plan of the party and state organs, which was released in March 2018.

The National Health Commission, formerly the National Health and Family Planning Commission, merges three former departments in charge of family planning into a new Department of Population Monitoring and Family Development (人口监测与家庭发展司). The new name and functions of this department reflect the end of China's government-enforced one-child policy. Two other new organisational units within the Commission, a Department for Senior Health Services (老龄健康司) as well as a Department of Occupational Health (职业健康司), reflect the health needs of an aging society and the increased emphasis on health and safety issues at the work place.

The Ministry of Science and Technology sets up a new agency for technology transfer and regional innovation (成果转化与区域创新司). It will be responsible for promoting the integration of industry, education and research, as well as for building regional innovation systems and guiding national innovation demonstration zones and high-tech industrial zones.

The restructuring programs for other ministries and national agencies have not yet been published. A full normalization of the work at the State Council is expected by the end of this year.

Online debates express concern over CCP interference in private sector

Netzizens take a stance against diminishing role of private sector after Alibaba Group founder Jack Ma announced his plan to retire from the tech company's executive position on September 7. They speculated whether the state's tightening control of the internet industry could have been a reason for his unexpected retreat.

On September 11, an article appeared on WeChat arguing for a lesser role of the private sector. The short piece was widely viewed as a test balloon for a potential change of course in economic policy. It sparked an angry uproar on China's social media, with netizens criticizing it as diminishing the role of entrepreneurs in China's economic development.

In the controversial article, Wu Xiaoping (吴小平), a self-identified "senior finance figure," claimed that, "the private sector in China has already completed its task of assisting state sector economic development, and it should now gradually diminish in importance." The author argued that, "in a battle between superpowers, China must concentrate its financial, material, and human resources, and must follow a planned development strategy."

Reacting to the public backlash, China's Economic Daily and People's Daily published an official commentary the following day, in which the author was criticized as misrepresenting, "China's socialist economic system that pursues the development of all types of enterprises." The article was then purged from the internet.

Signaling openness to private sector concerns, China's vice-premier and President Xi Jinping's top economic advisor Liu He attended the Chinese Economists 50 Forum at the Diaoyutai State Guesthouse in Beijing on September 16. According to the South China Morning Post, he did not address the audience, which included other high-ranking government officials, but he listened attentively to the speeches by liberal economists.

Discussion about masculinity splits Chinese media

A discussion on masculinity has erupted in Chinese media and society following an article by the Chinese news agency Xinhua on September 6. The article criticized the appearance of so-called "effeminate boys" (娘炮) in the program "First School Class" (开学第一课), a back-to-school television feature, and called for an end to this "perverse culture." The article led to discussions on social media and articles published in support of and opposition to the Xinhua piece.

"First School Class" is produced by China Central Television and the Ministry of Education. Parents are encouraged to watch it with their children. The program featured a group of male singers called New F4. They appeared in the program next to other celebrities like movie star Jackie Chan and education entrepreneur Yu Minhong.

The Xinhua article criticized their appearance and said that "the impact this sick culture will have on our young generation is immeasurable." It led not only to discussions online but received pushback from other state media. A People's Daily commentary positioned itself by stating that "we disagree with the derogatory remarks of 'effeminate man' or 'neither man nor woman.'" The China Women's Daily, the paper of the Communist Party's Women's Federation, said that people should not be defined by appearances. While gender relations and aesthetics among the younger Chinese have been shifting and become more dynamic in recent years, the Communist Party remains uneasy about the tension between traditional values and tolerance for individual identities.

News in brief

- Five-year legislative plan: NPC prioritizes laws on e-commerce and foreign investment
- "Lead students to love the CCP": Xi Jinping asserts CCP influence over education
- An Enemy of the People? Ibsen play canceled in China

ECONOMY, FINANCE AND TECHNOLOGY

Beijing rushes to the rescue of HNA Group

Beijing is seeking to replace the troubled HNA group's 7.6 percent stake in Deutsche Bank with a state-owned Chinese shareholder. China's sovereign wealth fund China Investment Corp (CIC) as well as other state-backed institutions such as Citic Group and China Merchants Group have expressed interest in the shares, as was first reported by the Wall Street Journal.

Offloading its stake in the German bank is part of a larger divestment plan of HNA, which has overstretched itself in the wake of its past 50 billion USD (42.8 billion EUR) global shopping spree. The conglomerate with business activities ranging from aviation to tourism and financial services has disposed of its shares in the Hilton group and is reportedly in talks to sell further assets in the United States and Switzerland. HNA had recently come under increasing pressure from Chinese regulators who view the company as a systemic risk to the financial system.

Beijing's ability to direct economic decisions of the (privately owned) HNA group as well as its ability to rally government-affiliated players to stand ready for the company's rescue reaffirm Beijing's state-capitalist approach.

This approach will also be on display at a national conference in support of China's state-owned enterprises (SOEs), scheduled for the end of this month. Vice-premier Liu He, Beijing's top economic adviser, is expected to use the conference as a platform to endorse the central role of SOEs in promoting the country's technological leadership.

Economic data point to slower credit and investment growth

Economic data for the month of August appear to indicate that the Chinese government's deleveraging campaign is starting to show results. The campaign seeks to reduce the Chinese economy's reliance on credit and to reduce risk. If it is effective, credit growth should fall; and since credit finances investments, those should contract as well.

Overall fixed asset investment fell to the lowest level on record, growing at 5.3 percent year-on-year in August, down from 5.5 percent in July and 5.7 percent in June. This was mostly driven by a steep drop in infrastructure investment (4.2 percent yoy) and and SOE's investments (1.1 percent). Private fixed-asset investment and real estate investments both remained firm at 8.7 and 10.1 percent each.

Total credit expanded by 10.1 percent yoy, down from 10.3 in July. Loan growth remained unchanged at 12.9 percent, consumer loan growth (in large part mortgages) fell slightly from 20.9 to 20.5 percent, which means that it is still progressing at a very high speed.

So far the campaign has in large part consisted of regulation targeting the lending practices of banks and the borrowing habits of local governments. On Tuesday, the government announced it would ramp up investment in infrastructure and accelerate spending on projects that have already been approved, as the nation tries to spur economic growth.

News in brief

- Liquidity boost: Chinese central bank injects 21 billion USD
- Slowing growth: FDI to China fell to lowest level in 2.5 years in August
- Research without borders: China calls for international cooperation on Artificial Intelligence
- Deleveraging: China orders SOEs to reduce debt ratios

THE EUROPEAN VIEW

EU prepares for push to maintain influence in the Balkans

Western European politicians are rediscovering the Balkans these days. The main reason is not necessarily their own interest in the region, but China's.

In a speech on September 12, German foreign minister Heiko Maas told the Bundestag: "It's important that we offer these [Western Balkan] countries a European perspective, and a reliable one, because they're otherwise turning to other countries, such as China." In a speech on the same day, European Commission President Jean-Claude Juncker told MEPs in Strasbourg, "we must find unity when it comes to the Western Balkans - once and for all (...) should we not, our immediate neighbourhood will be shaped by others."

German chancellor Angela Merkel has also made similar statements in recent months. In an OpEd in Handelsblatt on September 17, former German foreign minister Sigmar Gabriel urged the EU to step up its game if it wanted to compete with China in its regional neighborhood.

The Western Balkans refers to Albania and the countries that were formerly part of Yugoslavia with the exception of EU members Slovenia and Croatia. According to the MERICS BRI Tracker, the EU still vastly outspends Beijing on infrastructure projects in Central and Eastern European EU member states that are part of the 16+1 format with China. In non-EU Balkan states, money from Beijing makes up a much larger proportion of infrastructure finance. In Montenegro for example, Chinese loans are roughly on par with the combined value of infrastructure funds from EU sources.

Growing investments related to China's Belt and Road Initiative (BRI) in the Balkans and throughout the EU periphery are a cause for concern for Brussels and EU member states. China's infrastructure projects are creating instability in the EU's regional neighborhood and often fail to comply with EU rules and standards. An EU strategy paper with an informal response to the BRI is due to be published this October.

MERICS analysis:

China's Europe policy poses a challenge to EU cohesion. Blog article by Jan Weidenfeld, Head of European Affairs and Business Strategy.

Belt and Road reality check: How to assess China's investment in Eastern Europe. Blog article by Thomas Eder and Jacob Mardell.

PROFILE

Daniel Yong Zhang – Alibaba's future executive chairman

The 46 year old Daniel Zhang has a problem similar to the one Apple CEO Tim Cook faced when he took over from Steve Jobs. Even primary school-age children knew his predecessor's name, but only business insiders had ever heard of him. But Alibaba's founder and executive chairman Jack Ma gives his designated successor one year to increase his name recognition. On September 10, 2019, Zhang will take Ma's place at the helm of Alibaba Group. In the online community at least Zhang is best known for his signature achievement – he is said to be the creator of Single's Day, celebrated in China on November 11 since 2009. With four times the sales size of the US equivalents Black Friday and Cyber Monday combined, it has become the world's largest retail event.

Inside Alibaba, Zhang is no newcomer. He held the position of CEO and director of Alibaba Group as well as director at Weibo since May 2015. Zhang joined Alibaba Group in 2007 and held management positions in various departments. He first acted as CFO and COO at the Ebay-like online retail platform Taobao, then as president of the business-to-customer retail platform Tmall. Under his leadership, Taobao and Tmall expanded their business models from e-commerce to cloud computing, fintech and entertainment. Prior to Alibaba, Zhang was senior manager at the auditing company Pricewaterhouse-Coopers in his hometown Shanghai from 2002 to 2005. He holds a degree in finance from the Shanghai University of Finance and Economics.

Jack Ma explained his choice of Zhang in a letter: “His analytical mind is unparalleled, he holds dear our mission and vision, he embraces responsibility with passion, and he has the guts to innovate and test creative business models.” At an Alibaba investor conference on Tuesday, Ma added: “I'm 100% sure Daniel will do a better job than I do."

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