

China: Xi-Trump Meet Eases Risks Of Trade Conflict

Establishing Positive And Constructive Tone

The leaders of the world’s two largest economies met during 7-8 Apr in the US, and largely set a positive and constructive tone for future cooperation path ahead. Indeed, at the summit Chinese President Xi Jinping invited his US counterpart President Donald Trump to make a state visit to China this year, which the US President accepted.

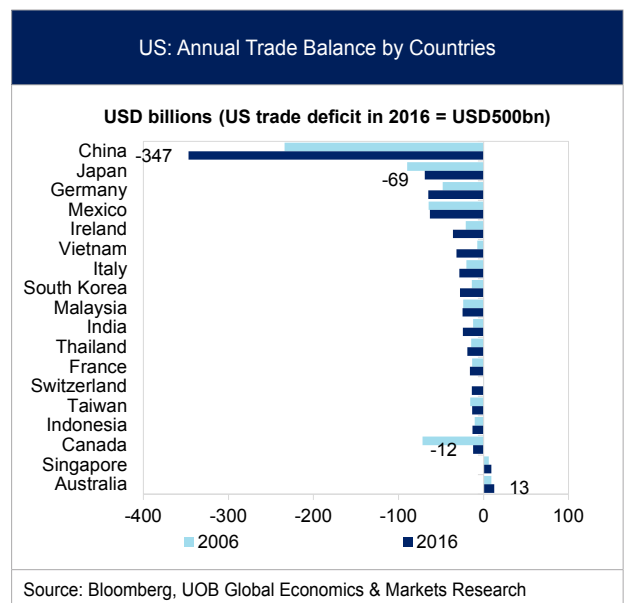
In a sign of relations warming, both sides also initiated a comprehensive economic dialogue, a diplomatic and security dialogue, a law enforcement and cybersecurity dialogue, and a social and cultural issues dialogue, which together form the four-pronged dialogue structure they established. Both sides agreed to upgrade a US-China dialogue by putting the two presidents at the head of the forum.

After the Xi-Trump summit, Chinese Foreign Ministry noted that the meeting had achieved the expected goals of enhancing understanding, building mutual trust and highlighting consensus. US Secretary of State Rex Tillerson noted the discussions as “very frank and candid” and that US President Trump and Chinese President Xi agreed to work in concert to expand areas of cooperation while managing differences based on mutual respect.”

Trade Friction And Currency Risks Lower But Still Present

While the summit was seen as a success to some extent, what is missing is the lack of a joint statement or communique from the two countries. **Nevertheless, risks of trade friction between the two countries have reduced at least for now, as both sides get down to work on a “100-day plan”** to raise US exports to China and reduce US trade deficit.

As shown in the charts, the US has been beset by trade deficits for decades that turn into a political issue, and China is the main source of that deficit.



Should there be any trade actions from the US, key Chinese exports such as mobile phones and telecoms equipment, computers and computer related products, toys, sporting goods, and apparels are particularly vulnerable given their substantial amounts, as shown in the chart.

As for the currency manipulator label – which Candidate Trump had threatened during the US presidential campaign in 2016 that he would slap on China on the first day of his presidency – there was apparently no reference of such during that meeting. **This means that the risks on exchange rate have also receded for now, but have not disappeared entirely.**

US Commerce Secretary Wilbur Ross said after the Xi-Trump meeting that the Chinese side had expressed an interest in reducing China's trade surplus as a way of controlling their own inflation and deferred the issue of "currency manipulation" to the upcoming US Treasury report which would address the issue. As such, the upcoming US Treasury Semiannual Report on International Economic and Exchange Rate Policies, due on or around 15 Apr 2017, would provide insights into how the new US government would handle exchange rate issues. Pending further developments, we maintain our USD/CNY forecasts of 7.02 for mid-2017 and 7.16 for end-2017.

Geopolitical Risks The Main Concern

While trade and currency risks appear to be easing, tension in the Korean Peninsula is the main flash point at this juncture that could create market turbulence. US President Trump is reported to be weighing on "options" to eliminate nuclear threat from North Korea. Clearly, the use of military force by the US, especially unilaterally, would drag neighbouring countries into the mix, including China, which would complicate relations between China and the US. A US carrier strike group has been reported to have changed course and sail towards the Korean Peninsula following surprise missile strikes on Syria, which suggest that the US appears to be turning aggressive in its diplomatic stance. With currency and international trade risks waning, geopolitical risks in North Asia are now a key factor for the market.

