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By Wilson Sy

A fight for love and glory

In a recent article (*A tweet is just a tweet,* September 16, 2019), we used parts of the song "As time goes by" to describe the US-China trade war. On the surface, the US-China conflict appears to be a tariff battle. However, upon closer observation, one can see that it goes beyond the trade war. The line "A fight for love and glory" from the song aptly describes Trump and Xi's battle for global supremacy. What started out as a trade skirmish now includes a technological race and a currency war. Recent developments have fuelled concerns that the dispute will now also include a capital war.

China's quest for global dominance

Below we list key initiatives undertaken by China to expand its influence and attain global supremacy.

1. **Made in China 2025.** China's comprehensive plan to upgrade its manufacturing sector also focuses on gaining global leadership in various high-tech industries by 2025.
2. **Militarization of South China Sea.** China has established military bases in man-made structures in the South China Sea. This gives China control over a major trade route and a strategic vantage point in case a war ensues. Moreover, it can provide China access to substantial oil and gas reserves which are believed to be in the seabed.
3. **One Belt, One Road.** China leads the construction of a wide infrastructure network that spans more than 150 countries. Though China offers loans to support infrastructure projects of other countries, the ultimate goal is to increase their trade volume with China and widen China's sphere of influence.

Thwarting China's global ambitions

Looking at Trump's actions, we can see that the trade war is a part of a bigger effort to impede China's growing global influence. The tariffs imposed by Trump have saddled China's export sector even as economic growth slowed to a 27-year low. Meanwhile, many analysts have said that banning American companies from selling to or purchasing from Huawei, and demands to reform intellectual property practices are meant to stifle China's goal of becoming the global leader in technology.

Trump officials mull capital restrictions on China

Last week, reports came out that the Trump administration is considering the imposition of controls on US investments in Chinese companies. One proposal is to delist Chinese firms listed in US exchanges. Another suggestion is to prohibit investments of US government pension funds in Chinese corporations. These measures were originally recommended by Republican Senator Michael Rubio and Democratic Senator Kirsten Gillibrand last June. If implemented, these will alter the composition of tracker funds, equity indices, and retirement portfolios. This will affect trillions of dollars in investments and disrupt the flow of capital globally.

The start of a capital war

Ray Dalio, the largest hedge fund manager in the world, said that current deliberations may lead to bigger moves to restrict capital flows to China. Though Trump officials have denied that they are mulling such measures, reports came out that the White House has floated an internal memo to study how the restrictions can be implemented. A full-blown capital war may prompt China to sell down its substantial holdings in US Treasuries and possibly distort global bond markets.

Historical precedents for capital and currency wars

We can look at examples in history to see what happens in a capital war. In 1941, US President Franklin Roosevelt imposed a freeze on all Japanese assets in the US, and an embargo of oil and gas exports to Japan. These actions provoked Japan into bombing Pearl Harbor.

A similar precedent is the 1985 Plaza Accord among the US, Japan, the UK, Germany, and France. It called for rigid currency controls which weakened the US dollar vs. the Japanese yen and the Deutsche mark. This resulted in an export-driven US recovery. However, the excessive strength of the yen weighed on Japan's exports and resulted in a prolonged period of deflation (The Lost Decades). China is clearly aware of these historical events and their ramifications.

China is unstoppable

A week ago, the Chinese celebrated the 70th anniversary of the People's Republic of China. They held a military parade which featured state-of-the-art weaponry including jets, tanks, supersonic drones, and intercontinental ballistic missiles. In his speech, Xi issued veiled threats to his enemies, perhaps alluding to the US. Xi proclaimed, "Today, a socialist China is standing in the east of the world and there is no force that can shake the foundation of this great nation. No force can stop the Chinese people and the Chinese nation from forging ahead."

"A case of do or die"

Despite the saber-rattling of Xi and Trump, both China and the US are clearly bleeding from self-inflicted wounds. China's economy continues to slow as its manufacturing sector contracted for the fifth straight month. Meanwhile, US manufacturing PMI came in at 47.8 for September. This is the lowest reading since March 2009 and has stoked fears that a global economic recession may be imminent.

Considering this, we are hopeful that both countries can reach a breakthrough when face-to-face negotiations resume this week. Though the battle for supremacy will likely continue, we believe that there are certain areas that both countries can agree on. For instance, China's additional purchases of US agricultural products, a pause/reversal of tariffs imposed on China, or a reprieve of the ban on Huawei transactions with American companies may be deemed as gestures of goodwill. Concessions such as these will be vital in de-escalating trade tensions which have hobbled the US, China, and the global economy. Progress in these negotiations may reverse the correction in stock markets caused by the ongoing US-China conflict.

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