

China Watch

A China Business Report prepared by David Mahon
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A u t u m n 2 0 2 6

*What makes a kingdom great,
is being like a flowing river,
the central point towards which all the smaller streams,
under Heaven converge.*

Lao Zi, fifth century BCE

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Return of the Middle Kingdom

China sits at the heart of global trade, scientific research and technological innovation. According to the most recent Pew Research survey, China is viewed more favourably than the United States in 27

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of 36 countries canvassed, a reversal of the ratio of three years ago, although this has been driven primarily by diminishing trust in the US rather than markedly improved views of China.

China has become an axial nation, more by circumstance than aspiration. Some 150 nations, developed and developing, count China as their number one trading partner. China is also close to Russia and Iran, both of which depend on it economically to a degree, but it uses its potential leverage with these nations sparingly. Beijing has benefited from the United States being distracted by multiple military entanglements — preventing it from focusing singularly on containing China — but is increasingly being forced to balance any benefits against the growing risks of escalating conflict and damage to the global economy.

For 40 years, China has striven to fulfil geopolitical and economic aims abroad primarily to ensure security and prosperity at home, but its external and domestic dynamics have profoundly changed over the

same period. China was unprepared for the increase in its economic power following the Global Financial Crisis. Great powers often accrue responsibilities as they venture beyond their immediate spheres of influence, and have obligations thrust upon them due to the unexpected demise of competitors. The radical reduction of American power is forcing China to adapt to geopolitical disruptions and power vacuums. The discreet, opaque nature of Chinese political culture inhibits its ability to communicate its intentions to other countries, often fuelling suspicion and conspiracy theories.

Chinese companies could also be more transparent with Western consumers regarding their technology by allowing third parties to verify that their software and connectivity systems are no threat. BYD could, for example, allay consumer fears that Beijing could remotely

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control their cars, or Goldwind and Envision that their wind turbines on Western horizons were capable of spying on citizens. The idea that BYD or any Chinese technology brand would destroy international markets' growing trust in their products is illogical. Chinese companies cannot afford for their

products to be Trojan horses for future interference in the economies of their trading partners. If BYD's systems were revealed to be 'spying' on their owners for nefarious ends, its brand would be destroyed in the West.

Consumers across the world have valid concerns regarding their privacy, given the continued harvest of their personal information by global brands, and exacerbated by the swift evolution of AI tools. Chinese companies and the Chinese Government are making a fair case for their good intentions in the AI sector. Their systems tend to be open-source and therefore able to be copied and adapted, facilitating greater third-party scrutiny and allowing users to set their own levels of security.

A diplomatic façade

Beijing has watched Moscow, Washington and Jerusalem initiate conflicts they had neither the strategy to wage effectively, let alone win, nor the diplomatic skill to bring to negotiated conclusions. Although President Xi has, controversially in many nations' eyes, refrained from condemning President Putin's invasion of Ukraine, he appears to have been a restraining influence behind the scenes, according to officials in

Beijing. China's role as an arbiter of compromise and peace is likely to increase.

President Xi manages to present a calm face to the world, being one of the few leaders, alongside Canada's Mark Carney and Spain's Pedro Sánchez, to stand up to Donald Trump. Armed with China's economic scale and his government's unchallenged authority to respond in kind, Xi retaliated firmly against Trump's tariffs and export controls, while largely avoiding escalation.

The uneasy entente and complex mutual economic interests that characterised US-China relations in the closing decades of the last century and the opening decade of this one have deteriorated into a façade of diplomacy, behind which conflict roils in all but its kinetic form. Many in the Chinese Government see Trump not as an aberration of American politics but as a stark manifestation of its underlying norms, where military adventure replaces diplomacy, and a missionary zeal for its own neoliberal, capitalist system and for global monopolies drives it to try to topple unco-operative foreign regimes, and bully even its closest allies.

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Today, Trump, Xi and their negotiating teams no longer acknowledge their nations were decades-long partners in one of the swiftest expansions of global trade and creations of common wealth in history. The irony of today's schism is that the US' and

China's economies are as complementary as they are competitive, and that they have more in common in principle as industrial nations than differences. Both value innovation, competition, education, domestic economic growth and stability.

Chinese people feel a mixture of anger and disappointment over the collapse of US-China relations. For years they blamed the government for screwing up such an important relationship, but now most see that the US is determined to stop China's rise. My colleagues have no illusions that, at some point, we must stabilise our relationship with the US. It is too powerful for us not to. America may think that one country must ultimately dominate the other in this rivalry. But my colleagues and I hope that post-Trump, a deal will be reached.

Beijing-based economist

The US-China summit held in September in Washington went smoothly on the surface, yet neither country met its deeper strategic and economic objectives. President Xi hoped President Trump would

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cancel his USD 14 billion arms deal with Taiwan and extend the trade truce until the end of his term, but Trump gave no undertaking regarding Taiwan and conceded a mere two-month extension to the trade truce. What remains is more of an odious

stalemate than a truce. The existing trade conflict, in which China and the US have each erected tariffs of roughly 30% on the other, beggars both nations.

Trump wanted, among other things, for Xi to guarantee reliable rare-earth supplies, support for his war with Iran and an undertaking that Beijing would play an active role in tripartite talks with Moscow to end the war in Ukraine. He received no such undertakings either. Set against China's trade surplus with the US of over USD 200 billion, and the raft of tariffs and export controls the two countries have erected against each other, the total of USD 60 billion of household and agricultural goods relieved from tariffs on both sides does not indicate a profound willingness by either party to compromise.

As long as Trump is in the White House, no nation can expect to secure lasting agreements with the US, for he lacks the integrity and, increasingly, the cognisance to act as a credible representative of his country. Even if his power is contained by the November mid-term elections, he will remain an impediment to détente and peace. Lame ducks can still quack and peck, and a lame Trump will still have the potential to act as a hungry raptor.

Triumph through acquiescence

China could achieve much in alleviating trade tensions by cutting tariffs on US goods to a minimum and loosening domestic regulations, such as by simplifying import procedures and accepting its more transparent trading partners' product standards, rather than always insisting on its own. Beijing is already reducing export tax rebates, which should go some way towards narrowing its trade surpluses. Rebates on solar panels were scrapped entirely in April, and those on batteries were cut to 6%, with full removal planned in January 2027. Beijing could also allow the renminbi to appreciate, which would lower trade surpluses further and encourage domestic spending by boosting

household purchasing power, at least to a limited degree. However, appreciation could also exacerbate the deflationary forces threatening the economy, so the People's Bank of China will need to manage exchange rates with caution.

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The three summits in 12 months and two more planned before the end of the year have encouraged some commentators to conclude that China-US relations are recovering. Any diplomatic engagement between adversaries is valuable, and the current sequence of Xi-

Trump summits is better than the alternative of anxious estrangement, which would create a greater risk of conflict or even war in Asia: one that would cost both sides dearly, and that the US would likely lose. While optimism is useful in personal interactions, it can be unhelpful and even dangerous in business and foreign affairs.

Once you have been demonised by the United States, they don't leave you alone. They still fight Russia as if the Cold War never ended, and it seems Cuba must pay forever for its revolution and the expulsion of American businesses. China failed to become like the US in the 1990s and early 2000s, so Americans and many in the West turned against us. Politicians on all sides in Washington have made China a scapegoat for America's domestic problems since. The American empire is collapsing, while becoming more and more dangerous because it still has strength.

Ningbo industrialist

ASEAN rising

President Trump appeared well disposed towards China during the summits, but as his intermittent tariff salvos, war on Iran and reactionary domestic economic policies have shown, he remains an unbalanced and corrupt leader driven by impulses of dominance, insecurity and boastfulness. His extreme and erratic reactions continue to damage all, including his own country. Trump appears constrained by a mixture of fear and awe of President Xi, while Xi humours and flatters Trump but understands his instability.

Over the past decade, Washington has failed to weaken the Chinese economy through tariffs and trading bans in technology, instead accelerating China's economic growth while slowing its own. Global South economies, such as Brazil and Mexico in Latin America, Morocco

in Africa, and ASEAN nations — particularly Vietnam, Malaysia, Thailand and Indonesia — have become direct beneficiaries of US-China estrangement.

This year, China's trade volume with ASEAN is more than double that of its trade with the US and about 40% higher than with the EU.

ASEAN nations have attracted investment and trade diverted from China while gaining a measure of geopolitical agency, as Washington and Beijing compete for their alignment. Over the coming decade, as the ASEAN economies strengthen, they may become even better equipped to resist US coercion and the dominance of Chinese companies, while perhaps gaining more leverage in negotiations with Beijing. In the short term, ASEAN's economic gains will be uneven,

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buffeted by increased exposure to Chinese overcapacity, US penalties on re-routed goods and pressure to choose sides. Most ASEAN nations have not chosen sides thus far and need not do so in the future.

With the exception of Taiwan, Japan and the Philippines, which China sees as US partners trying to contain it, Beijing is more conciliatory towards many of its Asian neighbours — even when dealing with territorial disputes — than ten years ago. This strategy may win more supporters in Asia over time, but only if Beijing is perceived as consistently less coercive than Washington.

A growth year

China's GDP is likely to expand by 4.5% this year, with exports forecast to grow roughly 25%. Beijing continues to experiment with subsidies and interest rate cuts designed to release constrained household consumption, but with mixed success, causing both domestic and foreign investors to remain cautious. The wider Chinese industrial economy is strengthening by the year as private sector investment and government policies drive the country's transition from a traditional manufacturing economy to an advanced technological one. As it achieves pre-eminence in the latter, it will likely sustain its dominance of the former, for Chinese factories already manufacture 30% of the world's goods.

China's tech competitors, particularly American AI firms, may retain their edge and create stronger global companies initially, but no other

nation is applying AI tools to their own industrial, financial and service sectors as swiftly and successfully as China.

China needs to avoid the echoes of its command-economic past. These may lead the economy to undervalue household consumption, fear capital markets' independent arbitration of value, and favour companies of scale over SMEs, all of which would drive further oversupply in trade partners' domestic markets. Domestic unemployment has not yet reached a point where policymakers believe more radical stimulus measures are needed, but they are walking a fine line. The real estate sector has not yet bottomed out in second- and third-tier cities. Despite some recovery, new technology and general manufacturing sectors are not strong enough on their own to lift wages, boost employment security and improve consumer and investor confidence.

China's priorities remain domestic stability and prosperity. Both depend on global stability. As China becomes more powerful economically, politically and militarily in the coming decade, it will need to find ways to refine its relations with great and smaller powers alike, perhaps by applying the same planning and foresight that led its largely successful domestic economic development. There are great gains to be had, but Beijing will also face unforeseen challenges. To address these, China needs to become a more ruthlessly objective student of great-power history than it has been to date. ☯