

China Watch

A China Business Report prepared by David Mahon
and the partners of Mahon China Investment Management Ltd

S p r i n g 2 0 2 5

*He who trusts to his abundance of natural virtue,
Is like an infant newly born,
Whom venomous reptiles will not sting,
Wild beasts will not seize,
Birds of prey will not strike.*

Lao Zi, 5th century BCE

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America's Cultural Revolution

Washington is abandoning its allies and neighbours, and walling in its economy, tariff-by-tariff, sanction-by-sanction. The government which came to power upon waves of popular anger and despair is destroying trade and diplomatic links daily. At the core of its actions is the deception that foreign countries are to blame for American domestic ills, and so punishing them is in the best interests of the people.

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The protection racket that now passes for international trade and political negotiations is irreparably destroying US prestige and soft power. By increasing the cost of imports and therefore prices to American consumers, Trump and his cabinet are engineering a domestic recession. Although triggered by

the stock market crash of 1929, it was the following tariff war that exacerbated and prolonged the Great Depression.

Some people will be revelling in Trump and his team of oligarchs' disruptive actions, for no other reason than their disdain for our current systems and their flaws. Those with more common sense are decrying the damage being inflicted on the global economic order and the livelihoods of ordinary people. Trump is not unique in bypassing

the rule of American law but he is unique in defying explicit court rulings, such as those against his deportations. The integrity of a democracy is not only that leaders are chosen by ballot but that those leaders are not above the rule of law. When this rule is subverted by politicians, all that remains is democracy's façade.

But demonising the United States misses the fact that Trump and his supporters only won by thin margins in last year's election. This is, and is not, the United States of America. The US' potential to recover its innate tolerance, generosity and informed leadership has not disappeared. All cultures are at risk of the power-hungry seizing

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political agency. While non-American observers may rage against the present perfidy of Washington as being exceptional, they risk missing the potential or even imminent threats of tyranny in their own countries. In this, China is no exception.

'It amuses us that so many in the United States really want to change our government and refer to Xi as a dictator, as if this is what we all want. I know we are "authoritarian" but it has been benign for some time. I know the horrors of chaotic dictatorship; my father was killed in the cultural revolution and I was brought up in poverty in western China. We should treasure the prosperity and stability of this era.'

Retired provincial official

As the US becomes more bellicose and distracted with imperial delusions, China would be wise to manifest the opposite characteristics and resist the temptation to take refuge in its own brand of nationalism and cultural exceptionalism, something it has succumbed at times to in recent decades.

'I am trying to be objective but it hard not to take some pleasure in seeing the US do such damage to itself. It has been bullying China for years. My daughter studies in Indiana; we owe America a great deal but things have gone mad. I am old enough to remember when we were mad in our own way. Perhaps this is America's cultural revolution.'

Beijing-based investment banker

Driven seemingly by an insatiable hunger for recognition, Trump will likely end up destroying as many of his own policies as those he implements. Only a minority of his often poorly conceived initiatives will have lasting impact. But in the meantime, he is distracting politicians around the world from important domestic work and is

serving as a catalyst for the fears and insecurities of tens of millions of people. In breaking trust with his allies, he is unwittingly giving greater flexibility and agency to the US' competitors and adversaries to trade outside of American spheres of influence and to form new alliances. Trump is China's unintended strategic benefactor.

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Washington cannot wage tariff wars on its major trading partners while expecting them to help it contain China and deny themselves the world's largest and fastest growing market. After three years of sanctions failing to cripple the Russian economy, which by purchasing power parity (PPP) is four times smaller than America's, it will never be able to contain, less cripple the Chinese economy, which by PPP is already 20% larger than that of the United States.

'Trump seems obsessed with two wars: the tariff war and the war in Ukraine, but we have been well prepared for economic pressure. We have already established ourselves in alternative markets and know that his actions will drive down the value of the renminbi which will be to our advantage for a while. But the greatest benefit is that much of the world will depend more on our market than the volatile US. This is also good for the Chinese economy as our policymakers will be pushed to reform this economy to sustain new alliances. As for the Ukraine war, it is hard to see how he can make peace. He does not seem to understand the conflict from any perspective and has an odd need for Putin's approval.'

Chinese professor of trade economics

Those looking for rational, conservative economic or even nationalist principles in the actions of Trump and his cohort may miss the possibility that Trump's actions are driven more simply by a desire to extract as much as possible from America's trading partners and to wreak revenge and havoc on any who resist or offend him. Whether Trump really believes that the US can annex Canada or Greenland is immaterial, because he will continue to damage the US economy and allies' trust the longer he makes such claims.

Canada and the EU are fighting back by lifting tariffs recently imposed on Chinese electric vehicles. The Australian Government is linked inextricably to Washington's regional China containment strategy, but facing 25% tariffs on Australian steel and aluminium, and probable 200% tariffs on wine and beer, Canberra may be forced to reconsider its

strategic partnership with the US. This would be a major political win for China.

A measured response

Chinese policymakers are striving to rebalance the domestic economy while strengthening the country's resilience to US attempts to slow or derail its growth. Even limited progress in these areas will make the Chinese economy more productive and competitive, and open its markets to more foreign participation.

'We don't need our economic and geopolitical choices to be defined by Washington anymore. Our best response to the US challenge is to make our own economy strong and open to trade and investment. You can see this is our strategy in the policy announcements in the recent National People's Congress. The next few years will not be easy but at least these stresses are forcing the government to make some long overdue reforms.'

Beijing policymaker

To date, Beijing has responded to increased US tariffs in a relatively measured, non-escalatory manner. While Trump and his cabinet are protesting and posturing, Xi Jinping and his cabinet are positioning China to benefit from the new order that will ensue. This is one in which the US is a weaker player, with its waning power demarcated by new alliances and trading blocs in which China will be stronger, and in many cases, the key economic arbiter. Rather than reacting to populist tantrums in Washington, the Chinese leadership appear to be pausing at each outburst and trying to assess their substance and what may be the appropriate response.

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It appears that China's strategy is to continue establishing itself as an economy of scale and stability to serve as a counterpoint to the unpredictability of the US, with its reactive tariffs, sanctions and increasingly weaponised currency.

Economic strategy

The Chinese Government set ambitious growth targets during the recent National People's Congress (NPC) in Beijing. Despite Washington's containment stance and escalation of tariffs, China has not succumbed to a siege mentality and is investing in leading sectors such as technology, renewable energy and in SMEs, while attempting to restructure embattled provincial balance sheets. Premier Li Qiang set a GDP growth target of 5% for 2025, which is ambitious but achievable. If Trump manages to apply his threatened tariffs on Chinese exports and sanctions Chinese technology companies further, China may fall short of Li's aim, but any growth over 4% this year would be healthy.

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It is problematic that Beijing has set a GDP target at all, rather than setting goals in core sectors needed to drive the economy forward. In setting a specific GDP target Beijing is demonstrating much needed confidence, but it also risks forcing local

officials to deliver macroeconomic numbers when they would be better off supporting the commercial performance of key sectors within their localities. As the private sector constitutes more than 80% of the Chinese economy by most measures – profits, tax revenue, employment and innovation – private companies often pay the price of such command-economic aims, for officials come to them demanding performance indicators that support growth data. Policy initiatives and stimulus packages announced in Beijing are paid for and implemented by the provinces, and most Chinese provinces have cashflow issues from carrying the huge costs related to the pandemic, and real estate crises. Policymakers perhaps recognised this in that the outstanding issues of welfare, pension and education reforms had only scant mention in the recent NPC. Local governments invariably pay for these.

The Chinese Government reiterated its long standing yet often misunderstood commitment to the private sector during the recent NPC, preceded a week earlier by a public meeting between President Xi and China's top tech entrepreneurs, including Alibaba's Jack Ma. The government has always been committed to the tech sector, but this was at times obscured by anti-trust measures and Beijing's attempts to manage and censor China's cyberspace. Beijing remains anxious at the unrestrained freedoms technology offers citizens, outside its guardrails and filters, some of which are prudent, but many unnecessary.

Challenges remain

For all China's strategic ambitions, the government remains tactically conservative, for there were few new radical policy announcements during the NPC, and no great stimulus packages or concessions to consumers. Premier Li acknowledged the need for government support for employment as urban unemployment has been officially 5.5% for the last 24 months, and unofficially may even have exceeded 7%.

The premier's report included indications that reserve requirement ratios in Chinese banks would drop by 0.5%, as would interest rates. He also said the government would implement new policies to assist more vulnerable citizens, such as unemployed graduates and the rural elderly, and that it would increase support to families with two or more children.

China will benefit from the realignment of the US' trading partners and adversaries, spurred by the disruptions and conflict emanating from Washington, but China's own continued rise and stability can only be ensured by deepening its domestic economic reforms. This requires Beijing to make more progress helping provinces, municipalities and counties to restructure their debts and recover their ability to generate revenues. Above all else, local officials must allow private citizens more access to capital, afflict them with far less bureaucracy, and enable greater personal economic agency.

Beijing has the understanding and tools to take the next step in liberalising local economies, yet it appears to still lack the confidence to loosen its control. This may change as it watches the unfolding chaos triggered by an intemperate president in the name of the United States of America, its greatest competitor and at-times in the past, generous partner. ☹