

China Watch

A China Business Report prepared by David Mahon
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S p r i n g 2 0 2 6

*If you know the enemy and know yourself,
you need not fear the result of a hundred battles.
If you know yourself but not the enemy,
for every victory gained you will also suffer a defeat.
If you know neither the enemy nor yourself,
you will succumb in every battle.*

Sun Zi, fifth century BCE

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Strategic non-action

China is responding to the Persian Gulf War as it did to Russia's invasion of Ukraine: with a stance of strategic non-action. President Xi Jinping apparently did not know Russia planned to invade Ukraine, but once the action had begun, took no side, passed no public judgement, maintained trade ties with both, and urged them behind closed doors to stop. China has been passive regarding the military conflict in the Gulf, but has been talking to all the regional belligerents behind the scenes. Working closely with Pakistan and using its particularly close relations with Iran, Beijing helped to mediate the US - Iranian ceasefire in recent days. But China could not restrain Israel, and

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there was not a ceasefire so much as a cessation of hostilities between the US and Iran.

Beijing will likely have emphasised to Tehran's leadership the economic damage the war has already inflicted and offered

support in reconstruction and, perhaps, post-conflict rearmament. Tehran cannot, however, have accepted the pause in fighting easily, for Israel and the US killed Iranian diplomats after Iran accepted two previous invitations to parley. Tehran will not wish to risk a temporary

peace today as long as the threat of a recurring war remains. Washington, for its part, will be sceptical of Beijing's impartiality, and while it may appear outwardly to acknowledge Iranian conditions of control of the Strait of Hormuz, security guarantees, and the lifting of all sanctions, it will not in reality. Lebanon is included in the Farsi version of the ceasefire demands, and Iran maintains the right to enrich uranium for civilian use, a point missing from the English version. In any case, the US is too committed to this folly and its economic interest in the region to withdraw now.

Israel triggered this war, knowing the US animus toward Iran, desire for leverage in the Gulf, and Trump's toxic need to demonstrate power and manipulate global markets. Israel is in fact fighting two wars: one to disable Iran's military and civilian infrastructure, and the other to expand its borders north into Lebanon while consolidating gains in Gaza and the West Bank. The US, for its role, has already sown the seeds of decades of deadly reprisals: a future series of perhaps lesser, but no less deadly, September 11ths.

In the past, China has taken on a passive but still influential role in dispute resolutions, as opposed to the US' proactive 'Camp David' approach, in which US presidents would use military might and economic incentives as diplomatic leverage, shuttling between adversaries for firm, swift outcomes. Where Washington coerces, Beijing facilitates. Indeed, Beijing facilitated the Saudi-Iranian security agreement in April 2001.

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Although it weakens the US' ability to contain China, Beijing does not welcome the current war, for China depends on unimpeded flows of global trade, especially through potential choke points such as the

Strait of Hormuz. China will nevertheless benefit in the medium term as it did after the Iraq War. It is now the major buyer of the oil so coveted by the US and its allies, and the control of which was one of the prime motives for their invasion of Iraq in 2003. China is also best placed to rebuild shattered Middle Eastern infrastructure once this Persian Gulf War ends.

Who benefits?

With each missile fired and each bombing run, Donald Trump is handing China military advantage in Asia. Washington is expending its military arsenal profligately, while redeploying missiles, missile defence systems, warships and marines away from China's borders to the Persian Gulf. It will take the US years to replenish its arsenals, while China will continue to expand its own. Multiple Pentagon war games have forecasted China's ability to resist US attempts to garrison Taiwan or strike Chinese bases in the South China Sea, and to even damage America seriously in a limited naval conflict, but the US remains and will remain the largest military force in the region for years to come.

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China has already won the struggle for economic primacy in Asia, and it has no intention of being drawn into war while it consolidates its regional economic influence. This is not only because such adventurism is inimical to it, but also because China knows its limitations. It prefers trade agreements to

political treaties, demonstrated by its Treaty of Good-Neighbourliness and Friendly Cooperation with Russia, which essentially states that China and Russia will not attack each other, but not that they will defend each other. It has one formal treaty with North Korea, a loose, mutual commitment of one to protect the other if attacked. Viewing alliances as dangerous political and military tethers, and often a historical cause rather than restraint on war, Beijing is one of the world's least allied nations. Another such nation is India.

The US is reacting to the loss of its empire and primacy across the globe by attacking cities in nations posing it no threat, spawning anarchy and imposing arbitrary sanctions and tariffs, while China is building its domestic economy and extending commercial and diplomatic influence steadily. Trump's largely amateur cabinet is alienating the US' beleaguered allies, and in doing so, weakening the economic and military coalition its predecessors had striven over decades to construct in order to contain China's rise. The United States will still remain a global economic and military power for the foreseeable future, and rather than replacing the US, China will slip into an uneasy equilibrium, sharing complex multipolarity with India and Russia, and acting as the steadier economic player.

Empires of the mind

US and Western soft power is embedded across Asia, which acknowledges the West's education, cultures, brands, entertainment, and much of the anglophone internet, and tries to emulate core aspects of Western institutions, including its civil and economic management and governance. China has its Belt and Road initiative, the largest developmental-credit endeavour undertaken by a sovereign nation in modern history. It has facilitated infrastructure and utilities, and generated greater trade, spawning economic growth and common wealth in Africa, South America and Southeast Asia, and establishing Chinese prestige while also creating degrees of obligation and dependence. China has yet to match the soft power of the West, or even

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the regional soft power generated by the popular cultures of its neighbours Japan, South Korea and to a lesser extent, India. The combined yin and yang of soft and hard power form the complete, enduring power that sustains nations' pre-eminence over generations, even centuries.

China's strength is its scale, its ability to plan and organise, the industry and endurance of its people, and also its geographical and relative political isolation. China is hard to attack and impossible to invade, let alone control. China's political isolation is also a disadvantage, for it has no great-power partners; in fact, apart from Russia, it often counts India, the US and the EU as adversaries. Where in previous centuries Chinese creativity, culture and civil institutions attracted it friends, today more nations and individuals seek the material and transactional benefits of dealing with China.

Hard power often comes from the barrel of a gun, while soft power flows from the endeavours of exceptional people — creating art, innovating, and directing scientific endeavours and enquiry into the self — unencumbered by government control. The American Empire seems committed to its own destruction, but it will take more than a few unbalanced presidents to diminish its soft power significantly. The British Empire unravelled swiftly after the Second World War, but Britain still projects soft power in language and culture eight decades later. China will enhance its comprehensive, lasting global influence when the government coerces and curates its society less, and rather than focusing on projects to grow soft power, allows it to emanate spontaneously. This will flow not only from China's contemporary popular and modern classical culture, but from unlocking thousands of

years of accrued civil, educational, creative, and metaphysical understanding.

American Caligula

In the Persian Gulf, Trump hoped, just as Putin did initially in Ukraine, that a short military campaign would secure territorial control and resources, allowing the more powerful nation to then sue for peace with a broken, humbled foe. After four years, Russia has failed to defeat Ukraine or end the war, despite its overwhelming advantage in military and human resources. After unleashing a localised armageddon, Israel is still struggling to drive Hamas out of one city in Palestine. Having forgotten the defeats of Vietnam, Iraq and Afghanistan, and seemingly incapable of learning from deeper history, Trump and his coterie cannot reflect upon yesterday's events, let alone last year's largely ineffectual strikes on Iran.

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By launching a war he cannot fight effectively or finish, and through the closure of the Strait of Hormuz and provocation of Iranian retaliatory strikes on the US' bases in the Gulf States, Trump has wrought economic chaos on the world. Like the first-century Roman Emperor Caligula, Trump engages in military adventures abroad in

part to distract the people from his economic and political incompetence and personal scandals at home. He is surrounded by men informed by distorted Christian and Rabbinic theology and who manipulate him through fawning displays of admiration and support. For Trump, the conflict with Iran is largely a performative war, undertaken to demonstrate his personal power and feed his vainglory, with little consideration for strategic objectives or humanitarian cost. Caligula allegedly appointed his horse to the Roman Senate; Trump has gone further and surrounded himself with a cabinet-coffle of asses.

Wars without cause, wars without end

The Chinese economy has been affected deeply by America and Israel's attack on Iran and this will continue. While China has oil reserves speculated to exceed 260 million tonnes and large, unknown stores of fertiliser, grain and other essentials, Beijing cannot afford to deplete them significantly as they are intended to be strategic assets in the event of direct attack or domestic natural disaster. Because belligerents

in the Persian Gulf War lack viable off-ramps, despite any 'ceasefires,' the conflict and its disruption will likely continue in some form for months.

The Chinese Government is already capping fuel prices to avoid the impact on the wider economy, but will subsidise gasoline and diesel prices soon and may impose carless days. The Chinese Ministry of Finance has been vigilant in controlling inflation, particularly food prices. It has been grappling with deep deflationary trends in the pork, beef and dairy sectors due to the rapid spread of scale farming in recent years, a significant part of which has been state-backed to increase food self-sufficiency. Chinese food companies and firms in many key sectors have slim margins with which to adjust to inflation accelerated by the war.

Although Chinese ships are able to pass through the Strait of Hormuz unmolested, as with all economies, China will struggle to sustain imports of petroleum and petroleum-derived products due to the destruction of processing capacity in the region. China will also suffer from falling demand in the damaged economies of its trading partners, while at the same time needing to pay more for imports of a wide range of goods and components. Commentators have focused primarily on the disruption of the supply of oil from the Persian Gulf for energy generation and its cost to the global economy. Equally important is that petroleum products are used to make plastic and other synthetic materials, helium for microchips, and material for fertilisers such as urea ammonium nitrate. Another 12 weeks of war will likely trigger famine in developing countries and potential widespread undernourishment of the poor in the West.

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Not since the immediate aftermath of the Second World War or the 1970s oil crisis have leading economies been so burdened by debt and deficits at a time when solvency was needed to mitigate the impact of external shocks. China's long-term strategic policies, such as its rapid transition to renewable energy and electric vehicles, and

its history of positive relations with non-North American oil producers, will help cushion it from some of the deeper impacts of fuel inflation. China's nearly USD 1.5 trillion trade surplus and USD 3.4 trillion foreign exchange reserves will also help it to endure this phase of global instability better than most. Non-US trading and currency

coalitions, such as BRICS, will unify and continue to expand to become arbiters of global trade.

With the US behaving increasingly as a rogue actor internationally, Western nations are forced to reassess whether siding with Washington on issues of security and war is strategically prudent, economically wise, or even moral. Some continue to do so directly or tacitly: the EU out of Russophobia, and the UK and Australia, through AUKUS, out of a fear of abandonment and loss of reflected power. Canada and the BRICS nations provide a different template; having taken firm stands against the war and American bullying, while exploring deeper economic ties with Beijing. As long as China presents itself as a counterpoint of stability, more and more nations will gravitate towards it. When caught in a leaking, storm-tossed vessel, it is better to be the passenger disembarking early, than the one swimming frantically from the sinking wreckage. ☯