US and China: The odd couple, decoupled

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The US and China are growing apart by the day, and whether Trump or Biden is in the White House come January may make no difference. What does this mean for financial institutions everywhere?

In March 2001, America's hawkish defence secretary Donald Rumsfeld handed a report to George W Bush. It urged the new US president to see not Russia but China as the primary threat, and to redeploy more military resources to Asia.

Doing so would have altered history, but that had other plans. The September 11 attacks redirected Washington's gaze from Beijing to west Asia. Three months after that, China joined the World Trade Organization and began its rise to become a trading superpower.

For 15 years, relations between the two powers were mostly cordial. Then Donald Trump came to power.

By now, America's 45th president's act is a known quantity. There is a lot of huffing and puffing, but most of it is hot air.

Except when it comes to China.

On the campaign trail, Trump accused Beijing of currency manipulation, stealing intellectual property and being “neither an ally or a friend” to America.

After the election, he dialled up the narrative, appointing Peter Navarro, author of ‘Death by China’, as his trade adviser. Later, he installed secretary of state Mike Pompeo and commerce secretary Wilbur Ross, China hawks both.

A trade war followed, then sanctions. Washington imposed tariffs of $360 billion on Chinese goods; Beijing retaliated with $110 billion in tariffs on US products.

All of that, it seems, was just a warm-up.

Trump banned smartphone firm Huawei from buying US semiconductors; in August, the firm said it was running short of processor chips. He then slapped sanctions on officials in Hong Kong and Xinjiang.

Beijing scoffed, but its banks didn’t. Terrified of being cut out of the dollar-funded financial system, lenders including Bank of China and China Construction Bank (CCB) are reportedly weighing up whether to do business with the officials.

Continuous hits

And the hits keep coming. Over the summer, as Covid cases continued intermittently to spike, the White House zeroed in on the financial markets.

On August 6, the president's working group on financial markets – a set of powerful US regulators – said firms might need to de-list from US bourses by January 2022 if they do not provide access to their audit papers.

China is the only nation named in the report, and it follows a host of accounting scandals involving US-listed mainland firms, including Luckin Coffee.

On August 19, the US state department told American colleges and universities to sell any holdings of Chinese securities in their endowments.

It said all endowments, whose total market value is more than $600 billion, had a "moral obligation and perhaps a fiduciary duty" to manage "clean investments and clean endowment funds", a phrase it left vague – perhaps intentionally so.

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>
> \- Anonymous

There are some who dismiss this is as grandstanding, noting the rise in rhetoric in the lead-up to the Republican Party's convention, taking place now.

But this ignores Trump's record on China. He targets its frailties with laser precision. Beijing has to import high-end semiconductors, so he cuts off that source. China is more dependent on trade with the US than vice versa, so hits that, too.

The same is true with those sanctions. No bank, even one run by Beijing, wants to be unable to raise money and lend in US dollars. Until the renminbi is a strong international currency, that will also be an Achilles heels.

"The folks advising the White House on China are very smart," says Tony Nash, a former adviser to think tanks in Washington and Beijing, and founder and CEO of Complete Intelligence, an artificial intelligence and data analytics platform. "The bumbling act is not the reality. These people really know where its pain points are."

Future flux

The future is in a state of flux and impossible to know, but a few thoughts occur.

Some level of US-China decoupling is inevitable. Firms are relocating factories from China to southeast Asia. Japan has set aside $2.2 billion to aid re-shoring.

Whoever is in the White House on January 20, rapprochement is unlikely. Relations between the two will be chilly if it's Joe Biden or frosty if it's Trump.

More Chinese firms will list in Hong Kong and on Shanghai's Nasdaq-style Star Market, but not all will abandon the US, which offers capital, specialist investors and a chance to get personal wealth far from Beijing's prying eyes. On August 10, wealth management portal Lufax filed to raise up to $3 billion in a US IPO by year's end.

Will the two countries financially decouple? That is far harder to answer. China will surely seek to make the RMB more globally relevant.

Trump may twist the arm of a few college endowments, but it is hard to see big institutional investors dumping their mainland holdings, experts say.

If anything, the financial rapport between the two is closer than ever. US investment banks are lining up to buy a majority stake in their China joint ventures. On Monday, China's banking regulator, the CBIRC, approved a wealth management joint venture owned by BlackRock, CCB and Singapore's Temasek.

Beijing, desperate for fresh sources of capital and for better capital markets, has a few options on the table.

"The brilliant move would be to open its stock markets completely to foreign investors," says one US-based lawyer. "That would make the Nasdaq and NYSE less relevant, which is exactly what the Chinese want."

Either way, after decades of bumping along in a relationship more co-dependent than harmonious, the world's two great powers seem set to grow apart for good. Who knows if it's what Trump wants, but it's what he's going to get.

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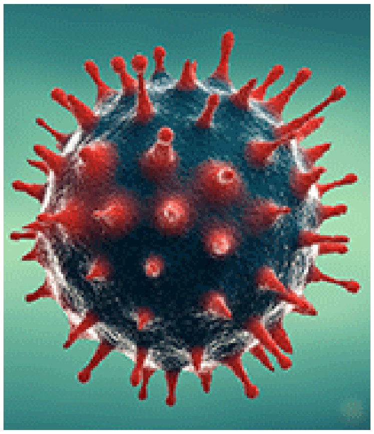

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