Greater China — Week in Review

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Highlights: Trade war 2.0: this time could be different

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During last week's market outlook seminar in Singapore, I conducted a survey with hundreds of our clients asking whether China would react differently to the impending Trade War 2.0. Most of our clients believed it would, though they were uncertain about how this response might differ. I share their view, albeit with some caveats regarding the likely approach.

When it comes to Trump's trade policies, there are both "knowns" and "unknowns." The "known" is that higher tariffs are a near certainty under his administration. The "unknowns" center around the implementation and strategic objectives of these tariffs.

In 2017–2018, Trump's trade war with China primarily served as a negotiating tool to boost U.S. agricultural exports, targeting swing-state voters. In 2024, however, having already secured both the electoral and popular vote victories, the objectives of Trade War 2.0 remain unclear. With no immediate political pressures, the motivations behind escalating tariffs are ambiguous.

During Trade War 1.0, China adopted a "trading time for space" strategy, offering concessions to mitigate Trump's intentions. However, in Trade War 2.0, with uncertain U.S. objectives and a clear willingness to employ tariffs, this approach may no longer be effective. **Instead, China may target Trump's capacity to wage a prolonged trade war, with U.S. inflation emerging as a critical vulnerability.**

Recent Reuters/Ipsos poll shows inflation is the top concern for 35% of American voters during Trump's first 100 days in office, far exceeding trade and tariffs (1%). While some economists argue that tariffs have minimal inflationary impact due to currency depreciation and subsidies offsetting costs, China could exploit inflation as a pressure point.

If China actively induces inflation, it could inflict considerable economic pressure on the Trump administration. A 60% tariff that fails to significantly impact U.S. inflation would validate Trump's tariff strategy, potentially encouraging further tariff hikes and triggering a destabilizing spiral.

Notably, China's Ministry of Finance announced on 15 November the removal or reduction of export tax rebates for certain goods. This policy shift could mark the beginning of a new strategy in trade wars, signaling China's willingness to adapt its approach.

We believe China's response could focus on two key areas: expanding domestic demand and reducing subsidies for overseas consumers. The competition between China and the U.S. has reached a point of no return, effectively

becoming a contest of economic development models. Sustained domestic economic growth will be critical for long-term competitiveness.

In the near term, targeting U.S. inflation could prove to be an effective countermeasure. By exporting inflation, China could directly impact U.S. consumers and businesses, applying political and economic pressure on the Trump administration. This shift suggests that the era of subsidizing overseas consumers through fiscal tools is nearing an end.

The prevailing market consensus anticipates significant RMB depreciation during an intensified trade war, with some forecasts suggesting USDCNY could reach 8. However, RMB depreciation effectively subsidizes U.S. consumers by offsetting the inflationary effects of tariffs. This dynamic undermines the strategic value of tariffs and reduces China's leverage.

A stable RMB might better serve China's interests in Trade War 2.0 by preserving its ability to export inflation while minimizing domestic economic disruptions. However, exporting inflation would likely create global ripple effects, exacerbating challenges for other economies and heightening market volatility.

As the year-end approaches, Hong Kong dollar liquidity has yet to tighten to the extent that was expected, conceivably due to weak asset market sentiment and loan demands. Nonetheless, there is no shortage of fund-raising activities, which should put a floor to HIBORs. Near term fund-raising activities include SF Holding's IPO (expected to raise HK$6.2 billion), and Alibaba's US$5 billion dual-currency bond issuance.

Hong Kong's labour market still leaned towards the tight side, despite marginal increase in unemployment rate. The seasonally adjusted unemployment rate inched up by 0.1 percentage point to 3.1% in August-October 2024, while underemployment rate edged down to 1.1%. We expect to see further weakening of job market in retail sales and trade related sectors further down the road, albeit only mildly.

Macau's real GDP rose by a notably slower pace of 4.7% YoY in the third quarter this year (2Q: 7.7% YoY), dragged by the moderated growth in exports of services. During the quarter, both external and domestic demand expanded further, but at decelerated pace of 4.7% YoY and 4.6% YoY respectively (2Q: 17.3% YoY and 1.0% YoY). In the first three quarters this year, Macau's GDP grew by 11.5% YoY, rebounding to around 85.9% of the pre-pandemic level in 2019.

The weakening of growth momentum was quite broad based. Growth of exports of gaming services moderated to 11.2% YoY (2Q: 21.5% YoY), while exports of other tourism services declined further by 14.5% YoY (2Q: -13.4% YoY). Taken together, exports of services grew by a much slower pace of 1.3% YoY in 3Q (2Q: 6.2% YoY). On domestic front, the private consumption expenditure recorded modest gain at 1.9% YoY (2Q: 4.3% YoY), as the base of comparison normalised. Nonetheless, growth of gross fixed capital formation picked up to 14.7% YoY (2Q: 1.6% YoY), as private sector stepped up investment.

Growth is likely to slow further in the remainder of this year, given the tighter scrutiny over gaming activities, still-weak macroeconomic backdrop in China and

the high base effect. We revised our full-year growth forecast down to 9% YoY, from the previous estimate of 11% YoY.

Separately, local government announced to carry over the wealth partaking scheme and pension fund cash injection program to the next fiscal year, alongside with the extension of existing subsidies, tax breaks and fee waivers. Specifically, cash handout of MOP10,000/ MOP6,000 will be given to each permanent/non-permanent resident, alongside MOP7,000 cash injection into eligible applicants' Central Provident Fund accounts.

Key Developments	
Facts	**OCBC Opinions**
▪ China's finance ministry said on 15 Nov it would reduce or cancel export tax rebates for a wide range of commodities and other products, effective Dec. 1. ▪ The country will reduce the export tax rebate rate for some refined oil products, photovoltaics, batteries, and certain non-metallic mineral products from 13% to 9%. ▪ It will also cancel the rebate for aluminum and copper products and chemically modified animal, plant, or microbial oils and fats.	▪ We believe China's response could focus on two key areas: expanding domestic demand and reducing subsidies for overseas consumers. The competition between China and the U.S. has reached a point of no return, effectively becoming a contest of economic development models. Sustained domestic economic growth will be critical for long-term competitiveness. ▪ In the near term, targeting U.S. inflation could prove to be an effective countermeasure. By exporting inflation, China could directly impact U.S. consumers and businesses, applying political and economic pressure on the Trump administration. This shift suggests that the era of subsidizing overseas consumers through fiscal tools is nearing an end. ▪ The prevailing market consensus anticipates significant RMB depreciation during an intensified trade war, with some forecasts suggesting USDCNY could reach 8. However, RMB depreciation effectively subsidizes U.S. consumers by offsetting the inflationary effects of tariffs. This dynamic undermines the strategic value of tariffs and reduces China's leverage. ▪ A stable RMB might better serve China's interests in Trade War 2.0 by preserving its ability to export inflation while minimizing domestic economic disruptions. However, exporting inflation would likely create global ripple effects, exacerbating challenges for other economies and heightening market volatility.

Key Economic News	
Facts	**OCBC Opinions**
▪ Hong Kong: Labour market still leaned toward the tight side, despite marginal increase in unemployment rate. The seasonally adjusted unemployment rate inched up by 0.1 percentage point to 3.1% in August-October 2024, while underemployment rate edged down to 1.1%.	▪ Compared to July-September period, Hong Kong's unemployed person went up by 0.7% (or 0.8k) in August-October, while total labour force fell by 0.1% (or -2.2k). Breaking down, unemployment rate in "import/export trade and wholesale" and "manufacturing" sectors rose the most, by 0.2 percentage point. Meanwhile, unemployment rates in most of the other sectors also inched up. ▪ We expect to see further weakening of job market in retail sales and trade related sectors further down the road, albeit only mildly.
▪ Hong Kong: As the low base effect dissipated, composite CPI rose by a much slower pace of 1.4% YoY in October 2024 (2.2% in September). The low base effect was the result of end of rates concession and the waiver of the extra public housing rent payable in the third quarter last year. On sequential basis, the composite CPI edged up by 0.2% MoM.	▪ Breaking down, month-on-month increases in prices were recorded across board in October, except for food (-0.1% MoM). Separately, underlying CPI (netting out the effect of government one-off relief measures) rose by an accelerated pace of 1.2% YoY in October 2024, due to upward adjustment in public housing rentals. ▪ In the first 10 months this year, composite CPI rose by an average 1.8% YoY, while underlying CPI rose by a milder 1.0% YoY. We revised downward the full-year inflation forecast from 1.9% to 1.7%, and forecast inflation rate in 2025 at 2.0%, on higher rent,

	services and utility charges.
▪ Macau's real GDP rose by a notably slower pace of 4.7% YoY in the third quarter this year (2Q: 7.7% YoY), dragged by the moderated growth in exports of services. During the quarter, both external and domestic demand expanded further, but at decelerated pace of 4.7% YoY and 4.6% YoY respectively (2Q: 17.3% YoY and 1.0% YoY). In the first three quarters this year, Macau's GDP grew by 11.5% YoY, rebounding to around 85.9% of the pre-pandemic level in 2019.	▪ The weakening of growth momentum was quite broad based. Growth of exports of gaming services moderated to 11.2% YoY (2Q: 21.5% YoY), while exports of other tourism services declined further by 14.5% YoY (2Q: -13.4% YoY). Taken together, exports of services grew by a much slower pace of 1.3% YoY in 3Q (2Q: 6.2% YoY). On domestic front, the private consumption expenditure recorded modest gain at 1.9% YoY (2Q: 4.3% YoY), as the base of comparison normalised. Nonetheless, growth of gross fixed capital formation picked up to 14.7% YoY (2Q: 1.6% YoY), as private sector stepped up investment. ▪ Growth is likely to slow further in the remainder of this year, given the tighter scrutiny over gaming activities, still-weak macroeconomic backdrop in China and the high base effect. We revised our full-year growth forecast down to 9% YoY, from the previous estimate of 11% YoY. ▪ Separately, local government announced to carry over the wealth partaking scheme and pension fund cash injection program to the next fiscal year, alongside with the extension of existing subsidies, tax breaks and fee waivers. Specifically, cash handout of MOP10,000/ MOP6,000 will be given to each permanent/non-permanent resident, alongside MOP7,000 cash injection into eligible applicants' Central Provident Fund accounts.

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