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The Impact of U.S./China Trade Friction

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Mizuho Bank, Ltd. China Business Promotion Department

Mizuho Bank (China), Ltd. Advisory Department

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- Executive Summary -

China's Economy	Business Opportunities for Foreign Joint-venture Securities Companies

The ratio of foreign capital contribution for foreign joint-venture securities companies was raised 51% in April 2018, and the limit to business activities was abolished, allowing such companies to enter the market with the same conditions as domestic securities companies in China. In reaction to this, the media reported that new joint-venture securities companies are being established with foreign capital accounting for the majority, while the ratio of foreign capital contribution for existing companies is being raised. Furthermore, thanks to recent innovation in the Chinese securities industry, the revenue structure for Chinese securities companies is changing. In the times ahead, it will be possible for foreign joint-venture securities companies to carry out diverse business activities, and they are expected to improve their business performance using their management expertise.

News from the China Advisory Department	The Impact of U.S./China Trade Frictions

U.S./China trade frictions are dragging on with no end in sight. The dispute is starting to resemble a hegemonic battle over high-tech products and other cutting-edge technologies. This article looks at the impact of these frictions on Japanese firms operating in China, based on the results of a survey of such firms.

Business Opportunities for Foreign Joint-venture Securities Companies

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In November 2017, the Chinese government raised the upper limit of the ratio of foreign capital contribution for securities companies, fund companies, and futures companies to 51%, while also releasing a roadmap for the deregulation on foreign capital in the financial sector, such as the abolition of the limit of the ratio of foreign capital contribution in three years. Furthermore, in April 2018, the China Securities Regulatory Commission (CSRC) announced "Administrative Measures for Foreign-Invested Securities Companies" clarifying its principle of deregulation regarding foreign joint-venture securities companies by raising the ratio of foreign capital contribution as well as an abolition of the limit on business activities. At this occasion, this article will overview the deregulation process and the business performance of foreign joint-venture securities companies in order to examine business opportunities for foreign joint-venture securities companies after the deregulation through the recent innovation in the Chinese securities industry that brought changes to the revenue structure of Chinese securities companies.

1. Deregulation of joint-venture securities companies

Figure 1 shows a summary of the history related to the establishment of foreign joint-venture securities companies. Until 2000, foreign capital contribution to securities companies was approved individually, but the system was deregulated in three steps thereafter.

Figure 1: History related to the establishment of foreign joint-venture securities companies

	From 2001 to 2011	From 2012 to 2016	In and after 2017
Deregulation	• Dec. 2001: China joined the WTO. • Jul. 2002: Regulation on the establishment of foreign joint-venture companies became effective. The ratio of foreign capital contribution was limited to one third, and business activities were limited. • Jun. 2003: The Closer Economic Partnership Arrangement (CEPA) was concluded between Mainland China and Hong Kong, or Macao. • Sep. 2010: The Cross-Strait Economic Cooperation Framework Agreement (ECFA) was concluded between Mainland China and Taiwan.	• Jun. 2012: The ninth supplementary agreement for the CEPA was concluded. • Oct. 2012: The regulations for the establishment of foreign joint-venture were revised, raising the upper limit of the ratio of foreign capital contribution to 49% with continued limitation on business activities by joint-venture companies. • Jun. 2013: The "Cross-Strait Service Trade Agreement" was concluded. • Aug. 2013: The 10th supplementary agreement of the CEPA was concluded. • Dec. 2014: The CEPA Guangdong agreement was concluded. • Oct. 2015: The promotion plan for the Shanghai Pilot Free Trade Zone was released. • Nov. 2015: The CEPA Service Trade Agreement was concluded.	• Jan. 2017: The State Council announced the expansion of the liberal market and measures to promote the active use of foreign capital. • Nov. 2017: The State Council released a roadmap for deregulation related to foreign joint-venture securities companies. • Apr. 2018: The upper limit of the ratio of foreign capital contribution was raised to 51%, with deregulation on the limited business activities for foreign joint-venture securities companies.

	From 2001 to 2011	From 2012 to 2016	In and after 2017
Participation of foreign companies	• Jan. 2002: The BOCI entered the market (BOC International (China)). • Mar. 2003: BNP Paribas entered the market (Changjiang BNP Paribas Peregrine Securities). • Mar. 2003: CLSA entered the market (China Euro Securities, after which the company name was changed to Fortune CLSA Securities). • Sep. 2004: Daiwa Securities entered the market (Daiwa SMBC-SSC Securities). • Dec. 2004: Goldman Sachs entered the market (Goldman Sachs Gao Hua Securities). • Dec. 2006: UBS entered the market (UBS Securities). • Oct. 2008: Credit Suisse entered the market (Credit Suisse Founder Securities). • Jul. 2009: Deutsche Bank entered the market (Zhong De Securities). • Apr. 2011: RBS entered the market (Huaying Securities). • Jun. 2011: J.P. Morgan entered the market (J.P. Morgan First Capital Securities). • Jul. 2011: Morgan Stanley entered the market (Morgan Stanley Huaxin Securities).	• Aug. 2012: Citigroup entered the market (Citi Orient Securities). • Jul. 2013: CLSA Limited entered the market (Fortune CLSA Securities, transferred from the CLSA). • Since 2015, many foreign companies applied to establish a joint-venture company via the CEPA scheme. • Sep. 2016: Mason Financial Holdings, etc., entered the market (Shengang Securities). • Nov. 2016: Maxson Securities entered the market (Huajing Securities).	• Jun. 2017: HSBC entered the market (HSBC Qianhai Securities). The Bank of East Asia entered the market (East Asia Qianhai Securities). • May 2018: Nomura Holding and J.P. Morgan applied to newly establish a joint-venture securities company. • Nov. 2018: Daiwa Securities concluded a memorandum with a Chinese company in order to newly establish a joint-venture securities company. • Dec. 2018: UBS obtained an approval to contribute 51% of capital (UBS Securities).
Withdrawal of foreign companies	• Jan. 2007: BNP Paribas withdrew from the market (Changjiang BNP Paribas Peregrine Securities Co. Limited). • Dec. 2010: Morgan Stanley sold its holdings to TGP and KKR, etc. (China International Capital Corporation Limited).	• Aug. 2014: Daiwa Securities withdrew from the market (Daiwa SMBC-SSC Securities). • Aug. 2014: CLSA Limited withdrew from the market (Fortune CLSA Securities).	• Jul. 2017: J.P. Morgan withdrew from the market (J.P. Morgan First Capital Securities Co., Ltd). • Sep. 2017: RBS withdrew from the market (Huaying Securities Co., Ltd.). • Dec. 2018: Citigroup announced its plan to transfer its holdings of Citi Orient Securities.

Source: Research by the author

From 2001 to 2011, it was possible for foreign capital joint-venture securities companies to be established, as China joined the WTO. However, the ratio of foreign capital contribution was capped to one third of the total capital and at least one stock holding company in China needed to be a securities company. Furthermore, the business activities of joint-venture securities companies were in principle limited to underwriting, sponsoring, the brokerage of bonds, and foreign stocks, as well as the self-dealing of bonds, while the brokerage business for A-stocks was prohibited. During this period, 11 foreign joint-venture securities companies were established.

From 2012 to 2016, there was some deregulation on foreign joint-venture securities companies. In 2012, the upper limit of the ratio of foreign capital contribution was raised to 49%. In 2013, it was made possible to raise the ratio of foreign capital contribution to 51% and to establish a fully licensed joint-venture securities company in Shanghai, Guangdong, and Shenzhen for financial institutions in Hong Kong and Macao based on the 10th supplementary agreement of the CEPA (Closer Economic Partnership Arrangement between Mainland China and Hong Kong, or Macau), as well as in Shanghai, Fujian Province, and Shenzhen for financial institutions in Taiwan based on the Cross-Strait Service Trade Agreement (Trade Agreement). Furthermore, it was no longer obligatory to have at least one securities company as a stockholder in China. During this period, three foreign joint-venture securities companies were established. It should

also be mentioned that, since 2016, multiple foreign joint-venture securities companies have applied to establish a company using the supplementary agreements of the CEPA, as well as the Trade Agreement scheme, and are waiting for the approval of the CSRC.

Since 2017, the Chinese government announced its plan to expand the liberal market. In November 2017, the upper limit of the ratio of foreign capital contribution was raised to 51%, while a roadmap was released to announce that the limitation on foreign capital contribution would be entirely abolished in three years after the raising of the upper limit, allowing securities companies entirely based on foreign capital to be established. Based on this roadmap, the CSRC officially released "Administrative Measures for Foreign-Invested Securities Companies" in April 2018, abolishing the limit on the business activities of foreign joint-venture securities companies while also lifting the condition that at least one stockholder in China must be a securities company. In addition, it was announced that based on the principle of liberalization of Chinese securities companies, the upper limit of the ratio of foreign capital contribution for securities companies would be raised to 51% until 2020, after which it would be possible for foreign capital to account for 100%. In reaction to this, foreign companies started to plan the establishment of joint-venture securities companies by contributing 51% of the total capital or to raise the ratio of capital contribution. Nomura Holdings and J.P. Morgan both applied to the CSRC in May 2018 to establish a new joint-venture securities company. Daiwa Securities Co., Ltd. concluded a memorandum with an asset management company in Beijing regarding the establishment of a new joint-venture securities company in November 2018. In December 2018, the application by USB to raise its capital contribution to a joint-venture securities company (UBS Securities) to 51% was approved by the CSRC.

Thus far, a total of 18 foreign joint-venture securities companies have been established, including China International Capital Corporation Limited, Everbright Securities Company Limited, and BOC International (China) Limited, which were established prior to 2001. However, due to poor business performance, five foreign stockholders have withdrawn their capital. As of the end of 2018, there are 13 foreign joint-venture securities companies (Fig. 2).

Figure 2: Current situation of foreign joint-venture securities companies

	Name of the joint-venture company	Ratio of foreign capital contribution (as of the end of December 2017)	Major business activities by foreign joint-venture securities companies (a: possible to enter the market, b: possible to enter the market with condition, c: impossible to enter the market)						Notes
			Underwriting and sponsoring	Financial advisory	Asset management	Brokerage	Self-dealing	Securities investment consulting	
1	China International Capital Corporation (CICC)	GIC (5.48%), etc.	a	a	a	a	a	a	

2	Everbright Securities Company	China Everbright Ltd. (23.30%)	a	a	a	a	a	a	As China Everbright Ltd. is a Hong Kong subsidiary of China Everbright Group, Everbright Securities Company Limited is virtually a company based on Chinese capital.
3	BOC International (China)	BOC International Holdings (37.14%)	a	a	a	a	a	a	As BOC International Holdings is a Hong Kong subsidiary of the Bank of China, BOC International (China) Limited is virtually a company based on Chinese capital.
4	UBS Securities	UBS (24.99%)	a	a	a	a	a	a	In December 2018, USB raised its capital contribution ratio to 51% and obtained approval.
5	Goldman Sachs Gao Hua Securities	Goldman Sachs (33%)	a	a	a	b	b	a	It is not possible to conduct a brokerage of A-stocks, and self-dealing is limited to bonds.
6	Credit Suisse Founder Securities	Credit Suisse (33.3%)	a	a	c	b	c	c	In November 2016, the company obtained a brokerage business license (limited to Guangdong Province, Shenzhen City, and the Qianhai Shenzhen-Hong Kong Modern Service Industry Cooperation Zone).
7	Zhong De Securities	Deutsche Bank (33.3%)	a	c	c	c	c	c	
8	Morgan Stanley Huaxin Securities	Morgan Stanley (49%)	a	a	c	c	b	c	Self-dealing is limited to bonds
9	Citi Orient Securities	Citigroup (33.33%)	a	a	c	c	c	c	Citigroup plans to transfer all its holdings to Orient Securities.
10	Shengang Securities	Mason Group (15%), Freeman Securities (15%), etc.	a	c	a	a	a	c	Using the CEPA scheme
11	Huajing Securities Co., Ltd.	Maxson Securities (48.82%)	a	c	a	a	c	a	Using the CEPA scheme
12	HSBC Qianhai Securities	HSBC (51%)	a	c	c	a	c	a	Using the CEPA scheme
13	East Asia Qianhai Securities	Bank of East Asia (49%)	a	c	a	a	a	c	Using the CEPA scheme

Source: Research by the author

2. Business performance of foreign joint-venture securities companies

The operating revenue of foreign joint-venture securities companies has been growing (Fig. 3). Looking at the figures for the five years up to 2017 that are available, the operating revenue was CNY 6.1 billion in 2013 and reached CNY 15.7 billion in 2017, recording an average annual growth rate of 26.3% in those five years. On the other hand, the market share of operating revenue by foreign joint-venture securities companies in the Chinese securities industry has remained stagnant at approximately 5%, although it is expanding. This suggests that the presence of foreign joint-venture securities companies in the Chinese securities industry has still been weak.

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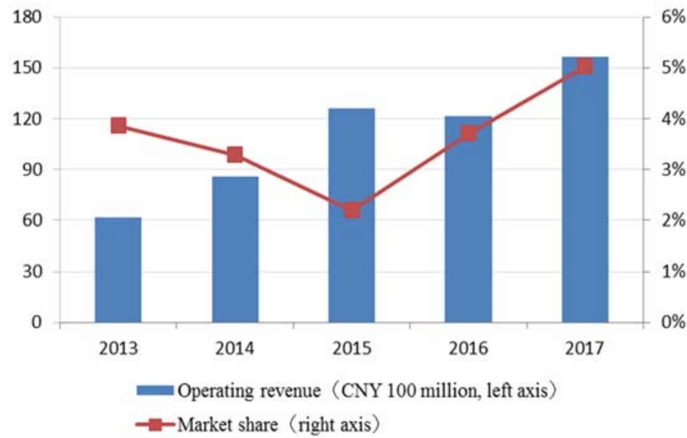
Fig 3: Operating revenue and market share by foreign joint-venture companies



Note: The stockholders of Everbright Securities Company Limited and BOC International (China) Limited are Hong Kong subsidiaries of a Chinese company. As they are virtually companies based on Chinese capital, they are excluded from the analysis.
Source: Compiled based on the documents of the Securities Association of China

This is because of the existing capped ratio of foreign capital contribution as well as the limitation on business activities by foreign joint-venture securities companies. As is shown in Fig. 2, there have only been two foreign stockholders that were able to contribute more than half of the capital—HSBC Qianhai Securities, which HSBC contributed capital for in June 2017, and USB Securities, which UBS raised its capital contribution ratio for in December 2018. It is thus considered that many other foreign stockholders have been unable to have the leading power in management for joint-venture securities companies without fully enjoying the predominance that they deserve. Furthermore, with regard to business activities as well, many foreign joint-venture securities companies are limited to only carrying out investment bank business mainly with underwriting and sponsoring, and only five companies succeeded in obtaining a full license: China International Capital Corporation, Everbright Securities Company, BOC International (China), UBS Securities, and Goldman Sachs Gao Hua Securities. For a long time, the brokerage business has been the most-lucrative business for Chinese securities companies, and it is said that, at the highest time, more than 60% of all the operating revenue of securities companies was based on brokerage.[1] Under such circumstances, it can be said that it was difficult for foreign joint-venture securities companies with limited business activities mainly based on underwriting and sponsoring to expand their operating revenue.

3. Innovation in the securities market: Bringing changes to the revenue structure of Chinese securities companies

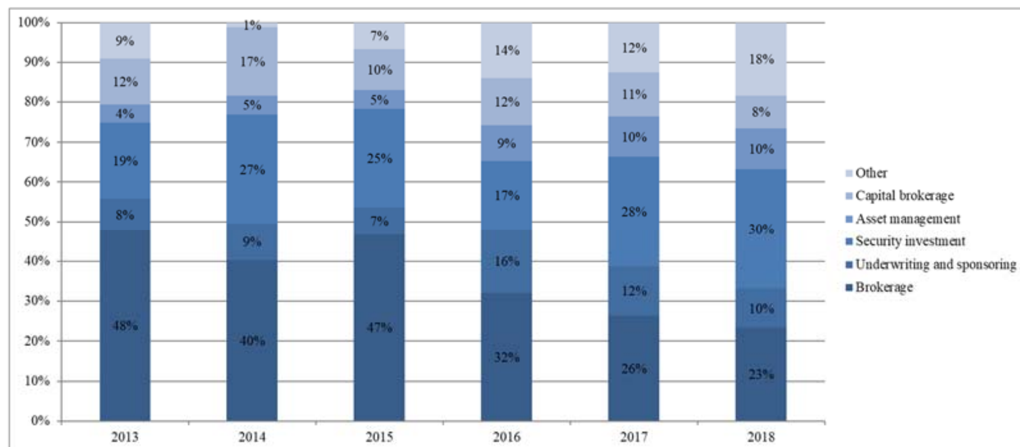
For Chinese securities companies, the business environment has been improved on for various business expansion and product development after a forum, held in May 2012, on the innovative development of securities companies. In the same month, the CSRC published "Thoughts and measures regarding the

[1] *Shanghai Securities News*, dated on December 7, 2018

promotion of the liberalization and innovative development of securities companies," raising the degree of freedom for securities companies in developing their network of business bases while also promising deregulation for their business activities, such as in asset management, securities investment (self-dealing and direct investment), capital brokerage, agent sales of financial products, over-the-counter transactions, and cross-border transactions, etc. In addition, the State Council published in May 2014 "Several Opinions on Further Promoting the Healthy Development of Capital Market" (the so-called "New National Nine Rules"), projecting a grand design so as to build a multi-layered capital markets by 2020. The New National Nine Rules includes reforms of the registration system for initial public offering stock, improvement of ChiNext and the NEEQ (National Equity Exchange and Quotations), the promotion of mutual transactions in the bond markets, the development of private markets, and promotion of the establishment of futures markets, etc.

As a result of the securities market system reforms, the operating revenue structure of securities companies in China has been changing (Fig. 4). The majority of the clients in the brokerage business are individual investors, and the ratio of operating revenue fell significantly from the 48% observed in 2013 to 23% in 2018. In general, the operating revenue of the brokerage business is easily influenced by trends in the stock market and is thus unstable by nature. As the Chinese stock market has been weak since 2016, while competition in commission rates recently intensified, with an increasing number of business offices, the operating revenue from the brokerage business seems to have declined.[2] It is considered that, as it was made possible to carry out various types of business activities, securities companies are seeing more reasons to shift to other business activities, mainly from brokerage activities.

Fig. 4: Component ratio of operating revenue for Chinese securities companies by major business activity



Source: Compiled based on the documents of the Securities Association of China

The operating revenue component ratio for underwriting and sponsoring business has been stable. The establishment of a multi-layered capital markets contributed to this business activity. Apart from the existing securities exchange, market participants are also observing the rapid development of the over-the-

[2] The number of business offices was increased, as the establishment of business offices for securities companies was deregulated in March 2013 and the securities companies needed to increase their business offices in order to obtain base clients. It should also be mentioned that securities companies mainly increased small-sized business offices only with network and communications facilities that do not require a server room. *Shanghai Securities News*, dated November 24 2018; *Jiemian*, dated December 10, 2018)

counter market, and this can mitigate the difficulty for small and medium-sized enterprises in procuring funds. In the over-the-counter market, China has National Equities Exchange and Quotations (NEEQ) and the regional equity market. The NEEQ is also referred to as the "New Third Board," and it has been rapidly growing since it spread throughout the country in 2013. As of 2013, the number of registered companies was 356, and total market capitalization was CNY 55.3 billion, while the number of registered companies reached 10,691 in 2018 and the total market capitalization reached CNY 447.8 billion. On the other hand, the regional equity market is referred to as the "Fourth Board," exclusively dedicated to small and medium-sized enterprises in each region. The first regional equity exchange was established in Tianjin in 2008, and, in 2013, 15 new exchanges were established. As of the end of 2017, there was the total of 40 regional equity markets nationwide, and the number of registered companies reached 25,391.

The operating revenue component ratio of securities investment business (self-dealing and direct investment) expanded from the 19% observed in 2013 to 30% in 2018, growing into the most-important source of revenue for securities companies. This is thanks to the fact that the Shanghai-Hong Kong Stock Connect channel was introduced between Mainland China and Hong Kong, while securities companies expanded business activities as a result of deregulation in self-dealing and direct investment, diversifying investment channels. With regard to self-dealing, registered securities were added to the New Third Board and to the regional equity market in November 2012, while the types of securities traded in the interbank bond market were expanded from the existing eight types (government bonds, international development organizations bonds denominated in Chinese yuan, central bank bills, financial bonds, debentures, MTN, CP, and corporate bonds) to all securities. Furthermore, securities that can be dealt over the counter via financial institutions were also expanded from securities managed by the CSRC to all securities managed by all financial institutions. With regard to direct investment, the mainstream is investment in funds through the establishment of a directly invested subsidiary. With the deregulation in November 2012, it was made possible for securities companies to establish a direct investment fund by registering with the Securities Association of China, while it was obligatory to obtain approval from the CSRC prior to the deregulation. In January 2014, the condition to invest in direct-investment funds was loosened from legal person investors to include individual investors with a total investment of CNY 10 million or above. Securities for direct investment were also expanded to include CP and MTN in the interbank bond market, accepting entry into the bond repo business. In December 2014, it was made possible for securities companies to establish a subsidiary based on direct investment with another investor, with the condition that the ratio of capital contribution does not fall below 51%.

The operating revenue from the asset management business has steadily been expanding. Almost 90% of the asset management business is for particular investors, such as for the "Directional Asset Management Plan." In such a business, securities companies are entrusted by commercial banks to manage assets based on the instructions given by the commercial banks. However, from the viewpoint that commercial banks entrust asset management in order to avoid the surveillance of the monetary authorities, there has been strict control since 2017, encouraging securities companies to shift their business to private investment trusts. It should be mentioned that, according to the documents published by the Asset Management Association of China, as of the end of 2018, the volume of asset management by securities companies shrank from the

CNY 16.57 trillion observed at the beginning of the year to CNY 13.4 trillion.

The capital brokerage business refers to trust transaction and repo transactions. While demand for fund procurement is growing among investors, trust transactions started in March 2010, after which securities repo transactions for clients based on one's own account started in October 2011 and stock collateral repo transactions started in June 2013, making capital brokerages an important source of revenue for securities companies. However, funds borrowed by clients turned into bad debts, bringing losses to securities companies. As a result, the component ratio of capital brokerages in the operating revenue declined in 2018. It seems that many securities companies recently used funds for capital brokerage business in self-dealing.[3]

4. Business opportunities for foreign joint-venture securities companies

As was discussed in the previous part, the Chinese securities market has recently been promoting innovation, developing an environment to diversify business activities for securities companies. Under such circumstances, there was deregulation on the establishment of foreign joint-venture securities companies in 2018, making it possible for foreign joint-venture securities companies to enter the market at the same standards as securities companies of Mainland China in the times ahead.

In June 2018, the MSCI Emerging Markets Index started to include A-stocks after which the FTSE decided to include A-Stocks in its flagship index in June this year, while the Bloomberg Barclays Global Aggregate Bond Index officially decided to use Chinese bonds from April this year. As a result, in addition to the Stock Connect channel and the Bond Connect channel that have already been opened between Mainland China and Hong Kong, a large amount of foreign capital is expected to flow into the Chinese market with the Stock Connect channel between China and London to be newly introduced. Moreover, the Shanghai Stock Exchange plans to introduce a market exclusively dedicated to high technology and innovation companies, the co-called "Sci-Tech Innovation Board," and to test the IPO registration system in this market. Against this backdrop, foreign joint-venture companies are expected to improve their business performance using their management expertise.

[3] *Shanghai Securities News*, dated January 23, 2019

The Impact of U.S./China Trade Frictions

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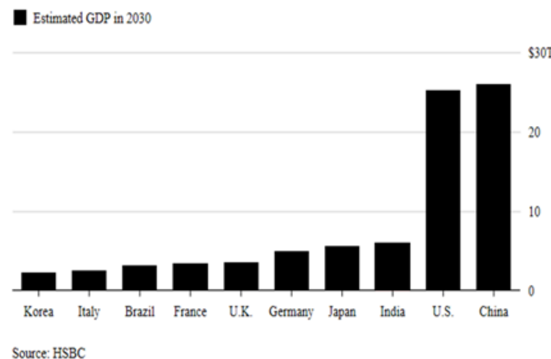
I. Intensified U.S./China trade frictions: Background

In March 2018, the U.S. announced that it was hiking tariffs on Chinese imports. This escalated U.S./China trade frictions.

Initially, the U.S. announced that it was hiking tariffs based on Section 301 of the U.S. *Trade Act* in order to force China to revise its policies regarding intellectual property and technology transfers, etc. However, the U.S. strategy then grew to encompass its deficit with China as well as China's "Made in China 2025" industrial policy. China hit back by saying that the U.S. had started a trade war in order to hold China back and maintain its hegemonic position.

Indeed, the trade dispute is starting to assume the appearance of a hegemonic battle over high-tech products and other cutting-edge technologies. While China has grown at a breakneck pace to become the world's second largest economy (with the U.S. as No.1), it seems that the U.S. is also strongly concerned that China might catch up even further when it comes to cutting-edge technology.

In September 2018, the U.K. bank, HSBC Holdings, projected that China would surpass the U.S. to become the world's largest economy by 2030. According to the bank's newest analysis of 75 countries, China will make the largest contribution to global growth over the next 10 years, with China's GDP set to hit $26 trillion (around 2,940 trillion yen) in 2030, up sharply on its current GDP of $14.1 trillion. In contrast, the analysis says that the U.S. GDP will drop below China's to hit $25.2 trillion (it currently stands at $20.4 trillion).



Source: https://www.bloomberg.com/news/articles/2018-09-25/hsbc-sees-china-economy-set-to-pass-u-s-as-number-one-by-2030

Furthermore, according to "The Cutting-edge Technologies that Most Excite Global Researchers (Ranked by Research Theme)," released by *Nihon Keizai Shimbun* (a Japanese newspaper), when it came to the number of research papers released by each country, China held the No.1 spot in the top four themes, and it also topped the rankings in 23 of the top 30 themes. However, the U.S. only held the No.1 spot in seven themes. This Chinese monopoly is due to Chinese efforts to strengthen research into science and technology. China believes that cutting-edge research will boost its industrial competitiveness over the next five to 20 years, thus it is conducting vigorous research into various themes that also overlap with its "Made in China 2025" policy, which aims to

nurture high-tech industries. According to the National Institute of Science and Technology Policy (NISTEP), part of Japan's Ministry of Education, Culture, Sports, Science and Technology (MEXT), China spent 45 trillion yen on research in 2016—a figure three to four times higher than 10 years ago (as reported in the morning edition of *Nihon Keizai Shimbun*, dated December 31, 2018). Some have criticized China for building a research environment that prioritizes quantity over quality, but China is also investing aggressively in training human resources that can be key in research as it seeks to raise research standards in the fields of science and technology.

The U.S. views these attempts by China to nurture industries (through subsidies and other forms of government support) as a threat to fair competition. As such, the U.S. has grown more cautious about national security and technology outflows to China, and this probably explains the recent deterrence measures.

II. Current situation regarding U.S./China trade frictions

U.S. tariff hikes began in March 2018 when the U.S. imposed high tariffs on steel and aluminum imports (equivalent to $3 billion). China then hit back with its own tariff hikes in April. The U.S. then placed a 25% tariff on $34 billion of Chinese imports in July on the pretext that Chinese policies related to intellectual property and technology transfers, etc., were against U.S. interests. China hit back by also slapping a 25% tariff on $34 billion of U.S. imports. In August, the U.S. retaliated by placing a 25% tariff on $16 billion of Chinese imports, with China striking back again by doing the same when it came to U.S. imports. The U.S. launched its third attack in September with the imposition of a 10% tariff on $200 billion of Chinese imports, with China then deciding to impose a further tariff of between 5–10% on $60 billion of U.S. imports. In this way, the U.S. has hiked tariffs on $250 billion of Chinese imports (close to half of all imports from China), while China has placed further tariffs on $110 billion of U.S. imports (over 80% of all imports from the U.S.).

Around half of all U.S. tariffs are aimed at Chinese imports of machinery and electrical equipment. In contrast, Chinese tariffs are targeted at a relatively diverse range of imports, including machinery and electrical machinery, vegetable products (soya beans), and transportation equipment.

The third round of punitive U.S. measures imposed a 10% tariff on Chinese imports in September 2018. There were concerns that U.S./China trade frictions could intensify when the U.S. raised this rate to 25% from January 2019. In the end, though, the U.S. agreed to postpone this hike for 90 days following a U.S./China heads-of-state meeting on the sidelines of the G20 Summit on December 1, 2018. This came after China pledged to buy a very substantial amount of agricultural, industrial, and other products to reduce the trade imbalance, with the two sides also agreeing to start negotiations aimed at resolving various problems, such as intellectual property rights infringements and cyber intrusions. The direction from here on will depend on the results of U.S./China trade talks.

The two sides have held a series of cabinet-level meetings entering 2019 in the run-up to the next deadline.

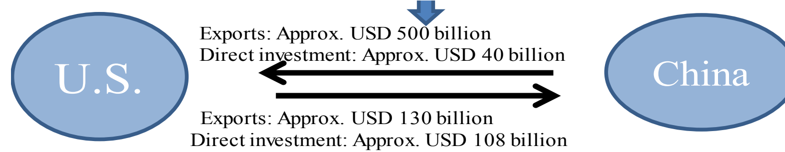
At a meeting in January 2019, China agreed to expand its U.S. imports and open up its markets further (by importing a further 5 million tons of U.S. soya beans, for example) as part of moves to eliminate its surplus with the U.S. There remained several sticking points, however, including the issue of forced technological transfers

imposed on U.S. firms and Chinese structural issues (such as industry subsidies).

Cabinet-level meetings were held over February 14–15, 2019. Furthermore, vice-ministerial-level and cabinet-level meetings have been scheduled for February 19–22. At the time of writing (February 20, 2019), things are still not settled, with signs emerging that the deadline could be pushed forward from March 1, for example.

U.S. sanctions on China

	Import amount (USD billion)	Tariff hike	Timeframe	Target imports
Imports	34	25%	From Jul. 6	Industrial machinery, airplanes, etc.
	16		From Aug. 23	
	200	10%	From Sep. 24	Food products, apparel, etc.
		(The hike from 10%→25% has been postponed)		
	280	After further Chinese measures?		
Investment	Limits on investments into the U.S. imposed by the Committee on Foreign Investment in the United States (CFIUS)			



Chinese sanctions on the U.S.

	Import amount (USD billion)	Tariff hike	Timeframe	Target imports
Imports	34	25%	From Jul. 6	Soya, chemicals, automobiles, etc.
	16		From Aug. 23	
	60	5%, 10%	From Sep. 24	Lumber, LNG, etc.
Qualitative countermeasures (non-tariff obstacles)		･Tougher import inspections on U.S. products ･Obstructing M&As involving U.S. firms ･Potentially boycotting U.S. products		

Source: Compiled by Mizuho Research Institute from U.S. Department of Commerce materials and various news reports

Ⅲ. Current impact of U.S./China trade frictions

From mid- to late-November 2018, Mizuho Bank (China), Ltd. surveyed its customers (Chinese subsidiaries of Japanese firms or local Chinese firms) regarding the impact of U.S./China trade frictions on business results and corporate strategy. Mizuho received replies from 606 of the approx. 1,000 companies surveyed, with the collected results then tabulated.

❖ Survey method

The target customers were presented with the following survey.

Step 1

Q1: Has your firm been impacted by U.S./China trade frictions?

(1) No or Yes, but in a good way, (2) Yes, in a bad way

=> If the answer is (2), go to Step 2.

Step 2

Q2: What has been the impact on the current fiscal year?

(1) Surplus, (2) Deficit

What will be the impact on the next fiscal year?

(1) Surplus, (2) Deficit

Q3. What specific impacts have the U.S./China trade frictions had? *Multiple answers permitted

(1) Falling exports, (2) Falling sales within China, (3) Falling sales prices, (4) Rising funding costs (due to tariffs), (5) Rising funding costs (not due to tariffs), (6) Deteriorating profits due to exchange rate fluctuation, (7) The emergence of bad debts/increased allowances for possible bad debts, (8) Deteriorating payment/collection conditions

Q4. Do you need to take countermeasures to deal with these impacts?

(1) No, (2) Yes

=> If the answer is (2), go to Q5.

Step 3

Q5. If you need to take countermeasures, what form will these take? *Multiple answers permitted

(1) Price pass-throughs, (2) Changing sales contacts, (3) Changing funding sources, (4) Shifting production outside China, (5) Asking the parent company for support

❖ Analysis of results

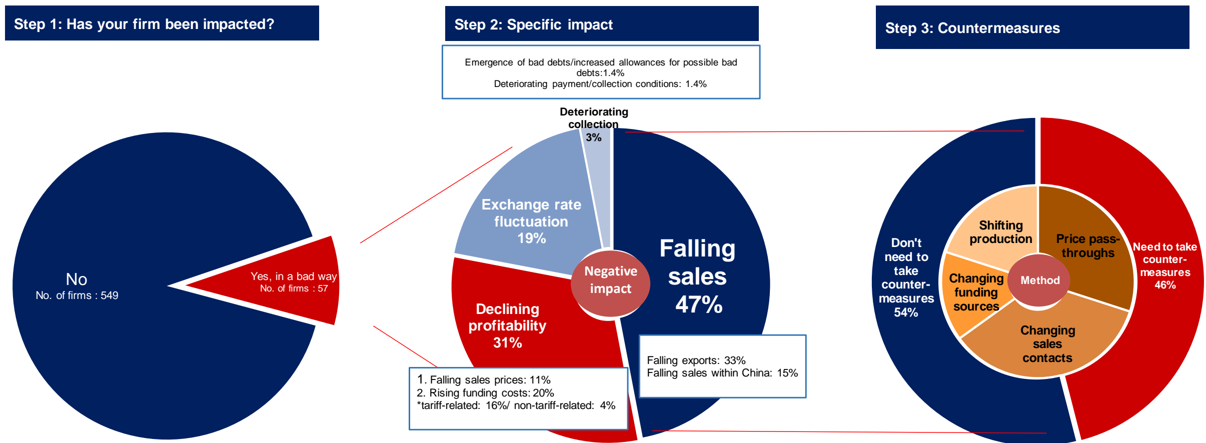
Fifty-seven firms replied, “Yes, in a bad way” to Q1 (around 9% of the total).

With regard to the impact on business results, most firms said that they expected to remain in the black, despite falling profits. Eleven firms said that they expected to book deficits this fiscal period, though only four firms said they expected to book a deficit in the next fiscal year.

As for specific impacts, the top answer at 47% was “Falling sales,” with many firms replying that exports had fallen due to the impact of tariffs. The next highest answer pertained to declining profitability, with 31% of respondents mentioning “Falling sales prices” and “Rising funding costs,” for example. If the impact of “Deteriorating profits due to exchange rate fluctuation” is included in the equation, then 50% of all respondents mentioned declining profitability. Only a few firms spoke about the emergence of bad debts or deteriorating collection conditions, though certain regions have been hit comparatively hard in these areas, thus the situation will require monitoring from here on.

Replies were divided essentially 50/50 when it came to the necessity for countermeasures, with no major gap emerging at this moment in time. Most of the respondents that said they needed to take countermeasures replied

that they would be looking at supporting themselves through "Price pass-throughs," "Changing sales contacts," or "Changing funding sources." Though some firms are also looking to shift production overseas, no respondents are considering "Asking the parent company for support."



Source: Compiled by Mizuho Bank (China), Ltd. based on the results of a customer survey

❖ Conclusion

Less than 10% of respondents to Mizuho's survey answered "Yes, in a bad way" as of the end of November 2018. The extent to which sales had fallen or profitability had declined (due to exchange rate fluctuations, etc.) differed according to industry or sales volumes. Some regions have seen a deterioration in collection conditions and an increase in credit costs (including allowances for possible bad debts), thus caution will be needed. Respondents were split essentially 50/50 when it came to the necessity for countermeasures, with many firms maintaining a wait-and-see attitude.

However, conditions surrounding the current Chinese economy continue to deteriorate.

The third round of punitive U.S. measures had imposed a 10% tariff on Chinese imports. This was set to rise to 25% from January 2019, but the U.S. agreed to postpone this hike for up to 90 days on the premise of further talks following a U.S./China heads-of-state meeting on December 1, 2018, for example, with a lid being kept on U.S./China trade frictions as a result of this temporary "ceasefire."

However, if an agreement is not reached in 90 days, the tariff on $200 billion of Chinese imports will rise to 25%. The U.S. has indicated that it wants to discuss rectifying forced technology transfers and non-tariff obstacles as well as moves to protect intellectual property rights, prevent cyber-attacks, and open up China's services and agricultural markets. All these moves would run counter to the "Made in China 2025" industrial policy, thus there is no room for optimism when it comes to talks from here on.

Nonetheless, China has adopted a conciliatory attitude. It had imposed retaliatory tariffs on U.S.-made automobiles and automobile parts, but it announced it would suspend these tariffs for three months from January 2019, for example. The backdrop to this is the deteriorating Chinese economy. According to the Chinese GDP data for Q4 2018, released by the National Bureau of Statistics on January 21, 2019, the preliminary real growth rate (discounting inflation) was up 6.4% on the same period in 2017. This represented the lowest level of growth since Q1 2009, just after the financial crisis. The GDP data for 2018 was also released at the same time. At +6.6%,

this represented the lowest annual growth in 28 years, dating back to the +3.9% recorded in 1990. Under these circumstances, the Chinese economy will be hit even harder if the U.S. introduces more punitive measures.

The U.S.'s goal is not only to rectify its trade imbalance with China but also to maintain and strengthen its superior position when it comes to high-tech industries. As such, this problem will probably become more prolonged and complex. The direct impact (falling exports and rising prices) has been limited, but if the dispute with the U.S. drags on, this could hit business and household sentiments, with investment and consumption falling sharply as a result, with foreign firms in China potentially revising their supply chains. If all this does come to pass, this could lead to a global economic slowdown. As such, market participants will need to keep a close watch on the indirect impacts of the frictions as well.

Many respondents to Mizuho's survey as of November 2018 said that the impact of the trade frictions had been limited. From here on, however, these firms will also need to consider countermeasures in case the situation deteriorates further.

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