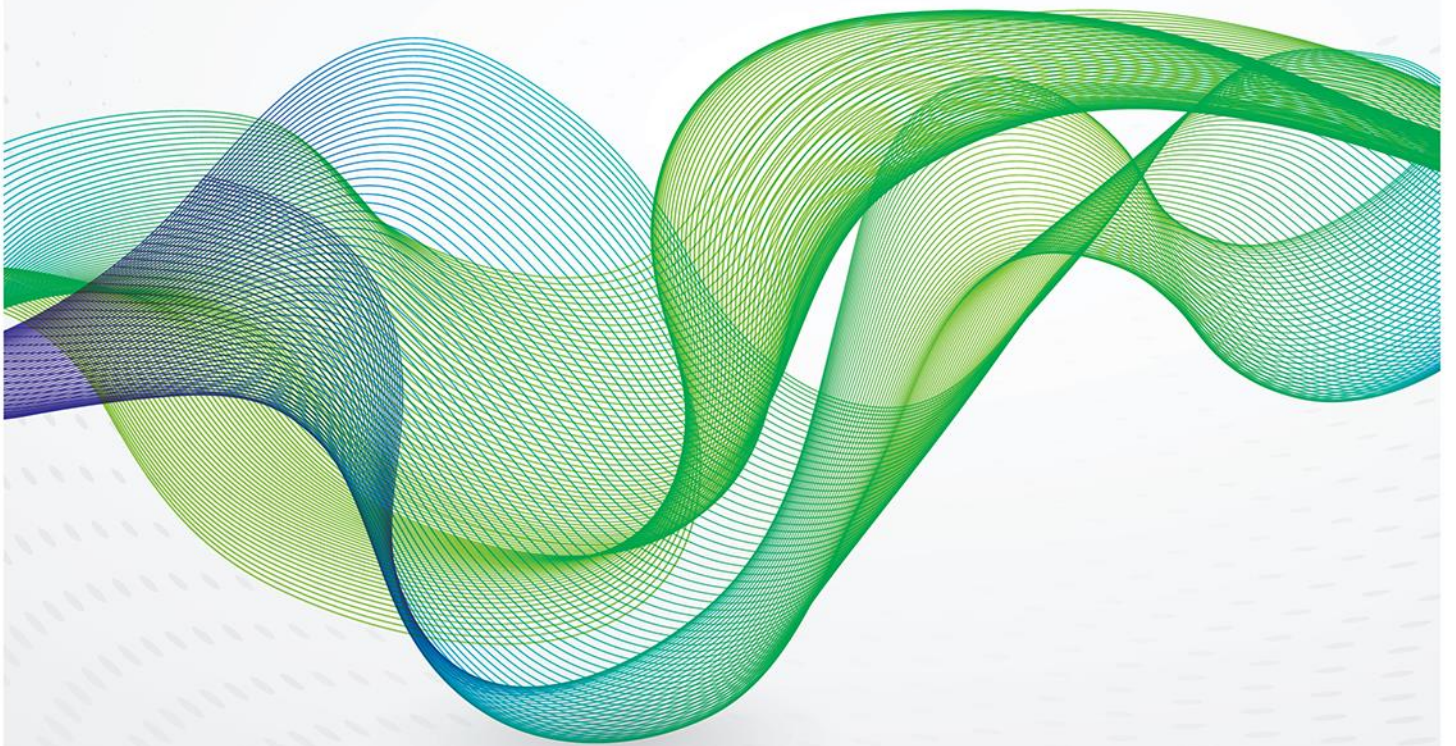




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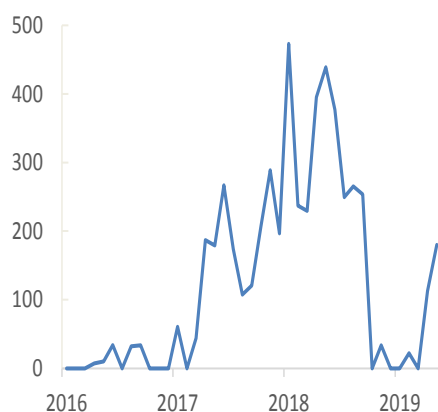
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## US-China Trade Tensions: Here we go again



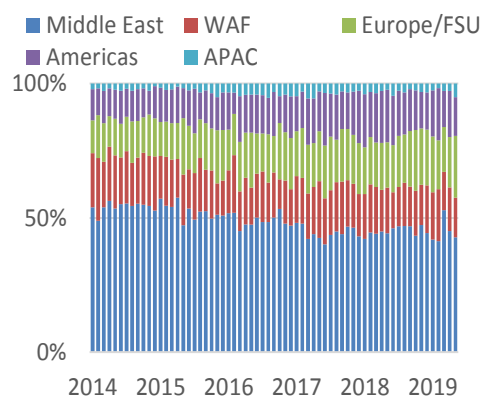
The brief reprieve in the US-China tariff tit-for-tat seems to be coming to an end following US President Donald Trump's tweet on 1 August, threatening to impose 10 per cent tariffs on \$300 billion-worth of Chinese imports effective 1 September 2019. The announcement led to a steep fall in oil prices as markets fear that the escalating trade war will further weaken the global economy and weigh on oil demand growth. If the tariffs do go ahead—and there is no reason to believe that they will be averted by China making big concessions—all of China's exports to the US will effectively be taxed. And as a result, China's retaliatory duties will widen to cover most, if not all, of its imports from the US, including crude oil. Even though US oil exports to China were under 0.10 mb/d in the first half of 2019, less than a third of their 2018 levels, hopes that a deal would be reached led to an uptick in flows in May and June this year, when China's crude imports from the US averaged 0.18 mb/d. And even though US exporters will find alternative destinations for these barrels, the prospects of an even shakier global economy will weigh on the oil complex. Moreover, the Chinese economy will continue slowing as Beijing pursues only targeted support measures. Indeed, this latest turn of events only reinforces the sense that the US-China trade war is unlikely to be resolved any time soon,<sup>1</sup> making a short term economic stimulus even less politically palatable for Beijing. To be sure, Beijing will want to put a floor under the country's slowing economic growth and tackle rising unemployment. Still, ahead of the 70<sup>th</sup> anniversary of the founding of the People's Republic of China (PRC) in October, China's leadership will continue supporting domestic consumption and the private sector, but will prioritise blue skies—which typically means industrial curtailments—over an economic bang. China's oil and gas demand growth is therefore set to halve from 2018 levels.

**Figure 1: China's Crude Imports from US, kb/d**  
Region



Source: China Customs

**Figure 2: China's Crude Imports by Region**



Source: China customs

### What's in a tweet

President Trump's latest announcement took energy and stock markets by surprise, coming only a day after US and Chinese negotiators completed a round of talks in Shanghai where Beijing promised to step up purchases of US agricultural goods and both sides agreed to meet in Washington in early September. In his tweet, President Trump announced that the 10 per cent tariff will be imposed on imports from China not yet subject to any duties, but also suggested that the tariffs were aimed at facilitating talks, and the 10 per cent rate could be ratcheted up or down, depending on the outcome of negotiations.

China's official response has so far been muted. China's Foreign Ministry spokeswoman stated that '...if the US is going to implement the additional tariffs, China will have to take necessary countermeasures...' without elaborating what those measures would be. A better defined response

<sup>1</sup> See Michal Meidan, 'US-China: The great decoupling', *OIES Energy Insight* 53, July 2019, <https://www.oxfordenergy.org/publications/us-china-the-great-decoupling/?v=79cba1185463>



will likely take several weeks as the Communist Party's top leadership is currently at the seaside resort of Beidaihe for their annual policy meeting.

Regardless of the discrete retaliatory measures, since Beijing has been highlighting its desire for 'sincerity' in talks, and is reportedly seeking the removal of all existing tariffs as a precondition for pursuing the structural reform commitments the US is seeking, this latest escalation by President Trump will only harden China's position. Not only is this latest threat a loss of face for China's negotiators after the positive soundings from the latest talks, but more importantly, leaders in Beijing will struggle to endorse any concession in the negotiations given the growing sense that President Trump is unpredictable and cannot be trusted to keep his word.

### **No stimulus in sight**

Given the trade imbalance between the two countries, China cannot match these duties on a dollar basis. While Beijing will likely move to tax all remaining US exports to China, including crude oil, it will also likely resort to other non-tariff measures, including an accelerated rollout of China's unreliable entities list; licensing delays and increased inspections of US firms in China, among others. And for its domestic audience, China will also intensify its nationalistic rhetoric, especially as the 70<sup>th</sup> anniversary of the founding of the PRC approaches on 1 October 2019.

But to what extent will Beijing try to boost the economy? The Chinese leadership places enormous emphasis on the anniversaries of important historical events, and last year, Chinese President Xi Jinping said that the 70<sup>th</sup> anniversary of the PRC would be celebrated with outstanding economic performance, suggesting that Beijing will seek to support economic growth. But markets should not confuse growth support with stimulus. The readout from the latest meeting of China's politburo—the Communist Party's 25-member top ruling body—showed no signs of a change in the current policy direction. And while China's economy is certainly decelerating, it is by no means crashing, even as Beijing has largely held its monetary and fiscal policies steady. China's GDP growth rate of 6.3 per cent in the first half of the year is still within the target range of 6 to 6.5 per cent for the year. Indeed, following the politburo meeting in late July, China's top leaders vowed to maintain their pro-active fiscal policy and keep monetary policy prudent, but refrained from committing to major easing plans<sup>2</sup> given the ongoing need to limit debt creation. The emphasis remains on reforming inefficient parts of the economy and on supporting consumption. The Beidaihe meeting could result in a change in tone and a more pronounced shift to monetary easing but, given the assessment that US-China frictions are unlikely to be resolved rapidly, the Chinese government will focus on the structural issues plaguing the Chinese economy, as a strong credit stimulus will only exacerbate existing problems. And for now, ahead of the 70<sup>th</sup> anniversary of the founding of the PRC, officials' marching orders include limiting pollution and curbing industrial activity in a bid to prevent large-scale accidents.<sup>3</sup> As long as the economy does not fall below 6 per cent, and unemployment is kept in check, Beijing will stay the current macroeconomic course.

This does not fundamentally alter the oil and gas demand trajectory for this year given that the trade war was unlikely to be short-term and Beijing's reluctance to stimulate growth has been consistently stated by the government. Unipecc—Sinopec's trading arm—for example, has been expecting product demand growth of just over 0.30 mb/d<sup>4</sup> this year, half the growth level seen in 2018. There are some downside risks to this view as additional tariffs could further weigh on sentiment and industrial curbs tend to weigh on chemical plants while 'Blue Sky' policies tend to restrict car use. Similarly, implied gas demand in the first half of the year grew by 10 per cent, a softening from the 15 per cent seen last year, suggesting a 30 bcm y/y increase in demand in 2019 compared to the 40 bcm increment seen in 2018.

<sup>2</sup> For the official readout of the meeting see 'The CCP politburo held a meeting presided by Xi Jinping, General Secretary of the CCP Central Committee' (Chinese), *Xinhua*, 30 July 2019, [http://www.xinhuanet.com/politics/leaders/2019-07/30/c\\_1124817133.htm](http://www.xinhuanet.com/politics/leaders/2019-07/30/c_1124817133.htm)

<sup>3</sup> Oceana Zhou, Eric Yep, Daisy Xu, 'Analysis: China's oil refineries to face curbs in Q3 ahead of anniversary celebrations', *Platts*, 25 July 2019, <https://www.spglobal.com/platts/en/market-insights/latest-news/oil/072519-analysis-chinas-oil-refineries-to-face-curbs-in-q3-ahead-of-anniversary-celebrations>

<sup>4</sup> 'Sinopec to substitute Iran crude with Saudi grades: exec', *Platts*, 13 June 2019, <https://www.spglobal.com/platts/en/market-insights/latest-news/oil/061319-sinopec-to-substitute-iran-crude-with-saudi-grades-exec>