



## Letter n°71

### The new faces of globalization (3): China, the threats to be averted.

*"When I look at myself, I feel sorry; When I compare myself, I console myself." Talleyrand.*

China no longer has and will no longer record the growth rates of the 2000s, but it still has potential. While we are more cautious from a fundamental point of view, in the short term, we consider it appropriate to overweight this market, which has been heavily penalized by its management of Covid and the real estate crisis.

China hesitated between 2 development models, that of Sweden and the welfare state, and that of Singapore and economic modernization associated with a single party and the promotion of meritocracy. It eventually rejected the first model but failed to translate the Singaporean model. Deng Xiao Ping was attracted to the Singaporean model, the success of a state deprived of raw materials or land but rich in a highly educated population.

But China is not ready to compete with Singapore, which, along with Qatar and Luxembourg, has one of the highest purchasing power/capita in the world, boasts the highest index of economic freedom in the world while China is in 158th place, is a world leader in the fight against corruption and has been a pioneer in gender equality.

Probably because China can no longer keep up with its rapid growth, China's foreign policy, long cautious and conciliatory, is now more assertive and virulent.

Faced with China's aggressiveness, the United States is pondering the Thucydides' trap, described by Graham Allison in his eponymous book on the warlike outcome of the rivalry between the two dominant powers.

Ready to take up the challenge, they are moving closer to their Western partners, but globalization is impacted.

In order to better understand the new face of globalization imposed by this evolution of China, we will analyze, on the one hand the international stage with China's assertion and the setbacks suffered, and on the other hand, the domestic scene with its initial successes and current difficulties.

#### **China's assertion and setback on the international stage:**

##### ***Assertion:***

Deng preached and practiced a quiet advance on the international stage, but Xi has broken this policy. At a time when he can no longer offer double-digit growth and rapid prosperity to his population, he is using nationalism as a new glue to bind the population and is trying to rely on a Chinese diaspora of 50 to 60 million people around the world whose economic weight is important.

11 quick points help to understand this Chinese assertion:

##### **- The West Challenged:**

Xi openly attacks the West on values, weapons, technology, space, the role of the dollar and influence in the world. China deploys aggressive diplomacy against Western countries, and wants to reform global governance and shape a post-Western world order. It opposes the universality of human rights, wants to redefine the concept of human rights by insisting on the right to prosperity, and wants to admit that democracy is not adapted to all cultures.

- Frequent tensions with Western countries:

With Britain, relations were historically good as the UK recognized Mao's China as early as 1950, but in recent years British alignment with US positions has strained relations. The abandonment of the "one country, two systems" policy with Hong Kong and the non-respect of the agreement reached at the time of the British handover of Hong Kong to China is a contributing factor.

With regard to Lithuania, following the opening of a Taiwanese representative office, China did not hesitate to deploy coercive economic diplomacy. This has undermined the strategy of influence deployed in Eastern Europe initiated in 2012, the 16+1 group, expanded in 2019 to Greece before the three Baltic countries left. The result is mediocre: in 2021, the stock of investments in Hungary, a country very favorable to China, did not exceed 3.5 billion, compared with 80 billion in the United Kingdom and 30 billion in Germany. Among the major assets held by China in Europe, the port of Piraeus in Greece and the port of Trieste in Italy are important entry points.

With regard to Australia, China, unhappy with critical policy statements, decided at a time to boycott coal imports.

- Willingness to take advantage of multilateral organizations:

China has penetrated the UN system and won the chairmanship of four of the 15 UN agencies, FAO, ICAO, UNIDO, International Telecommunication Union, and in 2020, narrowly lost out to Singapore for the leadership of the Intellectual Property Organization.

At the Human Rights Council, incorporated in 2016, China was able to block a debate on Xinjiang and obtain a declaration that Hong Kong was part of China's internal affairs.

At the World Health Organization, it was able to block the investigation of the origin of Covid.

- The desired rapprochement with third countries:

China is also strengthening its influence in the BRICS, which was established in 2004, and the SCO, the Shanghai Organization. The latter brings together 40% of the world's population and 30% of the world's GDP, and China would like to further expand its audience by welcoming Saudi Arabia for example.

In China's mind, the SCO and the BRICs are alternative forums to Western domination.

- Challenging the \$:

Some countries want to reduce their dependence on the \$ and China is taking the opportunity to promote the Yuan today, soon the digital Yuan and extend a transaction system that will rival SWIFT.

According to a study by Allianz, the Yuan could thus, in certain regions (Pakistan for example), exceed the Euro by 2027.

- Soft power:

To extend its cultural influence, China set up Confucius Institutes in 2004, modelled after the British Council or the Alliance Française. In 2020, there were 550 Confucius Institutes around the world, often close to universities, but a number of them, notably in the United States, have been closed down because the host countries complained about the work being done.

- The New Silk Road Program:

Launched in 2013, it provides partners with financing from the Asian Infrastructure Investment Bank and the implementation of projects allows the deployment of hundreds of thousands of Chinese workers worldwide.

- Strengthening ties with Russia:

China, despite the war in Ukraine, has reaffirmed its closeness to Russia. In 2022, trade volumes reached a record high as China increased hydrocarbon imports. At the same time, China is increasing investment in port and rail infrastructure.

- The desire to strengthen ties with Southeast Asian countries:

Relations with Southeast Asia are long-standing. We remember that at the beginning of the 15th century, Admiral Zheng He went to Indonesia. Then in the second half of the 19th century, more than a million Chinese fled the Western world and successfully settled in Burma, Singapore, Malaysia and Indonesia.

When the British settled in Singapore in 1820, they attracted many Chinese who ended up taking control of economic sectors even before the state gained independence in 1965.

In Thailand, as in Malaysia and the other countries in the region, large groups are owned by former Chinese.

While the Vietnamese keep their distance from the Chinese, and while the stock of foreign direct investment from China represents on average only 5% in the ASEAN countries, Chinese influence is strong in Laos (45% of GDP) and Cambodia, and not negligible in Singapore (12% of GDP).

Recently, China has been active in the signing of the RCEP free trade agreement, which brings together ASEAN countries but also China, Japan, South Korea, New Zealand and Australia. A significant share of world GDP, but let us not place too much hope in this agreement because, although it provides for a reduction of more than 90% in tariffs, it maintains tariffs in agriculture, offers significant timeframes for the removal of customs barriers, is very limited in services and does not prohibit subsidies to state-owned enterprises.

- Rapprochement with the countries of the Middle East:

China is strengthening its positions in the Middle East, a key region for covering its hydrocarbon needs, and is achieving a clever balance between rival countries in the region.

Thus, although, unsurprisingly, the two main destinations for Chinese investment over the past 20 years are Saudi Arabia, \$105 billion, and Kuwait, nearly \$100 billion, China reached an agreement with Iran in 2021 providing for \$400 billion in investment over 25 years and had Iran admitted to the Shanghai Cooperation Organization. China is thus Iran's leading economic partner even though it has very good relations with Israel and the Sunni regional powers.

Saudi Arabia, the leading oil supplier to China, wants to strengthen military cooperation and acquire ballistic missiles to compensate for the gradual erasure of the United States and the withdrawal of the Patriot missile defense system. At the recent Sino-Saudi summit, China was able to secure \$28 billion in contracts, including \$4 billion in military contracts, in response to China's desire to diversify its supplies.

From a diplomatic point of view, China, although dependent on Muslim countries for more than half of its hydrocarbon imports, has obtained their abstention on the Uighur issue.

- Penetrating Africa:

In Africa, China is multiplying loans to poor countries in return for strategic advantages. It has achieved a political, economic and military breakthrough: political, since now only the former Swaziland still recognizes Taiwan. Economic, since China has been able to access raw materials essential to its development such as cobalt and copper in Congo and bauxite in Guinea and is challenging Western hegemony in these countries. Military, finally, with the establishment of a base in Djibouti in 2017.

In telecommunications, the Chinese groups Huawei and ZTE have taken an important place and the same is true in infrastructure and mining.

Overall, since 2000, China has lent as much as the World Bank, i.e. \$150 billion, and it has concentrated its loans on the construction of infrastructure with 1/3 of the total on energy and mining projects. China declared that it had carried out between one third and one half of the continent's infrastructure since 2000.

While the EU was still Africa's largest trading partner in 2020, accounting for 28% of African exports and imports, China was a close second, receiving 23% of African exports and supplying 16% of African imports.

On the cultural front, China has established some 60 Confucius Institutes and awarded scholarships to 80,000 African students in China by 2021.

In the coming years, China will be in greater competition with the United States and Europe, which have decided to reinvest in the continent but also with India, Morocco and Turkey.

***The setbacks:***

- Tensions with the US and the EU:

There were, at Trump's initiative, the sanctions against Huawei, a company created in 1987, which in 2020 became a major player with 30% of the world market, like Nokia and Ericsson. Banned in the United States and a victim of US pressure on its customers elsewhere in the world, Huawei suffered a 30% contraction in turnover in 2021, but in 2022, over 9 months, it was up 6%. The group is expanding in the Chinese market and in markets such as Indonesia, South Africa, Turkey and Saudi Arabia. As a result, its market share has only decreased by two points to 28%. Today, the new challenge is the supply of semiconductors because of the new American embargo.

Between Xi and Biden, while the two leaders put on a show of reassuring words at the G20 in November 2022 to, according to Biden, rule out a new cold war or, according to Xi, develop relations, the American measures and Chinese postures heighten tensions.

Biden did not end the 20% tariffs imposed by Trump on two-thirds of Chinese imports from China but instead added new measures. He pushed through the CHIPS Act, a nearly \$55 billion plan to facilitate semiconductor production in the US.

Biden has closed the US market to Chinese telecommunications equipment, a measure that has had a heavy impact on Huawei, ZTE, China Mobile, China Telecom but also on suppliers of radio equipment and video surveillance companies such as Hytera or Dahua.

The latest sanction, raised by the United States, is to block any aid likely to promote the development of A.I. or quantum computing in China. China will thus have to replace suppliers such as Hitachi and Applied Materials, which will undoubtedly slow down the development of Chinese industry in related sectors. In response, China has decided to challenge the US at the WTO over these sanctions.

China can only lament the relocation of factories to neighboring countries, such as Apple which generates more than \$70 billion in turnover in China. Scalded by the recent lockdown in Zhengzhou of 300,000 workers at Foxconn for iPhone manufacturing, it wants to reduce its dependence and is turning to India and Vietnam. Apple's long-term goal is to produce 40 to 45% of its iPhones in India and its AirPods, laptops and smartwatches in Vietnam, but the bureaucracy in India, the diversity of regulations from one Indian state to another, and the lack of qualified workers in Vietnam are obstacles.

Consequence or coincidence of the closure of the United States under Trump and then under Biden, the closure of China: less investment abroad, less access to the NY Stock Exchange, more controls on the Internet, on cryptos to promote an e-Yuan, a larger role given to state-owned enterprises. The Chinese are closing their markets in sensitive sectors and are willing to rely less on imports for strategic products. Growth should thus be penalized.

With the EU, there are many tensions, such as the recent case of Tik Tok, a fast-growing company suspected of being a Trojan horse for Chinese influence and accused of allowing hateful content to spread.

- Setbacks with emerging countries:

With regard to emerging countries, Chinese breakthroughs are not without pitfalls. After having granted many loans, China finds itself, along with the poor countries, confronted with a problem of unpaid debts. Its share of the outstanding bilateral debt of poor countries has risen from 18% in 2010 to nearly 50% in 2021 and it will have to give up or defer payment of some of these debts.

China is not very generous with interest-free loans, 1.8 billion in 2021 against 15 billion for France and 42 billion for the US. China is a major creditor of countries with financial difficulties such as Congo, Angola, Guinea and Zambia. But, unlike the G20 countries, it has not been willing to cancel more than 2% of its loans. Politically, it denies any interference but in several elections it has supported a candidate in its favor, though this did not prevent it from losing in Zambia in 2021.

For 2 to 3 years, local protests have been growing and the number of Chinese workers posted to these countries has been decreasing.

- Tensions with Taiwan:

Chinese influence dates back to the end of the Ming dynasty in 1644 when Chinese fleeing the Manchus came to take refuge on the island. Then, in the 17th century, the Dutch established a trading post. In 1895, with the Treaty of Shimonoseki, Japan took possession of the island, began to modernize it, and extended its grip on the country's administration. In 1949, more than a million Chinese followed Chiang Kai-shek after his defeat by Mao.

Although Taiwanese entrepreneurs, through their investments in the mainland, have greatly contributed to the Chinese take-off, and although political relations were able to improve between 2008 and 2015, especially during the meeting between Xi Jinping and his Taiwanese counterpart in Singapore in 2015, since the accession to power of the CCP and its leader, relations have been much tenser, with no mention of independence on Taiwan's part.

Taiwan embarrasses China because it is the 14th largest economy in the world in terms of GDP per capita and it is a democracy. The first local elections were held in 1987 and the first presidential election by universal suffrage in 1996.

In 2020, there were 70,000 Taiwanese companies established in China, the largest of them being Foxconn with 1.2 million employees, which carries out 40% of the world's production of electronic goods as a subcontractor and, on its own, 4% of Chinese exports. The total investment made by Taiwanese in China is close to \$200 billion.

To seize Taiwan by force would mean the destruction of the TSMC group, the island's "silicon shield" which produces half of the world's semiconductors.

The US cannot allow Taiwan to fall into Chinese hands as this would undermine its protection from Japan and South Korea and its supply of semiconductors. A war in Taiwan could, according to the Rand Corporation, cost China a quarter of its GDP and the US 10%.

**After the successes, the difficulties on the domestic scene:**

***China is unavoidable:***

Let us mention here, the weight in the world economy, international trade, tourism, the fight against global warming and the presence of multinational firms.

- The weight in the world economy:

China's gross domestic product has grown from 1.6% of global GDP in the 1990s to 16 % today, and China is a key exporter, an investor in foreign markets, the leader of the Silk Road and the SCO, and an influential power at the UN.

- The weight in international trade and investment:

China accounts for 15% of world trade and is by far the world's leading exporter with \$3.4 trillion in exports, ahead of the United States, \$1.8 trillion, and Germany, \$1.4 trillion. China accounts for 18% of world exports of goods, ahead of the European Union, 16%, and the United States 10%.

Even though US imports from China have increased by only 6% in four years and even though the share of imports from China, which at its peak represented 21% of US imports, has declined, it remains overwhelming, 17% compared to 4% from Vietnam, 2.7% from India, 1.1% from Indonesia.

China is also the EU's largest trading partner, just ahead of the US.

In terms of investment, China, through the Silk Road, has invested nearly \$4 trillion over the last ten years. The G7 countries want to react but the amount of investment mentioned in the emerging countries, which has not yet been financed, is \$600 billion, mainly in Africa.

- The weight in tourism:

Chinese tourism in the world is appreciated by the receiving countries because in 2019, even if only 1/10th of Chinese had a passport, this represented 155 million tourists and \$250 billion in spending, twice as much as American tourists.

- Investments in the energy transition:

China is the world's leading polluter but it is also the leading country in terms of the amounts invested in decarbonization with \$265 billion in 2021 ahead of the United States \$115 billion.

China is consolidating its dominant position in electric vehicles and batteries and, in recent weeks, Enovate Motors has signed an agreement in Saudi Arabia to set up a factory.

Western countries want to reduce their dependence on China, but cooperation with China remains indispensable in solar panels. Production costs are much lower and China has 7 of the world's top 10 manufacturers.

The same is true for batteries. According to Benchmark Minerals, China in 2031 will have a production capacity of 322 gigawatt hours, far ahead of the Koreans, 192 gigawatt hours, and ahead of the French and Swedish. Thus, the Chinese group CATL supplies VW and Mercedes, the Chinese BYD supplies Stellantis and the Chinese Envision AESC supplies Nissan in the UK. Faced with such dependence, it is easy to understand the warning issued by Carlos Tavares, President of Stellantis.

- The deployment of multinational firms:

According to The Economist, 13% of the turnover of the top 200 Western multinationals is made in China. In luxury goods, China accounts for nearly a third of the world market. In technology, as we have seen, a firm like Apple owes part of its success to the Chinese market. Until recently, 90% of its production and a quarter of its turnover was made there. Today, despite relocations to Vietnam and India, it still accounts for 19% of its turnover. And often, in Vietnam in particular, Apple actually works with subsidiaries of its Chinese suppliers, Wingtech, Goertek and Luxshare.

Many Western companies continue to invest in China, such as VW in Xinjiang, because the group sells more in China than in Europe.

### ***The brakes on Chinese catch-up:***

In this paragraph, we will simply summarize some of the points made in a recent Letter.

GDP per capita is still (and will remain) low. As a result, China will find it difficult to lift its 400 million poor out of poverty.

China is concerned about the weakening of some of its assets:

- Demographics:

China faces a declining population, surpassed incessantly by India and aging faster than in Western countries. Looking ahead, the decline in the number of marriages from 13.5 million in 2013 to 7.6 million in 2021 makes it difficult to envisage a recovery in the birth rate.

- The investment rate:

The country is saturated with overcapacity in infrastructure and real estate. While real estate has contributed to nearly 30% of GDP in recent years, a very high level compared to other countries, it will take years to clear the stocks and clean up the companies in the sector.

- The growth model:

The growth model, to date, is unable to bring consumption to more than 40% of GDP and youth unemployment at 20% will not change this.

The level of debt, 3.5x GDP, of which 2.2x for companies, is high and this limits the ability to manipulate rates to stimulate growth.

Cost competitiveness is declining as wages are now at least twice as high as in Vietnam or India.

The effort to ensure the energy transition is unquestionable but 67% of electricity production is coal-based against only 5% from nuclear power and 28% from other renewable energies.

Food dependency, energy dependency, political and military tensions with neighboring countries will continue.

**Conclusion:** *"A leader leads by example, not by force."* Sun Tzu in The Art of War.

Let's bet that Xi will keep in mind these famous words of Sun Tzu because:

**From an economic point of view**, China is very dependent on Western countries to sell its products and on emerging countries to obtain supplies of primary products. In 2021, China's main export markets were the United States, 17%, and the European Union, 14%. There is therefore little reason for China to risk a war on Taiwan to expose itself to sanctions. With regard to the rest of the world, China, after the attraction of soft loans, is now worrying many indebted countries.

**From a cultural point of view**, it struggles to promote its cultural influence.

**From a geopolitical point of view**, the non-aligned countries have no reason to refuse the aid offered by China, especially since it is often unconditional on the organization of free elections or respect for human rights, but, opportunistically, they do not cut off relations with the Western countries.

**From a trade point of view**, "deglobalization" would be a loss for all actors and would slow down productivity gains. But we will come back to these points in our next Letter.

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