Letter n°123

How China is outsmarting the United States.

« Skill is worth more than inflexibility » Theognis of Megara.

To illustrate this idea, let's consider 8 points :

Trump's hesitations :

During his first term in office, Trump boasted about securing a promise from China to increase purchases from the United States by $200 billion, but 6 years on, this is far from being the case.

Notwithstanding this failure, while Trump has multiplied tariff measures against his closest partners in a matter of days, he shows hesitation towards China and would like to be optimistic about the possibility of a new agreement with China.

During the presidential election campaign, he spoke of tariffs of 60 or 65% against China. For now, he is no longer talking about it, temporising on TikTok, considering a visit to China within the year, and has limited himself to two instances of 10%, even if it is true, this adds to numerous existing measures.

Since 2018, the United States has reduced its direct dependence on China. Back then, 22% of US imports came from China ; in 2024, it was 13%. Nevertheless, China has circumvented trade barriers and sells a lot to the United States from Vietnam, Mexico or Bangladesh. In other words, American dependence on the Chinese economy has probably not diminished.

The United States remains China's leading trading partner :

In 2024, China's main trading partners (by exports & imports) were the United States ($688 billion), followed by South Korea ($338 billion), Japan ($308 billion), Vietnam ($261 billion), Russia ($245 billion), Malaysia ($212 billion), Germany ($202 billion), Brazil ($188 billion), India ($138 billion), the Netherlands ($110 billion), and the UK ($98 billion).

At $295 billion, China's trade surplus with the USA is its largest, ahead of the EU's $247 billion.

The setbacks of American companies in China :

A striking example, Apple's sales on the Chinese market fell by nearly 20% in Q4, while Huawei's sales rose by 15% in a market that contracted by 3.2%.

According to the American Chamber of Commerce in China, 30% of American companies based in China are considering leaving the country. Nearly one-fifth of them are considering relocating to the United States, while the others are thinking about relocating to other Asian countries.

China advocates free trade to dispose of its surpluses :
In 2024, exports contributed a third of China's growth, the highest percentage since 1997, and China has more to lose from its relationship with the United States than vice versa.

Today, China is more vulnerable than ever, with duties recently increased by 10% to as much as 45% on certain products. Although the percentage of exports to the United States is declining due to the real estate crisis, exports are the engine of growth and trade surpluses are generated with all regions of the world.

China has conquered overwhelming positions in just a few years. Electric cars, for example, account for 60% of global production and 80% of batteries.

China, grappling with overcapacity in many sectors, wants to be able to sell its surpluses on international markets.

Faced with increasing obstacles to exporting to Western countries, China is focusing on the countries of the South, notably flooding ASEAN countries, with an increase of 25% in exports in 3 years. Thailand is particularly affected, as its manufacturing output has declined by 10% since the beginning of 2022. The textile industry, like that in Indonesia, has been weakened by this competition.

Countries are taking action and trying to curb the growth of e-commerce from China, but these efforts have so far been in vain.

China records surpluses and exports deflation :

In 2024, exports grew by 5.9% to $3600 billion, or 20% of GDP, imports were €2390 billion, up only 2.9%, and the trade surplus was a record, close to $1000 billion compared to $813 billion in 2023, $878 billion in 2022 and $421 billion in 2019 before the Covid crisis.

The surplus in manufactured goods alone reached 10% of GDP (before taking into account the deficit on raw materials), a world record, as China buys less and less from the rest of the world and accounts for 27% of global industrial production according to the UN.

By way of comparison, Japan’s record trade surplus, set in 1993, was $96 billion, equivalent to $185 billion in today’s terms and Germany’s all-time high, set in 2017 was $326 billion in today’s terms. Nothing to do in proportion with Chinese dominance.

Chinese exports to the United States, $525 billion in 2024, a 4.9% increase, still represents 3% of GDP. In December, China’s trade surplus reached a record of $104 billion, up 16% in export volumes because many American companies had built up precautionary inventories.

On the surface, China’s trade surplus with the United States has fallen, from $375 billion in 2017 to $295 billion by the end of 2024. However, this does not take into account the sales by Chinese subsidiaries located around the world.

The Chinese trade surplus on the balance of goods alone was $360 billion in 2024, a 23% increase since Trump introduced tariffs in 2018, and this does not take into account the flow of Chinese products through third countries.

Since the end of Covid, export prices have fallen by 18%, which has fuelled a 38% growth in Chinese export volumes over the last 5 years.

A prime example of Chinese overcapacity is the automotive industry. Chinese factories are operating at 60% of their capacity, and Chinese capacity accounts for nearly half of global demand. In 2024, car exports rose by 25% to 4.8 million. In 3 years, these exports have tripled, and this expansion could continue. But all countries, even those in the South, are becoming more reticent in the face of this invasion. Even the Russian ally is concerned because the share of Chinese cars has increased from 9% to 60% since the start of the invasion of Ukraine in 2023, threatening the local automotive industry.

China or the strategy of graduated response :

In response to Donald Trump's decision to add a 10% tariff on $525 billion in imports from China, China has decided to raise tariffs by 12% on $14 billion in imports from the United States. China is thus imposing tariffs on 15% of American imports, mainly agricultural products such as soybeans, but this also affects Midwestern states such as Iowa, Republican strongholds. The US administration is therefore considering $30 billion in aid to compensate.

China is also targeting clothing companies and tech giants like Google. It is also increasing tariffs on American coal and LNG by 15% and tarriffs on agricultural and petroleum equipment by 10%.

These are all targeted measures, unpalatable to Trump's electorate.

In addition, China is limiting sales of products that are indispensable to the United States, where it has a dominant market share : this is the case for tungsten, essential in the military and space sectors and for which it accounts for 80% of global production. This is also the case for bismuth.

Finally, China continues to reduce its US debt. Not since 2009 has China held so few US Treasuries, $759 billion at the end of 2024, a drop of $57 billion during the year, but this does not necessarily mean a reduction of US$ positions.

At the same time, to please Trump, China is selling the ports it controls near the Panama Canal for nearly $19 billion.

China's quest for independence in food and technology :

- ***The deesire for independence in food*** :

While China accounts for 18% of the world's population, it has only 7% of the world's arable land, and its limited water resources are a hindrance to development. Domestically, China is concerned about its dependence on foreign sources of food, since 80% of its soya needs, 30% of its milk needs and 10% of its meat needs are met by imports.

- ***The desire for independence in tech*** :

In response to Trump's threats, the Chinese government is investing massively in sensitive technologies to increase its independence.

These investments are sometimes successful, for example in solar energy, electric vehicles, shipbuilding, Huawei or DeepSeek.

Sometimes however, these investments have mixed results, for example in advanced semiconductors, aeronautics and food (105 million tons of soybeans imported in 2024, 20% more than in 2019).

Xi, after years of favoring state-owned companies, has just brought together the big bosses of the private sector, as they are behind China's various international breakthroughs in many sectors. For China, this is a matter of moving in step with Trump.

China is also benefitting from the war in Ukraine, buying Russian products at knock-down prices and taking advantage of the West's withdrawal to export more and more to Russia, particularly cars. It is also extending its influence in Central Asia at a time when Russia is being absorbed by the conflict.

- ***Opportunistic China is taking advantage of US policy to strengthen its soft power*** :

The Chinese are taking advantage of the tensions created by the Americans with their historical allies to exploit resentment against the United States and to strengthen their ties with these countries.

A prime example of Chinese opportunism is Latin America, and Columbia in particular. Just after Trump's threats, the Chinese ambassador to Columbia pointed out that relations between China and Columbia have never been better in 45 years. Globally, China is the leading destination for South American exports, whereas in 2000, it was only ranked 7th.

Conclusion *: « There has never been a good war or a bad peace » Benjamin Franklin (1706-1790)*, one of the authors of the United States Declaration of Independence.

- ***Interdependence*** :

While the United States dominates international finance, thanks to the dollar, the Chinese dominate global industry and rare earths. The two powers cannot turn their backs on each other.

It's true that between 1990 and 2007, according to ***Acemoglu, Nobel Prize winner in Economics***, 3 million American jobs were lost to Chinese competition, mainly in low value-added sectors such as textiles and toys, or in sectors subsidised by the Chinese government.

But while this figure is significant, it is nonetheless lower than the number of jobs lost to automation, mainly in higher value-added sectors such as electronics, chemicals and automobiles. And this figure needs to be put into perspective, as there are nearly 160 million employees in the United States.

- ***What do China's trade surplus and US deficit tell us ?***

China's $1 trillion surplus reflects weak Chinese domestic consumption and strong US consumption, partly financed by international savings.

- ***What would be the right strategy*** ?

Trump needs to accept the reality of Chinese competition, and China's meteoric progress in AI, evidenced by the launch of DeepSeek, should bring him to his senses.

The Chinese must be encouraged to increase the share of consumption in GDP, which currently stands at less than 40% compared to over 70% in the United States. This requires the Chinese authorities to develop a kind of welfare state, with better coverage of healthcare costs and the widespread implementation of pension systems, to enable the Chinese to reduce their precautionary savings rate. China's recent announcements are a step in this direction, so let's wait and see how they materialise.

From a stock market perspective, during Trump's first trade war with China in 2017-2018, the Chinese stock market underperformed. However, since Trump's inauguration, the opposite has been observed. Does this mean that the markets do not believe in the implementation of Trump's promises of a 65% interest rate? This is a sign. Today, everything points us to be cautious on the US market, but we are still hesitant to commit to the Chinese market.

Geneva, March 20, 2025

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