

China Will Lose The Trade War With America, And That's Good For Its Citizens

China isn't well prepared to fight a trade war with America. For a couple of reasons: One of them is that its economy is slowing, as it faces the "middle income trap," and the Lewis turning point.

- The income trap is a situation where a country's growth rate slows down as it reaches middle income.
- The Lewis point is a situation where the "reserve army" of labor shrinks, pushing wages and eroding the country's competitive advantage in labor intensive industries. Chinese labor becomes expensive vis-à-vis India, Vietnam, and Indonesia. And that places additional pressure on the country's growth.
- Meanwhile, China has yet to develop a robust domestic consumer market that will accommodate its growing production capacity.

That's why China will have to give in to American demands.

Chief Market Strategist Brett Ewing of First Franklin agrees, though he thinks that Washington's win over Beijing will be more of a matter of PR rather than a matter of substance. *"I think that outlining what a win would look like is an important part to this question,"* says Ewing. *"We view a simplistic reduction in tariffs on China's side as strictly a PR move by Washington and we believe that would be a win for the state-owned enterprises in China and thus the communist politicians who profit from them. Our view of a real win for the U.S. is some combination of meaningful reforms in the ending of forced joint ventures, stopping intellectual property theft and empowering the WTO enforcement capabilities."*

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Financial markets have already sensed this outcome. Over the last three months, U.S. equities have gained 7.1% as China's markets have lost 9.1%.

U.S. Equities Versus China's

ETF	3-months	6-months
SPY	7.7%	7.1%
FXI	-9.4	-15.6
EEM	-4.4	-6.7

Source: Finance.yahoo.com 8/4/2018

While losing the trade war could be a bad thing for China's government, it could be a good thing for Chinese citizens. There are a couple of good explanations for it.

- One of them is that China will become an open economy providing Chinese consumers with more product choices at lower prices. *"China agreeing to deal with these issues in a real, measured way is-- interestingly enough--how we believe the Chinese consumer would win as well. That's because they would have a more open economy with real competition from the entire international community,"* adds Ewing. *"Having lower barriers on trade and less government control is better for the consumers in any country and would be no different for China."*
- Another reason the loss of a trade war is good for Chinese people is that it could break the real estate bubble and make home-buying affordable for younger generations. Affordable housing is an important factor for family formation and consumer spending, which could help China transition from an export driven to domestic driven economy.