Philequity Corner (December 9, 2019)
By Wilson Sy

More than a trade war

In a recent article, we explained that the battle between the US and China goes beyond a trade war (*A fight for love and glory*, October 7, 2019). The US-China conflict already includes a fierce technological race, a currency war, and a potential capital war. New bills passed by the US government on Hong Kong and the Uighurs hint of an ideological war as one country steps in to tell another country how it should run its domestic affairs.

New US laws support Hong Kong protests

Last week, Trump signed the Hong Kong Human Rights and Democracy Act of 2019 into law. The passage of the new law has angered Chinese officials because of its support for the protest actions in Hong Kong. The new law mandates an annual review of Hong Kong's autonomy from China to justify its unique treatment under US laws. It also bans the sale of ammunitions, such as tear gas and rubber bullets, to the Hong Kong police.

US Congress approves the Uighur bill

The US Congress also approved last week the Uighur Act of 2019. The proposed law mandates the US President to condemn human rights abuses committed by the Chinese government on Uighur Muslims in the region of Xinjiang. The legislation calls for the closure of mass detention camps in Xinjiang and the imposition of sanctions on Chinese government officials who are responsible for the abuses.

China asserts US is meddling, threatens retaliation

China has decried US legislation on Hong Kong and the Uighurs as unwarranted meddling in its domestic affairs. In response, China has suspended visits of US military vessels and aircraft to Hong Kong. China is also mulling visa restrictions on US officials who contributed in passing the Uighur bill and banning US diplomatic passport holders from entering Xinjiang. Aside from this, China has threatened to release a list of "unreliable entities" that may lead to potential sanctions or even the blacklisting of certain US companies in China.

Recent US laws complicate trade deal

The passage of the Hong Kong act into law and the congressional approval of the Uighur bill may make it difficult for American and Chinese negotiators to ratify a substantial phase one deal. Newly-passed US legislation have drawn angry responses from China along with the threat of potential retaliation. On the trade front, the Chinese are demanding a rollback of previously-imposed tariffs before agreeing to an initial trade deal. In response, Trump said that a trade deal with China can wait until after the 2020 election, further confounding investors.

NATO fears China's growing military might

Based on its continuous actions against China, it is apparent that the US is alarmed about the unrelenting rise of the Chinese economy. China is already the second-biggest economy in the world, and its policies have a strong influence on the direction of the global economy. The US and its allies have also become increasingly worried about China's growing military prowess. China continues to invest in upgrading its military and navy, making it the second biggest spender on defense after the US. In its conference last week, the North Atlantic Treaty Organization (NATO) has singled-out China's increasing military strength as a potential security risk to its member-countries.

Collateral damage

Despite the increasing tensions between the two countries, the Chinese and US stock markets have performed fairly well. Chinese stocks were buoyed by a substantial increase in weighting in the recent MSCI rebalancing. US indices are trading close to record highs on the back of accommodative Fed policies and sustained economic growth. Moreover, defensive stocks in the US market have benefitted from a flight to quality brought by deteriorating global market sentiment. Meanwhile, Asean indices, including the PSEi, have continued to languish after becoming collateral damage to the lingering uncertainty brought by the US-China trade war.

Philippine stocks succumb to regulatory risk

After experiencing heavy foreign selling in the MSCI rebalancing, the PSEi continued to be weak as certain stocks fell due to regulatory risk. President Duterte has ordered a review of contracts between the government and the water concessionaires, Manila Water Corp (MWC) and Maynilad Water Services Inc (Maynilad). This caused the stocks of their parent companies (namely Metro Pacific Investments Corp; DMCI Holdings, Inc; and Ayala Corp) to fall. Since the affected stocks are index constituents, their sharp declines have caused the PSEi and the Philippine stock market to falter as well.

December 15 is crucial for markets

Investors will be paying close attention to developments in the trade negotiations as we approach a tariff deadline on December 15. Without a last-minute agreement, a 15% tariff on $160b of Chinese goods would kick in. A tariff hike would cause market sentiment to further deteriorate and trigger a sharp correction in stocks. On the other hand, a postponement of the tariff hike would mean that both sides are still deep in negotiations and a trade deal may be forthcoming at a later date. News reports on China's decision to exempt US soybean and pork imports from tariffs may be signaling its willingness to accept significant concessions in the trade negotiations.

Battle for supremacy continues

The trade war has been the focus of the US-China conflict because of its stock market and economic consequences. However, considering recent events, it is apparent that the fight for supremacy between the US and China goes beyond the trade war. As the battle spreads into an ideological, technological, currency, and capital war, both Trump and Xi must tread carefully to avoid inflicting further damage to their respective countries and the global economy.

Philequity Management is the fund manager of the leading mutual funds in the Philippines. Visit www.philequity.net to learn more about Philequity's managed funds or to view previous articles. For inquiries or to send feedback, please call (02) 8250-8700 or email ask@philequity.net.