

# Fire and haze

Sino–US rivalry, the COVID-19 crisis  
and financial markets

Clingendael Report

Ties Dams  
Brigitte Dekker



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Netherlands Institute of International Relations



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# About CPEII

The China Platform for European Institutional Investors is an initiative aimed at supporting financial institutions in Europe with an interest in the Chinese financial sector. The platform enhances awareness and knowledge of relevant developments, both in China itself and internationally, by publishing a fortnightly newsletter and organising expert events. Two themes in particular are significant: green finance in China, a highly dynamic field with major potential relevance for international efforts to address climate change; and geopolitics, given the increasingly volatile and uncertain international political context of European investment in China.

The Platform is open to all European financial institutions. It was launched jointly by the Clingendael Institute and AXA IM in 2019. Clingendael China Centre acts as its secretariat. The CPEII Advisory Board consists of:

- Bert Hofman | former World Bank Country Director for China
- Dick Vietor | Professor, Harvard Business School
- Ed Kronenburg | former Netherlands' Ambassador to China
- Monika Sie Dhian Ho | General Director, Clingendael Institute

For further inquiries on CPEII and how to become involved, feel free to contact Dr Frans Paul van der Putten, coordinator of the Clingendael China Centre, via [fputten@clingendael.org](mailto:fputten@clingendael.org).

# 1 Fire and haze | Looking forward to 2021

If years could be given personalities, 2020 would surely be marked a firebrand. Looming tensions have escalated into ardent crises in several domains – from geopolitics to finance. Not only are there many fires to put out, but their smoky haze is making it near to impossible to keep a clear view on the long term. Whether it be the COVID-19 crisis, the Sino-US trade war or the state of financial markets, high volatility seems to be the status quo for years to come.

As crises cannot be dealt with only when they are over, this report aims to look beyond the haze, while the fire is still burning. It does so in three steps:

- It looks at the most disruptive events of 2020 in geopolitics and finance;
- It reflects on how these events impact long-term trends, and vice versa;
- And it translates that into relevant prospects for European institutional investors for the year to come, 2021.

Two events take centre stage: the ongoing conflict between the United States and China; and the COVID-19 pandemic. In their interaction, and their relation to long-term structural trends, lie the contours of the world in 2021 and beyond.

This report argues that – given all the uncertainties – investors should be sure to take the following prospects into account:

- Geopolitical tensions will come to dominate financial markets, as they already do with global trade;
- Europe will be challenged to become more strategically autonomous, meaning less exposed to regulatory and market volatility in both the US and China;
- And China will continue to offer important opportunities for European institutional investors in an increasingly challenging geopolitical context.

This first publication of the China Platform for European Institutional Investors (CPEII) exemplifies the platform's aims. CPEII is founded on the conviction that China's geopolitics will fundamentally reshape the world at large and financial markets in particular. It is a response to the growing need of European institutional investors to connect their financial expertise to deep and hands-on insights into China as a global power, the geopolitical disruptions it causes and the strategic opportunities it offers.

In the coming three to five years, almost 20 per cent of European institutional investors plan to increase their dedicated allocations to the Chinese equity market.<sup>1</sup> As 2020 has shown, virtually every major crisis, virtually every global challenge and virtually every relevant long-term trend requires European investors to get to grips with China's complex geopolitical role as a matter of strategic priority. This, in a nutshell, is what CPEII does.

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1 Daniel Connell and Brad Tingley, 2020. 'Crafting the optimal China allocation Strategy', Greenwich, 7 April, <https://www.greenwich.com/crafting-optimal-china-allocation-strategy-asset-owners-perspective-report-download> (accessed 16 October 2020).

## 2 2020 | A year of fire

2020 was marked by two major events: the Sino–US trade war; and the COVID-19 crisis. To understand the disruptive impact of the 2020 dual crisis, this section provides a timeline of the Sino–American tensions and the COVID-19 pandemic, whereby the impact on the financial markets will be discussed in detail. A more in-depth timeline of the events of 2020 can be found in Annex 1.

### 2.1 The non-trade war | Sino–US rivalry

China was central to Donald Trump’s 2016 campaign message, more so than any other foreign policy issue. Speaking at a rally in Indiana, he showed he was ready to take US criticism of China’s trade policies to a new level, by saying:

We can’t continue to allow China to rape our country, and that’s what we’re doing.<sup>2</sup>

Although this was disregarded by many as mere demagoguery, the Trump administration shook up US relations with China by translating words into deeds. Promising the American electorate to get ‘a better deal’ with China, President Donald Trump declared China a currency manipulator, challenged China on intellectual property (IP) and forced technology transfer concerns, and aimed to gain a competitive advantage over Chinese manufacturing sites.<sup>3</sup> Most significantly, however, in 2018 Trump began what soon became known as the Sino–US trade war.

Starting with three rounds of measures in 2018 and a fourth in 2019, the US imposed tariffs on more than USD 360 billion of Chinese goods. China retaliated with more than USD 110 billion of tariffs on US products.<sup>4</sup> Although the range of affected products is wide – from car parts to vinyl floor tiles – the main target of US measures

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2 BBC, 2016. ‘Trump accuses China of “raping” US with unfair trade policy’, *BCC*, 2 May, <https://www.bbc.com/news/election-us-2016-36185012> (accessed 20 October 2020).

3 Donald Trump, 2016. ‘Reforming the US–China trade relationship to make America great again’, DonaldDJTrump.com, <https://assets.donaldjtrump.com/US-China-Trade-Reform.pdf> (accessed 5 October 2020).

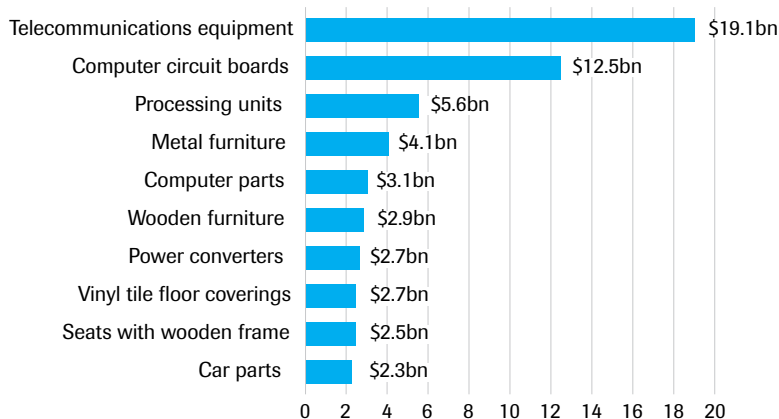
4 BBC, 2020. ‘A quick guide to the US–China trade war’, *BBC*, 16 January, <https://www.bbc.com/news/business-45899310> (accessed 5 October 2020).



is telecommunications and computer technology.<sup>5</sup> Although a truce seemed to have been reached at several points, mostly involving China buying large quantities of US agricultural products, the conflict continued to escalate. 2020 started on an optimistic note. A ‘Phase 1 trade deal’ was reached, a preliminary truce that cut some US tariffs on Chinese goods in exchange for Chinese pledges to purchase more American farm, energy and manufactured goods, and address US complaints about IP practices.<sup>6</sup> While market experts expressed scepticism because the deal does not open up significant new markets but rather shows a return to pre-trade-war levels of Chinese purchases, American financial markets soared. All three major indexes – the S&P, Dow Jones and Nasdaq – rose to new record highs in the following days.<sup>7</sup>

### What could be hit by the new tariffs?

Top 10 US imports from China facing a tariff increase from 10% to 25%



Source: US International Trade Commission (via BBC)

5 Daniele Palumbo and Ana Nicolaci da Costa, 2019. ‘Trade war: US–China trade battle in charts’, *BBC*, 10 May, <https://www.bbc.com/news/business-48196495> (accessed 6 October 2020).

6 Reuters staff, 2020. ‘What’s in the US–China Phase 1 trade deal’, Business News, *Reuters*, 15 January, <https://www.reuters.com/article/us-usa-trade-china-details-factbox-idUSKBN1ZE2IF> (accessed 5 October 2020).

7 Sergei Klebnikov, 2020. ‘Stocks hit record highs as US signs phase one trade deal with China’, *Forbes*, 15 January, <https://www.forbes.com/sites/sergeiklebnikov/2020/01/15/stocks-hit-record-highs-as-us-signs-phase-one-trade-deal-with-china/#334e69e01ea8> (accessed 5 October 2020).

Phase 1 prescribes steps for the financial services sector.<sup>8</sup> Increased market access as well as China's commitment to open up its financial market could create trust among and an incentive for financial investors to turn towards the Chinese market. In July 2020, China's National Development and Reform Commission and the Ministry of Commerce said it would remove restrictions on foreign shareholders in security companies, futures companies, fund management companies and life insurance companies.<sup>9</sup> This liberalisation of the market sent a positive signal to foreign entities interested in investing in China. Chinese financial markets had a muted reaction to the phase 1 trade deal, despite the renminbi being a significant point of contention in the negotiations.<sup>10</sup> To ease tensions with Beijing, the US Treasury Department decided to drop the designation of China as a currency manipulator, resulting in a more than five-month high of the renminbi in the days before the deal.<sup>11</sup>

Phase 1 eased growing tensions, but could never resolve the underlying issue: competition between the status-quo superpower and, certainly in the eyes of many in Washington, the aspiring successor. Many structural issues, such as cyber theft and industrial subsidies, were not addressed. The American focus on Chinese high telecommunications and information technology (IT) and China's reluctance to compromise in those areas, show that what started as a trade war was actually, and still is, an existential geopolitical struggle, fought by means of trade sanctions, in the arena of high-tech industries.

On 15 November 2020, China celebrated an important breakthrough in trade globalisation, when it signed the largest free-trade deal in history: namely, the Regional Comprehensive Economic Partnership (RCEP), which binds 15 Asia-Pacific countries, one-third of the world's population and economy, into a framework that paves the way for lower trade barriers. The deal is the first time that China, Japan and South Korea have entered into a joint free-trade pact. Notably, RCEP excludes the US,<sup>12</sup> pointing to

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8 Economic and Trade Agreement between the Government of the USA and the Government of the PRC, [https://ustr.gov/sites/default/files/files/agreements/phase%20one%20agreement/Economic\\_And\\_Trade\\_Agreement\\_Between\\_The\\_United\\_States\\_And\\_China\\_Text.pdf](https://ustr.gov/sites/default/files/files/agreements/phase%20one%20agreement/Economic_And_Trade_Agreement_Between_The_United_States_And_China_Text.pdf), chapter 4, pp. 4-1/4-4.

9 Joey Lu, 2020. 'China makes further moves to open up finance', IFLR, 24 September, <https://www.iflr.com/article/b1nf30mwcz04y7/china-makes-further-moves-to-open-up-finance> (accessed 20 October 2020).

10 James Politi and Brendan Greeley, 2020. 'US lifts China "currency manipulator" tag ahead of trade deal', *Financial Times*, 14 January, <https://www.ft.com/content/de8790be-3628-11ea-a6d3-9a26f8c3cba4> (accessed 12 October 2020).

11 Hudson Lockett, 2020. 'Where next for the Renminbi after US-China breakthrough?', *Financial Times*, 15 January, <https://www.ft.com/content/1db40dc4-376b-11ea-a6d3-9a26f8c3cba4> (accessed 12 October 2020).

12 Catherine Wong, 2020. '15 Asian nations sign RCEP, world's biggest free-trade deal, after eight year', *South China Morning Post (SCMP)*, 15 November, <https://www.scmp.com/news/china/diplomacy/article/3109939/china-declares-victory-15-asian-nations-sign-worlds-biggest> (accessed 20 November 2020).

the fact that US attempts to persuade its Asian partners to decouple from China are failing, whereas China's need to diversify away from the US is being met by increased engagement with its regional neighbours.

In short, Sino-US rivalry has come to dominate global markets,<sup>13</sup> and will do so for some time to come. Still, 2020 had another major crisis in store.

## 2.2 The financial flu | COVID-19

In booming 2019, no one expected the dominant financial narrative for 2020 to be a flu-like virus.

In February 2020, Western financial analysts still ascribed the then unknown virus causing COVID-19 in close relation to – and certainly not beyond – the Chinese city of Wuhan. Some discussed the broader implications for global supply-chain dependencies and the industrial slowdown because of the Chinese lockdown measures. Nevertheless, the market mood was still dominated by the belief that the novel coronavirus was a temporary setback, confined to China.<sup>14</sup> This quickly changed.

In March, the global decline in stock market valuations since January reached a staggering USD 13 trillion.<sup>15</sup> A parallel looming oil price war between Russia and Saudi Arabia and a collapsing European economy were the proverbial straws that broke the bull's back.<sup>16</sup> On 9 March 2020, financial indexes fell sharply and shares around the world had their worst day since the financial crisis of 2008.<sup>17</sup> This was followed by 12 March 2020, when investors' confidence hit an all-time low after President Trump announced a 30-day travel ban from the Schengen Area and the European Central Bank decided not to cut interest rates despite market expectations.<sup>18</sup>

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13 Ryan Hass and Abraham Denmark, 2020. 'More pain than gain: how the US-China trade war hurt America', Brookings Institution, 7 August. <https://www.brookings.edu/blog/order-from-chaos/2020/08/07/more-pain-than-gain-how-the-us-china-trade-war-hurt-america/> (accessed 5 October 2020).

14 Richard Harris, 2020. 'Between the coronavirus, trade war and more, financial markets have had an extraordinary six months. What's next?', *SCMP*, 3 July, <https://www.scmp.com/business/article/3091369/between-coronavirus-trade-war-and-more-financial-markets-have-had> (accessed 5 October 2020).

15 Katie Martin, 2020. 'Financial markets are being humbled by real life', *Financial Times*, 13 March, <https://www.ft.com/content/48be1cac-6511-11ea-a6cd-df28cc3c6a68> (accessed 5 October 2020).

16 Katie Martin, 2020. 'Financial markets are being humbled by real life', *Financial Times*, 13 March, <https://www.ft.com/content/48be1cac-6511-11ea-a6cd-df28cc3c6a68> (accessed 5 October 2020).

17 Katie Martin, 2020. 'Financial markets are being humbled by real life', *Financial Times*, 13 March, <https://www.ft.com/content/48be1cac-6511-11ea-a6cd-df28cc3c6a68> (accessed 5 October 2020).

18 Silvia Amaro, 2020. 'ECB surprises markets by not cutting rates, but announces stimulus to fight coronavirus impact', *CNBC*, 12 March, <https://www.cnbc.com/2020/03/12/european-central-bank-stimulus-package-amid-coronavirus.html> (accessed 5 October 2020).

After the initial crash, markets stabilised. In order to calm the financial markets' instability over COVID-19, the US Federal Reserve announced that it would buy as much government-backed debt as needed to bolster the markets for housing and Treasury bonds on 23 March 2020.<sup>19</sup> In addition to this, the Fed pledged to buy corporate bonds, including the riskiest investment-grade debt, and promised more support for small businesses.<sup>20</sup> The S&P 500 index has been rising since 23 March, just like China's CSI 300.

Chinese financial markets continue to offer glimmers of hope. In the early weeks of the outbreak, the Chinese government reacted by opening new stock-trading accounts on a large scale. Also, tens of thousands of new margin finance accounts were opened to borrow money to invest in stocks.<sup>21</sup> Later, the government launched a campaign to encourage Chinese citizens to invest in stocks. This had a significant effect.<sup>22</sup> BNP Paribas announced that foreign investors also heeded the call, pouring a record USD 7.6 billion into the Chinese market in the first four days of trading in July 2020, setting a record. Chinese stocks rose by trillions in just a few weeks, setting a record once more in October 2020, when their total value climbed to USD 10 trillion, propelled by China's accelerating economic recovery.<sup>23</sup>

The real economic challenge that COVID-19 poses lies ahead. Europe, China and the US will need to decide on long-term recovery strategies. The question is how compatible these will be. Already, the EU has announced a €4.2 trillion economic response,<sup>24</sup> using the full flexibility of EU fiscal rules, implementing a Support Mitigation Unemployment Risks in Emergency (SURE) initiative and a European Stability Mechanism Pandemic Crisis Support for member states. Moreover, a debate on a green and sustainable

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19 Federal Reserve, 2020. 'Federal Reserve press release', Federal Reserve, 23 March, <https://www.federalreserve.gov/newsevents/pressreleases/files/monetary20200323a1.pdf> (accessed 5 October 2020).

20 Jeanna Smialek, 2020. 'The Fed goes all in with unlimited bond-buying plan', *New York Times*, 23 March, <https://www.nytimes.com/2020/03/23/business/economy/coronavirus-fed-bond-buying.html> (accessed 4 October 2020).

21 Alexandra Stevenson, 2020. 'Froth Returns to China's Stock Market, Echoing the 2015 crisis', *New York Times*, 22 July 2020, <https://www.nytimes.com/2020/07/22/business/china-stock-market.html> (accessed 5 October 2020).

22 Guus Ritzen, 2020. 'De Schok van COVID-19 lijkt in China weggewerkt', *NRC*, 10 August 2020, <https://www.nrc.nl/nieuws/2020/08/10/is-in-china-weer-een-bubbel-in-de-maak-a4008331> (accessed 5 October 2020).

23 Hudson Lockett, 2020. 'China's stock market value hits record high of more than \$10tn', *Financial Times*, 14 October, <https://www.ft.com/content/7e2d1cae-8033-45b1-811c-bc7d4a413e33> (accessed 5 October 2020).

24 European Commission, 2020. 'Jobs and economy during the coronavirus pandemic', European Commission, 12 March, [https://ec.europa.eu/info/live-work-travel-eu/health/coronavirus-response/jobs-and-economy-during-coronavirus-pandemic\\_en](https://ec.europa.eu/info/live-work-travel-eu/health/coronavirus-response/jobs-and-economy-during-coronavirus-pandemic_en) (accessed 5 October 2020).

recovery has commenced in Europe, also in relation to the European Green Deal.<sup>25</sup> The EU has assigned over €2 billion to be invested in 140 key transport projects. This grant scheme aims not only to kickstart the economy, but also to deliver on the EU's climate objectives. As one of the world's largest markets for green finance, it is as yet unclear to what extent China's recovery plan will be 'green'. President Xi Jinping's promise to reduce China's carbon emissions to net zero by 2060 is promising, but his pledge still has to be translated into policy.<sup>26</sup> Meanwhile, in Washington, much depends on the incoming administration.

## 2.3 Adding crisis to conflict | 2020

During 2020, COVID-19 has heated up geopolitical strife, rather than quenching it. China is sticking to the strategic projects that appear most threatening to the US. Through its Belt and Road Initiative (BRI) and its digital subset the Digital Silk Road (DSR), the Chinese government strengthened its efforts to introduce high-tech applications based on Chinese technology and standards. The *Made in China 2025* strategy and its forthcoming follow-up *China Standards 2035* invigorate this goal and China's path to technological pre-eminence. The missing links in Chinese high-tech value chains have led to increased acquisitions by China of foreign high-tech assets, with the [Germany-based Kuka Robotics](#) acquisition portrayed as a starting point. After increased scrutiny, Chinese investors are now resorting to venture capital investment and institutional cooperation with international partners to go forward.<sup>27</sup> COVID-19 has aggravated the Sino-US conflict. President Trump called the pandemic the 'worst attack' the US had ever experienced, placing the blame firmly on China. Chinese Foreign Minister Wang Yi used the term 'new Cold War' in response,<sup>28</sup> arguing that 'some political forces in the US' are pushing the two countries 'to the brink of a new Cold War'. Disinformation campaigns between Washington and Beijing have escalated since, with both parties floating conspiracy theories that accuse the other of

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25 European Commission, 2020. 'Boosting the EU's green recovery: EU invests over €2 billion in 140 key transport projects to jump-start the economy', European Commission, 16 July, [https://ec.europa.eu/commission/presscorner/detail/en/ip\\_20\\_1336](https://ec.europa.eu/commission/presscorner/detail/en/ip_20_1336) (accessed 16 October 2020).

26 Fiona Harvey, 2020. 'Few countries living up to COVID "green recovery" pledges', *The Guardian*, 23 September, <https://www.theguardian.com/environment/2020/sep/23/few-countries-living-up-to-green-recovery-promises-analysis> (accessed 15 October 2020).

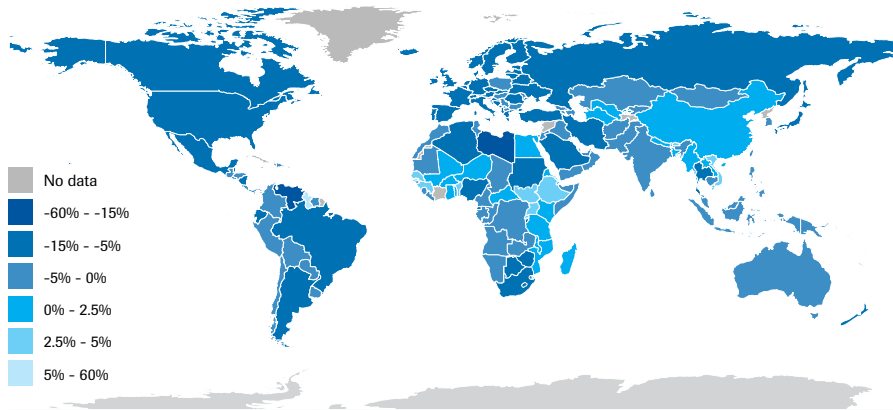
27 Max J. Zenglein and Anna Holzmann, 2019. 'Evolving "Made in China 2025"', MERICS report, July, p. 50, [https://merics.org/sites/default/files/2020-04/MPOC\\_8\\_MadeinChina\\_2025\\_final\\_3.pdf](https://merics.org/sites/default/files/2020-04/MPOC_8_MadeinChina_2025_final_3.pdf) (accessed 16 October 2020).

28 Matthias von Hein, 2020. 'Coronavirus pandemic further strains US-China relations', *Deutsche Welle (DW)*, 1 June, <https://www.dw.com/en/coronavirus-pandemic-further-strains-us-china-relations/a-53650763> (accessed 16 October 2020).

weaponising COVID-19. 2020, so far, has put Europe in a strategic tight spot. European leaders have largely been reluctant to join the American decoupling strategy. At the same time, Europe has to own up to an increasingly risk-ridden relationship with China and the reality that global crises, including financial crises, need global solutions.

### Majority of countries on the brink of recession

Real GDP growth, Q1 2020



Source: International Monetary Fund (via BBC)

## 3 Beyond the haze | A look at long-term trends

The challenge for investors will be to navigate the current crises with a view towards the long-term trends that are relevant for the geopolitical–financial nexus. Extrapolating from recent developments, three trends ought to take a central position in investors’ risk assessments of the changing geopolitical context. One, Sino–US rivalry will continue to strengthen mutual acts of protectionism. Two, there will be growing pressure on European governments and investors to ‘choose sides’, leading to a drive for ‘strategic autonomy’. Three, Chinese markets will continue to offer growth opportunities; the European need to grasp them will increase as well.

### 3.1 America First versus China First | The cycle towards protectionism

China and the US are caught up in a vicious cycle of great power competition that entails a mutually enforced drive towards protectionist trade and financial policies. This trend will likely continue, for at least four reasons.

First, the American strategic orientation towards Asia, away from Europe, started before Trump. It was President Obama whose signature geostrategic doctrine was the so-called ‘Pivot to Asia’. The term was coined by his Secretary of State Hillary Clinton in an essay called ‘America’s Pacific Century’, in which she states:

US commitment [in the Asia–Pacific] [...] will help build that architecture and pay dividends for continued American leadership well into this century, just as our post–World War II commitment to building a comprehensive and lasting transatlantic network of institutions and relationships has paid off many times over – and continues to do so. The time has come for the United States to make similar investments as a Pacific power.<sup>29</sup>

In China, the Pivot was widely seen as an assertive plot to contain and undermine China’s power in its own backyard.<sup>30</sup> The Trump years have only added to these fears. The American belief that China poses a fundamental geopolitical threat has since become an issue of

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29 Hillary Clinton, 2011. ‘America’s Pacific Century’, *Foreign Policy*, 11 October, <https://foreignpolicy.com/2011/10/11/americas-pacific-century/> (accessed 15 October).

30 Nina Silove, 2016. ‘The Pivot before the pivot’ *International Security*, vol. 40, no. 4 (spring 2016), pp. 45–88, [http://sdsc.bellschool.anu.edu.au/sites/default/files/publications/attachments/2017-02/16.05.05\\_the\\_pivot\\_before\\_the\\_pivot.pdf](http://sdsc.bellschool.anu.edu.au/sites/default/files/publications/attachments/2017-02/16.05.05_the_pivot_before_the_pivot.pdf).

unique bipartisan consensus in American politics. Interestingly, the 2020 US presidential election, as bitterly divisive as it was, seemed to prove China's point: Joe Biden was all too eager to compete with Trump on who had the toughest lines on China. China was once again the main foreign policy issue in the campaign, more so than global health, the coming worldwide recession or the severely damaged transatlantic relationship.<sup>31</sup>

Second, China has shown little motivation to address the structural issues that the US, Europe and others have been addressing for a long time, such as market access and IP issues. Moreover, it is doubling down on its efforts to become a global leader in high-tech industries. This is probably the biggest cause for concern of the US in the long run, as many – if not most – of these technologies in focus – from AI to semiconductors – take on vital roles in the 21<sup>st</sup> century networks of power and security.<sup>32</sup> The Chinese leadership took COVID-19 as an opportunity to reinforce, rather than slow down, these developments.<sup>33</sup>

Third, the appointment in 2012 of Xi Jinping as Secretary-General of the Chinese Communist Party set in motion a more geopolitically assertive line that is unlikely to waiver. Xi Jinping's background, his stated ideological principles and, indeed, his actual geopolitical strategy showcase a China that is done with 'biding its time' and wants to claim leadership in a number of global arenas, especially where Western leadership is failing. In a speech commemorating the Korean War, which in China is called the War to Resist American Aggression and Aid Korea, Xi Jinping reminded the Chinese people that a similar martial spirit is necessary to overcome today's challenges, just as it was necessary then:

The road ahead will not be smooth [...] It is necessary to speak to invaders in the language they know: that is, use war to prevent war [...] and use a [military] victory to win peace and respect. Arrogance, always doing as one pleases, acts of hegemony, overbearance or bullying will lead nowhere and surely result in a dead end in today's world. [...] This is a lesson some politicians in the West must

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31 Louise van Schaik and Ties Dams, 2020. 'No way back: why the transatlantic future needs a stronger EU', Clingendael Institute, 26 November, <https://www.clingendael.org/publication/no-way-back-why-transatlantic-future-needs-stronger-eu> (accessed 26 November 2020).

32 Ties Dams, 2019. 'Gaming the new security nexus', Clingendael Institute, 21 November, <https://www.clingendael.org/publication/gaming-new-security-nexus> (accessed 16 October).

33 Ties Dams, 2020. 'Pandemie zal opmars van China niet stuiten, maar juist versnellen', *Algemeen Dagblad*, <https://www.ad.nl/buitenland/pandemie-zal-opmars-van-china-niet-stuiten-maar-juist-versnellen~a6f0aa73/> (accessed 20 October).



keep in mind when they try to blackmail, block and exert maximum pressure on China.<sup>34</sup>

Xi's more assertive geopolitics must be seen as an anticipation of, reaction to, and – given the removal of his term limits as China's supreme leader – constant factor in Sino-US relations for years, if not decades, to come.

Fourth, the US has issued signals that it is willing to use financial instruments to apply pressure on China, adding to European investors' fears that they will be caught in the middle. In May 2020, President Trump ordered the US federal government's retirement fund to halt plans to invest in Chinese companies, following criticism by a bipartisan Senate coalition of the federal savings board's decision to switch to China-inclusive funds. Senator Marco Rubio said:

America's investors should never be a source of wealth funding Beijing's rise at the expense of our nation's future prosperity.<sup>35</sup>

Senior officials from both national security and economic policy circles within the administration warned the US federal retirement fund in an official letter against investing in Chinese companies, since:

[This] would expose the retirement funds to significant and unnecessary economic risk, and it would channel federal employees' money to companies that present significant national security and humanitarian concerns because they operate in violation of US sanction laws and assist the Chinese Government's efforts to build its military and oppress religious minorities. [...]

[There is a] possibility that future sanctions will result from the culpable actions of the Chinese government with respect to the global spread of the COVID-19 pandemic.<sup>36</sup>

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34 Shannon Tiezzi, 2020. 'In Korean war commemoration, Xi warns that China will "use war to prevent war"', *The Diplomat*, 24 October, <https://thediplomat.com/2020/10/in-korean-war-commemoration-xi-warns-that-china-will-use-war-to-prevent-war/> (accessed 16 October).

35 Thomas Franck, 2020. 'White House directs federal pension fund to halt investments in Chinese stocks', *CNBC*, 12 May, <https://www.cnbc.com/2020/05/12/white-house-directs-federal-pension-fund-to-halt-investments-in-chinese-stocks.html> (accessed 5 October 2020).

36 Lawrence Kudlow and Robert C. O'Brien, 2020. 'Letter to the White House', 11 May, <https://presentdangerchina.org/wp-content/uploads/2020/05/Kudlow-O'Brien-Letter-to-Sec.-Scalia-51120.pdf> (accessed 9 October 2020).

The concerns over economic risk are based on criticism of Chinese financial disclosure and investor protection laws, which, according to the US administration, are lacklustre, prevent US oversight from functioning in Chinese territory and have been party to various scandals, such as that of China MediaExpress.<sup>37</sup> Apart from this general concern, the US notes that some Chinese companies present a significant national security and/or humanitarian threat to the United States. This includes military contractors, telecommunications companies, companies that manufacture surveillance equipment and 'one company' that allegedly engages in economic activity with Iran and North Korea in violation of US sanctions. More broadly, because of COVID-19 and the possibility of future sanctions, all investments in China should be considered especially risky, according to the letter.<sup>38</sup>

In turn, Beijing has threatened to turn the trade war into a 'financial fight'.<sup>39</sup> Indeed, various sources from the higher echelons of Chinese financial policy-making have been warning for some time that a major financial conflict with the US is inevitable. Former Chinese Finance Minister Lou Jiwei made a prediction at a Beijing forum, saying:

The next step in the frictions between China and the United States is a financial war [*jīnróng zhàn*].

Zhou Yu, director of international finance research at the Shanghai Academy of Social Sciences, has also predicted a 'financial war'. China's focus in terms of policy seems to lie in creating or strengthening financial networks that do not depend on the dollar. A former central bank deputy governor and a former governor of the same institution called for China to find new ways to use the yuan instead of the dollar in international transactions.<sup>40</sup> Xi Jinping's somewhat quixotic enthusiasm for cryptocurrencies is also widely believed to be grounded in a perceived need to circumvent dollar hegemony.<sup>41</sup>

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37 Ryan Vlastelica and Daniel Bases, 2011. 'Special report: Chinese stock scams are the latest US import', *Reuters*, 11 May, <https://www.reuters.com/article/us-china-shortsellers-idUSTRE74A71F20110511> (accessed 9 October 2020).

38 Lawrence Kudlow and Robert C. O'Brien, 2020. 'Letter to the White House', 11 May, <https://presentdangerchina.org/wp-content/uploads/2020/05/Kudlow-O'Brien-Letter-to-Sec.-Scalia-51120.pdf> (accessed 9 October 2020).

39 Tom Mitchell and Don Weinland, 2020. 'Beijing hits back at Trump call to block US pension fund investment in China', *Financial Times*, 13 May, <https://www.ft.com/content/a0da73e0-33c2-4ac5-a635-fb5fd9160293> (accessed 9 October 2020).

40 Julian Gewirtz, 2019. 'Look out: Some Chinese thinkers are girding for a "financial war"', *Politico*, 17 December, <https://www.politico.com/news/magazine/2019/12/17/look-out-some-chinese-thinkers-are-girding-for-a-financial-war-086610> (accessed 5 November).

41 Steven Russolillo and Stella Yifan Xie, 2019. 'Bitcoin and Chinese tech stocks surge after Xi Jinping touts blockchain', 28 October, <https://www.wsj.com/articles/bitcoin-and-chinese-tech-stocks-surge-after-xi-jinping-touts-blockchain-11572259762> (accessed 16 October 2020).

The final measure China is able to take is weaponising its holdings of US sovereign debt, worth USD 1.1 trillion, although it is unlikely to take this course of action, as it would prove catastrophic to the American, Chinese *and* world economies.<sup>42</sup>

In conclusion, if US financial sanctions related to COVID-19 do come about, this would almost inevitably hurt European investors' portfolios.<sup>43</sup> In the short term, there may be advantages for Europe, as China would be more dependent on European capital. If, however, the US imposed secondary sanctions on European investors with interests in sanctioned Chinese entities, as it already does in its sanctions regime *vis-à-vis* Iran, this would have serious repercussions for European portfolios.

### 3.2 My way | Europe's drive for strategic autonomy

This vicious cycle towards protectionism is already exerting a fundamental influence on European geostrategy and, indeed, European trade and financial policies, challenging Europe to become more 'strategically autonomous' in a wide spectrum of fields, from defence to finance. This trend is only expected to increase.

European trust in American global leadership is eroding, independent of who occupies the White House in administrations to come. Prompted by escalations in Sino-US rivalry, the new European Commission, headed by Commission President Ursula von der Leyen, has stated its ambition to be a 'geopolitical commission' that strives to strengthen its 'strategic autonomy'. This means it wants to be able to make its own strategic considerations in its relations with, most importantly, the US and China, where it is now caught in the middle between not wanting to decouple from China and being pushed to do so anyway by the US. EU High Representative for Foreign Affairs and Security Josep Borrell said the following:

If the EU does not want to remain entrenched in the dispute between the US and China, it must look at the world from its own point of view and act to defend its values and interests, which do not always coincide with those of the US. In short, as I said on one occasion, the EU has to do things 'its own way'.

This led to some commentators calling my approach the 'Sinatra doctrine', a reference to his song 'My Way'. [...]

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42 Julian Gewritz, 2019. 'Look out: Some Chinese thinkers are girding for a "financial war"', *Politico*, 17 December, <https://www.politico.com/news/magazine/2019/12/17/look-out-some-chinese-thinkers-are-girding-for-a-financial-war-086610> (accessed 5 November).

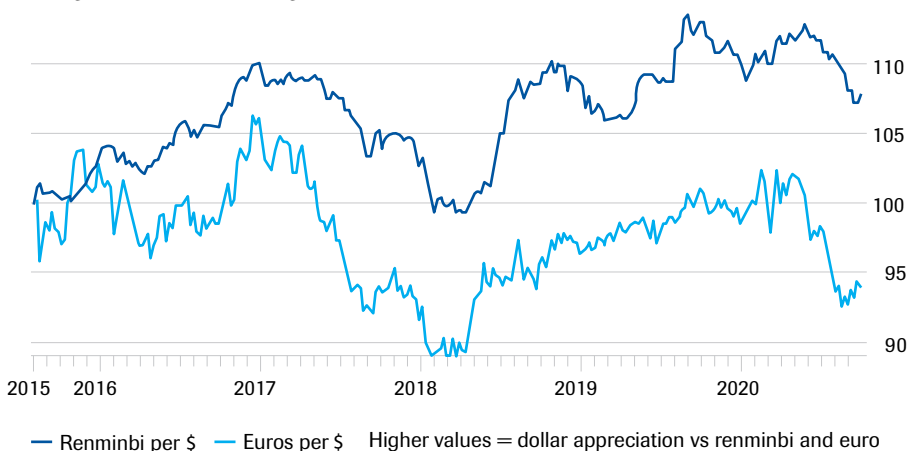
43 Sam Meredith, 2019. 'Europe will face more economic "pain" if US limits investment in China, analysts say', *CNBC*, 3 October, <https://www.cnbc.com/2019/10/03/trade-war-us-investment-curbs-against-china-would-hurt-europe-analysts-say.html#close> (accessed 16 October).

This doctrine would be based on two pillars: continuing the cooperation with Beijing in order to address global challenges such as climate change, combating the coronavirus, regional conflicts and development in Africa, while at the same time strengthening the EU's strategic sovereignty by protecting technological sectors of our economy, which are key to ensuring the necessary autonomy and to promoting international European values and interests.<sup>44</sup>

Borrell indicates that Europe has a different structural interest and geostrategic outlook on China than the US, thus making decoupling, including financial decoupling, undesirable. The coming COVID-19 aftermath will make cooperating with China even more important, if, as in some recent economic crises, the Chinese markets again prove to be relatively robust. Thinking of the crises to come, especially the climate crisis and the challenge of moving towards a green financial system, European leaders and markets seem to understand that ignoring China is not an option. Indeed, the EU might even leverage growing Sino-US hostilities to position itself as an even more important export market to China, to negotiate an ambitious investment agreement with Beijing, and to act as a geopolitical intermediary.<sup>45</sup>

### Since the renminbi floated more freely, other currencies have mirrored its fluctuations

Exchange rates rebased (11 August 2015 = 100)



Source: Refinitiv (via FT)

44 Josep Borrell Fontelles, 2020. 'The Sinatra doctrine: building a united European front', *Institut Montaigne*, 9 September, <https://www.institutmontaigne.org/en/blog/sinatra-doctrine-building-united-european-front> (accessed 16 October 2020).

45 Robert Basedow, 2019. 'The US-China trade war: Risks and opportunities for the EU and the United Kingdom', London School of Economics (LSE), 17 October, <https://blogs.lse.ac.uk/europpblog/2019/10/17/the-us-china-trade-war-risks-and-opportunities-for-the-eu-and-the-united-kingdom/> (accessed 16 October 2020).

The drive for strategic autonomy might have far-reaching consequences for European financial and currency policy. Already in 2018, the European Commission called for stronger internationalisation of the euro, as both a reaction to the re-imposed sanctions on Iran by the US and to the stronger positioning of the Chinese renminbi. European distress about how the Society for Worldwide Interbank Financial Telecommunication (SWIFT) was pressured by the US to comply with sanctions on Iran might challenge the EU to gain greater influence over the Brussels-based global financial transactions facilitator. Still, following adoption of the COVID-19 recovery plan, there are very few signs of more coherent European financial policies. Governments remain divided over the EU recovery strategy. As a recent study by the *Istituto Affari Internazionali* concludes:

Without a stronger and united EU, the common currency will not be able to properly challenge the dominance of the US dollar in global markets. Without a stronger international euro, the EU will not reinforce its economic and political autonomy, hampering its independence and credibility as a 'global actor' on the world stage.<sup>46</sup>

Consequently, rhetoric and strategy still diverge, but the chances of Europe veering away from the goal of strategic autonomy are small, as its geopolitical context demands it ever more. Still, as Adam Tooze puts it, as of today:

The hegemony of the dollar–Treasury nexus in global finance remains unchallenged.<sup>47</sup>

### 3.3 Green bonds and A-shares | Growing opportunities in China

Behind the haze of geopolitical volatility, market opportunities in China are growing. For a long time, European institutional investors were hesitant to enter the Chinese equity market, but the possibilities offered by China are causing many investors to reassess their outlook, despite growing geopolitical tensions.

As mentioned earlier, in the coming three to five years, almost 20 per cent of European institutional investors plan to increase their dedicated allocations to the Chinese equity market.<sup>48</sup> Exchange-traded funds (ETF) – a fund that tracks an index or an asset class

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46 Nicola Bilotta and Alissa Siara, 2020. 'From strategic autonomy to the internationalisation of the euro: Europe's challenges and the impact of the COVID-19 crisis', *Istituto Affari Internazionali*, April, <https://www.iai.it/en/publicazioni/strategic-autonomy-internationalisation-euro> (accessed 16 October 2020).

47 Adam Tooze, 2019. 'Is this the end of the American Century?', *London Review of Books*, vol. 41, no. 7, 4 April.

48 Daniel Connell and Brad Tingley, 2020. 'Crafting the optimal China allocation Strategy report', Greenwich, 7 April, <https://www.greenwich.com/crafting-optimal-china-allocation-strategy-asset-owners-perspective-report-download> (accessed 16 October 2020).

and trades like a stock – are still believed to be the easiest and cheapest way to invest in China. In EU markets, 24 ETFs are listed that have netted USD 5.1 billion. In the US, 56 China-underlying ETFs have attracted USD 20.3 billion in assets.<sup>49</sup>

Environmental, social and governance (ESG) criteria are becoming an increasingly important factor in companies' long-term prospects. Almost half of the institutional investors consider corporate governance for Chinese companies as the most important ESG factor.<sup>50</sup> Environmental concerns are also quickly growing in importance. Since the Chinese green bonds' introduction into the market in 2017, the market for green bonds has skyrocketed, causing the climate change issue to rise up the corporate agenda. The European Green Deal has further accelerated this trend.<sup>51</sup> The exclusion of 'clean coal projects' – that is, projects and technology that make use of carbon capture and storage – from China's updated list of projects eligible for green bonds in May 2020 shows the willingness of China to move towards global standards.<sup>52</sup>

China's ambitious goal of achieving carbon neutrality before 2060 also affects the green finance market and has been well received by regulators and markets. The number of Chinese green bonds issued already rose 33 per cent in 2019 to USD 55.8 billion.<sup>53</sup> Of these green bonds, a little over half also align with the definition of the Climate Bonds Initiative. In order to deal with the difference in standards for green bonds globally, the EU initiated rules aimed to curb 'greenwashing' and boost green investments among European institutional investors.<sup>54</sup> The efforts of the Climate Bonds Initiative are likely to include transition bonds (also known as 'brown-to-green' bonds), creating sustainable

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49 Enoch You, 2019. 'US, European institutional investors plan to pile into China's capital markets, survey finds', *SCMP*, 15 April, <https://www.scmp.com/business/companies/article/3006100/us-european-institutional-investors-plan-pile-chinas-capital> (accessed 16 October 2020).

50 Institutional Asset Manager, 2020. 'Institutional investors signal a shift to dedicated China investments, says new survey', *Institutional Asset Manager*, 7 April, <https://www.institutionalassetmanager.co.uk/2020/04/07/284552/institutional-investors-signal-shift-dedicated-china-investments-says-new-survey> (accessed 16 October 2020).

51 Elliot Smith, 2020. 'The numbers suggests the green investing "mega trend" is here to stay', 14 February, <https://www.cnbc.com/2020/02/14/esg-investing-numbers-suggest-green-investing-mega-trend-is-here.html> (accessed 20 October 2020).

52 Reuters staff, 2020. 'China excludes clean coal projects from list eligible for green bonds', *Reuters*, 29 May, [China excludes clean coal projects from list eligible for green bonds](https://www.reuters.com/article/china-green-bonds-excludes-clean-coal-projects-from-list-eligible-for-green-bonds-idUSKCN20M0001) | *Reuters* (accessed 24 November 2020).

53 Climate Bonds Initiative and China Central Depository and Clearing Research Centre, 2020. 'China green bond market: 2019 research report', June, [https://www.climatebonds.net/system/tdf/reports/2019\\_cbi\\_china\\_report\\_en.pdf?file=1&type=node&id=47441&force=0](https://www.climatebonds.net/system/tdf/reports/2019_cbi_china_report_en.pdf?file=1&type=node&id=47441&force=0) (accessed 20 October 2020).

54 European Parliament, 2020. 'Green finance: Parliament adopts criteria for sustainable investments', 18 June, <https://www.europarl.europa.eu/news/en/press-room/20200615IPR81229/green-finance-parliament-adopts-criteria-for-sustainable-investments> (accessed 20 October 2020).

opportunities for European institutional investors in China, especially now that European shareholders are moving forwards with ESG criteria and want their shares to reflect their companies' values.

Chinese A-shares are also likely to become more interesting to European institutional investors. Since 2003, Chinese A-shares – shares in mainland China-based companies that trade on the Shanghai Stock Exchange and the Shenzhen Stock Exchange – are also purchasable for foreign institutions through the Qualified Foreign Institutional Investor (QFII) system.<sup>55</sup> Steps taken to liberalise the Chinese capital market illustrate the expectation of growing foreign capital inflows to China. Chinese A-shares have been elevated in the Morgan Stanley Capital International (MSCI) index by 15 per cent (from 5 to 20 per cent).<sup>56</sup> The A-share market is dominated by retail investors, accounting for 80 per cent of the market turnover, and approximately 40 per cent of the A-shares consist of 'new economy' companies such as IT and healthcare.<sup>57</sup> While foreign institutional investors are underrepresented, the A-shares market does offer investors a much wider opportunity set and is still under-researched, with almost 70 per cent of the companies being covered by three or fewer analysts.<sup>58</sup> The A-shares market is also less exposed to overseas trends, thereby shielding itself from the uncertainty of the US–China dispute for the time being. That said, there are still limits to the extent that portfolio managers can invest in Chinese securities, as China is still considered a developing country. This status comes with restrictions on the investment strategy followed, and limits investors not focused on Emerging Markets from investing in China. Creating a transparent network and research on the A-shares market, with a possible Chinese department of the company, is therefore an interesting path forwards for European institutional investors.

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55 Troy Segal, 2020. 'China A-shares definition', *Investopedia*, 6 September, <https://www.investopedia.com/terms/a/a-shares.asp> (accessed 20 October 2020).

56 Jie Lu, 2019. 'Five reasons for strategic allocation of China A-shares', *Robeco*, 5 August, <https://www.robeco.com/nl/visie/2019/05/five-reasons-for-strategic-allocation-to-china-a-shares.html> (accessed 20 October 2020).

57 UBS, 2020. 'China A-shares: four key factors for investors', UBS, 19 August, <https://www.ubs.com/global/en/asset-management/insights/china/2020/china-a-shares-analysis.html> (accessed 20 October 2020).

58 UBS, 2020. 'China A-shares: four key factors for investors', UBS, 19 August, <https://www.ubs.com/global/en/asset-management/insights/china/2020/china-a-shares-analysis.html> (accessed 20 October 2020).

## 4 2021 | Prospects and scenarios

If 2020 has been a firebrand year, many hope that 2021 will be the year that extinguishes a world ablaze. This final section looks at prospects for the year to come in light of the structural trends and recent disruptions already identified. In what way will geopolitical and financial trends interact?

### 4.1 When the haze clears | COVID-19's economic aftermath

COVID-19's impact on global growth so far has quelled optimism for a speedy recovery. 'The ascent out of this calamity is likely to be long, uneven and highly uncertain', International Monetary Fund (IMF) chief economist Gita Gopinath wrote recently.<sup>59</sup>

The IMF's most recent prediction claims the world economy will shrink by 4.4 per cent in 2020, followed by 5.2 per cent growth in 2021 and roughly 3.5 per cent growth between 2022 and 2025.<sup>60</sup> The Organisation for Economic Cooperation and Development (OECD) forecasts similar figures: it expects the world economy to shrink by 4.5 per cent in 2020, before expanding by 5 per cent in 2021.<sup>61</sup> Above all, volatility persists, as week-to-week developments in COVID-19 infection rates and governments' responses lead to widely diverging performances in different countries and across time.

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59 Julia Horowitz, 2020. 'IMF cuts its global economic forecasts for 2021 and warns of "long, uneven", recovery, *CNN Business*, 13 October, <https://edition.cnn.com/2020/10/13/economy/imf-economic-outlook-coronavirus/index.html> (accessed 16 October 2020).

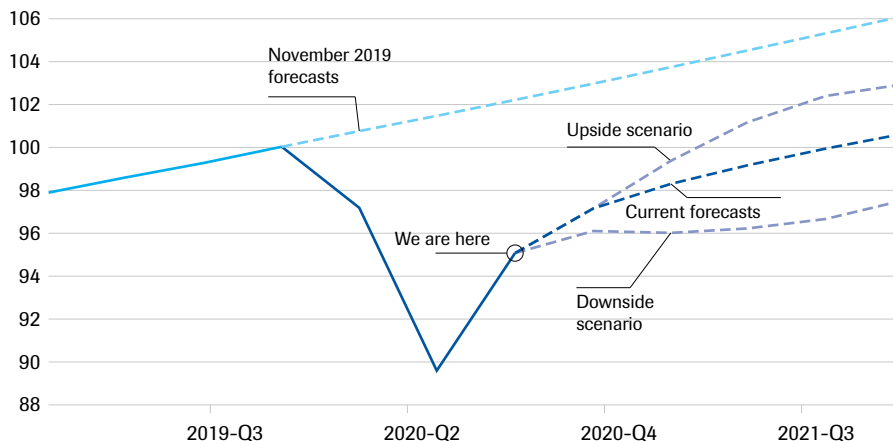
60 Julia Horowitz, 2020. 'IMF cuts its global economic forecasts for 2021 and warns of "long, uneven", recovery, *CNN Business*, 13 October, <https://edition.cnn.com/2020/10/13/economy/imf-economic-outlook-coronavirus/index.html> (accessed 16 October 2020).

61 Julia Horowitz, 2020. 'The outlook for top global economies is improving, OECD says', *CNN Business*, 16 September, <https://edition.cnn.com/2020/09/16/economy/oecd-economic-outlook-september/index.html> (accessed 19 October 2020).



### OECD Economic Outlook September 2020<sup>62</sup>

World GDP, index 2019-Q4=100



Source: OECD (2020), "OECD Economic Outlook, Interim Report September 2020", OECD Economic Outlook: Statistics and Projections (database)

The second wave of COVID-19 infections currently entangling much of Europe has worsened general prospects for the continent. In its autumn 2020 Economic Forecast, the European Commission projects that the euro area economy will contract by 7.8 per cent in 2020, before growing 4.2 per cent in 2021 and 3 per cent in 2022.<sup>63</sup> This assumes that a Brexit trade agreement is reached, which is in no way a done deal.<sup>64</sup>

Interestingly, China is the only major economy expected to expand in 2020. According to the World Bank, China's GDP is expected to grow 1.6 per cent this year, in stark contrast to the global recession figures. China's quick recovery is generally attributed to its stringent lockdown and population-tracking policies, as well as its public investment in infrastructure and spending incentives.<sup>65</sup> China will start 2021 with an increased share of

62 OECD, 2020. 'Building confidence crucial amid an uncertain recovery', OECD, 16 September, <https://www.oecd.org/economy/building-confidence-crucial-amid-an-uncertain-economic-recovery.htm> (accessed 1 December 2020).

63 [https://ec.europa.eu/commission/presscorner/detail/en/ip\\_20\\_2021](https://ec.europa.eu/commission/presscorner/detail/en/ip_20_2021) (accessed 19 October 2020).

64 Michael Savage, 2020. 'No-deal fears rise as Boris Johnson "least willing to budge on Brexit"', *The Guardian*, 15 November, <https://www.theguardian.com/politics/2020/nov/15/no-deal-fears-rise-as-boris-johnson-least-willing-to-budge-on-brexit> (accessed 19 October 2020).

65 Laura He, 2020. 'China is winning the global economic recovery', *CNN Business*, 11 October, <https://edition.cnn.com/2020/10/10/economy/china-global-economy-intl-hnk/index.html> (accessed 19 October 2020).

global GDP by about 1.1 percentage points, more than three times the share it gained in 2019. The US and Europe will see their share dip lightly. Louis Kuijs, chief Asia economist at Oxford Economics, argues that China's vital role in global supply chains has been strengthened by the COVID-19 economic storm, despite the US-China trade war:

In contrast to expectations of [...] changes in global supply chains away from China, it looks as if, at least for now, China's success in shaking off the COVID-19 outbreak and keeping factories operating has strengthened its role in global value chains.<sup>66</sup>

Although China seems to outperform both the US and the Eurozone so far, the US is projected to have a softer contraction but a slower recovery than the Eurozone.<sup>67</sup> The real test of which of the three countries – the US, EU or China – handled the economic aftermath best, however, will be in the year to come, when, among other things, a new US president, Joe Biden, assumes office.

## 4.2 Conquering COVID, courting Europe, containing China | Prospects for the Biden administration

Stock markets seem to believe Biden has a stronger recovery strategy in store for the US than a second Trump administration would have had. After the Biden victory was called, the Nikkei index reached its highest point since 1991, the FTSE jumped 4.4 per cent and in China, the Shanghai Composite was up by almost 1.9 per cent and Hong Kong shares rose 1.2 per cent.<sup>68</sup>

The question is whether Biden's election will actually empower his office to push through a meaningful fiscal stimulus, as he will possibly be opposed by a Republican Senate in his efforts to do so. Biden has promised to implement an Emergency Action Plan to Save the Economy in the early days of his administration, which would compel businesses to make medical supplies necessary to fight COVID-19, increase unemployment insurance and provide direct aid to small businesses. For this, however, he needs bipartisan support, which, as of today, he is unlikely to get. The fight against

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66 Laura He, 2020. 'China is winning the global economic recovery', *CNN Business*, 11 October, <https://edition.cnn.com/2020/10/10/economy/china-global-economy-intl-hnk/index.html> (accessed 19 October 2020).

67 Julia Horowitz, 2020. 'IMF cuts its global economic forecasts for 2021 and warns of "long, uneven", recovery', *CNN Business*, 13 October, <https://edition.cnn.com/2020/10/13/economy/imf-economic-outlook-coronavirus/index.html> (accessed 16 October 2020).

68 Martin Farrer and Julia Kollwe, 2020. 'Biden win boosts global stock markets as FTSE 100 surges', *The Guardian*, 9 November, <https://www.theguardian.com/business/2020/nov/09/biden-win-boosts-global-stock-markets-as-japanese-shares-soar-to-29-year-high> (accessed 23 November 2020).

climate change has won a vocal backer in Joe Biden. He has staked his administration on this issue more than any other. His climate proposals call for USD 1.7 trillion in federal investment in the next ten years. Finally, Biden has promised to reverse Trump's USD 1.5 trillion tax cut, by raising corporate taxes.<sup>69</sup> It remains to be seen whether Biden will be able to do all three: increase spending to fight COVID-19; increase spending to fight climate change; and raise taxes on corporations.

Geopolitically speaking, the US trajectory will not significantly be altered by the new administration. The arch of structural developments is intact, even though Biden's rhetoric will diverge most strongly from Trump's. Biden is expected to open his foreign policy with an appeal to transatlantic brotherhood, trying to restore some of the trust that Trump undermined in European capitals. This is likely to have limited effect: especially in Brussels, Trump is now seen as a symptom, rather than an incident, of erratic US global leadership. The EU's goal of strategic autonomy, therefore, is here to stay, and 2021 will most probably see a European Commission attempting to become less dependent on US markets for recovery, even though transatlantic trade has remained relatively robust throughout the pandemic.<sup>70</sup> China has been Biden's top foreign policy campaign issue. As the tougher stance on China has become an issue of bipartisan support, and indeed the Biden campaign competed with Trump in launching stronger and stronger rhetorical salvos across the Pacific, Biden cannot afford to step back significantly from Trump's trade policies towards China. The trade war is going nowhere. Biden has furthermore warned the UK that he will not offer a trade deal if British prime minister Boris Johnson continues to push through a no-deal Brexit.<sup>71</sup>

### 4.3 Opening up, continued | China's plans for financial market policy

While the world concentrated on the restricted flow of goods between the US and China, the Chinese government started opening the financial market doors ajar. With difficulties outdating the economic disruption and political tension caused by the COVID-19

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69 Dominic Rushe, 2020. 'Big tech and corporate tax cuts: the targets of Joe Biden's urgent economic plans', *The Guardian*, 7 November, <https://www.theguardian.com/us-news/2020/nov/07/joe-biden-most-urgent-economic-plans-key-elements> (accessed 23 November 2020).

70 Louise van Schaik and Ties Dams, 2020. 'No way back: why the transatlantic future needs a stronger EU', Clingendael Institute, 26 November, <https://www.clingendael.org/publication/no-way-back-why-transatlantic-future-needs-stronger-eu> (accessed 26 November 2020).

71 Dominic Rushe, 2020. 'Big tech and corporate tax cuts: the targets of Joe Biden's urgent economic plans', *The Guardian*, 7 November, <https://www.theguardian.com/us-news/2020/nov/07/joe-biden-most-urgent-economic-plans-key-elements> (accessed 23 November 2020).

pandemic, the pace of opening the financial market has been a slow and challenging process. Lured by China's lucrative USD 45 trillion financial services industry, many companies and investors are watching the barriers being torn down eagerly.<sup>72</sup>

In March 2018, the People's Bank of China (PBOC) set the liberalisation of the financial market in motion by eliminating restrictions for foreign payment institutions.<sup>73</sup> In July 2019, the China Banking and Insurance Regulatory Commission (CBIRC) followed, by issuing eleven measures for opening up the Chinese financial market. This included encouraging the establishment of, and investment in shares of, wealth management subsidiaries of commercial banks and allowing foreign financial institutions to form investment pension-management companies. This resulted in Allianz being the first wholly foreign-owned insurance company in China in January 2020.

As concluded in the Phase 1 US–China trade agreement, non-discriminatory participation in financial services was established and, in April 2020, restrictions on foreign shareholding ratios for fund management companies were removed. Since June 2020, foreign investors also no longer need to apply for any quotas under China's two inbound investment channels – the dollar-dominated QFII scheme and its yuan-denominated sibling, RQFII.<sup>74</sup>

From December 2020 onwards, restrictions on foreign shareholding ratios for securities companies will be removed nationwide. The State Administration of Foreign Exchange (SAFE) is also looking into easing restrictions on cross-border investment via its Qualified Foreign Limited Partnership (QFLP). This programme allows individual investors to invest through fund managers in Chinese assets.<sup>75</sup> Lastly, the Chinese government is aiming to launch a carbon-trading scheme, which allows individuals and financial firms to participate in order to increase funding for China's path towards carbon neutrality. Issuing green bonds to foreign investors and holding yuan-denominated green financial assets are also included in the Chinese government's plan, as well as

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72 Bloomberg News, 2020. 'China's finance world opens up to foreigners, sort of', *Washington Post*, 25 September, [https://www.washingtonpost.com/business/chinas-finance-world-opens-up-to-foreigners-sort-of/2020/09/24/e168d5c8-fee0-11ea-b0e4-350e4e60cc91\\_story.html](https://www.washingtonpost.com/business/chinas-finance-world-opens-up-to-foreigners-sort-of/2020/09/24/e168d5c8-fee0-11ea-b0e4-350e4e60cc91_story.html) (accessed 23 November 2020).

73 Joey Lu, 2020. 'China makes further moves to open up finance', IFLR, 24 September, <https://www.iflr.com/article/b1nf30mwcz04y7/china-makes-further-moves-to-open-up-finance> (accessed 24 November 2020).

74 Directly quoted from: Reuters staff, 2020. 'Beijing opens financial markets further amid tension with Washington', *Reuters*, 7 May, <https://www.reuters.com/article/us-china-markets-open-idUSKBN22J2ZQ> (accessed 23 November).

75 Timmy Shen, 2020. 'Authorities looking to loosen rules for foreign investment in Chinese assets', *Caixin*, 24 October, <https://www.caixinglobal.com/2020-10-24/authorities-looking-to-loosen-rules-for-foreign-investment-in-chinese-assets-101618518.html> (accessed 23 November 2020).

coordinating clear standards for green financing.<sup>76</sup> Nevertheless, barriers still remain, such as the lengthy application process that can – in the case of Visa – last for more than five years.<sup>77</sup>

#### 4.4 2021 | Four scenarios for geopolitics and finance

Zooming out from the present uncertainty and abstracting from the long-term prospects that were identified earlier, two major factors will impact European investors' interests in China: the ongoing conflict between China and the US, on the one hand; and the economic aftermath of the COVID-19 crisis for Europe, on the other.

Although the potential interactions between the two can only really be painted in many shades of grey, this report concludes by offering a charcoal sketch in black and white of the year ahead, as a tool to help European investors get to grips with the geopolitical context that impacts their investments in China. It argues that each trend will develop in a way that lies at some point between two extremes. These extremes are not likely to come about, but are meant to pose outer limits to the spectrum of potential realities. Concretely, 2021 will play out thus:

- Sino-US rivalry will either
  - **consolidate the status quo level of tension**, meaning no new wave of trade barriers will come about,
  - or it will **escalate to a full-on geopolitical conflict**, where the US imposes sanctions on European partners for trading with and/or investing in the Chinese market.
- The economic aftermath of the COVID-19 crisis in Europe will either be
  - **mild**, meaning that the global economy in 2020 will show a decline of about 4.5 per cent, which will be followed by 5 per cent growth in 2021. The EU and the US are expected to show similar trajectories, with both being outperformed by China,
  - or **severe**, meaning that European countries will not be able to agree on a strong European recovery strategy, causing the European market to retreat into recession, a situation possibly exacerbated by a no-deal Brexit and/or the failure of the Biden administration to push through a stimulus package.

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76 Bloomberg News, 2020. 'China seeks big money's help reaching its carbon-neutral goal', *Bloomberg Green*, 27 October, <https://www.bloomberg.com/news/articles/2020-10-27/china-seeks-big-money-s-help-reaching-its-carbon-neutral-goal?sref=npQiEL5j> (accessed 23 November 2020).

77 Bloomberg News, 2020. 'China's finance world opens up to foreigners, sort of', *Washington Post*, 25 September, [https://www.washingtonpost.com/business/chinas-finance-world-opens-up-to-foreigners-sort-of/2020/09/24/e168d5c8-fee0-11ea-b0e4-350e4e60cc91\\_story.html](https://www.washingtonpost.com/business/chinas-finance-world-opens-up-to-foreigners-sort-of/2020/09/24/e168d5c8-fee0-11ea-b0e4-350e4e60cc91_story.html) (accessed 23 November 2020).

Adding up these two factors and their extremes, four simple scenarios can be deduced, as the following graph shows:

		European economic aftermath of the COVID-19 crisis	
		Mild	Bad
Sino-US conflict	Consolidation	<b>Status quo</b> <i>Permanent higher levels of protectionism, but growing opportunities in China, steady going for Europe</i>	<b>Coming together</b> <i>Permanent higher levels of protectionism, great incentive for US and Europe to work together with China</i>
	Escalation	<b>Catch-22</b> <i>Growing pressure from the US, growing opportunities in China, causing huge dilemmas for European institutional investors</i>	<b>Double trouble</b> <i>Geopolitical conflict and economic headwind, leading to a vicious cycle that will hurt European interests significantly</i>

**The status quo scenario** seems best for European investors. In this scenario, investors should adjust their portfolios to match a consolidation of trade barriers between China and the US, will be continually attracted to increase their interests in the Chinese markets, especially in relation to green finance, and will be hurt by the economic aftermath of COVID-19, but can nevertheless rely on a steady, albeit slow, recovery in European and American markets, as well as faster growth in China.

**The catch-22 scenario** finds European investors faced by growing pressure from the US to decouple from China. In this scenario, a slow but strong recovery in the European market relieves some of the pressure to hitch the European financial wagon to Chinese recovery, but investors will still see, and to some extent need, the growing opportunities that the opening-up of the Chinese financial market offers. Here, it becomes ever more important that EU institutions, as well as member states, leverage the economic weight of the European internal market to protect European investors from the effects of Sino-US decoupling. In this case, the European economy may benefit from growing Sino-US rivalry, if it is able to form intermediary trade and financial links between the Pacific and Atlantic trading blocs.

**The coming together scenario** shows a severe global COVID-19 recession pushing the EU, US and China to overlook geopolitical tensions and work towards common recovery strategies. Here, given the political course that Biden, Von der Leyen and Xi Jinping lay out, substantial opportunities could arise for green finance, and a speedy liberalisation of Chinese financial policy is expected.

**The double trouble scenario** is the bleakest consequence, for European investors as well as for the world at large. Here, COVID-19 leads to a deep global recession, putting great pressure on European investors to hitch their wagon to relatively strong

Chinese growth, while at the same time the US will apply great pressure on European governments to limit investors' ability to do so.

These scenarios are simplifications, based on extremes, but offer some insight into the wide range of realities that European investors may have to face in 2021. If anything, volatility will be the status quo for years to come. Whatever kind of year 2021 proves to be, firebrand or clearing haze, European investors should take into account the basic prospect that, directly or indirectly, geopolitics will come to dominate financial markets, leading to risks and opportunities that were unimaginable only a few years ago.

# Annex 1

## Course of events, 2020

### Sino-American rivalry, COVID-19 crisis and financial markets

#### January

2020

- 7/01** Chinese authorities identify virus as new type of coronavirus
- 15/01** Phase 1 trade deal concluded
- 20/01** First US case of COVID-19
- 30/01** WHO declares global public health emergency

#### February

2020

- 19/02** S&P hits all time high
- 21/02** China unveils new tariff exemption lists for US exports
- 28/02** Stock markets worldwide report their largest single-week declines since 2008

#### March

2020

- 9/03** Black Monday
- 11/03** US travel ban Schengen zone
- 12/03** Black Thursday

#### April

2020

- 14/04** Trump orders halt of \$400 ml. funding for WHO

#### May

2020

- 04/05** Possible US ban on federal Pension fund investing in China stocks
- 21/05** US passes legislation that could delist Chinese companies
- 28/05** US plans to revoke Chinese researchers with military ties
- 29/05** China excludes 'clean coal' from green bonds list

#### June

2020

- 24/06** Pentagon lists 20 companies aiding Chinese military

#### July

2020

- 06/07** US formally withdraws from WHO
- 17/07** US investors still piling FDI money into China
- 27/07** €750 bl. recovery fund to rebuild EU economies

#### August

2020

- 11/08** Hong Kong's export to US be labelled Made in China
- 13/08** Discussions on fears of financial iron curtain and China being shut out of the global dollar system arise
- 20/08** TikTok ban in US imminent

#### September

2020

- 15/09** WTO ruling sides with China over US tariffs

#### October

2020

- 16/10** China set to pass tech protection law

#### November

2020

- 03/11** US elections
- 10/11** Stock markets rally sharply caused by Biden's victory and promising news of COVID-19 vaccine
- 15/11** RCEP Trade Deal is signed

#### December

2020

- 01/12** China's export control law comes into effect