What Some Blanket As *"Inflation"* Is In Fact China Closing Its Factories To The West

Inflation In A US Election Year, Markets Impact & *The Sinosphere*

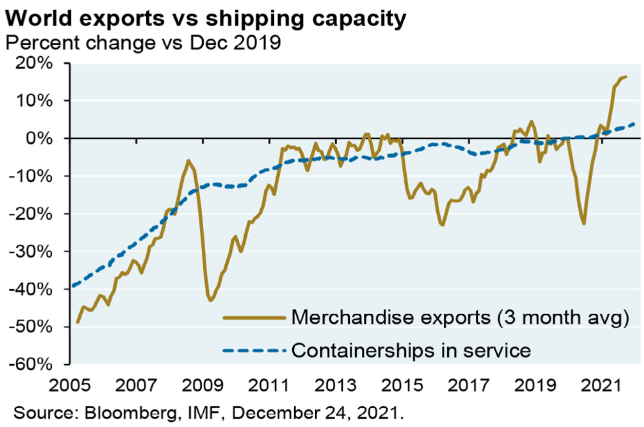
Rome maintained its empire on the full stomachs of its garrisons and today we inherit the word, Salary, meaning salt ration for the preserving of a soldier's rations.

Following the ***Carthaginian Peace*** – where a spiteful Rome salted the entire expanse of their North African foe, leaving the terrain infertile for a thousand years thereafter – garrisons' stipend of salt tripled in cost for the Roman Kingdom (not yet a Republic, c. 146 B.C.), leading to the first documented instance of **cost-push inflation**; some scholars attribute these pecuniary pressures to the fall of the Kingdom, ascending the Republic and then Empire, ***Pax Romana***.

The two lessons from history that savvy global investors have learnt is that firstly, **Cost-push inflation has done more to shift markets, politics and societies than Demand-pull inflation** ever has and secondly, since Western Civilization began with the **founding of Rome**, it's been the control of money, of currency that matters and in economics this is addressed from several angles, all of which intersect at the quantitative measurement of Inflation.

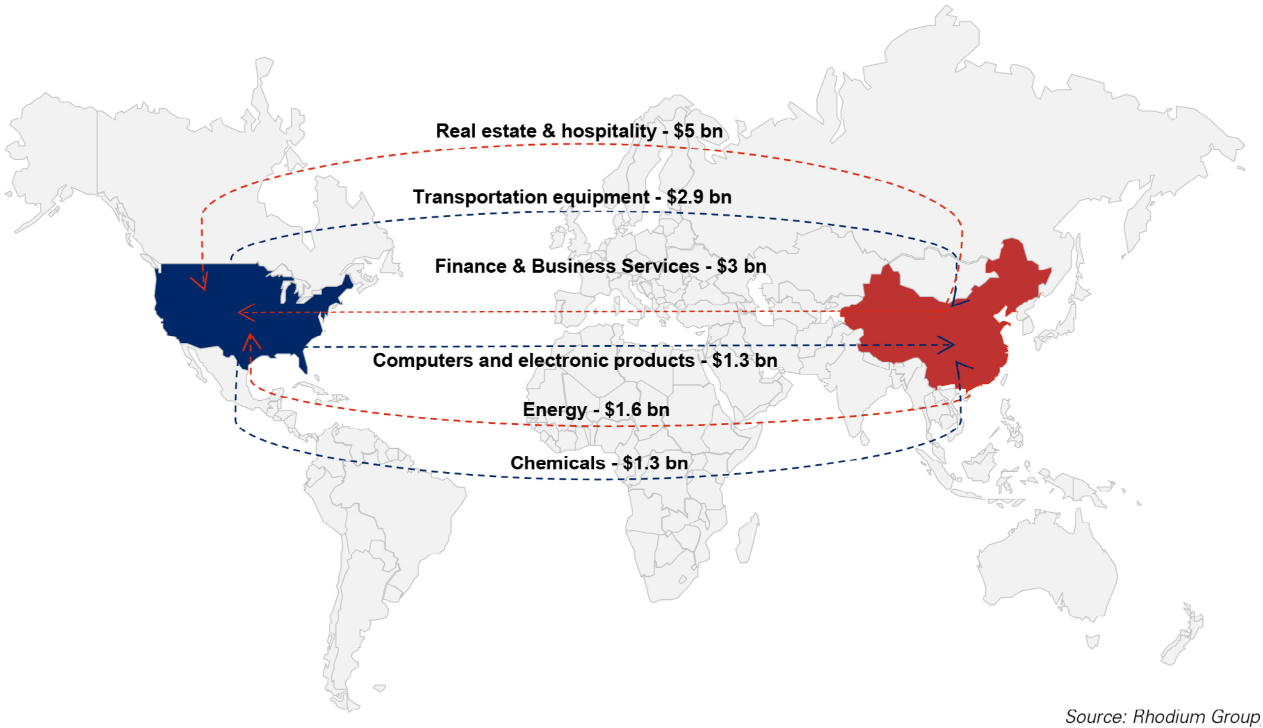
Watch: **Milton Friedman, How to Cure Inflation**, 1980
Cite:- **Back To The 70's Inflation Pushes Sydney Out Of Reach**, 12 September 2015
Cite:- **Cross Asset Inflation**, 13 March 2019

Despite the fact that **determining Inflation has always been difficult** and at times nebulous, there is evidence that the supply shocks of late 2021 and now early 2022 have more to do with edicts from the PRC's Běijīng-based Politburo than that of natural dynamics across transnational commerce.



Buried deep within the details of the **Economic And Trade Agreement Between The Government Of The United States Of America And The Government Of The People's Republic Of China** lie the conditional requirements for continued Sino-American outsourcing, or bluntly put, continuation of American and European factories and subsidies within the People's Republic.

Export growth has been a major component supporting China's rapid economic expansion and in the last few years, **machinery and transport equipment accounted for almost half of total exports**, in particular, electrical machinery, apparatus and appliances (14 percent), telecommunications and sound recording and reproducing apparatus and equipment (12 percent), office machines and automatic data processing machines (8 percent), general industrial machinery,



Source: Rhodium Group

equipment and mechanised parts (5 percent) – all of which looks very likely to change in 2022.

The ***Belt and Road Initiative***, or ***BRI*** – a global infrastructure and connectivity plan initiated by China – has undergone significant changes in its policy implementation environment since it was first proposed in 2013. Faced with escalating tensions between the US and China and a sweeping pandemic, many assumptions upon which the original BRI policy framework was formulated no longer stand.

As with other types of mega-scale infrastructure programmes, BRI outcomes depend on future changes in the system that are hard to predict as well as opposing preferences of stakeholders that are difficult to balance.

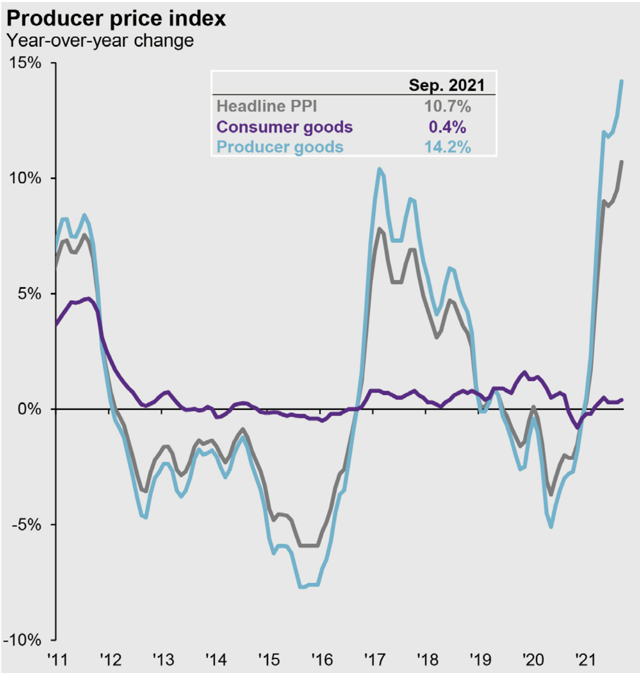
In May 2015, Chinese state planners launched another initiative to promote and support the development of advanced industries and technologies, titled ***China Manufacturing 2025 ('CM2025')***, the plan sets ambitious goals for developing ten industries.

There is no doubt that China's continuous, growing investments in research and development, and attempts to encourage its domestic industry to strive for quality and efficiency have a great deal of merit, notwithstanding, the broad set of policy tools that are being employed to facilitate CM2025's development are highly problematic and raise the spectre of China carefully closing their factories to the West, in so doing shifting the hegemonic balance back to the ***Middle Kingdom***.

This has already created problems for both China's economy and Western (European plus American) corporations.

Under recently passed legislation in the new energy vehicle (NEV) industry, for instance, European conglomerates are facing intense pressure to turn over advanced technology in exchange for near-term market access; in the field of industrial robotics, government subsidies are contributing to overcapacity in the low and mid-tiers of China's market and in the information technology industry US and British multinationals are seeing market access constrict further, with all the known and typical fingerprints of Běijīng.

To achieve quality growth over the medium-term, China will need to rebalance its economy and these transnational relations across several dimensions or else face the plight of history, falling fowl of the *Thucydides Trap* *tête-à-tête* the United States.



Source: CEIC, National Bureau of Statistics of China
Data are as of October 31, 2021.

Listen:- Australian Standfirst Podcast Guest Professor Ezra Vogel, 06 May 2020 (Professor Vogel's last interview, *Rest In Peace*)

Further exacerbating discord, over the past year, the Chinese government has embarked on a wide-ranging, severe and unprecedented melioration of its technology industries along with an array of powerful business interests, also distancing themselves from multilateralism, with President Xi warning of a "*new cold war*" if the US "*keeps up protectionism*" (sic).

Cite:- US China Trade Wars Are Not The Only Problem For Investors As Tech Fight Looms, 9 April 2018
Cite:- The Investment Theme We Like, For A Technology We Hate: Facial Recognition Technology (FRT) and Dual-Use Applications, 13 July 2020

Cite:- The Lucrative Investment Question Of Our Time: Chinese Technology – Sino Semiconductors, Digital 元 & Cyber-Sovereignty, 26 April 2021

2021 has been a year of change for Sino policymakers, continuing to normalise macroeconomic policies inline with these newer regulatory measures across numerous sectors.

Given the upcoming Běijīng Winter Olympics and the Twentieth Party Congress, the Politburo will continue its "***Zero Covid***" policy despite a high vaccination rate and medical improvements domestically and regionally.

Cite:- Anticipating China's Second COVID-19 Wave, 29 March 2020

The experience of the US-China trade war and the ***Global Corona Crisis, or GCC***, have likely convinced Chinese policymakers that resilience is more important than speed when it comes to growth and its implementations of both ***BRI*** and ***CM2025***.

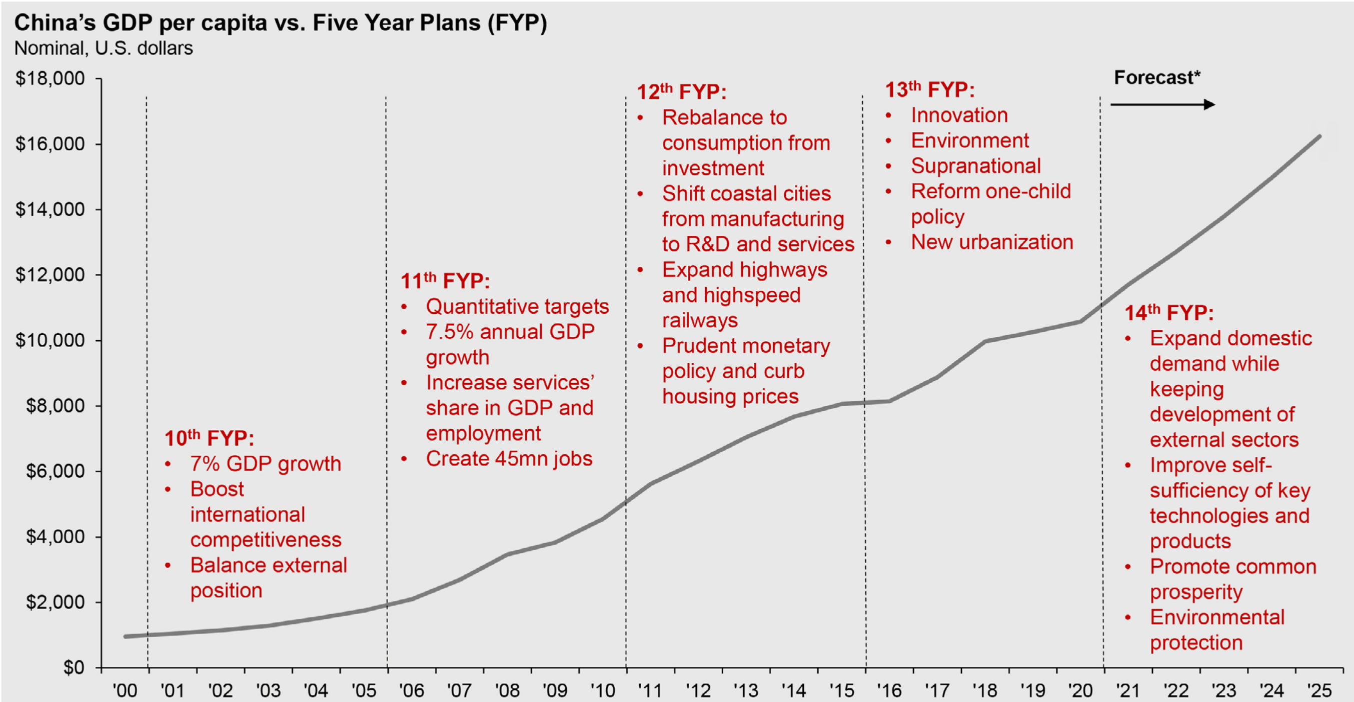
As President Xi aims to secure a third term later this year, the leadership seems to be taking an even longer-term view on development than before.

Framing all within this backdrop, the Chinese economy is settling into a new regime where policymakers accept slower growth in the near term for a more resilient economy in the long run.

Accepting this premise, then it becomes logical why the 2021 calendar year PPI-CPI inflation gap, which reached an all-time high in September, rattled both global bourses but also the ***US Federal Reserves' FOMC***.

Cite:- Gearing Up For Market Moments In The US, China and Europe, 8 August 2015
Cite:- Surviving The US Federal Reserve's Monetary Policy Rollercoaster, 21 March 2016

Throughout 2022, the ***People's Bank of China, or PBOC*** will continue to lean on structural monetary policy instruments – such as relending



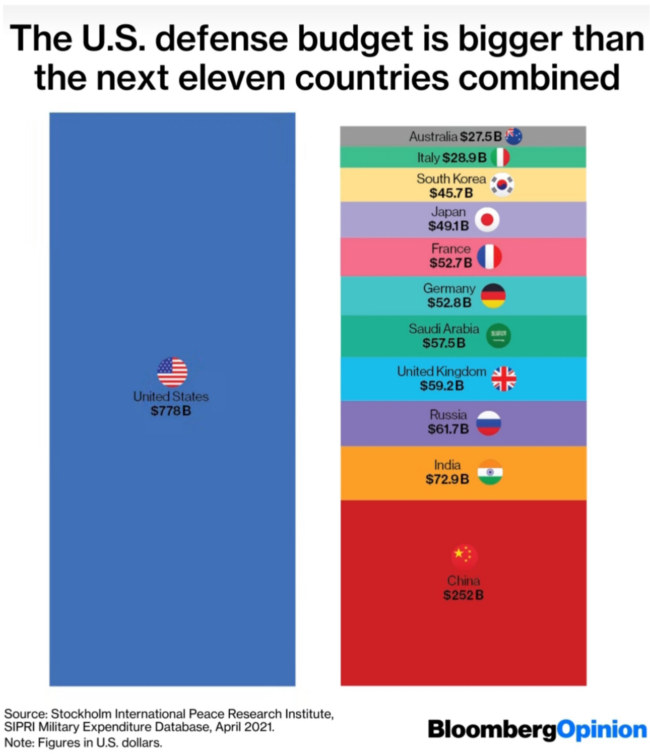
Source: CEIC, IMF-World Economic Outlook.

programmes – to provide more targeted support to the economy while refraining from changing policy rates in either direction.

Sino fiscal policy is likely to loosen somewhat as well after tightening significantly in 2021, with the augmented fiscal deficit rising from eleven to twelve percent last year, especially seen in Defence expenditure (on-book, let alone, off-book).

The US Defense Department's annual report on the Chinese military, released in December, revealed a chilling reality; ***The People's Liberation Army, or PLA*** could field one thousand nuclear warheads by 2030 — and has the ability to deliver them.

Cite:- War with China, Thinking Through the Unthinkable, 2016
Cite:- Taiwan's Looming Crisis Is A Much Bigger Threat Than Markets Realise, 20 June 2018
Cite:- Taiwanese War & Markets Fallout, 30 January 2019
Cite:- Military Conflict With China, 6 November 2019

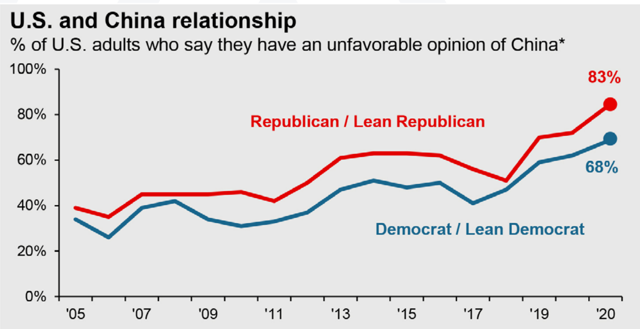


Cite:- Hong Kong Affects Backend Of Australian Wealth Management, 4 December 2019
Cite:- What Goes On While Global Focus Is Directed Elsewhere, 19 March 2020
Cite:- Goodbye Hong Kong, 19 April 2020
Cite:- Wolf Warrior Statecraft, 5 May 2020
Cite:- Australia's Impossible Choice: Taiwan, 13 December 2020

Sinospheric tensions extend beyond the theatres of military conflict, with December marking twenty years of China's WTO membership, which instead of reducing mercantile frictions and trade disputes, has only emboldened fracases, leaving the WTO as a deteriorated hub where it appears to be ***The Sinosphere*** versus everyone else.

Cite:- Why MSCI China A Inclusion Is A Big Deal, 23 May 2018
Watch:- Bloomberg: Rishaad Salamat, Yvonne Man & Australian Standfirst Discuss 2019 The Transition Year, 29 March 2019

Whether it is the Xi'an factory shutdowns masking the Politburo's true agenda of squeezing microprocessor supplies to Europe and North America after their tacit support of Taiwan or the Politburo's views on the Biden administration's



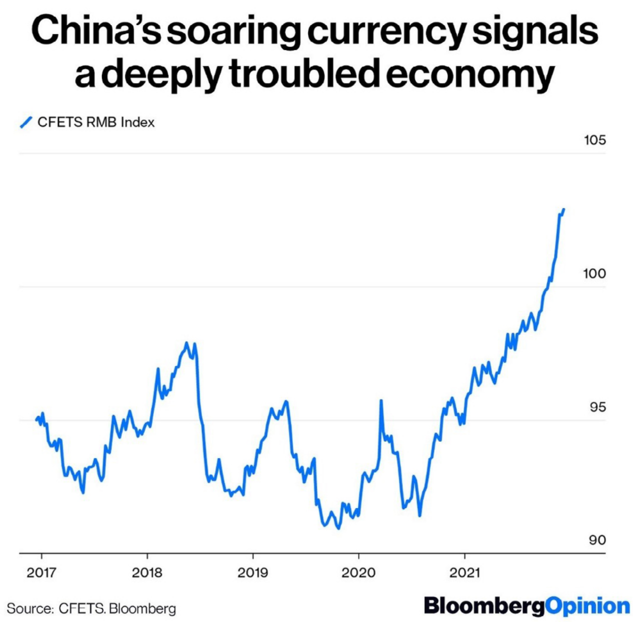
tariffs on China – as a means of reducing inflation, boosting employment and income *Stateside* – the Chinese have legitimate cause for holding such views, with US Senate Majority Leader Chuck Schumer keeping Chinese issues on the agenda by advancing the US Innovation and Competition Act, which includes sanctions on China for human rights issues, its trade with North Korea and state-sponsored cyberattacks.

Cite:- Why Cyber Security Will Be Key Issue In 2020s, 15 January 2020
Cite:- Stress-testing The Bull Case For Israeli Tech In Australian Global Portfolios, 3 February 2021
Watch:- Bloomberg Kathleen Hays & Australian Standfirst Discuss Iran, Cyber, US Markets & Australian Bushfires, 9 January 2020
Cite:- South Korean Bourses Surge During the Great Corona Crisis: An Alternative To Pax Sinica & The American Technology Rally, 23 August 2020

In addition, China is only sixty-two percent compliant with its Phase One trade deal agricultural purchases from the US, with tariffs estimated to have reduced US employment by 245,000 jobs, to have reduced annual US household income by US$675-$2,000 and to have reduced S&P500 earnings by circa seven to eight percent.

These seismic frictions help explain why trade compliance episodes have distorted inflationary metrics and since the start of the pandemic, why the Chinese Yuán has appreciated ten percent on a trade-weighted basis.

There are reasons to think that this heady pace of



appreciation will slow in 2022.

First, the boom in goods production and trade in the aftermath of the most acute phase of the ***GCC*** in 2020 was a major tailwind to the Chinese current account, as was the near-complete stop in tourist flows (a major services import), but both these drivers should eventually reverse as the economic recovery matures.

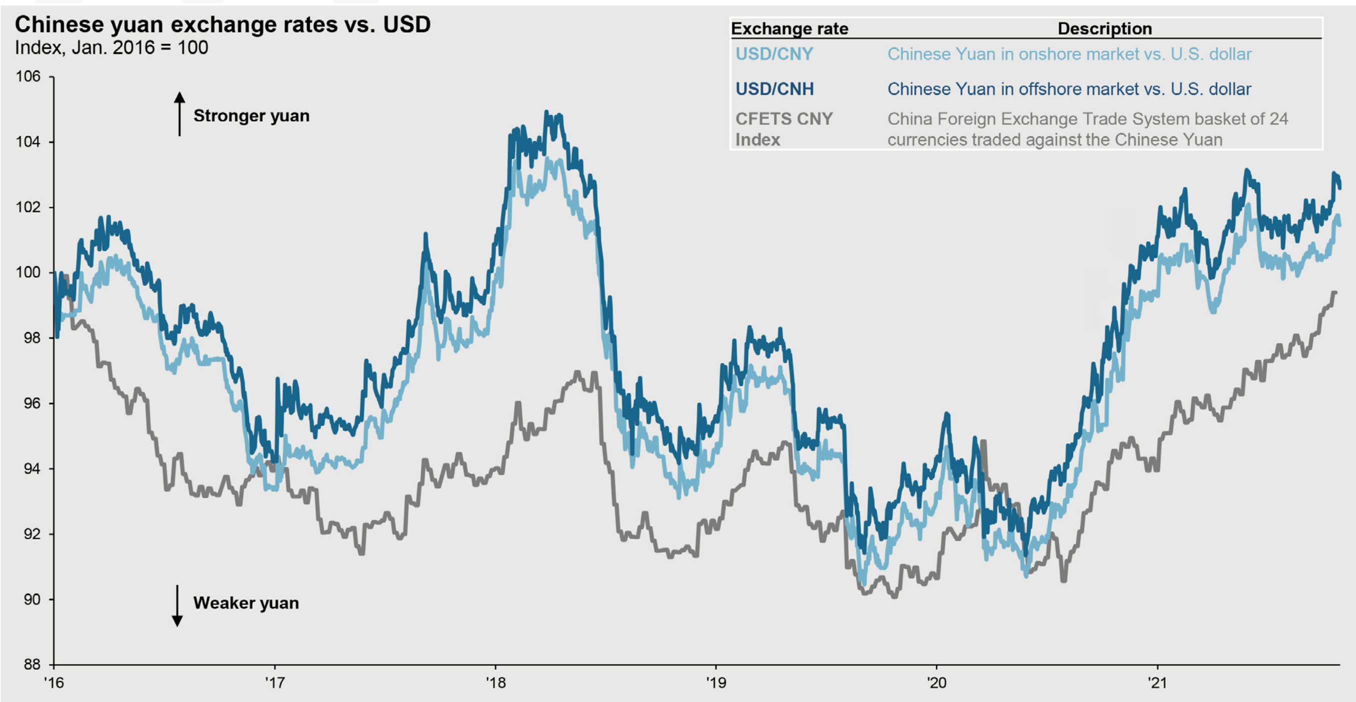
Cite:- How Chinas Devaluation Could Affect Australia, 15 August 2015

Second, interest rate differentials between China and its key trading partners are narrowing, as policy tightening gets going across the world and China's own economic growth profile settles at a lower level.

Third and most importantly, the ***PBOC*** has signalled some discomfort with the pace of appreciation over the past year, as there are two-sided risks to the Yuán continuing to appreciate, especially before ***Trumponics*** potentially resurfaces during US 2022 Mid-Term elections and the 2024 Presidential Election cycle.

Cite:- Will The Instosdriven Donald Trump Rally Last Long, 6 December 2016
Cite:- Trumponics Gaining Attention But Its China That Matters, 4 February 2017
Listen:- Bloomberg: Australian Standfirst Interview Discussing 2019 is All Important Transitional Year For China, 2019
Cite:- Trump's Bull Rally, 22nd Amendment & How The First American Republic Ends, 19 December 2019
Cite:- US War With Iran & The Greenback: Oscillations Between Denial, Panic & Bellicose, 2 August 2020

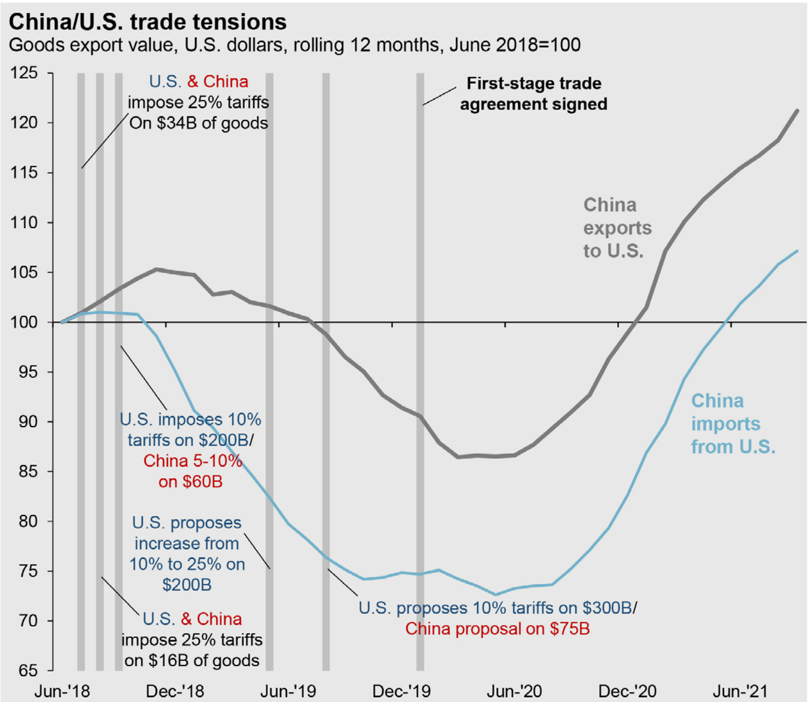
On the one hand, low Covid immunity levels mean that China is uniquely exposed among major economies to renewed outbreaks and lockdowns, which could weigh on the currency but equally inverse, the Biden Administration could consider reducing certain tariffs, thereby supporting the currency, although unlikely until after the US midterm elections.

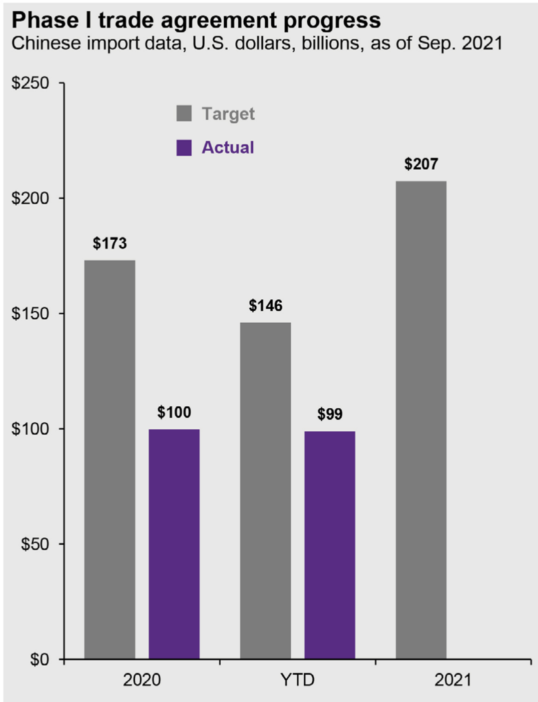


Source: FactSet, China Foreign Exchange Trade Center, Data are as of October 31, 2021.
Past performance is not a reliable indicator of current and future results.

Cite:- Proactively Positioning For 2022 US Midterm Elections: Making Sound Money In All Eventualities, 13 September 2021

Global inflation is close to the highest level in twenty years, driven by surging cost-push goods prices and changing consumption patterns due to pandemic, the inability of a ***just-in-time*** corporate sector to respond, soaring government debt, monetary policy that dwarfs anything seen after the ***Global Financial Crisis*** a decade ago and energy policies which reduce the supply of thermal energy much faster than they reduce demand.





Source: China Customs, (Left) CEIC; (Right) Peterson Institute for International Economics.

Cite:- Practical Guide For Australian Investors: 2020 to 2022 Roadmap, 13 April 2020

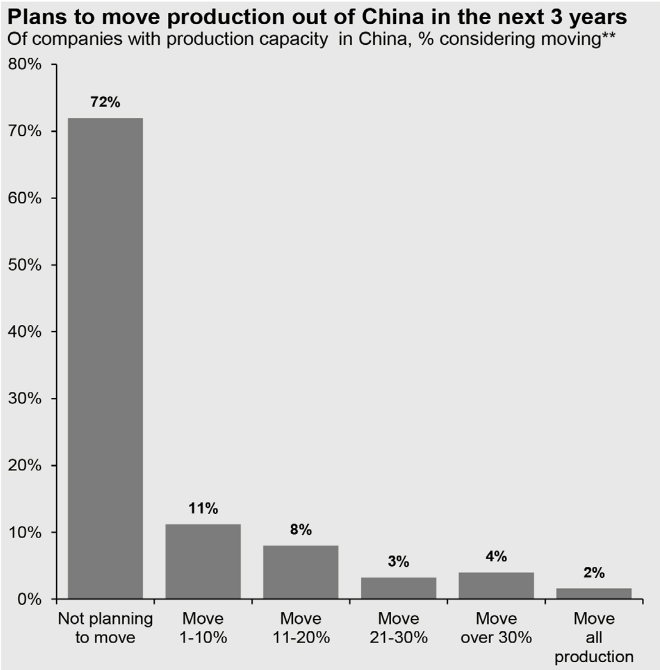
The surge in goods spending *vis-à-vis* services which sparked the supply chain mess in the first place is only being exacerbated further by China beginning to ***salt the earth***, by closing off its factory plus export capacities just when Europe and North America require them the most.

There is a growing realisation among companies that moving manufacturing out of China may be possible, but it will not come cheaply.

Acknowledging this and in response, the ***FOMC*** would likely welcome a moderate upward re-anchoring of inflation expectations in order to ensure the success of its own domestic goals under the new December 2021 policy framework of averaging two percent inflation in the future.

This is one reason why the committee announced three US rate hikes and a start date for balance sheet *run-off* in 2022, to maintain a steady pace of tightening thereafter, even though 2022 is expected to be a year in which both growth and inflation moderate considerably.

Cite:- Rates Riot Behind The Market Correction, 29 August 2015
Cite:- Truth Stranger Than Fiction As Yellen Sounds Death Knell For Economy, 19 September 2015
Watch:- Bloomberg: Rishaad Salamat & Australian Standfirst Discuss Powell Brings Business As Usual, 27 November 2017



Cite:- The Inexorable Effect Of Unconventional Monetary Experiments On Equity And Bond Prices, 5 July 2020
Cite:- German-American Interest Rate Differentials: The Bundesbank's, ESG & A Federalised Europe, 8 August 2020

Rome wasn't built in a day but it was brought down by expeditious forces, inflation and the debasement of its legal tender (currency), which leads us to another word we inherit today, Byzantine (of a system or situation which is excessively complicated and typically involving a great deal of administrative detail); the economic and markets impacts of Běijīng's injunctions and interferences should not be underestimated nor the misrepresentations of closing factory access to the West and misunderstanding those supply shocks as natural inflationary machinations.

This is not the end of this story. ■

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