



Issue 1/2019 (December 20, 2018 – January 10, 2019)

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METRIX

860,000,000,000

China's top planning agency, the National Development and Reform Commission, has approved urban rail projects worth a total of 860 billion RMB (125.3 billion USD) since the beginning of December. Among the projects approved are subway lines in the cities of Shanghai and Wuhan as well as regional lines in Jiangsu province. Overall China aims to build 6,800 kilometers of railways in 2019, including 3,200 kilometers of high-speed rails, adding to an existing network of 29,000 kilometers.

TOPIC OF THE WEEK: CHINA'S ECONOMY IN THE NEW YEAR

Pressure on export economy and job market increases: 2019 will be a difficult year for China

China's economy is headed into a challenging year in 2019. **Falling confidence among manufacturers** reflects growing uncertainty about growth prospects. Should trade negotiations with the United States fail, China's still massive export sector could take an immediate hit leading to mass layoffs of workers. Confronted with slower economic growth much is at stake for China's leadership. They will be particularly vigilant to ensure a stable labor market as rapidly rising unemployment could fuel social unrest.

The concerns were reflected in the government's **Central Economic Work Conference**, which concluded on a more subdued note compared to previous years. An official Chinese government summary of the event mentioned a "complicated international environment" and "pressure on the economy down the road." Sentiment in manufacturing measured by the Purchasing Managers' Index has fallen rapidly. A drop below 50 points in December for the first time since 2016 reflects business' expectation of weakening business activity.

The slowdown in 2018 was mainly caused by domestic factors including efforts to reign in rapid credit growth. The growth target of "around 6.5 percent" will be met for the year, but the second half of the year exposed weakening growth. GDP growth in the third quarter was 6.5, and it is likely that it fell below this mark in the last quarter, which has not yet been publicized.

So far, the labor market has remained fairly resilient. **Nearly 13 million new urban jobs** were created from January to November 2018 (surpassing the target of 10 million). Providing a stable employment environment is complicated by **rising numbers of university graduates** (8.4 million in 2018). Should the educated and part of the middle class find their employment and income expectations disappointed, this could quickly lead to more forceful expression of discontent.

China is entering the current trade negotiations with the US at a time when its economy is showing signs for struggling. A further escalation of the trade conflict could further push down economic growth and lead to rising unemployment. **20 provinces have introduced measures** to support employment as China faces what media has called the "worst employment season ever" ahead of the Chinese New Year celebrations.

MERICS-Analysis: Maximilian Kärfelt and Max J. Zenglein regularly analyze the development of the Chinese economy and publish their findings in the „**MERICS Economic Indicators**“. The analysis of the fourth quarter of 2018, including an outlook for 2019, will be published at the end of January.

CHINA AND THE WORLD

From Taiwan into space – China will increase power projection in 2019

The new year began with a series of events and announcements demonstrating China's determination to become a global power that can project military force in its region and beyond by 2049. President Xi Jinping stressed the need for the PLA to be prepared for battle and emphasized the use of force as an option to achieve reunification with Taiwan. The successful **landing of a Chinese spacecraft on the far side of the moon** illustrated the country's ambitions beyond traditional regions and domains and signalled that space may become a new area of contention between China and the United States.

All these activities so early in the year show that 2019 is most likely going to see a continuation of current trends in China's increasingly assertive international security activities. In a **speech on January 2**, at an event to mark the 40th anniversary of China's Message to Compatriots in Taiwan (which laid out Beijing's policy towards the island), **Xi called for peaceful reunification with Taiwan** and promised to respect its religious and legal freedoms under a "one country, two systems" model, but also emphasized that the use of force to achieve this goal remains an option. This was Xi's first major speech on the Taiwan issue. In practice, this means that Beijing's position on Taiwan will remain unchanged, but that the PLA is likely to intensify its activity around the island.

On January 5, **Xi spoke at a Central Military Commission meeting** in Beijing. He ordered the PLA to make sure they're always ready for battle and said that the "world is in an era of drastic changes and China is still in a strategically significant period vital to the country's development." Prior to that, the official newspaper of the PLA (PLA Daily) had outlined the top priorities for China's military in 2019 in its New Year's editorial on January 1, which included strengthening training and preparing for war.

The PLA will continue to focus on better training and the development of its combat capacity in line with Xi's priorities. This involves the development or acquisition of new (often dual-use) capabilities, supported by cooperation with the private sector, domestic innovation and actions to encourage tech transfers from Europe and the United States.

Xi has turned civil-military integration into a national strategy. This also covers China's space program. On January 3, China's space program landed a spacecraft (Chang'e-4) on the far side of the moon for the first time in history. Beijing plans to expand its footprint with further moon missions and by establishing a space station by 2022, creating competition with the International Space Station (ISS), which China is not a part of.

MERICS analysis: "Emerging technology dominance: what China's pursuit of advanced dual-use technologies means for the future of Europe's economy and defence innovation." Report by **Helena Legarda** and **Meia Nouwens**.

News in brief

- North Korea: **Kim unexpectedly visits Beijing amidst US-China trade talks, connection denied**

- BRI: [Survey finds 70 percent of Southeast Asians are cautious about China's BRI projects](#)
- Cross-strait tensions: [Taiwan announces new drill tactics to counter possible 'Chinese invasion'](#)
- Pakistan: [Beijing pledges to lend 2 billion USD to shore up rupee and avoid financial crisis](#)
- South Asia: [India claims Pakistan's new Chinese built frigate will not alter balance of power](#)

POLITICS, SOCIETY AND MEDIA

Jubilation and concern: 2019 marks 70th birthday of PRC and 30th anniversary of Tiananmen

2019 will be a year of many anniversaries for China. On October 1, the PRC will celebrate the 70th year of its existence, no doubt providing the leadership with many opportunities for festive speeches and ambitious announcements. But this year will also feature an anniversary the CCP is less keen on remembering. June 4 marks the 30th anniversary of the crackdown on the democracy movement in Tiananmen Square in 1989. Stability maintenance measures will be in full swing, as the CCP will do everything in its power to prevent social unrest or any form of commemoration.

During the jubilee year, party and state leader Xi Jinping will be measured against his plans to establish China as a global political and economic power. He will also have to stand the comparison with his predecessors Mao Zedong, the founder of the PRC, and with Deng Xiaoping, the architect of the country's economic reform and opening policy.

Despite its confident rhetoric, regime security remains a major concern for the CCP. The Chinese government spends billions on "stability maintenance" each year. According to [media reports](#), these expenditures may even exceed China's military budget.

Concern for political and social stability will put the CCP in constant crisis management mode in 2019. Repressive actions initiated in 2018, from tightened ideological controls and crackdowns on independent religious groups to the establishment of internment camps in Xinjiang, can be expected to be continued and intensified.

Hong Kong is the only place in China where the Tiananmen crackdown has been traditionally remembered. The Special Administrative Region of China still functions under different rules, though Beijing has been trying to close the gap. The Hong Kong Alliance in Support of Patriotic Democratic Movements in China has already announced that it will open a [June 4 museum](#) before the anniversary.

But June 4 is not the only sensitive anniversary in 2019. March 10 marks the 60th anniversary of the Tibetan Uprising in 1959. Its anniversary in 2008 saw widespread unrest. April marks the 20th anniversary of Falun Gong protests in Beijing, which resulted in the outlawing and systematic persecution of the movement. Ten years ago in July, major unrest broke out in Urumqi, Xinjiang. And, of course, the CCP also views the various anniversaries related to the dissolution of the Soviet bloc, including the fall of the Berlin Wall in November, as potential sources of political and social instability.

News in brief

- Cross-strait relations: **Xi calls reunification “inevitable,” threatens Taiwan with use of military force**
- Legal reform: **NPC Standing Committee recommends abolition of “custody and education” system used for prostitution-related offences**

ECONOMY, FINANCE AND TECHNOLOGY

US-China trade war carries on in 2019, bilateral talks raise hopes for resolution

Trade talks between US and Chinese government officials in Beijing have ended on a positive note this week, potentially **clearing the way for more high-level talks** later this month. A deal would have to be reached before March 2 to prevent the next round of planned US tariff hikes on Chinese imports from going into effect.

The visit of the US delegation, which was led by Deputy Trade Representative Jeffrey Gerrish, was the first official meeting between mid-level officials after Trump had declared a 90-day ceasefire on the sidelines of last year’s G20 meeting in Argentina.

Opportunities for higher-level exchanges will be Trump’s attendance at the World Economic Forum in Davos, Switzerland, later this month and a planned visit by China’s Vice Premier Liu He to Washington shortly thereafter.

As the bilateral talks were underway, China made a **large purchase of US soybeans** and issued approvals for the **import of five genetically modified US agricultural crops**. This appeared to be a small, but important sign of goodwill, especially as previous Chinese tariffs had targeted US farmers.

Stock markets responded positively to the news. **Asian stocks jumped** after the talks had been extended for an unexpected third day on Wednesday. The **Dow Jones** also started the day with gains.

In the face of slowing domestic growth, the trade standoff is especially dangerous for China. Both the Chinese stock market and the currency have registered losses in 2018 as a result of the trade war. Chinese companies reported lower export orders in the latest Purchasing Manager’s Index (see Topic of the Week), indicates that the trade war could soon be felt in the real economy.

News in brief

- 54 demands: **German Industry demands tougher EU line on China**
- Securing growth: **China’s Central Bank cuts reserve requirement ratio for fifth time in one year**
- Supporting businesses: **Premier Li calls on banks to provide more support to SMEs**
- Accelerated production: **Tesla could produce first e-vehicles in China by second half of 2019**

- Historical decline: **Car sales in China drop for first time in 20 years - VW still predicts rising sales in 2019**

THE EUROPEAN VIEW

Cyber-security becomes central issue in EU-China relations

If the scandal that erupted in December 2018 over an alleged Chinese hacking campaign against EU diplomats is any indication, more conflicts with China in cyberspace are bound to erupt in 2019, posing serious risks to European interests.

On December 18, 2018, a **New York Times investigation** had revealed that an elite unit of China's People's Liberation Army hacked EU diplomatic cables for over three years, obtaining access to sensitive information related to foreign policy and trade. The European Commission is still investigating this claim. In the following days, the **United Kingdom and the United States announced an indictment** against government-backed Chinese hackers alleged to be behind another attack on a range of global companies, with the aim to gain access to commercial secrets.

In the second case, a **United States District Court in New York charged** a group known as the Advanced Persistent Threat Group 10 (APT 10) with being the source of this and other attacks. It also issued an indictment against two members of the group and asserted that APT 10 acted in association with the Chinese Ministry of State Security. **British Foreign Secretary Jeremy Hunt called** the attack, "one of the most significant and widespread cyber intrusions against the UK and allies uncovered to date, targeting trade secrets and economies around the world."

China had stated its ambitions to improve its cyber capabilities in its 2015 Defense White Paper and related military restructurings. At the same time, China sought to quell international concerns. In 2015, it concluded legally non-binding political agreements with the United Kingdom and the United States committing not to conduct or support cyber-theft and cyber-espionage activities. The same type of deal was signed between China and Australia in 2017. In May 2018, German and China held cyber-security consultations for the first time.

Other European countries, among them **Germany, Denmark and Poland**, joined the UK in condemning China's cyber-espionage for undermining the rules-based international order, the stability of the cyberspace, and their countries' economies. Following these cases, the **EU is now reportedly set to toughen scrutiny** of potential security risks presented by Chinese technology companies, especially as EU countries hold 5G auctions, in which Chinese IT companies are bidding to build European 5G networks.

MERICs researcher **Lucrezia Poggetti**: "The latest cases of cyber-espionage cast doubts on the adequacy of non-binding agreements on cyber-security with China. They are also another example of China's lack of commitment to international agreements. The EU's plan to toughen scrutiny of Chinese IT companies is a good start. However, Europe will have to invest even more in its own cyber capabilities to protect its economic and security interests."

PROFILE

Xiang Songzuo: An outspoken critic of China's economic policy

This figure presumably left his audience breathless: while official estimates predict 6.5 percent growth for the Chinese economy in 2019, **Beijing People's University economist Xiang Songzuo** told a group of management students in December that the real growth was more likely to amount to a meager 1.67 percent. Xiang cited calculations by a group of researchers at an "important institute," also mentioning other estimates that predicted a "negative growth rate."

With his speech, titled, "**A Great Shift Unseen Over the Last Forty Years**" (四十年未有之大变局), the 53 year old joins a rather small group of economic experts who openly criticize Beijing's course. In the **25-minute long speech**, Xiang revisited the past year's major economic events – and suggested that official Chinese assessments and responses may have been misguided. China's official media had prematurely declared China the winner in the trade conflict with the United States. "Did we misjudge the gravity of the situation?" asked Xiang. He also questioned the assumption that the weakness of the economy could be remedied by stimulating consumption alone.

Xiang, who hails from Hubei province in Central China, is known as outspoken; but he is also recognized as part of the economic policy establishment. This makes his highly critical speech all the more remarkable. It was viewed 1.3 million times on Youtube, but is not publicly available in China. Until recently, Xiang was the chief economist of China's Agricultural Bank. Following his economic studies at the US-based Columbia University, among others, he embarked on a successful academic career, interrupted by stints at leading financial institutions, for example as an expert on currency policy at China's Central Bank.

Xiang concluded his speech in Beijing by appealing to the China's leaders: 40 years after the beginning of Deng Xiaoping's reform and opening up, they should send a signal for "deepening reforms." Otherwise, "the Chinese economy is going to be in for long-term and very difficult times."

The announcements by China's party and state leader Xi Jinping must have disappointed Xiang: Xi confirmed his intention to strengthen the role of the Communist Party in steering the economy. Shortly after that, the "**New York Times**" was unable to reach Xiang for comment.

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