China warns of retaliation as Trump launches trade probe

AFP, *Beijing*

Trade tensions between the United States and China heated up on Tuesday as Beijing warned that it "will not sit idle" if a US probe into its intellectual property practices leads to sanctions.

President Donald Trump's decision to order the investigation comes on top of strains between the two nations over how to handle Beijing's ally North Korea.

Trump on Monday signed a memorandum directing US Trade Representative Robert Lighthizer to determine whether Chinese policies hurt American investors or companies -- with retaliatory measures a possible outcome.

"We will stand up to any country that unlawfully forces American companies to transfer their valuable technology as a condition of market access. We will combat the counterfeiting and piracy that destroys American jobs," Trump said.

"Washington will turn a blind eye no longer," Trump said, vowing to safeguard copyrights, patents and other intellectual property that are "vital to our security and to our prosperity".

The president said the US would no longer tolerate Beijing's "theft" of US industrial secrets, long a concern of major foreign corporations seeking a share of the huge Chinese market.

"We will engage in a thorough investigation and, if needed, take action to preserve the future of US industry," Lighthizer said.

China's commerce ministry issued a statement voicing "serious concern" and warning that any US trade protectionism "will definitely harm bilateral trade relations".

"If the US side take actions that impair the mutual trade relations, disregarding the facts and disrespecting multilateral trade rules, China will not sit idle," the statement said.

REUTERS/FILE

US President Donald Trump, *left*, and Chinese President Xi Jinping meet on the sidelines of the G20 Summit in Hamburg, Germany, on July 8.

The ministry said the country "is definitely going to adopt all appropriate measures to vigorously defend the lawful rights and interest of China."

The United States is China's second-largest trading partner after the European Union, but Washington and Beijing have seen their relations grow increasingly fraught since a promising summit between Trump and China's Xi Jinping in April.

The new intellectual property inquiry joins numerous investigations launched by Washington into Chinese trade practices, notably those concerning steel and aluminum and their national security consequences, which the Trump administration began earlier this year.

However, the start of a US probe will not immediately result in open confrontation.

Lighthizer will first need to reach a preliminary finding of unfair practices by China before opening a formal investigation, which could take as much as a year, administration officials said.

The Chinese commerce ministry said the country has "always been paying high attention to intellectual property right protection, continuously perfecting the legislation," and that the progress it has made on that front is "obvious to all".

Yang Zhao, chief China economist at Nomura research firm, said a US tariff penalty would only cause minor impacts on the Chinese economy and fall short of a full blown trade war.

"The decision to launch this probe may raise the risk of tit-for-tat trade protectionism," Zhao said in a note.

"But we believe the Trump administration's strategy is more likely to be one that looks to raise its bargaining power to reach a better longer-lasting solution over the start of, or the threat of, a real trade war."

Since launching his successful run for the White House and then taking office, Trump has frequently accused China of undermining the US economy.

The bilateral US trade deficit with China approached $350 billion in 2016, and Trump has repeatedly blamed Chinese imports for gutting employment in US sectors such as steel.

Last week, Washington announced preliminary sanctions against Chinese imports of aluminium foil. But so far, the US has not imposed heavier trade measures on Chinese goods.

On Thursday, Trump reiterated the suggestion that he could soften his position on trade if Beijing were to do more to help rein in nuclear-armed North Korea.

China said it would halt iron, iron ore and seafood imports from North Korea starting Tuesday, in accordance with new UN sanctions that Beijing voted to approve.

US administration officials, however, have denied any link between the latest trade action and Pyongyang's nuclear ambitions.

Beijing echoed this view Monday, with the foreign ministry saying the two matters were "totally different." Despite Monday's expected action, Trump has so far refrained from making good on threats of retaliatory trade measures against China.

This includes in particular concerns over Beijing's requirement that foreign companies establish local joint ventures. According to Washington, this can mean surrendering technological know-how to Chinese partners.

Solid German growth gives Merkel election tailwind

REUTERS, *Berlin*

Strong household and state spending consolidated Germany's role as the euro zone's growth engine in the second quarter, helping Chancellor Angela Merkel to burnish her economic credentials less than six weeks before an election.

Tuesday's data are the last major growth figures to be published before the Sept. 24 vote, in which Merkel is seeking to win a fourth term. Merkel's conservatives enjoy a comfortable lead over the Social Democrats (SPD), their current coalition partner; an INSA poll on Tuesday put their support at 37 percent to the SPD's 25.

Yet while neither party wants another grand coalition, a fractured political landscape could make it hard to form another viable alliance.

Angela Merkel

In the second quarter, Germany's seasonally adjusted gross domestic product (GDP) was up 0.6 percent from the previous quarter - just below the consensus forecast of 0.7 percent in a Reuters poll, but still the 12th consecutive quarterly growth reading.

In addition, first-quarter growth was revised up to 0.7 percent from 0.6. Annual growth in the second quarter, adjusted for calendar effects, rose to 2.1 percent from 2.0.

"The German economy is proving its staying power, the upswing continues," Bankhaus Lampe economist Alexander Krueger said, adding that the European Central Bank's low interest rates and bond-buying programme kept on boosting domestic demand.

Germany's Constitutional Court said it had declined to hear a challenge to the ECB's 2.3 trillion euro ($2.7 trillion) asset purchase scheme, referring the case instead to the European Court of Justice.

Second-quarter growth was mainly driven by domestic demand as households and state authorities increased their spending and firms boosted investment in buildings and equipment, the Statistics Office said.

German consumers are benefiting from record employment, rising real wages and low borrowing costs. State authorities are also spending billions of euros on accommodating and integrating more than one million refugees who have arrived since the start of 2015, many from war zones in Syria and Iraq.

In addition, a growing population, increased job security and record-low interest rates are fuelling a construction boom in Europe's biggest economy.

Growth in the second quarter was dampened, however, by net foreign trade, since exports rose less strongly than imports, which the vibrant domestic economy sucked in at a higher rate.

"Germany's economic success story goes on and on and on," ING Bank analyst Carsten Brzeski said, adding there was very little reason to fear a sudden end to the current performance.

He cautioned, however, that the main drivers supporting the domestic economy, such as rising employment, rising wages and increased government spending, could lose some momentum in the coming quarters.

"The same holds for the export sector, where a stronger euro, weaker-than-expected U.S. growth and Brexit uncertainty could take some wind out of the sails without bringing exports to a halt," Brzeski said.

Unadjusted data showed the economy growing by 0.8 percent on the year in the second quarter. Easter fell in April this year while it was in March last year.

The Statistics Office provided only a qualitative assessment of the main growth drivers in the second quarter. A more detailed breakdown will be published on Aug. 25.

Yuan's strength against dollar fails to snuff out depreciation expectations

REUTERS, *Shanghai*

China has given those who bet against the yuan a bloody nose this year thanks to policy moves and intervention by the authorities. And yet, many traders and investors are still tipping the Chinese currency to decline against the US dollar in the next year.

They argue that after a Communist Party leadership meeting in the fall, which is expected to solidify President Xi Jinping's grip on power, there will be room for the yuan to weaken. The Chinese government is determined to keep the financial system and the wider economy stable ahead of the gathering, which is held once every five years.

Even after three consecutive months of strengthening against the U.S. dollar, the first such positive run since 2014, many market participants are unconvinced by the gains.

David Qu, markets economist at ANZ Bank in Shanghai, said he doesn't believe that even with its recent strength the yuan's broad downward trend of recent years has been fundamentally reversed. "I don't think the renminbi is back on an appreciation path," he said, using the other name for the currency.

The People's Bank of China (PBOC), the nation's central bank, did not provide answers to faxed questions about the yuan's trajectory. A Reuters poll of foreign exchange analysts published on August 3 found the yuan is forecast to weaken to 6.85 per dollar in six months and to 6.9 per dollar in a year. It settled at 6.6715 per dollar at the late night close on Monday.

The yuan slumped around 6.5 percent against the surging dollar last year, its largest decline since China unified official and market exchange rates in 1994. The global dollar index, which measures the dollar against a basket of major currencies, rose 3.6 percent in 2016.

This year, the yuan has gained around 4 percent as the greenback has slumped, but analysts say it should be up even more given that the dollar is down about 9 percent against other major currencies.

Companies wary of foreign exchange risks are keeping the yuan's gains in check.

"Half of our corporate clients who are purchasing dollars at current levels are still betting on a decline in the yuan in the belief that the rebound in the yuan has been a result of the weakness in the dollar and central bank intervention," said a forex trader at a regional bank in Shanghai.

Against other currencies, the yuan's value on a trade-weighted basis has actually fallen more than 1 percent this year, indicating it is actually weaker than the dollar exchange rate suggests. Tighter controls on capital outflows have been a big reason for yuan strength this year, along with dollar weakness and signs that the Chinese economy is improving, said Wang Tao, chief economist at UBS in Hong Kong.

"Some fundamental drivers of capital outflows remain - there is still strong demand among households and corporates to diversify their wealth into FX and overseas assets, while concerns about domestic asset bubbles and high leverage also remain high," Wang said. Much of the money changed into dollars in China will actually stay in Chinese bank accounts, rather than circumventing capital export controls, but it still serves as a hedge, experts say.

Japan economy posts longest expansion in over a decade

AFP, *Tokyo*

Japan has posted its longest economic expansion in over a decade on the back of a pickup in household and company spending, data showed Monday.

The country's Gross Domestic Product grew by 1.0 percent in the April-June period, marking the sixth straight winning quarter in the longest string of gains since 2006.

The world's number three economy has been picking up steam, mainly on the back of a surging exports including smartphones parts and memory chips, with investments linked to the Tokyo 2020 Olympics also giving growth a boost.

But the latest GDP figures -- which translate into a whopping 4.0 percent annualised growth rate -- were driven by robust domestic demand and capital spending, which offset a quarterly decline in exports.

Private consumption picked up 0.9 percent in the second quarter. Individual spending accounts for more than a half of Japan's GDP.

The second quarter growth blew past market expectations for a 0.6 percent rise, according to figures from the Cabinet Office. It was well up from a 0.4 percent expansion in January-March GDP.

The labour market is tight and business confidence is high but efforts to lift inflation have fallen flat despite years of aggressive monetary easing by Japan's central bank. The latest reading nonetheless means Japan's economy has had its best string of gains since the tenure of popular former prime minister Junichiro Koizumi.

Monday's figures are good news for the current prime minister Shinzo Abe -- whose brief and underwhelming first term as Japan's premier came directly after Koizumi.

A string of short-term leaders followed Abe's first term before he swept back to power in late 2012 on a pledge to reignite Japan's once-booming economy with a plan dubbed Abenomics.

AFP

A cargo ship leaves a Tokyo port pier on August 14.

The scheme -- a mix of huge monetary easing, government spending and reforms to the economy -- stoked a stock market rally and fattened corporate profits. Some critics have cast doubt on the plan, as heavily indebted Japan grapples with low birthrates and a shrinking labour force.

Abe has seen his public support ratings plummet in the past few months over an array of political troubles, including allegations of favouritism to a friend in a business deal. "This is a good result and tailwind for Abenomics," Shinke Yoshiki, chief economist at Dai-ichi Life Research Institute, said of Monday's data release.

"Consumption and corporate investment are particularly strong, a result of brisk corporate earnings and improved business confidence."

In a commentary, Barclays said: "The strength of private consumption reflects an improvement in employment and income conditions (eg, drop in unemployment, four consecutive years of increasing base pay), but likely also such factors as favourable weather during that period."

Still, wages have not been rising enough to kickstart tepid inflation, and few analysts expect the same kind of growth next quarter.

"Japan's structural problems have not changed: ageing population, decreasing working age population, deteriorating fiscal conditions," said Junko Nishioka, chief economist of Sumitomo Mitsui Banking Corp.

UK to seek 'temporary customs union' after Brexit

AFP, *London*

Britain said on Tuesday it would seek a "temporary customs union" with the European Union for one or two years after Brexit in an opening gambit for negotiations that got a cold response from Brussels.

The government said it would seek to agree a "time-limited period of implementation" after leaving the EU to provide certainty for businesses and allow new customs arrangements to be set up.

The Department for Exiting the EU said Britain wanted to be able to sign free trade agreements with third countries during this period, although these would only be implemented at the end of it.

Brexit minister David Davis told BBC radio that the transition period could last "something like two years" and would have to be over by the time of the next general election, which is set for 2022.

The proposal was welcomed by the Confederation of British Industry, Britain's big business lobby, but opposition parties dismissed it as "fantasy".

The European Commission, the EU's executive arm, said it would "take note" of the proposals but would not negotiate on the future relationship with Britain before other issues are resolved.

"'Frictionless trade' is not possible outside the single market and customs union," it said in a statement.

Britain says its membership of the EU customs union, which currently allows for the tariff-free movement of goods, will end along with its membership of the single market when it leaves the bloc in March 2019.

After that "one possible approach would be a temporary customs union between the UK and the EU," the Brexit ministry said in a statement, ahead of the publication of the full paper later on Tuesday.

Experts have warned it will be extremely difficult to negotiate a new EU-UK free trade agreement before Britain leaves the bloc -- particularly as Brussels has so far refused even to start trade talks.

It says there must be broad agreement first on three key issues -- Britain's financial settlement, the issue of expatriate rights, and the question of the border between British-controlled Northern Ireland and Ireland.

Asked about the divorce bill on Tuesday, Davis said that Britain would meet "any real international obligations" but added that "there won't be a number by October or November".