# CHINA ECONOMIC UPDATE AUGUST 2018

China's trade relationship with the European Union

NAB Group Economics

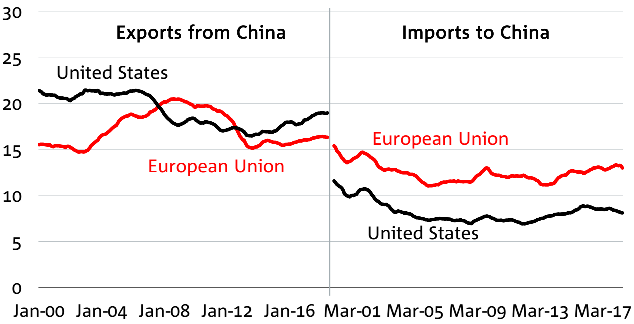
The sheer scale, and growth, of China's trade surplus with the United States is one of the key drivers of the current trade tensions between the countries. Critics in the United States have accused China of unfair trade practices since its admission to the World Trade Organisation in 2001, however it is worth noting China's trade with other regions – most notably the European Union – does not exhibit the same trends as those with the United States. Last month we highlighted the China-EU investment relationship, and this month we're looking into their trade ties.

## AN OVERVIEW OF THE EU-CHINA TRADE RELATIONSHIP

Much like the United States, the European Union is an important trading partner for China, however the profile of exports and imports differ considerably between the two. The EU accounts for a smaller share of China's exports than the US – at just over 16% of the total for the twelve months to June 2018, compared with 19% for the US – but a larger share of imports – around 13% of the total were sourced from the EU in the same period, compared with just 8% from the US.

## CHINA'S TRADE WITH THE US AND EU

**Greater share of imports from EU**

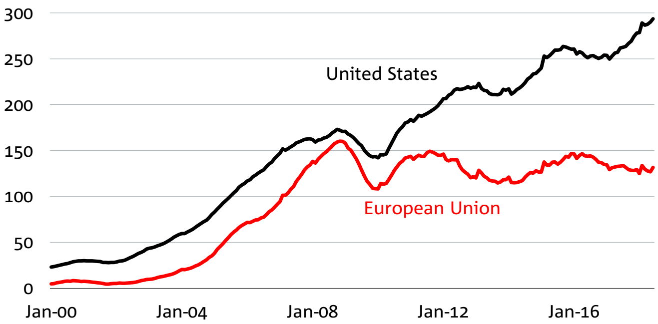


Source: CEIC, NAB Economics

The net effect of these differing trade profiles is a considerable difference in their respective trade balances. While China has sizeable trade surpluses with both the United States and European Union, the surplus with the US has steadily expanded since early 2010 (underpinning the tensions between the countries), while the surplus with the European Union tracked broadly sideways since the Global Financial Crisis. From a relatively similar level in early 2008, China's trade surplus with the US was more than double that of the EU in the twelve months to June – at US$294 billion (based on China Customs data), compared with US$132 billion.

## CHINA'S TRADE SURPLUS

**EU surplus flat as US has expanded**



Source: CEIC, NAB Economics

In part this may reflect the relatively stronger economic performance of the United States over this period – with the EU suffering a series of deep recessions over the period. This contributed to higher rates of unemployment in Europe than the US, limiting the growth of consumption in the region. Compared with the first quarter of 2008, private consumption in the European Union was only around 7% larger in Q1 2018, whereas it had increased by almost 20% in the United States. That said, as economic conditions in Europe started to recover, China's trade surplus started to narrow as the

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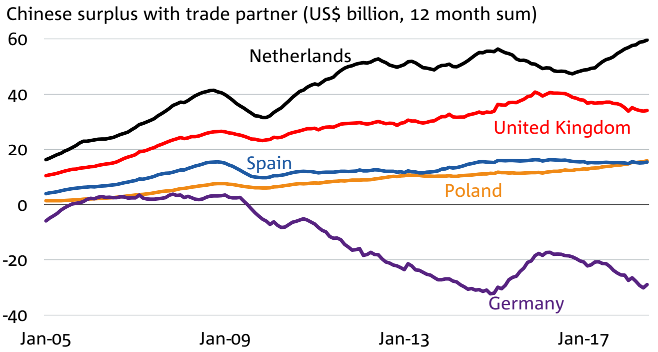
region's exports to China grew more rapidly than imports.

It is also worth noting that the trade balances of individual countries within the European Union differ considerably. China Customs data reports that the Netherlands has the largest trade deficit – at around US$60 billion in the twelve months to June 2018 (albeit as a major port of entry for the EU, some of these goods may be consumed in other markets) – followed by the United Kingdom (at around US$34 billion). In contrast, Germany has a trade surplus with China – at around US$29 billion over the same period.

# EU TRADE BALANCE DIFFERS BY COUNTRY

## China trade deficit with Germany

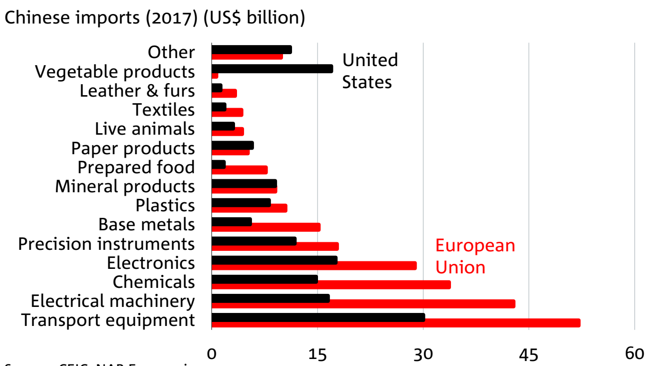


Source: CEIC, NAB Economics

The relatively rapid increase in European exports, and the comparative stability of China's trade surplus with the European Union, may also reflect the composition of the region's exports. Compared with the United States, EU exports to China are much stronger in higher value sectors – such as transport equipment, electrical machinery, chemicals and electronics. In contrast, agricultural products – led by soybeans – made up a larger share of US exports to China – accounting for just over 14% of the total in 2017.

# IMPORTS BY PRODUCT CATEGORY

## EU has a larger share of high value added goods



Source: CEIC, NAB Economics

While closer trade ties with the European Union could offset some of the damage from current US tariffs, it is unlikely to be a strong long term strategy. Although the entire EU economy – combining its 28 member countries – is slightly larger than the United States in a purchasing power parity terms, the EU is smaller than the US on a per capita basis. Longer term growth prospects are also more favourable for the US – while the overall population of the European Union is larger, its working age population (15-64) – the key demographic for Chinese consumer goods – has already peaked and is forecast to fall by almost 6% between 2015 and 2030 (UN Population Prospects). In contrast, the same cohort in the United States is expected to expand by almost 3%.

# CONCLUSIONS – EU-CHINA RELATIONSHIP COULD STILL IMPROVE

Although China's trade profile differs somewhat between the United States and the European Union, both partners have similar views when it comes to China's trade policies. In recent discussions, the US and EU have agreed to reforming the WTO and partnering to address unfair global trade practices. The EU cites a number of concerns related to China – suggesting that it has not fully implemented the commitments made when it entered the World Trade Organisation in 2001. These include discrimination against foreign companies (via industrial policies and non-tariff measures), government intervention (such as subsidies and cheap financing) that favours state-owned enterprises and poor protection and enforcement of intellectual property rights.

Progress on these measures would likely calm a range of the current tensions with the United States.

However, unlike the United States, the EU appears committed to progress via cooperation (rather than punitive trade measures). The first step appears to be the conclusion of a comprehensive EU-China Investment Agreement – where negotiations commenced in 2013 and limited progress has been made – which the EU argues must be achieved ahead of any negotiations around a free trade agreement.

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