May 5, 2017

Highlights of this Month’s Edition

- **Bilateral trade:** The U.S. goods trade deficit with China rose 1.2 percent year-on-year in the first quarter of 2017; in services, the United States the U.S. trade surplus in China for 2016 hit an all-time high of $37.4 billion.

- **Bilateral policy issues:** At their first summit, Presidents Trump and Xi agree to reform a flagship bilateral dialogue and launch a 100-day plan for addressing economic and trade issues; the U.S. Treasury does not cite China as a currency manipulator and notes China’s intervention to strengthen its currency; the USTR calls China’s barriers to cloud computing incompatible with its WTO commitments, and identifies market access restrictions and domestic support for China’s agricultural sector; the United States challenges China at the WTO over its failure to fully report its subsidies and launches investigations to protect its domestic steel and aluminum industries.

- **Quarterly review of China’s economy:** China’s economy grew 6.9 percent year-on-year in the first quarter of 2017, fueled primarily by surging industrial activity, property investment, and credit growth.

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Bilateral Trade

U.S. Goods Trade Deficit in Rises Slightly in 2017

In the first quarter of 2017, U.S. goods trade deficit with China rose 1.2 percent year-on-year to $78.8 billion (see Figure 1). While growth in U.S. exports to China has often been tepid in the first quarter due to the seasonal weak economic growth during China’s Lunar New Year holiday, U.S. export performance in the first quarter of 2017 was robust, rising 17 percent year-on-year to $29.5 billion, a sharp contrast to the previous two years. In the first quarter, imports of goods from China rose 5 percent year-on-year to $108.3 billion, led by imports of Chinese computer and electronic products.

Figure 1: First Quarter Change in U.S. Exports, Imports, and the Trade Deficit with China, 2012–2017

(>year-on-year<)

Note: In Q1 2014, U.S. trade deficit fell 0.1 percent year-on-year.

Top U.S. Imports from China Are Up

Four of the top five U.S. imports from China rose in the first quarter of 2017 (see Table 1). Computer and electronic products, accounting for 31.2 percent of total U.S. imports in March 2017, increased 8.5 percent year-on-year. Imports of electrical equipment, appliances, and components, the second-most imported product category from China, inched up 1.5 percent year-on-year while imports of non-electrical machinery grew 10.6 percent year-on-year. Growth in imports across the top five U.S. import categories from China contributed to the slight increase in the U.S. trade deficit.

Table 1: U.S. Trade with China: Top Five Exports and Imports

(US$ millions)
On the export side, transportation equipment continues to lead U.S. exports to China, accounting for 17.3 percent of total exports in the first quarter of 2017. The strongest growth among the top five U.S. exports to China came from transportation equipment (20.2 percent year-on-year), agricultural products (21.8 percent year-on-year), and chemical exports (17 percent). Exports of computer and electronic products fell 4.5 percent year-on-year.

U.S. oil and gas exports to China grew dramatically in the first quarter of 2017. Oil and gas, which until 2017 was not among the top ten U.S. exports to China, shot up to the sixth most exported product to China in the first quarter, rising 340 percent year-on-year to $1.4 billion. U.S. crude exports to China have been increasing ever since Washington lifted its four-decade ban on crude oil exports in 2015 in response to the shale boom and in February 2017, China became the United States’ largest buyer of crude oil. Despite this recent growth, U.S. crude oil exports to China still accounts for less than 1 percent of China’s total imports.

Advanced Technology Products

The U.S. trade deficit with China in advanced technology products (ATP) reached $26.9 billion in the first quarter of 2017, a $2.5 billion increase from the same period in 2016 (see Table 2). Imports of information and communications technology (ICT) products were the main contributor to the deficit, accounting for 91 percent of total ATP imports in the first quarter of 2017. Aerospace products remain the largest U.S. ATP export to China, accounting for 31 percent of total ATP exports to China in the first quarter of 2017, followed by electronics (21 percent) and ICT (15 percent).

Table 2: ATP Trade through March 2016

<table>
<thead>
<tr>
<th>Category</th>
<th>Exports (US$ millions)</th>
<th>Imports (US$ millions)</th>
<th>Balance (US$ millions)</th>
</tr>
</thead>
<tbody>
<tr>
<td>TOTAL</td>
<td>2,214</td>
<td>12,245</td>
<td>6,794</td>
</tr>
<tr>
<td>(01) Biotechnology</td>
<td>77</td>
<td>18</td>
<td>59</td>
</tr>
<tr>
<td>(02) Life Science</td>
<td>324</td>
<td>214</td>
<td>110</td>
</tr>
<tr>
<td>(03) Opto-Electronics</td>
<td>62</td>
<td>285</td>
<td>-223</td>
</tr>
<tr>
<td>(04) Information &amp; Communications</td>
<td>382</td>
<td>11,161</td>
<td>-10,779</td>
</tr>
<tr>
<td>(05) Electronics</td>
<td>460</td>
<td>345</td>
<td>115</td>
</tr>
<tr>
<td>(06) Flexible Manufacturing</td>
<td>259</td>
<td>104</td>
<td>155</td>
</tr>
<tr>
<td>(07) Advanced Materials</td>
<td>18</td>
<td>36</td>
<td>-18</td>
</tr>
<tr>
<td>(08) Aerospace</td>
<td>618</td>
<td>75</td>
<td>543</td>
</tr>
<tr>
<td>(09) Weapons</td>
<td>0</td>
<td>7</td>
<td>-7</td>
</tr>
<tr>
<td>(10) Nuclear Technology</td>
<td>12</td>
<td>1</td>
<td>11</td>
</tr>
</tbody>
</table>
U.S. Services Trade with China

In 2016, U.S. services surplus with China hit an all-time high of $37.4 billion, a 12.3 percent increase over 2015. Exports reached $53.5 billion, a 10.5 percent increase year-on-year, and imports $16 billion, a 6.6 percent increase (see Figure 2).

![Figure 2: U.S.-China Trade in Services, 2003–2016](image)

Tourism continues to dominate U.S. services exports, driven in large part by Chinese students coming to the United States to study. In total, U.S. tourism exports in 2016 rose to $32.5 billion (up 17.2 percent year-on-year) accounting for over 60 percent of all U.S. services exports to China. Tourism was also the biggest category on the imports side at $4.5 billion (a 6.8 increase year-on-year), though business services ($4.5 billion) and transport ($4.4 billion) were not far behind; together, these three categories accounted for 83 percent of all U.S. services imports from China.

**Bilateral Policy Issues**

**Trump-Xi Summit: Positive Atmosphere but Unclear Outcomes**

On April 7, 2017, President Donald Trump hosted a summit at the Mar-a-Lago resort in Palm Beach, Florida, with Chinese President and General Secretary of the Chinese Communist Party Xi Jinping. The first meeting of the two leaders was fraught with anticipation, considering President Trump’s rhetoric regarding China’s unfair trade practices and escalating tensions with North Korea during his presidential campaign and after he assumed office. Indeed, President Trump made it clear to President Xi and to the American public that these two issues would be front and center. President Trump told reporters on Air Force One that he intended to confront the Chinese side on chronic trade issues, stating, “We have been treated unfairly and have made terrible trade deals with China for many, many years. That’s one of the things we are going to be talking about.” According to China’s official news agency, Xinhua, and a statement from Secretary of State Rex Tillerson, the two sides did discuss problems with the trade deficit and North Korea. Despite these thorny topics, the meeting was generally friendly and both sides described the event as positive. President Trump committed to visiting China in 2017. The exact date has yet to

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be confirmed, but a likely time is in November when President Trump will attend the U.S.-Association of Southeast Asian Nations (ASEAN) and East Asia summit in the Philippines and the Asian Pacific Economic Cooperation summit in Vietnam.\(^8\) While the daylong meeting led to little in the way of tangible results, the two sides laid the groundwork for future interaction by establishing new diplomatic channels, a timeline for discussion on trade issues, and a cooperative stance on North Korea.\(^9\) The most important outcomes for the overall economic relationship were the restructuring of a key bilateral dialogue and the announcement of a 100-day plan to tackle outstanding trade and investment issues.

**The U.S.-China Comprehensive Dialogue: Reformatting an Obama-Era Institution**

The two sides agreed to restructure the Strategic and Economic Dialogue (S&ED)\(^*\) to create the United States-China Comprehensive Dialogue. The two presidents will oversee the dialogue, and it will be divided into four tracks: the Diplomatic and Security Dialogue, Comprehensive Economic Dialogue, Cyber and Law Enforcement Dialogue, and Social and People-to-People Exchange Dialogue.\(^10\) Neither Chinese nor U.S. officials released details on logistics and specific topics to be covered, though in a call between the two leaders on April 23, President Xi stated that the Diplomatic and Security Dialogue will be held in the next several months.\(^11\) The four dialogues will be scheduled at separate times; the S&ED, by contrast, was held over a two-day period.\(^12\) The Departments of State and Defense will lead the first round on diplomacy and security on the U.S. side, marking a departure from the S&ED, which was helmed in toto by the Departments of Treasury and State.\(^13\) Finally, one of the biggest differences between the Comprehensive Dialogue and the S&ED is that the former establishes a permanent mechanism\(^7\) for addressing bilateral cybersecurity issues.\(^14\)

**The 100-Day Plan: A Short Window for “Kickstarting” Progress**

The second big announcement was a 100-day plan to address trade and investment issues between the United States and China. The plan was proposed by President Xi, and his Administration has been advertising both the plan and its potential to improve relations in follow-up phone conversations and press releases.\(^15\) Trump Administration officials have publicized the plan with guarded optimism, framing it as a means to achieve short-term goals while “kick-starting” progress on longstanding issues like intellectual property rights and local standards.\(^16\)

National Economic Council Director Gary Cohn stated that the two sides discussed a wide variety of issues during the bilateral meeting and that China promised to begin allowing imports of U.S. rice and beef within the 100-day period.\(^17\) According to Mr. Cohn, the Chinese side also discussed allowing U.S. securities and insurance firms to hold larger stakes in joint ventures.\(^1\) Secretary of Commerce Wilbur Ross heralded the plan as a “sea change in the pace of discussion,” while at the same time admitting that 100 days was a “very, very short time period” for trade talks.\(^19\) The timeline is even tighter considering that President Trump’s nomination for U.S. trade

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\(^2\) Currently, foreign investors cannot hold a majority stake in securities and insurance companies in China. Tom Mitchell and Shawn Donnan, “China Offers Concessions to Avert Trade War with US,” *Financial Times*, April 9, 2017. [https://www.ft.com/content/6c14b8fe-1ce5-11e7-a454-ab04428977f9](https://www.ft.com/content/6c14b8fe-1ce5-11e7-a454-ab04428977f9).
representative has yet to be confirmed.” President Trump himself put a question mark on the broader impact of the plan when he tweeted, “Goodwill and friendship has formed, but only time will tell on trade.” Indeed, there is reason to be skeptical of the offers by the Chinese representatives. China did not provide specifics about the timing or degree of relaxation on service joint ventures during the summit, and the two sides had previously agreed to allow U.S. imports of rice and beef imports into China in 2016.

During his campaign and presidency, President Trump has focused on a relatively narrow range of China trade issues like currency manipulation and steel dumping (latest actions on currency and steel are discussed later in this bulletin). The announcements about the 100-day plan indicate that both sides may be willing to eschew a more comprehensive approach to reforming trade relations for a more transactional, piecemeal dynamic. For example, China’s agreement to allow rice and beef imports is most likely a sweetener to improve relations and discourage the Trump Administration from following through with the harsh policies promoted previously, like the imposition of a 45 percent tariff on Chinese imports and the promise to label China a currency manipulator. Furthermore, there was no mention in press releases after the summit of the long-negotiated Bilateral Investment Treaty (BIT), which has undergone 24 rounds of negotiation since 2008. Mr. Cohn mentioned that a small group of government officials discussed several issues that would be covered under the BIT, like intellectual property protection and data localization, but these topics do not seem to have been included as part of broader conversation about the investment treaty.

The Trump and Xi administrations have issued few updates on the 100-day plan since the summit, and, as of May 1, have yet to clarify or expand their priorities going forward. There have also been no signs of progress in enacting the existing goals under the plan of greater access for U.S. agricultural exports and better terms for U.S. investors in China’s financial sector.

U.S. Treasury Declines to Label China a Currency Manipulator

The U.S. Department of the Treasury did not designate China as a currency manipulator in the April 2017 issue of its biannual report to Congress on foreign exchange polices of U.S. trading partners. Under the Trade Facilitation and Trade Enforcement Act of 2015, Treasury assesses the policies of a foreign government against three criteria to determine whether that country engages in currency manipulation. In order to be deemed a currency manipulator, a country must have a bilateral trade deficit with the United States of at least $20 billion, a current account surplus equal to at least 3 percent of that nation’s gross domestic product (GDP), and persistent, one-sided intervention in currency markets with net purchases of foreign currency equal to at least 2 percent of that country’s GDP over a year-long period. In the April 2017 report, Treasury concluded that China only satisfied one of these criteria, a bilateral trade deficit of $20 billion or more. While China’s currency weakened against the dollar and other currencies, Treasury observed that China has taken significant steps to intervene in currency markets to strengthen the value of its currency, spending an estimated $435 billion of capital reserves in 2016 to limit the depreciation of its currency. Prior to the release of the Treasury Report, President Trump stated in a Wall Street Journal interview that he made the decision not to designate China a currency manipulator based on the fact that China has not recently manipulated their currency and because he did not want to endanger talks with Beijing on dealing with North Korea.


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and a current account surplus.\(^31\) In its April 2016 report, Treasury again determined that China had spent more than $400 billion of capital reserves to support its currency, and created a “monitoring list” of countries whose currency policies would receive special attention and that fulfilled two of the three criteria for currency manipulation; China was added to this list.\(^32\)

After matching only one criterion through two evaluations, China was set to be removed from this monitoring list in the April 2017 report under Treasury’s monitoring list methodology, but Treasury announced it would change this methodology and keep countries with a “disproportionate” share of the U.S. trade deficit—such as China—on its monitoring list regardless of whether it meets the three criteria for currency manipulation. Additionally, while Treasury has observed China’s intervention to support its currency in several recent reports, Treasury most recently noted that in the past China had regularly intervened to weaken its currency, creating a trade distortion that imposed “significant and long-lasting hardships on American workers and companies.”\(^33\) Treasury also warned China that it must “demonstrate that its lack of intervention to resist appreciation over the last three years represents a durable policy shift by letting the RMB [renminbi] rise with market forces once appreciation pressures resume,” and noted the United States is still concerned by a “wide array” of Chinese policies that restrict market access for U.S. exporters and slow progress in reducing the United States’ trade deficit with China.\(^34\)

In the event China is labeled a currency manipulator, the statutory consequences for China will be comparatively light and delayed. Under the Trade Facilitation and Trade Enforcement Act of 2015, after determining a country engages in currency manipulation, the United States must first enter into a year-long dialogue with that country to end the manipulation.\(^35\) If this dialogue is unsuccessful, the actions the United States can take under the law are unlikely to have dramatic effects on the Chinese economy. The United States can bar its development financing agency, the Overseas Private Investment Corporation (OPIC), from approving projects in China; however, OPIC has not approved development projects in China since the Tiananmen Square massacre in 1989.\(^36\) The United States can also restrict government purchases from offending countries under the Trade Facilitation and Trade Enforcement Act; however, these restrictions must not contradict the United States’ existing trade commitments, which limit the degree to which the United States can block foreign suppliers from government procurement.\(^37\) Finally, the act permits the United States to take other actions that seem unlikely to lead to remedial action due to their limited impact or that are already within the power of the Administration, such as requesting the International Monetary Fund (IMF) to more closely examine China’s macroeconomic policies, or directing the Office of the U.S. Trade Representative (USTR) to consider China’s currency policy when entering into a bilateral or multilateral trade agreement with it.\(^38\)

**USTR Calls China’s Digital Barriers to Trade Inconsistent with World Trade Organization Commitments, Highlights Chinese Support for Agricultural Sector**

In its 2017 National Trade Estimate,\(^3\) the USTR catalogued several long-recurring restrictions in China’s market, with two areas of elevated concern over the previous year: Chinese restrictions on digital trade and China’s support for domestic agriculture. The USTR highlighted barriers to digital trade in China as a major concern for U.S. exporters, noting that China’s Internet censorship is “restrictive and non-transparent,” that many Internet and data-related regulatory measures adopted by China in 2016 raise concerns, and that some of China’s measures are not compatible with its commitments to the World Trade Organization (WTO).\(^39\) The report noted China currently blocks foreign-invested firms from setting up cloud computing services inside China,\(^4\) and stated that this closure conflicted with China’s obligations under the General Agreement on Tariffs and Trade.\(^5\) \(^40\) The USTR also observed

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\(^2\) According to the USTR report, cloud computing firms typically offer their services either as an integrated service combining computing services, data storage, and processing over a network, or as a stand-alone service that customers can independently connect to. Both of these pathways are currently closed to foreign-invested firms in China. Office of the United States Trade Representative, National Trade Estimate Report on Foreign Trade Barriers, April 2017. https://ustr.gov/sites/default/files/files/reports/2017/NTE/2017%20NTE.pdf.

\(^3\) The General Agreement on Tariffs and Trade (GATT) was the body of rules governing international trade prior to the creation of the WTO. Upon the creation of the WTO, many GATT rules were incorporated into the WTO. World Trade Organization, “The GATT Years, from Havana to Marrakesh.” https://www.wto.org/english/thewto_e/whatis_e/tif_e/fact4_e.htm.
that China is working to prevent foreign firms from offering cloud computing services from outside China through a draft notice that prohibits Chinese telecommunications operators from selling leased lines or virtual private network connections to access overseas data centers. In January 2017, China’s Ministry of Industry and Information Technology (MIIT) issued a notice directing Chinese telecommunication firms to examine the use of networks by their customers to ensure virtual private networks and dedicated communication lines are not used without approval from the government and that these communication tools are not used to access overseas data centers. The notice also requires Chinese telecommunication firms to create a central database of its customers that use dedicated international communication lines.

China’s cloud computing sector is still nascent but projected to grow very quickly. China’s cloud computing market was estimated to be worth $1.5 billion in 2013, but is expected to grow to $20 billion by 2020. Despite regulatory barriers, U.S. businesses have provided cloud computing services to Chinese customers in the past. According to the Department of Commerce, China was the 11th-largest export market for cloud computing in 2016. However, U.S. businesses have complained that Chinese authorities are compromising their business in China. The U.S. Chamber of Commerce claims China’s regulators require U.S. cloud computing firms to transfer their technology and operating control in order to do business there. The USTR noted in its report that it has raised restrictions on cross-border cloud computing with China and is assessing whether these restrictions are a violation of its WTO commitments.

The report identified trade barriers in China’s censorship of websites. The USTR stated that “China continues to engage in extensive blocking of legitimate websites” through its Great Firewall, and that according to U.S. industry up to 3,000 sites are blocked, including 11 out of the 25 most visited global Internet sites. China currently blocks many top U.S. websites, likely resulting in billions of dollars in lost revenue. For example, the New York Times lost $3 million in the first year after it was blocked in China for reporting on the wealth of China’s then Prime Minister Wen Jiabao’s family, and by some estimates Google lost $3.5 billion worth of revenue in 2014 due to Chinese Internet restrictions. The USTR also received reports that China’s Internet censorship creates delays in the transmission of data, sometimes to a “commercially unacceptable level,” which can inhibit or prevent providing services across borders. In 2017, the American Chamber of Commerce in China reported that 93 percent of its surveyed firms encountered throttled Internet speeds in China, compromising their productivity and ability to conduct research.

The USTR also highlighted restrictions on entertainment software and online video in China. According to the report, “China restricts the online supply of foreign video and entertainment software through measures affecting both content and distribution systems.” The USTR noted that entertainment software and video are subject to “burdensome” content review by Chinese authorities. Under Chinese law, all foreign digital games must undergo a content review before being approved for distribution, and China has used its approval process to block foreign games from its market, most recently excluding South Korean games in retaliation for Seoul’s decision to deploy a Terminal High Altitude Area Defense (THAAD) missile defense system. With respect to online videos, the USTR stated China has implemented several measures that exclude foreign content and distribution, including directing Chinese online platforms to spend no more than 30 percent of their acquisition budget on foreign material and requiring that online video platforms be state owned, shutting out foreign video platforms. Both China’s digital game and online video sectors are growing quickly. China’s digital game market has grown to be the largest globally and is estimated to total $27.5 billion in 2017, and from 2013 to 2015 China’s online video sector grew at an annual compound rate of more than 70 percent, reaching $1.8 billion in 2015. The USTR stated in its report that it is weighing whether China’s restrictions on digital games and online videos contradict its commitments to the WTO, and will continue to engage China on these issues.

The USTR also highlighted concerns with China’s new cybersecurity law, which authorizes Chinese regulators to restrict Internet-related market access by requiring data storage to be located in China. Concern over the degree to which China’s cybersecurity law could close China’s digital market prompted the U.S. Chamber of Commerce to call for its immediate suspension. The Chamber noted that the Administration’s new 100-day plan to open China’s market cannot be deemed a success if the cybersecurity law and other digital restrictions are not removed.

The USTR also expressed concern over access to China’s Internet payment services market, which has been effectively closed due to licensing requirements. With respect to Internet payment services, the USTR cited a
recent study showing that while China issued 200 licenses to provide online payment services between 2010 and 2014, only two were provided to foreign firms.62

In addition to restrictions on digital trade, the USTR identified restrictions on trade in agriculture and subsidies for China’s agricultural sector. The USTR noted that China has instituted minimum purchase prices for domestic cotton and a purchasing reserve system for pork—both policies that support domestic production.63 The report reiterated U.S. concerns that China’s calculation for minimum price levels create “underestimates” that may result in excessive support for Chinese farmers.64 In September 2016, the USTR filed a case in the WTO against China’s support for rice, wheat, and corn, arguing that China had exceeded its allowable subsidy limit for these grains by $100 billion in 2015.65 In its most recent report, the USTR remarked it had reviewed reports from U.S. farm groups that indicate support for other agricultural goods, such as soybeans, also greatly exceed China’s WTO limits.66

Finally, the USTR’s report noted restrictions on trade in agricultural biotech goods, which require Chinese safety certificates for export.67 In February 2016, after years of dialogue with the USTR, China issued safety certifications for three U.S. biotech products; however, eight other U.S. biotech applications remain delayed, some of which were first submitted in 2011 and have since been approved by more than a dozen other countries.68 While the United States hoped to resolve delays in approving U.S. biotech crops for the Chinese market at the 2016 Joint Commission on Commerce and Trade meeting, China merely indicated it would review U.S. biotech safety applications and gave no indication as to whether certificates would be issued.69 China’s slow certification of U.S. biotech affects the United States in several ways. First, biotech developers face delays in bringing their product to China, the United States’ largest agricultural export market, which U.S. officials argue decreases their return on developing new crops and consequently reduces their incentive to innovate.70 Second, if Chinese authorities detect evidence of an unapproved biotech strain in a crop shipment, it can result in massive disruptions to trade in non-biotech crops, as all shipments come under review by Chinese authorities. This occurred in 2013 when Chinese inspectors detected traces of biotech-modified corn in a shipment from the United States, prompting China to reject more than 1.25 million metric tons worth of U.S. corn.71

United States and China Battle over Steel and Aluminum Industry Subsidies

The United States is challenging China’s subsidization of its steel and aluminum firms at the WTO and launching investigations into the impact of imports on national security and U.S.-based aluminum and steel firms. Though steel and aluminum overcapacity are global issues, China accounts for most of the excess capacity—unsurprising given its rise to become the world’s largest steel and aluminum producer in the span of a decade due to massive subsidies and other forms of support.72 China’s production of steel and aluminum has expanded beyond domestic needs, leading it to export its surplus, which worsens the worldwide glut.73 The scale of the crisis prompted the Organization for Economic Co-operation and Development (OECD) Steel Committee in December 2015 to call for “immediate action to address the excess capacity challenge and its effects in the steel sector.”74 On April 24, 2017, the United States, the EU, and Canada circulated a notice that seeks to start discussions on how the WTO in concert with the OECD’s Global Forum on Steel Excess Capacity can address subsidies contributing to overcapacity.75

The USTR has long accused the Chinese government of not adhering to its WTO obligations by failing to report its subsidies to the WTO.9 Per the WTO Agreement on Subsidies and Countervailing Measures, member countries must report all of their subsidies each year.76 In October 2015, China submitted a notification for national subsidies for 2009–2014, but this notification did not outline China’s provincial and local subsidies, where most of China’s government financial support is provided.77 In January 2016, the USTR claimed this notification was incomplete and provided WTO members a list of China’s subsidies for one of its largest steel firms and reported on the Chinese banking regulator’s instructions to increase direct funding and loosen financing restrictions to the steel sector.78 In October 2016, the USTR again raised its concerns about China’s incomplete notification by laying out subsidy programs that China’s notification did not mention and requesting additional clarification.79 On April 12, 2017, the United States and the EU jointly challenged China’s steel subsidies, identifying more than $1 billion in subsidies to

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7 For more information on China’s adherence to its WTO commitments, see U.S.-China Economic and Security Review Commission, Chapter 1, Section 1, “Year in Review: Economics and Trade,” in 2016 Annual Report to Congress, November 2016, 70–74. 
https://www.uscc.gov/sites/default/files/annual_reports/2016%20Annual%20Report%20to%20Congress.pdf. For a list of WTO cases brought by the United States against China, see https://www.uscc.gov/trade-table.
Hebei Iron and Steel Company, Shougang Steel, Chongqing Steel, and Baoshan Iron and Steel in 2011–2014 for the Chinese government to explain. The Chinese government responded to U.S. allegations on April 21, 2017, claiming yet again that its support for the steel industry is aimed at improving environmental protection, technological innovation, and industrial restructuring, and thus is not prohibited under the WTO. The USTR has not yet challenged this latest response.

On April 12, 2017, China accused the United States of failing to notify the WTO about its federal and state steel subsidy programs and requested additional information from the U.S. government on these alleged violations. China claims these programs have de jure specificity—where a subsidy is clearly limited to a particular company, industry, group of industries, or geographic region—and thus is a violation of the WTO rules. At the federal level, the Chinese government alleges $76.9 million in antidumping (AD) and countervailing duties (CVDs) paid out by the U.S. Customs and Border Protection in 2008–2015 and $7.7 billion in pensions provided to retired U.S. workers by the U.S. Department of Labor’s Pension Benefit Guaranty Group since 2003 are in fact subsidies. China accuses U.S. Customs and Border Protection of subsidizing the U.S. steel industry by imposing CVDs to offset subsidized imports from China and other countries. The WTO permits countries to enact ADs and CVDs after an investigation into the impact of subsidies on the importing countries’ industries. In line with WTO rules, as of December 1, 2016, the U.S. International Trade Commission has put in place 20 AD and CVD orders against imports of steel products from China, following an investigation. In addition, the Pension Benefit Guaranty Group—an independent government agency that guarantees pension benefits for private firms—is funded not by the federal government but by insurance premiums from private sector employers, assets held by pension funds it takes over, investment income, and bankruptcy assets from insolvent pension plans. The USTR has yet to formally respond to these allegations.

Beyond the WTO, President Trump initiated an investigation on April 19, 2017, under Section 232 of the Trade Expansion Act of 1962, starting a 270-day investigation into whether steel imports are a threat to national security. If the Department of Commerce determines these imports impair national security, the U.S. president would be able to “adjust imports” by imposing trade measures such as tariffs and quotas. In his written testimony before the USTR and Department of Commerce in April 2016, Douglas R. Matthews, senior vice president at U.S. Steel, urged the U.S. government to “formally recognize the American steel industry as a national security interest.” None of the nine steel-related cases the Department of Commerce has initiated have found a threat to national security. In 2001, then president George W. Bush initiated this option to address iron ore and semi-finished steel imports following the required Department of Commerce investigation; in that case, Section 232 was not applied because “there [was] no probative evidence that imports of iron ore or semi-finished steel threaten to impair U.S. national security.”

The U.S. government is similarly challenging China’s subsidization of its aluminum industry through the WTO and a Section 232 investigation. In January 2017, the USTR requested consultations with China at the WTO regarding China’s subsidies to its primary aluminum producers since 2007. The United States alleges the Chinese government has provided low-cost financing and inputs to its primary aluminum producers, which displaced and impeded U.S. imports of primary aluminum into China and the global market, suppressed global prices, and increased China’s global market share. The request for consultations is the first step in the dispute settlement process. On April 27, 2017, President Trump initiated an investigation under Section 232 of the Trade Expansion Act of 1962, starting a 270-day investigation into whether aluminum imports are a threat to national security. Since 2015, eight U.S. aluminum smelters have closed or curtailed production, leaving only two fully operational aluminum smelters.

**Quarterly Review of China’s Economy**

**China’s GDP Growth Reaches 6.9 Percent in First Quarter of 2017**

In the first quarter of 2017, official statistics indicated China’s real GDP grew 6.9 percent year-on-year, the country’s strongest economic gains since the third quarter of 2015. The Chinese government is aiming for 6.5 percent GDP growth in 2017 (see Figure 3). Electricity consumption (3.7 percent increase year-on-year), rail freight (15.3 percent increase year-on-year), and retail sales (10 percent increase year-on-year) all saw strong growth.
in the first quarter of the year. The economic growth data signals an improvement from 2016, when the country posted 6.8 percent year-on-year GDP growth in the fourth quarter and 6.7 percent annual growth for the entire year. The strong economic activity in 2017 Q1 prompted the investment bank Nomura to raise its China 2017 GDP growth forecast from 6.5 percent to 6.7 percent, while JPMorgan Chase revised its full year estimate from 6.6 percent to 6.7 percent. The IMF also raised its forecasts for China’s economic growth to 6.6 percent annual growth in 2017, up from 6.5 percent in its earlier estimates.

**Figure 3: China’s GDP Growth, 2014 Q1–2017 Q1**

![China’s GDP Growth, 2014 Q1–2017 Q1](image)

*Source: China’s National Bureau of Statistics via CEIC database.*

The strong first quarter was fueled in part by higher investment, with China’s fixed-asset investment (FAI) growth (excluding rural areas) increasing to 9.2 percent in the first quarter of the year, up from 8.1 percent year-on-year in 2016 (see Figure 4). Despite efforts to crack down on rising state debt levels, state-owned enterprises (SOEs) continue to account for the majority of new investment: SOE investments increased over 20 percent year-on-year in 2016, while private firms’ investments increased only 3.5 percent year-on-year. Private investment growth did rebound in the first quarter of 2017, however, increasing 7.7 percent year-on-year, though that was still less than the 13.6 percent year-on-year increase in SOE investments. SOEs’ share of FAI reached 35.7 percent in 2016, the highest level for state spending since February 2011. According to Larry Hu, the head of China economics at Macquarie Securities in Hong Kong, the trend of state-led investment cannot continue apace. “As returns get lower and lower,” Mr. Hu told the *Financial Times*, “SOEs lose usefulness as tools of macroeconomic policy and become a burden on the state. You have to pour in more and more credit to get the same impact.”
According to the Caixin/Markit manufacturing purchasing managers’ index (PMI), China’s manufacturing activity expanded for the tenth consecutive month in April 2017. Caixin’s estimate put China’s PMI at 50.3 in April, down from 51.2 in March and 51.7 in February. China’s official factory survey, meanwhile, showed that manufacturing activity grew to 51.8 in March 2017 (the fastest expansion in nearly five years) before dropping to 51.2 in April.

Industrial output was a primary driver of China’s first quarter growth, with value-added industrial output increasing 6.8 percent year-on-year, up from a 5.8 percent increase year-on-year in the fourth quarter of 2016. Industrial profits also totaled more than $250 billion the first quarter of 2017, an increase of 28.3 percent year-on-year. In March 2017 alone, industrial production grew by 7.6 percent, indicating the industrial sector is poised for a strong second quarter.

However, there are several reasons to doubt that industrial activity will continue apace in the final three quarters of 2017. The surge in industrial activity—specifically industrial profits—is partially a result of policies from 2016 that sought to curb excess capacity in steel, aluminum, and other materials. These policies temporarily depressed the production of industrial materials and supplies, boosting industrial output values in the first quarter of 2017. Vehicle manufacturing output by volume, for example, increased by 9 percent year-on-year, yet the output by value increased 15.3 percent year-on-year. As industrial inventories rise to meet demand, prices will begin to fall and industrial activity will slow. Additionally, increased construction activity boosted industrial activity in the first quarter. However, construction rates are expected to slow as Beijing implements new measures to cool down the red-hot property market, likely contributing to slower industrial activity.

Real Estate

Despite government efforts to increase controls over lending and tamp down on housing prices, China’s property market continued its rapid expansion in both real estate investment and new housing starts in the first quarter of 2017. Moody’s Investor Service estimates China’s property and construction sectors account for between 25 percent and 30 percent of China’s total GDP, making these sectors a leading driver of the country’s economy. In 2016, home prices rose as much as 60 percent in some cities, prompting policymakers to introduce new measures aimed at cooling the property market. These measures include restrictions on real estate financing for developers, a PMI reading above 50 points indicates an expansion of the manufacturing sector, while a reading below 50 points indicates a contraction.
banning real estate companies from issues bonds, and reducing home loans as a percentage of new loans to 30 percent from 45 percent.\textsuperscript{124}

Although the new measures moderated increases in housing sales in the first quarter, China’s property market activity continued to increase.\textsuperscript{125} In 2017 Q1, China’s commercial housing sales increased 25.1 percent year-on-year by value and 19.5 percent year-by-year by commercial housing floor space sold.\textsuperscript{126} These figures reflect a slowdown from the same period in 2016, when commercial building sales increased 54.1 percent year-on-year and floor space sales increased by 33.1 percent year-on-year (see Figure 5).\textsuperscript{127} Meanwhile, real estate investment increased 9.1 percent year-on-year (compared to 6.9 percent year-on-year in the fourth quarter of 2016), fueled largely by an 18.1 percent increase in new construction projects compared to the first quarter of 2016 (see Figure 6).\textsuperscript{128} In February 2017 alone, average new home prices in 70 major cities increased 12 percent year-on-year.\textsuperscript{129}

\textbf{Figure 5: Commercial Housing Sales, 2012 Q1–2017 Q1}

(quarterly, year-on-year)

\textit{Source: China’s National Bureau of Statistics via CEIC database.}

\textbf{Figure 6: Real Estate Investment, 2012 Q1–2017 Q1}

(quarterly, year-on-year)
Lending and Debt

In its April 2017 economic outlook report, the IMF raised its prediction for China’s 2017 GDP growth, but warned against the country’s reliance on government stimulus and credit expansion to maintain growth. In 2016, China’s credit grew twice as fast as its economy, with total debt swelling to 277 percent of GDP by the end of the year, up from 125 percent at the end of 2008. Total credit increased by nearly $1 trillion in the first quarter of 2017, raising fears that higher leverage could lead to a string of defaults on bad loans. However, Chinese government officials continue to insist they are managing the risks of increased credit, with Li Keqiang, China’s premier and leading voice on economic policy, stating in March 2017 that the government is “fully aware of potential risks and will take prompt and targeted action” to control the rise in unregulated loans. On May 1, 2017, Xu Zhong, head of the People’s Bank of China’s research bureau, reiterated that “China’s overall leverage level is reasonable but is rising at an alarming pace, especially in the financial sector.”

Since March 2017, the China Banking Regulatory Commission (CBRC) has sought to reduce risk in the banking sector by releasing at least seven policy documents tightening banking regulations. These policies include establishing spot checks for banking institutions, increasing transparency for investments in wealth management funds, and requiring banks to undertake investments through other financial institutions like mutual fund managers. The CBRC hopes these new practices will increase its ability to target bad loans, real estate sector funding, and interbank financing, among other banking risks. Following implementation of these policies in the first quarter of 2017, the CBRC imposed over $28 million in fines across dozens of Chinese banking institutions for charges ranging from hiding bad loans to circumventing banking regulations. Banks targeted include China Merchants Bank, Ping An Bank, and the Bank of Communications.

While these measures led new bank lending to slow in March 2017, overall lending has continued to rise as companies and property buyers find ways to finance new projects. In fact, the private data analytics firm China Beige Book found the cost of capital for companies actually decreased in the first quarter of 2017, with the shadow banking sector in particular seeing interest rates fall to their lowest levels since 2014. China’s unregulated shadow banking sector has seen increased lending activity as the government seeks to ease the country’s growing financial and property risks, prompting concerns that China’s economy is at risk of becoming excessively leveraged.

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Endnotes


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