

AN UPDATE ON THE GLOBAL LNG MARKET

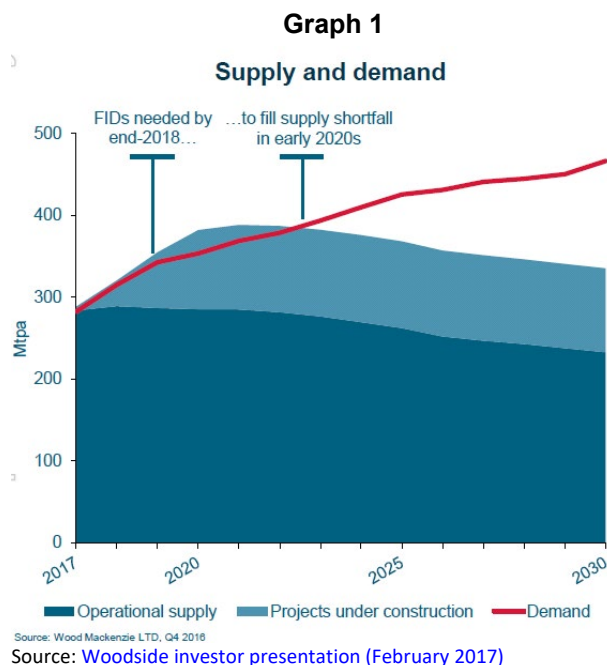
The structure of the global LNG market was explored in depth in [Cassidy and Kosev \(2015\)](#), which concluded that key factors influencing that the Asia-Pacific LNG market over the next decade would be: the large increase in US LNG production; changes to the composition of Asian demand; and the potential for changes to traditional oil-based pricing mechanisms in the Asia-Pacific. These remain key issues today. Although long-term contracts are still dominant and LNG markets remain segmented, LNG buyers and sellers are moving toward greater flexibility in new contracts, and spot prices are expected to remain low as global production increases.

Trends in Global LNG Supply and Demand

Global LNG supply is projected to outpace demand in the near term, leading to growing production surpluses (Graph 1).

LNG producers and analysts suggest that production is likely to exceed demand to at least 2020, and possibly until as far out as 2025, placing downwards pressure on spot prices.² Some in the industry have raised concerns that low spot prices combined with long lead times for LNG projects will result in supply shortages by the middle of the decade.³

Supply



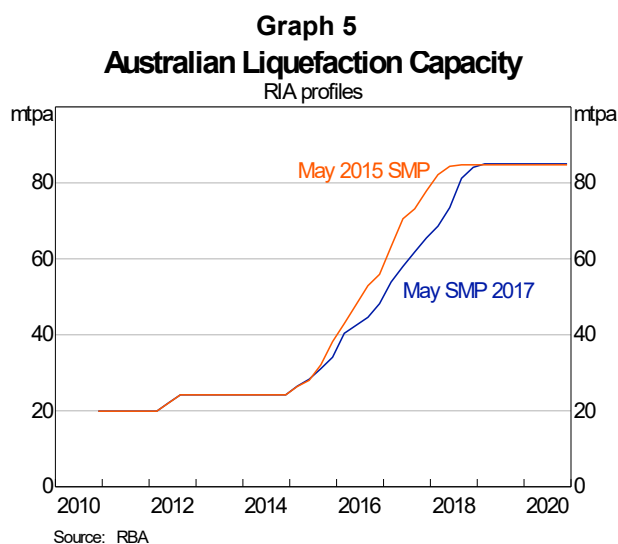
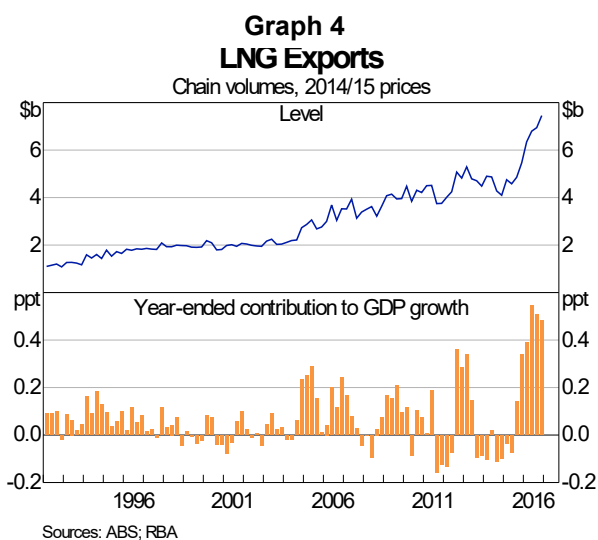
² Producer views are sourced from discussions in RIA's liaison program ([attributions](#)).

³ For example, AFR (4 April 2017) '[Woodside CEO appeals for long-term LNG contracts](#)'

Cassidy and Kosev (2015) noted that the size of the increase in US LNG production would be an important factor in the evolution of the Asia-Pacific LNG market due to the scale of the expected ramp-up in production capacity and the different pricing benchmark used in the US (Henry Hub).⁴ At the time, construction had commenced at four US LNG projects, which were expected to have a combined liquefaction capacity of around 50 mtpa by 2020.

Despite an expectation that most US LNG would be exported to Asia, US LNG production has so far been delivered to a variety of destinations. In 2016, US shipments were primarily to Latin America (58 per cent), with Asia (19 per cent) and the Middle East (14 per cent) making up the bulk of the remainder.⁶ Going forward, there is an expectation that US volumes will form the marginal supply for markets in Europe, Asia and Latin America.⁷

Australia’s LNG production has increased rapidly over the past two years, contributing substantially to growth in GDP (Graph 4). Compared to expectations, the commencement and ramp-up in LNG production at several Australian projects has been subject to a number of delays (Graph 5). However, total capacity is still expected to reach between 78-85 mtpa by 2019, equivalent to around 20 per cent of global supply. Reasons for the delays vary by project, but have included: weather and logistical challenges in cyclone-prone regions; issues with quality control for imported components; and overly ambitious labour productivity assumptions



Demand

8,9,10

4 During the period of high oil prices (from 2011 to 2014), estimates suggested that Henry Hub pricing was cheaper than average LNG import prices into Asia, which are typically oil-linked.

6 Source: [The LNG Industry: GIIGNL Annual Report 2017](#).

7 Source: [BP Energy Outlook, 2017 edition](#).

8 Unlike supply projections, which are available out to 2020, projections for LNG demand are only available to 2018.

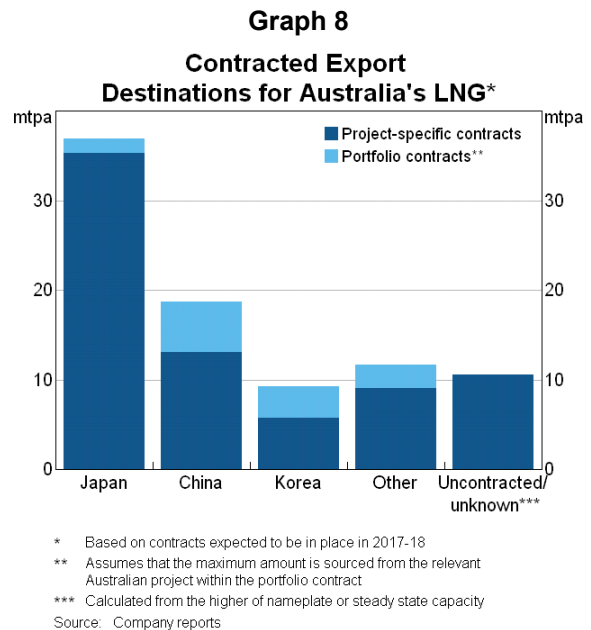
9 DOIS flagged in its 2015 report that the Australian and US share of Japanese and Korean imports was set to increase substantially.

10 Source: DOIS (2016), [Key factors affecting changes in China’s demand for liquefied natural gas](#).

see Appendix A.

Around 85 per cent of Australia’s projected steady state LNG capacity is sold under long-term contracts, mostly with Asian buyers (Graph 8). Available contract information suggests that once the new projects reach full production, around 40 per cent of Australia’s LNG exports are contracted to Japan, followed by China (around 20 per cent) and Korea (around 10 per cent).¹² This is a significant change from a few years ago, when more than 80 per cent of Australia’s LNG exports went to Japan.

Around 15 per cent of Australia’s projected steady state LNG production remains uncontracted, with few new long-term contracts entered into since 2015. Liaison suggests that most LNG producers are comfortable keeping a portion of production uncontracted in order to provide operational flexibility and to have exposure to spot prices.



Trends in LNG Market Structure and Pricing

There are still distinct Atlantic (US and Europe) and Asia-Pacific LNG markets. The pace of the shift towards a unified global LNG market is constrained and will likely take decades to fully achieve because around three-quarters of global LNG trade is currently under long-term contracts.

Global pricing

Pricing in the global LNG market remains highly segmented. The Atlantic market is based around spot price benchmarks for natural gas (e.g. Henry Hub or the UK’s National Balancing Point), while the Asia-Pacific market is heavily reliant on long-term, oil-linked contracts. These long-term contracts mean that price differences between the Asian and Atlantic markets can be sustained for extended periods. Although most

These estimates include LNG volumes sold on a portfolio basis where the destination is specified. Sales on a portfolio basis refer to contracts where an LNG producer with interests in multiple LNG projects commits to sell a given volume to a customer without specifying which project that LNG will be sourced from (i.e. sales are from their ‘portfolio’ of projects).

long-term LNG contracts contain options for prices to be renegotiated at various points over the life of a contract, both parties must agree in order for the price review to be concluded.

For example, when oil prices were elevated in the early part of the decade, liaison suggested that a push from Asian customers during price reviews for Henry Hub linked pricing rather than oil-linked pricing was resisted by Australian LNG producers, resulting in prolonged negotiations. As oil prices declined sharply from 2014, the push toward Henry Hub pricing lost momentum and has not yet re-emerged

The development of an Asian spot price index, akin to the Henry Hub or UK Balancing point price, has not occurred, with liaison contacts suggesting that this would require a deregulated trading gas hub in Asia in order to avoid market manipulation, and that this ‘remains some time away’.

Contract structure

There has been an ongoing shift towards greater flexibility in new LNG contracts, particularly from customers in Asia (Graph 10).

Japanese and Korean customers, who have traditionally had a preference for long-term contracts to ensure security of supply, may shift towards reduced tenure for new contracts as well. Asian customers have also reportedly been pushing for ‘destination flexibility’ in contracts in recent years, which would allow contracted surplus LNG to be diverted to other destinations than specified in the original contract.¹³ Customers typically favour these clauses, since it reduces the risk of being left with unwanted supply. Producers are more reticent as it would allow surplus cargoes to compete with uncontracted volumes, as well as creating uncertainty around shipping costs.¹⁴

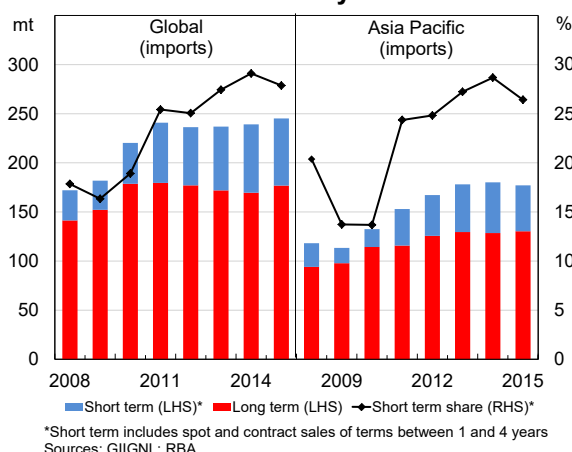
Historically, LNG producers have sold or contracted LNG volumes on a project-specific basis. More recently, there has been a shift from companies with multiple projects in multiple locations to market supply on a ‘whole-of-company’ basis, as part of a global portfolio. This allows LNG producers to more readily shift supply to a given customer from one project to another in order to better deal with production outages, minimise transport costs, and to arbitrage price differences between segmented markets. Contacts have suggested that this supply flexibility could assist in reducing spot price volatility.

Australian supply

The majority of Australia’s LNG production remains under contract until at least the early 2030s, and is therefore expected to be somewhat insulated from the effects of the ongoing changes in the LNG market

Graph 10

International LNG Trade by Contract Duration

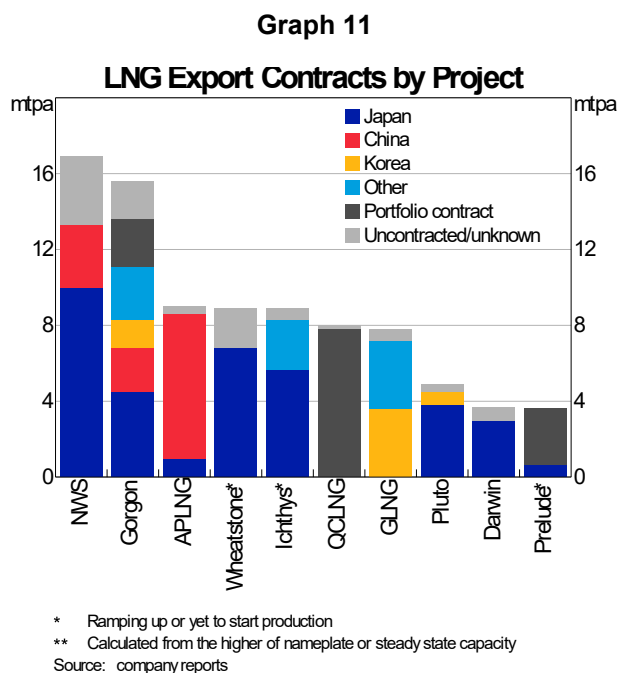


13 For example, in March 2017, the three largest LNG buyers (JERA, KOGAS and CNOOC) signed a [memorandum of understanding](#) regarding ‘cooperation in the LNG business’, with destination flexibility explicitly mentioned as an area to ‘share views’ on.

14 It has been suggested in liaison that producers would be more willing to accept these clauses if LNG is sold on a free on board (FOB) basis.

structure. The exceptions are the older LNG projects (North West Shelf and Darwin), where the existing contracts expire within the next five years, and projects with higher proportions of uncontracted and portfolio volumes, such as Prelude FLNG and QCLNG (Graph 11).

The different cost structures between conventional and CSG LNG projects are likely to result in different responses for uncontracted volumes in the event of sustained low spot prices. Liaison suggests that production at conventional projects is largely insensitive to spot prices in the short- to medium-term due to the lumpy nature of sustaining capex (drilling). However, CSG LNG production requires ongoing drilling. The GLNG project has already restricted production to contracted volumes only in response to capex constraints and low spot prices.¹⁵



Risks to Australian LNG demand and supply¹⁶

A number of factors could create additional uncertainty around the outlook for Australia's LNG sector, including subdued demand from Japan and South Korea, the pace of the Chinese demand ramp-up, and global supply forces. These are explored in more detail below.

Demand-side

- Future Japanese LNG demand may be weaker than is currently expected. While Japan remains the world's largest importer of LNG, its demand is likely to remain subdued over the next few years, reflecting: weak energy demand more broadly; a forecast decline in thermal coal prices; the expansion of renewable energy generation; and the possible re-start of nuclear capacity (DOIS, 2016).¹⁷
- The extent and speed of the acceleration in Chinese LNG demand represents one of the largest sources of uncertainty for Australia's LNG exports, with RIA contacts noting the existence of competition from pipeline gas and other energy sources as alternatives to LNG.
- There is a potential upside risk to demand from emerging nations, with a number of countries having recently installed small scale LNG-import capacity. This has involved converting old LNG export tankers into floating storage and regasification units, and has been completed in countries in the Middle East, Africa and South America. This avoids the need for large capital expenditure on physical port terminals, reducing infrastructure barriers to importing LNG for these smaller markets.¹⁸
- The International Maritime Organisation (IMO) has recently announced tighter emissions standards from 2020, which may increase the attractiveness of converting vessels from being fuelled by diesel to LNG. The use of LNG as an alternative to diesel in mining fleets has also been posited.

Supply-side

- The shift to a unified global market may occur more quickly than is currently anticipated, generating increased competition in the Asian LNG market (particularly from US production). Coordinated pressure from Asian LNG buyers could force LNG producers to renegotiate contracts to incorporate more flexibility or significantly reduce contracted volumes, which would expose more of Australian LNG production to the spot market.

¹⁵ See [Santos 2016 full-year results investor presentation](#) (p25)

¹⁶ Thanks to (OE) for her assistance on risks relating to nuclear energy generation in Japan.

¹⁷ Recent news reports indicate that there is still significant internal opposition within Japan to re-starting nuclear energy generation on the scale that existed prior to the 2011 Fukushima disaster (sources: [Business Insider](#), [The Mainichi](#), [The Japan News, ABC](#)).

¹⁸ See: <http://accelerateenergy.com/fsru-projects/>

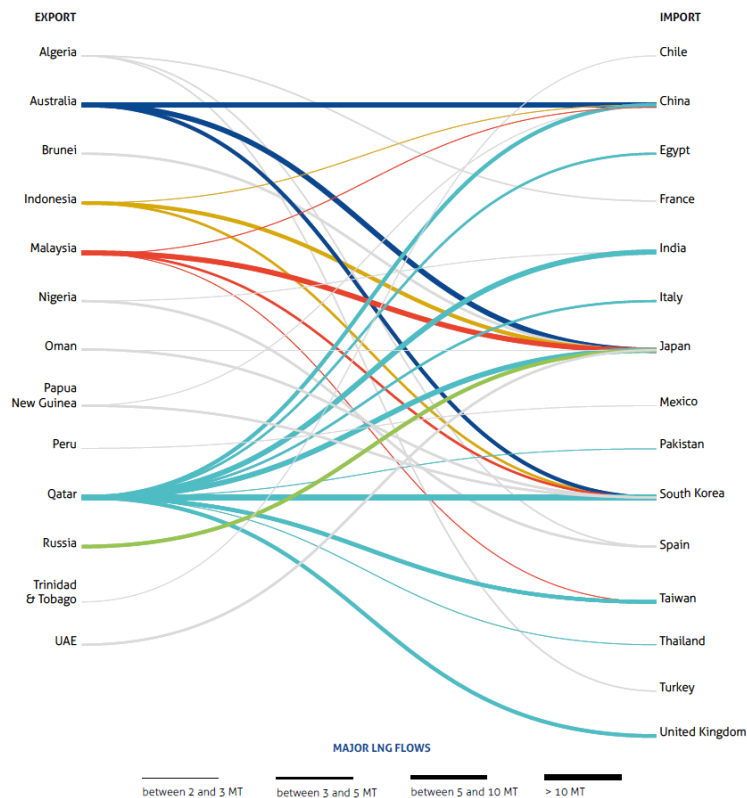
- Production volumes for Australia’s LNG projects could be more responsive to spot prices than anticipated. LNG contracts can contain a ‘downwards quantity tolerance’ (DQT) clause, which allows buyers to reduce the amount of LNG they are contracted to buy an agreed percentage each year, subject to a cumulative limit over the life of the contract. Information on DQTs in specific contracts is not available, but analyst reports suggest that DQT clauses have historically been up to 10 per cent.¹⁹
- High domestic gas prices (currently a concern on the east coast) combined with low LNG spot prices could result in the CSG LNG producers lowering production to contracted volumes only (or seek to source LNG from lower cost projects in the case of portfolio contracts). Exercise of DQTs by buyers from the CSG LNG projects could assist in easing the tightness in the east coast gas market.
- Over the longer-term, there may be insufficient sustaining capex to maintain LNG production at steady state capacity for some Australian projects due to a combination of: constrained budgets amid low oil and gas prices; long lead times for projects; and difficulties getting agreement between joint venture partners with interests in multiple projects. This is most applicable to older LNG plants, where new gas fields will need to be developed within the next decade in order to maintain feed gas, and for CSG LNG projects, where ongoing investment in drilling is required to sustain production.

Summary

Many of the key long-standing issues surrounding the global LNG market remain prominent today. It appears likely that supply will exceed demand for some time into the future, which is likely to place downward pressure on LNG spot prices, although Australia should be insulated against this to some extent due to the long-term nature of its contracts. However, the shift toward shorter term and more flexible contracts, particularly within the Asia-Pacific, may have implications for uncontracted Australian production and longer-term prospects for investment in additional capacity.

BAT and RIA / Economic Analysis Department
12 April 2017

Appendix A - 2016 LNG Trade Flows



Source: [GIIGNL Annual Report 2017](#)

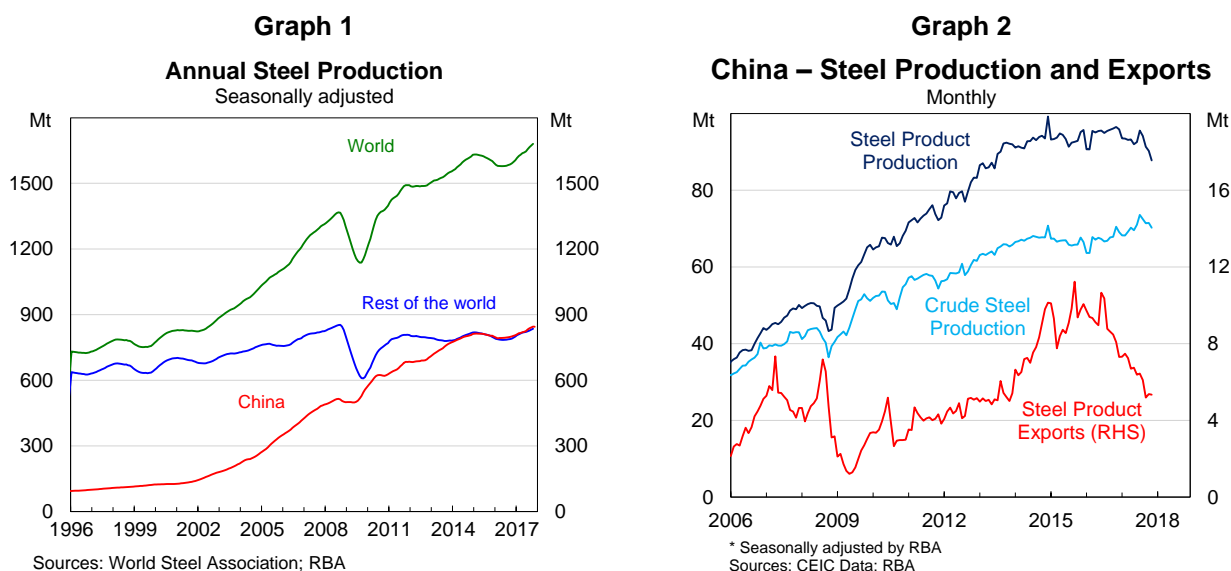
19 For example, Credit Suisse (September 2016) ‘[The World of LNG](#)’

WHY HAVE CHINESE STEEL EXPORTS DECLINED?

Chinese steel exports have declined sharply over the past 18 months, coinciding with a raft of anti-dumping measures implemented by its trading partners. This raises the question of whether such trade actions could, on their own, place downward pressure on Chinese crude steel production and hence iron ore demand. However, we find that there is little difference in the magnitude of the decline in Chinese steel product exports to countries with trade measures in place relative to those with no additional trade barriers. Instead, strong domestic demand for steel appears to be driving the recent decline in Chinese steel product exports, with external factors only having a marginal impact.

Background

Global steel production has increased considerably since the early 2000s, primarily driven by growth in China as the world's largest producer (Graph 1). Given China's dominance of global steel production, it is unsurprising that China is also the largest exporter of steel products, with its exports approximately equal to those of the next three largest steel exporters (Japan, Russia, and South Korea). In fact, China's steel exports are comparable in size to the entire domestic steel production of Japan and India.¹ The share of Chinese steel products that are exported is relatively small, averaging around 6.3 per cent since 2001. However, exports have fallen sharply since the beginning of 2016 (Graph 2).



The decline in exports by destination

China exports steel to over 200 countries, though exports to most destinations are small and volatile. While the decline in exports has been broad based by destination (Graph 3), it has been driven by a fall in exports to China's top ten steel export destinations (hereafter referred to as MTPs).² The decline in exports to MTPs accounts for 58 per cent of the fall over June 2016 to June 2017. However, the export market share held by these destinations only fell 2.1 per cent over the same period, reflecting the widespread slowing of Chinese steel exports.³

Since January 2016, 29 countries have taken out over 80 trade remedies against various Chinese steel products under the World Trade Organisation (WTO) framework.⁴ These measures include anti-dumping actions and countervailing duties, which permit tariffs to be imposed against Chinese steel producers specifically, and general safeguards which aim to protect a domestic industry by limiting imports from all

1 See Table A1: World's Largest Steel Producers in Appendix.

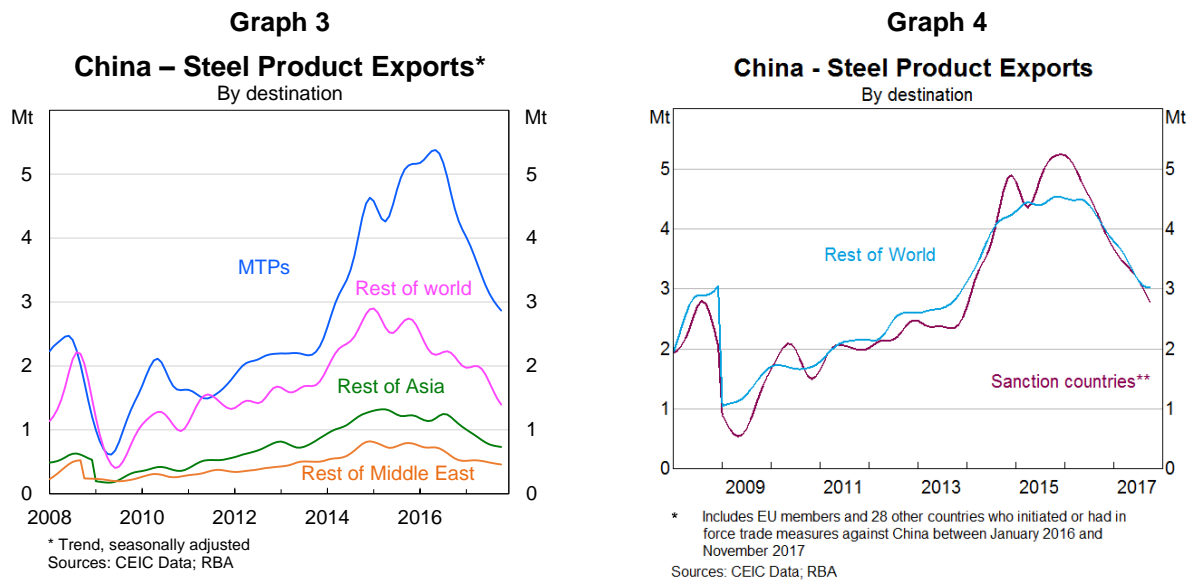
2 China's top ten steel trading partners in order are Korea, Vietnam, Thailand, Philippines, Indonesia, India, Saudi Arabia, Turkey, Malaysia, and Pakistan.

3 See Table A2: Chinese Steel Product Exports in Appendix.

4 This compares to around 400 measures over 2001-2015. The large volume of trade remedies introduced against China is unsurprising because most of the increase in world steel trade over this period was met with Chinese supply, while most other geographic regions' absolute export volumes have been broadly unchanged since 2005.

sources. Imports to countries imposing trade remedies ('sanction countries') over this period account for around half of China's steel product exports. Sanction countries saw a larger increase in Chinese steel exports over 2014-15 than other countries.⁵ However, there is little difference in the magnitude of the decline in Chinese steel product exports between those countries imposing trade measures and China's other steel export destinations (Graph 4). To some extent, this is to be expected, as WTO remedies can only be imposed against products which are identical to, or have characteristics closely resembling, the specific domestic product which is the subject of investigation.⁶

Furthermore, these trade measures can be circumvented by adjusting the composition of a steel product such that it no longer falls within the scope of the remedy.⁸



Domestic factors affecting steel exports

One commonly articulated 'rule of thumb' that may explain the recent decline in steel product exports is that China exports its 'surplus'.⁹ That is, when domestic steel consumption is weak and business conditions in the domestic steel industry are deteriorating, there is a tendency for producers to attempt to export products that they struggle to sell domestically. Indeed, export volumes are loosely correlated with the proportion of producers in the industry that are making losses (although the direction of causality is not always clear; Graph 5). In support of this hypothesis, the recent episode of weak exports coincides with strong domestic demand for steel from infrastructure and real estate investment, and reductions in overcapacity. Moreover, the decline in exports has been driven by a fall in rod exports, which are typically reproduced into products used intensively in construction.¹⁰

5 Although media reports sometimes emphasise US-China tensions over steel trade, the share of Chinese steel product exports to the United States is relatively small at 1.3 per cent in the year to June 2017, and thus any changes in US imports are likely to have a limited effect on total Chinese steel product exports.

6 [Anti Dumping Agreement](#) Art 2.6; [Subsidies Agreement](#) Art 51.1 footnote 46.

8 In the past, Chinese producers have been reported to have adjusted the physical composition of steel products to take advantage of favourable tax rebates for steel exports containing boron, and subsequently quickly readjusted production again when rebates were withdrawn in 2015 by removing boron from production. Exports of rods containing boron fell sharply at the time, while total exports of rods continued to grow strongly until mid-2016.

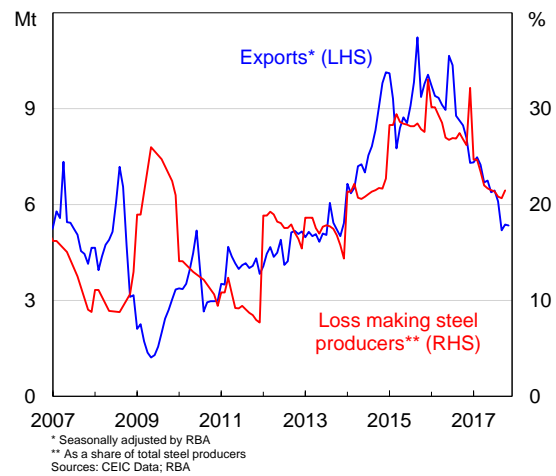
9 Song L and Liu H (2012), 'Steel Industry Development and Transformation in China: An Overview' in Song L and Liu H (eds), *The Chinese Steel Industry's Transformation: Structural Change, Performance and Demand on Resources*, Edward Elgar Publishing, Cheltenham, p 11.

10 Specifically, the decline has been in products classed 'hot rolled alloy irregularly wound coil' that are not silico-manganese or boron containing rods, and 'hot rolled alloy irregularly wound wire rods' that are not silico-manganese or boron containing rods. These rods are intermediate steel products which are typically processed into higher quality wire used to manufacture nails, wire mesh, mechanical springs, rope, stressed concrete wire and automotive parts. See US International trade Commission (2014), '[Carbon and Certain Alloy Steel Wire Rod from China](#)'.

This strong domestic demand, combined with limited growth in domestic production and imports, has put upward pressure on the domestic price of steel. In turn, this has resulted in Chinese steel exports becoming relatively more expensive since mid 2016, and surpassing domestic prices in North Europe in 2017 (Graph 6). It is likely to have resulted in some importers substituting to non-Chinese steel products.

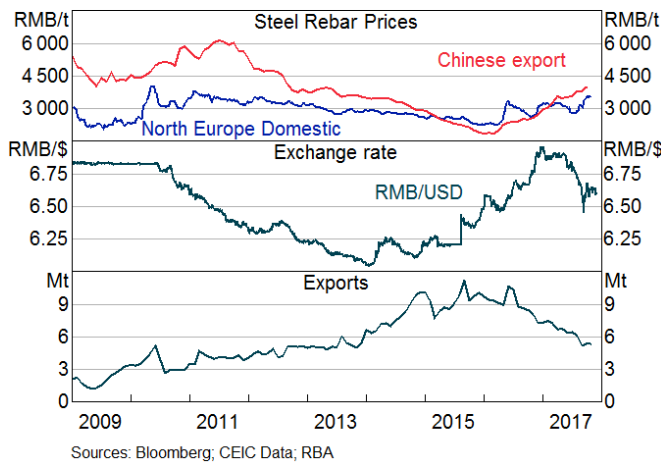
For Chinese producers, the depreciation in the renminbi since the beginning of 2016 appears to have provided little support for export demand.

Graph 5
China – Steel Industry Conditions and Exports

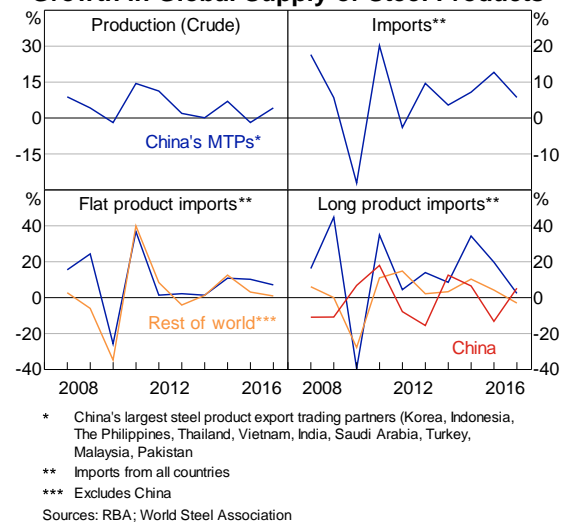


While China's steel exports to its MTPs have fallen, the overall steel demand of MTPs has remained strong. Total steel imports to these economies from all countries have continued to rise through 2016, albeit more slowly, and their own crude steel production has also increased a little over the past year (Graph 7). Growth in demand for long products, which includes rods from all destinations, has weakened in MTPs, and demand has decreased in the rest of the world. Chinese imports of long products have increased, corroborating the conjecture that Chinese domestic demand is soaking up both onshore and offshore supply and has driven the decline in Chinese steel exports. By contrast, global demand for imported flat products from all sources has remained resilient, which aligns with a recovery in global manufacturing.

Graph 6
Chinese Steel Exports and Prices



Graph 7
Growth in Global Supply of Steel Products



The outlook for steel exports

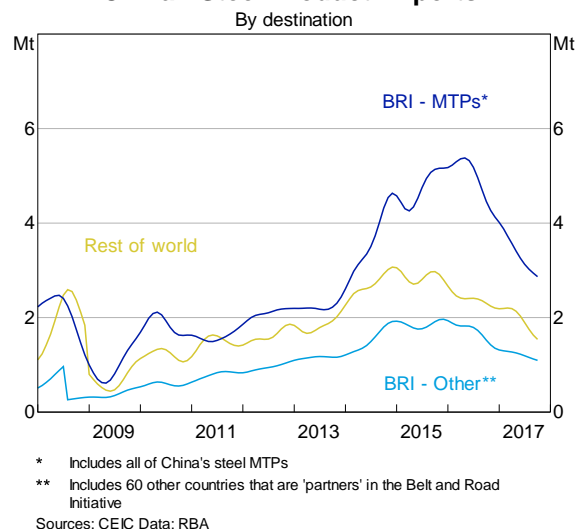
The above considerations suggest that China's steel exports are likely to increase in the event that Chinese domestic demand weakens and/or Chinese steel prices fall. In the near-term, prices look likely to remain elevated as production moderates in response to winter steel production cuts aimed at reducing air pollution from heavy users of coal fired power, which should also weigh on exports.¹³ However, the authorities recently [announced](#) that the export tax on steel products will be removed effective 1 January 2018. The removal of the export tax will improve the relative profitability of exporting, and may support export growth in 2018.

Over the longer term, [previous work](#) suggests that China's steel intensity (that is, the level of steel production per capita) is near its peak and unlikely to follow the trajectory of Japan and Korea, which export a much larger share of their steel. In fact, for China to follow the trajectory of these countries, it would need almost to double the level of its steel production and become the producer of the vast majority of the world's steel demand.¹⁴ While it is plausible that China will increase its market share of global exports, the extent to which this happens will depend on China increasing the quality of its exports to meet high-end/specialised steel demand, and maintaining competitiveness in steel manufacturing despite rising domestic wage and non-wage costs of production.

Some private sector analysts view China's 'Belt & Road Initiative' (BRI) as an upside risk to Chinese steel demand (and in turn, demand for Australia's bulk commodities).

However, the extent to which the BRI will drive additional steel demand by 'partner countries' is highly uncertain, as most projects (or even bilateral agreements to commence projects) remain at an early stage. As an indication, all of China's MTPs are BRI partner countries and using an upper bound estimate of the number of partner countries,¹⁷ these nations collectively already account for 70 per cent of China's steel exports. Chinese steel exports to BRI partner countries declined over the last twelve months (Graph 8).

Graph 8
China - Steel Product Exports



Asian Economies Research Unit
22 December 2017

¹³ See [D17/426383](#).

¹⁴ This estimate uses current ex-China world demand (around 700 million tonnes of crude steel) and the midpoint of steel production per capita in Korea and Japan in 2016.

¹⁷ Most countries have no formal commitments to the BRI, but around [70 countries](#) have given some preliminary indication of support for the BRI.

APPENDIX

Table A1: World's Largest Steel Producers

Annual, 2016

	Total production^(a)	Total exports^(b)	Export share of production
	Mt	Mt	Per cent
China	808.4	108.1	13.37
Japan	104.8	40.5	38.64
India	95.6	10.0	9.56
United States	78.5	9.2	11.72
Russia	70.8	31.2	44.06
South Korea	68.6	30.6	44.61

(a) Crude steel production, finished steel production is not available; (b) Exports are finished and semi-finished steel products

Sources: World Steel Association; International Trade Administration; RBA

Table A2: Chinese Steel Product Exports

Annualised

	June 2016	June 2017	% change
Total number of export destinations	231	215	-6.9
Total exports (Mt)	117.3	92.7	-20.9
Top 5 share (%)	38.1	40.6	6.5
Top 10 share (%)	53.5	52.4	-2.1

Sources: CEIC Data; RBA

From:
Sent: Wednesday, 19 September 2018 6:12 PM
To: EC - China and India Updates
Subject: Update: Implications for China from US trade protections and facts on China-US trade [SEC=UNCLASSIFIED]

Last week the United States invited China to recommence trade talks but bilateral trade tensions have worsened in the past 48 hours, following the announcement that the United States will proceed with imposition of a third tranche of tariffs.

Yesterday, the United States Trade Representative (USTR) [announced](#) that from 24 September 2018, a 10 percentage point tariff increase will be levied on US\$200 billion worth of Chinese imports. This [third tranche](#) will affect 5,745 product lines across a broad range of final goods imported into the United States (previous tranches appear more targeted towards intermediate electrical goods). The USTR has also announced that this 10 per cent tariff rate will increase to 25 per cent from 1 January 2019. The release suggested that this escalation was seen as necessary by the United States 'in order to obtain elimination of China's unfair policies' which are identified as 'theft of American intellectual property and forced transfer of American technology'. This final list exempted 286 product lines from the new tariffs – examples of exempted products include select electronics products (e.g. smart watches and Bluetooth devices), some chemical inputs for manufactured goods and agriculture and certain 'health and safety products' such as bicycle helmets, child car seats and playpens.

Overnight, Chinese authorities responded by announcing increased tariffs on US\$60 billion of imports from the United States. A 10 percentage point tariff increase will be imposed on around 3,500 goods and a 5 percentage point increase will be implemented on around 1,600 goods. China's increased tariffs will also be applied from 24 September 2018. Chinese official releases said retaliation was necessary 'in order to defend the legitimate rights and interests of the Chinese economy [under WTO] international obligations'.

De-escalation at this point seems unlikely. President Trump has previously threatened to impose tariffs on the remaining Chinese imports to the United States (around US\$250 billion). Chinese authorities continue to affirm that they will respond in kind to any American escalation. China's former Finance Minister Lou Jiwei also speculated this week that China could ban Chinese exports of key components, intermediate materials and equipment 'that American manufacturers depend on', if pushed. China also has an ongoing dispute before the WTO around the United States methodology for calculating the scale of dumping of a range of products (part of which the WTO has already found in favour of China) and in [recent weeks](#) has sought WTO permission to suspend concessions and other obligations previously granted for certain goods under the WTO framework.

The impacts on Chinese GDP remain uncertain. Fang Xinghai, vice-chairman of the China Securities Regulatory Commission, said the third tranche of US tariffs will have a negative effect on the Chinese economy, reducing its GDP growth by about 0.7 percentage points, but he noted that 'with ample room to manoeuvre fiscal and monetary policies, the Chinese economy is expected to remain stable'. Chinese authorities have already introduced several initiatives to support Chinese importers and exporters that may be hurt by the tariffs imposed by the United States. On 9 July, China's Ministry of Commerce [announced](#) that the tariff revenue collected from US exporters will be used to mitigate the tariff impact and be redirected to affected Chinese firms. In addition, on 5 September China's Ministry of Finance (MOF) [announced](#) that tax rebates for various Chinese exports, mainly electrical goods, will increase from 15 September 2018. This second announcement was not specifically linked by the MOF to the impacts of strained China-US trade relations, but it seems highly probable they are related. Yesterday Chinese media also reported that the State Council would prioritise reducing red tape and expediting processes for importers/exporters and extending financial support to exporters.

From:
Sent: Wednesday, 20 June 2018 5:48 PM

To: EC - China and India Updates

Subject: Update: Implications for China from US trade protections and facts on China-US trade [SEC=UNCLASSIFIED]

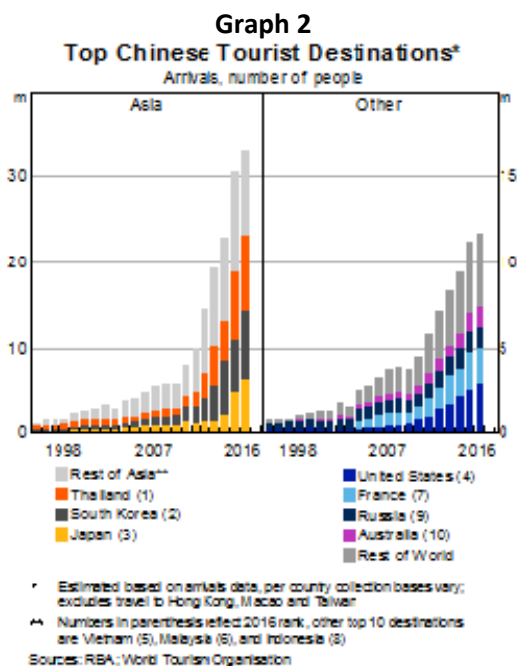
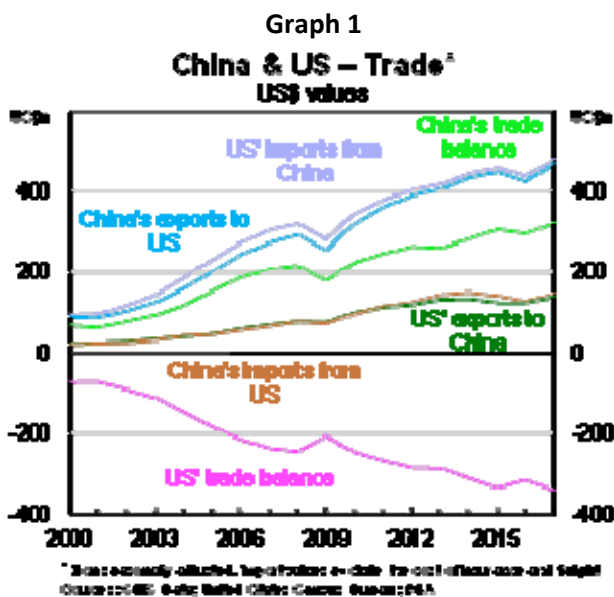
Over recent weeks, the United States has escalated trade tensions with China with some vigour.

On 15 June, 2018, the Office of the United States Trade Representative (USTR) [released](#) a list of 1012 product lines imported from China that will be subject to an additional tariff duty of 25 per cent. This announcement was broadly in line with those foreshadowed in [March 2018](#) (though there has been some shift in the products included – with a range of consumer goods no longer targeted and instead replaced with more electrical intermediate goods). The industries targeted overall include: aerospace, information and communications technology, robotics, industrial machinery, new materials and automobiles. The tariffs will be implemented in two tranches. The [first tranche](#) includes 818 product lines covering US\$34 billion worth of imports from China. Tariffs on the first tranche of products will take effect on 6 July, 2018. The [second tranche](#) includes the remaining 284 product lines that covers US\$16 billion worth of Chinese imports. Products in the second tranche, however, will be reviewed in a public notice and comment process before the USTR decides on a final product list that will be subject to the 25 per cent tariff duty.

China has reiterated its position of responding ‘proportionately’ to the US. China [announced](#) that a 25 per cent tariff duty on US\$34 billion worth of imports from the US would also be implemented on 6 July. The tariffs will be imposed on 545 product lines which include soyabeans, agricultural products, seafood products and automobiles. China has also flagged further tariffs on an additional US\$16 billion worth of US imports, targeting energy products, chemicals and medical equipment, the implementation date for which will be announced at a later time. China has also announced that all deals negotiated during the China-US trade talks with the US are now invalid.

In retaliation, on 19 June US President Donald Trump [foreshadowed](#) an additional tariff of 10 per cent on US\$200 billion worth of Chinese imports (the USTR is currently reviewing the list of products to which this tariff may be applied). China’s Ministry of Commerce has since [responded](#) that, if the US proceeds, China will implement a package of quantitative and qualitative measures against the US. While no specifics have been given, levying tariffs of >10 per cent on a smaller value of imports (because Chinese imports from the US are less than US\$200 billion; Graph 1),

To put things into perspective, in 2016 the US was ranked fourth globally as an outbound destination for Chinese tourists with around 3 million Chinese tourists visiting the US in that year (Graph 2; inbound Chinese tourists to the United States grew by 14.7 per cent over 2015-16). As such, any meaningful travel restrictions on Chinese tourists to the US may have non-trivial consequences for the US tourism sector.



From:

Sent: Thursday, 29 March 2018 5:21 PM

To: EC - China and India Updates

Subject: Briefing: Possible implications for China from US trade protections and facts on China-US trade
[SEC=UNCLASSIFIED]

It is clear from the developments over the past week from the White House that trade protectionist measures are directed towards China. The Chinese authorities have indicated a preparedness to respond in-kind to any unilateral actions by the US.

It is impossible to quantify the effect on Chinese-US goods trade at this stage. A lot of uncertainty remains as to exactly what measures will be imposed and their implications. US tariffs on broad classes of Chinese exports of machinery and electrical equipment (M&E) would have the greatest effect on China. However, the US implementing tariffs on most M&E imports seems somewhat unlikely given the impact on prices paid by US consumers.

Bearing these caveats in mind, a crude back-of-the-envelope calculation suggests that an *extreme* scenario in which China's exports to the US fell by the entire USD 60 billion (the estimated value of US imported goods that may be affected by the tariffs) could, as an *upper bound*, shave up to half a percentage point from China's 2018 GDP growth. This estimate assumes stable prices and exchange rates. It also does not account for any decline in imports of components from Taiwan and South Korea, which would be expected to reduce the effect from a net exports perspective.

Background

Media and market reports over the past week have highlighted a scenario whereby the United States applies 25 per cent tariffs on 'up to USD 60 billion' of Chinese products related to innovation (high value-added production in China).

- Specific final measures have not yet been finalised: it is not yet certain that the tariff will in fact be 25 per cent and to which products it will be applied.
- There is a general expectation that tariffs will be applied to 'innovative' sectors following an investigation into whether China's laws, policies, practices, or actions may have been unreasonable or discriminatory and harmed American intellectual property rights, innovation, or technology development. The investigation (as responded to on Friday in a [Presidential Memorandum of Understanding](#)) found that China pressures American firms to transfer technology to Chinese companies and intervenes in and restricts US firms' technology licensing agreements to the detriment of US firms. The President has directed US bureaucrats to advise within 15 days on whether tariffs should be increased on up to 1300 Chinese goods (covering about 150 product categories), and to identify which goods among this list should have tariffs imposed on them.
- Reporting refers to products produced by those sectors related to China's 'Made in China 2025' industrial policy ([in Chinese](#)), which seeks to upgrade China's manufacturing sector from low value-added to medium to high value-added products (from a 'Made in China' to a 'Created in China' base) and sets out 10 key products of focus: IT, automation and robots, aviation and aerospace equipment, ocean-engineering equipment and high-tech vessels, rail transport, energy efficient vehicles, electrical equipment, agricultural M&E, biomedicines and medical devices and 'new materials'.
- Possible restrictions on Chinese inbound investment into the US are also under consideration, which may also affect existing Chinese investments in the US.

Also on Friday, the US's previously announced tariffs of 25 per cent on steel and 10 per cent on aluminium came into effect, and China's Ministry of Commerce released [a proposal](#) (in Chinese) that considers:

- Imposing a 15 per cent tariff on around 120 goods categories (which the Ministry of Commerce estimates are equal to around USD 1 billion of US exports to China), including fresh fruit, dried fruit and nut products, wine, modified ethanol, American ginseng, and seamless steel pipes.
- Imposing a 25 per cent tariff on 8 additional categories (another estimated USD 2 billion of US exports), including pork and processed products, recycled aluminium.

The Financial Times has been reporting that as a concession to address the US's concerns about the bilateral deficit, China could divert some of its demand for semiconductors from South Korea and Taiwan to instead import more semiconductors from the US. There has been no official announcement on this yet.

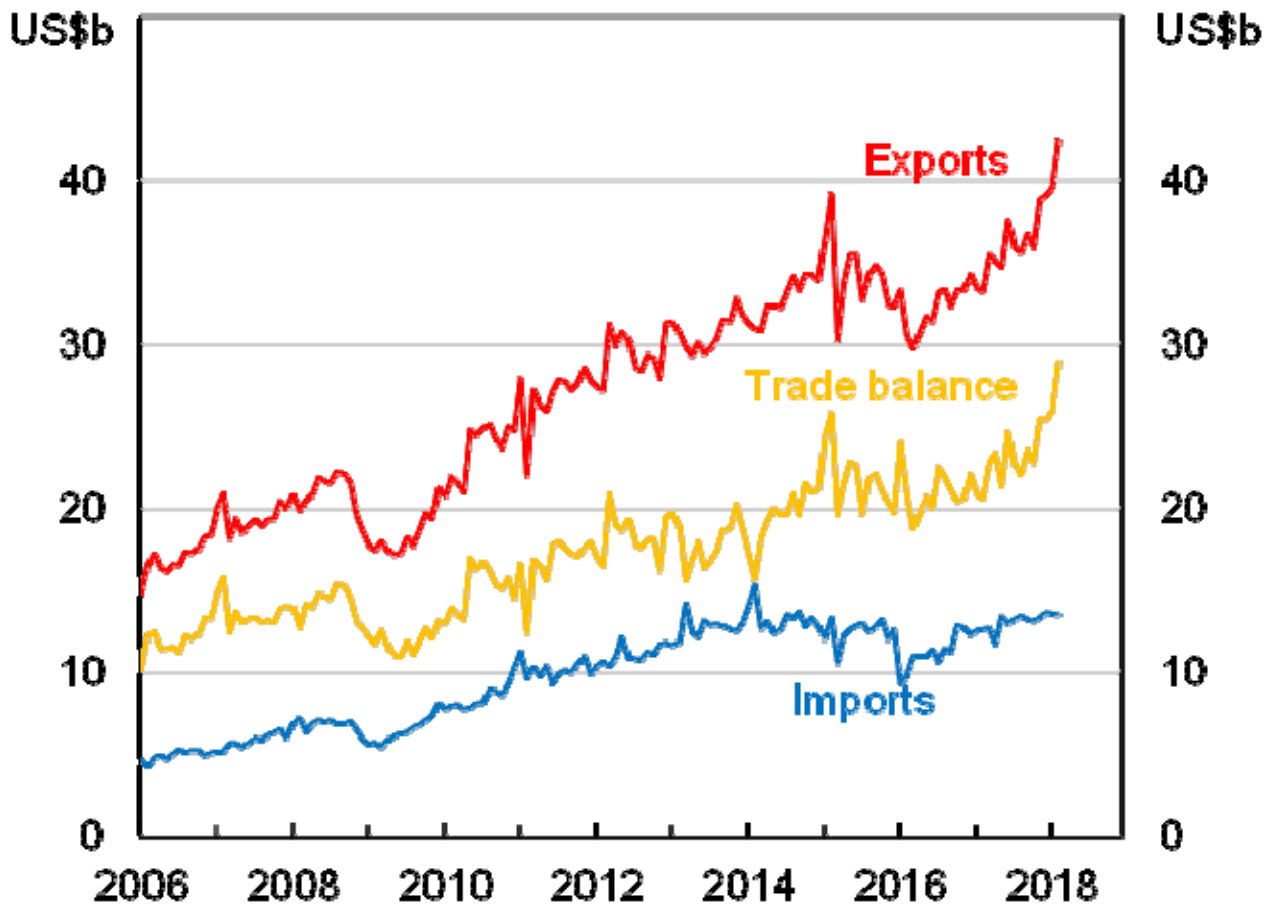
Facts on China's merchandise trade with the US

China Merchandise Trade				
	Total (US\$ billion)	Per cent of Chinese GDP	Trade with US (US\$ billion)	Trade with US, per cent of total
Exports	2280.4	18.6	433.1	19.0
Imports	1842.3	15.1	155.2	8.4

China Merchandise Trade with United States			
	Value (US\$ billion)	Per cent of total Chinese exports (imports)	Per cent of total US exports (imports)
Exports			
- Machinery & equipment (M&E)	305.7	13.4	70.6
- Steel	2.0	0.1	0.5
- Aluminium	1.9	0.1	0.4
Imports			
- M&E, vehicle, aircraft vessel & transport equipment	81.7	4.4	52.6
- Food & agricultural products	21.8	1.2	14.0
- Steel	0.6	0.0	0.4
- Aluminium	0.2	0.0	0.1

China – Merchandise Trade with US*

US\$ values



* Seasonally adjusted by RBA
Sources: CEIC Data; RBA