US-China trade dispute

Beijing hits back at Trump call to block US pension fund investment in China

Investors' fears rise that trade conflict could spread to financial markets

Donald Trump's latest salvo sent a signal to international investors and Chinese officials, say analysts © Bloomberg © AFP via Getty Images

Tom Mitchell in Singapore and **Don Weinland** in Beijing 7 HOURS AGO

Donald Trump's order to stop the US government's main pension fund from investing in Chinese equities will only hurt US investors, Beijing has warned as trade tensions between the countries threatened to turn into a "financial fight".

Beijing officials have been worried since late last year that Mr Trump would follow up his two-year China trade battle with action in financial markets.

The latest shot in that conflict was fired on Tuesday by the US president. In letters to the head of the government's main pension fund, which Mr Trump does not directly control, administration officials urged the Federal Retirement Thrift Investment Board not to invest in index funds that buy Chinese shares.

The president's instruction lacked the drama of the trade war's repeated declarations of punitive tariffs and counter-tariffs that have rocked global financial markets for most of 2018 and 2019. But the latest salvo still sent a clear signal to international investors and Chinese officials, who have been bracing themselves for such a move.

Trump administration officials linked the action to the coronavirus pandemic, which the US and Chinese governments have blamed on each other in increasingly bitter exchanges. They warned the FRTIB that the Chinese companies it backed could be sanctioned for allegedly "culpable actions of the Chinese government with respect to the global spread of the [coronavirus]".

On Wednesday, a Chinese foreign ministry spokesperson said Mr Trump's move would only hurt US investors. "China's capital markets are increasingly favoured by global investors," Zhao Lijian said. "Using national security issues as an excuse to keep US investors from entering the Chinese market will only cause them to miss the opportunity."

Thomas Fang, head of China global markets at UBS, said this was "quite a credible risk". "What we're watching is: will this extend beyond certain federal investment funds to the broader investment community? This is not a positive sign," he said.

The Trump administration is clearly eager to initiate a financial decoupling from China

Eswar Prasad, Cornell University

In a speech in November, Lou Jiwei, a former Chinese finance minister, predicted that US-China tensions would flare up in a "financial war characterised by the use of long-arm jurisdiction" by the Trump administration.

In a commentary published this month, the PLA Daily, published by the People's Liberation Army, warned of the need to "safeguard national financial security" and prepare for "smokeless wars in the financial markets".

Chinese officials had hoped that moves to open the country's financial markets to larger inflows of overseas capital would help pave the way for a lasting trade deal.

In February, when economic disruption caused by the coronavirus pandemic peaked in China, foreign investors still poured $10.7bn into the country's $13tn bond market.

The Trump administration, however, is signalling that it views portfolio investment flows into China to be just as undesirable as the migration of US supply chains to the country and Chinese investment into the US.

Robert Lighthizer, the US Trade Representative, criticised the "lemming-like desire for efficiency" that had caused many US companies to move operations overseas, in a comment article published in the New York Times this week.

"The era of reflexive offshoring is over, and with it the old overzealous emphasis on efficiency and the concomitant lack of concern for the jobs that were lost," he added.

The Trump administration's greater scrutiny of Chinese acquisitions of American companies on national security grounds has also triggered a collapse of investment flows into the US. Chinese direct investment in the US fell to just $5bn last year, compared with peak inflows of $45bn in 2016, according to figures published by the Rhodium Group, the research company.

Eswar Prasad, a China financial expert at Cornell University, said: "The Trump administration is clearly eager to initiate a financial decoupling from China."

"This effort will be reinforced by tariffs and other trade restrictions that reduce direct investment flows between the two countries," he said.

The FRTIB rejected another request by US lawmakers to shun Chinese stocks in November, and is not legally bound to heed the Trump administration's request.

For now, Prof Prasad noted, "portfolio flows will still be driven by economic factors such as expected returns rather than government pronouncements".

It is also unlikely that China will retaliate if the FRTIB does follow Mr Trump's directive.

After the coronavirus pandemic caused first-quarter economic output to collapse 6.8 per cent year on year, Chinese officials want more capital inflows to help boost the economy. Intel Capital, the venture capital arm of the US chipmaker, announced on Wednesday it had backed two Chinese start-ups as part of a broader round of investments.

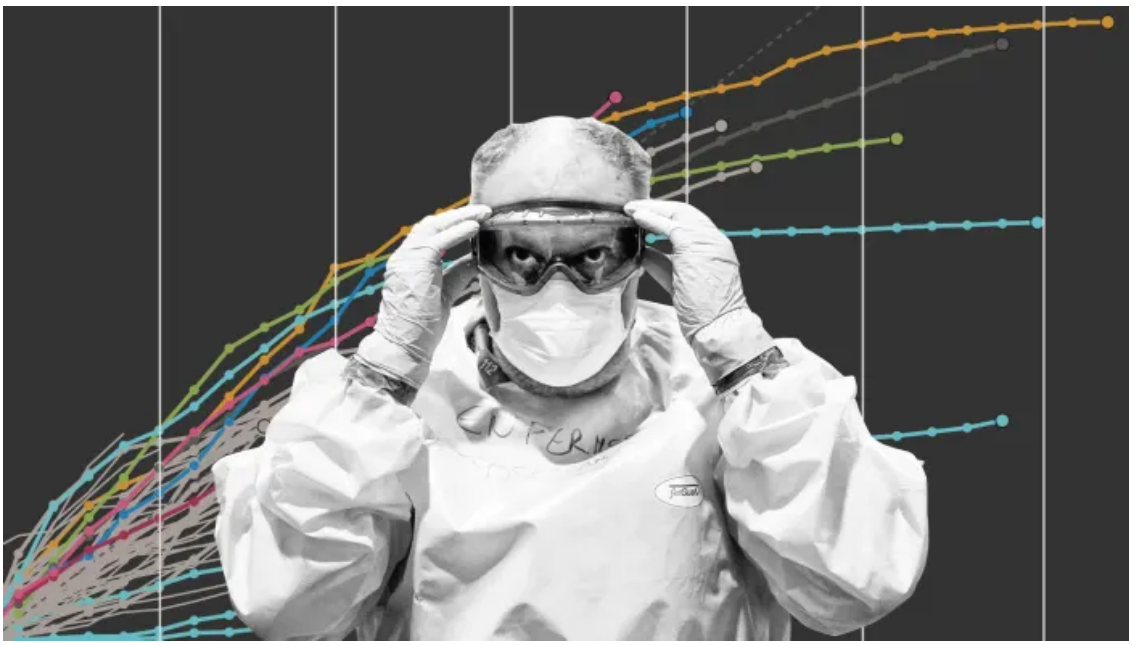
But Mr Trump's de facto declaration of a financial war between the world's two largest economies could also embolden hardliners in Beijing. They think the country should prepare itself for a more dramatic rupture with its largest trading partner, including the possible collapse of its "phase-one" trade deal agreed this year with the US.

The agreement focuses on increased Chinese purchases of US goods, with a two-year target of $200bn that many officials and analysts in Beijing thought were unrealistic even before the pandemic brought global economic activity to a halt.

"The agreed purchases were already beyond China's capacity [to absorb] before the pandemic," said Shi Yinhong, an international relations professor at Renmin University in Beijing.

Additional reporting by Xinning Liu

Editor's note



The Financial Times is making key coronavirus coverage free to read to help everyone stay informed. Find the latest here.