EUROPEAN CHAMBER SURVEY ON THE US-CHINA TRADE WAR FINDS MORE COMPANIES MAKING DIFFICULT STRATEGIC CHANGES TO ADAPT TO THE INDEFINITE NATURE OF THE TENSIONS

European Chamber
中国欧盟商会

Summary of findings

- Roughly one in four respondents import supplies/goods from the United States (US) that are affected by the tariffs, with 19 per cent of total respondents saying prices have gone up and 5 per cent stating that prices have remained stable.
- Nevertheless, the number of affected European companies in China that raised prices dropped, with nearly 60 per cent saying they would keep prices the same. 44 per cent of affected companies changed suppliers and others redirected their global production around the US-China 'border'.
- The share of respondents exporting goods to the US that are hit by American tariffs climbed to 35 per cent, but a strong majority are keeping their prices the same.
- Most respondents are still monitoring the situation, but others have taken more drastic steps, with 3 and 8 per cent moving relevant production out of the US and China respectively, while 6 per cent increased investment in China, chiefly to onshore supply chains and in order to negate the tariff risk.
- However, 15 per cent indicated that they have delayed investment/expansion in China

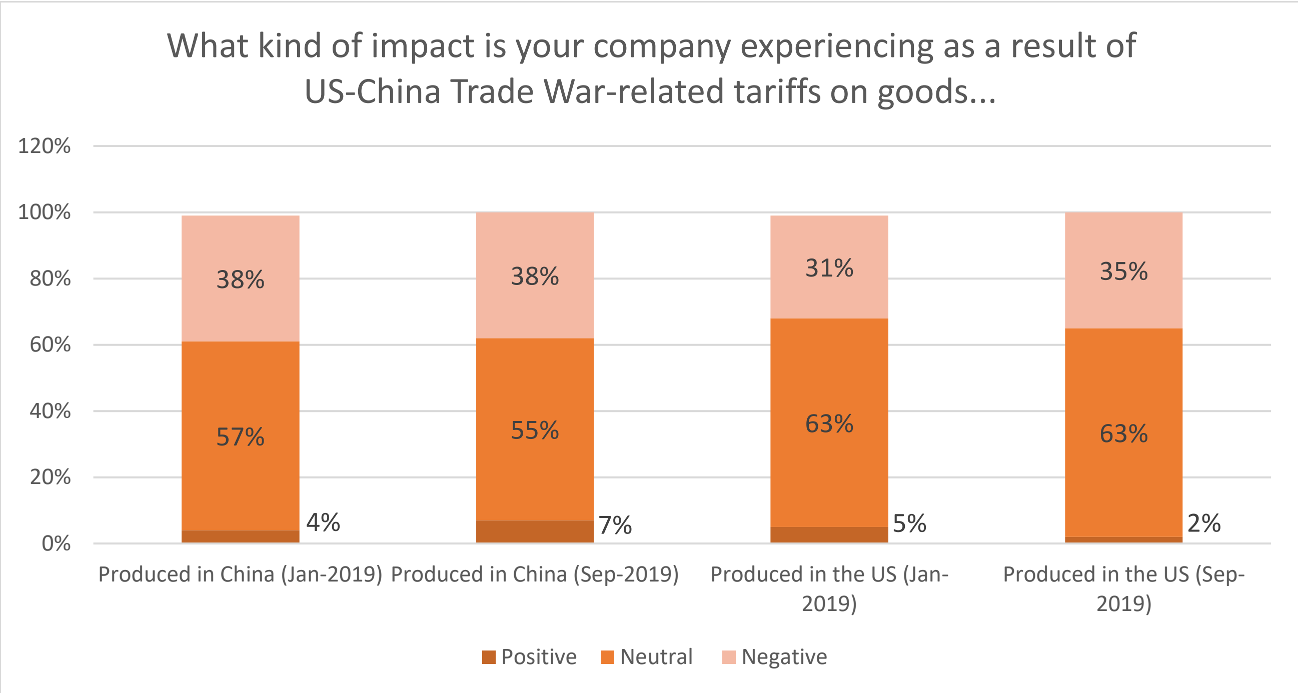
Many European firms have managed to mitigate the worst effects of the US-China trade war by adapting their strategies and supply chains to circumvent the US-China trade 'border' and avoid the heavy and broad-reaching tariffs imposed by the two sides. Some companies have successfully leveraged either their own global operations or highly diverse supply chains across other markets to shift production accordingly to dodge the tariffs entirely. Other companies that cannot make such changes have taken advantage of the high-quality reputation enjoyed by European brands that are not easily replaced, meaning they can often pass along costs without sacrificing much market share. Nevertheless, European companies in China continue to experience significant challenges brought on by the US-China trade war, with many seeing supply chains disrupted and others being forced to raise prices on goods sold both in China and the US.

The European Union Chamber of Commerce in China continues to agree with the US' frustrations over the structural issues in China's economy, but disagrees with the application of tariffs as a means of resolution. The European Chamber believes leaders in both the US and China should instead engage in good faith negotiations to end the trade war and meaningfully advance China's reform agenda.

"China needs timely and wide-ranging reforms, and the right amount of strategic pressure can help move things in the right direction, but there doesn't appear to be anything strategic about the ongoing application of tariffs," said Jörg Wuttke, president of the European Chamber. "In contrast, the EU has just concluded yet another free trade agreement (FTA), this time with the Mercosur Bloc in South America. We need something similar in China, and it is disappointing to note the limited progress in the talks on the EU-China Comprehensive Agreement on Investment, all while the EU concludes one FTA after the other."

Background: *From 12th–20th September 2019, the European Union Chamber of Commerce in China surveyed its member companies to better determine how they are being affected by the ongoing US-China trade war. The survey was a follow-up to questions asked in a dedicated survey in September 2018, with further questions included in the annual* European Business in China Business Confidence Survey 2019*, which collected responses in January 2019. 174 responses were collected in September 2019 in total, in comparison to the 193 collected in September 2018, and the 585 collected during the annual* Business Confidence Survey.

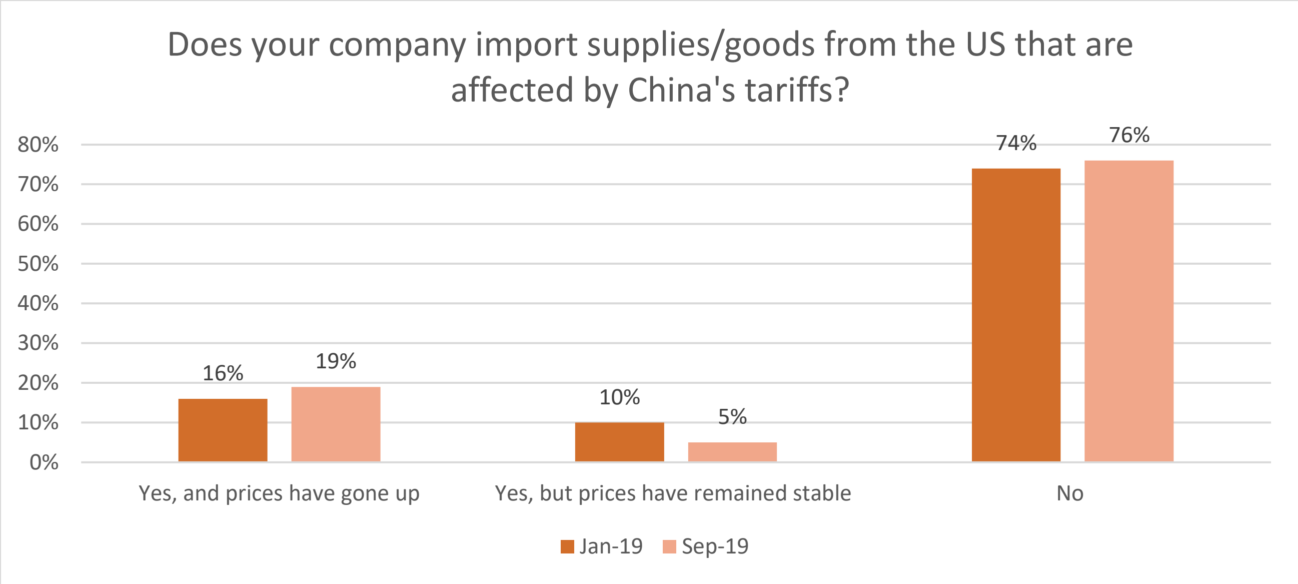
Survey Results and Analysis



There was little change in the overall effects of the ongoing trade war, however recent findings indicate that while the overall sentiment remains basically the same, companies have made considerable changes in an attempt to cope with the effects.

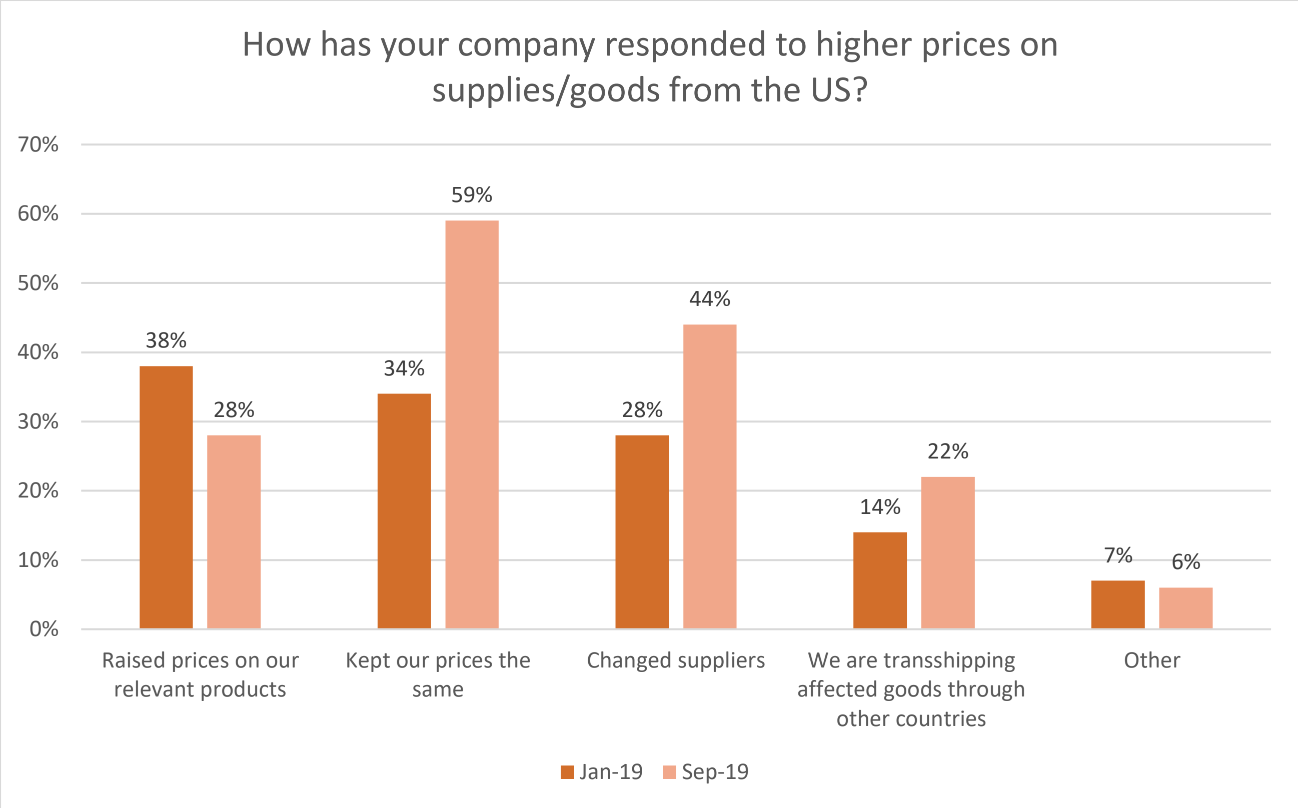
*Respondents indicating that they did not produce goods or have no need for a supply chain were removed

Respondents indicated that their supply chains have experienced at least some degree of disruption, with around 10 per cent stating that they were significantly or completely disrupted. The third of companies that have seen no disruption to their supply chains may either not have any link in their supply chain that crosses the US-China 'border', or they may have sufficient alternative sources to make adjustments and change suppliers, thereby avoiding the tariffs.



While the number of respondents reporting that prices have gone up is relatively small, as is the decrease in those saying that prices have remained stable, the data in this chart is best understood by looking at the gap between these two responses, which has grown from six percentage points in January to 14 in September. This expanded gap indicates that many of the US-based suppliers that previously felt that they could cut into margins to avoid passing price increases along to China-based customers have changed their strategy in recent months and allowed prices to rise, likely due to higher tariff rates and the challenge of managing price cuts in a protracted trade war. As a result, the proportion of US-based companies that are passing price increases along compared to those eating the costs of the tariffs has shifted considerably from about a 60/40 split to an 80~~75~~/20~~25~~ one.

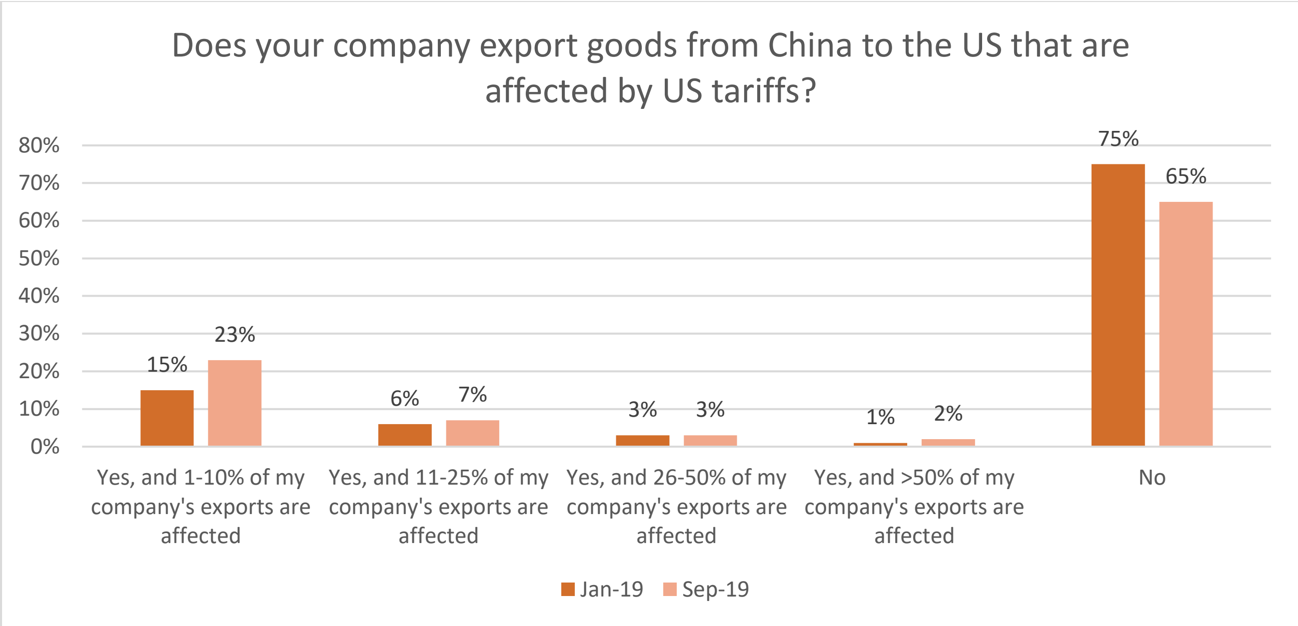
While US-based suppliers may have been willing to eat the cost of a 10 per cent tariff in order to maintain market share, they likely cannot do the same for the 25 per cent tariffs. Furthermore, companies that may have taken the decision to cut into margins, or even suffer temporary losses, in the hope that the trade war would quickly resolve itself, seem to have given up on that possibility.



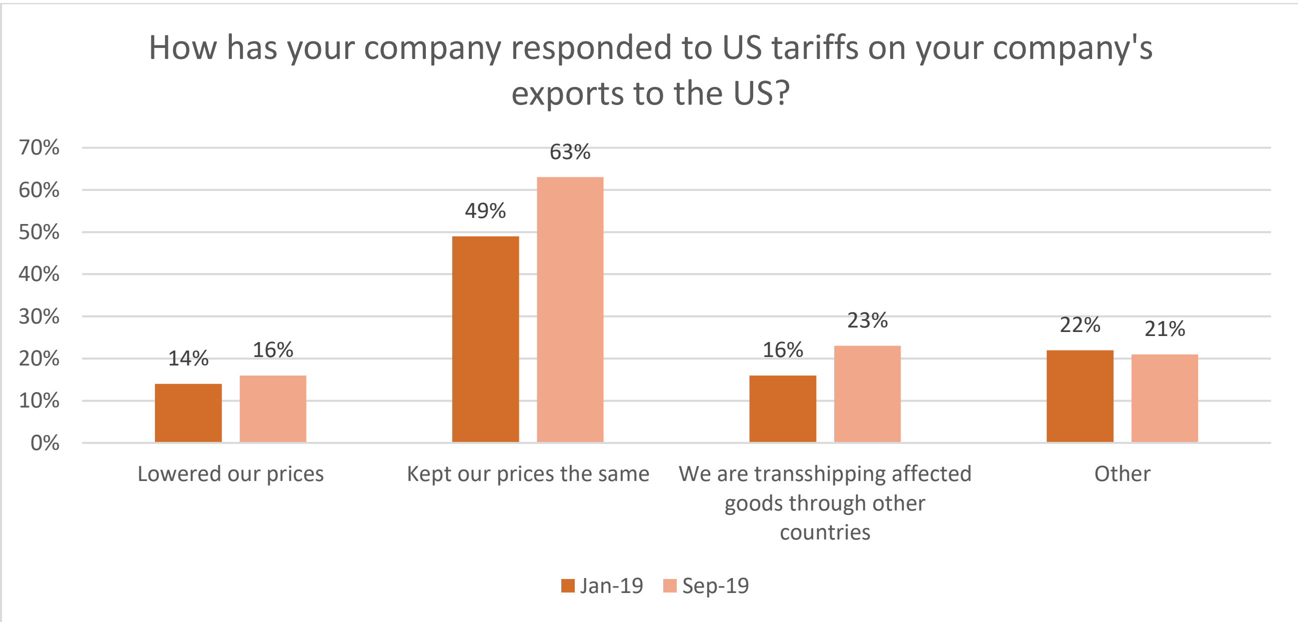
*Asked only if response to previous question "Does your company import supplies/goods from the US that are affected by China's tariffs?" was "Yes"

The steps that European companies have taken in response to higher prices from US-sourced goods have changed drastically from January. While the expectation may have been that higher costs would be passed down at higher rates as tariff rates climbed and the trade war lingered on, the opposite seems to have been the case, with a ten percentage point drop in those passing costs downstream. Meanwhile, the ratio of companies keeping their prices the same nearly doubled. This can be explained by the other responses to the same question, with far more companies having changed suppliers or found ways to source goods through other countries, thus avoiding the cost increase from the tariffs altogether and keeping their prices the same. Similarly, European multinational companies frequently have subsidiaries across many different markets that can be redirected to substitute production that would otherwise cross the US-China 'border', allowing them to completely avoid the tariffs.

European companies have clearly adapted to survive in an extended trade war rather than hunker down in the hope that it will run its course.

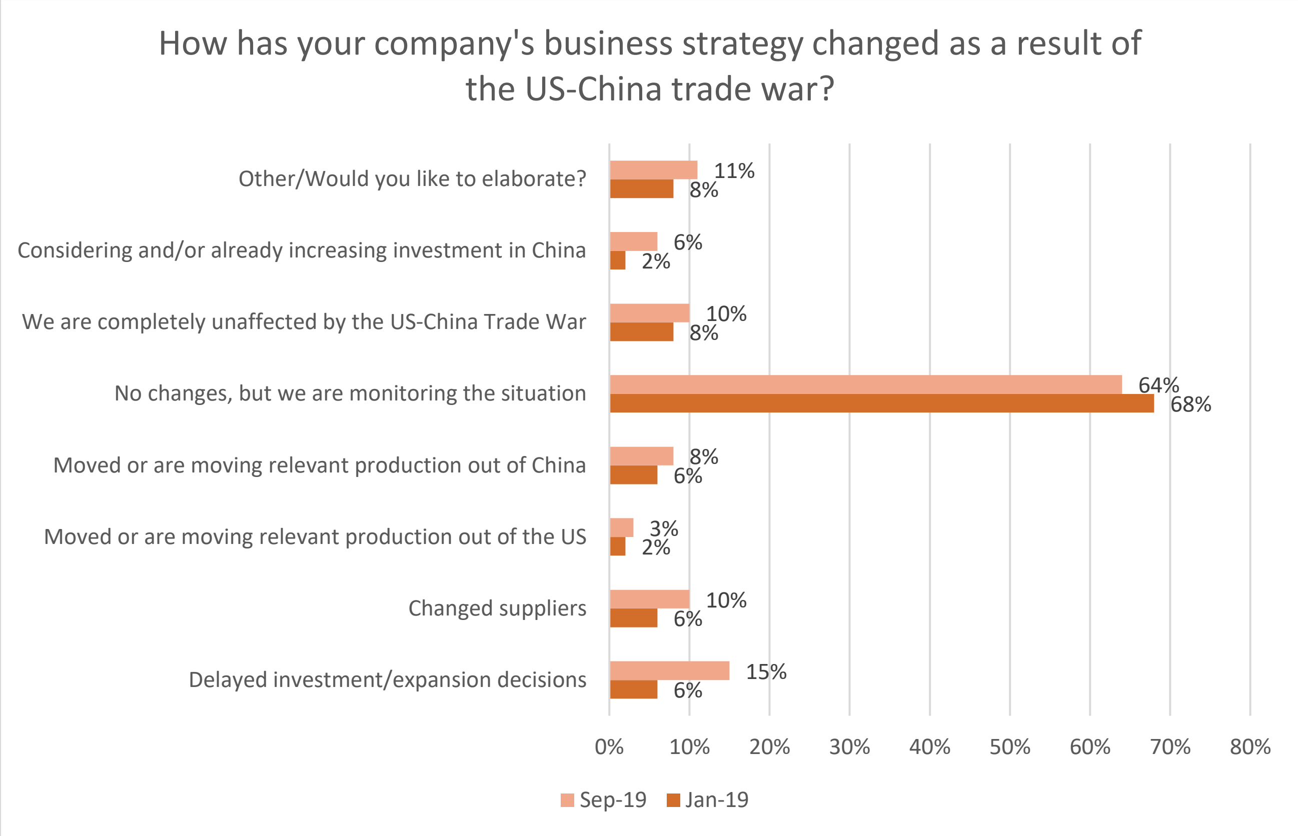


The number of European companies in China that export to the US and are affected by American tariffs also climbed significantly from 25 per cent to 35 per cent. The bulk of new companies hit by new tariffs seem to be less exposed, however, with the majority seeing only one to 10 per cent of exports affected. However, for those seeing higher proportions of exports affected, this could become a life-or-death situation.



*Asked only if response to previous question "Does your company export supplies/goods from China to the US that are affected by US tariffs?" was "Yes"

A significantly higher number of European companies are now keeping their prices the same, despite the tariffs at the US border that will increase the cost of their products. This expresses either acceptance that they cannot offset the 25 per cent tariff rates, or demonstrates their confidence that downstream purchasers cannot, or will not, accept another product from a different source. The increased number of firms that are transshipping has risen considerably, and many of the "other" respondents indicated that they are adjusting supply chains to service the US market from the EU or other third-markets. Companies appear to be making decisions based on the assumption that this will be a long-term issue.



More European companies have made strategic changes in response to the trade war compared to the European Chamber's previous survey. While small numbers have shifted investments out of the US or China, more have started to change suppliers. Interestingly, several firms are increasing their investment into China, essentially adopting the strategy of further onshoring to avoid tariffs altogether. However, the most concerning finding is that 15 per cent of respondents have delayed investment or expansion decisions.

Some of the individual responses to this question also shed additional light on the economic outlook:

- Several have simply shifted production of impacted goods to sister companies in Mexico to service both the US and China markets.
- One expressed the concern that their company is too reliant on China for suppliers, saying, "Our current dependency on Chinese suppliers might get very dangerous."
- Another noted that the effects of the trade war were indirect; that the overall demand on their products is driven by quickly-growing Chinese companies, which are now reducing their purchases as growth slows and they adopt a more sober outlook on the future.
- Two consultancies said that they were shifting services away from providing advice to Chinese companies looking to do mergers and initial public offerings abroad, which are less feasible in the US these days, towards providing service offerings that help companies cope with trade-war impacts.