



The Global CEO Advisory Firm

Teneo Insights

A weekly update from Teneo: U.S.-China Relations, Hong Kong National Security Law, and the Potential Implications for Business

A discussion between Paul Haenle, Simon Buckby, Gabriel Wildau, Jerome Hauer Ph.D., and Kevin Kajiwara.

Thursday, June 4, 2020

Kevin Kajiwara (KK): Well, good day everyone and welcome to our Teneo Insights call this week. I'm Kevin Kajiwara, Co-President of Teneo's Political Risk Advisory business and calling in from New York City today. Thank you for joining our weekly call on issues in the context of coronavirus. It's the most important bilateral relationship of the 21st Century. One side has been the undisputed global hegemon, and the other, the largest population, is striving to break out of the middle-income status. And in a low economic growth world where the U.S. and China are on the spectrum between conflict and cooperation is going to have an ongoing, profound impact on the global economic picture. Clearly relations have been on a negative trajectory and it is worth noting that today is the 31st Anniversary of the crackdown in Tiananmen Square.

So, China - U.S. relations is the topic of today's call. And joining me to discuss this are several of my colleagues. Paul Haenle is the Chairman of Teneo Asia Pacific. He is also the Director of the Carnegie-Tsinghua Center in Beijing. Paul was on the National Security Council staffs of President George W. Bush and President Barack Obama as the Director for China, Taiwan and Mongolian affairs. He was also the White House Representative to the U.S. negotiating team at the Six-Party Talks, nuclear negotiations. Gabriel Wildau is a Senior Vice

President and is Teneo Political Risk Advisory's Senior China Analyst based in the United States. Prior to joining Teneo, Gabe spent 14 years in China, most recently as the Shanghai Bureau Chief of the Financial Times. And before that was with Reuters. We are also joined by a relatively new colleague of ours, Simon Buckby. He is a Senior Managing Director in our office in Hong Kong on the Strategy and Communication side. He also was formerly with the Financial Times, way back when, and the BBC as well.

But we're going to start as usual with an update on the outbreak itself. Joining me is Dr. Jerry Hauer. Jerry served as the Acting Assistant Secretary for Public Health Emergency Preparedness at the U.S. Department of Health and Human Services during the SARS outbreak. And he coordinated the response to West Nile virus in New York City, where he was the Commissioner of the New York State Department of Homeland Security and Emergency Services. Happy to have all of them join me today. And you can send in your questions for any of them at any time via the moderator chat button toward the top of your screen.

So, Jerry, we're at 6.5 million confirmed cases worldwide, and 386,000 deaths. About 27% of both of those numbers are in the U.S. Let's quickly talk about the state of the outbreak in the U.S. at the moment. And as with almost

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everything else happening in this country right now, it needs to be looked at in the context of the ongoing protests here in the U.S. And a lot of people are out protesting in very close proximity. And regardless of how justified their protest is, the fact is, this is happening in the midst of the pandemic. New York City was the hardest hit by the virus and it is attempting to reopen starting on Monday. But it looks like the physical damage from the looting as well as curfews could push that back. But should we expect a spike here in New York and elsewhere in the country in coming weeks because of getting this many people in close proximity?

Jerry Hauer (JH): Yeah Kevin, thanks for having me this morning. Good morning, everyone. Kevin, when you think about the mechanisms of the spread for this virus, coughing, sneezing, loud talking, congregations of large numbers of people, all of that comes together during these demonstrations. A lot of the folks are wearing masks, which reduces the spread, but a number of the people attending these demonstrations don't have masks. So, when you think about all of these coalescing into one demonstration, I fully expect that sometime in the next 5 to 14-15 days, we will begin to see spikes. We're seeing them in Texas. We're seeing them in Arizona, and there are 16 states in total here in the U.S., where they opened early, and we're now seeing these kinds of upticks. So, I fully expect to see spikes.

History will give us some guidance on this. In the 1918 Spanish flu, Philadelphia decided to hold the parade when they recognized they might have the first case. St. Louis on the other hand, shut everything down in two days. Philly, it took eight days. The difference in the case fatality rate, St. Louis had 354 deaths per 100,000 people. Philly, where they held the parade was over twice that at 748 deaths per 100,000 people.

So, I think there is some lessons where we see these coming together of people that are going to portend problems for us in the next couple of weeks. And by the way, masks were required back during the 1918 Spanish flu. To show how stringent the enforcement was, in San Francisco a health officer shot and killed three people because one of them was not wearing a mask.

KK: So, if we sort of step away from the protest for a second, but clearly prior to that, sort of the major narrative was the reopening of the country essentially. But we had a lot of different levels of economic activity in a lot of different states that were in various stages of either getting through the pandemic or coming through the other side of the curve and with obviously differing healthcare institutional capacity. So, I know you've got your work cut out for you, you and your peers, and when you've got literally 50 different state policies on this. But overall, how would you look at the reopening picture at the moment?

JH: Well, again, I think it depends on the state. When you look at Alabama for instance, they continue to struggle with hospital beds because they did open early. They have seen the spike, continue to see a spike, and it continues to put strain on the healthcare system. Other states like California, where we are seeing an uptick, we are not seeing the kind of strain on the healthcare system as we did in say, New York. New York, on the other hand, we're seeing a decline in cases and that's allowing the various regions around the state, including New York City to start to reopen again. And the reopening, if done in a very measured fashion, seems to be going well in a lot of these states.

KK: So, I want to very quickly just to do a quick update on the vaccine developments. I noted that in the New York Times today, they are reporting

that the Trump Administration is getting close to designating five companies as the most likely candidates to produce a vaccine, which would make them eligible for further federal support. Moderna, which we discussed last week on the call, but also the AstraZeneca-Oxford Alliance, Johnson & Johnson, Merck, and Pfizer. What's the latest update on the vaccine front?

JH: Well, Kevin optimistic news on the vaccine front. Under Operation Warp Speed, the administration has already given out \$2.2 billion. They're doing that as I've said on previous calls to allow companies to go ahead and begin manufacturing vaccines while they're doing clinical studies. If the vaccine turns out to work, they'll have a few hundred million doses in place with the end of the clinical studies. If the vaccine doesn't work, the government will still pay that company for those doses, even though they are worthless.

KK: Right. And I want to use this as a segue into the China discussion here because we've now heard quite a bit about these vaccine developments. What are you hearing on the Chinese front? Because clearly, they've got their major labs and scientific companies involved as well.

JH: Sure. In China, it's primarily a public, private partnership. Two companies are working on five different vaccines. They hope to have 100 to 200 million doses ready by the end of the year. A smaller number considering the size of the country, but they're moving forward very aggressively as are we.

KK: And what about the state of the virus and outbreak itself in China? It would appear certainly from the official data, but even anecdotally that they've got the situation pretty much under control and some impressive, I mean, and when we've seen occasional spikes in cases, again, they have relocked down and gone through, especially in Wuhan and now in Wudang Shan, incredibly

impressive testing regimes. What's the status of the virus there now? And how concerned are you and their public health officials about a second wave come fall?

JH: Well, first they are not reporting new cases right now. When they do have a new case, they do surround it. They're aggressive in trying to contain any kind of a localized outbreak. The data, if it's to be believed, has been pretty consistent with no new cases in a number of weeks now. I think we can have some faith in the data because if they did have any kind of a spike, I think that would be reported because there's too many potential sources. As far as a second wave, I think we're all concerned about that. Not just in China, in all of Asia. And I'm very concerned about a second wave, or at least an immediate spike here in the U.S. and then a second wave here in the U.S. sometime late fall, early winter.

KK: Right. Okay, great. Thanks very much, Jerry. Stick with us, but I want to pivot now to our discussion on China, and there's a lot to cover here today. And just today we've seen some new developments. Hong Kong passed a law banning disrespect for China's national anthem. China appears to possibly be easing its ban on foreign airlines after U.S. demands and threats of retaliation yesterday. But a lifetime ago, meaning last week, we arranged this call as U.S.-China relations were spiraling. And there was a lot of rhetoric as you'll recall. The U.S. State Department saying that they could no longer confirm Hong Kong as autonomous, etc. And the proximate cause being Beijing's imposition of a National Security Law on Hong Kong.

Now, Xi Jinping was going to do this anyway, but I have to imagine that he listened to President Trump's Rose Garden speech about sending U.S. troops into U.S. cities against U.S. protesters with a degree of satisfaction. That the U.S., as personified by the president, had essentially lost

the moral authority to weigh in on their actions in Hong Kong. Paul, is that a fair assessment of how China is probably looking at this right now?

Paul Haenle (PH): Well, certainly they're using President Trump's statements about use of American military forces to quell the violence and protests in the U.S. heavily in their propaganda. To point out what they call hypocrisy of the United States and the chaos in the United States. It's an aggressive move by China. And I think President Xi saw a window of strategic opportunity to make this decision. They clearly are seeing in their own analysis, the balance of power tipping in China's favor with U.S. and other western democracies in political crisis, and other crises that they're dealing with, including the coronavirus. So that makes the Chinese Communist Party feel more empowered that it can take this step. And I think there's also a sense that even though the international community's rhetoric will be strong on this, Beijing hopes and maybe expects that the international community, including the United States, won't do much. And beyond these rhetorical statements. And they hope that little is done to harm China's interest. And to be fair, what we've heard from President Trump in the Rose Garden was that the U.S. government would begin the process of eliminating policy exemptions that give Hong Kong different special treatment. But his announcement was very light on details and he kicked a lot of that to working groups within the administration. There's a number of things that they can do.

Secretary of State, prior to President Trump's announcement, did announce a determination on Hong Kong that was no longer sufficiently autonomous under the 1992 Hong Kong Policy Act. But what the administration will do I think has been an open question. We have a lot at stake in Hong Kong. We have \$67 billion in trade between U.S and Hong

Kong. We have 85,000 residents in Hong Kong, 1,300 companies and it's the third largest financial center in the world. So, any steps that we take in this regard will also hurt our own interests.

KK: So just going back to the National Security Law itself, Gabe. Why did China press this issue now? I mean, they've used the rationale that Legco was obligated to do so itself under the basic law and it failed to do so and whatnot. But is it simply that there has been a strategic window of opportunity here? Or is there something bigger going on?

Gabriel Wildau (GW): Thanks, Kevin. I think Beijing had grown frustrated with the political stalemate that had developed in Hong Kong, in the wake of the protest that began last year and the persistence of street protests themselves. And the limited legal enforcement tools available to the Hong Kong government and to Beijing to try to quell those protests. The protest movement proved to be remarkably resilient. Even when it turned at times quite violent, there were signs that the Hong Kong public, the broader public and even those who weren't directly participating in violent acts, had some degree of sympathy or at least tolerance for the hardcore of more radical protesters who were engaged in it, because they believed in the underlying cause. And so that suggested a scenario in which protests could go on indefinitely and that's something that Beijing just wasn't comfortable with. And so, we saw last October at the annual Party Plenum on the meeting of the Central Committee, the top leaders of the Communist Party, they indicated their intention to create new mechanisms for new legal enforcement mechanisms to deal with the protest. So that was well telegraphed back in October. What was surprising was the particular mechanism that they chose, which was to override Hong Kong's local legislature, and to

impose this National Security Law directly, through the mainland National People's Congress. But I think they also recognized, I think their decisions to do this was a response to the domestic situation in Hong Kong, but I think it also reflects an increasing willingness to withstand and to absorb international criticism.

Certainly, Beijing knew that this would be greeted poorly in the rest of the world. But they felt strong enough and confident enough to take the step and to take the hit to their international reputation, because this is of course a sovereignty issue for them. And Hong Kong plays a really crucial function in terms of the conduit for foreign investment into and out of the country. In terms of capital markets, in terms of a gateway to China for foreign business. So, they just decided to bite the bullet. And as Paul said, I think their gamble seems to be paying off in the sense that the pushback from the rest of the world so far has been largely rhetorical.

KK: So, Simon, you're on the ground in Hong Kong. And I'm going to put you on the spot here and ask the question that we always ask, every time Hong Kong is in crisis. Does this mean the end of Hong Kong as we know it? Or conversely could, I mean, obviously the optics aren't great, but could operational stability actually improve for international companies doing business there?

Simon Buckby (SB): Well, I guess the fact that we ask that question regularly, implies that we're not sure that the answer is that Hong Kong is yet finished. We are likely to keep asking that question for some time yet, in my view. I think the mood in Hong Kong is one of resignation that not only is the National Security Law inevitable, but of course this is just another step in a very long-term trend that has been going on since 1997. Hong Kong is definitely evolving. And the most recent introductions of this security law is obviously a challenge to what there was before. It's important to

state that we only know a general framework. We don't yet have any detail, but there are more questions than answers. Will there be presumption of innocence? Will it be applied retrospectively? Will that be open to trials and so on? We don't know the answers to those questions yet. But I echo what Gabe said, there's deep plumbing here for firms built around the capital markets. Some corporations it's true, did leave for Singapore a decade or so ago. And some others have moved closer to their customers in mainland China. But most of those that are here have already factored into their long-term thinking. The long-term changes that have been happening and that we know are going to continue to happen through until 2027.

KK: And so, while we wait for a lot of that detail that you're describing is still unresolved on all of this, we're here in this sort of interim period and companies, especially high-profile companies, can be put into a difficult position. We have already seen a couple of large financial institutions, specifically HSBC and Standard Chartered come out in support of the law as it is. And we've already seen the blow back against them. So how should companies, and I guess this is a question for you, but also for Paul, as you're both advising companies doing business in the region, how do they thread that needle, particularly when much of their audience and customer base and employee base is outside the region?

SB: Well, if the introduction of this law was a strategic opportunity that they've seized they've been extremely lucky in their timing because they've got a tactical opportunity this week as the world's attention is distracted by things in the United States. And as you rightly say, some companies here HSBC, Standard Chartered, companies with long roots in Hong Kong have publicly now expressed support. And that's partly because they've come under a lot of public pressure and they're not the only ones. Swire, and Jardine

here, Li Ka-shing. Maybe most surprisingly, all eight of the local Hong Kong universities have all publicly expressed support for this. And as that pressure is applied, I think the advice that we would give to companies and organizations coming under that kind of pressure is, hold your nerve, stay calm, be aware of the environment that you're operating in and defend your market priorities. There's no simple solution to this tiptoeing through. And the pressure is likely to build and get worse as we approach the presidential election and these issues become entangled in the China-U.S. conflict. But the advice we would give is don't do anything rash and understand where your business opportunities lie.

PH: I agree with that. And I think despite the fact that the rhetoric is so extreme, that we hear from the Trump administration. And so, it may lead people to think things will change dramatically overnight. I agree that that's probably not going to happen. I agree with what was previously stated that China saw the current status quo in Hong Kong, that they didn't have any mechanisms to shape events as unsustainable and needed to have a mechanism to deal with it. But the big question now is, how will Beijing implement this law? And I think that's where U.S. responses will be designed to influence. And we will begin to see what China will do to carry out the law. And I suspect that we won't see a dramatic change overnight, but this will take place over a longer period of time and it's worth watching and waiting. And so, the other piece of advice is to play close attention to how China is implementing this law and how it is impacting your business.

KK: Well, Paul let me step back here for just a second and do a little bit of level setting, because we've referred throughout this call so far to U.S.-China relations. And maybe you can kind of give a sort of state of play assessment of that right

now. I mean, obviously the rhetoric has been deteriorating as we know. This has to be looked at as well in the context of U.S. presidential election season. And I think the Chinese are well aware and sensitive to that as well. But it was notable when we referenced the Rose Garden speech a week or so ago regarding China and the President spoke pretty tough. But it was also important what he didn't say, he didn't single out Xi Jinping himself. And he was very clear that he wanted to have continued good trade relations with China. So, in that context, how would you sort of define the state of play on U.S.-China relations in aggregate right now?

PH: Sure. I think you're right. President Trump, when he looks at China, clearly he has wanted a trade deal. But we do not see President Trump with ideological or particularly hawkish views on China. You find those in the administration in large numbers, I think. But President Trump himself I believe is not looking to derail the relationship, but the relationship is in a state of disrepair. And many of us had hoped that the coronavirus would provide an opportunity for the U.S. and China to sort of set hostilities aside and work together to save lives, American lives, Chinese and international. But that has not happened. Unfortunately, what we've seen is that those preexisting trends in the downward direction of the U.S.-China relationship and the growing friction and the growing antagonism have only been intensified because of the coronavirus.

And the relationship right now is entering, I would say, a pretty dangerous period. Because as you mentioned, the narratives coming out of the Trump Administration and in particular, the Trump campaign rhetoric, the GOP has circulated talking points to get all Republicans on the same sheet of music with China, which are very harsh. Blaming China for the

coronavirus, calling it a Chinese hit and run, costing thousands of American lives. And we see these points being deployed and they clash of course with the Chinese narrative that is coming out, under President Xi and the Chinese Communist Party, that China has handled the coronavirus very well, has their situation under control and can't be blamed for the poor way it was handled in the United States.

So, these are clashing narratives and I anticipate over the course of the next six months that this rhetoric will become even sharper. And a lot of focus in unofficial channels, of which I'm a part of at very senior levels, is on trying our best to avoid the worst outcomes over the next six months. So that opportunities can be seized if they present themselves in the fall, to move the relationship into a more constructive footing.

KK: Well, let me ask you maybe then a slightly provocative question as a follow-up to that, because you referenced the next six months and really that's the election season. Do you think that China, regardless of what they say rhetorically, but when they look at what their strategic objectives are, do they have a preference on say Trump versus Biden? I mean, we've talked about Trump, he does a lot to actually create space for them. And not just in his China policy, but in his policy toward the alliance system or the dismantling of the alliance system, depending on how you want to look at it. But at the same time, on a day to day basis, Trump and the administration can create a lot of problems for them as well. So, do you think they've got an actual preference here?

PH: It's a great question, Kevin. I think their preference is to stay as much as they can out of the crosshairs of the U.S. presidential election. I think they will figure out a way to work with whatever hand they're dealt in November. And I think they see benefits and downsides to both candidates. As you allude to, with

President Trump, I think from a geostrategic long-term standpoint, they see big benefits. President Trump is damaging U.S. international reputation by pulling it out of international multilateral organizations that creates space for China to move in and play and have much more influence. President Trump through his statements and actions undermines our alliance system, which Chinese strategists see as a major pillar of strength that the United States has in dealing with China. So, President Trump's America First Policy is, in a sense, a gift for China in a long-term strategic sense. However, I think they like what they think they will get with Biden, which is more predictability. I think they hope that it will be more of a traditional approach to China from the U.S. And I think here we may have misaligned expectations because with Biden I would expect a change in tone on China, but I think the content and the challenges that he will deal with with China will remain fairly similar to the Trump administration.

KK: Right. Gabe, I want to move on. So, Paul alluded to the trade deal and you've written extensively about this and it's one element that has kind of served to help keep the overall relationship from going too far negative. And even if China is unable to meet all of its obligations under the Phase 1 trade deal, direction of travel was going to be considered important. And certainly, the pandemic and the impact on the global economy impacts their ability to fulfill this. But what's your view on the state of play on the trade relationship between the United States, both in terms of Phase 1, and in the broader sense.

GW: At the moment, Phase 1 seems to be tenuously holding. It seems to be on some tenuous ground, but so far it remains intact. And I think the reason for that is the incentives on both sides, unlike so many other issues in the U.S-China relationship. When it comes to this Phase 1 agreement the incentives on

both sides are fairly well aligned. I think both sides have good reasons to want to keep the agreement intact and on track, even though the relationship is deteriorating in other areas. So, for China, obviously they're hurt by U.S. tariffs. They don't want those snapback tariffs that would occur if the deal were to break down, and then from the U.S. side, there would be also concern. It would be a huge market impact if the tariffs were reimposed. Obviously President Trump is sensitive to the stock market. There would be a reaction there if it reimposed. But also in terms of U.S. politics Trump wants to claim the Phase 1 deal as an achievement because he put the U.S. economy through a considerable hardship as a result of the tariffs. And so, if the deal breaks down now, and he has nothing to show for that hardship I think that that's a concern politically. On the other hand, as I said, the agreement is on tenuous ground because the anti-China sentiment in Washington and in the U.S. overall has accumulated so quickly over the last few months. And both Trump and Biden are seeking to outdo the other in terms of posturing as tough on China. And in that context, we could see a moment sometime between now and November, where the incentive to appear tough on China simply overwhelms the economic incentives to keep the deal intact, and overwhelms Trump's instinct to try to claim the deal as an achievement.

But I think the news this week has been positive. There were reports that China had stopped or had suspended purchases of U.S. agricultural products, but then that report then got contradicted and it looks like they are continuing to buy. A couple of weeks ago we had positive statements out of the U.S. trade representative, Bob Lighthizer's office, and from his counterparts saying that the deal was on track, that China was making progress to implement some of its commitments on market access. There is, as you say Kevin, just an issue with the full year targets, which were already very, very ambitious before the pandemic, and now with the pandemic and the hit

to Chinese demand as a result of it, the targets look impossible, and China is well behind the pace of purchases that it would need to reach in order to achieve the full year targets.

But the direction of travel, as you say, might be more important. As the election approaches, Trump will most likely be able to point to large purchases over the previous month. And therefore, to be able to argue that China is kind of making a good faith effort, and that the deal is still a net positive. So, I think that's where we stand now. The deal is still intact. It's on track, it's on shaky ground, but there are reasons to think it could hold through the election.

KK: Gabe, when you look at the domestic Chinese political picture, when we rewind the tape back to January, February when the virus was expanding rapidly in China and impacting its economy. And we had the famous doctor in Wuhan who gave the warning and was essentially silenced. And then later he himself was co-opted as a martyr by the Chinese Communist Party and whatnot. How has Xi weathered this, the handling of the pandemic, its international relations, and its domestic economic standing? How has he weathered that politically in China? And how is he regarded?

GW: Well, as you say, the turnaround since kind of early February has been pretty remarkable. There was a brief moment there where it was reasonable to ask whether Xi's status might be threatened, even whether the communist party's overall legitimacy might be under serious threat. That moment has passed and looking at it today, Xi appears to be at least as strong as he's ever been. And possibly he's been strengthened on that by the events of the last few months. There was this incredible outpouring of anger when Dr. Li Wenliang died. He was seen as a symbol of the government's commitment to censorship and authoritarian control and a symbol of the mistakes and the handling of the virus. But since then, China

has achieved great success in controlling the virus as Jerry discussed. And there's a great sense of national pride in that achievement also in the way that the government was able to mobilize resources into Wuhan, the bravery and professionalism of the doctors from elsewhere who rushed in to help there. The sacrifices around the country with the people in lock down, the delivery drivers who kept everyone supplied with the groceries when they were locked at home, etc., and Xi has been able to take credit for a lot of that. So, that's one part of it. The reality of China's success against the virus and the contrast with the lack of success in other places. There's a reality there. But the second part is propaganda. China has used domestic propaganda to sow doubt about the source of the virus. They've suggested that it may have come from the U.S. We regard those suggestions by some of the more aggressive Chinese diplomats as being sort of absurd. But a lot of Chinese people believe that now, especially older generations who are perhaps a little bit less savvy about distinguishing real news from fake news in terms of what circulates on WeChat and other Chinese social media.

So the combination of the reality of China's success against the virus with the propaganda, suggesting that it didn't even start in China and the failures elsewhere in the world, or the difficulties elsewhere in the world, I think, taken together that has strengthened Xi's status. And the Communist Party is able to claim that its form of government has been crucial to the successes.

KK: Well, Simon, how has that, what Gabe just talked about Simon, how has that resonated in Hong Kong? We've already talked about the direct China-Hong Kong issue, but this point of China's overall performance in addressing the pandemic and getting its economy restarted. Hong Kong, irrespective of how they feel about how they're being treated, obviously highly leveraged to the Chinese economy, so how is this resonating then in Hong Kong?

SB: Well, I think here, there's a sort of sense of waiting to see how the global economy is going to recover out of the coronavirus and whether Hong Kong can hook its wagon to the power of the Chinese economy, or whether we're going to be dragged back if the European and American economies don't recover as well as they might have done. And I think some of that is reflected in the fact that there is now much less protest activity, for example, on the street, because people here sort of sense that things are out of our hands now, that the Hong Kong issues have become embroiled in these bigger tensions between China and the United States, and we're sort of sitting here waiting for that to play out.

KK: Right. Paul and Gabe alluded to this a bit, China's international relations beyond the U.S. in all of this. We have seen some of that in the context of the coronavirus, both in terms of their attempts at sort of PPE diplomacy, if you want to call it that, in places like Italy, some of which was handled in a very junior varsity way, and they got some backlash for some of their triumphalism on that front, but also in terms of how they might be addressing bilateral debt relations with particularly emerging markets. How would you assess Paul, the diplomatic and international push that China is doing here and trying to not let a crisis, both their own crisis and the global and U.S. crisis, go to waste?

PH: This is a new feature from China, this effort to try to provide aid and assistance internationally around countries that are dealing with the coronavirus. And it's a new dynamic, it's a new feature from China. They're having some success with countries that are dependent on China, perhaps along the Belt and Road or other sort of developing countries who are benefiting from China's aid and assistance. But we're seeing tougher, more suspicious responses from more developed countries, western-led democracies. So, it's a bit of a mixed bag. And I think this is where one

of President Xi's challenges is. I agree with Gabe. At home, his support is pretty strong, and he managed to get that support back after some early difficulties around the initial response to the coronavirus, but nationalism is high and he has provoked what he calls a fighting spirit.

And we now have these Wolf Warrior diplomats, which he has been encouraging. And these are ambassadors and other diplomats across the world who have joined Twitter and Facebook platforms, which are blocked and censored in China, to push back, and not just on U.S. criticism, but on international criticism. And this is not playing well globally. There was an internal report circulated by the China Institute of Contemporary International Relations. This is a government affiliated think tank affiliated with China's top intelligence agency, that has warned China's leadership, that global anti-sentiment, it is at its highest since the 1989 Tiananmen Square crackdown. And it's not just the U.S. that is waking up to a China's rise, and I think a departure under this leadership from the tenants of domestic and foreign policy that we saw in the Deng era and the two presidents that followed Deng, and we're seeing pushback in Europe, throughout Asia, on China. And I think how this plays out will have a big impact on China's further development and evolution.

KK: Do you think that they see a big opportunity here in terms of not only have a lot of the western democracies not necessarily handled the pandemic well, they are in economic distress, that there is an opportunity here for China to kind of, not to overuse this term, but the divide and conquer kind of a strategy that allows them to use wedge issues like Huawei deployment and the like. That I mean, they're going to try to pick countries off to at least increase their influence.

PH: Absolutely, absolutely. And again, I think this gets back to my comments earlier about their assessment of President Trump, providing them an opportunity on the international stage to both enhance China's

influence and soft power as the U.S. retreats from its traditional international role. President Xi talks about taking the initiative and seizing the strategic opportunities presented. And I think this is why you see such a dramatic effort by the Chinese to get out and to portray China as a country that is trying to contribute to international public goods, at a time where America is not.

If you think about in the aftermath of the global financial crisis, it was the U.S. that led global efforts to create the G20. After the tsunami in 2004 in Asia, it was the U.S. that led the regional response, which resulted in the Quad. The United States has had a traditional role after international crises of this kind of magnitude for garnering and fostering a global response, and the U.S. is not doing that, and China is trying its best, as I said, at mixed success, to take advantage of that. Secondly, President Xi is also trying to bolster his domestic support through propaganda efforts by showing very clearly the chaos and confusion in the United States, both over the coronavirus but also around racial tensions, which indirectly says, the Chinese system isn't so bad after all; look at the chaos and confusion that emanates from the U.S.

KK: Right. Gabe, I want to turn to the economy, the big picture of the economy in just a second, but these comments by Paul with regards to its international relations and diplomatic efforts lead me to focus for one second on the Belt and Road Initiative, which obviously has been China's kind of most visible foreign international initiative of recent years. It's an economic initiative. It's a put to work initiative. It is a geopolitical initiative. It has implications for the debt profiles of a lot of countries. But with the slowdown in global economic activity, and we'll get into China's domestic economy in a second, how do you see Belt and Road kind of developing here in the near and medium term?

GW: Well, I think like so many other issues in China's international relations, Belt and Road has kind of become a Rorschach test for how you view China in general. So, some countries see Belt and Road as positive; as a chance to draw in investments in needed infrastructure. They see that as benign and positive. And then if you're skeptical of China and its influence in the world stage, you see Belt and Road as a debt trap, as a source of wasteful investment, as a kind of a form of cronyism, in which China enriches its own companies through these international contracts.

But like Paul alluded to a minute ago, the leadership is increasingly aware of international backlash against China's more assertive role generally, and I think Belt and Road is part of that. And even before the pandemic, there was some evidence that China was recalibrating Belt and Road; it was slowing down the pace of new investment and trying to respond to some of the criticisms around the discriminatory use of Chinese contractors, around country concerns about debts, around environmental issues.

And from an economic perspective, the rationale for Belt and Road from China's perspective, is no longer as strong as it was in 2013, when Xi first proposed it. Back then, China was accumulating foreign exchange reserves very, very rapidly, and was getting a very poor return on those reserves through its investment, mainly in U.S. Treasury. And so, it made a lot of sense to redeploy some of that foreign exchange into higher yielding investments that could also produce other diplomatic benefits and cement China's relationships around the world or strengthen those relationships. Today, China's foreign exchange position is stable, but it's no longer accumulating tens of billions of dollars per month, and so the urgency to deploy those reserves is less.

So, Belt and Road isn't going away, but I think its ambitions have moderated slightly, and China is trying to understand, it's trying to respond to some of the

criticism. I mean, the idea that they're intentionally trying to ensnare countries in debt, I don't think is well supported by the evidence. But to the extent that there's a perception of that China is sensitive, I mean, I think that there were several objectives to Belt and Road, but one of the important ones was to win friends and to earn soft power on the countries. To whatever extent there is a backlash against Belt and Road, I think Chinese leaders take that seriously, because that contravenes one of the main objectives.

KK: When Jerry and I were talking about the coronavirus in China, we kind of discussed how you have to compliment the official data with observation to kind of build a true picture of what's going on in the country. And similarly, we have to do that when we look at the Chinese economy. Given that, what's your assessment right now of Chinese economic recovery, Gabe, from the low point of the pandemic and the shutdown? It's particularly important, of course, because much of the rest of the world is further behind in the outbreak and the restarts. And if China is not going to be seen as being able to do epic stimulus, the way that they did following the financial crisis, at least they can provide some sort of floor on global demand. So, where do you see the Chinese economy right now? And what are the prospects for the rest of this year, now that they've eliminated a GDP forecast target for additional stimulus?

GW: So, the Chinese economic policy is at an odd and somewhat confusing inflection point at the moment, because April data, the recent data looks pretty good and upcoming data is probably going to stay good; at least the April data that will be coming out over the next week. And so, it's going to look like China's economy is recovering very strongly, and therefore a strong escalation of stimulus measures is unnecessary.

But I believe that that data is going to ultimately prove to have been misleading, in the sense that it reflects a lot of pent up demand, backlogged orders that were not able to be filled during the pandemic. In other words, it reflects the one-off impact of China's economic restart. So, production may be above trend over the next few months as that backlog is cleared. But once the backlog is cleared, the impact of poor demand, in other words, we're experiencing a supply recovery in China right now, and that flatters the data, it makes the data look good. But once that effect wears off, it will become increasingly clear that there's deficient demand in China. In part, because the global export demands is weak because of the global recession, and China still depends fairly significantly on global exports. And also, there was weakness in China's own domestic economy before the pandemic that's going to reemerge.

So, the outlook for policy, I believe, is conservative in the short term. China doesn't want to repeat the mistakes of the massive, the excessive stimulus that it's used in the past. So, it struck up a fairly cautious tone at the National People's Congress recently, including dropping the GDP growth data. But once the short-term impact of those supply recovery wears off, I think China's policymakers, their hands may be forced into reluctantly escalating stimulus, as China experiences the kind of W shaped or double dip. In other words, I've been predicting this W shaped recovery, where China's in the middle upwards section of the W right now. But there's going to be the middle downward section is coming. And that is when later this year, I expect them to have no choice but to escalate stimulus and to move back towards some of the traditional infrastructure stimulus that we've seen in the past.

KK: Well, thank you for that. And we're approaching the bottom of the hour here. So, I'd like to exit here with one final question, and it's

for you Simon. Because perhaps this might give us as much of a picture of what is going on in Hong Kong, or what's developed in Hong Kong as anything else. As I mentioned at the top of the call, today's the 31st Anniversary of the crackdown at Tiananmen Square. Traditionally, Hong Kong has been the location of the biggest recognition and marking of that event. How has that played out today in Hong Kong?

SB: Yes, as you say, Hong Kong is one of the few places in greater China where commemoration of Tiananmen Square traditionally happens, and it normally happens in Victoria Park. And for today, the authorities have said that there was no assembly permitted in Victoria Park, because of the coronavirus. We here have limits on public gathering of eight people, and that was used as a reason to not permit the gathering.

There's very, very few people, as I understand it, who have assembled, although the organizers said that they were intending to anyway. However, what has happened is people have been encouraged to light candles. And so, in a very non-provocative and non-assembling way, you should light the candle across the city. And although there have been some locations where people have been encouraged to go in small numbers, really, it's become more of a private, non-confrontational ceremony today.

And I think, again, that's part of wanting to downplay the street protests that we've had of last summer. It feels like we're slightly in a different era. A week or two ago, even there were predictions that there would have been large gatherings and potentially some confrontations. We know 3,000 extra police officers are on the streets today, water cannons are on the street today here, but I'm expecting that that will have passed off peacefully in the end.

KK: Great. Well, thank you so much. And gentlemen, I want to thank all of you, and I want to thank our audience for joining us, as usual. We'll be back again next Thursday with another call. But for the time being, I want to thank Paul Haenle, Jerry Hauer, Gabe Wildau and Simon Buckby for their comments and insights today. And thank you all for joining us. Have a great day and have a good and safe weekend. Thank you.



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