



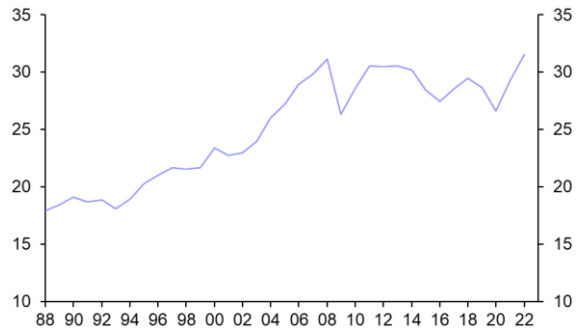
# LONG RUN UPDATE

## Economic fracturing to continue despite thaw in relations

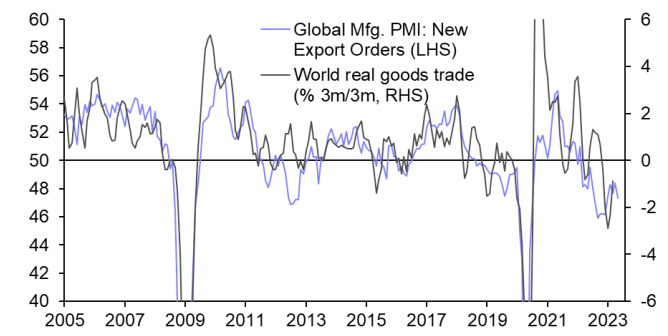
- **A series of high-level diplomatic meetings this week have raised hopes that strains in US-China relations will start to ease. But the politics of fragmentation was never likely to proceed in a linear direction. And even if there is a thaw in political relations over the coming months, there is growing evidence that fracturing is having an increasing influence on the operating environment for multinational firms.**
- The visit to China of US Secretary of State, Anthony Blinken, was the most important of the various meetings that are scheduled for this week. It ended yesterday with a last-minute bilateral with President Xi – testament to the progress made in meetings with other senior officials earlier in the first two days of the trip. It's possible that this will pave the way to a meeting between Presidents Biden and Xi later this year.
- However, while Secretary Blinken's visit to China is the most important of this week's meetings, it may not be the most interesting. The others include the visit of Indian Prime Minister, Narendra Modi to Washington DC, and the visit of Chinese Premier Li Qiang to Germany and France. Germany, France and India are large economies and geo-political heavyweights – that are each trying to navigate US-China fracturing.
- In [our work on fracturing](#), we placed India in the “lean US” camp. But a combination of democratic drift under Modi and the decision to continue purchasing Russian crude oil have strained US-India relations. Likewise, while Europe's major economies clearly align with the US over China, Qiang's visit to France will provide President Macron with an opportunity to practice his regional vision for “strategic sovereignty”.
- **The positive noises from this week's meetings come against a backdrop of recent macro data that have caused some to question the very idea of global economic fracturing. In particular, a combination of data from the IMF and World Bank suggests that global exports of goods and services rose to a record high as a share of world GDP in 2022.** (See Chart 1.) This has led some commentators to argue that fracturing is a theoretical threat rather than something that is really happening.
- **Several points are worth making in response. The first is that fracturing was never likely to manifest itself in a fall in global trade.** As we've argued before, fracturing should not be confused with deglobalisation (or, for that matter, reshoring). Fracturing will affect trade in some politically-sensitive areas such as technology, but most trade will continue as before. (See [here](#).) We argued in our Spotlight report on fracturing that world trade would start to *level out* as a share of GDP – and viewed over a long time horizon, this structural shift is happening. It's also worth noting that there has been a cyclical decline in goods trade this year as economic activity has softened (timely data on services trade are not available). (See Chart 2.)
- Likewise, the politics of fracturing were never likely to evolve in a linear way. **The meetings between Blinken and Chinese leaders are positive news, but the underlying drivers of fracturing have not gone away.** Accordingly, even if relations do improve for a time, new problems are likely to flare up over the coming years.
- **Finally, while there appears to have been some thawing in US-China relations at a political level, fracturing is continuing at a corporate level.** Astra-Zeneca is now discussing plans to hive off its China business and list it separately in Hong Kong. The Silicon Valley venture capital firm, Sequoia, announced similar plans last month. These moves reflect efforts by multinational companies to insulate themselves from US-China relations. Even if relations between Washington and Beijing continue to improve over the coming months, such efforts are likely to continue. This week's dialogue will ease fears of a more abrupt and damaging schism in US-China relations. But global fracturing remains this decade's dominant challenge for governments, investors and commercial leaders.



**Chart 1: World Trade in Goods and Services as a % of World GDP**



**Chart 2: Global Manufacturing PMI New Export Orders & Real Goods Trade**



Sources: World Bank, IMF, S&P Global, Refinitiv, Capital Economics



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