The US vs China – who will draw back?

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The two major powerhouses of the world's industrial and financial markets are not just at odds with each other but are fighting a 'cold war' that threatens the very foundations upon which all countries operate.

Both economies are suffering – and that's partly as a result of policies enacted by their own governments. For China, the purpose behind the policy error was to mask the adverse effects of decisions taken to protect its economic interests. China's real estate market – as just one example – failed a long time ago. It was well known that the massive city construction projects commissioned by the Chinese Communist Party (CCP) were intended to sustain economic activity, support construction firms and protect the livelihoods of employees – but it was an illusion. The only real surprise – as more and more ghost cities multiplied nationwide – is why economists and investors, both at home and abroad, took so long to acknowledge there was a problem.

For a while, the CCP's policy's agenda succeeded in obscuring the effects of an over-heated market and the government's shift toward massive road and rail construction prevented a massive bubble bursting. The positive knock-on effect of the policy was the protection of employment, the financial market and the Yuan (a.k.a., the Renminbi). But there are limits – even for superpowers – and the problem could not be hidden forever. Left to itself, the end result for the economy would have been total collapse. But that was never the CCP's intention. China bought itself extra time due to high capital inflows of foreign direct investment (FDI). In the background, China worked on the development of foreign loan and infrastructure projects, and on its BRICS relationships.

By shifting focus to include foreign projects like the Belt and Road Initiative (BRI), China generated revenue for the CCP's coffers, sustained construction companies abroad, and diversified income streams for state-run finance banks. Problems of falling wages and employment were therefore kept at bay. The upshot was that China continued to grow, albeit at a slower pace than had been initially hoped due to some non-performing loans.

However, the US found this situation unacceptable as it sensed its grip on global dominance slipping away. The rise of BRICS as an international trading bloc – free from the usual US-controlled constraints like the Federal Reserve, International Monetary Fund (IMF) and World Bank – demanded attention. The US remained devoted to the narrative that it must be the number one power in the world, dictating policy to its vassal states, and reached for the same playbook it had used to thwart Japan's export dominance in the 1960s.

Instead of easing restrictions on its own manufacturers so they could compete internationally on a level playing field, the US closed its market to Japanese exports and demanded its 'allies' did the same. There are several problems with this policy for the US in today's world. Firstly, in the 1960s, Japan was forced to accept US restrictions quietly as it was under US security guarantees. China is not obliged to follow any dictates from the US and has stated this clearly and publicly.

Secondly, at that time, there was still a lot of mistrust surrounding Japan, heavily intensified by American politicians and media. The US is now trying to employ this method against China – but today's world is different. A growing number of countries see China as the one they can trust, not the US. Back then, very few countries would have dared to speak out against the US. But now, a growing number of nations are making their voice heard with the help of China – and Russia and India too. The strategy is really hurting the US, as costs are growing in a market which is already hammered by the inflation stemming from its own money printing.

Thirdly, China was highly critical of Japan for buckling under US pressure and accepting the export blockade, along with an enforced rise in the value of the Yen (which single-handedly killed off the primarily export-driven economy).

China has seen the game the US is trying to play. It knows how it plays out and has taken measures to counter it. BRICS is a powerful international trade market, cushioned to some degree from Western sanctions, and is set to get bigger over the next couple of years. As it grows, the power of the US dollar wanes.

The US policy against China is nothing more than a model based on attrition. When used against Japan, it required very little effort. But today's game is being played out in a very different theatre. Japan was unable to sell its exports because the US said it couldn't. China can and is doing so – and at favourable prices. At the same time, it is reducing its energy costs with help not just from Russia, but from Saudi Arabia and Iran too. And the same applies to its food costs as well (with assistance from Russia, Brazil and Argentina). China will face financial pain, but unlike America in 2008, it will probably come in the form of a short sharp shock (in other words, sharp but relatively quick). And China can choose when, as the CCP has its hands on the levers of its own financial system.

The US appears to have its head in the sand for the moment. It is ignoring its rapidly shrinking list of allies (who are also in financial dire straits as a result of the US policy) and its shrinking foreign markets (outside that of the Military Industrial Complex) as well as its extremely costly climate change policies (while refusing to open further drilling and fracking licences for oil while its own strategic reserves run dry). Meanwhile, it is playing the money printing game to fund a war in Ukraine.

Make no mistake, China's markets and economy are hurting, but in the 'war of attrition' the odds would appear to be stacked in China's favour. Regardless, as a certain Admiral Yamamoto once said, "*I fear all we have done is to awaken a sleeping giant*".