



## Issue of March

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# Emerging Financial Market Watch

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## Overview

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The global recession has pushed the US-China relations to the center of the spotlight, as China has been playing an increasingly prominent role in restoring the world's economic strength. US-China relations now exhibit the dynamic of power play between two interdependent countries often at odds. The recent wide-ranging disputes between the US and China have a significant economic impact on both countries, mostly on trade and currency revaluation. How will these economic issues evolve in 2010 after a severe financial crisis?

## Focus: Economic consequences of recent tension in China-US relations

China-US relations have become much more strained recently than when US President Obama first took office in 2009. The current issues at stake are wide-ranging, from arms sales to Taiwan, to US president's meeting with the Dalai Lama, to the Google incident, to sanctions on Iran, to human rights disputes, and to climate talk impasse. Largely intertwined, these incidents have a considerable economic impact, widening the rift between the two countries in recent months.

The host of issues has a considerable economic impact, mostly in trade, currency and investment. Trade disputes between the two countries have increased significantly since last September, and are likely to continue to rise this year given the remaining high unemployment rate and weak demand in the US. We forecast trade friction to improve in 2H10 as a result of the US recovery. RMB is likely to appreciate by 3-5% this year starting from 2Q or 3Q along with recovery of economy and exports as well as international pressure. The capital flow to China is likely to continue despite the recent pause due to rising risk appetite and dollar appreciation. The monopolized sectors, domestic-consumption related sectors, and high-tech and new energy sectors in China are likely to remain hot picks. In addition to portfolio investment, we expect a new wave of direct investment in China's high-end manufacturing sectors and service sectors in the next few years, given China's large population and its increasing capacity and appetite for consumption.

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## CITIC Securities Research

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**Yifan Hu**  
(o) 852-22379116  
[yifanhu@citics.com.hk](mailto:yifanhu@citics.com.hk)

**Alexis Garatti**  
(o) 852-22379117  
[alexisgaratti@citics.com.hk](mailto:alexisgaratti@citics.com.hk)

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