The June edition of the *Executive Intelligence Brief* presents the following in-depth, strategic analyses:

**CHINA MONTHLY REPORT**
President Xi Jinping is pulling out all the stops to strengthen his internal political position ahead of a crucial Communist Party conclave this fall, but his ultimate success will depend on securing consensus among Party elites and elders. In the meantime, he faces looming challenges to domestic economic recovery and to regional stability.

**SOUTH KOREA/NEW PRESIDENCY**
President Moon Jae-in, keen on outreach to the North, walked straight from his inauguration last month into a crisis with a bellicose Pyongyang testing the mettle of the new US administration. Compounding Moon’s predicament are the South’s uncertainty over America’s commitment to East Asia, bullying by China over a missile deployment, and the potential for a rift with Japan.

**CHINA/RESOURCES QUEST**
Even as China’s economy grows at a slower rate, domestic shortfalls will still spur an overseas search for oil, natural gas and other critical resources. Global expansion by China’s state-owned energy and resource companies is driven by a mix of economic, geopolitical and security interests.

**AZERBAIJAN/POLITICAL RISK**
In the oil boom years President Ilham Aliyev had the financial muscle to assuage elite and popular discontent in his strategically important state, but now he has to rely more on coercion. Neighbors and western partners worry about the stability of Azerbaijan, which is a substantial energy supplier and where radical Islam, of both Sunni and Shia brands, is an emerging threat.

**BOTSWANA/DIAMOND DEPENDENCY**
Botswana, the world’s second-largest producer of diamonds, has managed its minerals wisely and become one of Africa’s richest nations. However, the global commodities slump has hit the extractive sector hard. Moreover, the country’s diamond reserves are finite. A search for new engines of economic growth will focus on huge coal deposits, agriculture, and upscale tourism.
XI TIGHTENS GRIP ON POWER AHEAD OF PARTY CONGRESS

President Xi Jinping is moving on multiple fronts to consolidate his political standing in the runup to a pivotal Communist Party congress this fall that will name the leadership team to run the country for the next five years. In the process, he is harnessing state and Party disciplinary and propaganda machinery to boost his legitimacy:

- Xi has used his anticorruption campaign to neutralize potential rivals and to enforce fealty within government and Party ranks, while scrapping the collective-leadership model adhered to by his predecessors.
- In recent weeks, Chinese courts have sentenced an unusually large number of senior officials on corruption charges; nevertheless, Xi’s assault on entrenched interests in government agencies, state-owned industries, and the military has evidently stirred resentment at subordinate levels.
- The resulting bureaucratic resistance has led to foot-dragging in carrying out Xi’s reforms and other central directives aimed at retooling the struggling economy.

The success of Xi’s political ambitions will depend on his securing consensus among Party elites and elders, and for this he is reliant on burnishing his ideological credentials. Since the beginning of the year, a state-backed publicity campaign has moved into high gear to cement Xi’s authority by portraying him as a great socialist thinker and worthy ideological successor to Mao Zedong and Deng Xiaoping:

- A surge of articles in state media and published tributes by government officials and Party academics underscore the point that Xi’s ideas are catalyzing China’s re-emergence as a global power.
- Government-funded research topics linked to Xi’s theories, via grants from the National Social Science Fund, have more than doubled this year compared to 2016 levels.
- Xi’s signature political-education campaign known as ‘Two Studies, One Action’ calls on Party cadres to study his speeches, and the Party’s propaganda apparatus appears poised to begin extolling ‘Xi Jinping Thought’ on governance in the coming months.

POTENTIAL DANGERS OVERSHADOW NASCENT ECONOMIC REVIVAL

China’s economic recovery has showed stronger-than-expected momentum in the second quarter, though Beijing’s debt crackdown and blowback from a credit downgrade signal possible economic storm clouds in the second half of the year. A key gauge of manufacturing activity is holding steady while the property market remains buoyant, indicating the economy is slowing less rapidly than anticipated:

- The official purchasing managers index (PMI), which is closely watched as an indicator of business sentiment, registered 51.2 in May. It has remained above 50, the level that delineates expansion from contraction, for ten consecutive months.
- The May PMI data suggest that Beijing’s recent regulatory tightening has not begun to constrain manufacturing activity, pointing to probable growth of about 6.7% in the second quarter, down slightly from 6.9% in the first quarter.
- In the second half, however, higher interest rates and clampdowns on local government spending — along with reduced infrastructure spending and a weaker property market — are likely to produce more significant slowing. The government aims to keep overall growth at about 6.5% for 2017 as a whole.

Another factor currently bolstering the economy is exports, which expanded for a third straight month in May due to strengthening US and European demand as well as reduced currency instability following a volatile year for the renminbi in 2016. Imports also grew faster than expected in May because of spillover effects from the strong property market.

For the first time in nearly three decades, Moody’s Investors Service cut China’s credit rating in late May, underscoring a series of stress factors including slowing growth, rising debt levels, and weaknesses in the financial system:

- The downgrade — which put China on a level with Japan and Israel, among other countries — underscores rising risks that corporate-sector debt will erode the country’s creditworthiness.
- It also will complicate efforts to attract more foreign capital to Chinese financial markets, which Beijing has been counting on to offset some of the outflows from Chinese businesses and domestic investors seeking to stash money abroad.
- One factor in Moody’s downgrade decision was the rise in loans that Chinese banks disguise as investments, and central bank data indicate that such lending this year has been running at five times the level for the same period in 2016.

SINO-US SPARRING OVER REGIONAL SECURITY ISSUES

Washington is attempting to assure nervous partners that it intends to expand its military and diplomatic pushback
against Chinese assertiveness in the Asia-Pacific region, while Beijing insists it is acting to safeguard China’s sovereignty and is not seeking to establish a ‘sphere of influence’. At a multination security conference in Singapore June 3–4, US Defense Secretary James Mattis said Washington is not withdrawing from global leadership and will continue to stand with its allies, building upon a $7.5 billion initiative unveiled in May to bolster the US regional military presence. The Pentagon claimed in a June 7 report that China’s efforts to extend its military reach include plans to base up to three regiments of fighter planes on the artificial islands it has constructed in disputed areas of the South China Sea; Beijing heatedly denounced the report as ‘exaggeration’.

Top US officials in June also stepped up pressure on Beijing to persuade North Korea to halt development of its ballistic-missile and nuclear weapons programs, which have become an urgent concern for Washington and US allies in East Asia. Given a dearth of viable military options, the western focus has been on diplomatic and economic means to rein in North Korea, and Beijing — as Pyongyang’s sole ally and principal economic benefactor — is key to both approaches. Statements by President Xi following the recent election of South Korean President Moon Jae-in, who favors dialogue over North Korea, suggest that Beijing’s game plan may now turn on improving previously strained relations with South Korea:

• The June 7 suspension by Seoul of parts of a US-operated missile defense system, in a seeming attempt to assuage domestic concerns, prompted worry among some US officials that Moon’s government is developing a new foreign policy more amenable to China.

• A top South Korean national-security official subsequently said, however, that promises under the South Korea–US alliance would not be altered and bilateral defense collaboration would continue.

• Beijing remains strongly opposed to the US missile shield being installed in South Korea, regarding it as a threat to China’s own national security because its advanced radar systems could undercut Chinese strategic capabilities.

Looking ahead...

Developing new options for climate cooperation. Following Beijing’s June affirmation that it will continue working to implement commitments made in the Paris climate accord, Chinese officials are looking to develop climate-cooperation agreements with Europe and individual US states now that the US federal government has abjured active global leadership on the issue. On June 6, the Ministry of Science and Technology signed an agreement with the California government for cooperative efforts to reach 2030 targets for reducing greenhouse-gas emissions, including collaboration on clean energy and low-carbon technology and coordination of emission-reduction programs. President Xi has endorsed stepped-up exchanges to ‘strengthen synergy’ between US states and Chinese provinces on climate and development strategies.

Reviving work on US-China economic deals. Announcement in May of a limited agreement, termed the US-China Comprehensive Economic Dialogue, set the stage for bilateral efforts in coming months to address a range of festering trade and regulatory issues. This was reinforced by concessions that were exchanged in some areas of trade in agricultural products and financial services, even though no numerical targets for exports or imports were set. Washington also signaled in early June that it expects to revive talks with Beijing toward a bilateral investment treaty that would give US firms improved access to the Chinese market. Nevertheless, US officials’ statements indicated resumption of active work on the investment treaty would be conditioned on achieving progress on other bilateral trade issues, reflecting the Trump administration’s priority objective of increasing US merchandise exports to China.
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