This year, China and the European Union celebrate the 40th anniversary of their diplomatic relations. Once marginal, their partnership has become one of the world's most important. Trade between Beijing and Brussels now exceeds €1.2 billion a year. Their level of interdependence is such that China's market meltdown this summer was felt in Europe immediately.

The two sides are currently discussing ways to link China's 'one belt, one road' (OBOR) initiative with the European Commission president Jean-Paul Juncker's plan for jobs and growth to boost two-way investment and commerce.

Closer Sino-European relations, however, risk weakening the transatlantic bond which was strained in March by the decision of Britain to join the Asian Infrastructure Investment Bank as a founding member despite United States pressure to stay out. Germany, France and Italy were quick to follow the British lead.

The state visit by Xi Jinping to Britain in October – the first by a Chinese president in 10 years – will be watched closely by the US and other EU states to see whether London will be able to send a reassuring message to Washington, while reaping the benefits of growing links with Beijing.

China's market turmoil hits Europe

The steep fall of the Shanghai and Shen-zhen stock exchanges this summer – triggered by concerns that the Chinese economy may be slowing down dramatically – and China's surprise move to devalue the renminbi in August, which was intended to make its exports more competitive, have had a dramatic impact on Europe. On the one hand, China's stock market shock has contributed to falling commodity prices – a trend favourable to Europe's industry, which relies heavily on imported resources. On the other hand, European companies more exposed to the Chinese market have suffered, with trade being the most important channel for contagion. China is Europe's second largest trading partner, accounting for 14 per cent of total extra-EU trade in goods in 2014, and is its fastest-growing export market. Consequently, any slowdown affects exporting companies' growth prospects.

A weaker renminbi creates additional problems. Throughout August, the euro appreciated almost 5 per cent against the renminbi, with the result that European companies struggled with higher prices as well as lower demand. Some sectors have been particularly badly hit: German carmakers as well as French and Italian luxury brands that now export to China have seen their shares plunge this summer.

The belt and road project

Current volatility on Chinese stock markets is actually contributing to flows of funds out of the country. Beijing's outbound direct investments increasingly target the countries touched by the OBOR initiative. This is China's biggest diplomatic project in decades. It combines a land-based Silk Road economic belt and a sea-based 21st century maritime Silk Road, which connects China to Europe through Southeast Asia, Central Asia and the Middle East, covering 55 per cent of world GNP, 70 per cent of global population, and 75 per cent of known energy reserves.

A study by Grisons Peak, a London-based boutique investment bank, published in June shows that the majority of 67 overseas loan commitments made by China's largest policy lenders –

China Development Bank and the Export-Import Bank of China – have been in areas interested in the OBOR project since its launch in late 2013. Loans for infrastructure projects contribute to upgrading the Chinese economy at a time of domestic restructuring of various sectors – including heavy industries involved in building and maintenance of transport and energy infrastructure, but also consumer goods. Trade financing serves to maintain existing, as well as find new, markets for Chinese products.

The stated aim of this grandiose project is to boost connectivity and commerce between China and 65 countries. China's financial commitment is likely to reach up to $300 billion in loans for infrastructure and trade financing in the coming years – not counting the leveraging effect on private investors and lenders. This sum includes a $40 billion contribution to the Chinese-led 'Silk Road Fund' for infrastructural developments. Sitting at the end-point of the Silk Roads project, central and eastern Europe, the Balkans and the Greek ports have been so far the main beneficiaries of these funds.

When Li Keqiang, the Chinese premier, attended the third meeting of heads of government of China and the 16 central and eastern European countries held in Belgrade in December 2104, he highlighted the role that these countries would play in the Silk Road project, pledging to inject more investment to boost infrastructure and sea and land connections between China and the region. This is in addition to the 69 cooperation projects between China and the central and eastern European countries implemented after the second meeting in Romania in November 2013.

The flagship project is a land-sea express route that will link the port of Piraeus – one of the largest container ports in Europe and where Chinese shipping giant Cosco has a 35-year concession – with at least six to eight central and eastern European countries, thus turning Piraeus into a Chinese hub for trade with Europe. The $2.5 billion project is financed by soft loans from China's Export-Import Bank and will be built by state-owned China Railway Construction Corporation. Work is expected to start by the end of 2015.

In June, Hungary became the first EU member to sign a memorandum of understanding with China on integrating the 'belt and road' initiative with Hungary's 'opening to the east' and 'opening to the south' initiatives. Poland is also considered a pivotal country for the OBOR project. Plans have been made for building a railway connecting the Chinese province of Sichuan with the Polish city of Lodz as well as for developing several Polish harbours such as Gdansk – all financed by soft loans from China.

Other EU members have integrated China's OBOR project with their own investment strategies or are in the process of doing so. For instance, in June China and France signed an agreement for prioritizing cooperation in third-party markets, including joint ventures and project financing.

By focusing on infrastructure projects, China seeks to build better connectivity as well as acquire political influence in the areas interested by the 'belt and road' project. From a geostrategic perspective, the OBOR is China's response to the US 'pivot to Asia'. Washington's rebalancing towards the Asia-Pacific region includes a significant military component, being clearly aimed at deterring China's hegemony. Beijing's OBOR initiative, instead, makes use of financial firepower, focusing on the Eurasian landmass as well as on the

Indian Ocean-Mediterranean maritime route to the EU – China's most important market, but also a potential partner for countering US primacy. It thus represents a great opportunity for the old continent to obtain financial capital from Beijing and acquire political leverage over Washington.

Opportunities, and pitfalls

At the last EU-China summit on June 29, 2015, Juncker called for the creation of synergies between his European Fund for Strategic Investments and China's 'belt and road' initiative. Premier Li Keqiang replied to Juncker by making a multibillion dollar investment commitment to the EFSI, though no precise amount has been unveiled so far.

Totalling €315 billion, Juncker's plan aims to relaunch growth and job creation in sectors ranging from innovation to research, education, and transport infrastructure. Policymakers in Brussels are identifying appropriate cooperation mechanisms between the belt and road initiative and Juncker's fund. Ideas presented so far include the establishment of a China-EU joint investment fund, joint contracting and co-financing. Infrastructure projects in eastern Europe and the Balkans are likely to become the first concrete examples of this enhanced Sino-European connectivity. European critics worry, however, that the initiative lacks transparency rules and the opaque financing deals may threaten the competitiveness of European companies.

All European governments are eager to attract Chinese investment as well as boost monetary links with Beijing. In October 2013, the People's Bank of China and the European Central Bank signed a bilateral currency swap agreement for a sum of €45 billion, the largest ever signed by Beijing outside the region. In November 2014, the ECB decided to add the renminbi to its foreign currency reserves.

All European central banks have already added – or are considering adding – the Chinese currency to their portfolio, often at the expense of the dollar. In October 2014, Britain raised 3 billion renminbi through a landmark offshore sovereign renminbi bond and kept the proceeds in its foreign exchange reserves rather than converting them into dollars. The number of renminbi clearing banks, known as RMB Qualified Foreign Institutional Investors, is also growing fast. The People's Bank of China has designated several 'renminbi hubs' in Europe, including London, Frankfurt, Paris, Luxemburg, Zurich and Prague.

Growing Sino-European monetary ties largely explain the decision by Britain, Germany, France and Italy to defy the United States and join the AIIB, a China-led regional bank seen as a potential rival to the World Bank.

Balancing Beijing and Washington

By joining the AIIB, Europe's four largest economies have sent a strong political message to Beijing – and irritated Washington. A similar rift in transatlantic relations over China was last seen in 2003, when the establishment of a comprehensive strategic partnership between Brussels and Beijing – and the concomitant proposal by the Union's large members to open discussion on lifting the EU arms embargo on China – strained feelings across the Atlantic. Opposition by the US and its Asian allies would eventually convince EU governments to shelve the arms embargo issue. The postponement went down well in Washington, but left Beijing disheartened.

Today, it is closer Sino-European relations in the financial and monetary areas that attracts the

attention, and the concern, of the US. The euro is seen in Beijing as a counterbalance to the dollar and instrumental for creating a multipolar currency system in which the renminbi would have its place. Consequently, China has divested away from the dollar and into the euro to a point that euro-denominated assets now represent more than a third of China's foreign currency reserves.

The state visit by Xi Jinping to Britain will focus on economic issues. London has become an attractive home for Chinese investments.

Beijing has pledged to invest £105 billion in British infrastructure by 2025, with energy, property and transport the biggest recipients. David Cameron will probably convey the message to President Xi that a more friendly investment environment makes the UK, and more generally Europe, a valuable destination for Chinese capital. And the British prime minister will not forget that the City of London is in the race to become the world's most important clearing house for renminbi trading outside mainland China.

Xi's visit will be watched closely by Washington and Britain's other EU partners to see if London can strike a balance between its historic transatlantic bond and China's focus on Europe. There could be a price to pay for greater Sino-European connectivity – let's hope, however, that this does not mean giving up norms and practices that Europe has long fostered.