

THE US-CHINA TRADE DEAL: FEW REASONS TO BE CHEERFUL

The US-China trade deal has brought relief. It avoids new tariff increases by the US with the risk of further escalation. The deal should be welcomed in China, given its ongoing growth slowdown, but also in the US where companies had increasingly expressed their concern about the trade confrontation. The rest of the world will monitor closely the extent of trade diversion which could follow from the agreement. Attention will now shift to the phase 2 negotiations, which could very well mean that trade uncertainty will intensify at some stage

From a counterfactual perspective any trade deal is better than no deal. It's like with monetary policy: low rates may not succeed in lifting inflation but the situation would be worse if policy rates were higher.

The Chinese GDP numbers published this week -6.1% growth in 2019, the slowest rate since 1990- remind us that weaker headwinds would be welcome. Some of these are structural -the rebalancing of the economy from export- and investment-led to being consumer-led-, but the trade confrontation also plays a role. Exports to the US have dropped, which partly explains the very slow pace of manufacturing investment in 2019, up only 3.1%.

In a trade conflict, one would obviously assume that the surplus country would suffer, but that does not automatically mean that the deficit country would gain. Recent research by the Federal Reserve Board¹ has found a negative influence on the US as well: "U.S. manufacturing industries more exposed to tariff increases experience relative reductions in employment as a positive effect from import protection is offset by larger negative effects from rising input costs and retaliatory tariffs. Higher tariffs are also associated with relative increases in producer prices via rising input costs."

In the absence of a trade deal, the factors mentioned above would have continued to play a role to the extent that there would have been further tariff escalation and prolonged uncertainty about where the confrontation would lead us. Counterfactual analysis, which compares an outcome with an alternative scenario, tells us that we should rejoice about the agreement. Leave the alternative aside and the conclusion is that there are fewer reasons to be cheerful.

The Chinese commitment to purchase more US goods only relates to the next two years and is less clear about what follows. Moreover, the commitment does not seem to be written in stone as the Chinese vice premier reportedly said that these purchases would be based on market demand in China. Third party countries, who are bystanders to this bilateral 'managed trade' deal, will be concerned about the consequences in terms of trade diversion. This concern was aired by Phil Hogan, the EU trade commissioner, in a speech in Washington DC, although he also welcomed the provisions on the protection of intellectual property rights³.

The deal is a phase 1 deal, so inevitably, attention of companies and governments will quickly shift to the next stage of negotiations. President Trump has said he could wait to get a phase 2 deal with China until after the 2020 election, thinking it would allow to negotiate a better deal for the US. Considering that negotiations are a game of the carrot and the stick, this could very well mean that after the relief, trade-related uncertainty would increase again.

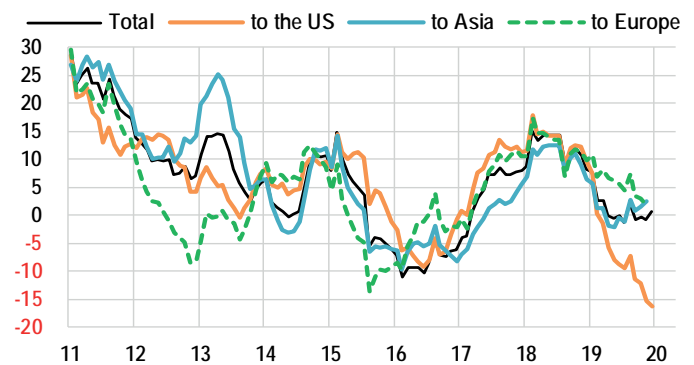
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¹Flaaen, Aaron, and Justin Pierce (2019), *Disentangling the effects of the 2018-2019 tariffs on a globally connected U.S. manufacturing sector*, Finance and Economics Discussion Series 2019-086, Board of governors of the Federal Reserve System, <https://doi.org/10.17016/FEDS.2019.086>.

² What's in (and Not in) the U.S.-China Trade Deal, New York Times, 15 January 2020

³ EU trade commissioner criticises US-China trade deal, Financial Times, 16 January 2020

EXPORTS OF GOODS IN USD (Y/Y, %) 6-MONTH MOVING AVERAGE



SOURCE: CHINA'S GENERAL ADMINISTRATION OF CUSTOMS, BNP PARIBAS



The US-China trade deal brings welcome relief but when attention shifts to the phase 2 negotiations, trade uncertainty will probably intensify again at some point.

