THE SPECTRE OF A STRUCTURAL DECOUPLING OF THE US AND CHINA

The scenario of a slowdown in the emerging economies in 2023 is based on two hypotheses: 1/a slowdown in global trade and 2/the recessionary impact of inflation and monetary tightening. The first hypothesis is now a certainty: exports have clearly contracted in recent months, in both the advanced countries and emerging economies. The causes are partially circumstantial, and hopefully the cooling of world trade will only be cyclical. It is possible, however, that the trade and technological decoupling of the US and China are also a contributing factor.

For the vast majority of both the advanced and emerging countries, the scenario of an economic slowdown in 2023 is based on two hypotheses: a slowdown in world trade, and the recessionary impact of inflation and monetary tightening. The second hypothesis has yet to manifest itself for two reasons: 1/savings accumulated during the pandemic and measures to boost household income have enabled consumption to withstand the eroding effect of inflation, and 2/higher interest rates have yet to have a very visible impact on lending.

Exports, in contrast, have clearly begun to contract. According to estimates by the Netherlands Bureau for Economic Policy Analysis (CPB), if we compare the average for November 2022-January 2023 with that of the three preceding months, exports contracted at an annualised rate of 10.5% in volume (-7.4% for the advanced countries and -16% for the emerging economies), whereas in mid-2022, exports were still increasing by 3% a year (by 2% and 5.2%, respectively). Markit business surveys conducted during the first months of the year confirm this decline. On average, the PMIs for export order books were significantly below 50, the threshold separating contraction from expansion. Concerning the emerging countries, non-commodity exporters have reported sharper declines in these indices than the other countries since mid-2022.

There has been a particularly sharp decline in exports for the Asian countries excluding China (-19%). This can be explained a priori by the erratic fluctuations in Chinese growth since Q4 2022, and by the downturn in the global electronics cycle. Yet structural factors could also be at work, reflecting the impact of the trade and technological decoupling of the US and China .

Since the outbreak of the trade war between the US and China in 2017, there has been a real break-off in external trade according to the Petersen Institute for International Economics[1]. The PIIE study covers exports of US goods and services to China. At first glance, total exports in 2022 seem to be at the same level as in 2016. Yet this can be attributed to circumstantial factors: 1/the Covid pandemic triggered a strong surge in exports of electronic components and medical equipment, and 2/higher commodity prices in 2020 and 2021 drove up the value of US coal and hydrocarbon exports. Moreover, the truce concluded between the two countries in 2020 resulted in a big increase in exports of agricultural products, even though China did not completely uphold its purchasing commitments. For other manufactured products, notably land and air transport equipment, the decoupling effect was very strong. Aircraft and engine exports were down threefold between 2017 and 2022, while exports of cars, trucks and spare parts were down 2.5x. In 2022, the decline in exports of electronic components and medical equipment was twice as severe as for all Chinese imports. Lastly, exports of services were down by about 30% between 2017 and 2022.

The structural decoupling of the United States and China has numerous consequences on emerging countries, with potentially opposing effects on foreign trade of merchandise and services[2].

More precisely, the partial break-up of trade between the two superpowers – whether due to higher trade barriers or bans/restrictions on trade – obviously has a negative impact on the foreign trade of third countries via the multiplier effect of world trade. This severance also impacts third countries that are a part of supply chains. According to the IMF, however, the consequences differ widely depending on the country's status. The big winners are countries that can substitute in for the United States or China as a supplier in new supply chains. In contrast, countries that are simple links in existing supply chains, without the capacity to strengthen their position among suppliers, will be hit at least by the repercussions of higher trade tariffs, or at worst, they will be evicted from new supply chains.

One might assume that the more industrialised countries with a diversified productive apparatus and that are geographically close to China or the US would rank among the winners. Yet the IMF study shows that between 2018 and 2022, Japan and South Korea both reported a decline in their share of Chinese imports, whereas India, Malaysia and Vietnam reported increases. Among Asian countries, Taiwan is the only country that validates the assumption. As to the US, Mexico is *a priori* a potential beneficiary. Yet between 2018 and 2022, exports of Mexican manufactured goods increased only moderately as a share of total American imports excluding oil (from 14.8% to 15.6%).

We can take comfort in the fact that the widespread contraction of exports in recent months is mainly due to cyclical factors. Although the subject still requires more in-depth research, so far the impact of the structural decoupling of the US and China is unlikely to facilitate matters.

François Faure
francois.faure@bnpparibas.com

1 Chad P. Bown & Yilin Wang: "Five years into the trade war, China continues its slow decoupling from US exports" Realtime Economics. PIIE. March 2023
2 IMF East Asia and the Pacific Economic Update - section 5.1. April 2023