

CHINA ECONOMIC UPDATE NOVEMBER 2019



Trade truce – US and China reach an agreement, but trade outlook still uncertain

NAB Group Economics

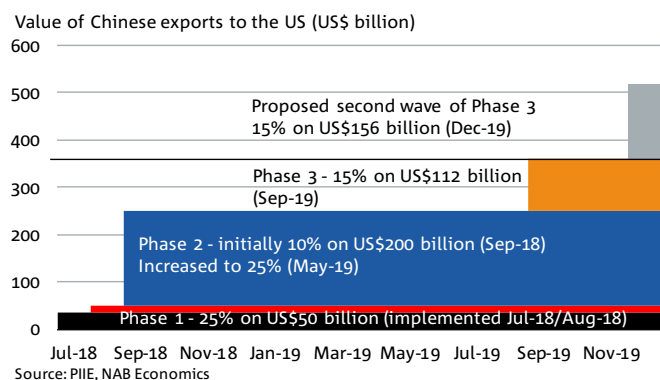
The US-China trade relationship has steadily deteriorated over the past eighteen months, as increasing trade barriers have negatively impacted the global economy. However, it appears that the two sides are close to a partial deal after talks in October that could begin to address the issues that ignited the trade war. The situation remains fluid – with negotiations apparently continuing ahead of a formal signing of the deal – and there remains some way to go around more complicated terms sought by the United States around intellectual property and subsidies.

CURRENT STATE OF PLAY – WHAT TARIFFS ARE IN PLACE?

China was a key target of President Trump during the 2016 election campaign, however the trade tensions between the US and China commenced in earnest in April 2018, with the Trump Administration announcing a 25% tariff on Chinese exports worth around US\$50 billion (introduced in two parts commencing in July 2018). This move followed earlier tariffs imposed on all imported washing machines, solar panels and steel and aluminium products, which impacted China (along with other trading partners) to differing degrees.

ESCALATING TRADE TENSIONS

Proposed December hike would bring almost all of China’s exports under tariffs



A second phase of US tariffs was implemented in September 2018 on around US\$200 billion of Chinese exports, initially at 10%, then subsequently raised to 25% in May 2019. Additional tariffs were imposed at

the start of September 2019 (at 15% on around US\$112 billion worth of goods), with further tariffs scheduled, which would bring almost the entirety of Chinese exports under these measures by mid-December 2019.

China retaliated to each US tariff imposition with its own measures, increasing the tensions between the two countries. That said, at various times the tensions appeared to ease – with expectations in early 2019 that a comprehensive trade deal would soon be concluded – only for tensions to escalate once again. However, the most recent rounds of trade negotiations appear to have been more fruitful.

WHAT IS THE PHASE ONE DEAL?

In mid-October, President Trump announced a “substantial phase one deal”, following the latest round of negotiations between US and Chinese officials. In contrast with earlier efforts to agree to a comprehensive trade deal, the scope of this agreement appeared to be relatively narrow. China agreed to larger agricultural purchases, greater market access to key services sectors (including financial services) and some improvements around intellectual property protection (with China having strengthened IP legislation in recent months).

China also promised greater transparency around currency intervention, with a promise not to engage in competitive devaluation. In exchange, the United States suspended a proposed tariff hike scheduled for mid-October – which would have increased the rate from 25% to 30% on the first two phases (equivalent to a combined US\$250 billion).

Observers were quick to note that the measures China agreed to in this deal were essentially identical to those proposed in earlier rounds of negotiations, suggesting that negotiators from both sides were keen to make some progress, following an extended series of unsuccessful talks. This increased urgency may reflect increasing signs of the impact of the trade war on both countries, particularly pressing from a US perspective ahead of the 2020 Presidential election.

The measures agreed to in this deal represent some of the easier points of agreement between the two countries, with a range of other issues delayed for later rounds. This includes agreement around the monitoring and enforcement of intellectual property protections and the structure of China's industrial policy, including industrial subsidies and progress on reforms of State-Owned Enterprises. Concluding the phase one deal does not mean that we should expect rapid progress towards phase two – as reports suggest negotiators remain far apart regarding these more complex issues.

CONCLUSION: WHERE TO FROM HERE?

A formal signing of the agreement had been expected at mid-November's APEC meeting in Chile – however this event has been cancelled due to the political turmoil in that country. At the time of writing, no alternative meeting has been agreed, and the final details of the agreement are still to be completed. It is worth noting that the official announcements from the United States have been far more positive regarding the deal than China's statements – which have noted "substantial progress" in negotiations.

A key question mark going forward is the status of US tariffs scheduled for 15 December. Chinese officials are seeking to have them suspended as part of the deal, and the US Treasury Secretary Steven Mnuchin has stated he expects them to go ahead if the deal is not concluded.

A large scale roll back of existing tariffs still appears unlikely. Statements from China's Vice Premier Liu in late October suggest that China is seeking to prevent further escalation, rather than a reduction in trade measures. That said, more recently it appears that China may seek to roll back the most recent tariffs, introduced at the start of September – highlighting the fluid nature of the negotiations. However, it is unclear what the US President's view on this is.

US trade policy sits in the hands of the President and changes can be made without any input from US lawmakers. This means that trade tensions could quickly escalate again if the Trump Administration feels China has failed to deliver on its commitments

under any trade agreement. Similarly, an improvement cannot be entirely ruled out either.

There had been earlier speculation – prior to the phase one deal – that Chinese negotiators were biding their time, expecting a more favourable negotiating environment should a Democratic candidate win the 2020 Presidential election. We argue that there is no reason to think that the trade environment would be materially different under a new administration. A tough approach to trade policy with China has broad, bipartisan support and trade policy has not been a major talking point in the Democratic Primary debates.

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