CHINA ECONOMIC UPDATE JULY 2022

How will the US respond to China's failure to meet its trade commitments?

NAB Group Economics

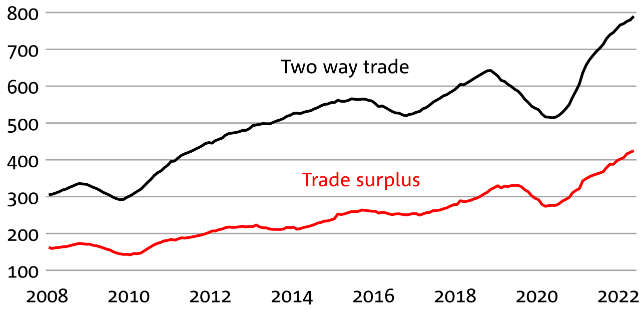
The US-China trade war, initiated by the Trump Administration, was concluded with the Phase One trade deal, that required China to expand its imports of US goods by the end of 2021. The failure of China to meet these commitments – whether realistic or not – raises the question of how the Biden Administration responds, given broad bipartisan support for action against China's trade policies.

US-CHINA TRADE WAR IN BRIEF

In early 2018, then US President Donald Trump implemented a series of tariffs on China's exports to the United States, following an investigation by the US Trade Representative that alleged China engaged in unfair trade practices in relation to technological transfers, intellectual property and innovation. This triggered a trade war between the two countries, as both countries responded with a succession of tit-for-tat tariff increases.

US-CHINA TRADE DATA

China's surplus has risen well above pre-trade war levels



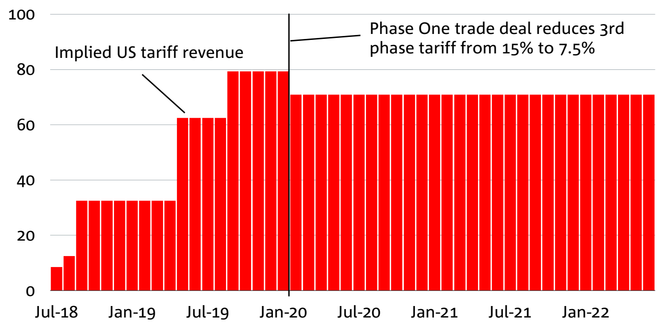
Source: Macrobond, NAB Economics

Prior to the trade war, China ran a sizeable and increasing trade surplus with the United States – a point of significant contention for many trade and economic advisors within the Trump White House. Two-way trade (the sum of imports and exports) – based on China's trade data – peaked in November 2018 at around US$642 billion (on a twelve-month rolling sum basis), however China's trade surplus peaked later – at around US$331 billion in June 2019. As the trade war intensified, this surplus steadily declined, down to US$274 billion in March 2020.

The Phase One trade deal – signed in January 2020, immediately prior to the outbreak of the COVID-19 pandemic – effectively ended the open trade hostility between the two countries, albeit most tariffs imposed remained in place. Under this deal, China committed to expanded purchases of a range of US exports of around US$200 billion in 2020 and 2021 (relative to 2017 levels). This comprised almost US$80 billion of manufactured goods, over US$50 billion in energy products and around US$32 billion in agricultural goods (with the remainder being largely unspecified, with some analysts attributing this to services trade).

US TARIFFS ON CHINA'S EXPORTS

Minor cut following Phase One deal, but most tariffs remained in place



Source: NAB Economics. * Based on estimated import values at the time tariffs announced.

Date **July 2022** | Author **Gerard Burg** – Senior Economist – International

CHINA'S TRADE PERFORMANCE SINCE THE PANDEMIC

As Chinese authorities implemented a strict lockdown in response to the initial COVID-19 outbreak, China's trade activity contracted rapidly, with both imports and exports plunging. However, as COVID-19 became a pandemic, China's exports surged – reflecting demand for medical products and personal protective equipment for the healthcare sector and electronics and furniture to support the increased trend of working from home. At the same time, many other countries – including the United States – implemented measures to control the spread of COVID-19, limiting the production of goods and services that could be exported to China.

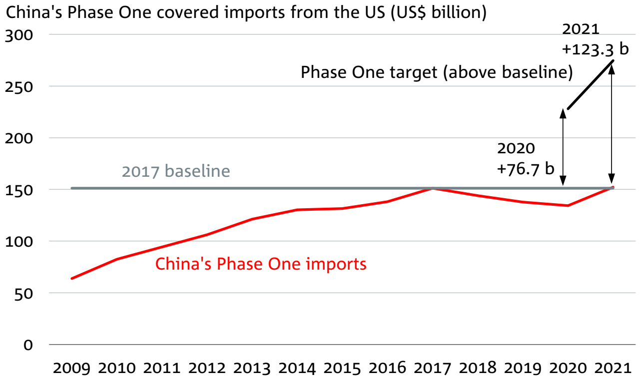
This saw both two-way trade (driven primarily by China's exports) and China's trade surplus with the United States rapidly increase from mid-2020 onwards. In the twelve months to May 2022, the surplus totalled US$425 billion – far in excess of the pre-trade war peak.

According to data produced by the Peterson Institute for International Economics, China fell substantially short of its commitments under the Phase One trade deal. While it could be argued that disruptions to US industry and transport and logistics due to the pandemic may have contributed to some degree – limiting the ability of exporters to supply China – many observers prior to the pandemic argued that the targets were likely to be unattainable.

CHINA'S PHASE ONE COMMITMENTS

China did not import any of the additional US$200 billion in goods & services required

China's Phase One covered imports from the US (US$ billion)



Source: PIIE, NAB Economics

The PIIE data show that China's imports over the two year period reached just 57% of the target under the Phase One deal – with agricultural imports coming the closest (at 83% of the target) and energy the lowest (at 37%). At the end of 2021, China's imports of goods specified under the agreement from the United States were only marginally above 2017 baseline, meaning that China effectively purchased none of the additional US$200 billion that was required.

CONCLUSIONS: THE US RESPONSE REMAINS UNCLEAR

While the transfer of power from the Trump to Biden Administration meant that US trade policy towards China was likely to be less confrontational, we argued in 2020 that it was unlikely to return to the openness prior to the Trump Administration. Stronger action against China was one of the few policies that has had broad bipartisan support in the US in recent years.

During his trip to Asia in May, President Biden unveiled a new international partnership currently known as the Indo-Pacific Economic Framework. Including the United States, the partnership brings together thirteen Asia-Pacific countries intended to promote US-led international policies around labour and environmental policy and counter China's geopolitical influence in the region. While there is significant overlap between the membership of this group and the Trans-Pacific Partnership – which former President Trump withdrew the United States from in 2017 – the relationship proposed excludes the trade liberalisation measures of the TPP.

Reports suggest that there is a divide within the White House regarding the Trump-era tariffs, with the US Trade Representative Katherine Tai suggesting that they provide significant leverage in managing the trade relationship, while Treasury Secretary Janet Yellen has suggested that they serve no strategic purpose and that reducing or removing them could be useful in lowering inflation.

The latter suggestion highlights a dilemma for the Democratic Party heading towards midterm elections in November. Inflation is a charged political issue at present, however tariffs are popular with key segments of the Democratic base – particularly labour unions.

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