TRADE WAR: MORE SMOKE LESS FIRE

World trade has been slowing down over the past few years. The year 2017 ushered in better trade prospects, but just as global trade has started showing positive momentum, the issue of trade wars has surfaced again. This is however not the first instance when countries have been involved in trade kerfuffle. World history is riddled with instances of prolonged trade wars. There are several interesting implication of such trade wars.

First, empirical evidence suggests that none of the trade wars which started bilaterally turn into a full fledged multilateral trade wars, though the trade wars were prolonged for close to a decade in some cases.

Second, such trade wars may not necessarily have any impact regarding financial stability, though some volatility was observed during the past periods of trade disputes, however the markets eventually recovered in all cases of trade wars. In fact, during 1993-2001 prolonged trade dispute between US and EU, the US markets kept on rising. The recent imposition of steel and aluminium tariffs has increased S&P 500 volatility. However, market has factored in the news and is stabilising. The dollar has also now started appreciating against the basket of 6 major currencies now that fears of full-fledged trade war between the US and China have dissipated.

During the last period of trade dispute 1993-2001, current account deficit of US increased significantly to 3.7% of GDP in 2001 from 0.9% of GDP in 1993. However, the US dollar appreciated against the Euro during this period.

The moot point is therefore the US $ will keep on appreciating even though US may be engaged in trade wars. This will have an impact on capital flows to emerging economies. The recent depreciation in emerging economies currencies, including India bears testimony to this fact.

Additionally, besides resorting to tariffs, US is also resorting to non-tariff barriers. Over the years it can be seen that non-tariff measures have risen considerably. Such non-tariff barriers are more a manifestation of protectionist measures.

Moreover, the ongoing banter between the US and China has not affected Indian stock markets much. Interestingly, if the relationship between US and China leads to some reduction in US exports to China and India capitalises on it by even trying to capture 1% of the total Chinese imports from US, we can see an additional 10% increase in India’s exports to China.
World trade has been slowing down over the past few years. Merchandise exports declined to $15.9 trillion in 2016 from around $18.3 trillion in 2011, while imports also registered a drop to $16.2 trillion from $18.5 trillion during the same period. Overall global merchandise trade witnessed a decline of 3.0% in 2016 compared to a double digit growth witnessed between 2003 and 2011 (2009 was the exception year). After 2011 trade growth fell significantly and even entered the negative territory from 2015. However, the year 2017 ushered in bettering trade prospects and the average growth has been 10% and 11% for exports and imports respectively. Just as global trade has started showing positive momentum, the issue of trade wars has surfaced again.

This is not the first instance when countries have been involved in trade kerfuffle. World history is riddled with instances of prolonged trade wars. The table lists some of them.

Historically, trade wars which started bilaterally have not turned into full fledged multilateral trade wars, though were prolonged.

**LOOMING THREAT OF TRADE WAR**

Ever since Donald Trump took charge as the President of USA, he has taken a number of protectionist measures with coming out of TPP (Trans Pacific Partnership) being the major one. Renegotiation of NAFTA, increase in tariffs and stricter regulations for H1B visa are other such measures taken by the US which point towards increased protectionism.

This year Trump announced levying import tariff on steel and aluminium at 25% and 10% respectively. The unilateral imposition of such sudden large magnitude of tariffs is against the WTO provisions. The rise in steel and aluminium tariffs might lead to some short term positive impact on steel industries but its negative impact on construction and manufacturing sectors, the major users of steel and aluminium cannot be ruled out. Moreover, the fear of trade war exists which will have serious implication for global growth. Historically also the US had imposed steel tariffs earlier in 2002. However, they were revoked the very next year as they led to job losses. From the recent steel and aluminium tariffs, Mexico and Canada were initially exempted and later temporary exemptions have also been extended to Korea, EU, Argentina, Australia and Brazil. But these exemptions lapsed on 1 May’18. While tariffs on Canada, Mexico and the EU have been held off, giving them a 30-day reprieve, US informed that agreements in principle have been reached with Argentina, Australia and Brazil and would be finalized shortly.

The steel tariffs as such are not going to have a major impact on China as the country exports only 2% of the total US steel imports. So China didn’t react immediately. However, following USTR’s Section 301 investigation the United States imposed additional tariffs covering approximately 1,300 separate tariff lines amounting to around $50 billion of Chinese imports, China imposed retaliatory tariffs on 128 US imports worth $3 billion, including fruits and pork, thus increasing the fears of trade war.
China vowed to impose measures of the "same strength" in response to a proposed US tariff hike. The discussions were held between China and US which led to some agreements between the two countries while differences still remain. The fears of full-fledged trade war between the two have now dissipated, though the US might continue to impose anti-dumping duties on Chinese goods.

Amidst ongoing trade dispute between the US and China, the latter posted a current account deficit in Q1 2018, for the first time in nearly 17 years. The trade balance has also declined to $49 billion. In Mar'18 the country registered trade deficit, the first time in over a year (last deficit in Feb’17). During the quarter, the goods trade still ran a surplus, while the service trade posted a large deficit thereby contributing to current account deficit.

Regarding the bilateral trade with US, exports to the US declined by around 18% qoq in Q1 2018 while in yearly terms, they have increased 13.6%. The surplus with US is still higher in Q1 2018 compared to Q1 2017. Thus it seems that the deficit in current account has more to do with the structural transformation that China is undergoing. In fact, the current account surplus of China has been witnessing a gradual decline to 1.3% of GDP in 2017 from 9.1% of GDP in 2008.

**FINANCIAL VOLATILITY AND TRADE WARS**

During the Great Depression, US adopted protectionist measure of imposing Smoot-Hawley Tariff Act. The general slowdown was prolonged due to the tariffs. In 1934, President Franklin D. Roosevelt signed the Reciprocal Trade Agreements Act, reducing tariff levels and promoting trade liberalization and cooperation with Foreign Governments. During 1930-34 the S&P 500 declined by more than 50%. However, the markets eventually recovered in all the cases of trade wars. In fact during 1993-2001, notwithstanding prolonged trade dispute between US and EU, the US markets kept on rising.

During the last period of trade dispute 1993-2001, current account deficit of US increased significantly to 3.69% of GDP in 2001 from 0.89% of GDP in 1993. The US trade deficit with EU increased to $64.6 billion by 2001 from $16.9 billion in 1997. Moreover, the US dollar appreciated against the Euro during this period.

More recently, S&P 500 started declining after Trump’s imposition of tariffs on washing machine and solar panels in Jan’18. In March again the imposition of tariffs increased S&P 500 volatility. However, the market has factored in the news and is stabilising.

The dollar index has also been volatile this year but it started declining since the mid-January even before the tariffs were announced by Trump. However, it has started gaining against the set of six major currencies now that the discussions on trade wars have also lost steam.

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**Table: China BoP Data ($ billion)**

<table>
<thead>
<tr>
<th>Year</th>
<th>Current Account Balance</th>
<th>Trade Balance</th>
<th>Exports to US</th>
<th>Imports from US</th>
<th>Trade Balance with US</th>
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<td>66</td>
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<td>Q4 2017</td>
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<td>133</td>
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<td>42</td>
<td>80</td>
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<td>Q1 2018</td>
<td>28</td>
<td>49</td>
<td>100</td>
<td>42</td>
<td>58</td>
</tr>
</tbody>
</table>

**Source:** SBI Research, General Administration of Customs, China, CEIC

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**Graph 1: S&P 500**

**Graph 2: Dollar Index (DXY)**

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**Source:** SBI Research, Bloomberg
IMPACT ON INDIA: CASE STUDY OF IRON AND STEEL INDUSTRY

- Of the total India’s iron and steel exports in FY17, only around 11% went to the US (a reduction from 14.2% in FY13). Also, if we look at the total of India’s exports to US, iron and steel accounted for only 1.9% in FY17 (reduction from 3.1% in FY13). Thus it seems that India’s overall exports to the US have been on a declining trend over the years and thus India might not be impacted much directly from increase in import tariff in the US.

- However, if this leads to increase in tariff by other countries in retaliation then this would have an adverse impact on global economic growth, including India.

- Also, another channel through which India could get hurt is if countries like China, who were earlier exporting to the US, start dumping their produce in India after facing higher tariffs in the US.

DOMESTIC STEEL INDUSTRY

- If the domestic production is looked at, India is increasingly producing more of both finished steel and crude steel. For FY17, exports of finished steel have increased while its imports have declined, implying we are becoming more self-sufficient. As per the latest data available in World Steel Association, India became net exporter of steel in 2016, importing 9.9 million tonnes and exporting 10.3 million tonnes. Various Government initiatives, including minimum import price and anti-dumping duty have provided support to the domestic steel industry. However, at the same time this has hampered the industries which use steel as an input. Thus, there is always a trade-off while giving protection to a particular industry.

- Unlike global prices, Indian domestic steel prices have maintained the ir strength. Long product prices have been strong due to seasonality and are likely to remain firm in Q1FY19 too. Flat product prices are also likely to remain strong, supported by an improvement in the Automotive sector. But challenges will come from US import tariff once this would create higher availability in the domestic market, if the same results in higher competition in the exports markets for India.

- Aluminium price fell by 7% mom while Copper prices fell by around 2% mom. Significant decline in Aluminium prices can primarily be attributed to commodity trade advisors (CTAs) liquidating their positions due to concerns about escalating trade hostilities post the imposition of import tariff by USA. Also, high unsold inventory of Aluminium in China and expectations of higher production post the winter heating period added to the worry for CTAs, leading to position unwinding and consequently price correction.

INDIA CAN GAIN MARKET SHARE

- The ongoing banter between the US and China has not affected Indian stock markets much. On the days the involved parties have made announcements the markets have seen some slide, but they have recouped again.

- US had exported goods worth $130 billion to China in 2017. Meanwhile in FY17 India exported $10 billion worth to China. So obviously we cannot match US in scale. However, if the relationship between US and China leads to some reduction in US exports to China and India capitalises on it by even trying to capture 1% of the total Chinese imports from US, we can see an additional 10% increase in India’s exports to China.
NON-TARIFF MEASURES

- Besides resorting to tariffs, the US is also resorting to non-tariff barriers as well. US has recently imposed antidumping duty on the stainless steel flanges imported from China and India on the ground that these countries provide subsidies to their exporters.

- From 20 Jan’17, through 20 Mar’18, the Commerce Department has initiated 102 antidumping and countervailing duty investigations – a 96% increase from 20 Jan’16, through 20 Mar’17. Commerce department currently maintains 428 antidumping and countervailing duty orders which provide relief to American companies and industries impacted by unfair trade.

- Over the years it can be seen that non-tariff measures, especially sanitary and phytosanitary and technical barriers to trade have risen considerably. All the economies should reach a consensus so that the non-tariff barriers are not abused and world trade keeps flourishing.

CONCLUSION

- During the periods of trade dispute between France, Germany and the US in 1962, global trade continued to increase. However, trade as well as GDP growth declined in 1993 when banana war began between EU and US and the end of this tariff war did not result in improvement in global trade and growth dynamics. Thus a conclusion stating one-on-one relationship between trade wars and world GDP growth would be too simplistic. However, as global trade growth and global GDP growth mirror each other, it is given that trade growth has to be there in order fuel global GDP growth.

- The current dispute between the US and China provides opportunity for other players to expand their trade and keep the momentum going.
ABOUT US

The Economic Research Department (ERD) in SBI Corporate Centre is the successor to the Economic and Statistical Research Department (E&SRD). The latter came into being in 1956, immediately after the State Bank of India was formed, with the objective of “tendering technical advice to the management on economic and financial problems in which the Bank has interest and which required expert analysis”.

After the first reorganization of the Bank, when specialized departments like Management Science, Management Information Systems, Planning and Market Segment Departments took over the statistical work of E&SRD, the Department was renamed as ERD.

However, with the ERD team now taking on multidimensional functionalities in the area of risk management, corporate analytics, strategy and so on, who knows, the time may have come to rename it again!

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CONTACT DETAILS

Dr. Soumya Kanti Ghosh
Group Chief Economic Adviser
State Bank of India
Corporate Centre
Madam Cama Road
Nariman Point

Email: soumya.ghosh@sbi.co.in
gcea.erd@sbi.co.in
Phone: 022-22742440
Twitter: @kantisoumya