

## TRADE WARS: A CHALLENGE FOR THE NEW GOVERNMENT?

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The ongoing trade skirmish between USA and China is showing no signs of abating with the US increasing tariffs from 10% to 25% on \$200 billion worth of Chinese products on 10 May 2019. China in retaliation has said that it will raise tariffs on \$60 billion worth US imports beginning 1 June 2019. China has already imposed tariffs on US products worth \$110 billion last year. Not just China, USA is waging tariff war with other countries, with tariffs imposed on its major trade partners Canada, Mexico and others as US is convinced that it has to reduce its burgeoning trade deficit.

Interestingly, we find that the impact of such tariffs may be hurting USA more and hence US may be caught in a vicious cycle of imposing more tariffs as a veiled threat of not retaliating. For example, Chinese data shows that the monthly growth of imports from USA has declined more as compared to Chinese exports to USA after July 2018. Although, China will be impacted more as the base of its exports to USA is much larger than its imports, it appears that US is not going to remain unscathed.

Overall, USA's goods trade deficit has still increased in 2018, with imports growing more than exports. A strengthening US economy and strong dollar have supported the imports, despite the hue and cry raised by Donald Trump on the trade deficit. On an annual basis, in the end use commodity category, Foods, Feeds, Beverages exports has seen the slowest growth. More than 800 U.S. food and agricultural products have been subject to retaliatory tariffs from China, the EU, Turkey, Canada, and Mexico. This could be reason for the slowing exports growth of agricultural products. With nearly 20% of farm income derived from exports, the trade war will impact the US farmers to a considerable extent. Although Q1 2019 trade deficit declined vis-à-vis Q1 2018 by \$7 billion, with imports showing de-growth of 0.1% and exports growth of 1.5%, it was relatively quiet phase with hopes of trade tensions getting resolved. However, with USA turning aggressive again, who knows what outcome 2019 will hold? Also, there could be severe turbulence in financial markets if China starts offloading its \$1.13 trillion US treasury holdings!

With 25% tariffs on \$250 billion Chinese goods, USA can generate revenue of \$62.5 billion annually. Will this be sufficient to compensate for the loss incurred by the American consumers and exporters and more importantly the harm to the China-US relations? A recent survey by Pew Research Centre found that American public is more positive about Free Trade Agreements and skeptical about tariffs. With the upcoming elections, it would not be amiss for the US President to take into account sound economic principles and people's mandate. **The worsening economic indicators in USA, like student loan delinquency and yield curve inversion, may pose challenges for the incumbent Indian Government too!**

### ONGOING TRADE FACEOFF BETWEEN USA AND ITS TRADE PARTNERS

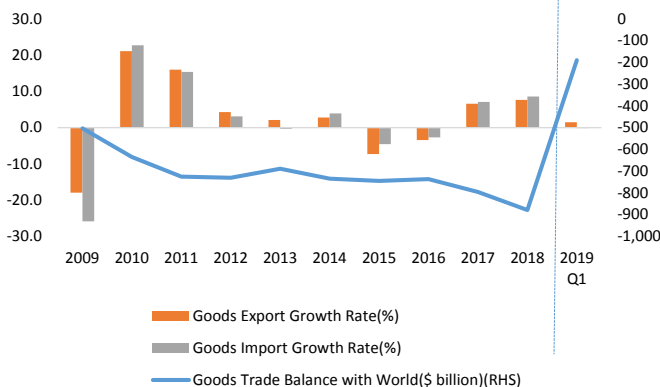
- ◆ The ongoing trade skirmish between USA and China is showing no signs of abating with the US increasing tariffs from 10% to 25% on \$200 billion worth of Chinese products on 10 May 2019. US has also raised the possibility of a new 25% duty on another \$300 billion on Chinese imports that are not currently subject to tariffs. If this move is implemented, nearly all of Chinese exports to US would be taxed. China in retaliation has said that it will raise tariffs on \$60 billion worth US imports starting 1 June 2019. China has already imposed tariffs on US products worth \$110 billion last year.
- ◆ The US President, Donald Trump, has created a lot of noise on the trade front, since he joined office, with the language of the various trade related documents making it amply clear that US has felt itself to be handed the short end of the stick by its trade partners. It began with the 2017 US Trade Policy Agenda outlining the new Administration's four trade priorities: promoting U.S. sovereignty, enforcing U.S. trade laws, leveraging American economic strength to expand their goods and services exports, and protecting U.S. intellectual property rights. Since then US has renegotiated NAFTA and KORUS FTA. USA has imposed tariffs on imported steel and aluminum, which have invoked retaliation from its trade partners.

Timeline of US and China actions		
	US	China
6-Jul-18	U.S. specifically targeted China by imposed 25% tariffs on \$34 billion of imported Chinese goods	China responded with similarly sized tariffs on U.S. products
22-Aug-18	A 25% tariff on additional \$16 billion of Chinese imports (chemical products, motorcycles, speedometers and antennas)	China responded immediately with 25% tariffs on an equal amount of American goods, such as chemical products and diesel fuel
24-Sep-18	A further tariff on \$200 billion of Chinese goods ranging from fire alarms to Christmas-tree lights	China responded with tariffs on \$60 billion of US goods ranging from honey to industrial chemicals
19-Nov-18	US pushed ahead with plan to tighten restrictions on technology exports	
1-Dec-18	Presidents Trump and Xi Jinping agreed to a truce and talks, freezing tariffs at the current level for 90 days	
14-Dec-18		China resumes purchase of US Soybeans and announces temporary removal of additional 25% tariffs on US autos and 5% tariffs on certain US auto parts for three months beginning January
24-Dec-18		China cuts tariffs on more than 700 imports. It also resumed imports of LNG and crude oil from the U.S in November, according to customs data
24-Feb-19	US delays the tariff increase on \$200 billion of imports from China scheduled to go into effect on March 1, 2019	
10-May-19	US increases tariffs on US\$200 billion worth of Chinese goods from 10% to 25%, as the US and China fail to reach a deal following the end of the first day of the eleventh round of high-level trade talks	
13-May-19		Beijing announces that it would raise tariffs to as high as 25% on more than 5,000 U.S. products starting June 1

Source: SBI Research

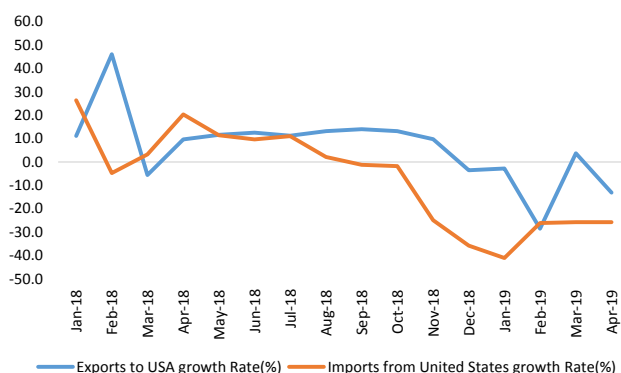
- ◆ With all the hullabaloo created over Trump’s trade measures, we looked at USA’s trade deficit and found that USA’s goods trade deficit has in fact increased in 2018, with imports growing more than exports. A strengthening US economy and strong dollar have supported the imports, despite the hue and cry raised by Donald Trump on the trade deficit. In 2018, the Chinese Yuan depreciated by around 5%, while the dollar index moved from 92.24 to 96.17. However, for Q1 2019 the trade deficit declined vis-à-vis Q1 2018 by \$7 billion, with imports showing de-growth of 0.1% and exports showing growth of 1.5%.
- ◆ On an annual basis, in the end use commodity category, consumer goods imports growth has picked up substantially in 2018 compared to 2017. In the exports category, Foods, Feeds, Beverages have seen the slowest growth. More than 800 U.S. food and agricultural products have been subject to retaliatory tariffs from China, the EU, Turkey, Canada, and Mexico. This could be a reason for the slowing exports growth of agricultural products. With nearly 20% of farm income derived from exports, trade war will impact the US farmers to a considerable extent.
- ◆ There is a large difference between the official trade statistics released by the United States and the People’s Republic of China. However, as the latest data is available in the Chinese General Administration of Customs, we analysed it and found that in absolute terms Chinese exports to USA have gone down from \$36.1 billion in Apr’18 to \$31.4 billion in Apr’19. Meanwhile Chinese imports from USA have declined from \$13.9 billion in Apr’18 to \$10.3 billion in Apr’19. The monthly growth of imports however, has declined more as compared to exports. Although, China will be impacted more as the base of its US exports is much larger than its US imports, it appears that US is not going to remain unscathed. US’s goods exports are going to suffer in the long run if it continues to antagonize its top trade partners. In 2018, Canada, Mexico and China were USA’s the top export and import destinations and these are the countries against which US has raised the biggest concerns. There are no free lunches in this world and restricting imports from other countries to benefit one section is going to impact adversely the exporters.
- ◆ There are even concerns about the tariff wars spilling over to the financial markets in the form of China cutting short its exposure in US Treasury Market. China owns \$1.13 trillion in Treasury, a fraction of the total \$22 trillion in U.S. debt outstanding but 17.7% of the various securities held by foreign governments, according to data from the Treasury and the Securities Industry and Financial Markets Association.
- ◆ With 25% tariffs on \$250 billion worth of Chinese goods, USA can generate revenue to the tune of \$62.5 billion annually. Will this be sufficient to compensate for the loss incurred by the American consumers and exporters and more importantly the harm caused to the China-US relations? A recent survey by Pew Research Centre has found that American Public is more positive about Free Trade Agreements and skeptical about tariffs. With the upcoming elections, it would not be amiss for the US President to take into account sound economic principles and people’s mandate.

Graph 1: US Goods Trade Movement



Source: us Census, SBI Research

Graph 2: Chinese Goods Trade with USA(Y-o-Y growth)



Source: US Census, SBI Research

US Top Exports and Imports with China					
US Exports	2018 (\$ billion)	Y-o-Y Growth	US Imports	2018 (\$ billion)	Y-o-Y Growth
Civilian aircraft, engines, equipment, and parts	18.2	12.0	Cell phones and other household goods, n.e.c.	71.8	2.1
Semiconductors	7.1	17.1	Computers	47.3	4.0
Industrial machines, other	6.8	25.3	Telecommunications equipment	33.9	1.4
Passenger cars, new and used	6.7	-34.9	Computer accessories	32.6	2.9
Crude oil	5.4	22.5	Toys, games, and sporting goods	28.2	5.5
Plastic materials	4.0	-0.3	Apparel, textiles, nonwool or cotton	25.2	4.2
Medicinal equipment	3.7	7.9	Furniture, household goods, etc.	22.7	9.8
Chemicals-other	3.2	7.6	Other parts and accessories of vehicles	16.4	13.7
Soybeans	3.2	-74.3	Household appliances	16.0	13.3
Measuring, testing, control instruments	3.1	13.3	Electric apparatus	15.9	13.1

Source: US Census, SBI Research

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