Global Economic Outlook: Risks from the Trade War

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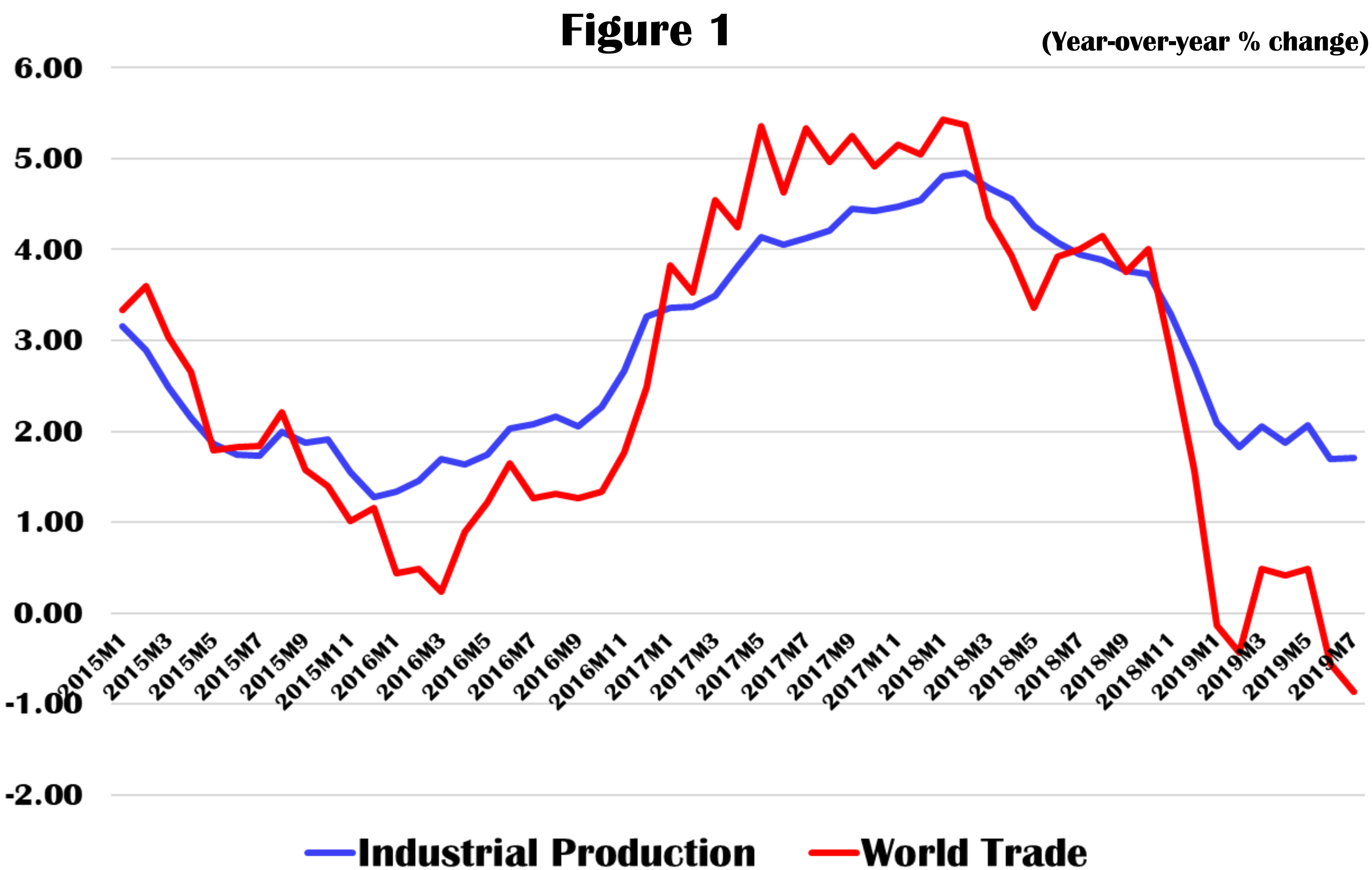
Global Economic Outlook

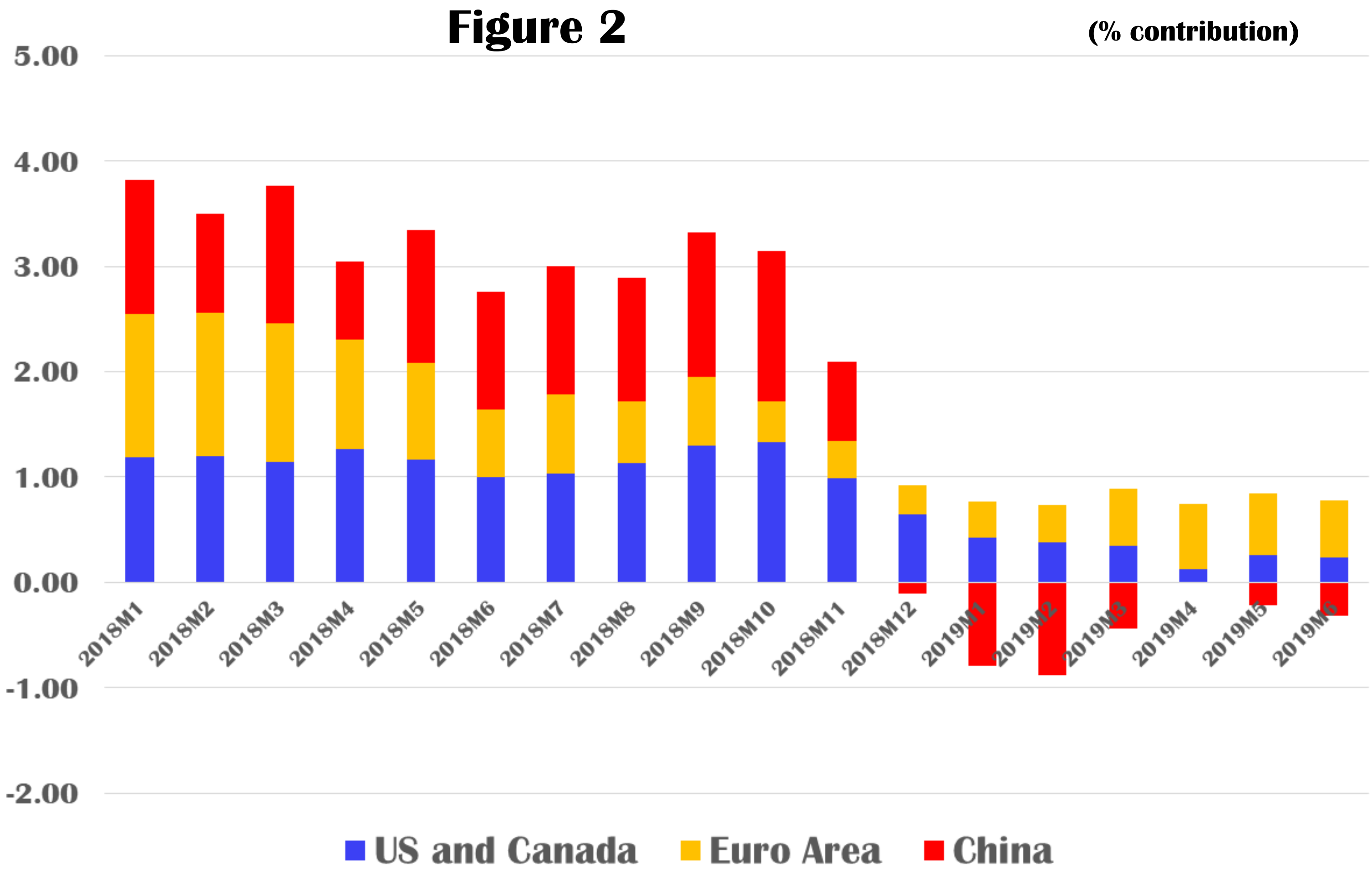
- Over past year, broad-based slowdown in global economy in terms of industrial production and trade (Figure 1)
- Driven by:
  - Downturn in auto production and sales
  - Weak business confidence due to US-China trade war
  - Slowdown in Chinese economy
- Slowdown in industrial production has fed into decline in trade growth (Figure 2)

Industrial Production and Trade



Source: IMF, October 2019

Contribution to Global Imports

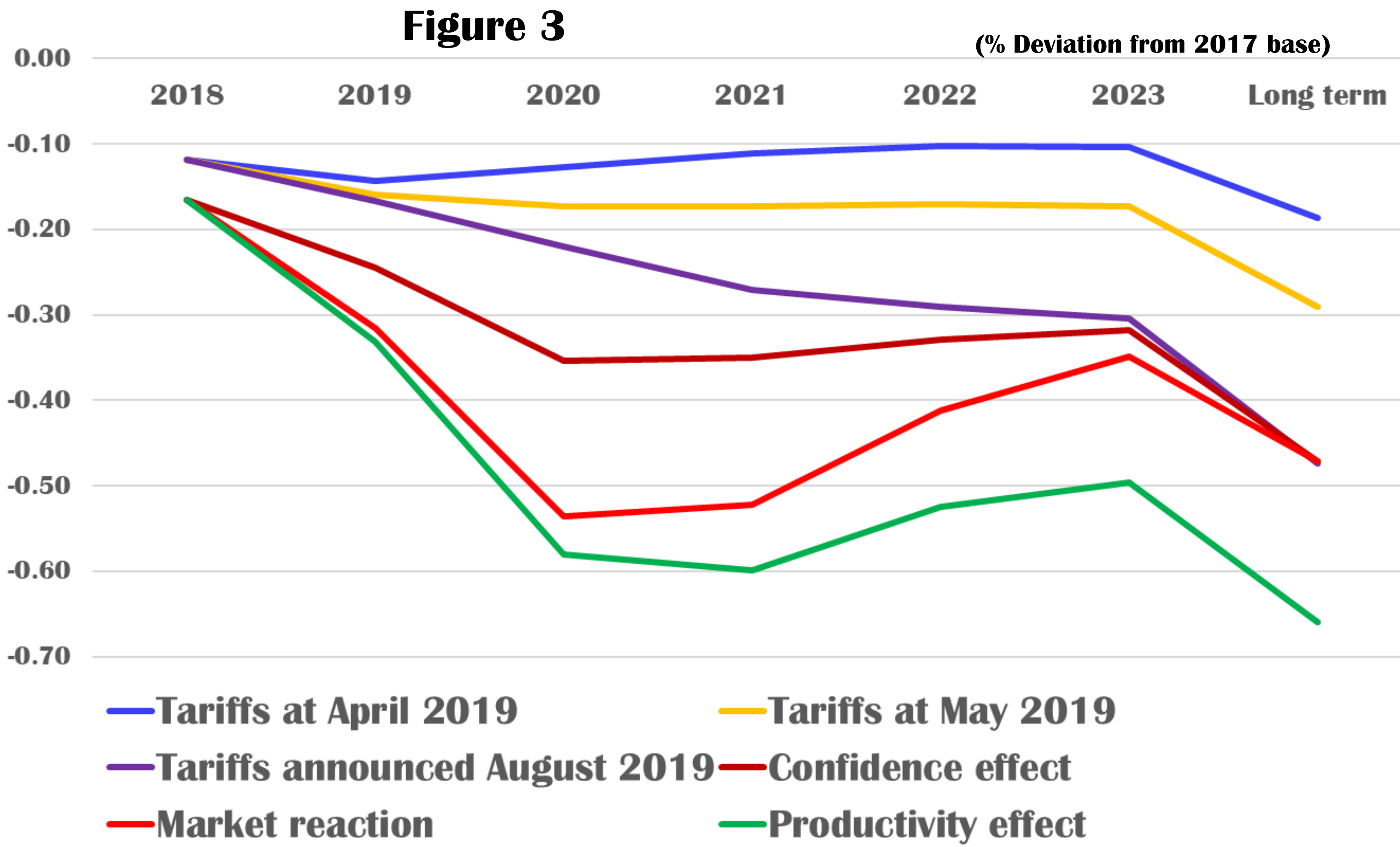


Source: IMF, October 2019

Risks Skewed to Downside

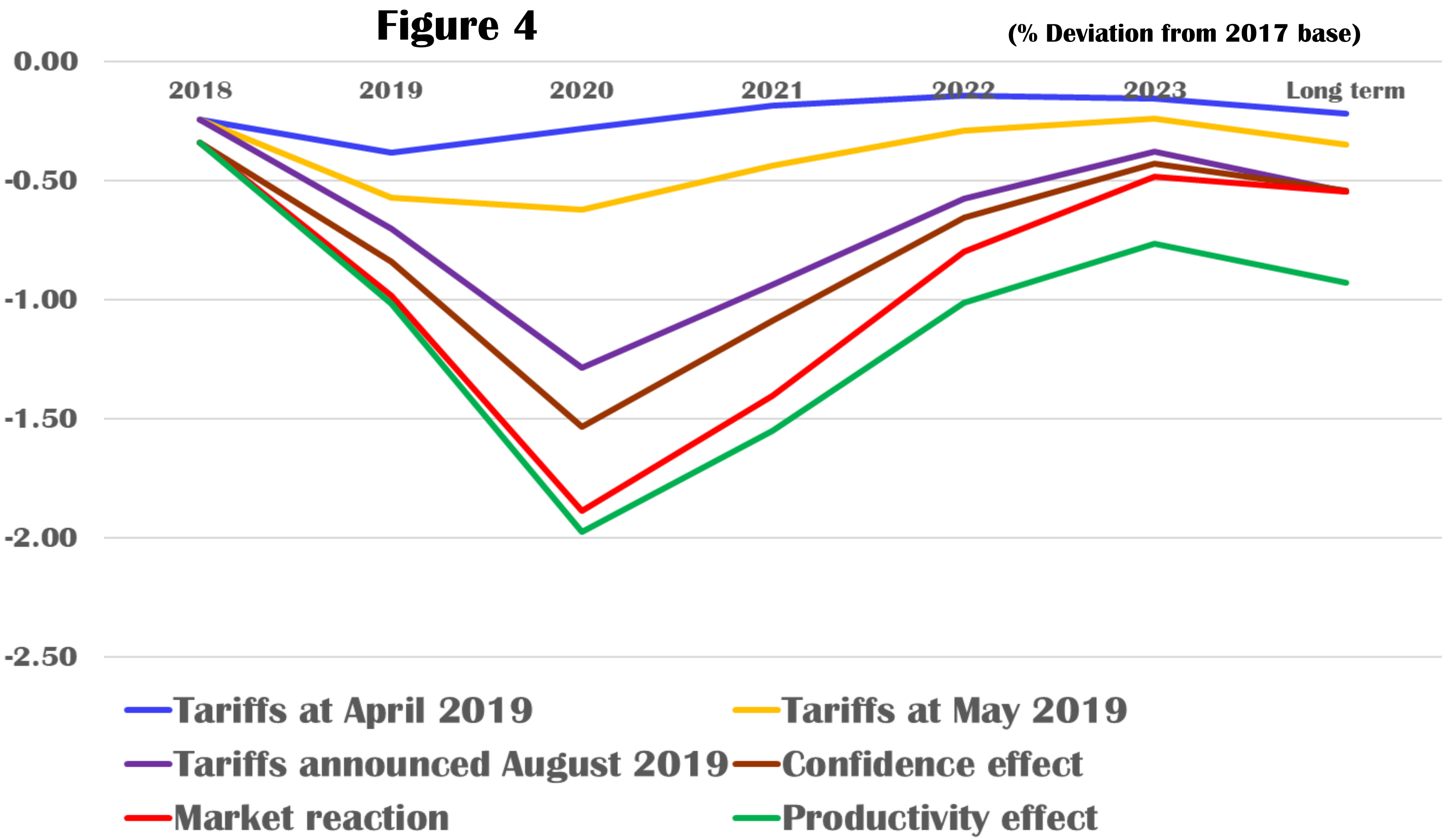
- Risks: (i) disruptions to trade/supply chains, (ii) declines in risk appetite/flight to safe assets, (iii) political uncertainty and conflict
- IMF forecasts that if US-China trade war continues, cost to global economy of $700 billion by end of 2020
- Both US and China affected by ratcheting up of trade war (Figures 3 and 4)
- General view: reduce trade tensions and return to solving issues via multilateral system, i.e., WTO

Impact on Real US GDP



Source: IMF, October 2019

Impact on Real Chinese GDP



Source: IMF, October 2019

Why Take on China?

- **Increase US market access: instigated trade war via “power-based bargaining” (Figure 5)**

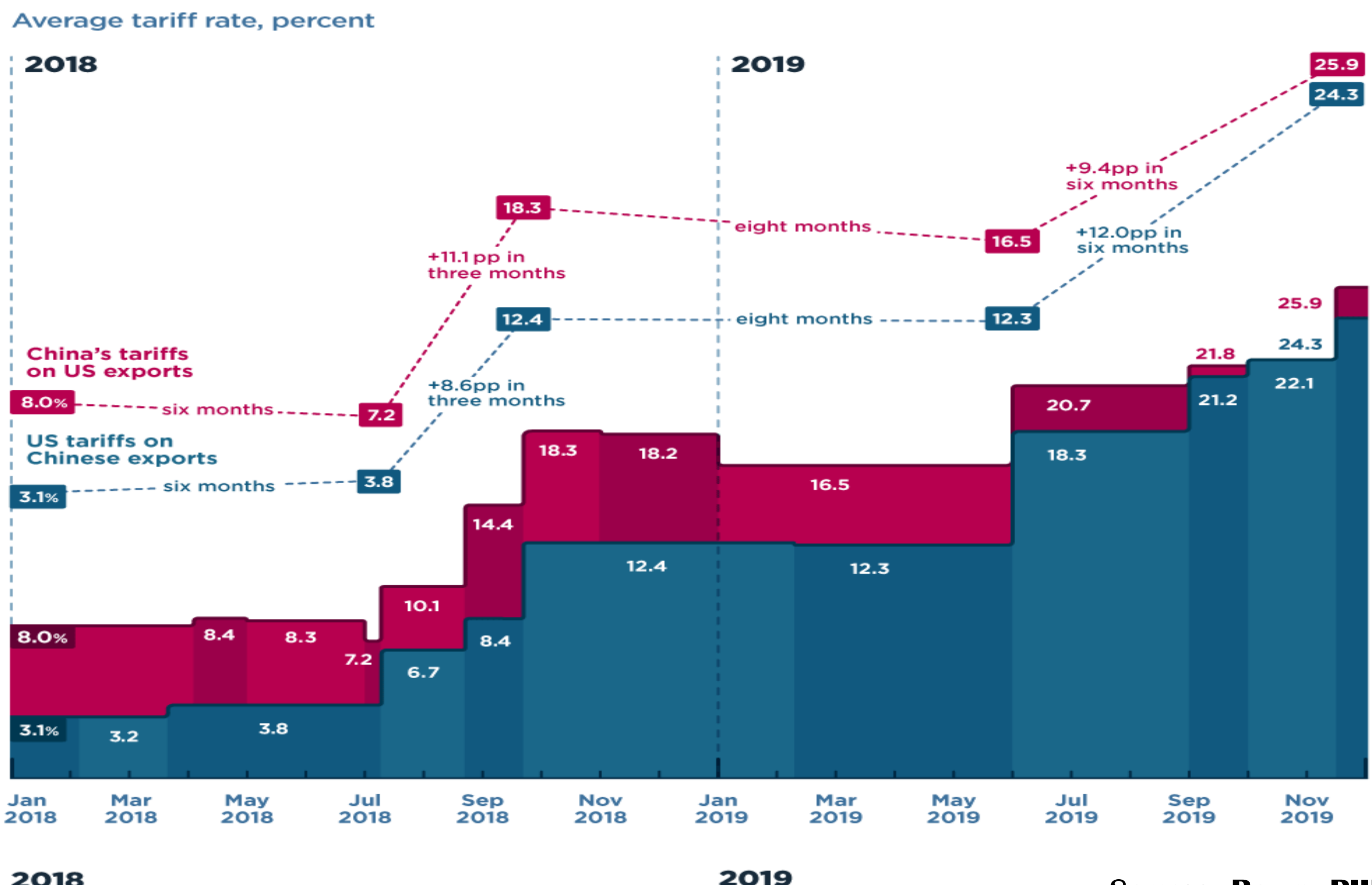
- **Reduce US trade deficit: but tariffs very unlikely to succeed as it is a macroeconomic issue, i.e., low US savings rate and fiscal deficit (Figure 6)**

- **Target exchange rate manipulation: prior to August 2019, China did *not* meet key criteria of either IMF or US Treasury**

- **Concerns over Chinese trade practices: risks to unilateral approach**

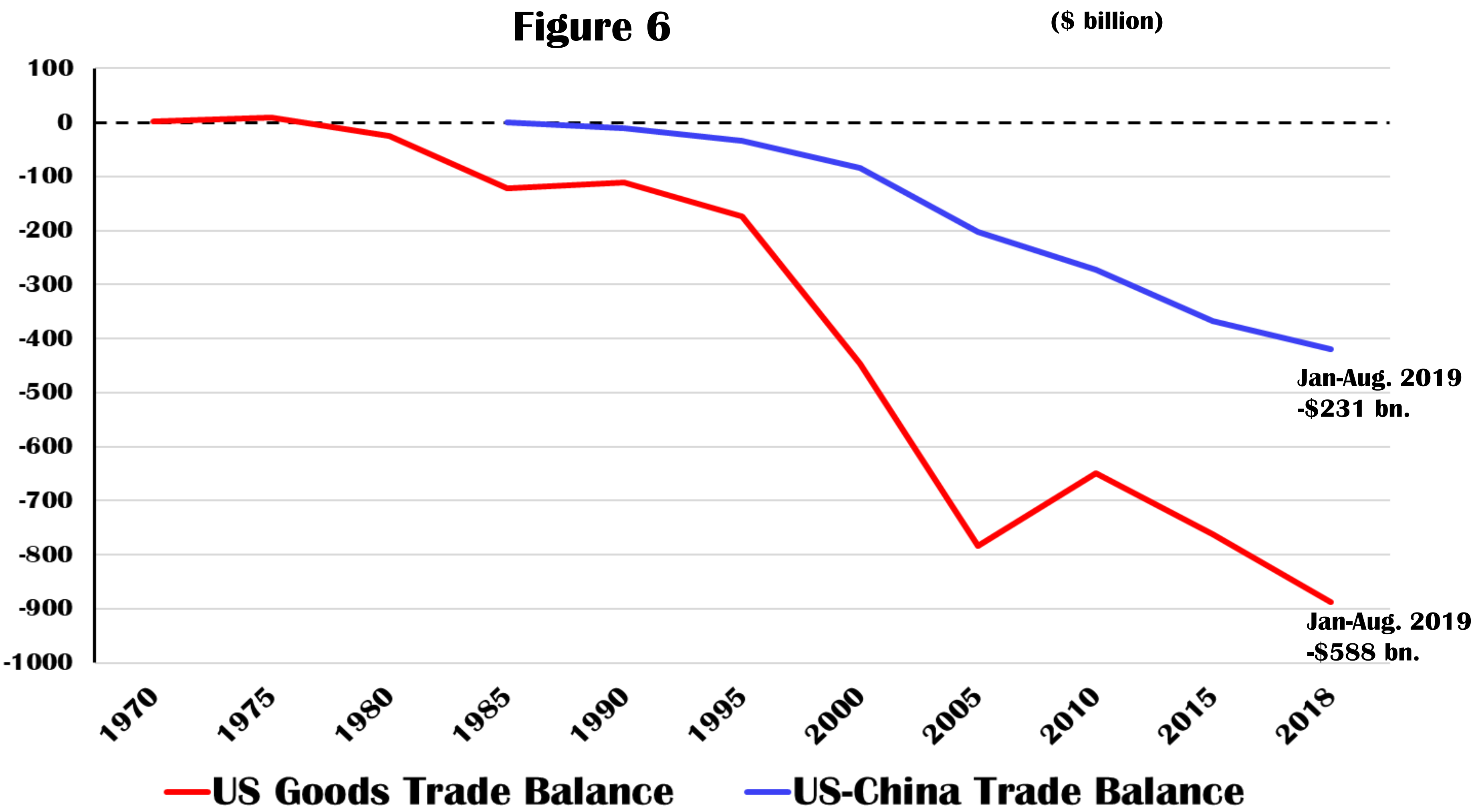
Trade War has Intensified

Figure 5



Source: Bown, PIIE, 8/29/19

US Goods Trade Balance

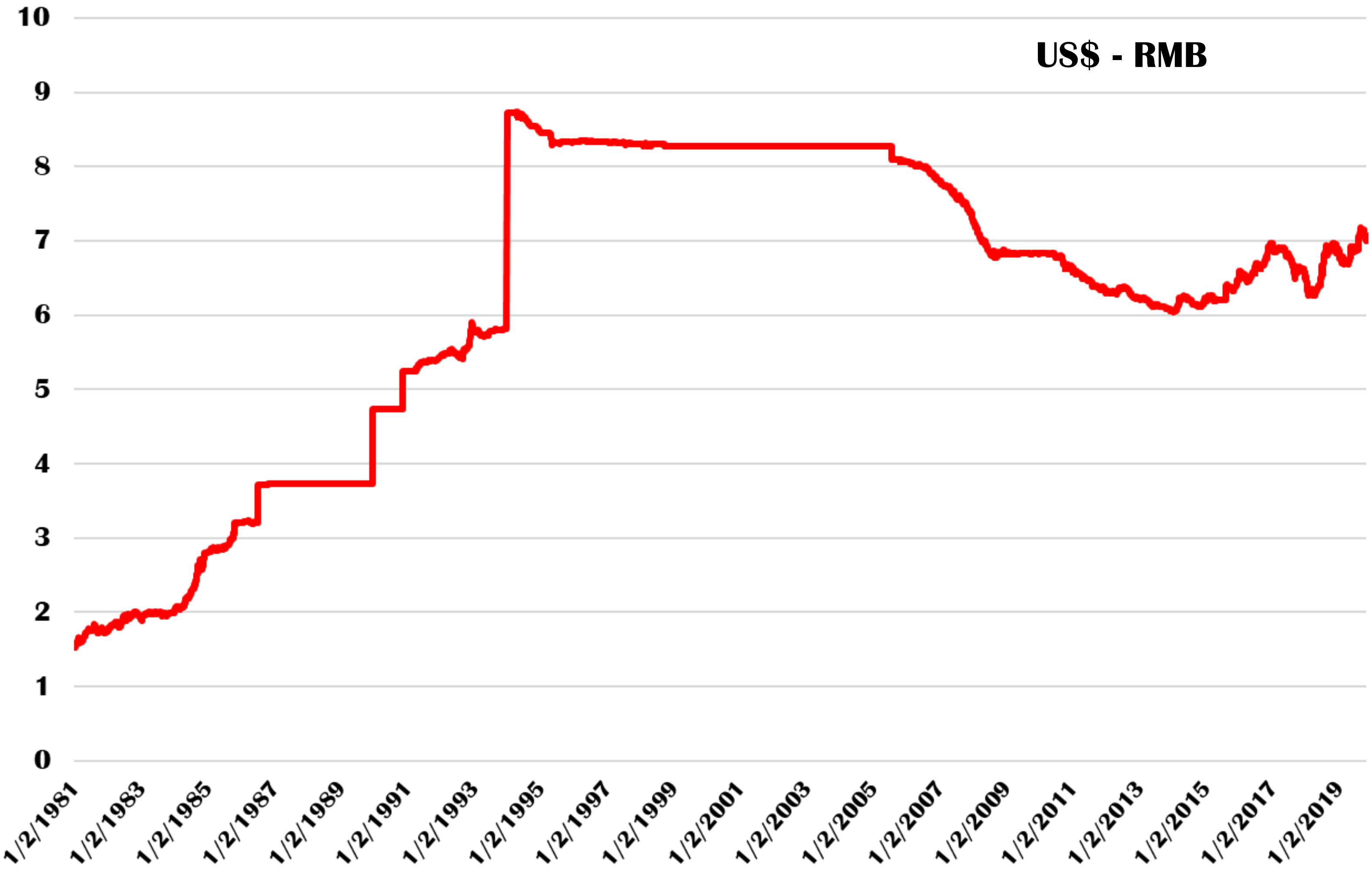


Source: US Census Bureau, October 2019

Chinese Currency Manipulation?

- Criteria for manipulation: (i) intervention to push down value of currency, (ii) large current account surplus, (iii) bilateral trade surplus with US
- Pre-2014 China slowed down appreciation of RMB, but then spent $1trillion propping up RMB over 2015-16
- 2016-18: China's current account surplus averaged 1% of GDP (US Treasury cutoff is 3%)
- Even if US had balanced trade and no currency manipulation, it could still have bilateral trade deficit with China
- US tariffs necessarily lead to depreciation of RMB

China's Exchange Rate



Source: Macrotrends, November 2019

Chinese Trade Practices

- Concerns about China's trade practices well-documented (USTR, 2018):
  - Forced technology transfer
  - Discriminatory licensing restrictions
  - Theft of intellectual property
  - Investment restrictions
  - Subsidies to state-owned enterprises (SOEs)
- Key issue: extent to which "China, Inc." makes it difficult to prove Chinese state is breaking WTO rules (Wu, 2016)

Go to WTO with "Big Case"

- WTO case could be made under GATT Article XXIII that one or more Chinese measures "nullify or impair" benefits of US and other WTO members
- Argued only way to approach this is through "grand coalition" of countries (Hillman, 2018)
- US frustrated with WTO dispute settlement
- Problem with US unilateral approach:
  - "Shallow" deal
  - "Free-riding"
  - Potential to undermine WTO

Phase 1 of Trade Agreement

- **What's In?**
  - Pause in tariff escalation
  - Concessions on intellectual property
  - Commitments on agricultural imports
  - Currency commitments by China
- **What's Not?**
  - Nothing done to address China's use of subsidies targeted to SOEs
  - Key impetus to trade war in first place – but unlikely to be solved unilaterally by US

Conclusions

- Trade war already imposing costs on US, which will increase as trade war intensifies
- Significant downside risk to global economy
- US-China trade deal likely to be "shallow", targeted at trade deficit with little focus "behind the border" (except perhaps IP protection)
- A coalition of WTO members would likely be more appropriate way to deal with China
- Failure of US to follow rules-based trading system runs risk China will not follow system if (when) it becomes dominant economic power