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

Figure 1

(Year-over-year % change)

Source: IMF, October 2019
Contribution to Global Imports

Figure 2

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

Figure 3 (% Deviation from 2017 base)

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
## US Trade Policy: Power-Based

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<td>Average MFN=3.4%</td>
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Trade War has Intensified

Figure 5

Average tariff rate, percent

2018

- China's tariffs on US exports
  - 8.0% six months
  - 7.2% eight months

- US tariffs on Chinese exports
  - 3.1% six months

2019

- +11.1pp in three months
- +8.6pp in three months
- +12.0pp in six months
- +9.4pp in six months

Source: Bown, PIIE, 8/29/19
US Goods Trade Balance

Figure 6

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 $1 trillion 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
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