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Trade: 'Tariff man' strikes again

Just as pockets of optimism had begun to emerge in the global economy, trade tensions are back. President Trump has taken the trade war a step further with the imposition of fresh tariffs on China, which also raises questions about the possibility of auto tariffs. That said, we still think a US-China trade deal remains likely

President Donald Trump at the White House, May 9th

A US-China trade deal is the most likely outcome

President Trump's decision to raise tariffs on Chinese imports has once again clouded the already weak trade outlook. But we think this will prove temporary because we think a deal between the US and China is still the most likely outcome.

World trade has been fighting an uphill battle in 2019. During the last two months of 2018 trade levels dropped no less than 3.8%, the largest two-month decline since 2009. As this has fed through, it has made it hard to obtain decent YoY growth rates in trade during 2019.

Annual trade figures have struggled to be decent this year

We expect trade to catch up with economic activity, undoing part of the late-2018 setback. We also expect the underlying pace of trade growth to return to the long-term average growth of 0.2% per month. These factors will only deliver 1.2% growth overall in 2019, thanks to the very negative carry over from 2018.

Donald Trump knows patience is beginning to run thin

Importantly, this doesn't fully account for the 2018 tariff hikes, which haven't fully run their course yet. It also doesn't take on board the latest hike in import tariffs from 10 to 25% on the USD200bn package, and the subsequent retaliation from China. We expect this response to be proportional to its response to the initial imposition of the 10% tariff hike from the US on this package of goods. The combined effect of these tariffs would lower our 2019 trade growth forecast by 0.7ppts, meaning that we expect only 0.5% trade growth this year.

We still think that there will be a deal in the end. The fact that negotiations are continuing amid the tougher rhetoric is positive. For China, the dependency on US demand for its products is significant, accounting for 3% of Chinese GDP. Conversely, President Trump knows that patience is beginning to run a little thin towards his aggressive trade policies in those sectors that have been most hit by Chinese retaliation (for example agriculture).

The US is likely to water down some of its demands

As we go on to discuss in the US article, we think President Trump wants a deal ahead of the 2020 election – not least to prevent his opponents being able to leverage the possible economic damage and stock market losses in their campaigns. Therefore, we think the US may end up watering down some of its demands, as it did in the renegotiation of NAFTA.

Temporary damage to world trade

For now, we think a deal will be struck at the end of Q3. In the meantime, the latest tariff hike is likely to do some temporary damage to world trade, although this could unwind once a deal is done – particularly if tariffs begin to be phased out. We think that half of the mutual tariff hikes will be removed shortly after a deal is done, with the other half phased out gradually in 2020, assuming both parties live up to their end of the bargain.

However, the risks are clearly tilted to the downside. Recent actions from President Trump show that tariff hikes remain his favourite policy tool. This is something to keep in mind when considering whether he will implement tariff hikes on cars.

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