

China, trade war with the US?

Diario Expansión (Spain)

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16 Apr 2018

There are concerns that the protectionist rhetoric and the so far limited tariff increases may lead to a full-blown trade war between the US and China which could put the brakes on world growth. Two weeks ago, the US president upped the ante by threatening to increase import duties on Chinese goods by US\$100 billion, on top of the US\$50 billion for which the tariff increase is already in a consultation period prior to being implemented in May, and on top of the duties approved for steel, aluminium, solar panels and washing machines. So far China's response has been very measured, approving increases in duties on US\$3 billion worth of imports, although with statements paving the way for an escalation of actions should they prove necessary. The next few weeks, before the measures already announced come into force, will be crucial in assessing whether an agreement will be reached or whether a broader trade war will be unleashed between the world's two leading economies.

This waiting period is consistent with the lack of clarity in the US measures on imports from China. The US intends to tax Chinese intellectual property and technology more heavily, although it is still not clear whether the import duties will focus on one or two categories of products or will be across the board. For its part, China would plan to counter-attack with duties targeting sectors that support Trump, focusing particularly on agricultural exports. The final profile of the package of US import duties, and China's retaliation, will be fundamental for determining the extent to which the trade dispute will intensify and what the consequences will be.

The objective of the bilateral negotiations between the US and China is wide ranging, covering trade issues, investment and the protection of intellectual property rights. The dialogue is made more difficult by the contradictory messages emanating from the Trump administration, while the Chinese authorities are maintaining a more conciliatory stance. In the inaugural speech he gave recently at the Boao Forum, President Xi Jinping stressed China's commitment to opening up its finance sector, reducing barriers to foreign participation in the automotive sector and strengthening protection of intellectual property. The US would like China to provide visible proof of its promises. In any case, greater transparency, or a simple confirmation that negotiations are ongoing, would go some way towards calming the fears of a trade war that are currently weighing on the financial markets. Until now it has seemed reasonable to think that the US position on trade is basically a tactic for applying pressure on China for it to make concessions, without this leading to major conflict, but if this changes, and there is great uncertainty about this, we could start to see more intense effects in the markets and in expectations and actual consumption and investment decisions.

Since the negotiations have not been formally broken off, and we believe both parties are conscious of the negative effects a trade war would have, our most likely assumption continues to be that no trade war will be break out. This scenario would have little effect on China's economy, so we are maintaining our economic growth forecasts at 6.3% in 2018 and 6.0% in 2019. We must not forget that the weight of exports and imports is decreasing with the increase in domestic demand, especially in the service sector. Nor must we underestimate the reach of China's One Belt One Road Initiative, with its Silk Road growing fast, when it comes to cushioning the long-term effects of a more protectionist US policy which would especially affect Chinese sectors with the greatest technological content.

In any case the risk of an open and prolonged trade war with the US could indeed affect China's macro-financial stability, endangering its growth targets. This in turn would test China's commitment to structural reforms, in a process of negative feedback.

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