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8 November 2019

Trade breakthrough ahead? Let's hope so

Nominal goods exports to the US from China and Germany (Q1 2015 = 100)



Quarterly data. Source: Deutsche Bundesbank, China Customs, Haver Analytics

- Trade wars hurt:** The tit-for-tat escalation of trade tariffs between the US and China that started in earnest in spring 2018 has taken a heavy toll on global trade and manufacturing. Two years after the synchronised global upswing of 2017, the most export-oriented parts of the world have fallen to the brink of recession. Some of the damage is obvious: China's goods exports to the US have declined by c15% from their peak in Q3 2018 (see chart). But the direct hit to trade from the new restrictions represents only a fraction of the damage done so far.
- The big hit:** The fraying of the decades-long process of globalisation and the uncertainty about the outlook for trade and cross-border supply chains has hurt business confidence around the world. Such second-order effects extend far beyond China and the US. Sentiment among manufacturers in export-oriented Europe is now at its lowest since 2012, in the wake of the euro crisis. As companies have held back on investment decisions, suppliers of investment goods have taken a particular hit.
- Over to the EU:** We will soon know whether global trade may suffer a further big blow. US President Donald Trump has until 13 November to announce whether he wants to levy punitive tariffs on car imports from Europe and some other regions, or give more time for negotiations. US Trade Secretary Wilbur Ross has suggested that Trump will not impose such additional car import tariffs (yet). In turn, European car manufacturers have reportedly promised to invest more in the US.
- The EU is not China:** The EU imports roughly 3.5 times more than China from the US and could hit back much harder. The fallout from a US-EU trade war could be huge. Fortunately, the risk of such an escalation remains low, in our view. The EU does not pose a geostrategic threat to the US, and we find little political appetite in the US for a trade war with the EU. Even if Trump may not like them, German cars and jobs at German carmakers are popular in the US.
- US-China tensions cooling off?** A spokesperson for the Chinese commerce minister in Beijing said yesterday that the US and China are working towards removing some of the tariffs that have been applied over the past 20 months. This would be a positive step forward. If confirmed, it would suit our view that, with Trump facing an election in 2020, and with Chinese President Xi Jinping contending with economic problems at home, the two leaders will be inclined to broker at least a truce, or even a partial deal, in the coming months.
- Our big bet for 2020:** For the global economy to rebound from its current trade-driven downturn, we do not need the US and China to fully resolve their differences. Instead, no further escalation, along with no nasty surprises on the US-EU side, will be enough. If the US and China were to strike a deal that reversed some of the tariffs imposed already, the relief could be significant. Major economies could then return to trend growth by the middle of next year.

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