

UPDATE BRIEFING: US-CHINA TRADE TENSIONS

A briefing for CBI members on the signing of a 'Phase One' trade deal

Time for a trade-war truce:

China's Vice Premier and lead trade negotiator, Liu He travelled to Washington D.C. this week, to sign what has been heralded as a 'Phase One' trade deal that aims to redress points of friction in US-China trade.

Given the international nature of supply chains, 18 months of the application of tit-for-tat tariffs and wider trade sanctions between the world's two largest economies has not been good for British business, or the wider global business community as whole. Indeed, the CBI noted how countries most exposed to US-China trade generally experienced downward revisions in terms of growth targets over the course of 2019, as the IMF downgraded the global forecast to just 3%, rising to 3.4% in 2020.¹ Irrespective of analysts' opinions on the extent to which the Phase One deal stands as a meaningful effort to address the mutually perceived shortcomings that exist in US-China trade, the announcement of a deal alone buoyed stock markets around the world, as traders interpreted the deal as a sign that there would be some degree of stability and growth for the first quarter at least.

By most accounts, the signing of a Phase One deal serves as a truce. From the US side, there is the view that it was important for the current Trump administration to force a deal across the line to bolster President Trump's credentials as a businessman who's effective on the world stage ahead of the 2020 election. In China, even before the signing of the deal had been announced, Chinese state media was readying public opinion on the matter, issuing opinion pieces in state media commenting on how Vice-Premier Liu had ensured China maintained a steady attitude and approached the negotiations with a rational calculation of the cost and benefits, in a concentrated effort to get China's house in order ahead of the lunar New Year.

In short, the signing of the deal is a good news story to either close out the year or set the stage for a new year of campaigning.

What's in the deal?

- China will agree to purchase an additional USD\$ 200 billion of American goods over two years. This includes, \$75 billion of manufactured goods, \$50 billion worth of energy, \$35 billion of agricultural goods and \$35-40 billion worth of services
- America will reduce its 15% tariffs on \$120 billion worth of Chinese goods to 7.5%
- China will take action to better protect the intellectual property of US firms doing business in and with China, and reiterated its pledge that US companies would not be forced to hand over their technology to Chinese authorities in exchange for market access
- Thursday 8th January, unrelated to the formal deal, China announced that it would open its oil and gas sector to foreign companies to conduct exploration and production outside of a joint venture
- On Tuesday 14th January, also separate to the formal trade deal, the US Treasury announced that it no longer considered China to be a currency manipulator; retracting an accusation first levied August 2019

¹ CBI Economics, "Economy in Brief," November 2019 (Accessible at: <https://www.cbi.org.uk/media/3733/2019-economy-in-brief-november-003.pdf>).

On the ground in Beijing:

As soon as a potential deal was announced, the Chinese Government set to preparing public opinion ahead of yesterday's signing. Opinion pieces across all of China's major newspapers sought to highlight how Liu He and his team have significantly advanced China's trade negotiation capabilities during these negotiations. The timing of the deal is significant. One week ahead of China's New Year celebrations, it provides a good news story to close out a year that has been marred by a multitude of economic challenges. Granted, it is unlikely that the specifics of the deal itself will be on the minds of many, as families across China sit down to celebrate the new year, but the fact that the Government has taken public and accountable action to redress the country's economic challenges - particularly the rising cost of pork prices - will undoubtedly resonate. Whether the signing of a trade deal is more than just a good news story in China remains to be seen. Many of the concessions that China has agreed to, the US has accused China of renegeing on before. Moreover, both sides have retained the right to apply punitive measures if they feel that specific issues have not been resolved to their satisfaction. Finally, and particularly worthy of note, is the fact that the Chinese Government has queued multiple pieces of legislation in the National People's Congress, which if passed – which they undoubtedly would – would position China as immediately ready to 'take-the-fight' back to the US.

On the ground in Washington DC:

The deal plays a similar function in the United States, with the Trump Administration equally willing to sidestep substance for style, in an effort to distract and set the stage for 2020. On the day that the House of Representatives voted to officially send its articles of impeachment to the Senate, President Trump still managed to steer the world's frontpages. American trade organisations have come out in favour of the deal, highlighting how it holds the potential "To rebuild trust and restore some stability to the world's most important commercial relationship." While President Trump may have won the day yesterday, how he proceeds will come under intense scrutiny on Capital Hill. While Chinese coverage of the deal focused on celebrating the moment, in the US, attention has turned to ensuring that Phase Two negotiations begin in a timely manner. China, as an economic and strategic threat to the US, is one of the few bipartisan issues in US politics at present. Both parties will likely be somewhat pleased with the terms of the deal, and both will want to claim varying degrees of responsibility in its passing. In particular, Trump will be hoping that China's commitment to buy \$35 billion worth of agricultural goods comes to fruition, considering that he badly needs the farming state of Iowa to not flip to the Democrats in the election. To do so, Trump is likely to be forced by the Democrats to add some substance to proceedings, considering that the Iowa Democratic Caucuses take place as early as next month; holding him and his team of trade officials much more to account than their Chinese contemporaries.

End Game Prediction:

- This deal will not meaningfully address the friction points in US-China trade or improve the fortunes of businesses that incorporate either China or the US in their supply chains
- Businesses and the stock market will be relieved that these measures are in place for the duration of Q1 at least, but will resuscitate their frustrations after the novelty of a respite wears off, since the deal leaves much of the new high-tariff infrastructure in place. While the average tariff on Chinese imported goods will fall from 25% to 19.3%, this number remains seven percentage points higher than just a year ago
- With 2020 being an election year, it is unlikely that Phase Two negotiations will take place soon, if ever. The signing of an agreement ahead of the start of campaigning suits Trump and his desire to be seen as a good businessman. Moreover, being able to call out China for having renegeed on what could potentially be impossible promises will work well on the campaign trail
- China is unlikely to be able to keep its commitments to purchase so much in additional goods from the US because the volumes are so large. By way of reference, China has never bought more than \$26 billion in agricultural goods from the US in a single year. Furthermore, China has other trade commitments with other trading partners that it will be equally cautious not to renege on
- Both countries will continue to design and develop trade defence instruments, and have few qualms in applying them. China has dusted off its Draft Export Control Law, which was reportedly previously shelved in 2017 and brought back in response to the trade tensions, and is waiting to bring it for a vote in the NPC; while it remains to be seen how the 'Unreliable Entity List' will be applied, if at all

The deal marks an easing in trade tensions, but requires careful monitoring and lobbying from business if it is to be effective