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More Questions Than Answers on Trade Agreement

Introduction

The impending Phase One trade agreement between the U.S. and China has delivered more questions than answers. The Office of the U.S. Trade Representative posted a two-page fact sheet on December 13 detailing the pending agreement in general terms but provided few details.

The topics covered in the trade agreement were wide-ranging, including intellectual property, technology transfer, agriculture, financial services, currency, expanding trade and dispute resolution. All of these pertain to factors agreed to by China to expand markets within China for U.S. exporters. Separately, the Office of the U.S. Trade Representative has acknowledged additional details to be included in the agreement on reciprocity and tariff reductions.

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BY STEVEN G. COCHRANE AND XIAO CHUN XU

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Tariff reductions on the agenda

The most critical chapters in the deal related to near-term economic impact are those on expanding trade and tariff reduction. China agreed to raise purchases of goods and services from the U.S. by at least US$200 billion over the 2017 pre-trade war level. This reportedly includes agricultural commodities of up to US$50 billion by 2021. In return, the U.S. suspended tariffs that were scheduled for December 15, reduced the tariff rate on US$120 billion of goods put in place in September from 15% to 7.5%, and will maintain the 25% tariff rate on approximately US$250 billion rather than raise it to 30%.

The increase in China imports from the U.S., particularly for agricultural commodities, is a positive factor for the U.S. economy (see Chart 1).

Farmers will regain a large market that was lost primarily to Latin American producers when China retaliated against U.S. tariffs with tariffs and restrictions of its own on U.S. farm products. This will not likely change the U.S. farm economy, but simply bring it back closer to what it was prior to the trade war—though there may be some permanent loss of market share given that some Chinese suppliers may be reluctant to go back to U.S. products. There is some risk that a surge in purchases of U.S. farm products could cause price increases not only for China but for other U.S. trade partners, so there may be some details in the final agreement relating to prices for farm goods.

The suspension of threatened tariffs and reduction of some existing tariffs by the U.S. on imports from China is more important for the signal it sends than for the impact on tariffs and trade. Indeed, no existing tariffs will be completely eliminated on the roughly $360 billion of goods going into the U.S. now subject to tariffs. Thus, the Phase One agreement simply caps most tariffs where they are and signals a truce for the moment between the U.S. and China. This is important nonetheless for China in signaling a reduction in trade tensions, which should spill over to investment decisions in China. But tariffs will still be paid by U.S. manufacturers for intermediate inputs from China, raising costs for the U.S. and limiting market access in the U.S.

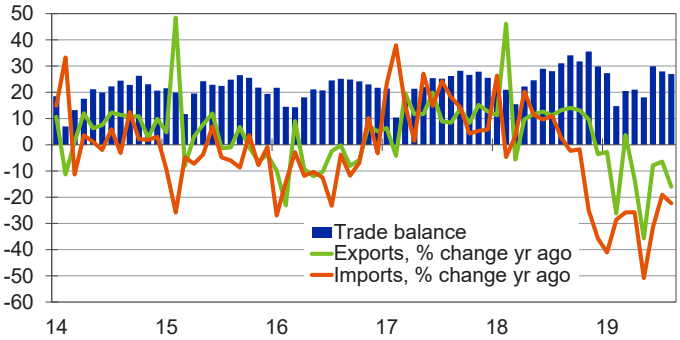
Details on thorny issues are scarce

The other chapters provide few details by which any economic impact may be assessed. The intellectual property and tech transfer chapters tick off the boxes the U.S. is concerned about, but very few details were provided.

Further, the chapters with other concessions by China, such as opening the financial services sector and greater transparency in

Chart 1: China's Trade With U.S. Plummeted

China's monthly bilateral merchandise trade with U.S., US$ bil



Sources: China National Bureau of Statistics, Moody's Analytics

currency market operations, have already been underway, so they were not hard concessions to make in context.

Thus, the only substantive measure of the Phase One agreement was the extra imports that China will buy from the U.S. Aside from the large supply of pork products now available from the U.S. to replace domestic supplies lost to the African swine fever, the greatest potential near-term benefit to China's economy is any improvement the agreement adds to investor confidence in the region.

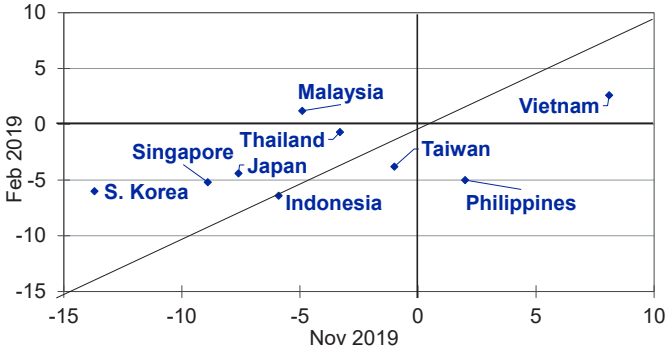
Phase Two tougher to bed down

The much-needed improvement in investment spending may be governed by a successful execution of Phase One—particularly regarding China's agricultural purchase agreement and Phase One's rather loosely defined dispute resolution procedures—along with expectations for a broader Phase Two agreement, which will likely focus on more difficult issues of state subsidies, state-owned enterprises and other nontariff issues related to the differences of the two economic systems. The USTR says negotiations are already underway, but given that Phase One is not yet finalized and that the simpler Phase One agreement took much longer to complete than expected, Phase Two may not be completed until 2021, if at all.

The Phase One agreement has some lofty claims that are almost too good to be true, so it will be important to see the details of the final agreement that is expected in January to understand how realistic it is to expect that trade issues will be addressed properly, and corrective measures will be properly and equitably enforced.

Chart 2: APAC Awaits More Stable Trade

Exports, $, NSA, % change yr ago



Sources: National statistics offices, Moody's Analytics

Positive reaction to Phase One

Phase One's announcement helped improve business expectations, giving equity markets in Asia and the U.S. a slight boost, reflecting the view that the deal is a step in the right direction, but investors were disappointed that the tariff rollbacks were less than expected, and they were cautious of the trade deal's details. The Chinese yuan appreciated on the news, from 7.04 per U.S. dollar to slightly below 7, reflecting higher expected capital inflows from more exports and investments.

At the very least, Phase One marks a truce in the ongoing trade war that relieves some uncertainty regarding economic growth and investment spending in Asia and globally in 2020. Indeed, all nations of the APAC region are eager for the trade war to come to an end (see Chart 2).

But there is no guarantee that we will not be revisiting these same trade issues once we get through the U.S. elections in November as the enforcement of Phase One is tracked and details of any Phase Two agreement begin to come to light.

About the Authors

Steven G. Cochrane is chief APAC economist with Moody's Analytics. He leads the Asia economic analysis and forecasting activities of the Moody's Analytics Research team, as well as the continual expansion of the company's international, national and subnational forecast models. In addition, Steve directs consulting projects for clients to help them understand the effects of regional economic developments on their business under baseline forecasts and alternative scenarios. Steve's expertise lies in providing clear insights into an area's or region's strengths, weaknesses and comparative advantages relative to macro or global economic trends. A highly regarded speaker, Steve has provided economic insights at hundreds of engagements during the past 20 years and has been featured on CNBC, ChannelNewsAsia, Bloomberg TV and Wall Street Radio. Through his research and presentations, Steve dissects how various components of the macro and regional economies shape patterns of growth. Steve holds a PhD from the University of Pennsylvania and is a Penn Institute for Urban Research Scholar. He also holds a master's degree from the University of Colorado at Denver and a bachelor's degree from the University of California at Davis. Dr. Cochrane is based out of the Moody's Analytics Singapore office.

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