Economic Update
Trade Wars
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Trade Wars

We listed the trade wars as one of our key themes for 2019 after US President Donald Trump decided in 2018 to impose tariffs on some of the US' largest trading partners in an attempt to force them to renegotiate their trade agreements with the US. While some of these disputes were resolved in the last year, such as the revised trade agreement with Canada and Mexico, a few unresolved disputes remain, and may either be resolved quickly or escalate substantially given President Trump's unpredictable nature. As such, we believe that 2020 will be another volatile year on the trade war front. The year started off with the US reaching some consensus on a path forward with China and France, but final agreement still seems a far way off.

China

For the most part of last year, news surrounding the trade war with China felt like it was in a never-ending cycle. This cycle typically started with news that the Trump administration would impose new tariffs on goods imported from China. Stock markets would then sell-off on fears that the trade war was escalating and would impact economic growth, only for the administration to hint a few weeks later that trade talks were going well and that a resolution seemed in sight. The markets would then temporarily rally on this news, again only for it to be reported a couple of weeks later that no progress was actually made, and the cycle would repeat.

Towards the end of 2019 however, the US and China announced that a "phase 1" trade agreement had been reached between the two nations. This agreement was signed on 15 January 2020. In this phase 1 deal, the US agreed to halve duties on US$120 billion worth of imports from China to 7.5% and to delay additional tariffs. In return, China vowed to purchase US$200 billion more American goods than it did in 2017, including US$32 billion worth of agricultural products over the next two years. China also vowed to stop forced technology transfer from US companies, and both countries pledged to not devalue their currencies in an attempt to benefit their exporters.

It can be however be argued that the deal does too little to address some of the more important aspects of the trade dispute, such as China's unfair state subsidies and still leaves 25% tariffs on US$250 billion of Chinese industrial goods in place. It will furthermore be challenging for China to import the additional US$200 billion worth of goods over the next two years, as US exports to China would need to rise from the US$186 billion exports reported in 2017, before the trade wars began, to around US$262 billion in 2020 and US$309 billion in 2021. Substantial trade diversion will likely need to take place as China will have to reduce imports from other countries to meet the higher import targets from the US. Australia's reserve bank has already given a warning that the country's agricultural exports to China will be negatively affected by the phase 1 deal after rising nearly 30% in 2019, with other countries are likely to be impacted similarly.

There is currently very little detail surrounding a phase 2 agreement, but, at present, it seems as though there will not be any further tariff reductions until at least after the US presidential election in November this year. The US will do a progress review 10 months after the signing of the phase 1 agreement, and will then only potentially consider any additional cuts to tariffs. There is still a long way to go for the negotiations, but the agreement is at least a step in the right direction and eases some of the uncertainty surrounding the trade war. The agreement should also reduce the trade deficit the US has with China, which Trump will see as a victory and might even prompt him to hold off any additional tariffs in the future, but it is not entirely unrealistic to assume that he will change his mind at some point in the future.

Europe

France is the latest country to get caught in Trump's crosshairs after it announced last year that it intends to impose a 'digital services tax' on companies providing digital services to French citizens. This will have an impact on US tech firms such as Amazon and Google, as the 3% revenue tax is subject to multinational companies that earn €750 million turnover globally and €25 million in France. Italy, Austria and Turkey have indicated that they intend on implementing similar taxes in the coming months. The US immediately lashed out against France and threatened 100% tariffs on US$2.4 billion worth of French goods such as wine, cheese and champagne.

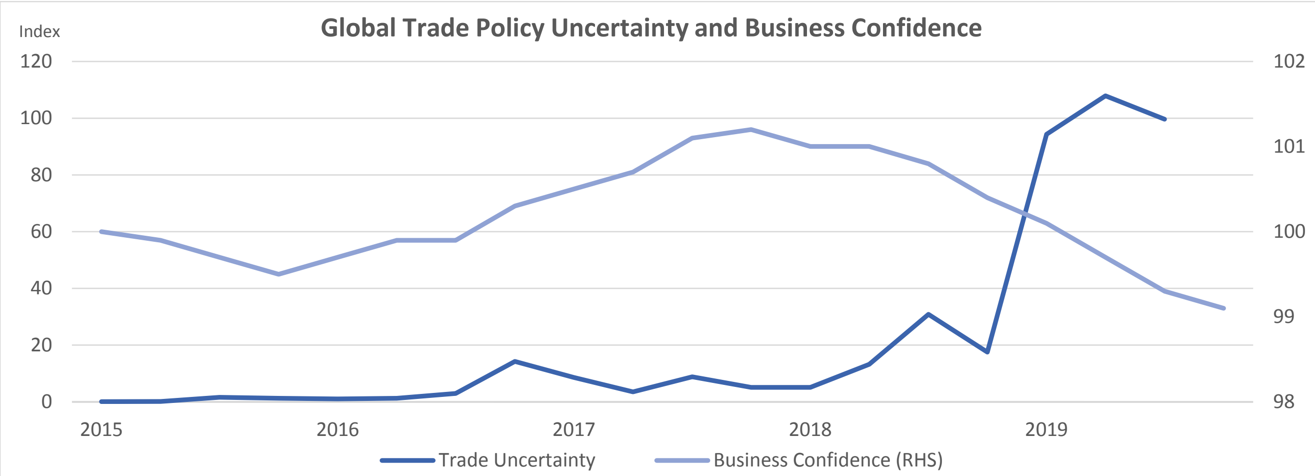
An escalation seems to have been averted for now after French president Emmanuel Macron announced on 20 January that both sides agreed to a ceasefire until the end of the year. As part of the truce, France will delay the digital services tax and in return the US will postpone retaliatory tariffs. Instead, both sides will continue with talks on the digital services tax at the Organisation for Economic Cooperation and Development (OECD), giving some time for a consensus to be reached.

The European Union attempted to reach an agreement on a digital services tax in 2019, but this required unanimity among the EU members. The plans were however later abandoned due to opposition from countries like Ireland and Luxembourg that house several of the large US tech companies' European headquarters. Trade relations between the US and EU are already under strain after the US' decision in 2018 to impose tariffs on European metals, its decision to impose tariffs on US$7.5 billion worth of European goods after a World Trade Organisation dispute over Airbus subsidies, and threats to implement tariffs on European automobile exports.

While the temporary trade truce with France does bring some relief to the trade tensions between the US and EU, the risk still remains that tensions will escalate significantly if no consensus is reached at the OECD, or if the US decides to impose tariffs on European automotive exports, which could knock 0.25 percentage points off the Eurozone's economic growth.

Impact on the Global Economy

The US' trade wars and protectionist policies have a severe impact on the global economy, as these weigh on business confidence and increase uncertainty. Such uncertainty and lack of confidence discourages businesses from investing, often causing them to delay major expansionary projects until the uncertainty has been cleared up.



Source: World Bank, IJG

The World Bank has announced that the easing trade tensions between the US and China is unlikely to result in a rapid improvement in global economic growth as the terms of the phase 1 deal will be difficult to achieve and that the risk remains that trade tensions between the two nations re-escalate. This will not only affect their economies, but also the rest of the world. While the Federal Reserve has resolved to ease monetary policy to soften the blow from the trade wars, little room remains for them to continue doing so going forward.

Trade wars lead to disrupted supply chains causing businesses to operate less efficiently and in turn weighing on earnings and output. Tariffs cause prices of products to rise due to higher input costs which manufacturers typically pass along to consumers. We explained in our Economic Outlook 2019 that tariffs lead to a reduction in consumption which in turn means that living standards are decreasing at the margin, all else being equal.

Tariffs usually also have an impact on countries like Namibia that are not directly involved in the trade wars. Less demand by the advanced economies for resources hurt small, resource-rich countries that are sensitive to lower commodity prices. Namibia is particularly prone to the impact from lower commodity prices as it is a small, open economy, with a trade deficit. A weak fiscal position means that external shocks such as a decline in commodity prices will add further pressure to an already struggling Namibian economy.

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