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WEBINAR

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President Trump's Tariffs – Assessing the Impact of Various Trade Scenarios - Q&A

All studies I've seen show that NAFTA and China joining the World Trade Organization increased U.S. GDP. U.S. manufacturing output has been increasing over this period (jobs down, output up). So I don't think it's fair to say that trade is a drag on growth. ... Isn't it a bit irresponsible to say that the significant increase in the U.S. trade deficit in the past 40 years is mainly due to NAFTA and the Chinese joining WTO?

NAFTA and China's entry into the WTO were a drag on U.S. GDP growth between the mid-1990s and mid-2000s given the resulting substantial widening in the U.S. trade deficit during this period. An increase in the trade deficit is a near-term drag on real GDP growth via the identity that GDP equals consumption plus investment plus government spending plus net trade. However, during the past more than a decade, NAFTA and China's entry into the WTO have boosted U.S. GDP as the trade deficit has stabilized. The increased trade has boosted GDP growth through stronger productivity, and potential GDP growth as a result of increased competition and the benefits of specialization. If unimpeded, trade with our NAFTA partners and China should be a significant contributor to U.S. GDP, as the deep and growing middle class in these nations will be large customers for the services and high-value-added products and resources produced in the U.S.

Where do you see interest rates heading in the Trade Skirmish and Trade War scenarios?

U.S. short-term rates are stable and long-term rates decline in the two scenarios, while in the baseline scenario rates rise. The tariff increases are a negative supply shock, hurting growth, increasing financial market volatility, and lifting inflation and inflation expectations. These cross-currents result in no significant change in monetary policy.

Long-term rates decline given the stronger impact of financial market volatility and resulting global flight-to-quality into U.S. Treasury bonds. However, interest rates on business and consumer loans spike in the short term as uncertainty and market volatility cause banks and other lenders to tighten up on credit availability until they get clear signals on the scope and impact of changes in tariff policy.

Have you evaluated the scenario where China concedes, and while not totally caving to U.S. demands it does negotiate better terms for the U.S?

Yes. In this scenario, the Chinese agree to ease up their technology transfer rules and treat foreign companies operating in China more like domestic companies. While this is a more favorable outcome than the baseline, these changes are not substantive enough to change the macroeconomic performance of the U.S. or global economy, at least not any time soon.

I thought China was financing the U.S. national debt. Can China react to these tariffs in regard to the debt?

The Chinese government holds almost a fifth of outstanding U.S. Treasury bonds owned by foreign governments, and any change to the size of its portfolio would certainly influence markets. China could react to tariffs by selling U.S. Treasuries but the Chinese would experience large losses in their international investment position as U.S. bond prices plunge.

In the Trade War scenario, we expect the Chinese government to engage in a competitive devaluation of the yuan. This would require China's central bank to increase its holdings of U.S. securities and would put additional downward pressure on long-run U.S. rates, offsetting a small part of the tariff-induced supply shock.

If these tariffs start to spiral out of control, what do you think are the chances that Congress might intervene and try to curb the powers that the president has on trade?

There are Republicans and Democrats on either side of this issue who support the president's agenda on trade, and pushback on tariffs and other protectionist measures has primarily stemmed from business associations and the Chamber of Commerce.

Restricting the president's tariff-setting authority would require cooperation between the two major political parties, and despite the sweeping nature of the Trump administration's proposed protectionist policies there is currently little appetite in either party for a deal. This may change after the November congressional elections.

Congress has granted the president wide-ranging power to set tariffs via the Trade Expansion Act of 1962 and International Emergency Economic Powers Act of 1977. A rollback would require cooperation on both sides of the aisle even if Democrats take the House in November.

What are the possible effects on commercial real estate capital markets in a trade skirmish and war?

The effects of a trade skirmish or potential trade war would be concentrated in major metropolitan area markets that have attracted large foreign capital inflows in recent years, such as New York, San Francisco, Los Angeles and Seattle. In a trade skirmish, commercial property prices would decline more quickly than the baseline, which calls for a modest correction. A potential trade war would deal a larger setback to commercial property prices given the devaluation of the yuan, which would reduce the purchasing power of Chinese investors in these key markets.

Will the business model of U.S. multinationals change now that the tax code has changed?

We don't expect the tax legislation to change this model, and U.S. multinationals will continue to grow and invest overseas. While trade frictions could restrict the ability of U.S. multinationals to expand in other countries, this is unlikely to result from higher tariffs alone. U.S. multinationals will continue to grow and invest abroad save for regulatory or other changes restricting market access.

How are you factoring in the lower corporate tax rates in the U.S.? Are you considering the potentially massive repatriation of business and dollars into the country?

We expect businesses to bring a larger share of profits back to the U.S. as a result of the recent tax changes. Any repercussions from trade are second-order effects. If a trade war reduces global incomes, corporate profits will be lower and the pool of foreign earnings that could be repatriated will be smaller.

Are U.S. manufacturers and especially auto manufacturers and suppliers changing their investment plans in Mexico?

While some automakers have nixed plans to build new plants in Mexico following criticism from the Trump administration early last year, most continue to ramp up production at existing facilities. European and Japanese automakers continue to add capacity in Mexico given its proximity to markets in both the U.S. and Latin America, low labor costs, and the large constellation of first-tier suppliers.

How did you estimate the inputs for the modeling scenarios into the global model?

The tariff increase impacts the economy through five key channels (in no order of importance):

- Prices
- Investor, consumer and business confidence
- Foreign exchange values
- Foreign direct investment
- Potential productivity growth

Variables in the global model where shocked to account for each of these channels. Each of the shocks was determined in part endogenously, and in part exogenously depending on how well the model is able to capture each channel.

Is the negative impact on U.S. services exports the primary factor resulting in GDP decline in the Trade War scenario?

Global services exports do fall relative to the baseline, and in the Trade War scenario, they decline outright. However, they are not the primary factor. Tariffs in the Trade War and Skirmish are levied primarily on tradable goods. However, to the extent that a trade skirmish and war erode global jobs and incomes, demand for a range of services from travel and business services to intellectual property would decline.

Mark Zandi is chief economist of Moody's Analytics, where he directs economic research. Moody's Analytics, a subsidiary of Moody's Corp., is a leading provider of economic research, data and analytical tools. Dr. Zandi is a cofounder of the company Economy.com, which Moody's purchased in 2005.

Dr. Zandi's broad research interests encompass macroeconomics, financial markets and public policy. His recent research has focused on mortgage finance reform and the determinants of mortgage foreclosure and personal bankruptcy. He has analyzed the economic impact of various tax and government spending policies and assessed the appropriate monetary policy response to bubbles in asset markets.

A trusted adviser to policymakers and an influential source of economic analysis for businesses, journalists and the public, Dr. Zandi frequently testifies before Congress on topics including the economic outlook, the nation's daunting fiscal challenges, the merits of fiscal stimulus, financial regulatory reform, and foreclosure mitigation.

Dr. Zandi conducts regular briefings on the economy for corporate boards, trade associations and policymakers at all levels. He is on the board of directors of MGIC, the nation's largest private mortgage insurance company, and The Reinvestment Fund, a large CDFI that makes investments in disadvantaged neighborhoods. He is often quoted in national and global publications and interviewed by major news media outlets, and is a frequent guest on CNBC, NPR, Meet the Press, CNN, and various other national networks and news programs.

Dr. Zandi is the author of Paying the Price: Ending the Great Recession and Beginning a New American Century, which provides an assessment of the monetary and fiscal policy response to the Great Recession. His other book, Financial Shock: A 360º Look at the Subprime Mortgage Implosion, and How to Avoid the Next Financial Crisis, is described by the New York Times as the "clearest guide" to the financial crisis.

Dr. Zandi earned his BS from the Wharton School at the University of Pennsylvania and his PhD at the University of Pennsylvania. He lives with his wife and three children in the suburbs of Philadelphia.

Cristian deRitis is a senior director at Moody's Analytics, where he leads a team of economic analysts and develops econometric models for a wide variety of clients. His regular analysis and commentary on consumer credit, policy and the broader economy appear on the firm's Economy.com web site and in other publications. He is regularly quoted in publications such as the Wall Street Journal for his views on the economy and consumer credit markets. Currently he is spearheading efforts to develop alternative sources of data to measure economic activity more accurately than traditional sources of data.

Before joining Moody's Analytics, Cristian worked for Fannie Mae and taught at Johns Hopkins University. He received his PhD in economics from Johns Hopkins University and is named on two U.S. patents for credit modeling techniques.

Marisa Di Natale is a senior director at Moody's Analytics. Ms. Di Natale's areas of specialization include international modeling and forecasting, U.S. regional economics, and labor economics. Ms. Di Natale previously oversaw the firm's U.S. subnational forecasting service prior to shifting to international economics. Before joining Moody's Analytics in 2004, she was an economist at the Bureau of Labor Statistics in Washington DC, where she analyzed monthly employment statistics. Ms. Di Natale received an MA in applied economics from Johns Hopkins University and a BA in international relations from Boston University.

Mark Hopkins is a director at Moody's Analytics, with responsibilities for international macroeconomic research and global forecasting, including the design and maintenance of the Moody's Analytics suite of country forecast models. Dr. Hopkins has also been responsible for forecasting Canada's economy and U.S. federal fiscal policy. Previously, he taught macroeconomics at Gettysburg College and served as international economist on the staff of the President's Council of Economic Advisers. He has published in the areas of international economics, economic growth, and foreign policy. He received his PhD in economics from the University of Wisconsin-Madison, an MSc from the London School of Economics, and a BA from Wesleyan University.

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Moody's Analytics added the economic forecasting firm Economy.com to its portfolio in 2005. This unit is based in West Chester PA, a suburb of Philadelphia, with offices in London, Prague and Sydney. More information is available at www.economy.com.

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